



The Necessity Retail REIT, Inc. (RTL)

Updated August 4th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$7.01	5 Year CAGR Estimate:	2.6%	Market Cap:	\$1.00 B
Fair Value Price:	\$5.28	5 Year Growth Estimate:	-3.0%	Ex-Dividend Date:	10/12/2023 ¹
% Fair Value:	133%	5 Year Valuation Multiple Estimate:	-5.5%	Dividend Payment Date:	10/17/2023
Dividend Yield:	12.1%	5 Year Price Target	\$4.53	Years Of Dividend Growth:	N/A
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Sell

Overview & Current Events

The Necessity Retail REIT is an externally managed real estate investment trust (REIT), focusing on acquiring and managing a diversified portfolio of primarily service-oriented and traditional retail and distribution-related commercial properties located primarily in the United States. As of June 30th, 2023, the company owned 991 properties, comprised of 27.3 million rentable square feet, which were 92.7% leased, including 882 single-tenant net-leased commercial properties (845 of which are retail properties) and 109 multi-tenant retail properties. Its 991 properties comprise 27.3 million rentable square feet, which were 92.7% leased. The Necessity Retail REIT generates around \$446.4 million in annual revenues and is headquartered in New York, New York.

On February 15th, 2022, American Finance Trust, Inc. (AFIN) changed its name and ticker to The Necessity Retail REIT (RTL).

On August 2nd, 2023, the Necessity Retail REIT reported its Q2 results for the period ending June 30th, 2023. Revenues fell 8.7% to \$106.7 million, primarily due to the company disposing of \$172.2 million worth of non-strategic assets year-to-date. AFFO fell by 27.5% to \$27.9 million. On a per-share basis, AFFO fell by eight cents to \$0.21. Higher interest expenses materially compressed the REIT's bottom line.

The trust's properties were 92.7% leased at the end of the quarter, with 6.9 years remaining weighted-average lease term. While financial guidance was not provided, we now forecast AFFO/share of \$0.88 for FY2023 based on the trust's current leasing and debt profile.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
AFFO/shr²	---	---	---	\$2.43	\$2.36	\$0.98	\$0.99	\$0.90	\$1.02	\$1.06	\$0.88	\$0.76
DPS	---	---	---	\$1.65	\$1.47	\$1.10	\$1.10	\$0.70	\$0.85	\$0.85	\$0.85	\$0.59
Shares³	---	---	---	32.7	49.8	105.6	106.4	108.4	115.4	132.0	133.8	170.0

The Necessity Retail REIT's performance is highly susceptible to economic downturns, soft occupancy levels, or a lack of rent collections. With 50% of its annualized straight-line rent coming from single-tenant retail properties, such issues are not uncommon. For instance, the trust took a hit on rent collections in the midst of the pandemic. In such cases, the trust usually issues large amounts of shares to stay afloat, resulting in significantly lower AFFO/share and dividend cuts. The trust's current growth catalysts include a 502,000 square foot leasing pipeline which is expected to increase multi-tenant Occupancy to 89.1% from 92.2%. Further, about 65% of leases have weighted-average contractual rent increases of 0.9% based on annualized straight-line rent, though this rate barely accounts for inflation. While AFFO/share growth is possible as the trust expands its portfolio, we forecast an annualized AFFO/share decline of 3% in over the medium-term, as we believe higher interest costs and aggressive dilution will weigh the result down in the coming years.

¹ Estimated dates based on past dividend dates.

² AFFO refers to FFO excluding certain income or expense items that are not a fundamental attribute of AFIN's operations.

³ Share count is 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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Dividend payments used to be made on a monthly basis, though they changed to a quarterly rate last year. The dividend has been cut more than once in a short period of time. We expect the possibility of further cuts moving forward due to an unfavorable medium-term AFFO/share outlook. Hence we have applied a projected annual dividend decline of 7%.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/AFFO	---	---	---	---	---	13.57	13.49	7.7	7.8	6.4	8.0	6.0
Avg. Yld.	---	---	---	---	---	8.2%	8.3%	10.0%	10.3%	12.5%	12.1%	13.0%

The Necessity Retail REIT experienced a massive rally since our last report, resulting in its P/AFFO expanding to 8.0X. Although we also initially perceived the company as undervalued, our analysis suggests that the stock should, in fact, be traded at a significantly lower valuation than its current one. This assessment is based on several factors, including the company's history of dividend cuts, concerns about its high level of indebtedness, and our expectations of further deterioration in its financials over the coming years. We have updated our multiple to 6.0X AFFOs, implying the possibility of a 5.5% annualized valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

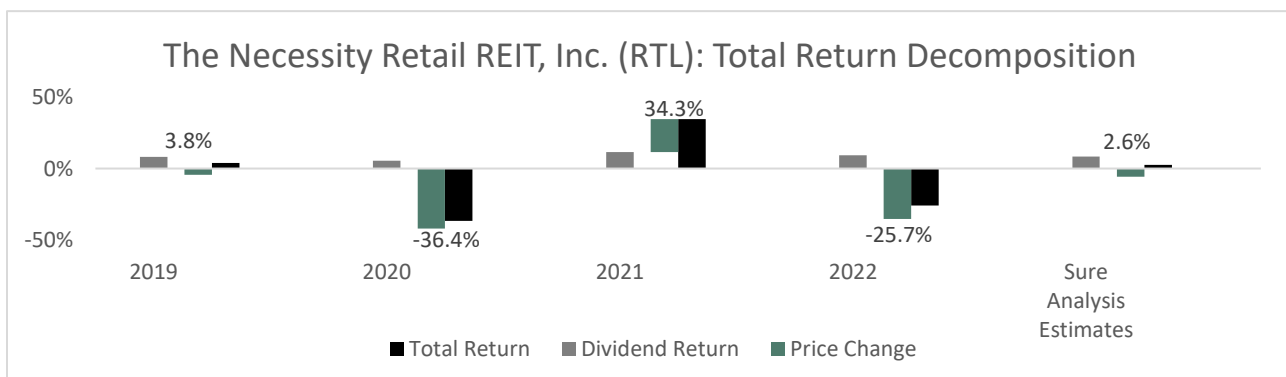
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	---	---	68%	62%	112%	111%	78%	83%	80%	97%	78%

The Necessity Retail REIT's generous dividend should not be considered trustworthy. A dividend cut is more than likely during a recession or less than optimal conditions in the retail real estate market. The trust's most noteworthy qualities include a robust acquisition platform and an investment-grade tenant base. Specifically, just over 69.3% of its top 20 tenants are investment-grade rated. However, the trust is also one of the most leveraged amongst its peers, featuring an uncomfortable net debt to EBITDA of 9.9X, while its weighted average interest rate of 4.7% is not particularly low and could worsen further in the current environment. We don't note any particular competitive advantages.

Final Thoughts & Recommendation

The Necessity Retail REIT has only a brief track record. The trust comes with elevated risks attached to its balance sheet. We forecast annualized returns of just 2.6%, primarily powered by the stock's generous yield, offset by the potential for a decline in earnings and dividends, as well as valuation headwinds. Thus, following the stock's prolonged rally, we are switching our rating from a buy to a sell. We highlight that income-oriented investors should not trust the dividend. It is likely to be cut again following a recession, debt refinancing at higher rates, or any other event that could negatively shift the dynamics of the trust's balance sheet and/or result in declining AFFO/share.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	---	158	172	177	271	291	300	305	335	446
Gross Profit	---	145	159	163	228	237	247	253	280	345
Gross Margin	---	91.5%	92.3%	92.3%	84.3%	81.4%	82.4%	82.9%	83.6%	77.4%
SG&A Exp.	---	6	24	29	41	56	59	61	71	79
D&A Exp.	---	95	103	102	148	123	116	129	128	193
Operating Profit	---	45	33	33	34	41	64	55	78	70
Operating Margin	---	28.7%	19.3%	18.5%	12.4%	14.1%	21.2%	18.0%	23.3%	15.7%
Net Profit	---	-2	-21	-54	-46	-37	4	-32	-40	-83
Net Margin	---	-1.3%	-12.3%	-30.7%	-17.2%	-12.8%	1.4%	-10.4%	-11.9%	-18.6%
Free Cash Flow	---	100	89	73	84	85	92	84	132	135
Income Tax	---	158	172	177	271	291	300	305	---	---

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	---	---	2237	2064	3297	3263	3490	3608	3814	4586
Cash & Equivalents	---	---	131	131	108	91	82	103	215	71
Accounts Receivable	---	---	---	---	29	38	47	67	71	67
Inventories	---	---	---	---	---	---	---	---	---	---
Goodwill & Int. Ass.	---	---	245	196	304	272	289	269	236	645
Total Liabilities	---	---	1110	1080	1556	1653	1788	1908	2104	2999
Accounts Payable	---	---	25	14	27	28	27	25	33	64
Long-Term Debt	---	---	1048	1033	1398	1521	1644	1772	1956	2759
Shareholder's Equity	---	---	1127	985	1737	1601	1683	1669	1700	1565
LTD/E Ratio	---	---	0.93	1.05	0.81	0.95	0.98	1.06	1.15	1.76

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	---	---	---	-2.52%	-1.73%	-1.14%	0.12%	-0.90%	-1.1%	-2.0%
Return on Equity	---	---	---	-5.14%	-3.42%	-2.24%	0.25%	-1.90%	-2.4%	-5.1%
ROIC	---	---	---	-2.59%	-1.80%	-1.19%	0.13%	-0.93%	-1.1%	-2.1%
Shares Out.	---	104	104	104	100	106	106	108	115	132
Revenue/Share	---	1.52	1.65	1.69	2.72	2.76	2.82	2.82	2.90	3.38
FCF/Share	---	0.96	0.86	0.70	0.84	0.80	0.86	0.77	1.14	1.02

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

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