



# Why Doesn't Everybody Own This Stock?

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I have recently been studying and analyzing Prospect Capital. It is a business development company (BDC) registered under the Investment Company Act of 1940. As such it is a tax efficient regulated

investment company legally obligated to return value to share holders. What this means is that when the company makes money, you make money, and not just on paper. As a BDC the company is required to return 90% of its taxable incomes to its shareholders which means that the better Prospect does the more cash it will have to return. Now, assuming that Prospect is indeed a sound and viable business

entity I have come up with four reasons why I think this stock is one that should be bought. Based on my initial research I can find no reason to think it isn't. The company has been in business for over ten years, has a BBB or better credit rating and is traded in a liquid market.

## 1) The Company Pays A High Dividend

The first pillar of investing, the traditional buy-and-hold build an account style of investing, is dividends. Build a position in a sound company that pays dividends and reap the rewards over time. Prospect pays what I will term a ridiculously high dividend, \$1 annually, with a yield near 12%. At 12%, according to the rule of 72, it will only take 6.5 years to double your money and that is only with the dividend. Normally such a large and generous dividend would be a warnings sign for me but upon further investigation I am much more comfortable with it than with the average high yielder. The reason the company can pay such a high rate, and pay it consistently, is because of the nature of the business. Prospect, as a BDC, is in the business of providing shareholder value through income and capital appreciation. It does not hold on to its earnings, it can't, and as a profitable business has earnings to return. Now, as for the dividend history and the safety of the payment the company has paid the dividend since its inception, and has always been able to generate a surplus of revenue in excess of its credit and dividend obligations. Since the companies founding it has returned that and more. The initial investors have all received over \$13.50 per share with a total near \$1.5 billion for dividend payments to date.



## ◀ 2) Capital Appreciation

One of the purposes Prospect lists on its company overview is capital appreciation. While the company has not been able to actively deliver on this, the stock is down from its IPO price near \$15 and trading just above the long term low near \$7.50, it has been able to compensate for it. Initial investors have seen a net loss in capital they have received more than enough dividends to make up for the decline and provide profit. The stock is now trading along long term support in an economic environment in which growth is expected. This puts Prospect in prime position to gain at least a few dollars and trade up to the top of the 6 year range. That gives a target nearly 50% above the current share price and a nice little chunk of change for new and old investors. In the nearer term short interest in the stock is high, likely due to a program of equity selling designed to raise cash for the company. Now that that program

has been halted the shorts could easily be squeezed out and spark a covering rally.

## 3) Dividend Growth

Despite the long history of consistent dividend payments, and over 5 years of payments in the double digits, the yield is at a low relative to past performance. This is in-line with the decline in share price over the past year and as such not overly concerning. If you think about it this way it may make sense; the company is required to pay 90% of its income, if it makes more you make more, if it makes less you make less. Whatever the cause, the combination of low relative yield, stock trading near long term lows and the current economic environment puts the company in position to increase the dividend. This may not come soon, the next three payments are already scheduled, but it could come in the next few quarters. This means that not only do you have the opportunity

for a huge dividend and capital appreciation, you have the chance at dividend growth as well. In the most recent earnings report company execs commented on the Prospects ability to consistently earn more than it spends, "raising the chance for future special dividends".

## 4) Optionable

This stock is optionable. This means that it can be leveraged in a myriad of ways to enhance gains, lock in profits and protect from negative events. Its optionability is not a deciding factor in this opinion but it does help. If you didn't get enough return with the dividend, can't wait for the stock to appreciate of a special dividend to be declared you can always sell a covered call.

## Why Not Own Prospect?

In the end I just can't figure out why someone with a long term investment horizon wouldn't want to own this stock. Prospect is a sound financial services company operating as a BDC so it can deliver returns to investors. It is in business to help businesses grow and as such is perfectly positioned to profit in the current economic environment. The stock pays a high dividend, nearly 12%, and comes a long stable history of consistent dividend payments. Added to that the stock is trading near long term lows and poised to rally, boosting the dividend return with a potential for 50% capital appreciation. Finally, in light of current economic outlook and growth potential it is not unreasonable to assume that Prospect will be able to increase in profitability and by extension increase the dividend or declare a special dividend which would be the sprinkles on the icing on the cake.

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