



Stellus Capital Management (SCM)

Updated June 3rd, 2025, by Josh Arnold

Key Metrics

Current Price:	\$13.14	5 Year CAGR Estimate:	5.6%	Market Cap:	\$374 M
Fair Value Price:	\$11.48	5 Year Growth Estimate:	-2.0%	Ex-Dividend Date:	06/30/25
% Fair Value:	115%	5 Year Valuation Multiple Estimate:	-2.7%	Dividend Payment Date:	07/15/25
Dividend Yield:	12.2%	5 Year Price Target	\$10.37	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Sector:	Financials	Rating:	Sell

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 just over \$100 million in revenue for 2025, and has a \$374 million market cap.

Stellus posted first quarter earnings on May 13th, 2025, and results were somewhat weak once again. Net investment income came to 35 cents per share, while core net investment income was 37 cents. Total investment income, which is the company's revenue metric, was down from \$26 million to \$24.95 million year-over-year.

The investment portfolio at fair value was \$991 million across 110 companies. Further, 98% of loans were secured and 91% were priced at floating rates. Five companies were on non-accrual, or 6.7% of total cost and 4% of fair value of the loan portfolio.

The company issued 656k shares for \$9.3 million during the quarter, presumably to fund its dividend. Stellus is getting further and further from being able to fund its dividend with income, despite the fact that management said they expect all dividends through at least Q3 to be 40 cents per quarter.

We now see \$1.35 in NII per-share for this year, which would create a shortfall of 25 cents per share against the dividend if that were to materialize.

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	\$1.35	\$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	\$1.24
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 see -2% earnings change going forward from 2025's low base.

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.



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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	9.7	8.5
Avg. Yld.	12.0%	13.0%	9.9%	10.6%	9.7%	12.8%	8.4%	10.3%	12.5%	11.6%	12.2%	11.9%

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 9.7 times NII, implying a meaningful headwind from the valuation in the coming years.

The dividend yield is now 12.2%, which is elevated by historical standards. 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%	119%	101%

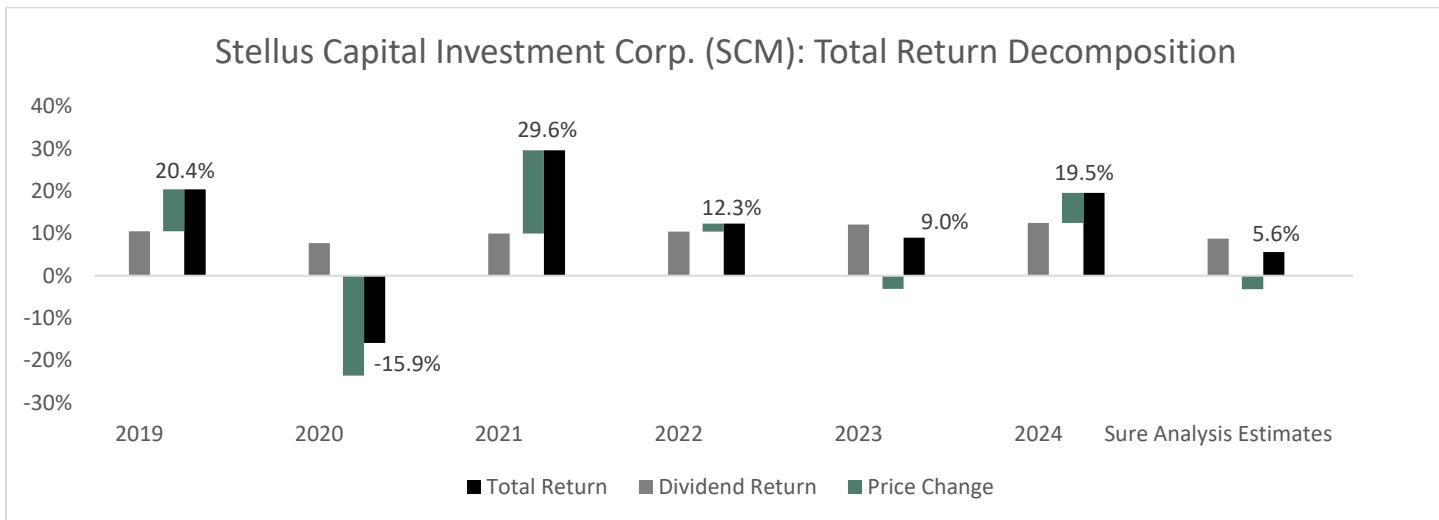
Stellus, like other BDCs, has no competitive advantages. It offers the same products as any other BDC to the same set of customers, so advantages are virtually impossible to achieve. In addition, BDCs suffer mightily during recessions because borrowers have a more difficult time meeting repayment timelines. 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 5.6% annually. Given the projected returns and lack of dividend safety, we're moving the stock from hold to sell. The yield is very high at 12.2%, 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 2.7% headwind and growth is set to be negative for the foreseeable future.

Total Return Breakdown by Year



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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

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