



Gladstone Capital (GLAD)

Updated December 5th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$10.22	5 Year CAGR Estimate:	8.1%	Market Cap:	\$359 M
Fair Value Price:	\$10.29	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	12/29/22
% Fair Value:	99%	5 Year Valuation Multiple Estimate:	0.1%	Dividend Payment Date:	12/30/22
Dividend Yield:	8.2%	5 Year Price Target	\$10.81	Years Of Dividend Growth:	1
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Gladstone Capital is a business development company, or BDC, that primarily invests in small and medium businesses. These investments are made via a variety of equity (10% of portfolio) and debt instruments (90% of portfolio), generally with very high yields. Loan size is typically in the \$7 million to \$30 million range and has terms up to seven years. The BDC's stated purpose is to generate income it can distribute to its shareholders. The company trades with a market capitalization of \$359 million and it pays distributions monthly, instead of quarterly.

Gladstone reported fourth quarter and full-year earnings on November 14th, 2022, and results were somewhat mixed. The trust reported net investment income per-share of 22 cents, which was a penny ahead of expectations. Total investment income was \$15.94 million, up 11% year-over-year, but missed expectations very slightly.

The trust invested \$59.6 million in four new portfolio companies, and \$26.4 million in existing portfolio companies. Gladstone saw \$64.2 million in net new originations accounting for repayments and net proceeds.

Gladstone also issued 430,425 common shares at a weighted average share price of \$10.53, for net proceeds of \$4.5 million.

Our initial estimate for fiscal 2023 is for 98 cents of NII per-share.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
NII	\$0.88	\$0.87	\$0.84	\$0.84	\$0.84	\$0.85	\$0.84	\$0.81	\$0.79	\$0.94	\$0.98	\$1.03
DPS	\$0.84	\$0.84	\$0.84	\$0.84	\$0.84	\$0.84	\$0.84	\$0.78	\$0.78	\$0.78	\$0.84	\$0.86
Shares¹	21.0	21.0	21.1	23.2	25.5	27.1	29.3	33.0	34.0	35.1	36.0	40.0

Gladstone reports net investment income per share, or NII, instead of earnings-per-share, which is consistent with other BDCs. On that measure, the company's results have been lackluster in terms of growth over the past decade. Our estimate of 98 cents for this year is largely in line with historical NII. Gladstone's share issuances have funded higher NII in dollar terms but haven't earned enough above its cost of capital to move the needle on NII-per-share. Given this history, we're moving our growth estimate from 0% to 1%.

The yields on the company's portfolio influence its ability to earn income and therefore, cover its expenses and pay distributions to shareholders. Over time, the company's portfolio yield has drifted higher to 10%+, where it is today. However, higher expenses have offset that growth recently, which is part of the reason why NII-per-share continues to be roughly flat over time. Gladstone's portfolio continues to grow in dollar terms, but given its offsetting rising expenses, NII hasn't grown. We see this cycle of new investments being largely offset by losses and higher expenses. The company has made profitable exits of late, not only generating gains, but also the ability to recycle that capital.

Gladstone's dividend had been at \$0.07 monthly, or \$0.84 annually, since 2010. However, the payout was trimmed in 2020, although Gladstone is in the process of rebuilding it, and it is now back to 84 cents annually. The current payout looks quite sustainable.

¹ Share count 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/NII	10.1	10.9	10.0	9.1	11.4	10.7	10.8	10.2	12.7	9.0	10.4	10.5
Avg. Yld.	9.5%	8.8%	10.0%	11.0%	8.8%	9.3%	9.2%	9.4%	7.8%	9.2%	8.2%	8.0%

Gladstone has traded at a price-to-NII ratio very near 10.5 in the past decade, which is where we assess fair value. At 10.4 times NII, the stock now appears to be fairly valued. We therefore see essentially no impact to total returns from the valuation.

The yield is lower than it has been for most of the past decade; Gladstone's average yield in the past decade has been close to 10%, and we see the yield remaining about where it is today, near 8%. We see the yield as warning investors that Gladstone is slightly overpriced today.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	95%	97%	100%	100%	100%	99%	100%	96%	99%	83%	86%	84%

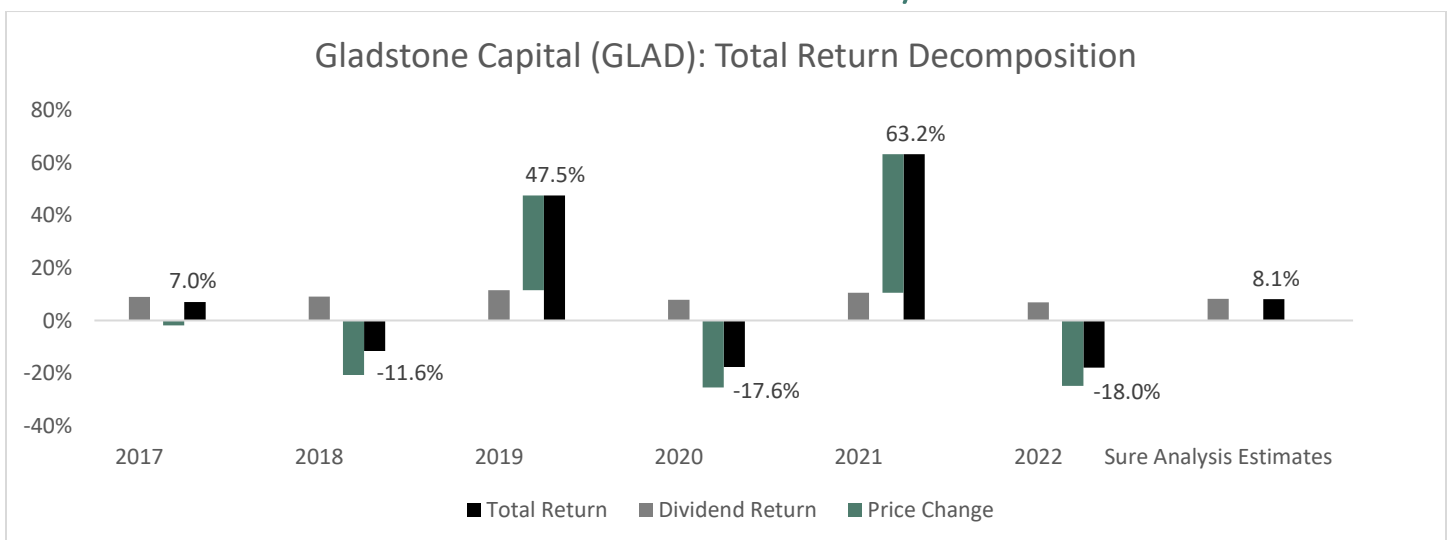
Gladstone doesn't have any competitive advantages as it operates in much the same way as any other BDC. It is also dependent upon funding costs and the spreads it can earn on its debt and equity investments. During recessions, Gladstone will likely struggle as repayments may become a problem for its debt investments. Indeed, this caused the company to cut its dividend during the Great Recession, and it hasn't recovered.

Gladstone cut its distribution for this reason in Q2 2020, and we believe the cut should be enough for the foreseeable future. NII is once again moving higher, and we see the payout as sustainable currently, particularly with strong recent earnings results supporting NII.

Final Thoughts & Recommendation

We forecast 8.1% total annual returns in the coming years. The stock remains elevated as the market is bidding up interest rate sensitive stocks. In addition, we see higher earnings this year supporting a higher share price, as well as the dividend. We see essentially no impact from the valuation, as well as 1% growth and the 8.2% yield. The stock continues to earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	43	24	21	25	30	31	33	8	95	32
SG&A Exp.	6	6	6	7	7	8	8	8	8	10
Net Profit	32	11	8	11	17	19	20	(2)	84	20
Net Margin	75.4%	46.1%	40.4%	46.0%	56.8%	59.5%	59.4%	-22.3%	89.0%	62.5%
Free Cash Flow	32	0	(74)	60	(13)	(18)	9	(46)	(14)	(76)

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	295	301	382	336	366	400	426	459	567	661
Cash & Equivalents	14	6	4	6	5	2	16	2	1	2
Accounts Receivable	2	3	6	2	2	3	3	3	2	3
Total Liabilities	89	102	191	134	146	162	177	225	248	345
Accounts Payable	1	1	1	1	1	1	1	2	2	3
Long-Term Debt	47	38	127	71	93	110	123	222	237	339
Shareholder's Equity	206	200	191	201	220	237	249	234	318	315
LTD/E Ratio	0.23	0.19	0.66	0.35	0.42	0.46	0.49	0.95	0.74	1.08

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	10.9%	3.8%	2.5%	3.2%	4.9%	4.9%	4.8%	-0.4%	16.4%	3.2%
Return on Equity	16.3%	5.5%	4.3%	5.8%	8.2%	8.2%	8.2%	-0.8%	30.5%	6.3%
ROIC	12.8%	4.6%	3.0%	3.8%	5.9%	5.7%	5.5%	-0.5%	16.7%	3.3%
Shares Out.	21.0	21.0	21.1	23.2	25.5	27.1	29.3	33.0	34.0	34.4
Revenue/Share	2.03	1.16	1.00	1.07	1.19	1.16	1.14	0.27	2.85	0.94
FCF/Share	1.53	0.02	(3.54)	2.59	(0.51)	(0.66)	0.32	(1.48)	(0.42)	(2.22)

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

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