



Office Properties Income Trust (OPI)

Updated February 20th, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	\$18	5 Year CAGR Estimate:	17.6%	Market Cap:	\$856 M
Fair Value Price:	\$27	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	4/21/2023 ¹
% Fair Value:	67%	5 Year Valuation Multiple Estimate:	8.2%	Dividend Payment Date:	5/18/2023
Dividend Yield:	12.2%	5 Year Price Target	\$29	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	B	Rating:	Buy

Overview & Current Events

Office Properties Income Trust (OPI) is a REIT that currently owns more than 160 buildings, which are primarily leased to single tenants with high credit quality. The REIT's portfolio currently has a 90.6% occupancy rate and an average building age of 17 years. OPI has a market capitalization of \$856 million.

On 12/31/2018, the predecessor company - Government Properties Income Trust - merged with Select Income REIT (SIR) and the combined company was renamed Office Properties Income Trust. The aggregate transaction value was \$2.4 billion, including the assumption of \$1.7 billion of debt from SIR. The combined company has enhanced geographic diversification and one of the highest percentages of rent paid by investment-grade rated tenants in the REIT universe. The U.S. Government is the largest tenant of OPI, as it represents 20% of the annual rental income of the REIT.

After acquiring First Potomac Realty Trust (FPO) in 2017 and merging with SIR, OPI is now in the process of selling assets to reduce its leverage to a healthy level. In 2019, it sold nearly \$1.0 billion of assets. It also sold \$110 million of assets in 2020, \$260 million of assets in 2021 and \$210 million of assets in 2022.

In mid-February, OPI reported (2/15/2023) financial results for the fourth quarter of fiscal 2022. The occupancy rate edged down sequentially from 90.7% to 90.6% and normalized funds from operations (FFO) per share dipped -6% over the prior year's quarter, from \$1.20 to \$1.13. Due to asset sales and the expiration of some leases, FFO per share have decreased -21% in total in the last three years. More than 90% of the debt of OPI is at fixed rates but we expect interest expense to increase this year due to high interest rates. We thus expect FFO per share of \$4.45 this year.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
FFO	\$2.12	\$2.29	\$2.39	\$2.36	\$2.02	\$1.99	\$6.01	\$5.39	\$4.87	\$4.76	\$4.45	\$4.91
DPS	\$1.72	\$1.72	\$1.72	\$1.72	\$1.72	\$1.72	\$2.20	\$2.20	\$2.20	\$2.20	\$2.20	\$2.20
Shares²	13.7	15.4	17.7	17.8	21.2	24.8	48.1	48.2	48.3	48.3	48.4	60.0

OPI has completed a major acquisition and a reverse split. It has also recently sold several of its assets in order to reduce its leverage and hence it is difficult to forecast future funds from operations. Furthermore, the pandemic may lead many companies to adopt a "work from home" model for the long run in order to reduce their operating costs. Such a shift would hurt OPI in the long run, but it is too early to evaluate the effect of the pandemic on this trend. We expect 2% average annual growth of FFO per share over the next five years.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/FFO	11.8	10.5	8.0	8.2	9.7	6.8	4.8	4.8	5.0	4.2	4.0	6.0
Avg. Yld.	6.9%	7.1%	9.0%	8.9%	8.8%	12.8%	7.6%	8.6%	9.1%	11.0%	12.2%	7.5%

¹ Estimated date.

² In millions.

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OPI has traded at an average price-to-FFO ratio of 7.4 during the last decade. The REIT is currently trading at a much lower FFO multiple of 4.0. However, as its mega merger was recently completed, it is hard to determine the fair valuation level. Moreover, given the high leverage of OPI, we prefer to be conservative and thus assume a fair price-to-FFO ratio of 6.0. If OPI reaches our fair valuation level in five years, it will enjoy an 8.2% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	81%	75%	72%	73%	85%	86%	37%	41%	45%	46%	49%	45%

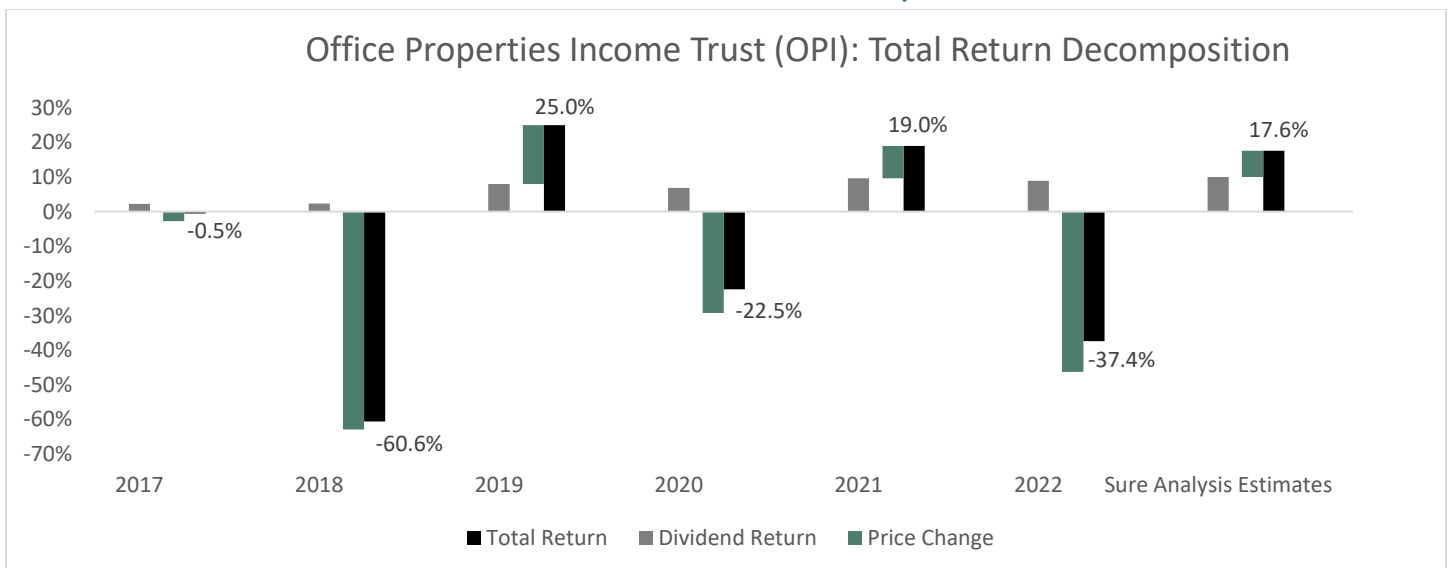
OPI generates 63% of its annual rental income from investment-grade tenants. This is one of the highest percentages of rent paid by investment-grade tenants in the REIT sector. Moreover, U.S. Government tenants generate about 20% of total rental income and no other tenant accounts for more than 4% of annual income. This exceptional credit profile constitutes a meaningful competitive advantage.

On the other hand, OPI has greatly increased its debt load after its latest acquisition. Its net debt is excessive, as it stands at \$2.5 billion, which is about 11 times the annual funds from operations and about triple the current market capitalization of the REIT. Fortunately, OPI is in the process of selling assets and hence it is likely to drive its leverage to healthier levels in the near future. Nevertheless, we remain concerned over its high debt load, which may result in a dividend cut whenever the next downturn, such as a recession, shows up.

Final Thoughts & Recommendation

Office Properties Income Trust is a REIT with an attractive business model, as it relies on tenants with a high-quality credit profile. Since our last research report, in November, OPI has rallied 30%, mostly thanks to its extremely cheap initial valuation. The stock could still offer a 17.6% average annual return over the next five years thanks to 2.0% growth of FFO per share, its 12.2% dividend and an 8.2% valuation tailwind. It thus maintains its buy rating. On the other hand, OPI is more volatile than most REITs. Due to its recent mega merger, there is little visibility in its future results. Additionally, given its high debt load, the stock will be vulnerable if the ongoing downturn from the work-from-home model and high inflation lasts longer than expected. Therefore, only those who realize this risk and can stomach the dramatic swings of the stock price of OPI should consider the security.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	227	251	249	258	317	427	678	588	576	554
Gross Profit	201	223	219	227	279	377	605	523	505	496
Gross Margin	88.7%	88.7%	88.0%	88.1%	88.0%	88.3%	89.1%	88.9%	87.5%	89.5%
SG&A Exp.	30	35	33	32	40	51	67	54	52	52
D&A Exp.	56	65	68	71	109	161	287	251	237	217
Operating Profit	75	75	67	68	64	73	127	112	105	111
Operating Margin	32.9%	29.8%	26.9%	26.3%	20.2%	17.2%	18.7%	19.0%	18.2%	20.0%
Net Profit	55	57	(210)	58	12	(22)	30	7	(8)	(6)
Net Margin	24.1%	22.5%	-84.5%	22.4%	3.8%	-5.1%	4.5%	1.1%	-1.4%	-1.1%
Free Cash Flow	108	131	115	127	138	145	215	234	221	193
Income Tax	0	0	0	0	0	0	1	0	0	0

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,632	2,428	2,169	2,385	3,704	5,239	4,193	3,946	4,242	3,980
Cash & Equivalents	8	14	9	30	17	35	94	42	83	12
Accounts Receivable	33	36	45	48	61	72	84	102	113	106
Total Liabilities	643	1,130	1,212	1,450	2,353	3,460	2,487	2,337	2,745	2,594
Accounts Payable	23	26	51	54	89	146	125	116	143	140
Long-Term Debt	598	1,085	1,146	1,382	2,245	3,255	2,327	2,203	2,578	2,433
Shareholder's Equity	990	1,297	957	935	1,330	1,779	1,706	1,609	1,497	1,386
LTD/E Ratio	0.60	0.84	1.20	1.48	1.66	1.83	1.36	1.37	1.72	1.76

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	3.4%	2.8%	-9.1%	2.5%	0.4%	-0.5%	0.6%	0.2%	-0.2%	-0.1%
Return on Equity	5.4%	4.9%	-18.6%	6.1%	1.1%	-1.4%	1.7%	0.4%	-0.5%	-0.4%
ROIC	3.5%	2.8%	-9.4%	2.6%	0.4%	-0.5%	0.7%	0.2%	-0.2%	-0.2%
Shares Out.	13.7	15.4	17.7	17.8	21.2	24.8	48.1	48.2	48.3	48.3
Revenue/Share	16.60	16.35	14.06	14.53	14.96	17.18	14.12	12.22	11.96	11.48
FCF/Share	7.93	8.52	6.53	7.13	6.50	5.84	4.48	4.85	4.60	3.99

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

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