Four reasons why Unibail may be a better investment than Westfield

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Westfield shareholders have a big question to answer. In December 2017, Unibail-Rodamco, a major European listed property trust, made an offer to purchase Westfield Corporation, based on a combination of cash and Unibail shares.

Due to a subsequent fall in Unibail's share price, the bid price is currently well below that implied at the time the offer was announced. For Westfield shareholders, this complicates matters. Unibail may increase its offer price but the fall could also imply the market thinks the deal is a poor one for the company.

So why would Westfield shareholders want to continue holding Unibail shares, through units to be listed on the ASX, in a foreign company they don't know much about?

Unibail offers four reasons why the ASX-listed merged entity will be a better investment for Westfield shareholders. Let's interrogate each of them.

1. A global property leader, strategically positioned in the world's best cities

Despite a cyclical "speed hump" in secondary retail property, it's hard to disagree with the proposition that the best shopping centre assets with high barriers to entry and well-curated retail offers, focused on experiences, lead to superior rental pricing power and good long-term rental growth. Unibail offers this prospect.

The merged entity will create one of the largest retail property portfolios on the planet. At about AU$92bn it will be both large and diverse, including a total of 104 assets (compared to 35 in the existing Westfield portfolio) and 56 flagship assets. Located in 27 cities in 13 countries, the merged portfolio offers greater geographical diversification than Westfield's US-centric assets.

2. Deliver rental growth and a pipeline that will boost future earnings

The merged entity should benefit from Unibail's portfolio, which has recently been delivering superior sales growth, net operating income growth and lower vacancy rates than Westfield's.

More details might emerge in this regard but, right now, Unibail beats Westfield on most measures. First, it enjoys a much higher distribution yield - circa 5% versus about 3.6% for Westfield. Second, it has a recent history of strong Dividend Per Unit (DPU) growth (about +5% p.a. versus negative 4% most recently for Westfield*). Third, it features a higher payout ratio. Finally, Unibail consensus distribution forecasts indicate superior growth.

As a lower risk, income-focused investor, in our view combining Unibail's portfolio with Westfield's improves the quality and magnitude of Westfield shareholders' future income stream.

3. Create significant value through operating and cost synergies

Some 100m Euro will saved due to operational synergies in the merged entity.

A large part of the savings are in executive salaries. The benefit to investors of eliminating the Westfield CEO expense will be substantial. A common metric when comparing companies is CEO remuneration as a proportion of gross assets. The Westfield ratio is eight times that of Unibail's. The merger would lead to an annual saving of US$19.4m in CEO remuneration alone. In addition, the combination of the two portfolios will deliver economies of scale never before seen in a global retail portfolio.

4. Moderation in development exposure and risk

Whilst the merged portfolio will have some growth potential, it usefully moderates Westfield's dependence on development.

With €4.9bn in Westfield's development pipeline, accounting for about 27% of its asset base, the proportion in the merged portfolio would fall to around 20%. We're more comfortable with this exposure as it reduces risk and focuses managerial resources on asset management rather than risky property development activities.

Debt management should also benefit from the larger Unibail balance sheet. Unibail has a larger, more diverse debt book with a lower weighted average cost of debt, higher interest cover ratio, longer duration of debt facilities and a higher credit rating. This implies lower debt servicing costs - savings which should eventually make their way to investors in the merged entity via higher distributions.

These are powerful arguments. Having analysed the various quantitative metrics, supported by our qualitative assessment, we're big supporters of this deal and hope it's concluded. We expect the new entity will be an attractive investment opportunity well suited to APN's lower risk, income-based philosophy.

As for Westfield shareholders ambivalent about taking on a foreign company they don't know much about, we'd suggest they have less to fear than they may think and much to gain.

*FY 16 AUD, actual DPU paid 2016 & 2017

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