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HVB Equity Research

CORPORATES & MARKETS

Company Flash | Mid Caps/Small Caps

Deutsche EuroShop

Outperform

EUR 36.60

(Reuters: DEQGn.F; Bloomberg: DEQ GR; WPK: 748020)

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Shopping centers detaching themselves further from the general retail environment – dividend for 2004 assured – increase in 2005 and 2006 probable

Performance (11/15/04)	1W	1M	3M
Absolute (%)	1.1	5.1	10.6
Relative to Euro STOXX 50 (%)	0.2	0.6	-1.8

Rating	
New: Outperform	Previous: Outperform

Price target	
New: EUR 40.00	Previous: EUR 40.00

Market cap. (EUR mn)	**571.9**
Free float (%)	78.8
Capital subscribed (EUR mn)	20.0
Number of shares (mn)	15.6
Shareholders	Family Otto 21.24 %

Annual general meeting	23-Jun-05
BPC, AC	18-Apr-05
Q1	10-May-05

	2004e	2005e	2006e
Sales (EUR mn)	48.0	55.1	57.3
EBITDA (EUR mn)	38.8	40.9	42.4
EBITA (EUR mn)	17.3	18.5	19.6
EBIT (EUR mn)	17.3	18.5	19.6
Net income (EUR mn)	0.9	5.1	6.2
EPS reported (EUR)	0.29	0.34	0.40
EPS adj. pre-goodwill (EUR)	0.29	0.34	0.40
P/E (EPS adj. pre-goodwill)	127.4	108.9	91.5
EV/sales	14.41	12.93	12.27
EV/EBITDA	17.9	17.5	16.6
EV/EBITA	40.1	38.6	35.8
Dividend (EUR)	1.92	2.00	2.05
Div. yield (%)	5.2	5.5	5.6

Retailers in the DES shopping centers continue to enjoy good sales. The retail sales on a space-adjusted basis of the stores in the German shopping centers of DES recorded further gains after nine months as well. In contrast to a 1.1% decrease in the German retail sector overall, these stores generated a 3.8% increase (up 4.4% including foreign shopping centers). DES' revenues were up by 0.4% in the first nine months, or by 3.0% after adjusting for the disposal of the shopping center in Udine. For the fourth quarter we project an 11% decrease, or an increase of 1% after adjusting for the loss of revenues from the deconsolidated operation in Udine. Overall, this therefore provides affirmation of the concept and of the advantages of shopping centers in good locations in what is a persistently tough environment for the retail sector.

DEVIATIONS FROM FORECASTS: 9M/2004

EUR mn	Rep.	HVBe	Dev.
Sales	36.8	37.0	-0.6%
y-o-y	*0.4%*	*1.0%*	
Investment income	7.5	7.5	-0.9%
y-o-y	*48%*	*49%*	
EBITDA	30.8	31.3	-1.5%
y-o-y	*8%*	*10%*	
EBITDA incl. investment income	38.3	38.8	-1.4%
y-o-y	*14%*	*16%*	
Earnings from ord. activities	8.8	8.8	-0.9%
y-o-y	*14%*	*15%*	
Net income	4.1	3.8	7.2%
y-o-y	*271%*	*246%*	
EPS (EUR)	0.26	0.24	7.2%

Sources: Deutsche EuroShop, HVB Global Markets Research

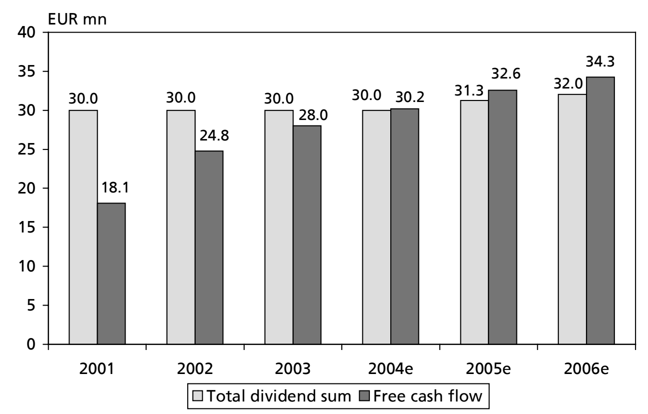
The book profit from the Udine center offsets the capital expenditure on the center in Wetzlar and produces good earnings. Whereas income from investments (+49% y-o-y), EBITDA (+14%) and EBT (+14%) were in line with our estimates, we were pleasantly surprised by the consolidated net income for the period, of EUR 4.1 mn. The reason for this lies in higher negative minority interests stemming from the capital-investment project in Wetzlar (9M expenses of EUR 2.8 mn). Moreover, the tax charge on the book profit from Udine (EUR 3.5 mn) turned out smaller than expected. Net income was up from the previous year by EUR 3.0 mn to EUR 4.1 mn. The previous year's figure would have been matched even without taking the non-recurring income from the Udine center into account, which is a good result in view of the ongoing investment project in Wetzlar, the restructuring measures being applied in Wuppertal and the roof repairs at the – now sold – center in Udine.

EUR mn	9M/2004	9M/2003	*y-o-y*
Sales	36.8	36.7	*0.4%*
Investment income	7.5	5.1	*47.7%*
EBITDA	30.8	28.5	*8.2%*
EBITDA incl. investment income	38.3	33.5	*14.2%*
Earnings from ord. activities	8.8	7.7	*14.0%*
Net income	4.1	1.1	*271.2%*

Source: Deutsche EuroShop

Dividend target of EUR 1.92 for 2004 reaffirmed, as expected. As we assumed, DES is sticking by its target of generating distributable free cash flow in 2004 of EUR 30 mn (HVBe: +8% to EUR 30.2 mn), the basis for paying out a dividend of EUR 30 mn or EUR 1.92 per share. With the additional rental income from Wetzlar (scheduled to open on February 16, 2005) and higher income from equity holdings especially in the Hamburg district of Harburg (since the end of September) and Klagenfurt (opening in early 2006), we still think an increase in the dividend in 2005 (EUR 2.00) and 2006 (EUR 2.05) is highly likely.

FCF AND TOTAL DIVIDEND PAYOUT



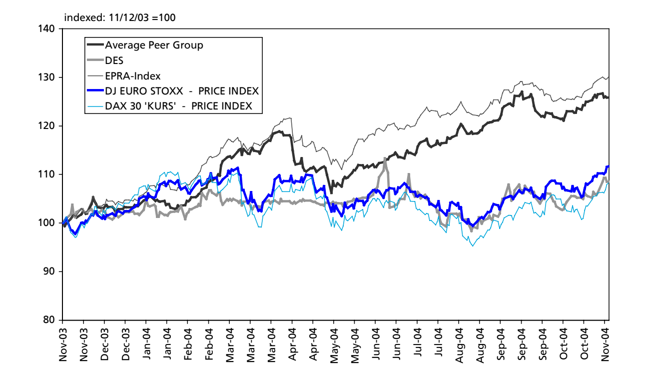
Sources: Deutsche EuroShop, HVB Global Markets Research

Upbeat guidance for Q4 earnings. Based on the good Q3 earnings and the strong guidance for Q4, we have adjusted our estimate of fiscal-2004 after-tax earnings from EUR 2.6 mn to EUR 4.5 mn. The figures do not produce any changes to our estimates of EPS for the subsequent two years, i.e. EUR 0.34 and EUR 0.40, respectively.

Capex policy remains geared to long-term profitability. DES currently has remaining liquidity of just over EUR 30 mn, now that some of the proceeds from the sale in Udine have already been spent on a piece of real estate in Klagenfurt. Management does not at present foresee any more capital investment this year, but instead next year. We do not regard this slightly changed plan as critical because, when it comes to selecting real estate worth between EUR 20 and 100 mn or so, the issue is not so much short-term use of cash but rather more so of getting a property that provides good returns over the long term. Acquisition of further properties is likely to have been put off so far on the one hand because of DES' high quality requirements and, on the other hand, by the limited number of attractive investment opportunities in the target markets of Poland, Hungary and the Czech Republic. The management board acknowledged that competitive pressure especially from closed-end real-estate funds in Germany – with Eastern Europe the target region – has increased. We expect DES to make at least one acquisition in the first half of 2005 that, as before, will also meet its profitability requirements. The main focus of business activity will, however, not be directed at external growth for the time being.

Target price of EUR 40 and dividend forecast reaffirmed – Outperform rating. We reaffirm our target price of EUR 40 based on Q3 business performance largely in line with expectations, reiteration of the dividend target and on-schedule development of the centers in Hamburg, Wetzlar and Klagenfurt. Our target price is based on our dividend-discount model (EUR 41.05) and on a comparison of NAV with the company's European rivals (EUR 39.20). The stock has regained some ground in recent weeks vis-à-vis the peer group and the EPRA index. In our valuation, we still apply a 10% discount on NAV vis-à-vis the current 17% and an 11% premium on the peer group (cf. study dated September 27, 2004).

COMPARISON OF 12-MONTH STOCK PERFORMANCE



Sources: Thomson Financial Datastream, HVB Global Markets Research

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Sources: Thomson Financial Datastream, HVB Global Markets Research