



Innovative Industrial Properties (IIPR)

Updated November 7th, 2022 by Nikolaos Sismanis

Key Metrics

Current Price:	\$110	5 Year CAGR Estimate:	22.7%	Market Cap:	\$3.0 B
Fair Value Price:	\$128	5 Year Growth Estimate:	15.0%	Ex-Dividend Date:	12/30/22
% Fair Value:	86%	5 Year Valuation Multiple Estimate:	3.1%	Dividend Payment Date¹:	01/13/22
Dividend Yield:	6.5%	5 Year Price Target	\$257	Years Of Dividend Growth:	6
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

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 REITs 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 \$3.0 billion REIT owns 111 properties in 19 states. Amid the cannabis boom over the past few years, as well as its exclusivity in terms of the listing giving the trust access to public markets, Innovate Industrial Properties remains one of the fastest-growing REITs in the world.

On September 15th, 2022, Innovative Industrial increased its dividend by 2.9% to a quarterly rate of \$1.80. The 2.9% increase compares to the prior dividend rate. Year-over-year, it implies an increase of 20%.

On November 2nd, 2022, Innovative Industrial announced its Q3 earnings for the period ending September 30th, 2022. For the quarter, revenues and normalized AFFO/share were \$70.9 million and \$2.13, an increase of 31.6%, and 24.6%, respectively. The company delivered another quarter of very high growth, including acquiring an industrial property in Massachusetts. Contractual rental escalations at certain properties also boosted results.

As of September 30th, 100% of IIPR’s properties were leased with a weighted-average remaining lease term of approximately 15.5 years, half a year less than the previous quarter, but a still very impressive one. The company did not collect contractual rents totaling \$5.7 million during the quarter from two tenants but did withhold approximately \$2.6 million from their security deposits.

Based on Innovative Industrial’s year-to-date results and the company’s overall trajectory, we continue to utilize an AFFO/share of \$8.00 for our fiscal 2022 estimates to be prudent. However, this figure will likely be higher.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
AFFO	---	---	---	---	\$(0.62)	\$0.67	\$1.34	\$3.27	\$5.00	\$5.55	\$8.00	\$16.09
DPS	---	---	---	---	---	\$0.55	\$1.20	\$2.83	\$4.47	\$5.72	\$7.20	\$11.60
Shares²	---	---	---	---	1	3.4	7.3	10.7	19.27	23.9	27.9	60.0

Industrial Innovating Properties has seen AFFO/share grow dramatically since the trust’s IPO. To capitalize on the growth of the cannabis sector, IIPR acquired 37 properties in 2021 alone. With the schedule-1 drug being decriminalized in one state after the other, we expect to see the current growth rates sustained in the medium term. In line with its AFFO growth, management has consistently raised the dividend, often on a sequential basis. Payouts grew by 28% in FY2021. We maintain our AFFO/share growth estimate at 15%. This is largely to be prudent in the current market environment. We have also lowered our dividend per share growth estimate from 15% to 10%, which again, is considerably lower than the company’s ongoing pace.

¹ Estimated dates based on past dividend dates.

² Share count is in millions.

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As we mentioned in previous reports, and it was once again proven in Q3's results, these estimates will likely turn out to be conservative, considering the IIPR's acquisition spree. Still, IIPR has short trading history, and its acquisition-driven strategy may see availability headwinds in the future, which also supports the case for our more reserved estimates.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/FFO	---	---	---	---	---	47.8	12.2	16.6	30.2	33.0	13.7	16.0
Avg. Yld.	---	---	---	---	---	3.4%	3.3%	2.8%	2.8%	2.6%	6.5%	4.5%

IIPR's shares have gained since our last report following their violent valuation multiple compression. The stock's valuation has shifted to 13.7 times our FY2022 expected AFFOs. That said, we continue to believe that the stock is steeply undervalued at its current levels. We maintain our fair valuation multiple at 16X through 2027, implying an annualized valuation tailwind of 3.1%. Shares are currently yielding 6.5%, which is quite substantial considering the REIT is undergoing such a rapid growth phase.

Safety, Quality, Competitive Advantage, & Recession Resiliency

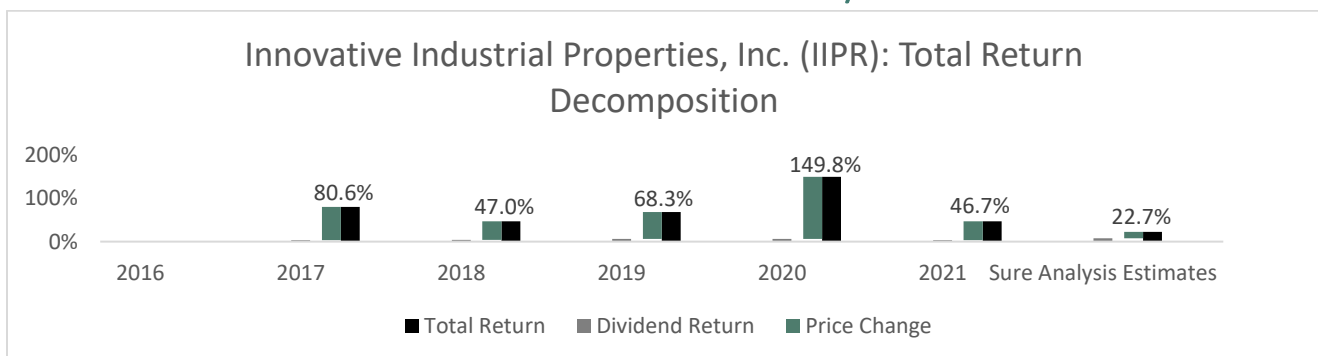
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	---	---	---	---	---	82%	90%	87%	89%	86%	90%	72%

The company's seemingly high payout ratio is non-meaningful as AFFOs proliferate and only reflect this year's cash flows. Being the only listed pure-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. With more states legalizing weed over time, the company is subject to a fantastic medium/long-term expansion trend. Despite the headwinds COVID-19 caused in many industries, IIPR was barely affected, continuing its proven acquisition-based growth model. Because of how new the cannabis sector is, its recession resiliency is untested to the passage of time and remains to be seen. Still, its average lease duration of 15.5 years is unparalleled to the industry. Not even the highest-quality, most mature REITs in the world get to enjoy such a lengthy lease profile, which adds to the dividend's safety.

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 rental cash flows from IIPR's facilities. We have specifically assumed prudent growth estimates ahead. Yet the stock is undervalued enough relative to our growth rates, leading to estimated annualized returns of 22.7% through 2027. Shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	---	---	---	\$0.32	\$6.42	\$14.79	\$44.67	\$116.90	\$204.6
Gross Profit	---	---	---	\$0.23	\$6.30	\$14.34	\$43.35	\$111.94	\$200.1
Gross Margin	---	---	---	72.9%	98.2%	97.0%	97.1%	95.7%	97.8%
SG&A Exp.	---	---	---	\$0.83	\$5.50	\$6.38	\$9.82	\$14.18	\$22.96
D&A Exp.	---	---	---	\$0.03	\$0.92	\$2.63	\$8.60	\$28.02	\$41.78
Operating Profit	---	---	---	-\$0.69	-\$0.11	\$5.34	\$24.94	\$69.74	\$135.37
Operating Margin	---	---	---	-213.4%	-1.7%	36.1%	55.8%	59.7%	66.2%
Net Profit	---	---	---	-\$4.39	-\$0.07	\$6.99	\$23.48	\$65.73	\$113.99
Net Margin	---	---	---	-1368.2%	-1.1%	47.2%	52.6%	56.2%	55.7%
Free Cash Flow	---	---	---	-\$28.34	\$5.02	\$15.69	\$44.93	\$110.81	\$188.75
Income Tax	---	---	---	\$0.32	\$6.42	\$14.79	\$44.67	---	---

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	---	---	---	\$63.33	\$80.03	\$281.47	\$745.86	\$1,768	\$2,085
Cash & Equivalents	---	---	---	\$33.00	\$11.76	\$13.05	\$82.24	\$126.01	\$81.10
Total Liabilities	---	---	---	\$2.89	\$6.48	\$17.17	\$197.85	\$243.11	\$472.9
Accounts Payable	---	---	---	\$0.07	\$1.08	\$4.40	\$28.39	\$41.14	\$53.99
Long-Term Debt	---	---	---	\$0.00	\$0.00	\$0.00	\$134.65	\$136.69	\$326.09
Shareholder's Equity	---	---	---	\$60.44	\$59.54	\$250.28	\$534.00	\$1,511	\$1,598
LTD/E Ratio	---	---	---	0.00	0.00	0.00	0.25	0.09	0.20

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	---	---	---	---	-0.1%	3.9%	4.6%	5.2%	5.9%
Return on Equity	---	---	---	-14.5%	-0.1%	4.5%	6.0%	6.4%	7.3%
ROIC	---	---	---	---	-0.1%	4.1%	5.0%	5.6%	6.3%
Shares Out.	---	---	---	0.96	3.38	7.29	10.68	19.56	26.26
Revenue/Share	---	---	---	\$0.33	\$1.90	\$2.03	\$4.18	\$5.98	\$7.79
FCF/Share	---	---	---	-\$29.43	\$1.49	\$2.15	\$4.21	\$5.67	\$7.19

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

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