



Douglas Emmett (DEI)

Updated May 26th, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	\$28	5 Year CAGR Estimate:	12.9%	Market Cap:	\$5.7 B
Fair Value Price:	\$32	5 Year Growth Estimate:	7.0%	Ex-Dividend Date:	6/28/2022 ¹
% Fair Value:	88%	5 Year Valuation Multiple Estimate:	2.6%	Dividend Payment Date:	7/14/2022
Dividend Yield:	4.0%	5 Year Price Target	\$45	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	D	Rating:	Buy

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 86% of its revenue from its office portfolio and 14% 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 \$5.7 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 May, Douglas Emmett reported (5/3/22) financial results for the first quarter of fiscal 2022. During the quarter, it signed a nearly all-time high number of 246 office leases, which cover almost 900,000 square feet. Its multifamily portfolio remained essentially fully leased at 99.7%, with rents rising at a fast clip in all submarkets. As a result, total revenue grew 10% and adjusted funds from operations (FFO) per share grew 13% over the prior year's quarter.

Management marginally raised its guidance for FFO per share in 2022, from \$2.01-\$2.07 to \$2.02-\$2.08, implying 10% growth at the mid-point. We expect the REIT to continue recovering from the pandemic this year.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
FFO	\$1.36	\$1.78	\$1.83	\$1.92	\$2.13	\$2.20	\$2.35	\$2.45	\$2.12	\$1.86	\$2.05	\$2.88
DPS	\$0.63	\$0.74	\$0.81	\$0.85	\$0.89	\$0.94	\$1.01	\$1.06	\$1.12	\$1.12	\$1.12	\$1.50
Shares²	173.1	145.8	148.1	150.6	153.2	161.2	169.9	173.4	175.4	175.5	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 3.5% 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 continued effect of 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
P/FFO	16.6	13.8	14.9	15.3	15.8	17.7	16.0	16.7	14.8	17.6	13.7	15.5
Avg. Yld.	2.8%	3.0%	3.0%	2.9%	2.6%	2.4%	2.7%	2.6%	3.6%	3.4%	4.0%	3.4%

¹ Estimated date.

² 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 10-year low price-to-FFO ratio of 13.7. If Douglas Emmett trades at its average valuation level in five years, it will enjoy a 2.6% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	46%	41%	44%	44%	42%	43%	43%	43%	53%	60%	55%	52%

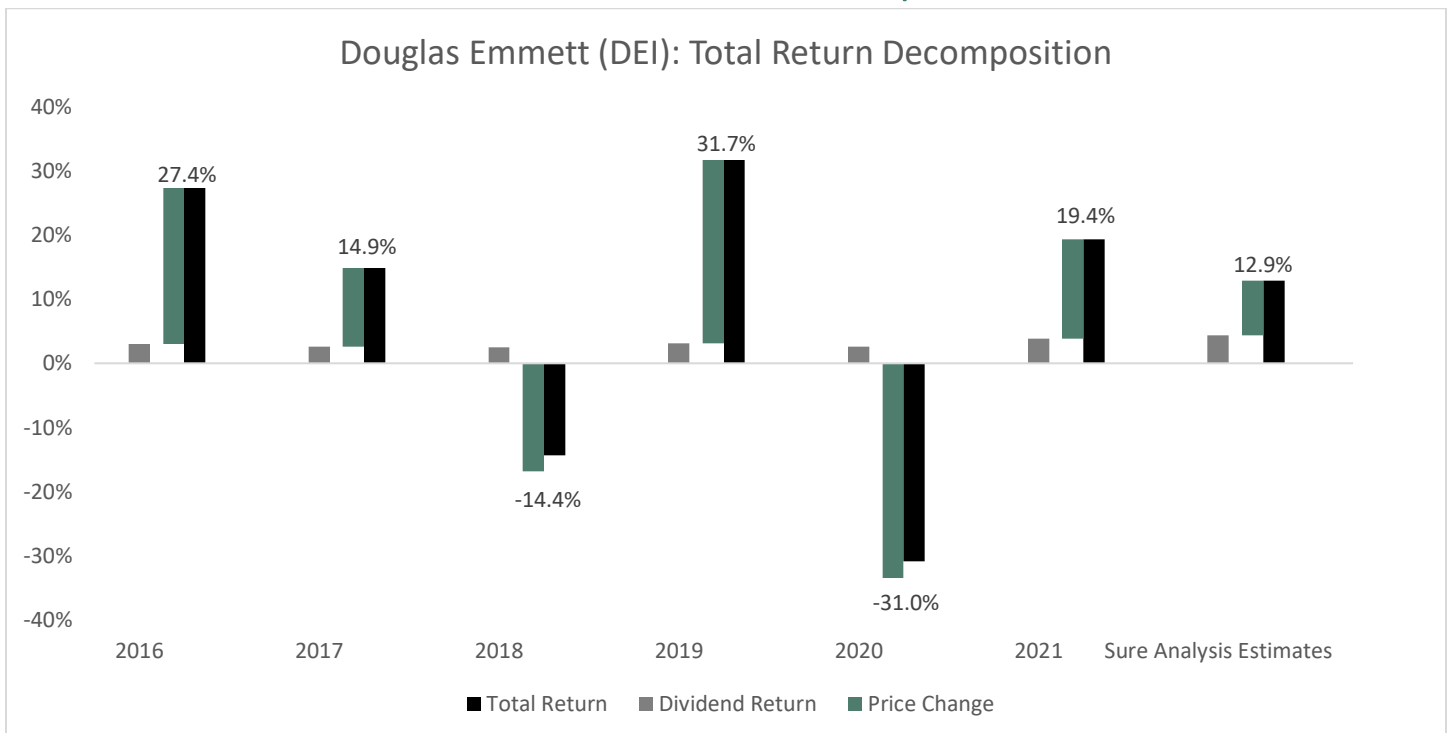
The markets of Douglas Emmett have the highest barriers to entry among the U.S. gateway markets. New office development in its core L.A. markets is limited due to restrictive zoning laws, density limits and anti-growth community sentiment. Total new supply of offices in these submarkets of L.A. and Honolulu 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, the company's interest coverage ratio has fallen from 1.8 in 2019 to 1.5 and the REIT has paid the same dividend for 10 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. The stock has shed -20% this year due to 40-year high inflation and fears of an upcoming recession. We view this correction as an opportunity and expect the stock to offer a 12.9% average annual rate over the next five years, thanks to 7.0% FFO growth, a 4.0% dividend and a 2.6% annualized valuation tailwind. As a result, Douglas Emmett receives a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	579	592	600	636	743	812	881	937	892	918
Gross Profit	389	397	398	425	505	554	600	639	586	615
Gross Margin	67.1%	67.1%	66.3%	66.9%	68.0%	68.2%	68.1%	68.2%	65.7%	67.0%
SG&A Exp.	28	27	27	30	35	36	39	38	40	43
D&A Exp.	167	176	186	186	231	259	288	341	369	362
Operating Profit	176	179	168	190	221	241	252	243	161	201
Operating Margin	30.4%	30.2%	28.0%	29.8%	29.7%	29.7%	28.6%	25.9%	18.1%	21.9%
Net Profit	23	45	45	58	85	94	116	364	50	65
Net Margin	4.0%	7.7%	7.4%	9.2%	11.5%	11.6%	13.2%	38.8%	5.7%	7.1%
Free Cash Flow	150	176	158	192	220	231	185	231	123	154

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	6,104	5,848	5,939	6,066	7,614	8,293	8,262	9,349	9,251	9,354
Cash & Equivalents	373	44	19	102	113	177	146	154	172	336
Accounts Receivable	65	71	77	82	95	109	129	140	134	128
Goodwill & Int. Ass.	7	6	6	6	7	6	5	8	7	6
Total Liabilities	3,713	3,481	3,625	3,785	4,600	4,391	4,413	4,978	5,255	5,367
Accounts Payable	19	21	22	24	37	63	75	66	82	83
Long-Term Debt	3,441	3,241	3,420	3,611	4,370	4,117	4,134	4,619	4,445	5,012
Shareholder's Equity	1,980	1,970	1,943	1,926	1,921	2,438	2,402	2,712	2,437	2,416
D/E Ratio	1.74	1.64	1.76	1.87	2.27	1.69	1.72	1.70	1.82	2.07

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.4%	0.8%	0.8%	1.0%	1.2%	1.2%	1.4%	4.1%	0.5%	0.7%
Return on Equity	1.2%	2.3%	2.3%	3.0%	4.4%	4.3%	4.8%	14.2%	2.0%	2.7%
ROIC	0.4%	0.8%	0.8%	1.0%	1.3%	1.2%	1.5%	4.3%	0.6%	0.7%
Shares Out.	173.1	145.8	148.1	150.6	153.2	161.2	169.9	173.4	175.4	175.5
Revenue/Share	3.34	4.06	4.05	4.22	4.85	5.04	5.19	5.34	5.08	5.23
FCF/Share	0.87	1.21	1.07	1.28	1.44	1.43	1.09	1.32	0.70	0.88

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

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