Dream Office REIT (DRETF)

Updated March 7th, 2022 by Samuel Smith

Key Metrics

Current Price:	$21.3	**5 Year CAGR Estimate:**	0.6%	**Market Cap:**	$1.1 B
Fair Value Price:	$16.5	**5 Year Growth Estimate:**	1.8%	**Ex-Dividend Date:**	02/25/22
% Fair Value:	129%	**5 Year Valuation Multiple Estimate:**	-4.9%	**Dividend Payment Date:**	03/15/22
Dividend Yield:	3.7%	**5 Year Price Target**	$18	**Years Of Dividend Growth:**	4
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	6.1%

Overview & Current Events

Dream Office REIT is an open-ended Investment Trust which acquires and manages predominantly office and industrial properties in major urban areas throughout Canada, with a focus on downtown Toronto. The trust's portfolio is made of: 68% of operations in Toronto, 14% in Montreal/Ottawa, 8% in Mississauga/North York, 4% in Calgary and 6% in other markets. Dream Office ownership interests include 5.5 million square feet of gross leasable area from 30 properties, which include 28 office properties, and two properties under development. Dream Office has leases with 500 tenants across Canada, a few of its larger tenants include: Government of Canada (8.2% of revenue), Government of Ontario (11.4%) and State Street Trust (5.4%). This $1.1 billion market capitalization trust is listed on the over-the-counter market in the U.S. under the trading symbol DRETF.

On February 17th, 2022 Dream Office released Q4 results. Diluted FFO per unit remained flat at $0.40 year-over-year. Q4 net income stood at $26.9 million, up from $15.6 million YoY. Net rental income decreased by $1.4 million to $26.5 million from $27.9 million in the year-ago quarter. Q4 comparative properties NOI deceased by 5.3% to $27.6 million from $29.2 million year-over-year primarily due to decline in weighted average occupancy in Toronto downtown. Meanwhile, at quarter end, the trust reported $8.8M of cash and cash equivalents, $2.6B of investments properties, $1.3B of total debt, and $3.1B of total assets. NAV per unit increased to $31.49 from $28.69 on December 31, 2020. Total portfolio in-place occupancy increased 0.2% sequentially.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
FFO/S	$2.81	$2.58	$2.29	$2.05	$1.94	$1.60	$1.26	$1.28	$1.21	$1.84	***$1.83***	***$2.00***
DPS	$1.58	$1.60	$1.61	$1.61	$1.16	$0.99	$0.73	$0.77	$0.80	$0.80	***$0.78***	***$0.80***
Shares[1]	97.6	103.4	107.9	107.9	104.8	73.7	59.4	56.2	50.6	47.5	***47.5***	***40.0***

Instead of EPS, we used funds from operations per share (FFO/S) as Dream Office's primary growth metric. We used FFO/S because it more accurately communicates a REIT's true performance, as EPS depreciates investment properties over time, however many investment properties actually increase in value over time. Dream Office's FFO/S has been very volatile over the last decade from inconsistent funds-from-operations, and also a rapidly increasing share count to 2014-2015, and then decreasing by over 50% from years 2016-2020. Since 2016, the trust has been engaged in heavy buybacks, dramatically reducing the shares outstanding.

Going forward we expect disruption from the coronavirus and the growing work-from-home movement to weigh on growth in the years to come. Given the company's considerable exposure to high quality assets in Toronto and fairly low payout ratio, it should be able to weather the storm better than some peers, but will still likely only see slow growth.

[1] In millions

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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
P/FFO	13.1	10.0	8.8	10.3	7.7	10.9	13.4	12.8	13.7	15.6	***11.6***	***9.0***
Avg. Yld.	4.2%	5.6%	6.4%	9.2%	5.7%	3.6%	3.3%	3.5%	4.7%	4.2%	***3.7%***	***4.4%***

Dream Office's average price to funds from operations ratio (P/FFO) has deviated significantly around its historic average of 10.6. Comparing current average P/FFO ratios to its historic average, Dream Office is overvalued at current prices. Given the uncertainty facing the global economy and office sector right now, we are lowering our fair value estimate to 9 times FFO, which is well below the current price to FFO ratio. We therefore expect valuation multiple compression to provide a meaningful headwind to total returns moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	55%	56%	56%	95%	46%	49%	44%	45%	66%	65%	***43%***	***40%***

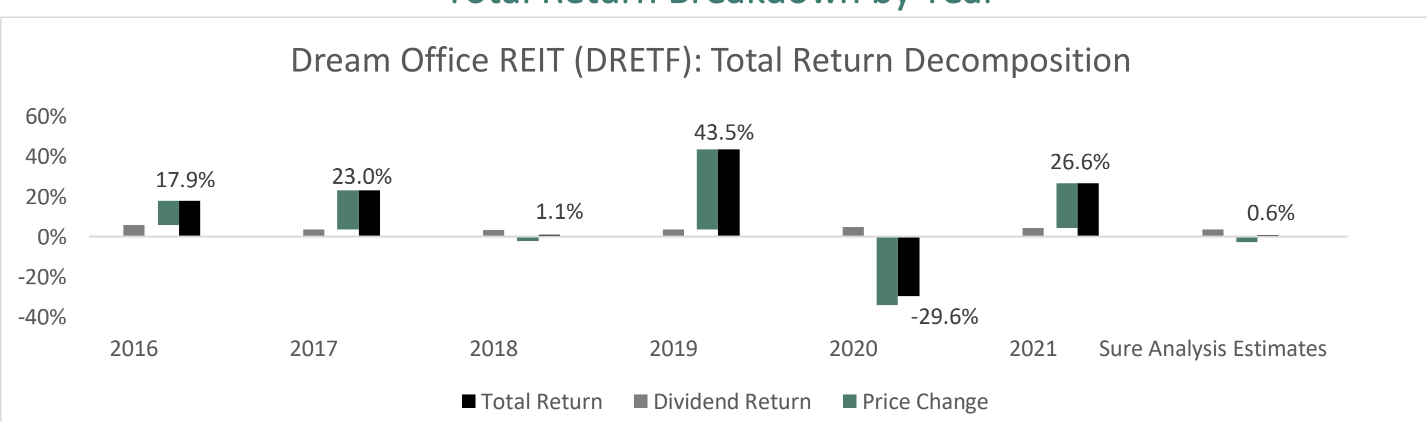
Dream Office has integrated best practices into its environmental platform since 2011. The trust has been proactively trying to reduce its environmental footprint by decreasing its resource consumption and greenhouse gas emissions. The trust also has a goal to use less energy and water to decrease waste to the environment. One way the trust cuts down on resources is by proactively developing and maintaining high-quality, energy-efficient buildings. All of Dream Office's buildings over 100,000 square feet are BOMA BEST Sustainable Buildings certified, which means the buildings are recognized in excellence in energy and environmental management and performance in commercial real estate.

Dream Office has not been around for a recession, but historically companies who operate predominantly office properties do not fare well in recessions. While local businesses are deteriorating, companies would be more likely to close offices rather than start new leases, so in a recession in the Canadian economy Dream Global should be adversely affected from potential losses of current and future tenants.

Final Thoughts & Recommendation

Overall, we expect total returns of 0.6% annually, mainly driven by Dream Office's dividend yield and FFO-per-share growth that will be offset by meaningful multiple compression. We believe the REIT's quality diversified portfolio will enable it to weather the current storm. However, due to the elevated valuation, we rate Dream Office REIT as a Sell at current prices and encourage conservative investors to look elsewhere given that the business model is not ideally suited to recessions and the total return potential is rather weak.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	608	667	639	541	502	366	187	173	154	156
Gross Profit	349	380	364	304	278	202	102	96	84	85
Gross Margin	57.3%	57.0%	56.9%	56.1%	55.5%	55.3%	54.4%	55.7%	54.7%	54.7%
SG&A Exp.	21	29	28	17	16	8	12	10	9	9
D&A Exp.	2	5	10	12	16	17	13	11	10	10
Operating Profit	325	348	333	285	260	189	88	85	74	75
Operating Margin	53.5%	52.2%	52.2%	52.6%	51.8%	51.5%	47.1%	49.2%	48.1%	48.3%
Net Profit	291	432	144	(43)	(664)	104	122	88	132	123
Net Margin	47.9%	64.8%	22.6%	-8.0%	-132%	28.4%	65.1%	51.2%	85.8%	78.7%
Free Cash Flow	115	159	155	115	73	39	22	75	44	44
Income Tax	2	0	1	1	1	(3)	0	0	(1)	(0)

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	6,386	6,692	6,056	4,873	4,069	2,642	2,293	2,229	2,266	2,404
Cash & Equivalents	24	29	9	1	6	77	6	73	10	7
Accounts Receivable	11	7	5	2	1	5	6	3	3	3
Goodwill & Int. Ass.	65	59	53	6	5	1	1	1		
Total Liabilities	3,072	3,195	2,802	2,364	2,310	1,262	1,194	1,097	1,090	1,190
Accounts Payable	7	10	3	2	1	3	3	7	4	5
Long-Term Debt	2,793	2,957	2,668	2,170	1,965	1,088	1,032	881	936	1,006
Shareholder's Equity	3,314	3,497	3,254	2,509	1,759	1,380	1,099	1,132	1,176	1,214
LTD/E Ratio	0.84	0.85	0.82	0.86	1.12	0.79	0.94	0.78	0.80	0.83

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	5.4%	6.6%	2.3%	-0.8%	-14.9%	3.1%	4.9%	3.9%	5.9%	5.3%
Return on Equity	10.8%	12.7%	4.3%	-1.5%	-31.1%	6.6%	9.8%	7.9%	11.5%	10.3%
ROIC	5.7%	6.9%	2.3%	-0.8%	-15.8%	3.4%	5.3%	4.3%	6.4%	5.7%
Shares Out.	97.6	103.4	107.9	107.9	104.8	73.7	59.4	56.2	50.6	47.5
Revenue/Share	6.23	6.45	5.92	5.02	4.79	4.96	3.15	2.70	2.55	2.78
FCF/Share	1.18	1.53	1.43	1.06	0.70	0.54	0.37	1.17	0.74	0.78

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