Australian National University

ANU Student Managed Fund

Investment Recommendation

Lendlease Group

ASX Code: LLC

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Notes:

All dollar amounts in this report are Australian dollars.

Glossary

AAE – Active Australian Equities

ANU – The Australian National University

CAGR – Compounded annual growth rate

CBE – ANU College of Business and Economics

CRU – Capital Release Unit

DCF – Discounted cash flow

EBITDA – Earnings before interest, tax, depreciation, and amortisation

EPS – Earnings per Share

ESG – Environmental, Social and Governance

ETF – Exchange Traded Funds

FCF – Free Cash Flow

FUM – Funds Under Management

FFO – Funds from Operations

FY – Financial year

GICS – Global Industry Classification Standard

IAC – Investment Advisory Committee

IC – Invested capital

IOZ – iShares Core S&P/ASX 200 ETF

MoS – Margin of safety

NOPLAT – Net operating profit less adjusted tax

NTA – Net tangible assets

P/B – Price to Book Ratio

PCP – Prior comparable period

REITs – Real Estate Investment Trust

ROI – Return on investment

ROIC – Return on invested capital

R&C – Risk and Compliance

RSFAS – Research School of Finance, Actuarial Studies, and Statistics

RT – Relationship Team

SMF – ANU Student Managed Fund

SRI – Socially responsible investment

WACC – Weighted Average cost of capital

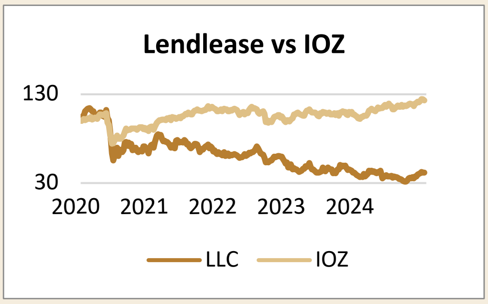
WALE – Weighted Average Lease Expiry

YoY – Year-on-Year

AUSTRALIA
ASX code: LLC

Price (8/10/2024)	$7.00
Valuation excl. FC	$8.52
Margin of safety excl. FC (MoS)	21.73%
Dividend yield	2.68%
Value of FC per share	$0.09
Valuation incl. FC	$8.61
Margin of safety incl. FC	23%
GICS	Industrial Services
52-week range	$5.32 - $7.73
Recommendation	**Buy**
Key assumptions	
Beta	1.12
WACC	7.49%
Carbon intensity	
LLC	16.1
ASX200	143.42

Five-year price history



Portfolio Recommendation

We recommend that the ANU Student Managed Fund (SMF) establish a **10% weighting** in Lendlease Group (LLC) within the Active Australian Equities (AAE) portfolio, funded by reducing holdings in the iShares Core S&P/ASX200 ETF (IOZ).

Investment Thesis

LLC is a property and infrastructure development company with three operating segments: investments, development, and construction. These segments are integrated, with project completions from construction and development funnelling into the approximately $47 billion FUM of the investments segment.

The development segment creates mixed-use precincts, while the construction segment specialises in providing project management, design, and construction services.

LLC has been unprofitable in recent years; however, in May 2024, it announced a significant strategy shift that aims to restore value to its shareholders. This strategic shift involved withdrawing from overseas construction and development markets, focusing on the more profitable Australian market where the company has had a proven track record. LLC has committed to selling its overseas assets via the Capital Release Unit (CRU), facilitating the recycling of $3.14 NTA per share.

LLC's share price declined by 7.23% in the week following the strategy update announcement, indicating the market's initial scepticism about the management's ability to successfully implement the proposed changes. However, a week after the company reported its earnings in August, the share price rebounded by 6.6%, suggesting that the market might be regaining confidence in Lendlease's ability to create value through its Australian operations post-restructuring. Although the share price has gained around 10% compared to pre-announcement levels, our valuation indicates that the market has not fully priced in the long-term value to be unlocked through the simplification of the business and reduction of financial risk.

With a long-term investment horizon, the strategy update presents value to the SMF as LLC rebuilds its project pipeline over the coming years, driving greater operating cash flows in FY27 onwards. Furthermore, the sale of assets supports cash flows in FY25 and FY26, helping to stabilize the company during its transition back to the Australian market. This is reflected in our DCF valuation of $8.52 per share implying a MoS of 21.73%.

Our investment thesis is underpinned by the following considerations:

- Value additive strategy update from sale of underperforming and unprofitable assets.
- Depressed property valuations.
- Competitive advantage derived from synergies between operating segments.

Key risks taken into consideration are:

- Execution of strategy update.

- Uncertainty surrounding the future of construction and development pipelines.

Key Upsides

Strategy Update

Realigning focus on Australian operations

In May 2024, LLC announced its restructuring plan to divest its international construction and development segments. Within the plan, the company has repositioned itself as an Australia-only construction and development business while retaining its global investment management business. This strategic pivot aims to simplify LLC's operations, reduce risk, and unlock capital that can be reinvested in its domestic operations, which have demonstrated stronger profitability historically. The 5-year average EBITDA margin for the Australian construction segment is 3.1%, compared to 2.0% when including international operations. The Australian development segment also performs significantly better, with a 5-year average ROIC of 13.4%, compared to a 4.5% global ROIC. By focusing on the Australian market where it has a competitive advantage, LLC is well-positioned to enhance the quality and sustainability of its earnings.

The divestments are expected to release over $4 billion in capital, which will be used to reduce LLC's net debt of $3.2 billion and lower its current gearing of 21%. Additionally, LLC aims to return capital to shareholders through a $500 million share buyback program, which will be EPS accretive. The restructuring aims to deliver $125 million in annual cost savings, including $65 million in reduced employee costs. In addition, LLC aims to sell $2.8 billion of assets from the CRU by the end of FY25, with $1.9 billion of transactions already announced. We expect the restructuring to result in a simpler business with lower financial leverage and higher-quality earnings.

LLC's historical average construction EBITDA margins of 3.1% is slightly below the industry average of 3.5%. The low margins can be attributed to the highly competitive nature of the construction industry, where aggressive pricing and tight project margins are prevalent. Hence, we maintain low margin and growth expectations for the construction segment as its main role is to provide expertise for the more profitable development segment. The development segment recorded an EBITDA margin of 19% across its domestic and international segments in FY24, which is in line with its competitors such as Charter Hall Group and Mirvac Group. Once the international development segment is divested, we expect the EBITDA margins to rise due to the company's strong track record in executing large-scale urbanization projects in Australia.

Depressed Property Valuations

LLC has potential upside due to sector-wide low property valuations. LLC holds $3.1 billion of investment properties within trusts and joint ventures and manages $47 billion of real estate investments. Our valuation indicates that a 10% increase in property valuations would create an additional $25 million in FY25 revenue from increased management fees on funds under management. Between co-investments and LLC's funds under management business, a 10% increase to property valuations adds 7% to the group valuation. This is exclusive of any additional performance fees they generate from increased valuations.

Workplace Property

Australian REITs are currently trading at a discount to historical valuations due to a combination of a high-interest rate environment and the impacts of COVID-19, which have suppressed property prices over the past four years. This has resulted in property trading at discounts to historical valuations. Workplace properties valuation, which makes up 53% of LLC's portfolio, have fallen the most. These assets are currently trading at 9.45x Price/FFO, an 18% discount to the five-year average of 11.55x. The rise of work-from-home (WFH) arrangements has been a concern of the market, with WFH arrangements increasing from pre-pandemic levels of 30% to 46% in 2022. Since 2022, there has been a gradual return to office, and WFH arrangements have now fallen to 36%. Whilst 2024 data is not available, it looks likely for WFH arrangements to continue to fall as some of the largest employers in Australia have begun mandating return to office. For instance, in

August, the NSW government mandated a return to office, while Amazon has announced a similar policy set to take effect next year. Whilst these are just 2 examples, they represent a broader trend of employers bringing workers back into the office to address productivity concerns.

Furthermore, the period of increased WFH has not materially affected underlying operating metrics of workplace real estate. Current occupancy rates and weighted average lease expiries across the sector are above pre-pandemic levels, (91.6% vs 89.5% and 4.63 vs 4.18 years respectively). This suggests that the market is overpricing in the negative effects of working from home on office spaces and there is a potential for an upward re-rating of workplace property as confidence in future earnings recovers.

LLC's workplace portfolio has seen similar trends to the sector, with the current occupancy rate and WALE sitting slightly above the sector average at 93% and 5.15 years respectively. Given that LLC's valuation of real estate in their portfolio reflects estimated market value, an upward revision of workplace real estate valuations will have a positive effect on LLC FUM. This is positive for valuation as it increases the management fees, which are 0.51% of FUM, and is likely to increase performance-related fees without increasing costs.

Top of the interest rate cycle

Whilst underlying metrics improved over the last five years, FFO has declined by 11% in sectors where LLC operates since 2019. Due to heightened interest rates, controlling for increased net interest expense, FFO has risen 4% since 2019 in a challenging operating environment. With interest rates peaking for the medium term there has been an international dovish pivot as US Federal Reserve, Central Bank of Europe and Bank of England all recently cut interest rates, with expectations of further cuts. In Australia, the fixed income market is pricing in 110 basis points of interest rate cuts, bringing the rate to 3.25% over the next 12 months, with an implied cash yield of 3.195% in March 2026. This is positive for property valuations, as lower interest rates reduce discount rates through a lower weighted average capitalization rate and boost net operating income by decreasing interest expenses.

Operating Synergies between Segments

LLC's business model, centred around its three main operating segments, have inherent value accretive synergies. The construction and development segments are closely linked, with talent shared across both segments. For instance, individual buildings built by the construction segment often contribute to larger developments, such as Melbourne Quarter Tower, which is a part of the broader Melbourne Quarter development. This combination allows for cost efficiencies and streamlines project completion by efficient allocation of resources, minimising delays, and optimising coordination between planning, building, and delivery of LLC projects. This results in increased returns within the development segment, LLC Australian developments operate at a higher ROIC than competitors (9% 3-year average ROIC vs 6.7% 3-year average ROIC).

Moreover, LLC's development operations provide a direct pipeline into its investment segment, where completed projects are added to the funds/assets under management. By generating the assets internally, LLC bypasses acquisition costs that many competitors face when establishing their investment portfolio. Over the next 4 years, there are approximately $10.4 billion worth of International and Australian development completions, all of which will transfer to the Investment segment, adding to the many Trusts and Funds that LLC operates. On a valuation basis, the transfer of these assets to the investment segment where they earn income results in an additional 42 cents per share, or 5.1%, to the group's value.

This pipeline creates a competitive advantage over other construction and real estate businesses as it attracts additional capital to fund developments. Customers also see the integrated model as desirable, assisting LLC in securing contracts during the tendering phase. LLC's business model not only enhances operational efficiency but also maximises the value derived from each of the different segments along a project's lifetime. Its integrated nature allows for cost efficiencies boosting the overall ROIC on their income-generating assets, something that the SMF sees as a competitive advantage and value driver for the business.

Risks to Recommendation

Execution of Strategy Update

There are risks involved with management's ability to execute the proposed strategy update, especially given management's previous poor performance in the international segments. With a tangible book value of $3.14 a share, these assets are significant to the valuation of LLC. The assets can be divided into two groups: assets on market and assets available for sale. Assets on market total $2.8 billion, including $1.9 billion of already announced transactions. This reduces the risks associated with asset sales, as over half of them are already in progress. However, there is greater uncertainty involved in the timing and pricing of the sale of the remaining assets. The assets on market are primarily development and construction assets that LLC has contractual obligations that prevent them from selling immediately. Potential delays in the completions will push out sale dates and delay the corresponding cash flows. While LLC has made $1.5 billion of strategy related impairments to the value of these assets, there is a risk these assets are sold below book value as LLC may prioritise a quick sale over achieving the best price. To account for this risk, a 15% discount has been placed on the book value of assets on the market.

Failure to restock pipelines

Construction

The valuation of the construction segment is heavily reliant on the forecast of the construction pipeline over the next five years. LLC currently has $10.6 billion in preferred book referring to projects where LLC has been exclusively nominated by the client as the preferred contractor pending finalisation of scope, commencement, price, and contract terms. The risk associated with this is LLC's ability to convert this preferred book into new work secured and to maintain the amount of new work secured over the next five years. This risk is reflected in the valuation by assuming a 30% conversion of the preferred book to new work secured in 2025, following their 37% conversion in FY24. From then onwards, new work secured has been forecasted to grow in line with a combination of industry and macroeconomic growth forecasts.

Development and investments

Although the valuation of the development segment is not reliant on a forecast of future projects, the operation of the development segment is contingent on securing and commencing new projects. Revenue for the investment segment is generated from FUM as LLC derives transaction fees of 0.05% of FUM and base revenue of 0.51% of FUM. The valuation assumes constant FUM growth of 3% from 2030 onwards, which is reliant on consistent additions from completion of development projects. Therefore, for the investment segment value to grow, additions from development completions must continue, which is only possible with a stocked pipeline.

However, the development pipeline currently consists of nine major projects, of which only three projects are set to commence beyond 2024 and only two projects are set to complete beyond 2027. The timing of these completions has impacted the SMF's outlook for the coming years. FY25 and FY27 will each see three completions and therefore generate a significant release of invested capital and development fees for the development segment, and FUM growth of over 5%. FY26 will see only one completion which has led to a softer outlook, with no invested capital to be released, only $0.56 million in development management fees, and a FUM growth forecasted to be 2.31%. From FY28 onwards, there is uncertainty surrounding the makeup of the development pipeline, and therefore the potential for earnings in the subsequent years. LLC outlines that there are currently five projects worth a total of $13 billion in the advanced opportunity stage, meaning that they are either exclusive or one of two parties who will secure the project. There are also another 20 projects worth a total of $27 billion in the early opportunity stage. Securing a significant amount of these projects will be essential for the future of the development pipeline, and subsequently essential for the revenues derived from both development and investment segments in the long term.

Model Summary

Investments

FUM

LLC's Funds Under Management for their investment portfolio represents a significant portion of the company's overall valuation, accounting for $1.35 billion of the value based on a FCF conversion. LLC has historically generated a base fee on FUM of approximately 0.51% with an additional 0.05% transaction & performance fee. Due to the relative consistency of this fee, as well as stable costs forecasts relating to an EBITDA margin of approximately 41%, the key driver of revenue for this forecast is derived from the change in FUM over time. Historically, additions to FUM are derived from project completions from the development segment as well as additional investment from institutional investors. LLC currently has approximately $10.4 billion dollars of development pipeline to be added to FUM in the next 4 years.

Withdrawals of FUM namely come from institutional investors of the trusts and funds. These investors can redeem their monies at set intervals, this divestment has been modelled to be at historical averages with a peak withdrawal of 5% of FUM in the upcoming main redemption window in FY27. Furthermore, revaluation of property is a significant contributor to yearly deviations of FUM, with $3.6 billion written off due to the company's strategy update. In line with our investment thesis, our expectation of property revaluation provides slight additions to FUM over the coming 5 years. The key drivers of FUM are shown in Appendix H and a forecasted chart of FUM is shown below.

Co-Investments

The Co-Investments segment is valued at 0.95x book value accounting for $2.945 billion of the company's value. As a part of their strategy update, LLC had made significant impairments on their assets, including the co-investments portfolio.

Development

The development segment is valued by modelling the release of capital of current Australian projects and the management fees they earn on each of their current projects.

Release of invested capital

LLC quotes $1.1 billion in invested capital in their nine current major projects, and $1.3 billion in invested capital in the development segment. This invested capital should be released at the completion of the respective projects, with LLC making a margin on each investment. Hence, the release of capital is modelled by taking the midpoint of each project's margin range to determine the return on invested capital for each project which is forecasted to be realised after each project. The remaining $200 million of unallocated invested capital has been added to the valuation of the capital release from the completion of the nine major projects. Since development projects operate with a ROIC close to WACC, any margin made on this $200 million of invested capital would be negated by discounting it to present value.

Development Management Fees

LLC has historically generated a development management fee of 3% of the total project costs incurred, calculated, and paid after completion. Hence, revenue from development management fees have been modelled by taking 3% of the end value of each project and weighted depending on how much of each project is owned by LLC. It is forecasted that this revenue will be received at the completion of each project, and that this management fee will be kept constant into the future. Costs have been modelled using quoted margins on each project relative to the projects end value.

The sum of these components gives a segment valuation of $1.40 billion, which is 1.08x book value.

Construction

As LLC is exiting its global construction operations, our model forecasts for the construction segment are solely based on its Australian business. Revenue projections are primarily based on backlog revenue realization and new work secured. Backlog revenue declined by 19% in 2023 and 32% in 2024 due to unfavourable operating conditions driven by elevated interest rates, which resulted in a significant fall in new projects secured. However, with the market expecting interest rates to start declining next year, we anticipate a recovery in new work secured and backlog revenue. Currently, LLC holds a $10.6 billion preferred book, where it has been exclusively nominated as the preferred contractor. We project that 30% of these projects will convert into new work secured in FY25. Future growth in new work secured is forecasted to align with broader industry growth and key macroeconomic indicators. Due to lower backlog revenue in the past two years, we expect revenue to decline by 24% in FY25 and 7% in FY26, before recovering to pre-FY22 levels.

While there was a decline in EBITDA margins in FY24 due to supplier insolvency issues, we forecast a gradual recovery to historical levels of around 3% as LLC's cost-cutting initiatives take effect. This anticipated margin recovery, combined with improved project volumes, should support a more stable financial outlook for the construction segment moving forward. In the long run, we expect revenue to grow in line with long-run GDP growth of 2%, and margins to settle at the historical average of 3.1%.

CRU

The CRU has been divided into assets for sale and assets on market. We have forecast total assets on market to be sold at book value. $1.9 billion of transactions have already been announced, above book value giving a buffer for the remaining $900 million of a total $2.8 billion in assets for sale. Already announced transactions have been forecast to be completed in the first half of 2024, based on management guidance and the remaining to be sold by the end of FY25. Sale timings are forecasted on project completions. Valuation from CRU is derived from the sale of assets, cash flows from operations are expected to be close to net zero given the segments low NOPLAT and statutory losses from the segment have mostly come from non-cash, non-operating impairments.

For assets on market, a 15% discount has been placed onto book values to account for uncertainty in sale prices. There is confidence that LLC have accurately reflected book values, given pressure from shareholders, impairments of over $1 billion were made to these assets to reflect more accurately their carrying value. Additionally, assets that have already had sales announced have been sold at or exceeding book value. Poor management is a risk to the execution of the sales at attractive prices, but this is somewhat mitigated by LLC contracting investment banks Gresham and Morgan Stanley to assist with the sale. Ultimately, this inspires some confidence that book values are an accurate reflection of what price can be achieved, and a 15% discount is applied as a conservative measure to account for any unexpected downside. The CRU has been valued at $3.6 billion enterprise value.

Corporate Costs

Corporate costs are expenses that are not assigned to any operating segment. They include recurring non-core expenses and rent expense. They have been modelled to grow at the rate of inflation with a steep decrease of $10 million in 2025 as a result of LLC's cost-saving initiatives announced in their strategy update.

SRI Considerations

LLC is compliant with the SMF SRI Policy. There is no evidence that LLC currently poses an unacceptable reputational risk to the SMF, nor does it draw revenue from any excluded sources. LLC currently has a carbon intensity score of 16.1. Thus, if a 10% stake in LLC is established, the AAE portfolio will maintain a 41.21% margin of safety from the SRI target (-30% from IOZ).

Appendix C outlines several SRI matters relevant to LLC. The most critical concerns pertain to LLC's governance such as the company's drastic strategic shift, the influence of external investors, and LLC's poor record of transparency. While due consideration must be afforded to each of these items independently, it is understood that these risks have been included appropriately in the valuation.

Scenario Analysis

Our bull case produces a target price of $10.14 a share (45% MoS) and our bear case produces a target price of $6.14 (-12% MoS). See Appendix M for a full breakdown of assumptions in each scenario.

Sensitivity Analysis

WACC

A sensitivity analysis has been conducted to understand the impacts of WACC on our target price (See Appendix K for details). The base case WACC of 7.49% represents a 21.73% MoS. A 14.15% WACC produces a 0% MoS.

Development ROIC

A sensitivity analysis has been conducted to understand the impacts if this assumption were not to hold and LLC invest capital into development at the level needed to maintain their current invested capital over the next five years, starting new projects as current projects finish. At a 6% ROIC over the next five years, enterprise value falls by $14.74 million. See Appendix K for the full sensitivity analysis breakdown.

Currency Risk Exposure

LLC use forward foreign exchange contracts as cash flow hedges for highly probable sale, purchase and dividend transactions, which will be particularly key with the sale of overseas assets. In FY24, the group held foreign exchange derivative contracts primarily held in GBP, USD, EUR and SGD to hedge their exposures, such that their gross payable exposure is $438 million. This analysis assumes that all other variables remain constant and exclude the effects of foreign exchange contracts and currency hedges. In FY24, a 10% weakening in currency rates would have led to a decrease in profit after tax of $125 million and an increase in net assets of $389 million. A 10% strengthening of currency rates would have led to a $104 million increase in PAT, and a $435 million decrease in net assets.

Valuation Summary and Recommendation

Our discounted cash flow (DCF) model generates a base case valuation of $8.51 This valuation provides a MoS of 17.21%. Our scenario analysis is outlined in Appendix M and provides a bull case valuation of $10.05 and a bear case valuation of $6.06.

Valuation Summary	**Bear case**	**Base case**	**Bull case**
Share price (08/10/24)	$7.00	$7.00	$7.00
Valuation	$6.13	**$8.51**	$10.14
Margin of safety	-12.43%	**21.73%**	44.86%

LLC offers exposure to the real estate market with a well-diversified portfolio of operations. LLC is undervalued on a fundamental cash flow analysis, with stable FUM growth and cost reduction initiatives associated with the strategy update. This presents LLC as an attractive investment opportunity for the fund. In conclusion, **we recommend that the SMF establish a 10% weighting in LLC within the AAE portfolio**, funded through the sale of our holdings in the iShares Core S&P/ASX200 ETF (IOZ).

Appendix

Appendix A: Portfolio Fit

LLC provides an opportunity for the fund to be exposed to the broader real estate and infrastructure industries. The company has no major concerns relating to ESG and are implementing major pushes for environmental sustainability. LLC complements the defensive nature of other assets held by the SMF and provides an opportunity for strong capital growth given the implied MoS of 21.73%. LLC's focus on the Australian urbanization projects offers long-term growth opportunities associated with an expanding population. Therefore, given the SMF's long-term investment horizon, LLC is a suitable addition to the portfolio.

Appendix B: Key Historical Financial Summary

Financial year (AUD million)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
Total revenue	11834	9143	8964	10373	9369
Revenue growth	-	-22.7%	-2%	15.7%	9.7%
Adjusted EBITDA	99	651	644	465	683
Adjusted EBITDA margins	1.9%	8.2%	9.0%	5.8%	8.5%
NOPLAT	(52)	332	368	326	492
NOPLAT margin	-	3.6%	4.11%	3.14%	5.25%

Appendix C: SRI Considerations

Environmental

Overall, LLC performs well on environmental objectives. Over the last 5 years, LLC's scope 1 emissions have decreased by an average of 32.56% YoY. Similarly, scope 2 emissions have fallen by 15.92% YoY. LLC plans, and is on track, to achieve net zero for scope 1 and 2 emissions by 2025. The company also has an absolute zero target for all scope emissions by 2040.

Social

LLC has a median gender pay gap of 32.2%. The average pay gap in construction is 31.8%, in real estate services it is 16.6%. Additionally, there are inherent WH&S concerns with LLC's construction and development segments, however, LLC's critical incident frequency rate is in the lower 25th percentile relative to the construction industry.

With the CFMEU in the legal and political spotlight, the union's links with LLC may be of concern. In 2022, the CFEMU and LLC jointly challenged the federal government on building code restrictions on union flags. Additionally, construction companies often pay union delegates to police their construction sites. The CFMEU is alleged to have used force and intimidation to enforce anti-competitive labour arrangements such that the union has formed a monopoly over major construction in capital cities. It is uncertain whether LLC has helped facilitate or been otherwise complicit in CFMEU-related corruption. Ultimately, the CFMEU risk likely pertains more to productivity related costs (e.g. project delays given the CFMEU-led construction worker strikes) than it does a reputational risk as the CFMEU have since been forced into administration, unscrupulous links to third-party companies have not been announced, and proving complicity would be a difficult task.

Governance

Compliance and legal risks

LLC is yet to adopt SASB and GRI accounting standards and hence certain ESG metrics are difficult to identify and verify. Nevertheless, LLC will be subject as a Group 1 company to the new sustainability-related financial reporting laws (*Treasury Laws Amendment (Financial Market*

Infrastructure and Other Measures) Bill 2024 (Cth)) in effect from 1 January 2025 which will improve reporting transparency and clarity of ESG matters.

Additionally, LLC have been criticised for a severe lack of transparency in their financial reporting and public disclosures. Several symptoms include the roughly $4 billion discrepancy between profits and free cash flows, not disclosing total (unallocated) group overheads, and a history of ambiguous non-operating and non-core charges. This inevitably creates more uncertainty in the valuation process assumptions which compounds the overall risk of investing in LLC.

An ancillary hazard with LLC's asset sales (besides price and timeframe) concerns antitrust regulation. As the ACCC flagged earlier in the year, LLC's proposed $1.3b sale of several community projects to Stockland Corporation allegedly reduced competition in the Illawarra region to unacceptable levels. The ACCC permitted the sale (subject to divestment conditions on Stockland) on 26 September, however, the risk of additional ACCC encounters will likely subsist for as long as LLC have assets on the market.

Moreover, in 2023, the UK government enacted retrospective legislation which increased the defects liability period of residential building from 6 to 30 years. This initially forced LLC to take a $200m provision, however, this has since been reduced. The current liability relates to approximately 60 buildings and thus may complicate the asset sales process.

Management risks

The largest driver behind LLC's monumental strategic shift comes undoubtedly from several vocal activist investors including Tanarra Capital, HMC Capital, and Allan Gray. In August 2023, HMC Capital's CEO David Di Pilla delivered a presentation that called LLC to offload assets, cut expenses and reduce its exposure to construction. On 3 April 2024, Tanarra Capital published a public letter pushing for 'fundamental change' to LLC, highlighting performance shortcomings, issues with the strategy, culture, and capital allocation, and proposing (drastic) recommended changes such as withdrawing from international construction and development. In late April 2024, managing director of Allan Gray endorsed Tanarra Capital's views and called for 'wholesale change' for LLC.

This produces several governance-related risks. Firstly, it is uncertain whether LLC have crafted and plan to execute a viable long-term strategy, or whether this is a fleeting appeasement to those shareholders who reminisce of a once >$20 per share Lendlease. Additionally, LLC announcing its strategic U-turn the month after Tanarra Capital's letter evinces more that management have caved to this synthetic catalyst of mounting investor pressures than it does management exercising their own good judgement.

Secondly, it is also uncertain whether this pressure and influence will subsist. If LLC's revised trajectory does not satisfy the demands or expectations of these activist investors, the risk of more aggressive actions such as hostile takeovers is amplified. In any case, LLC's management already appears in a vulnerable position. In addition to the departure of several international-based directors, non-executive director Nicola Evans and Company Secretary Wendy Lee have resigned since May. The Chairman, Michael Ullmer, is expected to follow suit after the company's AGM in November.

A final point is that announcing a company-wide strategic shakeup is not a novel trick in LLC's playbook. In 2021, the LLC CEO introduced the business 'reset' and asset simplification strategy wherein LLC would, inter alia, adopt a new management structure, broaden its urbanisation projects, increase development production, and achieve an improved ROIC by 2024. If the success of this strategy is to be assessed on share price, LLC is down by roughly 30%.

Appendix D: Pro-forma Financials – Segments

Investments	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
FUM ($b)	36.3	36.8	41.0	45.7	49.3	48.2
FUM Growth	16.2%	1.4%	11.5%	11.5%	7.8%	(2.1%)
Management Revenue	200	194	192	211	243	242
Management Expense	(115)	105)	(111)	(132)	(151)	(145)
Management EBITDA	85	89	81	79	92	97
Management EBITDA Margin	42.5%	45.9%	42.0%	37.6%	37.8%	40.1%
Other EBITDA	42	120	19	57	15	(5)
Co-investment Capital ($b)	1.9	2.1	2.4	2.8	3.2	3.1
% of FUM	5.1%	5.8%	5.8%	6.0%	6.6%	6.3%
Co-investment EBITDA	67	35	45	117	98	93
Co-investment Yield	3.7%	1.7%	2.0%	4.6%	3.3%	3.0%
Total EBITDA	194	244	145	253	205	185
Total OPAT	138	177	125	192	164	147
Invested Capital	1.9	2.1	2.4	2.8	3.2	3.0
Australian IC	1.1	1.0	1.0	1.2	1.2	1.1
International IC	0.8	1.1	1.3	1.5	2.0	1.9
Investments	**2025(E)**	**2026(E)**	**2027(E)**	**2028(E)**	**2029(E)**	**2030(E)**
FUM ($b)	49.8	50.9	53.5	53.8	52.7	51.5
FUM Growth	5.63%	2.31%	5.04%	0.63%	-1.99%	-2.41%
Management Revenue	255.72	261.64	274.83	276.55	271.04	264.51
Management Expense	150.53	154.02	161.79	162.80	159.55	155.71
Management EBITDA	105.19	107.62	113.05	113.76	111.49	108.80
Management EBITDA Margin	41.13%	41.13%	41.13%	41.13%	41.13%	41.13%
Other EBITDA	27.11	27.73	29.13	29.32	28.73	28.04

Development (AUD $m)	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
EBITDA	512	157	354	183	134	198
OPAT	362	105	250	122	96	107
Invested Capital ($b)	1.0	0.9	0.9	1.1	1.3	1.3
ROIC	31.1%	11.4%	28.6%	12.0%	7.8%	7.3%
WIP ($b)	3.8	6.3	8.4	9.2	10.3	7.5

Construction (AUD $m)	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
Revenue	4,052	3,217	2,868	3,187	3,707	3,437
EBITDA	126	97	112	121	105	60
Margin	3.1%	3.0%	3.9%	3.8%	2.8%	1.7%
OPAT	84	62	72	80	58	25
Invested Capital ($b)	0.1	(0.1)	(0.1)	(0.3)	(0.6)	(0.5)
Backlog ($b)	5.5	5.7	6.3	7.0	5.7	3.9

Construction	2025(E)	2026(E)	2027(E)	2028(E)	2029(E)
Revenue	2,613	2,436	2,885	3,095	3,252
EBITDA	49.65	53.59	72.12	86.65	100.81
Margin	1.9%	2.2%	2.5%	2.8%	3.1%
Invested Capital ($b)	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)
Backlog	4.5	5.3	5.7	6.0	6.2

CRU	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
EBITDA	(11)	(271)	169	246	159	356
OPAT	(30)	(261)	27	122	132	232
Invested Capital	4800	5200	4400	4500	5200	4500
ROIC	(0.6%)	(5.2%)	0.6%	2.7%	2.7%	4.5%

Appendix E: Pro-forma Financials – Group

Segment EBITDA	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	832	499	610	557	444	443
Capital Release Unit	(11)	(271)	169	246	159	356
Group	821	228	779	803	603	799

Corporate Costs	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	(54)	(46)	(54)	(70)	(59)	(50)
Capital Release Unit	(86)	(83)	(74)	(89)	(79)	(66)
Group	(140)	(129)	(128)	(159)	(138)	(116)

Treasury Costs	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	-	-	-	-	(10)	(10)
Capital Release Unit	-	-	-	-	(13)	(14)
Group	(25)	(29)	(33)	(21)	(23)	(24)

Depreciation and Amortisation	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	-	-	-	-	(72)	(53)
Capital Release Unit	-	-	-	-	(71)	(69)
Group	(122)	(244)	(207)	(163)	(143)	(122)

Net finance revenue/(expense)	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	-	-	-	-	(35)	(124)
Capital Release Unit	-	-	-	-	(53)	(114)
Group	(125)	(148)	(136)	(116)	(88)	(238)

Other exceptional items	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	-	-	-	(262)	-	(37)
Capital Release Unit	-	(9)	-	(159)	(295)	(1,459)
Group	-	(9)	-	(421)	(295)	(1,496)

Profit after tax	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	483	242	330	16	227	135
Capital Release Unit	(188)	(451)	(134)	(185)	(284)	(1,377)
Group	295	(209)	196	(169)	(57)	(1,242)

Earnings per security (cents)	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	85.2	40.1	48.0	2.3	32.9	19.6
Capital Release Unit	(33.2)	(74.8)	(19.5)	(26.8)	(41.2)	(199.6)
Group	52.0	(34.7)	28.5	(24.5)	(8.3)	(180.0)

Return on equity	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	20.4%	9.5%	12.1%	0.5%	7.6%	4.9%
Capital Release Unit	(4.7%)	(10.5%)	(3.1%)	(4.7%)	(7.3%)	(42.4%)
Group	4.7%	(3.2%)	2.8%	(2.5%)	(0.8%)	(21.0%)

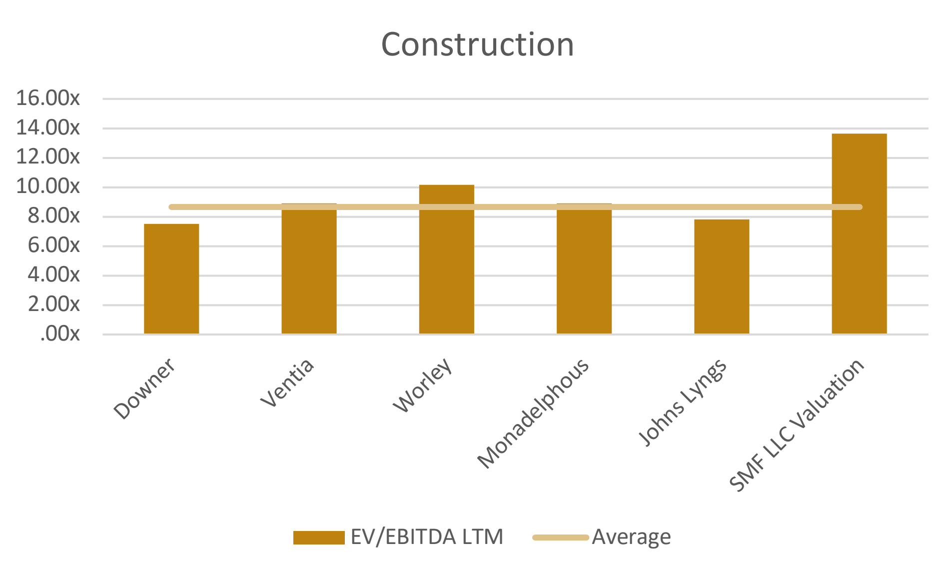
Investment Property Revaluations	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	96	(62)	30	61	(155)	(263)
Capital Release Unit	76	(39)	(4)	9	(20)	3
Group	172	(101)	26	70	(175)	(260)

Net Debt	2019(A)	2020(A)	2021(A)	2022(A)	2023(A)	2024(A)
I/D/C (ex. CRU)	553	298	291	467	1,026	1,072
Capital Release Unit	872	535	404	593	1,355	2,104
Group	1,425	833	695	1,060	2,381	3,176

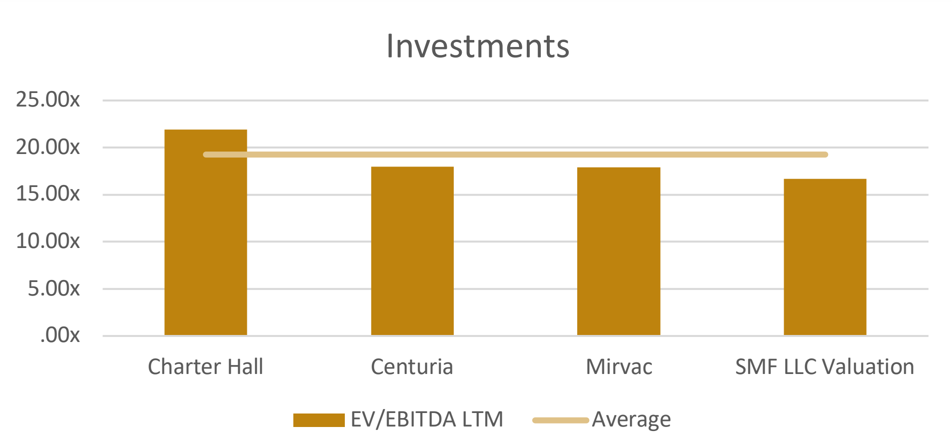
Appendix F: Development Pipeline

Project	Start	Target Completion	Ownership	Invested Capital ($b)	End Value ($b)	Margin
One Sydney Harbour R2	FY21	FY25	75%	0.3	1.7	30-40%
One Sydney Harbour R3	FY22	FY25	100%	0.4	0.6	0-10%
Victoria Cross OSD	FY23	FY25	75%	0.5	1.2	10-20%
Melbourne Quarter West	FY23	FY26	25%	0.0	0.5	10-20%
One Circular Quay	FY23	FY27	33%	0.3	3.1	30-40%
Town Hall Place	FY25	FY27	100%	0.0	0.4	N/A
Victoria Harbour	FY24	FY27	100%	0.0	0.4	10-20%
Victoria Harbour	FY25	FY30	100%	0.2	2.3	10-20%
Gurrowa Place, QVM	FY26	FY30	100%	0.0	1.3	N/A

Appendix G: Multiples Valuations



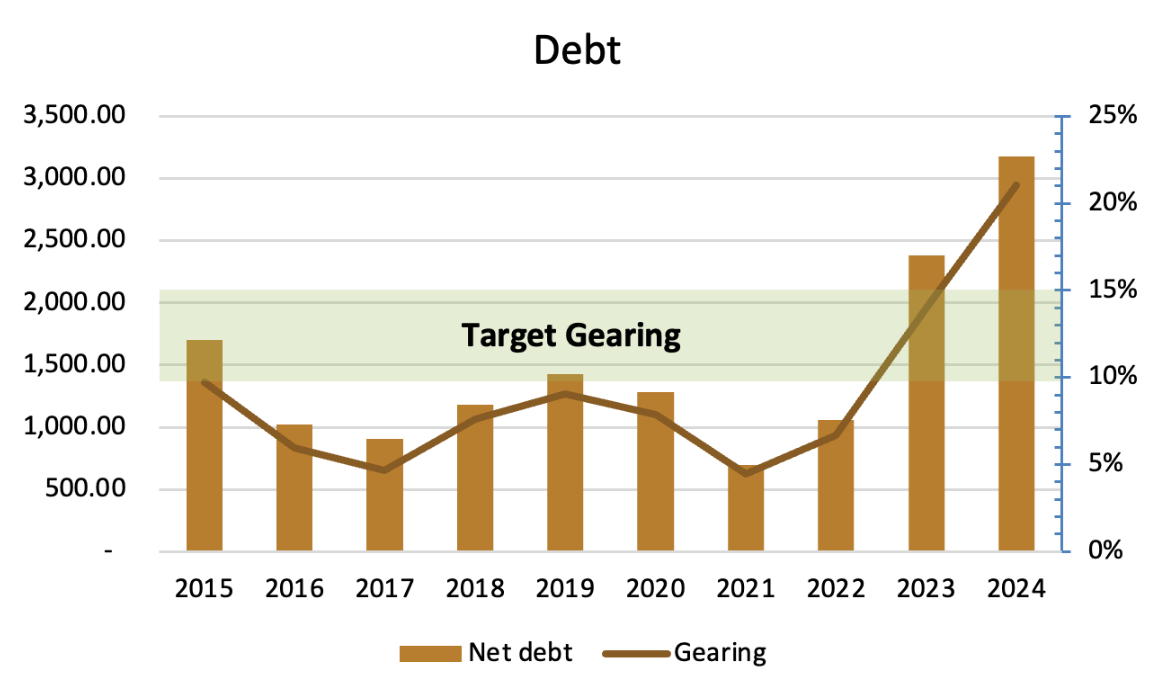
Construction premium to competitors is a result of weak EBITDA in FY24 and a recovery of margins over the next five years resulting in above average EBITDA growth. On FY23 EBITDA, LLC multiple is in line with competitors.



Appendix H: FUM Breakdown

Financial Year (AUD million)	2021(A)	2022(A)	2023(A)	2024(A)	2025(E)	2026(E)	2027(E)	2028(E)
Starting FUM	36000	39600	44400	48300	47100	49750.3	50937.4	53502.9
Additions	4800	3400	5300	3400	2200	1900	4900	1400
Divestments	-400	-1600	-1000	-800	-1135.12	-1198.99	-2546.9	-1289.43
Revaluations	200	2100	-1400	-3600	1585.39	486.18	212.37	223.06
FX/Other	-1000	900	1000	-200	-	-	-	-
Total Change	3600	4800	3900	-1200	2650.3	1187.2	2565.5	333.6
Final FUM	39600	44400	48300	47100	49750.3	50937.4	53502.9	53836.6

Appendix I: Debt

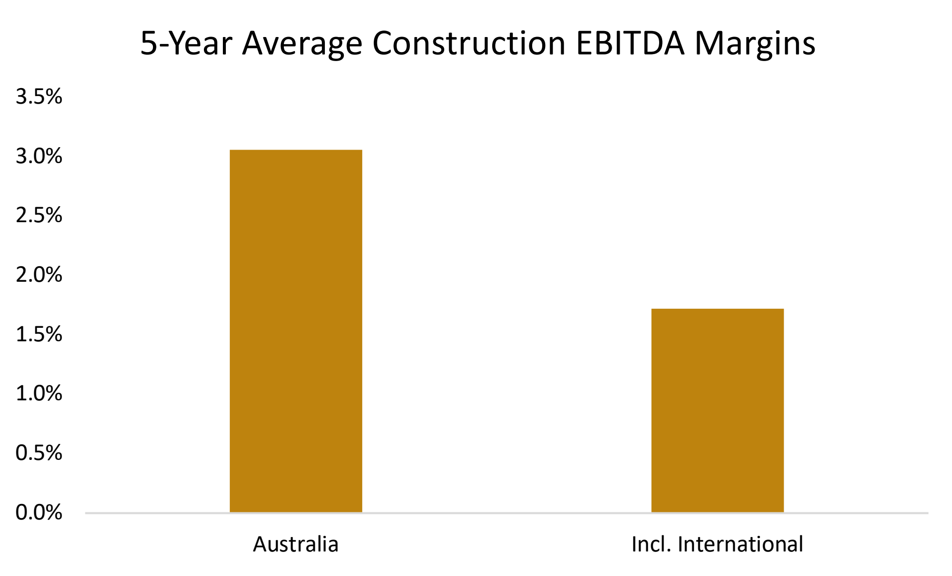


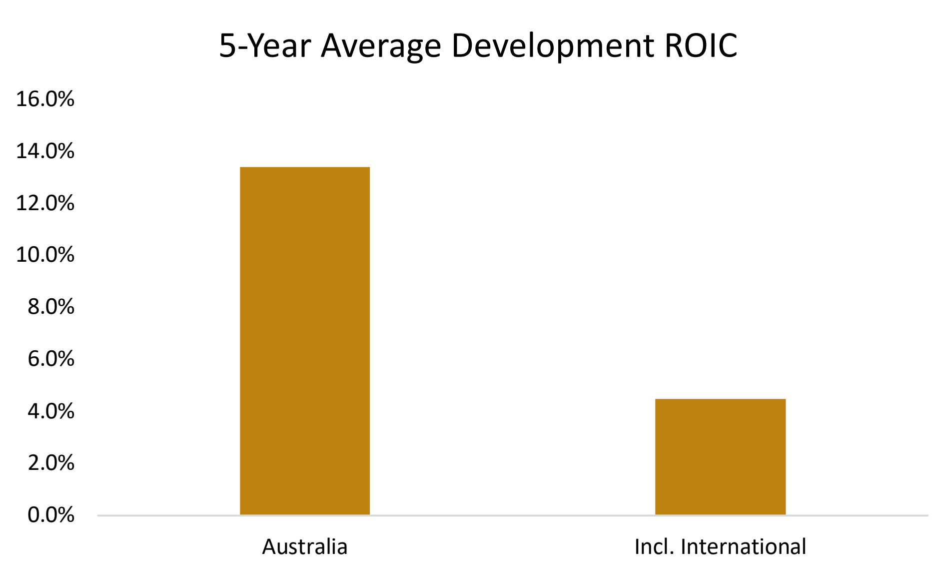
LLC are targeting net debt to tangible assets minus cash of 10-15%. Debt is set to paid off from the cash from the sale of CRU assets with the goal of hitting target gearing level to FY26. The fixed to floating ratio of debt is 43:57, the interest payments on floating debt are expected to decrease as global interest rates are cut. The SMF view is that LLC debt levels are manageable and there is no significant risk of LLC failing to meet their debt obligations with potential upside in LLC from the deleveraging over the next two years which will reduce risk.

Look through debt

LLC trusts have an average gearing of 34.5% in their real estate funds under management.

Appendix J: Domestic vs International Performance for Construction & Development





Appendix K: Sensitivity Analysis

WACC

WACC	Valuation	Margin of Safety
Base – 1.5%	$ 9.16	30.9%
Base – 1%	$ 8.92	27.4%
Base – 0.5%	$ 8.71	24.4%
Base	$ 8.51	21.7%
Base + 0.5%	$ 8.35	19.3%
Base + 1%	$ 8.20	17.1%
Base + 1.5%	$ 8.07	15.3%

Development ROIC

ROIC	Change to Enterprise Value ($m)
6%	$(14.73)
6.5%	$(9.89)
7%	$(5.04)
7.5%	$-
8%	$4.66
8.5%	$9.51
9%	$14.36

Currency Risk Exposure – Profit after tax

Currency (10% Weakening)	2023	2024	Currency (10% Strengthening)	2023	2024
USD	(4)	(72)	USD	4	58
GBP	(32)	(59)	GBP	32	48
SGD	(7)	5	SGD	(6)	(3)
EUR	1	(6)	EUR	(2)	6
CNY	(2)	(2)	CNY	2	2
MYR	5	9	MYR	(4)	(7)
Total	(25)	(125)	Total	26	104

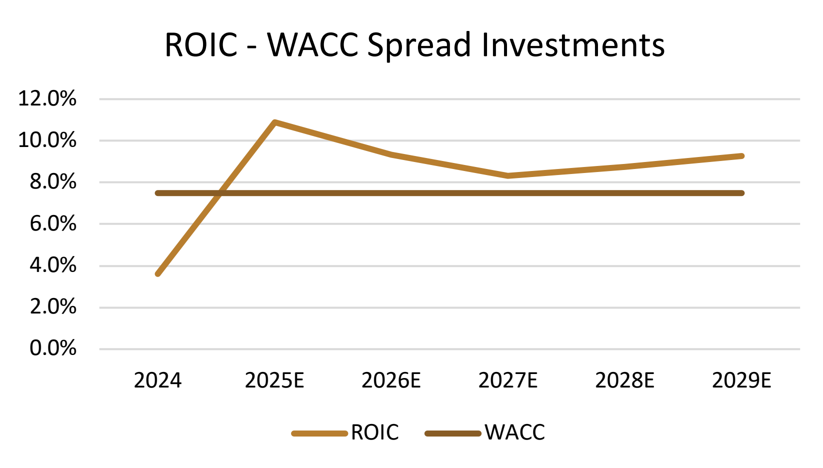
Currency Risk Exposure – Net Assets

Currency (10% Weakening)	2023	2024	Currency (10% Strengthening)	2023	2024
USD	175	97	**USD**	(80)	(143)
GBP	164	58	**GBP**	(49)	(136)
SGD	81	103	**SGD**	(85)	(67)
EUR	21	27	**EUR**	(22)	(16)
CNY	15	22	**CNY**	(18)	(12)
MYR	75	82	MYR	(69)	(61)
Total	531	389	**Total**	(323)	(435)

Appendix L: ROIC-WACC Spread

While we present investment ROIC for completeness, we do not believe ROIC to be the most appropriate metric to assess LLC's operations. LLC has a negative net working capital cycle; this leads to segments like construction and investments outside of the co-investments to having negative invested capital.

Investments invested capital is also overstated, as investments have been revalued upwards over time, they no longer reflect the cost to LLC and therefore limit what assumptions can be made about the return on future invested capital. The invested capital presented is the minimum co investments LLC aim for as a percent of FUM, which is viewed as operating invested capital. This number still overstates invested capital because there have been net positive revaluations, but it is the best estimate. The return on future invested capital is likely to be above what the presented ROIC is.



Appendix M: Scenario Analysis

	Bear Case	Base Case	Bull Cash
Construction	$ 405.18	$ 868.32	$ 1,262.74
Investments	$ 1,182.20	$ 1,537.63	$ 1,549.23
Development	$ 1,417.31	$ 1,479.27	$ 1,540.49
CRU	$ 3,316.59	$ 3,604.67	$ 3,794.61
Co Investments	$ 2,480.00	$ 2,952.81	$ 3,410.00
Corporate Costs	$ (965.86)	$ (1,016.69)	$ (1,067.53)
EV	$ 7,784.59	$ 9,426.02	$ 10,540.38
Debt	$ (4,176.00)	$ (4,176.00)	$ (4,176.00)
Non-Operating Cash	$ 621.00	$ 621.00	$ 621.00
Equity Value	$ 4,229.59	$ 5,871.02	$ 6,985.38
Target Price	$ 6.14	$ 8.52	$ 10.14
Share Price	$ 7.00	$ 7.00	$ 7.00
MoS (excl. FC)	**-12%**	**22%**	**45%**

Construction

- Bull case: greater conversion of pipeline to backlog, faster margin recovery
- Bear case: Weaker conversion of pipeline to backlog, lower margins for longer

Investments:

- Bull and bear cases compare different level of investor withdrawals

Development:

- Bull case assumes top of margin guidance for each project, bear case is bottom end of margin guidance. Base case is the midpoint

CRU

- Bear case 30% discount to book value of assets on market, bull case is a 5% premium

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