COPT Defense Properties (CDP)

Updated November 6th, 2023 by Felix Martinez

Key Metrics

Current Price:	$24	**5 Year CAGR Estimate:**	11.4%	**Market Cap:**	$2.7 B
Fair Value Price:	$30	**5 Year Growth Estimate:**	2.5%	**Ex-Dividend Date:**	12/29/2023[1]
% Fair Value:	77%	**5 Year Valuation Multiple Estimate:**	5.3%	**Dividend Payment Date:**	01/16/2024
Dividend Yield:	4.8%	**5 Year Price Target**	$34	**Years Of Dividend Growth:**	1
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Rating:**	Buy

Overview & Current Events

COPT Defense Properties 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. CDP's core portfolio of 192 properties encompassed 22.8 million square feet and was 95.3% leased. The company has a current market capitalization of $2.7 billion. On September 5th 2023, the company Announces New Name and Logo to Align with Defense and Mission Critical Sector Focus. Corporate Office Properties Trust (NYSE: OFC) ("COPT" or the "Company") announced that the Company is changing its name to COPT Defense Properties ("COPT Defense") and its ticker symbol for its common shares listed on the New York Stock Exchange from "OFC" to "CDP" effective September 15, 2023.

On October 26th, 2023, OFC reported third quarter results for Fiscal Year (FY)2023. The Company achieved solid results, with Funds From Operations (FFO) per share meeting their guidance range, allowing them to narrow the full-year guidance range. COPT Defense also outperformed in terms of same property cash Net Operating Income (NOI) growth, which rose by 4.5% in Q3 2023 compared to Q3 2022 and 6.2% year-to-date in 2023 over the same period in 2022. The company's robust financial performance led to an increase in their full-year change in same property cash NOI guidance.

From a financial standpoint, COPT Defense successfully sourced low-cost capital for its development projects. Furthermore, the company's investment grade balance sheet positions them well to navigate the challenging capital markets environment, given their lack of variable rate debt exposure and no significant debt maturity until 2026. In terms of operational highlights, the company's Defense/IT Portfolio remained strong, with 95.9% occupancy and 97.0% lease rate as of September 30, 2023. The same property cash NOI increased by 4.5% in the third quarter of 2023 compared to the same period in 2022. COPT Defense also made significant progress in leasing activities, with 82.0% and 82.5% tenant retention rates during the quarter and nine months ended September 30, 2023, respectively. Additionally, the company experienced positive rent spreads and average escalations on renewing leases, showcasing their successful leasing strategies.

Looking ahead, COPT Defense revised its full-year guidance, adjusting the ranges for diluted EPS and diluted FFOPS according to Nareit and as adjusted for comparability. The new guidance reflects the company's continued confidence in its strategic approach and ability to navigate the evolving market dynamics.

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***

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

[2] Share count is in millions.

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The most significant growth prospects from CDP will be the continuation of profitable acquisitions in the future and increasing rents at a modest rate. CDP 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 company. We expect CDP 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.

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	***9.8***	***12.7***
Avg. Yld.	4.6%	3.9%	5.0%	3.5%	3.8%	5.2%	3.7%	4.2%	3.9%	4.2%	***4.8%***	***3.5%***

CDP currently trades hands with a 9.8x FFO, which is lower than its peers. Over the ten years history of CDP, the Trust has ten-year multiple averages of 12.8x FFO. Thus, we think a multiple of 12.7x FFO is fair for CDP. This will provide a 5.3% 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%***

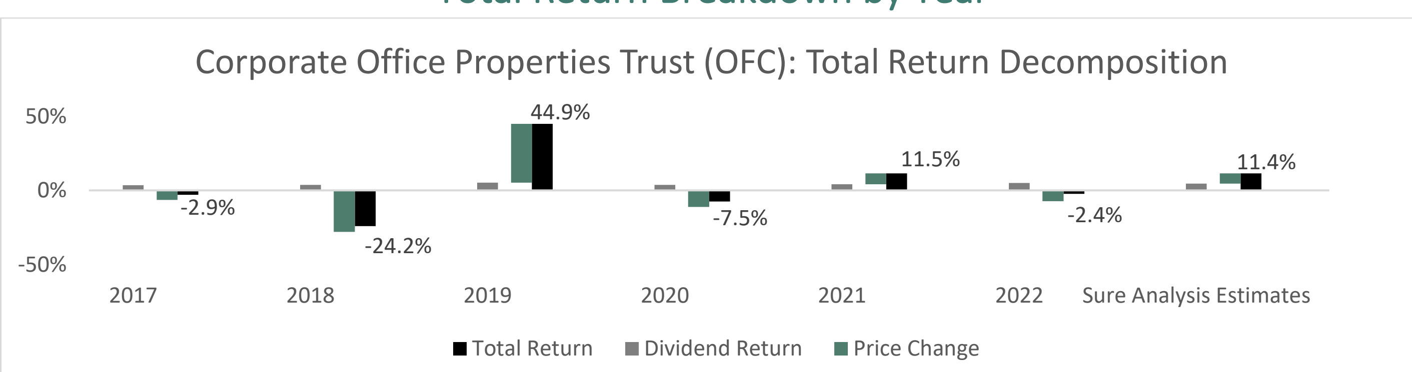
CDP's competitive advantage is that it has a strong management team. The company was very resilient during The Great Recession in 2008-2009 and droning the COVID-19 pandemic. During 2008, FFO increased by 9% to $2.44 per share. Also, in 2019, FFO increased by 2% to $2.49 per share. As mentioned above, CDP 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.

CDP 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

CDP 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 of 11.4%. Thus, at the current price, the stock earns a 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	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.