AURORA FUNDS MANAGEMENT

THE ALTERNATIVE VIEW

By Hugh Dive

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Westfield Shenanigans

One of the biggest decisions facing listed property fund managers is in determining the weight in the portfolio for both Scentre (SCG) and Westfield Corporation (WFD). These are the two largest trusts on the ASX and currently comprise around 38% of the ASX 200 A-REIT index, so a significant underweight or overweight will be a big driver of a manager's performance.

Last year, Westfield Group (WDC) and Westfield Retail Trust (WRT) announced a proposal whereby their combined assets will be restructured along geographical lines. Westfield's Australian/NZ businesses were consolidated as **Scentre Group (SCG)** and their US and UK assets, including the Westfield World Trade Center in New York, Century City in Los Angeles and Westfield London were retained as **Westfield Corporation (WFD)**. The investment thesis behind this quite costly move is that the market will rate the two separate companies more highly, and that offshore acquirers will now be more interested in Westfield's global assets without the baggage of part ownership shares in Australian shopping malls. We note that Westfield Corp now trades at a PE ratio similar to US-based REITs such as the US$57 billion Simon Property.

The above proposal was the latest in a long series of capital restructures conducted by the Westfield group since it was first listed in 1960. In this piece we are going to look at the various permutations of Westfield over the years and follow the "pea" or the Westfield entities that have given investors the greatest returns over the last 35 years. Recently we have fielded a few questions about our positioning in the two former Westfield vehicles in the Aurora Property Buy Write Trust.

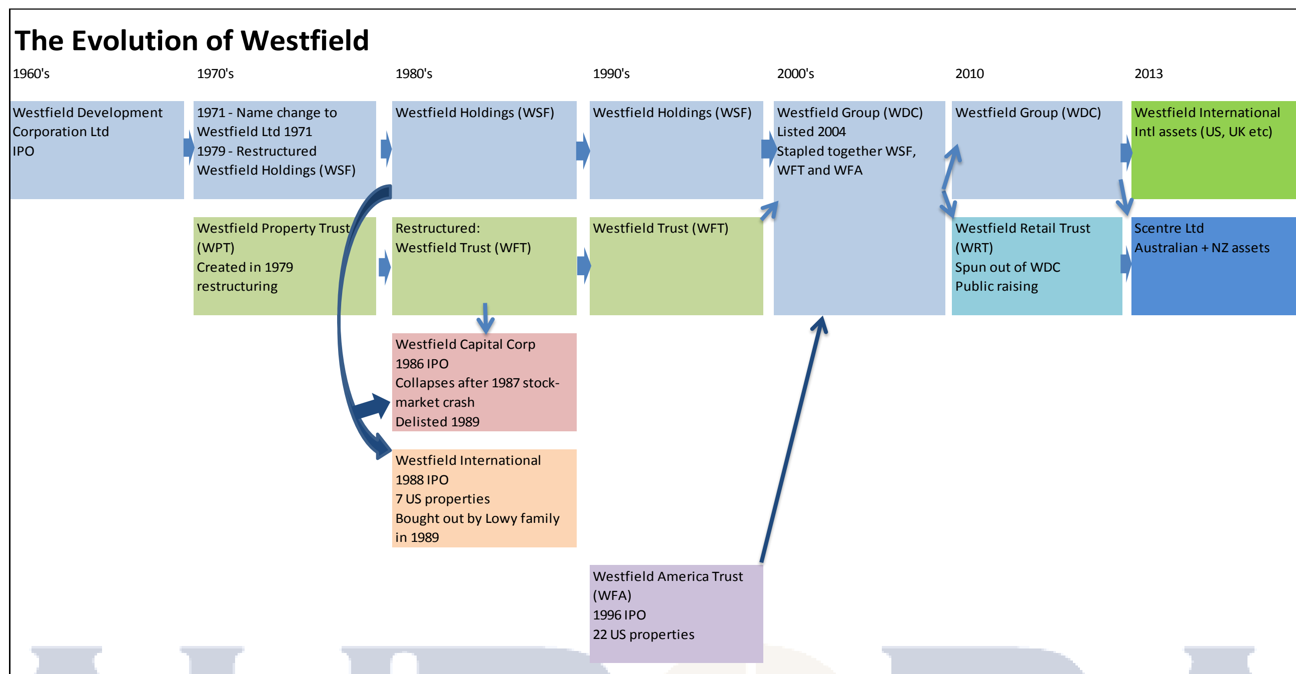
Westfield Blacktown 1959 – Where it all began

In the middle of the 1960-61 recession, when unemployment spiked to a post-war high of 3.1%, Westfield Development Corp's IPO offered 300,000 shares at 5 shillings (50% part paid at the IPO in September 1960 with the residual to be paid in 1961). Since then Westfield has been at the forefront of developing and exporting shopping malls globally and has grown into two listed entities with a combined market capitalisation of A$30.7B. As you can see on the flow chart on the following page Westfield has also been at the forefront of corporate restructures, splitting itself then recombining.

Setbacks

Whilst Westfield Holdings has been a profitable long term investment for investors, not all Westfield listed securities have been profitable investments. Westfield Capital Corp (WCC) was cash box floated in 1986, that proceeded to buy stakes in packaging company ACI and TV company Channel Ten. The company then collapsed after the 1987 crash and delisted in December 1989 after incurring a loss of $303 million. Similarly in 1988, Westfield Holdings split the company in two, so that the Australian and US

properties could stand alone; allowing two separate management teams to focus on the different geographies. Westfield International now owned 7 US shopping centres worth $1.1 billion and a large part of Westfield Holdings' debt. After performing poorly, Westfield International was privatised by the Lowy family in 1989.



Follow the Returns!

In 1979 Westfield Limited split the company between the development and management arm (Westfield Holdings) and the trusts owning the physical assets (Westfield Property Trust/Westfield Trust). Over the period from 1979 to 2004 when development arm was recombined with the trusts holding the assets, a $100 investment in property trusts turned into $765 with dividends reinvested. This equates to an annualised real return of 9% over 24 years. Conversely, a $100 investment in the development and management arm (Westfield Holdings) would have turned into $19,657 or an annualised real return of 25% over the same 24 years.

The end result of this large discrepancy in returns was that the development and management arm went from 33% to 90% of the value of the combined entities, whereas the property trust arm went from 66% to 10% of the value of the combined entities. As an investor the greatest return was to be following the Westfield company generating the development profits and earning management fees, rather than the entity collecting rents.

What to do?

Westfield Corporation gives the Aurora Property Trust a global retail property exposure, at the higher quality end of the available opportunity set and a falling AUD will boost the translated rents earned in USD and GBP. In looking at retail LPTs, we have historically taken the view that management would favour Westfield over Scentre (SCG), based on the thesis that Westfield is where the Lowy's have the bulk of their personal fortune invested and that following the Lowys is consistently the superior investment strategy. The Lowy's have retained a 9.5% interest in Westfield Corporation and have a 4% interest in the new Scentre group by virtue of the sale of WDC's Australian assets to Scentre. However, in light of their sale in 2013 of their entire holding in WRT, we would question their long-term commitment to the asset holding trust Scentre and will most likely focus on the off-shore entity generating greater development profits; Westfield Corporation. Historically, investors have earned the greatest returns since 1979 by investing in Westfield's development entity, rather than their asset-holding property trusts. Since the latest combination listed in June 2014, Westfield has returned +36% ahead of both Scentre +20% and the underlying index +12%!

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