National Retail Properties (NNN)

Updated August 22nd, 2019 by Samuel Smith

Key Metrics

Current Price:	$56	**5 Year CAGR Estimate:**	0.4%	**Volatility Percentile:**	28.4%
Fair Value Price:	$38	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	85.9%
% Fair Value:	147%	**5 Year Valuation Multiple Estimate:**	-7.4%	**Growth Percentile:**	26.6%
Dividend Yield:	3.6%	**5 Year Price Target**	$46	**Valuation Percentile:**	10.5%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	7.7%

Overview & Current Events

National Retail Properties is a REIT that owns almost 3,000 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%, while its current rate is 98%. 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 Q2 earnings on 8/1/19. Core FFO-per-share came in at 68 cents, which was flat year-over-year and in-line with analyst expectations. Q2 revenue was $164.8 million, exceeding analyst expectations by about $1.1 million. The portfolio occupancy rate improved by 60 basis points sequentially to an impressive 98.8%. The trust raised $82 million through the issuance of 1.53 million common shares during the quarter and raised an additional $42 million through property sales (at a $12.6 million profit). It recycled this equity alongside debt into $275.8 million in additional property investments at an initial cash yield of 6.9%, providing strong accretion to trust cash flow moving forward. While the aggressive capital recycling is a positive, some of this was offset by higher than expected G&A and real estate expenses, causing management to leave their full year guidance unchanged.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
FFO	$1.61	$1.31	$1.57	$1.74	$1.93	$2.08	$2.22	$2.41	$2.52	$2.68	***$2.74***	***$3.33***
DPS	$1.50	$1.51	$1.53	$1.56	$1.60	$1.65	$1.71	$1.78	$1.86	$1.95	***$2.00***	***$2.33***
Shares[1]	80	83	89	109	120	125	134	145	149	160	***165***	***190***

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 5.8% per year on average since 2009. 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 6.8% 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 $2.74 this year to $3.33 in 2024. 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.

[1] In millions

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/FFO	11.2	11.7	13.6	14.9	13.2	16.4	15.4	16.7	14.8	16.1	***20.3***	***13.8***
Avg. Yld.	8.3%	6.4%	6.0%	5.4%	4.7%	4.6%	4.4%	3.8%	4.4%	4.5%	***3.6%***	***5.1%***

Using the midpoint of management's 2019 FFO guidance, National Retail Properties is trading at a price-to-FFO ratio of 20.3, which is the highest it has been in the past decade, even as its growth is slowing to a crawl due to cap rate compression. The trust's 10-year average price-to-FFO ratio is 13.8 and that is where we assess fair value. 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 6.8% headwind to its total returns during this time period. That, combined with a rising dividend, should see the yield rise from 3.6% to 5.1% in that same time frame.

Safety, Quality, Competitive Advantage, & Recession Resiliency

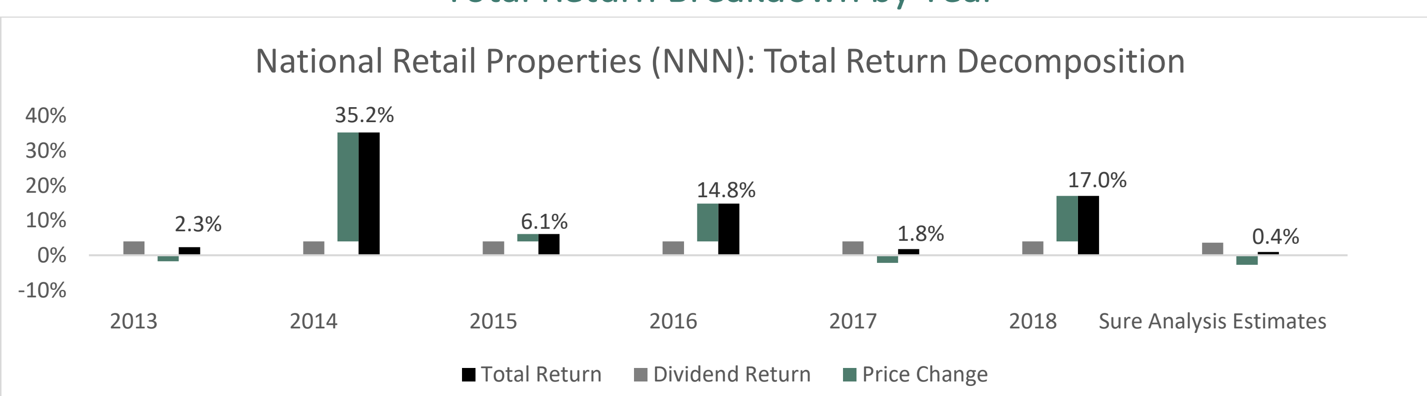
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	93%	115%	98%	90%	83%	79%	70%	74%	74%	73%	***73%***	***70%***

National Retail's payout ratio is being maintained under three-quarters of FFO, and we believe it will stay there for the foreseeable future. Given this, the dividend is fairly safe at this point with the trust's rising earnings. 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. The trust lacks any durable competitive advantages, though its scale and business network are gradually growing over time, which could give it increasing pricing power and economies of scale.

Final Thoughts & Recommendation

National Retail Properties continues to be very overvalued and has become more so since our last report. Despite the trust's strong performance, enviable track record of dividend growth, and other attractive characteristics, the impact of potential valuation contraction on its future returns is hard to overstate. Accordingly, National Retail Properties earns a sell recommendation from Sure Dividend at current prices as we see just 0.4% annualized total returns moving forward due to its 3.6% dividend yield and 4% expected annual FFO per share growth being largely offset by substantial expected multiple contraction.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	247	255	304	352	394	435	483	534	585	623
Gross Profit	231	242	287	334	375	416	463	513	562	598
Gross Margin	93.5%	94.8%	94.4%	95.0%	95.3%	95.6%	95.9%	96.1%	96.0%	96.0%
SG&A Exp.	35	23	29	32	31	33	35	37	34	34
D&A Exp.	48	49	59	75	100	116	135	149	174	174
Operating Profit	149	141	158	210	245	267	294	327	354	389
Operating Margin	60.4%	55.1%	52.2%	59.7%	62.2%	61.5%	60.8%	61.3%	60.6%	62.5%
Net Profit	55	73	92	142	160	191	198	240	265	292
Net Margin	22.2%	28.6%	30.4%	40.4%	40.7%	43.8%	41.0%	44.9%	45.3%	47.0%
Free Cash Flow	105	188	178	228	274	297	341	415	422	472
Income Tax	-1	0	1	-7	0	0	10	N/A	N/A	N/A

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	2591	2714	3435	3988	4455	4916	5460	6334	6561	7103
Cash & Equivalents	15	2	2	2	1	11	14	295	1	114
Accounts Receivable	N/A	N/A	3	3	4	3	3	3	4	4
Inventories	72	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Goodwill & Int. Ass.	N/A	N/A	38	45	70	78	72	65	51	50
Total Liabilities	1024	1185	1431	1690	1676	1832	2118	2417	2720	2949
Accounts Payable	25	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Long-Term Debt	962	1134	1339	1587	1570	1730	1976	2312	2580	2851
Shareholder's Equity	1472	1435	1910	2009	2202	2508	2767	2997	3208	3522
D/E Ratio	0.62	0.74	0.67	0.69	0.57	0.56	0.59	0.59	0.67	0.69

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.1%	2.8%	3.0%	3.8%	3.8%	4.1%	3.8%	4.1%	4.1%	4.3%
Return on Equity	3.8%	5.0%	5.5%	7.2%	7.6%	8.1%	7.5%	8.3%	8.5%	8.7%
ROIC	2.1%	2.8%	3.1%	3.9%	3.9%	4.2%	3.9%	4.1%	4.2%	4.4%
Shares Out.	80	83	89	109	120	125	134	145	149	160
Revenue/Share	3.09	3.08	3.42	3.22	3.28	3.49	3.59	3.69	3.91	3.98
FCF/Share	1.31	2.27	2.00	2.09	2.29	2.38	2.54	2.87	2.82	3.02

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