10 May 2005

Property ▪ Germany

Deutsche EuroShop

Rating: **Neutral (▼)** Price target: **€ 42.0** Closing price**: € 43.0**

Currency changes

DES reported its Q1 numbers, which surprised on the downside due to the fact that the company was not able to repeat an extra-ordinary unrealised currency capital gain of € 1.8m (on the prepayment of its Hungarian shopping center in Pécs in Hungary, which was taken into operation as of 31/3/2004) in Q1 2005 (booked under other operating income) compared to Q1 2004. This resulted in a decline in net profit under IFRS of 25% to € 4.4m. The decline is non-cash, which is relevant for the dividend payment (dividend will be at least at 2004's level of € 1.92). On a constant currency level, net profit increased by 11%. On a like-for-like number of shopping centers in operation, DES' rental income increased by 1%, which is lower than inflation.

DES in aiming to invest a maximum of € 100-150m into new shopping centers in 2005 but also states that it will not be easy to match this target. Interesting is that at the same time, DES' appraisers increased the net yield on DES' assets in 2004 from 6.20% to 6.54%, which seems a contradiction. Co. sticks to its profit and revenue forecast for 2005 of a flat currency adjusted EBT of € 28m -30m for FY 2005 (€ 28.2 in 2004; Q1 2005: € 7.0m) and is on track in realizing these goals.

During the property tour at our German event, DES gave more insight into the co-investors in its shopping centers (DES usually owns stakes in its shopping centers, mostly ranging between 50% and 100%). The other investors in its centers are in some cases managers from ECE (not the managers managing the centers themselves but general ECE managers), in 2 cases Mr. Böge (CEO) himself with smaller stakes dating from his ECE career, separate family members of the Otto family, closed-end funds like a DB fund or corporates like Karstadt (owner/occupiers). Although we do think that there is a point in alignment of interest by setting up the structure like this (ECE manages DES' German centers and all centers are in SPVs, whereby all shareholders in the SPV are treated in the same way), we do think that investors tend to regard it as negative as it does not make DES more transparent. DES' asset valuation does not provide for adjustments for the ownership of its centres, neither in cases where DES owns below 50% (in 3 out of 15 centers DES owns below 50% and in 2 cases exactly 50%). We would welcome a more transparent structure in this sense, although the set-up in some cases is chosen in order to avoid transfer taxes as well. In any case, we think that this justifies a discount in valuation to its European retail peers due to complexity of company structure.

The NNAV including 2004 dividend of € 1.92 and including profit for Q1 2005 is € 40.93 versus a share price of € 43. However, this NNAV is excluding our estimate of a decline in German property values in 2005 and 2006 (both years -0.4%), which leads to a FY 05 NNAV of € 39.76. Recent German GDP forecasts were slashed from 1.6% to 1.0% for 2005, as a result of which we think that German retail rents will remain under pressure. On a y-o-y level, we see DES' NNAV declining by roughly 2% per annum in the next two years. This implies stock is trading at a premium to spot NNAV of roughly 7% (11% for its European peers). The stock has performed well in recent weeks on the back of upgrades by other brokers. We downgrade the stock to **Neutral**, but stick to our **€ 42** Price Target.

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