Corporate Office Properties Trust (OFC)

Updated August 6th, 2023 by Felix Martinez

Key Metrics

Current Price:	$26	**5 Year CAGR Estimate:**	9.2%	**Market Cap:**	$2.97 B
Fair Value Price:	$30	**5 Year Growth Estimate:**	2.5%	**Ex-Dividend Date:**	09/30/2023[1]
% Fair Value:	85%	**5 Year Valuation Multiple Estimate:**	3.2%	**Dividend Payment Date:**	10/17/2023
Dividend Yield:	4.4%	**5 Year Price Target**	$34	**Years Of Dividend Growth:**	1
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Corporate Office Properties Trust is a Real Estate Investment Trust (REIT) that invests in office and data center buildings, mainly in the suburbs of the Washington, D.C. metropolitan area. It primarily leases to the U.S. government and its contractors. As of December 31, 2022, the company derived 91% of its core portfolio annualized rental revenue from Defense/IT Locations and 9% from its Regional Office Properties. OFC's core portfolio of 192 properties encompassed 22.8 million square feet and was 95.3% leased. The company was founded in 1988 by Clay W. Hamlin III as Royale Investments, Inc. However, the company now trades under the ticker symbol "OFC" and has a current market capitalization of $2.97 billion.

On July 27th, 2023, OFC reported second quarter results for Fiscal Year (FY)2023. For the quarter, diluted earnings per share (EPS) were $0.27, a slight decrease from $0.29 in the same quarter of 2022. Diluted funds from operations per share, and adjusted FFO were $0.60 for Q2 2023, up from $0.59 in Q2 2022. The core portfolio, totaling 22.9 million square feet, achieved an impressive 93.6% occupancy and 95.0% leasing rate as of June 30, 2023. The same-property portfolio, comprising 20.6 million square feet, demonstrated strong performance with 92.8% occupancy and 94.4% leasing. During Q2 2023, the Company leased 891,000 square feet, including 803,000 square feet through renewals and 88,000 square feet through new vacancy leases. In the first six months of 2023, total leasing encompassed 1.7 million square feet, involving 1.0 million square feet of renewals, 187,000 square feet of vacancy leasing, and 495,000 square feet in development projects. Tenant retention rates for expiring square feet were noteworthy, reaching 89.0% during the quarter and 82.7% for the first half of 2023. Lease terms averaged 5.0 years for renewing leases and 6.9 years for vacancy leasing in Q2 2023.

Management updated its full-year guidance, projecting diluted EPS and diluted FFO within new ranges of $1.49-$1.53 and $2.38-$2.42, respectively, compared to the prior guidance of $1.46-$1.52 and $2.35-$2.41. For the third quarter, diluted EPS is estimated at $0.26-$0.28, and diluted FFOPS is projected to fall within $0.59-$0.61. We will use $2.40 as our fair value and total return calculations.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$1.97	$1.88	$2.01	$2.01	$2.03	$2.01	$2.03	$2.12	$2.29	$2.36	***$2.40***	***$2.72***
DPS	$1.10	$1.10	$1.10	$1.10	$1.10	$1.10	$1.10	$1.10	$1.10	$1.38	***$1.14***	***$1.20***
Shares[2]	85.0	88.2	97.7	94.5	99.2	104.1	111.6	112.1	112.4	112.6	***112.6***	***112.5***

The most significant growth prospects from OFC will be the continuation of profitable acquisitions in the future and increasing rents at a modest rate. OFC had grown FFO at a Compound Annual Growth Rate (CAGR) of 2.0% over the past ten years. Over the past five years, FFO growth has improved with a CAGR of 3.6%. During the COVID-19 pandemic, most REITs had to cut their dividend, or FFO decreased for the year. However, FFO increased by 4% from 2019 to 2020 for the

[1] Ex-Dividend and Dividend payment dates are estimates.
[2] 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.

company. We expect OFC to continue to grow FFO at a 2.5% CAGR for the next five years. We expect the Trust to make $2.72 in FFO per share in 2028.

The dividend has not been increasing throughout the years. The company has been paying the same dividend rate of $1.10 per share for the past ten years. However, with the most recent increase of 3%, we think that the company will continue modest increases of 1% a year for the next five year.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	12	15.1	10.9	15.5	14.4	10.5	14.5	12.3	12.2	11	***10.8***	***12.7***
Avg. Yld.	4.6%	3.9%	5.0%	3.5%	3.8%	5.2%	3.7%	4.2%	3.9%	4.2%	***4.4%***	***3.5%***

OFC currently trades hands with a 10.8x FFO, which is lower than its peers. Over the ten years history of OFC, the Trust has ten-year multiple averages of 12.8x FFO. Thus, we think a multiple of 12.7x FFO is fair for OFC. This will provide a 3.2% tailwind expansion over the next five years. The current dividend yield of 4.4% is slightly higher than its five-year average. Thus, the company looks to be undervalued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	55.8%	58.5%	54.7%	54.7%	54.2%	54.7%	54.2%	51.9%	48.0%	58.5%	***48%***	***44%***

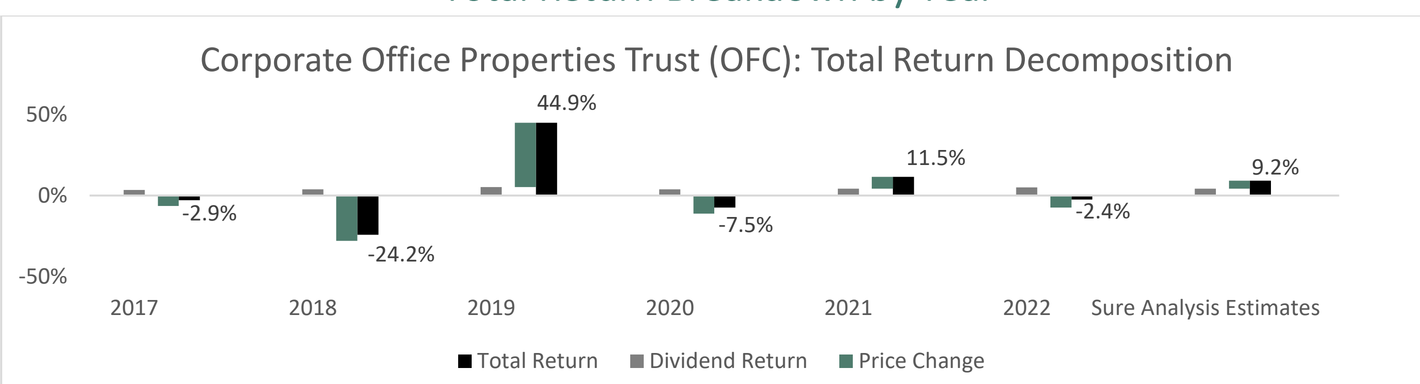
OFC's competitive advantage is that it has a strong management team. The company was very resilient during The Great Recession in 2008-2009 and droning the COVID-19 pandemic. During 2008, FFO increased by 9% to $2.44 per share. Also, in 2019, FFO increased by 2% to $2.49 per share. As mentioned above, OFC was one of the fortunate REITs that increased FFO in FY2020. This speaks volumes as most REITs struggle mightily during the pandemic. Also, OFC did not have to cut its dividend.

OFC has a good balance sheet. The Trust has an interest coverage ratio of 4.3 and a debt-to-equity ratio of 1.3. The dividend payment is meager compared to other REITs paying out 48% of its FFO. The low dividend payout ratio should help the company start a dividend growth policy in the future.

Final Thoughts & Recommendation

OFC is a well-run office REIT with a good balance sheet. The Trust went through the COVID-19 pandemic like it was not even there. The Trust offers an expected total return for the next five years to be 9.2%. Thus, at the current price, the stock earns a hold 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	523	586	625	574	613	578	612	582	664	739
Gross Profit	184	170	188	199	188	182	191	197	209	220
Gross Margin	35.2%	29.1%	30.1%	34.6%	30.7%	31.4%	31.3%	33.9%	31.5%	29.8%
SG&A Exp.	36	37	45	45	37	35	40	37	41	39
D&A Exp.	120	138	142	135	137	139	139	140	151	144
Operating Profit	148	133	143	154	151	147	152	160	169	181
Operating Margin	28.2%	22.7%	22.9%	26.8%	24.6%	25.4%	24.8%	27.5%	25.4%	24.5%
Net Profit	94	40	178	30	69	72	192	97	77	173
Net Margin	17.9%	6.9%	28.5%	5.2%	11.2%	12.5%	31.3%	16.7%	11.5%	23.4%
Free Cash Flow	135	165	181	208	207	156	204	206	219	229
Income Tax	2	0	0	0	1	0	0	0	0	0

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	3,630	3,664	3,909	3,781	3,595	3,656	3,854	4,077	4,262	4,257
Cash & Equivalents	54	6	60	210	12	8	15	18	13	12
Accounts Receivable	116	127	135	125	119	116	123	133	150	168
Goodwill & Int. Ass.	59	44	98	78	59	43	27	19	15	10
Total Liabilities	2,115	2,125	2,274	2,163	2,104	2,003	2,106	2,358	2,578	2,510
Accounts Payable	99	123	92	109	108	93	149	143	186	158
Long-Term Debt	1,928	1,914	2,078	1,904	1,828	1,824	1,831	2,087	2,272	2,232
Shareholder's Equity	1,177	1,252	1,345	1,351	1,402	1,585	1,679	1,661	1,623	1,682
LTD/E Ratio	1.35	1.32	1.35	1.25	1.30	1.15	1.09	1.26	1.40	1.33

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	2.6%	1.1%	4.7%	0.8%	1.9%	2.0%	5.1%	2.5%	1.8%	4.1%
Return on Equity	8.5%	3.3%	13.7%	2.2%	5.0%	4.8%	11.7%	5.8%	4.7%	10.5%
ROIC	2.7%	1.2%	5.0%	0.8%	2.0%	2.1%	5.4%	2.6%	2.0%	4.4%
Shares Out.	85.0	88.2	97.7	94.5	99.2	104.1	111.6	112.1	112.4	112.6
Revenue/Share	6.14	6.64	6.40	6.07	6.18	5.55	5.48	5.20	5.91	6.56
FCF/Share	1.58	1.87	1.85	2.20	2.09	1.50	1.83	1.84	1.95	2.04

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