
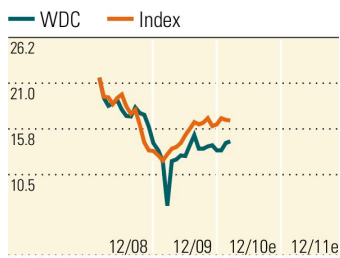


## Westfield Group WDC

### Snapshot

Business Risk	Low
Price Risk	Medium
Moat Rating	Narrow
Fair Value \$	13.00
Market Cap \$Mil	30,301
Morningstar Style Box	
Last Price \$	13.14
52 Week High/Low \$	14.33/9.46
Shares Issued Mil	2,308
Sector	GICS - Real Estate
Company Beta	1.54
Sector Beta	1.60

### Price vs. Market



NPAT	1,961.7	1,824.9	2,044.7	2,095.7
EPS¢	101.0	81.3	88.8	88.8
EPS Chg%	25.8	-19.4	9.2	0.0
DPS	106.5	94.0	64.0	64.0
Franked%	0	0	0	0
Div Yld%	8.1	7.2	4.9	4.9
P/E	13.0	16.1	14.8	14.8

Source: Morningstar analyst estimates.

### Business Description

Westfield Group (WDC) is a sub-sector specific Australian listed property trust, or AREIT, offering exposure solely to the super regional shopping centre markets in Australia, New Zealand, USA and UK. The trust was formed by the merger of Westfield Holdings Limited, Westfield Trust and Westfield America Trust. WDC is an internally managed, vertically integrated group undertaking ownership, development, design, construction, funds/asset management, leasing and marketing activities.

## 1Q10 update

Analyst Recommendation: **Hold**

04 May 2010



### Investment Rating

WDC is a major global retail property group established by the merger of Westfield Holdings, Westfield Trust and Westfield America Trust in July 2004, holding 119 shopping centres with the gross value of assets under management being \$62.3bn. The passive investment assets of the trusts will generate in excess of 80% of group pre-tax net income. A portfolio of this size generates significant redevelopment work captive to the group. Management is very high calibre with an impressive track record. WDC should be considered by income investors willing to bear moderate capital risk in the short term.

### Event

- WDC issued a positive March quarterly update.
- Australian retail sales increased 2% for the March quarter to A\$21.5bn. while New Zealand was down slightly to NZ\$2.1bn. Retail sales in the US turned positive quarter on quarter, up 5.3%. This compares against falls of 10.7% and 3.5% for the September and December quarters of 2009. On pcp basis, falls in sales narrowed from 9.5% in December to 5.4% in March.
- Conditions are improving in the US and UK. WDC will commence \$1bn of development projects in 2010. Around \$800m will be committed in Australia with the rest in the US. WDC is committed to 4 projects worth \$4bn, of which \$2.3bn has already been incurred. Development pipeline remains strong with \$10bn of opportunities undertaking pre-development activity. WDC is targeting between \$500m to \$1bn annually on project development post

2010. Large developments at Stratford in East London and Sydney City are on track for completion in 2H11 and 2010-12 respectively.

- Australian occupancy is near full capacity while US and UK were steady at 92.1% and 98.8% respectively.

### Impact

- No change to estimates, fair value and recommendation.

### Recommendation Impact

Recommendation unchanged. Hold.

# Westfield Group WDC

## Global property developer and manager

### Bulls Points

- ▶ Astute management and a high quality portfolio make WDC a premier retail property group.
- ▶ Organic revenue growth and a high yielding development pipeline will drive earnings and NTA per unit higher in the long term.
- ▶ A large and diversified portfolio minimises reliance on individual tenants, properties and regions.
- ▶ WDC has a conservative debt management strategy with \$7.8bn in available liquidity.
- ▶ Around 98% of rental income based on contracted rents with low exposure to percentage rent linked to sales.

### Bears Points

- ▶ With 32% of assets under management located in the United States and a further 14% in the UK, WDC is exposed to weakening retail conditions and soft property values.
- ▶ High level of foreign denominated debt increases earnings and balance sheet volatility through foreign exchange risk.
- ▶ Gearing is not insubstantial at 35.8% (December 2009), but well secured.
- ▶ Constrained credit markets will make it challenging and expensive to refinance maturing debt.
- ▶ Competition constraints make additional acquisitions in Australia unlikely, limiting the ability to further reduce local operating costs through greater economies of scale.

### Thesis Last Updated: 04 May 2010

Westfield Group (WDC) is one of the world's largest retail property groups. Astute management and a highly successful business model justify WDC trading at a premium to peers.

WDC is an internally managed, vertically integrated shopping centre group. It builds and operates shopping centres on both a wholly owned and joint venture basis. Around 85% of group revenue comes from its property portfolio, with the remainder coming from property development and management. WDC has a diverse portfolio with interests in 119 shopping centres spread across Australia, New Zealand, the United States and the United Kingdom, with 10.5 million square metres of Gross Lettable Area (GLA). WDC's share of shopping centre assets is \$45.5bn, with the gross value of assets under management being \$59.5bn (December 2009) - providing numerous captive in-house redevelopment opportunities. Centres are located close to major metropolitan areas and are anchored by several, large long-term tenancies with major retailers. Specialty stores feed off the stable consumer traffic generated by the majors and provide high margin returns to WDC. Tenants pay a base rent plus a percentage of turnover. Underperforming tenants can be replaced to maintain acceptable yields.

Management is very high calibre with a long and impressive track record of value accretive growth. Co-founder Frank Lowy steered the company from humble origins to become one of the world's most dominant property groups. Mr Lowy remains as Chairman, and is capably backed up by an experienced and talented team. Comfort is taken from the internal management structure, which avoids potential conflicts of interest with shareholders. Management has created a successful business model and strong brand that enable the Group to generate high development yields. Despite rising costs and land values, WDC still achieves initial yields on developments above its cost of capital - something many of its peers are unable to accomplish. Superior performance and first mover advantage make it unattractive for rivals to open shopping malls nearby. Additional barriers to entry include a lack of available space and town planning restrictions.

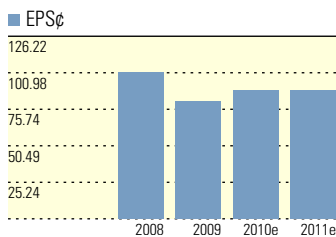
While WDC is an accomplished performer, it does have significant exposure to underperforming regions with 32% of assets under management located in the US and a further 14% in the UK. Though asset value falls are now abating around the world, weak US consumer spending will impact its business over the medium term, compounded by the volatility of the US dollar on translation. Should economic conditions fail to stabilise, major retailers may curtail expansion plans making it more difficult for WDC to secure anchors for new developments which supports their only tentative escalation of the development programme. Additionally, gearing is not insubstantial at 35.8% (December 2009) though 98% of debt is fixed rate and WDC has a war chest of \$7.8bn for new developments or corporate activity.

### Valuation Last Updated: 22 Feb 2010

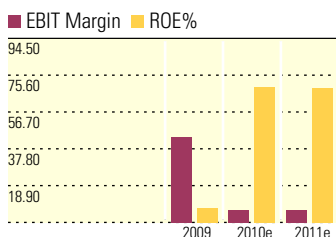
We have valued WDC on a discounted cash flow basis, cross referenced against distribution yield and relativity to NTA. Reflecting the robust core revenue from the resilient super-regional shopping centre portfolio, offset by management guidance for slowing growth, increasing cost of debt and decreased development, our fair value of WDC is \$13.00pu. This provides an CY10(e) distribution yield of 4.9% and a premium to NTA of 24.2%, which are considered appropriate, with WACC of 8.8% and cost of equity 9.7%.

# Westfield Group WDC

## EPS



## EBIT Margin vs. ROE



## Risk Last Updated: 22 Feb 2010

Principal risk to revenue arises from a sustained downturn in global retail spending over several years, leading to reduced specialty retailer demand for shops at lease renewal and on completion of developments together with limited anchor tenant demand for future developments. Decreased availability and increased cost of debt present refinancing risk though the risk to capital from softening values for super-regional shopping centres is abating.

## Financial Overview

### Growth

WDC should exhibit modest earnings growth over the medium term on the back of non-discretionary retail spending, supplemented by limited short term but robustly growing medium term profits from the development pipeline and an increasing proportion of third party fund management fees.

### Profitability

The benefits of around 85% annuity style earnings from investment property revenue and prudently structured debt are offset by the variable profitability from the development and management businesses, leading to potential volatility in profitability in the short term.

### Financial Health

Equity raising in 2009 was offset by property devaluations resulting in not insubstantial gearing of 35.8% (December 2009). Strong balance sheet with diverse funding sources and relatively manageable refinancing requirements in CY10 and CY11.

## Strategy Analysis Last Updated: 04 May 2010

WDC's main focus is on expanding its portfolio, primarily through the development of super-regional centres. Acquisitions and corporate activity are considered less attractive than development due to strong competition for quality centres. WDC follows a clustering strategy, seeking to own several centres in the same market to benefit from economies of scale, branding and regional advertising. Funding is sourced from debt, equity and joint venture partners as well as strategic asset sales.

# Westfield Group WDC

Forecasts	Actual			Forecast	
	31 Dec 2007	31 Dec 2008	31 Dec 2009	31 Dec 2010	31 Dec 2011
<b>Per Share</b>					
Earnings ¢	80.3	101.0	81.3	88.8	88.8
Dividends ¢	106.5	106.5	94.0	64.0	64.0
Franking %	–	–	–	–	–
<b>Profit &amp; Loss \$Mil</b>					
Rental Income	3,189.4	3,212.8	3,459.0	3,870.3	3,986.4
Investment Income	28.7	47.5	8.9	–	–
Other Income	1,047.4	1,211.7	707.6	1,063.3	1,095.2
Net Interest Expense	-492.3	-1,668.4	109.1	-848.2	-838.5
Profit Before Tax	1,750.1	1,434.2	1,917.0	1,823.3	1,913.2
Tax	-235.3	542.0	-84.4	–	–
Outside Equity Int.	-23.1	-14.5	-7.7	–	–
Adjusted NPAT	1,514.8	1,976.2	1,832.6	1,823.3	1,913.2
Significant Items	1,945.5	-4,158.3	-2,282.7	–	–
Reported NPAT	3,437.2	-2,196.6	-457.8	1,823.3	1,913.2
Preferred Dividends	–	–	–	–	–
<b>Growth %</b>					
Rental Income	-6.3	0.7	7.7	11.9	3.0
PBT	13.1	-18.1	33.7	-4.9	4.9
EPS	50.8	25.8	-19.4	9.2	0.0
DPS	0.0	0.0	-11.7	-31.9	0.0
<b>Ratios</b>					
Price/Earnings x	26.2	12.8	15.4	14.8	14.8
Dividend Yield %	5.1	8.2	7.5	4.9	4.9
NTA/share \$	14.2	12.6	10.5	0.2	0.2
Price/Book Value %	1.5	1.0	1.2	66.4	62.1
EBIT Margin %	53.8	71.3	43.8	6.2	6.5
Net Profit Margin %	35.8	45.1	44.3	4.9	5.1
ROE %	5.4	7.9	7.6	69.5	69.1
ROA %	3.7	5.7	3.7	1,239.4	1,185.8
ROREA %	115.8	102.5	75.3	78.7	82.2
Net Gearing %	33.5	40.5	37.3	35.4	34.7
Net Interest Cover x	4.6	1.9	-16.6	3.1	3.3
<b>Cash Flow \$Mil</b>					
Receipts from Customers	4,309.7	4,399.8	4,430.2	1,860.8	1,951.8
Funds from Operations	6,001.0	6,223.2	6,243.7	–	–
Net Operating CashFlow	2,871.5	2,704.5	2,696.3	–	–
Capex	-51.5	-68.6	-43.4	78.0	80.3
Aquisitions & Investments	-3,246.8	-3,857.5	-1,891.5	-235.9	-243.0
Net Investing Cashflow	-1,511.6	-3,732.9	-1,590.2	131.1	135.1
Proceeds from Issues	3,340.2	333.9	3,633.4	-1,928.1	-2,021.1
Dividends Paid	-1,872.0	-2,073.6	-2,119.8	10.7	11.1
Net Financing Cashflow	-1,236.3	910.9	-1,170.1	357.9	368.6
Net Increase Cash	123.6	-117.5	-64.0	–	–
Cash at Beginning	233.2	343.9	242.7	368.6	379.7
Exchange Rate Adjust.	-12.9	16.3	-5.7	–	–
Cash at End	343.9	242.7	173.0	–	–
<b>Balance Sheet \$Mil</b>					
Cash	344.2	311.0	182.3	357.9	368.6
Receivables	642.2	501.3	362.0	56.2	57.9
Other Current Assets	486.7	289.2	203.9	737.2	759.3
Investments	5,724.1	5,664.2	4,324.2	–	–
Property	41,671.9	46,909.1	40,454.0	53,404.3	53,404.3
Other Non-Current Assets	1,931.8	2,174.3	1,639.2	3,050.5	3,142.0
Total Assets	50,800.9	55,909.0	47,165.6	57,616.9	57,743.2
Trade Creditors	1,779.4	2,385.1	1,920.1	1,946.9	2,005.3
Other Current Liabilities	136.5	104.5	63.6	334.5	344.5
Borrowings	15,744.5	21,445.7	16,572.9	20,352.1	20,109.1
Oth Non-Current Liabilities	2,784.2	2,606.0	1,784.3	7,810.5	8,044.8
Total Liabilities	23,018.5	30,951.3	22,858.7	28,162.6	28,153.9
Net Assets	27,782.4	24,957.7	24,306.9	29,258.3	29,393.4

# Disclosure and Research Methodology

## Research Methodology

We seek undervalued stocks with a medium to long-term investment time horizon. Companies that make the best investments tend to be those able to grow earnings per share year after year and which are able to grow at rates above the average of the market. Earnings growth supports a solid and growing dividend stream which is the essence of shareholder return.

In searching for the best businesses in the market, we want to see an ability to turn revenue into profits and a record of strong returns to equity. The ability to generate strong free cash flow is critical as this is where the funds come from to pay dividends or to invest in new growth areas. The greatest free cash flow generators will have strong margins, good controls over working capital and limited requirement for capital expenditure. The best businesses will also have robust balance sheets including a not onerous level of debt. We believe in strong, experienced and disciplined management.

## Recommendations

Our qualitative recommendations are simple and easy to understand:

- Buy: Substantially undervalued
- Accumulate: Modestly undervalued
- Hold: Appropriately priced, neither buy nor sell
- Reduce: Sell part holding
- Sell: Sell all holdings now
- Avoid: Not investment grade

## Economic Moats

The pursuit of high quality businesses is central to our investment philosophy. These offer the greatest gains to the long term investor, so long as they are bought at a reasonable price. The concept of economic moats is valuable in assessing the quality of a business, with the phrase popularised by Warren Buffett and Charlie Munger. Just as wide moats protected castles from invaders in medieval times, businesses with wide economic moats have strong defences against their profits being competed away.

We ascribe a moat rating to each stock researched: Wide, Narrow or None.

The moat is the competitive advantage that one company has over other companies in the same industry. Wide moat firms have unique skills or assets, allowing them to stay ahead of the competition and earn above-average profits for many years. Returns on their invested capital will exceed the cost of that capital. Without a moat, highly profitable firms can have their profits competed away. Other companies will see how attractive the market is and try to move in to reap some

of the rewards themselves.

Sources of economic moats include innovation skills or first mover advantages, a superior cost position, the ability to provide a range of products to suit the needs of a variety of markets, high switching costs or locking out of competitors.

The moat rating is just one of the ingredients used in determining whether a company is undervalued, though it is obviously an important one. We are not saying that no-moat companies should be avoided. Simply, the very best long term investments are in wide moat firms bought when they are undervalued.

## Intrinsic Value

Intrinsic Value (otherwise known as Fair or Underlying Value) is the analyst's interpretation of what the stock is worth today. The stock is considered to be undervalued when the quoted price is below this point or overvalued where the price is above it.

Whether to invest in a stock will depend on consideration of the prospective return and the risk undertaken. Prospective return includes both share price moves and dividend yield. Our analysts incorporate the stock's risk in their intrinsic value. Other things being equal, lower risk stocks will have greater intrinsic value than higher risk ones. A stock becomes a buy when the quoted share price is at a discount to intrinsic value that provides a sufficient prospective return.

## Business Risk

Business risk encompasses all operational risk and financial risk. Companies with low business risk have the most reliable earnings streams. A change in business conditions may reduce earnings predictability and therefore increase risk. Examples are market entry of a new competitor, unfavourable shifts in the economy, changes in key management personnel, major investment in an uncertain new venture or acquisition, and increased interest burden caused by higher debt levels or raised interest rates.

## Pricing Risk

Pricing risk reflects the premium or discount implied in the current price of the shares. Many growth stocks trade on high earnings multiples giving them high pricing risk though they may have low business risk. Investors should consider their risk tolerance before investing in the share market. Many investors will decide to have only low risk stocks in their portfolio though others will accept higher risk levels in order to pursue higher returns.

## Declaration

Declaration of personal shareholdings. These positions can change at any time and are not additional recommendations. AAX, ABS, ACL, AFG, AGK, AHI, ALL, ALS, ALZ, AMP, ANP, ANZ, APA, ASX, AVX, AXA, AXO, BBG, BCM, BHP, BKN, BKW, BVA, BXB, CAB, CBA, CBD, CBH, CDR, CEY, CMR, COH, CRK, CTX, CXS, CYG, DOM, DOW, EGL, EQN, ERA, FLX, FXJ, FXL, GCL, GNS, GWT, HIC, HIL, HIT, HVN, IAG, IIN, IVC, LYC, MCR, MFC, MIG, MLB, MOG, MSL, MTS, MXL, NAB, NHC, NHF, NLB, PBT, PGA, PGL, PGM, PMM, PNA, PPT, PRE, PTM, PTS, QBE, RHC, RIO, SBP, SFH, SGB, SGL, SGT, SHL, SMX, SRX, STO, STW, SUN, TAH, TEN, TLS, TOL, TRF, TRS, TSE, UGL, UXC, VGH, VPG, WBC, WES, WOR, WOW, WPL, WSA