

# The Cantos transcript

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Aug 21 2007

**Brixton**

**Tim Wheeler, Chief Executive**

## Interim results 2007

### Results highlights

**Q.**

**You say that Brixton continues to deliver, so what for you are the key highlights?**

**A.**

Well this is a strong set of results again. Starting with NAV, that's gone up 11.4 per cent to 595p, profit before tax is up just under 50 per cent and adjusted earnings per share is up 14.7 per cent. Now investment profits dropped slightly (just under 5 per cent) and, as we flagged because of the extensive sales programme last year, net rental income has also gone down by just over 21 per cent. Actually, on a like-for-like basis, net rental income is up 2.5 per cent. And also the dividend has increased by 11.6 per cent to 4.8p.

Now driving all of this is really our rental growth out-performance – the thing we keep talking about. This half year has been really quite exceptional with the valuers' mark to market, the pricing of the rents, up by 4 per cent. On our combined lettings, rent reviews and lease renewals they went up by 4.8 per cent. IPD, for example, did 0.6 per cent in this same time. There's a strong capital surplus rolling through as well. 7.9 per cent, or 8.2 per cent like-for-like, against IPD's 1.4 per cent.

**Q.**

**So what's behind your ability to continue to drive this level of rental growth out-performance and NAV? How are you different from your peers?**

**A.**

It's about focus and specialisation. That's what differentiates us. We've always said that income is the one thing that a focused management team should be able to positively manage and affect going forward. It's also about the strategic call, about moving the portfolio back towards London, selling a quarter of it last year as you know, where we believed the returns would be higher and, indeed, these results are a reflection of that move.

On the other side of the coin, for the first time in several years, there's been quite a lot of evidence of investment transactions taking place in the Greater London industrial market. This hadn't happened for several years. We've consistently said that in our case, unlike retail and offices where there have been lots of properties transacted, this hasn't happened. So all of a sudden the valuers have got proper evidence to mark to market the pricing.

We've prepared a schedule, which is at the back of the analyst presentation, which shows over 20 transactions in Greater London this year. Of the investment transactions which Brixton weren't involved in – we were involved in two, there were 14 - at least eight of those were at equivalent yields keener than the average yield on our portfolio, which certainly says something. Only two of them were at a lower pricing level. So there's a lot of activity which is meaning the capital values are probably for the first time in three or four years more accurately assessed.

**Q.**

**But the share price and sentiment around the sector in general doesn't seem to reflect your sense of optimism about the prospects for Brixton?**

**A.**

I think share price is interesting. There are a lot of global influences taking effect across the markets at the moment, which we can have no control over at all. In the early part of this year as well there was the deflating of the REIT bubble if you like. People have perhaps forgotten that in the two year run up to 1 January, for those companies that did convert (Brixton included) we had on average an 80 per cent share price rise in that time.

When we look at where we sit at the moment, with the NAV that we've just announced of 595p, on Friday of last week the share price was 360p. That's a 40 per cent discount. Now the fundamentals of our business are no weaker. In fact, from the evidence that we've put forward in this statement, it's stronger than it has been for several years. So there is a definite disconnect there.

One story which you may find amusing is that in terms of buying, I bought a material amount of shares in this company in May at a price of around £5. I thought it was a good value proposition then, I don't think it's any worse a value proposition today.

**Q.**

**External influences aside, what can you actually do though?**

**A.**

Well it's our job to try and get the share price up for the benefit of the shareholders and what we do is we stick to our business plan. The business model is robust. It's producing returns that others aren't and therefore, at some point, one would hope that this would translate into a more appropriate pricing.

### **Strategic Activity and Development**

**Q.**

**You refocused the business back in 2006 and sold off the secondary elements in the main. Are you happy with the pace of reinvestment?**

**A.**

Yes, we were happy with the move that we made. Just to recap on that, we sold about a quarter of the portfolio, £560m, last year. It was a deliberate call as we could see this oversupply developing away from the capital and more new development coming through. Also the debt driven buyers that were really the force behind the secondary market were going to fall away as finance rates were going up to a higher level than the running return on the properties. So an absolutely deliberate move. We de-gearred to quite a lot of criticism at the time, but we were also saying that we were going to see more opportunities back in our core market. Indeed, that's what's happened. We bought 10 separate acquisitions since May last year with a total expenditure well over £225m and we also have a total commitment to development this year (development and refurbishment) of about another £100m. So there's quite a lot of spend going on.

**Q.**

**Some people might argue that with gearing under 40 per cent you're in need of another major acquisition. How do you answer that?**

**A.**

Gearing is quite interesting. One of the reasons that the gearing remains under 40 percent (it was 34 per cent at Christmas; it's 38 per cent now on a debt: equity basis) is because the valuation has been so strong. So you can't really have it both ways. We're very comfortable with where we are. We look at every opportunity, whether it's small or large, and we'll only buy if we see ways of creating value. It's as simple as that.

**Q.**

**You've characterised 2007 as the year of development for Brixton, so where have you got to with X2 and Park Royal?**

**A.**

The programme overall is progressing well. X2 has created a lot of interest. It is high profile, it's the first of its sort outside of Asia, it's on track to be completed, as we projected, just into the start of next year and there is interest in the scheme.

Origin, the old Guinness Brewery site, is the largest scheme that we'll be starting this year, pending planning coming through, and we're hoping that will be resolved pretty quickly.

Overall, the total cost of our development programme, including the land, is about £270m. You can estimate the end value at around £400m quite sensibly. That's £130m worth of profit – nearly 50 per cent on that development programme. What's significant about it is that all our speculative development, except one tiny little scheme (second phase at Basingstoke), is due to be completed by mid 2008. So those prospective returns, those profit levels I have indicated, are available pretty immediately.

**Q.**

**But strong competition may make it difficult for you to keep a reasonably priced development pipeline coming through. Is that fair comment?**

**A.**

I think I've sort of answered that already in the way that we've managed to get to a position of potentially having 50 per cent profit on costs on schemes that we bought in the open market. I will give you one example. We bought the Guinness Brewery site, exchanged contracts, just a year ago at £2m an acre. Land value deals in Park Royal have now taken place at over £3m an acre. So we're reasonably confident that with our track record of spotting undervalued opportunities both in the investment and development market we should be able to continue to compete really whatever the pricing levels are.

**Q.**

**But isn't it all about the availability of good sites?**

**A.**

Actually it's about the availability of space. I suppose what's concerning on a countrywide basis at the moment is that in the last 18 months new floor space availability has gone up by 45 per cent.

In Greater London it has gone up by less than 15 per cent. These are King Sturge's June floor space numbers and they estimate that in June in Greater London there were 11 schemes on site totalling 1.66 million square feet. By square footage, Brixton had half of those. Where we remain confident is the fact that in London and the South East the total amount of speculative development at the moment at about 3 million square feet is still only 0.3 per cent of the total stock.

It's particularly relevant also because, with the ownerships that we've got, we're now working up schemes for the next phase of our programme from within the portfolio. Things we bought recently will provide another 60 acres of development opportunities: three schemes in Park Royal and a further one at Heathrow.

## **Outlook**

**Q.**

**Downward industrial yield shift appears to have ended, if you believe the indices, so how does this affect Brixton?**

**A.**

We can all theorise about what's happening to yield shift. You're right, the IPD monthly index for July was down, the first time in this cycle that it's reversed. But it has reversed by one basis point. That follows on from the retail sector going backwards, i.e. yields rising in May. In the office sector yields are still, according to IPD, compressing. What I've explained to you is that in our market, in the London market, this year there is strong evidence of ever keener prices being paid and, indeed, some of the stronger evidence has come through in July and August, so after our results have effectively been posted.

What it comes down to really, and we believe this, is that it is going to be those knowledgeable focused companies that are continuing to drive rental growth that will outperform going forward. It's as simple as that and frankly our portfolio seems to be behaving in a different way to the indices and I think that there are reasons for that which we have explained many times.

**Q.**  
**So what are the markets really seeing here do you think?**

**A.**  
Well the property market is obviously being influenced at the moment by what's happening in a wider sense and there is a degree of uncertainty that hasn't been seen for some time. We find this a little perplexing given what we've seen within our portfolio, and are continuing to see, as the general credit crunch seems to be taking hold.

Let's just look at what drives the portfolio, what drives the need for people to make, store and move product from our properties in and around London. It's basically population growth, the strength of the city and the growth of Heathrow Airport; you will remember in March next year Terminal Five finally opens and that will increase the capacity by 50 per cent.

We're seeing no increase in bad debt provision. We're seeing tenants able to pay ever higher levels of rent and we're seeing a stabilisation and a falling vacancy rate. So what we're seeing in our own micro market are some very positive signs. Whether the overall global position translates into tangible negativity in consumption and growth, time only will tell. But we can only deal with those things that we can influence, which are the markets we choose to operate in and the way we choose to do business.

**Q.**  
**Given all that, what's next for Brixton?**

**A.**  
We'll still stick to what we're doing. It will be aimed at the primer end of the market. There will definitely be a move, as there has been towards quality. We think the markets generally will move that way. The "dash from trash" as people have said will be evidenced we're sure and that should help Brixton because we're well positioned, we're in the right locations and we have the primest stock.

We believe we'll still see further capital growth because of these rental enhancement activities that are still coming through. In other words, rental growth is coming through strongly, and we think that will mitigate against any negative yield movement which we certainly haven't seen yet, but may prevail across our sector going forward.

12 months ago at our interim stage I said that in a relative competitive advantage position I didn't think in my 20 years or so at Brixton we'd ever been stronger. I felt that then. I feel it even more so now.

#### **FORWARD LOOKING STATEMENT**

*This interview contains certain forward-looking statements with respect to the financial condition, results of operations and businesses of the Brixton plc. These statements and forecasts involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future. There are a number of factors which could cause actual results or developments to differ materially from those expressed or implied by these forward looking statements and forecasts. The statements have been made with reference to forecast price changes, economic conditions and the current regulatory environment. Nothing in this announcement should be construed as a profit forecast.*

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