COPT Defense Properties (CDP)

Updated February 10th, 2024 by Felix Martinez

Key Metrics

Current Price:	$24	**5 Year CAGR Estimate:**	11.9%	**Market Cap:**	$2.7 B
Fair Value Price:	$32	**5 Year Growth Estimate:**	2.5%	**Ex-Dividend Date:**	03/30/2024[1]
% Fair Value:	75%	**5 Year Valuation Multiple Estimate:**	5.8%	**Dividend Payment Date:**	04/15/2024
Dividend Yield:	4.8%	**5 Year Price Target**	$36	**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 February 8th, 2024, OFC reported fourth quarter results for Fiscal Year (FY)2023. The company earnings per share (EPS) of ($0.67), primarily affected by a notable impairment of assets in the Other segment during the third quarter. However, the company's adjusted Funds from Operations (FFO) per share exhibited resilience, increasing by 2.5% to reach $2.42 over the 2022 results. A key highlight was the robust performance of the Defense/IT Portfolio, achieving a 96.2% occupancy rate and an impressive 97.2% leasing rate—marking the highest levels since the segment's disclosure in 2015. Furthermore, the same Property Cash Net Operating Income (NOI) experienced a substantial 5.7% year-over-year increase, marking the highest annual surge in over 15 years. Notably, COPT Defense surpassed its leasing objectives by successfully placing 848,000 square feet of developments into service, achieving an impressive 98% lease rate. Stephen E. Budorick, COPT Defense's President & Chief Executive Officer, attributed the positive performance to the continued strength in defense spending over the past few years, resulting in growing tenant demand within their Defense/IT Portfolio to support critical national defense activities. Looking ahead, Budorick expressed confidence in the future, citing the favorable outlook for defense spending. The FY24 National Defense Authorization Act, passed in December, calls for a 3.3% year-over-year growth, expected to drive demand for space within COPT Defense's portfolio through 2025. The company foresees continued growth, projecting a 3.7% increase in FFO per share for 2024, and maintaining a compound annual growth rate of approximately 4% between 2023 to 2026.

Despite reporting an EPS of ($0.67) for 2023, inclusive of a $252.8 million impairment charge, the adjusted financial metrics and operational achievements position COPT Defense favorably within the dynamic defense and IT markets, setting the stage for continued success.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.88	$2.01	$2.01	$2.03	$2.01	$2.03	$2.12	$2.29	$2.36	$2.42	***$2.49***	***$2.82***
DPS	$1.10	$1.10	$1.10	$1.10	$1.10	$1.10	$1.10	$1.10	$1.10	$1.14	***$1.17***	***$1.23***
Shares[2]	88.2	97.7	94.5	99.2	104.1	111.6	112.1	112.4	112.6	112.0	***112.0***	***112.0***

[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 2.8% over the past ten years. Over the past five years, FFO growth has improved with a CAGR of 4.2%. 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 $2.82 in FFO per share in 2029.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	15.1	10.9	15.5	14.4	10.5	14.5	12.3	12.2	11	10.6	***9.6***	***12.7***
Avg. Yld.	3.9%	5.0%	3.5%	3.8%	5.2%	3.7%	4.2%	3.9%	4.2%	4.5%	***4.8%***	***3.4%***

CDP currently trades hands with a 9.6x FFO, which is lower than its peers. Over the ten years history of CDP, the Trust has ten-year multiple averages of 12.7x FFO. Thus, we think a multiple of 12.7x FFO is fair for CDP. This will provide a 5.8% tailwind expansion over the next five years. The current dividend yield of 4.8% is slightly higher than its five-year average. Thus, the company looks to be undervalued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2028
Payout	58.5%	54.7%	54.7%	54.2%	54.7%	54.2%	51.9%	48.0%	46.6%	47.1%	***47%***	***44%***

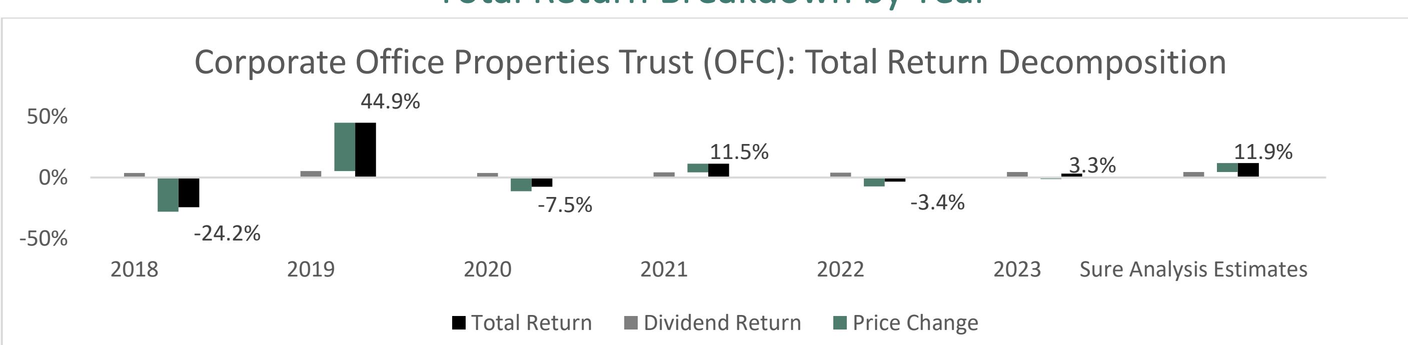
CDP's competitive advantage is that it has a strong management team. The company was very resilient during The Great Recession in 2008-2009 and droning the COVID-19 pandemic. During 2008, FFO increased by 9% to $2.44 per share. Also, in 2019, FFO increased by 2% to $2.49 per share. As mentioned above, 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 11.9%. Thus, at the current price, the stock earns a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	586	625	574	613	578	612	582	664	739	685
Gross Profit	170	188	199	188	182	191	197	209	220	231
Gross Margin	29.1%	30.1%	34.6%	30.7%	31.4%	31.3%	33.9%	31.5%	29.8%	33.7%
SG&A Exp.	37	45	45	37	35	40	37	41	39	43
D&A Exp.	138	142	135	137	139	139	140	151	144	
Operating Profit	133	143	154	151	147	152	160	169	181	188
Operating Margin	22.7%	22.9%	26.8%	24.6%	25.4%	24.8%	27.5%	25.4%	24.5%	27.4%
Net Profit	40	178	30	69	72	192	97	77	173	-73
Net Margin	6.9%	28.5%	5.2%	11.2%	12.5%	31.3%	16.7%	11.5%	23.4%	-10.7%
Free Cash Flow	165	181	208	207	156	204	206	219	229	
Income Tax	0	0	0	1	0	0	0	0	0	1

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	3,664	3,909	3,781	3,595	3,656	3,854	4,077	4,262	4,257	4,247
Cash & Equivalents	6	60	210	12	8	15	18	13	12	168
Accounts Receivable	127	135	125	119	116	123	133	150	168	198
Goodwill & Int. Ass.	44	98	78	59	43	27	19	15	10	
Total Liabilities	2,125	2,274	2,163	2,104	2,003	2,106	2,358	2,578	2,510	2,700
Accounts Payable	123	92	109	108	93	149	143	186	158	133
Long-Term Debt	1,914	2,078	1,904	1,828	1,824	1,831	2,087	2,272	2,232	2,416
Shareholder's Equity	1,252	1,345	1,351	1,402	1,585	1,679	1,661	1,623	1,682	1,484
LTD/E Ratio	1.32	1.35	1.25	1.30	1.15	1.09	1.26	1.40	1.33	1.63

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	1.1%	4.7%	0.8%	1.9%	2.0%	5.1%	2.5%	1.8%	4.1%	-1.7%
Return on Equity	3.3%	13.7%	2.2%	5.0%	4.8%	11.7%	5.8%	4.7%	10.5%	-4.5%
ROIC	1.2%	5.0%	0.8%	2.0%	2.1%	5.4%	2.6%	2.0%	4.4%	-1.9%
Shares Out.	88.2	97.7	94.5	99.2	104.1	111.6	112.1	112.4	112.6	112.2
Revenue/Share	6.64	6.40	6.07	6.18	5.55	5.48	5.20	5.91	6.56	6.11
FCF/Share	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.