![ERSTE]

CEE Real estate properties on the rise

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- Real estate investors should benefit more than developers, as vacancies are still high
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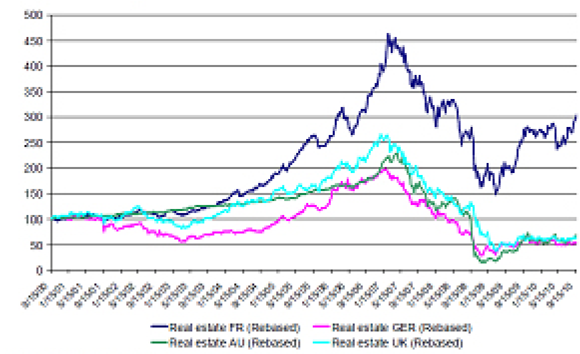
“Analysis of CEE real estate markets shows that we will very likely enter a period of continuously rising property values. The development will clearly be led by yield compression. Given the pretty high vacancy rates across the region and the finalization of a number of development projects, a substantial property value increase due to rising rent levels is still unrealistic for the next 4-6 quarters ahead”, says Günther Artner, Co-Head CEE Equity Research. “Given the economic outlook in Austria, Germany and the CEE region, P/BV ratios of around 0.6x for plenty of property stocks are still rather cheap levels in a long-term comparison, especially given the record-low level of interest rates. We regard an aggregate forward P/BV 2011e multiple of around 0.63x as realistic as of year-end 2010 and a forward P/BV 2012e of around 0.72x as of year-end 2011. This means that there would theoretically be only minor upside potential for the rest of 2010, but around 20-25% upside until year-end 2011 – both figures just for the main Austrian real estate companies not involved in a takeover process; thus, CA Immo, conwert, Immofinanz and Sparkassen Immo.”

Takeovers in fashion

CEE real estate stocks are currently in a phase of brisk corporate action. Financially sound companies with attractive assets are interesting takeover targets (e.g. CA Immo Int., conwert), while other companies are being taken over in order to use the rather low stock valuation to liquidate assets and take profit (ECO Business-Immo). Companies with stretched balance sheets are still struggling (Orco Property Group). “The stock prices of the major Austrian, German and UK property stocks are still clearly below the levels where they traded 10 years ago (see chart below), which puts last year’s increase into a somewhat different perspective. The upside potential is certainly dependent on a recovery of property prices, as, on the way down, the fall in property prices was multiplied by the leverage being used”, assumes Gernot Jany, CEE Real Estate Analyst at Erste Group.

Long-term development of real estate stocks



Real estate FR: Unibail-Rodamco, Gecina, Fonciere des Regions, ICADE
Real estate GER: Deutsche Euroshop, IVG Immobilien, Deutsche Wohnen, Gagfah
Real estate AU: conwert, Sparkassen Immo, Immofinanz, CA Immo
Real estate UK: Land Securities Group, British Land, Hammerson, Capital Shopping Center Group, Segro
Stocks weighted by market capitalization.

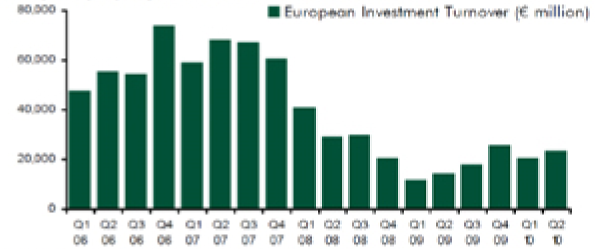
Source: Factset

Investments up by 70% y/y, mainly in the UK, German and French markets

The European investment market saw an increase in transaction volume of nearly 70% to EUR 43.8bn for 1H10 compared to the same period of last year. The focus on quality assets seems to be prevailing due to concerns

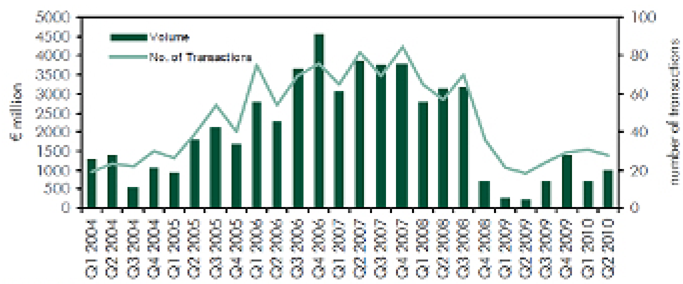
over a sovereign debt crisis in the region. 62% of the total transaction volume made up UK, German and French markets. In these countries as well, the large-size deals (above EUR 100mn) increased, with
13 transactions in Germany and 25 in the UK. The strongest q/q growth in investment activity could be observed in countries like Austria, Italy (+85%), Ireland and the Czech Republic.

European property investment transaction volume



Source: CB Richard Ellis, European Investment Quarterly, 2Q10

CEE property investment transaction turnover and number of transactions

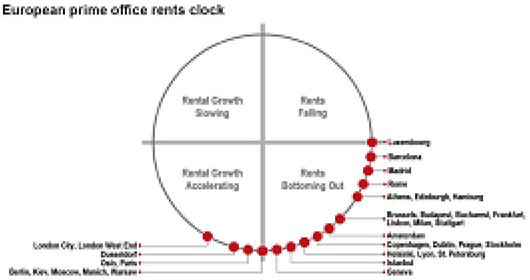


Source: CB Richard Ellis, Market View, CEE Property Investment, 1H10

"Although the quarterly investment volume in 2Q10 quadrupled in the Austrian market and reached a total volume of EUR 1,020mn in 1H10 (+28% y/y), the property investment market in the CEE region reported a far stronger growth of 190% to EUR 1.7bn, which is still far below the levels seen prior to 4Q08", summarizes Artner. Concerning asset classes, offices made 55% of the total turnover in Austria and 45% in CEE, where nearly 97% was placed in Poland, Russia and the Czech Republic, with Bulgaria and Romania being the next most important markets. In 2Q10, prime yields went down in Austria in the retail and office segment by 5bp q/q each. The prime yield compression in the major Western European countries spilled over to the CEE region. While shopping center yields tightened already in 1Q, office yields followed in 2Q. Combined with generally rather stable prime rents, this effect boosted capital values in Core Central and Eastern European markets. In SEE, on the other hand, some cities showed a decrease in prime rents at stable prime yields, which led to a reduction in capital values for this segment.

Office take-up in both Western and Central-Eastern Europe

European prime office rents clock

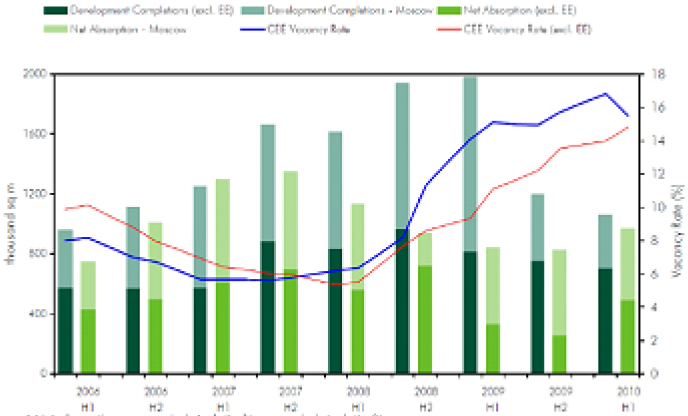


Source: The Jones Lang LaSalle office property clock, 2Q10

The economic recovery is starting to positively affect office take-up with 38% y/y in the first half of 2010 due to improved demand in both Western and Central-Eastern Europe. The vacancy rate remained at its pre-quarter level of 10.2%. However, the divergence in vacancy rates across Europe remains high, ranging from as low as 6.8% in Paris to levels above 15% in cities like Amsterdam, Dublin, Budapest and Moscow. The office segment recorded a further stabilization in rent levels, with some major cities even recording acceleration in rental growth on a quarterly basis. London West End (+13.3%), Paris (+7.1%) and London City (5.3%) saw the strongest increase in office rents. Demand for office space in CEE witnessed an increase by 36% y/y to 1.38mn sqm with by far strongest growth in Moscow, where take-up in 1H10 nearly reached pre-2008 levels. "For CEE as a whole, office vacancy saw a first decline by 30bp to 15.5% in 2Q, after a period of hiking rates since 2H07. Looking at the three sub-regions, however, different trends were recorded. While rates in CE and SEE were slightly increasing, EE vacancy rates have been declining by nearly 200bp to 16.3% compared to 2H09, which is even below the SEE level of 17.1%", explains Artner.

EU27-Retail sales nearly at the same level y/y in 1H10; HU, PL, RO and RUS accounted for the majority of investment activity

CEE development completion, net absorption, vacancy rate



* Net absorption = occupied stock (t=1) – occupied stock (t=0)

Source: CB Richard Ellis, CEE Office Investment, July 2010

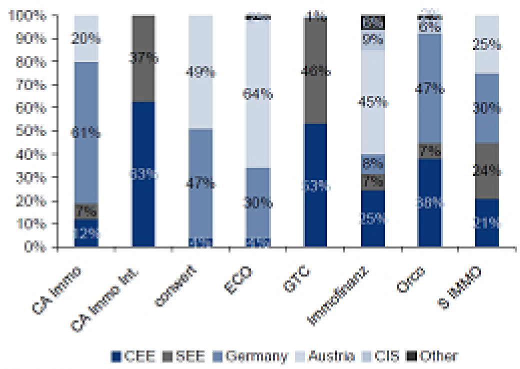
The investment volume in the European retail property market more than doubled y/y in 1H10, reaching EUR 10.6bn, reinforcing the increasing confidence. On the consumer level, potential tax hikes and uncertainty about the effects of governmental austerity measures dampen expenditure. Hence, retail sales for the EU27 were nearly at the same level y/y in 1H10. Across individual markets, however, sales growth shows strong divergence. In 1H10, retail investments in CEE amounted to EUR 633mn, representing growth of 5% relative to the previous half-year and a remarkable 190% compared to the low levels of 1H09. In terms of geographical markets, Hungary, Poland, Romania and Russia accounted for the majority of investment activity. Regarding the fields of investment, shopping centers remained the most attractive segment. “In the current environment, strong competitors are more likely to invest in new retail space, possibly buying out weaker market participants. Therefore, prime locations and highly frequented shopping areas remain the main focus of interest”, comments Jany.

Erste Group analyst’s recommendation and target price overview:

9/21/2010		Mcap	Price (lc)				Recommendation		Performance (EUR terms)			
Company	Curr.	(EURmn)	Current	Target NEW	Target OLD	Upside potent.	NEW	OLD	1M	3M	6M	12M
CA IMMO	EUR	920	10.54	12.00	10.20	13.9%	Accumulate	Accumulate	14.49	14.32	32.58	6.36
CA IMMO Int.	EUR	256	5.88	5.70	6.50	-3.1%	Reduce	Hold	5.00	-9.12	8.09	0.51
conwert	EUR	878	10.36	11.50	10.70	11.0%	Accumulate	Buy	14.73	17.73	23.33	12.36
ECO Business-Immo	EUR	244	7.15	7.10	7.15	-0.7%	Reduce	Hold	0.00	11.02	64.75	43.86
GTC	PLN	1,260	22.66	23.10	23.70	1.9%	Hold	Hold	1.21	-5.58	0.27	-5.58
Immofinanz	EUR	2,984	2.86	3.60	3.00	26.0%	Buy	Buy	5.42	18.59	14.32	14.32
Orco	EUR	101	7.20	8.20	7.20	13.9%	Accumulate	Under review	26.98	34.83	-7.10	-18.00
Sparkassen Immo	EUR	378	5.55	6.90	6.50	24.3%	Buy	Buy	6.22	16.11	14.67	3.35

Source: Erste Group estimates

Portfolio breakdown by region (1H10, fair value)



Source: Company data

- CA Immo. Based on clearly better than expected gains from the disposal of properties and a revaluation result coming in above estimates in 1H10, we increased our full-year forecast for 2010 considerably and made moderate adjustments to our mid-term estimates. Accumulate.
- CA Immo Int. We downgrade our recommendation to Reduce, with a target price of EUR 5.7 (previously EUR 6.5).
- conwert. After fully including the successfully taken over ECO Business-Immo in our forecasts, we increase the target price from EUR 10.7 to EUR 11.5. Accumulate.
- ECO Business-Immo. Following the successful takeover bid of conwert for ECO, we cut our recommendation to Reduce with a new target price of EUR 7.10.

■ GTC. We slightly lower our target price to PLN 23.1 per share (based on a DCF valuation), following the weaker 2Q10 results, and maintain our Hold recommendation.

■ Immofinanz. Based on the increased estimates we derive a 12-month target price of EUR 3.6 (previously EUR 3.0) and therefore stick to our Buy recommendation.

■ Orco. Our DCF model yields a EUR 8.2 per diluted share 12M target price. We thus have an Accumulate recommendation on Orco shares, as its risk profile calmed significantly.

■ Sparkassen Immo. Despite our somewhat reduced estimates, we keep our Buy recommendation for Sparkassen Immo and increase our target price to EUR 6.9 (from EUR 6.5).

Sector Report: CEE Real Estate [pdf; 2.8 MB]

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