Prospect Capital Corporation Q4 Earnings Conference Call - 7 Reasons To Love It

30 August 2015
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Prospect Capital Corporation released its Q4 2015 earnings a few days ago and now share prices are moving higher. The company has been in a long term down trend that may be coming to an end, driven by earnings, portfolio positioning, forward outlook and an enormous dividend yield. At current prices annual distribution of $1.00 is more than 13% and the way things are going there is a significant chance for additional special dividends. Along with this there are some other reasons to love Prospect, many of which are talked about on the conference call. This is my list of 7 take-aways high yield investors should be aware of.

Earnings Are On The Rise - The release, for the 4th quarter of fiscal 2015, ended in June, was better than expected. Not only did the heavily criticized BDC increase earnings over the previous quarter and the comparable quarter in the previous year it beat expectations. Net income of $94.8 million equates to $0.26 per share and 24% increase over the 4th quarter of 2014. Prospect earned $0.25 in the previous quarter, analyst consensus was in a range slightly below. NII also increased, totaling $89.5 million or $0.25 per share, with a recurring income mix of 96%. This too is up from last year when it

was only 86%. The really important measure, distributable income, was also up at $0.27 per share, significant because it exceeds dividend payments for the quarter. NAV rose as well, gaining a penny to come in at $10.31.

John Barry *- "Our recurring interest income mix in the June 2015 quarter was 96%, up from 86% in the June 2014 fiscal year . . . reflecting the high quality of our earnings stream with a lack of dependence on non-recurring fee income."*

Strong Portfolio – The loan portfolio is strong and getting stronger. Total originations, at the end of the quarter, are now more than $2 billion. This includes $460 million in new and follow on loans in the June quarter but does not include $310 million that have already been booked for the current quarter, or the more than $200 million in potential loans currently in the pipeline. In addition to new loans the company has also reported repayment of $438 million over the course of the quarter reducing cash investment to only $22 million. Average portfolio

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yield is 12.7%, up 0.3% from the previous quarter and 0.6% from the comparable quarter last year.

Other segments of the business are doing well too. The real estate arm is experiencing strong earnings due to rising rents, strong occupancy and rising cash yield. The financial services segment is yielding 18%-30% and online lending is on the rise. At the same time default rates on the CLO's is shrinking. At 0.15% is is well below the industry average of 1.24%.

Grier Eliasek, COO - "Because of declining unemployment and declining commodity prices, we believe the outlook for consumer credit is positive as we proceed through 2015, boding well for such companies."

FOMC Rate Hike Perspective - The upcoming if yet to be announced FOMC rate hike, expected sometime over the next 3 meetings, is cause for concern for many businesses but not for this one. The company has been working hard to position the portfolio in way as to benefit from such an event. This is done primarily through the use of fixed rate credit facilities while providing loans on a floating rate basis. As rates go up cost remains flat while income increases.

John Barry, CEO *- "Our Company has locked in a ladder of fixed rate liabilities, extending approximately 30 years into the future, while the significant majority of our loans float with LIBOR providing potential upside to shareholders should interest rate rise"*

Portfolio Rollover – The company has been actively in process of rolling lower yielding assets into higher yielding ones. At the low end of the range are those producing 8-9% returns while portfolio average is closer to 13%. This is done through strategic separation of the lower yielding loans which are then sold off to new investors. Not only do these sales result in higher portfolio yield, they also produce additional income through recurring service fees. Both the new loans and the fees are expected to produce positive impacts to earnings in coming quarters.

Grier Eliasek, COO - *"Recently, we've utilized our position as a majority holder to optimize our portfolio through improved financing and other terms by refinancing liabilities at lower rates...So far in 2015, we made 6 sales of such lower yielding investments, totaling $167.5 million ... We expect similar sales with related recurring servicing fees both this quarter and in the future as a potential earnings catalyst for the June 2016 fiscal year."*

Pure Play Spin-Offs In The Works – Prospect has been planning to do three pure-play spin-offs for several quarters. The spin's are still in process with the first expected to go public later this year. It is going to be put out as a rights offering to current shareholder and is waiting on regulatory approval at this time. The plays include portions of the CLO, on-line lending and real estate segments and are expected to increase share holder value in a number ways. First, the full value of these businesses is not being realized while they remain part of the greater Prospect BDC structure. By spinning them off into non-BDC entities they can begin trading at or near market multiples appropriate to them. The second is through additional income streams to the parent. Prospect will retain significant ownership in the new businesses and reap the benefit of distributions. Finally, by selling the pure plays Prospect will free up capital with which to originate new business.

> "Dividend health is of utmost concern for income investors and a yield as high as Prospect has is often cause for concern"

Grier Eliasek, COO - *"We believe these dispositions have significant potential to unlock shareholder value through pure play earnings multiple expansion, moving strategies in to faster growing non-BDC formats with reduced basket and leverage constraints and freeing up 30% basket and leverage capacity for new originations at Prospect."*

The fate of the spins, however, is still in question as regulatory and other hurdles remain. Both CEO John Barry and COO Grier Eliasek have commented to the effect that they are not guaranteed and depend heavily on market conditions.

Share Repurchases – The company has recently approved a share repurchase program that flew largely under the radar. Total value is up to $100 million with at least $30 million of that already done. While not an overly large repurchase program it does return some value to shareholders and is a sign of overall financial health. The only concern is the effect on debt to equity ratios and credit ratings but as of this time there is little worry over that.

Brian Owald, CFO - *"We currently have authorization for 100 million and we elected given available liquidity, we had some repayments recently and the backdrop of the share price. We elected to avail ourselves of that Board authorization and we repurchased approximately $30 million worth of stock in the past month"*

Dividend Health – Dividend health is of utmost concern for income investors and a yield as high as Prospect has is often cause for concern. Contrary to that belief, Prospects dividend is not only healthy, it is reliable. The company has just announced the next two distributions which make 87 consecutive payments since the IPO. Speaking to the health of the payment is earnings, which exceed dividend distributions on a quarterly and annual basis. This combination increases the chance of special dividends as has been alluded to in this and previous earnings reports. BDC's, as I'm sure you, are required to return at least 90% of taxable income to shareholders, the more they make, the more you make.

John Barry, CEO - *"Our distributable income for the full June 2015 fiscal year was $0.12 per share greater than our dividend"*

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