



# Great Elm Capital (GECC)

Updated June 1<sup>st</sup>, 2023 by Samuel Smith

## Key Metrics

<b>Current Price:</b>	\$8.0	<b>5 Year CAGR Estimate:</b>	13.3%	<b>Market Cap:</b>	\$59.9 M
<b>Fair Value Price:</b>	\$10.1	<b>5 Year Growth Estimate:</b>	-3.4%	<b>Ex-Dividend Date:</b>	6/14/23
<b>% Fair Value:</b>	79%	<b>5 Year Valuation Multiple Estimate:</b>	4.9%	<b>Dividend Payment Date:</b>	6/30/23
<b>Dividend Yield:</b>	17.6%	<b>5 Year Price Target</b>	\$8	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	Buy

## Overview & Current Events

Great Elm Capital Corporation is a business development company that specializes in loan and mezzanine, middle market investments. It seeks to create long-term shareholder value by building its business across three verticals: Operating Companies, Investment Management, and Real Estate. The company favors investing in media, healthcare, telecommunication services, communications equipment, commercial services and supplies. The company has a market capitalization of approximately \$59.9 million.

Great Elm Capital Corporation released its first quarter results on May 4<sup>th</sup>. In the first quarter of 2023, the net investment income (NII) of the company increased by 26% to reach \$2.8 million, or \$0.37 per share. This growth was attributed to strategic capital deployment and a shift towards higher-yielding floating rate investments. The quarter marked the highest cash income in the company's history, with only 15% of the total investment income being attributed to PIK (payment-in-kind) and accretion income. The net assets of the company were \$90.3 million, or \$11.88 per share, on March 31, 2023, compared to \$84.8 million, or \$11.16 per share, on December 31, 2022, and \$69.3 million, or \$15.06 per share, on March 31, 2022. Great Elm Healthcare Finance, LLC (GEHF) secured a \$50 million committed credit line from Encina Lender Finance to support the growth of its active pipeline. Additionally, the facility includes an uncommitted accordion of \$50 million, which can provide up to \$100 million in financing for healthcare-related secured lending. As of March 31, 2023, the company's asset coverage ratio stood at approximately 159.8%, an increase from 154.4% on December 31, 2022, and 147.5% on March 31, 2022. This ratio indicates the company's ability to cover its liabilities with its assets. The Board of Directors approved a quarterly dividend of \$0.35 per share for the second quarter of 2023, representing an 11.8% annualized yield based on the net asset value per share on March 31, 2023.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	---	---	---	---	\$1.52	\$1.44	\$1.07	\$0.54	\$3.02	\$1.67	<b>\$1.45</b>	<b>\$1.25</b>
<b>BVPS</b>	---	---	---	\$13.52	\$12.42	\$10.34	\$8.63	\$3.46	\$16.63	\$12.56	<b>\$11.88</b>	<b>\$10.00</b>
<b>DPS</b>	\$0.92	\$0.86	\$0.71	\$0.32	\$0.26	\$1.00	\$1.00	\$1.00	\$0.40	\$1.80	<b>\$1.40</b>	<b>\$1.20</b>
<b>Shares<sup>1</sup></b>	11.9	23.2	22.5	2.1	1.8	1.8	1.7	3.9	4.6	7.6	<b>7.6</b>	<b>13</b>

Great Elm Capital has had a very mixed record of earnings performance over the course of its existence. Furthermore, it has seen book value be very volatile since going public in 2016. We believe that the company will have a hard time growing book value and earnings per share as their large dividend payout will combine with their leveraged business model to stress the company's balance sheet during challenging periods.

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
<b>Avg. P/B</b>	---	---	---	0.86	0.79	0.76	0.90	0.85	0.83	0.83	<b>0.67</b>	<b>0.85</b>
<b>Avg. Yld.</b>	---	---	---	2.8%	2.6%	12.7%	12.9%	34.0%	2.9%	17.6%	<b>17.6%</b>	<b>14.1%</b>

<sup>1</sup> In millions

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The share price is currently undervalued based on the price-to-book value multiple, which we believe is the best single metric for valuing this security. Based on its history and our appraisal of management and the company's outlook, we believe paying 0.85x book value is fair for this company. Given that shares currently trade at 0.67 times book value, we view shares as trading below fair value, leading to an expected tailwind to total returns moving forward.

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

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	---	---	---	17%	69%	93%	185%	13%	108%	97%	96%

The company lacks any competitive advantage given its small size and diversified exposure. Furthermore, their extremely erratic earnings and book value support this view that the business is not stable.

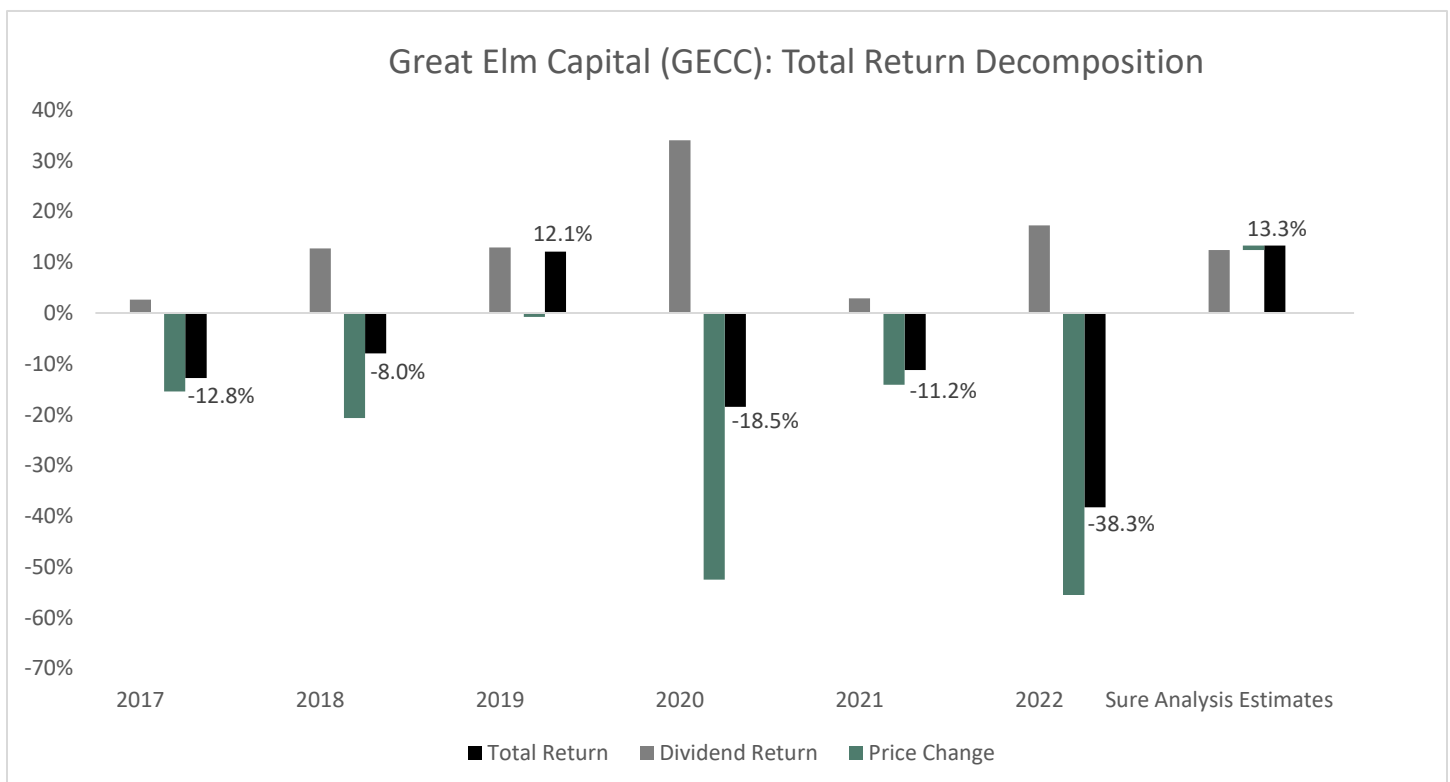
Great Elm Capital's balance sheet is also leveraged quite heavily, which leaves it exposed to rapid declines in book value like what was experienced a few years ago. As a result, even though it was not around for the Great Recession, we believe that it will not fare well in a protracted recession, making it a high-risk stock.

Finally, its payout ratio is quite elevated. Combined with the erratic earnings and book value, we view the dividend as risky.

## Final Thoughts & Recommendation

Great Elm Capital is not for the faint of heart. The dividend is at significant risk as indicated by the bloated yield and payout ratio. The earnings and book value history are erratic and unpredictable. That said, the stock is trading at a discount to book value. With 13.3% expected annualized total returns over the next half decade, the stock earns a Buy rating for very aggressive investors, but conservative income growth investors should steer clear.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	6	(6)	(4)	(14)	1	(5)	(5)	(29)	(7)	(16)
SG&A Exp.	2	1	2	4	3	3	2	2	3	3
Net Profit	4	(8)	(5)	(18)	(3)	(9)	(8)	(32)	(10)	(16)
Net Margin	65.1%	134.5%	116.9%	130.2%	-412%	168.3%	158.2%	110.7%	155.8%	96.9%
Free Cash Flow	(10)	(21)	(31)	9	(24)	(30)	(24)	27	(58)	(42)

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	113	155	161	237	240	282	291	283	426	310
Cash & Equivalents	18	-	4	67	3	4	5	53	9	1
Total Liabilities	52	82	61	64	108	171	204	204	352	225
Accounts Payable	1	26	16	24	70	88	74	78	204	70
Long-Term Debt	50	29	33	35	31	76	120	116	142	153
Shareholder's Equity	61	73	100	173	132	110	87	80	75	85
LTD/E Ratio	0.83	0.40	0.33	0.20	0.24	0.69	1.38	1.45	1.90	1.81

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	3.6%	-5.7%	-3.3%	-10.1%	-1.2%	-3.5%	-2.6%	-11.1%	-2.9%	-4.2%
Return on Equity	6.7%	-11.4%	-6.0%	-14.1%	-1.8%	-7.4%	-7.7%	-38.4%	-13.3%	-19.6%
ROIC	4.1%	-7.2%	-4.4%	-11.1%	-1.5%	-5.1%	-3.8%	-15.9%	-5.0%	-6.9%
Shares Out.	1.2	1.4	2.5	2.1	1.9	1.8	1.7	2.2	4.1	7.6
Revenue/Share	4.99	(3.91)	(1.80)	(6.41)	0.34	(3.01)	(2.79)	(13.02)	(1.62)	(2.57)
FCF/Share	(8.86)	(14.25)	(12.73)	4.07	(12.50)	(17.16)	(14.33)	12.35	(14.36)	(6.68)

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

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