



Equity Commonwealth

NYSE: EQC

Sector: Real Estate

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Industry Definition

- REITS are either Equity, Mortgage or Hybrid
 - Office REITs are Equity REITs
- Office REITs are of three classifications: Central Business District (CBD), Suburban or Urban infill
- Most Office REITs are now operating in all markets and focus on owning the best assets
- All REITS must generate **75%** of their income from real estate or rental income
- **90%** of taxable net income must be distributed to shareholders



SL Green Realty Corp
(NYSE:SLG)



Equity Commonwealth
(NYSE: EQC)



Boston Properties, Inc.
(NYSE: BXP)



Piedmont Office Realty Trust, Inc.
(NYSE: PDM)



Douglas Emmett, Inc.
(NYSE: DEI)



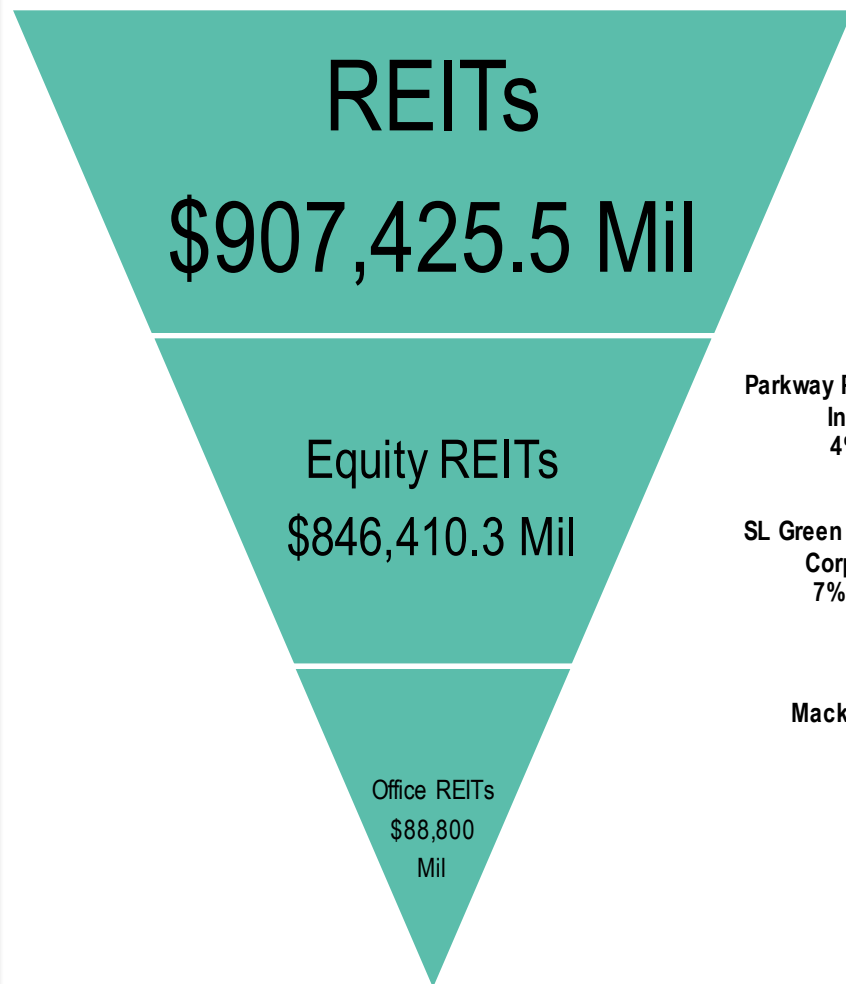
Kilroy Realty Corp
(NYSE: KRC)



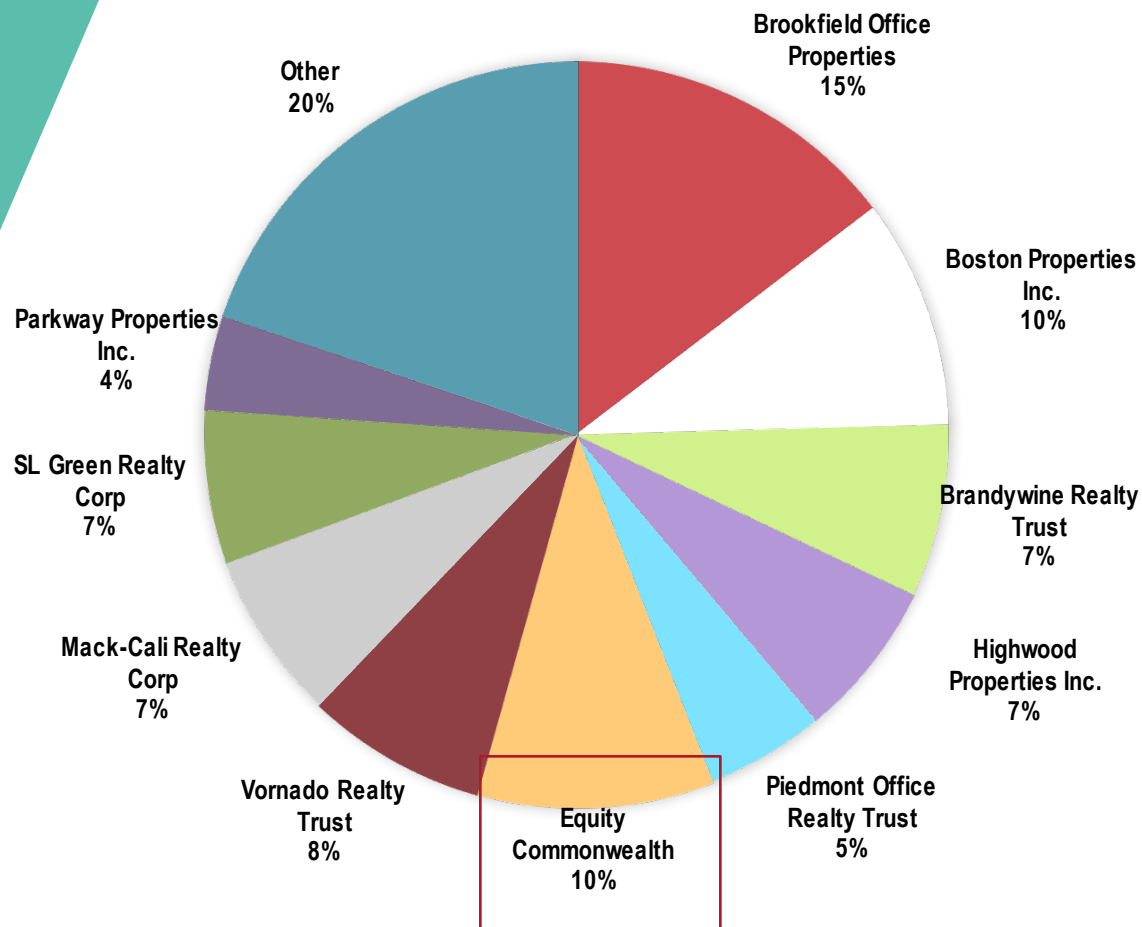
Vornado Realty Trust
(NYSE: VNO)



Columbia Property Trust, Inc.
(NYSE: CXP)



Industry Breakdown by Market Cap



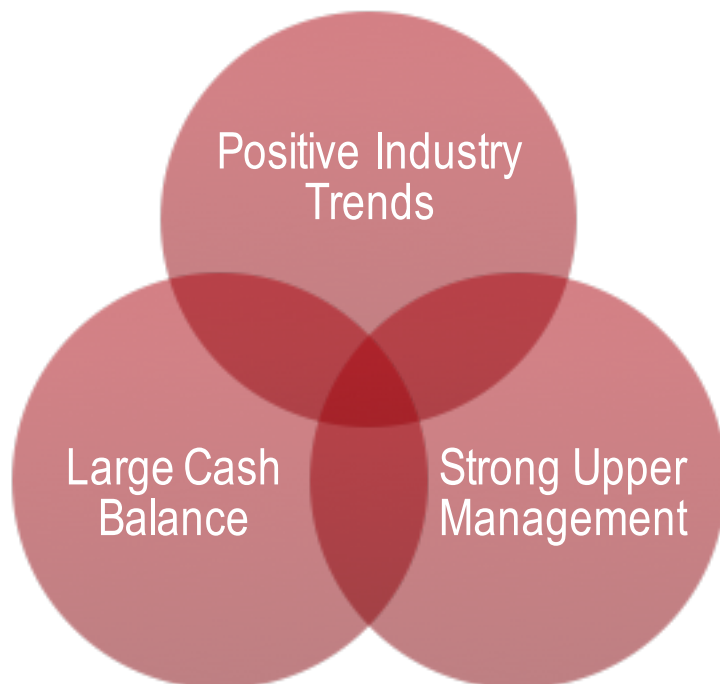
Revenue Generation Model



Valuation Summary

Recommendation

HOLD



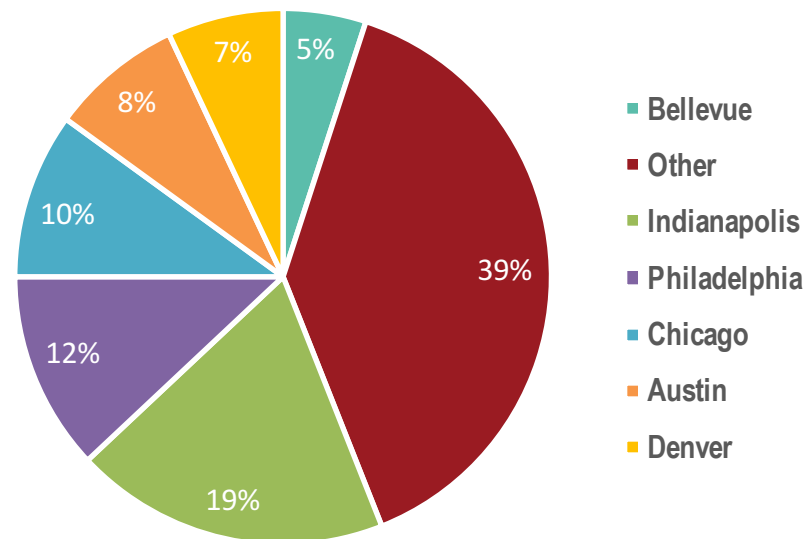
Recommendation Summary		
Company (Ticker)	EQC	
Current Trading Price (04-17-2016)	\$28.30	
Recommendation	Hold	
Target Price	\$31.13	
Upside Potential	10.0%	
Valuation Summary		
Method	Price	Weight
Discounted Cash Flow		
Perpetuity Growth Method	\$27.92	25%
Exit Multiple Method	\$34.77	25%
Comparable Company Analysis		
P/FFO	\$24.71	25%
EV/EBITDA	\$37.13	25%
Target Price	\$31.13	

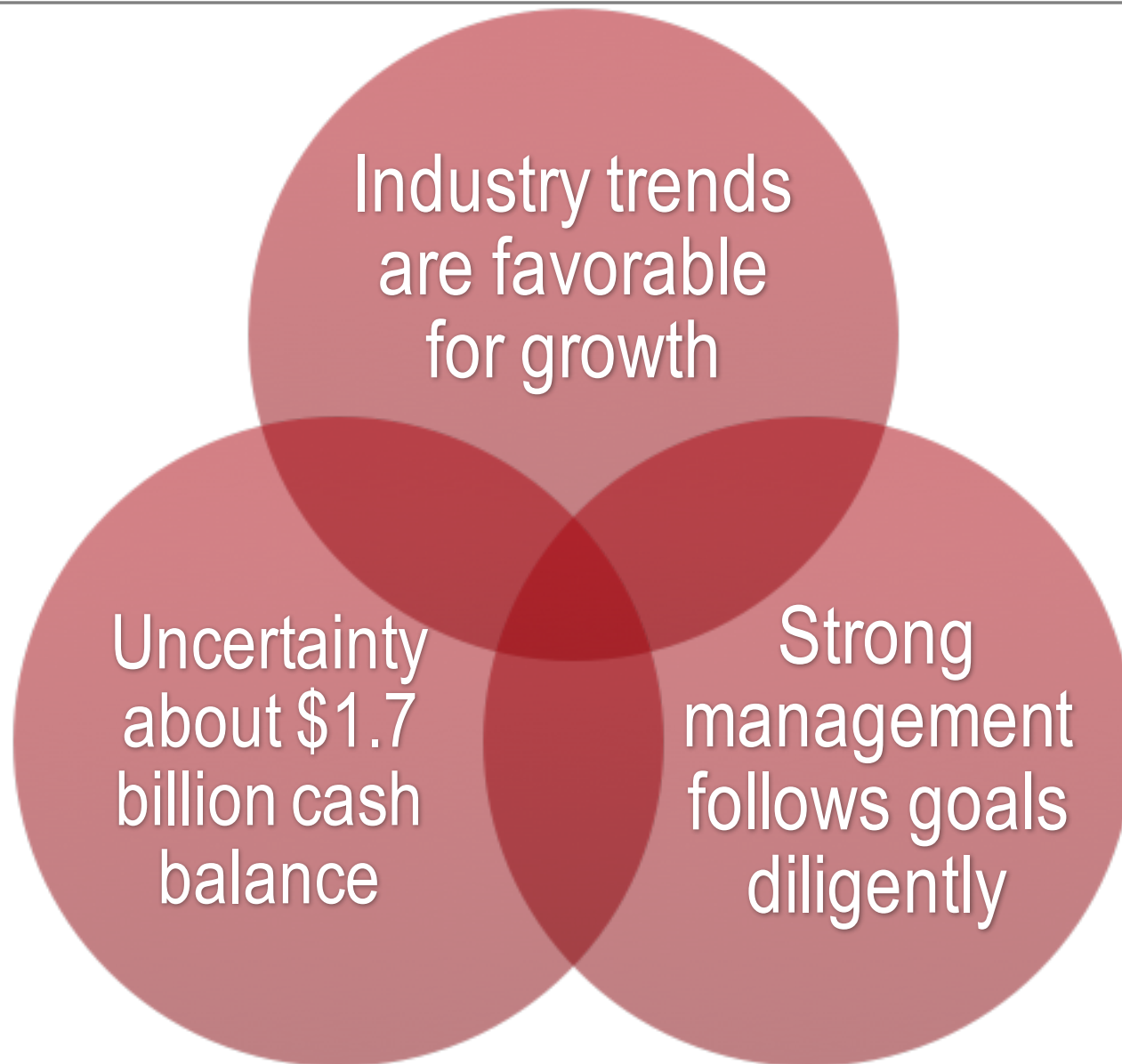
Company Overview

Portfolio/Property Name	Properties	Buildings	Sq. ft. (000's)	Average Size Buildings (000's)	% Leased	Annualized Rental Revenue (000's)	ARR Per Leased SF
Portfolio as of March 31, 2015	154	259	42,752	165	85.90%	\$774,422	\$21.09
Portfolio as of December 31, 2015	65	127	23,952	189	91.40%	\$490,069	\$22.38

- Equity Commonwealth is an Office REIT that owns 64 properties totaling 23.5 million Sq. ft.
- Currently sitting on \$1.7 Billion in cash (\$3.5 bn. Market Cap)
- Since being under new management in 2014:
 - Went from 170 properties to 64 properties
 - Including \$3 Billion in disposition activities
- \$714.9 million in revenue for 2015
- Top 30 Properties make up 87% of Annualized Rental Revenue

% ANNUALIZED RENTAL REVENUE BY MARKET

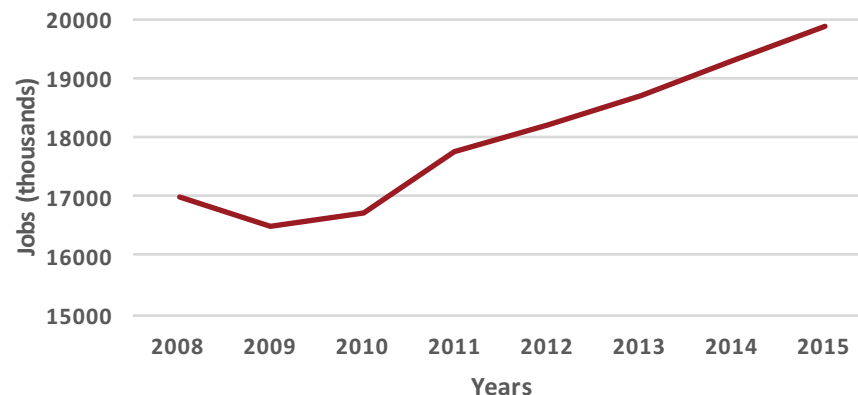




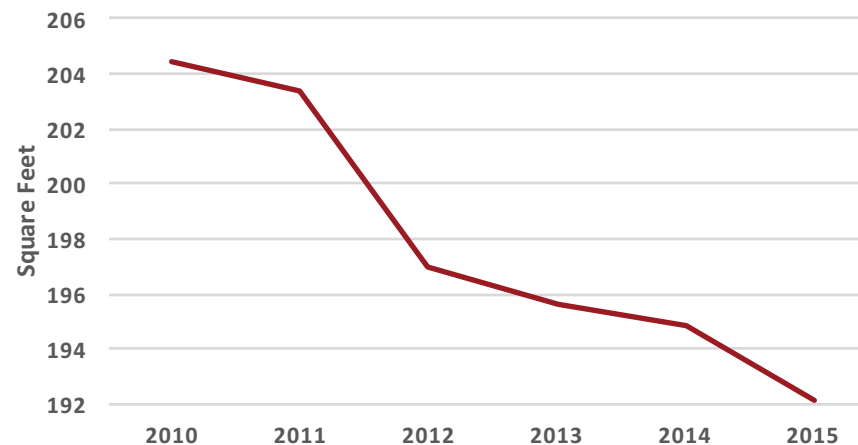
Despite first quarter recession fears, CRE growth looks promising

- Office space per employee **fell to 192 sq. ft. from 205 sq. ft.** from 2010 to 2015
- Amount of professional and business service jobs **increasing** at steady rate since 2010
- Showing signs of need for **more development** and move to markets less saturated
- Employment in U.S at **143.8 million**
- Leasing volume down to **50 million sq. ft.** in the first quarter
- Asking rents **grew 3.2%**

Professional and Business Service Jobs

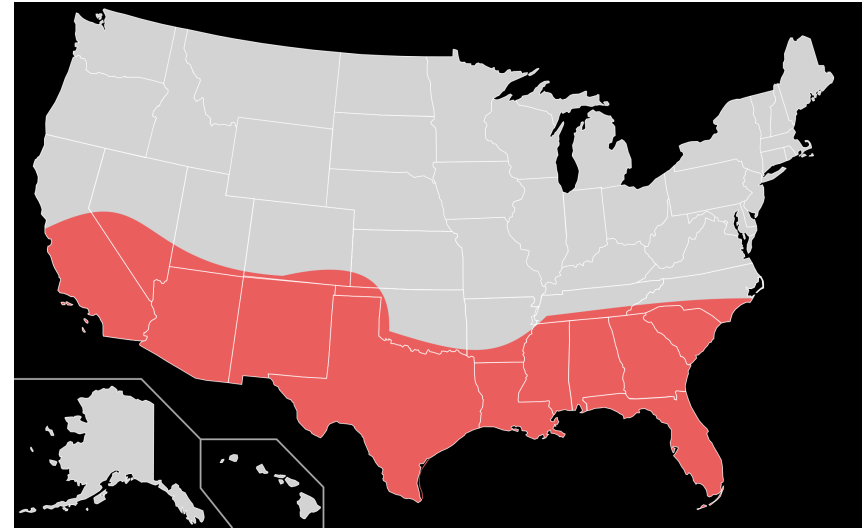


Office Space Per Employee

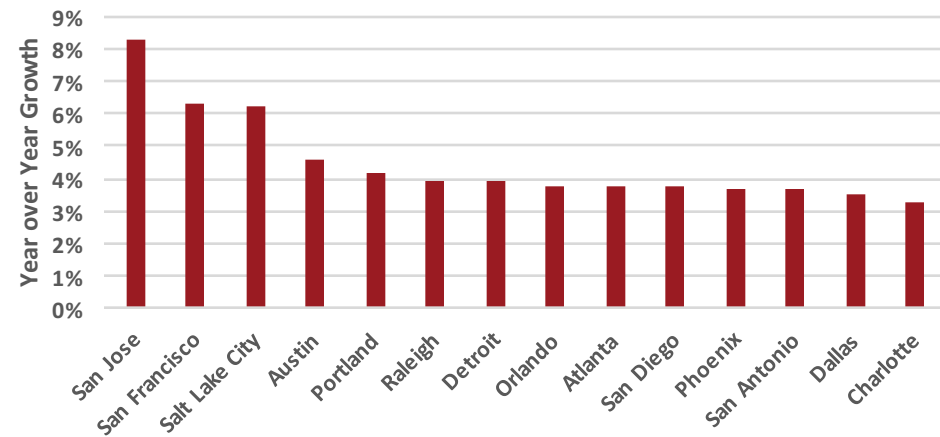


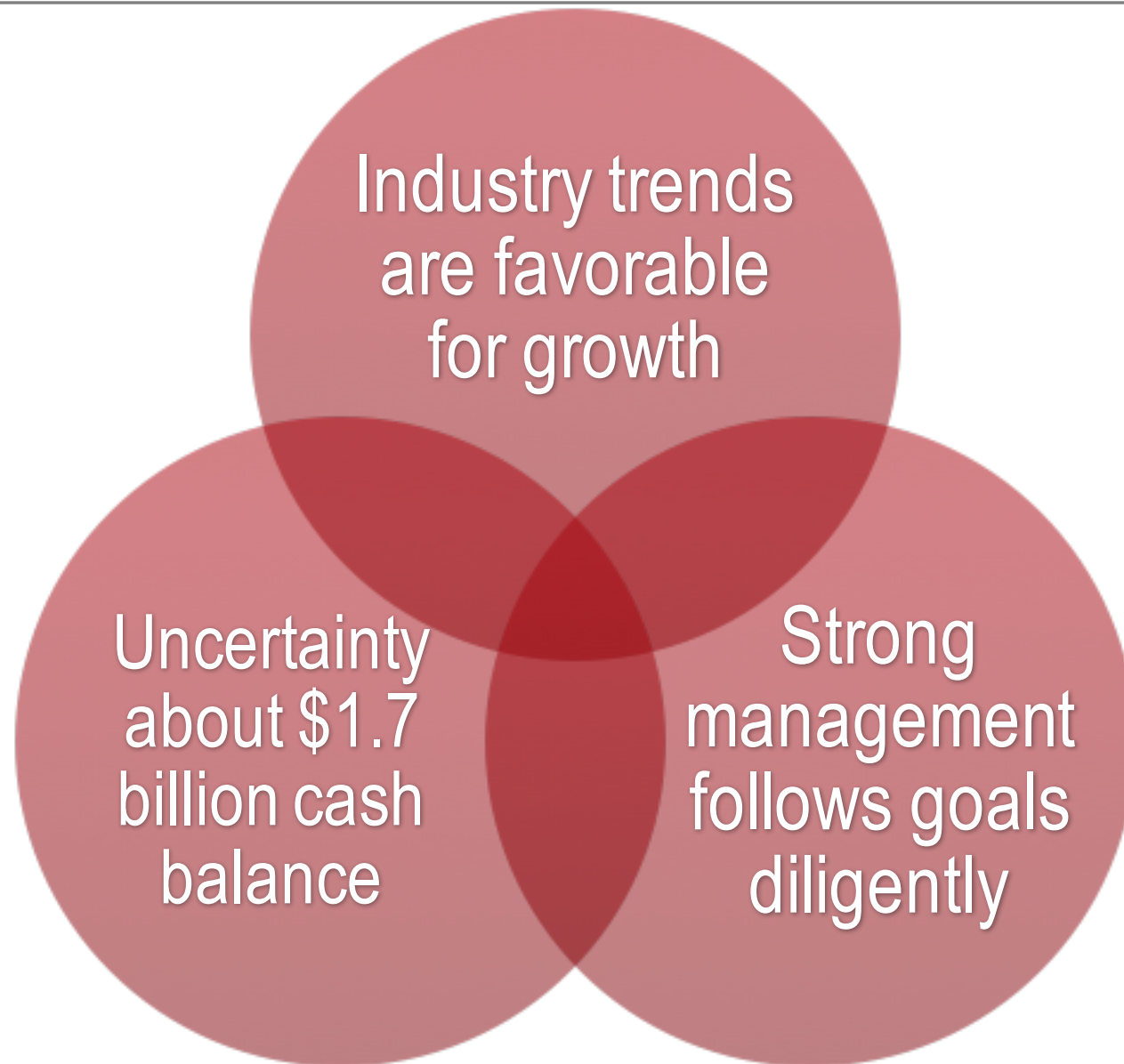
Conclusion: EQC's portfolio positioned well to avoid slumping primary market and benefit from growing secondary market

- **20.5%** growth in CBD office values
- EQC focusing on acquiring bigger properties in city locations
- EQC highly exposed to sunbelt properties benefitting from increased cost of having office space in bigger cities
- Nationwide office rental asking prices **rose 4 percent** in 2015
- Pwc in CRE outlook predicts growth for 2016 expected in secondary and tertiary markets
- EQC has **22** properties in the sunbelt



Top Cities for Office Employment Growth from 4Q 2015

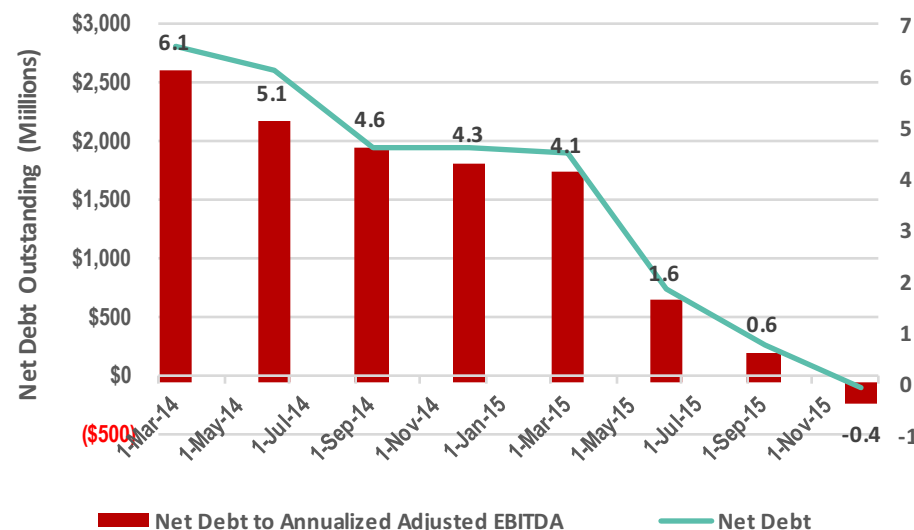




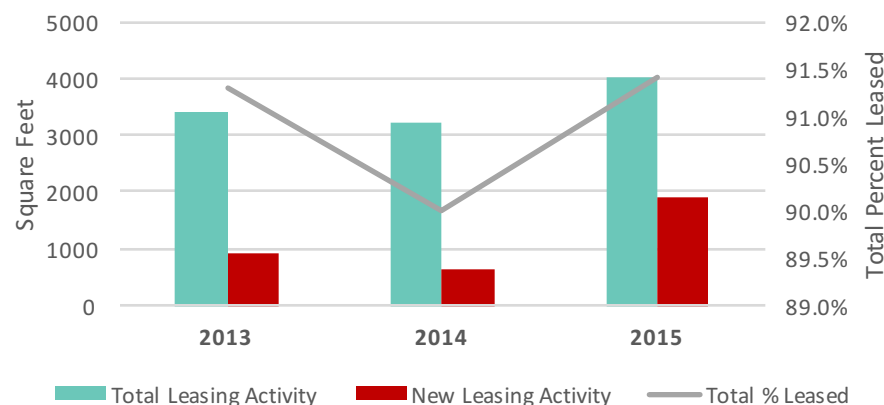
Strong Upper Management Follows Goals Diligently

- New management set out to structure portfolio based on a few simple rules
 - US properties
 - Properties over 150,000 sq. ft.
 - 90% lease occupancy rate or above
- Now have negative debt outstanding
- Lease occupancy rate **91.4%**
- Same site revenue showing positive growth
- Net debt went from **6.1x EBITDA** to **-0.4x**
- Overall net debt is **-\$230.7 million**

Net Debt to Adjusted Annualized EBITDA

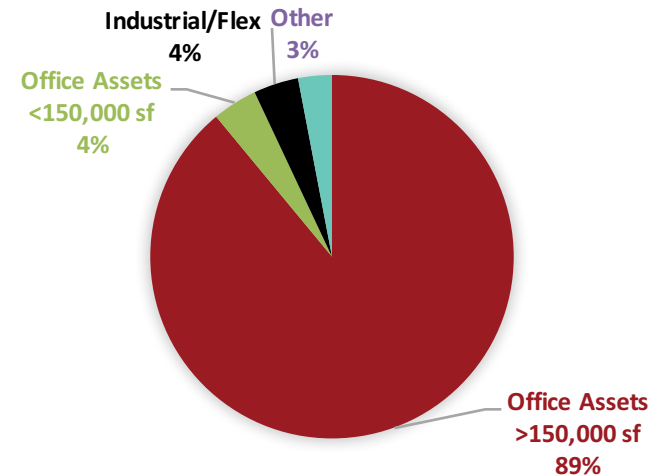


Same Property Leasing Activity

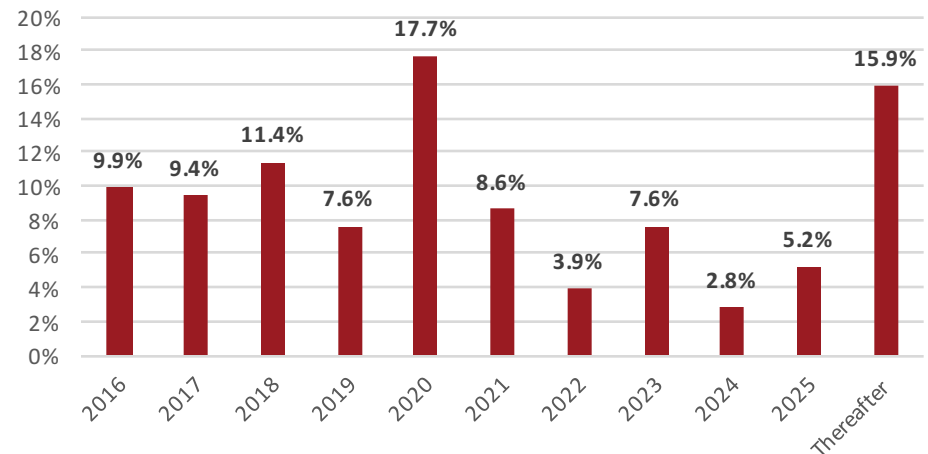


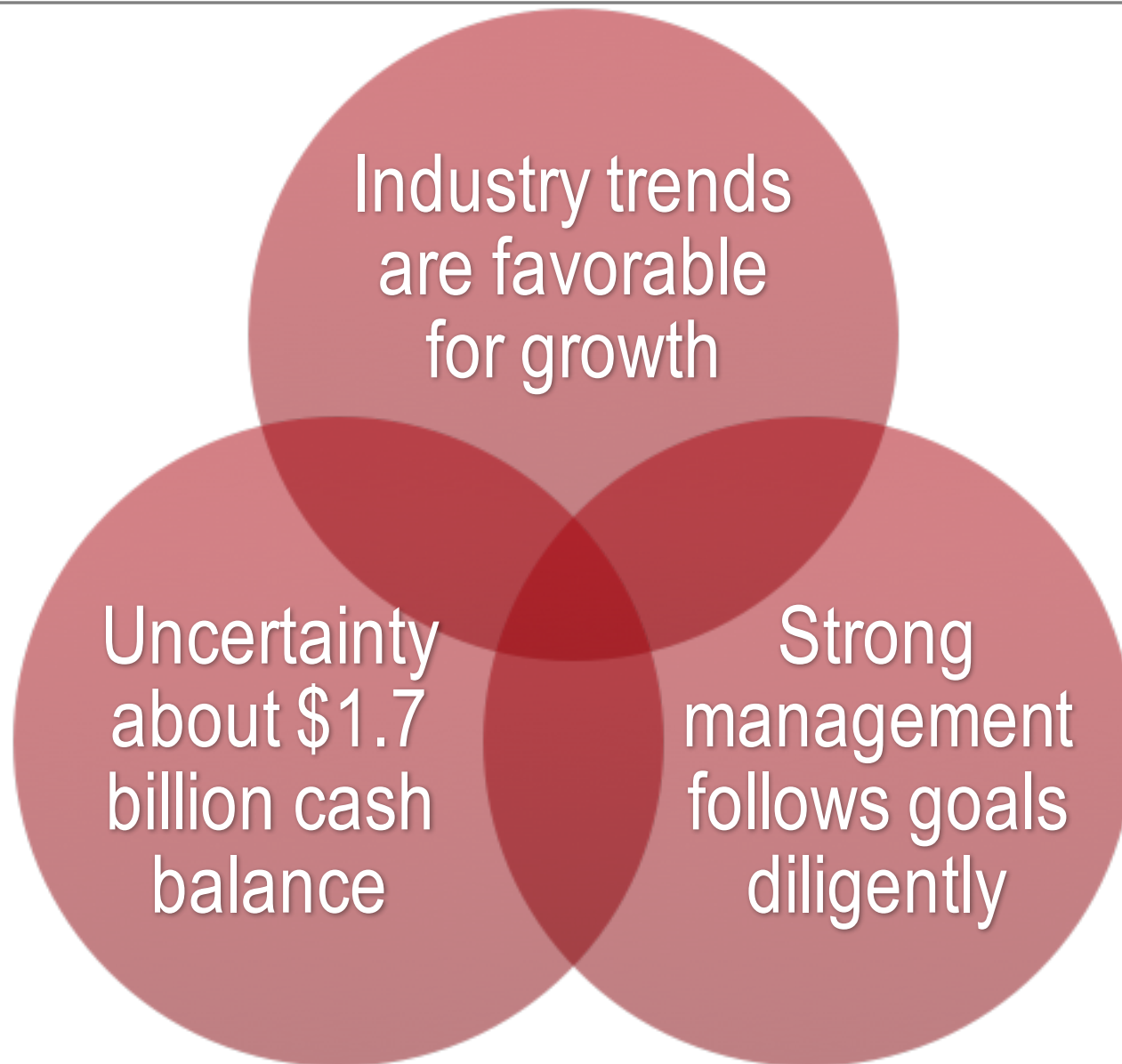
- Manageable lease expiration
- Diversified tenant base as no tenant represents more than **15% of ARR**
- Office assets greater than 150,000 sq. ft. make up **89% of the portfolio**

% ANNUALIZED RENTAL REVENUE BY TYPE



Lease Expiration Schedule

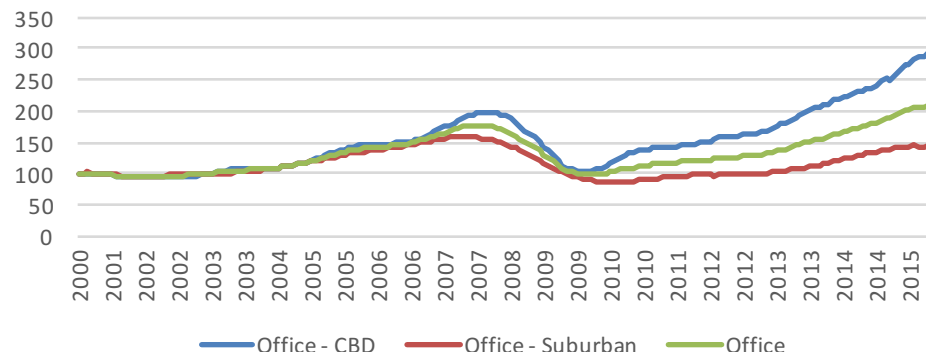




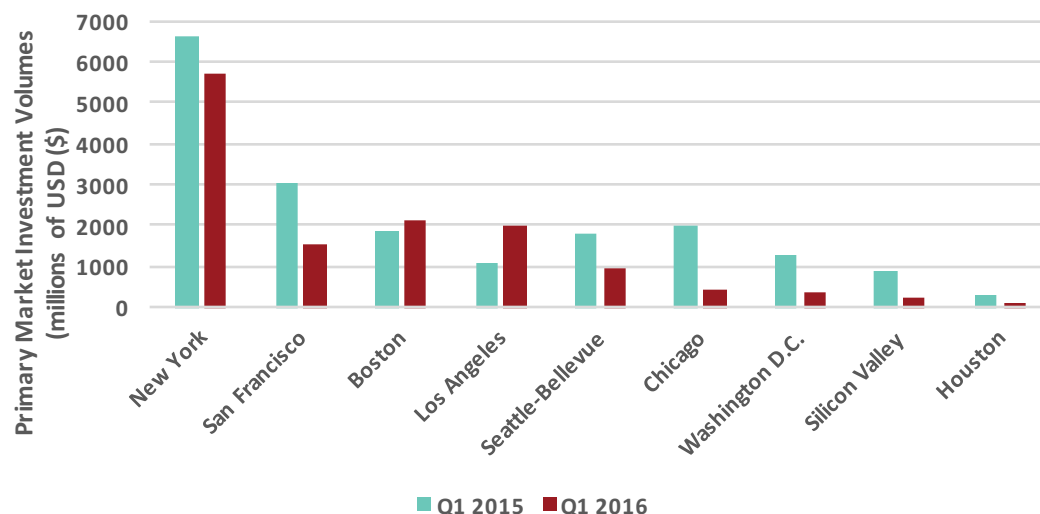
Uncertainty about \$1.7 Billion Cash Balance

- 2016 priorities
 - Continue executing disposition strategy
 - Continue entrepreneurial approach to leasing and ownership of the portfolio
 - Further de-lever
 - Use sales proceeds to continue paying off debt (up to \$875mm)
 - Focus on disciplined capital allocation
- Believes US will enter into mild recession
 - “Ninth inning of the current economic cycle”
- Recent macro-economic trends make it a recession prediction tough
 - Slight leveling off of CRE prices
 - Leasing volume down to 50 million sq. ft. in Q1
 - Secondary markets receiving more investment

Office Price Indices



Primary Market Investment Volumes



Conclusion: Growth of the company portfolio remains uncertain

BEGIN VALUATION

Comparable Yields Mixed Results

Company	EV	Market Cap	EBITDA	NI	EV/EBITDA	P/FFO	P/FFO 2016E	P/FAD
Equity Commonwealth	3818.23	3461.68	284.4	82.4	13.43	18.12	26.6	40.15
Piedmont	4998.29	2863.54	312.7	213.4	15.98	11.87	12.4	16.31
Douglas Emmett	8325.71	5115.14	394.8	58.4	21.09	19.13	18.18	24.3
Columbia	4466.18	2623.31	314.1	47.8	14.22	12.17	14	16.25
Kilroy Realty	7736.11	5422.14	373.7	220.8	20.70	18.67	18.18	29.48
High					21.09	19.13	26.6	40.15
Mean					17.08	15.99	17.87	25.30
Median					15.98	18.12	18.18	24.3
Low						11.87	12.4	16.25

P/FFO

LTM FFO \$198.70

Implied Price Target \$24.7052

Upside (Downside) % -11.6%

EV/ EBITDA

LTM EBITDA \$284.40

Implied Price Target \$37.4279

Upside (Downside) % 32.3%

	2016	2017	2018	2019	2020
FCF	163.78	148.28	151.00	153.78	156.61
NPV	648.71				

WACC Calculation:

Cost of Debt	5.03%
% Weight	36%
Cost of Equity	6.85%
% Weight	64%
WACC	6.19%

Key Assumptions

CAPM	6.85%
Cost of Debt	5.03%
WACC	6.19%
Terminal Growth Rate	1.84%
EBITDA Multiple	13.43%

DCF Valuation

Perpetuity Growth Method

Growth Rate	1.84%
Undiscounted TEV	\$ 3,663.08
Discounted TEV	\$ 2,712.52
DCF Value	\$ 3,361.22
Equity Value	\$ 3,591.39
Share Price	\$ 27.92
Implied Exit Multiple	10.13x

		WACC				
		5.19%	5.69%	6.19%	6.69%	7.19%
Terminal Growth Rate	2.84%	48.13	40.10	34.48	30.33	27.15
	2.34%	40.73	35.00	30.78	27.53	24.97
	1.84%	35.54	31.23	27.92	25.31	23.20
	1.34%	31.69	28.32	25.66	23.50	21.73
	0.84%	28.73	26.01	23.81	22.00	20.49
	0.34%	26.37	24.13	22.29	20.74	19.43

Exit Multiple Method

EBITDA Multiple	13.43x
Undiscounted TEV	\$ 4,852.53
Discounted TEV	\$ 3,593.31
DCF Value	\$ 4,242.01
Equity Value	\$ 4,087.52
Share Price	\$ 31.78
Implied Growth Rate	2.87%

		WACC				
		5.19%	5.69%	6.19%	6.69%	7.19%
Terminal EBITDA Multiple	15.43x	37.50	36.71	35.94	35.20	34.47
	14.43x	35.31	34.58	33.86	33.16	32.49
	13.43x	33.13	32.45	31.78	31.13	30.50
	12.43x	30.95	30.32	29.70	29.10	28.51
	11.43x	28.77	28.19	27.62	27.07	26.53
	10.43x	26.59	26.05	25.54	25.03	24.54

Conclusion: Change in growth expectations could lead to buy recommendation

Recommendation

HOLD

- Despite recommendation, we still feel EQC is a good company with a strong management
- Buy if price drops below **\$27.07**

Name	Cell Value	Formula	Status	Slack
		$\$C\$15=0.1$		
Upside Potential Hold	15.0%5		Binding	0

Recommendation Summary

Company (Ticker)	EQC
Current Trading Price (MM-DD-YYYY)	\$ 28.30
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Valuation Summary

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Target Price	\$ 31.13	

BACK UP SLIDES

Income Statement



Equity
Commonwealth

	<u>Historical</u>					<u>Forecasted</u>				
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	874.2	1,013.1	953.0	861.9	714.9	728.0	741.4	755.1	768.9	783.1
% growth		15.9%	-5.9%	-9.6%	-17.1%	1.8%	1.8%	1.8%	1.8%	1.8%
COGS (excl. D&A)	(412.6)	(425.3)	(371.2)	(573.1)	(342.1)	(334.2)	(340.3)	(346.6)	(352.9)	(359.4)
% of Revenue	47.19%	41.98%	38.95%	66.49%	47.85%	45.90%	45.90%	45.90%	45.90%	45.90%
Gross Profit	461.6	587.8	581.8	288.8	372.8	393.9	401.1	408.5	416.0	423.6
% Margin	52.8%	58.0%	61.1%	33.5%	52.1%	54.1%	54.1%	54.1%	54.1%	54.1%
SG&A	(46.8)	(51.7)	(77.2)	(113.2)	(57.5)	-57.8	34676	(58.9)	(60.0)	(62.2)
% of Revenue	5.35%	5.10%	8.10%	13.13%	8.04%	7.94%	7.94%	7.94%	7.94%	7.94%
EBITDA	414.9	536.1	504.6	175.6	315.3	336.0	342.2	348.5	354.9	361.4
% Margin	47.5%	52.9%	52.9%	20.4%	44.1%	46.2%	46.2%	46.2%	46.2%	46.2%
Depreciation	(218.7)	(245.7)	(218.9)	(227.5)	(194.0)	(140.7)	(143.3)	(145.9)	(148.6)	(151.3)
Total D&A	(218.7)	(245.7)	(218.9)	(227.5)	(194.0)	(140.7)	(143.3)	(145.9)	(148.6)	(151.3)
Total Operating Expenses	(265.4)	(297.4)	(296.1)	(340.7)	(251.5)	(198.5)	(202.2)	(205.9)	(209.7)	(213.6)
Operating Income (EBIT)	196.2	290.3	285.8	(51.9)	121.3	195.3	198.9	202.6	206.3	210.1
% Margin	22.4%	28.7%	30.0%	-6.0%	17.0%	26.8%	26.8%	26.8%	26.8%	26.8%
Interest Expense	(195.0)	(204.2)	(173.0)	(143.2)	(107.4)	(56.9)	(56.9)	(56.9)	(56.9)	(56.9)
Interest Income	1.7	1.4	1.2	1.6	6.0	6.0	6.0	6.0	6.0	6.0
Net Interest Inc. (Exp)	(193.3)	(202.8)	(171.8)	(141.7)	(101.4)	(50.9)	(50.9)	(50.9)	(50.9)	(50.9)
Other Non-Operating Income	11.3	9.5	(34.3)	29.4	82.2	-	-	-	-	-
EBT Excl. Unusual Items	14.2	97.0	79.7	(164.2)	102.2	144.4	148.0	151.6	155.4	159.1
% Margin	1.6%	9.6%	8.4%	-19.1%	14.3%	19.8%	20.0%	20.1%	20.2%	20.3%
Gain on Sale of Equity	11.2	7.2	66.3	188.6	-	-	-	-	-	-
EBT Incl. Gain on Sale of Equity	25.4	104.3	146.0	24.4	102.2	144.4	148.0	151.6	155.4	159.1
Income Tax Expense	(1.3)	(3.2)	(2.6)	(3.2)	(2.4)	4.7490626	4.9	5.0	5.1	5.2
Earnings from Cont. Ops	24.1	101.1	143.3	21.2	99.8	149.1	152.8	156.6	160.5	164.4
Earnings from Discounted Ops.	48.2	(180.9)	(232.8)	2.8	-	-	-	-	-	-
Extraord Item & Acct. Change	-	(15.6)	(20.1)	-	-	-	-	-	-	-
Net Income to Company	72.2	(95.4)	(109.6)	24.0	99.8	149.1	152.8	156.6	160.5	164.4
Preferred and Other Distributions	(47.0)	(56.5)	(44.6)	(48.3)	(27.9)	-41.723746	-42.761693	-43.818727	-44.895197	-45.991463
Net Income	25.3	(152.0)	(154.2)	(24.3)	71.9	107.4	110.1	112.8	115.6	118.4
% Margin	2.9%	-15.0%	-16.2%	-2.8%	10.1%	14.8%	14.8%	14.9%	15.0%	15.1%
EPS	\$ 0.33	\$ (1.81)	\$ (1.37)	\$ (0.19)	\$ 0.56	0.8132013	\$ 0.81	\$ 0.81	\$ 0.81	\$ 0.81

Balance Sheet



Equity
Commonwealth

	<u>Historical</u>					<u>Forecasted</u>				
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Cash And Equivalents	192.8	102.2	222.2	379.1	1,802.7	1,872.2	1,925.1	1,979.6	2,035.9	2,093.9
Accounts Receivable	225.5	270.0	245.87	265.816	206.921	201.0	204.7	208.4	212.3	216.2
Total Receivables	225.5	270.0	245.9	265.8	206.9	201.0	204.7	208.4	212.3	216.2
Total Current Assets	418.2	372.2	468.1	644.9	2,009.7	2,073.1	2,129.7	2,188.1	2,248.2	2,310.1
Gross Property, Plant & Equipment	7244.232	7829.409	5537.165	5728.443	3887.352	4,083.0	4,282.3	4,485.2	4,691.9	4,902.3
Accumulated Depreciation	-934.17	-1007.606	-895.059	-1030.445	-898.939	(1,039.6)	(1,182.9)	(1,328.9)	(1,477.5)	(1,628.8)
Other Long-Term Assets	718.74	995.592	1536.009	418.767	246.309	246.3	246.3	246.3	246.3	246.3
Total Assets	7,447.0	8,189.6	6,646.2	5,761.6	5,244.4	5,362.8	5,475.4	5,590.7	5,708.8	5,829.8
Accounts Payable	169.567	207.142	175.24	162.204	123.587	134.6	137.1	139.6	142.2	144.8
Total Current Liabilities	169.6	207.1	175.2	162.2	123.6	134.6	137.1	139.6	142.2	144.8
Long Term Debt	3577.331	4349.821	3005.41	2207.665	1710.324	1,710.3	1,710.3	1,710.3	1,710.3	1,710.3
Capital Leases & Current Portion	70.179	69.304	33.935	26.784	4.296	4.3	4.3	4.3	4.3	4.3
Other Non-Current Liabilities	61.432	457.939	68.263	45.403	37.678	37.7	37.7	37.7	37.7	37.7
Total Liabilities	3,878.5	5,084.2	3,282.8	2,442.1	1,875.9	1,886.9	1,889.4	1,891.9	1,894.5	1,897.1
Common and Preferred Stock	0.837	0.838	1.184	1.296	1.263	1.3	1.3	1.3	1.3	1.3
Additional Paid In Capital	4392.755	4219.061	4847.135	4871.79	4799.265	4,799.3	4,799.3	4,799.3	4,799.3	4,799.3
Retained Earnings	2482.321	2386.9	2209.84	2233.852	2333.709	2,441.1	2,551.2	2,664.0	2,779.6	2,898.0
Treasury Stock	-	-	-	-	-	-	-	-	-	-
Comprehensive Inc. and Other	-3307.396	-3501.371	-3694.573	-3787.355	-3765.75	(3,765.8)	(3,765.8)	(3,765.8)	(3,765.8)	(3,765.8)
Total Common Equity	3,568.5	3,105.4	3,363.6	3,319.6	3,368.5	3,475.9	3,586.0	3,698.8	3,814.3	3,932.7
Minority Interest	-	-	-	-	-	-	-	-	-	-
Total Equity	3,568.5	3,105.4	3,363.6	3,319.6	3,368.5	3,475.9	3,586.0	3,698.8	3,814.3	3,932.7
Total Liabilities and Equity	7,447.0	8,189.6	6,646.4	5,761.6	5,244.4	5,362.8	5,475.4	5,590.7	5,708.8	5,829.8
Balance Check	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK

Statement of Cash Flows

	Historical					Forecasted				
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Net Income	72.2	(79.8)	(89.5)	24.0	99.8	107.4	110.1	112.8	115.6	118.4
Add: Depreciation & Amortization	218.7	245.7	218.9	227.5	194.0	140.7	143.3	145.9	148.6	151.3
Less: Change in Net Working Capital	-	(7.0)	(7.8)	(33.0)	20.3	17.0	(1.2)	(1.2)	(1.3)	(1.3)
Less: Capital Expenditures	(868.4)	(762.6)	(268.6)	(99.7)	(70.6)	(195.7)	(199.3)	(202.9)	(206.7)	(210.5)
Operating Cash Flow	(577.5)	(603.7)	(147.0)	118.9	243.5	69.4	52.9	54.6	56.3	58.0
Initial Cash Balance	-	192.8	102.2	222.2	379.1	1,802.7	1,872.2	1,925.1	1,979.6	2,035.9
Cash Available for Investors	(577.5)	(410.9)	(44.8)	341.1	622.5	1,872.2	1,925.1	1,979.6	2,035.9	2,093.9
Debt Additions (Repayments)	-	-	-	-	-	-	-	-	-	-
Dividend Payments	(150.1)	(146.5)	(109.7)	(29.6)	-	-	-	-	-	-
Equity Additions (Share Repurchase)	-	-	-	-	-	-	-	-	-	-
Historical Cash Adjustment	920.3	659.7	376.7	67.5	1,180.2	-	-	-	-	-
Ending Cash Balance	192.8	102.2	222.2	379.1	1,802.7	1,872.2	1,925.1	1,979.6	2,035.9	2,093.9

Sources

- <https://drive.google.com/a/bu.edu/file/d/0B2ARbgMZDEDvZVc2RIBBV0daN2FVZExCZjN4RGllaVNpeVJR/view>
- <https://www.reit.com/investing/reit-basics/glossary-reit-terms>
- <http://finance.yahoo.com/q?s=EQC>
- <http://clients1.ibisworld.com.ezproxy.bu.edu/reports/us/industry/keystatistics.aspx?entid=1916>
- <http://www.newsmax.com/Finance/StreetTalk/sam-zell-recession-economy-trump/2016/04/14/id/723867/>

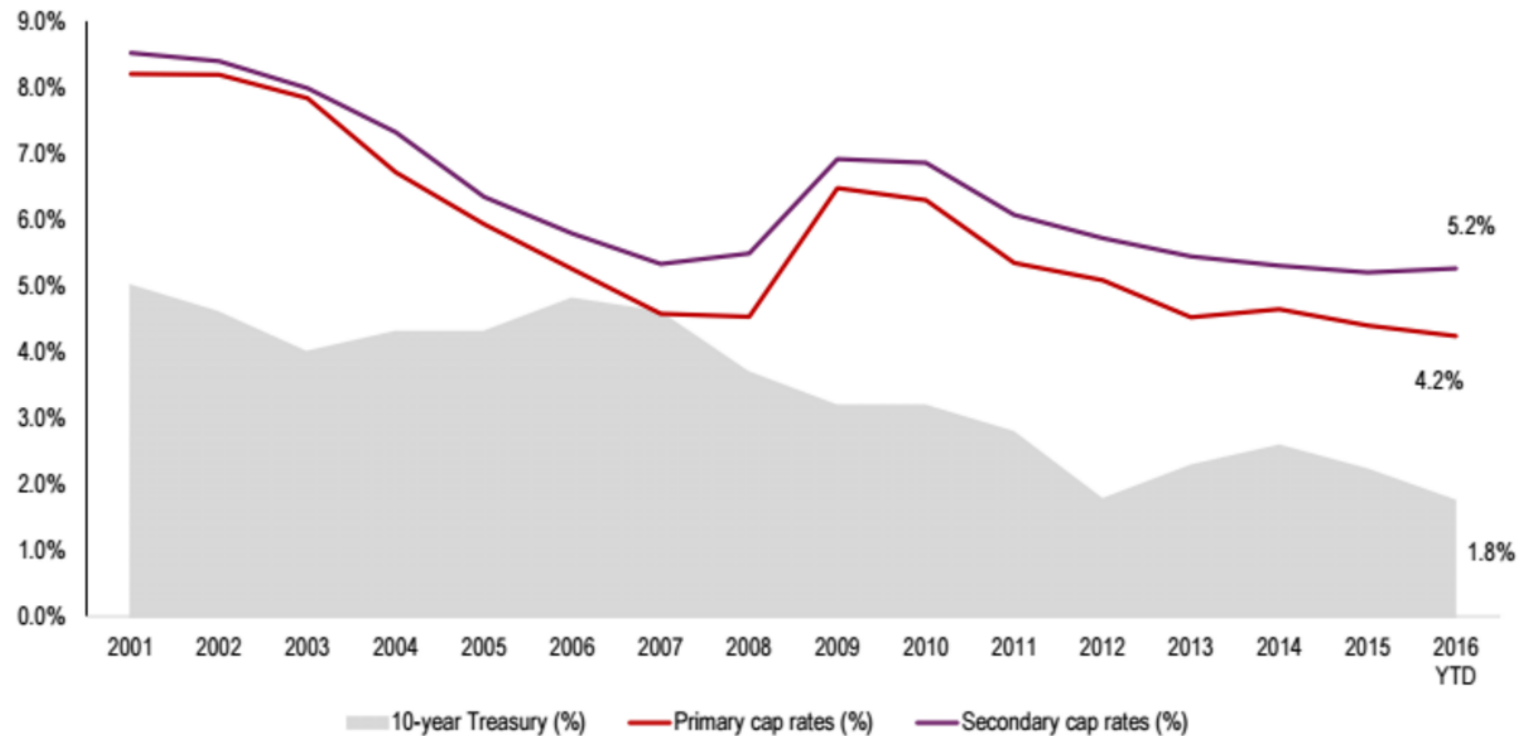
Sam Zell

- Calling for a milder version of 2008 recession
- Net worth: \$5 Billion
- Successfully called the top of the last Commercial Real Estate Cycle
- Most REIT CEOs agree a recession is coming, but not as soon as Sam Zell predicts
- Basing predictions on problems in global market, specifically citing Nigeria dropping growth expectations to 3.2% from 6.3%
- CRE prices becoming detached from actual value



Primary and secondary cap rates continue to decline

Despite the interest rate hike, the spread between office cap rates and the 10-year Treasury has widened slightly for primary and secondary markets has widened to 240 and 340bp, respectively



REIT Info

- Be structured as a taxable corporation
- Be managed by a board of directors or trustees
- distribute at least 90% of taxable net income as distributions to shareholders
- Have at least 75% of assets in real estate (real property or loans secured by
 - property)
- Derive at least 75% of gross income from real estate income (rents or interest
 - from mortgages)
- Have a minimum of 100 shareholders
- Have no more than 50% of shares held by five or fewer individuals
- Have no more than 25% of assets invested in stocks of taxable REIT
 - subsidiaries (TRS)
 - $\text{Cap RATE} = \text{NOI} / \text{Asset Value}$
 - High Cap rate = higher returns and greater perceived risk
 - $\text{FFO} = \text{NI} - \text{Gain on sale of property} + \text{Loss on sale of Property} + \text{Depreciation}$
 - $\text{AFFO} = \text{FFO} - \text{Normalized Recurring Real Estate Expenditures} - \text{Non-Cash Items}$
 - $\text{FAD} = \text{AFFO} - \text{Non-recurring expenditures}$

Recent News

- EQC will redeem all of its Series E preferred shares at a price of \$25/share on 5/16/16
 - Will cost EQC \$275 million
- Series D and E Preferred Dividends will be paid on 5/16/16
- Sale of Executive Park in Atlanta
 - 72.8% leased
 - \$16.04 ARR/ leased SF