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Befimmo (EUR 61.99 - Reduce) - Momentum to sell buildings on an expensive office market?

Befimmo published reported its Q1 '11 results yesterday after closing. Overall these results were in line with our expectations.

Facts

- Top-line, rental income increased to EUR 31.20m compared to 30.90 one year ago (+1%). The rental level was slightly better than expected, mainly due to some rental renewals. The company renewed 24,000sqm contracts (mainly Brussels CBD) and signed new contracts for 4,000sqm. The company did not quote on the negative reversion of the contracts. Compared to the beginning of the year the occupancy rate decreased from 95.53% to 94.82%. FFO/share increased from EUR 1.13 to EUR 1.18 over the year, mainly because of the higher rental income. Operating result (before portfolio revaluations) was stable at EUR 1.57/share.
- NAV stands at EUR 58.50, which is slightly lower than we expected and implies a premium of 5.62%. Lease maturity increased from 9.14 to 9.26 years QoQ. LfL portfolio value decreased from EUR 1,922.6 to EUR 1,915.2m (-0.38% QoQ). Main changes in fair value can be found in Luxembourg (-2.45% QoQ) and the Walloon region (-1.24 QoQ). The LfL portfolio in Brussels CBD decreased by -0.35%.
- The gross yield for the portfolio increases slightly from 6.60% to 6.63%. If buildings under construction are taken into account, such as Froissart & Science Montoyer, the potential yield would be 6.91%. We remind that the company still has EUR 179.7m fire power after its past acquisition in February '11 in the EU quarter. We note the building was purchased at a yield of 5.12%. In terms of investment pipeline, the management quoted that it is not running for the project in Bruges anymore.
- Finance: the company states that is currently fully hedged but acknowledged that they will have to anticipate when economic recovery takes place (because of 50% options). In this order the company is buying and will continue to buy forward starting instruments, when affordable.
- Befimmo reiterated its guidance of a EUR 3.94/share dividend (which currently offers a 6.35% yield).
- As expected, Befimmo will be delisted of NYSE Euronext Paris, mainly on account of the costs associated with keeping a dual listing. Befimmo will remain listed on the NYSE Euronext of Brussels.

Our view

Overall these results were in line with our expectations. However we recognize the positive top-line evolution, we remain cautious on this office portfolio, as the office segment doesn't show sustainable signs of recovery. Although the new signings for 24,000sqm are in favor of Befimmo, we expected a higher occupancy rate. Despite the increase in rental income, we note that Befimmo was not able to improve the operating result.

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). Unfortunately we do not see this evolution in the existing buildings of the portfolio. We might suggest that some one-offs/sales, in this market which is trading at historical low yields, could lead to additional dividend payments. In the light of the Royal Decree, the hurdle is lower to come to the financial markets again when good acquisition opportunities are there. In the light of this suggestion, we refer to the past transactions and extra dividend of Unibal-Rodamco.

Conclusion

We recognize that the portfolio of Befimmo is well secured for the coming year (99% secured), despite of the weakness of the Brussels office market and the pure play strategy of Befimmo, the rental momentum is negative and should remain so. Hence, we see 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 cautious on the stock. Although the stock price declined after the dividend paid out in December, we reiterate our reduce rating and EUR 57.40 TP, as a consequence of its pure office player positioning. In case the stock price should decrease further, we might become more optimistic on the stock as it would be a cheaper alternative than its peers.

in EUR m	Q1 10a	Q1 11a	% diff 11/10	Q1 11e	% diff A vs. E
Rental income	30.90	31.20	1.0%	30.75	1.5%
Occupancy rate	93.90%	94.82%	1.0%	95.00%	-0.2%
Direct result per share	1.13	1.18	4.4%	1.17	0.9%
NAV	58.80	58.50	-0.5%	59.82	-2.2%

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