EDISON

GLI Finance

Transformation continues

H113 results, 6.9% placement, CLO review

Financial services

As usual, we caveat the statutory accounts for GLI Finance (GLIF) where accounting of the CLO and security realisation does not present the real economic picture. H113 real income rose and both administration and financing costs fell, leading us to upgrade our 'real' pre-tax and EPS numbers by c 20%, supporting the attractive yield. On 30 September the group placed 9m new shares equivalent to 6.9% of its equity at 51p to fund growth. It is looking to segregate the CLO in a separate unit, which may obtain a separate listing in due course.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/11	11.4	2.3	2.4	4.2	21.6	8.1
12/12	14.9	7.2	7.1	4.7	7.3	9.1
12/13e	17.8	9.7	7.2	5.0	7.2	9.7
12/14e	18.0	9.7	6.8	5.3	7.6	10.2

Note: *PBT and EPS are Edison's adjusted numbers, including ongoing BMS re-valuation.

Look through statutory numbers to real growth

We caution against reliance on GLIF's statutory accounts, eg the marking to market of liabilities, which will be repaid at par. H113 was further distorted by the consolidation of HiWave, which was brought into the group as realised security for a defaulted loan and has now been sold. We believe real income (including the £0.8m BMS equity re-valuation in income) rose to £8.8m (from £7.4 in H112), costs fell from £3.1m to £2.7m and financing costs fell from £1.2m to £1.0m, leading us to upgrade estimates and underpinning the attractive yield.

6.9% placement to fund future growth

GLIF has also announced the placing of 9m new shares (6.9% of its existing equity base) at a price of 51p (conditional on shareholders agreeing to dis-apply pre-emption rights at an EGM scheduled for 25 October). These funds will be used on the group's expansion of its SME financing businesses, following the acquisition of BMS and investments in Platform Black and FundingKnight.

CLO position under review

The company is considering segregating the CLO portfolio (now in non-re-investment phase) in a subsidiary, possibly attracting third-party funding, both to reduce GLIF's exposure and to fund growth elsewhere. It will also give greater transparency to the strong growth expected from the recent UK-oriented deals. GLIF says it will consider a separate listing of the CLO portfolio but will ensure that, in aggregate, investors receive at least as high a dividend as they do currently.

Valuation: Yield support increasing

We believe the key issue for investors is whether the c 10% yield is sustainable. The underlying income, costs and financing costs were all ahead of our 2013 run rate, leading us to upgrade numbers and giving greater support to the yield. The shares are trading at a modest discount to NAV (H113: 53.1p).

2 October 2013

Price	**51.8p**
Market cap	**£73m***
	(*inc placement)
Net debt/cash (£m)	N/A
Shares in issue (inc placement)	140.1m
Free float	100%
Code	GLIF
Primary exchange	LSE
Secondary exchange	CISX

Share price performance

%	1m	3m	12m
Abs	1.5	(0.2)	7.3
Rel (local)	0.5	(4.7)	(6.6)
52-week high/low		55.0p	46.5p

Business description

GLI Finance (GLIF) is a Guernsey domiciled closed-ended investment fund, which aims for NAV stability and a predictable yield. It invests in US and UK mid-corporate senior, secured loans and increasingly in specialist providers of SME finance.

Next events

Q3 NAV/div	24 October 2013

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Edison profile page

GLI Finance is a research client of Edison Investment Research Limited

Revisions to estimates

As noted above, income at £8.8m in H113 was above our previous full-year run rates. Costs performance and funding costs were also better. Accordingly, we have revised our estimates by around 20%.

Exhibit 1: Changes to estimates

	Revenue (£m)		% change	Adj. pre-tax profit		% change	EPS (p)		% change	Dividend (p)		% change
	Old	New		Old	New		Old	New		Old	New	
FY13e	16.4	17.8	+9%	7.8	9.7	+24%	5.9	7.2	+22%	5.0	5.0	+0%
FY14e	16.6	18.0	+8%	7.7	9.7	+26%	5.8	6.8	+18%	5.3	5.3	+0%

Source: Edison Investment Research

Financials

H113 saw income ahead of our 2013 run rate, and administration and funding costs below. As expected, dividend income has been falling with the sale of equity positions associated with AMIC. Other income was especially strong in H113 compared with prior halves, including the upwards revision to the value of the BMS equity holding (now more than doubled since acquisition in November 2012). Historically, other income was earned on positions that were non-core and have been sold, but it may be argued that the recently acquired BMS is a core part of GLIF's long-term strategy and should be included in core income. Excluding this income, revenue was £8m in H1.

Looking forwards, we believe continued good economic conditions mean US corporate spreads are likely to remain under pressure. This should be offset by a more positive mix effect with strong growth in UK SME lending at higher spreads. We note that increased valuation of BMS equity implies a good performance from that unit, especially in H113, while the platform investments (FundingKnight/Platform Black) should start to make contributions in H213. Overall we have assumed H213 income will be 2% higher than H113 and that 2014 will be marginally ahead of 2013.

Costs fell materially for both investment management fees (following contractual renegotiations) and in management bonuses. The latter accrues at 10% of returns over a hurdle rate of 12% total return for shareholders. In H113 the total return was 5.8% and so accrual was zero.

We have not at this stage built in any incremental gains from deploying the equity raised in the placement (although we have included the dilution from the greater number of shares in issue). While the cash return is minimal, deployment of lending through the platforms could be material (most FundingKnight loans written in excess of 10% interest rates and Platform Black claiming a slightly higher IRR). GLIF could also carry out further equity investments in other companies. On the downside, the forecasts are at risk from a continued weakness of the dollar relative to the reporting-currency of sterling – income is currently primarily in dollars and costs are in a mix of dollars and sterling.

Adjustments to statutory numbers

In considering the cash cover for GLIF we make a number of adjustments trying to strip out where the accounting presents, in our opinion, a misleading picture. In particular, we include what may be considered cash income (ie interest income and dividends) and strip out MTM adjustments – the latter included MTM of liabilities and assets that will be held to maturity. To establish the business value we also include in other income the re-valuation of the BMS stake but exclude historic other income (which was primarily earned from positions which were non-core). This revaluation is not a cash item but does reflect real (and ongoing) value created. For the purposes of completeness in the table below we provide both measures.

Exhibit 2: Key adjusted financials

	2010	2011	2012	2013e	2014e
Interest and dividend income and BMS valuation (£)	9,756,442	11,418,985	14,863,481	17,800,000	18,000,000
Interest and dividend income exc BMS (£)	9,756,442	11,418,985	14,863,481	16,200,000	16,400,000
Expenses (£)	(6,034,735)	(6,753,780)	(5,419,829)	(5,600,000)	(5,750,000)
Finance costs (£)	(1,716,936)	(2,363,289)	(2,289,156)	(2,500,000)	(2,600,000)
Adjusted profit and loss inc BMS re-valuation (£)	2,004,771	2,301,916	7,154,496	9,700,000	9,650,000
Adjusted profit and loss exc BMS re-valuation (£)	2,004,771	2,301,916	7,154,496	8,100,000	8,050,000
Dividends paid (£)	3,492,000	3,832,008	4,892,597	6,654,750	7,425,300
Cover exc BMS re-valuation (x) (£)	0.57	0.60	1.46	1.46	1.30
Cover inc BMS re-valuation (x) (£)	0.57	0.60	1.46	1.22	1.08

Source: GLIF, Edison Investment Research

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