



Prospect Capital Corporation (PSEC)

Updated February 24th, 2024, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|--------|--|--------|----------------------------------|----------|
| Current Price: | \$5.74 | 5 Year CAGR Estimate: | 8.6% | Market Cap: | \$2.4 B |
| Fair Value Price: | \$6.97 | 5 Year Growth Estimate: | -5.0% | Ex-Dividend Date: | 02/26/24 |
| % Fair Value: | 82% | 5 Year Valuation Multiple Estimate: | 4.0% | Dividend Payment Date: | 03/20/24 |
| Dividend Yield: | 12.5% | 5 Year Price Target | \$5.39 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Rating: | Hold |

Overview & Current Events

Prospect Capital Corporation is a business development company, or BDC. It provides private debt and private equity to middle-market companies in the U.S. The company focuses on direct lending to owner-operated companies, as well as sponsor-backed transactions. Prospect invests primarily in first and second lien senior loans and mezzanine debt, with occasional equity investments. The company went public in 2004 and currently has a market capitalization of \$2.4 billion. Prospect produces just under \$900 million in annual revenue.

We note that Prospect has had to file amended 1099 tax forms at times in the past, causing additional work for those that own shares when filing taxes for dividends received from the company.

Prospect posted second quarter earnings on February 8th, 2024, and results were somewhat weak once again. Net investment income per share, which is akin to earnings-per-share for other companies, came to 24 cents. That was off three cents from the year-ago period. Total investment income, which is PSEC's measure of revenue, was \$211 million. That was down fractionally year-over-year from \$213 million.

Net asset value per share declined from the first quarter from \$9.25 to \$8.92.

Total originations rose to \$172 million for the quarter, which was up from \$131 million in Q1. The company noted for the third quarter-to-date, originations were \$63 million. Total repayments were \$131 million in the quarter, up from \$94 million in Q1. Total repayments to-date are \$22 million, implying net originations of +\$41 million so far in Q3.

We have updated our estimate to 82 cents in NII per-share, noting that despite net positive originations, PSEC is struggling with generating earnings growth.

Growth on a Per-Share Basis

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| NII | \$1.19 | \$1.03 | \$1.04 | \$0.85 | \$0.79 | \$0.79 | \$0.72 | \$0.75 | \$0.75 | \$0.89 | \$0.82 | \$0.63 |
| DPS | \$1.32 | \$1.19 | \$1.00 | \$1.00 | \$0.77 | \$0.72 | \$0.72 | \$0.72 | \$0.72 | \$0.72 | \$0.72 | \$0.62 |
| Shares¹ | 343 | 359 | 357 | 360 | 364 | 367 | 374 | 389 | 392 | 402 | 408 | 425 |

Growth has been tough to come by for Prospect in the past decade. The company weathered the financial crisis quite well – 2010 results excluded – but since 2012, net investment income has struggled. Part of this is due to Prospect's prodigious share count, which is much higher today what it was a decade ago. While it is typical for a BDC to issue shares to fund acquisitions, Prospect's dilution has been excessive at times. Given this history of dilution and weak net investment income performance, we expect -5% annual growth on a per-share basis.

Prospect has had additional trouble growing net investment income because its balance sheet has slowly grown smaller over time. The company's total assets are ~\$8 billion today, after having expanded rapidly in recent quarters.

The company's dividend has also shrunk over time as this year's payout of \$0.72 is less than half the value of the dividend from before the financial crisis. Shrinking net investment income has taken its toll on the company's ability to finance the dividend. We see the dividend potentially declining as NII barely covers the payout today. Prospect has

¹ Share count 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.



Prospect Capital Corporation (PSEC)

Updated February 24th, 2024, by Josh Arnold

funded deficits in its NII in the past, and we are still cautious on its ability to fund the dividend at current levels. However, the company has made it clear it intends to defend the payout. Prospect can cover it for now, but if projected earnings declines worsen, that could change.

Valuation Analysis

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Now | 2029 |
|------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Avg. P/NII | 8.8 | 6.9 | 9.9 | 8.7 | 8.0 | 8.2 | 8.2 | 8.5 | 9.3 | 7.0 | 7.0 | 8.5 |
| Avg. Yld. | 13.1% | 13.8% | 11.8% | 11.3% | 10.6% | 12.1% | 12.1% | 11.3% | 10.3% | 11.6% | 12.5% | 11.5% |

Prospect's price to net investment income has averaged ~8 in the past decade. We see fair value as 8.5 times net investment income given that the company's growth outlook has improved slightly with higher rates. We see a tailwind to total annual returns from the valuation moving higher over time from today's 7.

The company's current dividend yield is 12.5%, which is somewhat higher than its historical average. We forecast the yield declining to 11.5%, which would result from a potentially lower dividend payout over time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 111% | 116% | 96% | 118% | 97% | 85% | 100% | 96% | 90% | 81% | 88% | 97% |

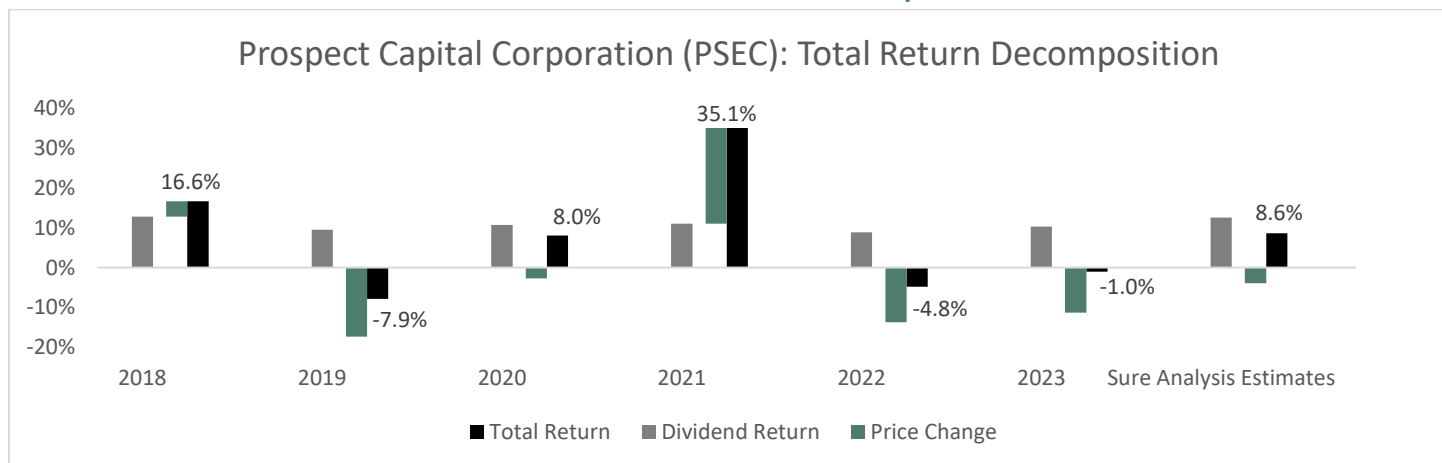
One of the issues with business development companies is that competitive advantages are very difficult to come by, and Prospect is certainly no exception. Scale is the name of the game for BDCs and with a stagnant balance sheet, Prospect has lost some of its relative scale over time. That began to reverse given Q2 2022 results, however, and total assets are reaching new highs again.

The company's payout ratio was over 100% for several years in the past decade but is slightly under that now given the higher NII-per-share. The dividend is covered by earnings for now, but we see a weak growth outlook as potentially threatening the dividend over time.

Final Thoughts & Recommendation

Prospect Capital offers investors a huge yield, but it is not without its risks. The valuation is quite favorable, particularly considering the company's unfavorable growth outlook. The yield is strong as well. We are forecasting 8.6% in total returns in the coming years, consisting of the 12.5% yield, -5% growth, and a 4% tailwind from the valuation. We are downgrading the stock from buy to hold after the most recent quarter's results.

Total Return Breakdown by Year



[Click here to rate and review this research report. Your feedback is important to us.](#)

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.



Prospect Capital Corporation (PSEC)

Updated February 24th, 2024, by Josh Arnold

Income Statement Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------|---------|-------|-------|-------|-------|-------|--------|-------|-------|-------|
| Revenue | 346 | 379 | 137 | 284 | 326 | 199 | 37 | 1,008 | 635 | (50) |
| SG&A Exp. | 31 | 30 | 32 | 32 | 26 | 34 | 33 | 30 | 30 | 41 |
| Net Profit | 319 | 346 | 103 | 253 | 300 | 144 | -16 | 964 | 583 | (102) |
| Net Margin | 92.3% | 91.4% | 75.3% | 89.2% | 92.0% | 81.1% | -43.7% | 95.7% | 91.8% | -167% |
| Free Cash Flow | (1,725) | 45 | 862 | 376 | 369 | 224 | 429 | 31 | (795) | (221) |

Balance Sheet Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 6,477 | 6,798 | 6,236 | 6,173 | 5,839 | 5,800 | 5,300 | 6,303 | 7,663 | 7,862 |
| Cash & Equivalents | 134 | 110 | 318 | 318 | 84 | 107 | 45 | 64 | 35 | 91 |
| Total Liabilities | 2,859 | 3,095 | 2,800 | 2,818 | 2,432 | 2,494 | 2,244 | 2,358 | 3,544 | 4,129 |
| Accounts Payable | 75 | 70 | 71 | 69 | 56 | 56 | 51 | 51 | 50 | 54 |
| Long-Term Debt | 2,773 | 2,984 | 2,667 | 2,642 | 2,312 | 2,383 | 2,138 | 2,233 | 2,737 | 2,585 |
| Shareholder's Equity | 3,618 | 3,703 | 3,436 | 3,355 | 3,407 | 3,306 | 3,056 | 3,808 | 4,119 | 3,733 |
| LTD/E Ratio | 0.77 | 0.81 | 0.78 | 0.79 | 0.68 | 0.72 | 0.70 | 0.57 | 0.66 | 0.69 |

Profitability & Per Share Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|------------------|--------|------|------|------|------|------|-------|-------|--------|--------|
| Return on Assets | 5.8% | 5.2% | 1.6% | 4.1% | 5.0% | 2.5% | -0.3% | 16.6% | 8.3% | -1.3% |
| Return on Equity | 10.2% | 9.5% | 2.9% | 7.4% | 8.9% | 4.3% | -0.5% | 28.1% | 14.7% | -2.6% |
| ROIC | 5.9% | 5.3% | 1.6% | 4.2% | 5.1% | 2.5% | -0.3% | 17.0% | 8.9% | -1.5% |
| Shares Out. | 343 | 359 | 357 | 360 | 364 | 367 | 374 | 389 | 434 | 399 |
| Revenue/Share | 1.15 | 1.07 | 0.39 | 0.79 | 0.90 | 0.54 | 0.10 | 2.61 | 1.46 | (0.13) |
| FCF/Share | (5.75) | 0.13 | 2.42 | 1.05 | 1.02 | 0.61 | 1.17 | 0.08 | (1.83) | (0.55) |

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

Disclaimer

Nothing presented herein is, or is intended to constitute, specific investment advice. Nothing in this research report should be construed as a recommendation to follow any investment strategy or allocation. Any forward-looking statements or forecasts are based on assumptions and actual results are expected to vary from any such statements or forecasts. No reliance should be placed on any such statements or forecasts when making any investment decision. While Sure Dividend has used reasonable efforts to obtain information from reliable sources, we make no representations or warranties as to the accuracy, reliability or completeness of third-party information presented herein. No guarantee of investment performance is being provided and no inference to the contrary should be made. There is a risk of loss from an investment in marketable securities. Past performance is not a guarantee of future performance.