Oxford Lane Capital Corp. (OXLC)

Updated February 5th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$9.27	**5 Year CAGR Estimate:**	10.1%	**Market Cap:**	$639.6 M
Fair Value Price:	$9.10	**5 Year Growth Estimate:**	-2.0%	**Ex-Dividend Date:**	4/14/2020
% Fair Value:	102%	**5 Year Valuation Multiple Estimate:**	-0.4%	**Dividend Payment Date:**	4/30/2020
Dividend Yield:	17.5%	**5 Year Price Target**	$8.25	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

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 $640 million.

In early February, Oxford reported (2/4/20) financial results for the third quarter of its fiscal year. Net asset value recovered from $6.63 at the end of previous quarter to $6.81. Net investment income came in at $0.32 per share. The quarterly net investment income has hovered around $0.35 per share for several quarters in a row despite a steep increase in the share count. The company recorded $32.4 million of investment income thanks to $30.8 million from its CLO equity investments and $1.6 million from its CLO debt investments. The weighted average yield of its debt portfolio stands at 12.4%, up from 10.4% last quarter. The same metric for its equity investments is flat at 16.4%.

Oxford issued 9.1 million shares in the third quarter and its management maintained the current monthly dividend of $0.135 for April, May and June.

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	***70.0***	***180.0***

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 about 69 million today.

While the 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 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.

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[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.

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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	***6.6***	***6.5***
Avg. Yld.	---	---	11.6%	15.4%	17.2%	17.7%	26.1%	23.4%	15.8%	16.0%	***17.5%***	***14.5%***

Oxford's price-to-NII ratio has been in the mid-6 area on average for the past four years and we think that represents fair value. The stock is currently trading for 6.6 times our estimate for this year, so we see a modest -0.4% annualized drag to total returns from the reversion of the valuation to its fair level.

The yield is absolutely enormous at 17.5% today, but a lower payout could lead the yield to come down 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%***	***94%***

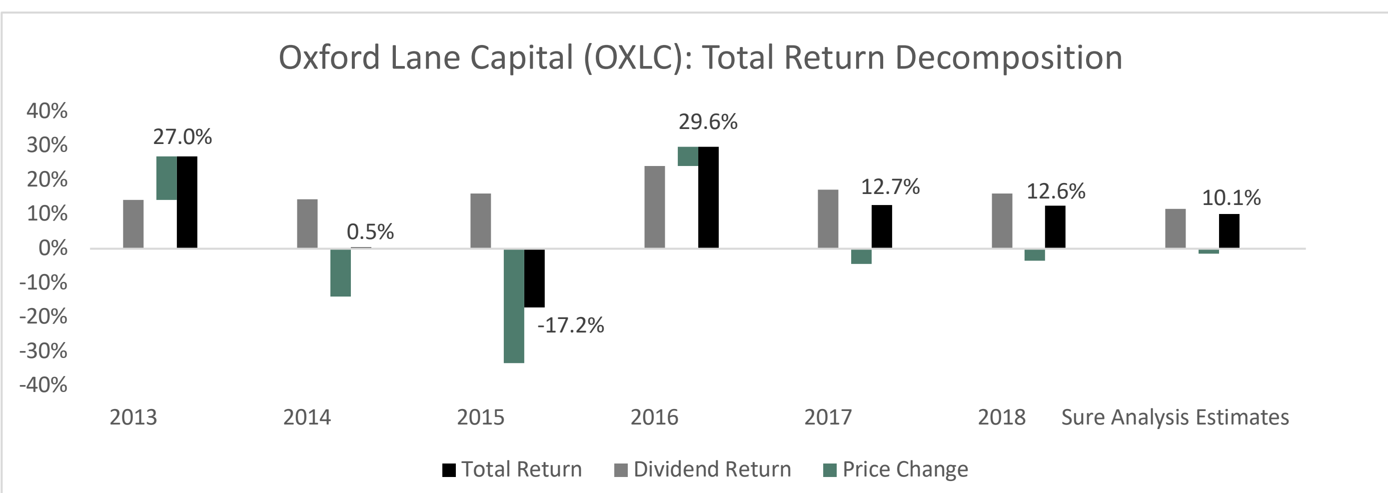
Oxford has no competitive advantages given that its business model is just like any other company that uses debt and equity to fund high-yield investments. The company is highly vulnerable to recessions, as some of the businesses that have borrowed money from Oxford will suffer and potentially be unable 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 94% 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 10.1% thanks to its 17.5% dividend yield but we rate the stock as a hold. The dividend yield is certainly enticing but the dividend may be cut whenever the next downturn shows up. The excessive issuance of new shares renders dividends burdensome for Oxford. Oxford's extremely high yield might be attractive for risk-seeking investors but it is not suitable for those looking for safety.

Total Return Breakdown by Year



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