Land Securities Preliminary Results Presentation

Thursday 15 May 2014

Speaker: Robert Noel – Chief Executive

Slide 1 – Title slide

Good morning everyone, welcome to Land Securities' results presentation

It's the usual drill today, a presentation from Martin on the financial results followed by some detail on progress in Retail and London.

But, before we launch in, I'd like to take a minute to give you my perspective on how we are putting our strategy into action.

First, people strategy. By any measure these are strong financial results. But we are also performing well in terms of people. We said we wanted to drive more pace. And we are. Across the business we have great people in all disciplines.

Second, property strategy. In London, we said we would be early cycle developers. And we have been. You will see the strength of our London development performance today. Our call to develop speculatively, early in the cycle, is paying off, and there is plenty more surplus to come.

In Retail, we have been talking for four years about the dramatic change in the landscape. We said we would refocus our portfolio away from secondary locations and into dominance, experience and convenience; through both development and acquisitions. And we have been, and our occupancy rate, at over 98%, and a return to ERV growth, are testament to our strategy. And this re-shaping will continue as consumer behaviour continues to evolve.

Third, risk strategy. The growing economy points to a strengthening retail market. The London market is resurgent. Everyone is feeling pretty chipper. But, as we have said before, we operate in cyclical and changing markets. And, just at the moment, at a time of political and economic uncertainty, both here and abroad.

The property business is maybe more risky than ever. Retailing, as we all know, continues to change at pace, and a lot of retail locations will not survive.

With London offices, not only is the market highly cyclical, the interconnectivity of London and global business mean change can happen faster.

That's why we also said we would be consistent, and disciplined, in the management of our balance sheet. We have been. Over the last four years, we have been running a broadly net debt neutral position, funding all our accretive activity through sales. The aim was to bring our LTV down as we move through the cycle. We have done, as Martin will show you and our business has become stronger every year.

Our strategy is working for shareholders. We are nurturing their capital, growing their dividend, managing risk and creating headroom for new opportunities.

Slide 2 – Agenda
I'll cover the huge amount of activity we have going on in the business in a few minutes. But first, let me hand you over to Martin.

Speaker: Martin Greenslade – Chief Financial Officer

Slide 3 – Valuation and financial results
Thank you Rob. Good morning everyone.

As Rob said, today we have reported a strong set of results. So let me start by taking you through the financial summary.

Slide 4 – Financial summary
I'll go into greater detail on many of these figures as I go through my presentation, but in summary: Our profit before tax more than doubled to £1,108.9m. Our assets rose by 7.1% over the year, delivering a valuation surplus of £763.8m, and our adjusted diluted NAV per

share was 1,013p. That's an increase of 12.2%. Looking at underlying earnings: revenue profit was ahead of expectations at £319.6m, up 9.9% and adjusted diluted earnings per share were up 10.1% to 40.5p. And, moving on to the dividend, today we are announcing a recommended final dividend of 7.9p, bringing the total to 30.7p for the financial year. That's up 3.0% and right in line with our aim of progressing the dividend in a sustainable manner.

And, since we use the final dividend as the basis of our next three quarterly dividends, it is likely that dividend growth next year will be a little higher than the 3.0% this year.

So let me take you through some of these numbers in a bit more detail, starting with the valuation surplus.

Slide 5 – Combined portfolio valuation

The value of our combined portfolio at 31 March was £11.9bn. Over the year, the valuation surplus was £763.8m, and that represents an increase of 7.1%. Of that total increase, London saw values rise by 11.9% and Retail by 2.2%.

The clear driver of the valuation surplus was, as you would expect, our development programme which delivered a 22.3% surplus representing £273.8m. The major contributor to this performance was 20 Fenchurch Street, which delivered a £100.7m surplus in the year and, to be clear, that is our 50% share.

Turning now to revenue profit.

Slide 6 – Revenue profit

Our revenue profit for the year was £319.6m, £28.9m higher than last year. The main reason for the increase was the £46.3m rise in net rental income partly offset by higher indirect costs and net interest charges. More on net rental income in a minute, but first a couple of comments on our costs and interest charges.

So starting with costs: as I am sure you will remember, this time last year I took you through a detailed breakdown of our costs because cost control is extremely important to us. But I also wanted to explain how some of our costs relate to our business model, like the costs of running car parks, while other costs, like development expenditure, represent an investment in our business. I have updated the detailed cost analysis and you will find it in the appendix.

What you will find in the cost breakdown is that tenant default and void related costs are down by some £3.8m while development related expenditure is up by £8.1m. The lower tenant default and void costs come through the 'net service charge expense' and 'direct property expenditure' lines along with £4.2m of the development expenditure increase. The increase in indirect costs is a result of an increase in development expenditure on sites which we have an option over but don't yet own, along with the increase in share based payments we saw at the half year.

Taking all our costs together, our total cost ratio for the year was 18.8%, down from 19.7% last year.

Our net interest charges increased by £10.5m. That was partly due to higher average debt balances, but also reflects the end to capitalised interest on our completed developments.

Let's now look at the breakdown of net rental income.

Slide 7 – Net rental income analysis

So, overall net rental income was up by £46.3m or 8.5%. Net rental income on the like-for-like portfolio was up overall by £5.7m. Behind that number, Retail is up £8.2m and London down £2.5m. Retail benefited from increased income on a number of properties as well as lower bad debts. London was down largely due to a surrender premium last year at Cardinal Place.

Net rental income from the development programme was £3.6m higher on the back of lettings at 123 Victoria Street and 62 Buckingham Gate partly offset by the loss of income from vacating Nova, Victoria, last year and 1 New Street Square this year. Completed developments were up £23.8m, primarily due to Trinity Leeds and Buchanan Street, Glasgow, alongside a £2m increase in net rental income from One New Change.

The major contributor to net rental income growth was acquisitions, with much of it the full year effect of the leisure acquisitions we made last year. These include the majority share of X-Leisure and the Printworks in Manchester.

Disposals, including Empress State, Bankside and Bon Accord in Aberdeen, resulted in a £21.0m fall in net rental income.

Those assets we have now sold contributed £34.5m of net rental income this year – income we will not be receiving in the year ahead.

Slide 8 – Cash flow and adjusted net debt

On this slide, you can see the major components of our cash flows, proportionately consolidated, and referenced to the movement in our adjusted net debt over the year. As you know, you will find almost none of these figures in our statutory results, so those of you who can't do without our IFRS cash flows should turn to the appendices where that information is available.

So we began the year with adjusted net debt of £4.29bn. Despite us delivering higher revenue profit than last year, operating cash inflow after interest was lower at £192.2m. As I explained at the half-year, with Easter weekend last year falling between 29 and 31 March, some £40m of interest related to the prior year was paid this year. This year, we paid £175.6m in cash dividends, a figure which will rise next year as the April dividend was the last one where we offered a scrip dividend alternative. After dividend, come three items related to capital transactions: acquisitions (including the increase in our share of the underlying X-Leisure assets), capital expenditure and disposals. Taking these three together, there is a net disinvestment of £342.9m.

After some sundry items, adjusted net debt ended the year at £3.95bn, down £342m over the year.

Slide 9 – Financing

So, on to financing. The decrease in our adjusted net debt coupled with the rise in asset values has led to a reduction in our Group LTV from 36.9% to 32.5%.

The weighted average maturity of our debt is 9.3 years with a weighted average cost of 5.0%. With no significant bond repayment before late 2017 and 94.5% of our debt fixed, any variation in our cost of debt will be driven by the level of drawing on our revolving credit facilities. With our low gearing and £1.1bn of available funds we have considerable capacity for rapid investment should opportunities arise.

Slide 10 – Adjusted net debt

Before I summarise, I'd like to remind you of a slide I put up at the interims last year. It shows the progression in our adjusted net debt.

Blue represents this year's adjusted net debt and red last year's. At the half year the difference between these two lines, the shaded part amounted to an average higher net debt of a little under £300m. And that £300m broadly represented the higher net investment we made in the first half compared to the year before. And in this ultra-low interest rate environment, each £100m of net investment represents around £4m to £6m per annum of increased revenue profit.

Now if we roll this forward to the end of the year, the two lines cross. While the average net debt for the year is still some £170m higher than the last year the end point isn't.

So the outlook for this coming year's revenue profit will be significantly influenced by the acquisitions or sales we make in the near term. Yes, we will have new rental income from 20 Fenchurch Street and further lettings on our completed developments in Victoria, but do remember that assets we have sold this year contributed £34.5m to our net rental income.

At this point in the cycle, and as Rob said right at the start we are continuing with a broadly net debt neutral approach. However our asset decisions, whether we buy or sell, are not made on the basis of this year's revenue profit alone. Instead we make them with a longer term view on total return. So let me summarise.

Slide 11 – Summary

Alongside our investments in leisure, our developments have driven earnings growth in the business. Our good operational performance, particularly in Retail, has also played its part. Our balance sheet is in great shape and gives us real flexibility to capitalise on whatever opportunities lie ahead. Our dividend cover is in great shape as well – giving us the ability to smooth out any earnings bumps which come from developments or disposals.

Now, I'll hand you back to Rob for more detail on the Retail and London Portfolios.

Speaker: Robert Noel – Chief Executive

Slide 12 – Portfolio update

Thank you Martin.

I'd now like to cover activity within the business, and I'll start with the retail portfolio.

Slide 13 – Retail market – anticipating structural change

Over the last few years, we have discussed with you, at these presentations, the effect of the shift in consumer behaviour. That shift is being driven by the requirement for connectivity, experience and/or convenience.

The impact of the supermarkets eating into non-food sales; the emergence of multi-channel retail, and how retailers have reacted in different ways; the threat of home delivery morphing into the emergence of click and collect models; and the rapid growth of eating out. They have all had an impact on bricks and mortar retailing, and they will continue to do so.

Fewer shopping trips, increased journey times and longer dwell times have combined to separate winning and losing locations. Winning locations reshape catchments.

All retailers are changing the way they use their space. Fashion retailers want bigger stores in fewer locations. Foodstores want smaller stores in more locations. Apart from very densely populated areas, the high street is on a downward slope with some of it already dead.

As you know, our overall plan for our Retail portfolio has been to reshape it in the face of this structural change by selling out of those assets less well able to cope with the changing landscape and using the proceeds to fund acquisitions and developments which fit in with our themes of dominance, experience and convenience. This is a process which has actually been going on for some years and has already seen our retail asset base transformed.

Slide 14 - Retail market – anticipating structural change

Looking at the left hand chart on this slide, you can see that when we converted to REIT status in 2007, our portfolio was dominated by secondary shopping centres, in light blue and retail warehouses. Since then, we have sold most of our secondary shopping, and most of our bulky goods retail warehouses. Today, dominance, experience and convenience are key.

Slide 15 - Retail activity

This year we have taken advantage of a liquid market to take money off the table in, Welwyn, Livingston, Aberdeen, Dundee and Preston. All conviction sells.

Dundee merits an explanation. We only bought it four years ago and its sale demonstrates how quickly we think this market is changing. Although it trades well at the moment, we couldn't improve the experience without disproportionate capital expenditure; and it risks not maintaining its position in the retail hierarchy.

The proceeds of the earlier sales have been reinvested in X-Leisure where we now own 95%, and also to work up schemes that get with the programme: a leisure extension at White Rose, Leeds; a leisure and retail extension to Buchanan Galleries, Glasgow; a leisure led mixed use scheme at Ealing Filmworks; edge-of-town schemes with retailer support at Taplow, Selly Oak, Maidstone and Worcester; and following on from our success at Trinity Leeds, a city centre scheme for Oxford.

Slide 16 - Trinity Leeds

Talking of Trinity Leeds, this time last year we had just opened it. Trinity Kitchen, our award winning new food concept, and Primark, opened in the autumn.

Footfall for the first 12 months was 22 million. With the run rate increasing after the opening of Trinity Kitchen and Primark.

In the 28 weeks since opening, Trinity Kitchen has generated almost as much income to us as we had planned for the whole first year of operation.

Interestingly, the impact on White Rose has been less significant than you might expect. Like-for-like, same store, sales at White Rose were up 1.2% for the year, and occupation is 99%, up from 98% last year.

Slide 17 - A resilient portfolio

And that resilience is borne out across the portfolio.

Over the year, while footfall was down by 0.8%, same store sales were up 0.9%, with same centre sales up 4.7%. Interestingly, the last quarter has seen a general improvement, with footfall and same store sales improving.

We completed £18.3m of lettings in the year.

Our voids and administrations in the like-for-like portfolio have fallen from 5.3% to 3.4%. And our occupancy has risen from 97.2% last year to 98.1% today.

We are virtually full. And as I said a minute ago, we have a good pipeline.

Slide 18 - Development opportunities (shopping centres)

We have two major city centre schemes we are working up.

In Oxford, in our joint venture with the Crown Estate we received planning consent during the year for the proposed redevelopment of the Westgate Centre. We anticipate agreeing detailed planning conditions, and agreeing terms with a building contractor by the end of the year for an earliest start on site in March 2015. This would see practical completion in October 2017.

The scheme will be anchored by a 140,000 sq ft John Lewis and a Curzon cinema, and our early discussions with retailers have been positive.

The city currently has a weak retail offer with a plethora of small, poorly configured, shops. We will be able to provide well configured retail and leisure space into an under supplied market.

Oxford is ranked number one on the PROMIS retailer requirements rankings and it's no wonder. It has an affluent catchment of 430,000 people with an annual spend of £4.2 bn. It's home to 30,000 students and there are 8 million day tourists every year with 1 million tourists that stay overnight.

In Glasgow, owned jointly with Henderson, we also have outline planning consent, have finalised tax increment funding for public realm and infrastructure works, and we have agreed terms with Network Rail.

By virtually doubling the existing area, we would establish it as the dominant retail centre of Glasgow, the second retail location in the UK outside London.

Extensions are difficult to manage but we have agreed terms to remodel John Lewis and deliver a new 150,000 sq ft Marks & Spencer. We have secured Showcase as a cinema operator, and we will be working on detailed design, and feasibility, over the summer.

At White Rose, we have received consent for an extension which will include a cinema and food and beverage outlets, and we're now working up detailed plans.

We have also been working up plans for schemes in Guildford and the O2 in Greenwich. Both under exclusivity agreements, and will report on progress on these in November.

Slide 19 - Development opportunities (edge-of-town)

In our edge-of-town programme, following success at Crawley and Wandsworth, we are on site at Taplow, with practical completion due in July. The scheme is 85% let or in solicitors' hands.

In Selly Oak, in JV with Sainsburys, and where we have planning, Sainsburys will be starting the land reclamation and preparation works shortly. This will clear the way for development from January 2016.

In Maidstone, our proposed scheme is 37% pre-let to Waitrose and Debenhams and our planning application is set to be heard at committee next month.

And in Worcester, we have 55% of the space in solicitors' hands and aim to submit a planning application in October.

As you know, we tend to secure these schemes by option or conditional contract. And it's only when we have support from the retailers, and local authorities, in the form of planning consent, that we spend any meaningful money. Development yields will be in the mid 6's with long lease lengths and, at the point we commit, relatively low risk.

Slide 20 - Summary

The retail landscape is fluid, but our strategy is right for these conditions. While economic growth and the emergence of a rise in real wages are welcome news for retailers, it will not lead to rental growth right across the market. We have talked about this before.

We have exited the most 'at risk' locations, and are recycling the capital into dominance, experience and convenience.

Selling and buying activity will continue this year, and we have some great development opportunities to continue the momentum.

Slide 21 - London Portfolio

I'd like to turn now to London, where you know our strategy has been to develop early and speculatively striking the construction cost curve at the low point, and at a time when development finance was scarce, rather than compete in the investment market.

Since we started in 2010 we have committed to over 3.3 million sq ft of speculative development with a total development cost of £2.4 billion.

Slide 22 - London activity

And again, we have been funding the capex through sales. In November, I talked about the majority of our sales so I won't cover them again today.

Our committed schemes are all due to complete within the next 28 months and we are quite content with that position. On the back of increased business confidence, occupier activity has increased over the year, and demand for our highly efficient, technically resilient schemes appears solid.

Our usual development disclosure is included within your packs but I will just run you through the programme.

Slide 23 - Developments - completed

On our completed developments, since the year end 123 Victoria Street has become fully let. Over the road, 62 Buckingham Gate is now 65% let.

As you will appreciate, Victoria is somewhat of a building site at the moment but despite this short term disruption, we are very pleased with the exceptional tenant mix we have achieved and the amount of interest in the remaining space. Rents achieved in both buildings are ahead of plan.

Slide 24 - Developments – on site

Sentiment was in a very different place when we announced the formation of a JV with Canary Wharf to build 20 Fenchurch Street, in this room, exactly 3 and a half years ago.

The building is now 87% let and the space has been handed over to tenants for fitting out. The scheme has already been very successful for us, and we are confident in leasing the remainder of the space this financial year.

Planning consent for the application of the solar shading solution has been received and works are now underway. These works are being carried out externally and will not interfere with tenant fit out or occupation. The cost has been negotiated with the cladding contractor and, as we previously guided, will not alter our original estimated total development cost for the building.

Slide 25 - Development – on site

Moving west, first to the Crossrail/Thameslink interchange. At New Ludgate, we are very encouraged by progress.

We announced this morning that the entirety of 2 New Ludgate has been let to Mizuho Group on a 20 year lease.

49% of the space is therefore pre-let, and we have a further 12% in solicitors' hands, with a year to go to practical completion.

Construction has now also started at 1 New Street Square with practical completion due 14 months later than New Ludgate, in June 16.

In the West End, at Kings Gate, we have made great progress on residential sales.

Completion of this scheme is now scheduled for next May following another slight delay due to the UKPN works and the very wet weather. We are not expecting this to impact timing further than it already has.

Next door, at The Zig Zag Building, we have let retail space to Mango and Iberica and have a healthy level of office negotiations.

Just up the road from these two is Nova.

Slide 26 - Developments on site

And here you can see the full scale of a 5.5 acre city centre project coming out of the ground.

First, there is the Nova Building, which is the residential element, in green. Then the two office buildings, shown in orange. These all sit above 2 new retail streets, shown in blue. And below all that, and going on at the same time, shown in pink, you can see the LUL site. They are working on the new Victoria Line station concourse and Crossrail ll future proofing. We are due to get this land back in 2016 for phases ll & lll.

Slide 27 - Developments – on site

Like Kings Gate, we have made great progress on residential sales. Based on like-for-like floor levels, pricing has been 20% ahead of Kings Gate on average. And, as with Kings Gate, the majority of the remaining apartments are at the top 2 levels which we would expect to sell post PC.

As you know, we also have planning consent to convert Portland House to private residential. But we are extending leases through to June 2016 while we work up our plans in more detail. At Portland, we will maintain optionality because the building remains a very popular office building as it is and has a good economic life expectancy.

Slide 28 - Developments – on site

Finally, at 20 Eastbourne Terrace, right on the entrance to the Paddington Crossrail station, the construction contract has been placed with Wates, and completion is set for February 2016.

And at Phase ll of Oriana, on Oxford Street, in our JV with Frogmore, demolition is underway and we will place the building contract very shortly. Completion is now estimated for September 2016.

As I said our usual disclosure on committed developments is set out in your pack and you will be able to work out there is plenty of surplus up for grabs over the next 2 years.

Slide 29 - Central London office market

I'd like now to spend a few minutes giving you our view on the London office market, because it's important to put our activity into context.

Up to December 2016, we believe there is very little that can be brought on stream to change the demand/supply balance.

However, development starts are set to pick up, and construction costs are rising, and that changes the risk profile of development, and so we have said that any new commitments by us are likely to require pre-lets.

Let me explain why we have taken this view.

Slide 30 - Supply – central London

The green bars on this slide show the historical run of development completions in central London.

The bars on the right hand side show what is forecast to be delivered over the next few years. Pre-let and speculative space, actually under construction, are shown in white and red respectively. The dotted bars are proposed and deliverable.

They include new schemes and Grade A refurbished accommodation.

The next two years are virtually set in stone and as you can see, in a historical context, that speculative development completions remain relatively modest. Especially when you consider vacancy.

If we overlay the vacancy rate, now shown in the red line, you can see that vacancy in 2009 was much lower than the previous vacancy peaks in 1992 and 2003, and it's now falling towards historically low levels.

Post the global financial crisis it was this lower vacancy peak, combined with a lack of development finance, and our conviction that people would still need to move, that gave us the confidence to start development in scale from 2010.
Last May, we talked about increased occupier activity on the horizon. We believed there was simply not enough new, efficient, technically resilient space being developed. And that's why we committed last year to build more speculative schemes, to be delivered in 15 & 16.

But, we've got to remember: these market dynamics will change at some point.

Funding for development is now available from a variety of sources.

We are witnessing strong bidding for sites, so development activity may start picking up, not only in central London but also in satellite locations. Don't forget, London is a polycentric city and, although we complain, the transport system is better than most capital cities, and it's improving.

The 30 odd million sq ft of development completions forecast in the bars on this chart over the next 5 years are concentrated in what we all now regard as mainstream markets. They would take us above the long term average for development completions.

Slide 31 - Supply – central London schemes

And they are all represented in this slide.

If we also consider potential building starts for offices in more fringe areas which are not included in this 30 million, and which were unthinkable when we started our programme.

Slide 32 - Supply - emerging London office schemes

Then we see a new dynamic shown in yellow, which we have to factor into our decision making.

As rents rise, the propensity for occupiers to move out increases.

Slide 33 - Supply – central London

Going back to our bar chart, we can add the yellow and show the scale of it. Now we are not saying this will all get built out, the point is that development risk is shifting.

We will shortly move from a period of below average delivery and low construction costs, to one of above average delivery and rising construction costs and although it will depend on the development response to improved market conditions, the demand supply balance beyond 2016 may start to change

This is why any new commitments by us in London are likely to require pre-lettings.

Before we wrap up, and following plenty of press coverage around Ebbsfleet Valley over recent weeks, I thought I would just mention our strategic land portfolio.

Slide 34 - Strategic land – unlocking value

As we said in Q&A in November 2012, we are not a general housebuilder, and we do not intend to become one. Our role is to unlock value by delivering plots to housebuilders, and as with everything else we said we would do, we have been.

We have four positions, three of which we own that sit within trading properties and had a book value of £108m in March.

There is one, Lodge Hill, which we don't own, which is classified as a long term contract, and we carry work in progress of £11m.

You can see their locations here and we have provided some more colour in your pack, where you will see there is plenty to shoot for.

Slide 35 - Summary

So to wrap up, we have continued to do exactly what we said we would, and our strategy is working for shareholders.

In retail, it's been about moving our assets up the retail hierarchy under the themes of dominance, experience and convenience, and we have made good progress. That will continue.

In London, it's been about speculatively developing fabulous work space into a market which doesn't have enough …and increasing lease lengths. This is paying off handsomely.

But it's a highly cyclical market. Cyclicality requires balance sheet and operational discipline, which we have continued to exercise.

As we have said before, markets are ever more transparent and quick to react. So we've got to manage each part of the cycle appropriately.

Looking forward to this year, we have a London development programme being delivered into the sweet spot; a resilient retail portfolio with plenty of development opportunity; a strong balance sheet; and great talent within the business and we look forward to reporting on progress in November.

And on that note, we'll hand over to you for questions.

- End -

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