



# Realty Income (O)

Updated November 2<sup>nd</sup>, 2018 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$60	<b>5 Year CAGR Estimate:</b>	7.6%	<b>Volatility Percentile:</b>	30.8%
<b>Fair Value Price:</b>	\$55	<b>5 Year Growth Estimate:</b>	5.2%	<b>Momentum Percentile:</b>	79.7%
<b>% Fair Value:</b>	110%	<b>5 Year Valuation Multiple Estimate:</b>	-1.9%	<b>Growth Percentile:</b>	42.8%
<b>Dividend Yield:</b>	4.3%	<b>5 Year Price Target</b>	\$70	<b>Valuation Percentile:</b>	34.2%
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	39.7%

## Overview & Current Events

Realty Income is a retail real estate focused REIT that has become famous for its successful dividend growth history and its monthly dividend payments. Realty Income owns more than 4,000 properties and is valued at \$17.8 billion. Realty Income owns retail properties that are not part of a wider retail development (such as a mall), but rather standalone properties. This means that the properties are viable for many different tenants, including government services, healthcare services, and entertainment. The company was founded in 1969 and is headquartered in San Diego.

Realty Income announced its third quarter earnings numbers on October 31. The company grossed revenues of \$338 million during the quarter, 10.2% more than during Q3 2017. The revenue increase was primarily driven by the acquisition of new properties during the last year. Realty Income acquired \$610 million worth of new properties during Q3 alone. Realty Income's funds from operations rose to \$0.81 per share, an increase of 5.2% year over year. Realty Income raised its guidance for this year's FFO to \$3.18-\$3.21 per share, which would mean a 4.9% growth rate over fiscal 2017 at the midpoint. Realty Income issued \$300 million in new equity during Q3, and negotiated an expansion of its revolving credit facility from \$2 billion to \$3 billion. The updated revolving credit facility has a lower interest rate, which should be a positive for Realty Income's profits. The surplus liquidity will be used for investments into new properties.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$1.83	\$1.86	\$1.86	\$2.01	\$2.06	\$2.41	\$2.57	\$2.74	\$2.88	\$3.05	<b>\$3.20</b>	<b>\$4.12</b>
<b>DPS</b>	\$1.66	\$1.71	\$1.72	\$1.74	\$1.77	\$2.15	\$2.19	\$2.27	\$2.39	\$2.53	<b>\$2.65</b>	<b>\$3.33</b>
<b>Shares</b>	101	104	118	133	133	207	225	250	260	284	<b>299</b>	<b>360</b>

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

Management plans to invest about \$1.75 billion in new properties during 2018, Realty Income's acquisitions of new properties totaled close to \$1.5 billion during the first three quarters of 2018. This 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. This is in stark contrast to 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 across Realty Income's portfolio 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
<b>P/AFFO</b>	12.6	14.0	18.3	17.4	19.4	15.4	18.7	19.0	19.8	18.7	<b>18.7</b>	<b>17.0</b>
<b>Avg. Yld.</b>	6.9%	7.6%	5.4%	5.1%	4.5%	5.0%	5.0%	4.6%	3.9%	4.4%	<b>4.3%</b>	<b>5.0%</b>

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Realty Income trades at close to 19 times this year's forecasted funds from operations per share. This is a relatively high valuation compared to how Realty Income's shares were valued throughout the last decade. We believe that the valuation will likely decline over the coming years, which will be a headwind for Realty Income's total returns. Investors get a dividend that yields 4.3% right here, which is attractive, but Realty Income's yield has been higher in the past.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	10.7%	10.9%	9.2%	9.0%	8.5%	7.5%	8.0%	8.2%	7.9%	8.2%	<b>8.0%</b>	<b>8.0%</b>
<b>Debt/A</b>	48.2%	49.1%	47.7%	49.9%	55.6%	45.8%	49.0%	44.8%	48.6%	47.6%	<b>48.0%</b>	<b>47.0%</b>
<b>Int. Cov.</b>	2.2	2.4	2.3	2.3	2.2	2.0	2.3	2.3	2.5	2.4	<b>2.5</b>	<b>2.5</b>
<b>Payout</b>	90.7%	91.9%	92.5%	86.6%	85.9%	89.2%	85.2%	82.8%	83.0%	82.9%	<b>82.8%</b>	<b>80.8%</b>
<b>Std. Dev.</b>	77.0%	56.9%	25.8%	25.7%	13.7%	22.0%	15.4%	20.2%	22.9%	16.5%	<b>18.0%</b>	<b>20.0%</b>

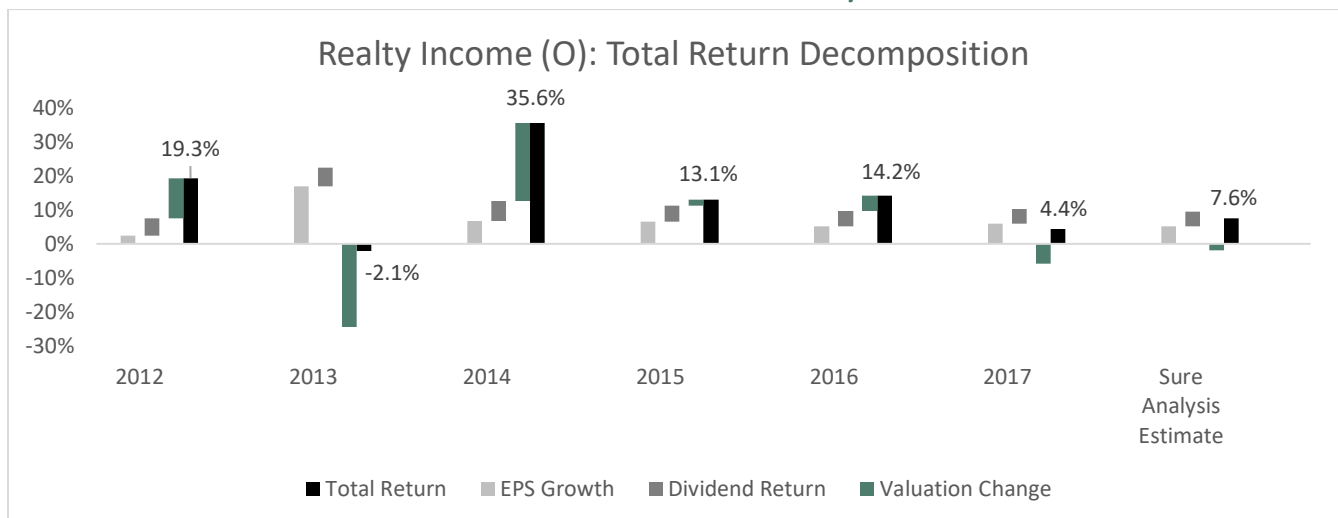
Realty Income generates relatively low gross profits relative to the assets the REIT owns, but on the other hand there are no significant operating expenses, which means that a large portion of gross profits turns up as cash that can be utilized. Roughly half of Realty Income's asset base is financed via debt. The interest coverage ratio looks quite low, but that is due to the fact that the REIT's earnings are depressed due to high non-cash depreciation expenses. Cash flows cover the REIT's interest expenses by a factor that is adequate (~5), so debt levels are not a problem for Realty Income. 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 relatively in line with the broader REIT universe.

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.. 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 successful history, and the company operates in an attractive niche in the retail REIT space. Its portfolio is strong, and it will not be impacted by troubles in the mall REIT space. The company raises its dividend regularly, and total returns of this low-risk stock will likely come in in the high-single digits range over the coming years. Shares trade above our fair value estimate, though, which is why we rate Realty Income a hold at the current price.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	325	323	333	412	485	780	934	1023	1103	1216
<b>Gross Profit</b>	320	316	328	397	463	741	880	968	1040	1146
<b>Gross Margin</b>	98.3%	98.0%	98.3%	96.3%	95.6%	95.0%	94.2%	94.6%	94.3%	94.3%
<b>SG&amp;A Exp.</b>	22	21	25	31	38	57	51	49	52	58
<b>D&amp;A Exp.</b>	89	90	92	117	148	307	375	409	450	499
<b>Operating Profit</b>	209	205	211	249	278	378	454	509	538	589
<b>Operating Margin</b>	64.3%	63.6%	63.2%	60.5%	57.3%	48.4%	48.6%	49.8%	48.8%	48.5%
<b>Net Profit</b>	132	131	131	157	159	246	271	284	316	319
<b>Net Margin</b>	40.6%	40.7%	39.2%	38.1%	32.8%	31.5%	29.0%	27.7%	28.6%	26.2%
<b>Free Cash Flow</b>	246	227	243	299	326	519	628	694	800	876
<b>Income Tax</b>	1	1	1	1	1	2	3	3	3	6

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	2994	2915	3536	4419	5429	9924	11013	11845	13153	14058
<b>Cash &amp; Equivalents</b>	47	10	18	4	5	10	4	40	9	7
<b>Accounts Receivable</b>	11	10	11	15	22	39	64	82	105	120
<b>Goodwill &amp; Int. Ass.</b>	17	17	43	171	259	951	1055	1050	1097	1210
<b>Total Liabilities</b>	1440	1427	1689	2165	3017	4503	5372	5292	6366	6667
<b>Long-Term Debt</b>	1370	1355	1600	2055	2870	4167	4931	4821	5840	6111
<b>Shareholder's Equity</b>	1217	1150	1509	1917	1803	4776	5218	6136	6371	7372
<b>D/E Ratio</b>	0.88	0.91	0.87	0.91	1.19	0.77	0.88	0.74	0.86	0.83

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	4.3%	4.4%	4.1%	3.9%	3.2%	3.2%	2.6%	2.5%	2.5%	2.3%
<b>Return on Equity</b>	10.9%	11.1%	9.8%	9.2%	8.6%	7.5%	5.4%	5.0%	5.0%	4.6%
<b>ROIC</b>	4.4%	4.5%	4.2%	4.0%	3.3%	3.3%	2.7%	2.6%	2.6%	2.4%
<b>Shares Out.</b>	101	104	118	133	133	207	225	250	260	284
<b>Revenue/Share</b>	3.21	3.11	3.15	3.27	3.65	4.07	4.27	4.33	4.32	4.44
<b>FCF/Share</b>	2.43	2.19	2.30	2.37	2.46	2.71	2.87	2.94	3.13	3.20

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

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