



Spirit Realty Capital (SRC)

Updated February 22nd, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$43	5 Year CAGR Estimate:	7.2%	Market Cap:	\$4.92B
Fair Value Price:	\$40	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	03/30/2021 ¹
% Fair Value:	108%	5 Year Valuation Multiple Estimate:	-1.5%	Dividend Payment Date:	04/15/2021
Dividend Yield:	5.8%	5 Year Price Target	\$48	Years Of Dividend Growth:	N/A
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Spirit Realty Capital is a premier net-lease REIT, mainly investing in single-tenant retail locations. The company's portfolio is well diversified, comprised of more than 1,860 properties in 48 states, leased to 301 tenants who operate in 28 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.

Simultaneously, however, its exposure in restaurants, movie theaters, and other entertainment properties, in general, have adversely affected its rental income, as COVID-19 remains active in the U.S. Spirit Realty is based in Dallas, Texas, and generates around \$500 million in annual rental revenues.

On February 19th, Spirit Realty reported its Q4 and full-year results for the period ending December 31st, 2020. For the quarter, rental income and FFO/share were \$128.6 million and \$0.74, recording an increase of 6.18% and a decline of 2.6%, respectively. The company's performance has improved further since Q3, with its occupancy ratio currently at a remarkable 99.6% (99.3% in Q3) and rental collections at 96.6%, compared to 90% in Q3 and 75% during Q2. The company purchased an additional 99 properties during the quarter, with an average cash yield of 6.7%. The new properties increased Spirit's portfolio diversification and reduce its exposure in movie theatres, which now account for around 5.1% of its industry exposure. Excluding movie theaters, rental collections would have been an astounding 99%. Management shared its guidance for FY2021 which forecasts FFO/share of \$3.00 to \$3.10, as the company's new properties begin producing cash flows and its contractually secured and CPI-linked rental increases (82.5% of rental revenues) kick in.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
FFO/Share²	\$1.57	\$2.85	\$2.07	\$3.06	\$4.09	\$4.20	\$3.91	\$3.71	\$3.34	\$2.73	\$3.05	\$3.71
DPS	---	---	1.35	\$2.99	3.06	3.15	3.20	2.95	2.50	2.50	\$2.50	\$2.50
Shares³	10	16	51	77	87	94	94	87	91	104	110	125

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 operational metrics during Q4 despite operating in the harshest real estate space due to the ongoing pandemic, we believe that its performance is poised to shine as the retail economy gradually recovers. We forecast FFO/Share of 4% in the medium term, driven by rental collections continuing to improve, rental escalations, and attractive yields in its newly acquired properties.

¹ Estimated dates

² FFO/Share in 2010 and 2011 are prior to SRC's listing in 2012, hence the lack of P/FFOs as well.

³ Share count is in millions.

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Regarding its DPS, it has fluctuated over the years, in line with Spirit's FFOs. Management has placed the annualized dividend at \$2.50, similar to last year, to prudently manage its cash outflows. We expect distributions to remain stagnant in the medium term as the company improves its payout ratio, reduces its debt, and preserves liquidity.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
P/FFO	---	12.28	22.5	16.33	10.26	14	9.7	9.4	12.9	12.8	14.0	13.0
Avg. Yld.	---	---	1.2%	4.8%	6.0%	5.4%	8.1%	8.3%	5.4%	6.9%	5.8%	5.2%

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 distributions, shares are currently yielding a sizeable 5.8%, significantly higher than the sector's average of ~3.8%. The market has effectively priced the risks related to its retail locations and absence of growth, hence the high yield. We expect Spirit's valuation multiple to remain around 13 times its FFO, supported by investors' attraction towards the security's high yield, and excellent rental metrics.

Safety, Quality, Competitive Advantage, & Recession Resiliency

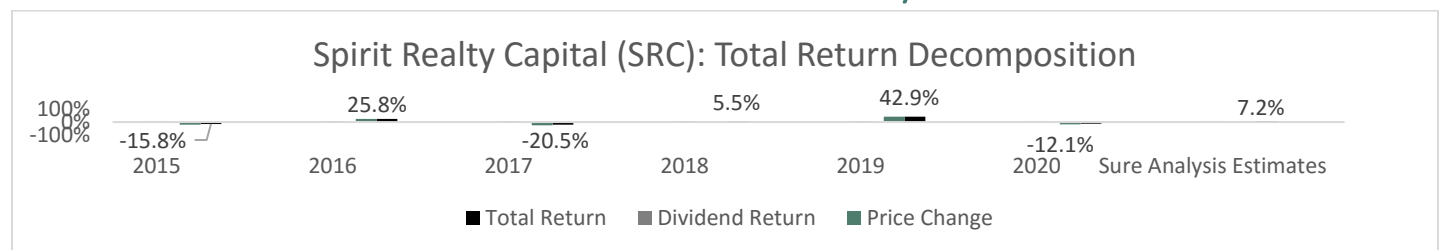
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	65%	98%	75%	75%	82%	80%	75%	92%	82%	67%

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. Although occupancy rates have been gradually improving since March's lows, some risks are to be taken into account. Interest coverage is only 2.01 times its operating cash flows, lower than the industry's median of 3.27. Additionally, considering the company's volatile performance and retail exposure, it's likely that creditors will demand higher rates upon refinancing its loans (current cost of debt is a modest 4.5%), further pressurizing interest payments.

Final Thoughts & Recommendation

Overall, Spirit Realty's Q4 results display some promising figures, including a rock-solid occupancy rate, improved rental collections, and increased rental revenues amid further acquisitions. Simultaneously, the market seems to have fully priced the underlying risks, as shares are currently valued below its industry's multiples. Still, with the company operating in what we believe remains the riskiest real estate space. Therefore, we expect a slight valuation compression in the medium term. Combined with our prudent growth estimates, we expect annualized returns of around 7.2% in the medium term. Hence, we rate the stock a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	263	273	419	603	667	435	431	445	516
Gross Profit	258	267	406	576	637	406	403	424	498
Gross Margin	98.0%	97.7%	96.8%	95.5%	95.4%	93.4%	93.4%	95.3%	96.4%
SG&A Exp.	28	36	36	56	48	49	55	53	52
D&A Exp.	112	112	168	248	261	262	256	198	175
Operating Profit	127	126	206	272	329	185	173	208	269
Op. Margin	48.2%	46.0%	49.1%	45.2%	49.2%	42.4%	40.0%	46.8%	52.1%
Net Profit	-64	-76	-2	-37	93	97	77	132	175
Net Margin	-24.3%	-27.9%	-0.4%	-6.1%	14.0%	22.4%	17.9%	29.7%	33.9%
Free Cash Flow	94	112	125	213	362	361	348	284	291
Income Tax	0	1	1	1	1	1	1	1	12

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3232	3248	7231	7964	7891	7678	7264	5096	5833
Cash & Equivalents	50	74	67	176	22	10	9	14	14
Goodwill & Int.	205	187	910	876	791	725	532	520	611
Total Liabilities	2705	1994	4113	4653	4429	3996	3944	2295	2419
Accounts Payable	32	54	115	123	142	149	132	---	---
Long-Term Debt	2627	1895	3778	4323	4093	3665	1713	2055	2153
Total Equity	526	1253	3118	3312	3462	3682	3153	2636	3247
D/E Ratio	4.99	1.51	1.21	1.31	1.18	1.00	0.52	0.73	0.63

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	-1.9%	-2.4%	0.0%	-0.5%	1.2%	1.3%	1.0%	2.1%	3.2%
Return on Equity	-11.4%	-8.6%	-0.1%	-1.1%	2.8%	2.7%	2.3%	4.6%	6.0%
ROIC	-2.8%	-2.4%	0.0%	-0.5%	1.2%	1.3%	1.2%	2.7%	3.4%
Shares Out.	9.9	15.7	51.0	77.4	86.5	93.8	93.6	86.5	90.9
Revenue/Share	26.72	17.37	8.22	7.79	7.71	4.64	4.61	5.15	5.68
FCF/Share	9.58	7.11	2.45	2.76	4.18	3.84	3.72	3.28	3.21

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

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