



Gladstone Commercial Corporation (GOOD)

Updated November 13th, 2023, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|-------|--|-------|----------------------------------|----------|
| Current Price: | \$12 | 5 Year CAGR Estimate: | 10.3% | Market Cap: | \$483 M |
| Fair Value Price: | \$15 | 5 Year Growth Estimate: | -2.0% | Ex-Dividend Date: | 12/15/23 |
| % Fair Value: | 80% | 5 Year Valuation Multiple Estimate: | 4.6% | Dividend Payment Date: | 12/29/23 |
| Dividend Yield: | 10.0% | 5 Year Price Target | \$14 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Rating: | Buy |

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 \$483 million.

Gladstone posted third quarter earnings on November 6th, 2023, and results were worse than expected on both the top and bottom lines. The company posted 34 cents in FFO per-share, which missed estimates by three cents. It also fell from 41 cents in the previous quarter. Revenue was off 8.5% year-over-year to \$36.46 million, missing estimates by \$2.37 million.

Operating expenses were \$29.6 million, down from \$33.7 million in Q2. Leasing activity was strong in Q3, with 96.6% of the trust's square feet being leased in Q3, up from 96.0% in the June quarter.

We now estimate \$1.43 in FFO-per-share for this year as revenue is in a tough spot, but the trust is beginning to see an uptick in leasing activity.

Growth on a Per-Share Basis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| FFO | \$1.49 | \$1.80 | \$1.54 | \$1.53 | \$1.54 | \$1.58 | \$1.58 | \$1.57 | \$1.54 | \$1.56 | \$1.43 | \$1.29 |
| DPS | \$1.50 | \$1.50 | \$1.50 | \$1.50 | \$1.50 | \$1.50 | \$1.50 | \$1.50 | \$1.50 | \$1.50 | \$1.20 | \$1.20 |
| Shares¹ | 15.7 | 17.3 | 21.2 | 23.2 | 26.4 | 28.8 | 33.0 | 35.3 | 37.8 | 40.0 | 43.0 | 52.0 |

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.

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 had 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. For the start of 2023, Gladstone cut its distribution by 20% to a new level of \$1.20 per year.

Valuation Analysis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|-------|------|
| Avg. P/E | 12.6 | 9.8 | 10.7 | 11.1 | 13.8 | 11.9 | 13.7 | 11.4 | 13.9 | 11.9 | 8.4 | 10.5 |
| Avg. Yld. | 8.0% | 8.5% | 9.1% | 8.8% | 7.1% | 8.0% | 7.0% | 8.4% | 7.0% | 8.1% | 10.0% | 8.8% |

Today the trust trades for 8.4 times this year's FFO-per-share estimate, which is very low 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 10.5 times earnings. This implies a reasonably strong tailwind from the valuation in the coming years.

The current 10% yield is ahead of historical yields. We see the yield potentially declining should the valuation rise to meet our fair value estimate.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 101% | 83% | 97% | 98% | 97% | 95% | 95% | 96% | 97% | 96% | 84% | 93% |

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.

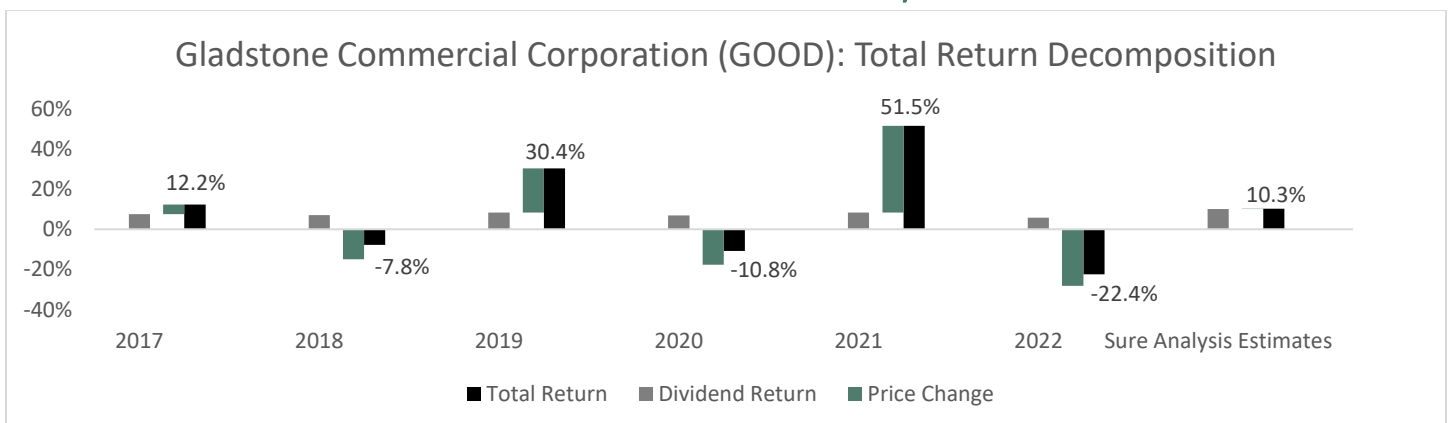
In the case of recession, Gladstone should fare quite well as it has long lease terms, so the impact on the trust's earnings should be minimal, which is consistent with how Gladstone performed during the Great Recession. Last year's challenges have shown that Gladstone can weather a tough environment.

The payout ratio is very high, but we see the trust's FFO-per-share of \$1.40+ annually as enough to maintain the lowered dividend. Investors should not expect a meaningful raise anytime soon due to the factors discussed above.

Final Thoughts & Recommendation

We forecast 10.3% total annual returns for Gladstone Commercial moving forward. We see the yield as attractive at 10%, and the stock is below fair value, with a resulting 4.6% tailwind. We like Gladstone's recession performance and its steady FFO-per-share, but there is a tough road ahead for growth. We're moving the stock from hold to buy on the improved valuation.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 61 | 74 | 84 | 86 | 95 | 107 | 114 | 133 | 138 | 149 |
| Gross Profit | 58 | 69 | 78 | 80 | 87 | 95 | 102 | 107 | 111 | 122 |
| Gross Margin | 94.5% | 93.6% | 93.7% | 93.2% | 91.9% | 89.3% | 89.0% | 80.5% | 80.3% | 81.9% |
| SG&A Exp. | 6 | 8 | 10 | 10 | 11 | 12 | 14 | 15 | 15 | 17 |
| D&A Exp. | 23 | 29 | 35 | 38 | 43 | 48 | 52 | 55 | 60 | 62 |
| Operating Profit | 29 | 32 | 33 | 33 | 33 | 36 | 36 | 37 | 35 | 43 |
| Operating Margin | 47.7% | 43.4% | 39.9% | 38.0% | 35.1% | 33.4% | 31.4% | 27.7% | 25.3% | 28.9% |
| Net Profit | 2 | (6) | 4 | 4 | 6 | 12 | 10 | 15 | 10 | 9 |
| Net Margin | 2.5% | -8.0% | 4.3% | 4.6% | 6.3% | 11.5% | 8.4% | 11.2% | 7.1% | 6.0% |
| Free Cash Flow | 20 | 28 | 31 | 41 | 47 | 56 | 60 | 65 | 70 | 69 |

Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------------|------|------|------|------|------|------|-------|-------|-------|-------|
| Total Assets | 691 | 788 | 827 | 852 | 928 | 939 | 1,040 | 1,098 | 1,143 | 1,202 |
| Cash & Equivalents | 9 | 9 | 5 | 5 | 7 | 7 | 7 | 11 | 8 | 12 |
| Goodwill & Int. Ass. | 80 | 99 | 105 | 106 | 119 | 111 | 115 | 117 | 114 | 112 |
| Total Liabilities | 507 | 570 | 593 | 612 | 662 | 684 | 828 | 882 | 941 | 997 |
| Accounts Payable | 2 | 8 | 6 | 6 | 7 | 3 | 6 | 4 | 7 | 10 |
| Long-Term Debt | 447 | 503 | 525 | 509 | 543 | 566 | 627 | 669 | 708 | 749 |
| Shareholder's Equity | 183 | 218 | 234 | 240 | 267 | 250 | 208 | 213 | 201 | 203 |
| LTD/E Ratio | 2.44 | 2.31 | 2.25 | 2.12 | 2.03 | 2.27 | 3.01 | 3.14 | 3.51 | 3.69 |

Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|------|-------|------|------|------|------|------|------|------|------|
| Return on Assets | 0.2% | -0.8% | 0.4% | 0.5% | 0.7% | 1.3% | 1.0% | 1.4% | 0.9% | 0.8% |
| Return on Equity | 1.0% | -2.9% | 1.6% | 1.7% | 2.3% | 4.8% | 4.2% | 7.1% | 4.7% | 4.6% |
| ROIC | 0.3% | -0.9% | 0.5% | 0.5% | 0.8% | 1.5% | 1.2% | 1.7% | 1.1% | 1.0% |
| Shares Out. | 15.7 | 17.3 | 21.2 | 23.2 | 26.4 | 28.8 | 33.0 | 35.3 | 37.8 | 39.0 |
| Revenue/Share | 4.56 | 4.15 | 3.79 | 3.58 | 3.60 | 3.72 | 3.73 | 3.91 | 3.77 | 3.82 |
| FCF/Share | 1.48 | 1.59 | 1.42 | 1.70 | 1.78 | 1.94 | 1.96 | 1.92 | 1.92 | 1.78 |

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

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