

HVB Equity Research

Company Flash

Mid Caps/Small Caps

Deutsche EuroShop

EUR 40.10

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

Outperform

Andre Remke, CFA, +49 (0) 89 378-18202

andre.remke@hvb.de

Positive news flow expected – Price target lifted from EUR 40.00 to EUR 44.70

Performance (1/28/05)	1W	1M	3M
Absolute (%)	3.9	3.9	4.8
Relative to Euro STOXX 50 (%)	3.4	3.4	4.8

Rating

New: Outperform Previous: Outperform

Price target

New: EUR 44.70 Previous: EUR 40.00

Market cap. (EUR mn)	626.6
Free float (%)	78.8
Capital subscribed (EUR mn)	20.0
Number of shares (mn)	15.6
Shareholders	Family Otto 21.24 %

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

	2004e	2005e	2006e
Sales (EUR mn)	48.0	55.1	57.3
EBITDA (EUR mn)	38.8	40.9	42.4
EBITA (EUR mn)	17.3	18.5	19.6
EBIT (EUR mn)	17.3	18.5	19.6
Net income (EUR mn)	0.9	5.1	6.2
EPS reported (EUR)	0.29	0.34	0.40
EPS adj. pre-goodwill (EUR)	0.29	0.34	0.40
P/E (EPS adj. pre-goodwill)	122.2	119.3	100.2
EV/sales	13.93	13.92	13.22
EV/EBITDA	17.3	18.8	17.9
EV/EBITA	38.8	41.5	38.6
Dividend (EUR)	1.92	2.00	2.05
Div. yield (%)	5.5	5.0	5.1

Now that Deutsche EuroShop shares have reached our price target of EUR 40.00, we are reiterating our Outperform rating and are increasing our price target to EUR 44.70. Investors should also keep in mind the virtually assured dividend of EUR 1.92 that is due in June.

We expect stronger news flow in the coming months.

On April 18, the first report based on IAS/IFRS will be published. The strongest impacts will show up in higher sales figures – through the addition of rental income from former property investments – and higher earnings since scheduled depreciation will no longer be carried out at the group level. The free cash flow, which is relevant for dividend payments, is not affected by this.

Moreover, we expect activities with regard to portfolio optimization to intensify in the coming months.

The management board already signaled a slight change of strategy in November. The purchase of an investment property scheduled for Q4 did not come to fruition, so the focus has now shifted to 2005. In our view, the remaining liquidity of around EUR 30 mn does not necessarily have to be used for a completely new property investment – we think that it could also be used for further small optimizations of the existing portfolio. In this context, the participation in one or more of the current investments could be increased. The inherent benefit to this strategy is that DES is already familiar with the investment, which implies a lower investment risk.

Foreign investment properties are interesting but are in high demand – the focus will remain on the German domestic market.

In our view, the limited number of attractive investment opportunities in the target markets Poland, Hungary and the Czech Republic are currently in high demand by those investors and funds that are compelled to shift their portfolios from Germany to foreign markets because of the returns. This constraint has only limited applicability for DES. The acquired expertise with regard to the German shopping center market and the focus on built-up areas and city center locations in mid-size cities should offer interesting domestic investment opportunities. This applies even more because the disposal of German properties by real estate funds should continue. The resulting effect

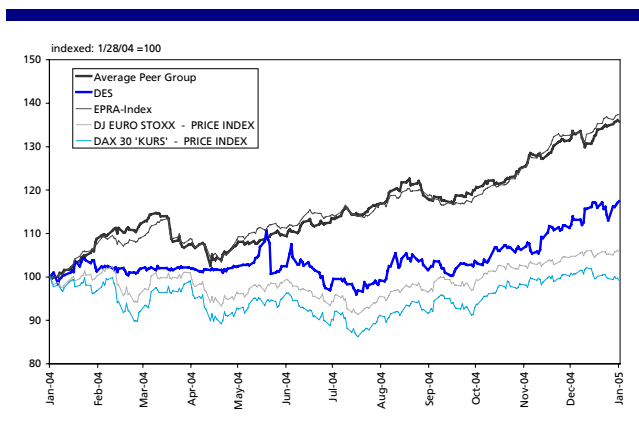
is that DES can choose the most attractive domestic investments from several possible properties, without having to compromise on quality requirements or return expectations. This contrasts with the impression we have in Eastern Europe, where prices almost equivalent to those of Western Europe are being paid, which will cause the long term return to suffer.

On February 16, the Forum Wetzlar will open in the center of the State of Hessen. 100% of the retail space has been leased. We expect that initial sales contributions will already be made in the first quarter. As with all other projects, there were no scheduling delays at Wetzlar. This fact combined with the fact that the property is almost completely leased speaks in favor of the excellent collaboration between ECE as project and center manager and DES as the investor.

The good performance of retail properties of shopping centers in particular should continue. For retail property markets, the diverging trend between prime city center locations and city district/subordinate locations has continued. In our view, this speaks in favor of a good financial performance for DES projects, which are exclusively located in city centers or at established locations.

The share price increase over the past few months, since the 9-month results were published in mid-November (see Company Flash from November 16, 2004), is attributable to several factors. First, DES shares tracked the performance of European competitors in the retail properties market (see chart). Second, the interest of institutional investors in particular has been strengthened for several reasons; these include higher interest for German real estate equities, the REIT discussion, enhanced orientation towards capital markets, MDAX entry, confirmation of the high dividend, and enhanced stock coverage.

12-MONTH PERFORMANCE IN COMPARISON

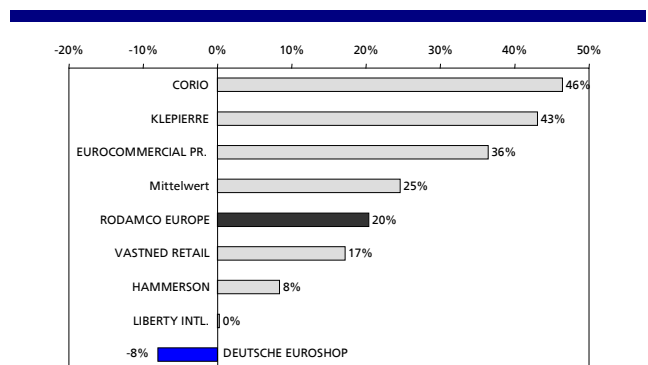


Sources: Thomson Financial Datastream, HVB Global Markets Research

Price target increased from EUR 40.00 to EUR 44.70. Besides the expected positive news flow in the coming months, the increase in our price target to EUR 44.70 is based on two factors. In our dividend discount model, we assume rising dividends by 2005 that are attributable to earnings contributions from several new property investments. Between 2004 and 2008, we assume a CAGR of 2.75% for the dividend and 1.25% thereafter. Overall, we derive a fair value of EUR 43.74.

With regard to our net asset value calculation, the delta versus other European competitors has actually increased. Upon our initiation of coverage in September, DES shares traded at a discount of 19% to NAV, while competitors traded at a premium of 11%. Presently, DES trades at a discount of 8%, while competitors have a premium of 25%. This should reflect the expectation of rising NAVs, which we also assume for DES. This is attributable to the first-time valuation of the shopping centers in Pecs, Hungary and in Breslau, Poland, which we believe have shown a strong investment performance. At year-end 2005, the centers in Hamburg and Wetzlar, which are also fully leased, should be rated.

DEVIATION OF CURRENT PRICE TO NAV



Sources: Thomson Financial Datastream, company data

Based on the average of the DDM and NAV valuations, we derive a price target of EUR 44.70. Based on the published NAV, we have so far assumed a discount of 10% to EUR 43.56 for DES. Although it has since fallen below this value, we believe that a slight premium of 5% is justified, given the solid share price performance of competitors and the rising demand for real estate (equities). We continue to assume a delta of 20% versus the peer group, due to lower returns and the weaker retail performance in Germany. In this respect, we expect a slight improvement in the course of the year so that a lower discount and thus additional share price potential should become apparent. Until that time, we calculate a fair value of EUR 45.74 based on the NAV valuation.

Disclaimer

Our recommendations are based on public information that we consider to be reliable but for which we assume no liability especially with regard to its completeness and accuracy. We reserve the right to change the views expressed here at any time and without advance notice. The investment possibilities discussed in this report may not be suitable for certain investors depending on their specific investment target or time horizon or in the context of their overall financial situation. This report is provided for general information purposes only and cannot be a substitute for obtaining independent advice. Please contact your bank's investment advisor. Provision of this information shall not be construed as constituting an offer to enter into a consulting agreement.

Please note that the provision of investment services may be restricted in certain jurisdictions. You are required to acquaint yourself with any local laws and restrictions on the usage and the availability of any services described therein. The information is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution would be contrary to local law or regulations.

Notice to UK residents:

This report is intended for clients of Bayerische Hypo- und Vereinsbank AG who are market counterparties or intermediate customers (both as defined by the Financial Services Authority ("FSA") and is not intended for use by any other person, in particular, private customers as defined by the rules of FSA. This report does not constitute a solicitation to buy or an offer to sell any securities. The information in this publication is based on carefully selected sources believed to be reliable, but we do not make any representation that it is accurate or complete. Any opinions herein reflect our judgement at this date and are subject to change without notice. We and/or other members of Bayerische Hypo- und Vereinsbank Group may take a long or short position and buy or sell securities mentioned in this publication. We and/or members of Bayerische Hypo- und Vereinsbank Group may act as investment bankers and/or commercial bankers for issuers of securities mentioned, be represented on the board of such issuers and/or engage in "market making" of such securities. The Bank and its affiliates may also, from time to time, have a consulting relationship with a company being reported upon.

The investments discussed or recommended in this report may be unsuitable for investors depending on their specific investment objectives and financial position. Investors should obtain the advice of their banker/broker about the investments concerned prior to making them.

Bayerische Hypo- und Vereinsbank AG London branch is regulated by FSA for the conduct of designated investment business in the UK.

Notice to U.S. residents:

The information contained in this report is intended solely for institutional clients of Bayerische Hypo- und Vereinsbank AG, New York Branch ("HypoVereinsbank") and HVB Capital Markets, Inc. ("HVB Capital" and, together with HypoVereinsbank, "HVB") in the United States, and may not be used or relied upon by any other person for any purpose. Such information is provided for informational purposes only and does not constitute a solicitation to buy or an offer to sell any securities under the Securities Act of 1933, as amended, or under any other U.S. federal or state securities laws, rules or regulations. Investments in securities discussed herein may be unsuitable for investors, depending on their specific investment objectives, risk tolerance and financial position.

In jurisdictions where HVB is not registered or licensed to trade in securities, commodities or other financial products, any transaction may be effected only in accordance with applicable laws and legislation, which may vary from jurisdiction to jurisdiction and may require that a transaction be made in accordance with applicable exemptions from registration or licensing requirements.

All information contained herein is based on carefully selected sources believed to be reliable, but HVB makes no representations as to its accuracy or completeness. Any opinions contained herein reflect HVB's judgement as of the original date of publication, without regard to the date on which you may receive such information, and are subject to change without notice.

HVB may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them. Past performance should not be taken as an indication or guarantee of further performance, and no representation or warranty, express or implied, is made regarding future performance.

HVB and any HVB affiliate may, with respect to any securities discussed herein: (a) take a long or short position and buy or sell such securities; (b) act as investment and/or commercial bankers for issuers of such securities; (c) engage in market-making for such securities; (d) serve on the board of any issuer of such securities; and (e) act as a paid consultant or adviser to any issuer.

The information contained in this report may include forward-looking statements within the meaning of U.S. federal securities laws that are subject to risks and uncertainties. Factors that could cause a company's actual results and financial condition to differ from its expectations include, without limitation: political uncertainty, changes in economic conditions that adversely affect the level of demand for the company's products or services, changes in foreign exchange markets, changes in international and domestic financial markets, competitive environments and other factors relating to the foregoing.

All forward-looking statements contained in this report are qualified in their entirety by this cautionary statement.

Sources: Thomson Financial Datastream, HVB Global Markets Research