AvalonBay Communities Inc. (AVB)

Updated November 22nd, 2022 by Samuel Smith

Key Metrics

Current Price:	$169	**5 Year CAGR Estimate:**	9.2%	**Market Cap:**	$23.6B
Fair Value Price:	$177	**5 Year Growth Estimate:**	4.9%	**Ex-Dividend Date:**	12/29/22
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	0.9%	**Dividend Payment Date:**	01/17/23
Dividend Yield:	3.8%	**5 Year Price Target**	$225	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Hold

Overview & Current Events

AvalonBay Communities (AVB) is a $23.6 billion multifamily REIT that owns a portfolio of several hundred apartment communities and is also an active developer of apartment communities. 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 ten consecutive years.

AvalonBay reported Q3 results on 11/03/22. Net Income for the three months ended September 30, 2022, was $494,747,000 and Q3 earnings per share increased by 530.4% to $3.53 from $0.56 for the prior year period, primarily attributable to an increase in gains on the sale of real estate and an increase in Same Store Residential NOI.

Diluted FFO per share for the three months ended September 30, 2022, increased 25.5% to $2.46 from $1.96 in the prior year period. Core FFO per share for the three months ended September 30, 2022, increased 21.4% to $2.50 from $2.06 in the prior year period.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
FFO/S	$5.43	$6.23	$6.78	$7.55	$8.19	$8.62	$9.00	$9.34	$8.69	$8.26	***$9.84***	***$12.50***
DPS	$3.88	$4.28	$4.64	$5.00	$5.40	$5.68	$5.88	$6.08	$6.36	$6.36	***$6.36***	***$8.31***
Shares[1]	114.4	129.4	132.0	137.0	137.0	137.7	138.1	140.3	139.2	139.5	***139.7***	***140***

Over the past decade, AvalonBay generated very impressive annualized Core FFO/share growth 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 before declining in 2020 and 2021 due to COVID-19. This year growth is expected to recover sharply as COVID-19 headwinds dissipate.

Additional potential headwinds for AvalonBay are the threat of future rent control legislation in its West Coast markets (this has already been on the ballot in recent elections) as well as the uncertain economic climate in AvalonBay's target markets as a result of the fallout from COVID-19, including the growing work from home trend. Furthermore, its denser markets will likely see less growth in the years to come as people become increasingly wary of moving to big cities due to social unrest and the lingering fears from the COVID-19 outbreak. However, they are also operating from a lower base after 2021 FFO per share declined from 2019 and 2020. As a result, we are projecting a 4.9% annualized growth rate over the next five years.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/FFO	25.3	18.2	19.0	24.2	21.8	20.7	19.2	23.3	19.0	29.2	***17.2***	***18.0***
Avg. Yld.	2.8%	3.8%	3.6%	2.7%	3.0%	3.2%	3.4%	2.8%	3.9%	2.7%	***3.8%***	***3.7%***

[1] In millions

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The recent valuation multiple has hovered at or above 20x Core FFO/share, and the dividend yield has ranged between 2.6% and 3.9%. 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 slowing growth relative to pre-COVID-19 levels. Therefore, the stock will warrant a lower valuation multiple and a higher dividend yield. Nevertheless, we still think the stock is slightly undervalued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2027**
Payout	71%	69%	68%	66%	66%	66%	65%	65%	73%	77%	***65%***	***66%***

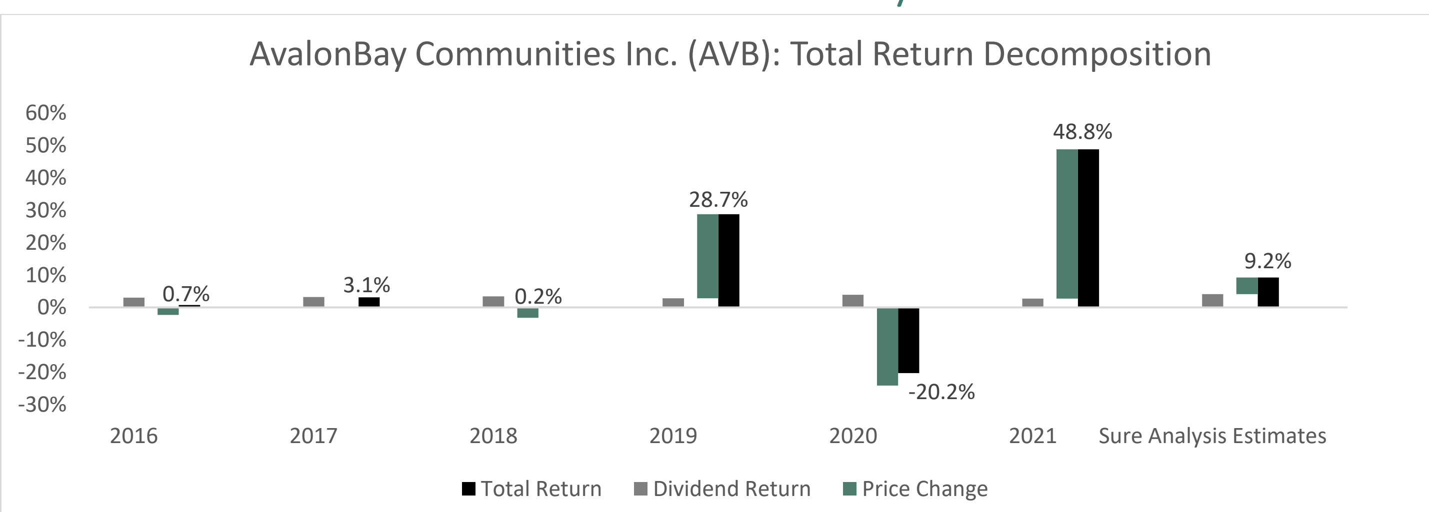
AvalonBay significantly outperformed the S&P 500 during the Great Recession due to the defensive nature of the multifamily sector. However, it still experienced a sizable decline in FFO/share (from $4.61 in 2007 down to a low of $3.89 in 2009). Additionally, multifamily apartments lack a strong competitive 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 fact, AvalonBay's investments are essentially a bet 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. AvalonBay appears slightly undervalued at the moment and likely to deliver solid 9.2% annualized total returns moving forward. As a result, we rate it a Hold. If growth prospects pick up or the stock price pulls back, shares will likely warrant buying, but until then we view AvalonBay as a Hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	1,001	1,463	1,685	1,856	2,045	2,159	2,285	2,325	2,301	2,295
Gross Profit	644	952	1,096	1,214	1,362	1,436	1,518	1,557	1,478	1,441
Gross Margin	64.3%	65.1%	65.0%	65.4%	66.6%	66.5%	66.4%	67.0%	64.2%	62.8%
SG&A Exp.	34	40	41	43	46	54	60	58	60	70
D&A Exp.	244	560	443	478	531	584	631	662	707	
Operating Profit	366	352	612	693	785	798	826	837	710	613
Operating Margin	36.6%	24.1%	36.3%	37.3%	38.4%	37.0%	36.2%	36.0%	30.9%	26.7%
Net Profit	424	353	684	742	1,034	877	975	786	828	1,004
Net Margin	42.4%	24.1%	40.6%	40.0%	50.6%	40.6%	42.7%	33.8%	36.0%	43.8%
Free Cash Flow	514	698	834	1,019	1,087	1,182	1,214	1,181	1,083	

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	11,160	15,328	16,141	16,931	17,867	18,415	18,380	19,121	19,199	19,902
Cash & Equivalents	2,734	281	509	401	215	67	92	40	217	420
Total Liabilities	4,319	6,728	7,094	7,091	7,696	8,027	7,748	8,131	8,447	8,969
Accounts Payable	53	95	102	99	101	85	97	92	94	
Long-Term Debt	3,851	6,134	6,490	6,457	7,031	7,329	7,040	7,296	7,564	8,104
Shareholder's Equity	6,837	8,596	9,046	9,841	10,171	10,388	10,633	10,990	10,752	10,933
LTD/E Ratio	0.56	0.71	0.72	0.66	0.69	0.71	0.66	0.66	0.70	0.74

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	4.3%	2.7%	4.3%	4.5%	5.9%	4.8%	5.3%	4.2%	4.3%	5.1%
Return on Equity	7.5%	4.6%	7.7%	7.9%	10.3%	8.5%	9.3%	7.3%	7.6%	9.3%
ROIC	4.5%	2.8%	4.5%	4.7%	6.2%	5.0%	5.5%	4.4%	4.5%	5.4%
Shares Out.	114.4	129.4	132.0	137.0	137.0	137.7	138.1	140.3	139.2	139.5
Revenue/Share	10.21	11.50	12.84	13.79	14.88	15.63	16.52	16.66	16.39	16.42
FCF/Share	5.25	5.48	6.35	7.57	7.91	8.56	8.78	8.46	7.71	

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