Global Net Lease (GNL)

Updated November 21st, 2019 by Samuel Smith

Key Metrics

Current Price:	$20	**5 Year CAGR Estimate:**	7.7%	**Volatility Percentile:**	41.1%
Fair Value Price:	$18	**5 Year Growth Estimate:**	0.0%	**Momentum Percentile:**	33.5%
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.8%	**Growth Percentile:**	2.5%
Dividend Yield:	10.7%	**5 Year Price Target**	$18	**Valuation Percentile:**	52.3%
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Total Return Percentile:**	56.6%

Overview & Current Events

Global Net Lease is a Real Estate Investment Trust (REIT) investing in commercial properties in the U.S. (56% of locations) and Europe (44% of locations) with an emphasis on sale-leaseback transactions. The trust owns well in excess of 300 properties, of which office is the largest sector, followed by industrial and retail. Global Net Lease is a $1.8 billion market capitalization business.

On November 8th, 2019 Global Net Lease reported Q3 results. Q3 core FFO-per-share came in at 45 cents, down significantly from 54 cents year-over-year, despite revenue increasing to $77.9 million from $71.9 million a year ago, and EBITDA rising to $58.3 million from $56.6 million last year. This is partly due to the large number of shares issued by the REIT over the past year.

A major shift during the quarter was GNL's significant reduction in its retail exposure, as management sold 32 Family Dollar stores to drive down retail exposure to 5% of its portfolio, rather than the 9% level previously. The trust then recycled those funds into acquiring 9 industrial and office properties in order to improve its strength in the current environment. As of quarter end, the portfolio stood at 99.6% leased with an 8-year weighted average remaining lease term.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
AFFO	---	---	---	---	---	---	$1.96	$2.24	$2.10	$2.11	***$2.15***	***$2.15***
DPS	---	---	---	---	---	---	$1.40	$2.13	$2.13	$2.13	***$2.13***	***$2.13***
Shares[1]	---	---	---	---	---	---	58	57	67	70	***75***	***85***

Note that Global Net Lease was not publicly listed until 2015, which results in a very short observation history.

From first glance, Global Net Lease appears to be a reasonable REIT with 111 tenants, including well-established names like FedEx, U.S. Customs, ING Bank, and Family Dollar, diversified across seven countries. However, there are a variety of underlying concerns, especially as it relates to potential growth.

General concerns include potential conflicts of interest due to being externally managed by AR Global Investments (which invests for other entities), the office space industry requiring increased capex, and categorizing some of its tenants as investment grade using an "implied" credit model.

Growth concerns can be more or less boiled down to what you see in the table above. Global Net Lease pays out effectively all of its AFFO in the form of cash dividends. As such, future growth cannot be fueled by internal funds and instead requires additional debt and/or share dilution. Global Net Lease has elected to issue more and more shares, which carry a very high cost given that the current dividend equates to a 11.0% starting yield. There's a hurdle rate problem in that properties must be more attractive than the 11.0% cost of issuing shares. Stated differently, even if the trust continues to increase total AFFO, the real test will be whether or not AFFO per share can increase. As a result, we expect no AFFO per share growth over the next half decade.

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[1] In millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/AFFO	---	---	---	---	---	12.2	10.5	9.8	8.4	***9.3***	***8.5***
Avg. Yld.	---	---	---	---	---	5.9%	9.1%	10.3%	12.1%	***10.7%***	***11.7%***

Given Global Net Lease's limited trading history, it's hard to assign a fair value multiple on the security. Over the past four years shares have traded hands in the $16 to $27 range, implying an AFFO multiple in the 7 to 13 range. We believe the current multiple is slightly above fair value given the attributes of the security and expect a slight annual headwind from multiple contraction over the next five years. On the one hand, the double-digit starting dividend – which is now paid in quarterly installments – appears very attractive for the income investor. On the other hand, it's this same dividend – taking up basically all of AFFO and creating a high hurdle rate – that will likely stymie growth in the years ahead.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	---	---	---	71%	95%	101%	101%	***99%***	***99%***

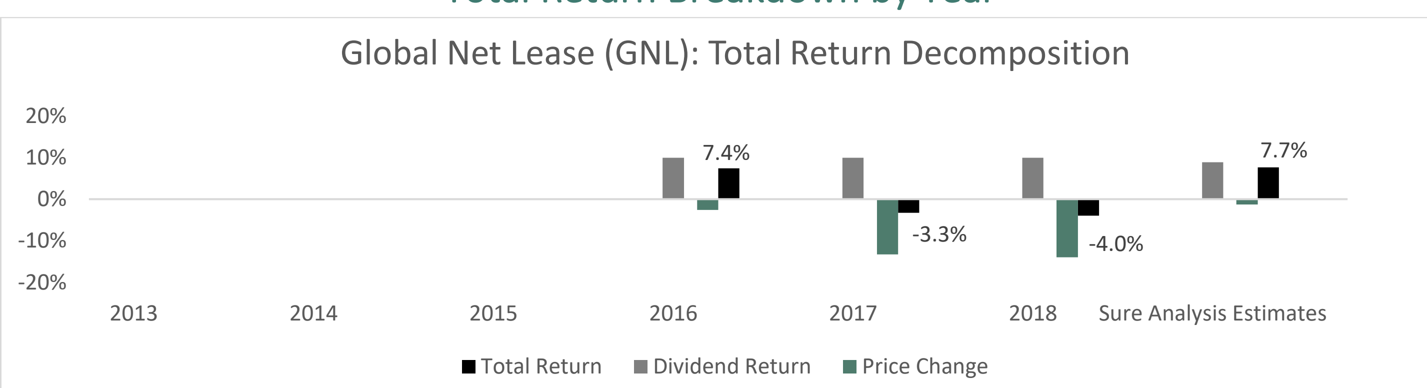
The balance sheet is reasonably liquid and flexible given the strong interest coverage ratio, low weighted-average interest rate, well laddered debt maturities, and high percentage of fixed-rate debt. However, its elevated payout ratio puts it at risk of a dividend cut if the business stumbles at all, and its reliance on equity issuances for acquisitions make it extremely challenging to grow.

As a net lease REIT, GNL does not enjoy any competitive advantages other than decent scale and a fairly large business network with tenants in Europe and the U.S. Its business model is fairly recession resistant, though its high exposure to office properties does put it at some risk. Its high payout ratio could prove problematic during the next recession by forcing a dividend cut.

Final Thoughts & Recommendation

The 10.7% starting yield is attractive to investors and – adjusting for slight expected annual multiple contraction – could lead to 7.7% total annual returns over the next half decade. However, there are a variety of areas where we advocate caution, including the past reverse split, management's potential conflict of interest, a limited history, the high payout ratio, and the trust's need to keep issuing more shares. Further, the hurdle rate for those new shares is quite high. This is a high-risk security with an elevated chance of a dividend cut during a recession. While its solid expected returns mean it's not a sell, this stock is very high-risk, so we rate it a hold for only the boldest investors.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	---	---	---	---	---	93	205	214	259	282
Gross Profit	---	---	---	---	---	85	187	195	230	253
Gross Margin	---	---	---	---	---	91.5%	91.1%	91.1%	88.9%	89.8%
SG&A Exp.	---	---	---	---	---	5	43	31	29	41
D&A Exp.	---	---	---	---	---	40	90	94	115	---
Operating Profit	---	---	---	---	---	40	54	70	88	93
Operating Margin	---	---	---	---	---	42.8%	26.2%	32.7%	34.0%	32.8%
Net Profit	---	---	---	---	---	-54	-2	47	24	11
Net Margin	---	---	---	---	---	-57.4%	-1.0%	22.0%	9.1%	3.9%
Free Cash Flow	---	---	---	---	---	-19	92	114	128	---
Income Tax	---	---	---	---	---	-1	6	4	3	2

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	---	---	---	---	---	2429	2541	2891	3039	3309
Cash & Equivalents	---	---	---	---	---	65	70	70	102	100
Goodwill & Int. Ass.	---	---	---	---	---	4	3	14	23	22
Total Liabilities	---	---	---	---	---	1012	1320	1535	1624	1881
Accounts Payable	---	---	---	---	---	15	19	23	23	32
Long-Term Debt	---	---	---	---	---	942	1242	1419	1514	1772
Shareholder's Equity	---	---	---	---	---	1417	1205	1348	1413	1425
D/E Ratio	---	---	---	---	---	0.66	1.03	1.05	1.07	1.24

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	---	---	---	---	---	-4.1%	-0.1%	1.7%	0.8%	0.3%
Return on Equity	---	---	---	---	---	-7.0%	-0.2%	3.7%	1.7%	0.8%
ROIC	---	---	---	---	---	-4.2%	-0.1%	1.8%	0.8%	0.4%
Shares Out.	---	---	---	---	---	---	58.1	56.7	66.9	69.7
Revenue/Share	---	---	---	---	---	1.66	3.53	3.78	3.88	4.05
FCF/Share	---	---	---	---	---	-0.33	1.58	2.01	1.91	---

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

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