



# Horizon Technology Finance Corp. (HRZN)

Updated March 10<sup>th</sup>, 2023 by Nikolaos Sismanis

## Key Metrics

<b>Current Price:</b>	\$11.76	<b>5 Year CAGR Estimate:</b>	9.7%	<b>Market Cap:</b>	\$392.8 M
<b>Fair Value Price:</b>	\$12.08	<b>5 Year Growth Estimate:</b>	0.0%	<b>Ex-Dividend Date:</b>	03/18/2024
<b>% Fair Value:</b>	97%	<b>5 Year Valuation Multiple Estimate:</b>	0.5%	<b>Dividend Payment Date:</b>	04/16/2024
<b>Dividend Yield:</b>	11.2%	<b>5 Year Price Target</b>	\$12.08	<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 technology, life sciences, sustainability, and healthcare-IT sectors, which account for around 39%, 38%, 14%, and 9% 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 16.6%. 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 27<sup>th</sup>, 2024, Horizon released its Q4 and full-year results for the period ending December 31<sup>st</sup>, 2023. For the quarter, total investment income grew 21.8% year-over-year to \$28.2 million, primarily due to growth in interest and fee income on investments resulting from an increase in the average size of the debt investment portfolio. The increase in interest rates was the main reason for the increase in interest income.

Net investment income per share (IIS) rose to \$0.45, up from \$0.40 compared to Q4-2022. For the year, IIS/share reached a record of \$1.98. Net asset value (NAV) per share landed at \$9.71, 6.7% lower sequentially or 15.3% lower year-over-year. After paying its monthly distributions, Horizon's undistributed spillover income as of December 31<sup>st</sup>, 2023 was \$1.25 per share, indicating a considerable cash cushion. Management reassured investors of the dividend's stability by declaring three forward monthly dividends at a rate of \$0.11. Our initial, prudent assumptions see FY2024 IIS/share of \$1.51. The company also announced a special dividend of \$0.05, payable in April. Thus, FY2024's DPS should be at least \$1.37.

## Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
<b>IIS<sup>1</sup></b>	\$1.11	\$1.25	\$1.48	\$1.07	\$1.20	\$1.52	\$1.18	\$1.41	\$1.46	\$1.98	<b>\$1.51</b>	<b>\$1.51</b>
<b>DPS</b>	\$1.38	\$1.38	\$1.38	\$1.20	\$1.20	\$1.20	\$1.25	\$1.25	\$1.28	\$1.37	<b>\$1.32</b>	<b>\$1.32</b>
<b>Shares<sup>2</sup></b>	9.6	11.2	11.5	11.5	11.5	13.5	17.5	20.0	24.7	31.0	<b>31.0</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 2029,

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

<sup>2</sup> Share count is in millions.

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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 see no DPS growth from Horizon's base rate of \$1.32 through 2029.

## Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	13.1	8.4	7.1	9.7	9.4	9.9	9.3	11.3	9.3	5.6	7.8	8.0
Avg. Yld.	9.6%	13.8%	11.8%	10.9%	11.4%	10.2%	10.2%	7.8%	9.4%	12.5%	11.2%	10.9%

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 above 16%, notably higher from 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 8.0, which is below the stock's historical average to account for a higher cost of equity lately. The stock appears to be trading above its NAV, though this is mostly due to its assets virtually declining in value due to higher interest rates.

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

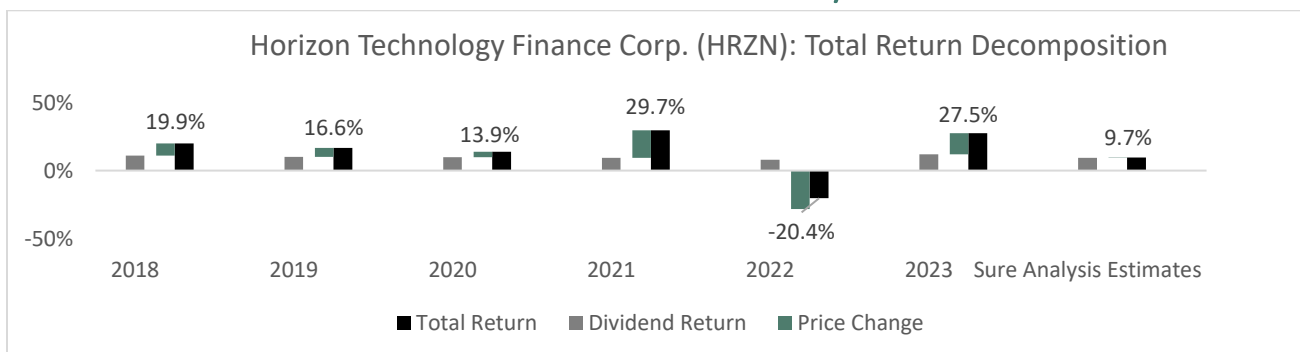
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	124%	110%	93%	112%	100%	79%	106%	89%	88%	69%	87%	87%

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 \$194.0 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 1.20, in line with 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 tiny valuation tailwinds and the 11.2% yield, we forecast annualized returns of 9.7% through 2029. Along with the idea that our FY2024 IIS/share is likely conservative, we rate shares a buy at current prices.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Revenue</b>	20.50	14.97	-1.76	12.40	14.90	21.30	14.78	10.33	33.27	26.64
<b>SG&amp;A Exp.</b>	5.26	3.46	3.24	2.87	3.04	3.41	3.45	3.75	4.69	4.78
<b>Net Profit</b>	15.43	11.86	-4.91	9.59	13.01	19.50	11.00	6.36	27.78	21.15
<b>Net Margin</b>	75.3%	79.2%	279.3%	77.3%	87.3%	91.5%	74.4%	61.6%	83.5%	79.4%
<b>Free Cash Flow</b>	36.68	-31.33	52.31	-14.84	-12.06	-51.41	-4.02	-25.28	-75.99	-246.3
<b>Income Tax</b>	0.16	---	-0.09	0.03	0.03	0.24	0.34	0.22	0.40	0.72

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Assets</b>	225.20	280.90	239.25	234.15	266.75	344.00	197.81	407.16	513.95	766.83
<b>Cash &amp; Equivalents</b>	8.42	20.77	37.14	6.59	12.59	6.47	1.30	19.50	38.05	20.61
<b>Total Liabilities</b>	86.95	121.15	100.06	99.07	132.49	159.95	67.93	194.56	268.62	448.38
<b>Accounts Payable</b>	3.32	3.98	3.45	3.46	3.46	4.67	0.00	5.79	6.37	9.16
<b>Long-Term Debt</b>	81.75	114.95	95.60	94.08	126.85	152.05	64.57	185.8	257.61	434.08
<b>Total Equity</b>	138.25	159.75	139.19	135.08	134.26	184.06	129.88	212.60	245.34	318.45
<b>LTD/E Ratio</b>	0.59	0.72	0.69	0.70	0.94	0.83	0.50	0.87	1.05	1.36

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Return on Assets</b>	6.3%	4.7%	-1.9%	4.1%	5.2%	6.4%	6.8%	1.7%	6.0%	3.3%
<b>Return on Equity</b>	11.3%	8.0%	-3.3%	7.0%	9.7%	12.3%	11.6%	3.2%	12.1%	7.5%
<b>ROIC</b>	6.5%	4.8%	-1.9%	4.1%	5.3%	6.5%	6.9%	1.7%	6.2%	3.4%
<b>Shares Out.</b>	9.62	11.18	11.54	11.52	11.53	13.48	7.61	17.53	20.03	24.73
<b>Revenue/Share</b>	2.13	1.34	-0.15	1.08	1.29	1.58	1.94	0.59	1.66	1.08
<b>FCF/Share</b>	3.81	-2.80	4.53	-1.29	-1.05	-3.81	-0.53	-1.44	-3.79	-9.96

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

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