EDISON

Scale research report - Update

publity

Focusing on its portfolio

In FY19, publity focused on expanding beyond its pure-play asset management profile through direct office real estate investment activities. This was driven by property acquisitions executed by publity investor, as well as obtaining a controlling stake in PREOS. As a result, the company moved to a more asset-heavy business model fuelled by debt financing. The company expects to continue the expansion, and considers the economic slowdown related to the coronavirus outbreak as an opportunity for acquisitions, with additional liquidity secured by the corporate bond issue planned for June 2020.

Revaluation gains drive net income increase

With a significant proportion of capacities devoted to managing the intergroup real estate portfolio in FY19 (following the consolidation of PREOS which was formerly publity's external client), publity reported lower income from asset management at €3.5m vs €28.3m in FY18, coupled with rental income from its own properties at €14.0m. On the back of first-time adoption of IFRS, it recorded €122.2m in revaluation gains, driving significantly higher EBIT and net income at €116.3m and €64.2m, respectively. Along with the expanding portfolio, publity's net debt was up from €29m as at end-2018 to €447m at end-2019 (now including debt of PREOS).

Bond issue to support liquidity and new acquisitions

Management states publity is well positioned to limit the negative impact of the coronavirus crisis and use it to acquire new properties on favourable terms. This would be assisted by the issue of a new €100m corporate bond planned for June 2020, with TO-Holding agreeing to invest an amount required to bring the issue volume to at least €50m. However, the main purpose of the issue is to refinance the five-year convertible bond (c €46m outstanding) maturing in November 2020.

Valuation: Real estate investors as peers

As balance sheet investments are becoming the main contributor to the company's earnings, we have decided to change its peer group to include office real estate investors. publity trades on a P/NAV multiple for 2019 (last available data) of 1.76x against a peer group average of 0.76x. In FY19 the company paid a dividend of €1.50 per share. Due to the impact of COVID-19, it was decided at the AGM that no dividend will be paid out of FY19 earnings at this time.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	37.2	30.9	3.26	0.00	11.0	N/A
12/19	20.3	116.3	5.25	1.50	6.8	4.2
12/20e	44.3	171.4	6.60	3.00	5.4	8.4
12/21e	48.7	242.5	8.44	4.00	4.2	11.2

Source: publity accounts, Refinitiv consensus as at 22 May 2020

Real estate asset management

27 May 2020

Price	€37.5
Market cap	€532m

Share price graph

Share details

Code	PBY
Listing	Deutsche Börse Scale
Shares in issue	14.9m
Last reported net debt at 31 December 2019	€447m

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 €1.1bn 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 may provide additional liquidity and funding for opportunistic investments.

Bear

- Expansion of own property portfolio increases leverage and sensitivity to property prices.
- Dependent on key shareholder.
- Work-from-home setup potentially more popular after COVID-19 reducing demand for office space.

Analyst

Milosz Papst +44 (0) 20 3077 5700

financials@edisongroup.com
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Financials: Higher transaction volumes in own portfolio

In FY19 publity expanded its managed portfolio from €4.6bn to €5.5bn. However, on top of its asset management mandates, it started building up its own property portfolio, which as at end-2019 stood at c €1.1bn. The shift in its operating focus from pure-play asset management towards office real estate investments (with the PREOS consolidation being an important driver) resulted in a c 45% y-o-y decline in external revenue, which was recorded at €20.3m in FY19. In FY18, over €28.3m (76% of total sales) were attributable to the income from asset management services to third parties, which included transaction-volume-based earnings (finders and exit fees in particular) as well as lump sum payments for the ongoing management of the property portfolio. On the back of more limited transaction activity on external clients' behalf (after PREOS became a consolidated entity rather than an external customer), this revenue shrank to just €3.5m in FY19 (with €30.2m revenues in the asset management segment in FY19 now being subject to intersegment eliminations). On the other hand, the company started to report income from its own properties, which in FY19 reached almost €14.0m, driven by rental income, mainly from the 100k sqm property in Essen-Bredeney, 21k sqm Access Tower in Frankfurt am Main and the 30k sqm Sky HQ near Munich.

Total cost of sales in FY19 reached €10.6m vs €6.8m in FY18, with cost attributable to the asset management activities declining from €5.7m to just €3.0m. As a result, gross profit in the third-party services segment after intersegmental eliminations reached €2.9m (€27.2m in FY18), while assets from its own portfolio contributed c €6.8m (€3.2m in FY18). It is worth noting, however, that this includes the result of legacy business related to servicing the non-performing loans (NPL) portfolio. As at end-December 2019 publity held only one closed-end NPL fund, which went into liquidation upon expiry at end-2018 and is still being wound up.

Exhibit 1: Financial highlights

€000s	2019	2018	y-oy
Revenue	**20,323**	**37,217**	**-45.4%**
Income from services to third parties (asset-management)	*3,483*	*28,348*	*-87.7%*
Income from own loan portfolios (portfolio assets)	*512*	*4,257*	*-88.0%*
Income from servicing of non-performing loans for third parties (asset-management)	*2,265*	*3,042*	*-25.5%*
Income from own properties (portfolio assets)	*13,954*	*0*	*N/M*
Other income (asset-management)	*109*	*1,569*	*-93.1%*
Cost of sales	(10,603)	(6,793)	56.1%
Gross profit	**9,720**	**30,424**	**-68.1%**
Other operating income	6,748	1,294	421.6%
Impairment losses on receivables	0	(143)	N/M
Personnel expenses	(2,547)	(2,024)	25.9%
Other operating expenses	(19,852)	(7,675)	158.7%
Result of remeasurement of investment properties	122,230	8,940	N/M
Result before taxes and interest	**116,299**	**30,816**	**277.4%**
Finance income	6,127	8,454	-27.5%
Finance costs	(14,360)	(2,851)	N/M
Impairment of non-current financial assets	(27,703)	(2,962)	N/M
Share of results of associates	(587)	(16)	N/M
Result before tax	**79,776**	**33,441**	**138.6%**
Income tax expense	(15,616)	(8,826)	76.9%
Earnings after taxes	**64,161**	**24,615**	**160.7%**
thereof attributable to shareholders of the parent company	*58,822*	*24,530*	*139.8%*

Source: publity accounts

In FY19 publity reported a significant increase in both other operating income and expenses, rising to €6.7m and €19.9m respectively, against €1.3m and €7.7m in FY18. The former improvement has been driven by deconsolidation results, related to the sale of St Martin Tower in Frankfurt am Main, completed on 12 December 2019 (just months after acquisition on 3 April 2019), amounting to €4.9m, while similar income in 2018 reached only €0.6m. The company also reported a €0.7m gain from the modification of the lease contract for the 'publity Center' and a €0.6m gain the from reduction of impairment allowances against receivables, which was not recorded in the previous year. Among other operating expenses, over €4.8m concerns derecognition of receivables (€2.0m in FY18), while legal and consulting costs, primary due to the capital increase and acquisition of properties and property holding companies, amounted to €3.5m (€1.9m in FY18). According to the company, c €5.7m of other operating expenses is related to companies formed or acquired in 2019.

We note, that FY19 is the first year prepared fully in accordance with IFRS only, resulting in the first revaluation of properties on its balance sheet under IFRS (as opposed to properties managed as part of its institutional mandates). Consequently, publity recognised the €122.2m result of remeasurement of investment properties, being attributable to the revaluation of the Theodor-Althoff-Straße 2, Eschborn, Sky, Access Tower, Sankt Martin Tower, Lüdenscheid and Oberhausen properties. Consequently, FY19 EBIT in the portfolio management reached €100.9m, which along with asset management result translated into group EBIT at €116.3m, against €30.8m in FY18.

publity's expanding balance sheet investments triggered an increase in leverage level (including debt acquired with the PREOS takeover), putting net debt at €447m as at end-2019 (including property related borrowings of €427m, lease and other liabilities of €45m and outstanding convertible bonds of €75m, while cash and cash equivalents sit at c €100m) compared with €29m at end-2018. As a result, its net debt to total assets ratio reached c 51% at end-2019 against 16% 12 months earlier. The move away from an asset-light business model also fuelled a visible increase in financing costs, which reached €14.4m in FY19 vs just €2.9m in FY18, with c €11m interest paid on borrowings (none in FY18). publity also recognised a €27.7m impairment of non-current financial assets, including charges against non-performing loan portfolios, due to the adjustments made to the amounts and timing of the expected cash inflows. Consequently, the net profit for 2019 stood at €64.2m compared to €24.6m in 2018.

Investment opportunities during economic slowdown

publity's portfolio is focused on office real estate, which at the present seems more resilient than retail and hotel properties, in suffering from the negative impacts of restrictions imposed by the German government to limit the spread of the pandemic. We note, however, that according to JLL, in Q120 investments in office real estate in Germany declined to c €5.0bn after €5.9bn in Q119. At the same time, overall transaction volume in Q120 improved by 82% y-o-y to €28bn, with c €10.7bn investments in residential and other real estate in the living asset class, confirming rising risk awareness among investors and a consequent search for diversification options. In Q120 office properties constituted only 18% of overall investment volume, while in the whole 2019 this share stood at c 40%.

According to management, publity is well-positioned not only to safely wait out the economic slowdown, but to even benefit from it, as it views temporary market slumps as additional opportunities for expansion. We note, however, that in 2019, publity acquired c €427m in property-level debt, with c €126.8m maturing within 12 months (€175m in total, including convertible bonds and other financial liabilities) and a further €246.1m payable in FY21. In connection with these borrowings, the company needs to adhere to standard financial covenants, including loan-to-value level, interest and debt ratios, as well as certain ratios of loan amounts to rental income. While at end-2019 the company complied with all covenants, the current macro environment could translate into a decline in property values, potentially leading to covenant breaches. On the other hand, we note that the company sold its 6,700 sqm office property in the Airport City in Dortmund in May 2020, likely leading to some minor de-leveraging and additional liquidity. We also note that in the long term, COVID-19 could result in more limited tenant demand for office space if the work-from-home model becomes more popular, depressing the valuation of office properties.

Refinancing its convertible bond

With the approaching redemption date of the 2015/2020 convertible bond on 17 November 2020, the company decided to issue a new non-convertible corporate bond to replace it. The original issue date was set at March 2020 and then postponed until autumn. However, on 18 May 2020, publity decided to move the issue to June 2020 and to double the volume to €100m, with the major shareholder and CEO of publity, Thomas Olek (via his investment company TO-Holding), agreeing to invest an amount required to bring the issue volume to at least €50m. The decision to bring the issue forward and increase its volume could be related to current macro conditions, as the issue proceeds will be used to strengthen publity's liquidity and finance further portfolio expansion.

The bond offering will also include an exchange offer for the convertible bond holders, under which they would be entitled to exchange their holdings at a 1:1 ratio, also receiving additional cash from an exchange premium, which is currently expected to sit at c €20 per bond. The coupon rate of the new issue is expected at 5.5% vs 3.5% for the 2015/2020 bond. Additionally, TO-Holding announced in May 2020 an offer to purchase the convertible bonds against 99% of the nominal price and accrued interest. This leaves convertible bond holders with three options (the conversion to equity option is out of the money): exchange their holdings for the new issue, sell the bond to TO-Holding or demand from publity repayment of their bonds at par plus accrued interest. The last option would be available only after the new issue, as due to the guarantee of a minimum issue volume of €50m, one of the 2015/2020 convertible bond covenants – regarding the major shareholder's ownership position – could be breached, giving the bondholders a right to repayment.

Valuation

Following the strategic realignment of the company, towards a combination of an asset manager business (focused on fees) and an asset owner (focused on NAV growth), we have decided to change the peer group we use for valuation purposes, to better reflect publity's new business model. The group now includes real estate investors from Germany and Austria, with a significant exposure to the office market segment. We believe that P/NAV would be the best measure to assess the company's valuation; however, consensus estimates for NAV for publity are not available. The last reported P/NAV ratio (based on the balance sheet value of equity at end-December 2019) stood at c 1.76x, against a peer group average of 0.76x. This may at least partially reflect the value attached to its asset management business, contributing to the earnings. Looking at P/E multiples based on FY20–22e Refinitiv consensus figures (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 FY19). In FY19 publity paid a dividend amounting to €1.50 per share, which constitutes a 4.1% yield, calculated based on the end-2019 share price. For now, publity's shareholders decided not to pay a dividend in FY19. However, according to the current Refinitiv consensus, improving net earnings should translate into attractive dividend payments, significantly outperforming the peer group average.

Exhibit 2: Peer group comparison

	Market cap (€m)	P/NAV (x) 2019	Dividend yield (%)			P/E (x)		
			2020e	2021e	2022e	2020e	2021e	2022e
CA Immobilien Anlagen	2,843	0.96	3.6	3.9	4.4	18.1	12.2	6.0
Immofinanz	1,750	0.60	6.1	6.7	7.0	21.3	12.0	10.5
DIC Asset	909	0.94	5.5	5.9	6.2	14.0	12.1	11.4
TLG Immobilien	1,730	0.61	7.0	7.3	N/A	10.5	9.5	N/A
Demire	452	0.68	1.2	2.8	3.8	7.5	9.5	9.3
Peer group average:		**0.76**	**4.7**	**5.3**	**5.4**	**14.3**	**11.0**	**9.3**
publity	532	1.76	8.4	11.2	11.2	5.4	4.2	4.7
Premium/(discount) to peers		**132%**	**3.7pp**	**5.9pp**	**5.8pp**	**(62%)**	**(62%)**	**(49%)**

Source: Refinitiv consensus as at 22 May 2020

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