Gladstone Investment Corp. (GAIN)

Updated February 7th, 2020 by Jonathan Weber

Key Metrics

Current Price:	$14	**5 Year CAGR Estimate:**	4.5%	**Market Cap:**	$450M
Fair Value Price:	$11	**5 Year Growth Estimate:**	3.6%	**Ex-Dividend Date:**	03/19/20
% Fair Value:	130%	**5 Year Valuation Multiple Estimate:**	-5.1%	**Dividend Payment Date:**	03/31/20
Dividend Yield:	6.0%	**5 Year Price Target**	$13	**Years Of Dividend Growth:**	9
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	2.9%

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 trades with a market capitalization of just $450 million.

Gladstone Investment reported its third quarter (fiscal 2019) earnings results on February 4. The company generated total investment income - Gladstone Investment's revenue equivalent - of $16 million during the quarter, which represents an increase of 7.0% compared to the prior year's quarter. This number beat the analyst consensus estimate easily, by $1.9 million, as analysts expected a decline for the company's top line.

Gladstone Investment's adjusted net investment income-per-share totaled $0.23 during the third quarter, which was ahead of what the analyst community had estimated. Adjusted net income-per-share was in line with the previous quarter. During the third quarter, Gladstone Investment invested $24 million into new and existing portfolio companies, which was more than the $20 million that the company invested during the previous quarter.

Gladstone Investment's net asset value per share totaled $12.51 on a per-share basis at the end of the third quarter, which was up slightly versus the $12.39 of net asset value per share that the company reported at the end of the previous quarter. The increase was due to net unrealized gains across Gladstone Investment's portfolio.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
NIIPS	$0.62	$0.48	$0.73	$0.62	$0.68	$0.73	$0.75	$0.68	$0.74	$0.77	***$0.90***	***$1.07***
DPS	$0.96	$0.48	$0.48	$0.61	$0.60	$0.71	$0.73	$0.75	$0.75	$0.82	***$0.84***	***$0.97***
Shares[1]	22	22	22	26	26	26	30	30	33	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 usually range from $5 million to $30 million. The company also takes equity stakes in such companies, with position sizes for equity investments typically ranging from $10 million to $40 million. The companies Gladstone Investment does business with usually cannot access debt or equity markets directly, as bond sales and public listings are not possible for them 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. Declining interest rates could turn into a headwind, but so far Gladstone Investment's weighted average interest yield has held up very well; the company generated a yield of 12.6% during the most recent quarter on its interest-bearing investments.

[1] In Millions

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
P/NII	7.7	13.3	10.1	12.1	10.7	10.5	10.2	11.9	12.8	15.3	***15.6***	***12.0***
Avg. Yld.	18.7%	7.5%	6.5%	8.1%	8.2%	9.2%	10.1%	9.3%	7.9%	7.0%	***6.0%***	***7.6%***

Gladstone Investment has been valued at a low-double-digit price to net investment income multiple throughout the majority of the last decade. Today, shares trade well above this historic valuation, which means that shares look overvalued at current prices. We therefore believe that multiple contraction will be a headwind for Gladstone Investment's total returns going forward. Shares still offer a high dividend yield of 6% at the current price.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	155%	100%	65.8%	98.4%	88.2%	97.3%	103%	110%	101%	106%	***93.3%***	***90.7%***

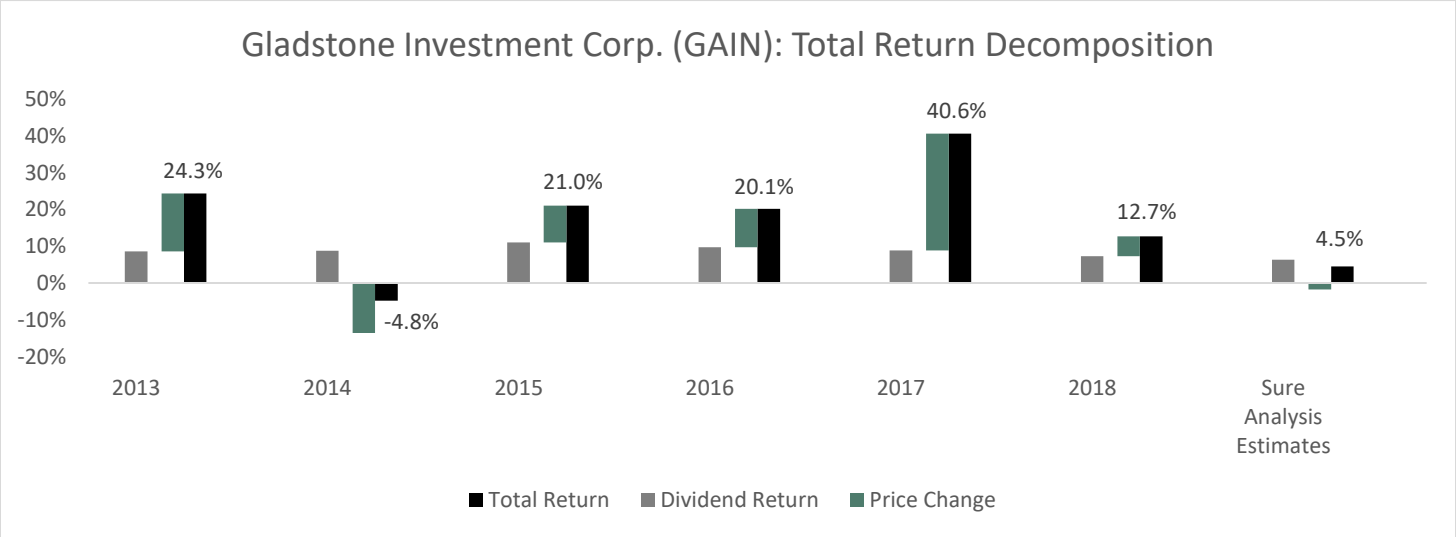
Gladstone Investment's dividend payout ratio, relative to its net investment income, has been close to or above 100% throughout several years during the last decade. The company usually is more profitable than the net investment income metric suggests, due to the fact that Gladstone Investment can also generate gains from its equity investments, which are not reflected in the net investment income metric. The company nevertheless had to cut its dividend during the last financial crisis, when both net investment income, as well as equity gains, declined substantially.

Gladstone Investment's equity investment gains explain the company's long-term book value growth. Gladstone Investment's recession performance is not very compelling compared to less cyclical income stocks, but at least the company remained profitable during the last financial crisis, unlike many other financial corporations. Both its dividend, as well as its net investment income, remain below pre-crisis levels today.

Final Thoughts & Recommendation

Gladstone Investment is a business development company that targets small companies that do not have the ability to access debt and/or equity markets easily. This allows Gladstone to demand above-average interest rates. The company does not generate a lot of growth, but the high payout ratio allows for an above-average dividend yield. Right now shares trade well above our fair value estimate, which is why we rate Gladstone Investment a sell at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	21	19	24	22	3	56	36	56	72	106
SG&A Exp.	7	2	3	6	7	8	11	11	10	13
D&A Exp.	0	0	0	1	0	0	0	0	1	1
Net Profit	-11	16	22	17	-1	50	25	45	61	82
Net Margin	-53.3%	87.8%	90.4%	77.8%	-39.5%	89.9%	69.4%	79.9%	84.8%	76.9%
Free Cash Flow	99	67	-49	-40	-34	-98	4	33	-30	94

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	297	241	325	380	331	484	503	515	611	635
Cash & Equivalents	88	81	92	86	5	5	4	3	4	2
Accounts Receivable	1	1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total Liabilities	104	42	118	139	110	210	224	214	257	228
Accounts Payable	0	0	1	1	1	1	1	1	1	1
Long-Term Debt	103	40	76	95	67	124	100	75	113	58
Shareholder's Equity	193	199	207	241	221	273	279	301	354	407
D/E Ratio	0.53	0.20	0.37	0.39	0.30	0.45	0.36	0.25	0.32	0.14

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	-3.5%	6.1%	7.8%	4.9%	-0.4%	12.3%	5.0%	8.8%	10.8%	13.1%
Return on Equity	-5.4%	8.4%	10.8%	7.7%	-0.6%	20.3%	9.0%	15.4%	18.5%	21.4%
ROIC	-3.6%	6.1%	8.4%	5.6%	-0.4%	14.7%	6.4%	11.9%	14.4%	17.5%
Shares Out.	22	22	22	26	26	26	30	30	33	33
Revenue/Share	0.94	0.85	1.10	0.92	0.13	2.10	1.18	1.85	2.22	3.23
FCF/Share	4.50	3.04	-2.20	-1.64	-1.27	-3.66	0.13	1.08	-0.92	2.85

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

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