Innovative Industrial Properties (IIPR)

Updated August 9th, 2020 by Nikolaos Sismanis

Key Metrics

Current Price:	$115	**5 Year CAGR Estimate:**	20.7%	**Market Cap:**	$2.49B
Fair Value Price:	$84	**5 Year Growth Estimate:**	25.0%	**Ex-Dividend Date:**	09/27/20
% Fair Value:	137%	**5 Year Valuation Multiple Estimate:**	-6.1%	**Dividend Payment Date:**	10/15/20
Dividend Yield:	3.7%	**5 Year Price Target**	$256	**Years Of Dividend Growth:**	4
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	76%[1]

Overview & Current Events

Innovative Industrial Properties, Inc. is a single-use “specialty REIT” that exclusively 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 available to businesses engaged in the marijuana business. IIPR went public in a “loophole” time period. No other cannabis-related companies have been approved for listing on the NYSE or the NASDAQ. Having the fortunate status as the only publicly traded marijuana REIT in the US has led to stunning returns and portfolio growth. The $2.49 billion company owns 61 properties in 15 states. Amid the cannabis boom over the past few years, as well as its exclusivity in terms of the listing, which gives the company access to public markets, Innovate Industrial Properties is currently the fastest-growing REIT in the world.

On August 5th, 2020, the company announced its Q2 2020 earnings for the period ending June 30th, 2020. For the quarter, revenues and normalized AFFO/share were to $24.3 million and $1.19, an increase of 182%, and 101%, respectively. The company delivered another quarter of explosive growth as a result of acquiring eight new properties, totaling approximately 775,000 located in California, Massachusetts, Michigan, New Jersey, and Pennsylvania. The company’s rental collections were robust, despite COVID-19, due to its tenants facing increasing marijuana production demand, amid the stay-at-home economy. Only 3 of its 23 tenants requested rental deferrals from April to June, while the trust collected 100% of rental payments for July.

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	***$4.66***	***$14.22***
DPS	---	---	---	---	---	---	---	$0.55	$1.20	$2.83	***$4.26***	***$10.60***
Shares[2]	---	---	---	---	---	---	1	3.4	7.3	10.7	***16.7***	***125***

Innovative Industrial properties has been snowballing, growing 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. We retain our AFFO/share and DPS medium-term CAGR at 25% and 20%, respectively, to be prudent. It’s highly likely that these figures will and up being much more favorable, considering the company’s current triple-digit growth rates. Still, the company has short trading history, and its acquisition-driven strategy may see availability headwinds in the future, hence our more reserved estimates.

Shares outstanding are nearly 17 times those of its IPO. We are confident that the company’s share issuance will continue increasing, as the company can achieve a higher ROI on the newly raised funds, compared to the additional dividend these shares will require in the future.

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[1] IIP grows its DPS on a quarterly basis or semi-annual basis. YoY DPS growth amounts to 76%. Its latest QoQ growth amounts to 6%.
[2] Share count is in millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/FFO	---	---	---	---	---	---	---	47.8	12.2	16.6	***24.6***	***18.0***
Avg. Yld.	---	---	---	---	---	---	---	3.4%	3.3%	2.8%	***3.7%***	***4.1%***

Despite shares currently trading a 52-week high, the valuation of 24.6X FY2020's expected AFFOs, is seemingly reasonable, considering the company's expansion. Shares are currently yielding around 3.7%, which is quite high for a company undergoing such a growth phase. We are raising our medium-term valuation multiple from 15 to 18. The company's growth exceeded our slowdown expectations, and rental collection remained exceptional, despite the start-up nature of the company's tenants. Future positive valuation drivers include the Federal legalization of Cannabis through the MORE Act, as well. 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

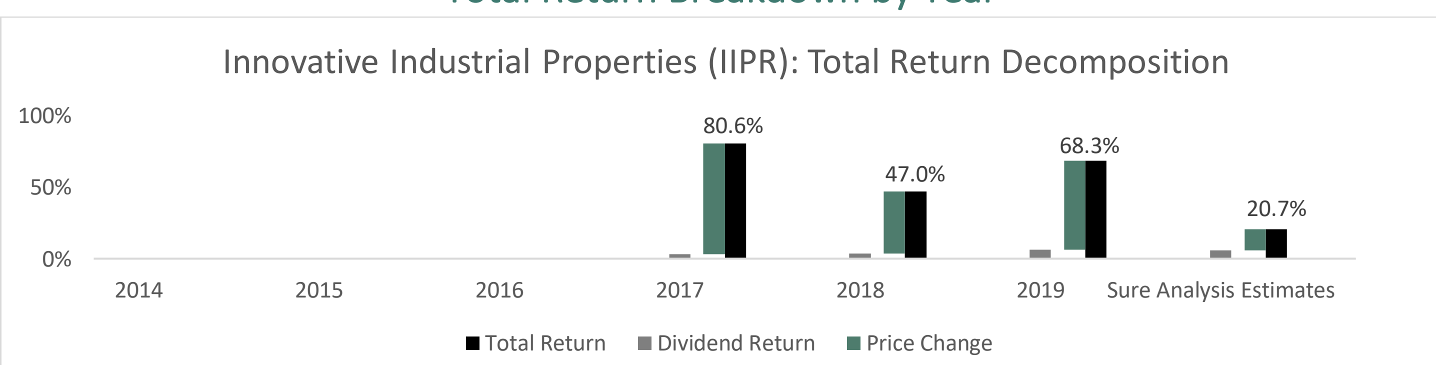
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	---	---	82%	90%	87%	***91%***	***75%***

The company maintains a healthy payout ratio, as it reserves capital to contribute towards future acquisitions. 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. IIPR can build more durable and sustainable relationships with tenants as it possesses higher credibility and transparency. Despite the headwinds COVID-19 caused in many industries, IIPR was barely affected, continuing its proven acquisition-based growth model. However, because of how new the cannabis sector is, its recession resiliency is untested to the passage of time and remains to be seen.

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. We believe that shares propose a special investment case that offers both the potential for substantial capital gains, while stockholders get to enjoy a rapidly growing stream of distributable income. As we see a potential valuation compression, we believe that shares are currently overvalued. However, we expect the stock to deliver double-digit, market-beating returns north of 20% over the next few years, powered by the company's unparalleled growth. We therefore rate IIPR 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	----	----	----	----	----	----	$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.