Realty Income (O)

Updated July 10th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$55	**5 Year CAGR Estimate:**	9.5%	**Volatility Percentile:**	33.6%
Fair Value Price:	$54	**5 Year Growth Estimate:**	5.2%	**Momentum Percentile:**	46.5%
% Fair Value:	102%	**5 Year Valuation Multiple Estimate:**	-0.5%	**Valuation Percentile:**	54.5%
Dividend Yield:	4.8%	**5 Year Price Target**	$69	**Total Return Percentile:**	60.9%

Overview & Current Events

Realty Income is a retail real estate focused REIT that has become famous for its successful dividend growth history and the fact that it pays dividends *monthly*. Realty Income owns more than 4,000 properties and is valued at $16 billion. Realty Income owns retail properties that are not part of a wider retail development (i.e. a mall), but rather standalone properties. This means that the properties are viable for many different tenants, and are used for many different purposes, including government services, healthcare services, and entertainment.

The company's most recent quarterly earnings were reported on May 8. Realty Income generated adjusted funds from operations of $0.79 per share during the first quarter. This came on the back of a 7% revenue increase compared to the prior year's quarter. The REIT continues to expect adjusted FFO of $3.14 to $3.20 per share for FY 2018, which implies a 4% increase over 2017's level of $3.05.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
AFFO	$1.83	$1.86	$1.86	$2.01	$2.06	$2.41	$2.57	$2.74	$2.88	$3.05	***$3.17***	***$4.08***
DPS	$1.66	$1.71	$1.72	$1.74	$1.77	$2.15	$2.19	$2.27	$2.39	$2.53	***$2.65***	***$3.33***

Realty Income does not generate extremely high growth rates, but the growth the REIT is experiencing is steady. AFFO per share grew by 5.6% annually over the last decade, which is a solid-if-unspectacular growth rate. Realty Income generates its growth through rising rents at existing locations as well as through the acquisitions of new properties.

The REIT plans to invest $1 to $1.5 billion into new properties during 2018, which should help drive profits going forward. Realty Income's properties are relatively Amazon-proof: The REIT owns standalone properties that can be used as cinemas, fitness centers, pharmacies, etc. Contrast this with mall REITs, which increasingly have trouble finding tenants for their properties. Realty Income's properties are in demand and will likely remain so.

The occupancy rates are high (at more than 98%) and the REIT has been growing its same-property rents continuously. Due to the fact that tenants pay a fixed rent, Realty Income's business is not cyclical at all. This is reflected by the fact that Realty Income's AFFO continued to grow through the last financial crisis.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
P/AFFO	12.6	14.0	18.3	17.4	19.4	15.4	18.7	19.0	19.8	18.7	***17.4***	***17.0***
Avg. Yld.	6.9%	7.6%	5.4%	5.1%	4.5%	5.0%	5.0%	4.6%	3.9%	4.4%	***4.8%***	***5.0%***

Realty Income's valuation has been growing consistently from 2008 onwards, but along with most other REITs and income stocks Realty Income's shares got less expensive during 2017. Shares of Realty Income nevertheless trade at a small premium compared to the historic median multiple right now.

Realty Income is popular among income investors, as its monthly dividend payments, reliable income growth and attractive dividend yield of 4.8% are a strong choice compared to many other income stocks and fixed income alternatives.

Disclosure: This analyst has a long position in the Realty Income (O).

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	10.7%	10.9%	9.2%	9.0%	8.5%	7.5%	8.0%	8.2%	7.9%	8.2%	***8.0%***	***8.0%***
Debt/A	48.2%	49.1%	47.7%	49.9%	55.6%	45.8%	49.0%	44.8%	48.6%	47.6%	***48.0%***	***47..0%***
Int. Cov.	2.2	2.4	2.3	2.3	2.2	2.0	2.3	2.3	2.5	2.4	***2.5***	***2.5***
Payout	90.7%	91.9%	92.5%	86.6%	85.9%	89.2%	85.2%	82.8%	83.0%	82.9%	***83.6%***	***81.7%***
Std. Dev.	77.0%	56.9%	25.8%	25.7%	13.7%	22.0%	15.4%	20.2%	22.9%	16.5%	***18.0%***	***20.0%***

Realty Income generates relatively low gross profits relative to the assets the REIT owns, but on the other hand there are no significant operating expenses, which means that a large portion of gross profits turns up as cash that can be utilized.

Roughly half of Realty Income's asset base is financed via debt. The interest coverage ratio looks quite low, but that is due to the fact that the REIT's earnings are quite low due to high depreciation expenses. Cash flows cover the REIT's interest expenses by a factor that is substantially higher (the cash flow to interest expenses ratio was 4.9 during 2017).

Despite the fact that its dividend has been raised multiple times a year Realty Income has managed to lower its payout ratio during the last decade. Realty Income's dividend payout ratio is in line with what REITs typically pay.

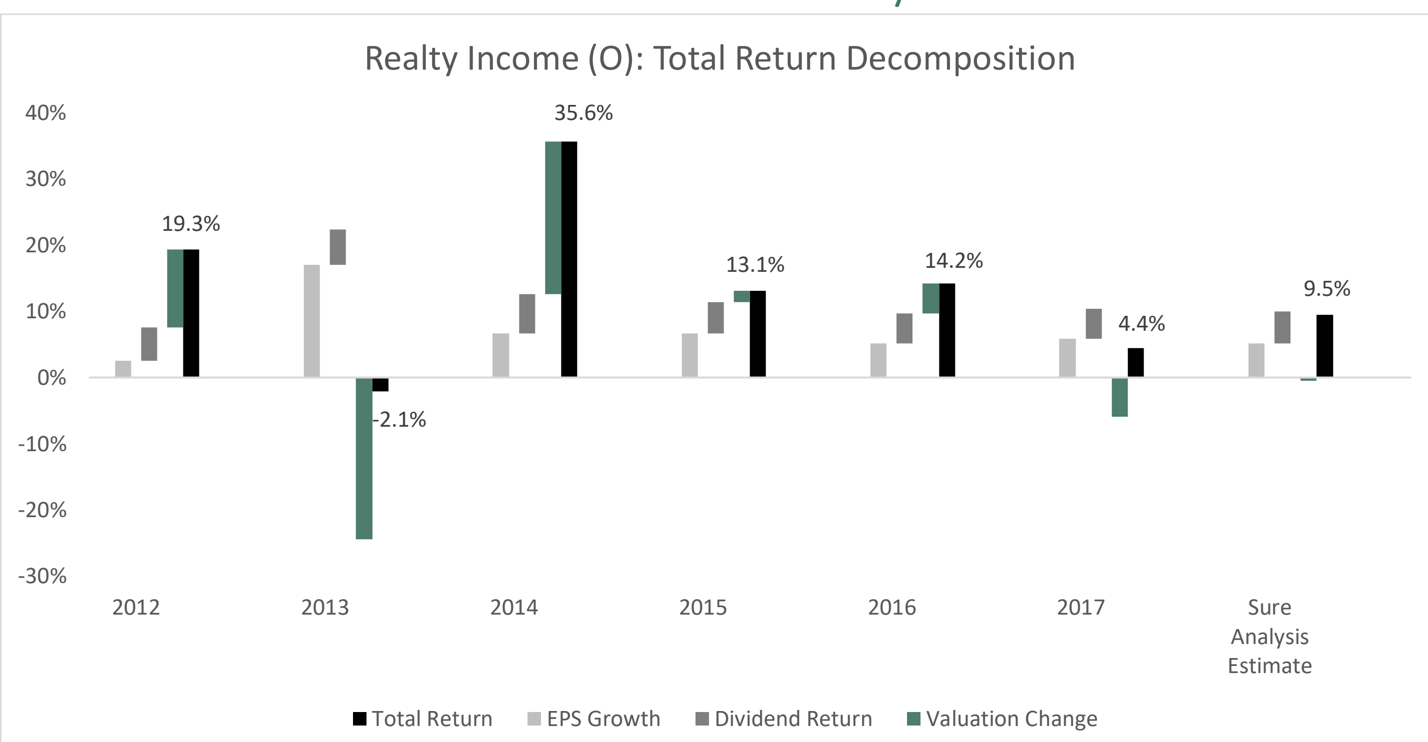
Relative to mall REITs, which are more threatened by Amazon, Realty Income looks very stable. The business is relatively recession-proof (AFFO per share grew during the last financial crisis), and the stock is not overly volatile. With its high occupancy rates and high-grade property portfolio Realty Income is well positioned relative to most other retail REITs.

Final Thoughts & Recommendation

Realty Income has a strong track record and a solid AFFO per share growth outlook. Its shares trade only slightly above the historic median multiples, therefore multiple compression will only be a minor headwind.

Realty Income is a low-risk investment that provides attractive, monthly income through its dividend that yields 4.8% right now. Its dividend will continue to grow at a rate that is significantly higher than the rate of inflation. Realty Income looks like a compelling stock for investors that want a sleep-well-at-night investment. Shares of the company are poised to provide high-single digits total returns through the next five years, so we're recommending them as a buy today.

Total Return Breakdown by Year



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