



COMPANY UPDATE / ESTIMATE CHANGES

Key Metrics

WSR - NYSE (as of 3/1/17)	\$14.06
Price Target	NA
52-Week Range	\$11.00 - \$16.30
Shares & Units Outstanding (mm)	30.6
Market Cap. (\$mm)	\$430
3-Mo. Average Daily Volume (000)	108.5
Institutional Ownership	45%
Debt/Total Market Capital (12/16)	55.4%
Est 3 -Year FFO Growth Rate	NA
Est 3 - Year Dividend Growth Rate	NA
Dividend	\$1.14
Dividend Yield	8.1%

Core FFO Per Share FY 12/31

	2015	2016	Prior 2017E	Curr. 2017E
1Q	\$0.34	\$0.34	\$0.28	\$0.33
2Q	\$0.35	\$0.32	\$0.30	\$0.34
3Q	\$0.34	\$0.33	\$0.30	\$0.34
4Q	\$0.34	\$0.34	\$0.31	\$0.34
Year	\$1.35	\$1.34	\$1.20	\$1.36
P/FFO	10.4x	10.5x		10.3x

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)

	2015	2016	Prior 2017E	Curr. 2017E
1Q	\$21.3	\$25.4	\$23.5	\$27.9
2Q	\$22.0	\$25.1	\$24.4	\$28.1
3Q	\$24.6	\$25.5	\$25.3	\$28.4
4Q	\$25.6	\$28.4	\$26.3	\$28.8
Year	\$96.4	\$104.4	\$99.5	\$113.2

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

Fourth Quarter Results

- **Fourth quarter Core FFO per share were \$0.34, equal to the year ago period.** Our Core FFO per share estimate was \$0.32. Weighted average shares and units outstanding rose 9.0% from the year ago period. Total property revenue increased 10.8%.
- **The acquisition pipeline remains active for Whitestone.** Whitestone has two properties under contract and two under negotiations.
- **We like the company's 8.1% dividend yield.** Management remains comfortable with the current dividend level. Given the company's high payout ratio, we would not expect a dividend increase for the next few years, at least.
- **We are raising our 2017 Core FFO per share estimate by \$0.16 to \$1.36.** (Our previous number assumed an outright, all cash sale of the company's non-core assets in 4Q16. The assets sold to Pillarstone Capital REIT (PRLE - \$3.55) are included in consolidated results.) Management initiated 2017 Core FFO per share guidance of \$1.34 to \$1.39.
- **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.

Fourth Quarter Results

Total property revenue increased 10.8% to \$28.4 million in the fourth quarter compared to \$25.6 million in the year ago period. Rental revenue increased 8.9%. Other revenue increased 16.7%. Total property expenses increased 9.7%.

General and administrative expense increased 45.0% from the year ago period. (G&A includes non-cash share based compensation expense, which was up \$1.2 million from the year ago period.) Net income for the quarter was \$0.5 million compared to \$2.1 million last year. Diluted EPS were \$0.01 versus \$0.07. Core funds from operations were \$10.6 million versus \$9.7 million. Core FFO per diluted common share and unit were \$0.34, flat with the year ago period on 9.0% more shares and units outstanding.

Occupancy & Leasing

Total occupancy of the operating portfolio was 89.7% at the end of the quarter. Total occupancy (including the Pillarstone properties) was 87%. The total lease value added in 4Q16 was \$20.0 million. The company signed 98 leases in 4Q16 compared to 104 leases signed in 4Q15.

Acquisitions, Dispositions & Developments

On December 1, WSR announced the sale of two non-core legacy properties located in the Houston market for \$4.9 million. Whitestone provided seller financing for part of the transaction, secured by the properties and a third-party guarantee. The company expects to record a \$2.1 million gain on the sale, with \$0.4 million recognized in 4Q16 and the \$1.7 million upon the receipt of principal payments on the 3-year seller financing loan.

On December 8, Whitestone announced it had completed the sale of 14 non-core properties to Pillarstone Capital REIT for a total transaction value of \$84.0 million, comprised of \$65.9 million of debt assumed and Pillarstone operating partnership units valued at \$18.1 million. Pillarstone is affiliated with certain members of WSR's management team and board. WSR will receive leasing and management fees from these properties for two years. We note that while WSR sold these properties, they still have an ownership interest in them through these OP units, and they remain consolidated for financial reporting.

Whitestone has substantially completed construction at its Shops at Starwood Phase III property.

Financials

The company has \$10.2 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 December 31, 2016, 65% 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 fourth quarter was 3.8%.

Guidance

Management initiated 2017 Core FFO per share guidance of \$1.34 to \$1.39. Management's guidance does not include any additional unannounced acquisitions or dispositions. Same property NOI growth is expected to be between 3% and 5%. Our 2017 Core FFO per share estimate is \$1.36.

Whitestone REIT

Consolidated Statement of Income (In thousands, except per share data)			
	4Q16	4Q15	% Change
Property revenues			
Rental revenues	\$21,153	\$19,417	8.9%
Other revenues	7,212	6,178	16.7%
Total property revenues	28,365	25,595	10.8%
Property expenses			
Property operations and maintenance	5,328	5,453	-2.3%
Real estate taxes	4,311	3,334	29.3%
Total property expenses	9,639	8,787	9.7%
Other expenses (income)			
General and administrative	7,455	5,142	45.0%
Depreciation and amortization	6,095	5,373	13.4%
Executive relocation expense			
Involuntary conversion			
Interest expense	5,018	4,246	18.2%
Interest income	(90)	(69)	
Total other expense	18,478	14,692	25.8%
Income from continuing operations before loss on disposal of assets and income taxes	248	2,116	-88.3%
Provision for income taxes	(42)	(98)	
Loss on sale or disposal of assets	(106)	63	
Income (loss) from discontinued operations		8	
Gain on sale of property	467		
Net income (loss)	567	2,089	-72.9%
Less: Redeemable operating partnership units	20	38	
Less: Net income (loss) attributable to noncontrolling interests	15		
Net income (loss) attributable to Whitestone REIT	\$532	\$2,051	-74.1%
Earnings per share - diluted	\$0.01	\$0.07	-85.7%
Weighted average number of common shares outstanding:			
Diluted	29,486	27,560	7.0%

Funds From Operations	4Q16	4Q15	% Change
Net income (loss) attributable to Whitestone REIT	\$532	\$2,051	-74.1%
Depreciation and amortization of real estate assets	5,984	5,342	12.0%
Loss (gain) on disposal of assets	(361)	(63)	
Net income (loss) attributable to noncontrolling interests	20	38	-47.4%
FFO	\$6,175	\$7,368	-16.2%
Non cash share-based compensation	3,361	2,137	
Acquisition costs	1,111	150	640.7%
Relocation arrangement			
Rent support agreement payments			
Legal and professional costs			
Gain on insurance settlement			
Core FFO	\$10,647	\$9,655	10.3%
Diluted FFO per common share and OP unit	\$0.20	\$0.26	-23.1%
Core FFO per common share and OP unit	\$0.34	\$0.34	0.0%
Weighted average number of common shares and OP units - dilutive	30,589	28,060	9.0%

Previous numbers have been restated.

Source: Company report

Whitestone REIT
Consolidated Balance Sheets

<i>(In thousands)</i>	12/31/2014	12/31/2015	12/31/2016
Assets			
Real estate assets, at cost			
Property	673,655	835,538	920,310
Accumulated depreciation	(71,587)	(89,580)	(107,258)
Real estate assets held-for-sale			
Total real estate assets	\$602,068	\$745,958	\$813,052
Cash and cash equivalents	4,236	2,587	4,168
Restricted cash		121	56
Marketable Securities	973	435	517
Escrows and acquisition deposits	4,092	6,668	6,620
Accrued rents and accounts receivable, net of allowance for doubtful accounts	11,834	15,466	19,951
Related party receivable			
Unamortized lease commissions and loan costs	8,879	9,970	8,083
Prepaid expenses and other assets	2,215	2,672	2,762
Total assets	\$634,297	\$783,877	\$855,209
Liabilities and Equity			
Liabilities:			
Notes payable	394,093	499,747	544,020
Accounts payable and accrued expenses	15,882	24,051	28,692
Tenants' security deposits	4,372	5,254	6,125
Dividends and distributions payable	6,627	7,834	8,729
Other liabilities			
Total liabilities	\$420,974	\$536,886	\$587,566
Commitments and contingencies:			
Equity:			
Preferred shares, par value			
Common shares, par value	23	27	29
Additional paid-in-capital	304,078	359,971	396,494
Accumulated other comprehensive income	(91)	(129)	859
Accumulated deficit	(93,938)	(116,895)	(141,695)
Total Whitestone REIT shareholders' equity	\$210,072	\$242,974	\$255,687
Noncontrolling interest	3,251	4,017	11,956
Total equity	213,323	246,991	267,643
Total liabilities and equity	\$634,297	\$783,877	\$855,209

Balance Sheet Ratio Analysis	12/31/2014	12/31/2015	12/31/2016
Total R/E Investments / Total Debt	152.8%	149.3%	149.5%
Debt to Equity	184.7%	202.3%	203.3%
Debt as % of Total Assets	62.1%	63.8%	63.6%
Shareholders' Equity as % of Total Assets	33.1%	31.0%	29.9%

Previous numbers have not been restated.

Source: Company reports

Valuation

At 10.3x our fiscal 2017 Core FFO per share forecast, Whitestone REIT is selling at a discount to its peer group. If we look at our 2017 Non-Core FFO per share estimate of \$1.02, WSR is trading at a 13.8x multiple, still a discount to its peer group. (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.) Based on historical multiples, the peer group does not look cheap to us. We believe WSR should trade at a discount to its peer group, given its one year and two year expected FFO growth rates. 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.	17/16E	Price/FFO	
		3/1/2017	Dividend			2015	2016E/A	2017E	Avg. Growth	Growth Rate	2016E/A	2017E
Vornado Realty Trust	VNO	\$109.27	\$2.84	2.6%	41.1%	\$4.50	\$6.91	\$5.35	9.4%	-22.6%	15.8x	20.4x
Washington Real Estate Investment Trust	WRE	\$32.96	\$1.20	3.6%	85.7%	\$1.71	\$1.40	\$1.78	2.0%	27.1%	23.5x	18.5x
Lexington Realty Trust	LXP	\$10.88	\$0.70	6.4%	76.1%	\$0.96	\$0.92	\$1.00	2.1%	8.7%	11.8x	10.9x
Cousins Properties	CUZ	\$8.53	\$0.24	2.8%	30.0%	\$0.89	\$0.80	\$0.60	-16.3%	-25.0%	10.7x	14.2x
Investors Real Estate Trust	IRET	\$6.52	\$0.28	4.3%	36.8%	\$0.64	\$0.76	\$0.49	-11.7%	-35.5%	8.6x	13.3x
Peer Average		\$33.63	\$1.05	4.0%	53.9%	\$1.74	\$2.16	\$1.84	-2.9%	-9.5%	14.1x	15.5x
S&P 500	SPX	2,395.96	\$48.08	2.0%	41.2%	\$118.23	\$116.75	\$129.74	4.9%	11.1%	20.5x	18.5x
Whitestone REIT	WSR	\$14.06	\$1.14	8.1%	85.1%	\$1.35	\$1.34	\$1.36	0.4%	1.5%	10.5x	10.3x

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: HL Estimates, Baseline, and Thomson One.

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 8.1% 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.

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	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017

Other Disclosures

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