



# Apollo Commercial Real Estate Finance (ARI)

Updated May 12<sup>th</sup>, 2023 by Samuel Smith

## Key Metrics

<b>Current Price:</b>	\$9.6	<b>5 Year CAGR Estimate:</b>	13.3%	<b>Market Cap:</b>	\$1.3B
<b>Fair Value Price:</b>	\$13.0	<b>5 Year Growth Estimate:</b>	-3.4%	<b>Ex-Dividend Date:</b>	6/30/23 <sup>1</sup>
<b>% Fair Value:</b>	74%	<b>5 Year Valuation Multiple Estimate:</b>	6.3%	<b>Dividend Payment Date:</b>	7/14/23 <sup>2</sup>
<b>Dividend Yield:</b>	14.6%	<b>5 Year Price Target</b>	\$11	<b>Years Of Dividend Growth:</b>	1
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	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 \$1.3 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.

On April 26<sup>th</sup>, 2023 Apollo Commercial Real Estate Finance, Inc. (ARI) reported results for the first quarter. The net income attributable to common stockholders per diluted share of common stock for the first quarter of 2023 was \$0.32. The Distributable Earnings per share of common stock was \$0.48, and Distributable Earnings prior to net realized loss on investments and realized gain on extinguishment of debt per share of common stock was \$0.51 for the same quarter.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$1.26	\$1.72	\$1.54	\$1.74	\$1.54	\$1.53	\$1.55	\$0.84	\$1.33	\$1.67	<b>\$1.63</b>	<b>\$1.37</b>
<b>DPS</b>	\$1.60	\$1.60	\$1.78	\$1.84	\$1.84	\$1.84	\$1.84	\$1.45	\$1.16	\$1.40	<b>\$1.40</b>	<b>\$1.40</b>
<b>Shares<sup>3</sup></b>	37.1	46.9	67.4	91.6	107.5	134.3	154.0	139.8	140.5	141.3	<b>141.3</b>	<b>160</b>

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

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
<b>Avg. P/E</b>	12.1	11.3	10	13.3	9.6	10.9	10	8.3	10.9	8.1	<b>5.9</b>	<b>8.0</b>
<b>Avg. Yld.</b>	10.5%	8.2%	11.6%	8.0%	12.4%	11.0%	11.9%	20.8%	8.0%	12.3%	<b>14.6%</b>	<b>12.8%</b>

Since 2010, shares of Apollo have traded hands with an average P/E ratio of about 11 times earnings. That being said, given the current interest rate environment and reduced demand for loans overhanging the business, we are reducing the fair value multiple to 8 times earnings. Given that shares currently trade for 5.9 times expected 2023 earnings, we

<sup>1</sup> Estimate

<sup>2</sup> Estimate

<sup>3</sup> 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.



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believe that shares are undervalued. The company's dividend yield is at 14.6%, which is pretty average on a historic basis.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	127%	93%	116%	106%	119%	120%	119%	173%	87%	84%	86%	102%

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.

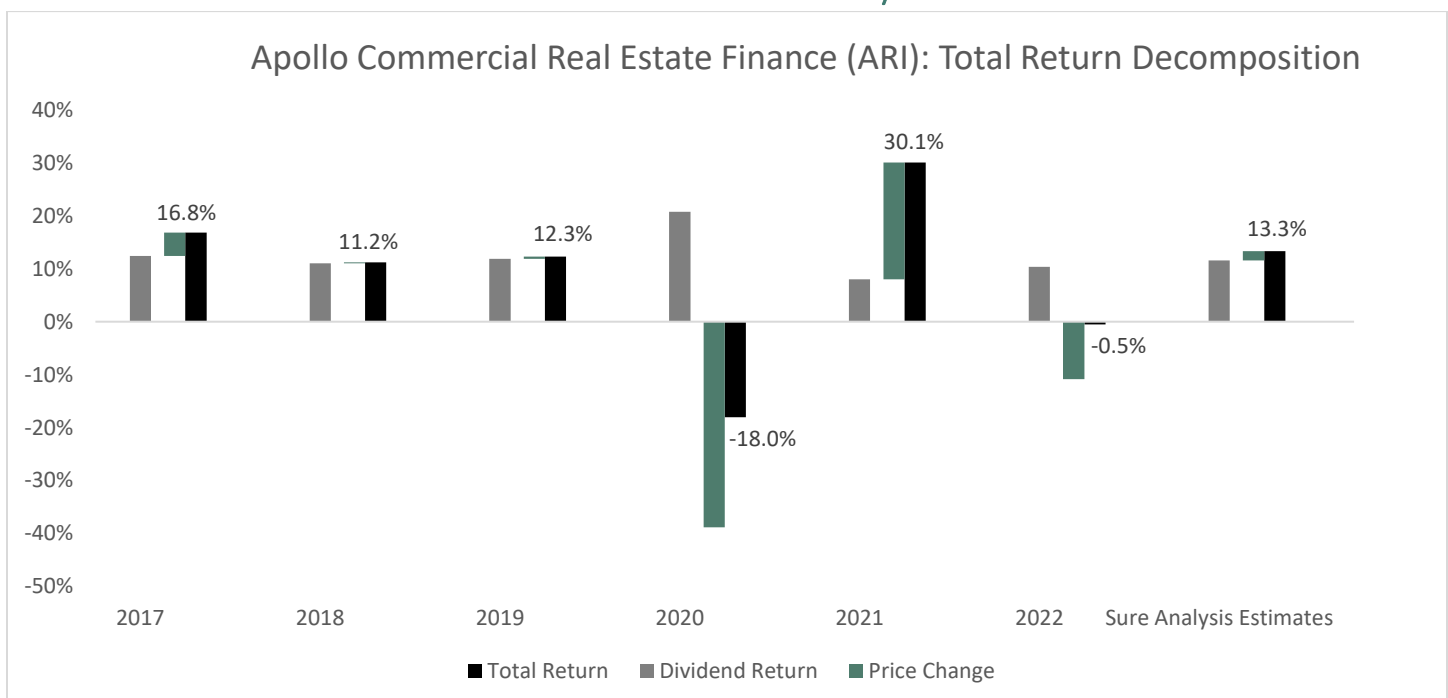
During the last recession, Apollo posted a net loss in 2009, reflecting its sensitivity to recessions and downturns in commercial real estate activity. Due to the elevated payout ratio, the trust funds growth through the issuance of common and preferred equity, both with high dividend yields. In turn, 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 rate 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 below our fair value estimate. That said, the dividend coverage is not great and with meaningful headwinds to growth expected to weigh on the business in the near future, we are not too confident in the risk-reward profile here. Overall, we expect 13.3% annualized total returns. As a result, we rate it a speculative Buy.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	70	101	126	181	255	299	315	211	278	369
SG&A Exp.	18	18	26	48	52	57	65	67	67	30
Net Profit	52	83	103	158	193	220	230	18	224	265
Net Margin	74.9%	81.9%	82.0%	87.1%	75.6%	73.5%	73.1%	8.7%	80.3%	71.9%
Free Cash Flow	46	67	88	124	155	266	273	164	199	235

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	908	1,845	2,713	3,483	4,089	5,096	6,888	6,940	8,417	9,568
Cash & Equivalents	20	41	67	201	78	110	452	325	343	222
Accounts Receivable	6	11	17	19	23	33	36	41	41	65
Total Liabilities	225	990	1,337	1,551	2,000	2,586	4,258	4,669	6,122	7,214
Accounts Payable	3	8	9	18	14	16	23	19	25	31
Long-Term Debt	-	336	366	1,475	1,916	623	1,272	1,235	2,013	2,298
Shareholder's Equity	683	855	1,375	1,932	2,088	2,510	2,630	2,270	2,295	2,354
LTD/E Ratio	-	0.39	0.27	0.76	0.92	0.25	0.48	0.54	0.88	0.98

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	6.2%	6.0%	4.5%	5.1%	5.1%	4.8%	3.8%	0.3%	2.9%	2.9%
Return on Equity	8.5%	10.8%	9.3%	9.5%	9.6%	9.6%	9.0%	0.8%	9.8%	11.4%
ROIC	8.5%	8.8%	7.0%	6.1%	5.2%	6.2%	6.5%	0.5%	5.7%	5.9%
Shares Out.	37.1	46.9	67.4	91.6	107.5	134.3	154.0	139.8	139.9	141.3
Revenue/Share	1.96	2.31	2.12	2.47	2.52	1.95	1.79	1.42	1.65	2.23
FCF/Share	1.29	1.53	1.49	1.69	1.53	1.73	1.56	1.11	1.18	1.42

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

## Disclaimer

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