Development Securities PLC

Interim results for six months ended 31st August 2014

DEVELOPMENT SECURITIES PLC

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OVERVIEW AND HIGHLIGHTS

Highlights

- Strong half year performance – high level of deal flow generates gains of £18.2m (31st Aug 2013: £13.3m)
  - £179.4m of acquisitions since 28th Feb 2014
  - £127.2m of disposals since 28th Feb 2014

- Business approaching 'critical mass':
  - Ability to generate gains of c.£50m per annum reinforced by Cathedral acquisition
  - Significant cash generation due as existing projects mature
  - Balance sheet efficiency improved with loan note restructure

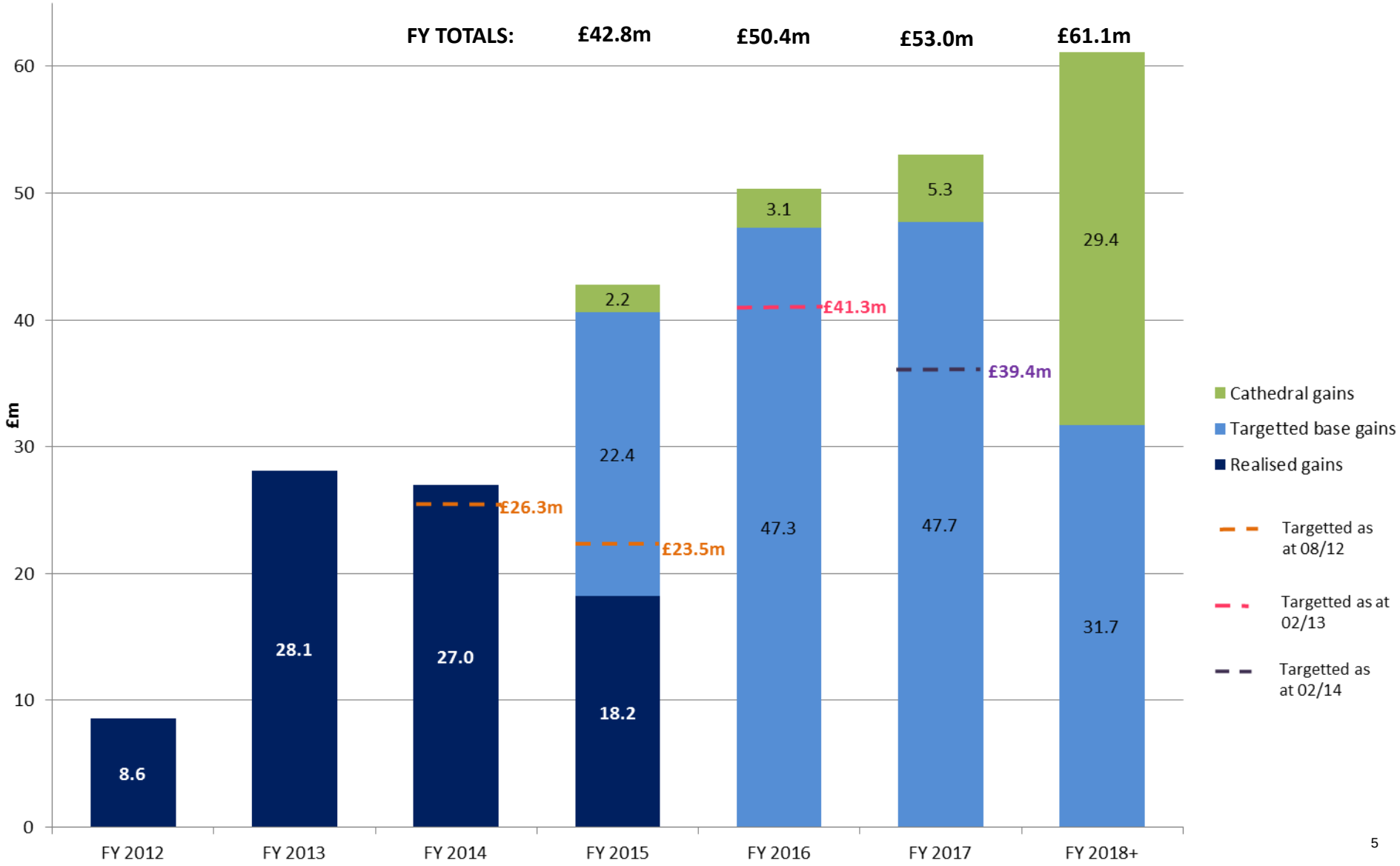
- Significant increase in underlying performance of business:
  - Profit before tax and exceptional items* of £18.0m (31st August 2013: pre-tax profit of £8.1m)
  - Basic NAV of £335.5m increased by £15.2m (4.8%) (28th Feb 2014:£320.3m)
  - EPRA NAV of £335.4m increased by £7.1m (2.2%) (28th Feb 2014:£328.3m)

- £5.3m increase in investment portfolio valuation including our share of JV assets (31st Aug 2013: £0.5m increase)

- Interim dividend of 2.4 pence per share declared (31st Aug 2013: 2.4 pence per share)

*Exceptional items of £10.6m relate to termination costs of cross currency swap (£7.9m) and acquisition costs of Cathedral Group (£2.7m)

Increasing gains add to cash flow



Good visibility on strong deal flow across a diversified portfolio

	FY 2015	FY 2016	FY 2017	FY 2018+
DEVELOPMENT AND TRADING PORTFOLIO				
Hale Barns	X	X		
Marsh Mills, Plymouth	X			
Tollgate House and Market Place, Romford	X			
Barnstable	X			
Blue Living – Norwich	X	X	X	X
Rembrandt House, Watford	X			
Robswall*	X	X		
399 Edgware Road	X	X	X	
Barwood	X	X	X	X
Wind Farms	X	X	X	
HDD	X	X	X	
The Old Vinyl Factory, Hayes	X	X		
Deeley Freed*	X	X		
N.London office portfolio	X			
Blue Living - Tilehurst		X		
Brentwood		X		
Launceston		X		
Luneside East		X	X	
Abbey Wood		X		
Shepherd's Bush Market		X	X	
Kensington Church Street		X	X	
Percy Place		X		
South Woodham Ferrers		X		
Sevenoaks		X		
Charlemont*		X		
Woking			X	
Axis Manchester			X	
Ilford			X	
Atlantic Park			X	
Pembroke Road*			X	
Lichfield				X
Morden Wharf				X

	FY 2015	FY 2016	FY 2017	FY 2018+
MAJOR DEVELOPMENTS				
Cambridge Science Park	X	X	X	
12 Hammersmith Grove	X		X	
10 Hammersmith Grove	X			
Harwell*	X	X	X	X
Southwark		X		X
Cambourne			X	X
Slough			X	X
Burlington House*			X	
Becket House*				X
Cannock*				X
INVESTMENT				
Colston Tower	X			
Wick Lane Wharf		X		
Sidcup*				X
CATHEDRAL*				
	X	X	X	X

*New acquisitions made since 28th February 2014

FINANCIAL RESULTS

Headline numbers

	Non-EPRA				EPRA			
	31st August 2014	28th February 2014	31st August 2013	Change in the half year	31st August 2014	28th February 2014	31st August 2013	Change in the half year
Profit before tax and exceptional items*	**£18.0m**	£19.5m	£8.1m	-	**£18.0m**	£19.5m	£8.1m	-
Profit before tax	**£7.4m**	£19.5m	£8.1m	-	**£7.4m**	£19.5m	£8.1m	-
Net Asset Value (NAV)	**£335.5m**	£320.3m	£312.6m	£15.2m	**£335.4m**	£328.3m	£320.5m	£7.1m
NAV per share	**269p**	262p	255p	7p	**269p**	269p	262p	-
Earnings per share	**6.7p**[+]	14.9p	5.9p	-	**6.5p**[+]	7.8p	5.1p	-
Development and trading profits	**£18.2m**	£27.0m	£13.3m	-	**£18.2m**	£27.0m	£13.3m	-
Dividend	**2.4p**	5.6p	2.4p	-	**2.4p**	5.6p	2.4p	-

*Exceptional items relating to termination costs of cross currency swap and acquisition costs of Cathedral Group total £10.6m in six months to 31st August 2014

[+] After exceptional items

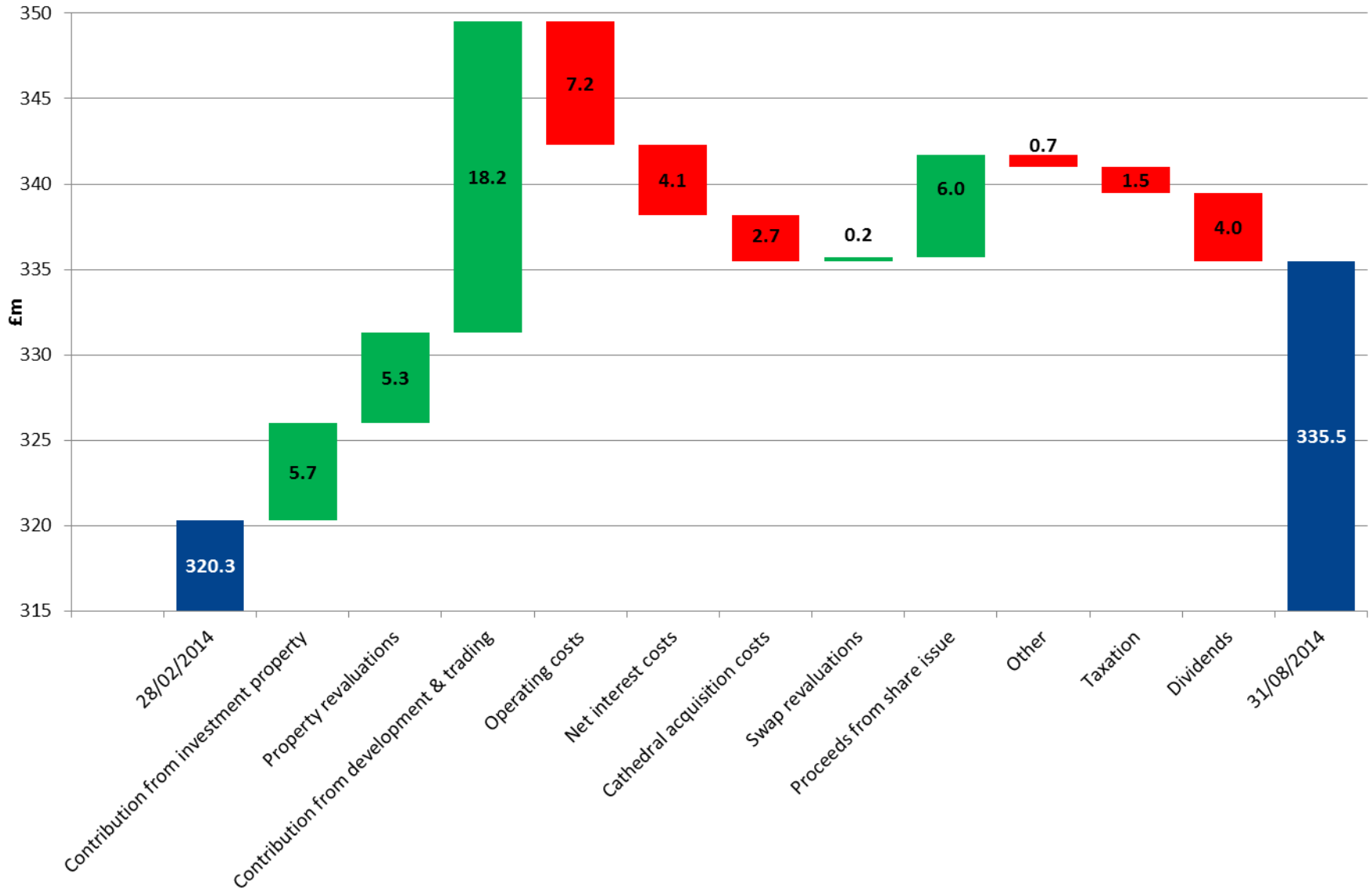
Results for the six months ended 31st August 2014

	31st Aug 2014 £m	31st Aug 2013 £m	28th Feb 2014 £m
Profit before revaluations, exceptional items interest & taxation	**15.4**	**12.7**	**25.7**
Net finance costs	**(3.2)**	**(5.8)**	**(11.9)**
Profit before revaluations, exceptional items and tax	**12.2**	**6.9**	**13.8**
Exceptional items:			
Cathedral acquisition costs	**(2.7)**	**-**	**-**
Termination of cross currency interest rate swap	**(7.9)**	**-**	**-**
Swap mark-to-market valuations	**0.5**	**0.7**	**0.9**
Property revaluation gains (including joint ventures)	**5.3**	**0.5**	**4.8**
Profit before tax	**7.4**	**8.1**	**19.5**
Basic profit per share	**6.7p**	**5.9p**	**14.9**
Dividend per share	**2.4p**	**2.4p**	**5.6p**

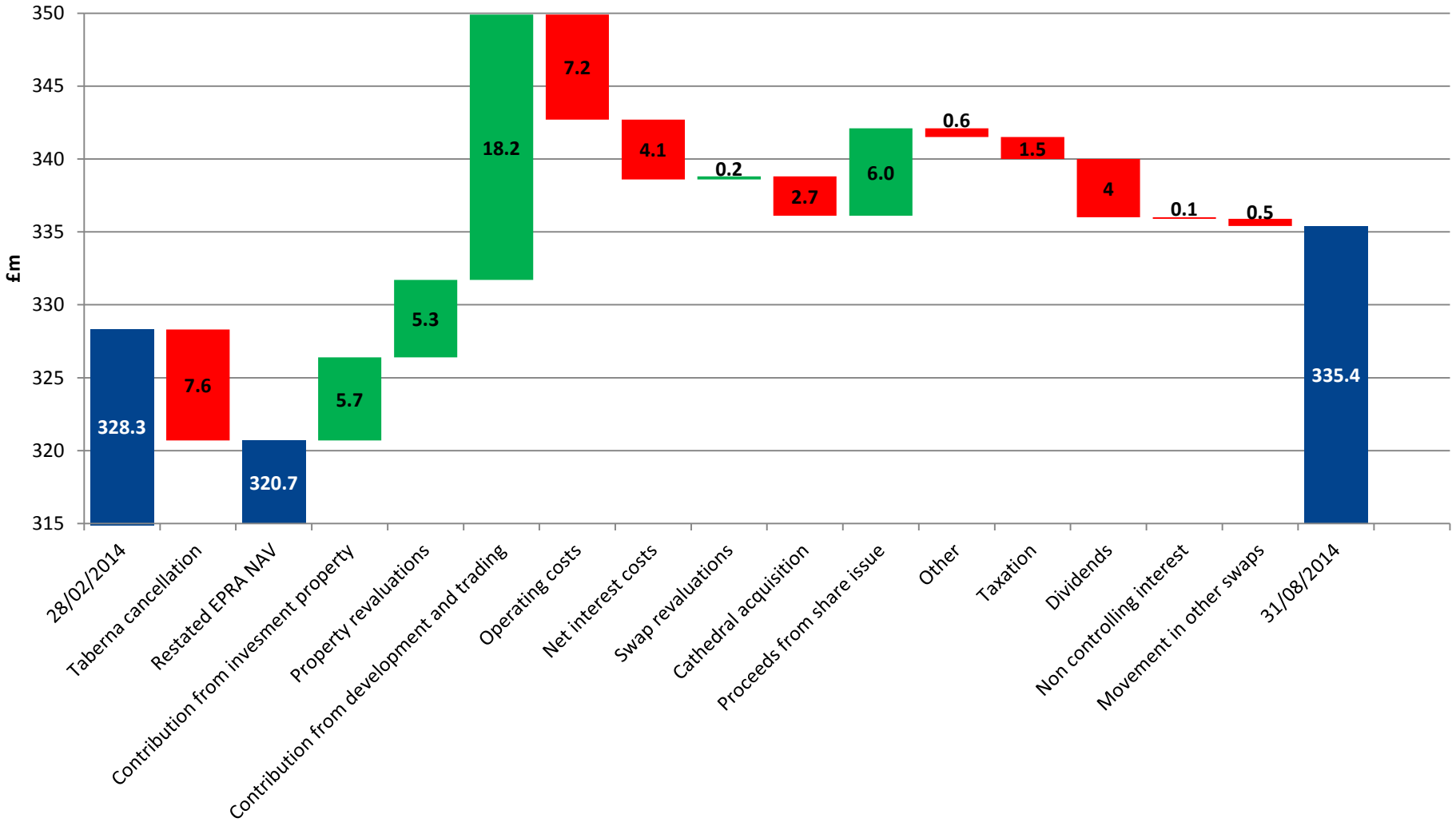
Contribution to basic NAV change

	£m	Cash-related in the period £m	Non cash-related in the period £m
Net assets attributable to Shareholders at 28th February 2014	320.3		
Contribution from investment property	5.7	5.7	-
Property revaluations	5.3	-	5.3
Contribution from development and trading portfolio	18.2	18.2	-
Operating costs	(7.2)	(7.2)	-
Net interest costs	(4.1)	(4.1)	-
Cathedral acquisition costs	(2.7)	(2.7)	-
Swap revaluations	0.2	-	0.2
Proceeds from share issue	6.0	6.0	-
Other	(0.7)	(0.6)	-
Sub-total	20.7	15.3	5.5
Taxation	(1.5)	(1.5)	-
Dividends	(4.0)	(4.0)	-
Total movement	15.2	9.8	5.5
Net assets attributable to Shareholders at 31st August 2014	335.5		

Increase in basic NAV through the period

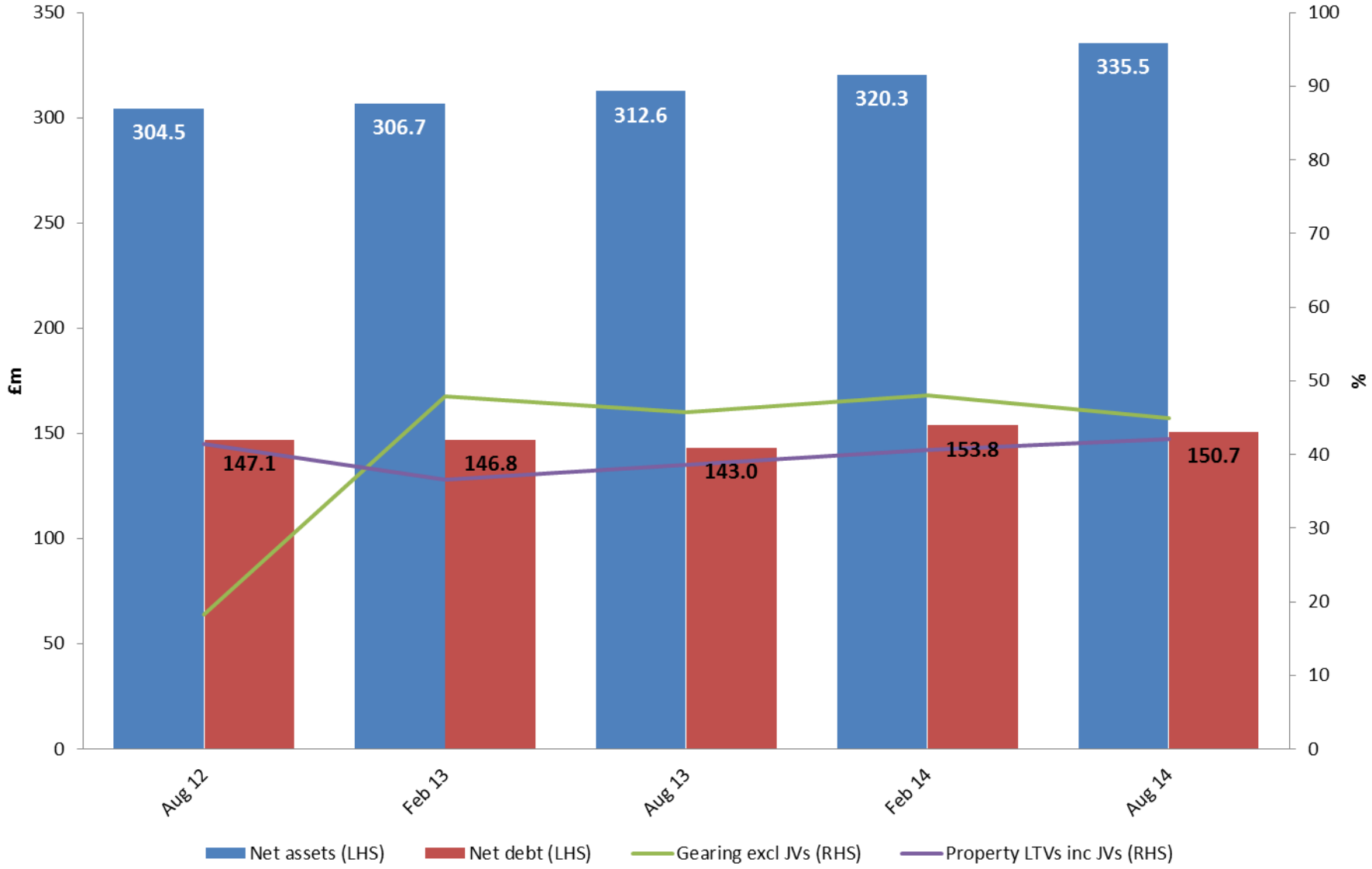


Movement in EPRA NAV through the period

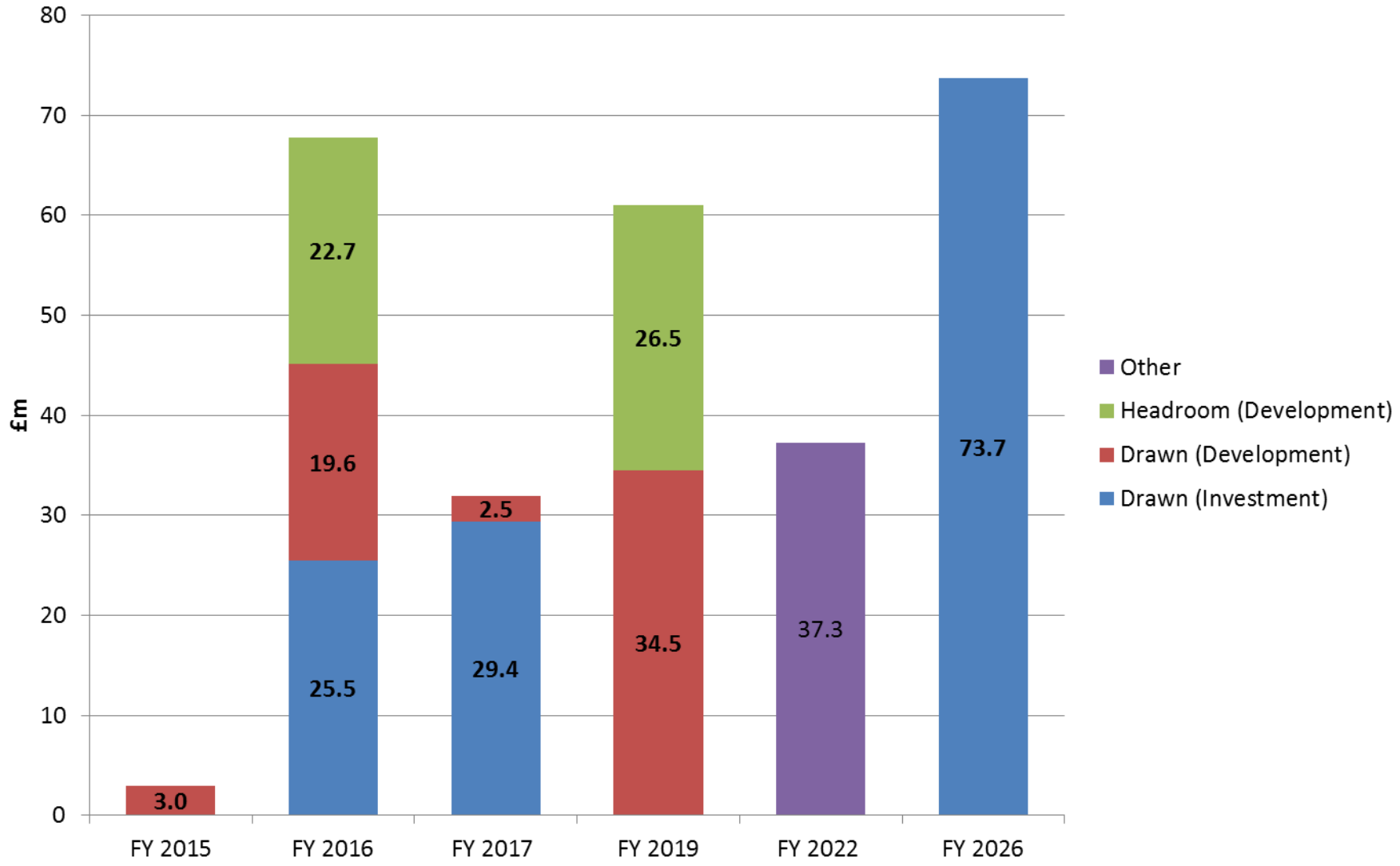


***Restructure of the Taberna Euro loan notes and related hedging has eliminated the previous mark to mark swap deficit of approximately £7.6m.**
Both this credit and the associated £7.9m cost of restructure are accounted for in the increase in basic NAV during the year of £15.2m.

Net debt, net assets and gearing



Debt maturity profile



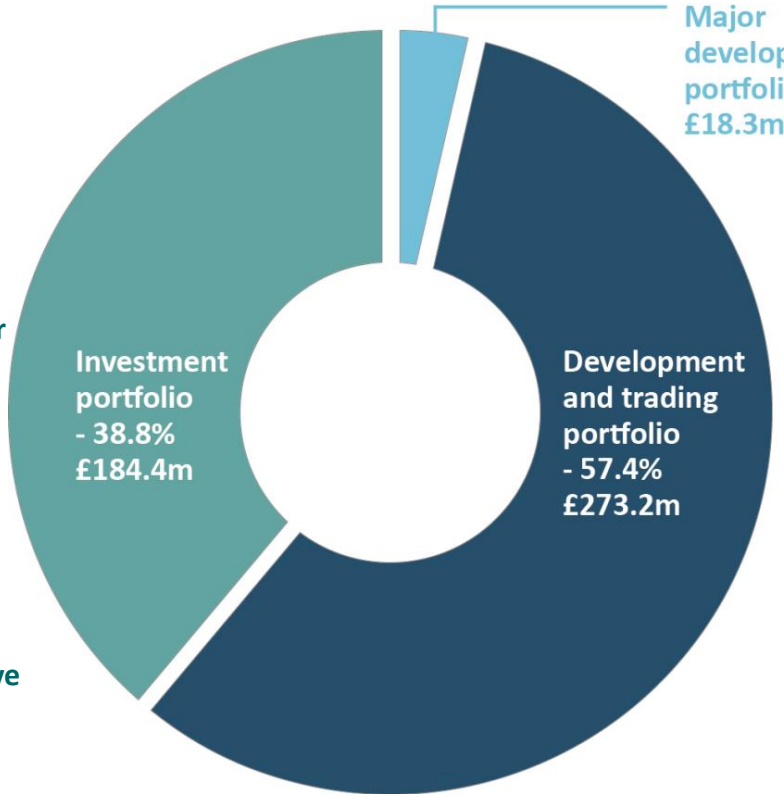
Net Debt

	31st Aug 2014 £m	28th Feb 2014 £m
Gross debt	221.5	221.1
Cash	(70.8)	(67.3)
Net debt	150.7	153.8
Gearing	44.9%	48.0%
Share of net debt in joint ventures	42.4	28.1
Net debt including joint ventures	193.1	181.9
Gearing including joint ventures	57.5%	56.8%
Analysis of gross debt		
Fixed rate	41.7%	43.5%
Capped / SWAP	37.0%	42.2%
Floating rate	21.3%	14.3%
Weighted average interest rate	5.1%	5.8%
Weighted average maturity	5.7 years	6.8 years

OPERATING REVIEW

Overview – a diversified portfolio of real estate assets

Portfolio composition by book value:



Investment portfolio held for consistent cash yield and to support overheads

Focus on long-term income opportunities with asset management and repositioning potential, notably food store-anchored retail schemes and alternative assets

Focus on prime commercial developments outside of core Central London (West End/Midtown/City) with reduced risk exposure through institutional forward-funding

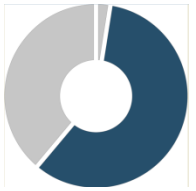
Diversified portfolio of projects including:

- Mixed-use regeneration
- PPP schemes
- Trading opportunities

Focus on Suburban London and South East England with growing presence in Dublin

Target project life cycles of three to four years with IRRs in excess of 20% p.a.

Development and trading – activity in the period



- **Further disposals continue to generate strong gains**
  - £18.2m of gains generated from development and trading portfolio including:
    - £4.4m of profits from sale of three out of five assets within portfolio of north London offices acquired in Feb 2014 – further asset sold since the half year
    - £1.4m of profit from residential site sales at The Old Vinyl Factory

- **Funding secured against two projects**
  - Shepherd's Bush Market - £44.1 million of financing secured into joint venture from Pramerica for land assembly and re-positioning of the market
  - Hale Barns - £14.8 million of funding secured from CBRE Global Investors to bring forward a food store-anchored mixed use development

- **Five mixed-use projects under construction**
  - The Square, Hale Barns – completion due at end of 2014
  - Cross Quarter, Abbey Wood – completion of Sainsbury's food store and residential in Q3 2015
  - 399 Edgware Road – completion of Morrisons food store in Q3 2015
  - St.Mark's Square, Bromley – completion due in Q2 2016
  - The Deptford project – completion due in Q4 2015

- **Planning success:**
  - Cathedral secures Resolution to Grant Planning consent for a £100m mixed-use regeneration scheme, Circus Street, Brighton

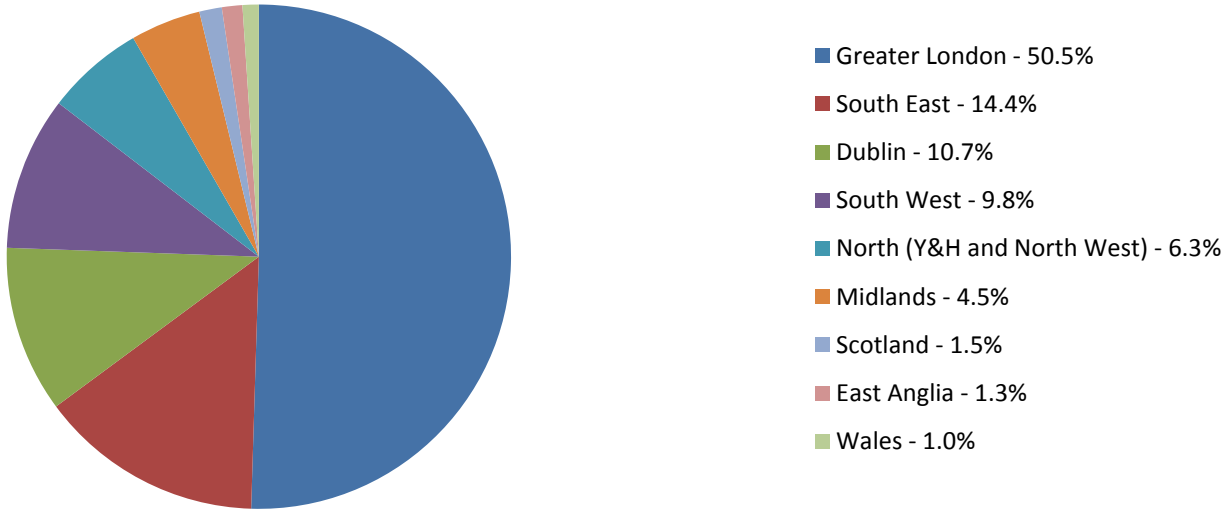
Focus on Greater London and the South East

- Focus on regeneration opportunities in well-connected Greater London/suburban London locations where we can add value initially through planning change of use:
  - 5 projects in Crossrail locations
  - 9 projects in Underground Zones 2-6

- Central London exposure is planning-led (e.g. Kensington Church Street, Algarve House in Southwark and Becket House in Waterloo)

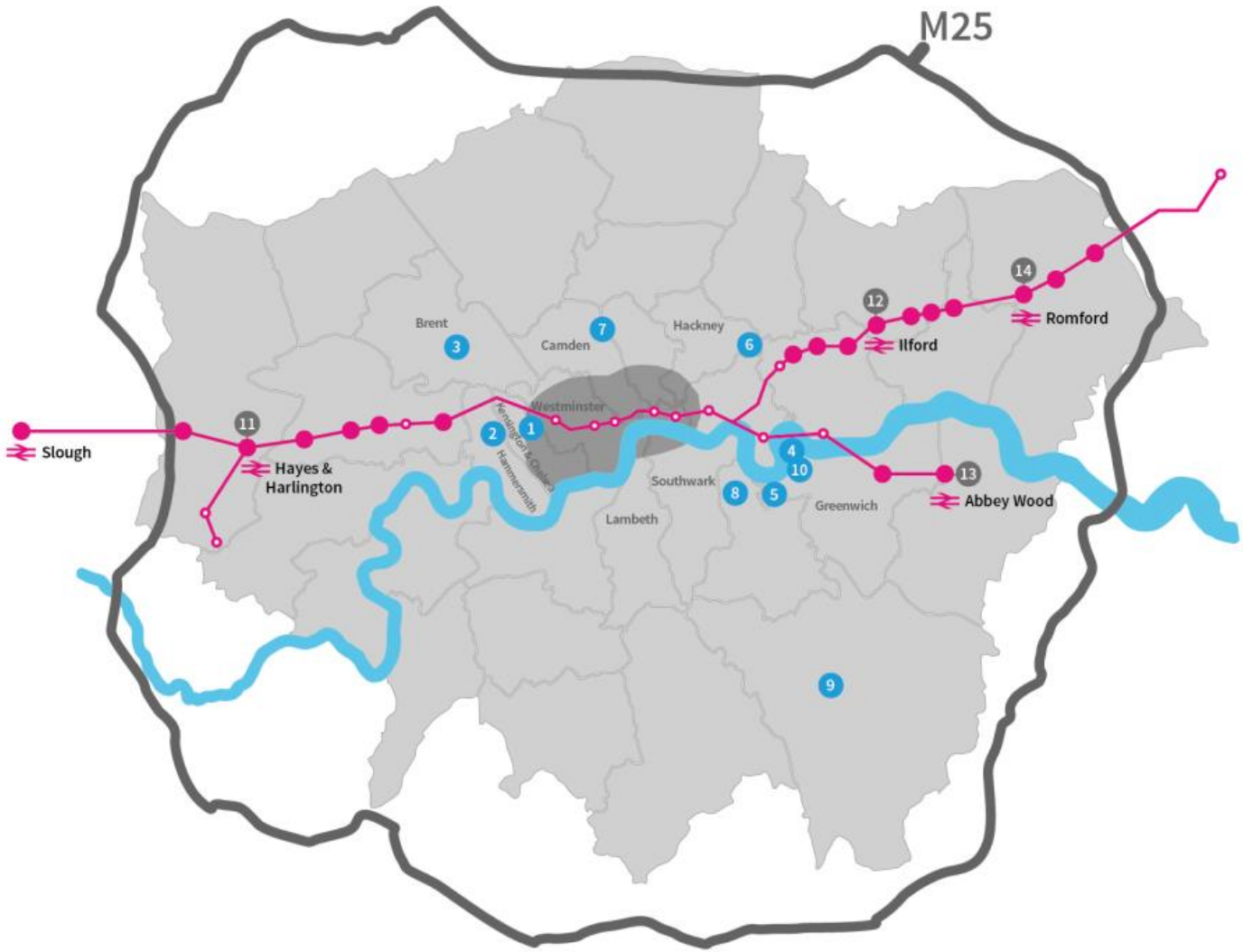
- Diversified portfolio of assets limits specific project risk

Development and trading portfolio - geographic breakdown by equity invested*



*Including Cathedral schemes

Focus on suburban London



Key Greater London assets

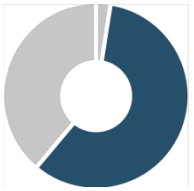
1 Kensington Church Street
2 Shepherd's Bush Market
3 399 Edgware Road
4 Morden Wharf, Greenwich
5 The MVMNT, Greenwich
6 Wick Lane Wharf, Hackney
7 Portfolio of five North London offices
8 The Deptford Project, Deptford
9 St Mark's Square, Bromley
10 Telegraph Works, Greenwich

Crossrail-enhanced projects

11 The Old Vinyl Factory, Hayes
12 Valentine's House, Ilford
13 Cross Quarter, Abbey Wood
14 Tollgate House and Market Place, Romford

Crossrail Route
M25
Prime Central London

Development and trading contribution



	31st Aug 2014 £m
10 Hammersmith Grove	**6.7**
12 Hammersmith Grove	**2.7**
North London office portfolio	**4.4**
The Old Vinyl Factory	**1.4**
Project management fees/net rental income	**2.7**
Other	**0.3**
Gross contribution	**18.2**

Recycling capital - new opportunities

Mixed-use regeneration

- Continued opportunities to create value through regeneration
- Planning change of use the key driver to value growth
- Cathedral Group a mixed-use regeneration and specialist in public private partnerships – builds our capacity to secure further opportunities
- Targeting residential-led mixed-use regeneration opportunities in Greater London and the South East (outside of Prime Central London)

Recycling capital - new opportunities cont…

Dublin

- Strong development, trading and regeneration opportunities as market returns to growth and liquidity
- Positive business environment and growing investor and occupier demand
- Our lack of 'legacy' debt issues and development expertise offer us a significant competitive advantage
- Six real estate opportunities secured to date representing c.£15 million of equity invested and further opportunities under offer

Burlington House, Dublin

Robswall, Malahide

Recycling capital - new opportunities cont…

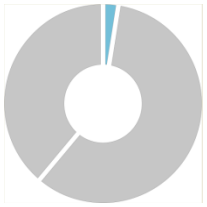
Residential

- Significant existing residential land bank of up to 11,000 units including Cathedral schemes
- Cathedral's added residential expertise provides greater optionality re: delivery of our residential land bank
- Two schemes under consideration to be built out on our own balance sheet or pre-funded and built out to maximise potential gain:
  - Valentine's House, Ilford and Telegraph Works, Greenwich – 382 units across both schemes
  - Mid-market product - £300 - £600psf in Suburban London locations with good transport connections

Valentine's House, Ilford

Telegraph Works, Greenwich

Major developments – overview/highlights



Focus on office-led development outside of core Central London locations:

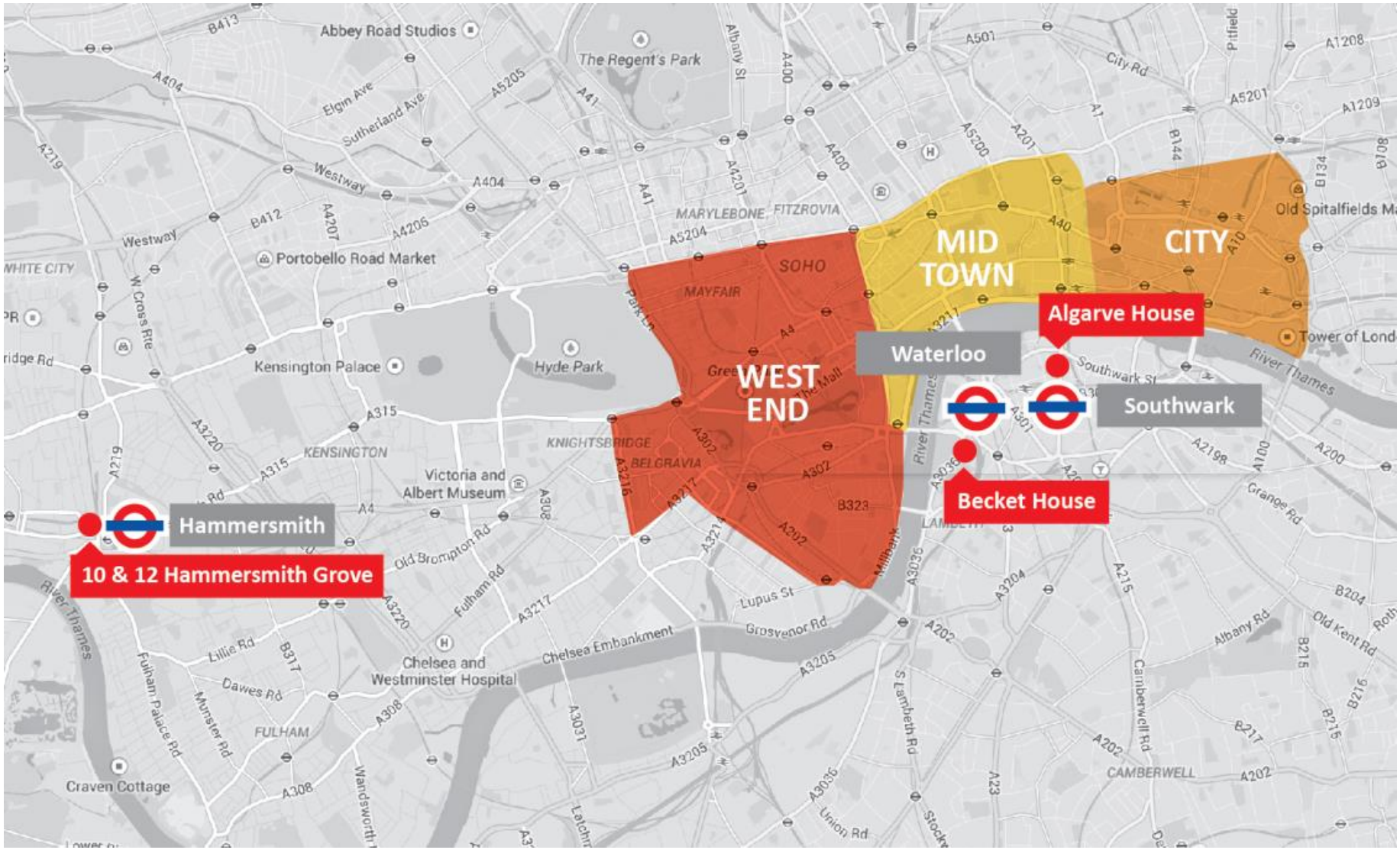
- 10 Hammersmith Grove
  - £6.7m of net profit delivered as building fully lets 14 months after practical completion
  - High quality tenants - Accor, Philip Morris, Fox and UKTV – set record rental level for Hammersmith – top rent at 10HG 54 % higher than previous top rents achieved
  - Capital value psf 39% ahead of pro forma including yield shift and achieved rents

- 12 Hammersmith Grove
  - £2.7m of profit realised from land sale
  - 167,000 sq. ft. prime office building forward-funded by SWIP Property Trust for £92.0m
  - Construction underway with practical completion anticipated in Q1 2016

- Master plan progressing for mixed-use regeneration at Algarve House adjacent to Southwark underground station – under negotiation with adjacent land owner to bring forward 225,000 sq. ft. development

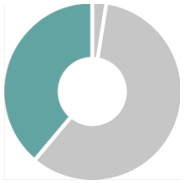
- Becket House, an income-producing office building in Waterloo, offers redevelopment potential in the medium-term

Focus on commercial hubs outside of traditional ‘core’ Central London markets



12 Hammersmith Grove
167,000 sq. ft. of grade A office
Delivery in Q1 2016
12

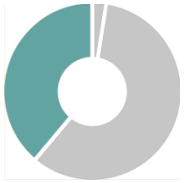
Investment portfolio – market overview



Growing investor confidence in secondary market

- Competitive tension returns to secondary market:
  - Demand spills out from perceived ‘overpriced’ Central London market as investors move higher up the risk curve in search of good quality, higher yielding secondary real estate – assets which form the core of our investment portfolio
  - Debt availability within secondary market increases
  - Yield compression in secondary market as economy continues to show signs of strengthening
- Outlook for secondary market is positive:
  - Early signs of occupational markets stabilising
  - Additional weight of money looking to invest in this market will drive further yield compression
  - Strengthening market place is encouraging us to recycle an element of our investment portfolio

Good performance against strengthening regional markets



Portfolio valuations increase and are set to recapture further value

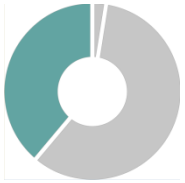
- £4.1m increase in core portfolio value in the period representing 2.6% growth (31st Aug 2013: £1.0m decrease)
- £5.3m increase in portfolio value including share of joint ventures (31st Aug 2013: £0.5m increase)

Proactive asset management to extract maximum value from our assets

- Good momentum in new lettings – 51,600 sq. ft. of space let in the period representing £0.5m of income (31st Aug 2013: £0.4m/21,000 sq. ft.)
- Contracted rent at £13.7m (28th Feb 2014: £14.1m)
- Void rates at 7.0% (28th Feb 2014: 6.3%)

Top 5 occupiers as at 31st Aug 2014		Annual rent £m	% of contracted rent
1	Waitrose	1.5	11.1%
2	J Sainsbury	0.5	3.6%
3	Sports World	0.3	2.5%
4	99p Stores	0.3	2.1%
5	Springhealth Leisure Ltd	0.3	1.9%

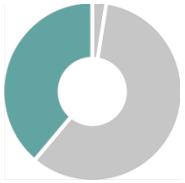
Recycling capital into new opportunities



- Continued good progress to recycle capital from assets where we have completed our individual business plans
- Disposals of investment assets worth £47.7m in the period
- 4 new acquisitions since 28th Feb 2014 totalling £112.9m (including JVs) – predominantly food store-anchored retail schemes and alternative assets
- Focus on stable, long-term income prospects with some development/redevelopment optionality
- Targeting £20m – £30m of additional acquisitions in order to achieve optimal portfolio size

Acquisition	Price
Chippenham shopping centre	£16.3m
Sidcup World of Golf	£2.2m
Armagh shopping centre	£7.4m
Becket House (JV)	£87.0m

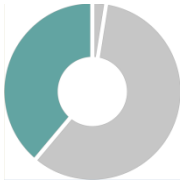
Direct investment portfolio – overview



	31st Aug 2014	28th Feb 2014
Portfolio value	**£184.2m**	**£202.1m**
Number of assets	**20**	**25**
Contracted rent	**£13.7m**	**£14.1m**
Valuation yield*	**7.6%**	**7.2%**
Equivalent yield*	**7.7%**	**7.7%**
Voids*	**7.0%**	**6.3%**

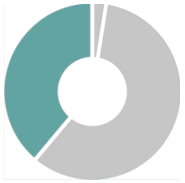
*Relates to core direct portfolio only

Investment property portfolio contribution (includes share of JVs)



	31st Aug 2014 £m	31st Aug 2013 £m	28th Feb 2014 £m
Revenue	**6.2**	**7.7**	**15.1**
Direct costs	**(1.3)**	**(1.2)**	**(2.7)**
	4.9	**6.5**	**12.4**
Gains on disposals	**0.8**	**(0.6)**	**0.5**
Asset management fees and joint venture net income	**-**	**0.6**	**1.0**
Contribution prior to revaluation	**5.7**	**6.5**	**13.9**
Revaluation gain/(loss)			
- Direct	**4.1**	**(1.0)**	**3.1**
- Share of JV	**0.6**	**1.5**	**1.7**
Contribution	**10.4**	**7.0**	**18.7**

Investment portfolio analysis – core investment portfolio*

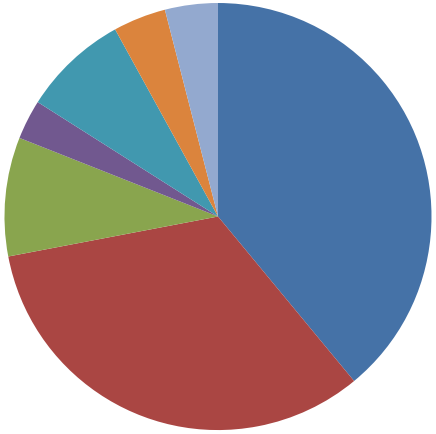


Sector	Capital value (£m)	% of portfolio by capital value	Void rates (%)	Net initial yield (%)	Weighted average lease length (years)	London/SE weighting (%)	Valuation movement** (%)
Foodstore anchored (Waitrose and Sainsbury's)	72.9	43.2	3.2	6.5	12.6	27.3	2.7
Foodstore anchored (outside DS ownership)	41.3	24.5	12.0	8.7	5.6	7.2	3.7
Other Retail	20.9	12.3	0.4	8.5	5.9	0.0	(1.2)
Commercial	8.6	5.1	16.7	11.3	5.1	0.0	3.6
Mixed-use	8.2	4.8	0.0	9.2	4.6	0.0	2.6
Leisure	17.1	10.1	3.1	5.7	20.0	5.5	3.5
Total	169.0	100.0	7.0	7.6	10.0	40.0	2.6

*Analysis covers core investment assets – direct investment portfolio excluding developable land and site assembly
**On a like for like basis

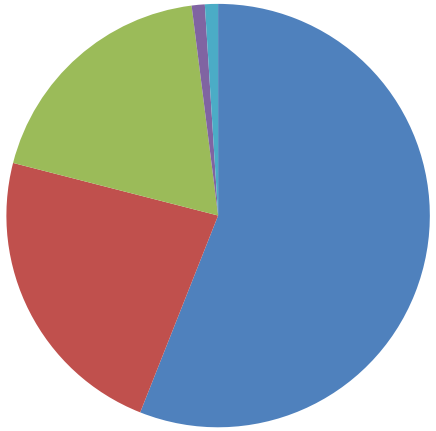
Direct investment portfolio – overview

Location profile



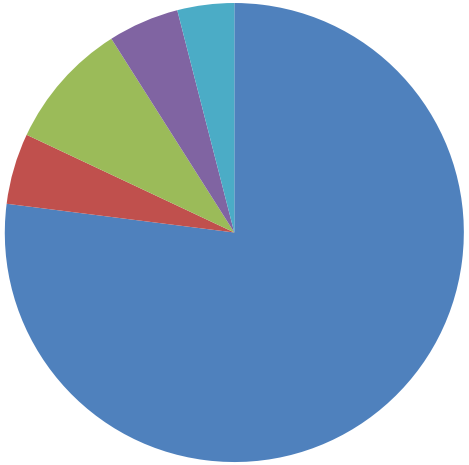
- South East - 39%
- South West - 33%
- North - 9%
- London - 3%
- Wales - 8%
- Midlands - 4%
- Northern Ireland - 4%

Tenant profile



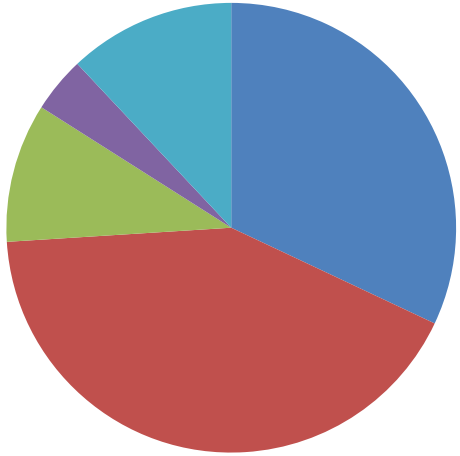
- PLC/Nationals - 56%
- Local traders - 23%
- Regional multiples - 19%
- Government - 1%
- FTSE 100 - 1%

Analysis by sector



- Retail - 77%
- Industrial - 5%
- Mixed - 9%
- Office - 5%
- Residential - 4%

Lease profile



- 0-5 years - 32%
- 5-10 years - 42%
- 10-15 years - 10%
- 15-20 years - 4%
- 20+ years - 12%

Appendix

Executive team

Michael Marx

Chief Executive

Marcus Shepherd

Finance Director

Matthew Weiner

Executive Director

(Investment)

Richard Upton

Executive Director

(Development)

Julian Barwick

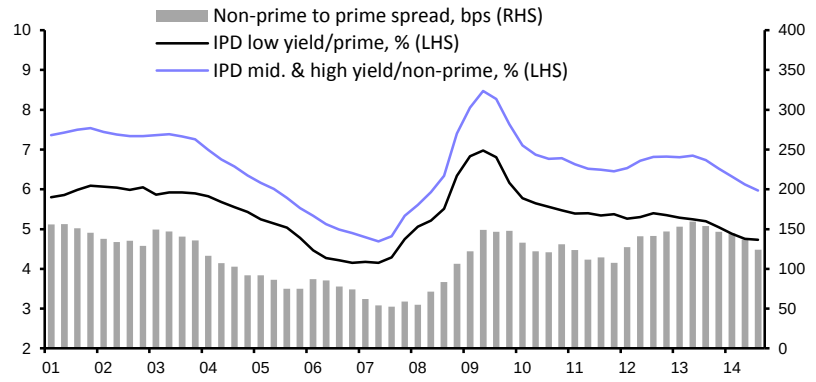
Executive Director

(Development)

Market context – key graphs

Initial Yield (%)

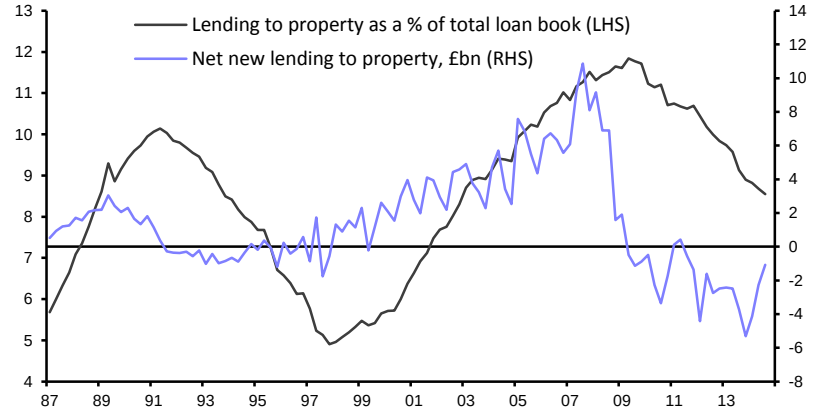
Arbitrage opportunities still strong



Source: Capital Economics

Lending to Commercial Property

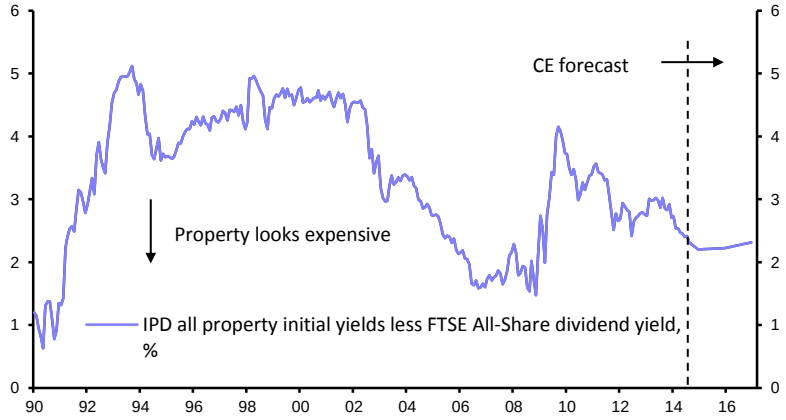
Net new lending negative for 8 consecutive quarters



Source: Capital Economics

All-property initial yield minus FTSE All Share dividend yield

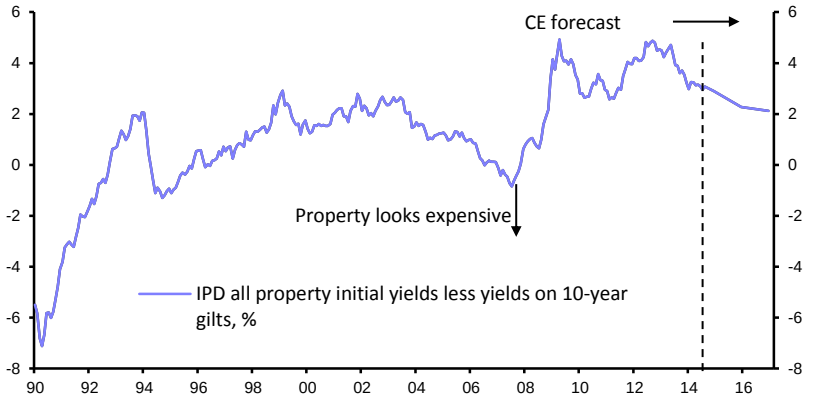
Real estate market fairly priced



Source: Capital Economics

All-property initial yield minus 10 year gilt yield

Real estate market fairly priced



Source: Capital Economics

Cathedral acquisition overview

- Acquisition of Cathedral Group (Holdings) Limited – a privately owned Greater London and South East of England mixed-use regeneration developer with a focus on public-private partnerships

Acquisition adds nine residential-led, mixed-use developments to current portfolio - enhances project pipeline and potential for increased trading gains from FY 2015

- Includes seven projects totalling over 4.5 million sq. ft. namely:
  - Telegraph Works in Greenwich
  - Morden Wharf in Greenwich*
  - The Deptford Project in Deptford
  - St. Mark's Square in Bromley
  - The Old Vinyl Factory in Hayes*
  - Circus Street in Brighton
  - Spirit of Sittingbourne in Kent
- In addition, two development opportunities totalling 582,700 sq. ft., where the acquisition of the sites is at an advanced stage of negotiation:
  - The Albany in Deptford
  - Preston Barracks in Brighton

Acquisition strengthens senior management and project delivery teams

- Board strengthened with two new members – Richard Upton set to join as Executive Director, Barry Bennett set to join as Non Executive Director
- 25 other Cathedral employees to join the Group, enhancing its capacity to undertake more projects at any one time

*a previous 50:50 JV project with Cathedral

Consideration structure and financing effects

- The consideration payable comprises a number of elements:
  - Initial consideration of £20.9 million comprising:
    - £17.5 million – initial consideration payable upon completion in:
      - £11.5 million of cash from existing resources
      - £6.0 million in new ordinary shares at 233.5 pence per share*, equating to 2.6 million shares. The shares will be locked up for a 42-month period (subject to limited customary exceptions) following completion
    - £3.4 million – deferred consideration payable in instalments of £1.2 million in May 2015 and £2.2 million in May 2016
  - £2.5 million – deferred consideration payable upon completing the acquisition of one of the development opportunities
  - c.£4.0 million** – contingent consideration payable in respect of Preston Barracks and Morden Wharf based on the performance of these projects and the overall performance of the acquired portfolio

- Transaction expected to have a minimal impact on earning per share in FY 2015 with enhanced earnings flowing as development projects are delivered over the coming years

*representing the average of the middle market quotations for the Company's shares for the ten business days preceding the announcement
**based on current business plan assumptions for individual assets

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