



Essex Property Trust Inc. (ESS)

Updated April 28th, 2022 by Samuel Smith

Key Metrics

Current Price:	\$349	5 Year CAGR Estimate:	-2.0%	Market Cap:	\$25 B
Fair Value Price:	\$250	5 Year Growth Estimate:	1.5%	Ex-Dividend Date:	06/30/22 ¹
% Fair Value:	139%	5 Year Valuation Multiple Estimate:	-6.4%	Dividend Payment Date:	07/14/22 ²
Dividend Yield:	2.5%	5 Year Price Target	\$270	Years Of Dividend Growth:	27
Dividend Risk Score:	B	Retirement Suitability Score:	C	Rating:	Sell

Overview & Current Events

Essex Property Trust Inc. (ESS) was founded in 1971 and became a publicly traded real estate investment trust (REIT) in 1994. The trust invests in west coast multifamily residential properties where it engages in development, redevelopment, management and acquisition of apartment communities and a few other select properties. Essex has ownership interests in several hundred apartment communities consisting of over 60,000 apartment homes. The trust has about 1,800 employees and produces approximately \$1.6 billion in annual revenue.

On April 26th, 2022 Essex reported first quarter results. Core FFO-per-diluted share increased 9.8% to \$3.37 from \$3.07 year-over-year. Total FFO per-diluted share increased 4% to \$3.36 from \$3.23 in the year-ago period. Net income decreased 56.8% to \$1.12 primarily due to a gain on sale recorded in the prior-year period. Same-property gross revenue increased by 6.5% and same-property net operating income increased by 7.3% year-over-year.

Meanwhile, Essex raised its 2022 core FFO per share guidance by \$0.25 at the midpoint to a range of \$13.77 - \$14.13, net income per diluted share guidance by \$0.11 at the midpoint to a range of \$4.79 - \$5.15, and expects full-year same-property revenue growth of 8.6% and same-property NOI growth of 10.7%.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
FFO	\$6.71	\$7.59	\$7.89	\$9.72	\$11.04	\$11.91	\$12.57	\$13.38	\$12.82	\$12.49	\$13.90	\$15.00
DPS	\$4.40	\$4.84	\$5.11	\$5.76	\$6.40	\$7.00	\$7.44	\$7.80	\$8.31	\$7.48	\$8.80	\$9.50
Shares³	37.9	38.6	65.1	65.4	65.5	66.0	65.7	66.2	65.0	65.2	65.3	66.0

Essex Property Trust has achieved impressive growth for several decades on the back of the strong west coast property market, but growth has been slowing in the past few years. Like many REITs, the trust historically has issued new shares to fund rapid growth. In 2014, the trust merged with BRE Properties, which drastically increased the trust's size and shares outstanding. Since then, the trust's rate of growth has slowed, and they have maintained a more static number of shares outstanding.

Consensus analyst expectations prior to the COVID-19 outbreak were for mid-single digit growth in FFO per share between in the coming years. We conservatively estimate low-single-digit growth over the next half decade through 2027, following the recent trend of slowing growth and because several major west coast cities have seen a recent dip or flattening out of property values, which could put pressure on rent prices.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/FFO	22.2	20.4	23.1	23.1	19.4	20.5	18.9	22.1	19.8	27.5	25.1	18.0
Avg. Yld.	3.0%	3.1%	2.8%	2.6%	3.0%	2.9%	3.1%	2.6%	3.3%	2.4%	2.5%	3.5%

¹ Estimate

² Estimate

³ Share count is in millions.

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Essex Property Trust currently trades for 25.1x FFO, which is above its recent historical average. While it is reasonable to pay up for a trust of this level of quality, we consider the historical valuation to be rich compared to the trust’s growth rate and current headwinds. Therefore, we believe the fair value should be closer to 18 times FFO moving forward, making the trust overvalued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	66%	64%	65%	59%	58%	59%	58%	58%	64%	67%	63%	63%

Essex Property Trust is a high-quality apartment REIT that has raised its dividend for 27 consecutive years from the time it first became a publicly traded trust. Real estate has a natural moat and Essex’s exposure to high-value cities with strong technology cultures further widens that moat. However, apartments generally have a more elastic supply than single family homes, which offsets some of that protection. This was shown during the previous recession, when the trust’s FFO fell, but not by an extreme amount, and Essex was able to continue raising its dividend.

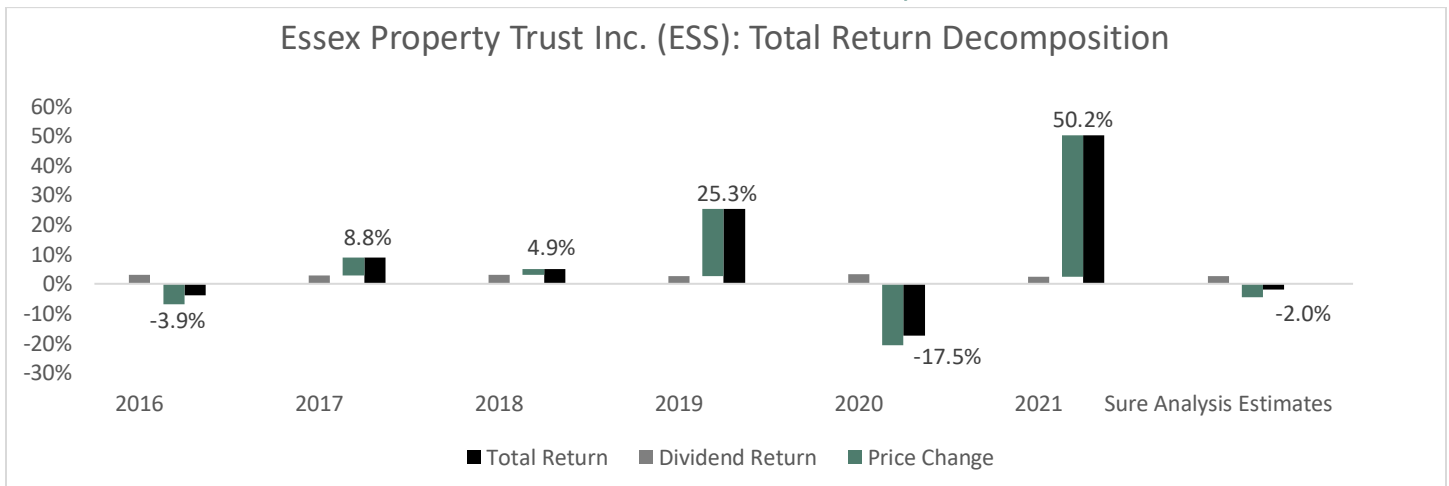
The trust has a solid BBB+ credit rating and currently has an interest coverage ratio of over 450%, which provides a very large margin compared to their debt covenant requirement of 150% or higher. Net debt to adjusted EBITDA is ~5.5x, which is solid. Like many real estate businesses, Essex Property Trust uses a substantial but fair amount of leverage and maintains a relatively safe balance sheet. Its weighted average interest rate is under 4.0%, which is quite low, reflecting the trust’s strong credit metrics.

Final Thoughts & Recommendation

Essex Property Trust has been a strong outperformer in terms of total returns since it went public in 1994 due to a combination of good management and a tailwind from the fast-growing west coast property market on the back of a strong technology industry in the region. However, property values in popular west coast cities are now some of the highest in the country and are showing some signs of peaking, or at least slowing growth. The growth rate of Essex Property Trust has been slowing lately, and the trust has at least moderate downside risk as the country is grappling with runaway inflation.

With -2% expected annualized total returns over the next half decade, we rate shares as a Sell. That said, Essex Property Trust remains a very high quality REIT and offers conservative dividend growth investors a solid yield, dividend growth track record, strong balance sheet, and sustainable payout ratio.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	535	611	971	1,194	1,294	1,364	1,400	1,460	1,496	1,441
Gross Profit	363	413	658	831	905	958	984	1,030	1,021	959
Gross Margin	67.8%	67.7%	67.8%	69.6%	69.9%	70.3%	70.3%	70.5%	68.2%	66.6%
SG&A Exp.	25	27	41	40	41	41	53	54	65	52
D&A Exp.	171	194	361	453	442	469	480	484	525	520
Operating Profit	169	194	257	337	423	448	450	492	430	387
Operating Margin	31.6%	31.8%	26.5%	28.2%	32.7%	32.9%	32.2%	33.7%	28.7%	26.9%
Net Profit	125	156	122	232	415	433	390	439	569	489
Net Margin	23.4%	25.6%	12.6%	19.4%	32.1%	31.8%	27.9%	30.1%	38.0%	33.9%
Free Cash Flow	222	248	414	561	652	697	745	817	713	784

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	4847	5187	11527	12008	12217	12496	12384	12705	12936	12998
Cash & Equivalents	19	18	26	30	65	45	134	70	74	48
Total Liabilities	2,963	3,184	5,367	5,626	5,880	6,060	5,954	6,264	6,721	6,787
Accounts Payable	65	67	135	131	138	128	127	158	153	181
Long-Term Debt	2,819	3,034	5,081	5,319	5,563	5,689	5,606	5,809	6,252	6,287
Shareholder's Equity	1,691	1,811	5,949	6,164	6,192	6,277	6,267	6,220	6,000	5,994
LTD/E Ratio	1.59	1.61	0.84	0.85	0.90	0.91	0.89	0.93	1.04	1.05

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.8%	3.1%	1.5%	2.0%	3.4%	3.5%	3.1%	3.5%	4.4%	3.8%
Return on Equity	8.2%	8.9%	3.1%	3.8%	6.7%	6.9%	6.2%	7.0%	9.3%	8.1%
ROIC	2.9%	3.2%	1.5%	2.0%	3.5%	3.6%	3.2%	3.6%	4.6%	3.9%
Shares Out.	37.9	38.6	65.1	65.4	65.5	66.0	65.7	66.2	65.0	65.2
Revenue/Share	15.24	16.35	17.13	18.36	19.73	20.70	21.19	22.14	22.81	22.13
FCF/Share	6.32	6.64	7.31	8.62	9.94	10.57	11.27	12.40	10.88	12.05

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

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