



Gladstone Commercial Corporation (GOOD)

Updated February 27th, 2021 by Josh Arnold

Key Metrics

Current Price:	\$19	5 Year CAGR Estimate:	6.4%	Market Cap:	\$675 M
Fair Value Price:	\$17	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	03/17/21
% Fair Value:	109%	5 Year Valuation Multiple Estimate:	-1.6%	Dividend Payment Date:	03/31/21
Dividend Yield:	7.9%	5 Year Price Target	\$18	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Gladstone Commercial Corporation is a real estate investment trust, or REIT, that specializes in single-tenant and anchored multi-tenant net leased industrial and office properties across the U.S. The trust targets primary and secondary markets that possess favorable economic growth trends, growing populations, strong employment, and robust growth trends. The trust's stated goal is to pay shareholders monthly distributions, which it has done for more than 10 consecutive years. Gladstone owns over 100 properties in 24 states that are leased to nearly 100 unique tenants and has a market capitalization of \$675 million.

Gladstone reported fourth quarter and full year earnings on February 16th, 2021 and results came in roughly in line with expectations. Core FFO-per-share came to \$0.38 in Q4 and was down -4.3% to \$13.4 million on a dollar basis, when compared with the year-ago period. The decline was primarily attributable to an increase in property operating expenses due to increased vacancy in the portfolio. Lower interest expense helped offset some of that, as did rental income from recent acquisitions. For the year, core FFO came to \$55.4 million, a 9.2% increase from 2019, but was fractionally lower on a per-share basis due to a higher share count.

Gladstone also reported that ~98% of January and February cash base rents had been collected. In addition, it added a new \$65 million term loan component to its existing credit facility and purchased nine fully occupied industrial properties with an aggregate 1.7 million square feet of rental space for \$130 million over the course of 2020.

Our initial estimate for this year is \$1.59 in core FFO per-share.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
FFO	\$1.53	\$1.48	\$1.49	\$1.80	\$1.54	\$1.53	\$1.54	\$1.58	\$1.58	\$1.57	\$1.59	\$1.67
DPS	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50
Shares¹	10.9	11.1	15.7	17.3	21.2	23.2	26.4	28.8	33.0	35.3	38.0	48.0

Gladstone reports funds-from-operations, or FFO, per share rather than earnings-per-share. This is consistent with other REITs and we'll use FFO as the preferred proxy for underlying earnings power.

Gladstone's FFO-per-share has been between \$1.50 and \$1.60 for most of the past decade as the trust continues to issue new shares and debt to fund acquisitions, but those acquisitions fail to provide an economic gain. In other words, while the trust's new properties provide growth on a dollar basis, when the cost of those acquisitions is factored in, it is essentially no gain on a per-share basis. We don't have any reason to believe this will change moving forward as Gladstone's common shares are quite expensive to issue, yielding 7% to 9% at most times, and its preferred stock and debt are not significantly cheaper. This means that Gladstone will struggle to produce economic gains with its capital issuances given that the yields on its properties are also in the high single digits. As a result, our long-term growth estimate for Gladstone is 1%. We don't see any cause for pessimism as earnings impairment isn't likely. However, investors should note that any sort of meaningful growth is going to be difficult to generate.

¹ Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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The distribution has also been flat at \$1.50 for the past decade as the trust has struggled to grow FFO-per-share and thus, has been unable to boost the distribution; we do not believe this will change anytime soon.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	11.4	11.9	12.6	9.8	10.7	11.1	13.8	11.9	13.7	11.4	11.9	11.0
Avg. Yld.	8.6%	8.5%	8.0%	8.5%	9.1%	8.8%	7.1%	8.0%	7.0%	8.4%	7.9%	8.2%

Today the trust trades for 11.9 times this year's FFO-per-share estimate, which is somewhat elevated against historical norms. The long-term average valuation for Gladstone is just over 11 times FFO-per-share, which we are reiterating as our fair value estimate. This implies a modest headwind from the valuation in the coming years.

The current 7.9% yield is more in line with historical valuations than the 10%+ yield in our early-2020 update. We see the yield rising to 8.2% over time as the distribution stays flat, and as the valuation potentially moves slightly lower.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	98%	101%	101%	83%	97%	98%	97%	95%	95%	96%	94%	90%

Gladstone doesn't necessarily have a competitive advantage given that it operates in much the same way as any other commercial REIT. However, Gladstone's selection of properties has been outstanding over time as its occupancy has never dipped below 96% and remains very close to 100% today.

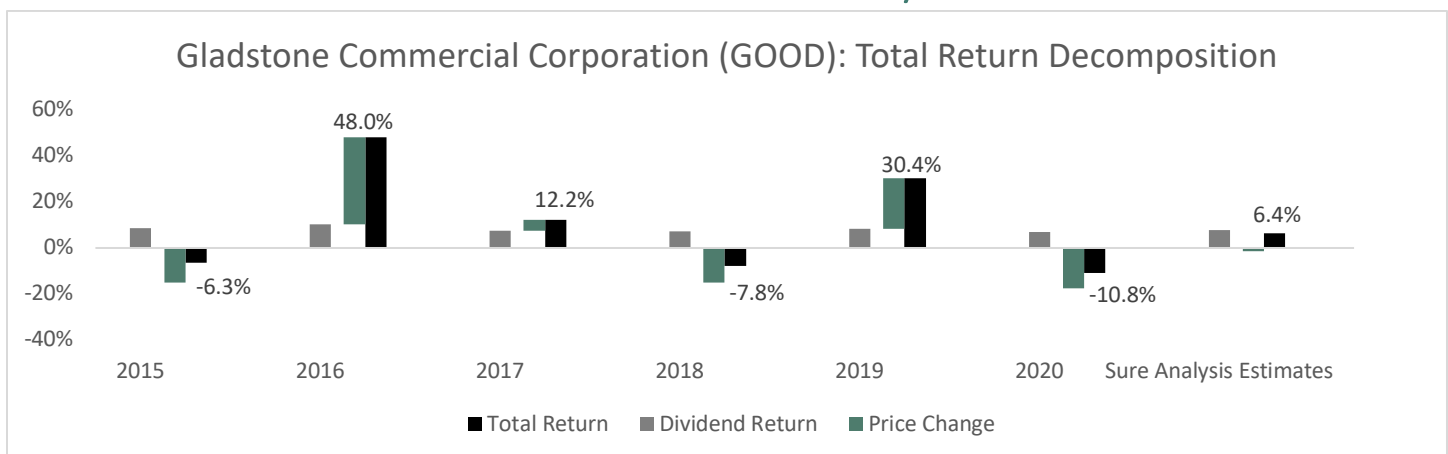
In the case of recession, Gladstone should fare quite well as more than half of its properties are leased through 2024, so the impact on the trust's earnings should be minimal, which is consistent with how Gladstone performed during the Great Recession. Last year's challenges have shown that Gladstone can weather a tough environment.

The payout ratio is very high, but we see the trust's steady FFO-per-share of more than \$1.50 annually as enough to maintain the current dividend. Investors should not expect a raise anytime soon due to the factors discussed above.

Final Thoughts & Recommendation

We see 6.4% total annual returns for Gladstone Commercial moving forward, which is mostly the product of an elevated valuation. We see the yield as attractive, but some of that is offset by a higher valuation. We like Gladstone's recession performance and its steady FFO-per-share, but there is little growth. We're reiterating Gladstone at a hold rating, thanks primarily to its yield.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	44	51	61	74	84	86	95	107	114	133
Gross Profit	43	50	58	69	78	80	87	95	102	107
Gross Margin	97.8%	96.9%	94.5%	93.6%	93.7%	93.2%	91.9%	89.3%	89.0%	80.5%
SG&A Exp.	5	6	6	8	10	10	11	12	14	15
D&A Exp.	14	17	23	29	35	38	43	48	52	55
Operating Profit	23	27	29	32	33	33	33	36	36	37
Operating Margin	53.2%	53.3%	47.7%	43.4%	39.9%	38.0%	35.1%	33.4%	31.4%	27.7%
Net Profit	6	4	2	-6	4	4	6	12	10	15
Net Margin	13.0%	7.3%	2.5%	-8.0%	4.3%	4.6%	6.3%	11.5%	8.4%	11.2%
Free Cash Flow	20	23	20	28	31	41	47	56	60	65

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	453	565	691	788	827	852	928	939	1040	1058
Cash & Equivalents	3	6	9	9	5	5	7	7	7	11
Goodwill & Int. Ass.	38	57	80	99	105	106	119	111	115	117
Total Liabilities	318	442	507	570	593	612	662	684	828	882
Accounts Payable	2	5	2	8	6	6	7	3	6	4
Long-Term Debt	304	384	447	503	530	515	547	570	627	669
Shareholder's Equity	135	122	183	218	234	240	267	250	208	213
D/E Ratio	2.25	3.14	2.44	2.31	2.27	2.14	2.05	2.28	3.01	3.14

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	1.3%	0.7%	0.2%	-0.8%	0.4%	0.5%	0.7%	1.3%	1.0%	1.4%
Return on Equity	4.6%	2.9%	1.0%	-2.9%	1.6%	1.7%	2.3%	4.8%	4.2%	7.1%
ROIC	1.4%	0.8%	0.3%	-0.9%	0.5%	0.5%	0.8%	1.5%	1.2%	1.7%
Shares Out.	10.9	11.1	15.7	17.3	21.2	23.2	26.4	28.8	33.0	35.3
Revenue/Share	4.27	4.64	4.56	4.15	3.79	3.58	3.47	3.61	3.73	3.91
FCF/Share	1.91	2.12	1.48	1.59	1.42	1.70	1.72	1.88	1.96	1.92

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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