

NATIONAL RETAIL PROPERTIES, INC.  
Form 10-Q  
May 01, 2018

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 March 31, 2018

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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.

153,849,191 shares of common stock, \$0.01 par value, outstanding as of April 27, 2018.



## 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>5</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>16</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>25</u>
Item 4. <u>Controls and Procedures</u>	<u>26</u>
Part II - Other Information	
Item 1. <u>Legal Proceedings</u>	<u>27</u>
Item 1A. <u>Risk Factors</u>	<u>27</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>27</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>27</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>27</u>
Item 5. <u>Other Information</u>	<u>27</u>
Item 6. <u>Exhibits</u>	<u>27</u>
<u>Signatures</u>	<u>28</u>
<u>Exhibit Index</u>	<u>29</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)

	March 31, 2018 (unaudited)	December 31, 2017
<b>ASSETS</b>		
Real estate portfolio:		
Accounted for using the operating method, net of accumulated depreciation and amortization	\$6,529,910	\$ 6,426,640
Accounted for using the direct financing method	9,422	9,650
Real estate held for sale	3,791	6,371
Cash and cash equivalents	4,002	1,364
Receivables, net of allowance of \$879 and \$1,119, respectively	3,863	4,317
Accrued rental income, net of allowance of \$1,936	26,361	25,916
Debt costs, net of accumulated amortization of \$13,023 and \$12,667, respectively	5,062	5,380
Other assets	78,245	80,896
Total assets	\$6,660,656	\$ 6,560,534
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Line of credit payable	\$ 176,400	\$ 120,500
Mortgages payable, including unamortized premium and net of unamortized debt costs	13,149	13,300
Notes payable, net of unamortized discount and unamortized debt costs	2,447,393	2,446,407
Accrued interest payable	36,379	20,311
Other liabilities	122,829	119,106
Total liabilities	2,796,150	2,719,624
Equity:		
Stockholders' equity:		
Preferred stock, \$0.01 par value. Authorized 15,000,000 shares		
5.700% Series E, 115,000 shares issued and outstanding, at stated liquidation value of \$2,500 per share	287,500	287,500
5.200% Series F, 138,000 shares issued and outstanding, at stated liquidation value of \$2,500 per share	345,000	345,000
Common stock, \$0.01 par value. Authorized 375,000,000 shares; 153,848,013 and 153,577,028 shares issued and outstanding, respectively	1,540	1,537
Capital in excess of par value	3,602,865	3,599,475
Accumulated deficit	(357,216 )	(379,181 )
Accumulated other comprehensive income (loss)	(15,509 )	(13,738 )
Total stockholders' equity of NNN	3,864,180	3,840,593
Noncontrolling interests	326	317
Total equity	3,864,506	3,840,910
Total liabilities and equity	\$6,660,656	\$ 6,560,534

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 March	
	31,	
	2018	2017
Revenues:		
Rental income from operating leases	\$ 147,829	\$ 136,493
Earned income from direct financing leases	230	257
Percentage rent	546	548
Real estate expense reimbursement from tenants	4,158	3,860
Interest and other income from real estate transactions	73	274
	152,836	141,432
Operating expenses:		
General and administrative	8,697	8,919
Real estate	5,862	5,663
Depreciation and amortization	44,498	40,143
Impairment losses – real estate and other charges, net of recoveries	2,248	1,206
Retirement severance costs	261	—
	61,566	55,931
Earnings from operations	91,270	85,501
Other expenses (revenues):		
Interest and other income	(25	) (137
Interest expense	26,602	26,614
	26,577	26,477
Earnings before gain on disposition of real estate	64,693	59,024
Gain on disposition of real estate	38,596	14,624
Net earnings	103,289	73,648
Loss (earnings) attributable to noncontrolling interests	(9	) 9
Net earnings attributable to NNN	103,280	73,657
Series D preferred stock dividends	—	(3,598
Series E preferred stock dividends	(4,097	) (4,097
Series F preferred stock dividends	(4,485	) (4,485
Excess of redemption value over carrying value of Series D preferred shares redeemed	—	(9,855
Net earnings attributable to common stockholders	\$94,698	\$ 51,622
Net earnings per share of common stock:		
Basic	\$0.62	\$ 0.35
Diluted	\$0.62	\$ 0.35
Weighted average number of common shares outstanding:		
Basic	153,041,056	146,929,678
Diluted	153,393,383	147,279,537
Other comprehensive income:		
Net earnings attributable to NNN	\$ 103,280	\$ 73,657
Amortization of deferred interest rate hedges	525	447
Deferred fair value of forward starting swaps	(2,164	) (554
Net gain (loss) – available-for-sale securities	(132	) 74
Comprehensive income attributable to NNN	\$ 101,509	\$ 73,624

See accompanying notes to condensed consolidated financial statements.

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

	Quarter Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net earnings	\$103,289	\$73,648
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	44,498	40,143
Impairment losses – real estate and other charges, net of recoveries	2,248	1,206
Amortization of notes payable discount	458	437
Amortization of debt costs	888	859
Amortization of mortgages payable premium	(21	) (21
Amortization of deferred interest rate hedges	525	447
Gain on disposition of real estate	(38,596	) (14,624
Performance incentive plan expense	2,275	2,755
Performance incentive plan payment	(432	) (862
Change in operating assets and liabilities, net of assets acquired and liabilities assumed:		
Decrease in real estate leased to others using the direct financing method	228	231
Decrease in receivables	125	307
Increase in accrued rental income	(998	) (675
Decrease in other assets	414	453
Increase in accrued interest payable	16,068	16,714
Decrease in other liabilities	(1,082	) (3,701
Other	110	(125
Net cash provided by operating activities	129,997	117,192
Cash flows from investing activities:		
Proceeds from the disposition of real estate	71,627	39,251
Additions to real estate:		
Accounted for using the operating method	(174,986	) (98,058
Other	207	(40
Net cash used in investing activities	(103,152	) (58,847

See accompanying notes to condensed consolidated financial statements.

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

	Quarter Ended March 31,	
	2018	2017
Cash flows from financing activities:		
Proceeds from line of credit payable	\$491,000	\$103,700
Repayment of line of credit payable	(435,100 )	(103,700 )
Repayment of mortgages payable	(134 )	(127 )
Payment of debt costs	(38 )	(92 )
Proceeds from issuance of common stock	1,554	49,011
Stock issuance costs	(174 )	(798 )
Redemption of Series D preferred stock	—	(287,500 )
Payment of Series D preferred stock dividends	—	(3,598 )
Payment of Series E preferred stock dividends	(4,097 )	(4,097 )
Payment of Series F preferred stock dividends	(4,485 )	(4,485 )
Payment of common stock dividends	(72,733 )	(66,781 )
Net cash used in financing activities	(24,207 )	(318,467 )
Net increase (decrease) in cash, cash equivalents and restricted cash	2,638	(260,122 )
Cash, cash equivalents and restricted cash at beginning of period <sup>(1)</sup>	1,364	294,540
Cash, cash equivalents and restricted cash at end of period <sup>(1)</sup>	\$4,002	\$34,418
Supplemental disclosure of cash flow information:		
Interest paid, net of amount capitalized	\$9,512	\$8,732
Taxes received	\$—	\$(3 )
Supplemental disclosure of noncash investing and financing activities:		
Change in other comprehensive income	\$1,171	\$33
Change in lease classification (direct financing lease to operating lease)	\$—	\$696

<sup>(1)</sup> Cash, cash equivalents and restricted cash is the aggregate of Cash and cash equivalents and Restricted cash and cash held in escrow from the Condensed Consolidated Balance Sheets. NNN did not have Restricted cash and cash held in escrow at March 31, 2018 and 2017.

See accompanying notes to condensed consolidated financial statements.



NATIONAL RETAIL PROPERTIES, INC.  
and SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
March 31, 2018  
(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” or the “Company” refer to National Retail Properties, Inc. and all of its consolidated subsidiaries.

NNN's assets primarily include real estate assets. 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”).

	March 31, 2018
Property Portfolio:	
Total properties	2,800
Gross leasable area (square feet)	29,116,000
States	48
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 (including normal recurring accruals) 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 ended March 31, 2018, may not be indicative of the results that may be expected for the year ending December 31, 2018. Amounts as of December 31, 2017, 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, 2017.

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.

Real Estate Portfolio – NNN records the acquisition of real estate 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. NNN recorded \$828,000 and \$554,000 in capitalized interest during the development period for the quarters ended March 31, 2018 and 2017, 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, as applicable, based on their respective fair values. Prior to the adoption of ASU 2017-01, “Business Combinations (Topic 805): Clarifying the definition of a Business,” on January 1, 2017, acquisition and closing costs incurred on the acquisition of real estate with an in-place lease were expensed as incurred and recorded as real estate acquisition costs.

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

7

---

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 options. 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 in that period. 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):

	March 31, 2018	December 31, 2017
Intangible lease assets (included in Other assets):		
Above-market in-place leases	\$ 16,467	\$ 16,583
Less: accumulated amortization	(9,601 )	(9,299 )
Above market in-place leases, net	\$ 6,866	\$ 7,284
In-place leases	\$ 106,831	\$ 104,592
Less: accumulated amortization	(63,497 )	(61,004 )
In-place leases, net	\$ 43,334	\$ 43,588
Intangible lease liabilities (included in Other liabilities):		
Below-market in-place leases	\$ 44,552	\$ 44,468
Less: accumulated amortization	(25,990 )	(26,055 )
Below-market in-place leases, net	\$ 18,562	\$ 18,413

The amounts amortized as a net increase to rental income for capitalized above-market and below-market leases for the quarters ended March 31, 2018 and 2017, were \$698,000 and \$660,000, respectively. The value of in-place leases amortized to expense for the quarters ended March 31, 2018 and 2017, were \$3,146,000 and \$3,327,000, respectively. Debt Costs – Line of Credit Payable – Debt costs incurred in connection with NNN's \$900,000,000 line of credit have been deferred and are being amortized to interest expense over the term of the loan commitment using the straight-line method, which approximates the effective interest method. NNN has recorded debt costs associated with the line of credit as an asset, in Debt costs on the Condensed Consolidated Balance Sheets.

Debt Costs – Mortgages Payable – Debt costs incurred in connection with NNN's mortgages payable have been deferred and are being amortized over the term of the respective loan commitment using the straight-line method, which approximates the effective interest method. These costs of \$147,000 at March 31, 2018 and December 31, 2017, are included in Mortgages payable on the Condensed Consolidated Balance Sheets net of accumulated amortization of \$60,000 and \$55,000, respectively.

Debt Costs – Notes Payable – Debt costs incurred in connection with the issuance of NNN's notes payable have been deferred and are being amortized to interest expense over the term of the respective debt obligation using the effective interest method. These costs of \$22,682,000 at March 31, 2018 and December 31, 2017, are included in Notes payable on the Condensed Consolidated Balance Sheets net of accumulated amortization of \$6,865,000 and \$6,337,000, respectively.

Revenue Recognition – In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606). The core principle of ASU 2014-09, is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Certain contracts are excluded from ASU 2014-09, including lease contracts within the scope of the FASB guidance included in Leases (Topic 842). NNN adopted ASU 2014-09 on January 1, 2018, and applied the cumulative catch-up transition method. Through the evaluation and implementation process, NNN determined the key revenue stream

8

---

impacted by ASU 2014-09 is Gain on disposition of real estate reported on the Condensed Consolidated Statements of Income and Comprehensive Income. NNN currently recognizes revenue at the time of closing (i.e., transfer of asset). Upon adoption of ASU 2014-09, NNN will evaluate any separate contracts or performance obligations to determine proper timing of revenue recognition, as well as, transaction price allocation. The adoption of ASU 2014-09 did not have a material impact on NNN's financial position and results of operations.

Earnings Per Share – Earnings per share have been computed pursuant to the FASB guidance included in Earnings Per Share. 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 March	
	31,	
	2018	2017
Basic and Diluted Earnings:		
Net earnings attributable to NNN	\$ 103,280	\$ 73,657
Less: Series D preferred stock dividends	—	(3,598 )
Less: Series E preferred stock dividends	(4,097 )	(4,097 )
Less: Series F preferred stock dividends	(4,485 )	(4,485 )
Less: Excess of redemption value over carrying value of Series D preferred shares redeemed	—	(9,855 )
Net earnings available to NNN's common stockholders	94,698	51,622
Less: Earnings allocated to unvested restricted shares	(147 )	(130 )
Net earnings used in basic and diluted earnings per share	\$94,551	\$ 51,492

Basic and Diluted Weighted Average Shares Outstanding:

Weighted average number of shares outstanding	153,678,913	147,581,522
Less: Unvested restricted stock	(237,617 )	(285,887 )
Less: Unvested contingent restricted shares	(400,240 )	(365,957 )
Weighted average number of shares outstanding used in basic earnings per share	153,041,056	146,929,678
Other dilutive securities	352,327	349,859
Weighted average number of shares outstanding used in diluted earnings per share	153,393,383	147,279,537

Fair Value Measurement – NNN's estimates of fair value of financial and non-financial assets and liabilities are based on the framework established in the fair value accounting guidance. The framework specifies a hierarchy of valuation inputs which was established to increase consistency, clarity and comparability in fair value measurements and related disclosures. The guidance describes a fair value hierarchy based upon three levels of inputs that may be used to measure fair value, two of which are considered observable and one that is considered unobservable. The following describes the three levels:

Level 1 – Valuation is based upon quoted prices in active markets for identical assets or liabilities.

Level 2 – Valuation is based upon inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include option pricing models, discounted cash flow models and similar techniques.



Accumulated Other Comprehensive Income (Loss) – The following table outlines the changes in accumulated other comprehensive income (loss) (dollars in thousands):

	Gains or (Losses) on Cash Flow Hedges <sup>(1)</sup>	Gains or (Losses) on Available-for-Sale Securities	Total
Beginning balance, December 31, 2017	\$(14,655)	\$ 917	\$(13,738)
Other comprehensive income (loss)	(2,164 )	(132 )	(2,296 )
Reclassifications from accumulated other comprehensive income to net earnings	525 <sup>(2)</sup>	—	525
Net current period other comprehensive income (loss)	(1,639 )	(132 )	(1,771 )
Ending balance, March 31, 2018	\$(16,294)	\$ 785	\$(15,509)

<sup>(1)</sup> Additional disclosure is included in Note 5 – Derivatives.

<sup>(2)</sup> Reclassifications out of other comprehensive income (loss) are recorded in Interest expense on the Condensed Consolidated Statements of Income and Comprehensive Income.

New Accounting Pronouncements – In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The FASB issued final guidance that requires lessees to put most leases on their balance sheets but recognize expenses in the income statement in a manner similar to today's accounting. The guidance also eliminates today's real estate-specific provisions and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs for all entities. For lessors, the standard modifies the classification criteria and the accounting for sales-type and direct financing leases. NNN is currently evaluating to determine the potential impact the adoption of ASU 2016-02 will have on its financial position or results of operations.

Use of Estimates – Management of NNN has made a number of estimates and assumptions relating to the reporting of assets and liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare these condensed consolidated financial statements in conformity with GAAP. Significant estimates include provisions for impairment and allowances for certain assets, accruals, useful lives of assets and purchase price allocation. Actual results could differ from those estimates.

Reclassification – Certain items in the prior year's consolidated financial statements and notes to consolidated financial statements have been reclassified to conform to the 2018 presentation.

Note 2 – Real Estate:

Real Estate – Portfolio

Leases – The following outlines key information for NNN's leases:

	March 31, 2018
Lease classification:	
Operating	2,830
Direct financing	7
Building portion – direct financing/land portion – operating	2
Weighted average remaining lease term (years)	11.4

The leases generally provide for limited increases in rent as a result of fixed increases, increases in the consumer price index, and/or increases in the tenant's sales volume. Generally, the tenant is also required to pay all property taxes and assessments, substantially maintain the Property and carry property and liability insurance coverage. Certain Properties are subject to leases under which NNN retains responsibility for specific costs and expenses of the Property. Generally, the leases provide the tenant with one or more multi-year renewal options, subject to generally the same terms and conditions of the base term of the lease, including rent increases.





Real Estate Portfolio – Accounted for Using the Operating Method – Real estate subject to operating leases consisted of the following as of (dollars in thousands):

	March 31, 2018	December 31, 2017
Land and improvements <sup>(1)</sup>	\$2,305,669	\$ 2,288,917
Buildings and improvements	5,056,056	4,968,778
Leasehold interests	3,971	5,261
	7,365,696	7,262,956
Less accumulated depreciation and amortization	(910,559 )	(878,236 )
	6,455,137	6,384,720
Work in progress for buildings and improvements	74,773	41,920
	\$6,529,910	\$ 6,426,640

<sup>(1)</sup> Includes \$30,434 and \$25,799 in land for Properties under construction at March 31, 2018 and December 31, 2017, respectively.

#### Real Estate – Held For Sale

On a quarterly basis, the Company evaluates its Properties for held for sale classification based on specific criteria as outlined in ASC 360, Property, Plant & Equipment, including management's intent to commit to a plan to sell the asset. NNN anticipates the disposition of Properties classified as held for sale to occur within 12 months. As of March 31, 2018, NNN had five of its Properties categorized as held for sale. NNN's real estate held for sale at December 31, 2017, included six Properties, one of which was sold in 2018. Real estate held for sale consisted of the following as of (dollars in thousands):

	March 31, 2018	December 31, 2017
Land and improvements	\$ 2,864	\$ 3,058
Building and improvements	5,134	6,284
	7,998	9,342
Less accumulated depreciation and amortization	(2,846 )	(2,885 )
Less impairment	(1,361 )	(86 )
	\$ 3,791	\$ 6,371

#### Real Estate – Dispositions

The following table summarizes the Properties sold and the corresponding gain recognized on the disposition of Properties (dollars in thousands):

	Quarter Ended March 31,			
	2018		2017	
	# of Sold Properties	Gain	# of Sold Properties	Gain
Gain on disposition of real estate	15	\$38,596 <sup>(1)</sup>	17	\$14,624

<sup>(1)</sup> Amount includes the recognition of a deferred gain related to a leasehold interest that was fully amortized in 2018

## Real Estate – Commitments

NNN has committed to fund construction commitments on 20 Properties. The improvements on such Properties are estimated to be completed within 12 months. These construction commitments, as of March 31, 2018, are outlined in the table below (dollars in thousands):

Total commitment <sup>(1)</sup>	\$ 147,559
Amount funded	105,207
Remaining commitment	42,352

<sup>(1)</sup> Includes land, construction costs, tenant improvements, lease costs and capitalized interest.

## Real Estate – Impairments

Management periodically assesses its real estate for possible impairment whenever certain events or changes in circumstances indicate that the carrying amount of the asset, including accrued rental income, may not be recoverable through operations. Events or circumstances that may occur include significant changes in real estate market conditions and the ability of NNN to re-lease or sell properties that are vacant or become vacant in a reasonable period of time. Impairments are measured as the amount by which the current book value of the asset exceeds the estimated fair value of the asset. As a result of the Company's review of long-lived assets, including identifiable intangible assets, NNN recognized real estate impairments, net of recoveries of \$2,248,000 and \$1,206,000 for the quarters ended March 31, 2018 and 2017, respectively.

The valuation of impaired assets is determined using widely accepted valuation techniques including discounted cash flow analysis, income capitalization, analysis of recent comparable sales transactions, actual sales negotiations and bona fide purchase offers received from third parties, which are Level 3 inputs. NNN may consider a single valuation technique or multiple valuation techniques, as appropriate, when estimating the fair value of its real estate.

## Note 3 – Line of Credit Payable:

NNN's \$900,000,000 unsecured revolving credit facility (the "Credit Facility") had a weighted average outstanding balance of \$145,396,000 and a weighted average interest rate of 2.5% during the quarter ended March 31, 2018. The Credit Facility matures January 2022, unless the Company exercises its option to extend maturity to January 2023. The Credit Facility bears interest at LIBOR plus 87.5 basis points; however, such interest rate may change pursuant to a tiered interest rate structure based on NNN's debt rating. The Credit Facility also includes an accordion feature to increase the facility size up to \$1,600,000,000, subject to lender approval. As of March 31, 2018, \$176,400,000 was outstanding and \$723,600,000 was available for future borrowings under the Credit Facility, excluding undrawn letters of credit totaling \$58,000.

## Note 4 – Stockholders' Equity:

In February 2018, NNN filed a shelf registration statement with the Securities and Exchange Commission (the "Commission") which permits the issuance by NNN of an indeterminate amount of debt and equity securities. Dividend Reinvestment and Stock Purchase Plan – In February 2018, NNN filed a shelf registration statement with the Commission for its Dividend Reinvestment and Stock Purchase Plan ("DRIP") which permits the issuance by NNN of up to 10,000,000 shares of common stock. The following table outlines the common stock issuances pursuant to NNN's DRIP (dollars in thousands):

	Quarter Ended	
	March 31,	
	2018	2017
Shares of common stock	44,659	16,320
Net proceeds	\$ 1,491	\$ 714



At-The-Market Offerings – NNN has established an at-the-market equity program ("ATM") which allows NNN to sell shares of common stock from time to time. The following outlines NNN's ATM programs:

	2018 ATM	2016 ATM
Established date	February 2018	March 2016
Termination date	February 2021	February 2018
Total allowable shares	12,000,000	12,000,000
Total shares issued as of March 31, 2018	—	10,044,656

There were no common stock issuances pursuant to NNN's ATM equity programs for the quarter ended March 31, 2018. The following table outlines the common stock issuances pursuant to NNN's ATM equity programs for the quarter ended March 31, 2017 (dollars in thousands, except per share data):

Shares of common stock	1,087,355
Average price per share (net)	\$ 43.92
Net proceeds	\$ 47,757
Stock issuance costs <sup>(1)</sup>	\$ 743

<sup>(1)</sup> Stock issuance costs consist primarily of underwriters' fees and commissions, and legal and accounting fees.

Dividends – The following table outlines the dividends declared and paid for each issuance of NNN's stock (dollars in thousands, except per share data):

	Quarter Ended March 31, 2017
Series D preferred stock <sup>(1)</sup> :	
Dividends	\$— 3,598
Per depositary share	—0.312847
Series E preferred stock <sup>(2)</sup> :	
Dividends	4,0097
Per depositary share	0.35625050
Series F preferred stock <sup>(3)</sup> :	
Dividends	4,4885
Per depositary share	0.32500000
Common stock:	
Dividends	726381
Per share	0.47355

<sup>(1)</sup> The Series D preferred stock was redeemed in February 2017. The dividends paid in 2017 included accumulated and

unpaid dividends through the redemption date.

<sup>(2)</sup> The Series E preferred stock has no maturity date and will remain outstanding unless redeemed by NNN. The earliest

redemption date for the Series E Preferred Stock is May 2018.

<sup>(3)</sup> The Series F preferred stock has no maturity date and will remain outstanding unless redeemed by NNN. The earliest

redemption date for the Series F preferred stock is October 2021.

In April 2018, NNN declared a dividend of \$0.475 per share, which is payable in May 2018 to its common stockholders of record as of April 30, 2018.

## Note 5 – Derivatives:

In accordance with the guidance on derivatives and hedging, NNN records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or a firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

NNN's objective in using derivatives is to add stability to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, NNN primarily uses treasury locks, forward swaps and interest rate swaps as part of its cash flow hedging strategy. Treasury locks and forward starting swaps are used to hedge forecasted debt issuances. Treasury locks designated as cash flow hedges lock in the yield/price of a treasury security. Forward swaps also lock the associated swap spread. Interest rate swaps designated as cash flow hedges are used to hedge the variable cash flows associated with floating rate debt and involve the receipt or payment of variable rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings.

NNN discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, the derivative expires or is sold, terminated or exercised, the derivative is re-designated as a hedging instrument or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

When hedge accounting is discontinued, NNN recognizes any changes in its fair value in earnings and continues to carry the derivative on the balance sheet or may choose to settle the derivative at that time with a cash payment or receipt.

The following table outlines NNN's derivatives which were hedging the risk of changes in forecasted interest payments on forecasted issuance of long-term debt (dollars in thousands):

Terminated	Description	Aggregate Notional Amount	Liability	Fair Value
			(Asset) Value When Terminated	Fair Deferred In Other Comprehensive Income <sup>(1)</sup>
June 2011	Two treasury locks	\$ 150,000	\$ 5,300	\$ 5,218
April 2013	Four forward starting swaps	240,000	3,156	3,141
May 2014	Three forward starting swaps	225,000	6,312	6,312
October 2015	Four forward starting swaps	300,000	13,369	13,369
December 2016	Two forward starting swaps	180,000	(13,352 )	(13,345 )
September 2017	Two forward starting swaps	250,000	7,690	7,688

<sup>(1)</sup> The amount reported in accumulated other comprehensive income will be reclassified to interest expense as interest payments are made on the related notes payable.

As of March 31, 2018, \$14,130,000 remained in other comprehensive income related to the effective portion of NNN's previously terminated interest rate hedges. During the quarters ended March 31, 2018 and 2017, NNN reclassified out of other comprehensive income \$525,000 and \$447,000, respectively, as an increase in interest expense. Over the next 12 months, NNN estimates that an additional \$2,165,000 will be reclassified as an increase in interest expense.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on NNN's long-term debt.

During the quarter ended March 31, 2018, NNN entered into two forward starting swaps with a total notional amount of \$250,000,000 to hedge the risk of changes in the interest-related cash outflows associated with the potential

issuance of long-term debt. The outstanding forward swaps were designated as cash flow hedges, and at March 31, 2018, have a fair value of \$2,164,000 included in Other liabilities and Accumulated other comprehensive income (loss) on the Condensed Consolidated Balance Sheets. The fair value of the forward starting swaps was based on a Level 2 valuation. No hedge ineffectiveness was recognized during the quarter ended March 31, 2018. These derivative financial instruments were still outstanding as of March 31, 2018.

NNN does not use derivatives for trading or speculative purposes or currently have any derivatives that are not designated as hedges.

Note 6 – Fair Value of Financial Instruments:

NNN believes the carrying value of its Credit Facility approximates fair value based upon its nature, terms and variable interest rate. NNN believes that the carrying value of its mortgages payable at March 31, 2018 and December 31, 2017, approximate fair value based upon current market prices of comparable instruments (Level 3). At March 31, 2018 and December 31, 2017, the fair value of NNN's notes payable net of unamortized discount and excluding debt costs was \$2,449,902,000 and \$2,507,106,000, respectively, based upon quoted market prices, which is a Level 1 valuation since NNN's notes payable are publicly traded.

Note 7 – Subsequent Events:

NNN reviewed its subsequent events and transactions that have occurred after March 31, 2018, the date of the condensed consolidated balance sheet. There were no reportable subsequent events or transactions.



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes included in the Annual Report on Form 10-K of National Retail Properties, Inc. for the year ended December 31, 2017. The terms "NNN" and the "Company" refer to National Retail Properties, Inc. and all of its consolidated subsidiaries.

### Forward-Looking Statements

The information herein contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934 (the "Exchange Act"). These statements generally are characterized by the use of terms such as "believe," "expect," "intend," "may," "estimated" or similar words or expressions. Forward-looking statements are not historical facts or guarantees of future performance and are subject to known and unknown risks. Certain factors that could cause actual results or events to differ materially from those NNN anticipates or projects include, but are not limited to, the following:

- Financial and economic conditions may have an adverse impact on NNN, its tenants, and commercial real estate in general;
- NNN may be unable to obtain debt or equity capital on favorable terms, if at all;
- Loss of rent from tenants would reduce NNN's cash flow;
- A significant portion of the source of the Property Portfolio annual base rent is concentrated in specific industry classifications, tenants and geographic locations;
- Owning real estate and indirect interests in real estate carries inherent risks;
- NNN's real estate investments are illiquid;
- Costs of complying with changes in governmental laws and regulations may adversely affect NNN's results of operations;
- NNN may be subject to known or unknown environmental liabilities and hazardous materials on Properties owned by NNN;
- NNN may not be able to successfully execute its acquisition or development strategies;
- NNN may not be able to dispose of properties consistent with its operating strategy;
- NNN may suffer a loss in the event of a default of or bankruptcy of a tenant or a borrower;
- Certain provisions of NNN's leases or loan agreements may be unenforceable;
- Property ownership through joint ventures and partnerships could limit NNN's control of those investments;
- Competition from numerous other REITs, commercial developers, real estate limited partnerships and other investors may impede NNN's ability to grow;
- NNN's loss of key management personnel could adversely affect performance and the value of its securities;
- Uninsured losses may adversely affect NNN's operating results and asset values;
- Acts of violence, terrorist attacks or war may affect the markets in which NNN operates and NNN's results of operations;
- Vacant properties or bankrupt tenants or borrowers could adversely affect NNN's business or financial condition;
- The amount of debt NNN has and the restrictions imposed by that debt could adversely affect NNN's business and financial condition;
- NNN is obligated to comply with financial and other covenants in its debt instruments that could restrict its operating activities, and the failure to comply with such covenants could result in defaults that accelerate the payment of such debt;
- The market value of NNN's equity and debt securities is subject to various factors that may cause significant fluctuations or volatility;
  - NNN's failure to qualify as a REIT for federal income tax purposes could result in significant tax liability;
- Even if NNN remains qualified as a REIT, NNN faces other tax liabilities that reduce operating results and cash flow;
-

Adverse legislative or regulatory tax changes could reduce NNN's earnings and cash flow and the market value of NNN's securities;

• Compliance with REIT requirements, including distribution requirements, may limit NNN's flexibility and may negatively affect NNN's operating decisions;

• Changes in accounting pronouncements could adversely impact NNN's or NNN's tenants' reported financial performance;

• NNN's failure to maintain effective internal control over financial reporting could have a material adverse effect on its business, operating results and the market value of NNN's securities;

• NNN's ability to pay dividends in the future is subject to many factors;

• Cybersecurity risks and cyber incidents could adversely affect NNN's business, disrupt operations and expose NNN to liabilities to tenants, employees, capital providers, and other third parties; and

Future investment in international markets could subject NNN to additional risks, including foreign currency exchange rate fluctuations, operational risks due to local economic and political conditions and laws and policies of the U.S. affecting foreign investment.

Additional information related to these risks and uncertainties are included in Item 1A. Risk Factors of NNN's Annual Report on Form 10-K for the year ended December 31, 2017, and may cause NNN's actual future results to differ materially from expected results. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. NNN undertakes no obligation to update or revise such forward-looking statements, whether as a result of new information, future events or otherwise.

#### Overview

NNN, a Maryland corporation, is a fully integrated real estate investment trust ("REIT") formed in 1984. NNN's assets are primarily real estate assets. NNN acquires, owns, invests in and develops properties that are leased primarily to retail tenants under long-term net leases and are primarily held for investment ("Properties" or "Property Portfolio", or individually a "Property").

As of March 31, 2018, NNN owned 2,800 Properties, with an aggregate gross leasable area of approximately 29,116,000 square feet, located in 48 states, with a weighted average remaining lease term of 11.4 years.

Approximately 99 percent of the Properties were leased as of March 31, 2018.

NNN's management team focuses on certain key indicators to evaluate the financial condition and operating performance of NNN. The key indicators for NNN include items such as: the composition of the Property Portfolio (such as tenant, geographic and line of trade diversification), the occupancy rate of the Property Portfolio, certain financial performance ratios and profitability measures, industry trends and industry performance compared to that of NNN.

NNN evaluates the creditworthiness of its current and prospective tenants. This evaluation may include reviewing available financial statements, store level financial performance, press releases, public credit ratings from major credit rating agencies, industry news publications and financial market data (debt and equity pricing). NNN may also evaluate the business and operations of its tenants, including periodically meeting with senior management of certain tenants.

NNN continues to maintain its diversification by tenant, geography and tenant's line of trade. NNN's largest lines of trade concentrations are the convenience store and restaurant (including full and limited service) sectors. These sectors represent a large part of the freestanding retail property marketplace and NNN's management believes these sectors present attractive investment opportunities. The Property Portfolio is geographically concentrated in the south and southeast United States, which are regions of historically above-average population growth. Given these concentrations, any financial hardship within these sectors or geographic regions could have a material adverse effect on the financial condition and operating performance of NNN.

## Results of Operations

## Property Analysis

General. The following table summarizes the Property Portfolio:

	March 31, 2018	December 31, 2017	March 31, 2017
Properties Owned:			
Number	2,800	2,764	2,543
Total gross leasable area (square feet)	29,116,000	29,093,000	27,311,000
Properties:			
Leased and unimproved land	2,777	2,740	2,520
Percent of Properties – leased and unimproved land	99	% 99	% 99
Weighted average remaining lease term (years)	11.4	11.5	11.4
Total gross leasable area (square feet) – leased	28,752,000	28,703,000	26,915,000

The following table summarizes the diversification of the Property Portfolio based on the top 10 lines of trade:

Lines of Trade	% of Annual Base Rent <sup>(1)</sup>			
	March 31, 2018	December 31, 2017	March 31, 2017	
1. Convenience stores	17.9	% 18.1	% 16.8	%
2. Restaurants – full service	12.0	% 12.1	% 11.7	%
3. Restaurants – limited service	8.0	% 7.6	% 7.5	%
4. Automotive service	7.6	% 6.9	% 7.0	%
5. Family entertainment centers	6.4	% 6.4	% 6.1	%
6. Health and fitness	5.6	% 5.6	% 5.7	%
7. Theaters	4.8	% 4.8	% 4.9	%
8. Automotive parts	3.6	% 3.6	% 3.8	%
9. Recreational vehicle dealers, parts and accessories	3.1	% 3.4	% 3.4	%
10. Wholesale clubs	2.4	% 2.2	% 2.3	%
Other	28.6	% 29.3	% 30.8	%
	100.0	% 100.0	% 100.0	%

<sup>(1)</sup> Based on annualized base rent for all leases in place for each respective period.

Property Acquisitions. The following table summarizes the Property acquisitions (dollars in thousands):

	Quarter Ended March 31,	
	2018	2017
Acquisitions:		
Number of Properties	52	24
Gross leasable area (square feet)	400,000	250,000
Initial cash yield	6.7	6.9