Scale research report - Update

publity

Real estate asset management

13 September 2019

Developing both as asset manager and owner

publity is evolving from a pure asset manager and is building its own portfolio of German office properties (valued at €243.3m at end-June 2019) through its subsidiary, publity Investor (Investor). The next strategic step is combining Investor with PREOS Real Estate (an asset owner also controlled by publity's main shareholder, Thomas Olek). We believe that the parent company will now devote part of its capacity to managing its subsidiary's portfolio (apart from third-party assets). However, this may drive property revaluation gains. publity's assets under management (AUM) now stand at €5.0bn (vs €4.6bn at end-2018).

Stronger focus on own property portfolio in H119

Following the acquisition of several properties on its own book in recent months, publity has recognised the first-time revaluation of its investment portfolio. This translated into a €31.9m positive impact on group net income, which in H119 stood at €21.0m vs €4.0m in H118. Meanwhile, it recorded lower revenues from its institutional asset management business (€3.5m in H119 vs €12.6m in H118), which according to the company is due to increased focus on managing its own property portfolio (as these services, amounting to €7.3m, are subject to intragroup eliminations). publity still guides to FY19 net income of €50m (vs €24.6m in FY18).

Initiatives to grow both business lines

publity recently embarked on initiatives to expand its own property portfolio. This includes the agreed combination of Investor with PREOS and the partnership with Meritz Financial Group and IGIS Asset Management to jointly finance publity's ongoing real estate acquisition programme. Having said that, it is not neglecting its third-party asset management business and has signed a letter of intent to set up a €1bn joint real estate fund with the Luxemburg investor Greenfinch Capital Management, where publity will serve as an asset manager.

Valuation: More than just net asset value

Although publity is gradually also becoming a property owner, we believe its valuation still largely reflects its asset management capabilities. This is demonstrated by its P/NAV ratio of 2.5x vs c 0.8–1.6x for German real estate owners. Refinitiv consensus (based on the estimates of one broker) implies a FY19e P/E for publity at 7.7x vs a peer average of 13.2x. However, we understand this may be distorted by publity's investment property revaluation gains.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	23.6	14.6	1.67	0.00	20.3	N/A
12/18	34.6	21.6	1.52	1.50	22.3	4.4
12/19e	38.5	69.8	4.41	0.00	7.7	N/A
12/20e	44.3	75.8	4.79	0.00	7.1	N/A

Source: publity accounts, Refinitiv consensus at 9 September 2019, based on the forecasts of one broker (First Berlin).

Price	€33.55
Market cap	€344m

Share price graph

Share details

Code	PBY
Listing	Deutsche Börse Scale
Shares in issue	10.3m
Last reported net debt at end June 2019	€263m

Business description

publity is an asset manager with a focus on German office buildings. It has an 18-year track record as an investor in commercial real estate in larger German cities and manages a portfolio worth €5.0bn.

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

- Expansion of own property portfolio increases leverage and sensitivity to property prices.
- Dependent on banks for property sourcing.
- Funding risk associated with convertible bonds.

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H119 financials: Revaluation gains on own portfolio

publity's operations can be divided into two segments: pure asset management on behalf of third-party entities (which generated revenue of €3.5m in H119 vs €13.9m in H118) and own balance sheet investments in German office properties (€3.0m in H119 vs €0.2m in H118). Reported revenue in H119 amounted to €6.4m compared with €14.1m in H118. According to publity, the decline resulted mainly from its deployment of a major part of its asset management capacities in its own property portfolio rather than third-party assets under management, with c €7.3m of revenue subject to intersegmental eliminations in the consolidated financial statement.

For H119, for the first time, publity reported its results in accordance with IFRS only, providing comparable data for H118. Consequently, it has performed the first revaluation of properties on its balance sheet under IFRS (as opposed to properties managed as part of its institutional mandates). Given that publity recently put increasing emphasis on expanding its own property portfolio (as discussed below), this resulted in considerable one-off non-cash income of €31.9m. Business activities related to own portfolio management generate rental income from currently held properties, as well as disposal gains arising from the optimisation and subsequent sale of these assets. Consequently, the company's intensified asset management efforts directed towards its own portfolio, while potentially limiting its top line in the short term, may enhance the value of its properties and result in subsequent revaluation/disposal gains.

The positive result from the fair value adjustment of investment properties of €31.9m was related mainly to two real estate projects acquired in H119: St Martin Tower in Frankfurt am Main (3 April) and Karstadt headquarters (HQ) in Essen (15 April). Hence, we conclude that both transactions represented timely purchases that allowed for revaluation gains soon after acquisition. We believe publity's portfolio was valued by external independent appraisers. Positive results also included valuation gains from two more properties in Mühlheim and Leipzig, which were acquired in 2018.

We understand that publity's transaction activity on behalf of its institutional clients was relatively limited in H119. Consequently, we assume the €3.5m revenues from the third-party asset management business in H119 represent predominantly ongoing management fees rather than transaction-based fees on property acquisition or disposal. This reflects overall market conditions in the German commercial real estate market, as transaction volumes in H119 declined by 12% y-o-y according to Jones Lang LaSalle (JLL). Large transactions have limited the extent of the decrease, as the overall number of transactions in Q219 fell almost 30% compared to Q119. Having said that, overall investor demand remains robust despite limited supply and rising prices, according to JLL. One of the key reasons for this is the persistent low interest rate environment.

Including the €31.9m revaluation, publity reported EBIT of €29.9m in its own property activities segment, while recognising a €2.9m EBIT loss in the asset management segment (again, due to increased focus on its own portfolio). This compares with €7.3m and a loss of €0.3m in H118, respectively. With net financial expense up to €2.9m in H119 vs €0.9m in H118 (mainly driven by higher debt), net income for the period reached €21.0m (compared with €4.0m in H118).

As the company has taken on debt to fund its property portfolio expansion, net debt reached €263m at end-June 2019 (when taking into account other financial liabilities, including outstanding convertible bonds) compared with €29m at end-2018. As a result, its total capital ratio reached c 64% at end-June 2019. This compares with 16% at end-2018 and illustrates publity's move away from a pure asset-light business model.

Exhibit 1: Financial results highlights

€000s	H119	H118	y-o-y
Revenue from Asset Management	*3,514*	*12,598*	*-72.1%*
Revenue from own portfolio	*2,927*	*182*	*N/M*
Total revenue	**6,441**	**14,105**	**-54.3%**
Operating expenses	(3,908)	(2,907)	34.4%
Results of ordinary activity	**2,533**	**11,198**	**-77.4%**
Result from fair value adjustments of investment property	31,896	0	N/M
Other operating income	200	337	-40.6%
Impairment loss on receivables	195	41	N/M
Personnel expenses	(1,034)	(1,113)	-7.1%
Other operating expenses	(6,802)	(3,468)	96.1%
EBIT	**26,989**	**6,994**	**285.9%**
Financial income	112	627	-82.1%
Financial expenses	(2,974)	(1,560)	90.6%
Result from associated companies	(244)	(12)	N/M
Pre-tax profit	**23,882**	**6,049**	**294.8%**
Income tax	(2,881)	(2,022)	42.5%
Net income	**21,001**	**4,027**	**421.6%**

Source: publity accounts

As net income reported in H119 was already close to the €24.6m for the whole of FY18 (although clearly driven by revaluations), management now guides to FY19 net income of €50m. The company expects positive developments in both its asset management business and own real estate portfolio. Since the beginning of the year, publity has reported a number of lease and floor space expansion successes, including full occupancy of the Karstadt HQ in Essen (prior to acquiring this property, as mentioned above), RC-Office in Cologne, Mülheim an der Ruhr and Access Tower in Frankfurt. The company has also laid the foundation for expansion of its property portfolio by entering into a partnership with Meritz Financial Group and IGIS Asset Management, under which they agreed to jointly finance publity's ongoing real estate acquisition programme over the next 18 months with an investment volume of €500-1,000m. The first transaction as part of this co-operation was the acquisition of the St Martin Tower project mentioned above, with a purchase price of €130m.

That said, publity also is expanding its third-party asset management business, as illustrated by the recently signed letter of intent to set up a joint real estate fund with the Luxemburg investor Greenfinch Capital Management. With €1bn AUM, the fund is expected to be launched in Q419 with publity serving as the asset manager. The partnership will be strengthened by both parties acquiring stakes in each another and there are plans to open further joint funds in the future.

Stronger expansion of its own property portfolio

publity executes its own portfolio management through the wholly owned subsidiary, publity Investor, which was recapitalised with €20m in December 2018 and turned into an investment vehicle with a targeted property portfolio worth €600m after full development, according to publity. Following the acquisitions of St Martin Tower in Frankfurt, the Karstadt HQ in Essen and the headquarters of Sky Germany in Unterföhring, the real estate portfolio of Investor and its subsidiaries consisted of four properties at end-June 2019, with a contractual obligation to acquire two other properties (one of which is Access Tower in Frankfurt). In H119, publity also concluded the first property disposal from its own portfolio, selling the fully let Grossmarkt Leipzig with leasable space of 18,000sqm to a New York-based investment fund management company for an undisclosed price.

On 19 July 2019, publity revealed its plans to transfer up to 94.9% of its stake in Investor to PREOS, a listed real estate company also controlled by Thomas Olek. Combining Investor and PREOS is a natural step, as both focus on similar German office properties and aim to benefit from publity's Manage-to-Core strategy. In January 2019, publity received an asset management mandate from PREOS allowing the latter to benefit from its extensive real estate database. The

PREOS-Investor deal will create a real estate investment group led by publity and valued at up to c €574m, according to management estimates (19 July 2019). publity will continue to manage the combined assets and support the development of the real estate business after the deal concludes. As part of these activities, it purchased a 10,100sqm office and technical centre in Lüdenscheid on behalf of PREOS in August 2019.

The transaction is structured as a non-cash capital increase for PREOS excluding current shareholders' subscription rights in exchange for a contribution in kind. Up to 47.45m new shares at €8.0 per share will be issued to publity in exchange for up to 94.9% of its stake in Investor at a 5:2 ratio, based on Investor's valuation of €400m. In addition, PREOS will issue a convertible bond with a volume of up to €300m, with publity's up to €150m claims under current and prospective shareholder loans to Investor contributed to PREOS. The PREOS AGM, which took place on 29 August 2019, approved the transaction.

€1.50 dividend per share paid in cash or new shares

Following a successful FY18, publity's AGM accepted dividend payment amounting to €1.50 per share with an option to receive dividend payments in the form of new shares instead of cash. Shareholders holding a total of c 78% of the share capital (including Thomas Olek with over 74%) have used this option. The pro-rata dividend claims were set at €1.07 per share, with the remaining amount of €0.43 to be paid in cash to cover any tax obligations. Consequently, 426,818 new shares at a subscription price of €19.26 per share have been issued, representing 4.3% of the previous share count. Interestingly, when factoring in the dividend in the form of new shares, Thomas Olek has invested a total of €95m in publity shares at market prices in the past 11 months.

Valuation

Although publity is developing its own real estate portfolio, we believe the market still considers it to be more of an asset manager (focused on fees) than an asset owner (focused on NAV growth). We feel this is illustrated by the fact that publity's shares currently trade at a P/NAV (based on the balance sheet value of equity at end June 2019) at c 2.5x, visibly ahead of the c 0.8–1.6x range for German listed real estate investors reporting under IFRS.

Therefore, we still consider the P/E multiple is the most appropriate measure to compare publity's value with its peers. Based on Refinitiv consensus (one broker only), which assumes results slightly below management guidance for 2019 and further improvement in the coming years, publity trades at a significant discount to its peers based on FY19–21e figures. However, we note that consensus figures may be somewhat distorted by revaluation gains (such as those booked in H119). publity has recently paid a dividend amounting to €1.50 per share, at a 4.4% yield – slightly above the peer average of 4.1%, which is inflated by Corestate Capital.

Exhibit 2: Peer group comparison

	Market cap	P/E (x)			Yield (%)
Company's name	**(€m)**	**2019e**	**2020e**	**2021e**	**2018**
Corestate Capital	689	5.1	4.8	4.7	8.3
Patrizia	1531	19.8	17.2	16.3	1.8
VIB Vermögen	745	11.6	11.1	10.7	2.6
TLG Immobilien	2,760	16.1	14.9	15.7	3.8
Average	**-**	**13.2**	**12.0**	**11.9**	**4.1**
publity	344	7.7	7.1	6.8	4.4
Premium/(discount) to peers	**-**	**(42%)**	**(41%)**	**(43%)**	**31bp**

Source: Refinitiv consensus as at 9 September, company accounts, Edison Investment Research. Note: Consensus based on the estimates of a single broker (First Berlin).