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The Management Board (the "Board")
Aareal Bank AG
Attn: Mr Hermann J. Merkens, Chairman of the Management Board
Paulinenstrasse 15
65189 Wiesbaden
Germany

15th October 2019

Dear Mr Merkens,

Today, Teleios Capital Partners LLC and its affiliated entities ("Teleios Capital") hold 2,675,060 shares in Aareal Bank AG ("Aareal" or, together with its subsidiaries, the "Group") representing an interest of 4.47% in Aareal's issued share capital.

As you are aware, Teleios Capital sent a letter to the Board on 26th September 2019 (the "Letter")¹ outlining our concerns that a structured and independent review of all strategic alternatives for Aareon AG ("Aareon"; the "Strategic Review") had not been undertaken, and that the Board was unreasonably inclined towards a course of action that risked resulting in a suboptimal outcome for Aareal's shareholders, namely the expedited sale of a minority stake in Aareon.

In the Board's letter of response on 7th October 2019 (the "Response")², you declined our request for a Strategic Review – the internal exercise you misleadingly refer to falls well short of our definition – and repeated various nebulous arguments from our prior discussions that have neither convinced us of the soundness of the Board's logic, nor that due process has been followed.

We wish to reiterate that any disposal of Aareal's shareholding in Aareon is a matter of the utmost importance where the Board must take due care to ensure that its statutory fiduciary duties are appropriately fulfilled. We and other shareholders are of the view that a sale of a minority stake in Aareon would be damaging to shareholder value in the long run. We thus cannot see how, in the absence of a Strategic Review, the Board could fulfil its fiduciary duties to shareholders were it to pursue this ill-conceived course of action.

Management's stubborn stance serves neither shareholders, nor Aareon

Management seems determined to retain a controlling shareholding in Aareon, considering it an "integral part" of the Group, but has repeatedly failed to justify this belief to shareholders, or to respond to the specific concerns highlighted in our Letter.

While holding an investor seminar as you did last May is a step in the right direction, such measures fall short of addressing the structural reasons for the Group's chronic undervaluation. As we elaborated, we remain doubtful that the Group will trade anywhere near its sum-of-the-parts valuation without a full

¹ <http://www.teleioscapital.com/documents/2019-09-26-Teleios-Letter-to-the-Board-of-Aareal.pdf>

² https://www.aareal-bank.com/fileadmin/04_Investoren/03_Other_PDF-files/20191007_Letter_to_Teleios_Capital_Partners.pdf

separation of Aareon. The profiles of Aareon and its parent company could not be more different, and the investor and analyst community will always struggle with this abnormal combination.

More importantly, the current ownership structure likely also impedes Aareon from achieving its full potential. Over the last cycle, including acquisitions, Aareon has grown revenues only at low single digits (3.5% 2006-18 CAGR)³, while its US-listed peers have thrived and compounded substantial shareholder value.⁴ Research analysts remain sceptical that management will deliver on its strategy and “give no credence to subsidiary Aareon’s growth case” to double EBITDA, “as the bank has had similar plans in the past without delivering on them”.⁵ We reiterate our view that the leadership and oversight, incentives and corporate culture that Aareon needs to prosper will only be fully achieved under separate ownership.

Fiduciary concerns and next steps

Our Letter called on the Board to conduct promptly a structured and independent Strategic Review to establish an adequate basis for an informed decision on all strategic alternatives for Aareon. Your Response declined our request on the basis that the Board was already “assessing all relevant options within our Group-wide strategic review”, an ongoing – and presumably internal – exercise that it deems to be adequate (the “Internal Process”).

Your labelling the Internal Process a strategic review is misleading: it is not equivalent to the Strategic Review we are proposing where, crucially, Management would not be in the driving seat. We are asking for an independent Strategic Review because we have reason to doubt the procedural integrity of the Internal Process. Shareholders deserve a review with a greater degree of transparency and independence, which we consider to be in line with standard practice.

In the absence of a Strategic Review, we ask the Board to provide clear answers to the following questions to address some of our concerns:

- 1. Shareholders including Teleios Capital have expressed a different view to the Board over Aareon’s future. In the absence of a Strategic Review to independently assess these opposing views, how has the Board balanced those views such that it believes it has fulfilled its fiduciary duties?**
- 2. Were the Board to undertake a structured sale process of Aareon, including one for a minority stake, the best outcome for Aareon and its shareholders would be achieved by appointing M&A advisors on merit alone. The most suitable advisors would have market-leading expertise in advising on sizeable transactions of software assets, and extensive execution capabilities in Germany. Do you agree?**
- 3. Were the Board to pursue such a sale process, or even just seek indications of interest, the best outcome for shareholders would be achieved by casting a wide net across the bidder universe. Can the Board confirm that all credible parties who expressed an interest in Aareon would receive appropriate consideration and not be unfairly precluded, and that the latter has not been the case so far?**
- 4. You refer in your Response to “regulatory constraints”. Has an independent study been commissioned by the Board as to the likely regulatory implications of a full or partial sale of Aareon, and could its findings be made available to shareholders?**

³ Aareon generated €236.6m revenues in 2018 and €156.1m in 2006; Aareon 2018 and 2006 annual report

⁴ Appfolio Inc’s share price has increased 8x since the firm’s IPO in 2015. RealPage Inc’s share price has increased 4x over the past five years. Aareon’s share price has declined by 8% over the past five years. Bloomberg, 14 October 2019

⁵ Kepler Cheuvreux, 10 September 2019

Each of these simple questions is answerable without a breach of the Board's fiduciary confidentiality obligations, and we will regard a reluctance to answer any of them as acknowledgement that the Board is willing to cut corners on procedural integrity, to the detriment of Aareal and its shareholders.

As already outlined in our Letter, we reserve all our rights in the event that the Board does not fulfil its statutory fiduciary duties, including the right to requisition an extraordinary general shareholders' meeting (*außerordentliche Hauptversammlung*) and/or to enforce a special audit (*Sonderprüfung*) of the Board's actions.

We look forward to hearing from you by return.

Yours sincerely,



Adam Epstein
Partner