

# BusinessSpectator

## COMMENTARY

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### KGB INTERROGATION: Glenn Rufrano

**Alan Kohler:** Glenn, you've been in the job since February, when you were pitched into a fairly interesting situation. How are you finding it personally?

**Glenn Rufrano:** Well firstly, I like Melbourne! [LAUGHS] It's a pleasant place to have moved to. My wife and I are here now and I think that's an important backdrop actually, because the business in itself means that you better like where you're living.

In terms of the job and the position, knowing a bit about Centro – I'd been here since last April – I expected that it would be a complicated situation. Complicated in that there are a number of lender groups and a number of lenders within the groups. Complicated because of the debt positions at either the parent company CNP, Centro Retail (CER) and the Super LLC [the vehicle for its US interests]. So I can't tell you that on a personal level there are a whole lot of surprises on the job. The intensity has probably been greater than I thought because the co-ordination across the continents and the 14 hour or 16 hour time difference makes completion of what you think would be something easy to complete take longer. But I don't think there are enough surprises either in the geographic move or the job itself that would disturb me.

**AK:** Have you learnt things about yourself that you didn't previously know?

**GR:** I'm not sure. I'm 58 so I know my frailties well and whatever strengths I have. At times I've learnt that I have more patience than I thought and then at other times I've learnt I have less patience than I thought.

**Robert Gottlieb:** Glenn, we're seeing the Westfield results affected by the US downturn. How have the operating results of Centro's US centres have been affected by that downturn?

**GR:** I'll start out with just a basic understanding of the logic of our business and then I'll answer that. We are in the shopping centre business. It's the open air shopping centre business. Much different than Westfield. We have in the States almost 700 shopping centres, predominantly grocery oriented. I don't think Westfield has more than 50 shopping centres in the States. So we have great diversification by geography, diversification by tenant and diversification by various formats.

I think there's one other important factor. Shopping malls in the United States have as a large proportion of their income percentage rents which are rents based upon sales. We have virtually none of that in our smaller shopping centres in the States so we are more diversified.

Frankly, it will take longer for the consumer issues in the United States to have an impact on our economics. As of February, our occupancies were holding at about what they were in December and our non-operating incomes (NOI) were about the same. I do expect from February going forward this year we will have some occupancy decline and we'll have some NOI decline but I don't believe we'll feel much of a dramatic influence because of the nature of our diversification, our locked-in leases and not as much dependence upon sales and percentage rents.

**RG:** Do you have to sell a portion of the US centres and how much would they have fallen below book value?

**GR:** Hard to say, because it's a question of book value. In the United States we don't have current value accounting so we're not sensitive to book values. We think about what is the value. Values go

up and values go down. Clearly values I believe have gone down from our last book value estimate. I say that even though there's not been a lot of transactional activity.

That's been the key issue – everybody's guessing. I would go based upon quality of asset and cap rates and there's an expectation that if you have an "A" quality of asset that perhaps cap rates could be higher by as much as 25 basis points. A "B" asset could be anywhere from 50 to 75 basis points. A "C" asset could be anywhere from 75 to 150 basis points higher. That would be the gradation of cap rate differential but that's an estimate, not based on fact.

**Stephen Bartholomeusz:** Glenn, can we shift the focus a little bit to what happened this week. How tense were the negotiations with the banks and did you ever doubt you'd get the extension? Did you fear that Centro would be forced into administration?

**GR:** The logic of this situation is compelling and I think you at *Business Spectator* have expressed it better than anybody. The logic is that it is much better for the banks and Centro to work together longer term than not. And that logic holds as long as we at Centro are doing our jobs and managing and leasing and running the funds management business properly. I believe that logic is correct. I believe we are doing the right job. I believe the banks believe we're the right people to run their collateral. Therefore, regardless of how tense those negotiations were, I fully believed they would be concluded.

**SB:** While there's an agreement to a December 15 extension, there are intermediate checkpoints, so the banks have to agree amongst themselves for a start. Given the behaviour of a couple of them this week, are you confident they can actually come to a consensus themselves?

**GR:** I'd start off by saying something I mentioned before. We have three different groups with multiple players in each group. By and large, most of the players agree with the terms and conditions of the extension. We do have because of some consideration – some of them outside everybody's control – a requirement for some time frame here, which is three weeks for the inter-creditor agreements. I think it's an adequate amount of time. I think the logic is still compelling and I think it will happen.

**SB:** To get past December without the banks demanding all their money back, do you have to put some sort of substantial solution in place or would it be enough simply to have started reducing debt levels?

**GR:** I would say from a personal standpoint I would want to put a substantial solution in place. I think it's the right way to proceed. This company needs to be put back on track in order to have good long-term value and I would hope and expect we would have a long term viable solution in place by December. Now, after I say that we're always subject to market conditions and if for some reasons market conditions were such that we could not put the right long term solution in place by December we may be able to have some alternative, whatever that alternative plan would be. It could be to pay down of some debt or continue to create within the company simplification. Again, it's only again interim step to ultimate restructuring which is the long-term solution and it would only be necessary beyond December if the markets didn't cooperate with us.

**RG:** CNP has an asset backing of \$1.31. Is that realistic given the US situation? Does it include the management contract value?

**GR:** The \$1.31 does not. The \$1.31 represents only the assets and not the services business. In terms of the US component of that, could the rise in cap rates I just mentioned to you in the US cause loss of value there? Yes. How much I'm not quite sure, but what I would also point out just in all fairness we're certainly having in Australia a potential change of cap rates too. Around the world value has been lost in almost every asset form, although I'm not sure about commodities – you seem to do pretty well in your country here or there. [LAUGHS]. But in many cases asset values have gone down.

**RG:** The same thing would apply to CER with its asset backing \$1.65. That also might become under pressure given what's happening in the US and possibly Australia.

**GR:** Absolutely. I would say that all asset values have been under some pressure from December to today in Centro, but also in every other real estate asset holding company we're talking about.

I don't think that's the most important issue. People can believe otherwise, but what really counts to me as an operator of business is not that value goes up and down. It always goes up and down. No one complains when it goes up. That's the issue. They always complain when it goes down. But as the operator of the business I need to maintain long-term the value of the business. As long as we can continue to run those businesses properly, or run those functions within the business properly, whatever loss we will have between December and this year we'll regain. And we'll regain with a plus for the value added that we've created.

**RG:** What are you doing to secure that management contract business that is obviously core to the Centro exercise?

**GR:** The management contract business gets secured first of all by doing our job right. As long as we continue to manage and lease and develop our properties properly, that's the number one test.

The number two test, which I know you're talking about, with all the managed funds is how can we maintain those contracts in light of the fact people like [Pelorus](#) for instance would choose to take them from us. And the way we're dealing with that is the way we've dealt with Pelorus the first time. We went to our investors. Our investors supported us. They realised that we had provided good returns. As long as we provide those I have confidence that longer term we should be able to keep the contracts.

**RG:** When you sell a shopping centre will you give preference to those who will keep Centro as a manager?

**GR:** There may be circumstances where that's the case where we believe it's a strategic holding for the company. There may be other cases where it's less important.

**SB:** Glenn, you said you've said you've had offers for the Australian and the US wholesale funds. You've had offers for individual assets and you've had offers to recapitalise the group. How would you characterise those offers? Are they opportunistic and will the extension put you in a better negotiating position?

**GR:** Without a doubt the extension puts us in a better negotiating position because without a longer-term extension we are perceived as unstable. If we're perceived as unstable, buyers will attempt to take advantage of us. There's no doubt about that. A longer-term extension does one simple thing. It gives us stability at which point we can have a more honest conversation with buyers. In terms of portfolios versus individual assets, in markets where debt becomes more difficult – and clearly that occurred in the United States at least a year ago if not more and it's starting to occur here – the larger the transaction the larger the potential discount to value because of the difficulty of obtaining debt.

We went through this and have been going through this in the United States and so we are finding that there may be situations whereby breaking up portfolios – such as in the case of the Centro Australia Wholesale Fund (CAWF) as we've announced – and selling assets to more strategic players who can provide in a more reasonable manner the debt, we may be able to get better value for the portfolio. It's a marketing strategy which in this market which is a dearth of debt, may make more sense.

**AK:** Would you consider offering packages of the shopping centre assets to the existing syndicate holders?

**GR:** If we've chosen assets that we believe are disposable assets, the buying group should be whoever provides the highest price. Certainly if there is a group within the syndicates who would be the best strategic buyer and is willing to pay the highest price, absolutely.

**SB:** You referred a bit earlier to your desire to simplify the structure. In a broad sense, assuming Centro's still around in 12 months or 24 months time, what would you like it to look like?

**GR:** The first part of simplification is not necessarily taking the managed funds and making wholesale changes. It's trying to simplify the inter-fund investments. To me, that is the more complicated part of Centro. So what you'd like to see in 18 to 24 months would be that inter-company form of investment no longer existing. Therefore, you're dealing with each managed fund without the conflicts of having internal investment.

**AK:** What about removing some of the tiers? For instance putting CNP and CER together?

**GR:** If I started out and just tried to create our structure visually for everyone, you've got CNP at the top. Then you have Centro Direct Property Fund and the Centro Direct Property Fund International in the middle, which are fund of funds. Then you have what I would call the managed funds, which are the syndicates, Centro Retail and the wholesale funds, the Centro America Fund and the CAWF. I call them managed funds because that's where the assets are.

Folding any one or two or three of those together may make sense, depending upon the long-term viability of what results. So that if there was an instance where – and I'll just take your example – where it made sense for CER and CNP to merge and long term you believed the value of the combined entities could do well relative to its public peer group, that may make sense. I think that before you make those simple deductions you probably have to think about the inter-fund investments before you could start combining any one, two or three of these.

**RG:** On the management contract business, how difficult would it be to sell off equity in that business and actually therefore pay a tangible value.

**GR:** Let me just define what we call here the services business because this actually was a new concept for me. Not a new concept, new phraseology coming out of the States. The services business for Centro has basically four income streams. The first one is the funds management business, which is really an income flow and therefore value is based upon the ability to access capital and create products from retail real estate from that capital. So that's the funds management piece. Then the last three – management, leasing and development – are income streams based upon your ability to manage lease and develop real estate assets, in this case retail in two countries.

So there are very different disciplines, very different functions, very different talents. All very valuable. It's all called the services business. Four different pieces.

Now to get to the question, could you monetise those? I'd say you could. You could have someone who is interested in the funds management piece – the access to capital and product creation. And then there could be someone interested in the property management piece – the management, leasing and development.

And then there could be someone who was interested in the entire spectrum. If you control all the funds management and property management, it's easier to control the income flows, which is really the basis for Centro. If you have the funds management business and control access to capital and products, you have the better means of controlling the contracts back at the management, leasing and development level.

The probability therefore is that most parties that have an interest would probably have an interest in all four streams. So that there can be a level of control and durability and probability to those streams long-term, and that would allow us to have the highest price. Those considerations have been made at the company level and at some point could be entertained as part of the capitalisation of the company or recapitalisation of the company.

**RG:** In book value terms, the management business is basically a bonus, isn't it?

**GR:** That's exactly right. It's over and above. Now, in our balance sheet we have extracted the management business from the \$1.30 but we also have an intangible number. The intangible number is goodwill and it's about \$1.7 billion as of December.

**RG:** Is that realistic or is it worth more than that?

**GR:** On February 29 we had our call to the market, where we introduced the December numbers and question came out about the value of the business. In order to establish the value of the intangibles on the balance sheet from an accounting standpoint, the company has to give an indication of what it believes the value of the services business is. We did give you that indication and we announced on February 29 that the company thought it was about \$3 billion. And that was down substantially. If you remember well before I got here, there was an outside valuation done of KPMG, I believe in early 2007 or late 2006 of \$5.5 billion.

**SB:** Are you now more confident as a result of the events of this week that when this process is over there will be something meaningful left for the equity holders?

**GR:** I've been fairly confident of that all along as long as we had the time to execute and if our financing group allowed us to have the stability to execute our plan. I believe what happened this week puts us one notch higher in that probability.

**SB:** Glenn, thanks very much indeed for your time and we wish you the best of luck.

