

# PREOS Real Estate AG

Buy (unchanged) Target: Euro 18.50 (old: Euro 15.50)



Der Spezialist für Finanzaktien

29 | September | 2020

■ Price (Euro)	16.30			
52 weeks range	17.50 / 4.67			
■ Key data				
ISIN	DE000A2LQ850			
Bloomberg	PAG:GR			
Reporting Standard	IFRS			
Market Cap (million)	1,168.00			
Number of shares (million)	107.5			
Free Float	14.0%			
Free Float Market Cap (million)	163.5			
■ Multiples	2019	2020e	2021e	2022e
Market Cap / Revenues	81.1	12.6	7.0	6.5
Price-Earnings Ratio (PER)	26.4	18.0	15.5	16.9
Dividend yield	0.0%	5.0%	5.0%	5.0%
■ Key data per share (Euro)	2019	2020e	2021e	2022e
Net income per share	0.62	0.91	1.05	0.96
Dividend per share	0.00	0.82	0.82	0.82
■ Financial Data (Euro '000)	2019	2020e	2021e	2022e
Rental revenues	14,394	92,736	166,348	180,913
Gross rental income (GRI)	6,744	52,240	93,707	101,911
Personnel expenses	-709	-744	-781	-820
Other operating expenses	-5,714	-82,159	-62,531	-64,290
Gain or loss on measurement of investment	101,683	223,670	234,853	246,596
EBIT	106,404	197,626	270,099	288,493
Interest income	6,096	814	0	119
Interest expenses	-18,116	-80,622	-117,821	-134,697
EBT	80,160	117,818	152,278	153,915
Tax	-13,847	-20,352	-26,304	-26,587
Net income	66,313	97,466	125,973	127,328
Earnings per share	0.62	0.91	1.05	0.96
Dividend per share	0.00	0.82	0.82	0.82
NAV per share (Euro)	4.19	4.76	7.07	7.73
Total Assets	912,866	2,604,624	4,187,454	3,466,769
Equity	263,214	352,900	591,966	859,540
Equity Ratio	28.8%	13.5%	14.1%	24.8%
Return on Equity	25.2%	31.6%	26.7%	17.5%
■ Main Shareholders				
publity AG	86.0%			
■ Financial Calendar				
Tokenization of shares		4Q 2020		
AGM		May 2021		
2020 annual report		May 2021		
■ Analyst	Dipl.-Kfm. Stefan Scharff, CREA			
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## PREOS triples its EBIT and is increasingly evolving into an innovative technology company. Target price up to Euro 18.50, rating remains Buy

Last week, on 24 September, PREOS released its 2020 semi-annual report. The EBIT for the first half of 2020 almost tripled from Euro 25m in the previous year to Euro 70m. The result after taxes also rose significantly from Euro 21.8m to Euro 30.9m. The portfolio volume was doubled to Euro 1.5bn in the same period and is expected to grow to around Euro 2bn by the end of the year. In the coming years, the portfolio is even planned to grow to Euro 4bn by 2022 and even to Euro 8bn by 2024.

The first half of 2020 followed the strong development from the previous year 2019. Despite the Covid 19 pandemic, PREOS was able to maintain its course. The company was able to report both rental successes and successful transactions. As one of the most important success factors, the company's own property database, which now has over 9,500 properties, forms the basis for the recently seen very dynamic development. Furthermore, an additional long-term investor for a stake of 5.4% in PREOS with a lock-up period of twelve months was acquired.

In parallel to the successful course of business and the broadening of the group of investors, the capital base was also strengthened. In addition to the previous financing agreements, PREOS was able to collect additional debt of Euro 50m by issuing a corporate bond. The increase in equity was also approved by the Supervisory Board. For the first time, a dividend of 5% is planned for FY 2020 and should be kept permanently at 5% of the weighted average share price within 3 months in front of the AGM.

PREOS is also developing strategically and recently decided to globalize its business model by initially targeting international locations such as Luxembourg, Paris, London, Vienna, Milan and Madrid as investment locations. This strategic development is underpinned by the advancing technology of the company. In the fourth quarter, PREOS will transfer some of its shares into so-called tokens based on blockchain technology. On this basis, individual investment vehicles and international locations are also to be tokenized. The company is one of the first to take a big step from a real estate company to a technology company. PREOS intends to implement artificial intelligence in its business model. This could result in significant upside potential for the company's value in the future.

**PREOS has so far proven to be crisis-resistant and at the same time was able to continue to implement its strategy. The decision to move towards globalization and technology goes hand in hand with the major goals of building the portfolio. At the same time, the capital base is created for this on a sustainable basis. As the new target price offers a remarkable upside potential of about 15%, we maintain our Buy recommendation.**

## SWOT Analysis

### Strengths

- PREOS has a very experienced management team, each with decades of expertise and a high-quality network, which is crucial for the success of the business model.
- Good structured processes from the entry, through asset management to minimize risk and increase the likelihood of strategic implementation.
- Strong deal flow proves ability for strategic implementation and, at the same time, is an indicator of the dimension in which PREOS intends to emerge (Euro 8bn by 2024).
- The financing is built on a broad basis and well-known financing partners have been won. The investor base was expanded.
- PREOS is considered as an active investor of high-yield commercial properties. While the expected cash flow represents a significant stabilizer, the continuously realized property sales are a considerable growth driver.

### Weaknesses

- Due to the young age of PREOS, there is only a short company history.
- Lack of comparability of previous corporate figures with the desired development.
- The valuation of the company is based exclusively on the DCF valuation, as a NAV observation in the context of current developments has still low significance.
- The PREOS share is currently listed in the Munich stock exchange's m:access segment, where transparency level is higher than in the "normal" open market. The next step for the share would be a Prime Standard listing.

### Opportunities

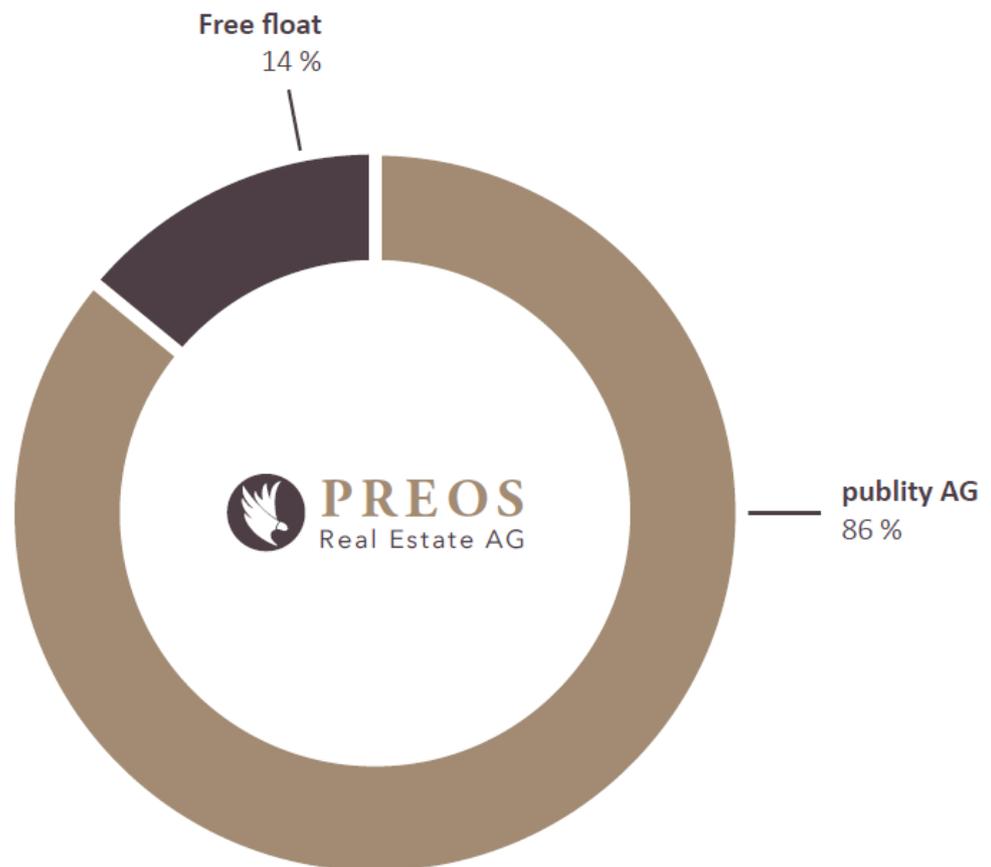
- Based on a revival of the economy, the strategic positioning of PREOS is expected to continue its significant earnings and balance sheet growth. The earnings contribution from the sales proceeds in combination with the relatively favorable financing conditions is the main driver of earnings.
- The combination of the strategic positioning and the management expertise of PREOS could, if successful, be the most efficient growth story in the current macro environment. The development towards a technology company holds great earnings potential.
- High-priced and large-volume office properties in German metropolitan areas are one of the most stable segments which should lead to a relative strength within the sector in the mid- to long-term.

### Threats

- The largely externally financed (leveraged) property purchases, which are an essential pillar of the strategy, represent a risk to the implementation of the strategy if there is a lack of willingness to finance the purchases.
- PREOS competes with many players in a competitive market and is therefore at risk of not getting the suitable assets.
- The market risk affects all companies in the real estate industry and should therefore be seen as a general one. The probability of a recession increased in the last half year which could lead to a market cooling meanwhile. This could also affect the earnings situation in the entire real estate sector. The development of rents and real estate prices as major earnings drivers could be affected negatively.

## The new PREOS – a concise round up

PREOS is positioning itself as a portfolio holder of high-yield commercial real estate that is still in dynamic development. The previous focus was on top German locations and is to be expanded to top international locations in the future with at least the same quality. The company's development to date has been very dynamic. Both the portfolio and the company figures grow consistently. This success is due to the management expertise. Both before and during the Covid 19 pandemic, the company showed high activity, followed by high transparency and news frequency. For added value, PREOS continues to pursue a manage-to-core approach, i.e. the increase in the value of the real estate is to take place through targeted asset management measures. Strategically, too, the company shows a very forward-looking and proactive approach. In this context, PREOS continues to develop in all areas. In addition to the location expansion, PREOS is positioning itself as an innovative technology company and is creating the necessary investor and capital structure for this. The most recent measures have attracted a long-term investor and the free float has doubled from under 7 to 14%.



Source: 2020 Semi-annual report

## Successful during a crisis: Milestones & News flow

### Strong news flow & dynamic development

#### May 2020

- First virtual annual general meeting with full approval of the agenda items. Authorization for further financing steps.

#### July 2020

- Long-term international investor takes a 5.4% stake in PREOS.
- Extraordinary general meeting approves capital increase by around Euro 35m to Euro 107m. Approval of all agenda items - including the approval of new capital of Euro 54m.
- PREOS sells real estate portfolio to GORE for Euro 200m as planned.
- PREOS plans to issue a corporate bond with a volume of up to Euro 400m.

#### August 2020

- PREOS plans dividend for 2020 and defines long-term dividend policy. The asset portfolio should grow to approx. Euro 2bn by the end of 2020.
- PREOS' parent company publicity AG plans to issue blockchain-based PREOS tokens for the digital securitization of PREOS shares.
- Successful implementation of a Euro 80m project in Essen - new police headquarters handed over to the Essen police force.

#### September 2020

- Internationalization of the business model planned through the establishment of international investment vehicles, stock exchange listing of investment companies and tokenization of the respective shares.
- Renaming of the company to PREOS Global Office Real Estate & Technology AG and relocation to Frankfurt.
- PREOS starts talks with Thomas Olek to take over the position of Chairman of the Board of Management (CEO).
- Successful sale of a property in Essen with 100,000 sqm.

### New long-term investor & capital base

### Dividend planned 5% yield

### Internationalization & tokenization

## **PREOS keeps momentum**

Despite the crisis, PREOS maintains its momentum. The newsflow continues the previous corporate strategy and confirms the reported and still planned strong growth with concrete measures. In the course of the year it became evident that both the new letting and the project completion could be carried out successfully. Based on the recently announced sale of the Essen property, the deal flow that is required to implement this dynamic corporate strategy is also proved.

## **Adequate capital measures**

At the same time, PREOS is also very active and forward-looking with regard to the necessary capital planning. In this context, the necessary room for maneuver for strengthening equity was created by means of corresponding resolutions. At the same time, borrowing will continue to be promoted through planned bond issues.

## **Innovation: from real estate to technology company**

As one of the first real estate companies, PREOS continues to move strongly towards the vision of the technology company. In addition to the database that has been built up for many years, which gives the company considerable information advantages over the competition, PREOS has now also announced that it will transfer part of its shares into digital tokens. The so-called tokenization of the shares works via the promising blockchain technology, which has already been used to process the first bond issues by other companies. In the course of the broader positioning of the company's shares, this step also serves to further expand the investor base. At the same time, PREOS is strengthening its reputation as a technology company and is taking an important step. PREOS may revolutionize the value creation process and transfer mechanism within the real estate industry.

## **Globalization of the business model & international locations**

In line with the technology, the business model is internationalized both virtually and physically. In this context, the establishment of country-specific investment vehicles is planned. The aim is to list them on the stock exchange in their respective target market at a later point in time or to bring them to companies that are already listed. The shares of the respective listed companies are then to be tokenized. PREOS is planning to create an independent technology company to bundle the blockchain technology required for tokenization. Accordingly, the company deals with the development of artificial intelligence in the areas of real estate investment as well as real estate administration and management. For this purpose, the company will be renamed PREOS Global Office Real Estate & Technology AG. In addition, investments will be made in real estate in Luxembourg and Paris and then in London, Vienna, Milan and Madrid. The first properties in Luxembourg and Paris are to be acquired as early as the fourth quarter of 2020.

## Corporate progress: Earnings, capital structure, stock price

### Almost tripling EBIT

### Almost doubling portfolio

### Database contains over 9,500 objects

**Portfolio size (Euro):**  
**H1 2020: 1,5 bn**  
**2020: 2 bn (planned)**  
**2024: 8 bn (planned)**

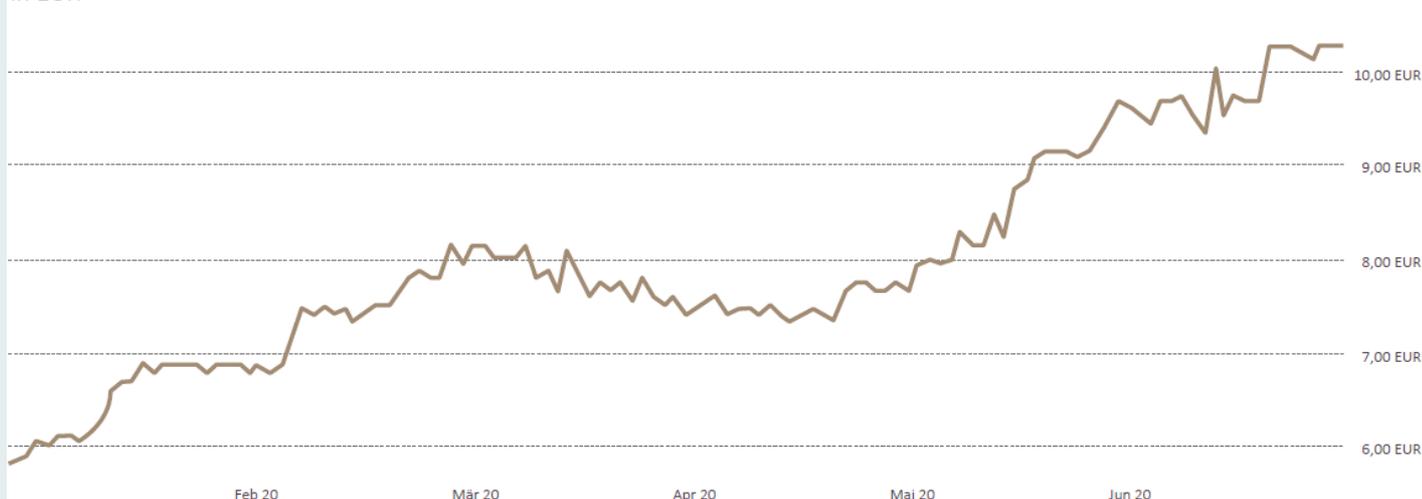
### Growing capital base

The most recent company results follow the previous development. The EBIT in the first half of 2020 was Euro 70m, almost tripling the previous year's figure of Euro 25.1m. Consolidated earnings after taxes rose from Euro 21.8m in 1H 2019 to Euro 30.9m in the first six months of 2020. The reported increase in earnings resulted primarily and still from the acquisition of further high-class commercial properties in very good locations. Meanwhile, the portfolio size has almost doubled compared to the same period in the previous year to Euro 1.5bn. Despite the Covid 19 pandemic, PREOS was able to continue successfully implementing its previous dynamic strategy. As a success-critical basis for this development, reference should again be made to the specially developed database, which now has over 9,500 objects. The portfolio is expected to grow to Euro 2bn by the end of 2020 and to Euro 8bn by 2024.

In the 1H 2020, equity increased from Euro 263m to Euro 301m, which is mainly the result of retained earnings. The balance sheet grew from approx. Euro 913m to Euro 1.28bn. The total liabilities rose through the financing measures from Euro 650m to Euro 973m. Due to portfolio growth, the equity ratio fell from 29% to around 23.5% in the period under review.

In the course of the strong development of the company figures, the PREOS share rose in 2020 from under 6 Euros to 16.30 Euros most recently, almost tripling as follows.

PREOS REAL ESTATE NA O.N. (Xetra)  
in EUR

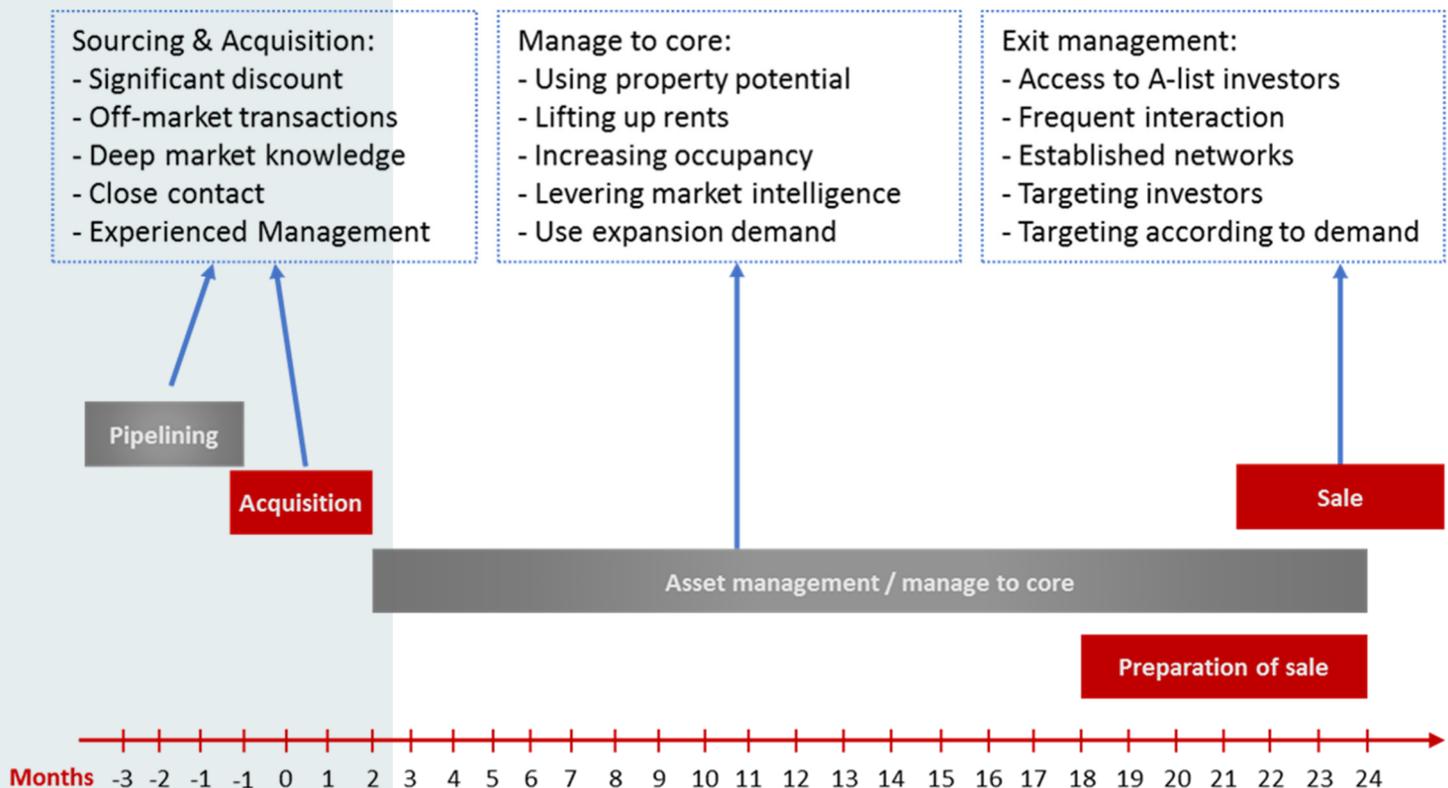


Source: 2020 Semi-annual report

## Manage-to-Core as Key Factor / Continuing Capital Measures

PREOS was able to back up its initially ambitious strategy to a high degree with facts. As along the value chain shown below, the company operates in all phases and this is extremely successful. The latest company figures for 1H 2020 and the transactions made therein testify this. The cooperation partners of PREOS are the basis for the effectiveness of the process shown below. As the most important partner, publicity AG is the majority shareholder, who is responsible for the biggest part of the process and is essential for the success of the asset management.

publicity as  
most important partner



Source: SRC Research

**Euro 50m raised via corporate bond / Euro 350m left**

**Further equity capital increases possible**

This tried and tested approach is also the basis for the digitization and internationalization strategy to be implemented. This step will also go hand in hand with the appropriate capitalization measures. By issuing a corporate bond, PREOS was able to raise Euro 50m in debt as part of the first tranche in June. A total of up to Euro 400m can be raised. This means that it is still possible to borrow Euro 350m through this program. Furthermore, we see the raising of additional equity as a logical measure to strengthen the ongoing strategic optimization. As part of the tokenization of the shares and as a separate measure, we consider a capital increase of between Euro 350m and Euro 400m to be possible in the next two calendar years.

**Company results are approaching forecasts.**

**Our new DCF model results in a higher fair value of Euro 18.63**

We use a DCF model (discounted cash flows) for the valuation of the company. To do so, we forecast free cash flows based on EBIT for the coming years to 2024 and then apply the Gordon Growth model for terminal value. The free cash flows of the individual years are discounted with the company's cost of capital (WACC) at the respective cash value. We assume that EBIT will grow until 2022. Due to the conservative approach, we assume a decline in EBIT for the last two years from 2023 to 2024 to price in the risk of the dynamic business model.

**DCF Valuation Model PREOS Real Estate AG  
(WACC Method)**

**Assumptions:**

Long-term Equity Ratio	29%	Beta-factor	1.4
Cost of Equity	8.1%	Risk-free interest rate	0.5%
Debt Costs	4.8%	Market premium	5.5%
Weighted Average Cost of Capital (WACC)	4.84%		
Years until first payout	0.6		
Long-term-growth Terminal Value	1.0%		

'000 Euro	2020e	2021e	2022e	2023e	2024e	Terminal Value
<b>EBIT</b>	<b>197,626</b>	<b>270,099</b>	<b>288,493</b>	<b>249,492</b>	<b>220,046</b>	
Financial Result	-74,309	-109,703	-125,305	-88,593	-31,008	
Taxes	-33,295	-43,307	-44,061	-43,443	-51,040	
<b>adjustments (Capex)</b>	<b>-19,763</b>	<b>-27,010</b>	<b>-28,849</b>	<b>-24,949</b>	<b>-22,005</b>	
<b>Free Cash-Flow</b>	<b>70,259</b>	<b>90,079</b>	<b>90,278</b>	<b>92,507</b>	<b>115,994</b>	
<b>Present Value Free Cash-Flow</b>	<b>65,176</b>	<b>79,708</b>	<b>76,198</b>	<b>74,477</b>	<b>89,079</b>	<b>2,206,400</b>

Present Value Detailed Forecast Period	384,638
Present Value Terminal Value	2,206,400
<b>Total Free Cash-Flows</b>	<b>2,591,038</b>
- net debt	-588,238
<b>Fair value of equity</b>	<b>2,002,800</b>

Number of shares ('000)	107,495
<b>Fair value of equity per share</b>	<b>€ 18.63</b>

**Current Price:** € 16.30

**Up / Down potential** 14%

Source: SRC Research

## EBIT growth expected in 2021 and 2022

## Slight decrease in 2023 and 2024 as a factoring in of the risk

Compared to the previous evaluations, the course of business was smoothed in the forecast until 2024, as PREOS has proven through the past results that it is doing justice to the forecasts and has created corresponding trust. This justifies a renewed appreciation of the share. We therefore see a fair value at Euro 18.63. At the current share price of around Euro 16, we see an upside potential of about 15%. The following forecast calculation serves as the basis for the valuation model shown.

### PREOS Real Estate AG 31/12 IFRS ('000)

	2019	2020e	2021e	2022e	2023e	2024e
Rental revenues	14,394	92,736	166,348	180,913	165,378	173,647
Recoverable operating expenses	-7,650	-40,496	-72,641	-79,001	-72,218	-75,829
<b>Gross rental income (GRI)</b>	<b>6,744</b>	<b>52,240</b>	<b>93,707</b>	<b>101,911</b>	<b>93,161</b>	<b>97,819</b>
Other operational income	4,408	4,628	4,860	5,103	5,358	5,626
Impairments on receivables	-8	-10	-9	-7	-8	-7
Personnel expenses	-709	-744	-781	-820	-861	-904
Other operating expenses	-5,714	-82,159	-62,531	-64,290	-57,764	-60,653
Gain or loss on measurement of investment property	101,683	223,670	234,853	246,596	209,607	178,166
<b>EBIT</b>	<b>106,404</b>	<b>197,626</b>	<b>270,099</b>	<b>288,493</b>	<b>249,492</b>	<b>220,046</b>
Interest income	6,096	814	0	119	1,780	0
Interest expenses	-18,116	-80,622	-117,821	-134,697	-96,929	-5,982
Long-term depreciation financial assets	-13,637	-14,319	-15,035	-15,787	-16,576	-17,405
Share in the result of associated companies	-587	0	0	0	0	0
<b>EBT</b>	<b>80,160</b>	<b>117,818</b>	<b>152,278</b>	<b>153,915</b>	<b>154,343</b>	<b>214,064</b>
Tax	-13,847	-20,352	-26,304	-26,587	-26,661	-36,977
<b>Net income</b>	<b>66,313</b>	<b>97,466</b>	<b>125,973</b>	<b>127,328</b>	<b>127,682</b>	<b>177,087</b>
Number of shares ('000)	107,495	107,495	119,765	132,035	132,035	132,035
<b>Earnings per share</b>	<b>0.62</b>	<b>0.91</b>	<b>1.05</b>	<b>0.96</b>	<b>0.97</b>	<b>1.34</b>
Dividend per share	0.00	0.82	0.82	0.82	0.82	0.82
<b>Portfolio size</b>	<b>1,100,000</b>	<b>2,604,624</b>	<b>4,187,454</b>	<b>3,466,769</b>	<b>3,379,063</b>	<b>2,703,250</b>
<b>Liabilities</b>	<b>649,652</b>	<b>2,092,831</b>	<b>3,340,612</b>	<b>2,445,612</b>	<b>2,145,612</b>	<b>1,445,612</b>
<b>NAV per share (Euro)</b>	<b>4.19</b>	<b>4.76</b>	<b>7.07</b>	<b>7.73</b>	<b>9.34</b>	<b>9.53</b>
<b>Total Assets</b>	<b>912,866</b>	<b>2,604,624</b>	<b>4,187,454</b>	<b>3,466,769</b>	<b>3,379,063</b>	<b>2,703,250</b>
<b>Equity</b>	<b>263,214</b>	<b>352,900</b>	<b>591,966</b>	<b>859,540</b>	<b>928,468</b>	<b>997,750</b>
<b>Equity Ratio</b>	29%	14%	14%	25%	27%	37%
<b>Return on Equity</b>	25%	32%	27%	18%	14%	18%

**SRC Research**  
**- Der Spezialist für Finanz- und Immobilienaktien -**

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**Rating chronicle:**

Company	Date	Rating	Former Price	Former Target
PREOS Real Estate AG	19 May 2020	Buy	13.20 €	15.50 €
PREOS Real Estate AG	12 March 2020	Hold	11.80 €	11.80 €
PREOS Real Estate AG	20 November 2019	Buy	9.05 €	10.40 €

**Please note:**

The share price mentioned in this report is from 28 September 2020. PREOS Real Estate AG mandated SRC Research for covering the share.

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