Monroe Capital Corporation (MRCC)

Updated May 7th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	$10.62	**5 Year CAGR Estimate:**	10.7%	**Market Cap:**	$226M
Fair Value Price:	$12.33	**5 Year Growth Estimate:**	0.0%	**Ex-Dividend Date:**	06/12/2021[1]
% Fair Value:	86%	**5 Year Valuation Multiple Estimate:**	3.0%	**Dividend Payment Date:**	06/30/2021
Dividend Yield:	9.4%	**5 Year Price Target**	$12.3	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	F	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	N/A

Overview & Current Events

Monroe Capital Corporation is a specialty finance company focused on providing financing solutions primarily to lower middle-market companies in the United States and Canada. It is externally managed by Monroe Capital and has chosen to be treated as a development company (BDC). The company primarily invests in senior and "unitranche" secured loans ranging between $2.0 million and $25.0 million each. It generates nearly $60 million annually in total investment income and is headquartered in Chicago, Illinois.

On May 4th, 2021, Monroe Capital Corporation reported its Q1 results for the period ended March 31st, 2021. Total investment income during those three months was $13.2 million, compared to $12.5 million in Q4. The $0.7 million increase during the quarter was primarily the result of an increase in prepayment gains and fee income. However, due to higher net base management and incentive fees (remember that they were waived in Q4), net investment income per share remained stable compare to the previous quarter, at $0.25. Net asset value (NAV) per share increased by 0.7% to $11.08 during the quarter, primarily as a result of net unrealized gains on the portfolio, partially offset by realized losses on the extinguishment of debt.

As of March 31st, the company's portfolio comprised 85 companies, totaling $521 million, with a weighted average annualized yield of 7.7%. Around 84.5% of its funds are allocated in 1st Lien Senior Secure and 1st Lien "unitranche" securities, while equities only account for less than 5% of its portfolio. In terms of the portfolio's industry exposure, high-tech, business services, and financials & real estate accounted for 14.9%, 14.4%, and 13.3%, respectively (updated annually.) We retain our FY2021 NII/share expectations of $1.45 to reflect the additional gains sourced from non-interest gains. For example, in Q1, the net increase in net assets from operations was $0.33, higher than the core $0.25.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
NII/share	---	$0.15	$1.13	$1.57	$1.60	$1.55	$1.40	$1.57	$1.42	$1.45	***$1.45***	***$1.45***
DPS	---	$0.34	$1.36	$1.36	$1.40	$1.40	$1.40	$1.40	$1.40	$1.10	***$1.00***	***$1.10***
Shares[2]	---	5.4	7.6	9.6	11.7	14.5	18.6	20.3	20.4	20.9	***22.3***	***30.0***

Since Monroe Capital Corporation's IPO in 2012, the company has produced stable net investment income per share, maintaining a robust relationship between its investment yields and financing costs. Performance remained resilient even during 2020, a year of significant challenges, assisted by management's fee waivers, which showcased prudent behavior. The mid-year dividend cut from a quarterly rate of $0.35 to $0.25 also displayed management's prudent behavior. Management assured investors that there was not a coverage issue, as Monroe achieved an adequate NII/share. Instead, this was only a precautionary decision, and they would readjust the dividend upon evidence of a sustained economic recovery resulting in a positive impact on its NII. With the economy gradually recovering, we have implemented a DPS CAGR of 2% over the next five years to price in the possibility of such a hike materializing. We are also expecting NII/share to remain rather stable in the medium term, as even if NII/share grows slightly moving forward,

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[1] Estimated dates based on past dividend dates

[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.

the possibility of a lower investment yield later cannot be ignored, and hence it has to be accounted for. The share count should continue to grow moving forward as Monroe continues to issue equity to funds its investments. Finally, while the dividend has always been covered, not deteriorating the underlying NAV, the NAV/share has gradually declined from $14.72 in its IPO to $11.08 as of its latest report, due to some of its equity and debt investments resulting in realized and unrealized loss of investment capital.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/NII	---	---	12.0	9.0	8.9	9.4	11.1	8.7	8.8	5.1	***7.3***	***8.5***
Avg. Yld.	---	2%	10%	10%	10%	10%	9%	10%	11%	15%	***9.4%***	***9.0%***

Monroe's valuation had remained close to that of its industry peers until 2019, hovering in the high-single to low double-digits. Along with the fact that the market didn't like the dividend cut, the multiple has now been compressed to around 7.3 times its net investment income. We expect the stock's valuation to expand closer to its fair value, at a P/NII of around 8.5, as investors get to appreciate more the company's high yield and potential for a dividend increase moving forward. The stock is also currently trading under its NAV/share at its current price of $10.62.

Safety, Quality, Competitive Advantage, & Recession Resiliency

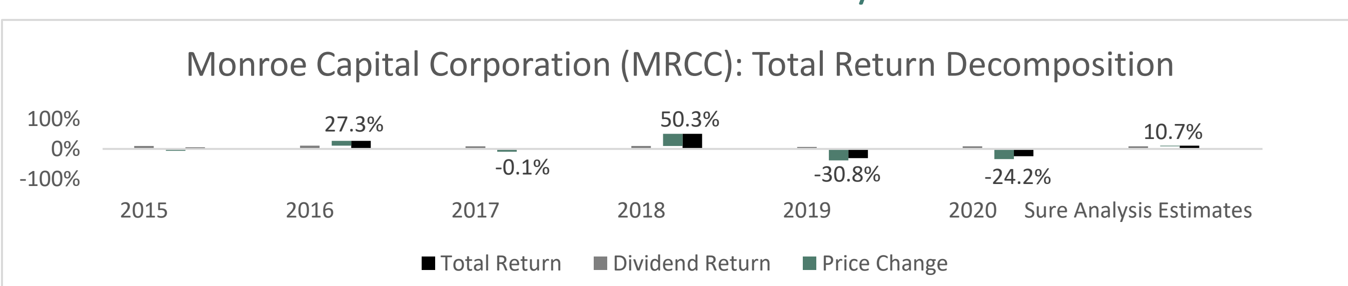
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	120%	87%	88%	90%	100%	89%	99%	76%	***69%***	***76%***

Monroe's dividend could be considered relatively safe, adequately covered by the company's net investment income generation. We believe another dividend cut is quite unlikely at this point. The company's qualities include a well-diversified portfolio of companies with a robust investment yield and a prudent management team. That being said, Monroe has not been tested by a prolonged recession, which could indeed damage its performance if it were to occur. Being a business development company of modest size, the company does not enjoy any noteworthy competitive advantage, other than the experience of its investment advisor, Monroe Capital, whose senior management average more than 30 years of experience, overseeing around $9.5 billion in assets under management. It's worth noting that during Q1, Monroe refinanced its 5.75% 2023 notes for 4.75% 2026 senior unsecured notes, which is a solid indicator of its financial health. Interest expenses should now decline (proportionally), likely to further boost NII/share.

Final Thoughts & Recommendation

Overall, we believe that Monroe Capital Corporation is a prudently managed company that has showcased resilient investment income results, despite experiencing some NAV losses over the years. Powered by our expectations of a potential dividend increase over time, along with the possibility for valuation expansion towards the stock's fair value and actual NAV/share, we forecast annualized returns of around 10.7% going forward. Shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue		1	13	17	22	29	17	11	24	7
SG&A Exp.		0	2	3	3	3	4	4	4	3
Net Profit		1	10	14	18	24	12	6	19	2
Net Margin		76.8%	77.0%	79.8%	82.6%	84.4%	73.2%	53.9%	81.5%	25.3%
Free Cash Flow		(132)	(63)	(12)	(83)	(52)	(70)	(55)	(39)	75

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets		139	226	244	357	425	507	580	655	585
Cash & Equivalents		4	15	5	5	6	4	4	2	7
Accounts Receivable		56	88	110	173	184	229	321	406	351
Total Liabilities		0	1	1	2	3	4	5	5	5
Long-Term Debt		55	84	106	163	178	222	314	396	344
Shareholder's Equity		84	138	134	185	241	279	259	249	234
D/E Ratio		0.66	0.61	0.79	0.88	0.74	0.80	1.21	1.59	1.47

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets			5.4%	5.9%	6.0%	6.2%	2.6%	1.1%	3.1%	0.3%
Return on Equity		2.3%	8.8%	10.2%	11.2%	11.5%	4.7%	2.2%	7.6%	0.7%
ROIC			5.4%	6.0%	6.1%	6.4%	2.6%	1.1%	3.2%	0.3%
Shares Out.		5.4	7.6	9.6	11.7	14.5	18.6	20.3	20.4	20.9
Revenue/Share		0.23	1.66	1.82	1.85	1.98	0.89	0.53	1.15	0.31
FCF/Share		(24.5)	(8.25)	(1.20)	(7.08)	(3.57)	(3.74)	(2.71)	(1.92)	3.58

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