Apollo Commercial Real Estate Finance, Inc.
Form 10-Q
April 24, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2019
or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number: 001-34452

Apollo Commercial Real Estate Finance, Inc.
(Exact name of registrant as specified in its charter)

Maryland	27-0467113
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Apollo Commercial Real Estate Finance, Inc.
c/o Apollo Global Management, LLC
9 West 57th Street, 43rd Floor,
New York, New York 10019
(Address of principal executive offices) (Zip Code)
(212) 515–3200
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
Emerging growth company	¨		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of April 23, 2019, there were 136,281,597 shares, par value $0.01, of the registrant's common stock issued and outstanding.

Table of Contents

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
Apollo Commercial Real Estate Finance, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)
(in thousands—except share data)

	March 31, 2019	December 31, 2018
Assets:		
Cash and cash equivalents	$109,343	$109,806
Commercial mortgage loans, net (includes $3,679,993 and $3,197,900 pledged as collateral under secured debt arrangements in 2019 and 2018, respectively)	4,003,089	3,878,981
Subordinate loans, net	1,183,910	1,048,612
Loan proceeds held by servicer	—	1,000
Other assets	36,540	33,720
Derivative assets, net	8,715	23,700
Total Assets	$5,341,597	$5,095,819
Liabilities and Stockholders' Equity		
Liabilities:		
Secured debt arrangements, net (net of deferred financing costs of $17,828 and $17,555 in 2019 and 2018, respectively)	$2,141,939	$1,879,522
Convertible senior notes, net	558,664	592,000
Accounts payable, accrued expenses and other liabilities	91,557	104,746
Payable to related party	9,613	9,804
Total Liabilities	2,801,773	2,586,072
Commitments and Contingencies (see Note 14)		
Stockholders’ Equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized:		
Series B preferred stock, 6,770,393 shares issued and outstanding ($169,260 liquidation preference)	68	68
Series C preferred stock, 6,900,000 shares issued and outstanding ($172,500 liquidation preference)	69	69
Common stock, $0.01 par value, 450,000,000 shares authorized, 136,254,352 and 133,853,565 shares issued and outstanding in 2019 and 2018, respectively	1,363	1,339
Additional paid-in-capital	2,671,100	2,638,441
Accumulated deficit	(132,776)	(130,170)
Total Stockholders’ Equity	2,539,824	2,509,747
Total Liabilities and Stockholders’ Equity	$5,341,597	$5,095,819

See notes to unaudited condensed consolidated financial statements.

Apollo Commercial Real Estate Finance, Inc. and Subsidiaries
Condensed Consolidated Statement of Operations (Unaudited)
(in thousands—except share and per share data)

	Three months ended March 31,	
	2019	2018
Net interest income:		
Interest income from commercial mortgage loans	$78,286	$ 52,114
Interest income from subordinate loans	40,839	33,853
Interest expense	(36,295)	(22,740)
Net interest income	82,830	63,227
Operating expenses:		
General and administrative expenses (includes equity-based compensation of $3,901 and $3,342 in 2019 and 2018, respectively)	(6,151)	(4,998)
Management fees to related party	(9,613)	(8,092)
Total operating expenses	(15,764)	(13,090)
Other income	518	203
Foreign currency gain	6,894	10,125
Loss on derivative instruments (includes unrealized losses of $14,985 and $8,855 in 2019 and 2018, respectively)	(6,720)	(11,032)
Net income	$67,758	$ 49,433
Preferred dividends	(6,835)	(6,835)
Net income available to common stockholders	$60,923	$ 42,598
Net income per share of common stock:		
Basic	$0.45	$ 0.38
Diluted	$0.43	$ 0.38
Basic weighted-average shares of common stock outstanding	134,607,107	110,211,853
Diluted weighted-average shares of common stock outstanding	164,683,086	111,871,429
Dividend declared per share of common stock	$0.46	$ 0.46

See notes to unaudited condensed consolidated financial statements.

Apollo Commercial Real Estate Finance, Inc. and Subsidiaries
Condensed Consolidated Statement of Changes in Stockholders' Equity (Unaudited)
(in thousands—except share and per share data)

	Preferred Stock		Common Stock		Additional	Accumulated	Total
	Shares	Par	Shares	Par	Paid-In-Capital	Deficit	
Balance at January 1, 2018	13,670,393	$137	107,121,235	$1,071	$ 2,170,078	$ (83,143)	$2,088,143
Capital increase (decrease) related to Equity Incentive Plan	—	—	345,996	4	(1,389)	—	(1,385)
Issuance of common stock	—	—	15,525,000	155	275,724	—	275,879
Offering costs	—	—	—	—	(377)	—	(377)
Net income	—	—	—	—	—	49,433	49,433
Dividends declared on preferred stock	—	—	—	—	—	(6,835)	(6,835)
Dividends declared on common stock - $0.46 per share	—	—	—	—	—	(57,328)	(57,328)
Balance at March 31, 2018	13,670,393	$137	122,992,231	$1,230	$ 2,444,036	$ (97,873)	$2,347,530

	Preferred Stock		Common Stock		Additional	Accumulated	Total
	Shares	Par	Shares	Par	Paid-In-Capital	Deficit	
Balance at January 1, 2019	13,670,393	$137	133,853,565	$1,339	$ 2,638,441	$ (130,170)	$2,509,747
Capital decrease related to Equity Incentive Plan	—	—	433,426	4	(1,099)	—	(1,095)
Conversions of convertible senior notes for common stock	—	—	1,967,361	20	33,758	—	33,778
Net income	—	—	—	—	—	67,758	67,758
Dividends declared on preferred stock	—	—	—	—	—	(6,835)	(6,835)
Dividends declared on common stock - $0.46 per share	—	—	—	—	—	(63,529)	(63,529)
Balance at March 31, 2019	13,670,393	$137	136,254,352	$1,363	$ 2,671,100	$ (132,776)	$2,539,824

See notes to unaudited condensed consolidated financial statements.

Apollo Commercial Real Estate Finance, Inc. and Subsidiaries
Condensed Consolidated Statement of Cash Flows (Unaudited)
(in thousands)

	For the three months ended March 31,	
	2019	2018
Cash flows (used in) provided by operating activities:		
Net income	$67,758	$49,433
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of discount/premium and PIK	(19,611)	(15,695)
Amortization of deferred financing costs	3,461	2,545
Equity-based compensation	(1,095)	(1,385)
Foreign currency gain	(5,828)	(9,853)
Unrealized loss on derivative instruments	14,985	8,855
Changes in operating assets and liabilities:		
Proceeds received from PIK	—	55,000
Other assets	(2,898)	(2,620)
Accounts payable, accrued expenses and other liabilities	620	2,075
Payable to related party	(191)	(76)
Net cash (used in) provided by operating activities	57,201	88,279
Cash flows used in investing activities:		
New funding of commercial mortgage loans	(197,000)	(476,951)
Add-on funding of commercial mortgage loans	(105,452)	(13,185)
New funding of subordinate loans	(244,844)	(11,687)
Add-on funding of subordinate loans	(4,879)	(5,208)
Proceeds and payments received on commercial mortgage loans	191,317	90,547
Proceeds and payments received on subordinate loans	130,010	257,548
Origination and exit fees received on commercial mortgage and subordinate loans	6,069	19,085
Decrease in collateral held related to derivative contracts	(18,180)	(15,220)
Net cash (used in) provided by investing activities	(242,959)	(155,071)
Cash flows from financing activities:		
Proceeds from issuance of common stock	—	275,879
Payment of offering costs	—	(38)
Proceeds from secured debt arrangements	412,434	416,549
Repayments of secured debt arrangements	(156,747)	(538,562)
Exchanges and conversions of convertible senior notes	(704)	—
Payment of deferred financing costs	(91)	(2,234)
Dividends on common stock	(62,762)	(57,328)
Dividends on preferred stock	(6,835)	(6,835)
Net cash (used in) provided by financing activities	185,295	87,431
Net increase (decrease) in cash and cash equivalents	(463)	20,639
Cash and cash equivalents, beginning of period	109,806	77,671
Cash and cash equivalents, end of period	$109,343	$98,310
Supplemental disclosure of cash flow information:		
Interest paid	$32,428	$26,517
Supplemental disclosure of non-cash financing activities:		
Exchange of convertible senior notes for common stock	$33,778	$—
Dividend declared, not yet paid	$70,364	$63,598
Offering costs payable	$—	$339
Loan proceeds held by servicer	$—	$1,000

Deferred financing costs, not yet paid	$3,643	$—

See notes to unaudited condensed consolidated financial statements.

Apollo Commercial Real Estate Finance Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
Note 1 – Organization
Apollo Commercial Real Estate Finance, Inc. (together with its consolidated subsidiaries, is referred to throughout this report as the "Company," "ARI," "we," "us" and "our") is a corporation that has elected to be taxed as a real estate investment trust ("REIT") for U.S. federal income tax purposes and primarily originates, acquires, invests in and manages performing commercial first mortgage loans, subordinate financings, and other commercial real estate-related debt investments. These asset classes are referred to as our target assets.
We were formed in Maryland on June 29, 2009, commenced operations on September 29, 2009 and are externally managed and advised by ACREFI Management, LLC (the "Manager"), an indirect subsidiary of Apollo Global Management, LLC (together with its subsidiaries, "Apollo").
We elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, commencing with the taxable year ended December 31, 2009. To maintain our tax qualification as a REIT, we are required to distribute at least 90% of our taxable income, excluding net capital gains, to stockholders and meet certain other asset, income, and ownership tests.
Note 2 – Summary of Significant Accounting Policies
Basis of Presentation
The accompanying condensed consolidated financial statements include our accounts and those of our consolidated subsidiaries. All intercompany amounts have been eliminated. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Our most significant estimates include loan loss reserves and impairment. Actual results could differ from those estimates.
These unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the Securities and Exchange Commission (the "SEC"). In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary to present fairly our financial position, results of operations and cash flows have been included. Our results of operations for the three months ended March 31, 2019 are not necessarily indicative of the results to be expected for the full year or any other future period.
We currently operate in one reporting segment.
Recent Accounting Pronouncements
In June 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-07 "Compensation - Stock Compensation (Topic 718): Improvements to Nonemployees Share-Based Payment Accounting" ("ASU 2018-07"). The intention of ASU 2018-07 is to expand the scope of Topic 718 to include share-based payment transactions in exchange for goods and services from nonemployees. These share-based payments will now be measured at grant-date fair value of the equity instrument issued. Upon adoption, only liability-classified awards that have not been settled and equity-classified awards for which a measurement date has not been established should be remeasured through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018 and is applied retrospectively. We adopted ASU 2018-07 in the first quarter of 2019 and it did not have any impact on our condensed consolidated financial statements.
In June 2016, the FASB issued ASU 2016-13 "Financial Instruments - Credit Losses - Measurement of Credit Losses on Financial Instruments (Topic 326)" ("ASU 2016-13"). ASU 2016-13 significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The guidance will replace the "incurred loss" approach under existing guidance with an "expected loss" model for instruments measured at amortized cost and require entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. It also simplifies the accounting model for purchased credit-impaired debt securities and loans. The guidance is effective for fiscal years beginning after December 15, 2019 and is to be adopted

through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. While we are currently evaluating the impact ASU 2016-13 will have on our condensed consolidated financial statements, we expect that the adoption will result in higher provisions for potential loan losses.

Note 3 – Fair Value Disclosure

GAAP establishes a hierarchy of valuation techniques based on the observability of the inputs utilized in measuring financial instruments at fair values. Market based, or observable inputs are the preferred source of values, followed by valuation models using management assumptions in the absence of market inputs. The three levels of the hierarchy as noted in ASC 820 "Fair Value Measurements and Disclosures" are described below:

Level I — Quoted prices in active markets for identical assets or liabilities.

Level II — Prices are determined using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing a security. These may include quoted prices for similar securities, interest rates, prepayment speeds, credit risk and others.

Level III — Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period), unobservable inputs may be used.

While we anticipate that our valuation methods will be appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. We will use inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

The estimated fair values of our derivative instruments are determined using a discounted cash flow analysis on the expected cash flows of each derivative. The fair values of interest rate caps are determined using the market standard methodology of discounting the future expected cash receipts (or payments) that would occur if variable interest rates rise above the strike rate of the caps. The variable interest rates used in the calculation of projected cash flows are based on an
expectation of future interest rates derived from observable market interest rate curves and volatilities. The fair values of
foreign exchange forwards are determined by comparing the contracted forward exchange rate to the current market exchange
rate. The current market exchange rates are determined by using market spot rates, forward rates and interest rate curves for
the underlying countries. Our derivative instruments are classified as Level II in the fair value hierarchy.

The following table summarizes the levels in the fair value hierarchy into which our financial instruments were categorized as of March 31, 2019 and December 31, 2018 ($ in thousands):

	Fair Value as of March 31, 2019				Fair Value as of December 31, 2018			
	Level I	Level II	Level III	Total	Level I	Level II	Level III	Total
Derivative assets, net	$—	$8,715	$ —	$8,715	$—	$23,700	$ —	$23,700
Total	$—	$8,715	$ —	$8,715	$—	$23,700	$ —	$23,700

Note 4 – Commercial Mortgage and Subordinate Loans, Net

Our loan portfolio was comprised of the following at March 31, 2019 and December 31, 2018 ($ in thousands):

Loan Type	March 31, 2019	December 31, 2018
Commercial mortgage loans, net	$4,003,089	$ 3,878,981
Subordinate loans, net	1,183,910	1,048,612
Total loans, net	$5,186,999	$ 4,927,593

Our loan portfolio consisted of 93% and 91% floating rate loans, based on amortized cost, as of March 31, 2019 and December 31, 2018, respectively.

9

Activity relating to our loan investment portfolio, for the three months ended March 31, 2019, was as follows ($ in thousands):

	Principal Balance	Deferred Fees/Other Items [1]	Provision for Loan Loss [2]	Carrying Value
December 31, 2018	$4,982,514	$(17,940)	$(36,981)	$4,927,593
New loan fundings	441,844	—	—	441,844
Add-on loan fundings [3]	110,331	—	—	110,331
Loan repayments	(322,354)	—	—	(322,354)
Gain (loss) on foreign currency translation	15,033	(136)	—	14,897
Deferred fees	—	(6,069)	—	(6,069)
PIK interest and amortization of fees	14,321	6,436	—	20,757
March 31, 2019	$5,241,689	$(17,709)	$(36,981)	$5,186,999

(1) Other items primarily consist of purchase discounts or premiums, exit fees and deferred origination expenses.
(2) In addition to the $37.0 million provision for loan loss, we recorded an impairment of $3.0 million against an investment previously recorded under other assets on our condensed consolidated balance sheet.
(3) Represents fundings for loans closed prior to 2019.

The following table details overall statistics for our loan portfolio at the dates indicated ($ in thousands):

	March 31, 2019	December 31, 2018
Number of loans	69	69
Principal balance	$5,241,689	$4,982,514
Carrying value	$5,186,999	$4,927,593
Unfunded loan commitments [1]	$1,039,089	$1,095,598
Weighted-average cash coupon [2]	8.4 %	8.4 %
Weighted-average remaining term [3]	2.9 years	2.8 years

(1) Unfunded loan commitments are primarily funded to finance property improvements or lease-related expenditures by the borrowers. These future commitments are funded over the term of each loan, subject in certain cases to an expiration date.
(2) For floating rate loans, based on applicable benchmark rates as of the specified dates.
(3) Assumes all extension options are exercised.

The table below details the property type of the properties securing the loans in our portfolio at the dates indicated ($ in thousands):

Property Type	March 31, 2019		December 31, 2018	
	Carrying Value	% of Portfolio	Carrying Value	% of Portfolio
Hotel	$1,330,842	25.7 %	$1,286,590	26.1 %
Residential-for-sale: construction	631,501	12.1 %	528,510	10.7 %
Residential-for-sale: inventory	421,815	8.1 %	577,053	11.7 %
Office	956,989	18.5 %	832,620	16.9 %
Urban Predevelopment	610,888	11.8 %	683,886	13.9 %
Multifamily	521,087	10.0 %	448,899	9.1 %
Industrial	227,206	4.4 %	32,000	0.6 %
Retail Center	156,008			