



Gladstone Investment Corp. (GAIN)

Updated May 8th, 2018 by Jonathan Weber

Key Metrics

Current Price: \$11	5 Year CAGR Estimate: 7.1%	Quality Percentile: N/A
Fair Value Price: \$9	5 Year Growth Estimate: 3.6%	Momentum Percentile: N/A
% Fair Value: 120%	5 Year Valuation Multiple Estimate: -3.6%	Total Return Percentile: N/A
Dividend Yield: 7.1%	5 Year Price Target: \$11	Valuation Percentile:

Overview & Current Events

Gladstone Investment is a business development company (BDC) that focuses on US based small and medium-sized companies. Industries which Gladstone Investment targets include aerospace & defense, oil & gas, machinery, electronic, media & communications. Gladstone Investment was founded in 2005, is headquartered in McLean, VA and is trading at a market capitalization of just \$370 million.

Gladstone Investment's most recent quarterly results were announced on February 6, the company reported net investment income (the EPS equivalent for BDCs) of \$0.23 per share, significantly above the analyst consensus of \$0.18. Gladstone Investment further reported that its revenues had increased by 21% to \$16 million. Net asset value per share was \$10.37 at the end of the most recent quarter, up three percent in three months.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
NIIPS	\$0.79	\$0.62	\$0.48	\$0.73	\$0.62	\$0.68	\$0.73	\$0.75	\$0.68	\$0.74	\$0.77	\$0.92
DPS	\$0.93	\$0.96	\$0.48	\$0.48	\$0.61	\$0.60	\$0.71	\$0.77	\$0.75	\$0.75	\$0.80	\$0.96

Gladstone Investment's net investment income per share is quite lumpy, on a year-over-year basis there were meaningful moves both up and down over the last decade. During the financial crisis the company's profits declined substantially, but Gladstone Investment remained profitable. Over the last five years profits grew by 3.6% annually, which isn't a very high growth rate, but which is not bad at all for a high-yielding investment either.

Gladstone Investment's business model is relatively straightforward. The company lends money to small- and mid-sized companies (with position sizes for debt investments being \$5 million to \$30 million) and also takes equity stakes in such companies (with position sizes for equity investments ranging from \$10 million to \$40 million).

The companies Gladstone Investment is doing business with usually can't access debt or equity markets directly (as bond sales and public listings are not viable due to their small size), which is why there is significant demand for business development companies such as Gladstone Investment to provide capital in the form of debt and/or equity.

Gladstone Investment makes its money via spreads between the interest rates the company pays on cash that it borrows and the interest rates the company receives on cash that it lends (the same principle as with banks). With interest rates rising due to the Fed's tightening, these spreads usually widen further, which is why rising rate environments are favorable for banks' profits, and also for the profits for Gladstone Investment and other BDCs.

Net investment income per share has been lower than Gladstone Investment's dividend payments in several years, but that is not necessarily a problem as the BDC's underlying earnings power oftentimes is higher than the net investment income the company reports (due to factors such as unrealized appreciation of equity investments). Gladstone Investment has grown its dividend by 4.2% annually over the last five years, but dividends will remain somewhat cyclical.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
P/NII	9.0	7.7	13.3	10.1	12.1	10.7	10.5	10.2	11.9	12.8	14.3	11.9
Avg. Yld.	13.1%	18.7%	7.5%	6.5%	8.1%	8.2%	9.2%	10.1%	9.3%	7.9%	7.1%	7.8%

Gladstone Investment's valuation was very low during the last financial crisis (and, correspondingly, its dividend yield has been very high before the payout got cut during 2010). Over the last couple of years the price to net investment income multiple averaged slightly less than twelve. Right now shares are more expensive. This is primarily due to the steep rise the BDC's share price has experienced since September 2017. The above-average valuation means that there is some multiple-compression downside, and the dividend yield is also lower than it used to be (although it is still quite high on an absolute basis).

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Debt/A	41.5%	34.3%	35.0%	17.4%	36.3%	36.6%	33.2%	43.5%	44.5%	41.6%	42.0%	45.0%
Int. Cov.	-	-	6.3	24.8	29.6	16.3	0.4	15.2	7.0	13.6	15.5	17.0
Payout	118%	155%	100%	65.8%	98.4%	88.2%	97.3%	103%	110%	101%	104%	104%
Std. Dev.	55.8%	63.7%	32.2%	19.2%	17.9%	11.3%	13.7%	15.3%	27.3%	16.0%	19.0%	17.0%

Gladstone Investment has a strong balance sheet. Even though it makes at least some of its money by borrowing money and lending it out at higher interest rates, its total liabilities are not very high, either on an absolute basis, or relative to the assets the company owns.

Over the last couple of years Gladstone Investment has increased its leverage somewhat. Thanks to continuously high interest coverage rates the increase in the company's leverage seems opportune as it will allow for higher net investment income and higher returns on equity (all else equal).

The fact that Gladstone Investment pays out more than 100% of its net investment income relatively often is not necessarily a reason to worry, as the BDC is able to capitalize on another source of funds... Due to a sizeable amount of its investments being allocated to equity (which can appreciate in value), the BDC generates investment gains on top of the interest income it generates from first and second lien debt. Those investment gains are partially paid out in the form of dividends, but some of those investments gains are retained, which explains the increasing book value.

Gladstone Investment's recession performance is not very compelling compared to less cyclical income stocks (e.g. most consumer staples), but at least Gladstone Investment remained profitable during the last financial crisis (unlike many other companies from the financial industry). With that said, Gladstone reduced its dividend 50% during the Great Recession. Its dividend *is still not back to pre-recession highs*.

Final Thoughts & Recommendation

Gladstone Investment is a high-yield investment, providing a 7.1% dividend yield (not including special dividends, which push the trailing dividend yield to 8.0%). Due to its valuation being higher than its historical average, total returns will come primarily from dividends in the future. Gladstone Investment should benefit from rising interest rates (especially since 97% of its debt portfolio consist of floating-rate debt), but results will remain cyclical.

Total Return Breakdown by Year

