



Great Elm Capital (GECC)

Updated March 10th, 2023 by Samuel Smith

Key Metrics

Current Price:	\$9.25	5 Year CAGR Estimate:	12.3%	Market Cap:	\$71.3 M
Fair Value Price:	\$11.2	5 Year Growth Estimate:	-2.2%	Ex-Dividend Date:	3/14/23
% Fair Value:	83%	5 Year Valuation Multiple Estimate:	3.8%	Dividend Payment Date:	3/31/23
Dividend Yield:	15.1%	5 Year Price Target	\$10	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

Overview & Current Events

Great Elm Capital Corporation is a business development company that specializes in loan and mezzanine, middle market investments. It seeks to create long-term shareholder value by building its business across three verticals: Operating Companies, Investment Management, and Real Estate. The company favors investing in media, healthcare, telecommunication services, communications equipment, commercial services and supplies. The company has a market capitalization of approximately \$71.3 million.

Great Elm Capital Corporation released its fourth quarter and FY2022 results on March 2nd. The company reported net investment income (NII) of \$2.3 million for the quarter ended December 31, 2022, which more than doubled NII of \$1.1 million for the previous quarter. This increase was attributed to capital deployment, rotation into higher yielding floating rate investments, and lower expenses. However, the company's net assets were negatively impacted by unrealized losses on certain investments. GECC partnered with an affiliate of Berkadia Commercial Mortgage, LLC to form Great Elm Healthcare Finance, LLC (GEHF). GEHF is a specialty, asset-based lending platform that provides capital to healthcare-related businesses across the U.S. In December 2022, GEHF purchased three healthcare asset-based loans.

As of December 31, 2022, GECC's asset coverage ratio was approximately 154.4%, a decrease from 165.5% as of September 30, 2022, and an increase from 151.1% as of December 31, 2021. The Board of Directors approved a quarterly dividend of \$0.35 per share for Q1 2023, equating to a 12.5% annualized yield on December 31, 2022 NAV per share..

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	---	---	---	---	\$1.52	\$1.44	\$1.07	\$0.54	\$3.02	\$1.67	\$1.45	\$1.25
BVPS	---	---	---	\$13.52	\$12.42	\$10.34	\$8.63	\$3.46	\$16.63	\$12.56	\$11.16	\$10.00
DPS	\$0.92	\$0.86	\$0.71	\$0.32	\$0.26	\$1.00	\$1.00	\$1.00	\$0.40	\$1.80	\$1.40	\$1.20
Shares¹	11.9	23.2	22.5	2.1	1.8	1.8	1.7	3.9	4.6	7.6	7.6	13

Great Elm Capital has had a very mixed record of earnings performance over the course of its existence. Furthermore, it has seen book value be very volatile since going public in 2016.

We believe that the company will have a hard time growing book value and earnings per share as their large dividend payout will combine with their leveraged business model to stress the company's balance sheet during challenging periods.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/B	---	---	---	0.86	0.79	0.76	0.90	0.85	0.83	0.83	0.83	1.0
Avg. Yld.	---	---	---	2.8%	2.6%	12.7%	12.9%	34.0%	2.9%	17.6%	15.1%	12.0%

¹ In millions

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The share price is currently undervalued based on the price-to-book value multiple, which we believe is the best single metric for valuing this security. Based on its history and our appraisal of management and the company's outlook, we believe paying 1x book value is fair for this company. Given that shares currently trade at 0.83 times book value, we view shares as trading below fair value, leading to an expected tailwind to total returns moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	---	---	---	17%	69%	93%	185%	13%	108%	97%	96%

The company lacks any competitive advantage given its small size and diversified exposure. Furthermore, their extremely erratic earnings and book value support this view that the business is not stable.

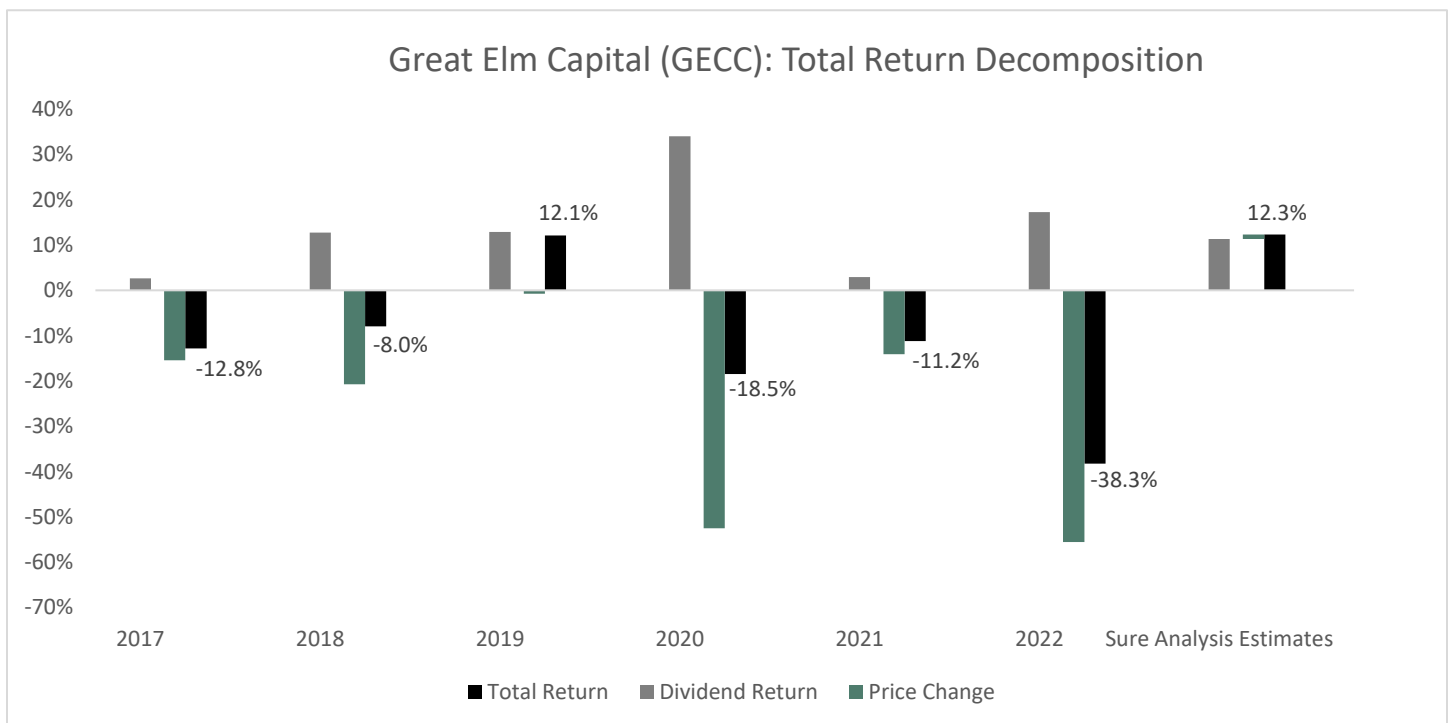
Great Elm Capital's balance sheet is also leveraged quite heavily, which leaves it exposed to rapid declines in book value like what was experienced a few years ago. As a result, even though it was not around for the Great Recession, we believe that it will not fare well in a protracted recession, making it a high-risk stock.

Finally, its payout ratio is quite elevated. Combined with the erratic earnings and book value, we view the dividend as risky.

Final Thoughts & Recommendation

Great Elm Capital is not for the faint of heart. The dividend is at significant risk as indicated by the bloated yield and payout ratio. The earnings and book value history is erratic and unpredictable. That said, the stock is trading at a discount to book value. With 12.3% expected annualized total returns over the next half decade, the stock earns a Buy rating for very aggressive investors, but conservative income growth investors should steer clear.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	6	(6)	(4)	(14)	1	(5)	(5)	(29)	(7)	(16)
SG&A Exp.	2	1	2	4	3	3	2	2	3	3
Net Profit	4	(8)	(5)	(18)	(3)	(9)	(8)	(32)	(10)	(16)
Net Margin	65.1%	134.5%	116.9%	130.2%	-412%	168.3%	158.2%	110.7%	155.8%	96.9%
Free Cash Flow	(10)	(21)	(31)	9	(24)	(30)	(24)	27	(58)	(42)

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	113	155	161	237	240	282	291	283	426	310
Cash & Equivalents	18	-	4	67	3	4	5	53	9	1
Total Liabilities	52	82	61	64	108	171	204	204	352	225
Accounts Payable	1	26	16	24	70	88	74	78	204	70
Long-Term Debt	50	29	33	35	31	76	120	116	142	153
Shareholder's Equity	61	73	100	173	132	110	87	80	75	85
LTD/E Ratio	0.83	0.40	0.33	0.20	0.24	0.69	1.38	1.45	1.90	1.81

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	3.6%	-5.7%	-3.3%	-10.1%	-1.2%	-3.5%	-2.6%	-11.1%	-2.9%	-4.2%
Return on Equity	6.7%	-11.4%	-6.0%	-14.1%	-1.8%	-7.4%	-7.7%	-38.4%	-13.3%	-19.6%
ROIC	4.1%	-7.2%	-4.4%	-11.1%	-1.5%	-5.1%	-3.8%	-15.9%	-5.0%	-6.9%
Shares Out.	1.2	1.4	2.5	2.1	1.9	1.8	1.7	2.2	4.1	7.6
Revenue/Share	4.99	(3.91)	(1.80)	(6.41)	0.34	(3.01)	(2.79)	(13.02)	(1.62)	(2.57)
FCF/Share	(8.86)	(14.25)	(12.73)	4.07	(12.50)	(17.16)	(14.33)	12.35	(14.36)	(6.68)

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

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