



# Spirit Realty Capital (SRC)

Updated November 3<sup>rd</sup>, 2020 by Nikolaos Sismanis

## Key Metrics

<b>Current Price:</b>	\$31	<b>5 Year CAGR Estimate:</b>	11.5%	<b>Market Cap:</b>	\$3.2B
<b>Fair Value Price:</b>	\$34	<b>5 Year Growth Estimate:</b>	4.0	<b>Ex-Dividend Date:</b>	12/30/2020
<b>% Fair Value:</b>	92%	<b>5 Year Valuation Multiple Estimate:</b>	1.6%	<b>Dividend Payment Date:</b>	01/15/2021
<b>Dividend Yield:</b>	8.0%	<b>5 Year Price Target</b>	\$41	<b>Years Of Dividend Growth:</b>	N/A
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Last Dividend Increase:</b>	N/A

## Overview & Current Events

Spirit Realty Capital is a premier net-lease REIT, mainly investing in single-tenant retail locations. The company's portfolio is well diversified, comprised of more than 1,700 properties in 48 states, leased to 294 tenants who operate in 28 different industries. Leveraging its diversified real estate assets, Spirit Realty aims to provide investors with long term stable returns. Its convenience and drug stores, home improvement stores, and various other essential properties that account for around half its portfolio have provided resilient cash flows during the pandemic. Simultaneously, however, its exposure in restaurants, movie theaters, and other entertainment properties, in general, have adversely affected its rental income, as COVID-19 remains active in the U.S. Spirit Realty is based in Dallas, Texas, and generates around \$500 million in annual rental revenues.

On November 2<sup>nd</sup>, Spirit Realty reported its Q3 results for the period ending September 30<sup>th</sup>, 2020. For the quarter, rental income and FFO/share were \$112.9 million and \$0.72, recording an increase of 1.7% and a decline of 17.2%, respectively. The company's performance has improved since Q2, with its occupancy ratio currently at a remarkable 99.3%, and rental collections at 90%, compared to 75% during Q2.

However, its exposure to COVID-19-sensitive properties has resulted in great amounts of differed rental collections, which, combined with some one-off income fees collected in Q3 2019, led to the decline in FFOs. For example, rental collections from its movie theatres, which account for around 5.4% of Spirit's revenues, were a devastating 8.3% in Q2 and 15.4% in Q3. Still, with total rental collections improving even further during October, at 93.3%, we remain cautiously optimistic about the company's future and dividend distributions, which have remained covered.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>FFO/Share<sup>1</sup></b>	\$1.18	\$1.57	\$2.85	\$2.07	\$3.06	\$4.09	\$4.20	\$3.91	\$3.71	\$3.34	<b>\$2.81</b>	<b>\$3.42</b>
<b>DPS</b>	--	--	--	\$1.35	\$2.99	\$3.06	\$3.15	\$3.20	\$2.95	\$2.50	<b>\$2.50</b>	<b>\$2.50</b>
<b>Shares<sup>2</sup></b>	5.2	9.9	15.7	51	77.4	86.5	93.8	93.6	86.5	90.9	<b>101.9</b>	<b>130.0</b>

Spirit Realty's FFOs have failed to grow over the past few years, mainly caused by the challenges faced by retail REITs due to the rise of e-commerce, several acquisitions/dispositions, and, most recently, the ongoing pandemic. Despite the weak results during the past few quarters, we expect Spirit to close FY2020 with FFO/Share ~\$2.81, implying that distributions remain relatively well-covered covered.

We forecast FFO/Share of 4% in the medium term, driven by rental collections continuing to improve, receiving differed revenues, and organic growth.

Regarding its DPS, it has fluctuated over the years, in line with Spirit's FFOs. Management has placed the annualized dividend at \$2.50, similar to last year, to prudently manage its cash outflows. We expect distributions to remain stagnant in the medium term as the company improves its payout ratio, reduces its debt, and preserves liquidity.

<sup>1</sup> FFO/Share in 2010 and 2011 are prior to SRC's listing in 2012, hence the lack of P/FFOs as well.

<sup>2</sup> Share count is in millions.

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## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/FFO	---	---	12.3	22.5	16.3	10.3	14.0	9.7	9.4	12.9	<b>11.1</b>	<b>12.0</b>
Avg. Yld.	---	---	---	1.2%	4.8%	6.0%	5.4%	8.1%	8.3%	5.4%	<b>8.0%</b>	<b>6.1%</b>

Due in part to the company's volatile FFO results, the stock's valuation has hovered in the high-single to low double-digits, lower than the REIT sector's average. As a result, despite the current DPS being lower than its past distributions, shares are currently yielding a sizeable 8%, significantly higher than the sector's average of ~3.7%. The market has effectively priced the risks related to its retail locations and absence of growth, hence the high yield.

We expect Spirit's valuation multiple to remain around 12 times its FFO, supported by investors' attraction towards the security's high yield.

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

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	65.2%	97.7%	74.8%	75.0%	81.8%	79.5%	74.9%	89.0%	<b>73.1%</b>

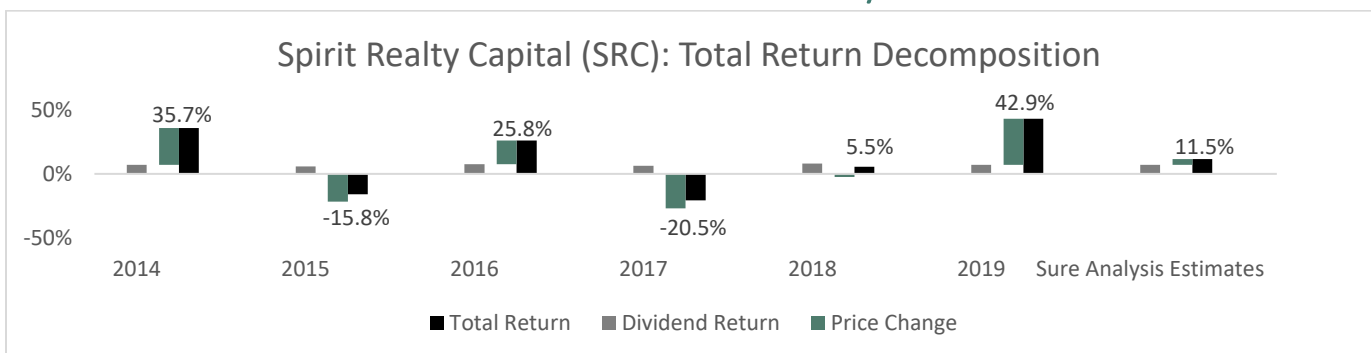
Spirit Realty's much-diversified portfolio is a double-edged sword. On the one hand, investors gain exposure in every single retail sub-sector, spread across hundreds of tenants in almost every state, enjoying a mixed stream of cash flows. On the other hand, having to manage thousands of smaller properties in what is currently the riskiest real estate sector has resulted in a lack of stability and growth in Spirit's FFOs. We believe the current dividend is safe for now, as distributions are covered despite COVID-19 being a serious negative for Spirit's operations.

Although occupancy rates have been gradually improving since March's lows, some risks are to be taken into account. Interest coverage is only 2.55 times its operating cash flows, lower than the industry's median of 3.11. Additionally, considering the company's volatile performance and retail exposure, it's likely that creditors will demand higher rates upon refinancing its loans (current cost of debt is a modest 4.55%), further pressurizing interest payments.

## Final Thoughts & Recommendation

Overall, Spirit Realty's Q3 results display some promising figures, including a rock-solid occupancy rate, improved rental collections, and increased rental revenues amid further acquisitions. Simultaneously, the market seems to have fully priced the underlying risks, as shares are currently trading below their IPO levels, offering a high 8% yield. Combined with the potential for slight growth, we see the stock delivering double-digit total returns, primarily from Spirit's distributions. Although investors must be aware of the current risks, including COVID-19 persisting in the States, we believe that concerns have been priced into shares, offering income-oriented investors a compelling investment case.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	289	263	273	419	603	667	435	431	445	516
Gross Profit	286	258	267	406	576	637	406	403	424	498
Gross Margin	99.1%	98.0%	97.7%	96.8%	95.5%	95.4%	93.4%	93.4%	95.3%	96.4%
SG&A Exp.	20	28	36	36	56	48	49	55	53	52
D&A Exp.	114	112	112	168	248	261	262	256	198	175
Operating Profit	157	127	126	206	272	329	185	173	208	269
Op. Margin	54.4%	48.2%	46.0%	49.1%	45.2%	49.2%	42.4%	40.0%	46.8%	52.1%
Net Profit	-87	-64	-76	-2	-37	93	97	77	132	175
Net Margin	-30.0%	-24.3%	-27.9%	-0.4%	-6.1%	14.0%	22.4%	17.9%	29.7%	33.9%
Free Cash Flow	89	94	112	125	213	362	361	348	284	291
Income Tax	0	0	1	1	1	1	1	1	1	12

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3397	3232	3248	7231	7964	7891	7678	7264	5096	5833
Cash & Equivalents	88	50	74	67	176	22	10	9	14	14
Goodwill & Int.	225	205	187	910	876	791	725	532	520	611
Total Liabilities	2807	2705	1994	4113	4653	4429	3996	3944	2295	2419
Accounts Payable		32	54	115	123	142	149	132		
Long-Term Debt	799	2627	1895	3778	4323	4093	3665	1713	2055	2153
Total Equity	590	526	1253	3118	3312	3462	3682	3153	2636	3247
D/E Ratio	1.35	4.99	1.51	1.21	1.31	1.18	1.00	0.52	0.73	0.63

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	-1.9%	-2.4%	0.0%	-0.5%	1.2%	1.3%	1.0%	2.1%	3.2%
Return on Equity	-10.9%	-11.4%	-8.6%	-0.1%	-1.1%	2.8%	2.7%	2.3%	4.6%	6.0%
ROIC	---	-2.8%	-2.4%	0.0%	-0.5%	1.2%	1.3%	1.2%	2.7%	3.4%
Shares Out.	9.9	9.9	15.7	51.0	77.4	86.5	93.8	93.6	86.5	90.9
Revenue/Share	29.29	26.72	17.37	8.22	7.79	7.71	4.64	4.61	5.15	5.68
FCF/Share	9.07	9.58	7.11	2.45	2.76	4.18	3.84	3.72	3.28	3.21

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

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