Innovative Industrial Properties (IIPR:NYSE) - Published May 25th, 2020

STOCK BROS

RESEARCH REPORT

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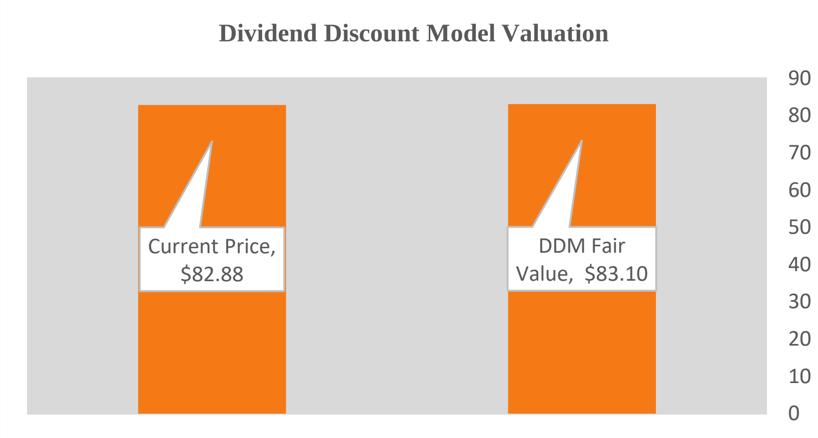


Company Description

Innovative Industrial Properties, Inc. is a self-advised Maryland corporation focused on the acquisition, ownership and management of specialized properties leased to experienced, state-licensed operators for their regulated medical-use cannabis facilities. Innovative Industrial Properties, Inc. has elected to be taxed as a real estate investment trust, commencing with the year ended December 31, 2017.

Assumptions Used in Valuation

Given that the main benefit of investing in REITs are their higher dividend yields, we will be using a 2-stage dividend discount model (DDM).

We used the Holt-Winters model to forecast future dividend payments.

We forecasted AFFO and used management's guidance of using 75%-85% of AFFO for dividends.

We used a discount rate of 12% and a perpetual growth rate of 3.5%.

Considering IIPR is a growth stock, if we use its expected earnings growth of 63.4% and its current P/E ratio of 33.47, we will arrive at a market cap of $1,734,219,000 (approximately 23% higher than the current market cap).

Catalysts & Key Points

One of the very few companies that are profitable in the fast-growing and volatile weed industry.

More resilient than recreational cananbis stocks as IIPR deals with medicinal marijuana.

Engages in absolute triple net long-term leases with annual rent escalations of 3-4% and a lease occupancy rate of 98.9%.

Conservatively leveraged balance sheet.

Experienced management team with a solid track record of creating stockholder value.

Current dividend yield of 4.97%.

Company Health

1. Company Margins are positive and good
2. Current AFFO is positive
3. Company can cover its short term liabilities with current assets
4. Company cannot cover long term liabilities with current assets

%

Income Statement
Gross Margin: 97.17%
EBITDA Margin: 87.08%
EBIT Margin: 66.25%
Profit Margin: 53.76%

$

Adjusted Funds From Operations (TTM):
$47,370,000

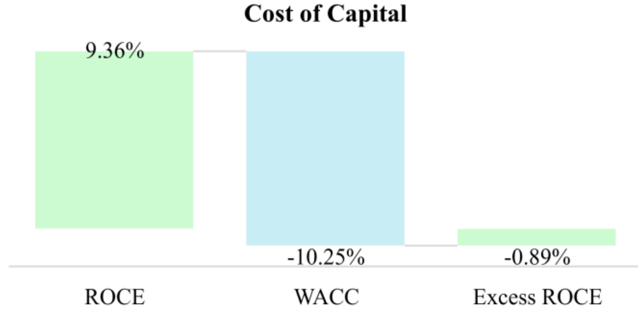
Balance Sheet
Price to Book: 1.7
Total Debt to Equity: 15.7%
Current Ratio: 6.75
Cash on Hand: $108,261,000

Management Efficiency

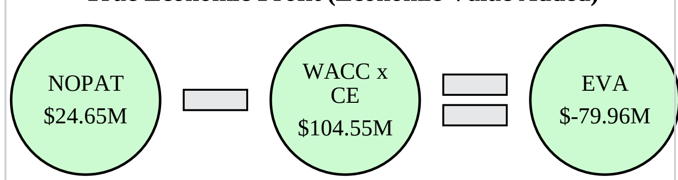
1. Management has not been efficient at managing capital as return on capital employed (ROCE) is less than the weighted average cost of capital (WACC).

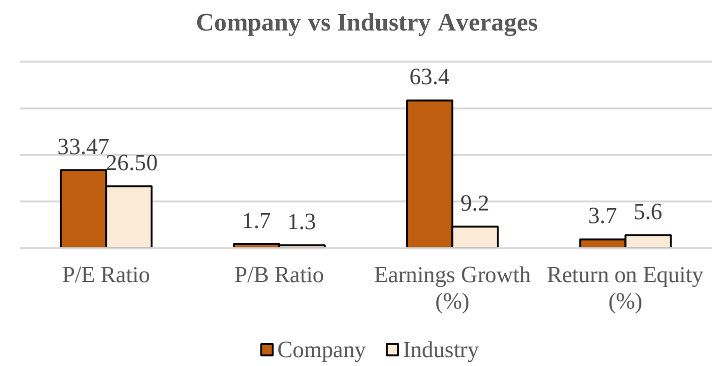
2. Economic value added (EVA) is negative.
(EVA is a measure of a company's true economic profit)

Return on Capital Employed vs. Weighted Average Cost of Capital



True Economic Profit (Economic Value Added)





Company vs Industry Analysis

1. Industry comparison chart score: 1/4
2. Company's price to earnings ratio is less than it's expected earnings growth which is known as the PEG ratio (price to earnings to growth ratio). A PEG ratio of less than 1 (P/E divided by growth) indicates that the stock is potentially undervalued.
3. Industry PEG ratio is greater than 1.
4. IIPR is likely to outperform the industry in terms of earnings growth.

Risk Analysis

1. Overall risk profile of the company is good.
2. Company earnings are likely to be correct and trustworthy based on the Montier C-score of 2 which is used to determine if a company is manipualting it's earnings with fraudulent behaviour. A score of less than 3 means the company is not a manipulator whereas a greater score indicates the possibility for fraudulent activities.
3. Currently, the downside risk of the company is 12.2% which is more than its potential upside of 0.26% that is based on the intrinsic value.
4. The bankruptcy risk is measured using the Ohlson O-score.

Earnings Quality Risk

- Montier C score: **2**
- Not an Earnings Manipulator

Downside Risk

- Standard Deviation 12.2%
- Bankruptcy Risk 2.41%

Payment Schedule

IIPR has no material payments maturing until 2024. Below are their contractual obgliations from their filings.

Contractual Obligations

The following table summarizes our contractual obligations as of March 31, 2020 (in thousands):

Payments Due by Year	Exchangeable Senior Notes	Interest	Office Rent	Total
2020 (nine months ending December 31)	$ —	$ 5,391	$ 152	$ 5,543
2021	—	5,391	235	5,626
2022	—	5,391	242	5,633
2023	—	5,391	249	5,640
2024	143,749	764	256	144,769
Thereafter	—	—	88	88
Total	$ 143,749	$ 22,328	$ 1,222	$ 167,299

Technical Price Target:
$99.00
Dividend Discount Model valuation:
$83.10
PEG Ratio valuation:
$101.79
Current Price: $82.88

Short-Term Thoughts:
IIPR is currently near a potential resistance at $85.00. Our suggestion is to wait for price to pull back if planning to buy the stock as it has gone up from around $66 to $82.88 per share in less than 2 weeks.