



# Horizon Technology Finance Corp. (HRZN)

Updated March 7<sup>th</sup>, 2023 by Nikolaos Sismanis

## Key Metrics

<b>Current Price:</b>	\$12.72	<b>5 Year CAGR Estimate:</b>	10.3%	<b>Market Cap:</b>	\$339.6 M
<b>Fair Value Price:</b>	\$14.21	<b>5 Year Growth Estimate:</b>	0.0%	<b>Ex-Dividend Date:</b>	03/16/2023
<b>% Fair Value:</b>	90%	<b>5 Year Valuation Multiple Estimate:</b>	2.2%	<b>Dividend Payment Date:</b>	04/14/2023
<b>Dividend Yield:</b>	10.4%	<b>5 Year Price Target</b>	\$14.21	<b>Years Of Dividend Growth:</b>	2
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	Buy

## Overview & Current Events

Horizon Technology Finance Corp. is a BDC (Business Development Company) seeking to provide venture capital to small and medium-sized companies, mainly in the life sciences, technology, sustainability, and healthcare-IT sectors, which account for around 42%, 41%, 12%, and 5% 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-twelve-month annualized portfolio yield of 14.5%. 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 \$60 million annually and is based in Farmington, Connecticut

On February 28<sup>th</sup>, 2023, Horizon released its Q4-2022 and full-year results for the period ending December 31<sup>st</sup>, 2022. For the quarter, total investment income grew 36.6% year-over-year to \$23.1 million, primarily due to growth in interest income on investments resulting from an increase in the average size of the debt investment portfolio and an increase in the base rate for most of the company's variable rate debt investments. The latter was driven by rising interest rates.

Net investment income per share (ISS) rose to \$0.40, one cent higher compared to Q4-2022. Net asset value (NAV) per share landed at \$11.47, 1.6% lower sequentially or 0.8% lower year-over-year. After paying its monthly distributions, Horizon's undistributed spillover income as of December 31<sup>st</sup> was \$0.68 per share, indicating a considerable cash cushion. The portfolio remained relatively stable, holding 98 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 \$0.11. Based on Horizon's current portfolio composition, we forecast FY2023 ISS of \$1.45.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>IIS<sup>1</sup></b>	\$1.38	\$1.11	\$1.25	\$1.48	\$1.07	\$1.20	\$1.52	\$1.18	\$1.41	\$1.46	<b>\$1.45</b>	<b>\$1.45</b>
<b>DPS</b>	\$1.38	\$1.38	\$1.38	\$1.38	\$1.20	\$1.20	\$1.20	\$1.25	\$1.25	\$1.28	<b>\$1.32</b>	<b>\$1.32</b>
<b>Shares<sup>2</sup></b>	9.6	9.6	11.2	11.5	11.5	11.5	13.5	17.5	20	24.7	<b>24.7</b>	<b>50.0</b>

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 caused BDCs to keep refinancing their loan assets at gradually lower rates up until recently, 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 dividends, 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. That said, we expect a stable IIS/share through 2028, as we are starting off a high base, and the direction of rates several years ahead is uncertain. While there's a chance DPS will grow further, we chose to remain prudent and forecast no DPS growth over the next five years.

<sup>1</sup> Investment Income per share

<sup>2</sup> 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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## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	9.7	13.1	8.4	7.1	9.7	9.4	9.9	9.3	11.3	9.3	<b>8.8</b>	<b>9.8</b>
Avg. Yld.	9.9%	9.6%	13.8%	11.8%	10.9%	11.4%	10.2%	10.2%	7.8%	9.4%	<b>10.4%</b>	<b>9.3%</b>

Horizon's yield is one of the highest amongst its peers, as its shares are currently trading at a discount compared to the industry. This is quite odd, in our opinion, considering the company's resilient reinvestment yield, which has averaged close to 15%, well above its industry peers. 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. We have set our fair P/E at 9.8, which is quite close to the stock's historical average. The stock appears modestly overvalued from a NAV point of view, though a small premium is deserved amid Horizon's unique qualities.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

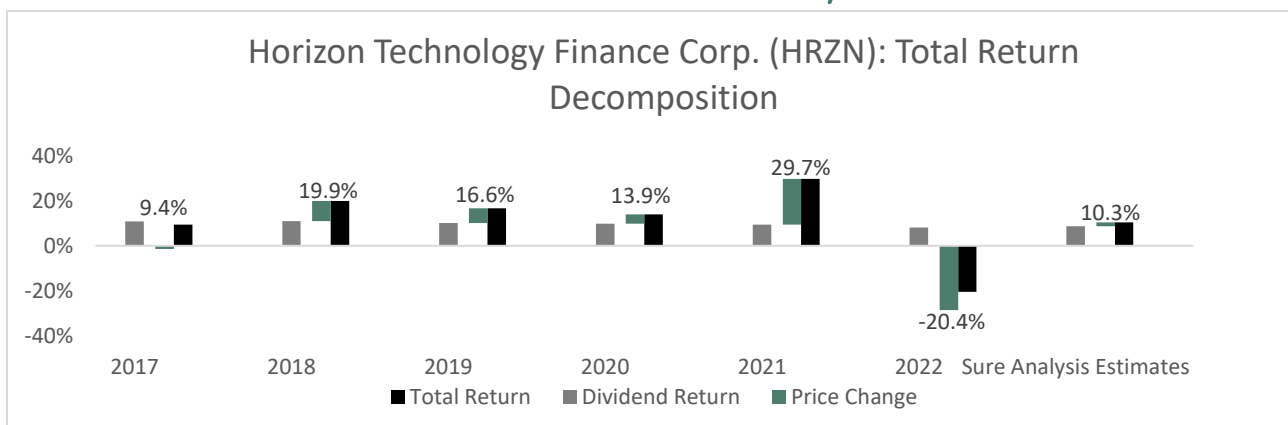
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	100%	124%	110%	93%	112%	100%	79%	106%	89%	88%	<b>91%</b>	<b>91%</b>

Horizon's dividend has 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 dividends 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 \$120.8 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 1.18, slightly below Horizon's 0.8-1.2 targeted leverage range. The asset coverage ratio for borrowed amounts was 172%, also at quite healthy levels.

## Final Thoughts & Recommendation

Horizon should be able to keep leveraging its niche expertise in tech and life sciences, demanding a higher return on its investments, which should keep resulting in very high investment yields. We believe that Horizon is one of the highest-quality BDCs amongst its competitors. Stemming from the potential for tiny valuation tailwinds and the 10.4% yield, we forecast annualized returns of 10.3% through 2028. Accordingly, we rate shares a buy at current prices. The stock's monthly dividends are likely to be appreciated by income-oriented investors.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	7.09	20.50	14.97	-1.76	12.40	14.90	21.30	14.78	10.33	33.27
<b>SG&amp;A Exp.</b>	3.48	5.26	3.46	3.24	2.87	3.04	3.41	3.45	3.75	4.69
<b>Net Profit</b>	3.51	15.43	11.86	-4.91	9.59	13.01	19.50	11.00	6.36	27.78
<b>Net Margin</b>	49.5%	75.3%	79.2%	279.3%	77.3%	87.3%	91.5%	74.4%	61.6%	83.5%
<b>Free Cash Flow</b>	6.50	36.68	-31.33	52.31	-14.84	-12.06	-51.41	-4.02	-25.28	-75.99
<b>Income Tax</b>	0.24	0.16	---	-0.09	0.03	0.03	0.24	0.34	0.22	0.40

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	263.74	225.20	280.90	239.25	234.15	266.75	344.00	197.81	407.16	513.95
<b>Cash &amp; Equivalents</b>	25.34	8.42	20.77	37.14	6.59	12.59	6.47	1.30	19.50	38.05
<b>Total Liabilities</b>	127.90	86.95	121.15	100.06	99.07	132.49	159.95	67.93	194.56	268.62
<b>Accounts Payable</b>	3.32	3.32	3.98	3.45	3.46	3.46	4.67	0.00	5.79	6.37
<b>Long-Term Debt</b>	122.34	81.75	114.95	95.60	94.08	126.85	152.05	64.57	185.8	257.61
<b>Total Equity</b>	135.84	138.25	159.75	139.19	135.08	134.26	184.06	129.88	212.60	245.34
<b>LTD/E Ratio</b>	0.90	0.59	0.72	0.69	0.70	0.94	0.83	0.50	0.87	1.05

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	1.4%	6.3%	4.7%	-1.9%	4.1%	5.2%	6.4%	6.8%	1.7%	6.0%
<b>Return on Equity</b>	2.5%	11.3%	8.0%	-3.3%	7.0%	9.7%	12.3%	11.6%	3.2%	12.1%
<b>ROIC</b>	1.4%	6.5%	4.8%	-1.9%	4.1%	5.3%	6.5%	6.9%	1.7%	6.2%
<b>Shares Out.</b>	9.58	9.62	11.18	11.54	11.52	11.53	13.48	7.61	17.53	20.03
<b>Revenue/Share</b>	0.74	2.13	1.34	-0.15	1.08	1.29	1.58	1.94	0.59	1.66
<b>FCF/Share</b>	0.68	3.81	-2.80	4.53	-1.29	-1.05	-3.81	-0.53	-1.44	-3.79

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

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