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Muddy Waters Questions for CPI PG's April 8, 2024 Annual Results Conference Call

Dear Mr. Greenbaum:

We note you most value the qualities "transparency, openness and solid business logic."[1] In this light we submit the following questions with regards to CPIPG's 2023 annual results.

1. In 2H 2023, CPIPG's lending to Radovan Vitek's company Senales Invest increased to approximately €416 million from just €169.6 million at YE 2022.[2] Two days before the year end, €273 million of Vitek's debt was offset in a non-cash transaction by means of a transfer of 20 luxury villas in Dubai, 17 of which were "various states of development." The €273 million appears to be include principal and interest. CPI financed this lending to Vitek through borrowings of its own -

    a. When cash flow is tight and liquidity for paying down CPIPG's expensive bridge loan is in your own words a "priority above all else",[3] why did management increase lending to Vitek?

    b. Why cancel €273 million of the debt receivable in exchange for luxury properties "in various stages of development" when i) neither this type of property nor this market are core to CPIPG and ii) valuations of incomplete properties seemingly are even more easily manipulated than for complete properties – particularly given Vitek and CPIPG's history of highly questionable valuations?

    c. Did CPIPG allow Vitek to PIK his interest obligation? CPIPG purportedly charged Vitek 5% interest; however, CPIPG's cash flow statement shows only €3.0 million of interest received, a small fraction of the €39 million in interest income reported the income statement.[4,5]

[1] CPIPG 2023 management report, p. 4
[2] CPIPG 2023 management report, p. 118, 149
[3] CPIPG 2023 management report, p.4 CEO's letter and https://www.recapitalnews.com/cpipg-obtains-e635m-bridge-loan-to-bolster-liquidity-protect-ratings/, "That seemed to us a reasonable concession to make for the extra year and a half of liquidity," says Greenbaum. "Of course, the cost of debt is a significant factor for us, and we are conscious of our interest coverage ratio. But, right now, prioritizing liquidity above all else meant we were willing to take on a longer-dated, more expensive bridge."
[4] 2023 MR, p. 136
[5] 2023 MR, p. 64, 73

Below: CPI PG 2023 Cash Flows show only €3m in interest received

Consolidated cash flow statement

The accompanying notes form an integral part of these consolidated financial statements.

	Note	Year-ended 31 December 2023	31 December 2022
Profit before income tax		**(886.8)**	682.0
Adjusted by:			
Net valuation loss	5.6	1,144.8	88.8
Net gain on the disposal of investment property and subsidiaries	5.7	34.4	(35.9)
Depreciation and amortization	5.9	47.2	46.2
Impairment of assets	5.9	(27.7)	53.3
Bargain purchase	5.10	-	(318.4)
Net interest expense		309.0	189.9
Net gain on revaluation of financial derivatives	5.12	92.6	(163.1)
Share of profit of equity accounted investees		20.2	(19.1)
Unrealized exchange rate differences and other non-cash transactions		(28.3)	18.4
Profit before changes in working capital and provisions		**705.4**	542.1
Increase in inventories		(18.9)	(12.0)
(Increase)/decrease in trade and other receivables		63.4	(56.8)
Increase/(decrease) in trade and other payables		(17.2)	88.6
Change in provisions		(0.6)	14.8
Income tax paid		(62.6)	(45.1)
Net cash from operating activities		**669.5**	**531.6**
Acquisition of subsidiaries, net of cash acquired	3.2, 3.3	(1.2)	(62.8)
Acquisition of associates		-	(35.7)
Acquisition/ sale of non-controlling interest	6.13	(10.8)	(1,490.6)
Acquisition of other financial investments		(10.4)	-
Proceeds from sale of non-controlling interest	6.13	61.0	87.8
Proceeds from disposals of subsidiaries, net of cash disposed		313.9	387.8
Purchase and expenditures on investment property	6.2	(362.9)	(622.9)
Purchase and expenditures on property, plant and equipment	6.3	(47.2)	(66.5)
Purchase of intangible assets	6.1	(9.0)	(12.1)
Purchase of biological assets		(3.2)	(1.6)
Proceeds from sale of investment property		370.0	331.3
Proceeds from sale of property, plant and equipment		8.9	27.3
Proceeds from sale of biological assets		1.5	4.9
Proceeds from sale of other investments		-	6.0
Loans provided	6.6	(449.1)	(700.4)
Loans repaid	6.6	211.0	503.4
→ Interest received		3.0	16.4
Dividends received		-	36.9
Net cash used in investing activities		**75.5**	**(1,590.8)**
Share buyback	6.13	(79.5)	(190.3)
Payment to perpetual note holders including repayment of perpetual bonds	6.13	(75.2)	(103.2)
Proceeds from bonds issued	6.14	75.0	1,042.4
Repayment of bonds issued	6.14	(588.6)	(1,374.1)
Interest paid	6.14	(386.9)	(186.4)
Drawings of loans and borrowings	6.14	2,970.4	4,377.6
Repayments of loans and borrowings	6.14	(2,650.5)	(1,978.4)
Net drawings of lease liabilities	6.14	(5.8)	3.0
Net cash from/ (used in) financing activities		**(741.1)**	**1,590.6**
Net increase/ (decrease) in cash		3.9	531.4
Cash and cash equivalents at the beginning of the period	6.9	1,033.2	501.8
Less: Cash and cash equivalents reclassified from/ (to) assets held for sale		(14.5)	-
Cash and cash equivalents at the end of the period		**1,022.6**	**1,033.2**

2. CPIPG reported purchasing the Galopota group of companies on Nov 24, 2023, which are involved in operating the Chuchle Arena racetrack in Prague, the breeding of thoroughbreds, as well as operating racing bets. Although management notes that this was a related party transaction, CPIPG excludes the fact that the Galopota group's €24.5 million in financial debts are owed to Vitek.

    a. You state that the key focus is on reducing leverage and maintaining CPIPG's interest coverage ratio – why then did CPIPG take over more money losing assets from Vitek?

    b. If the intent is to pay Vitek for his €24.5 million loan to the Galopota group companies, why record this as another €1 transaction?

The Galopota group companies' financials show that as of YE2022 they had in aggregate -€5m in equity and ongoing operating losses of ~-€4m. Like the Pietroni transaction (which we covered in our third report), this transaction was once again nominally completed for €1. The implicit risks in this related party transaction surpass just potential asset and liability inflation, but include regulatory risks associated with gambling and seemingly money laundering as well.[6]

Below: the Galopota group acquisition disclosure

3.3 Business combination in 2023

Galopota, a.s. Group

On 24 November 2023, the Group acquired 80% stake in Galopota, a.s. group an owner of a sport complex in Prague, the Czech Republic. Galopota controls subsidiaries Marcano, a.s., Chuchle Arena Praha, s.r.o., Turf Holding, a.s., Turf Praha, a.s., TMM s.r.o. and TOTO CZ a.s. all located in the Czech Republic. Apart from sport complex building classified as investment property, the group also owns certain biological assets and property plant and equipment. Galopota group does not earn any significant revenue but is held for capital appreciation by the Group.

The Galopota group was acquired from the Group´s majority shareholder for consideration of EUR 1.

The acquisition is treated as a business combination under IFRS 3 with acquisition date of 24 November 2023.

The fair value of the identifiable assets and liabilities as at the date of acquisition was as follows:

	Fair value
Investment property	14.5
Property, plant and equipment	2.9
Biological assets	5.4
Cash and cash equivalents	0.2
Other current assets	2.0
Financial debts	(24.5)
Current liabilities	(0.5)
Net identifiable assets acquired	-

The net cash inflow connected with the acquisition amounted to EUR 0.2 million.

Had Vitek converted his debt to equity, the transaction would likely have been recorded with consideration due to Vitek of €24.5 million, based on the deal structure disclosed. It seems that reporting this as another €1 transaction and omitting that the purported lender is indeed Vitek is intended to obscure material facts from lenders and bondholders. The "solid business logic" associated with transaction appears to be from Vitek's perspective, not CPIPG's.

Below: Marcano a.s. (Galopota group's key holdco) FY22 financials show the debts owed to Vitek personally[7]

[6] https://www.theguardian.com/australia-news/2023/oct/19/horse-racing-money-laundering-claims-australia
[7] https://or.justice.cz/ias/ui/vypis-sl-firma?subjektId=339908

4.5 Informace o transakcích se spřízněnými stranami — 4.5 Information about transactions with related parties

Pohledávky — Receivables

Zápůjčky a úvěry – ovládaná nebo ovládající osoba, podstatný vliv — Bonds and loans - controlled or controlled person, significant influence

Přehled těchto zápůjček a úvěrů je uveden v kapitole 4.1. — An overview of these bonds and loans is given in chapter 4.1.

Závazky — Liabilities

Long-term commitment - controlled or controlling person, substantial influence

Dlouhodobé závazky – ovládaná nebo ovládající osoba, podstatný vliv

2022	Splatnost	Splátkový kalendář	Úroková sazba	Zůstatek 31.12.2022	Splatno do 1 roku	Splatno od 1 do 5 let	Splatno v násl. letech
JUDr. Radovan Vítek	31.12.2025	ne	0,00%	455 780	--	289 298	--
JUDr. Radovan Vítek	31.12.2025	ne	0,00%	240 754	--	243 754	--
Celkem				**696 534**	**0**	**533 052**	**0**

	Maturity	Repayment schedule	Interest rate	Balance 31.12.2021	Payable w/in 1 yr	Payable from 1 to 5 yrs	

2021	Splatnost	Splátkový kalendář	Úroková sazba	Zůstatek 31.12.2021	Splatno do 1 roku	Splatno od 1 do 5 let	Splatno v násl. letech
JUDr. Radovan Vítek	31.12.2025	ne	0,00%	289 298	--	289 298	--
JUDr. Radovan Vítek	31.12.2025	ne	0,00%	243 754	--	243 754	--
Celkem				**533 052**	**0**	**533 052**	**0**

Marcano a.s., 2022 Financials

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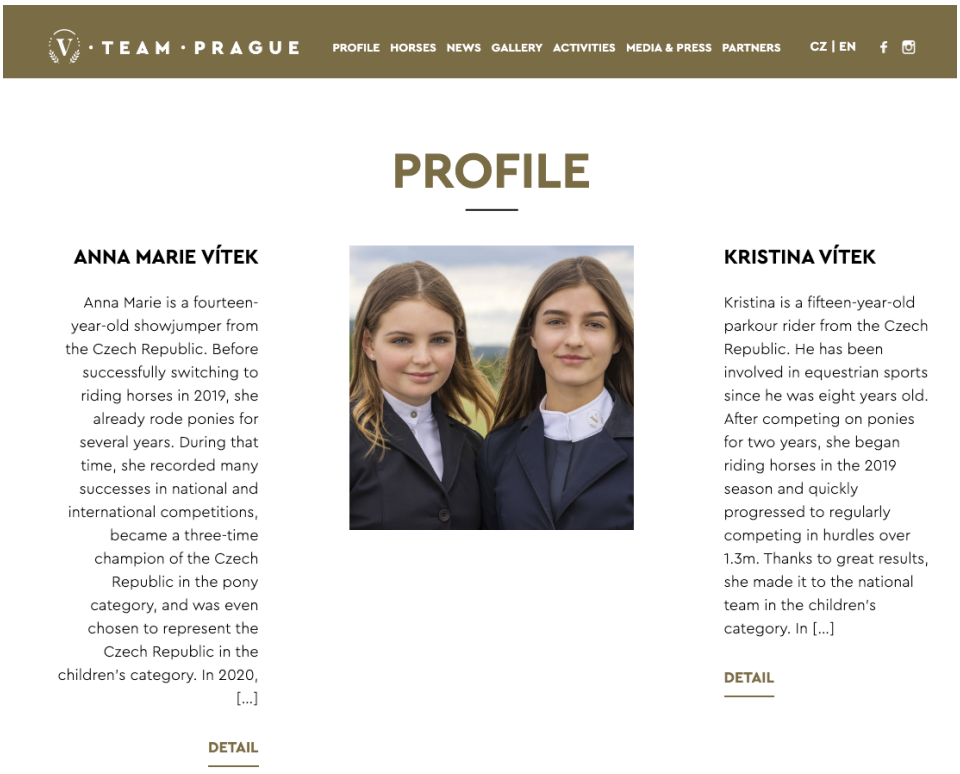
3. CPIPG sold V Team Praha s.r.o. to Vitek's Chuchle Arena Praha s.r.o. on January 1, 2023 and reacquired it via the Galopota acquisition. According to its website, V Team Praha is a show jumping team for Vitek's daughters Anne Marie and Kristina with a stable of approximately ten horses.[8] Its financials show that it is a money losing operation run by Vitek's wife Marie and financed with millions of Euro in loans provided by CPI FIM, which often only accrued PIK interest.

    a. Does CPIPG see a bright future in the equestrian industry? If not, how does financing activities many associate with douchebaggery comport with the group's real estate investment strategies?

    b. The January 1, 2023 sale to Vitek was excluded from the related party transaction disclosures in the management reports. Why was this omitted?

Below: V Team Prague's profile page shows the team is composed of Vitek's daughters

[8] https://vteam.cz/profil



Below: V Team Prague's 2020 financial statements show €5.8m (CZK 147m) in borrowings from CPI FIM

Závazky Liabilities: Long-term liabilities - controlled or controlling person, significant influence

Dlouhodobé závazky – ovládaná nebo ovládající osoba, podstatný vliv

2020	Splatnost	Splátkový kalendář	Úroková sazba	Zůstatek 31.12.2020	Splatno do 1 roku	Splatno od 1 do 5 let	Splatno v násl. letech
CPI FIM SA	01.10.2026	NE	5,86%	147 042	--	--	147 042
Celkem				**147 042**	**0**	**0**	**147 042**
	Maturity	Repayment schedule	Interest rate	Balance	Payable w/in 1 yr	Payable in 1 to 5 yrs	
2019	**Splatnost**	**Splátkový kalendář**	**Úroková sazba**	**Zůstatek 31.12.2019**	**Splatno do 1 roku**	**Splatno od 1 do 5 let**	**Splatno v násl. letech**
CPI FIM SA	01.10.2026	NE	5,86%	71 392	--	--	71 392
Celkem				**71 392**	**0**	**0**	**71 392**

Below: V Team Prague's 2020 financial statements show CPI receiving only non-cash PIK interest

Příloha účetní závěrky
za rok končící 31. prosincem 2020
(v tis. Kč)

V Team Prague, s.r.o.

Krátkodobé závazky – ovládaná nebo ovládající osoba, podstatný vliv

	Závazky k	
	31.12.2020	**31.12.2019**
CPI FIM SA	19 910	1 890
CPI Services, a.s.	18	--
Celkem	**19 928**	**1 890**

V rámci krátkodobých závazků – ovládaná nebo ovládající osoba, podstatný vliv Společnost vykazuje k 31. prosinci 2020 závazky za společností CPI FIM SA z titulu neuhrazených úroků ze zápůjčky ve výši 2 146 tis. Kč (2019 – 1 890 tis. Kč) dále za společností CPI FIM SA z titulu reálného cash poolingu v měnách CZK a EUR, celkem ve výši 17 764 tis. Kč (2019 – 0 tis. Kč). Jistina z cash poolingu je ve výši 17 724 tis. Kč, úroky ve výši 40 tis. Kč. Úroky jsou splatné měsíčně vždy následující měsíc. Dále společnost vykazuje závazek vůči společnosti CPI Services, a.s ve výši 18 tis. Kč (2019 – 0 tis. Kč).

Translation[9] (emphasis added): In the framework of short-term obligations - controlled or controlled person, significant influence As of December 31, 2020, the Company reports obligations for the company **CPI FIM SA due to unpaid interest on the loan in the amount of 2,146,000.** CZK (2019 - CZK 1,890 thousand) and for the company CPI FIM SA due to real cash pooling in CZK and EUR, totaling 17,764 thousand CZK (2019 - by thousand CZK). The principal amount from cash pooling is 17,724 thousand CZK, interest in the amount of 40 thousand CZK. Loans are payable monthly, always in the following month. Furthermore, the company reports a liability to CPI Services, a.s. in the amount of 18,000 thousand CZK (2019 – O Czk).

4. In 2023, the net equity value of GSG Berlin reported by CPIPG dropped from €3.718 billion at YE22 to just €311 million at YE23 – meanwhile reported profits doubled from €163 to €338 million.

    a. Why did the equity value of GSG Berlin decline by over 90% YoY?

    b. How do you reconcile the changes – including both the decrease in equity and increase in profits?

Below: In 2023, CPIPG reports GSG Berlin net equity dropped to €0.311b (-91.6%), but results for the year doubled to €338m[10]

Name of the undertaking	Country	Ccy	% held	Cost	Cost change	Cost	Accumulated Impairment	Reversal of impairment / (Impairment)	Accumulated Impairment	Carrying Value	Carrying Value	Net equity (3)	Result of 2023
			31.12.23	31.12.22	in 2023	31.12.2023	31.12.22	in 2023	31.12.2023	31.12.2022	31.12.2023		
Gewerbesiedlungs-Gessellschaft mbH	Germany	EUR	94.99%	74,768	--	74,768	--	--	--	74,768	74,768	311,042	338,091

[9] Translation by Google translate
[10] CPIPG 2023 management reports, pdf pg. 184

Below: In 2022, CPIPG reports GSG Berlin's (fka Gewerbesiedlungs-GmbH) net equity: €3.718b, results for the year: €162m[11]

Name of the undertaking	Country	Ccy	% held	Cost	Cost change	Cost	Accumulated Impairment	Reversal of impairment / (Impairment)	Accumulated Impairment	Carrying Value	Carrying Value	Net equity (3)	Result of 2022
			31.12.2022	31.12.2021	in 2022	31.12.2022	31.12.2021	in 2022	31.12.2022	31.12.2021	31.12.2022		
Gewerbesiedlungs-Gessellschaft mbH	Germany	EUR	94.99%	74,768	--	74,768	--	--	--	74,768	74,768	3,718,060	162,868

5. CPIPG's Net LTV measures debts against its quick-to-increase and slow-to-impair portfolio property fair values (PP values), including those made to undeveloped land or land with development permits only (i.e. Bubny, MQM, the yet-to-be started buildings at Polygon and any among the 17 the new luxury Dubai villas in development, etc.). Based on management's December 2023 response, FV gains are being booked even just on progress with planning permission and the "prospect for obtaining building permits."[12]

    a. Is management prepared to only publish fair values for properties under development for properties with actual construction starts – and if so, just for the discrete buildings that started, not the whole of the development in which they reside?

CPIPG's fair value policies indicate that once a plot of land or an old building is designated as an investment property under development, the valuer is to project forward the net profit of the fully leased project. This is a highly aggressive approach, which, by definition, disassociates the reported value with any potential recovery value unless and until the projects are completed – at which time, in the case of leased properties, they are converted to a DCF method, or in the case of residential properties, revert to the direct comparison method.[13]

Below: CPIPG valuation policy for investment properties under development[14]

(v) Investment property under development

The valuer used the Residual Value Approach for the valuation of the investment property under development. In order to assess the market value of the sites, the valuer undertook a development appraisal to assess the potential value (Gross Development Value) of the fully completed and leased development as currently proposed, and deducted hard costs, soft costs, financing costs and a developer's expected required profit (which reflects the required level of return to a developer and the risk of undertaking the project).

In assessing the Gross Development Value, the valuer adopted a market approach by estimating the market rental values for the accommodation being developed, and the appropriate capitalisation rate which a potential investor would require, to arrive at the Market Value of the completed and leased building.

Furthermore, CPIPG's 2023 disclosures report that its internal valuation department is conducting the valuations for assets in the UK, France, as well as the Czech Republic's residential portfolio (e.g. Polygon), landbanks (e.g. Bubny and MQM). The use of internal valuation teams compound the already significant valuation inflation inherent in this highly aggressive forward-looking valuation approach.[15]

Below: In 2023, CPIPG's internal valuation teams valued Czech Republic residential properties and landbanks

[11] CPIPG 2022 management report, pg. 175
[12] CPIPG response dated Dec 8, 2023, p.12
[13] CPIPG 2023 management report, p.117
[14] CPIPG 2023 management report, p. 117
[15] CPIPG 2023 management report, p. 117

2.3 Determination of fair value

(a) Investment property and Property, plant and equipment

Investment properties are stated at fair value as at 31 December 2023 and 2022 based on external valuations prepared by professionally qualified valuers, except for an insignificant part of the portfolio valued by an internal expert (see note 6.2). The Group's property portfolio in the Czech Republic is valued mainly by Jones iO Partner(former Jones Lang LaSalle in Czechia, Slovakia, Romania & Hungary left and their successor was named iO Partners), Cushman & Wakefield and CBRE, while selected properties are valued also by RSM, Mazars and Statikum. The property portfolios in Poland and Romania are valued by CBRE. Assets in Slovakia and Hospitality in Poland & Hungary are valued by Cushman & Wakefield. Remaining assets in Hungary are valued by iO Partners. The valuation of the Berlin portfolio is undertaken by Savills. The Group also uses its valuation department for providing internal valuations of selected assets, including United Kingdom assets part of the Czech Republic residential portfolio, land bank assets, certain Czech Republic retail assets and parts of assets in France.

Waiting until construction commencement to change your valuation reporting for land and vacant buildings from the comparative method to a potential residual valuation method would greatly aid lenders and bondholders as it would more accurately reflect potential recoveries. If for whatever reason projected future gains are fully booked but construction does not commence, lenders would face massive impairments.