Distressed Credit Research: **Aggregate**
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Content: **Review of assets and value available to bonds**

Introduction and Summary

Aggregate is a real estate developer focusing on large commercial projects based in major German cities. The developments are at various stages of completion. The developments, which are held in subsidiaries, have significant amounts of debt secured against the assets. Falling asset values due to the deteriorating real estate market have resulted in breaches of the terms of those debt facilities, such as LTV ratios. Aggregate is having to renegotiate existing debt terms and sell assets to raise cash to pay down debt to avoid defaults.

Aggregate's 6.875% €600 million 2025 unsecured notes held at the parent level are currently indicated around 18% on face after having agreed to defer all cash payments and waive covenants. The implication is that very little value will ultimately flow up to the parent level compared to the €2,773 million in residual value NAV at the parent group level presented in the last financial release.

The values realized in recent asset sales since the last balance sheet date are broadly consistent with the view implicit in the bond price, and backup management comments, that there's little value available to flow up to the parent company level, at least in the short term. The bond price very likely also reflects the risk of forced sales in an insolvent liquidation of some or all the assets. The bondholders by agreeing to the recent amendments clearly wanted to avoid precipitating that outcome.

The residual value method approach applied to determining the fair value of real estate assets on the balance sheet results in a big gap between the valuation on a longer-term going concern basis and the value achievable at short notice for complex real estate projects in the midst of construction in a falling market. This largely explains the gap between the group NAV presented in the last balance sheet and the current situation.

A potential area of upside are pockets of assets that could be realized and distributed to the parent. Given the low price of the bonds, they would be sensitive to modest realizations compared to the historical value of the balance sheet.

If information is made available that provides comfort that Aggregate can avoid defaults at its subsidiaries, potentially leading to cross-defaults, that could also increase the optional upside on the bonds.

This note reviews publicly available information regarding Aggregate's assets, focusing on asset sales since the date of the last balance sheet. On close inspection the asset sales confirm material declines in asset values.

Recent bond amendments

Aggregate Holding S.A (the parent company) announced on 24 May 2023 that its 6.875% €600 million 2025 notes and its 5.5% €250 million 2024 notes (the parent bonds) had agreed to amend their terms pursuant to the consent solicitation initiated at the end of April. All interest and principal cash payments on the Bonds are being deferred until November 2025, including extending the maturity date of the 2024 Bonds. Also, the LTV (Loan-to-Value) and interest coverage covenants are being removed. In return the coupon is being increased by 2.75% on both bonds.

Background to the bond amendments: Falling asset values

The background to the bond amendments is the deteriorating real estate market. Aggregate said, in its 27 April 2023 press release announcing the consent solicitation, that it expects a "…very material..." reduction in its net assets. The reduction in net assets is due to lower expected appraised values caused by the poor market conditions. Lower appraised values include lower estimates of what projects under construction will realize once complete. The reduction in net assets is also due to higher expected construction costs necessary to complete those projects. Aggregate said that if the bonds hadn't been amended it was expecting to breach its 65% LTV covenant ratio.

Illustrative implied value available to the bonds at the parent level

The impact of the deterioration in asset values has been reflected in the bond price for some time. The 2025 bonds have been indicated in the mid-30s (on 100 par) for almost a year. They fell further following the 27 April 2023 press release and are currently indicated around 18.

Based on the limited information available the total non-subordinated debt at the parent level at 30 June 2022 (excluding accrued interest on the parent bonds) was €1008 million. This included the parent bonds and €158 million in other debt. Since then, it appears that €219 million of the 2024 bonds are to be exchanged as part of an asset sale. Assuming the €158 million in other debt is pari passu, this roughly means Aggregate needs €142 million asset value to flow up from its subsidiaries to the parent level to cover the current indicated price of 18, ([1008 – 219] x 18%).

These illustrative figures assume there are no significant assets or non-debt liabilities at the parent. Also, these figures do not take into account significant guarantees provided by the parent that would crystalize in the event of an insolvent liquidation.

Aggregate said in its 27 April press release, "Aggregate believes that the net value that would flow up to the 2025 Notes and 2024 Notes at the Aggregate Holdings SA level from near-term asset sales would be very limited." This comment wouldn't apply to assets potentially held at the parent level. For example, Other Financial Assets discussed at the end of this note.

There is a large gap between the implied value of €142 million available at the parent level and the group's last financial release that showed €2773 million in excess value over and above the parent bonds.

Risk of default at the subsidiary level

The 30 June 2022 financials were prepared on a going concern basis however the Directors noted a material uncertainty warning regarding the going concern assumption.

The bulk of Aggregate's debt is in its subsidiaries. The 27 April press release said, "Aggregate is in constructive discussions to address existing or anticipated breaches of the terms of certain of its debt facilities, to achieve required amendments or waivers…" Given the context of the press release, the debt referred to means subsidiary debt. The possibility of Aggregate's subsidiaries defaulting on their debt is clearly a risk.

The amendments to the parent bonds include changing the definition of "Material Subsidiary" from 10% of consolidated assets to 20% based on the most recent set of financials. Events of Default in the parent bond terms include subsidiaries being unable to pay their debts and associated circumstances, but they only apply to Material Subsidiaries. In the event a subsidiary does default on its debt, this amendment makes it less likely that the default at the subsidiary will trigger a default on the parent bonds. This is the case in spite of recent sales reducing consolidated assets.

A default leading to insolvency at the subsidiary level would clearly be negative resulting in reduced assets and increased liabilities. It would very likely trigger cross-defaults, not only on finance contracts but possibly on material tenant contracts, giving leaseholders the option to renegotiate or terminate, potentially further reducing asset values. It would also crystalize guarantees provided by the parent company.

Residual NAV (Net Asset Value) data

The most recent set of financials were for the half year ended 30 June 2022 (unaudited) released on 28 October 2022. The presentation slides released along with the financial statements include two different breakdowns of net asset value.

The first breakdown is headed, "Segmental NAV breakdown". This breakdown separates all assets and liabilities into Aggregate's three operating segments, and it reconciles to the balance sheet. This data will be referred to as "balance sheet NAV data".

The second breakdown is headed, "Residual value NAV breakdown". This breakdown is more granular. It shows a breakdown by the three operating segments, and within each operating segment it further shows a breakdown by individual real estate project or other major non-real estate assets.

For the individual real estate projects, it shows the asset valuation (based on the residual value method explained below) and the net debt outstanding against each project. The NAV presented by the breakdown is the sum of the asset valuation and the net debt. It also shows unallocated debt. This data will be referred to as "residual NAV data". A copy of the full table is presented at the end of this report (the residual NAV table).

The residual NAV data is useful because it provides some limited insight into where pockets of value might be found on a solvent liquidation basis because it matches debt against individual projects.

The residual NAV data however does not reconcile to the balance sheet. Some of the reasons why are because it only includes debt liabilities, not other liabilities, and it appears to only include assets that can be realized into cash. As an indicator of where value might be found most of the assets and liabilities excluded wouldn't be meaningful in any event. The context and various other information suggests that the assets and liabilities that are included in the residual NAV data are included at the same value as the balance sheet although this is not expressly stated.

Most of the figures discussed below refer to residual NAV data unless otherwise stated.

Overview of Aggregate's Assets: GDV, residual value and NAV

Aggregate's primary assets after recent sales are large development projects based in major German cities. Those projects are at various stages of completion from planning, through partly constructed, to completed projects with tenants. The assets are held in subsidiary companies and financed first with secured senior project debt and then with junior debt at the subsidiary or intermediate holding company level.

At 30 June 2022, Aggregate reported €3805 million worth of NAV before parent group debt. At the parent level Aggregate had the €850 million (reported value €874 million) parent bonds plus another €158 million debt with no assets. The result is the reported €2,773 million NAV on a group basis. NAV is the fair value of the asset less the debt incurred against the asset.

Aggregate also has €151 million Hybrid notes and €476 million Mandatory Convertible bonds issued at the parent level, but they're classified as equity and therefore subordinated to the parent company bonds.

The €3805 million NAV value before parent group debt is made up of €7064 million asset value less €3109 million in net debt less €151 million NAV that belongs to minority interest holders in the subsidiaries.

Virtually all of the €7065 million asset value is based on fair value estimates. At least €4990 million of the €7065 million asset value is based on the residual valuation method.

Residual value is determined by estimating what the project will be worth once it's completed (Gross Development Value "GDV") less the estimated costs to complete. GDV valuation is sensitive to changes in key input assumptions such as estimated future rental rates. The GDV of the €4990 million residual asset value was €10,100 million. This implies a further estimated €5,110 million in costs necessary to complete those assets.

This means that a large portion of the asset value reported in June 2022 was based on what the assets were estimated to be worth in the future assuming construction would be completed. The valuation also assumes the debt necessary to finance that construction can be raised economically where it has not already been raised.

Introduction to asset sales since the balance sheet date

Since the last set of financials Aggregate has announced the sale of a significant portion of its assets. An add-on to the residual NAV table at the end of this report summarizes those sales.

It's clear from recent press releases that Aggregate would prefer to delay selling its assets in the hope that the market improves but is under pressure to sell sooner.

In the 27 April 2023 press release it said, "…market conditions…are not conducive to conducting further asset sales or refinancings on terms which we view as attractive…Aggregate is committed to realizing the underlying value of its prime Berlin-based assets to pay down debt and de-lever the company…Aggregate will focus the uses of future free cash proceeds on repaying debt…"

The details of those recent sales are set out below. On close inspection, they provide concrete data points that confirm that the sale prices achieved are in most cases very substantially below the valuations presented in the residual NAV data, corroborating management's warning.

Aggregates operational segments, sub-segments and recent sales

Aggregate separates its operations into three segments; Build & Sell, Build & Hold, and Financial Real Estate and Other. The rest of this note describes the assets in those segments focusing on the details of recent sales where relevant. All figures are stated as of 30 June 2022 unless otherwise stated.

Build & Sell Segment: Sale of the whole segment

The Build & Hold segment relates to Aggregate's operations in Portugal held by its subsidiary VIC Properties SA. (VIC).

On 5 May 2023 Aggregate announced the completion of the sale of VIC including all assets, liabilities and employees. The sale was to a consortium of investors led by AlbaCore Capital Group, Mudrick Capital Management, Owl Creek Asset Management, and the existing VIC management team. The strategies of those investment managers include a focus on opportunistic and distressed investments.

VIC is one of the largest developers in Portugal. Its assets relate to three developments, two in Lisbon on the waterfront, Prata and Matinha and one on the coast south of Lisbon, Pinheirinho.

The Prata development, with a total expected gross floor space (GFA) of 200,000sqm, included plots that had already been completed with a significant number of apartments sold as well as remaining plots still to be developed. Construction on the other two sites with a combined expected GFA of 527,000 sqm had not yet commenced.

At 30 June 2022 VIC accounted for €1,628 million out the total €3,805 million NAV held in Aggregate's subsidiaries.

The €1,628 million NAV is the combination of €2,251 million in asset value less €623 million in net debt. The €2,251 million in asset value was made up of €1,116 million residual value of the three developments plus €1,135 million in goodwill value ascribed to VIC. The GDV of the three developments was €3000 million implying an estimated further €1,884 million in costs necessary to complete the projects.

Aggregate described the economics of the sale as, "The total enterprise value of the transaction is more than €670 million, which will also result in a reduction in Aggregate's consolidated net debt by more than €670 million…As at 30 June 2022, VIC had net assets of €1,150 million and total assets of €1,882 million, including goodwill of €1,135 million. The sale of VIC will be at a premium to net tangible assets and a discount to net assets."

The 30 June 2022 assets figures quoted by Aggregate are based on the balance sheet NAV data which is why they differ from the residual value NAV figures.

Based on the above description it appears that Aggregate received little or no cash for the sale. The value paid appears to have been effectively the value of the outstanding debt. The purchase price was clearly far below both the residual value NAV and balance sheet NAV ascribed to VIC in the 30 June 2022 period end release.

The sale included the 3% €250 million 2025 bonds issued by VIC. Guarantees by Aggregate relating to VIC in the amount of €450 million were released and Aggregate expected no residual liabilities relating to VIC upon completion.

Following the sale VIC is due to receive significant new funding backstopped by the investors to complete the projects.

Build & Hold Segment: Sale of portions of the Quartier Heidestrasse (QH) project

The Build and Hold segment relate to four projects: Quartier Heidestrasse (QH), Fuerst, Walter and Green Living.

At 30 June 2022 the Build and Hold segment accounted for €1,522 million NAV out of the total €3,805 million NAV before parent group debt. The €1,522 million NAV is the combination of €3,874 million residual asset value less €2,201 million net debt and €151 million minority interests. The combined GDV of the four projects was €7,100 million implying an estimated further €3,226 million in costs necessary to complete the projects.

QH Project

The QH project is a mixed-use development project located in the center of Berlin. The total expected GFA is 371,000 sqm with a land area of 85,778 sqm and total expected net lettable area (NLA) of 236,000 sqm. Of the total NLA, 60% is office, 28% residential, 6% retail, and 6% hotel. As of August 2022, Aggregate reported that 73% of the construction had been completed as a percentage of estimated construction costs.

At 30 June 2022 the QH project accounted for €818 million NAV out of the total €1,522 million NAV ascribed to the Build &Hold segment. The €818 million NAV is the combination of €2,061 million residual asset value less €1,199 million net debt and €44 million minority interests. The QH GDV was €2,600 million implying an estimated further €539 million in costs necessary to complete the project. Assuming the €1,199 million net debt is a rough proxy for construction costs so far, that suggests total construction costs of around €1,738 million of which €1,199 million is 69%, which ties into the 73% construction costs completed figure.

The QH project is made up of seven sub-projects, Core, Spring, Straight, Colonnades, Crown 2, Crown 1, and Track. Since the 30 June 2022 period end data, Aggregate has entered into agreements to sell six out of the seven sub-projects for what Aggregate described in its press release dated 28 March 2023 as, "…total combined sales volume …" of €1,000 million.

QH Core and QH Spring sub-project sale

QH Core's GFA is 53,470 sqm and QH Spring's is 31,625 sqm which combined represents 23% of the QH project's GFA. At 30 June 2022 the construction of Core had already been completed and Spring was expected to complete by Q4 2022.

On 9 September 2022 Aggregate announced that the sale of Core had been closed and that the sale of Spring had been agreed, for a combined gross purchase price of €456 million. The transaction would reduce gross debt by around €440 million.

Aggregate said that the gross purchase price, "…implies a premium to book value…" and that, "The premium to book value achieved on the transaction demonstrates the strong underlying value of QH as a premium asset…"

Aggregate further reported that, “As part of the €456 million sale of QH Core and QH Spring, the equity purchase price of €219 million will be paid with 5.5% 2024 Aggregate Bonds.” and that the purchaser is Vivion Investments.

The total outstanding on the 5.5% 2024 Aggregate bonds at issue was €250 million. While the text is ambiguous, the implication is that €219 million of the €456 million gross purchase price was paid by Vivion using the face value of the 5.5% 2024 bonds which they hold.

The 2024 bonds appear to be illiquid so there may not be a meaningful indication for the bonds in September 2022 when the transaction was announced. However, the 2025 bonds which are pari passu with the 2024 bonds, were indicated around 38% on face. At that time the market was already concerned regarding Aggregate’s financial position.

This suggests that the value paid for QH Core and QH Spring was €320 million not €456 million, in which case it’s likely that the value paid for QH Core and QH Spring was less than book value. This is consistent with Aggregate’s concerns raised in its 27 April 2023 press release about reduced asset valuations.

Aggregate further reported in the subsequent events note to the 30 June 2022 financial statements that on 27 September 2022 a €296 million lending facility for the development of various QH sub-projects including Spring had been amended so that the undrawn portion could be used for up to €56 million to cover cost overruns and that, “This enabled in particular the continued capex funding on Spring up and until completion of the signed SPA.”

This suggests that Aggregate is still liable for Spring’s construction costs until the sale has been completed. It also highlights that rising costs is a distinct and additional factor to lower residual asset values causing a reduction in NAV.

QH Straight and QH Colonnades and QH Crown 2 sub-project sale

QH Straight’s GFA is 31,726 sqm, QH Colonnades’ is 31,022 sqm and QH Crown 2’s is 28,920 sqm, which combined represents 24.7% of the QH project’s GFA. At 30 June 2022 the expected construction completion date on the three sub-projects was Q1 2023, Q1 2023 and Q2 2023 respectively.

On 10 November 2022 Aggregate announced that the three sub-projects had been sold for a gross purchase price of €488 million which it said was a premium to the externally appraised GDV as at the financial year end 2021. Construction of the properties was, “…more than 65% completed, with remaining construction works to be completed by Q2 2023.”. The transaction would reduce QH group gross debt by €360 million. Aggregate also said that it will continue to develop and manage the assets until completion.

The text of the announcement isn’t 100% clear but suggests that Aggregate is responsible for the construction costs necessary to complete the projects.

The fact that the purchase price was at a premium to GDV is potentially a positive counter-indication to falling asset values, although the extent to which the GDV for the QH project as a whole can be accurately ascribed to the individual sub-projects isn’t clear.

QH Crown 1 sub-project sale

QH Crown 1's GFA is 33,363 sqm which represents 9% of QH projects GFA. Construction on the sub-project had not yet commenced at 30 June 2022.

On 28 March 2023 Aggregate announced an agreement to sell Crown 1. The announcement doesn't provide the sale price but says that the total combined sales volume for the six QH sub-projects sold is €1000 million. The combined sales volume of the previous five segments sold was reported as €950 million which implies Crown 1 was sold for €50 million. The transaction is expected to reduce group gross debt by €35 million.

QH Track sub-project not sold

QH Track's GFA is 160,874 sqm representing 43.4% of the QH project total GFA.

Aggregate's 10 November 2022 press release describes Track as a pure-play office building. It has 111,000 sqm net lettable area (NLA) of which 72,000 sqm has been pre-let including 37,000 sqm to QH's largest tenant, SAP and 23,000 sqm to QH's second largest tenant, a DAX40 group company. In total 65% of QH Track's NLA has been pre-let. In an earlier press release Aggregate said it expected QH Track tenant occupation to commence from Q4 2022.

Aggregate advised that the combined €950 million purchase price of the first five sub-segments sold represented one third of the QH project value. This suggests that QH Track ought to represent the bulk QH's value subject to Aggregate's more recent revision of asset values.

Fuerst Project

The Fuerst project is a commercial tower block redevelopment project located in the Kurfustendamm quarter in the center of Berlin with a Land area of 20,000 sqm, GFA of 183,000 sqm and an NFA of 107,535 sqm. 22% of the NFA has been completed with 37% expected to complete by Q4 2023 and the remaining 41% expected to complete by Q2 2024. The 22% completed portion is occupied and being rented. 52% of total construction costs were outstanding at 30 June 2022. At that time construction capex had increased by €76 million and Aggregate was in discussions to fund future construction costs.

Please see the residual NAV table at the end of this note for NAV related data relating to Fuerst.

Walter Project

The Walter project is a commercial development near the new Bandenburg airport with a land area of 142,425 sqm and a potential GFA of 395,000 sqm. The project is still in the planning stage with construction not having started. Intended use is 69% office and 18% hotel and 13% conference.

Please see the residual NAV table at the end of this note for NAV related data relating to Walter.

Green Living Project

The Green Living project is a mixed-use development project located in Berlin's Koepenick district with a land area of 309,300 sqm and a potential GFA of 367,218 sqm. The project is still in the planning stage with construction not having started. Intended use is 71% residential including 21% subsidized housing, 18% office and 11% retail.

Please see the residual NAV table at the end of this note for NAV related data relating to Green Living.

Financial Real Estate and Other Segment

The remaining assets encompass the following:

Assets held for sale

It appears that this category relates to eleven separate real estate projects with two based in Hamburg (AEIOU, AKC), one based in Frankfurt (Vegas), four based in Duesseldorf (Harbour, Heart, Qubo, Theo) and four based in Berlin (Eagle, Hauptstaadt, CBS, Ringbahnhoefe). There is limited information regarding these assets.

Please see the residual NAV data where these assets are stated at €230 million.

6.1% Stake in Adler

Adler is a German real estate company that was recently subject to a restructuring. Aggregate's stake has no material value.

Loan Book

It appears that this category relates to loans receivable from third parties. The interest rate on the loans varies from 3% to 20% with maturity dates from 6 months to 13 years. The interest income on these loans for the six-month period to 30 June 2022 was €22.5 million. It's not clear how these loans are structured into Aggregate's business or which group entity has made the loans, so it's not clear what independent value they may represent.

Please see the residual NAV data where these assets are stated at €464 million.

Other Financial Assets

It appears that this category primarily relates to loans receivable from related parties. On 30 June 2022 these loans included, €75.5 million made to Lavinia BV and €46 million made to Passiva Participations Sarl, both of which are described as parent companies or ultimate beneficial owners. According to the 2025 bond prospectus dated 27 November 2020 Lavinia BV is a 100% owner of Aggregate and is a 100% owned subsidiary of Mr. Gunther Walcher, the sole ultimate beneficial owner. Mr. Walcher is a Director and Chairman of Aggregate and has major business interests both inside and outside the real estate sector.

This means that Aggregate has provided material loans to entities controlled by the owner and Director. There is no information regarding the terms of those loans or which group entities made the loans. It's reasonably possible that the loans were provided by the parent company. This is because subsidiaries' use of proceeds would likely be restricted to purposes related to the relevant development project by financing terms. If the parent made the loans, then Aggregate's warning in its 27 April press release about the very limited net asset value that would, "…flow up..." to the parent bonds wouldn't apply to this asset because it would be held at the parent level. It's not clear if a change of management control in the event of insolvency could or would have an impact on how these loans are serviced.

Please see the residual NAV data where these assets are stated at € 220 million.

Aggreagte Holdings SA Group Residual Value NAV breakdown [4]								Post 30 June 2022 Asset Sales [5]				
	GDV	Assumed cost to complete	Residual Value / Book Value	Net Debt / Debt	NAV before MI	MI	NAV after MI	Asset Sold	Purchase price face	Purchase price value	Net debt reduction	Gross debt reduction
Build & Hold Segment												
QH - Berlin	2,600	(539)	2,061	(1,199)	862	(44)	818	QH except Track	994	858		(616)
Fuerst - Berlin	1,700	(519)	1,181	(782)	399	(40)	359					
Walter - Berlin near Berlin / Brandenburg Airport	1,400	(1,038)	362	(119)	243	(25)	218					
Green Living - Berlin Koepenick district	1,400	(1,130)	270	(101)	169	(42)	127					
Segment sub-total	7,100	(3,226)	3,874	(2,201)	1,673	(151)	1,522					
Build & Sell Segement - VIC Properties												
Goodwill			1,135				1,135					
Prata			311	(214)			97					
Matinha			372									
Pinheirinho			433									
Sub-total Matinha & Pinheirinho			805	(73)			732					
Other Liabilities												
3% 250 million 2025 VIC Convertible [1]				(363)			(363)					
Other debt				(6)			(6)					
Cash				33			33					
Segement sub-total [2]	3,000	(1,884)	2,251	(623)			1,629	VIC Properties	670	670	(670)	
Financial Real Estate Assets and Other												
Assets held for sale (11 assets)			230				230					
6.1% stake in Adler			25				25					
Loan Book			464				464					
Other financial assets			220				220					
Other Liabilities												
Unallocated debt				(285)			(285)					
Segement sub-total			939	(285)			654					
Sub-total before parent group debt			7,064	(3,109)		(151)	3,805					
Aggregate Holding SA												
6.875% 600 million 2025 bond				(615)			(615)					
5.5% 250 million 2024 Bond				(259)			(259)	5.5% 2024 Bond				(219)
Other debt				(158)			(158)					
Parent Company total [3]				(1,032)								
Group - Total			7,064	(4,141)		(151)	2,773					

Notes

[1] The note to the presentation slide confirms that the 250 million VIC convertible bond was included in the table at the value of 363 million

[2] The assumed cost to complete is difference between the GDV and the Book Value figure excluding the 1,135 million goodwill

[3] The Parent Company debt total does not include the Hybrid Capital Notes or Mandatory Convertible Bonds because classified as equity. Parent bonds include accrued interest.

[4] Source presentation slide issued with 30 June 2022 period end financial release

[5] Source press releases