



Oxford Square Capital Corp. (OXSQ)

Updated November 1st, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$4.25	5 Year CAGR Estimate:	3.9%	Market Cap:	\$211 M
Fair Value Price:	\$3.40	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	11/15/2021
% Fair Value:	125%	5 Year Valuation Multiple Estimate:	-4.4%	Dividend Payment Date:	11/30/2021
Dividend Yield:	9.9%	5 Year Price Target	\$3.4	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Oxford Square Capital Corp. is a BDC (Business Development Company) specializing in financing early and middle-stage businesses through loans and CLOs. The company holds an equally split portfolio of First-Lien, Second-Lien, and CLO equity assets spread across 8 industries, with the highest exposure in business services and healthcare, at 36.3% and 24.9%, respectively. The company's assets have a gross investment value of around \$421.1 million in 61 positions, with 62% of debt securities being secured. OXSQ generates around \$50 million in annual interest payments and is based in Greenwich, Connecticut.

On October 26th, Oxford Square reported its Q3 results for the period ended September 30th, 2021. The company generated approximately \$9.8 million of total investment income, an increase of 25.6% compared to the previous quarter, or 19.5% higher on a year-over-year basis. The growth was attributed to a larger debt and CLO equity portfolio, despite the declining rates over this period, which affected the company's investment yields. The weighted average yield of its debt investments was 7.5% at the current cost, compared to 7.6% during Q2-2021. The cash distribution yield from OXSQ's CLO equity investments also declined from 10.4% to 9.1% sequentially. Total expenses, which primarily include interest paid on its own financing and managers' fees, amounted to \$5.8 million, 13.7% higher vs. Q2-2021. As a result of higher growth in investment income against growth in expenses, NII (the net investment income) amounted to \$3.9 million, or \$0.08/share, 39.2% higher sequentially. Net asset value (NAV) per share was \$5.03 compared to \$4.91 last quarter due to the distribution cut during that period. Based on the results of the first nine months and Oxford Square's current investment yields, we expect this year's IIS/share to be around \$0.34.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
IIS¹	\$0.96	\$1.12	\$1.07	\$1.17	\$0.66	\$0.52	\$0.60	\$0.67	\$0.81	\$0.40	\$0.34	\$0.34
DPS	\$0.99	\$1.12	\$1.16	\$1.19	\$1.13	\$1.15	\$0.80	\$0.79	\$0.80	\$0.61	\$0.42	\$0.31
Shares²	32.4	38	51.1	58.8	59.8	51.9	51.5	49.7	47.8	49.4	49.6	55.0

The company's investment income per share has been declining at a 10-year CAGR of 9.3%, as financing has become cheaper, preventing Oxford Square from refinancing at its previously higher rates. Additionally, the company has been historically over-distributing dividends to shareholders, decaying its NAV, and hence its future income generation due to fewer assets. Considering that global yields are likely to remain razor-thin in the medium-term, we find it incredibly unlikely that Oxford Square will be able to return to its previously gross interest generated.

With rates a bit unlikely to continue moving any lower, income generation should stabilize over the next few years. Hence, we expect a stable IIS/share in the medium term. However, as has been the case in the past several times, we expect further dividend cuts over the medium term due to their currently unsustainable levels. We have embedded a -6% distribution decline on an annualized basis in our estimates as a result.

¹ Investment Income per share

² Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Since 2019, the company has switched its distributions' frequency from quarterly to monthly.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	9.3	8.4	9.0	8.1	10.5	11.1	11.3	10.6	7.9	7.0	12.5	10.0
Avg. Yld.	11.4%	11.0%	11.4%	11.5%	18.3%	19.9%	11.2%	12.2%	12.9%	21.0%	9.9%	9.1%

As per the company's goal and obligation (being a Business Development Company) to distribute the majority of its net income to shareholders, the stock's yield has hovered around the mid-teens, averaging nearly 14% over the past decade. Despite management's recent distribution slash to a monthly \$0.035 payout, the stock has declined enough to push the current yield to 9.9%. We believe a valuation multiple of 10 adequately reflects the stock's risk/reward investment case, though OXSQ is better valued through its book value, which currently stands at \$4.90, higher than the stock's price of \$4.70. This is likely due to investors already pricing in book value deterioration as a result of OXSQ's unsustainable distribution levels.

Safety, Quality, Competitive Advantage, & Recession Resiliency

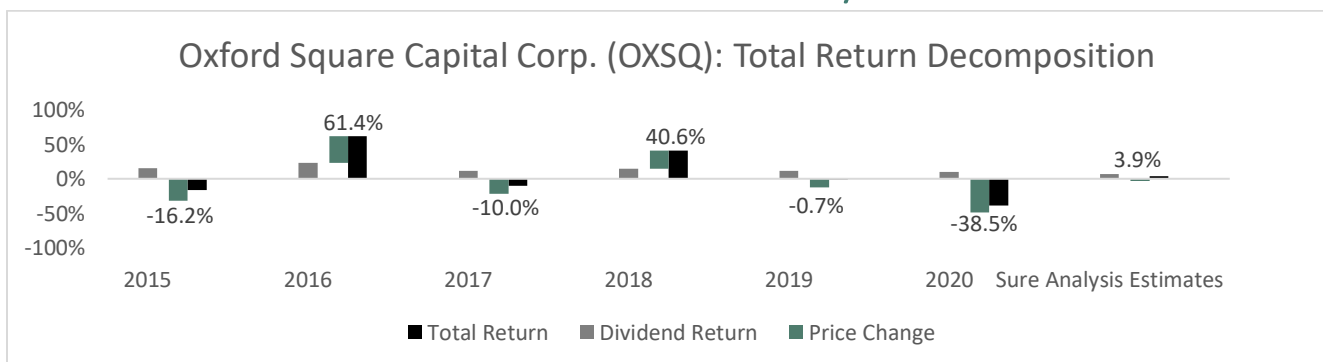
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	103%	100%	108%	102%	171%	221%	133%	118%	99%	153%	124%	91%

OXSQ's payout ratio has often been above 100% over the years, as management has historically paid investors more than what the company earned. While the stock's distribution yield has been seemingly attractive over the years, the company has been wiping an equal, and sometimes higher, amount from its NAV. Such a strategy could be sustained only via a gradually increased interest income. However, with rates declining over time, the company's receivables have been further pressurized, worsening its financials annually. The ongoing shareholder value deterioration trend does not seem to be nearing to an end- at least not anytime soon. Overall, we believe that the company's future investment income generation carries substantial risks, while a potential recession and an adverse economic environment could severely damage its interest income.

Final Thoughts & Recommendation

Oxford Square Capital Corp. currently operates in an unfavorable credit market environment, dominated by cheap financing, which prevents it from sustaining and growing its income. Distributions will likely not be covered from this year's results. Therefore, another distribution slash should not surprise investors. Combining Oxford Square's high yield, the likelihood for distribution cuts in the medium term, and valuation headwinds (or book value deterioration in this case,) we can see shares barely sustaining a positive total return outcome, which we estimate to be 3.9%. Shares earn a sell rating. Income investors should not rely on Oxford Square's distributions.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	24.80	84.09	83.90	23.88	-57.03	121.57	49.41	-5.52	-28.74	5.54
SG&A Expense	9.39	14.45	23.07	25.08	7.61	10.06	4.66	2.56	2.98	2.91
Net Income	14.21	68.32	58.94	-3.35	-66.13	110.36	43.61	-9.21	-32.80	1.71
Net Margin	57.3%	81.3%	70.3%	-14.0%	---	90.8%	88.3%	---	---	30.9%
Free Cash Flow	-114.5	-215.7	-201.6	-53.01	243.81	182.91	217.63	-33.86	47.76	95.05

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	424.1	756.0	998.2	1042.6	718.3	612.5	454.1	467.1	385.3	357.7
Cash & Equivalents	4.5	51.4	14.9	20.5	23.2	8.3	30.0	13.9	14.4	59.1
Total Liabilities	119.0	346.4	471.9	521.8	357.4	226.5	65.7	152.4	137.3	132.2
Accounts Payable	17.3	9.2	16.7	20.1	6.3	1.7	0.0	0.5	0.6	23.6
Long-Term Debt	99.7	330.3	450.7	501.1	347.7	220.0	62.3	148.2	134.4	106.9
Total Equity	305.1	409.6	526.2	520.8	360.9	386.0	388.4	314.7	248.0	225.4
DE Ratio	0.33	0.81	0.86	0.96	0.96	0.57	0.16	0.47	0.54	0.47

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	3.8%	11.6%	6.7%	-0.3%	-7.5%	16.6%	8.2%	-2.0%	-7.7%	0.5%
Return on Equity	4.6%	19.1%	12.6%	-0.6%	-15.0%	29.6%	11.3%	-2.6%	-11.7%	0.7%
ROIC	4.0%	11.9%	6.9%	-0.3%	-7.6%	16.8%	8.3%	-2.0%	-7.8%	0.5%
Shares Out.	32.43	40.58	61.11	68.86	69.79	61.77	51.48	49.66	47.76	49.48
Revenue/Share	0.76	2.07	1.37	0.35	-0.82	1.97	0.96	-0.11	-0.60	0.11
FCF/Share	-3.53	-5.32	-3.30	-0.77	3.49	2.96	4.23	-0.68	1.00	1.92

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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