



Stellus Capital Management (SCM)

Updated March 12th, 2025, by Josh Arnold

Key Metrics

Current Price:	\$13.81	5 Year CAGR Estimate:	4.1%	Market Cap:	\$382 M
Fair Value Price:	\$12.75	5 Year Growth Estimate:	-4.0%	Ex-Dividend Date:	03/28/25
% Fair Value:	108%	5 Year Valuation Multiple Estimate:	-1.6%	Dividend Payment Date:	04/15/25
Dividend Yield:	11.6%	5 Year Price Target	\$10.40	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Stellus Capital Management is a business development company, or BDC, that bills itself as a flexible source of capital for the middle market. The company provides capital solutions to companies with \$5 million to \$50 million of EBITDA and does so with a variety of instruments, the majority of which are debt. Stellus provides first lien, second lien, mezzanine, convertible debt, and equity investments to a diverse group of customers, generally at high yields, in the US and Canada. The company was formed in 2012, should produce about \$110 million in revenue for 2025, and has a \$382 million market cap.

Stellus posted fourth quarter and full-year earnings on March 4th, 2025, and results were about as expected. The company saw investment income total \$25.6 million, which was off from \$28 million a year ago. This is mostly interest income from the company's portfolio, and is akin to revenue.

Gross operating expenses were \$16 million, better than the \$16.4 million a year ago. Net investment income was \$9.6 million, or 35 cents per share, in Q4. A year ago, those were \$11.9 million, and 49 cents per share, respectively. Shares outstanding hurt NII per-share as they rose from 24.1 million to more than 27 million.

For the fourth quarter, the company's investment portfolio had a net change in unrealized depreciation of -\$6.9 million, down sharply from net appreciation of \$27 million a year ago. Net realized gains were \$6 million this quarter, much better than the \$30.5 million loss a year ago.

The net increase in net assets from operations was \$8.7 million, or 32 cents per share, in Q4. Compared to the year-ago period, both declined from \$11.5 million and 48 cents, respectively. The company funded \$109 million of investments during Q4 and received \$65 million of repayments, ending the year with a total portfolio of \$953 million at fair value. Stellus has also distributed \$16.69 per share in cumulative dividends since it began, well over 100% of the current share price. We start this year at \$1.50 in NII-per-share, noting the operating environment continues to deteriorate for Stellus.

Growth on a Per-Share Basis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
NII	\$1.33	\$1.39	\$1.21	\$1.42	\$1.23	\$1.13	\$1.12	\$1.46	\$1.92	\$1.64	\$1.50	\$1.22
DPS	\$1.36	\$1.36	\$1.36	\$1.36	\$1.36	\$1.09	\$1.08	\$1.36	\$1.60	\$1.60	\$1.60	\$1.11
Shares¹	12.5	12.5	14.9	16.0	18.9	19.5	19.5	19.7	24.1	27.5	30	40

Stellus, like most BDCs, has a difficult time growing NII. The combination of high funding costs (generally with debt and/or preferred stock) as well as varying yields on the company's debt portfolio, make it difficult to offset a rising share count over time. We're reiterating our growth estimate at -4% after 2024 results.

Stellus has reset much of its investment portfolio with higher rates, leading to a very strong portfolio yield. However, a possible headwind to this is interest rates declining off of currently elevated levels. The company's net assets continue to grow over time, but these gains have been largely offset by a rising share count. We think the share count will continue to be a headwind moving forward, and that Stellus will have a difficult time offsetting this with earnings gains.

¹ Share count 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.



Stellus Capital Management (SCM)

Updated March 12th, 2025, by Josh Arnold

Valuation Analysis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Now	2030
Avg. P/NII	8.5	7.5	11.3	9.0	11.4	8.4	11.5	9.1	6.7	8.4	9.2	8.5
Avg. Yld.	12.0%	13.0%	9.9%	10.6%	9.7%	12.8%	8.4%	10.3%	12.5%	11.6%	11.6%	10.7%

Stellus has traded with an average price-to-NII ratio of ~10 in its history as a public company, and we assess fair value at 8.5 times NII. We note, however, that Stellus' valuation has moved somewhat erratically, trading for 7.5 times NII in 2016 and then 11.3 times the next year, for instance. We see the stock as overvalued today given it trades for 9.2 times NII, implying a small headwind from the valuation in the coming years.

The dividend yield is now 11.6%, which is in line with historical values. Stellus moved from a monthly dividend to a quarterly one, which accompanied the dividend cut from \$1.36 annually to \$1.00. It has since been reinstated as a monthly payout, and raised to \$1.60 annually. We now believe there's a high likelihood Stellus will need to cut its dividend again, but it's continuing for now.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
Payout	102%	98%	112%	96%	106%	96%	96%	93%	83%	98%	107%	91%

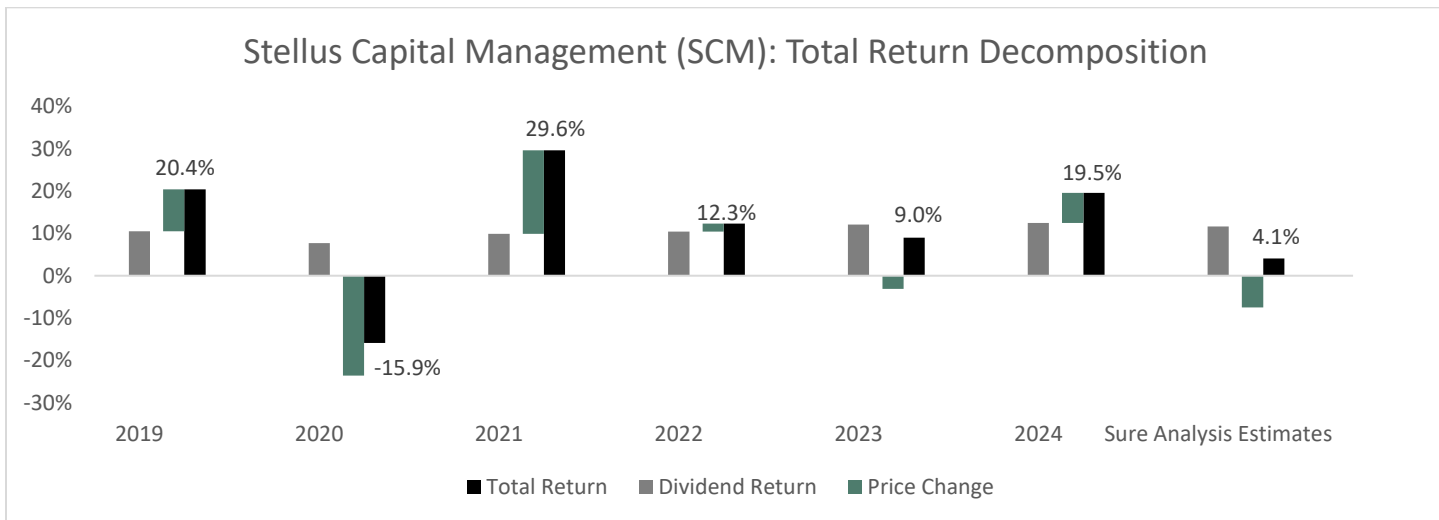
Stellus, like other BDCs, has no competitive advantages. It offers the same products as any other BDC to the same set of customers, so advantages are virtually impossible to achieve. In addition, BDCs suffer mightily during recessions because borrowers have a more difficult time meeting repayment timelines. Stellus wasn't around during the last recession, but we see it as having significant issues with NII generation during future recessions.

Stellus is required to pay virtually all its NII in distributions as a BDC, so the payout ratio will always be high. While the current payout should be safe for the time being, we note that the risk of lower rates means the payout is constantly at risk as well. Stellus has not cut its dividend yet, but we believe it is just a matter of time.

Final Thoughts & Recommendation

Total return potential comes in at 4.1% annually. Given the projected returns, we're reiterating the stock at a hold rating. The yield is very high at 11.6%, but we note the risks of owning a small BDC are high as well, so only investors with high-risk tolerances should consider Stellus. The valuation could drive a 1.6% headwind and growth is set to be negative for the foreseeable future.

Total Return Breakdown by Year



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.



Stellus Capital Management (SCM)

Updated March 12th, 2025, by Josh Arnold

Income Statement Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenue	35	26	27	31	32	26	43	21	21	51
Gross Profit	29	---	---	---	---	---	---	---	---	---
Gross Margin	83.4%	---	---	---	---	---	---	---	---	---
SG&A Exp.	7	4	5	4	4	5	5	5	6	6
Operating Profit	22	---	---	---	---	---	---	---	---	---
Operating Margin	62.8%	---	---	---	---	---	---	---	---	---
Net Profit	8	23	23	26	26	20	34	14	18	46
Net Margin	21.8%	87.7%	83.0%	84.3%	83.4%	78.0%	78.7%	66.7%	85.7%	89.5%
Free Cash Flow	(24)	9	19	(102)	(93)	(3)	(76)	(56)	(17)	(29)
Income Tax	0	(0)	(0)	1	1	1	4	1	(2)	2

Balance Sheet Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total Assets	365	380	400	526	649	675	821	898	908	981
Cash & Equivalents	11	9	25	17	16	18	44	48	26	20
Accounts Receivable	0	---	---	---	---	---	---	---	---	---
Total Liabilities	201	209	180	301	378	402	536	622	588	611
Accounts Payable	3	3	3	4	4	2	5	5	5	9
Long-Term Debt	196	203	174	292	366	393	518	604	576	593
Shareholder's Equity	165	171	220	225	271	273	285	276	320	370
LTD/E Ratio	1.19	1.19	0.79	1.30	1.35	1.44	1.82	2.19	1.80	1.60

Profitability & Per Share Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Return on Assets	2.2%	6.2%	5.8%	5.7%	4.5%	3.1%	4.5%	1.7%	1.9%	4.9%
Return on Equity	4.5%	13.8%	11.6%	11.8%	10.7%	7.4%	12.0%	5.2%	5.9%	13.3%
ROIC	2.2%	6.3%	5.9%	5.7%	4.6%	3.1%	4.6%	1.7%	2.0%	4.9%
Shares Out.	12.5	12.5	14.9	16.0	18.9	19.5	19.5	19.6	22.0	25.6
Revenue/Share	2.82	2.12	1.83	1.95	1.73	1.33	2.19	1.07	0.96	2.00
FCF/Share	-1.96	0.71	1.27	-6.42	-5.10	-0.18	-3.90	-2.88	-0.78	-1.12

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

Disclaimer

Nothing presented herein is, or is intended to constitute, specific investment advice. Nothing in this research report should be construed as a recommendation to follow any investment strategy or allocation. Any forward-looking statements or forecasts are based on assumptions and actual results are expected to vary from any such statements or forecasts. No reliance should be placed on any such statements or forecasts when making any investment decision. While Sure Dividend has used reasonable efforts to obtain information from reliable sources, we make no representations or warranties as to the accuracy, reliability or completeness of third-party information presented herein. No guarantee of investment performance is being provided and no inference to the contrary should be made. There is a risk of loss from an investment in marketable securities. Past performance is not a guarantee of future performance.