



Prospect Capital Corporation (PSEC)

Updated November 18th, 2024, by Josh Arnold

Key Metrics

Current Price:	\$4.42	5 Year CAGR Estimate:	7.5%	Market Cap:	\$1.9 B
Fair Value Price:	\$4.59	5 Year Growth Estimate:	-3.0%	Ex-Dividend Date:	11/26/24
% Fair Value:	96%	5 Year Valuation Multiple Estimate:	0.8%	Dividend Payment Date:	12/19/24
Dividend Yield:	12.2%	5 Year Price Target	\$3.94	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 \$1.9 billion. Prospect produces about \$750 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 first quarter earnings on November 8th, 2024, and results were weak. However, the big news was a 25% dividend cut. Prospect reduced its payout to 54 cents per share annually, sending the stock reeling.

Net investment income was 21 cents per share in Q1, and revenue was \$196 million. That was down 17% year-over-year. The company is in the midst of rotating its strategy to emphasize first lien senior secured lending instead of real estate investments and collateralized loan obligations, or CLOs. The company noted the returns on first lien senior secured lending are more reliable over time, but there is a short-term negative impact. It remains to be seen if this strategy will ultimately bear fruit, but for now, Prospect's short-term outlook has been damaged.

Total originations were \$291 million, up from \$242 million in the previous quarter. Total repayments and sales were \$282 million, up from \$245 million, netting \$8.3 million for the quarter.

Annualized current yield was 11.8% in Q1, down from 12.1% in Q4 and 12.7% a year ago. Total investments at fair value were \$7.48 billion, down from \$7.72 billion in June and \$7.74 billion a year ago.

We now see 54 cents in NII per-share for this year after a very rough start to fiscal 2025.

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	\$0.54	\$0.46
DPS	\$1.19	\$1.00	\$1.00	\$0.77	\$0.72	\$0.72	\$0.72	\$0.72	\$0.72	\$0.72	\$0.54	\$0.44
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.

¹ Share count in millions

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The company's dividend has also shrunk over time as this year's payout of \$0.54 is well under 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 finance the dividend. We see the dividend potentially declining further 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, even after the late-2024 cut. The cut we have been concerned about has finally come to fruition.

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	8.2	8.5
Avg. Yld.	13.8%	11.8%	11.3%	10.6%	12.1%	12.1%	11.3%	10.3%	11.6%	13.0%	12.2%	11.2%

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 tailwind to total annual returns from the valuation potentially drifting higher.

The company's current dividend yield is 12.2%, which is somewhat higher than its historical average. We forecast the yield declining to 11.2%, 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%	100%	95%

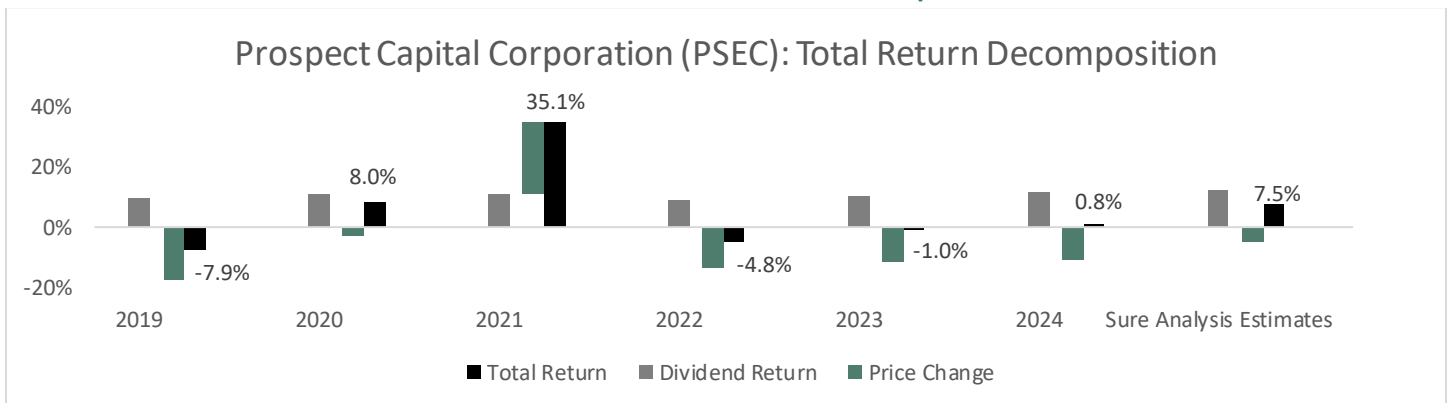
One of the issues with business development companies is that competitive advantages are very difficult to come by, and Prospect is certainly no exception. Scale is the name of the game for BDCs and with a stagnant balance sheet, Prospect has lost some of its relative scale over time. Prospect's assets are on the decline once more, producing yet another headwind for earnings and the dividend.

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 the newly reduced dividend may also be at risk in the coming years.

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 7.5% in total returns in the coming years, consisting of the 12.2% yield, -3% growth, and a fractional tailwind from the valuation. We are reiterating the stock at a hold rating after Q1 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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