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DEUTSCHE EUROSHOP

Prime quality retail, but expensive

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REDUCE

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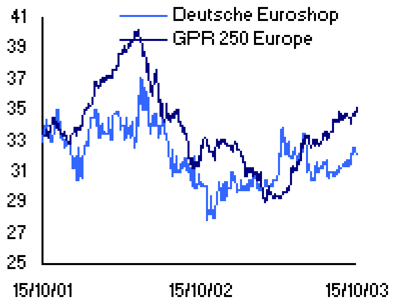
Deutsche EuroShop (DES) is internally managed since 1 July 2003. All historic links with Deutsche Bank (DB) have come to an end as DB recently replaced its final 45% stake in DES, due to which the share overhang has diminished and the stock is included in relevant property indices. The high 6.0% yield on the stock makes DES more attractive than investing in open-end funds, particularly for German private investors. However, the high dividend payments and ongoing softening of German retail property values leads to an estimated FY 02-05E NNAV CAGR of -2.2%. Trading at a 6% discount to the FY 04E NNAV, we initiate coverage on DES with a Reduce rating.

Price target	**€ 30.5**
Potential (incl. dividend)	**1%**
Date	**15 October 2003**
Last price	**€ 32.1**
Reason	**Initiating coverage**

Fiscal year:	2002	2003e	2004e	2005e
Net rental income (€ m)	46.5	49.3	51.3	53.7
EBITDA incl. participations (€ m)	36.1	42.4	48.2	52.1
Net income (€ m)	-3.0	0.3	2.9	6.3
EPS (€)	-0.19	0.02	0.18	0.40
CFPS (€)	1.58	1.86	1.95	2.20
Net asset value (€)	36.18	34.77	34.11	33.80
Dividend (€)	1.92	1.92	1.95	2.00
P/NAV-1	-11%	-8%	-6%	-5%
EV/EBITDA	21.2	21.6	18.9	17.3
P/CF	20.4	17.2	16.4	14.6
Dividend yield	6.0%	6.0%	6.1%	6.2%



Performance vs GPR 250 EUROPE

-1m	**-0.5%**	-3m	**-3.2%**	-12m	**-2.7%**

Market cap	€ 500m
Number of shares	15.625 million
Avg. daily volume	7,235
Reuters code	DEQGn.DE
Bloomberg code	DEQ GR
9M 03 results	28 November 2003

- Deutsche EuroShop (DES) is Germany's only listed retail property company. The portfolio (99% occupancy) comprises 13 fairly modern shopping centres, including three development projects. 9 sites are located in Germany, 2 in Italy, 1 in France and 1 in Hungary. Medium term, the company targets Austrian, Czech, Hungarian and Polish shopping centres in view of the eastbound expansion of the EU.
- Deutsche Bank recently nullified its stake in DES as part of a plan to reduce holdings in German companies. The shares were placed at some 1,500 German private investors, at an estimated average price of € 30. DES is internally managed since 1 July 2003, has strong growth ambitions and -in our view- could become a takeover target in case the German retail property market may be set for a recovery.
- The high dividend payments exceed cash flow at least until FY 03. Capital can be withdrawn from the reserves on a tax-efficient basis in order to meet plans relating to the high dividend concept. But further softening of retail property values leads to an estimated FY 02-05E NNAV CAGR of -2.2% vs. +3.0% for DES's European retail peers.
- Based on the 6% discount to the FY 04E NNAV and the current weak status of the German retail sector, we see no fundamental justification for further share price improvement. We initiate coverage with a **Reduce** rating and a +12M price target of € 30.5, with the remark that the stock is more attractive than German open-end funds and that it experiences technical demand due to take-up in the GPR 250 Europe index.

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Executive Summary

Deutsche EuroShop (DES) is Germany's only listed property company with a focus on regional shopping centres (86% Germany and 14% international), worth slightly more than € 1bn. DES is structured in the form of a closed-end investment company, which was initialised by Deutsche Bank in 2000 when it inserted its shopping centre portfolio into a fund, targeted at German private and smaller institutional investors. After the IPO, Deutsche Bank remained stuck with a 78% stake in DES. In the last 12 months, the bank completed the sale of its final 45% stake in DES. These shares were placed with some 1,500 German private investors in total. DES is taken up in the GPR 250 Europe index as of 1 October 2003 and is also placed on the watch list by EPRA (likely inclusion as of 1 January 2004), due to which the stock is coming into the scope of specialised European property fund managers. The company is internally managed as of 1 July 2003, whereby the asset management and property management contracts with DGM have expired almost free of charge.

Strengths

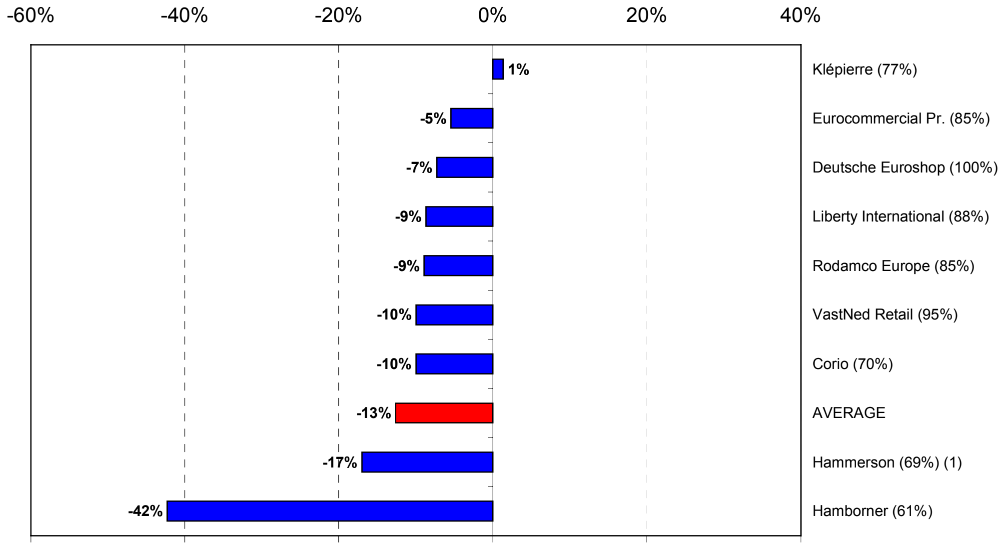
- Quality of management team, good information transparency and portfolio quality (most properties are realised by German market leader ECE);
- The management contract with DGM has expired almost free of charge for DES as of 30 June 2003, making DES an independent property company;
- Purely active in shopping centres, which expansion plans for Austrian, Czech, Hungarian and Polish shopping centres in view of the eastbound expansion of the EU;
- Daily share liquidity increased from 5,000 to 16,000 since the recent share replacements by DGM and the inherent increase of the free float (€ 395m);
- As tax-free capital withdrawals are possible and DES owns >€ 60m of tax-loss carry-forwards, it can virtually be considered a German REIT;
- M&A involvement is possible as no anti-takeover measures are put in place and DES targets to be among the Top-5 of European retail property players;
- Conservative financing (H1 03: 42% debt; medium-term target: 55% debt) translates into a war chest amounting to approximately € 200m;
- High yield (6.0% net) is more attractive than to be realised on German open-end funds. This is an important marketing tool towards German (and Dutch) private investors, which are exempt from withholding tax on DES.

Weaknesses

- DES cut itself loose from Deutsche Bank, but the bank still owns one golden share allowing them to appoint 2 (out of 6) Supervisory Board members;
- Relatively small company, dependent on only 5 people and with absolute low share trading liquidity;
- Potential conflict of interest between ECE is DES. The German Otto family is a majority shareholder in both entities;
- Assets are held through a holding structure. Not in all cases DES owns majority stakes; lack of transaction flexibility warrants a lower market value;
- Weak status of the German economy and retail sector is expected to lead to ongoing softening of German retail property values;
- Cash flow is not sufficient to cover dividend distribution at least until FY 03, which is an inherent burden on DES's equity base;
- We estimate the FY 02-05E NNAV CAGR to amount to -2.2% vs. +3.0% on average for the company's European retail property peer group.

We initiate our coverage on the stock with a **Reduce** rating and a price target of € 30.5. DES is trading at a 6% discount to the FY 04E NNAV. Moreover, when it comes to absolute share trading liquidity we think that DES still has to show improvement. It is, however, in our view not unthinkable that DES will become a takeover target in the medium term, for instance when the outlook on a recovery of the German retail property market becomes less hazy. Note that our fundamental stock ratings do not incorporate potential takeover speculation.

Graph 1: Discounts/premiums to spot (N)(N)NAV European retail stocks[1]



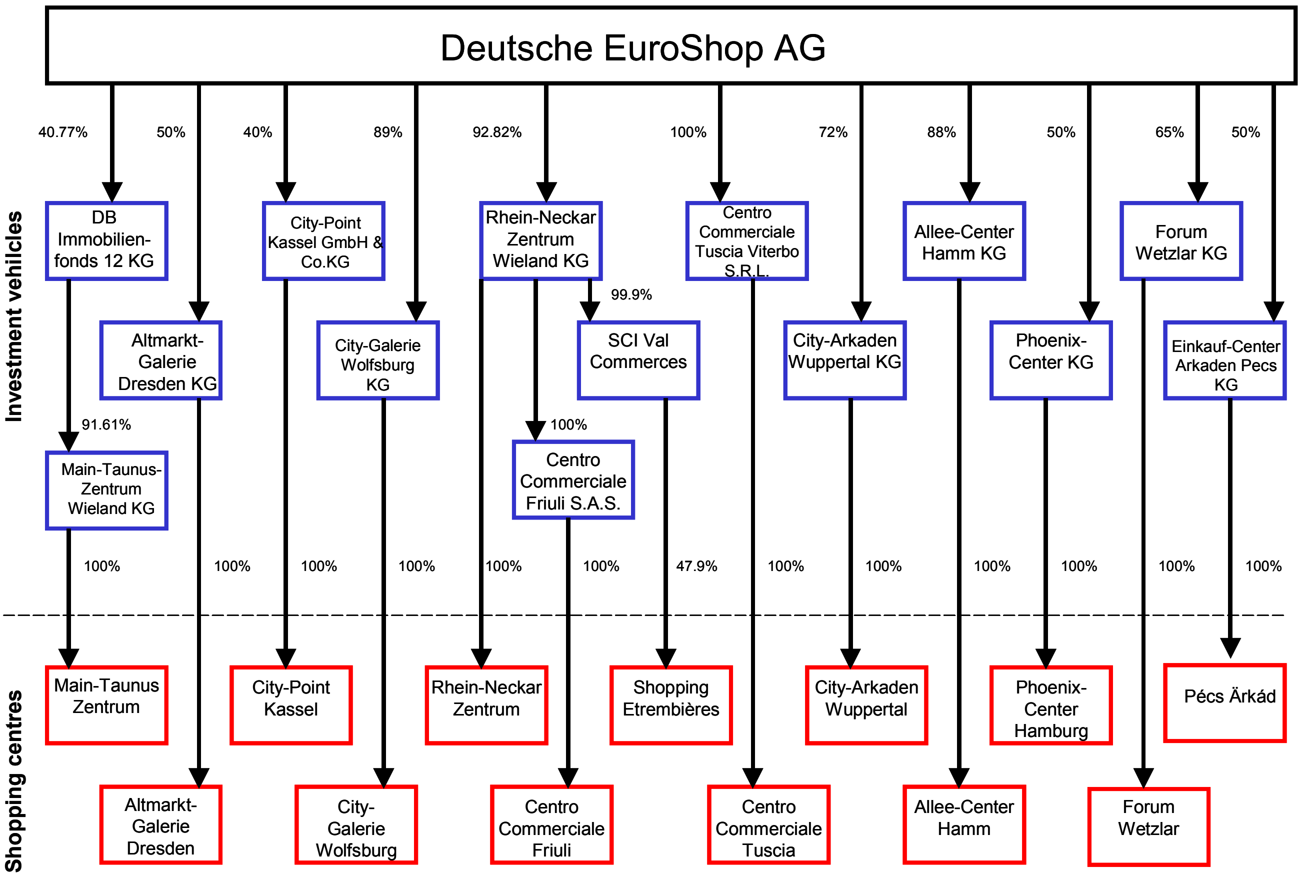
[1] (N)(N)NAV= based on latest NAV published by the company. The figures in brackets represent the percentage of retail in the respective portfolio.

Prime quality retail, but expensive

86% of DES's holdings are located in Germany

Short introduction to DES's company profile
Deutsche EuroShop (DES, market cap: € 500m) is the only listed German retail property company, investing in regional shopping centres (predominantly on inner-city locations). DES is structured in the form of a closed-end investment company. As a holding entity, Deutsche EuroShop AG holds equity interests (via '*Kommanditgesellschaften*' or '*KGs*' in German) in mainly German (86%) but also foreign (14%) shopping centres as a single business line (see Graph 2). Turnover is generated exclusively from rental income and divestments, although the latter is a non-recurring business activity. The main co-investors of DES are ECE, B&L Immobilien, HGA Capital Grundbesitz, TLG Immobilien, Karstadt Quelle and DB Real Estate. DES is internally managed and employs five people (including CEO Mr Böge and COO Mr Hasselbring), while the Supervisory Board consists of six people (one of which is Mr Alexander Otto).

Graph 2: Company structure of Deutsche EuroShop



Source: Kempen & Co, Deutsche EuroShop

DES has become independent in four steps

Series of secondary share replacements completed since 2001
DES is a property company initialised by Deutsche Bank (DB) in 2000 when it inserted its shopping centre portfolio into a fund, targeted at German private and smaller institutional investors. Presently, DES is also coming into the scope of specialised European property fund managers due to the take-up of the stock in the GPR 250 Europe index of 1 October 2003 (EPRA has placed DES on the watch list; likely inclusion in the EPRA Europe index as of 1 January 2004). Reason for the inclusion is that through a series of secondary share replacements (described below) by *Deutsche Grundbesitz Management* (DGM; subsidiary of DB) since 2001, the free float (78.8%) of DES presently amounts to € 395m. This figure ranks DES number 3 in the German listed property sector and number 40 (out of 74) in the European listed property sector.

The free float of DES presently amounts to 79%, or € 395m

1. The inception of DES was in October 2000. No new shares were issued at the IPO; a secondary placement of shares (at € 38.40 per share) from DGM to several institutional investors (mostly German insurance companies and asset management companies) was concluded. The IPO was regarded as a fault, since DGM remained stuck with a 78%-stake in DES.
2. In October 2001, DGM announced that it had placed 33% of its shares in DES with the German Otto family, who are well-known for their mail-order retailing company and their ownership of ECE, which acts as the shopping centre manager of most of DES's assets. This block was placed at an estimated 20% discount to NAV.
3. In June 2002, management indicated that DGM plans to sell more shares in DES to investors, mostly private individuals. In fact, DGM managed to sell 23% of its remaining 45%-stake to some 500 private investors in June 2003, at an average share price of € 30. This move was a further step towards a substantial increase in DES's share liquidity.
4. In Q3 03, DES announced that DGM had reduced its stake in DES from 23% to 0%, whereby the shares were sold in private placements to more than 1,000 (predominantly private) investors. Following the announcement, the free float has increased from 55.6% to 78.8%, with the Otto family (21.2%) currently being the only major shareholder in DES.

Table 1: Shopping centres owned by Deutsche EuroShop

Project	Location	Sqm	Opening	Stake owned	Total value in € m	Invested equity in € m	Occupancy rate
Main-Taunus Zentrum	Frankfurt	93,900	2001	37%	115.7	63.3	100%
Rhein-Neckar Zentrum	Viernheim	64,000	2002	93%	264.5	137.0	100%
Altmarkt-Galerie	Dresden	43,800	2002	50%	101.8	44.1	95%
City-Galerie	Wolfsburg	30,000	2001	89%	116.9	43.5	100%
City-Arkaden	Wuppertal	28,600	2001	72%	100.1	34.3	100%
City-Point	Kassel	29,400	2002	40%	45.2	17.0	100%
Allee-Center	Hamm	34,800	1992	88%	95.9	34.4	100%
Phoenix-Center	Hamburg	39,000	2004	50%	78.0	24.9	70%[1]
Forum Wetzlar	Wetzler	34,300	2005	65%	73.0	29.0	50%[2]
Shopping Etrembières	Annemasse (F)	8,600	1994	93%	31.2	31.2	100%
CC Friuli	Udine (IT)	28,600	1993	93%	60.1	60.1	100%
CC Tuscia	Tuscia (IT)	15,200	1998	100%	30.2	29.6	100%
Pécs Ärkád	Pécs (H)	34,200	2004	50%	41.2	19.0	90%[3]
Total / Unweighted average		**484,400**		**71%**	**1,153.6**	**567.4**	**99%[4]**

Source: Deutsche EuroShop, Kempen & Co

[1] *Phoenix-Centre* is under construction. In August 2003, 70% of the store space was pre-let. Management states that there are rental contracts near completion for an additional 10% of the store space, and assumes the centre to be completely let upon opening (Autumn 2004);
[2] *Forum Wetzler* is under construction. In October 2003, >50% of the store space was pre-let. Opening of the centre is scheduled for Spring 2005;
[3] *Pécs Ärkád* is under construction. In October 2003, >90% of the store space was pre-let. Opening of the centre is scheduled for Spring 2004;
[4] The 99% vacancy rate of DES's standing property portfolio excludes pre-lettings on DES's three development projects.

Shopping centre portfolio considered fairly modern

We visited four of DES's shopping centres, all of which have an appealing concept

DES owns a retail portfolio that consists of 13 shopping centres (market value of € 1.15bn), of which three are still under construction. Nine sites are located in Germany, 2 in Italy, 1 in France and 1 in Hungary. The total surface of the portfolio amounts to 484,500 sqm (of which pro-rata 314,600 sqm belongs to DES). With nine centres built (or fully renovated) after 2000, the portfolio is fairly modern. We recently visited four of DES's German shopping centres and conclude that they can be recognised as regional trendsetters in terms of inner-city retail trading. The centres are attractive experiencing zones, which also have an impact on the surrounding region. This is partly underpinned by the average 99% occupancy rate. DES's properties are managed by local specialists: *ECE* in Germany and Hungary, *Espace Expansion* (a subsidiary of Unibail) in France and *Espansione Commerciale* in Italy. Most of DES's shopping centres are concepts from undisputed German market leader ECE.

ECE has a total of 73 shopping centres under management (total GLA: 1.5 million sqm) involving a base of more than 6,000 tenants. ECE's know-how and expertise extends to developing, realising, leasing and managing shopping centres for third parties.

Net initial yield on new acquisitions expected be slightly above 6%

Recent acquisition of three shopping centre development projects

As said, three of DES's shopping centres concern development projects. These acquisitions were conducted in Q4 02, in Q3 03 and in Q4 03. The first one relates to a 50%-stake (€ 41.2m) in *Pécs Ärkád*, located in Hungary's fifth largest town Pécs (population: 160,000) and scheduled to be completed in Spring 2004. The second one relates to a 50%-stake (€ 78m) in *Phoenix-Centre* in Hamburg, to be opened in Autumn 2004. The co-investors in this project are *B&L Immobilien* (25%) and *ECE* (25%). The third development project regards a 65%-stake (€ 73m) in *Forum Wetzlar* in Wetzlar, to be opened in Spring 2005. Forum Wetzlar (catchment area: 530,000) will host approximately 110 shops on two levels with a total GLA of 23,000 sqm. 70% of the store space in *Phoenix-Centre* is already pre-let, while >50% of the store space of *Forum Wetzlar* is pre-let. We assume the centres to be 98-100% let upon opening, based on the track record of DES. The average debt component on the described projects amounts to 60%, while the net initial yield is expected to be slightly above 6%.

The top-10 tenants of DES generate 31% of the company's rental income

Sheltered from rental risks due to broad tenant base and contract profiles

Our main critical concern regarding investments in Germany, and particularly in German retail property, is that retail sales are expected to remain weak. We therefore expect prime retail rents to be stable at best in the next 12 months (see Graph 6, Appendix 2). According to DES's management, "*the shopping centre portfolio is sheltered from large risks due to the diversity of tenants*". We also think that DES's tenant base is set up quite defensively, being exposed to a variety of sectors (see Table 2). Note that any declining market rents will not immediately have an substantially negative impact on DES, given the 99% occupancy rate and the fact that not many contracts are due for expiry in the short term (see Graph 3). The top-10 tenants generate 31% of the company's rental income, which is roughly in line with the European average.

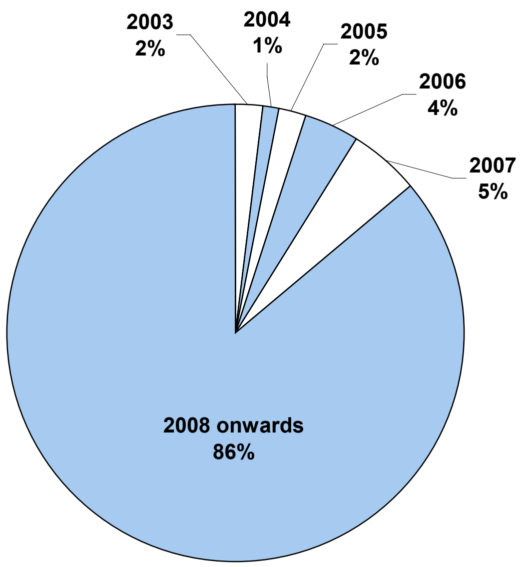
Table 2: Top-10 tenants of Deutsche EuroShop

Tenant	Sector	% of net rents
Carrefour	Hyper/Supermarkets	7.0%
Metro Group	Food- & non-food retail, retail warehousing, electronics	5.9%
Douglas Group	Personal care, books, fashion, jewelry	4.4%
P&C	Fashion	2.7%
Karstadt Group	Retail warehousing	2.3%
H&M	Retail fashion	2.3%
Palastbetriebe	Cinema	1.9%
Engelhorn	Fashion	1.7%
Ipercoop	Hypermarket	1.6%
Bauhaus	Do-it-yourself formula	1.5%
Total		**31.2%**

Source: Deutsche EuroShop, Kempen & Co

Any declining market rents do not have an immediate substantially negative impact on DES's cash flow

Graph 3: Maturity of rental contracts



Source: Deutsche EuroShop

DES has recently become an independent property company

The management contract with DGM has expired almost free of charge for DES

DES used to be managed by *Deutsche Grundbesitz Management* (DGM), a 100% subsidiary of Deutsche Bank. Since 1 July 2003, DES has become internally managed and as such stands on its own feet without any involvement of DGM. In our view, this change could be important for the investment appetite for DES, although we expect it to have a neutral effect on the company's earnings as the rates charged by DGM are considered not unreasonable. More importantly for DES, all management contracts expired on 30 June 2003 with DES only liable for a total amount of € 1.4m (0.06% of AuM; of which € 0.4m was already provided for in the FY 02 balance sheet). This is good news for DES, as Table 3 shows that a 2%-rate on average is charged by property asset managers in case management contracts are subject to cancellation.

DGM used to charge a fixed fee for its asset management activities (€ 0.5m p.a. or 0.1% of AuM; lower-end of the 0.1-0.6% range in Europe). DGM also had management contracts in place with all of DES's shopping centre companies (for a total annual consideration of € 0.9m). Lastly, DGM also charged a 3% fee on the investment amount for new acquisitions or disposals, something that is no longer recorded often in the European property sector. The latter item is one on which DES will clearly be able to save on costs in the future. For H1 03, DES paid DGM a total amount of € 347,000. For H2 03, a final payment of € 834,000 is due in order to complete the buy-off of all contracts with DGM.

DB still holds the only golden share in DES, but we think that this share will soon be cancelled

The Management Board consists of two people (Mr Böge and Mr Hasselbring) that are entirely committed to DES. No stock option plans or similar share-based incentive systems are currently in place. Note, however, that DES's Articles of Association state that the DGM owner of DES's single golden share is allowed to appoint 2 Supervisory Board members. Despite the recent retreat of DB, the bank still owns this golden share. It is no priority share (meaning that it does not allow for issuing new shares to dilute the voting rights of the standing shareholder base) and only relates to the described right. We think that the cancellation of this golden share is just a matter of time, given DGM's track record and since this is the best thing to do in terms of corporate governance.

Lastly, note that one could argue that there exists a potential conflict of interest between DES and the German Otto family, who are the main shareholders in both DES and ECE. DES is strongly dependent on ECE concerning the supply of new shopping centres. However, DES's CEO Mr. Böge underlines that the mutual relationship is structured at arm's length and that with the acquisition of new shopping centres DES is neither benefited nor disadvantaged by ECE.

Table 3: Buy-off transactions of property asset management contracts in Europe

Buyer	Seller	Sales price (as a % of AuM)
Aberdeen Asset Management	RREEF UK (Roproperty Holding)	0.51%
British Land	Aberdeen Asset Management	1.00%
Deutsche Bank	RREEF US (Roproperty Holding)	2.70%
Eurocommercial Properties	Sepal	2.90%
Noorman	Zeeman Vastgoed Beheer	0.30%
Rodamco NV	RREEF	1.96%
Uni-Invest	Homburg	3.00%
VastNed Retail	Foram	3.40%
Unweighted average		**1.97%**

Source: Kempen & Co

Possible eastbound expansion in the medium term

Continuous optimisation of the standing portfolio is priority number one

Although DES generally adopts a buy-and-hold strategy, we would welcome a more active asset rotation policy. The near-term investment focus tends to be 86% domestic and 14% international assets, which is in line with the status quo. However, management stated that -in view of the eastbound expansion of the EU as of May 2004- it is not unthinkable that management will critically look for acquisitions of Austrian-, Czech-, Hungarian- and Polish- shopping centres. But management's current main priorities are geared towards (i) optimisation of the standing portfolio, (ii) optimisation of the distributable free cash flow after taxes, amongst other by means of targeting a low Total Expense Ratio (TER) of <0.5% of equity (H1 03: 0.4%), which is far more attractive than the TER's posted by German open-end funds, and (iii) spending the available cash position (€ 18m) on new investments before year-end 2003. Note that DES does not own <50%-stakes outside Germany, so the flexibility of management is not affected should management be willing to sell the international centres in due time.

M&A involvement is possible but not likely to happen in the short term

No anti-takeover measures have been put in place at DES

Longer term, DES is considering to expand further: "*We wish to be among the top 5 European retail property companies*" was management's official statement at the analyst meeting in August 2003. We think that this target is ambitious, and difficult to meet without M&A involvement. Chances are, however, low that this will happen in the next 12 months as we understand that none of DES's peers are currently willing to expand in German retail property. This could reverse in due time, for instance when the German retail property market may be set for a recovery. Note that the potential for DES to be taken over by one of its European peers in the future is there, since no anti-takeover measures are put in place. The only thing that might be a hindrance in taking over DES is the current unwillingness of the Otto family to sell their holding in DES.

Conservative portfolio financing leaves room for expansion

DES's war chest amounts to approximately € 200m

Financing of DES is undertaken on the level of the separate shopping centre companies and not on a corporate level, meaning that DES does not have debt on a corporate level. The consolidated debt-to-total-assets ratio of DES amounts to a conservative 42% (H1 03), while the medium-term target amounts to 55%. Most (90%) of the total interest bearing debt is not due before 2008 (see Table 4). DES's conservative financing leaves room for further expansion of the portfolio in the medium term. Our estimates point towards a war chest amounting to € 200m, which is a figure including the available cash position (€ 18m) on the balance sheet. This would imply that the portfolio could grow to approximately € 1.35bn in due time.

Table 4: Debt maturity

	<1 year	1-5 years	>5 year
Liabilities to banks[1]	€ 4.1m	€ 37.1m	€ 368.2m

Source: Deutsche EuroShop

[1] 90% of the interest-bearing debt with an average nominal interest rate of 4.6% (FY 02) have a remaining maturity of >5 years.

DES can virtually be considered a German REIT

Dividend payments exceed cash flow, at least until FY 03

During its start-up phase (FY 00) DES did not pay out dividends, but currently a 6.0% net dividend yield can be achieved for German and Dutch private investors (not for tax-paying institutions in Europe). Table 5 shows that DES is cash flow positive (FY 02 P/CF multiple of 20.4). We underline that dividend payments exceed the company's operating cash flow at least until FY 03, whereby DES annually depreciates its assets at their maximum rates (France: 2.5%; Germany: 3.0%; Hungary: 2.5%; Italy: 6.0%). Note, however, that based on the following factors DES will continue to meet its plans relating to the high dividend concept. We expect cash flow to markedly exceed dividends before year-end 2005, which is also a company target.

1. Cash flows generated in the separate shopping centre companies can be transferred to the holding entity on a tax-free basis.
2. In accordance with the German tax regulation, tax-free withdrawals from the capital reserve are possible for another 7 years (until FY 10).
3. The withholding tax on the stock for German and Dutch private investors will likely remain nil until FY 10.
4. Since DES owns >€ 60m of tax-loss carry-forwards, the effective tax rate is pressed to nearly zero, compared to a regular 34.5% corporate tax rate for German MDAX companies.

Because of the described factors we believe DES can virtually be considered a German REIT, although officially it is not a tax-efficient property company. The introduction of a German REIT is not expected for the short term (see Appendix 1). Based on its good know-how and image, DES's management is actively setting the stage for a lobby towards a German REIT, as this would be of benefit for the broader German listed property sector.

Table 5: 2002 example of cash flow statement of DES

Item	€ m
EBDT	24.87
Foreign tax on income	-0.45
Amortisation	0.00
Financed investments	-0.14
Movement in liquid funds for maintenance and future investments	-0.45
Movement in expenses/ income of investment phase	+2.49
Free cash flow of the Group	**26.33**
Free cash flow minorities	-2.29
Free cash flow of the AG	**24.03**
Thereof income in the subsequent year (dividends)	-1.92
Income for the fiscal year	22.12
From previous year	2.50
Cash flow from ordinary business activities of the AG	**24.61**
Cash flow from ordinary business activities of the AG per share (€)	1.58
Average share price in FY 02	32.20
Implied FY 02 P/CF multiple	20.4

Source: Deutsche EuroShop, Kempen & Co

DES is trading at a 6% discount to the estimated FY 04 NNAV of € 34.1 per share

Net Asset Value expected to decline by 2.2% per annum until FY 05

DES's asset valuation in the balance sheet is based on depreciated historic cost price. The company does not transmit the market value of its stakes in the separate properties, but intends to do so in the future (an NAV might be published as at FY 04). However, several acquisitions are relatively new, implying that the respective book values are in line with their open market value. At the analyst meeting in August 2003, management stated that the shopping centre portfolio "*neither incorporates hidden reserves nor hidden losses*". In order to get a better feel for the double net NAV (after taxes) of the company, we made our own calculation, and also conclude that the FY 02 NNAV of € 36.2 per share is in line with the book value of the company's equity base in 2002.

Table 7 shows that our estimates point towards a FY 03E NNAV of € 34.8 per share, which is gradually declining to € 34.1 in FY 04E and to € 33.9 in FY 05E due to the impact of (i) annual earnings barely reaching positive territory, (ii) high dividend payouts exceeding cash flow and (iii) ongoing weak fundamentals of German retail leads to a softening of retail property valuations (the input factors for our base case scenario concerning DES's portfolio are reflected by Table 6). As a result, we estimate the FY 02-05E NNAV CAGR to amount to -2.2%. Amongst all European retail players, this is the least prospective growth rate. Consequently, DES is trading at a 6% discount to the FY 04E NNAV.

Table 6: Our input factors regarding future NAV growth of DES

Item	FY 01	FY 02	FY 03E	FY 04E	FY 05E
Occupancy rate	98%	98%	99%	99%	99%
Net yield on German portfolio	5.00%	5.20%	5.30%	5.35%	5.40%
Impact of yield shift Germany	N/a	-4.0%	-1.9%	-0.9%	-0.9%
Net yield on International portfolio	6.35%	6.30%	6.25%	6.30%	6.30%
Impact of yield shift International	n/a	+0.8%	+0.8%	-0.8%	0.0%
Average net yield	5.14%	5.35%	5.43%	5.48%	5.53%
Average yield impact[1]	n/a	-4.3%	-1.5%	-0.9%	-0.8%

Source: Kempen & Co
[1] concerns a *stand-alone* impact, i.e., excluding the effect of varying rents on property prices.

Table 7: Background of our base case NAV calculation

	€ m
Annualised gross rents	65.6
Annualised net rents	54.3
Implied net yield	5.4%
Market value rental portfolio	1,006
Total assets	1,000
Hidden reserve in portfolio	6.5
Income tax liabilities[1]	0.5
Adjustment to equity	6.0
Book value of equity (excl. minorities)	559.3
Market value of equity	565.3
Number of shares (in millions)	15.625
FY 02 NNAV per share (in €)	**36.18**
FY 03E NNAV	34.77
FY 04E NNAV	34.11
FY 05E NNAV	33.85
FY 02-05E NNAV CAGR	**-2.2%**

Source: Kempen & Co
[1] DES owns >€ 60m of tax-loss carry-forwards, which we believe is also sufficient to compensate for capital gain tax liabilities in case the shopping centre assets would be sold in due time.

DES entered the GPR 250 Europe index as of 1 October 2003

Share trading liquidity improves rapidly but is still modest

After DGM successfully concluded its final two share placements to a widely spread shareholder base in the last 12 months, the overhang in DES shares has finally diminished. With the free float standing at 79%, this leaves room for better liquidity in the short term. To some extent this will help improving investor appetite for the stock. DES became part of the SSB Property Europe index as of 31 January 2001. It also entered the GPR 250 Europe as of 1 October 2003, which means that we expect more technical demand for the stock. Moreover, EPRA has placed DES on the watch list, which will likely lead to inclusion of the stock in the EPRA Europe index as of 1 January 2004. Table 8 shows that the share trading liquidity of DES is still modest (€ 0.2m turnover on a daily basis), although we expect it to improve rapidly in the next 12 months.

Table 8: Liquidity of European retail stocks

	Market cap (in € m)	Free float (in € m)	Average daily turnover (in € m)
Klépierre (France)	2,122	866	2.1
DES (Germany)	500	395	**0.2**
Corio (Netherlands)	1,907	1,248	2.3
Eurocommercial Properties (Netherlands)	635	439	0.6
Rodamco Europe (Netherlands)	4,050	1,984	3.2
VastNed Retail (Netherlands)	654	518	0.8
Hammerson (UK)	2,204	1526	6.9
Liberty International (UK)	2,878	2,274	9.2
Unweighted average			**3.2**

Source: Kempen & Co

DES compared to its European retail property peers

DES is sharply valued, but this is a trend we see also at other European retail companies

When comparing DES to its European peers (Klépierre, Corio, Eurocommercial Properties, Rodamco Europe, VastNed Retail, Hammerson and Liberty International), the most important differences are the low liquidity as well as the buy-and-hold strategy of the company. However, the company is clearly improving its act, which is underlined by the appointment of CEO Mr Böge (former financial director at ECE). We are positive about this move towards a more dedicated, active management also because it will lead to confidence among investors.

In order to place the valuation DES in a European retail context, we compared the companies on several indicators, which are reflected by Table 9. It is important to state beforehand that a high EV/EBITDA multiple in itself does not mean that a stock is expensive. It is highly dependent on the investment country and quality of the assets. Germany is known to have low net yields (and thus high EV/EBITDA multiples), whereas net yields in the Netherlands for instance tend to be higher. One reason for this is the difference in planning regulation per country, whereby investors in countries with relaxed planning regulations require a higher net yield (and thus lower EV/EBITDA multiples) for the fact that scarcity is lower in such countries.

Table 9: Valuation indicators of European retail property investment companies

	Rating	P/CF 04E	EV/EBITDA 04E	P/NAV-1 spot	CFPS CAGR 02-05E	NNAV CAGR 02-05E
Klépierre (FR)	Neutral	10.0	14.5	+1%	+8.8%	+9.8%
DES (GER)	**Reduce**	**16.4**	**18.9**	**-7%**	**+11.6%**	**-2.2%**
Corio (NL)	Neutral	11.0	13.5	-10%	+5.4%	+2.2%
ECP (NL)	Neutral	15.0	16.2	-5%	+4.3%	+1.8%
Rodamco Europe (NL)	Neutral	13.9	14.0	-9%	+1.5%	+1.6%
VastNed Retail (NL)	Neutral	10.7	13.6	-10%	+2.4%	-1.2%
Hammerson (UK)	Not Rated	21.4	17.4	-17%	N/a	N/a
Liberty International (UK)	Neutral	23.7	17.3	-9%	+9.0%	+3.5%
Unweighted average		**15.3**	**15.7**	**-13%**	**+6.1%**	**+1.6%**

Source: Kempen & Co, Thomson Financial I/B/E/S

Our price target of € 30.5 translates into a 1% total return expectation for the next 12 months

Investment conclusion: initiating coverage with a Reduce rating

Although we are positive about DES's portfolio quality, management team and information transparency, the main reasons why we initiate our coverage on DES with a **Reduce** rating are summed up below. Nonetheless, given its company profile and the high net yield on the stock, we think that investing in DES is more attractive than investing in German open-end funds, particularly for German and Dutch private investors. Our +12M price target amounts to € 30.5, which translates into a 1% total return expectation for this period, a figure that is in line with the German inflation rate. It is in our view not unthinkable that DES will become a takeover target in the medium term, for instance when the outlook on a recovery of the German retail market becomes less hazy. Note that our fundamental stock ratings do not incorporate potential takeover speculation.

- We think that DES is coming into the scope of European institutional investors, whereas it used to be mainly marketed among German private investors. However, when it comes to absolute liquidity, DES still has to show improvement.
- With DES's net shopping centre yields (5.4%) being 100bps higher than the average cost of debt, EPS barely reaches positive territory. Due to high dividend payouts (6.0% net yield) and slightly negative revaluations until FY 05, we estimate the FY 02-05E NNAV CAGR of DES to amount to -2.2%. This is a sharp contrast with the company's peers, which are expected to post a FY 02-05E NNAV CAGR ranging from -1% to +10%, despite gradually weaker retail market conditions across Europe.
- The stock is trading at a 6% discount to the FY 04E NNAV, which is expensive in a European context, especially when taking into account the sliding trend in DES's NNAV.

Appendix 1: German economy is emerging slowly

Key Points
- **GDP growth expected to amount to 0.0% in 2003 and to 2.0% in 2004**
- **Consumer spending is ticking up but remains modest**
- **Low likelihood on introduction of a German REIT**

GDP growth is expected to pick up modestly in FY 04

For the German economy we expect GDP growth of 0.0% in 2003 and 2.0% in 2004. This is a bit above the consensus and based on recent hopeful signs in the manufacturing production sector. The IFO-index, which gauges producer sentiment, rose in September 2003 to 91.9, the highest reading in more than two years.

Table 10: German economic forecasts

% y-o-y	1999	2000	2001	2002	2003E	2004E
GDP	2.0	2.9	0.8	0.2	0.0	2.0
Private Consumption	3.7	2.0	1.4	-1.0	0.8	1.8
Gross Fixed Investment	7.2	10.1	-4.9	-9.1	0.9	3.8
Manufacturing Production	1.5	5.2	-0.2	-1.3	-0.4	2.0
CPI	0.5	1.3	2.0	1.3	1.0	0.9

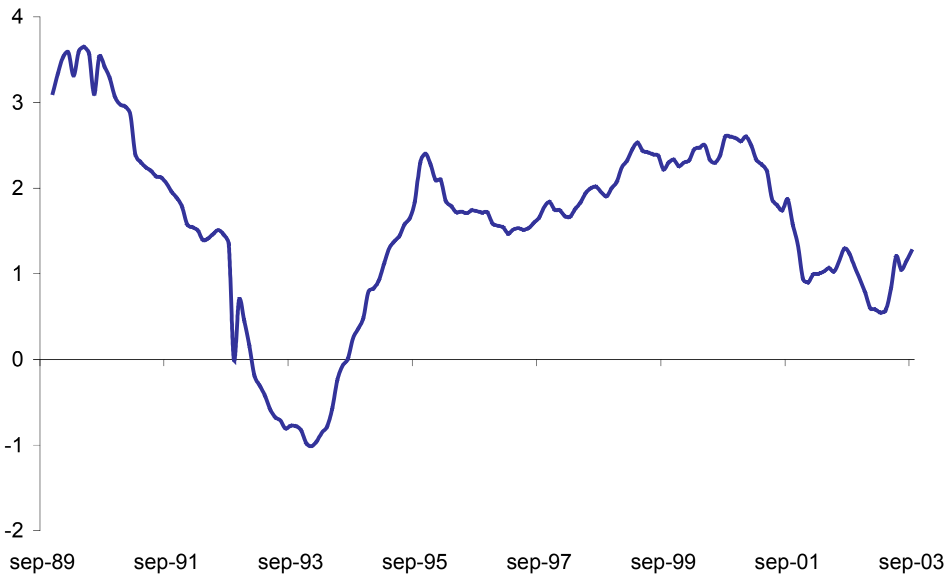
Source: Kempen & Co, Consensus Economics

Although the manufacturing industry in Germany is apparently recovering, the absolute level is still relatively low and fails to boost GDP to above-average growth as consumer spending is still in the doldrums. Consumer spending is also expected to pick up on a twelve-month horizon but our forecasted 1.8% increase will be below general economic growth we expect.

Consumer price inflation is expected to decline further in 2003 and 2004 compared to 2002. Although the changes of deflation are not completely absent, it is not part of our base-case scenario. The collective wage agreements in Germany for 2004 are pointing to an increase of wages of at least 2% and therefore are likely to offset declining prices in clothing and food prices.

Consumer spending is ticking up but remains vulnerable

Graph 4: Consensus expectations German consumer spending[1]



Source: Consensus Economics, Kempen & Co

[1] y-o-y, %, 12-month rolling forward Consumer Spending growth

All in all, we expect that the German economy will have reached its trough in 2003 and that in 2004 the economy will start to accelerate modestly. However, the economic growth for 2004 is expected to remain below average and consumer spending will attribute only marginally to overall growth.

Low likelihood on introduction of a German REIT

German open-end funds dominate the local market

The German listed property sector (market cap of around € 4bn) has been struggling since it emerged some six to eight years ago. The competition of the listed property companies like IVG Immobilien, Deutsche EuroShop, Deutsche Wohnen and TAG Tegernsee with the '*Publikumsfonds'* (non-listed open-end property funds for private investors; managing total assets of around € 77bn) and the '*Spezialfonds'* (non-listed open-end property funds for institutional investors; managing total assets of around € 10bn) has been an unfair battle from the start. Listed property companies pay normal corporation tax of 34.5% (although they have a number of ways to reduce the tax burden), whereas both versions of open-end funds do not pay corporation tax.

The tax treatment in terms of withholding tax is the same for shareholders in listed companies and open-end funds. However, the effective tax disadvantage for listed companies is just too large to be able to market themselves successfully among German investors (both private and institutional). Sooner or later this could be solved by offering listed companies the same tax treatment as open-end funds. Until then, listed property companies will have to find their own unique ways of positioning themselves among investors.

It might never come to equal tax treatment among German property entities

In any case, equal tax treatment would create fairer competition in the German property market. However, the opposition comprises of all major German banks, which are managing the open-end funds. Their power appears to be very strong, partly because the fee income from their management activities of the open-end funds is of such vital importance to the bottom-line figures of the German banks that they will not allow other parties to break their monopoly. Moreover, we think that the weak economic conditions in Germany do not stimulate the German government to provide tax advantages for listed property companies. Another indication to assume that it might never come to equal tax treatment among German property entities is that some listed property companies have started to set up fund management activities themselves, in order to be able to directly benefit from the capital inflow to these funds.

Appendix 2: German retail property market

Key Points

- **Not only have the German office and industrial sectors entered the recession cycle, but also the German retail sector**
- **Retail letting markets will remain weak in the next 12 months; rents are anticipated to decline by 5-7.5% while prime retail will portray stable rents at best**
- **Investment yields for German retail are low in a European perspective; retail values are set to decline limitedly in the next 12 months due to a rise in yields**

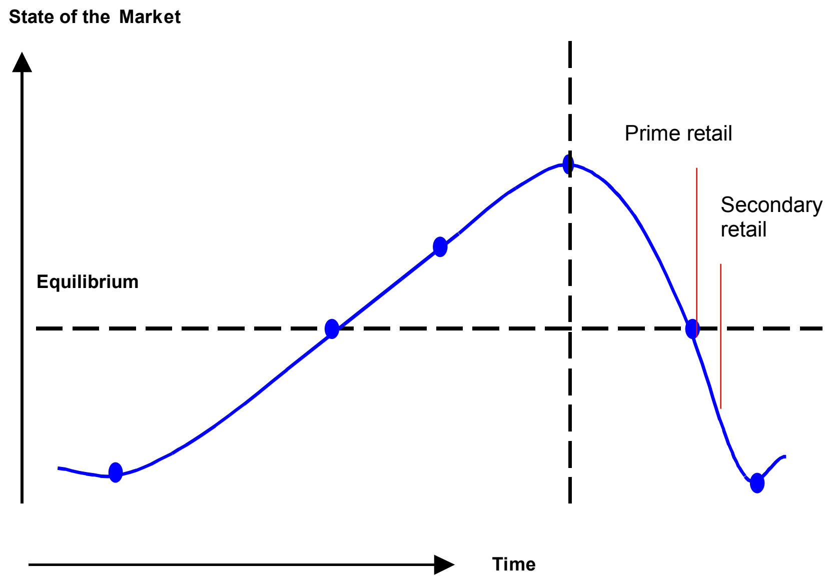
We expect no recovery of the German retail market before 2005

German retail market entered the recession cycle

As we forecasted in our *German Property Trends* (Outlook 2003), the substantial oversupply in the German retail market, coupled with negative demand growth (the market has passed through long-term occupancy averages) has sent the German retail market into recession (see Graph 5). To speak in terms of Mueller (Legg Mason), "a property recession phase begins as the respective market moves past the long-term occupancy average with high supply growth and low or negative demand growth". The cycle may reach bottom as new construction and completions start to cease, or as demand growth turns up and begins to grow at rates higher than that of new supply added to the marketplace. We do not see such an outlook before 2005.

In practice, we see landlords realising that they will quickly lose market share if their rental rates are not competitive. Therefore, they tend to lower rents to capture tenants even if only to cover their buildings' fixed expenses. Moreover, investment liquidity is also low or even nonexistent. This is illustrated by the difficulties that Dutch listed property company **VastNed Retail** (**Neutral**) experiences concerning the sale of its B-grade German retail portfolio amounting to approximately € 200m. We believe bid-ask spreads of German retail properties will continue to remain too wide for some time, which will have cause yields to remain under upward pressure.

Graph 5: State of the German retail property market



Source: Mueller, Real Estate Finance, Kempen & Co

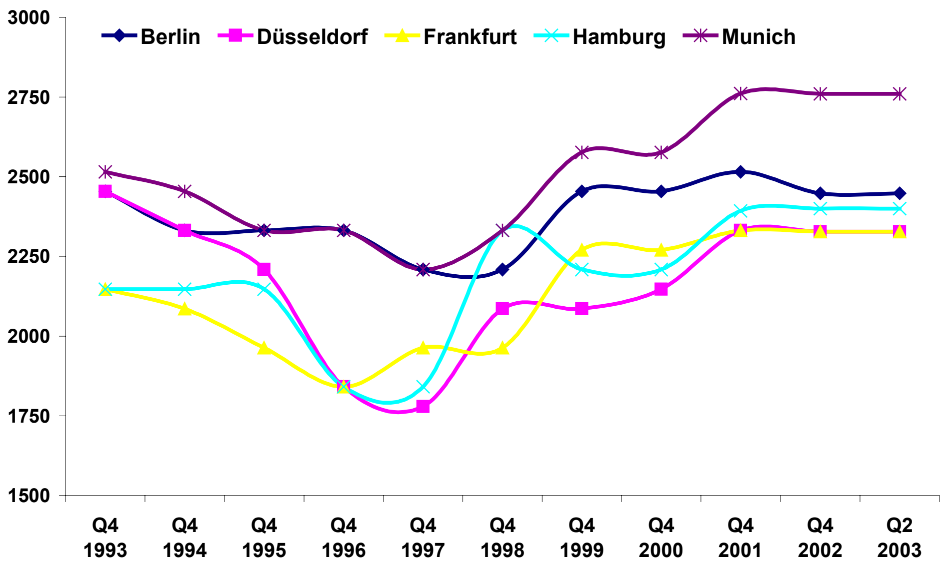
Prime retail rents may have risen too much in recent years

German retail rents under downward pressure

Although retail rents have held up relatively well in 2001 - H1 2003, we expect that B-grade rents could start declining substantially as of H2 03 (i.e., with a slight delay, due the market's late-cyclical character). The main reason is that availability of this niche is high in a historic perspective, which makes marketing of units very difficult. Moreover, rents come under pressure as changes in taxation and higher social security charges may yet add to the pressure on consumer spending. We do not exclude some rental pressure in the prime segment also from popping up, as currently about 750,000 sqm of retail space is under construction, much of it located in middle-sized cities.

Traditionally, rental contracts for German retail properties have a maturity of 10-20 years, although under current weak economic conditions there is a tendency for parties to negotiate contracts with a shorter life cycle. Tenants could benefit from negotiating break-option clauses in the rental contract, whereas landlords do not have the possibility to make a tenant leave when such breaks are due.

Graph 6: Prime annual German retail rents (in € per sqm)



Source: Jones Lang LaSalle

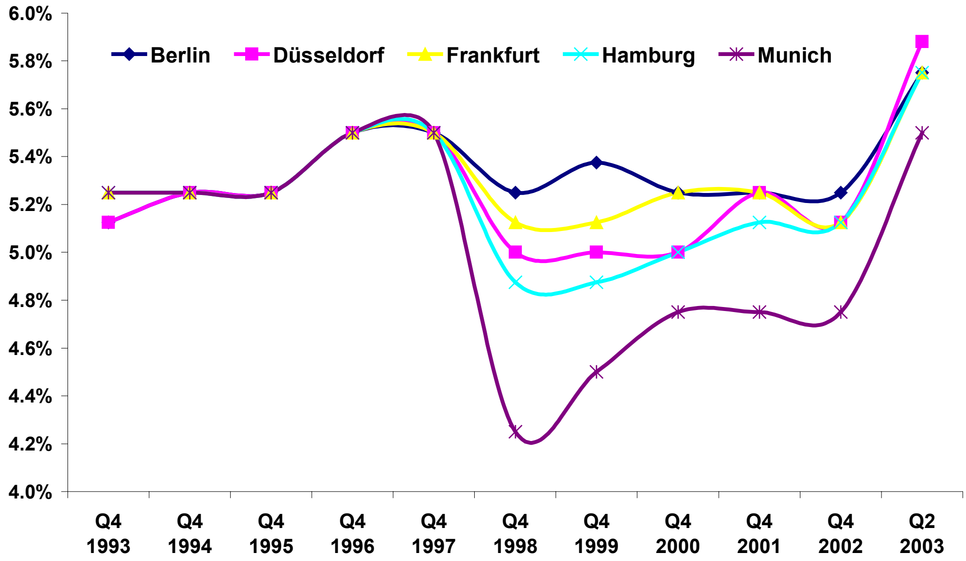
Yield rises are expected to continue in the next 12 months, although probably at a more rational pace than seen in 2002 and 2003

German retail yields subject to upward pressure

Traditionally, initial yields on German retail property investments are relatively low (±100 bps spread vs. 10-year bond yield). As this is exceptionally low in an international perspective, we think the current unattractive German investment environment will help in shifting retail yields to slightly higher levels in the next 12 months. However, the positive flipside of the weak German economy is that inflation and interest rates are kept at fairly low levels, implying that any rise in yields will realised at a more rational pace than seen in 2002 and 2003. In H1 03, average prime high street yields drifted up to 5.15%, while historically they followed levels sub-5% (see Graph 7). Weaker investment sentiment is affected by stricter lending policies in German banks, as can be seen elsewhere in Europe.

Well-managed inner-city shopping centres tend to attract more customers than high street retail, but the side effect is that a high number of shopping centres consisting of >10,000 sqm continue to be released on the market (the stock of shopping centers amounted to 365 in 2002, totalling 11 million sqm, versus 340 in 2001 and 280 in 2000). We do expect, however, that the investment risk perception towards shopping centres is lower than for high street retail, implying that shopping centres are better sheltered from large declines in value when compared to other retail segments in Germany.

Graph 7: Prime mid-point German retail yields



Source: Jones Lang LaSalle

Consolidated P&L A/c

(€ m)	2000	2001	2002	2003E	2004E	2005E
Net revenues from rents	0.0	22.7	46.5	49.3	51.3	53.7
Operating expenses	0.0	1.7	4.1	3.7	3.9	4.3
Gross income	0.0	21.1	42.7	45.8	47.6	49.6
% change			*102%*	*7%*	*4%*	*4%*
Gross margin %	*n/a*	*93%*	*92%*	*93%*	*93%*	*92%*
Depreciation & amortisation	0.0	11.9	21.6	22.7	23.1	23.5
Wages and administrative expenses	0.0	3.5	6.7	6.9	7.1	7.3
Other operating costs	0.5	11.3	4.4	3.8	2.0	2.5
EBIT	-0.5	-5.6	10.0	12.5	15.4	16.4
% change	*n/a*	*1062%*	*-278%*	*25%*	*23%*	*6%*
EBIT %	*n/a*	*-25%*	*21%*	*25%*	*30%*	*30%*
Net financial	2.3	-9.7	-11.4	-13.7	-16.2	-16.1
EBT	1.8	-15.2	-1.4	-1.2	-0.9	0.2
Taxes	-3.9	-4.5	-6.1	-5.7	-5.9	-6.2
Tax rate %	*219%*	*-29%*	*-421%*	*31%*	*31%*	*31%*
Participations (income from minority investments)	9.1	2.8	4.5	7.8	10.3	13.3
Minorities	0.0	0.0	0.0	-0.5	-0.6	-1.0
Net income (as published by company; basis for EPS)	7.0	-16.9	-3.0	0.3	2.9	6.3
% change	*n/a*	*-342%*	*-82%*	*-111%*	*745%*	*119%*
Net margin %	*n/a*	*-74%*	*-6%*	*1%*	*6%*	*12%*
Extraordinaries incl. withdrawals from capital reserves	-0.3	17.5	11.9	13.0	13.0	13.0
Net incl. extras ("consolidated unappropriated surplus")	6.6	0.6	8.9	13.3	15.9	19.3
Preference dividend	0.0	0.0	0.0	0.0	0.0	0.0
Attributable profit	7.0	-16.9	-3.0	0.3	2.9	6.3

Per Share Data

(€)	2000	2001	2002	2003E	2004E	2005E
Average share price	38.4	35.7	32.2	32.1	32.1	32.1
Average # of shs	15.6	15.6	15.6	15.6	15.6	15.6
Fully diluted # of shs	15.6	15.6	15.6	15.6	15.6	15.6
Ordinary EPS (€)	-1.08	-0.19	-0.19	0.02	0.18	0.40
% change	*N/a*	*-82%*	*-82%*	*-111%*	*745%*	*119%*
P/E multiple	1028.0	62.9	56.8	37.5	31.5	25.9
EPS including extra's	0.04	0.57	0.57	0.85	1.02	1.24
CFPS	-0.86	0.82	1.58	1.86	1.95	2.20
P/CF multiple	N/a	43.4	20.4	17.2	16.4	14.6
EBITDA	8.6	9.1	36.1	42.4	48.2	52.1
EV/EBITDA	75.1	73.9	21.2	21.6	18.9	17.3
Book value per share	38.85	37.89	35.80	34.73	33.80	33.03
P/Book value	99%	94%	90%	92%	95%	97%
NAV at market value, after def. tax (€)	38.94	37.99	36.18	34.77	34.11	33.85
P/NAV-1	-6%	-11%	-11%	-8%	-6%	-5%
DPS	0.00	1.92	1.92	1.92	1.95	2.00
Yield %	0.0%	5.4%	6.0%	6.0%	6.1%	6.2%
Payout %	0%	339%	339%	225%	192%	162%

Consolidated balance sheet

(€ m)	2000	2001	2002	2003E	2004E	2005E
Fixed assets	589.8	704.1	814.7	945.7	926.4	906.9
Current assets	346.1	228.7	189.9	39.5	44.2	51.7
- Stocks	0.0	5.6	0.0	0.0	0.0	0.0
- Debtors	85.8	27.0	31.7	31.7	31.7	31.7
- Cash and near-cash	259.5	196.1	153.9	3.4	8.1	15.7
- Other current assets	0.8	0.0	4.3	4.3	4.3	4.3
Current liabilities (net of debt)	0.8	1.0	2.7	2.7	2.7	2.7
- Trade creditors	0.0	0.0	0.0	0.0	0.0	0.0
- Other liabilities	0.8	1.0	2.7	2.7	2.7	2.7
CAPITAL INVESTED	935.1	931.8	1,001.8	985.2	970.6	958.7
Financed by:	935.1	931.8	1,001.8	985.1	970.6	958.6
Equity	607.0	592.0	559.3	542.7	528.1	516.2
Minority interests	6.1	5.1	2.5	2.5	2.5	2.5
Provisions	14.8	25.5	22.6	22.6	22.6	22.6
L/T debt	292.8	297.9	409.4	409.4	409.4	409.4
S/T debt	14.5	11.4	7.9	7.9	7.9	7.9

Ratios

	2000	2001	2002	2003E	2004E	2005E
Enterprise value to sales	n/a	29.5	16.5	18.6	17.7	16.8
Enterprise value to capital invested	0.7	0.7	0.8	0.9	0.9	0.9
Market cap/sales	n/a	24.5	10.8	10.2	9.8	9.3
Working capital/sales	n/a	10.0	4.0	0.7	0.8	0.9
Equity-to-assets	65%	63%	56%	55%	54%	54%
Debt-to-equity	51%	52%	75%	77%	79%	81%
Net gearing %	8%	19%	47%	76%	77%	78%
Interest cover	-3.8	-0.3	1.3	1.5	1.6	1.8

Enterprise value / EBITDA

(€ m)	2000	2001	2002	2003E	2004E	2005E
Market capitalisation	600.0	557.3	503.2	500.8	500.8	500.8
Net debt	47.8	113.1	263.4	413.9	409.2	401.6
Enterprise Value (EV)	647.8	670.5	766.6	914.6	909.9	902.4
EBIT	8.6	-2.8	14.5	19.7	25.0	28.6
DA	0.0	11.9	21.6	22.7	23.1	23.5
EBITDA	8.6	9.1	36.1	42.4	48.2	52.1
EV/EBITDA	75.1	73.9	21.2	21.6	18.9	17.3

Recent Property Research Publications

Company	Date	Title/Subject	Rating
Eurocommercial Properties	07-Oct-03	Expanding in Swedish mid-market retail	Neutral
Dutch Property Trends	03-Oct-03	October 2003	
Rodamco Asia	01-Oct-03	Takeover talks...	Neutral
French property companies	22-Sep-03	The French SIIC story continues	
Klépierre	12-Sep-03	Solid H1 03 results but fully valued	Neutral
Beni Stabili	11-Sep-03	Conservatively financed and a high discount	Add
Dutch Property Trends	04-Sep-03	September 2003	
PSP Swiss Property	29-Aug-03	Economic downturn visible through valuations	Reduce
Canary Wharf Group	26-Aug-03	Article fuelling bid speculation	Neutral
VastNed Retail	25-Aug-03	Significant write-off expected for H2 03	Neutral
CA Immobilien	22-Aug-03	Central Europe enterpreneur	Reduce
Société Foncière Lyonnaise	11-Aug-03	Smooth transition to SIIC status	Neutral
Metrovacesa	07-Aug-03	Bami merger is NNAV ‘neutral’	Reduce
Gecina	31-Jul-03	Continues to optimise	Add
Cofinimmo	22-Jul-03	Stability at a high price	Reduce
French property companies	21-Jul-03	Conversion to the new SIIC regime	
Liberty International	17-Jul-03	Shopping centres stand out	Neutral
Canary Wharf Group	07-Jul-03	Chances of a bid increase slightly	Neutral
WCM	03-Jul-03	Subject to ongoing distress	Reduce
Dutch Property Trends	03-Jul-03	July 2003	
Rodamco Asia	01-Jul-03	Underlying profits still good	Neutral
AEX-AMX rebalancing	01-Jul-03	Rodamco Europe AEX candidate	
Metrovacesa	24-Jun-03	The never-ending story	Reduce
IVG Immobilien	18-Jun-03	Potential M&A bottlenecks	Neutral
Metrovacesa	18-Jun-03	Bami confirms bid for extra 10%-stake	Reduce
British Land	16-Jun-03	Still benefiting from lease structure	Add
Canary Wharf Group	12-Jun-03	Potential bid arising?	Reduce
Land Securities	04-Jun-03	Cleaning up the balance sheet	Neutral
Dutch Property Trends	03-Jun-03	June 2003	
Rodamco Asia	03-Jun-03	Increasing its exposure to Seoul	Neutral
WCM	02-Jun-03	Battle over Sirius	Reduce
IVG Immobilien	20-May-03	Takeover rumours	Neutral
Corio	20-May-03	Q1 03 slightly above expectations	Neutral
European Property Sector	16-May-03	Compass – May 2003	
Land Securities	13-May-03	Shifting gear	Neutral
Corio	06-May-03	A new wind will blow	Neutral
Dutch Property Trends	05-May-03	May 2003	
AM	23-Apr-03	Retail is the profit driver	Add
Inmobiliaria Colonial	17-Apr-03	Weak Q1 03 not representative of FY 03	Add
Dutch Property Trends	04-Apr-03	April 2003	
SILIC	27-Mar-03	Valuations scaled back	Neutral
Beni Stabili	26-Mar-03	A rationale for delisting	Neutral
Canary Wharf Group	19-Mar-03	Uncomfortable surprise	Neutral
IVG Immobilien	18-Mar-03	Germany takes a beating	Neutral
VastNed Retail	12-Mar-03	FY 02 results mark a slowdown	Neutral
VastNed O/I	11-Mar-03	Cleaning up	Reduce

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