National Retail Properties (NNN)

Updated August 7th, 2018 by Nick McCullum

Key Metrics

Current Price:	$45	**5 Year CAGR Estimate:**	4.5%	**Volatility Percentile:**	34.2%
Fair Value Price:	$37	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	61.5%
% Fair Value:	122%	**5 Year Valuation Multiple Estimate:**	-3.9%	**Valuation Percentile:**	26.6%
Dividend Yield:	4.4%	**5 Year Price Target**	$45	**Total Return Percentile:**	25.0%

Overview & Current Events

National Retail Properties is a REIT that owns single-tenant, net-leased retail properties. It owns more than 2,700 properties across 48 states. The REIT is focused on retail customers because the latter are much more likely to accept decent rent hikes in order to avoid switching locations and losing their customer base. Thanks to this strategy, NNN has offered consistent growth with markedly low volatility. NNN is also characterized by very high occupancy rates. Its 15-year low occupancy rate is 96.4% while its current rate is 98.5%. National Retail Properties has increased its dividend for 29 consecutive years (a record matched by only three publicly-traded REITs), making the REIT a member of the Dividend Champions.

In early August, National Retail Properties reported (8/1/18) financial results for the second quarter of fiscal 2018. In the quarter, revenues increased by 6.8% while net earnings per common share increased by 21.2% and funds from operations (FFO) per share increased by 15.6%. Adjusted financial results were slightly weaker, but still quite strong. Core FFO and adjusted FFO increased by 6.3% and 4.6%, respectively, over the same period a year ago. National Retail Properties' strong financial performance was driven by robust operating results among its property portfolio. The company finished the reporting period with portfolio occupancy of 98.5%, while also investing $140.5 million in new property investments and selling 13 properties for $11.9 million (which, in aggregate, produced $4.1 million of gains on sales).

National Retail Properties also updated its 2018 financial guidance with the release of its second quarter financial results. The company now expects to generate adjusted funds from operations per share between $2.66 and $2.70. We have updated our 2018 FFO estimate to reflect the midpoint of this new guidance band.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
FFO	$1.99	$1.61	$1.31	$1.57	$1.74	$1.93	$2.08	$2.22	$2.41	$2.52	***$2.68***	***$3.26***
DPS	$1.48	$1.50	$1.51	$1.53	$1.56	$1.60	$1.65	$1.71	$1.78	$1.86	***$1.94***	***$2.34***

National Retail Properties has more than doubled its FFO since 2008 but it has also doubled its share count in order to fund its acquisitions of properties. As a result, the REIT has grown its FFO per share by only 3.1% per year on average since 2008. While the impact of dilution is noticeable, the dilution also has another, less obvious effect; it has greatly increased the financial burden of the dividend on the REIT. For instance, while the dividend per share has grown only 16% since 2013, the total amount that the REIT spends on dividends has jumped 45%, from $217 million to $315 million.

National Retail Properties has grown its FFO per share at a 7.7% average annual pace in the last five years but we believe that growth will slow moving forward as interest rates rise and the trust's cost of capital increases. We expect 4% FFO growth for the next five years, from $2.68 this year to $3.19 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/FFO	10.0	11.2	11.7	13.6	14.9	13.2	16.4	15.4	16.7	14.8	***16.8***	***13.8***
Avg. Yld.	7.4%	8.3%	6.4%	6.0%	5.4%	4.7%	4.6%	4.4%	3.8%	4.4%	***4.9%***	***5.3%***

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.

Using the midpoint of management's new 2018 FFO guidance, National Retail Properties is trading at a price-to-FFO ratio of 16.8. The trust's 10-year average price-to-FFO ratio is 13.8. Accordingly, we believe that valuation contraction will negatively impact the trust's total returns moving forward. If the trust's valuation multiple reverts to its long-term average over a period of 5 years, this will introduce a 3.9% headwind to its total returns during this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

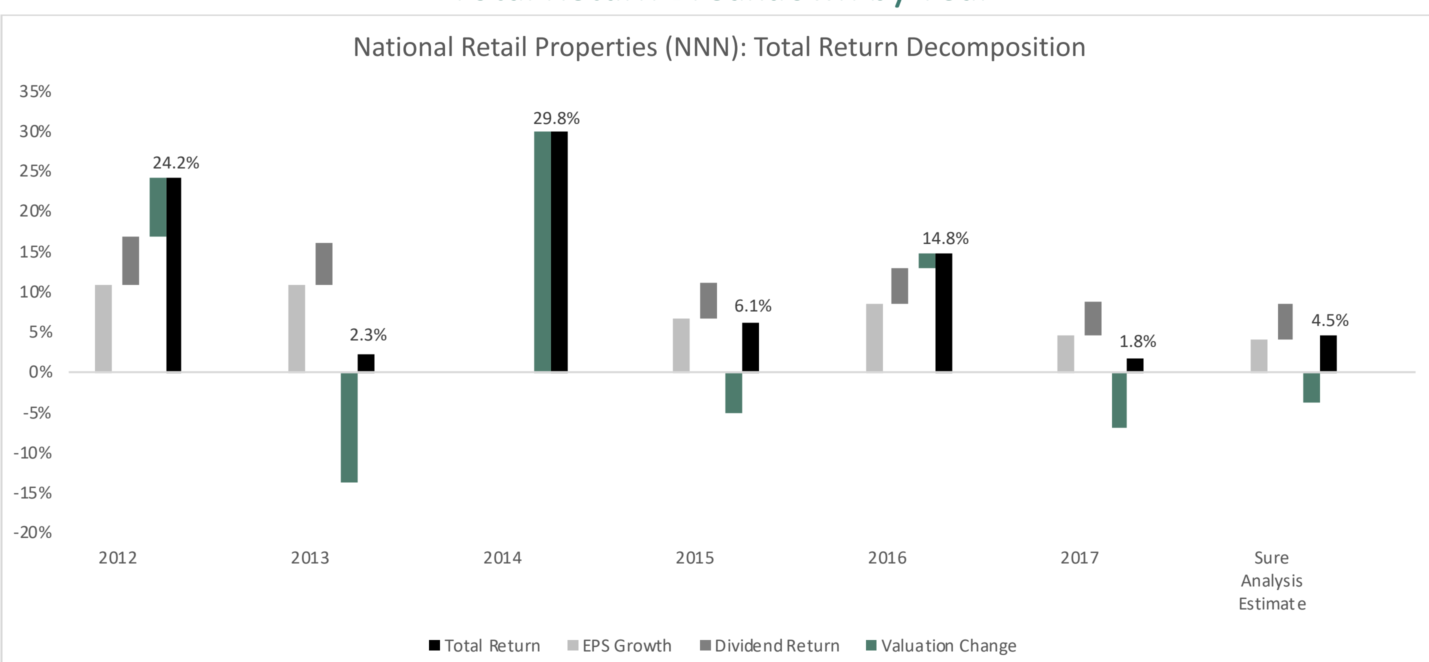
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	8.6%	8.9%	7.7%	7.1%	7.9%	8.4%	8.5%	8.5%	8.1%	8.6%	***8.6%***	***8.5%***
Debt/A	41.8%	39.6%	43.7%	41.7%	42.4%	37.7%	37.3%	38.8%	38.2%	41.5%	***42.0%***	***44.0%***
Int. Cov.	2.7	1.9	2.1	2.2	2.5	2.8	3.3	3.3	3.3	3.1	***3.1***	***3.0***
Payout	74.4%	93.2%	115%	97.5%	89.7%	82.9%	79.3%	70.0%	73.9%	73.8%	***74.0%***	***75.0%***
Std. Dev.	70.4%	55.5%	24.7%	22.0%	12.4%	23.1%	15.6%	20.1%	20.8%	18.3%	***19.0%***	***20.0%***

National Retail Properties has a healthy balance sheet, with a BBB+ credit rating. Its debt maturities are well-laddered and only $303 million of debt matures until 2021. As a result, the REIT can navigate through the current environment of rising interest rates while it will also be able to remain profitable whenever the next recession shows up. On the other hand, National Retail Properties is significantly affected by recessions. In the Great Recession, its funds from operations per share plunged 34%, from $1.99 in 2008 to $1.31 in 2010. Nevertheless, given that the financial crisis was triggered by the bubble in the housing market, the performance of the REIT in that crisis was satisfactory. However, investors should keep in mind that its downside potential will be significant whenever the next recession shows up, particularly given its current rich valuation.

Final Thoughts & Recommendation

Despite an increase to the firm's 2018 financial guidance with the release of its second quarter earnings report, National Retail Properties continues to be very overvalued. Despite the trust's strong performance, enviable track record of dividend growth, and other attractive characteristics, the impact of valuation contraction on its future returns is hard to overstate. Accordingly, National Retail Properties is either a hold or sell at current prices, depending on your target total return.

Total Return Breakdown by Year



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