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Over here, Carl Icahn!

The bullish analysis of CBL & Associates Properties, Inc. in the May 15 issue of *Grant's* has so far delivered a bearish result. Following is a reexamination of facts, premises and analyses. Racing down to the conclusion, we remain bullish—more so, in fact, in view of the splattered share price.

CBL is a Big Board-listed real-estate investment trust (market cap: $2.3 billion; shares outstanding: 170.5 million) that trades under its very own initials. It owns 80-odd "B"-quality shopping malls and outlet centers mainly in the Southeast and Midwest as well as some office buildings and other lesser miscellany. Most of its shopping centers are many miles from the nearest retail competition.

You might remember the opening sentences of our springtime report: "In general, if a parking spot on a Manhattan street appears to be unoccupied, it isn't a legitimate parking spot. So, by analogy, on Wall Street. If a company appears to be cheap in the sixth year of a bull market, it probably isn't a legitimate company, and it probably isn't cheap."

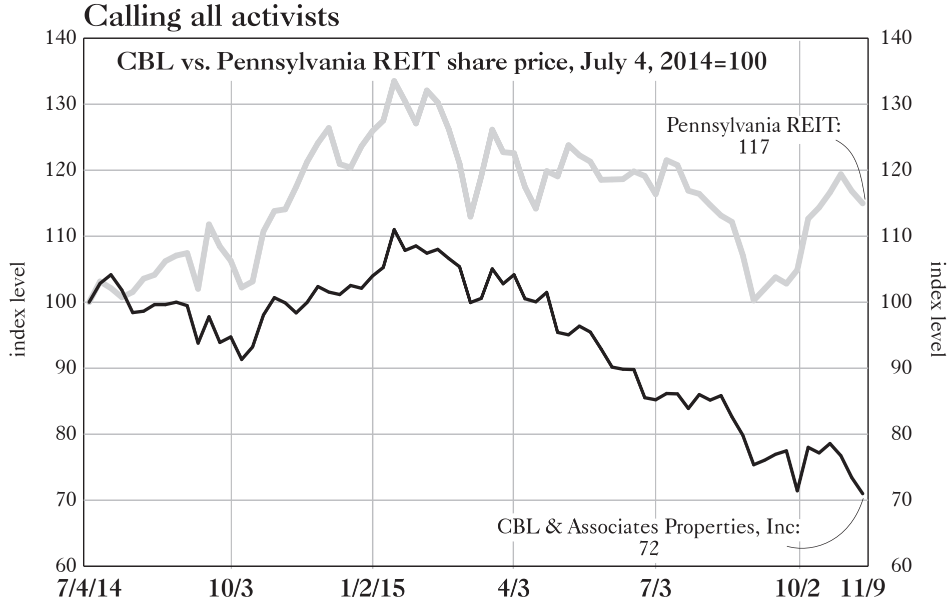
CBL is a legitimate company, all right. Its "B" malls, untroubled by close-in competition, generated growth in sales per square foot of 4.2% in the 12 months through Sept. 30. It's a result much sturdier than the ones reported over the same span by "A"-mall operators Simon Property Group (up by 0.5%) and General Growth Properties, Inc. (up by 3.3%).

Still, admittedly, CBL does have something of the figurative empty Manhattan parking spot about it. For one thing, no REIT is above suspicion now that interest rates may (or may not) have begun a long journey higher. For another, as mentioned in May, "the company gives the share price, therefore the stockholders, short shrift." The shortness of that shrift was underscored in June when management announced its purchase of a North Carolina shopping center for $192 million, a price equivalent to a low-6% cap rate. Before the news broke, CBL changed hands at $17.50, which implied a company-wide cap rate of 8.4%. Just why the front office decided that the Mayfaire Town Center and Community Center, of Wilmington, N.C., was a better investment than its own value-laden shares was a mystery. Nor could exasperated investors square the purchase with management's announced intention to shrink the portfolio by selling 19 underperforming properties.

"One anonymity-seeking investor in CBL (aren't they all, now?) describes the market's reaction to this provocation as 'hate-selling,'" colleague Evan Lorenz reports. "He tells me, 'We kept pushing and pushing them to do a share buyback, and they went off and bought Mayfaire. Their answer to us was, "It was a good thing we didn't do the buyback, because we would have been buying the stock at $17–$18 and now it is at $14." Our frustration is that the stock is at $14 because they weren't buying at $17–$18.'"

You wouldn't call Mayfaire a terrible investment. A local shopper would have to drive 100 miles to find a retail

Calling all activists



source: The Bloomberg

Cost of mistrust

source: The Bloomberg

alternative. Wrightsville Beach, a nearby affluent tourist community, furnishes a ready source of Mayfaire patrons. "The center has roughly 20,000 square feet of vacancy that we anticipate leasing with high-quality retailers," CEO Stephen D. Lebovitz (he's the son of the founder, the eponym Charles B. Lebovitz) told auditors on the second-quarter conference call. "Additionally, we are in the predevelopment phase to add 75,000–100,000 square feet on developable land that was acquired with the project." In other words, CBL paid a prospective cap rate closer to 8%-plus rather than 6%-plus—if, that is, management can deliver on its promises.

CBL blotted its copybook a second time when it pulled a bond offering on Sept. 28, the day of the scary break in the share price of commodity bellwether Glencore Plc. Then, again, Santander Holdings USA, Inc. and Westfield Corp. canceled debt financings on the same tumultuous day. CBL was back on Oct. 2 with $314.5 million of 10-year secured bank loans at a borrowing cost of 4.07%, a 1.78% improvement from maturing loans. More refinancings followed, each shaving basis points off the annual interest bill and leaving CBL with no major debt maturity closer than October 2017 (or October 2019, if management so elects; it has that option).

The consensus of opinion among the major ratings agencies (Standard & Poor's weighed in for the first time in September) is that CBL is a weak triple-B credit, investment grade but barely. Management tells Lorenz that it has ambitions to improve its credit profile by reducing its principal leverage ratio. At last report, debt was 6.9 times greater than earnings before interest, taxes, depreciation and amortization; 6.0 is the target.

Perhaps, having demonstrated its ability to tap the public-debt markets, management determined that the shareholders had had enough good news for the time being. So it was that on the Oct. 29 earnings call, Lebovitz passed along the stock-price wilting news that the company's asset–sale program, which had been slated for completion by early 2017, would in fact take much longer. Would the company, then, dialers-in wondered, consider selling some of its premium, therefore presumptively liquid, properties in order to close the gaping difference between the share price and the net asset value per share? The answer—prefaced with much hemming and hawing—was no. Nor, to date, has the company bought back a single share under the $200-million repurchase plan that the front office had tossed, bone-like, to the hungry owners. As for the insiders, in the year to date they've bought a grand total of 795 shares at an average price of $17.11. It's set them back by $13,601.25.

Lorenz asked, What's the holdup on the planned sale of the company's marginal shopping centers? Relaying by email, Katie A. Reinsmidt, senior vice president of investor relations and corporate investments, cites "the difficult financing environment." The would-be buyers are willing, she says. The problem lies with the would-be lenders: "Given this change in the market, we believe that the timeline we originally set is no longer realistic. However, the disposition of the remaining 19 malls remains a top priority for our company."

She continues: "We made the decision to dispose of these properties due to their lower growth rate; however, they provide CBL with an excellent source of cash flow which we are reinvesting in higher-growth properties. These centers are often the only mall in the market, serving as a retail hub. Occupancy in these centers is strong, and we have consistently strong retail demand. In fact, one of the trends we've seen in this section of our portfolio is the consolidation of retail into the mall, which serves to strengthen the mall's long-term position in the market."

Reinsmidt adds that the company has high hopes for the profitable disposition of its collection of community centers, or strip malls: "That market is very strong, and we anticipate it will be a great source of capital to reduce debt and potentially repurchase stock. We anticipate raising at least $100 million of equity."

Let it be noted that D.J. Busch, senior analyst at Green Street Advisors, does not wholly share this cheerful outlook. "We are making our best guess as to what low 'B'- and 'C'-mall property cap rates should be in the private market," Busch tells Lorenz. "There has been a lack of any transactions. The financing market appears to be closed for this asset quality. If there is no financing available, what is the right valuation for these properties? It might be much lower than we think. There may still be some downside risk to where our NAV estimate is currently, which would make it seem like it is a lower discount than what we are ascribing."

As it is, Busch relates, CBL trades at the deepest discount to estimated net asset value of any of the 85 stocks (77 REITs and eight hotel companies) in the Green Street analytical universe. A 34% discount at the time of our May story has ripened, let us call it, to a greater-than-40% discount today.

What, then, is the value of a stock that offers a 7.8% dividend yield and trades at a 9.3% cap rate? Our nameless CBL bull ruminates:

"We go through all the tier-1 assets, and they are worth roughly $15 a share. The tier-2 assets are $16 a share. The tier-3 malls are worth $4 a share. So, call that $35 all in. They are also selling non-mall assets like community centers and associated centers. That nets to about $2 a share. That is $37. There is $12.50 of debt between the individual mortgages, the bank loans and the preferreds. So, the net asset value is $24 and change. A private-equity guy coming in here could sell the entire portfolio today for $24. But, I say, forget about that, because clearly this thing is not going to trade at $24 because of all this concern about the tier-3 malls. So let's throw those away, and we are at $20.

"That is what gives us confidence here," our source continues. "Even if you forget about the tier-3 assets that they are trying to sell and that creates this noise, they are not a large part of the value of the portfolio. That's why they are trying to sell them. If they just wrote them off you would still have $20 of value. Even if the stock doesn't trade to that NAV, we are at what? $18 or $19? It doesn't matter, there is no way I'm selling right here."

Still cheap

CBL's valuation compared with other mall REIT peers

	share price	div. yld. (%)	P/2015 AFFO	implied cap rate (%)	net debt/ EBITDA
CBL & Associates Properties, Inc.	13.63	7.8	8.0	9.3	6.9
Rouse Properties, Inc.	17.54	4.1	13.4	7.2	10.8
WP GLIMCHER, Inc.	11.54	8.7	9.0	9.2	7.0
Pennsylvania REIT	22.00	3.8	19.3	6.6	14.0
Simon Property Group, Inc.	194.46	3.3	21.7	4.6	5.7
General Growth Properties, Inc.	26.84	2.8	23.6	4.1	8.5

sources: The Bloomberg, Green Street Advisors

The father-and-son CEO-and-chairman team, Stephen and Charles B. Lebovitz, together hold only 2% of the shares outstanding. Including the holdings of employees and board members, insiders own an aggregate of 11.5% of the stock. We draw these facts to the attention of Carl Icahn.

Perhaps the great Icahn is otherwise engaged. One now recalls how Land & Buildings Investment Management, a Stamford, Conn.–based investment adviser that takes an activist approach to real estate–related situations, began building a stake in Pennsylvania Real Estate Investment Trust in the second quarter of 2014. Under the hot breath of Land & Buildings, Pennsylvania named Michael J. DeMarco, a former executive vice president of Vornado Realty Trust and current president and COO of Mack-Cali Realty Corp., to the board. Good things followed, including an accelerated tempo of dispositions of Pennsylvania's underachieving malls. Since June 30 of last year, the Pennsylvania share price has vaulted by 17%. Over the same span of time, CBL has declined by 28%.

In May, this publication asserted, "What the management of Penn REIT did, CBL hasn't done. That it may one day emulate Penn REIT is at the heart of the bullish case on CBL." And so it remains.

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