SPIRIT REALTY

FRAMEWORK Investing

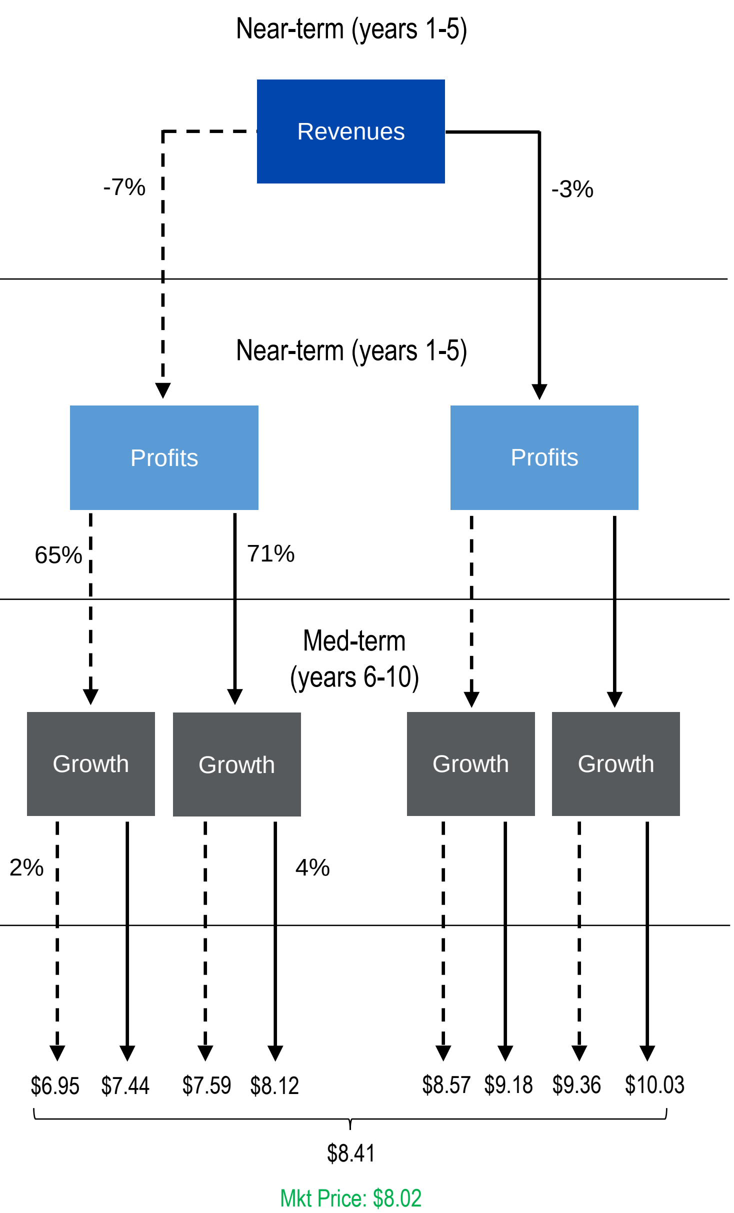
Valuation Waterfall

Revenue Growth
Spirit is in the midst of a major transition – it is spinning off about 40% of its high-risk properties into a new REIT and focusing on serving high credit rating tenants a-la Realty Income (O). After a big drop in revenues during 2018, the firm's contract escalators and its financial leverage will govern its worse-case growth rate (~2%). If the company is successful in property acquisitions, revenue growth is likely to be higher (~4%).

Profitability
We are using the same profitability range we used in our analysis of STORE Capital (STOR) even though historical profitability at Spirit has been lower. The new Spirit will receive management fees and dividends from the REIT it is spinning off (ticker: SMTA). While we do not have any historical basis for our profitability assumptions, we think this range is possible, given Spirit's new strategy and competent management.

Medium-Term Dividend Growth
Without seeing how the new Spirit performs, it is tough to make a bold projection of future dividend growth. This assumption implies that the company will attain a stable profitability range, then continue to grow its per-share dividends at a rate equal to its revenue growth rate. Note that for Spirit, as for all REITs, we use a dividend discount model (DDM) rather than a discounted cash flow (DCF) model to value the firm.

Fair Value Range
Our fair value range extends from \$7 to \$10 / share with an average value of \$8.41 / share using a **discount rate of 8.0%**. The stock is presently generating a dividend yield of around 9%, but we think this dividend will have to be cut after the spin-off of SMTA. With the stock trading now at \$8.02, our average valuation and five out of eight of our valuation scenarios are above the present price. Not as screaming of a bargain as a few months ago, but not bad.



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13 June 2018

Methodology
Framework Investing analyses focus on three main valuation drivers: revenue growth, profitability, and medium-term cash flow growth. We estimate a best- and worst-case scenario for each of these drivers resulting in a total of $2^3 = 8$ fair value scenarios based on discounted cash flow methodology. Profitability is measured by Owners' Cash Profit (OCP) margin and our measure of free cash flow is termed Free Cash Flow to Owners (FCFO). We use a discount rate of 10% for large capitalization stocks. A wide spread of lowest and highest fair values indicates a firm whose value is uncertain. Risk depends on the stock price's relationship to the valuation range. Best-case scenarios are represented with a solid line; worst-case scenarios, with a dotted one.