



Horizon Technology Finance Corp. (HRZN)

Updated November 1st, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$17.45	5 Year CAGR Estimate:	6.0%	Market Cap:	\$356.4M
Fair Value Price:	\$15.76	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	12/16/2021
% Fair Value:	111%	5 Year Valuation Multiple Estimate:	-2.0%	Dividend Payment Date:	01/13/2022
Dividend Yield:	6.9%	5 Year Price Target	\$17.39	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 around 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-nine-month annualized portfolio yield of 14.7%. 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 \$47 million annually and is based in Farmington, Connecticut.

On October 26th, 2021, Horizon released its Q3 results for the period ended September 30th, 2021. Total investment income grew 33% year-over-year to \$16.4 million, primarily due to growth in interest income on investments resulting from an increase in the average size of the debt investment portfolio, as well as higher fee income. Net investment income per share (ISS) grew to \$0.40, 17.6% higher compared to Q3-2020. The mismatch in growth to the total income was due to higher interest expenses, higher professional fees, and the additional share issuances that took place to fund the company's portfolio expansion. Net asset value (NAV) per share came in at \$11.63, compared to \$11.17 in the previous quarter, as Horizon earned more than what it paid out in distributions. In fact, after paying its monthly distributions, Horizon's undistributed spillover income as of September 30th was \$0.44 per share, indicating a considerable cash cushion. The portfolio remained relatively stable, holding 74 businesses at the end of the quarter. Management reassured investors of dividend stability going forward by declaring its three forward monthly dividends at a rate of \$0.10. Amid better than expected results, we raise our FY2021 ISS/share forecast from \$1.30 to \$1.37.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
IIS¹	\$1.38	\$1.41	\$1.38	\$1.11	\$1.25	\$1.48	\$1.07	\$1.20	\$1.52	\$1.18	\$1.37	\$1.51
DPS	\$1.63	\$1.35	\$1.38	\$1.38	\$1.38	\$1.38	\$1.20	\$1.20	\$1.20	\$1.20	\$1.20	\$1.20
Shares²	7.6	8.5	9.6	9.6	11.2	11.5	11.5	11.5	13.5	17.5	20.2	50.0

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 maintained quite stable distributions, 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 a 2% growth in its IIS/share and stable

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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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 five years. The dividend has only declined since 2011 on a per-share basis.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	11.5	11.0	9.7	13.1	8.4	7.1	9.7	9.4	9.9	9.3	12.7	11.5
Avg. Yld.	11.1%	10.8%	9.9%	9.6%	13.8%	11.8%	10.9%	11.4%	10.2%	10.2%	6.9%	6.9%

Horizon's yield is relatively low amongst its peers, as its shares are currently trading at a premium compared to the industry. The extended valuation is likely the result of the company's resilient reinvestment yield, which has remained near 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. Despite that, we believe that a valuation correction towards a P/E of 11.5 is likely more sustainable in the medium term. The stock is overvalued from a premium to its NAV perspective as well.

Safety, Quality, Competitive Advantage, & Recession Resiliency

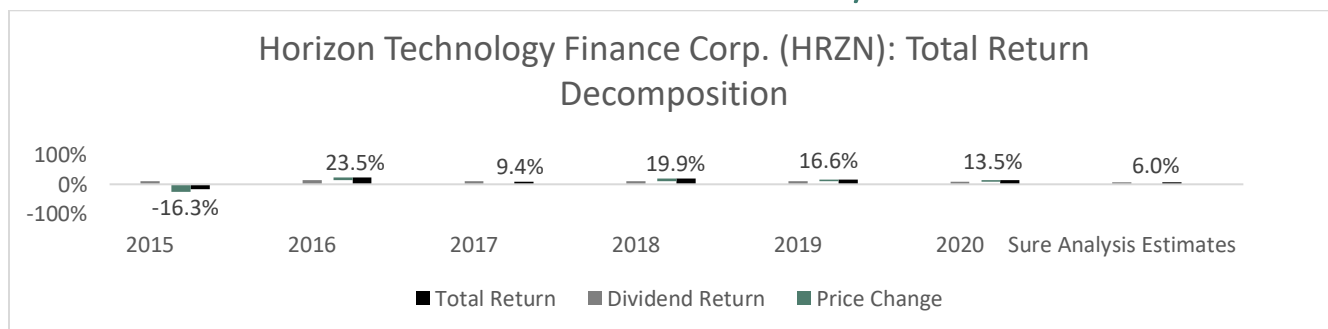
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	118%	96%	100%	124%	110%	93%	112%	100%	79%	102%	88%	79%

Horizon's distributions have remained well-covered over the past few years, including during the COVID-19 pandemic. 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 \$121.8 million of investment capacity available, investors and creditors alike are confident for the company's future. Additionally, the company has a healthy debt to equity ratio of 1.1.

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, which has resulted in shy-high investment yields. We believe that Horizon is one the highest-quality BDCs amongst its competitors. Due to the possibility of a valuation correction, however, we forecast annualized returns of around 6.0%. The stock's monthly distributions are likely to be appreciated by income-oriented investors, nonetheless. We rate shares a hold at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	7.32	7.09	20.50	14.97	-1.76	12.40	14.90	21.30	14.78	10.33
SG&A Exp.	3.10	3.48	5.26	3.46	3.24	2.87	3.04	3.41	3.45	3.75
Net Profit	3.99	3.51	15.43	11.86	-4.91	9.59	13.01	19.50	11.00	6.36
Net Margin	54.5%	49.5%	75.3%	79.2%	279.3%	77.3%	87.3%	91.5%	74.4%	61.6%
Free Cash Flow	-36.09	6.50	36.68	-31.33	52.31	-14.84	-12.06	-51.41	-4.02	-25.28
Income Tax	0.23	0.24	0.16	---	-0.09	0.03	0.03	0.24	0.34	0.22

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	239.66	263.74	225.20	280.90	239.25	234.15	266.75	344.00	197.81	407.16
Cash & Equivalents	1.05	25.34	8.42	20.77	37.14	6.59	12.59	6.47	1.30	19.50
Total Liabilities	94.69	127.90	86.95	121.15	100.06	99.07	132.49	159.95	67.93	194.56
Accounts Payable	3.30	3.32	3.32	3.98	3.45	3.46	3.46	4.67	0.00	5.79
Long-Term Debt	89.02	122.34	81.75	114.95	95.60	94.08	126.85	152.05	64.57	185.8
Total Equity	144.97	135.84	138.25	159.75	139.19	135.08	134.26	184.06	129.88	212.60
D/E Ratio	0.61	0.90	0.59	0.72	0.69	0.70	0.94	0.83	0.50	0.87

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	1.8%	1.4%	6.3%	4.7%	-1.9%	4.1%	5.2%	6.4%	6.8%	1.7%
Return on Equity	2.9%	2.5%	11.3%	8.0%	-3.3%	7.0%	9.7%	12.3%	11.6%	3.2%
ROIC	1.9%	1.4%	6.5%	4.8%	-1.9%	4.1%	5.3%	6.5%	6.9%	1.7%
Shares Out.	8.48	9.58	9.62	11.18	11.54	11.52	11.53	13.48	7.61	17.53
Revenue/Share	0.86	0.74	2.13	1.34	-0.15	1.08	1.29	1.58	1.94	0.59
FCF/Share	-4.26	0.68	3.81	-2.80	4.53	-1.29	-1.05	-3.81	-0.53	-1.44

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

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