



Spirit Realty Capital (SRC)

Updated May 7th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$46	5 Year CAGR Estimate:	8.5%	Market Cap:	\$5.33B
Fair Value Price:	\$47	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	06/29/2021 ¹
% Fair Value:	100%	5 Year Valuation Multiple Estimate:	0.0%	Dividend Payment Date:	07/15/2021
Dividend Yield:	5.4%	5 Year Price Target	\$57	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 1,880 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 May 5th, Spirit Realty reported its Q1 results for the period ended March 31st, 2021. For the quarter, rental income and FFO/share were \$135.12 million and \$0.76, recording an increase of 10.1% and a marginal decline of 2.5%, respectively. Higher revenues were the result of an improved occupancy compared to Q1 2020, which currently stands at a remarkable 99.5%. Rental collections were also robust, at 96%, compared to as low as 70% last year due to the pandemic's breakout. The company purchased an additional 25 properties during the quarter, with an average cash yield of 7.57%. The new properties increased Spirit's portfolio diversification and reduced its exposure in the still damaged movie theatre industry, which now accounts for around 4.4% of its tenant mix. Excluding movie theaters, rental collections would have been an astounding 98%. Management hiked its FY2021 FFO/share guidance which now aims at \$3.06 to \$3.14, due to lower lost rent, reducing financing costs, and excellent occupancy.

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	\$3.10	\$3.77
DPS	---	---	1.35	\$2.99	3.06	3.15	3.20	2.95	2.50	2.50	\$2.50	\$2.76
Shares³	10	16	51	77	87	94	94	87	91	104	114	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 Q1 despite operating in a challenging real estate space, we believe that its performance is poised to shine as the retail economy gradually recovers. We forecast an 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. 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. Amid improving results, we are increasing our DPS growth estimates to 2% since FFO/share growth should sustain marginal dividend increases while retaining such a ratio. Still, the DPS is likely to remain stable, too, if management prioritizes deleveraging instead.

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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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	15.0	15.0
Avg. Yld.	---	---	1.2%	4.8%	6.0%	5.4%	8.1%	8.3%	5.4%	6.9%	5.4%	4.9%

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 previous rate, shares are currently yielding a sizeable 5.4%, significantly higher than the sector's average of ~3.6%. The market has effectively priced the risks related to its retail locations and the absence of meaningful growth, hence the high yield. We expect Spirit's valuation to remain at its current levels, higher than our previous fair multiple of 13, due to investors flocking towards high yields in the current "yield-less" environment—especially to a well-covered one, like Spirit's.

Safety, Quality, Competitive Advantage, & Recession Resiliency

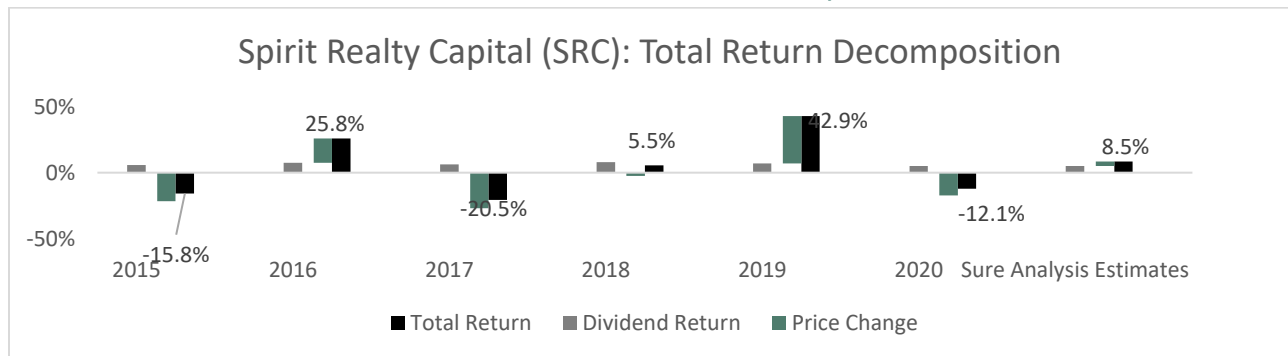
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	65%	98%	75%	75%	82%	80%	75%	92%	81%	73%

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. Although occupancy rates have been gradually improving since March's lows, some risks are to be taken into account. Interest coverage is only 2.17 times its operating cash flows, lower than the industry's median of 3.28. Additionally, considering the company's volatile performance and retail exposure, it's likely that creditors will demand higher rates upon refinancing its loans (the current cost of debt is a modest 4.24%). However, this seems to be changing as of recently amid Spirit's favorable refinancing. We see Spirit's qualities outweighing its dangers, overall.

Final Thoughts & Recommendation

Overall, Spirit Realty's Q1 results demonstrated another quarter of excellent recovery compared to the first half of 2020. The occupancy rate was rock-solid, rental collections were robust, and the company raised its FY2021 guidance. Simultaneously, the market seems to have fully priced the underlying risks, as shares are currently valued below its industry's multiples. Amid an attractive valuation, humble but decent growth prospects, and its current hefty yield, we forecast annualized returns of around 8.5% in the medium term at Spirit's current price levels. Shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	273	419	603	667	435	431	445	516	484
Gross Profit	267	406	576	637	406	403	424	498	459
Gross Margin	97.7%	96.8%	95.5%	95.4%	93.4%	93.4%	95.3%	96.4%	94.8%
SG&A Exp.	36	36	56	48	49	55	53	52	48
D&A Exp.	112	168	248	261	262	256	198	175	213
Operating Profit	126	206	272	329	185	173	208	269	196
Op. Margin	46.0%	49.1%	45.2%	49.2%	42.4%	40.0%	46.8%	52.1%	40.5%
Net Profit	-76	-2	-37	93	97	77	132	175	27
Net Margin	-27.9%	-0.4%	-6.1%	14.0%	22.4%	17.9%	29.7%	33.9%	5.6%
Free Cash Flow	112	125	213	362	361	348	284	291	302
Income Tax	1	1	1	1	1	1	1	12	0.3

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	3248	7231	7964	7891	7678	7264	5096	5833	6397
Cash & Equivalents	74	67	176	22	10	9	14	14	70
Goodwill & Int.	187	910	876	791	725	532	520	611	594
Total Liabilities	1994	4113	4653	4429	3996	3944	2295	2419	2796
Accounts Payable	54	115	123	142	149	132	---	---	---
Long-Term Debt	1895	3778	4323	4093	3665	1713	2055	2153	2506
Total Equity	1253	3118	3312	3462	3682	3153	2636	3247	3435
D/E Ratio	1.51	1.21	1.31	1.18	1.00	0.52	0.73	0.63	0.70

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	-2.4%	0.0%	-0.5%	1.2%	1.3%	1.0%	2.1%	3.2%	0.4%
Return on Equity	-8.6%	-0.1%	-1.1%	2.8%	2.7%	2.3%	4.6%	6.0%	0.8%
ROIC	-2.4%	0.0%	-0.5%	1.2%	1.3%	1.2%	2.7%	3.4%	0.5%
Shares Out.	15.7	51.0	77.4	86.5	93.8	93.6	86.5	90.9	104.5
Revenue/Share	17.37	8.22	7.79	7.71	4.64	4.61	5.15	5.68	4.63
FCF/Share	7.11	2.45	2.76	4.18	3.84	3.72	3.28	3.21	2.89

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

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