



Horizon Technology Finance Corp. (HRZN)

Updated August 1st, 2024 by Nikolaos Sismanis

Key Metrics

Current Price:	\$11.64	5 Year CAGR Estimate:	9.2%	Market Cap:	\$419.7 M
Fair Value Price:	\$11.44	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	08/16/2024
% Fair Value:	102%	5 Year Valuation Multiple Estimate:	-0.3%	Dividend Payment Date:	09/13/2024
Dividend Yield:	11.3%	5 Year Price Target	\$11.44	Years Of Dividend Growth:	2
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

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 38%, 39%, 13%, and 10% 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 portfolio yield of 15.9%. 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 July 30th, 2024, Horizon released its Q2 results for the period ending June 31st, 2024. For the quarter, total investment income fell 8.5% year-over-year to \$25.7 million, primarily due to lower interest income on investments from the debt investment portfolio. More specifically, the company's dollar-weighted annualized yield on average debt investments in Q2 of 2024 and Q2 of 2023 was 15.9% and 16.3%, respectively.

Net investment income per share (IIS) fell to \$0.36, down from \$0.54 compared to Q2-2023. Net asset value (NAV) per share landed at \$9.12, down from \$9.91 sequentially. After paying its monthly distributions, Horizon's undistributed spillover income as of June 30th, 2024 was \$1.28 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 updated assumptions see FY2024 IIS/share of \$1.43. The company has paid special dividend of \$0.05 so far this year. No special dividends were announced in Q2. 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
IIS¹	\$1.11	\$1.25	\$1.48	\$1.07	\$1.20	\$1.52	\$1.18	\$1.41	\$1.46	\$1.98	\$1.43	\$1.43
DPS	\$1.38	\$1.38	\$1.38	\$1.20	\$1.20	\$1.20	\$1.25	\$1.25	\$1.28	\$1.37	\$1.32	\$1.32
Shares²	9.6	11.2	11.5	11.5	11.5	13.5	17.5	20.0	24.7	31.0	35.4	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 2029, 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.

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	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	8.1	8.0
Avg. Yld.	9.6%	13.8%	11.8%	10.9%	11.4%	10.2%	10.2%	7.8%	9.4%	12.5%	11.3%	11.5%

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

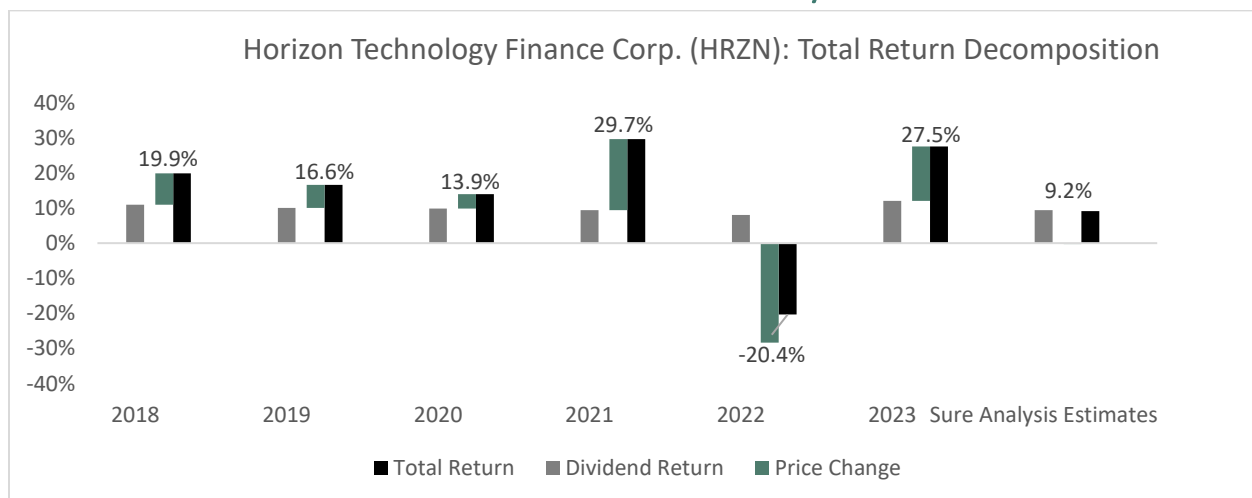
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	124%	110%	93%	112%	100%	79%	106%	89%	88%	69%	92%	92%

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 1.00, in line with Horizon's 0.8-1.2 targeted leverage range. The asset coverage ratio for borrowed amounts was about 174%, 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 continue to result in very high investment yields. We believe that Horizon is one of the highest-quality BDCs amongst its competitors. Stemming from the potential for a small valuation headwind and the 11.3% yield, we forecast annualized returns of 9.2% through 2029. We rate shares a hold at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	14.97	-1.76	12.40	14.90	21.30	14.78	10.33	33.27	26.64	-9.9
SG&A Exp.	3.46	3.24	2.87	3.04	3.41	3.45	3.75	4.69	4.78	5.7
Net Profit	11.86	-4.91	9.59	13.01	19.50	11.00	6.36	27.78	21.15	-17.2
Net Margin	79.2%	279.3%	77.3%	87.3%	91.5%	74.4%	61.6%	83.5%	79.4%	-174%
Free Cash Flow	-31.33	52.31	-14.84	-12.06	-51.41	-4.02	-25.28	-75.99	-246.3	-5.3
Income Tax	---	-0.09	0.03	0.03	0.24	0.34	0.22	0.40	0.72	1.5

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	280.90	239.25	234.15	266.75	344.00	197.81	407.16	513.95	766.83	802.4
Cash & Equivalents	20.77	37.14	6.59	12.59	6.47	1.30	19.50	38.05	20.61	46.6
Total Liabilities	121.15	100.06	99.07	132.49	159.95	67.93	194.56	268.62	448.38	478.4
Accounts Payable	3.98	3.45	3.46	3.46	4.67	0.00	5.79	6.37	9.16	11
Long-Term Debt	114.95	95.60	94.08	126.85	152.05	64.57	185.8	257.61	434.08	462
Total Equity	159.75	139.19	135.08	134.26	184.06	129.88	212.60	245.34	318.45	324
LTD/E Ratio	0.72	0.69	0.70	0.94	0.83	0.50	0.87	1.05	1.36	1.43

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	4.7%	-1.9%	4.1%	5.2%	6.4%	6.8%	1.7%	6.0%	3.3%	-2.2%
Return on Equity	8.0%	-3.3%	7.0%	9.7%	12.3%	11.6%	3.2%	12.1%	7.5%	-5.4%
ROIC	4.8%	-1.9%	4.1%	5.3%	6.5%	6.9%	1.7%	6.2%	3.4%	-2.2%
Shares Out.	11.18	11.54	11.52	11.53	13.48	7.61	17.53	20.03	24.73	30.96
Revenue/Share	1.34	-0.15	1.08	1.29	1.58	1.94	0.59	1.66	1.08	-0.32
FCF/Share	-2.80	4.53	-1.29	-1.05	-3.81	-0.53	-1.44	-3.79	-9.96	-0.17

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

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