



Spirit Realty Capital (SRC)

Updated March 10th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$40	5 Year CAGR Estimate:	9.2%	Market Cap:	\$5.63 B
Fair Value Price:	\$39	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	03/30/2023
% Fair Value:	102%	5 Year Valuation Multiple Estimate:	-0.3%	Dividend Payment Date:	04/14/2023
Dividend Yield:	6.7%	5 Year Price Target	\$48	Years Of Dividend Growth:	3
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 2,115 properties in 48 states, leased to 351 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 March 10th, 2023, Spirit Realty reported its Q4-2022 and full-year results for the period ending December 31st, 2022. For the quarter, total revenues and FFO/share were \$183.4 million and \$0.87, an increase of 17.5% and a decline of one cent, respectively. Higher revenues were driven by accretive acquisitions and record occupancy levels, currently standing at a remarkable 99.9%. Occupancy rose 10bps quarter-over-quarter. The disproportional increase in FFO/share against revenues was due to a 42% increase in total expenses and a 12.8% 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 \$0.88. For the year, FFO/share rose by 12.6% to \$3.66.

The company did not purchase additional properties during Q4. It actually disposed of 27 properties, generating \$134.8 million in gross proceeds. This boosted the company's liquidity to \$1.7 billion. Management introduced its FY2023 guidance, expecting AFFO/share between \$3.53 and \$3.59, the midpoint of which we have utilized in our calculations (core FFO should land quite close to this figure as well).

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	\$3.56	\$4.33
DPS	\$1.35	\$3.00	\$3.07	\$3.23	\$2.95	\$2.96	\$2.50	\$2.50	\$2.53	\$2.60	\$2.65	\$2.93
Shares¹	77	87	94	94	87	91	104	118	119	135	135	150

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.

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.

¹ Share count is in millions.

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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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	11.2	11.0
Avg. Yld.	1.2%	4.8%	6.0%	5.4%	8.1%	8.3%	5.4%	6.9%	5.3%	6.3%	6.7%	6.1%

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 6.7%, significantly higher than the sector's average of ~4.8%. The market has effectively priced the lack of meaningful growth, hence the high yield. We expect Spirit's P/FFO to remain close to its current levels, at about 11X FFOs, as rising rates should take a toll on the company's growth prospects. Investors should require a higher risk premium from a REIT with rates this high as well.

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%	74%	68%

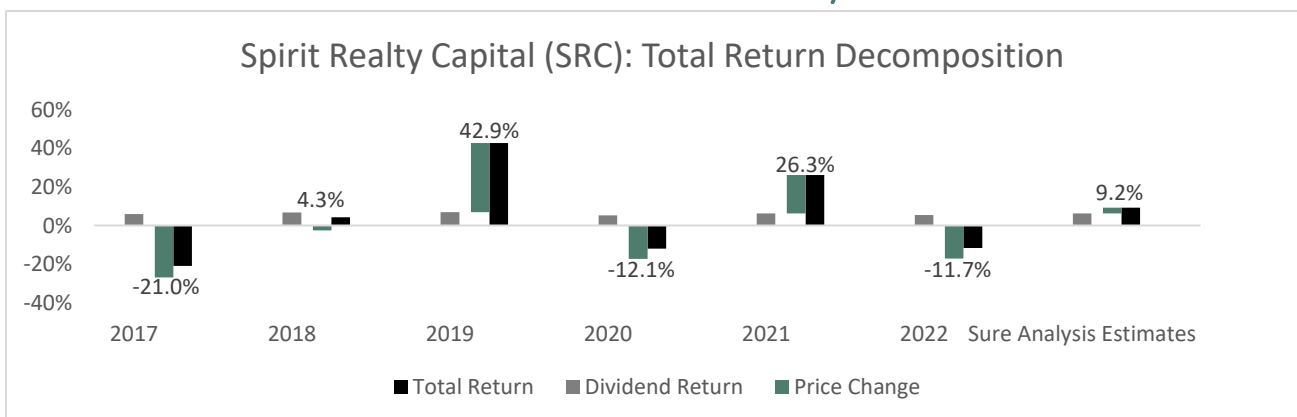
Spirit Realty's much-diversified portfolio is a double-edged sword. On the one hand, investors gain exposure in every single retail sub-sector, spread across hundreds of tenants in almost every state, enjoying a mixed stream of cash flows. On the other hand, having to manage thousands of smaller properties 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 2.9 times its operating cash flows, which is higher than the industry's median of 1.72. However, given the company's volatile performance, retail exposure, and rising rates, it's likely that creditors will demand higher rates upon refinancing its loans. In fact, the company's cost of interest came in at 3.73% in Q4 compared to 3.36% in Q3. Nevertheless, we believe Spirit Realty's qualities outweigh its dangers, overall.

Final Thoughts & Recommendation

Overall, Spirit's fiscal 2022 results demonstrated another quarter of resilient performance. The occupancy rate was phenomenal, rental collections were robust, and management's FY2023 guidance remains quite promising in the face of rising rates. We forecast annualized returns of 9.2% through 2028, driven by a starting yield of 6.7%, our growth estimates, and an annual valuation headwind of 0.3%. The stock earns a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	419	603	667	435	431	445	516	484	608
Gross Profit	406	576	637	406	403	424	498	459	585
Gross Margin	96.8%	95.5%	95.4%	93.4%	93.4%	95.3%	96.4%	94.8%	96.2%
SG&A Exp.	36	56	48	49	55	53	52	48	53
D&A Exp.	168	248	261	262	256	198	175	213	245
Operating Profit	206	272	329	185	173	208	269	196	287
Op. Margin	49.1%	45.2%	49.2%	42.4%	40.0%	46.8%	52.1%	40.5%	47.2%
Net Profit	-2	-37	93	97	77	132	175	27	172
Net Margin	-0.4%	-6.1%	14.0%	22.4%	17.9%	29.7%	33.9%	5.6%	28.3%
Free Cash Flow	125	213	362	361	348	284	291	302	389
Income Tax	1	1	1	1	1	1	12	0.3	0.6

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	7231	7964	7891	7678	7264	5096	5833	6397	7331
Cash & Equivalents	67	176	22	10	9	14	14	70	18
Goodwill & Int.	910	876	791	725	532	520	611	594	653
Total Liabilities	4113	4653	4429	3996	3944	2295	2419	2796	3331
Accounts Payable	115	123	142	149	132	---	---	---	---
Long-Term Debt	3778	4323	4093	3665	1713	2055	2153	2506	3013
Total Equity	3118	3312	3462	3682	3153	2636	3247	3435	3834
LTD/E Ratio	1.21	1.31	1.18	1.00	0.52	0.73	0.63	0.70	0.75

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.0%	-0.5%	1.2%	1.3%	1.0%	2.1%	3.2%	0.4%	2.5%
Return on Equity	-0.1%	-1.1%	2.8%	2.7%	2.3%	4.6%	6.0%	0.8%	4.7%
ROIC	0.0%	-0.5%	1.2%	1.3%	1.2%	2.7%	3.4%	0.5%	2.6%
Shares Out.	51.0	77.4	86.5	93.8	93.6	86.5	90.9	104.5	118.7
Revenue/Share	8.22	7.79	7.71	4.64	4.61	5.15	5.68	4.63	5.13
FCF/Share	2.45	2.76	4.18	3.84	3.72	3.28	3.21	2.89	3.28

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

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