Baptista Research

August 04, 2022

INITIATING COVERAGE

Equity | Investment/ Specialty Finance

Mill City Ventures III, Ltd. (OTCQB:MCVT; Target Price: $5.84)

Key Report Highlights	
Industry View:	Attractive
Stock Rating:	Buy
Price Target:	$5.84
Current Price:	$3.00
52-Week-Range:	$1.52 - $6.90

The relevance of specialty finance companies like Mill City Ventures III is increasing today as the Covid-19 pandemic has resulted in banks taking a more cautious approach to lend to small, high-growth businesses, tightening lending standards, increasing interest rates, and making credit markets more volatile. Many SMBs are in need of financing with rapid processing times and they do not mind incurring a higher borrowing cost for the same. Enter Mill City Ventures III. Instead of making sure that a borrower fits into the conventionally well-defined credit box, which loads of larger financial institutions rely on, Mill City Ventures III relies on its own analysis of the opportunity through a more aggressive approach that can produce alpha returns for their investors. It has incredibly strong fundamentals, offers excellent returns on its capital employed, and offers financial and operational guidance to its portfolio companies.

Annual Income Statement	2021	2022E	2023E
Revenues	2.66	4.60	6.51
Cost of Goods Sold	0.00	0.00	0.00
Gross Income (excl. D&A)	2.66	4.60	6.51
EBITDA	1.30	3.24	5.11
EBIT (incl. extraordinary exp)	1.30	3.24	5.11
Net Income	1.30	3.24	5.11
Cash from Operations	-1.89	-4.67	5.21
Free Cash Flows	-1.89	-4.67	4.95

INVESTMENT THESIS

This is our first report on Mill City Ventures III and we look to provide a detailed account of the various industries that the company operates in and the key macro-economic factors. Given its current size, Mill City Ventures III is exempt from many of the regulatory restrictions that apply to other traditional lenders or institutional rivals. As a result, they can adopt a more aggressive lending strategy and still produce competitive returns. A more aggressive strategy entails greater risks, but the management has put in place highly effective risk mitigation measures and is constantly concentrating on increasing blended portfolio returns. Due to their low operating expenses, they have greater income statement leverage, which maximizes profitability and Return on Equity for shareholders. It is also important to highlight that Mill City Ventures has the potential for inorganic growth through complementary and lucrative acquisitions of other investment management companies with substantial loan books. Overall, we believe that Mill City Ventures III has phenomenal growth prospects and is an excellent investment prospect. Baptista Research looks to evaluate the different factors that could influence Mill City Ventures III's price in the near future and attempts to carry out an independent valuation of the company using a Discounted Cash Flow (DCF) methodology to determine a suitable price for the company's stock.

Growth & Margins	2021	2022E	2023E
Sales Growth	104.6%	72.9%	41.5%
EBITDA Margin	48.9%	70.4%	78.5%
EBIT Margin	48.9%	70.4%	78.5%
Net Profit Margin	48.9%	70.4%	78.5%

Valuation Ratios	2021	2022E	2023E
EV/ Sales	12.1	13.6	11.3
EV/ EBITDA	24.7	19.3	14.4
EV/ EBIT	24.7	19.3	28.0
Price/Earnings	24.7	19.3	28.0

COMPANY OVERVIEW

Mill City Ventures III, Ltd can be classified as a specialty finance company that specializes in investing in equity and debt securities of public and private companies to fund their growth, expansion, and start-up costs. The company mainly concentrates on financing, investing, and offering managerial support to privately held and publicly traded companies. The management also looks at some form of active investments and advises the businesses in its portfolio on financial and operational matters. As they make every effort to reduce investor risk, their goal is to give investors returns that are above the market average. The management has particularly adept at balancing these two conflicting interests. It offers litigation finance, asset-backed loans, title loans, tax anticipation loans, real estate bridge loans, mortgages, and other financial services in addition to specialty finance. Mill City Ventures is headquartered in Wayzata, Minnesota.

KEY FACTORS DRIVING THE COMPANY'S PERFORMANCE

1. ROBUST BUSINESS MODEL
2. FINANCIAL METRICS & LENDING SUCCESS STORIES
3. THE AMMO FINANCING CASE STUDY
4. MACRO FOR SPECIALTY FINANCE
5. EXPERIENCED MANAGEMENT TEAM

Robust Business Model

- Mill City Ventures III started off as a business development company in 2013 and had since grown into a full-fledged specialty finance company and non-banking lender.
- It belongs to the group of specialty finance companies, which are essentially non-bank lenders that extend credit to SMBs who might otherwise have trouble obtaining financing.
- Specialty finance companies lend money to businesses and consumers for a variety of uses. Companies like Mill City Ventures assess each loan application by taking into account hard data like the borrower's intention and ability to pay as well as the asset value of any pledged collateral, in contrast to traditional banks' more formulaic, ratio-driven approach.
- The primary benefit of Mill City Ventures is its quick processing time, which makes up for the higher cost of borrowing for any borrower and explains why businesses swarm to them with loan requests.
- Since there are fewer reporting requirements and a great balance between aggressive lending and strong risk management, the company has a lot more flexibility when it comes to investments and lending policies.
- The company's strong risk management is demonstrated by the fact that it has not yet reported any non-performing assets. Given the lower volume of staff, lower overhead, and much flatter organizational structure than traditional banks, it also has a significantly lower cost of processing proposals, with quick loan request decision-making.

Financial Metrics & Lending Success Stories

- According to its most recent balance sheet, Mill City Ventures III is overseeing slightly less than $19 million in terms of funds under management when we take into account all of the company's debt and equity holdings.
- A trailing twelve-month revenue of $3.11 million and a net income of $1.50 million are currently being reported through the utilization of these funds which implies an overall return on capital employed is 9.4%, and a return on equity of a respectable 11%.
- As it looks to seize new lending opportunities in settled claims, asset-based loans, real estate-backed loans, and other specialized lending scenarios, Mill City Ventures III has had a number of notable success stories in the lending industry.
- Alatus Development LLC, one of their clients, borrowed $3.9 million from the business to continue working on ongoing apartment development projects.
- Alatus was a dependable client with a sizable net worth who was anticipated to pay back the loan after the apartments were sold. Alatus' share of the sale of a different apartment building was anticipated to generate $18 million.
- On this deal, Mill City Ventures III anticipates making a net interest and closing fee income of $365,000. This represents an ROI of more than 32%, which is absolutely incredible.
- The company's $3.4 million loan to Villas at 79th, which enabled them to close on the land and apply for final development approvals, is another illustration of a successful real estate lending deal.
- There was a 58.29% return on investment on this transaction.
- An example that is not related to real estate is the funding of GunBroker.com, the leading online marketplace for the legal sale of firearms, and Ammo Inc, the renowned American manufacturer of ammunition and munition components, by Mill City Ventures III. From this transaction, the company is anticipated to benefit significantly.

The Ammo Financing Case Study

- Mill City Ventures III has financed one of the companies that lies within our coverage as another high-potential small-cap prospct – Ammo, Inc. (NASDAQ:POWW), a well-known American ammunition and munition components manufacturer, and its unit, GunBroker.com, the top online marketplace for the legal sale of firearms, hunting, shooting, and related goods.
- Mill City Ventures has a strong upside in this transaction and is actively intervening in Ammo's business.
- Both entities are working together to provide GunBroker.com customers the choice to buy items through the GunBroker.com website using Mill City's short-term consumer financing.

- With GunBroker.com, the management's original strategy was to take advantage of the fantastic eBay-type platform by offering significant customer services and increased product offerings through various channels.

- The quick and efficient financing support from Mill City Ventures will help the company increase the number of users on the GunBroker.com platform through aggressive marketing.

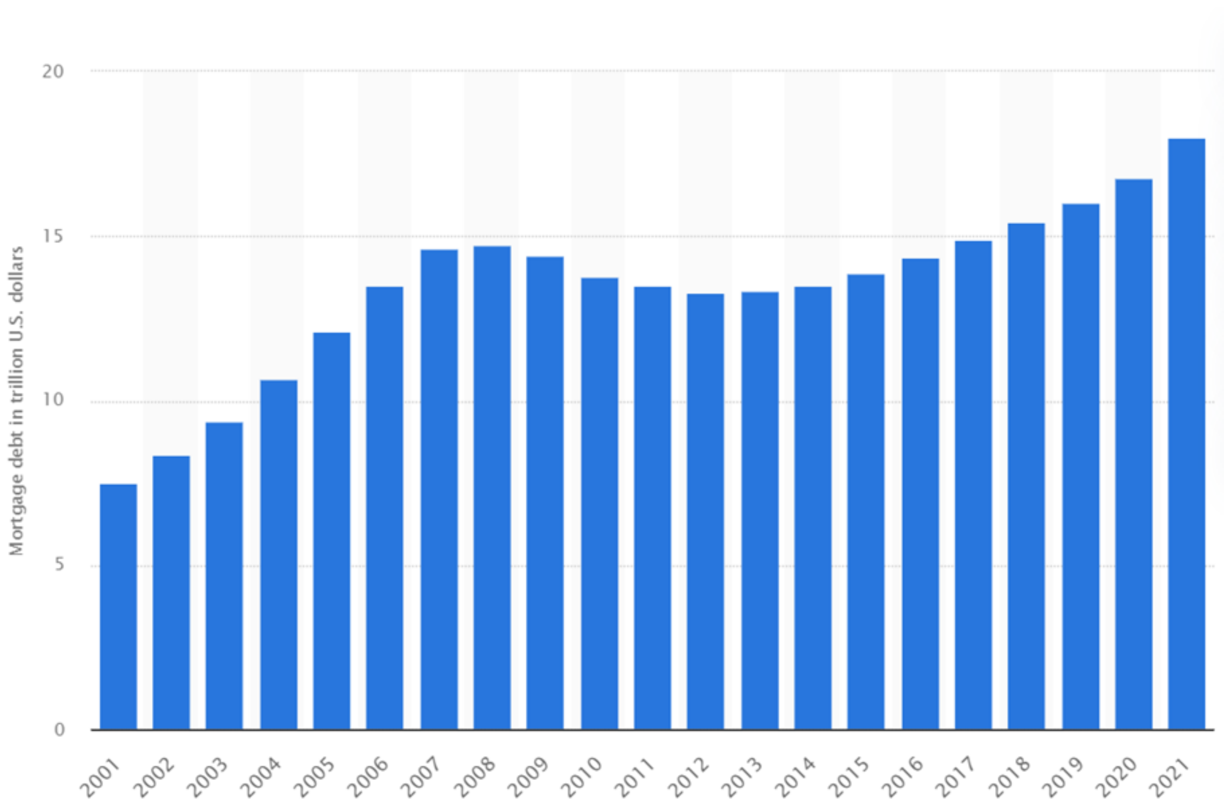
- The working capital financing helps Ammo to offer its customers a variety of payment options, such as split payments, monthly instalments, etc i.e., a point-of-sale consumer financing program.

- This working relationship with Ammo Inc. is expected to generate a strong return for Mill City Ventures shareholders.

Macro For Specialty Finance

- Mill City Ventures operates in the domain of specialty finance which is at an interesting inflexion point today. After the Covid-19 pandemic, banks have taken a more cautious approach to lend to small, high-growth businesses, tightening lending norms, increasing interest rates (as a result of the rate hikes by the Federal Reserve), and making credit markets more volatile.

- The credit market has largely been cyclical in nature depending on the policies of the Fed as evident from the chart below:



Source: Statista

- We are using the U.S. mortgage debt as a benchmark to analyze to overall credit market in the states which peaked out in 2021 and is seeing a downward trajectory from 2022 onwards.

- Specialty finance companies like Mill City Ventures are crucial in this situation because they offer SMBs the much-needed financing with quick processing times, albeit at a higher interest rate.

Source: Statista

- We see a reversal in the interest rate cycle as well in the above chart which paves the way for specialty finance companies like Mill City Ventures to expand their ROI.

- Instead of making sure that a borrower fits into the conventionally well-defined credit box, which loads of larger financial institutions rely on, such businesses rely on their own analysis of the opportunity.

- Thus, they are lending to companies that are not eligible for more conventional financing and have the opportunity to produce alpha returns for their investors.

- Overall, Mill City Ventures is bound to benefit significantly from the current macro-economic scenario of rising interest rates and tightening credit norms.

Experienced Management Team

- The success of a specialty finance company or any form of investment company for that matter, is often determined by the strength of its top management. It forms the basis for people investing in the company.

- It is the experience of the management and its ability to frame a robust investment policy that benefits its investors that truly determines whether the entity can generate alpha returns in the future.

- Mill City Ventures III is led by Douglas Polinsky, a highly experienced industry veteran who was serving as the CEO of Great North Capital Consultants, Inc since 1994.

- Great North Capital Consultants was known to make direct investments in both public and private companies and provides corporate clients with advice on issues related to commercial and governance structures, acquisitions of private companies by public companies, and other transaction-related matters.

- Mr. Polinksy has a vast experience in investment management and also served as an Independent director for the Pennsylvania-based podcast distribution technology company Liberated Syndication, Inc.

- His operational experience while serving public and private companies is also quite rich. He is ably supported by Joseph Geraci, the CFO of the company, who also has many decades of experience in consulting and advisory services.

- Mr. Geraci worked as a managing member in Isles Capital, LLC, a company that offers consulting and advisory services to help small businesses, both public and private, grow their businesses.

- He also served as the Director of Finance at Gelstat Corporation, a Bloomington, Minnesota-based company that sells homoeopathic medicines.

- Besides, Mr. Geraci has served as the Vice President of Oak Ridge Financial Services, Inc., a company that primarily emphasizes structuring and negotiating private debt and equity placements with privately held and publicly traded companies.

- To sum up, Mill City Ventures III is well-positioned because of its knowledgeable and experienced team members.

HISTORICAL FINANCIAL STATEMENTS & PROJECTIONS

Income Statement	**12/31/18**	**12/31/19**	**12/31/20**	**12/31/21**	**LTM**
Total Revenues	**0.15**	**0.16**	**1.30**	**2.66**	**3.11**
Cost of Goods Sold	0.00	0.00	0.00	0.00	0.00
Gross Profit	**0.15**	**0.16**	**1.30**	**2.66**	**3.11**
Selling General & Admin Expenses	-0.67	-0.83	-0.73	-1.35	-1.30
Other Expenses/ Adjustments	0.00	0.00	-0.01	-0.01	0.00
EBITDA	**-0.52**	**-0.67**	**0.56**	**1.30**	**1.81**
Depreciation & Amortization	-0.01	0.00	0.00	0.00	0.00
Other Operating Expenses/ Income	-0.68	-0.83	-0.74	-1.35	-1.30
Operating Income	**-0.53**	**-0.67**	**0.56**	**1.30**	**1.81**
Gain (Loss) On Sale Of Investments	2.18	0.02	1.94	2.58	0.31
EBT Incl. Unusual Items	**1.65**	**-0.66**	**2.5**	**3.89**	**2.05**
Net Income	**1.65**	**-0.66**	**2.21**	**2.83**	**1.5**
Net Income to Common Incl Extra Items	**1.65**	**-0.66**	**2.21**	**2.83**	**1.5**
Diluted EPS Excl Extra Items	0.15	-0.06	0.2	0.26	0.14
% Change YoY	161.80%	-139.80%	436.90%	30.00%	
Weighted Average Diluted Shares Outstanding	11.07	11.07	10.87	10.79	10.79
% Change YoY	-6.70%		-1.80%	-0.70%	

- Let us start off with analyzing the most recent and historical data reported by the company. When we analyze the company's annualized historical income statement, we see that the top-line was $2.66 million for the previous financial year ending in 2021.
- The revenue growth was more than 10 times from the 2018 numbers which is truly phenomenal and largely a function of the increased capital employed (as all the revenues are basically interest income and various forms of loan processing fees).
- The company's growth continued in 2022 and its TTM revenue is already $3.11 million.
- The company's overall annual EBITDA was negative a couple of years back mainly because it had a lower amount of capital employed.
- As its capital employed went up and as the company was able to maintain a double-digit ROI, it turned profitable since 2020
- In terms of the bottom-line, Mill City Ventures III reported an operating income (EBIT) of $1.81 million and a net income of $1.5 million.

Balance Sheet	**12/31/18**	**12/31/19**	**12/31/20**	**12/31/21**	**LTM**
Cash And Equivalents	0.97	8.07	5.44	1.94	0.07
Accounts Receivable	0.09	0.01	0.09	0.32	0.56
Other Receivables	0.00	0.00	0.00	0.00	0.00
Notes Receivable	0.25	0.25	0.25	0.25	0.25
Total Receivables	**0.34**	**0.26**	**0.34**	**0.57**	**0.81**
Inventory					
Prepaid Expenses	0.05	0.03	0.04	0.08	0.03
Total Current Assets	**4.18**	**2.50**	**4.08**	**6.40**	**6.23**
Gross Property Plant And Equipment	0.07	0.35	0.05	0.08	0.08
Accumulated Depreciation	-0.01	-0.04	0.00	-0.01	-0.01
Net Property Plant And Equipment	**1.36**	**8.35**	**5.82**	**2.59**	**0.91**
Goodwill	0.00	0.00	0.00	0.00	0.00
Net Property Plant And Equipment	0.00	0.04	0.02	0.00	0.00
Long-term Investments	9.96	1.74	6.67	14.10	20.09
Other Intangibles	0.00				
Total Assets	**11.32**	**10.14**	**12.51**	**16.70**	**21.00**
Accounts Payable	0.04	0.02	0.03	1.96	0.10
Accrued Expenses	0.00	0.00	0.00	0.00	0.00
Short-term Borrowings	0.00	0.00	0.00	0.00	0.00
Current Portion of Capital Lease Obligations	0.00	0.00	0.00	0.01	0.00
Current Income Taxes Payable	0.00	0.00	0.01	1.27	1.43
Unearned Revenue Current	0.00	0.00	0.00	0.00	0.00
Other Current Liabilities	0.00	0.00	0.54	0.00	0.00
Total Current Liabilities	**0.04**	**0.02**	**0.59**	**3.24**	**1.54**
Long-Term Debt	0.00	0.00	0.00	0.00	5.33
Capital Leases	0.00	0.04	0.03	0.00	0.00
Unearned Revenue Non Current	0.00	0.00	0.00	0.00	0.27

Deferred Tax Liability Non Current	0.00	0.00	0.26	0.05	0.04
Other Non Current Liabilities	0.00	0.00	0.00	0.00	0.00
Total Liabilities	**0.04**	**0.07**	**0.87**	**3.28**	**7.18**
Common Stock	0.01	0.01	0.01	0.01	0.01
Additional Paid In Capital	10.77	10.77	10.67	10.69	10.69
Retained Earnings	0.49	-0.72	0.96	2.71	3.12
Comprehensive Income and Other	0.00	0.00	0.00	0.00	0.00
Total Common Equity	**11.28**	**10.07**	**11.64**	**13.41**	**13.83**
Total Equity	**11.28**	**10.07**	**11.64**	**13.41**	**13.83**
Total Liabilities And Equity	**11.32**	**10.14**	**12.51**	**16.70**	**21.00**
Total Shares Out. on Filing Date	**11.07**	**11.07**	**10.79**	**10.79**	**10.86**

- Moving on to the company's historical annualized balance sheet, when we analyze the volume of capital that the company has been disbursing, we see a marked increase over the years with the current level being slightly shy of $19 million.

- This level of capital employed is expected to go up with more fresh equity issuances and this is bound to result in an increase in profitability assuming that the management is able to maintain its ROI.

Cash Flow Statement	**12/31/18**	**12/31/19**	**12/31/20**	**12/31/21**	**LTM**
Net Income	**1.65**	**-0.66**	**2.21**	**2.83**	**1.5**
Depreciation & Amortization	0.01	0.00	0.00	0.00	0.00
Amortization of Goodwill and Intangible Assets	0.00	0.00	0.00	0.00	0.00
Total Depreciation & Amortization	**0.01**	**0.00**	**0.00**	**0.00**	**0.00**
(Gain) Loss on Sale of Investments	-2.18	-0.02	-1.94	-2.58	-0.31
Asset Writedown & Restructuring Costs	0.00	0.00	0.00	0.00	0.00
Stock-Based Compensation	0.00	0.00	0.06	0.02	0.02
Other Operating Activities	-0.54	8.24	-2.72	-3.80	-5.95
Change In Accounts Receivable	0.21	0.09	-0.08	-0.24	-0.35
Change In Inventories	0.00	0.00	0.00	0.00	0.00
Change In Accounts Payable	-0.10	-0.03	-0.01	1.91	0.02
Change in Unearned Revenues	0.00	0.00	0.00	0.00	0.00
Change In Income Taxes	0.00	0.00	0.00	0.00	0.17
Change in Other Net Operating Assets	-0.25	0.03	0.01	-0.02	0.23
Cash from Operations	**-1.19**	**7.65**	**-2.46**	**-1.89**	**-4.67**
Cash from Investing	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Total Debt Issued	0.00	0.00	0.00	0.00	5.33
Total Debt Repaid	0.00	0.00	0.00	0.00	0.00
Issuance of Common Stock	0.00	0.00	0.00	0.00	0.00
Repurchase of Common Stock	0.00	0.00	-0.16	0.00	0.00
Special Dividend Paid	0.00	-0.55	0.00	-1.62	-1.62
Other Financing Activities	0.00	0.00	0.00	0.00	0.54
Cash from Financing	**0.00**	**-0.55**	**-0.16**	**-1.62**	**4.25**

Net Change in Cash	-1.19	7.10	-2.63	-3.50	-0.43

- Moving on to the company's historical annualized cash flow statement, when we analyze the operating cash flows, we see that it is burning cash for now as it has deployed most of its capital and the active investments are yet to be liquidated.
- Its cash flow from investment activities is expected to go up as the management might look to deploy capital to add more fish farms.
- The company might require additional rounds of financing in order to add more fish farms particularly to fuel the expansion in the U.S. market.

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Ratios	**8/31/16**	**8/31/17**	**12/31/18**	**12/31/19**	**LTM**
Return Ratios:					
Return on Assets %	-3.10%	-3.90%	3.10%	5.60%	6.40%
Return on Capital %	-4.70%	-6.70%	4.70%	9.70%	9.40%
Return On Equity %	15.80%	-6.20%	20.40%	22.60%	11.00%
Return on Common Equity %	15.80%	-6.20%	20.40%	22.60%	11.00%
Margin Analysis:					
Gross Profit Margin %	100.00%	100.00%	100.00%	100.00%	100.00%
SG&A Margin %	445.10%	514.60%	56.50%	51.00%	41.80%
EBITDA Margin %	-345.10%	-414.60%	43.50%	49.10%	58.20%
EBITA Margin %	-351.90%	-416.20%	43.30%	49.00%	58.20%
EBIT Margin %	-351.90%	-416.20%	43.30%	49.00%	58.20%
Income From Continuing Operations Margin %	1094.50%	-406.40%	170.60%	106.60%	48.20%
Net Income Margin %	1094.50%	-406.40%	170.60%	106.60%	48.20%
Normalized Net Income Margin %	-219.90%	-260.10%	27.10%	30.60%	35.00%
Net Avail. For Common Margin %	1094.50%	-406.40%	170.60%	106.60%	48.20%
Levered Free Cash Flow Margin %	-301.20%	-206.00%	68.10%	120.40%	74.30%
Unlevered Free Cash Flow Margin %	-301.20%	-206.00%	68.10%	120.40%	75.70%
Asset Turnover:					
Asset Turnover	0.01x	0.02x	0.10x	0.16x	0.15x
Fixed Assets Turnover	15.52x	6.80x	39.18x	187.53x	
Inventory Turnover					
Working Capital Turnover	0.11x	0.02x	0.25x	(4.12x)	(4.97x)
Short Term Liquidity:					
Current Ratio	32.95x	334.24x	9.93x	0.80x	0.59x
Quick Ratio	25.73x	322.98x	9.43x	0.70x	0.41x
Op Cash Flow to Current Liab	(28.99x)	306.21x	(4.20x)	(0.58x)	(3.04x)
Avg. Days Outstanding Inventory	NA	NA	NA	NA	NA
Avg. Days Payable Outstanding	NA	NA	NA	NA	NA

Long-Term Solvency:

Total Debt / Equity	0.00%	0.40%	0.20%	0.00%	38.50%
Total Debt / Capital	0.00%	0.40%	0.20%	0.00%	27.70%
Total Liabilities / Total Assets	0.40%	0.70%	7.00%	19.70%	34.20%
Total Debt / EBITDA		(0.08x)	0.04x	0.00x	
Net Debt / EBITDA	1.86x	13.45x	(8.59x)	(1.41x)	
Net Debt / (EBITDA - Capex)	1.86x	13.45x	(8.59x)	(1.41x)	

- The company does not pay any dividend.
- Its number of shares are expected to go up over time with many fresh issuances to raise capital, reduce the debt and leverage and also to expand their corpus.
- The company has a very low level of payables and very low current liabilities.
- The total asset turnover ratio measures the value of a company's sales or revenues relative to the value of its assets. The higher the asset turnover ratio, the more efficient a company is, with respect to using its assets to generate revenues.
- Mill City Ventures III's total assets turnover has been stable around the 0.15 mark in 2022.
- Return on assets is an excellent indicator of how efficient a company's management is in generating earnings from their economic resources or assets on their balance sheet.
- On the other hand, the return on equity of a company measures the value creation of the management and profitability in relation to stockholders' equity.
- The company's RoA is 6.4% and its RoE is 11% which are both very good.

Financial Forecasts	**2021**	**2022E**	**2023E**	**2023E**
Total Revenues	2.66	4.60	6.51	9.12
% Change YoY		72.93%	41.52%	40.09%
Cost of Goods Sold	0.00	0.00	0.00	0.00
% Margin	0.00%	0.00%	0.00%	0.00%
Gross Profit	2.66	4.60	6.51	9.12
% Margin	100.00%	100.00%	100.00%	100.00%
EBITDA	1.30	3.24	5.11	7.72
% Margin	48.87%	70.43%	78.49%	84.65%
Operating Income	1.30	3.24	5.11	7.72
% Margin	48.87%	70.43%	78.49%	84.65%

Net Income	1.30	3.24	5.11	7.72
% Margin	48.87%	70.43%	78.49%	84.65%
Cash from Operations	-1.89	-4.67	5.21	7.87
% Margin	-71.05%	-101.52%	80.06%	86.34%
Free Cash Flows	-1.89	-4.67	4.95	7.48
% Margin	-71.05%	-101.52%	76.06%	82.03%

- Now let us move on to Baptista Research's forecasts for Mill City Ventures III's income statement and cash flows.
- We forecast a top-line growth of 72.93% for 2022, around 41.52% for 2023.
- This growth is expected to translate into a positive net margin of over 70% in all the years as its fixed expenses are expected to remain stable.
- In terms of the cash flows, we expect Mill City Ventures III to generate a positive operating cash flow from 2022 onwards.
- The company should be free cash flow positive from 2022 itself. Also, its Net Debt is expected to increase as there is a chance that the company might use debt to expand its investable corpus.
- The Net Debt-to-EBITDA ratio is a measure of leverage, calculated as a company's interest-bearing liabilities minus cash or cash equivalents, divided by its EBITDA. It shows how many years it would take for a company to pay back its debt if net debt and EBITDA are held constant.
- The company could get a good credit rating in the near future and have a lot of leeway in terms of this ratio to raise debt.

DISCOUNTED CASH FLOW (DCF) VALUATION

Key DCF Assumptions	
WACC	16.4%
CoD	8.0%
CoE	19.3%
Market Rate	6.0%
Risk Free Rate	1.3%
Beta	3.0
Terminal Value	82.99
Tax Rate	0.0%

- For the purpose of carrying out the discounted cash flow valuation of Mill City Ventures III, we have used the standard capital asset pricing model (CAPM).
- We have used a 6.0% equity market risk premium based on the S&P 500 returns for the past 5 years.
- The risk-free rate has been assumed as the 10-year Treasury Constant Maturity Rate of the U.S. at 1.60%.
- The company's stock is more volatile than the market as a whole and has a beta of 3 which we shall use without leveraging the same as we are going for the enterprise value approach.
- This is used in order to arrive at the cost of equity (CoE) of 19.3% which appears reasonable for a company like Mill City Ventures III.
- Based on the company's long term debt and interest payments, the cost of debt is 8%.
- After incorporating the CoE and the CoD and average tax rate of 0.0%, we arrive at a Weighted Average Cost of Capital (WACC) of 16.4%.
- The terminal value is a key component of any DCF valuation as it accounts for the largest chunk of the total projected value of the company. There are a number of methodologies used to determine the same such as the perpetual growth rate method or the multiples method.
- In this case, we have gone ahead and determined the terminal value by applying the current EV/Sales ratio of 5x to our forecasted revenues of 2024. . .

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EV and Market Cap	Current	2022E	2023E	2024E
Price ($)	3.00	5.84	13.36	20.18

Outstanding Number of shares (million)	10.71	11.78	11.78	11.78
Total Market Cap (millions)	32.13	68.77	157.39	237.78
Net Debt	-0.07	-0.10	-0.90	-1.70
Enterprise Value (millions)	32.13	62.42	73.59	82.99

- After applying the discount rate (WACC) of 16.4%, we arrive at a price target of $5.84 for 2022.
- Our target price at the end of 2023 is $13.36 and for 2024 is $20.18 which implies a total appreciation of nearly 7x in the coming 3 years in the stock price.
- During this phase, we see the EV/ EBITDA to be around 13.3, the EV/ EBIT will be falling to a level of 28.0 over the coming 3 years.

Valuation Ratios	**Current**	**2022E**	**2023E**	**2024E**
EV/ Sales	12.08	13.57	11.30	9.10
EV/ EBITDA	24.72	19.27	14.40	10.75
EV/ EBIT	24.72	19.27	28.00	28.00
Price/Earnings	24.72	19.30	28.00	28.00

KEY RISKS

- It is important to highlight the key risks associated with an investment in Mill City Ventures III as well as the inherent risks associated with the financial projections and price forecasts presented in this report.

- Mill City Ventures III faces the classic risks associated with any specialty finance company with limited regulatory requirements. The company has extremely wide latitude in terms of investment policy which gives the management too much leeway to take high risks for maximizing returns.

- While the company may not have had any non-performing assets (NPAs) so far, there is no certainty that this trend will continue in the future. Also, the company could be lending a significantly large portion of its total corpus to a single entity resulting in a very high concentration risk.

- To accommodate growth and compete effectively, the Mill City management will need to build a large corpus which requires regular issuance of shares which could dilute existing shareholders and reduce the return on equity.

- The company also has a significant amount of debt on its balance sheet and a high cost of debt (around 8%). While this debt does help boost the return on equity, the leverage could also prove risky in the long term.

- There is a possibility that Mill City Ventures' management may struggle to successfully implement and execute their business tactics, operating strategies and growth initiatives. If the management fails to accomplish their growth and organizational modification effectively, it may destroy their business and operational results.

- The future of Mill City Ventures's business will depend upon its ability to obtain high-quality debt proposals that require sufficient financing and support from them.

- There is a possibility that the company may not be successful in getting good quality investment proposals while continuing to bare its cost of capital.

- One of the most significant risks that the company is currently facing is the ongoing global impact of Covid-19 as well as the geopolitical situation between Russia and Ukraine which could have a material impact on Mill City Ventures' lending activities.

- With respect to our price projection, we would like to clarify that the valuation of Mill City Ventures III in this report is specific to the date of the analysis i.e., 04-08-2022.

- Another one of the biggest risks to Mill City Ventures III' model is the fact that the company's top-line growth is assumed to be consistently growing by a certain rate in the model. There is a possibility that this assumption might not hold true if the COVID-19 situation persists for too long. With respect to our price projection, we would like to clarify that the valuation of Mill City Ventures III in this report is specific to the date of the analysis i.e., 4th August 2022.

- We must emphasize that the projected valuation and the share price of Mill City Ventures III are dependent on the realization of the revenue growth, free cash flows and the other assumptions taken into account. Our analysis cannot be directed to providing any assurance about the achievability of these financial forecasts. There is a possibility that the actual results of the company are different from the projected results as a result of unexpected events and circumstances such as the realization of the threats mentioned in the paragraph above. Lastly, we would like to clarify that we had no interaction with the management of the company and they did not comment on the achievability or the reasonableness of the assumptions underlying the financial forecasts. Please check out our detailed disclosures at the end for further details.

ANALYST RATINGS

- Buy: Expected to outperform market over next 6 to 12 months. Minimal risk to fundamentals and valuation. Good long-term investment.
- Outperform: Expected to outperform the market over next 6 to 12 months but there is a moderate risk to fundamentals and valuation.
- Sell: Expected to significantly underperform the market over next 6 to 12 months. There is a strong likelihood of the security delivering negative returns and a very high risk to fundamentals and valuation.
- Underperform: Expected to underperform the market over next 6 to 12. There is a moderate to high risk to fundamentals and valuation.
- Hold: Expected to perform in line with the market over next 6 to 12 months. However, there is a moderate to high risk to fundamentals and valuation.

ANALYST INDUSTRY VIEWS

- Attractive: The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.
- In-Line: The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.
- Cautious: The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.
- Benchmarks for each region are as follows: North America - S&P 500; Latin America – MSCI EM Latin America Index; Europe – MSCI Europe; Japan - TOPIX; Asia - relevant country index or sub-regional index. Please contact us to know the relevant index in case it is not specified in the report.

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