EDISON **Scale research report - Update**

publity

Real estate asset management

6 March 2018

Slower AUM growth and delayed disposals

The recent selling pressure on publity's shares (price down 48% ytd) was accompanied by negative newsflow in January, including a profit warning and missed AUM guidance for FY17. The negative sentiment might have also resulted from the ongoing discussions with bondholders around the modification of convertibles' terms and conditions. Management now guides to FY18 net profit in the range of €15-20m (implying c 34-80% y-o-y growth) based on a cautious assumption of no AUM growth this year (vs previous guidance of €7.0bn).

Lower earnings and missed AUM guidance

publity reported a preliminary FY17 net income of €11.2m, c 52% below the previous year's number. This is in line with the profit warning released in January, when the company indicated that post-tax profit should reach at least €10m, but will be below FY16 levels (€23.1m). The company cited delays in property disposals and lower than expected AUM growth as key reasons behind the poor results. Disposals worth c €280m could not be reflected in FY17 earnings and are now expected to be completed in the coming months. publity reached €4.6bn in AUM, missing its FY17 guidance of €5.2bn.

Several retail funds approaching life-end

Two of publity's retail funds investing in NPL portfolios (Performance Fonds Nos. 4 and 5) had a definite life until end-2017. Aggregate distributions to investors from these funds (as at 2 November 2017) reached only 98% and 99% of the paid-in capital so far (implying a minor loss to investors). Meanwhile, Performance Fonds No. 6 (which invests directly in office properties) is planning a 10% distribution following recent property disposals, bringing the aggregate payments to investors to 36% of the paid-in capital (in line with initial assumptions). The fund will reach the end of its term by end-2018 and aims to make a final distribution of 113%.

Valuation: Reflects disappointing earnings and AUM

publity's shares are trading at a P/E ratio of 9.7x based on FY17 preliminary earnings and 6.3x based on the mid-point of FY18 guidance. This represents a discount to peer group of 44% and 54%, respectively. Some potential reasons for the depressed valuation include: 1) missed AUM guidance; 2) weak FY17 results; and 3) ongoing discussions with bondholders around modification of the debt ceiling and covenant related to dividend payout ratio.

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/14	9.8	4.6	0.51	0.56	35.5	3.1
12/15	23.8	19.9	2.27	2.00	8.0	11.0
12/16	41.6	34.4	3.89	2.80	4.8	15.5
12/17*	25.6	N/A	1.87	N/A	9.7	N/A

Source: publity accounts. Note: *Preliminary FY17 results.

Price	**€18.0**
Market cap	**€108m**

Share price graph

Share details

Code	PBY
Listing	Deutsche Börse Scale
Shares in issue	6.05m
Last reported net debt as at 30 June 2017	€43.6m

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 currently 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
- Trading at a wide P/E discount to peers

Bear

- AUM growth below earlier guidance
- Dependent on banks for property sourcing
- Retail funds present mixed performance

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Financials: Preliminary FY17 results released

publity reported an FY17 net profit of €11.2m, which is in line with the profit warning issued in January (post-tax profit of at least €10m, but below FY16 levels). This represents a c 52% y-o-y decline vs FY16 and was largely driven, according to the company, by delays in disposals of properties worth c €280m (now expected to be closed in the coming months) and the deceleration in AUM growth associated with overall market trends. While publity was able to increase its AUM significantly to €4.6bn by end-2017 from €3.0bn at end-2016 (and €3.8bn by end-June 2017), it missed its earlier guidance of €5.2bn. Still, management guides to FY18 net profit of €15-20m, emphasising that this guidance cautiously does not assume any growth in AUM.

Exhibit 1: FY17 preliminary results highlights

€m	FY17	FY16	y-o-y change (%)
Revenue	25.6	41.6	(38.4)
EBIT	14.8	35.5	(58.3)
EBIT margin (%)	57.8	85.4	(2,757bp)
Net income	11.2	23.1	(51.5)
Net margin (%)	43.8	55.6	(1,181bp)
EPS (€)	1.87	3.89	(51.9)
AUM (€bn)	4.6	3.0	53.3

Source: publity accounts

Recent newsflow and upcoming catalysts

Asset disposals and distributions to investors

So far publity has established eight closed-end retail funds (Performance Fonds), of which the first five invested in NPLs and the latter three invest directly in office properties in Germany acquired through bank liquidations. publity was recently in the process of portfolio divestments in Fonds Nos. 4 and 5, whose performance was rather disappointing, with just 98% and 99% of the paid-in capital returned to investors as at 2 November 2017 (both funds had a definite life until end-2017). The company is planning additional distributions based on a liquidity reserve that was retained in the funds, but there is no visibility as to its level and timing. Management indicated that the key factor impacting the performance of these funds were regulatory changes which effectively prevented the funds from re-investments in NPLs. Although historical returns are not a guarantee of future performance and these funds invested in NPLs rather than directly in office projects (as is the case with newer funds Nos. 6, 7 and 8), there is a risk that these results might weigh to some extent on investor's sentiment towards publity's retail funds.

Following the publication of our last update note, the company announced four office project disposals with an aggregate floor space of c 17,000 sqm, which were part of Performance Fond No. 6's portfolio. This includes the Takko headquarters in Telgte, a 3,000 sqm office building complex in Munich-Unterschleißheim, a project in Bad Homburg, as well as the Haus der Wirtschaftsförderung premises in Duisburg. Together with the disposal of Hansa Center in Bottrop announced in June, publity therefore sold five real estate projects owned by Performance Fond No. 6 this year, after selling several properties from the same fund in 2016 as well. The fund intends to distribute 10% of the paid-in limited partner's capital, bringing total payments to investor since inception to 36% of the initially invested capital. This is broadly in line with original assumptions of distributing 5% in 2014 and 10% per annum in the period 2015-2017, with a targeted final distribution by end-2018 of 113%. The fund currently holds only two investments, which presumably will be liquidated towards the end of the fund's life at end-2018. Management takes into consideration the option of making early distributions from the liquid assets in the fund's portfolio or re-investing at least part of them in real estate projects with a larger final distribution at end-2018. Importantly, the recent disposals had only a minor impact on the lower than expected growth in AUM last year, as publity largely remained responsible for managing these assets.

Attempt to change convertibles' terms and conditions

We believe it is also worth highlighting the ongoing discussions between publity and investors (mostly institutional) who currently hold the company's 3.5% convertible bonds due on 17 November 2020. publity intends to amend the terms and conditions of these bonds to increase the cap on incurring new indebtedness from €5.0m to €30.0m as well as to change the wording in relation to the covenant which determines the maximum level of dividend payout ratio (currently at 50%). According to the management, the English section of the terms and conditions needs to be amended to be in line with the German part, which it believes is legally binding and does not impose any restrictions on the dividend distribution made from FY16 earnings. The English part of the terms and conditions on the other hand suggests that the restriction applies to this dividend distribution as well. Since it was done at a 72% payout ratio, it would technically constitute a covenant breach and allow investors to declare the bonds due and payable. The first vote to amend the terms and conditions without a meeting conducted by noteholders in November 2017 was inquorate, while the required majority was not reached during the second one. As a result, the original arrangement remains in force. However, management is planning to continue discussions with investors and eventually reach an agreement. Meanwhile, the price of the convertible bonds declined to c 80% of par value.

Small institutional mandate added

While AUM growth was below management expectations, the company continues to expand the asset management business for institutional investors. In November 2017, it announced that it won a minor asset management mandate with a German institutional real estate investor with an emphasis on deals in the range of €1.0-15.0m. This is different from the existing mandates, which mostly cover transactions of €25-100m. The contract involves, among other things, the purchase of five office premises in Germany in FY17 (which was executed as planned), primarily in Frankfurt and Munich, and is broadly in line with publity's general business focus. The deal volume under this mandate should reach €150m by the end of 2018 and is much smaller than the mandate with a South American investor obtained in April last year. publity did not disclose any additional details of the mandate, but stated that the agreement was in line with the company's usual terms.

Valuation

In our view, the P/E multiple is the most appropriate method to value publity, as it is an asset manager rather than a property fund, and as such focuses on generating earnings rather than NAV growth. We have compared publity to its German real estate fund management peers. As exhibited in the table below, the stock is currently trading at a P/E of 9.7x on FY17 earnings, which represents a 44% discount to peer group. Based on the mid-point of the FY18 guidance (€15-20m), the stock is trading at 6.3x, ie a 54% discount (no up-to-date consensus estimates for publity available). We believe that this may at least partially be a function of the missed AUM guidance and net profit decline, as well as some uncertainty among investors related to the performance of publity's retail funds and the ongoing discussions with bondholders.

publity's EPS in FY17 came in at €1.87 compared with €3.89 a year before. The shares may potentially provide a dividend yield of up to 5.2%, assuming the shareholders vote in favour of a distribution representing the maximum level allowed under the convertible notes covenant (ie 50% payout ratio). This compares with a peer average of 2.7%. However, publity's management has not yet made a final recommendation on the level of dividend payment. Moreover, we are not able to evaluate the cash quality of the FY17 earnings, given no available cash flow data.

Exhibit 2: Peer group comparison

	Market cap (€m)	P/E (x)		Dividend yield (%)
		2017e	2018e	2017e
Corestate Capital	1,070.6	15.5	8.9	3.9
Patrizia	1,635.2	27.1	20.6	1.4
VIB Vermogen	584.7	13.0	12.6	2.8
WCM Beteiligungs	526.7	14.0	12.7	2.6
Peer group average	**-**	**17.4**	**13.7**	**2.7**
publity	109.5	9.7	6.3	N/A
Premium/(discount) to peer group	**-**	**(44%)**	**(54%)**	**N/A**

Source: Company accounts, Bloomberg. Note: Prices as at 1 March 2018. Please note that publity's 2017 P/E multiple is based on preliminary FY17 results and 2018 is based on the mid-point of company guidance.

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