



Hercules Capital Inc. (HTGC)

Updated February 27th, 2023 by Samuel Smith

Key Metrics

Current Price:	\$15.7	5 Year CAGR Estimate:	6.7%	Market Cap:	\$1.8B
Fair Value Price:	\$12.8	5 Year Growth Estimate:	0.7%	Ex-Dividend Date:	03/01/23
% Fair Value:	122%	5 Year Valuation Multiple Estimate:	-3.9%	Dividend Payment Date:	03/09/23
Dividend Yield:	12.0%	5 Year Price Target	\$13	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Hercules Capital markets itself as the largest specialty finance company in the United States. The company focuses on providing senior secured venture growth loans to high-growth, innovative VC-backed companies in the sectors of technology, life sciences, and renewable energy. Since Hercules Capital's inception in December of 2003, the company has committed billions of dollars to scores of companies. Headquartered in Palo Alto, California, Hercules Capital trades on the New York Stock Exchange with a market capitalization of \$1.8 billion. Hercules Capital owns primarily debt securities as well as some equity securities and warrants.

HTGC announced its Q4 results on February 16th, 2023. The company's GAAP EPS for the quarter was \$0.47, beating estimates by \$0.06. The total investment income was \$100.2M, which is a 38.3% year-over-year increase, and exceeded expectations by \$9.36M. The NII for Q4 2022 provided a coverage of 121% of the recently increased base distribution. Additionally, there was an undistributed earnings spillover of \$124.6 million, which is equivalent to \$0.94 per ending share outstanding. The company's assets under management increased by 29.3% year-over-year, amounting to over \$3.6 billion.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$1.63	\$1.10	\$0.59	\$0.91	\$0.97	\$0.83	\$0.80	\$1.39	\$1.29	\$1.48	\$1.85	\$1.82
BVPS	\$10.51	\$10.18	\$9.94	\$9.90	\$9.96	\$9.90	\$10.55	\$11.26	\$11.45	\$10.45	\$10.70	\$11.07
DPS	\$1.07	\$1.22	\$1.22	\$1.23	\$1.23	\$1.24	\$1.24	\$1.38	\$1.55	\$2.04	\$1.88	\$1.58
Shares¹	62.6	64.7	72.6	82.8	85.0	96.1	110.4	114.7	118.7	135.5	135.5	152

Hercules Capital's earnings-per-share have been remarkably volatile over the last decade. Accordingly, we believe it is more meaningful to assess the company's growth in net worth, which we measure using book value per common share (BVPS in the table above). As you can see, the company's net worth has been volatile. Because of this, we are taking a very conservative approach and assuming that Hercules Capital's book value per share will only slightly increase for the foreseeable future.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	23.0	20.9	22.4	20.6	24.2	18.5	16.8	9.1	14.0	11.5	8.5	10
Avg. P/B	1.3	1.5	1.3	1.3	1.4	1.3	1.3	1.2	1.6	1.4	1.5	1.20
Avg. Yld.	2.9%	5.3%	9.2%	6.6%	5.2%	8.1%	9.2%	10.9%	7.4%	10.1%	12.0%	11.9%

Given Hercules Capital's volatile earnings-per-share history, we believe that measuring the security's valuation using the price-to-book ratio is a much more reasonable approach than the traditional price-to-earnings ratio. As the table above indicates, Hercules Capital's average price-to-book ratio has fluctuated between 1.2 and 1.6 over the last decade.

¹ In millions

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Hercules Capital's current price-to-book ratio is 1.5 and the company's current dividend yield is 12%. The company's long-term average price-to-book ratio suggests that the company is overvalued at current prices, and we therefore expect the price-to-book value to return to near 1.2 over a 5-year holding period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

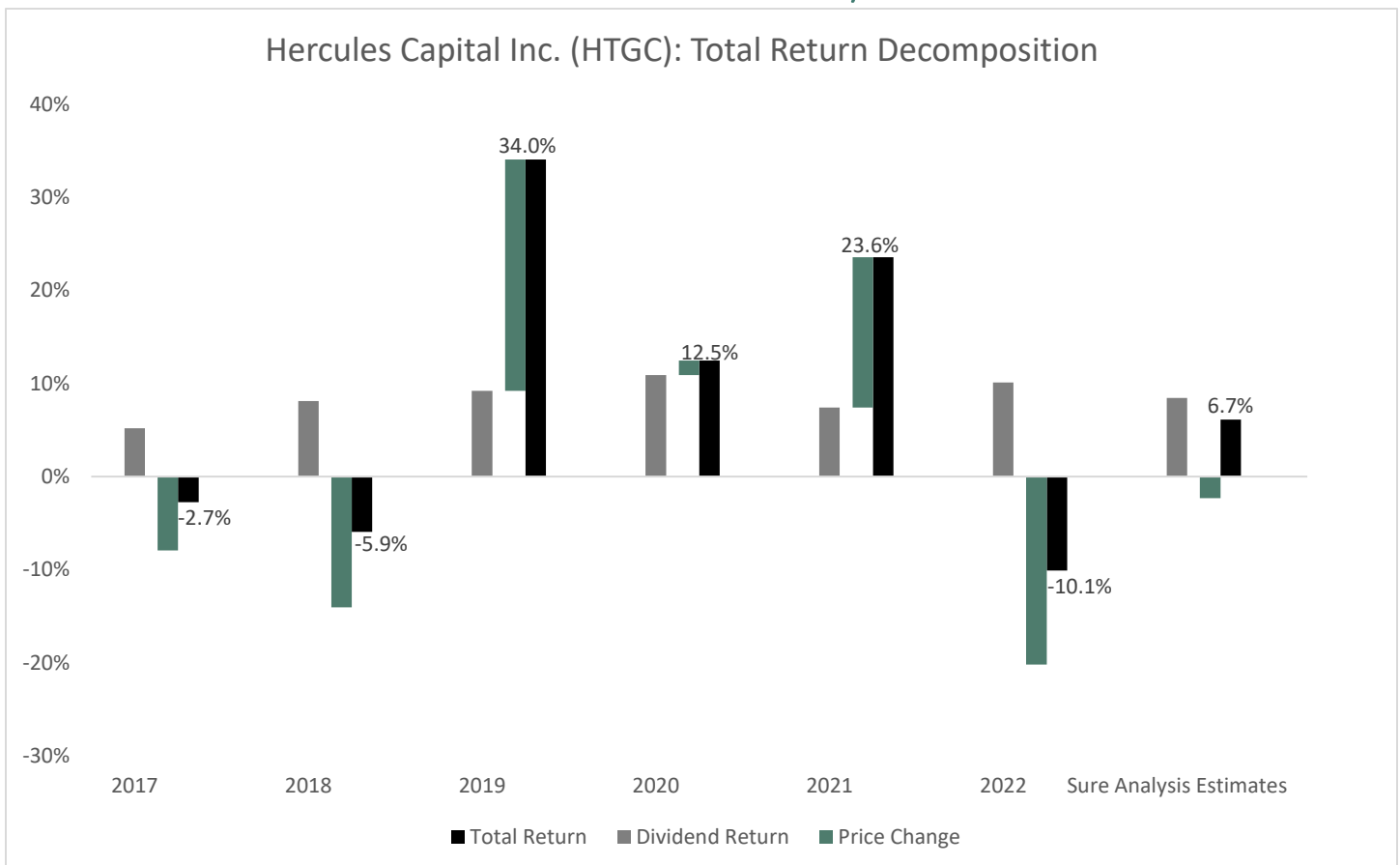
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	66%	111%	207%	135%	127%	149%	155%	99%	120%	138%	102%	87%

Hercules Capital's business model of lending to early-stage, high-growth companies is far from the most recession-resistant operation in our investment universe. With that said, we are modestly encouraged by the firm's prudent capital structure as it has one of the lower debt to equity ratios in the sector and has a history of allocating capital effectively. While we expect it to take a hit in a severe recession and almost certainly will be forced to cut its dividend, we still expect it to avoid the steep equity losses suffered by many of its peers.

Final Thoughts & Recommendation

Hercules Capital has a solid track record compared to other business development companies and offers investors decent total return potential at current prices due to the 12% dividend yield currently being offered. That said, there is not much margin for error should the heavily leveraged business model encounter any challenges. As a result, while we rate the stock a Hold given its 6.7% annualized total return potential and attractive dividend yield, we recommend that conservative dividend growth investors steer clear for now.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2021
Revenue	76	136	115	96	111	136	136	244	298	260
SG&A Exp.	8	9	10	17	16	16	15	19	19	16
Net Profit	47	99	71	43	69	79	76	174	227	174
Net Margin	61.3%	73.3%	61.9%	44.8%	61.7%	58.3%	56.2%	71.3%	76.3%	66.9%
Free Cash Flow	(194)	103	(27)	(115)	(139)	(19)	(249)	(241)	208	129

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2021
Total Assets	1,124	1,222	1,299	1,324	1,464	1,655	1,945	2,462	2,624	2,600
Cash & Equivalents	183	268	227	95	13	91	34	64	198	133
Total Liabilities	608	572	640	607	676	814	990	1,329	1,332	1,291
Long-Term Debt	596	557	626	590	655	787	964	1,299	1,296	1,244
Shareholder's Equity	516	650	659	717	788	841	955	1,133	1,292	1,309
LTD/E Ratio	1.16	0.86	0.95	0.82	0.83	0.94	1.01	1.15	1.00	0.95

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2021
Return on Assets	5.0%	8.5%	5.6%	3.3%	4.9%	5.1%	4.2%	7.9%	8.9%	6.7%
Return on Equity	9.9%	17.1%	10.9%	6.2%	9.1%	9.7%	8.5%	16.6%	18.7%	13.4%
ROIC	5.1%	8.6%	5.7%	3.3%	5.0%	5.1%	4.3%	8.0%	9.1%	6.8%
Shares Out.	61.7	62.6	64.7	72.6	82.8	85.0	96.1	110.4	114.7	118.7
Revenue/Share	1.55	2.25	1.82	1.37	1.51	1.64	1.49	2.40	2.65	2.24
FCF/Share	(3.95)	1.71	(0.42)	(1.64)	(1.88)	(0.23)	(2.74)	(2.38)	1.85	1.11

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

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