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Deutsche Pfandbriefbank ("pbb")

Destroying value each year is not „conservative"

January 2023

Outline

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I Executive summary

Executive summary

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- pbb's leadership has fallen into a trap accepting that the bank has not and is not planning to earn its cost of capital – a minimum return on equity (RoE) of 10-11%
- pbb has recently achieved RoEs of not more than ~5% and has not presented a plan to investors showing how the performance gap to a minimum RoE 10-11% will be closed
- Management's recent plan to grow the loan book and risk weighted assets (RWA) – despite not earning its cost of capital – is a recipe for further value destruction
- pbb has an ultra-risk averse focus on maintaining extremely high capital buffers (management buffer and CET1 excess capital of ~8%) – management has often hidden behind this overly conservative capitalisation to mask lack of underlying profitability
- ESG is a topic at pbb but focus is too low and progress too slow
- While other commercial real estate lenders such as Aareal have recently shown significant performance improvement, pbb is expected to worsen in light of certain headwinds (end of TLTRO, lower prepayment fees, higher funding costs)
- Consequently, pbb has been trading at a very high discount to its book value – of currently 64% (0.36x price / book value multiple)

pbb currently does not have a sustainable strategy securing its future – we demand a <u>fundamental strategic review</u> addressing all relevant business and value creation levers

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II Lack of sustainable business model

10-11% is pbb's cost of equity

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The capital market demands that pbb deploy capital at a return on equity of greater 10-11% to create value (and not destroy value)

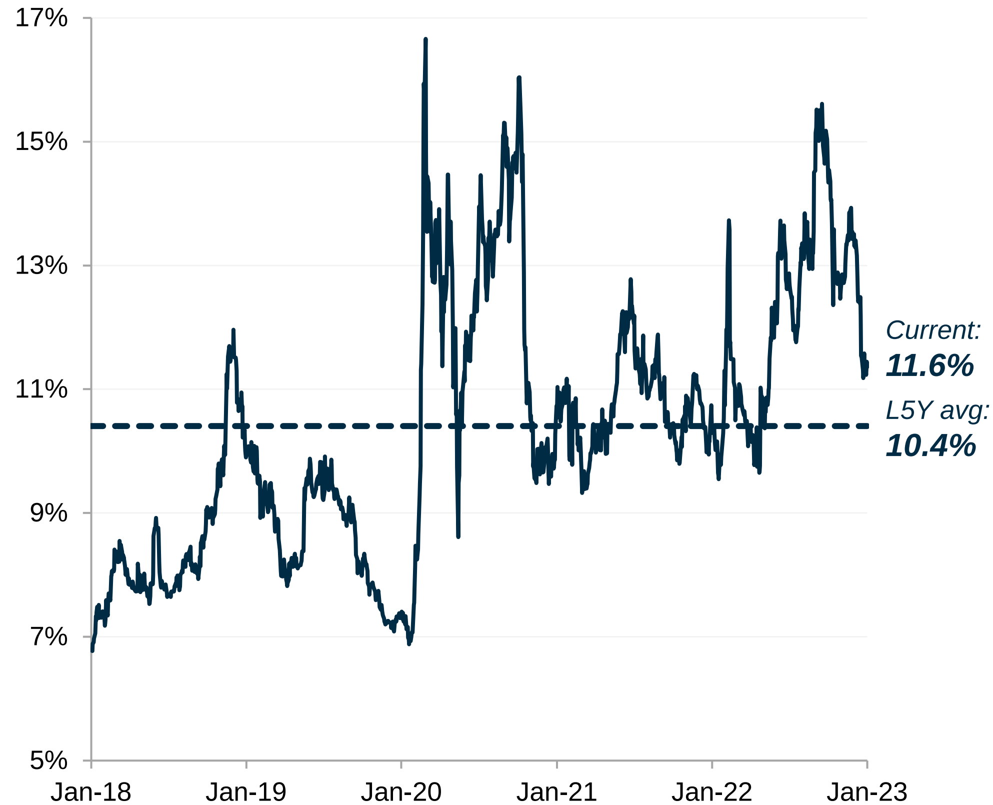
pbb cost of equity – based on broker research

Cost of equity used by research analysts to value pbb

Citi	13.8%
Kepler	11.9%
Oddo	10.9%
Metzler	10.2%
Deutsche Bank	10.0%
HSBC	8.5%
Average	**10.9%**

pbb cost of equity – market implied

Gordon Growth-implied cost of equity[(1)]



Notes: (1) Solving for cost of equity in P/BV = (RoE-growth)/(CoE-growth). Assuming 0% growth.
Source: Factset as of 31-Jan-2023, Broker research, Petrus Advisers analysis

Since 2017, pbb has never managed to achieve its cost of equity…

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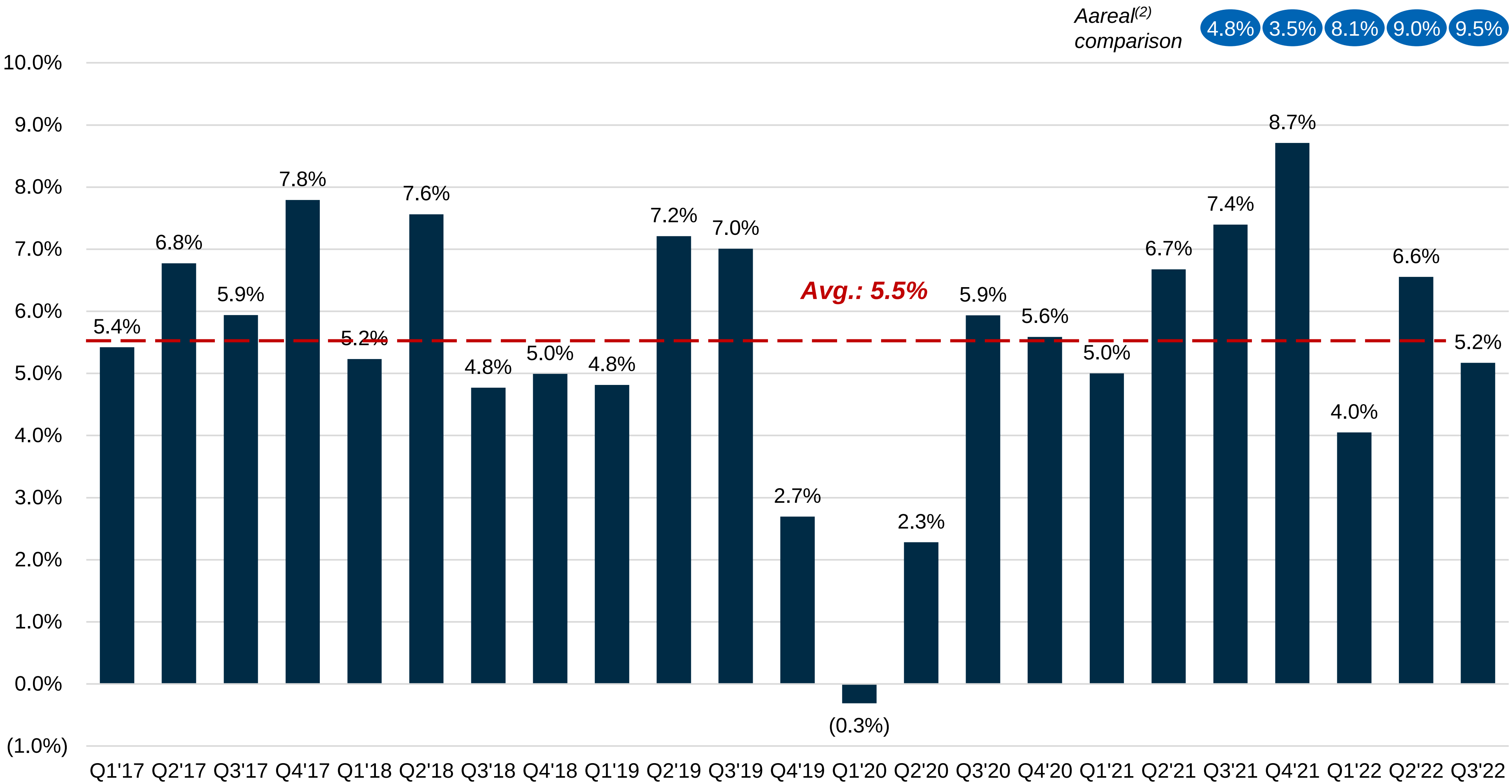
Historical quarterly Group RoE[(1)]



Notes: (1) Reported net income after allocated AT1 coupon divided by average shareholders' equity; (2) Adjustments include one-off tax effects, M&A and restructuring costs as well as loan loss provisions for Russian loans.
Source: Company filings, broker research, Petrus Advisers analysis

…with the outlook deteriorating in contrast to other European banks

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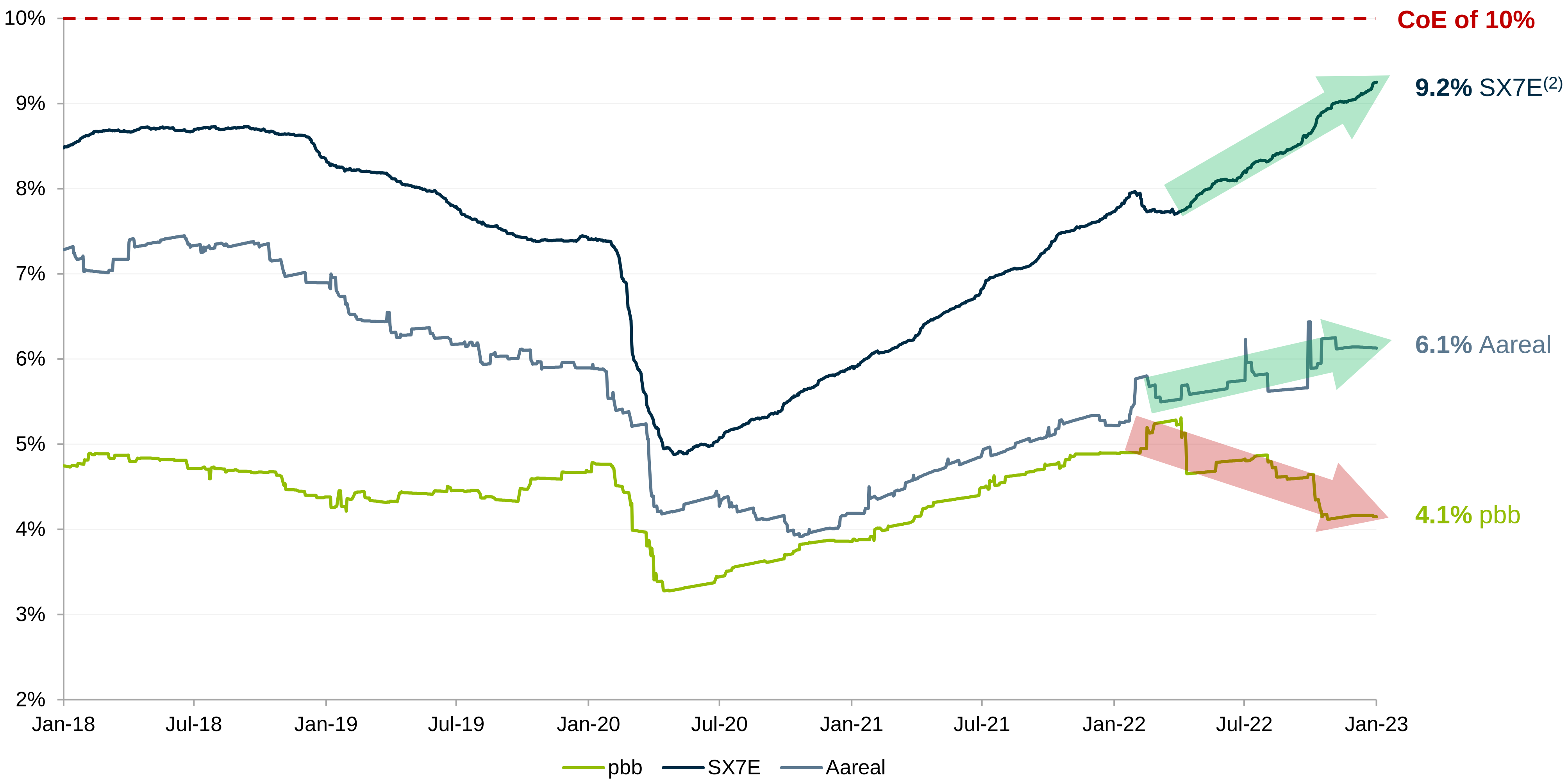
Disappointing return profile despite recent tailwinds from TLTRO, floor income and early repayment fees

Broker consensus *RoE (SNTM in %)*[1]



Notes: (1) Refers to second-next-twelve-months consensus RoE. RoE calculated as earnings per share / avg. book value per share; (2) Equal weighted SX7E.

Source: Factset as of 31-Jan-2023

Petrus Advisers' assessment of current pbb business model

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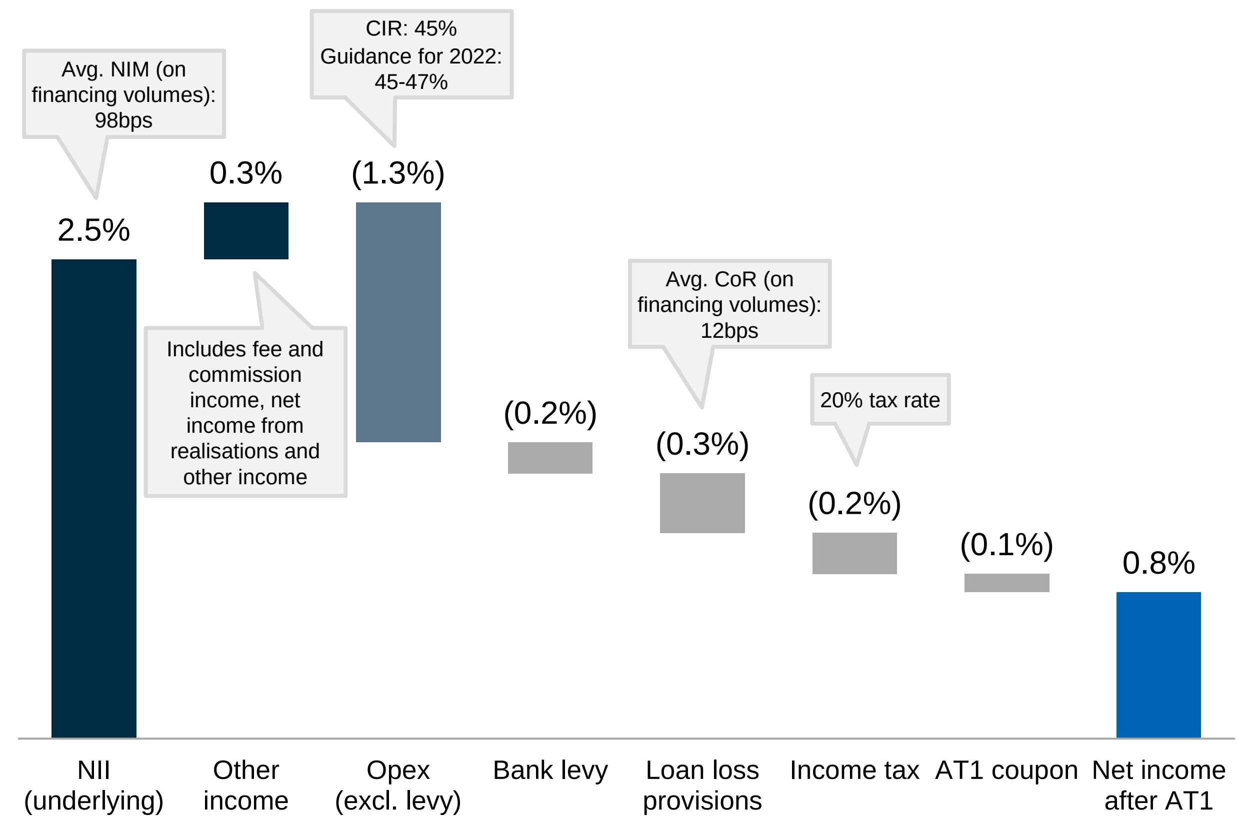
Over the last five years, pbb has not generated RoE>CoE – issues include (i) low-yielding asset base, (ii) high cost-income-ratio for simple business model and (iii) significant overcapitalisation

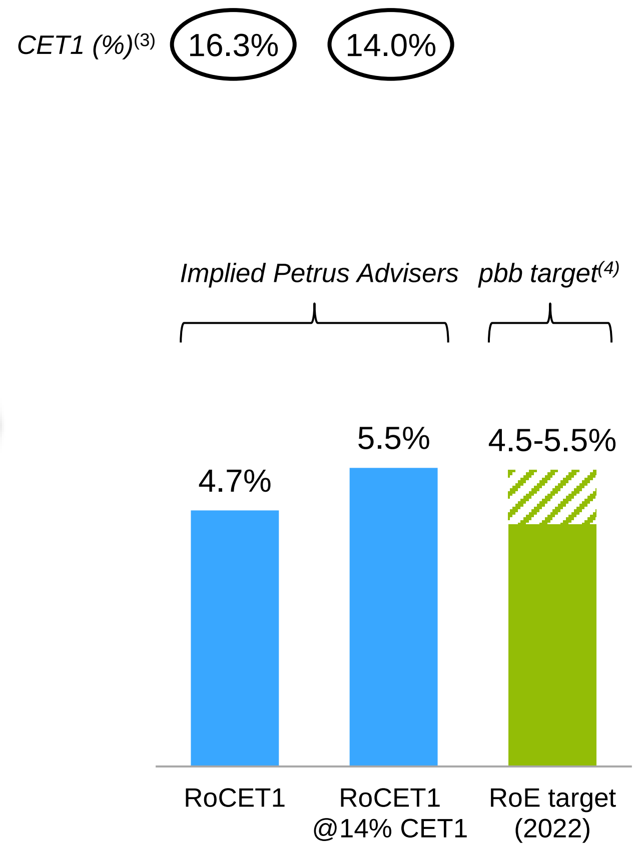
Return on RWA waterfall

Based on quarterly averages since 2017[1]. Excludes TLTRO contribution[2]



Implied return on equity

RoCET1 (in %)



Notes: (1) RWA before Q4'19 are illustratively adjusted for Basel 4 by applying Basel 4 / Basel 3 ratio from Q4'19 to prior quarters; (2) TLTRO contribution between Q3'20 and Q2'21 estimated at €9.4m per quarter and €10.5m between Q3'21 and Q2'22 (in line with Deutsche Bank Research). Estimate for Q3'22 at €12m; (3) 16.3% CET1 is the reported Q3'22 figure and is not yet adjusted for interim profits and expected loss shortfall; (4) See page 85/190 pbb 2021 annual report.

Source: Company filings, Petrus Advisers analysis

Many European banks have generated >10% RoCET1 this year – pbb lagging far behind

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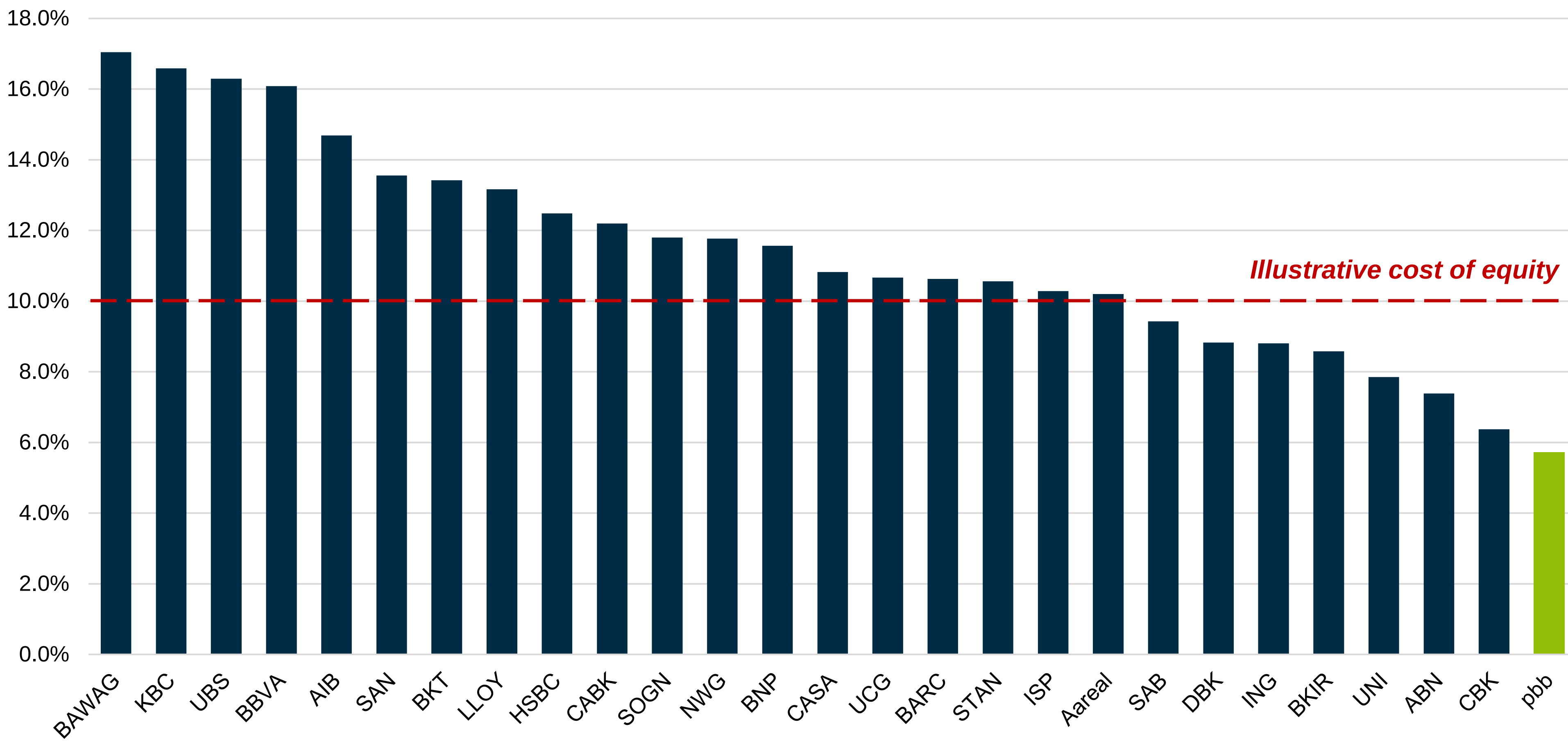
9M'22A annualised RoCET1[1]



Notes: (1) Based on Morgan Stanley coverage universe. Excl. Julius Baer due to its different business model. Annualised 9M'22 figures (or H1'22 if no further reporting available). Adjusted net income after AT1 coupon divided by average CET1 capital. Aareal Bank figures adjusted for one-off tax effects, M&A and restructuring costs as well as loan loss provisions for Russian loans.

Source: Morgan Stanley research, company filings, Petrus Advisers analysis

pbb pursues a value destruction strategy: using excess capital to grow its ultra-low-yielding loan book

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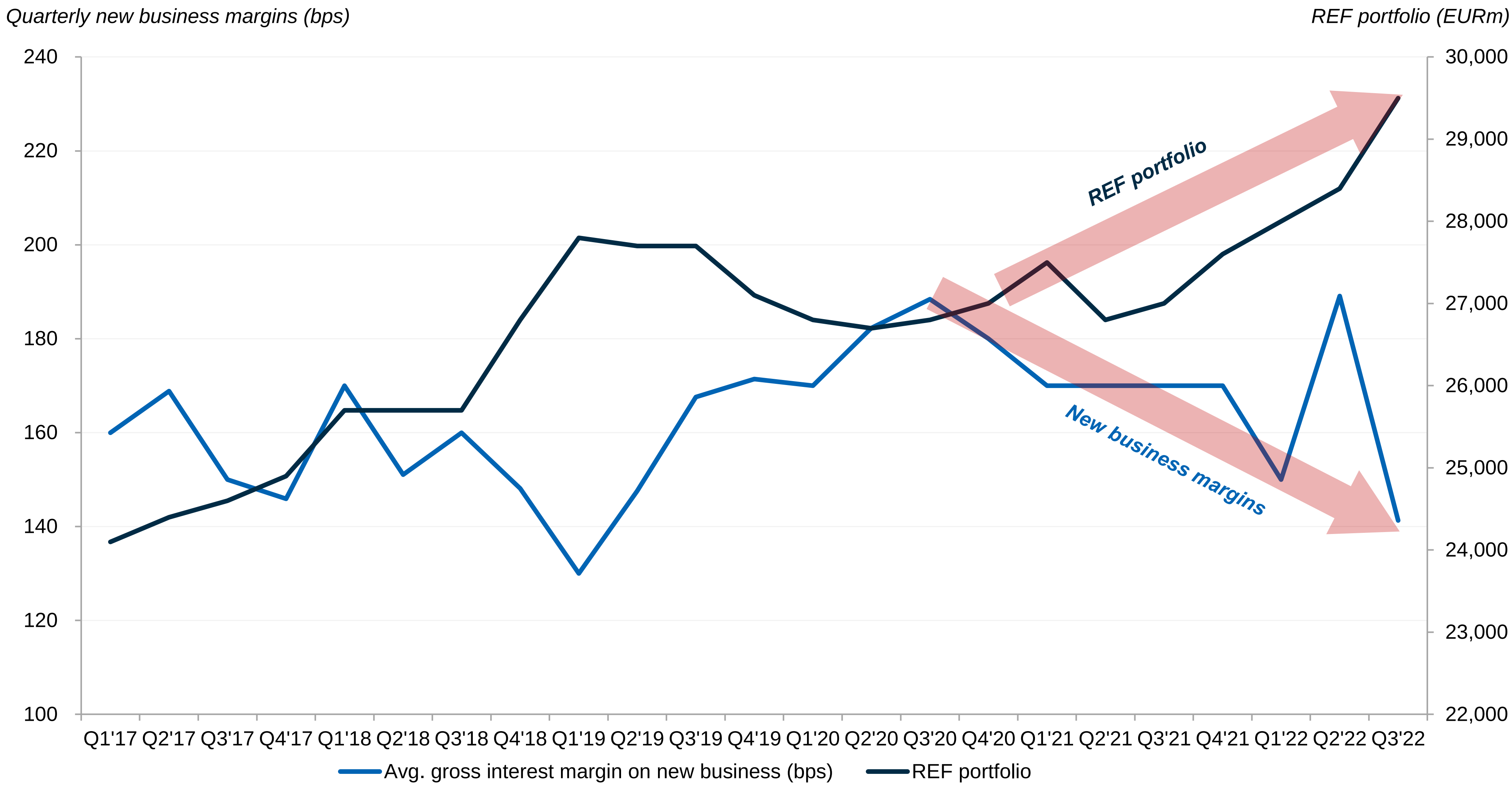
New business margins have been unimpressive



Source: Company filings, Petrus Advisers analysis

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III Hyper-conservative balance sheet approach

Management exploiting any opportunity to build buffers

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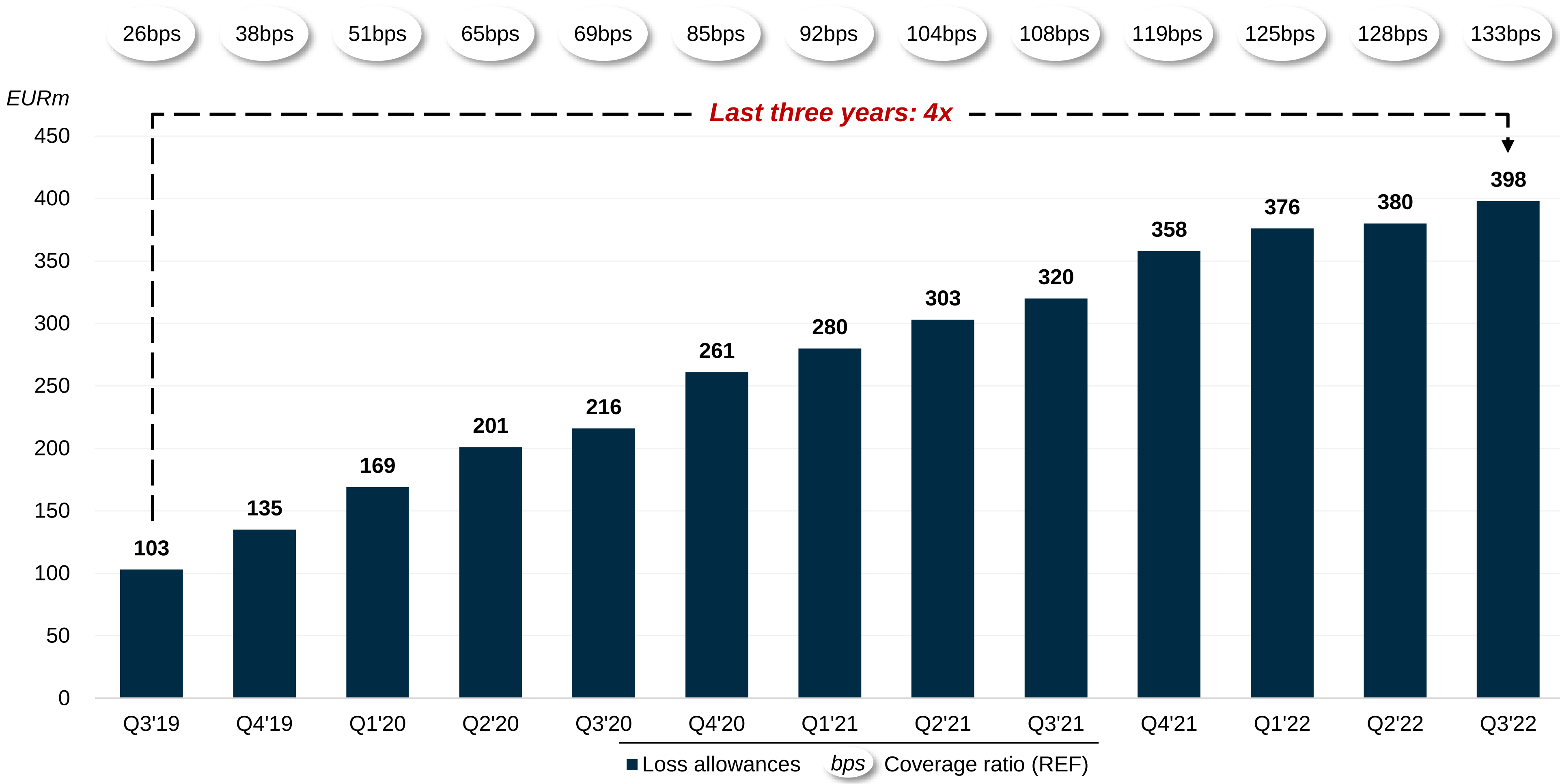
Loss allowance is 4x the pre-Covid level while LTV of the portfolio has decreased over the same period

Loss allowance balance and coverage ratio[1] over time



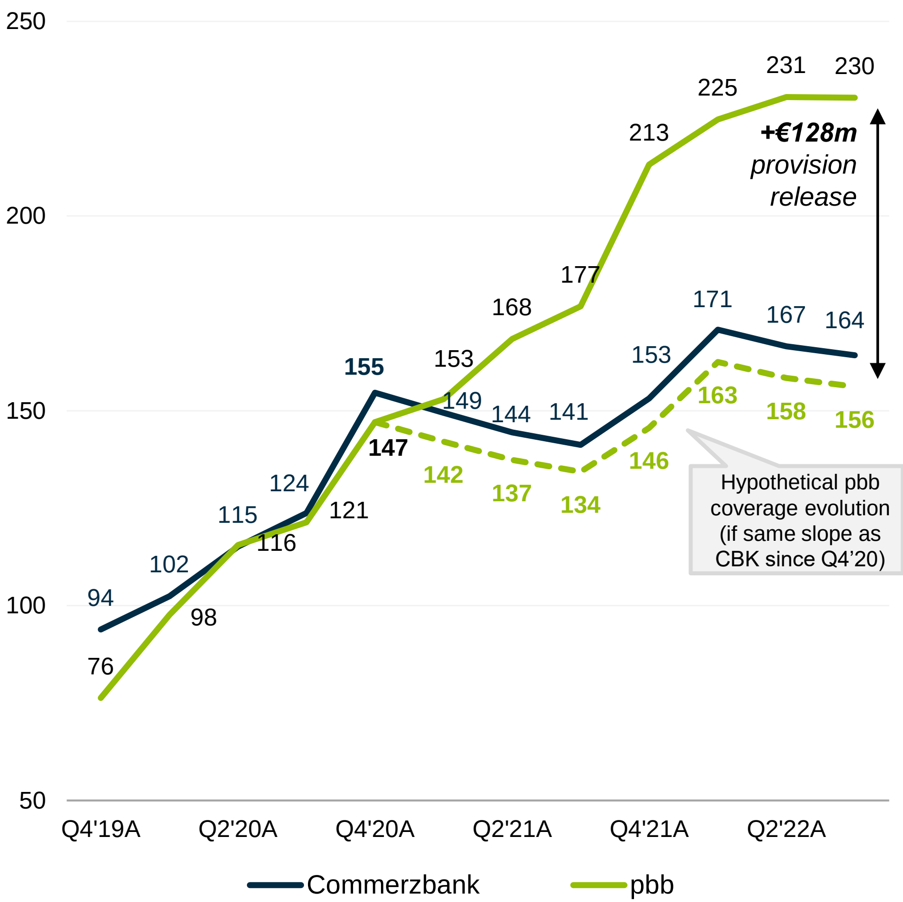
Notes: (1) Loss allowance REF / total REF loans.
Source: Company filings

While other banks have reduced Covid-buffers, pbb keeps on building

pbb's very conservative provisioning practises since the beginning of Covid leave room for releases

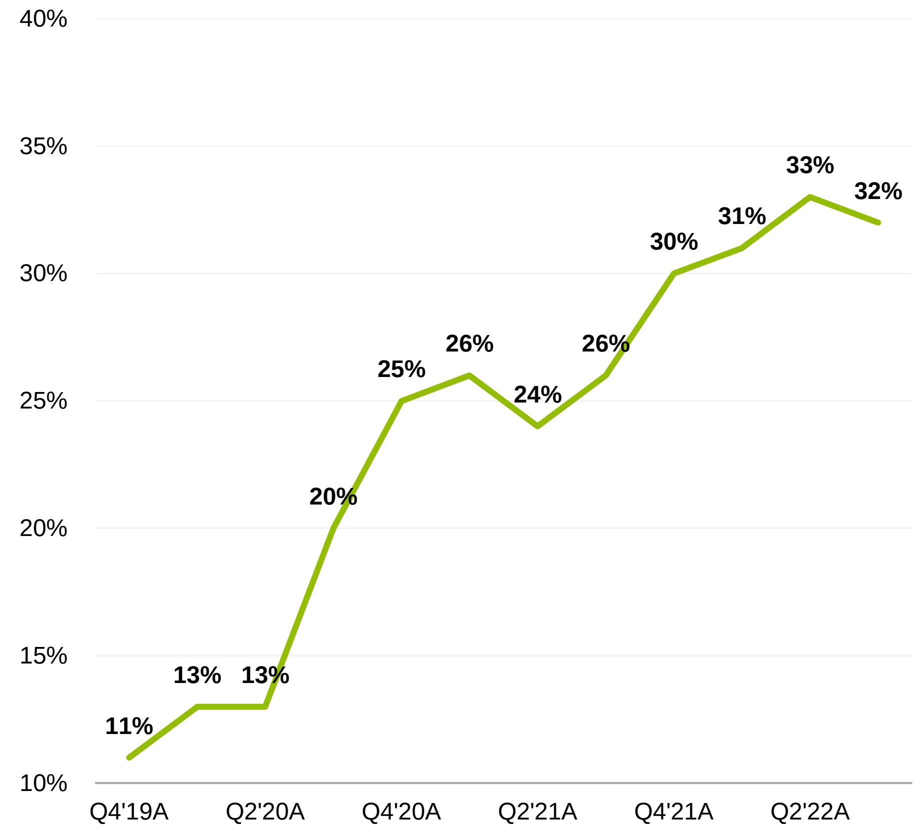
Coverage ratio (loan loss allowances/RWA)

Coverage ratio (in bps)



Stage 3 coverage ratio(1)

Stage 3 allowances / Total NPL (in %)



Notes: (1) Coverage ratio = credit loss allowances on financial assets in stage 3 / gross book values in stage 3 (loans and securities).
Source: Company filings, Petrus Advisers analysis

pbb's capital buffers are extremely high

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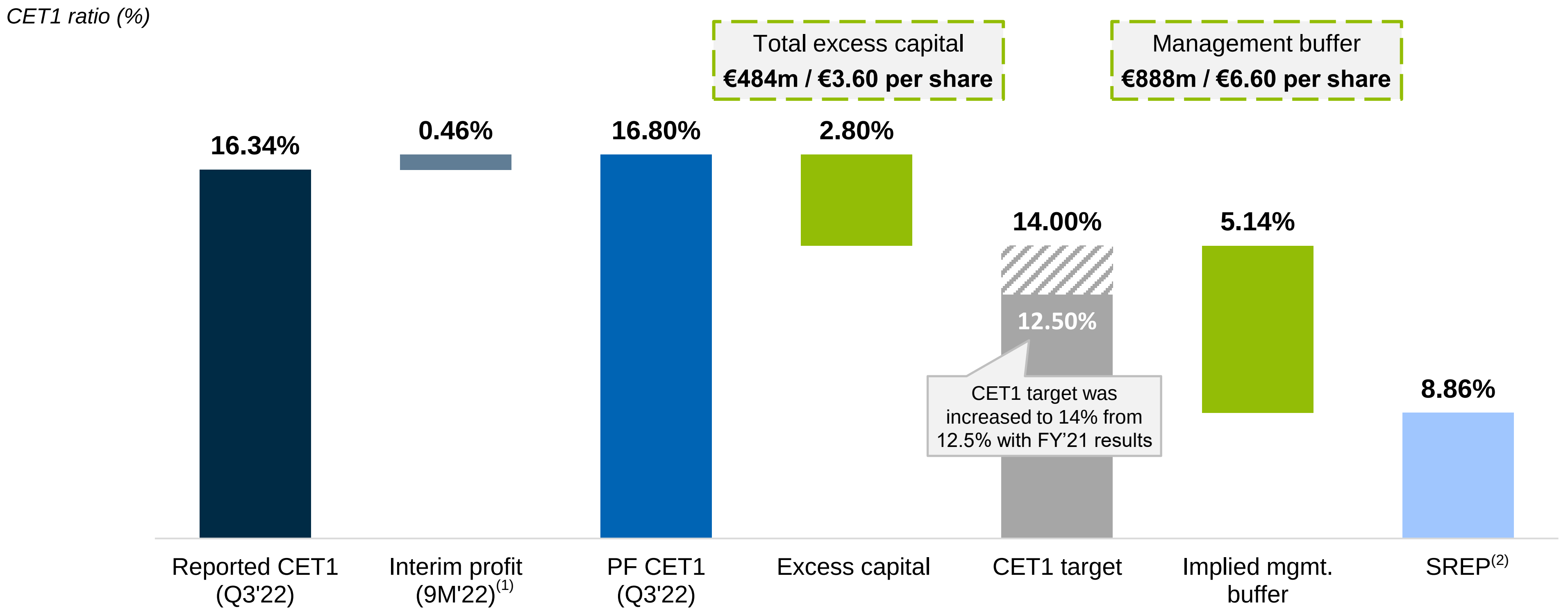
Assuming a very conservative (and recently increased) CET1 target of 14% (12.5% before), pbb has very substantial excess capital (~€500m) and additional buffer over SREP (~€900m)

CET1 capital overview



	Reported CET1 (Q3'22)	Interim profit (9M'22)[1]	PF CET1 (Q3'22)	Excess capital	CET1 target	Implied mgmt. buffer	SREP[2]
CET1 (€m)	2,823	80	2,903	(484)	2,419	(888)	1,531
RWA (€m)	17,279						

Notes: (1) Includes 9M'22 net income (not included in reported CET1 ratio, net income minus 50% base payout ratio as per guidance) + expected loss shortfall; (2) pbb intends to account for upcoming changes of country-specific countercyclical buffers and German sectoral systemic risk buffer with increase of already anticipated countercyclical buffer from 45bps to ~75bps in 2023.

Source: Company filings, Q3'22 conference call, Petrus Advisers analysis

No other European bank has comparably high capital buffers[1]…

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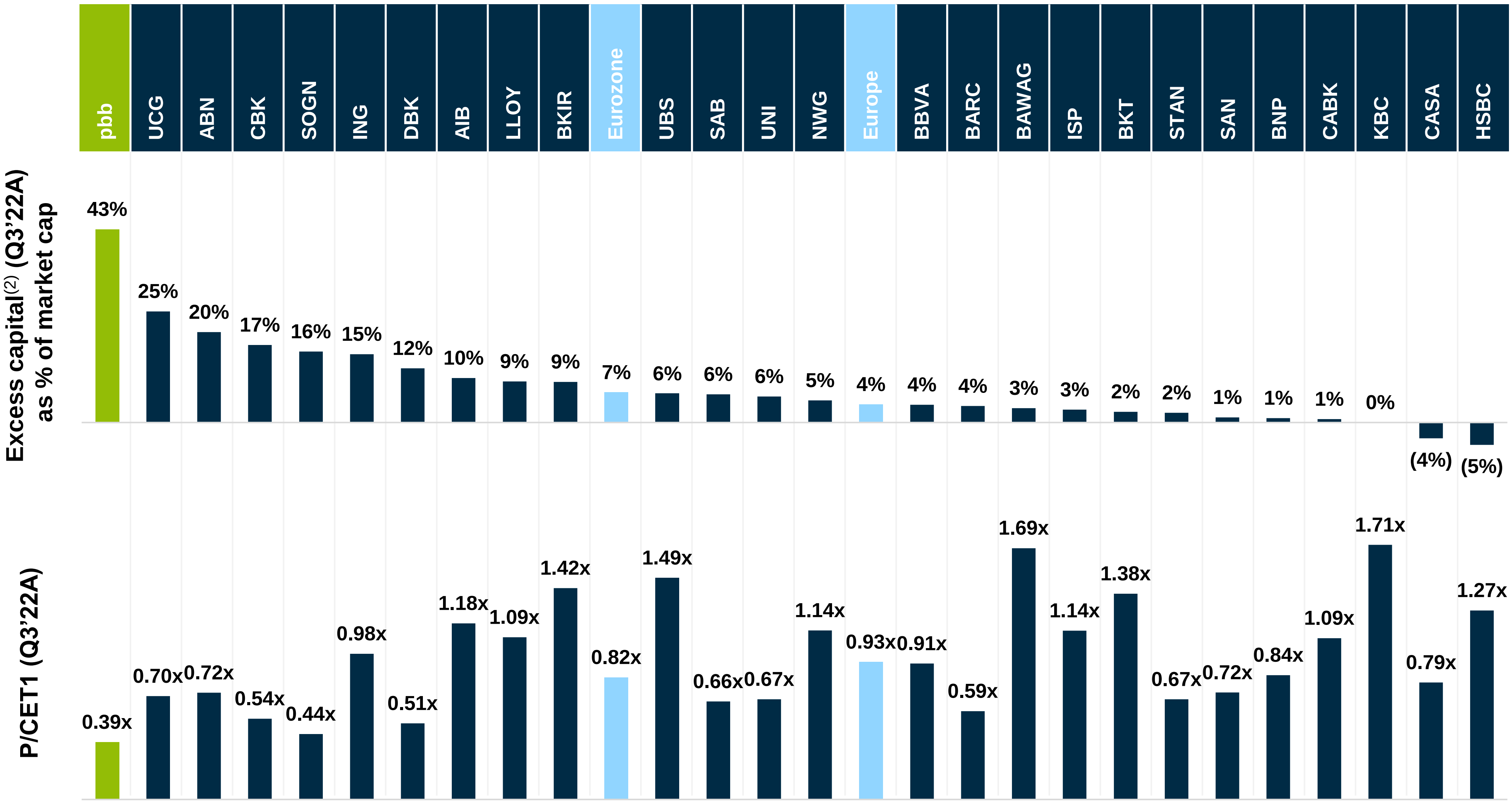

Notes: (1) Based on Morgan Stanley Research coverage universe. Excl. Julius Baer due to its different business model; (2) Q3'22 CET1 vs. latest communicated capital target.

Source: Factset as per 31-Jan-2023, Morgan Stanley research, company filings, Q3'22 conference call, Petrus Advisers analysis

…despite its management buffer also being significantly higher than any other European bank(1)

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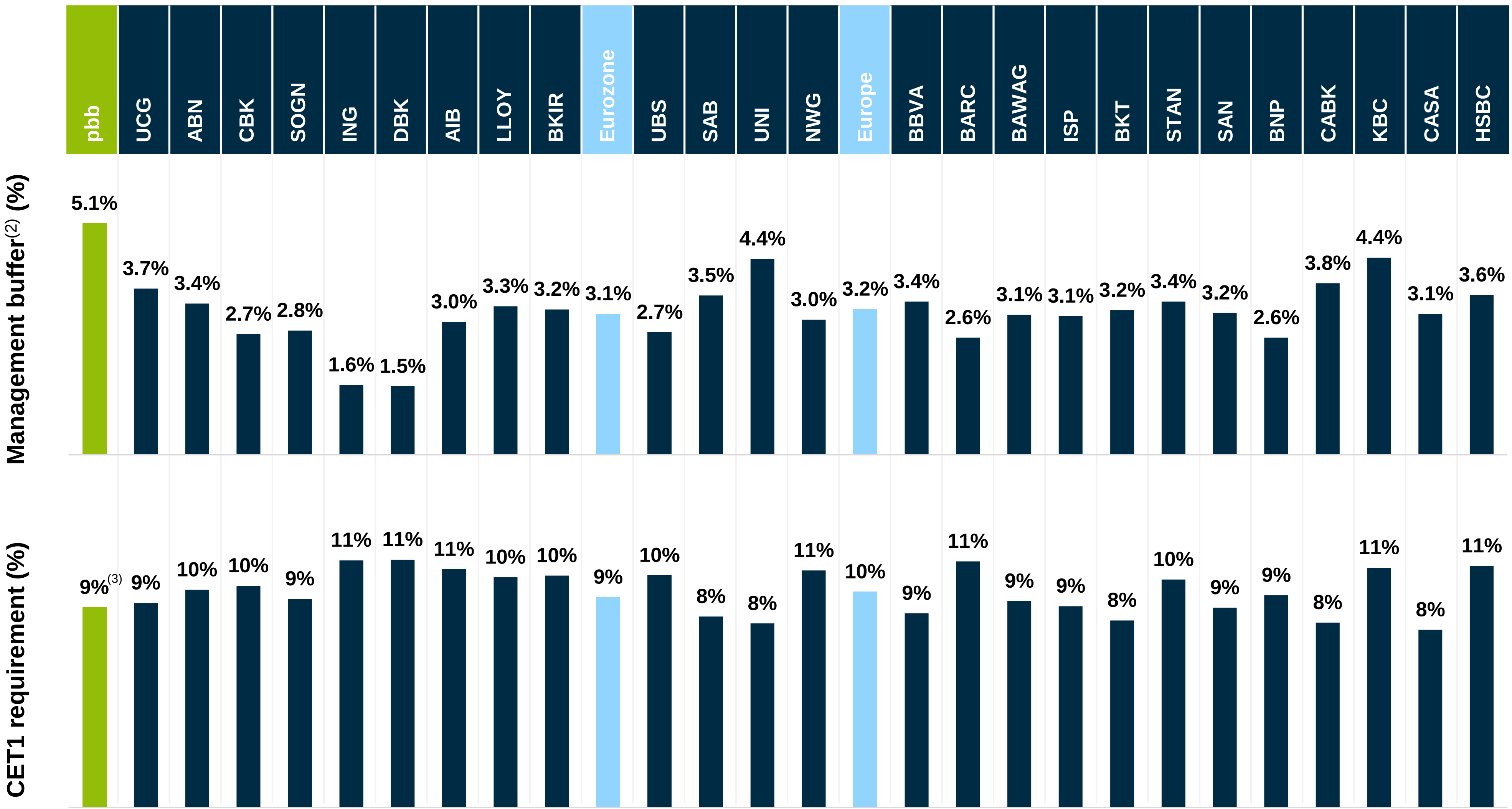

Notes: (1) Based on Morgan Stanley Research coverage universe. Excl. Julius Baer due to its different business model; (2) Management target minus latest CET1 requirement; (3) SREP incl. anticipated countercyclical buffer.
Source: Morgan Stanley research, company filings, Petrus Advisers analysis

In contrast to many other banks, pbb did not pay a catch-up dividend for 2019

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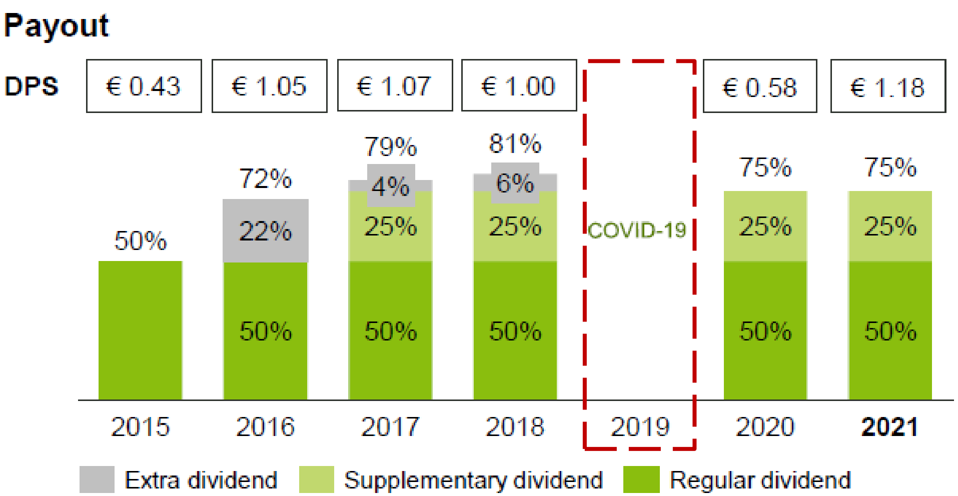
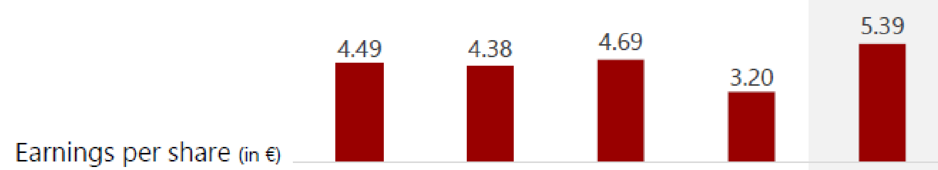
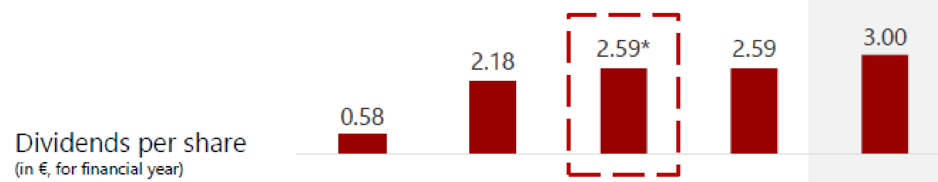
pbb dividend history



BAWAG dividend history

in € million	2017	2018	2019	2020	2021
Profit before tax	500	573	604	371	600
Net income	449	437	459	285	480
RoTCE	15%	15%	16%	10%	16%
Dividends (for financial year)	58	215	230*	230	267
Diluted # of shares outstanding (average, in million)	100.0	99.6	97.9	89.1	89.1





* Distributed in 2021 due to ECB dividend ban related to the pandemic in 2020

Source: Company filings

IV ESG concerns: lack of focus and speed

pbb’s current focus on green lending is far away from its own ambitions and needs to accelerate dramatically to meet targets

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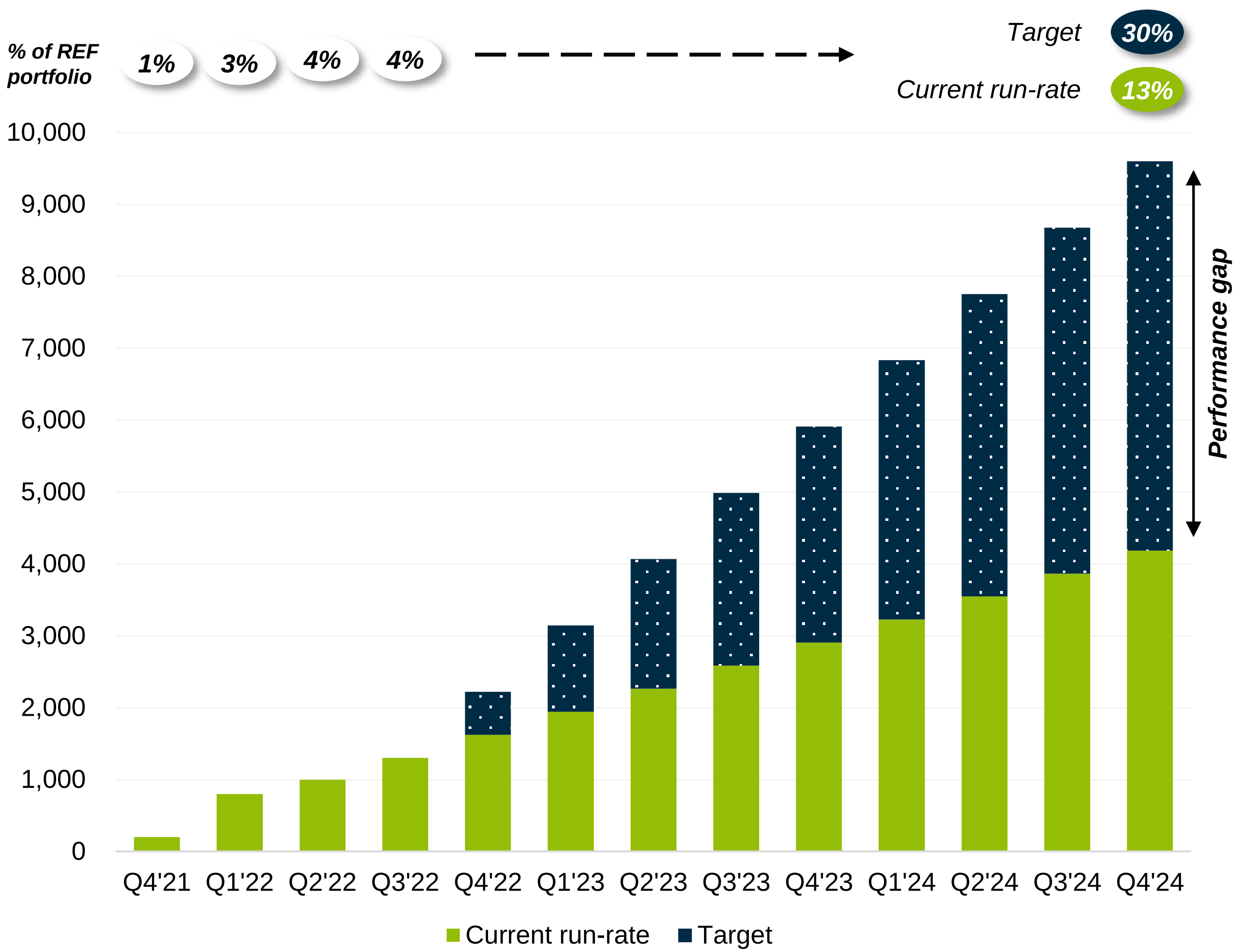
Current CEO has no incentive to deliver on green lending (contract runs out before targets are due)

Green lending volume: run-rate vs. target (€m)



Commentary

- pbb’s green lending efforts have been underwhelming – underperforming peers as well as its own targets
- On average, green lending has made up 14% of new business and currently, green loans make up only 4% of pbb’s REF loan book
- In its latest “outlook”, pbb has set the target to reach ~30% green lending contribution to REF loan book by 2024/25
- With the current contribution to new business, pbb will miss this target significantly(1)
- **The share of green loans in new business needs to be >40% every quarter to reach the target (vs. 14% delivered since the inception)**
- **No accountability for delivery as there are no near-term targets for the CEO on green lending before his contact ends in H1’24**

Notes: (1) Assuming avg. quarterly new business since 2017 (ca. €2.3bn), 14% of new business is green lending (as per historical average) and portfolio growth to €32bn as per latest target.

Source: Company filings, Petrus Advisers analysis

pbb's strategy is not attracting young talent

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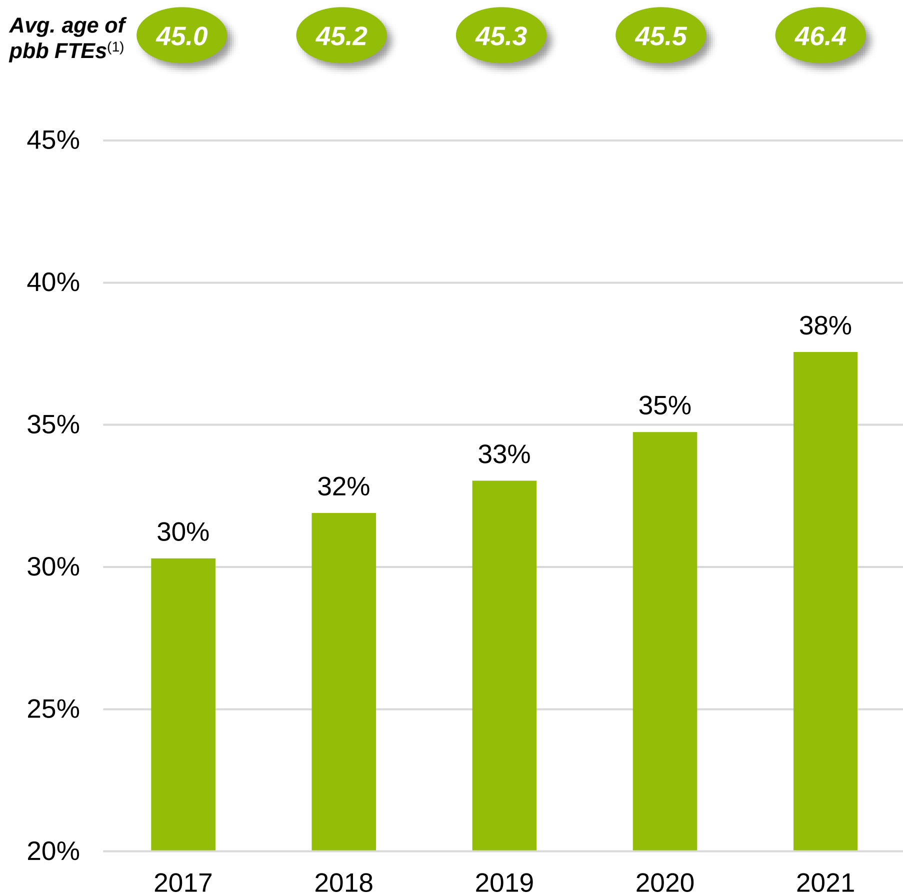
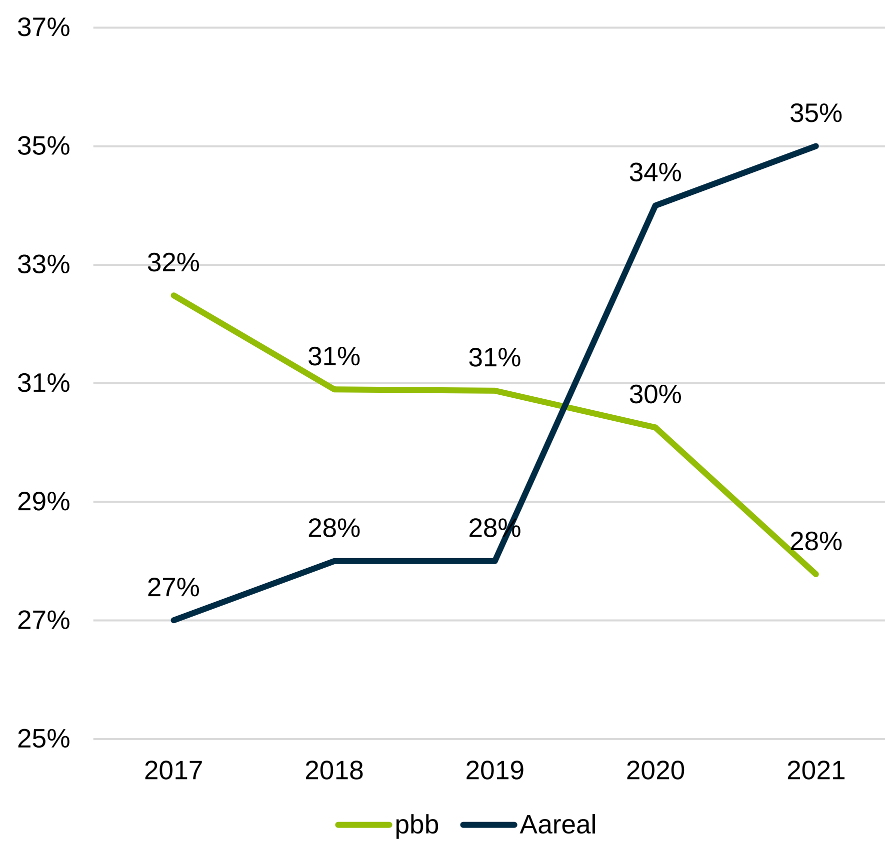
The average age of pbb's staff is creeping up; only 6% of staff is <30 years old

% of staff that is >50 yrs. old



% of staff that is <40 yrs. old



Notes: (1) Based on Non-Financial Report age structure disclosure. Assuming mid-point of age range is the average.

Source: Company filings, Petrus Advisers analysis

V Relative operating under-performance vs. peers

pbb not benefitting from generally improving environment for banks

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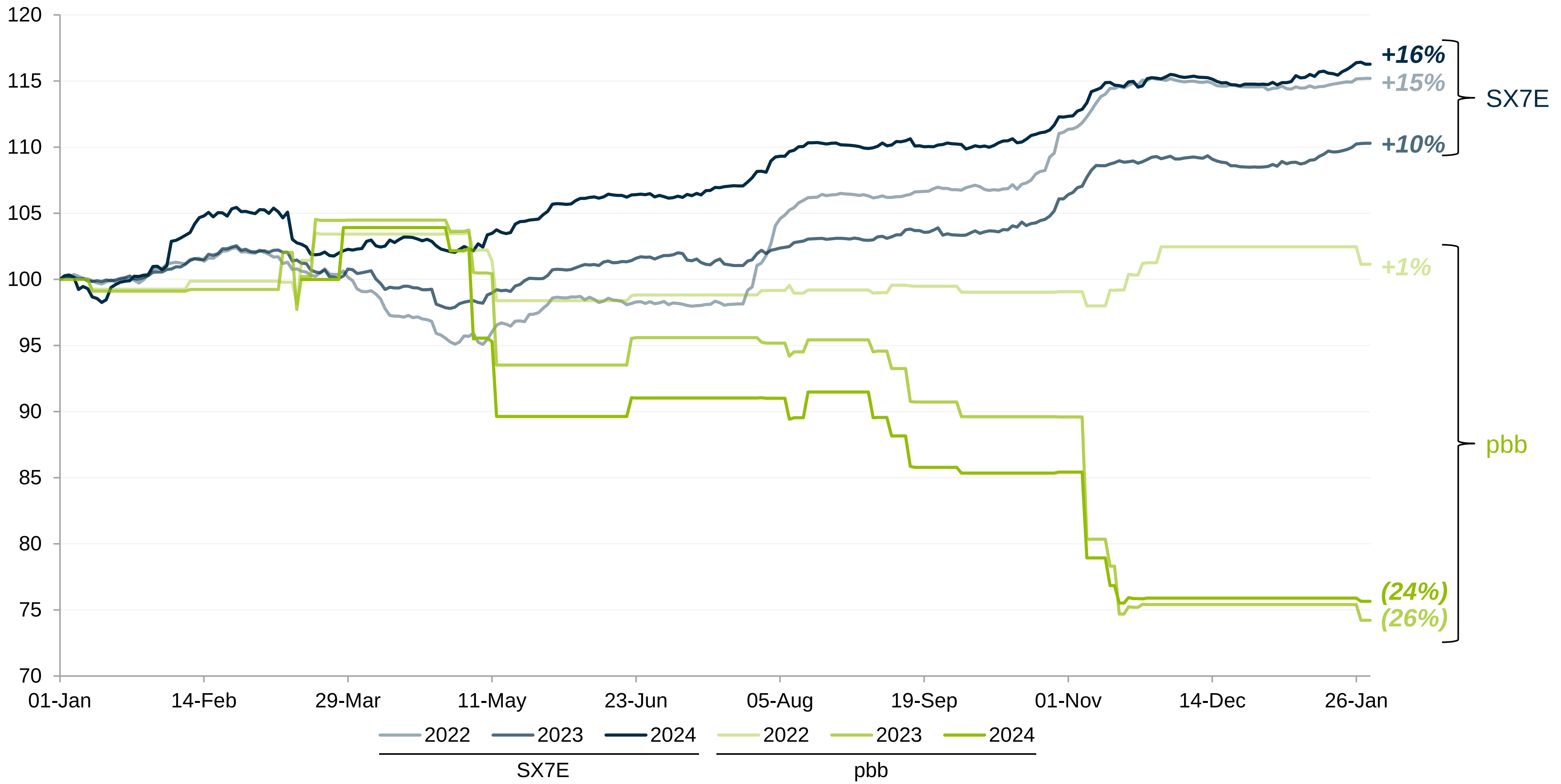
pbb EPS revisions are diverging from European banks

Indexed EPS consensus (since Jan-2022)



Source: Factset as of 31-Jan-2023

Revenue generation of asset base significantly lower than peers – there is no path to 10% RoE

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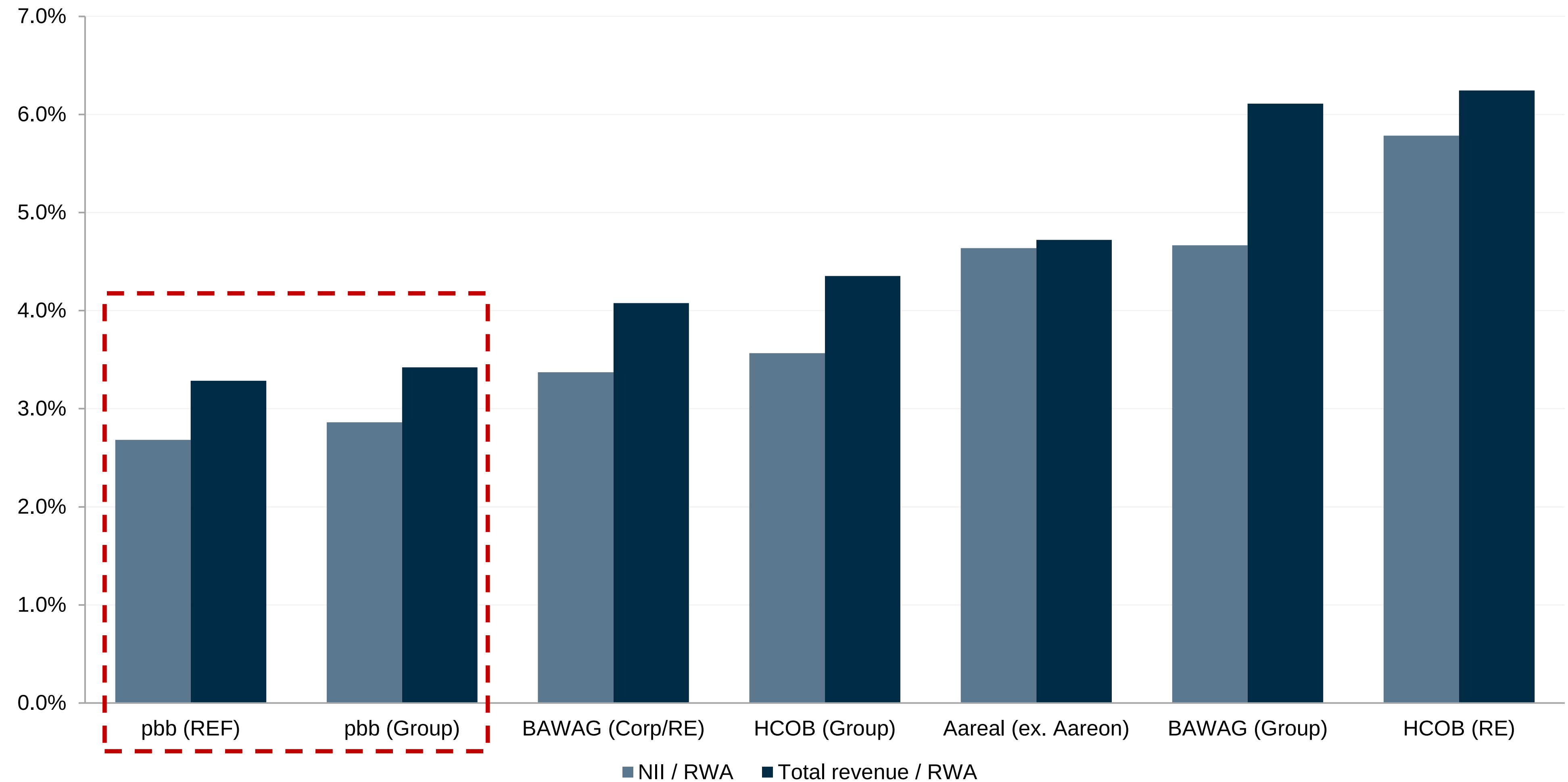
pbb's revenue generation on RWA[1] lags behind peers

Net interest income[2] / Avg. RWA & Total revenue[2] / Avg. RWA



Notes: (1) RWA as reported by the companies. pbb's very conservative approach of transitioning to Basel 4 in 2019 leads to lower revenue on RWA. However, as pbb targets are fully aligned to Basel 4, its ambition should also be to generate sufficient return on the more conservative capital levels; (2) Includes TLTRO contribution. Benchmarking based on FY'21 financials.

Source: Company filings, Petrus Advisers analysis

The performance gap to Aareal (peer) has been widening substantially

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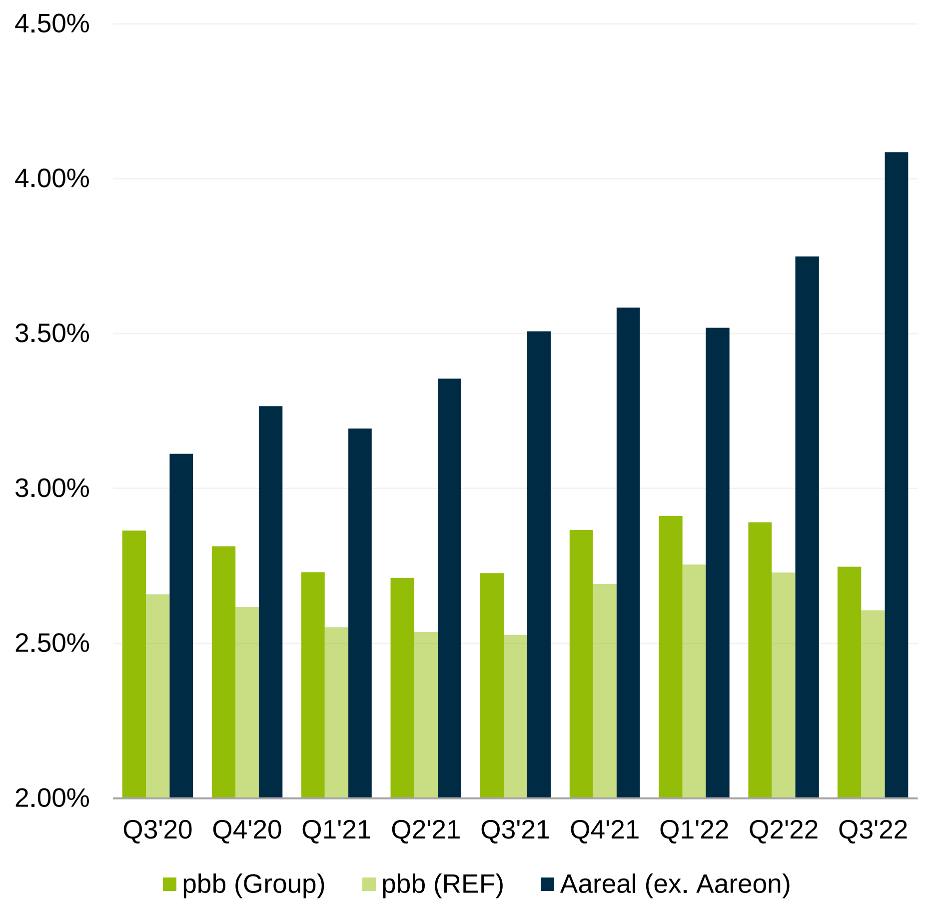
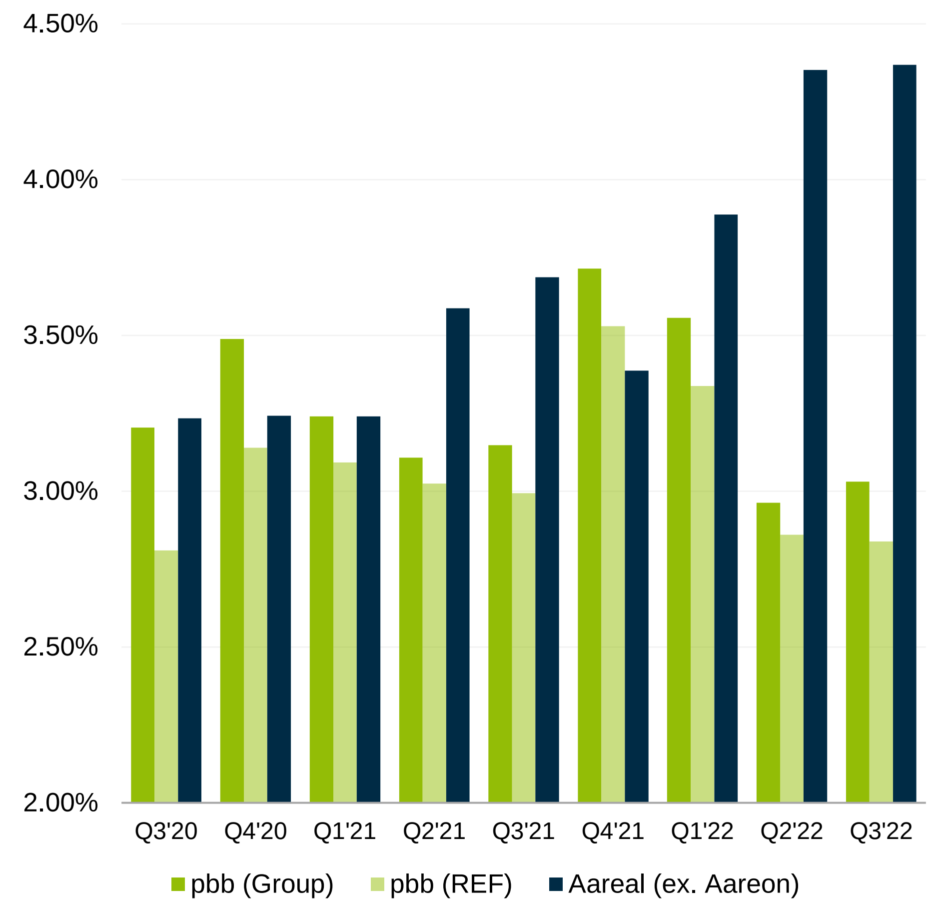
Net interest income / RWA (B4 FL[1])



Total revenue / RWA (B4 FL[1])



Notes: (1) For comparability, we are showing Aareal RWA on fully-loaded B4 basis. In some quarters, Aareal does not disclose this figure. In these cases, we have taken the prior quarter's B4 fully-loaded / B4 phase-in ratio and applied it to the B4 phase-in RWA.

Source: Company filings, Petrus Advisers analysis

Cost base has not sufficiently improved

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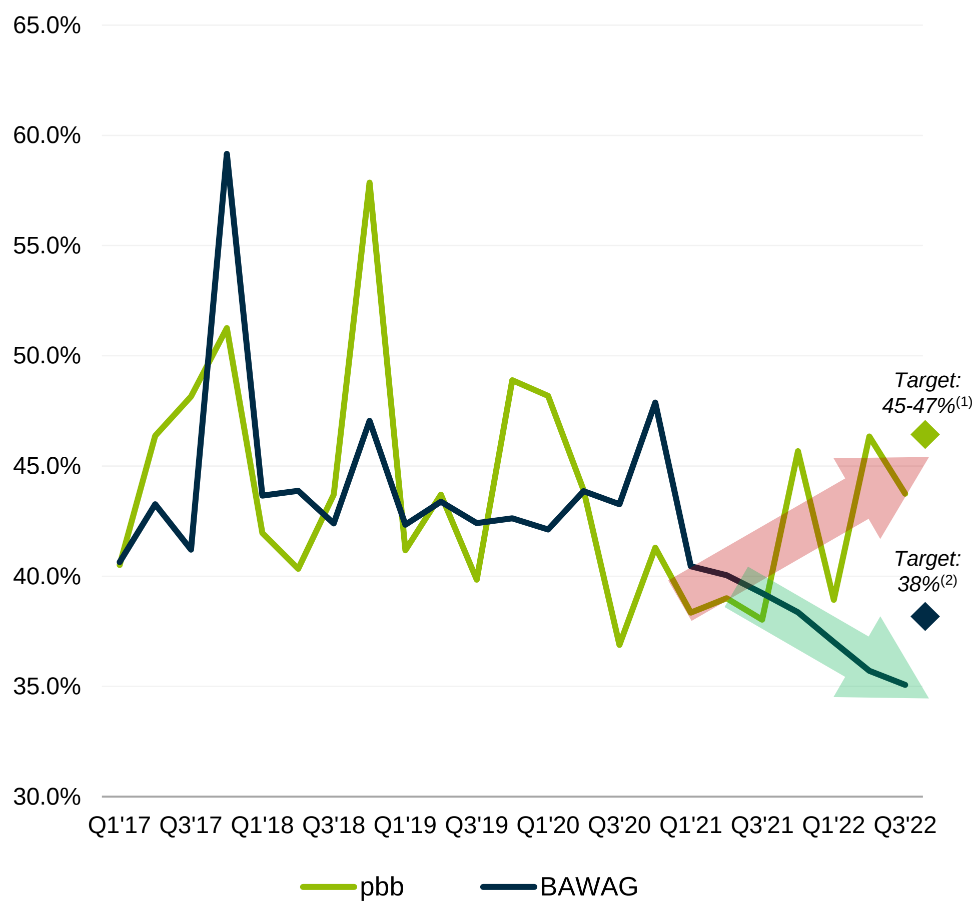
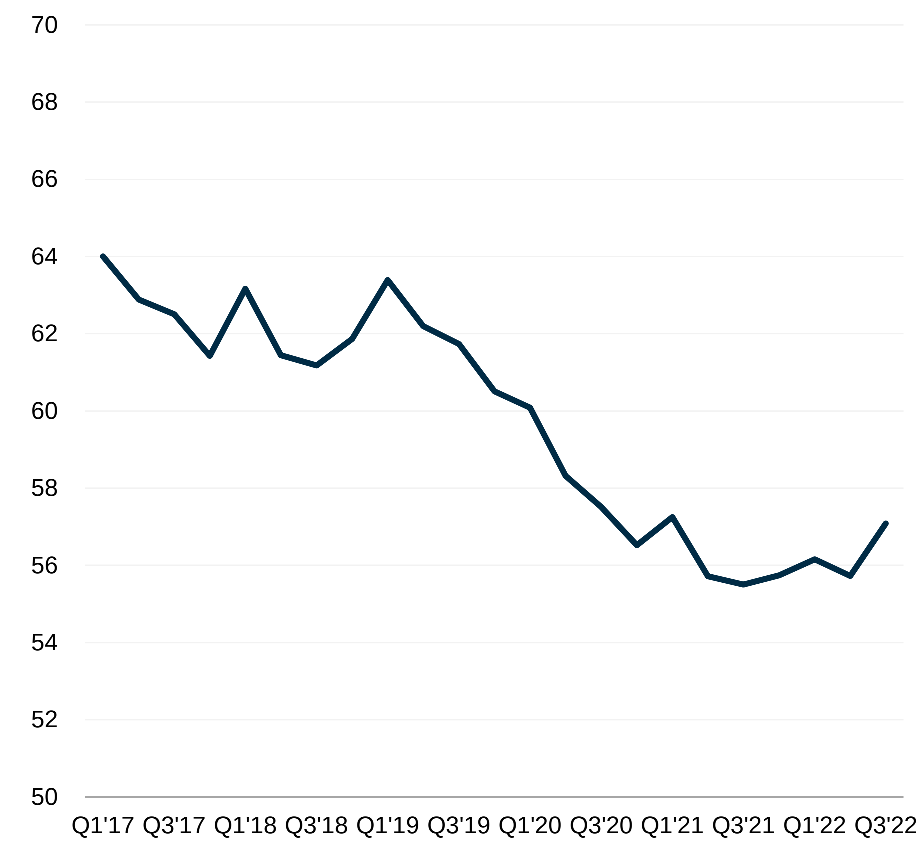
Efficiency has recently worsened – trend to continue

Cost-income-ratio (excl. banking levy, incl. TLTRO)



Portfolio reduction has not led to necessary streamlining of staff

Total financing volume (EURm) / # FTE



Notes: (1) Refers to 2022 target from FY'21 annual report; (2) Refers to 2022 target as per FY'21 presentation.

Source: Company filings, Petrus Advisers analysis

VI Valuation considerations

Since its IPO, pbb has failed to generate meaningful value for shareholders…

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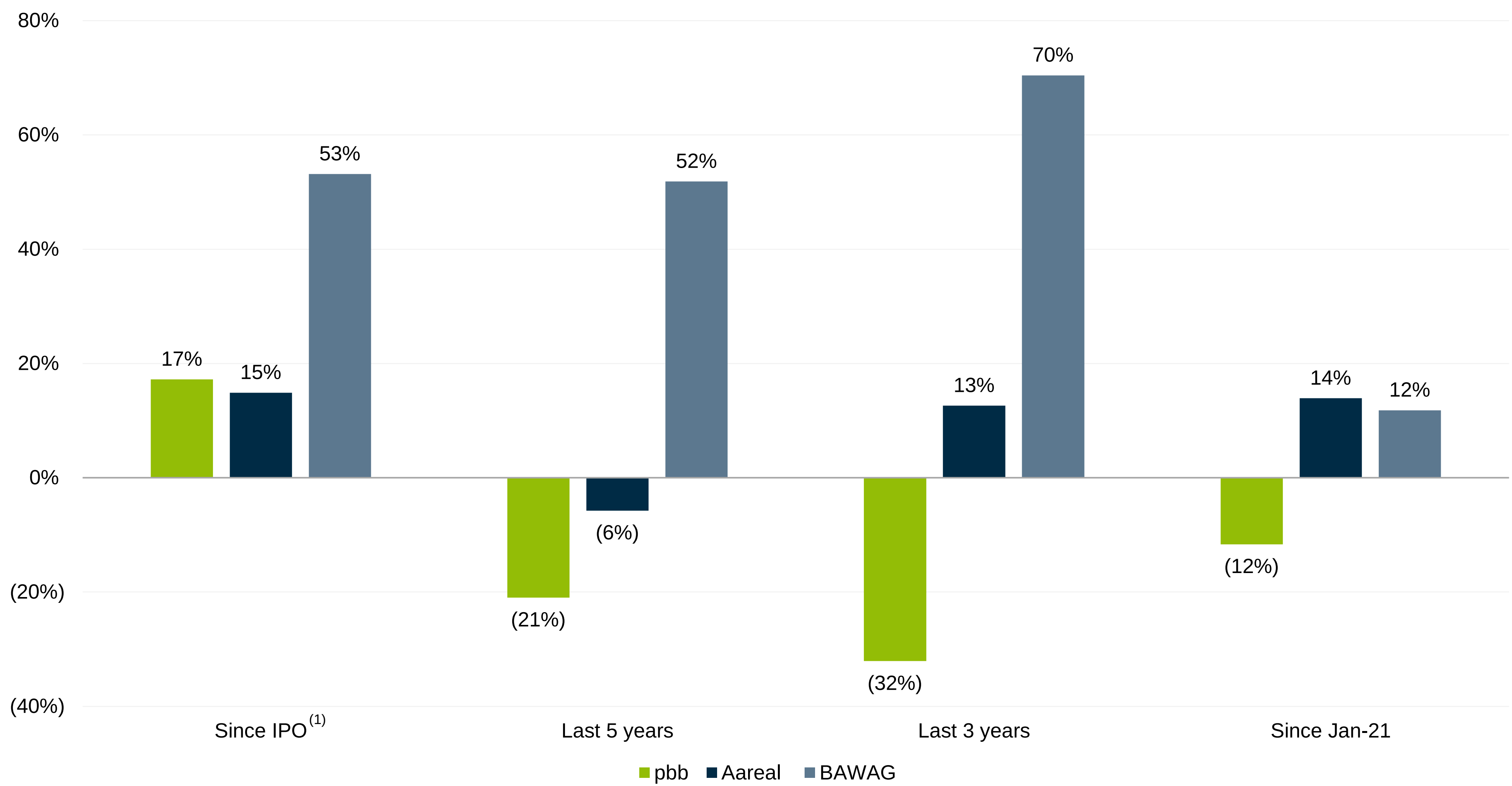
Share price performance since IPO (EUR)

Notes: (1) Adjusted for dividends (pre-tax), i.e. assuming reinvestment of dividends.

Source: Factset as of 31-Jan-2023

…underperforming its DACH peers with CRE exposure over most time horizons

Total shareholder return over various time periods (%)



Notes: (1) Since pbb IPO. For BAWAG refers to performance since BAWAG IPO.

Source: Factset as of 31-Jan-2023

The market is reflecting the lack of functional business model with ~2/3 discount to book value

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P/BV over time (L5Y)[1]

Notes: (1) Refers to NTM book value.
Source: Factset as of 31-Jan-2023

Broker community losing interest in pbb

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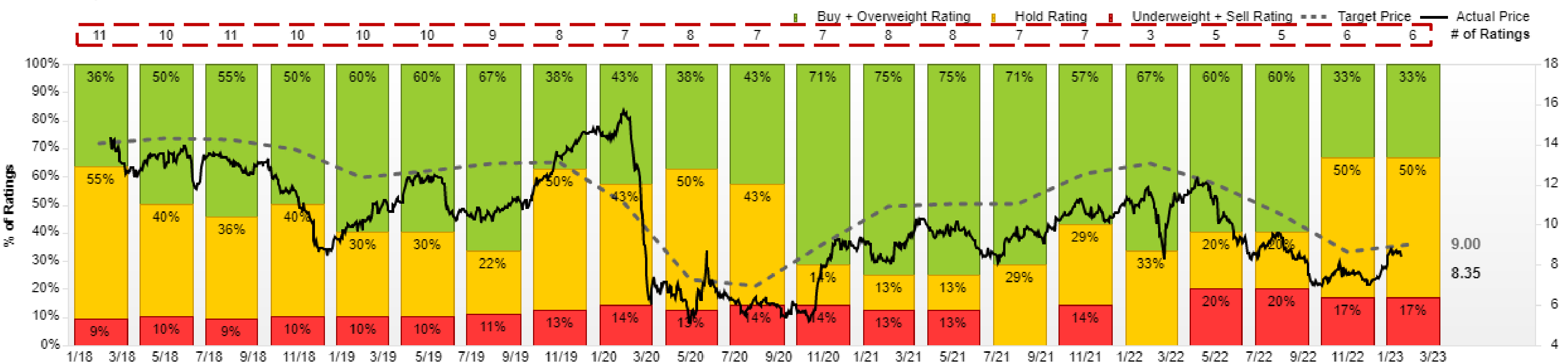
Broker target prices over time

~50% drop in broker coverage over the last 5 years (Factset)[1]



Notes: (1) Coverage on Bloomberg has also declined from 11 in 2017 to 8 in 2022. However, consensus estimates often only include fewer brokers.

Source: Factset as of 31-Jan-2023

Appendix

pbb’s 2021 performance masks the underlying problems

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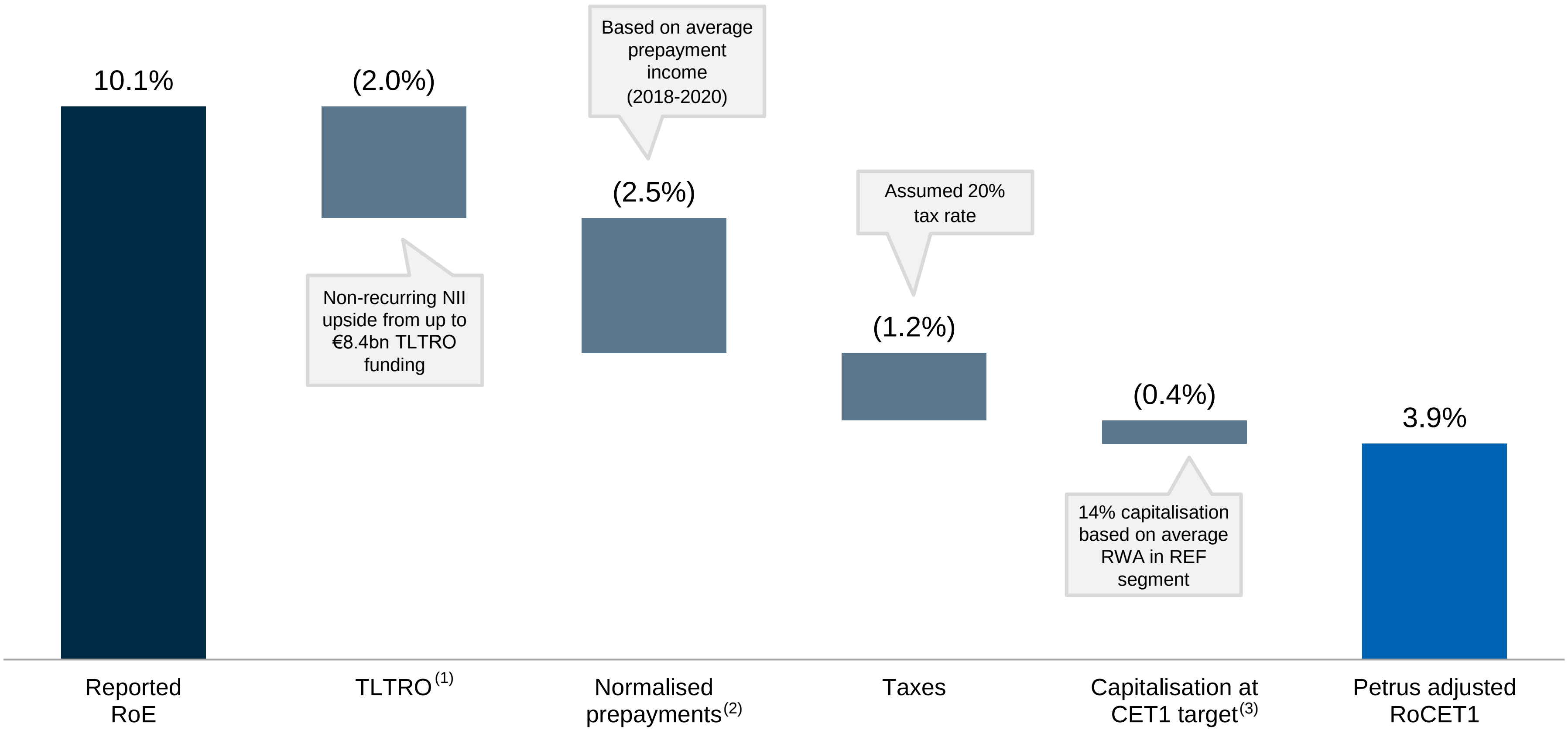
pbb’s equity investors require 10% return on CET1 for growth to be considered – the current business model is not able to deliver this

FY’21 RoE waterfall

Based on FY’21 REF segment financials



Notes: (1) TLTRO contribution for Q1 and Q2 estimated at €9.4m per quarter and €10.5m for Q3 and Q4; (2) 2021 pre-payment fees were extraordinarily high – pbb itself calls this “no run-rate” (see page 10/57 FY’21 earnings presentation). Normalised prepayments based on average net income from realisations in 2018-2020; (3) Capitalisation at target based on average RWA in REF segment multiplied with 14% CET1 target. The implied capitalisation on REF segment level is lower than 14% (see page 39/57 FY’21 earnings presentation).

Source: Company filings, Petrus Advisers analysis

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