Oxford Lane Capital Corp. (OXLC)

Updated August 27th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$10	**5 Year CAGR Estimate:**	12.1%	**Volatility Percentile:**	34.2%
Fair Value Price:	$9	**5 Year Growth Estimate:**	-2.0%	**Momentum Percentile:**	58.6%
% Fair Value:	111%	**5 Year Valuation Multiple Estimate:**	-2.0%	**Growth Percentile:**	1.0%
Dividend Yield:	16.1%	**5 Year Price Target**	$8	**Valuation Percentile:**	41.8%
Dividend Risk Score:	NA	**Retirement Suitability Score:**	NA	**Total Return Percentile:**	2.2%

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 $424 million.

In early August, Oxford reported (8/1/19) financial results for the first quarter of its fiscal year. Net asset value decreased from $8.32 at the end of previous quarter to $8.01. Net investment income came in at $0.35 per share, for an annual run rate of $1.40, which is in line with our consensus. The quarterly net investment income has hovered around $0.35 per share for several quarters in a row. The company recorded $27.3 million of investment income thanks to $26.3 million from its CLO equity investments and $1.0 million from its CLO debt investments. The weighted average yield of its debt portfolio stands at 11.8%, up from 11.7% last quarter. The same metric for its equity investments is 16.9%, up from 15.7% last quarter.

Our estimate for this year is net investment income (NII) of $1.40 per share, roughly flat with last year's results. Notably the net asset value has fallen from $9.98 a year ago to $8.01. This indicates that management distributes dividends that are higher than the net income of the company.

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[1]	---	---	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 affected by 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. We thus expect 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 render the dividend much more burdensome. 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

1. In millions.

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.

share count, we think shareholders could see $1.20 in distributions by 2024. Oxford has no catalysts for higher distributions and hence 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 is currently trading for 7.2 times our estimate for this year, 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, partly thanks to its low stock 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%***

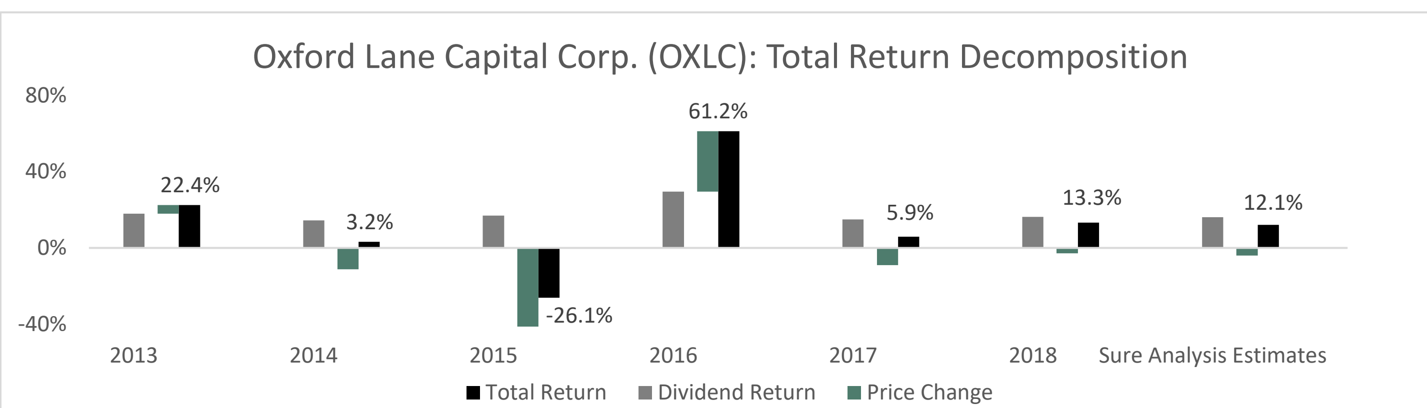
Oxford has no competitive advantages given that its business model is just like any other company that uses debt and equity to fund high-yield investments. The company is highly vulnerable to recessions, as some of the businesses that have borrowed money from Oxford will suffer and potentially be unable to repay their obligations. Oxford is certainly not a safe or recession-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 could do so again.

Final Thoughts & Recommendation

Oxford could offer an average annual return of 12.1% thanks to its 16.1% dividend yield. While the total return forecast is very high, we rate Oxford as a hold. The dividend yield is certainly enticing but the dividend may be cut whenever the next downturn shows up. 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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