Stellus Capital Investment Corp
Form 10-Q
November 06, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2014

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

COMMISSION FILE NUMBER: 1-35730

STELLUS CAPITAL INVESTMENT CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or other Jurisdiction of Incorporation or Organization)	46-0937320 **(I.R.S. Employer Identification No.)**

4400 Post Oak Parkway, Suite 2200
Houston, Texas 77027

(Address of Principal Executive Offices) (Zip Code)

(713) 292-5400

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
o	x
Non-accelerated filer	Smaller reporting company
o (do not check if a smaller reporting company)	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The number of shares of the issuer s Common Stock, $.001 par value, outstanding as of November 3, 2014 was 12,476,830.

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PART I FINANCIAL INFORMATION

STELLUS CAPITAL INVESTMENT CORPORATION

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

	September 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Non-controlled, non-affiliated investments, at fair value (amortized cost of $287,408,278 and $277,004,466, respectively)	$284,105,102	$277,504,510
Cash and cash equivalents	4,164,063	13,663,542
Receivable for sales and repayments of investments	38,021	
Interest receivable	5,357,554	4,713,912
Deferred offering costs	261,760	205,165
Deferred financing costs	844,606	
Accounts receivable	31,013	
Receivable for affiliated transaction		43,450
Prepaid loan structure fees	1,212,098	1,586,405
Prepaid expenses	381,799	411,321
Total Assets	$296,396,016	$298,128,305
Notes Payable	25,000,000	
Credit facility payable	90,000,000	110,000,000
Short-term loan		9,000,000
Dividends payable	1,413,224	
Base management fees payable	1,281,231	1,176,730
Incentive fees payable	215,887	1,056,942
Accrued offering costs	4,752	
Interest payable	336,275	234,051
Directors fees payable	86,000	96,000
Unearned revenue	129,548	146,965
Administrative services payable	551,383	263,226
Deferred Tax Liability	185,888	
Other accrued expenses and liabilities	96,567	262,877
Total Liabilities	119,300,755	122,236,791
Commitments and contingencies (Note 7)		
Net Assets	$177,095,261	$175,891,514
Common Stock, par value $0.001 per share (100,000,000 shares authorized, 12,473,293 and 12,099,022 shares issued and outstanding,	$12,473	$12,099

as of September 30, 2014 and December 31, 2013, respectively)		
Paid-in capital	180,909,398	175,614,738
Accumulated undistributed net realized gain	682,320	1,027,392
Distributions in excess of net investment income	(1,019,866)	(1,262,659)
Net Unrealized appreciation (depreciation) on investments and cash equivalents, net of provision for taxes of $185,888 and $0, as of September 30, 2014 and December 31, 2013, respectively	(3,489,064)	499,944
Net Assets	$177,095,261	$175,891,514
Total Liabilities and Net Assets	$296,396,016	$298,128,305
Net Asset Value Per Share	$14.20	$14.54

See Notes to Unaudited Consolidated Financial Statements.

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STELLUS CAPITAL INVESTMENT CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
INVESTMENT INCOME				
Interest income	$7,766,986	$7,604,636	$23,126,699	$20,640,265
Other income	55,511	312,995	557,753	1,065,033
Total Investment Income	7,822,497	7,917,631	23,684,452	21,705,298
OPERATING EXPENSES				
Management fees	$1,281,231	$1,140,675	$3,842,971	$3,065,877
Valuation fees	128,815	154,785	344,952	358,495
Administrative services expenses	312,870	220,249	856,804	619,825
Incentive fees	410,134	914,412	2,173,966	2,969,855
Professional fees	115,463	254,533	399,490	477,995
Directors fees	86,000	76,000	290,000	254,000
Insurance expense	121,730	119,695	361,220	354,933
Interest expense and other fees	1,409,565	968,674	3,841,487	2,253,433
Other general and administrative expenses	105,418	102,388	256,385	229,832
Total Operating Expenses	$3,971,226	$3,951,411	$12,367,275	$10,584,245
Waiver of Incentive Fees	(1,399,226)	(167,775)	(1,399,226)	(672,982)
Total operating expenses, net of fees waivers	2,572,000	3,783,636	10,968,049	9,911,263
Net Investment Income	$5,250,497	$4,133,995	$12,716,403	$11,794,035
Net Realized Gain on Investments and Cash Equivalents	$3,907	$5,061	$441,364	$1,007,978
Net Change in Unrealized Appreciation (Depreciation) on Investments and Cash Equivalents	$(2,955,085)	$(313,635)	$(3,803,120)	$1,033,121
Benefit/(Provision) for taxes on unrealized gain on investments	$(185,888)	$0	$(185,888)	$0
Net Increase in Net Assets Resulting from Operations	$2,113,431	$3,825,421	$9,168,759	$13,835,134
Net Investment Income Per Share	$0.42	$0.34	$1.04	$0.98
Net Increase in Net Assets Resulting from Operations Per Share	$0.17	$0.32	$0.75	$1.15
Weighted Average Shares of Common Stock Outstanding	12,404,485	12,066,548	12,214,875	12,051,013
Distributions Per Share	$0.34	$0.34	$1.09	$1.02

See Notes to Unaudited Consolidated Financial Statements.

STELLUS CAPITAL INVESTMENT CORPORATION CONSOLIDATED STATEMENTS OF OPERATIONS 8(unaudi

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STELLUS CAPITAL INVESTMENT CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (unaudited)

	For the nine months ended September 30, 2014	For the nine months ended September 30, 2013
Increase in Net Assets Resulting from Operations		
Net investment income	$12,716,403	$11,794,035
Net realized gain on investments and cash equivalents	441,364	1,007,978
Net change in unrealized appreciation (depreciation) on investments and cash equivalents	(3,803,120)	1,033,121
Provision for taxes on unrealized appreciation on investments	(185,888)	
Net Increase in Net Assets Resulting from Operations	9,168,759	13,835,134
Stockholder distributions	(13,260,046)	(12,291,447)
Capital share transactions		
Issuance of common stock	5,087,335	
Reinvestments of stockholder distributions	313,113	669,803
Sales load	(75,510)	
Offering costs	(29,904)	
Net increase in net assets resulting from capital share transactions	5,295,034	669,803
Total increase in net assets	1,203,747	2,213,490
Net assets at beginning of period	175,891,514	173,845,955
Net assets at end of period (includes $1,019,866 and $1,372,398 of distributions in excess of net investment income)	$177,095,261	$176,059,445

See Notes to Unaudited Consolidated Financial Statements.

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STELLUS CAPITAL INVESTMENT CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	For the nine months ended September 30, 2014	For the nine months ended September 30, 2013
Cash flows from operating activities		
Net increase in net assets resulting from operations	$9,168,759	$13,835,134
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by (used in) operating activities:		
Purchases of investments	(58,454,022)	(129,073,679)
Proceeds from sales and repayments of investments	49,485,710	84,105,057
Net change in unrealized (appreciation) depreciation on investments	3,803,220	(1,031,604)
Increase in investments due to PIK	(538,457)	(854,644)
Net amortization of premium and accretion of discount	(488,829)	(308,299)
Amortization of loan structure fees	452,054	419,927
Amortization of deferred financing costs	74,964	
Net realized gain on investments	(446,239)	(1,010,884)
Changes in other assets and liabilities		
Increase in interest receivable	(643,642)	(1,576,787)
Decrease in receivable for affiliated transaction	43,450	
Increase in accounts receivable	(31,013)	
Decrease in prepaid expenses and fees	29,522	384,904
Increase (decrease) in payable for investments purchased		(4,750,000)
Increase in management fees payable	104,501	613,642
Increase (decrease) in directors fees payable	(10,000)	46,548
Increase (decrease) in incentive fees payable	(841,055)	1,262,914
Increase in administrative services payable	288,157	
Increase in interest payable	102,224	225,682
Decrease in unearned revenue	(17,417)	
Increase in deferred tax liability	185,888	
Increase (decrease) in other accrued expenses and liabilities	(161,558)	91,632
Net cash provided by (used in) operating activities	2,106,217	(37,620,457)
Cash flows from financing activities		
Proceeds from notes issued	25,000,000	
Financing costs paid for credit facility and notes issued	(997,317)	(156,672)
Proceeds from the issuance of common stock	5,116,989	
Sales load for common stock issued	(75,510)	
Offering costs paid for common stock issued	(116,149)	(147,123)

Stockholder distributions paid	(11,533,709)	(11,621,644)
Borrowings under credit facility	78,000,000	105,000,000
Repayments of credit facility	(98,000,000)	(58,000,000)
Repayments of short-term loan	(9,000,000)	(76,000,643)
Borrowings on short-term loan		39,999,633
Net cash used in financing activities	(11,605,696)	(926,449)
Net decrease in cash and cash equivalents	(9,499,479)	(38,545,906)
Cash and cash equivalents balance at beginning of period	13,663,542	62,131,686
Cash and cash equivalents balance at end of period	$4,164,063	$23,585,780
Supplemental and non-cash financing activities		
Accrued deferred offering costs	4,752	
Value of shares issued pursuant to Dividend Reinvestment Plan	313,113	669,803
Interest expense paid	3,206,081	1,559,812

See Notes to Unaudited Consolidated Financial Statements.

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Stellus Capital Investment Corporation

Consolidated Schedule of Investments (unaudited)
September 30, 2014

Investments	Footnotes	Headquarters/Industry	Principal Amount/Shares	Amortized Cost	Fair Value(1)	% of Net Assets
Non-controlled, non-affiliated investments	(2)					
Abrasive Products & Equipment		Deer Park, TX				
Term Loan-Second Lien, L+10.5%, LIBOR floor 1.00%, due 3/5/20	(3)	Chemicals, Plastics, & Rubber	$4,507,500	$4,418,495	$4,418,495	2.49 %
APE Holdings, LLC Common Shares, Class A	(4)(6)		375,000 shares	375,000	375,000	0.21 %
Total				4,793,495	4,793,495	2.70 %
Atkins Nutritionals Holdings II, Inc.		Denver, CO				
Term Loan-Second Lien, L+8.50%, LIBOR floor 1.25%, due 4/3/2019	(3)	Beverage, Food, & Tobacco	$13,000,000	12,787,920	13,000,000	7.34 %
ATX Networks		West Ajax, Ontario				
Term Loan-Unsecured, 12.00% cash, 2.00% PIK due 5/12/2016	(5)(6)	High Tech Industries	$21,526,219	21,526,219	21,526,219	12.16%
Binder and Binder						
Term Loan-Unsecured, 13.00% cash, 2.00% PIK, 2.00% Default Rate, due 2/27/2016	(4)(5)(7)	Hauppauge, NY High Tech Industries	$13,200,354	13,200,354	8,716,919	4.92 %
Blackhawk Mining, LLC		Lexington, KY				
Term Loan-First Lien, 12.5%, due 10/9/2016		Metals & Mining	$4,565,698	$4,294,404	$4,333,676	2.45 %
Common Shares, Class B	(4)		36 shares	214,286	585,834	0.33 %
Total				4,508,690	4,919,510	2.78 %
Calero Software, LLC		Rochester, NY				
Term Loan-Second Lien, L+9.50%, LIBOR floor 1.00%, due 6/5/2019	(3)	Telecommunications	$10,000,000	$9,823,047	$9,716,886	5.49 %
Managed Mobility Holdings, LLC Partnership Units	(4)		8,507 units	500,000	437,790	0.25 %
Total				10,323,047	10,154,676	5.74 %
Colford Capital Holdings, LLC		New York, NY				
Term Loan-Unsecured, 12.25%, due 5/31/2018	(6)	Finance	$12,500,000	$12,276,214	$12,231,325	6.91 %
Term Loan-Unsecured, 12.25%, due 5/31/2018	(6)(8)		$1,000,000	978,594	978,506	0.55 %
Total				13,254,808	13,209,831	7.46 %

Digital Payment Technologies Corp. Term Loan-First Lien, L+8.50%, LIBOR floor 1.00%, due 1/31/2019	(3)(6)(9)	Burnaby, British Columbia Transportation & Logistics	$2,965,625	2,926,099	2,907,386	1.64 %
Eating Recovery Center, LLC Mezzanine Term Loan-Unsecured, 12.00% cash, 1.00% PIK, due 6/28/2018	(5)	Denver, CO Healthcare & Pharmaceuticals	$18,400,000	$18,111,464	$18,154,376	10.25%
ERC Group Holdings LLC Common Shares, Class A	(4)(6)		17,820 shares	1,674,648	2,130,645	1.20 %
Total				19,786,112	20,285,021	11.45%
Empirix Inc. Term Loan-Second Lien, L+9.50%, LIBOR floor 1.00%, due 5/1/2020	(3)(10)	Billerica, MA Software	$21,407,850	21,025,501	20,935,751	11.82%
Empirix Holdings I, Inc. Common Shares, Class A	(4)		1,304 shares	1,304,232	2,187,361	1.24 %
Empirix Holdings I, Inc. Common Shares, Class B	(4)		1,317,406 shares	13,174	22,094	0.01 %
Total				22,342,907	23,145,206	13.07
Glori Energy Production Inc. Term Loan-First Lien, L+10.00%, LIBOR floor 1.00%, due 3/14/2017	(3)(6)	Houston, TX Energy: Oil & Gas	$2,955,583	$2,906,991	$2,854,262	1.61 %

See Notes to Unaudited Consolidated Financial Statements.

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Stellus Capital Investment Corporation

Consolidated Schedule of Investments (unaudited) (continued) September 30, 2014

See Notes to Unaudited Consolidated Financial Statements.

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Stellus Capital Investment Corporation

Consolidated Schedule of Investments (unaudited) (continued) September 30, 2014

(1) See Note 1 of the Notes to Financial Statements for a discussion of the methodologies used to value securities in the portfolio.

(2) The Company s obligations to the lenders of the Credit Facility are secured by a first priority security interest in all non-controlled, non-affiliated investments and cash, but exclude $1,276,542 of cash and cash equivalents, $7,043,353 (at par) of the term loan of SQAD, LLC, 5,800 common and 5,624 preferred shares of SQAD Holdco, Inc., $9,750,000 (at par) of the term loan of Empirix, Inc., $9,609,095 (at par) of the term loan of Momentum Telecom, Inc., and $4,507,500 (at par) of the term loan of Abrasive Products & Equipment.

(3) These loans have LIBOR or Euro Floors which are higher than the current applicable LIBOR or Euro rates; therefore, the floors are in effect.

(4) Security is non-income producing.

(5) Represents a payment-in-kind security. At the option of the issuer, interest can be paid in cash or cash and PIK. The percentage of PIK shown is the maximum PIK that can be elected by the company.

(6) The investment is not a qualifying asset under the Investment Company Act of 1940, as amended.

(7) Investment was on non-accrual status as of January 1, 2014.

See Notes to Unaudited Consolidated Financial Statements.

Stellus Capital Investment Corporation

Consolidated Schedule of Investments (unaudited) (continued) September 30, 2014

(8) Excluded from the investment above is an unfunded term loan commitment in an amount not to exceed $4,000,000, an interest rate of 12.25% and a maturity of May 31, 2018. This investment is accruing a commitment fee of 0.50% on the undrawn balance.

(9) Digital Payment Technologies Corp. is the Canadian co-borrower of the term loan of T2 Systems, Inc.

(10) Excluded from the investment above is a delayed draw term loan commitment in an amount not to exceed $7,542,150, an interest rate of LIBOR plus 9.50%, LIBOR floor 1.00%, and a maturity of May 1, 2020. This investment is accruing an unused commitment fee of 0.50% per annum.

(11) On September 30, 2014, the interest rate on these loans was one month LIBOR of 0.15%, plus the applicable spread.

(12) Excluded from this investment is an undrawn commitment in an amount not to exceed $1,600,000, an interest rate of LIBOR plus 8.50% and a maturity of September 30, 2018. This investment is accruing an unused commitment fee of 0.50% per annum.

(13) This investment also includes an unfunded equity commitment in an amount not to exceed $112,362.

(14) This investment amended its coupon on August 21, 2014 from L+7.50% cash to L+8.50% cash. The PIK component and maturity are unchanged.

(15) This investment amended the PIK component of the coupon from 1.75% to 2.75% on August 21, 2014. The cash component and maturity are unchanged.

Abbreviation Legend

Euro	Euro Dollar
L	LIBOR
PIK	Payment-In-Kind

See Notes to Unaudited Consolidated Financial Statements.

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Stellus Capital Investment Corporation

Consolidated Schedule of Investments
December 31, 2013

Investments	Footnotes	Headquarters/Industry	Principal Amount/Shares	Amortized Cost	Fair Value(1)	% of Net Assets
Non-controlled, non-affiliated investments	(2)					
Aderant North America Inc.						
Term Loan-Second Lien, L + 8.75%, LIBOR floor 1.25%, due 6/20/2019		Atlanta, GA Software	$1,500,000	$1,480,112	$1,500,000	0.85 %
Ascend Learning, LLC						
Term Loan-Second Lien, Euro + 10.00%, Euro floor 1.50%, due 12/6/2017		Burlington, MA Software	$10,000,000	10,000,000	10,000,000	5.69 %
Atkins Nutritionals Holdings II, Inc.						
Term Loan-Second Lien, L + 8.50%, LIBOR floor 1.25%, due 4/3/2019		Denver, CO Beverage, Food, & Tobacco	$17,000,000	16,689,794	17,000,000	9.67 %
ATX Networks						
Term Loan-Unsecured, 12.00% cash, 2.00% PIK, due 5/12/2016	(3)(4)	West Ajax, Ontario High Tech Industries	$21,203,012	21,203,012	21,203,012	12.05%
Binder and Binder						
Term Loan-Unsecured, 13.00% cash, 2.00% PIK, due 2/27/2016	(3)	Hauppauge, NY Services: Consumer	$13,133,228	13,133,228	11,395,293	6.48 %
Blackhawk Mining, LLC						
Term Loan-First Lien, 12.50%, due 10/9/2016		Lexington, KY Metals & Mining	$4,806,071	4,445,365	4,547,024	2.59 %
Common Shares, Class B	(5)		36 shares	214,286	341,349	0.19 %
Total				4,659,651	4,888,373	2.78 %
Calero Software, LLC						
Term Loan-Second Lien, L + 9.50%, LIBOR floor 1.00%, due 6/5/2019		Rochester, NY Telecommunications	$10,000,000	9,802,547	9,802,547	5.57 %
Managed Mobility Holdings, LLC Ltd. Partnership	(5)		8,507 shares	500,000	500,000	0.28 %
Total				10,302,547	10,302,547	5.85 %
Colford Capital Holdings, LLC						
Term Loan-Unsecured 12.25%, due 5/31/2018	(4)(6)	New York, NY Finance	$12,500,000	12,242,889	12,491,250	7.1 %
ConvergeOne Holdings Corp.						
Term Loan-First Lien, L + 8.00%, LIBOR floor 1.25%, due 5/8/2019		Eagan, MN Telecommunications	$12,185,952	12,017,679	12,104,672	6.88 %
Eating Recovery Center, LLC	(3)	Denver, CO	$18,400,000	18,075,428	18,400,000	10.46%

Mezzanine Term Loan-Unsecured, 12.00% cash, 1.00% PIK, due 6/28/2018(3)		Health & Pharmaceuticals				
Common Shares, Class A(4)(5)	(4)(5)		17,528 shares	1,647,135	1,708,667	0.97 %
Total				19,722,563	20,108,667	11.43%
Empirix Inc.						
Term Loan-Second Lien, L + 9.50%, LIBOR floor 1.00%, due 5/1/2020	(7)	Billerica, MA Software	$21,407,850	20,988,492	20,988,492	11.93%
Common Shares, Class A(5)	(5)		1,304 shares	1,304,232	1,304,232	0.74 %
Common Shares, Class B(5)	(5)		1,317,406 shares	13,174	13,174	0.01 %
Total				22,305,898	22,305,898	12.68%
Grupo HIMA San Pablo, Inc.						
Term Loan-First Lien, L + 7.00%, LIBOR floor 1.50%, due 1/31/2018		San Juan, PR	$4,962,500	4,877,838	4,811,144	2.74 %
Term Loan-Second Lien, 13.75%, due 7/31/2018		Health & Pharmaceuticals	$4,000,000	3,822,486	3,548,400	2.02 %
Total				8,700,324	8,359,544	4.76 %
Help Systems, LLC						
Term Loan-Second Lien, L + 8.50%, LIBOR floor 1.00%, due 6/28/2020		Eden Prairie, MN Software	$15,000,000	14,784,682	15,000,000	8.53 %
Hostway Corp.						
Term Loan-Second Lien, L + 8.75%, LIBOR floor 1.25%, due 12/13/2020		Chicago, Il High Tech Industries	$6,750,000	6,615,231	6,615,231	3.76 %
Livingston International, Inc.						
Term Loan-Second Lien, L + 7.75%, LIBOR floor 1.25%, due 4/18/2020	(4)	Toronto, Ontario Transportation: Cargo	$6,841,739	6,714,636	7,012,783	3.99 %

See Notes to Unaudited Consolidated Financial Statements.

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Stellus Capital Investment Corporation

Consolidated Schedule of Investments (continued) December 31, 2013

(1) See Note 1 of the Notes to Financial Statements for a discussion of the methodologies used to value securities in the portfolio.

(2) The Company s obligations to the lenders of the Credit Facility are secured by a first priority security interest in all non-controlled non-affiliated investments and cash, but exclude Cash Equivalents.

See Notes to Unaudited Consolidated Financial Statements.

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Consolidated Schedule of Investments (continued) December 31, 2013

(3) Represents a payment-in-kind security. At the option of the issuer, interest can be paid in cash or cash and PIK. The percentage of PIK shown is the maximum PIK that can be elected by the company.

(4) The investment is not a qualifying asset under the Investment Company Act of 1940, as amended.

(5) Security is non-income producing.

(6) Excluded from the investment above is an unfunded term loan commitment in an amount not to exceed $12,500,000, an interest rate of 12.25% and a maturity of May 31, 2018. This investment is accruing an unused commitment fee of 0.50% per annum.

(7) Excluded from the investment above is a delayed draw term loan commitment in an amount not to exceed $7,542,150, an interest rate of LIBOR plus 9.50%, LIBOR floor 1.00%, and a maturity of May 1, 2020. This investment is accruing an unused commitment fee of 0.50% per annum.

(8) Excluded from the investment above is an undrawn revolving loan commitment in an amount not to exceed $900,000. This investment is accruing an unused commitment fee of 0.50% per annum. This investment amended its maturity to 9/30/18 on 9/30/13.

(9) This investment amended its maturity to 2/15/19 on 8/15/13. The interest rate was amended from 11% cash pay plus 2% PIK to 12.5% cash pay.

(10) This investment amended its maturity to 1/31/19 on 7/23/13. The interest rate was amended from 12% cash pay plus 2% PIK to 12% cash pay.

(11) Amended maturity to 2/18/17 on 3/4/13. Amended rate to 11.5% fixed on 12/6/13.

Abbreviation Legend

PIK	Payment-In-Kind
L	LIBOR
Euro	Euro Dollar

See Notes to Unaudited Consolidated Financial Statements.

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2014
(Unaudited)

NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Stellus Capital Investment Corporation (we , us , our and the Company) was formed as a Maryland corporation on M 18, 2012 (Inception) and is an externally managed, closed-end, non-diversified investment management company and is applying the guidance of Accounting Standards Codification (ASC) Topic 946, *Financial Services Investment Companies*. The Company has elected to be treated as a business development company under the Investment Company Act of 1940, as amended (the 1940 Act) and as a regulated investment company (RIC) for U.S. federal income tax purposes. The Company s investment activities are managed by Stellus Capital Management, LLC (Stellus Capital or the Advisor).

On November 7, 2012, the Company priced its initial public offering (the Offering), at a price of $15.00 per share. Through its initial public offering the Company sold 9,200,000 shares (including 1,200,000 shares through the underwriters exercise of the overallotment option) for gross proceeds of $138,000,000. Including the Offering, the Company has raised $180,409,145 including (i) $500,010 of seed capital contributed by Stellus Capital, (ii) $12,749,990 in a private placement to certain purchasers, including persons and entities associated with Stellus Capital, and (iii) $29,159,145 in connection with the acquisition of the Company s initial portfolio. The Company s shares are currently listed on the New York Stock Exchange under the symbol SCM .

Immediately prior to the pricing of the Offering the Company acquired its initial portfolio of assets for $165,235,169 in cash and $29,159,145 in shares of the Company s common stock, or $194,394,314 in total. The cash portion of the acquisition of the initial portfolio was financed by (i) borrowing $152,485,179 under a credit facility (Bridge Facility) with Sun Trust and (ii) using the $12,749,990 of proceeds received in connection with the private placement. The Bridge Facility had a maturity date of not more than 7 days after the pricing date of the Offering. Borrowings under the Bridge Facility bore interest at the highest of (i) a prime rate, (ii) the Federal Funds Rate plus 0.50% and (iii) Libor plus 1.00%. The Company used the net proceeds from the Offering together with borrowings under the Company s Credit Facility (see Note 9) to repay in full the outstanding indebtedness under the Bridge Facility, at which point the Bridge Facility terminated.

The Company has established wholly owned subsidiaries: SCIC ERC Blocker 1, Inc., SCIC SKP Blocker 1, Inc. and SCIC APE Blocker 1, Inc., which are structured as Delaware entities, to hold equity or equity-like investments in portfolio companies organized as limited liability companies, or LLCs (or other forms of pass-through entities)

(Taxable Subsidiaries). The Taxable Subsidiaries are consolidated for U.S. GAAP reporting purposes, and the portfolio investments held by them are included in the consolidated financial statements.

On June 14, 2013, we formed Stellus Capital SBIC LP or the SBIC subsidiary , and its general partner, Stellus Capital SBIC GP, LLC., as wholly owned subsidiaries of the Company, in Delaware. On June 20, 2014, the SBIC subsidiary received a license from the Small Business Administration, or SBA to operate as a Small Business Investment Company (SBIC) under Section 301(c) of the Small Business Investment Company Act of 1958. The SBIC subsidiary is consolidated for U.S. GAAP reporting purposes, and the portfolio investments held by it are included in the consolidated financial statements.

The SBIC license allows the SBIC subsidiary to obtain leverage by issuing SBA-guaranteed debentures, subject to the issuance of a capital commitment by the SBA and other customary procedures. SBA-guaranteed debentures are non-recourse, interest only debentures with interest payable semi-annually and have a ten year maturity. The principal amount of SBA-guaranteed debentures is not required to be paid prior to maturity but may be prepaid at any time without penalty. The interest rate of SBA-guaranteed debentures is fixed on a semi-annual basis at a market-driven spread over U.S. Treasury Notes with 10-year maturities. The SBA, as a

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

creditor, will have a superior claim to the SBIC s assets over the Company s stockholders in the event the Company liquidates the SBIC subsidiary or the SBA exercises its remedies under the SBA-guaranteed debentures issued by the SBIC subsidiary upon an event of default. On August 6, 2014, the SBIC subsidiary received a commitment letter from the SBA for SBA-guaranteed debentures totaling $32.5 million. As of September 30, 2014, the SBIC subsidiary had not yet issued any SBA-guaranteed debentures. SBA regulations currently limit the amount that an SBIC may borrow to a maximum of $150 million when it has at least $75 million in regulatory capital, receives a capital commitment from the SBA and has been through an examination by the SBA subsequent to licensing. As of September 30, 2014, the SBIC subsidiary had $32.5 million of regulatory capital, which implies a maximum borrowing of $65 million, subject to the criteria discussed above.

The Company s investment objective is to maximize the total return to its stockholders in the form of current income and capital appreciation through debt and related equity investments in middle-market companies. The Company seeks to achieve its investment objective by originating and investing primarily in private U.S. middle-market companies (typically those with $5.0 million to $50.0 million of EBITDA (earnings before interest, taxes, depreciation and amortization)) through first lien, second lien, unitranche and mezzanine debt financing, with corresponding equity co-investments. It sources investments primarily through the extensive network of relationships that the principals of Stellus Capital have developed with financial sponsor firms, financial institutions, middle-market companies, management teams and other professional intermediaries.

Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared on the accrual basis of accounting in conformity with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with U.S. GAAP are omitted. The unaudited consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries.

In the opinion of management, the unaudited consolidated financial results included herein contain all adjustments, consisting solely of normal recurring accruals, considered necessary for the fair presentation of financial statements for the interim periods included herein. The results of operations for the nine months ended September 30, 2014 and 2013 are not necessarily indicative of the operating results to be expected for the full year. Also, the unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2013. Certain reclassifications have been made to certain prior period balances to conform with current presentation.

In accordance with Regulation S-X under the Securities Act of 1933, as amended and Securities Exchange Act of 1934, as amended (the Exchange Act), the Company does not consolidate portfolio company investments.

The accounting records of the Company are maintained in U.S. dollars.

Portfolio Investment Classification

The Company classifies its portfolio investments with the requirements of the 1940 Act, (a) Control Investments are defined as investments in which the Company owns more than 25% of the voting securities or has rights to maintain greater than 50% of the board representation, (b) Affiliate Investments are defined as investments in which the Company owns between 5% and 25% of the voting securities and does not have rights to maintain greater than 50% of the board representation, and (c) Non-controlled, non-affiliate investments are defined as investments that are neither Control Investments or Affiliate Investments.

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and Cash Equivalents

At September 30, 2014, cash balances totaling $3,914,063 exceeded FDIC insurance protection levels, subjecting the Company to risk related to the uninsured balance. All of the Company s cash deposits are held at large established high credit quality financial institutions and management believes that risk of loss associated with any uninsured balances is remote.

Cash consists of bank demand deposits. We deem certain U.S. Treasury Bills and other high-quality, short-term debt securities as cash equivalents. At the end of each fiscal quarter, we may take proactive steps to ensure we are in compliance with the RIC diversification requirements under Subchapter M of the Internal Revenue Code (the Code), which are dependent upon the composition of our total assets at quarter end. We may accomplish this in several ways, including purchasing U.S. Treasury Bills and closing out positions after quarter-end or temporarily drawing down on the Credit Facility (see Note 9).

On September 30, 2014, we held no U.S. Treasury Bills. On December 31, 2013, we held approximately $10 million of U.S. Treasury Bills with a 25 day maturity purchased using $1 million in margin cash and the proceeds from a $9 million short term loan from Raymond James. The loan had an effective annual interest rate of approximately 6.25%. On January 2, 2014, we sold the Treasury Bills, repaid the remainder of the loan from Raymond James and received back the $1 million margin payment (net of fees and expenses of $1,875).

Use of Estimates

The preparation of the consolidated statements of assets and liabilities in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ materially.

Deferred Financing Costs

Deferred financing costs consist of fees and expenses paid in connection with the closing of credit facilities and are capitalized at the time of payment. Deferred financing costs are amortized using the straight line method over the term of the credit facility.

Deferred Offering Costs

Deferred offering costs consist of fees and expenses incurred in connection with the offer and sale of the Company s common stock and bonds, including legal, accounting, printing fees and other related expenses, as well as costs incurred in connection with the filing of a shelf registration statement. These costs are capitalized when incurred and recognized as a reduction of offering proceeds when the offering becomes effective.

Investments

As a business development company, the Company will generally invest in illiquid loans and securities including debt and equity securities of middle-market companies. Under procedures established by the board of directors, the Company intends to value investments for which market quotations are readily available at such market quotations. The Company will obtain these market values from an independent pricing service or at the median between the bid and ask prices obtained from at least two brokers or dealers (if available, otherwise by a principal market maker or a primary market dealer). Debt and equity securities that are not publicly traded or whose market prices are not readily available will be valued at fair value as determined in good faith by our board of directors. Such determination of fair values may involve subjective judgments and estimates. The Company will also engage independent valuation providers to review the valuation of each portfolio investment that does not have a readily available market quotation at least twice annually.

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments purchased within 60 days of maturity will be valued at cost plus accreted discount, or minus amortized premium, which approximate fair value. With respect to unquoted securities, our board of directors, together with our independent valuation providers, will value each investment considering, among other measures, discounted cash flow models, comparisons of financial ratios of peer companies that are public and other factors. When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, the board will use the pricing indicated by the external event to corroborate and/or assist us in our valuation. Because the Company expects that there will not be a readily available market for many of the investments in our portfolio, the Company expects to value most of our portfolio investments at fair value as determined in good faith by the board of directors using a documented valuation policy and a consistently applied valuation process. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a readily available market value existed for such investments, and the differences could be material.

In following these approaches, the types of factors that will be taken into account in fair value pricing investments will include, as relevant, but not be limited to:

- available current market data, including relevant and applicable market trading and transaction comparables;
- applicable market yields and multiples;
- security covenants;
- call protection provisions;
- information rights;
- the nature and realizable value of any collateral;
- the portfolio company s ability to make payments, its earnings and discounted cash flows and the markets in which it does business;
- comparisons of financial ratios of peer companies that are public;
- comparable merger and acquisition transactions; and
- the principal market and enterprise values.

Revenue Recognition

We record interest income on an accrual basis to the extent such interest is deemed collectible. For loans and debt securities with contractual payment-in-kind (PIK) interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, we do not accrue PIK interest if the portfolio company valuation indicates that such PIK interest is not collectible. We will not accrue interest on loans and debt securities if we have reason to doubt our ability to collect such interest. Loan origination fees, original issue discount and market discount or premium are capitalized, and we then accrete or amortize such amounts using the effective interest method as interest income. Upon the prepayment of a loan or debt security, any unamortized loan origination fee is recorded as interest income. We record prepayment premiums on loans and debt securities as other income. Dividend income, if any, will be recognized on the ex-dividend date.

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Net Realized Gains or Losses and Net Change in Unrealized Appreciation or Depreciation

We measure realized gains or losses by the difference between the net proceeds from the repayment or sale and the amortized cost basis of the investment, without regard to unrealized appreciation or depreciation previously recognized. Net change in unrealized appreciation or depreciation reflects the change in portfolio investment values during the reporting period, including any reversal of previously recorded unrealized appreciation or depreciation, when gains or losses are realized.

Payment-in-Kind Interest

We have investments in our portfolio that contain a PIK interest provision. Any PIK interest is added to the principal balance of such investments and is recorded as income, if the portfolio company valuation indicates that such PIK interest is collectible. In order to maintain our status as a RIC, substantially all of this income must be paid out to stockholders in the form of dividends, even if we have not collected any cash.

Investment Transaction Costs

Costs that are material associated with an investment transaction, including legal expenses, are included in the cost basis of purchases and deducted from the proceeds of sales unless such costs are reimbursed by the borrower.

Receivables and Payables for Unsettled Securities Transaction

The Company records all investments on a trade date basis.

U.S. Federal Income Taxes

The Company has elected to be treated as a RIC under Subchapter M of the Code, and to operate in a manner so as to qualify for the tax treatment applicable to RICs. In order to qualify as a RIC, among other things, the Company is required to timely distribute to its stockholders at least 90% of investment company taxable income, as defined by the

Code, for each year. So long as the Company maintains its status as a RIC, it generally will not pay corporate-level U.S. federal income taxes on any ordinary income or capital gains that it distributes at least annually to its stockholders as dividends. Rather, any tax liability related to income earned by the Company represents obligations of the Company s investors and will not be reflected in the consolidated financial statements of the Company.

To avoid a 4% federal excise tax on undistributed earnings, the Company is required to distribute each calendar year the sum of (i) 98% of its ordinary income for such calendar year (ii) 98.2% of its net capital gains for the one-year period ending October 31 of that calendar year (iii) any income recognized, but not distributed, in preceding years and on which the Company paid no federal income tax. The Company, at its discretion, may choose not to distribute all of its taxable income for the calendar year and pay a non-deductible 4% excise tax on this income. If the Company chooses to do so, all other things being equal, this would increase expenses and reduce the amount available to be distributed to stockholders. To the extent that the Company determines that its estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, the Company accrues excise taxes on estimated excess taxable income as taxable income is earned. The Company incurred no excise tax expense for the three and nine months ended September 30, 2014 and the three and nine months ended September 30, 2013.

The Company evaluates tax positions taken or expected to be taken in the course of preparing its tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions deemed to meet a more-likely-than-not threshold would be recorded as a tax benefit or expense in the applicable period. Although the Company files federal and state tax returns, its major tax jurisdiction is federal. The 2012 and 2013 federal tax years for the Company remain subject to examination by the Internal Revenue Service.

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

As of September 30, 2014 and December 31, 2013, the Company had not recorded a liability for any unrecognized tax positions. Management s evaluation of uncertain tax positions may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof. The Company s policy is to include interest and penalties related to income taxes, if applicable, in general and administrative expenses. There were no such expenses for the three and nine months ended September 30, 2014 and 2013, respectively.

The Company has direct wholly owned subsidiaries that have elected to be taxable entities. The Taxable Subsidiaries permit the Company to hold equity investments in portfolio companies which are pass through entities for tax purposes and continue to comply with the source income requirements contained in RIC tax provisions of the Code. The Taxable Subsidiaries are not consolidated with the Company for income tax purposes and may generate income tax expense, benefit, and the related tax assets and liabilities, as a result of their ownership of certain portfolio investments. The income tax expense, or benefit, if any, and related tax assets and liabilities are reflected in the Company s consolidated financial statements.

The Taxable Subsidiaries use the liability method in accounting for income taxes. Deferred tax assets and liabilities are recorded for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, using statutory tax rates in effect for the year in which the temporary differences are expected to reverse. A valuation allowance is provided against deferred tax assets when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses. Taxable income generally excludes net unrealized appreciation or depreciation, as investment gains or losses are not included in taxable income until they are realized.

For the three and nine months ended September 30, 2014 and September 30, 2013, the Company recorded deferred income tax expense of $185,888 and $0, respectively, related to the Taxable Subsidiaries. In addition, as of September 30, 2014 and September 30, 2013, the Company had a deferred tax liability of $185,888 and $0, respectively.

Earnings per Share

Basic per share calculations are computed utilizing the weighted average number of shares of common stock outstanding for the period. The Company has no common stock equivalents. As a result, there is no difference between diluted earnings per share and basic per share amounts.

Paid In Capital

The Company records the proceeds from the sale of its common stock on a net basis to (i) capital stock and (ii) paid in capital in excess of par value, excluding all commissions and marketing support fees.

Recently Issued Accounting Standards

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (FASB) or other standards setting bodies that are adopted by the Company as of the specified effective date. ASU No. 2013-08 *Financial Services Investment Companies (Topic 946): Amendments to the Scope, Measurement and Disclosure Requirements* was effective for an entity s interim and annual reporting periods in the fiscal years beginning after December 15, 2013. Accordingly, the Company has adopted the updated guidance and believes that the impact is limited to our disclosure requirements. In August 2014, the FASB issued ASU No. 2014-15 - Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern. In connection with the preparation of interim and annual reports, Management will evaluate whether conditions or events exist that raise substantial doubt about the entity s ability to continue as a going concern

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

within one year after the date that the financial statements are issued (or within one year after the date the financial statements are available to be issued, when applicable), and, if so, disclose that fact. Additionally, Management must evaluate and disclose whether its plans will alleviate that doubt. The guidance is effective for the Company beginning January 1, 2016. The Company believes that the impact of this and other recently issued standards that are not effective will not have a material impact on its consolidated financial statements upon adoption.

NOTE 2 RELATED PARTY ARRANGEMENTS

Investment Advisory Agreement

The Company entered into an investment advisory agreement with Stellus Capital. Pursuant to this agreement, the Company has agreed to pay to Stellus Capital a base annual fee of 1.75% of gross assets, including assets purchased with borrowed funds or other forms of leverage and excluding cash and cash equivalents, and an annual incentive fee.

For the three and nine months ended September 30, 2014, the Company recorded an expense for base management fees of $1,281,231 and $3,842,971, respectively. For the three and nine months ended September 30, 2013, the Company recorded an expense for base management fees of $1,140,675 and $3,065,877, respectively. As of September 30, 2014 and December 31, 2013, respectively, $1,281,231 and $1,176,730, were payable to Stellus Capital.

The incentive fee has two components, investment income and capital gains, as follows:

Investment Income Incentive Fee

The investment income component (Investment Income Incentive Fee) is calculated, and payable, quarterly in arrears based on the Company s pre-incentive fee net investment income for the immediately preceding calendar quarter, subject to a cumulative total return requirement and to deferral of non-cash amounts. The pre-incentive fee net investment income, which is expressed as a rate of return on the value of the Company s net assets attributable to the Company s common stock, for the immediately preceding calendar quarter, will have a 2.0% (which is 8.0% annualized) hurdle rate (also referred to as the Hurdle). Pre-incentive fee net investment income means interest income, dividend income and any other income accrued during the calendar quarter, minus the Company s operating expenses for the quarter excluding the incentive fee. Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with PIK interest and zero coupon securities), accrued income that the Company has not yet received in cash. The Advisor receives no incentive fee for any calendar quarter in which the Company s pre-incentive fee net investment income does not exceed the Hurdle. Subject to the cumulative total return requirement described below, the Advisor receives 100% of the Company s pre-incentive fee net investment income for any calendar quarter with respect to that portion of the pre-incentive net investment income for such quarter, if any, that exceeds the Hurdle but is less than 2.5% (which is 10.0% annualized) of net assets (also referred to as the Catch-up) and 20.0% of the Company s pre-incentive fee net investment income for such calendar quarter, if any, greater than 2.5% (10.0% annualized) of net assets.

The foregoing incentive fee is subject to a total return requirement, which provides that no incentive fee in respect of the Company s pre-incentive fee net investment income is payable except to the extent 20.0% of the cumulative net increase in net assets resulting from operations over the then current and 11 preceding calendar quarters exceeds the cumulative incentive fees accrued and/or paid for the 11 preceding quarters. In other words, any Investment Income Incentive Fee that is payable in a calendar quarter is limited to the lesser of (i) 20% of the amount by which the Company s pre-incentive fee net investment income for such calendar quarter exceeds the 2.0% hurdle, subject to the Catch-up, and (ii) (x) 20% of the cumulative net increase in

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 2 RELATED PARTY ARRANGEMENTS (continued)

net assets resulting from operations for the then current and 11 preceding quarters *minus* (y) the cumulative incentive fees accrued and/or paid for the 11 preceding calendar quarters. For the foregoing purpose, the cumulative net increase in net assets resulting from operations is the amount, if positive, of the sum of pre-incentive fee net investment income, realized gains and losses and unrealized appreciation and depreciation of the Company for the then current and 11 preceding calendar quarters. In addition, the Advisor is not paid the portion of such incentive fee that is attributable to deferred interest until the Company actually receives such interest in cash.

For the three and nine months ended September 30, 2014, the Company incurred $633,485 and $2,479,433, respectively, of Investment Income Incentive Fees. For the three and nine months ended September 30, 2013, the Company incurred $976,126 and $2,562,821, respectively, of Investment Income Incentive Fees. As of September 30, 2014 and December 31, 2013, $215,887 and $751,475, respectively, of such incentive fees are payable to the Advisor, of which $43,255 and $641,516, respectively, are currently payable (as explained below). As of September 30, 2014 and December 31, 2013, $172,632 and $109,959, respectively, of incentive fees incurred but not paid by the Company were generated from deferred interest (i.e. PIK, certain discount accretion and deferred interest) and are not payable until such amounts are received in cash.

Capital Gains Incentive Fee

GAAP requires that the incentive fee accrual considers the cumulative aggregate realized gains and losses and unrealized capital appreciation or depreciation of investments or other financial instruments in the calculation, as an incentive fee would be payable if such realized gains and losses and unrealized capital appreciation or depreciation were realized, even though such realized gains and losses and unrealized capital appreciation or depreciation is not permitted to be considered in calculating the fee actually payable under the investment management agreement (the Capital Gains Incentive Fee). There can be no assurance that unrealized appreciation or depreciation will be realized in the future. Accordingly, such fee, as calculated and accrued, would not necessarily be payable under the investment management agreement, and may never be paid based upon the computation of incentive fees in subsequent periods. For the three and nine months ended September 30, 2014, the Company incurred ($223,351) and ($305,467) respectively, of incentive fees related to the Capital Gains Incentive Fee. For the three and nine months ended September 30, 2013, the Company incurred ($61,714) and $407,034, of incentive fees related to the Capital Gains Incentive Fee. As of September 30, 2014 and December 31, 2013, $0 and $305,467 of Capital Gains Incentive Fees were payable to the Advisor, subject to the limitations set forth below.

A portion of the Capital Gains Incentive Fee may be payable to the Advisor on an annual basis. This portion of the fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the investment management agreement, as of the termination date). This component is equal to 20.0% of the Company s cumulative aggregate realized capital gains from inception through the end of that calendar year, computed net of the cumulative aggregate realized capital losses and cumulative aggregate unrealized capital depreciation through the end of such year. The aggregate amount of any previously paid capital gains incentive fees is subtracted from such capital gains incentive fee calculated. As of September 30, 2014 and December 31, 2013, no Capital Gains Incentive Fee was currently payable to the Advisor.

For the years ending December 31, 2012 and December 31, 2013, the Advisor agreed to waive its incentive fee to the extent required to support an annualized dividend yield of 9.0% (to be paid on a quarterly basis) based on the price per share of our common stock in connection with the Offering. The Advisor has entered into no such agreement with the Company for periods after December 31, 2013. As of September 30, 2014, the Advisor concluded that it was not likely to generate sufficient net investment income during the remainder of the year to support distributions for the nine months ended September 30, 2014. While under no

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 2 RELATED PARTY ARRANGEMENTS (continued)

obligation to do so, the Advisor waived incentive fees of $1,399,226 for the three and nine months ended September 30, 2014. Such waiver in no way implies that the Advisor will waive incentive fees in any future period. For the three and nine months ended September 30, 2013, the Advisor waived Investment Income Incentive Fees of $167,775 and $672,982, respectively.

The following tables summarize the components of the incentive fees discussed above:

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Investment Income Incentive Fees Incurred	$ 633,485	$ 976,126	$ 2,479,433	$ 2,562,821
Capital Gains Incentive Fee Incurred	(223,351)	(61,714)	(305,467)	407,034
Incentive Fees Incurred (before waiver)	$ 410,134	$ 914,412	$ 2,173,966	$ 2,969,855
Investment Income Incentive Fees Waived	(1,399,226)	(167,775)	(1,399,226)	(672,982)
Net Incentive Fee Expense	$ (989,092)	$ 746,637	$ 774,740	$ 2,296,873

	September 30, 2014	December 31, 2013
Investment Income Incentive Fee Currently Payable	$ 43,255	$ 641,516
Investment Income Incentive Fee Deferred	172,632	109,959
Capital Gains Incentive Fee Payable		305,467
Incentive Fee Payable	$ 215,887	$ 1,056,942

As of September 30, 2014 and December 31, 2013, the Company was due $0 and $43,450, respectively, from a related party of Stellus Capital for reimbursement of expenses paid for by the Company that were the responsibility of Stellus Capital. The amount due to the Company is included in the Consolidated Statements of Assets and Liabilities.

For the three months and nine months ended September 30, 2014, the Company recorded an expense relating to director fees of $86,000 and $290,000, respectively. For the three months and nine months ended September 30, 2013 the Company recorded an expense relating to director fees of $76,000 and $254,000, respectively. As of September 30, 2014 and December 31, 2013 $86,000 and $96,000, respectively, were payable relating to director fees.

We received exemptive relief from the SEC to co-invest with investment funds managed by Stellus Capital (other than the D. E. Shaw group funds, as defined below) where doing so is consistent with our investment strategy as well as applicable law (including the terms and conditions of the exemptive order issued by the SEC). Under the terms of the relief permitting us to co-invest with other funds managed by Stellus Capital, a required majority (as defined in Section 57(o) of the 1940 Act) of our independent directors must make certain conclusions in connection with a co-investment transaction, including (1) the terms of the proposed transaction, including the consideration to be paid, are reasonable and fair to us and our stockholders and do not involve overreaching of us or our stockholders on the part of any person concerned and (2) the transaction is consistent with the interests of our stockholders and is consistent with our investment objectives and strategies. We intend to co-invest, subject to the conditions included in the exemptive order we received from the SEC, with a private credit fund managed by Stellus Capital that has an investment strategy that is identical to our investment strategy. We believe that such co-investments may afford us additional investment opportunities and an ability to achieve greater diversification.

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS September 30, 2014 (Unaudited)

NOTE 2 RELATED PARTY ARRANGEMENTS (continued)

License Agreement

We have entered into a license agreement with Stellus Capital under which Stellus Capital has agreed to grant us a non-exclusive, royalty-free license to use the name Stellus Capital. Under this agreement, we have a right to use the Stellus Capital name for so long as Stellus Capital or one of its affiliates remains our investment advisor. Other than with respect to this limited license, we have no legal right to the Stellus Capital name. This license agreement will remain in effect for so long as the investment advisory agreement with Stellus Capital is in effect.

Administration Agreement

We have entered into an administration agreement with Stellus Capital pursuant to which Stellus Capital will furnish us with office facilities and equipment and will provide us with the clerical, bookkeeping, recordkeeping and other administrative services necessary to conduct day-to-day operations. Under this administration agreement, Stellus Capital will perform, or oversee the performance of, our required administrative services, which includes, among other things, being responsible for the financial records which we are required to maintain and preparing reports to our stockholders and reports filed with the SEC.

For the three months and nine months ended September 30, 2014, the Company recorded expenses of $149,913 and $438,786, respectively, relating to the administration agreement. For the three months and nine months ended September 30, 2013, the Company recorded expenses of $109,663 and $298,462, respectively. As of September 30, 2014 and December 31, 2013, $298,401 and $135,170, respectively, remained payable to Stellus Capital relating to the administration agreement.

Indemnifications

The investment advisory agreement provides that, absent willful misfeasance, bad faith or gross negligence in the performance of its duties or by reason of the reckless disregard of its duties and obligations under the investment advisory agreement, Stellus Capital and its officers, managers, partners, agents, employees, controlling persons and members, and any other person or entity affiliated with it, are entitled to indemnification from the Company for any damages, liabilities, costs and expenses (including reasonable attorneys fees and amounts reasonably paid in settlement) arising from the rendering of Stellus Capital s services under the investment advisory agreement or otherwise as our investment adviser.

NOTE 3 DISTRIBUTIONS

Distributions are generally declared by the Company s board of directors each calendar quarter and recognized as distribution liabilities on the ex-dividend date. The distribution frequency was changed from quarterly to monthly as of January 20, 2014. The Company intends to distribute net realized gains (*i.e.* , net capital gains in excess of net capital losses), if any, at least annually. The stockholder distributions, if any, will be determined by the board of directors. Any distribution to stockholders will be declared out of assets legally available for distribution.

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STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2014
(Unaudited)

NOTE 3 DISTRIBUTIONS (continued)

The following table reflects the Company s dividends declared and paid or to be paid on its common stock:

Date Declared	Record Date	Payment Date	Amount Per Share
December 7, 2012[(1)]	December 21, 2012	December 27, 2012	$ 0.1800
March 7, 2013	March 21, 2013	March 28, 2013	$ 0.3400
June 7, 2013	June 21, 2013	June 28, 2013	$ 0.3400
August 21, 2013	September 5, 2013	September 27, 2013	$ 0.3400
November 22, 2013	December 9, 2013	December 23, 2013	