



Prospect Capital Corporation (PSEC)

Updated September 2nd, 2024, by Josh Arnold

Key Metrics

Current Price:	\$5.23	5 Year CAGR Estimate:	7.6%	Market Cap:	\$2.2 B
Fair Value Price:	\$5.19	5 Year Growth Estimate:	-3.0%	Ex-Dividend Date:	09/26/24
% Fair Value:	101%	5 Year Valuation Multiple Estimate:	-0.2%	Dividend Payment Date:	10/22/24
Dividend Yield:	13.8%	5 Year Price Target	\$4.45	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Prospect Capital Corporation is a business development company, or BDC. It provides private debt and private equity to middle-market companies in the U.S. The company focuses on direct lending to owner-operated companies, as well as sponsor-backed transactions. Prospect invests primarily in first and second lien senior loans and mezzanine debt, with occasional equity investments. The company went public in 2004 and currently has a market capitalization of \$2.2 billion. Prospect produces just under \$900 million in annual revenue.

We note that Prospect has had to file amended 1099 tax forms at times in the past, causing additional work for those that own shares when filing taxes for dividends received from the company.

Prospect posted fourth quarter and full-year earnings on August 28th, 2024, and results were somewhat weak. Net interest income per share, which is akin to net earnings, was 25 cents. This was down from 28 cents a year ago, but much better than the 18 cents expected. Total investment income, which is Prospect's form of revenue, was down year-over-year, falling from \$221.5 million to \$212.3 million.

Total originations rose from \$220 million to \$242 million quarter-over-quarter. Total repayments and sales were \$245 million, more than double the prior quarter. Prospect noted that quarter-to-date for fiscal Q1, originations were \$161 million, while repayments were \$253 million, implying ~\$90 million of shrinkage in the portfolio.

Annualized current yield was 12.1%, unchanged from Q3, but down from 13.2% a year ago.

Total investments at fair value were \$7.72 billion, down from \$7.81 billion in March, but flat year-over-year.

We see 61 cents in adjusted NII-per-share for 2025, noting that results are extremely volatile, particularly as interest rates move around.

Growth on a Per-Share Basis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
NII	\$1.03	\$1.04	\$0.85	\$0.79	\$0.79	\$0.72	\$0.75	\$0.75	\$0.89	\$1.02	\$0.61	\$0.52
DPS	\$1.19	\$1.00	\$1.00	\$0.77	\$0.72	\$0.72	\$0.72	\$0.72	\$0.72	\$0.72	\$0.72	\$0.56
Shares¹	359	357	360	364	367	374	389	392	402	425	445	500

Growth has been tough to come by for Prospect in the past decade. The company weathered the financial crisis quite well – 2010 results excluded – but since 2012, net investment income has struggled. Part of this is due to Prospect's prodigious share count, which is much higher today than it was a decade ago. While it is typical for a BDC to issue shares to fund acquisitions, Prospect's dilution has been excessive at times. Given this history of dilution and weak net investment income performance, we expect -3% annual growth on a per-share basis.

Prospect has had additional trouble growing net investment income because its balance sheet has slowly grown smaller over time. The company's total assets are just under \$8 billion today, after having expanded rapidly in recent quarters.

The company's dividend has also shrunk over time as this year's payout of \$0.72 is less than half the value of the dividend from before the financial crisis. Shrinking net investment income has taken its toll on the company's ability to

¹ Share count in millions

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finance the dividend. We see the dividend potentially declining as NII barely covers the payout today. Prospect has funded deficits in its NII in the past, and we are still cautious on its ability to fund the dividend at current levels given the convergence of NII and the dividend payment. However, the company has made it clear it intends to defend the payout. Prospect can cover it for now, but if projected earnings declines worsen, that could change.

Valuation Analysis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Now	2030
Avg. P/NII	6.9	9.9	8.7	8.0	8.2	8.2	8.5	9.3	7.0	5.4	8.6	8.5
Avg. Yld.	13.8%	11.8%	11.3%	10.6%	12.1%	12.1%	11.3%	10.3%	11.6%	13.0%	13.8%	12.5%

Prospect's price to net investment income has averaged ~8 in the past decade. We see fair value as 8.5 times net investment income given that the company's growth outlook has improved slightly with higher rates. We see a fractional headwind to total annual returns from the valuation remaining about where it is.

The company's current dividend yield is 13.8%, which is somewhat higher than its historical average. We forecast the yield declining to 12.5%, which would result from a potentially lower dividend payout over time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
Payout	116%	96%	118%	97%	85%	100%	96%	90%	81%	71%	118%	106%

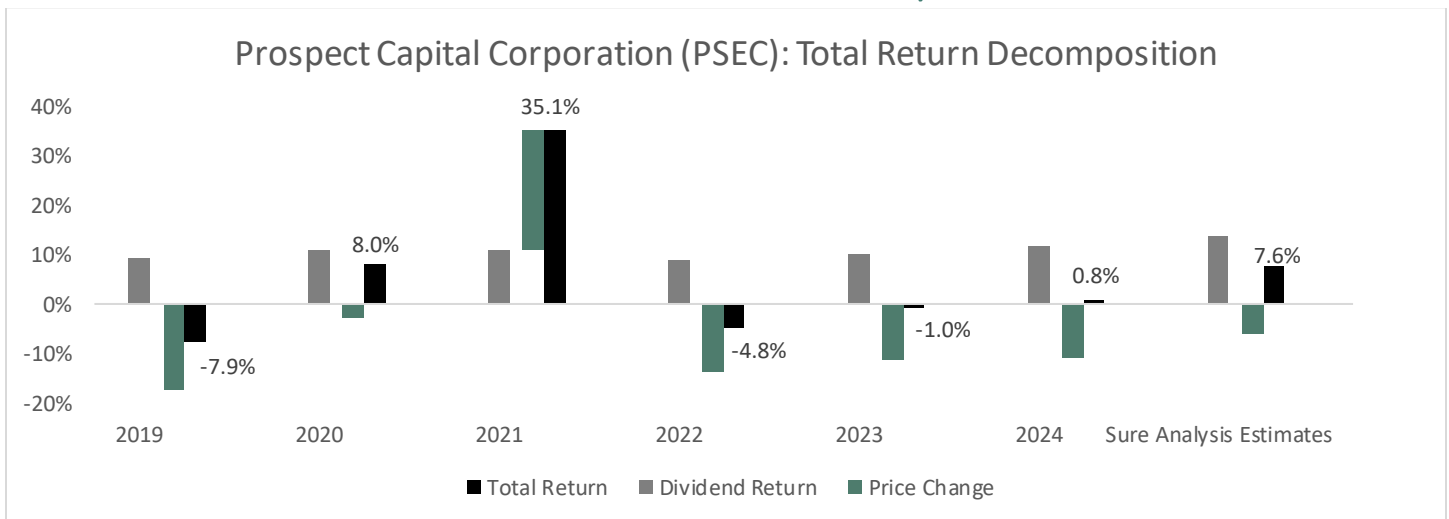
One of the issues with business development companies is that competitive advantages are very difficult to come by, and Prospect is certainly no exception. Scale is the name of the game for BDCs and with a stagnant balance sheet, Prospect has lost some of its relative scale over time. That began to reverse given Q2 2022 results, however, and total assets are reaching new highs again.

The company's payout ratio was over 100% for several years in the past decade and is once again for 2025. We believe it may be some time before the payout is covered by earnings again, and we believe a cut is coming.

Final Thoughts & Recommendation

Prospect Capital offers investors a huge yield, but it is not without its risks. The valuation is decent, particularly considering the company's unfavorable growth outlook. The yield is strong as well. We are forecasting 7.6% in total returns in the coming years, consisting of the 13.8% yield, -3% growth, and a fractional headwind from the valuation. We are reiterating the stock at a hold rating after Q4 results, and we note that this is a highly speculative stock.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenue	379	137	284	326	199	37	1,008	635	(50)	321
SG&A Exp.	30	32	32	26	34	33	30	30	41	44
Net Profit	346	103	253	300	144	-16	964	583	(102)	263
Net Margin	91.4%	75.3%	89.2%	92.0%	81.1%	-43.7%	95.7%	91.8%	-167%	81.9%
Free Cash Flow	45	862	376	369	224	429	31	(795)	(221)	280

Balance Sheet Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total Assets	6,798	6,236	6,173	5,839	5,800	5,300	6,303	7,663	7,862	7,857
Cash & Equivalents	110	318	318	84	107	45	64	35	91	82
Total Liabilities	3,095	2,800	2,818	2,432	2,494	2,244	2,358	3,544	4,129	4,145
Accounts Payable	70	71	69	56	56	51	51	50	54	47
Long-Term Debt	2,984	2,667	2,642	2,312	2,383	2,138	2,233	2,737	2,585	2,434
Shareholder's Equity	3,703	3,436	3,355	3,407	3,306	3,056	3,808	4,119	3,733	3,712
LTD/E Ratio	0.81	0.78	0.79	0.68	0.72	0.70	0.57	0.66	0.69	0.66

Profitability & Per Share Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Return on Assets	5.2%	1.6%	4.1%	5.0%	2.5%	-0.3%	16.6%	8.3%	-1.3%	3.3%
Return on Equity	9.5%	2.9%	7.4%	8.9%	4.3%	-0.5%	28.1%	14.7%	-2.6%	7.1%
ROIC	5.3%	1.6%	4.2%	5.1%	2.5%	-0.3%	17.0%	8.9%	-1.5%	4.2%
Shares Out.	359	357	360	364	367	374	389	434	399	625
Revenue/Share	1.07	0.39	0.79	0.90	0.54	0.10	2.61	1.46	(0.13)	0.51
FCF/Share	0.13	2.42	1.05	1.02	0.61	1.17	0.08	(1.83)	(0.55)	0.45

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

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