



Gladstone Investment Corp. (GAIN)

Updated August 25th, 2021 by Jonathan Weber

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|----------|
| Current Price: | \$15 | 5 Year CAGR Estimate: | 0.6% | Market Cap: | \$500M |
| Fair Value Price: | \$10 | 5 Year Growth Estimate: | 3.0% | Ex-Dividend Date: | 09/18/21 |
| % Fair Value: | 156% | 5 Year Valuation Multiple Estimate: | -8.5% | Dividend Payment Date: | 09/28/21 |
| Dividend Yield: | 5.6% | 5 Year Price Target | \$11 | Years Of Dividend Growth: | 9 |
| Dividend Risk Score: | F | Retirement Suitability Score: | D | Last Dividend Increase: | 2.9% |

Overview & Current Events

Gladstone Investment is a business development company (BDC) that focuses on US-based small- and medium-sized companies. Industries which Gladstone Investment targets include aerospace & defense, oil & gas, machinery, electronics, and media & communications. The company was founded in 2005 and is headquartered in McLean, VA.

Gladstone Investment reported its first quarter (Q1 2021 ended June 30) earnings results on August 2. The company generated total investment income - Gladstone Investment's revenue equivalent - of \$18 million during the quarter, which represents an increase of 51% compared to the prior year's quarter. This number beat the analyst consensus estimate by \$3 million, as analysts expected a weaker growth rate from the company's top line.

Gladstone Investment's adjusted net investment income-per-share totaled \$0.24 during the fiscal first quarter. That was up 20% from the previous quarter's level of \$0.20. Gladstone Investment's net asset value per share totaled \$12.66 on a per-share basis at the end of the quarter, which was up meaningfully versus the \$11.52 of NAV-per-share that the company reported at the end of the previous quarter. The increase was based on the fact that net profits, on a not-adjusted basis, during the quarter were higher than the dividend payments that Gladstone Investment Corp. made during the same period, while some fair value adjustments further pushed up Gladstone's net asset value during the quarter. 2020's NIIPS was down quite meaningfully versus 2019, due to the impact of the pandemic. It looks like the company will recover meaningfully during the current fiscal year, however.

Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| NIIPS | \$0.73 | \$0.62 | \$0.68 | \$0.73 | \$0.75 | \$0.68 | \$0.74 | \$0.77 | \$0.90 | \$0.69 | \$0.80 | \$0.93 |
| DPS | \$0.48 | \$0.61 | \$0.60 | \$0.71 | \$0.73 | \$0.75 | \$0.75 | \$0.82 | \$0.84 | \$0.84 | \$0.84 | \$0.88 |
| Shares¹ | 22 | 26 | 26 | 26 | 30 | 30 | 33 | 33 | 33 | 33 | 33 | 35 |

Gladstone Investment's net investment income per share is quite lumpy. During the financial crisis the company's profits declined substantially, but Gladstone Investment remained profitable. Over the last five years profits grew by 4.3% annually, which is not a very high growth rate, but which is also not at all disappointing for a high-yielding investment.

Gladstone Investment's business model is relatively straightforward. The company lends money to small- and mid-sized companies. Position sizes for debt investments usually range from \$5 million to \$30 million. The company also takes equity stakes in such companies, with position sizes for equity investments typically ranging from \$10 million to \$40 million. The companies Gladstone Investment does business with usually cannot access debt or equity markets directly, as bond sales and public listings are not possible for them due to their small size. Gladstone Investment makes its money via spreads between the interest rates the company pays on cash that it borrows, and the interest rates the company receives on cash that it lends - the same principle as with banks. Declining interest rates could turn into a headwind, but so far Gladstone Investment's weighted average interest yield has held up very well; the company generated a yield of around 13% before the pandemic. A short-term headwind stems from higher loan losses caused by the coronavirus crisis, but we do not see this impacting profitability in the long run.

¹ 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 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Now | 2026 |
|-----------|------|------|------|------|-------|------|------|------|-------|------|------|------|
| P/NII | 10.1 | 12.1 | 10.7 | 10.5 | 10.2 | 11.9 | 12.8 | 15.3 | 8.9 | 17.8 | 18.8 | 12.0 |
| Avg. Yld. | 6.5% | 8.1% | 8.2% | 9.2% | 10.1% | 9.3% | 7.9% | 7.0% | 10.5% | 6.8% | 5.6% | 7.9% |

Gladstone Investment has been valued at a low-double-digit price to net investment income multiple throughout the majority of the last decade. Today, shares trade well above this historic valuation, using our earnings-per-share estimate for the current fiscal year (FY 2021). We thus believe that multiple contraction will be a meaningful headwind for the company's total return outlook, since we expect that valuations will come down over the years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|--------|-------|-------|-------|-------|------|------|------|------|-------|------|------|-------|
| Payout | 65.8% | 98.4% | 88.2% | 97.3% | 103% | 110% | 101% | 106% | 93.3% | 122% | 105% | 95.2% |

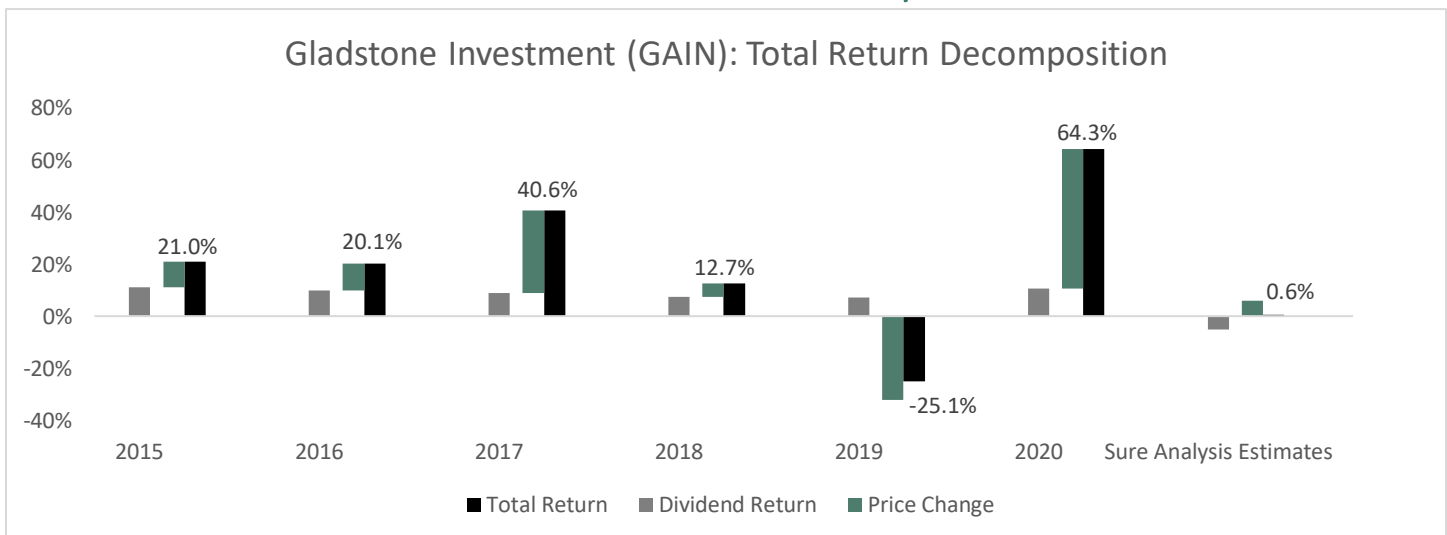
Gladstone Investment's dividend payout ratio, relative to its net investment income, has been close to or above 100% throughout several years over the last decade. The company usually is more profitable than the net investment income metric suggests, due to the fact that Gladstone Investment can also generate gains from its equity investments, which are not reflected in the net investment income metric. The company nevertheless had to cut its dividend during the last financial crisis, but so far, the company is confident it will not have to cut its payout during the pandemic.

Gladstone Investment's equity investment gains explain the company's long-term book value growth. Gladstone Investment's recession performance is not very compelling compared to less cyclical income stocks, but at least the company remained profitable during the last financial crisis, unlike many other financial corporations. We also see Gladstone remaining profitable during the current global crisis, but profits will be down from prior highs.

Final Thoughts & Recommendation

Gladstone Investment is a business development company targeting small companies that do not have the ability to access debt and/or equity markets easily. This allows Gladstone to demand above-average interest rates. The company does not generate a lot of growth, but the high payout ratio allows for an above-average dividend yield. Right now, shares trade well above fair value, which is why we rate Gladstone Investment a sell.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|----------------|-------|-------|------|-------|-------|-------|-------|-------|--------|-------|
| Revenue | 24 | 18 | (1) | 51 | 29 | 49 | 65 | 99 | 8 | 49 |
| SG&A Exp. | 3 | 3 | 3 | 3 | 4 | 4 | 4 | 6 | 6 | 6 |
| D&A Exp. | 22 | 17 | (1) | 50 | 25 | 45 | 61 | 82 | (7) | 42 |
| Net Profit | 90.4% | 93.5% | 138% | 98.7% | 85.3% | 90.6% | 92.9% | 82.2% | -90.4% | 87.1% |
| Net Margin | (49) | (40) | (34) | (98) | 4 | 33 | (30) | 94 | 35 | (30) |
| Free Cash Flow | 24 | 18 | (1) | 51 | 29 | 49 | 65 | 99 | 8 | 49 |

Balance Sheet Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|----------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 325 | 380 | 331 | 484 | 503 | 515 | 611 | 635 | 576 | 644 |
| Cash & Equivalents | 92 | 86 | 5 | 5 | 4 | 3 | 4 | 2 | 3 | 2 |
| Accounts Receivable | 118 | 139 | 110 | 210 | 224 | 214 | 257 | 228 | 207 | 261 |
| Total Liabilities | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Accounts Payable | 76 | 95 | 67 | 124 | 100 | 75 | 113 | 58 | 54 | 151 |
| Long-Term Debt | 207 | 241 | 221 | 273 | 279 | 301 | 354 | 407 | 369 | 382 |
| Shareholder's Equity | 0.37 | 0.39 | 0.30 | 0.45 | 0.36 | 0.25 | 0.32 | 0.14 | 0.15 | 0.40 |
| D/E Ratio | 325 | 380 | 331 | 484 | 503 | 515 | 611 | 635 | 576 | 644 |

Profitability & Per Share Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|------------------|-------|--------|--------|--------|------|-------|--------|-------|-------|--------|
| Return on Assets | 7.8% | 4.9% | -0.4% | 12.3% | 5.0% | 8.8% | 10.8% | 13.1% | -1.2% | 7.0% |
| Return on Equity | 10.8% | 7.7% | -0.6% | 20.3% | 9.0% | 15.4% | 18.5% | 21.4% | -1.9% | 11.3% |
| ROIC | 8.4% | 5.6% | -0.4% | 14.7% | 6.4% | 11.9% | 14.4% | 17.5% | -1.6% | 8.9% |
| Shares Out. | 22 | 26 | 26 | 26 | 30 | 30 | 33 | 33 | 33 | 33 |
| Revenue/Share | 1.10 | 0.76 | (0.04) | 1.91 | 0.96 | 1.63 | 2.02 | 3.02 | 0.24 | 1.47 |
| FCF/Share | (2.2) | (1.64) | (1.27) | (3.66) | 0.13 | 1.08 | (0.92) | 2.85 | 1.07 | (0.90) |

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

Disclaimer

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