

We do not see the opportunity for a value-creative investment in Realty Income at this time.

FWI Tear Sheet: Realty Income (O)

Valuation Only

Data as of 12 January 2017

Framework's Take

We valued O using a dividend discount model and converted operational statistics (e.g., revenues) to per-share values to normalize growth rates. O must continue to acquire properties (sale-leaseback transactions, acquisitions of other REITs) in order to grow and in growing, it issues debt and equity. Management is experienced, conservative, and seeks to maximize profits over the life of its loans. It specializes in free-standing retail locations, and targets businesses with a service component (theaters), low cost (dollar stores), and local necessity (drugstores). It's a well-run firm, but the market's quest for yield has pushed up its stock price too far to recommend.

Drivers

Revenue growth tied to acquisitions and client bankruptcies.
Proj: +6.5% (Best), +3.5% (Worst)
Profitability is very stable, even through 2009 bust.
Proj: +72% (B), +68% (W)
High efficacy based on spread between borrow rate and cap
rate. Proj (med-term growth): +7% (B), 4% (W)

Balance Sheet No issues noted.

90 80 70 \$67 50 \$49 We looked at the possibility of selling long-tenor puts (something we normally don't advise doing) but best-case returns were not impressive, and if and when investors start worrying about the next Fed rate increase, there may well be a better entry point. Selling puts if the stock trades in the mid- to low-\$50 range would be interesting to us. Note that because of the differences between an operating company and a REIT, we had to adopt our framework to this type of company. We made changes to our model's discount rate (7%) to account for dividend payments, and pulled back our terminal growth assumptions to Realty Income's "organic" revenue growth rate of around 2%. The company exhibits stable operations, but these model changes make us less confident of our valuation.

4/1/2018

Valuation & Return Valuation Uncertainty: Medium

10/3/2017

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	Low	Likely	High
Stock Fair Value (\$)	49	58	67
Stock Return (%)	-18	-3	11
Option Period Return (%)	NA	NA	NA
Option Annual Return (%)	NA	NA	NA

Historical Metrics

10/8/2016

4/6/2017

4/11/2016

	Historical Median		
	5-year	10-year	
Revenue Growth (%)	4	4	
Profit Margin (%)	71	71	
Med-term Growth	GDP	GDP	

Market Risk

Market perceives O's business as sensitive to interest rates, so talk of rising short-term rates may push the stock price down into a more reasonable range. Retail-focused so exposed to swings of perceived consumer spending.

9/28/2018

3/27/2019

