AvalonBay Communities Inc. (AVB)

Updated May 12th, 2020 by Samuel Smith

Key Metrics

Current Price:	$151	**5 Year CAGR Estimate:**	8.1%	**Market Cap:**	$22.1B
Fair Value Price:	$162	**5 Year Growth Estimate:**	3.1%	**Ex-Dividend Date:**	6/29/20
% Fair Value:	93%	**5 Year Valuation Multiple Estimate:**	1.4%	**Dividend Payment Date:**	7/15/20
Dividend Yield:	4.2%	**5 Year Price Target**	$189	**Years Of Dividend Growth:**	8
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	4.6%

Overview & Current Events

AvalonBay Communities (AVB) is a $22.1 billion multifamily REIT that owns a portfolio of 270 apartment communities with over 73,500 units, and is developing 18 additional properties with over 7,200 units. The trust's strategy consists of owning top-tier properties in the major metropolitan areas of New England, New York/New Jersey, Washington D.C., California, and the Pacific Northwest. It was formed by the 1998 merger of Avalon Properties with Bay Apartment Communities and has raised its dividend for eight consecutive years.

AvalonBay reported Q1 results on 5/6/20. FFO per diluted share fell by 1.3% year-over-year to $2.28 and Core FFO per share increased 3.9% to $2.39 year-over-year. Average rental rates increased by 2.7% and economic occupancy increased by 0.4%.

In April, AvalonBay collected 93.9% of their total rents due and 95.9% of their benchmark (97.9%), implying that the business is holding up remarkably well through the shutdown thus far.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
FFO	$3.98	$4.64	$5.43	$6.23	$6.78	$7.55	$8.19	$8.62	$9.00	$9.34	***$9.00***	***$10.50***
DPS	$3.57	$3.57	$3.88	$4.28	$4.64	$5.00	$5.40	$5.68	$5.88	$6.08	***$6.36***	***$7.00***
Shares[1]	85	91	98	127	131	135	137	138	138	138	***138***	***140***

Over the past decade, AvalonBay generated very impressive annualized Core FFO/share growth of ~9.7% thanks to its growing scale and strong rental rate growth. However, this growth rate has slowed dramatically in recent years, coming in at 5.5% in 2017, 4.4% in 2018, and just 3.8% in 2019. This year should see growth reaccelerate, with a 5.1% growth rate projected as occupancy remains strong, rental rate growth continues to creep higher, and new developments come online.

Potential headwinds for AvalonBay are the threat of future rent control legislation in its West Coast markets (this was already on the ballot in the 2018 mid-term elections) as well as the lateness of the economic cycle. As a result, we are projecting a 3.1% growth rate over the next five years despite this year's expected strength. We expect FFO per share to slightly outgrow the dividend during this time span due. As a result, we think the dividend will grow at about a 2% rate.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/FFO	28.5	28.9	25.3	18.2	19.0	24.2	21.8	20.7	19.2	23.3	***16.8***	***18.0***
Avg. Yld.	3.2%	2.2%	2.8%	3.6%	2.8%	2.7%	3.0%	3.2%	3.4%	2.8%	***4.2%***	***3.7%***

The recent valuation multiple has hovered at or above 20x Core FFO/share, and the dividend yield has ranged between 2.7% and 3.4%. However, the abundant new supply reaching markets combined with increasing inflationary pressures on margins - not to mention a challenging acquisition climate due to compressed cap rates – will lead to continued

[1] In millions

slowing growth. Therefore, the stock will warrant a lower valuation multiple and a higher dividend yield. Given the recent sharp pullback in the share price, we think the stock is slightly undervalued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	91.8%	89.7%	76.9%	71.5%	68.7%	68.4%	66.2%	65.9%	65.9%	65.3%	***70.7%***	***66.7%***

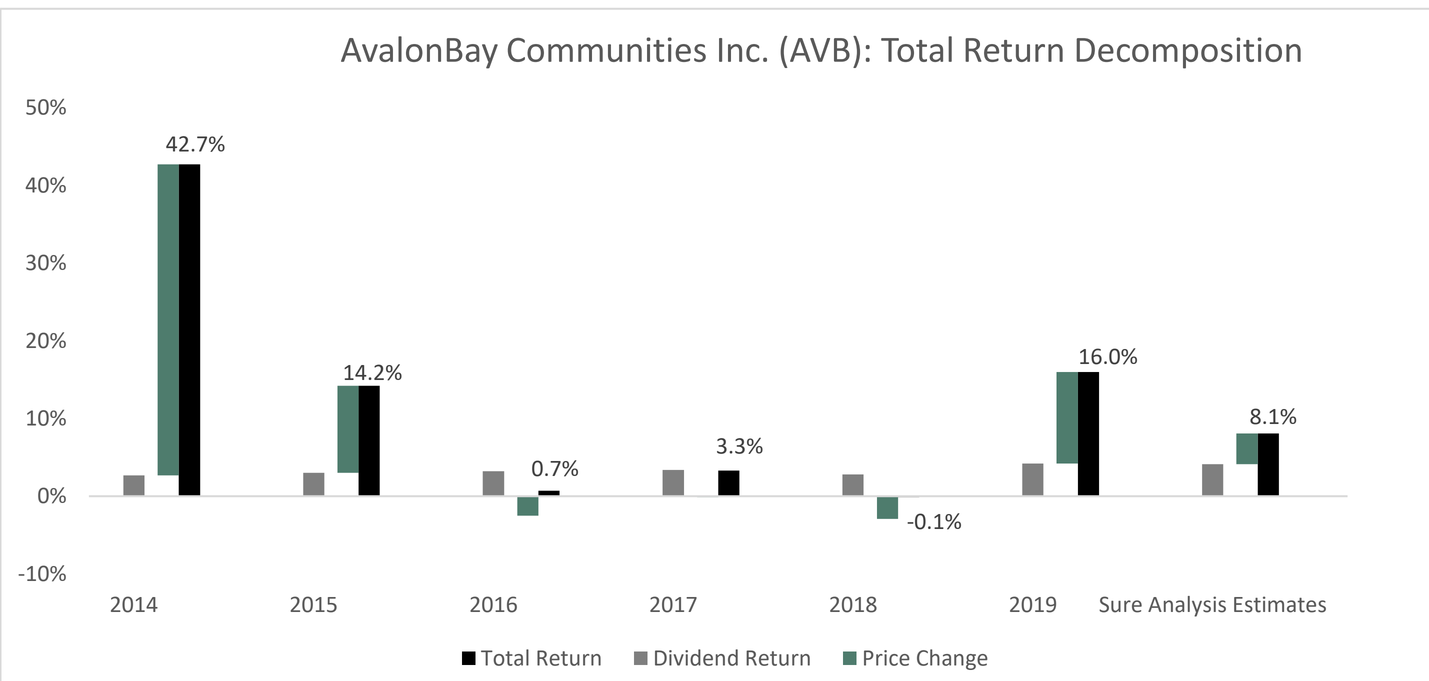
AvalonBay significantly outperformed the S&P 500 during the Great Recession due to the defensive nature of the multifamily sector. However, it still experienced a sizable decline in FFO/share (from $4.61 in 2007 down to a low of $3.89 in 2009). Additionally, multifamily apartments lack a strong competitive advantage due to the ease of creating new supply, as well as the alternative sources of affordable housing in large metropolitan areas in which AvalonBay operates. Given that, AvalonBay's investments are essentially plays on the economic strength of its core markets. Furthermore, the fact that most of its assets are high-quality "A" apartment units makes it even more levered to the state of the economy, as these apartments are in high demand during strong economic conditions, but are less affordable during a recession. AVB does have considerable economies of scale, low cost of capital, operational and marketing expertise, and a brand name advantage, which enable it to compete effectively against competitors.

The trust's balance sheet is also very strong, as its sector-leading A- credit rating makes clear. AvalonBay has plenty of resources to invest in its development projects and sustain the dividend during a downturn, while also reacting opportunistically to opportunities that may become available.

Final Thoughts & Recommendation

AvalonBay has an excellent track record and a stellar balance sheet. After a sharp pullback in the share price and fairly strong fundamental performance, AvalonBay appears undervalued at this time and likely to deliver solid risk-adjusted returns moving forward (average annualized total returns over the next five years). As a result, we rate it a hold.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	843	900	1,001	1,463	1,685	1,856	2,045	2,159	2,285	2,325
Gross Profit	509	564	644	952	1,096	1,214	1,362	1,436	1,518	1,557
Gross Margin	60.4%	62.7%	64.3%	65.1%	65.0%	65.4%	66.6%	66.5%	66.4%	67.0%
SG&A Exp.	27	29	34	40	41	43	46	54	61	62
D&A Exp.	221	227	244	560	443	478	531	584	631	662
Operating Profit	261	308	366	352	612	693	785	798	825	833
Operating Margin	31.0%	34.2%	36.6%	24.1%	36.3%	37.3%	38.4%	37.0%	36.1%	35.8%
Net Profit	175	442	424	353	684	742	1,034	877	975	786
Net Margin	20.8%	49.1%	42.4%	24.1%	40.6%	40.0%	50.6%	40.6%	42.7%	33.8%
Free Cash Flow	315	379	514	698	834	1,019	1,087	1,182	1,214	1,181

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	7,821	8,482	11,160	15,328	16,141	16,931	17,867	18,415	18,380	19,121
Cash & Equivalents	304	617	2,734	281	509	401	215	67	92	40
Total Liabilities	4,492	4,080	4,319	6,728	7,094	7,091	7,696	8,027	7,748	8,131
Accounts Payable	34	37	53	95	102	99	101	85	97	92
Long-Term Debt	4,007	3,599	3,851	6,134	6,490	6,457	7,031	7,329	7,040	7,296
Shareholder's Equity	3,311	4,395	6,837	8,596	9,046	9,841	10,171	10,388	10,633	10,990
D/E Ratio	1.21	0.82	0.56	0.71	0.72	0.66	0.69	0.71	0.66	0.66

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.3%	5.4%	4.3%	2.7%	4.3%	4.5%	5.9%	4.8%	5.3%	4.2%
Return on Equity	5.5%	11.5%	7.5%	4.6%	7.7%	7.9%	10.3%	8.5%	9.3%	7.3%
ROIC	2.4%	5.8%	4.5%	2.8%	4.5%	4.7%	6.2%	5.0%	5.5%	4.4%
Shares Out.	85	91	98	127	131	135	137	138	138	138
Revenue/Share	9.96	9.92	10.21	11.50	12.84	13.79	14.88	15.63	16.52	16.66
FCF/Share	3.72	4.18	5.25	5.48	6.35	7.57	7.91	8.56	8.78	8.46

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