Transcript of Preliminary Results Presentations 18.03.03

Tim Wheeler, Chief Executive:

Good morning and welcome.

Whilst you are all here obviously for the Results Presentation we are changing the format slightly and perhaps I could just run through the agenda.

Firstly, and before the Results themselves we'd like to show you a film – it deals with Heathrow – our core market and we commissioned this in the Autumn last year. We think it's particularly relevant to show this today to put a key element of our portfolio into context and to help elaborate on the reasons for our involvement. The spotlight on Heathrow has intensified in the course of making the film – T5 has commenced, cargo and passenger numbers have recovered post 9/11, major green belt applications have been refused and the government has issued and indeed re-issued its pre White Paper consultation on the future of airports in the UK. All this has lead to much commentary by press, property consultants, and indeed analysts – and its important that the true facts about Heathrow's dominance and future place in the airport hierarchy are fully understood.

Secondly I'd like to introduce you to Louise Patten who becomes our Chairman after the AGM on 15 May.

Louise joined our Board in 2001 and as well as remaining on the advisory Board of Bain she is a Director of GUS, Hilton and Somerfield. She has brought new ideas and particularly helped in our customer re-focus through B-Serv.

Her appointment comes alongside several new non-executive appointments this year to provide both for an effective transition of Board membership and also to widen the skill base and outlook.

Thanks particularly must go to our present Chairman Allan Gormly who has worked with me to fulfil this vision and allow for an effective non-executive succession. Allan and David Marlow, our Senior independent non-executive director retire at the AGM having served 9 and 10 years respectively on our Board.

As well as Louise the new team includes:

David Scotland aged 55 who is an executive Director of Allied Domecq and possesses great marketing and interpersonal skills.

Nicholas Fry is also 55 and is an accountant with a background in banking and corporate finance at Warburgs and KPMG.

John Rink, aged 56, joins after a highly successful career as a corporate litigation lawyer and has presided over a very active global growth period as Managing Partner at Allen & Overy for the last 9 years.

Michael Moore who has been a non-executive since 1997 provides a wide experience base as a barrister, banker and businessman with a variety of other Chairman roles including being a director of one of our major shareholder's subsidiary companies. His wise counsel continues to be valued.

We think we now have a great blend of skills, enthusiasm and dare I say it even relative youth on our Board. All the non-executives are here for a purpose to assist the business and not just play the corporate policing role – important as it is. We think the combination we've now got is quite unique, particularly in our sector.

Finally, and before starting the film, I would mention that to help digestion of all the information we'll be providing you with transcripts for you to take away of the text of the presentation, of the film's commentary and a summary of a King Sturge research paper commissioned by us on the Heathrow market.

(See film - Heathrow: The Growth Story)

You've seen the film – now please consider the facts.

There has been much obvious confusion as to the drivers behind Heathrow's growth and to the sustainability of its dominant role.

We believe that certain recent reports have missed the point and as such we commissioned King Sturge to set about verifying the widely varying statistics and correctly sourcing them.

In the document that accompanies the CD of the film you will see the conclusions of this research, but may I just highlight certain key points:

1. Despite the recent government consultation on the future of air transport in the UK only one thing is certain – T5 is being built and will increase passenger movements at

Heathrow by approximately 50%

2. Heathrow already accounts for more than 75% of the whole of the UK's bellyhold cargo market and over the last 10 years Heathrow has consistently handled more freight each year in total than all the other UK airports put together.

   The DFT estimates that bellyhold cargo demand is expected to grow faster than passenger demand indicating a higher rate of cargo growth than even Heathrow's 50% increase in passengers will allow.

3. FPDSavills in their recent report have misquoted and incorrectly analysed both historic and forecast freight growth figures.

   Savills report concentrated more on cargo handling via integrators using "freighter" aircraft expressing an opinion that growth in this sector is likely to outstrip growth in bellyhold, yet:

   - The share of UK air freight from freighters only increased from just over 30% to just under 34% between 1996 and 2001.
   - Whilst their key growth airports are Stansted and Luton which presently handle nearly 100% each of their cargo volumes in dedicated freighters they are only responsible for around 8% and 1% respectively of the UK air freight market compared with Heathrow at 55%.
     And,
   - Stansted is only estimated to be in a position to handle a greater overall volume of freight than Heathrow in 2030 on the assumption that Heathrow has already reached capacity and 3 new runways are operational at Stansted.
   - Stansted has a restriction on the number of dedicated freight flights; BAA prefer not to lose passenger slots to freighters as they miss out on passenger retail spend; and low cost short haul passenger flights do not carry significant air freight volume.
   - Despite the suggestions, Luton cannot be considered competition to Heathrow. In 2002 it handled less than 2% of Heathrow's cargo volumes – it has seen negative growth in freight volumes on average over the last 10 years. And it is dominated by easyJet which places pressure on landing slots.

Savills comments have to be put into context not to have a detrimental effect on Heathrow's prospects, although even they admitted "the role of freight around Heathrow…..will remain substantial".

4. It is extraordinary for the analysts who then followed the Savills report with their own note to suggest that, firstly, the increase in passenger flights permitted by T5 will reduce overall freight volumes, and secondly, that the main impact of the refusal of Argent's 2.25m sq ft green belt distribution park, the London International Freight Exchange, is to make Heathrow's position weaker in terms of rail freight. This is a red herring as the key impact of this decision is the maintenance of the green belt which positively assists the growth prospects for those owners with existing holdings and consented schemes.

I would implore you to read the attached document – the sources are accurate, the figures and analysis correct.

In conclusion, King Sturge summarise:

"Demand for industrial and warehouse property on and around Heathrow is intrinsically linked to demand for air freight (48% of new-space taken over the past three years was airport-related), which in turn is linked to passenger demand as over 90% is carried in the bellyhold of passenger aircraft. With Heathrow's commercial property market already constrained, the increased demand will benefit existing landlords making Heathrow a good long-term investment opportunity".

Turning now to the results, and I'll pass you over to Steve for his Review.

Steven Owen, Deputy Chief Executive:

Financial summary

Looking at the 7 bullet points of the financial summary the first 5 deal with the P & L and on an underlying basis have shown solid performance in challenging market conditions with like-for-like net rental income, investment profit and adjusted eps all up over the previous year. The last two bullet points relate to balance sheet performance where, because of the valuation deficit of £27.8m, adjusted NAV per share fell by 2.4% over the year to 325p and by 4.4% over the 2002 half year figure of 340p.

One of the advantages of investment property companies over other types of companies is the security and longevity of its income stream. In our case, this has helped us increase the dividend by 2.8% and this extends our unbroken record of increases to 35 years. It is worth

re-iterating that our policy is to achieve consistent, progressive dividend growth each year based on the level of post-tax investment profits.

Group profit and loss account

Net rental income for the year was £86.0m, a slight decrease of £0.3m over the 2001 figure but on a like-for-like basis the increase was £2.0m or 2.5%.

Admin expenses were up £1.1m or nearly 30% to £4.8m, although the 2001 figure included a non-recurring finance arrangement fee of £0.3m received from Equiton. The rest of the increase was due to a full year's costs at 50 Berkeley Street, abortive costs relating to a proposed joint venture and the recruitment of additional staff. Notwithstanding this increase, we still have one of the lowest proportionate administrative costs in the sector.

The reduction in the share of jv operating profits of £1.5m relates predominantly to the sale of the 41.2% interest in Equiton in July 2001.

Net interest payable including jv interest, fell by 9.2% to £44.4m a reduction of £4.5m. Of this, £4.0m was due to a lower rate of interest charged against profit – 6.6% in 2002 compared with 7.2% in 2001. The remainder of the decrease was due to sales of properties and the sale of part of our Equiton stake. Capitalised interest was £2.5m compared with £1.9m for 2001, the increase relating mostly to Aviator Park. The effect of lower interest rates and lower average debt has benefited income cover which increased to 2.0x in 2002 from 1.8x in the previous year.

This brings us to investment profit which, for the reasons outlined, increased by 3.9% to £42.7m.

Exceptional items of £4.7m are made up of two items, the main one being an exceptional interest charge of £4.4m and the other being a net £0.3m loss arising on the sale of properties. The interest charge relates to the premiums paid on the purchases of £13m of debenture stocks, which, as well as reducing the cost of debt and therefore being earnings enhancing, also reduce the level of secured debt.

The corporation tax charge fell by 16% to £4.2m but this includes £1.3m tax relief on the exceptional interest cost. Excluding this, the tax charge on investment profit was £5.5m and represents an effective rate of 12.9% compared with 12.2% for 2001. The low rate for both years was due mainly to the benefit from capital allowances and the release of provisions relating to prior years.

Adjusted eps, i.e. excluding the exceptional items and deferred tax increased by 2.7% to 15.3p. The dividend of 10.9p is covered 1.4 x by these earnings.

Tenant strength

We've reported in the Prelim that the diversity, quality, security and resilience of the tenant base is so important to our performance particularly in the current challenging market conditions.

We have a diverse tenant base – at the year end we had over 500 tenants in the wholly owned portfolio with the top 10 tenants producing about a quarter of our rent roll. Our tenants are represented in most of the FTSE sector analysis with the top 5 sectors being Support Services, Software and Computer Services, Transport, General Retailers, and Food Producers and Processors who, in total, account for nearly half of our rent roll.

The security of our tenant base is demonstrated by the average unexpired lease term, assuming conservatively that tenants vacate at the earliest opportunity, of 8.5 years for the industrial portfolio and 8.7 years for the whole portfolio. Ignoring breaks, the figure is 11 years for both the industrial and the whole portfolio.

Notwithstanding the current economic situation our bad and doubtful debt provision continues to remain low at £0.7m which is only 0.8% of the rent roll. We lost £1.0m of annualised income in both 2001 and 2002.

Tenant covenant

These are our top 10 tenants and you can see from the list how diverse their businesses are and how low our exposure is to any one particular tenant.

Summarised group balance sheet

Looking at the balance sheet, adjusted net assets excluding deferred tax, fell by 8p to 325p and were £791.3m at the end of 2002. The decrease was caused by the valuation deficit of 11p per share but tempered by the retained profit of 3p per share. Gearing increased from 82% to 88%. If we include our share of joint venture debt, which is non-recourse, gearing increased from 89% to 95%. The sale of Woodside earlier this year has reduced gearing on a pro forma basis by 2%.

Triple net NAV

Triple net NAV excluding FRS19 was 285p at the end of 2002 compared with 294p in 2001 – a 9p or 3.1% decrease.

Valuation

The valuation deficit of £27.8m on the whole portfolio represents a 1.7% decrease over last year end's valuation and a 1.8% decrease on a like-for-like basis.

The industrial portfolio produced a £9.2m deficit, which is a 0.7% decrease over the year. The deficit on the wholly owned industrial portfolio was £2.8m, equivalent to just over 1p per share. The joint venture properties produced a deficit of £6.4m, a decrease of 5.1% due to a more cautious view on development sites at Premier Greenford and a reduction for Woodside. However, Equiton produced a surplus of 4.3%.

Within the wholly owned portfolio, Greater London, where we have over half of our portfolio, continues to be the best performer for industrials with a surplus of 1.5% but the Rest of the South East produced a deficit of 2.6%.

One of the main reasons behind the changes in the valuation has been the continuing slowdown in the rate of rental growth reflecting lower levels of occupational demand. Overall like-for-like industrial rental growth since December 2001 in the wholly owned portfolio was flat but with Greater London showing growth of 2.2% and the Rest of the South East a fall of 2.5%.

Equivalent yields were broadly unchanged although the slight improvement of 10 to 25 basis points on a small number of the more prime estates that we reported at the first half was eliminated in the second half.

The deficit on the office portfolio of £18.6m reflects significant reductions in ERVs, but the office portfolio which is not a core holding only accounts for 13% of the total portfolio.

The valuation provides a fair reflection of market conditions at the present time and the robustness of this is evidenced by the fact that since 1996 we have sold £650m of UK property at a margin of 2.5% above the valuation figure prevailing before the sale. Last year we sold £69m at just over 1% above valuation. Notwithstanding this, the industrial portfolio only needs to see annual rental growth of 0.75% over the next 5 years for our pre-tax WACC to be exceeded.

Debt analysis

We have approximately £460m of committed bank facilities available, of which £219m were undrawn at the year end. The weighted average maturity of all borrowings at the end of the year was 8 years and the average cost of Group debt was 6.3%. The proportion of floating rate debt to total debt at the end of 2002 was 28% compared with 30% at the end of 2001 reflecting the
expiration of a short term swap. We don't operate with any pre-determined ratios of fixed to floating rate debt but we constantly review our interest rate profile against existing and forecast market conditions.

The ratio of secured to total borrowings was 26% at the end of the year compared with 29% at the end of 2001, reflecting the purchases of £13m of legacy debentures which have reduced the amount outstanding to £182m.

As a measure of our balance sheet strength and flexibility the value of our unencumbered portfolio at the end of 2002 was £1.2bn.

I'll now hand over to Tim for the remainder of the presentation.

Tim Wheeler, Chief Executive:

Thank you, Steve. Now let us look at some of the issues.

Prudent Market Positioning

You will no doubt recall our comments particularly at the Interim as to the continued caution that we believed was prudent and the various measures taken to deal with what we were anticipating would be realised: a slowing of the occupier market.

Brixton has:

- Reduced its speculative development programme
- Only bought key properties in core locations
- Developed B-Serv to get closer to our tenants
- Continue to sell lower performing, peripheral holdings.

We are entirely confident about the robustness of the valuation.

Equally, our tenant base continues to exhibit strongly resilient characteristics as has also been explained.

And the success of the various initiatives is reflected in those issues which I now want to talk about:

- The strength of our core markets and our income creation abilities
- The successful management of voids
- The outperformance of Equiton
- The development of B-Serv

Core market strength and income creation

Since December 1999 which was the low point in industrial availability in the UK, according to King Sturge, whilst availability as a whole in the South East increased by 22.5%, Greater London has only risen by 5.6%.

Over 5 years Brixton's Greater London industrials have shown 36% cumulative growth against our holdings in ROSE at 17%: Heathrow has shown 38%.

With over half our portfolio in Greater London industrial and warehouse property this is the main market and most important driver for us.

Our exposure to offices is limited and with overall vacancy levels likely to peak in the M25 at around the 10% mark by the end of 2003 (according to Knight Frank) and the fact that the two recently constructed buildings at Aviator Park make up less than 1% of our portfolio in vacancy terms, this market is not one to cause Brixton undue concern.

You've heard the Heathrow story – it's a simple tale of supply constraint – green belt – and guaranteed capacity expansion (T5) allied to an ever increasing role for the airport in cargo through its dominance of international routes and bellyhold demand.

We are confident of continuing to outperform at the income level.

Although in absolute terms new net income from lettings declined markedly from a positive £4.8m in 2001 to a negative £800,000 in 2002, over £3.1m of this in 2001 was due to the Orbis office letting. Net new income from rent reviews and lease renewals was £2.0m in 2002 compared with £1.6m and our industrials are still 10.8% reversionary with an average passing rent of just under £8 psf. The Greater London industrials are over 15% reversionary.

Where we continue to score is when we look at our performance in exceeding our valuers ERVs on lettings.

Looking at our industrials

- by 7.2% in 2002
- by more than 5% average over each of the last 5 years

And, also on our industrial rent reviews

- by 3.7% in 2002
- by 6% average over each of the last 5 years

Managing Voids

We understand our markets – our specialisation gives us a depth to this knowledge – and the successful management of voids is key and we are now running below forecast.

The important points are:

1. Our overall portfolio is now 7.8% vacant against our forecast of 10% for the year end.

   The industrial figure of 7.3% compares with the forecast of 9.4%. The office vacancy is also below forecast and whilst there has been a large relative rise this was almost entirely made up of the completion of the two buildings at Aviator – which make up only 0.9% of our portfolio.

2. Two of the locations which have the largest break and expiry profiles over the next two years provide great opportunities. At Radlett for example, where 4 units expire or have breaks before the end of 2004 totalling just under 300,000 sq ft, we are already discussing new leases on approximately 250,000 sq ft. Alternatively it would provide a 20 acre prime distribution site.

   And also Penguin Books at Polar Park, Heathrow, where we now have a resolution to grant planning at this key 13 acre site.

3. The two largest vacating situations we know about are Schindler who are leaving the Feltham Corporate Centre in October 2003 with the loss of £322,000 and Cap Gemini are vacating their unit at Metropolitan Park, Greenford in September 2003 where they are paying £275,000. The time periods here do allow us to plan for the re-letting, and the remainder of the breaks and expiries are generally accounted for by a large spread of much smaller income streams.

4. There are no significant office expiries or breaks in the next 2 years as:
   (i) The High Court has ruled that Procter and Gamble's break due last December at Staines on 44,000 sq ft with a passing rent of £1.04m pa was invalid. Whilst leave to Appeal to the Court of Appeal has been granted – the lease now has a further 12 years to run.
   (ii) Although Daewoo went into administration in October 2002 as reported in the Prelim we have already agreed to re-let this 39,000 sq ft office building at £20 pf for 20 years with a 15 year break to BACS. The previous rent was £19.40 psf and there was a break due in September 2004. This is a major result in this market and with the Morgan Stanley deal at Heathrow before Christmas indicates our ability to

achieve significant letting deals at strong levels even in difficult market conditions.

Outperformance of Equiton

With Woodside disposed of and Premier Greenford a site specific development joint venture Equiton is our genuine multi-party fund.

It also has shown great resilience and a strong performance with a 4.6% like-for-like valuation surplus producing an 11.9% total return against its performance IPD benchmark of 10.4%.

This provides the Prudential and the Equitable with another year of outperformance and the parties are keen to grow the fund further.

Development of B-Serv

To re-iterate its B-Serv's holistic effect on the properties it manages for Brixton and our joint venture partners that is the key.

The measure of its progress to date can best be seen in the results of the 2002 independent customer research survey and the successful use and implementation of OPRent. So lets quickly look at what's been achieved.

There can be no meaningful control experiment to determine precisely how this improved level of customer relationship translates into the bottom line but I think you'd have to agree that with such rating improvements and a genuine desire to increase flexibility in leases it would be difficult to argue that tenant retention levels would not improve.

The data demonstrates that our vacancies have tracked well below our forecasts as B-Serv has become more established.

Outlook

So what of the outlook?

Whilst conditions short term will be challenging, we anticipated these and we believe that our response and the initiatives we have taken have positioned us well for the longer term.

We've explained the benign position on new development and indeed general industrial voids in the South East – still less than 5% according to King Sturge – and the positive growth story at Heathrow.

Developing B-Serv is part of our whole philosophy and we and our partners should continue to benefit from Equiton's expansion.

We will continue to match the creation of a resilient income stream with driving rental outperformance and we remain confident of continuing the progressive dividend policy which has seen a track record of growth in dividends over 35 years.

* * *