Office Properties Income Trust (OPI)

Updated May 10th, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	$2.30	**5 Year CAGR Estimate:**	25.5%	**Market Cap:**	$112 M
Fair Value Price:	$8	**5 Year Growth Estimate:**	-3.0%	**Ex-Dividend Date:**	4/19/2024
% Fair Value:	28%	**5 Year Valuation Multiple Estimate:**	28.6%	**Dividend Payment Date:**	5/16/2024
Dividend Yield:	1.7%	**5 Year Price Target**	$7	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Sell

Overview & Current Events

Office Properties Income Trust (OPI) is a REIT that currently owns 151 buildings, which are primarily leased to single tenants with high credit quality. The REIT's portfolio currently has an 88.2% occupancy rate and an average building age of 19 years. OPI has a market capitalization of $112 million.

On 12/31/2018, the predecessor company - Government Properties Income Trust - merged with Select Income REIT (SIR) and the combined company was renamed Office Properties Income Trust. The aggregate transaction value was $2.4 billion, including the assumption of $1.7 billion of debt from SIR. The combined company has enhanced geographic diversification and one of the highest percentages of rent paid by investment-grade rated tenants in the REIT universe. The U.S. Government is the largest tenant of OPI, as it represents 20% of the annual rental income of the REIT.

After acquiring First Potomac Realty Trust (FPO) in 2017 and merging with SIR, OPI is now selling assets to reduce its debt. It sold nearly $1.0 billion of assets in 2019, $110 million in 2020, $260 million in 2021 and $210 million in 2022.

On April 11th, 2023, OPI announced that it agreed to acquire Diversified Healthcare Trust (DHC) in an all-stock deal of nearly $400 million. OPI pursued this acquisition to enhance its diversification and benefit from synergies. However, it cut its dividend by 55% and its stock plunged -24% on the news. Moreover, on September 1st, 2023, the two REITs mutually agreed to terminate their merger agreement, mostly due to the opposition of major shareholders of DHC.

In early May, OPI reported (5/1/2024) results for the first quarter of 2024. The occupancy rate dipped sequentially from 89.5% to 88.2% and normalized funds from operations (FFO) per share fell -27%, from $1.09 to $0.79. More than 90% of the debt of OPI is at fixed rates but interest expense currently exceeds operating income due to high interest rates. The REIT has a huge debt maturity of $650 million in February-2025 and hence it is highly risky. OPI recently cut its quarterly dividend by 96%, from $0.25 to $0.01, due to its high debt load. Due to daunting performance and poor guidance of OPI, which expects FFO per share of $0.62-$0.64 in the second quarter, we have lowered our forecast from $3.00 to $2.70.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
FFO	$2.29	$2.39	$2.36	$2.02	$1.99	$6.01	$5.39	$4.87	$4.76	$4.17	***$2.70***	***$2.32***
DPS	$1.72	$1.72	$1.72	$1.72	$1.72	$2.20	$2.20	$2.20	$2.20	$1.30	***$0.04***	***$0.04***
Shares[1]	15.4	17.7	17.8	21.2	24.8	48.1	48.2	48.3	48.3	48.5	***50.0***	***60.0***

OPI has completed a major acquisition and a reverse split and it just cancelled a major acquisition. It has also sold several of its assets in recent years in order to reduce its leverage and hence it is difficult to forecast future funds from operations. Furthermore, the pandemic may lead many companies to adopt a "work from home" model for the long run in order to reduce their operating costs. Such a shift would hurt OPI in the long run, but it is too early to evaluate the effect of the pandemic on this trend. Due to the disappointing business performance of OPI over the last seven years, its inability to create shareholder value and its high debt load, which will result in high interest expense, we expect a -3% average annual decline of FFO per share over the next five years.

[1] 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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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/FFO	10.5	8.0	8.2	9.7	6.8	4.8	4.8	5.0	4.2	2.1	***0.9***	***3.0***
Avg. Yld.	7.1%	9.0%	8.9%	8.8%	12.8%	7.6%	8.6%	9.1%	11.0%	14.8%	***1.7%***	***0.6%***

OPI has traded at an average price-to-FFO ratio of 6.4 during the last decade. The REIT is currently trading at a depressed FFO multiple of 0.9. Given the high leverage of OPI, we prefer to be conservative and thus assume a fair price-to-FFO ratio of 3.0. If OPI reaches our fair valuation level in five years, it will enjoy a 28.6% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	75%	72%	73%	85%	86%	37%	41%	45%	46%	31%	***1%***	***2%***

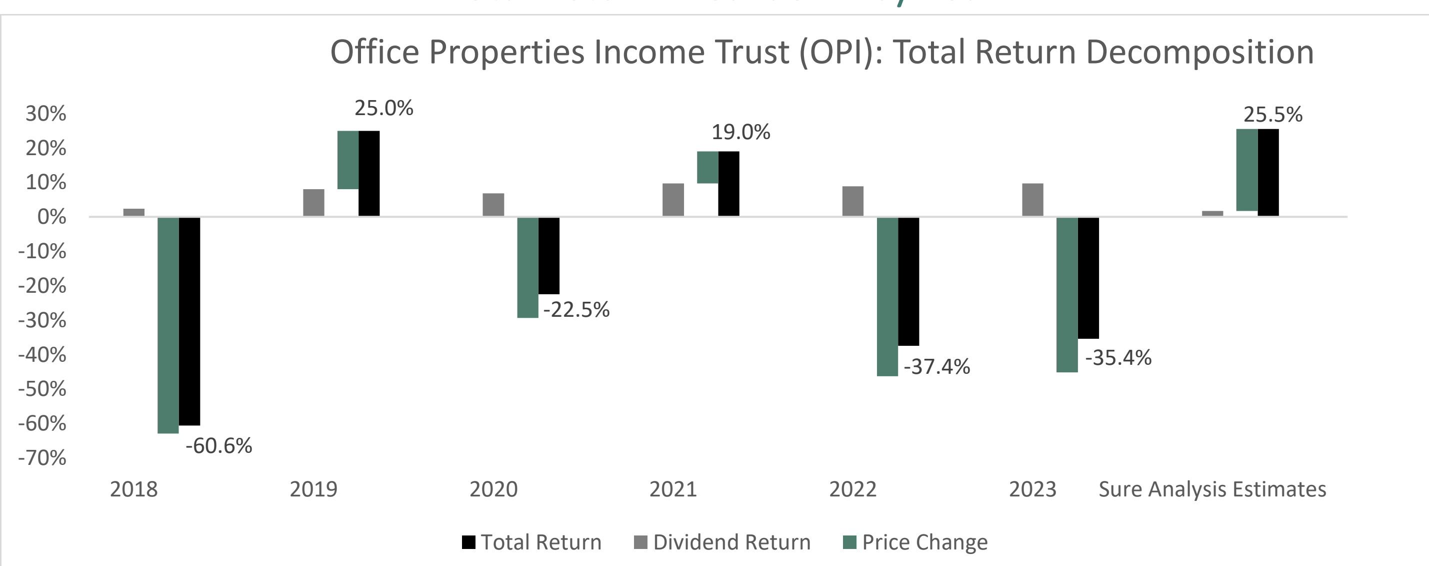
OPI generates 62% of its annual rental income from investment-grade tenants. This is one of the highest percentages of rent paid by investment-grade tenants in the REIT sector. Moreover, U.S. Government tenants generate about 20% of total rental income. This exceptional credit profile constitutes a competitive advantage.

On the other hand, OPI has greatly increased its debt load after its latest acquisition. Its net debt is excessive, as it stands at $2.5 billion, which is about 17 times the annual funds from operations and 22 times the current market cap of the REIT. OPI has a very poor record of enhancing shareholder value. During the last decade, it has plunged 98% whereas the S&P 500 has rallied 175%. The daunting underperformance is a testament to the excessive risk of this REIT. As OPI is also vulnerable to recessions, it is unsuitable for income-oriented investors.

Final Thoughts & Recommendation

Office Properties has plunged -99% in the last 16 months, mostly due to its high debt load and 16-year high interest rates. Due to the brutal sell-off, the stock could offer a 25.5% average annual return over the next five years thanks to its 1.7% dividend and a 28.6% valuation tailwind, partly offset by a -3.0% annual decrease in FFO per share. However, OPI has a very poor record of returns to its shareholders, it has a high debt load and it is vulnerable to recessions. We believe that OPI is suitable only for traders, not for long-term investors, and maintain our sell 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	251	249	258	317	427	678	588	576	554	534
Gross Profit	223	219	227	279	377	605	523	505	496	471
Gross Margin	88.7%	88.0%	88.1%	88.0%	88.3%	89.1%	88.9%	87.5%	89.5%	88.2%
SG&A Exp.	35	33	32	40	51	67	54	52	52	23
D&A Exp.	65	68	71	109	161	287	251	237	217	200
Operating Profit	75	67	68	64	73	127	112	105	111	102
Operating Margin	29.8%	26.9%	26.3%	20.2%	17.2%	18.7%	19.0%	18.2%	20.0%	19.1%
Net Profit	57	(210)	58	12	(22)	30	7	(8)	(6)	(69)
Net Margin	22.5%	-84.5%	22.4%	3.8%	-5.1%	4.5%	1.1%	-1.4%	-1.1%	-12.9%
Free Cash Flow	131	115	127	138	145	215	234	221	193	142
Income Tax	0	0	0	0	0	1	0	0	0	0

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	2,428	2,169	2,385	3,704	5,239	4,193	3,946	4,242	3,980	3,990
Cash & Equivalents	14	9	30	17	35	94	42	83	12	12
Accounts Receivable	36	45	48	61	72	84	102	113	106	133
Total Liabilities	1,130	1,212	1,450	2,353	3,460	2,487	2,337	2,745	2,594	2,734
Accounts Payable	26	51	54	89	146	125	116	143	140	140
Long-Term Debt	1,085	1,146	1,382	2,245	3,255	2,327	2,203	2,578	2,433	2,573
Shareholder's Equity	1,297	957	935	1,330	1,779	1,706	1,609	1,497	1,386	1,256
LTD/E Ratio	0.84	1.20	1.48	1.66	1.83	1.36	1.37	1.72	1.76	2.05

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	2.8%	-9.1%	2.5%	0.4%	-0.5%	0.6%	0.2%	-0.2%	-0.1%	-1.7%
Return on Equity	4.9%	-18.6%	6.1%	1.1%	-1.4%	1.7%	0.4%	-0.5%	-0.4%	-5.3%
ROIC	2.8%	-9.4%	2.6%	0.4%	-0.5%	0.7%	0.2%	-0.2%	-0.2%	-1.8%
Shares Out.	15.4	17.7	17.8	21.2	24.8	48.1	48.2	48.3	48.3	48.4
Revenue/Share	16.35	14.06	14.53	14.96	17.18	14.12	12.22	11.96	11.48	11.03
FCF/Share	8.52	6.53	7.13	6.50	5.84	4.48	4.85	4.60	3.99	2.93

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