



Horizon Technology Finance Corp. (HRZN)

Updated November 5th, 2020 by Nikolaos Sismanis

Key Metrics

Current Price:	\$11.6	5 Year CAGR Estimate:	9.1%	Market Cap:	\$205M
Fair Value Price:	\$11.9	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	02/18/2021
% Fair Value:	98%	5 Year Valuation Multiple Estimate:	0.5%	Dividend Payment Date:	03/16/2021
Dividend Yield:	10.4%	5 Year Price Target	\$11.9	Years Of Dividend Growth:	N/A
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Horizon Technology Finance Corp. is a BDC (Business Development Company) seeking to provide venture capital to small and medium-sized companies in the technology, life sciences, and healthcare-IT sectors, which account for 53%, 43%, and 4% of its portfolio, respectively. The company has been able to generate attractive risk-adjusted returns through directly originated senior secured loans and additional capital appreciation through warrants, featuring a last-twelve-month portfolio yield of 16.3%. The company has exceeded the typical industry average IRR of around 10% from its loan coupons by engaging in commitment fees, guidance fees, and potential equity rights, maximizing its total yield. Horizon Technology has gross investment income of around \$45 million annually and is based in Farmington, Connecticut.

On November 3rd, the company released its Q3 results for the period ending September 30th, 2020. Its gross investment income rose by 8.8% to \$12.3 million during the period due to expanding its debt portfolio. Additionally, its net income per share declined to \$0.34 from \$0.42 in the prior year, reflecting the issuance of shares to fund its portfolio's expansion as well as increased expenses. Horizon's current portfolio comprises 68 businesses after the company experienced liquidity events such as the return of principal loan and exits from 5 of its investments. Over the past nine months, the company has generated NII per share of \$0.98, which we expect to lead to an FY2020 investment income per share of \$1.25, adequately covering its current distribution.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
IIS¹	\$0.18	\$1.38	\$1.41	\$1.38	\$1.11	\$1.25	\$1.48	\$1.07	\$1.20	\$1.52	\$1.25	\$1.25
DPS	\$0.22	\$1.63	\$1.35	\$1.38	\$1.38	\$1.38	\$1.38	\$1.20	\$1.20	\$1.20	\$1.20	\$1.20
Shares²	7.6	7.6	8.5	9.6	9.6	11.2	11.5	11.5	11.5	13.5	16.5	20.0

Horizon's investment results have been quite stable over the years, despite many of its peers in the sector suffering due to the oversupply of cheap financing. Lower market rates have caused BDCs to keep refinancing their loan assets at gradually lower rates, damaging their investment results. However, Horizon's niche operations that require more unusual expertise in industries like biotech have maintained their higher ROIs amid a lack of cheap loans for such risky sectors, including early-stage tech companies.

As its successful due diligence record has made possible, the company has managed to maintain quite stable distributions, which are also paid out monthly, providing smooth capital returns to its investors. Horizon's sectors of interest are likely to remain quite high-risk and capital-hungry, which combined with management signaling towards a robust investment pipeline in a dynamic market, guides us to forecast stable performance in both its investment income per share and distributions in the medium term.

While there's a chance DPS grows, we chose to remain prudent and forecast no DPS growth over the next 5 years. The dividend has only declined since 2011 on a per share basis.

¹ Investment Income per Share

² Share count is 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
Avg. P/E	86	11.4	10.9	9.6	13.0	8.4	7.1	9.6	9.4	9.9	9.3	9.5
Avg. Yld.	5.8%	11.1%	10.8%	9.9%	9.6%	13.8%	1.8%	10.9%	11.4%	10.2%	10.4%	10.1%

Horizon's double-digit dividend yield results from BDCs being regulated to pay out at least 90% of their profits. In exchange, they are allowed not to pay corporate income tax on these profits before distributing them to shareholders. Still, Horizon's yield is relatively low for the sector, as shares are currently trading at a premium compared to peers, with a P/E at the high-single digits. The stock's valuation is likely the result of the company's robust reinvestment yield, which has remained above 15% despite the industry's downward trajectory. As industries like biotech and tech startups are usually free cash flow negative during their early stages, we expect financing in the sector to continue being expensive; hence Horizon retaining similar valuation metrics in the medium term.

Safety, Quality, Competitive Advantage, & Recession Resiliency

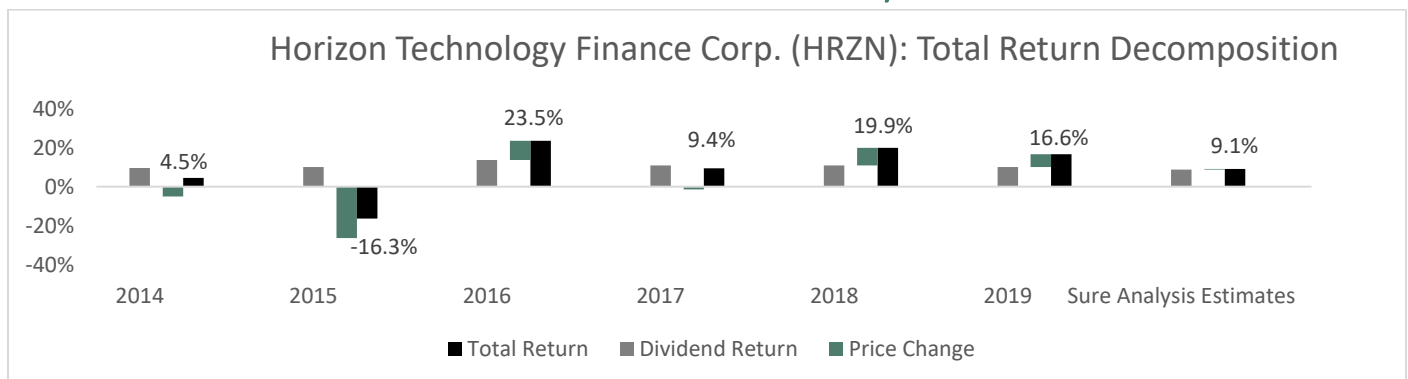
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	122%	118%	96%	100%	124%	110%	93%	112%	100%	79%	96%	96%

Horizon's distributions have remained well-covered over the past few years. As a result we estimate that a dividend cut is unlikely based on its ongoing performance. The company's competitive advantage lies in its team's expertise to identify the most promising companies in risky sectors, which requires professional knowledge and experience beyond finance. So far, this perk has stood solid, as the company's results have outperformed the rest of its peers, many of which were forced to cut their distribution due to increased market pressure. Horizon's stable performance over the years is also visible in its stock price, which is typically less volatile than its BDC peers. With \$204 million of investment capacity available, investors and creditors alike are confident for the company's future. Additionally, the company has a healthy 0.97 debt to equity ratio.

Final Thoughts & Recommendation

Horizon's type of business model is currently facing increased pressure as seen by many of its peers. However, the company has been able to leverage its niche expertise in tech and life sciences, demanding a higher return on its investments, while enjoying robust cash flows even under the ongoing pandemic. BDCs generally come with bigger risks attached due to their operations' complexity. However, we believe that Horizon is one the highest-quality amongst its competitors and forecast annualized returns of around 9%. Finally, management's monthly distribution policy is likely to be appreciated by income-oriented investors. We rate shares a hold 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	14.78	7.32	7.09	20.50	14.97	-1.76	12.40	14.90	21.30	14.78
SG&A Exp.	3.45	3.10	3.48	5.26	3.46	3.24	2.87	3.04	3.41	3.45
Net Profit	11.00	3.99	3.51	15.43	11.86	-4.91	9.59	13.01	19.50	11.00
Net Margin	74.4%	54.5%	49.5%	75.3%	79.2%	279.3%	77.3%	87.3%	91.5%	74.4%
Free Cash Flow	-4.02	-36.09	6.50	36.68	-31.33	52.31	-14.84	-12.06	-51.41	-4.02
Income Tax	0.34	0.23	0.24	0.16	---	-0.09	0.03	0.03	0.24	0.34

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	197.81	239.66	263.74	225.20	280.90	239.25	234.15	266.75	344.00	197.81
Cash & Equivalents	1.30	1.05	25.34	8.42	20.77	37.14	6.59	12.59	6.47	1.30
Total Liabilities	67.93	94.69	127.90	86.95	121.15	100.06	99.07	132.49	159.95	67.93
Accounts Payable	0.00	3.30	3.32	3.32	3.98	3.45	3.46	3.46	4.67	0.00
Long-Term Debt	64.57	89.02	122.34	81.75	114.95	95.60	94.08	126.85	152.05	64.57
Total Equity	129.88	144.97	135.84	138.25	159.75	139.19	135.08	134.26	184.06	129.88
D/E Ratio	0.50	0.61	0.90	0.59	0.72	0.69	0.70	0.94	0.83	0.50

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	6.8%	1.8%	1.4%	6.3%	4.7%	-1.9%	4.1%	5.2%	6.4%	6.8%
Return on Equity	11.6%	2.9%	2.5%	11.3%	8.0%	-3.3%	7.0%	9.7%	12.3%	11.6%
ROIC	6.9%	1.9%	1.4%	6.5%	4.8%	-1.9%	4.1%	5.3%	6.5%	6.9%
Shares Out.	7.61	8.48	9.58	9.62	11.18	11.54	11.52	11.53	13.48	7.61
Revenue/Share	1.94	0.86	0.74	2.13	1.34	-0.15	1.08	1.29	1.58	1.94
FCF/Share	-0.53	-4.26	0.68	3.81	-2.80	4.53	-1.29	-1.05	-3.81	-0.53

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

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