



# Oxford Square Capital Corp. (OXSQ)

Updated July 27<sup>th</sup>, 2022 by Nikolaos Sismanis

## Key Metrics

<b>Current Price:</b>	\$3.64	<b>5 Year CAGR Estimate:</b>	5.3%	<b>Market Cap:</b>	\$181.1 M
<b>Fair Value Price:</b>	\$2.97	<b>5 Year Growth Estimate:</b>	0.0%	<b>Ex-Dividend Date:</b>	08/16/2022
<b>% Fair Value:</b>	123%	<b>5 Year Valuation Multiple Estimate:</b>	-4.0%	<b>Dividend Payment Date:</b>	08/31/2022
<b>Dividend Yield:</b>	11.5%	<b>5 Year Price Target</b>	\$2.97	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	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 32.1% and 29.0%, respectively. The company's assets have a gross investment value of around \$369.4 million in 61 positions, with 69% of debt securities being secured. OXSQ generates around \$40 million in annual interest payments and is based in Greenwich, Connecticut.

On July 26<sup>th</sup>, Oxford Square reported its Q2 results for the period ending June 30<sup>th</sup>, 2022. The company generated approximately \$9.9 million of total investment income, stable from the previous quarter.

The stable performance was due to a relatively unchanged debt and CLO equity portfolio. Further, while the weighted average yield of the debt investments came in at 9.0% at the current cost, compared to 8.0% during Q1-2022, the increase was offset by a lower cash distribution yield from OXSQ's CLO equity investments, which declined from 23.8% to 20.7% sequentially. Total expenses, which primarily include interest paid on its own financing and managers' fees, amounted to \$5.6 million, also stable against Q1-2022. As a result of stable total investment income and expenses, NII (the net investment income) amounted to \$4.3 million, or \$0.09/share, remaining unchanged sequentially. Net asset value (NAV) per share was \$3.67 compared to \$4.65 last quarter. The decline was due to DPS once again exceeding NII/share during that period and a decrease in the value of the company's assets. Based on the company's current portfolio composition, we continue to 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
<b>IIS<sup>1</sup></b>	\$1.12	\$1.07	\$1.17	\$0.66	\$0.52	\$0.60	\$0.67	\$0.81	\$0.40	\$0.32	<b>\$0.33</b>	<b>\$0.33</b>
<b>DPS</b>	\$1.12	\$1.16	\$1.19	\$1.13	\$1.15	\$0.80	\$0.79	\$0.80	\$0.61	\$0.42	<b>\$0.42</b>	<b>\$0.31</b>
<b>Shares<sup>2</sup></b>	38	51.1	58.8	59.8	51.9	51.5	49.7	47.8	49.4	49.6	<b>49.7</b>	<b>55.0</b>

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. Rising interest rates should help boost the company's results in the medium-term. Thus, the company's investment activity has plenty of room for improvement. However, with the company's investments declining in value and a falling NAV creating a downward spiral on reinvested capital, 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.

<sup>1</sup> Investment Income per share

<sup>2</sup> 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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## 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	<b>11.0</b>	<b>9.0</b>
Avg. Yld.	11.0%	11.4%	11.5%	18.3%	19.9%	11.2%	12.2%	12.9%	21.0%	9.5%	<b>11.5%</b>	<b>10.4%</b>

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 11.5%. 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 \$3.67, somewhat in line with the stock's price of \$3.64. However, we argue that along with a lower P/E the stock should be trading below its NAV (usual historically) for the market to price in the upcoming 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

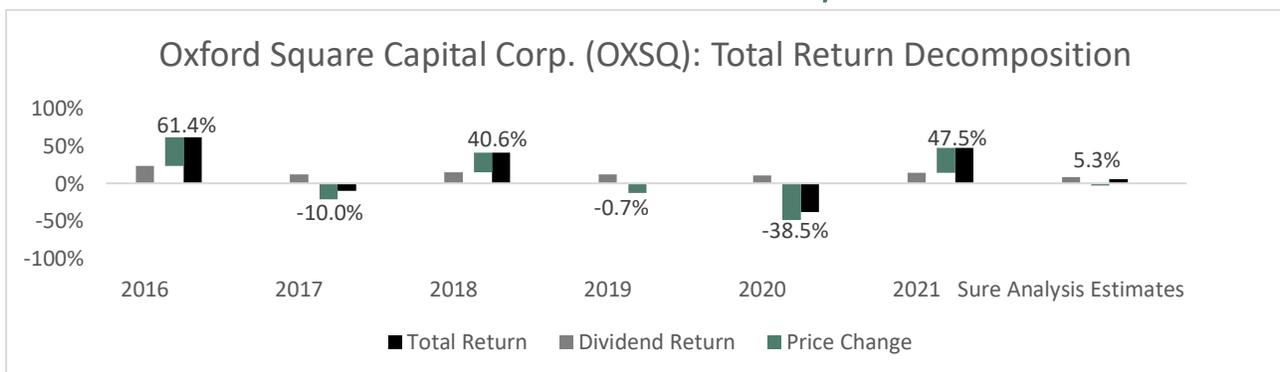
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	100%	108%	102%	171%	221%	133%	118%	99%	153%	131%	127%	<b>93%</b>

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 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. is likely to continue deteriorating 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 delivering medium-term returns of 5.3% on an annualized basis. Shares still earn a sell rating, as the risks attached to the company do not justify the potential returns. 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
<b>Revenue</b>	84.09	83.90	23.88	-57.03	121.57	49.41	-5.52	-28.74	5.54	44.9
<b>SG&amp;A Expense</b>	14.45	23.07	25.08	7.61	10.06	4.66	2.56	2.98	2.91	3.35
<b>Net Income</b>	68.32	58.94	-3.35	-66.13	110.36	43.61	-9.21	-32.80	1.71	39.58
<b>Net Margin</b>	81.3%	70.3%	-14.0%	---	90.8%	88.3%	---	---	30.9%	88.2%
<b>Free Cash Flow</b>	-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
<b>Total Assets</b>	756.0	998.2	1042.6	718.3	612.5	454.1	467.1	385.3	357.7	433.5
<b>Cash &amp; Equivalents</b>	51.4	14.9	20.5	23.2	8.3	30.0	13.9	14.4	59.1	9.0
<b>Total Liabilities</b>	346.4	471.9	521.8	357.4	226.5	65.7	152.4	137.3	132.2	188.9
<b>Accounts Payable</b>	9.2	16.7	20.1	6.3	1.7	0.0	0.5	0.6	23.6	1.2
<b>Long-Term Debt</b>	330.3	450.7	501.1	347.7	220.0	62.3	148.2	134.4	106.9	185.4
<b>Total Equity</b>	409.6	526.2	520.8	360.9	386.0	388.4	314.7	248.0	225.4	244.6
<b>LTD/E Ratio</b>	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
<b>Return on Assets</b>	11.6%	6.7%	-0.3%	-7.5%	16.6%	8.2%	-2.0%	-7.7%	0.5%	10.0%
<b>Return on Equity</b>	19.1%	12.6%	-0.6%	-15.0%	29.6%	11.3%	-2.6%	-11.7%	0.7%	16.8%
<b>ROIC</b>	11.9%	6.9%	-0.3%	-7.6%	16.8%	8.3%	-2.0%	-7.8%	0.5%	10.4%
<b>Shares Out.</b>	40.58	61.11	68.86	69.79	61.77	51.48	49.66	47.76	49.48	49.62
<b>Revenue/Share</b>	2.07	1.37	0.35	-0.82	1.97	0.96	-0.11	-0.60	0.11	0.88
<b>FCF/Share</b>	-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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