MASTER IN FINANCE

REALTY INCOME CORPORATION

COMPANY REPORT

REAL ESTATE INVESTMENT TRUST

16 DECEMBER 2022

STUDENT: ANATOLIY AXEL HOLOYAD 50507@novasbe.pt
STUDENT: YMIR SIGURDSSON 51145@novasbe.pt

The Leading Dividend Corporation

A Diverse and Sophisticated Portfolio of Properties

- Based on our DCF valuation, we recommend investors to **BUY** shares of Realty Income, we estimate the target share price to be 81.39$ by the end of FY23.
- Realty Income's dividends have grown consistently over the years, rising from $2.19 per share in 2014 to $2.83 per share in 2021. We anticipate that the company will continue to pay out attractive dividends to its shareholders in the following years with steady average yearly growth of 13.56%.
- Realty Income has remained resilient in harsh economic climates, improving, and growing its operations while maintaining at the same time strong liquidity and occupancy rate.
- We believe that the share price of the company has been subject to unfair price reduction since the beginning of the Covid-19 pandemic. Their operating performance has only improved while their share price has still not recovered from their highest price of $79.83 in February 2020.
- We think that the recent growth of the company due to acquisitions of real estate and the merger with VEREIT will further boost growth in earnings, however we believe that the company will slow down on acquisition to compensate their shareholders.

Company description

Realty Income Corporation, also known as “The Monthly Dividend Company”, is one of the leading REITs companies in the world. The company invests in free-standing, single tenant commercial real estate properties. It has over 11.700 properties that are leased to over 1.100 clients throughout the whole US, as well as Puerto Rico, the UK and Spain. The company was founded in 1969 and has its headquarters in San Diego, California.

Recommendation:	BUY
Price Target FY23:	**81.39 $**
Total shareholder return	*25,29%*
Price (as of 19-Jan-23)	**64.40$**
Reuters: O, Bloomberg: O:US	
52-week range ($)	55.50-75.40
Market Cap ($m)	40 364
Outstanding Shares (m)	627,15

Source: Company data, Bloomberg, and analysts' estimation

Source: Bloomberg

(Values in $ millions)	2021	2022E	2023F
Revenues	2 081	3 273	5 120
EBITDA	1 614	2 995	4 716
Net Profit	359	840	1 848
FFO	1 241	2 391	3 914
Dividend Per Share	2,83	3,25	4,85
Dividend Yield	2,8%	5,0%	5,95%
CAPEX	6 425	6 697	5 167
Occupancy Rate	98,5%	98,4%	98,4%

Source: Analysts Estimation and Company Data

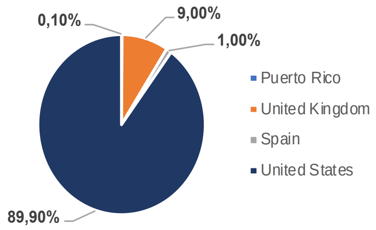
Table of Contents

Company Overview

Company Desciption

Realty Income Corporation was founded in 1969 by William E. Clark and Evelyn J. Clark. Their goal was to provide shareholders monthly dividends that increase over time by acquiring commercial real estate properties and leasing each property to companies with a strong financial profile in exchange for rental income. Realty Income is currently the 4th largest global REIT company (based on Nareit Global REITs Index and measured by equity market capitalization) and is listed on the New York Stock Exchange (NYSE), with a stock ticker "O".

Exhibit 1: Geographic Diversification



Source: *Company data and own analysis*

98.5 percent of the company's properties are leased to retail and industrial clients, while the remaining 1.5 percent are categorized as "Other". Realty Income leases over 11,700 commercial properties under long-term lease agreements to over 1,100 different clients which operate in 79 different industries across all 50 U.S. states, Puerto Rico, the U.K., and Spain. Roughly 90% of the company´s property portfolio is within the U.S., while the remaining 10% is divided by the rest of the world (Exhibit 1). The company has a diversified client portfolio and leases real estate properties to strong and creditworthy clients. Their five biggest clients in terms of contractual rent are companies that are well-known in the U.S. (*Dollar General, Walgreens, 7-Eleven, Dollar Tree, and FedEx*), and each and one of them has at least one investment grade from the three biggest rating agencies (*Moody´s/ Fitch/S&P*). When it comes to the European portfolio, the grocery industry is the largest industry in Realty Income´s portfolio, accounting for 51 percent of its total portfolio in terms of contractual rent. Moreover, two out of the three biggest European clients of Realty Income are Sainsbury´s and Tesco who are considered to be the top grocers in the U.K.

Ownership Structure and Dividend Policy

Exhibit 2: Five largest shareholders of Realty Income

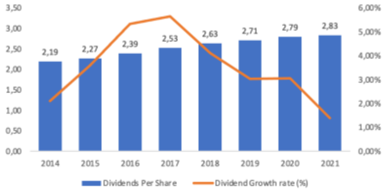
Top five Owners	
The Vanguard Group, Inc.	15,46%
SSgA Funds Management, Inc.	7,62%
BlackRock Fund Advisors	6,4%
Cohen & Steers Capital Management	5,4%
Managed Account Advisors LLC	2,9%

Source: *Own analysis*

Realty Income has a unique ownership structure where most of the shares are held by institutional investors (84.48 percent), investors who are classified as "other investors" hold 15.02 percent of the shares while the remaining 0.5 percent of the shares are held by "insiders". The five biggest owners of Realty Income hold 37.81 percent of total shares, where The Vanguard Group, INC. has the highest stake of 15.46% (Exhibit 2).

In order for Realty Income to classify as a REIT, the company is required to distribute dividends to shareholders that aggregate up to at least 90% of annual taxable income. Realty Income has a strict dividend policy and pays dividends on

Exhibit 3: Historical Dividend Per Share and Dividend Growth Rate



Source: *Company data and own analysis*

a monthly basis. Throughout its 53-year history, Realty Income has declared over 628 consecutive monthly stock dividends to its shareholders and since the company went public in 1994, 117 dividend increases have been made. As Exhibit 3 depicts, Realty Income´s dividends per share present an upward trend with attractive dividend growth each year. The company´s dividend per share rose from 2.19$ in 2014 to 2.83$ in 2021, where they distributed a record-breaking 1.17 billion USD to common shareholders. In addition, the company has had a 14.4% annual compounded return and a 4.4% compounded annual dividend growth rate since its listing in 1994. As for the future, Realty Income aims to continue to make dividend distributions to its shareholders in order to fulfill the requirements to classify as a REIT.

Business Model

The business model of Realty Income is built on 4 main pillars. The first pillar is **high quality real estate**: Realty Income focuses on acquiring freestanding, single tenant commercial properties that are leased to high-quality clients under long-term (usually more than 10 years) triple net lease agreements. Triple net leases agreements allow the company to better preserve consistent cash-flows for its investors.

The second pillar is a **conservative capital structure**: Realty Income focuses on managing their balance sheet conservatively which means that they seek to keep their debt level not too high. Realty Income is committed to maintain their “A3” and “A-“credit rating which means they need to keep a conservative capital structure. By maintaining this credit rating the company has a competitive advantage for two reasons. Firstly, it secures that their borrowing rate on debt is more attractive than it would be otherwise. Secondly, their liquidity increases because they have more access to capital which is key for stability and growth. This secures that when there are opportunities, Realty Income can grab them and make fast acquisitions at a favorable price.

The third pillar is a **prudent growth strategy**: Realty Income is very focused on sustainable growth in order to increase its monthly dividends and generate stockholders return. First of all, Realty Income has been growing geographically with investments in the U.K and continental Europe. Also, the triple net lease business model is scalable across property types, which enables Realty Income to invest in new property types if good opportunities arise. Finally, Realty Income uses technology, data analytics and predictive analytics in order to seek opportunities and grow, this helps a lot when deciding on key business decisions.

The fourth pillar is **corporate responsibility**: Realty Income is dedicated to operate in a way that upholds the greatest ethical standards. The company is committed to operate their business in an environmental responsible manner, providing an engaging, diverse, and safe workplace for their employees, and upholding their corporate responsibilities as a publicly listed company for the benefit of their stakeholders, including shareholders, colleagues, community, and clients.

Strategy

Realty Income's business model is further developed by being strategic in four areas: acquisitions, asset management, development, and client service.

Acquisitions: Realty Income specializes in acquiring high quality properties. Most of their tenants that operate in the retail industry are clients with a service, low price point and/or non-discretionary component. They also focus on industrial and distribution properties that are leased to Fortune 1000 companies with investment-grade ratings. Realty Income has a specialized team that is dedicated to sourcing and seeking opportunities. The team undertakes a thorough analysis and research to identify which clients, industries and property locations are appropriate for investments. When looking for net leasing opportunities in markets where Realty Income´s investment adds value, this research expertise is crucial. The acquisition of properties leased to clients who are leaders in their industry and provide stable and sustainable cash flow supports their business model and conservative strategy. Realty Income has acquired $32.9 billion worth of real estate since 2010 and for the first nine months of 2022 they have acquired real estate properties for $5.0 billion. This shows that Realty Income has been determined to grow and focus on providing attractive dividend and capital return for their shareholders.

Asset management: Realty Income continually monitors its portfolio in search for any changes or events that might affects their clients, the industries they operate in and locations that Realty Income has invested in. Additionally, they frequently evaluate their portfolio with the view towards optimizing the return generated by their portfolio and enhancing its credit quality. In order for Realty Income to sustain high occupancy, forge enduring bonds with our clients, and foster extra internal growth, active portfolio management is a crucial part of their long-term strategy. Further, the company's goals with active portfolio management are to structure the optimal portfolio of properties by having the ideal mix of certain clients, industries, property types and markets. Another goal is to retain asset value by maximizing their asset-level returns on properties that are sold, renewed, or released. Also, they have a goal to creatively add value by enhancing properties or pursue alternative uses, this creates incremental value from the existing portfolio.

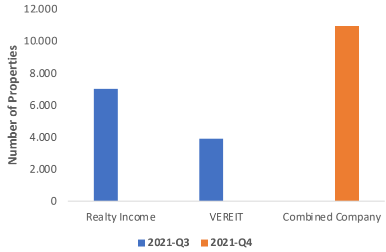
Development: Realty Income´s development team focuses on finding opportunities to develop properties for both new and existing clients as well as identifying opportunities to add value to their current portfolio. These development initiatives increase Realty Income´s investment opportunities, which can boost future earnings growth.

Client Service: Realty Income´s client services help organizations by financing upgrade projects, improve processes and efficiency, and solve operational emergencies.

Merger with Vereit

Realty Income acquired VEREIT, Inc. (NYSE: VER) for 16 billion USD in an all-stock transaction, on November 1, 2021. Much like Realty Income, VEREIT is a Single-Tenant REIT that owns and manages commercial properties in the U.S. In addition, both companies share a similar business model whereby real estate properties are leased to creditworthy clients under long-term lease agreements. Following this merger, the combined company continued to trade under Realty Income´s stock symbol, "O" on the New York Stock Exchange. According to the merger agreement, VEREIT shareholders received 0,705 of newly issued shares of Realty Income for each share of VEREIT stock. Shortly after the announcement of the merger, the two companies decided to contribute all office assets to a newly created company, Orion Office REIT Inc. After the completion of the Spin-Off, Orion started operating as a separate, publicly traded company on the New York Stock Exchange (NYSE: ONL).

Exhibit 4: Property Portfolio



Source: *Company data and own analysis*

Following the merger and combination of the two portfolios, the combined company managed to grow its property portfolio by 55 percent, going from 7.018 properties to 10.900 properties (Exhibit 4). In addition, the company strengthened its position in the market by achieving greater diversification of clients and geographic regions that further enabled growth opportunities. The company also captured immediate operating synergies, in form of cost savings and growth. The combined company was able to save on general and administrative cost and operating cost, but also, it was able to grow faster due to operating performance and value creation from development. In addition, the merger provided noteworthy financial synergy. Since Realty Income has a superior credit rating from two different rating agencies, it was able to refinance VEREIT´s upcoming debt at lower rates.

As a result, it is safe to assume that the combined company has all the necessary tools to maintain its position as the market leader in the net lease sector while at the same time continuing to grow and deliver attractive value to its shareholders.

Industry

Industry overview

Real estate investment trusts (REITs) are companies that own and acquire income producing real estate. In order to qualify as a REIT, these companies have to meet a number of requirements. For example, in order to qualify as a REIT a company must pay at least 90% of taxable income as shareholder dividends each year and invest 75% of its total assets in real estate, among other requirements. In the United States, REITs own and manage more than 535,000 properties and 15 million acres of land which results in $4.5 trillion in gross assets. REITs provide a good investment opportunity for both institutional and retail investors, in a way that investors earn a share of the income produced by real estate without having to buy, manage and finance properties by themselves.

Historically REITs have generated attractive total returns for investors based on their high and steady dividend income along with long-term capital appreciation. REITs have shown to have low correlation with other types of assets and are therefore a very effective portfolio diversifier that can reduce risk, increase returns, and improve the Sharpe ratio of portfolios.

The business model of REITs is in general relatively simple, that is, REITs acquire and lease Real estate properties and generate income in the form of rent. The biggest part of that income is then distributed to shareholders in the form of dividends. The two most common type of REITs are equity REITs and mortgage REITs. Equity REITs, which is the most common type of REITs, own Real estate properties and lease them to tenants and pay out the largest part of their income as a dividend. While mortgage REITs finance income-producing real estate by acquiring or originating mortgages, and mortgage-backed securities (MBS) and earning interest income on these assets. Usually, equity REITs try to focus on a single type of property, but some invest in many segments. The most common types of equity REITs are office REITs, industrial REITs, retail REITs, hotel REITs (resorts REITs) and residential REITs.

Macroeconomics

Since early 2020, the economic environment has been challenging for most economies in the world with the upbringing of the Covid-19 virus. Some of the measures taken in order to try minimizing the effect of the virus on the health of humans all over the world included travel restrictions, lockdowns, business restrictions and quarantines. This led to one of the harshest global recessions for decades with economic disruptions all over the world. These disruptions included global supply shortages, tourism collapsed due to travel restrictions and the retail sector faced severe disruption's where the foot traffic in the U.S decreased by 50-60 percent. During these disruptions, hundreds of millions of people lost their job and it is estimated that around 60 percent of businesses that closed during the pandemic will stay closed permanently[1]. Further, it is reported that the amount of money made in the first nine months of 2020 decreased globally by $3.5 trillion compared to the same period in the year before. Despite the recession, in May 2020, an economic expansion began in the U.S with economic activity recovering at a rapid pace, and this expansion continued throughout 2021. The recovery was a result of an unprecedentedly large fiscal and monetary stimulus. It is estimated that the fiscal policy measures taken in 2020 boosted GDP in 2021 by 6%[2].

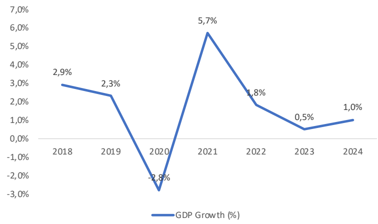
The federal Open Market Committee lowered the federal funds rate by 1.5% in March 2020 which supports increased demand and spending in the economy by lowering borrowing costs. These measures increased the demand for goods, services and capital which often comes with increased inflation. From May 2020 asset prices started to rise at a fairly high real rate throughout December 2021 where prices reached historical heights. Between December 2020 and December 2021 housing prices reached all time heights in Absolute and inflation-adjusted terms, with an increase of 17.5% in nominal terms. These price increases can be traced to the low interest rates during the pandemic which resulted in a great increase in real estate and financial wealth, but also in increasing inflation[3]. Further, in 2021, the U.S economy grew by staggering 5.7% which is the highest growth since 1984. As interest rates were kept at a near zero level throughout 2021, the demand for money grew, both for households and businesses and spending in the economy increased which led to surging inflation and it reached 6% in January 2022 which is well above the federal reserve 's target of 2%.

On February 24th, 2022, Russia invaded Ukraine which has had devastating effects on the economy of a number of countries in the world. With the underlying

[1] Sundaram, Anjali. "Yelp Data Shows 60% of Business Closures Due to the Coronavirus Pandemic Are Now Permanent." CNBC, 16 Sept. 2020, www.cnbc.com/2020/09/16/yelp-data-shows-60percent-of-business-closures-due-to-the-coronavirus-pandemic-are-now-permanent.html.(Sundaram, n.d.)
[2] "Inflation in the U.S. Economy: Causes and Policy Options." Inflation in the U.S. Economy: Causes and Policy Options - EveryCRSReport.com, 6 Oct. 2022, www.everycrsreport.com/reports/R47273.html.
[3] Labonte, Marc, and Lida Weinstock. U.S. Economic Recovery in The Wake of COVID-19: Successes And Challenges. crsreports.congress.gov

inflation already present, the war pushed inflation in the U.S to new heights in March 2022, reaching 8.5% which is the highest annual increase for decades and weakened the recovery from the pandemic. Further, the inflation continued to rise until it reached its peak in June 2022. The main effects of the war include surging energy prices, commodity and food prices increasing and various supply shortages. Since March this year, the Fed has been increasing interest rates steadily at a high pace up to 4% in November with the goal to drive the inflation down to the target inflation level and mitigate the effect of inflation on the purchasing power of American citizens. With increasing interest rates, it becomes more expensive for households and businesses to get loans, and the flow of money in the economy reduces. This can have serious effects for companies that rely on leverage and increasing interest payments can cut a large chunk of profits. Additionally, companies will operate more passively, growth slows down, unemployment can rise in tougher economic environments and recessions can sometimes occur if the economy slows down too much. Another concern is that inflation has grown faster than interest rates meaning that real interest rates have become substantially negative since the inflation began to rise, making it hard for money savers to earn positive real rate of return. However, the OECD expects that GDP in the U.S will grow by 1.8% in 2022, 0.5% in 2023 and 1% in 2024[4] (Exhibit 5).

Exhibit 5: Historical & forward-looking GDP growth (%)



Source: Trading Economics

Industry Outlook

The Covid-19 pandemic affected the operational performance of REITs, and it is clear when comparing funds from operations (FFO) on a quarterly basis. The average quarterly FFO declined by 18.5% in 2020 when comparing to the quarterly average in 2019. The decline in operating performance varied between different property type REITs. While it affected most equity REITs negatively, industrial REITs experienced improved performance due to the immense growth in e-commerce. On the other hand, the performance of REITs operating in the resort/lodging sector declined immensely since most hotels experienced a harsh decline in occupancy due to lockdowns and restrictions. Realty Income mostly operates in the retail sector which experienced a rather high decline in operating performance during 2020, the quarterly FFO decreased by roughly 20% from 2019 until 2020. However, Realty income remained resilient and the FFO increased from 1.14 billion to 1.24 billion meaning that Covid-19 did not have serious effects on

[4] "United States Economic Snapshot - OECD." United States Economic Snapshot - OECD, www.oecd.org/economy/united-states-economic-snapshot. Accessed 12 Dec. 2022.

the operations of Realty Income and the company was able to maintain its level of dividend payouts.

Despite the downturn in 2020, the performance of REITs in 2021 proved to be excellent and the sector quickly recovered from the pandemic. The FFO of REITs increased by 25% between 2020 and 2021. The low interest rate environment in 2021 was favorable for REITs since a large proportion of REITs have a high level of debt that they use for acquisitions and growth. The attractive debt pushed REITs on a buying spree and 2021 was a record year in net acquisitions. By taking advantage of the low interest rates, REITs have improved their balance sheet by locking in low interest for many years to come while also reducing their level of debt[5]. Additionally, the occupancy rate for REITs recovered quickly in 2021, especially for industrial, retail and apartment REITs while occupancy in office REITs has still not recovered from the pandemic.

As inflation and interest rates have been rising at a fast pace this year, REITs operational performance has been strong throughout the year with FFO and Net Operating Income (NOI) increasing for REITs. FFO increased by almost 15% from Q3 2021 compared to Q3 2022 where it reached a new peak. It is noteworthy that despite rising interest rates, inflation, and an overall challenging economic climate, the operational performance of REITs has remained resilient. The net operating income of REITs increased by 8.1% in October on a year-to-year basis which illustrates that the earnings growth of REITs has been keeping up with inflation[6]. Further, history has shown that REITs can provide a natural hedge against inflation, i.e., when inflation increases, real estate rent typically increases as well, which supports dividend growth. That way, investors still receive their dividend cash flows during surging inflation periods. Capitalization rates (cap rate) for REITs also tend to increase with rising interest rates and the implied cap rate for REITs has increased by 150 basis points in 2022, which is considered a significant increase. However, when interest rates increase, REITs tend to reduce their level of acquisitions and slow down growth. In the first two quarters of 2022, REITs have acquired $46.1 billion worth of real estate compared $128 billion in 2021, which indicates that the level of acquisitions has been slowing down this year. Further, for the first three quarters of 2022 REITs issued $11.4 billion in debt compared to $58.2 billion in 2021, which is at a vast decrease in issuance of debt.

[5] Schnure, Calvin. “REIT Net Acquisitions Hit Record High of $67.8 Billion in 2021.” Forbes, 9 Mar. 2022, www.forbes.com/sites/calvinschnure/2022/03/09/reit-net-acquisitions-hit-record-high-of-678-billion-in-2021.
[6] “REITs Well-Positioned for Ongoing Economic Uncertainty.” REITs Well-Positioned for Ongoing Economic Uncertainty | Nareit, www.reit.com/news/blog/media/reits-well-positioned-ongoing-economic-uncertainty. Accessed 3 Dec. 2022.

Going forward, it is highly uncertain how things in the economy will unfold in 2023 and beyond. It seems like the increasing interest rates are affecting inflation since the twelve months ended inflation in October is 7.7%, which is a 0.5% reduction from the month before. The increasing interest rates should slow down demand going forward and with supply constrains easing, the inflation should relax rather quickly in 2023. Further, the Federal Reserve is expected to keep being restrictive until late 2023 or 2024 in order to fight the inflation.

As mentioned before REITs have proved to perform well in high-inflation environment and they usually outperform global equities in the stock market, while underperforming in lower inflation environment. This can be explained by the fact that REITs can be less volatile, and they often don not capture the upswing of markets as well as other equities. The lease composition for REITs will also make a difference in performance in this high inflation climate. REITs with gross leases are more exposed to rising prices since they pay operating expenses for their properties and therefore their margins could be affected. Contrary, those with net lease agreements pass on that risk to their tenants, which is an indirect risk in itself since it could affect the ability of tenants to pay rent. As REITs carry high levels of debt on their balance sheet to fund acquisitions and develop properties, the increasing interest rates could be of concern, especially for highly leveraged companies. However, almost 80% of debt carried by REITs is at a fixed rate which has ensured them lower interest rates and more visibility and certainty on their debt obligations in the next few years. With that being said, most REITs are not exposed to the high interest rates immediately and the leverage ratios for REITs is at a historically low level, with limited short-term maturities[7]. Also, with high market interest rates today, REITs are expected to slow down on acquisitions and be more passive, after a record year in REIT acquisitions in 2021. The overall outlook for REITs in 2023 is that REITs will continue to perform well and grow their earnings at a steady pace, while slowing down on acquisitions.

Competitive Positioning

The REIT sector is one of the most competitive sectors in the world with a number of large companies with a long history. The majority of REIT companies hold particular property types in their portfolio, making any other companies operating in the same REIT sector a direct competitor. As for Realty Income, the same applies to them. However, Realty Income differentiates itself from its peers due to its unique size and scale. Their strategically positioned properties are spread over

[7] Reddy, Rohan. “REITs as a Potential Income Solution Amid Persistent Inflation.” Global X ETFs, 7 Sept. 2022, www.globalxetfs.com/reits-as-a-potential-income-solution-amid-persistent-inflation.

several countries, as opposed to being allocated to one single country. The company´s expansion into Europe significantly expands its market and creates distinctive growth opportunities with limited direct competition[8]. In addition, following the merger with VEREIT, Realty Income´s size and scale will further enhance its position in the competitive market.

For most REIT companies, capital strength is one of the key fundamentals to its success. By having strong credit ratings, companies can borrow capital at lower rates and therefore maintain their capital strength. Realty Income´s current credit rating of A3/A- from Moody´s and S&P, respectively, will not only allow them to access an attractive debt capital to acquire more investment properties but also ensure strong cash flows for dividend distribution which in turn will improve even further their competitive position. While the majority of the company´s competitors pay stock dividends on a quarterly basis to its shareholders, Realty Income has throughout its 53-year history paid consecutive monthly dividends and intends to keep doing so while maintaining a sustainable growth of dividends. Additionally, Realty Income has maintained an attractive dividend yield in the past years, with a yield of 3.97% in 2021. In comparison to the company´s competitors, Realty Income is one of the most appealing companies when it comes to dividends (Exhibit 6). By maintaining this attractive dividend policy and high yield, the company can expand its competitive advantage.

Exhibit 6: Dividend Policy and Yield of Realty Income´s Competitors, 2021.

Peer companies	Dividend Policy	Dividend Yield
Simon Property Group, Inc.	Quarterly	3,66%
Kimco Realty Corporation	Quarterly	2,76%
Regency Centers Corporation	Quarterly	3,20%
Store Capital Corporation	Quarterly	4,33%
Federal Realty Investment Trust	Quarterly	3,13%
National Retail Properties, Inc.	Quarterly	4,37%
Agree Realty Corporation	Monthly	3,65%

Source: *Companies reports and Bloomberg.*

To further understand how Realty Income is positioned in the market, we analyzed its two main competitors and compared them to the company´s historical performance.

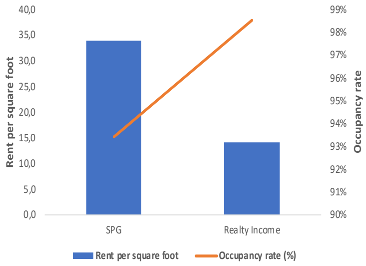
Simon Property Group Incorporation (NYSE: SPG)

SIMON PROPERTY GROUP

Like Realty Income, SPG specializes in the commercial retail industry. It owns, develops, and manages shopping malls, community centers, and other retail properties such as Target, Walmart, and Costco. Unlike Realty Income, SPG has made steps to expand its property portfolio by buying properties in the Asian market, giving them a possible competitive advantage over Realty Income. By finding attractive investments in Asia, SPG can diversify and further expand its portfolio and brand recognition thanks to this competitive edge. A key difference between the two companies is that Realty Income is a triple net lease operator, unlike SPG. In essence, this means that in addition to paying the standard rent, the tenant is also responsible for all expenses related to maintenance, property taxes, and property insurance. Since the tenant is responsible for all the costs associated with the property, Realty Income in return charges lower rent. However,

[8] Realty Income – Investors Presentation – 3Q2022.

Exhibit 7: Rent prices and Occupancy Rate.



Source: *Company´s report and own analysis*

the upside of such a business model enables Realty Income to preserve predictability for expenses each period and offer lease agreements for a longer time period to each tenant.

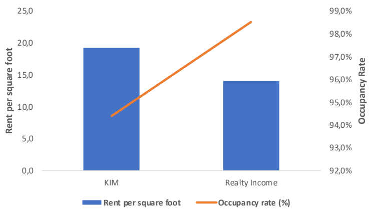
When comparing the two businesses rent prices and portfolio occupancy, it can be seen that SPG´s rent per square foot is $33.80, which is higher than Realty Income´s rent per square foot of $14.03. However, Realty Income´s occupancy rate of 98.5% is slightly higher than SPG´s rate of 93.4% (Exhibit 7).

Kimco Realty Corporation (NYSE: KIM)

Kimco Realty invests in shopping centers across all the U.S. with a focus on grocery-anchored stores. The company previously made the decision to expand its portfolio and grow internationally, particularly in South America and Canada. However, in recent years, they decided to exit all of their international investments and focus instead on the U.S. market. The company currently holds interests in 526 shopping centers and mixed-used assets with 91 million square feet of leasable space in the U.S.

The key differences between Realty Income and KIM are their growth strategies. Realty Income´s growth mechanism is primarily through acquisitions, while Kimco´s growth mechanism is through property development, particularly re-development of existing properties. As previously mentioned, Kimco disposed all of its properties in South America and Canada and intents to concentrate on redevelopment in the U.S., both in terms of repositioning and re-tenanting as they view it as the main driver of value creation. When it comes to occupied properties, both companies have similar occupancy rates, though Realty Income´s occupancy rate of 98.5% was slightly higher than Kimco´s 94.4% in the previous year. However, Kimco´s rent per square foot last year was 37% higher than Realty Income´s (Exhibit 8).

Exhibit 8: Rent prices and Occupancy Rate.



Source: *Company´s report and own analysis*

Risks Factors

The quality of Realty Income´s clients is in itself a risk factor where the risk mainly concerns the ability of the tenants to pay their rent on time, a decline in creditworthiness, and bankruptcies of clients. If a client would go bankrupt, there is no guarantee that Realty Income is able to attract new tenants or sell their property at an attractive price and it could take a substantial time since the type of properties owned by Realty Income are not considered liquid assets. However, they have a 101.8% rent recapture rate since 1996, which means that historically when their leases have expired, they have proven to be able to re-lease those properties and increase the rent. Further, Realty Income has stated that they will continue to focus on leasing to investment graded clients.

Another risk factor that Realty Income is exposed to is the composition of their lease agreements. As mentioned in the section above, Realty Income's uses triple net lease agreements which means that their tenants are responsible for paying property expenses including property taxes, insurance, and maintenance. The use of net lease agreements reduces the exposure of Realty Income to raising inflation and thereby rising property expenses since the client carries all the risk. However, if rising inflation has serious effects on the earnings of their clients, i.e., if their operating expenses increases more and faster than increase in revenue, it might affect their ability to pay rent. Also, since the largest part of lease agreements are tied to inflation, the rent payments might also increase as operating property expenses rise. One downside to these net lease agreements is that since the client bears the risk of paying operating expenses, Realty Income receives lower rent income compared to REITs that pay for operating expenses themselves.

Another risk factor that affects Realty Income is their debt composition. The negative effects of excessive debt can be limitations to further borrowings since overleveraged firms usually have poorer credit ratings and if a company gets additional debt, banks will charge extremely high interest rates. Further, investors are not attracted to overleveraged companies since the probability of distress is higher. Too much debt can also constrain the growth for a company if the invested capital has not increased earnings before the debt has to be paid. Further, excessive debt can prevent dividend payments if the company has to use the most part of its earnings to service debt holders. Lastly too much debt will increase Realty Income's vulnerability to recessions since they would be more likely to default on their loans.

Realty Income is subject to interest rate risk since they issue debt in order to finance a large part of their acquisitions. Realty Income's main debt components include their credit facility, commercial paper program, mortgages, term-loans, and long-term notes and bonds. Rising interest rates has a negative effect on the variable rate debt of Realty Income and can limit its growth since borrowing costs will increase. To limit the effects of interest rate changes that can affect the earnings negatively, Realty Income issues long-term notes and bonds at a fixed rate. For the nine months ended 2022, the company had $14.22 billion in fixed rate debt versus $1.92 billion in variable rate debt. Further with higher interest rates, the discount rate increases resulting in lower share prices and that also results in other less risky investments becoming more attractive for investors.

Of course, REITs are not limited to only the factors mentioned above, there are other risk factors such as geographical and regulation risks, lack of demand or oversupply of space, along with other factors that also affect REITs.

Value Drivers and Forecast

Revenue forecast

For Realty Income, the four main revenue growth drivers are same store rent growth, acquisitions, development, and dispositions. In order to project revenues until 2030, a bottom up-approach was utilized by projecting the fundamentals of each driver and then the sum of those drivers result in total comprehensive revenue for each year. The current state of the economy and the outlook for next few years influence our assumptions on growth for the company going forward.

Same store growth: The base for the revenue forecast is the growth in rents from already existing properties as of the third quarter of 2022. The starting point for estimating the increase in rents from already existing properties is the total building space the company has invested in. Currently the company has invested in 225,658,900 square feet of real estate. Since 2012, the occupancy for properties owned by Realty Income has been very stable at an average occupancy rate of 98.4%. Further, the average rent per square feet for Realty Income is $13.25. The company has a good and effective strategy for raising rent yearly where most properties of Realty Income (86%) provide increase in rent based on three criteria's: fixed rent increases that are pre-defined, increases that are tied to inflation or that they charge additional rents based on the operating performance of a tenant that is above a specific level. Our estimates of rental increases are mainly based on inflation rate for rents which usually moves closely with inflation of the economy. As the inflation is at a very high level, real estate rents are rising as well and are expected to continue to rise at an above average rate in 2023 and 2024. We expect that the rent for existing properties will eventually reach a growth of 2,5% which is approximately the average inflation in the U.S. In order to calculate the total rental revenue from already existing properties, the rent per square feet is multiplied by the occupied square feet. As 86% of the leases are subject to rent increases, 86% of rental income is increased by the corresponding rent inflation rate each year.

Acquisitions: Acquisitions is the core revenue growth driver for Realty Income, and it can have large impact on future earnings of the company. Realty Income is highly focused on growth from acquiring new properties compared to other REITs. As mentioned above, they have a clear investment strategy, focusing on single tenant free-standing properties and choosing their tenants carefully. In order to implement this strategy successfully, the company has a specialized team dedicated to research and scout investment opportunities. They have been incorporating predictive analytics and machine learning to further drive key decisions on whether they should expand into other markets or invest in new property types. In last year few years, Realty Income began expanding to Europe in order to improve partnership with multinational clients. Of their total acquisitions in 2021, their proportion of investments in Europe was 41.5%, which corresponds to $2.56 billion. Realty Income's business model, the triple net lease agreements allow them to expand and invest in other property types than they are currently doing. Recently Realty Income invested in 12 vineyards which is an example of their flexibility and ability to seek attractive deals outside of the commercial retail sector. This broadens their pool of investment opportunities where the company can exploit attractive investment opportunities outside of the U.S and across different property types. As of September 2022, Realty Income has sourced opportunities worth around $78 billion and invested $5.1 billion in real estate from that pool of opportunities. In order to fund their acquisitions, they mostly rely on capital markets, i.e., long term debt or equity issuance. Since 2012, the company has spent $27.6 billion (excluding VEREIT merger and 2021) in gross real estate investments which represents an CAGR in acquisitions of 8.98%.

In order to calculate the incremental revenues from acquisitions, a bottom-up approach was incorporated. Firstly, the acquisitions for each year until 2030 are projected based on our believes on the development of the overall economy, historical level of acquisitions and the fact that we believe that the company will slow down on growth in the near future. When the acquisitions for each year have been estimated, appropriate cash capitalization rates are applied in order to calculate the incremental net operating income produced by the yearly acquisitions. The cash capitalization rate is computed as the annual contractual cash net operating income dividend by the total costs of invested properties, i.e., a return that the company earns as NOI on its properties. When the NOI has been calculated for each year, the implied incremental revenue each year can be calculated by applying an appropriate NOI margin. Additionally, the accumulated incremental revenue each year grows at the appropriate same store rent inflation rate.

Since Cap rates usually increase with rising interest rates, the cash cap rates captured for investments in 2022 has been going up since the beginning of the year. However, for the past years, the cash cap rate has been slightly decreasing, from a yearly average of 7.1% in 2014 to 5.9% as of year 2022. That is mainly due to more quality tenants that provide less risky cash flows and because housing prices have been rising at a faster pace than increase in rents. In order to calculate the NOI margins, we define NOI as EBIT including non-recurring items to be consistent with Realty Income's computation of NOI. By doing it that way, the cash cap rate is consistent with the NOI margins, and the implied incremental revenues are reliable. Before the covid pandemic the NOI margins were very stable at a level close to 50%. However, the operating performance of Realty Income was impacted by the pandemic and the average NOI margin since the pandemic is at 40.41%, but it has increased from 34.42% in 2021.

When projecting future acquisitions, the first instinct was to base it on historical growth in acquisitions. However, the historical growth rate of acquisitions fluctuates significantly between years. As an example, in 2019, acquisitions grew by 106.7%, they decreased by 37.9% in 2020 and grew by 177.8% in 2021. As a result, we found it more reliable to estimate acquisitions as a percentage of net real estate held for investment. Prior to covid, that ratio was rather stable at around 14% except for 2019 where the ratio spiked up to 26.87%. As most REITs, Realty Income went on an acquisition spree after 2020 due to lower interest rates and the expansion in the economy, that resulted in that ratio reaching an average of 28.68% for 2021 and 2022. We believe that acquisitions will decrease going into the future for a few reasons. First of all, the growth in acquisitions for the past two years has been abnormal and the economic conditions will not be as favorable in the future. With rising interest rates the cost of borrowing has been increasing vastly and the industry has been slowing down on acquisitions this year and the level of acquisitions might decrease even further in 2023 and 2024. Also, when interest rates increase the spread between the cost of debt and cap rates reduces making investments riskier. In addition, Realty Income fund acquisitions largely by issuing common stock, resulting in shareholders getting diluted as historically they have invested more than they receive in dividend payments which we believe is unsustainable. Finally, due to the merger with VEREIT and recent acquisitions, the company has grown significantly since 2020 and we believe that the growth will slow down at a fast pace in order to compensate their shareholders with less capital needs and because of recent acquisitions will boost earnings significantly in the upcoming years. Therefore, we estimate that acquisitions as a percentage of net real estate held for investment will reach the pre-pandemic average of 14.62% after 2023, and slowly decline until it reaches 8% in 2030. With our projected acquisitions the level of dividends will slightly surpass the equity capital needs in 2024.

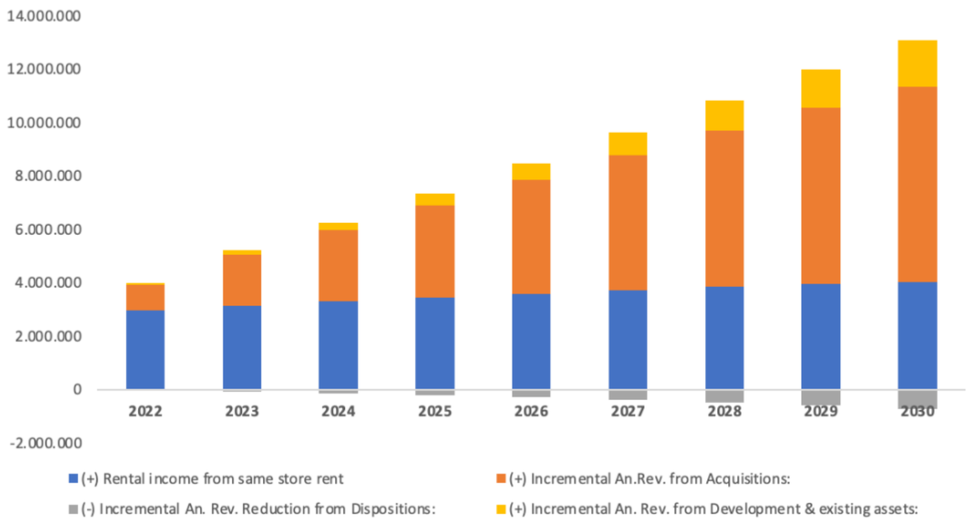
We estimate the cash cap yield on new acquisitions going forward as the historical yearly average since 2024. That results in a cash cap rate of 6.2% which is slightly higher than the current rate of 5.9% that they are yielding on their acquisitions. However, as Realty Income usually has lease agreements for a duration of longer than 10 years, they will still benefit from their previous investments at higher cash cap rates and the growth in housing prices is estimated to slow down which will push cap rates at higher levels. Further, we estimate that the NOI margin will remain the same in 2023 as in 2022 at 41.55% and increase to the pre-covid average of 50% in 2024.

Development: In addition to acquisitions, Realty Income invests in development projects and in their existing properties. Realty Income has a team focused on identifying and exploiting opportunities to develop properties for new or existing clients. By investing in development projects, Realty Income is able to find opportunities that often yield better returns than traditional acquisition but those investment often bear higher risk as well. However, Realty Income tries to make lease agreements with tenants before development has begun in order to mitigate the risk of the new properties not being occupied when finished.

The same bottom-up approach was used to calculate the incremental revenue from development projects as for the acquisitions, that is, by implementing appropriate cap rates and NOI margins for each of the projected years. As development projects can be riskier than traditional acquisition investments, they have usually had higher cash cap rates. However, as for the acquisitions, the cash cap rate has been decreasing, which usually implies that those investments are getting less risky. The average cash cap rate for development projects is 7.1% from 2014 until Q3 2022 where the average cash cap rate in FY2014 was 9.7%. For the NOI margins, the same values are used as for acquisitions in order to calculate the implied incremental revenue from development projects. Further, the growth in development projects and investments in existing properties are projected separately but they yield the same cash cap rate. We project that investments in development projects will increase in 2023 by the annual CAGR of 25.47% and from there the growth will decrease until it reaches the terminal growth value of 2.5%. The same method was used to project investments in existing properties, i.e., the CAGR for 2023 which is at 14.26%, which then decreases at a stable rate until reaching the terminal growth rate. The same cash cap rate was applied for investments in development projects and investments in existing properties, which is the yearly average cash cap rate of 7.1%.

Dispositions: It is also important to project the revenues that are lost due to dispositions of real estate properties owned by Realty Income. For the past years, Realty Income has been selling more real estate as they grow and especially for the past three years. However, those dispositions are only a small proportion relative to the acquisition they make each year, averaging about 8% of acquisitions. In order to achieve the lost revenue each year due to dispositions, we project how much the company will sell each year worth of real estate. Then the book value of those sales is estimated by deducting projected gain on those sales. By applying the appropriate cash cap rate and NOI margin for each year, the implied revenue reduction from those sales can be calculated. We believe that Realty Income will continue to sell more properties as they grow. We project that the dispositions will grow in 2023 by the CAGR of 19.4% and will eventually reach the terminal growth rate of 2.5%. Further, in order to estimate the book values of the sold properties, we use the historical arithmetic average gain on sale ratio of 22.6%. Additionally, the same cap cash rate and NOI margins were applied as for acquisitions.

Exhibit 9: Forecasted Annual Incremental Revenues & Reduction



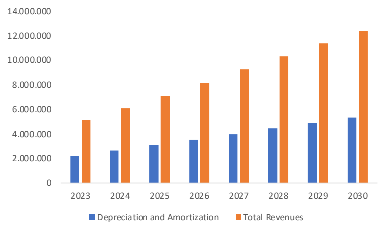
Source: *Own Analysis*

Cost structure

COS: REITs usually have rather low cost of sales (COS) since they are not selling or manufacturing goods. For REITs, COS consists of expenses that are directly related to the leased properties, properties for sale and general portfolio expenses. Those expenses mainly include maintenance, property taxes, utilities, insurance, legal fees, and property inspections. Realty Income does not recognize COS in their annual reports; however, they consider an item called property costs equivalent to COS. The fact that most of Realty Income's properties are leased under triple-net lease agreements, most of the operating expenses are passed onto their tenants which lowers their property expenses even further and reducing their exposure to rising costs. Since 2014 property costs have remained rather close to the historical average of 5.76% as a percentage of revenues, however those costs have been increasing slightly since 2020 and in the last reported quarter they were 6.3% of revenues. Since property costs have remained consistently close to the historical average of 5.76% of revenues, we use that as our estimate for the projected years.

G&A: General and Administrative expenses are costs associated with the operations of the company. They mainly include employee expenses, professional fees and other general overhead expenses related to day-to-day operations. As for the property costs, we also project G&A as a percentage of revenues. Further that ratio has remained rather stable for the past years resulting in an average of 4.95% which we use for our projected G&A expenses for the projected years. That ratio is rather low compared to other companies, and we believe the that is the result from excellent management skills and economies of scale.

Exhibit 10: Forecasted Depreciation & Amortization

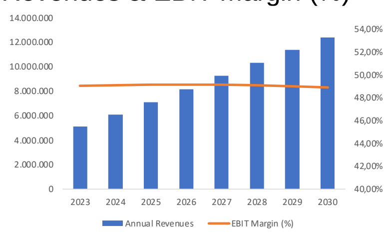


Source: *Own analysis*

Depreciation and Amortization: In order to project Depreciation & Amortization (D&A), we considered to calculate it as a percentage of net real estate held for investment, however that ratio has proven to fluctuate a lot through history. Instead, we estimate D&A as a percentage of revenues since that ratio has been very stable historically, with an average of 43.05%, which makes it by far the largest expense item on the income statement. Further, as the revenues for the company will increase as Realty Income invests in more properties, the D&A will increase as well as shown in Exhibit 10.

Operating Performance

Exhibit 11: Forecasted Revenues & EBIT margin (%)



Source: *Own analysis*

As a result of the revenue projections, the CAGR in revenue from 2023 until 2030 will be 11.64%, compared to a CAGR of 21.09% from 2012 until 2022. That makes sense since we project that the company will slow down on its investments and thereby its revenue growth will slow down, decreasing from 56.4% in 2023 to 8.8% in 2030. When looking at FFO, which is an accurate measure of REITs earnings, the evolution will be similar as for the revenues, where the CAGR was 24.8% from 2012 until 2022 and decreases to 12.9% from 2023 until 2030. The NOI margin will remain very stable until 2030 based on our projections, ranging from 48.90% to 49,13%, which is very consistent with the historical average. This is an expected result since our operating expenses are projected as a percentage of revenues. Further, when we look at the company's ability to generate value, we look at how much the company earns as NOI on its properties, which is an average cap rate generated from all its properties each year. Since we estimate that growth in acquisitions will slow down, while revenues will grow each year from previous investments, the average cash cap rate will increase each year going forward, from 5.9% in 2023 to 11.61% in 2030. It is worth to mention that this is not the return that Realty Income earns on new acquisitions but on all its investments on a yearly basis, similarly, to return on invested capital.

Capital Expenditures

Exhibit 12: Historical Fixed Assets & Intangible Assets

Source: *Company´s report and own analysis*

Since Real Income operates in a capital-intensive industry, they spend a significant amount on capital expenditure (CAPEX) each year. From 2012 until 2021, Realty Income spent on average 182% of revenues on investments in CAPEX. Consequently, Realty Income´s fixed assets (such as land and buildings) rose from 5$ billion to 32$ billion as the company concentrated on growth through acquisitions (Exhibit 12). The large increase in assets from 2020 to 2021 is due to the merger with VEREIT.

As previously mentioned, we assume that the company´s acquisitions will slow down in the upcoming years due to unfavorable economic conditions and our belief that the company will slow down its growth. As a result, we estimate that the Net real estate held for investment (similar to Net PP&E) will grow at a slower rate.

We forecast our Total real estate held for investment (Gross PP&E) based on the previous year´s balance plus any acquisitions and developments in existing properties made by the company. Furthermore, we account for divestments by subtracting all proceeds from asset dispositions made by the company in the following year. Eventually, we estimate Net real estate held for investment by deducting accumulated depreciation. Based on this, we forecast CAPEX by calculating the difference between Total real estate held for investment each year, which is simply all transactions that the company made in the following year regarding acquisitions, dispositions, and developments in existing properties.

Exhibit 13: Total Capital Expenditure.

Source: *Own analysis*

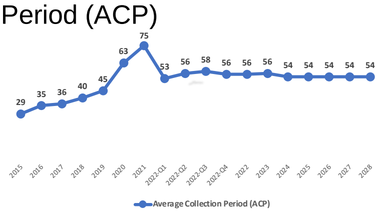
As Exhibit 13 demonstrates, we estimate that CAPEX will gradually rise through 2026 as the company will maintain a certain level of acquisitions. However, from 2027, the company will reduce its level of acquisitions and put more of an emphasis on making investments in already-existing assets. Finally, as the company eventually slows down its expansion and focuses more on maintenance CAPEX, its total CAPEX will decrease.

Net Working Capital

Net Working Capital (NWC) is one of the most important value drivers for Realty Income since it measures the company´s operating liquidity, efficiency, and financial health. The following accounts were included in the NWC calculations:

Operating Cash, Accounts Receivable, and Accounts Payable & Accrued Expenses.

Exhibit 14: Historical & Forecasted Average Collection Period (ACP)



Source: *Company´s report and own analysis*

We forecast Accounts Receivable as Average Collection Period (ACP), which is determined by Realty Income´s revenues. Historically, the ACP has been increasing, particularly during FY 2020 and FY 2021 due to the COVID-19 pandemic. During those years, many industries took a big hit, including industries in which Realty Income clients operated. As a result, the ACP rose to 63 days in FY 2020 and 75 days in FY 2021. However, the ACP has been decreasing again although still being higher than the ACP before the pandemic as many companies are still recovering from the impacts of the pandemic. As a result, we expect the company to maintain the current level of ACP (56 days) for the following year and then a slight decrease (54 days) as Realty Income clients will fully recover from the pandemic and improve their financial health. From there, we assume that the ACP will be steady as the company will become more efficient in the collection process in case of some economic downturn (Exhibit 14). However, we still assume that the ACP level will be higher than pre-covid since the company will grow and have more customers.

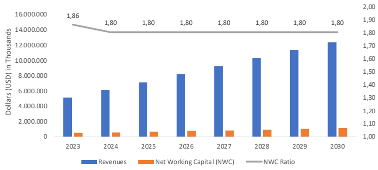
We forecast Accounts Payable and Accrued Expenses as a percentage of COS. The company´s COS is relatively small from one year to another in comparison to Accounts Payable and Accrued Expenses, which indicates that calculating the Average Payable Period based on COS would give an inaccurate picture of how long it takes the company to pay off its obligations to vendors. Therefore, following the Mckinsey[9] recommendations, we chose to forecast the item as a percentage of COS. When looking at the past years, the company´s Accounts Payable and Accrued Expenses have been increasing, especially during the COVID-19 pandemic since companies were given more time to pay their obligations. As a result, we forecasted these items using an 8-year historical average. However, we exclude the years impacted by the COVID-19 pandemic (FY 2020 & FY 2021) as we do not expect these economic conditions to happen in the near future.

Realty Income does not disclose how much cash is necessary for operations, although they do state that the majority of their cash amount is treated as working capital. We decided to avoid using the general “rule of thumb” to determine the company´s operating cash and excess cash. The rule implies that operating cash should be 2% of revenues. The disadvantage of such an approach is that it treats large and small companies in all industries equally, making no distinctions between

[9] Koller, Goedhart and Wessels. 2005. *Valuation: Measuring and Managing the Value of Companies*. Mckinsey & Company.

businesses. As a result, we decided to follow an alternative approach where we take the industry average to determine the amount of operating cash. According to an article from Damodaran[10], companies in the REIT industry hold on average 1.57% of Total Assets as operating cash, and any cash balance higher than the industry average is treaded as excess cash. Based on this rule, Realty Income´s historical and current cash balance can only treat its total cash as operating cash, with no room for excess cash. As a result, we decided to treat all of Realty Income´s cash balance as working capital, which is somewhat consistent with the company´s statement. The forecast driver for Realty Income´s operating cash is revenues, and we use the 4-year historical average to compute the future cash holding of the company. However, we exclude FY2020 due to a large outlier in the cash balance that year. Although Realty Income does not provide an explanation for such a high cash balance, we strongly believe that it was reserved as some kind of precautionary cash due to the COVID-19 pandemic.

Exhibit 15: Revenues, NWC & NWC Ratio.



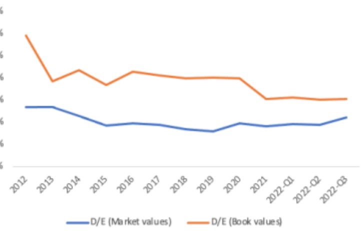
Source: *Own analysis*

To conclude, based on our projections, NWC will be steady in relation to revenues, averaging 9% of revenues in the following years. The NWC ratio, which measures the company´s current assets against its short-term liabilities, is expected to have a ratio of 1.86 for FY 2023. In the years after, the NWC ratio will decrease and maintain a steady ratio of 1.80 (Exhibit 15). As a result, we expect Realty Income to maintain strong liquidity and good Net Working Capital Management in the foreseeable future.

Capital Structure

Historically, Realty Income´s capital structure consisted of both debt and equity, and since FY 2012, the company´s Debt-to-Equity Market Values (D/E) ratio has ranged from 32% to 53%, with an average of 40.7%. With regard to the D/E ratio based on book values, the ratio has been relatively higher compared to the D/E ratio based on market values. The company´s D/E book ratio in FY 2012 was 118.9% but since then, the ratio has been decreasing relatively fast and as of FY 2021, the company has maintained a D/E ratio close to 61%. Exhibit 16 depicts that both D/E ratios have been decreasing since FY 2012. Moreover, Realty Income has announced that common stock should be the majority of its capital structure over the long term. As a result, we believe that the company will not make significant changes to its capital structure.

Exhibit 16: D/E Ratio Based on Market & Book Values.



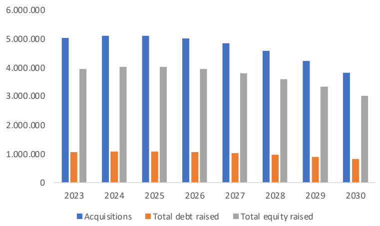
Source: *Company´s Report & Own analysis*

We assume that the company´s D/E book ratio will vary close to 60% for the following years, which is in line with the current D/E ratio. In addition, we expect

[10] Damodaran, Aswath. "*Dealing With Cash, Cross Holdings and Other Non-Operating Assets",* Sept. 2005.

the company to continue paying attractive dividends to its shareholders. Historically, Realty Income has distributed on average 85.3% of FFO as dividends and we assume that the company will maintain this ratio going forward. In addition, we assume that the company will continue to issue equity and debt to finance future acquisitions, which is in accordance with the company's strategy. In order to forecast future equity and debt issuance, we look at the company´s historical capital raised. Based on a 9-year historical average, Realty Income issued on average 78.70% of total capital raised as equity and 21,30% as debt. As a result, we expect the company to maintain this level in the future as they finance new acquisitions. According to Exhibit 17, the company´s external funding will be relatively high for the next few years, where they mainly raise equity to fund its growth. However, as the company slows down its acquisitions, Realty Income will not require as much external funding.

Exhibit 17: Forecasted Equity and Debt Issuance



Source: *Own analysis*

Realty Income has an attractive historical Interest Coverage Ratio (ICR), ranging from 2.2 to 2.5 (Exhibit 18). We expect that the company will continue to maintain this attractive ICR, particularly as it seeks to keep a conservative debt level on its balance sheet in the upcoming years. Consequently, the company´s ability to pay interest on its outstanding debt in the future should be of no worry to them.

In addition, Realty Income entered a new $4.25 billion revolving credit facility and restated the previous $3.0 billion credit facility in April 2022. The company expects to finance its future acquisitions with the help of its credit facility. As a result, the company will incur higher interest costs due to the higher amount of existing loans in the upcoming years, which we take into account. However, this pre-approved loan had no effect on the company´s credit rating and no major impact on its capital structure as the company still continued to issue equity.

Valuation

To value Realty Income, we chose to follow a Discounted Cash-Flow approach (DCF). The forecast period used to value the company is 8 years, from 2023 to 2030 as we believe that the company is operating in a well-known and established market.

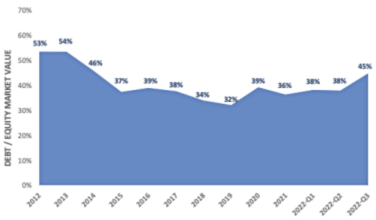
Discount Rate

To calculate the company´s value it is necessary to estimate an accurate discount rate that discounts the value of all future cash flows. To value the company, we use a Weighted Average Cost of Capital ("WACC") as our discount rate since we believe that there will be no significant changes to Realty Income´s capital structure. WACC is mainly based on two components, cost of equity and cost of debt. Since these components have a substantial impact on our valuation, we will provide reasonings and assumptions for each component in the following subchapters.

Cost of equity

To determine the cost of equity, we use the most common methodology, which is based on Capital Asset Pricing Model (CAPM) and is determined by three factors: the risk-free rate, the equity market risk premium (MRP), and the company´s beta (based on company´s industry beta). Since Realty Income is located in the U.S., we use the yield of the U.S. 10-year Treasury Bond as an approximation for the **risk-free rate**, which is equal to 3.58%[11]. For the estimation of **market risk premium**, we use 6.00% MRP[12] which is based on KPMG recommendations. The corresponding MRP is calculated using four markets (*AEX, S&P 500, FTSE, and STOXX 600*), where S&P 500, FTSE and STOXX 600 are given more weights. For the **beta estimation**, we start by regressing the company´s stock returns against MSCI World Index using monthly 5-year historical returns since more frequent return periods can lead to systematic biases[13]. We do that since one of the assumptions in the CAPM is that investors are globally diversified, and most of Realty Income's investors are investing globally. Realty Income´s regression beta with respect to MSCI World Index was 0.739. However, the regression´s R-squared was only 30.29% and the standard error of the beta was 0.15 which indicates that the true beta lies between 0,45 and 1,03 (at a 95% confidence interval) – which is not exactly a tight range. In order to improve the precision of the beta, we use six peers of Realty Income (all operating in the same sector, and all have similar risks). Firstly, we regress each company´s historical stock returns against MSCI World Index to determine regression beta. Secondly, we unlever each company´s beta by using their current Debt-to-Equity ratio. Thirdly, we calculate the average unlevered beta for Realty Income peer´s, resulting in a beta of 0.73. In the final step, we re-levered Realty Income´s beta based on the company´s target debt-to-equity ratio and the peer´s average unlevered beta. According to the company, they seek to maintain a conservative debt level on its balance sheet, therefore it is reasonable to assume that the average historical debt-to-equity ratio (Exhibit 19) based on equity market values, can reflect the target debt-to-equity ratio for Realty Income. As a result, using the target D/E ratio

Exhibit 19: Historical Debt-to-Equity Market Value.



Source: *Company report and own analysis*

[11] Data gathered from Bloomberg
[12] KPMG Equity Market Risk Premium, as of 30 September 2022 (last update).
[13] Koller, Goedhart and Wessels. 2005. *Valuation: Measuring and Managing the Value of Companies*. Mckinsey & Company.

Exhibit 20: Capital Asset Pricing Model

CAPM	
Risk-free rate (10-year)	3,58%
Market Risk Premium	6,00%
Beta	1,03
Cost of Equity	**9,75%**

Source: *Own analysis*

of 40.7% and the peer´s average unlevered beta of 0.73, we observe a levered beta of 1.03 for Realty Income.

Following these detailed calculations and assumptions, we estimate the company´s cost of equity by applying the CAPM formula. As Exhibit 20 shows, Realty Income´s cost of equity is 9.75%.

Cost of Debt

We estimate the cost of debt based on Realty Income´s credit rating and probability of default/loss given default. Based on Bloomberg, we chose 10-year Realty Income Corporate bond (Senior Unsecured) as a proxy for the company´s yield on long-term debt (5.406%). Given the current credit rating of A3 (Moody´s credit rating) for the company, we estimate an annual default rate of 0.18%[14]. To determine the recovery rate and loss-given default, we look for data on defaulted senior unsecured corporate bond recoveries, which is 51.10%, corresponding to a loss-given default of 48.90%. By entering these inputs into the following formula, we reach to cost of debt of 5.32%.

$$Cost\ of\ Debt = YTM - Annual\ Probability\ of\ Default * Loss\ Given\ Default$$

WACC

Exhibit 21: Weighted Average Cost of Capital

WACC	
Cost of Equity	9,75%
Cost of Debt	5,32%
E/V	71,1%
D/V	28,9%
Tax Rate	0,0%
WACC	**8,47%**

Source: *Own analysis*

Having calculated all the variables required to compute the WACC calculations, we reach a discount rate of 8.47% (Exhibit 21), using a D/E ratio of 40.7% and by assuming a tax rate of 0%. Since Realty Income is entitled to pay at least 90% of its taxable income as dividends, the company can pass the tax burned on to its shareholders, instead of paying federal income tax itself, therefore we assume a tax rate of 0%.

Valuation Outcome

As previously mentioned, we use the Discounted Cash-Flow (DCF) method to estimate the value of Realty Income. In this method, the company´s future free-cash-flows are discounted by using a relative discount rate (WACC).

Based on our calculations, the company´s free cash-flows have been negative for the previous few years, and we assume that this trend will continue through the end of the fiscal year 2023. From there on, the company will deliver positive cash-flows with an upward trend. Throughout the past years, Realty Income has been

[14] Moody´s report on default rates.

growing at a fast pace, acquiring real estate properties both in the U.S. and European market, where each acquisition is financed with external funds, thus, the company constantly issued more debt and equity to finance these investments. In addition, Realty Income successfully acquired VEREIT in an all-stock transaction in 2021. As a result, due to high investments in CAPEX in recent years, we estimate that the company will generate positive free cash-flows for the first time in 2024, mainly because the company´s increased revenues will offset the cost of investments in CAPEX.

However, it is important to note that even though Realty Income´s free cash-flows are negative according to the traditional DCF approach, the company is still generating cash for its shareholders since most of the CAPEX investments are funded externally, i.e., the CAPEX investments do not impact the company's ability to generate cash flows available to their shareholder since they are not taking capital out of the company and reinvesting it in new projects, which would reduce the funds available for distribution. Furthermore, their true earnings are captured through Adjusted Funds from Operations (AFFO), instead of Net Income. The reason why Net Income does not capture the true earnings is due to the high depreciation cost that is associated with real estate properties. Since real estate properties usually appreciate in value, the company´s Net Income is therefore an inaccurate measure of its true earnings. However, the term AFFO is considered a more appropriate measure of Realty Income´s operating performance since it adds back real estate depreciation, excludes gains/losses from real estate sales, and only considers recurring CAPEX, therefore making it a more appropriate measure of the company´s earnings.

For the Terminal value, we compute the growth rate (g) based on the growth rate of the U.S. economy. Realty Income pays out more dividends to its shareholders than it earns in net income each year, and the company is constantly issuing new debt and equity to fund acquisitions. As a result, the company´s historical reinvestment rate (RR) has been very close to 0%, and we expect it to remain so in the future. Having said that, we were unable to estimate the g based on RR and ROIC. To compute the g, we chose to follow an alternative approach where we estimate g based on the growth rate of the U.S. economy. Since 1990, the average annual GDP growth rate has been approximately 2.50%[15]. Unless a company is experiencing rapid growth, its g cannot exceed the rate of economic growth. Since Realty Income is already a mature company, we assume that its g will grow at the same pace as the economy. As a result, we expect Realty Income´s stable growth

[15] "Gross Domestic Product." Gross Domestic Product (GDP) | FRED | St. Louis Fed, 30 Nov. 2022, fred.stlouisfed.org/series/GDP.

Exhibit 22: Firm Value, Target price (FY2023) & Expected Gain

Final Value of RI & Expected Gain	
Enterprise Value	**$73.805.182**
Net Debt	$17.638.765
Non-Controlling Interests	$127.138
Equity Value	**$56.039.279**
Number of Shares (million)	688.532
Target Share Price	**$81,39**
Expected Capital Gain:	
Target Share Price	$81,39
Current Share Price	$64,40
Expected Capital Gain	**26,38%**
Expected Cash Gain:	
Dividend Yield	**5,96%**
Share Dilution	**-7,1%**
Total Expected Gain	**25,29%**

Source: *Own analysis*

rate to be 2.5% for the terminal value. In addition, the company´s growth rate will be challenged further in the sensitivity analysis.

To conclude, based on our forecast we arrive at an Enterprise Value of 73.8 billion USD, after subtracting Net Debt and Non-Controlling Interests as of FY 2023, we arrive at an Equity value of 56 billion USD. By assuming that the company will continue to issue equity and pay dividends, our estimated shares outstanding as of FY2023 is 688,531,509 million, which corresponds to a target price of 81.39$ per share. Given that the current share price of Realty Income is 64.40, this corresponds to an expected capital gain of 26.38% and a dividend yield of 5.96%. Since we expect the company to continue issuing shares, we factor in a 7.1% share dilution. As a result, the total expected gain over twelve months is 25.29%, resulting in a **BUY** recommendation (Exhibit 22).

Multiples Analysis

To further explore the fair value of Realty Income, we decided to compare the company to its peers by applying the Multiple approach. By identifying firms that operate in the same Sub-Industry (Retail REITs) and geographic region, facing similar risks, with similar capital structure and growth rate, we decided to follow the analysis with 6 companies *(Kimco Realty Corp., Regency Centers Corp., Store Capital Corp., Federal Realty Investment Trust, National Retail Properties and Agree Realty Corp.)*.

We excluded Simon Property Group (SPG) from our analysis although SPG is one of Realty Income´s main competitors. When comparing Realty Income´s and SPG´s profitability, SPG has a significantly higher Return on Invested Capital (ROIC), SPG´s ROIC is 10.14% while Realty Income´s ROIC is 2.79%[16]. By carefully examining the company, it becomes clear that SPG has been reducing the number of properties owned over the past few years. This shows that the management team of SPG is focusing more on delivering higher returns instead of promoting growth, contrary to Realty Income. Additionally, the capital structure of SPG is different from Realty Income, SPG has a significantly higher leverage ratio, and their Total Debt-to-Total Asset (D/A) ratio is 76.66% in comparison to Realty Income´s 36.66% D/A ratio[17]. Due to the fact that SPG and Realty Income do not share the same risk profile and capital structure, despite operating in the same sub-industry and geographic region, we decided to exclude the company from our analysis.

[16] Based on December 2022 numbers from Bloomberg.
[17] Based on December 2022 numbers from Bloomberg.

Since all Realty Income peer´s operate within the REIT sector, we chose to proceed the analysis with REIT-specific multiples. We found that the most relevant multiples for the analysis would be Price-to-Funds from Operations (**P/FFO**) and Enterprise Value-to-EBITDA (**EV/EBITDA**). We were unable to use Adjusted Funds from Operations (AFFO) instead of FFO, even though the former is considered to be a superior financial performance measure of REIT companies, since it takes into consideration the maintenance cost of real estate property, while FFO ignores it. Unfortunately, AFFO is defined differently from one company to another, and in some cases, they exclude it from their financial statements due to inconsistency in calculations that varies between companies. As a result, we based our multiples analysis on FFO instead of AFFO. We proceeded the analysis with P/FFO ratio which is a substitute for P/E ratio in REIT analysis, the main reason for that is due to depreciation expenses in the earnings calculations. For most companies, depreciation is considered an expense. However, since real estate properties typically appreciate, accounting depreciation as an expense would not accurately reflect the company´s earnings. Similarly, we proceeded the analysis with EV/EBITDA rather than EV/EBIT. In asset-intensive industries such as the real estate industry, companies are often highly leveraged, and their depreciation expenses are usually high. In those cases, EBITDA is considered to be a more reliable profitability metric which gives a better picture of the financial performance.

Exhibit 23: EV/EBITDA and P/FFO Multiples range

Range	EV/EBITDA	P/FFO
Maximum	24,7 x	20,1 x
75th Percentile	23,5 x	17,3 x
Average	**21,2 x**	**16,3 x**
Median	**21,3 x**	**15,8 x**
25th Percentile	**18,5 x**	**15,0 x**
Minimum	**17,9 x**	**13,7 x**

Source: *Own analysis*

Based on Trailing Twelve-Month earnings and data from most recent financial statements, both P/FFO and EV/EBITDA multiples concluded a relatively wide range of results. According to Exhibit 23, the EV/EBITDA multiple varies from 18.5x in the lower 25th percentile to 23.5x in the upper 75th percentile, and the P/FFO multiple ranges from 15.0x to 17.3x, respectively. Following this, we estimate Realty Income´s share price by applying the median approach, as recommended. This led to an implied share price of 66.57$ through the EV/EBITDA multiple after subtracting debt and minority interests, and 53.78$ through the P/FFO multiple (Exhibit 24). A wide share price discrepancy could be explained by the fact that five out of six comparables presented lower P/FFO, which was not the case for EV/EBITDA. As a result, due to large differences in companies' size and scales as well as multiples and share prices, it is reasonable to conclude that the comparable valuation does not lead to meaningful findings.

Exhibit 24: Realty Income´s Implied Share Price

EV/EBITDA	
Median EV/EBITDA	21,3 x
RI TTM EBITDA	2.736.500
Shares Outstanding	627.154
EBITDA Per Share	4,36
Implied Share Price	**66,57**

P/FFO	
Median P/FFO	15,8 x
RI TTM FFO	2.134.530
Shares Outstanding	627.154
FFO Per Share	3,40
Implied Share Price	**53,78**

Source: *Own analysis*

NAV

In addition to the multiple valuation, we also estimate the net asset value (NAV) of Realty Income. The NAV method is a way to provide accurate estimations of the market values of the company's real estate assets. The first step to calculate the NAV is to estimate forward looking NOI and since we have already projected the

Exhibit 25: Realty Income´s Equity Value per share.

Net Asset Value	
NOI E2023	2.511.218
MV of Real Estate Assets (6% cap rate)	45.201.929
Total Assets	56.866.617
Total Debt	16.468.820
Equity Value per Share	**59,08**

Source: *Own analysis*

NOI for 2023, we use that as our estimation. The second step is to calculate the market value of the real estate assets of the company by applying the current market cap rate available to Realty Income. As of Q3 2022, they are capitalizing 5.9% on their acquisitions. However, we believe that growth in housing prices will slow down while rents will increase with the inflation, therefore we estimate a slightly higher cap rate of 6%. That results in market value of real estate assets of $45.2 billion compared to the book value of $34.2 billion. To find the total equity value, we add all other assets and deduct interest bearing debt, which results in an equity value of $40.4 billion or $59.08 per share. It is worth to mention that this calculation was performed to analyze the current market value of the company's real estate assets, meaning that this share price is not forward looking and does not capture future growth in acquisitions and earnings. Therefore, we believe that this share price is below fair value.

Sensitivity and Scenario Analysis

Exhibit 26: Sensitivity analysis – Levered Beta, Cost of Equity and WACC.

	Levered Beta				
	0,528	**0,778**	**1,028**	**1,278**	**1,528**
Cost of Equity	6,75%	8,25%	**9,75%**	11,25%	12,75%
WACC	6,33%	7,40%	**8,47%**	9,53%	10,60%

Source: *Own analysis*

There are certain input variables in our model that can influence the share price to a great extent and therefore we perform a sensitivity analysis to quantify those influences. Firstly, we test how changes in the levered beta impacts the cost of equity and WACC by increasing or decreasing the base beta (1.028) at a total interval of 0.5 (Exhibit 26).

As expected, these results show that with different values for the levered beta, both the cost of equity and subsequently the WACC is greatly influenced. As the WACC can have a great impact on the share price, we also test how changes in the WACC, and the terminal growth affect the share price of Realty Income. The terminal growth rate is also of great importance since it determines at which rate the free cash flows will grow beyond 2030.

Exhibit 27: Sensitivity analysis – WACC and Growth rate

		WACC						
	81,39	**7,0%**	**7,47%**	**7,97%**	**8,47%**	**8,97%**	**9,47%**	**9,97%**
Growth (g)	**1,50%**	99,68	87,32	76,92	68,04	60,39	53,73	47,89
	1,8%	106,84	93,14	81,71	72,05	63,77	56,61	50,36
	2,2%	115,00	99,69	87,06	76,47	67,48	59,75	53,04
	2,5%	124,38	107,11	93,05	**81,39**	71,57	63,19	55,97
	2,8%	135,27	115,61	99,83	86,89	76,10	66,98	59,16
	3,2%	148,07	125,42	107,54	93,09	81,16	71,17	62,68
	3,5%	163,33	136,88	116,41	100,11	86,83	75,82	66,55

As a result, the share price is greatly affected by these two inputs, ranging from $47.89 to $163.33, with an average share price of $86.70, which is very close to target share price.

It also important to analyze how the share price is affected by changes in cap rates for future acquisitions and development projects. The cap rate incorporates two of the risk factors mentioned before. Firstly, the cap rate tends to follow changes in interest rates and secondly, with higher quality tenants and therefore less risky cash flows, cap rates tend to be lower.

Exhibit 28: Sensitivity analysis – Development Cap rate & Acquisitions Cap Rate

		Development Cap Rate				
	81,39	**6,06%**	**6,56%**	**7,1%**	**7,56%**	**8,06%**
ACQ Cap Rate	**7,24%**	97,13	99,23	101,34	103,44	105,54
	6,74%	87,19	89,30	91,40	93,51	95,62
	6,2%	77,17	79,28	**81,39**	83,50	85,61
	5,74%	67,06	69,18	71,30	73,41	75,53
	5,24%	56,88	59,00	61,12	63,24	65,37

Source: *Own analysis*

As the Exhibit 28 shows, the share price is very sensitive to changes in the cap rate. However, this analysis only incorporates the effects the cap rate has on cash flows of the company but ignores the impact it has on the WACC. Since higher interest rates and subsequently higher cap rate means that the risk-free rate will increase and the therefore the WACC will increase as well, which has the opposite effects on the share price. That is, when interest rates rise, the cap rate on new investments will increase, resulting in higher earnings which increases the share price, but with increasing interest rates the WACC will also increase which pressures the share price down.

Exhibit 29: Sensitivity analysis – WACC and Cap Rate

		WACC				
		7,47%	**7,97%**	**8,47%**	**8,97%**	**9,47%**
Cap Rate	**7,24%**	131,46	115,00	**101,34**	89,83	**80,01**
	6,74%	119,34	104,07	91,40	80,73	71,63
	6,2%	114,31	92,95	**81,39**	71,57	63,19
	5,74%	94,79	81,95	71,30	62,33	54,68
	5,24%	**82,36**	70,75	**61,12**	53,02	46,11

Source: *Own analysis*

Exhibit 29 shows that if cap rates increase, the share price increases as well, while holding WACC constant: However, when WACC increases with rising interest rates, the share price decreases, countering the positive effects from higher cap rates. If the cap rate increases to 7.24%, the share price increases to $101.34, holding WACC constant. However, if the WACC increases to 8.06% with the rising interest rates, the share price falls to $80.01. On the contrary if lower interest rates pressure the cap rate down to 5.24%, the share price falls down to $61.12 holding WACC constant. However, if the WACC decreases to 7.47% with lower interest rates the share price increases to $82.36. Additionally, it is worth to mention that increasing cap rates could mean that the value of the properties has decreased which could have negative effects on the share price.

Moreover, it is important to test how the level of acquisitions and investment in development projects affects the share price, since if those level rise, the earnings of the company will increase in future which impacts the share price positively, however CAPEX is deducted from free cash flows, which negatively impacts the share price. These results show that with increased level in acquisitions and investment in development projects, the impact of CAPEX on the share price weights more than the impact of earnings since the share price decreases with increased activity.

Exhibit 30: Sensitivity analysis – Acquisitions, Development and Occupancy Rate

Acquisitions				
-10%	-5%	neutral	+5%	+10%
86,93	84,26	**81,39**	78,30	74,97

Development				
-10%	-5%	neutral	+5%	+10%
98,91	91,77	**81,39**	66,61	45,95

Occupancy rate				
95,0%	96,1%	97,3%	98,4%	100,0%
69,94	72,87	75,80	**81,39**	82,84

Source: *Own analysis*

Finally, we test the impact of changes in the occupancy rate on the share price. We test how the share price changes if the occupancy rate ranges from 95% to 100%. Exhibit 30 shows that with small changes in the occupancy rate, the share price of the company changes significantly. However, it is highly unlikely that the occupancy rate will be lower than 98%. For the past 10 years it has only once been lower, in 2012 when the occupancy rate was 97.2%.

It is still highly uncertain how the economic climate will evolve going forward. If the war continues to disrupt the U.S economy, and inflation remains high, it is likely that interest rates will stay high in order to fight the inflation. This scenario will probably slow down economic growth, possibly resulting in a recession or worst case, in a stagflation. According to the sensitivity analysis, this might keep cap rates at higher-than-normal levels, indicating riskier cash flows and high discount rates. Further, this might impact Realty Income's tenants in a hurtful way, decreasing their rent collections and possibly decreasing their occupancy rate. In such environment, the company might slow down on their investments at a faster pace than we project.

On the contrary, if the war will have limited effects on the economy, and the high interest rates will be effective on reducing inflation, it is likely that a healthy economic environment will be present in one or two years, with lower interest rates. This would likely result in lower discount rates and lower cap rates. Further this could possibly drive a higher investment level than we are estimating, and the occupancy rate would probably stay at a very high level.

Final Recommendation

With the significant growth of Realty Income in recent years, they have managed to expand their portfolio, which we believe will result in improved operating performance and an increase in earnings in the future. As the pandemic has passed, the company's tenant credit and occupancy rate have improved, and based on our projections, it is well-positioned to generate earnings and distribute dividends to its shareholders in the future, even in times of high inflation. It is worth mentioning that there is great uncertainty about how the economy will unfold going forward. However, Realty Income has proven to be resilient in such periods where it rarely has a significant impact on its operation.

Based on our DCF valuation, which we believe to be the most suitable method to determine the fair value of Realty Income, we expect that the target share price for Realty Income will be 81,39$ as of December 31, 2023. After considering an expected dividend yield of 5,96% and a share dilution of 7,1%, the total expected capital gain will be 25,29%, over a 12-month period. As a result, our final recommendation for Realty Income stock is **BUY**.

Appendix

Financial Statements

	Historicals								Projections							
Reformulated Income Statement ($ Thousands)	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23E**	**FY24E**	**FY25E**	**FY26E**	**FY27E**	**FY28E**	**FY29E**	**FY30E**
Core Operations																
Rental (including reimbursable)	1.018.880	1.100.517	1.212.306	1.321.546	1.484.818	1.639.533	2.064.958	3.235.081	5.120.315	6.086.540	7.106.241	8.163.231	9.238.665	10.311.375	11.358.343	12.355.326
(-) Cost of Sale	55.352	62.865	69.480	66.326	88.585	104.603	133.605	209.655	295.098	350.784	409.552	470.470	532.450	594.273	654.613	712.072
Gross Profit	963.528	1.037.652	1.142.826	1.255.220	1.396.233	1.534.930	1.931.353	3.025.427	4.825.217	5.735.756	6.696.688	7.692.761	8.706.215	9.717.102	10.703.730	11.643.254
(-) General and administrative	49.298	51.966	58.446	84.148	66.483	73.215	96.980	134.579	253.220	301.003	351.431	403.704	456.888	509.938	561.714	611.019
(-) Provisions for impairment	10.560	20.664	14.751	26.269	40.186	147.232	38.967	21.839	30.668	30.668	30.668	30.668	30.668	30.668	30.668	30.668
(-) Total Core Expenses	59.858	72.630	73.197	110.417	106.669	220.447	135.947	156.417	283.888	331.672	382.100	434.372	487.556	540.606	592.383	641.687
Core EBITDA	**903.670**	**965.022**	**1.069.629**	**1.144.803**	**1.289.564**	**1.314.483**	**1.795.406**	**2.869.009**	**4.541.329**	**5.404.084**	**6.314.589**	**7.258.389**	**8.218.659**	**9.176.496**	**10.111.348**	**11.001.567**
(-) Depreciation and amortization	409.215	449.943	498.788	539.780	593.961	677.038	897.835	1.642.953	2.204.549	2.620.557	3.059.589	3.514.675	3.977.703	4.439.558	4.890.329	5.319.580
Core EBIT	**494.455**	**515.079**	**570.841**	**605.023**	**695.603**	**637.445**	**897.571**	**1.226.056**	**2.336.780**	**2.783.528**	**3.255.000**	**3.743.714**	**4.240.956**	**4.736.938**	**5.221.018**	**5.681.987**
Operating taxes (property tax)	-3.169	-3.262	-6.044	-5.340	-6.158	-14.693	-31.657	-	-	-	-	-	-	-	-	-
NOPLAT	**491.286**	**511.817**	**564.797**	**599.683**	**689.445**	**622.752**	**865.914**	**1.226.056**	**2.336.780**	**2.783.528**	**3.255.000**	**3.743.714**	**4.240.956**	**4.736.938**	**5.221.018**	**5.681.987**
Non Core Operations																
Total non Core Result before taxes	**26.648**	**24.634**	**1.934**	**30.935**	**39.024**	**83.090**	**-181.523**	**125.697**	**174.438**	**204.654**	**235.769**	**266.624**	**295.871**	**322.062**	**343.752**	**359.624**
Taxes on non Core items	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total non Core results	**26.648**	**24.634**	**1.934**	**30.935**	**39.024**	**83.090**	**-181.523**	**125.697**	**174.438**	**204.654**	**235.769**	**266.624**	**295.871**	**322.062**	**343.752**	**359.624**
NPLAT	**517.934**	**536.451**	**566.731**	**630.618**	**728.469**	**705.842**	**684.391**	**1.351.753**	**2.511.218**	**2.988.181**	**3.490.769**	**4.010.338**	**4.536.827**	**5.059.000**	**5.564.770**	**6.041.611**
Financing																
Interest	-233.079	-219.974	-247.413	-266.020	-290.991	-309.336	-323.644	-511.567	-663.160	-629.258	-657.402	-685.854	-706.377	-726.658	-738.807	-741.192
Financing Result	**-233.079**	**-219.974**	**-247.413**	**-266.020**	**-290.991**	**-309.336**	**-323.644**	**-511.567**	**-663.160**	**-629.258**	**-657.402**	**-685.854**	**-706.377**	**-726.658**	**-738.807**	**-741.192**
Net income	**284.855**	**316.477**	**319.318**	**364.598**	**437.478**	**396.506**	**360.747**	**840.187**	**1.848.059**	**2.358.923**	**2.833.368**	**3.324.484**	**3.830.449**	**4.332.342**	**4.825.963**	**5.300.419**

	Historicals								Projections							
Reformulated Balance sheet ($ Thousands)	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23E**	**FY24E**	**FY25E**	**FY26E**	**FY27E**	**FY28E**	**FY29E**	**FY30E**
Core																
Operating cash	40.294	9.420	6.898	10.387	54.011	824.476	258.579	170.577	274.550	326.358	381.034	437.710	495.374	552.893	609.031	662.488
Accounts receivable, net	81.678	104.584	119.533	144.991	181.969	285.701	426.768	499.035	790.184	900.474	1.051.334	1.207.711	1.366.816	1.525.519	1.680.412	1.827.911
Accounts payable and accrued expenses	-115.826	-121.156	-109.523	-133.765	-177.039	-241.336	-351.128	-380.636	-572.003	-679.942	-793.856	-911.935	-1.032.074	-1.151.909	-1.268.868	-1.380.244
Operating Working Capital	6.146	-7.152	16.908	21.613	58.941	868.841	334.219	288.976	492.731	546.890	638.513	733.486	830.116	926.502	1.020.575	1.110.156
Total Real estate held for investment, net	10.609.117	11.877.216	12.669.825	13.826.932	16.399.997	17.466.152	31.959.130	35.472.973	38.435.409	41.141.578	43.501.621	45.426.825	46.831.910	47.637.384	47.772.129	47.176.413
Core Invested Capital (excluding Goodwill)	**10.615.263**	**11.870.064**	**12.686.733**	**13.848.545**	**16.458.938**	**18.334.993**	**32.293.349**	**35.761.949**	**38.928.140**	**41.688.468**	**44.140.134**	**46.160.311**	**47.662.027**	**48.563.886**	**48.792.703**	**48.286.569**
Goodwill	15.321	15.067	14.970	14.630	14.430	14.180	3.676.705	3.731.478	3.731.478	3.731.478	3.731.478	3.731.478	3.731.478	3.731.478	3.731.478	3.731.478
Core Invested Capital (including Goodwill)	**10.630.584**	**11.885.131**	**12.701.703**	**13.863.175**	**16.473.368**	**18.349.173**	**35.970.054**	**39.493.427**	**42.659.618**	**45.419.946**	**47.871.612**	**49.891.789**	**51.393.505**	**52.295.364**	**52.524.181**	**52.018.047**
Non-Core																
Lease intangible assets, net	1.034.417	1.082.320	1.194.930	1.199.597	1.493.383	1.710.655	5.275.304	5.509.804	5.927.277	6.618.531	7.321.842	8.027.780	8.726.309	9.406.961	10.059.069	10.672.089
Investment in unconsolidated entities	-	-	-	-	-	-	140.967	-	-	-	-	-	-	-	-	-
Real estate and lease intangibles held for sale, net	9.767	26.575	6.674	16.585	96.775	19.004	30.470	9.563	11.241	12.552	13.886	15.225	16.549	17.840	19.077	20.240
Other non-current assets	75.276	37.689	45.336	47.361	314.231	420.117	1.369.579	1.905.846	2.582.981	3.070.400	3.584.795	4.118.002	4.660.512	5.201.649	5.729.800	6.232.735
Distributions payable (divident payable)	-50.344	-55.235	-60.799	-67.789	-76.728	-85.691	-146.919	-291.987	-478.022	-587.534	-695.301	-807.096	-921.871	-1.036.379	-1.149.073	-1.257.508
Other non-current liabilities	-53.965	-85.616	-116.869	-127.109	-262.221	-256.863	-759.197	-746.530	-1.099.789	-1.307.324	-1.526.345	-1.753.375	-1.984.367	-2.214.774	-2.439.651	-2.653.792
Non-Core Invested Capital	**1.015.151**	**1.005.733**	**1.069.272**	**1.068.645**	**1.565.440**	**1.807.222**	**5.910.204**	**6.386.697**	**6.943.688**	**7.806.625**	**8.698.877**	**9.600.535**	**10.497.132**	**11.375.298**	**12.219.222**	**13.013.764**
Total funds invested (excluding Goodwill)	**11.630.414**	**12.875.797**	**13.756.005**	**14.917.190**	**18.024.378**	**20.142.215**	**38.203.553**	**42.148.646**	**45.871.828**	**49.495.093**	**52.839.011**	**55.760.846**	**58.159.159**	**59.939.184**	**61.011.925**	**61.300.332**
Total funds invested (including Goodwill)	**11.645.735**	**12.890.864**	**13.770.975**	**14.931.820**	**18.038.808**	**20.156.395**	**41.880.258**	**45.880.124**	**49.603.306**	**53.226.571**	**56.570.489**	**59.492.324**	**61.890.637**	**63.670.662**	**64.743.403**	**65.031.810**
Financials																
Short term & Long term Debt	4.841.486	5.839.605	6.111.471	6.499.976	7.901.547	8.817.467	15.442.637	16.563.459	17.638.765	18.798.534	19.955.999	21.051.370	22.061.052	22.961.999	23.725.138	24.319.145
Lease intangible liabilities, net	250.916	264.206	268.796	310.866	333.103	321.198	1.308.221	1.459.030	1.645.136	1.836.996	2.032.202	2.228.138	2.422.017	2.610.935	2.791.930	2.962.075
Noncontrolling interests	21.737	20.249	19.207	32.236	29.702	32.247	76.826	127.138	127.138	127.138	127.138	127.138	127.138	127.138	127.138	127.138
Net Financial Assets	**5.114.139**	**6.124.060**	**6.399.474**	**6.843.078**	**8.264.352**	**9.170.912**	**16.827.684**	**18.149.627**	**19.411.040**	**20.762.668**	**22.115.340**	**23.406.646**	**24.610.207**	**25.700.072**	**26.644.206**	**27.408.359**
Total stockholders' equity	6.531.596	6.766.804	7.371.501	8.088.742	9.774.456	10.985.483	25.052.574	27.730.497	30.192.267	32.463.903	34.455.149	36.085.678	37.280.430	37.970.590	38.099.198	37.623.452
Total Financing capital	**11.645.735**	**12.890.864**	**13.770.975**	**14.931.820**	**18.038.808**	**20.156.395**	**41.880.258**	**45.880.124**	**49.603.306**	**53.226.571**	**56.570.489**	**59.492.324**	**61.890.637**	**63.670.662**	**64.743.403**	**65.031.810**

				Historicals								Projections:				
Consolidated Cash Flow Map ($ Thousands)	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23E**	**FY24E**	**FY25E**	**FY26E**	**FY27E**	**FY28E**	**FY29E**	**FY30E**
NOPLAT	491.286	511.817	564.797	599.683	689.445	622.752	865.914	1.226.056	2.336.780	2.783.528	3.255.000	3.743.714	4.240.956	4.736.938	5.221.018	5.681.987
Core Invested Capital	10.630.584	11.885.131	12.701.703	13.863.175	16.473.368	18.349.173	35.970.054	39.493.427	42.659.618	45.419.946	47.871.612	49.891.789	51.393.505	52.295.364	52.524.181	52.018.047
Change in Core Invested Capital	-903.463	-1.254.547	-816.572	-1.161.472	-2.610.193	-1.875.805	-17.620.881	-3.523.373	-3.166.191	-2.760.328	-2.451.666	-2.020.177	-1.501.716	-901.860	-228.817	506.135
Core Unlevered FCF (Operating FCF)	**-412.177**	**-742.730**	**-251.775**	**-561.789**	**-1.920.748**	**-1.253.053**	**-16.754.967**	**-2.297.317**	**-829.411**	**23.200**	**803.335**	**1.723.537**	**2.739.240**	**3.835.079**	**4.992.201**	**6.188.122**
Non-Core Results	26.648	24.634	1.934	30.935	39.024	83.090	-181.523	125.697	174.438	204.654	235.769	266.624	295.871	322.062	343.752	359.624
Non-Core Invested Capital	1.015.151	1.005.733	1.069.272	1.068.645	1.565.440	1.807.222	5.910.204	6.386.697	6.943.688	7.806.625	8.698.877	9.600.535	10.497.132	11.375.298	12.219.222	13.013.764
Change in Non-core Invested Capital	50.243	9.418	-63.539	627	-496.795	-241.782	-4.102.982	-476.493	-556.991	-862.937	-892.252	-901.658	-896.598	-878.165	-843.924	-794.542
Non-Core Unlevered FCF (Non-Operating FCF)	**76.891**	**34.052**	**-61.605**	**31.562**	**-457.771**	**-158.692**	**-4.284.505**	**-350.795**	**-382.553**	**-658.283**	**-656.483**	**-635.034**	**-600.727**	**-556.104**	**-500.173**	**-434.918**
Total Unlevered FCF	**-335.286**	**-708.678**	**-313.380**	**-530.227**	**-2.378.519**	**-1.411.745**	**-21.039.472**	**-2.648.112**	**-1.211.964**	**-635.084**	**146.851**	**1.088.503**	**2.138.513**	**3.278.975**	**4.492.028**	**5.753.204**
Financing results before taxes	-233.079	-219.974	-247.413	-266.020	-290.991	-309.336	-323.644	-511.567	-663.160	-629.258	-657.402	-685.854	-706.377	-726.658	-738.807	-741.192
Net Financial Assets	-5.114.139	-6.124.060	-6.399.474	-6.843.078	-8.264.352	-9.170.912	-16.827.684	-18.149.627	-19.411.040	-20.762.668	-22.115.340	-23.406.646	-24.610.207	-25.700.072	-26.644.206	-27.408.359
Change in Net Financial Assets	-64.975	1.009.921	275.414	443.604	1.421.274	906.560	7.656.772	1.321.943	1.261.413	1.351.628	1.352.672	1.291.306	1.203.561	1.089.865	944.134	764.153
Financing Cash Flow	**-298.054**	**789.947**	**28.001**	**177.584**	**1.130.283**	**597.224**	**7.333.128**	**810.376**	**598.253**	**722.370**	**695.270**	**605.452**	**497.184**	**363.207**	**205.327**	**22.961**
Equity	6.531.596	6.766.804	7.371.501	8.088.742	9.774.456	10.985.483	25.052.574	26.897.424	29.578.555	32.551.190	35.297.271	37.779.633	39.916.127	41.612.772	42.796.553	43.399.617
Equity Issuance	-	-	-	-	-	-	-	1.298.517	3.952.721	4.016.674	4.014.593	3.943.656	3.803.625	3.596.984	3.328.981	3.007.596
Dividends Distribution to Shareholders	-	-	-	-	-	-	-	-465.444	-3.339.009	-4.103.960	-4.856.715	-5.637.612	-6.439.322	-7.239.166	-8.026.337	-8.783.761
Total Equity	6.531.596	6.766.804	7.371.501	8.088.742	9.774.456	10.985.483	25.052.574	27.730.497	30.192.267	32.463.903	34.455.149	36.085.678	37.280.430	37.970.590	38.099.198	37.623.452
Change in Total Equity	918.195	235.208	604.697	717.241	1.685.714	1.211.027	14.067.091	2.677.923	2.461.770	2.271.636	1.991.246	1.630.529	1.194.752	690.160	128.607	-475.746
Net Income	284.855	316.477	319.318	364.598	437.478	396.506	360.747	840.187	1.848.059	2.358.923	2.833.368	3.324.484	3.830.449	4.332.342	4.825.963	5.300.419
Total Financing CF	**335.286**	**708.678**	**313.380**	**530.227**	**2.378.519**	**1.411.745**	**21.039.472**	**2.648.112**	**1.211.964**	**635.084**	**-146.851**	**-1.088.503**	**-2.138.513**	**-3.278.975**	**-4.492.028**	**-5.753.204**

				Historicals								Projections				
Funds From Operations ($ Thousands)	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**	**FY26**	**FY27**	**FY28**	**FY29**	**FY30**
Net income available to common stockholders	256.686	288.491	301.514	363.614	436.482	395.486	359.456	840.187	1.848.059	2.358.923	2.833.368	3.324.484	3.830.449	4.332.342	4.825.963	5.300.419
Depreciation and amortization	409.215	449.943	498.788	539.780	593.961	677.038	897.835	1.642.953	2.204.549	2.620.557	3.059.589	3.514.675	3.977.703	4.439.558	4.890.329	5.319.580
Depreciation of furniture, fixtures and equipment	-811	-747	-557	-650	-565	-588	-1.026	-1.971	-1.971	-1.971	-1.971	-1.971	-1.971	-1.971	-1.971	-1.971
Provisions for impairment	10.560	20.664	14.751	26.269	40.186	147.232	38.967	21.839	30.668	30.668	30.668	30.668	30.668	30.668	30.668	30.668
Gain on sales of real estate	-22.243	-21.979	-40.898	-24.643	-29.996	-76.232	-55.798	-124.815	-174.438	-204.654	-235.769	-266.624	-295.871	-322.062	-343.752	-359.624
Proportionate share of adjustments for unconsolidated ent	-	-	-	-	-	-	1.931	13.946	7.939	7.939	7.939	7.939	7.939	7.939	7.939	7.939
FFO adjustments allocable to noncontrolling interests	-970	-977	-933	-1.113	-477	-817	-785	-1.433	-901	-901	-901	-901	-901	-901	-901	-901
Normalized FFO available to common stockholders:	**652.437**	**735.395**	**772.665**	**903.257**	**1.039.591**	**1.142.119**	**1.240.580**	**2.390.706**	**3.913.905**	**4.810.562**	**5.692.922**	**6.608.270**	**7.548.016**	**8.485.573**	**9.408.276**	**10.296.110**

Multiples Analysis ($ Thousands)	**Trading Multiples**		**Total value**		**Implied Share Price**	
Calculating implied share price	**EV/EBITDA**	**P/FFO**	**EV/EBITDA**	**P/FFO**	**EV/EBITDA**	**P/FFO**
Maximum	24,7 x	20,1 x	67.628.746	42.809.849	$ 81,57	$ 68,26
75th Percentile	23,5 x	17,3 x	64.172.742	36.915.447	$ 76,06	$ 58,86
Average	**21,2 x**	**16,3 x**	**57.886.539**	**34.826.640**	**$ 66,04**	**$ 55,53**
Median	**21,3 x**	**15,8 x**	**58.220.554**	**33.728.357**	**$ 66,57**	**$ 53,78**
25th Percentile	**18,5 x**	**15,0 x**	50.598.112	32.085.804	$ 54,42	$ 51,16
Minimum	17,9 x	13,7 x	49.035.277	29.177.182	$ 51,93	$ 46,52

Disclosures and Disclaimers

Report Recommendations

Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

This report was prepared by Anatoliy Axel Holoyad and Ymir Sigurdsson, a Master in Finance students of Nova School of Business and Economics ("Nova SBE"), within the context of the Field Lab – Equity Research.

This report is issued and published exclusively for academic purposes, namely for academic evaluation and master graduation purposes, within the context of said Field Lab – Equity Research. It is not to be construed as an offer or a solicitation of an offer to buy or sell any security or financial instrument.

This report was supervised by a Nova SBE faculty member, acting merely in an academic capacity, who revised the valuation methodology and the financial model.

Given the exclusive academic purpose of the reports produced by Nova SBE students, it is Nova SBE understanding that Nova SBE, the author, the present report and its publishing, are excluded from the persons and activities requiring previous registration from local regulatory authorities. As such, Nova SBE, its faculty and the author of this report have not sought or obtained registration with or certification as financial analyst by any local regulator, in any jurisdiction. In Portugal, neither the author of this report nor his/her academic supervisor is registered with or qualified under COMISSÃO DO MERCADO DE VALORES MOBILIÁRIOS ("CMVM", the Portuguese Securities Market Authority) as a financial analyst. No approval for publication or distribution of this report was required and/or obtained from any local authority, given the exclusive academic nature of the report.

The additional disclaimers also apply:

USA: Pursuant to Section 202 (a) (11) of the Investment Advisers Act of 1940, neither Nova SBE nor the author of this report are to be qualified as an investment adviser and, thus, registration with the Securities and Exchange Commission ("SEC", United States of America's securities market authority) is not necessary. Neither the author nor Nova SBE receive any compensation of any kind for the preparation of the reports.

Germany: Pursuant to §34c of the WpHG (*Wertpapierhandelsgesetz*, i.e., the German Securities Trading Act), this entity is not required to register with or otherwise notify the *Bundesanstalt für Finanzdienstleistungsaufsicht* ("BaFin", the German Federal Financial Supervisory Authority). It should be noted that Nova SBE is a fully-owned state university and there is no relation between the student's equity reports and any fund raising programme.

UK: Pursuant to section 22 of the Financial Services and Markets Act 2000 (the "FSMA"), for an activity to be a regulated activity, it must be carried on "by way of business". All regulated activities are subject to prior authorization by the Financial Conduct Authority ("FCA"). However, this report serves an exclusively academic purpose and, as such, was not prepared by way of business. The author - a Master's student - is the **sole and exclusive responsible** for the information, estimates and forecasts contained herein, and for the opinions expressed, which exclusively reflect his/her own judgment at the date of the report. Nova SBE and its faculty have no single and formal position in relation to the most appropriate valuation method, estimates or projections used in the report and may not be held liable by the author's choice of the latter.

The information contained in this report was compiled by students from public sources believed to be reliable, but Nova SBE, its faculty, or the students make no representation that it is accurate or complete, and accept no liability whatsoever for any direct or indirect loss resulting from the use of this report or of its content.

Students are free to choose the target companies of the reports. Therefore, Nova SBE may start covering and/or suspend the coverage of any listed company, at any time, without prior notice. The students or Nova SBE are not responsible for updating this report, and the opinions and recommendations expressed herein may change without further notice.

The target company or security of this report may be simultaneously covered by more than one student. Because each student is free to choose the valuation method, and make his/her own assumptions and estimates, the resulting projections, price target and recommendations may differ widely, even when referring to the same security. Moreover, changing market conditions and/or changing subjective opinions may lead to significantly different valuation results. Other students' opinions, estimates and recommendations, as well as the advisor and other faculty members' opinions may be inconsistent with the views expressed in this report. Any recipient of this report should understand that statements regarding future prospects and performance are, by nature, subjective, and may be fallible.

This report does not necessarily mention and/or analyze all possible risks arising from the investment in the target company and/or security, namely the possible exchange rate risk resulting from the security being denominated in a currency either than the investor's currency, among many other risks.

The purpose of publishing this report is merely academic and it is not intended for distribution among private investors. The information and opinions expressed in this report are not intended to be available to any person other than Portuguese natural or legal persons or persons domiciled in Portugal. While preparing this report, students did not have in consideration the specific investment objectives, financial situation or particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in any security, namely in the security covered by this report.

The author hereby certifies that the views expressed in this report accurately reflect his/her personal opinion about the target company and its securities. He/ She has not received or been promised any direct or indirect compensation for expressing the opinions or recommendation included in this report.

[If applicable, it shall be added: *“While preparing the report, the author may have performed an internship (remunerated or not) in* [insert the Company’s name]. *This Company may have or have had an interest in the covered company or security”* and/ or *“A draft of the reports have been shown to the covered company’s officials (Investors Relations Officer or other), mainly for the purpose of correcting inaccuracies, and later modified, prior to its publication.”]*

The content of each report has been shown or made public to restricted parties prior to its publication in Nova SBE’s website or in Bloomberg Professional, for academic purposes such as its distribution among faculty members for students’ academic evaluation.

Nova SBE is a state-owned university, mainly financed by state subsidies, students tuition fees and companies, through donations, or indirectly by hiring educational programs, among other possibilities. Thus, Nova SBE may have received compensation from the target company during the last 12 months, related to its fundraising programs, or indirectly through the sale of educational, consulting or research services. Nevertheless, no compensation eventually received by Nova SBE is in any way related to or dependent on the opinions expressed in this report. The Nova School of Business and Economics does not deal for or otherwise offer any investment or intermediation services to market counterparties, private or intermediate customers.

This report may not be reproduced, distributed or published, in whole or in part, without the explicit previous consent of its author, unless when used by Nova SBE for academic purposes only. At any time, Nova SBE may decide to suspend this report reproduction or distribution without further notice. Neither this document nor any copy of it may be taken, transmitted or distributed, directly or indirectly, in any country either than Portugal or to any resident outside this country. The dissemination of this document other than in Portugal or to Portuguese citizens is therefore prohibited and unlawful.

A Work Project, presented as part of the requirements for the Award of a Finance from the NOVA – School of Business and Economics.

The Leading Dividend Corporation

The Case of the Resilient Monthly Dividend Company

Ymir Sigurdsson & 51145

A Project carried out on the Master in Finance Program, under the supervision of:

Nuno Quartin Bastos de Vasconcelos

16.12.22

Abstract

The purpose of this equity research is to estimate the fair value of Realty Income's equity where the result is that we recommend investors to BUY shares of the company. The valuation is conducted with a discounted cash flow model, discounting the forecasted cash flows to firm at the weighted average cost of capital. The estimated fair price based on the valuation is $81.39 resulting in a total projected upside of 25.29%. The main aspect of this individual part is that Realty Income will slow down on investments and that the share price is sensitive to changes in key inputs.

Keywords:

Realty Income

Investments

Fair Value

Share Price

This work used infrastructure and resources funded by Fundação para a Ciência e a Tecnologia (UID/ECO/00124/2013, UID/ECO/00124/2019 and Social Sciences DataLab, Project 22209), POR Lisboa (LISBOA-01-0145-FEDER-007722 and Social Sciences DataLab, Project 22209) and POR Norte (Social Sciences DataLab, Project 22209).

This report is part of the equity report (annexed), developed by Ymir Sigurdsson and Anatoliy Axel Holoyad and should be read has an integral part of it.

Table of Contents

Introduction

The purpose of the joint report is to estimate the fair equity value of Realty Income one year from today, with the goal to recommend investors to **BUY**, **HOLD** or **SELL** shares of the company relative to the current share price. Further, we present a possible upside or downside for investors in the form of capital gain, dividend yield and dilution of shares based on our valuation. The valuation is performed using a discounted cash flow model to estimate the intrinsic value of Realty Income, where we calculate the future free cash flows to firm and discount those cash flows with a calculated weighted average cost of capital. The weighted average cost of capital is used as a discount rate since the company's capital structure is expected to remain stable in the future. In order to project the future cash flows, the most important value drivers for this research are projected with a bottom-up analysis, by thoroughly analysing the historical performance of the company, our beliefs on how the company will operate going forward, and by analysing how the economy might develop in the upcoming years. While most of the less important drivers are projected based on historical averages since they have proven to be stable throughout the years. Since the share price of Realty Income can fluctuate when the most important input variables in the model change, we perform a sensitivity analysis to analyse to which extent those variables influence the share price. In addition to the discounted cash flow model, a multiple and net asset value analysis is performed.

The discounted cash flow valuation results in a share price of $81.39 compared to the current share price of $64.40, with a total upside of 25.29%. Therefore, we recommend investors to **BUY** shares of Realty Income. We believe that the company will continue to grow their earnings and dividends while slowing down on CAPEX investments.

The structure of the joint report is as follows: The first chapter covers a description of Realty Income in general, its operations, business model and strategy, and their recent merger with VEREIT. The second chapter covers the industry and relevant macroeconomic discussion. The third chapter covers the main risk factors. Chapter four provides an analysis of the main value drivers of the company. Chapter five and six present the results from the valuation and sensitivity analysis while chapter seven covers the final recommendation and final result. In this individual report the sections that are covered are the description of Realty Income's business model and strategy. Overview of the industry and its outlook, relevant macroeconomic discussion, and risk factors. Analysis of Realty Income's revenue and cost forecast. Finally, the results from the net asset value analysis and the sensitivity analysis. The sections covered by my pair are the following: The description of the company, its ownership structure, dividend policy and the merger with VEREIT. The company's competitive positioning within the industry. Forecast for CAPEX, net working capital, the capital structure and operating performance going forward. Main results from the discounted cash flow, and multiple valuations, and the final recommendations.

Company Overview

Business Model

The business model of Realty Income is built on 4 main pillars. The first pillar is **high quality real estate**: Realty Income focuses on acquiring freestanding, single tenant commercial properties that are leased to high-quality clients under long-term (usually more than 10 years) triple net lease agreements. Triple net leases agreements allow the company to better preserve consistent cash-flows for its investors.

The second pillar is a **conservative capital structure:** Realty Income focuses on managing their balance sheet conservatively which means that they seek to keep their debt level not too high. Realty Income is committed to maintain their "A3" and "A-"credit rating which means they need to keep a conservative capital structure. By maintaining this credit rating the company has a competitive advantage for two reasons. Firstly, it secures that their borrowing rate on debt is more attractive than it would be otherwise. Secondly, their liquidity increases because they have more access to capital which is key for stability and growth. This secures that when there are opportunities, Realty Income can grab them and make fast acquisitions at a favorable price.

The third pillar is a **prudent growth strategy**: Realty Income is very focused on sustainable growth in order to increase its monthly dividends and generate stockholders return. First of all, Realty Income has been growing geographically with investments in the U.K and continental Europe. Also, the triple net lease business model is scalable across property types, which enables Realty Income to invest in new property types if good opportunities arise. Finally, Realty Income uses technology, data analytics and predictive analytics in order to seek opportunities and grow, this helps a lot when deciding on key business decisions.

The fourth pillar is **corporate responsibility**: Realty Income is dedicated to operate in a way that upholds the greatest ethical standards. The company is committed to operate their business in an environmental responsible manner, providing an engaging, diverse, and safe workplace for their employees, and upholding their corporate responsibilities as a publicly listed company for the benefit of their stakeholders, including shareholders, colleagues, community, and clients.

Strategy

Realty Income's business model is further developed by being strategic in four areas: acquisitions, asset management, development, and client service.

Acquisitions: Realty Income specializes in acquiring high quality properties. Most of their tenants that operate in the retail industry are clients with a service, low price point and/or non-discretionary component. They also focus on industrial and distribution properties that are leased to Fortune 1000 companies with investment-grade ratings. Realty Income has a specialized team that is dedicated to sourcing and seeking opportunities. The team undertakes a thorough analysis and research to identify which clients, industries and property locations are appropriate for investments. When looking for net leasing opportunities in markets where Realty Income´s investment adds value, this research expertise is crucial. The acquisition of properties leased to clients who are leaders in their industry and provide stable and sustainable cash flow supports their business model and conservative strategy. Realty Income has acquired $32.9 billion worth of real estate since 2010 and for the first nine months of 2022 they have acquired real estate properties for $5.0 billion. This shows that Realty Income has been determined to grow and focus on providing attractive dividend and capital return for their shareholders.

Asset management: Realty Income continually monitors its portfolio in search for any changes or events that might affects their clients, the industries they operate in and locations that Realty Income has invested in. Additionally, they frequently evaluate their portfolio with the view towards optimizing the return generated by their portfolio and enhancing its credit quality. In order for Realty Income to sustain high occupancy, forge enduring bonds with our clients, and foster extra internal growth, active portfolio management is a crucial part of their long-term strategy. Further, the company's goals with active portfolio management are to structure the optimal portfolio of properties by having the ideal mix of certain clients, industries, property types and markets. Another goal is to retain asset value by maximizing their asset-level returns on properties that are sold, renewed, or released. Also, they have a goal to creatively add value by enhancing properties or pursue alternative uses, this creates incremental value from the existing portfolio.

Development: Realty Income´s development team focuses on finding opportunities to develop properties for both new and existing clients as well as identifying opportunities to add value to their current portfolio. These development initiatives increase Realty Income´s investment opportunities, which can boost future earnings growth.

Client Service: Realty Income´s client services help organizations by financing upgrade projects, improve processes and efficiency, and solve operational emergencies.

Industry

Industry overview

Real estate investment trusts (REITs) are companies that own and acquire income producing real estate. In order to qualify as a REIT, these companies have to meet a number of requirements. For example, in order to qualify as a REIT a company must pay at least 90% of taxable income as shareholder dividends each year and invest 75% of its total assets in real estate, among other requirements. In the United States, REITs own and manage more than 535,000 properties and 15 million acres of land which results in $4.5 trillion in gross assets. REITs provide a good investment opportunity for both institutional and retail investors, in a way that investors earn a share of the income produced by real estate without having to buy, manage and finance properties by themselves.

Historically REITs have generated attractive total returns for investors based on their high and steady dividend income along with long-term capital appreciation. REITs have shown to have low correlation with other types of assets and are therefore a very effective portfolio diversifier that can reduce risk, increase returns, and improve the Sharpe ratio of portfolios.

The business model of REITs is in general relatively simple, that is, REITs acquire and lease Real estate properties and generate income in the form of rent. The biggest part of that income is then distributed to shareholders in the form of dividends. The two most common type of REITs are equity REITs and mortgage REITs. Equity REITs, which is the most common type of REITs, own Real estate properties and lease them to tenants and pay out the largest part of their income as a dividend. While mortgage REITs finance income-producing real estate by acquiring or originating mortgages, and mortgage-backed securities (MBS) and earning interest income on these assets. Usually, equity REITs try to focus on a single type of property, but some invest in many segments. The most common types of equity REITs are office REITs, industrial REITs, retail REITs, hotel REITs (resorts REITs) and residential REITs.

Macroeconomics

Since early 2020, the economic environment has been challenging for most economies in the world with the upbringing of the Covid-19 virus. Some of the measures taken in order to try minimizing the effect of the virus on the health of humans all over the world included travel restrictions, lockdowns, business restrictions and quarantines. This led to one of the harshest global recessions for decades with economic disruptions all over the world. These disruptions included global supply shortages, tourism collapsed due to travel restrictions and the retail sector faced severe disruption's where the foot traffic in the U.S decreased by 50-60 percent. During these disruptions, hundreds of millions of people lost their job and it is estimated that around 60 percent of businesses that closed during the pandemic will stay closed permanently[1]. Further, it is reported that the amount of money made in the first nine months of 2020 decreased globally by $3.5 trillion compared to the same period in the year before. Despite the recession, in May 2020, an economic expansion began in the U.S with economic activity recovering at a rapid pace, and this expansion continued throughout 2021. The recovery was a result of an unprecedentedly large fiscal and monetary stimulus. It is estimated that the fiscal policy measures taken in 2020 boosted GDP in 2021 by 6%[2].

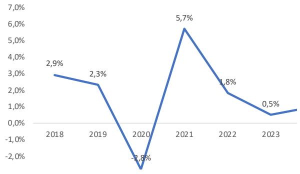
The federal Open Market Committee lowered the federal funds rate by 1.5% in March 2020 which supports increased demand and spending in the economy by lowering borrowing costs. These measures increased the demand for goods, services and capital which often comes with increased inflation. From May 2020 asset prices started to rise at a fairly high real rate throughout December 2021 where prices reached historical heights. Between December 2020 and December 2021 housing prices reached all time heights in Absolute and inflation-adjusted terms, with an increase of 17.5% in nominal terms. These price increases can be traced to the low interest rates during the pandemic which resulted in a great increase in real estate and financial wealth, but also in increasing inflation[3]. Further, in 2021, the U.S economy grew by staggering 5.7% which is the highest growth since 1984. As interest rates were kept at a near zero level throughout 2021, the demand for money grew, both for households and businesses and spending in the economy increased which led to surging inflation and it reached 6% in January 2022 which is well above the federal reserve 's target of 2%.

On February 24th, 2022, Russia invaded Ukraine which has had devastating effects on the economy of a number of countries in the world. With the underlying inflation already present, the war pushed inflation in the U.S to new heights in March 2022, reaching 8.5% which is the highest annual increase for decades and weakened the recovery from the pandemic. Further, the inflation continued to rise until it reached its peak in June 2022. The main effects of the war include surging energy prices, commodity and food prices increasing and various supply shortages. Since March this year, the Fed has been increasing interest rates steadily at a high pace up to 4% in November

[1] Sundaram, Anjali. "Yelp Data Shows 60% of Business Closures Due to the Coronavirus Pandemic Are Now Permanent." CNBC, 16 Sept. 2020, www.cnbc.com/2020/09/16/yelp-data-shows-60percent-of-business-closures-due-to-the-coronavirus-pandemic-are-now-permanent.html.(Sundaram, n.d.)
[2] "Inflation in the U.S. Economy: Causes and Policy Options." Inflation in the U.S. Economy: Causes and Policy Options - EveryCRSReport.com, 6 Oct. 2022, www.everycrsreport.com/reports/R47273.html.
[3] Labonte, Marc, and Lida Weinstock. U.S. Economic Recovery in The Wake of COVID-19: Successes And Challenges. crsreports.congress.gov

with the goal to drive the inflation down to the target inflation level and mitigate the effect of inflation on the purchasing power of American citizens. With increasing interest rates, it becomes more expensive for households and businesses to get loans, and the flow of money in the economy reduces. This can have serious effects for companies that rely on leverage and increasing interest payments can cut a large chunk of profits. Additionally, companies will operate more passively, growth slows down, unemployment can rise in tougher economic environments and recessions can sometimes occur if the economy slows down too much. Another concern is that inflation has grown faster than interest rates meaning that real interest rates have become substantially negative since the inflation began to rise, making it hard for money savers to earn positive real rate of return. However, the OECD expects that GDP in the U.S will grow by 1.8% in 2022, 0.5% in 2023 and 1% in 2024[4] (Exhibit 1).

Exhibit 1: Historical & forward-looking GDP growth (%)



Industry Outlook

The Covid-19 pandemic affected the operational performance of REITs, and it is clear when comparing funds from operations (FFO) on a quarterly basis. The average quarterly FFO declined by 18.5% in 2020 when comparing to the quarterly average in 2019. The decline in operating performance varied between different property type REITs. While it affected most equity REITs negatively, industrial REITs experienced improved performance due to the immense growth in e-commerce. On the other hand, the performance of REITs operating in the resort/lodging sector declined immensely since most hotels experienced a harsh decline in occupancy due to lockdowns and restrictions. Realty Income mostly operates in the retail sector which experienced a rather high decline in operating performance during 2020, the quarterly FFO decreased by roughly 20% from 2019 until 2020. However, Realty income remained resilient and the FFO increased from 1.14 billion to 1.24 billion meaning that Covid-19 did not have serious effects on the operations of Realty Income and the company was able to maintain its level of dividend payouts.

Despite the downturn in 2020, the performance of REITs in 2021 proved to be excellent and the sector quickly recovered from the pandemic. The FFO of REITs increased by 25% between 2020 and 2021. The low interest rate environment in 2021 was favorable for REITs since a large proportion of REITs have a high level of debt that they use for acquisitions and growth. The attractive debt pushed REITs on a buying spree and 2021 was a record year in net acquisitions. By taking advantage of the low interest rates, REITs have improved their balance sheet by locking in low interest for many years to come while also reducing their level of debt[5]. Additionally, the occupancy rate for REITs recovered quickly in 2021, especially for industrial, retail and apartment REITs while occupancy in office REITs has still not recovered from the pandemic.

As inflation and interest rates have been rising at a fast pace this year, REITs operational performance has been strong throughout the year with FFO and Net Operating Income (NOI) increasing for REITs. FFO increased by almost 15% from Q3 2021 compared to Q3 2022 where it reached a new peak. It is noteworthy that despite rising interest rates, inflation, and an overall challenging economic climate, the operational performance of REITs has remained resilient. The net operating income of REITs increased by 8.1% in October on a year-to-year basis which

[4] "United States Economic Snapshot - OECD." United States Economic Snapshot - OECD, www.oecd.org/economy/united-states-economic-snapshot. Accessed 12 Dec. 2022.
[5] Schnure, Calvin. "REIT Net Acquisitions Hit Record High of $67.8 Billion in 2021." Forbes, 9 Mar. 2022, www.forbes.com/sites/calvinschnure/2022/03/09/reit-net-acquisitions-hit-record-high-of-678-billion-in-2021.

illustrates that the earnings growth of REITs has been keeping up with inflation[6]. Further, history has shown that REITs can provide a natural hedge against inflation, i.e., when inflation increases, real estate rent typically increases as well, which supports dividend growth. That way, investors still receive their dividend cash flows during surging inflation periods. Capitalization rates (cap rate) for REITs also tend to increase with rising interest rates and the implied cap rate for REITs has increased by 150 basis points in 2022, which is considered a significant increase. However, when interest rates increase, REITs tend to reduce their level of acquisitions and slow down growth. In the first two quarters of 2022, REITs have acquired $46.1 billion worth of real estate compared $128 billion in 2021, which indicates that the level of acquisitions has been slowing down this year. Further, for the first three quarters of 2022 REITs issued $11.4 billion in debt compared to $58.2 billion in 2021, which is at a vast decrease in issuance of debt.

Going forward, it is highly uncertain how things in the economy will unfold in 2023 and beyond. It seems like the increasing interest rates are affecting inflation since the twelve months ended inflation in October is 7.7%, which is a 0.5% reduction from the month before. The increasing interest rates should slow down demand going forward and with supply constrains easing, the inflation should relax rather quickly in 2023. Further, the Federal Reserve is expected to keep being restrictive until late 2023 or 2024 in order to fight the inflation.

As mentioned before REITs have proved to perform well in high-inflation environment and they usually outperform global equities in the stock market, while underperforming in lower inflation environment. This can be explained by the fact that REITs can be less volatile, and they often don not capture the upswing of markets as well as other equities. The lease composition for REITs will also make a difference in performance in this high inflation climate. REITs with gross leases are more exposed to rising prices since they pay operating expenses for their properties and therefore their margins could be affected. Contrary, those with net lease agreements pass on that risk to their tenants, which is an indirect risk in itself since it could affect the ability of tenants to pay rent. As REITs carry high levels of debt on their balance sheet to fund acquisitions and develop properties, the increasing interest rates could be of concern, especially for highly leveraged companies. However, almost 80% of debt carried by REITs is at a fixed rate which has ensured them lower interest rates and more visibility and certainty on their debt obligations in the next few years. With that being said, most REITs are not exposed to the high interest rates immediately and the leverage ratios for REITs is at a historically low level, with limited short-term maturities[7]. Also, with high market interest rates today, REITs are expected to slow down on acquisitions and be more passive, after a record year in REIT acquisitions in 2021. The overall outlook for REITs in 2023 is that REITs will continue to perform well and grow their earnings at a steady pace, while slowing down on acquisitions.

Risks Factors

The quality of Realty Income´s clients is in itself a risk factor where the risk mainly concerns the ability of the tenants to pay their rent on time, a decline in creditworthiness, and bankruptcies of clients. If a client would go bankrupt, there is no guarantee that Realty Income is able to attract new tenants or sell their property at an attractive price and it could take a substantial time since

[6] "REITs Well-Positioned for Ongoing Economic Uncertainty." REITs Well-Positioned for Ongoing Economic Uncertainty | Nareit, www.reit.com/news/blog/media/reits-well-positioned-ongoing-economic-uncertainty. Accessed 3 Dec. 2022.
[7] Reddy, Rohan. "REITs as a Potential Income Solution Amid Persistent Inflation." Global X ETFs, 7 Sept. 2022, www.globalxetfs.com/reits-as-a-potential-income-solution-amid-persistent-inflation.

the type of properties owned by Realty Income are not considered liquid assets. However, they have a 101.8% rent recapture rate since 1996, which means that historically when their leases have expired, they have proven to be able to re-lease those properties and increase the rent. Further, Realty Income has stated that they will continue to focus on leasing to investment graded clients.

Another risk factor that Realty Income is exposed to is the composition of their lease agreements. As mentioned in the section above, Realty Income's uses triple net lease agreements which means that their tenants are responsible for paying property expenses including property taxes, insurance, and maintenance. The use of net lease agreements reduces the exposure of Realty Income to raising inflation and thereby rising property expenses since the client carries all the risk. However, if rising inflation has serious effects on the earnings of their clients, i.e., if their operating expenses increases more and faster than increase in revenue, it might affect their ability to pay rent. Also, since the largest part of lease agreements are tied to inflation, the rent payments might also increase as operating property expenses rise. One downside to these net lease agreements is that since the client bears the risk of paying operating expenses, Realty Income receives lower rent income compared to REITs that pay for operating expenses themselves.

Another risk factor that affects Realty Income is their debt composition. The negative effects of excessive debt can be limitations to further borrowings since overleveraged firms usually have poorer credit ratings and if a company gets additional debt, banks will charge extremely high interest rates. Further, investors are not attracted to overleveraged companies since the probability of distress is higher. Too much debt can also constrain the growth for a company if the invested capital has not increased earnings before the debt has to be paid. Further, excessive debt can prevent dividend payments if the company has to use the most part of its earnings to service debt holders. Lastly too much debt will increase Realty Income's vulnerability to recessions since they would be more likely to default on their loans.

Realty Income is subject to interest rate risk since they issue debt in order to finance a large part of their acquisitions. Realty Income's main debt components include their credit facility, commercial paper program, mortgages, term-loans, and long-term notes and bonds. Rising interest rates has a negative effect on the variable rate debt of Realty Income and can limit its growth since borrowing costs will increase. To limit the effects of interest rate changes that can affect the earnings negatively, Realty Income issues long-term notes and bonds at a fixed rate. For the nine months ended 2022, the company had $14.22 billion in fixed rate debt versus $1.92 billion in variable rate debt. Further with higher interest rates, the discount rate increases resulting in lower share prices and that also results in other less risky investments becoming more attractive for investors.

Of course, REITs are not limited to only the factors mentioned above, there are other risk factors such as geographical and regulation risks, lack of demand or oversupply of space, along with other factors that also affect REITs.

Value Drivers and Forecast

Revenue forecast

For Realty Income, the four main revenue growth drivers are same store rent growth, acquisitions, development, and dispositions. In order to project revenues until 2030, a bottom up-approach was utilized by projecting the fundamentals of each driver and then the sum of those drivers result in total comprehensive revenue for each year. The current state of the economy and the outlook for next few years influence our assumptions on growth for the company going forward.

Same store growth: The base for the revenue forecast is the growth in rents from already existing properties as of the third quarter of 2022. The starting point for estimating the increase in rents from already existing properties is the total building space the company has invested in. Currently the company has invested in 225,658,900 square feet of real estate. Since 2012, the occupancy for properties owned by Realty Income has been very stable at an average occupancy rate of 98.4%. Further, the average rent per square feet for Realty Income is $13.25. The company has a good and effective strategy for raising rent yearly where most properties of Realty Income (86%) provide increase in rent based on three criteria's: fixed rent increases that are pre-defined, increases that are tied to inflation or that they charge additional rents based on the operating performance of a tenant that is above a specific level. Our estimates of rental increases are mainly based on inflation rate for rents which usually moves closely with inflation of the economy. As the inflation is at a very high level, real estate rents are rising as well and are expected to continue to rise at an above average rate in 2023 and 2024. We expect that the rent for existing properties will eventually reach a growth of 2,5% which is approximately the average inflation in the U.S. In order to calculate the total rental revenue from already existing properties, the rent per square feet is multiplied by the occupied square feet. As 86% of the leases are subject to rent increases, 86% of rental income is increased by the corresponding rent inflation rate each year.

Acquisitions: Acquisitions is the core revenue growth driver for Realty Income, and it can have large impact on future earnings of the company. Realty Income is highly focused on growth from acquiring new properties compared to other REITs. As mentioned above, they have a clear investment strategy, focusing on single tenant free-standing properties and choosing their tenants carefully. In order to implement this strategy successfully, the company has a specialized team dedicated to research and scout investment opportunities. They have been incorporating predictive analytics and machine learning to further drive key decisions on whether they should expand into other markets or invest in new property types. In last year few years, Realty Income began expanding to Europe in order to improve partnership with multinational clients. Of their total acquisitions in 2021, their proportion of investments in Europe was 41.5%, which corresponds to $2.56 billion. Realty's Income business model, the triple net lease agreements allow them to expand and invest in other property types than they are currently doing. Recently Realty Income invested in 12 vineyards which is an example of their flexibility and ability to seek attractive deals outside of the commercial retail sector. This broadens their pool of investment opportunities where the company can exploit attractive investment opportunities outside of the U.S and across different property types. As of 2022, Realty Income has sourced opportunities worth around $78 billion and invested $5.1 billion in real estate from that pool of opportunities. In order to fund their acquisitions, they mostly rely on capital markets, i.e., long term debt or equity issuance. Since 2012, the company has spent $27.6 billion (excluding VEREIT merger and 2021) in gross real estate investments which represents an CAGR in acquisitions of 8.98%.

In order to calculate the incremental revenues from acquisitions, a bottom-up approach was incorporated. Firstly, the acquisitions for each year until 2030 are projected based on our believes on the development of the overall economy, historical level of acquisitions and the fact that we believe that the company will slow down on growth in the near future. When the acquisitions for each year have been estimated, appropriate cash capitalization rates are applied in order to calculate the incremental net operating income produced by the yearly acquisitions. The cash capitalization rate is computed as the annual contractual cash net operating income dividend by the total costs of invested properties, i.e., a return that the company earns as NOI on its properties. When the NOI has been calculated for each year, the implied incremental revenue each year can be calculated by applying an appropriate NOI margin. Additionally, the accumulated incremental revenue each year grows at the appropriate same store rent inflation rate.

Since Cap rates usually increase with rising interest rates, the cash cap rates captured for investments in 2022 has been going up since the beginning of the year. However, for the past years, the cash cap rate has been slightly decreasing, from a yearly average of 7.1% in 2014 to 5.9% as of year 2022. That is mainly due to more quality tenants that provide less risky cash flows and because housing prices have been rising at a faster pace than increase in rents. In order to calculate the NOI margins, we define NOI as EBIT including non-recurring items to be consistent with Realty Income's computation of NOI. By doing it that way, the cash cap rate is consistent with the NOI margins, and the implied incremental revenues are reliable. Before the covid pandemic the NOI margins were very stable at a level close to 50%. However, the operating performance of Realty Income was impacted by the pandemic and the average NOI margin since the pandemic is at 40.41%, but it has increased from 34.42% in 2021.

When projecting future acquisitions, the first instinct was to base it on historical growth in acquisitions. However, the historical growth rate of acquisitions fluctuates significantly between years. As an example, in 2019, acquisitions grew by 106.7%, they decreased by 37.9% in 2020 and grew by 177.8% in 2021. As a result, we found it more reliable to estimate acquisitions as a percentage of net real estate held for investment. Prior to covid, that ratio was rather stable at around 14% except for 2019 where the ratio spiked up to 26.87%. As most REITs, Realty Income went on an acquisition spree after 2020 due to lower interest rates and the expansion in the economy, that resulted in that ratio reaching an average of 28.68% for 2021 and 2022. We believe that acquisitions will decrease going into the future for a few reasons. First of all, the growth in acquisitions for the past two years has been abnormal and the economic conditions will not be as favorable in the future. With rising interest rates the cost of borrowing has been increasing vastly and the industry has been slowing down on acquisitions this year and the level of acquisitions might decrease even further in 2023 and 2024. Also, when interest rates increase the spread between the cost of debt and cap rates reduces making investments riskier. In addition, Realty Income fund acquisitions largely by issuing common stock, resulting in shareholders getting diluted as historically they have invested more than they receive in dividend payments which we believe is unsustainable. Finally, due to the merger with VEREIT and recent acquisitions, the company has grown significantly since 2020 and we believe that the growth will slow down at a fast pace in order to compensate their shareholders with less capital needs and because of recent acquisitions will boost earnings significantly in the upcoming years. Therefore, we estimate that acquisitions as a percentage of net real estate held for investment will reach the pre-pandemic average of 14.62% after 2023, and slowly decline until it reaches 8% in 2030. With our projected acquisitions the level of dividends will slightly surpass the equity capital needs in 2024.

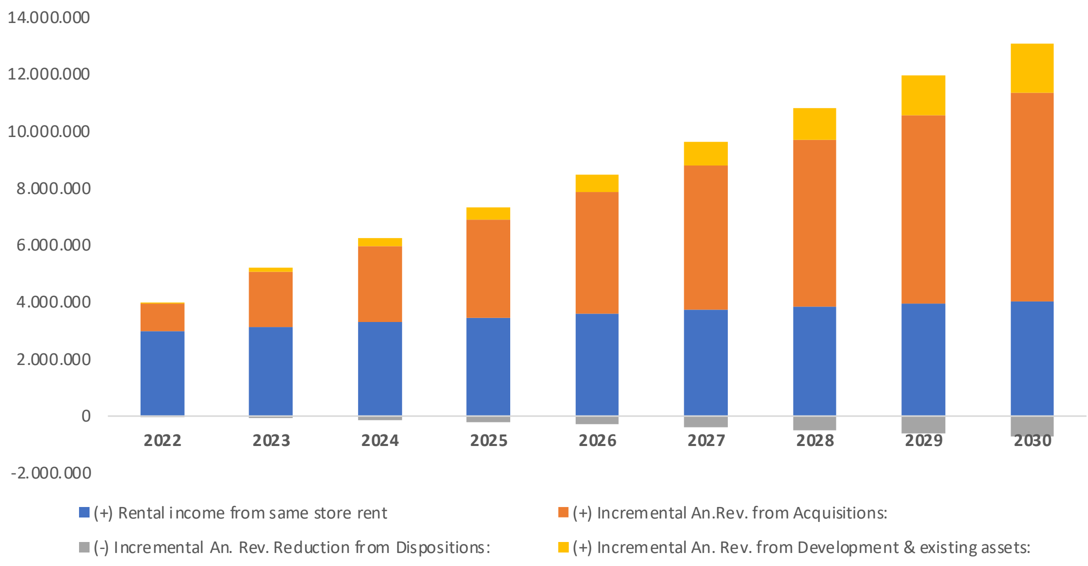
We estimate the cash cap yield on new acquisitions going forward as the historical yearly average since 2024. That results in a cash cap rate of 6.2% which is slightly higher than the current rate of 5.9% that they are yielding on their acquisitions. However, as Realty Income usually has lease agreements for a duration of longer than 10 years, they will still benefit from their previous investments at higher cash cap rates and the growth in housing prices is estimated to slow down which will push cap rates at higher levels. Further, we estimate that the NOI margin will remain the same in 2023 as in 2022 at 41.55% and increase to the pre-covid average of 50% in 2024.

Development: In addition to acquisitions, Realty Income invests in development projects and in their existing properties. Realty Income has a team focused on identifying and exploiting opportunities to develop properties for new or existing clients. By investing in development projects, Realty Income is able to find opportunities that often yield better returns than traditional acquisition but those investment often bear higher risk as well. However, Realty Income tries to make lease agreements with tenants before development has begun in order to mitigate the risk of the new properties not being occupied when finished.

The same bottom-up approach was used to calculate the incremental revenue from development projects as for the acquisitions, that is, by implementing appropriate cap rates and NOI margins for each of the projected years. As development projects can be riskier than traditional acquisition investments, they have usually had higher cash cap rates. However, as for the acquisitions, the cash cap rate has been decreasing, which usually implies that those investments are getting less risky. The average cash cap rate for development projects is 7.1% from 2014 until Q3 2022 where the average cash cap rate in FY2014 was 9.7%. For the NOI margins, the same values are used as for acquisitions in order to calculate the implied incremental revenue from development projects. Further, the growth in development projects and investments in existing properties are projected separately but they yield the same cash cap rate. We project that investments in development projects will increase in 2023 by the annual CAGR of 25.47% and from there the growth will decrease until it reaches the terminal growth value of 2.5%. The same method was used to project investments in existing properties, i.e., the CAGR for 2023 which is at 14.26%, which then decreases at a stable rate until reaching the terminal growth rate. The same cash cap rate was applied for investments in development projects and investments in existing properties, which is the yearly average cash cap rate of 7.1%.

Dispositions: It is also important to project the revenues that are lost due to dispositions of real estate properties owned by Realty Income. For the past years, Realty Income has been selling more real estate as they grow and especially for the past three years. However, those dispositions are only a small proportion relative to the acquisition they make each year, averaging about 8% of acquisitions. In order to achieve the lost revenue each year due to dispositions, we project how much the company will sell each year worth of real estate. Then the book value of those sales is estimated by deducting projected gain on those sales. By applying the appropriate cash cap rate and NOI margin for each year, the implied revenue reduction from those sales can be calculated. We believe that Realty Income will continue to sell more properties as they grow. We project that the dispositions will grow in 2023 by the CAGR of 19.4% and will eventually reach the terminal growth rate of 2.5%. Further, in order to estimate the book values of the sold properties, we use the historical arithmetic average gain on sale ratio of 22.6%. Additionally, the same cap cash rate and NOI margins were applied as for acquisitions.

Exhibit 2*: Forecasted Annual Incremental Revenues & Reduction*



Source: *Own Analysis*

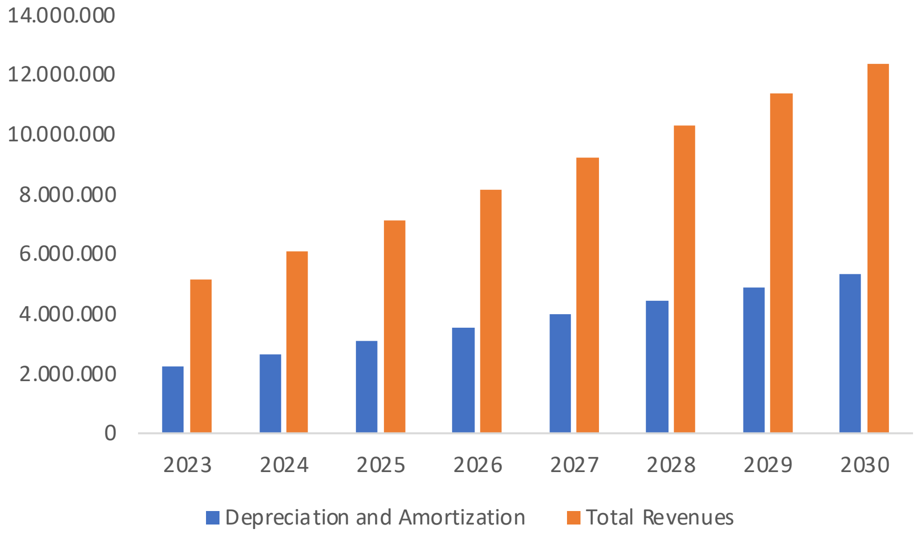
Cost structure

COS: REITs usually have rather low cost of sales (COS) since they are not selling or manufacturing goods. For REITs, COS consists of expenses that are directly related to the leased properties, properties for sale and general portfolio expenses. Those expenses mainly include maintenance, property taxes, utilities, insurance, legal fees, and property inspections. Realty Income does not recognize COS in their annual reports; however, they consider an item called property costs equivalent to COS. The fact that most of Realty Income's properties are leased under triple-net lease agreements, most of the operating expenses are passed onto their tenants which lowers their property expenses even further and reducing their exposure to rising costs. Since 2014 property costs have remained rather close to the historical average of 5.76% as a percentage of revenues, however those costs have been increasing slightly since 2020 and in the last reported quarter they were 6.3% of revenues. Since property costs have remained consistently close to the historical average of 5.76% of revenues, we use that as our estimate for the projected years.

G&A: General and Administrative expenses are costs associated with the operations of the company. They mainly include employee expenses, professional fees and other general overhead expenses related to day-to-day operations. As for the property costs, we also project G&A as a percentage of revenues. Further that ratio has remained rather stable for the past years resulting in an average of 4.95% which we use for our projected G&A expenses for the projected years. That ratio is rather low compared to other companies, and we believe the that is the result from excellent management skills and economies of scale.

Depreciation and Amortization: In order to project Depreciation & Amortization (D&A), we considered to calculate it as a percentage of net real estate held for investment, however that ratio has proven to fluctuate a lot through history. Instead, we estimate D&A as a percentage of revenues since that ratio has been very stable historically, with an average of 43.05%, which makes it by far the largest expense item on the income statement. Further, as the revenues for the company will increase as Realty Income invests in more properties, the D&A will increase as well as shown in Exhibit 3.

Exhibit 3: Forecasted Depreciation & Amortization



Source: *Own Analysis*

Valuation

NAV

In addition to the multiple valuation, we also estimate the net asset value (NAV) of Realty Income. The NAV method is a way to provide accurate estimations of the market values of the company's real estate assets. The first step to calculate the NAV is to estimate forward looking NOI and since we have already projected the NOI for 2023, we use that as our estimation. The second step is to calculate the market value of the real estate assets of the company by applying the current market cap rate available to Realty Income. As of Q3 2022, they are capitalizing 5.9% on their acquisitions. However, we believe that growth in housing prices will slow down while rents will increase with the inflation, therefore we estimate a slightly higher cap rate of 6%. That results in market value of real estate assets of $45.2 billion compared to the book value of $34.2 billion. To find the total equity value, we add all other assets and deduct interest bearing debt, which results in an equity value of $40.4 billion or $59.08 per share. It is worth to mention that this calculation was performed to analyze the current market value of the company's real estate assets, meaning that this share price is not forward looking and does not capture future growth in acquisitions and earnings. Therefore, we believe that this share price is below fair value.

Exhibit 4: Realty Income´s Equity Value per share.

Net Asset Value	
NOI E2023	2.511.218
MV of Real Estate Assets (6% cap rate)	45.201.929
Total Assets	56.866.617
Total Debt	16.468.820
Equity Value per Share	**59,08**

Source: *Own analysis*

Sensitivity and Scenario Analysis

There are certain input variables in our model that can influence the share price to a great extent and therefore we perform a sensitivity analysis to quantify those influences. Firstly, we test how changes in the levered beta impacts the cost of equity and WACC by increasing or decreasing the base beta (1.028) at a total interval of 0.5 (Exhibit 26).

Exhibit 5*: Sensitivity Analysis – Levered Beta, Cost of Equity and WACC*

	Levered Beta				
	0,528	**0,778**	**1,028**	**1,278**	**1,528**
Cost of Equity	6,75%	8,25%	**9,75%**	11,25%	12,75%
WACC	6,33%	7,40%	**8,47%**	9,53%	10,60%

Source: *Own Analysis*

As expected, these results show that with different values for the levered beta, both the cost of equity and subsequently the WACC is greatly influenced. As the WACC can have a great impact on the share price, we also test how changes in the WACC, and the terminal growth affect the share price of Realty Income. The terminal growth rate is also of great importance since it determines at which rate the free cash flows will grow beyond 2030.

Exhibit 6*: Sensitivity analysis – WACC and Growth rate*

		WACC						
	81,39	**7,0%**	**7,47%**	**7,97%**	**8,47%**	**8,97%**	**9,47%**	**9,97%**
Growth (g)	**1,50%**	99,68	87,32	76,92	68,04	60,39	53,73	47,89
	1,8%	106,84	93,14	81,71	72,05	63,77	56,61	50,36
	2,2%	115,00	99,69	87,06	76,47	67,48	59,75	53,04
	2,5%	124,38	107,11	93,05	**81,39**	71,57	63,19	55,97
	2,8%	135,27	115,61	99,83	86,89	76,10	66,98	59,16
	3,2%	148,07	125,42	107,54	93,09	81,16	71,17	62,68
	3,5%	163,33	136,88	116,41	100,11	86,83	75,82	66,55

Source: *Own Analysis*

As a result, the share price is greatly affected by these two inputs, ranging from $47.89 to $163.33, with an average share price of $86.70, which is very close to target share price.

It also important to analyze how the share price is affected by changes in cap rates for future acquisitions and development projects. The cap rate incorporates two of the risk factors mentioned before. Firstly, the cap rate tends to follow changes in interest rates and secondly, with higher quality tenants and therefore less risky cash flows, cap rates tend to be lower.

Exhibit 7: *Sensitivity Analysis – Cap Rates*

		Development Cap Rate				
	81,39	**6,06%**	**6,56%**	**7,1%**	**7,56%**	**8,06%**
ACQ Cap Rate	**7,24%**	97,13	99,23	101,34	103,44	105,54
	6,74%	87,19	89,30	91,40	93,51	95,62
	6,2%	77,17	79,28	**81,39**	83,50	85,61
	5,74%	67,06	69,18	71,30	73,41	75,53
	5,24%	56,88	59,00	61,12	63,24	65,37

Source: Own Analysis

As the Exhibit 7 shows, the share price is very sensitive to changes in the cap rate. However, this analysis only incorporates the effects the cap rate has on cash flows of the company but ignores the impact it has on the WACC. Since higher interest rates and subsequently higher cap rate means that the risk-free rate will increase and the therefore the WACC will increase as well, which has the opposite effects on the share price. That is, when interest rates rise, the cap rate on new investments will increase, resulting in higher earnings which increases the share price, but with increasing interest rates the WACC will also increase which pressures the share price down.

Exhibit 8: *Sensitivity Analysis – WACC and Cap Rate*

		WACC				
		7,47%	**7,97%**	**8,47%**	**8,97%**	**9,47%**
Cap Rate	**7,24%**	131,46	115,00	101,34	89,83	80,01
	6,74%	119,34	104,07	91,40	80,73	71,63
	6,2%	114,31	92,95	**81,39**	71,57	63,19
	5,74%	94,79	81,95	71,30	62,33	54,68
	5,24%	82,36	70,75	61,12	53,02	46,11

Source: *Own Analysis*

Exhibit 8 shows that if cap rates increase, the share price increases as well, while holding WACC constant: However, when WACC increases with rising interest rates, the share price decreases, countering the positive effects from higher cap rates. If the cap rate increases to 7.24%, the share price increases to $101.34, holding WACC constant. However, if the WACC increases to 8.06% with the rising interest rates, the share price falls to $80.01. On the contrary if lower interest rates pressure the cap rate down to 5.24%, the share price falls down to $61.12 holding WACC constant. However, if the WACC decreases to 7.47% with lower interest rates the share price increases to $82.36. Additionally, it is worth to mention that increasing cap rates could mean that the value of the properties has decreased which could have negative effects on the share price.

Moreover, it is important to test how the level of acquisitions and investment in development projects affects the share price, since if those level rise, the earnings of the company will increase in future which impacts the share price positively, however CAPEX is deducted from free cash flows, which negatively impacts the share price. These results show that with increased level in acquisitions and investment in development projects, the impact of CAPEX on the share price weights more than the impact of earnings since the share price decreases with increased activity.

Exhibit 9: *Sensitivity Analysis – Acquisitions and Development*

Acquisitions				
-10%	-5%	Neutral	+5%	+10%
86,93	84,26	**81,39**	78,30	74,97

Development				
-10%	-5%	Neutral	+5%	+10%
98,91	91,77	**81,39**	66,61	45,95

Source: *Own Analysis*

Finally, we test the impact of changes in the occupancy rate on the share price. We test how the share price changes if the occupancy rate ranges from 95% to 100%. Exhibit 10 shows that with small changes in the occupancy rate, the share price of the company changes significantly. However, it is highly unlikely that the occupancy rate will be lower than 98%. For the past 10 years it has only once been lower, in 2012 when the occupancy rate was 97.2%.

Exhibit 10: *Sensitivity Analysis – Occupancy Rate*

Occupancy rate				
95,0%	96,1%	97,3%	98,4%	100,0%
69,94	72,87	75,80	**81,39**	82,84

Source: *Own Analysis*

It is still highly uncertain how the economic climate will evolve going forward. If the war continues to disrupt the U.S economy, and inflation remains high, it is likely that interest rates will stay high in order to fight the inflation. This scenario will probably slow down economic growth, possibly resulting in a recession or worst case, in a stagflation. According to the sensitivity analysis, this might keep cap rates at higher-than-normal levels, indicating riskier cash flows and high discount rates. Further, this might impact Realty Income's tenants in a hurtful way, decreasing their rent collections and possibly decreasing their occupancy rate. In such environment, the company might slow down on their investments at a faster pace than we project.

On the contrary, if the war will have limited effects on the economy, and the high interest rates will be effective on reducing inflation, it is likely that a healthy economic environment will be present in one or two years, with lower interest rates. This would likely result in lower discount rates and lower cap rates. Further this could possibly drive a higher investment level than we are estimating, and the occupancy rate would probably stay at a very high level.