



City Office REIT, Inc. (CIO)

Updated August 8th, 2022 by Nikolaos Sismanis

Key Metrics

Current Price:	\$13.07	5 Year CAGR Estimate:	14.1%	Market Cap:	\$569.3 M
Fair Value Price:	\$15.60	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	10/07/22 ¹
% Fair Value:	84%	5 Year Valuation Multiple Estimate:	3.6%	Dividend Payment Date:	10/22/22
Dividend Yield:	6.1%	5 Year Price Target	\$19.91	Years Of Dividend Growth:	1
Dividend Risk Score:	C	Retirement Suitability Score:	A	Rating:	Buy

Overview & Current Events

City Office REIT is an internally-managed real estate investment trust focused on owning, operating, and acquiring high-quality office properties located in “18-hour cities” in the Southern and Western United States. Its target markets possess a number of attractive demographic and employment characteristics, which the trust believes will lead to capital appreciation and growth in rental income at its properties. At its most recent filing, City Office REIT owned 25 properties comprising of 60 office buildings with a total of approximately 6.0 million square feet of net rentable area that were approximately 86.9% leased. The trust generates around \$165 million in annual rental revenues and is headquartered in Dallas, Texas.

On August 4th, 2022, City Office REIT reported its Q2 results for the period ending June 30th, 2021. Rental and other revenues were \$45.5 million, up 13.9% year-over-year. Same-Store Cash NOI (Net Operating Income) declined 7.1% as compared to Q2-2021. However, amid lower growth in property operating expenses and general & administrative expenses, core FFO grew by 15% to \$17.6 million. On a per-share basis, FFO jumped from \$0.35 to \$0.40.

Occupancy stood at 86.9% at the end of the quarter, up 80 bps sequentially, but down 280 bps compared to Q2-2021. Occupancy was impacted by the newly constructed Bloc 83 property in Raleigh, North Carolina, which is completing its initial lease-up phase and has signed leases that have not yet taken occupancy. Excluding the Bloc 83 property, portfolio occupancy was 88.6%. During the quarter, City Office closed approximately 253,000 square feet of new and renewal leases. During and subsequent to quarter end, the company repurchased \$30.2 million worth of shares.

Following several acquisitions and dispositions last year, the company continues to expect almost no investment activity this year. Management slightly softened their FY2022 FFO/share outlook. They now expect it to land between \$1.54 and \$1.57 (down from \$1.56 and \$1.60 previously), the midpoint of which we have utilized in our estimates.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
FFO/shr	---	---	---	\$1.23	\$1.04	\$0.97	\$1.08	\$1.17	\$1.17	\$1.36	\$1.56	\$1.99
DPS	---	---	---	\$0.65	\$0.94	\$0.94	\$0.94	\$0.94	\$0.60	\$0.65	\$0.80	\$1.29
Shares²	---	---	---	12.4	20.5	30.2	37.3	44.0	47.2	43.4	43.6	60.0

City Office has posted relatively stable results since its public listing, with its office properties generating stable and predictable cash flows due to their attractive market characteristics. These include diverse employment bases, educated workforces, and strong and stable demand generators such as being near state capitals or within university proximity. Hence, these properties are likely to remain in high demand, as was the case during the pandemic, when the trust generated robust results despite the weak office market.

The dividend was cut in 2020, but this was in order for City Office to focus on growing its asset base and execute buybacks when its share price had significantly declined. Following the one-time effects from last year evaporating, we

¹ Estimated dates based on past dividend dates.

² Share count is in millions.

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are resetting our FFO/share CAGR estimate at 5% through 2027. We also retain our DPS CAGR estimate at 10% through this period due to comfortable room for dividend growth.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/FFO	---	---	---	10.5	12.8	12.8	10.6	11.5	8.5	12.5	8.4	10.0
Avg. Yld.	---	---	---	5.0%	7.1%	7.6%	8.2%	7.0%	6.0%	4.7%	6.1%	6.5%

City Office has traded at a very consistent P/FFO multiple, which has averaged around 11.3. The current multiple is right at this level. Despite the company's robust performance, shares have been impacted materially during the ongoing violent equity sell-off. As a result, the stock's valuation has been compressed notably, near an all-time low of 8.4 times the company's expected FFOs. We believe shares are undervalued at current levels and forecast a multiple expansion towards 10x FFO. The current yield is substantial and could even grow larger assuming dividend growth picks up.

Safety, Quality, Competitive Advantage, & Recession Resiliency

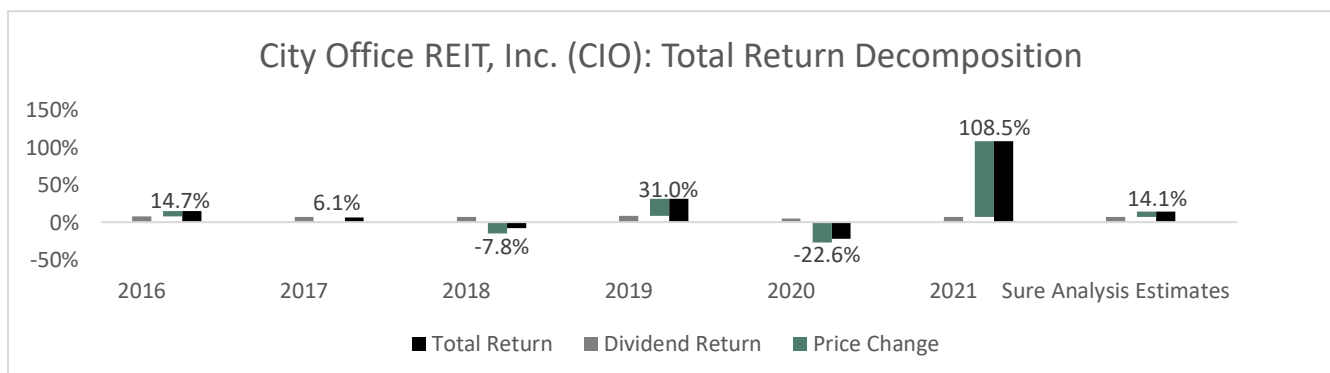
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	---	---	---	53%	90%	97%	87%	80%	51%	48%	51%	65%

While City Office's dividend was cut last year, this was done for management to capitalize on the possible growth avenues it sees ahead. In that regard, we consider the current payouts to be relatively safe. At an annual rate of \$0.80, the trust pays out only 51% of its total FFO. Amongst its qualities, we note that the REIT's portfolio of properties has an average remaining lease term of 4.9 years, which should provide solid cash flow visibility in the short-medium term. Further, the trust's tenant base is well diversified, with its top 10 tenants accounting for only 24.4% of its total rentable area and no tenant accounting for more than 3.5%. In fact, some of its tenants, like United Health Services, Ally Financial, and Kaplan, are not only credible companies with robust financials but are accommodated by City Office since 2008. Hence, they have a long-term relationship with the trust. Finally, the REIT has a healthy debt profile, featuring a weighted average rate of 3.7% and a weighted average debt maturity profile of 3.8 years. City Office should perform relatively resiliently during a recession, as proven during the pandemic, despite operating in a tough real estate space.

Final Thoughts & Recommendation

City Office REIT is a solid office REIT with numerous qualities. Last year's sale of its science portfolio to accelerate the growth of its office segment should help grow its AFFO/share and possibly DPS going forward. We estimate annualized returns of 14.1% in the medium-term, primarily driven by the 6.1% yield, our growth estimates, and valuation tailwinds. Hence, we assign City Office a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	12	20	37	55	72	106	129	156	161	164
Gross Profit	5	12	23	35	44	64	80	99	103	106
Gross Margin	47.5%	58.7%	61.2%	62.9%	60.9%	59.7%	61.5%	63.3%	63.7%	64.6%
SG&A Exp.	-		3	5	7	7	8	11	11	15
D&A Exp.	4	8	15	22	30	42	52	59	60	57
Operating Profit	2	4	5	8	7	15	19	29	31	33
Operating Margin	13.1%	20.7%	12.9%	14.5%	10.3%	14.3%	14.8%	18.4%	19.6%	20.1%
Net Profit	(2)	(4)	(3)	(7)	(1)	6	38	2	5	484
Net Margin	-13.9%	-20.2%	-8.2%	-12.0%	-1.2%	5.4%	29.5%	1.2%	2.8%	295%
Free Cash Flow	5	7	8	14	19	37	42	49	60	73

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	61	143	302	440	661	896	1,100	1,228	1,157	1,602
Cash & Equivalents	3	7	35	8	14	12	16	70	25	21
Accounts Receivable	0	5	1	1	2	2	2	3	2	3
Goodwill & Int. Ass.	4	14	29	41	56	65	76	68	44	69
Total Liabilities	55	115	210	366	405	537	702	679	739	731
Accounts Payable		2	4	9	13	18	26	29	25	27
Long-Term Debt	53	110	190	341	370	490	645	607	677	654
Shareholder's Equity	6	27	80	66	142	248	285	436	305	758
LTD/E Ratio	8.66	4.13	2.37	5.18	1.46	1.36	1.62	1.11	1.62	0.75

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	-3.0%	-4.1%	-1.4%	-1.8%	-0.2%	0.7%	3.8%	0.2%	0.4%	35.1%
Return on Equity	-13.8%	-25.2%	-5.7%	-9.0%	-0.8%	3.0%	14.3%	0.5%	1.2%	91.2%
ROIC	-3.0%	-4.2%	-1.5%	-1.9%	-0.2%	0.8%	4.0%	0.2%	0.4%	37.0%
Shares Out.				12.4	20.5	30.2	37.3	44.0	47.2	44.1
Revenue/Share	1.44	2.56	4.35	4.44	3.54	3.53	3.44	3.55	3.41	3.72
FCF/Share	0.67	0.90	0.92	1.14	0.94	1.21	1.12	1.13	1.27	1.66

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

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