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Introduction

The REIT sector is vast and versatile. There are numerous entities operating within different property sectors, allowing us to find attractive investment opportunities accompanied by different value propositions. Among retail, industrial, office, residential, etc. properties, there's one property sector that I find especially unique in terms of its value driver – the gaming property sector.

It holds numerous advantages over the retail/service-oriented property sector, highly favored by investors. Just to name a few of them:

- REITs operating within this sector are capable of securing better terms within their lease agreements
- retail properties are highly commoditized, which is not the case for gaming properties, as they often constitute a brand in itself. This limits the tenants' ability to switch locations
- high barriers to entry with rigorous regulations in place
- REITs operating within gaming property sector uphold outstanding occupancy rates as the tenants have limited ability to switch locations due to not only the brand associated with a given property but also the regulations
- immunity to the Amazon Effect and progressing digitization

Two Major Players

There are two major players in this sector:

Both of these entities enjoy the benefits coming from the unique value drivers accompanying the gaming property sector. None of them is as popular as, for example, Realty Income (O), which operates mainly within the retail/service-oriented property sector – often the most preferable one for REIT investors. However, they hold many advantages that we'll go through within this article.

The Competitive Edge VICI and GLPI Hold Over Other REITs

#1 Their properties are more than mission-critical

It's impossible not to emphasize VICI's crown jewels like Caesars Palace or The Venetian. Its gaming portfolio includes 54 properties across 54 states and 1 Canadian Province. With some of the key Trophy Assets on the Las Vegas Strip, around 47% of VICI's ABR is generated in Las Vegas.

On the other hand, GLPI is concentrated on regional properties outside of Las Vegas. While it may not have the most globally recognizable establishments within its portfolio, they own numerous properties that are #1 locations within their specific market. As of June 30, 2024, GLPI's portfolio included 65 gaming properties across 20 states.

It's important to recognize that both entities recorded outstanding, 100% occupancy rates as of June 2024, uncanny for many of popular property sectors.

For reference:

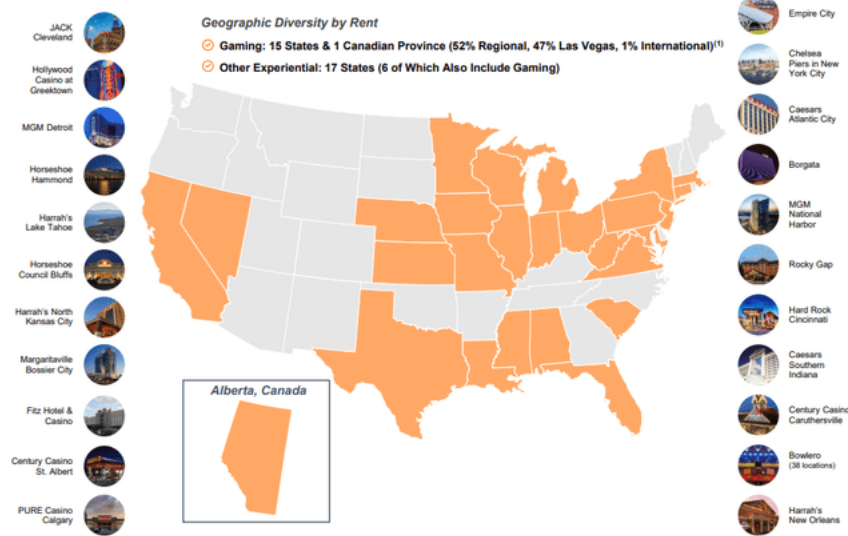
- industrial property sector is facing supply-to-demand related headwinds with most of its representatives recording relatively low occupancy rates
- top players of the retail property sector secure (at best) 99.8% occupancy rate

This speaks volumes about the quality and necessity of VICI's and GLPI's assets to their tenants. Moreover, plenty of their business is carried out thanks to strong brand factor of such properties (trophy assets of VICI or Top 1% in a given region properties of GLPI).

The regulatory environment limiting tenants' ability to switch locations also supports a high occupancy rate. This matter is also well-reflected within outstanding terms of lease agreements that both entities secure, which leads us to the next point.

HIGH-QUALITY PORTFOLIO OF REAL ESTATE...

54 Gaming and 39 Other Experiential Properties Spanning 26 States and 1 Canadian Province



VICI Investor Presentation

High Quality Real Estate Portfolio

The quality and relevance of our portfolio is demonstrated by the solid property performance of our market leading properties:



VICI Investor Presentation

#2 Strong negotiating position leading to the best-in-class terms

Upholding a high weighted-average lease term (WALT) ensures the cash flow predictability and stability. Both VICI and GLPI are capable of securing unparalleled lease terms.

As of June 30, 2024, VICI's WALT amounted to 41.2 years (incl. extension options), while most of GLPI's leases expire during the 2030 – 2040 period. However, they contain 15-25 year renewal options.

For reference, the WALT amounted to:

In light of the increasing probability of interest rate cuts, it's important to remember that REITs are an alternative asset class sharing some similarities to bonds. As a result, they share similarities when it comes to reacting to interest rate changes.

As bonds with higher duration are more sensitive to such changes, the same principle applies to REITs. With the highest WALTs in the entire sector, VICI and GLPI are likely to benefit more than a typical REIT, should the interest rate environment shift.

Another metric worth considering are annual rent escalators. They are embedded within the lease agreements, and they typically amount to 1% - 2%. VICI and GLPI tend to stick to the higher end of this range and often exceed it. VICI's minimal annual contractual rent escalator amounted to 1.7% as of May 2024.

Moreover, increasing proportion of its ABR is subject to CPI-linked escalators. Similarly for GLPI, which secures favorable terms in that regard, often exceeding 2% or reaching CPI-linked structures (for example its acquisition announced in May 2024.)

While this number may not seem like a lot for some, they constitute a main internal growth driver for rent revenue, heavily impacting the bottom line, especially under the triple net lease structure.

Moreover...

Positive Investment Spreads

As mentioned earlier, contractual rent escalations are the main source of internally-driven growth. However, they are not enough to uphold growth rates. REITs have to invest.

The larger you are, the more investment volume you require to uphold growth. Hence, Realty Income's recent acquisitions. Nevertheless, it's not just about investing but also about realizing positive investment spreads. To estimate investment spreads, let's use the (cap rate – cost of capital) formula.

For illustrative purposes, let's assume the cost of equity as AFFO yield (2024 AFFO per share guidance divided by recent stock price) and the cost of debt based on the credit rating of both entities.

Assuming the cap rate of 8.4% for GLPI and 7.7% for VICI we arrive at 1.6% and 1.2% investment spreads, respectively. Please refer to the table below for details and keep in mind that REITs may also fund investments through disposition proceeds or free cash flow.

Ticker Symbol	Cost of Equity	Cost of Debt	Cap rate	WACC	Spread
VICI	7.1%	5.6%	7.7%	6.5%	1.2%
GLPI	7.5%	5.6%	8.4%	6.8%	1.6%

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Both REITs Are Still 'Cheap' – Despite Recent Price Increases

Let's look at the valuation from the perspective of multiple method, which is a leading tool in M&A processes as it allows for accessible and market-driven benchmarking.

The main drawback of this method is that gathering an academically perfect reference group may not always be possible, especially when approaching leading players of a specific field, which I believe to be the case for VICI and GLPI. Nevertheless, the forward-looking P/FFO multiple stood at:

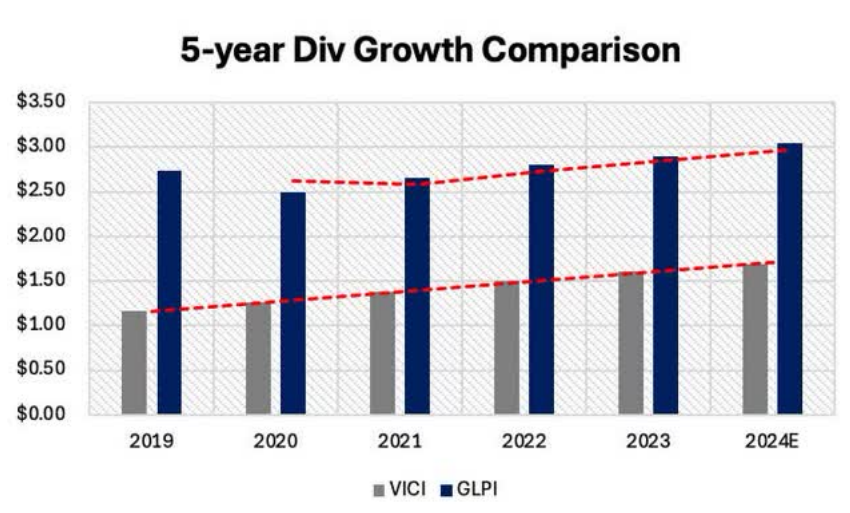
- 12x for VICI
- 12.9x for GLPI
- 17.7x for ADC
- 14.4x for O
- 15.2x for EPRT
- 9.2x for EPR

While the non-gaming experiential property sector shares some similarities with the gaming one, I don't believe EPR's multiple to be appropriate as it's a result of the post-covid headwinds the company is still facing. Nonetheless, I included it for transparency as not everyone may agree with my take on EPR.

Considering the unique value drivers accompanying both VICI and GLPI, as well as the quality of their businesses reflected in their business and credit metrics, as well as positive investment spreads, I believe we may expect a multiple appreciation to 14-15x range. Reaching this range would mean ~double-digit upside resulting solely from the multiple expansion.

Strong Dividend Growth And Occasional Specials

Both VICI & GLPI pay attractive dividends with forward dividend yields of 5.3% and 6.2% respectively. In the chart below you can see how their growth rates stack up over the past 5 years. One thing to note is Gaming & Leisure Properties cut their dividend during COVID by 8.76% from \$2.74 to \$2.50.



Author Creation

VICI continued to grow theirs by 7.26% during the same period. However, GLPI got back to business quickly, rewarding its shareholders with special dividends in 2021 & 2023. For the chart however, I chose to omit them. Still, over the past 5 years both have solid growth rates of 44.44% and 10.95% respectively.

Additionally, both REITs issued AFFO guidance for 2024 with VICI recently raising theirs due to a strong Q2. GLPI also raised their guidance from \$3.71 - \$3.74 to \$3.74 - \$3.76. Using both their midpoints of guidance, this gives them payout ratios of 75.1% and 81% respectively.

The Bottom Line

To summarize, I believe that both REITs are worth-considering as additions to a well-structured portfolio, as:

- they operate within resilient property sector supported by unique value drivers
- sustainably maintain out of the class business metrics (100% occupancy rate, outstanding WALT, high contractual rent escalators)
- they both offer attractive, growing, and well-covered dividends
- both entities have investment-graded balance sheets with well-laddered maturity profiles
- their valuation multiples remain detached from their long-term ability to generate cash flows
- they realize positive investment spreads

Nevertheless, as always – there are some risk factors to consider:

- both entities have a relatively high tenant concentration, magnifying risks associated with any potential tenant issues
- should the high-interest rate environment be upheld, they will witness higher costs associated with refinancing
- in case of VICI – further expansion outside of its main niche may lead to higher stock price volatility
- any other material adverse changes leading either to higher stock price volatility or worsening of the business and financial metrics (or both)

All in all both REITs are still trading at attractive valuations despite their recent price increases. Additionally, their strong fundamentals and high barriers to entry make them perfect portfolio additions for long-term dividend investors. We think both VICI Properties & Gaming And Leisure Properties are buys here.