EDISON **Scale research report - Update**

publity

Real estate

12 October 2020

Strengthening the second business pillar

As publity shifts towards a two-pillar business model, focused on real estate asset management and investment, its portfolio of fully owned properties (held by PREOS) expanded to €1.5bn, with €8.0bn targeted by 2024. The company aims for both domestic and international expansion, focused on large metropolitan areas in Europe. Prospective growth is planned to be fuelled by a €400m bond issue already announced by PREOS to replace its 2019/2024 convertible, which will be followed by issuing new capital market instruments. The onboarding of new international investors will reduce publity's stake in PREOS from 86.5%, with publity targeting 25.01% by 2023.

Asset-heavy business drives earnings improvement

In H120, publity reported over three-fold improvement in revenues, reaching €20.2m (€6.4m in H119), driven by the income from its own property portfolio (89% share). On the back of a €77.9m revaluation of investment properties, H120 EBIT increased to €75.0m from €27.0m in H119. Expanding financial costs and the reported impairment on financial assets partially offset the operational improvement, resulting in a net profit of €34.7m (€21.0m in H119).

TO-Holding buys publity's bonds and sells shares

As announced on 30 September 2020, publity completed the issue of its €100m bond, with the last €25m tranche acquired by TO-Holding (an investment vehicle of publity's CEO, Thomas Olek). The main purpose of the issue was to refinance the five-year convertible bond maturing in November 2020. Meanwhile, Thomas Olek decided to sell a 49% stake in publity to international investors, with approximately 37% of his remaining shares being subject to a 24-month lock-up.

Valuation: Between an asset manager and investor

As publity repositions its business model towards balance sheet investments, we compare its P/NAV ratio with a group of real estate investors from Germany and Austria, with a significant exposure to office real estate. Based on data at 30 June 2020, publity trades at a significant premium to peers. In contrast, based on the consensus P/E multiples for 2020e and 2021e, the company trades at a significant discount. We believe this disparity results from a two-pillar business model, which makes neither measure a fully appropriate valuation method.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	37.2	30.9	3.26	1.50	11.2	4.1
12/19	20.3	116.3	5.25	0.00	6.9	0.0
12/20e	44.3	N/A	6.60	N/A	5.5	N/A
12/21e	48.7	N/A	8.44	N/A	4.3	N/A

Source: publity accounts, Refinitiv consensus as at 12 October 2020

Price	**€36.45**
Market cap	**€543m**

Share price graph

Share details

Code	PBY
Listing	Deutsche Börse Scale
Shares in issue	14.9m
Last reported net debt at 30 June 2020	€797m

Business description

publity is a German real estate asset manager and investor, focused on office properties. It benefits from c 20 years' experience and an extensive database with c 9,500 properties covering nearly 75% of the relevant market. It manages a portfolio with c €5.5bn AUM, with €1.5bn attributable to own holdings.

Bull

- Experienced player with a focus on one segment of the property market.
- Expansion of own property portfolio to improve rental income and realise capital gains.
- New bond issue provides additional liquidity.

Bear

- Expansion of own property portfolio increases leverage and sensitivity to property prices.
- Expected dilution of publity's stake in PREOS.
- Working from home potentially more popular after COVID-19, reducing office space demand.

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H120 financials: PREOS portfolio drives results

Last year, publity adopted a two-pillar strategy, based on asset management services and its own balance sheet investments in office real estate, which has significantly reshaped publity's revenue structure. Its overall H120 sales reached €20.2m compared to €6.4m in H119, with close to 90% (or €18.1m) attributable to publity's own real estate portfolio, held through its subsidiary PREOS following its full consolidation in H219. Meanwhile, income from external asset management mandates declined by 42% y-o-y to €2.0m, which may be due to more limited transactional activity amid the COVID-19 crisis and the fact that fees attributable to PREOS are subject to intersegmental elimination. At 30 June 2020, publity's total assets under management (AUM) stood at €5.5bn (with c €1.5bn attributable to PREOS), against €5.0bn at end-June 2019. The PREOS consolidation, which contributed significant share of the increase, should also be a main driver of expansion to the targeted publity's AUM of €10bn by end 2023. The key own property investment concluded in H120 was the purchase of the Centurion office tower in Frankfurt am Main in April 2020.

With expanding its own portfolio, publity is bearing higher property management costs (reported under cost of sales), which increased in H120 to €7.9m from €1.4m in the first six months of 2019. Simultaneously, costs related to asset management mandates (services and commissions) reached €3.4m in H120, compared to €2.5m in H119. Consequently, gross profit improved to €8.9m in H120, from €2.5m in the comparable period, which translates into a 44% margin (vs 39% in H119). Over the same period, other operating expenses increased 41.4% to €9.6m from €6.8m, mainly due to write-downs on receivables (€2.1m in H120 vs none in H119). H120 EBIT improved from €27.0m to €75.0m, as it was further assisted by the result of remeasurement of investment properties amounting to €77.9m over first six months of 2020, against €31.9m in H119.

Exhibit 1: Financial highlights

in k€	H120	H119	y-o-y
Revenue	**20,241**	**6,441**	**214.3%**
Income from own real estate portfolio	18,069	2,901	522.9%
Income from asset management services to third parties	2,008	3,458	-41.9%
Other income	165	83	99.5%
Cost of sales	(11,348)	(3,908)	190.4%
Gross profit	**8,894**	**2,533**	**251.1%**
Result of remeasurement of investment properties	77,863	31,896	144.1%
Other operating income	1,318	200	559.1%
Impairment losses on receivables	(2,092)	195	NM
Personnel expenses	(1,406)	(1,034)	36.0%
Other operating expenses	(9,621)	(6,802)	41.4%
Earnings before taxes and interest	**74,956**	**26,989**	**177.7%**
Finance income	3,595	112	NM
Finance costs	(21,115)	(2,974)	609.9%
Impairment of non-current financial assets	(9,429)	0	NM
Share of results of associates	(59)	(244)	-75.8%
Earnings before tax	**47,948**	**23,882**	**100.8%**
Income tax expense	(13,246)	(2,881)	359.7%
Earnings after taxes	**34,702**	**21,001**	**65.2%**
Thereof attributable to shareholders of the parent company	25,902	20,440	26.7%
Result attributable to non-controlling shareholders	8,800	562	NM

Source: publity accounts

Together with the expansion of the more asset-heavy business segment, publity has further increased its net debt (adjusted for receivables from bond issue and share disposals) to €797.0m at end-June 2020 compared to €479.5m at 31 December 2019 and €263m at end-June 2019. This led to a decline in the equity ratio from 34.4% at end-December 2019 to 29.8% at 30 June 2020. Consequently, finance costs surged from €3.0m in H119 to €21.1m. We note that in H120 publity recognised a €9.4m impairment on non-current financial assets (no impairment was booked in H119), which further lowers the financial result and partially offsets the aforementioned operational improvements. It is also worth noting that a significant part of the company's own investment portfolio is held by non-fully controlled subsidiaries (including an 86.5% share in PREOS), which resulted in a meaningful part of the €34.7m net profit in H120 being attributable to non-controlling interests (€8.8m). In H120, the net income attributable to the shareholders of the parent company reached €25.9m, against €20.4m in H119.

PREOS embarking on a new strategy

On 28 July 2020, publity's subsidiary PREOS announced the issue of a new €400m, five-year corporate bond with a relatively high coupon of 7.5% and a redemption amount at maturity of 105% of the nominal value. As PREOS's share price has significantly increased in the year to date (from €5.90 on 2 January to €16.10 on 9 October 2020), it faced significant dilution risk resulting from the 2019/2024 convertible bond. Therefore, the new issue is partially addressed to the convertible bond holders, who could exchange their convertibles with an additional cash payment of €75 per bond and pro-rata accrued interest. publity, which holds convertible bonds with a face value of c €142.2m (c 79% of aggregate outstanding volume), has already informed PREOS that it will participate in the exchange offer.

In addition to repaying the outstanding convertible bond, the new issue is also intended to fuel expansion of the subsidiary's real estate portfolio. PREOS is targeting a portfolio value of €2.0bn by the end of 2020 and €8.0bn by 2024. Importantly, the company's new strategy involves investments outside of Germany, starting with Luxembourg and Paris (where the company expects to close first deals in Q420) and subsequently in London, Vienna, Milan and Madrid. PREOS plans to set up investment vehicles in these with the intention to float them on local exchanges as standalone entities or merge them with already listed property companies. On top of the above-mentioned bond issue, PREOS intends to finance the expansion by taking on new strategic investors, which is likely to result in the dilution of publity's stake (the company targets 25.01% by 2023). In line with this approach, publity has sold a 5.4% stake in PREOS to an international investor in early July 2020.

Moreover, on 7 August 2020 PREOS approved a long-term dividend policy (effective from FY20 results) with a target dividend yield at 5% (based on weighted average PREOS share price in the three months before the AGM). It is worth noting that the maximum overall pay-out from FY20 earnings is limited to €100m per year. The current share price implies a €86.5m annual payment.

publity's new bond issue and shareholder changes

As already described in our previous update note, publity has issued a new 5.50% corporate bond. The first €50m tranche was issued in June and was fully subscribed, including €17.1m as part of the exchange for publity's 2015/2020 convertible bonds. The rest of the outstanding convertible bonds have been subject to a voluntary public purchase offer by TO-Holding at an offer price of 102.72% of the nominal amount including pro-rata accrued interest. The second and third tranches of the new corporate bond, amounting to €25m each, have been successfully placed in August and September 2020 and as a result publity reached the maximum targeted issue volume of €100m. Thomas Olek, who guaranteed a minimum issue volume of €50m, has participated in each of the tranche issues through TO-Holding (subscription to new issue and exchange of the convertible bonds), exclusively underwriting the last one. Meanwhile, as announced on 28 May 2020, Thomas Olek, who held a majority stake in publity (indirectly through its investment vehicles), decided to sell a c 49% stake to a consortium of international investors for a price of €33.61 per share. Approximately 37% of his remaining shares are subject to a 24-month lock-up. Similar 12- and 24-month lock-up periods have been agreed upon for the stakes acquired by international institutional investors from TO-Holding and TO-Holding 2, respectively.

Subdued investment volume in office segment

The German real estate investment market was initially well placed to carry momentum forward from 2019 (transaction volume at a record high of €91.8bn), according to JLL. The Q120 figures reflected the limited impact of the coronavirus, with the €27.9bn overall transaction volume constituting the second-best quarterly result historically and a more than 81% y-o-y improvement. Even though the €14.7bn recorded in Q220 is just 15% below Q219 figure, it fell 47% against Q120, which illustrates the magnitude of the pandemic-induced slowdown.

The share of office real estate in the overall investment volume declined from c 40% in FY19 to 22% in H120, according to JLL. During the first six months of 2020 c 1.28m sqm of office space was either let to tenants or sold to owner-occupiers in seven largest German cities, which constitutes a c 36% y-o-y drop. It is worth noting that Q220 saw the weakest second-quarter new lettings take-up since 2009. We also note that the overall impact of the pandemic on the sector could be delayed due to the stimulus package launched by the government, which helped preserve job positions and avoid termination of lease agreements. According to JLL, the aggregate vacancy rate at end-June 2020 stayed low, at c 3.2%, helping the rental prices stay on a par with the pre-COVID-19 levels.

According to German Property Partners (GPP), the investment market started to rebound in Q320, with commercial property trading volume in the seven largest German cities reaching €6.5bn over this three-month period (of which 60% attributable to office properties), exceeding Q220 total by c €1.8bn (but still down 19% y-o-y). As the broad economic outlook remains uncertain, core properties constitute a significant part of the overall investment volume. GPP forecasts a total commercial property transaction volume for 2020 of €27.6bn (well below the five-year average of €33.1bn), which suggests €8.5bn in Q420, implying a c 30% q-o-q improvement against Q320.

Valuation

With the majority of revenues generated by its own property portfolio, for the valuation purposes we compare publity to a group of real estate investors from Germany and Austria, with a significant exposure to the office market segment. The last reported P/NAV ratio (based on the balance sheet value of equity at end-June 2020) stood at c 1.33x, against a peer group average of 0.63x. However, this comparison is somewhat distorted by the fact that publity is also an asset manager. Looking at P/E multiples based on FY20–22e Refinitiv consensus figures (including SRC Research and First Berlin), publity trades at a significant discount to its peers. However, we note that this multiple is not the best metric to compare investment companies and that consensus figures may be somewhat distorted by revaluation gains (such as those booked by publity in H120). It is also worth noting that Refinitiv consensus data for publity on dividend payments from 2020 to 2022 earnings have been withdrawn, which may reflect the increased uncertainty around the company's willingness to pay dividends rather than secure additional liquidity. publity's 2020 AGM has already decided not to pay out a dividend from FY19 earnings.

Exhibit 2: Peer group comparison

	Market cap (€m)	P/NAV (x) H120	P/E (x) 2020e	P/E (x) 2021e	P/E (x) 2022e	Dividend yield (%) 2020e	Dividend yield (%) 2021e	Dividend yield (%) 2022e
CA Immobilien Anlagen	2,584.2	0.86	14.4	13.3	13.9	3.8	4.2	4.4
Immofinanz	1,737.2	0.56	33.2	13.9	11.2	5.6	6.2	6.3
DIC Asset	833.3	0.60	13.9	12.1	11.1	6.1	6.5	6.8
TLG Immobilien	1,990.1	0.50	42.2	10.6	12.2	5.5	5.9	6.3
Demire	446.2	0.65	17.3	10.5	9.2	3.0	3.9	4.6
Peer group average:		**0.63**	**24.2**	**12.1**	**11.5**	**4.8**	**5.3**	**5.7**
publity	542.2	1.33*	5.5	4.3	N/A	N/A	N/A	N/A
Premium/(discount) to peers		**110%**	**(77%)**	**(64%)**	**N/A**	**N/A**	**N/A**	**N/A**

Source: Refinitiv as at 12 October 2020; *based on the balance sheet value of equity at end-June 2020.

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