# Equity Residential (EQR)

*Updated May 6th, 2019 by Samuel Smith*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $76 | **5 Year CAGR Estimate:** | 2.7% | **Volatility Percentile:** | 13.7% |
| **Fair Value Price:** | $63 | **5 Year Growth Estimate:** | 3.5% | **Momentum Percentile:** | 79.1% |
| **% Fair Value:** | 121% | **5 Year Valuation Multiple Estimate:** | -3.8% | **Growth Percentile:** | 20.2% |
| **Dividend Yield:** | 3.0% | **5 Year Price Target** | $75 | **Valuation Percentile:** | 25.3% |
| **Dividend Risk Score:** | F | **Retirement Suitability Score:** | D | **Total Return Percentile:** | 13.2% |

## Overview & Current Events

Equity Residential (EQR) is a $28.2 billion multifamily REIT that owns a portfolio of 303 apartment communities with over 78,300 units and is developing 3 additional properties with 443 units. The company's strategy consists of owning large, high-quality properties in the urban and suburban submarkets of Southern California, San Francisco, Washington, D.C., New York, Seattle, and Boston. It was formed 50 years ago (1969) as a property management partnership between two individuals and has grown into a large multifamily equity business today.

EQR reported solid Q1 results on 4/30/19. FFO per share came in at $0.82, in-line with consensus estimates and up from $0.77 in Q1 2018. Meanwhile, revenue grew by 4.7% year-over-year, beating expectations by nearly $7.5 million. Same-store revenue growth came in at 3.1% with same-store NOI increasing by 2.5% and physical occupancy at 96.3% (up 30 basis points year-over-year). Management now sees full year results falling near the top end of its guidance range of $3.34-$3.44.

## Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **FFO** | $2.41 | $2.41 | $2.58 | $2.76 | $2.99 | $3.17 | $3.46 | $3.09 | $3.13 | $3.25 | ***$3.39*** | ***$4.03*** |
| **DPS** | $1.64 | $1.47 | $1.58 | $1.78 | $1.85 | $2.00 | $2.21 | $2.02 | $2.02 | $2.16 | ***$2.16*** | ***$2.63*** |
| **Shares** | 274 | 283 | 295 | 320 | 354 | 378 | 381 | 382 | 383 | 384 | ***384*** | ***387*** |

Over the past decade, EQR has generated a solid ~3.4% Core FFO/share growth rate. This is even more impressive when you consider that the company downsized and deleveraged, which led to a decline in FFO/share between 2015 and 2016. Since the deleveraging, the growth rate has gradually accelerated, coming in at just over 1% in 2017, 3.8% in 2018, and is forecast to be 4.3% this year. This shows that the company continues to deploy capital effectively while manage its costs, despite rising margin pressures from inflation and plenty of competing new supply hitting key markets. These positive trends are due to the fact that when the company downsized several years ago, it sold out of its inland markets that have very low barriers to entry in order to concentrate on coastal markets which possess greater development challenges due to regulatory and land restrictions. Additionally, these coastal markets have strong economic fundamentals thanks to strong jobs growth in high-paying sectors. At the same time, the multifamily cycle is a bit long in the tooth and cap rate spreads are increasingly compressed due to inflation and rising interest rates. As a result, we are projecting a 3.5% growth rate over the next five years.

We expect the dividend to slightly outgrow FFO/share during this time span due to the low payout ratio and management's trend for doing so in recent years as well. Therefore, we think the dividend will grow at about a 4% clip.

## Valuation Analysis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Now | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/FFO** | 14.1 | 21.7 | 22.4 | 20.8 | 17.3 | 22.8 | 23.3 | 21.0 | 20.4 | 20.1 | ***22.5*** | ***18.5*** |
| **Avg. Yld.** | 4.3% | 3.2% | 2.2% | 3.1% | 3.2% | 3.9% | 3.1% | 2.5% | 3.1% | 3.4% | ***3.0%*** | ***3.5%*** |

The recent valuation multiple has hovered at or above 20x FFO/share and the dividend yield has ranged between 2.5% and 3.9%. However, due to the aforementioned flattening growth trend that we project for EQR, the stock will warrant a lower valuation multiple and a higher dividend yield. Therefore, we expect a fairly steep contraction in the valuation multiple towards 18.5x FFO. This number is not without precedent either as it fell to ~17x FFO back in 2013 during a general period of public market weakness in the multifamily sector.

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

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Payout** | 68.0% | 61.0% | 61.2% | 64.5% | 61.9% | 63.1% | 63.9% | 65.4% | 64.5% | 66.5% | ***63.7%*** | ***65.3%*** |

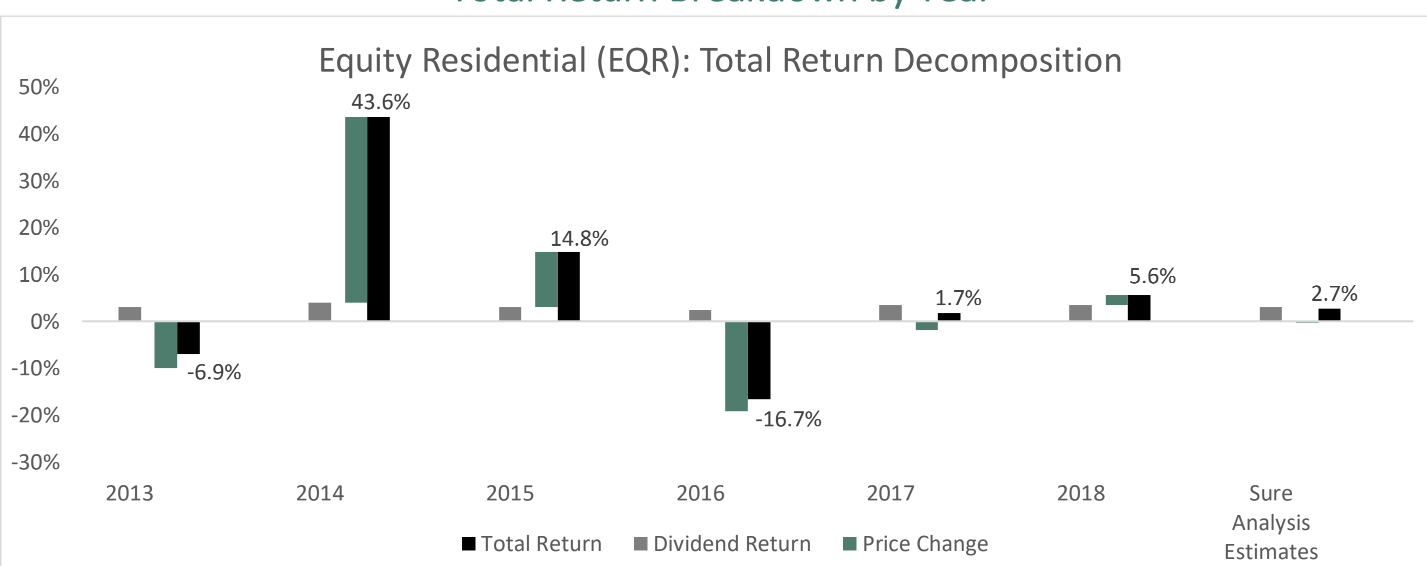
EQR experienced a lot of market volatility during the stock market crash but rebounded quickly from the Great Recession due to the defensive nature of the multifamily sector. However, it still experienced a sizable decline in FFO/share and a dividend cut during the recession. While multifamily apartments lack a strong competitive advantage due to the ease of creating new supply as well as the alternative sources of affordable housing in the large metropolitan areas in which EQR operates, the REIT does have the advantage of scale, low cost of capital, operational and marketing expertise, and a brand name advantage in markets that benefit from higher than average barriers to entry. A risk during a recession will be that the company's properties are mostly "A" quality which tend to outperform during economic expansions, but underperform during contractions.

The company's balance sheet is also very strong, as its sector-leading A- credit rating makes clear. After issuing $400 million of 10-year unsecured notes at a coupon of 4.15%, executing an accretive capital recycling program, and carrying a mid-60% payout ratio, EQR has plenty of resources to invest in its growth projects and sustain the dividend during a downturn while also reacting opportunistically to opportunities that may become available.

## Final Thoughts & Recommendation

EQR has a strong track record and a stellar balance sheet. That being said, its dividend yield is low and its growth potential remains limited. While it has carved out a competitive position for itself in a few strong markets, without a strong moat protecting its earnings power and the economy appearing poised for a general slowdown, EQR appears overpriced at this time and likely to deliver underwhelming total returns over the next several years (2.7% from a 3% dividend yield, 3.5% annual FFO per share growth, and a -3.8% annual headwind from multiple contraction), making it a sell.

## Total Return Breakdown by Year

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*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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## Income Statement Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 1640 | 1675 | 1525 | 1748 | 2388 | 2615 | 2745 | 2426 | 2471 | 2578 |
| Gross Profit | 1001 | 1015 | 956 | 1122 | 1553 | 1731 | 1840 | 1620 | 1645 | 1699 |
| Gross Margin | 61.1% | 60.6% | 62.7% | 64.2% | 65.1% | 66.2% | 67.0% | 66.8% | 66.6% | 65.9% |
| SG&A Exp. | 39 | 40 | 44 | 47 | 62 | 51 | 65 | 58 | 52 | 54 |
| D&A Exp. | 600 | 673 | 664 | 685 | 1013 | 759 | 766 | 706 | 744 | 786 |
| Operating Profit | 444 | 394 | 407 | 514 | 512 | 922 | 1009 | 856 | 849 | 859 |
| Operating Margin | 27.1% | 23.5% | 26.7% | 29.4% | 21.5% | 35.2% | 36.8% | 35.3% | 34.4% | 33.3% |
| Net Profit | 362 | 284 | 894 | 842 | 1831 | 631 | 870 | 4292 | 603 | 658 |
| Net Margin | 22.1% | 16.9% | 58.6% | 48.2% | 76.7% | 24.1% | 31.7% | 177% | 24.4% | 25.5% |
| Free Cash Flow | 4 | 723 | 793 | 885 | 729 | 1133 | 1171 | 1036 | 1062 | 1163 |
| Income Tax | 3 | 0 | 1 | 1 | 1 | 1 | 1 | 2 | 0 | 1 |

## Balance Sheet Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | 15418 | 16184 | 16659 | 17201 | 22835 | 22951 | 23110 | 20704 | 20571 | 20394 |
| Cash & Equivalents | 193 | 431 | 384 | 613 | 54 | 40 | 42 | 77 | 51 | 47 |
| Total Liabilities | 9985 | 10592 | 10796 | 9674 | 11989 | 12243 | 12414 | 10243 | 10097 | 9995 |
| Accounts Payable | 59 | 39 | 35 | 38 | 119 | 154 | 187 | 147 | 115 | 102 |
| Long-Term Debt | 9393 | 9948 | 9721 | 8529 | 10766 | 10845 | 10921 | 8987 | 8957 | 8818 |
| Total Equity | 4839 | 4890 | 5469 | 7240 | 10457 | 10318 | 10433 | 10192 | 10205 | 10136 |
| D/E Ratio | 1.86 | 1.95 | 1.71 | 1.17 | 1.02 | 1.05 | 1.04 | 0.88 | 0.87 | 0.87 |

## Profitability & Per Share Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | 2.3% | 1.8% | 5.4% | 5.0% | 9.1% | 2.8% | 3.8% | 19.6% | 2.9% | 3.2% |
| Return on Equity | 7.6% | 5.8% | 17.3% | 13.2% | 20.7% | 6.1% | 8.4% | 41.6% | 5.9% | 6.5% |
| ROIC | 2.4% | 1.9% | 5.7% | 5.3% | 9.7% | 2.9% | 4.0% | 20.9% | 3.1% | 3.4% |
| Shares Out. | 274 | 283 | 295 | 320 | 354 | 378 | 381 | 382 | 383 | 384 |
| Revenue/Share | 5.99 | 5.92 | 5.17 | 5.46 | 6.74 | 6.92 | 7.21 | 6.35 | 6.46 | 6.72 |
| FCF/Share | 0.01 | 2.56 | 2.69 | 2.77 | 2.06 | 3.00 | 3.08 | 2.71 | 2.77 | 3.03 |

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