

DIRECTORS' COMMENTARY

Introduction
Octodec is a Real Estate Investment Trust ("REIT") listed in the "Industrial and Office REITs" subsector of the JSE Limited ("JSE"). Octodec's application for REIT status was granted with effect from 1 September 2013. Octodec invests in the retail, industrial and office property sectors and has a growing residential component in its portfolio. All rental income received by the group, less operating costs, administration costs and interest on debt, is distributed bi-annually. The group does not distribute capital profits.

Review of results

Trading conditions and consumer confidence remained subdued during the financial period. The property portfolio continued to deliver strong growth in earnings with rental income increasing following a number of successful upgrades of properties and a proactive approach to letting.

The total distribution per linked unit for the six months of 88,60 cents per linked unit (2013: 78,70 cents) represents an increase of 12,6% (2013: 10,5%) on that paid in the comparative six-month period.

Rental income and net rental income increased by 8,2% (2013: 13,9%) and 12,2% (2013: 11,0%) respectively compared to the prior comparative six-month period. The increase in revenue was mainly due to contractual escalations, improved letting and an increase in the recovery of utility and assessment rate charges. The six-month period saw limited improvement in the office and industrial rental markets and a slight increase in vacancies. One of the primary objectives continued to be the improvement of the quality of the properties in order to attract new tenants. The performance of Killarney Mall, the company's flagship shopping centre, was extremely pleasing. The vacancies at Killarney Mall during the financial period were maintained at below 2% of gross lettable area ("GLA"). Despite rapidly escalating utility charges, the percentage of cost recovery in respect of electricity charges improved during the period due to improved efficiencies and increased focus on energy management initiatives. Bad debt write-offs and provisions during the period were at 1% (2013: 1%) of total tenant income. Arrears and doubtful debt provisions remain at acceptable levels and no significant deterioration is anticipated.

Property and investment portfolio

Octodec completed three major projects during the period and two others are under construction. The total cost of these projects is approximately R189,4 million of which an amount of R110,9 million had already been spent by 28 February 2014.

Details of these projects are:

- The upgrade of Time Place, a residential property which is situated in the Pretoria CBD, was completed in September 2013. The total cost of the project was R9,7 million.
- The redevelopment of Medical City, a residential property situated in the Johannesburg CBD. The total cost of the project was R42,9 million. The offices were converted into a college with residential accommodation and were occupied in November 2013.
- The upgrade of the residential units at Castle Mansions and the construction of an additional 12 residential units. The property is situated in the Johannesburg CBD and the project was completed in December 2013 at a cost of R14,3 million.
- The upgrade of Essenyb flats, situated in the Johannesburg CBD. The upgrade will be completed in May 2014 at a total cost of R16,1 million.
- Octodec is currently well advanced with the redevelopment of Bosman Place which is situated in the Johannesburg CBD and has an estimated completion date of March 2015. The property consists of a retail component and 9 779 m² of vacant offices. The offices will be converted into 225 residential units at a cost of approximately R106,4 million. The fully let initial yield is expected to be 8,4%.

IPS Investments Proprietary Limited ("IPS")

During the year Octodec's associate company IPS repurchased City Property Administration Proprietary Limited's ("City Property") shares and shareholders loan account in IPS ("City Property's interest in IPS") for a cash consideration of R127,5 million and R48,1 million respectively. Prior to the repurchase Premium Properties Limited ("Premium") and Octodec each held 40% of the issued share capital of IPS and City Property held the remaining 20%. Following the repurchase, Octodec's and Premium's shareholdings in IPS increased to 50% each. IPS also acquired the balance of the 50% shareholding in Vuselela Investments Proprietary Limited ("Vuselela") from its co-shareholder.

Pursuant to the repurchase, Octodec issued 9 122 981 linked units to City Property in exchange for the equivalent cash consideration of R175,6 million equating to R19,25 per Octodec linked unit.

Octodec's investment in IPS provided strong growth with profits earned from its associate company, excluding fair value gains, increasing to R19,2 million. This is an increase of 62,3% on the prior period.

The performance of IPS was positively impacted by the improved occupancy levels achieved during the period at the mixed-use developments of Kempton Place and Tail's Place. An increase in interest income was recorded as a result of increased funding to IPS to fund further investments including the purchase of the 50% interest from its co-shareholder in Vuselela and City Property's interest in IPS. The construction of Jeff's Place, a greenfield residential development situated in the Pretoria CBD, commenced in February 2012. The date of completion was March 2014. The total cost of the project was R141,4 million and it is anticipated that this will yield an initial return of 9,2% once fully let.

Vacancies

Vacancies in the Octodec portfolio at 28 February 2014, including properties held for redevelopment, amounted to 15,4% (2013: 13,6%) of total lettable area. Details of these vacancies are set out in the table below.

	Total lettable area m ²	Total vacancies %	Properties held for redevelo- ment %	Core vacancies %
28 February 2014				
Offices	128 341	7,1	(4,9)	2,2
Retail – shops	139 488	1,2	(0,3)	0,9
Retail – shopping centres	84 111	0,3	–	0,3
Industrial	196 104	5,3	–	5,3
Residential	32 709	1,5	(1,4)	0,1
Total	580 753	15,4	(6,6)	8,8
31 August 2013				
Offices	127 485	6,5	(3,3)	3,2
Retail – shops	141 355	0,7	(0,1)	0,6
Retail – shopping centres	85 168	0,6	–	0,6
Industrial	193 725	4,1	(0,1)	4,0
Residential	34 497	1,7	(1,7)	–
Total	582 230	13,6	(5,2)	8,4

Most of the properties remained fully let. As anticipated, a number of properties under development or those which were recently upgraded, had vacancies. In recent years certain properties, for example Bosman Building, were acquired by Octodec with large vacancies and where no or little consideration was paid in respect of the vacant space which offered redevelopment opportunities. As the opportunities arise, the value of these vacancies is being realised.

Octodec was successful in letting a number of properties that had been vacant for a considerable period. The residential vacancies consist, as expected, of vacant units at Essenyb, Time Place and Castle Mansions which are currently undergoing upgrades.

Borrowings

Octodec's ratio of loans to value of its investment portfolio at period-end was 33,8% against 35,9% at 31 August 2013.

Interest rates in respect of 57,6% of borrowings at 28 February 2014 have been hedged, maturing at various dates in 2017 and 2018. The average weighted interest rate of all borrowings is 8,4% per annum, with unutilised banking facilities in an amount in excess of R228 million. Details of borrowings are set out in the table below:

	Nominal amount R'000	Interest rate %
Fixed rate borrowings expiry		
April 2018	100 000	12,06
October 2018	75 000	11,72
	175 000	11,91
Swap maturity		
February 2017	150 000	7,68
August 2017	200 000	8,96
September 2017	50 000	9,31
January 2018	50 000	9,43
April 2018	100 000	5,68
May 2018	50 000	10,13
August 2018	50 000	9,40
	650 000	8,35
Total hedged borrowings	825 000	9,10
Variable rate borrowings	607 096	7,50
Total borrowings	1 432 096	8,40

Revaluation of property portfolio

It is the group's policy to perform directors' valuations of all the properties at the interim stage and at year-end.

At 28 February 2014 the entire portfolio was valued by independent external registered valuers in anticipation of the proposed merger of Octodec and Premium. The internal and external valuations are based on the income capitalisation method which is consistent with the basis used in prior years.

The internal valuation of the portfolio of R3,4 billion represents an increase in the valuation amounting to R57,5 million or 1,8% for the six-month period ended 28 February 2014. The valuation of the portfolio by the external valuers amounts to R3,3 billion, which is 2,0% less than the directors' valuation.

Net asset value ("NAV")

NAV increased by 1,9% to 2 275 cents per linked unit.

Changes to the directorate

Mr Gerard Kemp (SB) was appointed as an independent non-executive director, on 1 October 2013. Gerard will also serve on the audit, risk, social, ethics & remuneration and nominations committees. Gerard brings to the board a wealth of knowledge and experience in the areas of corporate finance, black economic empowerment and labour relations.

Cautionary

Linked unitholders are referred to the joint announcement released on SENS on 7 April 2014 by Octodec and Premium and are reminded that the company is still trading under cautionary in respect of the proposed merger with Premium.

Prospects

Octodec is considering a number of redevelopment opportunities for certain existing properties which will enhance the quality of the property portfolio and result in sustainable growing distributions in the future. Growth in the local economy is expected to remain subdued. Barring unforeseen events, current indications are that the distribution for the next six-month period should be in line with the distribution for the first six-month period. This represents growth in distributions per linked unit of approximately 14% for the full financial year.

The abovementioned information has not been reviewed nor reported on by the company's auditors.

DECLARATION OF DIVIDEND 48 ("the distribution")

Notice is hereby given that dividend number 48 of 88,60 cents (2013: 78,70 cents) per linked unit (out of income reserves) has been declared for the period 1 September 2013 to 28 February 2014, payable to linked unitholders recorded in the register on Friday, 30 May 2014.

Salient dates relating to the dividend:

Last date to trade "CUM" distribution
Commence trading "EX" distribution
Record date
Payment date

Friday, 23 May 2014
Monday, 26 May 2014
Friday, 30 May 2014
Monday, 2 June 2014

No dematerialisation or rematerialisation of linked unit certificates may take place between Monday, 26 May 2014 and Friday, 30 May 2014, both days inclusive.

As Octodec has REIT status, linked unitholders are advised that the distribution meets the requirements of a "qualifying distribution" for the purposes of section 25BB of the Income Tax Act, No 58 of 1962 ("Income Tax Act"). The distribution to Octodec linked units will be deemed to be dividends, for South African tax purposes, in terms of section 25BB of the Income Tax Act.

Tax implications for South African tax residents

Distributions received by or accrued to South African tax residents must be included in the gross income of such linked unitholders and are not exempt from income tax in terms of the exclusion to the general dividend exemption contained in section 10(1)(k)(i) of the Income Tax Act, because they are dividends distributed by a REIT. These distributions are however exempt from dividend withholding tax ("dividend tax") in the hands of South African tax resident linked unitholders provided that the South African tax resident linked unitholders have provided the following forms to the Central Securities Depository Participant ("CSDP") or broker, as the case may be, in respect of uncertificated linked units, or the transfer secretaries, in respect of certificated linked units:

- a declaration that the distribution is exempt from dividend tax and
- a written undertaking to inform the CSDP, broker or transfer secretaries, as the case may be, should the circumstances affecting the exemption change or the beneficial owner cease to be the beneficial owner,

both in the form prescribed by the Commissioner for the South African Revenue Service.

Octodec linked unitholders are advised to contact their CSDP or broker, as the case may be, to arrange for the abovementioned documents to be submitted prior to the payment of the distribution.

Tax implications for non-resident linked unitholders

Distributions received by non-resident linked unitholders will not be taxable as income and instead will be treated as ordinary dividends which are exempt from income tax in terms of the general dividend exemption section 10(1)(k)(i) of the Income Tax Act. It should be noted that up to 31 December 2013 distributions received by non-residents from a REIT were not subject to dividend tax. With effect from 1 January 2014, any distribution received by a non-resident from a REIT will be subject to dividend tax at 15%, unless the rate is reduced in terms of any applicable agreement for the avoidance of double taxation ("DTA") between South Africa and the country of residence of the non-resident linked unitholder. Assuming dividend tax will be withheld at a rate of 15%, the net amount due to non-resident linked unitholders is 75,31 cents per share. A reduced dividend withholding rate in terms of the applicable DTA may only be relied on if the non-resident linked unitholder has provided the following forms to their CSDP or broker, as the case may be, in respect of uncertificated linked units, or the transfer secretaries, in respect of certificated linked units:

- a declaration that the dividend is subject to a reduced rate as a result of the application of the DTA; and
- a written undertaking to inform the CSDP, broker or the transfer secretaries, as the case may be, should the circumstances affecting the reduced rate change or the beneficial owner cease to be the beneficial owner,

both in the form prescribed by the Commissioner of the South African Revenue Services.

If applicable, Non-resident linked unitholders are advised to contact the CSDP, broker or the transfer secretaries, as the case may be, to arrange for the abovementioned documents to be submitted prior to payment of the distribution if such documents have not already been submitted.

Shareholders are encouraged to consult with their professional advisors should they be in any doubt as to the appropriate action to take.

The number of linked units in issue at the date of this declaration is 117 347 898 and the company's tax reference number is 9925/033/71/5.

By order of the board

S WAPNICK
Chairman
6 May 2014

JP WAPNICK
Managing director

www.octodec.co.za

REVIEWED CONDENSED CONSOLIDATED INTERIM FINANCIAL RESULTS

FOR THE SIX MONTHS ENDING 28 FEBRUARY 2014

➤ Distribution up by 12,6% to 88,60 cents per linked unit

➤ Weighted average increase in distributable income of 17,6%

➤ Total investments of R4,3 billion

➤ Weighted average cost of debt reduces to 8,4% per annum

➤ Obtained REIT status effective from 1 September 2013

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

R'000	% change	Reviewed Six months 28 February 2014	Unaudited Six months 28 February 2013	Audited Year to 31 August 2013
Revenue		269 256	245 975	506 670
Earned on contractual basis	8,2	267 391	247 059	505 732
Straight-line lease adjustment		1 865	(1 084)	938
Operating costs		(128 316)	(123 150)	(254 820)
Net property income		140 940	122 825	251 850
Earned on contractual basis	12,2	139 075	123 909	250 912
Straight-line lease adjustment		1 865	(1 084)	938
Administrative costs		(14 196)	(12 872)	(25 290)
Profit from operations	15,3	126 744	109 953	226 560
Amortisation of deemed debenture premium		11 632	10 311	21 054
Fair value adjustments of investment properties		57 530	92 490	131 501
Fair value adjustments of interest rate derivatives		6 740	4 081	35 214
Profit from ordinary activities before finance costs		202 646	216 835	414 329
Profit on sale of investment property		111	15	15
Investment income		58 657	36 396	77 781
Interest received		1 101	785	1 584
Listed investment		18 919	15 114	29 670
Associate		38 637	20 497	46 527
Profit from ordinary activities before finance costs		261 414	253 246	492 125
Finance costs	12,8	(60 189)	(53 380)	(110 638)
Interest on borrowings		(60 787)	(54 701)	(112 461)
Interest capitalised		598	1 321	1 823
Profit before debenture interest	0,7	201 225	199 866	381 487
Debt interest	22,1	(103 454)	(84 751)	(169 718)
Profit before taxation		97 771	115 115	211 769
Taxation charge		7 926	(15 808)	171 690
Deferred taxation		7 834	(15 696)	172 004
Normal taxation		92	(112)	(314)
Profit for the period		105 697	99 307	383 459
Other comprehensive income for the period				
Fair value adjustment of listed investment		(16 094)	25 168	18 792
Total comprehensive income for the period attributable to equity holders		89 603	124 475	402 251
Weighted linked units in issue ('000)		112 207	108 225	108 225
Linked units in issue ('000)		117 348	108 225	108 225
Basic earnings per share (cents)	2,7	94,2	91,8	354,3
Fully diluted earnings per share (cents)	(1,8)	90,1	91,8	354,3
Basic earnings per linked unit (cents)	9,6	186,4	170,1	511,1
Fully diluted earnings per linked unit (cents)	4,8	178,2	170,1	511,1
Distribution per linked unit (cents)				
Dividends		0,44	0,39	0,78
Interest		88,16	78,31	156,82
Total	12,6	88,60	78,70	157,60

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

R'000	Reviewed Six months 28 February 2014	Unaudited Six months 28 February 2013	Audited Year to 31 August 2013
CASH FLOW FROM OPERATING ACTIVITIES			
Net rental income from properties	124 879	111 037	225 622
Adjustment for:			
Depreciation and amortisation	6 210	6 859	12 059
Working capital change	14 451	(1 810)	(5 373)
Cash generated from operations	145 540	116 086	232 308
Investment income	36 961	18 650	57 217
Finance costs	(60 189)	(53 380)	(110 638)
Taxation paid	124	(423)	(99)
Distribution to linked unitholders paid	(85 389)	(71 537)	(156 710)
Net cash inflow from operating activities	37 047	9 396	22 078
CASH FLOW FROM INVESTING ACTIVITIES			
Investing activities	(221 324)	(57 126)	(279 863)
Proceeds from disposal of investment properties	2 200	6 650	6 650
Net cash outflow used in investing activities	(219 124)	(50 476)	(273 213)
CASH FLOW FROM FINANCING ACTIVITIES			
Issue of new units	174 528	–	–
Increase in interest-bearing borrowings	12 979	57 989	270 463
Net cash generated from financing activities	187 507	57 989	270 463
NET INCREASE IN CASH AND CASH EQUIVALENTS	5 430	16 909	19 328
Cash and cash equivalents at beginning of year	(12 763)	(32 091)	(32 091)
Cash and cash equivalents at end of period	(7 333)	(15 182)	(12 763)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

R'000	Share capital	Non-dis- tributable reserves	Retained earnings	Total
Balances at 31 August 2012	102 645	1 236 372	56 268	1 395 285
Total comprehensive income for the year	–	–	402 251	402 251
Transfer to capital – deemed debenture premium	21 054	–	(21 054)	–
Dividends paid	–	–	(779)	(779)
Adjustment to valuation of listed investment, net of deferred tax	–	18 792	(18 792)	–
Profit on sale of investment properties	–	15	(15)	–
Fair value adjustments				
Investment properties, net of deferred tax	–	333 171	(333 171)	–
Associate, net of deferred tax	–	21 797	(21 797)	–
Interest rate derivatives, net of deferred tax	–	25 354	(25 354)	–
Balances at 31 August 2013	123 699	1 635 501	37 557	1 796 757
Total comprehensive income for the year	–	–	89 603	89 603
Issue of new units	862	–	862	862
Transfer to capital – deemed debenture premium	11 632	–	(11 632)	–
Dividends paid	–	–	(422)	(422)
Adjustment to valuation of listed investment, net of deferred tax	–	(16 094)	16 094	–
Profit on sale of investment properties	–	111	(111)	–
Fair value adjustments				
Investment properties	–	57 530	(57 530)	–
Associate	–	19 447	(19 447)	–
Interest rate derivatives	–	6 740	(6 740)	–
Balances at 28 February 2014	136 193	1 703 235	47 372	1 886 800

NOTES TO THE FINANCIAL STATEMENTS

Basis of preparation: These reviewed condensed consolidated interim financial statements for the six months ended 28 February 2014 are prepared in accordance with International Financial Reporting Standard, (IAS) 34 Interim Financial Reporting, the SAICA Financial Reporting Guides as issued by the Accounting Practices Committee and Financial Pronouncements as issued by Financial Reporting Standards Council and the requirements of the Companies Act of South Africa.

The accounting policies applied in the preparation of these interim financial statements are in terms of IFRS and are consistent with those applied in the previous annual financial statements. The group adopted the new, revised or amended accounting pronouncements as issued by the International Accounting Standards Board which were effective and applicable to the group from 1 September 2013, none of which had any material impact on the group's financial results.

These interim results have been prepared under the historical cost convention except for investment properties which are measured at fair value and certain financial instruments which are measured at either fair value or amortised cost. The fair value of investment properties is determined by directors with reference to market-related information while investment in associates and other financial liabilities are valued with reference to market-related information and valuations as appropriate. Financial instruments measured at fair value include the listed investment (level 1 measurement using the quoted market price) and derivatives (level 2 measurement using information based indirectly on quoted prices). There have been no material changes in judgements or estimates of amounts reported in previous reporting periods.

These condensed consolidated interim financial statements were prepared under the supervision of Mr AK Stein (CA)SA, in his capacity as group financial director.

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION