



# Innovative Industrial Properties (IIPR)

Updated November 3<sup>rd</sup>, 2023 by Nikolaos Sismanis

## Key Metrics

|                             |      |                                            |       |                                           |          |
|-----------------------------|------|--------------------------------------------|-------|-------------------------------------------|----------|
| <b>Current Price:</b>       | \$78 | <b>5 Year CAGR Estimate:</b>               | 14.1% | <b>Market Cap:</b>                        | \$2.18 B |
| <b>Fair Value Price:</b>    | \$85 | <b>5 Year Growth Estimate:</b>             | 5.0%  | <b>Ex-Dividend Date:</b>                  | 12/29/23 |
| <b>% Fair Value:</b>        | 91%  | <b>5 Year Valuation Multiple Estimate:</b> | 1.8%  | <b>Dividend Payment Date<sup>1</sup>:</b> | 01/12/24 |
| <b>Dividend Yield:</b>      | 9.3% | <b>5 Year Price Target</b>                 | \$108 | <b>Years Of Dividend Growth:</b>          | 6        |
| <b>Dividend Risk Score:</b> | F    | <b>Retirement Suitability Score:</b>       | C     | <b>Rating:</b>                            | 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 \$2.18 billion REIT owns 108 properties in 19 states. Due 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 is a truly unique REIT.

On November 1<sup>st</sup>, 2023, Innovative Industrial announced its Q3 results for the period ending September 30<sup>th</sup>, 2023. For the quarter, revenues and normalized AFFO/share were \$77.8 million and \$2.29, up 9.8% and 7.5%, respectively. The company's growth was primarily driven by an increase in tenant reimbursements compared to last year, as well as activity in prior periods for the acquisition and leasing of new properties. Additional building infrastructure allowances provided to tenants at certain properties that resulted in increases to base rent and contractual rental escalations at certain properties also boosted results.

As of September 30<sup>th</sup>, 2023, 98.5% of IIPR's properties were leased with a weighted average remaining lease term of approximately 14.9 years. The company collected 97% during the quarter due to SH Parent, Inc., a tenant at one of the company's properties in Pennsylvania, defaulting. Based on Innovative Industrial's lease profile, we forecast AFFO/share of \$8.50 for fiscal 2023.

## Growth on a Per-Share Basis

| Year                      | 2013 | 2014 | 2015 | 2016    | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   | 2023          | 2028           |
|---------------------------|------|------|------|---------|--------|--------|--------|--------|--------|--------|---------------|----------------|
| <b>AFFO</b>               | ---  | ---  | ---  | -\$0.62 | \$0.67 | \$1.34 | \$3.27 | \$5.01 | \$6.66 | \$8.45 | <b>\$8.50</b> | <b>\$10.85</b> |
| <b>DPS</b>                | ---  | ---  | ---  | ---     | \$0.55 | \$1.20 | \$2.83 | \$4.47 | \$5.72 | \$7.10 | <b>\$7.20</b> | <b>\$9.19</b>  |
| <b>Shares<sup>2</sup></b> | ---  | ---  | ---  | 1       | 3.4    | 7.3    | 10.7   | 19.4   | 23.9   | 27.3   | <b>28.3</b>   | <b>35.0</b>    |

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 and nine properties in 2021 and 2022, respectively. 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 24% in FY2022. We have now lowered our AFFO/share growth estimate to 5%. This is largely to be prudent against rising interest rates and the possibility of some of the company's tenants being unable to pay rent. We have also set our dividend per share growth estimate at 5%, which implies a deceleration relative to the company's most recent dividend hikes. As we mentioned in previous reports, and it was once again proven in FY2022 results, these

<sup>1</sup> Estimated dates based on past dividend dates.

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

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estimates will likely turn out to be conservative. 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       | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now  | 2028 |
|------------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/FFO | ---  | ---  | ---  | ---  | 47.8 | 12.2 | 16.6 | 30.2 | 33.0 | 18.9 | 9.1  | 10.0 |
| Avg. Yld.  | ---  | ---  | ---  | ---  | 3.4% | 3.3% | 2.8% | 2.8% | 2.6% | 4.4% | 9.3% | 8.5% |

IIPR's shares have undergone a violent valuation multiple compression this year. The stock's valuation has shifted to 9.1 times our FY2023 expected AFFOs. With its results remaining robust, we continue to assess that the stock is undervalued at its current levels. We have set our fair valuation multiple at 10 through 2028, implying an annualized valuation tailwind of 1.8%. Shares are now yielding 9.3%, which is tremendous considering the company's sustained growth.

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

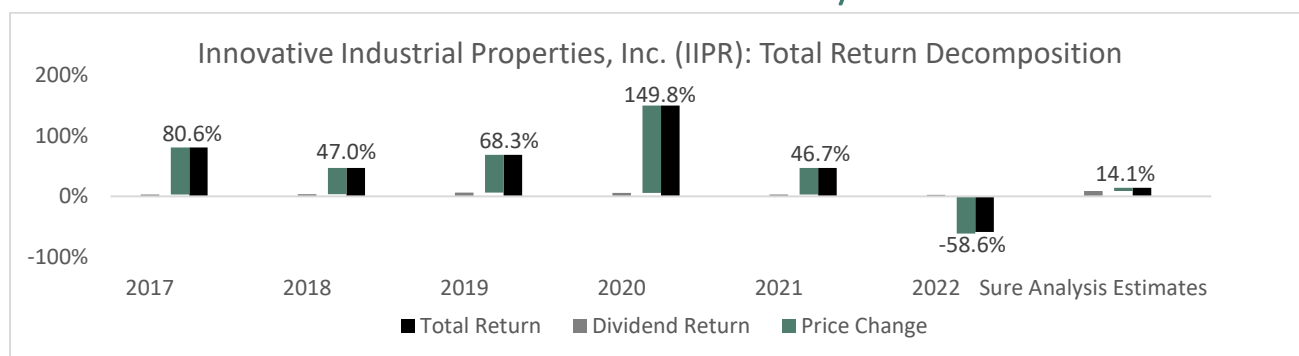
| Year   | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | ---  | ---  | ---  | ---  | 82%  | 90%  | 87%  | 89%  | 86%  | 84%  | 85%  | 85%  |

Despite the company's high payout ratio, we believe the dividend should remain well-covered. Last year's bold dividend increases reassure us of that. Regarding its qualities, 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. That said, because of how new the cannabis sector is, its recession resiliency is untested to the passage of time and remains to be seen. And, despite its average lease duration standing at a fantastic 14.9 years, we are wary of the tenants' ability to commit to their leasing obligations. This is due to many of them facing financial hurdles as a result of the steep competition in the cannabis space, as well as the industry's razor-thin margins.

## 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. Although we have made conservative predictions about the growth of the company, the stock seems to be undervalued relative to our growth estimates. This has led us to forecast a high annualized return of 14.1% until 2028. Shares earn a buy rating, but for investors who are prepared to deal with significant fluctuations in the stock price.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year             | 2014 | 2015 | 2016     | 2017    | 2018    | 2019    | 2020     | 2021     | 2022  |
|------------------|------|------|----------|---------|---------|---------|----------|----------|-------|
| Revenue          | ---  | ---  | \$0.32   | \$6.42  | \$14.79 | \$44.67 | \$116.90 | \$204.6  | 276.4 |
| Gross Profit     | ---  | ---  | \$0.23   | \$6.30  | \$14.34 | \$43.35 | \$111.94 | \$200.1  | 266   |
| Gross Margin     | ---  | ---  | 72.9%    | 98.2%   | 97.0%   | 97.1%   | 95.7%    | 97.8%    | 96.2% |
| SG&A Exp.        | ---  | ---  | \$0.83   | \$5.50  | \$6.38  | \$9.82  | \$14.18  | \$22.96  | 38.52 |
| D&A Exp.         | ---  | ---  | \$0.03   | \$0.92  | \$2.63  | \$8.60  | \$28.02  | \$41.78  | 61.30 |
| Operating Profit | ---  | ---  | -\$0.69  | -\$0.11 | \$5.34  | \$24.94 | \$69.74  | \$135.37 | 166   |
| Operating Margin | ---  | ---  | -213.4%  | -1.7%   | 36.1%   | 55.8%   | 59.7%    | 66.2%    | 60.1% |
| Net Profit       | ---  | ---  | -\$4.39  | -\$0.07 | \$6.99  | \$23.48 | \$65.73  | \$113.99 | 154   |
| Net Margin       | ---  | ---  | -1368.2% | -1.1%   | 47.2%   | 52.6%   | 56.2%    | 55.7%    | 55.7% |
| Free Cash Flow   | ---  | ---  | -\$28.34 | \$5.02  | \$15.69 | \$44.93 | \$110.81 | \$188.75 | 234   |
| Income Tax       | ---  | ---  | \$0.32   | \$6.42  | \$14.79 | \$44.67 | ---      | ---      | ---   |

## Balance Sheet Metrics

| Year                 | 2014 | 2015 | 2016    | 2017    | 2018     | 2019     | 2020     | 2021     | 2022  |
|----------------------|------|------|---------|---------|----------|----------|----------|----------|-------|
| Total Assets         | ---  | ---  | \$63.33 | \$80.03 | \$281.47 | \$745.86 | \$1,768  | \$2,085  | 2,415 |
| Cash & Equivalents   | ---  | ---  | \$33.00 | \$11.76 | \$13.05  | \$82.24  | \$126.01 | \$81.10  | 87    |
| Total Liabilities    | ---  | ---  | \$2.89  | \$6.48  | \$17.17  | \$197.85 | \$243.11 | \$472.9  | 453   |
| Accounts Payable     | ---  | ---  | \$0.07  | \$1.08  | \$4.40   | \$28.39  | \$41.14  | \$53.99  | 40    |
| Long-Term Debt       | ---  | ---  | \$0.00  | \$0.00  | \$0.00   | \$134.65 | \$136.69 | \$326.09 | 302   |
| Shareholder's Equity | ---  | ---  | \$60.44 | \$59.54 | \$250.28 | \$534.00 | \$1,511  | \$1,598  | 1,948 |
| LTD/E Ratio          | ---  | ---  | 0.00    | 0.00    | 0.00     | 0.25     | 0.09     | 0.20     | 0.15  |

## Profitability & Per Share Metrics

| Year             | 2014 | 2015 | 2016     | 2017   | 2018   | 2019   | 2020   | 2021   | 2022  |
|------------------|------|------|----------|--------|--------|--------|--------|--------|-------|
| Return on Assets | ---  | ---  | ---      | -0.1%  | 3.9%   | 4.6%   | 5.2%   | 5.9%   | 6.9%  |
| Return on Equity | ---  | ---  | -14.5%   | -0.1%  | 4.5%   | 6.0%   | 6.4%   | 7.3%   | 8.7%  |
| ROIC             | ---  | ---  | ---      | -0.1%  | 4.1%   | 5.0%   | 5.6%   | 6.3%   | 7.4%  |
| Shares Out.      | ---  | ---  | 0.96     | 3.38   | 7.29   | 10.68  | 19.56  | 26.26  | 27.66 |
| Revenue/Share    | ---  | ---  | \$0.33   | \$1.90 | \$2.03 | \$4.18 | \$5.98 | \$7.79 | 9.99  |
| FCF/Share        | ---  | ---  | -\$29.43 | \$1.49 | \$2.15 | \$4.21 | \$5.67 | \$7.19 | 8.46  |

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

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