



Gladstone Investment Corp. (GAIN)

Updated May 26th, 2020 by Jonathan Weber

Key Metrics

Current Price:	\$11	5 Year CAGR Estimate:	6.6%	Market Cap:	\$360M
Fair Value Price:	\$9	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	06/19/20
% Fair Value:	125%	5 Year Valuation Multiple Estimate:	-4.4%	Dividend Payment Date:	06/30/20
Dividend Yield:	7.6%	5 Year Price Target	\$11	Years Of Dividend Growth:	9
Dividend Risk Score:	D	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. The company was founded in 2005 and is headquartered in McLean, VA.

Gladstone Investment reported its fourth quarter (fiscal 2019 ended March 31) earnings results on May 12. The company generated total investment income - Gladstone Investment's revenue equivalent - of \$12 million during the quarter, which represents a decline of 26% compared to the prior year's quarter. This number missed the analyst consensus estimate by \$2 million, as analysts expected a smaller decline from the company's top line.

Gladstone Investment's adjusted net investment income-per-share totaled \$0.19 during the fourth quarter, which was below what the analyst community had estimated. Adjusted net income-per-share was down from \$0.23 during the previous year's quarter. Gladstone Investment's net asset value per share totaled \$11.17 on a per-share basis at the end of the fourth quarter, which was down meaningfully versus the \$12.51 of NAV-per-share that the company reported at the end of the previous quarter. The decline was mainly due to unrealized depreciation across Gladstone Investment's investment portfolio, primarily caused by the coronavirus crisis and its impact on the companies Gladstone lends money to and holds equity stakes in. The crisis will most likely pressure 2020's NIIPS meaningfully, but we see an eventual recovery, which is why we calculate fair value using an earnings power estimate of \$0.80 per share.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
NIIPS	\$0.48	\$0.73	\$0.62	\$0.68	\$0.73	\$0.75	\$0.68	\$0.74	\$0.77	\$0.90	\$0.65	\$0.97
DPS	\$0.48	\$0.48	\$0.61	\$0.60	\$0.71	\$0.73	\$0.75	\$0.75	\$0.82	\$0.84	\$0.84	\$0.93
Shares¹	22	22	26	26	26	30	30	33	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 4.3% annually, which is not a very high growth rate, but which is also not at all disappointing for a high-yielding investment.

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 13.2% during last year. A short-term headwind will stem from higher loan losses that will be caused by the coronavirus crisis, but we do not see this impacting profitability in the long run.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/NII	13.3	10.1	12.1	10.7	10.5	10.2	11.9	12.8	15.3	8.9	13.8	11.0
Avg. Yld.	7.5%	6.5%	8.1%	8.2%	9.2%	10.1%	9.3%	7.9%	7.0%	10.5%	7.6%	8.7%

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 above this historic valuation, even using our earnings power estimate, which backs out one-time impacts caused by the virus crisis. We thus believe that multiple contraction will be a headwind for Gladstone Investment's total returns going forward, although investors still get a quite high dividend yield.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	100%	65.8%	98.4%	88.2%	97.3%	103%	110%	101%	106%	93.3%	105%	95.3%

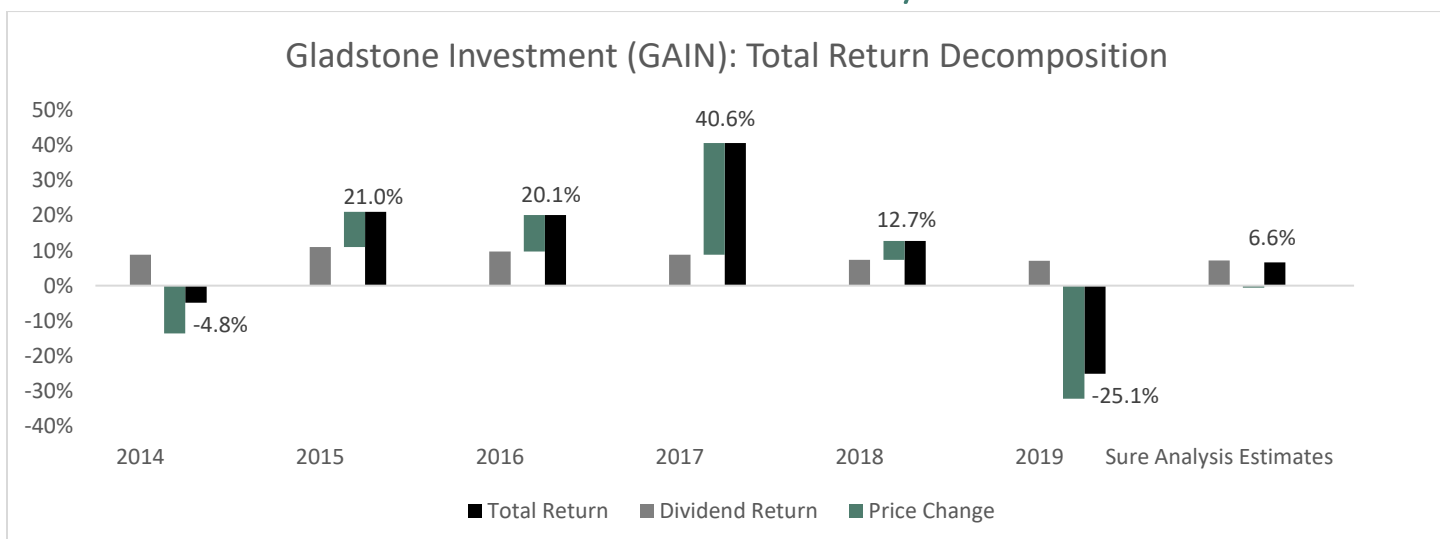
Gladstone Investment's dividend payout ratio, relative to its net investment income, has been close to or above 100% throughout several years during the last decade. The company usually is more profitable than the net investment income metric suggests, due to the fact that Gladstone Investment can also 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, but so far the company is confident it will not have to cut its payout during the pandemic crisis.

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. We also see Gladstone remaining profitable during the current global crisis, but profits will take a hit during the current year.

Final Thoughts & Recommendation

Gladstone Investment is a business development company targeting 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	19	24	22	3	56	36	56	72	106	15
SG&A Exp.	2	3	3	3	3	4	4	4	6	6
D&A Exp.	16	22	17	(1)	50	25	45	61	82	(7)
Net Profit	87.8%	90.4%	77.8%	-39.5%	89.9%	69.4%	79.9%	84.8%	76.9%	-48.7%
Net Margin	67	(49)	(40)	(34)	(98)	4	33	(30)	94	35
Free Cash Flow	19	24	22	3	56	36	56	72	106	15

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	241	325	380	331	484	503	515	611	635	576
Cash & Equivalents	81	92	86	5	5	4	3	4	2	3
Accounts Receivable	1									
Total Liabilities	42	118	139	110	210	224	214	257	228	207
Accounts Payable	0	1	1	1	1	1	1	1	1	1
Long-Term Debt	40	76	95	67	124	100	75	113	58	54
Shareholder's Equity	199	207	241	221	273	279	301	354	407	369
D/E Ratio	0.20	0.37	0.39	0.30	0.45	0.36	0.25	0.32	0.14	0.15

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	6.1%	7.8%	4.9%	-0.4%	12.3%	5.0%	8.8%	10.8%	13.1%	-1.2%
Return on Equity	8.4%	10.8%	7.7%	-0.6%	20.3%	9.0%	15.4%	18.5%	21.4%	-1.9%
ROIC	6.1%	8.4%	5.6%	-0.4%	14.7%	6.4%	11.9%	14.4%	17.5%	-1.6%
Shares Out.	22	22	26	26	26	30	30	33	33	33
Revenue/Share	0.85	1.10	0.92	0.13	2.10	1.18	1.85	2.22	3.23	0.45
FCF/Share	3.04	(2.20)	(1.64)	(1.27)	(3.66)	0.13	1.08	(0.92)	2.85	1.07

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

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