



Gladstone Investment Corp. (GAIN)

Updated August 2nd, 2018 by Jonathan Weber

Key Metrics

Current Price: \$11	5 Year CAGR Estimate: 7.0%	Volatility Percentile: 48.3%
Fair Value Price: \$9	5 Year Growth Estimate: 3.6%	Momentum Percentile: 76.2%
% Fair Value: 121%	5 Year Valuation Multiple Estimate: -3.6%	Valuation Percentile: 20.0%
Dividend Yield: 7.0%	5 Year Price Target: \$11	Total Return Percentile: 37.8%

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 \$390 million.

Gladstone Investment reported its second quarter earnings results on August 1. The company generated net investment income of \$0.20 per share, slightly ahead of analyst estimates, and 11% higher than the results from Q2 2017. Gladstone Investment's total revenues were up by 13%, hitting \$16 million. Gladstone Investment's net asset value per share rose to \$11.57, a steep 7% increase in just one quarter.

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 have been 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 not a very high growth rate, but which is not disappointing 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. Position sizes for debt investments range from \$5 million to \$30 million. The company 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 cannot access debt or equity markets directly as bond sales and public listings are not viable due to their small size. This 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. All else equal, rising interest rates should widen these spreads, which would be beneficial for Gladstone Investment.

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%	7.0%	7.8%

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

Right now Gladstone Investment's shares look expensive compared to how the company was valued in the past. We forecast some multiple contraction over the coming years. Shares offer a relatively high dividend yield of 7.0% right here, but investors should keep in mind that the dividend has been cut several times in recent years.

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. 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 returns on equity, all else equal.

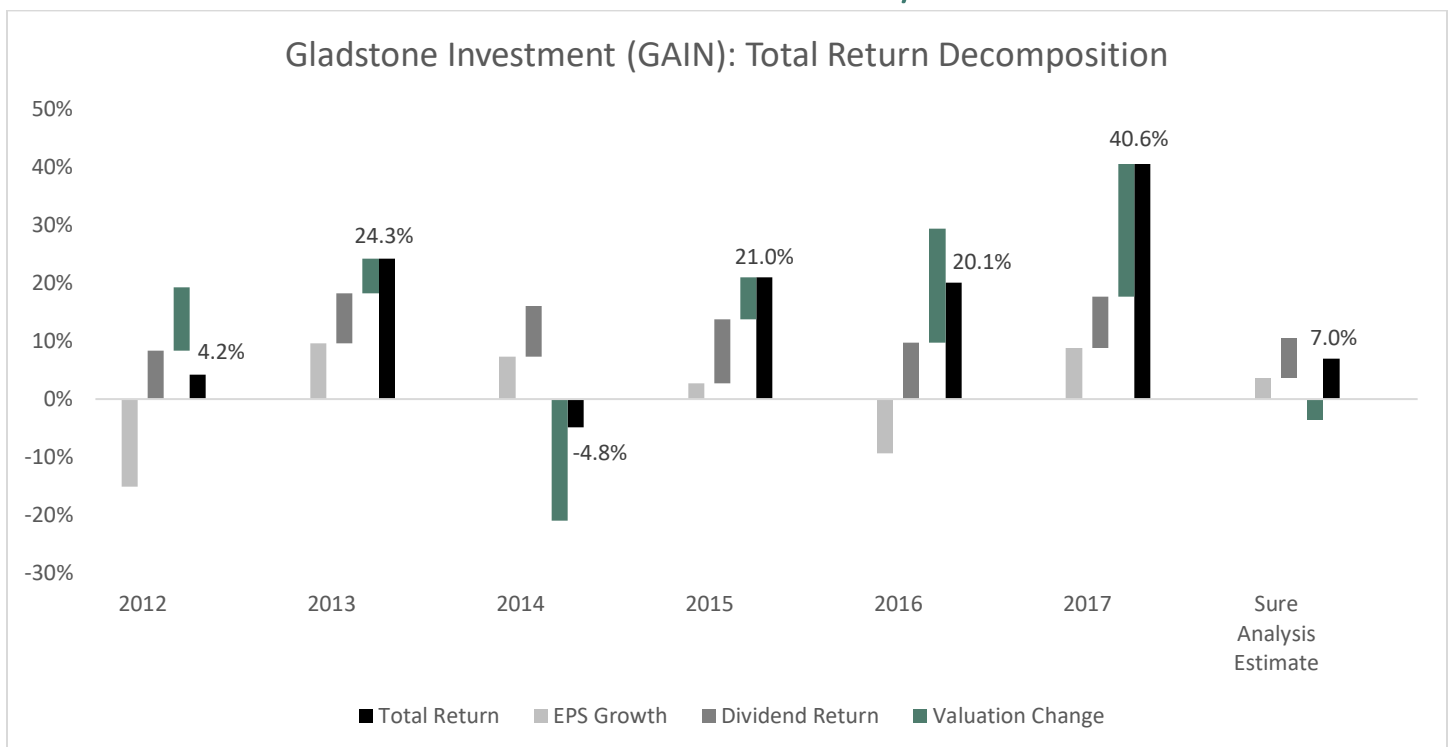
The fact that Gladstone Investment pays out more than 100% of its net investment income relatively often is not necessarily a reason to worry, as the BDC is able to capitalize on another source of funds. Due to some of its investments being allocated to equity, which can appreciate in value, the BDC 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, but at least Gladstone Investment remained profitable during the last financial crisis. With that said, Gladstone reduced its dividend 50% during the Great Recession, and its dividend remains below the pre-crisis highs to this day.

Final Thoughts & Recommendation

Gladstone Investment is a high-yield stock with relatively low growth rates. Its business model is vulnerable versus steep economic downturns, and right now shares are valued at a premium over the fair valuation. Due to the high yield that looks safe for now, we rate Gladstone Investment a hold for income investors.

Total Return Breakdown by Year



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