



COMPANY UPDATE

Key Metrics

GOOD - NASDAQ - 5/2/17	\$22.08
2-3 Year Price Target	\$23.50
52-Week Range	\$15.92 - \$23.35
Shares Outstanding (mm)	25.8
Market Cap. (\$mm)	\$569.7
1-Mo. Average Daily Volume	36,512
Institutional Ownership	32.0%
Debt/Total Capital Mar-17	45.0%
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	6.79%
Est. Fixed Charge Coverage	2.5X

FFO

	2016	Prior 2017E	2017E	Prior 2018E	Current 2018E
1Q	\$0.39	--	\$0.38	A \$0.40	\$0.40
2Q	\$0.39	\$0.39	\$0.39	\$0.41	\$0.41
3Q	\$0.39	\$0.40	\$0.40	\$0.42	\$0.42
4Q	\$0.38	\$0.41	\$0.41	\$0.43	\$0.43
Year	\$1.55	\$1.58	\$1.58	\$1.65	\$1.65
P/E	14.2x		14.0x		13.4x

Note that quarters may not add due to rounding

Revenue (\$mm)

	2016	Prior 2017E	Current 2017E	Prior 2018E	Current 2018E
1Q	\$21.5	--	\$22.3	A \$25.9	\$25.9
2Q	\$21.2	\$23.5	\$23.5	\$26.5	\$26.5
3Q	\$21.6	\$24.4	\$24.4	\$27.4	\$27.4
4Q	\$22.1	\$25.2	\$25.2	\$28.0	\$28.0
Year	\$86.4	\$95.8	\$95.4	\$107.9	\$107.9

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.

Gladstone Commercial Corp.

GOOD -- NASDAQ – Long-term Buy-3

First Quarter Earnings

Investment Highlights

- GOOD reported Q1 diluted core FFO of \$0.38 a share, equal to our estimate and the consensus. We note that GOOD kept its expenses low during the quarter, allowing recent investments to heavily impact the bottom line. This offset some modest dilution from recent asset sales. While these sales were dilutive, they did generate solid returns for the period GOOD owned them. Beyond that, the quarter was in line with our expectations with no real surprises.
- GOOD management has not made any meaningful investments so far in 2017 despite the recent sharp move up in the share price, which has reduced its cost of capital. In fact, the only transaction the company has announced so far in 2017 is a divestiture. While we continue to expect that GOOD management will remain disciplined in its acquisition strategy, with the drop in the cost of capital we anticipate that acquisition activity will increase in the remainder of the year.
- We will wait for the 8:30 conference call before making any changes and at this point our rating for GOOD remains Long-term Buy as does our 2-3 year price target of \$23.50 a share, which is based on a multiple of 12.5 times our 2020 FFO projection, a reasonable multiple in our view and in-line with historic multiples and a discount to the peer group. We would not be surprised to see the company undertake an equity offering of some type in the near future with the company's share price topping \$22 a share, a level not seen since 2006. We note that the shares are fast approaching our 2-3 year price target of \$23.50 and will be evaluating our thesis following the conference call.

Note Important Disclosures on Pages 6-7.
Note Analyst Certification on Page 6.

First Quarter Review

Total operating revenues were \$22.3 million, compared to \$21.5 million in Q1 '16, up 3.7% year over year (please see page 3). Rental revenue was up 6.3% at \$22.0 million, as acquisitions completed in the latter half of last year resulted in an increased rent. As most of GOOD's properties are under triple net lease agreements, tenant reimbursement had been only a nominal portion of GOOD's total revenues, with a 25.8% decline to \$0.36 million. A loan payoff eliminated interest income, which amounted to \$0.39 million last year.

Property level operating expenses fell 14.3% to \$1.38 million from \$1.61 million. There was a 37.2% increase year-over-year in base management fees to \$1.18 million. In the 2017 first quarter, the incentive fee was \$0.57 million, compared to \$0.62 million in the year earlier period. G&A expenses were down 6.3% at \$0.55 million. We note that due to GOOD's outside management structure, G&A expense is typically small. Total operating expenses were up 88.8% year-over-year to \$7.8 million, although this was a function of a non-cash impairment charge of \$3.75 million.

EBITDA for Q1 was \$14.5 million compared to \$17.4 million in Q1 '16, a 16.5% decline, again a function of the charge. Interest expense fell 8.5% to \$6.2 million from \$6.7 million in the year earlier quarter as a result of less debt outstanding. Preferred stock dividends (including senior common dividends) were higher at \$2.6 million, up 33.4% as a result of recently added senior common and preferred stock. The company also recognized a large, \$5.9 million gain on the sale of an asset.

Net income available to common shareholders was \$1.7 million versus a loss of \$0.4 million in 2016's first quarter. Most of the company's dividend remains 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 expenses. This provides investors with an even higher after tax return on this investment, especially attractive with income tax rates higher for high income investors. Funds from operations, which exclude real estate gains and non-recurring charges, were \$9.7 million, versus \$9.1 million in the previous year. FFO per share was \$0.378 versus \$0.389, on 10.4% more shares outstanding.

Gladstone Commercial saw the leverage on its balance sheet move down a bit since yearend with a ratio of a little over 1.6x debt-to-equity (please see page 4) compared to nearly 2.0X in the year ago period. The company went from having a \$64.1 million balance on its credit line at the end of 2016 to \$63.8 million at the end of Q1 2017. Mortgage debt fell to \$432.5 million from \$445.3 million at year end 2016. 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.

Acquisitions – GOOD announced no meaningful investments during the first quarter, although it did sell a 183,000 square foot industrial property for gross proceeds of \$12.8 million, earning a 24% return on investment based on the original purchase price of \$8.2 million. We are anticipating a significant bump up in acquisition and investment activity going forward with the significant jump in the share price over the past several months, although we anticipate they will continue to be disciplined in their investment activity. Subsequent to quarter end, the company sold a small property for \$2.1 million and continued its \$7.0 million property expansion that will increase rental income upon completion.

Capital Raising Activity – GOOD issued shares under its “at the market” (ATM) equity issuance program and preferred stock ATM program. During the quarter the company issued nearly 120,000 shares of common stock, as well as almost 90,000 shares of preferred raising a total of \$4.6 million net of offering costs. Subsequent to quarter end the company issued more common (nearly 190,000 shares) and preferred (nearly 70,000 shares) stock raising a total of \$5.9 million net of offering costs. In addition, the company also paid off \$27.2 million in higher cost debt.

Quarterly Income Statement

	1st Q 17	1st Q 16	% Change
Rental Revenue	\$21,954,000	\$20,657,000	6.3%
Tenant Recovery Revenue	360,000	485,000	-25.8%
Interest Income from Mortgage Note Receivable	0	385,000	-100.0%
Total Operating Revenues	22,314,000	21,527,000	3.7%
Property Operating Expenses	1,380,000	1,610,000	-14.3%
Base Management Fee	1,181,000	861,000	37.2%
Administration Fee	360,000	404,000	-10.9%
Incentive Fee	569,000	618,000	-7.9%
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	0	0	
Impairment Charge	3,746,000	43,000	0.0%
General and Administrative Expenses	551,000	588,000	-6.3%
Total Operating Expenses	7,787,000	4,124,000	88.8%
Credit to Incentive Fee	0	0	
EBITDA	14,527,000	17,403,000	-16.5%
Interest Expense	6,158,000	6,731,000	-8.5%
Depreciation and Amortization Expenses	9,921,000	9,133,000	8.6%
Interest Income from Temporary Investments	0	0	
Interest Income - Employee Loans	0	0	
Other Income (expense)	2,000	0	
Discontinued Operations (loss)	5,906,000	0	
Net Income	\$4,356,000	\$1,539,000	183.0%
Preferred Dividends	\$2,621,000	\$1,965,000	33.4%
Net Income Available to Common Shareholders	\$1,735,000	(\$426,000)	
Net EPS (diluted)	\$0.07	(\$0.02)	
Avg. Shares Outstanding (diluted)	25,762,314	23,345,402	10.4%
Funds From Operations			
	1st Q 17	1st Q 16	
Net Income Available to Common Shareholders	\$1,735,000	(\$426,000)	
Depreciation and Amortization (incl. discontinued op)	9,921,000	9,133,000	8.6%
Other	-1,912,000	369,000	
Total Funds From Operations	\$9,744,000	\$9,076,000	7.4%
FFO Per Share	\$0.378	\$0.389	-2.7%

Source: Company reports.

Condensed Balance Sheet

	March 31, 2017	December 31, 2016
Real Estate (Net of Depreciation)	\$683,851,000	\$690,088,000
Mortgage Note Receivable	0	0
Lease Intangibles (net)	102,075,000	105,553,000
Real estate assets & related held for sale	2,359,000	9,562,000
Cash and Cash Equivalents	4,105,000	4,658,000
Restricted Cash	3,116,000	3,030,000
Funds Held in Escrow	4,281,000	6,806,000
Interest Receivable - Mortgage Note	0	0
Interest Receivable - Officers	0	0
Deferred Rent Receivable	30,151,000	29,725,000
Deferred Financing Cost	0	0
Prepaid Expenses	0	0
Deposits on Real Estate	0	0
Other Assets	3,039,000	2,320,000
Total Assets	\$832,977,000	\$851,742,000
Mortgage Note Payable	\$432,471,000	\$445,278,000
Borrowings under Line of Credit/Term loan	\$63,797,000	\$64,117,000
Deferred Rent Liability	12,316,000	12,647,000
Asset Retirement Obligation Liability	3,440,000	3,406,000
Accounts Payable and Accrued Expenses	3,461,000	5,891,000
Due to Adviser	2,103,000	2,075,000
Other Liabilities related to assets for sale	332,000	1,041,000
Rent Received / Security Deposits / Other	7,488,000	6,667,000
Total Liabilities	525,408,000	541,122,000
Preferred, Senior common Stock	72,968,000	70,746,000
Common Stock	25,000	25,000
Additional Paid in Capital	465,790,000	463,436,000
Notes Receivable - Employees	0	0
Distribution in Excess of Accumulated Earnings	(231,214,000)	(223,587,000)
Total Shareholders' Equity	\$307,569,000	\$310,620,000
Total Liabilities and Shareholders' Equity	\$832,977,000	\$851,742,000

Balance Sheet Ratio Analysis	March 31, 2017	December 31, 2016
Investments (net) as % of Assets	82.1%	81.0%
Cash & Equiv. and Restricted Cash as % of Assets	0.9%	0.9%
Debt to Equity	161.4%	164.0%
Total Liabilities as % of Assets	63.1%	63.5%
Shareholders' Equity as % of Assets	36.9%	36.5%

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.

First Take

GOOD's Q1 results were pretty much in line with our expectation. There was not really much beyond a typical quarter for the company. They did sell an asset, albeit at a very solid return and made no meaningful investment during the quarter, despite the decline in the company's cost of capital with the sharp rise in the share price. The company continues to be proactive on its lease maturities, and at this point only has leases on about 5% of its properties expiring over the next four years. The company also signed leases on two existing properties, bringing them up to full occupancy. We expect management to pay more attention to acquisitions as a result of the share price rise, as finding accretive investments should prove easier. Having said that, we do not believe that management will change its disciplined nature when making investments, and we expect that they will still look at the long-term opportunity when making investments, much like what was illustrated with the sale made during Q1. Management also continues to lower interest expense through refinancing debt when appropriate.

While the increase in share price over the last few months has made management's job easier when making investments, it also has made the shares less attractive for investors, as it closes in on our \$23.50 a share target. As such, we will be paying close attention to management commentary as we update our position on the shares. The yield has now dropped below 7%, the lowest level we can ever remember for GOOD shares in spite of the likelihood of a rise in interest rates over the longer term.

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 \$570 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.

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 - \$9.75; Neutral), Gladstone Land Corp. (LAND - \$11.15; Long-term Buy), Gladstone Commercial Corporation and Gladstone Capital Corporation (GLAD - \$9.86; 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 May 2, 2017 Hilliard Lyons customers own at least 5% of the outstanding common stock of Gladstone Commercial Corp.

As of May 2, 2017 Hilliard Lyons or its affiliates beneficially own (as defined for purposes of Section 13d of the 1934 Act) 1% or more of Gladstone Commercial Corp. pfd D (GOODM-\$25.83).

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

Hilliard Lyons 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 Investment, Gladstone Commercial and Gladstone Land 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.

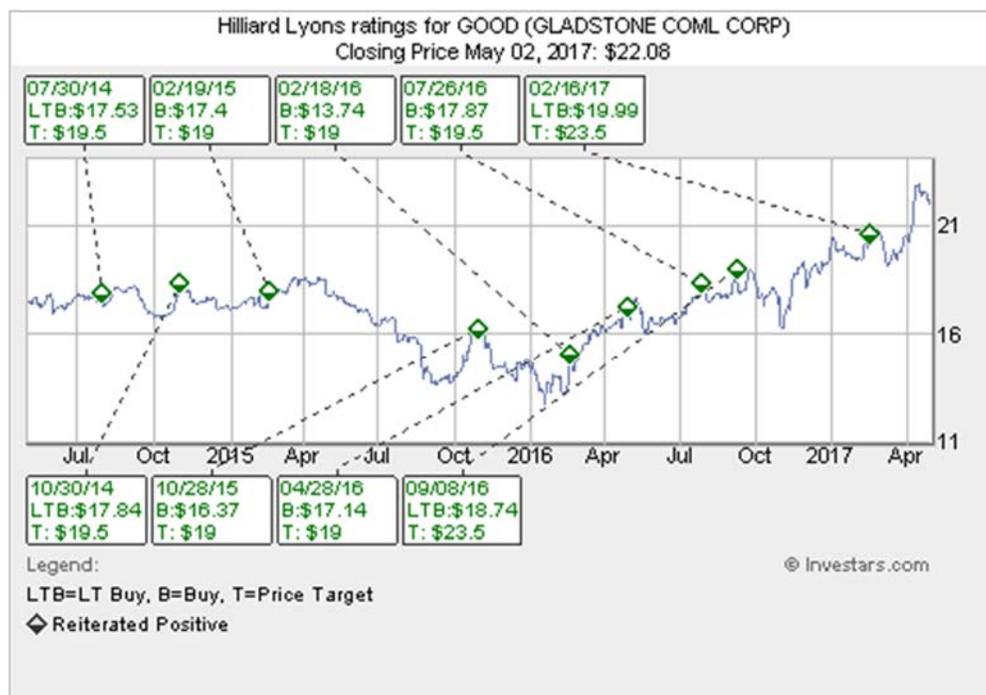
Suitability Ratings

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 base.

Hilliard Lyons Recommended Issues			Investment Banking Provided in Past 12 Mo.	
<u>Rating</u>	<u># of Stocks Covered</u>	<u>% of Stocks Covered</u>	<u>Banking</u>	<u>No Banking</u>
Buy	36	30%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 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.

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