

Befimmo

- ▶ High-quality office space provider whose asset values imply negative reversionary potential
- ▶ Brussels office market may become more volatile but remains more defensive than other European office centres
- ▶ Initiating with a Neutral rating and a EUR50 target price

Investment summary

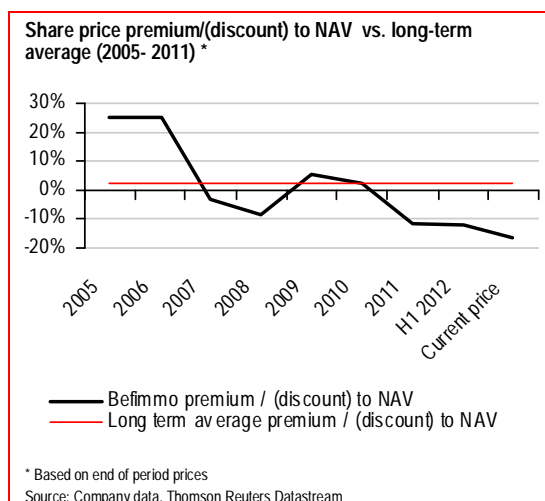
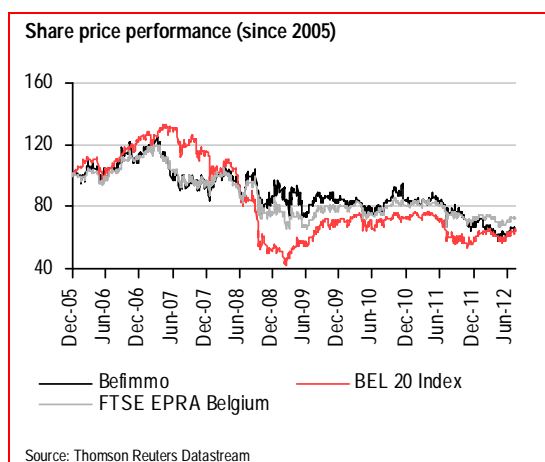
Initiating with Neutral rating and EUR50 TP

- ▶ Befimmo is a Belgian REIT exclusively focused on the domestic office markets, in particular Brussels (CBD, decentralised, periphery). Although Brussels has long been the most solid and stable office market in Europe, given the strong presence of the public sector as a core tenant base, landlords are currently facing oversupply in the city and weakening letting markets (space demand in 2011 is the lowest in the past 10 years).
- ▶ Its high-quality space and the long lease length as well as its 60% exposure to tenants from the public sector may reduce revenue volatility, but although the 94.5% occupancy rate looks solid, the portfolio's decentralised locations in the periphery of Brussels remain challenging for Befimmo (both regions have occupancy levels of around 81-85%).
- ▶ According to CBRE, relatively little new space supply is expected in Brussels, but we do not foresee sufficient net absorption in 2012-13 to bring the market vacancy rate down below 10% (currently 11.5%) as long as tenant demand remains fragile. We therefore adopt a cautious and realistic view on the Brussels market as a whole, but take a positive view of Befimmo's track record of attracting tenants and maintaining its assets at a competitive level as regards quality.
- ▶ The EUR1.92bn portfolio is currently 7.5% over-rented (negative reversionary potential) in an environment of slightly falling rental levels, in which portfolio values have fallen for four years in a row – although at a relatively low rate of 1-2% of GAV. This illustrates the challenges in Brussels.
- ▶ Funds of EUR175m available for development could lead to increasing headline revenues despite our estimate of falling organic growth for 2012-13e.
- ▶ The stand-alone valuation is attractive compared to historical NAV discounts premiums but less attractive in a broader peer comparison. Dividend yields are attractive at present, at 7.0%, but we expect DPS to fall in line with declining organic rental income.

Key triggers

- ▶ Acquisitions in addition to the committed EUR175m development pipeline.
- ▶ Recovering space demand in the Brussels office market.

Historical pricing



Outlook 2012-13e

We are forecasting a slight decline in NNNNAV p/s for 2012 and 2013, triggered by a negative portfolio valuation shift of 1.3-1.6%. However, we expect a moderate rise in gross rents of 2.2-3.2% each year from 2013-15e despite negative LFL growth. Moreover, income on development completions might offset negative LFL rents.

Key forecasts (2010-15e)

EURm/EUR	2010a	2011e	2012e	2013e	2014e	2015e
NAV per share	60.6	57.2	55.7	54.7	54.8	56.1
Growth (y-o-y %)	9.1%	-5.7%	-2.5%	-1.9%	0.3%	2.4%
NNNAV per share	60.3	57.0	55.6	54.5	54.7	56.0
Growth (y-o-y %)	8.5%	-5.4%	-2.5%	-1.9%	0.3%	2.4%
Gross rents	124.2	124.8	126.8	130.9	134.4	137.3
Growth (y-o-y %)	4.3%	0.5%	1.6%	3.2%	2.7%	2.2%
Net rents	116.3	117.0	117.9	121.8	125.0	127.6
Growth (y-o-y %)	1.9%	0.6%	0.8%	3.3%	2.6%	2.1%
HSBC EBITDA	112.6	117.2	103.9	107.6	110.7	113.3
Growth (y-o-y %)	5.9%	4.1%	-11.4%	3.6%	2.9%	2.3%
HSBC PBT	91.4	85.9	68.8	69.7	71.9	72.6
Growth (y-o-y %)	117.4%	-6.1%	-19.9%	1.3%	3.2%	1.0%

Source: Company data, HSBC estimates

Company at a glance

Pure office player

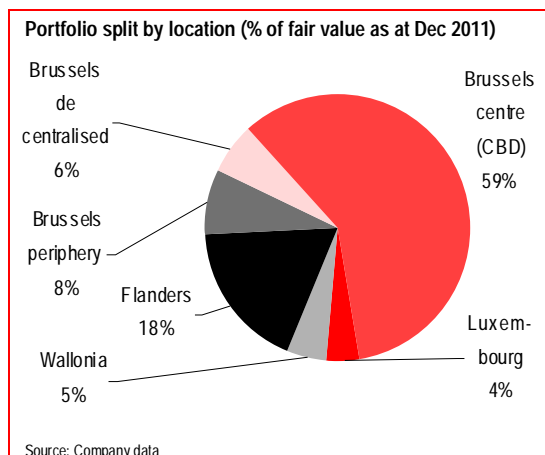
Befimmo is an asset manager pursuing a pure-player strategy, which invests in quality office buildings in districts where there is a structural shortage, such as city centres. Its home markets are Brussels and more generally Belgium.

Befimmo is a 100% office player with a presence in city centre locations, and 73% of its portfolio exposure is to Brussels offices. The group has more than 50% of its investments in Brussels CBD, making it a proxy for Brussels high-quality office market exposure. The 851,441 sq m portfolio has an occupancy rate of 94.3% and an average lease length of 9.02 years, which is longer than most of its peers.

The top 10 tenants generate 84.2% of total income, and the lease duration is more than 10 years, thanks to the portfolio's substantial exposure to the public sector, which accounts for 66.6% of total income. This makes it a relatively defensive play compared with other office peers. Public sector tenants include federal and regional government tenants, along with European institutions such as the European Commission and European Parliament.

Portfolio overview

Portfolio development



Key events since the inception of the group in 1995 include the Cibix Sicafi merger in 2001 and the Fedimmo acquisition in 2006, followed by two capital increases in 2007 and 2009. The group started investing small amounts of capital in quality office buildings, but greatly increased its exposure following the merger with Cibix in 2001, which gave it access to an office portfolio primarily concentrated in the business districts of Brussels that are well served by public transport.

Befimmo's portfolio was further improved by the 90% acquisition of Fedimmo SA, comprising 62 office buildings occupied by federal public services. This further exposure to the public sector strengthened the relative defensiveness of the group's income stream.

Brussels Central Business District (CBD), (59%)

Status quo and outlook

Befimmo owns a EUR1.1bn office portfolio in its core region, Brussels CBD, which posted a marginal 0.86% decline in LFL values in 2011. The occupancy rate of 95.7% is clearly better than the market average. We view the 10.2-year average lease duration as very healthy. However,

the portfolio has negative reversion of 6.8%. Thus we are rather cautious on future rental growth.

Brussels decentralised (6%)

Status quo and outlook

The decentralised Brussels portfolio accounts for 6.5% of the total portfolio and its value dropped by 3.66% LFL in 2011 – the sharpest fall among the periphery. Its 7.5% negative reversionary potential is in line with the average across the entire portfolio.

Brussels periphery (8%)

Status quo and outlook

The EUR156.7m assets located in Brussels periphery account for around 8% of total assets and are among Befimmo's more challenging locations. The seven assets under management have a high vacancy rate of 19.3% but are only 2.9% over-rented versus the portfolio's average reversionary rate of 7.5%.

Flanders (18%)

Status quo and outlook

The value of the EUR368.7m Flanders portfolio is currently marginally below the acquisition price and it has a 5.81% net rental yield – almost rack-rented with a small positive potential reversion rate of 0.3%. The average lease duration is 3.5 years. The value of the Flanders portfolio has picked up slightly, by 1.2%, in the past 12 months. Despite the 8.8% negative reversion rate, it has the longest average remaining lease length in the entire portfolio – 13 years. This provides good income protection and, with 16.5% of total rental income, the Flanders region is the second-largest exposure in Bef's portfolio. The portfolio consists of 33 buildings, which are 100% occupied.

Wallonia (5%)

Status quo and outlook

The Wallonia portfolio consists of 20 buildings. These are 100% occupied but are rented at around 21% above market levels according to the

company. This area is rather difficult, but plays a minor role in Bef's allocation, and the long average lease length gives good protection.

Luxembourg City (4%)

Status quo and outlook

Luxembourg is a small, interesting but relatively illiquid market. According to management in the event of upcoming opportunities this market could play a more important role in the future.

Development capex of EUR175m for the coming three years

Befimmo provides a three-year capex forecast for its development pipeline. Except for the New Finance Center, these are mainly refurbishment measures aimed at securing the quality level of its assets. Such refurbishments are often made on the basis of agreements with existing tenants at the time of a lease renewal. According to the CFO no yield on capex is disclosed, so the potential impact on rental revenues is difficult to predict.

We estimate an initial yield of 6% on the New Finance centre – implying around EUR4.5m annualised rental income based on a 24-year lease. Although the company has undrawn credit facilities of EUR411m, we exclude larger new investments in 2012.

Development pipeline (three-year forecast) (EURm)

Project name	GLA sq m	Already invested	Remaining capex	Total
Brederode	13,400	0.9	26.7	27.6
Central Gte	33,000	9.3	14.3	23.6
Empress Court	na	4.8	0	4.8
Froissart	3,200	0.1	0.1	0.2
New Finance Center	39,000	2.4	88.4	90.8
Science-Montoyer	5,300	7.2	0	7.2
WTC Tower III	75,800	4.4	4.8	9.2
Others	na	7	32.7	39.7
Green investments	na	3.9	10.3	14.2
Total	169,700	40.1	177.3	217.4

Source: Company data, HSBC calculations

Dividend linked to sustainable EPS

Under the Sica regime in Belgium, Befimmo enjoys exemption from corporation tax but has to

pay out 80% of its profit to its shareholders. Thus Bef is traditionally a dividend stock. For 2012 it plans to pay out EUR3.45 per share which equates to a payout ratio of 90% based on EPRA earnings. We forecast a decline in DPS in 2012-13e as we expect falling organic rents and rising vacancy rates to dilute the cash flow profile.

Debt statistics

Financing well diversified

Debt statistics (last reported)	
Net gearing (%)	87%
LTV (%)	44%
Weighted average cost of debt (%)	3.6%
Interest cover (x)	n.a.
Net debt (EURm)	873
Debt maturity profile (EURm) to 2013	664
% of total debt	76%
Weighted average maturity (WAM) - (years)	4.51
Cash & committed undrawn facilities (EURm)	410

Source: Company data

Befimmo has a diversified debt portfolio including a syndicated loan, bilateral loans, commercial paper and retail bonds as well as classic fixed-rate loans. This broad use of debt instruments is the result of a programme launched at the beginning of 2011 aimed at achieving a financing structure that was less dependent on banks and more diversified.

Two retail bonds with a combined total volume of EUR272m were successfully placed in April 2011 and December 2011.

With an average cost of debt including hedging costs of 3.6% over the past 12 months, Bef is at the lower end of European RE universe under our coverage; however, it is guiding for rising average interest rates and is using a level of 4% for its internal calculations. Given the refinancing schedule, the CFO's current priority is the refinancing of the two syndicated loans.

EUR450m in all must be refinanced in 2012/13. The average debt maturity is 4.5 years, which we regard as solid. Currently 83.5% of the loans have fixed rates (including hedging instruments).

Valuation

Valuation	
WACC	7.0%
CoE	9.6%
RFR	3.0%
ERP	6.0%
Beta	1.1
FCF growth	0.75%
DCF value (EUR)	50.8
2013e NNAV p/s (EUR)	54.5
Discount (%)	10%
NNNAV value p/s (EUR)	49.1
(DCF+NNNAV)/2 (EUR)	50.0
Rounded TP (EUR)	50.0
Share price (EUR)	47.7
Potential return	4.8%
Rating	N

Source: Company data, HSBC estimates

Our EUR50 target price is the average of our DCF valuation of EUR50.8 and our NNAV valuation of EUR49.1, which is based on our 2013e NNAV forecast after applying a 10% discount.

We have applied a low growth rate of 1% to the portfolio given its 100% office exposure and its dependence on the oversupplied Brussels office market, which we expect to remain flat or on a slight downward trend the coming years.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5 percentage points above and below the hurdle rate for eurozone stocks of 9.0%.

Our target price of EUR50 implies a potential return of 4.8%, within the Neutral band of our model; therefore, we are initiating coverage on Befimmo with a Neutral rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Upside risks

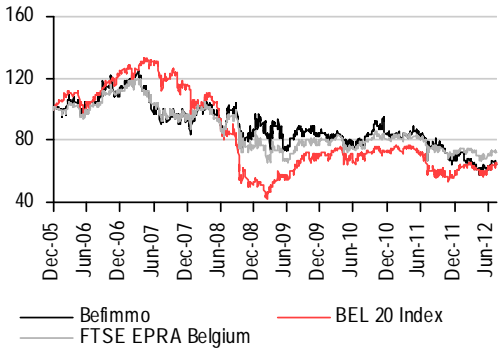
- ▶ Better-than-expected performance from the Brussels office market
- ▶ Faster-than-expected execution of the existing development pipeline at a higher-than-previously calculated yield on cost

Downside risks

- ▶ Worsening macro environment in Belgium and slowing space demand in the Brussels market
- ▶ Yield shift triggered by slowing transaction activity, falling estimated rental values and increasing interest costs

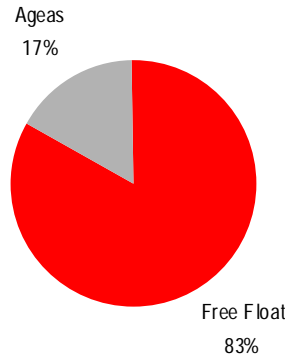
Befimmo in pictures

Share price performance (2005 to date)



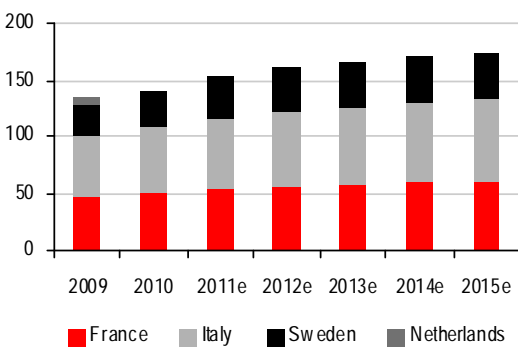
Source: Bloomberg

Shareholder structure (last reported)



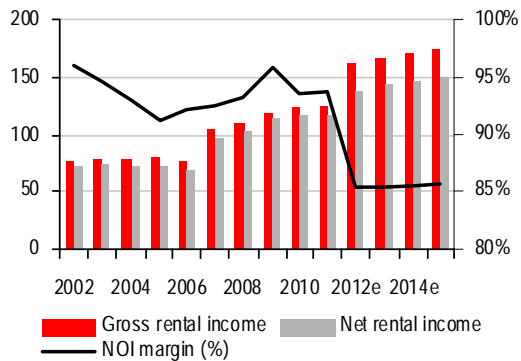
Source: Bloomberg

Portfolio split by region (2008-15e) measured by NRI (EURm)



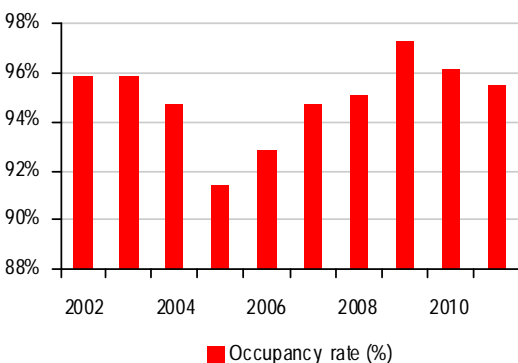
Source: Company data, HSBC estimates

Gross & net rental income (LHS) (EURm), NOI margin (RHS) (%) (2002-15e)



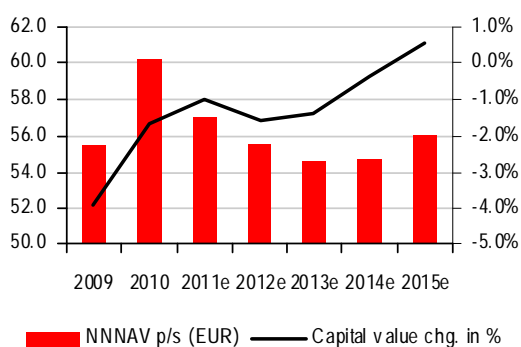
Source: Company data, HSBC estimates

Occupancy level (%) (2002-11)



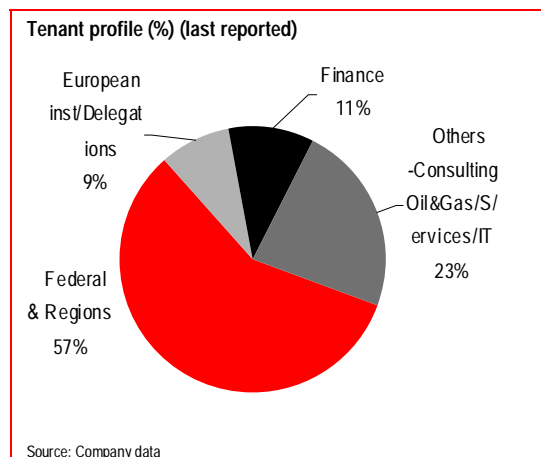
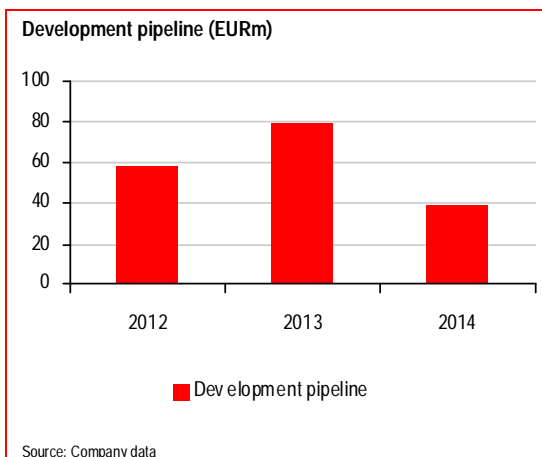
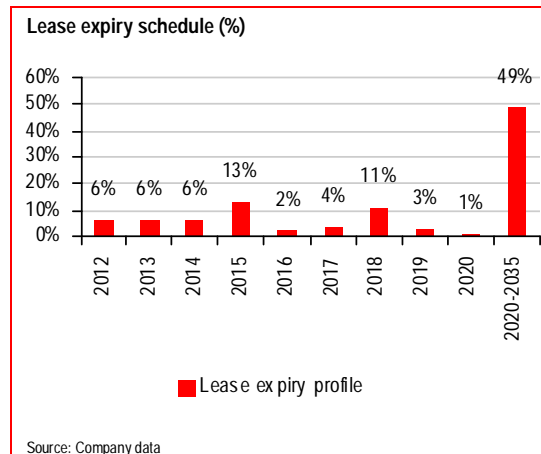
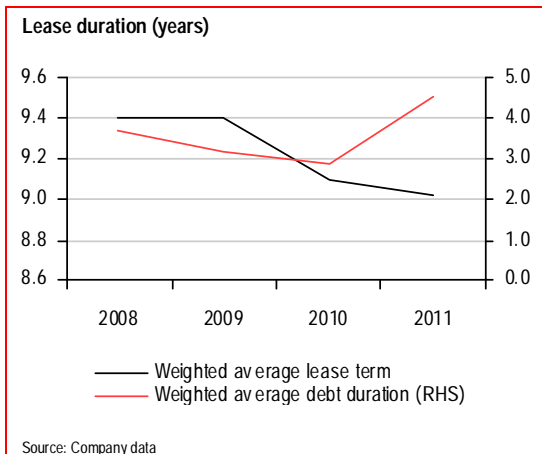
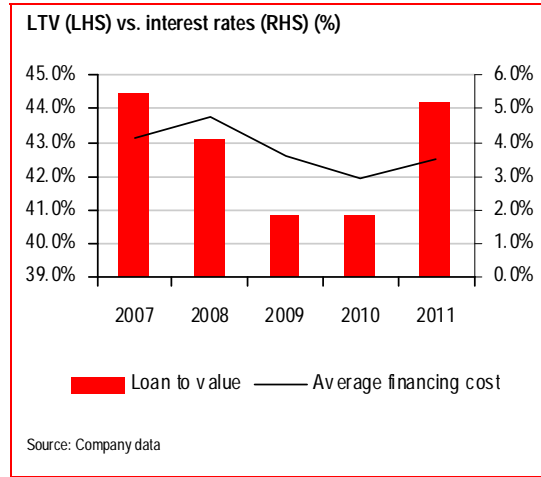
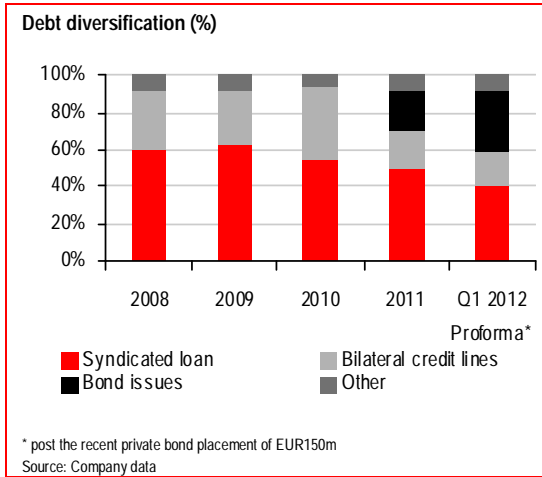
Source: Company data

Capital value growth (RHS) and NNAV (LHS) (2003-15e) (%)



Source: Company data, HSBC estimates

Befimmo in pictures (contd)



Net rental income forecast split by region (2010-15e)

EURm	2010 (12 months, 30/09/10)	2011 (15 months, 31/12/2011)	2012e	2013e	2014e	2015e
Brussels CBD	62.5	82.7	63.4	65.6	66.5	67.9
% of total	54%	56%	54%	54%	53%	53%
Brussels decentralised	8.2	9.6	8.4	8.6	9.3	9.5
% of total	7%	7%	7%	7%	7%	7%
Brussels periphery	9.2	11.4	9.9	10.1	10.5	10.7
% of total	8%	8%	8%	8%	8%	8%
Wallonia	10.1	13.3	10.8	11.5	12.2	12.4
% of total	9%	9%	9%	9%	10%	10%
Flanders	20.4	24.7	20.4	20.9	21.3	21.9
% of total	18%	17%	17%	17%	17%	17%
Luxembourg city	5.3	5.1	5.0	5.1	5.2	5.3
% of total	5%	3%	4%	4%	4%	4%
Total	115.7	146.8	117.9	121.8	125.0	127.6
y-o-y (%)		26.8%	-19.7%	3.3%	2.6%	2.2%

Source: Company data, HSBC estimates

Profit and loss

Profit and loss (2009-15e)

EURm	2009a	2010a	2011a	2012e	2013e	2014e	2015e
Gross rental income	119.1	124.2	124.8	126.8	130.9	134.4	137.3
Net operating income	114.1	116.3	117.0	117.9	121.8	125.0	127.6
NOI margin	96%	94%	94%	93%	93%	93%	93%
Profit from disposals	0.2	0.4	14.6	0.0	0.0	0.0	0.0
Profit from developments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit from other activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other operating income	1.9	8.7	-0.2	0.0	0.0	0.0	0.0
Total revenues	116.2	125.3	131.4	117.9	121.8	125.0	127.6
Fair value measurement (IAS 40)	-75.0	-31.6	-19.0	-32.0	-28.0	-8.0	12.0
Total income	41.2	93.7	112.4	85.9	93.8	117.0	139.6
Admin costs	-9.8	-12.7	-14.2	-14.0	-14.2	-14.3	-14.3
Personnel costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other operating costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total operating costs	-9.8	-12.7	-14.2	-14.0	-14.2	-14.3	-14.3
EBITDA	31.4	81.0	98.2	71.9	79.6	102.7	125.3
HSBC EBITDA	106.3	112.6	117.2	103.9	107.6	110.7	113.3
EBITDA margin	92%	90%	89%	88%	88%	89%	89%
EBIT	31.4	81.0	98.2	71.9	79.6	102.7	125.3
HSBC EBIT	106.3	112.6	117.2	103.9	107.6	110.7	113.3
EBIT margin	92%	90%	89%	88%	88%	89%	89%
Financial result	-64.3	-21.2	-31.3	-35.1	-37.9	-38.8	-40.7
PBT	-32.9	59.8	66.9	36.8	41.7	63.9	84.6
HSBC PBT	42.1	91.4	85.9	68.8	69.7	71.9	72.6
PBT margin	36%	73%	65%	58%	57%	58%	57%
PAT	-33.4	59.2	66.2	36.8	41.7	63.9	84.6
Minorities	-1.1	-4.1	-4.2	-4.0	-4.0	-4.0	-4.0
PAT after minorities	-34.5	55.0	62.0	32.8	37.7	59.9	80.6
HSBC PAT	41.6	90.5	85.0	68.1	69.0	71.2	71.9

Source: Company data, HSBC estimates

Balance sheet

Balance sheet (2009-15e)

EURm	2009a	2010a	2011a	2012e	2013e	2014e	2015e
Investment property	1,918.3	1,885.0	1,971.3	2,045.3	2,078.3	2,131.3	2,204.3
Investment property under development	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other assets	21.4	20.8	27.0	27.0	27.0	27.0	27.0
Current assets excl. Cash	43.6	75.9	22.8	22.8	22.8	22.8	22.8
Deferred tax	0.0	0.0	2.6	2.6	2.6	2.6	2.6
Net debt	-896.8	-871.4	-873.1	-972.2	-1,023.8	-1,074.0	-1,124.3
Deferred tax	0.0	0.0	-14.5	-14.5	-14.5	-14.5	-14.5
Other liabilities	-36.5	-28.3	-65.6	-65.6	-65.6	-65.6	-65.6
Minority	-61.6	-64.4	-67.8	-67.8	-67.8	-67.8	-67.8
IFRS shareholder funds	988.4	1,017.4	1,002.6	977.5	958.9	961.7	984.4
Total assets	1,989.4	1,985.1	2,027.8	2,102.2	2,130.7	2,183.7	2,256.7
Cash	6.1	3.5	4.2	4.5			
Equity ratio	50%	51%	49%	46%	45%	44%	44%
Net gearing	91%	86%	87%	99%	107%	112%	114%
LTV	47%	46%	44%	48%	49%	50%	51%
NAV per share (EUR)	55.5	60.6	57.17	55.7	54.7	54.8	56.1
EPRA NAV per share (EUR)	55.5	61.7	57.37	55.9	54.9	55.0	56.3
EPRA NNAV per share (EUR)	55.5	60.3	57.02	55.6	54.5	54.7	56.0
Discount to NNAV (%)	-14%	-21%	-16%	-14%	-13%	-13%	-15%

Source: Company data, HSBC estimates

Financials & valuation: Befimmo

Neutral

Financial statements

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Profit & loss summary (EURm)				
Revenue	124.8	126.8	130.9	134.4
EBITDA	117.2	103.9	107.6	110.7
Depreciation & amortisation	0.0	0.0	0.0	0.0
Operating profit/EBIT	117.2	103.9	107.6	110.7
Net interest	-31.3	-35.1	-37.9	-38.8
PBT	66.9	36.8	41.7	63.9
HSBC PBT	85.9	68.8	69.7	71.9
Taxation	-0.7	0.0	0.0	0.0
Net profit	66.2	36.8	41.7	63.9
HSBC net profit	85.0	68.1	69.0	71.2

Cash flow summary (EURm)

Cash flow from operations	85.9	68.8	69.7	71.9
Capex	0.0	-25.0	-25.0	-25.0
FCF enterprise	116.5	78.9	82.6	85.7
Cash flow from investment	0.0	-110.0	-65.0	-65.0
Dividends	-65.5	-57.9	-56.2	-57.1
Change in net debt	39.0	99.2	51.6	50.2
FCF equity	85.2	43.8	44.7	46.9

Balance sheet summary (EURm)

Tangible fixed assets	1971.3	2045.3	2078.3	2131.3
Current assets	27.0	27.3	22.8	22.8
Cash & others	4.2	4.5	0.0	0.0
Total assets	2027.8	2102.2	2130.7	2183.7
Gross debt	942.9	1042.3	1089.4	1139.6
Net debt	938.7	1037.8	1089.4	1139.6
Shareholders funds	1002.6	977.5	958.9	961.7
Invested capital	2004.7	2065.7	2102.7	2175.7

Ratio, growth and per share analysis

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Y-o-y % change				
Revenue	0.5	1.6	3.2	2.7
EBITDA	4.1	-11.4	3.6	2.9
EBIT	4.1	-11.4	3.6	2.9
PBT	11.8	-45.0	13.4	53.3
HSBC EPS	-6.1	-19.9	1.3	3.2

Ratios (%)

Revenue/IC (x)	0.1	0.1	0.1	0.1
ROIC	5.0	4.3	4.4	4.4
ROE	8.4	6.9	7.1	7.4
ROA	2.7	1.6	1.5	1.5
EBITDA margin	93.9	81.9	82.2	82.4
Operating profit margin	93.9	81.9	82.2	82.4
EBITDA/net interest (x)	3.7	3.0	2.8	2.9
Net debt/equity	87.7	99.3	106.1	110.7
Net debt/EBITDA (x)	8.0	10.0	10.1	10.3
CF from operations/net debt	9.1	6.6	6.4	6.3

Per share data (EUR)

EPS Rep (fully diluted)	3.94	2.19	2.48	3.81
HSBC EPS	5.06	4.05	4.11	4.24
DPS	3.45	3.35	3.40	3.45
NAV	59.72	58.22	57.11	57.28
NAV (adjusted)	57.02	55.59	54.53	54.69

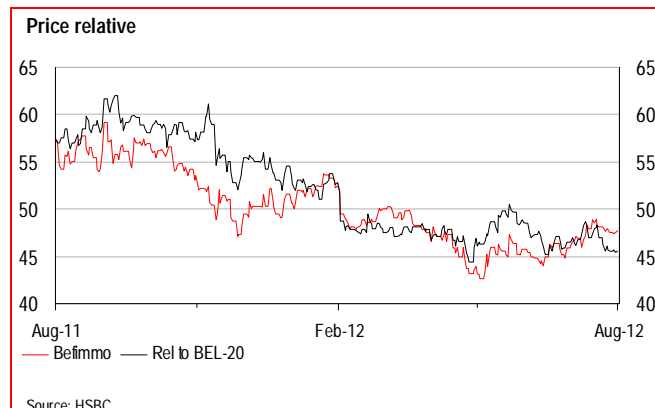
Valuation data

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Premium/ (discount) to NAV	0.8	0.8	0.8	0.8
Premium/ (discount) to NAV (adj)	0.8	0.9	0.9	0.9
PE*	9.4	11.8	11.6	11.3
FCF yield (%)	9.8	5.0	5.2	5.4
Dividend yield (%)	7.2	7.0	7.1	7.2

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (EUR)	47.70	Target price (EUR)	50.00
Reuters (Equity)	BEFB.BR	Bloomberg (Equity)	BEFB BB
Market cap (USDm)	1,065.0	Market cap (EURm)	867.0
Free float (%)	83	Enterprise value (EURm)	1,904.8
Country	Belgium	Sector	Real Estate
Analyst	Thomas Martin	Contact	+49 211 910 3276



Note: price at close of 15 Aug 2012