



Spirit Realty Capital (SRC)

Updated May 8th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$39	5 Year CAGR Estimate:	9.5%	Market Cap:	\$5.55 B
Fair Value Price:	\$39	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	06/29/2023
% Fair Value:	100%	5 Year Valuation Multiple Estimate:	0.0%	Dividend Payment Date:	07/14/2023
Dividend Yield:	6.8%	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 2,083 properties in 48 states, leased to 347 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 May 3rd, 2023, Spirit Realty reported its Q1 results for the period ending March 31st, 2023. For the quarter, total revenues and FFO/share were \$188.3 million and \$0.90, an increase of 11.8% and a decline of five cents, respectively. Higher revenues were driven by accretive acquisitions and record occupancy levels, currently standing at a remarkable 99.8%. The disproportional increase in FFO/share against revenues was due to a 19% increase in total expenses and a 10.2% increase in outstanding shares year-over-year. AFFO/share, which excludes certain one-off items and non-cash compensation expenses, grew by one cent to \$0.89.

During the quarter, the company invested \$228.9 million in seven properties and also disposed of 35 properties, generating \$44.0 million in gross proceeds. Liquidity stays robust at \$1.6 billion. Management raised its FY2023 guidance, expecting AFFO/share between \$3.54 and \$3.60 (up from \$3.53 to \$3.59 previously), 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	\$3.57	\$4.34
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	141	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.

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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	11.0	11.0
Avg. Yld.	1.2%	4.8%	6.0%	5.4%	8.1%	8.3%	5.4%	6.9%	5.3%	6.3%	6.8%	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 6.8%, significantly higher than the sector's average of ~5.0%. 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%	67%

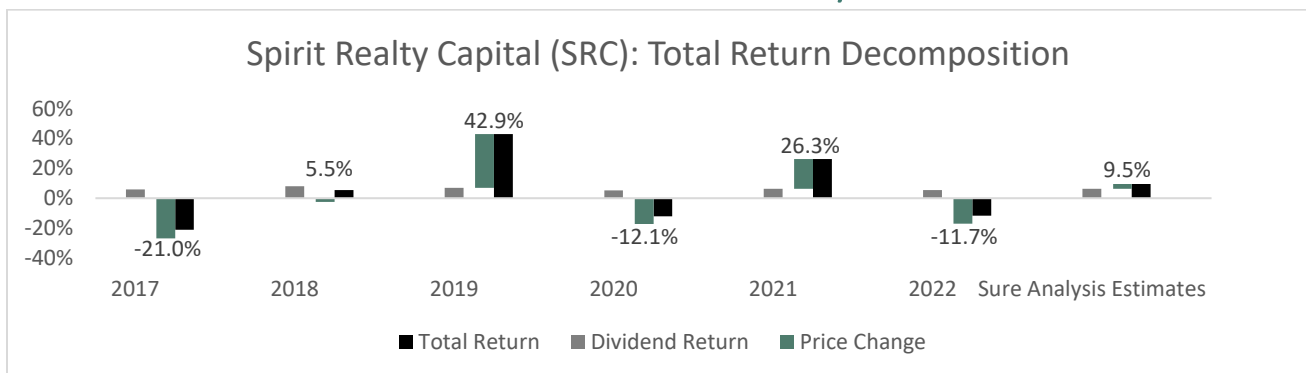
Spirit Realty's much-diversified portfolio is a double-edged sword. On the one hand, investors gain exposure in every single retail sub-sector, spread across hundreds of tenants in almost every state, enjoying a mixed stream of cash flows. On the other hand, having to manage thousands of smaller properties 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 unless marginal DPS increases occur.

Interest coverage currently stands at 2.7 times its operating cash flows, which is higher than the industry's median of 1.7. 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. That said, Spirit's cost of interest came in at 3.36% in Q1, down from 3.68% in Q4-2022, as the company was able to secure some beneficial swaps during the quarter. Overall, we believe Spirit Realty's qualities outweigh its dangers, overall.

Final Thoughts & Recommendation

Overall, Spirit's Q1 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 9.5% through 2028, driven by a starting yield of 6.8%, our growth estimates, and assumptions of a stable valuation. The stock earns 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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