



# Considerations on Aareal

*Greed is never good. It destroys  
banks*

November 2020

- I. Executive Summary
- II. Aareal Historical Performance in Context
- III. Compensation Excess in Detail
- IV. Putting the Compensation Bonanza in Context

I

## Executive Summary

# Executive Summary

- Aareal Bank AG (**Aareal**) is a boutique lender to the commercial real estate industry with total assets (2019) of Euro 43 billion and a current market capitalization of Euro 1,134 million<sup>(1)</sup>
- Aareal Bank<sup>(2)</sup> has not been able to find answers to the challenging market environment of low interest rates and increasing regulatory pressures
  - Earnings have consequently been dropping since 2015 as cost measures have not been able to offset lower revenues from its core lending business
  - Underlying assets have also dropped by some 3.7% per year since 2015
  - General provisions taken in 2020 will lead to only barely positive or even negative net income this year
- Aareal has a tradition of overpaying its staff – especially top management and the supervisory board
  - Between 2015 and 2019 period, the management board has taken home Euro 12 to 19 million per year
  - The supervisory board makes c. Euro 1.5 million per year
  - Over the past five years, the two boards have cost nearly Euro 80 million or c. 7% of the current market capitalization<sup>(3)</sup>
- Compensation targets appear to have been adjusted downwards, so they are achievable even with lower profits
  - The CEO's bonus target achievement was 100% to 135% in 2015-2019 despite Aareal group net income declining in 4 of those 5 years
  - Total Shareholder Returns and compensation are out of sync
  - The high compensation levels are excessive and unethical and multiple times higher than any relevant peer in Germany or Austria
  - Compared to its size and complexity (e.g. measured by total assets) and profitability (i.e. net income), Aareal pays multiple times the compensation levels of peers (3-30x) – compared to its closest peer pbb the factor for 2019 was 4-5x
  - While no final bonus decision for 2020 has been taken yet, Aareal has made provisions assuming a target achievement of 100% for 2020

- **We demand compensation restrained and disciplined**
  - **Zero bonus for 2020 in light of worst-in-class performance and a year when shareholders received no dividend**
  - **Recovery only allowed after a sustainable post-tax RoE of 8-10% is achieved by Aareal Bank<sup>(4)</sup> (excluding release of Covid provisions)**
  - **Board must evaluate how to recover past compensation for it is obvious that reckless risk-taking has occurred**
  - **Aareal to reduce the number of members of both the management board and supervisory board**

Footnotes: (1) Per 19 November 2020; (2) Aareal Group excluding Aareon AG, herewith "**Aareal Bank**"; (3) Euro 1,134 million per 19 November 2020 as per FactSet; (4) I.e. excluding any impact from Aareon AG.

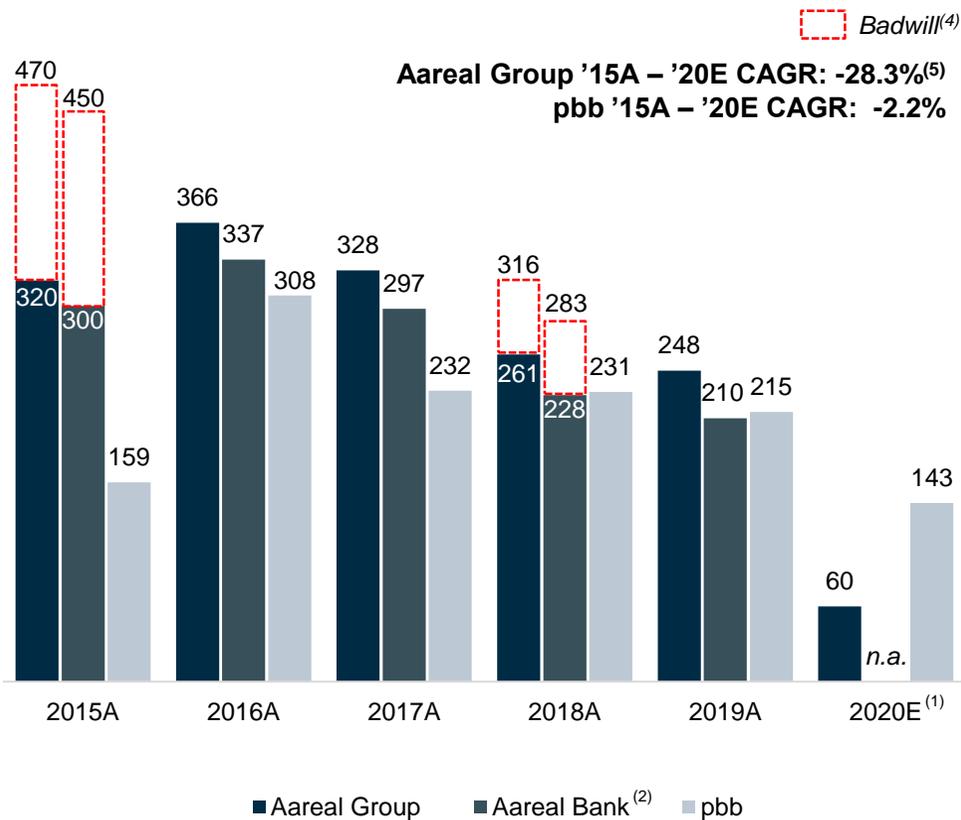


## Aareal Historical Performance in Context

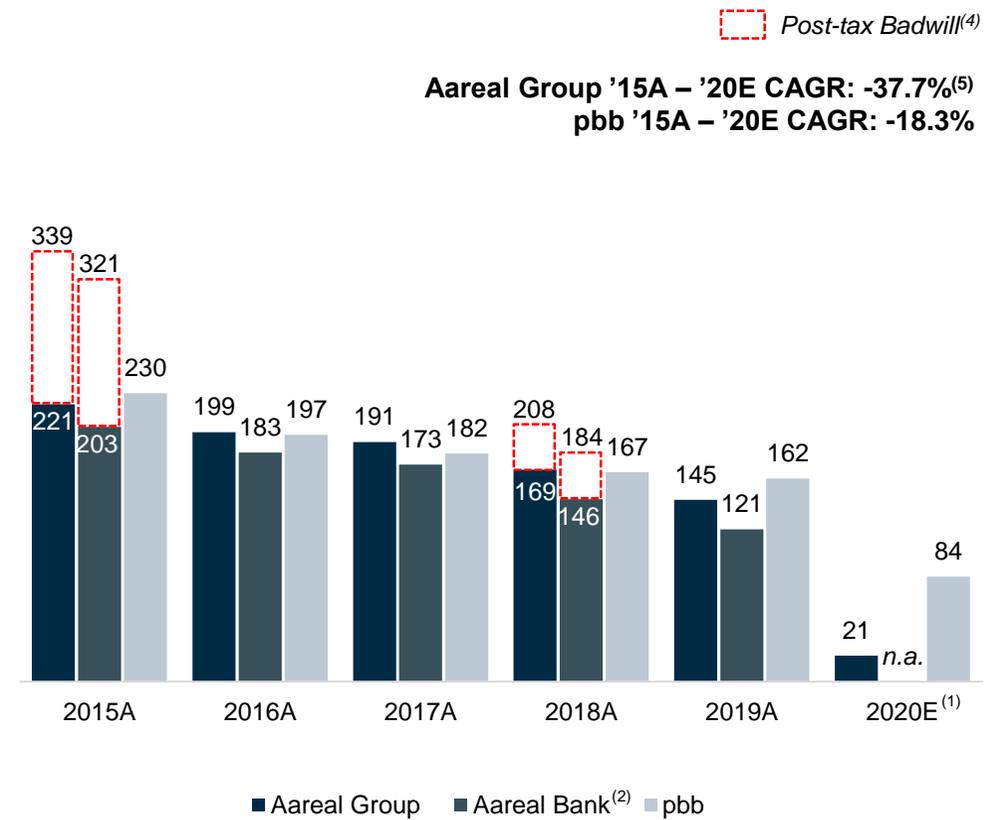
# A History of Declining Earnings

Net Income has declined at a 38% CAGR from 2015 to 2020, double the rate of pbb

Operating Profit Evolution (€m)



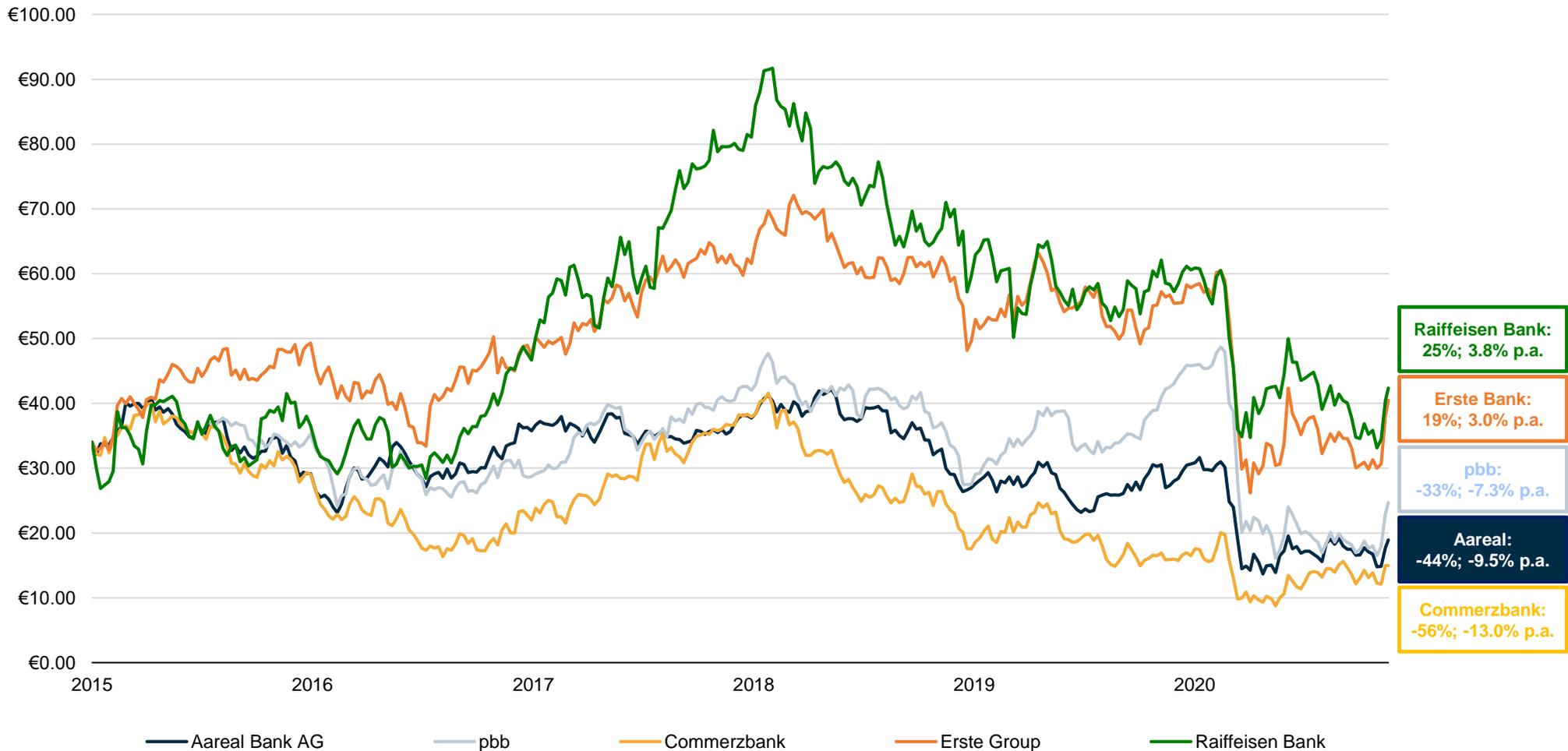
Net Income Evolution<sup>(3)</sup> (€m)



Footnotes: (1) 2020E based on FactSet consensus as of 19<sup>th</sup> Nov 2020; (2) Aareal Group excluding Aareon AG per Aareon's audited accounts, small delta driven by reconciliation of the accounts; (3) Post minorities and AT1 expense; (4) 2015A and 2018A for Aareal has been adjusted for badwill of EUR 150m and EUR 55m respectively, net income adjusted using effective tax rate of 21.5% and 29.3%; (5) Adjusted for Badwill.

# A History of a Declining Share Price

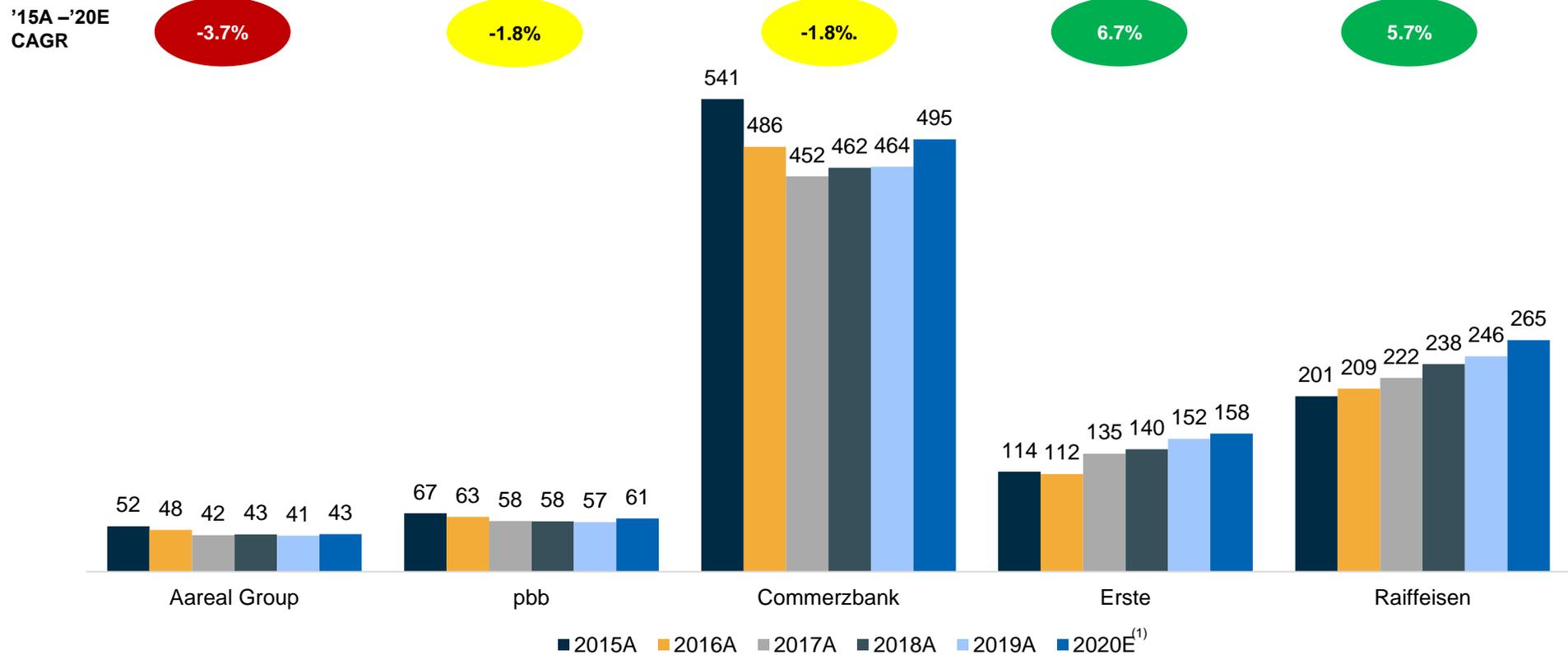
2015 – 2020 YTD Areal Share Price Performance vs. Peers (Rebased to Areal)



# A History of Managing For No Growth

- Aareal has been a niche boutique lender with a focused business model
- It has not found a way to grow and develop a viable business model

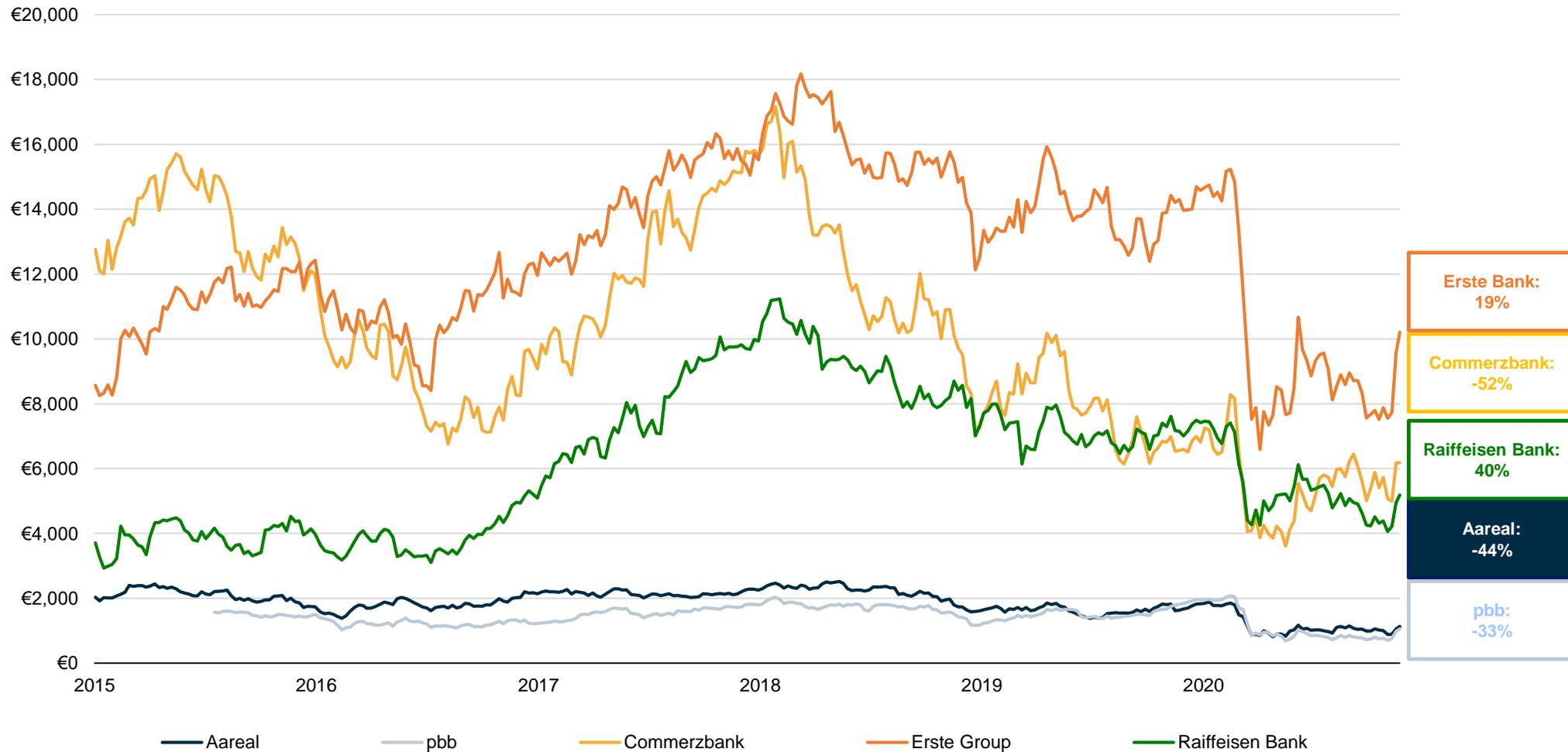
2015A – 2020E Total Assets (€bn)



(1) 2020E based on FactSet consensus as of 19<sup>th</sup> Nov 2020.  
Source: Aareal Bank annual reports; FactSet

# The Result: Value Destruction Leads to a Negligible Market Capitalisation

2015 – 2020 YTD Aareal Market Cap vs. Peers (€m)



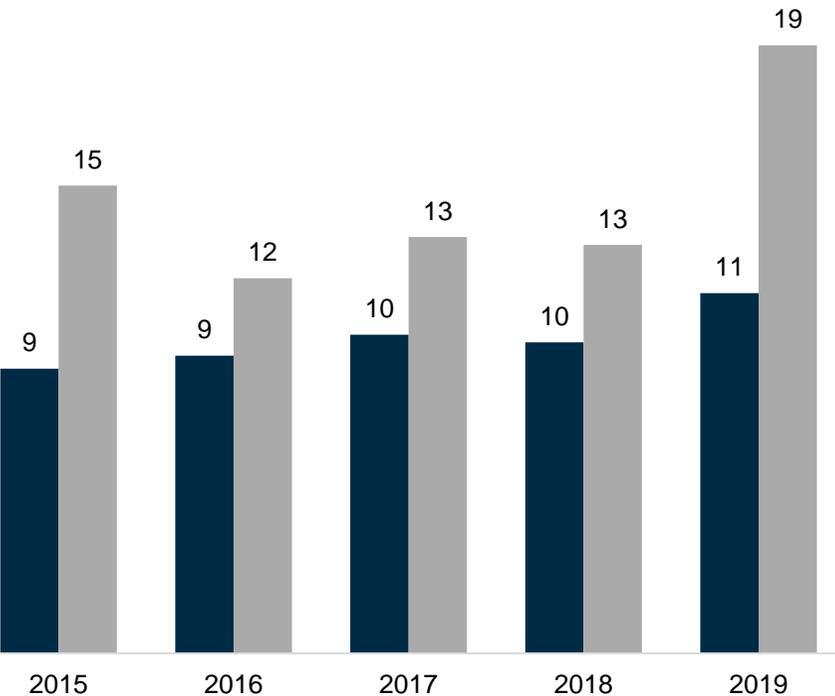


## Compensation Excess in Detail

# A Tradition of Fat Cat Banker Pay...

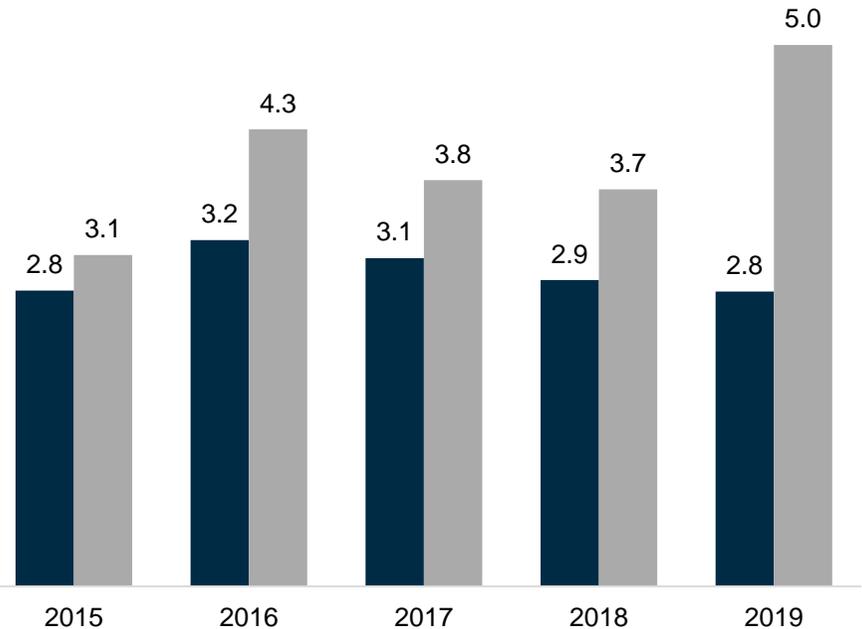
- Aareal's decaying performance has not been reflected in compensation discipline
- Management compensation has in fact continued to increase, reaching astronomic levels

2015 – 2019 Management Board Compensation (€m)



■ Management Board Compensation (Ex Benefits)  
 ■ Management Board Compensation (Incl. Benefits)

2015 – 2019 CEO Compensation (€m)

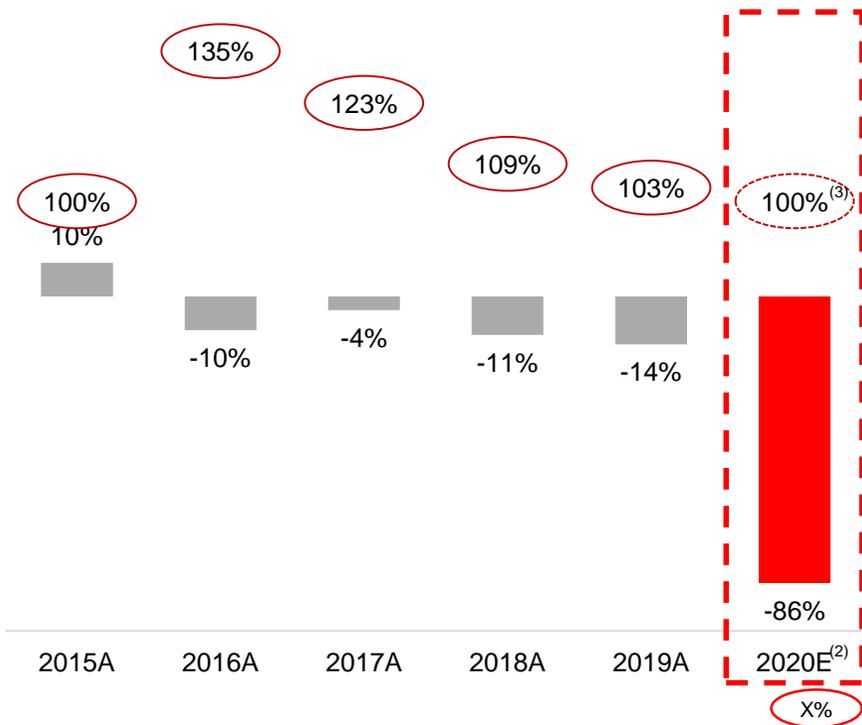


■ CEO Compensation (Ex Benefits)  
 ■ CEO Compensation (Incl. Benefits)

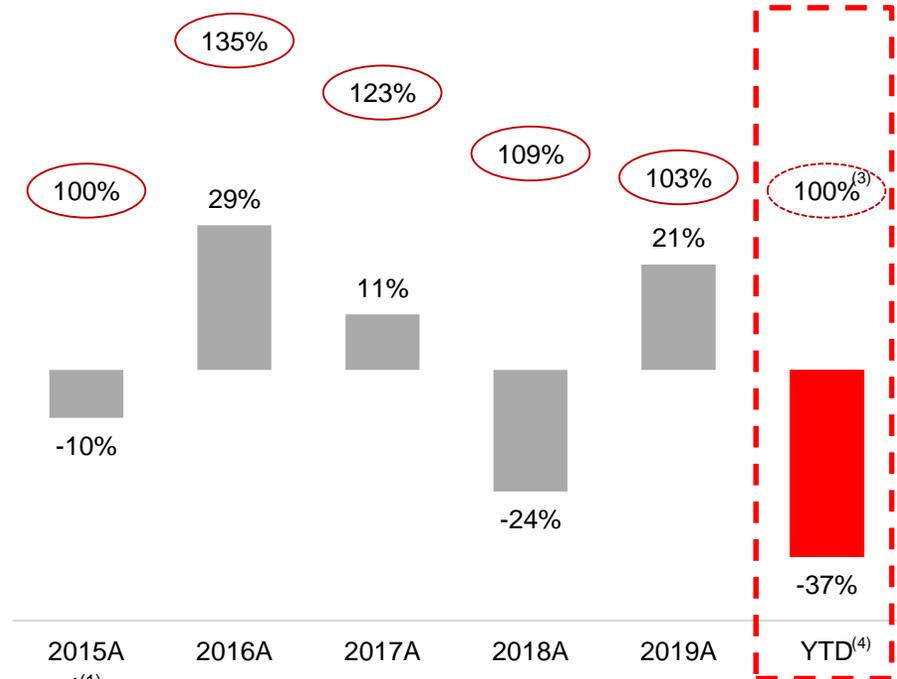
# Management's Incentives Not Aligned with Shareholder Value Creation

- The management team has profited from consistently portraying failure as success
- The CEO example below shows how profitability and targets have differed

2015A – 2020E CEO Target Achievement vs Reported Group Net Income Growth



2015A – 2020 YTD<sup>(4)</sup> CEO Target Achievement vs TSR



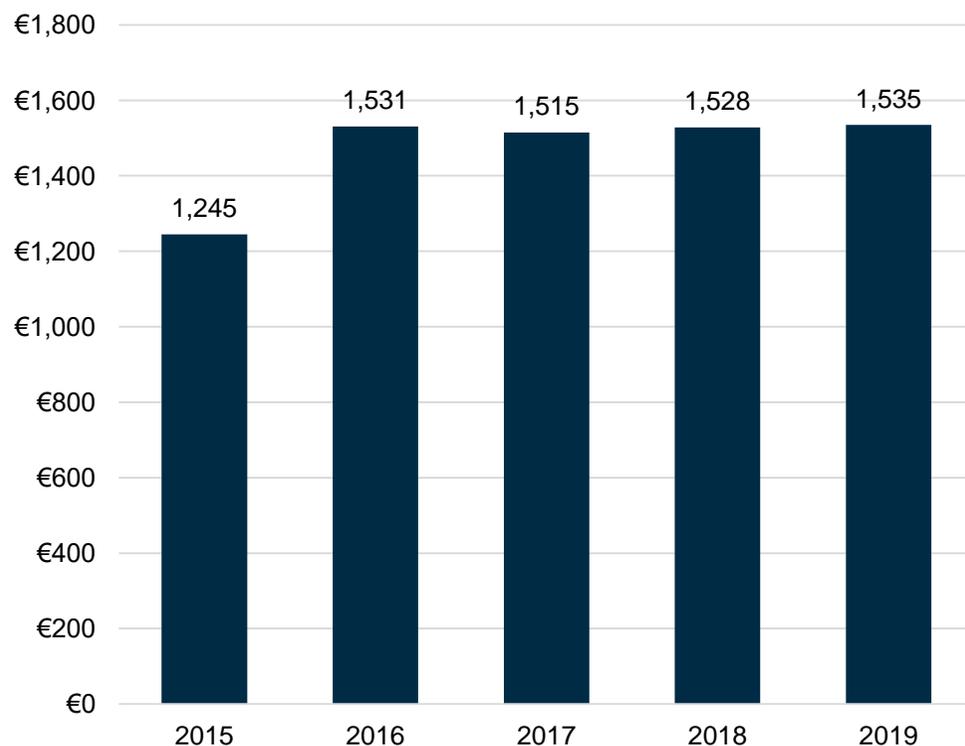
**Targets are being consistently set to be undemanding and easily achievable while they are completely detached from economic reality**

Footnotes: 1) As defined by remuneration committee:  $\frac{\text{total variable compensation}}{\text{total variable compensation at 100\% target achievement}}$ ; 2) 2020E based on Factset consensus as of 19<sup>th</sup> Nov 2020; 3) Represents 100% provision for bonification as per Q3 2020 conference call; 4) As of 19<sup>th</sup> November 2020.  
Source: Aareal Bank annual reports; FactSet

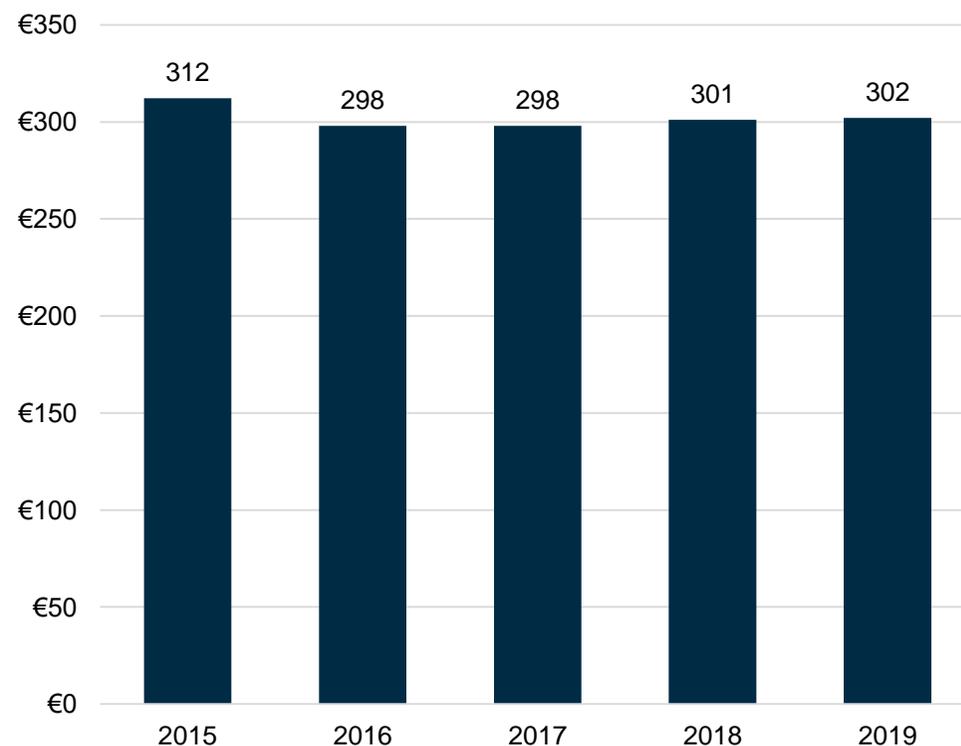
## ...with the Supervisory Board Sharing in the Feast ...

- The cost to shareholders of Aareal's supervisory board has remains excessive
- Not included below are costs for the personal assistant and office of the Chairwoman as well as at least one senior manager in charge of supporting her / the Supervisory Board

2015 – 2019 Supervisory Board Compensation (€'000)



2015 – 2019 Chairwoman Compensation (€'000)



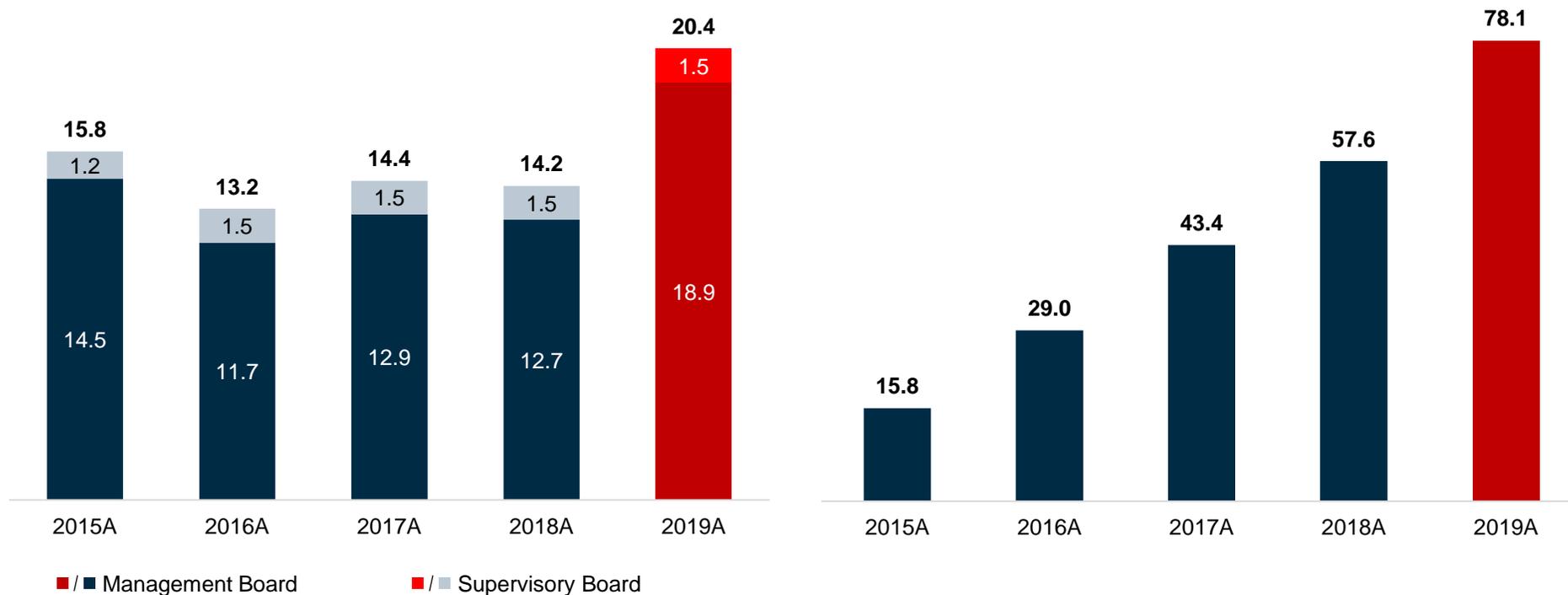
# ...Resulting in More Than €20m Pay to the Boards in 2019

Marija Korsch's leadership has allowed the two boards to rack up cumulative costs of ~€80m in 5 business years or c. 7% of the current market capitalisation<sup>(1)</sup>

2015A-2019A Management Board and Supervisory Board Total Paid Compensation (Incl. Benefits, €m)

Annual

Cumulative



(1) Euro 1,134 million per 19 November 2020 as per FactSet.  
Source: Aareal Bank annual reports

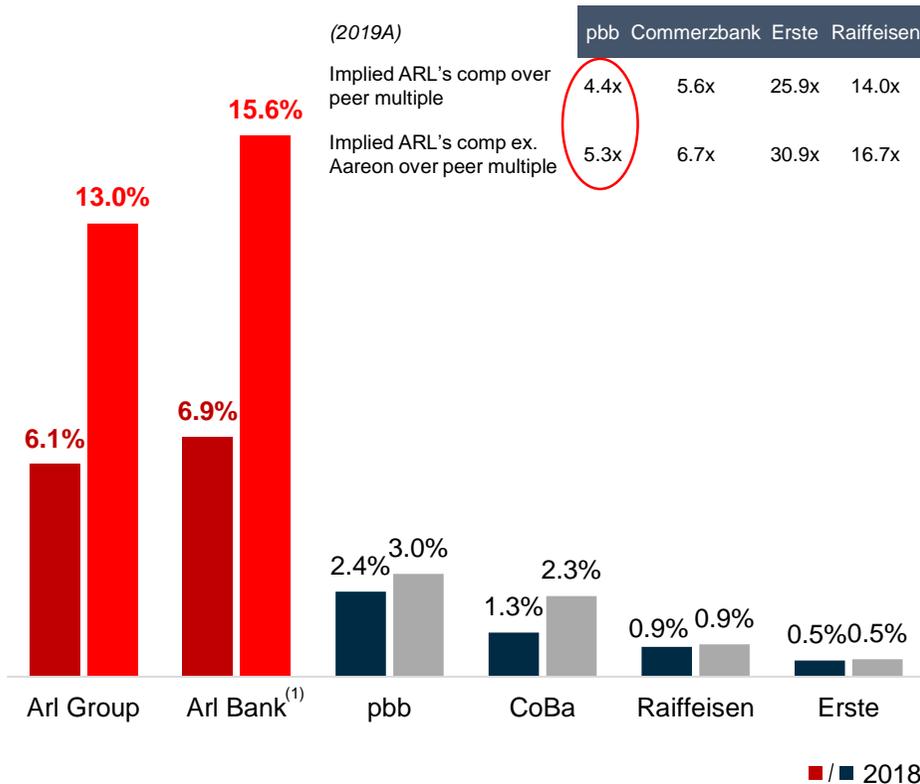
**IV**

**Putting the Compensation Bonanza in Context**

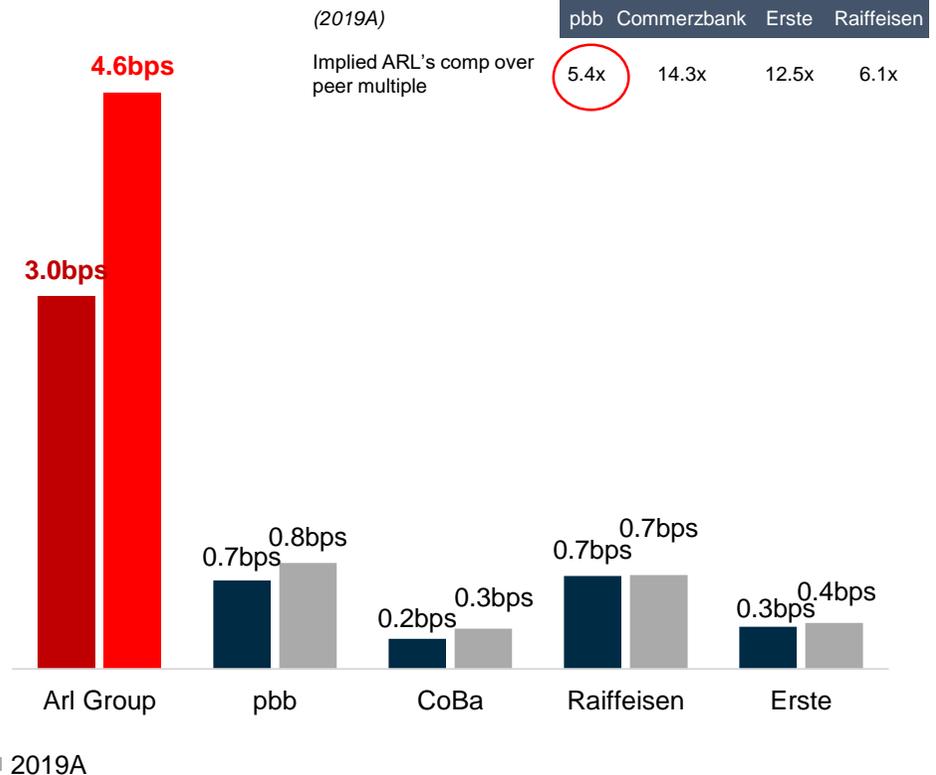
# Aareal's Compensation is a Sign of Reckless and Unethical Culture PETRUSADVISERS

- Aareal affords a pay bonanza. In 2019, it was ~4-5x higher than its direct peer pbb
- With 100% bonus achievement provisioned for 2020, we expect this relative gap to significantly increase

**2018-2019 Management Board Compensation (Incl. Benefits, Paid) / Net Income**



**2018-2019 Management Board Compensation (Incl. Benefits, Paid) / Total Assets**

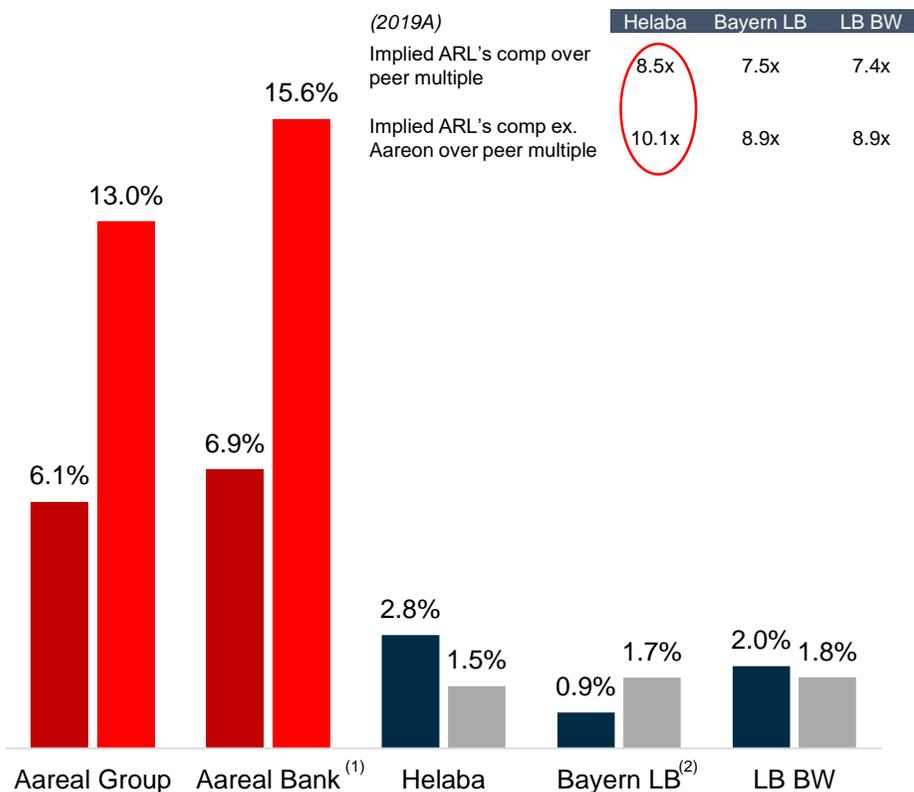


(1) Aareal Group excluding Aareon AG per Aareon's audited accounts. Source: Annual Reports, FactSet

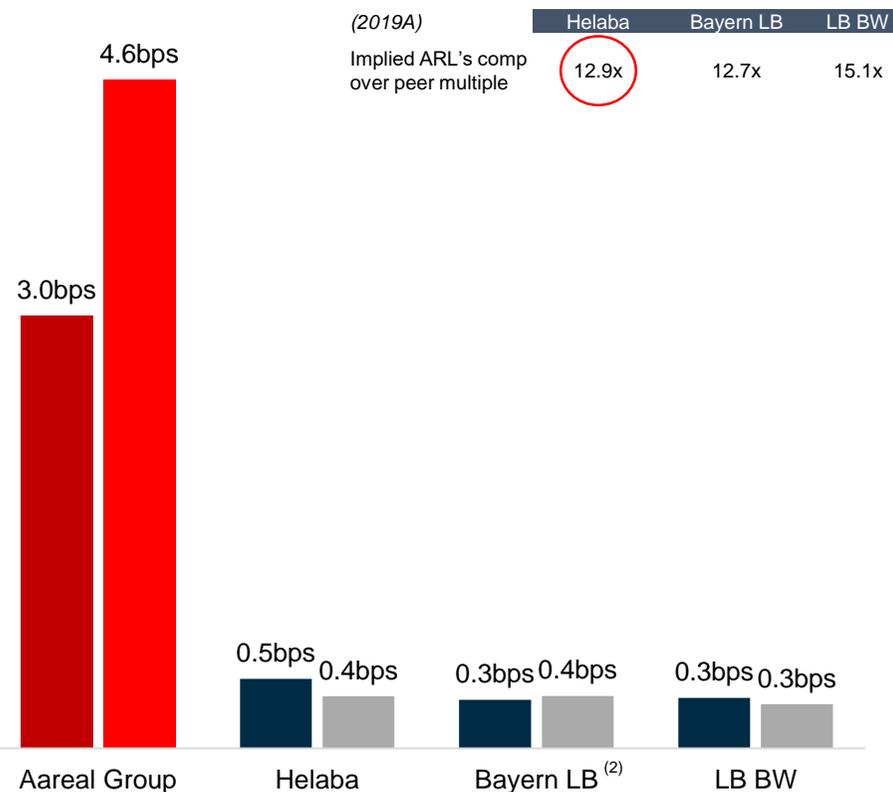
# A Comparison with German Landesbanken Demonstrates Aareal's Excessive Pay and Unethical Culture

Aareal has paid dimensionally more to management than Helaba, Bayern LB and LB BW combined

2018-2019 Management Board Compensation (Incl. Benefits, Paid) / Net Income



2018-2019 Management Board Compensation (Incl. Benefits, Paid) / Total Assets

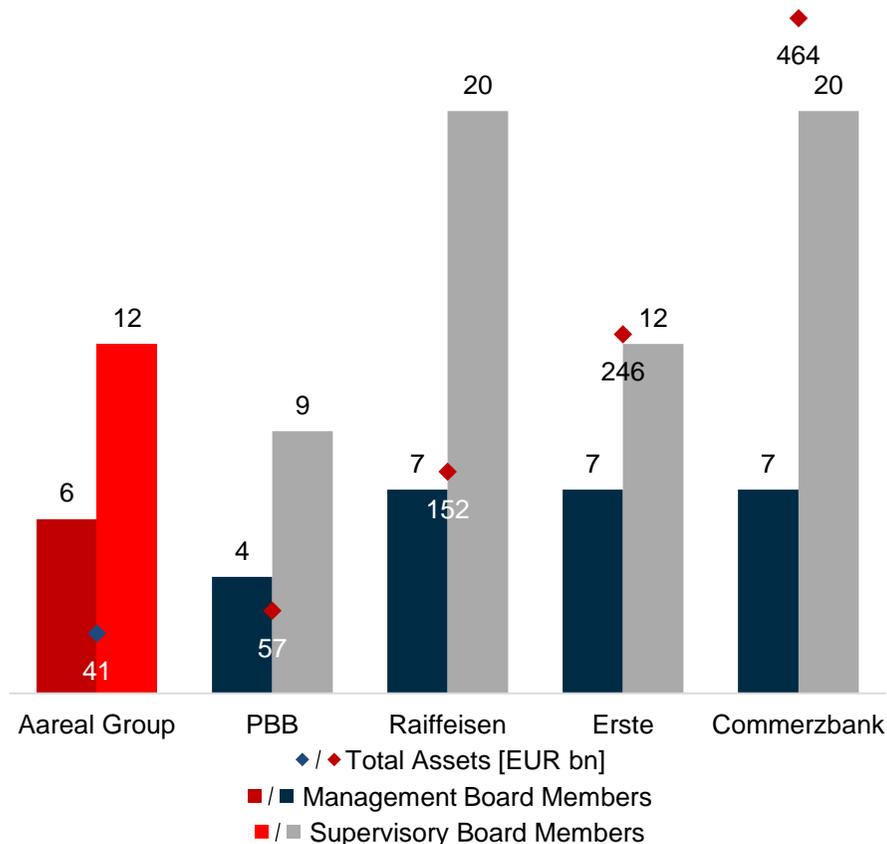


■ / ■ 2018A ■ / ■ 2019A

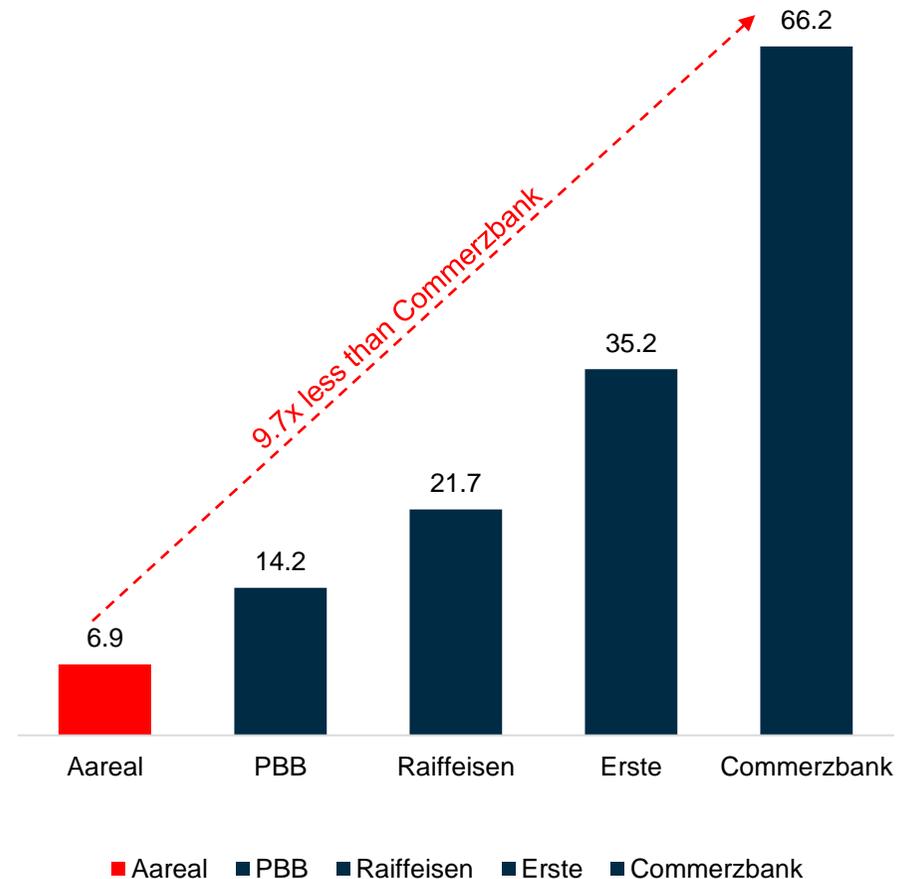
Footnotes: (1) Aareal Group excluding Aareon AG per Aareon's audited accounts; (2) Adjusted to exclude one-off post-employment benefits. Source: Annual Reports

# Oversize Boards Relative to Aareal's Size

Number of Management and Supervisory Board Members



Total Assets (EUR bn) per Management Board Member



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