



## REITs

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## COMPANY UPDATE / ESTIMATE CHANGES

Key Metrics	
WSR - NYSE (as of 8/2/17)	\$12.88
Price Target	NA
52-Week Range	\$10.80 - \$15.51
Shares & Units Outstanding (mm)	39.6
Market Cap. (\$mm)	\$510
3-Mo. Average Daily Volume (000)	508
Institutional Ownership	36%
Debt/Total Market Capital (6/17)	58.3%
Est 3 - Year FFO Growth Rate	NA
Est 3 - Year Dividend Growth Rate	NA
Dividend	\$1.14
Dividend Yield	8.9%

### Core FFO Per Share FY 12/31

	2016	Prior 2017E	Curr. 2017E		Prior 2018E	Curr. 2018E
1Q	\$0.34		\$0.32	A	\$0.33	\$0.32
2Q	\$0.32		\$0.31	A	\$0.34	\$0.32
3Q	\$0.33	\$0.33	\$0.32		\$0.34	\$0.33
4Q	\$0.34	\$0.34	\$0.32		\$0.34	\$0.33
Year	\$1.34	\$1.35	\$1.29		\$1.36	\$1.30
P/FFO	9.6x		10.0x			9.9x

The four quarter amounts may not add up to the full year amount due to rounding and the dilution effect of share based compensation.  
 Previous numbers have not been restated.

### Revenue (\$mm)

	2016	Prior 2017E	Curr. 2017E		Prior 2018E	Curr. 2018E
1Q	\$25.4		\$28.3	A	\$33.9	\$33.4
2Q	\$25.1		\$30.2	A	\$33.5	\$33.1
3Q	\$25.5	\$33.0	\$32.7		\$33.9	\$33.6
4Q	\$28.4	\$33.6	\$33.2		\$34.5	\$34.1
Year	\$104.4	\$127.2	\$124.4		\$135.8	\$134.3

**Company Description:** *Whitestone REIT, headquartered in Houston, Texas, was founded in 1998. Whitestone owns and operates commercial properties in established or developing culturally diverse neighborhoods. Whitestone owns and manages properties in Texas, Arizona, and Illinois.*

## Whitestone REIT

WSR -- NYSE – Neutral -- 4

### Second Quarter Results

- **Second quarter Core FFO per share were \$0.31, a penny below the year ago period.** Our Core FFO per share estimate was \$0.36. Weighted average shares and units outstanding rose 34.4% from the year ago period. Total property revenue increased 20.2%.
- **The acquisition pipeline remains active for Whitestone.**
- **We like the company's 8.9% dividend yield.** Given the company's high payout ratio, we would not expect a dividend increase for the next few years, at least.
- **We are lowering our 2017 Core FFO per share estimate by \$0.06 to \$1.29.** Management lowered 2017 Core FFO per share guidance by five cents to a range of \$1.29 to \$1.34.
- **We are maintaining our Neutral rating on Whitestone.** We believe the shares are fairly valued at this time.

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

## **Second Quarter Results**

Total property revenue increased 20.2% to \$30.2 million in the second quarter compared to \$25.1 million in the year ago period. Rental revenue increased 17.1%. Other revenue increased 31.4%. Total property expenses increased 23.5%.

General and administrative expense increased 8.0% from the year ago period. (G&A includes non-cash share based compensation expense and acquisition cost.) Net income for the quarter was \$2.0 million compared to \$1.5 million last year. Diluted EPS were \$0.05 versus \$0.05. Core funds from operations were \$11.6 million versus \$9.2 million. Core FFO per diluted common share and unit were \$0.31, down a penny from the year ago period on 34.4% more shares and units outstanding.

## **Occupancy & Leasing**

Total occupancy of the wholly owned operating portfolio was 89.3% (including developments) at the end of the quarter. Total occupancy [including the Pillarstone (PRLE - \$3.24) properties] was 87%. The total lease value added in 2Q17 was \$21.0 million. The company signed 89 leases in 2Q17 compared to 101 leases signed in 2Q16.

## **Acquisitions**

In May, Whitestone purchased two Texas properties for a total of \$204.6 million. Eldorado Plaza, located in the Dallas suburb of McKinney, is a 221,577 square foot lifestyle center. This center contains the option to purchase an additional 1.86 acres of developable land. BLVD Place, located in Uptown Houston, is a 216,944 square foot lifestyle center. WSR plans to develop a mixed use building on the developable land at this site.

## **Offering & ATM**

In April, WSR completed a public offering of 8,000,000 common shares at a price of \$13.00 per share. The net proceeds from this offering of \$100 million were used to initially repay a portion of debt on its credit facility and for general corporate purposes. In 2Q17, WSR sold an additional 176,576 common shares for net proceeds of \$2.4 million, which were used for general corporate purposes.

## **Financials**

The company has \$9.7 million of debt maturing and scheduled amortization payments in 2017. Maturities and scheduled amortization payments continue to be light in 2018 at \$12.1 million. As of June 30, 2017, 67% of the company's debt was at a fixed rate. The company's weighted average interest rate on all fixed debt at the end of the second quarter was 3.9%.

## **Guidance**

WSR lowered 2017 Core FFO per share guidance by five cents to a range of \$1.29 to \$1.34, due to several items, including the impact of the April equity offering, acquisitions, and lower than anticipated same store growth in the Pillarstone portfolio. Management's guidance does not include any additional unannounced acquisitions or dispositions. Same property NOI growth is expected to be between 2% and 4%. Our revised 2017 Core FFO per share estimate is \$1.29.

## Whitestone REIT

Consolidated Statement of Income (In thousands, except per share data)			
	2Q17	2Q16	% Change
Property revenues			
Rental revenues	\$23,010	\$19,649	17.1%
Other revenues	7,198	5,480	31.4%
Total property revenues	30,208	25,129	20.2%
Property expenses			
Property operations and maintenance	5,375	4,683	14.8%
Real estate taxes	4,487	3,304	35.8%
Total property expenses	9,862	7,987	23.5%
Other expenses (income)			
General and administrative	5,848	5,413	8.0%
Depreciation and amortization	6,681	5,521	21.0%
Executive relocation expense			
Involuntary conversion			
Interest expense	5,629	4,748	18.6%
Interest income	(101)	(78)	
Total other expense	18,057	15,604	15.7%
Income from continuing operations before loss on disposal of assets and income taxes	2,289	1,538	48.8%
Provision for income taxes	(89)	(11)	
Loss on sale or disposal of assets	(72)	(18)	
Income (loss) from discontinued operations	16		
Gain on sale of property			
Net income (loss)	2,144	1,509	42.1%
Less: Redeemable operating partnership units	60	25	
Less: Non-controlling interests in consolidated partnership	101		
Less: Net income (loss) attributable to noncontrolling interests		25	
Net income (loss) attributable to Whitestone REIT	\$1,983	\$1,484	33.6%
Earnings per share - diluted	\$0.05	\$0.05	0.0%
Weighted average number of common shares outstanding:			
Diluted	36,544	27,513	32.8%

Funds From Operations	2Q17	2Q16	% Change
Net income (loss) attributable to Whitestone REIT	\$1,983	\$1,484	33.6%
Depreciation and amortization of real estate assets	6,445	5,479	17.6%
Loss (gain) on disposal of assets	55	18	
Net income (loss) attributable to noncontrolling interests	60	25	140.0%
FFO	\$8,543	\$7,006	21.9%
Non cash share-based compensation	2,390	1,819	
Acquisition costs	716	393	82.2%
Relocation arrangement			
Rent support agreement payments			
Legal and professional costs			
Gain on insurance settlement			
Core FFO	\$11,649	\$9,218	26.4%
Diluted FFO per common share and OP unit	\$0.22	\$0.24	-8.3%
Core FFO per common share and OP unit	\$0.31	\$0.32	-3.1%
Weighted average number of common shares and OP units - dilutive	37,630	27,997	34.4%

Source: Company report

Whitestone REIT  
Consolidated Balance Sheets

<i>(In thousands)</i>	12/31/2015	12/31/2016	6/30/2017
Assets			
Real estate assets, at cost			
Property	835,538	920,310	1,140,299
Accumulated depreciation	(89,580)	(107,258)	(118,442)
Real estate assets held-for-sale			
Total real estate assets	<b>\$745,958</b>	<b>\$813,052</b>	<b>\$1,021,857</b>
Cash and cash equivalents	2,587	4,168	9,267
Restricted cash	121	56	127
Marketable Securities	435	517	550
Escrows and acquisition deposits	6,668	6,620	7,408
Accrued rents and accounts receivable, net of allowance for doubtful accounts	15,466	19,951	20,482
Related party receivable			
Unamortized lease commissions and loan costs	9,970	8,083	8,283
Prepaid expenses and other assets	2,672	2,762	3,431
Total assets	<b>\$783,877</b>	<b>\$855,209</b>	<b>\$1,071,405</b>
Liabilities and Equity			
Liabilities:			
Notes payable	499,747	544,020	663,480
Accounts payable and accrued expenses	24,051	28,692	30,206
Tenants' security deposits	5,254	6,125	6,600
Dividends and distributions payable	7,834	8,729	11,289
Other liabilities			
Total liabilities	<b>\$536,886</b>	<b>\$587,566</b>	<b>\$711,575</b>
Commitments and contingencies:			
Equity:			
Preferred shares, par value			
Common shares, par value	27	29	38
Additional paid-in-capital	359,971	396,494	507,227
Accumulated other comprehensive income	(129)	859	845
Accumulated deficit	(116,895)	(141,695)	(159,413)
Total Whitestone REIT shareholders' equity	<b>\$242,974</b>	<b>\$255,687</b>	<b>\$348,697</b>
Noncontrolling interest	4,017	11,956	11,133
Total equity	246,991	267,643	359,830
Total liabilities and equity	<b>\$783,877</b>	<b>\$855,209</b>	<b>\$1,071,405</b>

Balance Sheet Ratio Analysis	12/31/2015	12/31/2016	6/30/2017
Total R/E Investments / Total Debt	149.3%	149.5%	154.0%
Debt to Equity	202.3%	203.3%	184.4%
Debt as % of Total Assets	63.8%	63.6%	61.9%
Shareholders' Equity as % of Total Assets	31.0%	29.9%	32.5%

Previous numbers have not been restated.

Source: Company reports

## Valuation

At 9.9x our fiscal 2018 Core FFO per share forecast, Whitestone REIT is selling at a discount to its peer group. If we look at our 2018 Non-Core FFO per share estimate of \$1.20, WSR is trading at a 10.7x multiple, still a discount to its peer group, but near WSR's 5 year historic forward price/FFO multiple. (Non-Core FFO includes the impact of non-cash share based compensation and acquisition costs. These costs are added back to Non-Core FFO to arrive at Core FFO.) We believe WSR should trade at a discount to its peer group, given its low one year and negative two year expected FFO growth rates and shorter history as a public company. We believe the shares are fairly valued at this time and rate the stock Neutral.

Peer REITs	Symbol	Price	Current	Yield	Payout Ratio	FFO Per Share			2 -Year Exp.	18/17E	Price/FFO	
		8/2/2017	Dividend			2016	2017E	2018E	Avg. Growth	Growth Rate	2017E	2018E
Vornado Realty Trust	VNO	\$78.76	\$2.40	3.0%	56.3%	\$7.68	\$4.26	\$4.16	-22.9%	-2.3%	18.5x	18.9x
Washington Real Estate Investment Trust	WRE	\$33.36	\$1.20	3.6%	65.9%	\$1.76	\$1.82	\$1.87	3.1%	2.7%	18.3x	17.8x
Lexington Realty Trust	LXP	\$10.13	\$0.70	6.9%	72.9%	\$1.10	\$0.96	\$1.01	-4.1%	5.2%	10.6x	10.0x
Cousins Properties	CUZ	\$9.19	\$0.24	2.6%	39.3%	\$0.72	\$0.61	\$0.65	-4.9%	6.6%	15.1x	14.1x
Investors Real Estate Trust	IRET	\$6.23	\$0.28	4.5%	70.0%	\$0.76	\$0.40	\$0.35	-27.0%	-12.5%	15.6x	17.8x
<b>Peer Average</b>		<b>\$27.53</b>	<b>\$0.96</b>	<b>4.1%</b>	<b>60.9%</b>	<b>\$2.40</b>	<b>\$1.61</b>	<b>\$1.61</b>	<b>-11.1%</b>	<b>-0.1%</b>	<b>15.6x</b>	<b>15.7x</b>
<b>S&amp;P 500</b>	<b>SPX</b>	<b>2,477.57</b>	<b>\$49.10</b>	<b>2.0%</b>	<b>37.6%</b>	<b>\$117.75</b>	<b>\$130.74</b>	<b>\$139.52</b>	<b>9.2%</b>	<b>6.7%</b>	<b>19.0x</b>	<b>17.8x</b>
<b>Whitestone REIT</b>	<b>WSR</b>	<b>\$12.88</b>	<b>\$1.14</b>	<b>8.9%</b>	<b>88.4%</b>	<b>\$1.34</b>	<b>\$1.29</b>	<b>\$1.30</b>	<b>-1.5%</b>	<b>0.8%</b>	<b>10.0x</b>	<b>9.9x</b>

Note: IRET is rated Neutral by Hilliard Lyons; the rest are not rated.  
IRET has an April fiscal year end.  
Whitestone's FFO estimates are Core FFO.  
Peer group is based on a select group of REITs NAREIT considers WSR's peers.  
SPX figures are EPS not FFO per share.

Source: NAREIT, HL Estimates, and Thomson Eikon.

**Dividend** - Whitestone's dividend is declared quarterly and paid monthly. The annual amount is \$1.14 per share. We find the current dividend yield of 8.9% attractive. Given the company's high payout ratio, we would not expect a dividend increase for a few years, at least. Over the long term, management would like to maintain a dividend payout ratio of 85%.

## Suitability

We assign shares of Whitestone REIT a suitability rating of 4 on our scale of 1 - 4 (1=most conservative, 4=most aggressive). Our rating is based on the company's small market cap, low relative trading volume, and lower occupancy rate than the peer group.

## Risks and Considerations

Risks to investment in WSR include, but are not limited to: general economic risk, interest rate risk, inability to secure financing or raise capital, a change in consumer spending, slower than expected capital deployment, bankruptcy of tenants, tenant closings, inclement weather, political risk, demographic changes in WSR's markets, and the inability to lease up properties as quickly as anticipated. Whitestone and Pillarstone Capital REIT share some management and board members.

We note that Whitestone is thinly traded. Liquidity could be a concern for some investors.

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, Carol L. Kemple, 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**

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

Hilliard Lyons acted as a manager or co-manager of an offering of securities of Whitestone REIT in the past 12 months.

Hilliard Lyons received investment banking compensation from Whitestone REIT in the past 12 months.

### **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 total 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 decline 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



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 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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