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Presidio Property Trust (SQFT-NASDAQ)

SQFT: 3Q21 Portfolio Shifts Towards Higher-Margin Property Types

Presidio Property Trust is a REIT that holds properties primarily in markets characterized by strong growth. The company's portfolio consists of diversified commercial properties and model homes, with minimal exposure to the retail real estate market. SQFT believes that the diversified nature of its portfolio has been a competitive advantage during the economic downturn associated with the pandemic.

OUTLOOK

SQFT's 3Q21 same-store rental revenue was up about 3.5% y/y. Management attributes improving rental revenue and the high rate of revenue collection to the diversified nature of its property portfolio. SQFT's strategy is to focus on smaller markets that are less dependent on mass transport and generally characterized by strong economic and population growth. Consistent with this strategy, the company recently purchased a single tenant triple net (NNN) property in Houston, which is a rapidly-growing market, recorded an uptick in lease activity, and has a strong cash position to support real estate portfolio growth.

Current Price (11/17/21) **\$3.72**
Valuation **\$6.25**

SUMMARY DATA

52-Week High **\$5.56**
52-Week Low **\$2.63**
One-Year Return (%) **N/A**
Beta **N/A**
Average Daily Volume (sh) **116,198**

Shares Outstanding (mil) **11**
Market Capitalization (\$mil) **\$42**
Short Interest Ratio (days) **N/A**
Institutional Ownership (%) **5**
Insider Ownership (%) **6**

Annual Cash Dividend* **\$0.41**
Dividend Yield (%) **11.07**

5-Yr. Historical Growth Rates

Sales (%) **N/A**
Earnings Per Share (%) **N/A**
Dividend (%) **N/A**

P/E using TTM EPS **N/A**

P/E using 2021 Estimate **N/A**

P/E using 2022 Estimate **N/A**

*Annualized based on 2Q21

Risk Level **N/A,**
Type of Stock **Small-Value**
Industry **Real Estate**

ZACKS ESTIMATES

Revenue

(in millions of \$)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2019	7 A	7 A	7 A	7 A	29 A
2020	7 A	6 A	6 A	6 A	24 A
2021	6 A	5 A	4 A	6 E	21 E
2022					24 E

Per Share Earnings / Loss

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2019	-\$0.10 A	-\$0.14 A	\$0.27 A	-\$0.10 A	-\$0.07 A
2020	-\$0.12 A	-\$0.22 A	-\$0.20 A	-\$0.31 A	-\$0.85 A
2021	-\$0.28 A	\$0.08 A	-\$0.13 A	-\$0.09 E	-\$0.42 E
2022					-\$0.34 E

Quarters might not sum due to rounding & share counts

Disclosures on page 9

KEY POINTS

What's New? 3Q21 Key Takeaways:

- **Strong 3Q21 results underscore positives of the company's strategy**
 - **Real estate portfolio continues to strengthen**
 - **Non-dilutive preferred stock offering enhanced liquidity**
 - **Strong cash balance positions company for portfolio growth**
- Same-store rental revenue was up about 3.5% compared to 3Q20, looking only at the 11 properties held consistently during both the 2020 and 2021 comparable periods. The company sold four properties earlier in 2021. The absence of rental revenue from those properties contributed to a decline in *reported* rental revenue to \$4.2 million compared to \$5.4 million in 3Q20.
- Management attributes its improving same-store rental revenue and high rate of revenue collection to the diversified nature of its property portfolio. SQFT's strategy is to focus on smaller markets that are less dependent on mass transport for daily commuting and generally characterized by strong economic and population growth.
- The company continues to transition its real estate portfolio towards properties that have strong growth prospects and margins. In 3Q21, the mix of properties shifted towards model homes, which is a category earmarked for growth and is characterized by substantially lower operating costs compared to other real estate categories. As a result, SQFT's rental operating costs as a percentage of total revenue fell to 32.3% compared to 37.2% in 3Q20.
- Consistent with its focus on rapidly-growing smaller cities, the company also purchased a single tenant property in Houston, which is a rapidly-growing market, for roughly \$4.9 million. The property is a newly-built single story 10,500 square foot building that is completely occupied under a 15-year NNN lease.
- The company recorded an uptick in lease activity, which management believes bodes well for ongoing growth. SQFT signed 11 new or renewed office, retail and / or industrial leases in the quarter and over 40 through the first three quarters of 2021.
- With a strong cash balance following capital issuances and asset divestitures earlier this year, SQFT is well-positioned to add to its real estate portfolio and has several potential acquisitions currently in the due diligence process.

RECENT RESULTS: HIGHLIGHTS

San Diego, California-based Presidio Property Trust (NASDAQ: SQFT) recorded 3Q21 revenue of \$4.4 million, down from \$5.7 million in 3Q20. The revenue decline was partially driven by pandemic-related rent deferrals or abatements offered to tenants, but primarily reflects the absence of revenue from properties that were sold recently.

In fact, same-store rental revenue was up about 3.5% compared to 3Q20, looking only at the 11 properties held consistently during both the 2020 and same period of 2021. Presidio sold four properties earlier in 2021 – three Colorado office properties and a California retail property. Same-store occupancies declined to 82.7% at the end of 3Q21 compared to 86.1% at the end of 3Q20 on the same basis.

Nevertheless, rental collection remained strong, which SQFT attributes to the benefits of its portfolio strategy. Presidio achieved an average rental collection rate of 96% of rents billed during the period. SQFT collected 100% of budgeted revenue in its model homes in 3Q21. Rent collections for industrial properties declined slightly, while collections on retail properties improved sequentially and compared to the prior year. Moreover, the company has reduced the contribution of the retail real estate category in its portfolio over the past several quarters. As a result, retail accounts for only an estimated 12%-14% of total consolidated net operating income (NOI). In addition, SQFT currently has a California retail center on the market for divestiture. Once this transaction closes, the company's exposure to the retail sector is expected to be further reduced, all else remaining equal.

Management attributes its high rate of revenue collection to the diversified nature of its property portfolio. SQFT's strategy is to focus on smaller markets that are less dependent on mass transport for daily commuting and generally characterized by strong economic and population growth. The company believes that its targeted smaller markets have been more stable during the COVID-19 pandemic than larger metropolitan markets, in part because of lower reliance on public transportation. Reflecting the benefits of this strategy, management indicated that, with one exception, the roughly 220 tenants in SQFT's portfolio have all either satisfied their rental obligations or are abiding by their current rental terms.

Reported rental operating costs fell nearly 33% year-over-year, largely due to the above-noted sale of four commercial properties during the first three quarters of 2021. On a same-store basis, rental operating costs increased by 2.9% year-over-year against the above-noted 3.5% same-store rental revenue improvement. Thus, same-store rental operating costs as a percentage of same-store rental revenue fell slightly to 41.6% compared to 41.9% in 3Q20. Same-store net operating income (NOI) improved 5.7% compared to 3Q20 to \$2.15 million (compared to \$2.06 million).

Moreover, the mix of properties shifted towards model homes, which have substantially lower operating costs. As a result, SQFT's *reported* rental operating costs as a percentage of total revenue fell to 32.3% compared to 37.2% in 3Q20.

General & administrative expenses were up slightly to \$1.5 million (from \$1.4 million), primarily reflecting increased stock compensation expense following the company's October 2020 IPO. Total interest expense was lower in 3Q21 due to the sale of four properties in 2021 and reduction in debt. SQFT has eliminated costly mezzanine debt.

Core funds from operations (FFO), a key measurement of cash flow, reached \$1.67 million through the first three quarters of 2021, up from \$1.55 million in the same period of 2020. In part, this improvement reflects lower interest expense noted above.

Portfolio shifts towards high-growth, higher-margin properties

The company continues to transition its real estate portfolio towards properties that have solid rental revenue prospects and margins. In August, for example, the company purchased a single tenant triple net (NNN) property in Houston, which is a rapidly-growing market, for roughly \$4.9 million. The property is a newly-built single story 10,500 square foot building that is completely occupied under a 15-year NNN lease.

SQFT sold 39 model homes in 2021 through 3Q21 for roughly \$19.0 million, recognizing a gain of roughly \$2.9 million. During the same period, the company also purchased six model homes for about \$2.9 million and leased them back to the homebuilders under NNN leases. Subsequent to the quarter end, SQFT acquired an additional three model home properties outside of Dallas-Fort Worth. The company's strategy is to target regional cities experiencing high growth. In Dallas-Fort Worth, the days-on-market for homes in September 2021 averaged 52 days compared to 86 days in September 2020, according to management.

The company recorded an uptick in lease activity, which management believes bodes well for resumed growth. SQFT signed 11 new or renewed office, retail and / or industrial leases in 3Q21 and more than 40 in the first three quarters of 2021. These leases are expected to boost rental revenue and auger well for ongoing growth, management believes. Roughly a third of these were with new tenants and the others were lease renewals or extensions with existing tenants.

The company believes the uptick in lease signings and / or renewals reflects the general resumption of business activity as markets re-open following the closures mandated by the COVID-19 pandemic. Management is optimistic about leasing demand going forward. SQFT has other prospective lease transactions in its pipeline. Moreover, SQFT continues to identify and evaluate several other properties for potential acquisition opportunities to enhance the portfolio, in addition to the Dallas-Fort Worth property noted above.

STRONG BALANCE SHEET

Preferred stock offering added liquidity

Earlier in 2021, SQFT raised capital through a preferred stock offering – SQFT issued shares of 9.375% Series D cumulative redeemable preferred shares – and subsequent common equity offering. The preferred share issuance was non-dilutive to equity shareholders, which is consistent with SQFT's goal to minimize potential dilution to public common stockholders. The offerings strengthened the company's balance sheet, helping to position SQFT for portfolio growth.

SQFT ended 3Q21 with \$27.8 million in cash, cash equivalents and restricted cash compared to \$11.5 million at year-end 2020. The company intends to use the net proceeds from the above-noted offerings to potentially acquire additional properties, as well as for working capital and for other general corporate purposes.

REAL ESTATE ASSET PORTFOLIO CHANGES

As noted, SQFT is proactively managing its real estate portfolio to maximize portfolio value, disposing and acquiring assets at times that management deems appropriate. Asset sales completed in the first three quarters of 2021 include the sale of Waterman Plaza for \$3.5 million and Garden Gateway for \$11.2 million, as illustrated below, among other transactions.

SQFT Disposition Highlights Through 3Q21 (\$ Millions)

<u>Property</u>	<u>Date of transaction</u>	<u>Price</u>
Waterman Plaza	28-Jan-21	\$3.5
Garden Gateway	19-Feb-21	\$11.2
Highland Court	20-May-21	\$10.2
Executive Office Park	21-May-21	\$8.1
39 model homes		\$19.0

Source: Company reports

SQFT is well-positioned to finance potential acquisitions leveraging the capital that it raised recently. SQFT has several potential acquisitions currently in the due diligence process. Reflecting management's extensive experience in the real estate sector, the company can leverage relationships to find both off-market and on-market properties in order to add assets to its portfolio at attractive terms and enhance portfolio and shareholder value.

As noted, SQFT is focused on markets that are characterized by strong population growth, as noted, including from university and government sources, and believes that there are many attractive potential acquisition opportunities available.

VALUATION

We are optimistic that SQFT can continue to manage its property portfolio to produce attractive returns. As the company continues to transition its portfolio away from retail and into attractive commercial and industrial and model home properties, we estimate resumed steady growth commencing in approximately 2022 – 2023.

We value SQFT on a price-to forward FFO basis. We estimate FFO of \$3.5 million in 2022. We think the current share price at this level does not fully reflect the fundamental value of the company's portfolio, particularly as SQFT continues to shift into properties that management believes are more attractive. At \$6.25 in the near-term, the shares would trade at a multiple of roughly 16x our forward FFO forecast, which is a multiple that many other REITS command.

As the portfolio reaches the targeted property type composition and the economy stabilizes, we believe SQFT can achieve steady FFO growth in the 20% to 25% range, consistent with historical trends, and we would anticipate further share price appreciation. While a longer than currently anticipated economic downturn represents a potential risk to our valuation, we believe the risk / reward ratio could be attractive for investors who have a higher than average risk tolerance and longer time horizon.

RECENT NEWS

- On November 11, 2021, the company reported 3Q21 results.
- SQFT provided a business update on its model home activity on October 29, 2021.
- On August 10, 2021, the company reported 2Q21 results.
- Presidio announced the closing of its \$10 million registered direct equity offering on July 14, 2021.
- On June 17, 2021, SQFT announced that the underwriters of its preferred equity offering fully exercised their over-allotment option.
- Presidio closed its upsized offering of preferred stock on June 15, 2021.
- On May 27, 2021, SQFT sold the Highland Court and Executive Office Park properties.
- On March 9, 2021, the company signed a lease with the Make-A-Wish Foundation of San Diego.
- SQFT declared a 3Q21 dividend on February 24, 2021.
- SQFT sold its Garden Gateway Property on February 22, 2021.
- Presidio announced the results of 2020 leasing activity on February 11, 2021.
- SQFT announced the signing of a major lease with the U.S. General Services Administration on Feb 3, 2021.
- On January 28, 2021, Presidio sold the Waterman Plaza retail center.
- Presidio announced that it had completed the sale of a building at Executive Office Park on December 4, 2020.

RISKS

Risks to SQFT achieving its objectives, and to our valuation, include the following.

- Another economic downturn.
- A decrease in real estate values could have a negative impact on SQFT's portfolio.
- Competition from other REITs and/or property developers could increase.
- A default by one of SQFT's tenants could have a negative impact on FFO.
- The company's might need to raise additional capital sooner than management anticipates.

PROJECTED FINANCIALS

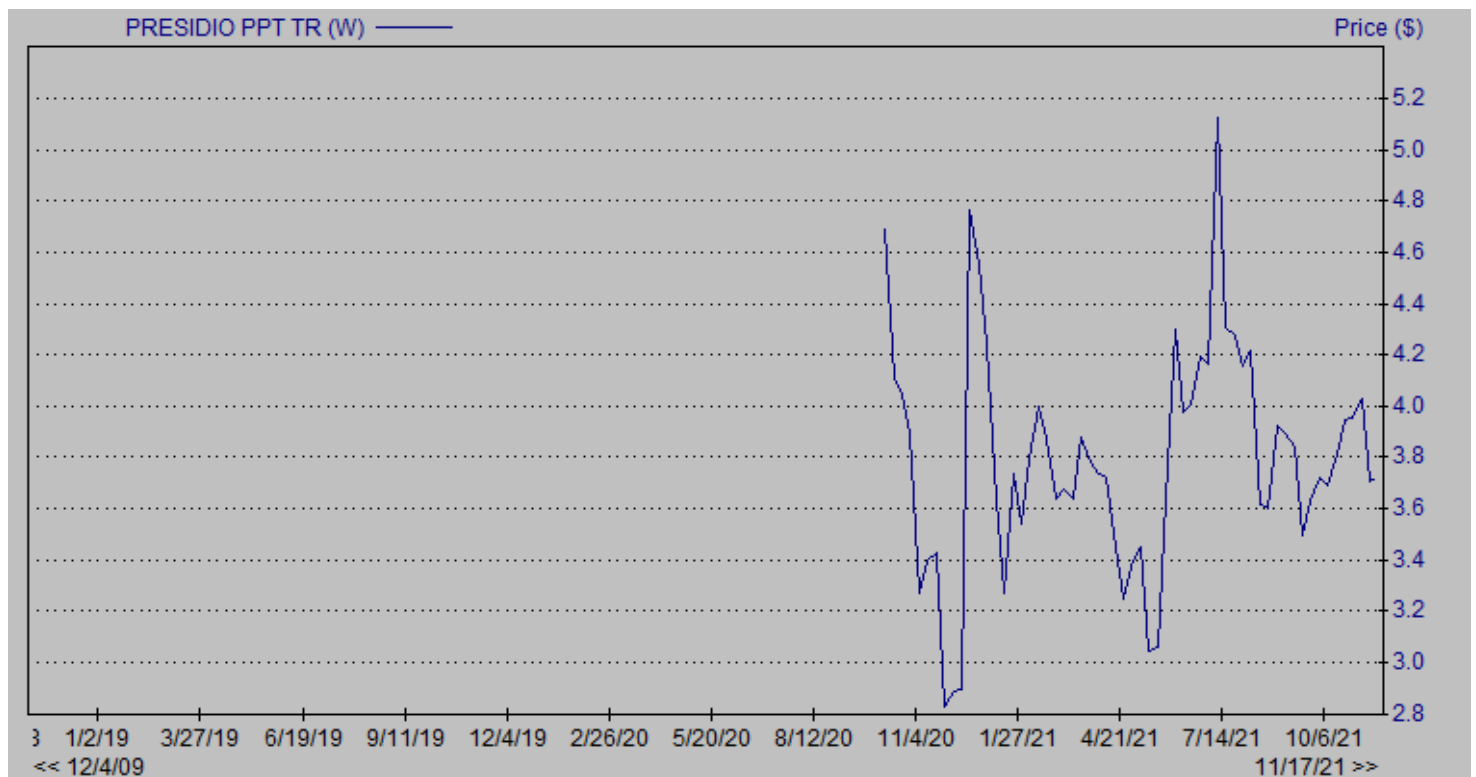
Presidio Property Income Statement & Projections (\$)

	2019	1Q20	2Q20	3Q20	4Q20A	2020A	1Q21A	2Q21A	3Q21A	4Q21E	2021E	2022E
Revenues:												
Rental income	\$27,467,410	\$6,785,685	\$5,879,526	\$5,433,303	\$5,345,605	\$23,444,119	\$5,477,223	\$4,553,798	\$4,185,212	\$5,710,456	\$19,926,689	\$22,954,919
Fees and other income	1,173,701	243,466	241,878	230,265	192,064	907,673	191,531	292,785	190,967	242,011	917,294	963,299
Total revenue	28,641,111	7,029,151	6,121,404	5,663,568	5,537,669	24,351,792	5,668,754	4,846,583	4,376,179	5,952,467	20,843,983	23,918,218
Rental operating costs	10,410,574	2,381,092	1,999,834	2,108,621	2,328,736	8,818,283	1,838,923	1,485,815	1,414,518	2,055,764	6,795,020	8,034,222
General and administrative	5,268,315	1,351,345	1,278,971	1,366,380	1,755,058	5,751,754	1,537,265	1,344,770	1,479,261	1,398,830	5,760,126	5,932,929
Depreciation and amortization	7,364,688	1,574,526	1,622,230	1,626,917	1,450,648	6,274,321	1,428,934	1,368,209	1,306,874	1,610,326	5,714,343	6,408,766
Impairment of real estate assets	-	-	845,674	-	885,177	1,730,851	300,000	-	-	-	300,000	-
Total costs and expenses	23,043,577	5,306,963	5,746,709	5,101,918	6,419,619	22,575,209	5,105,122	4,198,794	4,200,653	5,064,920	18,569,489	20,375,917
Operating income	5,597,534	1,722,188	374,695	561,650	(881,950)	1,776,583	563,632	647,789	175,526	887,547	2,274,494	3,542,301
Operating margin	20%	25%	6%	10%	-16%	7%	10%	13%	4%	15%	11%	15%
Interest expense mortgage notes / other	(2,226,101)	-	-	-	-	-	(1,305,021)	(1,207,036)	(1,030,883)	(1,183,016)	(4,725,956)	(4,678,696)
Interest expense	(8,423,545)	(2,553,846)	(2,273,356)	(2,143,960)	6,971,162	-	(279,373)	-	-	-	(279,373)	-
Interest and other income (expense)	141,306	(6,995)	8,400	(12,270)	(8,822,838)	(8,833,703)	(32,785)	(20,657)	(13,886)	(12,896)	(80,224)	(48,281)
Gain /(loss) on sales of real estate	6,319,272	(9,835)	334,096	332,714	588,485	1,245,460	(1,161,328)	2,594,341	627,322	349,686	2,410,021	1,405,669
Other	(635,532)	(83,631)	(51,369)	(122,602)	(192,136)	(449,738)	10,000	-	(182,607)	(54,029)	(226,636)	(180,647)
Total other income (expense)	(4,824,600)	(2,654,307)	(1,982,229)	(1,946,118)	(1,455,327)	(8,037,981)	(2,768,507)	1,366,648	(600,054)	(900,255)	(2,902,168)	(3,501,956)
Net (loss) income	772,934	(932,119)	(1,607,534)	(1,384,468)	(2,337,277)	(6,261,398)	(2,204,875)	2,014,437	(424,528)	(12,707)	(627,673)	40,344
Taxes							(50,199)	(238,701)			(288,900)	(140,567)
Net income / (loss)							(2,255,074)	1,775,736	(424,528)	(12,707)	(916,573)	(100,222)
Less: (Loss) income - noncontrolling intere	(1,383,140)	(175,011)	(315,282)	(363,777)	(558,437)	(1,412,507)	(406,608)	(925,697)	(427,303)	(382,333)	(2,141,941)	(1,205,416)
Attributable to Presidio	(610,206)	(1,107,130)	(1,922,816)	(1,748,245)	(2,895,714)	(7,673,905)	(2,661,682)	850,039	(851,831)	(395,041)	(3,058,515)	(1,305,638)
Less: Preferred Stock Series D dividends								(95,836)	(539,056)	(539,056)	(1,173,948)	(2,156,224)
Presidio net income (loss)								754,203	(1,390,887)	(934,097)	(4,232,463)	(3,461,862)
EPS/(LPS)	(\$0.07)	(\$0.12)	(\$0.22)	(\$0.20)	(\$0.31)	(\$0.85)	(\$0.28)	\$0.08	(\$0.13)	(\$0.09)	(\$0.42)	(\$0.34)
Avg shares out (FD)*	8,862,957	8,881,842	8,897,037	8,922,525	9,394,253	9,023,914	9,508,363	9,508,363	10,833,847	10,509,263	10,089,959	10,091,559

Source: Company reports, Zacks estimates

*Pro forma for reverse stock split.

HISTORICAL STOCK PRICE



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