Equity Residential (EQR)

Updated March 31st, 2020 by Samuel Smith

Key Metrics

Current Price:	$59	**5 Year CAGR Estimate:**	5.2%	**Market Cap:**	$21.3B
Fair Value Price:	$51	**5 Year Growth Estimate:**	4.6%	**Ex-Dividend Date:**	3/20/20[1]
% Fair Value:	116%	**5 Year Valuation Multiple Estimate:**	-2.9%	**Dividend Payment Date:**	4/13/20[2]
Dividend Yield:	3.9%	**5 Year Price Target**	$64	**Years Of Dividend Growth:**	9
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	6.2%

Overview & Current Events

Equity Residential (EQR) is a $21 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 Q4 results on 1/28/20. Normalized FFO per share came in at $0.91, up significantly from $0.84 in the year-ago quarter. Same-store revenue grew by 3.2% and occupancy stood at 96.1% in Q4. For the full year, same-store revenue grew by 3.2% and average occupancy was 96.4%. In Q4, same-store NOI rose by 3.2% year-over-year.

Moving forward, management has cautioned that new rent control regulation sin California and New York will likely result in same-store revenue growth declining from 2019 levels. That being said, prior to the coronavirus outbreak, they still expected to grow FFO per share by a decent amount year-over-year.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
FFO	$2.41	$2.58	$2.76	$2.99	$3.17	$3.46	$3.09	$3.13	$3.25	$3.47	***$3.00***	***$3.75***
DPS	$1.47	$1.58	$1.78	$1.85	$2.00	$2.21	$2.02	$2.02	$2.16	$2.27	***$2.31***	***$2.50***
Shares[3]	283	295	320	354	378	381	382	383	384	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. With the headwinds from the coronavirus outbreak and some restrictions on evictions being enacted, we believe that EQR's FFO will drop off significantly this year. However, the dividend should be safe and we expect the REIT to bounce back pretty well in the years to come.

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[1] Estimate

[2] Estimate

[3] In millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/FFO	22.4	20.8	17.3	22.8	23.3	21.0	20.4	20.1	24.5	24.5	***19.7***	***17.0***
Avg. Yld.	2.2%	3.1%	3.2%	3.9%	3.1%	2.5%	3.1%	3.4%	2.7%	2.7%	***3.9%***	***3.9%***

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. Adding in the headwinds from the coronavirus reduces our target fair value multiple further to 17 times 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

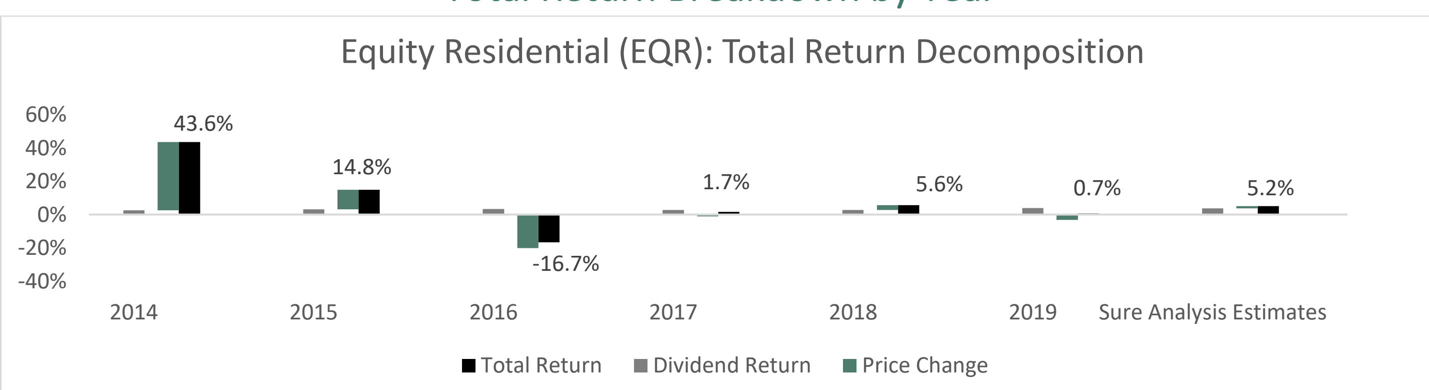
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	61.0%	61.2%	64.5%	61.9%	63.1%	63.9%	65.4%	64.5%	66.5%	65.4%	***77.0%***	***66.7%***

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-70% 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, however, without a strong moat protecting its earnings power and the economy appearing poised for a general slowdown, the stock appears fairly priced at this time and likely to deliver mediocre annualized total returns (5.2%) over the next several years. We therefore rate it a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1,675	1,525	1,748	2,388	2,615	2,745	2,426	2,471	2,578	2,701
Gross Profit	1,015	956	1,122	1,553	1,731	1,840	1,620	1,645	1,699	1,793
Gross Margin	60.6%	62.7%	64.2%	65.1%	66.2%	67.0%	66.8%	66.6%	65.9%	66.4%
SG&A Exp.	40	44	47	62	51	65	58	52	54	53
D&A Exp.	673	664	685	1,014	762	769	709	748	790	843
Operating Profit	394	407	514	512	922	1,009	856	849	859	909
Operating Margin	23.5%	26.7%	29.4%	21.5%	35.2%	36.8%	35.3%	34.4%	33.3%	33.6%
Net Profit	284	894	842	1,831	631	870	4,292	603	658	970
Net Margin	16.9%	58.6%	48.2%	76.7%	24.1%	31.7%	177%	24.4%	25.5%	35.9%
Free Cash Flow	723	793	885	729	1,133	1,171	1,036	1,062	1,163	1,274
Income Tax	0	1	1	1	1	1	2	0	1	(2)

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	16184	16659	17201	22835	22951	23110	20704	20571	20394	21173
Cash & Equivalents	431	384	613	54	40	42	77	51	47	46
Total Liabilities	10592	10796	9674	11989	12243	12414	10243	10097	9995	10628
Accounts Payable	39	35	38	119	154	187	147	115	102	94
Long-Term Debt	9948	9721	8529	10766	10845	10921	8987	8957	8818	9037
Total Equity	4890	5469	7240	10457	10318	10433	10192	10205	10136	10278
D/E Ratio	1.95	1.71	1.17	1.02	1.05	1.04	0.88	0.87	0.87	0.88

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.8%	5.4%	5.0%	9.1%	2.8%	3.8%	19.6%	2.9%	3.2%	4.7%
Return on Equity	5.8%	17.3%	13.2%	20.7%	6.1%	8.4%	41.6%	5.9%	6.5%	9.5%
ROIC	1.9%	5.7%	5.3%	9.7%	2.9%	4.0%	20.9%	3.1%	3.4%	5.0%
Shares Out.	283	295	320	354	378	381	382	383	384	384
Revenue/Share	5.92	5.17	5.46	6.74	6.92	7.21	6.35	6.46	6.72	6.99
FCF/Share	2.56	2.69	2.77	2.06	3.00	3.08	2.71	2.77	3.03	3.30

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