

NATIONAL RETAIL PROPERTIES, INC.
Form 10-Q
November 05, 2012

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 September 30, 2012

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.

110,036,842 shares of common stock, \$0.01 par value, outstanding as of October 30, 2012.

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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)

| | September 30, 2012 (unaudited) | December 31, 2011 |
|--|--------------------------------------|----------------------|
| ASSETS | | |
| Real estate portfolio: | | |
| Accounted for using the operating method, net of accumulated depreciation and amortization | \$3,565,782 | \$3,211,022 |
| Accounted for using the direct financing method | 24,539 | 26,518 |
| Real estate held for sale | 53,361 | 50,202 |
| Investment in unconsolidated affiliate | — | 4,358 |
| Mortgages, notes and accrued interest receivable, net of allowance | 29,682 | 33,428 |
| Commercial mortgage residual interests | 12,508 | 15,299 |
| Cash and cash equivalents | 141,446 | 2,082 |
| Receivables, net of allowance of \$1,057 and \$1,403, respectively | 1,220 | 2,149 |
| Accrued rental income, net of allowance of \$3,086 and \$4,870, respectively | 25,806 | 25,187 |
| Debt costs, net of accumulated amortization of \$17,887 and \$15,381, respectively | 11,318 | 10,832 |
| Other assets | 68,536 | 53,352 |
| Total assets | \$3,934,198 | \$3,434,429 |
| LIABILITIES AND EQUITY | | |
| Liabilities: | | |
| Line of credit payable | \$— | \$65,600 |
| Mortgages payable, including unamortized premium of \$202 and \$0, respectively | 10,873 | 23,171 |
| Notes payable – convertible, net of unamortized discount of \$3,174 and \$6,363, respectively | 358,561 | 355,371 |
| Notes payable, net of unamortized discount of \$9,571 and \$5,033, respectively | 1,165,429 | 894,967 |
| Accrued interest payable | 22,112 | 15,108 |
| Other liabilities | 99,145 | 76,336 |
| Total liabilities | 1,656,120 | 1,430,553 |
| Equity: | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.01 par value. Authorized 15,000,000 shares | | |
| Series D, 11,500,000 depositary shares issued and outstanding, at stated liquidation value of \$25 per share | 287,500 | — |
| Series C, 3,680,000 depositary shares issued and outstanding, at stated liquidation value of \$25 per share | — | 92,000 |
| Common stock, \$0.01 par value. Authorized 375,000,000 shares; 109,421,774 and 104,754,859 shares issued and outstanding, respectively | 1,096 | 1,049 |
| | — | — |

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Excess stock, \$0.01 par value. Authorized 390,000,000 shares; none issued or outstanding

| | | |
|---|-------------|-------------|
| Capital in excess of par value | 2,075,112 | 1,958,225 |
| Retained earnings (loss) | (83,497 |) (44,946) |
| Accumulated other comprehensive income (loss) | (3,448 |) (3,830) |
| Total stockholders' equity of NNN | 2,276,763 | 2,002,498 |
| Noncontrolling interests | 1,315 | 1,378 |
| Total equity | 2,278,078 | 2,003,876 |
| Total liabilities and equity | \$3,934,198 | \$3,434,429 |

See accompanying notes to consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands, except per share data)

(Unaudited)

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|-----------------------------|----------|---------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenues: | | | | |
| Rental income from operating leases | \$80,411 | \$62,158 | \$230,415 | \$175,463 |
| Earned income from direct financing leases | 608 | 639 | 1,854 | 2,072 |
| Percentage rent | 242 | 229 | 574 | 476 |
| Real estate expense reimbursement from tenants | 2,647 | 2,437 | 7,967 | 6,859 |
| Interest and other income from real estate transactions | 512 | 381 | 1,982 | 1,534 |
| Interest income on commercial mortgage residual interests | 593 | 782 | 2,064 | 2,325 |
| | 85,013 | 66,626 | 244,856 | 188,729 |
| Retail operations: | | | | |
| Revenues | — | 12,402 | 19,008 | 33,702 |
| Operating expenses | — | (11,563) | (18,543) | (32,175) |
| Net | — | 839 | 465 | 1,527 |
| Operating expenses: | | | | |
| General and administrative | 8,652 | 7,036 | 23,278 | 20,261 |
| Real estate | 3,878 | 4,434 | 12,437 | 11,983 |
| Depreciation and amortization | 17,465 | 14,777 | 54,253 | 41,707 |
| Impairment – commercial mortgage residual interests valuation | — | — | 2,718 | 396 |
| Impairment losses and other charges | 7,261 | — | 7,296 | — |
| | 37,256 | 26,247 | 99,982 | 74,347 |
| Earnings from operations | 47,757 | 41,218 | 145,339 | 115,909 |
| Other expenses (revenues): | | | | |
| Interest and other income | (1,194) | (457) | (1,913) | (1,083) |
| Interest expense | 22,866 | 20,086 | 61,905 | 55,260 |
| | 21,672 | 19,629 | 59,992 | 54,177 |
| Earnings from continuing operations before income tax benefit | | | | |
| (expense) and equity in earnings of unconsolidated affiliate | 26,085 | 21,589 | 85,347 | 61,732 |
| Income tax benefit (expense) | 7,426 | (68) | 7,190 | (258) |
| Equity in earnings of unconsolidated affiliate | 3,769 | 109 | 4,074 | 321 |
| Earnings from continuing operations | 37,280 | 21,630 | 96,611 | 61,795 |
| Earnings from discontinued operations, net of income tax expense (Note 9) | 710 | 978 | 4,679 | 2,936 |
| Earnings including noncontrolling interests | 37,990 | 22,608 | 101,290 | 64,731 |
| Loss (earnings) attributable to noncontrolling interests: | | | | |
| Continuing operations | 32 | 20 | 87 | 113 |

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| | | | | | |
|----------------------------------|----------|----------|-----------|----------|---|
| Discontinued operations | (7 |) 4 | (24 |) (89 |) |
| | 25 | 24 | 63 | 24 | |
| Net earnings attributable to NNN | \$38,015 | \$22,632 | \$101,353 | \$64,755 | |

See accompanying notes to consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.

and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands, except per share data)

(Unaudited)

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|-----------------------------|------------|---------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| Net earnings attributable to NNN | \$38,015 | \$22,632 | \$101,353 | \$64,755 |
| Series C preferred stock dividends | — | (1,696 |) (1,979 |) (5,089 |
| Series D preferred stock dividends | (4,762 |) — | (10,688 |) — |
| Excess of redemption value over carrying value of preferred shares redeemed | — | — | (3,098 |) — |
| Net earnings attributable to common stockholders | \$33,253 | \$20,936 | \$85,588 | \$59,666 |
| Net earnings per share of common stock: | | | | |
| Basic: | | | | |
| Continuing operations | \$0.30 | \$0.23 | \$0.76 | \$0.67 |
| Discontinued operations | 0.01 | 0.01 | 0.04 | 0.03 |
| Net earnings | \$0.31 | \$0.24 | \$0.80 | \$0.70 |
| Diluted: | | | | |
| Continuing operations | \$0.29 | \$0.23 | \$0.75 | \$0.66 |
| Discontinued operations | 0.01 | 0.01 | 0.04 | 0.03 |
| Net earnings | \$0.30 | \$0.24 | \$0.79 | \$0.69 |
| Weighted average number of common shares outstanding: | | | | |
| Basic | 107,487,935 | 87,109,406 | 106,140,002 | 84,896,946 |
| Diluted | 110,339,705 | 87,788,250 | 108,091,909 | 85,438,870 |
| Other comprehensive income: | | | | |
| Net earnings attributable to NNN | \$38,015 | \$22,632 | \$101,353 | \$64,755 |
| Amortization of interest rate hedges | 57 | 38 | 171 | (47 |
| Fair value treasury locks | — | — | — | (5,218 |
| Unrealized gain - commercial mortgage residual interests | — | — | 213 | 599 |
| Stock value adjustments | (1 |) (8 |) (2 |) (34 |
| Comprehensive income attributable to NNN | \$38,071 | \$22,662 | \$101,735 | \$60,055 |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|--|---------------------------------|------------|
| | 2012 | 2011 |
| Cash flows from operating activities: | | |
| Earnings including noncontrolling interests | \$ 101,290 | \$ 64,731 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Performance incentive plan expense | 7,010 | 5,057 |
| Depreciation and amortization | 54,926 | 42,802 |
| Impairment losses and other charges | 9,043 | 431 |
| Impairment – commercial mortgage residual interests valuation | 2,718 | 396 |
| Amortization of notes payable discount | 3,641 | 5,032 |
| Amortization of debt costs | 2,506 | — |
| Amortization of mortgages payable premium | (14 |) — |
| Amortization of deferred interest rate hedges | 171 | (47 |
| Equity in earnings of unconsolidated affiliate | (4,074 |) (321 |
| Distributions received from unconsolidated affiliate | 7,019 | 432 |
| Gain on disposition of real estate portfolio | (4,446 |) (140 |
| Gain on note receivable and property foreclosure | (198 |) — |
| Other | — | 266 |
| Change in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations: | | |
| Additions to held for sale real estate | (4,941 |) (790 |
| Proceeds from disposition of held for sale real estate | — | 1,058 |
| Decrease in real estate leased to others using the direct financing method | 1,222 | 1,191 |
| Increase in work in process | (1,225 |) (856 |
| Decrease in mortgages, notes and accrued interest receivable | 37 | 170 |
| Decrease in receivables | 1,014 | 1,734 |
| Decrease (increase) in commercial mortgage residual interests | 286 | (204 |
| Decrease (increase) in accrued rental income | (695 |) 93 |
| Decrease in other assets | 1,365 | 571 |
| Increase in accrued interest payable | 7,004 | 15,029 |
| Increase (decrease) in other liabilities | (4,893 |) 1,548 |
| Increase (decrease) in current tax liability | (7,192 |) 962 |
| Net cash provided by operating activities | 171,574 | 139,145 |
| Cash flows from investing activities: | | |
| Proceeds from the disposition of real estate, Investment Portfolio | 32,371 | 8,138 |
| Additions to real estate: | | |
| Accounted for using the operating method | (414,843 |) (434,532 |
| Accounted for using the direct financing method | — | (1,747 |
| Increase in mortgages and notes receivable | (8,768 |) (5,706 |
| Principal payments on mortgages and notes receivable | 10,668 | 4,938 |
| Payment of lease costs | (1,583 |) (862 |
| Return of investment from unconsolidated affiliate | 1,220 | — |

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| | | | |
|---------------------------------------|----------|------------|---|
| Other | (313 |) (2,191 |) |
| Net cash used in investing activities | (381,248 |) (431,962 |) |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|--|---------------------------------|-----------|
| | 2012 | 2011 |
| Cash flows from financing activities: | | |
| Proceeds from line of credit payable | \$685,900 | \$504,800 |
| Repayment of line of credit payable | (751,500) | (665,800) |
| Payment of interest rate hedge | — | (5,300) |
| Proceeds from notes payable | 320,011 | 295,731 |
| Repayment of notes payable | (50,000) | — |
| Payment of debt costs | (2,992) | (5,464) |
| Repayment of mortgages payable | (19,134) | (816) |
| Proceeds from issuance of common stock | 119,259 | 299,528 |
| Proceeds from issuance of preferred stock | 287,500 | — |
| Redemption of preferred stock | (92,000) | — |
| Payment of Series C preferred stock dividends | (1,979) | (5,089) |
| Payment of Series D preferred stock dividends | (10,688) | — |
| Payment of common stock dividends | (124,139) | (96,915) |
| Noncontrolling interest distributions | — | (45) |
| Noncontrolling interest contributions | — | 41 |
| Stock issuance costs | (11,200) | (10,224) |
| Net cash provided by financing activities | 349,038 | 310,447 |
| Net increase in cash and cash equivalents | 139,364 | 17,630 |
| Cash and cash equivalents at beginning of year | 2,082 | 2,048 |
| Cash and cash equivalents at end of year | \$141,446 | \$19,678 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid, net of amount capitalized | \$50,872 | \$37,117 |
| Taxes paid (received) | \$125 | \$(541) |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Issued 396,577 and 141,351 shares of restricted and unrestricted common stock in 2012 and 2011, respectively, pursuant to NNN's performance incentive plan | \$8,576 | \$3,456 |
| Issued 12,373 and 6,975 shares of common stock in 2012 and 2011, respectively, to directors pursuant to NNN's performance incentive plan | \$346 | \$177 |
| Issued 14,836 and 19,962 shares of common stock in 2012 and 2011, respectively, pursuant to NNN's Deferred Director Fee Plan | \$223 | \$338 |
| Surrender of 4,712 and of 5,215 shares of restricted common stock in 2012 and 2011, respectively | \$113 | \$109 |
| Change in other comprehensive income | \$(382) | \$(4,701) |
| Change in lease classification (direct financing lease to operating lease) | \$757 | \$3,407 |
| Mortgage payable assumed in connection with real estate transaction | \$6,634 | \$— |
| Real estate acquired in connection with mortgage receivable foreclosure | \$490 | \$— |
| Real estate received in note receivable foreclosure | \$1,595 | \$— |

See accompanying notes to consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2012
(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 term “NNN” or the “Company” refers 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” or “Property Portfolio”).

| | September 30, 2012 |
|-----------------------------------|--------------------|
| Property Portfolio: | |
| Total properties | 1,530 |
| Gross leasable area (square feet) | 18,331,000 |
| States | 47 |

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 nine months ended September 30, 2012, may not be indicative of the results that may be expected for the year ending December 31, 2012. Amounts as of December 31, 2011, 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, 2011.

Principles of Consolidation – NNN's condensed consolidated financial statements include the accounts of each of the 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 nine months ended September 30, 2012, NNN recorded \$336,000 and \$1,204,000, respectively, in capitalized interest and recorded \$278,000 and \$846,000 in capitalized interest during the same periods in 2011, 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, value of in-place leases and value of tenant relationships, based in each case on their relative 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 the fair values of these assets. The as-if-vacant fair value of a property is provided to management by a qualified appraiser.

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, including the probability of renewal periods. 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 would renew the option whereby the Company would amortize 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 (in thousands):

| | September 30, 2012 | December 31, 2011 |
|---|--------------------|-------------------|
| Intangible lease assets (included in Other assets): | | |
| Value of above market in-place leases, net | \$6,910 | \$5,907 |