Preferred Apartment Communities (APTS)

Updated December 11th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$8.20	**5 Year CAGR Estimate:**	16.8%	**Market Cap:**	$415 M
Fair Value Price:	$10.80	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	12/14/2020
% Fair Value:	76%	**5 Year Valuation Multiple Estimate:**	5.7%	**Dividend Payment Date:**	1/15/2021
Dividend Yield:	8.5%[1]	**5 Year Price Target**	$13.80	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

Overview & Current Events

Preferred Apartment Communities (APTS) is a real estate investment trust (REIT) engaged primarily in the ownership and operation of Class A multifamily properties, grocery-anchored shopping centers, office buildings and student housing properties. It was founded in 2011 and has a market capitalization of $415 million. It currently has 125 properties in 15 states, primarily in the Southeast region of the U.S. Preferred Apartment Communities has very young properties, with an average age around 6 years old, in high-quality suburban markets in the Sun Belt area.

In early November, Preferred Apartment Communities reported (11/9/20) financial results for the third quarter of fiscal 2020. Despite the pandemic, the REIT reported high rental collection rates (~99%) in all the categories of its properties except for shopping centers, in which it collected 95% of its rental revenues in the third quarter. In addition, the pandemic has caused a surge in the operating expenses of the REIT, which is also burdened by high interest expense due to its hefty debt load. As a result, its adjusted funds from operations (FFO) per unit fell from $0.12 in last year's quarter to $0.07. In the first nine months of the year, adjusted FFO per unit have decreased -12%, from $0.66 to $0.58. Due to the pandemic, Preferred Apartment Communities cut its dividend by -33% in the second quarter, from $0.2625 to $0.175. While the results of the REIT are decent, we note that the pandemic caught the REIT with a huge debt load. Its net debt stands at $3.9 billion, which is nearly 10 times the market cap of the stock and about 85 times its annual funds from operations. On the bright side, the REIT does not have high debt maturities until 2024.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	---	$0.49	$0.66	$0.82	$0.85	$0.98	$1.11	$1.20	$1.36	$1.04	***$0.90***	***$1.15***
DPS	---	$0.38	$0.55	$0.61	$0.66	$0.73	$0.82	$0.94	$1.02	$1.05	***$0.79***	***$0.90***
Shares[2]	---	3.8	5.2	9.5	17.4	22.2	24.0	31.9	40.0	44.3	***49.7***	***100.0***

Preferred Apartment Communities has consistently grown its revenues and its earnings by adding high-quality assets in areas with promising economic prospects. During the last decade, the REIT has grown its FFO per unit at a 7.0% average annual rate. However, the REIT has stumbled in the last two years. In 2019, it incurred hefty expenses due to a restructuring of its asset portfolio, which resulted from a somewhat aggressive growth strategy in the preceding years. Moreover, the REIT has been hurt by the pandemic, which has reduced rental collection rates in shopping centers and has greatly increased selling & administrative expenses. Nevertheless, we expect the pandemic to subside in the second half of 2021 and the REIT to grow its FFO per unit at a 5.0% average annual rate over the next five years.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/FFO	---	15.4	11.7	10.4	10.0	11.0	12.0	13.9	*11.6*	14.3	***9.1***	***12.0***
Avg. Yld.	---	5.0%	7.1%	7.0%	7.7%	6.7%	6.2%	5.6%	*6.4%*	7.1%	***8.5%***	***6.5%***

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[1] Forward dividend yield.

[2] In millions.

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Due to the concerns of the market over the impact of the pandemic on Preferred Apartment Communities, the stock is currently trading at a decade-low price-to-FFO ratio of 9.1, which is much lower than the historical average FFO multiple of 12.0. We expect the stock to revert to its average valuation level over the next five years. If this occurs, the stock will enjoy a 5.7% annualized gain in its returns thanks to the expansion of its price-to-FFO ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

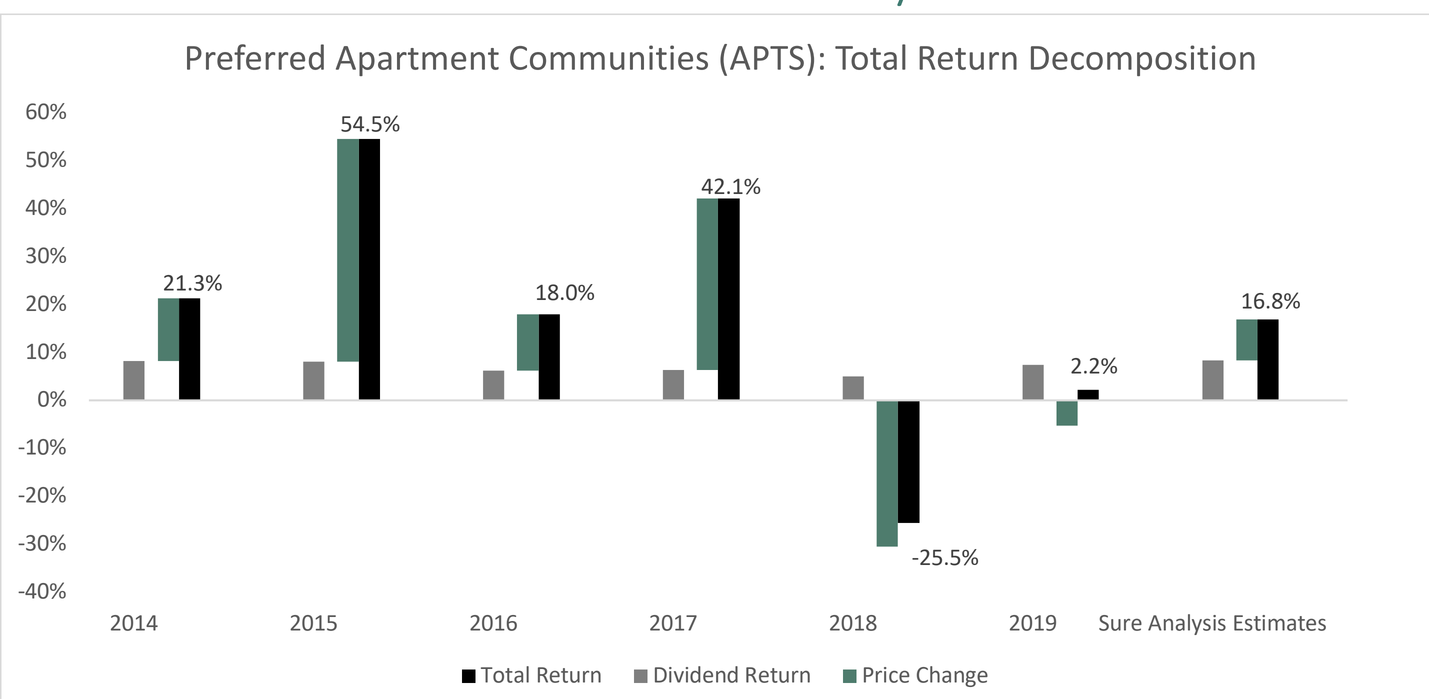
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	77%	83%	74%	77%	74%	74%	78%	75%	101%	***78%***	***78%***

Preferred Apartment Communities had grown its FFO per unit every year between its IPO in 2011 and 2018. It also grew its dividend every year between 2011 and 2019. However, the coronavirus crisis caught the REIT off-guard, with an excessive debt load, and thus the REIT slashed its dividend by -33% this year. This is a stern reminder of the high risk of companies that pursue growth by adding too much debt. Due to its leveraged business model, Preferred Apartment Communities is not considered a reliable income grower. However, we believe that the reduced dividend is safe for the foreseeable future and thus the cheaply valued stock is now suitable for income-oriented investors who are confident that the pandemic will subside by the second half of next year.

Final Thoughts & Recommendation

Preferred Apartment Communities has plunged -40% this year due to impact of the pandemic on its business and its high debt load. As the REIT was caught with a huge debt load in this recession, we are critical of its management. However, we believe that the stock has been punished to the extreme and hence it has become attractive. We expect the stock to offer a 16.8% average annual return over the next five years thanks to its 8.5% dividend, a 5.7% annualized expansion of its valuation level and our expectations for 5% average annual growth of FFO per unit off this year's low base. We thus rate the stock as a buy but only for investors who are confident that the pandemic will not extend beyond 2021 and can stomach the high volatility of the stock price of Preferred Apartment Communities for extended periods.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	---	5	12	32	57	109	200	294	397	470
Gross Profit	---	4	9	23	44	80	142	211	282	333
Gross Margin	---	67.4%	71.7%	73.1%	77.5%	72.8%	71.0%	71.8%	70.9%	70.7%
SG&A Exp.	---	2	3	5	8	13	25	35	38	45
D&A Exp.	---	8	4	15	16	38	78	113	165	179
Operating Profit	---	(4)	2	3	20	28	39	59	70	100
Operating Margin	---	-73.5%	18.9%	10.6%	34.6%	25.7%	19.3%	20.2%	17.6%	21.3%
Net Profit	---	(8)	(0)	(4)	2	(2)	(10)	28	43	(7)
Net Margin	---	-160%	-1.2%	-12.4%	3.7%	-2.2%	-4.8%	9.4%	10.9%	-1.5%
Free Cash Flow	---	1	4	9	15	35	62	86	145	146

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	---	92	123	342	691	1,296	2,421	3,252	4,411	4,771
Cash & Equivalents	---	5	3	9	3	2	12	21	39	94
Accounts Receivable	---	0	1	1	4	11	15	38	42	65
Goodwill & Int. Ass.	---	---	---	1	13	19	79	103	136	155
Total Liabilities	---	58	73	176	400	770	1,536	1,972	2,802	2,836
Accounts Payable	---	1	1	2	5	13	21	31	39	42
Long-Term Debt	---	56	70	170	382	709	1,465	1,843	2,362	2,637
Shareholder’s Equity	---	35	50	165	289	523	884	1,276	1,608	1,931
D/E Ratio	---	1.61	1.41	1.03	1.32	1.36	1.66	1.44	1.47	1.37

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	---	-0.1%	-1.7%	0.4%	-0.2%	-0.5%	1.0%	1.1%	-0.2%
Return on Equity	---	-50.0%	-0.3%	-3.7%	0.9%	-0.6%	-1.4%	2.6%	3.0%	-0.4%
ROIC	---	---	-0.1%	-1.7%	0.4%	-0.3%	-0.5%	1.0%	1.2%	-0.2%
Shares Out.	---	3.8	5.2	9.5	17.4	22.2	24.0	31.9	40.0	44.3
Revenue/Share	---	1.39	2.42	3.40	3.25	4.93	8.35	9.21	9.92	10.63
FCF/Share	---	0.14	0.81	0.92	0.89	1.59	2.57	2.70	3.63	3.29

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