**REIT Valuation Case Study: AvalonBay [AVB] – Stock Pitch Outline**

* **Recommendation:** We recommend LONGING AvalonBay [AVB] because:
  + It’s undervalued by 20-30% currently because the market has incorrectly penalized the company for in-line Q4 earnings (and several misses in 2017) and expectations of rising interest rates and a multifamily slowdown in the company’s key coastal markets.
  + Even if we’re wrong, and there is a recession/multifamily market downturn in the next 1-2 years, the company is only overvalued by ~10%.
  + Catalysts include the stabilization of the company’s record $1.9 billion in FY 17 deliveries, same-store rental increases above guidance, and the company’s expansion into new markets, such as Denver, South Florida, and Baltimore, to maintain its Development yields.
  + Investment risks include a recession and coastal multifamily market downturn in the next 1-2 years, development delays/cost overruns/lower-than-expected yields, and lower NOI margins due to rising concessions in certain markets. We could mitigate these risks by purchasing put options, longing multifamily REITs in different geographies or ones that focus less on development, or shorting a broader multifamily/real estate index fund or ETF.
* **Company Background:** [State the business model, multiples, financial projections, and revenue/NOI by segment.]
* **Investment Thesis:** The stock is priced imperfectly because:
  + Rising interest rates actually help the company because they make mortgages more expensive, discouraging home ownership, and approximately 83% of AVB’s Debt is fixed-rate with an average maturity of ~10 years. We assumed a Cost of Debt of close to 4% in the DCF, above the company’s current rate of 3%; even with a Cost of Debt of 5%, the company would still be undervalued by ~10%.
  + While there is a substantial risk of a recession, it is more likely to affect the single-family home market because of the exorbitant cost of housing in key markets such as LA, SF, and Northern Virginia (where even software engineers might spend 30-45% of their income to own an average house). Historically, AVB’s rental revenue has never declined by more than 2% over the past 20 years.
  + Consensus estimates significantly understate AVB’s projected revenue and NOI – forecast growth rates are in the 3-4% range, as if the company’s Development pipeline did not exist and it simply planned to maintain its existing assets. Even in the Base Case, we forecast revenue that’s 10-15% higher than consensus forecasts by Year 5.
* **Catalysts:**
  + The stabilization of the company’s $1.9 billion in FY 17 deliveries at a 6.0 – 6.5% weighted average yield.
  + Same-store rental increases at the top end of company guidance (or above it), resulting in total same-store rental growth close to 3%.
  + The company’s expansion into new markets, such as Denver, South Florida, and Baltimore to maintain its yields.
* **Valuation:** [We’ll briefly describe the results from the NAV, DCF, and comparable companies and transactions.]
* **Risk Factors:**
  + The potential recession and a coastal multifamily market slowdown in the next 1-2 years (~10% share price impact).
  + Development delays, cost overruns, and lower-than-expected yields (~10% share price impact with 5-year average development time and Downside Case yields).
  + Lower NOI margins due to rising concessions in certain markets, such as LA (~10% share price impact if NOI margins are 2% below forecast everywhere).
  + We could mitigate these risks by purchasing put options, longing multifamily REITs in different geographies or that use different strategies, or shorting a broader multifamily/real estate index fund or ETF.
  + **Worst-Case Scenario:** If we get a true “perfect storm” of all these elements together, the company’s stock price could potentially fall to ~$130 within the next year (~20% loss). But we view that as highly unlikely, and we can hedge against that risk with the strategies above.