Innovative Industrial Properties (IIPR)

Updated June 9th, 2020 by Nikolaos Sismanis

Key Metrics

Current Price:	$93	**5 Year CAGR Estimate:**	21.1%	**Market Cap:**	$1.72B
Fair Value Price:	$68	**5 Year Growth Estimate:**	25.0%	**Ex-Dividend Date:**	03/29/20
% Fair Value:	138%	**5 Year Valuation Multiple Estimate:**	-6%	**Dividend Payment Date:**	04/14/20
Dividend Yield:	4.3%	**5 Year Price Target**	206	**Years Of Dividend Growth:**	4
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	8.6%

Overview & Current Events

Innovative Industrial Properties, Inc. focuses on owning properties used for the cultivation and production of marijuana. Because the industry is in the midst of a legal transition, there are constraints on capital in this industry. IIP went public in a "loophole" time period. No other cannabis-related companies have been approved for listing on the NYSE or the NASDAQ. The $1.72 billion company owns 56 properties in 15 states. Innovate Industrial Properties is currently the fastest-growing REIT in the world thanks to the fast growing cannabis industry and its exclusive listing status.

On May 6th, 2020, the company announced earnings for Q1 2020 for the period ending March 31st, 2020. For the quarter, revenues and normalized AFFO/share grew to $21.1 million and $1.12, an increase of 210%, and 249%, respectively. The growth was driven primarily by the acquisition and leasing of new properties, as well as contractual rental escalations at certain facilities. From January 1st to May 6th, 2020, the company acquired nine properties totaling ~1.1 million rentable square feet. The aggregate investment cost $202.1 million. Management reassured investors that the company should not be affected by COVID-19; governmental authorities have recognized both medical-use and adult-use cannabis operations as "essential businesses." With another stunning quarter in terms of top and bottom line expansion, the company retains its status of being the fastest-growing REIT in the world, while yielding 4.17%.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
AFFO	---	---	---	---	---	---	-$0.62	$ 0.67	$ 1.34	$ 3.27	**$4.50**	**$13.73**
DPS	---	---	---	---	---	---	---	$0.55	$1.20	$2.83	**$4.00**	**$8.41**
Shares[1]	---	---	---	---	---	---	1	3.4	7.3	10.7	**15.9**	**125**

IIP grpwm AFFO/share dramatically since the company's IPO. Over the past three years, not a single quarter has seen less AFFO/share than the one before it, fueled by non-stop acquisitions. To capitalize on the growth of the cannabis sector, IIP acquired 35 properties in 2019 alone. With the schedule-1 drug being decriminalized in one state after the other, we expect growth to be sustained in the medium term. In line with its AFFO growth, management has been raising the dividend once every two quarters consistently. Distributions grew by an astonishing 135.8% in FY2019. Despite such expansion, the stock is currently yielding a considerable 4.17%, amid a few risks. They include regulatory and tenant-credibility concerns that keep the valuation at reasonable levels. To fund these mass-acquisitions, the company has been issuing lots of additional equity. Shares outstanding are around 15 times those of its IPO. Considering the juicy ROI the company is achieving on the raised capital, share issuance has been well-managed and successful.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/FFO	--	--	--	--	--	--	--	47.76	12.16	16.6	**20.4**	**15.0**
Avg. Yld.	--	--	--	--	--	--	--	3.4%	3.3%	2.8%	**4.3%**	**4.1%**

[1] Share count is in millions.

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Despite its proven expansion model and the ever-improving outlook for the cannabis sector, the stock's valuation remains in reasonable territory. At around 20 times the current AFFOs, IIP is currently yielding an attractive 4.1%. As the industry matures, we expect the valuation multiple to come down to approximately 15, as the first competitors enter the sector amid potential deregulation. Positive valuation drivers include the federal legalization of Cannabis through The MORE Act. The bill would make marijuana federally legal across all states and remove the plant's categorization as a schedule-1 drug. Moreover, it would tax cannabis products at 5% and enable establishing trust funds for various purposes.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	---	---	201.%	80.3%	73.5%	74.5%	**61%**

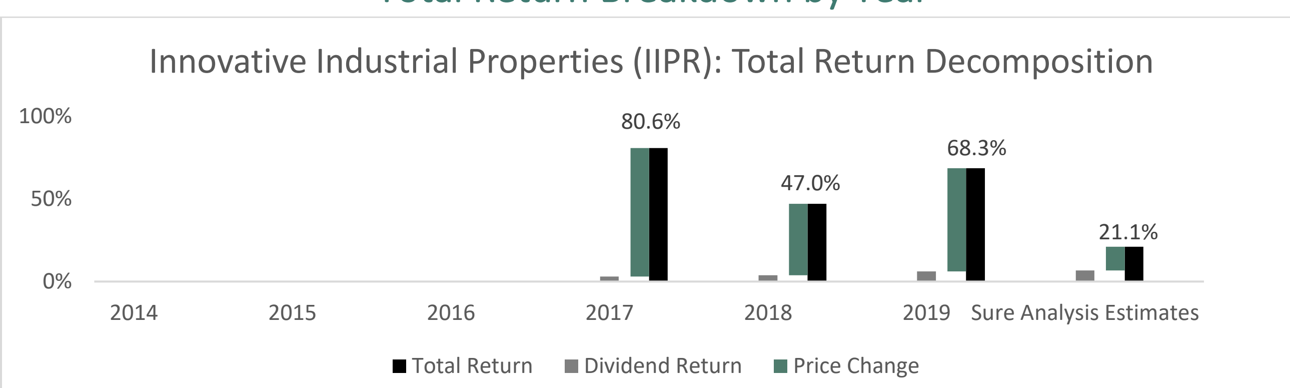
The company maintains a healthy payout ratio, as it reserves capital to contribute towards future acquisitions. We expect the ratio to continue declining as the company has been consistently growing AFFO/share faster than DPS. Being the only listed cannabis REIT, the company has a massive moat. With access to public markets, management can issue debt and equity much cheaper than its few private competitors. IIP can build more durable and sustainable relationships with tenants as it possesses higher credibility and transparency. However, because of how new the cannabis sector is, its recession resiliency is untested.

Moreover, cannabis is mostly a commodity. IIP's tenants operate in a massively competitive sector with razor-thin margins. Considering their weak profitability and immature business models, IIP faces a higher tenant risk than other specialty REITs. For the time being, we believe the dividend to be relatively safe, powered by consistent growth that suggests management confidence in the medium term.

Final Thoughts & Recommendation

Innovative Industrial Properties is a genuinely unique investment case. Instead of guessing which cannabis-producing stock will be a long-term winner, investors can profit off of what every producer needs, which is specialized property. This way, the sector's growth can be taken advantage of, while benefiting from the consistent cash flows from renting IIP's facilities. The trend towards national legalization is progressively materializing, further boosting demand for IIP's properties. Tenant-credibility is not optimal, and the cannabis sector has not been tested during a recession. Assuming a more modest future valuation multiple, we believe that shares are currently a bit overvalued. However, we expect above-average market CAGR returns of around 20% over the next five years, amid sustainable growth. IIP is a buy at current prices thanks to its excellent growth prospects.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	---	---	---	---	---	---	$0.32	$6.42	$14.79	$44.67
Gross Profit	---	---	---	---	---	---	$0.23	$6.30	$14.34	$43.35
Gross Margin	---	---	---	---	---	---	72.9%	98.2%	97.0%	97.1%
SG&A Exp.	---	---	---	---	---	---	$0.83	$5.50	$6.38	$9.82
D&A Exp.	---	---	---	---	---	---	$0.03	$0.92	$2.63	$8.60
Operating Profit	---	---	---	---	---	---	-$0.69	-$0.11	$5.34	$24.94
Operating Margin	---	---	---	---	---	---	-213.4%	-1.7%	36.1%	55.8%
Net Profit	---	---	---	---	---	---	-$4.39	-$0.07	$6.99	$23.48
Net Margin	---	---	---	---	---	---	-1368.2%	-1.1%	47.2%	52.6%
Free Cash Flow	---	---	---	---	---	---	-$28.34	$5.02	$15.69	$44.93
Income Tax	---	---	---	---	---	---	$0.32	$6.42	$14.79	$44.67

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	---	---	---	---	---	---	$63.33	$80.03	$281.47	$745.86
Cash & Equivalents	---	---	---	---	---	---	$33.00	$11.76	$13.05	$82.24
Total Liabilities	---	---	---	---	---	---	$2.89	$6.48	$17.17	$197.85
Accounts Payable	---	---	---	---	---	---	$0.07	$1.08	$4.40	$28.39
Long-Term Debt	---	---	---	---	---	---	$0.00	$0.00	$0.00	$134.65
Shareholder’s Equity	---	---	---	---	---	---	$60.44	$59.54	$250.28	$534.00
D/E Ratio	---	---	---	---	---	---	0.00	0.00	0.00	0.25

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	---	---	---	---	---	---	-0.1%	3.9%	4.6%
Return on Equity	---	---	---	---	---	---	-14.5%	-0.1%	4.5%	6.0%
ROIC	---	---	---	---	---	---	---	-0.1%	4.1%	5.0%
Shares Out.	---	---	---	---	---	---	0.96	3.38	7.29	10.68
Revenue/Share	---	---	---	---	---	---	$0.33	$1.90	$2.03	$4.18
FCF/Share	---	---	---	---	---	---	-$29.43	$1.49	$2.15	$4.21

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