Deutsche Pfandbriefbank ("pbb")

Stop window-dressing – start working for value creation and shareholders

April 2023

Outline

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I

Executive summary

Executive summary

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- In response to our letters from January and February 2023, pbb has – for the first time ever – presented a mid-term target of 9% RoCET1
- **No hard measures and window-dressing**: Management is relying on lower cost of risk and window-dressing instead of hard measures such as cost improvement and capital efficiency
  - RoE has been redefined as net profit / CET1 capital while book value of the equity is the clear market standard and right benchmark for shareholders (who own the book equity) – the targeted RoE is only ~8%[(1)]
  - 10-15 bps cost of risk assumption appears aggressive and not sustainable
  - Against the industry trend, management has a track record of not managing cost and hence productivity losses
- **UK and US**: As a late market entrant, pbb's UK and US businesses are high-risk
  - NPL ratios[(2)] of 13.3% and 6.1% point to significant problems in pbb's activities in the UK and the US, respectively
  - The cost structure of the UK business appears very lavish while the portfolio has been shrinking
  - Reducing pbb's engagement in the UK and the US will create value for shareholders and free up capital
- **CAPVERIANT**: One of management's expensive but unsuccessful adventures
  - Having lost more than EUR 20 million, management has not yet presented a plan towards profitability
  - CAPVERIANT should be sold or closed to stop the cash-burn
- **Share buy-back**: Not buying back stock at 0.36x book value makes no sense
  - Excess capital at 41% of market cap vs. 14% CET1 target and at 120% vs. CET1 requirement is extremely high
  - pbb would save dividend cost of up to EUR 53m on repurchased shares (at current share price)
  - Assuming management achieves its ~8% RoE target, the implied return on investment on shares re-purchased would be an astonishing 22% p.a.

Notes: (1) Return on shareholders' equity. The difference between CET1 capital (a regulatory measure) and the book value of shareholders' equity is ~10% („CET1 deductions"). Using CET1 as a base, pbb makes use of a smaller denominator which automatically translates into a higher RoE; (2) Calculated as NPL balance divided by REF exposure.

Source: Company filings, Factset as of 14-Apr-2023, Petrus Advisers analysis

pbb’s new mid-term plan has failed to convince the market

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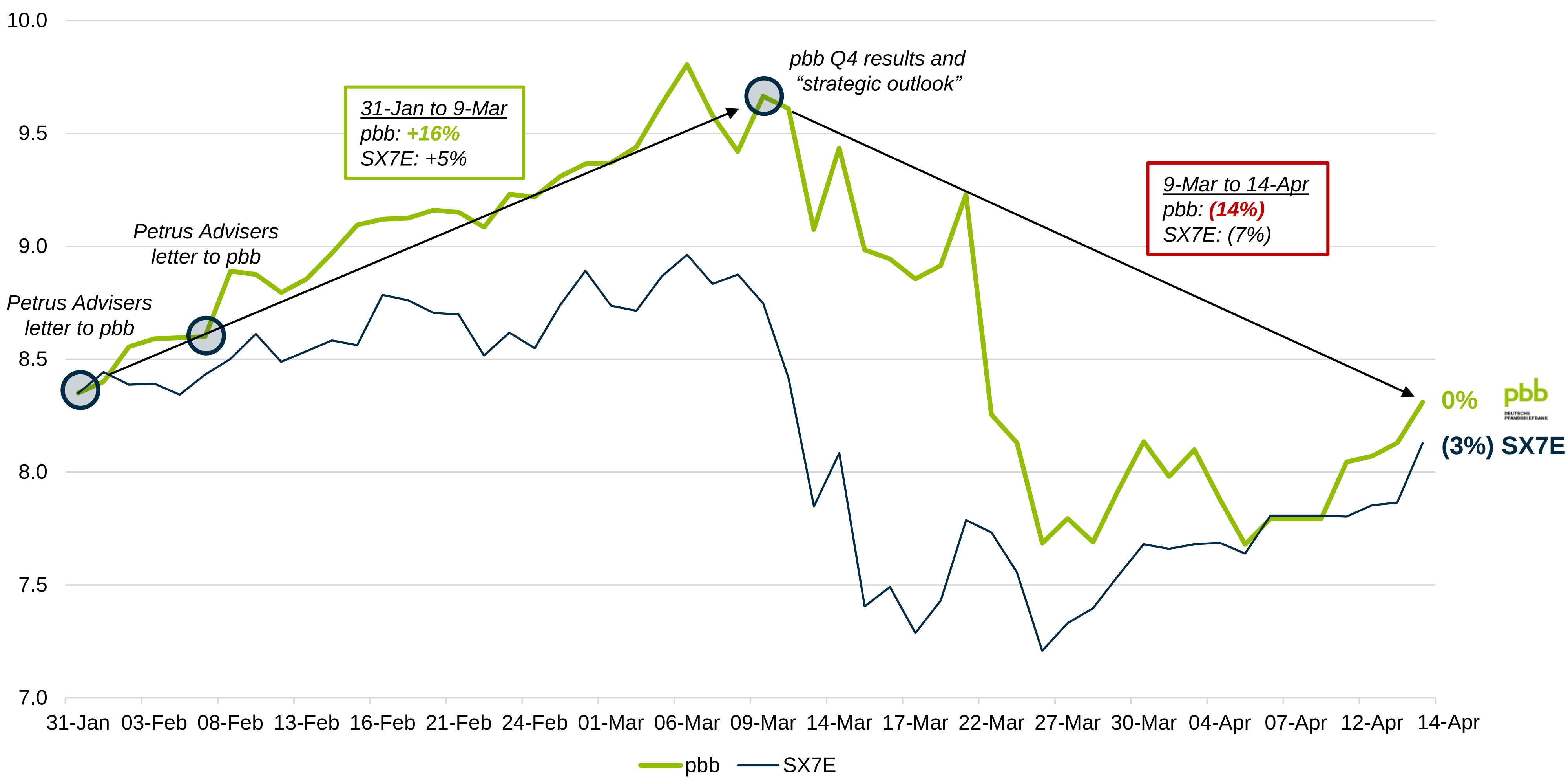
Share price performance since Petrus Advisers public engagement (in EUR, indexed to pbb share price)



II New guidance: Window-dressing and reliance on low cost of risk instead of self-help

Window-dressing has pushed up RoE by ca. 10%

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Since Q4'22, pbb defines its return target as RoCET1[1] vs. the previous target of return of shareholders' equity – no other bank in the Euro Stoxx Banks follows this approach

Change in pbb RoE target definition

RoE definition until Q3 2022[2]:

$$\text{Return on equity after tax} = \frac{\text{annualised net income attributable to shareholders less AT1-coupon}}{\text{average equity excluding accumulated OCI from cash flow hedge accounting, financial assets at fair value through OCI, AT1 capital and non-controlling interest}}$$

RoE definition per Q4 2022[3]:

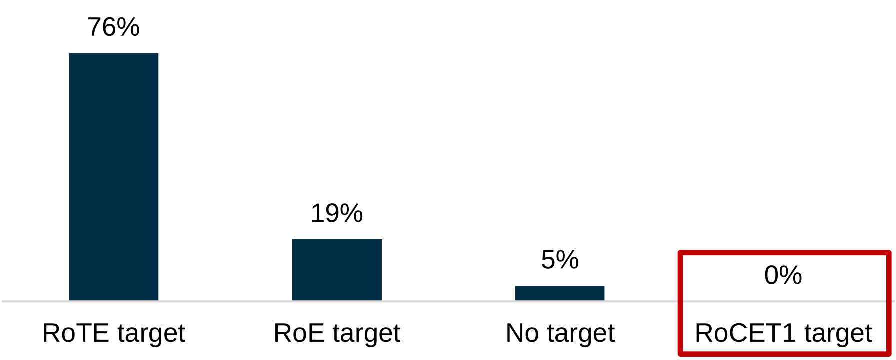
> 10%

RoE b.t.

(> 9% RoCET1 a.t.)

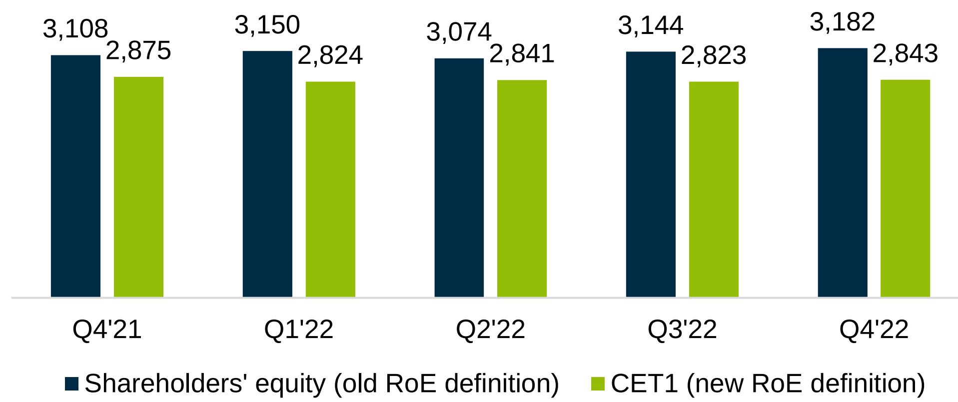
Both refer to RoCET1

Euro Stoxx Banks targets:

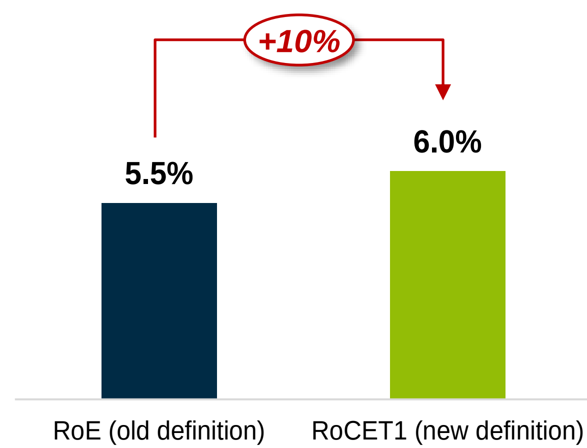


Side-by-side comparison pbb RoE targets

Denominator of pbb RoE targets (EURm)



2022 RoE:



Notes: (1) Return on common equity tier 1; (2) Refer to https://www.pfandbriefbank.com/fileadmin/user_upload/downloads/investor_relations/reports/2208_Alternative_Performance_Measures.pdf; (3) Page 36/62 Q4'22 presentation.

Source: Company filings, Petrus Advisers analysis

Low cost-of-risk assumptions driving management's plan – limited self-help visible

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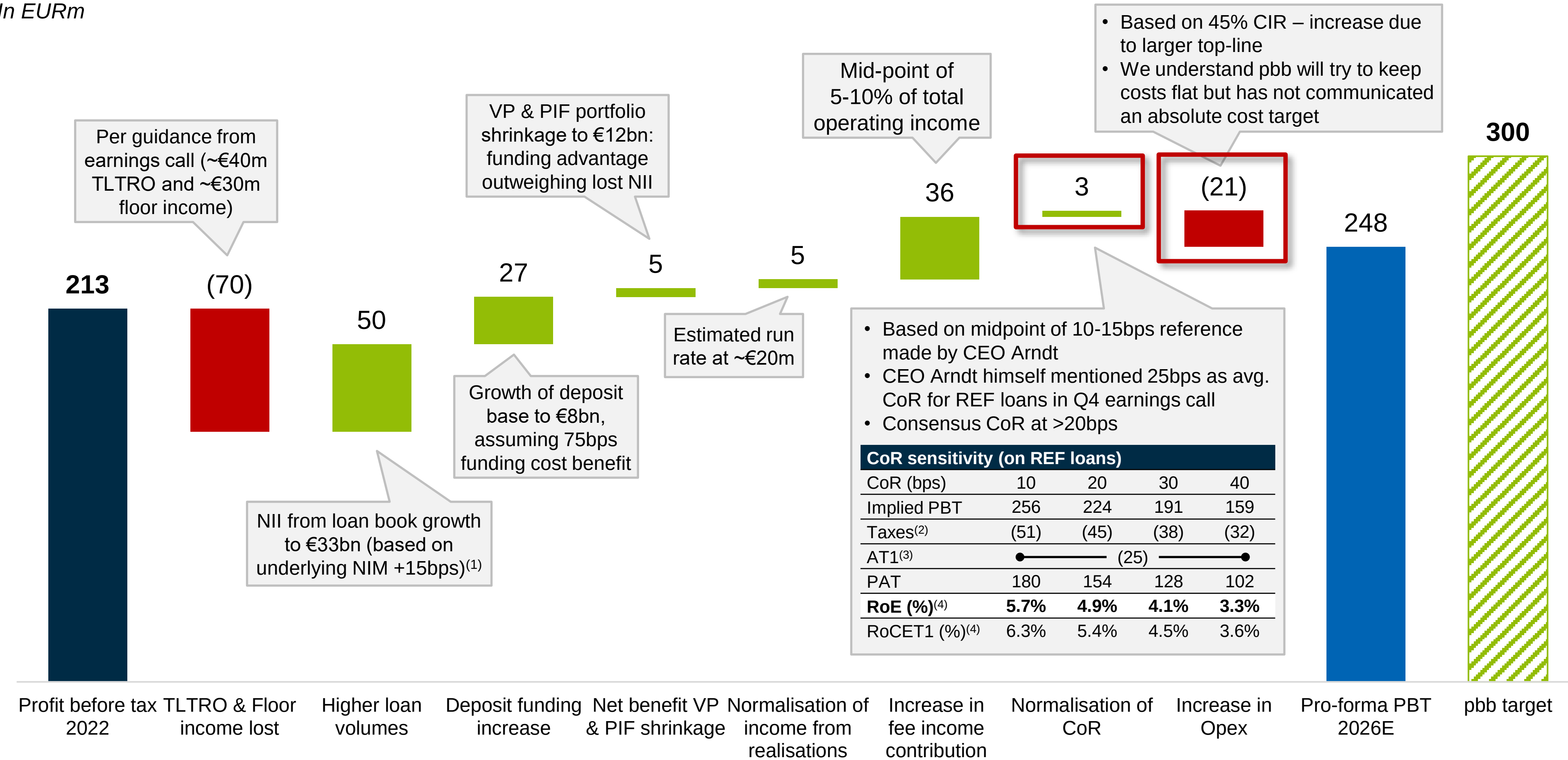
pbb's 2026 targets rely on unsustainable cost of risk assumptions of 10-15bps – this is not run-rate profitability

PBT bridge (2022 to 2026 guidance) – Petrus Advisers reconciliation analysis

In EURm



CoR sensitivity (on REF loans)				
CoR (bps)	10	20	30	40
Implied PBT	256	224	191	159
Taxes(2)	(51)	(45)	(38)	(32)
AT1(3)	(25)	(25)	(25)	(25)
PAT	180	154	128	102
RoE (%)(4)	**5.7%**	**4.9%**	**4.1%**	**3.3%**
RoCET1 (%)(4)	6.3%	5.4%	4.5%	3.6%

*Notes: (1) NIM (ex. TLTRO and floor income) of ~120bps + 15bps margin increase * 33bn - 29.3bn; (2) Based on 20% consensus tax rate; (3) Based on estimated reset of AT1 coupon (5Y mid-swap rate per 14-Apr-2023); (4) For illustrative purposes based on Q4'22 equity.*

Source: Company filings, earnings call transcript, Bloomberg as of 14-Apr-2023

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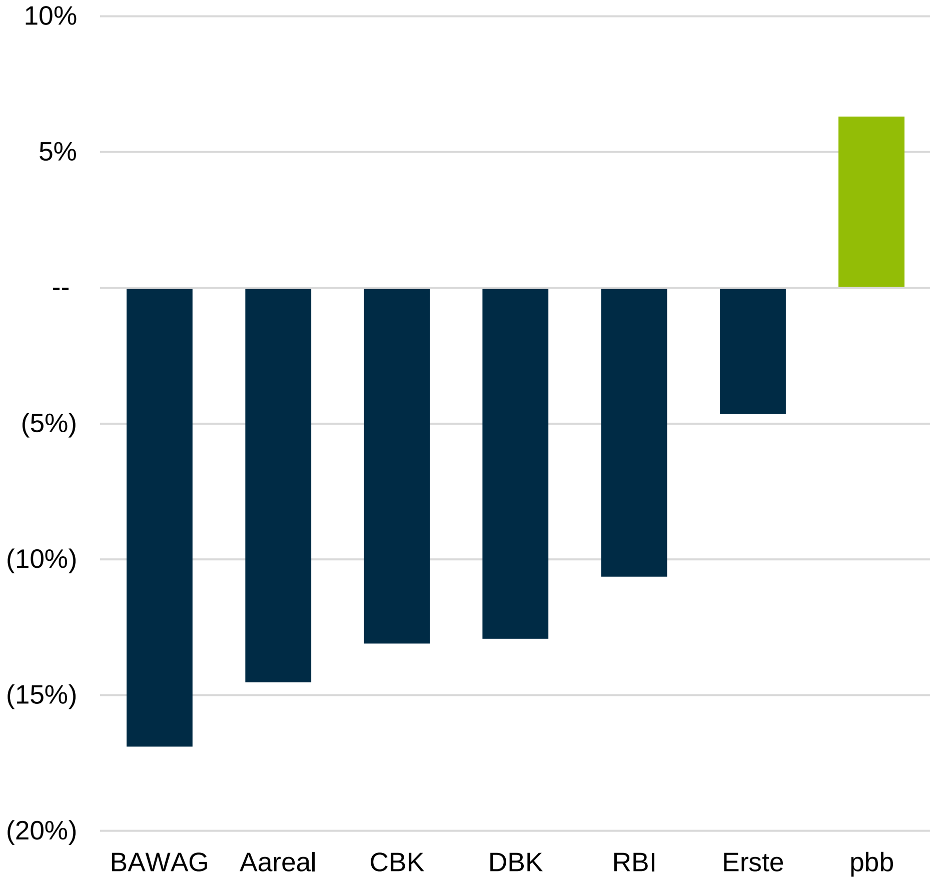
III

Cost: Not a focus at pbb

pbb, against the industry trend in Germany/Austria, has been growing headcount despite significant IT spending

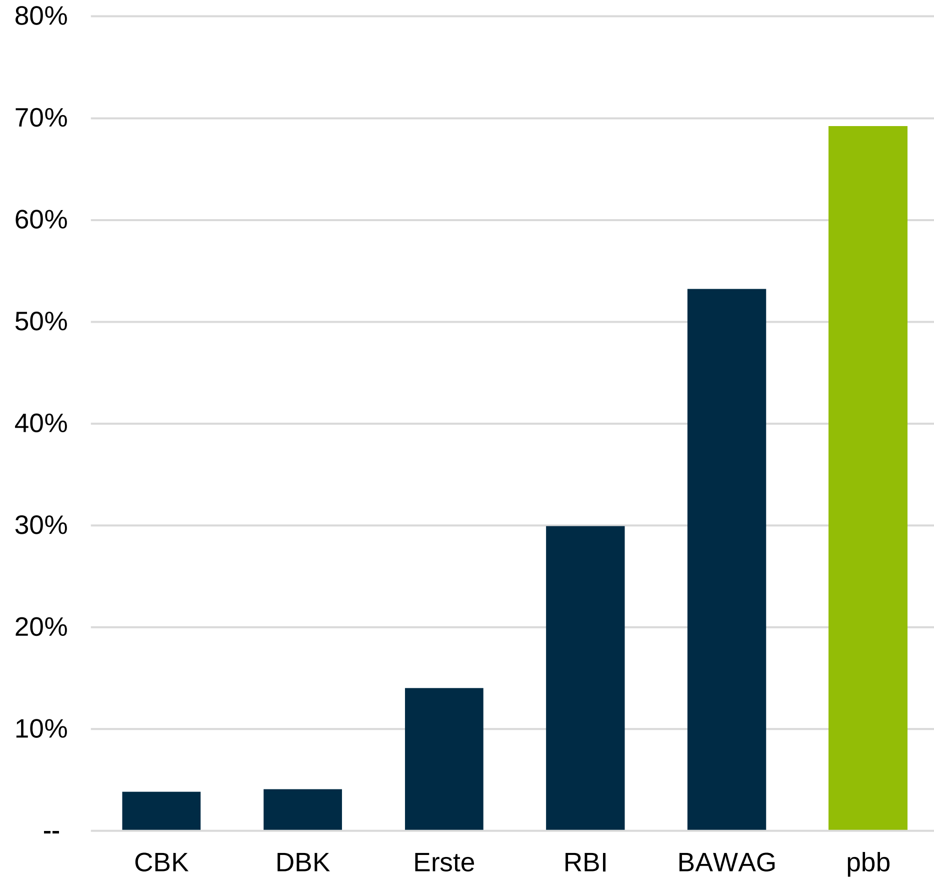
Delta in number of FTEs (2022 vs. 2017)(1)

(% change 2022 vs. 2017)



Delta in IT cost (2022 vs. 2017)(2)

(% change 2022 vs. 2017)



Notes: (1) BAWAG, CBK, DBK, RBI, Erste and pbb refers to year-end FTE. Aareal refers to avg. FTE employed (Aareal Group ex. Aareon); (2) Refers to IT expenses plus software (in-house developed and purchased) amortisation. No comparable data available for Aareal.

Source: Company filings, Petrus Advisers analysis

Productivity at pbb has been on the decline vs. substantial improvements at German/Austrian listed banks

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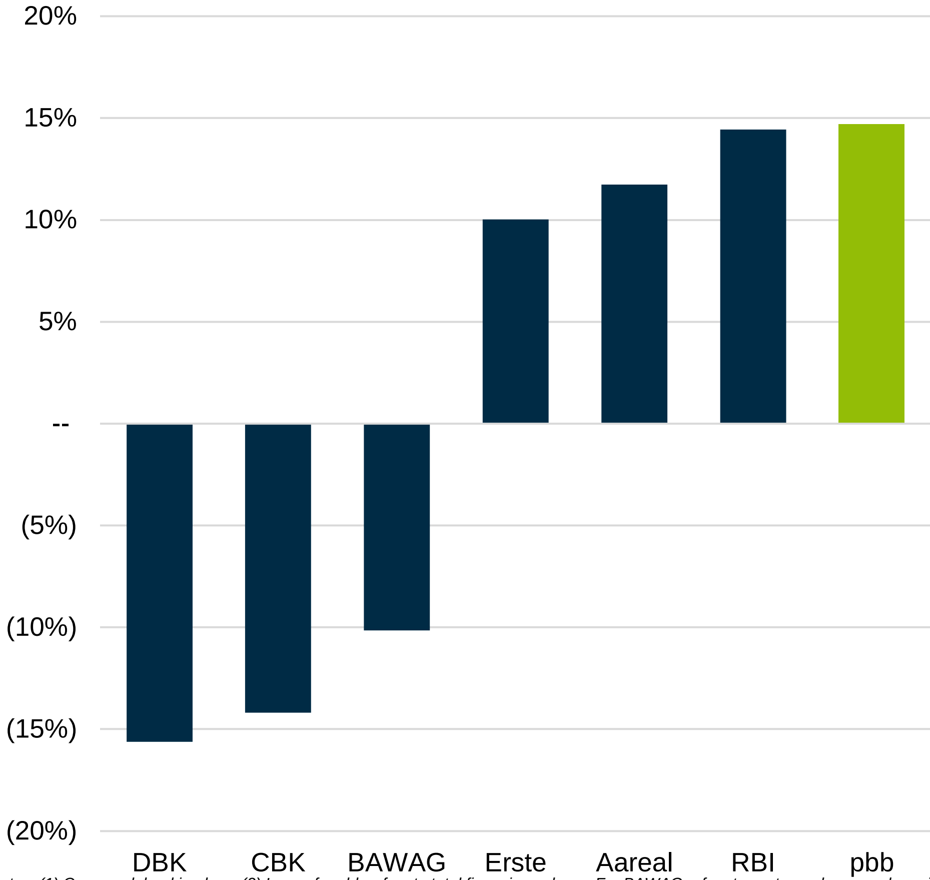
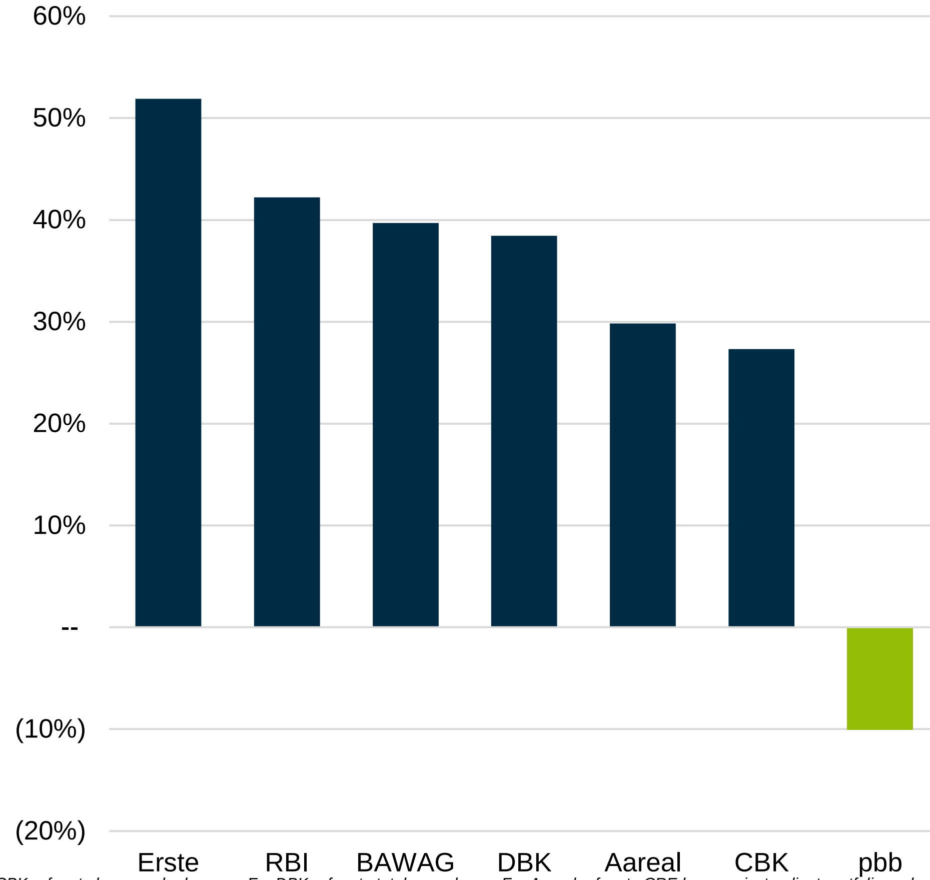
Delta in total opex (2022 vs. 2017)(1)

(% change 2022 vs. 2017)



Change in productivity: Loan volume/FTE (2022 vs. 2017)(2)

(Loans/FTE 2022 vs. Loans/FTE 2017)



Notes: (1) Opex excl. banking levy; (2) Loans for pbb refers to total financing volume. For BAWAG refers to customer loans and receivables. For CBK refers to loans and advances. For DBK refers to total gross loans. For Aareal refers to CRE loans, private client portfolio and public sector loans. For RBI and Erste refers to loans and advances to customers. The result of this analysis also holds when defining efficiency as total assets/FTE.

Source: Company filings, Petrus Advisers analysis

Setting the bar too low: pbb has consistently guided for increasing cost-income-ratios

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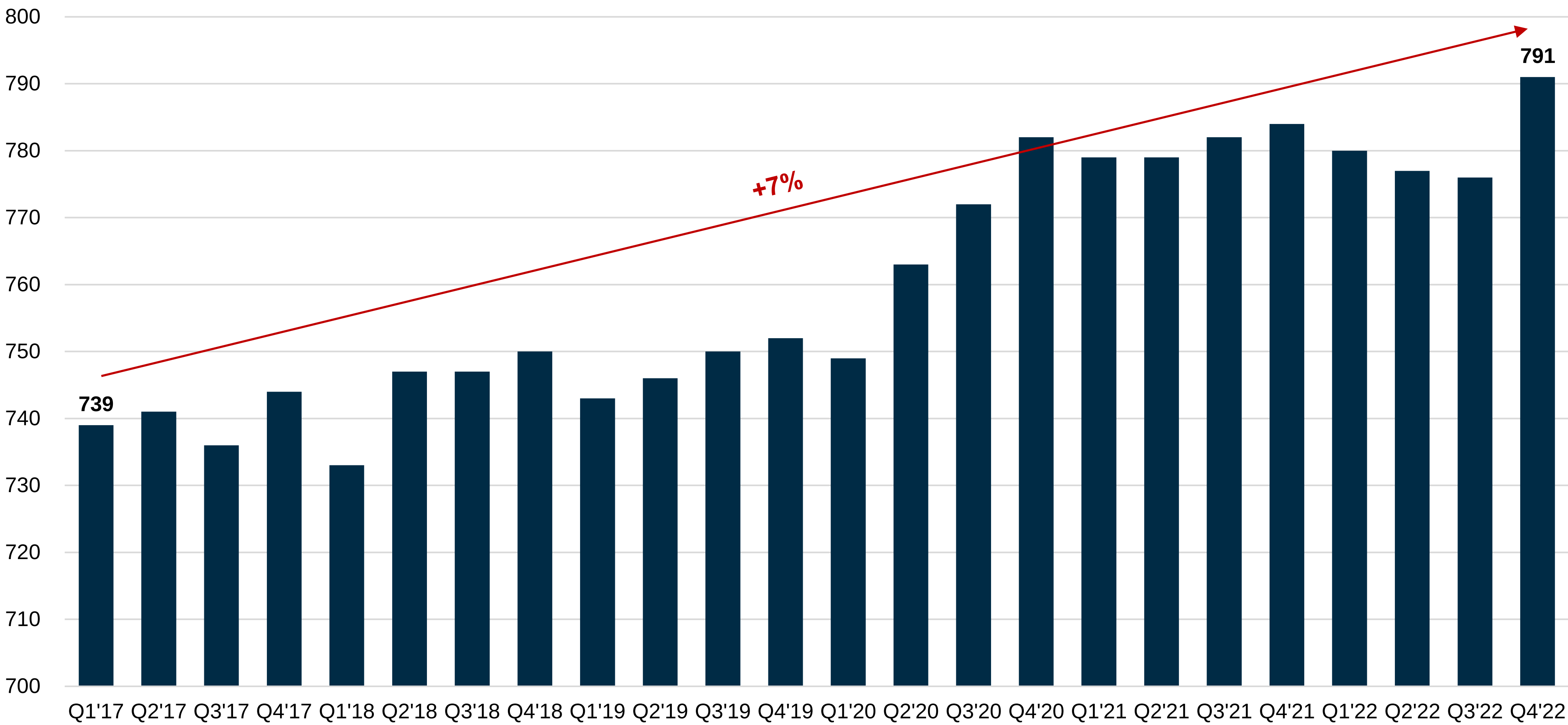
Next year's "target"	
Year	**Cost-income-ratio**
2016	"pbb is targeting the cost/income ratio to **stabilise** in 2016 **at** the previous year's level of **51.8%**"
2017	"**Significantly higher** than in 2016 [from 39%], as this year was favoured by non-recurring income related to Heta"
2018	"Slight **increase** [from 50.9%]"
2019	"Slight **increase** [from 44.2%]"
2020	"Slight **increase** [from 43.5%]"
2021	"Slight **increase** [from 42.2%]"
2022	**45%-47%** [from 40.4%]
2023	**50%-55%** [from 46%]

Source: Company filings

pbb FTE analysis

FTE base has been consistently growing over the last five years

Number of FTE over time



Source: Company filings

BAWAG and HCOB have demonstrated that efficiency increases drive returns – FTE reduction seems inevitable for pbb

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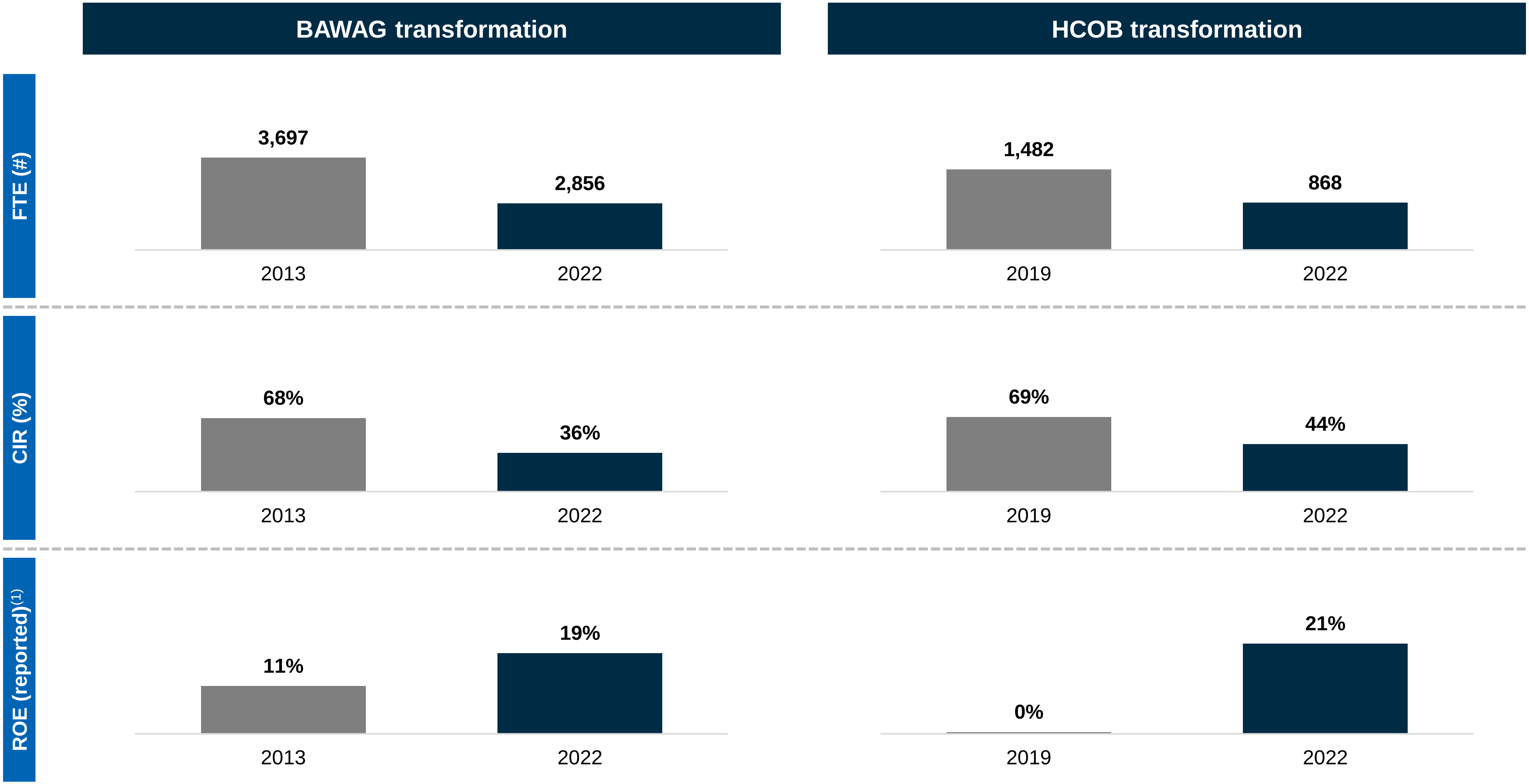
Through their restructurings, BAWAG and Hamburg Commercial Bank (HCOB) managed to lower their cost-income-ratios by 25-30%pts – staff streamlining has been a major contributor



Notes: (1) For BAWAG refers to RoTE. 2022 RoTE excludes write-off of City of Linz receivable. For HCOB refers to RoE after taxes based on a 13%-ratio of invested CET1 capital as reported.

Source: Company filings

While BAWAG, CBK and HCOB have focused on efficiency over the last five years, pbb has increased spending and staff count

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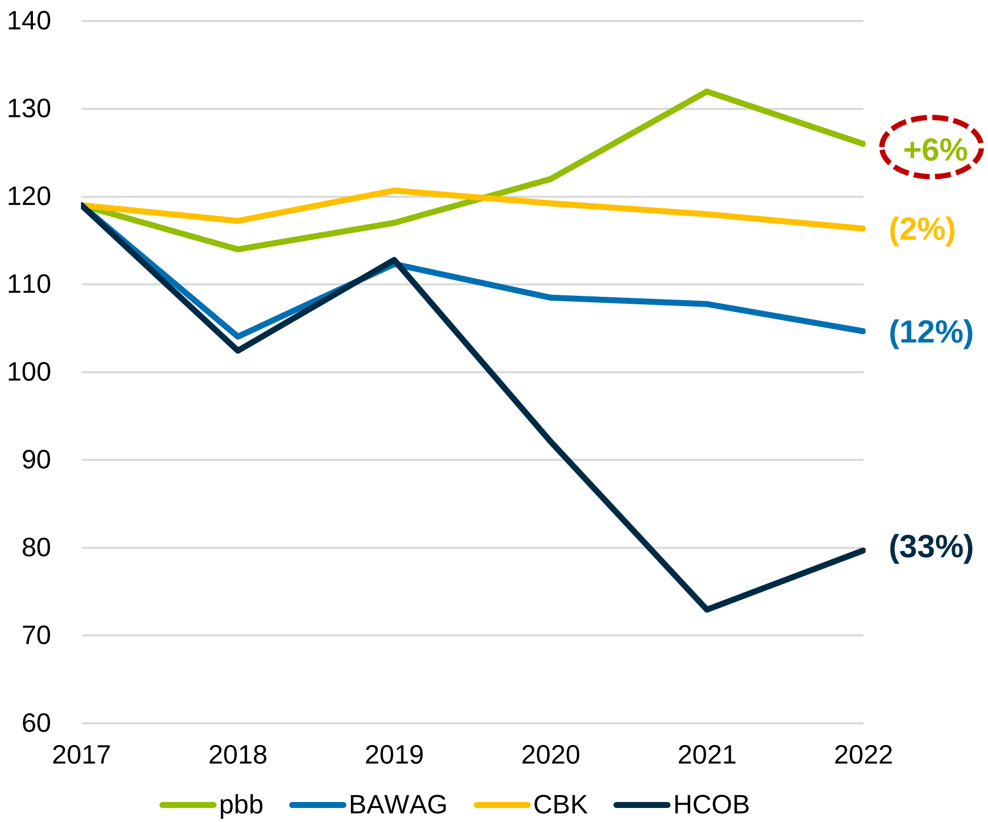
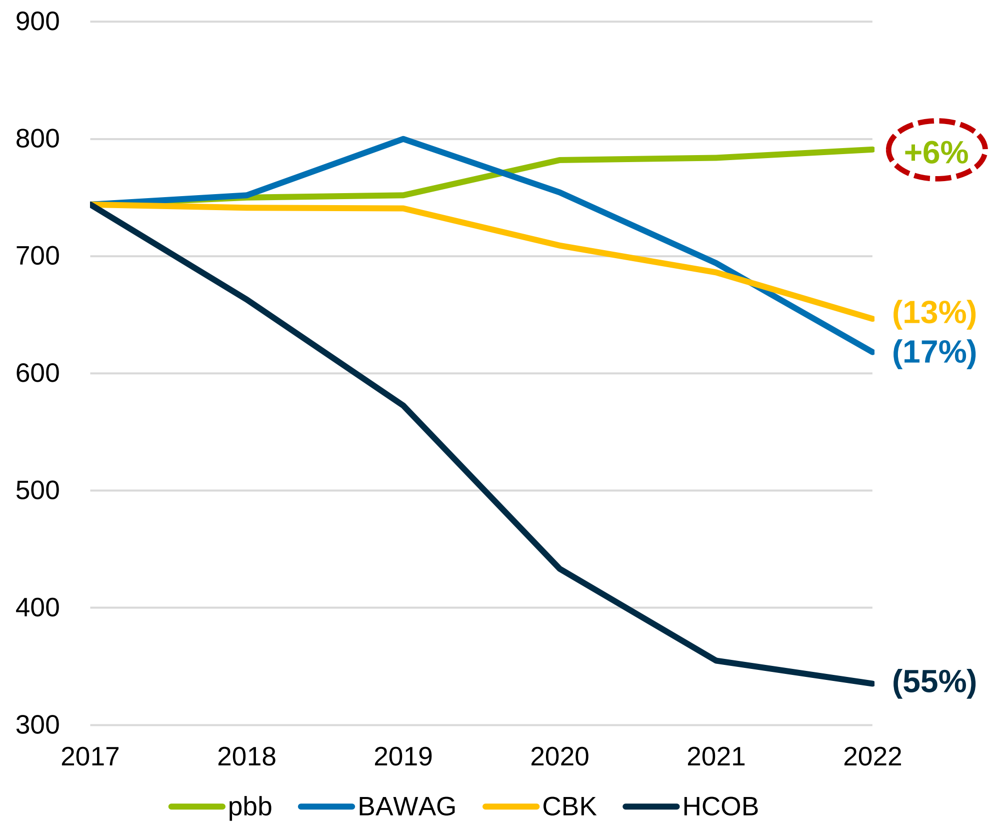
Staff cost

Staff cost (EURm, indexed to pbb cost base)



FTE

FTE (#, indexed to pbb)



Source: Company filings

pbb still relying on consultants to do the work

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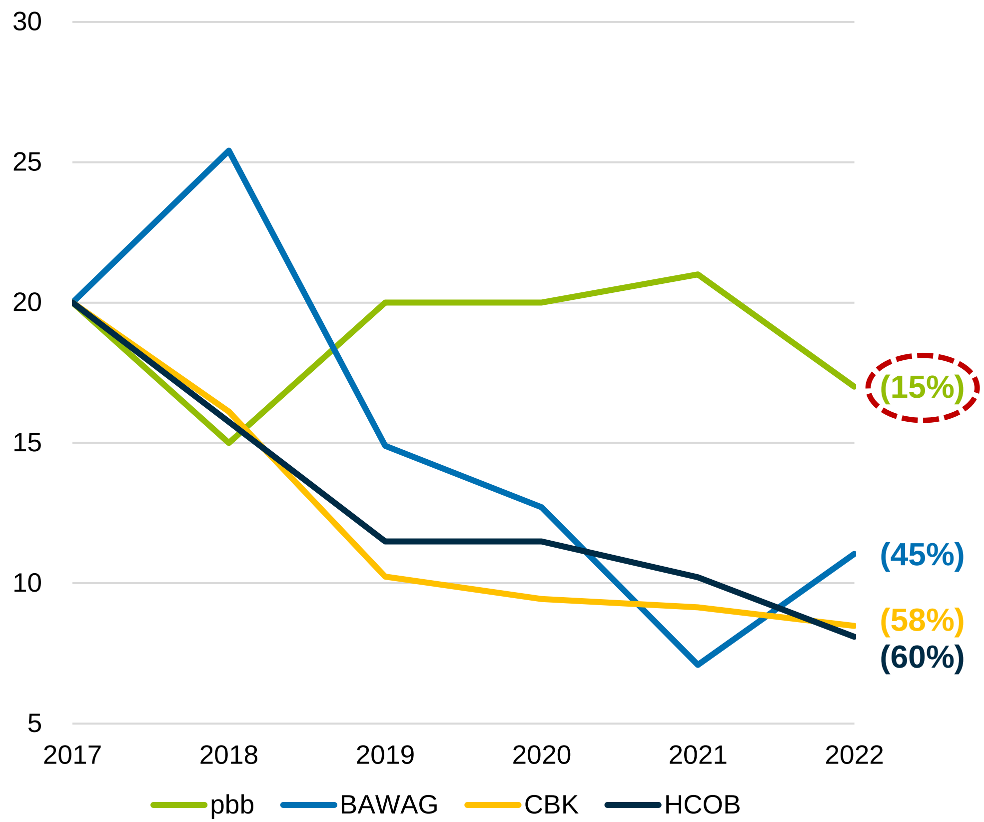
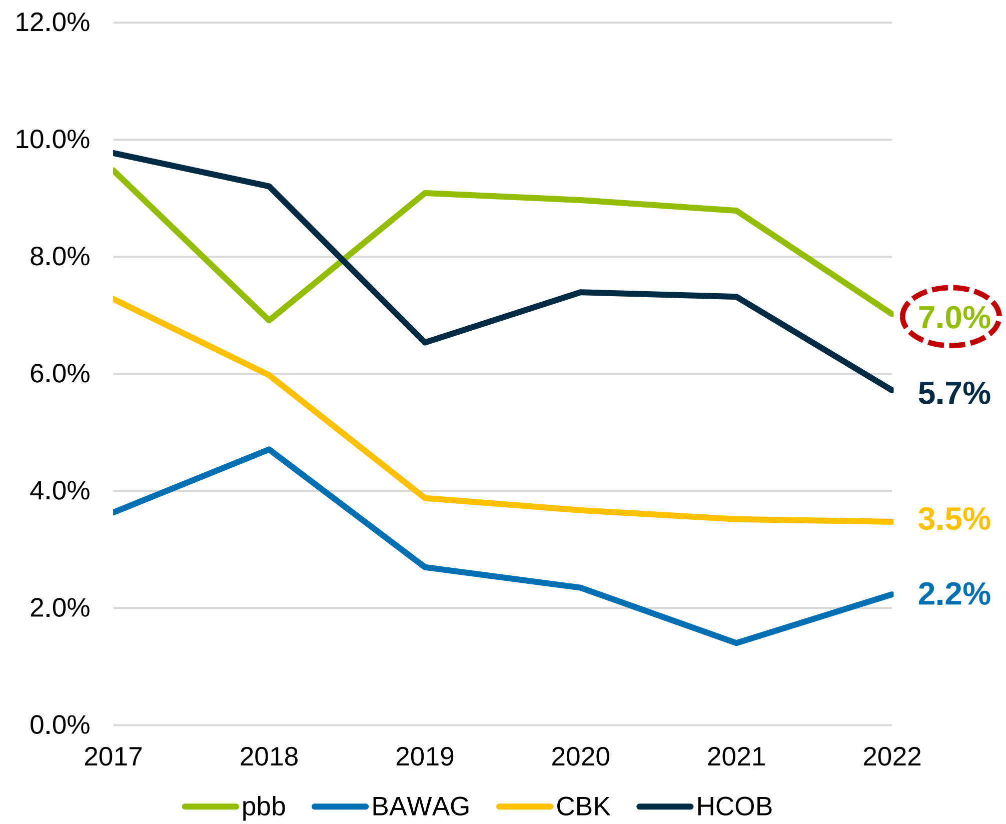
pbb's consulting costs have averaged ~€20m p.a. – BAWAG, CBK and HCOB have reduced spending by ~50%

Consulting cost[(1)]

Consulting cost (EURm, indexed to pbb cost base)



Consulting cost % of total opex



Notes: (1) pbb refers to "Consulting expenses", BAWAG refers to "Legal, consulting, outsourcing", CBK refers to "Advisory, audit and other expenses required to comply with company law", HCOB refers to "Costs for external services and project work".
Source: Company filings

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IV UK and US: Questionable markets for pbb

UK has lost relevance in pbb's strategy

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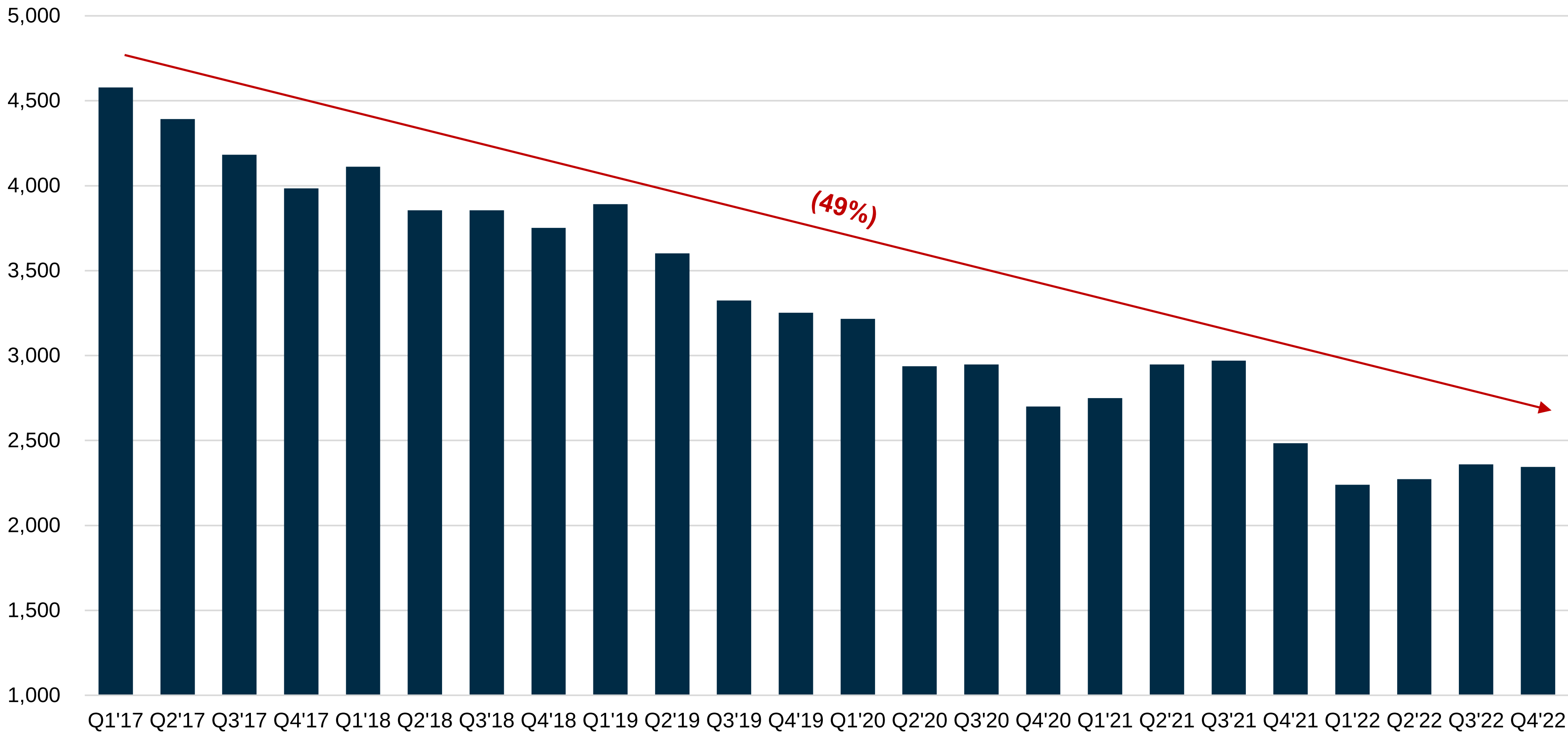
UK loan book has halved since 2017 and new UK business has only made up 7% of total in 2023

UK REF loans outstanding (EURm)[1]



Notes: (1) pbb reports country breakdowns for exposure at default (EaD). We have applied that percentage to REF financing volume. Chart looks very similar for EaD.

Source: Company filings

High UK NPLs question ability of pbb management to operate in that market

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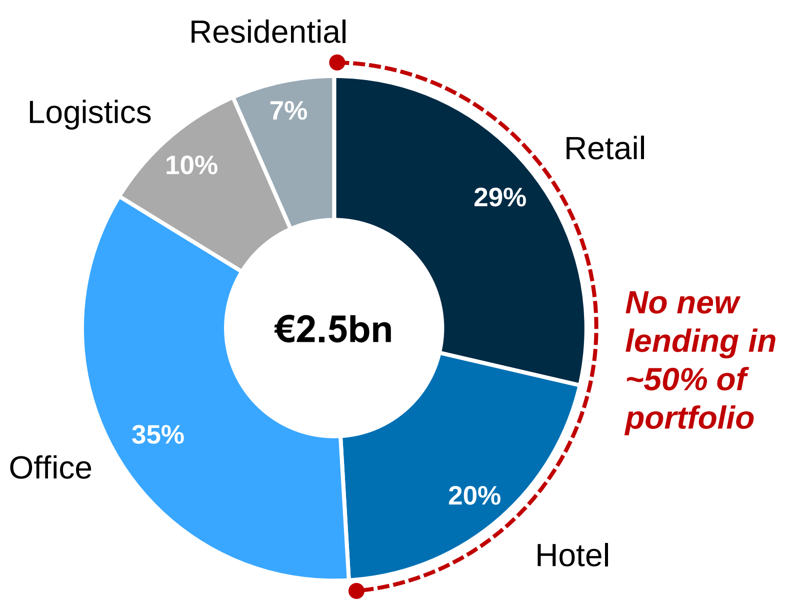
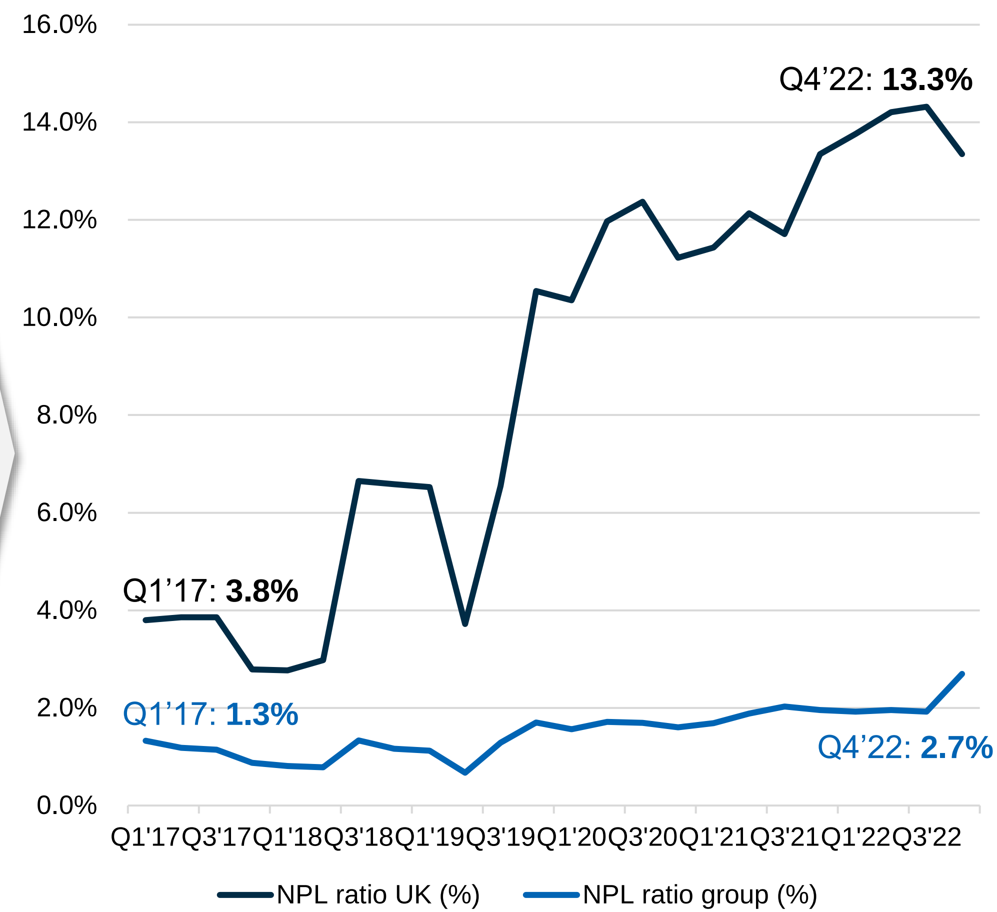
UK NPL ratio has skyrocketed to >13% in Q4'22

Exposure at default by sector (UK), Q3'22(1)



NPL ratio (% of EaD)(2)



Notes: (1) pbb has changed its reporting and does not report exposure breakdowns by sector and geography anymore since Q4'22; (2) Calculated as UK NPL balance divided by UK REF exposure.
Source: Company filings, Petrus Advisers analysis

pbb seems to be a late entrant into the US with focus on the difficult New York office segment – the NPL ratio is worrying

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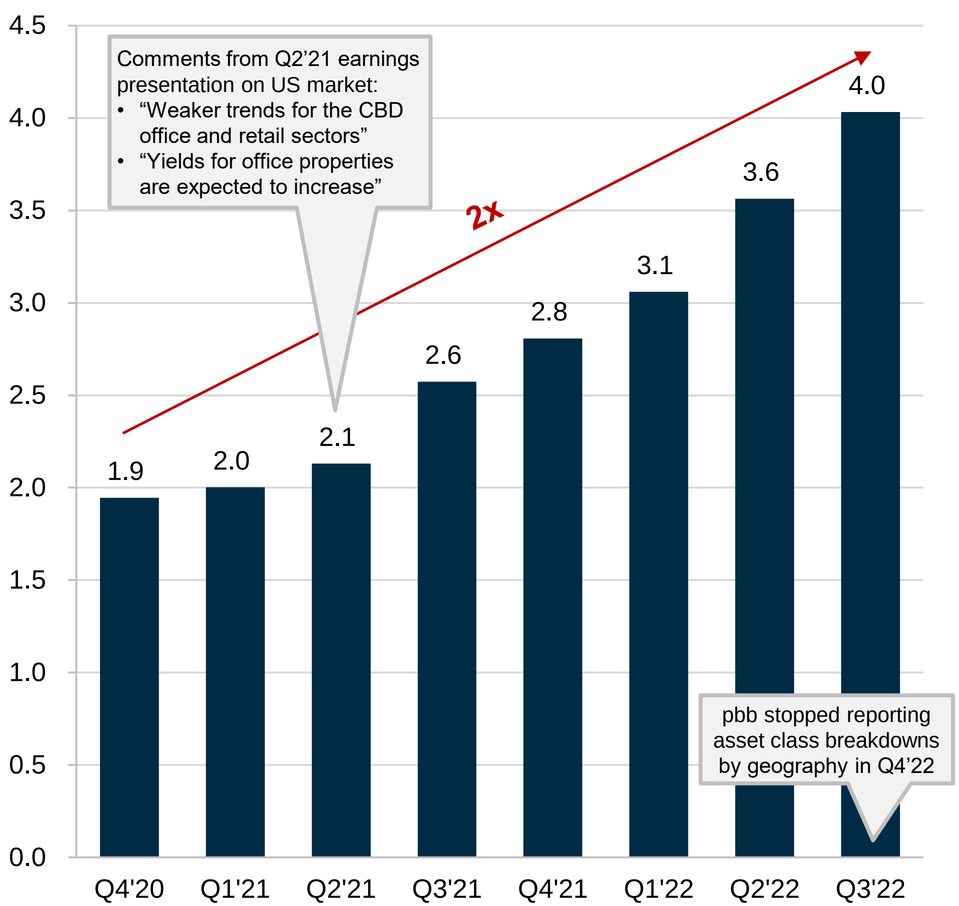
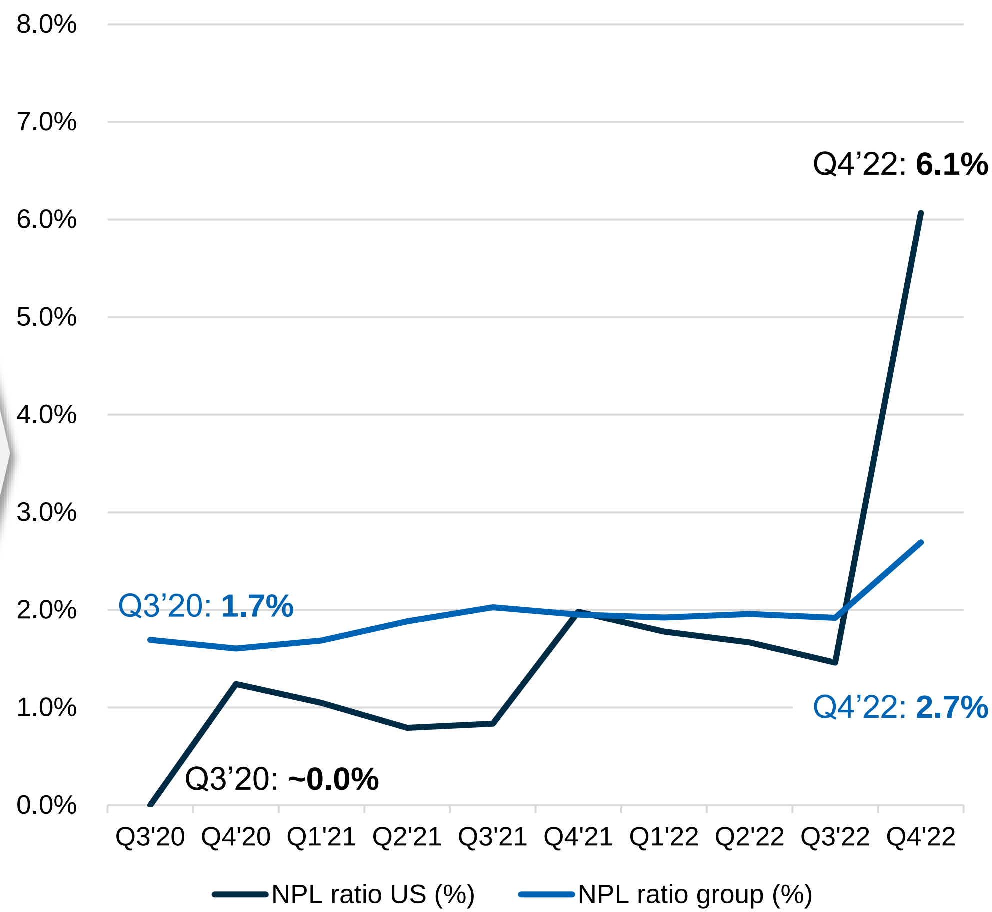
Despite signalling a weaker US market as far back as Q2'21 earnings release, pbb has doubled its US office exposure in the last 18 months

US office (exposure at default, EURbn)



NPL ratio (% of EaD)[1]



Notes: (1) Reported NPL balance divided by REF exposure at default. For US, reporting of actual numbers only began in Q4'22. For NPL ratios before that, we made estimates based on the NPL breakdown charts that do not include data labels for the US portion prior to Q4'22.
Source: Company filings, Petrus Advisers analysis

Office locations

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While the two largest German offices are in moderate locations, the UK and US offices seem rather lavish

pbb office overview

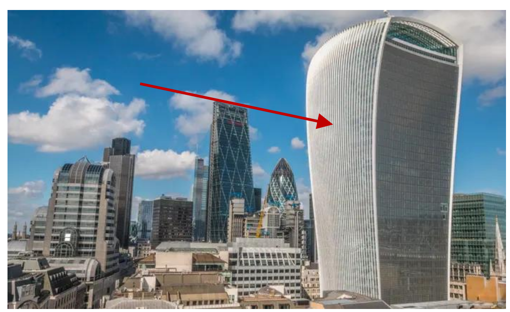
City	Location
Garching	Parkring 28
London	**20 Fenchurch St., 23rd floor**
Eschborn	Ludwig-Erhard-Straße 14
Paris	11, Rue Saint Georges
Madrid	Monte Esquinza nº 30, 4º derecha
Stockholm	Mäster Samuelsgatan 42
New York	**330 Madison Avenue, 30th floor**
Berlin	Leipziger Platz 9
Düsseldorf	Benrather Straße 12
Hamburg	Schauenburgerstraße 10

Garching

Eschborn

New York

London



Source: Company website

Poor investment judgment combined with lack of cost discipline challenge profitability of pbb's UK business

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Outside-in cost-income ratio estimate at ~65% for the London office

Before cost of risk (CoR): We estimate CoR has fully wiped out UK profitability

High-level office economics		
Estimated office space (SQF)	7,200	*Based on 48 FTE[1] and 150 sq. ft. average office space per FTE (JLL report)*
Assumed monthly rent per SQF (£)	75	*Based on CoStar data (lower end of 20 Fenchurch St.)*
Implied annual rent (£m)	6.5	
Estimated wages (£m)	7.6	*Based on individual estimates[1]*
Estimated other staff cost (£m)	1.8	*Same proportion as Group (incl. social security, pension and other personnel)*
Estimated IT, compliance, audit (£m)	4.0	*Allocation of Group IT + consulting expenses (€72m) proportionate to FTE base*
Total cost London office (£m)	**19.9**	
Total cost London office (€m)	**22.6**	
Estimated NII (€m)	31.6	*Based on Q4 UK loans outstanding and NIM per REF segment*
Estimated other income (€m)	3.5	*~10% of total income from non-NII line*
Total income (€m)	**35.2**	
Implied CIR	**64%**	*Before any allocation of HQ cost (e.g. treasury, risk-management and other middle/back-office functions)*

Notes: (1) We have identified more than 40 employees currently working in pbb's London office via LinkedIn. Out of those, 10 have the title "Managing Director" and 13 "Director". We have estimated wages for all employees identified based on seniority and title.
Source: Company filings, LinkedIn as per 17-Feb-2023, Factset per 14-Apr-2023, CoStar, JLL, Petrus Advisers analysis

V

CAPVERIANT: A debacle that should have been ended long ago

CAPVERIANT: No strategic overlap whatsoever

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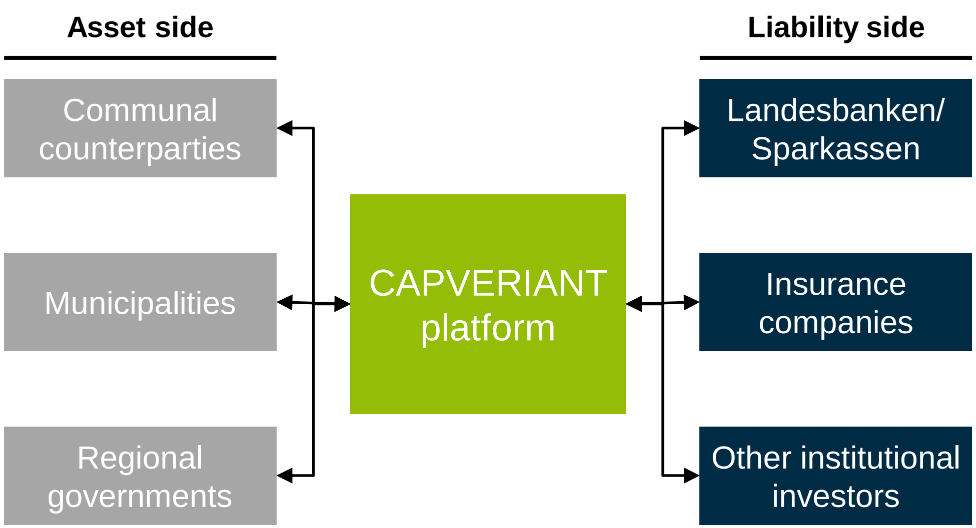
In 2017, pbb founded a digital marketplace to connect public sector entities with institutional investors – delivery so far has been underwhelming

Illustrative business model



Business overview

- Founded in 2017 by pbb (https://www.capveriant.com/)
- Digital platform connecting public entities to financial institutions to facilitate loan origination
- 21 employees total (15 Munich + 6 France)
- Ownership: 71.43% pbb, 28.57% by CDC (French government held)
  - pbb sold stake in 2021 (price not disclosed)
- Business activities:
  - Onboarding services for asset side
  - They post their requirements (loan type, interest payment, maturity, etc.)
  - Investors can then provide a quote based on uploads
  - Loan agreements stored on the platform or usage of own contract
  - Administration of loan documentation
  - Settlement of the transaction

Source: Company filings, earnings call transcripts, CAPVERIANT website

CAPVERIANT: Decade-long cash burn

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pbb's CEO has continuously overpromised on CAPVERIANT performance since 2018; based on the latest business plan, the company will only break even in 2025 with further need for cash injections until then

Statements on CAPVERIANT

Q1 2018 earnings call, Andreas Arndt:

"*Ultimately, what I think where the **money will come from in two, three years' time** is a platform which has a secondary market function, which has a shoeshine trading function and things like that*"
"*It is a business where we have every intension to invest going forward this year and next year in order to see it flying*"

Q4 2019 earnings call, Andreas Arndt:

"[CAPVERIANT] *is up and running well. […] We see significantly, substantially increased financing requests and client onboardings and we are looking forward to further good and well development – good development in 2020*"

Q4 2020 earnings call, Andreas Arndt:

"*We probably **will not breakeven with the whole exercise before the end of 2021, 2023, so around 2024**. That's the time which we will still have to build in for making this venture profitable*"

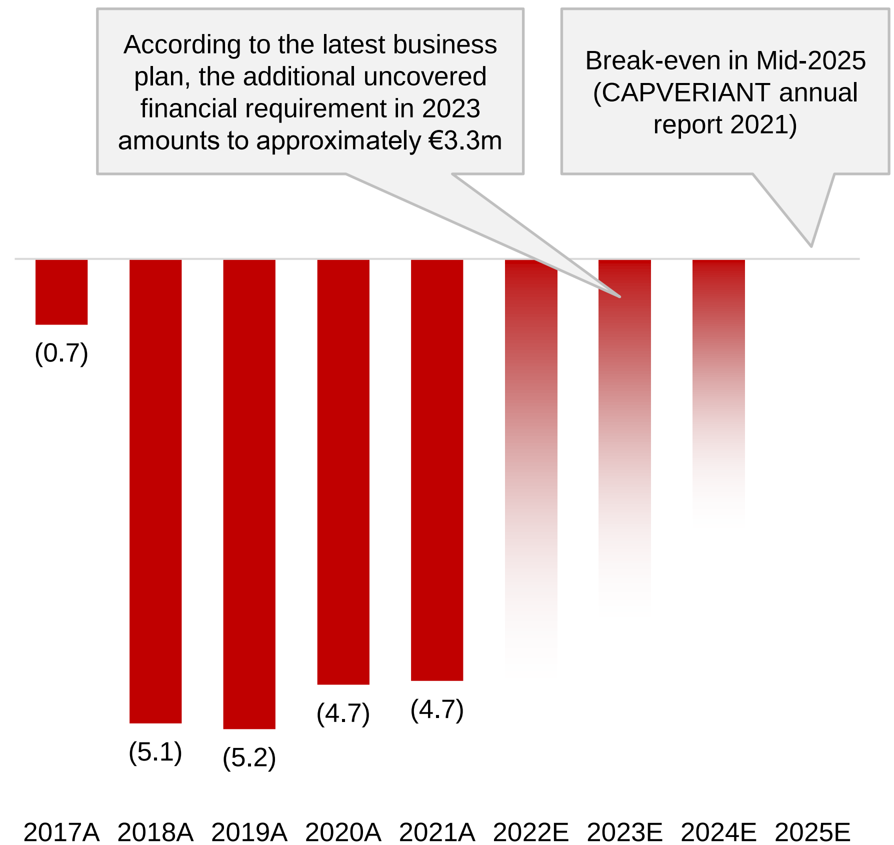
2021 CAPVERIANT **annual report**:

"*According to the company's current multi-year plan, which was approved by the Supervisory Board on 29 November 2021, the so-called **"break-even" should be reached in mid-2025**. Until then, CAPVERIANT will remain dependent on the support of its shareholders to finance its ongoing business activities*"

Q4 2022 earnings call, Andreas Arndt:

"[CAPVERIANT is] *in terms of actual transactions, transactions closed, **still behind the expectations***"

CAPVERIANT net income (€m)



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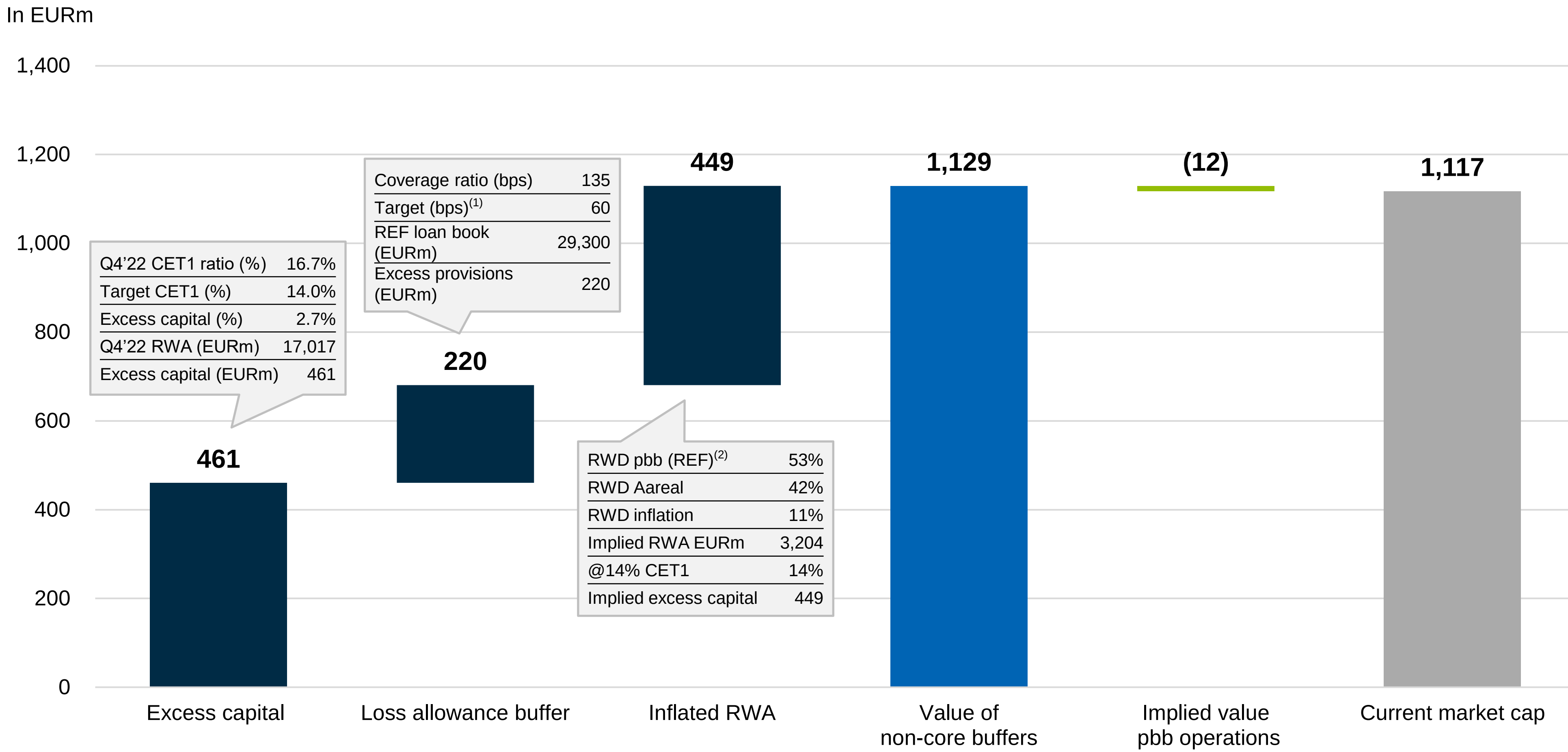
VI Not buying back stock destroys value

pbb's buffers now exceed its market cap

pbb could return its entire market capitalisation to shareholders

Sum of pbb's "conservative" buffers vs. current market cap



Notes: (1) Refer to page 19/62 Q4'22 presentation. 40-80bps REF coverage target. We have chosen the mid-point; (2) RWD = risk weight density (i.e. risk weighted assets / total CRE loans). pbb's RWD is extremely conservative after transitioning to Basel VI significantly ahead of the required timeline. Comparing metrics like LTV, LGD, PD, etc., we assume pbb's RWA could be managed more effectively. Aareal's RWD should be a good benchmark.

Source: Company filings, Factset as of 14-Apr-2023

“We are a dividend stock” argument makes no sense as investors are better off buying the AT1

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AT1 has delivered a higher yield at significantly lower volatility than pbb shares

Comparison of AT1 yield and dividend yield of pbb shares (since AT1 inception)

Source: Factset as of 14-Apr-2023, Bloomberg as of 14-Apr-2023

Total return of the AT1 has been better than pbb shares

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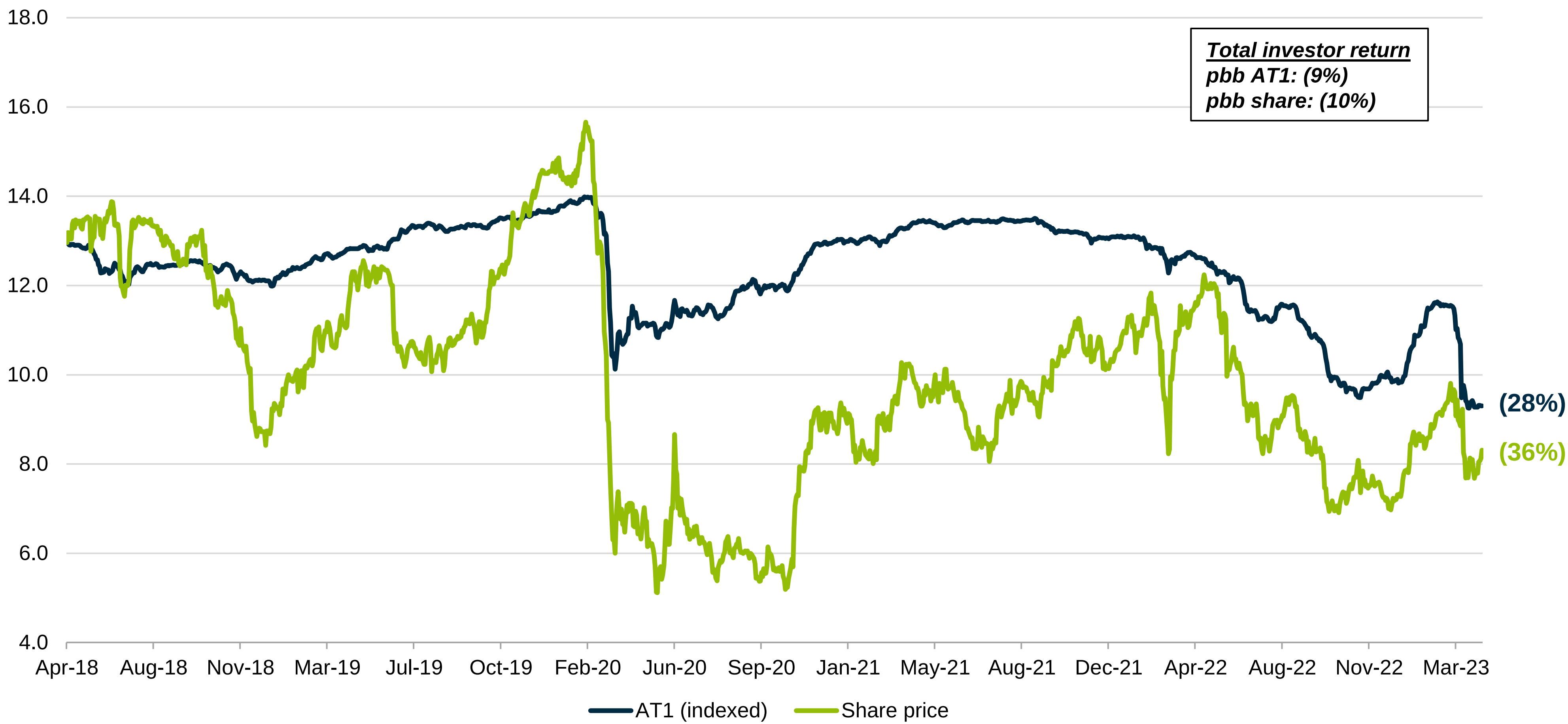
Share price/AT1 price performance (since AT1 inception, indexed to pbb share price in EUR)



Source: Factset as of 14-Apr-2023, Bloomberg as of 14-Apr-2023

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