

publity

Stable AUM despite asset disposals

After being able to considerably grow its assets under management (AUM) in 2017 (albeit below initial management guidance), publity's focus in 2018 is on retaining the asset base in line with the prior year. Despite the disposal of several office projects covering 100,000 sqm of lettable office space in H118, AUM remained stable at €4.6bn. publity is confident the current advanced-stage discussions around asset purchases should allow it to maintain the AUM level at the end of 2018 despite another sizeable disposal announced in August. Meanwhile, the FY18 earnings guidance was lowered in June, discussions with bondholders continue and shareholders approved a new share issue.

H118 earnings meet revised company expectations

publity's H118 net income declined c 20% y-o-y to €4.4m despite a 3.6% y-o-y revenue increase to €13.3m, mainly due to costs associated with property disposals executed in H118 as part of its asset management business (reflected in other operating expense line). Management highlighted that the H118 result is in line with their expectations. This follows a downward FY18 guidance revision announced in June, with current net income expectations in line with the FY17 level (final reported at €10.1m) compared with earlier guided range of €15-20m.

Talks with bondholders still in progress

publity continues its discussions with holders of its convertible bonds to resolve the issue related to an alleged covenant breach. Bondholders representing 30% of the initial face value (c €15m) declared the bonds due and payable and publity has already repurchased €2.04m. publity has made an offer to refinance the bonds with a new convertible bond issuance with a higher coupon rate. Moreover, publity's shareholders approved the issue of up to 3.8m new shares to raise €40.5m of fresh equity.

Valuation: Reflecting profit uncertainty and dilution

publity shares are trading at a 53% and 26% discount to peer group on last 12-month (LTM) P/E and LTM EV/EBITDA ratio, respectively (no consensus forecasts are available for the company). We believe the main factors behind the low valuation include the ongoing discussions with holders of convertible bonds, dilution from the recently announced share issue, as well as overall uncertainty around future profits following the recent downward guidance revisions.

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/14	9.8	4.6	0.51	0.56	20.5	5.3
12/15	23.8	19.9	2.27	2.00	4.6	19.1
12/16	41.6	34.2	3.89	2.80	2.8	26.7
12/17	23.6	14.5	1.67	0.00	6.3	0.0

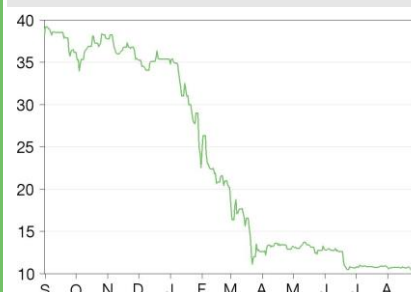
Source: publity

Real estate asset management

31 August 2018

Price €10.48
Market cap €63m

Share price graph



Share details

Code	PBY
Listing	Deutsche Börse Scale
Shares in issue	6.05m
Last reported net debt as at 30 June 2018	€35.6m

Business description

publity is an asset manager with a focus on German office buildings. It has a 17-year track record as an investor in commercial real estate in larger German cities and manages a portfolio worth €4.6bn.

Bull

- Experienced player with a focus on one segment of the property market.
- New asset management mandates with institutional investors.
- Strong demand in the German office market.

Bear

- AUM growth below earlier guidance.
- Dependent on banks for property sourcing.
- Funding risk associated with convertible bonds.

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Financials: EBIT down despite slight top-line growth

Despite the slight increase in revenues at 3.6% y-o-y to €13.3m, publity has recorded a 10.3% y-o-y decline in EBIT to €7.3m and a nearly 20% y-o-y drop in net income to €4.4m in H118 (see Exhibit 1). This was driven by a 33.0% y-o-y increase in other operating expenses, which is mainly the result of costs associated with property disposals realised in the first half of the year as part of the company's asset management business (in particular a large transaction representing total lettable space of 100,000 sqm), as well as expenses related to a claim settlement. Management revised its FY18 guidance back in June from the initial expectations of net income in the range of €15–20m (implying c 50–100% y-o-y growth) and is now guiding for a number in line with FY17 level (€10.1m), which implies a y-o-y improvement of c 24% in H218. Similarly, the company expects EBIT to be broadly flat y-o-y in FY18. This follows a profit warning issued in January 2018, when publity highlighted that FY17 net income would be below the FY16 level of €23.1m and that it missed AUM guidance (€4.6bn reported at end-2017 vs initial expectations at €5.2bn). publity has originally guided to AUM at €7.0bn in FY18, but subsequently applied a more cautious assumption in line with the FY17 level.

Exhibit 1: H118 highlights

€'000s unless otherwise stated	H118	H117	y-o-y change
Revenue	13,315	12,851	3.6%
Other operating income	259	51	405.9%
Cost of materials	(156)	(87)	78.3%
Personnel expenses	(937)	(941)	-0.4%
Other operating expenses	(5,709)	(4,291)	33.0%
D&A	(95)	(98)	-3.0%
Income from profit transfer	585	608	-3.8%
EBIT	7,261	8,092	-10.3%
<i>EBIT margin (%)</i>	<i>54.5%</i>	<i>63.0%</i>	<i>-843 bps</i>
Financial result	(645)	3	nm
PBT	6,616	8,095	-18.3%
Income tax and other taxes	(2,202)	(2,584)	-14.8%
<i>effective tax rate (%)</i>	<i>33.3%</i>	<i>31.9%</i>	<i>137 bps</i>
Net income	4,414	5,511	-19.9%
<i>net margin (%)</i>	<i>33.1%</i>	<i>42.9%</i>	<i>-973 bps</i>

Source: publity accounts, Edison Investment Research

New share issuance and further talks with bondholders

A significant part of publity's capital represents the €50m convertible bonds issued in November 2015 with a 3.5% coupon and five-year maturity. The bond terms include a covenant related to the dividend payout ratio limit at 50% of annual net profit. As the payment from 2016 earnings was done at a payout ratio of 72%, part of the noteholders (30%) declared the bonds due and payable. Even though the management considers these terminations as unjustified (see our [previous update note](#) for details), €2.04m out of the total c €15m declared amount has already been repurchased by publity. Initially, the company proposed an exchange of the convertible bonds for acquisition rights to a new bond with 7% coupon and a 3.5% mark-up for the first six months. The noteholders were not willing to accept the deal back then but voted in favour of appointing a single third party (One Square Advisory Services) to represent the remaining bondholders to resolve the issue. The convertible bond trades at around 82% of face value. It is worth noting that as at end June 2018 the company held cash and cash equivalents amounting to €14.4m. The company's net debt to equity ratio stood at 57% at end June compared with 73% at the end of 2017.

Meanwhile, publity's shareholders approved the issuance of up to 3.8m new shares (representing a 62.5% dilution) at a price of €10.70 per share. The issuance's success in raising c €40.5m of new share capital is underpinned by the declaration of TO-Holding (publity's main shareholder) that it

will subscribe for all new shares not subscribed for by other shareholders. The disclosed purpose of the issuance is to strengthen the capital base to fund future growth, but the offering is also associated with ongoing discussions with the convertible bonds holders, as some requested that publity raised additional equity. Still, it cannot be ruled out that publity will not be able to come to an agreement with the bondholders, which would likely lead to a litigation process and potentially force the company to redeem the remaining outstanding bonds early as well. Also, it is worth noting that the capital raise is conducted at prices close to all-time historical lows.

Office occupancy rates driven by strong take up

The German real estate market is shaped by a number of positive factors supporting further development. However, growth is also limited by persistent bottlenecks due to a shortage of workforce and general contractor capacity in the construction sector. Demand in the German office market remains strong, with H118 take up standing at 1.8m sqm, which is 18% ahead of the 10-year average, according to Colliers. At the same time, supply increased only moderately and, as a result, the vacancy rate for the big seven cities (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich and Stuttgart) reached a new record low level of 3.7% at the end of June 2018. As a result, average office rents increased across all big seven cities, with the strongest growth recorded in Berlin, Munich and Frankfurt (at 22%, 10% and 7% y-o-y in H118, respectively). The low vacancy rates in central business district (CBD) locations in selected cities has triggered the relocation of activities from CBDs to the city fringe submarkets (eg Munich, Hamburg and Düsseldorf). This may potentially prove beneficial to publity.

The tight demand/supply balance determines the characteristics of the properties publity is now acquiring. Initially, the company targeted properties with a certain level of vacancy, which are currently more difficult to find. All of the acquisitions announced by publity so far this year involved fully (or nearly fully) let office buildings, which require different value enhancement measures than merely an increase in occupancy rate. However, it should be highlighted that publity's 'manage-to-core' strategy is not solely dependent on the ability to find projects with vacant space. The company benefits from its multi-year market experience and well-established business relations with German banks, which enable it to quickly acquire properties at attractive prices. Moreover, publity is embarking on other asset management initiatives, including optimisation of the tenant structure, lease length and rent roll. Finally, the company may benefit from the current upward trend in real estate prices in Germany upon asset disposal.

Along with the recent property acquisitions, publity has concluded disposals of several properties, including the delayed transactions from FY17. The two sizeable disposals announced by publity so far this year represent a total letting space of 170,000 sqm and significantly exceeded the total area of projects acquired until date (c 45,000 sqm). According to management, further purchase transactions are to be completed in the upcoming months with multiple advanced-stage negotiations underway, which should allow publity to keep its AUM level stable versus the end of last year.

The company was also able to secure two institutional asset management mandates with a total volume of €500m. The first agreement with a US investment company covers 10 office projects with a total office space of 115,000 sqm, with a mandate to expand the portfolio to 25 projects. The second contract involves five office buildings with 100,000 sqm of letting area on behalf of another institutional investor. publity was also able to sign a contract with the acquirer of office projects recently sold by Consus Real Estate (the company originally signed an asset management mandate with Consus).

Valuation

In our view, P/E and EV/EBITDA multiples are the most appropriate measures to value publicly as it is an asset manager rather than a property fund, so it focuses on generating earnings rather than NAV growth. Given that consensus estimates for publicly are no longer available, we have also included last 12 months (LTM) ratios for both the company and its peers. The company's shares are trading at a 53% and 26% discount to peer group on LTM P/E and LTM EV/EBITDA ratio, respectively. This reflects the ongoing discussions with bondholders, earnings dilution resulting from the currently conducted share issuance and overall uncertainty around future profits following the recent downward guidance revisions.

As a further measure to strengthen its capital base (on top of the share issuance), the company decided to retain all FY17 profits and thus refrain from paying a dividend. As a result, the very attractive dividend yield valuation based on previous periods' payments as well as earlier consensus forecasts is no longer valid.

Exhibit 2: Peer group comparison

	Market cap (€m)	PE (x)			EV/EBITDA (x)		
		LTM	2018e	2019e	LTM	2018e	2019e
Corestate Capital	949.2	11.8	7.9	7.2	8.8	9.9	8.9
Patrizia	1,666.0	21.0	22.7	17.0	12.5	15.1	11.7
VIB Vermogen	639.9	12.1	13.2	12.5	15.1	15.1	15.0
TLG Immobilien	2,326.7	15.2*	12.8	14.8	10.1*	22.4	20.3
Peer group average	-	15.0	14.1	12.9	11.6	15.6	11.9
publicly	63.4	7.1	N/A	N/A	8.6	N/A	N/A
Premium/(discount) to peer group	-	(53.1%)	N/A	N/A	(26.3%)	N/A	N/A

Source: Company accounts, Bloomberg consensus as at 29 August 2018. Note: *Adjusted for the result from re-measurement of investment property.

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