National Retail Properties (NNN)

Updated March 1st, 2021 by Samuel Smith

Key Metrics

Current Price:	$43.8	**5 Year CAGR Estimate:**	3.9%	**Market Cap:**	$7.7B
Fair Value Price:	$37.0	**5 Year Growth Estimate:**	2.7%	**Ex-Dividend Date:**	4/28/21[1]
% Fair Value:	119%	**5 Year Valuation Multiple Estimate:**	-3.5%	**Dividend Payment Date:**	5/16/21[2]
Dividend Yield:	4.7%	**5 Year Price Target**	$42	**Years of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	N/A

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 98.8%.

National Retail reported Q4 earnings on 02/11/21. FFO-per-share came in at $0.69, beating the average analyst estimate of $0.65 per share and falling from $0.71 in the year-ago quarter. Revenue came in at $163.3 million, a decline from $173.4M in the year-ago quarter. Portfolio occupancy stood at 98.5% as of quarter end compared to 98.4% in Sept and 99.0% in year-ago period. The trust reported that it had collected ~95.7% of rent due for the quarter and ~95.0% of rent originally due in January 2021. The trust also reported $102.0 million of property investments that includes 42 acquired properties with an aggregate gross leasable area of ~150k square feet at an initial cash yield of 6.2%. Meanwhile, the trust produced $2.6 million of gains on sales at a cap rate of 7.2% due to selling 13 properties with net proceeds of $12 million.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
FFO	$1.57	$1.74	$1.93	$2.08	$2.22	$2.41	$2.52	$2.68	$2.76	$2.59	***$2.62***	***$3.00***
DPS	$1.53	$1.56	$1.60	$1.65	$1.71	$1.78	$1.86	$1.95	$2.06	$0.40	***$2.08***	***$2.30***
Shares[3]	89	109	120	125	134	145	149	160	172	175	***180***	***195***

National Retail Properties has more than doubled its FFO since 2011, but it has also significantly increased its share count in order to fund its acquisitions of properties. As a result, the REIT has grown its FFO per share by only 5.7% per year on average since 2011. 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 3.8% annually since 2013, the total amount that the REIT spends on dividends has jumped ~9% annually.

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. We expect some lingering 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

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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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/FFO	13.6	14.9	13.2	16.4	15.4	16.7	14.8	16.1	19.2	15.4	***16.7***	***14.0***
Avg. Yld.	6.0%	5.4%	4.7%	4.6%	4.4%	3.8%	4.4%	4.5%	3.9%	5.1%	***4.7%***	***5.5%***

Using expected 2021 FFO numbers, National Retail Properties is trading at a price-to-FFO ratio of 16.7. 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 compression will provide a headwind to the trust's total returns moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

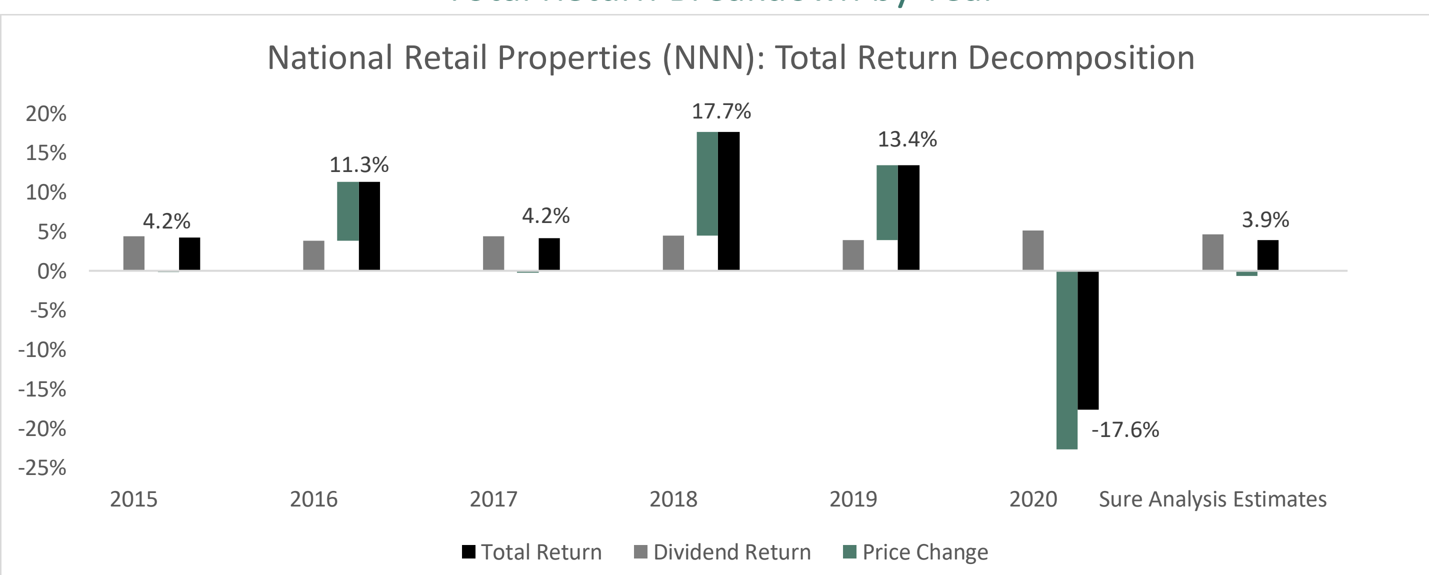
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	98%	90%	83%	79%	70%	74%	74%	73%	75%	79%	***79%***	***77%***

National Retail's payout ratio is being maintained near 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 fairly attractive dividend growth stock at current market pricing. On the one hand, it offers investors an attractive 4.7% dividend yield backed by a strong balance sheet. On the other hand, it only offers estimated 3.9% annualized total returns over the next half decade. As a result, we rate it a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	304	352	394	435	483	534	585	623	670	661
Gross Profit	287	334	375	416	463	513	562	598	643	632
Gross Margin	94.4%	95.0%	95.3%	95.6%	95.9%	96.1%	96.0%	96.0%	95.9%	95.7%
SG&A Exp.	29	32	31	33	35	37	34	34	38	38
D&A Exp.	59	75	100	116	135	149	174	174	189	197
Operating Profit	158	210	245	267	294	327	354	389	416	397
Operating Margin	52.2%	59.7%	62.2%	61.5%	60.8%	61.3%	60.6%	62.5%	62.1%	60.2%
Net Profit	92	142	160	191	198	240	265	292	299	229
Net Margin	30.4%	40.4%	40.7%	43.8%	41.0%	44.9%	45.3%	47.0%	44.6%	34.6%
Free Cash Flow	178	228	274	297	341	415	422	472	502	450
Income Tax	1	(7)	0	(0)	10					

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	3,435	3,988	4,455	4,916	5,460	6,334	6,561	7,103	7,435	7,638
Cash & Equivalents	2	2	1	11	14	295	1	114	1	267
Accounts Receivable	3	3	4	3	3	3	4	4	3	4
Goodwill & Int. Ass.	38	45	70	78	72	65	51	66	76	70
Total Liabilities	1,431	1,690	1,676	1,832	2,118	2,417	2,720	2,949	3,103	3,319
Long-Term Debt	1,339	1,587	1,570	1,730	1,976	2,312	2,580	2,851	2,988	3,221
Shareholder's Equity	1,910	2,009	2,202	2,508	2,767	2,997	3,208	3,522	3,987	3,974
D/E Ratio	0.67	0.69	0.57	0.56	0.59	0.59	0.67	0.69	0.69	0.75

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	3.0%	3.8%	3.8%	4.1%	3.8%	4.1%	4.1%	4.3%	4.1%	3.0%
Return on Equity	5.5%	7.2%	7.6%	8.1%	7.5%	8.3%	8.5%	8.7%	8.0%	5.7%
ROIC	3.1%	3.9%	3.9%	4.2%	3.9%	4.1%	4.2%	4.4%	4.2%	3.1%
Shares Out.	89	109	120	125	134	145	149	160	172	175
Revenue/Share	3.42	3.22	3.28	3.49	3.59	3.69	3.91	3.98	4.06	3.84
FCF/Share	2.00	2.09	2.29	2.38	2.54	2.87	2.82	3.02	3.04	2.61

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