



Main Street Capital Corporation (MAIN)

Updated August 26th, 2019 by Quinn Mohammed

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|---------------------------------|-------|
| Current Price: | \$44 | 5 Year CAGR Estimate: | 8.9% | Volatility Percentile: | 4.3% |
| Fair Value Price: | \$40 | 5 Year Growth Estimate: | 4.0% | Momentum Percentile: | 76.3% |
| % Fair Value: | 109% | 5 Year Valuation Multiple Estimate: | -1.7% | Growth Percentile: | 26.4% |
| Dividend Yield: | 6.6% | 5 Year Price Target | \$49 | Valuation Percentile: | 37.5% |
| Dividend Risk Score: | D | Retirement Suitability Score: | B | Total Return Percentile: | 40.7% |

Overview & Current Events

Headquartered in Houston, TX, Main Street Capital Corporation is a Business Development Company (BDC) that provides long-term debt and equity capital to lower middle market companies and debt capital to middle market companies. Main Street defines lower middle market companies as generally having annual revenues between \$10 million and \$150 million. The company's investments typically support management buyouts, recapitalizations, growth financings, refinancing and acquisitions. As of the end of first quarter 2019, Main Street had an interest in 69 lower middle market companies, 51 middle market companies and 62 private loan investments. The company has a market capitalization of \$2.8 billion and generated \$157 million in net investment income last year.

On August 8th, Main Street Capital released second quarter results and reported net investment income of \$39.6 million, compared to \$39.5 million in the same period a year ago. The corporation generated net investment income per share of \$0.63 for the quarter, down 4.6% from last year's income of \$0.66. Distributable net investment income totaled \$0.67 per share, representing a 4.3% decline from the second quarter of 2018.

Main Street's net asset value increased \$0.08 to \$24.17 since the start of 2019, an increase of 0.3%. Adjusting for the semi-annual supplemental cash dividend, net asset value would have increased by \$0.33 per share or 1.4%. Return on equity for the quarter of 10.1% was just slightly lower than the trailing twelve months return on equity of 10.6%.

The company completed \$31.7 million in total lower middle market portfolio investments, \$15.1 million of which was issued to a new company in the lower middle market portfolio, Trantech Radiator Products. All three portfolios faced net decreases in value for the quarter.

Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| NIIPS | \$0.92 | \$1.16 | \$1.69 | \$2.01 | \$2.06 | \$2.20 | \$2.18 | \$2.23 | \$2.39 | \$2.60 | \$2.70 | \$3.28 |
| DPS | \$1.50 | \$1.50 | \$1.56 | \$1.71 | \$2.66 | \$2.55 | \$2.65 | \$2.73 | \$2.79 | \$2.85 | \$2.92 | \$3.28 |
| Shares¹ | 10.0 | 16.3 | 22.9 | 29.5 | 36.6 | 43.5 | 49.1 | 52.0 | 56.7 | 60.2 | 63.0 | 85.0 |

NIIPS stands for Net Investment Income Per Share. Main Street's calculation of distributable net investment income excludes the impact of share-based compensation. We believe this is a real expense, and thus have elected to use net investment income instead. Main Street has put together a solid record in the past decade. From 2008 through 2018, Main Street was able to grow net investment income by an average compound rate of 8.5% per year. This despite the fact that the company pays out basically all of its income in the form of dividends and needs to issue shares in order to fund growth. Speaking of which, both aspects are worth describing in a bit more detail. Main Street's dividend policy is somewhat different from your typical firm. The company pays a monthly dividend, currently sitting at \$0.205 or \$2.46 on an annual basis, along with supplemental dividends in June and December. The supplemental dividend was recently lowered from \$0.275 to \$0.25, while the company keeps its trend of increasing the regular monthly dividend by \$0.005 every few quarters. The supplemental dividends have been a result of generating realized gains from Main Street's equity investments. Starting in 2019, Main Street plans to gradually reduce its supplemental dividend and absorb it into

¹ In millions

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the regular monthly dividend. Importantly, as a result of the BDC structure, dividends are classified as both ordinary and qualified dividends along with realized gains. With regard to the share count, you can see this growing significantly over time. In order to avoid corporate income tax, Main Street must distribute at least 90% of their taxable income, leaving little wiggle room to fund growth. While this strategy has worked extremely well since the last recession, we do caution that this method of funding becomes substantially less attractive (and more expensive) in lesser times. As such, we have tempered our growth expectations.

Valuation Analysis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Now | 2024 |
|-----------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E | 17.5 | 15.7 | 12.6 | 15.2 | 15.9 | 13.3 | 13.3 | 16.5 | 16.6 | 13.3 | 16.3 | 15.0 |
| Avg. Yld. | 9.3% | 8.2% | 7.5% | 6.4% | 8.1% | 6.9% | 7.3% | 7.4% | 7.0% | 6.7% | 6.6% | 6.7% |

Over the past decade shares of Main Street have traded at an average P/E ratio of 15 times earnings. We believe this is a fair multiple for the security, and we see a decline of 1.7% as the valuation drops to our estimate. We believe the yield will remain high around 7%, and the payout ratio will remain around 100%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

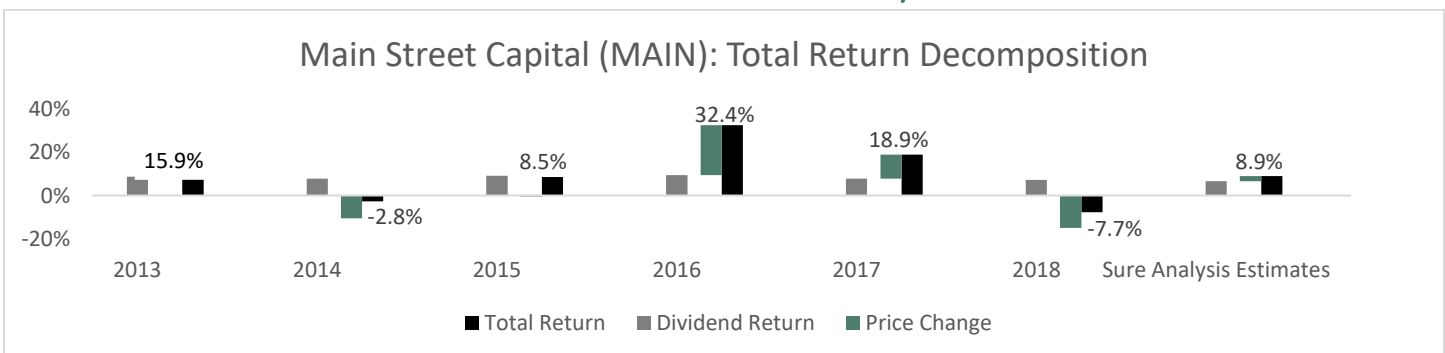
| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|--------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Payout | 163% | 129% | 92% | 85% | 129% | 116% | 122% | 122% | 117% | 110% | 108% | 100% |

Main Street's competitive advantage lies in its portfolio of small company interests, allowing for equity and debt exposure that would be difficult to replicate, along with the company's management. In the last decade the company has performed well, acting like a fund for small companies and passing along the income and gains to investors. The payout ratio detailed above is notable for two reasons. From an income standpoint, it highlights the BDC's pass through status, requiring the company to pay a substantial dividend. From a safety standpoint, it shows that there is not much room for lesser performance. Indeed, given the idea of continued equity issuance to fund investments, growth could come under serious pressure during the next recession.

Final Thoughts & Recommendation

Main Street has put together a solid record in the last decade. The company's model is unusual for common equity, but typical of a pass through entity – paying out all of earnings and funding growth by issuing shares. This leads to two distinct items: an above average dividend yield and an ever-increasing share count. We estimate total returns of 8.9% moving forward, consisting of the 6.6% yield, in addition to the 4.0% earnings growth and -1.7% from multiple valuation compression. We rate shares as a hold at the current price, noting shares are fully valued and a dividend reduction is likely in the event of a severe recession.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|------------------|-------|--------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 16 | 37 | 66 | 91 | 116 | 141 | 165 | 178 | 206 | 233 |
| SG&A Exp. | 3 | 8 | 13 | 16 | 18 | 24 | 30 | 34 | 40 | 21 |
| Operating Profit | 13 | 28 | 53 | 75 | 99 | 117 | 135 | 144 | 165 | 200 |
| Operating Margin | 81.3% | 77.6% | 79.7% | 82.8% | 84.9% | 83.2% | 81.9% | 80.9% | 80.4% | 85.8% |
| Net Profit | 12 | 39 | 63 | 104 | 97 | 101 | 104 | 139 | 171 | 168 |
| Net Margin | 74.7% | 106.1% | 95.1% | 115% | 83.1% | 71.6% | 63.5% | 77.9% | 82.9% | 72.1% |
| Free Cash Flow | 8 | 17 | -183 | -136 | -241 | -191 | -131 | -43 | 73 | N/A |
| Income Tax | -2 | 1 | 6 | 11 | 0 | 6 | -9 | -1 | 24 | 6 |

Balance Sheet Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|----------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 196 | 449 | 738 | 1036 | 1360 | 1694 | 1879 | 2072 | 2265 | 2553 |
| Cash & Equivalents | 31 | 22 | 43 | 64 | 35 | 60 | 20 | 24 | 52 | 54 |
| Accounts Receivable | N/A | N/A | N/A | N/A | N/A | 23 | 10 | 2 | 2 | N/A |
| Total Liabilities | 67 | 199 | 327 | 393 | 568 | 754 | 808 | 871 | 885 | 1077 |
| Accounts Payable | 1 | 1 | 2 | 5 | 11 | 11 | 12 | 14 | 20 | 18 |
| Long-Term Debt | 65 | 195 | 309 | 343 | 515 | 707 | 780 | 840 | 797 | 996 |
| Shareholder's Equity | 130 | 246 | 406 | 643 | 793 | 940 | 1071 | 1201 | 1380 | 1476 |
| D/E Ratio | 0.50 | 0.79 | 0.76 | 0.53 | 0.65 | 0.75 | 0.73 | 0.70 | 0.58 | 0.67 |

Profitability & Per Share Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 6.5% | 12.0% | 10.6% | 11.8% | 8.1% | 6.6% | 5.8% | 7.0% | 7.9% | 7.0% |
| Return on Equity | 9.9% | 20.7% | 19.3% | 19.9% | 13.5% | 11.6% | 10.4% | 12.2% | 13.2% | 11.8% |
| ROIC | 6.6% | 12.1% | 10.8% | 12.2% | 8.4% | 6.8% | 6.0% | 7.1% | 8.1% | 7.2% |
| Shares Out. | 10.0 | 16.3 | 22.9 | 29.5 | 36.6 | 43.5 | 49.1 | 52.0 | 56.7 | 60.2 |
| Revenue/Share | 1.59 | 2.24 | 2.90 | 3.06 | 3.18 | 3.23 | 3.35 | 3.43 | 3.63 | 3.88 |
| FCF/Share | 0.80 | 1.02 | -8.02 | -4.59 | -6.57 | -4.39 | -2.68 | -0.82 | 1.29 | N/A |

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

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