Befimmo (Reduce - EUR 63.13) Difficult hunt for new opportunities in a challenging letting market

Befimmo published its H1 '11 results yesterday after closing. We attended the analyst meeting. Overall these results were in line with our expectations.

Facts

- Top-line, net rental income decreased to EUR 60.99m compared to 62.02 one year ago (-1.66%). We banked on a net rental income of 60.01. Top line decreased mainly due to sales of Empress court and Kattendijkdok. Furthermore the income guarantee for the Axento building (Luxembourg Kirchberg) expired on 31 December. Befimmo acquired the Pavilion in mid-February 2011, which contributed for approx. EUR 500k in Q2 2011.
- The slight beat on higher rent was mainly driven by some rental renewals. The company renewed 25,818sqm contracts and signed new contracts for 6,712sqm. As expected, the Axento building (Luxembourg Kirchberg): increased its occupancy to 85% vs. 65% at year-end. No signings so far on the Froissart and Science Montoyer building. Although discussions are going on right now, management has stated that neither building will be let immediately, as they believe the current market is "difficult".
- Compared to Q1 the occupancy rate decreased by 1.7% from 95.53% (6 months ago) to 93.86%. Main reason for this decrease is the fact that some tenants are leaving Brussels and moving out of Belgium.
- The company did not quote on the negative reversion of the contracts. The conclusion of the expert points out that the level of passing rent obtained is approx. 6% above the current average rental value.
- FFO/share decreased from EUR 2.31 to EUR 2.27 over the year. Operating result (before portfolio revaluations) decreased to EUR 51.8m or -2.8% YoY. We expected EUR 51m as we penciled in net real estate charges (compensation associated with departing tenants) and other operating charges (rent free grants) to remain as high as last year.
- NAV stands at EUR 60.07, which is slightly higher than we expected and implies a premium of 6%. Lease maturity increased from 9.14 to 9.20 years QoQ (Pavillion effect).
- LfL portfolio value decreased by -0.66% in the first half of 2011 (vs. our estimate of -0.57% for H1), mainly due to the non-Fedimmo portfolio. The non-Fedimmo portfolio decreased by -1.16% during this period. Main changes in fair value for H1 can be found in the Brussels periphery -2.64% and the Walloon region -2.69%. The LfL portfolio in Brussels CBD decreased by -0.27%.
- The gross yield for the portfolio decreases from 6.63% to 6.49%. If buildings under construction are taken into account, such as Froissart & Science Montoyer, the potential yield would be 7%. Even after its past acquisition in February '11 in the EU quarter (Pavillion), we remind that the company still has EUR 179.7m fire power or EUR 100m when limiting the debt ratio to 50%.
- Finance: the company has to refinance EUR 400m in 2011/12 and EUR 520m in 2012/13. First stage was the bond issue of EUR 162m. Debt ratio and LTV stand respectively at 46.1% and 43.1%. Management quoted that it will try to diversify the liabilities, e.g. through convertible bonds, medium term notes. Average cost of financing stands at 3.03%, while 55.5% is mainly floating rate financed.
- Froissart building obtained a BREEAM Excellent score, which is rather hard to get for renovated buildings.
- Befimmo reiterated its guidance of a EUR 3.94/share dividend (which currently offers a 6.18% yield). Additionally the company reiterated guidance for 2012 and a dividend of EUR 3.98/share.

Our view

- Overall these results where in line with our expectations. We remain cautious on this office portfolio, as the office segment doesn't show sustainable signs of recovery. Although the new signings are in favor of Befimmo, we expected a higher occupancy rate.
- In terms of its acquisition policy, the company quotes that prime yields are declining in the Brussels office market (supported by several real estate agents and transactions). It will be a challenge for the company to find good opportunities (LT leases) in the current Brussels office market.
- In light of the new Royal Decree, Befimmo is evaluating whether to offer a stock dividend, while currently it is not required in order to grow. Hopefully the company receives some good opportunities in order to pay for the return on additional equity (former cap increase has been expensive due to the same reason). We don't expect many large tenders on the Brussels office market during the coming months.

Conclusion

We recognize that Befimmo's portfolio is well secured for the coming year (99% secured), However due to weakness of the Brussels office market and the pure play strategy of Befimmo, the rental momentum is negative and is likely to remain so. Hence, we are convinced that on the Brussels office market, prime rent is stable but that economical rent is decreasing. Reported results confirm our expectations on the company and therefore we remain cautions on the stock. Additionally we don't expect Befimmo to profit from current increase of inflation as it is mainly financed at floating rates which will increase as well. Finding good opportunities will remain challenging for quite some time. Although the stock price increased in the past months thanks to safe haven status of real estate, we remain cautious on the stock, as a consequence of its pure office player positioning. Therefore we reiterate our reduce rating and EUR 56.00 TP.

in EURm	H1 2010a	H1 2011a	% diff 11/10	H1 2011e	% diff A vs. E
Net rental income	62.02	60.99	-1.66%	60.01	1.63%
FFO	39.16	38.04	-2.86%	37.38	1.75%
FFO/share	2.35	2.27	-3.40%	2.23	1.79%
NAV	58.90	60.07	1.99%	59.50	0.96%

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