Are you getting a fair price for your Westfield shares

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Westfield investors have a big decision to make. Should they approve or reject one of the biggest corporate transactions the Australian Real Estate Investment Trust (AREIT) market has ever seen?

The Unibail-Rodamco (Unibail) takeover bid for Westfield Corporation (WFD) will soon to be decided (Westfield/ Unibail merger: What happens next). Shareholders can take a long term perspective and accept the offer, or they can reject it outright.

In our opinion, Unibail is one of the best managers of retail property in the world [see article Unibail/Westfield] with a long, successful track record in investing, developing, leasing and managing retail property, especially in Europe.

Conceptually, it is better positioned to manage Westfield's property assets in the interests of shareholders than is Westfield. This assertion is effectively supported by Westfield's directors and senior management team. Both endorse the deal.

The quantitative aspect of the proposal - the price being offered to acquire Westfield shares - is more controversial. Let's examine it in more detail, starting with the details of the bid.

Unibail is offering 0.01844 of its shares plus US$2.67 in cash for each Westfield security. This means Westfield shareholders are currently being offered about 65% in stock and around 35% in cash for their shares (as at date offer made - 11 December 2017).

The offer also includes a holding in a technology business that aims to help retailers compete more effectively. It will be spun out of Westfield. The holding is small enough to be immaterial. The cash and shares component is where you should focus your attention.

At the time of the bid the cash component in Australian dollars was equivalent to $3.54 per share. Subsequent currency movements have reduced this figure to $3.48. Keep that figure in mind.

Now to the shares component. At the time of the bid Westfield shares were trading at A$8.50. The bid represented an 18% premium to the pre-bid price and a 22.7% premium to the company's share price three months prior to the bid.

Since then, Unibail's share price has fallen from €224.1 per share to €189.85 per share (as at 17/4). This 15% fall flows straight through to the current "headline" value of the bid.

The total value of the bid on 11 Dec last year $10.01. The value of the Unibail shares a Westfield investor would receive on 17 April this year has fallen from $6.47 to $5.58. Adding the cash component to this figure means the total value of the bid as of 17 April is now close to A$9.00 for each Westfield share.

There's an argument that Unibail should increase its offer price as a result. We see this as simplistic. An assessment of value should not be made based on the daily share price movements but the long term estimation of the value of the combined entity. This is what the Lowy family did when it initially agreed to the transaction.

Before the bid, the value of Unibail was assessed at between €200.50 per share to €219.20 per share1. Research analysts that follow Unibail estimate an (average) price target of €232.302. Both are significantly higher than Unibail's current trading price.

Grant Samuel, the Independent Expert appointed to assess the merits of the proposal, believes that, in the absence of a superior offer, the transaction is in the best interest of Westfield unitholders. It values Westfield at A$9.22 to A$9.78 (a midpoint of A$9.50) per share. Grant Samuel also points out that the current Westfield share price is significantly higher (based on cash flow multiples) than comparable major listed REITs in the United States.

On a Net Asset Value basis our Westfield valuation is in the range of $8.50 to $9.00. Our cash flow based valuation, however, is a bit higher and accords with that of Grant Samuel.

All this points in one direction: That the long term value a Westfield investor will achieve by accepting the Unibail bid should exceed that delivered by hanging under current ownership. On this basis we believe shareholders should accept the offer.

Unfortunately, the Scheme documents do not include the combined entity's 2018 financial forecasts, although Unibail will provide an update for 2018 as soon as it can do so.

Having dealt with the value on offer, what about the yield?

Having assessed the proposal on the earnings and distribution of each entity on a standalone basis, we assess the distribution yield from Unibail to be about 5.7% on current pricing. The comparable figure for Westfield is around 3.8%. This again points in the direction of supporting the bid.

If investors, like us, have a preference for strong distribution yields from their REIT investments, the Unibail opportunity, enhanced by the addition of the Westfield portfolio, beats Westfield on a standalone basis.

Without Westfield, Unibail expects recurring EPS to be 5.8-7.1% higher in 2018. The company also expects €100m of synergies (i.e. savings) from the transaction over the next 18 months. This should further enhance the earnings and value of the combined entity.

It will also offer greater asset diversification, better access to global growth in Europe, less exposure to risky development, a higher yield, excellent growth prospects and access to top notch management.

There remains a slim possibility of another bid. If, however, the offer is rejected and a superior bid has not emerged, Westfield directors have stated they believe the share price may fall 2. This is a real prospect.

After a detailed analysis, as an income-focused long term investor, we will be following the Lowy family and Westfield board and accept the Unibail bid.

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