Douglas Emmett (DEI)

Updated November 3rd, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	$12	**5 Year CAGR Estimate:**	21.8%	**Market Cap:**	$2.2 B
Fair Value Price:	$28	**5 Year Growth Estimate:**	0.0%	**Ex-Dividend Date:**	12/28/2023[1]
% Fair Value:	42%	**5 Year Valuation Multiple Estimate:**	18.8%	**Dividend Payment Date:**	1/17/2024
Dividend Yield:	6.3%	**5 Year Price Target**	$28	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**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 80% of its revenue from its office portfolio and 20% 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 $2.2 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 late October, Douglas Emmett reported (10/31/23) financial results for the third quarter of fiscal 2023. Revenue grew 0.7% thanks to higher tenant recoveries but adjusted funds from operations (FFO) per share dipped -15% over the prior year's quarter due to increased interest expense. Management reiterated its guidance for FFO per share of $1.81-$1.85 in 2023, as high interest rates will continue weighing on interest expense. The trust also cut its dividend by 32% in January due to this headwind. Fortunately, 87% of debt is at fixed rates and there are no debt maturities until the end of 2024, though we note that interest expense has exceeded operating income in the last two quarters.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
FFO	$1.78	$1.83	$1.92	$2.13	$2.20	$2.35	$2.45	$2.12	$1.86	$2.03	***$1.83***	***$1.83***
DPS	$0.74	$0.81	$0.85	$0.89	$0.94	$1.01	$1.06	$1.12	$1.12	$1.03	***$0.76***	***$0.76***
Shares[2]	145.8	148.1	150.6	153.2	161.2	169.9	173.4	175.4	175.5	175.8	***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. 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 work-from-home trend but also the negative effect of high interest rates on interest expense, we expect Douglas Emmett to post essentially flat FFO per share over the next five years.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
P/FFO	13.8	14.9	15.3	15.8	17.7	*16.0*	16.7	14.8	17.6	12.1	***6.6***	***15.5***
Avg. Yld.	3.0%	3.0%	2.9%	2.6%	2.4%	*2.7%*	2.6%	3.6%	3.4%	4.2%	***6.3%***	***2.7%***

[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 10-year low price-to-FFO ratio of 6.6 due to fears that high interest rates will greatly increase interest expense and thus they will reduce FFO per share. If Douglas Emmett trades at its average valuation level in five years, it will enjoy an 18.8% 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%	***42%***	***42%***

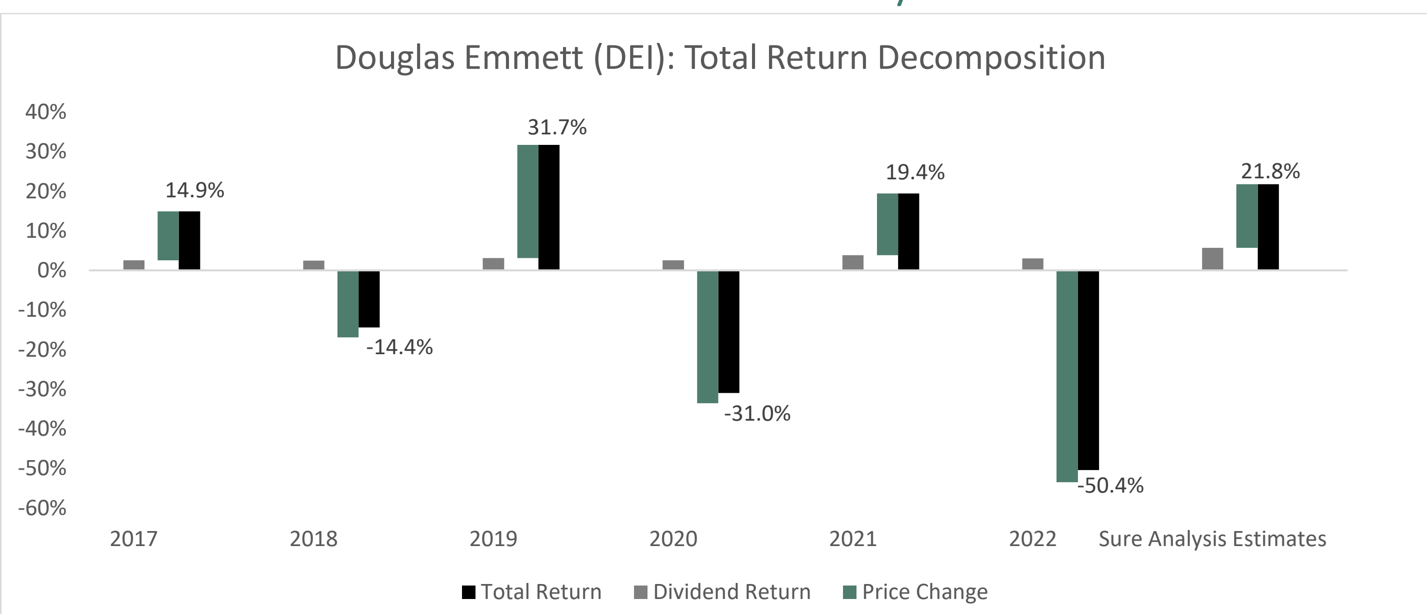
The markets of Douglas Emmett have the highest barriers to entry among the U.S. gateway markets. New office development in its core L.A. markets is limited due to restrictive zoning laws, density limits and anti-growth community sentiment. Total new supply of offices in these submarkets of L.A. and Honolulu 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 work-from-home trend and multi-year high interest rates, interest expense has surpassed operating income in the last two quarters. In addition, the REIT cut its dividend by 32% last year, 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

Douglas Emmett has been severely hurt by high interest expense and a persistent work-from-home trend. We view these headwinds as temporary. Thanks to its depressed price, the stock could offer a 21.8% average annual rate over the next five years thanks to its 6.3% dividend and an 18.8% annualized valuation gain. 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 confident that interest rates will revert to normal levels in the years ahead.

Total Return Breakdown by Year



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Income Statement Metrics

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

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	5,848	5,939	6,066	7,614	8,293	8,262	9,349	9,251	9,354	9747
Cash & Equivalents	44	19	102	113	177	146	154	172	336	269
Accounts Receivable	71	77	82	95	109	129	140	134	128	122
Goodwill & Int. Ass.	6	6	6	7	6	5	8	7	6	4
Total Liabilities	3,481	3,625	3,785	4,600	4,391	4,413	4,978	5,255	5,367	5472
Accounts Payable	21	22	24	37	63	75	66	82	83	---
Long-Term Debt	3,241	3,420	3,611	4,370	4,117	4,134	4,619	4,445	5,012	5192
Shareholder's Equity	1,970	1,943	1,926	1,921	2,438	2,402	2,712	2,437	2,416	2562
D/E Ratio	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
Return on Assets	0.8%	0.8%	1.0%	1.2%	1.2%	1.4%	4.1%	0.5%	0.7%	1.0%
Return on Equity	2.3%	2.3%	3.0%	4.4%	4.3%	4.8%	14.2%	2.0%	2.7%	3.9%
ROIC	0.8%	0.8%	1.0%	1.3%	1.2%	1.5%	4.3%	0.6%	0.7%	1.1%
Shares Out.	145.8	148.1	150.6	153.2	161.2	169.9	173.4	175.4	175.5	175.8
Revenue/Share	4.06	4.05	4.22	4.85	5.04	5.19	5.34	5.08	5.23	5.65
FCF/Share	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.