



Great Elm Capital (GECC)

Updated December 16th, 2020 by Samuel Smith

Key Metrics

Current Price:	\$4.00	5 Year CAGR Estimate:	12.6%	Market Cap:	\$85.3 M
Fair Value Price:	\$7.20	5 Year Growth Estimate:	-1.9%	Ex-Dividend Date:	N/A
% Fair Value:	56%	5 Year Valuation Multiple Estimate:	4.6%	Dividend Payment Date:	N/A
Dividend Yield:	25.0%	5 Year Price Target	\$6.50	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Great Elm Capital Corporation is a business development company that specializes in loan and mezzanine, middle market investments. It seeks to create long-term shareholder value by building its business across three verticals: Operating Companies, Investment Management, and Real Estate. The company favors investing in media, healthcare, telecommunication services, communications equipment, commercial services and supplies. The company has a market capitalization of approximately \$85.3 million and produced \$23.25 million in revenue in 2020.

Great Elm Capital Corporation released its third quarter results on November 9th, 2020. Net investment income increased to \$1.9 million from \$0.9 million quarter-over-quarter. The company's asset coverage ratio was approximately 150.9%, up by 144.5% sequentially. Net assets also increased to approximately \$60.5 million from \$53.2 million quarter-over-quarter. Meanwhile, NAV per share grew to \$5.53, from \$5.10 per share sequentially. The company reported that for the first nine months of 2020 they have already repurchased \$5.3 million in aggregate principal of their senior notes at a weighted average price of \$19.16 per note.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	---	\$0.56	\$0.43	\$0.54	\$-0.88	-\$0.35	-\$0.43	-\$2.09	-\$0.24	-\$0.85	\$0.63	\$1.00
BVPS	---	---	---	---	---	---	\$13.52	\$12.42	\$10.34	\$8.63	\$5.53	\$7.25
DPS	---	\$0.75	\$0.92	\$0.92	\$0.86	\$0.71	\$0.32	\$0.26	\$1.00	\$1.00	\$1.00	\$0.50
Shares¹	---	5.15	6.22	7.02	8.70	14.80	22.66	12.85	11.66	10.65	10.25	10.25

Great Elm Capital has had a very mixed record of earnings performance over the course of its existence. Furthermore, it has seen book value erode rapidly since going public in 2016. That said, its dividend per share has grown over time, signaling management confidence in the business.

While we do believe that they will bounce back from this year's artificially suppressed earnings and book value (we assume a normalized book value per share of \$8), we believe that the long-term trend in book value per share will be downward as their large dividend payout will combine with their leveraged business model to stress the company's balance sheet during challenging periods. We expect book value per share to decline by -1.9% per year over the next half decade.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Avg. P/E	---	---	---	---	---	---	---	---	---	---	6.3	7.2
Avg. P/B	---	---	---	---	---	---	0.86	0.79	0.76	0.90	0.72	0.90
Avg. Yld.	---	---	---	---	---	---	2.0%	1.7%	7.4%	10.4%	25.0%	7.7%

The share price is currently meaningfully undervalued based on the price-to-book value multiple, which we believe is the best single metric for valuing this security given its earnings volatility. Based on its past history and our appraisal of

¹ In millions

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management and the company's outlook, we believe paying 0.9x book value is fair for this company. However, shares currently trade at 0.72 times book value. As a result, we expect 4.6% annualized expansion of the valuation multiple, providing a meaningful tailwind to expected total returns over that period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2026
Payout	---	134%	214%	170%	---	---	---	---	---	---	159%	50%

The company lacks any competitive advantage given its small size and diversified exposure. Furthermore, their extremely erratic earnings and declining book value support this view that the business is not stable.

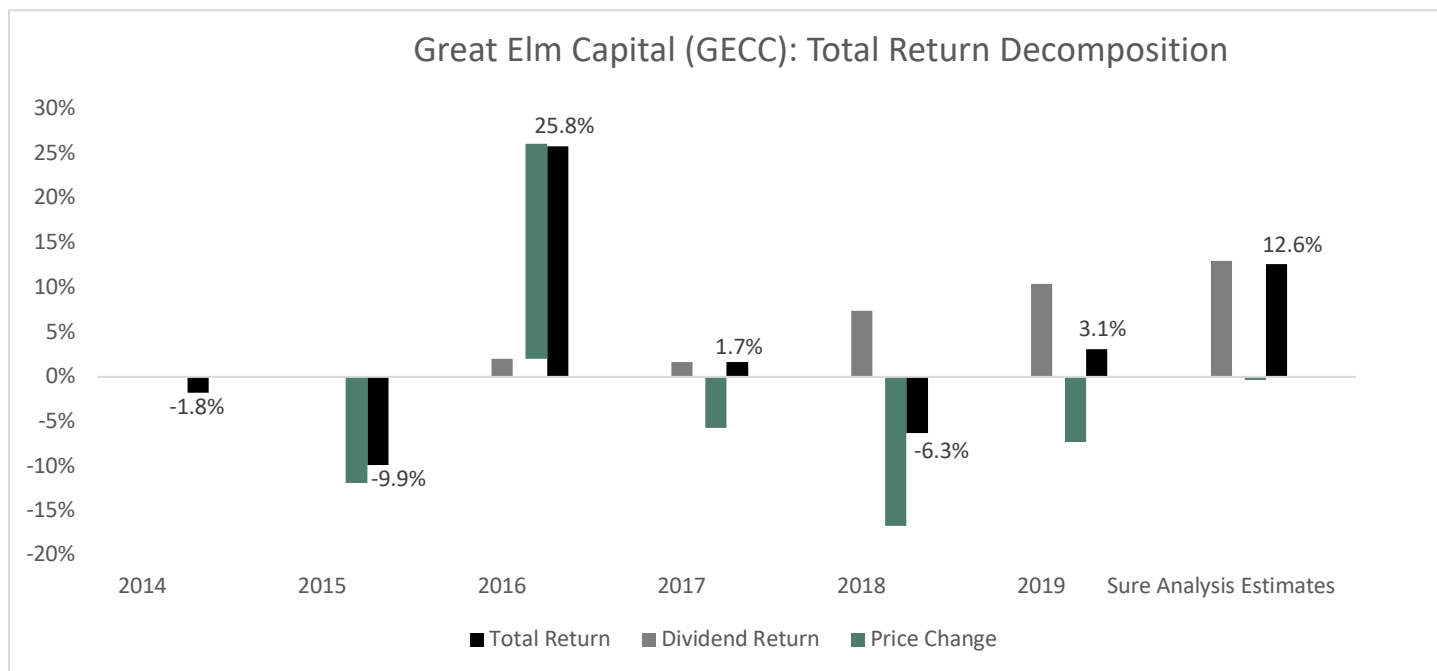
Great Elm Capital's balance sheet is also leveraged quite heavily, which leaves it exposed to rapid declines in book value like what was experienced earlier this year. As a result, even though it was not around for the Great Recession, we believe that it will not fair well in a protracted recession, making it a high-risk stock.

Finally, its payout ratio is quite elevated. Combined with the erratic earnings and its downward trending book value, we expect a major cut in the dividend over the next half decade.

Final Thoughts & Recommendation

Great Elm Capital is not for the feint of heart. The dividend is at significant risk as indicated by the bloated 25% yield and 159% payout ratio. The earnings history is erratic, and the book value is trending downward at a rapid rate. That said, the stock is trading at a steep discount to book value as well as relative to historical levels. We expect a recovery from this year's steep decline in book value but believe the long-term downward trend will continue. With 12.6% expected annualized total returns over the next half decade, the stock earns a buy rating for very aggressive investors, but conservative income growth investors should steer clear.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	4	4	6	(6)	(4)	(14)	1	(5)	(5)
SG&A Exp.	1	2	2	1	2	4	3	3	2
Net Profit	3	3	4	(8)	(5)	(18)	(3)	(9)	(8)
Net Margin	74.2%	60.9%	65.1%	135%	117%	130%	-412%	168%	158%
Free Cash Flow	17	(13)	(10)	(21)	(31)	9	(24)	(30)	(24)

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	88	99	113	155	161	237	240	282	291
Cash & Equivalents	5	1	18	---	4	67	3	4	5
Total Liabilities	32	46	52	82	61	64	108	171	204
Accounts Payable	0	1	1	26	16	24	70	88	74
Long-Term Debt	3	22	50	29	33	35	31	76	120
Shareholder's Equity	56	53	61	73	100	173	132	110	87
D/E Ratio	0.06	0.41	0.83	0.40	0.33	0.20	0.24	0.69	1.38

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	2.9%	3.6%	-5.7%	-3.3%	-10.1%	-1.2%	-3.5%	-2.6%
Return on Equity	---	4.9%	6.7%	-11.4%	-6.0%	-14.1%	-1.8%	-7.4%	-7.7%
ROIC	---	4.0%	4.1%	-7.2%	-4.4%	-11.1%	-1.5%	-5.1%	-3.8%
Shares Out.	---	5.15	6.22	7.02	8.70	22.66	12.85	11.66	10.65
Revenue/Share	0.73	0.68	0.83	(0.65)	(0.30)	(1.07)	0.06	(0.50)	(0.47)
FCF/Share	3.09	(2.06)	(1.48)	(2.37)	(2.12)	0.68	(2.08)	(2.86)	(2.39)

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

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