

Main Street Capital Corporation (MAIN)

Updated September 21st, 2020 by Quinn Mohammed

Key Metrics

Current Price:	\$29.7	5 Year CAGR Estimate:	7.9%	Market Cap:	\$2.0B
Fair Value Price:	\$25.0	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	10/28/2020
% Fair Value:	119%	5 Year Valuation Multiple Estimate:	-3.4%	Payment Date:	11/13/2020
Dividend Yield:	10%	5 Year Price Target	\$28	Years of Dividend Growth:	5
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	5.1%

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 2Q2020, Main Street had an interest in 69 lower middle market companies, 44 middle market companies and 64 private loan investments. The company has a market capitalization of \$2.0 billion and generated \$157 million in net investment income last year.

On August 6th, Main Street Capital released second quarter results. Net investment income of \$31.3 million was a 21% decrease compared to \$39.6 million a year ago. The corporation generated net investment income per share of \$0.48, down 24% from last year's income of \$0.63. Distributable net investment income totaled \$0.52 per share, down 22% from \$0.67 in the second quarter of 2019.

Main Street's net asset value decreased from last year. From \$23.91 net asset value per share at the end of 2019, MAIN dropped to \$20.85 today. This represents a total net asset value of \$1.37 billion, which today the company is trading above with a market cap of \$2.0 billion.

The corporation declared monthly dividends of \$0.205, however no special dividends were issued at this time as is tradition. There is currently no clarity on whether special dividends will come this year. The dividend income which MAIN earns from their investment portfolio dropped by \$5.0 million, or 39% from the prior year period.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
NIIPS	\$1.16	\$1.69	\$2.01	\$2.06	\$2.20	\$2.18	\$2.23	\$2.39	\$2.60	\$2.50	\$1.85	\$2.04
DPS	\$1.50	\$1.56	\$1.71	\$2.66	\$2.55	\$2.65	\$2.73	\$2.79	\$2.85	\$2.91	\$2.97	\$3.28
Shares¹	16.3	22.9	29.5	36.6	43.5	49.1	52.0	56.7	60.2	63	68.0	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 2010 through 2019, Main Street was able to grow net investment income by an average compound rate of 8.9% per year. This even though the company pays out basically all 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 (skipped this June due to COVID-19). The supplemental dividend was last lowered from \$0.25 to \$0.24, 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 began gradually reducing its supplemental dividend and

¹ In millions

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absorbing it into 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. Regarding 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.7	12.6	15.2	15.9	13.3	13.3	16.5	16.6	13.3	16.4	16.1	13.5
Avg. Yld.	8.2%	7.5%	6.4%	8.1%	6.9%	7.3%	7.4%	7.0%	6.7%	6.8%	10%	12%

Over the past decade shares of Main Street have traded at an average P/E ratio of 15 times earnings. Given the current crisis, we estimate fair value of 13.5 times earnings, and see an annual decline of the valuation by 3.4%. We believe the yield will remain around 10%, and the payout ratio is in dangerous dividend reduction territory. It is possible the corporation will not pay much in special dividends this year and thus our 2020 dividend estimate can drop from here.

Safety, Quality, Competitive Advantage, & Recession Resiliency

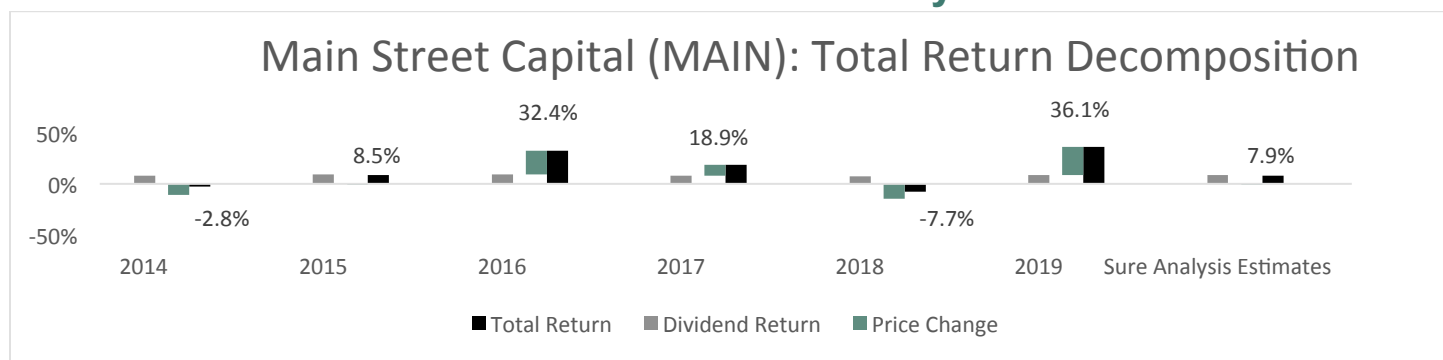
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	129%	92%	85%	129%	116%	122%	122%	117%	110%	116%	161%	161%

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 has come under serious pressure during the ongoing COVID-19 crisis, particularly within the middle market portfolio.

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 7.9% moving forward, consisting primarily of the dividend. We rate shares as a hold at the current price, noting the gloomy economic outlook and a likely dividend reduction if the crisis persists.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	37	66	91	116	141	165	178	206	233	173
SG&A Exp.	8	13	16	18	24	30	34	40	21	13
Operating Profit	28	53	75	99	117	135	144	165	200	
Operating Margin	77.6%	79.7%	82.8%	84.9%	83.2%	81.9%	80.9%	80.4%	85.8%	
Net Profit	39	63	104	97	101	104	139	171	168	130
Net Margin	106%	95.1%	115%	83.1%	71.6%	63.5%	77.9%	82.9%	72.1%	74.8%
Free Cash Flow	17	-183	-136	-241	-191	-131	-43	73	N/A	-34
Income Tax	1	6	11	0	6	-9	-1	24	6	1

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	449	738	1036	1360	1694	1879	2072	2265	2553	2712
Cash & Equivalents	22	43	64	35	60	20	24	52	54	55
Accounts Receivable	N/A	N/A	N/A	N/A	23	10	2	2	N/A	
Total Liabilities	199	327	393	568	754	808	871	885	1077	1175
Accounts Payable	1	2	5	11	11	12	14	20	18	45
Long-Term Debt	195	309	343	515	707	780	840	797	996	1114
Shareholder's Equity	246	406	643	793	940	1071	1201	1380	1476	1536
D/E Ratio	0.79	0.76	0.53	0.65	0.75	0.73	0.70	0.58	0.67	0.73

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	12.0%	10.6%	11.8%	8.1%	6.6%	5.8%	7.0%	7.9%	7.0%	4.9%
Return on Equity	20.7%	19.3%	19.9%	13.5%	11.6%	10.4%	12.2%	13.2%	11.8%	8.6%
ROIC	12.1%	10.8%	12.2%	8.4%	6.8%	6.0%	7.1%	8.1%	7.2%	5.1%
Shares Out.	16.3	22.9	29.5	36.6	43.5	49.1	52.0	56.7	60.2	63
Revenue/Share	2.24	2.90	3.06	3.18	3.23	3.35	3.43	3.63	3.88	2.75
FCF/Share	1.02	-8.02	-4.59	-6.57	-4.39	-2.68	-0.82	1.29	N/A	-0.53

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

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