HVB
CORPORATES & MARKETS

Company Report | Mid Caps/Small Caps

Deutsche EuroShop

Outperform

Price on 9/24/04	**EUR 35.10**
High/Low (12M)	37.80/31.50
Price target	**EUR 40.00**

STOCK DATA

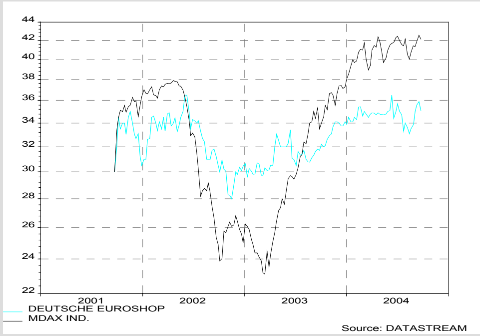
Reuters	DEQGn.F
Bloomberg	DEQ GR
WPK	748020
Average daily volume (tds.)	17.7
Free float (%)	78.8

COMPANY DATA

Market capitalization (EUR mn)	548.4
No. of shares in issue (mn)	15625.0
Capital subscribed (EUR mn)	20.0
Capital authorized (EUR mn)	10.0
Shareholders	Family Otto 21.24 %

Annual general meeting	23-Jun-05
9M/Q3	16-Nov-04
PC, AC	Apr-05

PRICE CHART



RELATIVE PERFORMANCE (% CHG.)

	1M	3M	6M
DAX	0	3.4	2.5
Euro STOXX 50	0.7	3.9	6.0
ES Financ. S.	-0.9	-6.0	-2.2

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SHOPPING FOR SHOPPING CENTERS

- **We are initiating our coverage of Deutsche EuroShop AG with an Outperform rating.** Following its admission to the MDAX, interest in this real estate company should increase further.

- **Clearly focused and increasingly transparent strategy.** As a pure holding company, DES focuses exclusively on shopping centers. Shopping centers have for years now been experiencing a boom in the retail trade and the real estate market.

- **Good portfolio and prospect of further acquisitions.** A profitable and stable (in terms of value) portfolio has been assembled in collaboration with a strong center manager. Together with the properties under construction, the available free cash flow will increase further and therefore cover the dividend from 2005 on.

- **The price target of EUR 40.00 combined with the tax-free dividend yield of 5.5%** offers a total return of roughly 20%.

	2003	2004e	2005e	2006e
Sales (EUR mn)	49	50	57	59
% change	*6.0*	*1.9*	*13.0*	*3.9*
Net income (EUR mn)	-2.3	0.3	3.8	5.3
% change	*-24.6*	*-114.1*	*1101.6*	*38.3*
EPS reported (EUR)	-0.03	0.17	0.34	0.40
% change	*-81.8*	*-599.3*	*103.5*	*18.1*
EPS adjusted (EUR)	-0.03	0.17	0.34	0.40
% change	*-81.8*	*-599.3*	*103.5*	*18.1*
EPS adj. pre-goodwill (EUR)	-0.03	0.17	0.34	0.40
% change	*-81.8*	*-599.3*	*103.5*	*18.1*
CFPS (EUR)	1.40	1.63	1.81	1.90
% change	*16.8*	*16.4*	*11.2*	*5.0*
Dividend (EUR)	1.92	1.92	2.00	2.05
EBITA margin (%)	26.6	34.5	33.9	34.6
CAGR (Sales; 03-06e)				6.2%
CAGR (EBITA; 03-06e)				15.9%
EV/Sales	13.43	13.46	12.29	11.67
EV/EBITDA	18.6	16.8	16.5	15.7
EV/EBITA	50.5	39.0	36.3	33.7
EV/EBIT	50.5	39.0	36.3	33.7
P/E (EPS adj. pre-goodwill)	-944.1	209.6	103.0	87.2
PEG ratio			-0.5	-0.3
PCF	22.6	21.5	19.4	18.4
Div. yield (%)	6.1	5.5	5.7	5.8

Contents

Investment Story

Deutsche EuroShop (DES) has a clear investment strategy and was conceived at the end of 2000 as a dividend payout model. Equipped with equity of EUR 600 mn, the initial investments in shopping centers stemmed from the Deutsche Grundbesitz. By the end of 2003, the capital was invested in a total of 13 shopping centers with the focus on Germany. The model provides for the tax-free disbursement of the liquidity surpluses of the shopping centers in the amount of 5% of the initial capital invested. Alongside the two shopping centers currently under construction, the company's goal is to acquire 2-3 properties each year. Target areas are primarily Germany, Austria, the Czech Republic, Hungary and Poland. The company will continue to purchase exclusively shopping centers. Shopping centers have been experiencing a boom for some years now. They meet consumers' higher demands and can therefore decouple from the weak overall retail segment. They offer the highest total return among the real estate types and are well located. All in all, the selected focus is correct, as evidenced by the net asset value published for the first time at the beginning of the year. Including the dividends paid out, EV has been increased 18% in three and a half years.

Value Drivers

After the initial phase of the almost complete investment of the initial capital, Deutsche EuroShop is on the verge of the next phase, which will be dominated by portfolio optimization and the acquisition of further shopping centers. The parameters for this are good:

1. **The current portfolio offers a strong basis. It is characterized by attractive locations, high property quality, strong center management, a good renter structure, a 99% occupancy rate and secure rental income.**

2. **The demands on the quality and returns of future properties are high. The close ties to the European center management market leader ECE suggest that properties will also be attractive in the future.**

3. **Alongside the clear focus, the company is also becoming increasingly transparent. Following the first-time publication of the NAV in spring 2004, the 2004 financial statements will switch to IAS/IFRS, which will also result in a strong optical increase in consolidated profit and better comparability with its European competitors.**

4. **The increase in transparency should also attract foreign investors. Together with the admission to the MDAX on September 20, this can form the basis for further external growth**.

Valuation

The company is a value stock with a high tax-free dividend yield of roughly 5.5%. The main reason for our Outperform rating is the additional possibility at the moment of stock price gains. The basis for this is a dividend discount model (EUR 41.05) and a NAV comparison with the European comparables (EUR 39.20). The steep discount to the NAV (19%) is, in our view, not justified. Our price target is EUR 40.00.

Valuation

Our valuation of DES stock is based on a dividend discount model (fair value: EUR 41.05) and net asset value (fair value: EUR 39.20). We have taken the average as our price target (EUR 40.00). Combined with a secure dividend yield of at least 5% (currently 5.5%), that provides adequate potential for an Outperform rating.

The dividend discount model shows that the market is currently expecting a return of 7%, which we think is too high. A more realistic discount rate of 6.25% produces a price target of EUR 41.05. Not least because of the strong performance of real estate stocks in Europe – but not in Germany – the difference between the 19% discount to NAV and the 11% premium for the peer group has widened. Over the short to medium term, we expect this discount to decline to 10%. Furthermore, it is realistic that DES's NAV will increase in the coming years, since a first-time valuation to market is pending on further new properties. A price target based on a peer group comparison does not make much sense, in our view, since there are hardly direct comparables that focus exclusively on shopping centers. The only key ratio comparison that makes sense, in our view, is EV/EBITDA, since this neutralizes the various depreciation methods.

Dividend discount model

The DDM arrives at a fair value of EUR 41.05

In our view, the main valuation model for DES is a dividend discount model, since the corporate strategy is based on the disbursement of a dividend. We use a two-phase model with a concrete forecast of the dividend up to 2007. We expect the dividend to be increased to EUR 2.00 in 2005. With the recently acquired shopping centers and the three centers currently under construction, which will generate rental income from the end of September 2004 (Hamburg), spring 2005 (Wetzlar) and the beginning of 2006 (Klagenfurt), we think dividend growth of 3% p.a. is realistic from 2004 to 2007. For the second phase from 2008, we assume annual dividend growth of 1%. Our discount rate is 6.25%. This reflects the dividend yield the investor demands on his capital. At the moment, the dividend yield is roughly 5.5%; the yield on Bunds and open-ended real estate funds is substantially lower. We think, however, that a higher return can be expected because of the appeal of shopping centers in general and those of DES in particular. Furthermore, the 6.25% is roughly equivalent to the yield of the centers, which we estimate at between 5,5% and 7%. Based on the current stock price, our sensitivity analysis currently calls for a return – all other things equal – of roughly 7%, which we think is too high. The reasons for this are probably the company's short history and – until the switch to IAS at the end of 2004 – the still relatively low transparency. Furthermore, three of the 14 properties are still under construction, so the investor demands a higher payout in the investment phase as a risk premium. We think, however, that all three reasons will disappear or at least decline in the next couple of quarters.

DIVIDEND DISCOUNT MODEL

EUR	2001	2002	2003	2004e	2005e	2006e	2007e	2008e
Dividend per share	1.92	1.92	1.92	1.92	2.00	2.05	2.10	2.12
y-o-y (%)		*0%*	*0%*	*0%*	*4.2%*	*2.5%*	*2.4%*	*1.0%*
Years				0	1	2	3	4
Present Value				1.92	1.88	1.82	1.75	33.68
Total Present Value								41.05

SENSITIVITY ANALYSIS

	Dividend growth p.a. after planning phase					
Demanded dividend yield	**0.50%**	**0.75%**	**1.00%**	**1.25%**	**1.50%**	**1.75%**
5.00%	48.21	50.61	53.30	56.36	59.85	63.87
5.50%	43.57	45.47	47.59	49.95	52.60	55.61
5.75%	41.58	43.29	45.18	47.28	49.62	52.26
6.00%	39.77	41.32	43.01	44.89	46.97	49.30
6.25%	38.12	39.52	**41.05**	42.73	44.60	46.66
6.50%	36.61	37.88	39.27	40.79	42.46	44.31
7.00%	33.93	35.00	36.15	37.40	38.77	40.27
7.50%	31.64	32.54	33.51	34.56	35.70	36.94

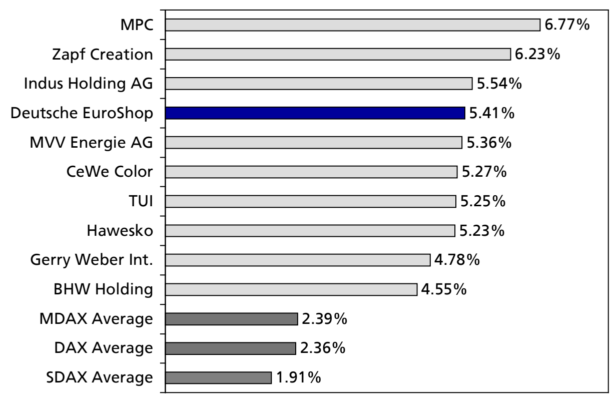
Source: HVB Equity Research

Dividend comparison

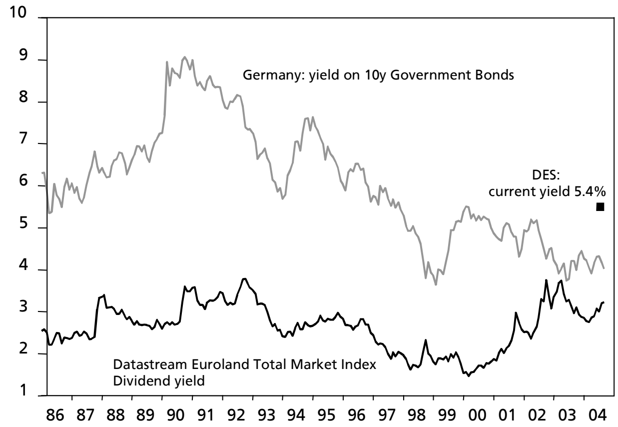
High after-tax yield of 5.4%

The unchanged payout of EUR 1.92 expected for 2004 currently translates into a dividend yield of 5.5%. Among the DAX, MDAX and SDAX stocks, DES therefore has a leading position. Factoring in that the dividend can be paid out to investors tax free because of the corporate structure of DES, the company has the highest dividend yield after taxes among the 110 largest German listed stocks. Furthermore, we consider the payment for 2004 to be guaranteed. With the comparables, we use HVB estimates for the companies we cover and I/B/E/S data for the remainder. Experience shows that there can be major deviations to the actual payout above all with the consensus estimates. A comparison to the 10Y Bund yield (4.1%) or to the average of Euroland stocks (3.2%) reveals that the DES dividend yield is outstanding. At the open-ended real estate funds with a structure similar to that of DES, the performance (BVI method) last year was 3.3% with a falling trend in 2004.

Comparison with yields in the DAX/MDAX/SDAX



Comparison with Bunds and Euroland equities



Sources: Thomson Financial Datastream, HVB Equity Research

NAV comparison

First-ever publication of NAV

A valuation based on net asset value (NAV) was made much easier with the first-time publication of the NAV by Deutsche EuroShop at the beginning of the year. NAV is total assets at market prices minus borrowed capital and is therefore the economic equity capital. The NAV does not yet include the shopping centers in Breslau, Pécs, Hamburg, Wetzlar and Klagenfurt, since they were purchased after the calculation or have not yet been completed. At the end of the year, we expect a first-time valuation for Breslau and Pécs at market values. The Phoenix-Center, opened at the end of September, and Forum Wetzlar (spring 2005) will be valued next year; the City-Arkaden in Klagenfurt will not be valued until the end of 2006. The goal is to have each shopping center valued by an external expert every 3-4 years.

NAV of EUR 43.56

NNAV of EUR 41.48

The valuation as of December 31, 2003 produces a NAV of EUR 43.56 per share. The stock is currently trading at a 19% discount to NAV. Factoring in the deferred taxes, the net NAV (NNAV), which is standard practice particularly in other European countries, is EUR 41.48 (discount: 15%). This after-tax NAV factors in the possibility of sales from the portfolio subject to tax, which we consider to be improbable for the time being following the sale of the Italian shopping center in July 2004.

CALCULATION OF NET ASSET VALUE

		12/31/03
Tangible assets	**EUR mn**	**0.037**
NAV of existing properties	EUR mn	553.558
Book values of other financial investments	EUR mn	64.945
Financial assets	**EUR mn**	**618.503**
Claims on affiliated companies	EUR mn	20.786
Other assets	EUR mn	0.923
Liquid funds	EUR mn	41.559
Deferred item	EUR mn	0.014
Total assets	**EUR mn**	**681.822**
Liabilities	EUR mn	-0.006
Provisions (excl. provisions for deferred taxes)	EUR mn	-1.165
Total borrowed capital	**EUR mn**	**-1.171**
NAV	EUR mn	680.651
Number of shares	mn	15.625
NAV per share	**EUR**	**43.56**
Deferred taxes	EUR mn	-32.600
Net NAV (NNAV)	EUR mn	648.051
Net NAV per share	**EUR**	**41.48**

Source: Deutsche EuroShop

Peer group comparison based on NAV

To determine the appropriate discount to NAV, we use a comparison with European real estate companies that focus on retail real estate. Even in this environment, there are no companies that have exclusively shopping centers in their portfolios. The average NAV premium of the peer group to the market cap is 11%, compared to a discount of 19% at DES. The level depends in each case on several factors, such as country specifics, tax parameters (advantages in France, the Netherlands), company specifics, name recognition factor and the prospects for the various types of real estate. In our valuation we assume a discount for DES of 10%. We still think a discount is justified, since the focus in on Germany, a market with weak retail sales and lower real estate returns. Furthermore, DES's market capitalization and therefore probably also its name recognition factor is the lowest, which has so far limited the interest of foreign investors in particular. A final reason is that 3-4 shopping centers are only in the start-up or construction phase, which harbors a certain risk. A 10% discount produces a fair value of EUR 39.20, which should be achieved over the short to medium term. Catalysts could be the release of the NAV of further shopping centers or the switch to IAS.

PEER GROUP COMPARISON BASED ON NAV

mn	Country		Share of retail real estate properties	Free Float	Market cap.	NAV 2003 (before tax)	Discount (%)
Corio	NL	EUR	70%	61%	2,656	2,073	28%
Eurocommercial Pr.	NL	EUR	87%	100%	771	637	21%
Hammerson	GB	GBP	68%	44%	2,083	2,221	-6%
Klepierre	F	EUR	81%	96%	2,795	2,165	29%
Liberty Intl.	GB	GBP	88%	45%	2,827	3,187	-11%
Rodamco Europe	NL	EUR	85%	46%	4,948	4,330	14%
Vastned Retail	NL	EUR	99%	98%	800	785	2%
Median							**14%**
Average							**11%**
Deutsche EuroShop	**D**	**EUR**	**100%**	**79%**	**554**	**681**	**-19%**

Sources: Company data, Thomson Financial Datastream, HVB Equity Research

Performance has lagged behind competitors

Ground to make up on European comparables. The difference between the NAV discount for DES stock and the NAV premium of the European competitors has even increased over the last 12 months. While the EPRA Index (European Public Real Estate Association) added 34%, DES stock gained only 12% (including dividend: +19%), which is therefore on par with the DAX and SDAX. The reason why the stock could not track the European listed real estate companies is, once again, the lack of foreign interest in the young company. We suspect another reason is the weakness of the German retail trade and the low interest in German real estate stocks. While the 30 large European real estate stocks (E&G EPIX 30) added 26% in 12 months, German real estate stocks (E&G DIMAX) are almost unchanged.

PERFORMANCE COMPARISON REAL ESTATE STOCKS AND INDEXES

	Price 9/23/04	1 week	1 month	2 months	3 months	6 months	12 months
Corio	39.50	-1%	7%	12%	12%	13%	38%
Eurocommercial Properties	25.25	-2%	-1%	3%	3%	7%	18%
Hammerson	753.00	-2%	4%	7%	9%	14%	33%
Klepierre	60.55	-2%	7%	10%	6%	8%	32%
Liberty Intl.	854.50	1%	7%	9%	15%	15%	34%
Rodamco Europe	55.20	-2%	6%	9%	12%	9%	24%
Vastned Retail	47.78	0%	5%	7%	12%	1%	17%
Average		**-1%**	**5%**	**8%**	**10%**	**10%**	**28%**
Epra Europe Real Estate Index	1522	0%	5%	6%	7%	11%	34%
Epra/Nareit Global Index	1248	-1%	3%	6%	6%	4%	18%
DJ Euro STOXX	249	0%	5%	3%	0%	4%	11%
DAX 30 Performance	3942	0%	6%	4%	0%	6%	14%
EGDIMAX	n/a	0%	-2%	-3%	-4%	1%	-1%
EGEPX30	244	-1%	4%	7%	8%	7%	26%
Deutsche EuroShop	**35.45**	**0%**	**6%**	**6%**	**2%**	**3%**	**12%**

Source: Thomson Financial Datastream

Peer group comparison

Not very informative

Calculating a price target based on the earnings estimates of the peer group companies does not make much sense for real estate companies. The P/E range for the peer group is, for example, very large. Deutsche EuroShop's EPS is, furthermore, distorted by the lack of IAS accounting and the highest possible use of depreciation. The only multiple that makes sense for real estate companies is EV/EBITDA, since it neutralizes various depreciation variants. The higher multiple for DES is, however, no surprise given the very young portfolio.

PEER GROUP COMPARISON

		Price 9/23/04	EV/EBITDA 2004e	EV/EBITDA 2005e	P/E 2004e	P/E 2005e	Dividend 2004e	Dividend yield 2004e
Corio	EUR	39.35	16.2	15.5	13.4	12.8	2.34	5.9%
Eurocommercial Pr.	EUR	25.80	15.9	15.0	16.8	15.9	1.57	6.1%
Hammerson	GBP	751.50	20.5	19.9	25.3	23.8	17.96	2.4%
Klepierre	EUR	59.50	15.1	12.3	23.9	21.6	2.21	3.7%
Liberty Intl.	GBP	843.50	19.1	18.1	30.2	30.0	26.25	3.1%
Rodamco Europe	EUR	55.75	16.2	15.1	15.2	14.6	2.96	5.3%
Vastned Retail	EUR	47.65	15.8	14.9	12.5	12.3	4.30	9.0%
Median			**16.2**	**15.1**	**16.8**	**15.9**		**5.3%**
Average			**17.0**	**15.8**	**19.6**	**18.7**		**5.1%**
Deutsche EuroShop	**EUR**	**35.40**	**16.8**	**16.5**	**209.6**	**103.0**	**1.92**	**5.4%**

Source: Thomson Financial Datastream

The sole pure-play shopping center AG

With its exclusive focus on shopping centers, Deutsche EuroShop is clearly unique among German real estate companies. Furthermore, the company, which can be described as a financial investor, is very young, as evidenced by its relatively new real estate portfolio based on strategic considerations. Of the currently 14 shopping centers in which DES has an interest (ranging from 33% to 99.9%), nine are located in Germany and 5 in other European countries. The company, which was previously funded by Deutsche Bank Group, was created at the end of 2000 as a dividend payout model with equity of EUR 600 mn. The business model is based on a payment of a high regular dividend payment, which is to be generated from the surplus liquidity generated by the investments.

Business activity – Pure play for shopping centers

Unique focus as a listed real estate company

Deutsche EuroShop AG is the only listed real estate company that invests exclusively in shopping centers. The company has an interest in nine domestic and five foreign shopping centers. Of the latter, one is located in each of France, Italy, Poland, Hungary and Austria. The fourteen total centers have a leasable area of 517,100 square meters and around 1,290 store units. With good city center locations and shopping centers located at established sites, the occupancy rate is currently above 99%. This generates positive, long-term earnings from rental income that is both indexed and includes a share of the rental revenues. External center management ensures high profitability. This is geared to achieving a high free cash flow, which is to be paid out as a dividend. Furthermore, the company's aim is to expand its portfolio of shopping centers and to increase their value over the long term. This is being achieved by measures to preserve the value of existing properties and through portfolio optimization. This can take the form of divestments and new acquisitions.

Lean structures are appropriate

The holding company currently has a headcount of five. These include the two board members, Claus-Matthias Böge as spokesman (since October 2001) and Dirk Hasselbring (since June 2003). Both board members have many years of experience in the real estate business. Prior to joining Deutsche EuroShop, Mr. Böge was an executive of the ECE Group, which acts as center manager for most of the DES investments. While the holding company's lean structure does harbor a certain personnel risk, decision-making processes are extremely short and personnel costs are low. Furthermore, this headcount is a limiting factor on the group's further external growth, since work on a single project can easily tie up one board member for half a year. From this standpoint, no more than two to three acquisitions or sales of shopping centers should currently be possible each year. Since this number is in line with the company's goals and in our view is also consistent with the company's financing possibilities, we think this lean structure is appropriate overall.

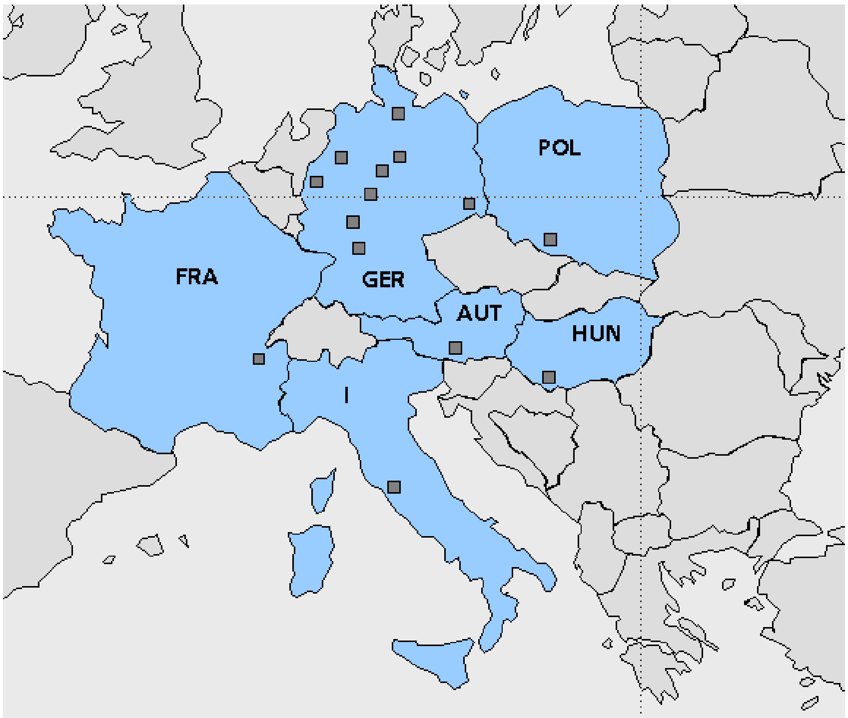
Shareholder structure – Mix of majority and minority stakes

Investment manager with limited risk

Deutsche EuroShop normally becomes involved early on, i.e. before a shopping center is opened, as an equity investor indirectly via equity stakes in promising shopping centers. At the moment, the Deutsche EuroShop Group consolidates – alongside the AG – only those companies where the AG has the majority of the voting rights, which is the case at seven property companies. The other seven companies, where the equity stakes range from 33% to 50%, are shown in the consolidated balance sheet as investments. The stake in a target company can take the form of the acquisition of existing shares of a company or within the framework of a capital increase by the target company. With this structure, the risk for DES AG as a pure investment manager is relatively limited. Provided that the shopping centers are well managed, their value is relatively stable with the cash flow yield guaranteed long term from rental income. Another factor that minimizes the risk, in our view, is the composition of the partners with whom DES holds or shares the equity stakes.

REGIONAL OVERVIEW OF THE SHOPPING CENTER PORTFOLIO

Focus on Germany and selected European locations



Germany:
Sulzbach, Viernheim, Kassel, Wolfsburg, Wuppertal, Hamm, Dresden, Hamburg-Harburg, Wetzlar

Austria:
Klagenfurt

France:
Annemasse

Italy:
Viterbo

Hungary:
Pécs

Poland:
Breslau

Source: Deutsche EuroShop

History – High transparency thanks to short history

Short history

The company has a short history. It only started its real business activity at the end of 2000. The company, which evolved from the Deutsche Grundbesitz Management, invested the bulk of its initial equity capital of EUR 600 mn in shopping centers in an initial phase up to the end of 2003. In the second phase, which began in 2003, the company turned to the capital market. The interim peak was admission to the MDAX. Alongside the expected continuation of this phase in the future, we expect – after almost complete investment – a further third phase of portfolio optimization and expansion.

High degree of transparency

While in the first phase the efforts were mainly internal, i.e. to assemble a profitable portfolio, the second phase was already exploited to create the structures for a transparent company story. Alongside the creation and intensification of investor relations, clear company goals were communicated. Together with a clear focus on one type of real estate – shopping centers – the company has achieved a high degree of transparency. This holds particularly true for an investment and real estate company. One advantage here is that growth of the portfolio has been less "wild" than with other listed real estate companies, which in many cases tend to give the impression of historical but not strategic growth. This often results in a lack of transparency.

Milestones of the company's short history

1997 **October:** Company founded with the name TORWA Beteiligungs-AG

2000 **September:** Name changed to Deutsche EuroShop AG, Eschborn

Offering of 15.625 million shares (equity capital of EUR 20 mn) from the holding of the old stockholder Deutsche Grundbesitz Management GmbH at a price of EUR 38.40 per share (total: EUR 600 mn). The proceeds were due to the old stockholder, which provided Deutsche Euroshop AG – within the framework of an increase in the equity capital – with further funds totaling EUR 580 mn as a capital reserve. As a result, DES had equity capital of EUR 600 mn.

Start of actual business activity

Acquisition of the interests in Sulzbach, Dresden, Kassel, Wolfsburg, Viernheim, Wuppertal, Annemasse, Udine

2001 **January: Official listing**

March: Acquisition of the interest in Viterbo, Italy (99.9% share)

November: An investor group around the Otto family, acquires 33% of the shares

2002 **February:** Acquisition of the interest in Hamm (87.7%)

November: Acquisition of the interest in Pècs, Hungary (50%)

2003 **July:** Admission to the **SDAX**

August: Acquisition of the interest in Hamburg (50%)

September: Deutsche Bank completes the third phase of the sale of its stake. Free float increases to 79%

October: Acquisition of the interest in Wetzlar (65%)

December: Acquisition of the interest in Breslau, Poland (33.3%)

2004 **January:** Admission to the **EPRA Index**

July: Sales of the interest in Udine, Italy

August: Acquisition of the interest in Klagenfurt (50%)

September: Admission to the **MDAX**

Weak consumer and real estate environment has little impact

At first sight, a shopping center AG combines two sectors affected by both the economic weakness and structural problems. But the first impression is misleading. In terms of retail sales, the shopping centers – at least those in good locations – are an exception. Sales of the German shopping centers increased 3.9% in the first six months of 2004, while total retail sales in Germany were down 1.5% y-o-y. There is also no talk at shopping centers – again in good locations – of falling rental income and high vacancy rates as for office or residential real estate. Overall, retailers in shopping centers are therefore experiencing a boom, which is resulting in good profitability of the corresponding retail real estate.

Real estate cycles have little impact

Real estate cycles are not decisive

High vacancy rates, falling rents and increasing sales areas are the dominant headlines in the real estate industry. The return on existing properties in Germany has declined strongly over the last two years. The entire real estate market is, however, very heterogeneous, so we do not wish to make blanket comments or forecasts. Real estate cycles, which are in different phases depending on region and real estate segment, have only marginal importance for the shopping centers. The various real estate indexes refer exclusively to office and residential real estate, but not to retail real estate. While the fight for market share in the retail sector has also resulted in consolidation processes in the real estate market, this is more a structural problem than a direct impact of the economic development.

Retail real estate with high net cash flow yields

Over the long term, retail properties generate the highest total return. The appeal of retail real estate comes from the fact that it has the highest and most stable return among all types of real estate. According to Deutsche Immobilien Datenbank GmbH (DID), retail properties profit above all from above-average net cash flow returns, which in the 5Y average was 5.9% versus 5.1% for all existing properties. The second component in calculating the total return, the value change return, also declined less strongly in the last two years than for other types of real estate. Overall, the total return even in the weak years 2002 and 2003 was 5.4% and 4.9%, respectively, while 4.3% and 2.5%, respectively, was calculated for all existing properties. According to estimates from the DID, retail real estate will also report the highest returns of all real estate segments in 2004. Undoubtedly, the consolidation process in the industry will continue. While specialized outlets in good locations and well managed shopping centers should perform well, secondary locations or those in the suburbs will report higher vacancy rates and will therefore decline in value.

GERMAN REAL ESTATE INDEX: PERFORMANCE AS % P.A. FOR EXISTING PROPERTIES

	1996	1997	1998	1999	2000	2001	2002	2003	5Y-Average
Total Return									
Retail	4.7	6.7	5.0	5.0	5.1	6.0	5.4	4.9	5.3
Office	4.5	2.9	5.1	5.2	6.0	6.2	4.6	1.6	4.7
Residential	-2.4	5.7	3.9	4.1	5.1	5.4	3.1	5.2	4.6
Mixed retail/office	3.4	0.9	3.8	3.3	4.0	4.3	2.8	1.6	3.2
Other uses	3.2	5.7	3.6	4.8	5.4	6.0	4.4	2.5	4.6
All existing properties	**3.5**	**3.7**	**4.8**	**5.0**	**5.6**	**5.9**	**4.3**	**2.5**	**4.7**
Net cash flow yield									
Retail	6.8	6.1	6.2	5.8	5.5	6.3	6.1	5.9	5.9
Office	5.6	5.2	5.2	4.8	5.0	5.5	5.6	5.0	5.2
Residential	5.1	5.2	4.6	4.6	4.3	4.3	4.4	4.3	4.4
Mixed retail/office	5.3	5.0	5.4	4.7	4.9	4.6	4.2	3.7	4.4
Other uses	5.4	5.2	4.6	5.3	5.2	6.1	5.5	4.8	5.4
All existing properties	**5.7**	**5.3**	**5.3**	**5.0**	**5.0**	**5.4**	**5.3**	**4.9**	**5.1**
Value change yield									
Retail	-2.1	0.6	-1.1	-0.8	-0.4	-0.3	-0.6	-1.0	-0.6
Office	-1.1	-2.3	-0.1	0.4	1.0	0.7	-1.0	-3.4	-0.5
Residential	-7.6	0.5	-0.7	-0.5	0.8	1.1	-1.4	0.9	0.2
Mixed retail/office	-1.9	-4.1	-1.5	-1.5	-0.9	-0.3	-1.4	-2.1	-1.2
Other uses	-2.2	0.5	-1.0	-0.5	0.2	0	-1.1	-2.3	-0.8
All existing properties	**-2.2**	**-1.6**	**-0.5**	**0**	**0.7**	**0.5**	**-1.1**	**-2.4**	**-0.5**

Sources: DID Deutsche Immobilien Datenbank GmbH

Consumer climate remains bleak

Sector with structural and macroeconomic problems

The weak state of private consumption and the retail trade is not resulting in a decline in rents at the DES shopping centers. While German retail sales were down 1.5% y-o-y in the first six months of 2004, retail sales at the German DES shopping centers were up 3.9% (all centers +4.5%) on a like-for-like basis. The reasons for this are the high occupancy rate, the good sector mix and the centers' good locations. Of course, this decoupling from the consumer environment cannot be assumed for all retail shopping centers. In fact, the entire sector is suffering from structural problems and continuing consumer restraint.

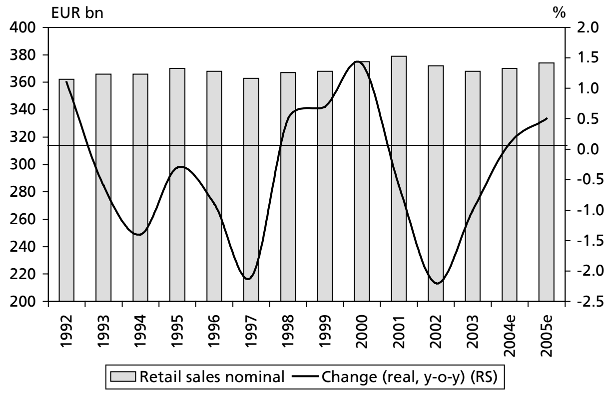
Retail sales still weak

No recovery in the retail trade for the time being. As of mid-September, the Association of German Trade and Retail (*Hauptverband des Deutschen Einzelhandels* (HDE)) lowered its full-year forecast for 2004 sales because of the sluggish economic recovery from a nominal +0.5% to -0.5%. For the second half of the year, the HDE expects only nominal sales growth of 0.3% after a decline of 1.5% in the first half of the year. This is therefore the third year in which a decline is expected. For 2005 the DHE has withdrawn its forecast so far of -0.5%

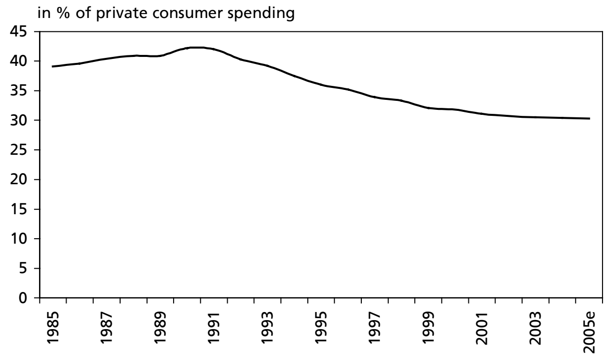
entirely because of the uncertain economic situation. Surveys conducted by the market research group GfK have noted a further deterioration primarily in East Germany, with pressure coming from the high oil price and the discussion of labor market reforms (Hartz IV), income expectations and the propensity to buy.

THE RETAIL TRADE IN GERMANY

German retail sales in the narrower sense



Share of retail sales in consumer spending



Sources: BAG, HDE, Statistisches Bundesamt, HVB Equity Research

Outlook remains guarded

The parameters for long-term growth in the retail trade are not good. Alongside economic fluctuations, the pressure on households within the framework of inadequate structural reforms are weighing heavily. Additional costs for healthcare, pension provisioning and social insurance will not trigger a sustained trend reversal. Even on an economic recovery, the lack of impact on the labor market will have a restraining effect. The share of retail sales in consumer spending has been falling steadily since the beginning of the 90s. No sustained break in this trend should be expected in the coming years either, since other consumer expenses such as rent, ancillary residential costs, services and expenditures for mobility should increase further, thereby limiting retail spending.

Retail facing sales area problems

The German retail trade is facing a growing sales area problem. The strong competition for market share and the pressure on margins have increased further since German unification. Sales area has quadrupled in East Germany since 1989. Between 1995 and 2003, the population in West Germany increased by 0.3% p.a. (Source: Federal Statistical Office, IfH), while sales area increased by 1.5% p.a. In East Germany, the divergence increased even more with minus 0.6% (population) and plus 3.1% (sales area). As a result, at 1.23 square meters, per capita sales area almost reached the level in West Germany with 1.32 square meters, with much lower purchasing power. There are many reasons for the strong expansion of sales areas. On the one hand, market exit costs are very high. Long-dated rental contracts and costs for personnel measures scare many retail chains away from closing even unprofitable sales areas. **On the other hand, consumer demands have changed.** First, with a pronounced shift to **Discounters**, second, with demands on location (accessibility, market atmosphere and ambiance, parking, product line, and uniform opening hours), which have increased considerably. These demands are in turn benefiting the **shopping centers**. These trends are not expected to reverse over the short to medium term, since it will take years until the weak locations are closed. In fact, retailers are being compelled to go along with the trend to larger and preferred locations and facilities to subsidize unprofitable locations. Whether – and above all when – this will result in adjustments is of course anyone's guess.

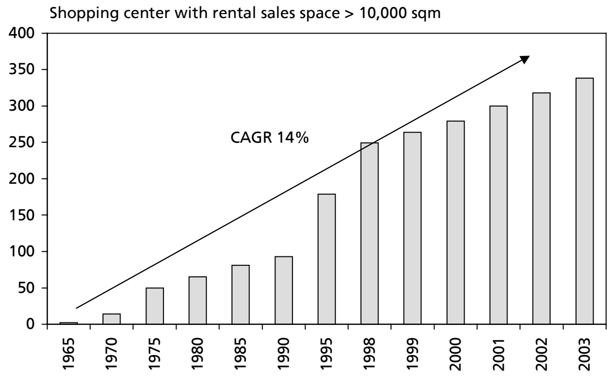
Shopping centers are exacerbating the problem

Sales area capacities are not a problem for everyone. The shopping center operators and initiators reacted, above all to the higher demands of consumers, with their center offerings. With their own economy, they are therefore exacerbating the sales area problem in the retail trade. On the one hand, there are therefore the profitable, well-managed shopping centers and, on the other, the retailers whose location problem is resulting in low returns.

INCREASE IN SALES AREAS AND IN THE NUMBER OF SHOPPING CENTERS

Excess sales areas increasing …

… not least because of the trend to shopping centers



Sources: ECE, HDE, HVB Equity Research

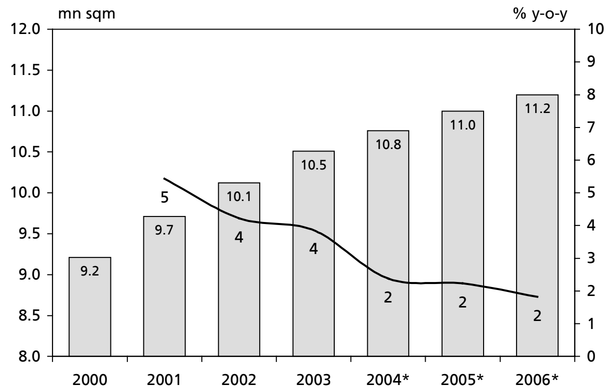
Shopping centers have their own economy

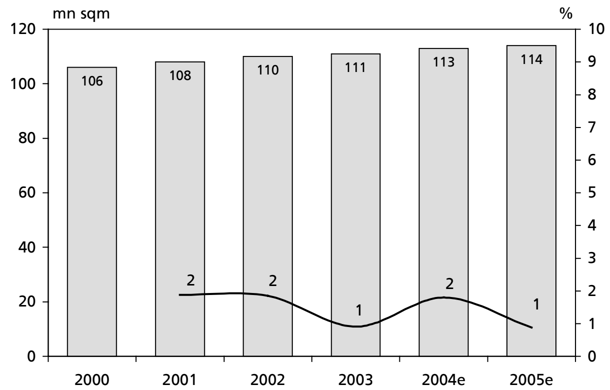
Development of the shopping centers

The number of shopping centers has also risen strongly in Germany since the end of the 70s. After becoming established in the USA and Canada, the number of shopping centers with a rental area of over 10,000 square meters increased in the initial stage from 1965 to 1980 by 26% p.a., but slowed to 4% p.a. in the 80s and made the final breakthrough in the 90s with an increase of 186 shopping centers (+12% p.a.). Since 1999, the number has increased by no less than an average of 7% p.a. to roughly 350 shopping centers (mid-2003) from a sales area of 10,000 square meters and to 455 centers with a sales area of 8,000 square meters. As a result, growth rates are substantially higher than for overall retail sales areas. This trend should continue for the time being, so there appears to be no solution to the previously described sales area problem in the retail trade.

ABOVE-AVERAGE GROWTH AT SHOPPING CENTERS

Growth of center sales areas** stronger than … … the growth of total retail sales areas





* Forecast data based on planned projects, 7/04

** Shopping centers from a sales area of 10,000 square meters

Sources: EHI, Kemper`s, HDE

The shopping center concept

The strong increase in the number of shopping centers has to do with the undoubted advantage these centers offer compared to the rest of the stationary retail trade. In contrast to the shopping and business centers that have evolved, the shopping centers are deliberately planned to bundle retail and other service providers, which are uniformly administered and managed. Above all this group system sets yardsticks for customers because of standardization. These include area concentration, standard opening hours, adequate parking and infrastructure links and a balanced sector mix. In this context, **center management** assumes decisive importance. It ensures a friendly and bright shopping atmosphere and organizes sales and events in the center. In many cases, a staggered rent system has a positive impact on the entire shopping center and therefore on the entire appeal of the city center. The center manager ensures that individual businesses pay a rent dependent on the sector, which is for example lower for a hairdresser than for a jeweler.

Market segmentation with advantages for centers in city locations

As the number of centers increases, various segments have become established. Differentiated by center type, the focus is on classical shopping centers (roughly 60%), followed by specialized centers (21%), shopping galleries and passages (14%) and other variants (5%).

- In East Germany the trend has been primarily to large **shopping centers outside the cities**.
- In West Germany, primarily **city center locations** were selected for shopping centers in recent years. As a rule, they offer a high-end and therefore high-priced range of goods. On the other hand, discounters and department stores offer their generally lower priced products above all outside the cities or on the city outskirts and in the suburbs.
- There has in recent years been an increase in the importance of **specialized centers**, which differ primarily in the rent structure and the sales area dominance of the magnet renters, above all discount-oriented specialized outlets. As a result these are positioned on the outskirts of cities with good transportation links, but their architecture is as a rule less appealing.
- There has also been the emergence of **factory outlet centers** with large numbers of brand manufacturers. The renter and sector mix tends to be dominated by clothing.
- **Off-price centers** have also emerged, where brand products are offered at discounts; retailers often buy the goods in bulk from various manufacturers.

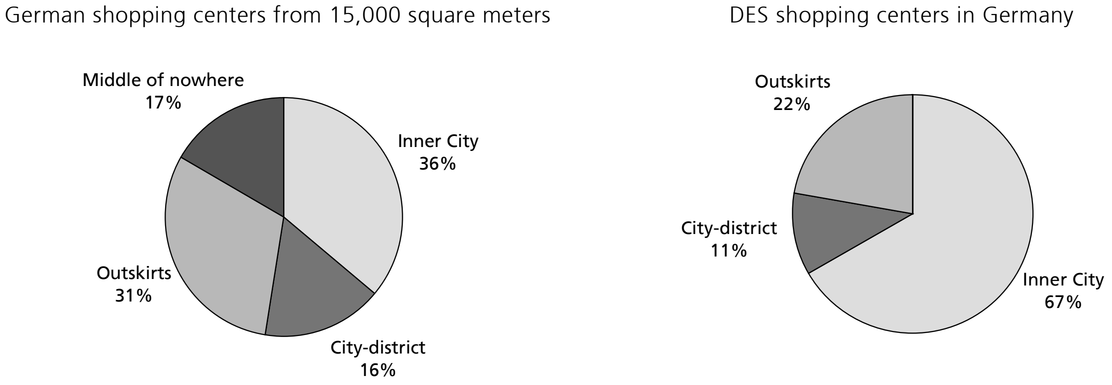
A higher ratio of leisure facilities is not desirable

The integration of leisure facilities into shopping centers is sluggish. This feature, which is widespread above all in the USA, is having a difficult time in the German market. So-called **Urban Entertainment Centers** (UEC) are rare and are in most cases integrated into cinemas or game centers. The reason for this is probably that Germany and Europe already have high quality of leisure possibilities in the inner cities. We think that no expansion should be expected in the future either, since the potential to combine shopping and leisure tends to be on the low side. In fact, the potential will be limited to combining shopping and gastronomy. The rents obtainable for leisure uses are as a rule lower than for retail uses. Furthermore, the risks in the fast-moving leisure market are much higher. On financial aspects, the shopping center as retail real estate is therefore much less risky. At the 14 centers in the DES portfolio, there are only two centers (Rhein-Neckar/Main-Taunus) that integrate a multiplex movie theater.

Center operators prefer city locations

Shopping center operators are increasingly focusing on city centers. The perennial question of whether shopping centers should be located in the city center or in the suburbs has in the interim been basically answered. The backdrop is that newly planned centers are not to form a counterpoint to local retailers. In fact, the operators are betting on integration into the inner-city environment, ideally with integration to neighboring shopping streets and public buildings. Despite competition, the retail trade has so far even profited from the additional potential purchasing power.

LOCATION OF SHOPPING CENTERS IN GERMANY AS A WHOLE VERSUS DES CENTERS IN GERMANY



Sources: Institut für Gewerbezentren, Deutsche EuroShop, HVB Equity Research

Large centers remain the number 1 attraction

The different center characteristics nevertheless have some similarities and are therefore in a position to compete with each other. In our view, however, the advantage of the large shopping centers is that they also attract passing customers and develop into a larger customer magnet. DES's focus on shopping centers located above all in cities and at established locations appears to us to have the lowest risks. The size, location and the renter/industry structure is most suited to endure over the long term and therefore to generate the required return on capital employed. The roughly 30 new centers created in 2002 and 2003 had an average sales area of 24,000 square meters. Generally speaking, the larger shopping centers have a much lower vacancy rate than smaller centers, as a survey conducted by Bulwien AG in 2003 showed. The advantage is as a rule an attractive sector mix and professional management, which ensure optimal conceptual parameters and therefore minimize the vacancy risk.

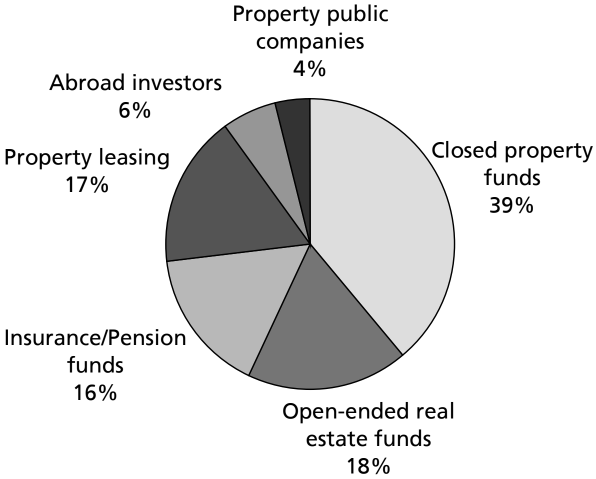
Alternative shopping channels still no competition

A change in shopping habits can undoubtedly pose a risk to the concept of the shopping centers. Over the short term, however, we think the risk is low. First, shopping centers have increasingly become established as a concept. Second, the share of consumer spending over the Internet is still very low. GfK Prisma estimates Internet consumer sales in 2004 at roughly EUR 11 bn, which translates into roughly 5% of total non-food sales. According to this calculation, the increase in Internet sales comes not only at the expense of the stationary retail trade. In fact, traditional mail-order business (excluding Internet) will lose market share. While the Internet does offer advantages in terms of price versus the stationary retail trade, the general argument for buying on the Internet – i.e. the wide range of products – is only partly correct compared to shopping centers, since this is exactly the advantage in centers with a good sector mix and a large range of products. Above all, in the sectors with the highest sales (food and clothing), the importance of online trading is very low: shopping centers are more event oriented, while the Internet permits more direct price comparisons, comfort and greater shopping speed, but not better delivery.

Real estate stocks as an investment alternative

The ratio of listed real estate companies in real estate investments in Germany is still negligible. The highest trading volumes and investments are generated by the real estate funds (open-ended or closed-end), insurance companies and pension funds. If there is to be no direct investment, investors basically have three possibilities to invest in real estate: in open-ended real estate funds, in closed-end real estate funds or shares of listed real estate companies. If the investment is also to be fungible, the closed-end funds are also excluded as an alternative. For cost considerations, share investment is preferable in the fund variant; on return considerations, the decision is more difficult. With its lower volatility and high dividend yield, DES shares can, however, be considered a clear alternative to the open-ended funds.

BREAKDOWN OF REAL ESTATE INVESTMENTS OF INSTITUTIONAL INVESTORS IN GERMANY IN 2002/03



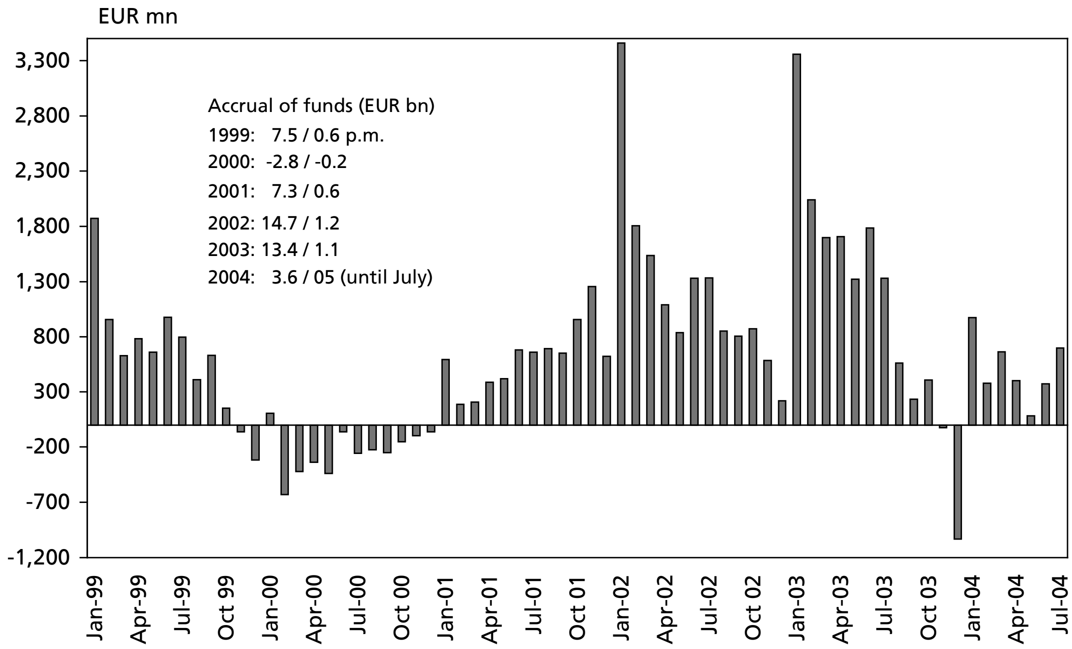
Source: DID Deutsche Immobilien Datenbank GmbH

Open-ended real estate funds – The alternative so far

High inflows resulted in investment emergency

The open-ended real estate funds can be considered direct competitors of DES. On the one hand, the goal is to acquire attractive shopping centers, on the other to generate additional capital for financing, above all via the capital market. After the record inflows to the real estate funds in 2002 (EUR 14.9 bn) and 2003 (EUR 13.7 bn), these funds came under pressure to invest the cash profitably long term. The funds were compelled to press ahead with the globalization of their investment strategy to exploit risk diversification and different real estate cycles. Overall, this investment activity also generated strong demand for shopping centers. The transactions DES concluded in 2003 were, however, a testimony to the company's good market position.

INFLOWS TO OPEN-ENDED REAL ESTATE FUNDS



Source: BVI

Open-ended real estate funds have some internal problems

Inflows to the funds appear, however, to have dried up since the end of 2003. There are many reasons for this – some due to the market and some due to the funds:

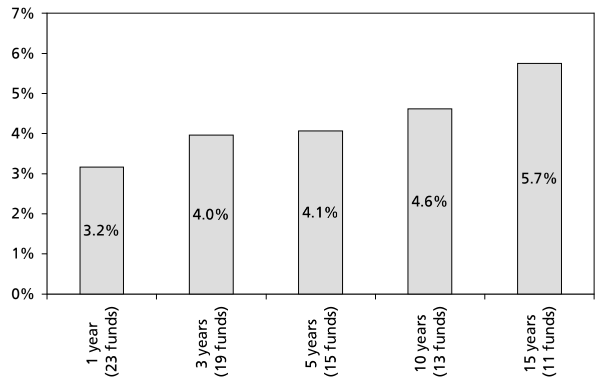
- The funds are no longer being marketed as strongly as in the last two years
- At the end of the year – in the hope of an economic recovery – investors switched to equity fund and – over the last few months – to bond funds
- Furthermore, the returns of the open-ended funds have in many cases declined strongly, which basically detracts from their appeal

- The transparency of many funds leaves a lot to be desired, since an annual valuation of the real estate portfolio is not regulated and is therefore seldom conducted

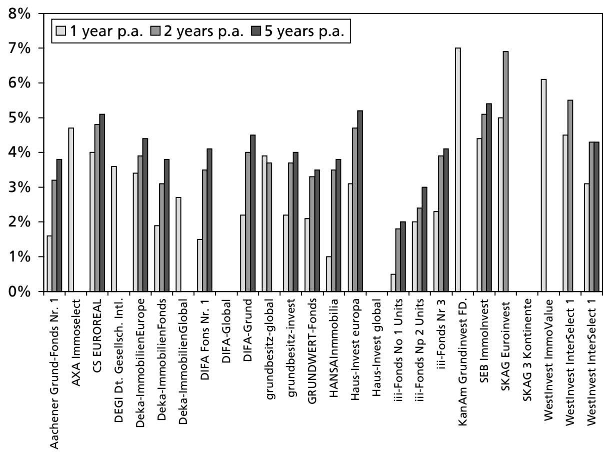
- The latest headlines on bribery scandals in the real estate fund scene in no way enhance their appeal.

VALUE OF OPEN-ENDED REAL ESTATE FUNDS BASED ON THE BVI METHOD

Good long-term return, but falling trend



Anything but homogeneous performance of the funds



Source: BVI, as of 7/30/2004

Higher costs and lower return

On the one hand higher costs, on the other falling returns. We think DES stock is a viable alternative to open-ended real estate funds, even though its name recognition, marketing and volume (market capitalization versus fund volume) are low. In addition to a front-end fee of roughly 5%, the investment funds also charge custody and management fees. In contrast, DES's transaction and current administrative costs are much lower. The argument so far of a relatively safe return is also not confirmed by the numbers published recently by the BVI. Annual returns are clearly declining. The 2003 return of 3.3% will probably be undercut again in 2004, and the funds are far removed from their multi- year averages. Their performance has not yet improved substantially with the possibility (since 2002) to invest in international properties, in fact the return gap between individual funds has increased substantially.

REITs – a new investment alternative in preparation

Discussion in full swing

We expect that the current debate on the introduction of REIT structures will have positive effects for listed real estate companies in general but not for DES in particular. The discussion is currently in full swing, and the *Initiative Finanzstandort Deutschland* (IFD) is advocating a liquid and transparent market for real estate investments, which is undoubtedly a worthy goal. The main point is the introduction of the ImmobilienInvest-AG as the German equivalent of REITs (Real Estate Investment Trusts). The business objective is the acquisition, sale and rental of real estate as well as high dividend payout rates. The companies enjoy tax benefits since there are no income taxes at the company level if the trust pays high percentages of the generated income to the owners. In the 19 countries that already have REIT structures, these are between 75% (e.g. France) and 90% (USA). While the open-ended real estate funds have become established in Germany, listed real estate companies have developed in other countries as the preferred form of indirect real estate investment.

DES already profits from tax exemption

Advantages would result for individual companies, which DES is, however, already enjoying. In addition to the points raised above, capital employed in company real estate is to be mobilized by lowering transaction costs, which, for example, in the case of Germany's IVG, would result in additional business potential. Deutsche EuroShop already pays out its entire earnings from ordinary business activities. Furthermore, the dividends are exempt from tax because of the company's special construction.

Listed real estate companies as an asset class could profit

The introduction in Germany appears to be a question of time. Now that the discussion is in full swing in the United Kingdom, it is our impression that the issue is becoming increasingly topical in Germany as well. As of mid-September, the Finance Ministry confirmed that it was compiling a report and that the findings could already be available at the end of 2004. Corresponding legislation could be passed within the next 18 months. At first sight, one aspect that could argue against their introduction is the tax revenue shortfalls for the government. However, increased trading in real estate can result in the realization of hidden reserves, which would be subject to applicable income taxes. For DES, later introduction would not be important, since for the coming years its loss carry-forwards already mean tax exemption. But earlier introduction appears to be the more probable scenario. In this case, new listed real estate companies will likely emerge. While they would mean competition for DES as an investment alternative, at the same time the listed real estate company as such would focus investor attention on a new investment alternative. At the moment, we think any forecast with respect to the impact on DES shares is clearly premature. The discussion of the introduction of REIT structures in other countries at an early stage has, however, already resulted in France and the UK in gains for real estate stocks (see HVB's IVG Report dated July 6, 2004).

Strategy – Clearly focused and transparent

Deutsche EuroShop is the only listed company that invests exclusively in shopping centers. The composition of the shopping center portfolio therefore determines whether the investment targets are achieved. The target of an annual dividend payout is based on the generation of long-term income from the investments, i.e. rental income. Furthermore, portfolio management and external center management decide on its long-term increase in value. Above all the first corporate goal – the acquisition of further properties – serves as the basis for the investment goals.

Clearly communicated investment and company targets

Clear strategy

Deutsche EuroShop has clearly communicated goals and transparent targets. The focus on and expertise in the field of shopping centers was conceived over the last three to four years and filled with life. Special attention was paid to investor relations and communicating transparency. DES distinguishes between investment and corporate goals.

Investment goals:

- Generate a high total return, which is paid out in the form of dividends
- Achieve sustained growth in the value of the portfolio

Corporate goals:

- Acquire 2-3 shopping centers each year
- Admission to the MDAX (already achieved)
- Ranking among the Top 5 retail real estate companies in the euro zone

High payout ratio

The company was conceived as a dividend payout model. The payment of a dividend as the primary investment goal is geared to the liquidity payouts, i.e. free cash flow the AG generates from long-term leases.

Sustained increase in the value of the properties through active portfolio management

To diversify the portfolio but also to increase its value, the capital is invested in various shopping centers in European regions with a focus on Germany. The strategic goal is to create a well-balanced, diversified portfolio of German and European shopping centers. Alongside the current portfolio, which was financed mainly from the capital of EUR 600 mn raised since the company was created, active portfolio management will be a core element of the future business strategy. DES and the respective center manager constantly monitor the retail real estate market and the performance of the group's shopping centers and these data form the basis for decisions on possible divestments and acquisitions.

Focus on external growth

The company's primary goal is to acquire two to three new properties each year. This goal will basically determine the group's future performance. For that reason the decision is in each case based on an in-depth market and location analysis. Alongside regional aspects and an assessment of the quality of the property, other aspects such as the general tax situation and portfolio weightings also play a role. Business expansion does of course focus on external growth, since as a rule the existing properties show only limited growth in rental income. To increase the free cash flow, additional properties can be acquired.

Equity ratio of at least 45% long term

The equity ratio of currently 52% is not to fall below 45% over the long term despite the planned business expansion. The company would therefore remain solidly financed. Since the equity capital was fully invested by the end of 2003, the acquisition of further properties will be funded by short-term borrowing. Furthermore, there is the possibility to sell properties in the current portfolio. But with the sale, completed in July, of the weakest property in Udine, the scope for this should be narrow. The company's other properties generate good returns or are still within the 10Y tax period for sales.

Target to rank among the Top 5 retail real estate companies is ambitious

Like the goal – achieved recently – of admission to the MDAX, we think the goal to become one of the Top 5 listed retail real estate companies as part of its capital market orientation. The backdrop here is to increase the company's profile both at home and abroad to obtain more favorable terms and conditions for its planned external growth. At the moment, DES AG ranks No. 7 in terms of market capitalization in the EPRA Index. The gap to the No. 6, Eurocommercial Properties, is roughly EUR 300 mn, however.

Portfolio construction – First guarantee for profitability

Prerequisites for investment decisions

DES's success so far in terms of its operating performance is based on the strict criteria the company applies before it makes an investment. After compiling a portfolio of properties when it launched operations at the end of 2000, new investments have – or had – to met the following prerequisites:

- Direct or indirect acquisition via equity stakes
- Leasable area from 10,000 square meters (DES average: 37,400 square meters), of which at most 15% office space
- Pre-rental rate of at least 50% (during development) and at least 80% (during operation).
- At least 25% of the space must have a residual lease of over five years (during operation)
- Binding building permit must have been issued
- Sustainable living area of at least 100,000 inhabitants (DES average: 850,000)

In-depth analysis forms the basis for decisions

Alongside these prerequisites, investment decisions are based on an in-depth analysis of the parameters for the center in the form of expert opinions and market analysis. These include studies of the microlocation, the transport infrastructure and the functionality of the building. In part, this analysis takes the form of retail reports conducted by external experts. Of key importance for DES is the analysis of the project with respect to its economic, financial, legal and tax advantages. To minimize risk, external consultants are used to examine purchase agreements, existing lease agreements and other contracts. Other aspects influencing investment decisions are country and regional aspects as well as portfolio weightings. Once DES acquires a property, the management is informed at regular intervals on the progress of construction. This includes monthly project reports with data on current occupancy rates, construction costs and the current stage of construction.

Attractive properties are in strong demand

Good contacts are imperative to find attractive properties. Shopping centers are offered by brokers, previous investors and project developers. As a rule, there is an adequate supply of properties, but on the demand side there are many competitors for attractive properties such as insurance companies, foreign competitors, private investors and above all real estate funds. In past years particularly the latter was a main competitor because of the enormous inflow of funds to open-ended real estate funds. These strong net inflows resulted, however, in a sort of "investment emergency." This trend reversed at the beginning of 2004. There were again an increasing number of objects being sold by the funds on the market. The backdrop here was the companies' increasing focus on other European countries to generate further inflows and to increase profitability. In our view, one decisive factor in acquiring attractive properties is close contacts with sellers and project developers. Most of the properties in the DES portfolio were acquired because of the good ties to ECE Projektmanagement GmbH.

Center management – Second guarantee for profitability

Long-term success through strong center management

Alongside the parameters outlined above, the long-term success of an investment is determined by the quality of the center management. The center management company ensures long-term success as early as the evaluation phase by optimizing occupancy rates, rental structure and the sector mix. From then on, the respective company is responsible for constant optimization, marketing, and the care and maintenance of the property.

Focus on ECE

DES is focusing increasingly on ECE Projektmanagement. For 12 of its currently 14 centers, ECE Projektmanagement G.m.b.H. & Co. KG is responsible for center management. ECE is considered the market leader in Europe and operates 76 inner-city shopping centers and suburban shopping centers. The portfolio is comprised of 7,200 rental partners, 2.2 million square meters in sales area and annual sales of about EUR 8.4 bn. Now that the center in Friuli (Italy), which was managed by Carrefour, has been sold, only the centers in Tuscia, Italy (Espansione Commerciale, 45 shopping centers) and in Annemasse, France (Unibail – Espance Expansion, 27 shopping centers) are managed by other center managers.

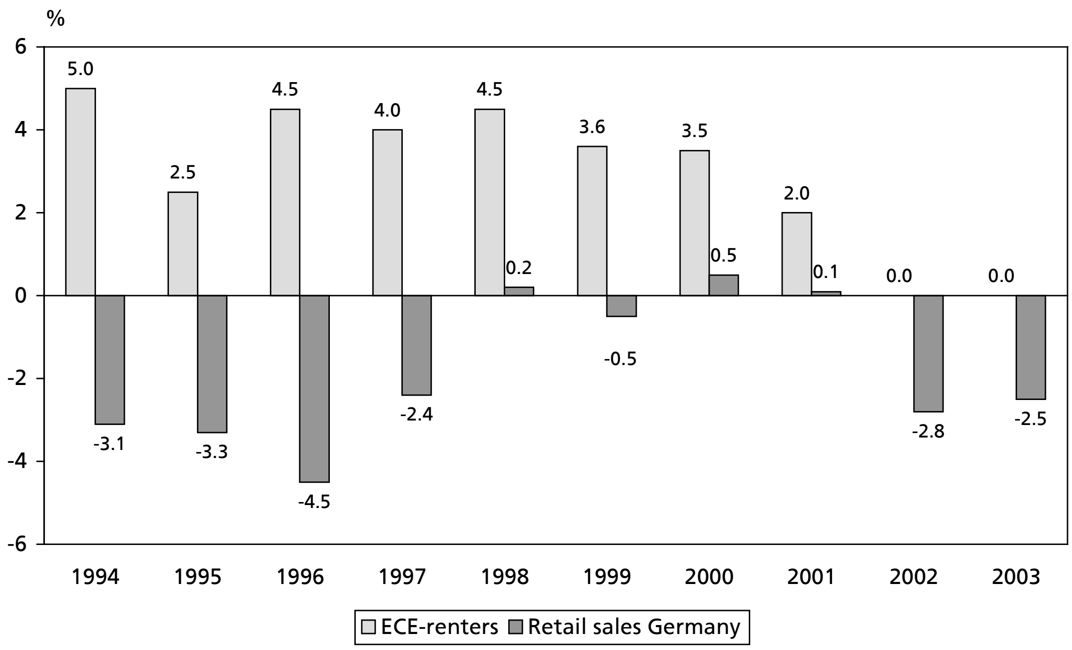
The advantages outweigh the risks

The risk of DES becoming overly dependent on ECE is tolerable, in our view. In fact, the long-term business relationship is cemented further with each additional joint project. This in turn could increase the probability of especially interesting properties being offered to DES. Furthermore, ECE's four decades of experience ensures that the centers are a lasting success, since ECE is known for its loyalty to a location. Since 2000, Alexander Otto, who is on the DES supervisory board, has been the CEO of ECE. ECE's regional focus is an excellent fit with DES's strategy. The emphasis is on city-center locations with a focus on Germany. Furthermore, ECE is increasingly operating/planning centers in Poland (2 in operation/1 under construction), the Czech Republic (0/2), Hungary (2/0), Turkey (4/1) and Austria (0/1). DES is involved in three out of 13 properties.

ECE retailers have advantages

A glance at like-for-like sales reveals the advantages offered by a strong center manager. Sales growth is in some cases much higher than for the retail trade as a whole. Even though the retailers in the ECE centers have not been able to post sales growth in the last two years, they have in recent years decoupled strongly from the retail trade as a whole. In part, this development can, however, also be attributed to the strong demand from retailers for established or attractive locations. Overall, this results for the shopping center investor in positive effects on rental income, which at the DES properties also depends on the sales trend. Furthermore, ECE shares directly in the center's success via an 8% share in the rental income, which means additional motivation for good center management.

LIKE-FOR-LIKE RETAIL SALES VS. ECE RENTERS



Sources: BAG, GfK Prisma, ECE

Portfolio structure – Third guarantee for profitability

75% abroad
25% domestic

In regional terms, the focus is on Germany. On risk considerations, the diversification with some foreign locations makes sense, but knowledge of the market in the respective countries must be ensured. As a result of the strong focus on ECE, which is also active in Europe, further acquisitions of attractive centers in other European countries should also be possible in the future.

City locations
or established
locations

Shopping centers not in metropolitan areas, but at locations interesting for several regions. All DES properties are in city locations or established locations such as the Rhein-Neckar-Zentrum, the Main-Taunus-Zentrum and the foreign property in Annemasse.

High quality of
the properties

All properties are reviewed at regular intervals for necessary renovations or refurbishment. The fact that the centers remain popular is illustrated by the Rhein-Neckar-Zentrum and the Main-Taunus-Zentrum, which are already 30 and 40 years old, respectively. The value of the location and the properties was ensured with refurbishment measures between 2000 and 2004. Now that the Allee-Center in Hamm has been refurbished, the next projects are, in our view, a possible renovation in Annemasse (1994) and Viterbo (1998), but according to the company, they are currently performing very well. With the exception of these two centers, all shopping centers are therefore not older (initial opening or refurbishment) than three years.

OVERVIEW OF DES SHOPPING CENTERS

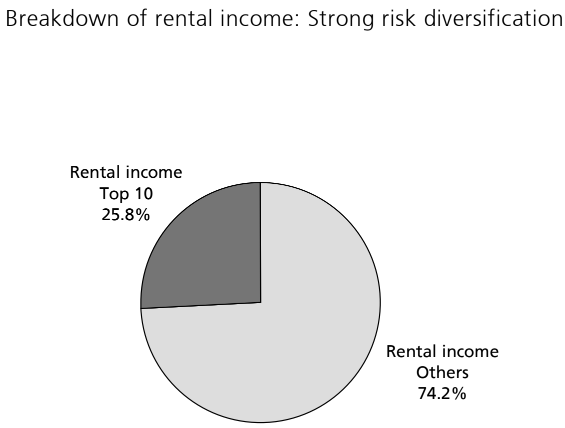
	Shopping center	City/ Country	Center manager	Rental area sqm	thereof DES share sqm	Store units No.	Occupancy rate %	Catchment area mn inhabitants	Parking spaces No.	Opening	Refurbish-ment	Location
1	Rhein-Neckar-Zentrum	Viernheim	ECE	64,000	59,392	100	100%	1.4	3500	1972/2002	2000-02	Region
2	Main-Taunus-Zentrum	Sulzbach	ECE	93,900	35,119	100	100%	2.2	5000	1964/2001	2001, 2003-04	Region
3	City-Galerie	Wolfsburg	ECE	30,000	26,700	90	100%	0.6	800	2001		City
4	Altmarkt-Galerie	Dresden	ECE	43,800	21,900	100	97%	1.0	520	2002		City
5	City-Arkaden	Wuppertal	ECE	28,100	20,232	90	100%	0.7	650	2001		City
6	Allee-Center	Hamm	ECE	34,800	30,520	80	100%	1.0	1290	1992	2002-03	City
7	Phoenix-Center	Hamburg	ECE	39,000	19,500	120	96% (under constr.)	0.6	1600	Sep 04		City
8	Forum Wetzlar	Wetzlar	ECE	34,300	22,295	110	83% (under constr.)	0.5	1700	Spring 2005		City
9	City-Point	Kassel	ECE	29,400	11,760	60	100%	0.8	200	2002		City
10	City-Arkaden Klagenfurt	Austria	ECE	36,300	18,150	120	50% (under constr.)	0.4	880	Spring 2006		City
11	Centro Commerciale Tuscia, Viterbo	Italy	Espansione	15,200	15,185	40	100%	0.3	1100	1998		City
12	Shopping Etrembieres, Annemasse	France	Unibail	8,600	7,981	50	100%	0.8	1000	1994		Region
13	Árkád Pécs	Hungary	ECE	34,200	17,100	130	98%	0.5	850	March 04		City
14	Galeria Dominikanska, Breslau	Poland	ECE	32,600	10,856	100	100%	1.0	920	2001		City
	Average			**37,443**	**22,621**	**92**	**99% (in operation)**	**0.8**	**1427**			
	Total			**524,200**	**316,689**	**1290**	**99% (in operation)**	**11.8**	**19980**			
	Sold											
	Centro Commerciale Friuli, Udine	Italy	Carrefour	28,600	26,541	50	100%	0.3	1500	1993		Region

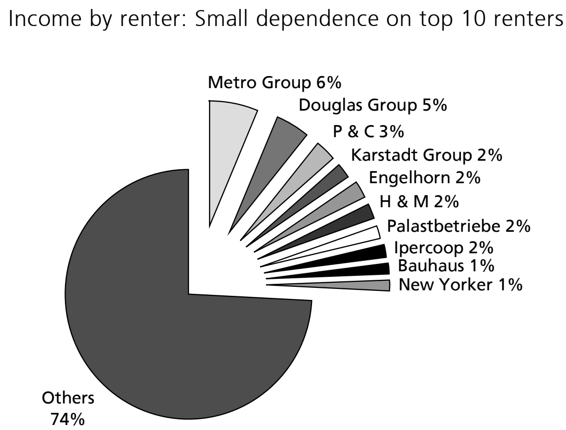
Sources: Deutsche EuroShop, HVB Equity Research

Balanced renter mix

On risk considerations, the widest possible renter mix is desirable. The share of the top 10 renters is currently almost 26%. DES also targets a good sector mix with specialist outlets, chain outlets and local retailers. ECE's experience is also advantageous here, since it anchors strong magnet renters in the centers.

RENTER STRUCTURE





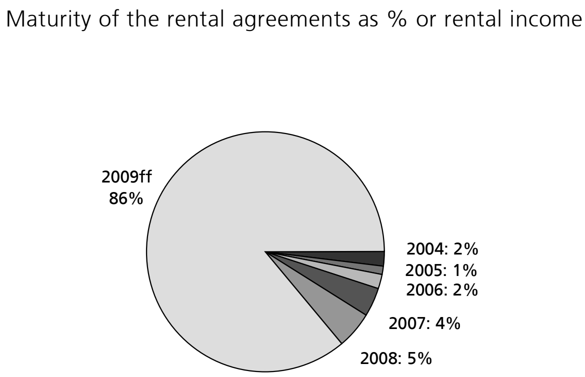
as of 12/31/2003 without Pécs, Klagenfurt, Hamburg and Wetzlar

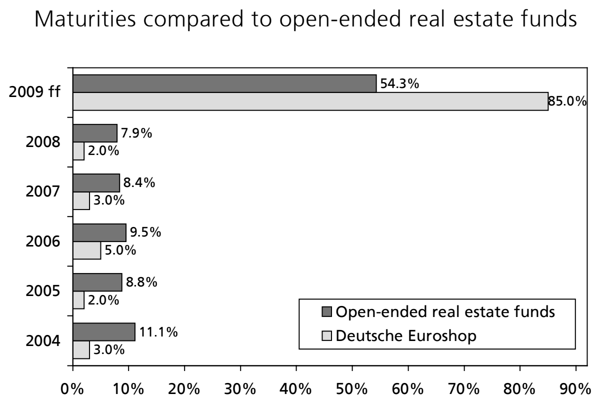
Source: Deutsche EuroShop

Long-term rental contracts

Long-term rental contracts ensure the income stream. As a rule, the rental contracts run for 10 years. Of the contracts currently in place, 86% of rental income is contractually guaranteed until 2009. Interestingly, ECE and DES do not target longer rental agreements, but use expiration of the contracts to terminate and conclude new rental agreements. The reason for this is the possibility to regularly review and change the sector mix without extraordinary terminations. As a result, the company can react early to specific consumer trends.

MATURITY STRUCTURE OF THE RENTAL AGREEMENTS





Sources: Deutsche EuroShop, BVI

Constant income stream from rental proceeds

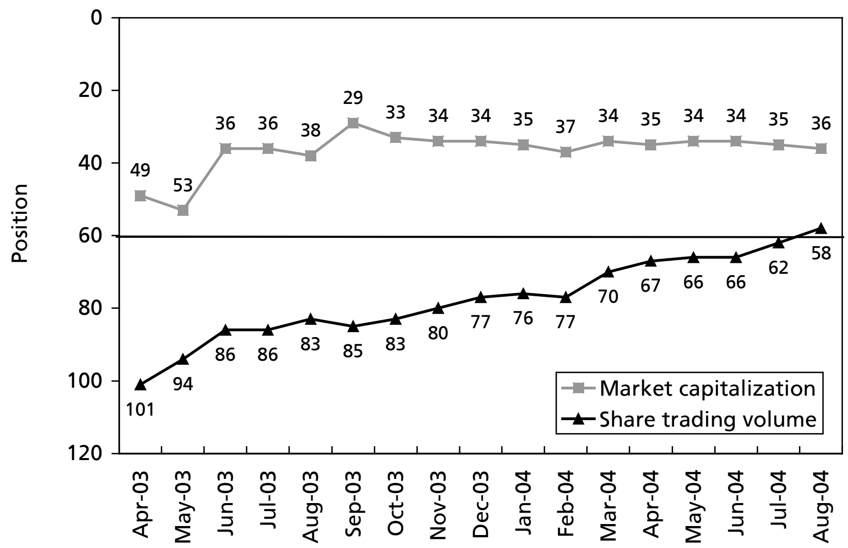
Indexed rents and a potential additional share of the revenue growth from the retail trade support the regular payment stream. Indexed rents are agreed based on the cost-of-living index. DES has profited from this above all in the last two years, which were weak in terms of consumption. Consequently, we think the income stream is ensured over the medium to long term. The high occupancy rate of almost 100% and low rental defaults (2003: 1.5%) underpin this expectation. For our planning horizon, we assume no major change in these ratios. The advantage of indexed rent adjustments was revealed in 2003 by the slight increase in sales, while the general retail and real estate environment tended to be negative. With the additional contractually agreed share of the revenue growth from the retail trade, DES offers additional revenue potential. So far, the share of the rental revenues in total revenues has been roughly 2-3%.

MDAX membership thanks to intensive IR work and solid operating performance

High market capitalization and steady increase in trading volume

At the beginning of 2003, Deutsche EuroShop stated that its corporate goal was to be admitted to the MDAX. This goal was achieved on September 20, 2004, and therefore less than 14 months after its admission to the SDAX in July 2003. The stock had met one criterion for membership for some time, namely market capitalization: DES stock has a secure ranking in the 30 range. The only prerequisite still to be met was trading volume. In the decisive August ranking, DES ranked No. 58 in terms of trading volume and therefore secured for the first time a ranking necessary for admission among the top 60 stocks in terms of trading volume. While this may have been a close call, one positive aspect is that the stock's trading volume has increased steadily over the last one and a half years.

STEADY IMPROVEMENT IN THE RANKING FOR ADMISSION TO THE MDAX



Sources: Deutsche Börse, Deutsche EuroShop

Admission to the MDAX is the reward for increased capital market orientation

Alongside a solid operating performance, MDAX membership is the reward for the company's increased capital market orientation. Once Deutsche Bank divested its majority stake, Deutsche EuroShop was from 2003 able to focus more on the capital market and DES has intensified its IR work considerably over the last twelve months. Conference calls are, for example, now held for the quarterly numbers, roadshows are organized and the company pursues corporate governance. In July, DES was awarded the 2004 Capital Investor Relations Prize in the SDAX category. At the beginning of 2004, the net asset value calculated by an external expert was then published for the first time, thereby increasing comparability in terms of valuation with other real estate stocks.

Long-term MDAX membership realistic

We expect DES will become an MDAX stalwart. A raft of factors suggests that DES will remain in the MDAX over the long term. First, there is the company's high market capitalization ranking, which is relatively secure because of the stock's low price volatility and high free float. Second, its inclusion in the index should make investors more aware of the stock, which should have a positive impact on trading volume. Third, the company will switch from HGB to IAS with its 2004 financial statements, which could attract more foreign investors, since its European competitors have already made the switch. Fourth, there are only a few listed real estate companies in Germany and the index, so DES would meet a soft criterion for the ranking decision.

Advantages for financing external growth

Both admission to the MDAX and the greater capital market focus are enormously important when it comes to funding further expansion. A capital increase, which the company has announced for 2005 or 2006, could therefore receive considerable interest. The company's medium to long-term goal is to acquire further properties, whose profitability is so high that there will be no dilution effects for current stockholders.

Stable shareholder structure and high free float

Stable shareholder structure

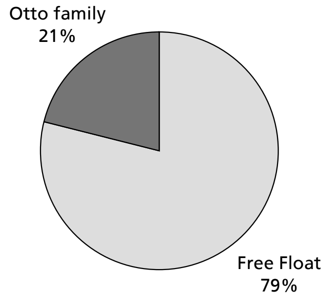
We expect that the current stockholder structure will remain the same over the medium to long term. Last year, Deutsche Bank divested its remaining 44.8% stake as part of its policy to divest industrial and non-core holdings. The stake was sold in three private placements. As a result, the free float has increased to 78.77%. The major stockholder (21.23%) is still the Otto family. We consider this holding to be long term, especially since ECE, which acts as a center manager for DES, is also owned by the Otto family.

Almost exclusively domestic investors

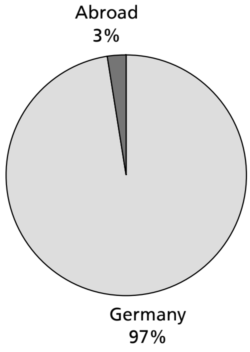
The switch to IAS could increase foreign interest in the stock. The small involvement of foreign investors so far is attributable to several factors, all of which are in a state of flux. The switch to IAS/IFRS is assuming importance, since it will increase comparability with the company's European competitors. Discussion of the introduction of REITs in other European countries is increasing real estate investors' interest in real estate companies. A discussion in Germany is already in full swing. With each additional property, DES should also attain a higher weighting throughout Europe. With the company's inclusion in the EPRA real estate index in January and its admission to the MDAX in September, the interest of foreign investors should increase.

SHAREHOLDER STRUCTURE

High free float and solid firm holding



So far, almost exclusively domestic investors



Source: Deutsche EuroShop

(Solid) portfolio growth

Our assessment of the company's strategy is geared to the company's target to acquire two to three properties each year. This is, in our view, in line with the given management capacities and financing possibilities. After the initial investments of the last three years, portfolio management is gaining in importance for both the payout policy and the development of the value of the portfolio.

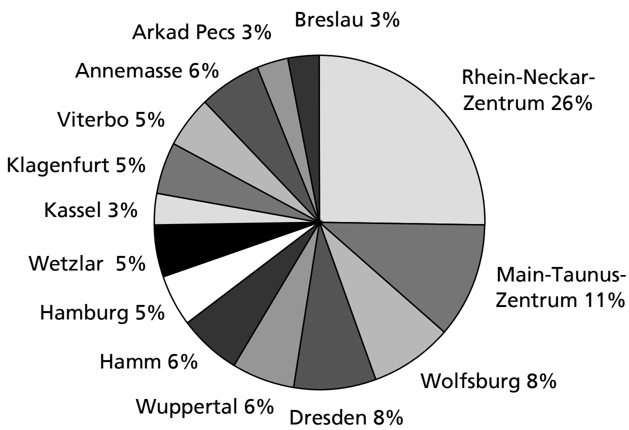
First phase concluded in 2003 – Equity capital invested

Funds from KE 2000 exhausted

Three shopping centers were acquired in the past fiscal year. With the stakes in the Phoenix-Center in Hamburg, Forum Wetzlar and the Galeria Dominikanska in Breslau, the funds from the 2000 capital increase (EUR 600 mn) were exhausted except for a residual amount of EUR 3 mn. As a result, the company can concentrate on the strategic optimization of the portfolio.

Invested equity capital: EUR 553 mn

BREAKDOWN OF THE EQUITY CAPITAL INVESTED IN THE CENTERS



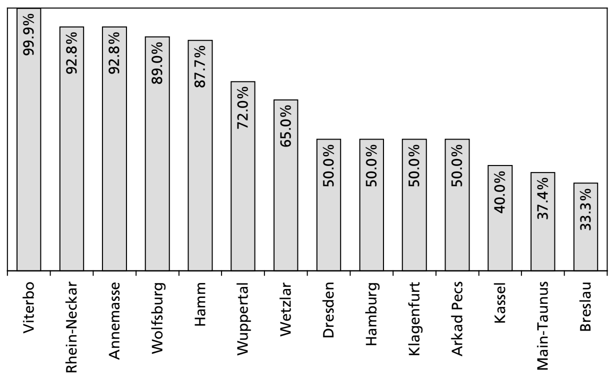
Source: Deutsche EuroShop

Phoenix center and Forum Wetzlar in the planning stage

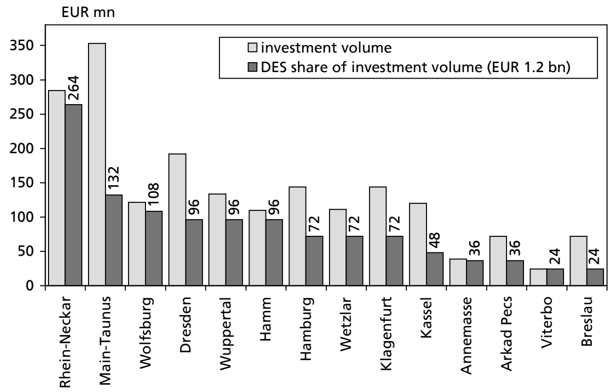
Centers in the planning stage in Hamburg and Wetzlar. The two properties in Hamburg and Wetzlar, both of which were acquired in 2003, are still under construction and, according to the company, will open on schedule at the end of September 2004 and before Easter 2005, respectively. The pre-occupancy rate of both properties suggests full occupancy at the opening. As normal, investment costs are within budget.

INVESTMENT STRUCTURE

% stake in the shopping centers



Volume invested in the shopping centers



Source: Deutsche EuroShop

Phase 2 is already under way – Portfolio optimization

Initially interim financing and financing from divestments

The company's goal is to add two to three new shopping centers each year to the existing portfolio. There are two possibilities to finance this growth: **1)** interim financing or **2)** divestments from the existing portfolio. In the current fiscal year, the second variant has been selected so far. On the one hand, the company divested its interest in Italy and, on the other, announced the acquisition of a new stake in the City-Arkaden in Klagenfurt, Austria. We expect one additional acquisition for the fourth quarter. Depending on the size of the investment and the property, it should be possible to finance this investment from the remaining liquidity of roughly EUR 30 mn available from the sale in Italy.

Sale in Italy was expected

In mid-July, DES sold – as part of its portfolio optimization – the Italian center in Udine to SEB Immobilien-Investment GmbH for EUR 62 mn (EUR 57.5 mn for the 92.8% stake). In the third quarter there will be a book profit before taxes on this sale of EUR 3.5 mn. After offsetting the rental income against the roof repair in 2003 and 2004, which cost roughly EUR 4 mn, DES divested what it claimed to be the weakest center in the portfolio at a breakeven price. The weak return is attributable primarily to the excessively high purchase price.

Klagenfurt as new foreign property

Some of the liquid funds from the sale of the center in Italy were reinvested in the City-Arkaden in Klagenfurt, Austria. One positive note is that this is a property in Central Europe, which constitutes a regional diversification for DES. Construction on the center, which was acquired at the beginning of August, got under way in mid-September, and the opening date for City-Arkaden is scheduled for spring 2006. The pre-occupancy rate is already over 50% and suggests full occupancy when the center opens. The total invested is EUR 170 mn: EUR 20 mn is for renter expansions, and ECE and DES are each financing EUR 75 mn. Of the EUR 75 mn, EUR 30 mn, i.e. 40%, was financed with equity capital.

Further property probable by the end of the year

After the transactions in Italy and Klagenfurt, DES currently has liquidity of about EUR 30 mn. According to the management, this will probably be invested in a further property in the fourth quarter. The target areas are the Czech Republic, Poland, Hungary and Austria. Because of the stiff competition in France and Italy, these markets are less interesting for further properties. But each acquisition is to a large extent a question of opportunity. For that reason the acquisition policy is largely driven by opportunity.

Further portfolio optimization improbable short term

With the investment in the property announced for the end of the year, the question arises whether further sales from the existing portfolio are likely. After the sale in Italy, we think this is improbable over the short term for a variety of reasons:

- The business model is based on a buy-and-hold strategy, i.e. the company does not trade in real estate, which would result in the payment of trade tax.
- The properties in Germany are subject to a speculation period of ten years. The first properties were only acquired at the end of 2000.
- The domestic properties form the basis of the portfolio.
- Abroad, a sale is possible on tax considerations, but the properties were either acquired only recently or show adequately high profitability (Italy, France).
- A glance at the ratings for the existing portfolio compiled in spring by external experts does not justify the complete sale of a center; in fact, DES could attempt to improve the ratings at one center or another through corresponding measures.

Good rating quality of the centers

Ratings reveal little need for adjustment. The investment rating is comprised of the components property rating (macrolocation and microlocation, competitive situation, property quality, renter risk) and profitability (ratio of the property-specific, risk-weighted return to the return on investment). Overall, the DES properties rated received the third best rating A on the ten-stage rating scale, i.e. an excellent investment rating.

INVESTMENT RATINGS OF THE DES PROPERTIES (2003)

Weighting factor	Investment rating	Property rating 50.00%	Profitability 50.00%
Domestic properties			
Main-Taunus-Zentrum	A	A	AA
Altmarkt-Galerie-Dresden	A	A	AA
Rhein-Neckar-Zentrum	A	A	AA
Allee-Center Hamm	A	A	AA
City-Galerie Wolfsburg	A	B+	AA
City-Point Kassel	A	B+	A
City-Arkaden Wuppertal	B+	B+	A
Foreign properties			
Centro Commerciale Tuscia	A	A	AA
Shopping Etrembieres	A	B+	A
Centro Commerciale Friuli*	C	B+	C
Weighted average	**A**	**A**	**A**

* already sold

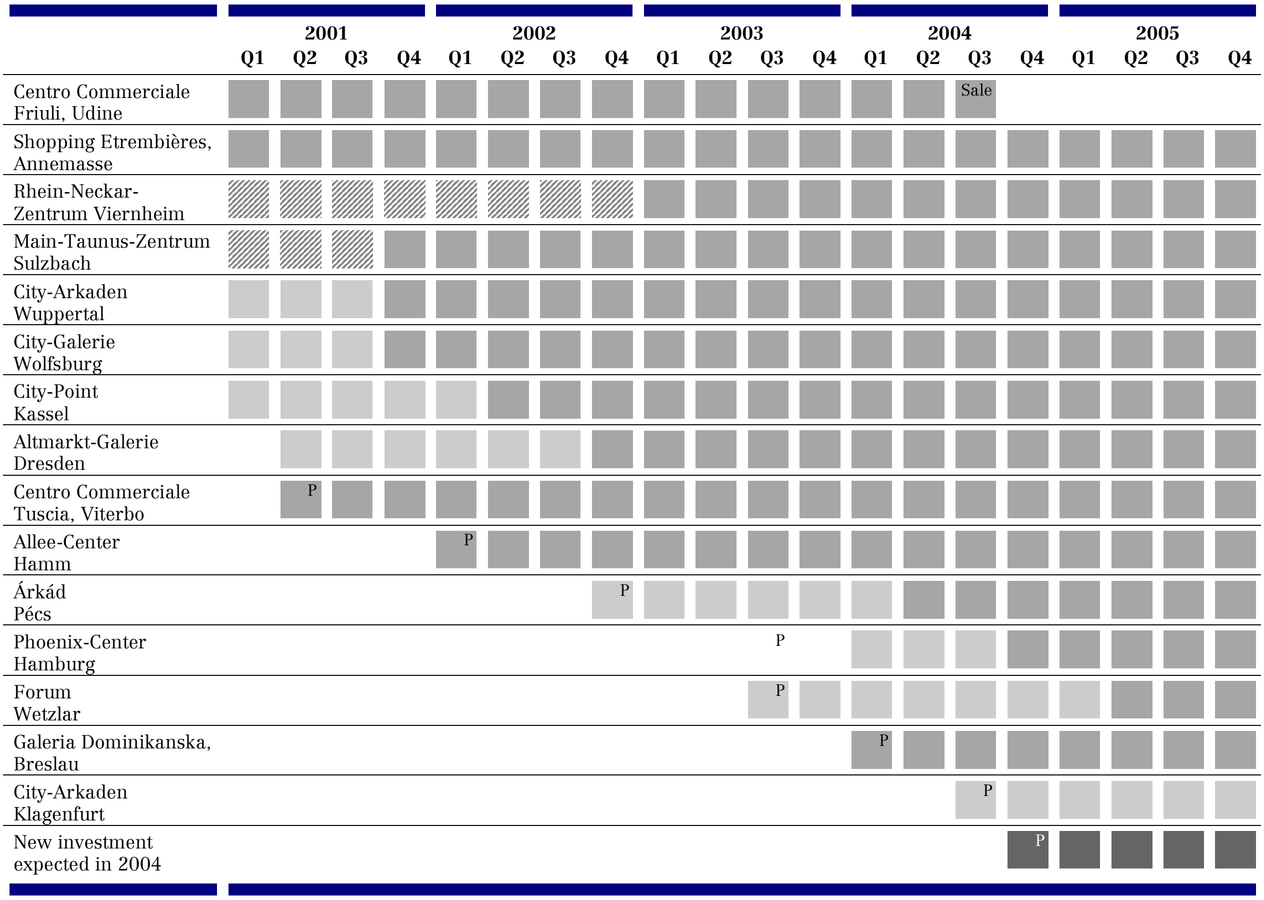
Sources: Deutsche EuroShop, Feri Research GmbH

Phase 3 will follow – Borrowing without dilution

Capital increase only after the acquisition of further properties

With further properties in FY 2005, the projects funded initially with interim financing should then be replaced with a capital increase. Since an acquisition or sale generally ties up management capacities for several months, we tend to expect further projects will be staggered. Consequently, a capital increase should only become a topic again at the earliest after several new properties in 2005. The prerequisite for final financing using equity capital is the guarantee of an adequate return on equity. The company's goal must be to ensure at least a return equal to that of the existing properties. In this way, the dividend yield of roughly 5% targeted over the medium term can also be achieved. Depending on the respective investment volume, which, as previously stated, is to a large extent driven by opportunity, we do not, however, expect a possible capital increase before the end of 2005. Similar to the situation with the stakes acquired so far, we expect the invested equity capital in future properties to be between EUR 20 mn and EUR 50 mn. Accordingly, three to five additional properties could be purchased and financed initially before a capital increase of, for example, EUR 100 mn is carried out. Based on the information at our disposal, the company does not intend to generate capital without having already purchased the corresponding properties, since the funds would otherwise have to be invested at a low rate of return.

DEVELOPMENT OF THE SHOPPING CENTER PORTFOLIO



Operation
Construction
Refurbishment
open
P Purchase

Sources: Deutsche EuroShop, HVB Equity Research

SWOT analysis

Strengths

- Clear focus on shopping centers and therefore a pure play in the real estate segment
- After the Udine sale, all shopping centers in the portfolio have a good location, a high occupancy rate with adequately long rental periods and a good rating.
- The success of a shopping center is determined to a large extent by a strong center manager, which has been found in the European market leader ECE.
- The company, which is conceived as a dividend payout model, focuses on a high, tax-free and secure dividend.
- The lean structures at the AG result in short decision-making processes and low administrative costs.
- The greater IR focus since mid-2003 is resulting in steadily growing investor interest.

Weaknesses

- In terms of both center management and the search for further properties, too strong a focus on ECE could result in dependence. But we think the advantages clearly outweigh the risks.
- In a weak consumer environment, retailers in shopping centers can also declare insolvency and therefore trigger value adjustments for rental income.
- Further properties can also be financed with external funds (borrowed funds, capital increase) until properties in the portfolio are sold.
- So far only muted investor interest in listed real estate companies.

Opportunities

- On an upturn in the retail trade, the share of rental revenues in overall revenues could increase.
- After admission to the EPRA and the MDAX, investor interest should increase further and improve the parameters for external growth.
- The good positioning in the market for shopping centers and the relationship with ECE are a good basis to be offered attractive properties.

Threats

- Centers under construction could entail specific real estate risks with respect to construction costs, the site and construction time.
- The shopping center concept could be overtaken by other trends in shopping behavior.
- The trend with rents depends not only on the center management but also on external variables such as the overall economy and the retail trade or shopping locations.

Basics of finances

To assess the company's true earning power, we first discuss some specifics of the company's financials. DES was conceived as a dividend payout model. The goal when the company was formed was to achieve a return of 5% on the equity capital of EUR 600 mn and to pay it out tax free to stockholders. The goal is not the highest possible consolidated profit but the highest possible liquidity payout after taxes. These form the basis for the dividend payments. Despite payments already in the investment phase, the published NAV shows the creation of EUR 108 mn in enterprise value in the first three years. This highlights that the DES concept is paying off. Based on our forecasts, the dividend will for the first time be generated from the operating business in 2004. In FY 2004 the company will be switching from HGB to IAS/IFRS. As a result, the concept, which required explanation so far, is much more transparent.

Conceived as a dividend payout model

Target yield of 5%

DES was conceived as a dividend payout model. The goal when the company was formed was to achieve a return of 5% on the equity capital of EUR 600 mn and to pay it out tax free to the stockholders. This was to be achieved by acquiring real estate whose rental income generates a liquidity surplus. Each year the 5% return resulted in EUR 30 mn (on EUR 600 mn), or EUR 1.92 per share (issue price of EUR 38.40), in dividends, which were paid out in the first three years. An alternative plough-back would have resulted in the acquisition of only 1-2 properties and would not have offered an attractive dividend over three years. The initiators and the company thought this would not arouse investor interest.

Losses in the group impact taxes

The goal is not the highest possible consolidated profit but the highest possible liquidity payout after taxes. In the investment phase, there were of course losses at the group level, which can now be offset over a lengthy period against future profits. To this end all possible tax approaches are being used:

1. For properties under construction, 10-15% of the investment costs are posted as directly deductible expense. Alternatively, 50% of the expense could have been capitalized with no impact on earnings.

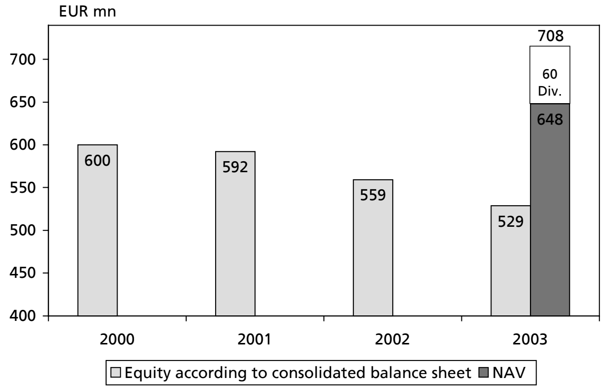
2. The highest possible depreciation rates were used to amortize the properties' book values. Here, the highest depreciation rates for shopping centers were used.

3. As an alternative approach, provisions were formed for deferred taxes as balance sheet provisioning for possible payments on the possible sale of a property.

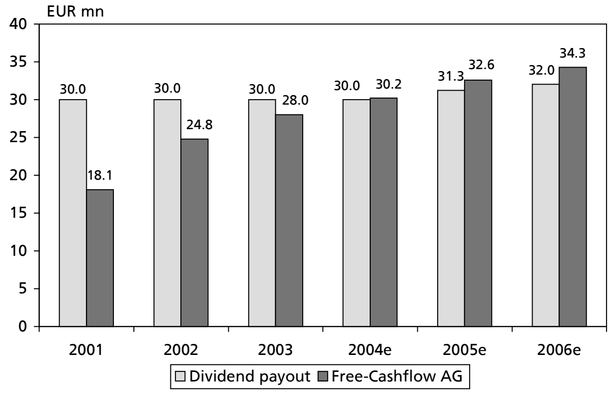
Without these conservative approaches, the profit would have been substantially higher.

NAV AND THE DISBURSABLE FREE CASH FLOW

Enterprise value of EUR 108 mn created



From 2004, the free cash flow will be generated entirely from liquidity surpluses



Sources: Deutsche EuroShop, HVB Equity Research

Enterprise value created

The dividend policy is based on the result from ordinary activities of the AG, which DES classifies as disbursable free cash flow. This is primarily the income from the investment companies. It is important here that the procurement costs of these companies for the property are reduced by tax write-downs. This lowers consolidated profit, but the companies distribute the counter-value of the depreciation to the AG. Overall, the disbursable free cash flow of the AF increased from EUR 18 mn to EUR 28 mn between 2001 and 2003. From this, there was an allocation to the deferred tax provisions. To be able to pay a dividend of EUR 30 mn in each of the three years, a withdrawal was made from the capital reserve. This reduction of equity capital did not compare with a decline in market values. In fact, the calculation of the net asset value at the last balance sheet cutoff date showed that the depreciation of book values resulted in considerable hidden reserves in the balance sheet. That clearly confirms two things that are a prerequisite for the concept. First, the capital repayment is not a loss of net asset value. Second, the disbursed depreciation is not required to maintain the value of the shopping centers. The switch to IAS will make this concept much more transparent, since the balance sheet must then show market values and since scheduled depreciation will no longer affect consolidated earnings. The graph above highlights the creation of enterprise value on the capital employed. As planned, reserves were withdrawn from the 2000 equity capital of EUR 600 mn, but this compares with an increase in the market value to EUR 648 mn after taxes in 2003. Furthermore, EUR 60 mn was paid out up to the end of 2003, which also means an increase in value. As a result the company has created enterprise value of EUR 108 mn in three years.

TRANSITION GROUP TO AG

EUR mn	2000	2001	2002	2003	2004e	2005e	2006e
Group net profit	**6.974**	**-16.777**	**-3.002**	**-2.263**	**0.318**	**3.825**	**5.288**
Plus depreciation of tangible assets	0.003	11.852	21.603	22.393	22.848	23.003	23.468
Plus expenses of the investment phase	0	23.196	2.451	2.588	2.000	1.500	1.500
Plus withdrawal (Minus allocations to the liquidity reserves of the property companies)	0	-0.285	-0.750	0.233	-0.042	-0.207	0
Minus minority interests	0	-1.137	-2.327	-2.350	-2.776	-3.700	-4.553
Plus/Minus payout overhang	0	-2.498	0.293	-0.045	0	0	0
Net profit of the AG	**6.976**	**14.351**	**18.268**	**20.556**	**22.348**	**24.420**	**25.703**
Taxes	0	3.720	6.546	7.414	7.852	8.140	8.568
Result from ordinary activities of the AG	**0**	**18.071**	**24.814**	**27.970**	**30.200**	**32.560**	**34.271**

AG PROFIT AND LOSS ACCOUNT

EUR mn	2000	2001	2002	2003	2004e	2005e	2006e
Income from investments	9.099	12.570	23.139	26.534	29.550	33.160	35.670
Net interest income	2.275	6.876	4.476	3.241	2.500	1.400	0.800
Other expense and income	-0.482	-1.375	-2.801	-1.805	-1.850	-2.000	-2.200
Result from ordinary activities	**10.892**	**18.070**	**24.814**	**27.970**	**30.200**	**32.560**	**34.270**
Taxes on income	3.918	3.720	6.546	7.414	7.852	8.140	8.568
Net income for the period	**6.974**	**14.350**	**18.268**	**20.556**	**22.348**	**24.420**	**25.703**
Profit carried forward	0	6.624	0	0	0	0	0
Withdrawals from the capital reserve	0	9.743	12.645	9.465	7.652	6.830	6.329
Additions to the profit reserve	-0.349	-0.718	-0.913	-0.020	0	0	0
Balance sheet profit	6.625	30.000	30.000	30.000	30.000	31.250	32.031

Sources: Deutsche EuroShop, HVB Equity Research

Dividend increase possible from 2005

Dividend will increase

For 2004, we expect that for the first time the result from ordinary activities will be enough to pay the dividend sum of presumably again EUR 30 mn. From the coming year, a dividend increase should be possible above all because of higher investment income and higher profit. We expect an increase to EUR 2.00 for 2005 and EUR 2.05 for 2006.

Dividend remains tax free for the time being

As in the last three years, we expect that the dividend can also be paid out tax free in the coming years. The reason for this can be found in the Income Tax Code, which stipulates that investors residing in Germany do not have to pay income or corporation tax, provided that the dividend payout is considered a repayment of equity. For the purposes of tax law, the payout does not represent a profit distribution. The actual inflows can therefore be disbursed tax free. Given the high loss carry-forwards, the company expects to be able to pay out a tax-free dividend for some years to come.

Transition HGB – IAS

Reported group result increases

The switch to IAS will have a positive impact on reported earnings and transparency, but will have no implications for the disbursable free cash flow. In FY 2004 the company will be switching from HGB to IAS/IFRS. The quarterly reports in 2004 will still be based on HGB, since there are no comparable numbers for 2003. We expect the first IAS/IFRS report will come on presentation of the annual accounts. At the beginning of 2005, comparable 2003 accounts will be supplied.

Greater transparency

We expect especially positive effects due to transparency and comparability with the European real estate companies that already report based on IAS. The impact on earnings should be positive overall. One positive effect will come from the disappearance of scheduled depreciation. Because of the different treatment of the settlement of discounts, interest expense should be slightly higher. Consolidated sales will be roughly 20% higher, since the non-consolidated investments will be reported with their pro-rated stakes (excluding Main-Taunus and Breslau). On the other hand, this will lower the consolidated investment result, so the overall impact will be neutral. The impact from changes in market value is almost impossible to plan, so we have not received an assessment from the company on this either. We do not, however, expect major deviations from the NAV calculation only made at the beginning of the year, especially since most properties are relatively new.

Our forecasts are based on HGB

Because of the Q3 report scheduled for release in November, our focus is on the HGB accounts. It is possible to calculate IAS accounts from our planning model, but we have decided against a detailed explanation for purposes of clarity.

Solid operating performance

After good sales and investment income, the second half of the year should bring a strong improvement in earnings. For the full year, we are predicting that the operating earnings will generate the entire dividend payout for the first time. For the two following years, for which we have compiled a detailed forecast model, we expect a further increase in earnings and the dividend.

H1 2004 affected by construction in Wetzlar

Sales +4.9%
Investment income +40%

In the first half of 2004, the group profited from a 4.9% increase in sales to EUR 25.5 mn, so the consolidated centers decoupled from the general consumer restraint. There were positive effects from the modernization at the Rhein-Neckar-Zentrum in 2003 and new rentals in the Italian center in Viterbo. At the non-consolidated centers, there were positive effects from higher income in Kassel and Dresden as well as initial contributions from Breslau and Pècs. Total investment income increased as a result by 40% to EUR 5.1 mn.

Higher investment costs and interest expense

This positive performance compared with a EUR 2 mn increase in operating expense versus the previous year. EUR 0.550 mn of this related to the construction at Forum Wetzlar (opening scheduled for spring 2005) and EUR 1.6 mn related to roof repairs at the now sold center in Udine. Net interest expense increased by an additional EUR 2.6 mn. Net interest income was affected negatively by the lower interest income (higher investments) and by the higher interest expense (construction interest because of Forum Wetzlar), but this was scheduled. The outcome was that EBT fell EUR 1.6 mn to EUR 4.4 mn. At EUR 1.4 mn, the bulk was attributable to the construction in Wetzlar.

H2 expected to bring a strong improvement in earnings

Book profit from the sale of Udine

Even without book profit, higher earnings expected. In the third quarter, a book profit of EUR 3.5 mn before taxes will be posted from the sale of the shopping center in Udine, which will result in a strong boost to earnings. While this is a one-time effect within the framework of active portfolio management, it is attributable to the operating business, which will strongly increase the earnings from ordinary activities. Per quarter, this income compared with roughly EUR 1.1 mn in lower rental income from the center and the disappearance of depreciation. Furthermore, interest income will increase as a result of the short-term investment of the liquidity. Even without this effect, we expect the second half of the year to bring an improvement in earnings, both compared to the first half of the year and the comparable period of the previous year.

Restructuring in Wuppertal

Sales and earnings will probably be affected in the third quarter by the insolvency of a larger renter at the 72% interest in Wuppertal. EUR 1.8 mn was withdrawn from the property's liquidity reserves to divide up the sales area previously spread over three floors. We expect a negative impact on earnings for DES of roughly EUR 0.8 mn. The center manager ECE quickly developed a restructuring strategy. The result is a 10% reduction in the relevant area. In terms of the total area of the center, this is, however, equivalent to only almost 2%. The rent shortfall should therefore be limited. In return, ECE has ensured high quality renters with Zara (textiles), Voswinkel (sport) and dm (drugstore) starting in the autumn.

Phoenix-Center

Investment income from the Phoenix-Center Hamburg expected in the fourth quarter. There will be additional income in the fourth quarter from the investment income at the Phoenix-Center in Hamburg-Harburg, which opened at the end of September. We assume EUR 0.4 mn.

Prospect of further investment at the end of the year

After the acquisition in Klagenfurt, a further property is realistic in the fourth quarter. In our forecast model, we have, however, made no assumptions since neither the timing nor the size is exactly predictable. We do, however, think a further stake in a property in Eastern Europe valued at up to EUR 30 mn is realistic. As a result, the company would be fully invested again at the end of the year.

2004 – Dividend generated fully from the FCF for the first time

Forecast 2004:

Sales +2%

Investment income +56%

For FY 2004, we expect a further increase in investment income. First, the existing properties are fully rented. Second, the new properties will have a positive impact on the payment stream. The shopping center in Pècs was opened on March 31, 2004, and the Phoenix-Center will follow at the end of September. As a result, there will be additional rental income for three quarters and one quarter, respectively. The sales in Italy will have a contrary effect (5 months less). Overall, we expect consolidated sales to be up 2% to EUR 50.2 mn and investment income to be up 56% to EUR 10.2 mn. With assumed depreciation of EUR 22.8 mn and net interest income of EUR -17.4, we expect the operating earnings to improve to EUR 11.1, after EUR 6.5 mn in the previous year.

Free cash flow enough to generate the dividend

Target of a free cash flow of EUR 30 mn appears realistic. Based on our estimates, we expect earnings from ordinary activities at the AG of EUR 30.2 mn. As a result, the total dividend, which we still see at EUR 30 mn, or EUR 1.92 per share, will be generated for the first time fully by the rental and investment income.

REVENUES FROM RENTAL INCOME (EUR MN)

	2001	2002	y-o-y	2003	y-o-y	2004e	y-o-y	2005e	y-o-y	2006e	y-o-y
Rhein-Neckar-Zentrum	8.991	12.537	*39%*	14.778	*18%*	16.108	*9%*	16.752	*4%*	17.255	*3%*
City-Galerie Wolfsburg	2.746	7.704	*181%*	7.731	*0%*	8.079	*5%*	8.321	*3%*	8.571	*3%*
City-Arkaden Wuppertal	1.984	7.587	*282%*	7.685	*1%*	7.700	*0%*	8.008	*4%*	8.248	*3%*
Allee-Center Hamm		8.704		8.824	*1%*	9.442	*7%*	9.725	*3%*	10.017	*3%*
Forum Wetzlar								7.400		8.073	*9%*
Domestic sales	**13.721**	**36.532**	***166%***	**39.018**	***7%***	**41.329**	***6%***	**50.207**	***21%***	**52.163**	***4%***
Centro Commerciale Friuli	4.139	4.293	*4%*	4.443	*3%*	2.644	*-41%*				
Centro Commerciale Tuscia	1.765	2.465	*40%*	2.553	*4%*	2.796	*10%*	2.935	*5%*	3.053	*4%*
Shopping Etrembières	3.099	3.201	*3%*	3.251	*2%*	3.446	*6%*	3.618	*5%*	3.763	*4%*
Foreign revenues	**9.003**	**9.959**	***11%***	**10.247**	***3%***	**8.885**	***-13%***	**6.554**	***-26%***	**6.816**	***4%***
Total revenues	**22.724**	**46.491**	***105%***	**49.265**	***6%***	**50.214**	***2%***	**56.760**	***13%***	**58.979**	***4%***

Sources: Deutsche EuroShop, HVB Equity Research

INVESTMENT INCOME (EUR MN)

	2001	2002	y-o-y	2003	y-o-y	2004e	y-o-y	2005e	y-o-y	2006e	y-o-y
Rhein-Neckar-Zentrum (incl. Friuli, Etrembières)	7.454	9.397	*26%*	10.409	*11%*	9.700	*-7%*	9.500	*-2%*	10.000	*5%*
City-Galerie Wolfsburg	1.050	3.031	*189%*	2.921	*-4%*	3.200	*10%*	3.200	*0%*	3.200	*0%*
City-Arkaden Wuppertal	0.468	2.141	*357%*	1.908	*-11%*	1.600	*-16%*	1.700	*6%*	1.800	*6%*
Allee-Center Hamm		2.280		2.769	*21%*	2.800	*1%*	2.800	*0%*	2.800	*0%*
Centro Commerciale Tuscia	0.785	1.741	*122%*	2.012	*16%*	2.100	*4%*	2.150	*2%*	2.180	*1%*
Forum Wetzlar								1.800		2.000	*11%*
Group companies	**9.757**	**18.590**	***91%***	**20.019**	***8%***	**19.400**	***-3%***	**21.150**	***9%***	**21.980**	***4%***
Main-Taunus-Zentrum	2.813	2.809	*0%*	3.483	*24%*	3.800	*9%*	3.850	*1%*	3.900	*1%*
Altmarkt-Galerie Dresden		0.771		2.027	*163%*	2.600	*28%*	2.680	*3%*	2.750	*3%*
City-Point Kassel		0.969		1.005	*4%*	1.050	*4%*	1.080	*3%*	1.100	*2%*
Galeria Dominikanska Breslau						1.200		1.300	*8%*	1.320	*2%*
Árkád Pécs						1.100		1.300	*18%*	1.320	*2%*
Phoenix-Center Hamburg						0.400		1.800	*350%*	2.000	*11%*
City-Arkaden Klagenfurt										1.300	
Investment companies	**2.813**	**4.549**	***62%***	**6.515**	***43%***	**10.150**	***56%***	**12.010**	***18%***	**13.690**	***14%***
Income from investments	**12.570**	**23.139**	***84%***	**26.534**	***15%***	**29.550**	***11%***	**33.160**	***12%***	**35.670**	***8%***

Sources: Deutsche EuroShop, HVB Equity Research

OTHER OPERATING EXPENSES (EUR MN)

	2001	2002	*y-o-y*	2003	*y-o-y*	2004e	*y-o-y*	2005e	*y-o-y*	2006e	*y-o-y*
Property administration costs	4.214	4.726	*12%*	5.457	*15%*	5.750	*5%*	6.000	*4%*	6.300	*5%*
Business procurement/ center management	1.392	2.309	*66%*	2.535	*10%*	2.650	*5%*	2.800	*6%*	2.930	*5%*
Financing costs /infrastructure costs	1.994	0	*-100%*	0.903		0.700	*-22%*	0.750	*7%*	0.800	*7%*
Value adjustments on rent defaults	0.067	0.501	*648%*	0.758	*51%*	0.950	*25%*	0.900	*-5%*	0.800	*-11%*
Rental costs	1.965	1.336	*-32%*	0.695	*-48%*	0.750	*8%*	0.800	*7%*	0.850	*6%*
Business procurement DB Real Estate Mgmt. GmbH	1.865	1.765	*-5%*	0.358	*-80%*						
Project controlling DB Real Estate Mgmt. GmbH	1.790										
Donations	0	0.506		0.006							
Demolition costs	0.875	0.004		0							
Other	2.312	1.755	*-24%*	2.127	*21%*	1.893	*-11%*	2.000	*6%*	2.000	*0%*
Total other operating expenses	**16.474**	**12.902**	***-22%***	**12.839**	***0%***	**12.693**	***-1%***	**13.250**	***4%***	**13.680**	***3%***

Sources: Deutsche EuroShop, HVB Equity Research

Consolidated income statement

		2002	2003	2004e	2005e	2006e
Sales	**EUR mn**	**46.5**	**49.3**	**50.2**	**56.8**	**59.0**
Changes in inventory	EUR mn	0	0	0	0	0
Internally produced and capitalized assets	EUR mn	0	0	0	0	0
Total output	EUR mn	46.5	49.3	50.2	56.8	59.0
Cost of materials	EUR mn	0	0	0	0	0
as a percentage of total output	*%*	*0*	*0*	*0*	*0*	*0*
Personnel expenses	EUR mn	-0.5	-0.8	-0.9	-1.0	-1.1
as a percentage of total output	*%*	*1.1*	*1.5*	*1.7*	*1.7*	*1.9*
Other operating income	EUR mn	0.3	0.7	4.5	0.7	0.7
as a percentage of total output	*%*	*0.6*	*1.5*	*8.9*	*1.2*	*1.2*
Other operating expenses	EUR mn	-12.9	-12.8	-12.7	-13.3	-13.7
as a percentage of total output	*%*	*27.8*	*26.1*	*25.3*	*23.3*	*23.2*
Other taxes	EUR mn	-0.9	-0.9	-1.0	-1.0	-1.0
as a percentage of total output	*%*	*1.9*	*1.8*	*2.0*	*1.8*	*1.7*
EBITDA	**EUR mn**	**32.5**	**35.5**	**40.2**	**42.2**	**43.9**
as a percentage of total output	*%*	*69.9*	*72.1*	*80.0*	*74.4*	*74.4*
Depreciation (without goodwill amortization)	EUR mn	-21.6	-22.4	-22.8	-23.0	-23.5
as a percentage of total output	*%*	*46.5*	*45.5*	*45.5*	*40.5*	*39.8*
EBITA	**EUR mn**	**10.9**	**13.1**	**17.3**	**19.2**	**20.4**
as a percentage of total output	*%*	*23.4*	*26.6*	*34.5*	*33.9*	*34.6*
Goodwill amortization	EUR mn	0	0	0	0	0
as a percentage of total output	*%*	*0*	*0*	*0*	*0*	*0*
EBIT	**EUR mn**	**10.9**	**13.1**	**17.3**	**19.2**	**20.4**
as a percentage of total output	*%*	*23.4*	*26.6*	*34.5*	*33.9*	*34.6*
Write-downs on financial and current assets	EUR mn	0	0	0	0	0
Income from investments	EUR mn	4.5	6.5	10.2	12.0	13.7
Net interest income	EUR mn	-11.4	-14.1	-17.4	-18.5	-19.0
as a percentage of total output	*%*	*-24.6*	*-28.6*	*-34.6*	*-32.6*	*-32.2*
Earnings from ordinary activities	**EUR mn**	**4.9**	**6.5**	**11.1**	**13.7**	**16.1**
as a percentage of total output	*%*	*10.5*	*13.1*	*22.1*	*24.2*	*27.3*
Reported non-recurrent result	EUR mn	0	0	0	0	0
Earnings before income taxes	**EUR mn**	**4.0**	**5.6**	**10.1**	**12.7**	**15.1**
as a percentage of total output	*%*	*8.6*	*11.3*	*20.1*	*22.5*	*25.6*
Income taxes	EUR mn	-7.0	-7.8	-9.8	-8.9	-9.8
Income tax rate	*%*	175.1	140.7	96.8	70.0	65.0
Net income	**EUR mn**	**-3.0**	**-2.3**	**0.3**	**3.8**	**5.3**
as a percentage of total output	*%*	*-6.5*	*-4.6*	*0.6*	*6.7*	*9.0*
Adjustment items	EUR mn	0	0	0	0	0
Earnings before minorities	EUR mn	-3.0	-2.3	0.3	3.8	5.3
as a percentage of total output	*%*	*-6.5*	*-4.6*	*0.6*	*6.7*	*9.0*
Minority interests	EUR mn	0.1	1.7	2.3	1.5	1.0
Earnings after minority interests	**EUR mn**	**-2.9**	**-0.5**	**2.6**	**5.3**	**6.3**
EPS reported	**EUR**	**-0.18**	**-0.03**	**0.17**	**0.34**	**0.40**
EPS adjusted	**EUR**	**-0.18**	**-0.03**	**0.17**	**0.34**	**0.40**
Goodwill per share	EUR	0	0	0	0	0
Adjusted EPS before goodwill	**EUR**	**-0.18**	**-0.03**	**0.17**	**0.34**	**0.40**

Cash flow statement

		2002	2003	2004e	2005e	2006e
Net income	**EUR mn**	**-3.0**	**-2.3**	**0.3**	**3.8**	**5.3**
Depreciation charges on fixed assets	EUR mn	21.6	22.4	22.8	23.0	23.5
Changes in other long term provisions	EUR mn	-2.9	4.9	5.6	6.9	6.9
- Changes in trade receivables	EUR mn	0.1	0.4	0	0	0
- Changes in receivables and other assets	EUR mn	8.6	-2.4	-2.4	-1.0	-1.0
- Changes in deferrals	EUR mn	0	-1.9	1.9	0	0
Changes in trade accounts payable	EUR mn	-1.9	0.8	-0.2	0	0
Changes in other liabilities	EUR mn	-0.2	4.1	-4.8	0	0
Changes in deferred income	EUR mn	-0.2	-0.5	0.2	0	0
Cash flow from operations	**EUR mn**	**22.1**	**25.5**	**23.4**	**32.7**	**34.6**
Asset disposals (without leasing)	EUR mn	7.3	0	60.0	0	0
Capital spending on fixed assets	EUR mn	-120.5	-43.2	-40.0	-30.0	0
Capital spending on financial assets	EUR mn	-17.7	-23.4	-46.0	-40.0	-30.0
Adjustment factors	EUR mn	-13.4	-4.6	18.0	0	0
Cash flow from investments	**EUR mn**	**-144.2**	**-71.1**	**-8.0**	**-70.0**	**-30.0**
Free cash flow	**EUR mn**	**-122.2**	**-45.6**	**15.4**	**-37.3**	**4.6**
Inflow/outflow from interest-bearing debt	EUR mn	111.6	-0.8	26.4	0	0
Payments to stockholders	EUR mn	-4.0	-2.3	0	0	0
Less previous year's dividend	EUR mn	-30.0	-30.0	-30.0	-30.0	-31.3
Cash flow from the financing sector	**EUR mn**	**77.6**	**-33.1**	**-3.6**	**-30.0**	**-31.3**
Changed parity relations, consolidation- and others effects	EUR mn	-3.3	13.4	4.5	6.2	8.1
Cash and cash equivalents on 1/1	**EUR mn**	**201.7**	**153.9**	**88.6**	**104.8**	**43.7**
Changes in cash and cash equivalents	**EUR mn**	**-47.8**	**-65.3**	**16.2**	**-61.1**	**-18.6**
Cash and cash equivalents at FY end	**EUR mn**	**153.9**	**88.6**	**104.8**	**43.7**	**25.2**

Consolidated balance sheet

		2002	2003	2004e	2005e	2006e
ASSETS						
Fixed assets	**EUR mn**	**814.7**	**851.8**	**858.9**	**905.9**	**912.4**
Intangible assets	EUR mn	0.4	0.4	0.3	0.3	0.2
Property, plant and equipment	EUR mn	670.9	691.6	648.8	655.8	632.3
Financial assets	EUR mn	143.4	159.8	209.8	249.8	279.8
Current assets	**EUR mn**	**185.6**	**127.0**	**127.7**	**67.5**	**50.0**
Inventories	EUR mn	0	0	0	0	0
Accounts receivable	EUR mn	2.4	2.0	2.0	2.0	2.0
Other assets	EUR mn	29.3	36.4	20.8	21.8	22.8
Marketable securities and cash	EUR mn	153.9	88.6	104.8	43.7	25.2
Deferred charges	**EUR mn**	**0**	**1.9**	**0**	**0**	**0**
Balance sheet total	**EUR mn**	**1,000.3**	**980.7**	**986.6**	**973.4**	**962.4**
EQUITY AND LIABILITIES						
Equity	**EUR mn**	**556.8**	**535.7**	**510.4**	**490.4**	**472.5**
Capital subscribed	EUR mn	20.0	20.0	20.0	20.0	20.0
Capital surplus	EUR mn	528.5	497.9	469.5	447.4	427.4
Earnings reserves	EUR mn	2.0	2.0	2.0	2.0	2.0
Net disposable profit	EUR mn	8.9	8.9	12.1	13.0	13.1
Differences due to currency translation	EUR mn	0	0	0	0	0
Minorities	EUR mn	-2.5	6.9	6.9	8.0	10.0
Special reserves for the year	EUR mn	0	0	0	0	0
Provisions	**EUR mn**	**22.6**	**27.5**	**33.2**	**40.0**	**46.9**
Pension provisions	EUR mn	0	0	0	0	0
Other provisions	EUR mn	22.6	27.5	33.2	40.0	46.9
Liabilities	**EUR mn**	**420.0**	**417.1**	**442.5**	**442.5**	**442.5**
Liabilities due to banks	EUR mn	409.4	408.6	435.0	435.0	435.0
Trade payable	EUR mn	0.9	1.7	1.5	1.5	1.5
Other liabilities	EUR mn	9.7	6.8	6.0	6.0	6.0
Deferred charges	**EUR mn**	**0.8**	**0.3**	**0.5**	**0.5**	**0.5**
Balance sheet total	**EUR mn**	**1,000.3**	**980.7**	**986.6**	**973.4**	**962.4**

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