



# Simon Property Group (SPG)

Updated June 30<sup>th</sup>, 2020 by Samuel Smith

## Key Metrics

|                             |      |                                            |       |                                  |                      |
|-----------------------------|------|--------------------------------------------|-------|----------------------------------|----------------------|
| <b>Current Price:</b>       | \$68 | <b>5 Year CAGR Estimate:</b>               | 12.4% | <b>Market Cap:</b>               | \$24B                |
| <b>Fair Value Price:</b>    | \$85 | <b>5 Year Growth Estimate:</b>             | 1.9%  | <b>Ex-Dividend Date:</b>         | 8/13/20 <sup>1</sup> |
| <b>% Fair Value:</b>        | 80%  | <b>5 Year Valuation Multiple Estimate:</b> | 4.6%  | <b>Dividend Payment Date:</b>    | 8/28/20 <sup>2</sup> |
| <b>Dividend Yield:</b>      | 7.6% | <b>5 Year Price Target</b>                 | \$94  | <b>Years of Dividend Growth:</b> | 10                   |
| <b>Dividend Risk Score:</b> | D    | <b>Retirement Suitability Score:</b>       | B     | <b>Last Dividend Increase:</b>   | 2.4%                 |

## Overview & Current Events

Simon Property Group is a real estate investment trust (REIT) that was formed in 1993. The trust focuses on retail properties, mainly in the US, with the goal of being the premier destination for high-end retailers and their customers. The trust has interests in about 230 different properties that amount to nearly 200 million square feet of leasable space. Simon produces about \$5 billion in annual revenue and has a market capitalization of \$24 billion.

Simon reported Q1 earnings on 5/11/20. FFO per share came in at \$2.78, missing analyst estimates of \$2.89. Revenue also fell to \$1.35B from \$1.45B in the year-ago quarter. Given the uncertainty from the COVID-19 outbreak, management suspended or eliminated over \$1 billion in capital expenditures and drew \$3.75 billion from its revolving credit facilities. Occupancy stood at 94% at quarter end with base minimum rent per square foot of \$55.76.

## Growth on a Per-Share Basis

| Year                      | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016    | 2017    | 2018    | 2019    | 2020           | 2025           |
|---------------------------|--------|--------|--------|--------|--------|--------|---------|---------|---------|---------|----------------|----------------|
| <b>FFO/Shr</b>            | \$5.01 | \$6.89 | \$7.98 | \$8.85 | \$8.90 | \$9.86 | \$10.49 | \$11.21 | \$12.13 | \$12.37 | <b>\$10.00</b> | <b>\$11.00</b> |
| <b>DPS</b>                | \$2.60 | \$3.50 | \$4.10 | \$4.65 | \$5.15 | \$6.05 | \$6.50  | \$7.15  | \$7.90  | \$8.20  | <b>\$5.20</b>  | <b>\$6.00</b>  |
| <b>Shares<sup>3</sup></b> | 293    | 294    | 310    | 310    | 311    | 309    | 313     | 311     | 309     | 306     | <b>306</b>     | <b>295</b>     |

Simon's FFO history is quite good in that it saw only a minor dip in profitability during the Great Recession. Funds from operations have since more than doubled. Simon's focus on high-end retailing has proven an immense source of strength in recent years and we see that steady performance continuing. Recent years have seen a growth rate of ~6%, but given Simon's already-dominant position in the retail sector, the unstoppable rise of e-commerce crimping demand for physical stores, and how mature the current economic cycle is, it looks like Simon and other retail REITs will have a harder time with future FFO growth. That said, Simon is still the best retail REIT in the market by many metrics. Its occupancy rates remain high. It also charges more than \$55 per square foot on average, which is tremendously high for the retail space. Simon has built a niche with high-end retailers over the years such that it has the most desirable spaces and developments, and thus sees a virtuous combination of high occupancy and leasing rates. The distribution is obviously a big draw for Simon's shareholders as the trust allocates much of its excess capital in this way. The distribution should rise in line with FFO, and we see it hitting \$6 per share by 2025. Another tailwind to the per-share growth thesis is that Simon is one of the few REITs with the balance sheet and free cash flow generation capacity to repurchase shares. Given the current discount to NAV in the shares, doing this will unlock significant value for shareholders while also growing FFO-per-share at a more rapid pace, and thereby helping to offset the drag on growth from the rise of e-commerce. Unfortunately, its ability to do so will be limited given the massive redevelopment expenses coming its way in the wake of the COVID-19 related bankruptcies.

<sup>1</sup> Estimate

<sup>2</sup> Estimate

<sup>3</sup> In millions

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## Valuation Analysis

| Year       | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now  | 2025 |
|------------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/FFO | 17.6 | 16.5 | 18.7 | 18.4 | 19.0 | 19.1 | 19.2 | 15.1 | 13.9 | 11.9 | 6.8  | 8.5  |
| Avg. Yld.  | 3.0% | 3.1% | 2.7% | 2.9% | 3.0% | 3.2% | 3.2% | 4.2% | 4.7% | 5.6% | 7.6% | 6.4% |

Simon's valuation has been remarkably steady for much of the past decade and today, at just 6.8 times this year's FFO estimate, the stock is extremely cheap. We see fair value at 8.5 times FFO, implying a significant annual tailwind to total returns in the years to come. We've moved our estimate of fair value down since the last report, reflecting concerns raised by management over retail tenants, as well as overall slowing growth due to the coronavirus uncertainty.

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

| Year   | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020  | 2025  |
|--------|------|------|------|------|------|------|------|------|------|------|-------|-------|
| Payout | 52%  | 51%  | 51%  | 53%  | 58%  | 61%  | 62%  | 64%  | 65%  | 66%  | 52.0% | 54.5% |

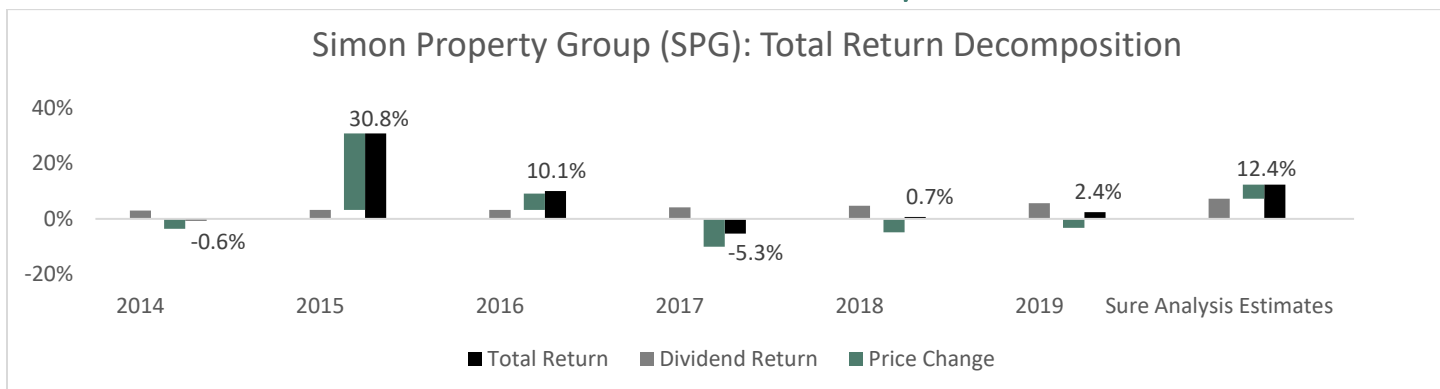
Simon's quality metrics have been very stable in the past decade as the trust has kept operating metrics such as balance sheet leverage and interest coverage, in a fairly narrow range. Profitability has improved over time as the trust's strength has afforded it the ability to raise prices, but we believe most of the profitability gains have been made. Simon's lease pricing is already an industry-best and has stagnated in recent quarters, leading us to believe further margin gains from here will be challenging. The payout ratio should rise as Simon has been boosting its distribution more quickly than FFO; given the forecast for slowing FFO growth, this should continue.

Simon's competitive advantage is in its world-class portfolio of properties that allows it to charge industry-best leasing rates. Another advantage is its low cost of capital that comes from its A-rated balance sheet, enabling it to invest in ways that competitors cannot afford to. That being said, it is not immune to recession as it did cut its dividend during the last downturn. However, despite the cut, its overall business held up fairly well during that period should be able to again. It is also one of the best positioned retail REITs to weather the impact of e-commerce on bricks-and-mortar retail stores.

## Final Thoughts & Recommendation

Overall, we forecast Simon to produce robust 12.4% total annualized returns in the coming years. We continue to rate the stock a buy as Simon offers investors an attractively priced stock with a high yield and distribution growth prospects. While the balance sheet is A-rated, investors should remember that it did cut its dividend during the last recession and that it faces substantial headwinds and uncertainty at this time. That being said, its strong balance sheet, world-class management, and high-quality real estate portfolio should enable it to rebound fairly quickly once the current headwinds pass.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year             | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue          | 3958  | 4306  | 4256  | 4544  | 4871  | 5266  | 5435  | 5539  | 5658  | 5,755 |
| Gross Profit     | 3095  | 3387  | 3456  | 3706  | 3988  | 4306  | 4464  | 4559  | 4650  | 4,734 |
| Gross Margin     | 78.2% | 78.6% | 81.2% | 81.6% | 81.9% | 81.8% | 82.1% | 82.3% | 82.2% | 82.2% |
| SG&A Exp.        | 228   | 282   | 291   | 319   | 355   | 350   | 366   | 338   | 334   | 185   |
| D&A Exp.         | 1016  | 1112  | 1301  | 1333  | 1286  | 1239  | 1328  | 1357  | 1350  | 1,394 |
| Operating Profit | 1816  | 1943  | 2000  | 2189  | 2385  | 2669  | 2721  | 2802  | 2911  | 2,908 |
| Operating Margin | 45.9% | 45.1% | 47.0% | 48.2% | 49.0% | 50.7% | 50.1% | 50.6% | 51.5% | 50.5% |
| Net Profit       | 617   | 1025  | 1434  | 1320  | 1409  | 1828  | 1839  | 1948  | 2440  | 2,102 |
| Net Margin       | 15.6% | 23.8% | 33.7% | 29.0% | 28.9% | 34.7% | 33.8% | 35.2% | 43.1% | 36.5% |
| Free Cash Flow   | 1499  | 1560  | 1711  | 1860  | 1934  | 2004  | 2574  | 2862  | 2969  | 2,932 |
| Income Tax       | 4     | 12    | 16    | 40    | 28    | 20    | 30    | 23    | 37    | 30    |

## Balance Sheet Metrics

| Year               | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019   |
|--------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| Total Assets       | 24857 | 26217 | 32587 | 33325 | 29532 | 30565 | 31104 | 32258 | 30686 | 31,232 |
| Cash & Equivalents | 797   | 799   | 1185  | 1691  | 612   | 701   | 560   | 1482  | 514   | 669    |
| Acc. Receivable    | N/A   | 487   | 521   | 520   | 580   | 625   | 665   | 743   | 764   | 832    |
| Goodwill & Int.    | N/A   | 296   | 507   | 376   | 312   | 276   | 285   | 209   | 151   | 96     |
| Total Liabilities  | 19224 | 20673 | 25694 | 26502 | 23581 | 25349 | 26144 | 28019 | 26889 | 28,320 |
| Accounts Payable   | N/A   | 1092  | 1374  | 1223  | 1260  | 1324  | 1214  | 1269  | 1317  | 1,391  |
| Long-Term Debt     | 17474 | 18446 | 23113 | 22670 | 20853 | 22417 | 22977 | 24564 | 23238 | 24,096 |
| Total Equity       | 4785  | 4605  | 5866  | 5805  | 5049  | 4428  | 4267  | 3643  | 3254  | 2,484  |
| D/E Ratio          | 3.62  | 3.97  | 3.91  | 3.88  | 4.09  | 5.01  | 5.33  | 6.66  | 7.05  | 9.54   |

## Profitability & Per Share Metrics

| Year             | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 2.4%  | 4.0%  | 4.9%  | 4.0%  | 4.5%  | 6.1%  | 6.0%  | 6.1%  | 7.8%  | 6.8%  |
| Return on Equity | 13.4% | 21.8% | 27.4% | 22.6% | 26.0% | 38.6% | 42.3% | 49.3% | 70.8% | 73.3% |
| ROIC             | 2.6%  | 4.4%  | 5.3%  | 4.4%  | 5.0%  | 6.7%  | 6.6%  | 6.9%  | 8.7%  | 7.8%  |
| Shares Out.      | 293   | 294   | 310   | 310   | 311   | 309   | 313   | 311   | 309   | 306   |
| Revenue/Share    | 13.58 | 14.67 | 14.04 | 14.65 | 15.68 | 16.98 | 17.38 | 17.78 | 18.27 | 18.69 |
| FCF/Share        | 5.14  | 5.32  | 5.64  | 5.99  | 6.22  | 6.46  | 8.23  | 9.19  | 9.59  | 9.52  |

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

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