



AvalonBay Communities Inc. (AVB)

Updated February 14th, 2023 by Samuel Smith

Key Metrics

Current Price:	\$182	5 Year CAGR Estimate:	7.0%	Market Cap:	\$25.1B
Fair Value Price:	\$188	5 Year Growth Estimate:	2.9%	Ex-Dividend Date:	03/30/23
% Fair Value:	97%	5 Year Valuation Multiple Estimate:	0.7%	Dividend Payment Date:	04/17/23
Dividend Yield:	3.6%	5 Year Price Target	\$217	Years Of Dividend Growth:	0
Dividend Risk Score:	C	Retirement Suitability Score:	B	Rating:	Hold

Overview & Current Events

AvalonBay Communities (AVB) is a \$25.1 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 Q4 results on 02/08/23. Q4 FFO per share was \$2.59. FY22 Same Store total revenue increased \$222,830,000, or 11.0%, to \$2,250,368,000. Management guided for FQ1'23 FFO per share of \$2.47 — \$2.57, vs. the consensus estimate of \$2.57. Management guided for FY23 FFO of \$10.06 — \$10.56, vs. the consensus estimate of \$10.50.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
FFO/S	\$6.23	\$6.78	\$7.55	\$8.19	\$8.62	\$9.00	\$9.34	\$8.69	\$8.26	\$9.79	\$10.45	\$12.04
DPS	\$4.28	\$4.64	\$5.00	\$5.40	\$5.68	\$5.88	\$6.08	\$6.36	\$6.36	\$6.36	\$6.60	\$8.31
Shares¹	129.4	132.0	137.0	137.0	137.7	138.1	140.3	139.2	139.5	139.7	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. In 2022 FFO per share resumed growth as COVID-19 headwinds dissipated and 2023 is expected to see continued growth.

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. Overall, we are projecting a 2.9% annualized growth rate over the next five years.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
P/FFO	18.2	19	24.2	21.8	20.7	19.2	23.3	19	29.2	17.2	17.4	18.0
Avg. Yld.	3.8%	3.6%	2.7%	3.0%	3.2%	3.4%	2.8%	3.9%	2.7%	3.8%	3.6%	3.8%

The P/FFO valuation multiple has varied between the high teens and the low 20s over the past decade, and the dividend yield has ranged between 2.6% and 3.9%. However, the abundant new supply reaching markets combined with increasing inflationary and rising interest rate 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

¹ In millions

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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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	68.7%	68.4%	66.2%	65.9%	65.9%	65.3%	65.1%	73.2%	77.0%	65.0%	63.2%	69.0%

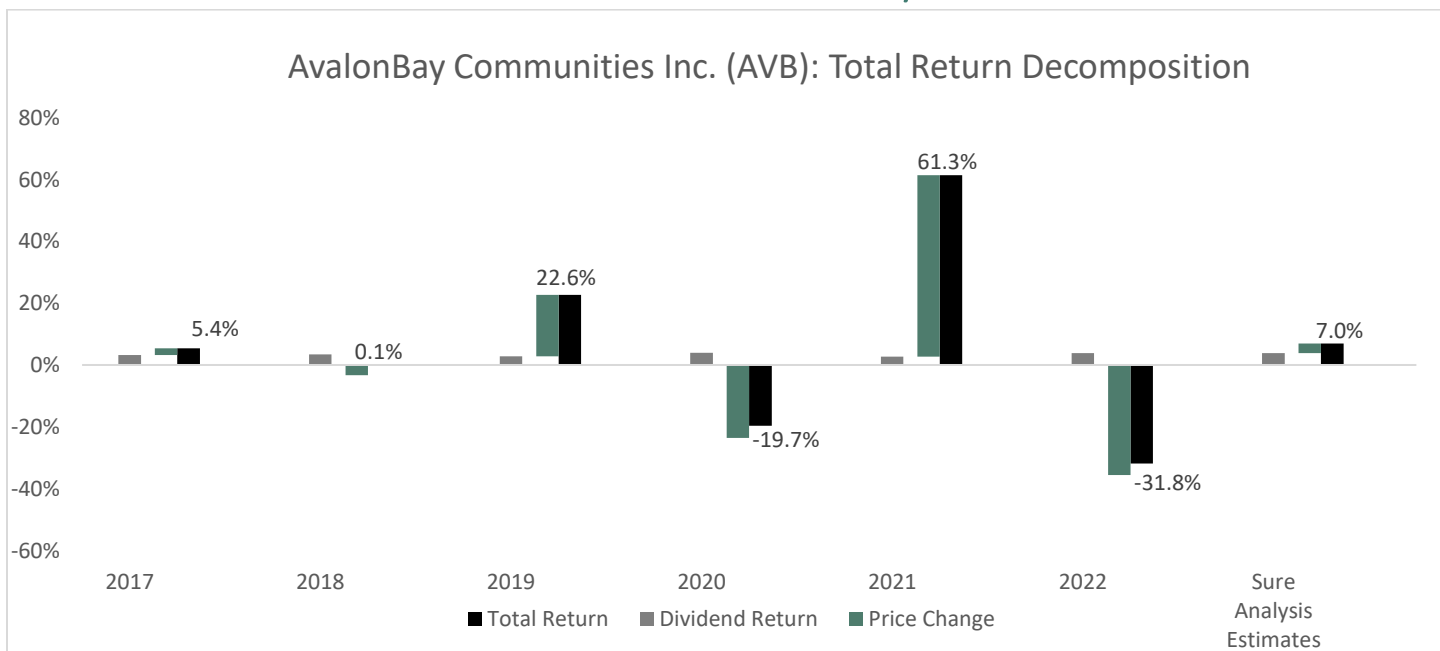
AvalonBay significantly outperformed the S&P 500 during the Great Recession due to the defensive nature of the multifamily sector. However, it still experienced a sizable decline in FFO/share (from \$4.61 in 2007 down to a low of \$3.89 in 2009). Additionally, multifamily apartments lack a strong competitive 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 7.0% 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1,463	1,685	1,856	2,045	2,159	2,285	2,325	2,301	2,295	2,593
Gross Profit	952	1,096	1,214	1,362	1,436	1,518	1,557	1,478	1,441	1,674
Gross Margin	65.1%	65.0%	65.4%	66.6%	66.5%	66.4%	67.0%	64.2%	62.8%	64.6%
SG&A Exp.	40	41	43	46	54	60	58	60	70	74
D&A Exp.	560	443	478	531	584	631	662	707	759	
Operating Profit	352	612	693	785	798	826	837	710	613	769
Operating Margin	24.1%	36.3%	37.3%	38.4%	37.0%	36.2%	36.0%	30.9%	26.7%	29.6%
Net Profit	353	684	742	1,034	877	975	786	828	1,004	1,137
Net Margin	24.1%	40.6%	40.0%	50.6%	40.6%	42.7%	33.8%	36.0%	43.8%	43.8%
Free Cash Flow	698	834	1,019	1,087	1,182	1,214	1,181	1,083	1,050	

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	15,328	16,141	16,931	17,867	18,415	18,380	19,121	19,199	19,902	20,458
Cash & Equivalents	281	509	401	215	67	92	40	217	420	613
Total Liabilities	6,728	7,094	7,091	7,696	8,027	7,748	8,131	8,447	8,966	9,202
Accounts Payable	95	102	99	101	85	97	92	94	64	
Long-Term Debt	6,134	6,490	6,457	7,031	7,329	7,040	7,296	7,564	8,104	8,316
Shareholder's Equity	8,596	9,046	9,841	10,171	10,388	10,633	10,990	10,752	10,933	11,254
LTD/E Ratio	0.71	0.72	0.66	0.69	0.71	0.66	0.66	0.70	0.74	0.74

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	2.7%	4.3%	4.5%	5.9%	4.8%	5.3%	4.2%	4.3%	5.1%	5.6%
Return on Equity	4.6%	7.7%	7.9%	10.3%	8.5%	9.3%	7.3%	7.6%	9.3%	10.2%
ROIC	2.8%	4.5%	4.7%	6.2%	5.0%	5.5%	4.4%	4.5%	5.4%	5.9%
Shares Out.	129.4	132.0	137.0	137.0	137.7	138.1	140.3	139.2	139.5	139.7
Revenue/Share	11.50	12.84	13.79	14.88	15.63	16.52	16.66	16.39	16.42	18.53
FCF/Share	5.48	6.35	7.57	7.91	8.56	8.78	8.46	7.71	7.51	

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

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