



New Mountain Finance Corp. (NMFC)

Updated March 2nd, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$12.67	5 Year CAGR Estimate:	9.2%	Market Cap:	\$1.28 B
Fair Value Price:	\$13.30	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	03/16/2023
% Fair Value:	95%	5 Year Valuation Multiple Estimate:	1.0%	Dividend Payment Date:	03/31/2023
Dividend Yield:	10.1%	5 Year Price Target	\$13.30	Years Of Dividend Growth:	2
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

New Mountain Finance Corp. is a BDC (Business Development Company) specializing in financing quality, middle-stage businesses that display “defensive growth” characteristics. Its businesses typically generate anywhere from \$10-\$200 million of EBITDA, to which NMFC provides senior secured debt, including 1st lien, 2nd lien, and uni-tranche loans. Its portfolio consists of 108 individual investments, the top 15 of which represent around \$1.25 billion worth of equity stake or 38.6% of its investments. In terms of its key industry exposures, around 26.7% of its investments operate in the enterprise software industry, 17.7% in business services, and another significant 16.3% of its capital is allocated to healthcare. For management to align its interest with shareholders, around 9% of the company’s shares are owned by its employees, showcasing strong insider confidence. New Mountain Finance generated nearly \$295 million of gross investment income last year and is based in New York, New York.

On February 27th, 2023, the company reported its Q4-2022 and full-year results for the period ending December 31st, 2022. During the quarter, the company generated a net investment income per share of \$0.25, seven cents lower compared to the previous quarter.

Overall, operations remained very stable, and management reiterated that the company is well-positioned to continue finding opportunities in “defensive growth” industries. Management also mentioned they remain confident that net investment income per share will meet or exceed the company’s raised quarterly dividend for the foreseeable future. Finally, the company introduced a supplemental dividend program to ensure it is optimizing its ability to return capital to shareholders in 2023. No supplemental dividends have been declared thus far this year, nonetheless.

Due to the value of some of its equity positions depreciating, NAV/share fell by 1.4% to \$13.02 during the quarter. We now forecast FY2023 IIS/share of \$1.40.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
IIS¹	\$1.76	\$0.88	\$0.55	\$1.72	\$1.47	\$0.95	\$1.32	\$0.60	\$2.08	\$0.75	\$1.40	\$1.40
DPS	\$1.48	\$1.48	\$1.36	\$1.36	\$1.36	\$1.36	\$1.36	\$1.24	\$1.20	\$1.22	\$1.28	\$1.28
Shares²	35	52	60	65	74	76	85	97	97	97	100	140

BDCs tend to specialize and allocate capital in the niche industry they have the most expertise. New Mountain Finance focuses on ‘defensive growth’ industries, allocating capital to companies that they understand well and can produce relatively resilient cash flows. With rates hovering near 0% until recent years, financing had become cheaper than ever. This was especially the case with defensive industries in which NMFC specializes, as they can attract low-cost capital, gradually lowering NMFC’s investment spreads. For context, the company’s portfolio used to yield 10.3% back in Q3 2018. This figure was slowly but gradually falling, standing at 8.8% in Q1 2022. Consequently, the company generated declining returns over time, resulting in small dividend cuts over the years. Rates are now on the rise, resulting in

¹ Investment Income per Share

² Share count is in millions.

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NMFC's portfolio yield jumping to 11.7% in Q4 2022. We expect no growth in IIS or the dividend moving forward, as they are already starting off a high base which could sway either way in the medium-term amid future macro developments.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/IIS	8.52	16.45	26.3	8.2	9.21	14.2	10.3	15.0	6.5	16.1	9.1	9.5
Avg. Yld.	9.1%	10.0%	9.4%	11.8%	9.3%	10.3%	10.0%	10.0%	8.8%	10.0%	10.1%	9.6%

Following New Mountain's most recent dividend increase, the company now trades with a yield of 10.1%. That's in line with its industry peers these days. We have set our fair P/IIS at 9.5X, which implies that shares could be slightly undervalued at their current levels. The most recent dividend hike and the fact the company's portfolio focuses on defensive-growth industries should attract investor interest in the stock. Shares trade below their NAV as well.

Safety, Quality, Competitive Advantage, & Recession Resiliency

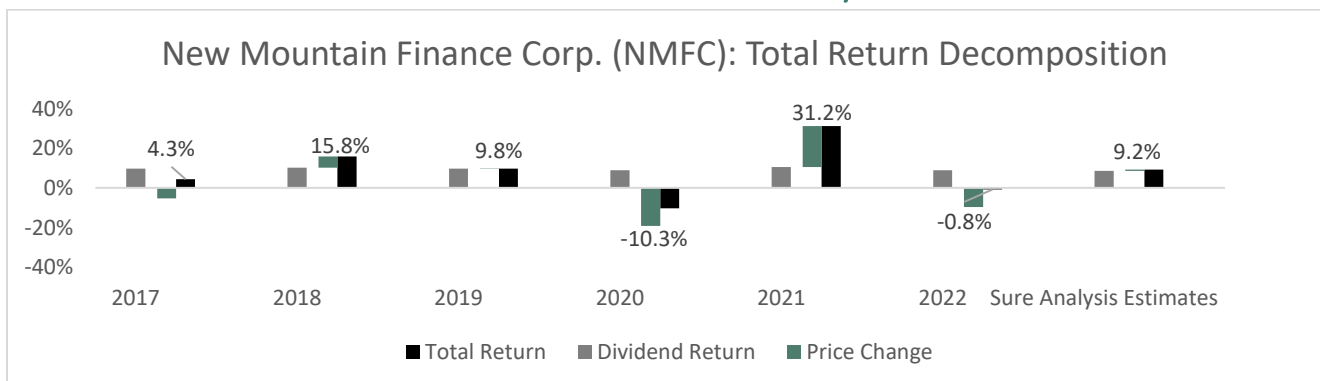
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	84%	168%	247%	79%	93%	143%	103%	207%	58%	163%	91%	91%

New Mountain's payout ratio has become a bit more uncomfortable compared to the company's earlier years, primarily due to poorer available credit opportunities. However, considering that its portfolio is well-diversified, with its more heavily weighted sectors (software and healthcare) performing well during the pandemic, we expect its medium-term results to remain relatively stable. This was adequately displayed during FY2020, during which the company produced a slightly increased net investment income. The most substantial risk we can identify is NMFC's sky-high cost of equity, similar to its peers. New Mountain has been issuing stock to fund its investments. While its investment yield has now recovered substantially following rising interest rates, NMFC's cost of equity remains very high. Thus, management is likely to favor additional debt issuance compared to shares. This could increase the company's leverage over time, incurring additional credit risks. NMFC's leverage currently stands at 1.29X, compared to 1.23X last year.

Final Thoughts & Recommendation

Despite New Mountain's business model being hurt by low rates in the past, which led to dividend cuts, the company has generated consistently positive returns for its shareholders. With rates now on the rise, investment income per share has already moved notably higher. While some fundamental risks regarding NMFC's investment yields persist, we like the company's diversified portfolio and favorable sector exposure. Additionally, we believe that management's substantial skin in the game increases investors' safety margins, aligning both parties' interests. We forecast annualized returns of 9.2% in the medium-term. Accordingly, we rate shares a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	102.28	71.24	35.68	113.0	109.97	75.81	109.12	56.90	203.7
SG&A Exp.		5.00	7.33	7.36	8.07	10.04	8.91	9.79	9.58
Net Profit	61.92	45.58	32.96	111.68	109.40	72.35	112.56	58.47	201.4
Net Margin	60.5%	64.0%	92.4%	98.8%	99.5%	95.4%	103.2%	102.7%	98.9%
Free Cash Flow	-49.88	-289.6	-63.3	60.5	-166.3	-393.5	-718.5	301.1	-22.1
Income Tax	---	0.93	1.34	-0.49	0.42	0.40	0.00	-0.99	0.23

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	650.11	1514.9	1588.1	1656.0	1928.0	2448.7	3266.1	3098	3296
Cash & Equivalents	0.00	23.45	30.10	45.93	34.94	49.66	48.57	78.97	58.08
Total Liabilities	0.0	712.7	751.2	717.5	893.0	1442.4	1982.6	1861	1953
Accounts Payable	0.00	27.81	7.78	5.91	5.11	32.54	18.26	42.43	25.30
Long-Term Debt	0.00	670.6	728.1	696.7	869.5	1384.1	1942.3	1798	1907
Total Equity	650.1	802.2	836.9	938.6	1035.0	1006.3	1283.5	1222	1321
LTD/E Ratio	0.00	0.84	0.87	0.74	0.84	1.38	1.51	1.47	1.44

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	12.4%	4.2%	2.1%	6.9%	6.1%	3.3%	3.9%	1.8%	6.3%
Return on Equity	12.5%	6.3%	4.0%	12.6%	11.1%	7.1%	9.8%	4.7%	15.8%
ROIC	12.5%	4.3%	2.2%	7.0%	6.2%	3.4%	4.0%	1.9%	6.4%
Shares Out.	35.09	56.16	66.97	72.86	84.00	88.63	100.46	110.08	110.21
Revenue/Share	2.91	1.27	0.53	1.55	1.31	0.86	1.09	0.52	1.85
FCF/Share	-1.42	-5.16	-0.95	0.83	-1.98	-4.44	-7.15	2.74	-0.20

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

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