[Befimmo (Buy, TP=€55.0) - Rating upgrade - High dividend yield and limited risk for NAV - H. Quadrelli (2p)]

Update

In our sector report released today (link to Real Estate Europe), we shift to an economic scenario of weak long-term growth along with a higher cost of debt. This scenario benefits from still-low long-term rates (4.0% for the eurozone vs 3.4% in September) and in particular from the sharp decline in the risk premium adjusted by our strategists to 4.7% from 9.7% in September. We have: 1) adjusted our sector premium from +8% to -5%, 2) increased our beta by lowering the LTV pivot level from 35% to 30%, 3) increased spreads by 30bp on average, and 4) reduced value creation from 50bp to 25bp on top of the inflation component used in the Gordon-Shapiro model.

Impact

For Befimmo, we have lowered our cash flow per share and NNNAV 2013e estimates by 9.0% and 18.0%. The adjustments to our model have a -20% impact on our fair value, but our target price is unchanged at €55 after factoring in the items mentioned above.

Target price & rating At €55 (unchanged), our target price is derived by applying a discount of 5% (-5% sector, -2% liquidity, +2% reputation) to our fair value of €57.9. Our fair value is the average of a 10-year DCF with perpetual growth of 2% and a WACC of 7.6% (€49.7), the Gordon-Shapiro formula with normalised dividend (€60.8) and a 10-year dividend discount model with an exit value in line with the average of gross and net NAV in 10 years (€63.1). Given current share price levels, we are upgrading our rating to Buy (from Hold), and highlight the following points: 1) Befimmo operates in the relatively stable Belgian property market; 2) it benefits from defensive positioning in both geographic and asset quality terms (upscale segment in central Brussels) within the volatile office property segment; 3) dividend yield is high (>8% in 2011e), based on a prudent cash flow payout policy (77%); 4) LTV is a reasonable 36% for 2011e. Risks to our TP: fluctuations in risk premium and 'risk-free' rate. A 100bp increase in the risk premium and the 'risk-free' rate would lead us to adjust our target price to €42. We have not modelled a break-up of the single currency, but factoring in domestic market LT rates and risk premium would yield a per-share valuation of €68 (+24% versus our current target price).

Next events & catalysts

FY11 results on 17 February 2011.