



# City Office REIT, Inc. (CIO)

Updated August 2<sup>nd</sup>, 2024 by Nikolaos Sismanis

## Key Metrics

|                             |        |  |        |                                  |                       |
|-----------------------------|--------|--|--------|----------------------------------|-----------------------|
| <b>Current Price:</b>       | \$5.71 | <b>5 Year CAGR Estimate:</b>               | 7.0%   | <b>Market Cap:</b>               | \$229.3M              |
| <b>Fair Value Price:</b>    | \$5.54 | <b>5 Year Growth Estimate:</b>             | -5.0%  | <b>Ex-Dividend Date:</b>         | 10/07/24 <sup>1</sup> |
| <b>% Fair Value:</b>        | 76%    | <b>5 Year Valuation Multiple Estimate:</b> | 5.7%   | <b>Dividend Payment Date:</b>    | 10/24/24              |
| <b>Dividend Yield:</b>      | 7.0%   | <b>5 Year Price Target</b>                 | \$5.83 | <b>Years Of Dividend Growth:</b> | N/A                   |
| <b>Dividend Risk Score:</b> | D      | <b>Retirement Suitability Score:</b>       | B      | <b>Rating:</b>                   | Hold                  |

## 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 23 properties comprising of 56 office buildings with a total of approximately 5.6 million square feet of net rentable area that were approximately 84.5% leased. The trust generates around \$180 million in annual rental revenues and is headquartered in Dallas, Texas.

On August 1<sup>st</sup>, 2024, City Office REIT reported its Q2 results for the period ending June 30<sup>th</sup>, 2024. For the quarter, rental and other revenues were \$42.3 million, down 5.1% year-over-year. Renewal cash rents increased 4.3% as compared to expiring cash rents, but rental revenues fell due to recent property disposals.

Same-Store Cash NOI (Net Operating Income) fell by 2.0% as compared to Q2-2023. Further, due to higher interest expenses, FFO fell by 21% to \$10.4 million. On a per-share basis, FFO came in at \$0.25 compared to \$0.32 last year. At the end of the quarter, occupancy stood at 83% at the end of the quarter, stable sequentially.

For FY2024, the company reiterated its outlook, expecting core FFO/share to be between \$1.14 and \$1.18, the midpoint of which we have utilized in our estimates.

## Growth on a Per-Share Basis

| Year                      | 2014 | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   | 2023   | 2024          | 2029          |
|---------------------------|------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>FFO/shr</b>            | ---  | \$1.23 | \$1.04 | \$0.97 | \$1.08 | \$1.17 | \$1.17 | \$1.36 | \$1.48 | \$1.28 | <b>\$1.16</b> | <b>\$0.90</b> |
| <b>DPS</b>                | ---  | \$0.65 | \$0.94 | \$0.94 | \$0.94 | \$0.94 | \$0.60 | \$0.65 | \$0.80 | \$0.50 | <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   | 43.5   | 42.1   | 39.9   | <b>40.2</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 is over, 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 estimate to a negative 5% through 2029. 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.

<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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## Valuation Analysis

| Year       | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Now  | 2029 |
|------------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/FFO | ---  | 10.5 | 12.8 | 12.8 | 10.6 | 11.5 | 8.5  | 12.5 | 8.4  | 5.3  | 4.9  | 6.5  |
| Avg. Yld.  | ---  | 5.0% | 7.1% | 7.6% | 8.2% | 7.0% | 6.0% | 4.7% | 6.4% | 7.3% | 7.0% | 7.9% |

City Office has traded at a very reasonable P/FFO multiple, which has averaged around 10. 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 depressed P/FFO of 4.9. We believe City Office is undervalued at current levels, but can see a humble valuation persisting moving forward, though multiple expansion is possible. The current yield is substantial despite the recent cut.

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

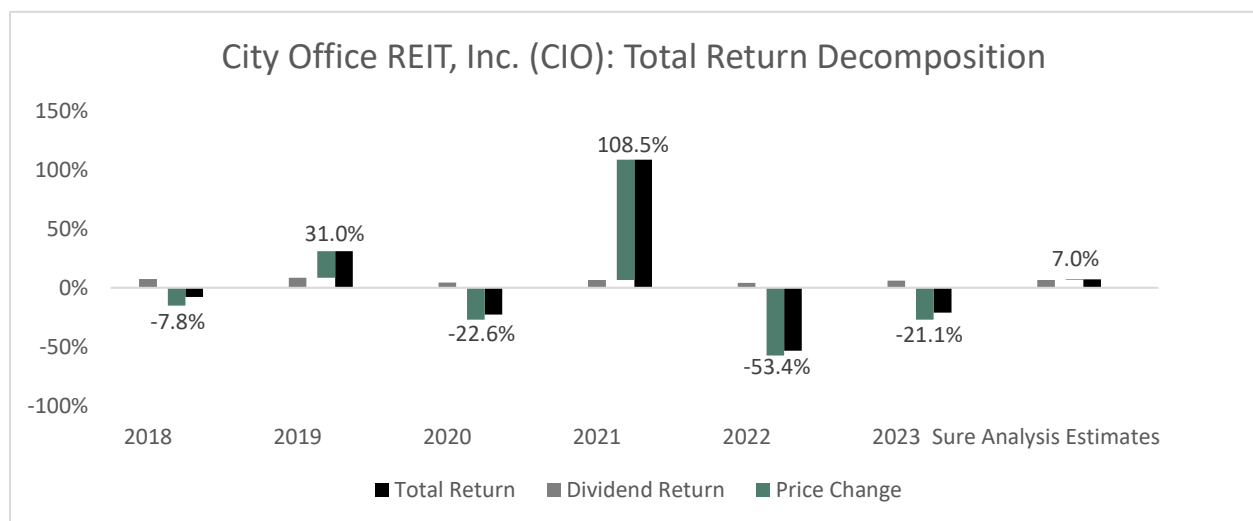
| Year   | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | ---  | 53%  | 90%  | 97%  | 87%  | 80%  | 51%  | 48%  | 54%  | 39%  | 34%  | 52%  |

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 \$0.40, the trust pays out only 34% of its total FFO. Amongst its qualities, we note that the REIT's portfolio of properties has an average remaining lease term of 4.5 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% of its total rentable area and no tenant accounting for more than 3.6%. In fact, some of its tenants, like United Health Services, Ally Financial, and Kaplan, are not only credible companies with robust financials, but have been accommodated by City Office since 2008. Hence, they have a long-term relationship with the trust. City Office features a weighted average interest rate of 5.0% and a weighted average debt maturity of just 2.3 years. With commercial properties battling with refinancing issues these days, City Office could come under heavy pressure once its maturities hit.

## 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 7.0% in the medium-term, primarily driven by the 7.0% yield and the possibility for a valuation expansion, offset by a potentially declining FFO/share. Hence, shares earn a hold 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          | 37    | 55     | 72    | 106   | 129   | 156   | 161   | 164   | 180.5 | 179    |
| Gross Profit     | 23    | 35     | 44    | 64    | 80    | 99    | 103   | 106   | 113   | 109    |
| Gross Margin     | 61.2% | 62.9%  | 60.9% | 59.7% | 61.5% | 63.3% | 63.7% | 64.6% | 62.6% | 60.9%  |
| SG&A Exp.        | 3     | 5      | 7     | 7     | 8     | 11    | 11    | 15    | 14    | 15     |
| D&A Exp.         | 15    | 22     | 30    | 42    | 52    | 59    | 60    | 57    | 63    | 63     |
| Operating Profit | 5     | 8      | 7     | 15    | 19    | 29    | 31    | 33    | 36.5  | 31     |
| Operating Margin | 12.9% | 14.5%  | 10.3% | 14.3% | 14.8% | 18.4% | 19.6% | 20.1% | 20.2% | 17.3%  |
| Net Profit       | (3)   | (7)    | (1)   | 6     | 38    | 2     | 5     | 484   | 17    | (3)    |
| Net Margin       | -8.2% | -12.0% | -1.2% | 5.4%  | 29.5% | 1.2%  | 2.8%  | 295%  | 9.4%  | (1.7%) |
| Free Cash Flow   | 8     | 14     | 19    | 37    | 42    | 49    | 60    | 73    | 107   | 57     |

## Balance Sheet Metrics

| Year                 | 2014 | 2015 | 2016 | 2017 | 2018  | 2019  | 2020  | 2021  | 2022  | 2023  |
|----------------------|------|------|------|------|-------|-------|-------|-------|-------|-------|
| Total Assets         | 302  | 440  | 661  | 896  | 1,100 | 1,228 | 1,157 | 1,602 | 1,574 | 1,511 |
| Cash & Equivalents   | 35   | 8    | 14   | 12   | 16    | 70    | 25    | 21    | 28    | 30    |
| Accounts Receivable  | 1    | 1    | 2    | 2    | 2     | 3     | 2     | 3     | 5     | 5     |
| Goodwill & Int. Ass. | 29   | 41   | 56   | 65   | 76    | 68    | 44    | 69    | 55    | 42    |
| Total Liabilities    | 210  | 366  | 405  | 537  | 702   | 679   | 739   | 731   | 771   | 739   |
| Accounts Payable     | 4    | 9    | 13   | 18   | 26    | 29    | 25    | 27    | ---   | ---   |
| Long-Term Debt       | 190  | 341  | 370  | 490  | 645   | 607   | 677   | 654   | 690   | 670   |
| Shareholder's Equity | 80   | 66   | 142  | 248  | 285   | 436   | 305   | 758   | 691   | 660   |
| LTD/E Ratio          | 2.37 | 5.18 | 1.46 | 1.36 | 1.62  | 1.11  | 1.62  | 0.75  | 0.86  | 0.87  |

## Profitability & Per Share Metrics

| Year             | 2014  | 2015  | 2016  | 2017 | 2018  | 2019 | 2020 | 2021  | 2022 | 2023   |
|------------------|-------|-------|-------|------|-------|------|------|-------|------|--------|
| Return on Assets | -1.4% | -1.8% | -0.2% | 0.7% | 3.8%  | 0.2% | 0.4% | 35.1% | 1.1% | (0.1%) |
| Return on Equity | -5.7% | -9.0% | -0.8% | 3.0% | 14.3% | 0.5% | 1.2% | 91.2% | 2.4% | (0.3%) |
| ROIC             | -1.5% | -1.9% | -0.2% | 0.8% | 4.0%  | 0.2% | 0.4% | 37.0% | 1.1% | (0.2%) |
| Shares Out.      |       | 12.4  | 20.5  | 30.2 | 37.3  | 44.0 | 47.2 | 44.1  | 42.9 | 39.9   |
| Revenue/Share    | 4.35  | 4.44  | 3.54  | 3.53 | 3.44  | 3.55 | 3.41 | 3.72  | 4.21 | 4.49   |
| FCF/Share        | 0.92  | 1.14  | 0.94  | 1.21 | 1.12  | 1.13 | 1.27 | 1.66  | 2.49 | 1.43   |

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

### Disclaimer

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