CORESTATE Capital Holding S.A.

Corestate Q3 2022 Results Conference Call and Webcast

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Transcript

Speakers:

Dr Kai Gregor Klinger

Stavros Efremidis

Udo Giegerich

Dr Kai Gregor Klinger

Ladies and gentlemen, thank you for joining us today on our earnings call for the presentation of our financial results for the first nine months of 2022 and I hope that the postponement of our call from originally 11 a.m. to 2 p.m. did not cause you any problems. On the Corestate investor relations website, you will find the press release, the interim financial statement and the corresponding slide deck. As usual, I'd like to draw your attention to the forward-looking statement and disclaimer wording on page 2 of our presentation. This safe harbor language applies to the presentation and all comments we'll be making today.

I would also like to mention that everything is being recorded. You can replay the call and view the transcript on our investor relations website a few hours after the call. With me on the call are the CEO of the Corestate Capital Group, Stavros Efremidis, and our CFO, Udo Giegerich.

Now we would like to start to guide you through the presentation, followed by the usual Q&A session. The time frame for today's call is about 30 minutes. Now it's my pleasure to hand over to the CEO of Corestate. Stavros, the floor is yours.

Stavros Efremidis

Thank you, Kai. Good morning, ladies and gentlemen, and a very warm welcome from my side.

There is a lot going on, not just at Corestate, but all over the world – both economically and politically. But first things first. Please allow me to start by giving you an overview of the ongoing financial restructuring process and the past timeline.

In May 2022, Corestate initiated the preparation of alternative measures to address the refinancing topic of the expiring notes and started one month later an extensive due diligence process with the financial and legal advisers of a group of major noteholders with the objective of achieving a successful financial restructuring solution. This creditor group controls almost 50% of the convertible bond and close to 80% of the 2023 notes.

Following the presentation of a company proposal at the beginning of July, the noteholder group together with its advisors submitted several counterproposals to Corestate. Later, mid-October, certain members of the noteholder group entered into a confidentially agreement with Corestate. Furthermore, also mid-October, the advisers of the bondholder group provided an updated proposal to Corestate, which contained conditions for an amendment of the bonds.

Around the same time, a group of certain potential equity investors provided the company with binding equity commitment letters, which also included terms for an amendment of the notes. Both proposals from the noteholder group and from the equity investor group are not compatible – even though on balance they are not that far apart commercially. Main differences were the essential terms of the fresh money, the allocation of equity upside and governance

To create the necessary preconditions for a financial restructuring on the capital side and to be flexibly positioned for various measures Corestate has invited to an EGM on 22 November 2022 to increase the authorized capital by 200 million new shares and to amend the Articles of Association.

On the basis of the existing business proposals and the authorization resolution, an ultimate decision on the restructuring of the two bonds and thus on the continuation of Corestate is to be made at a bondholders' meeting on 28 November. The corresponding resolution proposals and documents for the meeting are available on our website.

Now, the proposals are on the table, and we continue to support the involved parties in their discussions towards a potential agreement in order to be ready for a noteholder meeting based on a joint proposal for a resolution before maturity of the convertible bond.

As we have already stated several times, the most important and urgent goal this year is to restructure the outstanding refinancing. We are pursuing this goal in the best interests of the company to ensure the continuity of the group and to give our clients and our employees a solid and reliable future perspective.

Now we are approaching the final round of discussions with bondholder representatives and their consultants. Therefore, please understand that we are not able to provide you with further information on the status of these ongoing discussions in our Q&A session. Once there are updates that can be shared with the capital markets, further information will be provided via the usual channels.

Please, follow me now on page four. The economic conditions have continued to deteriorate over the last few months. In the real estate sector, the central banks' interest rate increases and the fallout from Russia's war in Ukraine have severely shaken many of the pillars that ensured stability up to now. The real estate super-cycle that had lasted more than a decade has ended abruptly.

We are facing an extremely demanding situation at the moment. There had been critical impacts on the overall global investment market. Moreover, transaction volumes weakened further overall. The market is now experiencing a perfect storm.

Taking these general conditions into account, Corestate showed a very subdued business course in the first nine months of 2022, as expected. And as a result, from company-specific reasons, the management had to adjust the goodwill and certain balance sheet positions in the third quarter again.

All in all, this has an enormous impact on our interim statements. Our CFO will go into this in more detail later.

Nevertheless, we continue to pursue our strategy by focusing on our core business and preparing the company for a comprehensive restart. We are already well on track with our organizational restructuring measures and ongoing extended efficiency program.

A key objective in the context of the transformation of the Group is also focusing the business model on core real estate activities to sharpen our profile in the market. Thus, one of the strategic decisions was to divest a large part of the personnel-intensive and low-margin property management business by selling Capera and to dispose the non-core asset management.

At the end of the reporting period of 2022, assets under management in our core business decreased to 17.3 billion euros due to the absence of some institutional clients. In comparison, this figure was 20 billion at the end of 2021.

The changes on the central bank side mean nothing less than a comprehensive and deep adjustment process for the real estate industry. Asset valuation is already and will be hit quite hard by the current market recession.

In our special situation, this negative development is intensified by the value adjustments and risk provisions made as well as the open refinancing issue and the resulting increased uncertainty on the corporate side.

Naturally, we are experiencing a certain degree of reluctance with our clients towards new business.

Please flip to page five. In the light of the stormy market situation, risk aversion of institutional clients went up significantly and the transaction volume fell sharply across the industry. However, during the first nine months 2022 we have completed on behalf of our clients several transactions and investments. This brings us to a total amount of assets under management in our real estate equity core business of currently 13.2 billion euros. The main reason for the reduction was on the one hand the disposal of some smaller commercial and micro-living portfolios. And on the other hand, due to the loss of three asset management contracts, what happened in the third quarter.

Within our AuM universe, we have an unchanged focus on specific asset classes like office and student accommodation/micro living closely followed by retail and residential assets. This also speaks to the fact that our property management specialist for student housing in the UK, CRM, which was previously held for sale, is now considered as part of the core business going forward.

Please, go to page six. One of Corestate's most significant events in the debt segment is the discontinuation of business with the Stratos funds. Beyond the challenging market situation, the decisive factor for the decision was that the redemption of unit certificates was suspended and, in this context, distributions and payments by the fund manager were also discontinued. Later on, a comprehensive restructuring of the Stratos funds was agreed between the responsible fund manager and the investors. Therefore, our subsidiary HFS will probably cease to act as investment advisor for the debt funds of the Stratos family by next year at the latest. In the light of the major financial significance of the funds for HFS' short to medium-term business prospects, this subsequently led to a strategic reassessment. In addition, the resulting lack of earnings prospects meant that Corestate had to adjust the corresponding balance sheet items, in particular had to impair the entire goodwill of HFS.

Amid market volatility and high inflation, lenders are now increasingly focused on mitigating risk. This has led to a shift in the markets which – combined with the rise in key interest rates – has significantly increased the cost of debt for borrowers. The more than doubled financing costs also caused many investors recalculating in ongoing bidding processes and reducing their willingness to pay. This causes delays and many properties or development projects were taken off the market again. That is exactly what we have seen in the last months, a very weakish transaction environment and a sharp decline in our debt structuring and financing business at Corestate Bank. Furthermore, we had decided in view of the significant worsening in the macroeconomic environment to adjust the goodwill of Corestate Bank as well. And I am also convinced that our debt advisory business at Corestate Bank will recover once the backlog in the transaction market has cleared. In times of rising interest rates, there is a clear need for bank-independent financing solutions – here we can offer a unique value chain and track record.

With this, I would like to hand over to Udo Giegerich. Please flip to Page 7 and Udo, the floor is yours.

Udo Giegerich

Many thanks, Stavros, and a very warm welcome to all of you, also, from my side. Firstly, I'd like to give you information on our income lines. As my colleague has already pointed out, economic conditions in the real estate market deteriorated increasingly since the end of last year. And the real estate sector has already been noticeably affected by this and shows significantly lower transaction volumes. Combined with our company-specific issues, this is weighing on our new business and leading to lower earnings, especially from acquisition- and performance-related fees. For this reason, Corestate recorded a very subdued business course in the first nine months of 2022.

Including the revenue from Real Estate Equity Segment, from Real Estate Debt Segment and the income from Other Segments, at around 50 million euros, aggregate revenues and gains from continuing operations in the reporting period were significantly below the previous year's figures of 157 million euros.

Let us take a deeper look into the individual top-line development of the different reporting segments. The Real Estate Equity segment generated revenues of 44 million euros, this means roughly 15 million euros below the previous year, in particular due to the lack of the transaction business. For the same reason revenue from sales and promote fees realized decreased from 12.4 million euros to 0.7 million euros and the acquisition fees in this segment went down from 6.5 million euros to 2.2 million euros. Revenue from asset management proved to be a relatively stable component. These fees went down slightly to 24.4 million euros from 26.7 million euros in the previous year. Revenues from property management increased from 11.7 million euros to 14.7 million euros, mirroring of course higher occupancy rates and increased assets under management especially for our student housing specialist CRM in the UK. Revenue from development fees was stable at 1.9 million euros. The total income in the Debt Segment went down considerably by 78 percent to 20 million euros from 91.7 million euros last year. The underwriting and structuring fees together with the income from trading activities were rather weak and fell from 31 to 3.6 million euros, characterized strongly by project cancellations and a very weakish private debt market in 2022. Driven by the suspension of dividends and payments of the Stratos II fund no performance fees could be recognized in the current reporting period. In the last year we still generated 34 million euros performance fees. Income from bridge loans decreased from 14.2 to 5.4 million euros, primarily due to the maintained and increased risk provision. Revenues from asset management were almost stable at 11 million euros, thereby mirroring the slightly reduced fund volumes. Last but not least, the other segments generated an income of minus 14.3 million euros, coming from 5.8 million euros in the last year. This was mainly caused by higher losses from fair value measurement in an amount of almost 19 million euros, due to the value adjustments in the Stratos funds.

Moving on to slide eight, please. With this chart, as usual, we would like to give you a little more background on our P&L figures for the first nine months 2022. All in all, we had OpEx of 158 million euros, up from 75 million euros in the previous year. This development was strongly characterized by one-time expenses and risk provisions, such as the write-down on bridge loans and the value adjustment of contract assets totaling 100 million euros. All costs were digested directly in the operating lines.

The G&A expenses are rather flattish with 38 million euros in comparison with the prior year's figure. Despite the several measures from the efficiency program already realized, we expect the first cost effects will be seen maybe end of the year. Nevertheless, the absolute number of full-time-employees decreased already from 811 at the end of last year to 446 at the end of the third quarter. This development was mainly driven by the disposal of Capera in June. Irrespective of Capera we've already reduced our remaining staff by around 20 percent at the end of September.

As we have already explained in past presentations, the main focus in the coming months will remain on significantly improving the overall cost structure by reducing complexity, avoiding duplicate functions in the organization, and consistently cutting costs at all levels and in all areas. In summary, this led to a Group EBITDA from continued operations of minus 108.3 million euros in the reporting period, compared to 53.4 million euros in 2021. This development was beside the substantial one-time charges, chiefly attributable to the clearly lower fee volume despite the yet to be adjusted cost structure across all segments. Depreciation and amortization went up significantly to 459 million euros from 23 million euros, mainly driven by complete impairment of goodwill at HFS and the partial impairment at Corestate Bank due to the changed income expectations. Furthermore, this position also includes a small amount from depreciation and impairments of intangible assets recognized business combinations. Our reported net profit from continued operations for the first nine months 2022 stood at minus 582 million euros. Taking into account the one-time charges, the PPA-effects and the deferred tax liabilities the corresponding adjusted net profit from continued operations amounting to minus 137 million euros. I would just like to mention this for reasons of completeness. Earnings per share after the first three quarters of 2022 are minus 17 euros. EPS in the comparable period last year stood at 0.14 euros.

Please, flip to the next page. On page 9, I would like to flag some balance sheet items and their development in the relevant reporting period of 2022. The most significant change in our balance sheet as of the end of September 2022 occurred in the position goodwill and other intangible assets, mainly driven by the impairments in our debt business. Goodwill dropped from 496 million euros last year to 99 million euros and the intangible assets decreased to 29 from 86 million euros. Cash and cash equivalents amounted to 40 million euros, down from 65 million in December 2021.

Against the backdrop of the negative earnings development and one-time effects, total equity decreased drastically from 626 million euros in 2021 to 43 million euros at the end of the reporting period. The Group's equity ratio thus fell to roughly 6 percent, compared with 44 percent on 31 December 2021. In this context, please be aware as a result of further potential risk provisioning or adjustments of the book values, a negative equity at the end of the year cannot be completely ruled out.

Our financial liabilities totaled 612 million euros as of 30 September 2022, after 622 million euros in 2021. With this, net financial debt – including cash and cash equivalents as well as restricted cash and adjusted for lease liabilities – were slightly up at 556 from 527 million euros. The increase mainly results from the temporary acquisition of an office building project in Augsburg, which is expected to be placed in the next couple of months.

We will continue to work on monetizing balance sheet assets. But we are also struggling with these market conditions. Therefore, to safeguard the operating business over the coming quarters and to enable real estate equity transactions as well as opportunistic deals in the near future, there is a clear need of fresh money. As you have already heard before, this aspect is reflected in both restructuring proposals.

In a nutshell, the 9 months figures are overshadowed by major one-off effects such as an extensive risk provisioning, unavoidable impairments and the substantial valuation adjustments on key balance sheet items. These measures were indispensable and driven by the market turmoil as well as the company-specific problems in the last months and have thus significantly changed the operational growth perspectives. With this, I would like to thank you for your attention, and, please, skip to page ten. Stavros, turn to you.

Stavros Efremidis

Many thanks, Udo. Beyond the bond restructuring and securing liquidity, the top priority is to stabilize our operations by reassuring our employees and clients by remaining convinced of the business model and the future potential of Corestate. In parallel, we are working flat out on our cost-cutting measures to adapt the company to the current needs of the business. To this end, we have already bundled operating areas, systematically reduced double functions and overhead; we are also in the process of closing offices and consistently reviewing all non-personnel costs and other expenses. On the earnings side, the savings will already be evident at least end of year and will then be fully reflected in the coming year. The aim is to implement a structural adjustment of the Group to make it an efficient and effective investment house with the existing focus on real estate equity and real estate debt.

After the agreement on a solution of the pending financing issue, we can start further measures to secure the future of our company. For example, we want to initiate a comprehensive re-branding of Corestate and carry out a repositioning of the Group. With a robust and adjusted strategy, we will again be able to strengthen our own competitiveness and regain the necessary trust of clients and investors.

Corestate continues to find itself in a perfect storm. In view of the dynamic market environment and the demanding situation on the corporate side, we are challenged every day. Therefore, it is important that we set the right course now so that the company can once again operate successfully in the future. To make such a new start possible, we have rigorously reviewed and adjusted numerous risk positions in our balance sheet. We are now working with high pressure to find a solid solution for our restructuring and to implement our strategic agenda.

I am highly motivated and committed to achieving these

	important targets together with my colleagues on the Management and Supervisory Board. With this outcome, I would like to hand back to the operator. We are all now ready to answer your questions. Thank you.
Operator	Thank you. Ladies, and gentlemen, at this time, we will begin the question-and-answer session. Anyone who wishes to ask a question may press star followed by one on their touchtone telephone. If you wish to remove yourself from the question queue, you may press star followed by two. If you are using speaker equipment today, please, lift the handset before making a selection. Anyone who has a question may press star followed by one at this time. One moment for the first question, please.
	The first question is from the line of Peter Bergman from Independent Bond Research. Please, go ahead.
Peter Bergman	Yes, thank you very much for taking my questions. I've got three, actually. So, the first question would be why was the goodwill of HFS fully written off in Q3, when according to the business plan of the published cleansing document, it still estimates a future P&L?
Dr Kai Gregor Klinger	Maybe, Udo, would you take this question?
Udo Giegerich	Yes, maybe. Yes. The agreement with HFS was done after the completing of the business plan. Therefore, firstly, we will stop the old private debt business with HFS as of the end of this year, for the funds. We will plan to restart a new business latest from 2024 onwards. In the business plan, basically, the termination of the Stratos Funds was planned, terminating over the next three years. And therefore, there is a discrepancy between the business plan and the current situation.
Peter Bergman	Okay, thank you for that. The second question from my side would be can you confirm media reports that in the course of the bond restructuring, that highly confidential internal company information was passed on to third parties by members of the Board of Management without authorisation? Thank you.
Dr Kai Gregor Klinger	It’s Kai. I'm sorry, but this would be an internal matter. And, of course, we do not comment on any press articles or speculations. So, I'm sorry.
Peter Bergman	Yes, sure. That's understood. And my final question, thanks for that. Do you know whether individual members of the Board of Management, in particular, the CFO, have received assurances from noteholders that they will continue to work for the company, while retaining their individual remuneration if they support the noteholders’ proposal?

	Thanks.
Dr Kai Gregor Klinger	Again, we can't comment on speculation and market rumours like that. Udo, do you want to add anything?
Udo Giegerich	No. Nothing to add on this.
Dr Kai Gregor Klinger	So, thank you. Thank you for your questions.
Peter Bergman	Thank you.
Operator	Ladies, and gentlemen, as a reminder, if you would like to ask a question, please press star followed by one on your telephone. So far, we have no further questions, and I hand back to Dr Klinger for closing comments.
Dr Kai Gregor Klinger	Thank you so much for listening. We appreciate your interest. Do not hesitate to contact us if you have further questions. I would like to repeat that you will find the documents for the EGM and the bondholder meetings on our homepage under the section shareholders. Once again, thank you, we look forward to speak to you soon, take care, and stay healthy. Bye-bye.