

Essex Property Trust (ESS)

\$213.02 (As of 08/21/20)

Price Target (6-12 Months): **\$226.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/15/18)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:D

Value: D

Growth: D

Momentum: C

Summary

Essex Property's second-quarter results displayed a dismal environment with a "sharp decline" in rental demand early in the quarter due to the pandemic and shelter-in-place ordinances. Yet, in the same-property portfolio, cash delinquencies as percentage of scheduled rent was 2.7% in July compared with the 4.3% witnessed in the second quarter. A sturdy property base, technological initiatives, substantial exposure to the West Coast market and healthy balance sheet offer ample scope to bolster top-line growth. However, with pandemic's adverse impact on economy and job market, demand for rental units and tenants' rent-paying capabilities are being affected. These are likely to thwart the company's rental rates, occupancy and rent collections. Its shares have underperformed the industry over the past year.

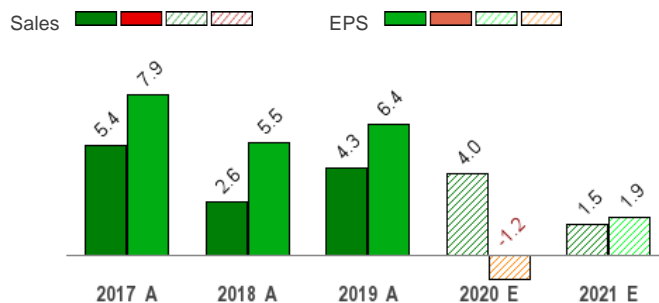
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$334.17 - \$175.81
20 Day Average Volume (sh)	427,262
Market Cap	\$13.9 B
YTD Price Change	-29.2%
Beta	0.64
Dividend / Div Yld	\$8.31 / 3.9%
Industry	REIT and Equity Trust - Residential
Zacks Industry Rank	Bottom 25% (189 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-4.2%
Last Sales Surprise	-3.1%
EPS F1 Est- 4 week change	-0.3%
Expected Report Date	NA
Earnings ESP	1.1%
P/E TTM	15.9
P/E F1	16.1
PEG F1	2.8
P/S TTM	9.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	377 E	380 E	385 E	389 E	1,541 E
2020	392 A	371 A	377 E	378 E	1,518 E
2019	356 A	362 A	367 A	375 A	1,460 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$3.26 E	\$3.32 E	\$3.39 E	\$3.42 E	\$13.47 E
2020	\$3.48 A	\$3.16 A	\$3.23 E	\$3.23 E	\$13.22 E
2019	\$3.23 A	\$3.33 A	\$3.35 A	\$3.45 A	\$13.38 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/21/2020. The reports text is as of 08/24/2020.

Overview

Headquartered in San Mateo, CA, Essex Property Trust, Inc. is a real estate investment trust (REIT) engaged in the acquisition, development, redevelopment and management of multifamily residential properties in supply constrained markets.

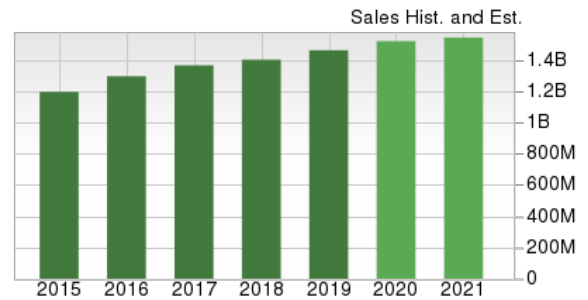
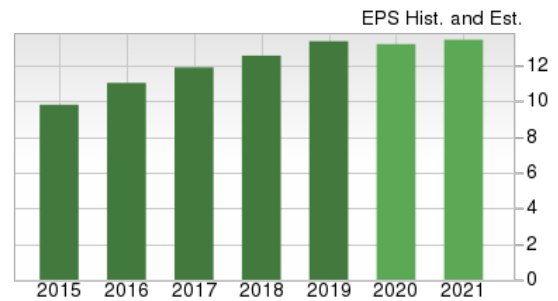
Specifically, the company enjoys concentration of assets in select coastal submarkets along the West Coast, including Southern California (Los Angeles, Orange, San Diego, and Ventura counties), Northern California (the San Francisco Bay Area) and the Seattle metropolitan areas. Notably, in April 2014, Essex Property completed the merger with BRE Properties which led to the creation of a premium West Coast pure play multifamily REIT.

As of Jun 30, 2020, Essex Property has ownership stake in 248 apartment communities providing around 60,341 apartment homes. Additionally, the company enjoys ownership stake in preferred interest co-investments and loan investments and one operating commercial building as well as seven active developments.

As of the same date, Essex Property's development pipeline included four consolidated projects and three unconsolidated joint-venture projects.

During second-quarter 2020, the company disposed two apartment communities — One South Market and Museum Park — located in San Jose, CA, for a total contract price of \$232 million.

Note: All EPS numbers presented in this report represent funds from operations ("FFO") per share. FFO, a widely used metric to gauge the performance of REITs, is obtained after adding depreciation and amortization and other non-cash expenses to net income.



Reasons To Buy:

- ▲ Essex Property enjoys a sturdy property base and strong management team. Importantly, the company's merger with BRE Properties in 2014 led to the creation of a premium West Coast pure-play multifamily REIT. Its markets have high barriers to housing construction. This residential REIT's substantial exposure to the West Coast market offers ample scope to enhance its top line over the long term. The West Coast is home to several innovation and technology companies. Several of the tech companies are in growth mode, have suffered minimal damages to their business model amid the pandemic and a number of them benefited from the shelter-in-place restrictions. Moreover, over the years, the region has been witnessing solid job growth, higher median household incomes, increased percentage of renters than owners, and favorable migration trends with the influx of workers to its markets. Moreover, due to high cost of homeownership, transition from renter to homeowner is difficult in its markets.
- ▲ Apart from this, demographic growth continues to be strong in the young adult age cohort, which has a higher propensity to rent. In fact, a significant change in lifestyle has taken place and life-cycle events are getting delayed. This is leading to an extension of the average age of first-time homeownership. This age cohort also experiences a considerable part of the net job growth and provides a significant source of pent-up demand.
- ▲ The company is also banking on its technology, scale and organizational capabilities to drive innovation and margin expansion in its portfolio. This has become all the more essential in this social-distancing era, as the virus outbreak needed a quick shift to virtual operations for the continuity of normal business operations. The company is making steady progress on the technology front and leasing agents are becoming more productive by leveraging on these tools. In addition, the company is providing high-speed Internet offered by leading fiber providers at 10% of its assets, and expects to complete installation at another 50% of its assets by year end. The move adds value to the company's assets in the work-from-home environment.
- ▲ Essex Property maintains a solid balance sheet and enjoys financial flexibility. The company exited the June-end quarter with cash and cash equivalents, including restricted cash, of \$256.5 million, up from the \$81.1 million recorded at the end of 2019. As of Jul 31, Essex Property had \$1.2 billion in undrawn capacity on its unsecured credit facilities and the company's immediate available liquidity surpassed \$1.4 billion. Also, over the years, the company made concerted efforts to increase its unencumbered NOI to adjusted total NOI, which stood at 94% in second-quarter 2020. With a high percentage of such assets, the company can enjoy accessibility to secured and unsecured debt markets, and maintain availability on the line. Additionally, Essex Property currently enjoys Baa1/BBB+ credit rating, with stable outlook from Moody's and S&P Global, respectively. Therefore, with solid liquidity position, no debt maturities in 2020 and funding commitments well covered, and investment grade ratings, the company remains well poised to navigate through these challenging times.
- ▲ Solid dividend payouts are arguably the biggest attraction for REIT investors and Essex Property has been steadily raising its payout. This February, the company announced a 6.5% hike in its quarterly dividend. The company has raised its dividend every year since the IPO in 1994 and the latest hike marked the company's 26th consecutive annual dividend increase. Since its IPO, the company has generated compound annual dividend per share growth of 6.4%. Such shareholder-friendly efforts are encouraging.

Essex Property is poised to gain from strong property base in the West Coast market. It has a healthy balance sheet and is leveraging technology, scale and organizational capabilities to drive growth.

Reasons To Sell:

- ▼ The coronavirus pandemic's adverse impact on economy and job-market environment is resulting in household contraction and consolidation. Loss of leisure and hospitality and other services jobs is affecting demand in the company's markets. Apart from these, a number of factors are affecting rental demand, including work-from-home flexibility that is resulting in a shift of some renter demand away from higher cost and urban/infill markets. In addition, record-low mortgage rates and the desire for space are driving homes sales. In addition, there is a decline in demand from two categories of renters — corporate and students — since most temporary corporate assignments have been canceled, while higher education is adopting remote learning models and limiting on-campus activities for the fall. Though operations in certain areas have been allowed to fully or partially re-open, many areas are witnessing new closures subsequent to re-opening. Thus, the choppy environment is expected to prevail in the near term and affect demand in many urban submarkets.
- ▼ Furthermore, amid slowdown in demand, concession activity is likely to be high. Moreover, amid this situation, rent-paying capability of tenants has been affected. Cash delinquencies as a percentage of scheduled rental income for the company's same-property portfolio increased from 0.3% for second-quarter 2019 to 4.3% for second-quarter 2020. Also, eviction moratoriums and laws that limit rent hikes during emergency times and prohibit the ability to collect unpaid rent during certain timeframes, have been enacted in various formats in Essex's markets. Amid these, the company's cash flows will likely be affected and considering the magnitude of uncertainty in the economy and about reopening, any turnaround is unlikely in the near term. Moreover, new rent-control regulations have been introduced in some of the major markets in recent times, while a number of other markets are being considered for establishing such regulations in future. This is likely to curb any significant growth in the top line.
- ▼ Essex Property has a significant concentration of assets in Southern California, Northern California, and the Seattle metropolitan area. Specifically, 82% of the company's rental revenues were generated from communities located in California for the year ended Dec 31, 2019. This makes the company's operating results and financial conditions susceptible to any unfavorable fluctuations in local markets.
- ▼ Shares of Essex Property have depreciated 33.4% over the past year compared with the industry's decline of 20.3%. Moreover, the trend in estimate revisions of 2020 FFO per share does not indicate a favorable outlook for the company. The Zacks Consensus Estimate for the current-year FFO per share has been revised marginally downward in a month's time. Therefore, given the above-mentioned concerns and downward estimate revisions, the stock has limited upside potential in the near term.

Adverse impacts of coronavirus pandemic on economy and job market will likely affect demand and hurt the rent-paying capability of tenants, leading to rental concessions and pricing-power moderation.

Last Earnings Report

Essex Property Q2 FFO and Revenues Miss Estimates

Essex Property reported second-quarter 2020 core FFO per share of \$3.16, missing the Zacks Consensus Estimate of \$3.30. The figure also fell 5.1% from the year-ago quarter's \$3.33.

Results reflect a tepid environment with a "sharp decline" in rental demand early in the quarter due to the coronavirus pandemic and shelter-in-place ordinances. Nevertheless, management witnessed improvements in employment trends at the end of the quarter and is "cautiously optimistic" about the continuation of these trends.

Total revenues of \$370.5 million missed the Zacks Consensus Estimate of \$382.2 million. However, the figure was up 2.5% year over year.

The company did not reinstate the full-year 2020 guidance due to the pandemic's uncertain nature as well as the evolving re-opening plans of the economy. However, the company, in its operational update, noted that in the same-property portfolio, cash delinquencies as percentage of scheduled rent was 2.7% in July compared with the 4.3% witnessed in the second quarter.

New lease rates declined 5.8% in July compared with a fall of 1.9% for the second quarter, while renewal rates slipped 1.9% in the month as against a rise of 0.4% during the quarter. However, financial occupancy improved to 96.2% in July, up from the June-end quarter's 94.9%.

Quarter in Detail

During the April-June quarter, Essex Property's same-property gross revenues declined 3.8% from the prior-year period. The company recorded an additional \$9.7 million of delinquencies in the quarter compared with the year-ago period.

Moreover, same-property operating expenses flared up 6% year on year, reflecting a 9.6% increase in real estate taxes on higher taxes in Seattle. Consequently, same-property NOI dropped 7.4% year over year. Financial occupancies of 94.9% contracted 190 basis points (bps) sequentially and 170 bps year over year.

During the reported quarter, the company disposed two apartment communities — One South Market and Museum Park — located in San Jose, CA, for a total contract price of \$232.0 million.

Balance Sheet

Essex Property exited the June-end quarter with cash and cash equivalents, including restricted cash, of \$256.5 million, up from the \$81.1 million recorded at the end of 2019. As of Jul 31, Essex Property had \$1.2 billion in undrawn capacity on its unsecured credit facilities and the company's immediate available liquidity surpassed \$1.4 billion.

Notably, in June, the company issued \$150 million of 12-year senior unsecured notes due in March 2032, having an interest rate per annum of 2.65% and an effective yield of 2.09%. Also, in April 2020, Essex Property originated a \$200-million unsecured term loan, priced at LIBOR + 1.20%, with a one-year maturity and two 12-month extension options, which are exercisable at the company's option. It used the proceeds to repay all residual consolidated debt having maturity this year.

During the reported quarter, the company repurchased 87,988 shares of its common stock amounting to \$20.1 million at an average price of \$228.36 per share. As of Jul 31, the company had \$203.3 million of purchase authority remaining under the stock-repurchase plan.

Quarter Ending 06/2020

Report Date	Aug 03, 2020
Sales Surprise	-3.06%
EPS Surprise	-4.24%
Quarterly EPS	3.16
Annual EPS (TTM)	13.44

Recent News

Dividend Update

On May 14, Essex Property announced a regular quarterly cash dividend of \$2.0775 per share. The dividend was paid out on Jul 15, to shareholders of record as of Jun 30, 2020.

Valuation

Essex Property's shares have been down 33.4% in the trailing 12 months. Stocks in the Zacks sub-industry and the Zacks Finance sector declined 20.3% and 7.1%, over the past year, respectively.

The S&P 500 Index has been up 18.3% over the past year.

The stock is currently trading at 15.92X forward 12-month FFO, which compares to 17.76X for the Zacks sub-industry, 16.40X for the Zacks sector and 22.85X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 23.75X and as low as 12.85X, with a 5-year median of 19.94X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$226 price target reflects 16.89X FFO.

The table below shows summary valuation data for ESS.

Valuation Multiples - ESS					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	15.92	17.76	16.40	22.85
	5-Year High	23.75	22.36	16.40	22.85
	5-Year Low	12.85	15.54	11.60	15.25
	5-Year Median	19.94	18.47	14.26	17.58
P/S F12M	Current	9.06	9.44	6.23	3.71
	5-Year High	14.5	12.16	6.67	3.71
	5-Year Low	7.62	7.58	4.97	2.53
	5-Year Median	11.33	9.28	6.06	3.05
P/B TTM	Current	2.19	2.41	2.47	4.59
	5-Year High	3.43	3.30	2.91	4.59
	5-Year Low	1.88	1.82	1.72	2.83
	5-Year Median	2.47	2.42	2.53	3.75

As of 08/21/2020

Industry Analysis Zacks Industry Rank: Bottom 25% (189 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Equity Residential (EQR)	Neutral	3
Investors Real Estate Trust (IRET)	Neutral	3
MidAmerica Apartment Communities, Inc. (MAA)	Neutral	3
NexPoint Residential Trust, Inc. (NXRT)	Neutral	3
United Dominion Realty Trust, Inc. (UDR)	Neutral	3
Apartment Investment and Management Company (AIV)	Underperform	4
AvalonBay Communities, Inc. (AVB)	Underperform	4
Camden Property Trust (CPT)	Underperform	4

Industry Comparison Industry: Reit And Equity Trust - Residential				Industry Peers		
	ESS	X Industry	S&P 500	AVB	EQR	UDR
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	4	3	3
VGM Score	D	-	-	F	F	D
Market Cap	13.89 B	1.28 B	23.62 B	21.45 B	20.36 B	10.06 B
# of Analysts	9	5	14	7	11	10
Dividend Yield	3.90%	3.84%	1.65%	4.17%	4.41%	4.23%
Value Score	D	-	-	D	D	D
Cash/Price	0.02	0.04	0.07	0.02	0.01	0.06
EV/EBITDA	17.46	16.63	13.29	19.29	12.85	16.15
PEG Ratio	2.83	4.11	3.03	10.24	4.26	3.96
Price/Book (P/B)	2.19	1.76	3.11	1.97	1.88	2.98
Price/Cash Flow (P/CF)	15.64	13.55	12.69	14.36	10.93	14.41
P/E (F1)	16.02	16.22	21.51	16.90	16.32	16.41
Price/Sales (P/S)	9.23	5.80	2.43	9.09	7.53	8.18
Earnings Yield	6.21%	6.17%	4.46%	5.92%	6.13%	6.10%
Debt/Equity	0.99	0.99	0.76	0.72	0.78	1.41
Cash Flow (\$/share)	13.62	2.46	6.93	10.61	5.00	2.36
Growth Score	D	-	-	C	D	C
Hist. EPS Growth (3-5 yrs)	7.36%	2.54%	10.44%	3.84%	1.29%	5.46%
Proj. EPS Growth (F1/F0)	-1.20%	-2.75%	-5.53%	-3.43%	-3.99%	-0.14%
Curr. Cash Flow Growth	5.93%	7.20%	5.20%	-9.39%	23.84%	8.47%
Hist. Cash Flow Growth (3-5 yrs)	12.62%	15.38%	8.52%	6.67%	5.74%	5.98%
Current Ratio	1.83	1.42	1.33	1.40	1.06	4.08
Debt/Capital	50.00%	47.18%	44.50%	41.83%	44.70%	62.12%
Net Margin	41.70%	13.64%	10.13%	33.32%	41.64%	15.31%
Return on Equity	9.81%	4.71%	14.67%	7.21%	10.62%	5.63%
Sales/Assets	0.12	0.12	0.51	0.12	0.13	0.13
Proj. Sales Growth (F1/F0)	3.98%	1.95%	-1.54%	5.62%	-2.83%	9.43%
Momentum Score	C	-	-	F	F	F
Daily Price Chg	0.24%	0.00%	-0.15%	-0.84%	-1.01%	-0.93%
1 Week Price Chg	-1.81%	-1.45%	1.09%	-0.53%	-1.45%	-2.42%
4 Week Price Chg	-1.53%	2.62%	1.64%	2.88%	-0.26%	-4.40%
12 Week Price Chg	-14.40%	5.67%	6.72%	-4.16%	-10.15%	-11.37%
52 Week Price Chg	-33.64%	-25.65%	1.00%	-27.03%	-34.11%	-29.27%
20 Day Average Volume	427,262	406,782	1,873,576	848,570	2,493,190	1,542,807
(F1) EPS Est 1 week change	-0.06%	0.00%	0.00%	-0.35%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.27%	0.00%	1.79%	-0.58%	0.05%	-0.81%
(F1) EPS Est 12 week change	-1.10%	-1.10%	3.35%	-1.17%	-1.31%	-1.24%
(Q1) EPS Est Mthly Chg	-0.56%	0.00%	0.42%	-0.93%	-0.04%	-0.92%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	D
Momentum Score	C
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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