



Gladstone Investment Corp. (GAIN)

Updated November 6th, 2018 by Jonathan Weber

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|---------------------------------|-------|
| Current Price: | \$11 | 5 Year CAGR Estimate: | 8.4% | Volatility Percentile: | 51.2% |
| Fair Value Price: | \$9 | 5 Year Growth Estimate: | 3.6% | Momentum Percentile: | 49.2% |
| % Fair Value: | 86% | 5 Year Valuation Multiple Estimate: | -2.9% | Growth Percentile: | 18.8% |
| Dividend Yield: | 7.7% | 5 Year Price Target | \$11 | Valuation Percentile: | 33.9% |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Total Return Percentile: | 52.7% |

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, electronics, and media & communications. Gladstone Investment was founded in 2005, is headquartered in McLean, VA and is trading at a market capitalization of just \$340 million.

Gladstone Investment has reported its third quarter earnings results on November 5. The company generated total investment income of \$13.1 million, a decrease of 15.5% versus the prior year's quarter. Adjusted net investment income per share was only \$0.10, substantially below the analyst consensus of \$0.20. Gladstone Investment was able to grow its assets (book value) by \$0.93 per share nevertheless, primarily due to a steep increase in its net unrealized appreciation. The company announced three dividend payments of \$0.068 per share for October, November, and December, which was 1.5% more than the previous monthly dividend. Gladstone Investment also announced a supplemental distribution of \$0.06 that will be paid out in December.

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 | \$0.73 | \$0.75 | \$0.75 | \$0.80 | \$0.96 |
| Shares | 22 | 22 | 22 | 22 | 26 | 26 | 26 | 30 | 30 | 33 | 33 | 35 |

Gladstone Investment's net investment income per share is quite lumpy. 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 is not a very high growth rate, but which is not disappointing 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.

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.

NIIPS has been lower than dividend payments in several years, but that is not necessarily a problem. The BDC's underlying earnings power is higher than NII, due to factors such as unrealized appreciation of equity investments.

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 | 13.8 | 11.9 |
| Avg. Yld. | 13.1% | 18.7% | 7.5% | 6.5% | 8.1% | 8.2% | 9.2% | 10.1% | 9.3% | 7.9% | 7.7% | 8.0% |

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Shares of Gladstone Investment are valued at a little less than 14 times this year's expected net investment income, which represents a premium over how shares were valued in the past. Multiple contraction could therefore be a headwind going forward. Investors get a high dividend yield of 7.7%, which will provide the majority of total returns.

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% |

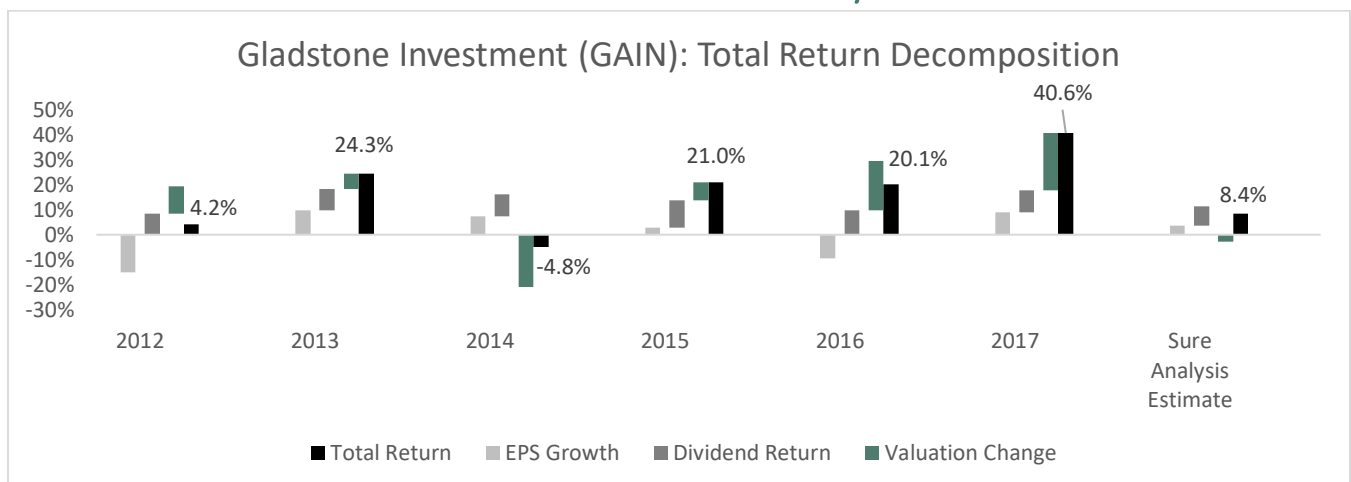
Gladstone Investment has a strong balance sheet. Even though it makes at least some of its money by borrowing money and lending it out at higher interest rates, its total liabilities are not very high. Over the last couple of years Gladstone Investment has increased its leverage somewhat. Thanks to continuously 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. These investment gains explain the book value growth. Gladstone Investment's recession performance is not very compelling compared to less cyclical income stocks, 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 small business development company that provides a high dividend yield of almost 8%. Its net interest income does not cover the dividend payout in every year, but the company's gains on its equity investments make up for that. Gladstone Investment's valuation is higher than it used to be, which will be a headwind for total returns over the coming year. Primarily thanks to its dividend yield Gladstone Investment should nevertheless produce high-single digits total returns. Due to the above-average valuation we rate Gladstone Investment a hold at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|------------------|-------|--------|-------|-------|-------|-------|------|------|------|------|
| Revenue | 26 | 21 | 26 | 21 | 31 | 36 | N/A | N/A | N/A | N/A |
| SG&A Exp. | 6 | 7 | 9 | 7 | 14 | 18 | 8 | 10 | 9 | 16 |
| D&A Exp. | 20 | 0 | 0 | 3 | 1 | 0 | N/A | N/A | N/A | N/A |
| Operating Profit | 19 | 13 | 17 | 14 | 15 | 18 | -3 | -8 | -6 | -10 |
| Operating Margin | 72.6% | 60.6% | 64.7% | 63.8% | 50.5% | 48.5% | N/A | N/A | N/A | N/A |
| Net Profit | -11 | -11 | 16 | 22 | 17 | -1 | 50 | 25 | 45 | 61 |
| Net Margin | -44% | -53.3% | 63.1% | 103% | 56.6% | -3.7% | N/A | N/A | N/A | N/A |
| Free Cash Flow | 14 | 99 | 67 | -49 | -40 | -34 | -98 | 4 | 32 | -29 |

Balance Sheet Metrics

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|----------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 327 | 297 | 241 | 325 | 380 | 331 | 484 | 503 | 515 | 611 |
| Cash & Equivalents | 7 | 88 | 81 | 92 | 86 | 5 | 5 | 4 | 3 | 4 |
| Accounts Receivable | 3 | 1 | 1 | 2 | N/A | N/A | 5 | N/A | N/A | N/A |
| Total Liabilities | 112 | 104 | 42 | 118 | 139 | 110 | 210 | 224 | 214 | 257 |
| Accounts Payable | | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Long-Term Debt | 110 | 103 | 40 | 76 | 95 | 67 | N/A | N/A | N/A | N/A |
| Shareholder's Equity | 215 | 193 | 199 | 207 | 241 | 221 | 273 | 279 | 301 | 354 |
| D/E Ratio | 0.51 | 0.53 | 0.20 | 0.37 | 0.39 | 0.30 | N/A | N/A | N/A | N/A |

Profitability & Per Share Metrics

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|------------------|-------|-------|------|-------|-------|-------|-------|------|------|-------|
| Return on Assets | -3.4% | -3.5% | 6.1% | 7.8% | 4.9% | -0.4% | N/A | N/A | N/A | N/A |
| Return on Equity | -5.4% | -5.4% | 8.4% | 10.8% | 7.7% | -0.6% | N/A | N/A | N/A | N/A |
| ROIC | -3.4% | -3.6% | 6.1% | 8.4% | 5.6% | -0.4% | N/A | N/A | N/A | N/A |
| Shares Out. | 22 | 22 | 22 | 22 | 26 | 26 | 26 | 30 | 30 | 33 |
| Revenue/Share | 1.20 | 0.94 | 1.18 | 0.96 | 1.26 | 1.37 | N/A | N/A | N/A | N/A |
| FCF/Share | 0.63 | 4.50 | 3.04 | -2.20 | -1.64 | -1.27 | -3.66 | 0.13 | 1.07 | -0.89 |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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