



Oxford Square Capital Corp. (OXSQ)

Updated May 22nd, 2022 by Nikolaos Sismanis

Key Metrics

Current Price:	\$3.98	5 Year CAGR Estimate:	3.5%	Market Cap:	\$197.9 M
Fair Value Price:	\$2.97	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	06/15/2022
% Fair Value:	134%	5 Year Valuation Multiple Estimate:	-5.7%	Dividend Payment Date:	06/30/2022
Dividend Yield:	10.6%	5 Year Price Target	\$2.97	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Sell

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 7 industries, with the highest exposure in business services and software, at 32.2% and 29.1%, respectively. The company's assets have a gross investment value of around \$406.2 million in 59 positions, with 67% of debt securities being secured. OXSQ generates around \$40 million in annual interest payments and is based in Greenwich, Connecticut.

On April 28th, Oxford Square reported its Q1 results for the period ending March 31st, 2022. The company generated approximately \$9.9 million of total investment income, a decline of 2.9% compared to the previous quarter.

The decline on a sequential basis was attributed to a smaller debt and CLO equity portfolio, despite a higher investment yield. Specifically, the weighted average yield of its debt investments was 8.0% at the current cost, compared to 7.7% during Q4-2021. The cash distribution yield from OXSQ's CLO equity investments also increased from 21.2% to 23.8% sequentially. Total expenses, which primarily includes interest paid on its own financing and managers' fees, amounted to \$5.5 million, were \$0.1 million lower versus Q4-2021. As a result of lower total investment income, however, NII (the net investment income) amounted to \$4.3 million, or \$0.09/share, implying a 4.4% decline sequentially. Net asset value (NAV) per share was \$4.65 compared to \$4.92 last quarter, as DPS once again exceeded NII/share during that period. Based on the company's current portfolio composition, we forecast a FY2022 ISS of \$0.33.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2021	2027
IIS¹	\$1.12	\$1.07	\$1.17	\$0.66	\$0.52	\$0.60	\$0.67	\$0.81	\$0.40	\$0.32	\$0.33	\$0.33
DPS	\$1.12	\$1.16	\$1.19	\$1.13	\$1.15	\$0.80	\$0.79	\$0.80	\$0.61	\$0.42	\$0.42	\$0.31
Shares²	38	51.1	58.8	59.8	51.9	51.5	49.7	47.8	49.4	49.6	49.7	55.0

The company's investment income per share has been declining at a 10-year CAGR of 13%, as Oxford Square has been failing when it comes to refinancing its investment at attractive yields, resulting in declining investment spreads. 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. On the one hand, the company's investment activity has plenty of room for improvement. On the other hand, with a declining investment portfolio and soft yields, income generation could further decline. 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.

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

¹ Investment Income per share

² Share count is in millions.

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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	8.4	9.0	8.1	10.5	11.1	11.3	10.6	7.9	7.0	13.8	12.1	9.0
Avg. Yld.	11.0%	11.4%	11.5%	18.3%	19.9%	11.2%	12.2%	12.9%	21.0%	9.5%	10.6%	10.4%

As per the company's goal and obligation (as 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 latest distribution slash to a monthly \$0.035 payout, the stock has declined enough to push the current yield to 10.6%. We believe a valuation multiple of 9 adequately reflects the stock's risk/reward investment case. OXSQ is better valued through its book value, which currently stands at \$4.65, higher than the stock's price of \$3.98. This is likely due to investors already pricing in book value deterioration as a result of OXSQ's unsustainable distribution levels. For context, NAV/share stood at \$5.03, \$4.92, and \$4.65 in Q3-2021, Q4-2021, and Q1-2022, respectively.

Safety, Quality, Competitive Advantage, & Recession Resiliency

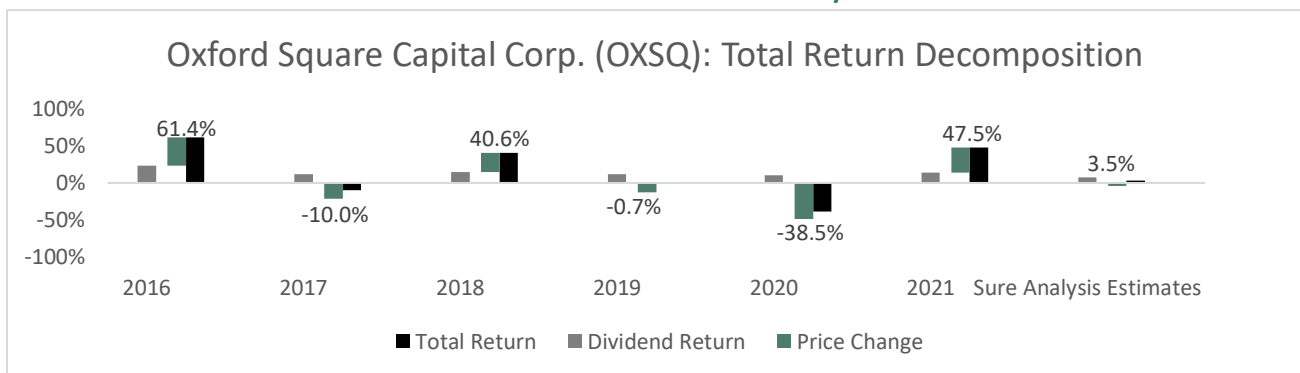
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	100%	108%	102%	171%	221%	133%	118%	99%	153%	131%	127%	93%

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 total investment income declining over time amid a shrinking investment portfolio, we can hardly see any reversal from the current predicament. The ongoing shareholder value deterioration trend does not seem to be nearing 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. is almost certain to deteriorate shareholders' equity value going forward. Distributions will likely not be covered by this year's results. Therefore, another distribution reduction 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 see shares barely sustaining a positive total return outcome. We estimate total return to be 3.5% on an annualized basis. 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	84.09	83.90	23.88	-57.03	121.57	49.41	-5.52	-28.74	5.54	44.9
SG&A Expense	14.45	23.07	25.08	7.61	10.06	4.66	2.56	2.98	2.91	3.35
Net Income	68.32	58.94	-3.35	-66.13	110.36	43.61	-9.21	-32.80	1.71	39.58
Net Margin	81.3%	70.3%	-14.0%	---	90.8%	88.3%	---	---	30.9%	88.2%
Free Cash Flow	-215.7	-201.6	-53.01	243.81	182.91	217.63	-33.86	47.76	95.05	-107.4

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	756.0	998.2	1042.6	718.3	612.5	454.1	467.1	385.3	357.7	433.5
Cash & Equivalents	51.4	14.9	20.5	23.2	8.3	30.0	13.9	14.4	59.1	9.0
Total Liabilities	346.4	471.9	521.8	357.4	226.5	65.7	152.4	137.3	132.2	188.9
Accounts Payable	9.2	16.7	20.1	6.3	1.7	0.0	0.5	0.6	23.6	1.2
Long-Term Debt	330.3	450.7	501.1	347.7	220.0	62.3	148.2	134.4	106.9	185.4
Total Equity	409.6	526.2	520.8	360.9	386.0	388.4	314.7	248.0	225.4	244.6
LTD/E Ratio	0.81	0.86	0.96	0.96	0.57	0.16	0.47	0.54	0.47	0.76

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	11.6%	6.7%	-0.3%	-7.5%	16.6%	8.2%	-2.0%	-7.7%	0.5%	10.0%
Return on Equity	19.1%	12.6%	-0.6%	-15.0%	29.6%	11.3%	-2.6%	-11.7%	0.7%	16.8%
ROIC	11.9%	6.9%	-0.3%	-7.6%	16.8%	8.3%	-2.0%	-7.8%	0.5%	10.4%
Shares Out.	40.58	61.11	68.86	69.79	61.77	51.48	49.66	47.76	49.48	49.62
Revenue/Share	2.07	1.37	0.35	-0.82	1.97	0.96	-0.11	-0.60	0.11	0.88
FCF/Share	-5.32	-3.30	-0.77	3.49	2.96	4.23	-0.68	1.00	1.92	(2.17)

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

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