PREOS Real Estate AG

Germany / Real Estate
Munich Stock Exchange
Bloomberg: PAG GR
ISIN: DE000A2LQ850

Initiation of coverage

RATING	**ADD**
PRICE TARGET	**€ 10.50**
Return Potential	**21.4%**
Risk Rating	High

HIGH GROWTH PLAY IN GERMAN OFFICE SPACE

PREOS Real Estate AG is an emerging German commercial property landlord in the early stages of implementing a high growth strategy. Over recent quarters, the company has strengthened management and infrastructure to support its ambitious expansion plans and rapidly built a stable of office assets. The company now plans to issue new corporate debt to fill the financial coffers. This would allow PREOS to capitalise on a still strong commercial property market and deliver exceptional growth over the next years. Using an economic profit model, we derive fair value of €10.5 per PREOS share and start coverage with an Add rating.

Emerging German office property play We like PREOS for its strategic approach and position in the German property market. In late 2018, the company joined the current workspace buying frenzy across Germany and is presently focused on office complexes. Led by a bolstered management team, PREOS embarked on an aggressive growth campaign this year, which included the takeover of publity Investor GmbH and its portfolio. We estimate the value of the PREOS' office portfolio will top €700m at YE compared to the €94m reported YE18. This figure could top €1bn based on a pipeline of late stage candidates. The growth ranks favourably with the performance of Germany's leading commercial landlords, and management see excellent opportunities for similar performance ahead.

Operational roadmap for further growth PREOS will pursue an active cash recycling strategy that combines a classic buy and hold approach with opportunistic disposals. The company wants to leverage its expertise and network to optimise underperforming assets acquired at market discounts and sell them to augment external financing sources. We have assumed PREOS will successfully place the recently announced €300m convertible bond issuance by the end of Q1/20 to finance future growth and retire legacy debt. We note that our forecasts and valuation hinge upon the successful placement of corporate debt. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2018	2019E	2020E	2021E	2022E
Net rent (€m)	1.04	11.20	57.63	77.17	116.48
Adj. EBITDA (€m)	-0.90	-4.02	38.12	57.77	96.32
Net income (€m)	3.00	62.46	98.40	73.43	115.70
EPS (diluted) (€)	0.0	0.90	0.96	0.72	1.13
EPRA NAV (€m)	26.21	361.83	473.17	549.86	652.34
NAVPS (€)	1.20	5.05	6.60	7.67	9.10
DPS (€)	0.00	0.00	0.00	0.00	0.00
FFO 2 (€m)	-2.65	-0.25	38.80	65.72	204.51
FFOPS 2 (€)	-0.12	-0.01	0.54	0.92	2.85
Liquid assets (€m)	2.56	88.14	108.76	44.69	48.72

RISKS

Risks include, but are not limited to, insufficient financing, weaker than expected trends for German office markets, failure to capture planned reversionary potential, or undershooting forecasted acquisitions.

COMPANY PROFILE

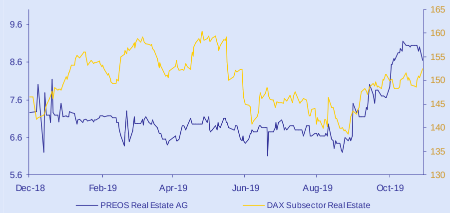
PREOS Real Estate is a real estate landlord specialised in the acquisition and optimisation of commercial properties throughout Germany. The company focuses on building a diverse portfolio of value-add assets and presently concentrates on office buildings.

MARKET DATA

MARKET DATA	As of 11/18/2019
Closing Price	€ 8.65
Shares outstanding	71.67m
Market Capitalisation	€ 619.95m
52-week Range	€ 6.10 / 9.15
Avg. Volume (12 Months)	4,895

Multiples	2018	2019E	2020E
P/FFO 2	n.a.	n.a.	16.0
P/EPRA NAV	7.2	1.7	1.3
FFO 2 Yield	n.a.	n.a.	6.3%
Div. Yield	0.0%	0.0%	0.0%

STOCK OVERVIEW



COMPANY DATA

COMPANY DATA	As of 30 Jun 2019
Liquid Assets	€ 11.78m
Current Assets	€ 13.59m
NAV	€ 44.44m
Total Assets	€ 118.48m
Current Liabilities	€ 1.92m
Total Equity	€ 47.95m

SHAREHOLDERS

publity AG	93.2%
Free Float	6.8%

Analyst: Ellis Acklin, Tel. +49 (0)30 - 80 93 96 83

CONTENTS **PAGE**

INVESTMENT CASE

German office pure play

PREOS is a commercial property player with a focus on office assets located in metropolitan and suburban locations throughout western Germany. The company is led by Frederik Mehlitz, who brings 20+ years of CRE (commercial real estate) credentials. Historically underutilised operations were rebooted in 2018 and included beefed up management and supervisory boards plus a seed portfolio populated with below-market deals. This will be the hallmark of PREOS operations. The landlord kicked off an aggressive expansion strategy this year in order to capitalise on still strong CRE dynamics.

Not just an old hat "buy and hold" model

PREOS combines a buy and hold strategy with an asset rotation component to drive value creation and sustainable rental income (RI) as well as capture attractive disposal returns for fully optimised properties. A blended value-add (manage-to-core), Core, and Core+ portfolio will provide cash flows, while future disposals will recycle cash and replenish the financial coffers for further portfolio growth. We believe this "buy, hold, optimise, then sell" approach is well suited to today's environment, where an active asset management strategy promises much greater rewards than a classic and more static buy and hold strategy.

Office space is still the right place to be

PREOS will focus on Germany's office segment, which is booming at present thanks to: (1) frothy occupier demand and uptake; (2) an acute shortage of existing stock; (3) a paucity of new supply coming online; (4) rising rents across Germany's metropolitan hubs; and (5) shifting dynamics in the workforce. PREOS consequently has a 100% office exposure and sees this trend continuing over the near term.

Strong investment volumes planned for 2020 to 2022

Investments YTD have topped €316m with another €263m set to close by year end. This sets the stage for the ambitious expansion plans over the next three years. Plus, the company's intensified cash recycling strategy is off to a good start with the St Martin Tower disposal. The company wants to place €300m in convertible debt by the end of Q1/20 to execute on an attractive pipeline and retire some €113m in legacy debt. We model €800m in investments next year and a total of €2.6bn through 2022. PREOS will lean on its trusted partner, publity AG, to arrange off-market transactions that should allow PREOS to ink deals below their respective market values. This should result in strong revaluation gains with good execution of its manage-to-core approach.

Portfolio approaching €0.7bn threshold

PREOS has a stable of 17 office assets with an annualised rental income run rate of €22.5m. Another four properties are expected to close in Q4 with an annualised rental income run rate of €23.5m, which should propel GAV (gross asset value) north of €0.7bn with upside towards €1.0bn this year. We expect the company to generate net rental income (NRI) of €65m in 2020 and €6.6m in FFO 1 (funds from operations). On our numbers, PREOS should have around €240m in financial firepower available next year to acquire new properties if management tap up the convertible debt. Plus, the company will be able to redeploy cash flow from disposals during the course of the year.

Early success paves the way for good value

We start coverage with an Add rating and €10.5 price target. This is based on an economic profit model, which demonstrates PREOS' ability to spur growth and reward investors. The main drivers for potential value generation are a €0.7bn YE portfolio with embedded revisionary upside, strengthened executive and supervisory boards, and an improved network and business platform than can spur rental income and FFO streams. Good execution would also allow management to reward investors with a first-time dividend on 2020 earnings. We consider the brief large-scale track record the key risk to our targets.

SWOT ANALYSIS

STRENGTHS

- **Strategic diversification** The strategy will combine steady cash flows from rental income streams, while the 'Manage-to-Core' / opportunistic disposal approach will yield add-on profits from the sale of optimised properties.
- **The right partnership** The company will rely upon the expertise, market intelligence, and vast networks of publity AG to source off-market deals, manage the properties, and oversee disposals.
- **Process agility** Management is able to react swiftly to opportunities. In today's fast-paced CRE market, this should allow PREOS to scoop up properties quicker than rivals saddled with a multi-layered decision making process.
- **A clean slate** There are no underperforming legacy assets or poorly structured debt loads to weigh down performance after the company refinanced its seed portfolio in April. Management can load up the balance sheet with hand-picked office properties and debt that better reflect the current favourable environment.

WEAKNESSES

- **Highly leveraged** PREOS will finance growth chiefly with bank, mezzanine, and corporate debt. The latter will likely have to be issued at relatively high interest rates (~7.5%) vs larger peers with good credit ratings. This structure translates into a potential LTV north of 70% and a rather low ICR (interest coverage ratio) of 2.7x on projected 2020 figures.
- **Brief track record** PREOS supercharged operations in 2019 and is on pace to add ~€0.6bn to its stable of office assets. And while indications for the envisioned growth look good, this is uncharted territory for the company in terms of scale.
- **Conflicts of interest** PREOS has strong ties to publity AG, which will play a key role helping the company grow operations and manage the properties. publity is also the majority shareholder (>93%). This overlap could lead to investor backlash if performance or transparency is unsatisfactory.
- **Transparency** Portfolio reporting is not on par with the commercial real estate stalwarts. If the company is going to step up in weight class, this will have to improve.

Opportunities

- **Reversionary potential** The company wants to populate its portfolio with Manage-to-Core assets. These are often defined by higher vacancy rates and harbour good reversionary upside to drive LFL growth metrics.
- **Sweet spot of the property market** Business is focused on the German commercial sector—primarily the office segments. The commercial sector is much earlier in the cycle than the residential market, providing better growth and value extraction opportunities.
- **Expansion of focus** PREOS could branch out into other asset types as market trends shift.

Threats

- **Plenty of competition** Office assets are highly coveted by large, well financed and networked commercial landlords, who are racing to buy portfolios to satisfy large yield appetites. PREOS may not be able to match the firepower of these operators to drive the envisioned growth.
- **Execution going off track** Weaker than expected execution on deal flow, having to pay higher prices than we currently model due to market conditions, or the slower corralling of revisionary upside could all lead to slower rental income and FFO growth than we forecast.
- **The tailgating economy** Germany narrowly dodged a technical recession after posting 0.1% GDP growth in Q3 (Q2: -0.1%). GDP forecasts for EU constituents continue to be revised down by market analysts and fears are mounting that the 19-nation Eurozone bloc is heading towards recession.
- **Relatively late** CRE real estate has been booming for years and has yet to slow down. Compared to listed German rivals, PREOS is ramping up operations relatively late in the cycle.

FINANCIAL COCKPIT

EURm	2019E	2020E	2021E	2022E	EURm	2019E	2020E	2021E	2022E
Rental & operating income	13	68	91	137	Investment properties	702	1,523	1,829	1,956
Revaluations	96	135	108	121	Trade receivables	1	7	10	15
Rental expenses	-1	-3	-5	-7	Cash & equivalents	88	109	45	49
Operating expenses	-20	-32	-37	-40	Other assets	0	0	0	0
EBITDA	88	167	157	211	Total assets	792	1,640	1,884	2,020
EBIT	88	167	157	211	Equity	350	451	527	646
EBT	78	124	96	145	LT bank debt	284	864	1,028	1,057
Net income	64	101	76	119	Corporate debt	140	290	290	290
DPS (€)	0.00	0.00	0.00	0.00	Deferred tax liabilities	15	28	31	18
Adjusted EBITDA	-4.0	38.1	57.8	96.3	Other liabilities	3	6	8	9

EURm	2019E	2020E	2021E	2022E	EURm	2019E	2020E	2021E	2022E
NRI growth	n.m.	415%	34%	51%	GAV	702	1523	1829	1956
NRI margin	85%	85%	85%	85%	EPRA NAV	362	473	550	652
Adjusted EBITDA margin	n.m.	66%	75%	83%	LTV	60%	76%	72%	69%
Adjusted EBITDA growth	n.m.	-1064%	52%	67%	Equity ratio	44%	28%	28%	32%
Net income growth	n.m.	58%	-25%	58%	Net debt / EBITDA	-85x	27x	22x	13x
FFO 2	-0.2	38.8	65.7	204.5	ICR	0.9x	2.0x	2.2x	4.2x
FFO 2 growth	n.m.	n.m.	69%	211%	NAVPS (€)	5.0	6.6	7.7	9.1
FFO 2 margin	-2%	57%	72%	149%	NAVPS growth	319%	31%	16%	19%

Valuation (EURm)		Valuation multiples	2019E	2020E	2021E	2022E
Economic profit model	1,071	P/ FFO 2	0.0x	16.0x	9.4x	3.0x
PER	990	P/NAV	1.7x	1.3x	1.1x	1.0x
FFOPS 2 ratio	794					

Source: First Berlin Equity Research estimates

UNDERLYING FORECAST AND VALUATION ASSUMPTIONS

PREOS is in the early stages of an aggressive growth strategy kick started this year. After exiting 2018 with a €94m seed portfolio, the landlord is on pace to invest ~€0.6bn into the German office space this year. In our model, we expect the company to add another €800m in new office properties next year. We refer to the following key factors to calculate expected growth:

- PREOS will rely heavily upon its close partnership with publity. The latter has good access to off-market deals, which should allow PREOS to buy office assets below their corresponding market values and provide quick revaluation uplift;
- The company has announced a convertible bond issuance and wants to raise proceeds of up to €190m by the end of Q1/20 to provide the equity component for portfolio expansion. We assume an LTV of up to 75% at the SPV level for acquired properties;
- We model a purchase multiple of 18x to 20x to NRI for acquisitions beginning in 2020;
- Vacancy rates of 10% to 15% for Core and Core+ properties and higher vacancy for value-add assets;
- Reversionary upside is driven by a 4.0% LFL rental income growth target. This includes 3.5% LFL rent and 0.5% LFL occupancy growth;
- Annual revaluation gains of 4% to 7% for existing properties and portfolios.

COMPANY VALUATION

We use an economic profit model to value PREOS Real Estate AG. In general, we believe this method best illustrates the company's ability to add value through its rental income streams cash recycling strategy. We have also provided a peer group analysis as a reference, although the early stage of operations—earnings will be modest during the portfolio build up—means that comparable multiples are unlikely to be a reliable gauge of fair value.

ECONOMIC PROFIT MODEL

We assign a WACC of 5.4% based on our multifactor risk model which takes into account company specific risks such as (1) strength of management; (2) earnings quality; (3) portfolio structure; (4) financial risk; (5) competitive position; (6) as well as company size and expected free float. The primary gating factor from our perspective is capital required to spur future external growth, while the brief track record for large-scale operations is also considered. In our view, the 11.5% COE suitably reflects the risk associated with the nascent operations, the small stable of office properties, and the share of revaluation and capital gains compared to larger CRE peers.

in €m	2019E	2020E	2021E	2022E	TV
EBITDA	-4	38	58	96	98
(+) Revaluations	96	135	108	121	49
(-) Tax Expense	0	-3	-4	-7	-7
NOPAT	**92**	**170**	**161**	**210**	**139**
Total assets	**792**	**1,640**	**1,884**	**2,020**	**2,020**
(-) Current liabilities	3	6	8	9	9
(+) Current financial debt	0	0	0	0	0
(-) Cash	88	109	45	49	49
(+) Deferred taxes	15	28	31	18	18
Capital employed (CE)	**715**	**1,552**	**1,863**	**1,980**	**1,980**
Average CE	404	1,134	1,707	1,921	1,980
ROCE	22.8%	15.0%	9.4%	10.9%	7.0%
WACC	5.4%	5.4%	5.4%	5.4%	5.4%
ROCE-WACC	17.4%	9.6%	4.0%	5.5%	1.6%
Economic Profit	70	109	69	106	33
NPV	**70**	**103**	**62**	**90**	**721**
Fair value calculation					
Total return	**1,045**				
(+) NAV 2018	26				
(-) Dividend to be paid (2019)	0				
Equity value	**1,071**				
Diluted SO (m)	102				
Fair value per share (€)	**10.50**				
Cost of Equity	11.5%				
Pre-tax cost of debt	3.0%				
Tax rate	7.5%				
After tax cost of debt	2.8%				
Share of debt capital	70.0%				
Share of equity capital	30.0%				
WACC	**5.4%**				

ROCE is north of the WACC for the forecast period. We have assumed a 1.5% growth rate for terminal value (TV) and a theoretical 7.5% tax rate common for property operators. Our model discounts economic profits through 2022 plus terminal value to derive a total return of €1,045m. We add 2018 NAV (€26m) for an equity value of €1,071m. This equates to fair value per share of €10.5 based on a fully diluted share count of 102m. We note our valuation hinges on the successful placement of corporate debt in the coming quarters.

STACKING UP THE GERMAN COMMERCIAL LANDLORDS

Our peer group encompasses a wide range of commercial landlords focused on the German market. These rivals predominantly pursue a buy and hold strategy and feature mixed portfolios (office, hotel, retail, and logistics) across German hubs. The Munich-based FCR Immobilien AG follows a similar hybrid strategy applied to small town retail and is the only peer that generates significant variance in FFO 1 vs FFO 2.

Table 1: German CRE comparables

	FFO Yield			FFOPS Growth			P / FFO		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Aroundtown	5.0%	5.6%	6.4%	-1.8%	13.3%	12.9%	20.1x	17.7x	15.7x
Alstria Office REIT AG	3.9%	3.9%	4.1%	-2.3%	1.6%	5.3%	25.9x	25.5x	24.2x
Demire Real Estate AG	4.8%	5.8%	6.6%	25.0%	20.0%	13.3%	20.6x	17.2x	15.2x
DIC Asset AG	9.3%	9.8%	10.7%	36.2%	5.9%	9.3%	10.8x	10.2x	9.3x
Hamborner REIT AG	6.9%	7.4%	7.6%	8.1%	7.5%	2.8%	14.5x	13.5x	13.1x
TLG Immobilien AG	5.0%	5.5%	5.9%	3.0%	10.8%	7.3%	20.0x	18.1x	16.8x
Deutsche Konsum REIT	6.3%	7.6%	7.5%	66.7%	20.3%	-0.3%	15.9x	13.2x	13.2x
FCR Immobilien AG	10.6%	11.3%	15.6%	125.0%	6.5%	38.3%	9.4x	8.9x	6.4x
Godewind Immobilien AG	2.1%	4.9%	7.2%	n.a.	133.0%	45.4%	47.1x	20.2x	13.9x
Median	**5.0%**	**5.8%**	**7.2%**	**16.5%**	**10.8%**	**9.3%**	**20.0x**	**17.2x**	**13.9x**
Mean	**6.9%**	**7.6%**	**7.6%**	**32.5%**	**24.3%**	**14.9%**	**20.5x**	**16.0x**	**14.2x**
PREOS	**n.a.**	**n.a.**	**n.a.**	**-140.4%**	**1331.9%**	**79.6%**	**185.9x**	**13.0x**	**7.2x**
Variance to median	***n.a.***	***n.a.***	***n.a.***	***n.m.***	***n.m.***	***n.m.***	***n.m.***	***-24.5%***	***-48.0%***

Source: First Berlin Equity Research; Bloomberg

Funds from Operations (FFO) is the key industry indicator for recurring cash flow. We thus prefer FFO metrics to other measures of fair value. Commercial landlords tend to only sell non-core assets from large portfolios or fully revitalised properties from their portfolios. Therefore, FFO 2, which encompasses disposal gains, rarely deviates significantly from FFO 1. The former KPI tends to be more volatile and less predictable for landlords. However, the disposal of optimised properties is a cornerstone of the PREOS business model. On our numbers, the company will generate significant FFO 2 in 2020 when it will be able to cash in on the substantial investments made this year. It therefore makes little sense to compare PREOS to more mature peers strictly on an FFO basis.

Table 2: German CRE PER comparables

		Market		P/E			EPS Growth		
	Price (€)	cap (€m)	SO (m)	2019E	2020E	2021E	2019E	2020E	2021E
Aroundtown	7.68	9,399	1,224	19.7	16.8	15.1	18.1%	17.4%	11.2%
Alstria Office REIT AG	16.70	2,966	178	26.6	25.0	22.7	2.9%	6.6%	9.9%
Demire Real Estate AG	5.16	556	108	10.0	10.2	11.5	-9.4%	-2.5%	-11.4%
DIC Asset AG	13.94	1,007	72	16.6	16.0	15.1	-2.5%	3.6%	6.1%
Hamborner REIT AG	9.70	773	80	44.1	38.3	36.2	-9.5%	15.1%	5.7%
TLG Immobilien AG	26.80	3,001	112	8.0	15.3	15.6	21.9%	-47.6%	-1.9%
Deutsche Konsum REIT	15.10	483	32	7.4	7.6	8.1	111.3%	-2.5%	-6.8%
FCR Immobilien AG	10.20	93	9	16.8	17.3	10.7	295.7%	-2.5%	61.9%
Godewind Immobilien AG	4.15	451	109	2.7	6.2	6.8	1648.9%	-55.8%	-9.1%
Median				**16.6**	**16.0**	**15.1**	**18.1%**	**-2.5%**	**5.7%**
Mean				**16.9**	**17.0**	**15.8**	**230.8%**	**-7.6%**	**7.3%**
PREOS	**9.05**	**649**	**72**	**5.9**	**5.0**	**5.5**	**3567.0%**	**17.9%**	**-9.3%**
Variance to median				***-64.4%***	***-68.7%***	***-63.3%***	***n.m.***	***-828.6%***	***-263.8%***

Source: First Berlin Equity Research estimates; Bloomberg

We think price to earnings is a better suited metric to compare PREOS to its peers, since the bottom line immediately captures revaluation upside from acquired properties. This method hints at fair value of €1.0bn.

Table 3: PER and FFOPS 2 fair values

	EPS				FFO 2			
	2019E	2020E	2021E	*Average*	2019E	2020E	2021E	*Average*
PREOS (€)	0.90	0.96	0.72		-0.01	0.54	0.92	
Fair value to median (€m)	**1,078**	**1,111**	**782**	***990***	**n.a.**	**671**	**918**	***794***
Fair value to mean (€m)	**1,098**	**1,178**	**817**	***1,031***	**n.a.**	**625**	**938**	***782***

Source: First Berlin Equity Research estimates

But even this comparison has drawbacks, given the early stage of PREOS operations which distorts near-term comparables to the more mature and larger peers. We thus consider the economic profit model a more suitable method to determine fair value.

COMPANY PROFILE

PREOS Real Estate AG specialises in the acquisition and optimisation of income-generating properties in the German commercial real estate market with the aim of building a high yield portfolio of manage-to-core office properties.

The company was founded in 2014 as AMG Immobilien Berlin GmbH and kicked off small-scale landlord operations. After being acquired by Olek Holding GmbH in early 2018, the company updated its legal form and rebranded as PREOS Real Estate AG. The changes heralded a more aggressive strategic focus spearheaded by a new management team with deeper market expertise.

Figure 1: Active across the CRE value chain

Source: First Berlin Equity Research; German Office Real Estate

PREOS targets office properties chiefly in the suburbs of Germany’s metropolitan hubs, where yields are spurred by strong fundamentals and market dynamics. Although a number of commercial landlords pursue a similar strategy, we believe PREOS is differentiated through its ability to secure coveted assets at below market values through off-market deals, thanks to management’s well-established network.

The company wants to capitalise on favourable dynamics for German office assets. PREOS predominantly follows a classic buy and hold concept to drive value creation and sustainable rental income (RI). The company also opportunistically rotates assets to recycle cash. This allows management to lock in revaluation upside when a property has been fully optimised and reinvest in new properties.

CORPORATE OVERVIEW

PREOS is headquartered in Leipzig, Germany and trades on the Open Market of the Munich and Frankfurt Stock Exchanges. publity AG is the largest shareholder with a 93.2% stake following the deal for publity Investor GmbH and publity's contribution in kind transaction with TO-Holding GmbH and TO Holding 2 GmbH for their PREOS shares.

Real estate operations are run through the fully owned PREOS Immobilien GmbH, while publity Investor GmbH (94.9% stake) houses the recent portfolio additions. See overleaf for complete corporate structure.

Table 4: Current portfolio overview

	Type	Lettable area (m²)	Vacancy	GAV (€k)	GAV (€/m²)	RI (€k) p.a.	Rent /€m²	NRI Yield	WALT
Ratingen I	Office	1,646	0%	5,150	3,129	315	15.9	6.1%	12
Köln	Office	3,593	0%	13,700	3,813	718	16.6	5.2%	9
Krefeld	Office	15,290	0%	19,200	1,256	1,220	6.6	6.4%	11
Roßdorf	Office	4,772	26%	9,380	1,966	413	9.7	4.4%	11
Ratingen II	Office	2,996	0%	6,980	2,330	417	11.6	6.0%	3
Nieder-Olm	Office	4,065	0%	9,010	2,216	514	10.5	5.7%	13
Sindelfingen	Office	6,515	0%	10,950	1,681	613	7.8	5.6%	3
Grafing	Office	3,935	0%	4,130	1,050	317	6.7	7.7%	12
Waltrop	Office	6,150	5%	4,880	793	373	5.3	7.7%	10
Ratingen III	Office	5,000	0%	12,150	2,430	678	11.3	5.6%	11
Oberhausen	Office	2,500	0%	7,120	2,848	426	14.2	6.0%	6
Lüdenscheid	Office	10,085	10%	6,400	635	331	3.1	5.2%	5
Müllheim	Office	12,578	100%	17,500	1,391	-	-	0.0%	-
St Martin Tower[1]	Office	26,139	0%	146,200	5,593	5,693	18.2	3.9%	8
Essen, Karstadt	Office	92,069	9%	119,436	1,297	2,440	2.4	2.0%	21
Portfolio total		**197,333**	**11.8%**	**392,186**	**1,987**	**14,468**	**5.4**	**3.7%**	**9**

[1] St Martin Tower has been sold and is scheduled to close by end of Q4

Source: First Berlin Equity Research estimates

We currently value PREOS' portfolio at €392m. This includes 15 office properties with 197,333 m² of lettable area. The assets are diversified across various metropolitan hubs and their suburbs. The seed portfolio comprises 12 properties with 66,547 m² of lettable space, while the three assets from the publity Investor GmbH deal add another 130,786 m² in rentable space.

GAV of €263m set to close in Q4 with potential for another late closing Management have communicated several signings for >69k m² that are scheduled to close by YE. We gather from the pipeline that at least one other closing for €200m will be announced by the end of the year. On our numbers this could boost GAV by another €463m.

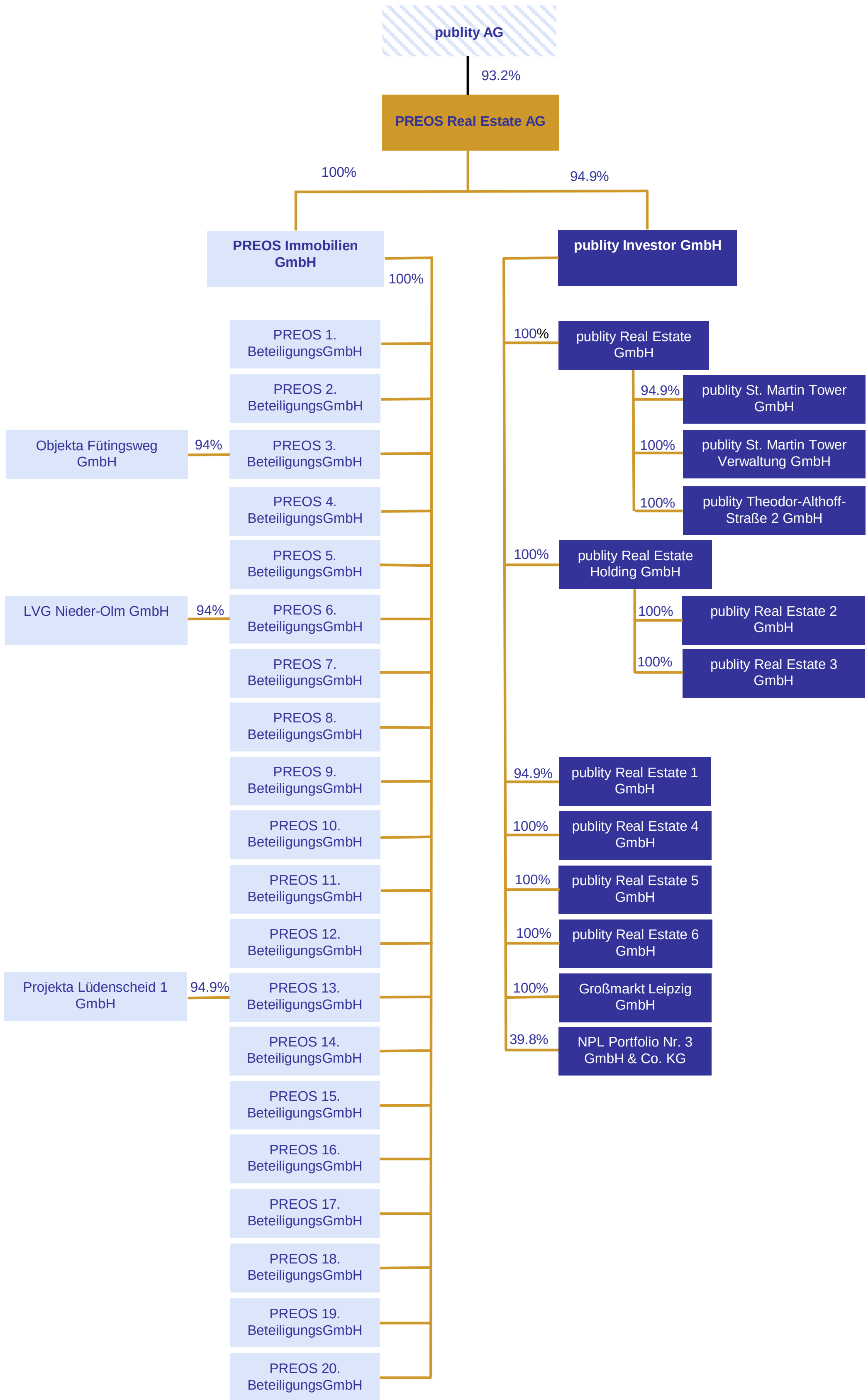
Table 5: Expected closings by YE19

	Type	Lettable area (m²)	Vacancy	GAV (€k)	GAV (€/m²)	RI (€k) p.a.	Rent /€m²	NRI Yield
Les 3	Office	17,867	0%	60,000	3,358	2,624	12.2	4.4%
Access Tower	Office	20,926	15%	105,000	5,018	2,907	13.6	2.8%
Sky Deutschland	Office	30,391	0%	97,750	3,216	5,109	14.0	5.2%
Expansion I	*Office*	*30,000*	*0%*	*200,000*	*6,667*	*6,840*	*19.0*	*3.4%*
Portfolio total		**99,184**	**3.2%**	**462,750**	**4,666**	**17,481**	**14.2**	**3.8%**

Source: First Berlin Equity Research estimates

Growth targets include: (1) medium-term investment of ~€2,600m in properties; (2) a capital structure anchored by a 70% LTV; and (3) upside through disposals. Management have yet to commit to a dividend policy at this time given the aggressive growth strategy. We have therefore not modelled a payout at this juncture.

Figure 2: PREOS corporate structure post Investor GmbH acquisition



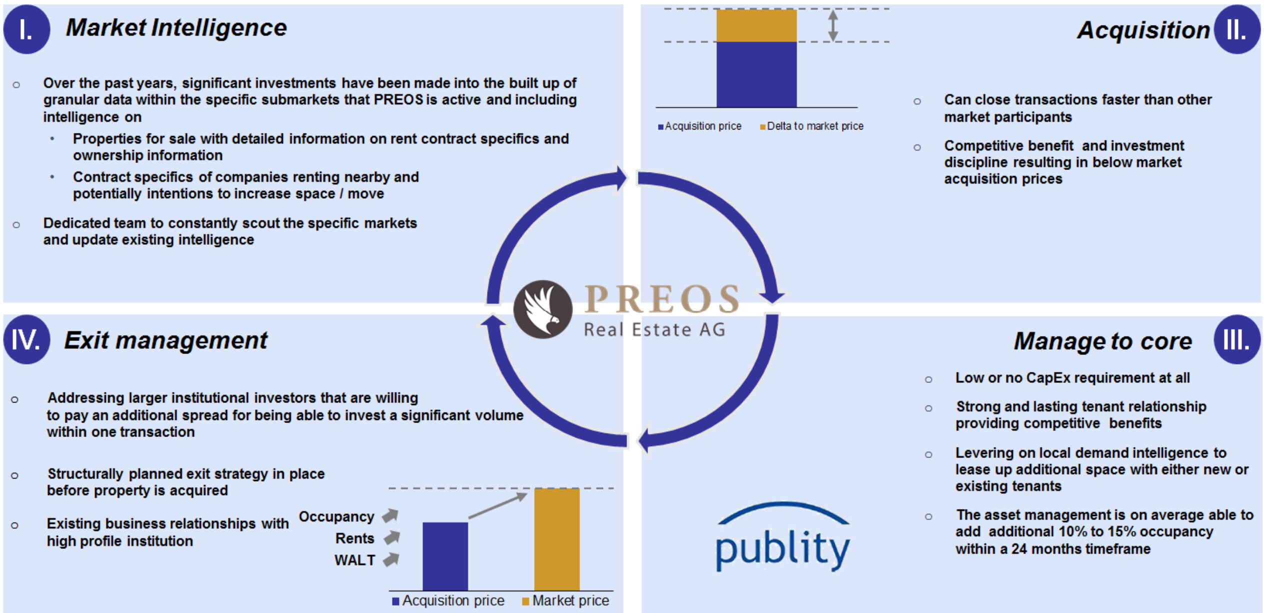
Source: First Berlin Equity Research; PREOS AG

BUSINESS MODEL

PREOS predominantly follows a buy and hold strategy to drive value creation and sustainable rental income with a stable of value-add office assets. The company applies a focused acquisition approach that targets single assets concentrated around metropolitan hubs in western Germany.

Operations follow the strategic blueprint depicted below with publity AG serving as the operational backbone in sourcing off-market deals, managing the properties held, and overseeing disposals.

Figure 3: Blueprint to leverage off-market pipeline



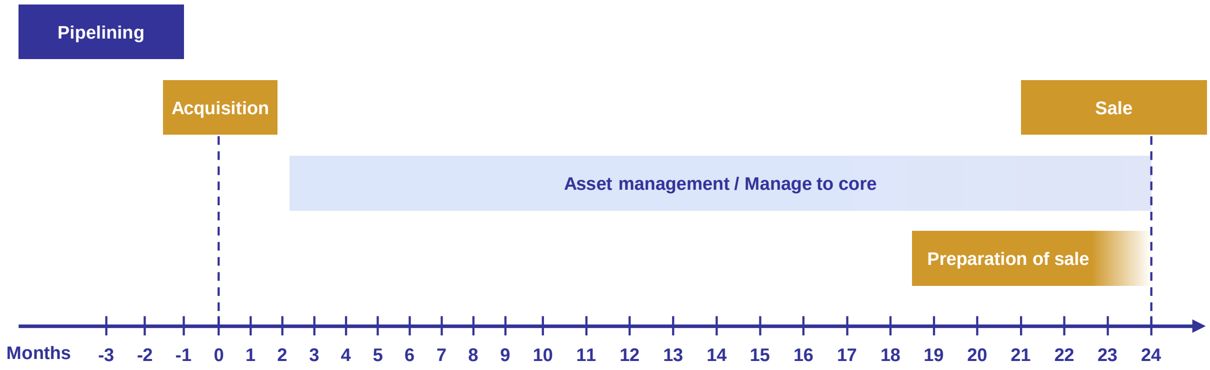
Source: First Berlin Equity Research; PREOS AG

Buy low and optimise… In the early stages of the operational reboot, PREOS strictly targeted assets in the €10m - €25m range, which are often too small for institutional investors but too large for private landlords. Following the publity Investor GmbH takeover, the company has moved up in weight class and has better market clout to target much larger deals to accelerate expansion.

The cornerstone of the business model is the ability to source off-market deals that allows management to secure assets below their market value. This is made possible by a database that silos granular data on suitable properties.

We expect PREOS to use a 4% - 5% yield hurdle to filter its pipeline allowing for both external and organic cash flow and NAVPS growth. Organic growth is achieved through LFL rent and occupancy increases as the company extracts embedded value from properties that were often previously mismanaged. Management comb the database for Core(+) properties that feature 10% to 15% vacancy and that the property management team believes it can fill up within 18 months.

Figure 4: Creating value within a two year holding period



Source: First Berlin Equity Research

… then sell high to rotate assets As depicted above, asset rotation will also be a hallmark of the overall PREOS strategy once a property has been fully optimised. Management believe this strategy is best suited to today's environment that requires a more active management approach. Exits will also be orchestrated by publity (see overleaf), which boasts excellent access to international investors seeking German office yields.

PREOS will look to hold its properties around 18 to 24 months. Disposals will lock in revaluation profits and help replenish the financial war chest. Depending on market conditions, PREOS wants to generate gains above book value equal to ~21x net rent. The remaining cash net of the associated debt repayment will then be recycled into equity for future acquisitions.

PORTFOLIO OF MIXED OFFICE ASSETS

PREOS follows the common blueprint among landlords of looking for properties that feature good economic demographics, solid structural shape, i.e. low CapEx needs, and in select cases attractive revisionary potential. The company wants to diversify cash flows by building a mixed portfolio of metropolitan offices segmented into the categories defined below.

Office pure play PREOS targets commercial properties exclusively in the German office segment that harbour clear upside for value creation through active asset management—manage-to-core properties. The strict focus on the German office segment distinguishes PREOS from most of the publicly traded German landlords—with the exception of Godewind Immobilien AG—that also combines manage-2-core with Core(+) assets.

"Manage-2-core" Value-add properties typically generate in-place cash flow but offer attractive upside over time through active asset management and / or repositioning to reduce high vacancies, and secure quality tenants. Physical improvements can also allow landlords to command higher rents, although PREOS is mainly interested in properties with low CapEx requirements. Once the owner has fully optimised the property, the asset is often sold to lock in the resulting value appreciation. The potential upside of investment in these properties is associated with higher execution risk, but PREOS believes it has the ideal cooperation partner to help manage this risk.

Core properties are regarded as the least risky because they are often stabilised, fully leased, secure, and located in big dynamic markets. Core properties feature long-term leases with high credit rating tenants. Buildings are of A-quality and situated in highly desirable central locations. Buyers are conservative and want to generate stable income with low risk. Core properties provide steady income streams alongside their low risk profiles.

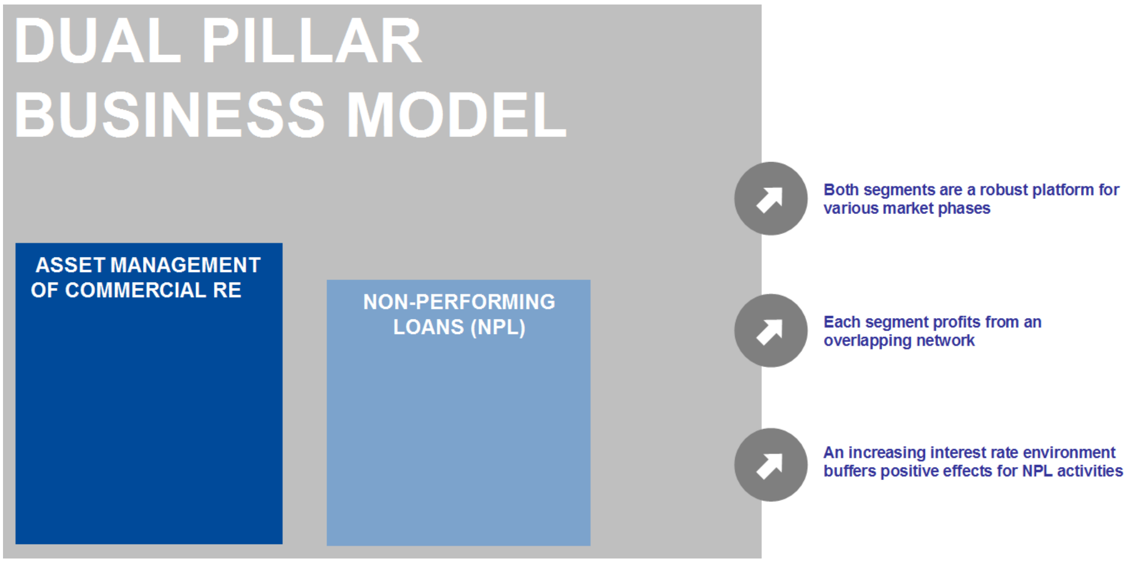
Core + properties carry a slightly higher risk profile than Core assets. Owners typically have the ability to increase cash flows through light property optimisation. Similar to core properties, these properties tend to be of high-quality and are well-occupied providing investors a balance of steady income and upside.

STRONG COOPERATION PARTNER

PREOS wants to leverage its partnership with publity AG to source undervalued off-market deals. The asset management company specialises in activities surrounding the German commercial property market. publity's services cover several key steps of the real estate value chain from sourcing, due diligence, and acquisition, to property management and potential disposals. publity will handle asset and property management duties for PREOS.

publity has an extensive track record having completed over 1,100 successful property transactions including > 620 property acquisitions and 530 disposals over the last seven years. This experience, combined with a robust infrastructure built upon a massive proprietary database (>9,000 properties), is the foundation of a proven ability to execute quickly at key steps of the property value chain. publity presently controls some €5.5bn of German commercial real estate assets (AuM) that entails 120 properties and 12 international clients.

Figure 5: publity's core activities



Source: First Berlin Equity Research; publity AG

The wealth of property data siloed in publity's databank should provide good opportunities for PREOS to populate its portfolio with assets ideally suited to its corporate strategy. We regard the strategic partnership with publity as the operational fulcrum. However, transparency between publity and PREOS needs to be high in order to avoid any potential conflict of interest backlash from third party clients or investors.

FINANCIAL HISTORY AND OUTLOOK

PREOS rebooted operations in early 2018. Under the previous regime, business was limited to small-scale landlord activities. The company changed its legal form and rebranded in Q1/18. Management also conducted a capital increase in March 2018 increasing the share capital from €25k to €22m.

Year 1 reporting reflects portfolio and infrastructure ramp up Business during 2018 was largely shaped by the IPO and subsequent ramp up of infrastructure needed to embark on its acquisition campaign. The other operating expense figure owes mainly to the costs associated with the IPO and capital increase.

The economic transfer of its seed portfolio (ten properties) occurred in Q4/18 meaning full year reporting (1 April to 31 December) included only modest rental income of €0.9m. Net income amounted to €3.0m, thanks to some €7.4m in revaluation gains on the Cologne, Krefeld, and Nieder-Olm properties. There are no comparative Group IFRS figures for 2017.

Table 6: FY 2018 KPIs

All figures in EUR '000	2018*	2017	*variance*
Net rental income	909	n.a.	-
Other operating income	85	n.a.	-
Staffing costs	-182	n.a.	-
Other OpeEx	-2,499	n.a.	-
Revaluation gains	7,418	n.a.	-
EBIT	5,731	n.a.	-
Net financial result	-2,183	n.a.	-
Tax result	-456	n.a.	-
Net income	3,092	n.a.	-
Minority interests	96	n.a.	-
Net income to shareholders	2,996	n.a.	-

** abbreviated financial year aligned with operational reboot and there are no comparative IFRS figure for the prior year*

Source: First Berlin Equity Research; PREOS AG

Funds from operations (FFO 1) is the property industry standard indicator for recurring cash flows. PREOS reported FFO 1 of €-2.0m for the abbreviated financial year ended. However, we do not accept deferred taxes of €0.6m as part the reported figure and calculate FFO 1 of €-2.7m for the period.

Table 7: Funds from operations

All figures in EUR '000	2018*	2017	*variance*
EBITDA	5,736	n.a.	-
Capital gains, property revaluations & other	-7,417	n.a.	-
Other adjustments	788	n.a.	-
Adjusted EBITDA, long-term recurring	-893	n.a.	-
Financial expense /income	-2,182	n.a.	-
Tax expense	-457	n.a.	-
Other non-cash / one- off exp.	878	n.a.	-
FFO 1	-2,654	n.a.	-

** abbreviated financial year aligned with operational reboot and there are no comparative IFRS figure for the prior year*

Source: First Berlin Equity Research; PREOS AG

PREOS exited 2018 with total equity of €26m against investment properties totalling €94m as the main line item under the assets side. EPRA NAV, which is adjusted for deferred tax liabilities and non-controlling interests, topped €26m equating to NAVPS of €1.19 for the period ended. The €68m debt load included a shareholder loan of €22m. This has now been converted into equity.

Table 8: YE18 Balance sheet highlights

All figures in EUR '000	YE18*	31-Mar-18	*variance*
Cash and liquid assets	2,558	22,275	*-89%*
Investment property	93,630	0	-
Total assets	98,785	22,520	*339%*
Total debt	67,678	0	-
Net debt (cash)	65,120	-22,275	-
Total equity	25,917	22,024	*18%*
Equity ratio	26%	98%	-
EPRA NAV	26,214	n.a.	-
Loan-to-value (LTV)	70%	n.a.	-

** abbreviated financial year aligned with operational reboot*

Source: First Berlin Equity Research; PREOS AG

Six month results still not reflective of portfolio PREOS also reported headline figures for the first six months of 2019. Rental income amounted to €2.7m, while EBIT totalled €3.0m. The bottom line equalled €0.3m vs a pro-forma net loss of €-0.7m in the prior year period. The results did not include any contributions from the new assets included in the publity Investor GmbH takeover.

Other key milestones this year PREOS hit a major milestone in August with the acquisition of publity Investor GmbH and its office portfolio. The company acquired a 94.9% in the landlord subsidiary of publity AG as part of a contribution in kind capital increase. PREOS issued 47.45m shares at €8 per share.

In March 2019, the company issued 2.213m new shares from authorised capital at €10 per share for contribution in kind swapping out the €22m in shareholder loans TO-Holding GmbH and TO Holding 2 GmbH for equity.

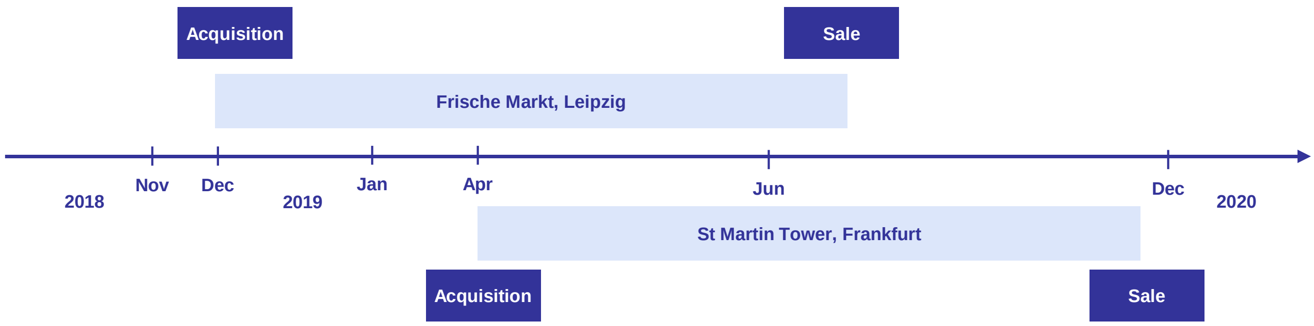
Management also struck a deal with Hamburg Commercial Bank to refinance operations securing €70m in new debt at a 3% interest rate. While this is above the rate enjoyed by larger peers, the deal demonstrates the ability to secure debt on properties, and we expect this rate to drop to ~2% for future deals as clout improves.

BUSINESS CASE STUDIES

The business model hinges upon the acquisition of properties at below-market prices, a <24 month optimisation period and profitable disposal. Although the current company iteration is relatively young, the brief track already includes two case studies of good business execution.

1. PREOS bought Frische Markt in December 2018 and sold the Leipzig property to a New York, US-based fund manager.
2. St Martin Tower with ~26k m² of lettable space in Frankfurt am Main was acquired in April 2019. A joint venture between Barings and Corea AG is set to buy the property and close by YE

Figure 6: Disposal schedule for H2/19

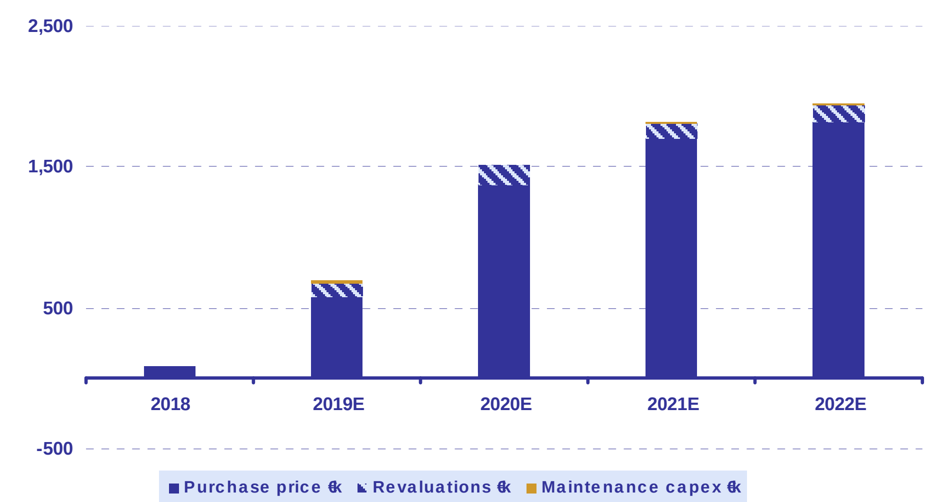


Source: First Berlin Equity Research estimates; PREOS AG

FORECASTING ASSUMPTIONS

PREOS is a high growth story After modest historical performance, the rebooted company has embarked on an aggressive growth journey. The company has acquired €316m in office properties this year. Now management want to issue a convertible bond for ~€150m in Q1/20 to continue the trajectory set this year. The company will complement the rental income streams from a landlord business model with the sale of optimised properties within an 18 to 24 month span.

Figure 7: Breakdown of property market values



Source: First Berlin Equity Research estimates; PREOS AG

PREOS has bought six properties so far this year and now controls some 197,333 m² of lettable space. This includes the portfolio in conjunction with the publity Investor GmbH deal. Management have also indicted another €263m in properties will close by year end, and we have assumed a further deal of around €200m after reviewing the pipeline. Plus, St Martin Tower (GAV: €146m) and a property in Leipzig (GAV: €16m) have been sold this year with the former set to close by YE. We thus see GAV at ~€702m at the end of 2019.

Table 9: Expected Q4/19 deal closings and signings

	Type	Lettable area (m²)	Vacancy	GAV (€k)	GAV (€/m²)	RI (€k) p.a.	Rent /€m²	NRI Yield
Les 3	Office	17,867	0%	60,000	3,358	2,624	12.2	4.4%
Access Tower	Office	20,926	15%	105,000	5,018	2,907	13.6	2.8%
Sky Deutschland	Office	30,391	0%	97,750	3,216	5,109	14.0	5.2%
Expansion I	*Office*	*30,000*	*0%*	*200,000*	*6,667*	*6,840*	*19.0*	*3.4%*
Portfolio total		**99,184**	**3.2%**	**462,750**	**4,666**	**17,481**	**14.2**	**3.8%**

Source: First Berlin Equity Research estimates; PREOS AG

Our rental income and disposal forecasts are based on the following assumptions and conditions: (1) operating cash flow and proceeds from sold assets will be recycled to finance portfolio growth; (2) access to off-market deals will allow the company to acquire office space below market levels leading to good reversionary upside through optimisation; (3) revitalised properties will fetch attractive margins above their purchase price and produce strong capital gains, and (4) access to inexpensive debt financing remains favourable.

Based on these conditions, we believe PREOS will invest some €2.6bn from 2020 to 2022 into the German office space. Access to publity's robust database and pipeline for deal flow supports this assumption. Management have hinted at even higher growth, but we want to see a longer track record before ratcheting up our forecasts to uncharted levels.

Vacancy reductions to spur rental income We look for net rental income to top €57m in 2020 with the full contribution and optimisation of the assets acquired this year. This corresponds to an NRI yield of 4.9%. PREOS' current vacancy rate stands at around 12%, owing in large part to the 26% vacancy at Roßdorf (1.2k m² vacant space) and 100% vacancy at Müllheim (12.6k m² vacant space). We expect the vacancy rate to remain stable in the forecasting period. New assets will likely come with vacancy ranging from up to 15% to offset high occupancy properties that are sold.

Lean operating structure publity will assume the bulk of portfolio management duties for PREOS, which should allow for a lean operating structure with low staffing requirements. Current staffing should be able handle the next phase of growth, although we expect the headcount to expand as the company grows.

ADJUSTED EBITDA AND FFO FORECASTS

'Adjusted EBITDA' is the key performance measurement for operating results. The KPI reflects the underlying operational profit of the commercial portfolio by excluding revaluation effects, disposal gains, and the share of profits from other investments. Funds from operations (FFO 1) is the property industry standard indicator for recurring cash flows, while FFO 2 captures disposal gains.

Table 10: Adjusted EBITDA developments

All figures in EUR '000	2018	2019E	2020E	2021E	2022E
Net rent (NRI)	1,039	11,199	57,626	77,165	116,484
Recoverable operating costs	0	1,976	10,169	13,617	20,556
Property management income	1,039	13,175	67,796	90,783	137,040
NRI margin	*n.a.*	*85%*	*85%*	*85%*	*85%*
Capital gains, property revaluations & other	7,417	95,601	134,639	107,572	120,630
Property operating expenses	-130	-659	-3,390	-4,539	-6,852
Administration & other expenses	-2,680	-19,655	-31,851	-36,850	-39,548
EBITDA	**5,646**	**88,462**	**167,194**	**156,966**	**211,270**
Adjusted EBITDA, long-term recurring[1]	**-898**	**-3,956**	**38,117**	**57,774**	**96,317**
Margin	*n.a.*	*n.a.*	*66%*	*75%*	*83%*

[1] adjusted for non-recurring and revaluation gains

Source: First Berlin Equity Research estimates; PREOS AG

PREOS pursues an active portfolio management strategy that hinges upon its ability to optimise underperforming assets acquired below market value and sell them for high profits in a relatively short time frame (>2 years). We thus regard FFO 2 as the most important cash flow measurement for the company. Given the early stage of expansion and the considerable financing costs associated with the growth, we forecast a modest FFO 2 in 2019 with a sharp increase next year when the company can better cash in on its disposal strategy.

Table 11: Funds from operations developments

All figures in EUR '000	2018	2019E	2020E	2021E	2022E
Operating profit	5,731	88,456	167,160	156,920	211,201
Depreciation & amortisation	5	7	34	45	69
EBITDA	5,736	88,462	167,194	156,966	211,270
Capital gains, property revaluations & other	-7,417	-95,601	-134,639	-107,572	-120,630
Other adjustments	788	3,183	5,563	8,380	5,677
Adjusted EBITDA, long-term recurring	**-893**	**-3,956**	**38,117**	**57,774**	**96,317**
Financial expense /income	-2,182	-10,017	-42,666	-60,747	-66,609
Tax expense	-457	297	-2,859	-4,333	-7,224
Other non-cash / one- off exp.	878	0	0	0	0
FFO 1	**-2,654**	**-13,676**	**-7,408**	**-7,307**	**22,484**
Disposal gains	0	13,428	46,210	73,028	182,026
FFO 2	**-2,654**	**-248**	**38,803**	**65,721**	**204,510**
FFOPS 2 (€)	-0.12	-0.01	0.54	0.92	2.85

Source: First Berlin Equity Research estimates; PREOS AG

During the forecasting period, we look for the company to sell properties with an FBe value of €1.9bn and calculate a gross profit from disposals—including selling expenses—of about €313m (table 12). This also presumes PREOS will sell optimised assets within 18 to 24 months post acquisition.

Table 12: Disposal schedule

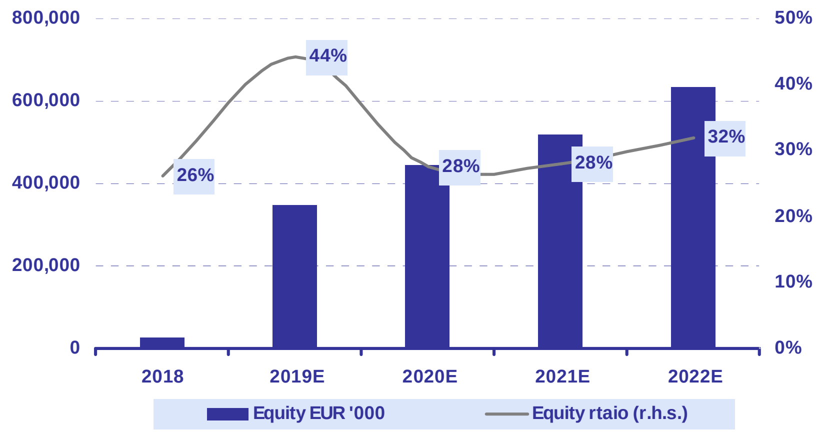
All figures in EUR '000	2018	2019E	2020E	2021E	2022E
Property disposal income	0	160,567	119,436	511,888	1,100,688
Cost of sales	0	142,853	71,093	426,077	891,905
Selling expenses	0	4,286	2,133	12,782	26,757
Disposal profit	0	13,428	46,210	73,028	182,026
Disposal margin	*n.a.*	*8%*	*65%*	*17%*	*20%*

Source: First Berlin Equity Research estimates

CAPITAL STRUCTURE

According to the historical financials, PREOS exited 2018 with €26m in shareholders' equity and €68m in short and long term debt. The company issued another 47.45m shares from authorised capital this summer at €8 per share in conjunction with the publity Investor GmbH as a contribution in kind transaction. To our knowledge, there are no plans for a capital increase at this juncture, although PREOS has authorised capital of 22.475m shares approved by the 28 August 2019 AGM.

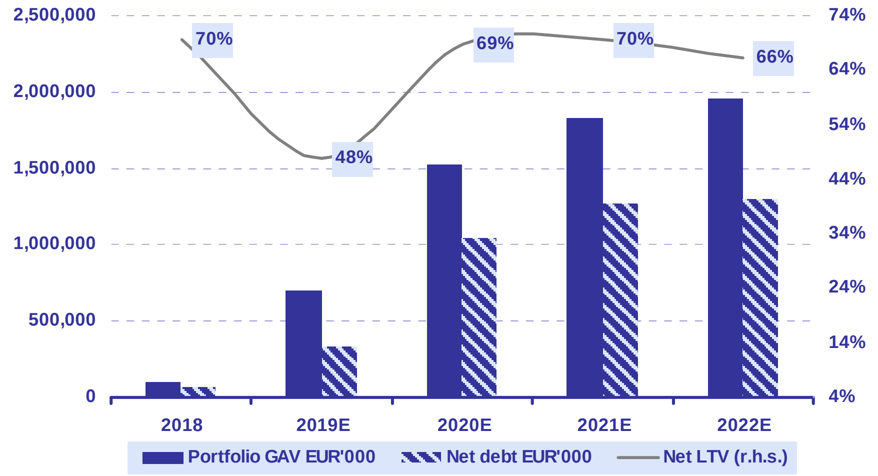
Figure 8: Equity and equity ratio developments



Source: First Berlin Equity Research estimates; PREOS AG

Convertible bond considerations On 11 November, PREOS issued convertible debt against contribution of €113m loan receivables from publity Investor GmbH (94.9% PREOS stake). In return publity subscribed to bonds with a total nominal amount of €108m. The issuance has a five maturity with a 7.5% coupon and €9.9 conversion price. PREOS will launch a public offering for the bond later this month targeting an aggregate volume of €300m at the same terms. Full placement would result in 30.3 dilutive shares.

Figure 9: LTV development

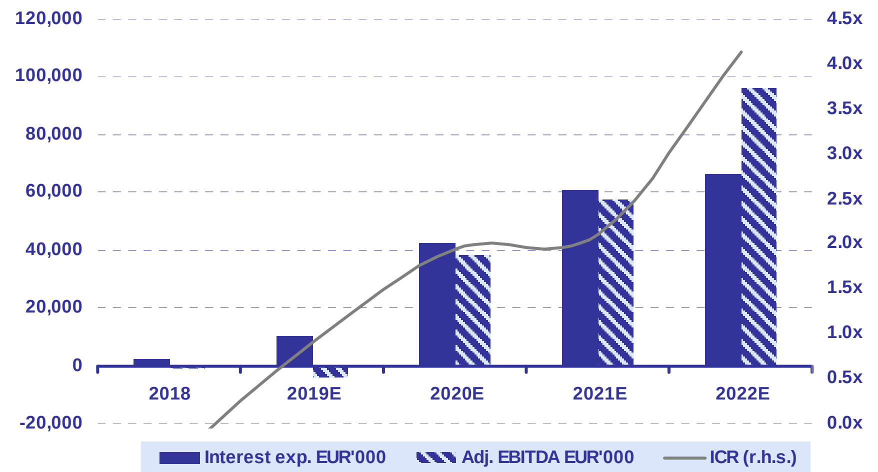


Source: First Berlin Equity Research estimates; PREOS AG

Debt structure and LTV assumptions We believe the company should be able to secure bank debt around 3.0%. This is higher than peers who can leverage their stronger equity ratios and credit ratings (S&P, Moody's) to secure bank debt of ~1%. PREOS could also explore mezzanine or other bridge financing options, but we have assumed bank debt for our calculations. The high leverage on the balance sheet combined with the early stage of portfolio expansion means the interest coverage ratio is quite low over the next years until the ratio of acquistions vs disposals normalises.

We target an LTV range at the AG level of up to 75% depending on the timing of disposal management. However, this could fall below 50% if the bond converts to equity, which is more consistent with commercial landlord peers.

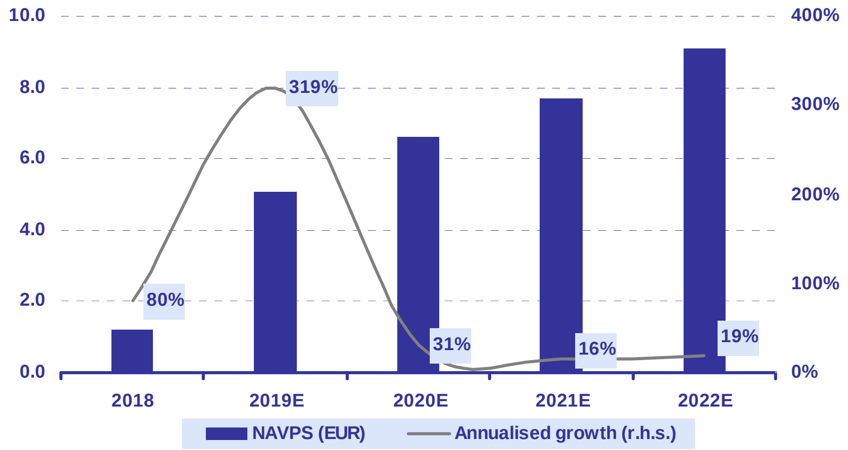
Figure 10: Interest coverage development



Source: First Berlin Equity Research estimates; PREOS AG

Net income and capital gains to spur NAV growth Assuming good business execution from the rental of held properties and profitable sale of optimised office assets, we believe EPRA NAV could top €473m in 2020 and €652m in 2022. This corresponds to a 22% three year CAGR for the time frame 2020 to 2022. Given the expected stable share count, NAVPS tracks EPRA NAV developments in our model. These figures do not include the potential conversion of the planned convertible bonds, while they remain out of the money.

Figure 11: NAVPS development



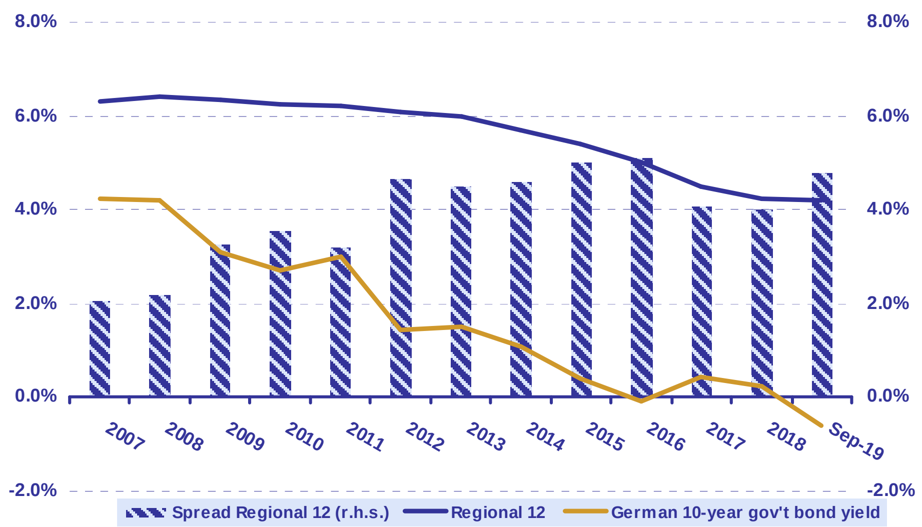
Source: First Berlin Equity Research estimates; PREOS AG

MACRO THEMES TO KEEP AN EYE ON

CRE STILL OFFERS GOOD RETURNS

Is there still upside in the German property market? In our view, German CRE continues to harbour better growth potential than residential RE where yields have been compressing for years. We regard the commercial sector as lagging the late cycle residential space—a view supported by higher yields offered by the former. Good market fundamentals also give us confidence in the sustainability of the current cycle and growth potential into 2020. The main considerations supporting our view are: (1) good growth potential driven by brisk occupier demand; (2) persistent high demand for prime space fuelled by yield hungry investors; (3) limited alternative asset classes with comparable yields and income potential; (4) real estate yields that remain highly attractive over bond yields; and (5) healthy balance sheets among the landlords with gearing and LTVs at comfortable levels, meaning less funding risk in the system. Taking account of these factors, we see nothing from today's perspective that is a harbinger of a major reversal in the current market trajectory.

Figure 12: German Regional 12 office over German bond yields



Source: Bulwiengesa, Bloomberg; First Berlin Equity Research

Bond yield spread offers considerable comfort A key driver of investment demand has been the attractive yields offered by real estate relative to alternative assets. A year ago, investors grew jittery in the wake of rising bond yields and a narrowing spread when the German 10-year bond yield hit 0.8% last February. However, such fears are hardly supported by the fundamental evidence depicted in the figure above. Even if German bond yields edge higher to normalised levels, we think the spread will remain comfortably wide. The German 10-year peaked at 0.6% last October but has been a tailspin most of 2019 and recently bottomed out below -0.7% since retreated and is now ranging between 0.2% and 0.3%. The historical regional spread since 2007 is 3.8% compared to around 4.8% currently.

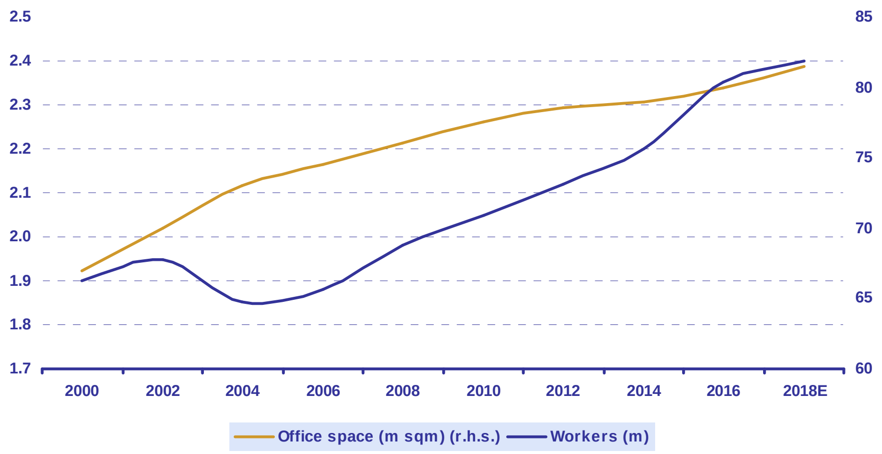
GOING LONG OFFICE SPACE

PREOS' business activities are primarily driven by the German office market, which has been booming. The office segment accounted for some 37% of the €79bn German property transaction volume last year. Of this aggregate amount, 58% (€46bn) occurred in Germany's Big 7 (Berlin, Frankfurt, Stuttgart, Hamburg, Düsseldorf, Munich, and Cologne).

Looking ahead, the office sector should continue to see strong occupier demand and letting momentum as it continues to benefit from the strong economic environment. Office uptake remains at the high levels seen in 2017 led by Munich and Berlin. JLL noted in its H1 market update that the vacancy rate for the Big 7 has fallen by a further 20 basis points to 4.3% within the last three months. “If this pace is maintained, all vacancies in the Big 7 would disappear in around five years’ time.” The theoretical point underscores the acute shortage of quality space throughout Germany’s metropolises.

Bursting at the seams For a long time, there had been little desire for developers to build new work space. Germany had a reassuring 7 million square meters of vacant office space back in 2007 before the economic uptick in 2010. Demand for workspace has been growing strongly since, but new build has not matched the trajectory with demand in the Big 7 over the ten year time frame having surged some 24% led by Berlin at nearly 33%. New office space coming online trailed far behind at 6%.

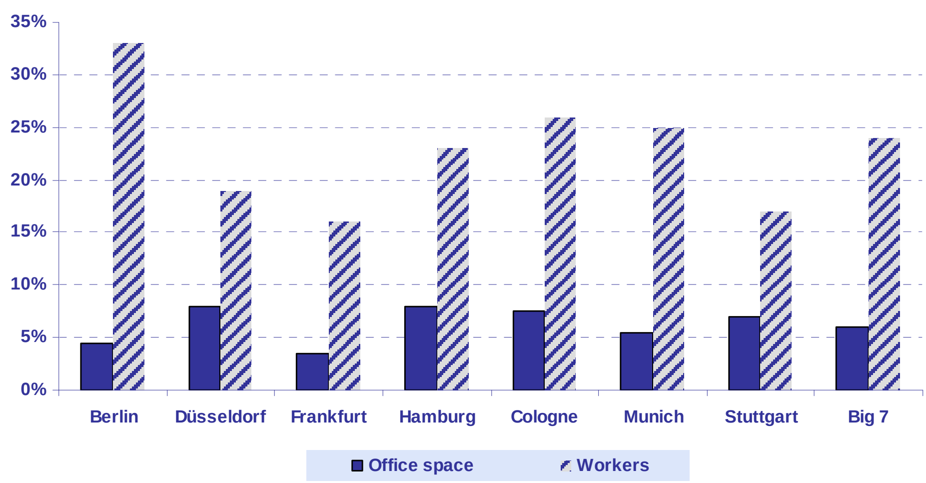
Figure 13: Office space vs employment growth



Source: DZ Hyp, Bulwiengese; DZ Bank estimates

New build unable to fill the gap in the near term In the first six months of 2018, only 329k m² of new office space came online across the Big 7 with another 674k m² set for completion in H2. Even more sobering is the fact that only 141k m² of this new space is still available with the bulk already pre-let.

Figure 14: Big 7 growth in office workers vs new workspace 2007 to 2017



Source: Bulwiengesa; Feri; First Berlin Equity Research

Table 13: Office rent developments for Germany's Big 7

	Prime rents (€ / m²)			Growth (Y/Y)		
	2017	2018E	2019E	2017	2018E	2019E
Berlin	30.0	32.7	34.0	7.1%	9.0%	4.0%
Düsseldorf	24.5	25.0	25.5	0.0%	2.0%	2.0%
Frankfurt	38.5	39.5	40.5	8.5%	2.6%	2.5%
Hamburg	26.5	27.0	27.5	1.9%	1.9%	1.9%
Cologne	21.0	21.5	21.9	0.0%	2.4%	2.0%
Munich	36.0	37.0	38.0	3.7%	2.8%	2.7%
Stuttgart	21.4	22.0	22.5	8.6%	2.8%	2.3%
Big 7	**29.3**	**30.5**	**31.3**	**4.7%**	**4.1%**	**2.8%**

Source: Bulwiengesa, Feri; DZ Bank Research

THE SPUTTERING GERMAN ECONOMY

For equity investors, a faltering economy is the juggernaut tailgating in the rear view mirror. And as Germany goes, so goes Europe. At home, economic data continues to deteriorate. Germany narrowly dodged a technical recession by posting 0.1% GDP growth in Q3 following contraction of 0.1% in Q2. The engine of the euro zone economy is sputtering worse than feared, and it's dragging the rest of the bloc down with it. GDP forecasts for EU constituents continue to be revised down by market analysts and fears are mounting that the 19-nation bloc is heading towards recession.

Table 14: Germany's GDP outlook

	2017	2018	2019E	2020E
GDP - new	2.5	1.5	0.7	1.6
GDP - old			1.3	1.6
Revision			*-46%*	*0%*

Source: International Monetary Fund World Economic Outlook; July 2019

Impact on property operators and German Office Real Estate Although it is too early to predict the full impact of a prolonged economic slowdown, we expect property players with the lowest balance sheet risk (low cost, long term debt and strong equity ratios) to best weather the downturn. From that standpoint, PREOS has a higher risk profile than the large landlords and will depend on strong execution. The main risk from our viewpoint is a major collapse of the job market, which would hamper the company's ability to fill up vacancies and capture disposal profits.

Lastly, banking meltdowns are an unfortunate part of human history—there were 124 of them between 1970 and 2007. The precise shape of the next one is unclear; otherwise it would be avoided. But one way or another, the next financial crisis is likely to involve property, which would substantially alter the prospects for PREOS.

EXECUTIVE BOARD

CEO

Frederik Mehlitz has over 20 years of banking and finance experience. He was appointed CEO of PREOS in August 2018 and is responsible for asset management, financing, liquidity and risk management. Previously, he served five years on the publity AG executive board and was also the managing director of publity Performance GmbH. During his tenure at publity, he oversaw all transactions with banks and financial investors. Mr Mehlitz studied industrial engineering in Karlsruhe, Germany.

CFO

Libor Vincent has over 20 years of banking and capital markets experience. He was appointed CFO of PREOS in August 2018. Prior to joining PROES, Mr Vincent has been Partner at Targa Communications GmbH since 2015 and is responsible for IR, fundraising and financial public relations. From 2005 to 2012, he was head of capital market communications and investor relations at EUROHYPO AG. From 1996 to 2005, he was a senior investor relations officer of Deutsche Bank AG in Frankfurt and New York, where he led IR activities during the bank’s listing and headed IR at the New York, US office. Mr Vincent studied law at the Universities of Nijmegen and Rotterdam, Netherlands and worked at ABN AMRO Group from 1994 to 1996.

SUPERVISORY BOARD

Chairman

Udo Roland Wahid Masrouki has been a member of the management board of FinanzNet Holding AG since 2002. Previously, he was a director of the Deutsche Bank insurance group from 1995 to 2000. Mr Masrouki was portfolio manager in the Deutsche Bank asset management division from 1993 to 1995 and solely responsible for the futures & options division. He was also managing director of GAMAX Vertriebs GmbH.

Deputy Chairman

Wolfgang Faillard brings a wealth of legal experience dating back to 1984. Mr. Faillard has been working for the auditing firm HLFH GbR Faillard-Hürter since 1990, where he is one of the namesake partners. In 2013, Mr Faillard was appointed to the supervisory board of publity Performance GmbH. He also previously worked as a freelancer at the auditing firm Halft & Lohmar.

Board member

Christoph Blacha brings nearly 25 years of real estate and legal experience. He was on the publity executive board from 2008 to 2016 and helped orchestrate the development of financial products, the drafting of legal concepts and the preparation of sales prospectuses. Mr Blacha is also the owner of the law firm Blacha Rechtsanwälte based in Leipzig, Germany.

SHAREHOLDERS & STOCK INFORMATION

Stock Information	
ISIN	DE000A2LQ850
WKN	A2LQ85
Bloomberg ticker	PAG:GR
No. of issued shares	71,663,688
Transparency Standard	Open Market
Country	Germany
Sector	Real Estate
Subsector	Financial Services

Source: Börse Frankfurt, First Berlin Equity Research

Shareholder Structure	
publity AG	93.2%
Free Float	6.8%

Source: PREOS Real Estate AG

INCOME STATEMENT

All figures in EUR '000	2018	2019E	2020E	2021E	2022E
Net rental income	**1,039**	**11,199**	**57,626**	**77,165**	**116,484**
Recoverable operating costs	0	1,976	10,169	13,617	20,556
Property management income	**1,039**	**13,175**	**67,796**	**90,783**	**137,040**
Property OpEx	-130	-659	-3,390	-4,539	-6,852
Capital gains, property revaluations & other	7,417	95,601	134,639	107,572	120,630
Other operating income	85	0	0	0	0
Administration & other expenses	-2,680	-19,655	-31,851	-36,850	-39,548
Depreciation & amortisation	0	-7	-34	-45	-69
Operating income	**5,731**	**88,456**	**167,160**	**156,920**	**211,201**
Net financial result	-2,182	-10,017	-42,666	-60,747	-66,609
Other financial expenses	0	0	0	0	0
Pre-tax income (EBT)	**3,549**	**78,439**	**124,494**	**96,173**	**144,593**
Income taxes	-457	297	-2,859	-4,333	-7,224
Deferred taxes	0	-14,340	-20,196	-16,136	-18,095
Net income / loss (NI)	**3,092**	**64,395**	**101,439**	**75,704**	**119,274**
Other tax & income	0	0	0	0	0
Comprehensive NI	**3,092**	**64,395**	**101,439**	**75,704**	**119,274**
Minority interests	-96	-1,932	-3,043	-2,271	-3,578
Net income after minorities	**2,996**	**62,463**	**98,396**	**73,433**	**115,696**
Basic EPS (in €)	**0.14**	**1.61**	**1.37**	**1.02**	**1.61**
Diluted EPS (in €)	**0.14**	**0.90**	**0.96**	**0.72**	**1.13**
Adjusted EBITDA	**-898**	**-3,956**	**38,117**	**57,774**	**96,317**
Ratios					
Adj. EBITDA margin	n.m.	n.m.	66.1%	74.9%	82.7%
Tax rate	15.0%	7.5%	7.5%	7.5%	7.5%
Expenses as % of revenues					
Property OpEx	12.5%	5.0%	5.0%	5.0%	5.0%
Administration & other expenses	257.9%	149.2%	47.0%	40.6%	28.9%
Y-Y Growth					
Rental income	n.a.	977.8%	414.6%	33.9%	51.0%
Adj. EBITDA	n.a.	n.m.	n.m.	51.6%	66.7%
Net income/ loss	n.a.	n.a.	57.5%	-25.4%	57.6%
Operating profit	**5,731**	**88,456**	**167,160**	**156,920**	**211,201**
Depreciation & amortisation	5	7	34	45	69
EBITDA	**5,736**	**88,462**	**167,194**	**156,966**	**211,270**
Capital gains, property revaluations & other	-7,417	-95,601	-134,639	-107,572	-120,630
Other adjustments	788	3,183	5,563	8,380	5,677
Adjusted EBITDA, long-term recurring	**-893**	**-3,956**	**38,117**	**57,774**	**96,317**
Financial expense /income	-2,182	-10,017	-42,666	-60,747	-66,609
Tax expense	-457	297	-2,859	-4,333	-7,224
Other non-cash / one- off exp.	878	0	0	0	0
FFO 1	**-2,654**	**-13,676**	**-7,408**	**-7,307**	**22,484**
Disposal gains	0	13,428	46,210	73,028	182,026
FFO 2	**-2,654**	**-248**	**38,803**	**65,721**	**204,510**
FFOPS 2 (€)	-0.12	-0.01	0.54	0.92	2.85

** 2018 was an abbreviated financial year aligned with operational reboot*

BALANCE SHEET

All figures in EUR '000	2018	2019E	2020E	2021E	2022E
Assets					
Current assets, total	**4,182**	**89,783**	**116,390**	**54,839**	**63,943**
Cash and cash equivalents	2,559	88,136	108,756	44,685	48,720
Assets held for sale	0	0	0	0	0
Trade receivables	367	1,444	7,430	9,949	15,018
Other current assets	1,256	204	204	205	205
Non-current assets, total	**94,601**	**702,151**	**1,523,144**	**1,828,914**	**1,956,135**
Property, plant & equipment	57	64	98	143	212
Intangible assets	0	0	0	0	0
Investment property	93,629	702,088	1,523,047	1,828,771	1,955,923
Advanced payments	0	0	0	0	0
Deferred taxes	0	0	0	0	0
Other LT assets	915	0	0	0	0
Total assets	**98,784**	**791,934**	**1,639,534**	**1,883,753**	**2,020,078**
Shareholders' equity & debt					
Current liabilities, total	**50,149**	**3,259**	**6,332**	**7,605**	**9,057**
Short-term debt	45,577	0	0	0	0
Trade payables	2,002	3,259	6,332	7,605	9,057
Provisions & current liabilities	2,570	0	0	0	0
Long-term liabilities, total	**22,718**	**438,976**	**1,182,064**	**1,349,306**	**1,364,905**
Convertible bond	0	140,000	290,000	290,000	290,000
Long-term bank debt	22,101	284,019	864,163	1,028,141	1,056,962
Other liabilities	0	0	0	0	0
Deferred tax liabilities	617	14,957	27,902	31,166	17,943
Shareholders' equity	**25,020**	**346,870**	**445,266**	**518,699**	**634,395**
Share capital	22,000	71,664	71,664	71,664	71,664
Capital reserve	0	209,723	209,723	209,723	209,723
Loss carryforward / retained earnings	3,020	65,483	163,879	237,312	353,008
Minority interests	897	2,829	5,872	8,143	11,721
Total equity	**25,917**	**349,699**	**451,138**	**526,842**	**646,116**
Total consolidated equity and debt	**98,784**	**791,934**	**1,639,534**	**1,883,753**	**2,020,078**
Ratios					
EPRA NAV	26,214	361,827	473,168	549,865	652,338
NAVPS (€)	1.2	5.0	6.6	7.7	9.1
Net debt	65,119	335,883	1,045,407	1,273,456	1,298,242
Interest cover (ICR)[1]	-0.4x	0.9x	2.0x	2.2x	4.2x
Equity ratio	26%	44%	28%	28%	32%
LTV	72%	60%	76%	72%	69%

** 2018 was an abbreviated financial year aligned with operational reboot*

CASH FLOW STATEMENT

All figures in EUR '000	2018	2019E	2020E	2021E	2022E
Net income	**3,092**	**64,395**	**101,439**	**75,704**	**119,274**
Non-cash gains / losses	-7,417	-95,601	-134,639	-107,572	-120,630
Other non-cash expenses / income	41	0	0	0	0
Depreciation & amortisation	5	7	34	45	69
Net financial result	2,182	10,017	42,666	60,747	66,609
Tax result	457	14,043	23,055	20,469	25,318
Operating cash flow	**-1,640**	**-7,139**	**32,554**	**49,394**	**90,640**
Trade receivables & other assets	3,500	1,233	-2,914	-1,247	-3,618
Trade & other payables	0	-2,570	-7,251	-12,872	-31,317
Tax paid	-457	297	-2,859	-4,333	-7,224
Net operating cash flow	**1,403**	**-8,179**	**19,530**	**30,942**	**48,481**
Investment in fixed/intangible assets	-62	-13	-68	-91	-137
Outflows for investment property	-59,318	-436,174	-805,756	-710,041	-1,107,210
Sale of real esate	0	160,567	119,436	511,888	1,100,688
Inflows from financial assets	-806	915	0	0	0
Interest income	3	0	0	0	0
Cash flow from investing	**-60,183**	**-274,706**	**-686,387**	**-198,244**	**-6,659**
Debt financing, net	41,492	238,478	580,144	163,978	28,821
Corporate debt, net	0	140,000	150,000	0	0
Equity financing, net	0	0	0	0	0
Interest paid	-2,430	-10,017	-42,666	-60,747	-66,609
Dividends paid	0	0	0	0	0
Others	0	0	0	0	0
Cash flow from financing	**39,062**	**368,461**	**687,478**	**103,231**	**-37,787**
Net cash flows	**-19,716**	**85,576**	**20,621**	**-64,071**	**4,035**
Cash, start of the year	22,275	2,559	88,136	108,756	44,685
Cash, end of the year	**2,559**	**88,136**	**108,756**	**44,685**	**48,720**

** 2018 was an abbreviated financial year aligned with operational reboot*

FIRST BERLIN RECOMMENDATION & PRICE TARGET HISTORY

Report No.:	Date of publication	Previous day closing price	Recommendation	Price target
Initial Report	19 November 2019	€ 8.65	Add	€ 10.50

Authored by: Ellis Acklin, Senior Analyst

Company responsible for preparation:

First Berlin Equity Research GmbH
Mohrenstraße 34
10117 Berlin

Tel. +49 (0)30 - 80 93 96 83 Fax +49 (0)30 - 80 93 96 87

info@firstberlin.com
www.firstberlin.com

Person responsible for forwarding or distributing this financial analysis: Martin Bailey

INFORMATION PURSUANT TO SECTION 34B OF THE GERMAN SECURITIES TRADING ACT [WPHG], TO REGULATION (EU) NO 596/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL OF APRIL 16, 2014, ON MARKET ABUSE (MARKET ABUSE REGULATION) AND TO THE GERMAN ORDINANCE ON THE ANALYSIS OF FINANCIAL INSTRUMENTS [FINANV]

First Berlin Equity Research GmbH (hereinafter referred to as: "First Berlin") prepares financial analyses while taking the relevant regulatory provisions, in particular the German Securities Trading Act [WpHG], Regulation (EU) No 596/2014 of the European Parliament and of the Council of April 16, 2014, on market abuse (market abuse regulation) and the German Ordinance on the Analysis of Financial Instruments [FinAnV] into consideration. In the following First Berlin provides investors with information about the statutory provisions that are to be observed in the preparation of financial analyses.

CONFLICTS OF INTEREST

In accordance with Section 34b Paragraph 1 of the German Securities Trading Act [WpHG] and Regulation (EU) No 596/2014 of the European Parliament and of the Council of April 16, 2014, on market abuse (market abuse regulation) financial analyses may only be passed on or publicly distributed if circumstances or relations which may cause conflicts of interest among the authors, the legal entities responsible for such preparation or companies associated with them are disclosed along with the financial analysis.

First Berlin offers a range of services that go beyond the preparation of financial analyses. Although First Berlin strives to avoid conflicts of interest wherever possible, First Berlin may maintain the following relations with the analysed company, which in particular may constitute a potential conflict of interest (further information and data may be provided on request):

- The author, First Berlin, or a company associated with First Berlin holds an interest of more than five percent in the share capital of the analysed company;
- The author, First Berlin, or a company associated with First Berlin provided investment banking or consulting services for the analysed company within the past twelve months for which remuneration was or was to be paid;
- The author, First Berlin, or a company associated with First Berlin reached an agreement with the analysed company for preparation of a financial analysis for which remuneration is owed;
- The author, First Berlin, or a company associated with First Berlin has other significant financial interests in the analysed company;

In order to avoid and, if necessary, manage possible conflicts of interest both the author of the financial analysis and First Berlin shall be obliged to neither hold nor in any way trade the securities of the company analyzed. The remuneration of the author of the financial analysis stands in no direct or indirect connection with the recommendations or opinions represented in the financial analysis. Furthermore, the remuneration of the author of the financial analysis is neither coupled directly to financial transactions nor to stock exchange trading volume or asset management fees.

If despite these measures one or more of the aforementioned conflicts of interest cannot be avoided on the part of the author or First Berlin, then reference shall be made to such conflict of interest.

INFORMATION PURSUANT TO SECTION 64 OF THE GERMAN SECURITIES TRADING ACT [WPHG] (2ND FIMANOG) OF 23 JUNE 2017, DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL OF 15 MAY 2014 ON MARKETS IN FINANCIAL INSTRUMENTS AND AMENDING DIRECTIVE 2002/92/EC AND DIRECTIVE 2011/61/EU, ACCOMPANIED BY THE MARKETS IN FINANCIAL INSTRUMENTS REGULATION (MIFIR, REG. EU NO. 600/2014)

First Berlin notes that is has concluded a contract with the issuer to prepare financial analyses and is paid for that by the issuer. First Berlin makes the financial analysis simultaneously available for all interested security financial services companies. First Berlin thus believes that it fulfils the requirements of section 64 WpHG for minor non-monetary benefits.

PRICE TARGET DATES

Unless otherwise indicated, current prices refer to the closing prices of the previous trading day.

AGREEMENT WITH THE ANALYSED COMPANY AND MAINTENANCE OF OBJECTIVITY

The present financial analysis is based on the author's own knowledge and research. The author prepared this study without any direct or indirect influence exerted on the part of the analysed company. Parts of the financial analysis were possibly provided to the analysed company prior to publication in order to avoid inaccuracies in the representation of facts. However, no substantial changes were made at the request of the analysed company following any such provision.

ASSET VALUATION SYSTEM

First Berlin's system for asset valuation is divided into an asset recommendation and a risk assessment.

ASSET RECOMMENDATION

The recommendations determined in accordance with the share price trend anticipated by First Berlin in the respectively indicated investment period are as follows:

Category		1	2
Current market capitalisation (in €)		0 - 2 billion	> 2 billion
Strong Buy[1]	An expected favourable price trend of:	> 50%	> 30%
Buy	An expected favourable price trend of:	> 25%	> 15%
Add	An expected favourable price trend of:	0% to 25%	0% to 15%
Reduce	An expected negative price trend of:	0% to -15%	0% to -10%
Sell	An expected negative price trend of:	< -15%	< -10%

[1] The expected price trend is in combination with sizable confidence in the quality and forecast security of management.

Our recommendation system places each company into one of two market capitalisation categories. Category 1 companies have a market capitalisation of €0 – €2 billion, and Category 2 companies have a market capitalisation of > €2 billion. The expected return thresholds underlying our recommendation system are lower for Category 2 companies than for Category 1 companies. This reflects the generally lower level of risk associated with higher market capitalisation companies.

RISK ASSESSMENT

The First Berlin categories for risk assessment are low, average, high and speculative. They are determined by ten factors: Corporate governance, quality of earnings, management strength, balance sheet and financial risk, competitive position, standard of financial disclosure, regulatory and political uncertainty, strength of brandname, market capitalisation and free float. These risk factors are incorporated into the First Berlin valuation models and are thus included in the target prices. First Berlin customers may request the models.

INVESTMENT HORIZON

Unless otherwise stated in the financial analysis, the ratings refer to an investment period of twelve months.

UPDATES

At the time of publication of this financial analysis it is not certain whether, when and on what occasion an update will be provided. In general First Berlin strives to review the financial analysis for its topicality and, if required, to update it in a very timely manner in connection with the reporting obligations of the analysed company or on the occasion of ad hoc notifications.

SUBJECT TO CHANGE

The opinions contained in the financial analysis reflect the assessment of the author on the day of publication of the financial analysis. The author of the financial analysis reserves the right to change such opinion without prior notification.

Legally required information regarding

- **key sources of information in the preparation of this research report**
- **valuation methods and principles**
- **sensitivity of valuation parameters**

can be accessed through the following internet link: http://firstberlin.com/disclaimer-english-link/

SUPERVISORY AUTHORITY: Bundesanstalt für Finanzdienstleistungsaufsicht (German Federal Financial Supervisory Authority) [BaFin], Graurheindorferstraße 108, 53117 Bonn and Lurgiallee 12, 60439 Frankfurt

EXCLUSION OF LIABILITY (DISCLAIMER)

RELIABILITY OF INFORMATION AND SOURCES OF INFORMATION

The information contained in this study is based on sources considered by the author to be reliable. Comprehensive verification of the accuracy and completeness of information and the reliability of sources of information has neither been carried out by the author nor by First Berlin. As a result no warranty of any kind whatsoever shall be assumed for the accuracy and completeness of information and the reliability of sources of information, and neither the author nor First Berlin, nor the person responsible for passing on or distributing the financial analysis shall be liable for any direct or indirect damage incurred through reliance on the accuracy and completeness of information and the reliability of sources of information.

RELIABILITY OF ESTIMATES AND FORECASTS

The author of the financial analysis made estimates and forecasts to the best of the author's knowledge. These estimates and forecasts reflect the author's personal opinion and judgement. The premises for estimates and forecasts as well as the author's perspective on such premises are subject to constant change. Expectations with regard to the future performance of a financial instrument are the result of a measurement at a single point in time and may change at any time. The result of a financial analysis always describes only one possible future development – the one that is most probable from the perspective of the author – of a number of possible future developments.

Any and all market values or target prices indicated for the company analysed in this financial analysis may not be achieved due to various risk factors, including but not limited to market volatility, sector volatility, the actions of the analysed company, economic climate, failure to achieve earnings and/or sales forecasts, unavailability of complete and precise information and/or a subsequently occurring event which affects the underlying assumptions of the author and/or other sources on which the author relies in this document. Past performance is not an indicator of future results; past values cannot be carried over into the future.

Consequently, no warranty of any kind whatsoever shall be assumed for the accuracy of estimates and forecasts, and neither the author nor First Berlin, nor the person responsible for passing on or distributing the financial analysis shall be liable for any direct or indirect damage incurred through reliance on the correctness of estimates and forecasts.

INFORMATION PURPOSES, NO RECOMMENDATION, SOLICITATION, NO OFFER FOR THE PURCHASE OF SECURITIES

The present financial analysis serves information purposes. It is intended to support institutional investors in making their own investment decisions; however in no way provide the investor with investment advice. Neither the author, nor First Berlin, nor the person responsible for passing on or distributing the financial analysis shall be considered to be acting as an investment advisor or portfolio manager vis-à-vis an investor. Each investor must form his own independent opinion with regard to the suitability of an investment in view of his own investment objectives, experience, tax situation, financial position and other circumstances.

The financial analysis does not represent a recommendation or solicitation and is not an offer for the purchase of the security specified in this financial analysis. Consequently, neither the author nor First Berlin, nor the person responsible for passing on or distributing the financial analysis shall as a result be liable for losses incurred through direct or indirect employment or use of any kind whatsoever of information or statements arising out of this financial analysis.

A decision concerning an investment in securities should take place on the basis of independent investment analyses and procedures as well as other studies including, but not limited to, information memoranda, sales or issuing prospectuses and not on the basis of this document.

NO ESTABLISHMENT OF CONTRACTUAL OBLIGATIONS

By taking note of this financial analysis the recipient neither becomes a customer of First Berlin, nor does First Berlin incur any contractual, quasi-contractual or pre-contractual obligations and/or responsibilities toward the recipient. In particular no information contract shall be established between First Berlin and the recipient of this information.

NO OBLIGATION TO UPDATE

First Berlin, the author and/or the person responsible for passing on or distributing the financial analysis shall not be obliged to update the financial analysis. Investors must keep themselves informed about the current course of business and any changes in the current course of business of the analysed company.

DUPLICATION

Dispatch or duplication of this document is not permitted without the prior written consent of First Berlin.

SEVERABILITY

Should any provision of this disclaimer prove to be illegal, invalid or unenforceable under the respectively applicable law, then such provision shall be treated as if it were not an integral component of this disclaimer; in no way shall it affect the legality, validity or enforceability of the remaining provisions.

APPLICABLE LAW, PLACE OF JURISDICTION

The preparation of this financial analysis shall be subject to the law obtaining in the Federal Republic of Germany. The place of jurisdiction for any disputes shall be Berlin (Germany).

NOTICE OF DISCLAIMER

By taking note of this financial analysis the recipient confirms the binding nature of the above explanations.

By using this document or relying on it in any manner whatsoever the recipient accepts the above restrictions as binding for the recipient.

QUALIFIED INSTITUTIONAL INVESTORS

First Berlin financial analyses are intended exclusively for qualified institutional investors.

This report is not intended for distribution in the USA and/or Canada.