



Horizon Technology Finance Corp. (HRZN)

Updated May 7th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$11.62	5 Year CAGR Estimate:	14.0%	Market Cap:	\$333.0 M
Fair Value Price:	\$15.77	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	05/17/2023
% Fair Value:	74%	5 Year Valuation Multiple Estimate:	6.3%	Dividend Payment Date:	06/14/2023
Dividend Yield:	11.4%	5 Year Price Target	\$15.77	Years Of Dividend Growth:	2
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	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 45%, 39%, 12%, and 4% 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 15.5%. 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 May 2nd, 2023, Horizon released its Q1 results for the period ending March 31st, 2023. For the quarter, total investment income grew 97% year-over-year to \$28.0 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 \$0.46, 77% higher compared to Q1-2023. Net asset value (NAV) per share landed at \$11.34, 1.1% lower sequentially or 2.9% lower year-over-year. After paying its monthly distributions, Horizon's undistributed spillover income as of March 31st was \$0.81 per share, indicating a considerable cash cushion.

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 \$1.66.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
IIS¹	\$1.38	\$1.11	\$1.25	\$1.48	\$1.07	\$1.20	\$1.52	\$1.18	\$1.41	\$1.46	\$1.66	\$1.66
DPS	\$1.38	\$1.38	\$1.38	\$1.38	\$1.20	\$1.20	\$1.20	\$1.25	\$1.25	\$1.28	\$1.32	\$1.32
Shares²	9.6	9.6	11.2	11.5	11.5	11.5	13.5	17.5	20	24.7	28.4	50.0

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.

¹ Investment Income per share

² 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	7.0	9.5
Avg. Yld.	9.9%	9.6%	13.8%	11.8%	10.9%	11.4%	10.2%	10.2%	7.8%	9.4%	11.4%	8.4%

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 9.5, which is quite close to the stock's historical average. The stock appears to be trading slightly above its NAV, though a small premium is deserved amid Horizon's unique qualities.

Safety, Quality, Competitive Advantage, & Recession Resiliency

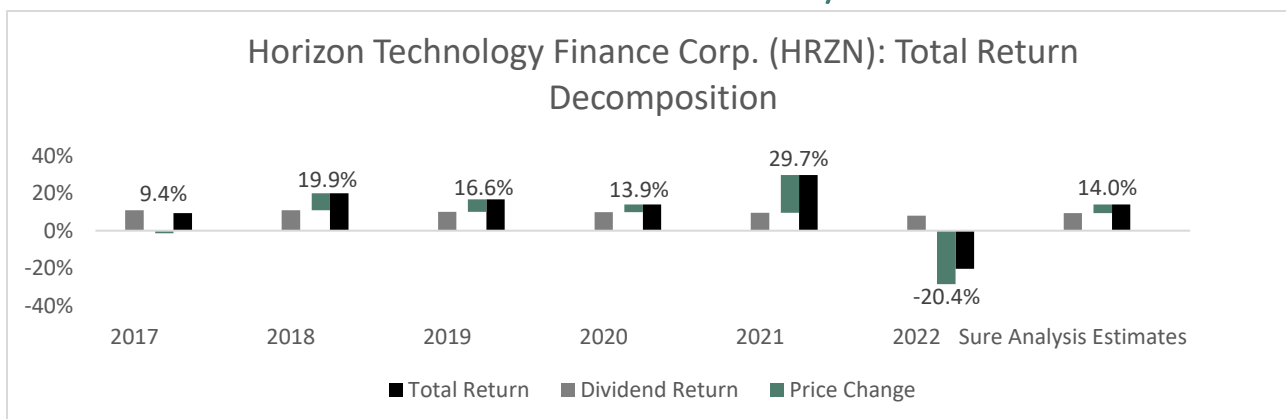
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	100%	124%	110%	93%	112%	100%	79%	106%	89%	88%	80%	80%

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 \$110 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 1.37, slightly above Horizon's 0.8-1.2 targeted leverage range. The asset coverage ratio for borrowed amounts was about 170%, 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 11.4% yield, we forecast annualized returns of 14.0% 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	20.50	14.97	-1.76	12.40	14.90	21.30	14.78	10.33	33.27	
SG&A Exp.	5.26	3.46	3.24	2.87	3.04	3.41	3.45	3.75	4.69	
Net Profit	15.43	11.86	-4.91	9.59	13.01	19.50	11.00	6.36	27.78	
Net Margin			279.3							
	75.3%	79.2%	%	77.3%	87.3%	91.5%	74.4%	61.6%	83.5%	
Free Cash Flow	36.68	-31.33	52.31	-14.84	-12.06	-51.41	-4.02	-25.28	-75.99	
Income Tax	0.16	---	-0.09	0.03	0.03	0.24	0.34	0.22	0.40	

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	225.20	280.90	239.25	234.15	266.75	344.00	197.81	407.16	513.95	
Cash & Equivalents	8.42	20.77	37.14	6.59	12.59	6.47	1.30	19.50	38.05	
Total Liabilities	86.95	121.15	100.06	99.07	132.49	159.95	67.93	194.56	268.62	
Accounts Payable	3.32	3.98	3.45	3.46	3.46	4.67	0.00	5.79	6.37	
Long-Term Debt	81.75	114.95	95.60	94.08	126.85	152.05	64.57	185.8	257.61	
Total Equity	138.25	159.75	139.19	135.08	134.26	184.06	129.88	212.60	245.34	
LTD/E Ratio	0.59	0.72	0.69	0.70	0.94	0.83	0.50	0.87	1.05	

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	6.3%	4.7%	-1.9%	4.1%	5.2%	6.4%	6.8%	1.7%	6.0%	
Return on Equity	11.3%	8.0%	-3.3%	7.0%	9.7%	12.3%	11.6%	3.2%	12.1%	
ROIC	6.5%	4.8%	-1.9%	4.1%	5.3%	6.5%	6.9%	1.7%	6.2%	
Shares Out.	9.62	11.18	11.54	11.52	11.53	13.48	7.61	17.53	20.03	
Revenue/Share	2.13	1.34	-0.15	1.08	1.29	1.58	1.94	0.59	1.66	
FCF/Share	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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