



# Douglas Emmett (DEI)

Updated February 14<sup>th</sup>, 2023 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$16	<b>5 Year CAGR Estimate:</b>	18.0%	<b>Market Cap:</b>	\$3.3 B
<b>Fair Value Price:</b>	\$29	<b>5 Year Growth Estimate:</b>	2.0%	<b>Ex-Dividend Date:</b>	3/29/2023 <sup>1</sup>
<b>% Fair Value:</b>	54%	<b>5 Year Valuation Multiple Estimate:</b>	13.0%	<b>Dividend Payment Date:</b>	4/14/2023
<b>Dividend Yield:</b>	4.8%	<b>5 Year Price Target</b>	\$33	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	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 \$3.3 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 February, Douglas Emmett reported (2/7/23) financial results for the fourth quarter of fiscal 2022. The trust leased 772,000 square feet in the quarter and its multifamily portfolio remained essentially fully leased. Revenue grew 6.4% and adjusted funds from operations (FFO) per share grew 6% over the prior year's quarter. However, management provided poor guidance for 2023, expecting FFO per share of \$1.87-\$1.93, primarily due to a significant increase in interest expense (\$0.16 per share) expected this year amid higher interest rates. The trust also cut its dividend by 32% due to this headwind. Fortunately, 87% of debt is at fixed rates and there are no debt maturities until the end of 2024.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>FFO</b>	\$1.78	\$1.83	\$1.92	\$2.13	\$2.20	\$2.35	\$2.45	\$2.12	\$1.86	\$2.03	<b>\$1.90</b>	<b>\$2.10</b>
<b>DPS</b>	\$0.74	\$0.81	\$0.85	\$0.89	\$0.94	\$1.01	\$1.06	\$1.12	\$1.12	\$1.03	<b>\$0.76</b>	<b>\$0.84</b>
<b>Shares<sup>2</sup></b>	145.8	148.1	150.6	153.2	161.2	169.9	173.4	175.4	175.5	175.8	<b>176.0</b>	<b>200.0</b>

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. The company has grown its adjusted FFO per share at a 1.4% average annual rate over the last decade. In addition, the REIT has ample development opportunities within its existing portfolio. Given the low comparison base formed this year due to the continued effect of the pandemic but also the negative effect of high interest rates on interest expense, we expect Douglas Emmett to grow its FFO per share at a 2.0% average annual rate over the next five years.

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
<b>P/FFO</b>	13.8	14.9	15.3	15.8	17.7	16.0	16.7	14.8	17.6	12.1	<b>8.4</b>	<b>15.5</b>
<b>Avg. Yld.</b>	3.0%	3.0%	2.9%	2.6%	2.4%	2.7%	2.6%	3.6%	3.4%	4.2%	<b>4.8%</b>	<b>2.6%</b>

<sup>1</sup> Estimated date.

<sup>2</sup> 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 8.4. If Douglas Emmett trades at its average valuation level in five years, it will enjoy a 13.0% annualized gain in its returns.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	41%	44%	44%	42%	43%	43%	43%	53%	60%	51%	40%	40%

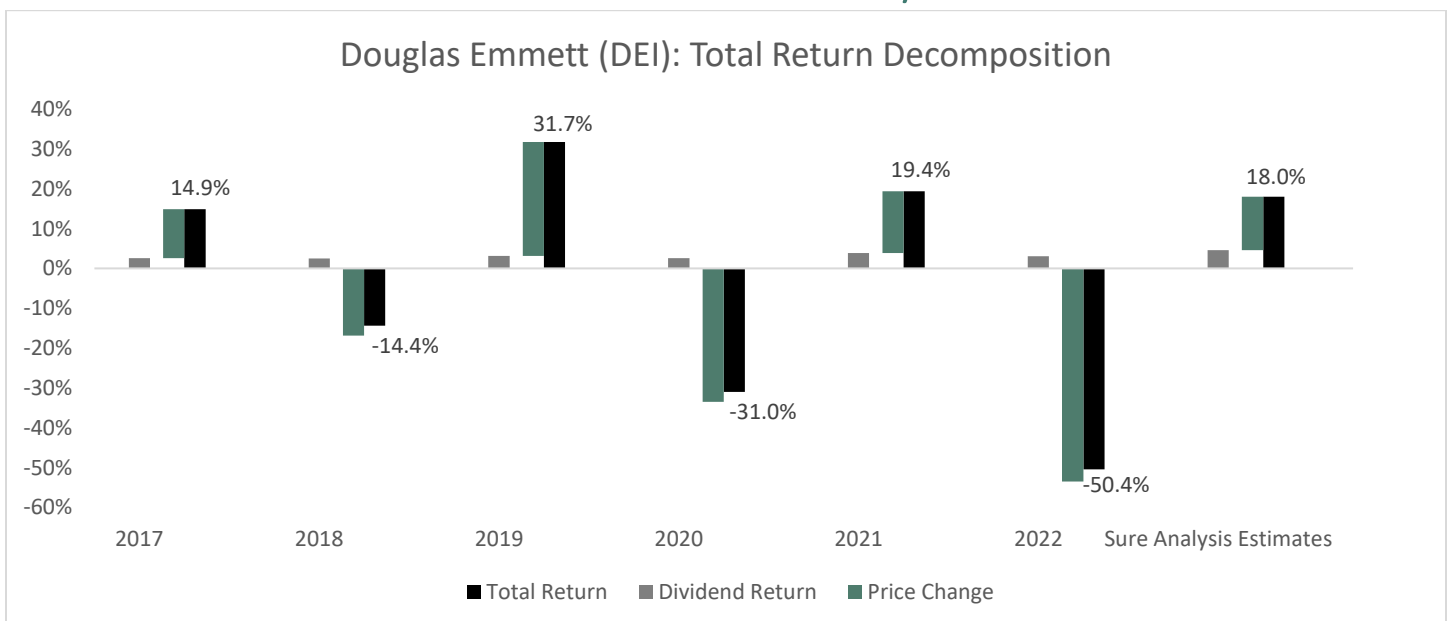
The markets of Douglas Emmett have the highest barriers to entry among the U.S. gateway markets. New office development in its core L.A. markets is limited due to restrictive zoning laws, density limits and anti-growth community sentiment. Total new supply of offices in these submarkets of L.A. and Honolulu 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 1.6 and the REIT recently cut its dividend by 32%, after having paid the same dividend for 12 consecutive quarters. The REIT 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. The stock has shed -48% over the last 12 months due to 40-year high inflation, high interest expense and fears that the pandemic may have a permanent impact on the occupancy of office space. We view this sell-off as an opportunity and expect the stock to offer an 18.0% average annual rate over the next five years thanks to 2.0% FFO growth, a 4.8% dividend and a 13.0% annualized valuation tailwind. The REIT receives a buy rating but we note that it is suitable only for patient investors, who can tolerate stock price pressure and remain focused on the long term.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Revenue</b>	592	600	636	743	812	881	937	892	918	994
<b>Gross Profit</b>	397	398	425	505	554	600	639	586	615	660
<b>Gross Margin</b>	67.1%	66.3%	66.9%	68.0%	68.2%	68.1%	68.2%	65.7%	67.0%	66.4%
<b>SG&amp;A Exp.</b>	27	27	30	35	36	39	38	40	43	45
<b>D&amp;A Exp.</b>	176	186	186	231	259	288	341	369	362	---
<b>Operating Profit</b>	179	168	190	221	241	252	243	161	201	242
<b>Operating Margin</b>	30.2%	28.0%	29.8%	29.7%	29.7%	28.6%	25.9%	18.1%	21.9%	24.3%
<b>Net Profit</b>	45	45	58	85	94	116	364	50	65	97
<b>Net Margin</b>	7.7%	7.4%	9.2%	11.5%	11.6%	13.2%	38.8%	5.7%	7.1%	9.8%
<b>Free Cash Flow</b>	176	158	192	220	231	185	231	123	154	---

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Assets</b>	5,848	5,939	6,066	7,614	8,293	8,262	9,349	9,251	9,354	9747
<b>Cash &amp; Equivalents</b>	44	19	102	113	177	146	154	172	336	269
<b>Accounts Receivable</b>	71	77	82	95	109	129	140	134	128	122
<b>Goodwill &amp; Int. Ass.</b>	6	6	6	7	6	5	8	7	6	4
<b>Total Liabilities</b>	3,481	3,625	3,785	4,600	4,391	4,413	4,978	5,255	5,367	5472
<b>Accounts Payable</b>	21	22	24	37	63	75	66	82	83	---
<b>Long-Term Debt</b>	3,241	3,420	3,611	4,370	4,117	4,134	4,619	4,445	5,012	5192
<b>Shareholder's Equity</b>	1,970	1,943	1,926	1,921	2,438	2,402	2,712	2,437	2,416	2562
<b>D/E Ratio</b>	1.64	1.76	1.87	2.27	1.69	1.72	1.70	1.82	2.07	2.0262

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Return on Assets</b>	0.8%	0.8%	1.0%	1.2%	1.2%	1.4%	4.1%	0.5%	0.7%	1.0%
<b>Return on Equity</b>	2.3%	2.3%	3.0%	4.4%	4.3%	4.8%	14.2%	2.0%	2.7%	3.9%
<b>ROIC</b>	0.8%	0.8%	1.0%	1.3%	1.2%	1.5%	4.3%	0.6%	0.7%	1.1%
<b>Shares Out.</b>	145.8	148.1	150.6	153.2	161.2	169.9	173.4	175.4	175.5	175.8
<b>Revenue/Share</b>	4.06	4.05	4.22	4.85	5.04	5.19	5.34	5.08	5.23	5.65
<b>FCF/Share</b>	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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