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Fifth Street Finance: The Best Surprise Is No Surprise

No great surprise in Fifth Street Finance's (FSC) results for the quarter ended December 2009 (see press release here). As expected, Net Investment Income Per Share (NIIPS) dropped from $0.26 to $0.22, thanks to the dilution from the company's extra shares: up 24% on average shares outstanding.

Yes, the earnings per share are 8 cents below the recently announced 30 cents a quarter dividend, but FSC has plenty of dry powder to spend to bring the two metrics back in sync before long.

FSC has been adding assets at a rapid clip: $138mn in just the last 3 months. The momentum should continue in the months ahead. We calculate that the company only needs to add that many more assets in the next quarter to bring earnings in line with the dividend. (Of course that doesn't take into account the new equity raised just a few weeks ago). FSC has $150mn in SBIC money to spend, $11mn in cash, undrawn amounts on its revolver and another line of credit being negotiated. Plus the new equity monies: nearly $80mn.

Thankfully credit quality remains OK. The company still has two non-accruing loans, but nine loans in total in distress. That's unchanged from the prior quarter. Unlike what we've seen with some other BDCs there's been no Realized Loss cleansing of under-performing loans this quarter. We'll get more color from the conference call.

Anyway, the perennial questions for us is whether the dividend is:

A. Paying a fair return?

B. Safe?

The answer to both questions seems to be in the affirmative. At Tuesday's close FSC was trading at $10.6, and the annualized dividend was $1.20 for a yield of 11.3%. That's higher than the 10.6% return when we last wrote about this stock in mid January 2010. The stock price is 12% below its 52 week high.

Moreover, management is hinting that FSC will continue to increase the dividend in 2010. Even at the current NIIPS, FSC is trading at a reasonable enough 12x multiple.

As for the dividend's sustainability, we look to the guidance we're getting from management. It's worth noting, though, that in the past FSC has surprised its shareholders by suddenly cutting its dividend even when in a growth mode. That was just a year ago. We're guessing the available capital and the more favorable economic environment will ensure we don't get fooled again, to quote The Who.

Disclosure: *Author holds a long position in FSC*