



Gladstone Capital (GLAD)

Updated November 18th, 2024, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|----------|
| Current Price: | \$23 | 5 Year CAGR Estimate: | 6.7% | Market Cap: | \$579 M |
| Fair Value Price: | \$20 | 5 Year Growth Estimate: | 1.0% | Ex-Dividend Date: | 11/21/24 |
| % Fair Value: | 112% | 5 Year Valuation Multiple Estimate: | -2.3% | Dividend Payment Date: | 11/30/24 |
| Dividend Yield: | 8.6% | 5 Year Price Target | \$22 | Years Of Dividend Growth: | 2 |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Rating: | Hold |

Overview & Current Events

Gladstone Capital is a business development company, or BDC, that primarily invests in small and medium businesses. These investments are made via a variety of equity (10% of portfolio) and debt instruments (90% of portfolio), generally with very high yields. Loan size is typically in the \$7 million to \$30 million range and has terms up to seven years. The BDC's stated purpose is to generate income it can distribute to its shareholders. The company trades with a market capitalization of \$579 million and it pays distributions monthly, instead of quarterly.

Gladstone posted fourth quarter and full-year earnings on November 13th, 2024, and results were short of analyst estimates. Net investment income, which is akin to earnings, came to 50 cents per share. NII was expected to be 53 cents, and was down from 57 cents in the prior quarter. Total investment income, which is a revenue measure, came to \$23.7 million, down from \$25.7 million in the previous quarter.

Total repayments and net proceeds were \$12.6 million, down from \$86.4 million in the prior quarter. Total investments at fair value rose 5.1% quarter-over-quarter to \$796 million. Net asset value per common share was \$21.18 in September, up from \$20.18 in June. The net increase in assets resulting from operations was \$31.8 million, or \$1.46 per share. This was up from \$19.1 million, or 88 cents per share in the prior quarter. It was primarily attributable to \$20.8 million in net unrealized appreciation.

We start fiscal 2025 with an estimate of \$2.05 in NII per share, which would be down from \$2.11 if achieved.

Growth on a Per-Share Basis

| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2029 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| NII | \$1.68 | \$1.68 | \$1.68 | \$1.70 | \$1.68 | \$1.62 | \$1.58 | \$1.88 | \$2.20 | \$2.11 | \$2.05 | \$2.15 |
| DPS | \$1.68 | \$1.68 | \$1.68 | \$1.68 | \$1.68 | \$1.56 | \$1.56 | \$1.56 | \$1.92 | \$1.98 | \$1.98 | \$2.08 |
| Shares¹ | 10.55 | 11.6 | 12.75 | 13.55 | 14.65 | 16.5 | 17 | 17.55 | 21.8 | 22.3 | 24 | 30 |

Gladstone reports net investment income per share, or NII, instead of earnings-per-share, which is consistent with other BDCs. On that measure, the company's results have been lackluster in terms of growth over the past decade. Our estimate of \$2.05 for this year is roughly in line with historical NII. Gladstone's share issuances have funded higher NII in dollar terms but haven't earned enough above its cost of capital to move the needle on NII-per-share. We're currently looking for 1% annual NII-per-share growth from here.

The yields on the company's portfolio influence its ability to earn income and therefore, cover its expenses and pay distributions to shareholders. Over time, the company's portfolio yield has drifted higher to 14%. Despite the cost of funding rising as well, Gladstone has managed to increase its yield spreads. Gladstone's portfolio continues to grow in dollar terms, and the higher spreads on a larger portfolio is leading to earnings growth.

Gladstone's dividend had been at \$0.07 monthly, or \$0.84 annually, for many years. However, the current payout is up to \$1.98 annually after another raise in July 2023.

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.



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Valuation Analysis

| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Now | 2030 |
|------------|-------|-------|------|------|------|------|------|------|-------|------|-------------|-------------|
| Avg. P/NII | 10.0 | 9.1 | 11.4 | 10.7 | 10.8 | 10.2 | 12.7 | 9.0 | 8.8 | 11.4 | 11.2 | 10.0 |
| Avg. Yld. | 10.0% | 11.0% | 8.8% | 9.3% | 9.2% | 9.4% | 7.8% | 9.2% | 10.0% | 8.2% | 8.6% | 9.7% |

Gladstone has traded at a price-to-NII ratio very near 10.5 in the past decade, which is near where we assess fair value. At 11.2 times NII, the stock appears to be overvalued. We therefore see a modest negative impact to total returns from the valuation.

The yield is lower than it has been for most of the past decade; Gladstone’s average yield in the past decade has been close to 10%, and we see the yield with the potential to move slightly higher in the coming years, as the stock could see a valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2030 |
|--------|------|------|------|------|------|------|------|------|------|------|------------|------------|
| Payout | 100% | 100% | 100% | 99% | 100% | 96% | 99% | 83% | 87% | 94% | 97% | 97% |

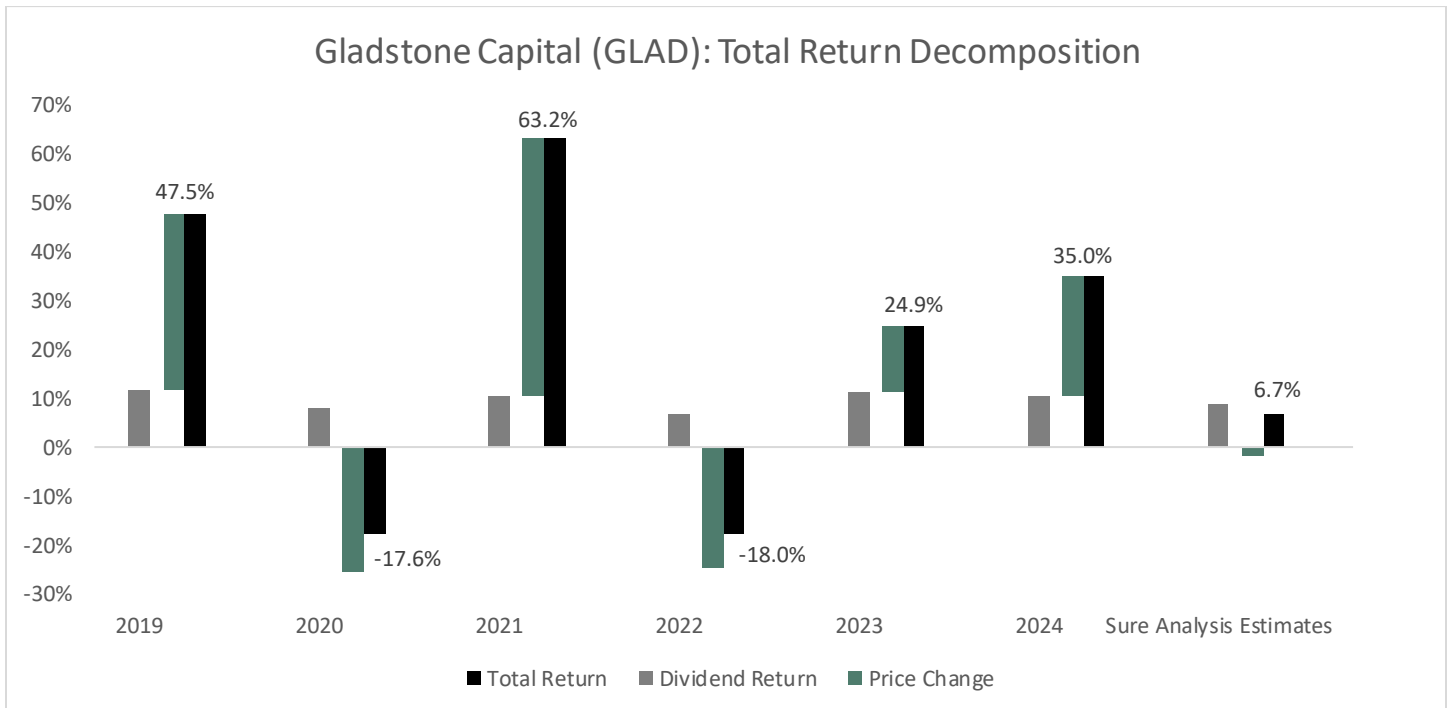
Gladstone doesn’t have any competitive advantages as it operates in much the same way as any other BDC. It is also dependent upon funding costs and the spreads it can earn on its debt and equity investments. During recessions, Gladstone will likely struggle as repayments may become a problem for its debt investments.

Gladstone cut its distribution for this reason in Q2 2020, and with earnings estimates coming down, the payout ratio is just under 100% again, making us cautious. The most recent increase is seen as a vote of confidence from management.

Final Thoughts & Recommendation

We forecast 6.7% total annual returns in the coming years. The stock is overvalued, in our view. However, the dividend payout ratio is back under 100%. We see a 2.3% headwind from the valuation, as well as 1% growth and the 8.6% dividend yield. The stock continues to earn a hold rating as we enter fiscal 2025 with slightly lower earnings estimates.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|----------------|-------|-------|-------|-------|-------|--------|-------|-------|-------|-------|
| Revenue | 21 | 25 | 30 | 31 | 33 | 8 | 95 | 32 | 59 | 99 |
| SG&A Exp. | 6 | 7 | 7 | 8 | 8 | 8 | 8 | 10 | 3 | 14 |
| Net Profit | 8 | 11 | 17 | 19 | 20 | (2) | 84 | 20 | 43 | 95 |
| Net Margin | 40.4% | 46.0% | 56.8% | 59.5% | 59.4% | -22.3% | 89.0% | 62.5% | 72.8% | 96.1% |
| Free Cash Flow | (74) | 60 | (13) | (18) | 9 | (46) | (14) | (76) | (11) | 3 |

Balance Sheet Metrics

| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|----------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 382 | 336 | 366 | 400 | 426 | 459 | 567 | 661 | 719 | 812 |
| Cash & Equivalents | 4 | 6 | 5 | 2 | 16 | 2 | 1 | 2 | 1 | 2 |
| Accounts Receivable | 6 | 2 | 2 | 3 | 3 | 3 | 2 | 3 | 6 | --- |
| Total Liabilities | 191 | 134 | 146 | 162 | 177 | 225 | 248 | 345 | 311 | 334 |
| Accounts Payable | 1 | 1 | 1 | 1 | 1 | 2 | 2 | 3 | 4 | 4 |
| Long-Term Debt | 127 | 71 | 93 | 110 | 123 | 222 | 237 | 339 | 301 | 325 |
| Shareholder's Equity | 191 | 201 | 220 | 237 | 249 | 234 | 318 | 315 | 409 | 471 |
| LTD/E Ratio | 0.66 | 0.35 | 0.42 | 0.46 | 0.49 | 0.95 | 0.74 | 1.08 | 0.74 | 0.68 |

Profitability & Per Share Metrics

| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|------------------|--------|------|--------|--------|------|--------|--------|--------|--------|-------|
| Return on Assets | 2.5% | 3.2% | 4.9% | 4.9% | 4.8% | -0.4% | 16.4% | 3.2% | 6.2% | 12.4% |
| Return on Equity | 4.3% | 5.8% | 8.2% | 8.2% | 8.2% | -0.8% | 30.5% | 6.3% | 11.8% | 21.3% |
| ROIC | 3.0% | 3.8% | 5.9% | 5.7% | 5.5% | -0.5% | 16.7% | 3.3% | 6.3% | 12.5% |
| Shares Out. | 21.1 | 23.2 | 25.5 | 27.1 | 29.3 | 33.0 | 34.0 | 34.4 | 37.3 | 21.8 |
| Revenue/Share | 1.00 | 1.07 | 1.19 | 1.16 | 1.14 | 0.27 | 2.85 | 0.94 | 1.57 | 4.52 |
| FCF/Share | (3.54) | 2.59 | (0.51) | (0.66) | 0.32 | (1.48) | (0.42) | (2.22) | (0.29) | 0.15 |

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

Disclaimer

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