

Buy (old: Hold) **Target: Euro 15.50** (old: Euro 11.80)

19 | May | 2020

Price (Euro)	13.20			
52 weeks range	13.40 / 6.20			
Key data				
ISIN	DE000A2LQ850			
Bloomberg	PAG:GR			
Reporting Standard	IFRS			
Market Cap (million)	946.44			
Number of shares (million)	71.7			
Free Float	6.6%			
Free Float Market Cap (million)	62.5			
Multiples	2019	2020e	2021e	2022e
Market Cap / Revenues	65.8	10.2	5.7	5.2
Price-Earnings Ratio (PER)	14.3	8.5	4.6	4.6
Dividend yield	0.0%	0.0%	0.0%	0.0%
Key data per share (Euro)	2019	2020e	2021e	2022e
Net income per share	0.93	1.55	2.87	2.84
Dividend per share	0.00	0.00	0.00	0.00
Financial Data (Euro '000)	2019	2020e	2021e	2022e
Rental revenues	14,394	92,736	166,348	180,913
Gross rental income (GRI)	6,744	84,703	157,914	172,056
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	309,362	315,260
EBIT	106,404	230,089	408,814	427,302
Interest income	6,096	814	0	119
Interest expenses	-18,116	-80,622	-117,821	-134,697
EBT	80,160	150,281	290,993	292,724
Tax	-13,847	-39,269	-85,302	-88,978
Net income	66,313	111,013	205,691	203,746
Earnings per share	0.93	1.55	2.87	2.84
Dividend per share	0.00	0.00	0.00	0.00
NAV per share (Euro)	6.28	7.14	11.82	14.25
Total Assets	912,866	2,604,624	4,187,454	3,466,769
Equity	263,214	329,528	440,540	646,231
Equity Ratio	28.8%	12.7%	10.5%	18.6%
Return on Equity	25.2%	37.5%	53.4%	37.5%
Main Shareholders				
publity AG	93.4%			
Financial Calendar				
AGM	25 May 2020			
1H 2020 report	September 2020			
2020 annual report	May 2021			
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PREOS' final figures above prelims after increasing portfolio by Euro 1bn in 2019 – keeping momentum despite Covid-19. Target price up to Euro 15.50, rating up to Buy

Last week, on 13 May, PREOS released its 2019 annual report. The company added approx. Euro 1bn to the portfolio in the period under review and recorded a massive leap in profits by the factor of 8. The property portfolio at the end of the year was Euro 1.1bn. With its results, PREOS proves the continuously emphasized market access via the asset manager and main shareholder publicly and the expertise bundled therein.

2019 was a strong year for PREOS. The EBIT increased from Euro 11m (2018) to Euro 106m, EBT was Euro 80m after Euro 11m in 2018. The group result has therefore increased approx. eightfold from Euro 8m in 2018 to Euro 66m. Total assets rose from Euro 98m to Euro 913m in the period under review, while equity rose from Euro 29m to Euro 263m. Overall, the PREOS portfolio has a rentable total area of 313,000 sqm and thus a sufficient portfolio size, which means that the company should be well equipped for even difficult times.

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. Proven by the excellent network and the numerous transactions even into the Covid-19 crisis, the company once again underlines its market position and expertise. The database covers almost 75% of the relevant German market, which is the basis for the identification of attractive real estate objects also in the future. The prestigious properties acquired, such as Essen (tenants: Karstadt Headquarter, Police, 100,000 sqm), Access Tower (Frankfurt, 21,000 sqm) or the Sky Headquarters near Munich (30,000 sqm) serve as evidence of the strength of implementation and quality.

This track record is also based on a reliable financing basis, with well-known partners such as Meritz, Hamburg Commercial Bank and Helaba. In addition, a further financing volume of around Euro 140m was acquired (possible vol. Euro 300m) through the issue of a convertible bond in December 2019.

The company remains focused on the top locations for office properties with properties valued at over Euro 50m. This segment shows a comparatively higher stability within the real estate sector, which is why PREOS wants to continue its strategy despite the Covid-19 pandemic and remains confident as the current situation also opens up opportunities for the implementation of new projects.

In view of the current Covid-19 pandemic, we generally see the market environment as somewhat clouded, but at the same time take into account the strength of PREOS, which has been proven through numerous transactions, in generating income. We raise our target price from Euro 11.80 to Euro 15.50. As the new target price offers a 17% upside, we lift our rating from Hold to Buy.

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 exit minimize risk and increase the likelihood of strategic implementation.
- The objects that have already been acquired serve as a good demonstration of the ability for strategic implementation and, at the same time, an indicator of the dimension in which PREOS intends to emerge (Euro 1bn within 1 year).
- The financing is built on a broad basis and well-known financing partners have been won.
- PREOS is considered to be an active real estate investor. While the expected cash flow represents a significant stabilizer, the expected and partially 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 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

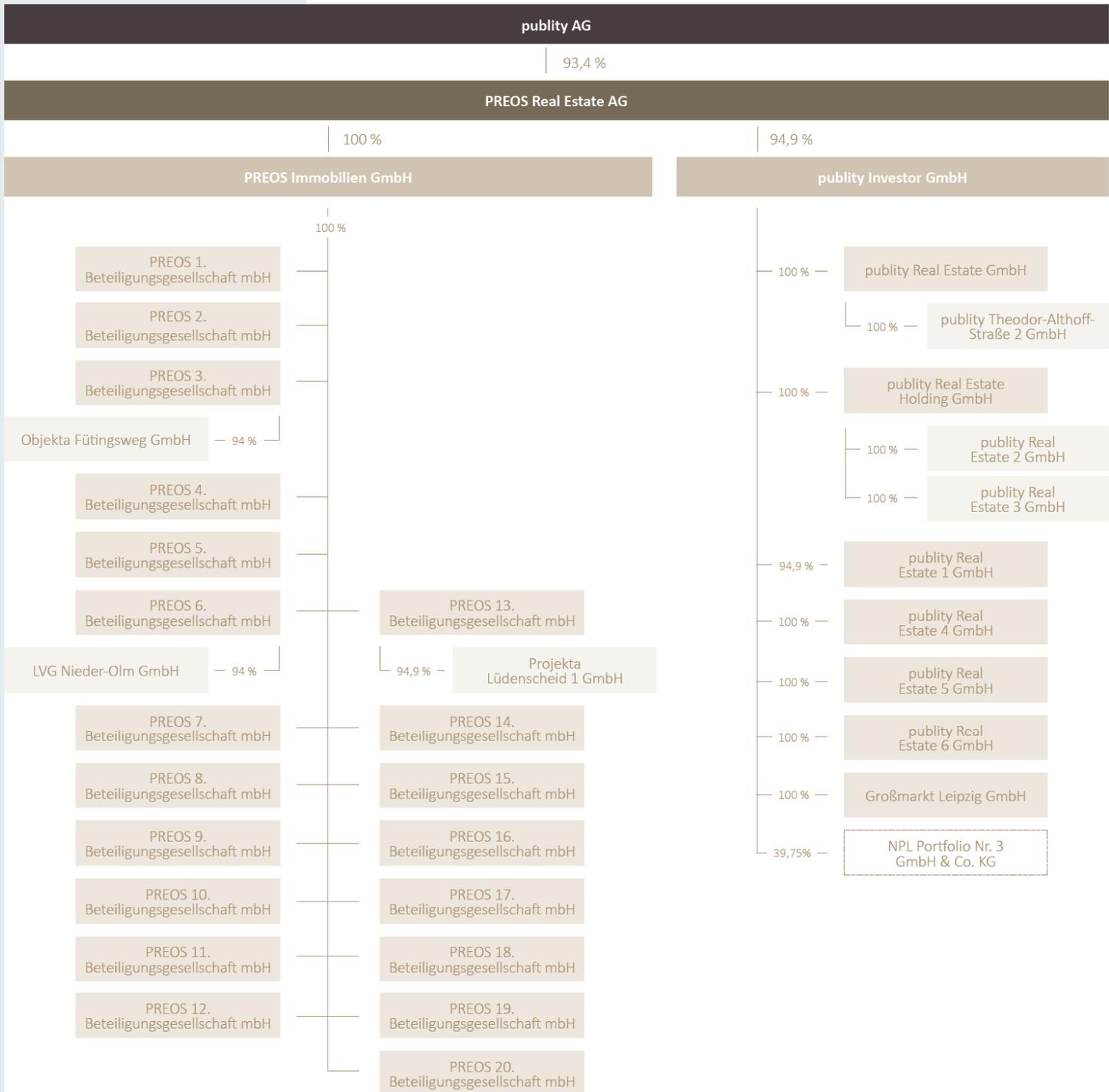
- If the economy and, consequently, the real estate markets restart their positive development, the strategic positioning of PREOS is expected to continue its significant earnings and balance sheet growth. The earnings contribution from the sales proceeds in combination with the relatively favorable 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.
- 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 two months 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.

Structure

The following organizational chart of PREOS illustrates the group structure. At the same time, it becomes clear that the individual real estate projects are organized via so-called project companies, as is customary in the industry, whereby these are in almost all cases subject to full control by PREOS.

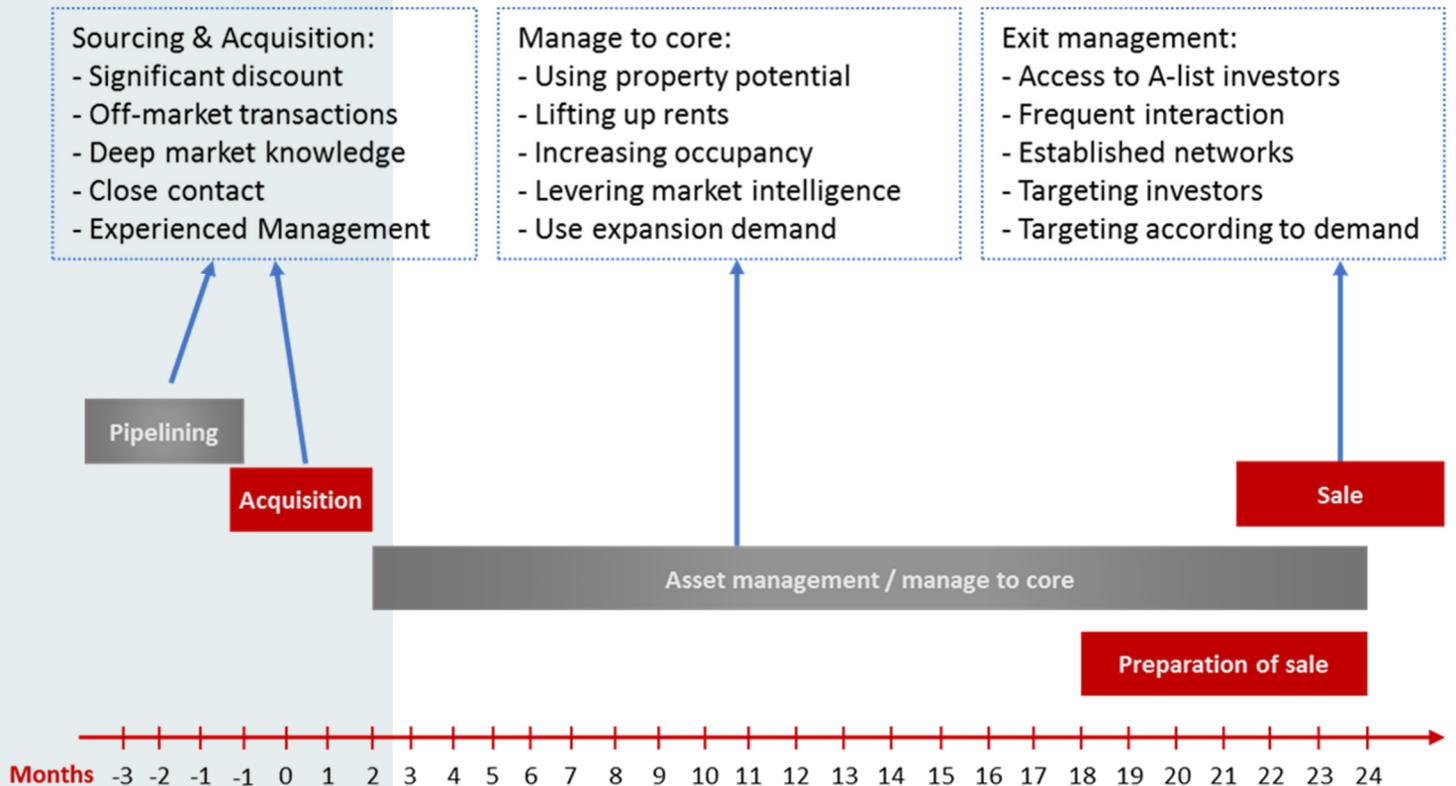


Source: 2019 annual report

Proven Track Record & Efficient Process

Topped own goals

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 2019 and the transactions made therein testify this.



Source: SRC Research

Euro 1.1bn Portfolio
19 Properties
Top German cities
313,000 rentable area

The PREOS portfolio is now Euro 1.1bn, with some of the transactions being finalized in the first quarter of 2020. The portfolio currently consists of 19 properties located in the metropolitan areas around Munich, Frankfurt and the Ruhr area in North Rhine-Westphalia. The total rentable area is around 313,000 sqm. Selected objects are listed below.

Selected Objects

The following properties are an extract from the portfolio of currently 19 properties. The properties shown are among the largest and most profitable of the company and underline its plans for further growth.



Essen, TA2:

Bought:	2019
Tenant structure:	multi
Construction:	1969/1975; complete refurbishment 2020
Rental Area:	94,000 sqm
Occupancy:	100 %
WALT:	21 years



Frankfurt, Access Tower:

Bought:	2019
Tenant structure:	multi
Construction:	1970; complete refurbishment 2002/2015
Rental Area:	21,000 sqm
Occupancy:	100 %
WALT:	9.4 years



Munich, Sky Headquarters:

Bought:	2019
Tenant structure:	single
Construction:	2010
Rental Area:	30,391 sqm
Occupancy:	100 %
WALT:	7.4 years



Frankfurt, Centurion:

Bought:	2020
Tenant structure:	multi
Construction:	1993; refurbishment 2015
Rental Area:	28,680 sqm
Occupancy:	100 %
WALT:	3.9 years

Source: Company Data

Financing / Transactions / Markets

Well-known partners:

**Meritz
Hamburg Com. Bank
Helaba**

As already shown, PREOS has Meritz, Hamburg Commercial Bank and Helaba as well-known financing partners and reliable sources of finance that are essential for PREOS business model. As mentioned in the SWOT analysis, restricting these sources of funding would be an obstacle in the PREOS business model. The first indications already point to a closer examination of loans and could lead to a possible reluctance at the credit institutions to grant loans or higher interest rates on corporate basis. It must be pointed out, that lending is differentiated and, above all, dependent on creditworthiness. In this context, PREOS would realise these difficulties if the property prices fall in the short- and mid term, which we will discuss in more detail in the Macro section in the aftermath. At this point it should be mentioned that PREOS financing by the banks is always at the property level. Given PREOS solid relationships with the banks and its track record, this is likely to show itself in slightly increasing credit spreads, which in turn slightly reduces company's margins. We believe that a theoretically possible broad reluctance to lend is unlikely and credit markets will continue working as usual.

Stable sector, stable financing

Also decisive for lending in the top real estate sector, on which PREOS focuses, is the overall development of the market, which should ultimately also have an impact on lending. According to an evaluation by the real estate service provider CBRE, the transaction volume of German office properties in February 2020 was around Euro 40bn, which was 25% above the previous year's value at record levels. In 2019, Germany's top 7 regions accounted for approximately 82% of investments. These facts confirm the attractiveness of the PREOS business area also with regard to the above-average stability.

Euro ~140m through convertible bond

In addition to the lending by the banks, an additional Euro 139.4m in financing volume was secured at the end of 2019 by issuing a convertible bond, which is further evidence of confidence.

Possible cooling:

**No risk on finance,
only margin risk**

In summary, we only see the possible disruptive factors as the increase in financing costs, which, however, would only reduce the margin and would apply to the overall market. In this context, PREOS access to finance is seen as solid. With regard to the financing base of PREOS, the positive assessment remains and the financing options are available.

Strong money supply...

M3-Growth: +7,5 %

...may continue driving markets

Macro Environment

The Covid-19 crisis is certainly not yet fully understood and it will probably take longer to overcome and change almost all industries. In detail, the short to medium-term course and its effects cannot be foreseen, especially due to the lack of a database. However, the recent extremely convincing announcements by central banks and governments regarding the support measures give hope that this crisis can also be overcome. The essential fundamental and economic factor of the M3 money supply is more than just speculation. The actual development can be seen in the chart below: it is extremely promising.



Source: Bloomberg

M3 monetary growth was 7.5% in March 2020. From this it can be derived that both financial markets and the real economy experience a large surge in liquidity. In comparison to the money supply, the diagram above shows that the DAX serves as an established mood barometer for the German economy as a whole and follows the money supply expansion with a positive trend. The inflation figures for March and April are also promising. In addition to the 1.1% increase in food prices from March to April, the net cold rent in Germany is 0.1% (Source: Bloomberg) on a monthly basis, even over the crisis months. A valuation correction seen as probable should therefore only lead to rising rental yields at the valuation level for a short time. In the medium to long term, the real estate markets should also benefit from the broadly positioned aid measures from Governments and Central Banks.

Results increase probability of forecasts occurring

Our new DCF model results in a higher fair value of Euro 15.77

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 in the first three years of the period under review. Due to the conservative approach, we assume a decline in EBIT for the last two years from 2023 to 2024 back near to the 2019 level.

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

Assumptions:

Long-term Equity Ratio	29%	Beta-factor	1.7
Cost of Equity	9.8%	Risk-free interest rate	0.5%
Debt Costs	4.8%	Market premium	5.5%
Weighted Average Cost of Capital (WACC)	5.31%		
Years until first payout	0.6		
Long-term-growth Terminal Value	1.0%		

'000 Euro	2020e	2021e	2022e	2023e	2024e	Terminal Value
EBIT	230,089	408,814	427,302	352,509	144,817	
Financial Result	-74,309	-109,703	-125,305	-88,593	-31,008	
Taxes	-42,061	-80,760	-81,539	-71,257	-30,728	
adjustments (Capex)	-23,009	-40,881	-42,730	-35,251	-14,482	
Free Cash-Flow	90,710	177,470	177,728	157,408	68,599	
Present Value Free Cash-Flow	83,550	155,224	147,615	124,149	51,378	1,156,308

Present Value Detailed Forecast Period	561,917
Present Value Terminal Value	1,156,308
Total Free Cash-Flows	1,718,224
- net debt	-588,238
Fair value of equity	1,129,986

Number of shares ('000) 71,664

Fair value of equity per share € 15.77

Current Price: € 13.20

Up / Down potential 19%

Source: SRC Research

**Smoothed P&L
Higher equity
Reduced Beta**

Compared to the previous valuations, the EBIT was smoothed and the result for 2024 increased due to the higher probability. In addition, the equity ratio was increased due to the potential headwinds in transactions to take account of the uncertainty. Furthermore, due to the stable fundamental and technical development, the Beta was reduced to 1.7. The fair value per share is Euro 15.77. At the current share price of Euro 13.20, this results in a price potential of about 19%.

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	57,882
Recoverable operating expenses	-7,650	-8,033	-8,434	-8,856	-9,299	-9,764
Gross rental income (GRI)	6,744	84,703	157,914	172,056	156,080	48,119
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	-7,898
Gain or loss on measurement of investment property	101,683	223,670	309,362	315,260	249,705	99,882
EBIT	106,404	230,089	408,814	427,302	352,509	144,817
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
EBT	80,160	150,281	290,993	292,724	257,360	138,834
Tax	-13,847	-39,269	-85,302	-88,978	-78,463	-7,124
Net income	66,313	111,013	205,691	203,746	178,897	131,710
Number of shares ('000)	71,664	71,664	71,664	71,664	71,664	71,664
Earnings per share	0.93	1.55	2.87	2.84	2.50	1.84
Dividend per share	0.00	0.00	0.00	0.00	0.00	0.00
Portfolio size	1,100,000	2,604,624	4,187,454	3,466,769	3,379,063	2,703,250
Liabilities	649,652	2,092,831	3,340,612	2,445,612	2,145,612	1,445,612
NAV per share (Euro)	6.28	7.14	11.82	14.25	17.21	17.55
Total Assets	912,866	2,604,624	4,187,454	3,466,769	3,379,063	2,703,250
Equity	263,214	329,528	440,540	646,231	849,978	1,028,875
Equity Ratio	29%	13%	11%	19%	25%	38%
Return on Equity	25%	37%	53%	37%	24%	14%

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Rating chronicle:

Company	Date	Rating	Former Price	Former Target
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 18 May 2020. PREOS Real Estate AG mandated SRC Research for covering the share.

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