PSU Stock Pitch

Framework for Making a Stock Call

Todd Thomas, KeyBanc Capital Markets, PSU ’01
Diane Wade, CBRE Clarion Securities, PSU ‘90

Anatomy of a Stock Pitch

Why are you making the call?

What message do you want to convey?

Do you have conviction?

Be prepared to answer questions!

Anatomy of a Stock Pitch

- Summarize the call. Begin with the investment conclusion and try to have an early impact on the listener in order to gain their attention.

- It might be necessary to provide a brief mention of Company's business, subsector/industry, and basic stock info.

- Bullet point the supporting data behind your conclusion, but only give the "Need to Know" data and information.

  - Investment positives
  - Investment concerns
  - Near-term and long-term catalysts

- Discussion of valuation (if not incorporated above).

Anatomy of a Stock Pitch

- You have three minutes to tell a compelling story in a traditional stock pitch.

- Start with the conclusion!

- Do it with enthusiasm and confidence, but speak slowly, and pace yourself.

  - If you do not have conviction, your thesis and analysis will not have the impact on the listener it should.

- Convey the message in a structured matter. Keep in mind that others are taking notes. The easier someone else can digest the idea, the more impactful it is going to be.

Anatomy of a Stock Pitch – Q&A

How well do you REALLY know the company?

Why should we listen to you?

- Are you up to date on current company announcements and important initiatives?
- Are you up to date on current industry trends?
- Why is the stock mispriced? (How are its peers valued?)
- What is proprietary about your call?

Primary Earnings Gauges – A Look at FFO and AFFO

- Funds From Operations (FFO)
  - The EPS equivalent for the REIT sector
  - Biggest adjustment from net income is the addback of real estate depreciation/amortization to reflect that real estate is an appreciating asset over time
  - Over the years, non-cash accounting changes have increased noise and many REITs now provide NAREIT definition FFO and their own adjusted "Core" FFO

- Adjusted Funds From Operations (AFFO)
  - Adjusts FFO to provide an approximation of operating cash flow
  - Biggest adjustments from FFO to AFFO include maintenance capex and leasing costs and straight-line rent adjustments

- Normalized FFO/AFFO
  - Normalizing results removes noise from one-time benefits/negatives and non-cash items, which provides a better picture of underlying earnings trends and a better basis of comparison to gauge relative value across the sector

Reconciliation of Net Income (Loss) to FFO and AFFO:

Net Income

- **Adjustments:**

  Add: Depreciation
  Add: Amortization
  Add or (Subtract): Loss or (Gain) from the sale of property
  Add or (Subtract): Loss or (Gain) from the sale of assets

Funds From Operations

- **Adjustments:**

  Add or (Subtract): Maintenance capex
  Add or (Subtract): Straight-line rent adjustments (only for lease durations >1 yr)
  Add or (Subtract): Above or Below market rent adjustments (impacts rent rev)
  Add or (Subtract): Above or Below market debt adjustments (impacts int. exp)

Adjusted Funds From Operations

REIT Valuation Analysis

Key Metrics in REIT Valuation Toolbox

- **Relative Metrics**
  - Price/AFFO and Price/FFO
  - Implied Values
    - Implied Cap Rates
    - Implied Per Square Foot or Unit

- **Absolute Metrics**
  - Net Asset Value (NAV)
  - Replacement Cost

- **Other Measures**
  - Growth Rates – FFO, AFFO, NOI
  - Dividend Yields

- **Leverage/Balance Sheet Metrics**
  - Fixed Charge Coverage
  - Debt/GAV
  - Debt/EBITDA

What Is NAV?

Net Asset Value (NAV)

- Private market value of a REIT's real estate, after deducting related debt

- Property Net Operating Income (NOI) is the basis for valuing operating properties and generally reflects property gross margin or gross rent less property operating expenses

- Cap Rates are the denominator used to arrive at gross asset value. In other words, they are the reciprocal of EV/EBITDA, where EV has been adjusted to remove non-income producing assets like land and development/redevelopment projects. Capitalization rates are derived from private market transactions and can vary across property types and geographies. Lower cap rates reflect the growth profile and the quality (A, B or C) of an asset.

- Normalized NOI – We adjust NOI to reflect the impact of recent acquisition or development activity to bridge the gap between reported vs. potential NOI

- Implied Values – We use NAV calculations to derive implied cap rates and implied values per square foot, which are also useful metrics

Getting to NAV

- **Gross Asset Value (GAV)** – Gross asset value is derived by adding operating property value and the value of non-income producing assets of the REIT.
  - **Operating Property Value** – The real estate portfolio's property NOI divided by a blended market cap rate.
  - **Non-Income Producing Assets** – Development-in-progress, land, cash and other assets (i.e., restricted cash, tenant receivables, pre-paid expenses).
- Total Liabilities – Wholly owned and joint venture debt, preferred stock and other liabilities (i.e., accrued expenses, dividends payable).
- Total Shares Outstanding – Fully diluted shares outstanding at period end plus operating partnership units.
- **NAV/share = (GAV – Total Liabilities) / Shares and Units Outstanding**
- If a stock is trading above (at a premium to) NAV, it could be overvalued (depending your estimate of NAV and on historic trends). If the stock is trading below (at a discount to) NAV, it could be undervalued.