Real estate

Belgium

Previously: Hold

Buy

Befimmo

Waiting for the trigger

16/08/06

Reuters: BEFIT.BR

Price: €81.25

Previously: €80

12-mth target: €90

- **Befimmo offers an underlying property portfolio with the same, if not higher, quality as main rival Cofinimmo, but at a higher yield.**
- **The latter is not inflated by sizeable non-cash items.**
- **The Befimmo share is currently and, we believe, unfairly penalised by psychological perceptions.**

Befimmo offers a high-quality portfolio offering a risk profile equivalent to, if not better than, arch-rival Cofinimmo (€137.20, HOLD); its exposure to the beleaguered Brussels decentralised & Periphery locations is moderate (c.34% of appraised value, above 40% at Cofinimmo), and the duration of rental income satisfactory (61% of rental income guaranteed till 2009, 62% at Cofinimmo). Only diversification looks lower versus its main peer (two main assets represent over 25% of the portfolio, below 15% for Cofinimmo) but are rented to Belgian public administrations. Actually, public administrations pay close to 50% of rents (one-third at Cofinimmo). Full potential yields of both property portfolios are very close (7.71% versus 7.56% for the last full year).

Recurrent income is not inflated by non-cash items; as a reminder, operating revenues as reported by Cofinimmo include the non-cash revaluation of the North Galaxy building (c.€9m for FY06). Another point is the higher leverage of Cofinimmo's balance sheet (expected to be close to 50% at the latter as of end-December 2006, versus under 40% for Befimmo at end-September 2006). In other words, Befimmo retains a higher upside from new investments. Let us recall that the legal indebtedness ceiling was recently raised to 65% (gross debts versus total assets).

Attractive yield; both shares trade at a premium versus 'fair value' (ie, excluding transaction costs) NAVs, at c.20%, but at current prices the Befimmo share offers a dividend yield at 60bp above Cofinimmo. Moreover, Befimmo's dividend is payable next December, ie, five months before Cofinimmo.

Lack of genuine triggers in the short run; no important news is expected, as adequate investment opportunities (ie, at acceptable yields) remain scarce; Befimmo recently reiterated its interest in investing abroad, but nothing material is likely to emerge in the short run. The only positive surprise in the short term would come from the State SICAFI (*société d'investissement à capital fixe en immobilier*) (Befimmo applied with three other candidates to be manager & shareholder of the latter). We believe this 'sleeping' image of Befimmo versus a more 'buzzing' Cofinimmo is already discounted in the share price. Our estimates are computed on a strict 'standalone' basis and do not include any external growth nor any impact from the State SICAFI. Still, our DCF valuation suggests a fair value of €90 per share, leaving an attractive total return above 15%: we raise our TP from €80 to €90, upgrade from Hold to **BUY**, and suggest switching from Cofinimmo to Befimmo.

12-month forecast returns (%)

Share price	10.8
Dividend	6.1
12m f'cst total return	**16.8**

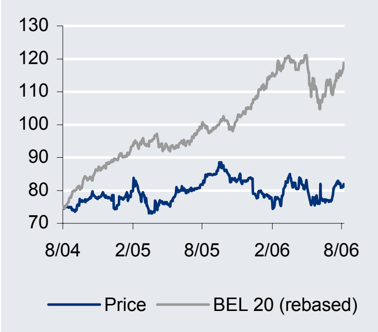
Forecasts and ratios

Yr to Sep (€m)	2005	2006F
Turnover	77.9	75.9
EBITDA	65.7	62.5
Net profit	66.6	52.0
Adj EPS	5.05	4.81
Adj PER (x)	16.1	16.9
Dividend yield (%)	5.9	6.1
EV/EBITDA (x)	18.2	18.9
Price/NAV (x)	1.3	1.2
ROE (%)	10.4	8.2

Share data

No. of shares (m)	9.8
Daily turnover (shares)	4,306.0
Free float (%)	83.8
Enterprise value (€m)	1,181.3
Market cap (€m)	796.2

Share price performance



Source: ING

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17 August 2006

Company profile

Company profile

Listed in 1995, Befimmo is the first closed-end property investment company established under the SICAFI/V-BEVAK legislation (excl ServiceFlats). Initial assets consisted mainly of properties formerly held by Bernheim-Comofi (now part of the Fortis group), which, as statutory manager, retains the managing control of Befimmo despite the dilution of its stake. In 2001 Befimmo merged with Cibix, a smaller 100% offices peer resulting in non-office assets further marginalized and a higher weight of offices in Brussels intra muros vs. the Brussels Periphery, not a bad thing as the latter continues to suffer in the current economic context. Since the acquisition of the Poelaert building (Dec. 2003), a 14,000 sq.m. office building fully leased to the Belgian State for 18 years, no new acquisitions have taken place reflecting the lack of suitable investment opportunities in the Brussels office market. This is not to say Befimmo stayed idle; several important issues were addressed recently such as the disposal of non-strategic assets (Charleroi), the sale of the huge Borschette conference center and an agreement on the allegedly asbestos-plagued WTC building (the State took-over the Belgian Post lease and extended it till end 2018). With a vacancy above 25%, the Shell building remains the main challenge in the short term.

Strategy

As a registered SICAFI, Befimmo's sole activity is the active management of a property portfolio. Its assets consist mainly of office premises located in/around Brussels. A main feature of the portfolio is its low risk profile epitomized by the high weight of government-like tenants, the relatively low contribution of Decentralized & Brussels Periphery locations and the high rental duration (61% of rents guaranteed till 2009). It also holds hi-tech and semi-industrial buildings in Brussels and other attraction poles (Brussels-Antwerp axis). Given the lack of suitable investment opportunities, the company recently hinted it might expand abroad, albeit only for a small portion of its portfolio.

Sicafi regime

As a SICAFI, Befimmo can only manage a property portfolio. The SICAFI status is similar to REIT-type frameworks existing a/o in the US, France and The Netherlands. Main features are a/o fiscal transparency (no corporate tax), minimum payout (80% of recurring cash flow), marked-to-market assets (independently appraised), minimum diversification (no asset can account for more than 20% of the portfolio) and capped leverage (gross debt at max. 65% of assets).

Main risks

Market risk: mainly exposed to the Brussels office market but mitigated by long-term leases & top tenants. **Interest rate risk**: 80% of the financial debt is at floating rates, but most of it is hedged.

Financials

Yr to Sep (€m)	2005	2006F	2007F	2008F
Income statement				
Turnover	77.9	75.9	78.0	79.9
EBITDA	65.7	62.5	65.0	67.2
Net financial charges	(15.4)	(14.2)	(14.4)	(15.3)
Operating exceptionals	1.3	4.4	5.4	5.4
Adj pre-tax profit	50.1	48.1	50.4	51.7
Corporate exceptionals				
Profit/loss on sale of tangible fixed assets	13.2	0.5	0.0	0.0
Amortisation of goodwill	0.0	0.0	0.0	0.0
Pre-tax profit	64.6	53.0	55.8	57.2
Taxes	(0.7)	(1.0)	(1.0)	(1.0)
Extraordinary items (net)	2.6	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0
Preference dividend	0.0	0.0	0.0	0.0
Net profit	66.6	52.0	54.8	56.2
Balance sheet				
Investment Properties	1,089.8	1,061.4	1,066.8	1,072.2
Working capital	10.3	10.9	10.1	9.5
L/T non-interest-bearing liabilities	79.2	37.7	38.3	38.9
Enterprise net assets	(68.9)	(26.8)	(28.2)	(29.4)
Group equity	623.3	649.1	655.7	662.4
Net debt	399.2	387.2	384.5	382.1
Capital employed	1,022.6	1,036.3	1,040.2	1,044.5
Cash flow				
Operating cash flow	76.7	68.0	66.4	68.4
Cash taxes	(0.7)	(1.0)	(1.0)	(1.0)
Net financial charges (CF)	(15.4)	(14.2)	(14.4)	(15.3)
Gross cash flow	60.6	52.8	51.0	52.1
Capital expenditures (net of disposals)	36.8	5.6	0.0	0.0
Free cash flow	97.4	58.4	51.0	52.1
Ratios (%)				
EBITDA margin	84.4	82.4	83.3	84.1
Operating margin	84.1	82.1	83.0	83.9
Net debt/equity	64.0	59.6	58.7	57.7
ROACE	4.7	4.7	5.0	5.1
ROE	10.4	8.2	8.4	8.5
Growth (%)				
Turnover	(0.5)	(2.5)	2.8	2.3
EBITDA	(1.5)	(4.8)	3.9	3.4
Net profit	31.1	(18.7)	5.4	2.6
Valuation				
EV/EBITDA (x)	18.2	18.9	18.1	17.5
Adj EPS	5.05	4.81	5.04	5.18
Adj PER (x)	16.1	16.9	16.1	15.7
Price/NAV (x)	1.3	1.2	1.2	1.2
DPS	4.80	4.92	5.05	5.18
Dividend yield (%)	5.9	6.1	6.2	6.4

Source: Company data, ING estimates

Disclosures Appendix

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Buy	44%	19%
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	100%	

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Buy: Forecast 12-mth absolute total return greater than +15%

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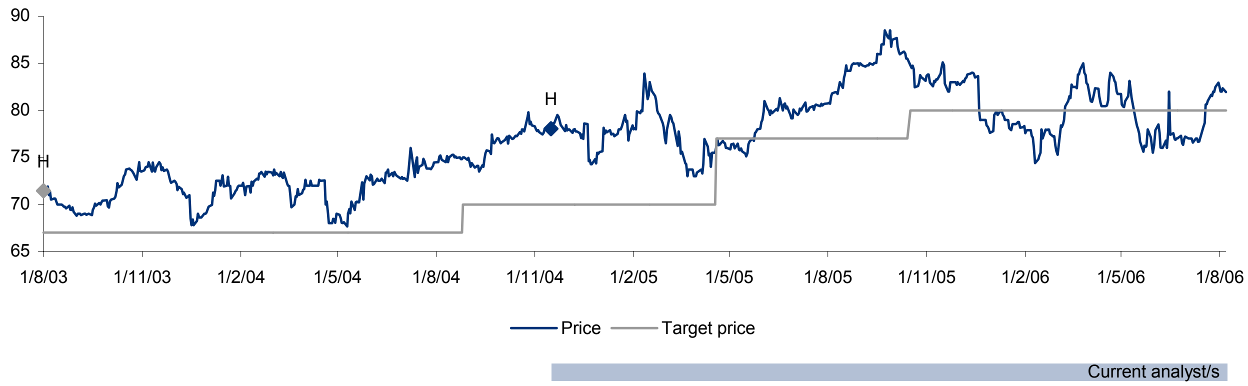
Sell: Forecast 12-mth absolute total return less than -5%

Total return: forecast share price appreciation to target price plus forecast annual dividend. Price volatility and our preference for not changing recommendations too frequently means forecast returns may fall outside of the above ranges at times.

Research published prior to 15/12/05: EMEA equities' ratings were based on US dollar total returns; Western Europe's were based on: absolute return +25%, Strong Buy; greater than +10%, Buy; +10% to -10%, HOLD; lower than -10%, Sell.

PRICE AND RATINGS CHART: BEFIMMO (BEFIT.BR)



SB = Strong Buy; B = Buy; H = Hold; S = Sell; NR = Not Rated; R = Restricted
Where ING coverage is longer than three years, chart shows recommendation current at start of the share price history

Source: ING

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