



COMPANY UPDATE

Key Metrics

GOOD - NASDAQ - 2/15/17	\$19.99
2-3 Year Price Target	\$23.50
52-Week Range	\$13.41 - \$20.68
Shares Outstanding (mm)	25.0
Market Cap. (\$mm)	\$499.8
1-Mo. Average Daily Volume	36,512
Institutional Ownership	32.0%
Debt/Total Capital Dec-16	49.0%
Est 3-year FFO Growth Rate	1.0%
Est 3-year Dividend Growth Rate	0.0%
Book Value	\$10.67
Annual Dividend Rate	\$ 1.50
Dividend Yield	7.50%
Est. Fixed Charge Coverage	2.3X

FFO

	2015	2016	Prior 2017E	Current 2017E
1Q	\$0.38	--	\$0.39	\$0.39
2Q	\$0.39	--	\$0.39	\$0.41
3Q	\$0.38	--	\$0.39	\$0.42
4Q	\$0.39	--	\$0.38	\$0.42
Year	\$1.54	\$1.55	\$1.65	\$1.65
P/E	13.0x	12.9x		12.1x

Note that quarters may not add due to rounding

Revenue (\$mm)

	2015	2016	Prior 2017E	Current 2017E
1Q	\$19.9	--	\$21.5	\$22.6
2Q	\$20.7	--	\$21.2	\$23.2
3Q	\$21.4	--	\$21.6	\$23.9
4Q	\$21.8	--	\$22.1	\$24.5
Year	\$83.8	\$86.4	\$94.2	\$94.2

Company Description: Gladstone Commercial Corp., headquartered in McLean, VA, is a real estate investment trust (REIT) that is focused on investments in industrial and commercial properties and mortgage loans, primarily to small to medium sized businesses.

Real Estate Investment Trusts

John Roberts
J.J.B. Hilliard, W.L. Lyons, LLC
502.588.1165 / jmroberts@hilliard.com
Institutional Sales Desk: George Moorin
502.588.9141/GMoorin@hilliard.com
February 16, 2017

Gladstone Commercial Corp.

GOOD -- NASDAQ – Long-term Buy-3

Fourth Quarter Earnings

Investment Highlights

- Last night after the close, GOOD reported Q4 normalized FFO of \$0.38 a share, a penny below our estimate and the consensus. The quarter was largely in line with our expectations with the difference a function of slightly lower revenue than we anticipated. At this point, we are retaining our 2017 FFO estimate at \$1.65 a share, although we may adjust that number after the 8:30 AM conference call.
- GOOD management continued its investment activity during the quarter, but also fine-tuned its portfolio with the disposition of a couple of non-core properties during the quarter and recognizing double digit returns on both sales. The company also made one of the largest purchases in its history during the quarter, adding a large office property. GOOD's portfolio is currently over 97% leased, with all tenants currently paying.
- GOOD has among the highest yields in the REIT sector at 7.5%, and the company consistently paid the dividend through the recessionary environment. We note that the yield has dropped recently on an absolute basis, however, as we have seen significant strength in the share price. We have no reason to believe the company will not continue to pay the dividend now that the economy is improving.
- Our rating for GOOD remains Long-term Buy and our price target remains at \$23.50, which is based on a multiple of 12 times our projection of 2019 FFO (\$1.96 a share), which is in line with historic multiples and a large discount to the peer group. We believe that the current share price is attractive for aggressive investors with longer investment horizons looking for a combination of high income and some capital appreciation. We will have a report out with updated estimates and management commentary following the company's conference call this morning.

Note Important Disclosures on Pages 6-7.

Note Analyst Certification on Page 6.

Fourth Quarter Review

Total operating revenues were \$22.0 million, compared to \$21.8 million in Q4 '15, up 0.8% year over year (please see page 3) as asset sales, a drop in tenant recovery income and mortgage payoffs largely offset the positive impact of recent purchases. Rental revenue rose 3.9% to \$21.7 million.

Property level operating expenses fell 7.1% to \$1.44 million from \$1.54 million. There was a 29.1% increase year-over-year in base management fees to \$1.14 million. In the 2016 fourth quarter, the incentive fee was \$0.54 million, compared to \$0.60 million in the year earlier period. G&A expenses were up 23.6% at \$0.52 million. We note that due to GOOD's outside management structure, G&A expense is typically small. Total operating expenses were up 4.5% year-over-year to \$4.0 million.

EBITDA for Q4 was flat at \$18.0 million year over year. Interest expense fell 17.5% to \$5.9 million from \$7.2 million in the year earlier quarter. Net income available to common shareholders was a loss of \$0.3 million compared to a profit of \$1.3 million. The company's typical reported losses shows how little of GOOD's distribution is likely to be taxed to shareholders. In fact typically about 70% of the company's dividend has been a return of capital, which is a function of most of GOOD's cash flow generation being sheltered on a net income basis by depreciation and amortization expense, which are non-cash items. This provides investors with an even higher after tax return on investment. Preferred dividend and senior common stock payments rose 67.2% year-over-year as a result of issuances during the year. Core funds from operations, which exclude real estate gains and due diligence expenses, were \$9.4 million in this year's fourth quarter versus \$8.9 million last year. FFO per share was \$0.38 versus \$0.39, on a 8.0% increase in shares outstanding.

The leverage on GOOD's balance sheet has come down quite a bit since yearend and now stands at approximately 1.64x, compared to 1.93x debt-to-equity (please see page 4) at 2015 yearend. The company went from having a \$69.5 million balance on its credit line at the end of 2015 to having \$64.1 million at the end of Q4 '16 including a \$24.9 million term loan balance. Mortgage debt fell to \$445.3 million from \$455.9 million at yearend. GOOD management has historically believed that the company could support leverage of 2.5x debt-to-equity, although in recent discussions with management, they have significantly lowered that threshold and continue to push down leverage.

Other Q4 Activity

Acquisition/Investment/Leasing Activity: During the quarter, GOOD purchased one property, a 103,334 square foot office building in a Philadelphia, PA suburb for \$25.5 million that is leased to a single tenant under a 15-year lease at an average capitalization rate of 8.7%. The company also announced an expansion during the quarter for an existing property amounting to \$7 million, and a lease extension once the project is completed at an expected cap rate of 10.4% over the lease term. Also the company sold two non-core properties for a total of \$3.9 million at a return of just over 11% on its investment, as well as another subsequent to quarter end for \$12.8 million generating a 24% return on the investment. During the full year the company purchased three properties for \$66.6 million with an average cap rate of 8.4%. We note that the company also announced the signing of several leases and new tenants on existing properties during the year renewing 4 leases, and leased some vacant space.

Capital Markets Activity: GOOD announced during the quarter that it had entered into a direct placement of common stock, placing 774,000 shares at an average offering price of \$18.35 a share, raising a total of \$13.9 million after offering expenses.

Quarterly Income Statement

	4th Q 16	4th Q 15	% Change
Rental Revenue	\$21,746,000	\$20,939,000	3.9%
Tenant Recovery Revenue	263,000	654,000	-59.8%
Interest Income from Mortgage Note Receivable	0	244,000	-100.0%
Total Operating Revenues	22,009,000	21,837,000	0.8%
Property Operating Expenses	1,435,000	1,544,000	-7.1%
Base Management Fee	1,141,000	884,000	29.1%
Administration Fee	389,000	365,000	6.6%
Incentive Fee	544,000	596,000	
Professional Fees	0	0	
Insurance	0	0	
Shareholder Related Expenses	0	0	
Asset Retirement Obligation Expense	0	0	
Stock Option Compensation Expense	0	0	
Due Diligence expense	-14,000	33,000	
Director Fees	0	0	
General and Administrative Expenses	518,000	419,000	23.6%
Total Operating Expenses	4,013,000	3,841,000	4.5%
Credit to Incentive Fee	0	(1,000)	
EBITDA	17,996,000	17,995,000	0.0%
Interest Expense	5,902,000	7,153,000	-17.5%
Depreciation and Amortization Expenses	9,720,000	9,128,000	6.5%
Interest Income from Temporary Investments	0	0	
Interest Income - Employee Loans	0	0	
Other Income (expense)	(188,000)	0	
Discontinued Operations (loss)	794,000	1,538,000	
Net Income	\$2,980,000	\$3,252,000	-8.4%
Preferred Dividends	\$3,292,000	\$1,969,000	67.2%
Net Income Available to Common Shareholders	(\$312,000)	\$1,283,000	-124.3%
Net EPS (diluted)	(\$0.01)	\$0.06	-122.5%
Avg. Shares Outstanding (diluted)	24,824,397	22,976,182	8.0%
Funds From Operations			
	4th Q 16	4th Q 15	
Net Income Available to Common Shareholders	(\$312,000)	\$1,283,000	-124.3%
Depreciation and Amortization (incl. discontinued op	9,720,000	9,128,000	6.5%
Less Gain on Sale of Real Estate (net of taxes)/other	-26,000	-1,505,000	
Total Funds From Operations	\$9,382,000	\$8,906,000	5.3%
FFO Per Share	\$0.378	\$0.388	-2.5%

Source: Company reports.

Condensed Balance Sheet

	December 31, 2016	December 31, 2015
Real Estate (Net of Depreciation)	\$690,088,000	\$668,134,000
Mortgage Note Receivable	0	5,900,000
Lease Intangibles (net)	105,553,000	104,914,000
Real estate assets & related held for sale	9,562,000	1,077,000
Cash and Cash Equivalents	4,658,000	5,152,000
Restricted Cash	3,030,000	4,205,000
Funds Held in Escrow	6,806,000	7,534,000
Interest Receivable - Mortgage Note	0	0
Interest Receivable - Officers	0	0
Deferred Rent Receivable	29,725,000	27,443,000
Deferred Financing Cost	0	0
Prepaid Expenses	0	0
Deposits on Real Estate	0	0
Other Assets	2,320,000	2,825,000
Total Assets	\$851,742,000	\$827,184,000
Mortgage Note Payable	\$445,278,000	\$455,863,000
Borrowings under Line of Credit/Term loan	\$64,117,000	\$69,469,000
Deferred Rent Liability	12,647,000	9,657,000
Asset Retirement Obligation Liability	3,406,000	3,674,000
Accounts Payable and Accrued Expenses	5,891,000	6,388,000
Due to Adviser	2,075,000	1,858,000
Other Liabilities related to assets for sale	1,041,000	0
Rent Received / Security Deposits / Other	6,667,000	8,304,000
Total Liabilities	541,122,000	555,213,000
Preferrd Stock	70,746,000	38,103,000
Common Stock	25,000	22,000
Additional Paid in Capital	463,436,000	418,897,000
Notes Receivable - Employees	0	0
Distribution in Excess of Accumulated Earnings	(223,587,000)	(185,051,000)
Total Shareholders' Equity	\$310,620,000	\$271,971,000
Total Liabilities and Shareholders' Equity	\$851,742,000	\$827,184,000

Balance Sheet Ratio Analysis	December 31, 2016	December 31, 2015
Investments (net) as % of Assets	81.0%	81.5%
Cash & Equiv. and Restricted Cash as % of Assets	0.9%	1.1%
Debt to Equity	164.0%	193.2%
Total Liabilities as % of Assets	63.5%	67.1%
Shareholders' Equity as % of Assets	36.5%	32.9%

Source: Company reports.

Dividend

As we anticipated, GOOD management chose not to implement a dividend increase in 2015 or 2016. With the dividend only barely covered by FFO we had not anticipated any near term increases in the dividend until the company's payout ratio declined and we anticipate that lack of dividend increases will continue into the foreseeable future. The dividend has remained at \$1.50 a share annualized, paid monthly and we anticipate it staying there for several more years at the least. With its shareholder friendly management team and high dividend yield, we believe GOOD could provide an alternative for yield-oriented investors.

First Take

GOOD's numbers were largely in line with our expectations. Acquisition activity, however, so far in 2017 is a little below our expectations. With the share price having improved and the company having raised capital late last year, we believe this is likely a function of a lack of appropriate opportunities, although we will get a better feel on this after the company's conference call. Revenues were slightly under our expectations, while interest expense was also lower with recent financing activity driving down rates. Overall, operations were not far removed from what was anticipated. The company continued to address its lease expirations and has recently signed several new leases, as well as undertaking some expansion activity, as well as continuing to rationalize its portfolio through the sale of non-core properties. We will wait until talking to management before making any changes to our forward estimates. With the share price having moved up recently, this should offer management some flexibility on the investment front, although we believe that they will remain very disciplined on making investments, only adding new assets when the return is appropriate. The expansion project announced during the quarter is indicative that management may be looking at some other higher yield opportunities. However, we will have to wait until the conference call at 8:30 this morning before making a final decision on any potential changes in our expectation for acquisition activity. At this point our Long-term Buy rating is retained, with the company's shares remaining below our price target.

Suitability

GOOD has a suitability rating of 3 on our 1-4 scale. We find the company to have a diversified portfolio of properties with a long list of tenants and relatively long lease terms. Further, the company's occupancy rate is relatively high and the company's lease rollovers are limited over the next several years. On the other hand, the company's balance sheet is more levered than many of its peers, with a higher level of debt on its properties, leading to the lower suitability rating than many of the other REITs we follow.

Risk Factors for Gladstone Commercial

There are a variety of risk factors investors should consider when considering investment in Gladstone Commercial. We believe these risk factors include:

Interest Rate Risk – Like all REITs, GOOD is interest rate sensitive. If short term interest rates were to rise, the spread between the company's return yield and its cost of capital could shrink.

Asset Size – Gladstone Commercial, with market capitalization of approximately \$500 million, is one of the smallest REITs tracked by NAREIT. As such, it could be difficult to compete against other larger REITs for property acquisitions and in its attempts to raise capital.

Execution Risk – Gladstone Commercial's unique acquisition strategy makes the company more dependent on the skills of David Gladstone and his management team, more so than other more "traditional" REITs in our opinion.

Operation Expense Risk – Results for the last three years have been significantly helped by the waiving of shareholder approved incentive fee. We note that while only a small amount of the fee was waived in the most recent quarter, due to two tenants leaving, more may be waived to allow cash flow to cover the dividend.

Capital Constraint Risk – With share prices below the peer group on both the company’s common and preferred stock, the company may be constrained in their ability to complete future deals due to a higher cost of capital. Further, if management does decide to undertake an offering to grow, dilution is likely to be fairly significant, which could easily result in GOOD missing our estimates.

Annual yield is calculated by dividing the distribution amount by the current market price of the security. For US income tax purposes, the Company may classify all or a portion of its distributions as dividends or other non-dividend distributions. Note that for some investors, for US income tax purposes all or a portion of the Company’s 2016 dividend or distribution was treated as return of capital and not as “dividend income” as reflected on the IRS Form 1099-Div for the 2016 tax year. The Company generally makes a final determination regarding the proper tax treatment of distributions after calendar year end. We urge each shareholder to consult with his or her own tax advisor to determine the tax consequences of the distributions received, including any state, local or foreign tax considerations.

Additional information is available upon request.

Analyst Certification

I, John M. Roberts, 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

Gladstone Investment Corporation (GAIN - \$9.21; rated Neutral by Hilliard Lyons), Gladstone Commercial Corporation, Gladstone Land Corp. (LAND - \$12.26; rated Long-term Buy) and Gladstone Capital Corporation (GLAD - \$9.36; rated Underperform) share the same management and board.

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

As of February 15, 2017 Hilliard Lyons customers own at least 5% of the outstanding common stock of Gladstone Commercial and Gladstone Investment Corp.

Hilliard Lyons has participated in a selling group for an offering of securities of Gladstone Commercial in the past 12 months.

Hilliard Lyons has received investment banking compensation from Gladstone Commercial in the past 12 months.

The author of this report or members of his household have a long position in Gladstone Commercial Corp. and Gladstone Investment Corp. common stock, but may not engage in buying or selling contrary to the recommendation.

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 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 set back in the next 12 months.

Suitability Ratings

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

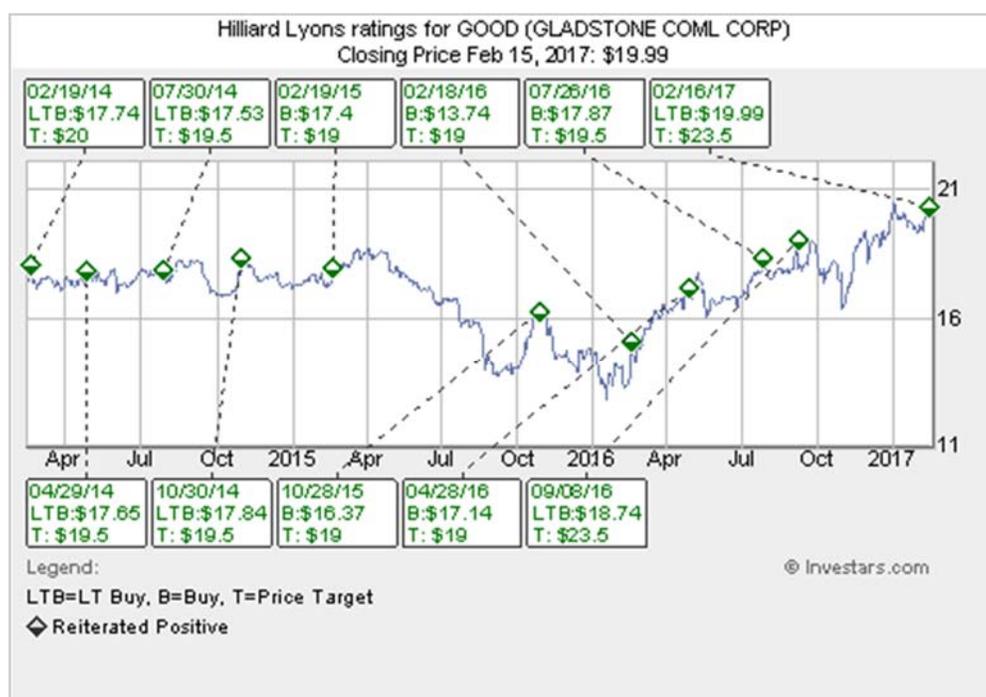
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

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

Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.		
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 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.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

The information herein has been obtained from sources we believe to be reliable but is not guaranteed and does not purport to be a complete statement of all material factors. This is for informational purposes and is not a solicitation of orders to purchase or sell securities. Reproduction is forbidden unless authorized. All rights reserved.