



Specialty Finance

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 J.J.B. Hilliard, W.L. Lyons, LLC
 May 16, 2017

COMPANY UPDATE/ ESTIMATE CHANGE

Key Metrics

GAIN - NASDAQ (as of 05/15/17)	\$9.20
Price Target	N/A
52-Week Range	\$6.70-\$9.84
Shares Outstanding (mm)	32.4
Market Cap. (\$mm)	\$298
3-Mo. Average Daily Volume (000)	188.9
Institutional Ownership	22.0%
Debt / Equity	61.7%
Return on Common Equity	20.2%
Net Asset Value per Share	\$9.82
Price/Net Asset Value per Share	0.94x
Dividend Yield	8.3%
Price/LTM Earnings	4.8x

Net Investment Income Per Share FY 3/31

	2017A	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	\$0.23	\$0.18	\$ 0.17	-	\$ 0.17
2Q	\$0.17	\$0.18	\$ 0.17	-	\$ 0.17
3Q	\$0.17	\$0.18	\$ 0.17	-	\$ 0.17
4Q	\$0.17	\$0.18	\$ 0.17	-	\$ 0.17
Year	\$0.74	\$0.72	\$0.69	-	\$0.69
P/Nil	12.4x		13.4x		13.4x

Investment Income FY 3/31

	2017A	Prior 2018E	2018E	Prior 2019E	Curr. 2019E
1Q	\$14,393	\$13,074	\$12,793	-	\$13,633
2Q	\$11,744	\$13,383	\$12,925	-	\$13,966
3Q	\$13,374	\$13,619	\$13,186	-	\$14,226
4Q	\$12,364	\$13,638	\$13,244	-	\$14,264
Year	\$51,875	\$53,714	\$52,147	-	\$56,089

Company Description: Headquartered in McLean, Virginia, Gladstone Investment Corporation operates as a business development company which requires the company to pay out at least 90% of earnings to shareholders. GAIN invests in debt and equity securities of small- and medium-size companies, with each investment generally ranging from \$5 million to \$30 million.

Gladstone Investment Corporation

GAIN -- NASDAQ – Neutral - 3

F4Q17 Review – Reaffirming Neutral Rating

- **Earnings Update:** F4Q17 operating net investment income was \$0.17 per share, which was in line with our estimate and \$0.01 below the Street consensus.
- **Operating Highlights:** Total investment income decreased \$1.0 million linked-quarter (LQ) to \$12.4 million due to a \$0.6 million decline in interest income to \$11.1 million and a \$0.4 million fall in other income to \$1.3 million. We had projected total investment income of \$12.7 million.

Net investment income rose \$0.1 million to \$5.3 million LQ as the decline in total investment income was more than offset by a \$1.1 million decrease in total expenses.

Net asset value (NAV) per share increased \$0.13 sequentially to \$9.95, resulting from \$3.9 million and \$0.2 million of unrealized and realized gains, respectively.

The company completed a public offering of 2.1 million shares of common stock on May 15, generating net proceeds of \$18.6 million. Underwriters have an option that expires June 9 to purchase up to 315,000 additional shares to cover any overallocments.

- **Estimates & Valuation:** We are reducing our FY 2018 net investment income per share estimate by \$0.03 to \$0.69 reflecting the dilutive impact of the F1Q18 capital raise. We are introducing our FY 2019 estimate at \$0.69.

GAIN’s share price has advanced 36% YOY based on intraday trading. With this advance, its dividend yield has declined from 11.1% to 8.3%, which is below the median yield for small-cap BDCs of 9.3%. We await a more compelling entry point and reaffirm our Neutral rating.

Note Important Disclosures on pages 7-8
Note Analyst Certification on page 7

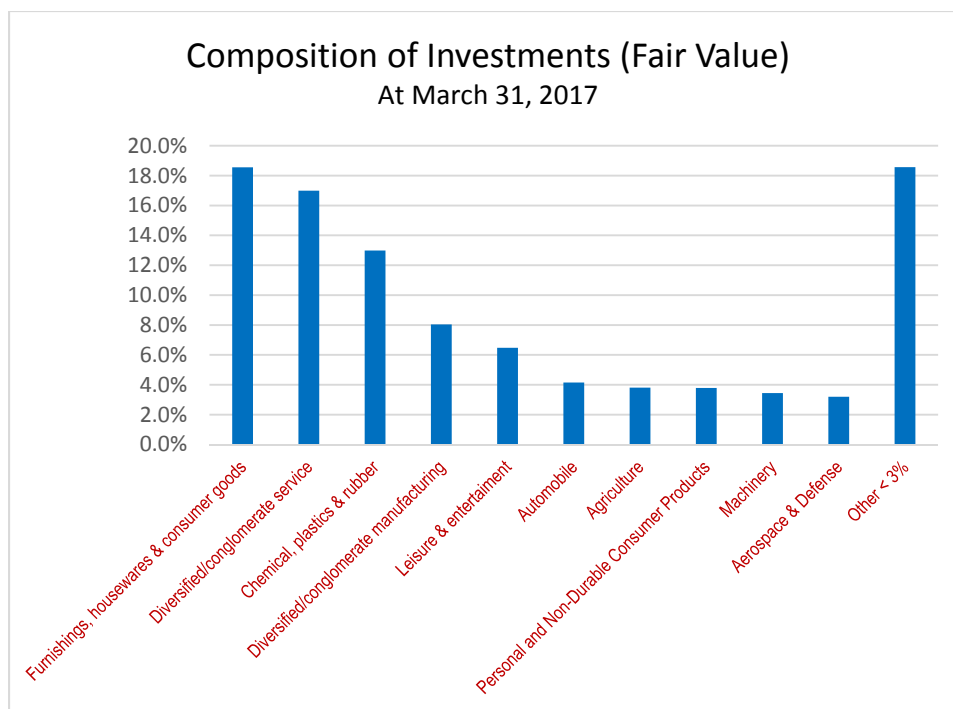
OTHER KEY TAKEAWAYS

- The company invested \$28.9 million in a new portfolio company during the quarter through a combination of secured first lien debt and preferred equity. GAIN also invested \$2.4 million into existing portfolio companies.
- GAIN exited one investment during the quarter, resulting in full repayment of the company's \$5.0 million debt investment and a \$0.5 million success fee.
- Certain loans to two portfolio companies, Alloy Die Casting and Tread Corporation, were on nonaccrual status at quarter-end with an aggregate cost basis of \$15.6 million, or 4.1% of the cost basis of all debt investments in the company's portfolio.
- Alloy Die was placed on nonaccrual status in F4Q17 due to cash flow issues. GAIN has made changes to the management team and the company's fundamentals are improving.
- Borrowings from GAIN's line of credit increased \$26.0 million to \$69.7 million LQ.
- The debt-to-equity ratio increased seven bps to 0.69X sequentially.
- Subsequent to quarter-end, GAIN sold its investment in Mitchell Rubber Products, Inc. The company received net cash proceeds of \$19.0 million, including the repayment of its debt investment of \$13.6 million at par.
- In April, GAIN announced a \$0.004 increase in its monthly dividend to \$0.064 plus a supplemental distribution of \$0.060 payable June 15 to shareholders of record on June 5.
- The following chart provides information regarding the company's investment portfolio. Total net depreciation for the portfolio was (4.5%) at quarter-end, up from (5.5%) at December 31, 2016. Hilliard Lyons does not project any changes in the valuation of the portfolio.

PORTFOLIO HOLDINGS

HOLDINGS @ March 31, 2017						
Company	Sector	Cost	Fair Value	Appreciation / (Depreciation)		Portfolio At Cost
		\$000	\$000	\$000	%	%
<u>Control Investments</u>						
1 Galaxy Tool Holding Corp.	Aeropace & Defense	21,312	16,042	(5,270)	(24.7)	4.1
<u>Affiliate Investments</u>						
2 Alloy Die Casting Corp	Diversified/Conglomerate Manufacturing	18,245	10,644	(7,601)	(41.7)	3.5
3 Brunswick Bowling Prod.	Furnishings, Housewares & Consumer Products	16,250	22,636	6,386	39.3	3.1
4 B+T Group Acquisition Inc.	Telecommunications	18,196	14,000	(4,196)	(23.1)	3.5
5 Cambridge Sound Mgmt.	Home & Office Furnishings	20,500	27,046	6,546	31.9	3.9
6 Channel Technologies	Diversified/Conglomerate Manufacturing	1,841	-	(1,841)	(100.0)	0.4
7 D.P.M.S, Inc.	Diversified/Conglomerate Manufacturing	8,797	7,175	(1,622)	(18.4)	1.7
8 Edge Adhesives Holdings	Diversified/Conglomerate Manufacturing	15,474	12,866	(2,608)	(16.9)	2.9
9 GI Plastek, Inc.	Chemicals, Plastics, Rubber	20,150	20,754	604	3.0	3.8
10 Head Country Food	Beverage, Food & Tobacco	13,050	14,802	1,752	13.4	2.5
11 JR Hobbs, Co. - Atlanta, LLC	Diversified/Conglomerate Services	29,870	29,870	-	-	5.7
12 Logo Sportswear, Inc.	Textiles and Leather	10,750	20,370	9,620	89.5	2.0
13 Meridian Rack & Pinion	Automobile	13,041	11,536	(1,505)	(11.5)	2.5
14 The Mountain Corporation	Personal and Non-Durable Consumer Products	25,500	18,753	(6,747)	(26.5)	4.9
15 NDLI Inc.	Cargo Transport	3,600	-	(3,600)	(100.0)	0.7
16 Old World Christmas Inc.	Home & Office Furnishings, Housewares	21,950	22,905	955	4.4	4.2
17 Precision Southeast Inc.	Diversified/Conglomerate Manufacturing	13,448	9,618	(3,830)	(28.5)	2.6
18 SOG Specialty K&T LLC	Leisure, Motion Picture, Entertainment	28,149	19,111	(9,038)	(32.1)	5.4
<u>Non-control/Non-affiliate investments</u>						
19 AquaVenture Holdings Limited	Utilities	3,397	3,433	36	1.1	0.6
20 B-Dry LLC	Personal, Food and Miscellaneous Services	14,249	4,355	(9,894)	(69.4)	2.7
21 Counsel Press, Inc.	Diversified/Conglomerate Services	30,495	29,617	(878)	(2.9)	5.8
22 Country Club Enterprises	Automobile	11,725	9,256	(2,469)	(21.1)	2.2
23 Diligent Delivery Systems	Cargo Transport	13,500	15,890	2,390	17.7	2.6
24 Drew Foam Company	Chemicals, Plastics, Rubber	13,351	25,242	11,891	89.1	2.5
25 Frontier Packaging Inc.	Containers, Packaging, Glass	11,025	18,265	7,240	65.7	2.1
26 Funko LLC	Personal and Non-Durable Consumer Products	167	257	90	53.9	0.0
27 Ginsey Home Solutions	Home & Office Furnishings	22,891	20,476	(2,415)	(10.5)	4.4
28 Jackrabbit Inc.	Farming & Agriculture	14,650	14,421	(229)	(1.6)	2.8
29 Mathey Investments Inc.	Machinery	9,379	6,721	(2,658)	(28.3)	1.8
30 Mitchell Rubber Products	Containers, Plastics, Rubber	16,378	19,161	2,783	17.0	3.1
31 Nth Degree Inc	Diversified/Conglomerate Services	18,950	25,761	6,811	35.9	3.6
32 SBS Industries LLC	Machinery	13,571	10,561	(3,010)	(22.2)	2.6
33 Schylling, Inc.	Leisure, Motion Picture, Entertainment	17,081	13,343	(3,738)	(21.9)	3.3
34 Star Seed Inc.	Farming & Agriculture	6,500	4,675	(1,825)	(28.1)	1.2
35 Tread Corporation	Oil & Gas	7,737	2,017	(5,720)	(73.9)	1.5
Total Investments		525,169	501,579	(23,590)	(4.5)	100

Source: Company, Hilliard Lyons



Source: Company, Hilliard Lyons

SUITABILITY

Our suitability rating on GAIN is 3 on our scale of 1 to 4 (1 = most conservative, 4 = most aggressive). Factors contributing to our suitability rating include the company's market capitalization, liquidity and trading volume, diversity of revenues and the geographic diversification of its footprint.

RISKS AND CONSIDERATIONS

Gladstone Investment Corporation is exposed to various risks including:

- **Economic Risk** – A widespread economic downturn could weaken the credit quality of GAIN's portfolio companies which could lead to higher than expected write downs and limit future growth opportunities in the small and medium sized companies GAIN invests in.
- **Interest Rate Risk** - A rise in interest rates could place stress on GAIN's portfolio companies and eventually affect their ability to pay. Additionally, as interest rates rise, GAIN's high dividend may lose appeal and lead to lower demand for the stock.
- **Investment Criteria Risk** - Failure to invest in securities that will support the dividend and future growth of GAIN could eventually lead to dividend cuts.
- **Sector Rotation** – The share price of the company's common stock may be vulnerable to any sector rotation that might occur.

GLOSSARY

Regulated Investment Company (RIC): As regarded by the Internal Revenue Service. By following a few requirements, the most important of which is paying out at least 90% of taxable income (ordinary income plus short-term capital gains), the company does not pay federal income tax. This *avoids double taxation*. A typical company distributes common dividends out of net income (after-tax). Taxes are paid again by the shareholder upon receipt of a dividend. Sometimes a RIC will report income taxes paid. Any amount of taxable income greater than 90% but less than 98% not paid to shareholders is subject to a 4% excise tax and a 35% rate on any taxable income retained. There may be some instances where it is in the RIC's best interest to retain income in spite of paying the taxes.

Business Development Company (BDC): Structure provided in the Investment Company Act of 1940. Basic requirements: 1) Qualifying assets – 70% of total assets must be small private U.S. companies. 2) Asset coverage – assets must cover the company's borrowings by at least 200% or debt to equity cannot exceed 1. 3) Significant managerial assistance – BDCs must offer to provide guidance to its portfolio companies.

Non-Diversified Company: May have investments exceeding 5% of total assets or an equity interest in a company exceeding 10%.

Gladstone Investment Corporation												GAIN:NEUTRAL		
	6/30/16	9/30/16	12/31/16	3/31/17	6/30/17	9/30/17	12/31/17	3/31/18	3/31/18	3/31/19				
	1Q17A	2Q17A	3Q17A	4Q17A	1Q18E	2Q18E	3Q18E	4Q18E	FY 2017 A	FY 2018 E	FY 2019 E	FY 2017 A	FY 2018 E	FY 2019 E
\$ Thousands, Except for Per Share Data														
Income Statement Analysis														
Investment Income:														
Total Interest Income	11,628	11,730	11,707	11,082	11,489	11,621	11,855	11,881	46,397	46,147	50,388	-0.5%	1.5%	7.6%
Total Other Income	2,765	14	1,667	1,282	1,304	1,304	1,330	1,363	4,558	5,728	5,702	25.7%	-7.5%	7.6%
Total Investment Income	14,393	11,744	13,374	12,364	12,793	12,925	13,186	13,244	50,955	51,875	56,089	1.8%	0.5%	7.6%
Expenses:														
Management Fee	2,509	2,489	2,441	2,462	2,546	2,548	2,600	2,665	9,925	9,925	10,360	0.0%	4.4%	7.7%
Management Fee Credit	(837)	(1,114)	(535)	(1,020)	(891)	(892)	(910)	(933)	(3,126)	(3,506)	(3,906)	12.2%	3.4%	7.7%
Administration Fee	289	275	251	285	288	291	297	298	1,190	1,120	1,173	-5.9%	4.8%	7.6%
Interest Expense	971	953	825	791	854	835	945	1,103	4,154	3,540	3,737	-14.8%	5.6%	56.2%
Dividends on Preferred Stock	2,065	2,115	2,251	2,252	2,251	2,251	2,251	2,251	7,963	8,683	9,005	9.0%	3.7%	0.0%
Other	874	1,365	1,759	943	1,250	1,250	1,275	1,275	4,954	4,941	5,150	-0.3%	2.2%	2.0%
Total Expenses Before Incentive Fee	5,881	6,083	6,992	5,747	6,298	6,283	6,458	6,660	25,060	24,703	28,509	-1.4%	4.0%	10.9%
Pre Incentive Fee Net Investment Income	8,512	5,661	6,382	6,617	6,495	6,642	6,728	6,584	25,895	27,172	27,580	4.9%	-2.7%	4.3%
Incentive Fee	1,700	549	1,178	1,323	932	1,091	1,188	1,056	5,179	4,267	5,399	-8.3%	-10.2%	26.5%
Total Expenses	7,581	6,632	8,170	7,070	7,230	7,374	7,646	7,716	30,239	29,453	33,908	-2.6%	1.7%	13.2%
Net Investment Income	6,812	5,112	5,204	5,284	5,563	5,552	5,540	5,528	20,716	22,422	22,181	8.2%	-1.1%	0.0%
Realized & Unrealized Gain (Loss):														
Total Net Realized Gain/(Loss)	18,560	(193)	(3,137)	157	-	-	-	-	(4,599)	15,387	-	-434.6%	-100.0%	NA
Net Unrealized (Depreciation) / Appreciation	(838)	(5,021)	8,888	3,925	-	-	-	-	8,737	6,954	-	-20.4%	-100.0%	NA
Net Dec./Inc. in Net Assets from Operations	24,534	(102)	10,955	9,376	5,563	5,552	5,540	5,528	24,854	44,763	22,181	80.1%	-50.4%	0.0%
Balance Sheet														
Assets:														
Total Investments At Cost	522,363	522,375	498,955	525,169	517,669	525,669	538,669	551,669	518,125	525,169	551,669	1.4%	5.0%	7.6%
Total Investments At Fair Value	490,981	486,972	471,440	501,579	494,079	502,079	515,079	528,079	487,656	501,579	528,079	2.9%	5.3%	8.0%
Unrealized Gain/(Loss)	(31,382)	(36,403)	(27,515)	(23,590)	(23,590)	(23,590)	(23,590)	(23,590)	(30,469)	(23,590)	(23,590)	-22.8%	0.0%	0.0%
Cash & Cash Equivalents	5,233	5,097	3,993	2,868	4,500	4,500	4,500	4,500	4,481	2,868	4,500	-36.0%	56.9%	0.0%
Other Assets	10,938	10,825	7,993	10,576	11,468	11,468	11,468	11,468	10,938	11,468	11,468	4.8%	0.0%	0.0%
Total Assets	507,039	498,062	486,009	515,915	510,047	510,047	531,047	544,047	503,075	515,915	544,047	2.6%	5.5%	7.7%
Liabilities & Shareholders' Equity:														
Line of Credit at Fair Value (\$185 million)	79,600	63,500	43,700	69,700	47,738	56,402	70,077	83,765	95,000	69,700	83,765	-26.6%	20.2%	53.3%
Mandatorily Redeemable Preferred Stock	118,465	134,459	134,639	134,835	134,835	134,835	134,835	134,835	118,465	134,835	134,835	13.8%	0.0%	0.0%
Other Secured Borrowings	5,096	5,096	5,096	5,096	5,096	5,096	5,096	5,096	5,096	5,096	5,096	0.0%	0.0%	0.0%
Total Borrowings	203,161	203,065	183,435	209,631	187,669	196,333	210,008	233,696	218,561	209,631	223,696	-4.1%	6.7%	20.0%
Liabilities	5,998	3,905	5,192	4,482	4,482	4,482	4,482	4,482	8,677	4,482	4,482	-48.3%	0.0%	0.0%
Total Liabilities	209,159	206,960	188,627	214,113	192,151	200,815	214,490	228,178	227,238	214,113	228,178	-5.8%	3.8%	3.8%
Shareholders' Equity (Net Assets)	297,880	292,102	297,382	301,802	317,896	317,232	316,557	315,869	279,022	301,802	315,869	8.2%	4.7%	-13.6%
Total Liabilities & Shareholders' Equity	507,039	498,062	486,009	515,915	510,047	510,047	531,047	544,047	506,260	515,915	544,047	1.9%	5.5%	-42.4%
Share & Per Share Data:														
Common Shares Outstanding (000)	30,271	30,271	30,271	30,271	32,371	32,371	32,371	32,371	30,271	30,271	32,371	0.0%	6.9%	0.0%
Average Diluted Shares (000)	30,271	30,271	30,271	30,271	32,021	32,371	32,371	32,371	30,268	30,271	32,284	0.0%	6.6%	0.3%
Net Investment Income Per Share	0.23	0.17	0.17	0.17	0.17	0.17	0.17	0.17	0.68	0.74	0.69	8.2%	-7.2%	-0.3%
Dividends	0.19	0.19	0.19	0.19	0.25	0.19	0.19	0.19	0.75	0.75	0.83	0.0%	10.4%	-7.2%
Net Investment Income Payout Ratio	83%	111%	108%	107%	145%	112%	112%	112%	110%	101%	121%	-7.6%	19.0%	-7.0%
Earnings Per Share	0.81	(0.00)	0.36	0.31	0.17	0.17	0.17	0.17	0.82	1.48	0.69	80.1%	-53.5%	-0.3%
Net Asset Value Per Share	9.84	9.65	9.82	9.97	0.17	0.17	0.17	0.17	9.24	9.97	9.68	7.9%	-2.1%	-0.8%
Performance Ratios:														
Interest Income / Avg. Investments at Cost	9.06%	9.11%	9.30%	8.78%	8.84%	8.84%	8.84%	8.84%	8.93%	8.84%	8.84%	-9	0	0
Interest Expense / Avg. Borrowings	1.84%	1.88%	1.71%	1.61%	1.72%	1.74%	1.86%	2.03%	1.90%	1.84%	1.84%	-6	0	55
Total Expenses / Investment Income	52.67%	56.47%	61.09%	57.18%	56.51%	57.05%	57.99%	58.26%	59.34%	57.46%	57.46%	-188	0	299
Total Expenses / Assets	5.96%	5.32%	6.72%	5.48%	5.67%	5.69%	5.76%	5.67%	6.01%	5.51%	5.79%	-86	0	28
Return on Assets	4.84%	-0.02%	2.25%	1.82%	1.09%	1.07%	1.04%	1.02%	4.94%	4.08%	3.76%	-86	0	-29
Return on Common Equity	8.24%	-0.03%	3.68%	3.11%	1.75%	1.75%	1.75%	1.75%	8.91%	7.02%	7.06%	-188	0	6
Balance Sheet Ratios:														
Assets/Equity	1.70x	1.71x	1.63x	1.71x	1.60x	1.63x	1.68x	1.72x	1.80x	1.71x	1.60x	-9	-11	27
Total Debt to Equity	0.68x	0.70x	0.62x	0.69x	0.59x	0.62x	0.66x	0.71x	0.78x	0.69x	0.86x	-9	-10	27
Net Debt to Equity	0.66x	0.68x	0.60x	0.69x	0.58x	0.60x	0.65x	0.69x	0.77x	0.69x	0.58x	-8	-11	27

Source: Company reports and Hilliard Lyons estimates.

Additional information is available upon request.

Analyst Certification

I, Andrew W. Stapp, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Gladstone Commercial Corp. (GOOD-\$20.18), Gladstone Capital Corp. (GLAD-\$9.97), and Gladstone Land Corp. (LAND-\$11.08) share the same management and board as Gladstone Investment Corp.

Hilliard Lyons acted as a manager or co-manager of an offering of securities of Gladstone Investment in the past 12 months.

Hilliard Lyons has received investment banking compensation from Gladstone Investment in the past 12 months.

Hilliard Lyons expects to receive investment banking compensation from Gladstone Investment in the coming 3 months.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history

2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	32	26%	13%	88%
Hold/Neutral	79	64%	8%	92%
Sell	12	10%	0%	100%

As of 8 May 2017

Other Disclosures

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

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