Equity Residential (EQR)

Updated November 29th, 2019 by Samuel Smith

Key Metrics

Current Price:	$85	**5 Year CAGR Estimate:**	0.7%	**Volatility Percentile:**	8.3%
Fair Value Price:	$64	**5 Year Growth Estimate:**	3.4%	**Momentum Percentile:**	71.9%
% Fair Value:	132%	**5 Year Valuation Multiple Estimate:**	-5.5%	**Growth Percentile:**	24.7%
Dividend Yield:	2.7%	**5 Year Price Target**	$76	**Valuation Percentile:**	23.6%
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Total Return Percentile:**	11.8%

Overview & Current Events

Equity Residential (EQR) is a $32 billion multifamily REIT that owns a portfolio of 303 apartment communities with over 78,000 units, with more in development. The trust'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 as a property management partnership between two individuals and has grown into a large multifamily equity business today.

EQR reported Q3 results on 10/22/19. Normalized FFO-per-share came in at $0.91, up significantly from $0.83 in the year-ago quarter on the strength of same store NOI growth of 3.3% and physical occupancy of 96.5%. The strong performance caused management to boost the midpoint of its full-year FFO-per-share guidance by $0.01 to $3.47. We have adjusted our 2019 forecast accordingly.

One item of concern moving forward, however, is the impact of rent control in some of its markets. In New York, management reported that rent renewal increases are down 50 basis points as the result of a new rent law. Furthermore, in California, management believes that 70% of its assets in the state could be subject to new rent caps. As a way of diversifying away from these regulatory threats, management plans to more than triple its NOI exposure to Denver by acquiring more assets in that market.

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	***$3.47***	***$4.11***
DPS	$1.64	$1.47	$1.58	$1.78	$1.85	$2.00	$2.21	$2.02	$2.02	$2.16	***$2.27***	***$2.63***
Shares[1]	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 trust 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 trust continues to deploy capital effectively while managing 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 trust 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 property value 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 (~4%) FFO/share during this time span due to the low payout ratio and management's trend for doing so in recent years as well.

[1] In millions

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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	***24.5***	***18.5***
Avg. Yld.	4.3%	3.2%	2.2%	3.1%	3.2%	3.9%	3.1%	2.5%	3.1%	3.4%	***2.7%***	***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 Equity Residential, 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, 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%	***65.4%***	***64.0%***

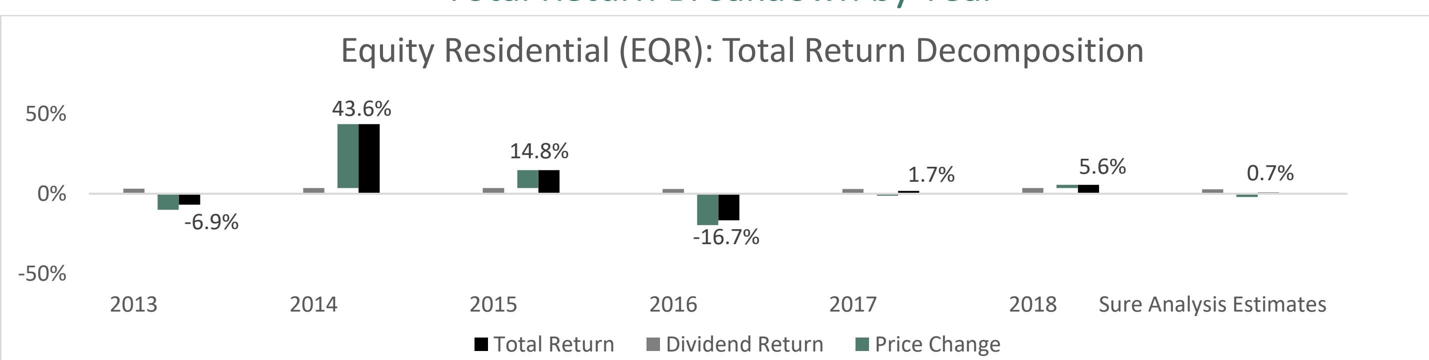
Equity Residential experienced a lot of market volatility during the stock market crash, but rebounded quickly from the Great Recession due to the defensive nature of the multifamily sector. However, it still experienced a sizable decline in FFO/share and a dividend cut during the recession. While multifamily 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 Equity Residential 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 trust's properties are mostly "A" quality, which tend to outperform during economic expansions but underperform during contractions.

The trust'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

Equity Residential has a strong track record and a stellar balance sheet, but its dividend yield and growth potential remain weak. Without a strong moat protecting its earnings power and the economy appearing poised for a general slowdown, the stock appears overpriced at this time and likely to deliver underwhelming total returns (0.7%) over the next several years as significant margin compression will largely offset income from dividends and appreciation from FFO growth. Consequently we rate it a sell.

Total Return Breakdown by Year



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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.