National Retail Properties (NNN)

Updated November 5th, 2018 by Josh Arnold

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	3.6%	**Volatility Percentile:**	31.1%
Fair Value Price:	$37	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	83.3%
% Fair Value:	127%	**5 Year Valuation Multiple Estimate:**	-4.7%	**Growth Percentile:**	20.2%
Dividend Yield:	4.3%	**5 Year Price Target**	$45	**Valuation Percentile:**	16.6%
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Total Return Percentile:**	13.5%

Overview & Current Events

National Retail Properties is a REIT that owns more than 2,800 single-tenant, net-leased retail properties across the United States. It is focused on retail customers because they are much more likely to accept rent hikes in order to avoid switching locations and losing their customer base. Thanks to this strategy, National Retail has offered consistent growth with markedly low volatility. It is also characterized by very high occupancy rates; its 15-year low occupancy rate is 96.4% while its current rate is 98.7%. National Retail has increased its dividend for 29 consecutive years (a record matched by only three publicly-traded REITs), making it a member of the Dividend Champions.

National Retail reported Q3 results on 11/1/18 and results were largely in line with expectations. Revenue was up better than 5% as rental income was strong once again. Occupancy came in at 98.7% in Q3 against 98.5% in Q2 and 99.2% for Q1; National Retail continues to post industry-leading occupancy rates. National Retail acquired 18 properties for a consideration of $78.6 million and sold 18 other properties for $37.6 million. The trust also raised $87 million from the issuance of nearly 2 million common shares and a further $700 million in long-term debt. This capital will continue to fuel National Retail's ever-rising property total and future FFO growth. In total, adjusted FFO rose 4.6% in Q3 and management trimmed FFO guidance by two cents; we've slightly lowered our estimate in sympathy.

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	***$2.67***	***$3.25***
DPS	$1.48	$1.50	$1.51	$1.53	$1.56	$1.60	$1.65	$1.71	$1.78	$1.86	***$2.00***	***$2.40***
Shares	74	80	83	89	109	120	125	134	145	149	***159***	***175***

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 $318 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 $2.67 this year to $3.25 in 2023. The trust's high level of occupancy should afford it low single digit levels of revenue growth, while slightly increasing margins should continue to see it growing FFO-per-share despite the ever-rising share count. The bulk of National Retail's FFO-per-share growth will come from net new property acquisitions, which it is well-positioned to execute upon with its recent capital raises.

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	***17.6***	***13.8***
Avg. Yld.	7.4%	8.3%	6.4%	6.0%	5.4%	4.7%	4.6%	4.4%	3.8%	4.4%	***4.3%***	***5.3%***

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Using the midpoint of management's new 2018 FFO guidance, National Retail Properties is trading at a price-to-FFO ratio of 17.6. 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 4.7% headwind to its total returns during this time period. That, combined with a rising dividend, should see the yield rise from 4.3% to 5.3% in that same time frame.

Safety, Quality, Competitive Advantage, & Recession Resiliency

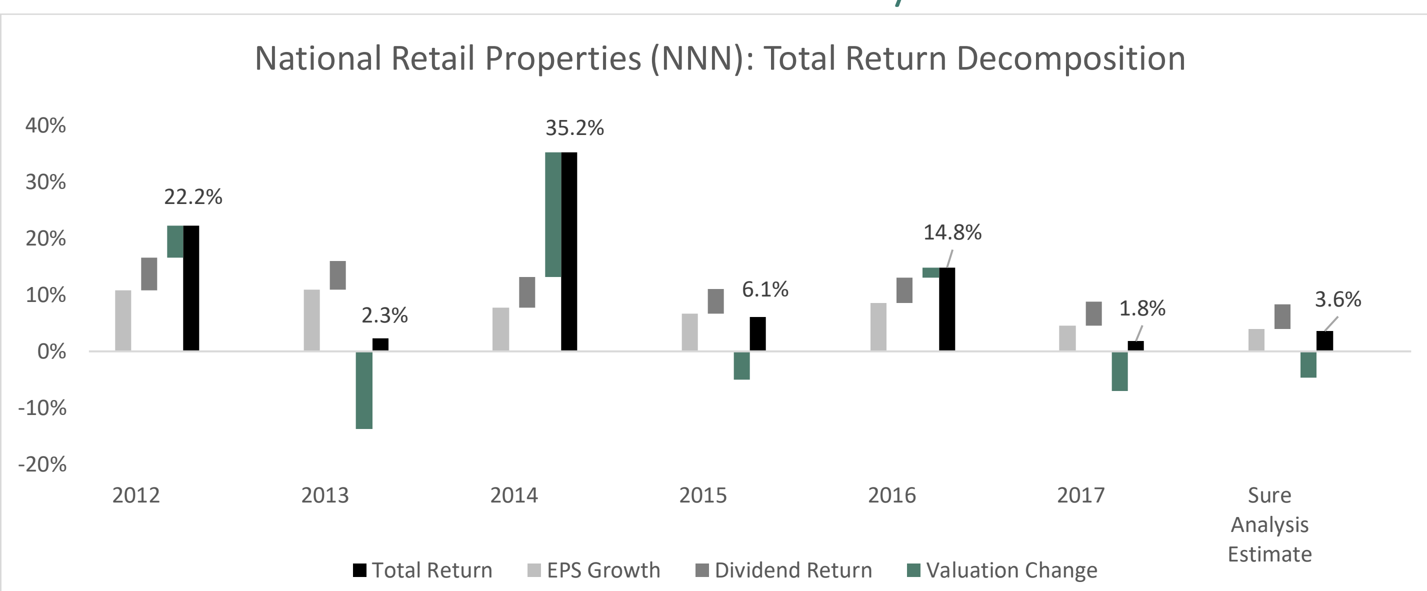
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	8.6%	8.9%	7.7%	7.1%	7.9%	8.4%	8.5%	8.5%	8.1%	8.6%	***8.6%***	***8.5%***
Debt/A	41.8%	39.6%	43.7%	41.7%	42.4%	37.7%	37.3%	38.8%	38.2%	41.5%	***42.0%***	***44.0%***
Int. Cov.	2.7	1.9	2.1	2.2	2.5	2.8	3.3	3.3	3.3	3.1	***3.1***	***3.0***
Payout	74.4%	93.2%	115%	97.5%	89.7%	82.9%	79.3%	70.0%	73.9%	73.8%	***74.9%***	***73.8%***
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 before 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 impacted 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

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 earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	231	247	255	304	352	394	435	483	534	585
Gross Profit	227	231	242	287	334	375	416	463	513	562
Gross Margin	97.9%	93.5%	94.8%	94.4%	95.0%	95.3%	95.6%	95.9%	96.1%	96.0%
SG&A Exp.	35	35	23	29	32	31	33	35	37	34
D&A Exp.	45	48	49	59	75	100	116	135	149	174
Operating Profit	146	149	141	158	210	245	267	294	327	354
Operating Margin	63.3%	60.4%	55.1%	52.2%	59.7%	62.2%	61.5%	60.8%	61.3%	60.6%
Net Profit	123	55	73	92	142	160	191	198	240	265
Net Margin	53.2%	22.2%	28.6%	30.4%	40.4%	40.7%	43.8%	41.0%	44.9%	45.3%
Free Cash Flow	-116	105	188	178	228	274	297	341	415	422
Income Tax	-8	-1	0	1	-7	0	0	10	0	0

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	2649	2591	2714	3435	3988	4455	4916	5460	6334	6561
Cash & Equivalents	3	15	2	2	2	1	11	14	295	1
Goodwill & Int. Ass.	N/A	N/A	N/A	38	45	70	78	72	65	51
Total Liabilities	1106	1024	1185	1431	1690	1676	1832	2118	2417	2720
Long-Term Debt	1027	962	1134	1339	1587	1570	1730	1976	2312	2580
Shareholder's Equity	1450	1472	1435	1910	2009	2202	2508	2767	2997	3208
D/E Ratio	0.67	0.62	0.74	0.67	0.69	0.57	0.56	0.59	0.59	0.67

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	4.7%	2.1%	2.8%	3.0%	3.8%	3.8%	4.1%	3.8%	4.1%	4.1%
Return on Equity	8.9%	3.8%	5.0%	5.5%	7.2%	7.6%	8.1%	7.5%	8.3%	8.5%
ROIC	4.9%	2.1%	2.8%	3.1%	3.9%	3.9%	4.2%	3.9%	4.1%	4.2%
Shares Out.	74	80	83	89	109	120	125	134	145	149
Revenue/Share	3.11	3.09	3.08	3.42	3.22	3.28	3.49	3.59	3.69	3.91
FCF/Share	-1.55	1.31	2.27	2.00	2.09	2.29	2.38	2.54	2.87	2.82

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.