Dream Office REIT (DRETF)

Updated February 27th, 2023 by Samuel Smith

Key Metrics

Current Price:	$12.5	**5 Year CAGR Estimate:**	2.5%	**Market Cap:**	$623.9M
Fair Value Price:	$9.6	**5 Year Growth Estimate:**	1.6%	**Ex-Dividend Date:**	02/27/2023
% Fair Value:	130%	**5 Year Valuation Multiple Estimate:**	-5.1%	**Dividend Payment Date:**	03/15/2023
Dividend Yield:	5.9%	**5 Year Price Target**	$10	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Rating:**	Sell

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 $623.9 million market capitalization trust is listed on the over-the-counter market in the U.S. under the trading symbol DRETF.

Dream Office reported on February 17th, 2023 that its Q4 revenue was C$27.34M, which is a 3.1% year-over-year increase. As of December 31, 2022, the net asset value per unit decreased to C$31.36 compared to C$31.49 on December 31, 2021. The comparative properties NOI for the three months ended December 31, 2022 increased by 0.1% compared to the same quarter the previous year. The diluted funds from operations per unit for the three months ended December 31, 2022 decreased by C$0.03 per unit to C$0.37 per unit, which is lower than the C$0.40 per unit reported in Q4 2021.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
FFO/S	$2.58	$2.29	$2.05	$1.94	$1.60	$1.26	$1.28	$1.21	$1.84	$1.23	***$1.07***	***$1.16***
DPS	$1.60	$1.61	$1.61	$1.16	$0.99	$0.73	$0.77	$0.80	$0.80	$0.73	***$0.74***	***$0.74***
Shares[1]	103.4	107.9	107.9	104.8	73.7	59.4	56.2	50.6	47.5	46.1	***46.1***	***40.0***

Instead of EPS, we use funds from operations per share (FFO/S) as Dream Office's primary growth metric. We use FFO/S because it more accurately reflects a REIT's true performance, as it accounts for the effects of real estate depreciation 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 aggressive buybacks, dramatically reducing the shares outstanding.

We expect disruption from 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. While the headwinds will likely offset much of the normal organic rent growth, buybacks should boost per-share metrics, leading us to forecast 1.6% annualized FFO per share growth through 2028.

[1] In millions

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
P/FFO	10	8.8	10.3	7.7	10.9	13.4	12.8	13.7	15.6	9.4	***11.7***	***9.0***
Avg. Yld.	5.6%	6.4%	9.2%	5.7%	3.6%	3.3%	3.5%	4.7%	4.2%	6.3%	***5.9%***	***7.1%***

Dream Office's average price to funds from operations ratio (P/FFO) has deviated significantly around its historic average of 10.6. Comparing the current P/FFO ratios to its historic averages, 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 below the current price to FFO ratio. We therefore expect valuation multiple compression to provide a headwind to total returns moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	62%	70%	79%	60%	62%	58%	60%	66%	43%	59%	**69%**	**64%**

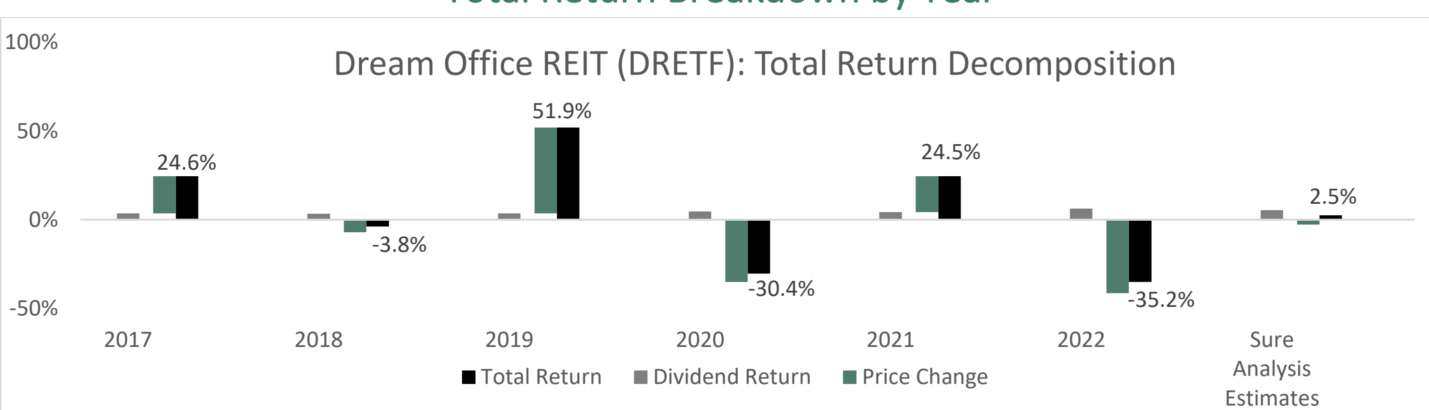
Dream Office has integrated best practices into its environmental platform since 2011. The trust has been proactively trying to reduce its environmental footprint by decreasing its resource consumption and greenhouse gas emissions. The trust also has a goal to use less energy and water to decrease waste 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 just 2.5% annually, mainly driven by Dream Office's dividend yield and FFO-per-share growth that will be somewhat offset by meaningful multiple compression. We believe the REIT's quality diversified portfolio will enable it to weather the current storm and the dividend yield is very attractive. However, due to the slightly 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 unattractive.

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	667	639	541	502	366	187	173	154	156	151
Gross Profit	380	364	304	278	202	102	96	84	85	82
Gross Margin	57.0%	56.9%	56.1%	55.5%	55.3%	54.4%	55.7%	54.7%	54.7%	54.1%
SG&A Exp.	29	28	17	16	8	12	10	9	9	9
D&A Exp.	5	10	12	16	17	13	11	10	10	9
Operating Profit	348	333	285	260	189	88	85	74	75	72
Operating Margin	52.2%	52.2%	52.6%	51.8%	51.5%	47.1%	49.2%	48.1%	48.3%	47.7%
Net Profit	432	144	(43)	(664)	104	122	88	132	123	49
Net Margin	64.8%	22.6%	-8.0%	-132%	28.4%	65.1%	51.2%	85.8%	78.7%	32.4%
Free Cash Flow	159	155	115	73	39	22	75	44	44	59
Income Tax	0	1	1	1	(3)	0	0	(1)	(0)	1

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	6,692	6,056	4,873	4,069	2,642	2,293	2,229	2,266	2,404	2,260
Cash & Equivalents	29	9	1	6	77	6	73	10	7	6
Accounts Receivable	7	5	2	1	5	6	3	3	3	1
Goodwill & Int. Ass.	59	53	6	5	1	1	1			
Total Liabilities	3,195	2,802	2,364	2,310	1,262	1,194	1,097	1,090	1,190	1,131
Accounts Payable	10	3	2	1	3	3	7	4	5	4
Long-Term Debt	2,957	2,668	2,170	1,965	1,088	1,032	881	936	1,006	1,011
Shareholder's Equity	3,497	3,254	2,509	1,759	1,380	1,099	1,132	1,176	1,214	1,129
LTD/E Ratio	0.85	0.82	0.86	1.12	0.79	0.94	0.78	0.80	0.83	0.90

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	6.6%	2.3%	-0.8%	-14.9%	3.1%	4.9%	3.9%	5.9%	5.3%	2.1%
Return on Equity	12.7%	4.3%	-1.5%	-31.1%	6.6%	9.8%	7.9%	11.5%	10.3%	4.2%
ROIC	6.9%	2.3%	-0.8%	-15.8%	3.4%	5.3%	4.3%	6.4%	5.7%	2.2%
Shares Out.	103.4	107.9	107.9	104.8	73.7	59.4	56.2	50.6	47.5	46.1
Revenue/Share	6.45	5.92	5.02	4.79	4.96	3.15	2.70	2.55	2.78	3.27
FCF/Share	1.53	1.43	1.06	0.70	0.54	0.37	1.17	0.74	0.78	1.28

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