



Douglas Emmett (DEI)

Updated October 5th, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	\$32	5 Year CAGR Estimate:	7.5%	Market Cap:	\$6.6 B
Fair Value Price:	\$28	5 Year Growth Estimate:	7.0%	Ex-Dividend Date:	9/29/2021
% Fair Value:	114%	5 Year Valuation Multiple Estimate:	-2.6%	Dividend Payment Date:	10/15/2021
Dividend Yield:	3.5%	5 Year Price Target	\$39	Years Of Dividend Growth:	10
Dividend Risk Score:	D	Retirement Suitability Score:	D	Last Dividend Increase:	5.7%

Overview & Current Events

Douglas Emmett (DEI) is a real estate investment trust (REIT) that was founded in 1971. It is the largest office landlord in Los Angeles and Honolulu, with a 38% average market share of office space in its submarkets. The REIT generates 85% of its revenue from its office portfolio and 15% of its revenue from its multifamily portfolio. It has approximately 2,700 office leases in its portfolio, annual revenue of \$1 billion and a market capitalization of \$6.6 billion.

The merits of being the largest office landlord in Los Angeles are obvious, as Los Angeles County is the third-largest city in the world, with GDP of \$1 trillion, behind only Tokyo and New York. The dominant position of Douglas Emmett creates operational synergies. In addition, the REIT benefits from high barriers to entry, which reduce competition. Moreover, the proximity to premier housing attracts affluent tenants, who offer reliable cash flows to the company.

In early August, Douglas Emmett reported (8/3/21) financial results for the second quarter of fiscal 2021. During the quarter, it signed a record number of 253 office leases, which cover an all-time high of 1.3 million square feet. Nevertheless, record leasing was not sufficient to completely offset the exceptionally high lease expirations during the quarter. Moreover, tenant improvement costs (office improvements before the tenant moves in) rose abnormally due to the record number of new leases. As a result, adjusted funds from operations (FFO) declined -3% over last year's quarter. Management provided guidance for FFO per share of \$0.44-\$0.46 in the third quarter and stated that it cannot provide guidance for the fourth quarter due to the high sensitivity of results to the course of the pandemic.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
FFO	\$1.38	\$1.36	\$1.78	\$1.83	\$1.92	\$2.13	\$2.20	\$2.35	\$2.45	\$2.12	\$1.81	\$2.54
DPS	\$0.49	\$0.63	\$0.74	\$0.81	\$0.85	\$0.89	\$0.94	\$1.01	\$1.06	\$1.12	\$1.12	\$1.50
Shares¹	160.0	173.1	145.8	148.1	150.6	153.2	161.2	169.9	173.4	175.4	176.0	200.0

The markets of Douglas Emmett are characterized by high rent growth and relatively low volatility. Rents in the West Los Angeles submarkets of the REIT have grown 150% over the last 25 years, at a 3.7% average annual rate, the highest growth rate among all the U.S. gateway markets. Douglas Emmett certainly benefits from this trend, as its leases include 3%-5% annual rent hikes. Thanks to this tailwind, the company has grown its adjusted FFO per share at a 4.9% average annual rate over the last decade. In addition, the REIT has ample development opportunities within its existing portfolio. Given also the low comparison base formed this year due to the pandemic, we expect Douglas Emmett to grow its FFO per share at a 7.0% average annual rate over the next five years.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
P/FFO	13.5	16.6	13.8	14.9	15.3	15.8	17.7	16.0	16.7	14.8	17.7	15.5
Avg. Yld.	2.6%	2.8%	3.0%	3.0%	2.9%	2.6%	2.4%	2.7%	2.6%	3.6%	3.5%	3.8%

¹ In millions.

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Douglas Emmett has traded at a remarkably narrow range of price-to-FFO ratios over the last decade, with an average price-to-FFO ratio of 15.5. The stock is currently trading at a nearly decade-high price-to-FFO ratio of 17.7 due to the suppressed results of this year amid the pandemic. We expect Douglas Emmett to revert to its average valuation level over the next five years. If this proves correct, the stock will incur a -2.6% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	35%	46%	41%	44%	44%	42%	43%	43%	43%	53%	62%	59%

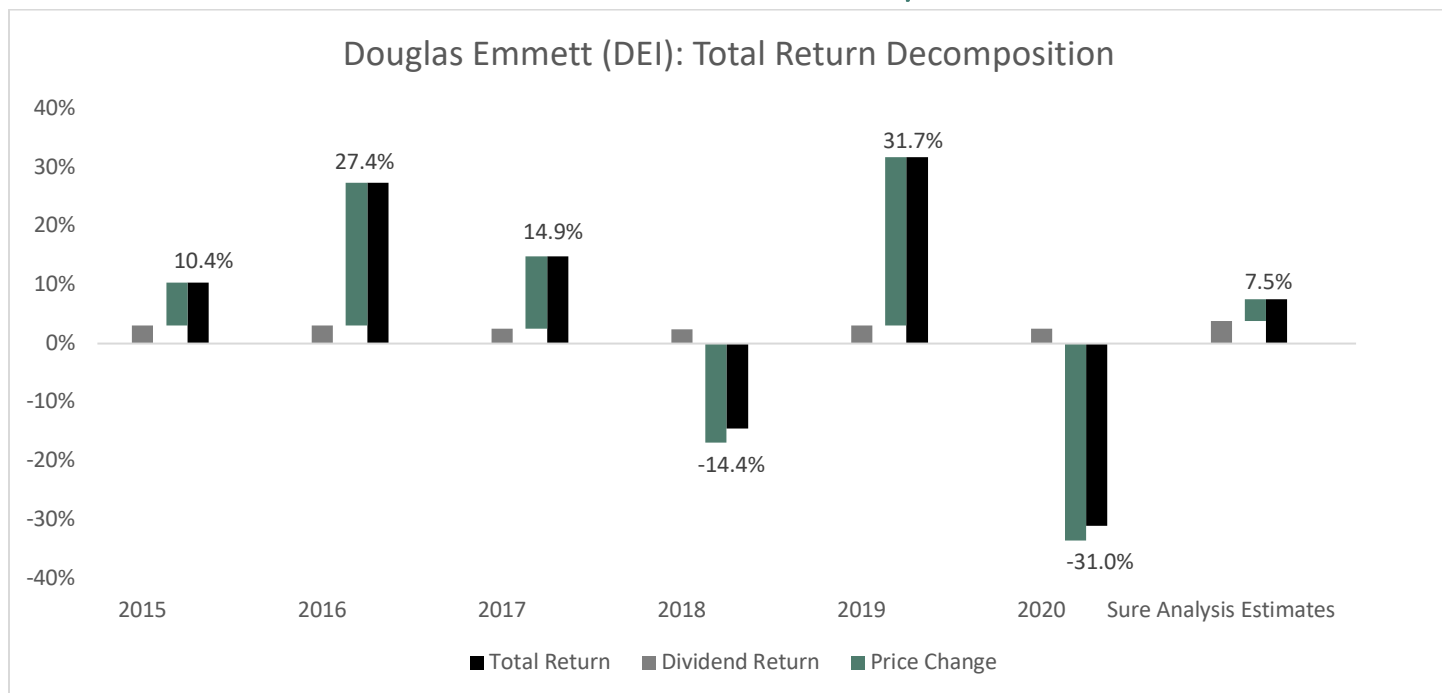
The markets of Douglas Emmett have the highest barriers to entry among the U.S. gateway markets. New office development in its core L.A. markets is limited due to restrictive zoning laws, density limits and anti-growth community sentiment. Total new supply of offices in these submarkets of L.A. and Honolulu has been only 2% and 0%, respectively, since 2009. These high barriers to entry offer a dominant position to Douglas Emmett, which can thus raise rents by 3%-5% per year. The annual rent hikes greatly support cash flows during downturns and offer reliable growth. Moreover, thanks to economies of scale and its efficient team that optimizes design before move-ins, Douglas Emmett minimizes vacancy time and enjoys higher operating margins than its peers.

Overall, Douglas Emmett is somewhat resilient but not immune to recessions, mostly due to its leverage. Due to the pandemic, interest coverage ratio has plunged from 1.8 in 2019 to 1.1 and the REIT has paid the same dividend for 8 consecutive quarters. It also cut its dividend by -47% during the Great Recession, in 2009.

Final Thoughts & Recommendation

The pandemic is still weighing on the business of Douglas Emmett but the worse seems to be behind the REIT. We thus expect the stock to offer a 7.5% average annual rate over the next five years, thanks to 7.0% FFO growth and a 3.5% dividend, which may be partly offset by a -2.6% annualized contraction of valuation level. As a result, Douglas Emmett receives a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	575	579	592	600	636	743	812	881	937	892
Gross Profit	387	389	397	398	425	505	554	600	639	586
Gross Margin	67.3%	67.1%	67.1%	66.3%	66.9%	68.0%	68.2%	68.1%	68.2%	65.7%
SG&A Exp.	29	28	27	27	30	35	36	39	38	40
D&A Exp.	185	167	176	186	186	231	259	288	341	369
Operating Profit	152	176	179	168	190	221	241	252	243	161
Operating Margin	26.5%	30.4%	30.2%	28.0%	29.8%	29.7%	29.7%	28.6%	25.9%	18.1%
Net Profit	1	23	45	45	58	85	94	116	364	50
Net Margin	0.3%	4.0%	7.7%	7.4%	9.2%	11.5%	11.6%	13.2%	38.8%	5.7%
Free Cash Flow	153	150	176	158	192	220	231	185	231	123

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	6,232	6,104	5,848	5,939	6,066	7,614	8,293	8,262	9,349	9,251
Cash & Equivalents	407	373	44	19	102	113	177	146	154	172
Accounts Receivable	60	65	71	77	82	95	109	129	140	134
Goodwill & Int. Ass.	8	7	6	6	6	7	6	5	8	7
Total Liabilities	3,916	3,713	3,481	3,625	3,785	4,600	4,391	4,413	4,978	5,255
Accounts Payable	28	19	21	22	24	37	63	75	66	82
Long-Term Debt	3,624	3,441	3,241	3,420	3,611	4,370	4,117	4,134	4,619	4,445
Shareholder's Equity	1,865	1,980	1,970	1,943	1,926	1,921	2,438	2,402	2,712	2,437
D/E Ratio	1.94	1.74	1.64	1.76	1.87	2.27	1.69	1.72	1.70	1.82

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	0.0%	0.4%	0.8%	0.8%	1.0%	1.2%	1.2%	1.4%	4.1%	0.5%
Return on Equity	0.1%	1.2%	2.3%	2.3%	3.0%	4.4%	4.3%	4.8%	14.2%	2.0%
ROIC	0.0%	0.4%	0.8%	0.8%	1.0%	1.3%	1.2%	1.5%	4.3%	0.6%
Shares Out.	160.0	173.1	145.8	148.1	150.6	153.2	161.2	169.9	173.4	175.4
Revenue/Share	3.60	3.34	4.06	4.05	4.22	4.85	5.04	5.19	5.34	5.08
FCF/Share	0.96	0.87	1.21	1.07	1.28	1.44	1.43	1.09	1.32	0.70

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

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