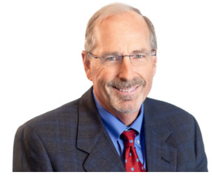
FEBRUARY 16, 2021



Bill Smead
Chief Investment Officer

Simon Says

Dear fellow investors,

When we were kids, we used to play a game called "Simon says." Everyone would line up and if the leader said, "Simon says take two steps," you took two steps forward. If the leader says, "take two steps forward" and you acted on the instruction, you were forced to go back to the starting line and be way behind your competitors. The object of the game was to get to the finish line first and then become the leader the next round.

The stock market has its own game of "Simon says" and that is in the mall property world. David Simon and his father Herbert Simon have been the leader of the Class A mall REIT world for decades. In their Q4 2020 earnings report, David Simon said some very important things:

> *"We earned $9.11 per diluted share and funds from operation (FFO) for the full year, which includes a $0.06 per share dilution from our recent equity offering in November. We generated over $2.3 billion in operating cash flow. We acquired an 80% interest in the Taubman Realty Group, made strategic investments in several widely recognized retail brands at attractive valuations and have already made significant progress in repositioning each brand and increasing their operating cash flow. We raised over $13 billion in debt and equity markets; opened two new international shopping destinations, expanded two others, completed three domestic redevelopments; abated rent for thousands of small and local businesses, regional entrepreneurs and restaurateurs who, frankly, needed our help to survive; paid $700 million in real estate taxes which, unbelievably, was an increase from 2019 despite losing approximately 13,500 shopping days in our domestic portfolio during the year due to the restrictive governmental orders placed upon us, and that's roughly 20% of the whole year to put in perspective; and we returned $2 billion in cash to our shareholders in dividends."*

Simon says that his company did about five things in one year that most companies would be happy to do in five years. They widened their moat, they flexed their financial strength and they paid huge dividends in the most difficult year in the retail world this side of 2008's financial crisis. Simon says, "We are moving forward!"

Simon says:

> *"Now, finally, let's move on to 2021 because I do, frankly, want to turn the page on 2020 as I'm sure we all -- as you all do. We feel confident we've turned the corner. We expect growth in cash flow and earnings. In 2021, our guidance is $9.50 to $9.75 per share."*

To maintain your REIT status, a company must distribute at least 90% of its taxable income to shareholders to escape being taxed on the corporate level. Therefore, only the shareholders pay the tax on distributions of funds from operations (FFO), minus whatever part of the FFO which is considered return of capital. This indicates a dividend restoration in the coming years from the current $1.30 per share per quarter to around $2.12 per quarter or around $8.50 annually. This indicates an 8% yield in a yield-starved world. It is also an inflation-adjusted forward yield because, as Scarlett O'Hara's Dad said in *Gone with the Wind*, "The land is the only thing that lasts!"

Simon says:

> *"Yeah. Listen, I can't sit here and make a prediction other than what I said earlier, which is I think suburbia is going to be -- really make a major comeback. It was all about street retail. It was all about urbanization.*
>
> *I think you're going to see a movement toward suburbs, and that will be -- that will spell a good opportunity for us. And I'm not overly concerned about people who are going to have their disposable income and go here and there. And I think we'll get our fair share of the growth that's expected when we get past COVID and resume our more normalized -- not overly worried about it."*

Millennials are moving out of the major coastal city downtown areas to the suburbs and to the mid-sized cities all across the country where suburban Class A malls dominate the shopping landscape. It currently costs $200 to rent an 8 by 11-foot trailer from U-Haul (Amerco; UHAL) to go from Phoenix to Los Angeles one way. The same one way from LA to Phoenix is $1,200.

Lastly, Simon says on valuations:

> *"We set the cap rates, so look at the Taubman transaction. We think the industry should be valuing us at the cap rate we paid to buy 80% of Taubman."*

At the 16 times FFO from July 1, 2019 to June 30, 2020 Simon Property Group (SPG) paid for Taubman, Simon would be worth $145.60 per share. It currently trades on February 11, 2021 around $110 per share. Simon Property Group would also spread significant income icing on top of the price appreciation cake as its dividend gets restored.

Macerich (MAC), another premier Class A mall REIT with a less fortress-like balance sheet, but a higher concentration of premier malls, is trading around $13 per share with FFO in the depressed 2020 year of $2.17. Macerich looks to rebound on the reopening of the U.S. economy to FFO of $3.15 in the 2021 to 2023 time frame. Based on what Simon says, they could be worth between $34 and $50 per share in the not-too-distant future (even if the Reddit Robinhood short squeezers stay in the Sherwood Forest). Macerich could also see dividend restoration to around $2.85 per year in that same 2021 to 2023 time period.

In conclusion, our research shows that most of the investable assets in the U.S. are in the hands of baby-boomer investors, who are looking for income in retirement. Your opportunity cost is skipping the 1.53% dividend yield in the S&P 500 Index or the 1.15% yield on the ten-year Treasury Bond. Long-term bonds and the S&P 500 are what Warren Buffett would describe as "the secret of life". This is because on an income basis they are, in his words, "weak competition." We would say it is a ticket to stock market failure. The rebound in the mall REITS could bring them back into favor as a source of retirement income and lay some serious capital gains in the laps of those who step when Simon says!

Warm regards,

William Smead

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