# Corporate Office Properties Trust (OFC)

*Updated December 5th, 2021 by Felix Martinez*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $27 | **5 Year CAGR Estimate:** | 8.0% | **Market Cap:** | $3.0 B |
| **Fair Value Price:** | $29 | **5 Year Growth Estimate:** | 3.0% | **Ex-Dividend Date:** | 12/30/2021 |
| **% Fair Value:** | 92% | **5 Year Valuation Multiple Estimate:** | 1.8% | **Dividend Payment Date:** | 01/18/2022 |
| **Dividend Yield:** | 4.2% | **5 Year Price Target** | $34 | **Years Of Dividend Growth:** | 0 |
| **Dividend Risk Score:** | D | **Retirement Suitability Score:** | C | **Last Dividend Increase:** | N/A |

## Overview & Current Events

Corporate Office Properties Trust is a Real Estate Investment Trust (REIT) that invests in office and data center buildings, mainly in the suburbs of the Washington, D.C. metropolitan area. It primarily leases to the U.S. government and its contractors. As of September 30, 2021, the Company derived 88% of its core portfolio annualized rental revenue from Defense/IT Locations and 12% from its Regional Office Properties. COPT's core portfolio of 184 office and data center shell properties encompassed 21.5 million square feet and was 94.8% leased. Also, the Company owns one wholesale data center that is 86.7% leased. The Company was founded in 1988 by Clay W. Hamlin III as Royale Investments, Inc. However, the Company now trades under the ticker symbol "OFC" and has a current market capitalization of $3.0 billion.

On October 28, 2021, OFC reported third-quarter results for Fiscal Year (FY)2021. The Company's total revenue was $174.6 million for the quarter versus $154.8 million for the third quarter of 2020, which is an increase of 12.8% year-over-year. For the nine months of the fiscal year, OFC grew total revenue by 12.4% compared to the same nine-month period of FY2020. The revenue increase was driven by rent increases and an increase in leasing. Net income for the quarter was $27.1 million compared to a loss of $(31.8) million in 3Q2020. For the nine months of the fiscal year, net income is up 300% versus the same nine months of FY2020. Diluted funds from operations per share were $0.56 for the third quarter of 2021 compared to $0.04 for 2020. This represents an increase of 1300%. During the quarter and nine months ended September 30, 2021, the Company renewed 75.7% and 74.6% of expiring square feet, respectively. The Company's development pipeline consists of 13 properties totaling 1.8 million square feet that are 94% leased. These projects have a total estimated cost of $585.7 million.

OFC management team provided the full year 2021 guidance in the quarterly report. Management is increasing its full-year guidance FFO from $2.24-$2.28 per share to a new range of $2.26-$2.28 per share. We will use $2.28 as our fair value and total return calculations.

## Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $2.17 | $2.13 | $1.97 | $1.88 | $2.01 | $2.01 | $2.03 | $2.01 | $2.03 | $2.12 | ***$2.28*** | ***$2.64*** |
| **DPS** | $1.61 | $1.10 | $1.10 | $1.10 | $1.10 | $1.10 | $1.10 | $1.10 | $1.10 | $1.10 | ***$1.10*** | ***$1.10*** |
| **Shares[1]** | 69.4 | 73.5 | 85.0 | 88.2 | 97.7 | 94.5 | 99.2 | 104.1 | 111.6 | 112.1 | ***112.4*** | ***115.0*** |

The most significant growth prospects from OFC will be the continuation of profitable acquisitions in the future and having the ability to increase rents at a modest rate. OFC had grown FFO at a Compound Annual Growth Rate (CAGR) of (0.3)% over the past ten years. Over the past five years, FFO growth has been improving with a CAGR of 2.6%. During the COVID-19 pandemic, most REITs had to cut their dividend or FFO decreased for the year. However, FFO increased FFO by 4% from 2019 to 2020. We expect OFC to continue to grow FFO at a 3% CAGR for the next five years. This means that we expect the Trust to make $2.64 in FFO per share in 2026.

[1] Share count is in millions.

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The dividend has not been increasing throughout the years. The Company has been paying the same dividend rate of $1.10 per share for the past ten years. Thus, we do not foresee any dividend increase over the next five years.

## Valuation Analysis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Now | 2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Avg. P/E | 9.8 | 11.7 | 12 | 15.1 | 10.9 | 15.5 | 14.4 | 10.5 | 14.5 | 12.3 | ***11.6*** | ***12.7*** |
| Avg. Yld. | 7.8% | 4.4% | 4.6% | 3.9% | 5.0% | 3.5% | 3.8% | 5.2% | 3.7% | 4.2% | ***4.2%*** | ***3.3%*** |

OFC currently trades hands with an 11.6x FFO, which is lower than its peers. Over the ten years history of OFC, the Trust has ten-year multiple averages of 12.7x FFO. Thus, we think a multiple of 12.7x FFO is fair for OFC. This will provide a 1.8% tailwind expansion over the next five years. The current dividend yield of 4.2% is right in-line with its five-year average. Thus, the Company looks to be slightly undervalued.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Payout | 74.2% | 51.6% | 55.8% | 58.5% | 54.7% | 54.7% | 54.2% | 54.7% | 54.2% | 51.9% | ***48%*** | ***42%*** |

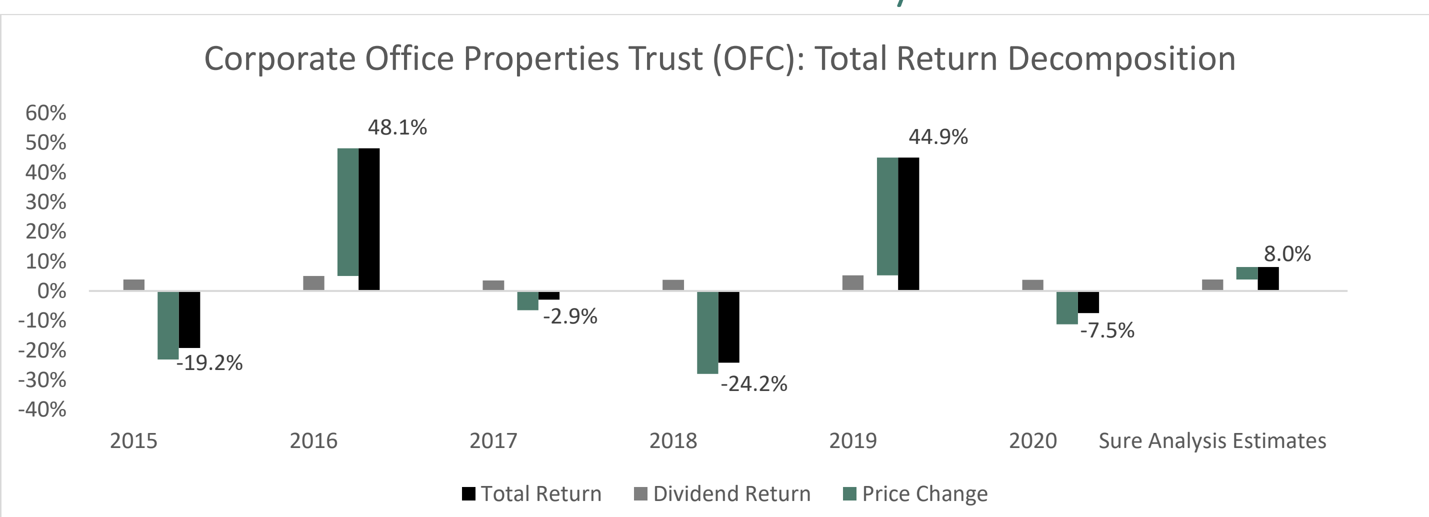
OFC's competitive advantage is that it has a strong management team. The Company was very resilient during The Great Recession in 2008-2009 and droning the COVID-19 pandemic. During 2008, FFO increased by 9% to $2.44 per share. Also, in 2019, FFO increased by 2% to $2.49 per share. As mentioned above, OFC was one of the fortunate REITs that increased FFO in FY2020. This speaks volumes as most REITs struggle mightily during the pandemic. Also, OFC did not have to cut its dividend.

OFC has a good balance sheet. The Trust has an interest coverage ratio of 3.4 and a debt to equity ratio of 1.3. The dividend payment is meager compared to other REITs paying out 48% of its FFO. The low dividend payout ratio should help the Company start a dividend growth policy in the future.

## Final Thoughts & Recommendation

OFC is a well-run office REIT with a good balance sheet. The Trust went through the COVID-19 pandemic like it was not even there. The Trust looks to be fairly valued, with an expected total return for the next five years to be 8.0%. However, we give OFC a Hold rating at the current price.

## Total Return Breakdown by Year

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## Income Statement Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 493 | 508 | 523 | 586 | 625 | 574 | 613 | 578 | 641 | 609 |
| Gross Profit | 150 | 170 | 184 | 170 | 188 | 199 | 188 | 182 | 196 | 200 |
| Gross Margin | 30.4% | 33.5% | 35.2% | 29.1% | 30.1% | 34.6% | 30.7% | 31.4% | 30.6% | 32.8% |
| SG&A Exp. | 36 | 38 | 36 | 37 | 45 | 45 | 37 | 35 | 40 | 37 |
| D&A Exp. | 137 | 124 | 120 | 138 | 142 | 135 | 137 | 139 | 139 | 140 |
| Operating Profit | 114 | 133 | 148 | 133 | 143 | 154 | 151 | 147 | 156 | 162 |
| Operating Margin | 23.0% | 26.1% | 28.2% | 22.7% | 22.9% | 26.8% | 24.6% | 25.4% | 24.4% | 26.6% |
| Net Profit | (119) | 21 | 94 | 40 | 178 | 30 | 69 | 72 | 192 | 97 |
| Net Margin | -24.2% | 4.1% | 17.9% | 6.9% | 28.5% | 5.2% | 11.2% | 12.5% | 29.9% | 16.0% |
| Free Cash Flow | 135 | 172 | 135 | 165 | 181 | 208 | 207 | 156 | 204 | 206 |
| Income Tax | (7) | 0 | 2 | 0 | 0 | 0 | 1 | (0) | (0) | 0 |

## Balance Sheet Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | 3,864 | 3,654 | 3,630 | 3,664 | 3,909 | 3,781 | 3,595 | 3,656 | 3,854 | 4,077 |
| Cash & Equivalents | 6 | 11 | 54 | 6 | 60 | 210 | 12 | 8 | 15 | 18 |
| Accounts Receivable | 113 | 103 | 116 | 127 | 135 | 125 | 119 | 116 | 123 | 135 |
| Goodwill & Int. Ass. | 89 | 76 | 59 | 44 | 98 | 78 | 59 | 43 | 27 | 19 |
| Total Liabilities | 2,658 | 2,217 | 2,133 | 2,143 | 2,293 | 2,186 | 2,127 | 2,029 | 2,135 | 2,383 |
| Accounts Payable | 96 | 98 | 99 | 123 | 92 | 109 | 108 | 93 | 149 | 143 |
| Long-Term Debt | 2,426 | 2,019 | 1,928 | 1,914 | 2,078 | 1,904 | 1,828 | 1,824 | 1,831 | 2,087 |
| Shareholder's Equity | 916 | 1,032 | 1,177 | 1,252 | 1,345 | 1,351 | 1,402 | 1,585 | 1,679 | 1,661 |
| D/E Ratio | 2.14 | 1.48 | 1.35 | 1.32 | 1.35 | 1.25 | 1.30 | 1.15 | 1.09 | 1.26 |

## Profitability & Per Share Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | -3.1% | 0.6% | 2.6% | 1.1% | 4.7% | 0.8% | 1.9% | 2.0% | 5.1% | 2.5% |
| Return on Equity | -11.1% | 2.2% | 8.5% | 3.3% | 13.7% | 2.2% | 5.0% | 4.8% | 11.7% | 5.8% |
| ROIC | -3.3% | 0.6% | 2.7% | 1.2% | 5.0% | 0.8% | 2.0% | 2.1% | 5.5% | 2.7% |
| Shares Out. | 69.4 | 73.5 | 85.0 | 88.2 | 97.7 | 94.5 | 99.2 | 104.1 | 111.6 | 112.1 |
| Revenue/Share | 7.11 | 6.92 | 6.14 | 6.64 | 6.40 | 6.07 | 6.18 | 5.55 | 5.74 | 5.44 |
| FCF/Share | 1.95 | 2.34 | 1.58 | 1.87 | 1.85 | 2.20 | 2.09 | 1.50 | 1.83 | 1.84 |

*Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.*