
THE STANGER REPORT™

A GUIDE TO DPP, NT-REIT & NT-BDC INVESTING

VOLUME XXXIX - SPECIAL REPORT

JANUARY 3, 2017

EDITORIAL OPINION

Bottom of the Ninth – RCA Investors At Bat

Will AFIN and ARC Global “Pitch” the Perfect Game?

Pitch (Verb) – Definition from the English/Oxford Dictionary:

In Sports – to throw the ball for the batter to hit

In Business – to try to persuade someone to buy or accept something

The success of many endeavors is often reliant on the quality of the “pitching.” In the world of sports, at no time is the focus on pitching more intense than during the World Series. Fans and commentators wish for the almost unimaginable “Perfect Game” where one pitcher squares off against 27 batters, none of whom make it to first base. During the 140 years of Major League Baseball and over 210,000 games played, only twenty-three Perfect Games have ever been pitched and only one during a World Series (Don Larsen in the 1956 World Series between the NY Yankees and Brooklyn Dodgers). The team which pitches a Perfect Game never loses. In theory, baseball has a “Perfect Perfect Game” where the pitcher strikes out each and every one of the 27 batters he faces – an almost unimaginable feat that has never been accomplished.

In business, the “pitching” is equally important, especially when it comes to major transactions proposed by a company. And so it is with the proposed merger of American Finance Trust (“AFIN”) and American Realty Capital Retail Cen-

ters of America (“RCA”), where the “pitcher” is AFIN and its advisor, AR Global LLC (together, the “AFIN Team”) and the batter, up until the ninth inning, has been the Special Committee of RCA (the “RCA Special Committee”). Through the first eight and two thirds innings the RCA Special Committee has stood in the batter’s box on behalf of RCA investors and faced the “pitches” thrown by the AFIN Team. Now, the pitching to the final batter of the ninth inning has commenced with the release of the proxy solicitation statement, and the RCA investors have at last come into the ballgame and are at bat.

Before we tune in to the live action, let’s follow the play-by-play (based on the chronology in the recently filed proxy solicitation statement) to see how the RCA Special Committee has fared against the pitches thrown by the AFIN Team.

Pre-Game Warm-Up: (The Concept) Managements concluded that the game should be played between two teams which in reality are in different leagues. AFIN owns a disparate portfolio of 459

small, single tenant net leased properties at an average cost of \$4.8 million. RCA owns a focused portfolio of 35 power and lifestyle centers at an average cost of \$36 million. RCA has lower leverage, a significantly lower debt cost, and better MFFO cash distribution coverage than AFIN. Moreover, RCA has the potential to increase shareholder value significantly by using its excess financing capacity to make additional acquisitions and from active management by Lincoln Property Company¹, one of the nation's leading real estate investment and property managers with recognized expertise in adding value to acquired retail properties.

1st Inning: (Process) The game plan and players engaged by the RCA Special Committee in the process of evaluating strategic alternatives, deciding on a course of action and conducting the negotiations for the transaction set the field of play. Despite the size and property specific focus of the RCA portfolio which makes it an attractive and financeable cash acquisition candidate, the RCA Special Committee eschews marketing the portfolio and pursuing an all-cash transaction with an independent, third-party buyer or a merger with an existing independent, publicly traded company – both of which would have provided RCA investors with a liquidity option in a non-conflicted transaction. Instead, the RCA Special Committee entangles the RCA investors in a complicated, affiliated-party, non-cash, non-liquidity-providing transaction with AFIN – Strikeout #1. In pursuit of that transaction, only the RCA Special Committee will square off against AFIN pitching. The RCA Special Committee apparently never engages in any substantive dialogue with a third-party buyer prior to approving the merger – Strikeout #2. Instead, it subjects the final merger agreement to a “45 Day Go Shop Period” in an attempt to legitimize a flawed process – Strikeout #3. So, we score this as three strikeouts against RCA.

First Inning RCA At Bat: Three up; three down.

2nd Inning: (Consideration Paid) The merger is ultimately pitched with total consideration to RCA investors of .385 shares of AFIN plus \$.95 in cash in exchange for each share of RCA. But AFIN shares are not listed, so RCA investors will not obtain liquidity through the transaction. Interestingly,

the proxy also discloses that AFIN has been approved for listing on the NYSE, reinforcing the appearance of near-term liquidity at a time when retail REITs are trading at a 12% discount to net asset value – Strikeout #1. The value of AFIN shares has been set not in efficient trading markets but rather by estimates of underlying real estate value – Strikeout #2. Value estimates contained in the proxy solicitation statement show that the consideration paid to RCA investors could be as low as \$8.58 per share, a midpoint set by UBS as investment bankers to AFIN. By our estimates, this price, and offering the post-merger AFIN stock as currency, are inadequate compensation for the RCA investors – Strikeout #3.

Second Inning RCA At Bat: Three up; three down.

3rd Inning: (Apparent Exclusion of Asset/Property Manager from the Process) Lincoln Property Company, the firm which assembled the RCA portfolio and conducted asset and property management and leasing services, apparently is being left in the dugout during the entire game. Based on the absence of any reference to Lincoln in the proxy disclosure of negotiations, the firm most familiar with the RCA portfolio apparently is not consulted during negotiations on the transaction – Strikeout #1. Similarly, Lincoln apparently never gets an at bat in connection with the negotiation of the pricing of the merger – Strikeout #2. Most disturbing, there appears to be no assurance that Lincoln will continue to be involved in the asset and property management and leasing of the RCA portfolio post-merger (in fact, there is a reference to a risk of Lincoln not being around). In stark contrast to Lincoln's qualifications, AFIN's advisor appears to have minimal if any on-the-ground experience performing such services for lifestyle center portfolios – Strikeout #3.

Third Inning RCA At Bat: Three up; three down.

4th Inning: (Onerous Management Agreement) As the fourth inning opens, the RCA Special Committee whiffs on the pitch that moves its investors post-merger into an externally-advised REIT with a 20-year, virtually non-cancellable, management agreement with ARC Global – Strikeout #1. Mak-

¹ In the interest of full disclosure, it should be noted that Robert A. Stanger & Company, Inc. has been previously and separately engaged to provide financial advisory services to Lincoln Property Company in connection with its initial entry into the non-listed REIT market and by the special committee of an ARC-sponsored non-listed REIT not involved in this transaction in connection with the extension and modification of its external management agreement.

ing a move to such an onerous long-term agreement would be expected to reduce significantly any valuation ascribed to AFIN shares if and when they are ever listed – Strikeout #2. To close out the inning, the AFIN Team pitches a curve ball to the RCA Special Committee – it provides for an escape from the 20-year, non-cancellable contract via paying AR Global an internalization fee that could exceed \$110 million. The RCA Special Committee swings and misses – Strikeout #3.

Fourth Inning RCA At Bat: Three up; three down.

5th Inning: (Elimination of Investor Protections). To enable RCA to merge into AFIN, the pitching includes asking RCA investors to approve the elimination of certain investor protection provisions of the RCA charter which would make the merger more difficult to consummate in its current form. This neutering of the RCA corporate charter includes: the elimination of the ability of RCA to dismiss its advisor due to poor performance or any other reason – Strikeout #1; the elimination of the investors’ ability to change the terms or length of the management agreement – Strikeout #2; and the failure to offer RCA investors any material amount of the consideration in the form of cash equal to the underlying net asset value per share of RCA – Strikeout #3.

Fifth Inning RCA At Bat: Three up; three down.

6th Inning: (Financial Advisor/Banker Potential Conflicts of Interest): UBS represents AFIN and Bank of Montreal (“BMO”) represents RCA in the merger. However, UBS is unable to advise the AFIN board on the revisions to the management agreement because UBS had previously represented AR Global during its negotiation of the terms of the advisory agreement with AFIN. At the same time, it appears from the proxy disclosure that BMO, the advisor engaged by the RCA Special Committee, does not provide any specific recommendation or opinion of fairness regarding the terms of the 20-year advisory agreement or the terms of the potential internalization of AFIN which will be inherited by the RCA investors after the merger – Strikeout #1. It is noteworthy that although BMO opines (on September 6, 2016) as to the fairness of the “*merger consideration*” to be received by the RCA investors in the transaction

(which consideration is shares of the consolidated entity), BMO never provides an estimated value of those shares. BMO also represented the special committee of, and received substantial compensation from, another AR Global affiliate, Global Net Lease II, an entity recently merged with Global Net Lease, Inc. (NYSE: GNL) involving the same conflicted process, and inclusion of a 20-year management contract to an AR Global entity, suggesting a possible high tolerance by BMO for conflicted transactions with entities managed by AR Global – Strikeout #2. Finally, both UBS and BMO will be paid substantial fees aggregating over \$9.6 million for this conflicted, affiliated-party transaction which fees are conditioned upon the completion of the merger – Strikeout #3. While conflicts of interest can exist in advisory/banking relationships and may be mitigated to some degree, their existence in this game is noteworthy given the many complicating issues related to the proposed merger and post-merger entity.

Sixth Inning RCA At Bat: Three up; three down.

7th Inning Stretch and Sing: “Take Me Out of This Merger”

7th Inning: (Failure to Evaluate Replacing ARC) Given the recent disclosures regarding the indictment of an officer and purported partner of AR Global and possible ongoing investigations relating to the firm and/or its officers or owners, no serious analysis of strategic alternatives involving RCA should fail to consider these facts. Yet, based on absence of disclosure in the proxy relating to consideration of the implications of this situation or the evaluation of continuing with or replacing AR Global as the advisor, the RCA Special Committee presumably goes down looking at the fast ball which blows these issues by the RCA Special Committee – Strikeout #1. Nor did the financial advisors/bankers perform any disclosed analysis of the comparative terms of the proposed management agreement or the implications of continuing with AR Global as advisor on the future performance or potential trading value of AFIN shares after the merger – Strikeout #2. Finally, the structure of RCA suggests a ready alternative to potentially replace the existing advisor – the company which assembled the portfolio, negotiated its acquisition, and provides asset and property management and leasing services for the portfolio – Lincoln Property

Company. Despite Lincoln's reputation as among the highest quality deal makers, asset/property managers, and value-add specialists in the retail real estate space and the firm's deep relationships with most major retailers, the RCA Special Committee apparently chose to leave Lincoln to languish in the dugout rather than ask Lincoln to make a plate appearance – Strikeout #3.

Seventh Inning RCA At Bat: Three up; three down.

8th Inning: (Failure to Require AR Global to Cover Failed Deal Costs): In a typical roll-up transaction, the sponsor is required to pay failed deal costs. However, the RCA Special Committee apparently did not see the knuckle ball pitched to them and will have RCA investors shoulder the costs of a rejected merger with AFIN -- costs estimated at \$10 million or possibly significantly higher. Ten million dollars equates to Strikeouts #1, #2 and #3 where we come from.

Eighth Inning RCA At Bat: Three up; three down.

9th Inning (Failure to Recognize Similarities to New York REIT): The RCA Special Committee and its financial advisor should have recognized the options available after witnessing the very public

failure of the New York REIT merger proposal. That transaction, proposed by AR Global and involving New York REIT and JBG Cos., was handily rejected as too conflicted, too self-serving and significantly mispriced. New York REIT ultimately moved to cancel the deal, terminate the AR Global-affiliate advisor and then commence a liquidation of the company. We score this failure as Strikeout #1 and Strikeout #2 of the ninth inning. Cancelling the merger is now in the hands of the next and last batter – the investors.

Ninth Inning RCA At Bat: Three up.....Two down.

BACK TO LIVE ACTION

With two outs in the bottom of the ninth, RCA investors are now in the batter's box. Despite the pitching of the AFIN Team and the 26 strikeouts incurred by the RCA Special Committee, the RCA investors have a chance to hit a walk-off home run in the bottom of the ninth inning by voting AGAINST the AFIN-RCA Merger.

Predicting the outcome of votes has recently been proven to be a fool's errand. However, we are cautiously optimistic that common sense will prevail and that the RCA investors, like the Chicago Cubs, will send their goat packing. ■