# Stock Pick of the Week: Post Properties (PPS)

The best stock picks have to meet certain criteria. The company must have strong fundamentals like rising profits and return on invested capital (ROIC). The company must also have a catalyst to continue growing. No one wants to buy a company that won't grow into the future. Lastly, the best stocks are undervalued by the market. As we continue to analyze 2014 10-Ks we're finding out just how over and undervalued companies are. In doing so, we've identified a company this week that meets the three criteria above. This company operates as a REIT, but doesn't necessarily face the same issues many fear within this industry. This week's stock pick of the week is Post Properties Inc. (PPS).

### What is Post Properties?

Post Properties, founded in 1971, owns and manages upscale multi-family apartment communities in a few markets around the United States. Post not only purchases apartment complexes but also oversees the construction and maintenance of new buildings, and manages the leasing and property management duties of each complex. The company is largely spread across four main areas, with the 29% of operations occurring in Atlanta, Georgia and 22% in Dallas, Texas.

### Why Look at Post Today?

Post is operating at levels of profitability not seen in the past 16 years. In 2014, Post earned an after-tax operating profit (NOPAT) of almost $302 million, its highest ever in our model. Total revenues grew 4% year over year and the company's NOPAT was up 80% over 2013's profits. Profit growth over the long-term is just as impressive as NOPAT has grown by 5% compounded annually over the past decade and astounding 41% compounded annually since 2009. As renting has become more popular than owning, Post has positioned itself to benefit from this trend.

On top of growing its profits, Post is becoming increasingly more efficient with its core business. The company's 2014 ROIC of 14% is the highest of the last 16 years, and is up from its ROIC of 2% only five years ago.

### But Aren't REITs Dangerous?

The big worry within the REIT sector concerns the probability of rising interest rates. This fear is focused more on the mortgage REIT side where companies make money off of interest rate spreads when purchasing mortgages. However, Post Properties is much different. Because Post actually buys, develops, and manages the real estate it holds, it derives its income from rental revenues, not from loan products. Rather than fearing interest rate hikes, Post Properties is more dependent on a strong economy, job creation, and consumers forgoing buying a home and choosing to rent. As the "millennial generation" continues to choose renting over buying, Post Properties, with its strategic locations, is poised to continue growing rental revenues.

### These Adjustments Reveal Posts' Operating Profitability and Valuation

We make several key adjustments to the earnings and balance sheets of companies to uncover the recurring cash flows of each company's core business and the value left for shareholders. We made the following major adjustments to Post's earnings in 2014:

- Removed $63 million reported non-operating expenses included in operating earnings
- Removed $27 million in reported after-tax non-operating expenses included in operating earnings

The removal of these non-recurring items led Post's 2014 NOPAT to be 43% higher than its reported net income. When considering Post's valuation, we also add $11 million in off-balance sheet debt due to operating leases (1% of total debt) to Post's total debt, bringing the company's total debt to $938 million, or 38% of its market capitalization.

### Post is a Deal at This Price

After removing the non-operating expenses highlighted above, we see that Post's 2014 NOPAT was even more impressive than its GAAP net income. While net income increased by over 50% year over year, NOPAT was up 80% year over year.

Because of this understated profitability, Post is currently very undervalued. At its price of ~$56/share, Post has a price to economic book value (PEBV) ratio of just 0.7. This ratio implies that the market expects Post's profits to permanently decline by 30%. This seems extremely pessimistic when considering Post has grown NOPAT by 40% compounded annually as of late. Such low expectations, coupled with the strong fundamentals above lead to Post receiving our Very Attractive rating.

If Post can grow NOPAT by just 3% compounded annually for the next 7 years, the company is worth $103/share — an 84% upside from current levels.

*Disclosure: David Trainer Kyle Guske II receive no compensation to write about any specific stock, style, or theme.*

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2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

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