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OPPENHEIM RESEARCH

Germany - Backbone of European recovery

Dr. Wolfgang Sawazki, Managing Director Research

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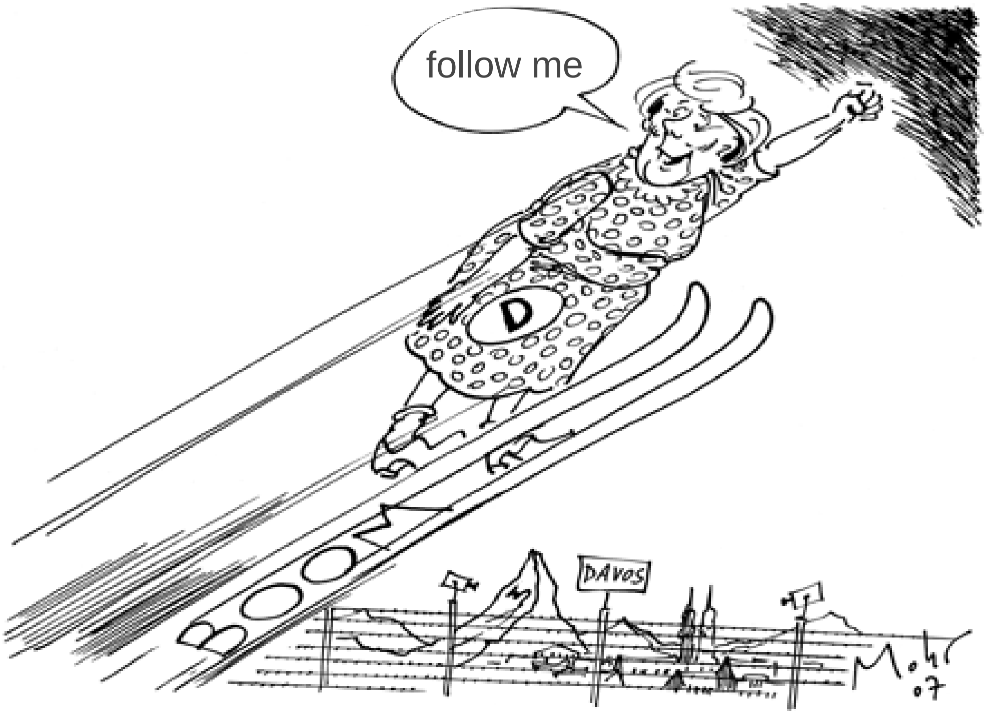
A two tier market also offers opportunities



It goes down further, before it moves up again

- A very pronounced slowing of growth in the US and some slowing in Europe is our base case – however unusually high risks of a vicious cycle (financials crisis & recession) have to be taken into account - drivers are emerging markets (BRIC), Middle East and European consumers
- Expansionary Fed policy will help markets with a lag
- We expect better entry points over Q1/Q2. Valuation, expansionary monetary policy, corporate activities (M&A, share buy-backs) and falling commodity prices support a recovery in equity markets
- Solid returns to shareholders via dividends, share buy-backs and M&A markets
- Year end targets
  - › DAX: 8400 70% likelihood, 6300-6400 as the bottom of the downturn
  - › EURO STOXX 50: 4550 70% likelihood, 3500-3600 downside risk
- We keep overweighting defensives (consumer staples, telecoms, pharma, retail).
  Cyclical sectors are in the middle of a correction

Significant downward revisions of growth estimates, further risks prevail

EMU MACRO FORECASTS

	2006	2007	2008e	2009e
Real GDP	2.9	2.7	1.5	2.0
Personal consumption	1.9	1.5	1.3	1.8
Government consumption	1.9	2.0	1.1	1.3
Fixed investment	5.2	4.3	2.5	1.5
Exports	7.9	6.1	3.6	3.6
Imports	7.6	5.3	3.6	3.2
Inflation	2.1	2.2	2.3	1.9

FORECAST GDP GERMANY

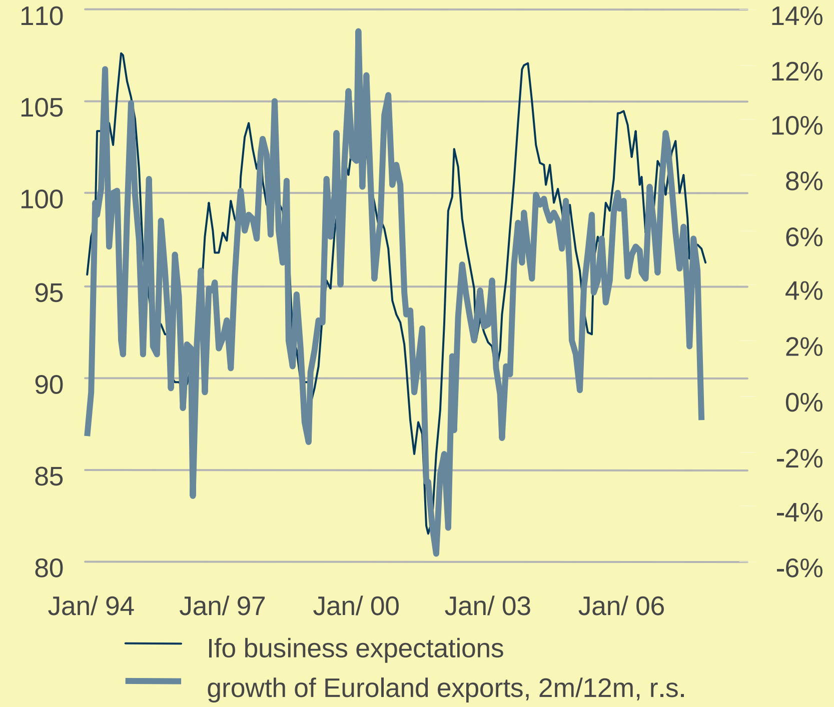
	2006	2007e	2008e	2009e
GDP	3.1	2.6	1.5	2.0
Private consumption	1.1	-0.3	1.4	2.1
Government consumption	0.9	2.1	1.0	1.2
Investment M&E	9.0	8.2	3.6	3.1
Building investment	5.4	2.9	1.8	2.8
Exports (goods & services)	12.9	8.4	6.2	4.1
Imports (goods & services)	11.5	6.2	6.5	4.7
Inflation	1.7	2.2	2.2	1.5

We bet on a pretty hard ‘soft landing’ of growth in the US, but we see reasonably strong growth at private consumption in Germany; strong shift from investment spending to consumption

How long will decoupling hold?

Nominal German exports: regional allocation and growth			
	Share in 2007 ytd	Delta 2007 vs 2006 (Jan-Nov) in bn €	Delta 2007 vs 2006 (Jan-Nov) in %
Total		76.7	9.4%
Europe	75.3%	71.5	11.9%
thereof Euroland	**42.7%**	36.9	10.7%
Poland	3.7%	6.8	**25.8%**
Russia	2.9%	4.9	**23.2%**
Czech Republic	2.7%	3.5	**17.0%**
America	10.5%	-2.0	-2.1%
thereof US	7.6%	**-3.3**	**-4.7%**
Asia	11.6%	5.5	5.7%
thereof China	3.1%	2.6	**10.5%**
Memo item:			
UK	7.3%	6.3	10.6%
Spain	5.0%	6.2	16.3%

Growth of Euroland exports vs Ifo business expectations ex fd+bev



In 2007, China, India, Middle East and CEE compensated for the weak US, but momentum in key European markets has weakened significantly in recent months.

Germany: Further earnings growth expected – Germany stronger than EU

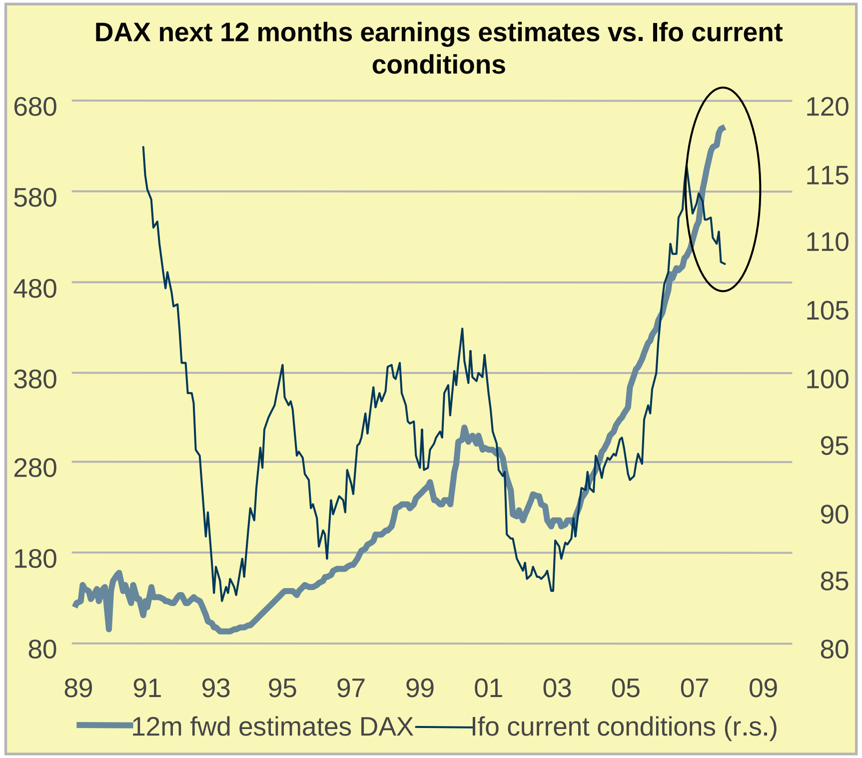
OPPENHEIM ESTIMATES							
	Adj. EPS			EPS growth in %		PER	
	2007e	2008e	2009e	2008e	2009e	2008e	2009e
DAX	561	620	699	10.5	12.9	11.3	10.0
DJ EURO STOXX 50	337	365	397	8.4	8.6	10.4	9.6

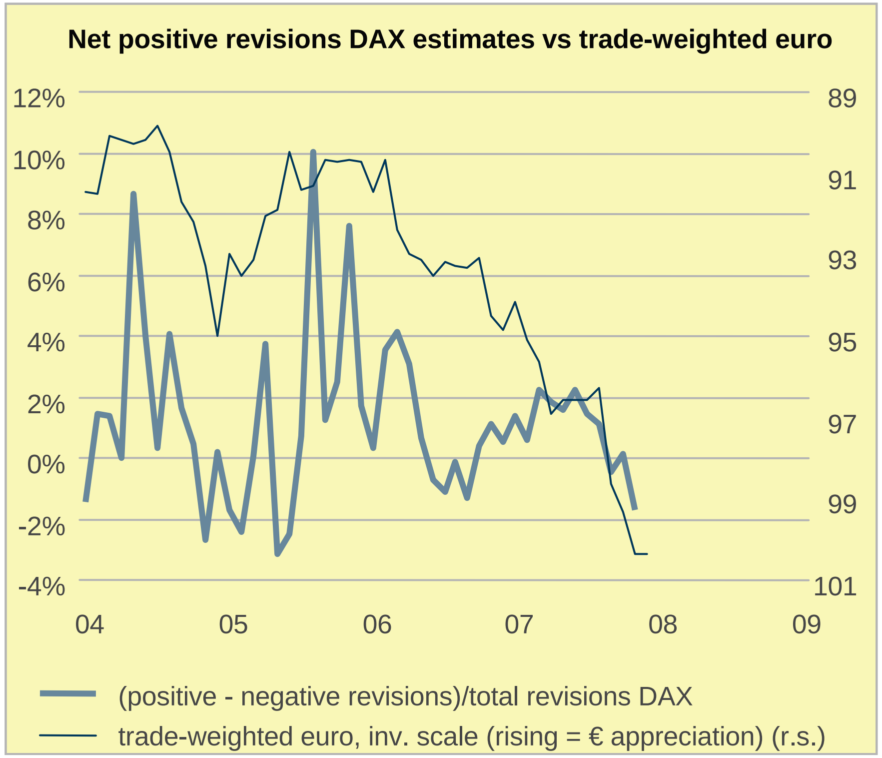
- Underlying earnings growth will weaken → Negative revision expected in Q2; Banking: Huge losses in Q1 2008
- Extraord. restructuring or consolidation effects (Daimler, Linde, Bayer, Siemens, Dt. Telekom) overshadow this
- Mid Caps with supportive valuation after sharp correction

Earnings driven by still solid growth in European economy; leverage to investment needs in China and India; consolidation synergies; restructuring benefits and lower tax payments in Germany in 2008

Germany: Less geared to financial crisis, commodities and oil

Weaker growth and strong Euro are burdening estimates





Markets are ahead of analysts as the latter have not yet revised their estimates. After 4 years during which companies could outperform the estimates by analysts, the incentive to cut quickly is rather limited.

Corporate tax reform raises DAX earnings by some 4-6% in 2008

- German corporate taxes move from high end to the middle of the international tax scale: Reduction by 9 pp from 38.6% to 29.8% for domestically taxed corporations
- Counter financing: Broader tax base (e.g. switch from degressive to linear depreciation, higher taxation of debt); net relief for German corporations: €7.6 bn
- DAX earnings increase by 4-6% due to globalized tax base less than the highest possible increase of 15% (above average: Deutsche Boerse, ThyssenKrupp, Altana, RWE, E.ON, BMW, Deutsche Postbank, SAP)
- Main winners: German Small and Mid Caps, which are highly exposed to German tax code and are not affected by higher taxation of debt (United Internet, MVV Energy, A.S. Création)

25% withholding tax for interest income of private investors. This benefits long-term growth stories and pre-buying of investment funds

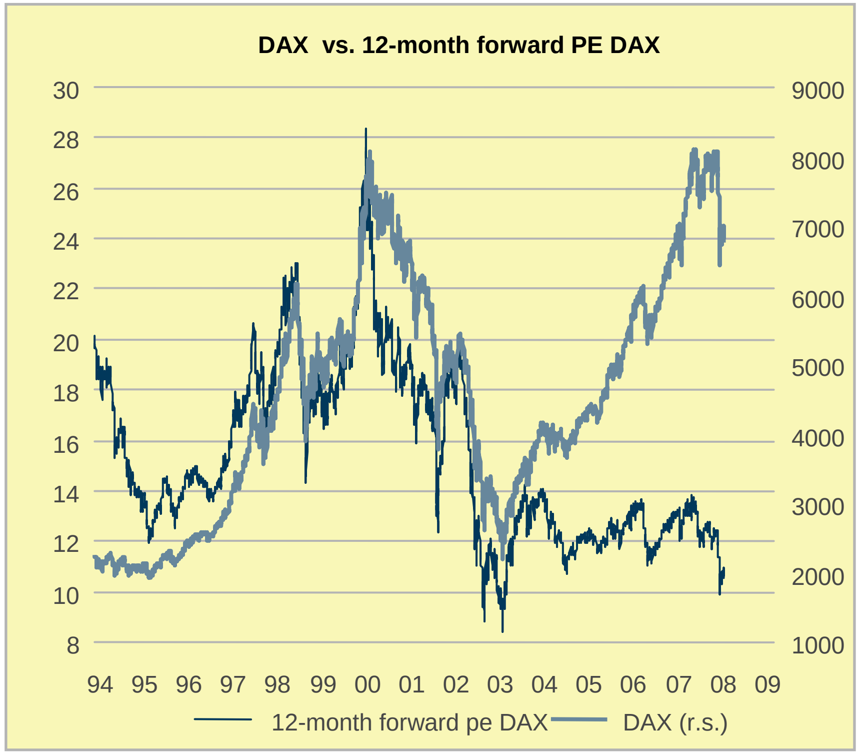
German REITs – Introduction in 2007 > Window could open in H2

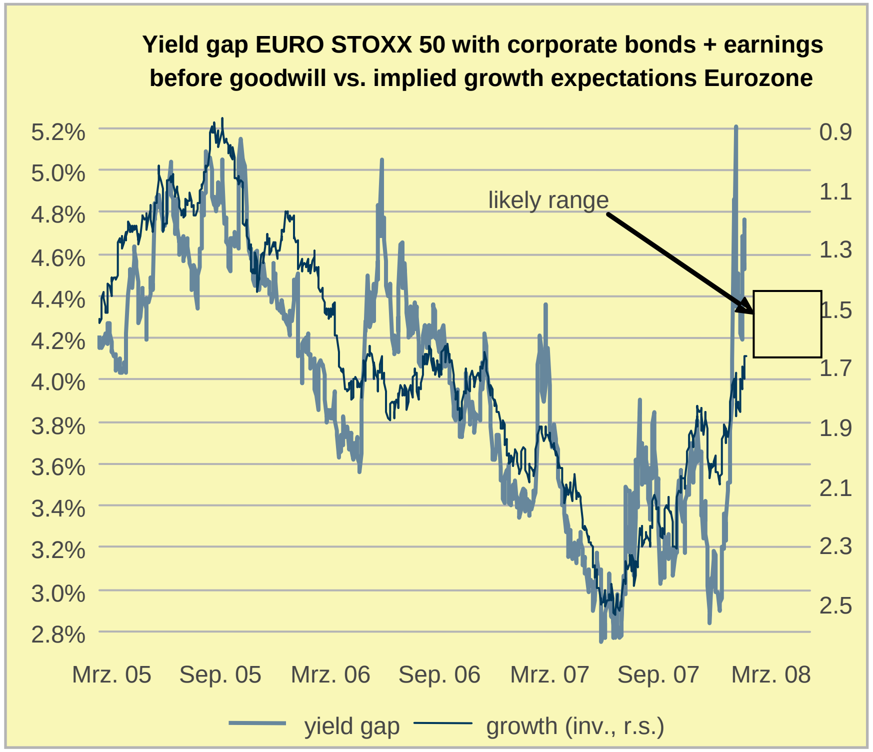
- German corporates: Greater than proportionate value of capital tied up in Real Estate (in an international comparison)
- Transformation of Commercial (ex residential) Real Estate into REITs supports internal and external growth as well as an improvement of ROCE ratios → Supports revaluation
- Transformation of hidden reserves only partly taxed
- Start summer 2007
- Open up new asset class in Germany at the bottom of the cycle

→ Low valuation - due to subprime crisis - impedes vitalization of the new market

Potential corporate winners: Deutsche Telekom, insurance companies, Daimler Chrysler, TUI, RWE, Fresenius, MVV Energy

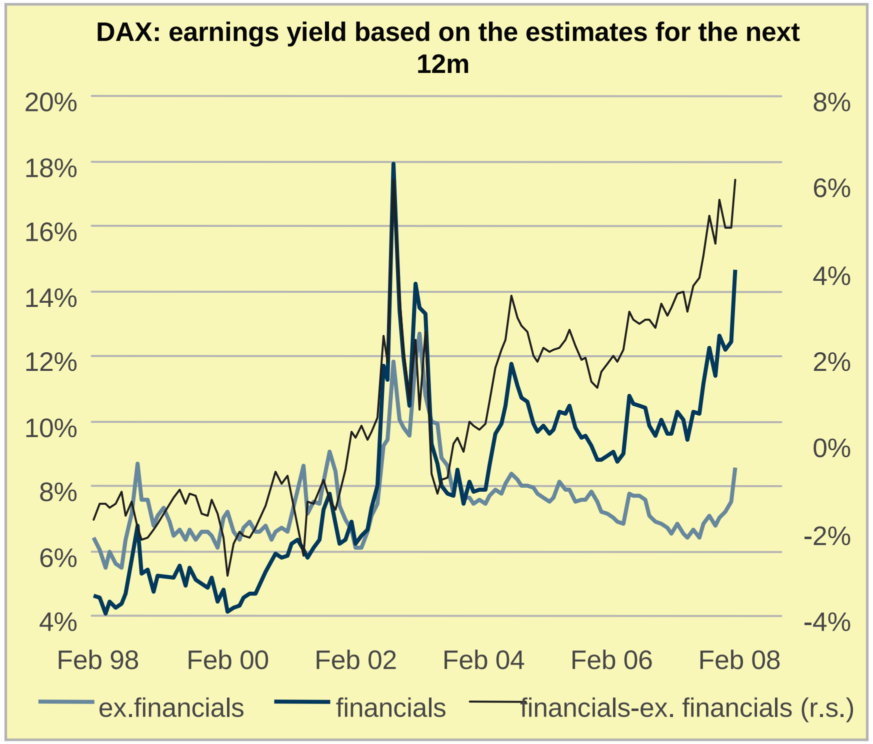
Valuation looks cheap on the regular Fed model > Reflects lower growth expectations

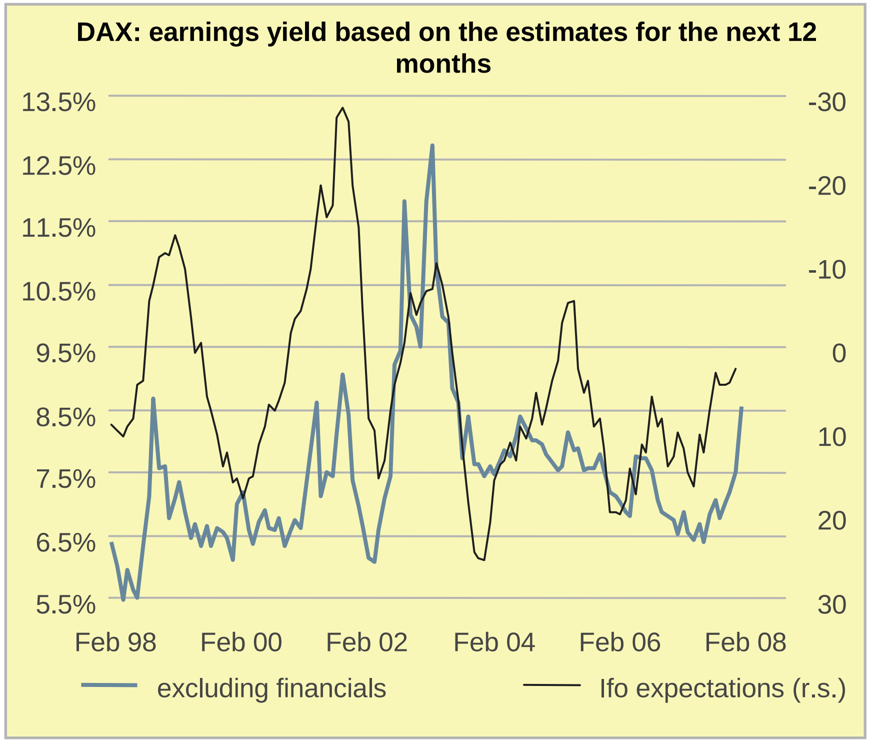




Low valuation is a reflection of slowing growth expectations and widened credit spreads / risk awareness; Valuation will rise once the mix of growth vs. inflation expectations improves and risk awareness decreases

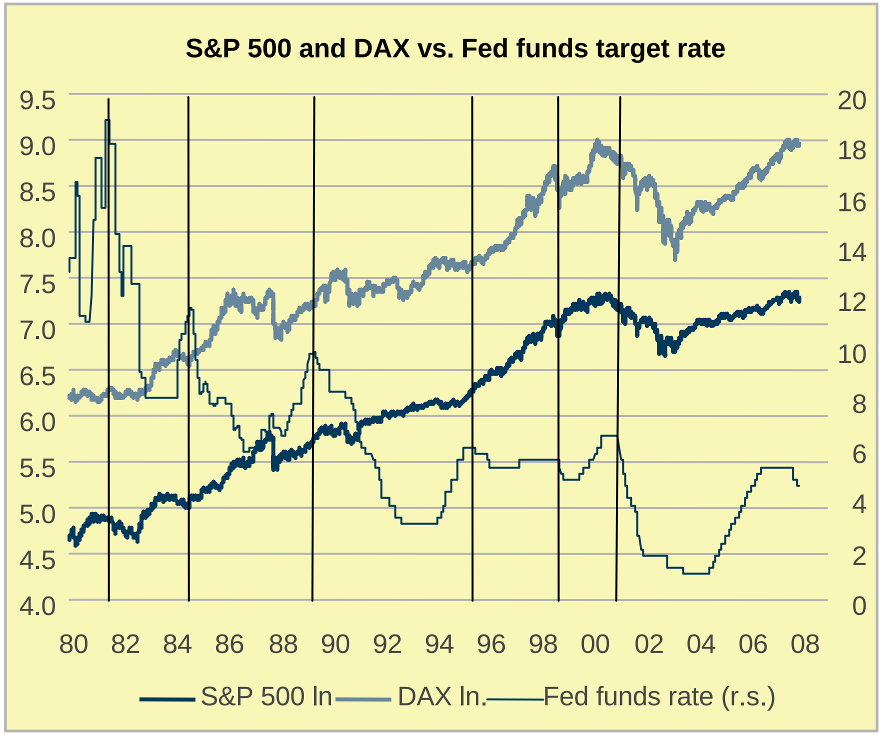
Low valuation comes mainly from financials - But further cuts in Q1 2008 expected

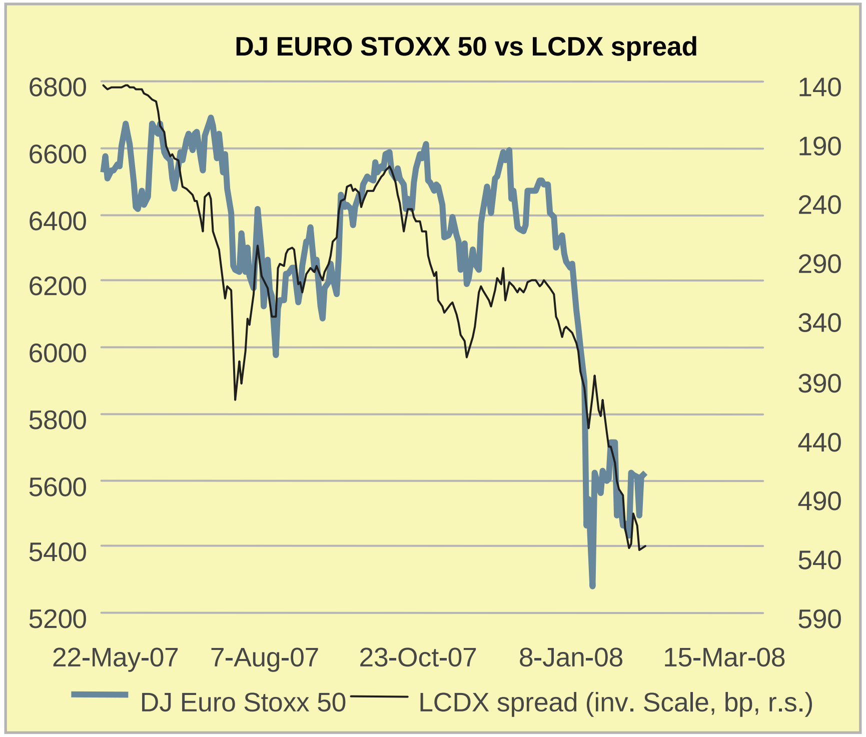




The valuation of financials is rather low as nobody has any trust in the estimates. The valuation of non-financials has improved a lot but is not always cheap for this stage of the cycle. → Be selective.

Rate cuts help - The Fed will force us into risk taking over time





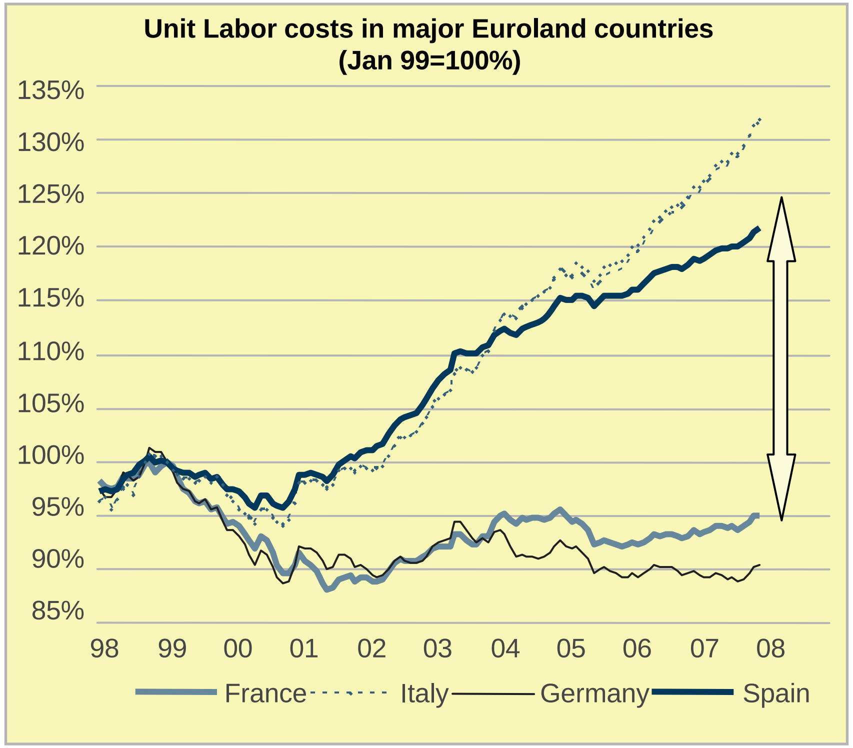
Currently, there is still no major relief at interbank markets or other spread products. But at one point spread products should be less risky than government bonds. This should then lead to more risk taking particularly as spreads are huge when one takes into account the low level of bond yields.

Germany: The star performer in Europe

- Reform policy of German government
- Company restructuring benefits
- Industrial leverage to infrastructure spending
- High rates of utilities, infrastructure, pharmaceuticals, agro weights and Deutsche Telekom

Why is Germany so unique?

Germany: Ongoing improvements of unit labor costs reach peak



- Reform policy of federal government
- Relocation of production
- Low wage settlements
- Corporate restructuring and portfolio optimization

→ Higher wage settlements and reform standstill indicate no further improvement

Germany has gained competitive ground in Europe in recent years; reflection of low wage settlements and productivity gains; 2008 will reach a peak level
Consumers will benefit from the still improving labor market

Lower US Dollar sensitivity – Emerging markets become more important

EEC: TRADE EXPORT WEIGHT								
	EU*	**USA**	**Switzerland**	**Russia**	**China**	**Japan**	**Other Asian countries**	**Others**
2003	35.5%	15.8%	6.0%	2.8%	3.3%	2.9%	12.8%	18.7%
2004	34.8%	15.0%	5.8%	3.1%	3.5%	2.9%	13.1%	19.1%
2005	33.9%	14.9%	5.7%	3.5%	3.5%	2.7%	13.3%	19.7%
2006	34.1%	14.5%	5.5%	4.0%	3.9%	2.5%	13.2%	19.6%

* European Union (without Euroland)

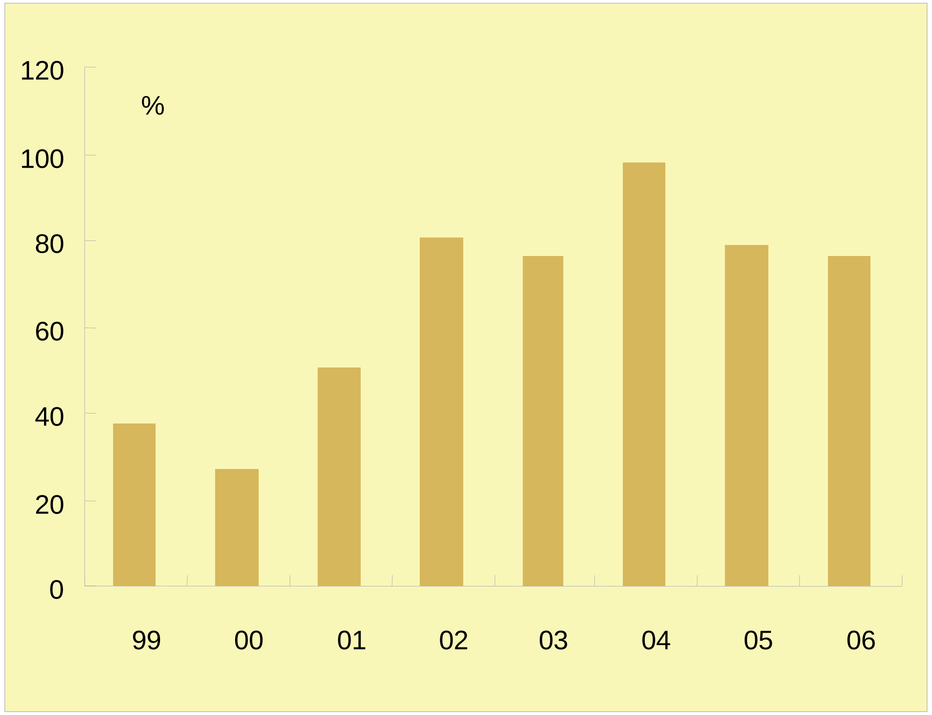
Source: Monthly report ECB, April 2007

US Dollar less important than in the past

CORPORATE SECTOR

Germany: Strong corporate sector
- High self financing capacity and profitability ratio

D: INTERNAL FINANCING



D: ENTREPRENEURIAL INCOME RATIO

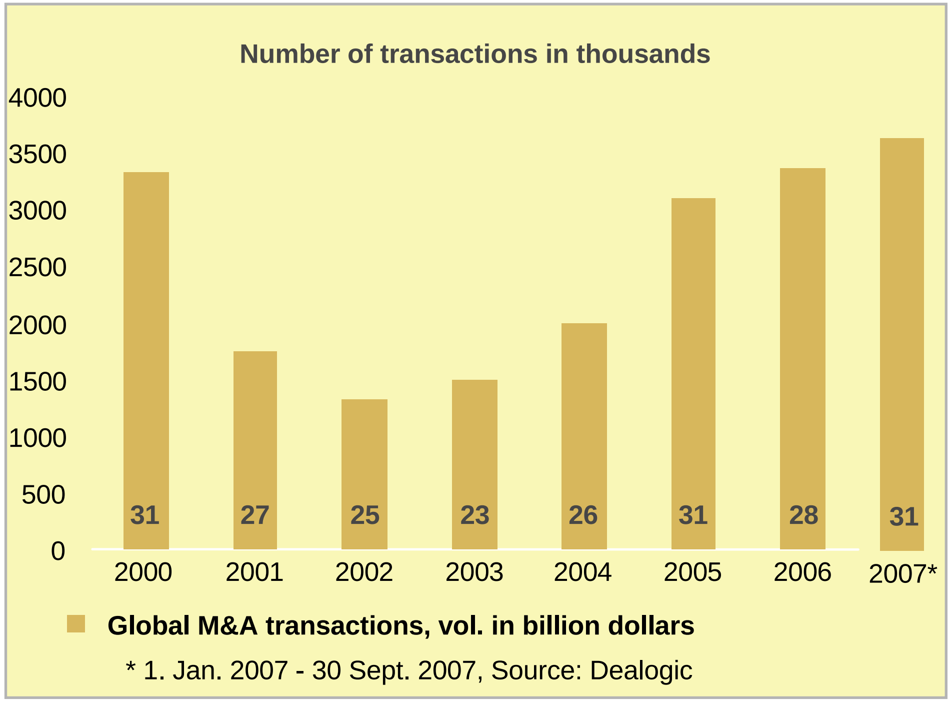
German corporates can grow - even in a tougher environment, but entrepreneurial income ratio will peak due to higher wage settlements

M&A stabilizes equity market – Refocus on Mid-Caps

- Positive M&A environment
  - Capital markets ask for growth
  - Still low interest rates
  - Private Equity investment and exit needs
  - Strong corporate free cash flows – growth focus

  But securitization of big deals impossible at the moment
- Private Equity participation decreases
- Strategic buyers of increasing importance

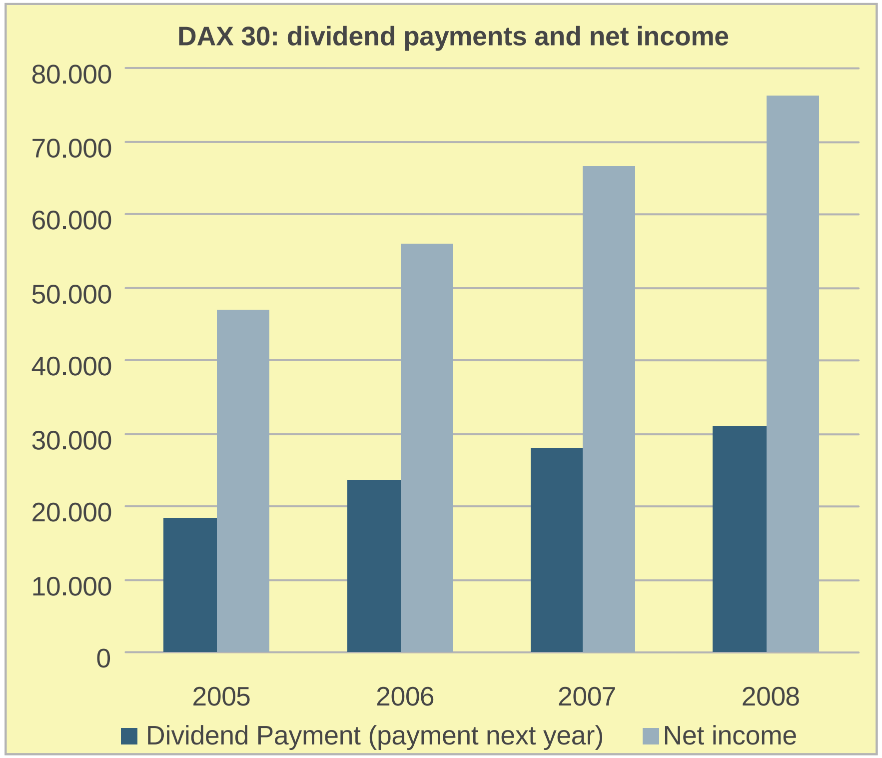
M&A PEAK LEVEL REACHED



Source: Boersenzeitung, Thomson Financial

Increasing dividends and share buy-backs are supportive

- Top dividend yields with Deutsche Bank and Deutsche Telekom
- Highest payments with Deutsche Telekom, E.ON and Allianz (above €2 bn)
- Share buy backs with Daimler, E.ON, Siemens, BASF and Munich Re



Companies return €40-45 bn back to shareholders in 2008 (yield > 4%)

Summary: Germany – Industrial growth engine of Europe

- Strong leverage to the infrastructure and capital investment needs in China, India, Middle East and Eastern Europe
- Still earnings growth (tax reform, winner of global investment cycle, strong industrial economy in EU, positive accounting changes (+20% basis))
- Tax reform
- M&A market still intact
- Low exposure to financials
- No Real Estate crisis in Germany; spill over from UK, Spain or Eastern Europe?
- Higher purchasing power of consumers (lower unemployment costs and higher wage settlements)

Germany remains a top performer in Europe - Increasing value in Mid-Caps

DAX target 8400 in late 2008 but short-term negative economic inflation and earnings figures (especially at financials) will burden markets further → **Buy into dips**

Equity remains favorable asset class, but short-term still negative

- It gets weaker before markets recover
  - Negative earnings revision - Recession in the US
  - Unfavorable growth vs. inflation profile > Monetary policy less pronounced
  - Investors reduce risk exposure
  - Further losses in the banking sector with Q1 2008 reporting

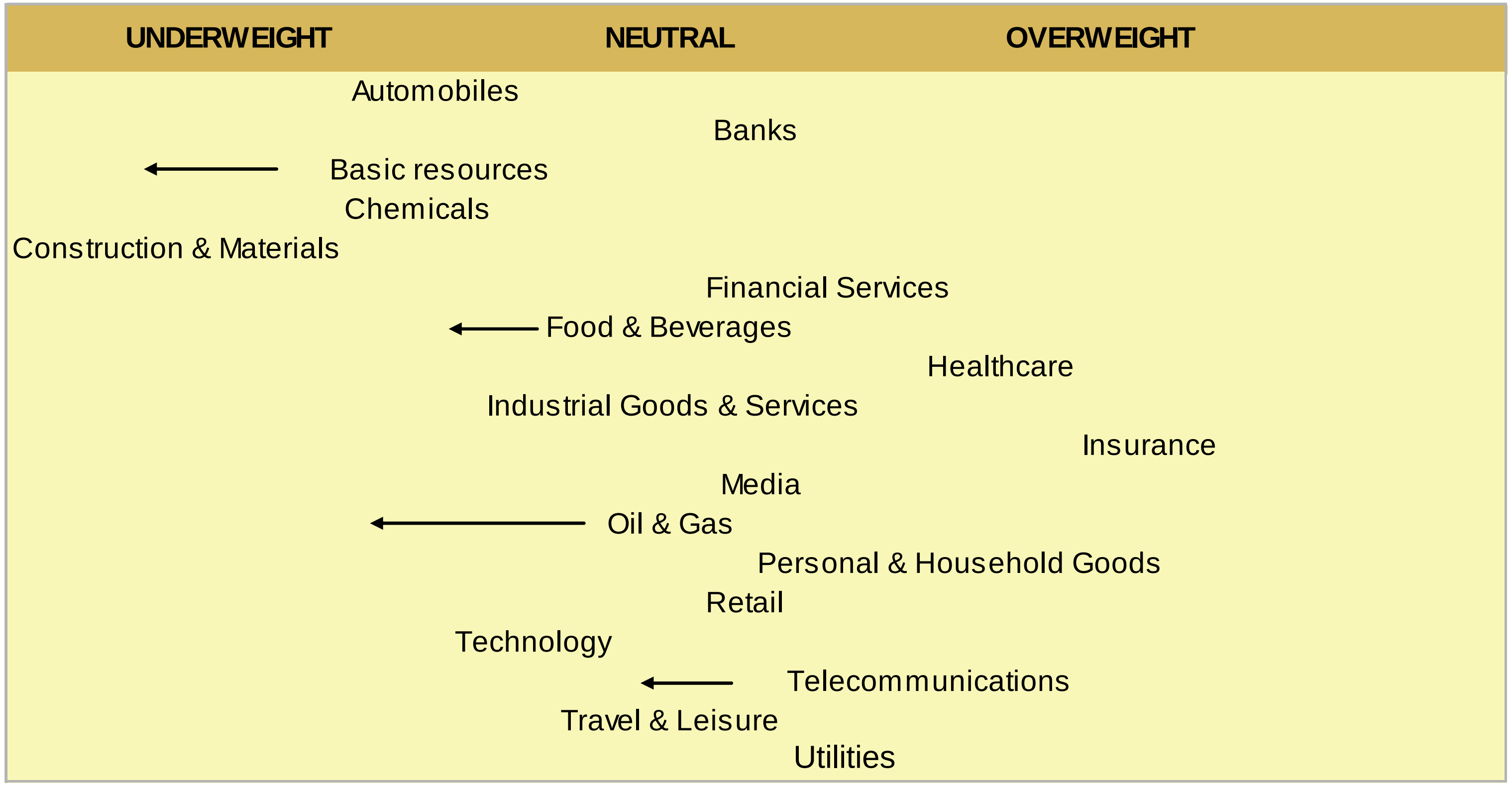
→ Short-term: Stay in defensives

- Recovery of markets over the course of the year
  - Soft landing
  - Expansionary Monetary Policy
  - Low valuation
  - Normalization of credit markets
  - Corporate actions (M&A, share buy-backs)

Buy into weakness - selective value in Mid Caps

SECTOR ALLOCATION

Defensive sectors are overweighted



Negative revisions should burden cyclical stocks, at financials this is largely anticipated

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