SN VALUATION
SN CAPITAL SN CONSULTING SN ENGLISH

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SNV Financials Fund: Gladstone Corp. (GLAD)

Overview

Market cap of $180MM. Dividend yield at 9.8%. P/B at 0.96. Monthly dividend security. $188MM in book value.

The closed end fund invests in senior debt, with interest rates typically above 10%. The total interest income/outstanding debt investments was 13% in 2012 ($36MM in interest income/$274MM in debt investment fair value, or a 75% of cost value, or $365MM). The interest income plus $5MM in other income, for a combined $40MM in income offsets the near $10MM in management expenses, $1MM in admin fee, $1MM in professional fee, $4.5MM in interest expense, $1.2MM in amortization for deferred financing fee, $1.3MM for other G&A, or a combined $20MM. Line of credit borrowing rate is 6% and has $59MM outstanding, so the bulk of their investments were financed by common shareholders.. From an operational cash flow basis, the fund is generating $20MM in positive flows, which is distributed as monthly dividend at an annual rate of $16MM. Thereby, the 9.8% dividend yield is secured

From a valuation basis, the continued unrealized depreciation of the debt investments is the greatest contributor to the dilution of the assets. The fair value of the portfolio has dropped 25% compared to the cost, or face value of the debt commitments. The actual loss may be much smaller, should the portfolio companies repay the debt in full come maturity. So, the losses reflected in the financials may not be representative of a deterioration in the intrinsic value, or capturable maturity value

The risk is inherent in the invested companies, which bears the burden of the higher interest payments. Therefore, there is greater insolvency risk in the portfolio than a typical debt fund. Although the debt are senior tranche, and presumably supported by the assets, it is common to see a couple blow ups in the ~50 security portfolio as witnessed by their Sunburst Media investment, depreciating from $6MM to $2.5MM, and BAS Holdings depreciating from $7.5MM to $1.9MM to name a couple. Senior and Senior Subordinated debt accounts for 85% of the portfolio's fair value. Independent, third party companies assess the value for the portfolio.

Assessment

We like the high dividend yield, but we believe the high payment is to compensate for the higher risk associated with the business, as it deals with more riskier debt securities, although they may be senior tranche. Portfolio companies with riskier capital structures are the main borrowers at +10% interest rates. We don't feel comfortable with the business at the time being.