

Andreas Arndt (CEO, Chief Financial Officer), Dr Günther Bräunig (Chairman of the Supervisory Board)
Deutsche Pfandbriefbank („pbb“)
Parkring 28
85748 Garching

London, 16 April 2023

Dear Mr Arndt, dear Mr Bräunig,

The last five weeks have once again proven that your business model – which you claim is “conservative” – is in fact perceived as volatile by the capital market. In the period between our first letter to you and your first ever “strategic outlook” presentation, the pbb share price has outperformed European banks¹ by more than 10%. However, since you presented your “strategic outlook”, your share price has underperformed significantly, and short interest has increased. We on the other hand have increased our Petrus Advisers stake in pbb to 3.2%.

We appreciate your first attempts to react to our criticism of your leadership at pbb. Unfortunately, your new 9% mid-term RoCET1 target presented on 9 March 2023 is another half-hearted compromise.

First, you disguise the true number of ca. 8% RoE² (to be calculated on the book value of your equity) by using an off-market definition based³ only on CET1 capital⁴. *Second*, you keep bragging about your ‘high’ dividend yield when this yield is solely based on your meagre EUR 1.1 billion market cap, which represents no more than 0.36x book value. At the same time, you state that you require your full book equity of EUR 3.1 billion to run the business⁵. *Third*, your plans to increase profitability rely primarily on lower cost of risk of only 10-15 bps, which implies buffer releases. We do not believe this is a prudent and sustainable plan and it stands in contrast to your leadership style which you market as “conservative”. You keep refraining from committing to intelligent self-help measures such as in particular cost discipline and capital efficiency.

Our demand for a fundamental strategic review has not been met and the following areas remain of continued particular concern:

Cost

You are the only listed German bank that has managed to become less productive over the past years. You have increased both staff cost and FTE numbers and consistently guided for increasing cost-income ratios. Operating expenditure has increased by close to 15% over the past five years, while productivity (indicated by loans/FTE) has dropped by 10%. Your mid-term plan assumes a further increase in cost. Successful transformations at your peers show: pbb needs an absolute cost reduction target.

UK & US Business

pbb seems to be yet another German bank destroying capital after a late entry into markets you do not understand (see financial crisis). Your UK business has an unacceptably high cost base, while the credit portfolio has reached a shockingly high non-performing loans (NPL) ratio of 13.3%⁶ and has been shrinking. In the US,

¹ Refers to EURO STOXX Banks.

² Return on Equity, defined as after-tax net income divided by average shareholders’ equity.

³ 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. The 9% RoCET1 target thus actually means only ca. 8% RoE (return on shareholders’ equity).

⁴ Common Equity Tier 1.

⁵ <https://www.bloomberg.com/news/articles/2023-03-23/pfandbriefbank-chef-kontert-hedgefonds-bei-kapitalabschopfung>.

⁶ Calculated as UK NPL balance divided by UK REF exposure.

you are in the process of growing in what seems a difficult market for office buildings in New York, very much in contrast to the marketing of your leadership style as “conservative”. Your NPL-ratio in the US has recently swollen to 6.1%⁷. We urge the Supervisory Board to analyse these destructive mistakes carefully and to consider bonus clawbacks from the involved managers.

CAPVERIANT

You founded CAPVERIANT in 2017 and you have consistently burnt money and destroyed value with this new business venture over the last five years. We calculate cumulative losses north of EUR 20 million with a targeted break-even in 2025 at the earliest. We expect you to explain to shareholders how this will be fixed, sold entirely, or shut down.

Capital Efficiency

At your current valuation of 0.36x book value and your implied ‘high’ dividend yield of 11.4%⁸, you can buy back stock significantly below your refinancing costs while achieving a highly attractive return on investment of ca. 22% per year⁹ – so long as you believe in your own mid-term targets. You should finance such buy-backs by ending any new business in the US and the UK, while reducing the existing loan books in those markets.

Since the IPO of pbb in 2015, you have not generated any real value for shareholders¹⁰ and your dividend yield on shareholders’ equity has been an underwhelming 3.4%¹¹. The bank needs entrepreneurial decision-making rather than lame excuses and value destructive loan book growth.

We urge you to stop window-dressing and finally start working to create a sustainable future for pbb. Otherwise, pbb will become yet another consolidation victim of poor management in the German banking market.

Sincerely,



Klaus Umek
Managing Partner



Till Hufnagel
Partner

⁷ Calculated as US NPL balance divided by US REF exposure.

⁸ Factset as per 14 April 2023. Dividend as per AGM proposal (€0.95 / share) divided by current share price.

⁹ Return on investment (RoI): 8% RoE / 0.36x (current P/BV multiple).

¹⁰ Total shareholder return and inflation (CPI) in Germany are both ca. 20%.

¹¹ Refers to 2015-2021 dividends divided by shareholders’ equity per respective AGM/EGM date.