

DEUTSCHE EUROSHOP

Property • Germany

NEUTRAL (↑)

Hidden reserve of 12%

Deutsche EuroShop (DES) published a NAV (€ 43.6 per share) for the first time in its history, which came out substantially higher than market consensus. The hidden reserve in the portfolio amounts to 12%, whereby our conservative estimates had incorporated neither hidden reserves nor hidden losses. We raise our price target from € 30.5 to € 34.5 and upgrade DES from Reduce to Neutral.

New price target	€ 34.5
Potential (incl. dividend)	4%
Date	03 March 2004
Last price	€ 34.9
Reason	Analyst meeting

Fiscal year:	2002	2003	2004e	2005e
Net rental income (€ m)	46.5	49.3	51.2	53.6
EBITDA (€ m)	36.1	42.0	47.4	52.1
Net income (€ m)	-3.0	-0.5	2.9	6.2
EPS (€)	-0.19	-0.03	0.18	0.40
CFPS (€)	0.00	1.79	1.89	2.10
NNAV (€)	0.0	41.4	40.4	39.9
Dividend (€)	0.00	1.92	1.95	2.00
P/NAV-1	0.0%	-23%	-14%	-12%
EV/EBITDA	21.2	21.8	20.2	18.2
P/CF	0.0	19.5	18.5	16.6
Dividend yield	0.0%	5.5%	5.6%	5.7%



Performance vs GPR 250 EUROPE
-1m -6.0% -3m -8.3% -12m -19.7%

- NAV published for the first time** The FY 2003 NAV (before deferred tax liabilities) amounts to € 43.6 per share; the FY 2003 NNAV (after deferred tax liabilities) amounts to € 41.4. These figures are substantially higher than consensus in the market, including our own estimates. We had used a too low amount of net rents as a basis for our valuation in our initiating coverage report, caused by a too conservative conversion of the item participations into a pro-rata estimate of net rental income derived from DES's minority interests in shopping centre companies.
- Circumstantial evidence on German retail** DES applied a discount factor of 6.2% for the portfolio valuation. VastNed Retail's German portfolio is valued at 5.8% net, while Hammerson recently concluded two shopping centre sale transactions in Germany at 5.8% and 6.1% respectively. As such, DES's portfolio does not appear to be too aggressively valued in a German context.
- Portfolio incorporates a hidden reserve of 12%** The portfolio was appraised 12% above the book value. Note that in August 2003, management stated that the portfolio "neither incorporates hidden reserves nor hidden losses". Our new price target of € 34.5 translates into a 4.4% total return expectation, and justifies an upgrade from Reduce to **Neutral**. However, we anticipate a retail sector-wide low FY 2003-2005E NNAV CAGR of -1.8%, due to DES' high dividend concept and the weak German economy.

Market cap	€ 545m
Number of shares	15.6m
Avg. daily volume	4,189
Reuters code	DEQn.DE
Bloomberg code	DEQ GR
Next announcement	

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Hidden reserve of 12%

NAV came out substantially higher than consensus in the market

NAV published for the first time in the company's history

At an analyst meeting, management of Deutsche EuroShop (DES) commented on the FY 2003 (revealed no surprises; FY 2003 EPS: € -0.03) and a NAV (published for the first time in the company's history). The FY 2003 NAV (before deferred tax liabilities) amounts to € 43.6 per share, while the FY 2003 NNAV (after deferred tax liabilities) amounts to € 41.4. These figures are substantially higher than consensus in the market, including our own estimates. As far as we are concerned, the main reason for the difference is that we had used a too low amount of net rents as a basis for our valuation in our initiating coverage report on DES (October 2003), caused by a too conservative conversion of the item participations into a pro-rata estimate of net rental income derived from DES's minority interests in shopping centre companies. Improving information transparency at DES are expected by us to improve this conversion process in the near future. The market value NAV as published by management is based on 50-year DCF models, and takes into account that the value of the property and the land amounts to nil at the end of the horizon (i.e., no sale is assumed in the meanwhile). In contrast to the 'Ertragswert' (cap rate method) that is traditionally being used by German property appraisers, rents in DES' portfolio are plugged in at an estimated market value at the time of maturity of the respective rental contracts (86% matures in FY 2008 onwards).

DES portfolio valuation does not appear to be too aggressive

Circumstantial evidence on valuations of German retail property

DES applied an average discount factor of 6.2% (range: 5.7-7.5%) for the valuation of its portfolio. We consider this a realistic level and in line with the market conditions for DES' fairly modern shopping center portfolio, whereby the discount factor is equivalent to a premium of approximately 210 bps to the current 10-year German bond yield (4.1%). Although not directly comparable, some market evidence of current pricing in the German retail property market is derived from Dutch listed property company VastNed Retail (Reduce) and UK listed property company Hammerson (Not Rated). VastNed Retail's German B-grade single-shop portfolio is valued at 5.8% net, while Hammerson concluded two shopping centre sale transactions in Germany (i.e., the *Luisencenter* in Darmstadt and the *City Centre* in Essen) during H2 2003 at a net yield of 5.8% and 6.1% respectively. We consider DES' shopping center portfolio of better quality than the retail assets owned by VastNed Retail and Hammerson, implying that DES' portfolio does not appear to be too aggressively valued. Other important input factors in the NAV calculation, which underpin our stance in this respect are: (i) inflation rate: 1.2% and (ii) average operating costs: 13.1% (range: 11.7-14.9%).

We had expected no hidden reserves in the portfolio before publication of the NAV

Portfolio incorporates a hidden reserve of 12%

As a basis for the NAV calculation DES used an extensive external valuation, which was conducted by *Feri Research* and *GfK PRISMA*. As a result, the portfolio was appraised 12% above the book value. Note that in August 2003, management stated that the shopping centre portfolio "*neither incorporates hidden reserves nor hidden losses*". At the time of our initiating coverage report, we also adopted this conservative stance. Given the fact that the German economy is emerging only slowly and German consumer spending remains modest, we continue to expect retail letting markets in DES' target markets to remain weak in the next 12 months. Moreover, investment yields for German retail are still very low in a European perspective, and as such we think that German retail values are set to decline limitedly in the next 12 months due to a rise in yields. Consequently, we pencil the following valuations for FY 2004 and FY 2005 into our estimates: -1.5% and -1.0% for Germany (85% of total), and -0.75% and -0.5% for the international portfolio (15% of total).

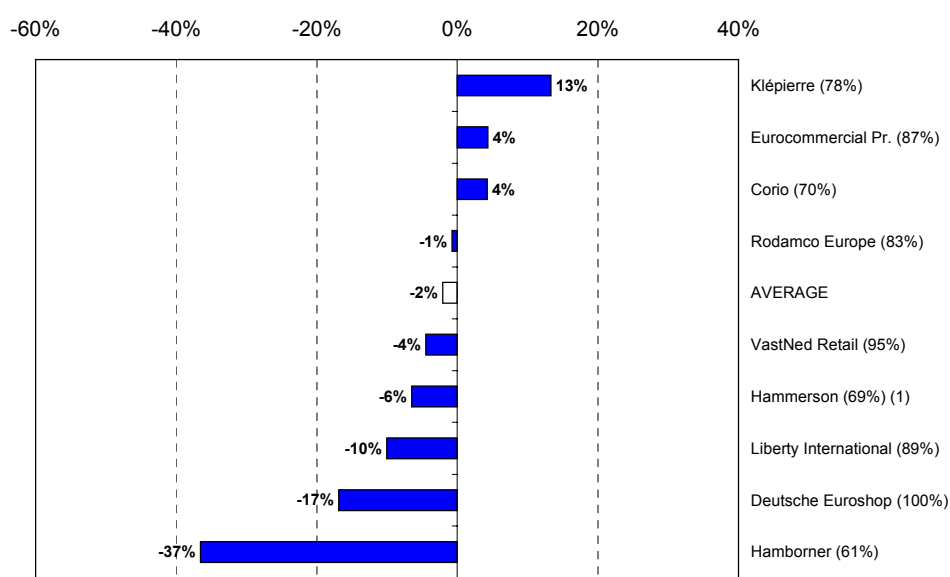


6 out of 14 of DES' participations concern stakes of ≤50%

New price target is based on 15% target discount to the +12M NNAV

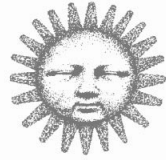
Our new estimates point towards a FY 2004E NNAV of € 40.4 per share, which is declining to € 39.9 in FY 2005 due to the impact of (i) high dividend payouts exceeding cash flow and (ii) softening of the portfolio value due to the factors described before. All in all, we estimate the FY 2003-2005E NNAV CAGR to amount to -1.8%. We raise our price target from € 30.5 to € 34.5, which is based on a 15% target discount to the +12M NNAV (€ 40.3). The reason for the relatively high target discount are (i) the risks related to the troubled situation of the German retail sector and (ii) the fact that 6 out of 14 of DES' shopping center participations concern stakes of ≤50%, which are less liquid (and thus -in our view- less valuable) than majority stakes in shopping centre companies. Our new price target of € 34.5 (was: € 30.5) translates into a 4.4% total return expectation, and justifies an upgrade from Reduce to **Neutral**. Note that on 1 April 2004, DES will re-enter the GPR 250 Europe index.

Graph 1: Discounts/Premiums to Spot (N)NAV RETAIL PLAYERS



Source: Kempen & Co





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