National Retail Properties (NNN)

Updated March 31st, 2020 by Samuel Smith

Key Metrics

Current Price:	$30	**5 Year CAGR Estimate:**	12.1%	**Market Cap:**	$5.2B
Fair Value Price:	$35	**5 Year Growth Estimate:**	3.7%	**Ex-Dividend Date:**	4/30/20[1]
% Fair Value:	86%	**5 Year Valuation Multiple Estimate:**	3.1%	**Dividend Payment Date:**	5/14/20[2]
Dividend Yield:	6.9%	**5 Year Price Target**	$42	**Years of Dividend Growth:**	30
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	3%

Overview & Current Events

National Retail Properties is a REIT that owns ~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 99%. National Retail has increased its dividend for 30 consecutive years (a record matched by only three publicly traded REITs), making it a member of the Dividend Champions.

National Retail reported Q4 earnings on 2/11/20. FFO-per-share came in at $0.70, up from $0.63 per share in the year-ago quarter. Revenue came in at $173.4 million, up from $159 million in the year-ago quarter. Q4 operating expenses fell slightly year-over-year as well, showing improving economies of scale and efficiencies. The company also sold $31.4 million of properties at a cap rate of 6.4% - gaining $7 million – and recycled the capital into $242.9 million of properties at initial cash yields of 6.8%.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
FFO	$1.31	$1.57	$1.74	$1.93	$2.08	$2.22	$2.41	$2.52	$2.68	$2.76	***$2.50***	***$3.00***
DPS	$1.51	$1.53	$1.56	$1.60	$1.65	$1.71	$1.78	$1.86	$1.95	$2.06	***$2.07***	***$2.30***
Shares[3]	83	89	109	120	125	134	145	149	160	165	***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%.

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 investment spreads compress, and the law of large numbers makes it increasingly challenging to move the needle with acquisitions. 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.

We expect some headwinds this year from the coronavirus outbreak, but assume that the company will bounce back fairly well in the years to come.

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[1] Estimate

[2] Estimate

[3] In millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/FFO	11.7	13.6	14.9	13.2	16.4	15.4	16.7	14.8	16.1	19.2	***12.0***	***14.0***
Avg. Yld.	6.4%	6.0%	5.4%	4.7%	4.6%	4.4%	3.8%	4.4%	4.5%	3.9%	***6.9%***	***5.5%***

Using the midpoint of management's 2019 FFO guidance, National Retail Properties is trading at a price-to-FFO ratio of 19.2, 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, while recent multiples have been far higher due to low interest rates and strong results, we believe that current headwinds justify a lower valuation. Therefore, we are placing 14 times FFO as our fair value estimate. Accordingly, we believe that multiple expansion will positively impact the trust's total returns moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

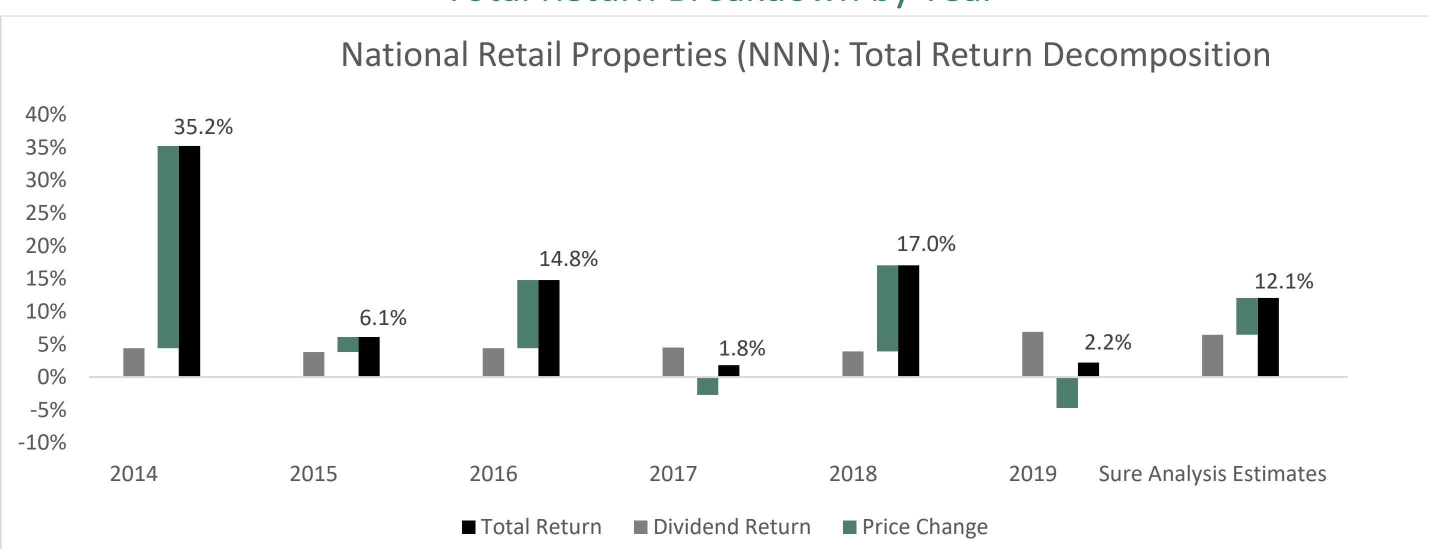
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	115%	98%	90%	83%	79%	70%	74%	74%	73%	75%	***83%***	***77%***

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 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 is a very attractive dividend growth stock at current market pricing. It offers investors an attractive 6.9% dividend yield backed by a strong balance sheet and a very impressive dividend growth history. It also will provide an estimated 12.1% annualized total return over the next half decade. As a result, we rate it a buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	255	304	352	394	435	483	534	585	623	670
Gross Profit	242	287	334	375	416	463	513	562	598	643
Gross Margin	94.8%	94.4%	95.0%	95.3%	95.6%	95.9%	96.1%	96.0%	96.0%	95.9%
SG&A Exp.	23	29	32	31	33	35	37	34	34	38
D&A Exp.	49	59	75	100	116	135	149	174	174	189
Operating Profit	141	158	210	245	267	294	327	354	389	416
Operating Margin	55.1%	52.2%	59.7%	62.2%	61.5%	60.8%	61.3%	60.6%	62.5%	62.1%
Net Profit	73	92	142	160	191	198	240	265	292	299
Net Margin	28.6%	30.4%	40.4%	40.7%	43.8%	41.0%	44.9%	45.3%	47.0%	44.6%
Free Cash Flow	188	178	228	274	297	341	415	422	472	502
Income Tax	0	1	(7)	0	(0)	10				

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,714	3,435	3,988	4,455	4,916	5,460	6,334	6,561	7,103	7,435
Cash & Equivalents	2	2	2	1	11	14	295	1	114	1
Accounts Receivable		3	3	4	3	3	3	4	4	3
Goodwill & Int. Ass.		38	45	70	78	72	65	51	66	76
Total Liabilities	1,185	1,431	1,690	1,676	1,832	2,118	2,417	2,720	2,949	3,103
Long-Term Debt	1,134	1,339	1,587	1,570	1,730	1,976	2,312	2,580	2,851	2,988
Shareholder's Equity	1,435	1,910	2,009	2,202	2,508	2,767	2,997	3,208	3,522	3,987
D/E Ratio	0.74	0.67	0.69	0.57	0.56	0.59	0.59	0.67	0.69	0.69

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.8%	3.0%	3.8%	3.8%	4.1%	3.8%	4.1%	4.1%	4.3%	4.1%
Return on Equity	5.0%	5.5%	7.2%	7.6%	8.1%	7.5%	8.3%	8.5%	8.7%	8.0%
ROIC	2.8%	3.1%	3.9%	3.9%	4.2%	3.9%	4.1%	4.2%	4.4%	4.2%
Shares Out.	83	89	109	120	125	134	145	149	160	165
Revenue/Share	3.08	3.42	3.22	3.28	3.49	3.59	3.69	3.91	3.98	4.06
FCF/Share	2.27	2.00	2.09	2.29	2.38	2.54	2.87	2.82	3.02	3.04

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