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*In this bulletin, we'll review our income stocks, three Business Development Companies (BDCs) and one REIT (though a REIT with a difference). These companies have indicated yields from 5.6% for the newest of the four to 8.7% for the most established. There are some good current buys among this group. We also look at the latest high-potential investment from* ***Altius Minerals****.*

## EARN HIGH, GROWING DIVIDENDS ON THESE SOLID COMPANIES

BDCs lend money to small and middle-market companies and pass on the income generated to shareholders. Dividends tend to be high, dependable and growing. BDCs differ among themselves, of course: they can be more or less conservative; invest in more or less equity, sometimes owning entire companies; and have other different attributes. Our REIT is similar in that it buys buildings occupied by small businesses and leases the buildings back on a triple-net basis. We'll update our holdings below; our last major review of the sector was in Bulletin #293. Two of these companies have yet to report year-end results and no doubt we will have additional comments at that time.

### Gladstone's caution tests patience…but we're patient!

**Gladstone Capital** (GLAD, Nasdaq, 21.46) is arguably the most conservative of the BDCs, investing almost exclusively in senior debt, always fully collateralized. In addition, CEO David Gladstone is conservative by nature, and currently cautious. Since going public in 2001, it has invested funds slowly, while the pace of pre-payments was "never expected", with the result that the company has been on a treadmill of late.

In the latest quarter, for example, $26.7 million was invested in new companies, but $38.7 million came back in repayments and exits. Given that Gladstone—investing as it does in senior debt—rarely gets equity with its loans, this makes it difficult for the company to grow. And this has tested the patience of the market, specifically some analysts.

But, though we would love to see a faster pace of investments and more growth, we are not concerned. We have every confidence that David Gladstone is doing the right thing. Long-term success in investing—whether a public company putting millions to work or an individual putting thousands into stocks—depending largely on picking one's spots. If there is nothing in which to invest, hold on to the cash.

### Is the dividend secure?

The pipeline of new investments remains very full, but the pricing is still too aggressive, and Gladstone has made it clear that he will not change his credit criteria or his return objectives just to spend the money. So while he waits, we wait, collecting our none-too-shabby 7.55% yield.

This investment thesis depends on the dividend being secure, of course. At present, the dividend is running ahead of net investment income, but Gladstone says he does not see income catching up as "much of a challenge…I don't believe (the dividend) will be cut." I do suspect, however, that the dividend will stay static for a while—it's been the same monthly payout since July—until the operating income catches up.

The credit quality remains solid, improved after recent exits, including from some weaker loans. Despite occasional mark-downs on carrying value of loans, they have frequently been made whole on a sale; Gladstone has never had an investment without a positive IRR. With such appreciation in the latest quarter, the book value has increased to $13.74. At 1.5x book, GLAD is trading marginally above its peers, justified because of its more conservative nature.

## Room to grow, at little risk

Because of the cautious investing stance, GLAD is using little leverage, with $55 million borrowed and $155 million in equity. This gives it plenty of room to grow should market conditions change; BDCs can lever themselves one-for-one. The new management agreement, by the way, was approved. Eliminating options for management, it is shareholder friendly.

Some recent shorting saw the stock drop from over $23.50 in mid-December to a low under $20, before the recent modest recovery. The stock can be accumulated on weakness; there is no need to pay up, since I don't see dramatic changes in the immediate term. (Indeed, some of this recent rally is short covering.) But for patient investors, any weakness should be welcomed as an opportunity to buy as a long-term holding.

## More growth potential in less senior loans

**Gladstone Investment** (GAIN, Nasdaq, 14.90) is Gladstone's newest company, and focuses on smaller investments, less senior debt, and garners more equity. As such, it is less conservative than GLAD, but has much more appreciation potential.

GAIN, which has been public less than a year, has put its money out at a more rapid pace than GLAD, with $90 million invested, about 40% of its IPO funds. However, much of this is in syndicated senior loans, simply parking places for the money, until it can make more of its typical buy-out investments. It is still very slow at investing in these higher-yielding investments. (GAIN can invest profitably in lower-yielding syndicated since it is using IPO funds, whereas GLAD is now borrowing money for new investments, so it would make no sense to borrow money only to invest in low-yield vehicles.)

## A low-risk buy with a dividend set to grow

This switch over is underway, however, and the pipeline is strong. The dividend has increased again, to 7 cents a month, from 4 cents; although this rate is ahead of net income, it is catching up from the nominal dividends paid earlier, and Gladstone said he expects the full-year income will cover the year's dividend by year end. Clearly, there would have been no need to increase the dividend by that amount were they not confident of so doing. (The indicated yield is 5.6%, but given that the company has yet to see its one-year anniversary, this number is not totally meanginful.)

David Gladstone believes that the year-ending March 2006 "should be on target (while) March 2007 will be a wonderful year."

Right now, the stock is trading little above NAV ($13.91). Given that more than half of that is in cash, and the company has plenty of room to grow, this makes it a high-potential investment at very low risk.

As more money is put to work, and increasingly more in buyouts, the dividend should continue to grow. Although the stock has jumped from under $13.50 in mid-December to the current price just under $15, it is still a very good buy, if you can accept a lower current yield. We would be very aggressive on any weakness. (We had "buys" on both GLAD and GAIN at lower prices in recent weeks.)

## American Capital is larger and more innovative

**American Capital** (ACAS, Nasdaq, 36.35) is a more complex company. A significantly larger company (with around $3 billion of assets), it makes a broader range of investments, including buying entire companies. It has grown more rapidly than the Gladstone companies, partly because its bigger balance sheets enables it to invest across the credit spectrum. This growth continues, as the company has raised another $300 million in recent months, in two separate tranches. Its portfolio credit quality has improved in recent quarters to satisfactory levels, and we are comfortable with the dividend, increased again in December by another penny (although the rate of increase has slowed); the forward yield is 8.7%.

## New units start to invest

The most important development is that the new divisions we discussed in our last review (#293) are now making their first investments: European Capital made its first buy-out in November, and has subsequently made a handful of major investments; the Commercial Mortgage Backed Securities division has invested $81 million, at a 40% face-value discount, in a package of 195 loans on commercial and multi-family properties; and the new energy unit has last week made its first investment, $85 million in three ethanol plants. We await the year-end report with interest.

So we are comfortable with the credit quality and the dividend, and see significant growth over the next several years, if not imminent dividend increases. The stock has also rallied from a sell-off that took it down to $34.50, but it remains a solid long-term investment, and a strong buy on weakness.

## A REIT with a difference

Lastly, **Gladstone Commercial** (GOOD, Nasdaq, 18.40), which also has yet to report year-end numbers, is building its portfolio more rapidly than the other Gladstone companies; it all depends where the opportunities are! The dividend was raised this quarter from 10 cents a month to 12 cents, for an indicated yield of 7.8%, far more than the typical REIT today. The company holds long-term, triple-net leases, so it is relatively secure. One way to look at this is that Gladstone is essentially investing in the small businesses that are the tenants, with the real estate as collateral. Given the stock's strong recent and sharp rally, from the $16.50 level most of last year, we would not buy, but hold for current income.

## Altius plans major investment, again with other people's money

In a recent bulletin, we discussed the entrepreneurial management at **Altius Minerals** and their innovative business model. Well, *they've done it again!* Altius has announced the formation of 37.5% owned Newfoundland Refining and plans for the construction of a new oil refinery in southeast Newfoundland. Backed by Irish and U.K. investor money, Altius was the inspiration for this venture.

The idea will be to process crude that comes from the offshore rigs, but also to process oil from other areas, that would be delivered on supertankers. It would be built adjacent to an existing smaller refinery, which was recently put up for sale. This existing refinery does not process any of the crude from the local offshore rigs, and Altius' plan to include that has generated strong support from local government.

The location is ideal: in addition to being adjacent to an existing facility, and being able to process local crude, it has an ice-free deep-water port; a skilled local workforce; and is close to the U.S. northeast market. A $7 million, 10-month feasibility study is now underway. (To learn more, go to www.NLRefining.com.)

This is a stroke of genius on the part of Altius, and its dynamic CEO Brian Dalton. If it proceeds, the first revenue from the refinery would be years into the future, but it would provide long-term cash flow to Altius. Again, Altius is risking little capital of its own. **Altius Minerals** (ALS, Toronto, 4.99) is one of our top junior resource companies, without doubt. The stock can be volatile; in the past month alone it has made a round trip from $5.25, down to $4.50 and back again. It's a good buy under $5, but be more aggressive on any pullback to those previous lows.

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**HEAR ME!** Joe Bradley recently interviewed me on his most interesting and valuable *Investor's Hotline*; these in-depth interviews, usually two per issue, come via CD on a monthly basis. In our interview, we discuss global markets, including China and Japan, and gold and other resource markets. You can listen to the interview on-line at www.investorshotline.com/day/.

**SEE ME!** Join me in Toronto in early March for the annual Prospectors and Developers convention (PDAC). Though directed primarily at a technical and institutional audience, there will be investor sessions on Sunday afternoon, 5th, with Bob Bishop, John Doody, Paul van Eeden and others. I'll be speaking on "How to Minimize Risk in High-Potential Gold Stocks". Go to www.pdac.com.

**In our next issue**, we'll complete the review of our current holdings.

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**AND IT'S OUR BUSINESS BECAUSE…?** An Indian steel company (Mittal) wants to take over a French company (Arcelor). So the U.S. Justice Department launches an investigation. Where did we come into this picture?…Not that the Europeans have been acting any better in this affair, attacking Mittal with barely disguised **racist barbs**: former French president, the hauty Valery Giscard d'Estaing attacked "the Indian predator (who fights) by the laws of the jungle", while Arcelor's president, another sophisticated, elegant Frenchman, said Mittal is "full of Indians who want to buy (us) with monkey money." (Thanks to Dennis Gartman for locating these quotes.) Mittal, incidentally, is the largest steel company in the world.

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