



Spirit Realty Capital (SRC)

Updated November 3rd, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$38	5 Year CAGR Estimate:	9.5%	Market Cap:	\$5.39 B
Fair Value Price:	\$38	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	12/29/2023 ¹
% Fair Value:	100%	5 Year Valuation Multiple Estimate:	-0.2%	Dividend Payment Date:	01/12/2024
Dividend Yield:	7.0%	5 Year Price Target	\$46	Years Of Dividend Growth:	4
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Spirit Realty Capital is a premier net-lease REIT, mainly investing in single-tenant retail locations. As of its latest filings, the company's portfolio is well diversified, comprised of more than 2,037 properties in 48 states, leased to 338 tenants who operate in 34 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 account for around half of the trust's portfolio and have provided resilient cash flows during the pandemic. Spirit Realty is based in Dallas, Texas, and generates around \$700 million in annual rental revenues.

On August 10th, 2023, Spirit Realty raised its dividend by 1% to a quarterly rate of \$0.6696.

On October 30th, 2023, Realty Income (O) agreed to acquire Spirit Realty Capital in an all-stock transaction with an enterprise value of ~\$9.3 billion. Under the terms of the deal, SRC shareholders will get 0.762 newly issued Realty Income (O) common shares for each SRC common share they own. Consequently, the stock price of SRC will remain dynamic until the merger's completion, correlating with the fluctuations in the value of Realty Income's stock. The transaction should close sometime during the first quarter of 2024.

On November 2nd, 2023, Spirit Realty reported its Q3 results for the period ending September 30th, 2023. For the quarter, total revenues and FFO/share were \$193.4 million and \$0.92, an increase of 5.7% and a decline of one cent, respectively. Higher revenues were driven by accretive acquisitions and strong occupancy levels, currently standing at a remarkable 99.6%. The disproportional increase in FFO/share against revenues was due to an increase in total expenses and an increase in outstanding shares year-over-year. AFFO/share, which excludes certain one-off items and non-cash compensation expenses, grew by three cents to \$0.93.

In light of the company's proposed merger with Realty Income, management withdrew their previous guidance. We continue to utilize a FFO/share estimate of \$3.59.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
FFO/Share	\$3.06	\$4.09	\$4.20	\$3.91	\$3.71	\$3.34	\$2.73	\$3.26	\$3.26	\$3.66	\$3.59	\$4.37
DPS	\$1.35	\$3.00	\$3.07	\$3.23	\$2.95	\$2.96	\$2.50	\$2.50	\$2.53	\$2.60	\$2.68	\$2.96
Shares²	77	87	94	94	87	91	104	118	119	135	141	160

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. With the company delivering robust operating metrics during fiscal 2022 despite a rather challenging real estate space, we believe that its performance is poised to shine as the retail economy gradually recovers. That said, we remain mindful of the ongoing increase in interest rates, which could suppress its bottom line and future growth prospects.

¹ Estimated dates based on past dates.

² Share count is in millions.

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We forecast an FFO/Share of 4% in the medium-term, driven by occupancy maximization, rental escalations, and attractive yields in last year's acquired properties. Regarding its DPS, it has fluctuated over the years, in line with Spirit's FFOs. Management has mentioned that it intends to maintain a payout ratio of around 75% to FFO/share. Following improving results, we retain our DPS growth estimates to 2% since FFO/share growth should sustain marginal dividend increases while retaining a ratio below that target, to be prudent.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
P/FFO	22.5	16.3	10.3	14.0	9.7	9.4	12.9	12.8	14.4	11.2	10.6	10.5
Avg. Yld.	1.2%	4.8%	6.0%	5.4%	8.1%	8.3%	5.4%	6.9%	5.3%	6.3%	7.0%	6.4%

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 rates, shares are currently yielding a sizeable 7.0%, significantly higher than the sector's average of ~5%. We don't expect changes in Spirit's P/FFO due to the upcoming merger with Realty Income.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	98%	75%	75%	82%	80%	75%	92%	77%	77%	71%	75%	68%

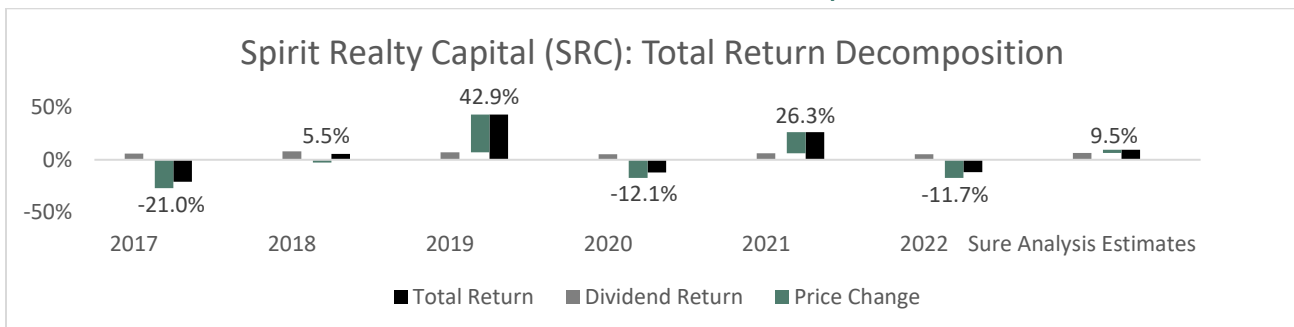
Spirit Realty's much-diversified portfolio is a double-edged sword. On the one hand, investors gain exposure in every single retail sub-sector, spread across hundreds of tenants in almost every state, enjoying a mixed stream of cash flows. On the other hand, having to manage thousands of smaller properties 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 payouts are covered adequately, while rental escalations should grow that margin further over time unless marginal DPS increases occur.

Interest coverage currently stands at 2.7 times its operating cash flows, which is lower than the industry's median of 3.4. Along with its retail exposure and rising rates, it's likely that creditors will demand higher rates upon refinancing its loans. Spirit's weighted average stated interest rate stood at 3.42% in Q3-2023.

Final Thoughts & Recommendation

Overall, Spirit's Q3 results demonstrated another quarter of resilient performance. The occupancy rate was fantastic, while rental collections were robust. We would normally forecast annualized returns of 9.5% through 2028, driven by a starting yield of 7.0%, our growth estimates, and assumptions of a relatively stable valuation. However, our forecast is more or less meaningless given the upcoming merger with Realty Income. The stock would earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	603	667	435	431	445	516	484	608	705
Gross Profit	576	637	406	403	424	498	459	585	676
Gross Margin	95.5%	95.4%	93.4%	93.4%	95.3%	96.4%	94.8%	96.2%	95.9%
SG&A Exp.	56	48	49	55	53	52	48	53	62
D&A Exp.	248	261	262	256	198	175	213	245	293
Operating Profit	272	329	185	173	208	269	196	287	325
Op. Margin	45.2%	49.2%	42.4%	40.0%	46.8%	52.1%	40.5%	47.2%	46.1%
Net Profit	-37	93	97	77	132	175	27	172	286
Net Margin	-6.1%	14.0%	22.4%	17.9%	29.7%	33.9%	5.6%	28.3%	40.6%
Free Cash Flow	213	362	361	348	284	291	302	389	398
Income Tax	1	1	1	1	1	12	0.3	0.6	0.9

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	7964	7891	7678	7264	5096	5833	6397	7331	8,473
Cash & Equivalents	176	22	10	9	14	14	70	18	9
Goodwill & Int.	876	791	725	532	520	611	594	653	649
Total Liabilities	4653	4429	3996	3944	2295	2419	2796	3331	3912
Accounts Payable	123	142	149	132	---	---	---	---	218
Long-Term Debt	4323	4093	3665	1713	2055	2153	2506	3013	3575
Total Equity	3312	3462	3682	3153	2636	3247	3435	3834	4395
LTD/E Ratio	1.31	1.18	1.00	0.52	0.73	0.63	0.70	0.75	0.78

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	-0.5%	1.2%	1.3%	1.0%	2.1%	3.2%	0.4%	2.5%	3.6%
Return on Equity	-1.1%	2.8%	2.7%	2.3%	4.6%	6.0%	0.8%	4.7%	6.9%
ROIC	-0.5%	1.2%	1.3%	1.2%	2.7%	3.4%	0.5%	2.6%	3.8%
Shares Out.	77.4	86.5	93.8	93.6	86.5	90.9	104.5	118.7	134.7
Revenue/Share	7.79	7.71	4.64	4.61	5.15	5.68	4.63	5.13	5.24
FCF/Share	2.76	4.18	3.84	3.72	3.28	3.21	2.89	3.28	2.95

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

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