The background of the slide is a photograph of a grand, multi-story building with classical architectural features, including arched windows, ornate balconies, and a prominent brick corner with a decorative golden scrollwork element. The image is split vertically, with the left side being a faded, blue-tinted version of the same scene.

# Aareal Q1 2021 Earnings – Cost Analysis

May 2021

# Executive Summary

- We welcome Aareal's announcement regarding planned improvements to be achieved by 2023 and first steps taken
  - Reduction of the Management Board size by merging the redundant roles of Chief Risk Officer and Chief Lending Officer<sup>(1)</sup>
  - Announcing a planned reduction of Managing Directors by 15%<sup>(2)</sup> with now specified cost impact communicated
  - Simplification of the IT platform with unspecified cost impact<sup>(2)</sup>
  - Further unspecified improvement measures<sup>(2)</sup>
  - A partial re-development of the headquarter property in Wiesbaden into residential flats targeting a capital gain of €10m<sup>(2)</sup>
- We remain sceptical that Aareal's leadership is committed to go after the full cost potential
  - Transparency around cost savings targets is very limited
  - Aareal has a history of manipulating financial KPIs by excluding parts of the business and/or using intercompany pricing – for instance, the communicated < 40% CIR for SPF excludes the Banking & Digital Solutions segment, which Aareal uses to fund about 1/3 of the SPF business
- Aareal's Q1 2021 results have again highlighted how significant the cost opportunity is
  - A comparison with pbb's cost base points to a ~€20m gap in operating costs on a quarterly basis or c. €80m per year
  - Aareal Bank's<sup>(4)</sup> reported SG&A expenses (excl. bank levies and similar duties) of €76m vs. pbb's SG&A expenses of €56m; a gap of ~€20m on a quarterly basis for businesses with the same size commercial real estate lending book<sup>(3)</sup>
  - The true 2023 CIR target for Aareal Bank excl. Aareon is 44%, which compares to pbb's 2020 CIR of 42% and 38% in Q1 2021<sup>(5)</sup>

**We remain convinced substantial cost improvement potential exists at Aareal Bank<sup>(4)</sup>. Management's 2023 targets appear conservative compared to key peer pbb**

**We therefore demand that a new CEO be hired with the relevant experience and full commitment to go after the tremendous cost improvement potential at Aareal**

Sources: Company filings

(1) Per Aareal's press release of 17 May 2021.

(2) See Aareal Q1 2021 Analyst Call presentation of 11 May 2021, page 56.

(3) Per 31 March 2021, Aareal had assets of Euro 27.6 billion in its CRE lending portfolio (on total assets of Euro 46.5 billion) vs. Euro 27.6 billion at pbb (on total assets of Euro 58.1 billion).

(4) Defined as Aareal Bank AG excluding Aareon AG.

(5) We recommend not to rely on quarterly CIR numbers. Aareal Bank's Q1 2021 CIR was 56%.

# Aareal Bank's<sup>(1)</sup> Efficiency Substantially Lagging Behind pbb

## Cost/Income Ratio of Aareal Bank<sup>(1)</sup> ~18%pt higher than pbb in Q1 2021

All in EURm	Q1'21A Side-by-Side			
	pbb	ARL Bank	Delta	Delta (%)
<b>Net interest income</b>	123	138	15	12%
Net fee and commission income	2	6	4	200%
Net income from fair value measurement	2	(1)	(3)	(150%)
Net income from realisations <sup>1</sup>	21	0	(21)	n.m.
Net income from hedge accounting	(1)	(3)	(2)	200%
<b>Operating Income</b>	<b>147</b>	<b>140</b>	<b>(7)</b>	<b>(5%)</b>
LLPs / Cost of risk	(10)	(7)	3	(30%)
<b>Opex (incl. D&amp;A) <sup>2</sup></b>	<b>(56)</b>	<b>(76)</b>	<b>(20)</b>	<b>36%</b>
Bank levies and similar dues	(28)	(24)	4	(14%)
<b>Net other operating income / expenses <sup>3</sup></b>	<b>(1)</b>	<b>(5)</b>	<b>(4)</b>	<b>400%</b>
<b>Pre-tax profit</b>	<b>52</b>	<b>28</b>	<b>(24)</b>	<b>(46%)</b>

CIR (pbb Group, ARL definition)<sup>3</sup>

38%

CIR (Aareal Bank ex Aareon)<sup>3</sup>

56%

CIR (SPF)<sup>4</sup> <sup>4</sup>

52%

Target ('23) of  
<40% CIR for SPF

- 1 pbb mainly benefitted from some higher individually driven pre-payments fees (no run-rate figure) while Aareal Bank's<sup>(1)</sup> figure was impacted by de-risking measures (related to Italian bonds)
- 2 Aareal Bank's<sup>(1)</sup> Opex also includes a €3m impact from phantom shares driven by share price increase – €20m gap vs. pbb's cost base
- 3 Aareal Bank's<sup>(1)</sup> figure includes lower income from its own hotel operations due to Covid-19, while pbb does not operate meaningful own real estate assets
- 4 Aareal's disclosed < 40% CIR target includes the "Structured Property Finance" segment only and does not take into account "Banking & Digital Solutions" – understating the true CIR of Aareal Bank (ex. Aareon)<sup>(1)</sup>

Source: Company filings

1) Defined as Aareal Group excluding Aareon AG.

2) Includes pbb's "net other operating income", reported as part of "operating income". For like-for-like comparison with Aareal, this line item has been moved below the top-line, matching Aareal's disclosure.

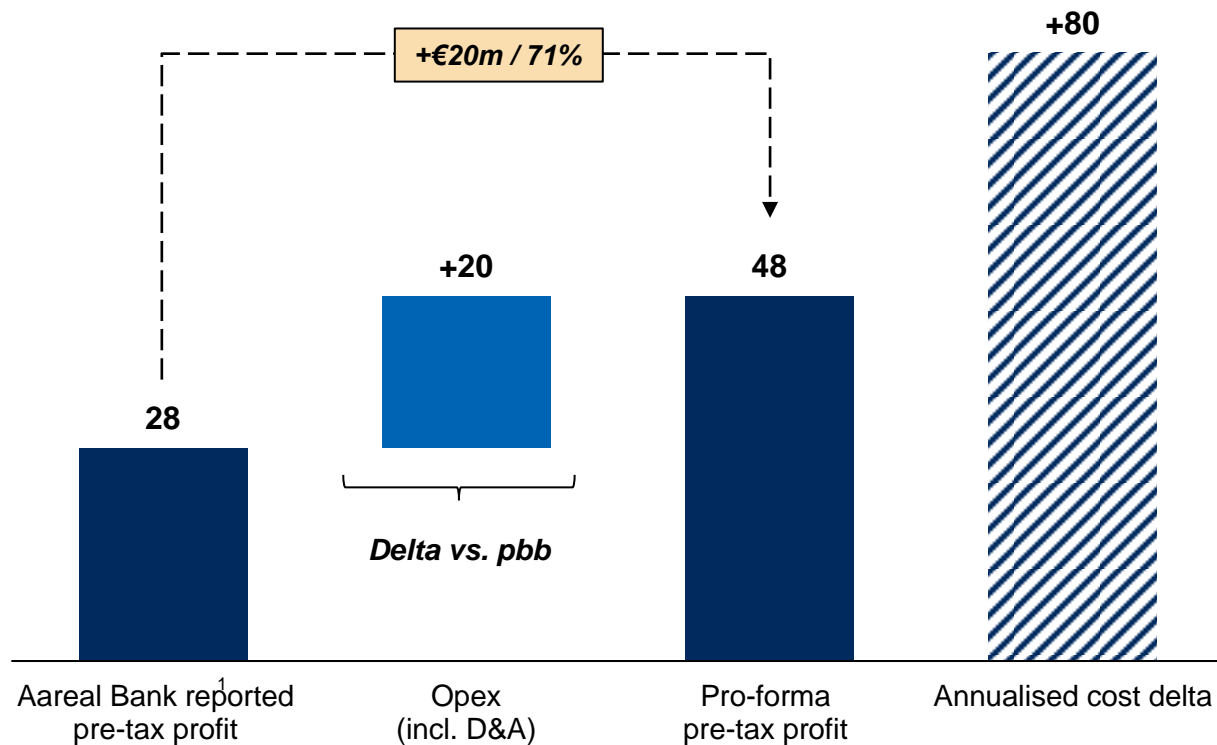
3) Defined as (Opex incl. D&A) / (operating income + net other operating income / expenses).

4) As disclosed by Aareal for the SPF segment.

# ~€80m Cost Savings p.a. by Reaching pbb's Efficiency

Significant cost saving potential for Aareal Bank<sup>(1)</sup> in comparison to its direct peer pbb

Q1 2021A Revenue Fall-Through Bridge – Aareal Bank<sup>(1)</sup> vs. pbb (€m)



- In Q1 2021, despite higher net interest income and fee income than pbb's by €19m, Aareal Bank<sup>(1)</sup> fell behind pbb's by €24m on pre-tax profit
- Significantly higher administrative costs were the main drivers – €20m gap on a quarterly basis
- Assuming Aareal Bank<sup>(1)</sup> managed to reach pbb's cost base (should not be unrealistic given similar size of loan books and balance sheet), it could increase its pre-tax profit by almost ~€80m p.a.

# Comparison With pbb Over Time Also Confirms a Significant Cost Gap

- A higher-risk business and cost inefficiencies resulted in inferior conversion from income to profit vs. pbb
- The gap between Aareal Bank<sup>(1)</sup> and pbb's Cost/Income Ratio has also widened recently

All in EURm	FY'19A Side-by-Side				FY'20A Side-by-Side			
	pbb	ARL Bank	Delta	Delta (%)	pbb	ARL Bank	Delta	Delta (%)
<b>Net interest income</b>	<b>458</b>	<b>534</b>	<b>76</b>	<b>17%</b>	<b>479</b>	<b>513</b>	<b>34</b>	<b>7%</b>
Net fee and commission income	6	21	15	250%	6	21	15	250%
Net income from fair value measurement	(7)	1	8	n.m.	(8)	(32)	(24)	300%
Net income from realisations	48	64	16	n.m.	26	28	2	n.m.
Net income from hedge accounting <sup>2</sup>	(2)	(3)	(1)	50%	4	8	4	100%
<b>Operating Income</b>	<b>503</b>	<b>617</b>	<b>114</b>	<b>23%</b>	<b>507</b>	<b>538</b>	<b>31</b>	<b>6%</b>
LLPs / Cost of risk	(49)	(90)	(41)	84%	(126)	(344)	(218)	173%
<b>Opex (incl. D&amp;A)</b>	<b>(220)</b>	<b>(294)</b>	<b>(74)</b>	<b>34%</b>	<b>(223)</b>	<b>(263)</b>	<b>(40)</b>	<b>18%</b>
Bank levies and similar dues	(24)	(21)	3	(13%)	(26)	(18)	8	(31%)
<b>Net other operating income / expenses<sup>3</sup></b>	<b>3</b>	<b>(1)</b>	<b>(4)</b>	<b>n.m.</b>	<b>22</b>	<b>(15)</b>	<b>(37)</b>	<b>n.m.</b>
<b>Pre-tax profit</b>	<b>213<sup>5</sup></b>	<b>211</b>	<b>(2)</b>	<b>(1%)</b>	<b>154</b>	<b>(102)</b>	<b>(256)</b>	<b>n.m.</b>

CIR (pbb Group, ARL definition)<sup>4</sup>

43%

42%

CIR (Aareal Bank ex Aareon)<sup>4</sup>

48%

50%

2020 opex also include a €2m relief in provisions for phantom shares due to a lower share price vs. a €10m charge for phantom shares in 2019

Source: Company filings

Notes: 1) Defined as Aareal Group excluding Aareon AG; 2) Includes "net gain or loss from investments accounted for using the equity method"; 3) Includes pbb's "net other operating income", reported as part of "operating income". For like-for-like comparison with Aareal, this line item has been moved below the top-line, matching Aareal's disclosure; 4) Defined as (Opex incl. D&A) / (operating income + net other operating income / expenses); 5) Excludes €3m income from restructuring.



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