



Oxford Square Capital Corp. (OXSQ)

Updated November 10th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$2.95	5 Year CAGR Estimate:	12.0%	Market Cap:	\$166.4 M
Fair Value Price:	\$3.75	5 Year Growth Estimate:	-3.0%	Ex-Dividend Date:	12/14/2023
% Fair Value:	79%	5 Year Valuation Multiple Estimate:	4.9%	Dividend Payment Date:	12/29/2023
Dividend Yield:	14.2%	5 Year Price Target	\$3.22	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

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 software and business services, at 39.3% and 21.6%, respectively. The company's assets have a gross investment value of \$285.5 million in 58 positions, with 68% of debt securities being secured. OXSQ generates around \$43 million in annual interest payments and is based in Greenwich, Connecticut.

On November 7th, 2023, Oxford Square reported its Q3 results for the period ending September 30th, 2023. For the period, the company generated approximately \$13.0 million of total investment income, down 3.7% from the previous quarter.

The decline in investment income was due to a smaller investment portfolio, offset by rising interest rates. Specifically, the weighted average yield of the debt investments came in at 13.1% at current cost, compared to 12.8% during Q2-2023. This increase was further bundled with a higher cash distribution yield from OXSQ's CLO equity investments, which grew from 18.4% to 20.1% sequentially. Total expenses, which primarily include interest paid on its own financing and managers' fees, amounted to \$6.6 million, \$0.2 million lower than Q2-2023. Due to lower investment income, NII (the net investment income) amounted to \$6.4 million, down \$0.3 million sequentially. On a per-share basis, NII came in at \$0.11. Net asset value (NAV) per share was \$2.78 compared to \$2.88 last quarter. Based on the company's current portfolio composition, we now forecast a FY2023 IIS of \$0.50.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
IIS¹	\$1.07	\$1.17	\$0.66	\$0.52	\$0.60	\$0.67	\$0.81	\$0.40	\$0.32	\$0.42	\$0.50	\$0.43
DPS	\$1.16	\$1.19	\$1.13	\$1.15	\$0.80	\$0.79	\$0.80	\$0.61	\$0.42	\$0.42	\$0.42	\$0.38
Shares²	51.1	58.8	59.8	51.9	51.5	49.7	47.8	49.4	49.6	49.8	56.7	70.0

The company's investment income per share has been declining at a 10-year CAGR of 9.9%, 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, as was the case in its Q2 results. However, with the company's investments declining in value and a generally falling NAV creating a downward spiral on reinvested capital, income generation could further decline. Hence, we expect a -3% IIS/share decline in the medium-term. As has been the case in the past several times, we expect further dividend cuts over the medium-term due to their

¹ Investment Income per share

² Share count is in millions.

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barely sustainable levels. We have embedded a -2% 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.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2013
Avg. P/E	9.0	8.1	10.5	11.1	11.3	10.6	7.9	7.0	13.8	10.8	5.9	7.5
Avg. Yld.	11.4%	11.5%	18.3%	19.9%	11.2%	12.2%	12.9%	21.0%	9.5%	12.2%	14.2%	11.8%

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 14.2%. We believe a valuation multiple of 7.5X adequately reflects the stock's risk/reward investment case. OXSQ is better valued through its book value, which currently stands at \$2.78, lower than the stock's price of \$2.95. This is likely because investors expect a rebound in NAV following higher NII. It could be the case in the short term, but believe the long-term trend of NAV deterioration will last. We remind that NAV/share stood at \$5.03, \$4.92, \$4.65, \$3.67, \$3.34, and \$2.78 in Q3-2021, Q4-2021, Q1-2022, Q2-2022, Q3-2022, and Q4-2022 respectively.

Safety, Quality, Competitive Advantage, & Recession Resiliency

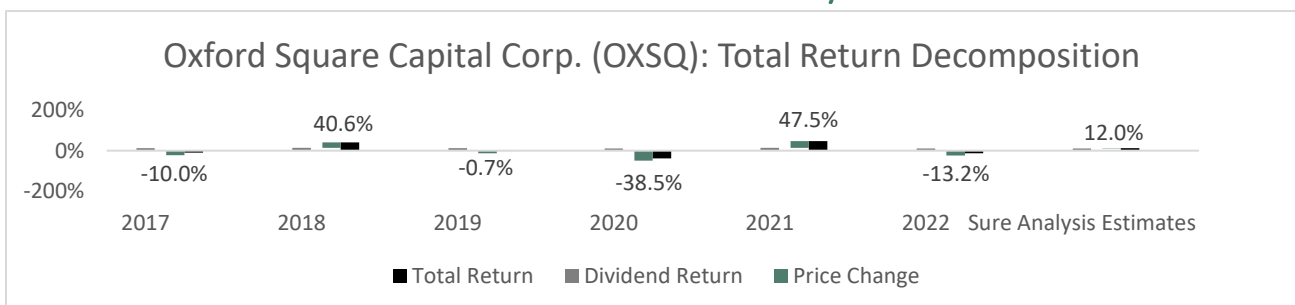
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	108%	102%	171%	221%	133%	118%	99%	153%	131%	100%	84%	88%

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. may benefit from rising yields in the short-term, but it is likely to continue deteriorating shareholders' equity value over the medium-term. Therefore, another distribution reduction should not surprise investors. Regardless, we forecast an annualized total return potential of 12.0% in the medium term. This is because our weakening earnings and distribution projections could be more than offset by the current yield and possibility of modest valuation tailwinds. We thus maintain our rating to a buy. Still, we highlight that income investors should not rely on Oxford Square's distributions.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	83.90	23.88	-57.03	121.57	49.41	-5.52	-28.74	5.54	44.9	(81)
SG&A Expense	23.07	25.08	7.61	10.06	4.66	2.56	2.98	2.91	3.35	3
Net Income	58.94	-3.35	-66.13	110.36	43.61	-9.21	-32.80	1.71	39.58	(86)
Net Margin	70.3%	-14.0%	---	90.8%	88.3%	---	---	30.9%	88.2%	(106%)
Free Cash Flow	-201.6	-53.01	243.81	182.91	217.63	-33.86	47.76	95.05	-107.4	20

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	998.2	1042.6	718.3	612.5	454.1	467.1	385.3	357.7	433.5	328
Cash & Equivalents	14.9	20.5	23.2	8.3	30.0	13.9	14.4	59.1	9.0	9.0
Total Liabilities	471.9	521.8	357.4	226.5	65.7	152.4	137.3	132.2	188.9	189.3
Accounts Payable	16.7	20.1	6.3	1.7	0.0	0.5	0.6	23.6	1.2	1.2
Long-Term Debt	450.7	501.1	347.7	220.0	62.3	148.2	134.4	106.9	185.4	186
Total Equity	526.2	520.8	360.9	386.0	388.4	314.7	248.0	225.4	244.6	139
LTD/E Ratio	0.86	0.96	0.96	0.57	0.16	0.47	0.54	0.47	0.76	1.34

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	6.7%	-0.3%	-7.5%	16.6%	8.2%	-2.0%	-7.7%	0.5%	10.0%	(22.5%)
Return on Equity	12.6%	-0.6%	-15.0%	29.6%	11.3%	-2.6%	-11.7%	0.7%	16.8%	(44.7%)
ROIC	6.9%	-0.3%	-7.6%	16.8%	8.3%	-2.0%	-7.8%	0.5%	10.4%	(22.7%)
Shares Out.	61.11	68.86	69.79	61.77	51.48	49.66	47.76	49.48	49.62	49.76
Revenue/Share	1.37	0.35	-0.82	1.97	0.96	-0.11	-0.60	0.11	0.88	(1.64)
FCF/Share	-3.30	-0.77	3.49	2.96	4.23	-0.68	1.00	1.92	(2.17)	0.41

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

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