



Gladstone Commercial Corporation (GOOD)

Updated March 11th, 2024, by Josh Arnold

Key Metrics

Current Price:	\$13	5 Year CAGR Estimate:	11.4%	Market Cap:	\$535 M
Fair Value Price:	\$14	5 Year Growth Estimate:	3.0%	Ex-Dividend Date:	03/20/24
% Fair Value:	92%	5 Year Valuation Multiple Estimate:	1.8%	Dividend Payment Date:	03/29/24
Dividend Yield:	9.0%	5 Year Price Target	\$17	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 \$535 million.

Gladstone posted fourth quarter and full-year earnings on February 21st, 2024, and results were weaker than expected. Total revenue was \$35.9 million, missing consensus by \$0.9 million, and down \$0.6 million from the third quarter. The trust's management team saw its total assets fall by 3% year-over-year to \$1.13 billion, and off about 1% quarter-over-quarter. The team said they believe that same-store rents will continue to grow at their long-term rate of about 2% annually, as they focus on industrial properties.

Core funds-from-operation came to 36 cents for the quarter, a penny better than expected, and up from 34 cents in Q3. Operating expenses were \$28.1 million, down from \$29.6 million in the prior quarter.

Square feet leased rose to 96.8%, up from 96.6% in the third quarter. The management team also noted that subsequent to the end of the quarter, they'd sold one non-core property for \$4.5 million as part of its capital recycling strategy.

We start the year with an estimate of \$1.38 in FFO-per-share, which would mark yet another year of lower earnings should it come to fruition.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
FFO	\$1.80	\$1.54	\$1.53	\$1.54	\$1.58	\$1.58	\$1.57	\$1.54	\$1.56	\$1.47	\$1.38	\$1.60
DPS	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.20	\$1.20	\$1.20
Shares¹	17.3	21.2	23.2	26.4	28.8	33.0	35.3	37.8	40.0	40.0	40.0	50.0

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

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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estimate for Gladstone is 3%. 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 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	9.8	10.7	11.1	13.8	11.9	13.7	11.4	13.9	11.9	9.0	9.6	10.5
Avg. Yld.	8.5%	9.1%	8.8%	7.1%	8.0%	7.0%	8.4%	7.0%	8.1%	9.1%	9.0%	7.1%

Today the trust trades for 9.6 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 to 10.5 times earnings. This implies a reasonably strong tailwind from the valuation in the coming years.

The current 9% yield is in line with historical yields. We see the yield potentially declining should the valuation rise to meet our fair value estimate, assuming no distribution growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	83%	97%	98%	97%	95%	95%	96%	97%	96%	82%	87%	75%

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.

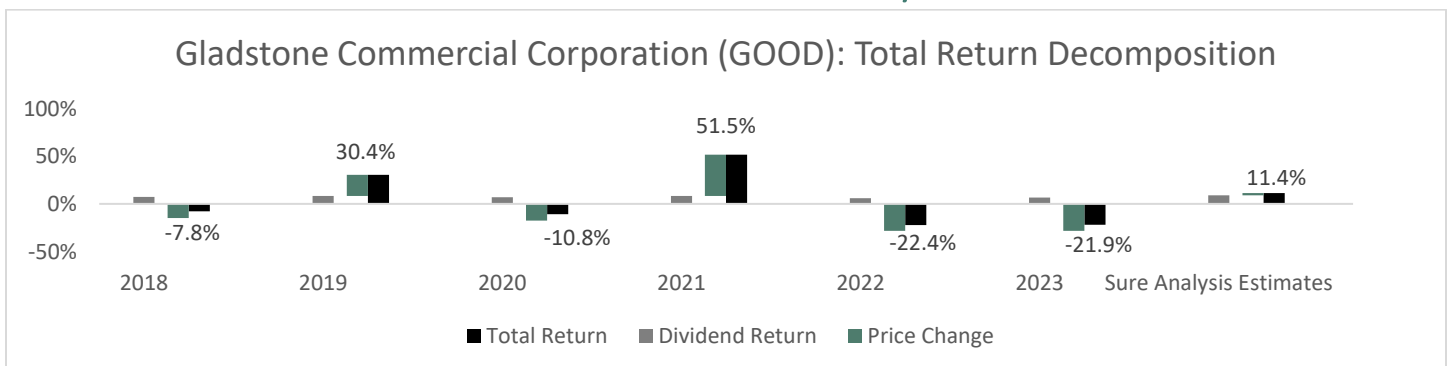
In the case of recession, Gladstone should fare quite well as it has long lease terms, so the impact on the trust's earnings should be minimal, which is consistent with how Gladstone performed during the Great Recession. Last year's challenges have shown that Gladstone can weather a tough environment.

The payout ratio is very high, but we see the trust's FFO-per-share of about \$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 11.4% total annual returns for Gladstone Commercial moving forward. We see the yield as attractive at 9%, and the stock is below fair value, with a resulting 1.8% tailwind. We like Gladstone's recession performance and its steady FFO-per-share, and have a buy rating on the shares today.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	74	84	86	95	107	114	133	138	149	148
Gross Profit	69	78	80	87	95	102	107	111	122	122
Gross Margin	93.6%	93.7%	93.2%	91.9%	89.3%	89.0%	80.5%	80.3%	81.9%	82.4%
SG&A Exp.	8	10	10	11	12	14	15	15	12	13
D&A Exp.	29	35	38	43	48	52	55	60	60	58
Operating Profit	32	33	33	33	36	36	37	35	45	51
Operating Margin	43.4%	39.9%	38.0%	35.1%	33.4%	31.4%	27.7%	25.3%	28.9%	34.5%
Net Profit	(6)	4	4	6	12	10	15	10	11	5
Net Margin	-8.0%	4.3%	4.6%	6.3%	11.5%	8.4%	11.2%	7.1%	6.0%	3.4%
Free Cash Flow	28	31	41	47	56	60	65	70	69	60

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	788	827	852	928	939	1,040	1,098	1,143	1,202	1,133
Cash & Equivalents	9	5	5	7	7	7	11	8	12	12
Goodwill & Int. Ass.	99	105	106	119	111	115	117	114	112	101
Total Liabilities	570	593	612	662	684	828	882	941	997	979
Accounts Payable	8	6	6	7	3	6	4	7	10	14
Long-Term Debt	503	525	509	543	566	627	669	708	749	739
Shareholder's Equity	218	234	240	267	250	208	213	201	203	153
LTD/E Ratio	2.31	2.25	2.12	2.03	2.27	3.01	3.14	3.51	3.69	4.82

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	-0.8%	0.4%	0.5%	0.7%	1.3%	1.0%	1.4%	0.9%	0.8%	0.4%
Return on Equity	-2.9%	1.6%	1.7%	2.3%	4.8%	4.2%	7.1%	4.7%	4.6%	2.8%
ROIC	-0.9%	0.5%	0.5%	0.8%	1.5%	1.2%	1.7%	1.1%	1.0%	0.5%
Shares Out.	17.3	21.2	23.2	26.4	28.8	33.0	35.3	37.8	39.0	39.9
Revenue/Share	4.15	3.79	3.58	3.60	3.72	3.73	3.91	3.77	3.82	3.69
FCF/Share	1.59	1.42	1.70	1.78	1.94	1.96	1.92	1.92	1.78	1.51

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

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