

NATIONAL RETAIL PROPERTIES, INC.

Form 10-Q

November 05, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

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)

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Maryland **56-1431377**
(State or other jurisdiction of **(I.R.S. Employer**
incorporation or organization) **Identification No.)**
450 South Orange Avenue, Suite 900, Orlando, Florida 32801
(Address of principal executive offices, including zip code)
(407) 265-7348
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) for the Securities Exchange Act of 1934 during the preceding 12 months (or for 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, or a non-accelerated filer or 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 Exchange 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.

83,481,761 shares of common stock, \$0.01 par value, outstanding as October 28, 2010.

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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, 2010 (unaudited) | December 31, 2009 |
|--|--------------------------------------|----------------------|
| <u>ASSETS</u> | | |
| Real estate, Investment Portfolio: | | |
| Accounted for using the operating method, net of accumulated depreciation and amortization | \$ 2,406,985 | \$ 2,328,576 |
| Accounted for using the direct financing method | 30,173 | 31,317 |
| Real estate, Inventory Portfolio, held for sale | 31,995 | 72,423 |
| Investment in unconsolidated affiliate | 4,553 | 4,703 |
| Mortgages, notes and accrued interest receivable | 38,583 | 41,976 |
| Commercial mortgage residual interests | 15,278 | 20,153 |
| Cash and cash equivalents | 4,009 | 15,225 |
| Receivables, net of allowance of \$1,690 and \$583, respectively | 1,049 | 1,946 |
| Accrued rental income, net of allowance of \$3,139 and \$2,875, respectively | 25,870 | 25,745 |
| Debt costs, net of accumulated amortization of \$12,823 and \$10,008, respectively | 10,453 | 13,884 |
| Other assets | 40,807 | 35,014 |
| Total assets | \$ 2,609,755 | \$ 2,590,962 |
| <u>LIABILITIES AND EQUITY</u> | | |
| Liabilities: | | |
| Line of credit payable | \$ 37,100 | \$ 25,290 |
| Mortgages payable | 24,532 | 25,290 |
| Notes payable convertible, net of unamortized discount of \$13,778 and \$18,355, respectively | 347,957 | 343,380 |
| Notes payable, net of unamortized discount of \$1,168 and \$1,324, respectively | 598,833 | 618,676 |
| Accrued interest payable | 18,400 | 7,471 |
| Other liabilities | 40,207 | 29,283 |
| Total liabilities | 1,067,029 | 1,024,100 |
| Equity: | | |
| Stockholders equity: | | |
| Preferred stock, \$0.01 par value. Authorized 15,000,000 shares | | |
| Series C, 3,680,000 depositary shares issued and outstanding, at stated liquidation value of \$25 per share | 92,000 | 92,000 |
| Common stock, \$0.01 par value. Authorized 190,000,000 shares; 83,481,071 and 82,427,560 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively | 836 | 825 |

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| | | |
|---|--------------|--------------|
| Excess stock, \$0.01 par value. Authorized 205,000,000 shares; none issued or outstanding | | |
| Capital in excess of par value | 1,425,069 | 1,408,491 |
| Retained earnings | 22,343 | 62,413 |
| Accumulated other comprehensive income | 1,198 | 511 |
| Total stockholders' equity of NNN | 1,541,446 | 1,564,240 |
| Noncontrolling interests | 1,280 | 2,622 |
| Total equity | 1,542,726 | 1,566,862 |
| Total liabilities and equity | \$ 2,609,755 | \$ 2,590,962 |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.

and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(dollars in thousands, except per share data)

(unaudited)

| | Quarter Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Revenues: | | | | |
| Rental income from operating leases | \$ 52,633 | \$ 51,978 | \$ 156,745 | \$ 157,562 |
| Earned income from direct financing leases | 746 | 797 | 2,265 | 2,297 |
| Percentage rent | 197 | 317 | 381 | 583 |
| Real estate expense reimbursement from tenants | 1,682 | 1,881 | 5,052 | 6,283 |
| Interest and other income from real estate transactions | 600 | 1,102 | 2,528 | 3,560 |
| Interest income on commercial mortgage residual interests | 798 | 1,046 | 2,705 | 3,100 |
| | 56,656 | 57,121 | 169,676 | 173,385 |
| Disposition of real estate, Inventory Portfolio: | | | | |
| Gross proceeds | | 353 | 5,600 | 353 |
| Costs | | (317) | (4,959) | (317) |
| Gain | | 36 | 641 | 36 |
| Retail operations: | | | | |
| Revenues | 9,225 | 7,317 | 24,458 | 7,317 |
| Operating expenses | (8,579) | (7,550) | (23,513) | (7,575) |
| Net | 646 | (233) | 945 | (258) |
| Operating expenses: | | | | |
| General and administrative | 5,927 | 4,937 | 17,313 | 16,028 |
| Real estate | 2,985 | 3,398 | 9,630 | 9,925 |
| Depreciation and amortization | 11,897 | 11,247 | 35,662 | 34,071 |
| Impairment real estate | | | | 1,064 |
| Impairment commercial mortgage residual interests valuation adjustment | | | 3,848 | |
| Restructuring costs | | | | 731 |
| | 20,809 | 19,582 | 66,453 | 61,819 |
| Earnings from operations | 36,493 | 37,342 | 104,809 | 111,344 |

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Other expenses (revenues):

| | | | | |
|---------------------------|--------|--------|---------|---------|
| Interest and other income | (332) | (262) | (1,170) | (1,025) |
| Interest expense | 16,501 | 15,558 | 48,524 | 46,424 |
| | 16,169 | 15,296 | 47,354 | 45,399 |

Earnings from continuing operations before income tax (expense) benefit, equity in earnings of unconsolidated affiliate, gain (loss) on note receivable and property foreclosures and gain on extinguishment of debt

| | | | | |
|--|--------|--------|--------|---------|
| | 20,324 | 22,046 | 57,455 | 65,945 |
| Income tax (expense) benefit | (170) | 281 | (497) | 1,184 |
| Equity in earnings of unconsolidated affiliate | 107 | 105 | 320 | 315 |
| Gain (loss) on note receivable and property foreclosures | | | 67 | (7,816) |
| Gain on extinguishment of debt | | | | 3,432 |

| | | | | |
|-------------------------------------|--------|--------|--------|--------|
| Earnings from continuing operations | 20,261 | 22,432 | 57,345 | 63,060 |
|-------------------------------------|--------|--------|--------|--------|

Earnings (loss) from discontinued operations (Note 9):

| | | | | |
|--|-----|------|-------|-------|
| Real estate, Investment Portfolio, net of income tax | 938 | (34) | 1,542 | 4,359 |
| Real estate, Inventory Portfolio, net of income tax | (5) | 398 | 256 | 416 |
| | 933 | 364 | 1,798 | 4,775 |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.

and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS CONTINUED

(dollars in thousands, except per share data)

(unaudited)

| | Quarter Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Earnings including noncontrolling interests | \$ 21,194 | \$ 22,796 | \$ 59,143 | \$ 67,835 |
| Loss (earnings) attributable to noncontrolling interests: | | | | |
| Continuing operations | (17) | 53 | (363) | (444) |
| Discontinued operations | 33 | (406) | 2 | (55) |
| | 16 | (353) | (361) | (499) |
| Net earnings attributable to NNN | \$ 21,210 | \$ 22,443 | \$ 58,782 | \$ 67,336 |
| Net earnings attributable to NNN | \$ 21,210 | \$ 22,443 | \$ 58,782 | \$ 67,336 |
| Series C preferred stock dividends | (1,696) | (1,696) | (5,089) | (5,089) |
| Net earnings available to common stockholders | \$ 19,514 | \$ 20,747 | \$ 53,693 | \$ 62,247 |
| Net earnings per share of common stock: | | | | |
| Basic: | | | | |
| Continuing operations | \$ 0.22 | \$ 0.26 | \$ 0.63 | \$ 0.72 |
| Discontinued operations | 0.01 | | 0.02 | 0.06 |
| Net earnings | \$ 0.23 | \$ 0.26 | \$ 0.65 | \$ 0.78 |
| Diluted: | | | | |
| Continuing operations | \$ 0.22 | \$ 0.26 | \$ 0.63 | \$ 0.72 |
| Discontinued operations | 0.01 | | 0.02 | 0.06 |
| Net earnings | \$ 0.23 | \$ 0.26 | \$ 0.65 | \$ 0.78 |
| Weighted average number of common shares outstanding: | | | | |
| Basic | 82,779,476 | 80,343,958 | 82,638,786 | 79,232,298 |
| Diluted | 82,915,376 | 80,455,033 | 82,769,556 | 79,334,739 |

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See accompanying notes to condensed 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, 2010 | 2009 |
| Cash flows from operating activities: | | |
| Earnings including noncontrolling interests | \$ 59,143 | \$ 67,835 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Performance incentive plan expense | 4,297 | 3,152 |
| Stock option expense tax effect | 122 | |
| Depreciation and amortization | 36,227 | 35,710 |
| Impairment real estate | | 1,064 |
| Impairment commercial mortgage residual interests valuation | 3,848 | |
| Amortization of notes payable discount | 4,734 | 4,479 |
| Amortization of deferred interest rate hedges | (124) | (119) |
| Equity in earnings of unconsolidated affiliate | (320) | (315) |
| Distributions received from unconsolidated affiliate | 442 | 481 |
| Gain on disposition of real estate, Investment Portfolio | (1,013) | (1,633) |
| Gain on extinguishment of debt | | (3,432) |
| Loss (gain) on note receivable and property foreclosures | (67) | 7,816 |
| Gain on disposition of real estate, Inventory Portfolio | (941) | (594) |
| Deferred income tax expense (benefit) | 275 | (2,019) |
| Income tax valuation allowance | 265 | |
| Change in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations: | | |
| Additions to real estate, Inventory Portfolio | (397) | (2,507) |
| Proceeds from disposition of real estate, Inventory Portfolio | 42,817 | 5,679 |
| Decrease in real estate leased to others using the direct financing method | 1,144 | 1,018 |
| Increase in work in process | (499) | (1,307) |
| Increase in mortgages, notes and accrued interest receivable | (264) | (365) |
| Decrease (increase) in receivables | 925 | 1,413 |
| Decrease (increase) in commercial mortgage residual interests | 1,812 | (1,144) |
| Increase accrued rental income | (211) | (1,395) |
| Decrease in other assets | 452 | (112) |
| Increase in accrued interest payable | 10,929 | 10,840 |
| Decrease (increase) in other liabilities | (1,610) | 1,328 |
| Increase (decrease) in current tax liability | (95) | 101 |
| Net cash provided by operating activities | 161,891 | 125,974 |
| Cash flows from investing activities: | | |
| Proceeds from the disposition of real estate, Investment Portfolio | 7,103 | 8,549 |

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| | | |
|---|-------------|-------------|
| Additions to real estate, Investment Portfolio: | | |
| Accounted for using the operating method | (106,525) | (35,178) |
| Increase in mortgages and notes receivable | (8,502) | (709) |
| Principal payments on mortgages and notes | 14,026 | 3,075 |
| Payment of lease costs | (965) | (275) |
| Acquired additional interest in controlled subsidiary | (1,603) | |
| Other | (2,087) | (719) |
| Net cash used in investing activities | \$ (98,553) | \$ (25,257) |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.

and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS CONTINUED

(dollars in thousands)

(unaudited)

| | Nine Months Ended | |
|--|-----------------------|------------|
| | September 30, 2010 | 2009 |
| Cash flows from financing activities: | | |
| Proceeds from line of credit payable | \$ 38,100 | \$ 132,400 |
| Repayment of line of credit payable | (1,000) | (158,900) |
| Repayment of mortgages payable | (6,190) | (742) |
| Repurchase of notes payable convertible debt component | | (14,785) |
| Repurchase of notes payable convertible equity component | | (796) |
| Repayment of notes payable | (20,000) | |
| Proceeds from issuance of common stock | 14,220 | 57,519 |
| Payment of Series C preferred stock dividends | (5,089) | (5,089) |
| Payment of common stock dividends | (93,762) | (89,422) |
| Noncontrolling interest contributions | 28 | 152 |
| Noncontrolling interest distributions | (861) | (325) |
| Stock issuance costs | | (104) |
| Net cash used in financing activities | (74,554) | (80,092) |
| Net increase (decrease) in cash and cash equivalents | (11,216) | 20,625 |
| Cash and cash equivalents at beginning of period | 15,225 | 2,626 |
| Cash and cash equivalents at end of period | \$ 4,009 | \$ 23,251 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid, net of amount capitalized | \$ 35,616 | \$ 35,109 |
| Taxes paid | \$ 430 | \$ 285 |
| Supplemental disclosure of non-cash investing and financing activities: | | |
| Issued 392,474 and 262,546 shares of restricted and unrestricted common stock in 2010 and 2009, respectively, pursuant to NNN's performance incentive plan | \$ 7,490 | \$ 4,290 |
| Issued 7,912 and 5,108 shares of common stock in 2010 and 2009, respectively, to directors pursuant to NNN's performance incentive plan | \$ 177 | \$ 88 |

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| | | | | |
|--|----|-------|----|----------|
| Issued 18,605 and 31,756 shares of common stock in 2010 and 2009, respectively, pursuant to NNN's Deferred Director Fee Plan | \$ | 279 | \$ | 456 |
| Change in other comprehensive income | \$ | 687 | \$ | 18 |
| Mortgage receivable accepted in connection with real estate transactions | \$ | 5,950 | \$ | 1,550 |
| Mortgages payable assumed in connection with real estate transactions | \$ | 5,432 | \$ | |
| Real estate acquired in connection with mortgage receivable foreclosure | \$ | 4,350 | \$ | 4,240 |
| Assets received in note receivable foreclosure | \$ | | \$ | 4,276 |
| Note receivable foreclosure | \$ | | \$ | (16,768) |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.

and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

(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 operations are divided into two primary business segments: (i) investment assets, including real estate assets, mortgages and notes receivable and commercial mortgage residual interests (collectively, Investment Assets), and (ii) inventory real estate assets (Inventory 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 (Investment Properties or Investment Portfolio). NNN's Investment Portfolio consisted of the following:

| | September 30, 2010 |
|--|--------------------|
| Investment Portfolio: | |
| Total properties (including retail operations) | 1,037 |
| Gross leasable area (square feet) | 11,741,000 |
| States | 43 |

The Inventory Assets typically represent direct and indirect investment interests in real estate assets acquired or developed primarily for the purpose of selling the real estate (Inventory Properties or Inventory Portfolio). NNN owned 17 Inventory Properties at September 30, 2010.

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 accounting principles generally accepted in the United States of America. 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, 2010, may not be indicative of the results that may be expected for the year ending December 31, 2010. Amounts as of December 31, 2009, 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, 2009.

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.

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Investment in an Unconsolidated Affiliate NNN accounts for its investment in an unconsolidated affiliate under the equity method of accounting.

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 and cash equivalents consist of cash and money market accounts. Cash equivalents 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; 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, historical bad debt levels, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts.

Other Comprehensive Income The components for the change in other comprehensive income consisted of the following (dollars in thousands):

| | Nine Months Ended September 30, 2010 |
|--|--|
| Balance at beginning of period | \$ 511 |
| Amortization of interest rate hedges | (124) |
| Unrealized gain commercial mortgage residual interests | 785 |
| Noncontrolling interests | 26 |
| Balance at end of period | \$ 1,198 |

NNN's total comprehensive income (dollars in thousands):

| | Quarter Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Net earnings | \$ 21,210 | \$ 22,443 | \$ 58,782 | \$ 67,336 |
| Other comprehensive income (loss) | 628 | (2,758) | 661 | 459 |
| Comprehensive income including noncontrolling interests | 21,838 | 19,685 | 59,443 | 67,795 |
| Comprehensive (income) loss attributable to noncontrolling interests | | 324 | 26 | (441) |
| Comprehensive income attributable to NNN | \$ 21,838 | \$ 20,009 | \$ 59,469 | \$ 67,354 |

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 contain 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.

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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 | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Basic and Diluted Earnings: | | | | |
| Net earnings attributable to NNN | \$ 21,210 | \$ 22,443 | \$ 58,782 | \$ 67,336 |
| Less: Series C preferred stock dividends | (1,696) | (1,696) | (5,089) | (5,089) |
| Net earnings available to NNN's common stockholders | 19,514 | 20,747 | 53,693 | 62,247 |
| Less: Earnings attributable to unvested restricted shares | (93) | (127) | (238) | (406) |
| Net earnings used in basic earnings per share | 19,421 | 20,620 | 53,455 | 61,841 |
| Reallocated undistributed income | | | | |
| Net earnings used in diluted earnings per share | \$ 19,421 | \$ 20,620 | \$ 53,455 | \$ 61,841 |
| Basic and Diluted Weighted Average Shares Outstanding: | | | | |
| Weighted average number of shares outstanding | 83,429,299 | 81,011,968 | 83,244,062 | 79,862,801 |
| Less: unvested restricted stock | (649,823) | (668,010) | (605,276) | (630,503) |
| Weighted average number of shares outstanding used in basic earnings per share | 82,779,476 | 80,343,958 | 82,638,786 | 79,232,298 |
| Effects of dilutive securities: | | | | |
| Common stock options | 3,054 | 7,835 | 3,825 | 9,263 |
| Directors' deferred fee plan | 132,846 | 103,240 | 126,945 | 93,178 |
| Weighted average number of shares outstanding used in diluted earnings per share | 82,915,376 | 80,455,033 | 82,769,556 | 79,334,739 |

The potential dilutive shares related to convertible notes payable were not included in computing earnings per common share because their effects would be antidilutive.

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.

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Business Combination Retrospective Adjustment In connection with the default in June 2009 by one of NNN's tenants under a note receivable and certain lease agreements with NNN, NNN acquired the operations of the tenant's 12 auto service businesses which were operated on the respective Investment Properties. A preliminary fair value of the assets acquired was recorded during the quarter ended June 30, 2009. As of December 31, 2009, a final valuation of the assets was completed and recorded by NNN. This adjustment was applied retrospectively and resulted in the following non-cash adjustment to the amounts and per share amounts as originally reported in NNN's Form 10-Q for the nine months ended September 30, 2009, and as restated or adjusted in this Form 10-Q.

| | Nine Months Ended September 30, 2009 |
|--|--|
| Net earnings, as reported | \$ 76,200 |
| Loss on note receivable and property foreclosure | (8,864) |
| Net earnings attributable to NNN | \$ 67,336 |

| | Nine Months Ended September 30, 2009 | |
|--|---|----------------|
| | As Originally Reported | As Adjusted |
| Net earnings per share of common stock: | | |
| Basic: | | |
| Continuing operations | \$ 0.83 | \$ 0.72 |
| Discontinued operations | 0.06 | 0.06 |
| Net earnings | \$ 0.89 | \$ 0.78 |
| Diluted: | | |
| Continuing operations | \$ 0.83 | \$ 0.72 |
| Discontinued operations | 0.06 | 0.06 |
| Net earnings | \$ 0.89 | \$ 0.78 |

New Accounting Pronouncements In June 2009, FASB issued guidance on the accounting for the transfers of financial assets. The new guidance eliminates the concept of a qualifying special-purpose entity and changes the requirements for derecognizing financial assets. The new guidance is effective on a prospective basis for annual periods beginning after November 15, 2009, and interim and annual periods thereafter. The adoption of the standard did not have a significant impact on NNN's financial position or results of operations.

In June 2009, FASB issued revised guidance on the accounting for variable interest entities. The revised guidance reflects the elimination of the concept of a qualifying special-purpose entity. The guidance also replaces the quantitative-based risks and rewards calculation of the previous guidance for determining which company, if any, has a controlling financial interest in a variable interest entity with an approach that is primarily qualitative. The new guidance requires ongoing assessments of whether an enterprise is the primary beneficiary of the variable interest entity as well as additional disclosures. The guidance is effective for financial statements issued for fiscal years beginning after November 15, 2009. The adoption of the standard did not have a significant impact on NNN's financial position or results of operations.

In August 2009, FASB issued new guidance for the accounting for the fair value measurement of liabilities. The new guidance provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the approved techniques. The new guidance clarifies that

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both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements. The guidance is effective for the first reporting period (including interim periods) beginning after issuance. The adoption of the standard did not have a significant impact on NNN's financial position or results of operations.

In January 2010, the FASB issued *Fair Value Measurements and Disclosures, Improving Disclosures about Fair Value Measurements*. This update requires new disclosures for transfer in and out of Level 1 and 2, as well as disclosure about the valuation techniques and inputs used to measure fair value for Level 1 and 2. In addition, activity in Level 3 should present separately information about purchases, sales, issuances and settlements on a gross basis (rather than as one net number). A reporting entity should provide fair value measurements disclosures for each class of assets and liabilities. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. NNN is currently evaluating the provisions to determine the potential impact, if any, the adoption will have on its financial position and results of operations.

In February 2010, the FASB issued *Subsequent Events, Amendments to Certain Recognition and Disclosure Requirements*. An entity that is a filer with the Securities and Exchange Commission (SEC) is required to evaluate subsequent events through the date that the financial statements are issued. An entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. This change alleviates potential conflicts between Subtopic 855-10 and the SEC requirements. The scope of the reissuance disclosure requirements is refined to include revised financial statements only. Revised financial statements include financial statements revised either as a result of correction of an error or retrospective application of accounting principles generally accepted in the United States of America. All of the amendments in this are effective upon issuance of the final update, except for the use of the issued date for conduit debt obligors. That amendment is effective for interim or annual periods ending after June 15, 2010. The adoption of the standard did not have an impact on NNN's 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 accounting principles generally accepted in the United States of America. Significant estimates include provision for impairment and allowances for certain assets, accruals, useful lives of assets and capitalization of costs. Actual results could differ from those estimates.

Reclassification Certain items in the prior year's condensed consolidated financial statements and notes to condensed consolidated financial statements have been reclassified to conform to the 2010 presentation.

Table of Contents**Note 2 Real Estate Investment Portfolio:**

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

| | September 30, 2010 |
|--|--------------------|
| Lease classification: | |
| Operating | 1,007 |
| Direct financing | 16 |
| Building portion direct financing / land portion operating | 7 |
| Weighted average remaining lease term | 11 Years |

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 interior and exterior of the building and carry property and liability insurance coverage. Certain of NNN's Investment Properties are subject to leases under which NNN retains responsibility for certain costs and expenses of the property. Generally, the leases of the Investment Properties provide the tenant with one or more multi-year renewal options subject to generally the same terms and conditions, including rent increases, consistent with the initial lease term.

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

| | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| Land and improvements | \$ 1,092,518 | \$ 1,054,888 |
| Buildings and improvements | 1,500,799 | 1,450,357 |
| Leasehold interests | 1,290 | 1,290 |
| | 2,594,607 | 2,506,535 |
| Less accumulated depreciation and amortization | (212,955) | (183,956) |
| | 2,381,652 | 2,322,579 |
| Work in process | 25,333 | 5,997 |
| | \$ 2,406,985 | \$ 2,328,576 |

NNN has remaining funding commitments as follows (dollars in thousands):

| | # of Properties | September 30, 2010 Total Commitment ⁽¹⁾ | September 30, 2010 Amount Funded | Remaining Commitment |
|----------------------|--------------------|--|--|-------------------------|
| Investment Portfolio | 24 | \$ 74,364 | \$ 51,217 | \$ 23,147 |

⁽¹⁾ Includes land and construction costs.

Table of Contents**Note 3 Real Estate Inventory Portfolio:**

The Inventory Portfolio consisted of the following (dollars in thousands):

| | September 30, 2010 | December 31, 2009 |
|------------------------------|-----------------------|----------------------|
| Inventory Properties: | | |
| Land | \$ 19,654 | \$ 37,088 |
| Building | 18,487 | 47,684 |
| | 38,141 | 84,772 |
| Less impairment | (6,146) | (12,349) |
| | \$ 31,995 | \$ 72,423 |

The following table summarizes the number of Inventory Properties sold and the corresponding gain recognized on the disposition of Inventory Properties included in continuing and discontinued operations (dollars in thousands):

| | Quarter Ended | | | | Nine Months Ended | | | | | |
|--|-----------------------|------|-----------------------|-----------|-----------------------|------------|-----------------------|------------|----|-----------|
| | September 30, 2010 | | September 30, 2009 | | September 30, 2010 | | September 30, 2009 | | | |
| | # of Properties | Gain | # of Properties | Gain | # of Properties | Gain | # of Properties | Gain | | |
| Continuing operations | \$ | 1 | \$ | 36 | 2 | \$ | 641 | 1 | \$ | 36 |
| Noncontrolling interest | | | | (14) | | | (320) | | | (14) |
| Total continuing operations attributable to NNN | | | | 22 | | | 321 | | | 22 |
| Discontinued operations | | | | | 2 | 85 | 2 | 527 | | |
| Intersegment eliminations | | | | | | 215 | | 31 | | |
| Noncontrolling interest | | | | | | (43) | | | | |
| Total discontinued operations attributable to NNN | | | | | | 257 | | 558 | | |
| | \$ | 1 | \$ | 22 | 4 | \$ | 578 | 3 | \$ | 580 |

Note 4 Mortgages, Notes and Accrued Interest Receivable:

Mortgages and notes are secured by real estate, real estate securities or other assets and include structured finance investments which are secured by the borrowers' pledge of their respective membership interests in the entities which own the respective real estate. Mortgages, notes and accrued interest receivable consisted of the following (dollars in thousands):

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| | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Mortgages and notes receivable | \$ 38,204 | \$ 41,707 |
| Accrued interest receivables, net of reserves | 445 | 269 |
| Unamortized discount | (66) | |
| | \$ 38,583 | \$ 41,976 |

Note 5 Commercial Mortgage Residual Interests:

During the nine months ended September 30, 2010, NNN acquired the 21.1% non-controlling interest in its majority owned and controlled subsidiary, Orange Avenue Mortgage Investments, Inc. (OAMI), for \$1,603,000, and OAMI became a wholly owned subsidiary of NNN. NNN accounted for the transaction as an equity transaction in accordance with the FASB guidance on consolidation. OAMI holds the commercial mortgage residual interests (Residuals) from seven securitizations. Each of the Residuals is recorded at fair value based upon an independent valuation. Unrealized gains and losses are reported as other comprehensive income in stockholders' equity and other than temporary losses as a result of a change in the timing or amount of estimated cash flows are recorded as an other than temporary valuation impairment.

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Due to changes in loan performance relating to the Residuals, the independent valuation adjusted certain of the valuation assumptions. The following table summarizes the key assumptions used in determining the value of the Residuals as of:

| | September 30, 2010 | December 31, 2009 |
|--|-----------------------|-----------------------|
| Discount rate | 25% | 25% |
| Average life equivalent CPR speeds range | 4.3% - 22.9% CPR | 14.5% to 20.7% CPR |
| Foreclosures: | | |
| Frequency curve default model | 0.1% - 14.3% range | 6% average rate |
| Loss severity of loans in foreclosure | 20% | 20% |
| Yield: | | |
| LIBOR | Forward 3-month curve | Forward 3-month curve |
| Prime | Forward curve | Forward curve |

The following table summarizes the recognition of unrealized gains and/or losses recorded as other comprehensive income as well as other than temporary valuation impairments recorded in condensed consolidated statements of earnings (dollars in thousands):

| | Quarter Ended | | Nine Months Ended | |
|---|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Unrealized gains (losses) | \$ 658 | \$ (2,718) | \$ 785 | \$ 578 |
| Other than temporary valuation impairment | \$ | \$ | \$ 3,848 | \$ |

Note 6 Line of Credit Payable:

NNN's \$400,000,000 revolving credit facility had a weighted average outstanding balance of \$208,000 and a weighted average interest rate of 3.8% during the nine months ended September 30, 2010. In November 2009, NNN entered into a credit agreement for a new \$400,000,000 revolving credit facility, replacing the existing revolving credit facility (as the context requires, the previous and new revolving credit facility, the Credit Facility). The Credit Facility matures November 2012, with an option to extend the maturity to November 2013. The Credit Facility bears interest at LIBOR plus 280 basis points with a 1.0% LIBOR floor; 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 for NNN to increase, at its option, the facility size up to \$500,000,000. As of September 30, 2010, \$37,100,000 was outstanding and \$362,900,000 was available for future borrowings under the Credit Facility, excluding undrawn letters of credit totaling \$647,000.

Table of Contents**Note 7 Stockholders Equity:**

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

| | Nine Months Ended | |
|----------------------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 |
| Series C preferred stock: | | |
| Dividends | \$ 5,089 | \$ 5,089 |
| Per share | 1.3828 | 1.3828 |
| Common stock: | | |
| Dividends | 93,762 | 89,422 |
| Per share | 1.130 | 1.125 |

⁽¹⁾ The Series C preferred stock has no maturity date and will remain outstanding unless redeemed.

In October 2010, NNN declared a dividend of \$0.38 per share, which is payable in November 2010 to its common stockholders of record as of October 29, 2010.

In June 2009, NNN filed a shelf registration statement with the Securities and Exchange Commission for its Dividend Reinvestment and Stock Purchase Plan (DRIP). The following outlines the common stock issuances pursuant to the DRIP (dollars in thousands):

| | Nine Months Ended | |
|-------------------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 |
| DRIP shares permitted | 16,000,000 | 16,000,000 |
| Shares of common stock issued | 663,741 | 3,247,883 |
| Net proceeds | \$ 14,159 | \$ 56,874 |

Note 8 Income Taxes:

NNN elected to be taxed as a REIT under the Internal Revenue Code (Code), commencing with its taxable year ended December 31, 1984. To qualify as a REIT, NNN must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 90% of its REIT taxable income to its stockholders. NNN intends to adhere to these requirements and maintain its REIT status. As a REIT, NNN generally will not be subject to corporate level federal income tax on taxable income that it distributes currently to its stockholders. NNN may be subject to certain state and local taxes on its income and property, and to federal income and excise taxes on its undistributed taxable income, if any. The provision for federal income taxes in NNN's consolidated financial statements relates to its TRS operations and any potential taxable built-in gain. NNN did not have significant tax provisions or deferred income tax items during the periods reported hereunder.

In June 2006, the FASB issued guidance, which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB guidance included in *Income Taxes*. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

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NNN is subject to the provisions of the FASB guidance as of January 1, 2007, and has analyzed its various federal and state filing positions. NNN believes that its income tax filing positions and deductions are well documented and supported. Additionally, NNN believes that its accruals for tax liabilities are adequate. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to the FASB guidance. In addition, NNN did not record a cumulative effect adjustment related to the adoption of the FASB guidance.

NNN has had no increases or decreases in unrecognized tax benefits for current or prior years since the date of adoption. Further, no interest or penalties have been included since no reserves were recorded and no significant increases or decreases are expected to occur within the next 12 months. When applicable, such interest and penalties will be recorded in non-operating expenses. The periods that remain open under federal statute are 2007 through 2010. NNN also files in many states with varying open years under statute.

Note 9 Earnings from Discontinued Operations:

Real Estate Investment Portfolio NNN classified the revenues and expenses related to (i) all Investment Properties that were sold and leasehold interests which expired, and (ii) all Investment Properties that were held for sale as of September 30, 2010, as discontinued operations. The following is a summary of the earnings from discontinued operations from the Investment Portfolio (dollars in thousands):

| | Quarter Ended | | Nine Months Ended | |
|--|---------------|----------------|-------------------|-----------------|
| | September 30, | September 30, | September 30, | September 30, |
| | 2010 | 2009 | 2010 | 2009 |
| Revenues: | | | | |
| Rental income from operating leases | \$ 440 | \$ 281 | \$ 840 | \$ 4,476 |
| Real estate expense reimbursement from tenants | 4 | 3 | 16 | 120 |
| Interest and other income from real estate transactions | | | 19 | 1 |
| Interest and other income from non-real estate | | 3 | | 5 |
| | 444 | 287 | 875 | 4,602 |
| Operating expenses: | | | | |
| General and administrative | 15 | | 7 | 3 |
| Real estate | 107 | 198 | 200 | 594 |
| Depreciation and amortization | 19 | 125 | 125 | 1,279 |
| | 141 | 323 | 332 | 1,876 |
| Earnings (loss) before gain on disposition of real estate and income tax expense | 303 | (36) | 543 | 2,726 |
| Gain on disposition of real estate | 635 | | 1,013 | 1,633 |
| Income tax (expense) benefit | | 2 | (14) | |
| Earnings (loss) from discontinued operations attributable to NNN | \$ 938 | \$ (34) | \$ 1,542 | \$ 4,359 |

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Real Estate Inventory Portfolio NNN has classified as discontinued operations the revenues and expenses related to (i) Inventory Properties which generated rental revenues prior to disposition, and (ii) Inventory Properties which generated rental revenues and were held for sale as of September 30, 2010. The following is a summary of the earnings from discontinued operations from the Inventory Portfolio (dollars in thousands):

| | Quarter Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Revenues: | | | | |
| Rental income from operating leases | \$ 500 | \$ 1,524 | \$ 2,868 | \$ 3,756 |
| Real estate expense reimbursement from tenants | 113 | 191 | 1,254 | 1,307 |
| Interest and other income from real estate transactions | 13 | 47 | 509 | 104 |
| | 626 | 1,762 | 4,631 | 5,167 |
| Disposition of real estate: | | | | |
| Gross proceeds | | | 37,470 | 5,402 |
| Costs | | | (37,170) | (4,844) |
| Gain | | | 300 | 558 |
| Operating expenses: | | | | |
| General and administrative | 10 | 21 | 66 | 86 |
| Real estate | 197 | 307 | 1,618 | 1,938 |
| Depreciation and amortization | 22 | 61 | 137 | 259 |
| | 229 | 389 | 1,821 | 2,283 |
| Other expenses (revenues): | | | | |
| Interest and other income | | | (2) | |
| Interest expense | 385 | 980 | 2,271 | 2,805 |
| | 385 | 980 | 2,269 | 2,805 |
| Earnings before income tax expense | 12 | 393 | 841 | 637 |
| Income tax (expense) benefit | (17) | 5 | (585) | (221) |
| Earnings (loss) from discontinued operations including noncontrolling interests | (5) | 398 | 256 | 416 |
| Loss (earnings) attributable to noncontrolling interests | 33 | (406) | 2 | (55) |
| Earnings (loss) from discontinued operations attributable to NNN | \$ 28 | \$ (8) | \$ 258 | \$ 361 |

Note 10 Derivatives:

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FASB ASC 815 provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FASB ASC 815, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. FASB ASC 815 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

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 firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to

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hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives used to hedge the foreign currency exposure of a net investment in a foreign operation are considered net investment hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting under FASB ASC 815.

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 and forward swaps (forward hedges) and interest rate swaps as part of its cash flow hedging strategy. Forward hedges designated as cash flow hedges lock in the yield/ price of a treasury security or the fixed rate of the underlying interest rate swap. Interest rate swaps designated as cash flow hedges hedging the variable cash flows associated with floating rate debt involve the receipt of variable rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. To date, such derivatives have been used to hedge the variable cash flows associated with floating rate debt and forecasted interest payments of a forecasted issuance of debt.