



Gladstone Capital (GLAD)

Updated August 13th, 2024, by Josh Arnold

Key Metrics

Current Price:	\$23	5 Year CAGR Estimate:	7.2%	Market Cap:	\$495 M
Fair Value Price:	\$20	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	08/21/24
% Fair Value:	113%	5 Year Valuation Multiple Estimate:	-2.5%	Dividend Payment Date:	08/30/24
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 \$495 million and it pays distributions monthly, instead of quarterly.

Gladstone implemented a 1-for-2 stock split on April 5th, 2024. We've updated all of our historical data to reflect this for the sake of comparability.

Gladstone posted third quarter earnings on August 7th, 2024, and results were better than expected on both the top and bottom lines. Net investment income was 57 cents per share, which was four cents better than estimates. Likewise, total investment income was \$25.69 million, which was up almost 13% year-over-year, and was almost a million dollars better than expected. Total investment income was driven primarily by higher dividend income and an increase in prepayment fee income.

Total expenses rose fractionally, but the increase was negligible compared to the boost in revenue, leading to better profit margins and higher earnings.

Net increase in net assets resulting from operations was \$19.1 million, or 88 cents per share, resulting from a \$3.4 million gain in net unrealized appreciation, and \$3.3 million in net realized gains.

Following the strong showing in the third quarter, we've added eight cents to our estimate of NII-per-share for this year to \$2.03.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
NII	\$1.74	\$1.68	\$1.68	\$1.68	\$1.70	\$1.68	\$1.62	\$1.58	\$1.88	\$2.20	\$2.03	\$2.24
DPS	\$1.68	\$1.68	\$1.68	\$1.68	\$1.68	\$1.68	\$1.56	\$1.56	\$1.56	\$1.92	\$1.98	\$2.08
Shares¹	10.5	10.55	11.6	12.75	13.55	14.65	16.5	17	17.55	18.65	19	23

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 \$2.03 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 2% 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.

¹ Share count in millions

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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.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/NII	10.9	10.0	9.1	11.4	10.7	10.8	10.2	12.7	9.0	8.8	11.3	10.0
Avg. Yld.	8.8%	10.0%	11.0%	8.8%	9.3%	9.2%	9.4%	7.8%	9.2%	10.0%	8.6%	9.3%

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 11.3 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	97%	100%	100%	100%	99%	100%	96%	99%	83%	87%	98%	93%

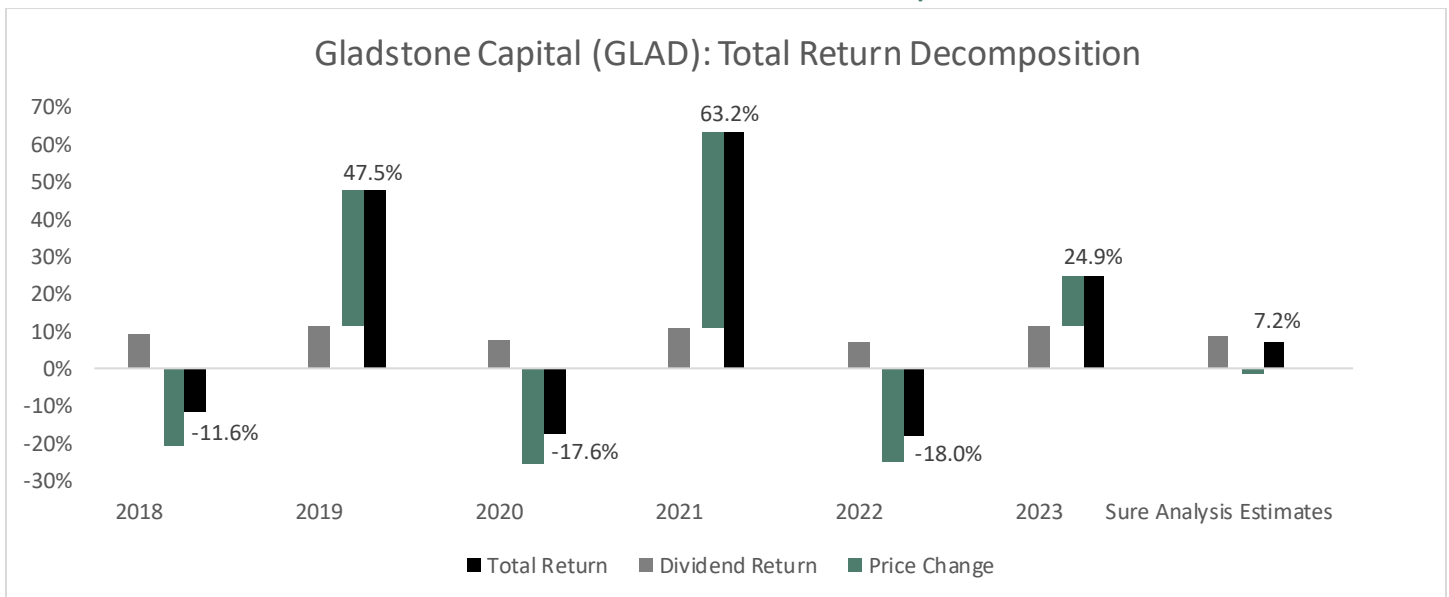
Gladstone doesn't have any competitive advantages as it operates in much the same way as any other BDC. It is also dependent upon funding costs and the spreads it can earn on its debt and equity investments. During recessions, Gladstone will likely struggle as repayments may become a problem for its 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 7.2% total annual returns in the coming years. The stock is overvalued, in our view. However, our estimate of NII is now meaningfully higher after good Q3 results, and the dividend payout ratio is back under 100%. We see a 2.5% headwind from the valuation, as well as 2% growth and the 8.6% dividend yield. The stock continues to earn a hold rating as the share price has risen commensurately with earnings.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	24	21	25	30	31	33	8	95	32	59
SG&A Exp.	6	6	7	7	8	8	8	8	10	3
Net Profit	11	8	11	17	19	20	(2)	84	20	43
Net Margin	46.1%	40.4%	46.0%	56.8%	59.5%	59.4%	-22.3%	89.0%	62.5%	72.8%
Free Cash Flow	0	(74)	60	(13)	(18)	9	(46)	(14)	(76)	(11)

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	301	382	336	366	400	426	459	567	661	719
Cash & Equivalents	6	4	6	5	2	16	2	1	2	1
Accounts Receivable	3	6	2	2	3	3	3	2	3	6
Total Liabilities	102	191	134	146	162	177	225	248	345	311
Accounts Payable	1	1	1	1	1	1	2	2	3	4
Long-Term Debt	38	127	71	93	110	123	222	237	339	301
Shareholder's Equity	200	191	201	220	237	249	234	318	315	409
LTD/E Ratio	0.19	0.66	0.35	0.42	0.46	0.49	0.95	0.74	1.08	0.74

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	3.8%	2.5%	3.2%	4.9%	4.9%	4.8%	-0.4%	16.4%	3.2%	6.2%
Return on Equity	5.5%	4.3%	5.8%	8.2%	8.2%	8.2%	-0.8%	30.5%	6.3%	11.8%
ROIC	4.6%	3.0%	3.8%	5.9%	5.7%	5.5%	-0.5%	16.7%	3.3%	6.3%
Shares Out.	21.0	21.1	23.2	25.5	27.1	29.3	33.0	34.0	34.4	37.3
Revenue/Share	1.16	1.00	1.07	1.19	1.16	1.14	0.27	2.85	0.94	1.57
FCF/Share	0.02	(3.54)	2.59	(0.51)	(0.66)	0.32	(1.48)	(0.42)	(2.22)	(0.29)

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

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