



PS Business Parks, Inc. (PSB)

Updated November 13th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$177	5 Year CAGR Estimate:	4.9%	Market Cap:	\$4.88 B
Fair Value Price:	\$161	5 Year Growth Estimate:	4.5%	Ex-Dividend Date:	12/14/2021
% Fair Value:	110%	5 Year Valuation Multiple Estimate:	-2.0%	Dividend Payment Date:	12/30/2021
Dividend Yield:	2.4%	5 Year Price Target	\$200	Years Of Dividend Growth:	N/A
Dividend Risk Score:	C	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

PS Business Parks, Inc. is a fully integrated, self-advised, and self-managed REIT that owns, operates, and acquires primarily multi-tenant industrial, flex, and office properties. The company owns and operates 28.1 million rentable square feet of commercial space in six states, comprising 97 parks and 680 buildings, along with two other joint ventures. PS Business Parks generates around \$370 million in annual rental revenues and is headquartered in Glendale, California.

On October 28th, PS Business Parks reported its Q3 results for the period ending September 30th, 2021. Rental income grew 6.5% to \$110.45 million. FFO/share came in at \$1.72, representing an increase of 10.9% compared to Q3-2020, which resulted from higher NOI, partially offset by higher administrative expenses. Specifically, same-park cash NOI was driven by cash rental income growth of 8.4%, which was primarily attributable to gains in occupancy and rental rate growth. During the quarter, the company's leasing activity included closing deals for 2.0 million square feet with a weighted average cash rental growth rate of 5.0%. This is higher than the previous quarter's 3.1%.

However, the company's average lease term stood at 3.7 years, compared to 3.3 years in the previous quarter, suggesting enhanced future cash flow visibility. Additionally, as of Oct. 27th, PSB had collected 99.7% of revenue billed during the nine months ending Sep. 30th, likely indicating higher demand in the office REIT space moving forward. In fact, weighted average occupancy during the quarter was 94.8%, compared to 94.7% for the same period in 2020, suggesting a slow but gradual return towards offices.

Following PSB's latest results, we have hiked our FY2021 FFO/share estimates from \$6.86 to \$6.98, powered by the company's rental growth, leasing agreements, and predictable revenues due to its multi-year contracts.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
FFO/shr	\$4.69	\$4.24	\$5.15	\$4.72	\$4.76	\$5.17	\$5.83	\$6.47	\$6.47	\$6.51	\$6.98	\$8.70
DPS	\$1.76	\$1.76	\$1.76	\$2.00	\$2.20	\$3.00	\$3.40	\$3.80	\$4.20	\$4.20	\$4.20	\$5.62
Shares¹	24.5	24.2	24.7	26.9	27	27.1	27.2	27.3	27.4	27.5	27.5	30.0

PS Business Parks has done a decent job over the past decade in terms of growing its revenues and underlying FFO. Over the past 5 years, FFO/share has grown by around 6.2% per annum. Future FFO/share growth is massively dependent on whether one believes demand for office properties will flourish in a post-COVID-19 world or remain relatively stagnant, limiting PSB's overall prospects. Currently, we are supporting the former case, expecting FFO/share growth of around 4.5% in the medium term, powered by the likelihood for the company to continue closing new leasing deals at higher rental rates, as was the case over the first half of the year. The recent results pointed to promising developments, after all. That being said, we don't consider the latter scenario unlikely since occupancy recovery remains soft. Our sentiment, therefore, could change in the short term. PSB also displays a robust dividend history, with no dividend cuts taking place since 1998. Since then, the company has quadrupled its DPS with substantial, double-digit hikes, though with pauses in-between. Increases likely occur when the company feels it has reached a new profitability plateau. We estimate a DPS

¹ Share count is in millions.

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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CAGR of 6% ahead, lower than the company's 5 and 10-year CAGRs of 7% and 10.1%, respectively, but consecutive annual hikes should not be expected.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/FFO	11.1	15.8	15.1	17.8	17.9	20.3	22.1	19.3	24.9	20.4	25.4	23.0
Avg. Yld.	3.4%	2.6%	2.3%	2.4%	2.6%	2.9%	2.6%	3.0%	2.6%	3.2%	2.4%	2.8%

PSB's valuation has remained rather stable over the past decade, with the stock hovering at an average P/FFO of around 21.4 during this time. We believe that PSB's valuation multiple will likely be compressed modestly. The stock could be slightly overvalued at the moment but the current low-rate environment does justify a premium at the moment. We forecast the yield to converge towards around 2.8% in the coming years assuming valuation headwinds do materialize.

Safety, Quality, Competitive Advantage, & Recession Resiliency

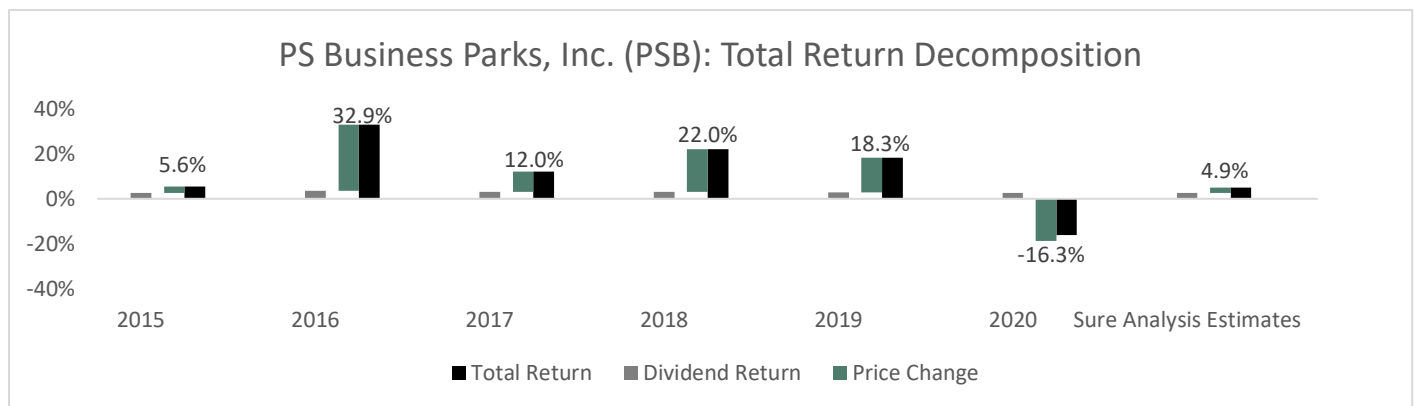
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	38%	42%	34%	42%	46%	58%	58%	59%	65%	65%	60%	65%

We consider PSB's current DPS as relatively safe. The company has been prudent with its dividend increases, resulting in retaining a healthy payout ratio, which currently stands at just around 60%. Hence, the dividend should remain covered even if cash flows were to come under pressure. PSB possesses several qualities, including a very diverse customer base. Its top 10 tenants account for only 10% of its annualized rental income. These tenants are also of the highest credit qualities, with its top 2 being the U.S. Government and Amazon. PSB also boasts an A- corporate credit rating by S&P, featuring a fortress balance sheet with \$0 long-term debt. The company funds its acquisition through issuing preferred stock, which currently trades with an average coupon (dividend) rate of 5.0%. These payouts are covered by around 6 times PSB's operating cash flows. We expect the company to perform relatively resilient during a recession, as was the case during the Great Financial Crisis, due to its leasing contracts having an average duration longer than 3 years.

Final Thoughts & Recommendation

PSB has delivered satisfactory returns over the past few years, posting robust FFO and DPS growth. However, we anticipate annualized returns of 4.9%, as our modest growth estimates could be offset by potential valuation headwinds ahead. We believe the company enjoys several noteworthy qualities, though the stock's investment case does not seem incredibly enticing at the moment. Shares earn a sell rating for the time being, as there are likely more attractive opportunities in the real estate space these days elsewhere. That said, PSB is a high-quality company.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	298	347	360	377	373	387	402	414	430	416
Gross Profit	198	233	245	250	252	264	280	289	302	290
Gross Margin	66.5%	67.1%	68.1%	66.2%	67.5%	68.2%	69.6%	69.9%	70.1%	69.8%
SG&A Exp.	9	9	5	14	14	15	13	12	14	15
D&A Exp.	85	109	109	110	105	99	94	94	100	92
Operating Profit	105	115	131	126	133	149	173	178	183	179
Operating Margin	35.2%	33.1%	36.4%	33.3%	35.6%	38.6%	43.0%	42.9%	42.7%	43.1%
Net Profit	94	89	103	174	130	128	155	227	175	174
Net Margin	31.6%	25.7%	28.7%	46.2%	35.0%	33.1%	38.5%	54.8%	40.7%	41.8%
Free Cash Flow	132	152	163	174	192	219	220	236	246	225

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	2,139	2,152	2,239	2,227	2,187	2,119	2,100	2,069	2,046	2,058
Cash & Equivalents	5	13	31	152	189	129	115	37	63	69
Accounts Receivable	3	5	5	3	2	2	2	1	1	2
Total Liabilities	778	538	324	319	326	309	210	85	85	82
Long-Term Debt	717	468	250	250	250	-	-	-	-	-
Shareholder's Equity	581	561	723	718	740	734	734	806	801	812
D/E Ratio	0.61	0.32	0.15	0.15	0.15	-	-	-	-	-

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	5.0%	4.2%	4.7%	7.8%	5.9%	5.9%	7.3%	10.9%	8.5%	8.5%
Return on Equity	16.0%	15.6%	16.1%	24.1%	17.9%	17.4%	21.1%	29.5%	21.8%	21.5%
ROIC	5.2%	4.3%	4.9%	8.0%	6.1%	6.5%	8.4%	11.7%	8.9%	8.8%
Shares Out.	24.5	24.2	24.7	26.9	27	27.1	27.2	27.3	27.4	27.5
Revenue/Share	12.12	14.27	14.49	13.96	13.79	14.23	14.67	15.08	15.62	15.08
FCF/Share	5.38	6.26	6.58	6.45	7.11	8.04	8.02	8.62	8.94	8.15

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

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