Oxford Lane Capital Corp. (OXLC)

Updated June 10th, 2019 by Josh Arnold

Key Metrics

Current Price:	$10	**5 Year CAGR Estimate:**	12.1%	**Volatility Percentile:**	56.0%
Fair Value Price:	$9	**5 Year Growth Estimate:**	-2.0%	**Momentum Percentile:**	64.9%
% Fair Value:	111%	**5 Year Valuation Multiple Estimate:**	-2.0%	**Growth Percentile:**	0.9%
Dividend Yield:	16.1%	**5 Year Price Target**	$8	**Valuation Percentile:**	30.1%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Total Return Percentile:**	62.8%

Overview & Current Events

Oxford Lane Capital Corp. is a publicly-traded closed-end management investment company. It seeks to achieve maximum risk-adjusted total returns by investing in debt and equity tranches of collateralized loan obligations, or CLO, which is a form of securitization where payments from multiple borrowers are pooled and passed on to different owners. Oxford built its portfolio to have little to no exposure to real estate loans, mortgage loans, or consumer-based debt. Oxford trades with a current market capitalization of $465 million.

Oxford reported its fiscal Q4 earnings on 5/2/19 and results showed some signs of strength. Net asset value increased from the third quarter from $7.56 to $8.32. Core net investment income came in at $0.53, for an annual run rate of $2.12, which is much higher than what Oxford has been able to produce in its operating history. The company had a very strong quarter from its equity portfolio, recording $22 million in net investment income, while its debt portfolio produced $1.5 million. The company also recorded nearly $30 million of unrealized appreciation on its investments. Note that in any particular quarter Oxford's results can be quite volatile given the nature of its investments, but Q4 certainly looked good compared to other recent quarters.

The weighted average yield of its debt portfolio stands at 11.7%, which is up from 11.2% last quarter. The same metric for its equity investments is 15.7%, down slightly from 15.8% last quarter.

Our initial estimate for this year is net investment income (NII) of $1.40 per share, roughly flat with last year's results. Oxford's NII has been roughly flat for the entirety of its existence given that it tends to pay out excess earnings in the form of distributions, so its earning asset base is generally stable over time.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
NII/S	---	---	$1.19	$1.17	$1.24	$1.37	$1.64	$1.54	$1.61	$1.41	***$1.40***	***$1.27***
DPS	---	---	$1.75	$2.20	$2.20	$2.50	$2.40	$2.40	$1.80	$1.62	***$1.62***	***$1.20***
Shares	---	---	2.5	7.6	15.2	16.0	18.8	22.8	28.8	42.3	***48.0***	***65.0***

As mentioned, growth is difficult to come by for Oxford. The company earns income by borrowing money and then investing it in debt or equity instruments. This means the company's margins are beholden to interest rate moves as well as scale, as measured by its earning asset base. Since Oxford pays out more than it earns each year, its earning asset base is funded by obligations and not retained earnings. Over time, this crimps margins and the company's ability to continue to borrow. As such, we're estimating a 2% annual decline in NII over time.

Oxford issues preferred stock and common shares in large amounts in order to fund its investments; both of these have their own costs. Preferred stock is generally expensive to service, with interest rates in the 7% to 9% range, while common shares dilute shareholders over time and make paying the distribution more expensive. Indeed, Oxford's share count has risen from just 2.5 million in 2011 to more than 40 million today. We expect Oxford to end this year with 48 million shares outstanding.

While the Q1 declared dividends – paid monthly – are at a run rate of $1.62 annually, which is flat with last year, we see the payout as unsustainable at today's level. Therefore, due to a combination of declining earnings capacity and a higher

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share count, we think shareholders could see $1.20 in distributions by 2024. Oxford has no catalysts for higher distributions, so we think the risk is clearly to the downside on the payout.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/NII	---	---	12.6	13.7	13.4	10.0	5.8	6.9	6.5	7.3	***7.2***	***6.5***
Avg. Yld.	---	---	11.6%	15.4%	17.2%	17.7%	26.1%	23.4%	15.8%	16.0%	***16.1%***	***14.6%***

Oxford's price-to-NII ratio has been in the mid-6 arena on average for the past four years, and we think that represents fair value. The stock trades for 7.2 times our estimate for this year today, so we see a 2% annual headwind to total returns as the share price moderates over time.

The yield is absolutely enormous at 16.1% today, but a lower payout could see the yield come down slightly to 14.6% over time. Oxford will continue to pay a huge dividend for the foreseeable future with its low share price.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	147%	212%	231%	177%	152%	162%	103%	116%	***116%***	***95%***

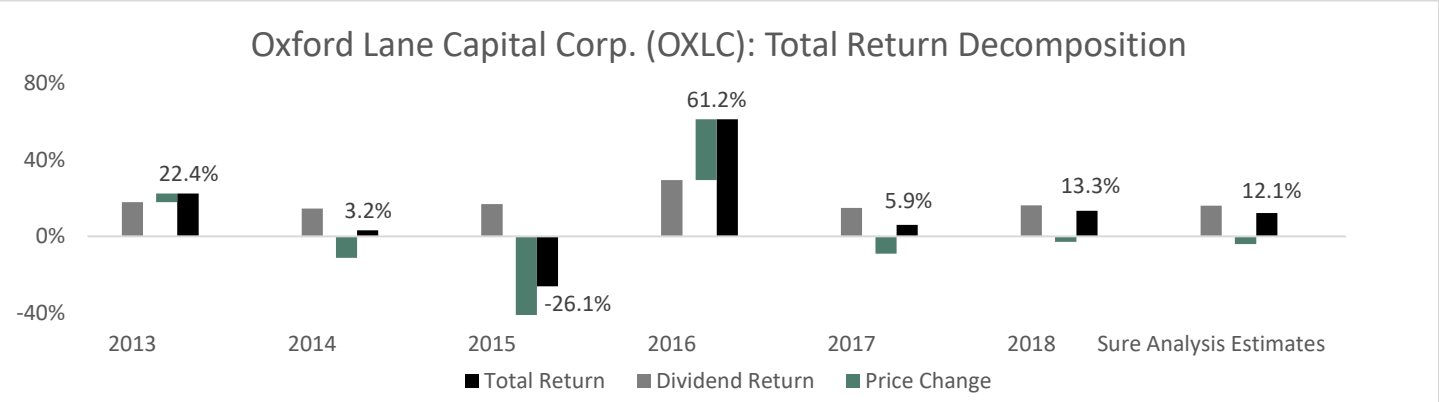
Oxford has no competitive advantages given that its business model is just like any other shop that uses debt and equity to fund high-yield investments. Recessions will also be very unkind to Oxford as some of the businesses that have borrowed money from Oxford will suffer and potentially be unable to repay their obligations. Oxford is certainly not a safe or recessions-resistant stock.

The payout ratio has been above 100% of NII every year the company has been in existence. However, the company has been distributing money off of its balance sheet for some time, and we think the time for that is nearing an end. We see the payout ratio declining to 95% over time, and certainly, the dividend is very far from safe. Oxford has cut its payout multiple times and it will do so again.

Final Thoughts & Recommendation

We see Oxford producing total annual returns of 12.1%, consisting of the 16.1% dividend yield, 2% headwind from the valuation falling, and a 2% headwind from earnings each year. While that total return forecast is very high, we rate Oxford as a hold. The dividend yield is certainly quite attractive, but given that we don't see the payout as safe, we fear a fairly imminent distribution cut. In addition, the stock trades above what we see as fair value. For risk-seeking investors, Oxford's extremely high yield might be attractive. However, it is not suitable for those looking for safety.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue										
Gross Profit										
Gross Margin										
SG&A Exp.										
D&A Exp.										
Operating Profit										
Operating Margin										
Net Profit										
Net Margin										
Free Cash Flow										
Income Tax										

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets										
Cash & Equivalents										
Accounts Receivable										
Inventories										
Goodwill & Int. Ass.										
Total Liabilities										
Accounts Payable										
Long-Term Debt										
Shareholder's Equity										
D/E Ratio										

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets										
Return on Equity										
ROIC										
Shares Out.										
Revenue/Share										
FCF/Share										

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