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# Unlocking Value through M&A

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Mergers and Acquisitions (M&A) have always been the subject of in-depth studies. Indeed, the markets responses to such activities have been rather unpredictable. A key issue arising from such a context is the extent to which it promotes efficient market outcomes. Conceptually, mergers and acquisitions are a means of achieving growth, gaining market share, creating economic profits, and enhancing value for shareholders.

There are many ways that real estate companies can unlock value. One well-established method of unlocking value, which we have witnessed a surge of recently, is through mergers and acquisitions (M&A) transactions. There has been substantial press coverage recently regarding the perceived gap in public Real Estate Investment Trusts (REITs) underlying real estate value. This is calculated by comparing the private trading multiples to the real property and the implied value of the real estate based on stock trading price. This resulting value gap suggests that the underlying real estate is being undervalued or discounted by the public markets. Naturally, one way to unlock this value is for public REITs to consider embarking on either a privatisation transaction or a strategic merger with a compatible partner. Another compelling advantage of M&A is the ability to reduce costs. Operating as a public company incurs substantial expenses that are not present in the private environment or may be duplicative, and therefore, able to be reduced in a merger.



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Property portfolios of equity REITs are unique in that they trade on two distinct markets: the public stock market and the private commercial real estate market. Analysts routinely estimate the net asset value (NAV) of the REITs' property portfolio in the private market. Whether these estimated NAVs and their deviations from stock prices represent mispricing (and associated arbitrage opportunities) or are simply a function of slow-moving private market valuations is subject to debate. However, recent empirical evidence suggests these price-to-NAV ratios are meaningful measures of relative valuation to both managers and shareholders.

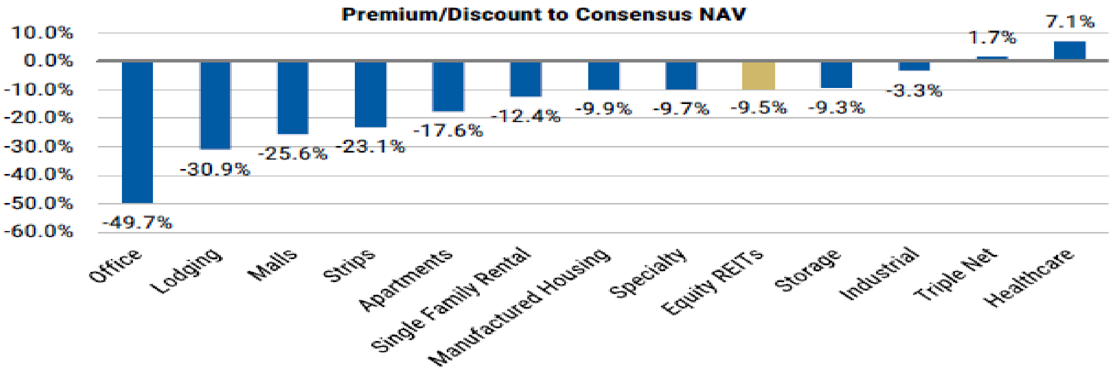
In this report we explore the most recent M&A transactions, including transactional activity, that could have significant reverberations on the South Africa Listed REIT environment. There are several common themes among the transactional activity, although the details differ from deal to deal. One of the driving forces behind this activity is the discount at which REIT share prices are trading in comparison to the value of the properties they hold. This public-private arbitrage can, at times be a strong incentive for deal-making and can also put a floor under equity market valuations. Other deals, however, are more focused on the opportunities in strong and growing sectors of the property market. The Industrial sector, has been a notable outperformer, driven by rising demand for warehouse and distribution facilities.

REIT NAV discounts remain wide both locally and globally, which is a positive for M&A activity, but may be offset by a still-tough financing environment. The four factors that have determined the share price performance of M&A companies post the deal announcement have been:

1) Immediate earnings accretion,
2) Neutral or improved level of gearing,
3) Improved portfolio quality and
4) Strategic benefits, such as economies of scale, enhanced liquidity and lower cost of capital.

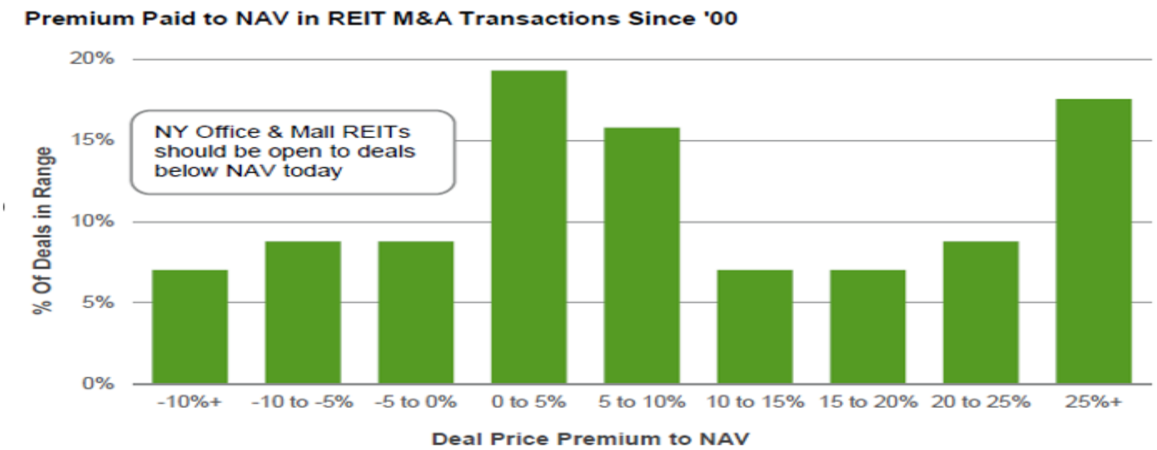
Morgan Stanley conducted research on 64 Global real estate M&A transactions valued at $337bn from 2017-2022. The average deal premium was +12.8%, with circa 40% of transactions by value being public REIT privatisations. While higher cost of capital and the risk of a mild recession have raised the return hurdle for transactions, estimates are that circa $300bn of dry powder on the sidelines and continued institutional appetite for alternative assets is supportive of more privatisation activity with a focus on higher quality assets.

**Figure 1: Global Listed REITs dispersion by subsector**




*Source: Morgan Stanley Research May 2023.*

GoodwinLaw's research on recent global real estate transactions involving publicly traded targets estimated an average purchase premium to the unaffected share price of 26.95%, with a median of 22.50%. This is notably higher than the historical average of 22.5%, and median of 16.7%, which represents the premium to unaffected share price calculated using all publicly traded transactions in their database going back to 2012. A factor likely at play is the pronounced disparity in recent years between NAV and share prices across many sectors. Greenstreet research shows that more than half of Global REIT M&A deals in the last twenty years have been at prices within 10% of the NAV of the target company.




*Source: Greenstreet Research*

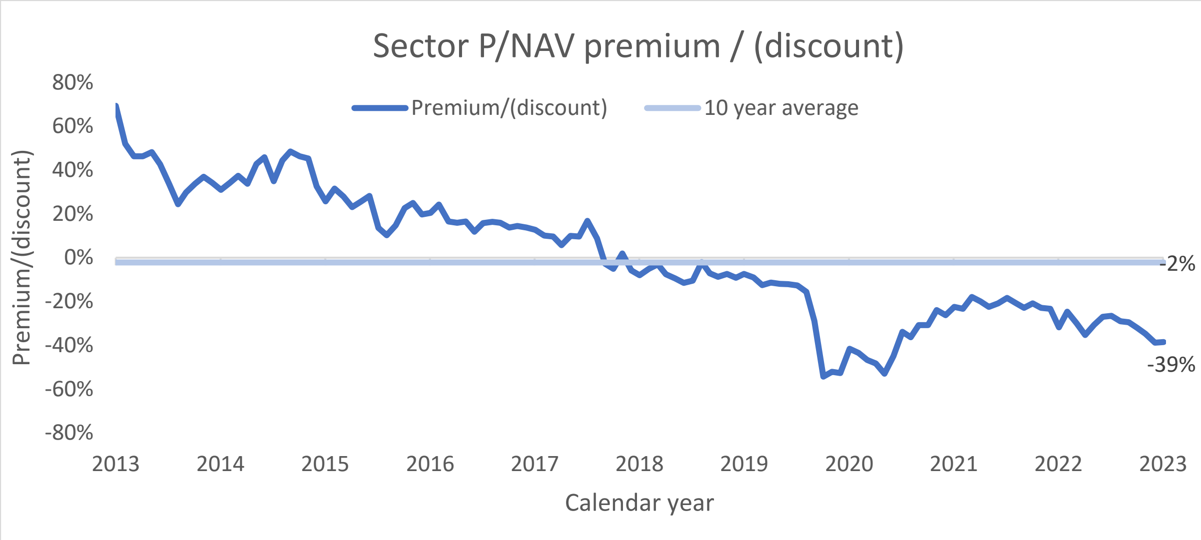
The lack of liquidity, increased costs of capital, and a significant discount to net asset value have led to an increase in much-needed consolidation in the South African listed property sector. We highlight some of the more substantial corporate action YTD (Table 1). We've observed that buyers have been opportunistic in bidding for property portfolios, offering prices below reported NAVs. Only the industrial sector was able to achieve prices above book value given the favourable fundamentals facing the sector. The price paid for the majority of the transactions has been at material premiums to spot prices, unlocking significant shareholder value in the process. Key themes from the below corporate action include a focus on sector specialisation, increased investment in sectors with strong fundamental underpin, expected cost synergies, reduced gearing, and improved liquidity.

**Table 1: SA Listed Property - Corporate Action YTD**

| # | Buyer | Target | Deal Type | Target Property Sector | Purchase Price | Premium to 30/90day vwap | NAV pre-offer | Acquisition discount/premium to NAV/Book Value |
|---|---|---|---|---|---|---|---|---|
| 1 | Emira | Transcend | Emira intends to make an offer to acquire all of the issued ordinary shares in the share capital of Transcend not owned by Emira | Residential | R6.3/share | 10.50% | R8.2 | -23% |
| 2 | SA Corporate | Indluplace | Cash offer for the entire issued ordinary share capital of Indluplace | Residential | R3.4/share | 12.80% | R6.6 | -49% |
| 3 | Blackstone | Industrials REIT | Cash offer for Industrials REIT to be taken private | Industrial | 168p/share | 40.60% | 162p | 4% |
| 4 | GEPF | Attacq/ AWIC | Acquisition of 30% of Attacq Waterfall Investment Company Proprietary Limited ("AWIC") | Diversified | R2.69bn | n/a | R3.16bn | -15% |
| 5 | Herriot | Safari | Cash Offer - Public REIT acquiring Public REIT | Retail | R5.6/share | 7.7% | R9.2 | -39% |
| 6 | Various | Rebosis | Property disposals in line with Rebosis' business rescue plan | Diversified | R7.66bn | n/a | R8.27bn | -7% |
| 7 | Standard Bank/ Liberty | Liberty 2 Degrees | Acquisition of all of L2D's issued ordinary shares | Retail/Diversified | R5.6/share | 46% | R7.59 | -27% |
| 8 | California State Teachers' Retirement System and Panattoni UK | Equites | UK Land Sale | Industrial | R1.44bn | n/a | n/a | n/a |

*Source: Catalyst FM, Anchor Research*

REITs trading at discounts to NAV are more likely to be targeted in M&A transactions. Acquirers can purchase the REIT at attractive valuations relative to the private market value, and target shareholders are satisfied to sell at adequate premiums to their current stock price. Given that the SA-listed sector continues to trade at a significant discount to net asset values, and based on publicly available information, we believe more corporate action is likely to take place. We view corporate action as another avenue that management teams and boards can explore to unlock value, and we remain supportive of transactions that, on the whole, lead to an improvement in portfolio quality and increased shareholder value in the long term. Potential corporate actions in the sector include Growthpoint and Capital & Regional, Hammerson's disposal of Value Retail (VA) portfolio, Fortress capital restructuring, iGroup purchase of remaining shares not owned in Emira, and Vukile increased stake in Spanish retail landlord LarEspana.




*Source: Catalyst Fund Managers, Data as at 20/09/2023*

The sector's discount to NAV as of 20th September 2023 was 39%, which continues to be below the historical 10-year discount to NAV of c. -2%. NAV growth is expected to be subdued at best reflecting the weak economic outlook, potential capitalisation rate expansion (due to higher bond yields), and the possibility of further downward revisions to market rental growth assumptions. A material dispersion still exists between geographies, with SA-centric companies at a discount to NAV of 43% and offshore companies trading at a discount of 28% and within subsectors. Although the uncertain macro environment will likely continue to drive elevated volatility in asset prices both locally and abroad in the short term, we currently expect the SA Listed Property sector to deliver total returns of between 13% – 16% per annum over the long term.

"Buying something for less than its value. In my opinion, this is what it's all about—the most dependable way to make money. Buying at a discount from intrinsic value and having the asset's price move toward its value doesn't require serendipity; it just requires that market participants wake up to reality. When the market's functioning properly, value exerts a magnetic pull on price." – **Howard Marks, The Most Important Thing**

**Glacier Research would like to thank Mvula Seroto for his contribution to this week's *Funds on Friday***

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Mvula joined Catalyst Fund Managers in 2014 as an Investment Analyst. He started his career at PricewaterhouseCoopers (PwC) working in the Insurance and Investment Management division. He is a qualified Chartered Accountant CA (SA) and a Chartered Financial Analyst (CFA) charter holder. Mvula further completed the Property Development Programme at the UCT Graduate School of Business (GSB) in 2016.