



## COMPANY UPDATE / ESTIMATE CHANGES

### Key Metrics

IRET - NASDAQ (as of 9/11/2017)	\$6.26
Price Target	N/A
52-Week Range	\$5.60 - \$7.28
Shares & Units Outstanding (mm)	135
Market Cap. (\$mm)	\$845
3-Mo. Average Daily Volume (000)	398
Institutional Ownership	49%
Debt/Total Capitalization (7/17)	47%
Est 3-Year Dividend Growth Rate	0%
Dividend	\$0.28
Dividend Yield	4.5%

### FFO Per Share FY End 4/30

	2016	2017	Prior 2018E	Curr. 2018E
1Q	\$0.16	\$0.12		\$0.10A
2Q	\$0.06	\$0.12	\$0.09	\$0.09
3Q	\$0.40	\$0.09	\$0.08	\$0.08
4Q	\$0.14	\$0.07	\$0.10	\$0.10
Year	\$0.76	\$0.40	\$0.35	\$0.37
P/FFO	8.2x	15.7x		16.9x

### Revenue (\$mm)

	2016	2017	Prior 2018E	Curr. 2018E
1Q	\$51	\$50		\$53A
2Q	\$52	\$51	\$51	\$55
3Q	\$56	\$51	\$53	\$56
4Q	\$49	\$54	\$52	\$56
Year	\$188	\$206	\$207	\$219

Quarterly amounts may not add up to full year amounts due to rounding and the timing of dispositions.

Prior to 4Q16, revenue includes TRS senior housing revenue.

Previous numbers have not been restated.

**Company Description:** *Investors Real Estate Trust, headquartered in Minot, North Dakota, is a REIT focused on the ownership and management of a portfolio of real estate properties.*

## REITs

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September 12, 2017

## Investors Real Estate Trust

IRET -- NYSE -- Neutral -- 3

### First Quarter Results

- **First quarter (ended July 31, 2017) FFO per share were \$0.10 compared to \$0.12 in the year ago period.** 1Q18 results were above our estimate but equal to the consensus estimate.
- **On June 6, 2016, IRET announced a strategic move to become a pure play multifamily REIT.** The company plans to sell its office and healthcare portfolios. This move should simplify IRET's portfolio, making it easier for investors and analysts to value, in our view. IRET plans to focus on improving margins in the multifamily segment and strengthening the company's balance sheet.
- **IRET has made progress on its strategic plans.** During the quarter, IRET sold one retail property for \$3.4 million. Subsequent to quarter end, IRET sold several additional non-core properties.
- **We continue to rate IRET Neutral as we believe the shares are fairly valued at this time.**

**Note Important Disclosures on Pages 7 and 8.  
Note Analyst Certification on Page 7.**

**Additional Discussion**

The company reported fiscal 1Q18 total real estate revenue of \$52.7 million, 6.3% above the year ago period (please see quarterly income statement on page 3). Real estate NOI (net operating income) increased 1.8% to \$28.5 million. Occupancy was up in the multifamily portfolio. Net income available to common shareholders (after noncontrolling interests and dividends to its preferred shareholders) was a loss of \$13.6 million, compared to a loss of \$24.5 million in the year ago period.

Funds from operations (FFO), which exclude real estate gains and losses, were \$13.1 million versus \$15.9 million. FFO per share were \$0.10, compared to \$0.12 per share in the year ago period, on a 1.3% reduction in shares and units outstanding.

**Balance Sheet** - At quarter end, total debt to total market capitalization was 46.8%, whereas debt to total assets was 55.1% (please see balance sheet on page 4). IRET's debt service coverage ratio (for the three months ended 7/31/2017) of 1.75x appears adequate, in our opinion. Most of IRET's debt (72.8%) is fixed rate debt. As of July 31, 2017, the weighted average interest rate on its debt was 4.37%. IRET has \$28.7 million and \$63.4 million of debt maturing in fiscal 2018 and fiscal 2019, respectively (including mortgages held for sale). As of July 31, 2017, IRET had approximately \$125.9 million outstanding on its revolving line of credit.

**Segment Analysis**

Fiscal 2018 First Quarter Segment Analysis (in thousands)					
	Residential	Medical	All Other	Corporate & Other	Total
Total Revenue	\$38,430	\$11,378	\$2,927		\$52,735
% of Total Revenue	72.9%	21.6%	5.6%	0.0%	100.0%
Total Real Estate Operating Expenses	\$17,465	\$4,285	\$793	\$1,707	\$24,250
% of Total Expenses	72.0%	17.7%	3.3%	7.0%	100.0%
% of Segment Revenue	45.4%	37.7%	27.1%		46.0%
Total NOI (Net Operating Income)	\$20,965	\$7,093	\$2,134	(\$1,707)	\$28,485
% of Segment Revenue	54.6%	62.3%	72.9%		54.0%

Fiscal 2017 First Quarter Segment Analysis (in thousands)					
	Residential	Medical	All Other	Corporate & Other	Total
Total Revenue	\$35,042	\$11,541	\$3,028		\$49,611
% of Total Revenue	70.6%	23.3%	6.1%	0.0%	100.0%
Total Real Estate Operating Expenses	\$14,879	\$4,192	\$725	\$1,838	\$21,634
% of Total Expenses	68.8%	19.4%	3.4%	8.5%	100.0%
% of Segment Revenue	42.5%	36.3%	23.9%		43.6%
Total NOI (Net Operating Income)	\$20,163	\$7,349	\$2,303	(\$1,838)	\$27,977
% of Segment Revenue	57.5%	63.7%	76.1%		56.4%

Note: April fiscal year

Source: Company reports

**Quarterly Income Statement**

April fiscal year

(in thousands, except per share data)	1Q18	1Q17	% Change
Real Estate Revenue	\$52,735	\$49,611	6.3%
Real Estate Expenses	24,250	21,634	12.1%
Real Estate NOI	28,485	27,977	1.8%
Interest Expense	9,295	10,364	-10.3%
Real Estate Depreciation and Amortization	28,927	14,267	102.8%
Administrative Expenses	4,002	3,501	14.3%
Advisory and Trustee Services			
Acquisitions and Investment Related Costs			
Other Operating Expenses			
Non-Real Estate Amortization			
Impairment of Real Estate Investment	256	54,153	
Operating Income (Loss)	(13,995)	(54,308)	
Gain on Involuntary Conversion			
Interest Income	231	188	22.9%
Other Income			
(Loss) on Extinguishment of Debt	(199)		
Income Tax Benefit			
Gain (Loss) on Sale of Real Estate and Other Investments	124	8,958	
Gain on Bargain Purchase			
Net Income (Loss) Attributable to Noncontrolling Interests - RE	371	15,655	
Net Income Attributable to Noncontrolling Interests - OP*	1,644	3,296	
Income (Loss) before Discontinued Operations	(11,824)	(26,211)	
Discontinued Operations	560	4,568	
Net Income (Loss)	(11,264)	(21,643)	
Redemption of Preferred Shares			
Dividends to Preferred Shareholders	(2,286)	(2,879)	
Net Income (Loss) Available to Common Shareholders	(\$13,550)	(\$24,522)	
<b>EPS</b>	<b>(\$0.11)</b>	<b>(\$0.20)</b>	
Weighted Average Common Shares	120,421	121,117	-0.6%

<b>Funds From Operations</b>	1Q18	1Q17	% Change
Net Income (Loss) Available to Common Shareholders	(\$13,550)	(\$24,522)	
Depreciation and Amortization	28,119	13,437	109.3%
Noncontrolling Interest - OP*	(1,644)	(3,296)	
Impairment of Real Estate Investment	256	39,189	
(Gain) Loss on Depreciable Property Sales	(124)	(8,958)	
<b>Funds From Operations</b>	<b>\$13,057</b>	<b>\$15,850</b>	-17.6%
<b>FFO Per Share</b>	<b>\$0.10</b>	<b>\$0.12</b>	-16.7%
Weighted Average Common Shares and Units	135,549	137,402	-1.3%

\*OP refers to operating units.

2017 results have been restated.

Source: Company reports

**Condensed Balance Sheet**

April fiscal year

(in thousands)	30-Apr-16	30-Apr-17	31-Jul-17
Property Owned	\$1,681,471	\$1,677,481	\$1,744,252
Less Accumulated Depreciation	(312,889)	(340,417)	(368,769)
	<b>\$1,368,582</b>	<b>\$1,337,064</b>	<b>\$1,375,483</b>
Development in Progress	51,681		
Unimproved Land	20,939	18,455	15,195
Mortgage Loan Receivable (net)			
<b>Net Real Estate Investments</b>	<b>\$1,441,202</b>	<b>\$1,355,519</b>	<b>\$1,390,678</b>
Real Estate Held for Sale, Etc.	220,761	37,708	37,552
Cash and Cash Equivalents	66,698	28,819	23,801
Restricted Cash			
Marketable Securities	50		
Receivables - Straight-lining of Rents	7,179	7,822	7,992
Accounts Receivable	1,524	2,600	2,184
Real Estate Deposits	0	23,659	
Prepaid and Other Assets	2,937	3,131	2,125
Notes Receivable			3,000
Intangible Assets (net)	1,858	658	1,249
Tax, Insurance, and Other Escrow	5,450	5,050	4,285
Property and Equipment (net)	1,011	901	836
Goodwill	1,680	1,572	1,572
Deferred Charges and Leasing Costs (net)	9,827	7,075	7,076
<b>Total Assets</b>	<b>\$1,760,177</b>	<b>\$1,474,514</b>	<b>\$1,482,350</b>
<b>Liabilities Held for Sale</b>	<b>\$77,712</b>	<b>\$30,062</b>	<b>\$29,683</b>
<b>Revolving Line of Credit</b>	<b>\$17,500</b>	<b>\$57,050</b>	<b>\$125,900</b>
<b>Mortgage Payable</b>	<b>\$817,324</b>	<b>\$661,960</b>	<b>\$660,753</b>
Accounts Payable and Accrued Expenses	39,727	40,350	36,859
Other Liabilities	82,130	41,817	20,205
<b>Total Liabilities</b>	<b>\$1,034,393</b>	<b>\$831,239</b>	<b>\$873,400</b>
Commitments and Contingencies			
Redeemable Noncontrolling Interests - Consolidated RE Entities	7,522	7,181	7,010
Preferred Shares	138,674	111,357	111,357
Common Shares	922,084	916,121	912,625
Accumulated Distributions in Excess of Net Income	(442,000)	(466,541)	(488,535)
<b>Total Shareholders' Equity</b>	<b>\$618,758</b>	<b>\$560,937</b>	<b>\$535,447</b>
Noncontrolling Interests - Consolidated Real Estate Entities	21,020	1,924	1,704
Noncontrolling Interests - OP	78,484	73,233	64,789
<b>Total Equity</b>	<b>\$718,262</b>	<b>\$636,094</b>	<b>\$601,940</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$1,760,177</b>	<b>\$1,474,514</b>	<b>\$1,482,350</b>

<b>Balance Sheet Ratio Analysis</b>	30-Apr-16	30-Apr-17	31-Jul-17
Total R/E Investments / Total Debt	157.9%	181.0%	170.4%
Debt to Equity	127.0%	117.8%	135.6%
Debt as % of Total Assets	51.8%	50.8%	55.1%
Shareholders' Equity as % of Total Assets	35.2%	38.0%	36.1%

Previous numbers have not been restated.

Source: Company reports

**Additional Discussion Continued**

**Strategic Move** - On June 6, 2016, IRET announced a strategic move to become a pure play multifamily REIT. The company plans to sell its office and healthcare portfolios. This move should simplify IRET's portfolio, making it easier for investors and analysts to value, in our view. IRET plans to focus on improving margins in the multifamily segment and strengthening the company's balance sheet. Proceeds from these potential asset sales will likely be used to reduce debt and fund multifamily acquisitions.

**Acquisitions & Dispositions** - During the first quarter, IRET purchased one multifamily property for \$61.5 million and sold one retail property for \$3.4 million. Subsequent to the end of the quarter, IRET entered into an agreement to acquire a 500 unit multifamily property for \$92.3 million. IRET sold several non-core properties subsequent to quarter end.

**Other Investments** - In July, IRET originated a loan on a multifamily development located less than 10 miles from the central business district of Minneapolis. The loan value is \$16.2 million and will be funded through 3Q18. This investment matures in 2023 and has an initial return of 6.0%. IRET has the option to purchase this development before the loan matures.

**Share Repurchase** - In 1Q18, IRET repurchased 682,000 common shares for \$3.9 million and redeemed 960,000 units for \$5.7 million.

**Outlook** - IRET continues to work towards becoming a pure play multifamily REIT. While we think this is a good direction for IRET, we believe earnings could be lumpy in the near term. The timing between asset sales and the redeployment of sales proceeds could impact earnings.

During the quarter, IRET completed a six month strategic exercise to create a plan to serve as a roadmap through IRET's transformation and beyond. The company plans to deepen its multifamily presences in the Twin Cities metro and enter into Denver and Chicago markets. These markets have strong fundamentals and there is a lack of coverage by the public multifamily REITs in these markets.

## Valuation

At 16.5x our forward 2018 FFO forecast, Investors Real Estate Trust is selling at a premium to a select group of “Diversified” REITs as defined by NAREIT, at a discount to the S&P 500, and at a premium to its median historic five year forward price/FFO multiple. We are impressed with the progress IRET has made so far on its transformation strategy. We believe IRET’s shares are fairly valued at this time and rate the stock Neutral. Investors should note that most REITs are on a calendar year, so IRET’s April fiscal year end may distort valuation comparisons.

Diversified REITs	Symbol	Closing Price	Current	Yield	Payout Ratio	FFO Per Share			2-Year Exp.	18/17	Price/FFO	
		9/11/2017	Dividend			2016	2017E	2018E	Average Growth	Growth Rate	2017E	2018E
Vorando Realty Trust	VNO	\$74.91	\$2.40	3.2%	56.5%	\$7.68	\$4.25	\$4.02	-23.8%	-5.4%	17.6x	18.6x
Lexington Realty Trust	LXP	\$9.99	\$0.70	7.0%	73.7%	\$1.10	\$0.95	\$1.02	-3.6%	7.4%	10.5x	9.8x
Cousins Properties, Inc.	CUZ	\$9.27	\$0.24	2.6%	39.3%	\$0.72	\$0.61	\$0.65	-4.9%	6.6%	15.2x	14.3x
Washington Real Estate Investment	WRE	\$33.13	\$1.20	3.6%	65.9%	\$1.76	\$1.82	\$1.88	3.4%	3.3%	18.2x	17.6x
Peer Average		\$31.83	\$1.14	4.1%	58.9%	\$2.82	\$1.91	\$1.89	-7.2%	3.0%	15.4x	15.1x
S&P 500	.SPX	2,488.11	\$48.92	2.0%	37.5%	\$117.75	\$130.35	\$140.58	9.7%	7.8%	19.1x	17.7x
Investors Real Estate Trust	IRET	\$6.26	\$0.28	4.5%	70.0%	\$0.76	\$0.40	\$0.37	-25.7%	-7.5%	15.7x	16.9x
FFO Adjusted Forward	IRET					\$0.40	\$0.37	\$0.38	-2.5%	2.7%	16.9x	16.5x

Note: IRET is on an April fiscal year, while the rest are on a calendar fiscal year. The results are not completely comparable.  
 FFO adjusted forward refers to the fiscal year that ends the following April.  
 2017 FFO per share for IRET is actual FFO per share, not estimated.  
 SPX figures are EPS not FFO per share.

Source: NAREIT, HL Estimates, and Thomson Eikon.

**Dividend** - The company currently pays a \$0.07 per share quarterly common share dividend.

## Suitability

We assign shares of Investors Real Estate Trust a suitability rating of 3 on our scale of 1 - 4 (1=most conservative, 4=most aggressive). Our rating is based on the company’s higher leverage and small market cap, offset somewhat by property type diversification.

## Risks and Considerations

**Interest Rate Risk** - Like all REITs, IRET is interest rate sensitive. The company’s debt to total market capitalization is 46.8%. However, with a majority of total debt at fixed rates (at the end of the first quarter), we believe IRET would be able to weather an increase in interest expense in a rising rate environment.

**Economic Risk Due to Geographic Concentration** - IRET’s real estate portfolio is highly concentrated in the two states of Minnesota and North Dakota. The local economy would not be immune if the national economy were to experience a marked slowdown in consumer spending as a result of a residential housing problem or by other forces beyond IRET’s control, including a significant change in oil prices.

**Other Risk** - General economic uncertainty, an increase in apartment move-outs, an increase in home buying, acquisition or dispositions taking longer than anticipated, etc.

*Additional information is available upon request.*

### **Analyst Certification**

I, Carol L. Kemple, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

### **Important Disclosures**

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

As of September 11, 2017 Hilliard Lyons and/or its affiliates beneficially owned (as defined for purposes of Section 13d of the 1934 Act) 1% or more of Investors Real Estate Trust pfd B 7.95% (IRET.B - \$25.53).

### **Investment Ratings**

**Buy** - We believe the stock has significant total return potential in the coming 12 months.

**Long-term Buy** - We believe the stock is an above average holding in its sector, and expect solid total returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

**Neutral** - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

**Underperform** - We believe the stock is vulnerable to a price decline in the next 12 months.

### **Suitability Ratings**

**1** - A large cap, core holding with a solid history

**2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

**3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

**4** - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base



	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
<b>Rating</b>				
<b>Buy</b>	40	32%	10%	90%
<b>Hold/Neutral</b>	77	62%	8%	92%
<b>Sell</b>	8	6%	0%	100%

*As of 6 September 2017*

**Other Disclosures**

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

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