EDISON

Scale research report - Update

publity

Real estate

2 July 2021

Lower transaction activity in FY20

While publity continues to pursue its two-pillar strategy based on real estate asset management and own investments, it is in discussions with a large Asian conglomerate to sell a majority stake in PREOS, which (through publity Investor and GORE German Office Real Estate) holds the group's investment properties. The parties are also negotiating the provision of an additional three-digit million euro in funding to PREOS (on the successful closure of the deal) to fuel its international portfolio expansion. Meanwhile, the FY20 results of the asset management business were below FY19 due to the impact of the pandemic on property transaction volumes.

Asset management fees affected by deal volume

Starting from FY20, publity presents only standalone accounts in line with German accounting standards (HGB), which mainly reflect its asset management business (and some minor property management and rental operations). The reduced property transaction activity in FY20 translated into a c 53% y-o-y decline in publity's revenues to €16.0m in FY20. It booked a €15.2m net gain on disposals of financial assets, while FY19 results included a €304.5m gain from the business combination between publity Investor and PREOS (see our previous note for details). With a net financial result of €6.2m (vs €5.2m in FY19), driven mainly by interest income from PREOS convertible bonds, publity's FY20 net profit was €12.1m versus €5.0m in FY19 (adjusted for the publity Investor-PREOS deal).

Office space demand dependent on WFH expansion

The revival in the German office market brought the Q121 take-up in the Big 7 cities almost back to pre-pandemic levels. However, the average vacancy rate increased slightly to 3.9% and could reach 4.5% in 2021, according to JLL. The potential adoption of a hybrid workplace set-up, including working from home (WFH), in a number of industries could dampen the demand for office space going forward, with existing properties that are not up to modern requirements most at risk.

Valuation: Over 40% share price decline in 2021 ytd

publity's share price has declined ytd from €33.40 to €18.60 and it trades at a slight discount to peers based on the FY20 P/E multiple. publity's 2020 AGM decided not to pay dividends based on FY19 earnings and management has not proposed any distribution from FY20 profit. We note that BaFin has recently launched an investigation into potential market manipulation in publity and PREOS shares.

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	23.6	14.6	1.67	0.0	11.1	0.0
12/18	34.7	21.6	1.52	1.5	12.2	8.1
12/19	34.1	312.0	20.47	0.0	0.9	0.0
12/20	16.0	12.0	0.81	0.0	23.0	0.0

Source: publity accounts. Note: standalone figures in accordance with HGB.

Price	€18.60
Market cap	€277m

Share price graph

Share details

Code	PBY
Listing	Deutsche Börse Scale
Shares in issue	14.9m
Reported net debt at 31 December 2020	€48.6m

Business description

publity is a German real estate asset manager, focused on office properties in top locations. It benefits from c 20 years' experience and an extensive database with c 9,500 properties covering nearly 75% of the relevant market. It is also the majority shareholder of listed real estate investor PREOS.

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.
- Extensive database monitoring c 9.5k properties

Bear

- Potential long-term impact of COVID-19 on office real estate market.
- Declining exposure to real estate investment activities through partial PREOS divestment.
- Potential impact from the BaFin investigation.

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Edison profile page

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Financials: Muted asset management performance

With the publication of the FY20 annual report, publity opted to give up IFRS reporting (which it previously provided voluntarily) and publish its financial statements using HGB only. According to management this still provides all the necessary data to the market, while enabling some cost savings. Having said that, we note that the published statement presents only the standalone results of the parent company, with the contribution of subsidiaries presented in the financial result.

Exhibit 1: Financial highlights

(€000s)	2020	2019	y-o-y
Revenue	**16,009**	**34,077**	**-53.0%**
Other operating income	34,428	304,777	-88.7%
Cost of materials	(3,057)	(3,069)	-0.4%
Gross profit	**47,380**	**335,786**	**-85.9%**
Personnel expenses	(1,896)	(1,467)	29.2%
D&A	(145)	(87)	65.6%
Other operating expenses	(39,466)	(27,444)	43.8%
EBIT	**5,874**	**306,786**	**-98.1%**
Income from a profit and loss transfer agreement	682	1,063	-35.8%
Income from other securities and from loans held as financial assets	8,928	732	1119.5%
Other interest and similar income	684	6,015	-88.6%
Interest and similar expenses	(4,123)	(2,588)	59.3%
Financial result	**6,171**	**5,222**	**18.2%**
Earnings before tax	**12,045**	**312,008**	**-96.1%**
Income tax and other taxes	30	(7,518)	NM
Net income	**12,075**	**304,490**	**-96.0%**

Source: publity accounts

In FY20, publity reported revenue of €16.0m compared to €34.1m in FY19. The 53% y-o-y decline was mainly attributable to the asset management operations, as income within the segment fell from €33.2m to just €14.8m. As an asset manager, publity earns commission based on the value of assets under management, as well as transaction fees on property acquisitions and disposals, with the latter affected by lower property transaction volumes due to COVID-19. Meanwhile, the company reported a slight improvement in income from property management (€509k in FY20 vs €493k in FY19) and an increase in rental income (€646k vs €176k a year earlier).

The company also recognised €34.4m in other operating income in FY20, mainly due to the disposal of financial assets (€33.5m). In FY19, the corresponding figures were €304.8m and €304.5m respectively and were related to the combination of publity Investor (the real estate property investing subsidiary) with PREOS. publity also reported c 43.8% increase in other operating expenses to €39.5m, with €18.3m related to the aforementioned disposal of financial assets. Other operating expenses in FY20 included losses from the disposal of fixed assets (€6.0m), the cost of the bond issue and the tokenisation (the issue of digital blockchain-based tokens representing equity shares) of PREOS shares (€5.7m), as well as bad debt expenses and write-downs on receivables (€2.6m). This brough FY20 EBIT (per our calculations) to €5.9m.

The financial result line increased slightly y-o-y from €5.2m in FY19 to €6.2m on the back of improved interest income from subsidiaries (€9.0m in FY20 vs €6.7m), mainly from the 7.5% 2019/2024 convertible bond of publity's listed subsidiary, PREOS (publity's holding was valued based on the bond's market price of €101m at end-2020 following the subscription to an additional €40m in October 2020). FY20 net income reached €12.1m compared with FY19 net income (adjusted for the publity Investor-PREOS combination) of c €5.0m, according to management. The company did not pay a dividend from FY19 earnings and it has not announced any distribution from the FY20 result. publity's equity ratio sits at 88.2% at end-2020, compared to 90.6% 12 months earlier. We note however, that all the leveraged, asset-heavy business operations were already transferred to PREOS and are thus not reflected in publity's standalone ratio.

PREOS will retain IFRS reporting to better reflect its business developments. Its FY20 figures are due to be released in July 2021, according to the company's financial calendar. In H120 alone, PREOS reported a robust improvement in earnings, highlighted by a c 179% y-o-y increase in EBIT to c €70m (including €68.3m in revaluation gains) and net income including minorities for the period amounting to €30.9m, compared to €21.8m in H119 (€26.8m and €21.3m excluding minorities, respectively). The company targeted a property portfolio value of €2bn at end-2020 and €8bn by the end of 2024 (vs €1.5bn at end-June 2020). On 7 August 2020, PREOS approved a long-term dividend policy (effective from the FY20 results) with a targeted dividend yield of 5%. However, in December 2020 PREOS announced that it will postpone its cash dividend payments plans for at least one more year, opting instead for a bonus share issue.

As transaction activity in the office real estate market in Germany picked up in 2021 ytd, publity has already announced property disposals on behalf of its clients and subsidiaries, as well as several minor new lettings and prolonged lease agreements in H121. The management expects FY21 sales to be slightly below FY20 level and a net income for the year ranging from €9m to €12m.

Several capital measures and shareholder changes

PREOS token and share offering on hold

PREOS embarked on a number of funding measures in 2020 mostly aimed at fuelling its portfolio expansion. It announced a new bond issue with part of the proceeds earmarked for the refinancing of its 2019/2024 convertible bond, as management saw a potential dilution risk resulting from the robust share price performance at the time. However, in November 2020 it postponed the issue until H221 as it expected its near-term funding needs to be covered by the PREOS token issue (see below) and funding from publity. Moreover, PREOS also noted the uncertain macro environment at that time. Since then, the dilution risk has abated due to the decline in the PREOS share price (conversion price set at €6.60 vs share price as at 1 July close of €4.86).

On 24 November 2020, publity announced its plan to tokenise up to 50m existing PREOS shares it held (25m in the first stage), at an initial price equal to the 23 November 2020 close (€9.25 per token). The transaction involves offering on the Ethereum blockchain a digital 'twin' to these shares. Each token is assigned to a specific share and gives its holder the same dividend and voting rights as an ordinary share. Furthermore, investors have a right to exchange their tokens for a conventional PREOS share at any time. Tokenisation makes PREOS shares available to investors worldwide and potentially also makes them more easily tradeable. publity also announced on 27 November 2020 a sale offer for 14m existing PREOS shares as part of a plan to reduce its stake. To encourage investors to purchase the shares, publity offered a 15% discount to the PREOS closing price at 20 November 2020, which put the offer price at €8.67 per share.

On 26 February 2021, both token and shares offerings have been prematurely terminated amid negotiations between publity and a large Asian conglomerate regarding the sale of a majority stake in PREOS, first announced in January 2021. Even though initially the transaction was expected by publity to be closed in Q221, it was postponed till after the FY20 audited financial statements publication with the deal closure now expected in H221.

Long-standing CEO and large shareholder steps down from management board

In June 2020, Thomas Olek sold TO Holding 2, one of his investment vehicles holding c 41% of the shares in publity, to an international consortium of investors (now represented on publity's shareholder register by PBL Capital) for €50m. As a consequence, he reduced his stake in publity to c 38% (through TO Holding) as at end-2020. Moreover, on 22 September 2020 publity announced that Thomas Olek would resign as CEO (effective 31 December 2020) and become CEO of PREOS. However, the latter was postponed on 27 December 2020, with Thomas Olek assuming a consulting role focused on Big Data real estate analysis and the international expansion for the entire publity group. publity's management board now consists of Frank Schneider (CEO) who previously served as the company's COO and Stephan Kunath (CFO) who previously served as assistant to the management board (2010–2018), authorised representative of the company (2018–2020) and managing director of business administration (2018–2020).

German office market robust, though WFH a risk factor

The office market in the German Big 7 cities saw a robust take-up in Q121 at 715k sqm (close to the Q120 level) and JLL expects the take-up to increase by 10% y-o-y in 2021. While the average vacancy rate has increased recently it was still a moderate 3.9% in Q121, with JLL forecasting some further growth to an average 4.5% in 2021. However, it considers the vacancy risk to be significantly lower for new, flexible and well-appointed spaces. At the same time, JLL expects new office completions in the Big 7 German cities should stand at almost 1.9m sqm, which is 300k sqm below the expectations at end-2020, suggesting that development projects continue to be postponed. Overall, 4.2m sqm of new office space is under construction (of which around 50% has already been pre-let), representing a relatively moderate 4.4% of total stock.

However, we note that the COVID-19 lockdowns validated the 'work from home' set-up in a number of industries and we believe that a significant portion of employees will prefer to work at least in a hybrid set-up (eg three days in the office, two days working at home) even after the pandemic. This may encourage companies to reduce their leased office space, which could dampen office demand going forward. A good example is DWS which recently reached an agreement with the works council that allows it to reduce office space per employee by 30%. The impact could be exacerbated by a potential economic downturn once government support is phased out. We also note that employee expectations towards office design may change (eg in favour of a blend of private offices and open space). This may reduce the demand for existing office space that does not meet these requirements and may force owners to incur additional refurbishment expenses.

Valuation

Given that publity now only reports standalone figures, which only partially capture the earnings of subsidiaries (through dividends and profit-sharing agreements), we have decided to retain the peer group including real estate investors while also reinstating the previous peer group of asset managers. Given the lack of Refinitiv consensus estimates, we compare publity to peers based on FY20 reported figures. Its share price fell in early April 2021 from over €30 per share to less than €20, and it now trades at a slight discount to peers based on the FY20 P/E ratio. On an EV/EBITDA ratio, the company trades at significant premium, but we note that it does not capture income from PREOS which makes it less meaningful. We also note that recently BaFin launched an investigation regarding potential market manipulation in publity and PREOS shares.

Exhibit 2: Peer group comparison

	Market cap	EV/EBITDA (x)			P/E (x)		
	(€m)	2020	2021e	2022e	2020	2021e	2022e
Corestate Capital	387	45.6	7.9	6.0	0.0	6.3	3.9
Patrizia	2,033	16.5	13.6	12.4	52.4	25.8	23.3
VIB Vermogen	999	18.1	19.4	18.7	15.1	14.9	14.1
TLG Immobilien	3,179	5.0	20.3	22.0	6.1	15.2	14.3
Asset managers average:		**21.3**	**15.3**	**14.8**	**24.6**	**15.6**	**13.9**
CA Immobilien Anlagen	3,743	28.7	28.5	27.4	15.0	14.2	14.4
IMMOFINANZ	2,411	N/A	26.5	24.4	N/A	15.7	17.8
DIC Asset	1,209	15.2	16.4	15.6	16.8	15.3	15.0
Demire	469	N/A	19.7	17.5	54.4	13.2	10.7
Real estate investors average:		**21.9**	**22.8**	**21.2**	**28.7**	**14.6**	**14.5**
publity	277	54.1			23.0		

Source: publity and peer accounts, Refinitiv consensus as at 2 July 2021

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