Apollo Commercial Real Estate Finance (ARI)

Updated May 11th, 2024 by Samuel Smith

Key Metrics

Current Price:	$10.1	**5 Year CAGR Estimate:**	10.2%	**Market Cap:**	$1.4B
Fair Value Price:	$10.6	**5 Year Growth Estimate:**	-1.1%	**Ex-Dividend Date:**	6/27/24[1]
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.9%	**Dividend Payment Date:**	7/15/24[2]
Dividend Yield:	13.9%	**5 Year Price Target**	$10	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Rating:**	Buy

Overview & Current Events

Apollo Commercial Real Estate Finance, Inc. was founded in 2009. It is a real estate investment trust (REIT) that invests in debt securities including senior mortgages, mezzanine loans, and other commercial real estate-related debt. Apollo's investments, placed in the U.S. and Europe, are collateralized by the underlying estate properties. Apollo is externally managed by ACREFI Management, LLC, an indirect subsidiary of Apollo Global Management, LLC. Apollo Commercial Real Estate Finance holds a multi-billion-dollar commercial real estate portfolio, with 26% of this portfolio made up of Hotels, 17% Office Properties, 14% Urban Predevelopment, 12% Residential-for-sale inventory and 11% Residential-for-sale construction. The $1.4 billion market capitalization trust has roughly 34% of its portfolio based in Manhattan, New York, 14% in the United Kingdom, 13% in the Midwest, 12% in the West and 11% in the Southeast.

Apollo Commercial Real Estate Finance (NYSE:ARI) reported its first-quarter distributable earnings, which surpassed the Wall Street consensus but declined both sequentially and from a year ago. The mortgage REIT experienced a decrease in interest income and a rise in expenses during the quarter. Despite this, CEO and President Stuart Rothstein highlighted that the company's ability to pay dividends remained unaffected, maintaining a dividend of $0.35 per share for sixteen consecutive quarters. The company's book value per share suffered a decline of $1.00 in the first quarter, attributed to an incremental CECL allowance of about $142 million on a mezzanine loan secured by an ultra-luxury condominium development in New York City, due to a reduction in sales price and delayed timing on the remaining units. Distributable earnings per share for the quarter were $0.35, beating the average analyst estimate of $0.32 but slipping from $0.36 in the previous quarter and $0.48 a year earlier. Total net revenue was $23.9 million, falling well below the consensus of $68.4 million, dropping from $84.2 million in the previous quarter and rising from $16.1 million in the first quarter of 2023. Net interest income decreased to $56.7 million from $58.0 million in the previous quarter and $71.0 million in the first quarter of last year. Operating expenses totaled $41.3 million compared to $37.8 million in the previous quarter and $34.5 million in the first quarter of 2023.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.72	$1.54	$1.74	$1.54	$1.53	$1.55	$0.84	$1.33	$1.67	$1.09	***$1.32***	***$1.25***
DPS	$1.60	$1.78	$1.84	$1.84	$1.84	$1.84	$1.45	$1.16	$1.40	$1.40	***$1.40***	***$1.20***
Shares[3]	46.9	67.4	91.6	107.5	134.3	154.0	139.8	140.5	141.3	142.1	***142.2***	***160***

Apollo's two main growth catalysts are its overall loan portfolio growth and higher returns on its loans. Given soaring interest rates and the rapidly declining demand for new mortgage loans, we expect Apollo to face severe headwinds to growth in the coming quarters. On top of that, if we end up entering a severe recession, Apollo could suffer a higher rate of defaults on its loans, leading to a further reduction in income. As a result, when combining its high payout ratio and

[1] Estimate
[2] Estimate
[3] In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

the growth headwinds, we expect Apollo to experience a slight reduction in earnings per share over the next half-decade.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	11.3	10	13.3	9.6	10.9	10	8.3	10.9	8.1	8.0	***7.7***	***8.0***
Avg. Yld.	8.2%	11.6%	8.0%	12.4%	11.0%	11.9%	20.8%	8.0%	12.3%	13.9%	***13.9%***	***12.0%***

Given the current interest rate environment and reduced demand for loans overhanging the business, we are reducing the fair value multiple to a discount to its historical average of 8 times earnings. Given that shares currently trade for 7.7 times expected 2024 earnings, we believe that shares are slightly undervalued. The company's dividend yield is at 13.9%, which is a bit high on a historic basis.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	93%	116%	106%	119%	120%	119%	173%	87%	84%	128%	***106%***	***96%***

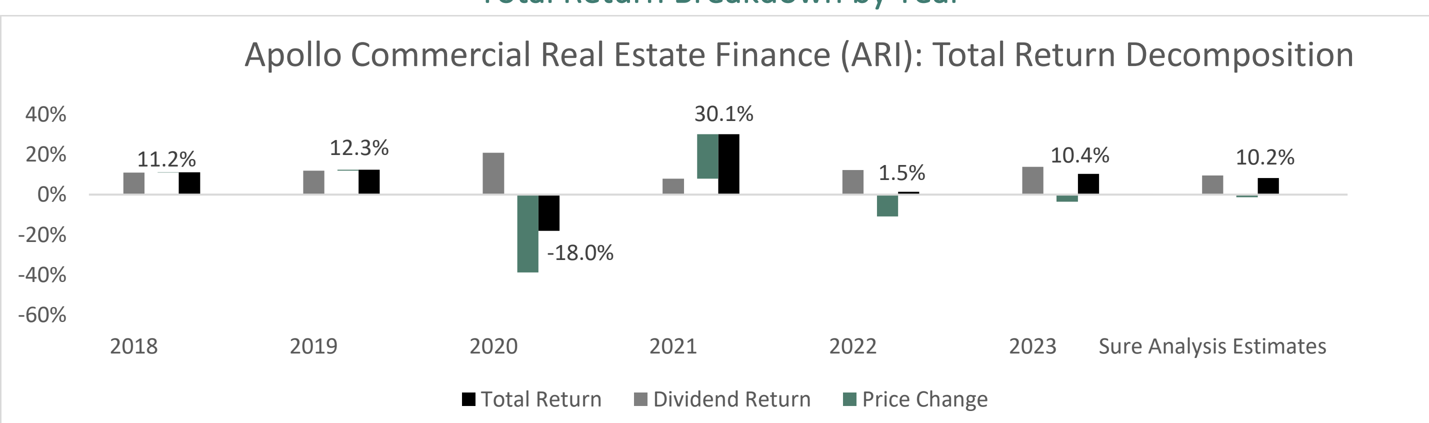
Apollo has had an exceptionally high dividend yield at times, but its dividend payout ratio is something that investors should closely monitor going forward. This is often the case with high yielders. The trust has frequently distributed over 100% of annual earnings, but given recent cuts, it is much lower than it has been. While payout ratios greater than 100% are possible when cash flows exceed earnings – as is the case with Apollo – this significantly limits the trust's safety in weaker economic conditions.

During the last recession, Apollo posted a net loss in 2009, reflecting its sensitivity to recessions and downturns in commercial real estate activity. Due to the elevated payout ratio, the trust funds growth through the issuance of common and preferred equity, both with high dividend yields. In turn, this creates a high hurdle rate, limiting the trust's growth prospects. So far it has worked out fine, but we are certainly cautious moving forward. As a mortgage REIT, the trust lacks any significant competitive advantages and remains highly sensitive to interest rates and macroeconomic conditions.

Final Thoughts & Recommendation

The trust's dividend has been cut meaningfully several times in the past. As a result, the stock should only be considered with this risk in mind. The dividend yield remains very attractive, and the valuation multiple is in line with our fair value estimate. Overall, we expect 10.2% annualized total returns. As a result, we rate it a Buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	101	126	181	255	299	315	211	278	369	266
SG&A Exp.	18	26	48	52	57	65	27	67	68	67
Net Profit	83	103	158	193	220	230	18	224	265	58
Net Margin	81.9%	82.0%	87.1%	75.6%	73.5%	73.1%	8.7%	80.3%	71.9%	21.9%
Free Cash Flow	67	88	124	155	266	273	164	199	235	201

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,845	2,713	3,483	4,089	5,096	6,888	6,940	8,417	9,568	9,297
Cash & Equivalents	41	67	201	78	110	452	325	343	222	225
Accounts Receivable	11	17	19	23	33	36	41	41	65	72
Total Liabilities	990	1,337	1,551	2,000	2,586	4,258	4,669	6,122	7,214	7,088
Accounts Payable			7	13	14	16	14	16	24	31
Long-Term Debt	336	366	1,475	1,916	2,472	3,945	4,521	6,010	6,970	6,955
Shareholder's Equity	855	1,375	1,932	2,088	2,510	2,630	2,270	2,295	2,354	2,209
LTD/E Ratio	0.39	0.27	0.76	0.92	0.98	1.50	1.99	2.62	2.96	3.15

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	6.0%	4.5%	5.1%	5.1%	4.8%	3.8%	0.3%	2.9%	2.9%	0.6%
Return on Equity	10.8%	9.3%	9.5%	9.6%	9.6%	9.0%	0.8%	9.8%	11.4%	2.5%
ROIC	8.8%	7.0%	6.1%	5.2%	4.9%	4.0%	0.3%	3.0%	3.0%	0.6%
Shares Out.	46.9	67.4	91.6	107.5	134.3	154.0	139.8	140.5	141.3	142.1
Revenue/Share	2.31	2.12	2.47	2.52	1.95	1.79	1.42	1.65	2.23	1.88
FCF/Share	1.53	1.49	1.69	1.53	1.73	1.56	1.11	1.18	1.42	1.42

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