

Hermann Josef Merkens (CEO), Marc Oliver Heß (CFO)

Aareal Bank AG (“**Aareal**”)

Paulinenstraße 15

65189 Wiesbaden

Cc: Marija Korsch (Chairwoman of the Supervisory Board), Richard Peters (Vice-Chairman of the Supervisory Board)

London, 6th of November 2020

Dear Mr Merkens, dear Mr Heß,

it has been a little more than one year since Petrus Advisers, as your largest investor, have constructively engaged with the management board and the supervisory board of Aareal. Despite our strong preference for a spin-off of Aareon to us shareholders, we have publicly endorsed the sale of a minority stake to private equity as proposed by you.

### **Lack of a Sustainable Strategy for the Bank Part of Aareal**

With your communication of the partial sale of Aareon, it ultimately became clear to us that Aareal Bank (Aareal group without Aareon, “**Aareal Bank**”) does not have a strategy in place that credibly targets sustainable success as a boutique lender to the commercial real estate industry. Even in a ‘good’ year, such as 2019, the RoE of Aareal Bank was a mere 5.1%<sup>1</sup>. We have clearly communicated to you that it is our firm belief that the minimum target post-tax RoE needs to be 8-10%, combined with a certain growth plan in order for Aareal Bank to become investable.

Capital markets share our view: the current valuation<sup>2</sup> implies a value of **LESS THAN ZERO** for the bank – only Aareon has positive value<sup>3</sup>. This means the market is telling you ‘loud and clear’ that there is no future for Aareal Bank with its current strategy. In the eyes of the capital markets, the best strategy to create shareholder value is to run down and dissolve the bank.

### **Need for a Strategic Review**

We do not agree with the view of the market. We do, however, believe that the management and the supervisory boards of Aareal urgently need to act consistently and swiftly to **NOW** set the course for sustainable value generation. Ever since the presentation of Aareal Next Level – at which point it became clear that the current strategy of the bank is not sufficient – we have in our intensive and time-consuming discussions with you asked for a strategic review. We have furthermore proposed support by independent and renowned experts, which you have so far not taken up. We are therefore worried that the current management team and supervisory board have not yet understood the seriousness of the current situation and that you – without support – will not, or too slowly, embark on the difficult and demanding transition that is so necessary for Aareal Bank.

### **Core Components of a Strategic Review**

As repeatedly communicated to you, we see the following improvement levers:

#### **(1) Cost**

Compared to national and international peers, Aareal’s cost base is very elevated, especially personnel cost. So far, we see a lack of commitment to aggressively work on your cost base. High costs for well-paid bankers and low returns for shareholders seem acceptable to you. Using pbb’s cost/income as benchmark<sup>4</sup> yields cost savings opportunities of ca. Euro 30-50 million, resulting in a 100-150bps RoE improvement.

#### **(2) Reduction of Equity**

Aareal has accumulated enormous equity capital buffers. Ms. Korsch has communicated that Euro 350 million can be paid to shareholders as soon as the ECB consents to it. Further 100bps of RoE improvement seem possible.

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1) RoE calculation assuming a full spin-off of Aareon.

2) Based on the share price of Euro 15.41 and a market capitalisation of Euro 922.4 million, per 5 November 2020.

3) Based on the purchase price for Aareon (100% Basis) of Euro 860 million paid by Advent International, without considering the earn-out of up to Euro 167 million (100% basis) and assuming a minority discount of 25-30%, we calculate a value for Aareon of Euro 1.1 – 1.2 billion and – assuming the sales proceeds remain in Aareon – an implied value for Aareal Bank of negative Euro 138 million to negative Euro 196 million.

4) 43.5% in 2019 vs. 51.9% for Aareal Bank (excluding Aareon).

### (3) Commissions / Fees

Historically, Aareal relied primarily on Aareon's earnings to produce RWA-efficient income. This very focus is equally needed for Aareal Bank. We expect that you publicly announce plans showing how you will sustainably create such RWA-efficient growth both in your payment processing as well as your structured real estate financing segments.

### (4) New Business Areas

Naturally, leveraging Aareal's core competences in the areas of financing of commercial real estate into new business areas seems promising. Any such move should, however, only be undertaken in case shareholders will not have to accept excessive acquisition and integration risks. Unlike the management board and the supervisory board, we shareholders are exposed to significant financial downside.

### (5) Pensions

For months, we have been demanding that Aareal's extremely high pension provisions be hived off. We are convinced that Euro 30-50 million of shareholder value can be created. We have no tolerance for this option not to be swiftly examined and executed because banking staff, and in particular the management board, seek to optimize their bloated pension benefits.

### (6) Aareal Headquarters in Wiesbaden

While Aareal Bank's valuation is **LESS THAN ZERO**, the bank resides in a true palace directly in Wiesbaden's posh spa park area. The building is dramatically oversized and by itself is worth more than Aareal Bank's implied value. We therefore demand a thorough analysis of a sale of the building including a move into a more appropriate, much more modest building in the wider Rhine-Main area.

### Communication with Capital Markets

We deem the communication of your Q3 results as your last chance to send the right signals. Unfortunately, the reaction of the capital markets to your communication in previous quarters was consistently negative – this needs to change **NOW**. We therefore recommend the following points be clearly communicated:

- (1) **Covid Impact:** transparent communication of the status of your loan book, in particular including details with respect to the hotel portfolio. We believe you have been a prudent and conservative lender which you should now show;
- (2) **Aareon:** detailed update on Aareon – we expect tangible progress by now;
- (3) **Strategic Review:** announcement of a thorough and open strategic review for Aareal Bank with independent external support, including a clear commitment to sustainably achieve a post-tax RoE of 8-10% or higher. Listing of central improvement levers such as cost, commissions / fees, pensions and Aareal's headquarters. Presentation of your revised strategy by January 2021.

Until now, we have been very patient. The progress that we and the capital markets have discerned is not acceptable. Your strategy is in a sorry state. Lack of immediate action, or too little thereof, would expose the company to enormous risks.

Sincerely,



Klaus Umek  
Managing Partner



Till Hufnagel  
Partner