



Gladstone Commercial Corporation (GOOD)

Updated May 27th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$20	5 Year CAGR Estimate:	6.8%	Market Cap:	\$759 M
Fair Value Price:	\$18	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	06/21/22
% Fair Value:	109%	5 Year Valuation Multiple Estimate:	-1.7%	Dividend Payment Date:	06/30/22
Dividend Yield:	7.5%	5 Year Price Target	\$20	Years Of Dividend Growth:	3
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

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 17 consecutive years. Gladstone owns over 100 properties in 24 states that are leased to about 100 unique tenants and has a market capitalization of \$759 million.

Gladstone reported first quarter earnings on May 4th, 2022, and results were weaker than expected on both revenue and earnings. FFO-per-share came to 40 cents, which was one cent lower than estimates. Revenue was \$35.53 million, which was up fractionally year-over-year, but missed estimates by \$610k.

The company noted it collected 100% of cash rents during all three months of the first quarter. Core FFO was up 1.3% year-over-year, primarily due to the additional lease revenue from acquisitions during the quarter.

Gladstone acquired two fully-occupied industrial properties during the quarter, containing 136k square feet for \$13.3 million. The weighted average cap rate on the properties was 6.58%.

We've slightly revised estimates down for this year to \$1.60 in FFO-per-share, a decline of a nickel.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
FFO	\$1.48	\$1.49	\$1.80	\$1.54	\$1.53	\$1.54	\$1.58	\$1.58	\$1.57	\$1.54	\$1.60	\$1.77
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	11.1	15.7	17.3	21.2	23.2	26.4	28.8	33.0	35.3	37.8	39.0	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 2%. 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.

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. Gladstone raised its

¹ Share count in millions

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dividend 0.1% for the first quarter 2022 payments, marking what will be three consecutive years of higher dividends after years of stagnant payments. The increases have been small enough that they haven't amounted to even a penny per share in higher payments, but it is technically boosting its dividend.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	11.9	12.6	9.8	10.7	11.1	13.8	11.9	13.7	11.4	13.9	12.5	11.5
Avg. Yld.	8.5%	8.0%	8.5%	9.1%	8.8%	7.1%	8.0%	7.0%	8.4%	7.0%	7.5%	7.4%

Today the trust trades for 12.5 times this year's FFO-per-share estimate, which is slightly elevated against historical norms. The long-term average valuation for Gladstone is just over 11 times FFO-per-share, and we've moved our fair value estimate down slightly to 11.5 times earnings. This implies a small headwind from the valuation in the coming years.

The current 7.5% yield is quite low compared to the trust's historical average, which is owed to the high valuation. We see the yield remaining near where it is today in the mid-7% area.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	101%	101%	83%	97%	98%	97%	95%	95%	96%	97%	94%	85%

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 remained high through a variety of economic conditions.

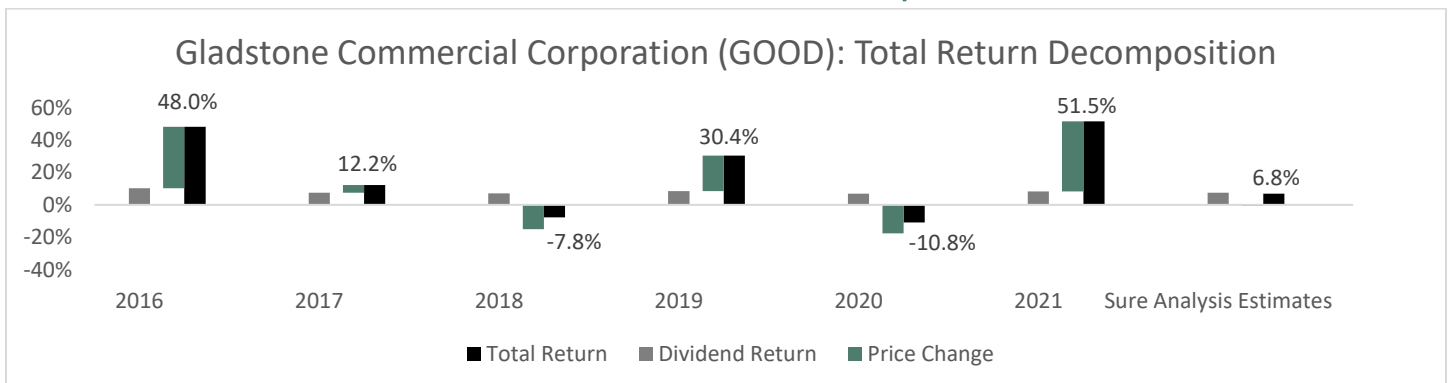
In the case of recession, Gladstone should fare quite well as more than half of its properties are leased through 2024, so the impact on the trust's earnings should be minimal, which is consistent with how Gladstone performed during the Great Recession. Last year's challenges have shown that Gladstone 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 meaningful raise anytime soon due to the factors discussed above.

Final Thoughts & Recommendation

We forecast 6.8% total annual returns for Gladstone Commercial moving forward. 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	51	61	74	84	86	95	107	114	133	138
Gross Profit	50	58	69	78	80	87	95	102	107	111
Gross Margin	96.9%	94.5%	93.6%	93.7%	93.2%	91.9%	89.3%	89.0%	80.5%	80.3%
SG&A Exp.	6	6	8	10	10	11	12	14	15	15
D&A Exp.	17	23	29	35	38	43	48	52	55	60
Operating Profit	27	29	32	33	33	33	36	36	37	35
Operating Margin	53.3%	47.7%	43.4%	39.9%	38.0%	35.1%	33.4%	31.4%	27.7%	25.3%
Net Profit	4	2	(6)	4	4	6	12	10	15	10
Net Margin	7.3%	2.5%	-8.0%	4.3%	4.6%	6.3%	11.5%	8.4%	11.2%	7.1%
Free Cash Flow	23	20	28	31	41	47	56	60	65	70

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	565	691	788	827	852	928	939	1,040	1,098	1,143
Cash & Equivalents	6	9	9	5	5	7	7	7	11	8
Goodwill & Int. Ass.	57	80	99	105	106	119	111	115	117	114
Total Liabilities	442	507	570	593	612	662	684	828	882	941
Accounts Payable	5	2	8	6	6	7	3	6	4	7
Long-Term Debt	384	447	503	525	509	543	566	627	669	708
Shareholder's Equity	122	183	218	234	240	267	250	208	213	201
LTD/E Ratio	3.14	2.44	2.31	2.25	2.12	2.03	2.27	3.01	3.14	3.51

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.7%	0.2%	-0.8%	0.4%	0.5%	0.7%	1.3%	1.0%	1.4%	0.9%
Return on Equity	2.9%	1.0%	-2.9%	1.6%	1.7%	2.3%	4.8%	4.2%	7.1%	4.7%
ROIC	0.8%	0.3%	-0.9%	0.5%	0.5%	0.8%	1.5%	1.2%	1.7%	1.1%
Shares Out.	11.1	15.7	17.3	21.2	23.2	26.4	28.8	33.0	35.3	37.8
Revenue/Share	4.64	4.56	4.15	3.79	3.58	3.60	3.72	3.73	3.91	3.77
FCF/Share	2.12	1.48	1.59	1.42	1.70	1.78	1.94	1.96	1.92	1.92

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

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