

To Aareal Investors

London, 4th May 2021

Dear fellow investors,

Following a very active past four weeks including numerous discussions with other shareholders and stakeholders, we would like to take the opportunity to clarify our position in respect of certain key aspects of our engagement around Aareal Bank AG (“Aareal”).

In Summary

- 1) Background Of Our Public Engagement – Long And Intense Constructive Work Behind The Scenes
- 2) Petrus Advisers Did Not Back Aareal’s New Supervisory Board Nominees At The 2020 AGM
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- 7) A Final Decision On New Management Board Members Before The 2021 AGM Is Very Risky

In More Detail

1) Background Of Our Public Engagement – Long And Intense Constructive Work Behind The Scenes

Our relationship with Aareal began in September 2015. At that time, we approached former CEO Hermann Merkens to understand the rationale of owning a bank and a software company under one umbrella. We were told that the software unit was not very relevant as profitability was limited. This half-truth related to the fact that Aareon AG was back then reported together with the loss-making payment services operations as part of Aareal’s Consulting / Services segment.

Aareal only started to create transparency around Aareon at their May 2019 Capital Markets Day. At that event, the software unit was introduced to investors in more detail, including market position, financial performance and key peer Real Page Inc. Shortly thereafter, another investor publicly demanded the sale of Aareon combined with a distribution of proceeds to shareholders. Following constructive discussions with the top management of Aareal, we publicly backed Aareal’s plan to bring on board a private equity minority investor at the Aareon level in order to help develop the business. Our preference at the time – as today – has been a spin-off of Aareon to us shareholders as we are convinced that developing both Aareon and Aareal Bank (“Aareal Bank” defined as Aareal without Aareon AG) under one roof results in negative synergies. However, Aareal management insisted that Aareon management was not yet ready to be stand-alone and that the business needed further development. We therefore agreed to back the minority sale to PE.

In January 2020, Aareal announced the Aareal Next Level strategy, including the planned Aareon minority sale. In light of increased transparency around the Aareon financials, we realised that no sustainable strategy was in place at Aareal Bank that would allow the business to earn its cost of capital (defined as 8-10% post-tax RoE). Following intense and constructive discussions, Aareal management agreed that a strategic review needed to be undertaken in order to analyse improvement options. These discussions began before the start of the covid crisis and continued throughout the following months. Between October 2019 and November 2020, we have counted 30 meetings / Teams sessions / Calls between Aareal’s leadership and Petrus Advisers.

2) Petrus Advisers Did Not Back Aareal’s New Supervisory Board Nominees At The 2020 AGM

We were not given a fair chance to propose supervisory candidates for the 2020 AGM. While we were invited to contribute proposals to the process – which we did – Marija Korsch did not tell us about the profile of the candidates she was looking for and ex post told us the candidates we had proposed did not meet such profile requirements. The three independent candidates we had proposed included a former CEO of a German Landesbank, a former Management Board member of a German bank (DAX) as well as a former top manager of a large Swiss insurance company. The level of seniority and the experience set of these candidates are significantly superior to the candidates nominated by Aareal Bank AG.

As a result, we did not vote for Christof von Dryander and Jana Bendel, the new candidates proposed by Aareal.

3) Petrus Advisers Did Not Choose To Make Our Views Public – We Have Been Left No Other Option

During the months of September and October 2020, we realised that traction of our discussions with Aareal was fading with push-back on cost improvements and a strengthening of the Supervisory Board. We therefore summarised the points we had been discussing with the CEO, CFO and Chairwoman for months in a letter and accompanying presentation of 6 November 2020. This letter was sent confidentially to selected people at Aareal (CEO, CFO, Chairwoman, Vice-Chairman).

On 7 November 2020, Hermann Merkens declared to his Supervisory Board that he was taking a 3-4 month medical leave, a decision which was made public on 8 November 2020. The following week, the contents of the letter reached the press. Petrus Advisers did not leak the letter or any of its content! The following week, Petrus Advisers asked on the Q3 earnings call of Aareal what bonus allocation had been provisioned for 2020 (the answer was 100%!!!).

On 16 November 2020, Aareal – in writing – ended the constructive engagement with Petrus Advisers, mentioning our letter and the ensuing press coverage as main reasons. Given we had not leaked the letter, we took this as an aggressive move by Aareal and since then have been forced to communicate our views regarding value creation at Aareal publicly.

4) We Demand No Sale But A Distribution Of The 70% Aareal Owns In Aareon AG To Aareal Shareholders

We deem the strategic necessities and resulting execution challenges at Aareal Bank and Aareon as very distinct:

Aareon: Speed up the growth of a SaaS focused software company to dominate not only the German market but also other European markets. Drive further digital solutions that will allow residential real estate companies – and in the future increasingly also utilities and commercial real estate companies – to digitize their processes thus enabling higher RPU¹. Aareal has repeatedly failed to execute on these strategic pillars in the past (2012, 2015) and therefore, we do not see any management synergies from Aareon being part of the Aareal group.

Aareal Bank: Address structural problems of the current business model by addressing excessive cost (mainly expensive management cost), increase RWA² light revenue streams, improve capital efficiency, sell and downsize the headquarter and optimise the extensive pension liabilities.

We are fundamentally convinced that both businesses are better off managing such strategic aspects separately. Furthermore, we discussed with Aareal management as far back as November 2019, that a separation of the businesses was operationally not very difficult. The main issue is around the joint offering of software solutions and payment solutions to residential real estate companies. Right now, Aareon AG offers the software and Aareal Bank the payment solutions. As this is already structured out of two different legal entities, there is no reason why a joint collaboration cannot be structured in the future – after a separation of Aareon from Aareal. In fact, Aareal management consistently agreed with us and as a result the unbundling of Aareon and Aareal Bank has been part of Aareal's Next Level strategy announced in January 2020 and formally reviewed per February 2020.

If at all, there appears to be disagreement around the timing of such unbundling. We want it to be completed in 2021 or 2022 at the latest. Aareal's position seems to point to a 2024/25 timeline.

5) A Strengthening Of The Supervisory Board Is Necessary

In our interaction with Aareal, its Management Board and selected members of the Supervisory Board, it became very clear that a culture of excessive remuneration had developed over the years – across management roles and levels. Our analysis has confirmed that Aareal Bank managers are paid substantially more than the benchmark and have very generous pension packages. There seems to be no correlation between historical operating performance and bonus allocations. There is at least one management level too much for the size and complexity of the bank. This has been confirmed by external HR expert consultants we have worked with.

We believe this is the main reason for Aareal's opposition to stringently address what believe are obvious cost improvement opportunities. Completing a U-turn is very hard for existing Supervisory Board members who have backed such unethical management remuneration for many years. Therefore, we have aimed our proposed independent candidates at members of the Remuneration Control Committee of Aareal's Supervisory Board. It is especially these people who have failed to reign in excessive remuneration and instill a culture that fosters shareholder value creation.

6) There Are Specific Reasons For Demanding The Dismissal Of Ms. Korsch, Mr. von Dryander And Mr. Voigtländer

We see a host of reasons for the dismissals proposed by us:

¹ Revenue per Unit.

² Risk weighted assets.

a) Failure To Reign In Excessive Management Remuneration

As mentioned above, Ms. Korsch, Mr. von Dryander and Mr. Voigtländer have all consistently backed the excessive management compensation at Aareal. We deem this a very significant failure and a major reason to replace all three.

b) Lack Of Sustainable Strategy At Aareal As Well As Historical Failure To Develop Aareon's Full Potential

Ms Korsch as Chairwoman as well as Mr Voigtländer as Chairman of the Technology and Innovation Committee must be blamed for grave strategic shortcomings at Aareal. The discussions we have held with Ms Korsch have confirmed that she is not up to her job and lacks a sound understanding of the underlying businesses at Aareal Bank and Aareon, including their respective strategic necessities.

c) Refusal To Address Cost Improvement Opportunities At Aareal

In our discussion with Ms. Korsch, we started highlighting the cost improvement potential at Aareal as early as February 2020. Her reaction and the reaction of Aareal have demonstrated that she is not willing to act but prefers the old ways at Aareal when bankers were paid a lot of money independent of the performance of the bank.

d) Search For New Management Board Members

In light of historical failures and significant strategic mistakes backed by the current Supervisory Board under the leadership of Ms. Korsch, we believe that new and stronger candidates need to be involved in driving the search for top talent at Aareal.

7) A Final Decisions On New Management Board Members Before The 2021 AGM Is Very Risky

Following Mr Merkens recent decision not to return to his mandate as CEO of Aareal and in light of further management board mandates at Aareal coming to their end, a significant re-shuffling of Aareal's top management is imminent. We believe it is of paramount importance that experienced Supervisory Board members drive this process. In light of the significant failures identified above, we deem it very necessary that the independent candidates proposed by us be involved to make sure the best and highly motivated talent can be found and hired for Aareal. We are, in particular, worried that the existing Supervisory Board is trying to rush a decision regarding a new CEO before the 2021 AGM on 18 May 2021. We deem it unlikely that strong candidates (who tend to have alternative career options) will decide to join Aareal before clarity around the Supervisory Board composition has been achieved.

We hope these points can contribute to clarify our position on what is a relatively complicated situation around Aareal. Petrus Advisers stand for the highest level of transparency – you can find any of the documents we have made public on www.reviveaareal.de or on www.petrusadvisers.com (under: active investments/Aareal Bank). As a team, we stand ready for engagement calls with other investors at your convenience. Lastly, we are more than happy to facilitate engagement calls with the independent Supervisory Board candidates we have proposed.

Sincerely,



Klaus Umek
Managing Partner



Till Hufnagel
Partner