



# City Office REIT, Inc. (CIO)

Updated May 11<sup>th</sup>, 2023 by Nikolaos Sismanis

## Key Metrics

<b>Current Price:</b>	\$4.55	<b>5 Year CAGR Estimate:</b>	12.7%	<b>Market Cap:</b>	\$181.5M
<b>Fair Value Price:</b>	\$7.86	<b>5 Year Growth Estimate:</b>	-5.0%	<b>Ex-Dividend Date:</b>	07/06/23 <sup>1</sup>
<b>% Fair Value:</b>	58%	<b>5 Year Valuation Multiple Estimate:</b>	11.6%	<b>Dividend Payment Date:</b>	07/21/23
<b>Dividend Yield:</b>	8.8%	<b>5 Year Price Target</b>	\$6.08	<b>Years Of Dividend Growth:</b>	N/A
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	A	<b>Rating:</b>	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 84.9% leased. The trust generates around \$180 million in annual rental revenues and is headquartered in Dallas, Texas.

On May 5<sup>th</sup>, 2023, City Office REIT reported its Q1 results for the period ending March 31<sup>st</sup>, 2023. For the quarter, rental and other revenues were \$46.0 million, up 2.5% year-over-year.

Same-Store Cash NOI (Net Operating Income) rose by 3.0% as compared to Q1-2022. However, due to larger growth in property operating expenses and general & administrative expenses, core FFO fell by 14.8% to \$15.0 million. On a per-share basis, core FFO (which excludes share-based compensation) came in at \$0.37 compared to \$0.40 last year, aided by share repurchases. Specifically, the company repurchased \$50.2 million worth of stock last year, and approved a new \$50 million buyback program. Occupancy stood at 84.9% at the end of the quarter, 130 bps lower sequentially.

For FY2023, the company affirmed its outlook, expecting FFO/share of \$1.28 and \$1.33, the midpoint of which we have utilized in our estimates. However, given a rather uncertain macroeconomic outlook, the company slashed its dividend by 50% to a quarterly rate of \$0.10.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>FFO/shr</b>	---	---	\$1.23	\$1.04	\$0.97	\$1.08	\$1.17	\$1.17	\$1.36	\$1.48	<b>\$1.31</b>	<b>\$1.01</b>
<b>DPS</b>	---	---	\$0.65	\$0.94	\$0.94	\$0.94	\$0.94	\$0.60	\$0.65	\$0.80	<b>\$0.40</b>	<b>\$0.46</b>
<b>Shares<sup>2</sup></b>	---	---	12.4	20.5	30.2	37.3	44.0	47.2	43.4	42.0	<b>39.8</b>	<b>60.0</b>

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, and once again most recently in 2023. While the pandemic has evaporating, the real estate office market remains under pressure as hybrid working conditions have persisted. Along with rising rates, we expect the company’s profitability to remain under pressure. Accordingly, we have adjusted our FFO/share CAGR

<sup>1</sup> Estimated dates based on past dividend dates.

<sup>2</sup> Share count is in millions.

*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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estimate to a negative 5% through 2028. We expect the dividend to grow by about 3% per annum, assuming the company gradually shifts to a more optimistic macro outlook. That said, this is speculative given the recent cut.

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/FFO	---	---	10.5	12.8	12.8	10.6	11.5	8.5	12.5	8.4	3.5	6.0
Avg. Yld.	---	---	5.0%	7.1%	7.6%	8.2%	7.0%	6.0%	4.7%	6.4%	8.8%	7.6%

City Office has traded at a very reasonable P/FFO multiple, which has averaged around 11. Despite the company's robust performance, shares have slumped, as investors' appetite for office REITs has been worsening by the quarter. Investors have further punished the stock further given the sequential dividend cuts, resulting in shares trading at a seemingly very cheap P/FFO of 3.5. We believe City Office is undervalued at current levels, but can see a humble valuation persisting moving forward, albeit multiple expansion is possible. The current yield is substantial despite the recent cut.

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

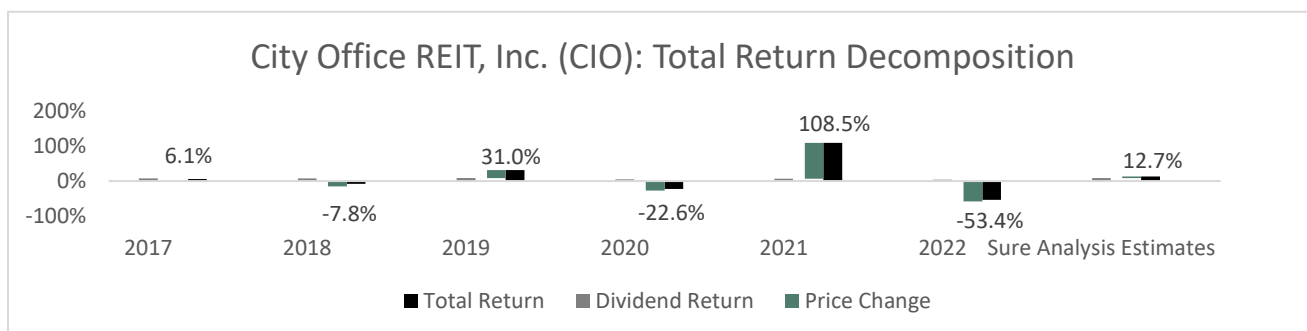
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	---	53%	90%	97%	87%	80%	51%	48%	54%	31%	46%

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 61% of its total FFO. Amongst its qualities, we note that the REIT's portfolio of properties has an average remaining lease term of 4.8 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 23.2% 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. That said, while City Office has a healthy debt profile, featuring a weighted average interest rate of 4.5% and a weighted average debt maturity of 3.0 years, rising interest rates could be a headwind to its profitability moving forward. Overall, however, City Office should perform relatively resiliently during a recession, as proven during the pandemic, despite modest declines in FFO during tough times.

## Final Thoughts & Recommendation

City Office REIT is a solid office REIT with numerous qualities. Despite the company's relatively robust results, its two recent dividend cuts have generated considerable investor aversion toward the stock. We estimate annualized returns of 12.7% in the medium-term, primarily driven by the 8.8% yield and the possibility for a strong valuation expansion, offset by a potentially declining FFO/share. Hence, shares earn a speculative buy rating.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	20	37	55	72	106	129	156	161	164	180.5
Gross Profit	12	23	35	44	64	80	99	103	106	113
Gross Margin	58.7%	61.2%	62.9%	60.9%	59.7%	61.5%	63.3%	63.7%	64.6%	62.6%
SG&A Exp.		3	5	7	7	8	11	11	15	14
D&A Exp.	8	15	22	30	42	52	59	60	57	63
Operating Profit	4	5	8	7	15	19	29	31	33	36.5
Operating Margin	20.7%	12.9%	14.5%	10.3%	14.3%	14.8%	18.4%	19.6%	20.1%	20.2%
Net Profit	(4)	(3)	(7)	(1)	6	38	2	5	484	17
Net Margin	-20.2%	-8.2%	-12.0%	-1.2%	5.4%	29.5%	1.2%	2.8%	295%	9.4%
Free Cash Flow	7	8	14	19	37	42	49	60	73	107

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	143	302	440	661	896	1,100	1,228	1,157	1,602	1,574
Cash & Equivalents	7	35	8	14	12	16	70	25	21	28
Accounts Receivable	5	1	1	2	2	2	3	2	3	5
Goodwill & Int. Ass.	14	29	41	56	65	76	68	44	69	55
Total Liabilities	115	210	366	405	537	702	679	739	731	771
Accounts Payable	2	4	9	13	18	26	29	25	27	---
Long-Term Debt	110	190	341	370	490	645	607	677	654	690
Shareholder's Equity	27	80	66	142	248	285	436	305	758	691
LTD/E Ratio	4.13	2.37	5.18	1.46	1.36	1.62	1.11	1.62	0.75	0.86

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	-4.1%	-1.4%	-1.8%	-0.2%	0.7%	3.8%	0.2%	0.4%	35.1%	1.1%
Return on Equity	-25.2%	-5.7%	-9.0%	-0.8%	3.0%	14.3%	0.5%	1.2%	91.2%	2.4%
ROIC	-4.2%	-1.5%	-1.9%	-0.2%	0.8%	4.0%	0.2%	0.4%	37.0%	1.1%
Shares Out.			12.4	20.5	30.2	37.3	44.0	47.2	44.1	42.9
Revenue/Share	2.56	4.35	4.44	3.54	3.53	3.44	3.55	3.41	3.72	4.21
FCF/Share	0.90	0.92	1.14	0.94	1.21	1.12	1.13	1.27	1.66	2.49

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

## Disclaimer

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