Innovative Industrial Properties (IIPR)

Updated August 15th, 2024 by Nikolaos Sismanis

Key Metrics

Current Price:	$119	**5 Year CAGR Estimate:**	7.0%	**Market Cap:**	$3.38 B
Fair Value Price:	$99	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	09/27/24
% Fair Value:	120%	**5 Year Valuation Multiple Estimate:**	-3.6%	**Dividend Payment Date[1]:**	10/14/24
Dividend Yield:	6.4%	**5 Year Price Target**	$126	**Years Of Dividend Growth:**	7
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Rating:**	Hold

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 $3.38 billion REIT owned 108 properties in 19 states at the end of Q2-2024. Due to 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 June 14th, 2024, Innovative Industrial Properties raised its dividend by 4.4% to a quarterly rate of $1.90.

On August 5th, 2024, Innovative Industrial Properties posted its Q2 results for the period ending June 30th, 2024. For the quarter, revenues and normalized AFFO/share were $79.8 million and $2.29 and down 4.4% and 1.3%, respectively. Higher revenue was primarily driven by a $3.9 million disposition-contingent lease termination fee from the sale of IIP's Los Angeles property and a $3.6 million increase in contractual rent and property management fees, mainly due to rent escalations. These gains were largely offset by a $2.9 million decline in rent and fees received during the quarter, and a $1.3 million reduction in recognized revenue due to the reclassification of two sales-type leases. AFFO/share reflected the soft increase in revenues.

As of June 30th, 2024, 95.6% of IIPR's properties were leased with a weighted average remaining lease term of about 14.4 years. Based on Innovative Industrial's lease profile, we forecast AFFO/share of $9.00 for fiscal 2024.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
AFFO	---	---	-$0.62	$0.67	$1.34	$3.27	$5.01	$6.66	$8.45	$9.08	***$9.00***	***$11.49***
DPS	---	---	---	$0.55	$1.20	$2.83	$4.47	$5.72	$7.10	$7.22	***$7.60***	***$8.39***
Shares[2]	---	---	1.0	3.4	7.3	10.7	19.4	23.9	27.3	28.0	***28.6***	***35.0***

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 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 just 1.7% in FY2023. We retain 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 2%, reflecting the recent deceleration in dividend growth. As mentioned in previous reports, and it was once again proven in FY2022 results, these estimates will likely turn out to be prudent.

[1] Estimated dates based on past dividend dates.

[2] Share count is in millions.

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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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/FFO	---	---	---	47.8	12.2	16.6	30.2	33.0	18.9	8.9	***13.2***	***11.0***
Avg. Yld.	---	---	---	3.4%	3.3%	2.8%	2.8%	2.6%	4.4%	9.0%	***6.4%***	***6.6%***

IIPR's shares underwent a violent valuation multiple compression last year. The stock's P/FFO now stands at 11.6X our FY2024 expected AFFOs. We believe the stock is slightly overvalued here. The REIT's financials remain robust, but we remain wary of the intricacies of its tenant base and higher interest rates. We have set our fair valuation multiple at 11X through 2029. Shares are now yielding 6.4%, which remains a hefty tangible return considering the company's sustained growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

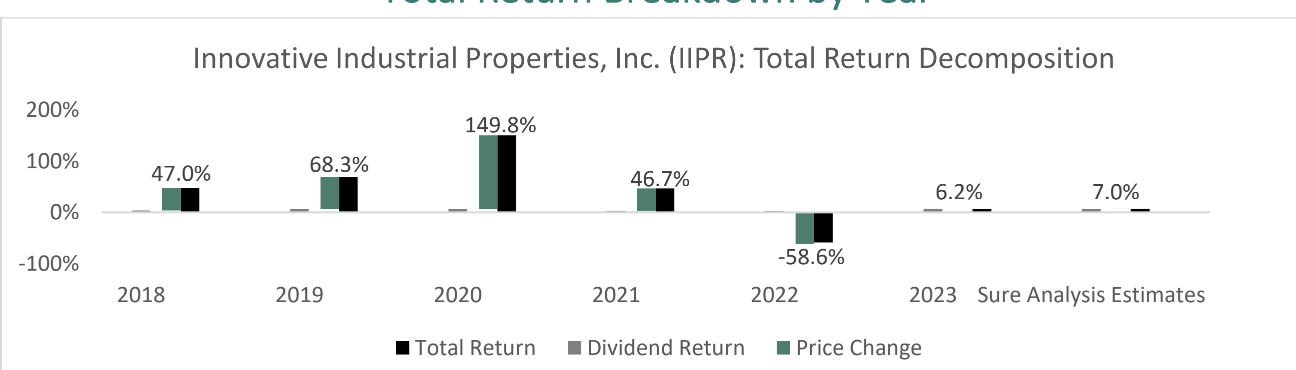
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	---	---	---	82%	90%	87%	89%	86%	84%	80%	***84%***	***73%***

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 14.8 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. While most cannabis producers still struggle to make money, IIPR continues to post robust results. We forecast an annualized return of 7.0% until 2029, driven by our growth estimates and the dividend, offset by potential valuation headwinds. Shares earn a hold rating.

Total Return Breakdown by Year



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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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	---	---	$0.32	$6.42	$14.79	$44.67	$116.90	$204.6	276.4	310
Gross Profit	---	---	$0.23	$6.30	$14.34	$43.35	$111.94	$200.1	266	285
Gross Margin	---	---	72.9%	98.2%	97.0%	97.1%	95.7%	97.8%	96.2%	91.9%
SG&A Exp.	---	---	$0.83	$5.50	$6.38	$9.82	$14.18	$22.96	38.52	43
D&A Exp.	---	---	$0.03	$0.92	$2.63	$8.60	$28.02	$41.78	61.30	67
Operating Profit	---	---	-$0.69	-$0.11	$5.34	$24.94	$69.74	$135.37	166	175
Operating Margin	---	---	-213.4%	-1.7%	36.1%	55.8%	59.7%	66.2%	60.1%	56.5%
Net Profit	---	---	-$4.39	-$0.07	$6.99	$23.48	$65.73	$113.99	154	166
Net Margin	---	---	-1368.2%	-1.1%	47.2%	52.6%	56.2%	55.7%	55.7%	53.5%
Free Cash Flow	---	---	-$28.34	$5.02	$15.69	$44.93	$110.81	$188.75	234	256
Income Tax	---	---	$0.32	$6.42	$14.79	$44.67	---	---	---	---

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	---	---	$63.33	$80.03	$281.47	$745.86	$1,768	$2,085	2,415	2,391
Cash & Equivalents	---	---	$33.00	$11.76	$13.05	$82.24	$126.01	$81.10	87	140
Total Liabilities	---	---	$2.89	$6.48	$17.17	$197.85	$243.11	$472.9	453	438
Accounts Payable	---	---	$0.07	$1.08	$4.40	$28.39	$41.14	$53.99	40	21
Long-Term Debt	---	---	$0.00	$0.00	$0.00	$134.65	$136.69	$326.09	302	301
Shareholder's Equity	---	---	$60.44	$59.54	$250.28	$534.00	$1,511	$1,598	1,948	1,939
LTD/E Ratio	---	---	0.00	0.00	0.00	0.25	0.09	0.20	0.15	0.15

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	---	---	---	-0.1%	3.9%	4.6%	5.2%	5.9%	6.9%	6.9%
Return on Equity	---	---	-14.5%	-0.1%	4.5%	6.0%	6.4%	7.3%	8.7%	8.5%
ROIC	---	---	---	-0.1%	4.1%	5.0%	5.6%	6.3%	7.4%	7.3%
Shares Out.	---	---	0.96	3.38	7.29	10.68	19.56	26.26	27.66	28.3
Revenue/Share	---	---	$0.33	$1.90	$2.03	$4.18	$5.98	$7.79	9.99	10.95
FCF/Share	---	---	-$29.43	$1.49	$2.15	$4.21	$5.67	$7.19	8.46	9.04

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