



Solar Senior Capital Ltd. (SUNS)

Updated February 26th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$15.20	5 Year CAGR Estimate:	4.6%	Market Cap:	\$244 M
Fair Value Price:	\$13	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	03/17/2021
% Fair Value:	117%	5 Year Valuation Multiple Estimate:	-3.1%	Dividend Payment Date:	04/02/2021
Dividend Yield:	7.9%	5 Year Price Target	\$13	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Solar Senior Capital is a Business Development Company (BDC) which is externally managed by Solar Capital Partners. It invests primarily in senior first lien secured loans of private, middle-market companies. Its investment criteria include companies that generate revenues between \$50 million and \$1 billion, EBITDA of \$15 million to \$100 million, and demonstrate resilient cash flows through economic cycles. Hence management avoids speculative investments as much as possible. Solar Senior Capital was founded in 2010 and is based in New York, New York.

On February 24th, 2021, Solar Senior Capital reported its Q4-2020 results for the quarter ended December 31st, 2020. Net investment income (NII) was once again \$4.8 million, a -15.7% decline year-over-year, similarly to its last quarter. The company's portfolio yield was heavily reduced due to its exposure to LIBOR (London Interbank Offer Rate) as well as an overall smaller portfolio due to exiting some of its investments. During the year, the company's net investment income totaled \$20.4 million compared to \$22.6 million in Q4-2019, or \$1.27 compared to \$1.41 on a per-share basis. However, amid realizing losses in some of the year's underperformers, EPS came in at \$0.87 for the year. Despite slightly cutting its dividend, the company paid out more funds than it earned during the year, therefore it ended 2020 with a NAV/share of \$15.91, 2.5% lower YoY.

Solar Senior's current investment portfolio is diversified across approximately 206 unique borrowers in over 120 industries with an average issuer exposure at \$2.2 million, or <0.5% of its total loans. We expect FY2021 EPS of \$1.30, in line with the company's current net investment income, assuming no other one-off external realized losses materialize.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
IIS¹	(\$0.03)	\$1.46	\$1.10	\$1.01	\$0.09	\$1.88	\$1.46	\$0.86	\$1.43	\$0.87	\$1.30	\$1.30
DPS	\$0.60	\$1.29	\$1.41	\$1.41	\$1.41	\$1.41	\$1.41	\$1.41	\$1.41	\$1.27	\$1.20	\$1.20
Shares²	8.6	9.5	11.4	11.5	11.5	12.9	16.0	16.0	16.0	16.0	16.0	16.0

Solar Senior's conservative investment strategy has been a double-edged sword. The company's avoidance of higher-risk investments has failed to deliver stable returns, as originally intended. Low-risk companies can easily access financing at the current ultra-low rate environment, not allowing Solar to get high-enough portfolio yields.

Financial services, insurance, and other traditional companies account for the majority of its investments. Industries that could potentially attract higher yields are almost completely absent, such as software, which makes up only 6.5% of its investments. Hence, investment income per share (IIS) has struggled to sustain distributions.

With the pandemic further increasing global credit availability and with higher credit yields only found in tech at the moment, management was forced to cut its distributions in 2020 to an annualized rate of \$1.20. This was a move that was necessary considering the lackluster results as of late. The company pays its dividends on a monthly basis. The

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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company's recent exits should hopefully reallocate capital towards more fruitful returns. However, we don't expect any IIPS or DPS growth going forward.

It's quite common for BDCs to issue equity in order to fund their future expansion, since they have to distribute at least 90% of their net income. As table depicts, the company has not issued any shares lately, indicating the lack of available investments that meet both the company's conservative criteria and adequate yields.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/I	---	12.3	16.7	16.9	---	11.4	11.8	19.3	11.7	22.5	11.7	10.0
Avg. Yld.	3.5%	7.6%	7.6%	9.1%	9.9%	8.8%	8.7%	8.7%	8.1%	8.1%	7.9%	9.2%

Solar Senior Capital's valuation has been slightly higher than its peers, despite the company's relatively weak performance. We believe that the company will continue to struggle due to its strict and limited industry investment criteria. Hence, we believe that the company's current multiple on our expected FY2021 results is not quite justified. We believe that valuing the stock around 10 times its underlying net income, which is closer to the industry average, is more suitable. This implies the possibility of a small valuation headwind in the medium term.

The yield presently sits at around 8%, which should be the main driver of future shareholder returns. We can see the stock with a higher yield attached in the future as its valuation may be possibly compressed lower.

Safety, Quality, Competitive Advantage, & Recession Resiliency

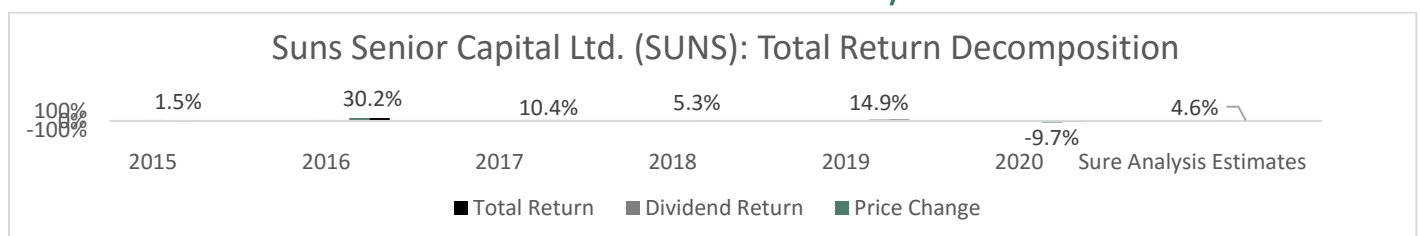
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	88%	128%	140%	---	75%	97%	164%	99%	146%	92%	92%

The recent distribution cut should help the company sustain its current annualized dividend. However, considering the company's investment style, which limits portfolio growth, another cut is not impossible. While the company was not public during the last recession, its investment performance held relatively ok during the challenges caused by the pandemic. The company's issues are mostly related to the available investments and refinancing rates, rather than its underlying portfolio, which is currently 100% operational. Finally, while there are some qualities to appreciate, such as the stable cash flows and the external management that reduces costs, the company doesn't showcase any competitive advantages whatsoever.

Final Thoughts & Recommendation

Solar Senior Capital has performed decently over the past few years, with a relatively stable distribution track record despite the recent cut. However, as financing has become cheaper, the company's portfolio has been performing weaker both due to LIBOR declining, and companies having cheaper capital options. Total return potential comes in at 4.6% per annum, driven by the 7.9% distribution yield offset by a potential valuation headwind. Shares earn a sell rating amid lack of favorable risk/reward ratio.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	8	17	15	14	3	25	24	16	23
SG&A Exp.	1	3	2	2	2	3	3	3	3
Net Profit	(0)	14	13	12	1	24	23	14	23
Net Margin	-3.2%	83.2%	83.9%	86.4%	38.5%	97.4%	96.8%	88.2%	98.1%
Free Cash Flow	(176)	(20)	(44)	(26)	54	60	(47)	(126)	84

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	187	217	273	385	363	522	522	459	578
Cash & Equivalents	3	3	3	42	53	152	109	5	107
Total Liabilities	15	43	65	181	174	253	252	198	316
Accounts Payable	5	2	1	37	57	153	124	26	105
Long-Term Debt	9	39	61	143	116	98	124	169	209
Shareholder's Equity	172	174	208	204	188	269	270	261	262

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	6.9%	5.2%	3.6%	0.3%	5.5%	4.5%	2.8%	4.4%
Return on Equity	---	8.0%	6.6%	5.7%	0.5%	10.6%	8.7%	5.2%	8.8%
ROIC	---	7.1%	5.2%	3.8%	0.3%	7.2%	6.1%	3.4%	5.1%
Shares Out.	8.6	9.5	11.4	11.5	11.5	12.9	16.0	16.0	16.0
Revenue/Share	0.91	1.76	1.32	1.17	0.24	1.94	1.51	0.98	1.46
FCF/Share	(20.35)	(2.07)	(3.83)	(2.25)	4.67	4.63	(2.91)	(7.85)	5.25

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

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