

Company results

Belgium

Befimmo

Keep the faith

Real estate

03/12/07

€74.33

Befimmo boasts an ultra-low risk profile (government-like tenants generate 64% of rents, high duration of leases, moderate and hedged indebtedness...). Despite its relative outperformance YTD, Befimmo shows attractive multiples.

Solid FY07 results... with net current EPS at €4.68, ahead of market expectations and down a mere 1.9% despite the dilutive effect of the summer capital increase.

... overshadowed by a sharply lower earnings guidance... FY08 CFPS guidance (close to net current EPS figures) is down to €3.79 vs €4.15 previously. The stock reacted angrily before recouping most losses.

... which merely brings an 'unrealistic' guidance back to reality. The two main factors behind the lower company guidance (higher interest rates, Extension Justice renovation ahead of schedule) were already well known and duly integrated in our earnings scenario. There is actually no degradation of the underlying business whatsoever.

Hence, earnings estimates only slightly adjusted. Our net current EPS estimates are only slightly down for FY07 and FY08 and slightly up afterwards. Despite very cautious assumptions, we raise our DCF-based target price slightly from €82.5 to €84 per share. In the current nervous market context we like the ultra-low risk profile of Befimmo despite the recent communication glitches. **BUY.**

Forecasts and ratios

Yr to Sep (€m)	2006	2007	2008F	2009F
Turnover	76.3	104.9	110.3	119.5
EBITDA	62.6	88.3	91.0	100.3
Net profit	84.5	129.0	71.7	79.9
Adj EPS (€)	4.85	4.55	3.75	4.25
Adj PER (x)	15.3	16.4	19.8	17.5
Dividend yield (%)	6.6	6.1	6.1	6.2
EV/EBITDA (x)	17.9	20.5	20.3	20.0
Price/NAV (x)	1.1	1.0	1.0	1.0
ROE (%)	10.1	11.2	6.4	7.1

Source: Company data, ING estimates

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DISCLOSURES AND ANALYST CERTIFICATION

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Maintained

Buy

4 December 2007

Target price (12 mth): Previously €82.50

€84

Reuters

BEFB.BR

12-month forecast returns (%)

Share price	13.0
Dividend	6.1
12m f'cst total return	19.1

Key ratios (%)

	2006	2007
Turnover growth	(3.7)	37.6
EBITDA margin	82.1	84.1
Operating margin	81.9	84.0
Net debt/equity	59.7	80.9
ROACE	7.6	8.6

Share data

No. of shares (m)	13.1
Daily turnover (shares)	13,185
Free float (%)	83.8
Enterprise value (€m)	1,805.4
Market cap (€m)	970.7

Share price performance



Source: ING

FY07 results' review

Satisfactory EBIT at €88.1m (+41.1%) on the back of a strong occupancy...

FY07 (closed 30 September) net current profit (share of the group) of €49.2m (+3.5%) was only slightly below our estimates (€50.3m). This is actually the result of satisfactory EBIT (up 41.1% at €88.1m (€84.2m expected) but higher-than-expected financial expenses (€34.4m excluding IAS39 adjustments, €31.9m expected). Revenues (+38.1% at €104.9m) were supported by good occupancy (end-of-period occupancy at 95.1%, 94.9% expected, 94.7% one year ago), whereas costs were well contained with a rise limited to 22.4% at €16.5m. These occupancy figures include all assets in portfolio including those under renovation; excluding the Bréderode 2 building both empty and under renovation would result in an occupancy at 96.4%.

... and well reined expenses

The latter are the main positive surprise. As expected, corporate expenses were moderately up (+13.1% at €8.9m) given a/o the enlarged consolidation scope. Property costs, more related to the property portfolio size, were logically up but less than expected and below rental growth. These two factors explain that total operating expenses, over 1.2% of the (average) portfolio investment value during FY06 fell to 1.1% for FY07, ie, close to levels reached by the much larger Cofinimmo (1.0%). Conversely, the EBIT margin also improved significantly to 84.2% (82.2% one year ago).

Net current EPS down 1.9% at €4.68

Absolute figures are not comparable given the enlarged consolidation scope (Fedimmo consolidated since January) and the higher average shares' outstanding since the June capital increase; average shares' outstanding for FY07 are up 10%. Adjusted EPS excluding IAS 39 adjustments are down 1.9% at €4.68 (€4.55 including IAS 39 losses) vs our estimate of €4.62 and consensus at €4.58.

Fig 1 P&L highlights

Income statement (€m)	1HFY06	2HFY06	FY06	1HFY07	2HFY07	FY07	YoY var.
Rents	37.9	38.4	76.3	48.6	56.3	104.9	37.6%
% Change Rents		1.2					
Operating expenses	-9.4	-4.1	-13.5	-8.8	-7.7	-16.5	22.4%
EBIT	31.1	31.3	62.5	41.9	46.2	88.1	41.1%
margin %	76.8	88.4	82.2	82.6	85.8	84.2	
Net interest*	-6.5	-7.8	-14.3	-15.9	-19.9	-35.7	149.6%
Tax	-0.5	-0.1	-0.6	-0.3	-0.3	-0.6	-6.1%
Minorities	0.0	0.0	0.0	-1.0	-1.6	-2.6	NM
Net current profit*	24.2	23.4	47.5	24.7	24.5	49.2	3.5%
Extraordinary items	0.0	0.0	0.0	0.0	0.0	0.0	NM
Realised capital gains	0.5	0.0	0.5	1.2	0.1	1.3	158.7%
Unrealised capital gains	7.0	11.0	18.0	27.2	11.4	38.6	114.8%
Portfolio results	7.4	11.0	18.5	28.4	11.5	39.9	116.0%
Net reported results	31.6	34.4	66.0	53.1			68.1
Per share data (€)							
Adj. EPS	2.47	2.39	4.85	2.52	2.06	4.5	-6.3%
Adj. EPS excl. IAS 39 adjustments	2.37	2.39	4.77	2.66	2.08	4.7	-1.9%
Reported EPS	3.23	3.51	6.74	5.42	3.03	8.2	22.2%
NAVPS	63.92		67.41	68.11		73.66	9.3%

* including IAS 39. Fiscal year closes end-September

Source: Company data, ING estimates

Reported results came out 35.0% higher at €89.1m (reported EPS up 22.2% at €8.23) as unrealised gains more than doubled and the company sold the Tocopro building

with a €1.3m capital gain. Small coquetry of the company, full year gross dividend is 1 eurocent higher than its previous guidance at €4.51 per share. As a reminder the share trades ex-interim dividend (€3.07) since June.

NAVPS was up 9.3% at €73.66 (+9.3%); actually NAVPS as of end-September is somewhat lower (€71.36) as the interim dividend detached in June is already booked as debt (but will only be paid in December, together with the final dividend¹); we nevertheless adjusted the figure in order to show the evolution of and comparison between two NAVPS before appropriation. The appraised portfolio yield now stands at 6.40% (6.73% if fully let) vs 7.15% (7.55% fully let) one year ago, mainly on the back of the Fedimmo acquisition. Since end-March, the portfolio yields are flat; most of the FY06/07 unrealised gains were booked in the first half-year.

Befimmo does not disclose a current EPS guidance; the closest available prospective figures are CFPS (the main difference being realised gains) of €4.62 for FY07. The actual figure was slightly higher at €4.78 per share.

All in all, these results are solid amid more optimistic noises on the Brussels office letting market. The investment market was once again euphoric as witnessed by the sharp revaluation of assets across the board (+3.5% excluding Fedimmo).

¹ The point was to allow new shares, only entitled to dividends as from June, to be fungible with existing ones.

Outlook

Solid FY07 results were overshadowed by a sharply lower earnings guidance, especially for FY08 (see table), the stock lost 6.2% in the next two days following the announcement. Befimmo reckons main factors behind the lower guidance are:

- more prudent estimates for interest rates (3 months Euribor) now set at 4.53% for FY08, 4.29% for FY09 and 4.46% for FY10. The offering memorandum of the recent capital increase (June) assumed rates at 4.14%, 3.91% and 3.96%, respectively. The latter assumptions rapidly looked hopelessly optimistic as rates climbed as soon as in August and culminated at 4.80% at end-September before easing somewhat. New company assumptions now look more realistic (ING FY08 quarterly average forecast stands at 4.43%);
- the refurbishment works at the *Extension Justice* building starting last September, ie, seven months earlier than expected. This results in a negative impact on FY08 (six months of rental income 'lost' or c.14 eurocents per share) but recouped during FY09 (works expected to be completed end-February 2009).

Sharply lower company guidance earnings merely brings it close to market expectations

We believe this lower guidance is a non-event as: 1) rate assumptions were obviously overoptimistic, our old FY08 earnings scenario already included an average cost of debt post hedging at 4.38% and 2) the earlier refurbishment of the Extension Justice was already announced in August (9M trading update – see *Benelux Daily*, 31 August 2007) and duly integrated in our earnings scenario. This is illustrated by the fact that our old net current EPS estimates are very close to the new Befimmo guidance² that is €3.74 (estimated Befimmo guidance) vs our estimate of €3.80. In other words, we believe the sharply lower guidance shows more a lack of communication of the company and a deterioration of the underlying business.

Fig 2 Financial expenses - main assumptions (€m)

	2007*	2008F	2009F	2010F
Average financial debt		831.0	926.3	1,008.1
Assumed 3M Euribor		4.43%	4.54%	4.50%
Margin (bp)	22	40	35	35
IRS 3.73% callable March 2009		200.0	100.0	
IRS 3.90% callable Jan. 2011		75.0	100.0	100.0
Twin caps 3.5% - 5.0%			300.0	400.0
Unhedged debt		556.0	426.3	508.1
Interest expenses		38.3	40.7	44.3
As a % of average debt		4.61%	4.40%	4.39%
Previous estimate		4.38%	4.38%	4.38%

* = actual

Source: Company data, ING estimates

Hence, we have only slightly adjusted our earnings scenario. The main adjustments include the financing costs which are slightly up on the basis of slightly higher market rates and a higher credit margin (22bp in FY07, 40bp assumed for FY08, 35bp thereafter) as the bridge loan is refinanced a market margins. Given our market rate assumptions, we have not considered the caps at 4.57% and 4.75% (notional amounts

² Befimmo does not publish a guidance for net current EPS. However, given, that no assumption is made on realized capital gains, net current EPS expected by Befimmo, as estimated by us, are very close to CFPS figures are disclosed by the company. The small remaining differences are related to residual depreciation and other small non-cash items.

of €168m and €200m, respectively) nor the cap at 5% (€368m). Other adjustments include lower property expenses as from FY09 further helped by the gradually lower vacancy.

One can notice that, all in all, our assumed cost of debt (as a % of average financial debt) is only slightly up. Hence, our EPS estimates are only slightly amended and our earnings scenario is unchanged, that is, a difficult FY08 followed by a strong revival in FY09 as the Extension Justice and other assets (Bréderode 2, Woluwe Garden D, Axento...) start generating rents.

Befimmo kept its dividend projections unchanged, ie, a flat dividend in FY08 at €4.51 (gross) and dividends at €4.60 and €4.65, respectively, for FY09 and FY10. However, this means payout ratios vs net current EPS well above 100% for at least two fiscal years.

Fig 3 Data per share - change of estimates (€)

	2007*	2008F	2009F	2010F
Befimmo old CFPS guidance	4.78	4.15	4.58	5.07
Befimmo new CFPS guidance		3.79	4.42	4.69
%ch		-8.7%	-3.5%	-7.5%
Befimmo new net current EPS guidance (estimates)	**4.55	3.74	4.47	4.70
ING old net current EPS estimates	4.62	3.80	4.19	4.31
ING new net current EPS estimates		3.75	4.25	4.37
Average shares' outstanding (m)	10.8	13.1	13.1	13.1

* = actual

* = actual - ** including IAS 39 losses

Source: Company data, ING estimates

Valuation

Given the only minor changes in our earnings estimates, it is not surprising that valuation is barely affected. Despite lower long-term rates we have kept the assumed risk-free rate used in our DCF model at 4.50%. As an additional measure of caution we raised our beta to 0.70 (+0.05), ie, the same level as that for Cofinimmo (€130.95, HOLD, TP: €143). In our view, the risk profile for Befimmo remains better (two-thirds of rental income are generated by public tenants, no large exposure to some corporates – see our company report, *Befimmo: Inexpensive safety*, dated 14 August 2007), but the communication skills of the company are lower as witnessed by the ups and downs of earnings guidance.

Fig 4 DCF assumptions

Gearing* (%)	51.1
Tax rate (%)	0.00
Cost of debt before tax (%)	4.90
Cost of Debt after tax (%)	4.90
Medium-term growth rate (%)	4.90
Long-term growth rate (%)	1.50
Risk free 10Y (%)	4.50
Risk premium (%)	5.00
Beta	0.70
Cost of equity (%)	8.00
WACC (%)	6.41

* = gross

Source: ING estimates

Target price slightly up to €84 per share (+€1.5)

All in all, we raise our target price marginally to €84 (+€1.5) per share as a higher beta and lower FY08 earnings estimates are compensated by higher estimates as from FY09.

Fig 5 Discounted cash flow model (€m)

	FY08F	FY09F	FY10F	FY11F
Operating cash flow	59.5	-47.3	90.6	105.5
Discount factor	0.95	0.90	0.84	0.79
Present value of free cash flow	56.8	-42.4	76.3	83.5
Cumulative present value of free cash flow	174.3			
+ Present value of terminal value	1,667.9			
+ Other financial assets (€)	34.1			
= Enterprise value	1,876.3			
- Net Financial Debt (group share)	-845.4			
= Theoretical market capitalisation	1,030.8			
Fair value per share	78.9			
12M Price target	84.0			

Source: ING estimates

Befimmo and arch-rival Cofinimmo show similar ratios but in the current market context we prefer the ultra-low risk Befimmo share

A comparison with Cofinimmo shows that, despite the consistent outperformance of the Befimmo share (gross return YTD at -6.8% vs -9.1% for its larger peer), both shares show quite similar multiples. Admittedly the higher (gross) dividend yield is obtained with a very high payout but, despite the communication glitches, we believe Befimmo retains a very low risk profile vs the more dynamic Cofinimmo and most of listed property shares across Europe. Hence, in the current nervous market context we continue to prefer the Befimmo share and sustain our BUY rating.

Fig 6 Befimmo- Cofinimmo comparison

	Befimmo	Cofinimmo
Price as of 3 December 2007 (€)	74.33	130.95
Gross yield (%)	6.15%	5.92%
Gross yield (adjusted) (%)	6.26%	6.13%
Last yearly NAV (€)	73.66	116.34
Next yearly NAV (€)	72.25	123.95
<i>as of</i>	Sep-2008	Dec-2007
Premium/discount (%)	2.88%	5.64%
Premium/discount (adjusted) (%)	0.99%	1.98%
Target price (€)	82.9	143.0
<i>12M upside/downside</i>	14.9%	15.1%
Current recommendation	BUY	HOLD

Source: ING estimates

Risk factors

Market risk: mainly exposed to the Brussels office market but mitigated by long-term leases and top tenants.

Interest rate risk: most of the financial debt is at floating rates, but a sizeable part is hedged.

Comments on financials

As a registered SICAFI (Belgian REIT-like closed-end property investment company), Befimmo does not pay taxes on recurrent income. Property is booked at market value and appraised by external appraisers; unrealised gains are booked as 'portfolio results' (included in exceptional items). Hence, no depreciation is booked on property.

Minimum payout stands at 80% of recurrent earnings.

Since FY05/06 Befimmo has published its results under IFRS.

Properties are now booked at 'fair value' (IAS40), which is the investment value minus 2.5%; the latter is a compromise figure lower than official transfer costs in Belgium (10% to 12.5%) as most SICAFIs do not actually pay full transfer costs.

Most of the financial debt is financed at short-term rates. However, Befimmo hedges a substantial part of its interest rate exposure. The hedging only works at high interest rates (current cap for €368m at 5%) but the trigger will be lowered as from January 2009 (twin caps at 3.5% - 5.0% for €400m). Two additional caps are in place till end-2008 for a notional amount of €368m). Two callable IRS are also in place for a total notional amount of €300m.

Income statement (€m)

Yr to Sep	2006	2007	2008F	2009F
Turnover	76.3	104.9	110.3	119.5
Total operating revenues	76.3	104.9	110.3	119.5
Costs of goods sold	(76.3)	(104.9)	(110.3)	(119.5)
Staff costs				
Other operating costs	(13.3)	(16.4)	(19.0)	(18.8)
Depreciation	(0.2)	(0.2)	(0.2)	(0.2)
Amortisation of goodwill	0.0	0.0	0.0	0.0
Total operating costs	(13.5)	(16.5)	(19.2)	(19.0)
EBIT before exceptionals	62.5	88.1	90.8	100.2
Operating exceptionals	18.0	38.6	11.3	12.2
Profit/loss on sale of tangible fixed assets	0.5	1.3	0.0	0.0
EBITA	62.5	88.1	90.8	100.2
Operating profit	62.5	88.1	90.8	100.2
EBITDA	62.6	88.3	91.0	100.3
Income from associates (pre-tax)				
Net interest income	(14.3)	(35.7)	(37.8)	(40.6)
Investment income				
Net financial charges	(14.3)	(35.7)	(37.8)	(40.6)
Adj pre-tax profit	48.1	52.4	53.0	59.6
Exceptionals & GW	18.5	39.9	11.3	12.2
Pre-tax profit	66.6	92.3	64.3	71.7
Taxes	(0.6)	(0.6)	(0.7)	(0.7)
Extraordinary items (net)	18.5	39.9	11.3	12.2
Group profit	84.5	131.6	75.0	83.2
Minorities	0.0	(2.6)	(3.3)	(3.3)
Net profit	84.5	129.0	71.7	79.9
Net attributable profit	84.5	129.0	71.7	79.9
Adj net attributable profit	47.5	49.2	49.0	55.5
Net attributable profit from ordinary ops	66.0	89.1	60.4	67.7
Dividend on ordinary shares	(48.2)	(48.8)	(58.9)	(60.1)
Retained earnings	36.3	80.2	12.8	19.8

Source: Company data, ING estimates

Cash flow (€m)

Yr to Sep	2006	2007	2008F	2009F
EBITDA (CF)	63.1	89.5	91.0	100.3
Change in working capital	3.5	7.9	11.0	2.4
Change in provisions	0.0	0.0	0.0	0.0
Operating cash flow (pre-tax)	66.6	97.4	102.0	102.7
Cash taxes	(0.6)	(0.6)	(0.7)	(0.7)
Operating cash flow (after-tax)	66.0	96.8	101.3	102.0
Net financial charges	(14.3)	(35.7)	(37.8)	(40.6)
Capital expenditure (net of disposals)	2.4	(716.5)	(41.3)	(157.4)
Free cash flow	54.1	(655.5)	22.2	(96.1)

Source: Company data, ING estimates

Balance sheet (€m)

Yr to Sep	2006	2007	2008F	2009F
Investment Properties	1,078.4	1,815.1	1,866.4	2,031.9
Other current operating assets	13.3	24.0	16.0	17.3
Goodwill	0.0	16.2	16.2	16.2
S/T debt	317.4	662.7	692.1	833.0
S/T hybrid debt	0.0	0.0	0.0	0.0
L/T debt	91.4	148.6	158.6	168.6
L/T hybrid debt	0.0	0.0	0.0	0.0
L/T non-interest-bearing liabilities	40.0	88.6	61.6	65.3
Minority interests (equity)	0.0	64.9	68.2	71.5
Shareholders' equity	660.2	931.9	943.5	952.3

Source: Company data, ING estimates

Per share and other data

Yr to Sep	2006	2007	2008F	2009F
Per share data (€)				
Adj EPS	4.85	4.55	3.75	4.25
DPS	4.92	4.51	4.51	4.60
NAV	67.41	71.36	72.25	72.92
Ratios (%)				
EBITDA margin	82.1	84.1	82.5	84.0
Operating margin	81.9	84.0	82.3	83.9
EBITDA growth	(5.6)	40.9	3.1	10.3
Operating profit growth	(5.6)	41.1	3.1	10.3
Adj tax rate	1.3	1.1	1.3	1.2
ROE	10.1	11.2	6.4	7.1
ROACE	7.6	8.6	5.5	5.7
Net debt/equity	59.7	80.9	83.6	97.3
Valuation (x)				
EV/turnover	14.7	17.2	16.8	16.8
EV/EBITDA	17.9	20.5	20.3	20.0
Adj PER	15.3	16.4	19.8	17.5
Price/NAV	1.1	1.0	1.0	1.0
P/FCFPS	13.5	(1.2)	43.7	(10.1)
Adj PEG	(3.1)	(2.6)	(1.1)	1.3
Dividend yield (%)	6.6	6.1	6.1	6.2

Source: Company data, ING estimates

Company profile

Listed in 1995, Befimmo is the first closed-end property investment company established under the SICAFI/V-BEVAK legislation (ex-ServiceFlats). Assets consisted mainly of properties formerly held by Bernheim-Comofi (now part of Fortis), which, as statutory manager, retains the managing control of Befimmo despite the dilution of its stake.

In 2001, Befimmo merged with Cibix, resulting in further marginalisation of non-office assets and a higher weight of offices in central Brussels versus 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 (December 2003), a 14,000m² office building fully leased to the Belgian state for 18 years, no new acquisitions have taken place reflecting the lack of investment opportunities. However, Befimmo has not been 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 until end-2018). With a vacancy rate 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 epitomised by the high weight of government-like tenants (64% of rental income), the relatively low contribution of decentralised and periphery Brussels locations and the high rental duration (total duration of 9 years). It also holds hi-tech and semi-industrial buildings in Brussels and other attractive areas (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.

Risks

Market risk: mainly exposed to the Brussels office market but mitigated by long-term leases and top tenants.

Interest rate risk: most of the financial debt is at floating rates, but a sizeable part is hedged.

Disclosures Appendix

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Buy	49%	28%
Hold	43%	26%
Sell	8%	24%
	100%	

* Percentage of companies in each rating category that are Investment Banking clients of ING Financial Markets LLC or an affiliate.

RATING DEFINITIONS

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

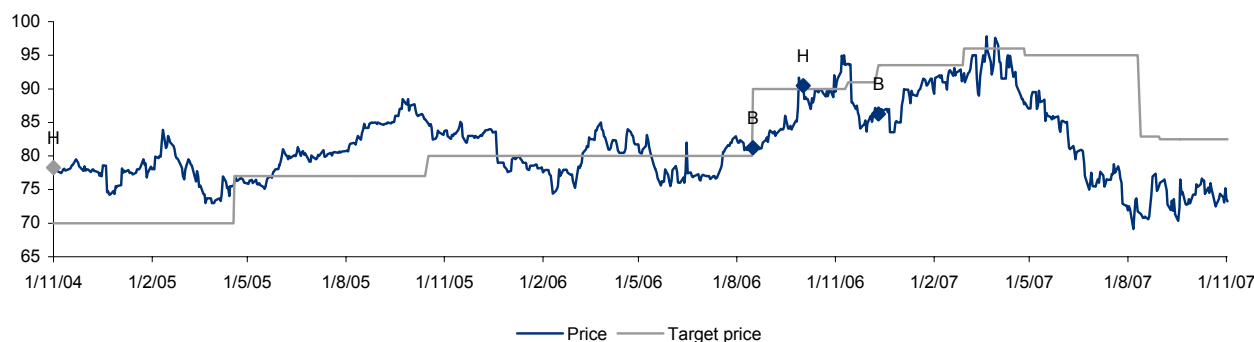
Hold: Forecast 12-mth absolute total return of +15% to -5%

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.

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PRICE & RATINGS HISTORY TO 02/11/07: BEFIMMO (BEFB.BR)



SB = Strong Buy; B = Buy; H = Hold; S = Sell; NR = Not Rated; R = Restricted

Chart shows ING coverage: current analyst may or may not have covered the stock for the entire period shown
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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