

NATIONAL RETAIL PROPERTIES, INC.
Form 10-Q
July 30, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended June 30, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from _____ to _____

Commission file number 001-11290

NATIONAL RETAIL PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of
incorporation or organization)

56-1431377

(I.R.S. Employer Identification No.)

450 South Orange Avenue, Suite 900

Orlando, Florida 32801

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (407) 265-7348

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

134,435,306 shares of common stock, \$0.01 par value, outstanding as of July 29, 2015.

TABLE OF CONTENTS

	PAGE REFERENCE
Part I - Financial Information	
Item 1. <u>Financial Statements:</u>	
<u>Condensed Consolidated Balance Sheets</u>	<u>3</u>
<u>Condensed Consolidated Statements of Income and Comprehensive Income</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>8</u>
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	<u>18</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>28</u>
Item 4. <u>Controls and Procedures</u>	<u>29</u>
Part II - Other Information	
Item 1. <u>Legal Proceedings</u>	<u>30</u>
Item 1A. <u>Risk Factors</u>	<u>30</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>30</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>30</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>30</u>
Item 5. <u>Other Information</u>	<u>30</u>
Item 6. <u>Exhibits</u>	<u>30</u>
<u>Signatures</u>	<u>34</u>
<u>Exhibit Index</u>	<u>35</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except per share data)

	June 30, 2015	December 31, 2014
ASSETS	(unaudited)	
Real estate portfolio:		
Accounted for using the operating method, net of accumulated depreciation and amortization	\$4,935,472	\$4,715,906
Accounted for using the direct financing method	15,987	16,974
Real estate held for sale	3,753	7,169
Mortgages, notes and accrued interest receivable, net of allowance of \$124 at June 30, 2015	10,628	11,075
Commercial mortgage residual interests	10,832	11,626
Cash and cash equivalents	2,448	10,604
Receivables, net of allowance of \$2,166 and \$1,784, respectively	1,778	3,013
Accrued rental income, net of allowance of \$3,086	25,359	25,659
Debt costs, net of accumulated amortization of \$14,501 and \$14,353, respectively	15,105	16,453
Other assets	110,603	108,235
Total assets	\$5,131,965	\$4,926,714
LIABILITIES AND EQUITY		
Liabilities:		
Line of credit payable	\$127,500	\$—
Mortgages payable, including unamortized premium of \$787 and \$890, respectively	25,109	26,339
Notes payable, net of unamortized discount of \$9,646 and \$10,285, respectively	1,715,354	1,714,715
Accrued interest payable	17,448	17,396
Other liabilities	100,400	85,172
Total liabilities	1,985,811	1,843,622
Equity:		
Stockholders' equity:		
Preferred stock, \$0.01 par value. Authorized 15,000,000 shares		
6.625% Series D, 115,000 shares issued and outstanding, at stated liquidation value of \$2,500 per share	287,500	287,500
5.700% Series E, 115,000 shares issued and outstanding, at stated liquidation value of \$2,500 per share	287,500	287,500
Common stock, \$0.01 par value. Authorized 375,000,000 shares; 134,434,132 and 132,010,104 shares issued and outstanding, respectively	1,346	1,322
Capital in excess of par value	2,803,522	2,711,678
Retained earnings (loss)	(225,777	) (196,827
Accumulated other comprehensive income (loss)	(8,284	) (8,658
Total stockholders' equity of NNN	3,145,807	3,082,515
Noncontrolling interests	347	577
Total equity	3,146,154	3,083,092

Total liabilities and equity	\$5,131,965	\$4,926,714
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See accompanying notes to condensed consolidated financial statements.

3

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(dollars in thousands, except per share data)
(Unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues:				
Rental income from operating leases	\$ 112,715	\$ 100,730	\$ 224,189	\$ 199,786
Earned income from direct financing leases	397	435	802	879
Percentage rent	112	223	297	312
Real estate expense reimbursement from tenants	3,324	3,228	6,838	6,460
Interest and other income from real estate transactions	213	543	376	1,334
Interest income on commercial mortgage residual interests	447	454	892	906
	117,208	105,613	233,394	209,677
Operating expenses:				
General and administrative	7,830	8,055	16,435	16,762
Real estate	4,658	4,746	9,417	9,086
Depreciation and amortization	34,202	28,007	66,343	56,019
Impairment – commercial mortgage residual interests valuation	428	77	428	235
Impairment losses	2,686	89	3,714	485
	49,804	40,974	96,337	82,587
Earnings from operations	67,404	64,639	137,057	127,090
Other expenses (revenues):				
Interest and other income	(35	) (94	) (47	) (158
Interest expense	21,678	21,761	43,464	42,040
Real estate acquisition costs	96	19	695	227
	21,739	21,686	44,112	42,109
Earnings from continuing operations before income tax benefit (expense)	45,665	42,953	92,945	84,981
Income tax benefit (expense)	495	(441	) 54	(349
Earnings from continuing operations	46,160	42,512	92,999	84,632
Earnings (loss) from discontinued operations, net of income tax expense	—	18	—	(18
Earnings before gain on disposition of real estate, net of income tax expense	46,160	42,530	92,999	84,614
Gain on disposition of real estate, net of income tax expense	30	3,054	7,230	4,810
Earnings including noncontrolling interests	46,190	45,584	100,229	89,424
Earnings attributable to noncontrolling interests:				
Continuing operations	(2	) (13	) (62	) (520
Net earnings attributable to NNN	\$ 46,188	\$ 45,571	\$ 100,167	\$ 88,904

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(dollars in thousands, except per share data)
(Unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net earnings attributable to NNN	\$46,188	\$45,571	\$100,167	\$88,904
Series D preferred stock dividends	(4,762	) (4,762	) (9,523	) (9,523
Series E preferred stock dividends	(4,096	) (4,096	) (8,194	) (8,194
Net earnings attributable to common stockholders	\$37,330	\$36,713	\$82,450	\$71,187
Net earnings per share of common stock:				
Basic:				
Continuing operations	\$0.28	\$0.30	\$0.62	\$0.58
Net earnings	\$0.28	\$0.30	\$0.62	\$0.58
Diluted:				
Continuing operations	\$0.28	\$0.30	\$0.62	\$0.58
Net earnings	\$0.28	\$0.30	\$0.62	\$0.58
Weighted average number of common shares outstanding:				
Basic	133,267,292	122,490,306	132,470,700	122,035,670
Diluted	133,600,656	122,832,524	132,824,800	122,392,731
Other comprehensive income:				
Net earnings attributable to NNN	\$46,188	\$45,571	\$100,167	\$88,904
Amortization of interest rate hedges	418	216	832	351
Fair value forward starting swaps	—	(2,939	) —	(6,312
Net gain (loss) – commercial mortgage residual interests	(38	) 240	(384	) 925
Net gain (loss) – available-for-sale securities	(147	) (23	) (74	) 91
Comprehensive income attributable to NNN	\$46,421	\$43,065	\$100,541	\$83,959

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2015	2014
Cash flows from operating activities:		
Earnings including noncontrolling interests	\$ 100,229	\$ 89,424
Adjustments to reconcile earnings including noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization	66,343	56,019
Impairment losses	3,714	548
Impairment – commercial mortgage residual interests valuation	428	235
Amortization of notes payable discount	639	614
Amortization of debt costs	1,423	1,353
Amortization of mortgages payable premium	(104)	(29)
Amortization of deferred interest rate hedges	832	351
Interest rate hedge payment	—	(6,312)
Gain on disposition of real estate	(7,260)	(5,020)
Performance incentive plan expense	4,968	4,712
Performance incentive plan payment	(676)	(2,808)
Change in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Decrease in real estate leased to others using the direct financing method	676	666
Decrease (increase) in mortgages, notes and accrued interest receivable	71	(231)
Decrease in receivables	1,235	1,033
Increase in accrued rental income	(18)	(1,118)
Increase in other assets	(964)	(249)
Increase in accrued interest payable	52	1,390
Decrease in other liabilities	(3,528)	(3,112)
Decrease (increase) in other	(231)	785
Net cash provided by operating activities	167,829	138,251
Cash flows from investing activities:		
Proceeds from the disposition of real estate	24,904	29,510
Additions to real estate:		
Accounted for using the operating method	(284,612)	(186,390)
Increase in mortgages and notes receivable	—	(5,131)
Principal payments on mortgages and notes receivable	876	2,933
Other	(1,114)	(1,342)
Net cash used in investing activities	(259,946)	(160,420)

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2015	2014
Cash flows from financing activities:		
Proceeds from line of credit payable	\$679,800	\$319,000
Repayment of line of credit payable	(552,300)	(365,400)
Repayment of mortgages payable	(1,126)	(554)
Proceeds from notes payable	—	349,293
Repayment of notes payable	—	(150,000)
Payment of debt costs	(75)	(3,384)
Proceeds from issuance of common stock	88,694	76,098
Payment of Series D Preferred Stock dividends	(9,523)	(9,523)
Payment of Series E Preferred Stock dividends	(8,194)	(8,194)
Stock issuance costs	(1,623)	(1,104)
Payment of common stock dividends	(111,400)	(98,958)
Noncontrolling interest distributions	(292)	(1,232)
Net cash provided by financing activities	83,961	106,042
Net increase (decrease) in cash and cash equivalents	(8,156)	83,873
Cash and cash equivalents at beginning of period	10,604	1,485
Cash and cash equivalents at end of period	\$2,448	\$85,358
Supplemental disclosure of cash flow information:		
Interest paid, net of amount capitalized	\$41,570	\$39,282
Taxes paid	\$196	\$101
Supplemental disclosure of noncash investing and financing activities:		
Issued 274,693 and 378,965 shares of restricted and unrestricted common stock in 2015 and 2014, respectively, pursuant to NNN's performance incentive plan	\$8,594	\$10,609
Issued 7,243 and 8,229 shares of common stock in 2015 and 2014, respectively, pursuant to NNN's Deferred Director Fee Plan	\$131	\$131
Change in other comprehensive income	\$374	\$4,945
Mortgage receivable accepted in connection with real estate transactions	\$500	\$62
Note receivable accepted in connection with real estate transactions	\$—	\$70
Change in lease classification (direct financing lease to operating lease)	\$311	\$—

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2015
(Unaudited)

Note 1 – Organization and Summary of Significant Accounting Policies:

Organization and Nature of Business – National Retail Properties, Inc., a Maryland corporation, is a fully integrated real estate investment trust (“REIT”) formed in 1984. The terms “NNN” and the “Company” refer to National Retail Properties, Inc. and all of its consolidated subsidiaries. NNN has elected to treat certain subsidiaries as taxable REIT subsidiaries. These taxable subsidiaries and their majority owned and controlled subsidiaries are collectively referred to as the “TRS.”

NNN's assets include: real estate, mortgages and notes receivable, and commercial mortgage residual interests. NNN acquires, owns, invests in and develops properties that are leased primarily to retail tenants under long-term net leases and primarily held for investment (“Properties”, “Property Portfolio”, or individually a “Property”).

June 30, 2015

Property Portfolio:

Total properties	2,138
Gross leasable area (square feet)	23,747,000
States	47
Weighted average remaining lease term (years)	11.4

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by U.S. generally accepted accounting principles (“GAAP”). The unaudited condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented. Operating results for the quarter and six months ended June 30, 2015, may not be indicative of the results that may be expected for the year ending December 31, 2015. Amounts as of December 31, 2014, included in the condensed consolidated financial statements have been derived from the audited consolidated financial statements as of that date. The unaudited condensed consolidated financial statements, included herein, should be read in conjunction with the consolidated financial statements and notes thereto as well as Management's Discussion and Analysis of Financial Condition and Results of Operations in NNN's Form 10-K for the year ended December 31, 2014.

Principles of Consolidation – NNN’s condensed consolidated financial statements include the accounts of each of the Company's respective majority owned and controlled affiliates, including transactions whereby NNN has been determined to be the primary beneficiary in accordance with the Financial Accounting Standards Board (“FASB”) guidance included in Consolidation. All significant intercompany account balances and transactions have been eliminated. NNN applies the equity method of accounting to investments in partnerships and joint ventures that are not subject to control by NNN due to the significance of rights held by other parties.

Real Estate Portfolio – NNN records the acquisition of real estate which is not subject to a lease at cost, including acquisition and closing costs. The cost of properties developed by NNN includes direct and indirect costs of construction, property taxes, interest and other miscellaneous costs incurred during the development period until the project is substantially complete and available for occupancy. During the quarter and six months ended June 30, 2015, NNN recorded \$558,000 and \$948,000, respectively, in capitalized interest during the development period and recorded \$487,000 and \$921,000 in capitalized interest during the development period for the same periods in 2014, respectively.

Purchase Accounting for Acquisition of Real Estate Subject to a Lease – In accordance with the FASB guidance on business combinations, the fair value of the real estate acquired with in-place leases is allocated to the acquired tangible assets, consisting of land, building and tenant improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases and the value of in-place leases, based on their

respective fair values. Acquisition costs incurred in connection with a business combination are expensed when incurred.

The fair value of the tangible assets of an acquired leased property is determined by valuing the property as if it were vacant, and the "as-if-vacant" value is then allocated to land, building and tenant improvements based on the determination of their fair values.

In allocating the fair value of the identified intangible assets and liabilities of an acquired property, above-market and below-market in-place lease values are recorded as other assets or liabilities based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases, and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining term of the lease and the applicable option terms if it is probable that the tenant will exercise the option. The capitalized above-market lease values are amortized as a reduction of rental income over the remaining terms of the respective leases. The capitalized below-market lease values are amortized as an increase to rental income over the initial term unless the Company believes that it is likely that the tenant will renew the lease for an option term whereby the Company amortizes the value attributable to the renewal over the renewal period.

The aggregate value of other acquired intangible assets, consisting of in-place leases, is measured by the excess of (i) the purchase price paid for a property after adjusting existing in-place leases to market rental rates over (ii) the estimated fair value of the property as-if-vacant, determined as set forth above. The value of in-place leases exclusive of the value of above-market and below-market in-place leases is amortized to expense over the remaining non-cancelable periods of the respective leases. If a lease were to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be written off. The value of tenant relationships is reviewed on individual transactions to determine if future value was derived from the acquisition.

Intangible assets and liabilities consisted of the following as of (dollars in thousands):

	June 30, 2015	December 31, 2014
Intangible lease assets (included in Other assets):		
Value of above market in-place leases, net	\$11,582	\$11,751
Value of in-place leases, net	66,155	65,770
Intangible lease liabilities (included in Other liabilities):		
Value of below market in-place leases, net	27,740	29,162

Cash and Cash Equivalents – NNN considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents consist of demand deposits and money market accounts and are stated at cost plus accrued interest, which approximates fair value.

Cash accounts maintained on behalf of NNN in demand deposits at commercial banks and money market funds may exceed federally insured levels or may be held in accounts without any federal insurance or any other insurance or guarantee. However, NNN has not experienced any losses in such accounts.

Valuation of Receivables – NNN estimates the collectability of its accounts receivable related to rents, expense reimbursements and other revenues. NNN analyzes accounts receivable and historical bad debt levels, tenant credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. In addition, tenants in bankruptcy are analyzed and estimates are made in connection with the expected recovery of pre-petition and post-petition claims.

Earnings Per Share – Earnings per share have been computed pursuant to the FASB guidance included in Earnings Per Share. Effective January 1, 2009, the guidance requires classification of the Company's unvested restricted share units, which carry rights to receive nonforfeitable dividends, as participating securities requiring the two-class method of computing earnings per share. Under the two-class method, earnings per common share are computed by dividing the sum of distributed earnings to common stockholders and undistributed earnings allocated to common stockholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities based on the weighted average shares outstanding during the period.

The following table is a reconciliation of the numerator and denominator used in the computation of basic and diluted earnings per common share using the two-class method (dollars in thousands):

	Quarter Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Basic and Diluted Earnings:				
Net earnings attributable to NNN	\$46,188	\$45,571	\$100,167	\$88,904
Less: Series D preferred stock dividends	(4,762	) (4,762	) (9,523	) (9,523
Less: Series E preferred stock dividends	(4,096	) (4,096	) (8,194	) (8,194
Net earnings available to NNN's common stockholders	37,330	36,713	82,450	71,187
Less: Earnings allocated to unvested restricted shares	(176	) (198	) (340	) (361
Net earnings used in basic and diluted earnings per share	\$37,154	\$36,515	\$82,110	\$70,826
Basic and Diluted Weighted Average Shares				
Outstanding:				
Weighted average number of shares outstanding	134,163,959	123,495,650	133,313,523	122,957,186
Less: Unvested restricted stock	(420,417	) (489,095	) (404,463	) (446,439
Less: Unvested contingent shares	(476,250	) (516,249	) (438,360	) (475,077
Weighted average number of shares outstanding used in basic earnings per share	133,267,292			