

Stellus Capital Investment Corp

Form 497

April 28, 2014

This preliminary prospectus supplement relates to an effective registration statement under the Securities Act of 1933, as amended, but the information in this preliminary prospectus supplement is not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell and are not soliciting an offer to buy these securities in any jurisdiction where the offer and sale is not permitted.

**Filed Pursuant to Rule 497  
Securities Act File No. 333-189938**

**SUBJECT TO COMPLETION, DATED APRIL 28, 2014**

**PRELIMINARY PROSPECTUS SUPPLEMENT  
(to Prospectus dated January 30, 2014)**

**\$25,000,000**

**Stellus Capital Investment Corporation**

**% Notes due 2019**

We are an externally managed, closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, or the 1940 Act. Our investment objective is to maximize the total return to our stockholders in the form of current income and capital appreciation through debt and related equity investments in middle-market companies.

We are offering \$25,000,000 in aggregate principal amount of % notes due 2019, which we refer to as the Notes. The Notes will mature on April 30, 2019. We will pay interest on the Notes on February 15, May 15, August 15 and November 15 of each year, beginning August 15, 2014. We may redeem the Notes in whole or in part at any time or from time to time on or after April 30, 2016, at the redemption price of par, plus accrued interest, as discussed under the caption Specific Terms of the Notes and the Offering Optional redemption in this prospectus supplement. The Notes will be issued in minimum denominations of \$25 and integral multiples of \$25 in excess thereof.

The Notes will be our direct senior unsecured obligations and rank *pari passu* with all outstanding and future unsecured unsubordinated indebtedness issued by Stellus Capital Investment Corporation.

We intend to list the Notes on the New York Stock Exchange and we expect trading to commence thereon within 30 days of the original issue date under the trading symbol SCQ. The Notes are expected to trade flat. This means that purchasers will not pay, and sellers will not receive, any accrued and unpaid interest on the Notes that is not included in the trading price. Currently, there is no public market for the Notes and there can be no assurance that one will develop.

This prospectus supplement and the accompanying prospectus, contain important information you should know before investing in the Notes. Please read this prospectus supplement and the accompanying prospectus before you invest and keep it for future reference. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission, or SEC. The SEC also maintains a website at <http://www.sec.gov> that contains such information. This information is also available free of charge by contacting us at 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027, Attention: Investor Relations, or by calling us collect at (713) 292-5400 or on our website at [www.stelluscapital.com](http://www.stelluscapital.com). Information contained on our website is not incorporated by reference into this prospectus, and you should not consider that information to be part of this prospectus supplement, and the accompanying prospectus.

We are an emerging growth company under the federal securities laws and are subject to reduced public company reporting requirements.

**Investing in the Notes involves a high degree of risk. Before buying any Notes, you should read the discussion of the material risks of investing in our common stock in Risk Factors beginning on page S-13 in this prospectus supplement and page 18 of the accompanying prospectus.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

|   | Per Note | Total        |
|---|----------|--------------|
| Public offering price                         | 100.0 %  | \$25,000,000 |
| Underwriting discount (sales load)            | 2.5 %    | \$625,000    |
| Proceeds to us before expenses <sup>(1)</sup> | 97.5 %   | \$24,375,000 |

(1) Before deducting expenses payable by us related to this offering, estimated at \$250,000. The underwriters may also purchase up to an additional \$3,750,000 total aggregate principal amount of Notes offered hereby, to cover over-allotments, if any, within 30 days of the date of this prospectus supplement. If the underwriters exercise this option in full, the total public offering price will be \$28,750,000, the total underwriting discount (sales load) paid by us will be \$718,750, and total proceeds, before expenses, will be \$28,031,250.

**THE NOTES ARE NOT DEPOSITS OR OTHER OBLIGATIONS OF A BANK AND ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION OR ANY OTHER GOVERNMENT AGENCY.**

Delivery of the Notes in book-entry form only through The Depository Trust Company will be made on or about , 2014.

**Keefe, Bruyette & Woods**  
*A Stifel Company*

omery Scott

**Oppenheimer & Co.**  
 The date of this prospectus supplement is , 2014

TABLE OF CONTENTS

**TABLE OF CONTENTS**  
**PROSPECTUS SUPPLEMENT**

|   | Page        |
|---|-------------|
| <u>SUMMARY OF THE SPECIFIC TERMS OF THE NOTES AND THE OFFERING</u>                            | <u>S-1</u>  |
| <u>SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>                                      | <u>S-6</u>  |
| <u>THE COMPANY</u>  | <u>S-7</u>  |
| <u>SUPPLEMENTARY RISK FACTORS</u>   | <u>S-13</u> |
| <u>USE OF PROCEEDS</u>  | <u>S-17</u> |
| <u>CAPITALIZATION</u>   | <u>S-18</u> |
| <u>RATIO OF EARNINGS TO FIXED CHARGES</u>   | <u>S-19</u> |
| <u>SENIOR SECURITIES.</u>   | <u>S-20</u> |
| <u>SELECTED FINANCIAL AND OTHER DATA</u>  | <u>S-21</u> |
| <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.</u> | <u>S-22</u> |
| <u>DESCRIPTION OF THE NOTES</u>   | <u>S-36</u> |
| <u>CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS.</u>  | <u>S-47</u> |
| <u>UNDERWRITING</u>   | <u>S-53</u> |
| <u>CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR</u>                            | <u>S-56</u> |
| <u>LEGAL MATTERS</u>  | <u>S-56</u> |
| <u>INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>  | <u>S-56</u> |
| <u>AVAILABLE INFORMATION</u>  | <u>S-56</u> |
| <u>INDEX TO FINANCIAL STATEMENTS</u>  | <u>SF-1</u> |
| PROSPECTUS  |             |
| <u>PROSPECTUS SUMMARY</u>   | <u>1</u>    |
| <u>THE OFFERING</u>   | <u>7</u>    |
| <u>FEES AND EXPENSES</u>  | <u>14</u>   |
| <u>SELECTED FINANCIAL DATA</u>  | <u>17</u>   |
| <u>RISK FACTORS</u>   | <u>18</u>   |
| <u>SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>                                      | <u>46</u>   |
| <u>USE OF PROCEEDS</u>  | <u>47</u>   |
| <u>PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS</u>  | <u>48</u>   |
| <u>RATIOS OF EARNINGS TO FIXED CHARGES</u>  | <u>50</u>   |
| <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>  | <u>51</u>   |
| <u>SENIOR SECURITIES</u>  | <u>63</u>   |
| <u>THE COMPANY</u>  | <u>64</u>   |
| <u>PORTFOLIO COMPANIES</u>  | <u>76</u>   |
| <u>MANAGEMENT</u>   | <u>79</u>   |
| <u>MANAGEMENT AGREEMENTS</u>  | <u>86</u>   |
| <u>RELATED PARTY TRANSACTIONS AND CERTAIN RELATIONSHIPS</u>                                   | <u>95</u>   |
| <u>CONTROL PERSONS AND PRINCIPAL STOCKHOLDERS</u>   | <u>97</u>   |
| <u>SELLING STOCKHOLDER</u>  | <u>99</u>   |



TABLE OF CONTENTS

|  | Page       |
|--|------------|
| <u>DETERMINATION OF NET ASSET VALUE</u>                            | <u>100</u> |
| <u>SALES OF COMMON STOCK BELOW NET ASSET VALUE</u>                 | <u>102</u> |
| <u>DIVIDEND REINVESTMENT PLAN</u>                                  | <u>107</u> |
| <u>MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS</u>             | <u>109</u> |
| <u>DESCRIPTION OF OUR COMMON STOCK</u>                             | <u>116</u> |
| <u>DESCRIPTION OF OUR PREFERRED STOCK</u>                          | <u>122</u> |
| <u>DESCRIPTION OF OUR SUBSCRIPTION RIGHTS</u>                      | <u>123</u> |
| <u>DESCRIPTION OF OUR DEBT SECURITIES</u>                          | <u>124</u> |
| <u>DESCRIPTION OF OUR WARRANTS</u>                                 | <u>137</u> |
| <u>REGULATION</u>  | <u>139</u> |
| <u>PLAN OF DISTRIBUTION</u>  | <u>144</u> |
| <u>CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR</u> | <u>146</u> |
| <u>BROKERAGE ALLOCATION AND OTHER PRACTICES</u>                    | <u>146</u> |
| <u>LEGAL MATTERS</u>   | <u>147</u> |
| <u>INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>               | <u>147</u> |
| <u>AVAILABLE INFORMATION</u>                                       | <u>147</u> |
| <u>INDEX TO FINANCIAL STATEMENTS</u>                               | <u>F-1</u> |

S-ii

---

TABLE OF CONTENTS

## **ABOUT THIS PROSPECTUS SUPPLEMENT**

This document is in two parts. The first part is this prospectus supplement, which describes the specific terms of the Notes we are offering and certain other matters relating to us. The second part, the accompanying prospectus, gives more general information about the securities which we may offer from time to time, some of which may not apply to the Notes offered by this preliminary prospectus supplement. For information about the Notes, see Summary of the Specific Terms of the Notes and the Offering and Description of the Notes in this prospectus supplement and Description of Our Debt Securities in the accompanying prospectus.

If information varies between this prospectus supplement and the accompanying prospectus, you should rely only on such information in this prospectus supplement. The information contained in this prospectus supplement supersedes any inconsistent information included in the accompanying prospectus. In various places in this prospectus supplement and the accompanying prospectus, we refer you to other sections of such documents for additional information by indicating the caption heading of such other sections. The page on which each principal caption included in this prospectus supplement and the accompanying prospectus can be found is listed in the table of contents above. All such cross references in this prospectus supplement are to captions contained in this prospectus supplement and not in the accompanying prospectus, unless otherwise stated.

**YOU SHOULD RELY ONLY ON THE INFORMATION CONTAINED IN THIS PROSPECTUS SUPPLEMENT AND THE ACCOMPANYING PROSPECTUS. WE HAVE NOT, AND THE UNDERWRITERS HAVE NOT, AUTHORIZED ANY OTHER PERSON TO PROVIDE YOU WITH DIFFERENT OR ADDITIONAL INFORMATION. IF ANYONE PROVIDES YOU WITH DIFFERENT OR ADDITIONAL INFORMATION, YOU SHOULD NOT RELY ON IT. WE ARE NOT, AND THE UNDERWRITERS ARE NOT, MAKING AN OFFER TO SELL THESE SECURITIES IN ANY JURISDICTION WHERE THE OFFER OR SALE IS NOT PERMITTED. YOU SHOULD ASSUME THAT THE INFORMATION APPEARING IN THIS PROSPECTUS SUPPLEMENT AND THE ACCOMPANYING PROSPECTUS IS ACCURATE ONLY AS OF THEIR RESPECTIVE DATES, REGARDLESS OF THE TIME OF DELIVERY OF THIS PROSPECTUS SUPPLEMENT AND THE ACCOMPANYING PROSPECTUS OR ANY SALES OF THE SECURITIES. OUR BUSINESS, FINANCIAL CONDITION, RESULTS OF OPERATIONS AND PROSPECTS MAY HAVE CHANGED SINCE THOSE DATES.**

S-iii

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TABLE OF CONTENTS

## SUMMARY OF THE SPECIFIC TERMS OF THE NOTES AND THE OFFERING

This summary sets forth certain terms of the Notes that we are offering pursuant to this prospectus supplement and the accompanying prospectus that is attached to the back of this prospectus supplement. This section and the Description of Our Notes section in this prospectus supplement outline the specific legal and financial terms of the Notes. You should read this section and the Description of Our Notes section in this prospectus supplement together with the more general description of the Notes in the accompanying prospectus under the heading Description of Our Debt Securities before investing in the Notes. Capitalized terms used in this prospectus supplement and not otherwise defined shall have the meanings ascribed to them in the accompanying prospectus or in the indenture governing the Notes.

|  |   |
|--|---|
| Issuer   | Stellus Capital Investment Corporation  |
| Title of the securities                          | % Notes due April 30, 2019  |
| Initial aggregate principal amount being offered | \$25,000,000  |
| Over-allotment option                            | The underwriters may also purchase from us up to an additional \$3,750,000 aggregate principal amount of Notes to cover over-allotments, if any, within 30 days of the date of this prospectus supplement.  |
| Initial public offering price                    | 100% of the aggregate principal amount  |
| Principal payable at maturity                    | 100% of the aggregate principal amount; the principal amount of each Note will be payable on its stated maturity date at the office of the Trustee, Paying Agent, Registrar and Transfer Agent for the Notes or at such other office in New York City as we may designate.                  |
| Type of Note                                     | Fixed rate note   |
| Listing  | We intend to list the Notes on the New York Stock Exchange, or the NYSE, within 30 days of the original issue date under the trading symbol SCQ.  |
| Interest Rate                                    | % per year  |
| Day count basis                                  | 360-day year of twelve 30-day months  |
| Original issue date                              | , 2014  |
| Stated maturity date                             | April 30, 2019  |
| Date interest starts accruing                    | , 2014  |
| Interest payment dates                           | Every February 15, May 15, August 15 and November 15 commencing August 15, 2014. If an interest payment date falls on a non-business day, the applicable interest payment will be made on the next business day and no additional interest will accrue as a result of such delayed payment. |
| Interest periods                                 |   |

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The initial interest period will be the period from and including \_\_\_\_\_, 2014, to, but excluding, the initial interest payment date, and the subsequent interest periods will be the periods from and including an interest payment date to, but excluding, the next interest payment date or the stated maturity date, as the case may be.

Regular record dates for interest

Every February 1, May 1, August 1 and November 1, commencing August 1, 2014

S-1

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TABLE OF CONTENTS

Specified currency

U.S. Dollars

Place of payment

New York City

Ranking of Notes

The Notes will be our direct unsecured obligations and will rank:

*pari passu*, or equal, with our future senior unsecured indebtedness;

senior to any of our future indebtedness that expressly provides it is subordinated to the Notes;

effectively subordinated to all of our existing and future secured indebtedness (including indebtedness that is initially unsecured to which we subsequently grant security), to the extent of the value of the assets securing such indebtedness, including without limitation, borrowings under our \$135.0 million senior secured revolving credit facility, or the Credit Facility, of which \$123.0 million was outstanding as of April 25, 2014; and

structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries.

Denominations

We will issue the Notes in denominations of \$25 and integral multiples of \$25 in excess thereof.

Business Day

Each Monday, Tuesday, Wednesday, Thursday and Friday that is not a day on which banking institutions in New York City are authorized or required by law or executive order to close.

Optional redemption

The Notes may be redeemed in whole or in part at any time or from time to time at our option on or after April 30, 2016 upon not less than 30 days nor more than 60 days written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount of the Notes to be redeemed plus accrued and unpaid interest payments otherwise payable thereon for the then-current quarterly interest period accrued to the date fixed for redemption. Before redeeming any Notes, we would have to comply with certain requirements under our Credit Facility, to the extent such requirements remain in effect at such time, or otherwise obtain consent from the lenders.

You may be prevented from exchanging or transferring the Notes when they are subject to redemption. In case any Notes are to be redeemed in part only, the redemption notice will provide that, upon surrender of such Note, you will receive, without a charge, a new Note or Notes of authorized denominations representing the principal amount of your remaining unredeemed Notes.

Any exercise of our option to redeem the Notes will be done in compliance with the 1940 Act.

If we redeem only some of the Notes, the trustee will determine the method for selection of the particular Notes to be redeemed, in accordance with the indenture and in accordance with the rules of any national securities exchange or quotation system on which the Notes are listed. Unless we default in payment of the redemption price, on and after the date of redemption, interest will cease to accrue on the Notes called for redemption.

S-2

TABLE OF CONTENTS

Sinking fund

The Notes will not be subject to any sinking fund.

Repayment at option of holders

Holders will not have the option to have the Notes repaid prior to the stated maturity date.

Defeasance

The Notes are subject to defeasance by us.

Covenant Defeasance

The Notes are subject to covenant defeasance by us.

Form of Notes

The Notes will be represented by global securities that will be deposited and registered in the name of The Depository Trust Company, or DTC, or its nominee. This means that, except in limited circumstances, you will not receive certificates for the Notes. Beneficial interests in the Notes will be represented through book-entry accounts of financial institutions acting on behalf of beneficial owners as direct and indirect participants in DTC. Investors may elect to hold interests in the Notes through either DTC, if they are a participant, or indirectly through organizations that are participants in DTC.

Trustee, Paying Agent, Registrar and Transfer Agent

U.S. Bank National Association

Other covenants

In addition to any covenants described elsewhere in this prospectus supplement or the accompanying prospectus, the following covenants shall apply to the Notes:

We agree that for the period of time during which the Notes are outstanding, we will not violate Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act or any successor provisions, whether or not we continue to be subject to such provisions of the 1940 Act, but giving effect, in either case, to any exemptive relief granted to us by the SEC. Currently, these provisions generally prohibit us from making additional borrowings, including through the issuance of additional debt or the sale of additional debt securities, unless our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowings. See Risk Factors Risks Relating to our Business and Structure Pending legislation may allow us to incur additional leverage in the accompanying prospectus.

We agree that for the period of time during which the Notes are outstanding, we will not violate Section 18(a)(1)(B) as modified by (i) Section 61(a)(1) of the 1940 Act or any successor provisions and (ii) the exception set forth below, despite the fact that we are not currently subject to such provisions of the 1940 Act and will not be subject to such provisions as a result of this offering, except that we will be permitted to declare a cash dividend or distribution notwithstanding the prohibition contained in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act, but only up to such amount as is necessary in order for us to maintain our status as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986 and, provided that, any such prohibition will not apply until such time as our asset coverage has been below the minimum asset coverage required pursuant to clause (i) above for more than

S-3

TABLE OF CONTENTS

six consecutive months. If Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act were currently applicable to us in connection with this offering, these provisions would generally prohibit us from declaring any cash dividend or distribution upon any class of our capital stock, or purchasing any such capital stock if our asset coverage, as defined in the 1940 Act, were below 200% at the time of the declaration of the dividend or distribution or the purchase and after deducting the amount of such dividend, distribution or purchase.

If, at any time, we are not subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, or the Exchange Act, to file any periodic reports with the SEC, we agree to furnish to holders of the Notes and the Trustee, for the period of time during which the Notes are outstanding, our audited annual consolidated financial statements, within 90 days of our fiscal year end, and unaudited interim consolidated financial statements, within 45 days of our fiscal quarter end (other than our fourth fiscal quarter). All such financial statements will be prepared, in all material respects, in accordance with applicable United States generally accepted accounting principles.

Events of default

You will have rights if an Event of Default occurs with respect to the Notes.  
The term "Event of Default" in respect of the Notes means any of the following:

We do not pay the principal of (or premium, if any, on) any Note within five days of its due date.

We do not pay interest on any Note when due, and such default is not cured within 30 days.

We remain in breach of any other covenant with respect to the Notes for 60 days after we receive a written notice of default stating we are in breach. The notice must be sent by either the Trustee or holders of at least 25% of the principal amount of the Notes.

We file for bankruptcy or certain other events of bankruptcy, insolvency or reorganization occur and in the case of certain orders or decrees entered against us under any bankruptcy law, such order or decree remains undischarged or unstayed for a period of 60 days.

On the last business day of each of twenty-four consecutive calendar months, the Notes have an asset coverage of less than 100%, after giving effect to any exemptive relief granted to us by the SEC.

Further issuances

We have the ability to issue additional debt securities under the indenture with terms different from the Notes and, without the consent of the holders thereof, to reopen the Notes and issue additional Notes.

S-4

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TABLE OF CONTENTS

Use of proceeds

We estimate that the net proceeds we will receive from the sale of the \$25,000,000 aggregate principal amount of Notes in this offering will be approximately \$24,125,000 (or approximately \$27,781,250 if the underwriters fully exercise their over-allotment option), in each case assuming a public offering price of 100% of par, after deducting the underwriting discount of \$625,000 (or approximately \$718,750 if the underwriters fully exercise their over-allotment option) payable by us and estimated offering expenses of approximately \$250,000 payable by us. We intend to use all of the net proceeds of this offering to repay a portion of the amount outstanding under the Credit Facility. As of April 25, 2014, we had \$123.0 million outstanding under the Credit Facility. The Credit Facility has a maturity date of November 12, 2016. Borrowings under the Credit Facility currently bear interest on a per annum basis equal to LIBOR plus 3.00% with no LIBOR floor. See Use of Proceeds in this prospectus supplement for more information.

S-5

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TABLE OF CONTENTS

## **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Some of the statements in this prospectus supplement and the accompanying prospectus constitute forward-looking statements, which relate to future events or our future performance or financial condition. The forward-looking statements contained in this this prospectus supplement and the accompanying prospectus involve risks and uncertainties, including statements as to:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the effect of investments that we expect to make;
- our contractual arrangements and relationships with third parties;
- actual and potential conflicts of interest with Stellus Capital Management;
- the dependence of our future success on the general economy and its effect on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- the use of borrowed money to finance a portion of our investments;
- the adequacy of our financing sources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;
- the ability of Stellus Capital Management to locate suitable investments for us and to monitor and administer our investments;
- the ability of Stellus Capital Management to attract and retain highly talented professionals;
- the potential that we will become subject to corporate-level U.S. federal income tax on all of our income if we are unable to qualify or maintain our qualification as a regulated investment company, or RIC, under Subchapter M of the Internal Revenue Code of 1986, as amended, which we refer to as the Code, which would have a material adverse effect on our financial performance; and
- the effect of future changes in laws or regulations (including the interpretation of these laws and regulations by regulatory authorities) and conditions in our operating areas, particularly with respect to business development companies or RICs.

Such forward-looking statements may include statements preceded by, followed by or that otherwise include the words may, might, will, intend, should, could, can, would, expect, believe, estimate, anticipate or similar words.

We have based the forward-looking statements included in this prospectus supplement and the accompanying prospectus on information available to us on the date of this prospectus supplement and the accompanying prospectus. Actual results could differ materially from those anticipated in our forward-looking statements, and future results could differ materially from historical performance. We undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law or SEC rule or regulation. You are advised to consult any additional disclosures that we may make directly to you, including in the form of a prospectus supplement or post-effective amendment to the registration statement to which this prospectus supplement or the accompanying prospectus relate, or through reports that we in the future may file with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

You should understand that, under Sections 27A(b)(2)(B) of the Securities Act and Section 21E(b)(2)(B) of the Exchange Act, the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 do not apply to statements made in connection with any offering of securities pursuant to this prospectus supplement and the

accompanying prospectus, if any.

S-6

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TABLE OF CONTENTS

## THE COMPANY

*This summary highlights some of the information in this prospectus supplement and the accompanying prospectus. It is not complete and may not contain all of the information that you may want to consider. You should read the more detailed information set forth under Risk Factors and the other information included in this prospectus supplement and the accompanying prospectus carefully.*

*Except as otherwise indicated, the terms we, us, our, and the Company refer to Stellus Capital Investment Corporation; and Stellus Capital Management refers to our investment adviser and administrator, Stellus Capital Management, LLC.*

### Stellus Capital Investment Corporation

We are an externally managed, closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the 1940 Act and a RIC for U.S. federal income tax purposes.

We originate and invest primarily in private 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, often times with a corresponding equity investment. Unitranche debt is typically structured as first lien loans with certain risk characteristics of mezzanine debt. Mezzanine debt includes senior unsecured and subordinated loans.

Our investment activities are managed by our investment adviser, Stellus Capital Management, LLC, or Stellus Capital Management, an investment advisory firm led by Robert T. Ladd and other senior investment professionals. We source investments primarily through the extensive network of relationships that the principals of Stellus Capital Management have developed with financial sponsor firms, financial institutions, middle-market companies, management teams and other professional intermediaries. The companies in which we invest are typically highly leveraged, and, in most cases, our investments in such companies will not be rated by national rating agencies. If such investments were rated, we believe that they would likely receive a rating below investment grade (i.e., below BBB or Baa), which are often referred to as junk.

Our investment objective is to maximize the total return to our stockholders in the form of current income and capital appreciation by:

- accessing the extensive origination channels that have been developed and established by the Stellus Capital Management investment team that include long-standing relationships with private equity firms, commercial banks, investment banks and other financial services firms;
- investing in what we believe to be companies with strong business fundamentals, generally within our core middle-market company focus;
- focusing on a variety of industry sectors, including business services, energy, general industrial, government services, healthcare, software and specialty finance;
- focusing primarily on directly originating transactions;
- applying the disciplined underwriting standards that the Stellus Capital Management investment team has developed over their extensive investing careers; and
- capitalizing upon the experience and resources of the Stellus Capital Management investment team to monitor our investments.

In addition, we received exemptive relief from the SEC to co-invest with investment funds managed by Stellus Capital

Management (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 Management, 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

S-7

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## TABLE OF CONTENTS

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 Management 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.

## **Portfolio Composition**

Our investments generally range in size from \$5 million to \$30 million, and we may also selectively invest in larger positions, and we generally expect that the size of our positions will increase in proportion to the size of our capital base. Pending such investments, we may reduce our outstanding indebtedness or invest in cash, cash equivalents, U.S. government securities and other high-quality debt investments with a maturity of one year or less. In the future, we may adjust opportunistically the percentage of our assets held in various types of loans, our principal loan sources and the industries to which we have greatest exposure, based on market conditions, the credit cycle, available financing and our desired risk/return profile.

As of December 31, 2013, we had \$277.5 million (at fair value) in portfolio investments under management. Our portfolio was comprised of 37 investments in 26 companies. As of December 31, 2013, our portfolio included approximately 17% of first lien debt, 43% of second lien debt, 38% of mezzanine debt and 2% of equity investments at fair value. As of December 31, 2013, \$114.3 million of our debt investments at fair value were at fixed interest rates, which represented approximately 42% of our total portfolio of debt investments at fair value. As of December 31, 2013, \$158.8 million of our debt investments at fair value were at floating interest rates, which represented approximately 58% of our total portfolio of debt investments at fair value. The weighted average yield on all of our debt investments as of December 31, 2013, was approximately 11.4%, of which approximately 10.8% was current cash interest. The information set forth above regarding our investment portfolio does not include approximately \$10.0 million of United States Treasury securities at fair value that we held at December 31, 2013.

## **Stellus Capital Management**

Stellus Capital Management manages our investment activities and is responsible for analyzing investment opportunities, conducting research and performing due diligence on potential investments, negotiating and structuring our investments, originating prospective investments and monitoring our investments and portfolio companies on an ongoing basis. Stellus Capital Management is an investment advisory firm led by the former head, Robert T. Ladd, and certain senior investment professionals of the direct capital business of D. E. Shaw & Co., L.P. and its associated investment funds and affiliated entities (collectively, the D. E. Shaw group), which spun out of the D. E. Shaw group in January 2012. The Stellus Capital Management investment team was responsible for helping the D. E. Shaw group build its middle-market direct investment business until it spun out in January 2012. The senior investment professionals of Stellus Capital Management have an average of over 24 years of investing, corporate finance, restructuring, consulting and accounting experience and have worked together at several companies, including the D. E. Shaw group. The Stellus Capital Management investment team has a wide range of experience in middle-market investing, including originating, structuring and managing loans and debt securities through market cycles. The Stellus Capital Management investment team continues to provide investment advisory services to the D. E. Shaw group with respect to an approximately \$430 million investment portfolio (as of December 31, 2013) in middle-market companies pursuant to sub-advisory arrangements.

In addition to serving as our investment adviser and the sub-advisor to the D. E. Shaw group as noted above, Stellus Capital Management currently manages a private credit fund that has an investment strategy that is identical to our investment strategy and energy private equity funds. We received exemptive relief from the SEC to co-invest with

investment funds managed by Stellus Capital Management (other than the D. E. Shaw group funds) 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). We believe that such co-investments may afford us additional investment opportunities and an ability to achieve greater diversification. We will not co-invest with the energy private equity funds, as the energy private equity funds focus on predominantly equity-related investments, and we focus on predominantly credit-related investments.

S-8

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## TABLE OF CONTENTS

Stellus Capital Management is headquartered in Houston, Texas, and also maintains offices in New York City and Washington, D.C. areas.

### **Market Opportunity**

We originate and invest primarily in private middle-market companies through first lien, second lien, unitranche and mezzanine debt financing, often times with a corresponding equity investment. We believe the environment for investing in middle-market companies is attractive for several reasons, including:

***Robust Demand for Debt Capital.*** We believe that private equity firms have significant committed but uncalled capital, a large portion of which is still available for investment in the United States. We expect the large amount of uninvested capital commitments will drive buyout activity over the next several years, which should, in turn, create lending opportunities for us. In addition to increased buyout activity, a high volume of senior secured and high yield debt was originated in the calendar years 2004 through 2007 and will come due in the near term and, accordingly, we believe that new financing opportunities will increase as many companies seek to refinance this indebtedness.

***Reduced Availability of Capital for Middle-Market Companies.*** We believe there are fewer providers of, and less capital available for, financing to middle-market companies, as compared to the time period prior to the recent economic downturn. We believe that, as a result of that downturn, many financing providers have chosen to focus on large, liquid corporate loans and managing capital markets transactions rather than lending to middle-market businesses. In addition, we believe recent regulatory changes, including the adoption of the Dodd-Frank Act and the introduction of new international capital and liquidity requirements under the Basel III Accords, or Basel III, have caused banks to curtail their lending to middle-market-companies. As a result, we believe that less competition will facilitate higher quality deal flow and allow for greater selectivity throughout the investment process.

***Attractive Deal Pricing and Structures.*** We believe that the pricing of middle-market debt investments is higher, and the terms of such investments are more conservative, compared to larger liquid, public debt financings, due to the more limited universe of lenders as well as the highly negotiated nature of these financings. These transactions tend to offer stronger covenant packages, higher interest rates, lower leverage levels and better call protection compared to larger financings. In addition, middle-market loans typically offer other investor protections such as default penalties, lien protection, change of control provisions and information rights for lenders.

***Specialized Lending Requirements.*** Lending to middle-market companies requires in-depth diligence, credit expertise, restructuring experience and active portfolio management. We believe that several factors render many U.S. financial institutions ill-suited to lend to middle-market companies. For example, based on the experience of Stellus Capital Management's investment team, lending to middle-market companies in the United States (a) is generally more labor intensive than lending to larger companies due to the smaller size of each investment and the fragmented nature of the information available with respect to such companies, (b) requires specialized due diligence and underwriting capabilities, and (c) may also require more extensive ongoing monitoring by the lender. We believe that, through Stellus Capital Management, we have the experience and expertise to meet these specialized lending requirements.

### **Competitive Strengths**

***Experienced Investment Team.*** Through our investment adviser, Stellus Capital Management, we have access to the experience and expertise of the Stellus Capital Management investment team, including its senior investment professionals who have an average of over 24 years of investing, corporate finance, restructuring, consulting and accounting experience and have worked together at several companies. The Stellus Capital Management investment

team has a wide range of experience in middle-market investing, including originating, structuring and managing loans and debt securities through market cycles. We believe the members of Stellus Capital Management's investment team are proven and experienced, with extensive capabilities in leveraged credit investing, having participated in these markets for the predominant portion of their careers. We believe that the experience and demonstrated ability of the Stellus Capital Management investment team to complete transactions enhances the quantity and quality of investment opportunities available to us.

S-9

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## TABLE OF CONTENTS

***Established, Rigorous Investment and Monitoring Process.*** The Stellus Capital Management investment team has developed an extensive review and credit analysis process. Each investment that is reviewed by Stellus Capital Management is brought through a structured, multi-stage approval process. In addition, Stellus Capital Management takes an active approach in monitoring all investments, including reviews of financial performance on at least a quarterly basis and regular discussions with management. Stellus Capital Management's investment and monitoring process and the depth and experience of its investment team should allow it to conduct the type of due diligence and monitoring that enables it to identify and evaluate risks and opportunities.

***Demonstrated Ability to Structure Investments Creatively.*** Stellus Capital Management has the expertise and ability to structure investments across all levels of a company's capital structure. While at the D. E. Shaw group, the Stellus Capital Management investment team invested approximately \$5.4 billion across the entire capital structure in 193 middle-market companies. These investments included secured and unsecured debt and related equity securities. Furthermore, we believe that current market conditions will allow us to structure attractively priced debt investments and may allow us to incorporate other return-enhancing mechanisms such as commitment fees, original issue discounts, early redemption premiums, payment-in-kind, or PIK, interest or some form of equity securities.

***Resources of Stellus Capital Management Platform.*** We have access to the resources and capabilities of Stellus Capital Management, which has 15 investment professionals, including Messrs. Ladd, Dean D Angelo, Joshua T. Davis and Todd A. Overbergen, who are supported by one managing director, six principals, two vice presidents and two analysts. These individuals have developed long-term relationships with middle-market companies, management teams, financial sponsors, lending institutions and deal intermediaries by providing flexible financing throughout the capital structure. We believe that these relationships provide us with a competitive advantage in identifying investment opportunities in our target market. We also expect to benefit from Stellus Capital Management's due diligence, credit analysis, origination and transaction execution experience and capabilities, including the support provided with respect to those functions by Mr. W. Todd Huskinson, who serves as our chief financial officer and chief compliance officer, and his staff of five additional mid- and back-office professionals.

## **SBIC License**

We have applied for a license to form a small business investment company, or SBIC, subsidiary; however, the application is subject to approval by the Small Business Administration, or SBA. We can make no assurances that the SBA will approve our application, or of the timeframe in which would receive a license, should one ultimately be granted. The SBIC subsidiary would be allowed to issue SBA-guaranteed debentures up to a maximum of \$150 million under current SBIC regulations, subject to required capitalization of the SBIC subsidiary and other requirements. SBA guaranteed debentures generally have longer maturities and lower interest rates than other forms of debt that may be available to us, and we believe therefore would represent an attractive source of debt capital. In addition, we have applied for exemptive relief from the SEC, to permit us to exclude the debt of an SBIC subsidiary licensed by the SBA guaranteed by the SBA from the 200% asset coverage ratio we are required to maintain under the 1940 Act. We can provide no assurance that the SBA will grant us an SBIC license or that the SEC will grant us relief to exclude the debt of an SBIC subsidiary guaranteed by the SBA from the 200% asset coverage ratio. Pursuant to the 200% asset coverage ratio limitation, we are permitted to borrow one dollar for every dollar we have in assets less all liabilities and indebtedness not represented by debt securities issued by us or loans obtained by us. If the SEC were to grant us exemptive relief and the SBA were to grant us an SBIC license, we would, in effect, be permitted to have a lower asset coverage ratio than the 200% asset coverage ratio limitation under the 1940 Act and, therefore, we could have more debt outstanding than assets to cover such debt.

## Recent Developments

### Investments

Since December 31, 2013, we made six new investments totaling \$44.6 million and received proceeds from repayments and sales of \$26.0 million resulting in net investment of \$18.6 million. This activity increased our investment portfolio to approximately \$296.1 million and the average investment per company to \$10.2 million as follows:

S-10

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## TABLE OF CONTENTS

On January 31, 2014, we made a \$6.5 million investment in the unsecured term loan of SKOPOS. We also invested \$0.7 million in the company's equity.

On January 31, 2014, we made a \$6.1 million investment in the first lien term loan of T2 Systems.

On January 31, 2014, we made a \$2.5 million investment in the second lien term loan of Vandelay Industries.

On January 31, 2014, we received full repayment on our second lien loan of Ascend Learning at par resulting in total proceeds of \$10.0 million.

On February 25, 2014, we realized our second lien loan of Transaction Network Services (TNS) at 101.5% of par, resulting in total proceeds of \$2.6 million.

On February 28, 2014, we realized \$3.0 million of our \$8.0 million investment in the second lien term loan of Telecommunications Management, LLC. at 101.5% of par, resulting in total proceeds of \$3.0 million.

On February 28, 2014, we realized our second lien loan to Aderant North America, Inc. at 101.5% of par, resulting in total proceeds of \$1.5 million.

On March 10, 2014, we made the following investments in Momentum Telecom, Inc.: (a) a \$21.5 million in the first lien term loan; (b) \$2.5 million in the unfunded revolver; and (c) \$1.0 million in the company's equity.

On March 14, 2014, we made a \$3.0 million investment in the first lien term loan of Glori Energy, Inc.

On March 31, 2014, we sold \$5.0 million of the first lien term loan of Momentum Telecom, Inc. to a third party at our cost of 98% of par, resulting in total proceeds of \$4.9 million. We also sold \$0.6 million of the unfunded revolver of the company.

On each of April 3, 2014 and April 11, 2014, we invested \$33,333 in the equity of SKOPOS.

On April 4, 2014, we sold \$1.9 million of the unfunded revolver of Momentum Telecom, Inc. to a third party and retained a portion of the economics of the revolver.

On April 22, 2014, we made a \$4.0 million investment in the subordinated term loan and \$50,000 in the equity of OG Systems, LLC.

On April 22, 2014, we sold \$4.0 million of the 2nd lien term loan of Atkins Nutritionals, Inc. to a third party at 100.5% of par, resulting in total proceeds of \$4.0 million.

### **Credit Facility**

The outstanding balance under the Credit Facility as of April 25, 2014 was \$123.0 million. In addition, we expect to increase our borrowing capacity under the Credit Facility from \$135.0 million to \$150.0 million subject to notice requirements under the Credit Facility.

### **Preliminary Estimates of Results for the Three Months Ended March 31, 2014**

Set forth below are certain preliminary estimates of our financial condition and results of operations for the three months ended March 31, 2014. These estimates are subject to the completion of our financial closing procedures and are not a comprehensive statement of our financial results for the three months ended March 31, 2014. We advise you that our actual results may differ materially from these estimates as a result of the completion of our financial closing procedures, final adjustments and other developments arising between now and the time that our financial results for the three months ended March 31, 2014 are finalized.

Our total investment income is estimated to have totaled between \$7.6 million and \$8.0 million for the three months ended March 31, 2014.

Our net investment income is estimated to have totaled between \$3.6 million and \$4.0 million, or between \$0.30 and \$0.33 per share, for the three months ended March 31, 2014.



TABLE OF CONTENTS

Our net increase in net assets resulting from operations is estimated to have totaled between \$4.2 million and \$4.6 million, or between \$0.35 and \$0.38 per share, for the three months ended March 31, 2014.

Our net asset value as of March 31, 2014 is estimated to be between \$14.45 and \$14.55 per share.

Subsequent to year end we placed one loan on non-accrual status, which represents approximately 4.7% of the loan portfolio at cost and 4.1% based on valuation as of December 31, 2013.

The preliminary financial data herein have been prepared by, and is the responsibility of, management and have not been approved by our Board of Directors. Grant Thornton LLP, our independent registered public accounting firm, has not audited, reviewed, compiled or performed any procedures with respect to these preliminary estimates. Accordingly, Grant Thornton LLP does not express an opinion or any other form of assurance with respect thereto.

The Company paid a monthly dividend of \$0.1133 per share on February 14, 2014, March 14, 2014 and April 15, 2014 to shareholders of record as of January 31, 2014, February 28, 2014 and March 31, 2014, respectively. Our Board of Directors has also declared a monthly dividend of \$0.1133 per share to be paid on May 15, 2014, June 16, 2014 and July 15, 2014 to shareholders of record as of April 30, 2014, May 30, 2014 and June 30, 2014, respectively.

## **Management Updates**

Subsequent to the date of the accompanying prospectus, the following changes have been made to the biographies of certain of our independent directors:

William C. Repko retired from Evercore Partners in February 2014 where he had served as a senior advisor, senior managing director and was a co-founder of the firm's Restructuring and Debt Capital Markets Group since September 2005.

Paul Keglevic has served as executive vice president and chief financial officer for Energy Future Holdings Corp. (EFH Corp.), a Dallas-based energy company with a portfolio of competitive and regulated businesses, since June 2008. In April 2014, EFH Corp. disclosed that its affiliate breached certain covenants in its debt agreements that, if not remedied, would result in various defaults. Upon the occurrence of an event of default under any of these debt agreements, unless the borrower files for Chapter 11 bankruptcy protection, the lenders or noteholders thereunder could elect to declare all amounts outstanding under such debt agreements to be immediately due and payable. If lenders or noteholders accelerate the repayment of all borrowings, EFH Corp. and its subsidiaries would not have sufficient assets and funds to repay those borrowings. Such occurrence would result in EFH Corp. and its applicable subsidiaries filing for protection under Chapter 11 of the US Bankruptcy Code.

S-12

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TABLE OF CONTENTS

## **SUPPLEMENTARY RISK FACTORS**

### **The Notes will be unsecured and therefore will be effectively subordinated to any secured indebtedness we have currently incurred or may incur in the future.**

The Notes will not be secured by any of our assets or any of the assets of any future subsidiaries and will rank equally in right of payment of our future unsubordinated, unsecured senior indebtedness. As a result, the Notes are effectively subordinated to any secured indebtedness we or our subsidiaries have currently incurred and may incur in the future (or any indebtedness that is initially unsecured to which we subsequently grant security) to the extent of the value of the assets securing such indebtedness. In any liquidation, dissolution, bankruptcy or other similar proceeding, the holders of any of our existing or future secured indebtedness and the secured indebtedness of any future subsidiaries may assert rights against the assets pledged to secure that indebtedness in order to receive full payment of their indebtedness before the assets may be used to pay other creditors, including the holders of the Notes. As of April 25, 2014 we had \$123.0 million outstanding under the Credit Facility. The indebtedness under the Credit Facility is effectively senior to the Notes to the extent of the value of the assets securing such indebtedness.

### **The Notes will be structurally subordinated to the indebtedness and other liabilities of any future subsidiaries.**

The Notes are obligations exclusively of Stellus Capital Investment Corporation and not of our subsidiaries. None of our subsidiaries will be a guarantor of the Notes and the Notes are not required to be guaranteed by any subsidiaries we may acquire or create in the future. Except to the extent we are a creditor with recognized claims against our subsidiaries, all claims of creditors of our subsidiaries will have priority over our equity interests in such subsidiaries (and therefore the claims of our creditors, including holders of the Notes) with respect to the assets of such subsidiaries. Even if we are recognized as a creditor of one or more of our subsidiaries, our claims would still be effectively subordinated to any security interests in the assets of any such subsidiary and to any indebtedness or other liabilities of any such subsidiary senior to our claims. Consequently, the Notes will be structurally subordinated to all indebtedness, including any future SBA-guaranteed debentures, and other liabilities of any of our subsidiaries and subsidiaries that we may in the future acquire or establish. In addition, our subsidiaries may incur substantial additional indebtedness in the future, all of which would be structurally senior to the Notes.

### **The indenture under which the Notes will be issued contains limited protection for holders of the Notes.**

The indenture under which the Notes will be issued offers limited protection to holders of the Notes. The terms of the indenture and the Notes do not restrict our or any of our subsidiaries' ability to engage in, or otherwise be a party to, a variety of corporate transactions, circumstances or events that could have an adverse impact on your investment in the Notes. In particular, the terms of the indenture and the Notes will not place any restrictions on our or our subsidiaries' ability to:

issue securities or otherwise incur additional indebtedness or other obligations, including (1) any indebtedness or other obligations that would be equal in right of payment to the Notes, (2) any indebtedness or other obligations that would be secured and therefore rank effectively senior in right of payment to the Notes to the extent of the values of the assets securing such debt, (3) indebtedness of ours that is guaranteed by one or more of our subsidiaries and which

therefore is structurally senior to the Notes and (4) securities, indebtedness or obligations issued or incurred by our subsidiaries or that would be senior to our equity interests in those entities and therefore rank structurally senior to the Notes with respect to the assets of our subsidiaries, in each case other than an incurrence of indebtedness or other obligation that would cause a violation of Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act or any successor provisions, whether or not we continue to be subject to such provisions of the 1940 Act, but giving effect, in each case, to any exemptive relief granted to us by the SEC. Currently, these provisions generally prohibit us from making additional borrowings, including through the issuance of additional debt or the sale of additional debt securities, unless our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowings;

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S-13

TABLE OF CONTENTS

pay dividends on, or purchase or redeem or make any payments in respect of, capital stock or other securities ranking junior in right of payment to the Notes, including subordinated indebtedness, in each case other than dividends, purchases, redemptions or payments that would cause a violation of Section 18(a)(1)(B) as modified by (i) Section 61(a)(1) of the 1940 Act or any successor provisions and (ii) the exception set forth below, despite the fact that we are not currently subject to such provisions of the 1940 Act in connection with the offer and sale of the Notes, except that we will be permitted to declare a cash dividend or distribution notwithstanding the prohibition contained in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act, but only up to such amount as is necessary in order for us to maintain our status as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986 and, provided that, any such prohibition will not apply until such time as our asset coverage has been below the minimum asset coverage required pursuant to clause (i) above for more than six consecutive months. If Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act were currently applicable to us in connection with this offering, these provisions would generally prohibit us from declaring any cash dividend or distribution upon any class of our capital stock, or purchasing any such capital stock if our asset coverage, as defined in the 1940 Act, were below 200% at the time of the declaration of the dividend or distribution or the purchase and after deducting the amount of such dividend, distribution or purchase;

sell assets (other than certain limited restrictions on our ability to consolidate, merge or sell all or substantially all of our assets);

enter into transactions with affiliates;

create liens (including liens on the shares of our subsidiaries) or enter into sale and leaseback transactions;

make investments; or

create restrictions on the payment of dividends or other amounts to us from our subsidiaries.

In addition, the indenture will not require us to offer to purchase the Notes in connection with a change of control or any other event.

Furthermore, the terms of the indenture and the Notes do not protect holders of the Notes in the event that we experience changes (including significant adverse changes) in our financial condition, results of operations or credit ratings, as they do not require that we or our subsidiaries adhere to any financial tests or ratios or specified levels of net worth, revenues, income, cash flow, or liquidity other than as described under **Description of Our Notes** **Events of Default**.

Our ability to recapitalize, incur additional debt and take a number of other actions that are not limited by the terms of the Notes may have important consequences for you as a holder of the Notes, including making it more difficult for us to satisfy our obligations with respect to the Notes or negatively affecting the trading value of the Notes.

Other debt we issue or incur in the future could contain more protections for its holders than the indenture and the Notes, including additional covenants and events of default. For example, the indenture under which the Notes will be issued does not contain cross-default provisions that are contained in the Credit Facility. The issuance or incurrence of any such debt with incremental protections could affect the market for and trading levels and prices of the Notes.

**An active trading market for the Notes may not develop, which could limit the market price of the Notes or your ability to sell them. Moreover, the Notes are not expected to be rated, which may subject them to greater volatility than rated notes and particularly, greater than similar securities with an investment grade rating.**

The Notes are a new issue of debt securities for which there currently is no trading market. We intend to list the Notes

An active trading market for the Notes may not develop, which could limit the market price of the Notes or your ability

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on the NYSE within 30 days of the original issue date under the symbol SCQ. Although we expect the Notes to be listed on the NYSE, we cannot provide any assurances that an active trading market will develop or be maintained for the Notes or that you will be able to sell your Notes. If the Notes are traded

S-14

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TABLE OF CONTENTS

after their initial issuance, they may trade at a discount from their initial offering price depending on prevailing interest rates, the market for similar securities, our credit ratings, general economic conditions, our financial condition, performance and prospects and other factors. The Notes are not currently expected to be rated which would impact their trading and subject them to greater price volatility. To the extent they are rated and received a non-investment grade rating, their price and trading activity could be negatively impacted. Moreover, if a rating agency assigns the Notes a non-investment grade rating, the Notes may be subject to greater price volatility than securities of similar maturity without such a non-investment grade rating. Certain of the underwriters have advised us that they intend to make a market in the Notes, but they are not obligated to do so. The underwriters may discontinue any market-making in the Notes at any time at their sole discretion. Accordingly, we cannot assure you that a liquid trading market will develop for the Notes, that you will be able to sell your Notes at a particular time or that the price you receive when you sell will be favorable. To the extent an active trading market does not develop, the liquidity and trading price for the Notes may be harmed. Accordingly, you may be required to bear the financial risk of an investment in the Notes for an indefinite period of time.

**We may choose to redeem the Notes when prevailing interest rates are relatively low.**

On or after April 30, 2016, we may choose to redeem the Notes from time to time, especially when prevailing interest rates are lower than the rate borne by the Notes. If prevailing rates are lower at the time of redemption, you would not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as the interest rate on the Notes being redeemed. Our redemption right also may adversely impact your ability to sell the Notes as the optional redemption date or period approaches.

**Our amount of debt outstanding will increase as a result of this offering, and if we default on our obligations to pay our other indebtedness, we may not be able to make payments on the Notes.**

As of April 25, 2014, we had approximately \$123.0 million of indebtedness outstanding under the Credit Facility. Any default under the agreements governing our indebtedness, including a default under the Credit Facility or other indebtedness to which we may be a party that is not waived by the required lenders, and the remedies sought by the holders of such indebtedness could make us unable to pay principal, premium, if any, and interest on the Notes and substantially decrease the market value of the Notes. If we are unable to generate sufficient cash flow and are otherwise unable to obtain funds necessary to meet required payments of principal, premium, if any, and interest on our indebtedness, or if we otherwise fail to comply with the various covenants, including financial and operating covenants, in the instruments governing our indebtedness (including the Credit Facility), we could be in default under the terms of the agreements governing such indebtedness. In the event of such default, the holders of such indebtedness could elect to declare all the funds borrowed thereunder to be due and payable, together with accrued and unpaid interest, the lenders under the Credit Facility or other debt we may incur in the future could elect to terminate their commitments, cease making further loans and institute foreclosure proceedings against our assets, and we could be forced into bankruptcy or liquidation. Our ability to generate sufficient cash flow in the future is, to some extent, subject to general economic, financial, competitive, legislative and regulatory factors as well as other factors that are beyond our control. We cannot assure you that our business will generate cash flow from operations, or that future borrowings will be available to us under the Credit Facility or otherwise, in an amount sufficient to enable us to meet our payment obligations under the Notes and our other debt and to fund other liquidity needs.

If our operating performance declines and we are not able to generate sufficient cash flow to service our debt

obligations, we may in the future need to refinance or restructure our debt, including any Notes sold, sell assets, reduce or delay capital investments, seek to raise additional capital or seek to obtain waivers from the required lenders under the Credit Facility or other debt that we may incur in the future to avoid being in default. If we are unable to implement one or more of these alternatives, we may not be able to meet our payment obligations under the Notes and our other debt. If we breach our covenants under the Credit Facility or other debt and seek a waiver, we may not be able to obtain a waiver from the required lenders. If this occurs, we would be in default under the Credit Facility or other debt, the lenders could exercise their rights as described above, and we could be forced into bankruptcy or liquidation. If we are unable to repay debt, lenders having secured obligations could proceed against the collateral securing the debt. Because the Credit

TABLE OF CONTENTS

Facility has, and any future credit facilities will likely have, customary cross-default provisions, if the indebtedness under the Notes, the Credit Facility or under any future credit facility is accelerated, we may be unable to repay or finance the amounts due.

**We will be subject to corporate-level U.S. federal income tax if we are unable to maintain our qualification as a RIC under the Code and our effort to maintain such qualification may result in other adverse consequences.**

No assurance can be given that we will be able to maintain our qualification as a RIC under the Code.

To maintain our qualification as a RIC under the Code, we must meet the following source-of-income, asset diversification and distribution requirements. The source-of-income requirement will be satisfied if we obtain at least 90% of our gross income for each taxable year from dividends, interest, gains from the sale of stock or securities or certain other sources. The asset diversification requirement will be satisfied if we diversify our holdings so that at the end of each quarter of our taxable year at least 50% of the value of our assets consists of cash, cash equivalents, U.S. government securities, securities of other RICs, and other acceptable securities and no more than 25% of the value of our assets is invested in the securities, other than U.S. government securities or securities of other RICs, of one issuer or of two or more issuers that are controlled, as determined under the Code, by us and that are engaged in the same or similar or related trades or businesses or in the securities of one or more qualified publicly traded partnerships. The annual distribution requirement will be satisfied if we distribute to our stockholders, for each taxable year, at least 90% of our net ordinary taxable income and net realized short-term capital gains in excess of our net realized long-term capital losses, if any.

Our efforts to meet these requirements may result in our having to dispose of certain investments quickly (and because most of our investments will be in private companies, and therefore will be relatively illiquid, any such dispositions could be made at disadvantageous prices and could result in substantial losses), raise additional debt or equity capital or forgo new investment opportunities in order to prevent the loss of our qualification as a RIC under the Code. In addition, we may have difficulty meeting the annual distribution requirement because we include in our taxable income certain amounts that we have not yet received in cash, such as PIK interest or original issue discount and because we are subject to certain asset coverage ratio requirements under the 1940 Act, as well as future financial covenants under loan and credit agreements that could, under certain circumstances, restrict us from making distributions necessary to satisfy the annual distribution requirement.

If we fail to qualify for as a RIC under the Code for any reason and/or are or become subject to corporate-level U.S. federal income tax, the resulting corporate taxes could substantially reduce our net assets and the amount of income available for distribution with respect to the Notes or reinvestment. See *Certain U.S. Federal Income Tax Considerations* in this prospectus supplement and *Material U.S. Federal Income Tax Considerations* in the accompanying prospectus.

TABLE OF CONTENTS

## **USE OF PROCEEDS**

We estimate that the net proceeds we will receive from the sale of the \$25,000,000 aggregate principal amount of Notes in this offering will be approximately \$24,125,000 (or approximately \$27,781,250 if the underwriters fully exercise their over-allotment option), in each case assuming a public offering price of 100% of par, after deducting the underwriting discount of \$625,000 (or approximately \$718,750 if the underwriters fully exercise their over-allotment option) payable by us and estimated offering expenses of approximately \$250,000 payable by us. We may change the size of this offering based on demand and market conditions.

We intend to use all of the net proceeds of this offering to repay a portion of the amount outstanding under the Credit Facility. As of April 25, 2014, we had \$123.0 million outstanding under the Credit Facility. The Credit Facility has a maturity date of November 12, 2016. Borrowings under the Credit Facility currently bear interest on a per annum basis equal to LIBOR plus 3.00% with no LIBOR floor. Affiliates of certain of the underwriters for this offering are lenders under the Credit Facility. See Underwriting Other Relationships. Pending such use, we will invest the net proceeds of this offering primarily in short-term securities consistent with our BDC election and our qualification as a RIC for U.S. federal income tax purposes. See Regulation Temporary Investments in the accompanying prospectus.

S-17

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TABLE OF CONTENTS**CAPITALIZATION**

The following table sets forth our capitalization as of December 31, 2013:

on an actual basis; and

on an as adjusted basis to reflect the sale of \$25,000,000 aggregate principal amount of Notes in this offering (assuming no exercise of the overallotment option), after deducting the underwriting discounts and commissions of \$625,000 payable by us and estimated offering expenses of approximately \$250,000 payable by us.

This table should be read in conjunction with our Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and notes thereto included in this prospectus supplement and the accompanying prospectus.

|   | As of December 31, 2013 |                            |
|---|-------------------------|----------------------------|
|   | Actual                  | As Adjusted <sup>(1)</sup> |
| Assets  |                         |                            |
| Cash and cash equivalents   | \$ 13,663,542           | \$ 13,663,542              |
| Investments, at fair value  | \$ 277,504,510          | \$ 277,504,510             |
| Other assets  | \$ 6,960,253            | \$ 7,835,253               |
| Total assets  | \$ 298,128,305          | \$ 299,003,305             |
| Liabilities:  |                         |                            |
| Credit Facility   | \$ 110,000,000          | \$ 85,875,000              |
| Notes Payable   |                         | \$ 25,000,000              |
| Other liabilities   | \$ 12,236,791           | \$ 12,236,791              |
| Total liabilities   | \$ 122,236,791          | \$ 123,111,791             |
| Stockholder's equity:   |                         |                            |
| Common stock, par value \$0.001 per share 100,000,000 authorized, actual; 12,099,022 issued and outstanding, actual | \$ 12,099               | \$ 12,099                  |
| Paid-in capital in excess of par value  | \$ 175,614,738          | \$ 175,614,738             |
| Accumulated undistributed net realized gain   | \$ 1,027,392            | \$ 1,027,392               |
| Distributions in excess of net investment income  | \$ (1,262,659 )         | \$ (1,262,659 )            |
| Unrealized appreciation (depreciation) on investments and cash equivalents  | \$ 499,944              | \$ 499,944                 |
| Total stockholders' equity  | \$ 175,891,514          | \$ 175,891,514             |
| Total liabilities and stockholders' equity  | \$ 298,128,305          | \$ 298,128,305             |
| Net asset value per share   | \$ 14.54                | \$ 14.54                   |

(1) Excludes up to \$3,750,000 Notes issuable by us upon exercise of the underwriters' over-allotment option.

S-18

TABLE OF CONTENTS**RATIOS OF EARNINGS TO FIXED CHARGES**

The following table contains our ratio of earnings to fixed charges for the periods indicated, computed as set forth below. You should read these ratios of earnings to fixed charges in connection with our Consolidated Financial Statements, including the notes to those statements, included in this prospectus.

|  | For The Year<br>Ended December<br>31, 2013 | For The Year<br>Ended<br>December 31,<br>2012 |
|--|--|---|
| Earnings to Fixed Charges <sup>(1)</sup> | 6.6  | 5.4   |

For purposes of computing the ratios of earnings to fixed charges, earnings represent net increase in net assets resulting from operations plus (or minus) income tax expense (benefit) including excise tax expense plus fixed charges. Fixed charges include interest and credit facility fees expense and amortization of debt issuance costs.

(1) Earnings include net realized and unrealized gains or losses. Net realized and unrealized gains or losses can vary substantially from period to period.

S-19

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TABLE OF CONTENTS**SENIOR SECURITIES**

Information about our senior securities is shown in the following table for the fiscal years ended December 31, 2013 and December 31, 2012. The report of Grant Thornton LLP, our independent registered public accountants, on the senior securities table as of December 31, 2012, is attached as an exhibit to the registration statement of which this prospectus is a part.

| Class and Year                 | Total<br>Amount<br>Outstanding<br>Exclusive of<br>Treasury<br>Securities <sup>(1)</sup><br>(Dollars in thousands) | Asset<br>Coverage per<br>Unit <sup>(2)</sup> | Involuntary<br>Liquidating<br>Preference per<br>Unit <sup>(3)</sup> | Average<br>Market<br>Value per<br>Unit <sup>(4)</sup> |
|--------------------------------|---|--|---|---|
| Credit Facility                |   |  |   |   |
| Fiscal 2012                    | \$ 38,000   | \$ 3,090                                     | \$  | \$ N/A  |
| Fiscal 2013                    | \$ 110,000  | \$ 2,470                                     | \$  | \$ N/A  |
| Short-Term Loan <sup>(5)</sup> |   |  |   |   |
| Fiscal 2012                    | \$ 45,000   | \$ 3,090                                     | \$  | \$ N/A  |
| Fiscal 2013                    | \$ 9,000  | \$ 2,470                                     | \$  | \$ N/A  |

(1) Total amount of senior securities outstanding at the end of the period presented.

(2) Asset coverage per unit is the ratio of the carrying value of our total assets, less all liabilities and indebtedness not represented by senior securities, in relation to the aggregate amount of senior securities representing indebtedness.

Asset coverage per unit is expressed in terms of dollar amounts per \$1,000 of indebtedness.

(3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it. The indicates information which the SEC expressly does not require to be disclosed for certain types of senior securities.

(4) Not applicable because senior securities are not registered for public trading.

(5) Refers to short-term loans that the Company obtained from Raymond James and repaid in full on January 2, 2013 and October 1, 2013, respectively.

S-20

TABLE OF CONTENTS**SELECTED FINANCIAL AND OTHER DATA**

The following selected financial data for the years ended December 31, 2012 and 2013 set forth below was derived from our financial statements which have been audited by Grant Thornton LLP, our independent registered public accounting firm. The data should be read in conjunction with our financial statements and related notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this prospectus supplement and the accompanying prospectus.

| Statement of Operations Data:                            | As of and<br>for the year<br>ended December<br>31, 2013 | As of and<br>for the period from<br>Inception (May 18,<br>2012) through<br>December 31,<br>2012 |
|--|---|---|
| Total Investment Income                                  | \$ 29,400,736   | \$ 3,696,432  |
| Total expenses, net of fee waiver                        | \$ 13,389,007   | \$ 2,392,076  |
| Net investment income                                    | \$ 16,011,729   | \$ 1,304,356  |
| Net increase in net assets resulting from operations     | \$ 17,544,997   | \$ 1,298,424  |
| Per Share Data:  |   |   |
| Net asset value  | \$ 14.54  | \$ 14.45  |
| Net investment income                                    | \$ 1.33   | \$ 0.11   |
| Net increase in net assets resulting from operations     | \$ 1.45   | \$ 0.11   |
| Distributions declared                                   | \$ 1.43   | \$ 0.18   |
|  |   |   |
| Balance Sheet Data:                                      | At December 31,<br>2013                                 | At December 31,<br>2012   |
| Investments at fair value                                | \$277,504,510   | \$195,451,256   |
| Short-term investments at fair value.                    | \$9,999,900   | \$49,999,500  |
| Cash and cash equivalents                                | \$13,663,542  | \$62,131,686  |
| Total assets   | \$298,128,305   | \$262,542,977   |
| Total Liabilities  | \$122,236,791   | \$88,697,022  |
| Total net assets   | \$175,891,514   | \$173,845,955   |
| Other Data:  |   |   |
| Number of portfolio companies at period end              | 26  | 15  |
| Weighted average yield on debt investments at period end | 11.4  | % 12.5  |

S-21

TABLE OF CONTENTS

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Overview

We were organized as a Maryland corporation on May 18, 2012 and formally commenced operations on November 7, 2012. Our investment objective is to maximize the total return to our stockholders in the form of current income and capital appreciation through debt and related equity investments in middle-market companies.

We are an externally managed, non-diversified, closed-end investment company that has elected to be regulated as a BDC under the 1940 Act. As a BDC, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least 70% of our total assets in qualifying assets, including securities of private or thinly traded public U.S. companies, cash, cash equivalents, U.S. government securities and high-quality debt investments that mature in one year or less.

As a BDC, we must not acquire any assets other than qualifying assets specified in the 1940 Act unless, at the time the acquisition is made, at least 70% of our total assets are qualifying assets. Qualifying assets include investments in eligible portfolio companies. Under the relevant SEC rules, the term eligible portfolio company includes all private operating companies, operating companies whose securities are not listed on a national securities exchange, and certain public operating companies that have listed their securities on a national securities exchange and have a market capitalization of less than \$250 million, in each case organized and with their principal of business in the United States.

In order to expedite the ramp-up of our investment activities and further our ability to meet our investment objectives, on November 7, 2012, we acquired our initial portfolio composed of investments in 11 portfolio companies from a private investment fund to which the D. E. Shaw group serves as investment adviser and Stellus Capital Management, LLC serves as a non-discretionary sub-adviser. The total consideration paid for our initial portfolio was \$194.4 million (excluding accrued interest of approximately \$2.3 million), consisting of \$165.2 million in cash and \$29.2 million in shares of our common stock based on the price of \$15.00 per share.

We financed the cash portion of the acquisition of our initial portfolio by (i) borrowing \$152.5 million under a \$156 million credit facility led by SunTrust Bank (the Bridge Facility) and (ii) using the \$12.7 million of proceeds we received in connection with the sale of shares of our common stock in a private placement transaction to certain purchasers, including persons and entities associated with Stellus Capital Management, at a purchase price of \$15.00 per share.

On November 13, 2012, we completed our IPO and sold 9,200,000 shares (including 1,200,000 shares through the underwriters' exercise of their over-allotment option) of our common stock through a group of underwriters at an initial public offering price of \$15.00 per share. We received \$132.2 million of total net proceeds in connection with the IPO. We used the net proceeds from our IPO and borrowings under the Credit Facility (as defined below) to pay down all amounts outstanding under the Bridge Facility and terminated the Bridge Facility in conjunction with such repayment.

On November 13, 2012, we entered into a senior secured revolving credit facility (the Credit Facility), with various lenders, including SunTrust Bank, which also serves as administrative agent. The Credit Facility provides for

borrowings in an aggregate amount up to \$115 million on a committed basis and an accordion for an additional \$35 million for a total facility size of \$150 million. The exercise of the accordion will require sufficient borrowing base and additional commitments from the existing lender group and/or new lenders. On July 30, 2013, we exercised a portion of the accordion feature to increase our borrowing capacity under the Credit Facility from \$115 million to \$135 million. Borrowings under the Credit Facility bear interest, subject to the Company's election, on a per annum basis equal to (i) LIBOR plus 3.00% with no LIBOR floor or (ii) 2.00% plus an alternate base rate based on the highest of the Prime Rate, Federal Funds Rate plus 0.5% or one month LIBOR plus 1.0%. The Company pays unused commitment fees of 0.50% per annum on the unused lender commitments under the Credit Facility. Interest is payable quarterly in arrears. Any amounts borrowed under the Credit Facility will mature, and all accrued and unpaid interest thereunder

S-22

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TABLE OF CONTENTS

will be due and payable, on November 12, 2016. As of December 31, 2013, we had \$110 million in borrowings outstanding under the Credit Facility and substantially all our assets were pledged as collateral under the Credit Facility.

The Company incurred costs of \$2.0 million in connection with obtaining the Credit Facility, which the Company has recorded as prepaid loan structure fees on its statement of assets and liabilities and is amortizing these fees over the life of the Credit Facility. The Company incurred costs of \$0.1 million in connection with the \$20 million commitment increase. As of December 31, 2013, \$1.6 million of such prepaid loan structure fees have yet to be amortized.

We have elected to be treated for tax purposes as a RIC under Subchapter M of the Code. To maintain our qualification as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements. As of December 31, 2013, we were in compliance with the RIC requirements. As a RIC, we generally will not have to pay U.S. federal corporate-level taxes on any income we distribute to our stockholders.

## Portfolio Composition and Investment Activity

### Portfolio Composition

We originate and invest primarily in privately-held middle-market companies (typically those with \$5.0 million to \$50.0 million of EBITDA) through first lien, second lien, unitranche and mezzanine debt financing, often times with a corresponding equity investment.

As of December 31, 2013, we had \$277.5 million (at fair value) invested in 26 companies. As of December 31, 2013, our portfolio included approximately 17% of first lien debt, 43% of second lien debt, 38% of mezzanine debt and 2% of equity investments at fair value. As of December 31, 2012, we had \$195.5 million (at fair value) invested in 15 companies. As of December 31, 2012, our portfolio included approximately 22% of first lien debt, 20% of second lien debt, 57% of mezzanine debt and 1% of equity investments at fair value. In addition, we held approximately \$10.0 million and \$50.0 million of United States Treasury securities at fair value at December 31, 2013 and December 31, 2012, respectively. The United States Treasury securities were purchased and temporarily held in connection with complying with RIC diversification requirements under Subchapter M of the Code.

The composition of our investments as of December 31, 2013 and December 31, 2012 was as follows:

|                   |             | As of December 31, 2013 |                | As of December 31, 2012 |                |
|-------------------|-------------|-------------------------|----------------|-------------------------|----------------|
|                   |             | Cost                    | Fair Value     | Cost                    | Fair Value     |
| Senior Secured    | First Lien  | \$ 48,341,121           | \$ 48,745,767  | \$ 44,014,214           | \$ 44,014,214  |
| Senior Secured    | Second Lien | 117,166,001             | 118,171,725    | 38,597,293              | 38,597,622     |
| Unsecured Debt    |             | 107,318,517             | 106,219,596    | 111,129,878             | 111,125,134    |
| Equity            |             | 4,178,827               | 4,367,422      | 1,714,286               | 1,714,286      |
| Total Investments |             | \$ 277,004,466          | \$ 277,504,510 | \$ 195,445,671          | \$ 195,451,256 |

The following is a summary of geographical concentration of our investment portfolio as of December 31, 2013:

|  | Cost | Fair Value | % of Total Investments |
|--|------|------------|------------------------|
|--|------|------------|------------------------|

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|               |               |               |       |   |
|---------------|---------------|---------------|-------|---|
| New York      | \$ 41,093,388 | \$ 39,601,590 | 14.27 | % |
| Colorado      | 36,412,357    | 37,108,667    | 13.37 | % |
| Minnesota     | 34,087,185    | 34,510,922    | 12.44 | % |
| Massachusetts | 32,305,898    | 32,305,898    | 11.64 | % |
| Canada        | 27,917,648    | 28,215,795    | 10.17 | % |
| Texas         | 17,973,043    | 18,200,000    | 6.56  | % |
| Florida       | 16,910,423    | 16,910,423    | 6.09  | % |
| Illinois      | 14,008,782    | 14,115,231    | 5.09  | % |
| Indiana       | 11,169,118    | 11,169,118    | 4.02% |   |

S-23

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TABLE OF CONTENTS

|              | Cost           | Fair Value     | % of Total<br>Investments |   |
|--------------|----------------|----------------|---------------------------|---|
| New Jersey   | 10,176,677     | 10,176,677     | 3.67                      | % |
| Pennsylvania | 9,669,695      | 9,738,000      | 3.51                      | % |
| Puerto Rico  | 8,700,324      | 8,359,544      | 3.01                      | % |
| Missouri     | 7,925,241      | 8,120,000      | 2.93                      | % |
| Kentucky     | 4,659,651      | 4,888,373      | 1.76                      | % |
| Virginia     | 2,514,924      | 2,584,272      | 0.93                      | % |
| Georgia      | 1,480,112      | 1,500,000      | 0.54                      | % |
|              | \$ 277,004,466 | \$ 277,504,510 | 100.00                    | % |

The following is a summary of geographical concentration of our investment portfolio as of December 31, 2012:

|                | Cost           | Fair Value     | % of Total<br>Investments |   |
|----------------|----------------|----------------|---------------------------|---|
| Pennsylvania   | \$ 33,708,952  | \$ 33,704,209  | 17.24                     | % |
| Canada         | 20,778,456     | 20,778,456     | 10.63                     | % |
| Colorado       | 19,532,633     | 19,532,633     | 9.99                      | % |
| Kentucky       | 17,095,646     | 17,095,646     | 8.75                      | % |
| Florida        | 16,639,880     | 16,639,880     | 8.51                      | % |
| South Carolina | 15,000,000     | 15,000,000     | 7.67                      | % |
| New York       | 13,000,000     | 13,000,000     | 6.65                      | % |
| Texas          | 12,119,671     | 12,120,000     | 6.20                      | % |
| Massachusetts  | 10,000,000     | 10,000,000     | 5.12                      | % |
| Utah           | 9,902,063      | 9,902,062      | 5.07                      | % |
| New Jersey     | 9,879,189      | 9,879,189      | 5.05                      | % |
| Indiana        | 8,969,955      | 8,969,955      | 4.59                      | % |
| Connecticut    | 7,351,604      | 7,351,604      | 3.76                      | % |
| Georgia        | 1,477,622      | 1,477,622      | 0.77                      | % |
|                | \$ 195,455,671 | \$ 195,451,256 | 100.00                    | % |

The following is a summary of industry concentration of our investment portfolio as of December 31, 2013:

|                                    | Cost          | Fair Value    | % of Total<br>Investments |   |
|------------------------------------|---------------|---------------|---------------------------|---|
| Software                           | \$ 48,570,692 | \$ 48,805,898 | 17.59                     | % |
| Healthcare & Pharmaceuticals       | 35,707,711    | 35,874,461    | 12.93                     | % |
| High Tech Industries               | 35,211,794    | 35,318,243    | 12.73                     | % |
| Telecommunications                 | 33,269,455    | 33,491,491    | 12.07                     | % |
| Transportation: Cargo              | 17,883,754    | 18,181,901    | 6.55                      | % |
| Beverage, Food, & Tobacco          | 16,689,794    | 17,000,000    | 6.13                      | % |
| Services: Business                 | 16,910,423    | 16,910,423    | 6.09                      | % |
| Media: Broadcasting & Subscription | 13,339,965    | 13,532,500    | 4.88                      | % |
| Finance                            | 12,242,889    | 12,491,250    | 4.50                      | % |
| Services: Consumer                 | 13,133,228    | 11,395,293    | 4.10                      | % |
| Retail                             | 10,176,677    | 10,176,677    | 3.67                      | % |
| Consumer Goods: Non-Durable        | 9,669,695     | 9,738,000     | 3.51                      | % |

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|                   |                |                |        |   |
|-------------------|----------------|----------------|--------|---|
| Energy: Oil & Gas | 9,538,738      | 9,700,000      | 3.49   | % |
| Metals & Mining   | 4,659,651      | 4,888,373      | 1.76   | % |
|                   | \$ 277,004,466 | \$ 277,504,510 | 100.00 | % |

S-24

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TABLE OF CONTENTS

The following is a summary of industry concentration of our investment portfolio as of December 31, 2012<sup>(1)</sup>:

|                                    | Cost           | Fair Value     | % of Total<br>Investments |
|------------------------------------|----------------|----------------|---------------------------|
| Consumer Goods: Non-Durable        | \$ 33,708,952  | \$ 33,704,209  | 17.24 %                   |
| Services: Business                 | 31,117,502     | 31,117,501     | 15.93 %                   |
| High Tech Industries               | 30,778,456     | 30,778,456     | 15.75 %                   |
| Health & Pharmaceuticals           | 26,884,237     | 26,884,237     | 13.75 %                   |
| Retail                             | 19,781,252     | 19,781,252     | 10.12 %                   |
| Media: Broadcasting & Subscription | 15,000,000     | 15,000,000     | 7.67 %                    |
| Automotive                         | 12,345,646     | 12,345,646     | 6.32 %                    |
| Telecommunications                 | 12,119,671     | 12,120,000     | 6.20 %                    |
| Transportation: Cargo              | 8,969,955      | 8,969,955      | 4.59 %                    |
| Metals & Mining                    | 4,750,000      | 4,750,000      | 2.43 %                    |
|                                    | \$ 195,455,671 | \$ 195,451,256 | 100.00 %                  |

(1) The Company has changed the industry classification of certain investments to conform to new industry classifications as of December 31, 2013.

At December 31, 2013, our average portfolio company investment at amortized cost and fair value was approximately \$10.7 million and \$10.7 million, respectively, and our largest portfolio company investment by amortized cost and fair value was approximately \$22.3 million and \$22.3 million, respectively. At December 31, 2012, our average portfolio company investment at amortized cost and fair value was approximately \$13.0 million and \$13.0 million, respectively, and our largest portfolio company investment by amortized cost and fair value was approximately \$33.0 million and \$33.0 million, respectively.

At December 31, 2013, 58% of our debt investments bore interest based on floating rates (subject to interest rate floors), such as LIBOR, and 42% bore interest at fixed rates. At December 31, 2012, 40% of our debt investments bore interest based on floating rates (subject to interest rate floors), such as LIBOR, and 60% bore interest at fixed rates.

The weighted average yield on all of our debt investments as of December 31, 2013 and December 31, 2012 was approximately 11.4% and 12.5%, respectively. The weighted average yield was computed using the effective interest rates for all of our debt investments, including accretion of original issue discount.

As of December 31, 2013 and December 31, 2012, we had cash of \$3.7 million and \$12.1 million, respectively, and United States Treasury securities of approximately \$10.0 million and \$50.0 million, respectively. The United States Treasury securities were purchased and temporarily held in connection with complying with RIC diversification requirements under Subchapter M of the Code.

### ***Investment Activity***

On November 7, 2012, we acquired our initial portfolio composed of investments in 11 portfolio companies from a private investment fund to which the D. E. Shaw group serves as investment adviser and Stellus Capital Management, LLC serves as a non-discretionary sub-adviser. The total consideration paid for our initial portfolio was \$194.4 million in total (excluding accrued interest of approximately \$2.3 million) consisting of \$165.2 million in cash and

\$29.2 million in shares of our common stock based on the price of \$15.00 per share. Our initial portfolio was comprised of a portion of the loans to middle-market companies that were originated over the previous three years by the Stellus Capital Management, LLC investment team during their time with the D. E. Shaw group and were selected for our initial portfolio because they are similar to the type of investments we originate. Our initial portfolio included middle-market loans that had an internal risk rating of 2 or better (i.e., investments that were performing at or above expectations and whose risks were neutral or favorable compared to the expected risk at the time of the original investment). We engaged an independent third-party valuation firm to assist in our determination of the acquisition price of the initial portfolio, which was ultimately approved by our board of directors (which includes a majority of independent directors). The independent third-party valuation firm that we engaged is also the third party

S-25

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TABLE OF CONTENTS

valuation firm that was engaged by the D. E. Shaw group to value the initial portfolio for the D. E. Shaw group fund in the ordinary course of such fund's operations.

During the year ended December 31, 2013, we made \$176.4 million of investments in 16 new portfolio companies and six to existing portfolio companies. During the year ended December 31, 2013, we received \$97.4 million in proceeds principally from prepayments of our investments, including \$3.5 million from amortization of certain other investments.

Subsequent to November 7, 2012 through December 31, 2012, we made \$67.5 million (\$68.4 million at par) of investments in 7 new portfolio companies and none for existing portfolio companies. During the period from November 7, 2012 through December 31, 2012, we received \$66.5 million in proceeds principally from prepayments of our investments and the paydown and amortization of certain other investments.

Our level of investment activity can vary substantially from period to period depending on many factors, including the amount of debt and equity capital to middle market companies, the level of merger and acquisition activity, the general economic environment and the competitive environment for the types of investments we make.

## Asset Quality

In addition to various risk management and monitoring tools, Stellus Capital Management uses an investment rating system to characterize and monitor the credit profile and expected level of returns on each investment in our portfolio.

This investment rating system uses a five-level numeric scale. The following is a description of the conditions associated with each investment rating:

Investment Rating 1 is used for investments that are performing above expectations, and whose risks remain favorable compared to the expected risk at the time of the original investment.

Investment Rating 2 is used for investments that are performing within expectations and whose risks remain neutral compared to the expected risk at the time of the original investment. All new loans are initially rated 2.

Investment Rating 3 is used for investments that are performing below expectations and that require closer monitoring, but where no loss of return or principal is expected. Portfolio companies with a rating of 3 may be out of compliance with financial covenants.

Investment Rating 4 is used for investments that are performing substantially below expectations and whose risks have increased substantially since the original investment. These investments are often in work out. Investments with a rating of 4 are those for which some loss of return but no loss of principal is expected.

Investment Rating 5 is used for investments that are performing substantially below expectations and whose risks have increased substantially since the original investment. These investments are almost always in work out.

Investments with a rating of 5 are those for which some loss of return and principal is expected.

The following table shows the investment rankings of our investments at fair value as of December 31, 2013 and December 31, 2012:

| Investment Rating | Fair Value as of December 31, 2013 | % of Portfolio | Number of Portfolio Companies |
|-------------------|------------------------------------|----------------|-------------------------------|
| 1                 | \$ 21,169,118                      | 8 %            | 2                             |
| 2                 | 236,580,555                        | 85 %           | 22                            |
| 3                 | 8,359,544                          | 3 %            | 1                             |

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|       |                |     |   |    |
|-------|----------------|-----|---|----|
| 4     | 11,395,293     | 4   | % | 1  |
| 5     |                | 0   | % |    |
| Total | \$ 277,504,510 | 100 | % | 26 |

S-26

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TABLE OF CONTENTS

| Investment Rating | Fair Value as of December 31, 2012 | % of Portfolio | Number of Portfolio Companies |
|-------------------|------------------------------------|----------------|-------------------------------|
| 1                 | \$                                 |                |                               |
| 2                 | 195,451,256                        | 100 %          | 15                            |
| 3                 |                                    |                |                               |
| 4                 |                                    |                |                               |
| 5                 |                                    |                |                               |
| Total             | \$ 195,451,256                     | 100 %          | 15                            |

**Loans and Debt Securities on Non-Accrual Status**

We will not accrue interest on loans and debt securities if we have reason to doubt our ability to collect such interest. As of December 31, 2013 and December 31, 2012, we had no loans on non-accrual.

**Results of Operations**

An important measure of our financial performance is net increase (decrease) in net assets resulting from operations, which includes net investment income (loss), net realized gain (loss) and net unrealized appreciation (depreciation). Net investment income (loss) is the difference between our income from interest, dividends, fees and other investment income and our operating expenses including interest on borrowed funds. Net realized gain (loss) on investments is the difference between the proceeds received from dispositions of portfolio investments and their amortized cost. Net unrealized appreciation (depreciation) on investments is the net change in the fair value of our investment portfolio.

**Comparison of the Years ended December 31, 2013 and December 31, 2012****Revenues**

We generate revenue in the form of interest income on debt investments and capital gains and distributions, if any, on investment securities that we may acquire in portfolio companies. Our debt investments typically have a term of five to seven years and bear interest at a fixed or floating rate. Interest on our debt securities is generally payable quarterly. Payments of principal on our debt investments may be amortized over the stated term of the investment, deferred for several years or due entirely at maturity. In some cases, our debt investments may pay interest in-kind, or PIK. Any outstanding principal amount of our debt securities and any accrued but unpaid interest will generally become due at the maturity date. The level of interest income we receive is directly related to the balance of interest-bearing investments multiplied by the weighted average yield of our investments. We expect that the total dollar amount of interest and any dividend income that we earn to increase as the size of our investment portfolio increases. In addition, we may generate revenue in the form of prepayment fees, commitment, loan origination, structuring or due diligence fees, fees for providing significant managerial assistance and consulting fees. Total investment income for the year ended December 31, 2013 totaled \$29.4 million and was primarily composed of interest income, including \$1.1 million of PIK income and \$1.4 million of miscellaneous fees. Total investment income for the period from Inception (May 18, 2012) through December 31, 2012 was \$3.7 million and was composed entirely of interest income, including \$18,000 of PIK income.

The increase in our total investment income for the year ended December 31, 2013 as compared to period from inception (May 18, 2012) through December 31, 2012 was primarily attributable to the fact that we only acquired our initial investment portfolio on November 7, 2012 and, as a result, our total investment income for the period from

inception (May 18, 2012) through December 31, 2012 only reflected our receipt of investment income from the initial investment portfolio for an approximate two-month period. Our total investment income for year ended December 31, 2013 reflected a full-year of investment income from our investment portfolio. Such increase was partially offset by a decrease in the weighted average yield of our debt investments from 12.5% to 11.4% during the year-over-year period.

S-27

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TABLE OF CONTENTS

**Expenses**

Our primary operating expenses include the payment of fees to Stellus Capital Management under the investment advisory agreement, our allocable portion of overhead expenses under the administration agreement and other operating costs described below. We bear all other out-of-pocket costs and expenses of our operations and transactions, which may include:

- the cost of calculating our net asset value, including the cost of any third-party valuation services;
- the cost of effecting sales and repurchases of shares of our common stock and other securities;
- fees payable to third parties relating to making investments, including out-of-pocket fees and expenses (such as travel expenses) associated with performing due diligence and reviews of prospective investments;
- transfer agent and custodial fees;
- out-of-pocket fees and expenses associated with marketing efforts;
- federal and state registration fees and any stock exchange listing fees;
- U.S. federal, state and local taxes;
- independent directors' fees and expenses;
- brokerage commissions;
- fidelity bond, directors' and officers' liability insurance and other insurance premiums;
- direct costs, such as printing, mailing, long distance telephone and staff;
- fees and expenses associated with independent audits and outside legal costs;
- costs associated with our reporting and compliance obligations under the 1940 Act and other applicable U.S. federal and state securities laws; and
- other expenses incurred by Stellus Capital Management or us in connection with administering our business, including payments under the administration agreement that are based upon our allocable portion of overhead (subject to the review of our board of directors).

Operating expenses, net of fee and expense waiver for the year ended December 31, 2013 totaled \$13.4 million.

Operating expenses totaled \$2.4 million for the period from Inception through December 31, 2012. Operating expenses, net of fee and expense waiver consisted of base management fees, incentive fees, administrative services expenses, fees related to the Credit Facility, professional fees, valuation fees, insurance expenses, directors' fees and other general and administrative expenses, partially offset by the waiver of incentive fee.

The base management fee for the year ended December 31, 2013 was \$4.2 million. The base management fee for the period from Inception (May 18, 2012) through December 31, 2012 was \$0.5 million, as provided for in the investment advisory agreement.

For the year ended December 31, 2013, the Company incurred incentive fees totaling \$4.6 million, as compared to none for the period from Inception (May 18, 2012) through December 31, 2012. The Company records an expense accrual in the statements of operations relating to the capital gains incentive fee payable by the Company to its investment adviser when the unrealized gains on its investments exceed all realized capital losses on its investments given the fact that a capital gains incentive fee would be owed to the investment adviser if the Company were to liquidate its investment portfolio at such time. The actual incentive fee payable to the Company's investment adviser related to capital gains will be determined and payable in arrears at the end of each fiscal year and will include only realized capital gains for the period. As of December 31, 2013, \$0.3 million of the \$4.6 million in accrued incentive fees related to such expense accrual.

## TABLE OF CONTENTS

Pursuant to its agreement with the Company, Stellus Capital Management waived \$1.8 million and all of its incentive fee for the year ended December 31, 2013 and the period from Inception (May 18, 2012) through December 31, 2012, respectively, in order to support a minimum annual dividend yield of 9% based on the price per share of our common stock in connection with our IPO.

The total gains incentive fee payable to Stellus Capital Management under the investment management agreement as of December 31, 2013 and December 31, 2012 was \$0.3 million and \$0, respectively.

Borrowings under the Credit Facility were \$110.0 million and \$38.0 million as of December 31, 2013 and December 31, 2012, respectively.

For the year ended December 31, 2013 the effective interest rate under the Credit Facility was approximately 3.3% (approximately 3.7% including commitment fees on the unused portion of the Credit Facility). Interest is paid quarterly in arrears. The Company recorded interest and fee expense of \$3.1 million for the year ended December 31, 2013, of which \$2.3 million was interest expense, \$0.5 million was amortization of loan fees paid on the Credit Facility, \$0.3 million related to commitment fees on the unused portion of the Credit Facility, and \$50 thousand related to loan administration fees. The average borrowings under the Credit Facility for the year ended December 31, 2013 were \$68 million.

For the period from Inception (May 18, 2012) through December 31, 2012 the effective interest rate under the Credit Facility was approximately 3.6% (approximately 5.4% including commitment fees on the unused portion of the Credit Facility). The Company recorded interest and fee expense of \$0.3 million for the period ended December 31, 2012, of which \$0.2 million was interest expense, \$61 thousand related to commitment fees on the unused portion of the Credit Facility and \$18 thousand related to other loan fees. The average borrowings under the Credit Facility for the period ended December 31, 2013 were \$25 million.

Administrative services expenses for the year ended December 31, 2013 totaled \$0.9 million, \$0.4 million of which was allocated to us from Stellus Capital Management, as our administration. Administrative services expenses from Inception through December 31, 2012 totaled \$103 thousand, \$63 thousand was related to our third party administrator and \$40 thousand of which was allocated to us from Stellus Capital Management, LLC. Expenses for valuation, professional fees, insurance expenses, directors fees, and other general and administrative expense for the year ended December 31, 2013 and the period from Inception through December 31, 2012 totaled \$2.3 million and \$1.2 million, respectively.

### **Net Investment Income**

For the year ended December 31, 2013, net investment income was \$16.0 million, or \$1.33 per common share (based on 12,059,293 weighted-average common shares outstanding at December 31, 2013). Net investment income includes expense accruals of \$0.3 million of incentive fees related to realized and unrealized gains.

For the period from Inception (May 18, 2012) through December 31, 2012, net investment income was \$1.3 million, or \$0.11 per common share (based on a weighted average of 12,035,023 common shares outstanding for the period from Inception through December 31, 2012).

### **Net Realized Gains and Losses**

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, using the specific identification method, without regard to unrealized

appreciation or depreciation previously recognized.

Repayments of investments and amortization of other certain investments for the year ended December 31, 2013 totaled \$97.4 million and net realized gains totaled \$1.0 million.

We did not recognize any realized gains or losses on our investments during the period from Inception (May 18, 2012) through December 31, 2012.

### **Net Change in Unrealized Appreciation of Investments**

Net change in unrealized appreciation primarily reflects the change in portfolio investment values during the reporting period, including the reversal of previously recorded appreciation or depreciation when gains or losses are realized.

S-29

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## TABLE OF CONTENTS

Net change in unrealized appreciation (depreciation) on investments and cash equivalents for the year ended December 31, 2013 totaled \$0.5 million.

Net change in unrealized depreciation on investments totaled \$6 thousand for the period from Inception (May 18, 2012) through December 31, 2012 and primarily related to unrealized depreciation on our holdings of United States treasury securities.

### **Net Increase in Net Assets Resulting from Operations**

For the year ended December 31, 2013, net increase in net assets resulting from operations totaled \$17.5 million, or \$1.45 per common share (based on 12,059,293 weighted-average common shares outstanding at December 31, 2013).

For the period from Inception (May 18, 2012) through December 31, 2012, net increase in net assets resulting from operations totaled \$1.3 million, or \$0.11 per common share (based on 12,035,023 common shares outstanding at December 31, 2012).

## **Financial condition, liquidity and capital resources**

### **Cash Flows from Operating and Financing Activities**

Our operating activities used cash of \$68.6 million for the year ended December 31, 2013, primarily in connection with the purchase of investments. Our financing activities for the year ended December 31, 2013 provided cash of \$20.1 million primarily from borrowings under the Credit Facility.

Our operating activities used cash of \$164.4 million for the period from Inception (May 18, 2012) through December 31, 2012, primarily in connection with the purchase of investments, including the initial investment portfolio we acquired immediately prior to our IPO from a private investment fund to which the D. E. Shaw group serves as investment adviser and Stellus Capital Management serves as a non-discretionary sub-adviser. Our financing activities provided cash of \$226.5 million primarily from our IPO and borrowings under the Credit Facility.

Our liquidity and capital resources are derived from the Credit Facility and cash flows from operations, including investment sales and repayments, and income earned. Our primary use of funds from operations includes investments in portfolio companies and other operating expenses we incur, as well as the payment of dividends to the holders of our common stock. We used, and expect to continue to use, these capital resources as well as proceeds from turnover within our portfolio and from public and private offerings of securities to finance our investment activities.

Although we expect to fund the growth of our investment portfolio through the net proceeds from future public and private equity offerings and issuances of senior securities or future borrowings to the extent permitted by the 1940 Act, our plans to raise capital may not be successful. In this regard, if our common stock trades at a price below our then-current net asset value per share, we may be limited in our ability to raise equity capital given that we cannot sell our common stock at a price below net asset value per share unless our stockholders approve such a sale and our board of directors makes certain determinations in connection therewith. A proposal, approved by our stockholders at our 2013 Annual Meeting of Stockholders, authorizes us to sell shares equal to up to 25% of our outstanding common stock of our common stock below the then current net asset value per share of our common stock in one or more offerings for the period ending on the earlier of (i) May 23, 2014, the one year anniversary of our 2013 Annual Meeting of Stockholders, or (ii) the date of our 2014 Annual Meeting of Stockholders. We would need similar future

approval from our stockholders to issue shares below the then current net asset value per share any time after the expiration of the current approval. In addition, we intend to distribute between 90% and 100% of our taxable income to our stockholders in order to satisfy the requirements applicable to RICs under Subchapter M of the Code. Consequently, we may not have the funds or the ability to fund new investments, to make additional investments in our portfolio companies, to fund our unfunded commitments to portfolio companies or to repay borrowings. In addition, the illiquidity of our portfolio investments may make it difficult for us to sell these investments when desired and, if we are required to sell these investments, we may realize significantly less than their recorded value.

S-30

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## TABLE OF CONTENTS

Also, as a business development company, we generally are required to meet a coverage ratio of total assets, less liabilities and indebtedness not represented by senior securities, to total senior securities, which include all of our borrowings and any outstanding preferred stock, of at least 200%. This requirement limits the amount that we may borrow. We were in compliance with the asset coverage at all times. As of December 31, 2013 and December 31, 2012 our asset coverage ratio was 248% and 309%, respectively. The amount of leverage that we employ will depend on our assessment of market conditions and other factors at the time of any proposed borrowing, such as the maturity, covenant package and rate structure of the proposed borrowings, our ability to raise funds through the issuance of shares of our common stock and the risks of such borrowings within the context of our investment outlook. Ultimately, we only intend to use leverage if the expected returns from borrowing to make investments will exceed the cost of such borrowing. As of December 31, 2013 and December 31, 2012, we had cash of \$3.7 million and \$12.1 million, respectively, and United States Treasury securities of approximately \$10.0 million and \$50.0 million, respectively.

### **Credit Facility**

The Credit Facility is a syndicated multi-currency facility and provides for borrowings up to \$135 million and matures in November 2016. As of December 31, 2013, we had \$110 million of borrowings outstanding under the Credit Facility. Borrowings under the Credit Facility generally bear interest at LIBOR plus 3.00%. The Credit Facility size may be increased up to \$150 million, subject to certain conditions, with additional new lenders or through an increase in commitments of current lenders. On July 30, 2013, we exercised a portion of the accordion feature to increase our borrowing capacity from \$115 million to \$135 million. The Credit Facility is a four-year revolving facility secured by substantially all of our investment portfolio assets. The Credit Facility contains affirmative and restrictive covenants, including but not limited to maintenance of a minimum shareholders' equity amount and maintenance of a ratio of total assets (less total liabilities other than indebtedness) to total indebtedness of not less than 2.0:1.0. In addition to the asset coverage ratio described in the preceding sentence, borrowings under the Credit Facility (and the incurrence of certain other permitted debt) are subject to compliance with a borrowing base that applies different advance rates to different types of assets in our portfolio. We have also generally agreed under the terms of the Credit Facility not to incur any additional secured indebtedness. In addition, we have agreed not to incur any additional unsecured indebtedness that has a maturity date prior to the maturity date of the Credit Facility. Furthermore, the Credit Facility contains a covenant requiring us to maintain compliance with RIC provisions at all times, subject to certain remedial provisions. Unless extended, the period during which the Company may make and reinvest borrowings under the Credit Facility will expire on November 13, 2015 and the maturity date of the Credit Facility is November 12, 2016.

### **Other**

We have applied for a license to form and operate an SBIC subsidiary; however, the application is subject to approval by the SBA. We can make no assurances that the SBA will approve our application, or the time frame in which we would receive a license, should one ultimately be granted. The SBIC subsidiary would be allowed to issue SBA-guaranteed debentures up to a maximum of \$150 million under current SBIC regulations, subject to required capitalization of the SBIC subsidiary and other requirements. SBA guaranteed debentures generally have longer maturities and lower interest rates than other forms of debt that may be available to us, and we believe therefore would represent an attractive source of debt capital.

### **Contractual Obligations**

As of December 31, 2013, our future fixed commitments for cash payments on contractual obligations for each of the next five years and thereafter are as follows:

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|                                | Total                  | 2014     | 2015 | 2016       | 2017 | 2018 | 2019 and thereafter |
|--------------------------------|------------------------|----------|------|------------|------|------|---------------------|
|                                | (dollars in thousands) |          |      |            |      |      |                     |
| Credit facility payable        | \$ 110,000             |          |      | \$ 110,000 |      |      |                     |
| Short-term loan                | \$ 9,000               | \$ 9,000 |      |            |      |      |                     |
| Administrative service expense | \$ 460                 | \$ 460   |      |            |      |      |                     |
|                                | \$ 119,460             | \$ 9,460 | \$   | \$ 110,000 | \$   | \$   | \$                  |

S-31

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TABLE OF CONTENTS

## **Off-Balance Sheet Arrangements**

We may be a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of our portfolio companies. As of December 31, 2013, our only off-balance sheet arrangements consisted of \$20.9 million of unfunded commitments, which was comprised of \$20.9 million to provide debt financing to three of our portfolio companies. As of December 31, 2012, our only off-balance sheet arrangements consisted of a \$2.0 million unfunded commitment to provide debt financing to one of our portfolio companies.

## **Regulated Investment Company Status and Dividends**

We have elected to be treated as a RIC under Subchapter M of the Code. So long as we maintain our status as a RIC, we will not be taxed on our investment company taxable income or realized net capital gains, to the extent that such taxable income or gains are distributed, or deemed to be distributed, to stockholders on a timely basis.

Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation until realized. Dividends declared and paid by us in a year may differ from taxable income for that year as such dividends may include the distribution of current year taxable income or the distribution of prior year taxable income carried forward into and distributed in the current year. Distributions also may include returns of capital.

To qualify for RIC tax treatment, we must, among other things, distribute, with respect to each taxable year, at least 90% of our investment company net taxable income (i.e., our net ordinary income and our realized net short-term capital gains in excess of realized net long-term capital losses, if any). If we maintain our qualification as a RIC, we must also satisfy certain distribution requirements each calendar year in order to avoid a federal excise tax on or undistributed earnings of a RIC. See **Certain U.S. Federal Income Tax Considerations Taxation as a Regulated Investment Company** in this prospectus supplement.

We intend to distribute to our stockholders between 90% and 100% of our annual taxable income (which includes our taxable interest and fee income). However, the covenants contained in the Credit Facility may prohibit us from making distributions to our stockholders, and, as a result, could hinder our ability to satisfy the distribution requirement. In addition, we may retain for investment some or all of our net taxable capital gains (i.e., realized net long-term capital gains in excess of realized net short-term capital losses) and treat such amounts as deemed distributions to our stockholders. If we do this, our stockholders will be treated as if they received actual distributions of the capital gains we retained and then reinvested the net after-tax proceeds in our common stock. Our stockholders also may be eligible to claim tax credits (or, in certain circumstances, tax refunds) equal to their allocable share of the tax we paid on the capital gains deemed distributed to them. To the extent our taxable earnings for a fiscal taxable year fall below the total amount of our dividends for that fiscal year, a portion of those dividend distributions may be deemed a return of capital to our stockholders.

We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of these distributions from time to time. In addition, we may be limited in our ability to make distributions due to the asset coverage test for borrowings applicable to us as a business development company under the 1940 Act and due to provisions in Credit Facility. We cannot assure stockholders that they will receive any distributions or distributions at a particular level.

In accordance with certain applicable Treasury regulations and private letter rulings issued by the Internal Revenue Service, a RIC may treat a distribution of its own stock as fulfilling its RIC distribution requirements if each

stockholder may elect to receive his or her entire distribution in either cash or stock of the RIC, subject to a limitation that the aggregate amount of cash to be distributed to all stockholders must be at least 20% of the aggregate declared distribution. If too many stockholders elect to receive cash, each stockholder electing to receive cash must receive a pro rata amount of cash (with the balance of the distribution paid in stock). In no event will any stockholder, electing to receive cash, receive less than 20% of his or her entire distribution in cash. If these and certain other requirements are met, for U.S. federal income tax purposes, the amount of the dividend paid in stock will be equal to the amount of cash that could have been received

S-32

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## TABLE OF CONTENTS

instead of stock. We have no current intention of paying dividends in shares of our stock in accordance with these Treasury regulations or private letter rulings.

## **Recent Accounting Pronouncements**

See Note 1 to the financial statements for a description of recent accounting pronouncements, if any, including the expected dates of adoption and the anticipated impact on the financial statements.

## **Critical Accounting Policies**

The preparation of our financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Changes in the economic environment, financial markets and any other parameters used in determining such estimates could cause actual results to differ. In addition to the discussion below, our significant accounting policies are further described in the notes to the financial statements.

## **Valuation of portfolio investments**

As a business development company, we generally invest in illiquid loans and securities including debt and equity securities of middle-market companies. Under procedures established by our board of directors, we value investments for which market quotations are readily available at such market quotations. We obtain these market values from an independent pricing service or at the mean 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 are 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, although we engage independent valuation providers to review the valuation of each portfolio investment that does not have a readily available market quotation at least once each quarter. Investments purchased within 60 days of maturity are valued at cost plus accreted discount, or minus amortized premium, which approximates value. With respect to unquoted securities, our board of directors, together with our independent valuation advisors, values 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, our board of directors uses the pricing indicated by the external event to corroborate and/or assist us in our valuation. Because there is not a readily available market for substantially all of the investments in our portfolio, we value most of our portfolio investments at fair value as determined in good faith by our 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.

With respect to investments for which market quotations are not readily available, our board of directors undertakes a multi-step valuation process each quarter, as described below:

Our quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals of Stellus Capital Management responsible for the portfolio investment;

Preliminary valuation conclusions are then documented and discussed with our senior management and Stellus Capital Management;

The audit committee of our board of directors then reviews these preliminary valuations;

At least once each quarter, the valuation for each portfolio investment is reviewed by an independent valuation firm; and

The board of directors then discusses valuations and determines the fair value of each investment in our portfolio in good faith, based on the input of Stellus Capital Management, the independent valuation firm and the audit committee.

S-33

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## TABLE OF CONTENTS

### **Revenue recognition**

We record interest income on an accrual basis to the extent that we expect to collect such amounts. For loans and debt securities with contractual 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 is recorded as interest income. We record prepayment premiums on loans and debt securities as interest income. Dividend income, if any, will be recognized on the ex-dividend date.

### **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.

### **Unrealized Gains Incentive Fee**

Under GAAP, the Company calculates the unrealized gains incentive fee payable to the Advisor as if the Company had realized all investments at their fair values as of the reporting date. Accordingly, the Company accrues a provisional unrealized gains incentive fee taking into account any unrealized gains or losses. As the provisional incentive fee is subject to the performance of investments until there is a realization event, the amount of provisional unrealized gains incentive fee accrued at a reporting date may vary from the incentive fee that is ultimately realized and the differences could be material.

### **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.

### **Quantitative and Qualitative Disclosures About Market Risk**

We are subject to financial market risks, including changes in interest rates. For the years ended December 31, 2013 and December 31, 2012, 58% and 40%, or 19 and 9 of the loans in our portfolio bore interest at floating rates, respectively. For the year ended December 31, 2013, 17 of these 19 loans in our portfolio have interest rate floors, which have effectively converted the loans to fixed rate loans in the current interest rate environment. In the future, we expect other loans in our portfolio will have floating rates. Assuming that the Statement of Assets and Liabilities as of December 31, 2013, were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical one percent increase in LIBOR would increase our net income by less than \$144,000 due the current

floors in place. A hypothetical decrease in LIBOR would not affect our net income, again, due to the aforementioned floors in place. Although we believe that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect net increase in net assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate. We may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts subject to the requirements of the 1940 Act. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments. For the years ended December 31, 2012 and December 31, 2013, we did not engage in hedging activities.

S-34

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TABLE OF CONTENTS

Changes in interest rates will affect our cost of funding. Our interest expense will be affected by changes in the published LIBOR rate in connection with the Credit Facility. As of December 31, 2013, we had not entered into any interest rate hedging arrangements. At December 31, 2013, based on our applicable levels of our Credit Facility, a 1% increase in interest rates would have decreased our net investment income by approximately \$671 thousand for the year ended December 31, 2013.

S-35

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TABLE OF CONTENTS

## DESCRIPTION OF THE NOTES

The Notes will be issued under an indenture and the first supplemental indenture thereto, each dated as of \_\_\_\_\_, 2014, between us and U.S. Bank National Association, as trustee. We refer to the indenture, as well as any supplements thereto, as the indenture and to U.S. Bank National Association as the trustee. The Notes are governed by the indenture, as required by federal law for all bonds and notes of companies that are publicly offered. An indenture is a contract between us and the financial institution acting as trustee on your behalf, and is subject to and governed by the Trust Indenture Act of 1939, as amended. The trustee has two main roles. First, the trustee can enforce your rights against us if we default. There are some limitations on the extent to which the trustee acts on your behalf, described in the second paragraph under **Events of Default Remedies if an Event of Default Occurs**. Second, the trustee performs certain administrative duties for us with respect to our Notes.

This section includes a description of the material terms of the Notes and the indenture. Because this section is a summary, however, it does not describe every aspect of the Notes and the indenture. We urge you to read the indenture because it, and not this description, defines your rights as a holder of the Notes. The indenture has been attached as an exhibit to the registration statement of which this prospectus is a part and filed with the SEC. See **Available Information** for information on how to obtain a copy of the indenture.

We are permitted, under specific conditions, to issue multiple classes of indebtedness if our asset coverage, as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance after giving effect to any exemptive relief granted by the SEC. See **Risk Factors Risk Relating to Our Business and Structure** Pending legislation may allow us to incur additional leverage in the accompanying prospectus. In addition, while any indebtedness and senior securities remain outstanding, we must make provisions to prohibit distributions to our stockholders or the repurchase of such securities or shares in certain cases, unless we meet the applicable asset coverage ratios at the time of the distribution or repurchase. We may also borrow amounts up to 5% of the value of our total assets for temporary purposes without regard to asset coverage.

### General

The Notes will mature on April 30, 2019. The principal payable at maturity will be 100% of the aggregate principal amount. The interest rate of the Notes is \_\_\_\_\_ % per year and will be paid every February 15, May 15, August 15 and November 15, beginning August 15, 2014, and the regular record dates for interest payments will be every February 1, May 1, August 1 and November 1, commencing August 1, 2014. If an interest payment date falls on a non-business day, the applicable interest payment will be made on the next business day and no additional interest will accrue as a result of such delayed payment. The initial interest period will be the period from and including \_\_\_\_\_, 2014, to, but excluding, the initial interest payment date, and the subsequent interest periods will be the periods from and including an interest payment date to, but excluding, the next interest payment date or the stated maturity date, as the case may be.

We will issue the Notes in denominations of \$25 and integral multiples of \$25 in excess thereof. The Notes will not be subject to any sinking fund and holders of the Notes will not have the option to have the Notes repaid prior to the stated maturity date.

The indenture does not contain any provisions that give you protection in the event we issue a large amount of debt or we are acquired by another entity.

We have the ability to issue indenture securities with terms different from the Notes and, without the consent of the holders thereof, to reopen the Notes and issue additional Notes.

## **Optional Redemption**

The Notes may be redeemed in whole or in part at any time or from time to time at our option on or after April 30, 2016 upon not less than 30 days nor more than 60 days written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount of the Notes to be redeemed plus accrued and unpaid interest payments otherwise payable thereon for the then-current quarterly interest period accrued to the date fixed for redemption.

S-36

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## TABLE OF CONTENTS

You may be prevented from exchanging or transferring the Notes when they are subject to redemption. In case any Notes are to be redeemed in part only, the redemption notice will provide that, upon surrender of such Note, you will receive, without a charge, a new Note or Notes of authorized denominations representing the principal amount of your remaining unredeemed Notes. Any exercise of our option to redeem the Notes will be done in compliance with the 1940 Act.

If we redeem only some of the Notes, the trustee will determine the method for selection of the particular Notes to be redeemed, in accordance with the indenture and in accordance with the rules of any national securities exchange or quotation system on which the Notes are listed. Unless we default in payment of the redemption price, on and after the date of redemption, interest will cease to accrue on the Notes called for redemption.

## **Global Securities**

Each Note will be issued in book-entry form and represented by a global security that we deposit with and register in the name of The Depository Trust Company, New York, New York, known as DTC, or its nominee. A global security may not be transferred to or registered in the name of anyone other than the depository or its nominee, unless special termination situations arise. As a result of these arrangements, the depository, or its nominee, will be the sole registered owner and holder of all the Notes represented by a global security, and investors will be permitted to own only beneficial interests in a global security. For more information about these arrangements, see Book-Entry Procedures below.

## **Termination of a Global Security**

If a global security is terminated for any reason, interests in it will be exchanged for certificates in non-book-entry form (certificated securities). After that exchange, the choice of whether to hold the certificated Notes directly or in street name will be up to the investor. Investors must consult their own banks or brokers to find out how to have their interests in a global security transferred on termination to their own names, so that they will be holders.

## **Payment and Paying Agents**

We will pay interest to the person listed in the trustee's records as the owner of the Notes at the close of business on a particular day in advance of each due date for interest, even if that person no longer owns the Note on the interest due date. That day, usually about two weeks in advance of the interest due date, is called the record date. Because we will pay all the interest for an interest period to the holders on the record date, holders buying and selling the Notes must work out between themselves the appropriate purchase price. The most common manner is to adjust the sales price of the Notes to prorate interest fairly between buyer and seller based on their respective ownership periods within the particular interest period. This prorated interest amount is called accrued interest.

## **Payments on Global Securities**

We will make payments on the Notes so long as they are represented by a global security in accordance with the applicable policies of the depository as in effect from time to time. Under those policies, we will make payments directly to the depository, or its nominee, and not to any indirect holders who own beneficial interests in the global security. An indirect holder's right to those payments will be governed by the rules and practices of the depository and its participants, as described under Book-Entry Procedures.

## **Payments on Certificated Securities**

In the event the Notes become represented by certificated securities, we will make payments on the Notes as follows. We will pay interest that is due on an interest payment date to the holder of the Notes as shown on the trustee's records as of the close of business on the regular record date. We will make all payments of principal and premium, if any, by check at the corporate trust office of the applicable trustee in New York, New York and/or at other offices that may be specified in the indenture or in a notice to holders against surrender of the Note.

Alternatively, at our option, we may pay any cash interest that becomes due on the Notes by mailing a check to the holder at his, her or its address shown on the trustee's records as of the close of business on the regular record date or by transfer to an account at a bank in the United States, in either case, on the due date.

S-37

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TABLE OF CONTENTS

## **Payment When Offices Are Closed**

If any payment is due on the Notes on a day that is not a business day, we will make the payment on the next day that is a business day. Payments made on the next business day in this situation will be treated under the indenture as if they were made on the original due date. Such payment will not result in a default under the Notes or the indenture, and no interest will accrue on the payment amount from the original due date to the next day that is a business day.

**Book-entry and other indirect holders should consult their banks or brokers for information on how they will receive payments on the Notes.**

## **Events of Default**

You will have rights if an Event of Default occurs in respect of the Notes, as described later in this subsection. The term **Event of Default** in respect of the Notes means any of the following:

We do not pay the principal of (or premium, if any, on) any Note within five days of its due date.

We do not pay interest on any Note when due, and such default is not cured within 30 days.

We remain in breach of any other covenant with respect to the Notes for 60 days after we receive a written notice of default stating we are in breach. The notice must be sent by either the Trustee or holders of at least 25% of the principal amount of the Notes.

We file for bankruptcy or certain other events of bankruptcy, insolvency or reorganization occur and in the case of certain orders or decrees entered against us under any bankruptcy law, such order or decree remains undischarged or unstayed for a period of 60 days.

On the last business day of each of twenty-four consecutive calendar months, the Notes have an asset coverage of less than 100%, after giving effect to any exemptive relief granted to us by the SEC.

An Event of Default for the Notes does not necessarily constitute an Event of Default for any other series of debt securities issued under the same or any other indenture. The trustee may withhold notice to the holders of the Notes of any default, except in the payment of principal or interest, if it in good faith considers the withholding of notice to be in the best interests of the holders.

## **Remedies if an Event of Default Occurs**

If an Event of Default has occurred and is continuing, the trustee or the holders of not less than 25% in principal amount of the Notes may declare the entire principal amount of all the Notes to be due and immediately payable. This is called a declaration of acceleration of maturity. In certain circumstances, a declaration of acceleration of maturity may be canceled by the holders of a majority in principal amount of the Notes if (1) we have deposited with the trustee all amounts due and owing with respect to the Notes (other than principal that has become due solely by reason of such acceleration) and certain other amounts, and (2) any other Events of Default have been cured or waived.

The trustee is not required to take any action under the indenture at the request of any holders unless the holders offer the trustee protection from expenses and liability reasonably satisfactory to it (called an **indemnity** ). If indemnity reasonably satisfactory to the trustee is provided, the holders of a majority in principal amount of the Notes may direct the time, method and place of conducting any lawsuit or other formal legal action seeking any remedy available to the trustee. The trustee may refuse to follow those directions in certain circumstances. No delay or omission in exercising any right or remedy will be treated as a waiver of that right, remedy or Event of Default.

Before you are allowed to bypass the trustee and bring your own lawsuit or other formal legal action or take other steps to enforce your rights or protect your interests relating to the Notes, the following must occur:

you must give the trustee written notice that an Event of Default has occurred and remains uncured; the holders of at least 25% in principal amount of all the Notes must make a written request that the trustee take action because of the default and must offer reasonable indemnity to the trustee against the costs, expenses and other liabilities of taking that action;

S-38

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## TABLE OF CONTENTS

the trustee must not have taken action for 60 days after receipt of the above notice and offer of indemnity; and the holders of a majority in principal amount of the Notes must not have given the trustee a direction inconsistent with the above notice during that 60-day period.

However, you are entitled at any time to bring a lawsuit for the payment of money due on your Notes on or after the due date.

**Book-entry and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and how to declare or cancel an acceleration of maturity.**

Each year, we will furnish to the trustee a written statement of certain of our officers certifying that to their knowledge we are in compliance with the indenture and the Notes, or else specifying any default.

### **Waiver of Default**

The holders of a majority in principal amount of the Notes may waive any past defaults other than a default:

the payment of principal of (or premium, if any) or interest; or  
in respect of a covenant that cannot be modified or amended without the consent of each holder.

### **Merger or Consolidation**

Under the terms of the indenture, we are generally permitted to consolidate or merge with another entity. We are also permitted to sell all or substantially all of our assets to another entity. However, we may not take any of these actions unless all the following conditions are met:

where we merge out of existence or convey or transfer our assets substantially as an entirety, the resulting entity must agree to be legally responsible for our obligations under the Notes;  
the merger or sale of assets must not cause a default on the Notes and we must not already be in default (unless the merger or sale would cure the default). For purposes of this no-default test, a default would include an Event of Default that has occurred and has not been cured, as described under **Events of Default** above. A default for this purpose would also include any event that would be an Event of Default if the requirements for giving us a notice of default or our default having to exist for a specific period of time were disregarded; and  
we must deliver certain certificates and documents to the trustee.

### **Modification or Waiver**

There are three types of changes we can make to the indenture and the Notes issued thereunder.

### **Changes Requiring Your Approval**

First, there are changes that we cannot make to your Notes without your specific approval. The following is a list of those types of changes:

change the stated maturity of the principal of or interest on the Notes;  
reduce any amounts due on the Notes;  
reduce the amount of principal payable upon acceleration of the maturity of a Note following a default;  
change the place or currency of payment on a Note;  
impair your right to sue for payment;



## TABLE OF CONTENTS

adversely affect any rights to convert or exchange any note in accordance with its terms;  
reduce the percentage of holders of Notes whose consent is needed to modify or amend the indenture;  
reduce the percentage of holders of Notes whose consent is needed to waive compliance with certain provisions of the indenture or to waive certain defaults; and  
modify any other material aspect of the indenture dealing with supplemental indentures, modification and waiver of past defaults, reduction of the quorum or voting requirements or the waiver of certain covenants.

### **Changes Not Requiring Approval**

The second type of change does not require any vote by the holders of the Notes. This type is limited to clarifications and certain other changes that would not adversely affect holders of the Notes in any material respect.

### **Changes Requiring Majority Approval**

Any other change to the indenture and the Notes would require the following approval:

if the change affects only the Notes, it must be approved by the holders of a majority in principal amount of the Notes; and

if the change affects more than one series of debt securities issued under the same indenture, it must be approved by the holders of a majority in principal amount of all of the series affected by the change, with all affected series voting together as one class for this purpose.

In each case, the required approval must be given by written consent.

The holders of a majority in principal amount of all of the series of debt securities issued under an indenture, voting together as one class for this purpose, may waive our compliance with some of our covenants in that indenture.

However, we cannot obtain a waiver of a payment default or of any of the matters covered by the bullet points included above under Changes Requiring Your Approval.

### **Further Details Concerning Voting**

When taking a vote, we will use the principal amount that would be due and payable on the voting date if the maturity of the Notes were accelerated to that date because of a default, to decide how much principal to attribute to the Notes:

The Notes will not be considered outstanding, and therefore not eligible to vote, if we have deposited or set aside in trust money for their payment or redemption. The Notes will also not be eligible to vote if they have been fully defeased as described later under Defeasance Full Defeasance.

We will generally be entitled to set any day as a record date for the purpose of determining the holders of the Notes that are entitled to vote or take other action under the indenture. However, the record date may not be more than 30 days before the date of the first solicitation of holders to vote on or take such action. If we set a record date for a vote or other action to be taken by holders of the Notes, that vote or action may be taken only by persons who are holders of the Notes on the record date and must be taken within eleven months following the record date.

**Book-entry and other indirect holders should consult their banks or brokers for information on how approval may be granted or denied if we seek to change the indenture or the Notes or request a waiver.**

## Defeasance

The following defeasance provisions will be applicable to the Notes. Defeasance means that, by depositing with a trustee an amount of cash and/or government securities sufficient to pay all principal and interest, if any, on the Notes when due and satisfying any additional conditions noted below, we will be deemed to have been discharged from our obligations under the Notes. In the event of a covenant defeasance, upon depositing such funds and satisfying similar conditions discussed below we would be

S-40

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## TABLE OF CONTENTS

released from certain covenants under the indenture relating to the Notes. The consequences to the holders of the Notes would be that, while they would no longer benefit from certain covenants under the indenture, and while the Notes could not be accelerated for any reason, the holders of Notes nonetheless would be guaranteed to receive the principal and interest owed to them.

### **Covenant Defeasance**

Under current U.S. federal tax law and the indenture, we can make the deposit described below and be released from some of the restrictive covenants in the indenture under which the Notes were issued. This is called covenant defeasance. In that event, you would lose the protection of those restrictive covenants but would gain the protection of having money and government securities set aside in trust to repay your Notes. If we achieve covenant defeasance and your Notes were subordinated as described under Indenture Provisions Ranking below, such subordination would not prevent the trustee under the indenture from applying the funds available to it from the deposit described in the first bullet below to the payment of amounts due in respect of such debt securities for the benefit of the subordinated debtholders. In order to achieve covenant defeasance, we must do the following:

Since the Notes are denominated in U.S. dollars, we must deposit in trust for the benefit of all holders of the Notes a combination of cash and U.S. government or U.S. government agency notes or bonds that will generate enough cash to make interest, principal and any other payments on the Notes on their various due dates;

we must deliver to the trustee a legal opinion of our counsel confirming that, under current U.S. federal income tax law, we may make the above deposit without causing you to be taxed on the Notes any differently than if we did not make the deposit;

we must deliver to the trustee a legal opinion of our counsel stating that the above deposit does not require registration by us under the 1940 Act, and a legal opinion and officers' certificate stating that all conditions precedent to covenant defeasance have been complied with;

defeasance must not result in a breach or violation of, or result in a default under, the indenture or any of our other material agreements or instruments; and

no default or event of default with respect to the Notes shall have occurred and be continuing and no defaults or events of default related to bankruptcy, insolvency or reorganization shall occur during the next 90 days.

If we accomplish covenant defeasance, you can still look to us for repayment of the Notes if there were a shortfall in the trust deposit or the trustee is prevented from making payment. In fact, if one of the remaining Events of Default occurred (such as our bankruptcy) and the Notes became immediately due and payable, there might be a shortfall.

Depending on the event causing the default, you may not be able to obtain payment of the shortfall.

### **Full Defeasance**

If there is a change in U.S. federal tax law, as described below, we can legally release ourselves from all payment and other obligations on the Notes (called full defeasance ) if we put in place the following other arrangements for you to be repaid:

Since the Notes are denominated in U.S. dollars, we must deposit in trust for the benefit of all holders of the Notes a combination of money and U.S. government or U.S. government agency notes or bonds that will generate enough cash to make interest, principal and any other payments on the Notes on their various due dates;

we must deliver to the trustee a legal opinion confirming that there has been a change in current U.S. federal tax law or an IRS ruling that allows us to make the above deposit without causing you to be taxed on the Notes any differently than if we did not make the deposit;

we must deliver to the trustee a legal opinion of our counsel stating that the above deposit does not require registration by us under the 1940 Act, and a legal opinion and officers certificate stating that all conditions precedent to defeasance have been complied with;

S-41

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## TABLE OF CONTENTS

defeasance must not result in a breach or violation of, or constitute a default under, of the indenture or any of our other material agreements or instruments; and

no default or event of default with respect to the Notes shall have occurred and be continuing and no defaults or events of default related to bankruptcy, insolvency or reorganization shall occur during the next 90 days.

If we ever did accomplish full defeasance, as described above, you would have to rely solely on the trust deposit for repayment of the Notes. You could not look to us for repayment in the unlikely event of any shortfall. Conversely, the trust deposit would most likely be protected from claims of our lenders and other creditors if we ever became bankrupt or insolvent. If your Notes were subordinated as described later under Indenture Provisions Ranking, such subordination would not prevent the trustee under the Indenture from applying the funds available to it from the deposit referred to in the first bullet of the preceding paragraph to the payment of amounts due in respect of such Notes for the benefit of the subordinated debtholders.

## **Other Covenants**

In addition to any other covenants described in this prospectus, as well as standard covenants relating to payment of principal and interest, maintaining an office where payments may be made or securities can be surrendered for payment, payment of taxes by the Company and related matters, the following covenants will apply to the Notes:

We agree that for the period of time during which the Notes are outstanding, we will not violate Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act or any successor provisions, whether or not we continue to be subject to such provisions of the 1940 Act, but giving effect, in either case, to any exemptive relief granted to us by the SEC. Currently, these provisions generally prohibit us from making additional borrowings, including through the issuance of additional debt or the sale of additional debt securities, unless our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowings. See Risk Factors Risks Relating to our Business and Structure Pending legislation may allow us to incur additional leverage in the accompanying prospectus.

We agree that for the period of time during which the Notes are outstanding, we will not violate Section 18(a)(1)(B) as modified by (i) Section 61(a)(1) of the 1940 Act or any successor provisions and (ii) the exception set forth below, despite the fact that we are not currently subject to such provisions of the 1940 Act and will not be subject to such provisions as a result of this offering, except that we will be permitted to declare a cash dividend or distribution notwithstanding the prohibition contained in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act, but only up to such amount as is necessary in order for us to maintain our status as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986 and, provided that, any such prohibition will not apply until such time as our asset coverage has been below the minimum asset coverage required pursuant to clause (i) above for more than six consecutive months. If Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act were currently applicable to us in connection with this offering, these provisions would generally prohibit us from declaring any cash dividend or distribution upon any class of our capital stock, or purchasing any such capital stock if our asset coverage, as defined in the 1940 Act, were below 200% at the time of the declaration of the dividend or distribution or the purchase and after deducting the amount of such dividend, distribution or purchase.

If, at any time, we are not subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, or the Exchange Act, to file any periodic reports with the SEC, we agree to furnish to holders of the Notes and the Trustee, for the period of time during which the Notes are outstanding, our audited annual consolidated financial statements, within 90 days of our fiscal year end, and unaudited interim consolidated financial statements, within 45 days of our fiscal quarter end (other than our fourth fiscal quarter). All such financial statements will be prepared, in all material respects, in accordance with applicable United States generally accepted accounting principles.

S-42



TABLE OF CONTENTS

## **Form, Exchange and Transfer of Certificated Registered Securities**

If registered Notes cease to be issued in book-entry form, they will be issued:

only in fully registered certificated form;  
without interest coupons; and

unless we indicate otherwise, in denominations of \$25 and amounts that are multiples of \$25.

Holders may exchange their certificated securities for Notes of smaller denominations or combined into fewer Notes of larger denominations, as long as the total principal amount is not changed and as long as the denomination is equal to or greater than \$25.

Holders may exchange or transfer their certificated securities at the office of the trustee. We have appointed the trustee to act as our agent for registering Notes in the names of holders transferring Notes. We may appoint another entity to perform these functions or perform them ourselves.

Holders will not be required to pay a service charge to transfer or exchange their certificated securities, but they may be required to pay any tax or other governmental charge associated with the transfer or exchange. The transfer or exchange will be made only if our transfer agent is satisfied with the holder's proof of legal ownership.

We may appoint additional transfer agents or cancel the appointment of any particular transfer agent. We may also approve a change in the office through which any transfer agent acts.

If any certificated securities of a particular series are redeemable and we redeem less than all the debt securities of that series, we may block the transfer or exchange of those debt securities during the period beginning 15 days before the day we mail the notice of redemption and ending on the day of that mailing, in order to freeze the list of holders to prepare the mailing. We may also refuse to register transfers or exchanges of any certificated securities selected for redemption, except that we will continue to permit transfers and exchanges of the unredeemed portion of any debt security that will be partially redeemed.

If a registered debt security is issued in book-entry form, only the depositary will be entitled to transfer and exchange the debt security as described in this subsection, since it will be the sole holder of the debt security.

## **Resignation of Trustee**

The trustee may resign or be removed with respect to the Notes provided that a successor trustee is appointed to act with respect to the Notes. In the event that two or more persons are acting as trustee with respect to different series of indenture securities under the indenture, each of the trustees will be a trustee of a trust separate and apart from the trust administered by any other trustee.

## **Indenture Provisions    Ranking**

The Notes will be designated as Senior Securities and, therefore, Senior Indebtedness under the indenture. Senior Indebtedness is defined in the indenture as the principal of (and premium, if any) and unpaid interest on:

our indebtedness (including indebtedness of others guaranteed by us), whenever created, incurred, assumed or guaranteed, for money borrowed, that we have designated as Senior Indebtedness for purposes of the indenture and in accordance with the terms of the indenture (including any indenture securities designated as Senior Indebtedness), and renewals, extensions, modifications and refinancings of any of this indebtedness.

As unsecured obligations of the Company designated as Senior Indebtedness under the indenture, the Notes will rank

*pari passu*, or equal, with our future senior unsecured indebtedness;  
senior to any of our future indebtedness that expressly provides it is subordinated to the Notes;

S-43

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## TABLE OF CONTENTS

effectively subordinated to all of our existing and future secured indebtedness (including indebtedness that is initially unsecured to which we subsequently grant security), to the extent of the value of the assets securing such indebtedness, including without limitation, borrowings under our \$135.0 million senior secured revolving credit facility, or the Credit Facility, of which \$123.0 million was outstanding as of April 25, 2014; and

structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries. In particular, as designated Senior Indebtedness under the indenture, the Notes will rank senior to any future securities we issue under the indenture that are designated as subordinated debt securities. Any such indenture securities designated as subordinated debt securities will be subordinated in right of payment of the principal of (and premium if any) and interest, if any, on such subordinated debt securities to the prior payment in full of the Notes, and all other Senior Indebtedness under the indenture, upon any distribution of our assets upon our dissolution, winding up, liquidation or reorganization. In addition, no payment on account of principal (or premium, if any), sinking fund or interest, if any, may be made on such subordinated debt securities at any time unless full payment of all amounts due in respect of the principal (and premium, if any), sinking fund and interest on the Notes, and all other Senior Indebtedness, has been made or duly provided for in money or money's worth.

In the event that, notwithstanding the foregoing, any payment by us is received by the trustee in respect of subordinated debt securities or by the holders of any of such subordinated debt securities, upon our dissolution, winding up, liquidation or reorganization before the Notes, and all other Senior Indebtedness, are paid in full, the payment or distribution must be paid over to the holders of our Senior Indebtedness, including the Notes, or on their behalf for application to the payment of all Senior Indebtedness, including the Notes, remaining unpaid until all Senior Indebtedness, including the Notes, have been paid in full, after giving effect to any concurrent payment or distribution to the holders of our Senior Indebtedness, including the Notes. Subject to the payment in full of the all Senior Indebtedness, including the Notes, upon this distribution by us, the holders of such subordinated debt securities will be subrogated to the rights of the holders of our Senior Indebtedness, including the Notes, to the extent of payments made to the holders of our Senior Indebtedness, including the Notes, out of the distributive share of such subordinated debt securities.

By reason of this subordination, in the event of a distribution of our assets upon our insolvency, our Senior Indebtedness, including the Notes, and certain of our senior creditors, may recover more, ratably, than holders of any subordinated debt securities or the holders of any indenture securities that are not Senior Indebtedness. The indenture provides that these subordination provisions will not apply to money and securities held in trust under the defeasance provisions of the indenture.

## **Book-Entry Procedures**

The Notes will be represented by global securities that will be deposited and registered in the name of The Depository Trust Company ( DTC ) or its nominee. This means that, except in limited circumstances, you will not receive certificates for the Notes. Beneficial interests in the Notes will be represented through book-entry accounts of financial institutions acting on behalf of beneficial owners as direct and indirect participants in DTC. Investors may elect to hold interests in the Notes through either DTC, if they are a participant, or indirectly through organizations that are participants in DTC.

The Notes will be issued as fully registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered certificate will be issued for each issuance of the Notes, in the aggregate principal amount of such issue, and will be deposited with DTC. Interests in the Notes will trade in DTC's Same Day Funds Settlement System, and any permitted secondary market trading activity in such Notes will, therefore, be required by DTC to be settled in immediately

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available funds. None of the Company, the Trustee or the Paying Agent will have any responsibility for the performance by DTC or its participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

DTC is a limited-purpose trust company organized under the New York Banking Law, a banking organization within the meaning of the New York Banking Law, a member of the Federal Reserve System, a

S-44

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TABLE OF CONTENTS

clearing corporation within the meaning of the New York Uniform Commercial Code, and a clearing agency registered pursuant to the provisions of Section 17A of the Exchange Act. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ( Direct Participants ) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly owned subsidiary of The Depository Trust & Clearing Corporation ( DTCC ).

DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ( Indirect Participants ). DTC has Standard & Poor's Ratings Services' highest rating: AAA. The DTC Rules applicable to its participants are on file with the SEC. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of the Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Notes on DTC's records. The ownership interest of each actual purchaser of each security, or the Beneficial Owner, is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Notes are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Notes, except in the event that use of the book-entry system for the Notes is discontinued.

To facilitate subsequent transfers, all Notes deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of the Notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not affect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts the Notes are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Notes within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Redemption proceeds, distributions, and interest payments on the Notes will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from us or the Trustee on the payment date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts

of customers in bearer form or registered in street name, and will be the responsibility of such Participant and not of DTC nor its nominee, the Trustee, or us, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and interest payments to Cede & Co. (or such other nominee as may be requested by

S-45

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TABLE OF CONTENTS

an authorized representative of DTC) is the responsibility of us or the Trustee, but disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Notes at any time by giving reasonable notice to us or to the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, certificates are required to be printed and delivered. We may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, certificates will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that we believe to be reliable, but we take no responsibility for the accuracy thereof.

S-46

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TABLE OF CONTENTS

## **CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS**

The following summary describes generally certain U.S. federal income tax considerations (and, in the case of a non-U.S. holder (as defined below), certain U.S. federal estate tax consequences) applicable to an investment in the Notes. This summary does not purport to be a complete description of the income tax considerations applicable to such an investment. The summary is based upon the Internal Revenue Code of 1986, as amended (the Code), U.S. Treasury Regulations, and administrative and judicial interpretations, each as of the date of this prospectus supplement and all of which are subject to change, potentially with retroactive effect, or to different interpretations. Investors should consult their own tax advisors with respect to tax considerations that pertain to their investment in the Notes.

This summary discusses only Notes held as capital assets within the meaning of Section 1221 of the Code (generally, property held for investment purposes) and does not purport to address persons in special tax situations, such as financial institutions, insurance companies, controlled foreign corporations, passive foreign investment companies and regulated investment companies (and shareholders of such corporations), dealers in securities or currencies, traders in securities, former citizens of the United States, persons holding the Notes as a hedge against currency risks or as a position in a straddle, hedge, constructive sale transaction or conversion transaction for U.S. federal income tax purposes, entities that are tax-exempt for U.S. federal income tax purposes, retirement plans, individual retirement accounts, tax-deferred accounts, persons subject to the alternative minimum tax, pass-through entities (including partnerships and entities and arrangements classified as partnerships for U.S. federal income tax purposes) and beneficial owners of pass-through entities, or persons whose functional currency is not the U.S. dollar (as defined in Section 985 of the Code). It also does not address beneficial owners of the Notes other than original purchasers of the Notes who acquire the Notes in this offering for a price equal to their original issue price (i.e., the first price at which a substantial amount of the Notes are sold other than to bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers).

For purposes of this discussion, the term U.S. holder means a beneficial owner of a Note that is, for U.S. federal income tax purposes:

an individual who, for U.S. federal income tax purposes, is a citizen or resident of the United States;  
a corporation or other entity treated as a corporation for U.S. federal income tax purposes, created or organized in or under the laws of the United States, any state thereof, or the District of Columbia;  
a trust (a) subject to the control of one or more U.S. persons and the primary supervision of a court in the United States, or (b) that existed on August 20, 1996 and has made a valid election (under applicable U.S. Treasury Regulations) to be treated as a domestic trust;

an estate the income of which is subject to U.S. federal income taxation regardless of its source.

The term non-U.S. holder means a beneficial owner of a Note that is neither a U.S. holder nor a partnership (including an entity or arrangement treated as a partnership for U.S. federal income tax purposes). An individual may, subject to exceptions, be deemed to be a resident alien, as opposed to a non-resident alien, by, among other ways, being present in the United States (i) on at least 31 days in the calendar year, and (ii) for an aggregate of at least 183 days during a three-year period ending in the current calendar year, counting for such purposes all of the days present in the current year, one-third of the days present in the immediately preceding year, and one-sixth of the days present in the second preceding year. Resident aliens are subject to U.S. federal income tax as if they were United States citizens.

If a partnership (including an entity or arrangement treated as a partnership for U.S. federal income tax purposes) holds any Notes, the U.S. federal income tax treatment of a partner of the partnership generally will depend upon the

status of the partner, the activities of the partnership and certain determinations made at the partner level. Partnerships holding Notes, and persons holding interests in such partnerships, should each consult their own tax advisors as to the consequences of investing in the Notes in their individual circumstances.

S-47

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## TABLE OF CONTENTS

Investors considering purchasing the Notes should consult their own tax advisors concerning the application of the U.S. federal income tax laws to their individual circumstances, as well as any consequences to such investors relating to purchasing, owning and disposing of the Notes under the laws of any other taxing jurisdiction.

### **Taxation of Note Holders**

#### **Taxation of U.S. Holders.**

#### **Payments of Interest**

Payments or accruals of interest on a Note generally will be taxable to a U.S. holder as ordinary interest income at the time they are received (actually or constructively) or accrued, in accordance with the U.S. holder's regular method of tax accounting.

#### **Sale, Exchange, Redemption or Other Taxable Disposition of a Note**

Upon the sale, exchange, redemption or other taxable disposition of a Note, a U.S. holder generally will recognize capital gain or loss equal to the difference between the amount realized on the sale, exchange, redemption or other taxable disposition (excluding amounts representing accrued and unpaid interest, which are treated as ordinary income to the extent not previously included in income) and the U.S. holder's tax basis in the Note. A U.S. holder's tax basis in a Note generally will equal the U.S. holder's initial investment in the Note. Capital gain or loss generally will be long-term capital gain or loss if the U.S. holder's holding period in the Note was more than one year. Long-term capital gains generally are taxed at reduced rates for individuals and certain other non-corporate U.S. holders. The deductibility of capital losses is subject to limitations.

#### **Unearned Income Medicare Contribution**

A tax of 3.8% will be imposed on certain net investment income (or undistributed net investment income, in the case of estates and trusts) received by certain taxpayers with adjusted gross income above certain threshold amounts. Net investment income as defined for U.S. federal Medicare contribution purposes generally includes interest payments and gain recognized from the sale or other disposition of the Notes. Tax-exempt trusts, which are not subject to income taxes generally, and foreign individuals will not be subject to this tax. U.S. holders should consult their own tax advisors regarding the effect, if any, of this tax on their ownership and disposition of the Notes.

#### **Information Reporting and Backup Withholding**

In general, a U.S. holder that is not an exempt recipient will be subject to U.S. federal backup withholding tax at the applicable rate (currently 28%) with respect to payments on the Notes and the proceeds of a sale, exchange, redemption or other taxable disposition of the Notes, unless the U.S. holder provides its taxpayer identification number to the paying agent and certifies, under penalty of perjury, that it is not subject to backup withholding on an IRS Form W-9 (Request for Taxpayer Identification Number and Certification) or a suitable substitute form (or other applicable certificate) and otherwise complies with the applicable requirements of the backup withholding rules. Backup withholding is not an additional tax. The amount of any backup withholding from a payment to a U.S. holder

may be allowed as a credit against such U.S. holder's U.S. federal income tax liability and may entitle such U.S. holder to a refund, provided the required information is furnished to the IRS in a timely manner. In addition, payments on the Notes made to, and the proceeds of a sale, exchange, redemption or other taxable disposition by, a U.S. holder generally will be subject to information reporting requirements, unless such U.S. holder is an exempt recipient and appropriately establishes that exemption.

S-48

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TABLE OF CONTENTS

**Taxation of Non-U.S. Holders.**

**Payments of Interest**

Subject to the discussion below under Information Reporting and Backup Withholding, a non-U.S. holder generally will not be subject to U.S. federal income or withholding tax on interest paid on the Notes as long as that interest is not effectively connected with the non-U.S. holder's conduct of a trade or business within the United States and:

the non-U.S. holder does not, directly or indirectly, actually or constructively own 10% or more of the total combined voting power of all classes of our stock entitled to vote;

the non-U.S. holder is not a controlled foreign corporation for U.S. federal income tax purposes that is related to us, actually or by attribution, through stock ownership;

the non-U.S. holder is not a bank receiving the interest pursuant to a loan agreement entered into in the ordinary course of the non-U.S. holder's trade or business; and

either (i) the non-U.S. holder certifies under penalties of perjury on IRS Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)) or IRS Form W-8BEN-E (Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)), as applicable, or a suitable substitute form (or other applicable certificate) that it is not a U.S. person, and provides its name, address and certain other required information or (ii) a securities clearing organization, bank or other financial institution that holds customers' securities in the ordinary course of its trade or business and holds the Notes on behalf of the non-U.S. holder, certifies under penalties of perjury that the certification referred to in clause (i) has been received from the non-U.S. holder or an intermediate financial institution and furnishes to us a copy thereof.

A non-U.S. holder that does not qualify for exemption from withholding as described above generally will be subject to withholding of U.S. federal income tax at a rate of 30% on payments of interest on the Notes (except as described below with respect to effectively connected income). A non-U.S. holder may be entitled to the benefits of an income tax treaty under which interest on the Notes is subject to a reduced rate of withholding tax or is exempt from U.S. withholding tax, provided the non-U.S. holder furnishes us with a properly executed IRS Form W-8BEN or IRS Form W-8BEN-E, as applicable, or a suitable substitute form (or other applicable certificate) claiming the reduction or exemption and the non-U.S. holder complies with any other applicable procedures.

**Sale, Exchange, Redemption or Other Taxable Disposition of a Note**

Generally, a non-U.S. holder will not be subject to U.S. federal income or withholding taxes on any amount that constitutes capital gain upon the sale, exchange, redemption or other taxable disposition of a Note, provided that:

the gain is not effectively connected with the conduct of a trade or business in the United States by the non-U.S. holder (and, if required by an applicable income tax treaty, is not attributable to a U.S. permanent establishment maintained by the non-U.S. holder); and

the non-U.S. holder is not an individual who is present in the U.S. for 183 days or more in the taxable year of the sale, exchange, or other taxable disposition and meets certain other conditions (unless such holder is eligible for relief under an applicable income tax treaty).

Certain other exceptions may be applicable, and non-U.S. holders should consult their own tax advisors with regard to whether taxes will be imposed on capital gain in their individual circumstances.

## **Effectively Connect Income**

If interest or gain recognized by a non-U.S. holder on a note is effectively connected with the non-U.S. holder's conduct of a trade or business within the United States (and, if a treaty applies, is attributable to a permanent establishment maintained by the non-U.S. holder in the United States), the non-U.S. holder will be exempt from the withholding tax on interest previously discussed if the non-U.S.

S-49

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## TABLE OF CONTENTS

holder provides us with a properly completed and executed IRS Form W-8ECI (Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States) or a suitable substitute or successor form or such other form as the IRS may prescribe, but the Non-U.S. Holder generally will be subject to U.S. federal income tax on such interest or gain as if it were a United States person (as defined in the Code). In addition to such U.S. federal income tax, if the non-U.S. holder is treated as a corporation for U.S. federal income tax purposes, such income may be subject to an additional branch profits tax (which is generally imposed on a non-U.S. corporation on the actual or deemed repatriation from the United States of earnings and profits attributable to a United States trade or business) at a 30% rate, or such lower rate provided by an applicable income tax treaty.

## **Information Reporting and Backup Withholding**

Under current U.S. Treasury regulations, we must report annually to the IRS and to each non-U.S. holder the amount of interest paid to the non-U.S. holder and the amount of tax withheld, if any, from those payments. These reporting requirements apply regardless of whether U.S. withholding tax on such payments was reduced or eliminated by any applicable tax treaty or otherwise. Copies of the information returns reporting those payments and the amounts withheld may also be made available to the tax authorities in the country where a non-U.S. holder is a resident under the provisions of an applicable income tax treaty or agreement.

Under some circumstances, U.S. Treasury regulations require backup withholding and additional information reporting on payments of interest and other reportable payments. Such backup withholding and additional information reporting will not apply to payments on the Notes made by us or our paying agent to a non-U.S. holder if the certification described above under Payments of Interest is received from the non-U.S. holder.

Backup withholding and information reporting generally will not apply to payments of proceeds from the sale, exchange, redemption or other taxable disposition of a Note made to a non-U.S. holder by or through the foreign office of a broker. However, information reporting requirements, and possibly backup withholding, will apply if such broker is, for U.S. federal income tax purposes, a United States person (as defined in the Code) or has certain other enumerated connections with the United States, unless such broker has documentary evidence in its records that the non-U.S. holder is not a U.S. person (as defined in the Code) and certain other conditions are met, or the non-U.S. holder otherwise establishes an exemption. Payments of proceeds from the sale, exchange, redemption or other taxable disposition of a Note made to a non-U.S. holder by or through the U.S. office of a broker are subject to information reporting and backup withholding at the applicable rate unless the non-U.S. holder certifies, under penalties of perjury, that it is not a United States person (as defined in the Code) and it satisfies certain other conditions, or the non-U.S. holder otherwise establishes an exemption. Backup withholding is not an additional tax. The amount of any backup withholding from a payment to a non-U.S. holder may be allowed as a credit against such non-U.S. holder's U.S. federal income tax liability and may entitle such non-U.S. holder to a refund, provided the required information is furnished to the IRS in a timely manner.

Non-U.S. holders are urged to consult their tax advisors regarding the application of information reporting and backup withholding in their particular situations, the availability of an exemption therefrom, and the procedures for obtaining such an exemption, if available.

## **Estate Tax**

A Note that is held by an individual who, at the time of death, is not a citizen or resident of the United States (as specially defined for U.S. federal estate tax purposes) generally will not be subject to the U.S. federal estate tax, unless, at the time of death, (i) such individual directly or indirectly, actually or constructively, owns ten percent or

more of the total combined voting power of all classes of our stock entitled to vote within the meaning of Section 871(h)(3) of the Code and the Treasury Regulations thereunder or (ii) such individual's interest in the Notes is effectively connected with the individual's conduct of a U.S. trade or business.

S-50

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TABLE OF CONTENTS

## Foreign Account Tax Compliance Act

Sections 1471 through 1474 of the Code ( FATCA ) generally impose a U.S. federal withholding tax of 30% on payments of interest or gross proceeds from the disposition of a debt instrument paid after December 31, 2012 to certain non-U.S. entities, including certain foreign financial institutions and investment funds, unless such non-U.S. entity complies with certain reporting requirements regarding its U.S. account holders and its U.S. owners. Pursuant to U.S. Treasury regulations and other Treasury guidance, these rules do not apply to payments on, or with respect to, obligations that are outstanding on July 1, 2014, unless such obligations are significantly modified (and thus are treated as being reissued for U.S. federal income tax purposes) after such date and, accordingly, these rules do not apply to the Notes.

Non-U.S. holders should consult their own tax advisors regarding FATCA and whether it may be relevant to their acquisition, ownership and disposition of the Notes.

*Investors should consult their own tax advisors with respect to the particular tax consequences of an investment in the Notes in their individual circumstances, including the possible effect of any pending legislation or proposed regulations.*

## Taxation as a Regulated Investment Company

For any taxable year in which we:

qualify as a RIC; and

satisfy the Annual Distribution Requirement,

we generally will not be subject to U.S. federal income tax on the portion of our income we distribute (or are deemed to distribute) to stockholders. We will be subject to U.S. federal income tax at the regular corporate rates on any income or capital gains not distributed (or deemed distributed) to our stockholders.

We will be subject to a 4% nondeductible U.S. federal excise tax on certain undistributed income unless we distribute in a timely manner an amount at least equal to the sum of (1) 98% of our net ordinary income for each calendar year, (2) 98.2% of our capital gain net income for the one-year period ending October 31 in that calendar year and (3) any income recognized, but not distributed, in preceding years and on which we paid no corporate-level U.S. federal income tax (the Excise Tax Avoidance Requirement ). We generally will endeavor in each taxable year to make sufficient distributions to our stockholders to avoid any U.S. federal excise tax on our earnings.

In order to qualify as a RIC for U.S. federal income tax purposes, we must, among other things:

continue to qualify as a BDC under the 1940 Act at all times during each taxable year;

derive in each taxable year at least 90% of our gross income from dividends, interest, payments with respect to loans of certain securities, gains from the sale of stock or other securities, net income from certain qualified publicly traded partnerships, or other income derived with respect to our business of investing in such stock or securities (the 90% Income Test ); and

diversify our holdings so that at the end of each quarter of the taxable year:

at least 50% of the value of our assets consists of cash, cash equivalents, U.S. Government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer; and

no more than 25% of the value of our assets is invested in the securities, other than U.S. government securities or securities of other RICs, of one issuer, of two or more issuers that are controlled, as determined under applicable Code rules, by us and that are engaged in the same or similar or related trades or businesses or of certain qualified publicly traded partnerships (the Diversification Tests ).

We may be required to recognize taxable income in circumstances in which we do not receive cash. For example, if we hold debt obligations that are treated under applicable tax rules as having original issue

S-51

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## TABLE OF CONTENTS

discount (such as debt instruments with PIK interest or, in certain cases, increasing interest rates or issued with warrants), we must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by us in the same taxable year. We may also have to include in income other amounts that we have not yet received in cash, such as PIK interest, deferred loan origination fees that are paid after origination of the loan or are paid in non-cash compensation such as warrants or stock, or certain income with respect to equity investments in foreign corporations. Because any original issue discount or other amounts accrued will be included in our investment company taxable income for the year of accrual, we may be required to make a distribution to our stockholders in order to satisfy the Annual Distribution Requirement, even though we will not have received any corresponding cash amount.

Gain or loss realized by us from the sale or exchange of warrants acquired by us as well as any loss attributable to the lapse of such warrants generally will be treated as capital gain or loss. Such gain or loss generally will be long-term or short-term, depending on how long we held a particular warrant.

Although we do not presently expect to do so, we are authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, we are not permitted to make distributions to our stockholders while our debt obligations and other senior securities are outstanding unless certain asset coverage tests are met. Moreover, our ability to dispose of assets to meet our distribution requirements may be limited by (1) the illiquid nature of our portfolio and/or (2) other requirements relating to our status as a RIC, including the Diversification Tests. If we dispose of assets in order to meet the Annual Distribution Requirement or the Excise Tax Avoidance Requirement, we may make such dispositions at times that, from an investment standpoint, are not advantageous. If we are prohibited from making distributions or are unable to obtain cash from other sources to make the distributions, we may fail to qualify as a RIC, which would result in us becoming subject to corporate-level U.S. federal income tax.

In addition, we will be partially dependent on our SBIC subsidiaries for cash distributions to enable us to meet the RIC distribution requirements. Our SBIC subsidiaries may be limited by the Small Business Investment Act of 1958, and SBA regulations governing SBICs, from making certain distributions to us that may be necessary to maintain our status as a RIC. We may have to request a waiver of the SBA's restrictions for our SBIC subsidiaries to make certain distributions to maintain our RIC status. We cannot assure you that the SBA will grant such waiver. If our SBIC subsidiaries are unable to obtain a waiver, compliance with the SBA regulations may cause us to fail to qualify as a RIC, which would result in us becoming subject to corporate-level U.S. federal income tax.

## **Failure to Qualify as a Regulated Investment Company**

If we fail to satisfy the 90% Income Test or the Diversification Tests for any taxable year, we may nevertheless continue to qualify as a RIC for such year if certain relief provisions are applicable (which may, among other things, require us to pay certain corporate-level U.S. federal income taxes or to dispose of certain assets).

If we were unable to qualify for treatment as a RIC and the foregoing relief provisions are not applicable, distributions to our stockholders would not be required, and we would be subject to tax on all of our taxable income at regular corporate rates, regardless of whether we make any distributions to our stockholders. To requalify as a RIC in a subsequent taxable year, we would be required to satisfy the RIC qualification requirements for that year and dispose of any earnings and profits from any year in which we failed to qualify as a RIC. Subject to a limited exception applicable to RICs that qualified as such under the Code for at least one year prior to disqualification and that requalify as a RIC no later than the second year following the nonqualifying year, we could be subject to tax on any unrealized net built-in gains in the assets held by us during the period in which we failed to qualify as a RIC that are

recognized within the subsequent 10 years (five years for taxable years beginning prior to December 31, 2013), unless we made a special election to pay corporate-level tax on such built-in gain at the time of our requalification as a RIC.

S-52

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page of this prospectus supplement and some of the Notes to certain other Financial Industry Regulatory Authority members at the public offering price less a concession not in excess of % of the aggregate principal amount of the Notes. The underwriters may allow, and the dealers may reallocate, a discount not in excess of % of the aggregate principal amount of the Notes. After the initial offering of the Notes to the public, the public offering price and such concessions may be changed. No such change shall change the amount of proceeds to be received by us as set forth on the cover page of this prospectus supplement.

The expenses of the offering, not including the underwriting discount, are estimated at \$250,000 and are payable by us.

S-53

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Any of these activities may cause the price of the Notes to be higher than the price that otherwise would exist in the open market in the absence of such transactions. These transactions may be affected in the over-the-counter market or otherwise and, if commenced, may be discontinued at any time without any notice relating thereto.

## **Electronic Offer, Sale and Distribution of Notes**

A prospectus in electronic format may be made available on the Internet sites or through other online services maintained by one or more of the underwriters and/or selling group members participating in this offering, or by their affiliates. In those cases, prospective investors may view offering terms online and, depending upon the particular underwriter or selling group member, prospective investors may be allowed to place orders online. The underwriters may agree with us to allocate a limited principal amount of the Notes for sale to online brokerage account holders. Any such allocation for online distributions will be made by the underwriters on the same basis as other allocations.

S-54

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## Other Jurisdictions

The Notes offered by this prospectus supplement may not be offered or sold, directly or indirectly, nor may this prospectus supplement or any other offering material or advertisements in connection with the offer and sale of any such Notes be distributed or published in any jurisdiction, except under circumstances that will result in compliance with the applicable rules and regulations of that jurisdiction. Persons into whose possession this prospectus supplement comes are advised to inform themselves about and to observe any restriction relating to the offering and the distribution of this prospectus supplement. This prospectus supplement and the accompanying prospectus do not constitute an offer to sell or a solicitation of an offer to

S-55

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TABLE OF CONTENTS

buy the Notes offered by this prospectus supplement and the accompanying prospectus in any jurisdiction in which such an offer or a solicitation is unlawful.

## **CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR**

Our securities are held by State Street Bank and Trust Company pursuant to a custody agreement. State Street Bank and Trust Company will also serve as our transfer agent, distribution paying agent and registrar. The principal business address of State Street Bank and Trust Company is 225 Franklin Street, Boston, Massachusetts 02110. U.S. Bank National Association, our trustee under an indenture and the first supplemental indenture thereto relating to the Notes, is the paying agent, registrar and transfer agent relating to the Notes. The corporate trust office address of our trustee is One Federal Street, 10th Floor, Boston, Massachusetts 02110, unless otherwise specified in the indenture.

## **LEGAL MATTERS**

Certain legal matters in connection with this offering will be passed upon for us by Sutherland Asbill & Brennan LLP, Washington, DC 20001. Certain legal matters in connection with the offering will be passed upon for the underwriters by Fried, Frank, Harris, Shriver & Jacobson LLP, New York, New York.

## **INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The financial statements and financial highlights of Stellus Capital Investment Corporation included in this prospectus supplement and the accompanying prospectus and elsewhere in the registration statement have been so included in reliance upon the report of Grant Thornton LLP, independent registered public accountants, upon the authority of said firm as experts in giving said reports. Information about our senior securities is shown in the senior securities table for the fiscal year ended December 31, 2012 included in this prospectus supplement have been so included in reliance upon the report of Grant Thornton LLP, upon the authority of said firm as experts in giving said reports. Grant Thornton LLP's principal business address is 175 W. Jackson Blvd., 20th Floor, Chicago, Illinois, 60604.

## **AVAILABLE INFORMATION**

We have filed with the SEC a registration statement on Form N-2, together with all amendments and related exhibits, under the Securities Act of 1933, as amended, with respect to the Notes offered by this prospectus supplement. The registration statement contains additional information about us and the Notes being offered by this prospectus supplement.

We also file with or submit to the SEC annual, quarterly and current reports, proxy statements and other information meeting the informational requirements of the Exchange Act. You may inspect and copy these reports, proxy statements and other information, as well as the registration statement and related exhibits and schedules, at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549-0102. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090.

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We maintain a website at [www.stelluscapital.com](http://www.stelluscapital.com) and make all of our annual, quarterly and current reports, proxy statements and other publicly filed information available, free of charge, on or through our website. Information contained on our website is not incorporated into this prospectus supplement or the accompanying prospectus, and you should not consider information on our website to be part of this prospectus supplement or the accompanying prospectus. You may also obtain such information by contacting us in writing at 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027, Attention: Investor Relations. The SEC maintains a website that contains reports, proxy and information statements and other information we file with the SEC at [www.sec.gov](http://www.sec.gov). Copies of these reports, proxy and information statements and other information may also be obtained, after paying a duplicating fee, by electronic request at the following e-mail address: [publicinfo@sec.gov](mailto:publicinfo@sec.gov), or by writing the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-0102.

S-56

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TABLE OF CONTENTS

## Index to Financial Statements

|   |              |
|---|--------------|
| <u>Report of Independent Registered Public Accounting Firm</u>  | <u>SF-2</u>  |
| <u>Statements of Assets and Liabilities as of December 31, 2013 and December 31, 2012</u>   | <u>SF-3</u>  |
| <u>Statements of Operations for the year ended December 31, 2013 and the period from Inception through December 31, 2012</u>            | <u>SF-4</u>  |
| <u>Statements of Changes in Net Assets for the year ended December 31, 2013 and the period from Inception through December 31, 2012</u> | <u>SF-5</u>  |
| <u>Statements of Cash Flows for the year ended December 31, 2013 and the period from Inception through December 31, 2012</u>            | <u>SF-6</u>  |
| <u>Schedule of Investments as of December 31, 2013 and December 31, 2012</u>  | <u>SF-7</u>  |
| <u>Notes to the Financial Statements</u>  | <u>SF-12</u> |

SF-1

---

TABLE OF CONTENTS

**REPORT OF INDEPENDENT REGISTERED PUBLIC  
ACCOUNTING FIRM**

Board of Directors and Shareholders  
Stellus Capital Investment Corporation

We have audited the accompanying statements of assets and liabilities of Stellus Capital Investment Corporation (a Maryland corporation) (the Company), including the schedules of investments, as of December 31, 2013 and 2012, and the related statements of operations, changes in net assets, and cash flows for the year ended December 31, 2013 and the period from inception (May 18, 2012) to December 31, 2012 and the financial highlights for the year ended December 31, 2013 and the period from inception (May 18, 2012) to December 31, 2012. These financial statements and financial highlights are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our procedures included verification by confirmation of securities as of December 31, 2013 and 2012, by correspondence with the portfolio companies and custodians, or by other appropriate auditing procedures where replies were not received. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Stellus Capital Investment Corporation as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the year ended December 31, 2013 and the period from inception (May 18, 2012) to December 31, 2012 and the financial highlights for the year ended December 31, 2013 and the period from inception (May 18, 2012) to December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP  
Houston, Texas  
March 6, 2014

SF-2

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SF-3

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|--|--------------|--------------|
| Cash and cash equivalents balance at end of year/period              | \$13,663,542 | \$62,131,686 |
| Non-cash items   |              |              |
| Purchase of portfolio companies through the issuance of common stock | \$           | \$29,159,145 |
| Accrued deferred offering costs                                      |              | 147,123      |
| Shares issued pursuant to Dividend Reinvestment Plan                 | 899,964      | 112,948      |

*See notes to financial statements*

SF-6

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|---|--|-----------------|------------|------------|--------|
| 4/30/2019 <sup>(3)</sup>  | Subscription                             |                 |            |            |        |
| Common Shares, Series A <sup>(5)</sup>  |  | 5,000<br>shares | 50,000     | 50,000     | 0.03 % |
| Preferred Shares, Series A <sup>(5)</sup>                                     |  | 4,500<br>shares | 450,000    | 450,000    | 0.26 % |
| Total   |  |                 | 5,414,724  | 5,412,500  | 3.08 % |
| <u>Studer Group, LLC (The)</u> <sup>(10)</sup>                                | Gulf Breeze, FL                          |                 |            |            |        |
| Term Loan-Unsecured, 12.00%,<br>due<br>1/31/2019                              | Services: Business                       | \$16,910,423    | 16,910,423 | 16,910,423 | 9.61 % |
| <u>Telecommunications<br/>Management, LLC</u>                                 | Sikeston, MO                             |                 |            |            |        |
| Term Loan-Second Lien, L +<br>8.00%, LIBOR floor 1.00%,<br>due 10/30/2020     | Media: Broadcasting<br>&<br>Subscription | \$8,000,000     | 7,925,241  | 8,120,000  | 4.62 % |
| <u>Telular Corp.</u>  | Chicago, IL                              |                 |            |            |        |
| Term Loan-Second Lien, Euro<br>+ 8.00%,<br>Euro floor 1.25%, due<br>6/24/2020 | High Tech Industries                     | \$7,500,000     | 7,393,551  | 7,500,000  | 4.26 % |

SF-8

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of December 31, 2013

During the year ended December 31, 2013, there was one transfer from Level 3 to Level 2 due to the increase in the availability of significant observable inputs in determining the fair value of these investments.

Transfers are reflected at the value of the securities at the beginning of the period.

SF-21

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|                             |                |                |        |   |
|-----------------------------|----------------|----------------|--------|---|
| Retail                      | 10,176,677     | 10,176,677     | 3.67   | % |
| Consumer Goods: Non-Durable | 9,669,695      | 9,738,000      | 3.51   | % |
| Energy: Oil & Gas           | 9,538,738      | 9,700,000      | 3.49   | % |
| Metals & Mining             | 4,659,651      | 4,888,373      | 1.76   | % |
|                             | \$ 277,004,466 | \$ 277,504,510 | 100.00 | % |

SF-23

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|                                     |               |                                |                                       |           |
|-------------------------------------|---------------|--------------------------------|---------------------------------------|-----------|
|                                     |               |                                |                                       | (.15      |
| Equity investments                  | \$4,367,422   | Market approach <sup>(4)</sup> | Underwriting multiple/EBITDA Multiple | 5x to 13x |
| Total Long Term Level 3 Investments | \$244,315,566 |                                |                                       |           |

(1) Weighted average based on fair value as of December 31, 2013.

(2) Inclusive of but not limited to the income approach (by discounting future cash flows using an appropriate yield) and the market approach (by ensuring sufficient enterprise value).

The Company calculates the price of the loan by discounting future cash flows using an appropriate yield calculated as of the valuation date. This yield is calculated based on the loan's yield at the original investment and is adjusted as of the valuation date based on: changes in comparable credit spreads (per Barclay's high yield indexes), changes in risk free interest rates (per swap rates), and changes in credit quality (via an estimated shadow rating).

(3) Significant movements in any of these factors would result in a significantly lower (higher) fair value measurement. As an example, the Range (Average) for first lien debt instruments in the table above indicates that the change in the HY spreads between the date a loan closed and the valuation date ranged from -1.58% (158 basis points) to .46% (46 basis points). The average of all changes was -.95%.

SF-24

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changes in risk free interest rates (per swap rates), and changes in credit quality (via an estimated shadow rating). Significant movements in any of these factors would result in a significantly lower (higher) fair value measurement. As an example, the Range (Average) for first lien debt instruments in the table above indicates that the change in the HY spreads and the risk free rates between the date a loan closed and the valuation date ranged from -.22% (22 basis points) to .00% (0 basis points). The average of all changes was -.15%.

The primary significant unobservable input used in the fair value measurement of the Company's equity investments is the EBITDA multiple, or the Multiple. Significant increases (decreases) in the Multiple in isolation would result in a significantly higher (lower) fair value measurement. To determine the Multiple for the market (4) approach, the Company considers current market trading and/or transaction multiple, portfolio company performance (financial ratios) relative to public and private peer companies and leverage levels, among other factors. Changes in one or more of these factors can have a similar directional change on other factors in determining the appropriate Multiple to use in the market approach.

SF-25

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Portfolio Turnover<sup>(4)</sup> 41 % 35 %

- (1) Financial highlights are based on weighted average shares outstanding as of year/period ended.
- (2) Total return on market value is based on the change in market price per share since the end of the prior quarter and includes dividends paid. The total returns are not annualized.
- Financial highlights for periods of less than one year are annualized and the ratios of operating expenses to average
- (3) net assets, net investment income to average net assets and total return based on change in net asset value are adjusted accordingly.
- (4) Calculated as payoffs divided by average portfolio balance and is not annualized.
- (5) Total return on net asset value is based on the change in net asset value per share since the end of the prior year and includes dividends paid. The total returns are not annualized.

SF-27

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period of time such that the Company will not have to pay corporate-level U.S. federal income tax for the year ended December 31, 2013. We will be subject to a 4% nondeductible U.S. federal excise tax on our undistributed income to the extent we did not distribute an amount equal to at least 98% of our net ordinary income plus 98.2% of our capital gain net income attributable to the period. The Company has accrued approximately \$24,000 and \$0, in U.S. federal excise tax for the years ended December 31, 2013 and December 31, 2012, respectively.

Ordinary dividend distributions from a RIC do not qualify for the reduced maximum tax rate on qualified dividend income from domestic corporations, except to the extent that the RIC received the income in the

SF-29

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team are proven and experienced, with extensive capabilities in leveraged credit investing, having participated in these markets for the predominant portion of their careers. We believe that the experience and demonstrated ability of the Stellus Capital Management investment team to complete transactions enhances the quantity and quality of investment opportunities available to us.

***Established, Rigorous Investment and Monitoring Process.*** The Stellus Capital Management investment team has developed an extensive review and credit analysis process. Each investment that is

3

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Shaw group, pursuant to sub-advisory arrangements, with respect to a private investment fund and a strategy of a private multi-strategy investment fund (collectively with the D. E. Shaw group fund, the D. E. Shaw group funds ) to which the D. E. Shaw group serves as investment adviser that have an investment strategy similar to our investment strategy. Our investment policies, fee arrangements and other circumstances may vary from those of other investment funds, accounts or investment vehicles managed by Stellus Capital Management.

We have received exemptive relief from the SEC to co-invest with investment funds managed by Stellus Capital Management (other than the D. E. Shaw group funds, as defined below) where doing so is consistent



## Corporate Information

Our principal executive offices are located at 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027, and our telephone number is (713) 292-5400. We maintain a website located at [www.stelluscapital.com](http://www.stelluscapital.com).

5

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expense was \$1,581,808. This item is based on our assumption that our average borrowings and our interest costs for the remainder of 2013 will be similar to those for the nine months ended September 30, 2013. If, in the future, we issue any debt securities, interest payments on borrowed funds will include estimated annual interest payments for any debt securities we may issue. The amount of leverage that we employ at any particular time will depend on, among other things, our board of directors' assessment of market and other factors at the time of any proposed borrowing.







advisory agreement. We can offer no assurance, however, that Stellus Capital Management's investment professionals will continue to provide investment advice to us.

Stellus Capital Management's investment committee, which provides oversight over our investment activities, is provided to us by Stellus Capital Management under the investment advisory agreement. Stellus Capital Management's investment committee consists of three members of our board of directors, Messrs. Ladd, D'Angelo and Davis, and two investment professionals of Stellus Capital Management, Messrs. Overbergen and Huskinson. The loss of any member of Stellus Capital Management's investment committee would limit our ability to achieve our investment objective and operate our business. This could have a material adverse effect on our financial condition, results of operations and cash flows.



Stellus Capital Management, members of its investment committee or its other investment professionals may face conflicts of interest in connection with making business decisions for these portfolio companies to the extent that such decisions affect the debt and equity holders in these portfolio companies differently. In addition, Stellus Capital Management may face conflicts of interests in connection with making investment or other decisions, including granting loan waivers or concessions, on our behalf with respect to these portfolio companies given that they also provide investment advisory services to a private investment fund that holds the equity interests in these portfolio companies. Although our investment adviser will endeavor to handle these investment and other decisions in a fair and equitable manner, we and the holders of the shares of our common stock could be adversely affected by these decisions. Moreover, given the subjective nature of the investment and other decisions made by our investment adviser on our behalf, we



more speculative securities than would otherwise be the case, which could result in higher investment losses, particularly during economic downturns.

**We may be obligated to pay Stellus Capital Management incentive compensation even if we incur a loss and may pay more than 20.0% of our net capital gains because we cannot recover payments made in previous years.**

Stellus Capital Management is entitled to incentive compensation for each fiscal quarter in an amount equal to a percentage of the excess of our investment income for that quarter (before deducting incentive compensation) above a threshold return for that quarter and subject to a total return requirement. The general effect of this total return requirement is to prevent payment of the foregoing incentive compensation except to the extent 20.0% of the cumulative net increase in net assets resulting from operations over the then current











have considerably greater financial, technical and marketing resources than we do. For example, we believe some of our competitors may have access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company or the source-of-income, asset diversification and distribution requirements we must satisfy to maintain our RIC qualification. The competitive pressures we face may have a material adverse effect on our business, financial condition, results of operations and cash flows. As a result



inability on our part to access the capital markets successfully could limit our ability to grow our business and execute our business strategy fully and could decrease our earnings, if any, which would have an adverse effect on the value of our shares of common stock.

**You may not receive distributions, or our distributions may not grow over time.**

We intend to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution. We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. Our ability to pay





TABLE OF CONTENTS

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, or warrants, options or rights to acquire our common stock, at a price below then-current net asset value per share of our common stock if our board of directors determines that such sale is in our best interests, and if our stockholders approve such sale. On July 29, 2013, our stockholders voted to allow us to issue common stock at a price below net asset value per share for the period ending on the earlier of the one year anniversary of the date of the Company's 2013 Annual Meeting of Stockholders and the date of the Company's 2014 Annual Meeting of Stockholders, which is expected to be held in June 2014. Our stockholders did not specify a maximum discount below net asset value at which we are able to issue our common stock, although the number of shares sold in each offering may not exceed 25% of our outstanding common stock immediately prior to such sale. In addition, we cannot issue shares of our common stock below net asset value unless our board of directors determines that it would be in our and our stockholders' best interests to do so. Sales of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share. In addition, continuous sales of common stock below net asset value may have a negative impact on total returns and could have a negative impact on the market price of our shares of common stock. If we raise additional funds by issuing common stock, then the percentage ownership of our stockholders at that time will decrease, and you may experience dilution. See Risks Related to this Offering Stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock for a discussion of a proposal approved by our stockholders that permit us to issue shares of our common stock below net asset value.

**Because we finance our investments with borrowed money, the potential for gain or loss on amounts invested in us is magnified and may increase the risk of investing in us.**

The use of leverage magnifies the potential for gain or loss on amounts invested. The use of leverage is generally considered a speculative investment technique and increases the risks associated with investing in our securities. If we continue to use leverage to partially finance our investments through banks, insurance companies and other lenders, you will experience increased risks of investing in our common stock. Lenders of these funds have fixed dollar claims on our assets that are superior to the claims of our common stockholders, and we would expect such lenders to seek recovery against our assets in the event of a default. As of September 30, 2013, substantially all of our assets were pledged as collateral under the Credit Facility. In addition, under the terms of the Credit Facility and any borrowing facility or other debt instrument we may enter into, we are likely to be required to use the net proceeds of any investments that we sell to repay a portion of the amount borrowed under such facility or instrument before applying such net proceeds to any other uses. If the value of our assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged, thereby magnifying losses or eliminating our stake in a leveraged investment. Similarly, any decrease in our revenue or income will cause our net income to decline more sharply than it would have had we not borrowed. Such a decline would also negatively affect our ability to make distributions with respect to our common stock. Our ability to service any debt depends largely on our financial performance and is subject to prevailing economic conditions and competitive pressures. Moreover, as the base management fee payable to Stellus Capital Management is payable based on the value of our gross assets, including those assets acquired through the use of leverage, Stellus Capital Management will have a financial incentive to incur leverage, which may not be consistent with our stockholders' interests. In addition, our common stockholders bear the burden of any increase in our expenses as a result of our use of leverage, including interest expenses and any increase in the base management fee payable to Stellus Capital Management.

As a business development company, we generally are required to meet a coverage ratio of total assets to total borrowings and other senior securities, which include all of our borrowings and any preferred stock that we may issue

Because we finance our investments with borrowed money, the potential for gain or loss on amounts invested in us

in the future, of at least 200%. If this ratio declines below 200%, we will not be able to incur additional debt until we are able to comply with the 200% asset coverage ratio under the 1940 Act. This could have a material adverse effect on our operations, and we may not be able to make distributions. The amount of leverage that we employ will depend on Stellus Capital Management's and our board of directors' assessment of market and other factors at the time of any proposed borrowing. We cannot assure you that we will be able to obtain credit at all or on terms acceptable to us.

TABLE OF CONTENTS

*Illustration.* The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual results may be higher or lower than those appearing below.

**Assumed Return on Our Portfolio<sup>(1)</sup>  
(net of expenses)**

|  |         |        |        |       |        |
|--|---------|--------|--------|-------|--------|
|  | (10.0)% | (5.0)% | 0.0%   | 5.0%  | 10.0%  |
| Corresponding net return to common stockholder | (16.5)% | (9.1)% | (1.1)% | 6.8 % | 14.2 % |

(1) Assumes \$273.1 million in total assets, \$85.0 million in debt outstanding, \$176.1 million in net assets, and an average cost of funds of 3.8%. Actual interest payments may be different.

In addition, our debt facilities may impose financial and operating covenants that restrict our business activities, including limitations that hinder our ability to finance additional loans and investments or to make the distributions required to maintain our qualification as a RIC under the Code.

**We may default under the Credit Facility or any future borrowing facility we enter into or be unable to amend, repay or refinance any such facility on commercially reasonable terms, or at all, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.**

As of September 30, 2013, substantially all of our assets were pledged as collateral under the Credit Facility. In the event we default under the Credit Facility or any other future borrowing facility, our business could be adversely affected as we may be forced to sell all or a portion of our investments quickly and prematurely at what may be disadvantageous prices to us in order to meet our outstanding payment obligations and/or support working capital requirements under the Credit Facility or such future borrowing facility, any of which would have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, following any such default, the agent for the lenders under the Credit Facility or such future borrowing facility could assume control of the disposition of any or all of our assets, including the selection of such assets to be disposed and the timing of such disposition, which would have a material adverse effect on our business, financial condition, results of operations and cash flows.

**Substantially all of our assets are subject to security interests under the Credit Facility and if we default on our obligations under the Credit Facility we may suffer adverse consequences, including foreclosure on our assets.**

As of September 30, 2013, substantially all of our assets were pledged as collateral under the Credit Facility. If we default on our obligations under the Credit Facility, the lenders may have the right to foreclose upon and sell, or otherwise transfer, the collateral subject to their security interests or their superior claim. In such event, we may be forced to sell our investments to raise funds to repay our outstanding borrowings in order to avoid foreclosure and these forced sales may be at times and at prices we would not consider advantageous. Moreover, such deleveraging of our company could significantly impair our ability to effectively operate our business in the manner in which we have

historically operated. As a result, we could be forced to curtail or cease new investment activities and lower or eliminate the dividends that we have historically paid to our stockholders.

In addition, if the lenders exercise their right to sell the assets pledged under the Credit Facility, such sales may be completed at distressed sale prices, thereby diminishing or potentially eliminating the amount of cash available to us after repayment of the amounts outstanding under the Credit Facility.

**Because we use debt to finance our investments and may in the future issue senior securities including preferred stock and debt securities, if market interest rates were to increase, our cost of capital could increase, which could reduce our net investment income.**

Because we borrow money to make investments and may in the future issue senior securities including preferred stock and debt securities, our net investment income will depend, in part, upon the difference between the rate at which we borrow funds and the rate at which we invest those funds. As a result, we can offer no assurance that a significant change in market interest rates would not have a material adverse effect



restrictions on leverage which may affect the amount of funding that may be obtained. There may also be certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, a violation of which could limit further advances and, in some cases, result in an event of default. Furthermore, we expect that the terms of the Credit Facility will contain a covenant requiring us to maintain compliance with RIC provisions at all times, subject to certain remedial provisions. Thus, a failure to maintain compliance with RIC provisions

## TABLE OF CONTENTS

could result in an event of default under the Credit Facility. An event of default under the Credit Facility or any other borrowing facility could result in an accelerated maturity date for all amounts outstanding thereunder, which could have a material adverse effect on our business and financial condition. This could reduce our revenues and, by delaying any cash payment allowed to us under the Credit Facility or any other borrowing facility until the lenders have been paid in full, reduce our liquidity and cash flow and impair our ability to grow our business and maintain our qualification as a RIC.

### **We may in the future determine to fund a portion of our investments with preferred stock, which would magnify the potential for gain or loss and the risks of investing in us in the same way as our borrowings.**

Preferred stock, which is another form of leverage, has the same risks to our common stockholders as borrowings because the dividends on any preferred stock we issue must be cumulative. Payment of such dividends and repayment of the liquidation preference of such preferred stock must take preference over any dividends or other payments to our common stockholders, and preferred stockholders are not subject to any of our expenses or losses and are not entitled to participate in any income or appreciation in excess of their stated preference.

### **Adverse developments in the credit markets may impair our ability to enter into any other future borrowing facility.**

During the economic downturn in the United States that began in mid-2007, many commercial banks and other financial institutions stopped lending or significantly curtailed their lending activity. In addition, in an effort to stem losses and reduce their exposure to segments of the economy deemed to be high risk, some financial institutions limited refinancing and loan modification transactions and reviewed the terms of existing facilities to identify bases for accelerating the maturity of existing lending facilities. If these conditions recur (for example, as a result of a broadening of the current Euro zone credit crisis), it may be difficult for us to enter into a new borrowing facility, obtain other financing to finance the growth of our investments, or refinance any outstanding indebtedness on acceptable economic terms, or at all.

### **If we do not invest a sufficient portion of our assets in qualifying assets, we could fail to maintain our qualification as a business development company or be precluded from investing according to our current business strategy.**

As a business development company, we may not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are qualifying assets.

We believe that most of the investments that we may acquire in the future will constitute qualifying assets. However, we may be precluded from investing in what we believe to be attractive investments if such investments are not qualifying assets for purposes of the 1940 Act. If we do not invest a sufficient portion of our assets in qualifying assets, we could violate the 1940 Act provisions applicable to business development companies. As a result of such violation, specific rules under the 1940 Act could prevent us, for example, from making follow-on investments in existing portfolio companies (which could result in the dilution of our position).

If we do not maintain our status as a business development company, we would be subject to regulation as a registered closed-end investment company under the 1940 Act. As a registered closed-end investment company, we would be subject to substantially more regulatory restrictions under the 1940 Act which would significantly decrease our

We may in the future determine to fund a portion of our investments with preferred stock, which would magnify the p

operating flexibility.

**Most of our portfolio investments are recorded at fair value and will continue to be recorded as fair value as determined in good faith by our board of directors and, as a result, there may be and will continue to be uncertainty as to the value of our portfolio investments.**

Most of our portfolio investments will take the form of securities that are not publicly traded. The fair value of loans, securities and other investments that are not publicly traded may not be readily determinable, and we value these investments at fair value as determined in good faith by our board of directors, including to reflect significant events affecting the value of our investments. Most, if not all, of our investments (other

TABLE OF CONTENTS

than cash and cash equivalents) are classified as Level 3 under ASC Topic 820. This means that our portfolio valuations are based on unobservable inputs and our own assumptions about how market participants would price the asset or liability in question. Inputs into the determination of fair value of our portfolio investments require significant management judgment or estimation. Even if observable market data is available, such information may be the result of consensus pricing information or broker quotes, which include a disclaimer that the broker would not be held to such a price in an actual transaction. The non-binding nature of consensus pricing and/or quotes accompanied by disclaimers materially reduces the reliability of such information. We have retained the services of independent service providers to review the valuation of these loans and securities. The types of factors that the board of directors may take into account in determining the fair value of our investments generally include, as appropriate, comparison to publicly traded securities including such factors as yield, maturity and measures of credit quality, the enterprise value of a portfolio company, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings and discounted cash flow, the markets in which the portfolio company does business and other relevant factors. Because such valuations, and particularly valuations of private securities and private companies, are inherently uncertain, may fluctuate over short periods of time and may be based on estimates, our determinations of fair value may differ materially from the values that would have been used if a ready market for these loans and securities existed. Our net asset value could be adversely affected if our determinations regarding the fair value of our investments were materially higher than the values that we ultimately realize upon the disposal of such loans and securities.

We adjust quarterly the valuation of our portfolio to reflect our board of directors' determination of the fair value of each investment in our portfolio. Any changes in fair value are recorded in our statement of operations as net change in unrealized appreciation or depreciation.

**We may experience fluctuations in our quarterly operating results.**

We could experience fluctuations in our quarterly operating results due to a number of factors, including the interest rate payable on the loans and debt securities we acquire, the default rate on such loans and securities, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions. In light of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

**We are an emerging growth company under the JOBS Act, and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.**

We are and we will remain an emerging growth company as defined in the JOBS Act until the earlier of (a) the last day of the fiscal year (i) following the fifth anniversary of the completion of our initial public offering, (ii) in which we have total annual gross revenue of at least \$1.0 billion, or (iii) in which we are deemed to be a large accelerated filer, which means the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the prior June 30<sup>th</sup>, and (b) the date on which we have issued more than \$1.0 billion in non-convertible debt during the prior three-year period. For so long as we remain an emerging growth company we may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act. We cannot predict if investors will find our common stock less attractive because we will rely on some or all of these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

Most of our portfolio investments are recorded at fair value and will continue to be recorded as fair value as determined

In addition, Section 107 of the JOBS Act also provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We are choosing to take advantage of the extended transition period for complying with new or revised accounting standards, which may make it more difficult for investors and securities analysts to evaluate us

TABLE OF CONTENTS

since our financial statements may not be comparable to companies that comply with public company effective dates and may result in less investor confidence.

**If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud. As a result, stockholders could lose confidence in our financial and other public reporting, which would harm our business and the trading price of our common stock.**

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports and, together with adequate disclosure controls and procedures, are designed to prevent fraud. Any failure to implement required new or improved controls, or difficulties encountered in their implementation could cause us to fail to meet our reporting obligations. In addition, any testing by us conducted in connection with Section 404 of the Sarbanes-Oxley Act, or the subsequent testing by our independent registered public accounting firm (when undertaken, as noted below), may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses or that may require prospective or retroactive changes to our consolidated financial statements or identify other areas for further attention or improvement. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our common stock.

We are required to disclose changes made in our internal control and procedures on a quarterly basis and our management is required to assess the effectiveness of these controls annually. However, for as long as we are an emerging growth company under the recently enacted JOBS Act, our independent registered public accounting firm will not be required to attest to the effectiveness of our internal control over financial reporting pursuant to Section 404. We could be an emerging growth company for up to five years. An independent assessment of the effectiveness of our internal controls could detect problems that our management's assessment might not. Undetected material weaknesses in our internal controls could lead to financial statement restatements and require us to incur the expense of remediation.

**Our status as an emerging growth company under the JOBS Act may make it more difficult to raise capital as and when we need it.**

Because of the exemptions from various reporting requirements provided to us as an emerging growth company and because we will have an extended transition period for complying with new or revised financial accounting standards, we may be less attractive to investors and it may be difficult for us to raise additional capital as and when we need it.

Investors may be unable to compare our business with other companies in our industry if they believe that our financial accounting is not as transparent as other companies in our industry. If we are unable to raise additional capital as and when we need it, our financial condition and results of operations may be materially and adversely affected.

**New or modified laws or regulations governing our operations may adversely affect our business.**

We and our portfolio companies are subject to regulation by laws at the U.S. federal, state and local levels. These laws and regulations, as well as their interpretation, may change from time to time, and new laws, regulations and

If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately

interpretations may also come into effect. Any such new or changed laws or regulations could have a material adverse effect on our business.

Additionally, changes to the laws and regulations governing our operations related to permitted investments may cause us to alter our investment strategy in order to avail ourselves of new or different opportunities. Such changes could result in material differences to the strategies and plans set forth in this prospectus and may shift our investment focus from the areas of expertise of Stellus Capital Management to other types of investments in which Stellus Capital Management may have little or no expertise or experience. Any such changes, if they occur, could have a material adverse effect on our results of operations and the value of your investment.

TABLE OF CONTENTS

**Our board of directors may change our investment objective, operating policies and strategies without prior notice or stockholder approval.**

Our board of directors has the authority, except as otherwise provided in the 1940 Act, to modify or waive certain of our operating policies and strategies without prior notice and without stockholder approval. However, absent stockholder approval, we may not change the nature of our business so as to cease to be, or withdraw our election as, a business development company. We cannot predict the effect any changes to our current operating policies and strategies would have on our business, operating results and the market price of our common stock. Nevertheless, any such changes could adversely affect our business and impair our ability to make distributions to our stockholders.

**If we receive qualification from the SBA to be licensed as an SBIC but we are unable to comply with SBA regulations after the SBIC subsidiary is licensed as an SBIC, our business plan and investment objective could be adversely affected.**

We have applied for a license to form and operate an SBIC subsidiary; however, the application is subject to approval by the SBA. We can make no assurances that the SBA will approve our application, or of the timeframe in which we would receive a license, should one ultimately be granted. If we receive this qualification, we will become subject to SBA regulations that may constrain our activities. We may need to make allowances in our investment activity to comply with SBA regulations. In addition, SBA regulations may impose parameters on our business operations and investment objective that are different than what we otherwise would do if we were not subject to these regulations. Failure to comply with the SBA regulations could result in the loss of the SBIC license and the resulting inability to participate in the SBA-sponsored debenture program. The SBA also limits the maximum amount that may be borrowed by any single SBIC. The SBA prohibits, without prior SBA approval, a change of control of an SBIC or transfers that would result in any person (or a group of persons acting in concert) owning 10% or more of a class of capital stock of a licensed SBIC. A change of control is any event which would result in the transfer of the power, direct or indirect, to direct the management and policies of an SBIC, whether through ownership, contractual arrangements or otherwise. To the extent that we obtain an SBIC license, this would prohibit a change of control of our SBIC subsidiary without prior SBA approval. If we are unable to comply with SBA regulations, our business plan and growth strategy could be materially adversely affected.

**Pending legislation may allow us to incur additional leverage.**

As a business development company under the 1940 Act, we are generally not permitted to incur indebtedness unless immediately after such borrowing we have an asset coverage for total borrowings of at least 200% (i.e., the amount of debt may not exceed 50% of the value of our assets). Recent legislation introduced in the U.S. House of Representatives, if passed, would modify this section of the 1940 Act and increase the amount of debt that business development companies may incur by modifying the percentage from 200% to 150%. As a result, we may be able to incur additional indebtedness in the future and therefore your risk of an investment in common stock may increase.

**Our board of directors is authorized to reclassify any unissued shares of common stock into one or more classes of preferred stock, which could convey special rights and privileges to its owners.**

Under Maryland General Corporation Law and our charter, our board of directors is authorized to classify and reclassify any authorized but unissued shares of stock into one or more classes of stock, including preferred stock. Prior to issuance of shares of each class or series, the board of directors will be required by Maryland law and our charter to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to stockholder distributions, qualifications and terms or conditions of redemption for each class or series. Thus, the board of directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or that otherwise might be in their best interest. The cost of any such reclassification would be borne by our common stockholders. Certain matters under the 1940 Act require the separate vote of the holders of any issued and outstanding preferred stock. For example, the 1940 Act provides that holders of preferred stock are entitled to vote separately from holders of common stock to elect two preferred stock directors. We currently have no

TABLE OF CONTENTS

plans to issue preferred stock. The issuance of preferred shares convertible into shares of common stock may also reduce the net income and net asset value per share of our common stock upon conversion, provided, that we will only be permitted to issue such convertible preferred stock to the extent we comply with the requirements of Section 61 of the 1940 Act, including obtaining common stockholder approval. These effects, among others, could have an adverse effect on your investment in our common stock.

**Provisions of the Maryland General Corporation Law and of our charter and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.**

The Maryland General Corporation Law and our charter and bylaws contain provisions that may discourage, delay or make more difficult a change in control of Stellus Capital Investment Corporation or the removal of our directors. We are subject to the Maryland Business Combination Act, subject to any applicable requirements of the 1940 Act. Our board of directors has adopted a resolution exempting from the Business Combination Act any business combination between us and any other person, subject to prior approval of such business combination by our board of directors, including approval by a majority of our independent directors. If the resolution exempting business combinations is repealed or our board of directors does not approve a business combination, the Business Combination Act may discourage third parties from trying to acquire control of us and increase the difficulty of consummating such an offer. Our bylaws exempt from the Maryland Control Share Acquisition Act acquisitions of our stock by any person. If we amend our bylaws to repeal the exemption from the Control Share Acquisition Act, the Control Share Acquisition Act also may make it more difficult for a third party to obtain control of us and increase the difficulty of consummating such a transaction.

We have also adopted measures that may make it difficult for a third party to obtain control of us, including provisions of our charter classifying our board of directors in three classes serving staggered three-year terms, and authorizing our board of directors to classify or reclassify shares of our stock in one or more classes or series, to cause the issuance of additional shares of our stock, to amend our charter without stockholder approval and to increase or decrease the number of shares of stock that we have authority to issue. These provisions, as well as other provisions of our charter and bylaws, may delay, defer or prevent a transaction or a change in control that might otherwise be in the best interests of our stockholders. See Description of our Capital Stock Certain Provisions of the Maryland General Corporation Law and Our Charter and Bylaws.

**Stellus Capital Management can resign as our investment adviser or administrator upon 60 days notice and we may not be able to find a suitable replacement within that time, or at all, resulting in a disruption in our operations that could adversely affect our financial condition, business and results of operations.**

Stellus Capital Management has the right under the investment advisory agreement to resign as our investment adviser at any time upon 60 days written notice, whether we have found a replacement or not. Similarly, Stellus Capital Management has the right under the administration agreement to resign at any time upon 60 days written notice, whether we have found a replacement or not. If Stellus Capital Management was to resign, we may not be able to find a new investment adviser or administrator or hire internal management with similar expertise and ability to provide the same or equivalent services on acceptable terms within 60 days, or at all. If we are unable to do so quickly, our operations are likely to experience a disruption, our financial condition, business and results of operations as well as our ability to pay distributions to our stockholders are likely to be adversely affected and the market price of our

shares may decline. In addition, the coordination of our internal management and investment or administrative activities, as applicable, is likely to suffer if we are unable to identify and reach an agreement with a single institution or group of executives having the expertise possessed by Stellus Capital Management. Even if we are able to retain comparable management, whether internal or external, the integration of such management and their lack of familiarity with our investment objective may result in additional costs and time delays that may adversely affect our business, financial condition, results of operations and cash flows.

TABLE OF CONTENTS

**We are highly dependent on information systems and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to make distributions to our stockholders.**

Our business is highly dependent on the communications and information systems of Stellus Capital Management. In addition, certain of these systems are provided to Stellus Capital Management by third party service providers. Any failure or interruption of such systems, including as a result of the termination of an agreement with any such third party service provider, could cause delays or other problems in our activities. This, in turn, could have a material adverse effect on our operating results and negatively affect the market price of our common stock and our ability to make distributions to our stockholders.

**Recent market conditions materially and adversely affected debt and equity capital markets in the United States and around the world. If these conditions recur, debt capital may not be available to us on favorable terms, or at all, which could negatively affect our financial performance and results.**

From 2007 through 2009, the global capital markets experienced a period of disruption resulting in increasing spreads between the yields realized on riskier debt securities and those realized on risk-free securities and a lack of liquidity in parts of the debt capital markets, significant write-offs in the financial services sector relating to subprime mortgages and the re-pricing of credit risk in the broadly syndicated market. These events, along with the deterioration of the housing market, illiquid market conditions, declining business and consumer confidence and the failure of major financial institutions in the United States, led to a decline of general economic conditions. This economic decline materially and adversely affected the broader financial and credit markets and reduced the availability of debt and equity capital for the market as a whole and to financial firms in particular during that time. These conditions may recur (for example, as a result of a broadening of the current Euro zone credit crisis), in which case, to the extent that we wish to use debt to fund our investments, the debt capital that will be available to us, if at all, may be at a higher cost, and on terms and conditions that may be less favorable, than what we expect, which could negatively affect our financial performance and results. A prolonged period of market illiquidity may cause us to reduce the volume of loans and debt securities we originate and/or fund and adversely affect the value of our portfolio investments, which could have a material and adverse effect on our business, financial condition, results of operations and cash flows.

## **Risks Related to our Investments**

**Economic recessions or downturns could impair our portfolio companies and harm our operating results.**

Many of the portfolio companies in which we make, and expect to make, investments, including those currently included in our portfolio, are likely to be susceptible to economic slowdowns or recessions and may be unable to repay our loans during such periods. Therefore, the number of our non-performing assets are likely to increase and the value of our portfolio is likely to decrease during such periods. Adverse economic conditions may decrease the value of collateral securing some of our loans and debt securities and the value of our equity investments. Economic slowdowns or recessions could lead to financial losses in our portfolio and a decrease in revenues, net income and assets. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets

or result in a decision by lenders not to extend credit to us. These events could prevent us from increasing our investments and harm our operating results.

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its assets, which could trigger cross-defaults under other agreements and jeopardize our portfolio company's ability to meet its obligations under the loans and debt securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company. In addition, lenders in certain cases can be subject to lender liability claims for actions taken by them when they become too involved in the borrower's business or exercise control over a borrower. It is possible that we could become subject to a lender's liability claim, including as a result of actions taken if we render significant managerial assistance to the borrower. Furthermore, if one of our portfolio companies were to file for bankruptcy protection, a bankruptcy court might re-characterize our debt holding and subordinate all or a portion of our claim to claims of other creditors, even though we may have structured our investment as senior secured debt.

TABLE OF CONTENTS

The likelihood of such a re-characterization would depend on the facts and circumstances, including the extent to which we provided managerial assistance to that portfolio company.

**Our investments in leveraged portfolio companies may be risky, and we could lose all or part of our investment.**

Investment in leveraged companies involves a number of significant risks. Leveraged companies in which we invest may have limited financial resources and may be unable to meet their obligations under their loans and debt securities that we hold. Such developments may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of our realizing any guarantees that we may have obtained in connection with our investment. Smaller leveraged companies also may have less predictable operating results and may require substantial additional capital to support their operations, finance their expansion or maintain their competitive position.

**We may hold the loans and debt securities of leveraged companies that may, due to the significant operating volatility typical of such companies, enter into bankruptcy proceedings.**

Leveraged companies may experience bankruptcy or similar financial distress. The bankruptcy process has a number of significant inherent risks. Many events in a bankruptcy proceeding are the product of contested matters and adversary proceedings and are beyond the control of the creditors. A bankruptcy filing by a portfolio company may adversely and permanently affect that company. If the proceeding is converted to a liquidation, the value of the portfolio company may not equal the liquidation value that was believed to exist at the time of the investment. The duration of a bankruptcy proceeding is also difficult to predict, and a creditor's return on investment can be adversely affected by delays until the plan of reorganization or liquidation ultimately becomes effective. The administrative costs in connection with a bankruptcy proceeding are frequently high and would be paid out of the debtor's estate prior to any return to creditors. Because the standards for classification of claims under bankruptcy law are vague, our influence with respect to the class of securities or other obligations we own may be lost by increases in the number and amount of claims in the same class or by different classification and treatment. In the early stages of the bankruptcy process, it is often difficult to estimate the extent of, or even to identify, any contingent claims that might be made. In addition, certain claims that have priority by law (for example, claims for taxes) may be substantial.

**Our investments in private and middle-market portfolio companies are risky, and we could lose all or part of our investment.**

Investment in private and middle-market companies involves a number of significant risks. Generally, little public information exists about these companies, and we rely on the ability of Stellus Capital Management's investment professionals to obtain adequate information to evaluate the potential returns from investing in these companies. If we are unable to uncover all material information about these companies, we may not make a fully informed investment decision, and we may lose money on our investments. Middle-market companies may have limited financial resources and may be unable to meet their obligations under their loans and debt securities that we hold, which may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of our realizing any guarantees we may have obtained in connection with our investment. In addition, such companies typically have shorter operating histories, narrower product lines and smaller market shares than larger businesses, which tend to render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns. Additionally, middle-market companies are more likely to depend on the management talents and efforts of a small group of persons. Therefore, the death, disability, resignation or termination of one or more of these persons could

have a material adverse impact on one or more of the portfolio companies we invest in and, in turn, on us. Middle-market companies also may be parties to litigation and may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence. In addition, our executive officers, directors and investment adviser may, in the ordinary course of business, be named as defendants in litigation arising from our investments in portfolio companies.

TABLE OF CONTENTS

**The lack of liquidity in our investments may adversely affect our business.**

Most of our assets are invested in illiquid loans and securities, and a substantial portion of our investments in leveraged companies are subject to legal and other restrictions on resale or are otherwise less liquid than more broadly traded public securities. The illiquidity of these investments may make it difficult for us to sell such investments if the need arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. Also, as noted above, we may be limited or prohibited in our ability to sell or otherwise exit certain positions in our portfolio as such a transaction could be considered a joint transaction prohibited by the 1940 Act.

**Price declines and illiquidity in the corporate debt markets may adversely affect the fair value of our portfolio investments, reducing our net asset value through increased net unrealized depreciation.**

As a business development company, we are required to carry our investments at market value or, if no market value is ascertainable, at fair value as determined in good faith by our board of directors. As part of the valuation process, we may take into account the following types of factors, if relevant, in determining the fair value of our investments:

- 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.

When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, we use the pricing indicated by the external event to corroborate our valuation. We record decreases in the market values or fair values of our investments as unrealized depreciation. Declines in prices and liquidity in the corporate debt markets may result in significant net unrealized depreciation in our portfolio. The effect of all of these factors on our portfolio may reduce our net asset value by increasing net unrealized depreciation in our portfolio. Depending on market conditions, we could incur substantial realized losses and may suffer additional unrealized losses in future periods, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

**We are a non-diversified investment company within the meaning of the 1940 Act, and therefore we are not limited with respect to the proportion of our assets that may be invested in securities of a single issuer.**

We are classified as a non-diversified investment company within the meaning of the 1940 Act, which means that we are not limited by the 1940 Act with respect to the proportion of our assets that we may invest in securities of a single issuer. Beyond the asset diversification requirements associated with our qualification as a RIC under the Code, we do not have fixed guidelines for diversification. To the extent that we assume large positions in the securities of a small number of issuers or our investments are concentrated in relatively few industries, our net asset value may fluctuate to

a greater extent than that of a diversified investment company as a result of changes in the financial condition or the market's assessment of the issuer. We may also be more susceptible to any single economic or regulatory occurrence than a diversified investment company.

TABLE OF CONTENTS

**Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio.**

Following an initial investment in a portfolio company, we may make additional investments in that portfolio company as follow-on investments, in seeking to:

increase or maintain in whole or in part our position as a creditor or equity ownership percentage in a portfolio company;

exercise warrants, options or convertible securities that were acquired in the original or subsequent financing; or  
preserve or enhance the value of our investment.

We have discretion to make follow-on investments, subject to the availability of capital resources. Failure on our part to make follow-on investments may, in some circumstances, jeopardize the continued viability of a portfolio company and our initial investment, or may result in a missed opportunity for us to increase our participation in a successful operation. Even if we have sufficient capital to make a desired follow-on investment, we may elect not to make a follow-on investment because we may not want to increase our level of risk, because we prefer other opportunities or because we are inhibited by compliance with business development company requirements of the 1940 Act or the desire to maintain our qualification as a RIC. Our ability to make follow-on investments may also be limited by Stellus Capital Management's allocation policy.

**Because we generally do not hold controlling equity interests in our portfolio companies, we may not be able to exercise control over our portfolio companies or to prevent decisions by management of our portfolio companies that could decrease the value of our investments.**

We do not hold controlling equity positions in any of the portfolio companies included in our portfolio and, although we may do so in the future, we do not currently intend to hold controlling equity positions in our portfolio companies (including those included in our portfolio). As a result, we are subject to the risk that a portfolio company may make business decisions with which we disagree, and that the management and/or stockholders of a portfolio company may take risks or otherwise act in ways that are adverse to our interests. Due to the lack of liquidity of the debt and equity investments that we hold in our portfolio companies, we may not be able to dispose of our investments in the event we disagree with the actions of a portfolio company and may therefore suffer a decrease in the value of our investments.

**Defaults by our portfolio companies will harm our operating results.**

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its assets. This could trigger cross-defaults under other agreements and jeopardize such portfolio company's ability to meet its obligations under the loans or debt or equity securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms, which may include the waiver of certain financial covenants, with a defaulting portfolio company.

**Prepayments of our debt investments by our portfolio companies could adversely impact our results of operations and ability to make stockholder distributions and result in a decline in the market price of our shares.**

We are subject to the risk that the debt investments we make in our portfolio companies may be repaid prior to maturity. We expect that our investments will generally allow for repayment at any time subject to certain penalties.

When this occurs, we intend to generally reinvest these proceeds in temporary investments, pending their future investment in accordance with our investment strategy. These temporary investments will typically have substantially lower yields than the debt being prepaid, and we could experience significant delays in reinvesting these amounts.

Any future investment may also be at lower yields than the debt that was repaid. As a result, our results of operations could be materially adversely affected if one or more of our portfolio companies elects to prepay amounts owed to us.

Additionally, prepayments could negatively impact our ability to make, or the amount of, stockholder distributions with respect to our common stock, which could result in a decline in the market price of our shares.

TABLE OF CONTENTS

**Uncertainty relating to the LIBOR calculation process may adversely affect the value of our portfolio of the LIBOR-indexed, floating-rate debt securities.**

Concerns have been publicized that some of the member banks surveyed by the British Bankers' Association, or BBA, in connection with the calculation of LIBOR across a range of maturities and currencies may have been under-reporting or otherwise manipulating the inter-bank lending rate applicable to them in order to profit on their derivatives positions or to avoid an appearance of capital insufficiency or adverse reputational or other consequences that may have resulted from reporting inter-bank lending rates higher than those they actually submitted. A number of BBA member banks have entered into settlements with their regulators and law enforcement agencies with respect to alleged manipulation of LIBOR, and investigations and reviews of the framework for the setting of LIBOR by regulators and governmental authorities in various jurisdictions are ongoing. In this regard, the recommendation of one governmental committee undertaking such a review will result in the transfer of the administration of LIBOR to NYSE Euronext Rates Administration Limited in early 2014.

Actions by the LIBOR Administrator, regulators or law enforcement agencies may result in changes to the manner in which LIBOR is determined. Uncertainty as to the nature of such potential changes may adversely affect the market for LIBOR-based securities, including our portfolio of LIBOR-indexed, floating-rate debt securities. In addition, any further changes or reforms to the determination or supervision of LIBOR may result in a sudden or prolonged increase or decrease in reported LIBOR, which could have an adverse impact on the market for LIBOR-based securities or the value of our portfolio of LIBOR-indexed, floating-rate debt securities.

**Our portfolio companies may incur debt that ranks equally with, or senior to, our investments in such companies.**

We invest a portion of our capital in second lien and subordinated loans issued by our portfolio companies. The portfolio companies usually have, or may be permitted to incur, other debt that ranks equally with, or senior to, the loans in which we invest. By their terms, such debt instruments may provide that the holders are entitled to receive payment of interest or principal on or before the dates on which we are entitled to receive payments in respect of the loans in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of debt instruments ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution in respect of our investment. After repaying senior creditors, a portfolio company may not have any remaining assets to use for repaying its obligation to us. In the case of debt ranking equally with loans in which we invest, we would have to share any distributions on an equal and ratable basis with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant portfolio company.

Additionally, certain loans that we make to portfolio companies may be secured on a second priority basis by the same collateral securing senior secured debt of such companies. The first priority liens on the collateral will secure the portfolio company's obligations under any outstanding senior debt and may secure certain other future debt that may be permitted to be incurred by the portfolio company under the agreements governing the loans. The holders of obligations secured by first priority liens on the collateral will generally control the liquidation of, and be entitled to receive proceeds from, any realization of the collateral to repay their obligations in full before us. In addition, the value of the collateral in the event of liquidation will depend on market and economic conditions, the availability of buyers and other factors. There can be no assurance that the proceeds, if any, from sales of all of the collateral would be sufficient to satisfy the loan obligations secured by the second priority liens after payment in full of all obligations secured by the first priority liens on the collateral. If such proceeds were not sufficient to repay amounts outstanding under the loan obligations secured by the second priority liens, then we, to the extent not repaid from the proceeds of

the sale of the collateral, will only have an unsecured claim against the portfolio company's remaining assets, if any.

We may also make unsecured loans to portfolio companies, meaning that such loans will not benefit from any interest in collateral of such companies. Liens on such portfolio companies' collateral, if any, will secure the portfolio company's obligations under its outstanding secured debt and may secure certain future debt that

TABLE OF CONTENTS

is permitted to be incurred by the portfolio company under its secured loan agreements. The holders of obligations secured by such liens will generally control the liquidation of, and be entitled to receive proceeds from, any realization of such collateral to repay their obligations in full before us. In addition, the value of such collateral in the event of liquidation will depend on market and economic conditions, the availability of buyers and other factors. There can be no assurance that the proceeds, if any, from sales of such collateral would be sufficient to satisfy our unsecured loan obligations after payment in full of all secured loan obligations. If such proceeds were not sufficient to repay the outstanding secured loan obligations, then our unsecured claims would rank equally with the unpaid portion of such secured creditors' claims against the portfolio company's remaining assets, if any.

The rights we may have with respect to the collateral securing the loans we make to our portfolio companies with senior debt outstanding may also be limited pursuant to the terms of one or more intercreditor agreements that we enter into with the holders of such senior debt. Under a typical intercreditor agreement, at any time that obligations that have the benefit of the first priority liens are outstanding, any of the following actions that may be taken in respect of the collateral will be at the direction of the holders of the obligations secured by the first priority liens:

- the ability to cause the commencement of enforcement proceedings against the collateral;
- the ability to control the conduct of such proceedings;
- the approval of amendments to collateral documents;
- releases of liens on the collateral; and
- waivers of past defaults under collateral documents.

We may not have the ability to control or direct such actions, even if our rights are adversely affected.

**If we make subordinated investments, the obligors or the portfolio companies may not generate sufficient cash flow to service their debt obligations to us.**

We may make subordinated investments that rank below other obligations of the obligor in right of payment. Subordinated investments are subject to greater risk of default than senior obligations as a result of adverse changes in the financial condition of the obligor or economic conditions in general. If we make a subordinated investment in a portfolio company, the portfolio company may be highly leveraged, and its relatively high debt-to-equity ratio may create increased risks that its operations might not generate sufficient cash flow to service all of its debt obligations.

**The disposition of our investments may result in contingent liabilities.**

Substantially all of our investments involve loans and private securities. In connection with the disposition of an investment in loans and private securities, we may be required to make representations about the business and financial affairs of the portfolio company typical of those made in connection with the sale of a business. We may also be required to indemnify the purchasers of such investment to the extent that any such representations turn out to be inaccurate or with respect to potential liabilities. These arrangements may result in contingent liabilities that ultimately result in funding obligations that we must satisfy through our return of distributions previously made to us.

**We may not realize gains from our equity investments.**

When we invest in loans and debt securities, we may acquire warrants or other equity securities of portfolio companies as well. We may also invest in equity securities directly. To the extent we hold equity investments, we will attempt to dispose of them and realize gains upon our disposition of them. However, the equity interests we receive may not appreciate in value and, may decline in value. As a result, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any

If we make subordinated investments, the obligors or the portfolio companies may not generate sufficient cash flow

other losses we experience.

TABLE OF CONTENTS

## **Risks Relating to an Offering of Our Securities**

### **We may be unable to invest a significant portion of the net proceeds raised from our offerings on acceptable terms, which would harm our financial condition and operating results.**

Delays in investing the net proceeds raised in our offerings may cause our performance to be worse than that of other fully invested BDCs or other lenders or investors pursuing comparable investment strategies. We cannot assure you that we will be able to identify any investments that meet our investment objective or that any investment that we make will produce a positive return. We may be unable to invest the net proceeds from any offering on acceptable terms within the time period that we anticipate or at all, which could harm our financial condition and operating results. We anticipate that, depending on market conditions, it may take a substantial period of time to invest substantially all of the net proceeds of any offering in securities meeting our investment objective. During such a period, we will continue to invest the net proceeds of any offering primarily in cash, cash equivalents, U.S. government securities, repurchase agreements and high-quality debt instruments maturing in one year or less from the time of investment, which may produce returns that are significantly lower than the returns which we expect to achieve when our portfolio is fully invested in securities meeting our investment objective, and given our expense ratio and the prevailing interest rate climate, there is a possible risk of losing money on the offering proceeds of certain securities, such as debt securities during this interval. As a result, any distributions that we pay during such period may be substantially lower than the distributions that we may be able to pay when our portfolio is fully invested in securities meeting our investment objective. In addition, until such time as the net proceeds of any offering are invested in securities meeting our investment objective, the market price for our securities may decline. Thus, the return on your investment may be lower than when, if ever, our portfolio is fully invested in securities meeting our investment objective.

### **Shares of closed-end investment companies, including business development companies, frequently trade at a discount from their net asset value.**

Shares of closed-end investment companies, including business development companies, frequently trade at a discount from their net asset value. This characteristic of closed-end investment companies is separate and distinct from the risk that our net asset value per share of common stock may decline. We cannot predict whether our common stock will trade at, above or below net asset value. On July 29, 2013, our stockholders voted to allow us to issue common stock at a price below net asset value per share for the period ending on the earlier of the one year anniversary of the date of the Company's 2013 Annual Meeting of Stockholders and the date of the Company's 2014 Annual Meeting of Stockholders, which is expected to be held in June 2014. Our stockholders did not specify a maximum discount below net asset value at which we are able to issue our common stock, although the number of shares sold in each offering may not exceed 25% of our outstanding common stock immediately prior to such sale. In addition, we cannot issue shares of our common stock below net asset value unless our board of directors determines that it would be in our and our stockholders' best interests to do so. Sales of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share. In addition, continuous sales of common stock below net asset value may have a negative impact on total returns and could have a negative impact on the market price of our shares of common stock. See Stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock for a discussion of a proposal approved by our stockholders that permit us to issue shares of our common stock below net asset value.

**There is a risk that you may not receive distributions or that our distributions may not grow over time and a portion of our distributions may be a return of capital.**

We intend to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution (i.e., not subject to any legal restrictions under Maryland law on the distribution thereof). We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. Our ability to pay distributions might be adversely affected by the impact of one or more of the risk factors described in this prospectus. Due to the asset coverage test applicable to us under the 1940 Act as a business development company, we may be limited in

TABLE OF CONTENTS

our ability to make distributions. In addition, for so long as the Credit Facility, or any other borrowing facility that we enter into, is outstanding, we anticipate that we may be required by its terms to use all payments of interest and principal that we receive from our current investments as well as any proceeds received from the sale of our current investments to repay amounts outstanding thereunder, which could adversely affect our ability to make distributions.

When we make distributions, we will be required to determine the extent to which such distributions are paid out of current or accumulated earnings and profits. Distributions in excess of current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of an investor's basis in our stock and, assuming that an investor holds our stock as a capital asset, thereafter as a capital gain. See Material U.S. Federal Income Tax Considerations.

**We may allocate the net proceeds from an offering in ways with which you may not agree.**

We will have significant flexibility in investing the net proceeds of an offering and may use the net proceeds from an offering in ways with which you may not agree or for purposes other than those contemplated at the time of the offering. In addition, we can provide you with no assurance that by increasing the size of our available equity capital our expense ratio or debt ratio will be lowered.

**Stockholders may experience dilution in their ownership percentage if they do not participate in our dividend reinvestment plan.**

All distributions declared in cash payable to stockholders that are participants in our dividend reinvestment plan are generally automatically reinvested in shares of our common stock. As a result, stockholders that do not participate in the dividend reinvestment plan may experience dilution over time. Stockholders who receive distributions in shares of common stock may experience accretion to the net asset value of their shares if our shares are trading at a premium and dilution if our shares are trading at a discount. The level of accretion or discount would depend on various factors, including the proportion of our stockholders who participate in the plan, the level of premium or discount at which our shares are trading and the amount of the distribution payable to a stockholder.

**Existing stockholders may incur dilution if, in the future, we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock.**

The 1940 Act prohibits us from selling shares of our common stock at a price below the current net asset value per share of such stock, with certain exceptions. One such exception is prior stockholder approval of issuances below net asset value provided that our board of directors makes certain determinations. In this regard, on July 29, 2013, our common stockholders voted to allow us to issue common stock at a price below net asset value per share for the period ending on the earlier of the one year anniversary of the date of the Company's 2013 Annual Meeting of Stockholders and the date of the Company's 2014 Annual Meeting of Stockholders, which is expected to be held in June 2014. Continued access to this exception will require approval of similar proposals at future stockholder meetings. Any decision to sell shares of our common stock below the then current net asset value per share of our common stock would be subject to the determination by our board of directors that such issuance is in our and our stockholders' best interests.

If we were to sell shares of our common stock below net asset value per share, such sales would result in an immediate dilution to the net asset value per share. This dilution would occur as a result of the sale of shares at a price below the then current net asset value per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting interest in us than the increase in our assets resulting from such issuance.

Because the number of shares of common stock that could be so issued and the timing of any issuance is not currently known, the actual dilutive effect cannot be predicted; however, the example below illustrates the effect of dilution to existing stockholders resulting from the sale of common stock at prices below the net asset value of such shares. Please see "Sales of Common Stock Below Net Asset Value" for a more complete discussion of the potentially dilutive impacts of an offering at a price less than net asset value per share.

*Illustration: Example of Dilutive Effect of the Issuance of Shares Below Net Asset Value.* Assume that Company XYZ has 1,000,000 total shares outstanding, \$15,000,000 in total assets and \$5,000,000 in

TABLE OF CONTENTS

total liabilities. The net asset value per share of the common stock of Company XYZ is \$10.00. The following table illustrates the reduction to net asset value, or net asset value, and the dilution experienced by Stockholder A following the sale of 40,000 shares of the common stock of Company XYZ at \$9.50 per share, a price below its net asset value per share.

|  | Prior to Sale<br>Below NAV | Following<br>Sale<br>Below NAV | Percentage<br>Change |       |
|--|----------------------------|--------------------------------|----------------------|-------|
| Reduction to NAV                       |                            |                                |                      |       |
| Total Shares Outstanding               | 1,000,000                  | 1,040,000                      | 4.0                  | %     |
| NAV per share                          | \$10.00                    | \$9.98                         | (0.2)                | %     |
| Dilution to Existing Stockholder       |                            |                                |                      |       |
| Shares Held by Stockholder A           | 10,000                     | 10,000                         | (1)                  | 0.0 % |
| Percentage Held by Stockholder A       | 1.00 %                     | 0.96 %                         | (3.8)                | %     |
| Total Interest of Stockholder A in NAV | \$100,000                  | \$99,808                       | (0.2)                | %     |

(1) Assumes that Stockholder A does not purchase additional shares in the sale of shares below NAV.

### **Our shares might trade at premiums that are unsustainable or at discounts from net asset value.**

Shares of business development companies like us may, during some periods, trade at prices higher than their net asset value per share and, during other periods, as frequently occurs with closed-end investment companies, trade at prices lower than their net asset value per share. The perceived value of our investment portfolio may be affected by a number of factors including perceived prospects for individual companies we invest in, market conditions for common stock generally, for initial public offerings and other exit events for venture capital backed companies, and the mix of companies in our investment portfolio over time. Negative or unforeseen developments affecting the perceived value of companies in our investment portfolio could result in a decline in the trading price of our common stock relative to our net asset value per share.

The possibility that our shares will trade at a discount from net asset value or at premiums that are unsustainable are risks separate and distinct from the risk that our net asset value per share will decrease. The risk of purchasing shares of a business development company that might trade at a discount or unsustainable premium is more pronounced for investors who wish to sell their shares in a relatively short period of time because, for those investors, realization of a gain or loss on their investments is likely to be more dependent upon changes in premium or discount levels than upon increases or decreases in net asset value per share.

### **Investing in our securities may involve an above average degree of risk.**

The investments we make in accordance with our investment objective may result in a higher amount of risk, and higher volatility or loss of principal, than alternative investment options. Our investments in portfolio companies may be speculative and, therefore, an investment in our securities may not be suitable for someone with lower risk tolerance.

**The market price of our securities may fluctuate significantly.**

The market price and liquidity of the market for our securities may be significantly affected by numerous factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include:

- significant volatility in the market price and trading volume of securities of business development companies or other companies in our sector, which is not necessarily related to the operating performance of these companies;
- changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;
- loss of our qualification as a RIC or business development company;
- changes in earnings or variations in operating results;

42

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TABLE OF CONTENTS

changes in the value of our portfolio of investments;  
changes in accounting guidelines governing valuation of our investments;  
any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;

departure of Stellus Capital Management's key personnel;  
operating performance of companies comparable to us; and  
general economic trends and other external factors.

**Sales of substantial amounts of our common stock may have an adverse effect on the market price of our common stock.**

As of September 30, 2013 we had 12,082,221 shares of common stock outstanding. On \_\_\_\_\_, 2013, the SEC declared effective our shelf registration statement on Form N-2 (File No. 333-189938), allowing us to offer, from time to time, up to \$300 million worth of our common stock, preferred stock, subscription rights, debt securities, or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities on terms to be determined at the time of the offering. Sales of substantial amounts of our common stock, or the availability of shares for sale, could adversely affect the prevailing market price of our common stock. If this occurs and continues, it could impair our ability to raise additional capital through the sale of equity securities should we desire to do so.

**If we issue preferred stock and/or debt securities, the net asset value and market value of our common stock may become more volatile.**

We cannot assure you that the issuance of preferred stock and/or debt securities would result in a higher yield or return to the holders of our common stock. The issuance of preferred stock and/or debt securities would likely cause the net asset value and market value of our common stock to become more volatile. If the distribution rate on the preferred stock, or the interest rate on the debt securities, were to approach the net rate of return on our investment portfolio, the benefit of leverage to the holders of our common stock would be reduced. If the distribution rate on the preferred stock, or the interest rate on the debt securities, were to exceed the net rate of return on our portfolio, the use of leverage would result in a lower rate of return to the holders of common stock than if we had not issued the preferred stock and/or debt securities. Any decline in the net asset value of our investment would be borne entirely by the holders of our common stock. Therefore, if the market value of our portfolio were to decline, the leverage would result in a greater decrease in net asset value to the holders of our common stock than if we were not leveraged through the issuance of preferred stock and/or debt securities. This decline in net asset value would also tend to cause a greater decline in the market price for our common stock.

There is also a risk that, in the event of a sharp decline in the value of our net assets, we would be in danger of failing to maintain required asset coverage ratios which may be required by the preferred stock and/or debt securities or of a downgrade in the ratings of the preferred stock and/or debt securities or our current investment income might not be sufficient to meet the distribution requirements on the preferred stock or the interest payments on the debt securities. In order to counteract such an event, we might need to liquidate investments in order to fund redemption of some or all of the preferred stock and/or debt securities. In addition, we would pay (and the holders of our common stock would bear) all costs and expenses relating to the issuance and ongoing maintenance of the preferred stock and/or debt securities. Holders of preferred stock and/or debt securities may have different interests than holders of common stock and may at times have disproportionate influence over our affairs.

**The trading market or market value of our debt securities or any convertible debt securities, if issued to the public, may be volatile.**

Our debt securities or any convertible debt securities, if issued to the public, may or may not have an established trading market. We cannot assure investors that a trading market for our debt securities or any convertible debt securities, if issued to the public, would develop or be maintained if developed. In addition to

TABLE OF CONTENTS

our creditworthiness, many factors may materially adversely affect the trading market for, and market value of, our publicly issued debt securities or any convertible debt securities. These factors include, but are not limited to, the following:

- the time remaining to the maturity of these debt securities;
- the outstanding principal amount of debt securities with terms identical to these debt securities;
- the general economic environment;
- the supply of debt securities trading in the secondary market, if any;
- the redemption, repayment or convertible features, if any, of these debt securities;
- the level, direction and volatility of market interest rates generally; and
- market rates of interest higher or lower than rates borne by the debt securities.

There also may be a limited number of buyers for our debt securities. This too may materially adversely affect the market value of the debt securities or the trading market for the debt securities. Our debt securities may include convertible features that cause them to more closely bear risks associated with an investment in our common stock.

**Terms relating to redemption may materially adversely affect the return on any debt securities.**

If we issue any debt securities or any convertible debt securities that are redeemable at our option, we may choose to redeem the debt securities at times when prevailing interest rates are lower than the interest rate paid on the debt securities. In addition, if the debt securities are subject to mandatory redemption, we may be required to redeem the debt securities at times when prevailing interest rates are lower than the interest rate paid on the debt securities. In this circumstance, a holder of our debt securities may not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as the debt securities being redeemed.

**The issuance of subscription rights, warrants or convertible debt that are exchangeable for our common stock, will cause your interest in us to be diluted as a result of any such rights, warrants or convertible debt offering.**

Stockholders who do not fully exercise rights, warrants or convertible debt issued to them in any offering of subscription rights, warrants or convertible debt to purchase our common stock should expect that they will, at the completion of the offering, own a smaller proportional interest in us than would otherwise be the case if they fully exercised their rights, warrants or convertible debt. We cannot state precisely the amount of any such dilution in share ownership because we do not know what proportion of the common stock would be purchased as a result of any such offering.

In addition, if the subscription price, warrant price or convertible debt price is less than our net asset value per share of common stock at the time of such offering, then our stockholders would experience an immediate dilution of the aggregate net asset value of their shares as a result of the offering. The amount of any such decrease in net asset value is not predictable because it is not known at this time what the subscription price, warrant price, convertible debt price or net asset value per share will be on the expiration date of such offering or what proportion of our common stock will be purchased as a result of any such offering. The risk of dilution is greater if there are multiple rights offerings. However, our board of directors will make a good faith determination that any offering of subscription rights, warrants or convertible debt would result in a net benefit to existing stockholders.

**Future offerings of debt securities, which would be senior to our common stock upon liquidation, or equity securities, which could dilute our existing stockholders and may be senior to our common stock for the purposes of distributions, may harm the value of our common stock.**

In the future, we may attempt to increase our capital resources by making offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred stock or common stock, subject to the restrictions of the 1940 Act. Upon a liquidation of our

TABLE OF CONTENTS

company, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings would receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings by us may dilute the holdings of our existing stockholders or reduce the value of our common stock, or both.

Any preferred stock we may issue would have a preference on distributions that could limit our ability to make distributions to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our stockholders bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in us. In addition, proceeds from a sale of common stock will likely be used to increase our total assets or to pay down our borrowings, among other uses. This would increase our asset coverage ratio and permit us to incur additional leverage under rules pertaining to business development companies by increasing our borrowings or issuing senior securities such as preferred stock or additional debt securities.

TABLE OF CONTENTS

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements in this prospectus and the accompanying prospectus supplement, if any constitute forward-looking statements, which relate to future events or our future performance or financial condition. The forward-looking statements contained in this prospectus and the accompanying prospectus supplement, if any involve risks and uncertainties, including statements as to:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the effect of investments that we expect to make;
- our contractual arrangements and relationships with third parties;
- actual and potential conflicts of interest with Stellus Capital Management;
- the dependence of our future success on the general economy and its effect on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- the use of borrowed money to finance a portion of our investments;
- the adequacy of our financing sources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;
- the ability of Stellus Capital Management to locate suitable investments for us and to monitor and administer our investments;
- the ability of Stellus Capital Management to attract and retain highly talented professionals;
- our ability to qualify and maintain our qualification as a RIC and as a business development company; and
- the effect of future changes in laws or regulations (including the interpretation of these laws and regulations by regulatory authorities) and conditions in our operating areas, particularly with respect to business development companies or RICs.

Such forward-looking statements may include statements preceded by, followed by or that otherwise include the words may, might, will, intend, should, could, can, would, expect, believe, estimate, anticipate, or similar words.

We have based the forward-looking statements included in this prospectus and the accompanying prospectus supplement, if any on information available to us on the date of this prospectus and the accompanying prospectus supplement, if any, and we assume no obligation to update any such forward-looking statements. Actual results could differ materially from those anticipated in our forward-looking statements, and future results could differ materially from historical performance. We undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law or SEC rule or regulation. You are advised to consult any additional disclosures that we may make directly to you, including in the form of a prospectus supplement or post-effective amendment to the registration statement to which this prospectus relates, or through reports that we in the future may file with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

You should understand that, under Sections 27A(b)(2)(B) of the Securities Act and Section 21E(b)(2)(B) of the Exchange Act, the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 do not apply to statements made in connection with any offering of securities pursuant to this prospectus and the accompanying prospectus supplement, if any.



TABLE OF CONTENTS

## **USE OF PROCEEDS**

Unless otherwise specified in any prospectus supplement accompanying this prospectus, we intend to use the net proceeds of this offering, to make new investments in portfolio companies in accordance with our investment objective and strategies as described in this prospectus, to reduce a portion of our outstanding borrowings under the Credit Facility and for general working capital purposes. Pending such use, we will invest the net proceeds primarily in high quality, short-term debt securities consistent with our business development company election and our election to be taxed as a RIC.

We will not receive any proceeds from any sale of common stock by the selling stockholder.

47

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TABLE OF CONTENTS

## PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on the New York Stock Exchange, or NYSE, under the symbol SCM. In connection with our initial public offering, our shares of common stock began trading on November 8, 2012, and before that date, there was no established trading market for our common stock.

The following table sets forth, for each fiscal quarter since our common stock began trading, the range of high and low closing prices of our common stock as reported on the NYSE, the sales price as a percentage of our net asset value, or NAV, and the dividends declared by us for each fiscal quarter since our initial public offering.

| Fiscal Year Ended                                    | NAV Per Share <sup>(1)</sup> | Closing Sales Price <sup>(2)</sup> |          | Premium or Discount of High Sales to NAV <sup>(3)</sup> | Premium or Discount of Low Sales to NAV <sup>(3)</sup> |
|--|------------------------------|------------------------------------|----------|---|--|
|  |                              | High                               | Low      |   |  |
| December 31, 2014                                    |                              |                                    |          |   |  |
| First Quarter (through January 28, 2014)             | *                            | \$ 14.99                           | \$ 14.56 | *   | *  |
| December 31, 2013                                    |                              |                                    |          |   |  |
| Fourth Quarter                                       | *                            | \$ 15.44                           | \$ 14.35 | *   | *  |
| Third Quarter  | 14.57                        | \$ 15.28                           | \$ 14.74 | 105 %   | 101 %  |
| Second Quarter                                       | 14.60                        | \$ 15.31                           | \$ 14.29 | 105 %   | 97.9 %   |
| First Quarter  | \$ 14.56                     | \$ 16.73                           | \$ 14.51 | 115 %   | 99.7 %   |
| December 31, 2012                                    |                              |                                    |          |   |  |
| November 8, 2012 to December 31, 2012 <sup>(4)</sup> | \$ 14.45                     | \$ 16.38                           | \$ 15.00 | 113 %   | 104 %  |

NAV is determined as of the last date in the relevant quarter and therefore may not reflect the NAV per share on (1) the date of the high and low sales prices. The NAVs shown are based on outstanding shares at the end of each period.

(2) Closing sales price is determined as the high or low closing sales price noted within the respective quarter, not adjusted for dividends.

(3) Calculated as of the respective high or low sales price divided by the quarter end NAV.

(4) Our stock began trading on November 8, 2012.

\* Not determinable at the time of filing.

On January 28, 2014, the last reported sales price of our common stock was \$14.85 per share. As of January 28, 2014, we had 29 stockholders of record, which did not include stockholders for whom shares are held in nominee or street name.

Shares of business development companies may trade at a market price that is less than the value of the net assets attributable to those shares. The possibility that our shares of common stock will trade at a discount from net asset value or at premiums that are unsustainable over the long term are separate and distinct from the risk that our net asset value will decrease. Since they began trading on November 8, 2012, in connection with our initial public offering, our shares of common stock have traded at times at a discount to the net assets attributable to those shares.

## Edgar Filing: Stellus Capital Investment Corp - Form 497

To the extent that we have income available, we intend to make quarterly distributions to our stockholders. Our quarterly stockholder distributions, if any, will be determined by our board of directors. Any stockholder distribution to our stockholders will be declared out of assets legally available for distribution. The amount of any such distribution will be based on a minimum annual dividend yield of 9.0%.

We have elected to be treated as a RIC under the Code. To obtain and maintain RIC tax treatment, we must distribute at least 90% of our net ordinary income and net short-term capital gains in excess of our net long-term capital losses, if any, to our stockholders. In order to avoid certain excise taxes imposed on RICs, we currently intend to distribute during each calendar year an amount at least equal to the sum of: (a) 98% of our net ordinary income for such calendar year; (b) 98.2% of our capital gain net income for the one-year

TABLE OF CONTENTS

period ending on October 31 of the calendar year; and (c) any net ordinary income and capital gain net income for preceding years that were not distributed during such years and on which we previously paid no U.S. federal income tax.

We currently intend to distribute net capital gains (*i.e.*, net long-term capital gains in excess of net short-term capital losses), if any, at least annually out of the assets legally available for such distributions. However, we may decide in the future to retain such capital gains for investment and elect to treat such gains as deemed distributions to you. If this happens, you will be treated for U.S. federal income tax purposes as if you had received an actual distribution of the capital gains that we retain and reinvested the net after tax proceeds in us. In this situation, you would be eligible to claim a tax credit (or in certain circumstances a tax refund) equal to your allocable share of the tax we paid on the capital gains deemed distributed to you. See **Material U.S. Federal Income Tax Considerations**. We cannot assure you that we will achieve results that will permit us to pay any cash distributions, and if we issue senior securities, we may be prohibited from making distributions if doing so would cause us to fail to maintain the asset coverage ratios stipulated by the 1940 Act or if such distributions are limited by the terms of any of our borrowings.

We have adopted an **opt out dividend reinvestment plan** for our common stockholders. Unless you elect to receive your distributions in cash, we intend to make such distributions in additional shares of our common stock under our dividend reinvestment plan. Although distributions paid in the form of additional shares of our common stock will generally be subject to U.S. federal, state and local taxes in the same manner as cash distributions, investors participating in our dividend reinvestment plan will not receive any corresponding cash distributions with which to pay any such applicable taxes. If you hold shares of our common stock in the name of a broker or financial intermediary, you should contact such broker or financial intermediary regarding your election to receive distributions in cash in lieu of shares of our common stock. Any distributions reinvested through the issuance of shares through our dividend reinvestment plan will increase our gross assets on which the base management fee and the incentive fee are determined and paid to Stellus Capital Management. See **Dividend Reinvestment Plan**.

The following table summarizes our quarterly cash distributions, including dividends and returns of capital, if any, per share that have been declared by our board of directors since our initial public offering:

| Fiscal Year Ended             | Date Declared     | Record Date       | Payment Date       | Per Share Amount |
|-------------------------------|-------------------|-------------------|--------------------|------------------|
| December 31, 2014             |                   |                   |                    |                  |
| First Quarter                 | December 27, 2013 | January 15, 2014  | January 24, 2014   | \$ 0.065         |
| December 31, 2013             |                   |                   |                    |                  |
| Fourth Quarter                | November 25, 2013 | December 9, 2013  | December 23, 2013  | \$ 0.340         |
| Third Quarter                 | August 21, 2013   | September 5, 2013 | September 27, 2013 | \$ 0.340         |
| Second Quarter                | June 6, 2013      | June 21, 2013     | June 28, 2013      | \$ 0.340         |
| First Quarter                 | March 7, 2013     | March 21, 2013    | March 28, 2013     | \$ 0.340         |
| December 31, 2012             |                   |                   |                    |                  |
| Fourth Quarter <sup>(1)</sup> | December 7, 2012  | December 21, 2012 | December 27, 2012  | \$ 0.180         |
| Total                         |                   |                   |                    | \$ 1.605         |

(1) The amount of this initial distribution was at least equal to an estimated annualized dividend yield of 9.0% based on the price per share of our common stock in connection with our initial public offering and was proportionately reduced to reflect the number of days remaining in the quarter after completion of our initial public offering, which closed on November 13, 2012.

49

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TABLE OF CONTENTS

## RATIOS OF EARNINGS TO FIXED CHARGES

The following table contains our ratio of earnings to fixed charges for the periods indicated, computed as set forth below. You should read these ratios of earnings to fixed charges in connection with our Consolidated Financial Statements, including the notes to those statements, included in this prospectus.

|  | For The Nine Months<br>Ended<br>September 30, 2013 | For The Year Ended<br>December 31, 2012 |
|--|--|---|
| Earnings to Fixed Charges <sup>(1)</sup> | 7.1  | 5.4                                     |

For purposes of computing the ratios of earnings to fixed charges, earnings represent net increase in net assets resulting from operations plus (or minus) income tax expense (benefit) including excise tax expense plus fixed charges. Fixed charges include interest and credit facility fees expense and amortization of debt issuance costs.

(1) Earnings include net realized and unrealized gains or losses. Net realized and unrealized gains or losses can vary substantially from period to period.

50

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TABLE OF CONTENTS

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Overview

We were organized as a Maryland corporation on May 18, 2012 and formally commenced operations on November 7, 2012. Our investment objective is to maximize the total return to our stockholders in the form of current income and capital appreciation through debt and related equity investments in middle-market companies.

We are an externally managed, non-diversified, closed-end investment company that has elected to be regulated as a BDC under the 1940 Act. As a BDC, we are required to comply with certain regulatory requirements.

As a BDC, we must not acquire any assets other than qualifying assets specified in the 1940 Act unless, at the time the acquisition is made, at least 70% of our total assets are qualifying assets (with certain limited exceptions). Qualifying assets include investments in eligible portfolio companies. Under the relevant SEC rules, the term eligible portfolio company includes all private companies, companies whose securities are not listed on a national securities exchange, and certain public companies that have listed their securities on a national securities exchange and have a market capitalization of less than \$250 million, in each case organized in the United States.

In order to expedite the ramp-up of our investment activities and further our ability to meet our investment objectives, on November 7, 2012, we acquired our initial portfolio composed of investments in 11 portfolio companies from a private investment fund to which the D. E. Shaw group serves as investment adviser and Stellus Capital Management, LLC serves as a non-discretionary sub-adviser. The total consideration paid for our initial portfolio was \$194.4 million (excluding accrued interest of approximately \$2.3 million), consisting of \$165.2 million in cash and \$29.2 million in shares of our common stock based on the price of \$15.00 per share.

We financed the cash portion of the acquisition of our initial portfolio by (i) borrowing \$152.5 million under a \$156 million credit facility led by SunTrust Bank (the Bridge Facility) and (ii) using the \$12.7 million of proceeds we received in connection with the sale of shares of our common stock in a private placement transaction to certain purchasers, including persons and entities associated with Stellus Capital Management, LLC, at a purchase price of \$15.00 per share.

On November 13, 2012, we completed our initial public offering (IPO) and sold 9,200,000 shares (including 1,200,000 shares through the underwriters' exercise of their overallotment option) of our common stock through a group of underwriters at an initial public offering price of \$15.00 per share. We received \$132.2 million of total net proceeds in connection with the IPO. We used the net proceeds from our IPO and borrowings under the Credit Facility (as described below) to pay down all amounts outstanding under the Bridge Facility and terminated the Bridge Facility in conjunction with such repayment.

On November 13, 2012, we entered into a senior secured revolving credit facility (the Credit Facility), with various lenders, including SunTrust Bank, which also serves as administrative agent. The Credit Facility provides for borrowings in an aggregate amount up to \$115 million on a committed basis and an accordion for an additional \$35 million for a total facility size of \$150 million. The exercise of the accordion will require sufficient borrowing base and additional commitments from the existing lender group and/or new lenders. Borrowings under the Credit Facility

bear interest, subject to the Company's election, on a per annum basis equal to (i) LIBOR plus 3.00% with no LIBOR floor or (ii) 2.00% plus an alternate base rate based on the highest of the Prime Rate, Federal Funds Rate plus 0.5% or one month LIBOR plus 1.0%. The Company pays unused commitment fees of 0.50% per annum on the unused lender commitments under the Credit Facility. Interest is payable quarterly in arrears. Any amounts borrowed under the Credit Facility will mature, and all accrued and unpaid interest thereunder will be due and payable, on November 12, 2016. As of September 30, 2013, we had \$85 million in borrowings outstanding under the Credit Facility and substantially all our assets were pledged as collateral under the Credit Facility.

The Company incurred costs of \$2.0 million in connection with obtaining the Credit Facility, which the Company has recorded as prepaid loan structure fees on its statement of assets and liabilities and is amortizing

TABLE OF CONTENTS

these fees over the life of the Credit Facility. The Company incurred costs of \$0.1 million in connection with the \$20 million commitment increase. As of September 30, 2013, \$1.7 million of such prepaid loan structure fees have yet to be amortized.

We have elected to be treated for tax purposes as a RIC under Subchapter M of the Code. To maintain our qualification as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements. As of September 30, 2013, we were in compliance with the RIC requirements. As a RIC, we generally will not have to pay corporate-level taxes on any income we distribute to our stockholders.

## Portfolio Composition and Investment Activity

### Portfolio Composition

We originate and invest primarily in privately-held middle-market companies (typically those with \$5.0 million to \$50.0 million of EBITDA) through first lien, second lien, unitranche and mezzanine debt financing, often times with a corresponding equity investment.

As of September 30, 2013, we had \$243.6 million (at fair value) invested in 23 companies. As of September 30, 2013, our portfolio included approximately 24.9% of first lien debt, 32.5% of second lien debt, 41.8% of mezzanine debt and 0.8% of equity investments at fair value.

As of December 31, 2012, we had \$195.5 million (at fair value) invested in 15 companies. As of December 31, 2012, our portfolio included approximately 22.5% of first lien debt, 19.7% of second lien debt, 56.9% of mezzanine debt and 0.9% of equity investments at fair value.

The composition of our investments as of September 30, 2013 and December 31, 2012 was as follows:

|                            | As of September 30, 2013 |                | As of December 31, 2012 |                |
|----------------------------|--------------------------|----------------|-------------------------|----------------|
|                            | Cost                     | Fair Value     | Cost                    | Fair Value     |
| Senior Secured First Lien  | \$ 60,321,841            | \$ 60,606,097  | \$ 44,014,214           | \$ 44,014,214  |
| Senior Secured Second Lien | 78,381,468               | 79,195,140     | 38,597,293              | 38,597,622     |
| Unsecured Debt             | 102,180,525              | 101,914,951    | 111,129,878             | 111,125,134    |
| Equity                     | 1,714,286                | 1,909,121      | 1,714,286               | 1,714,286      |
| Total Investments          | \$ 242,598,120           | \$ 243,625,309 | \$ 195,455,671          | \$ 195,451,256 |

The following is a summary of geographical concentration of our investment portfolio as of September 30, 2013:

|           | Cost          | Fair Value    | % of Total Investments |   |
|-----------|---------------|---------------|------------------------|---|
| Colorado  | \$ 36,243,568 | \$ 36,870,097 | 15.13                  | % |
| Minnesota | 34,794,479    | 35,027,004    | 14.38                  | % |
| Canada    | 27,961,549    | 28,143,492    | 11.55                  | % |
| New York  | 25,298,910    | 25,298,910    | 10.38                  | % |
| Kentucky  | 16,870,095    | 17,245,099    | 7.08                   | % |
| Florida   | 16,893,530    | 16,893,530    | 6.93                   | % |
| Texas     | 16,536,414    | 16,508,037    | 6.78                   | % |

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|               |                |                |        |   |
|---------------|----------------|----------------|--------|---|
| Indiana       | 11,169,118     | 11,169,118     | 4.59   | % |
| Massachusetts | 10,000,000     | 10,088,000     | 4.14   | % |
| Pennsylvania  | 9,659,583      | 9,417,001      | 3.87   | % |
| New Jersey    | 9,161,316      | 9,161,316      | 3.76   | % |
| Puerto Rico   | 8,702,234      | 8,231,865      | 3.38   | % |
| Missouri      | 7,923,260      | 8,120,000      | 3.33   | % |
| Illinois      | 7,390,621      | 7,390,500      | 3.03   | % |
| Virginia      | 2,513,997      | 2,585,190      | 1.06   | % |
| Georgia       | 1,479,446      | 1,476,150      | 0.61   | % |
|               | \$ 242,598,120 | \$ 243,625,309 | 100.00 | % |

---

52

TABLE OF CONTENTS

The following is a summary of our geographical concentration of our investment portfolio as of December 31, 2012:

|                | Cost           | Fair Value     | % of Total<br>Investments |   |
|----------------|----------------|----------------|---------------------------|---|
| Pennsylvania   | \$ 33,708,952  | \$ 33,704,209  | 17.24                     | % |
| Canada         | 20,778,456     | 20,778,456     | 10.63                     | % |
| Colorado       | 19,532,633     | 19,532,633     | 9.99                      | % |
| Kentucky       | 17,095,646     | 17,095,646     | 8.75                      | % |
| Florida        | 16,639,880     | 16,639,880     | 8.51                      | % |
| South Carolina | 15,000,000     | 15,000,000     | 7.67                      | % |
| New York       | 13,000,000     | 13,000,000     | 6.65                      | % |
| Texas          | 12,119,671     | 12,120,000     | 6.2                       | % |
| Massachusetts  | 10,000,000     | 10,000,000     | 5.12                      | % |
| Utah           | 9,902,063      | 9,902,062      | 5.07                      | % |
| New Jersey     | 9,879,189      | 9,879,189      | 5.05                      | % |
| Indiana        | 8,969,955      | 8,969,955      | 4.59                      | % |
| Connecticut    | 7,351,604      | 7,351,604      | 3.76                      | % |
| Georgia        | 1,477,622      | 1,477,622      | 0.77                      | % |
|                | \$ 195,455,671 | \$ 195,451,256 | 100.00                    | % |

The following is a summary of industry concentration of our investment portfolio as of September 30, 2013:

|                                    | Cost           | Fair Value     | % of Total<br>Investments |   |
|------------------------------------|----------------|----------------|---------------------------|---|
| Services: Business                 | \$ 36,826,331  | \$ 37,008,274  | 15.19                     | % |
| Healthcare & Pharmaceuticals       | 35,563,222     | 35,271,962     | 14.48                     | % |
| High Tech Industries               | 28,485,813     | 28,485,692     | 11.69                     | % |
| Software                           | 26,258,893     | 26,343,650     | 10.81                     | % |
| Telecommunications                 | 22,165,027     | 22,311,794     | 9.16                      | % |
| Beverage, Food, & Tobacco          | 16,679,376     | 17,255,000     | 7.08                      | % |
| Automotive                         | 12,055,183     | 12,309,375     | 5.05                      | % |
| Finance                            | 12,232,466     | 12,232,466     | 5.02                      | % |
| Transportation: Cargo              | 11,169,118     | 11,169,118     | 4.59                      | % |
| Energy: Oil & Gas                  | 9,603,620      | 9,603,937      | 3.94                      | % |
| Consumer Goods: Non-Durable        | 9,659,583      | 9,417,001      | 3.87                      | % |
| Retail                             | 9,161,316      | 9,161,316      | 3.76                      | % |
| Media: Broadcasting & Subscription | 7,923,260      | 8,120,000      | 3.33                      | % |
| Metals & Mining                    | 4,814,912      | 4,935,724      | 2.03                      | % |
|                                    | \$ 242,598,120 | \$ 243,625,309 | 100.00                    | % |

The following is a summary of industry concentration of our investment portfolio as of December 31, 2012:

|                             | Cost          | Fair Value    | % of Total<br>Investments |   |
|-----------------------------|---------------|---------------|---------------------------|---|
| Consumer Goods: Non-Durable | \$ 33,708,952 | \$ 33,704,209 | 17.24                     | % |
| Services: Business          | 31,117,502    | 31,117,501    | 15.93                     | % |
| High Tech Industries        | 30,778,456    | 30,778,456    | 15.75                     | % |

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|                                    |            |            |         |
|------------------------------------|------------|------------|---------|
| Health & Pharmaceuticals           | 26,884,237 | 26,884,237 | 13.75 % |
| Retail                             | 19,781,252 | 19,781,252 | 10.12 % |
| Media: Broadcasting & Subscription | 15,000,000 | 15,000,000 | 7.67%   |

53

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TABLE OF CONTENTS

|                       | Cost           | Fair Value     | % of Total Investments |   |
|-----------------------|----------------|----------------|------------------------|---|
| Automotive            | 12,345,646     | 12,345,646     | 6.32                   | % |
| Telecommunications    | 12,119,671     | 12,120,000     | 6.20                   | % |
| Transportation: Cargo | 8,969,955      | 8,969,955      | 4.59                   | % |
| Metals & Mining       | 4,750,000      | 4,750,000      | 2.43                   | % |
|                       | \$ 195,455,671 | \$ 195,451,256 | 100.00                 | % |

At September 30, 2013, our average portfolio company investment at amortized cost and fair value was approximately \$10.5 million and \$10.6 million, respectively, and our largest portfolio company investment by amortized cost and fair value was approximately \$21.0 million and \$21.0 million, respectively. At December 31, 2012, our average portfolio company investment at amortized cost and fair value was approximately \$13.0 million and \$13.0 million, respectively, and our largest portfolio company investment by amortized cost and fair value was approximately \$33.0 million and \$33.0 million, respectively.

At September 30, 2013, 54% of our debt investments bore interest based on floating rates (subject to interest rate floors), such as LIBOR, and 46% bore interest at fixed rates. At December 31, 2012, 40% of our debt investments bore interest based on floating rates (subject to interest rate floors), such as LIBOR, and 60% bore interest at fixed rates.

The weighted average yield on all of our debt investments as of September 30, 2013 and December 31, 2012 was approximately 11.4% and 12.5%, respectively. The weighted average yield was computed using the effective interest rates for all of our debt investments, including accretion of original issue discount.

As of September 30, 2013 and December 31, 2012, we had cash of \$13.3 million and \$12.1 million, respectively, and United States Treasury securities of \$10.0 million and \$50.0 million, respectively. The United States Treasury securities were purchased and temporarily held in connection with complying with RIC diversification requirements under Subchapter M of the Code.

**Investment Activity**

On November 7, 2012, we acquired our initial portfolio composed of investments in 11 portfolio companies from a private investment fund to which the D. E. Shaw group serves as investment adviser and Stellus Capital Management, LLC serves as a non-discretionary sub-adviser. The total consideration paid for our initial portfolio was \$194.4 million in total (excluding accrued interest of approximately \$2.3 million) consisting of \$165.2 million in cash and \$29.2 million in shares of our common stock based on the price of \$15.00 per share. Our initial portfolio was comprised of a portion of the loans to middle-market companies that were originated over the previous three years by the Stellus Capital Management, LLC investment team during their time with the D. E. Shaw group and were selected for our initial portfolio because they are similar to the type of investments we originate. Our initial portfolio included middle-market loans that had an internal risk rating of 2 or better (i.e., investments that were performing at or above expectations and whose risks were neutral or favorable compared to the expected risk at the time of the original investment). We engaged an independent third-party valuation firm to assist in our determination of the acquisition price of the initial portfolio, which was ultimately approved by our board of directors (which includes a majority of independent directors). The independent third-party valuation firm that we engaged is also the third party valuation firm that was engaged by the D. E. Shaw group to value the initial portfolio for the D. E. Shaw group fund in the ordinary course of such fund's operations.

During the three months ended September 30, 2013, we made \$16.8 million of investments in one new portfolio company and to an existing portfolio company. During the nine months ended September 30, 2013, we made \$129 million of investments in 12 new portfolio companies and to existing portfolio companies.

During the three months ended September 30, 2013, we received \$35.4 million in proceeds principally from prepayments of our investments, including \$0.5 million from amortization of certain other investments. During the nine months ended September 30, 2013, we received \$84 million in proceeds principally from prepayments of our investments, including \$2 million from amortization of certain other investments.

## TABLE OF CONTENTS

Our level of investment activity can vary substantially from period to period depending on many factors, including the amount of debt and equity capital to middle market companies, the level of merger and acquisition activity, the general economic environment and the competitive environment for the types of investments we make.

### Asset Quality

In addition to various risk management and monitoring tools, Stellus Capital Management, LLC uses an investment rating system to characterize and monitor the credit profile and expected level of returns on each investment in our portfolio. This investment rating system uses a five-level numeric scale. The following is a description of the conditions associated with each investment rating:

Investment Rating 1 is used for investments that are performing above expectations, and whose risks remain favorable compared to the expected risk at the time of the original investment.

Investment Rating 2 is used for investments that are performing within expectations and whose risks remain neutral compared to the expected risk at the time of the original investment. All new loans are initially rated 2.

Investment Rating 3 is used for investments that are performing below expectations and that require closer monitoring, but where no loss of return or principal is expected. Portfolio companies with a rating of 3 may be out of compliance with financial covenants.

Investment Rating 4 is used for investments that are performing substantially below expectations and whose risks have increased substantially since the original investment. These investments are often in work out. Investments with a rating of 4 are those for which some loss of return but no loss of principal is expected.

Investment Rating 5 is used for investments that are performing substantially below expectations and whose risks have increased substantially since the original investment. These investments are almost always in work out. Investments with a rating of 5 are those for which some loss of return and principal is expected.

The following table shows the investment rankings of our investments at fair value:

| Investment Rating | As of September 30, 2013 |                      |                               | As of December 31, 2012 |                      |                               |
|-------------------|--------------------------|----------------------|-------------------------------|-------------------------|----------------------|-------------------------------|
|                   | Fair Value               | % of Total Portfolio | Number of Portfolio Companies | Fair Value              | % of Total Portfolio | Number of Portfolio Companies |
| 1                 | \$ 11.1                  | 4 %                  | 1                             | \$                      | %                    |                               |
| 2                 | 211.2                    | 87 %                 | 20                            | 195.5                   | 100                  | 15                            |
| 3                 | 21.3                     | 9 %                  | 2                             |                         |                      |                               |
| 4                 |                          |                      |                               |                         |                      |                               |
| 5                 |                          |                      |                               |                         |                      |                               |
|                   | \$ 243.6                 | 100 %                | 23                            | \$ 195.5                | 100 %                | 15                            |

### Loans and Debt Securities on Non-Accrual Status

We will not accrue interest on loans and debt securities if we have reason to doubt our ability to collect such interest. As of September 30, 2013 and December 31, 2012, we had no loans on non-accrual.

### Results of Operations for the Three Months and Nine months ended September 30, 2013

An important measure of our financial performance is net increase (decrease) in net assets resulting from operations, which includes net investment income (loss), net realized gain (loss) and net unrealized appreciation (depreciation). Net investment income (loss) is the difference between our income from interest, dividends, fees and other investment income and our operating expenses including interest on borrowed funds. Net realized gain (loss) on investments is the difference between the proceeds received from dispositions of

portfolio investments and their amortized cost. Net unrealized appreciation (depreciation) on investments is the net change in the fair value of our investment portfolio.

## TABLE OF CONTENTS

### **Revenues**

We generate revenue in the form of interest income on debt investments and capital gains and distributions, if any, on investment securities that we may acquire in portfolio companies. Our debt investments typically have a term of five to seven years and bear interest at a fixed or floating rate. Interest on our debt securities is generally payable quarterly. Payments of principal on our debt investments may be amortized over the stated term of the investment, deferred for several years or due entirely at maturity. In some cases, our debt investments may pay interest in-kind, or PIK. Any outstanding principal amount of our debt securities and any accrued but unpaid interest will generally become due at the maturity date. The level of interest income we receive is directly related to the balance of interest-bearing investments multiplied by the weighted average yield of our investments. We expect that the dollar amount of interest and any dividend income that we earn to increase as the size of our investment portfolio increases. In addition, we may generate revenue in the form of prepayment fees, commitment, loan origination, structuring or due diligence fees, fees for providing significant managerial assistance and consulting fees.

Investment income for the three months and nine months ended September 30, 2013 totaled \$7.9 million and \$21.7 million, respectively, and was primarily composed of interest income.

### **Expenses**

Our primary operating expenses include the payment of fees to Stellus Capital Management, LLC under the investment advisory agreement, our allocable portion of overhead expenses under the administration agreement and other operating costs described below. We bear all other out-of-pocket costs and expenses of our operations and transactions, which may include:

- the cost of calculating our net asset value, including the cost of any third-party valuation services;
- the cost of effecting sales and repurchases of shares of our common stock and other securities;
- fees payable to third parties relating to making investments, including out-of-pocket fees and expenses associated with performing due diligence and reviews of prospective investments;
- transfer agent and custodial fees;
- out-of-pocket fees and expenses associated with marketing efforts;
- federal and state registration fees and any stock exchange listing fees;
- U.S. federal, state and local taxes;
- independent directors' fees and expenses;
- brokerage commissions;
- fidelity bond, directors' and officers' liability insurance and other insurance premiums;
- direct costs, such as printing, mailing, long distance telephone and staff;
- fees and expenses associated with independent audits and outside legal costs;
- costs associated with our reporting and compliance obligations under the 1940 Act and other applicable U.S. federal and state securities laws; and
- other expenses incurred by Stellus Capital Management, LLC or us in connection with administering our business, including payments under the administration agreement that are based upon our allocable portion of overhead (subject to the review of our board of directors).

Operating expenses for the three months and nine months ended September 30, 2013 totaled \$3.8 million and \$9.9 million, respectively and consisted of base management fees, incentive fees, administrative services expenses, fees related to the Credit Facility, professional fees, valuation fees, insurance expenses, directors' fees, and other general and administrative expenses.

The base management fee for the three months and nine months ended September 30, 2013 was \$1.1 million and \$3.1 million, respectively.

## TABLE OF CONTENTS

For the three and nine months ended September 30, 2013, the Company incurred incentive fees totaling \$0.7 million and \$2.3 million, respectively. For the three and nine months ended September 30, 2012, the Company adjusted its realized gains incentive fee accrual related to realized gains by (\$0.1) million and \$0.1 million, respectively, and related to unrealized gains by \$0.0 million and \$0.4 million respectively.

The total realized gains incentive fee payable to Stellus Capital Management, LLC, the Company's advisor, under the investment management agreement as of September 30, 2013 and December 31, 2012 was \$0.4 million and \$0, respectively. The realized gains incentive fee related to realized gains payable to the Company's advisor under the investment management agreement as of September 30, 2013 and December 31, 2012 was \$0.1 million and \$0, respectively.

Borrowings under the Credit Facility were \$85.0 million and \$38.0 million as of September 30, 2013 and December 31, 2012, respectively.

For the three months ended September 30, 2013 the effective interest rate under the Credit Facility was approximately 3.3% (approximately 3.6% including commitment fees on the unused portion of the Credit Facility). Interest is paid quarterly in arrears. The Company recorded interest and fee expense of \$1.0 million for the three months ended September 30, 2013, of which \$0.7 million was interest expense, \$0.2 million was amortization of loan fees paid on the Credit Facility, \$53 thousand related to commitment fees on the unused portion of the Credit Facility, and \$13 thousand related to loan administration fees.

For the nine months ended September 30, 2013 the effective interest rate under the Credit Facility was approximately 3.3% (approximately 3.8% including commitment fees on the unused portion of the Credit Facility). Interest is paid quarterly in arrears. The Company recorded interest and fee expense of \$2.3 million for the nine months ended September 30, 2013, of which \$1.6 million was interest expense, \$0.4 million was amortization of loan fees paid on the Credit Facility, \$0.2 million related to commitment fees on the unused portion of the Credit Facility, and \$37 thousand related to loan administration fees.

The Company paid \$0.7 million and \$1.6 million in interest expense and unused commitment fees for the three and nine months ended September 30, 2013, respectively. The average borrowings under the Credit Facility for the three and nine months ended September 30, 2013 were \$87.4 million and \$63.4 million, respectively.

Administrative services expenses for the three months ended September 30, 2013 totaled \$0.2 million, \$0.1 million of which was related to our third party administrator and \$0.1 million of which was allocated to us from Stellus Capital Management, LLC. Administrative expenses for the nine months ended September 30, 2013 totaled \$0.6 million, \$0.3 million of which was related to our third party administrator and \$0.3 million of which was allocated to us from Stellus Capital Management, LLC. Expenses for valuation, professional fees, insurance expenses, directors' fees, and other general and administrative expense for the three months and nine months ended September 30, 2013 totaled \$0.7 million and \$1.7 million, respectively. Expenses for valuation, professional fees, insurance expenses, directors' fees, and other general and administrative expense for the three months and nine months ended September 30, 2012 totaled \$0.1 million and \$0.3 million, respectively.

## **Net Investment Income**

For the three months ended September 30, 2013, net investment income was \$4.1 million, or \$0.34 per common share (based on 12,066,548 weighted-average common shares outstanding at September 30, 2013. Net investment income includes incremental accruals of (\$0.1) million of incentive fees related to realized and unrealized gains.

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For the nine months ended September 30, 2013, net investment income was \$11.8 million, or \$0.98 per common share (based on 12,051,013 weighted-average common shares outstanding at September 30, 2013. Net investment income includes accruals of \$0.4 million of incentive fees related to realized and unrealized gains.

57

---

TABLE OF CONTENTS

## **Net Realized Gains and Losses**

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, using the specific identification method, without regard to unrealized appreciation or depreciation previously recognized.

Repayments of investments and amortization of other certain investments for the three months ended September 30, 2013 totaled \$35.4 million and net realized gains totaled \$0.0 million. Repayments of investments and amortization of other certain investments for the nine months ended September 30, 2013 totaled \$84.1 million and net realized gains totaled \$1.0 million.

## **Net Change in Unrealized Appreciation (Depreciation) of Investments and Cash Equivalents**

Net change in unrealized appreciation primarily reflects the change in portfolio investment values during the reporting period, including the reversal of previously recorded appreciation or depreciation when gains or losses are realized.

Net change in unrealized appreciation (depreciation) on investments and cash equivalents for the three and nine months ended September 30, 2013 totaled (\$0.3) million and \$1.0 million, respectively.

## **Net Increase in Net Assets Resulting from Operations**

For the three months ended September 30, 2013, net increase in net assets resulting from operations totaled \$3.8 million, or \$0.32 per common share (based on 12,066,548 weighted-average common shares outstanding at September 30, 2013). For the nine months ended September 30, 2013, net increase in net assets resulting from operations totaled \$13.8 million, or \$1.15 per common share (based on 12,051,013 weighted-average common shares outstanding at September 30, 2013).

## **Financial condition, liquidity and capital resources**

### **Cash Flows from Operating and Financing Activities**

Our operating activities used cash of \$37.8 million for the nine months ended September 30, 2013, primarily in connection with the purchase of investments. Our operating activities used cash of \$0.0 million for the nine months ended September 30, 2012, primarily related to the formation of the Company. Our financing activities for the nine months ended September 30, 2013 used cash of \$0.8 million primarily to paydown the short-term loan and make distributions to shareholders.

Our liquidity and capital resources are derived from the Credit Facility and cash flows from operations, including investment sales and repayments, and income earned. Our primary use of funds from operations includes investments in portfolio companies and other operating expenses we incur, as well as the payment of dividends to the holders of our common stock. We used, and expect to continue to use, these capital resources as well as proceeds from turnover within our portfolio and from public and private offerings of securities to finance our investment activities.

Although we expect to fund the growth of our investment portfolio through the net proceeds from future public and private equity offerings and issuances of senior securities or future borrowings to the extent permitted by the 1940

Act, our plans to raise capital may not be successful. In this regard, if our common stock trades at a price below our then-current net asset value per share, we may be limited in our ability to raise equity capital given that we cannot sell our common stock at a price below net asset value per share unless our stockholders approve such a sale and our board of directors makes certain determinations in connection therewith. A proposal, approved by our stockholders at our 2013 Annual Meeting of Stockholders, authorizes us to sell shares of our common stock below the then current net asset value per share of our common stock in one or more offerings for the period ending on the earlier of (i) May 23, 2014, the one year anniversary of our 2013 Annual Meeting of Stockholders, or (ii) the date of our 2014 Annual Meeting of Stockholders. We would need similar future approval from our stockholders to issue shares below the then current net asset value per share any time after the expiration of the current approval.

In addition, we intend to distribute between 90% and 100% of our taxable income to our stockholders in order to satisfy the requirements applicable to RICs under Subchapter M of the Code. Consequently, we may

58

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## TABLE OF CONTENTS

not have the funds or the ability to fund new investments, to make additional investments in our portfolio companies, to fund our unfunded commitments to portfolio companies or to repay borrowings. In addition, the illiquidity of our portfolio investments may make it difficult for us to sell these investments when desired and, if we are required to sell these investments, we may realize significantly less than their recorded value.

Also, as a business development company, we generally are required to meet a coverage ratio of total assets, less liabilities and indebtedness not represented by senior securities, to total senior securities, which include all of our borrowings and any outstanding preferred stock, of at least 200%. This requirement limits the amount that we may borrow. We were in compliance with the asset coverage at all times. As of September 30, 2013 and December 31, 2012 our asset coverage ratio was 288% and 309%, respectively.

The amount of leverage that we employ will depend on our assessment of market conditions and other factors at the time of any proposed borrowing, such as the maturity, covenant package and rate structure of the proposed borrowings, our ability to raise funds through the issuance of shares of our common stock and the risks of such borrowings within the context of our investment outlook. Ultimately, we only intend to use leverage if the expected returns from borrowing to make investments will exceed the cost of such borrowing.

As of September 30, 2013 and December 31, 2012, we had cash of \$13.6 million and \$12.1 million, respectively, and United States Treasury securities of \$10.0 million and \$50.0 million, respectively.

## **Credit Facility**

The Credit Facility is a syndicated multi-currency facility and provides for borrowings up to \$135 million and matures in November 2016. As of September 30, 2013, we had \$85 million of borrowings outstanding under the Credit Facility. Borrowings under the Credit Facility generally bear interest at LIBOR plus 3.00%. The Credit Facility size may be increased up to \$150 million, subject to certain conditions, with additional new lenders or through an increase in commitments of current lenders. The Credit Facility is a four-year revolving facility secured by substantially all of our investment portfolio assets. The Credit Facility contains affirmative and restrictive covenants, including but not limited to maintenance of a minimum shareholders' equity amount and maintenance of a ratio of total assets (less total liabilities other than indebtedness) to total indebtedness of not less than 2.0:1.0. In addition to the asset coverage ratio described in the preceding sentence, borrowings under the Credit Facility (and the incurrence of certain other permitted debt) are subject to compliance with a borrowing base that applies different advance rates to different types of assets in our portfolio. We have also generally agreed under the terms of the Credit Facility not to incur any additional secured indebtedness. In addition, we have agreed not to incur any additional unsecured indebtedness that has a maturity date prior to the maturity date of the Credit Facility. Furthermore, the Credit Facility contains a covenant requiring us to maintain compliance with RIC provisions at all times, subject to certain remedial provisions.

## **Other**

We have applied for a license to form and operate an SBIC subsidiary; however, the application is subject to approval by the SBA. We can make no assurances that the SBA will approve our application, or the time frame in which we would receive a license, should one ultimately be granted. The SBIC subsidiary would be allowed to issue SBA-guaranteed debentures up to a maximum of \$150 million under current SBIC regulations, subject to required capitalization of the SBIC subsidiary and other requirements. SBA guaranteed debentures generally have longer maturities and lower interest rates than other forms of debt that may be available to us, and we believe therefore would represent an attractive source of debt capital.

## **Off-Balance Sheet Arrangements**

We may be a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of our portfolio companies. As of September 30, 2013, our only off-balance sheet arrangements consisted of \$14.5 million of unfunded commitments, which was comprised of \$14.5 million to provide debt financing to two of our portfolio companies. As of December 31, 2012, our only off-balance sheet arrangements consisted of \$2.0 million of unfunded commitments, which was comprised of \$2.0 million to provide debt financing to one of our portfolio companies.

TABLE OF CONTENTS

## **Regulated Investment Company Status and Dividends**

We have elected to be treated as a RIC under Subchapter M of the Code. So long as we maintain our status as a RIC, we will not be taxed on our investment company taxable income or realized net capital gains, to the extent that such taxable income or gains are distributed, or deemed to be distributed, to stockholders on a timely basis.

Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation until realized. Dividends declared and paid by us in a year may differ from taxable income for that year as such dividends may include the distribution of current year taxable income or the distribution of prior year taxable income carried forward into and distributed in the current year. Distributions also may include returns of capital.

To qualify for RIC tax treatment, we must, among other things, distribute, with respect to each taxable year, at least 90% of our investment company net taxable income (i.e., our net ordinary income and our realized net short-term capital gains in excess of realized net long-term capital losses, if any). If we maintain our qualification as a RIC, we must also satisfy certain distribution requirements each calendar year in order to avoid a federal excise tax on or undistributed earnings of a RIC. See Material U.S. Federal Income Tax Considerations Taxation as a RIC.

We intend to distribute to our stockholders between 90% and 100% of our annual taxable income (which includes our taxable interest and fee income). However, the covenants contained in the Credit Facility may prohibit us from making distributions to our stockholders, and, as a result, could hinder our ability to satisfy the distribution requirement. In addition, we may retain for investment some or all of our net taxable capital gains (i.e., realized net long-term capital gains in excess of realized net short-term capital losses) and treat such amounts as deemed distributions to our stockholders. If we do this, our stockholders will be treated as if they received actual distributions of the capital gains we retained and then reinvested the net after-tax proceeds in our common stock. Our stockholders also may be eligible to claim tax credits (or, in certain circumstances, tax refunds) equal to their allocable share of the tax we paid on the capital gains deemed distributed to them. To the extent our taxable earnings for a fiscal taxable year fall below the total amount of our dividends for that fiscal year, a portion of those dividend distributions may be deemed a return of capital to our stockholders.

We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of these distributions from time to time. In addition, we may be limited in our ability to make distributions due to the asset coverage test for borrowings applicable to us as a business development company under the 1940 Act and due to provisions in Credit Facility. We cannot assure stockholders that they will receive any distributions or distributions at a particular level.

In accordance with certain applicable Treasury regulations and private letter rulings issued by the Internal Revenue Service, a RIC may treat a distribution of its own stock as fulfilling its RIC distribution requirements if each stockholder may elect to receive his or her entire distribution in either cash or stock of the RIC, subject to a limitation that the aggregate amount of cash to be distributed to all stockholders must be at least 20% of the aggregate declared distribution. If too many stockholders elect to receive cash, each stockholder electing to receive cash must receive a pro rata amount of cash (with the balance of the distribution paid in stock). In no event will any stockholder, electing to receive cash, receive less than 20% of his or her entire distribution in cash. If these and certain other requirements are met, for U.S. federal income tax purposes, the amount of the dividend paid in stock will be equal to the amount of cash that could have been received instead of stock. We have no current intention of paying dividends in shares of our stock in accordance with these Treasury regulations or private letter rulings.

## **Recent Accounting Pronouncements**

See Note 1 to the financial statements for a description of recent accounting pronouncements, if any, including the expected dates of adoption and the anticipated impact on the financial statements.

60

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TABLE OF CONTENTS

## **Critical Accounting Policies**

The preparation of our financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Changes in the economic environment, financial markets and any other parameters used in determining such estimates could cause actual results to differ. In addition to the discussion below, our significant accounting policies are further described in the notes to the financial statements.

### **Valuation of portfolio investments**

As a business development company, we generally invest in illiquid loans and securities including debt and equity securities of middle-market companies. Under procedures established by our board of directors, we value investments for which market quotations are readily available at such market quotations. We obtain these market values from an independent pricing service or at the mean 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 are 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, although we engage independent valuation providers to review the valuation of each portfolio investment that does not have a readily available market quotation at least once each quarter. Investments purchased within 60 days of maturity are valued at cost plus accreted discount, or minus amortized premium, which approximates value. With respect to unquoted securities, our board of directors, together with our independent valuation advisors, values 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, our board of directors uses the pricing indicated by the external event to corroborate and/or assist us in our valuation. Because there is not a readily available market for substantially all of the investments in our portfolio, we value most of our portfolio investments at fair value as determined in good faith by our 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.

With respect to investments for which market quotations are not readily available, our board of directors undertakes a multi-step valuation process each quarter, as described below:

Our quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals of Stellus Capital Management, LLC responsible for the portfolio investment; Preliminary valuation conclusions are then documented and discussed with our senior management and Stellus Capital Management, LLC;

The audit committee of our board of directors then reviews these preliminary valuations; At least once each quarter, the valuation for each portfolio investment is reviewed by an independent valuation firm; and

The board of directors then discusses valuations and determines the fair value of each investment in our portfolio in good faith, based on the input of Stellus Capital Management, LLC, the independent valuation firm and the audit committee.

## Revenue recognition

We record interest income on an accrual basis to the extent it is deemed collectible. For loans and debt securities with contractual 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

## TABLE OF CONTENTS

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 is recorded as interest income. We record prepayment premiums on loans and debt securities as interest income. Dividend income, if any, will be recognized on the ex-dividend date.

### **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.

### **Unrealized Gains Incentive Fee**

Under GAAP, the Company calculates the unrealized gains incentive fee payable to the Advisor as if the Company had realized all investments at their fair values as of the reporting date. Accordingly, the Company accrues a provisional unrealized gains incentive fee taking into account any unrealized gains or losses. As the provisional incentive fee is subject to the performance of investments until there is a realization event, the amount of provisional unrealized gains incentive fee accrued at a reporting date may vary from the incentive fee that is ultimately realized and the differences could be material.

### **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.

### **Recent Developments**

On October 24, 2013, we received full repayment on our first lien of Holley Performance Products at par plus a 2% prepayment premium resulting in total proceeds of \$12.3 million.

On October 31, 2013, we made a \$5.0 million investment in the unsecured term loan of SQAD, LLC. We also invested \$0.5 million in the company's equity.

On November 1, 2013, we made a \$21.4 million investment in the second lien term loan of Empirix, Inc. We also invested \$1.3 million in the company's equity.

On November 9, 2013, we made another \$1.5 million investment in the second lien term loan of Securus Technologies Holdings.

On November 29, 2013, we made an additional \$0.1 million equity investment in the ERC Group Holdings, LLC.

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On December 5, 2013, we made a \$9.8 million investment in the second lien term loan of Calero Software, LLC. We also invested \$0.5 million in the company's equity.

On December 27, 2013, we made a \$6.6 million investment in the second lien term loan of Hostway Corporation.

The outstanding balance under the Credit Facility as of January 8, 2014, was \$104 million.

We have received exemptive relief from the SEC to co-invest with certain investment funds managed by Stellus Capital Management (other than the D. E. Shaw group funds) 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). As a result, we intend to co-invest, subject to the conditions included in the exemptive order we received from the SEC, with the private credit fund that is also managed by Stellus Capital Management.

TABLE OF CONTENTS**SENIOR SECURITIES**

Information about our senior securities is shown in the following table as of September 30, 2013, and for the fiscal year ended December 31, 2012. The report of Grant Thornton LLP, our independent registered public accountants, on the senior securities table as of December 31, 2012, is attached as an exhibit to the registration statement of which this prospectus is a part.

| Class and Year                 | Total Amount<br>Outstanding<br>Exclusive of<br>Treasury<br>Securities <sup>(1)</sup><br>(Dollars in<br>thousands) | Asset<br>Coverage per<br>Unit <sup>(2)</sup> | Involuntary<br>Liquidating<br>Preference per<br>Unit <sup>(3)</sup> | Average Market<br>Value per<br>Unit <sup>(4)</sup> |
|--------------------------------|---|--|---|--|
| Credit Facility                |   |  |   |  |
| Fiscal 2012                    | \$ 38,000   | \$ 3,090                                     | \$  | \$ N/A   |
| September 30, 2013 (unaudited) | \$ 85,000   | \$ 2,870                                     | \$  | \$ N/A   |
| Short-Term Loan <sup>(5)</sup> |   |  |   |  |
| Fiscal 2012                    | \$ 45,000   | \$ 3,090                                     | \$  | \$ N/A   |
| September 30, 2013 (unaudited) | \$ 8,999  | \$ 2,870                                     | \$  | \$ N/A   |

(1) Total amount of senior securities outstanding at the end of the period presented.

(2) Asset coverage per unit is the ratio of the carrying value of our total assets, less all liabilities and indebtedness not represented by senior securities, in relation to the aggregate amount of senior securities representing indebtedness. Asset coverage per unit is expressed in terms of dollar amounts per \$1,000 of indebtedness.

(3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it. The indicates information which the SEC expressly does not require to be disclosed for certain types of senior securities.

(4) Not applicable because senior securities are not registered for public trading.

(5) Refers to short-term loans that the Company obtained from Raymond James and repaid in full on January 2, 2013 and October 1, 2013, respectively.

TABLE OF CONTENTS

## THE COMPANY

### Stellus Capital Investment Corporation

We are an externally managed, closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the 1940 Act. We originate and invest primarily in private 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, often times with a corresponding equity investment. Unitranche debt is typically structured as first lien loans with certain risk characteristics of mezzanine debt. Mezzanine debt includes senior unsecured and subordinated loans.

Our investment activities are managed by our investment adviser, Stellus Capital Management, LLC, an investment advisory firm led by Robert T. Ladd and other senior investment professionals. We source investments primarily through the extensive network of relationships that the principals of Stellus Capital Management have developed with financial sponsor firms, financial institutions, middle-market companies, management teams and other professional intermediaries. The companies in which we invest are typically highly leveraged, and, in most cases, our investments in such companies will not be rated by national rating agencies. If such investments were rated, we believe that they would likely receive a rating below investment grade (*i.e.*, below BBB or Baa), which are often referred to as junk.

Our investment objective is to maximize the total return to our stockholders in the form of current income and capital appreciation by:

- accessing the extensive origination channels that have been developed and established by the Stellus Capital Management investment team that include long-standing relationships with private equity firms, commercial banks, investment banks and other financial services firms;
- investing in what we believe to be companies with strong business fundamentals, generally within our core middle-market company focus;
- focusing on a variety of industry sectors, including business services, energy, general industrial, government services, healthcare, software and specialty finance;
- focusing primarily on directly originated transactions;
- applying the disciplined underwriting standards that the Stellus Capital Management investment team has developed over their extensive investing careers; and
- capitalizing upon the experience and resources of the Stellus Capital Management investment team to monitor our investments.

In addition, we have received exemptive relief from the SEC to co-invest with investment funds managed by Stellus Capital Management (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 Management, 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 that (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 Management 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.

As a business development company, we are required to comply with regulatory requirements, including limitations on our use of debt. We are permitted to, and expect to continue to, finance our investments through borrowings.

However, as a business development company, we are only generally allowed to borrow amounts

## TABLE OF CONTENTS

such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. The amount of leverage that we employ will depend on our assessment of market conditions and other factors at the time of any proposed borrowing, such as the maturity, covenant package and rate structure of the proposed borrowings, our ability to raise funds through the issuance of our securities and the risks of such borrowings within the context of our investment outlook. Ultimately, we only intend to use leverage if the expected returns from borrowing to make investments will exceed the cost of such borrowings.

We have elected to be treated for federal income tax purposes as a RIC under Subchapter M of the Internal Revenue Code, or the Code. As a RIC, we generally will not have to pay corporate-level federal income taxes on any net ordinary income or capital gains that we distribute to our stockholders if we meet certain source-of-income, distribution and asset diversification requirements.

We have applied for a license to form and operate an SBIC subsidiary; however, the application is subject to approval by the SBA. We can make no assurances that the SBA will approve our application, or of the timeframe in which we would receive a license, should one ultimately be granted. The SBIC subsidiary would be allowed to issue SBA-guaranteed debentures up to a maximum of \$150 million under current SBIC regulations, subject to required capitalization of the SBIC subsidiary and other requirements. SBA guaranteed debentures generally have longer maturities and lower interest rates than other forms of debt that may be available to us, and we believe therefore would represent an attractive source of debt capital.

Our principal executive office is located at 4400 Post Oak Parkway, Suite 2200, Houston, Texas, 77027 and our telephone number is (713) 292-5400. Stellus Capital Management is headquartered in Houston, Texas, and also maintains offices in the New York City area and the Washington, D.C. area. We maintain a website on the Internet at [www.stelluscapital.com](http://www.stelluscapital.com). Information contained on our website is not incorporated by reference into this prospectus or any accompanying prospectus and you should not consider information contained on our website to be part of this prospectus or any accompanying prospectus.

## **Portfolio Composition**

As of September 30, 2013, we had investments in 23 portfolio companies. The fair value of the investments was \$243.6 million. As of September 30, 2013, our portfolio included approximately 24.9% first lien debt, 32.5% second lien debt, and 41.8% mezzanine debt and 0.8% of equity investments at fair value, of which 46% is invested in fixed-rate debt and the remaining 54% is invested in floating rate debt. The weighted average yield on all of our debt investments at September 30, 2013, was approximately 11.4% of which 10.8% will be current cash interest. The weighted average yield was computed using the effective interest rates for all debt investments within the initial portfolio, including accretion of original issue discount. The information set forth above regarding our investment portfolio does not include approximately \$9.0 million of United States Treasury securities at fair value that we held at September 30, 2013.

Our investments generally range in size from \$5 million to \$30 million, and we may also selectively invest in larger positions, and we generally expect that the size of our larger positions will increase in proportion to the size of our capital base. Pending such investments, we may reduce our outstanding indebtedness or invest in cash, cash equivalents, U.S. government securities and other high-quality debt investments with a maturity of one year or less. In the future, we may adjust opportunistically the percentage of our assets held in various types of loans, our principal loan sources and the industries to which we have greatest exposure, based on market conditions, the credit cycle, available financing and our desired risk/return profile.

## **Stellus Capital Management**

Stellus Capital Management manages our investment activities and is responsible for analyzing investment opportunities, conducting research and performing due diligence on potential investments, negotiating and structuring our investments, originating prospective investments and monitoring our investments and portfolio companies on an ongoing basis. Stellus Capital Management is an investment advisory firm led by the former head, Robert T. Ladd, and certain senior investment professionals of the D. E. Shaw group's direct capital business, which was spun out of the D. E. Shaw group in January 2012. The Stellus Capital Management investment team was responsible for building the D. E. Shaw group's middle-market direct investment business until it was spun out in January 2012. The senior investment professionals

65

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## TABLE OF CONTENTS

of Stellus Capital Management have an average of over 24 years of investing, corporate finance, restructuring, consulting and accounting experience and have worked together at several companies including the D. E. Shaw group.

The Stellus Capital Management investment team has a wide range of experience in middle-market investing, including originating, structuring and managing loans and debt securities through market cycles. The Stellus Capital Management investment team continues to provide investment advisory services to the D. E. Shaw group with respect to an approximately \$440 million investment portfolio (as of September 30, 2013) in middle-market companies pursuant to sub-advisory arrangements.

In addition to serving as our investment adviser, Stellus Capital Management currently manages a private credit fund that has an investment strategy that is identical to our investment strategy and an energy private equity funds. We have received exemptive relief from the SEC to co-invest with investment funds managed by Stellus Capital Management

(other than the D. E. Shaw group funds) 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). We intend to co-invest with the private credit fund consistent with the terms and conditions of the exemptive order issued by the SEC. We believe that such co-investments may afford us additional investment opportunities and an ability to achieve greater diversification. We will not co-invest with the energy private equity funds, as the energy private equity funds will focus on predominantly equity-related investments and we will focus on predominantly credit-related investments.

## **Market Opportunity**

We originate and invest primarily in private middle-market companies through first lien, second lien, unitranche and mezzanine debt financing, often times with a corresponding equity investment. We believe the environment for investing in middle-market companies is attractive for several reasons, including:

***Robust Demand for Debt Capital.*** We believe that private equity firms have significant committed but uncalled capital, a large portion of which is still available for investment in the United States. We expect the large amount of uninvested capital commitments will drive buyout activity over the next several years, which should, in turn, create lending opportunities for us. In addition to increased buyout activity, a high volume of senior secured and high yield debt was originated in the calendar years 2004 through 2007 and will come due in the near term and, accordingly, we believe that new financing opportunities will increase as many companies seek to refinance this indebtedness.

***Reduced Availability of Capital for Middle-Market Companies.*** We believe there are fewer providers of, and less capital available for financing to middle-market companies, as compared to the time period prior to the recent economic downturn. We believe that, as a result of that downturn, many financing providers have chosen to focus on large, liquid corporate loans and managing capital markets transactions rather than lending to middle-market businesses. In addition, we believe recent regulatory changes, including the adoption of the Dodd-Frank Act and the introduction of new international capital and liquidity requirements under Basel III, have caused banks to curtail their lending to middle-market-companies. As a result, we believe that less competition will facilitate higher quality deal flow and allow for greater selectivity throughout the investment process.

***Attractive Deal Pricing and Structures.*** We believe that the pricing of middle-market debt investments is higher, and the terms of such investments are more conservative, compared to larger liquid, public debt financings, due to the more limited universe of lenders as well as the highly negotiated nature of these financings. These transactions tend to offer stronger covenant packages, higher interest rates, lower leverage levels and better call protection compared to larger financings. In addition, middle-market loans typically offer other investor protections such as default penalties, lien protection, change of control provisions and information rights for lenders.

Specialized Lending Requirements. Lending to middle-market companies requires in-depth diligence, credit expertise, restructuring experience and active portfolio management. We believe that several factors render many U.S. financial institutions ill-suited to lend to middle-market companies. For example, based on the experience of Stellus Capital Management's investment team, lending to middle-market companies in the United States (a) is generally more labor intensive than lending to larger companies due to the smaller size of each investment and the fragmented nature of the information available with respect to such companies, (b) requires specialized due diligence and underwriting capabilities, and (c) may also require more extensive

## TABLE OF CONTENTS

ongoing monitoring by the lender. We believe that, through Stellus Capital Management, we have the experience and expertise to meet these specialized lending requirements.

### **Competitive Strengths**

We believe that the following competitive strengths will allow us to achieve positive returns for our investors:

***Experienced Investment Team.*** Through our investment adviser, Stellus Capital Management, we have access to the experience and expertise of the Stellus Capital Management investment team, including its senior investment professionals who have an average of over 24 years of investing, corporate finance, restructuring, consulting and accounting experience and have worked together at several companies. The Stellus Capital Management investment team has a wide range of experience in middle-market investing, including originating, structuring and managing loans and debt securities through market cycles. We believe the members of Stellus Capital Management's investment team are proven and experienced, with extensive capabilities in leveraged credit investing, having participated in these markets for the predominant portion of their careers. We believe that the experience and demonstrated ability of the Stellus Capital Management investment team to complete transactions enhances the quantity and quality of investment opportunities available to us.

***Established, Rigorous Investment and Monitoring Process.*** The Stellus Capital Management investment team has developed an extensive review and credit analysis process. Each investment that is reviewed by Stellus Capital Management is brought through a structured, multi-stage approval process. In addition, Stellus Capital Management takes an active approach in monitoring all investments, including reviews of financial performance on at least a quarterly basis and regular discussions with management. Stellus Capital Management's investment and monitoring process and the depth and experience of its investment team should allow it to conduct the type of due diligence and monitoring that enables it to identify and evaluate risks and opportunities.

***Demonstrated Ability to Structure Investments Creatively.*** Stellus Capital Management has the expertise and ability to structure investments across all levels of a company's capital structure. While at the D. E. Shaw group, the Stellus Capital Management investment team invested approximately \$5.4 billion across the entire capital structure in 193 middle-market companies. These investments included secured and unsecured debt and related equity securities. Furthermore, we believe that current market conditions will allow us to structure attractively priced debt investments and may allow us to incorporate other return-enhancing mechanisms such as commitment fees, original issue discounts, early redemption premiums, payment-in-kind, or PIK, interest or some form of equity securities.

***Resources of Stellus Capital Management Platform.*** We have access to the resources and capabilities of Stellus Capital Management, which has 15 investment professionals, including Messrs. Ladd, D'Angelo, Davis and Overbergen, who are supported by one managing director, six principals, two vice presidents and two analysts. These individuals have developed long-term relationships with middle-market companies, management teams, financial sponsors, lending institutions and deal intermediaries by providing flexible financing throughout the capital structure. We believe that these relationships provide us with a competitive advantage in identifying investment opportunities in our target market. We also expect to benefit from Stellus Capital Management's due diligence, credit analysis, origination and transaction execution experience and capabilities, including the support provided with respect to those functions by Mr. Huskinson, who serves as our chief financial officer and chief compliance officer, and his staff of four additional mid- and back-office professionals.

## **Investment Strategy**

The Stellus Capital Management investment team employs an opportunistic and flexible investing approach, combined with strong risk management processes, which we believe will yield a highly diversified portfolio across companies, industries, and investment types. We seek direct origination opportunities of first lien, second lien, unitranche and mezzanine debt financing, often times with modest corresponding equity investments, in middle-market companies. We believe that businesses in this size range often have limited access to public financial markets, and will benefit from Stellus Capital Management's reliable lending

## TABLE OF CONTENTS

partnership. Many financing providers have chosen to focus on large corporate clients and managing capital markets transactions rather than lending to middle-market businesses. Further, many financial institutions and traditional lenders are faced with constrained balance sheets and are requiring existing borrowers to reduce leverage.

With an average of over 24 years of investing, corporate finance, restructuring, consulting and accounting experience, the senior investment team of Stellus Capital Management has demonstrated investment expertise throughout the balance sheet and in a variety of situations, including financial sponsor buyouts, growth capital, debt refinancings, balance sheet recapitalizations, rescue financings, distressed opportunities, and acquisition financings. Our investment philosophy emphasizes capital preservation through superior credit selection and risk mitigation. We expect our portfolio to provide downside protection through conservative cash flow and asset coverage requirements, priority in the capital structure and information requirements. We also anticipate benefiting from equity participation through warrants and other equity instruments structured as part of our investments. This flexible approach enables Stellus Capital Management to respond to market conditions and offer customized lending solutions.

Stellus Capital Management invests across a wide range of industries with deep expertise in select verticals including, but not limited to, business services, energy, general industrial, government services, healthcare software and specialty finance. Our typical transactions include providing financing for leveraged buyouts, acquisitions, recapitalizations, growth opportunities, rescue financings, distressed or turnaround situations and bridge loans. We seek to maintain a diversified portfolio of investments as a method to manage risk and capitalize on specific sector trends.

Our objective is to act as the lead or largest investor in transactions, generally investing between \$5 million and \$30 million per transaction. We expect the average investment holding period to be between two and four years, depending upon portfolio company objectives and conditions in the capital markets.

We focus on middle-market companies with between \$5 million and \$50 million of EBITDA in a variety of industry sectors with positive long-term dynamics and dependable cash flows. We seek businesses with management teams with demonstrated track records and economic incentives in strong franchises and sustainable competitive advantages with dependable and predictable cash flows.

We employ leverage prudently and within the limitations of the applicable laws and regulations for business development companies. Any decision on our part to use leverage will depend upon our assessment of the attractiveness of available investment opportunities in relation to the costs and perceived risks of such leverage.

## **Transaction Sourcing**

As access to investment opportunities is highly relationship-driven, the senior investment team and other investment professionals of Stellus Capital Management spend considerable time developing and maintaining contacts with key deal sources, including private equity firms, investment banks, and senior lenders. The senior investment team and other investment professionals of Stellus Capital Management have been actively investing in the middle-market for the past decade and have focused on extensive calling and marketing efforts via speaking engagements, sponsorships, industry events, and referrals to broaden their relationship network. Existing relationships are constantly cultivated through transactional work and other personal contacts.

In addition to financial sponsors, Stellus Capital Management has developed a network of other deal sources, including:

management teams and entrepreneurs;

portfolio companies of private equity firms;  
other investment firms that have similar strategies to Stellus Capital Management and are seeking co-investors;  
placement agents and investment banks representing financial sponsors and issuers;  
corporate operating advisers and other financial advisers; and

## TABLE OF CONTENTS

consultants, attorneys and other service providers to middle-market companies and financial sponsors. We believe that Stellus Capital Management's broad network of deal origination contacts will afford us with a continuous source of investment opportunities.

These origination relationships provide access not only to potential investment opportunities but also to market intelligence on trends across the credit markets. Stellus Capital Management has completed financing transactions with more than 100 equity sponsors and completed multiple financing transactions with 19 of those equity sponsors.

We believe that, over the past decade, the senior investment team and other investment professionals of Stellus Capital Management have built a reputation as a thoughtful and disciplined provider of capital to middle-market companies and a preferred financing source for private equity sponsors and management teams. We believe these factors give Stellus Capital Management a competitive advantage in sourcing investment opportunities, which are put to use for our benefit.

## **Investment Structuring**

Stellus Capital Management believes that each investment has unique characteristics that must be considered, understood and analyzed. Stellus Capital Management structures investment terms based on the business, the credit profile, the outlook for the industry in which a potential portfolio company operates, the competitive landscape, the products or services which the company sells and the management team and ownership of the company, among other factors. Stellus Capital Management relies upon the analysis conducted and information gathered through the investment process to evaluate the appropriate structure for our investments.

We invest primarily in the debt securities of middle-market companies. Our investments typically carry a high level of cash pay interest and may incorporate other return-enhancing mechanisms such as commitment fees, original issue discounts, early redemption premiums, PIK interest and some form of equity participation, including preferred stock, common stock, warrants and other forms of equity participation. We expect that a typical debt investment in which we invest will have a term at origination of between five and seven years. We expect to hold most of our investments to maturity or repayment, but we may sell some of our investments earlier if a liquidity event occurs, such as a sale, recapitalization or worsening of the credit quality of the portfolio company.

Stellus Capital Management negotiates covenants in connection with debt investments that provide protection for us but allow appropriate flexibility for the portfolio company. Such covenants may include affirmative and negative covenants, default penalties, lien protection and change of control provisions. Stellus Capital Management requires comprehensive information rights including access to management, financial statements and budgets and, in some cases, membership on the board of directors or board of directors observation rights. Additionally, Stellus Capital Management generally requires financial covenants and terms that restrict an issuer's use of leverage and limitations on asset sales and capital expenditures.

## **Secured Debt**

Secured debt, including first lien, second lien and unitranche financing, has liens on the assets of the borrower that serve as collateral in support of the repayment of such loans.

*First Lien Debt.* First lien debt is structured with first-priority liens on the assets of the borrower that serve as collateral in support of the repayment of such loans. First lien loans may provide for moderate loan amortization in the early years of the loan, with the majority of the amortization deferred until loan maturity.

*Second Lien Debt.* Second lien debt is structured as junior, secured loans, with second priority liens on an issuer's assets. These loans typically provide for moderate loan amortization in the initial years of the loan, with the majority of the amortization deferred until loan maturity.

*Unitranche Debt.* Unitranche debt typically is structured as first lien loans with certain risk characteristics of mezzanine debt. Unitranche debt typically provides for moderate loan amortization in the initial years of the debt, with the majority of the principal payment deferred until loan maturity. Since

## TABLE OF CONTENTS

unitranche debt generally allows the borrower to make a large lump sum payment of principal at the end of the loan term, there is a risk of loss if the borrower is unable to pay the lump sum or refinance the amount owed at maturity. In some cases, we will be the sole lender, or we together with our affiliates will be the sole lender, of unitranche debt, which can provide us with more influence interacting with a borrower in terms of monitoring and, if necessary, remediation in the event of underperformance.

## **Mezzanine Debt**

Mezzanine debt, including senior unsecured and subordinated loans, is not secured by any collateral and is effectively subordinated to the borrower's secured indebtedness (to the extent of the collateral securing such indebtedness), including pursuant to one or more intercreditor agreements that we enter into with holders of a borrower's senior debt.

*Senior Unsecured Loans.* Senior unsecured loans are structured as loans that rank senior in right of payment to any of the borrower's unsecured indebtedness that is contractually subordinated to such loans. These loans generally provide for fixed interest rates and amortize evenly over the term of the loan. Senior unsecured loans are generally less volatile than subordinated loans due to their priority to creditors over subordinated loans.

*Subordinated Loans.* Subordinated loans are structured as unsecured, subordinated loans that provide for relatively high, fixed interest rates that provide us with significant current interest income. These loans typically have interest-only payments (often representing a combination of cash pay and PIK interest) in the early years, with amortization of principal deferred to maturity. Subordinated loans generally allow the borrower to make a large lump sum payment of principal at the end of the loan term, and there is a risk of loss if the borrower is unable to pay the lump sum or refinance the amount owed at maturity. Subordinated loans are generally more volatile than secured loans and may involve a greater risk of loss of principal. Subordinated loans often include a PIK feature, which effectively operates as negative amortization of loan principal, thereby increasing credit risk exposure over the life of the loan.

## **Equity Securities**

In connection with some of our debt investments, we may also invest in preferred or common stock or receive nominally priced warrants or options to buy an equity interest in the portfolio company. As a result, as a portfolio company appreciates in value, we may achieve additional investment return from this equity interest. We may structure such equity investments and warrants to include provisions protecting our rights as a minority-interest holder, as well as a put, or right to sell such securities back to the issuer, upon the occurrence of specified events. In many cases, we may also seek to obtain registration rights in connection with these equity interests, which may include demand and piggyback registration rights.

## **Investment Process**

Through the resources of Stellus Capital Management, we have access to significant research resources, experienced investment professionals, internal information systems and a credit analysis framework and investment process. Stellus Capital Management has designed a highly involved and interactive investment management process, which is the core of its culture and the basis for what we believe is a strong track record of investment returns. The investment process seeks to select only those investments which it believes have the most attractive risk/reward characteristics. The process involves several levels of review and is coordinated in an effort to identify risks in potential investments. Stellus Capital Management applies its expertise to screen many of our investment opportunities as described below.

This rigorous process combined with our broad origination capabilities have allowed the Stellus Capital Management team to be prudent in selecting opportunities in which to make an investment.

All potential investment opportunities undergo an initial informal review by Stellus Capital Management's investment professionals. Each potential investment opportunity that an investment professional determines merits investment consideration is presented and evaluated at a weekly meeting in which Stellus Capital Management's investment professionals discuss the merits and risks of a potential investment opportunity as well as the due diligence process and the pricing and structure. If Stellus Capital Management's investment professionals believe an investment opportunity merits further review, the deal team prepares and

TABLE OF CONTENTS

presents to the investment committee for initial review a prescreen memorandum that generally describes the potential transaction and includes a description of the risks, due diligence process and proposed structure and pricing for the proposed investment opportunity.

Prior to making an investment, Stellus Capital Management conducts rigorous diligence on each investment opportunity. In connection with its due diligence on a potential investment opportunity, Stellus Capital Management utilizes its internal diligence resources which include its internally developed credit analytical framework, subscriptions to third party research resources, discussions with industry experts, internal information sharing systems, and the analytical expertise of its investment professionals. Stellus Capital Management typically reviews the company's historical financials; industry drivers and outlook, competitive threats, customer concentration, asset coverage, projected financials, and credit metrics; management background checks; and, if applicable, the track record and funding capabilities of the private equity sponsor.

Upon review of the prescreen memorandum, if the investment committee determines to proceed with the review of an investment opportunity, the deal team continues its diligence and deal structuring plans, and prepares a credit approval memorandum for review by the investment committee. The credit approval memorandum, updates the prescreen memorandum with more deal specific detail, including an update to the diligence process and any changes in the structure and pricing of the proposed investment. Upon unanimous approval by the investment committee of the proposed investment as presented in the credit approval memorandum, the Chief Investment Officer reviews any amendments before finalizing and closing negotiations with the prospective portfolio company.

## **Investment Committee**

Each new investment opportunity is unanimously approved by Stellus Capital Management's investment committee.

Follow-on investments in existing portfolio companies requires the investment committee's approval beyond that obtained when the initial investment in the company was made. In addition, temporary investments, such as those in cash equivalents, U.S. government securities and other high quality debt investments that mature in one year or less, may require approval by the investment committee. The purpose of Stellus Capital Management's investment committee is to evaluate and approve all of our investments. The investment committee process is intended to bring the diverse experience and perspectives of the committee's members to the analysis and consideration of each investment. The investment committee consists of Messrs. Robert T. Ladd, Dean D. Angelo, Joshua T. Davis, Todd A. Overbergen and W. Todd Huskinson. The investment committee serves to provide investment consistency and adherence to our core investment philosophy and policies. The investment committee also determines appropriate investment sizing and suggests ongoing monitoring requirements.

In addition to reviewing investments, investment committee meetings serve as a forum to discuss credit views and outlooks. Potential transactions and deal flow are reviewed on a regular basis. Members of the investment team are encouraged to share information and views on credits with the investment committee early in their analysis. We believe this process improves the quality of the analysis and assists the deal team members to work more efficiently.

Each transaction is presented to the investment committee in a formal written report. All of our new investments require unanimous approval by the investment committee. Each member of the investment committee performs a similar role for other accounts managed by Stellus Capital Management. In certain instances, our board of directors may also determine that its approval is required prior to the making of an investment.

## Monitoring Investments

In most cases, we do not have board influence over portfolio companies. In some instances, Stellus Capital Management's investment professionals may obtain board representation or observation rights in conjunction with our investments. Stellus Capital Management takes an active approach in monitoring all investments, including reviews of financial performance on at least a quarterly basis and regular discussions with management. The monitoring process begins with structuring terms and conditions, which require the timely delivery and access to critical financial and business information on portfolio companies.

## TABLE OF CONTENTS

Specifically, Stellus Capital Management's monitoring system consists of the following activities:

*Regular Investment Committee Updates.* Key portfolio company developments are discussed each week as part of the standard investment committee agenda.

*Written Reports.* The deal teams provide written updates as appropriate for key events that impact portfolio company performance or valuation. In addition, deal teams provide written updates following each portfolio company board meeting.

*Quarterly Full Portfolio Review.* Our Chief Investment Officer and Chief Compliance Officer perform a quarterly comprehensive review of every portfolio company with the deal teams. This process includes a written performance and valuation update, and credit-specific discussion on each of our portfolio companies. In addition, pursuant to our valuation policy, quarterly valuations are reviewed by our independent third party valuation firm.

As part of the monitoring process, Stellus Capital Management also tracks developments in the broader marketplace. Stellus Capital Management's investment professionals have a wealth of information on the competitive landscape, industry trends, relative valuation metrics, and analyses that assist in the execution of our investment strategy. In addition, Stellus Capital Management's extensive communications with brokers and dealers allows its investment professionals to monitor market and industry trends that could affect portfolio investments. Stellus Capital Management may provide ongoing strategic, financial and operational guidance to some portfolio companies either directly or by recommending its investment professionals or other experienced representatives to participate on the board of directors. Stellus Capital Management maintains an extensive network of strategic and operational advisers to call upon for industry expertise or to supplement existing management teams.

## **Risk Ratings**

In addition to various risk management and monitoring tools, Stellus Capital Management uses an investment rating system to characterize and monitor the credit profile and expected level of returns on each investment in our portfolio.

This investment rating system uses a five-level numeric scale. The following is a description of the conditions associated with each investment rating:

Investment Rating 1 is used for investments that are performing above expectations, and whose risks remain favorable compared to the expected risk at the time of the original investment.

Investment Rating 2 is used for investments that are performing within expectations and whose risks remain neutral compared to the expected risk at the time of the original investment. All new loans are initially rated 2.

Investment Rating 3 is used for investments that are performing below expectations and that require closer monitoring, but where no loss of return or principal is expected. Portfolio companies with a rating of 3 may be out of compliance with financial covenants.

Investment Rating 4 is used for investments that are performing substantially below expectations and whose risks have increased substantially since the original investment. These investments are often in work out. Investments with a rating of 4 are those for which some loss of contractual return but no loss of principal is expected.

Investment Rating 5 is used for investments that are performing substantially below expectations and whose risks have increased substantially since the original investment. These investments are almost always in work out.

Investments with a rating of 5 are those for which some loss of return and principal is expected.

In the event that Stellus Capital Management determines that an investment is underperforming, or circumstances suggest that the risk associated with a particular investment has significantly increased, Stellus Capital Management will increase its monitoring intensity and prepare regular updates for the investment committee, summarizing current operating results and material impending events and suggesting recommended actions. While the investment rating system identifies the relative risk for each investment, the rating alone does not dictate the scope and/or frequency of any monitoring that is performed. The frequency of Stellus Capital Management's monitoring of an investment is determined by a number of factors, including, but not

## TABLE OF CONTENTS

limited to, the trends in the financial performance of the portfolio company, the investment structure and the type of collateral securing the investment.

### **Determination of Net Asset Value and Portfolio Valuation Process**

The net asset value per share of our outstanding shares of common stock is determined quarterly by dividing the value of total assets minus liabilities by the total number of shares outstanding.

In calculating the value of our total assets, investment transactions will be recorded on the trade date. Realized gains or losses will be computed using the specific identification method. Investments for which market quotations are readily available are valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued at fair value as determined in good faith by our board of directors based on the input of our management and audit committee. In addition, our board of directors retains one or more independent valuation firms to review at least once per quarter, the valuation of each portfolio investment for which a market quotation is not available. We also have adopted Accounting Standards Board Accounting Standards Codification 820, *Fair Value Measurements and Disclosures*, or ASC 820. This accounting statement requires us to assume that the portfolio investment is assumed to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance with ASC Topic 820, the market in which we can exit portfolio investments with the greatest volume and level activity is considered our principal market.

A readily available market value is not expected to exist for most of the investments in our portfolio, and we value these portfolio investments at fair value as determined in good faith by our board of directors under our valuation policy and process. The types of factors that our board of directors may take into account in determining the fair value of our investments generally include, as appropriate, comparisons of financial ratios portfolio company to peer companies that are public, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings and discounted cash flow, the markets in which the portfolio company does business, and other relevant factors.

When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, we consider the pricing indicated by the external event to corroborate our valuation. 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 the investments may differ materially from the values that would have been used had a readily available market value existed for such investments. In addition, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different from the valuations currently assigned.

With respect to investments for which market quotations are not readily available, our board of directors undertakes a multi-step valuation process each quarter, as described below:

our quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals of Stellus Capital Management responsible for the portfolio investment; preliminary valuation conclusions are then documented and discussed with our senior management and Stellus Capital Management;

the audit committee of our board of directors then reviews these preliminary valuations;

at least once quarterly, the valuation for each portfolio investment is reviewed by an independent valuation firm; and the board of directors then discusses the valuations and determines the fair value of each investment in our portfolio in good faith, based on the input of Stellus Capital Management, the independent valuation firm and the audit committee.

73

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## TABLE OF CONTENTS

In following these approaches, the types of factors that are taken into account in fair value pricing our investments include, as relevant, but are not 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.

Determination of fair values involves subjective judgments and estimates not susceptible to substantiation by auditing procedures. Under current auditing standards, the notes to our financial statements refer to the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on our financial statements.

## **Realization of Investments**

The potential exit scenarios of a portfolio company play an important role in evaluating investment decisions. As such, Stellus Capital Management formulates specific exit strategies at the time of investment. Our debt-orientation provides for increased potential exit opportunities, including (a) the sale of investments in the private markets, (b) the refinancing of investments held, often due to maturity or recapitalizations, and (c) other liquidity events including the sale or merger of the portfolio company. Since we seek to maintain a debt orientation in our investments, we expect to receive interest income over the course of the investment period, resulting in a significant return on invested capital well in advance of final exit.

## **Managerial Assistance**

As a business development company, we offer, and must provide upon request, managerial assistance to our portfolio companies. This assistance could involve monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. Stellus Capital Management or an affiliate of Stellus Capital Management provides such managerial assistance on our behalf to portfolio companies that request this assistance. We may receive fees for these services and will reimburse Stellus Capital Management or an affiliate of Stellus Capital Management for its allocated costs in providing such assistance, subject to the review by our board of directors, including our independent directors.

## **Competition**

Our primary competitors in providing financing to middle-market companies include public and private funds, other business development companies, commercial and investment banks, commercial financing companies and, to the extent they provide an alternative form of financing, private equity and hedge funds. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, we believe some competitors may have access to funding sources that are not available to us. In addition,

some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company or to the distribution and other requirements we must satisfy to maintain our qualification as a RIC.

## TABLE OF CONTENTS

We use the expertise of the investment professionals of Stellus Capital Management to which we have access to assess investment risks and determine appropriate pricing for our investments in portfolio companies. In addition, we believe that the relationships of the investment professionals of Stellus Capital Management enable us to learn about, and compete effectively for, financing opportunities with attractive middle-market companies in the industries in which we invest.

### **Administration**

We do not have any direct employees, and our day-to-day investment operations are managed by Stellus Capital Management. We have a chief executive officer, a chief investment officer, a chief financial officer and a chief compliance officer. To the extent necessary, our board of directors may hire additional personnel going forward. Our officers are employees of Stellus Capital Management and our allocable portion of the cost of our chief financial officer and chief compliance officer and their respective staffs are paid by us pursuant to the administration agreement.

### **Properties**

We do not own any real estate or other physical properties materially important to our operation. Our headquarters are located at 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027. All locations are provided to us by Stellus Capital Management pursuant to the administration agreement. We believe that our office facilities are suitable and adequate for our business as we contemplate conducting it.

### **Legal Proceedings**

We and Stellus Capital Management are not currently subject to any material legal proceedings.

TABLE OF CONTENTS

## **PORTFOLIO COMPANIES**

The following table sets forth certain unaudited information as of September 30, 2013, for the portfolio companies in which we had a debt or equity investment. Other than these investments, our only formal relationships with our portfolio companies are the managerial assistance ancillary to our investments and the board observer or participation rights we may receive in connection with our investment. We do not control any of our portfolio companies, as defined in the 1940 Act. In general, under the 1940 Act, we would control a portfolio company if we owned more than 25.0% of its voting securities and would be an affiliate of a portfolio company if we owned 5.0% or more of its voting securities. As of September 30, 2013, we did not own more than five percent of the voting securities of any portfolio company.

76

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TABLE OF CONTENTS

77

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TABLE OF CONTENTS

(1) Principal amount includes amount of PIK interest.

This investment also includes a delayed draw term loan commitment in an amount not to exceed \$12,500,000, an interest rate of LIBOR plus 12.25%, and a maturity of May 31, 2018. This investment is accruing an unused commitment fee of 0.50% per annum.

This investment also includes an undrawn revolving loan commitment in an amount not to exceed \$2,000,000, an interest rate of LIBOR plus 7.5%, and a maturity of September 30, 2018. 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.

(4) 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.

(5) 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.

78

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TABLE OF CONTENTS

## **MANAGEMENT**

### **Board of Directors and Its Leadership Structure**

Our business and affairs are managed under the direction of our board of directors. The board of directors consists of seven members, four of whom are not interested persons of Stellus Capital Management, or its affiliates as defined in Section 2(a)(19) of the 1940 Act. We refer to these individuals as our independent directors. The board of directors elects our officers, who serve at the discretion of the board of directors. The responsibilities of the board of directors include quarterly valuation of our assets, corporate governance activities, oversight of our financing arrangements and oversight of our investment activities.

Oversight of our investment activities extends to oversight of the risk management processes employed by Stellus Capital Management as part of its day-to-day management of our investment activities. The board of directors anticipates reviewing risk management processes at both regular and special board meetings throughout the year, consulting with appropriate representatives of Stellus Capital Management as necessary and periodically requesting the production of risk management reports or presentations. The goal of the board of directors' risk oversight function is to ensure that the risks associated with our investment activities are accurately identified, thoroughly investigated and responsibly addressed. Investors should note, however, that the board of directors' oversight function cannot eliminate all risks or ensure that particular events do not adversely affect the value of investments.

The board of directors has established an audit committee, a compensation committee and a nominating and corporate governance committee, and may establish additional committees from time to time as necessary. The scope of the responsibilities assigned to each of these committees is discussed in greater detail below. Mr. Ladd serves as Chief Executive Officer, Chairman of the board of directors and a member of Stellus Capital Management's investment committee and Messrs. D'Angelo and Davis are each a member of Stellus Capital Management's investment committee and a member of our board of directors. We believe that Mr. Ladd's history with Stellus Capital Management, his familiarity with its investment platform, and his extensive knowledge of and experience in the financial services industry qualify him to serve as the Chairman of our board of directors.

The board of directors does not have a lead independent director. We are aware of the potential conflicts that may arise when a non-independent director is Chairman of the board of directors, but believe these potential conflicts are offset by our strong corporate governance practices. Our corporate governance practices include regular meetings of the independent directors in executive session without the presence of interested directors and management, the establishment of an audit committee, a compensation committee and a nominating and corporate governance committee, each of which is comprised solely of independent directors, and the appointment of a Chief Compliance Officer, with whom the independent directors meet without the presence of interested directors and other members of management, for administering our compliance policies and procedures.

The board of directors believes that its leadership structure is appropriate in light of our characteristics and circumstances because the structure allocates areas of responsibility among the individual directors and the committees in a manner that affords effective oversight. Specifically, the board of directors believes that the relationship of Messrs. Ladd, D'Angelo and Davis with Stellus Capital Management provides an effective bridge between the board of directors and management, and encourages an open dialogue between management and our board of directors, ensuring that these groups act with a common purpose. The board of directors also believes that its small size creates a highly efficient governance structure that provides ample opportunity for direct communication and interaction between our management, Stellus Capital Management and the board of directors.

## **Board of Directors**

We have adopted provisions in our articles of incorporation that divide our board of directors into three classes. At each annual meeting, directors will be elected for staggered terms of three years (other than the initial terms, which extend for up to three years), with the term of office of only one of these three classes of directors expiring each year. Each director will hold office for the term to which he or she is elected and until his or her successor is duly elected and qualifies.

TABLE OF CONTENTS

Information regarding the board of directors is as follows:

| Name                  | Year of Birth | Position  | Director Since | Term Expires | Other Directorships Held |
|-----------------------|---------------|---|----------------|--------------|--------------------------|
| Interested Directors  |               |   |                |              |                          |
| Robert T. Ladd        | 1956          | Chairman, Chief Executive Officer, President and Chief Investment Officer | 2012           | 2015         |                          |
| Dean D. Angelo        | 1967          | Director  | 2012           | 2016         |                          |
| Joshua T. Davis       | 1972          | Director  | 2012           | 2014         |                          |
| Independent Directors |               |   |                |              |                          |
| J. Tim Arnoult        | 1949          | Director  | 2012           | 2015         | Cardtronics Inc.         |
| Bruce R. Bilger       | 1952          | Director  | 2012           | 2014         |                          |
| Paul Keglevic         | 1954          | Director  | 2012           | 2015         |                          |
| William C. Repko      | 1949          | Director  | 2012           | 2016         |                          |

The address for each of our directors is c/o Stellus Capital Investment Corporation, 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027.

## Executive Officers Who Are Not Directors

Information regarding our executive officers who are not directors is as follows:

| Name              | Year of Birth | Position   |
|-------------------|---------------|--|
| W. Todd Huskinson | 1964          | Chief Financial Officer, Chief Compliance Officer, Treasurer and Secretary |

The address for each of our executive officers is c/o Stellus Capital Investment Corporation, 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027.

## Biographical Information

The board of directors considers whether each of the directors is qualified to serve as a director, based on a review of the experience, qualifications, attributes and skills of each director, including those described below. The board of directors also considers whether each director has significant experience in the investment or financial services industries and has held management, board or oversight positions in other companies and organizations. For the purposes of this presentation, our directors have been divided into two groups – independent directors and interested directors. Interested directors are interested persons as defined in the 1940 Act.

### Independent Directors

J. Tim Arnoult serves as a member of our board of directors. Mr. Arnoult has over 30 years of banking and financial services experience. From 1979 to 2006, Mr. Arnoult served in various positions at Bank of America, including its predecessors, including president of Global Treasury Services from 2005 – 2006, president of Global Technology and

Operations from 2000 to 2005, president of Central U.S. Consumer and Commercial Banking from 1996 to 2000 and president of Global Private Banking from 1991 to 1996. Mr. Arnoult is also experienced in mergers and acquisitions, having been directly involved in significant transactions such as the mergers of NationsBank and Bank America in 1998 and Bank of America and FleetBoston in 2004. Mr. Arnoult currently serves on the board of directors of Cardtronics Inc. (NasdaqGM: CATM) and has served on a variety of boards throughout his career, including the board of Visa USA. Mr. Arnoult holds a B.A. in Psychology and a M.B.A. from the University of Texas at Austin. We believe Mr. Arnoult's extensive banking and financial services experience bring important and valuable skills to our board of directors.

Bruce R. Bilger serves as a member of our board of directors. Mr. Bilger has over 35 years of providing advice on mergers and acquisitions, financings, and restructurings, particularly in the energy industry.

## TABLE OF CONTENTS

Mr. Bilger is a senior advisor at Lazard Frères & Co. LLC, a leading investment bank, where he began in January, 2008 as managing director, chairman and head of Global Energy, and co-head of the Southwest Investment Banking region. Prior to joining Lazard Frères & Co. LLC, Mr. Bilger was a partner at the law firm of Vinson & Elkins LLP, where he was head of its 400-plus-attorney Energy Practice Group and co-head of its 175-plus-attorney corporate and transactional practice. Mr. Bilger is or has been a board or committee member with numerous charitable and civic organizations, including the Greater Houston Partnership, the Greater Houston Community Foundation, Reasoning Mind, Positive Coaching Alliance, Texas Children's Hospital, Asia Society Texas Center, St. Luke's United Methodist Church, St. John's School, Dartmouth College and the University of Virginia. Mr. Bilger graduated Phi Beta Kappa from Dartmouth College and has an M.B.A. and law degree from the University of Virginia. We believe Mr. Bilger's extensive merger and acquisition, financing, and restructuring experience bring important and valuable skills to our board of directors.

Paul Keglevic serves as a member of our board of directors. Mr. Keglevic has over 33 years of experience with public companies across several industry sectors, including utilities, telecom and transportation. Mr. Keglevic has served as executive vice president and chief financial officer for Energy Future Holdings Corp., a Dallas-based energy company with a portfolio of competitive and regulated businesses, since June 2008. From July 2002, Mr. Keglevic was at PricewaterhouseCoopers, an accounting firm, where he served as the U.S. utility sector leader for six years and the clients and sector assurance leader for one year. Prior to PricewaterhouseCoopers, Mr. Keglevic led the utilities practice for Arthur Andersen, where he was a partner for 15 years. Mr. Keglevic is a member of the board of directors of the Dallas Chamber of Commerce and has previously served on the state of California Chamber Board and several other charitable and advisory boards. In 2011, Mr. Keglevic was named CFO of the Year by the Dallas Business Journal and received a Distinguished Alumni Award in accounting from Northern Illinois University. Mr. Keglevic received his B.S. in accounting from Northern Illinois University and is a certified public accountant. We believe Mr. Keglevic's extensive experience with public companies and knowledge of accounting and regulatory issues brings important and valuable skills to our board of directors.

William C. Repko serves as a member of our board of directors. Mr. Repko has nearly 40 years of investing, finance and restructuring experience. Mr. Repko has served as a senior advisor, senior managing director and was a co-founder of Evercore Partners Inc.'s Restructuring and Debt Capital Markets Group since joining the firm in September 2005. Prior to joining Evercore Partners Inc., Mr. Repko served as chairman and head of the Restructuring Group at J.P. Morgan Chase, a leading investment banking firm, where he focused on providing comprehensive solutions to clients' liquidity and reorganization challenges. Mr. Repko entered the workout banking world in 1980 at Manufacturers Hanover Trust, a commercial bank, which after a series of mergers became part of J.P. Morgan Chase. Mr. Repko has been named to the Turnaround Management Association (TMA)-sponsored Turnaround, Restructuring and Distressed Investing Industry Hall of Fame. Mr. Repko received his B.S. in Finance from Lehigh University. We believe Mr. Repko's extensive investing, finance, and restructuring experience bring important and valuable skills to our board of directors.

## **Interested Directors**

Robert T. Ladd serves as the Chairman of our board of directors and Chief Executive Officer and President. Mr. Ladd is the managing partner and Chief Investment Officer of Stellus Capital Management. Mr. Ladd has more than 33 years of investing, finance, and restructuring experience. Prior to joining Stellus Capital Management, he had been with the D. E. Shaw group, a global investment and technology development firm, where he led the D. E. Shaw group's Direct Capital Group from February 2004 to January 2012. Prior to joining the D. E. Shaw group, Mr. Ladd served as the president of Duke Energy North America, LLC, a merchant energy subsidiary of Duke Energy Corporation, and president and chief executive officer of Duke Capital Partners, LLC, a merchant banking subsidiary

of Duke Energy Corporation, from September 2000 to February 2004. From February 1993 to September 2000, Mr.

Ladd was a partner of Arthur Andersen LLP where he last served as worldwide managing partner for Arthur Andersen's corporate restructuring practice and U.S. managing partner for that firm's corporate finance practice. Before joining Arthur Andersen, from June 1980 to February 1993, Mr. Ladd served in various capacities for First City Bancorporation of Texas, Inc., a bank holding company, and its subsidiaries, including serving as president of First City Asset Servicing Company, an asset management business and executive vice president for the Texas

## TABLE OF CONTENTS

Banking Division of First City Bancorporation of Texas, Inc., a bank holding company. He is a member of the Council of Overseers of the Jesse H. Jones Graduate School of Business of Rice University, as well as a member of the University of Texas Health Science Center Development Board and the University of Texas Medical School of Houston Advisory Council. Mr. Ladd received a B.A. in managerial studies and economics from Rice University, and an M.B.A. from The University of Texas at Austin, where he was a Sord Scholar and recipient of the Dean's Award for Academic Achievement. We believe Mr. Ladd's extensive investing, finance, and restructuring experience bring important and valuable skills to our board of directors.

Dean D. Angelo serves as a member of our board of directors. Mr. D. Angelo is a founding partner of Stellus Capital Management and co-head of the Private Credit strategy and serves on its investment committee. He has over 21 years of experience in investment banking and principal investing. From August 2005 to January 2012, Mr. D. Angelo was a director in the Direct Capital Group at the D. E. Shaw group, a global investment and technology development firm. Prior to joining the D. E. Shaw group, Mr. D. Angelo was a principal of Allied Capital Corporation, a publicly-traded business development company, where he focused on making debt and equity investments in middle-market companies from May 2003 to August 2005. From September 2000 to April 2003, Mr. D. Angelo served as a principal of Duke Capital Partners, LLC, a merchant banking subsidiary of Duke Energy Corporation, where he focused on providing mezzanine, equity, and senior debt financing to businesses in the energy sector. From January 1998 to September 2000, Mr. D. Angelo was a product specialist for Banc of America Securities, LLC where he provided banking services to clients principally in the energy sector. Mr. D. Angelo began his career in the bankruptcy and consulting practice of Coopers & Lybrand L.L.P. in Washington, D.C. Mr. D. Angelo received his B.B.A. in accounting from The College of William and Mary, his M.A. in international economics and relations from The Paul H. Nitze School of Advanced International Studies at The Johns Hopkins University, and his M.B.A., with a concentration in finance, from the Wharton School of the University of Pennsylvania. We believe Mr. D. Angelo's extensive investment banking and principal investing experience bring important and valuable skills to our board of directors.

Joshua T. Davis serves as a member of our board of directors. Mr. Davis is a founding partner of Stellus Capital Management and co-head of the Private Credit strategy and serves on its investment committee. He has more than 18 years of investing, finance, and restructuring experience. Prior to joining Stellus Capital Management, Mr. Davis was a director in the Direct Capital Group at the D. E. Shaw group, a global investment and technology development firm, since March 2004. Prior to joining the D. E. Shaw group, Mr. Davis served as a managing director at Milestone Merchant Partners, LLC, a boutique merchant bank from May 2003 to February 2004 and a vice president of Duke Capital Partners, LLC, a merchant banking subsidiary of Duke Energy Corporation, from May 2002 to May 2003. Mr. Davis also served as a director of Arthur Andersen LLP, a consulting firm, from May 1995 to May 2002. Mr. Davis received a B.B.A. in accounting and finance from Texas A&M University. We believe Mr. Davis's extensive investing, finance, and restructuring experience bring important and valuable skills to our board of directors.

## **Executive Officers Who Are Not Directors**

W. Todd Huskinson serves as our Chief Financial Officer, Chief Compliance Officer, Treasurer and Secretary. Mr. Huskinson is also a founding partner of Stellus Capital Management. He has over 25 years of experience in finance, accounting and operations. From August 2005 to January 2012, Mr. Huskinson was a director in the D. E. Shaw group's Direct Capital Group, a global investment and technology development firm. Prior to joining the D. E. Shaw group, Mr. Huskinson was a Managing Director at BearingPoint (formerly KPMG Consulting), a management consulting firm, where he led the Houston office's middle-market management consulting practice from July 2002 to July 2005. Prior to BearingPoint, Mr. Huskinson was a partner of Arthur Andersen, LLP, an accounting firm, where he served clients in the audit, corporate finance and consulting practices from December 1987 to June 2002. Mr.

Huskinson received a B.B.A in accounting from Texas A&M University and is a certified public accountant.

## **Audit Committee**

The members of the audit committee are Messrs. Keglevic, Bilger and Repko, each of whom meets the independence standards established by the SEC and the NYSE for audit committees and is independent for purposes of the 1940 Act. Mr. Keglevic serves as chairman of the audit committee. Our board of directors has

82

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## TABLE OF CONTENTS

determined that Mr. Keglevic is an audit committee financial expert as that term is defined under Item 407 of Regulation S-K of the Exchange Act. The audit committee is responsible for approving our independent accountants, reviewing with our independent accountants the plans and results of the audit engagement, approving professional services provided by our independent accountants, reviewing the independence of our independent accountants and reviewing the adequacy of our internal accounting controls. The audit committee is also responsible for aiding our board of directors in fair value pricing debt and equity securities that are not publicly traded or for which current market values are not readily available. The board of directors and audit committee will utilize the services of an independent valuation firm to help them determine the fair value of these securities.

## **Nominating and Corporate Governance Committee**

The members of the nominating and corporate governance committee are Messrs. Arnoult, Bilger and Keglevic, each of whom is independent for purposes of the 1940 Act and the NYSE corporate governance regulations. Mr. Arnoult serves as chairman of the nominating and corporate governance committee. The nominating and corporate governance committee is responsible for selecting, researching and nominating directors for election by our stockholders, selecting nominees to fill vacancies on the board or a committee of the board, developing and recommending to the board a set of corporate governance principles and overseeing the evaluation of the board and our management.

The nominating and corporate governance committee will consider nominees to the board of directors recommended by a stockholder if such stockholder complies with the advance notice provisions of our bylaws. Our bylaws provide that a stockholder who wishes to nominate a person for election as a director at a meeting of stockholders must deliver written notice to our corporate secretary. This notice must contain, as to each nominee, all of the information relating to such person as would be required to be disclosed in a proxy statement meeting the requirements of Regulation 14A under the Exchange Act, and certain other information set forth in the bylaws. In order to be eligible to be a nominee for election as a director by a stockholder, such potential nominee must deliver to our corporate secretary a written questionnaire providing the requested information about the background and qualifications of such person and a written representation and agreement that such person is not and will not become a party to any voting agreements or any agreement or understanding with any person with respect to any compensation or indemnification in connection with service on the board of directors, and would be in compliance with all of our publicly disclosed corporate governance, conflict of interest, confidentiality and stock ownership and trading policies and guidelines.

The nominating and corporate governance committee has not adopted a formal policy with regard to the consideration of diversity in identifying individuals for election as members of the board of directors, but the committee will consider such factors as it may deem are in our best interests and those of our stockholders. Those factors may include a person's differences of viewpoint, professional experience, education and skills, as well as his or her race, gender and national origin. In addition, as part of the board's annual-self assessment, the members of the nominating and corporate governance committee will evaluate the membership of the board of directors and whether the board maintains satisfactory policies regarding membership selection.

## **Compensation Committee**

The members of the Compensation Committee are Messrs. Repko, Bilger and Arnoult, each of whom is independent for purposes of the 1940 Act and the NYSE corporate governance regulations. Mr. Repko serves as chairman of the Compensation Committee. The compensation committee is responsible for overseeing our compensation policies generally and making recommendations to the board of directors with respect to our incentive compensation and equity-based plans that are subject to board approval, evaluating executive officer performance, overseeing and setting compensation for our directors and, as applicable, our executive officers and, as applicable, preparing the report on

executive officer compensation that SEC rules require to be included in our annual proxy statement. Currently, none of our executive officers is compensated by us and as such the compensation committee is not required to produce a report on executive officer compensation for inclusion in our annual proxy statement.

The compensation committee has the sole authority to retain and terminate any compensation consultant assisting the compensation committee, including sole authority to approve all such compensation consultants

TABLE OF CONTENTS

fees and other retention terms. The compensation committee may delegate its authority to subcommittees or the chairman of the compensation committee when it deems appropriate and in our best interests.

## Compensation of Directors

The following table shows information regarding the compensation received by our independent directors for the year ending December 31, 2013. No compensation is paid to directors who are interested persons for their service as directors.

| Name                         | Aggregate Cash Compensation from Stellus Capital Investment Company | Total Compensation from Stellus Capital Investment Company Paid to Director |
|------------------------------|---|---|
| <b>Interested Directors</b>  |   |   |
| Robert T. Ladd               | \$  | \$  |
| Dean D Angelo                | \$  | \$  |
| Joshua T. Davis              | \$  | \$  |
| <b>Independent Directors</b> |   |   |
| J. Tim Arnoult               | \$ 84,000   | \$ 84,000   |
| Bruce R. Bilger              | \$ 85,000   | \$ 85,000   |
| Paul Keglevic                | \$ 92,000   | \$ 92,000   |
| William C. Repko             | \$ 89,000   | \$ 89,000   |

The independent directors receive an annual fee of \$55,000. They also receive \$2,500 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attending in person or telephonically each regular board of directors meeting and each special telephonic meeting. They also receive \$1,000 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with each committee meeting attended in person and each telephonic committee meeting. The chairmen of the audit committee, the compensation committee and the nominating and corporate governance committee receive an annual fee of \$10,000, \$5,000 and \$5,000, respectively. We have obtained directors and officers liability insurance on behalf of our directors and officers. Independent directors have the option of having their directors fees paid in shares of our common stock issued at a price per share equal to the greater of net asset value or the market price at the time of payment. No compensation is paid to directors who are interested persons.

## Investment Committee

The investment committee of Stellus Capital Management meets regularly to consider our investments, direct our strategic initiatives and supervise the actions taken by Stellus Capital Management on our behalf. In addition, the investment committee reviews and determines by unanimous vote whether to make prospective investments identified by Stellus Capital Management and monitors the performance of our investment portfolio. Stellus Capital Management's investment committee consists of Messrs. Ladd, D Angelo, Davis, Overbergen and Huskinson. Stellus Capital Management may, however, increase the size of its investment committee from time to time.

Information regarding the member of Stellus Capital Management's investment committee who is not also a director or executive officer is as follows:

Todd A. Overbergen is a founding partner of Stellus Capital Management and head of the Energy Private Equity strategy. He has more than 23 years of investing, finance, and restructuring experience. Prior to joining Stellus Capital Management, Mr. Overbergen served as a director in the Direct Capital Group of the D. E. Shaw group, a global investment and technology development firm, since February 2004. Prior to joining the D. E. Shaw group, Mr. Overbergen was a founding principal of Duke Capital Partners, LLC, a merchant banking subsidiary of Duke Energy Corporation, from December 2000 to April 2003. From 1998 to December 2000, Mr. Overbergen was a director in Arthur Andersen LLP's Global Corporate Finance group. Mr. Overbergen received a B.B.A. in accounting and finance from Texas A&M University.

TABLE OF CONTENTS

## **Portfolio Management**

Each investment opportunity requires the unanimous approval of Stellus Capital Management's investment committee, which is comprised of Messrs. Ladd, D'Angelo, Davis, Overbergen and Huskinson. Follow-on investments in existing portfolio companies require the investment committee's approval beyond that obtained when the initial investment in the company was made. In addition, temporary investments, such as those in cash equivalents, U.S. government securities and other high quality debt investments that mature in one year or less, may require approval by the investment committee. The day-to-day management of investments approved by the investment committee are overseen by Messrs. D'Angelo and Davis. Biographical information with respect to Messrs. D'Angelo and Davis is set out under Biographical Information.

The members of our investment committee receive compensation by Stellus Capital Management that may include an annual base salary, an annual individual performance bonus, contributions to 401(k) plans, and a portion of the incentive fee or carried interest earned in connection with their services.

Each of Messrs. Ladd, D'Angelo, Davis, Overbergen and Huskinson has a direct ownership and financial interests in, and may receive compensation and/or profit distributions from, Stellus Capital Management. None of Messrs. Ladd, D'Angelo, Davis, Overbergen and Huskinson receives any direct compensation from us. Messrs. Ladd, D'Angelo, Davis, Overbergen and Huskinson are also primarily responsible for the day-to-day management of other pooled investment vehicles and other accounts in which their affiliates receive incentive fees, with a total amount of \$546 million in assets under management as of September 30, 2013. See Related Party Transactions and Certain Relationships.

TABLE OF CONTENTS

## **MANAGEMENT AGREEMENTS**

Stellus Capital Management serves as our investment adviser and is registered as an investment adviser under the Investment Advisers Act of 1940 as amended, or the Advisers Act.

### **Investment Advisory Agreement**

Subject to the overall supervision of our board of directors and in accordance with the 1940 Act, Stellus Capital Management manages our day-to-day operations and provides investment advisory services to us. Under the terms of the investment advisory agreement, Stellus Capital Management:

determines the composition of our portfolio, the nature and timing of the changes to our portfolio and the manner of implementing such changes;

- identifies, evaluates and negotiates the structure of the investments we make;
- executes, closes, services and monitors the investments we make;
- determines the securities and other assets that we will purchase, retain or sell;
- performs due diligence on prospective portfolio companies; and

provides us with such other investment advisory, research and related services as we may, from time to time, reasonably require for the investment of our funds.

Pursuant to the investment advisory agreement, we have agreed to pay Stellus Capital Management a fee for investment advisory and management services consisting of two components – a base management fee and an incentive fee. The cost of both the base management fee and the incentive fee is ultimately borne by our stockholders.

### **Management Fee**

The base management fee is calculated at an annual rate of 1.75% of our gross assets, including assets purchased with borrowed funds or other forms of leverage (including preferred stock, public and private debt issuances, derivative instruments, repurchase agreements and other similar instruments or arrangements) and excluding cash and cash equivalents. For services rendered under the investment advisory agreement, the base management fee is payable quarterly in arrears. For the first quarter of our operations, the base management fee was calculated based on the initial value of our gross assets. Beginning with our second quarter of operations, the base management fee has been and will be calculated based on the average value of our gross assets, excluding cash and cash equivalents, at the end of the two most recently completed calendar quarters. Base management fees for any partial month or quarter are appropriately pro-rated.

### **Incentive Fee**

We pay Stellus Capital Management an incentive fee. Incentive fees are calculated as below and payable quarterly in arrears. The incentive fee, which provides Stellus Capital Management with a share of the income that it generates for us, has two components, ordinary income and capital gains, calculated as follows:

The ordinary income component is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income for the immediately preceding calendar quarter, subject to a total return requirement and deferral of non-cash amounts, and is 20.0% of the amount, if any, by which our pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets attributable to our common stock, for the immediately preceding calendar quarter, exceeds a 2.0% (which is 8.0% annualized) hurdle rate and a catch-up provision measured

as of the end of each calendar quarter. Under this provision, in any calendar quarter, Stellus Capital Management receives no incentive fee until our pre-incentive fee net investment income equals the hurdle rate of 2.0%, but then receives, as a catch-up, 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.5%.

The effect of the catch-up provision is that, subject to the total return and deferral provisions discussed below, if pre-incentive fee net investment income exceeds 2.5% in any calendar quarter, Stellus Capital Management receives 20.0% of our pre-incentive fee net investment income as if a hurdle rate did not apply.

TABLE OF CONTENTS

For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees, such as commitment, origination, structuring, diligence, managerial assistance and consulting fees or other fees that we receive from portfolio companies) accrued during the calendar quarter, minus our operating expenses for the quarter (including the base management fee, expenses payable under the administration agreement (as defined below), and any interest expense and any distributions paid on any issued and outstanding preferred stock, but 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 we have not yet received in cash. 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 will be 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 quarters exceeds the cumulative incentive fees accrued and/or paid for the 11 preceding quarters. In other words, any ordinary income incentive fee that is payable in a calendar quarter will be limited to the lesser of (i) 20.0% of the amount by which our pre-incentive fee net investment income for such calendar quarter exceeds the 2.0% hurdle, subject to the catch-up provision, and (ii) (x) 20.0% of the cumulative net increase in net assets resulting from operations for the then current and 11 preceding calendar 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 portion of such incentive fee that is attributable to deferred interest (such as PIK interest or OID) will be paid to Stellus Capital Management, together with interest thereon from the date of deferral to the date of payment, only if and to the extent we actually receive such interest in cash, and any accrual thereof will be reversed if and to the extent such interest is reversed in connection with any write-off or similar treatment of the investment giving rise to any deferred interest accrual. Any reversal of such accounts would reduce net income for the quarter by the net amount of the reversal (after taking into account the reversal of incentive fees payable) and would result in a reduction and possible elimination of the incentive fees for such quarter. There is no accumulation of amounts on the hurdle rate from quarter to quarter, and accordingly there is no clawback of amounts previously paid if subsequent quarters are below the quarterly hurdle, and there is no delay of payment if prior quarters are below the quarterly hurdle. Stellus Capital Management has agreed to permanently waive any interest accrued on the portion of the incentive fee attributable to deferred interest (such as PIK interest or OID).

Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Because of the structure of the incentive fee, it is possible that we may pay an incentive fee in a quarter where we incur a loss, subject to the total return requirement and deferral of non-cash amounts. For example, if we receive pre-incentive fee net investment income in excess of the quarterly minimum hurdle rate, we will pay the applicable incentive fee even if we have incurred a loss in that quarter due to realized and unrealized capital losses. Our net investment income used to calculate this component of the incentive fee is also included in the amount of our gross assets used to calculate the 1.75% base management fee. These calculations will be appropriately prorated for any period of less than three months and adjusted for any share issuances or repurchases during the current quarter.

TABLE OF CONTENTS

The following is a graphical representation of the calculation of the income-related portion of the incentive fee:

## **Quarterly Incentive Fee Based on Net Investment Income**

### **Percentage of Pre-incentive Fee Net Investment Income**

### **Allocated to Income-Related Portion of Incentive Fee**

The capital gains component of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the investment advisory agreement, as of the termination date), and is equal to 20.0% of our cumulative aggregate realized capital gains from inception through the end of that calendar year, computed net of our aggregate cumulative realized capital losses and our aggregate cumulative unrealized capital depreciation through the end of such year, less the aggregate amount of any previously paid capital gains incentive fees. If such amount is negative, then no capital gains incentive fee will be payable for such year. Additionally, if the investment advisory agreement is terminated as of a date that is not a calendar year end, the termination date will be treated as though it were a calendar year end for purposes of calculating and paying the capital gains incentive fee.

#### **Examples of Quarterly Incentive Fee Calculation**

#### **Example 1: Income Related Portion of Incentive Fee before Total Return Requirement Calculation:**

##### **Alternative 1**

##### **Assumptions**

Investment income (including interest, dividends, fees, etc.) = 1.25%  
Hurdle rate<sup>(1)</sup> = 2.0%  
Management fee<sup>(2)</sup> = 0.4375%  
Other expenses (legal, accounting, custodian, transfer agent, etc.)<sup>(3)</sup> = 0.2%  
Pre-incentive fee net investment income  
(investment income - (management fee + other expenses)) = 0.6125%

Pre-incentive fee net investment income does not exceed hurdle rate, therefore there is no income-related incentive fee.

TABLE OF CONTENTS

**Alternative 2**

**Assumptions**

$$\begin{aligned}
 &\text{Investment income (including interest, dividends, fees, etc.)} = 2.9\% \\
 &\quad \text{Hurdle rate}^{(1)} = 2.0\% \\
 &\quad \text{Management fee}^{(2)} = 0.4375\% \\
 &\text{Other expenses (legal, accounting, custodian, transfer agent, etc.)}^{(3)} = 0.2\% \\
 &\quad \text{Pre-incentive fee net investment income} \\
 &\quad \text{(investment income - (management fee + other expenses))} = 2.2625\% \\
 &\text{Incentive fee} = 100\% \times \text{Pre-incentive fee net investment income (subject to catch-up}^{(4)}) \\
 & \\
 &= 100\% \times (2.2625\% - 2.0\%) \\
 &= 0.2625\%
 \end{aligned}$$

Pre-incentive fee net investment income exceeds the hurdle rate, but does not fully satisfy the catch-up provision, therefore the income related portion of the incentive fee is 0.2625%.

**Alternative 3**

**Assumptions**

$$\begin{aligned}
 &\text{Investment income (including interest, dividends, fees, etc.)} = 3.5\% \\
 &\quad \text{Hurdle rate}^{(1)} = 2.0\% \\
 &\quad \text{Management fee}^{(2)} = 0.4375\% \\
 &\text{Other expenses (legal, accounting, custodian, transfer agent, etc.)}^{(3)} = 0.2\% \\
 &\quad \text{Pre-incentive fee net investment income} \\
 &\quad \text{(investment income - (management fee + other expenses))} = 2.8625\% \\
 &\text{Incentive fee} = 100\% \times \text{Pre-incentive fee net investment income (subject to catch-up}^{(4)}) \\
 &\text{Incentive fee} = 100\% \times \text{catch-up} + (20.0\% \times (\text{Pre-Incentive Fee Net Investment Income} - 2.5\%)) \\
 & \\
 &\quad \text{Catch-up} = 2.5\% - 2.0\% \\
 & \\
 &= 0.5\% \\
 & \\
 &\text{Incentive fee} = (100\% \times 0.5\%) + (20.0\% \times (2.8625\% - 2.5\%)) \\
 & \\
 &= 0.5\% + (20.0\% \times 0.3625\%) \\
 &= 0.5\% + 0.0725\% \\
 &= 0.5725\%
 \end{aligned}$$

Pre-incentive fee net investment income exceeds the hurdle rate, and fully satisfies the catch-up provision, therefore the income related portion of the incentive fee is 0.5725%.

- (1) Represents 8.0% annualized hurdle rate.
- (2) Represents 1.75% annualized base management fee.

(3) Excludes organizational and offering expenses.

The catch-up provision is intended to provide Stellus Capital Management with an incentive fee of 20.0% on all (4) pre-incentive fee net investment income as if a hurdle rate did not apply when our net investment income exceeds 2.5% in any fiscal quarter.

89

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TABLE OF CONTENTS

## Example 2: Income Portion of Incentive Fee with Total Return Requirement Calculation:

### Alternative 1:

#### Assumptions

Investment income (including interest, dividends, fees, etc.) = 3.5%

Hurdle rate<sup>(1)</sup> = 2.0%

Management fee<sup>(2)</sup> = 0.4375%

Other expenses (legal, accounting, custodian, transfer agent, etc.)<sup>(3)</sup> = 0.2%

Pre-incentive fee net investment income

(investment income (management fee + other expenses) = 2.8625%

Cumulative incentive compensation accrued and/or paid for preceding 11 calendar quarters = \$9,000,000

20.0% of cumulative net increase in net assets resulting from operations over current and preceding 11 calendar quarters = \$8,000,000

Although our pre-incentive fee net investment income exceeds the hurdle rate of 2.0% (as shown in Alternative 3 of Example 1 above), no incentive fee is payable because 20.0% of the cumulative net increase in net assets resulting from operations over the then current and 11 preceding calendar quarters did not exceed the cumulative income and capital gains incentive fees accrued and/or paid for the preceding 11 calendar quarters.

### Alternative 2:

#### Assumptions

Investment income (including interest, dividends, fees, etc.) = 3.5%

Hurdle rate<sup>(1)</sup> = 2.0%

Management fee<sup>(2)</sup> = 0.4375%

Other expenses (legal, accounting, custodian, transfer agent, etc.)<sup>(3)</sup> = 0.2%

Pre-incentive fee net investment income

(investment income (management fee + other expenses) = 2.8625%

Cumulative incentive compensation accrued and/or paid for preceding 11 calendar quarters = \$9,000,000

20.0% of cumulative net increase in net assets resulting from operations over current and preceding 11 calendar quarters = \$10,000,000

Because our pre-incentive fee net investment income exceeds the hurdle rate of 2.0% and because 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 income and capital gains incentive fees accrued and/or paid for the preceding 11 calendar quarters, an incentive fee would be payable, as shown in Alternative 3 of Example 1 above.

(1) Represents 8.0% annualized hurdle rate.

(2) Represents 1.75% annualized base management fee.

(3) Excludes organizational and offering expenses.

The catch-up provision is intended to provide Stellus Capital Management with an incentive fee of 20.0% on all (4) pre-incentive fee net investment income as if a hurdle rate did not apply when our net investment income exceeds 2.5% in any fiscal quarter.

90

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TABLE OF CONTENTS

**Example 3: Capital Gains Portion of Incentive Fee(\*):**

**Alternative 1:**

**Assumptions**

Year 1: \$2.0 million investment made in Company A ( Investment A ), and \$3.0 million investment made in Company B ( Investment B )

Year 2: Investment A sold for \$5.0 million and fair market value ( FMV ) of Investment B determined to be \$3.5 million

Year 3: FMV of Investment B determined to be \$2.0 million

Year 4: Investment B sold for \$3.25 million

The capital gains portion of the incentive fee would be:

Year 1: None

Year 2: Capital gains incentive fee of \$0.6 million ( \$3.0 million realized capital gains on sale of Investment A multiplied by 20.0% )

Year 3: None \$0.4 million (20.0% multiplied by (\$3.0 million cumulative capital gains less \$1.0 million cumulative capital depreciation)) less \$0.6 million (previous capital gains fee paid in Year 2)

Year 4: Capital gains incentive fee of \$50,000 \$0.65 million (\$3.25 million cumulative realized capital gains multiplied by 20.0%) less \$0.6 million (capital gains incentive fee taken in Year 2)

**Alternative 2**

**Assumptions**

Year 1: \$2.0 million investment made in Company A ( Investment A ), \$5.25 million investment made in Company B ( Investment B ) and \$4.5 million investment made in Company C ( Investment C )

Year 2: Investment A sold for \$4.5 million, FMV of Investment B determined to be \$4.75 million and FMV of Investment C determined to be \$4.5 million

Year 3: FMV of Investment B determined to be \$5.0 million and Investment C sold for \$5.5 million

Year 4: FMV of Investment B determined to be \$6.0 million

Year 5: Investment B sold for \$4.0 million

The capital gains incentive fee, if any, would be:

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Year 1: None

Year 2: \$0.4 million capital gains incentive fee 20.0% multiplied by \$2.0 million (\$2.5 million realized capital gains on Investment A less \$0.5 million unrealized capital depreciation on Investment B)

Year 3: \$0.25 million capital gains incentive fee<sup>(1)</sup> \$0.65 million (20.0% multiplied by \$3.25 million (\$3.5 million cumulative realized capital gains less \$0.25 million unrealized capital depreciation)) less \$0.4 million capital gains incentive fee received in Year 2

Year 4: \$0.05 million capital gains incentive fee \$0.7 million (\$3.50 million cumulative realized capital gains multiplied by 20.0%) less \$0.65 million cumulative capital gains incentive fee paid in Year 2 and Year 3

Year 5: None \$0.45 million (20.0% multiplied by \$2.25 million (cumulative realized capital gains of \$3.5 million less realized capital losses of \$1.25 million)) less \$0.7 million cumulative capital gains incentive fee paid in Year 2, Year 3 and Year 4<sup>(2)</sup>

91

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TABLE OF CONTENTS

The hypothetical amounts of returns shown are based on a percentage of our total net assets and assume no leverage.  
\*There is no guarantee that positive returns will be realized and actual returns may vary from those shown in this example.

As illustrated in Year 3 of Alternative 1 above, if a portfolio company were to be wound up on a date other than its (1) fiscal year end of any year, it may have paid aggregate capital gains incentive fees that are more than the amount of such fees that would be payable if such portfolio company had been wound up on its fiscal year end of such year.

As noted above, it is possible that the cumulative aggregate capital gains fee received by Stellus Capital (2) Management (\$0.70 million) is effectively greater than \$0.45 million (20.0% of cumulative aggregate realized capital gains less net realized capital losses or net unrealized depreciation (\$2.25 million)).

**Payment of Our Expenses**

All investment professionals of Stellus Capital Management, when and to the extent engaged in providing investment advisory and management services to us, and the compensation and routine overhead expenses of personnel allocable to these services to us, are provided and paid for by Stellus Capital Management and not by us. We bear all other out-of-pocket costs and expenses of our operations and transactions, including, without limitation, those relating to:

organization and offering;

calculating our net asset value (including the cost and expenses of any independent valuation firm);  
fees and expenses payable to third parties, including agents, consultants or other advisors, in monitoring financial and legal affairs for us and in monitoring our investments and performing due diligence on our prospective portfolio companies or otherwise relating to, or associated with, evaluating and making investments;  
interest payable on debt, if any, incurred to finance our investments and expenses related to unsuccessful portfolio acquisition efforts;

offerings of our common stock and other securities;

base management and incentive fees;

administration fees and expenses, if any, payable under the administration agreement (including our allocable portion of Stellus Capital Management's overhead in performing its obligations under the administration agreement, including rent and the allocable portion of the cost of our chief compliance officer, chief financial officer and their respective staffs);

transfer agent, dividend agent and custodial fees and expenses;

U.S. federal and state registration fees;

all costs of registration and listing our shares on any securities exchange;

U.S. federal, state and local taxes;

independent directors' fees and expenses;

costs of preparing and filing reports or other documents required by the SEC or other regulators;

costs of any reports, proxy statements or other notices to stockholders, including printing costs;

costs associated with individual or group stockholders;

costs and fees associated with any fidelity bond, directors and officers/errors and omissions liability insurance, and any other insurance premiums;

direct costs and expenses of administration, including printing, mailing, long distance telephone, copying, secretarial and other staff, independent auditors and outside legal costs;

92

## TABLE OF CONTENTS

proxy voting expenses; and  
all other expenses incurred by us or Stellus Capital Management in connection with administering our business.

### **Duration and Termination**

Unless terminated earlier as described below, the investment advisory agreement will continue in effect for a period of two years from its effective date. It will remain in effect from year to year thereafter if approved annually by our board of directors or by the affirmative vote of the holders of a majority of our outstanding voting securities, and, in either case, if also approved by a majority of our directors who are not interested persons. The investment advisory agreement automatically terminates in the event of its assignment, as defined in the 1940 Act, by Stellus Capital Management and may be terminated by either party without penalty upon 60 days' written notice to the other. The holders of a majority of our outstanding voting securities may also terminate the investment advisory agreement without penalty upon 60 days' written notice. See Risk Factors Risks Relating to our Business and Structure We are dependent upon key personnel of Stellus Capital Management for our future success. If Stellus Capital Management were to lose any of its key personnel, our ability to achieve our investment objective could be significantly harmed.

### **Indemnification**

The investment advisory agreement provides that Stellus Capital Management 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 us for any damages, liabilities, costs and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) arising from the rendering of Stellus Capital Management's services under the investment advisory agreement or otherwise as our investment adviser. Our obligation to provide indemnification under the investment advisory agreement, however, is limited by the 1940 Act and Investment Company Act Release No. 11330, which, among other things, prohibit us from indemnifying any director, officer or other individual from any liability resulting directly from the willful misconduct, bad faith, gross negligence in the performance of duties or reckless disregard of applicable obligations and duties of the directors, officers or other individuals and require us to set forth reasonable and fair means for determining whether indemnification shall be made.

### **Administration Agreement**

Under the administration agreement, Stellus Capital Management furnishes us with office facilities and equipment and provides us with clerical, bookkeeping, recordkeeping and other administrative services at such facilities. Stellus Capital Management also performs, or oversees the performance of, our required administrative services, which includes being responsible for the financial and other records that we are required to maintain and preparing reports to our stockholders and reports and other materials filed with the SEC. In addition, Stellus Capital Management assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports and other materials to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the administration agreement, Stellus Capital Management also provides managerial assistance on our behalf to those portfolio companies that have accepted our offer to provide such assistance.

Payments under the administration agreement equal an amount based upon our allocable portion (subject to the review of our board of directors) of Stellus Capital Management's overhead in performing its obligations under the administration agreement, including rent, the fees and expenses associated with performing compliance functions and our allocable portion of the cost of our chief financial officer and chief compliance officer and their respective staffs.

In addition, if requested to provide significant managerial assistance to our portfolio companies, Stellus Capital Management will be paid an additional amount based on the services provided, which shall not exceed the amount we

receive from such portfolio companies for providing this assistance. The administration agreement has an initial term of two years and may be renewed with the approval of our board of directors. The administration agreement may be terminated by either party without penalty upon 60 days written notice to the other party. To the extent that Stellus Capital Management

## TABLE OF CONTENTS

outsources any of its functions, we will pay the fees associated with such functions on a direct basis without any incremental profit to Stellus Capital Management. Stockholder approval is not required to amend the administration agreement.

### **Indemnification**

The administration agreement provides that Stellus Capital Management, its affiliates and their respective directors, officers, managers, partners, agents, employees, controlling persons and members, and any other person or entity affiliated with it, are entitled to indemnification from us for any damages, liabilities, costs and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) arising from the rendering of Stellus Capital Management's services under the administration agreement or otherwise as our administrator. Our obligation to provide indemnification under the administration agreement, however, is limited by the 1940 Act and Investment Company Act Release No. 11330, which, among other things, prohibit us from indemnifying any director, officer or other individual from any liability resulting directly from the willful misconduct, bad faith, gross negligence in the performance of duties or reckless disregard of applicable obligations and duties of the directors, officers or other individuals and require us to set forth reasonable and fair means for determining whether indemnification shall be made.

### **License Agreement**

We have entered into a license agreement with Stellus Capital Management under which Stellus Capital Management 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 Management or one of its affiliates remains our investment adviser. 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 Management is in effect.

TABLE OF CONTENTS

## **RELATED PARTY TRANSACTIONS AND CERTAIN RELATIONSHIPS**

### **Policies and Procedures for Managing Conflicts; Co-investment Opportunities**

We have entered into agreements with Stellus Capital Management, in which our senior management and members of Stellus Capital Management's investment committee have indirect ownership and other financial interests.

Stellus Capital Management also manages, and in the future may manage, other investment funds, accounts or investment vehicles that invest or may invest in assets eligible for purchase by us. For example, Stellus Capital Management currently manages a private credit fund that has an investment strategy that is identical to our investment strategy and, pursuant to sub-advisory arrangements, Stellus Capital Management provides non-discretionary advisory services to the D. E. Shaw group related to a private investment fund and a strategy of a private multi-strategy investment fund to which the D. E. Shaw group serves as investment adviser. Our investment policies, fee arrangements and other circumstances may vary from those of other investment funds, accounts or investment vehicles managed by Stellus Capital Management.

We have received exemptive relief from the SEC to co-invest with investment funds managed by Stellus Capital Management (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 Management, 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 that (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 Management 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.

In addition, as of September 30, 2013 our investment portfolio consists of 10 assets in 7 portfolio companies acquired from the D. E. Shaw group fund to which the D. E. Shaw group serves as investment adviser. Stellus Capital Management provides advisory services with respect to the D. E. Shaw group fund pursuant to a sub-advisory arrangement. However, the D. E. Shaw group fund has retained equity investments in 6 of those 7 portfolio companies. To the extent that our investments in these portfolio companies need to be restructured or that we choose to exit these investments in the future, our ability to do so may be limited if such restructuring or exit also involves an affiliate or the D. E. Shaw group fund therein because such a transaction could be considered a joint transaction prohibited by the 1940 Act in the absence of our receipt of relief from the SEC in connection with such transaction. For example, if the D. E. Shaw group fund were required to approve a restructuring of our investment in one of these portfolio companies in its capacity as an equity holder thereof and the D. E. Shaw group were deemed to be our affiliate, such involvement by the D. E. Shaw group fund in the restructuring transaction may constitute a prohibited joint transaction under the 1940 Act. However, we do not believe that our ability to restructure or exit these investments will be significantly hampered due to the fact that the equity investments retained by the D. E. Shaw

group fund are minority equity positions and, as a result, it is unlikely that the D. E. Shaw group fund will be or will be required to be involved in any such restructurings or exits. Moreover, although we have received exemptive relief in relation to certain joint transactions with certain investment funds affiliated with Stellus Capital Management, we do not intend to apply such exemptive relief to the D. E. Shaw group funds sub-advised by Stellus Capital Management. See Risk Factors Our ability to sell or otherwise exit investments in which affiliates of Stellus Capital Management also have an investment may be restricted.

## **Investment Advisory Agreement**

We have entered into an investment advisory agreement with Stellus Capital Management. Pursuant to this agreement, we have agreed to pay to Stellus Capital Management a management fee and incentive fee. Messrs. Ladd, D Angelo and Davis, each an interested member of our board of directors, have a direct or

## TABLE OF CONTENTS

indirect pecuniary interest in Stellus Capital Management. See Management Agreements. The incentive fee is computed and paid on income that we may not have yet received in cash at the time of payment. This fee structure may create an incentive for Stellus Capital Management to invest in certain types of speculative securities. Additionally, we rely on investment professionals from Stellus Capital Management to assist our board of directors with the valuation of our portfolio investments. Stellus Capital Management's management fee and incentive fee is based on the value of our investments and, therefore, there may be a conflict of interest when personnel of Stellus Capital Management are involved in the valuation process for our portfolio investments.

## **License Agreement**

We have entered into a license agreement with Stellus Capital Management pursuant to which Stellus Capital Management has granted us a non-exclusive, royalty-free license to use the name Stellus Capital.

## **Administration Agreement**

We have entered into an administration agreement with Stellus Capital Management pursuant to which Stellus Capital Management furnishes us with office facilities and equipment and provides us with the clerical, bookkeeping, recordkeeping and other administrative services necessary to conduct day-to-day operations. Under this administration agreement, Stellus Capital Management performs, or oversees the performance of, our required administrative services, which include, 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. The beneficial interests in Stellus Capital Management are indirectly owned by Messrs. Ladd, D Angelo, Davis, Overbergen and Huskinson. See Management Agreements. We reimburse Stellus Capital Management for the allocable portion (subject to the review of our board of directors) of overhead and other expenses incurred by it in performing its obligations under the administration agreement, including rent, the fees and expenses associated with performing compliance functions, and our allocable portion of the cost of our chief financial officer and chief compliance officer and their respective staffs.

TABLE OF CONTENTS**CONTROL PERSONS AND PRINCIPAL STOCKHOLDERS**

The following table sets forth, as of January 28, 2014, the beneficial ownership of each director, each executive officer, each person known to us to beneficially own 5% or more of the outstanding shares of our common stock, and the executive officers and directors as a group.

Beneficial ownership is determined in accordance with the rules of the SEC and includes voting or investment power with respect to the securities. Common stock subject to options or warrants that are currently exercisable or exercisable within 60 days of January 28, 2014 are deemed to be outstanding and beneficially owned by the person holding such options or warrants. Such shares, however, are not deemed outstanding for the purposes of computing the percentage ownership of any other person. Percentage of ownership is based on 12,101,625 shares of common stock outstanding as of January 28, 2014.

Unless otherwise indicated, to our knowledge, each stockholder listed below has sole voting and investment power with respect to the shares beneficially owned by the stockholder, except to the extent authority is shared by their spouses under applicable law. Unless otherwise indicated, the address of all executive officers and directors is c/o Stellus Capital Investment Corporation, 4400 Post Oak Parkway, Suite 2200, Houston, Texas 77027.

The Company's directors are divided into two groups interested directors and independent directors. Interested directors are interested persons as defined in Section 2(a)(19) of the 1940 Act.

| Name and Address of Beneficial Owner        | Number of Shares Owned Beneficially <sup>(1)</sup> | Percentage of Class |   |
|---|--|---------------------|---|
| Interested Directors                        |  |                     |   |
| Robert T. Ladd                              | 63,730   | *                   |   |
| Dean D Angelo                               | 53,111   | *                   |   |
| Joshua T. Davis                             | 53,111   | *                   |   |
| Independent Directors                       |  |                     |   |
| J. Tim Arnoult                              | 10,870   | *                   |   |
| Bruce R. Bilger                             | 7,461  | *                   |   |
| Paul Keglevic                               | 1,866  | *                   |   |
| William C. Repko                            | 10,000   | *                   |   |
| Executive Officers                          |  |                     |   |
| W. Todd Huskinson                           | 9,998  | *                   |   |
| Executive officers and directors as a group | 210,147  | 1.7                 | % |
| 5% Holders                                  |  |                     |   |
| DC Funding SPV 2, L.L.C. <sup>(2)</sup>     |  |                     |   |
| 1166 Avenue of the Americas                 |  |                     |   |
| Ninth Floor                                 | 1,875,858  | 15.5                | % |
| New York, New York 10036                    |  |                     |   |

\*

Less than 1%

(1)

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Beneficial ownership has been determined in accordance with Rule 13d-3 of the Securities Exchange Act of 1934, as amended.

(2) This information regarding DC Funding SPV 2, L.L.C. is based on information included in the Form 4 filed by DC Funding SPV 2 L.L.C. with the SEC on September 16, 2013.

97

---

TABLE OF CONTENTS

The following table sets forth, as of December 2, 2013, the dollar range of our securities owned by our directors and executive officers.

| Name                   | Dollar Range of Equity Securities<br>Beneficially Owned <sup>(1)</sup> |
|------------------------|--|
| Interested Director:   |  |
| Robert T. Ladd         | over \$100,000   |
| Dean D Angelo          | over \$100,000   |
| Joshua T. Davis        | over \$100,000   |
| Independent Directors: |  |
| J. Tim Arnoult         | over \$100,000   |
| Bruce R. Bilger        | over \$100,000   |
| Paul Keglevic          | \$10,001 \$50,000  |
| William C. Repko       | over \$100,000   |
| Executive Officers:    |  |
| W. Todd Huskinson      | over \$100,000   |

<sup>(1)</sup> Beneficial ownership has been determined in accordance with Rule 16a-1(a)(2) of the Securities Exchange Act of 1934, as amended.

98

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TABLE OF CONTENTS**SELLING STOCKHOLDER**

This prospectus also relates to 1,875,858 shares being offered for resale on behalf of the selling stockholder identified below. The selling stockholder acquired the shares from us in connection with our formation transactions prior to our initial public offering. We are registering the shares to permit the selling stockholder to resell the shares when and as they deem appropriate. The following table sets forth:

the name of the selling stockholder;

the number and percent of shares of our common stock that the selling stockholder beneficially owned prior to the offering for resale of the shares under this registration statement;

the number of shares of our common stock that may be offered for resale for the account of the stockholder under this registration statement, some or all of which shares may be sold pursuant to this prospectus and any prospectus supplement; and

the number and percent of shares of our common stock to be beneficially owned by the selling stockholder after an offering under this registration statement (assuming all of the offered resale shares are sold by the selling stockholder).

The number of shares in the column **Number of Shares Being Offered** represents all of the shares that the selling stockholder may offer under this registration statement. We do not know how long the selling stockholder will hold the shares before selling them or how many shares it will sell and we currently have no agreements, arrangements or understandings with the stockholder regarding the sale of any of the shares under this registration statement. The shares offered by this prospectus may be offered from time to time by the selling stockholder listed below.

This table is prepared solely based on information supplied to us by the listed stockholder and any public documents filed with the SEC, and assumes the sale of all of the resale shares. The applicable percentages of beneficial ownership are based on an aggregate of 12,101,625 shares of our common stock issued and outstanding on January 28, 2014, adjusted as may be required by rules promulgated by the SEC.

| Stockholder   | Shares Beneficially Owned<br>Prior to Offering |         | Number of<br>Shares Being<br>Offered | Shares Beneficially<br>Owned<br>After Offering |         |
|---|--|---------|--------------------------------------|--|---------|
|   | Number   | Percent |                                      | Number   | Percent |
| DC Funding SPV 2, L.L.C. <sup>(1)</sup><br>1166 Avenue of the Americas<br>Ninth Floor<br>New York, New York 10036 | 1,875,858                                      | 15.5 %  | 1,875,858                            |  |         |

DC Funding SPV 2, L.L.C. is a wholly owned subsidiary of the D. E. Shaw group-advised private investment fund from which we acquired our initial portfolio, as outlined in more detail elsewhere in this prospectus. The shares <sup>(1)</sup>being registered by this registration statement represent shares issued to DC Funding SPV 2, L.L.C. as partial consideration for such acquisition.

Shares of our common stock sold by the selling stockholder will generally be freely tradable. Sales of substantial amounts of our common stock, including by the selling stockholder, or the availability of such common stock for sale, whether or not sold, could adversely affect the prevailing market prices for our common stock.



TABLE OF CONTENTS

## **DETERMINATION OF NET ASSET VALUE**

The net asset value per share of our outstanding shares of common stock is determined quarterly by dividing the value of total assets minus liabilities by the total number of shares outstanding.

In calculating the value of our total assets, investment transactions are recorded on the trade date. Realized gains or losses are computed using the specific identification method. Investments for which market quotations are readily available will be valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued at fair value as determined in good faith by our board of directors based on the input of our management and audit committee. In addition, our board of directors retains one or more independent valuation firms to review the valuation of each portfolio investment for which a market quotation is not available at least quarterly. We also have adopted SFAS 157 (ASC Topic 820). This accounting statement requires us to assume that the portfolio investment is assumed to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance with SFAS 157 (ASC Topic 820), the market in which we can exit portfolio investments with the greatest volume and level activity is considered our principal market.

The valuation process is conducted at the end of each fiscal quarter, with all of our valuations of portfolio companies without market quotations subject to review by one or more independent valuation firm each quarter. When an external event with respect to one of our portfolio companies, such as a purchase transaction, public offering or subsequent equity sale occurs, we consider the pricing indicated by the external event to corroborate our valuation.

A readily available market value is not expected to exist for most of the investments in our portfolio, and we value these portfolio investments at fair value as determined in good faith by our board of directors under our valuation policy and process. The types of factors that our board of directors may take into account in determining the fair value of our investments generally include, as appropriate, comparisons of financial ratios of the portfolio companies that issued such private equity securities to peer companies that are public, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings and discounted cash flow, the markets in which the portfolio company does business, and other relevant factors. When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, the company considers the pricing indicated by the external event to corroborate the private equity valuation. 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 the 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 addition, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different from the valuations currently assigned. See Risk Factors Risks Related to our Investments Price declines and illiquidity in the corporate debt markets may adversely affect the fair value of our portfolio investments, reducing our net asset value through increased net unrealized depreciation.

With respect to investments for which market quotations are not readily available, our board of directors undertakes a multi-step valuation process each quarter, as described below:

our quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals of Stellus Capital Management responsible for the portfolio investment;  
preliminary valuation conclusions are then documented and discussed with our senior management and Stellus Capital Management;

the audit committee of our board of directors then reviews these preliminary valuations; at least once quarterly, the valuation for each portfolio investment is reviewed by an independent valuation firm; and  
100

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TABLE OF CONTENTS

the board of directors then discusses valuations and determines the fair value of each investment in our portfolio in good faith, based on the input of Stellus Capital Management, the independent valuation firm and the audit committee.

In following these approaches, the types of factors that are taken into account in fair value pricing investments 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.

Determination of fair values involves subjective judgments and estimates not susceptible to substantiation by auditing procedures. Under current auditing standards, the notes to our financial statements refer to the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on our financial statements.

TABLE OF CONTENTS

## **SALES OF COMMON STOCK BELOW NET ASSET VALUE**

On July 29, 2013, our stockholders voted to allow us to issue common stock below the then current net asset value, or NAV, per share of our common stock for the period ending on the earlier of the one year anniversary of the date of the

Company's 2013 Annual Meeting of Stockholders and the date of the Company's 2014 Annual Meeting of Stockholders, which is expected to be held in June 2014. Our stockholders did not specify a maximum discount below net asset value at which we are able to issue our common stock, although the number of shares sold in each offering may not exceed 25% of our outstanding common stock immediately prior to such sale. In order to sell shares pursuant to this authorization:

a majority of our independent directors who have no financial interest in the sale must have approved the sale; and a majority of such directors, who are not interested persons of the Company, in consultation with the underwriter or underwriters of the offering if it is to be underwritten, must have determined in good faith, and as of a time immediately prior to the first solicitation by us or on our behalf of firm commitments to purchase such shares or immediately prior to the issuance of such shares, that the price at which such shares are to be sold is not less than a price which closely approximates the market value of those shares, less any underwriting commission or discount. We are also permitted to sell shares of common stock below net asset value per share in rights offerings. Any offering of common stock below net asset value per share will be designed to raise capital for investment in accordance with our investment objectives and business strategies.

In making a determination that an offering below net asset value per share is in our and our stockholders' best interests, our board of directors would consider a variety of factors including:

the effect that an offering below net asset value per share would have on our stockholders, including the potential dilution they would experience as a result of the offering;

the amount per share by which the offering price per share and the net proceeds per share are less than the most recently determined net asset value per share;

the relationship of recent market prices of our common stock to net asset value per share and the potential impact of the offering on the market price per share of our common stock;

whether the proposed offering price would closely approximate the market value of our shares;

the potential market impact of being able to raise capital during the current financial market difficulties;

the nature of any new investors anticipated to acquire shares in the offering;

the anticipated rate of return on and quality, type and availability of investments to be funded with the proceeds from the offering, if any; and

the leverage available to us, both before and after any offering, and the terms thereof.

Sales by us of our common stock at a discount from net asset value pose potential risks for our existing stockholders whether or not they participate in the offering, as well as for new investors who participate in the offering.

TABLE OF CONTENTS

The following three headings and accompanying tables will explain and provide hypothetical examples on the impact of an offering at a price less than net asset value per share on three different sets of investors:

existing stockholders who do not purchase any shares in the offering;  
existing stockholders who purchase a relatively small amount of shares in the offering or a relatively large amount of shares in the offering; and

new investors who become stockholders by purchasing shares in the offering.

## Impact on Existing Stockholders who do not Participate in the Offering

Our existing stockholders who do not participate in an offering below net asset value per share or who do not buy additional shares in the secondary market at the same or lower price we obtain in the offering (after expenses and commissions) face the greatest potential risks. These stockholders will experience an immediate decrease (often called dilution) in the net asset value of the shares they hold and their net asset value per share. These stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we will experience in our assets, potential earning power and voting interests due to the offering. These stockholders may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential decreases in net asset value per share. This decrease could be more pronounced as the size of the offering and level of discount to net asset value increases.

The following table illustrates the level of net asset value dilution that would be experienced by a nonparticipating stockholder in four different hypothetical offerings of different sizes and levels of discount from net asset value per share. Actual sales prices and discounts may differ from the presentation below.

The examples assume that Company XYZ has 10,000,000 common shares outstanding, \$150,000,000 in total assets and \$50,000,000 in total liabilities. The current net asset value and net asset value per share are thus \$100,000,000 and \$10.00. The table illustrates the dilutive effect on nonparticipating Stockholder A of (1) an offering of 1,000,000 shares (10% of the outstanding shares) at \$9.00 per share after offering expenses and commissions (a 10% discount from net asset value), and (2) an offering of 2,500,000 shares (25% of the outstanding shares) at \$8.50 per share after offering expenses and commissions (a 15% discount from net asset value).

|  | Prior to Sale<br>Below NAV | Example 1<br>10% Offering at<br>10% Discount<br>Following Sale | %<br>Change | Example 2<br>25% Offering at<br>15% Discount<br>Following Sale | %<br>Change |
|--|----------------------------|--|-------------|--|-------------|
| Offering Price                             |                            |  |             |  |             |
| Price per Share to Public <sup>(1)</sup>   |                            | \$9.58   |             | \$9.05   |             |
| Net Proceeds per Share to Issuer           |                            | \$9.00   |             | \$8.50   |             |
| Increase in Shares and Decrease to NAV     |                            |  |             |  |             |
| Total Shares Outstanding                   | 10,000,000                 | 11,000,000   | 10.00 %     | 12,500,000   | 25.00 %     |
| NAV per Share                              | \$10.00                    | \$9.91   | (0.90) %    | \$8.50   | (4.00) %    |
| Dilution to Nonparticipating Stockholder A |                            |  |             |  |             |
| Share Dilution                             |                            |  |             |  |             |
| Shares Held by Stockholder A               | 100,000                    | 100,000  |             | 100,000  |             |
|  | 1.00 %                     | 0.91 %   | (9.09) %    | 0.80 %   | (20.00) %   |

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Percentage Outstanding Held by  
Stockholder A

NAV Dilution

|  |             |             |          |              |          |
|--|-------------|-------------|----------|--------------|----------|
| Total NAV Held by Stockholder A  | \$1,000,000 | \$991,000   | (0.90 )% | \$850,000    | (4.00 )% |
| Total Investment by Stockholder A<br>(Assumed to be \$10.00 per Share) | \$1,000,000 | \$1,000,000 |          | \$1,000,000  |          |
| Total Dilution to Stockholder A (Total<br>NAV Less Total Investment)   |             | \$(9,000 )  |          | \$(150,000 ) |          |
| NAV Dilution per Share   |             |             |          |              |          |
| NAV per Share Held by Stockholder A                                    |             | \$9.91      |          | \$8.50       |          |

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TABLE OF CONTENTS

|   |                                  | Example 1<br>10% Offering at<br>10% Discount | Example 2<br>25% Offering at<br>15% Discount |
|---|----------------------------------|--|--|
|   | Prior to<br>Sale<br>Below<br>NAV | Following%<br>Sale                           | Following%<br>Sale                           |
|   |                                  | Change                                       | Change                                       |
| Investment per Share Held by Stockholder A<br>(Assumed to be \$10.00 per Share on Shares Held<br>Prior to Sale)     | \$ 10.00                         | \$10.00                                      | \$ 10.00                                     |
| NAV Dilution per Share Experienced by<br>Stockholder A (NAV per Share Less Investment<br>per Share)                 |                                  | \$(0.09 )                                    | \$(1.50 )                                    |
| Percentage NAV Dilution Experienced by<br>Stockholder A (NAV Dilution per Share Divided<br>by Investment per Share) |                                  | (0.90 )%                                     | (4.00 )%                                     |

(1) Assumes 5% in selling compensation and expenses paid by us.

## Impact on Existing Stockholders who do Participate in the Offering

Our existing stockholders who participate in an offering below net asset value per share or who buy additional shares in the secondary market at the same or lower price as we obtain in the offering (after expenses and commissions) will experience the same types of net asset value dilution as the nonparticipating stockholders, albeit at a lower level, to the extent they purchase less than the same percentage of the discounted offering as their interest in our shares immediately prior to the offering. The level of net asset value dilution to such stockholders will decrease as the number of shares such stockholders purchase increases. Existing stockholders who buy more than their proportionate percentage will experience net asset value dilution but will, in contrast to existing stockholders who purchase less than their proportionate share of the offering, experience an increase (often called accretion) in net asset value per share over their investment per share and will also experience a disproportionately greater increase in their participation in our earnings and assets and their voting power than our increase in assets, potential earning power and voting interests due to the offering. The level of accretion will increase as the excess number of shares purchased by such stockholder increases. Even a stockholder who over-participates will, however, be subject to the risk that we may make additional discounted offerings in which such stockholder does not participate, in which case such a stockholder will experience net asset value dilution as described above in such subsequent offerings. These stockholders may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential decreases in net asset value per share. This decrease could be more pronounced as the size of the offering and the level of discount to net asset value increases.

The following chart illustrates the level of dilution and accretion in the hypothetical 25% offering at a 15% discount from the prior chart (Example 2) for a stockholder that acquires shares equal to (1) 50% of its proportionate share of the offering (i.e., 12,500 shares, which is 0.5% of an offering of 2,500,000 shares rather than its 1.0% proportionate share) and (2) 150% of such percentage (i.e., 37,500 shares, which is 1.5% of an offering of 2,500,000 shares rather than its 1.0% proportionate share). It is not possible to predict the level of market price decline that may occur.



TABLE OF CONTENTS

|  | Prior to Sale<br>Below NAV | 50% Participation<br>Following<br>Sale | %<br>Change | 150% Participation<br>Following<br>Sale | %<br>Change |
|--|----------------------------|--|-------------|---|-------------|
| Offering Price   |                            |  |             |   |             |
| Price per Share to Public <sup>(1)</sup>   |                            | \$9.05                                 |             | \$9.05                                  |             |
| Net Proceeds per Share to Issuer   |                            | \$8.50                                 |             | \$8.50                                  |             |
| Increase in Shares and Decrease to<br>NAV  |                            |  |             |   |             |
| Total Shares Outstanding   | 10,000,000                 | 12,500,000                             | 25.00 %     | 12,500,000                              | 25.00%      |
| NAV per Share  | \$10.00                    | \$9.70                                 | (3.00 )%    | \$9.70                                  | (3.00 )%    |
| Dilution/Accretion to Participating<br>Stockholder A   |                            |  |             |   |             |
| Share Dilution/Accretion   |                            |  |             |   |             |
| Shares Held by Stockholder A   | 100,000                    | 112,500                                | 12.50 %     | 137,500                                 | 37.50%      |
| Percentage Outstanding Held by<br>Stockholder A  | 1.00 %                     | 0.90 %                                 | (10.00)%    | 1.10 %                                  | 10.00%      |
| NAV Dilution/Accretion   |                            |  |             |   |             |
| Total NAV Held by Stockholder A  | \$1,000,000                | \$1,091,250                            | 9.13 %      | \$1,333,750                             | 33.38%      |
| Total Investment by Stockholder A<br>(Assumed to be \$10.00 per Share on<br>Shares Held Prior to Sale)                                     |                            | \$1,113,125                            |             | \$1,339,750                             |             |
| Total Dilution/Accretion to Stockholder<br>A (Total NAV Less Total Investment)   |                            | \$(21,875 )                            |             | \$(5,625 )                              |             |
| NAV Dilution/Accretion per Share   |                            |  |             |   |             |
| NAV per Share Held by Stockholder A  |                            | \$9.70                                 |             | \$9.70                                  |             |
| Investment per Share Held by<br>Stockholder A (Assumed to be \$10.00<br>per Share on Shares Held Prior to Sale)                            | \$10.00                    | \$9.89                                 | (1.10 )%    | \$9.74                                  | (2.60 )%    |
| NAV Dilution/Accretion per Share<br>Experienced by Stockholder A (NAV<br>per Share Less Investment per Share)                              |                            | \$(0.19 )                              |             | \$(0.04 )                               |             |
| Percentage NAV Dilution/Accretion<br>Experienced by Stockholder A (NAV<br>Dilution/Accretion per Share Divided<br>by Investment per Share) |                            |  | (1.92 )%    |   | (0.41 )%    |

(1) Assumes 5% in selling compensation and expenses paid by us.

TABLE OF CONTENTS**Impact on New Investors**

Investors who are not currently stockholders, but who participate in an offering below net asset value and whose investment per share is greater than the resulting net asset value per share due to selling compensation and expenses paid by us will experience an immediate decrease, albeit small, in the net asset value of their shares and their net asset value per share compared to the price they pay for their shares (Example 1 below). On the other hand, investors who are not currently stockholders, but who participate in an offering below net asset value per share and whose investment per share is also less than the resulting net asset value per share will experience an immediate increase in the net asset value of their shares and their net asset value per share compared to the price they pay for their shares (Examples 2, 3 and 4 below). These latter investors will experience a disproportionately greater participation in our earnings and assets and their voting power than our increase in assets, potential earning power and voting interests. These investors will, however, be subject to the risk that we may make additional discounted offerings in which such new stockholder does not participate, in which case such new stockholder will experience dilution as described above in such subsequent offerings. These investors may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential decreases in net asset value per share. This decrease could be more pronounced as the size of the offering and level of discount to net asset value increases.

The following chart illustrates the level of dilution or accretion for new investors that would be experienced by a new investor in the same hypothetical discounted offerings as described in the first chart above. The illustration is for a new investor who purchases the same percentage (1.00%) of the shares in the offering as Stockholder A in the prior examples held immediately prior to the offering. The prospectus supplement pursuant to which any discounted offering is made will include a chart for these examples based on the actual number of shares in such offering and the actual discount from the most recently determined net asset value per share.

|   |                               | Example 1<br>10% Offering at<br>10% Discount |             | Example 2<br>25% Offering at<br>15% Discount |             |
|---|-------------------------------|--|-------------|--|-------------|
|   | Prior to<br>Sale Below<br>NAV | Following Sale                               | %<br>Change | Following Sale                               | %<br>Change |
| Offering Price  |                               |  |             |  |             |
| Price per Share to Public <sup>(1)</sup>                                    |                               | \$9.58                                       |             | \$9.05                                       |             |
| Net Proceeds per Share to Issuer  |                               | \$9.00                                       |             | \$8.50                                       |             |
| Increase in Shares and Decrease to NAV                                      |                               |  |             |  |             |
| Total Shares Outstanding  | 1,000,000                     | 11,000,000                                   | 10.00%      | 12,500,000                                   | 25.00%      |
| NAV per Share   | \$10.00                       | \$9.91                                       | (0.90)%     | \$9.70                                       | (3.00)%     |
| Dilution/Accretion to New Investor A  |                               |  |             |  |             |
| Share Dilution  |                               |  |             |  |             |
| Shares Held by Investor A   |                               | 10,000                                       |             | 25,000                                       |             |
| Percentage Outstanding Held by Investor A                                   | 0.00%                         | 0.09%  |             | 0.20%  |             |
| NAV Dilution  |                               |  |             |  |             |
| Total NAV Held by Investor A  |                               | \$99,100                                     |             | \$242,500                                    |             |
| Total Investment by Investor A (At Price to Public)                         |                               | \$95,800                                     |             | \$226,250                                    |             |
| Total Dilution/Accretion to Investor A<br>(Total NAV Less Total Investment) |                               | \$3,300                                      |             | \$16,250                                     |             |

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|  |        |        |
|--|--------|--------|
| NAV Dilution per Share                   |        |        |
| NAV per Share Held by Investor A         | \$9.91 | \$9.70 |
| Investment per Share Held by Investor A  | \$9.58 | \$9.05 |
| NAV Dilution/Accretion per Share         |        |        |
| Experienced by Investor A (NAV per Share | \$0.33 | \$0.65 |
| Less Investment per Share)               |        |        |
| Percentage NAV Dilution/Accretion        |        |        |
| Experienced by Investor A (NAV           |        |        |
| Dilution/Accretion per Share Divided by  | 3.44 % | 7.18 % |
| Investment per Share)                    |        |        |

(1) Assumes 5% in selling compensation and expenses paid by us.

106

---

TABLE OF CONTENTS

## **DIVIDEND REINVESTMENT PLAN**

We have adopted a dividend reinvestment plan that provides for reinvestment of our stockholder distributions, unless a stockholder elects to receive cash as provided below. As a result, if our board of directors authorizes, and we declare, a cash distribution, then our stockholders who have not opted out of such dividend reinvestment plan will have their cash distribution automatically reinvested in additional shares of our common stock, rather than receiving the cash distribution.

No action is required on the part of a registered stockholder to have its cash distribution reinvested in shares of our common stock. A registered stockholder may elect to receive an entire distribution in cash by notifying State Street Bank and Trust Company, the plan administrator and our transfer agent, registrar and distribution disbursing agent, in writing so that such notice is received by the plan administrator no later than five (5) days prior to the record date for distributions to stockholders. The plan administrator will set up an account for shares acquired through the plan for each stockholder and hold such shares in non-certificated form. Upon request by a stockholder participating in the plan, received in writing not less than five (5) days prior to the record date, the plan administrator will, instead of crediting shares to the participant's account, issue a certificate registered in the participant's name for the number of whole shares of our common stock and a check for any fractional share. The plan administrator is authorized to deduct a \$15.00 transaction fee plus a brokerage commission from the proceeds of the sale of any fractional share.

Those stockholders whose shares are held by a broker or other financial intermediary may receive distributions in cash by notifying their broker or nominee of their election.

We expect to use primarily newly issued shares to implement the plan, whether our shares are trading at a premium or at a discount to net asset value. Under such circumstances, the number of shares to be issued to a stockholder is determined by dividing the total dollar amount of the distribution payable to such stockholder by 95% of the market price per share of our common stock at the close of trading on the payment date fixed by our board of directors. Market price per share on that date will be the closing price for such shares on the NYSE or, if no sale is reported for such day, at the average of their reported bid and asked prices. We reserve the right to purchase shares in the open market in connection with our implementation of the plan. Shares purchased in open market transactions by the plan administrator will be allocated to a stockholder based on the average purchase price, excluding any brokerage charges or other charges, of all shares of common stock purchased in the open market.

There are no brokerage charges or other charges to stockholders who participate in the plan. The plan administrator's fees are paid by us. If a participant elects by written notice to the plan administrator prior to termination of his or her account to have the plan administrator sell part or all of the shares held by the plan administrator in the participant's account and remit the proceeds to the participant, the plan administrator is authorized to deduct a \$15.00 transaction fee plus a brokerage commission from the proceeds.

Stockholders who receive distributions in the form of stock are generally subject to the same U.S. federal, state and local tax consequences as are stockholders who elect to receive their distributions in cash. However, since a participating stockholder's cash distributions will be reinvested, such stockholder will not receive cash with which to pay any applicable taxes on reinvested distributions. A stockholder's basis for determining gain or loss upon the sale of stock received in a distribution from us will generally be equal to the total dollar amount of the distribution payable to the stockholder. Any stock received in a distribution will have a new holding period for tax purposes commencing on the day following the day on which the shares are credited to the U.S. stockholder's account.

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Participants may terminate their accounts under the plan by notifying the plan administrator by filling out the transaction request form located at the bottom of the participant's statement and sending it to the plan administrator at the address below.

Those stockholders whose shares are held by a broker or other nominee who wish to terminate his or her account under the plan may do so by notifying his or her broker or nominee.

The plan may be terminated by us upon notice in writing mailed to each participant at least 30 days prior to any record date for the payment of any stockholder distribution by us. All correspondence concerning the

107

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TABLE OF CONTENTS

plan should be directed to the plan administrator by mail at Stellus Capital Investment Corporation, c/o State Street Bank and Trust Company, 200 Clarendon Street, JHT1651, Boston, Massachusetts 02145.

If you withdraw or the plan is terminated, you will receive the number of whole shares in your account under the plan and a cash payment for any fraction of a share in your account.

If you hold your common stock with a brokerage firm that does not participate in the plan, you will not be able to participate in the plan and any distribution reinvestment may be effected on different terms than those described above. Consult your financial advisor for more information.

108

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TABLE OF CONTENTS

## **MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS**

The following discussion is a general summary of the material U.S. federal income tax considerations applicable to us and to an investment in our shares of common stock. This summary does not purport to be a complete description of the U.S. federal income tax considerations applicable to such an investment. For example, we have not described certain considerations that may be relevant to certain types of holders subject to special treatment under U.S. federal income tax laws, including stockholders subject to the alternative minimum tax, tax-exempt organizations, insurance companies, dealers in securities, pension plans and trusts, and financial institutions. This summary assumes that investors hold our common stock as a capital asset (within the meaning of the Code). The discussion is based upon the Code, Treasury regulations, and administrative and judicial interpretations, each as of the date of this prospectus and all of which are subject to change, possibly retroactively, which could affect the continuing validity of this discussion.

We have not sought and will not seek any ruling from the Internal Revenue Service, or the IRS, regarding this offering. This summary does not discuss any aspects of U.S. estate or gift tax or foreign, state or local tax. It does not discuss the special treatment under U.S. federal income tax laws that could result if we invested in tax-exempt securities or certain other investment assets.

A U.S. stockholder is a beneficial owner of shares of our common stock that is for U.S. federal income tax purposes:

an individual who is a citizen or resident of the United States;

a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, created or organized in or under the laws of the United States or any state thereof or the District of Columbia;

an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or  
a trust if either a U.S. court can exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions or the trust was in existence on August 20, 1996, was treated as a U.S. person prior to that date, and has made a valid election to be treated as a U.S. person.

A Non-U.S. stockholder is a beneficial owner of shares of our common stock that is not a U.S. stockholder.

If a partnership (including an entity treated as a partnership for U.S. federal income tax purposes) is the beneficial owner of shares of our common stock, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. A prospective investor that is a partner in a partnership that will hold shares of our common stock should consult its tax advisors with respect to the partnership's purchase, ownership and disposition of shares of our common stock.

Tax matters are very complicated and the tax consequences to an investor of an investment in our shares of common stock will depend on the facts of his, her or its particular situation. We encourage investors to consult their tax advisors regarding the specific consequences of such an investment, including tax reporting requirements, the applicability of U.S. federal, state, local and foreign tax laws, eligibility for the benefits of any applicable tax treaty, and the effect of any possible changes in the tax laws.

### **Election to be Taxed as a RIC**

As a business development company, we have elected to be treated as a RIC under Subchapter M of the Code. As a RIC, we generally will not have to pay corporate-level U.S. federal income taxes on any ordinary income or capital gains that we timely distribute to our stockholders as dividends. To maintain our qualification as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In

addition, we must distribute to our stockholders, for each taxable year, at least 90% of our investment company taxable income, which is generally our net ordinary taxable income plus the excess of our realized net short-term capital gains over our realized net long-term capital losses, or the Annual Distribution Requirement.

TABLE OF CONTENTS

## Taxation as a RIC

For any taxable year in which we:

qualify as a RIC; and  
satisfy the Annual Distribution Requirement;  
we will not be subject to U.S. federal income tax on the portion of our investment company taxable income and net capital gain, defined as net long-term capital gains in excess of net short-term capital losses, we distribute to stockholders. We will be subject to U.S. federal income tax at the regular corporate rates on any net income or net capital gain not distributed (or deemed distributed) to our stockholders.

We will be subject to a 4% nondeductible U.S. federal excise tax on our undistributed income unless we distribute in a timely manner an amount at least equal to the sum of (a) 98% of our net ordinary income for each calendar year, (b) 98.2% of our capital gain net income for the one-year period ending October 31 in that calendar year and (c) any income realized, but not distributed, in the preceding year and on which we paid no U.S. federal income tax, or the Excise Tax Avoidance Requirement. For this purpose, however, any net ordinary income or capital gain net income retained by us that is subject to corporate income tax for the tax year ending in that calendar year will be considered to have been distributed by year end (or earlier if estimated taxes are paid). We currently intend to make sufficient distributions each taxable year to satisfy the Excise Tax Avoidance Requirement.

In order to maintain our qualification as a RIC for U.S. federal income tax purposes, we must, among other things:

qualify to be regulated as a business development company under the 1940 Act at all times during each taxable year; derive in each taxable year at least 90% of our gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale of stock or other securities, or other income derived with respect to our business of investing in such stock or securities, and net income derived from interests in qualified publicly traded partnerships (which generally are partnerships that are traded on an established securities market or tradable on a secondary market, other than partnerships that derive 90% of their income from interest, dividends and other permitted RIC income), or the 90% Income Test; and

diversify our holdings so that at the end of each quarter of the taxable year:  
at least 50% of the value of our assets consists of cash, cash equivalents, U.S. government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer; and  
no more than 25% of the value of our assets is invested in the securities, other than U.S. government securities or securities of other RICs, of one issuer or of two or more issuers that are controlled, as determined under applicable tax rules, by us and that are engaged in the same or similar or related trades or businesses or in the securities of one or more qualified publicly traded partnerships, or the Diversification Tests.

We may invest in partnerships, including qualified publicly traded partnerships, which may result in our being subject to state, local or foreign income, franchise or withholding liabilities.

Any underwriting fees paid by us are not deductible. We may be required to recognize taxable income in circumstances in which we do not receive cash. For example, if we hold debt obligations that are treated under applicable tax rules as having original issue discount (such as debt instruments with PIK interest or, in certain cases, with increasing interest rates or issued with warrants), we must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by us in the same taxable year. Because any original issue discount accrued will be included in our investment company taxable income for the year of accrual, we may be required to make a distribution to our



TABLE OF CONTENTS

even though we will not have received any corresponding cash amount. If we are not able to obtain sufficient cash from other sources to satisfy the Annual Distribution Requirement, we may fail to maintain our qualification as a RIC and become subject to corporate-level U.S. federal income taxes on all of our taxable income without the benefit of the dividends-paid deduction.

Although we do not presently expect to do so, we are authorized to borrow funds and to sell assets in order (i) to satisfy the Annual Distribution Requirement and to otherwise eliminate our liability for U.S. federal income and excise taxes and (ii) to satisfy the Diversification Tests. However, under the 1940 Act, we are not permitted to borrow additional funds or to make distributions to our stockholders while our debt obligations and other senior securities are outstanding unless certain asset coverage tests are met. See Regulation Senior Securities. Moreover, our ability to dispose of assets to meet the Annual Distribution Requirement, the Excise Tax Avoidance Requirement or the Diversification Tests may be limited by (a) the illiquid nature of our portfolio and/or (b) other requirements relating to our qualification as a RIC. If we dispose of assets in order to meet the Annual Distribution Requirement, the Excise Tax Avoidance Requirement, or the Diversification Tests, we may make such dispositions at times that, from an investment standpoint, are not advantageous.

In addition, if we form and operate a SBIC subsidiary, we will be partially dependent on the SBIC subsidiary for cash distributions to enable us to meet the RIC distribution requirements. The SBIC subsidiary may be limited by the Small Business Investment Act of 1958, and SBA regulations governing SBICs, from making certain distributions to us that may be necessary to maintain our status as a RIC. We may have to request a waiver of the SBA's restrictions for the SBIC subsidiary to make certain distributions to maintain our RIC status. We cannot assure you that the SBA will grant such waiver. If the SBIC subsidiary is unable to obtain a waiver, compliance with the SBA regulations may cause us to fail to maintain our qualification as a RIC, which would result in us becoming subject to corporate-level federal income tax.

Certain of our investment practices may be subject to special and complex U.S. federal income tax provisions that may, among other things, (a) treat dividends that would otherwise constitute qualified dividend income as non-qualified dividend income, (b) treat dividends that would otherwise be eligible for the corporate dividends received deduction as ineligible for such treatment, (c) disallow, suspend or otherwise limit the allowance of certain losses or deductions, (d) convert lower-taxed long term capital gain into higher-taxed short-term capital gain or ordinary income, (e) convert an ordinary loss or a deduction into a capital loss (the deductibility of which is more limited), (f) cause us to recognize income or gain without a corresponding receipt of cash, (g) adversely affect the time as to when a purchase or sale of stock or securities is deemed to occur, (h) adversely alter the characterization of certain complex financial transactions and (i) produce income that will not be qualifying income for purposes of the 90% Income Test. We intend to monitor our transactions and may make certain tax elections to mitigate the effect of these provisions and prevent our disqualification as a RIC.

Gain or loss realized by us from warrants acquired by us as well as any loss attributable to the lapse of such warrants generally will be treated as capital gain or loss. Such capital gain or loss generally will be long term or short term, depending on how long we held a particular warrant.

Some of the income and fees that we may recognize will not satisfy the 90% Income Test. In order to ensure that such income and fees do not disqualify us as a RIC for a failure to satisfy the 90% Income Test, we may hold assets that generate such income and provide services that generate such fees indirectly through one or more entities treated as corporations for U.S. federal income tax purposes. Such corporations will be required to pay U.S. federal corporate income tax on their earnings, which ultimately will reduce our return on such income and fees.

## **Failure to Maintain our Qualification as a RIC**

If we are unable to qualify for treatment as a RIC, and if certain remedial provisions are not available, we would be subject to tax on all of our taxable income at regular corporate rates. We would not be able to deduct distributions to stockholders, nor would they be required to be made.

Distributions, including distributions of net long-term capital gain, would generally be taxable to our stockholders as ordinary dividend income to the extent of our current and accumulated earnings and profits.

## TABLE OF CONTENTS

Subject to certain limitations under the Code, corporate stockholders would be eligible to claim a dividends received deduction with respect to such distributions, non-corporate stockholders would be able to treat such dividend income as qualified dividend income, which is subject to reduced rates of U.S. federal income tax. Distributions in excess of our current and accumulated earnings and profits would be treated first as a return of capital to the extent of the stockholder's tax basis, and any remaining distributions would be treated as a capital gain. If we fail to qualify as a RIC for a period greater than two taxable years, to requalify as a RIC in a subsequent year we may be subject to regular corporate tax on any net built-in gains with respect to certain of our assets (*i.e.*, the excess of the aggregate gains, including items of income, over aggregate losses that would have been realized with respect to such assets if we had been liquidated) that we elect to recognize on requalification or when recognized over the next ten years (or shorter applicable period).

The remainder of this discussion assumes that we will maintain our qualification as a RIC and will satisfy the Annual Distribution Requirement.

## **Tax on Investment Income**

A 3.8% tax is imposed on the net investment income of certain individuals, and on the undistributed net investment income of certain estates and trusts. Among other items, net investment income generally includes gross income from interest, dividends and net gains from certain property sales, less certain deductions. U.S. stockholders should consult their tax advisors regarding the possible implications of this legislation in their particular circumstances.

## **Taxation of U.S. Stockholders**

Distributions by us generally are taxable to U.S. stockholders as ordinary income or capital gains. Distributions of our investment company taxable income (which is, generally, our net ordinary income plus net short-term capital gains in excess of net long-term capital losses) will be taxable as ordinary income to U.S. stockholders to the extent of our current and accumulated earnings and profits, whether paid in cash or reinvested in additional shares of our common stock. To the extent such distributions paid by us to non-corporate stockholders (including individuals) are attributable to dividends from U.S. corporations and certain qualified foreign corporations and if certain holding period requirements are met, such distributions generally will be treated as qualified dividend income and will be eligible for a maximum U.S. federal income tax rate of 20%. In this regard, it is anticipated that distributions paid by us will generally not be attributable to dividends and, therefore, generally will not qualify for the 20% maximum U.S. federal income tax rate. Distributions of our net capital gains (which is generally our realized net long-term capital gains in excess of realized net short-term capital losses) properly reported by us as capital gain dividends will be taxable to a U.S. stockholder as long-term capital gains (currently at a maximum U.S. federal income tax rate of 20%) in the case of individuals, trusts or estates, regardless of the U.S. stockholder's holding period for his, her or its common stock and regardless of whether paid in cash or reinvested in additional shares of common stock. Distributions in excess of our earnings and profits first will reduce a U.S. stockholder's adjusted tax basis in such stockholder's common stock and, after the adjusted basis is reduced to zero, will constitute capital gains to such U.S. stockholder. U.S. stockholders receiving distributions in the form of additional shares of our common stock purchased in the market should be treated for U.S. federal income tax purposes as receiving a distribution in an amount equal to the amount of money that the stockholders receiving cash distributions will receive, and should have a cost basis in the shares received equal to such amount. A U.S. stockholder receiving a distribution in newly issued shares of our common stock will be treated as receiving a distribution equal to the value of the shares received, and should have a cost basis of such amount.

Although we currently intend to distribute any net long-term capital gains at least annually, we may in the future decide to retain some or all of our net long-term capital gains but designate the retained amount as a deemed

distribution. In that case, among other consequences, we will pay tax on the retained amount, each U.S. stockholder will be required to include its share of the deemed distribution in income as if it had been distributed to the U.S. stockholder, and the U.S. stockholder will be entitled to claim a credit equal its allocable share of the tax paid on the deemed distribution by us. The amount of the deemed distribution net of such tax will be added to the U.S. stockholder's tax basis for their shares of common stock. Since we expect to pay tax on any retained capital gains at our regular corporate tax rate, and since that rate is in excess of the maximum rate currently payable by individuals on long-term capital gains, the amount of tax that individual

TABLE OF CONTENTS

U.S. stockholders will be treated as having paid and for which they will receive a credit will exceed the tax they owe on the retained net capital gain. Such excess generally may be claimed as a credit against the U.S. stockholder's other U.S. federal income tax obligations or may be refunded to the extent it exceeds a stockholder's liability for U.S. federal income tax. A stockholder that is not subject to U.S. federal income tax or otherwise required to file a U.S. federal income tax return would be required to file a U.S. federal income tax return on the appropriate form in order to claim a refund for the taxes we paid. In order to utilize the deemed distribution approach, we must provide written notice to our stockholders prior to the expiration of 60 days after the close of the relevant taxable year. We cannot treat any of our investment company taxable income as a deemed distribution.

For purposes of determining (a) whether the Annual Distribution Requirement is satisfied for any year and (b) the amount of capital gain dividends paid for that year, we may, under certain circumstances, elect to treat a dividend that is paid during the following taxable year as if it had been paid during the taxable year in question. If we make such an election, the U.S. stockholder will still be treated as receiving the dividend in the taxable year in which the distribution is made. However, any dividend declared by us in October, November or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of the following year, will be treated as if it had been received by our stockholders on December 31 of the year in which the dividend was declared.

If an investor purchases shares of our common stock shortly before the record date of a distribution, the price of the shares of our common stock will include the value of the distribution and the investor will be subject to tax on the distribution even though it represents a return of their investment.

A U.S. stockholder generally will recognize taxable gain or loss if the stockholder sells or otherwise disposes of their shares of our common stock. Any gain arising from such sale or disposition generally will be treated as long-term capital gain or loss if the stockholder has held their shares of common stock for more than one year. Otherwise, it would be classified as short-term capital gain or loss. However, any capital loss arising from the sale or disposition of shares of our common stock held for six months or less will be treated as long-term capital loss to the extent of the amount of capital gain dividends received, or undistributed capital gain deemed received, with respect to such shares.

In addition, all or a portion of any loss recognized upon a disposition of shares of our common stock may be disallowed if other shares of our common stock are purchased (whether through reinvestment of distributions or otherwise) within 30 days before or after the disposition. In such a case, the basis of the common stock acquired will be increased to reflect the disallowed loss.

In general, individual U.S. stockholders currently are subject to a maximum U.S. federal income tax rate of 20% on their net capital gain, (*i.e.*, the excess of realized net long-term capital gain over realized net short-term capital loss for a taxable year), including a long-term capital gain derived from an investment in our shares of common stock. Such rate is lower than the maximum rate on ordinary income currently payable by individuals. Corporate U.S. stockholders currently are subject to U.S. federal income tax on net capital gain at the maximum 35% rate also applied to ordinary income. Non-corporate stockholders with net capital losses for a year (*i.e.*, net capital losses in excess of net capital gains) generally may deduct up to \$3,000 of such losses against their ordinary income each year; any net capital losses of a non-corporate stockholder in excess of \$3,000 generally may be carried forward and used in subsequent years as provided in the Code. Corporate stockholders generally may not deduct any net capital losses for a year, but may carryback such losses for three years or carry forward such losses for five years.

We or the applicable withholding agent will send to each of our U.S. stockholders, as promptly as possible after the end of each calendar year, a notice reporting the amounts includible in such U.S. stockholder's taxable income for such year as ordinary income and as long-term capital gain. In addition, the U.S. federal income tax status of each year's distributions generally will be reported to the IRS. Distributions may also be subject to additional state, local and

foreign taxes depending on a U.S. stockholder's particular situation. Dividends distributed by us generally will not be eligible for the dividends-received deduction or the lower tax rates applicable to certain qualified dividends.

We may be required to withhold U.S. federal income tax ( backup withholding ) from all distributions to any non-corporate U.S. stockholder (a) who fails to furnish us with a correct taxpayer identification number

## TABLE OF CONTENTS

or a certificate that such stockholder is exempt from backup withholding or (b) with respect to whom the IRS notifies us that such stockholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect. An individual's taxpayer identification number is his or her social security number. Any amount withheld under backup withholding is allowed as a credit against the U.S. stockholder's U.S. federal income tax liability and may entitle such stockholder to a refund, provided that proper information is timely provided to the IRS.

A 30% U.S. federal withholding tax is imposed on payments of certain types of income to foreign financial institutions that fail to enter into an agreement with the U.S. Treasury to report certain required information with respect to accounts held by U.S. persons (or held by foreign entities that have U.S. persons as substantial owners). The types of income subject to the tax include U.S. source interest and dividends paid after June 30, 2014, and the gross proceeds from the sale of any property that could produce U.S.-source interest or dividends paid after December 31, 2016. The information required to be reported includes the identity and taxpayer identification number of each account holder that is a U.S. person and transaction activity within the holder's account. In addition, subject to certain exceptions, a 30% withholding tax is also imposed on payments to foreign entities that are not financial institutions unless the foreign entity certifies that it does not have a greater than 10% U.S. owner or provides the withholding agent with identifying information on each greater than 10% U.S. owner. When these provisions become effective, a U.S. stockholder that holds its shares through foreign intermediaries or foreign entities could be subject to this 30% withholding tax with respect to distributions on their shares and proceeds from the sale of their shares. Under certain circumstances, a U.S. stockholder might be eligible for refunds or credits of such taxes.

## **Taxation of Non-U.S. Stockholders**

Whether an investment in the shares of our common stock is appropriate for a Non-U.S. stockholder will depend upon that person's particular circumstances. Non-U.S. stockholders should consult their tax advisors before investing in our common stock.

Distributions of our investment company taxable income to Non-U.S. stockholders (including interest income, net short-term capital gain or foreign-source dividend and interest income, which generally would be free of withholding if paid to Non-U.S. stockholders directly) will be subject to withholding of U.S. federal income tax at a 30% rate (or lower rate provided by an applicable treaty) to the extent of our current and accumulated earnings and profits unless the distributions are effectively connected with a U.S. trade or business of the Non-U.S. stockholder, and, if an income tax treaty applies, attributable to a permanent establishment in the United States, in which case the distributions will be subject to U.S. federal income tax at the rates applicable to U.S. persons. In that case, we will not be required to withhold U.S. federal income tax if the Non-U.S. stockholder complies with applicable certification and disclosure requirements. Special certification requirements apply to a Non-U.S. stockholder that is a foreign partnership or a foreign trust, and such entities are urged to consult their tax advisors.

Under a provision that applies to taxable years beginning before January 1, 2014, properly reported dividends received by a Non-U.S. stockholder generally are exempt from U.S. federal withholding tax when they (a) are paid in respect of our qualified net interest income (generally, our U.S. source interest income, other than certain contingent interest and interest from obligations of a corporation in which we hold 10% or more of total combined voting power or a partnership in which we hold 10% or more of the capital or profits, reduced by expenses that are allocable to such income), or (b) are paid in connection with our qualified short-term capital gains (generally, the excess of our net short-term capital gain over our long-term capital loss for such taxable year). Depending on the circumstances, we may report all, some or none of our potentially eligible dividends as such qualified net interest income or as qualified short-term capital gains, or treat such dividends, in whole or in part, as ineligible for this exemption from withholding.

In order to qualify for this exemption from withholding, a Non-U.S. stockholder must comply with applicable

certification requirements relating to its non-U.S. status (including, in general, furnishing an IRS Form W-8BEN or an acceptable substitute or successor form). In the case of shares held through an intermediary, the intermediary could withhold tax even if we properly report the payment as qualified net interest income or qualified short-term capital gain. Non-U.S. stockholders should contact their intermediaries with respect to the application of these rules to their accounts. Although this provision has been subject to previous extensions, we cannot be certain whether this exception will apply for any taxable years beginning after December 31, 2013.

TABLE OF CONTENTS

Actual or deemed distributions of our net capital gains to a Non-U.S. stockholder, and gains realized by a Non-U.S. stockholder upon the sale of our common stock, will not be subject to U.S. federal withholding tax and generally will not be subject to U.S. federal income tax unless the distributions or gains, as the case may be, are effectively connected with a U.S. trade or business of the Non-U.S. stockholder and, if an income tax treaty applies, are attributable to a permanent establishment maintained by the Non-U.S. stockholder in the United States or, in the case of an individual Non-U.S. stockholder, the stockholder is present in the United States for 183 days or more during the year of the sale or capital gain dividend and certain other conditions are met.

If we distribute our net capital gains in the form of deemed rather than actual distributions (which we may do in the future), a Non-U.S. stockholder will be entitled to a U.S. federal income tax credit or tax refund equal to the stockholder's allocable share of the tax we pay on the capital gains deemed to have been distributed. In order to obtain the refund, the Non-U.S. stockholder must obtain a U.S. taxpayer identification number and file a U.S. federal income tax return even if the Non-U.S. stockholder would not otherwise be required to obtain a U.S. taxpayer identification number or file a U.S. federal income tax return. For a corporate Non-U.S. stockholder, distributions (both actual and deemed), and gains realized upon the sale of our common stock that are effectively connected with a U.S. trade or business may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate (or at a lower rate if provided for by an applicable treaty).

A Non-U.S. stockholder who is a non-resident alien individual, and who is otherwise subject to withholding of U.S. federal income tax, may be subject to information reporting and backup withholding of U.S. federal income tax on dividends unless the Non-U.S. stockholder provides us or the distribution paying agent with an IRS Form W-8BEN (or an acceptable substitute form) or otherwise meets documentary evidence requirements for establishing that it is a Non-U.S. stockholder or otherwise establishes an exemption from backup withholding.

A 30% U.S. federal withholding tax is imposed on payments of certain types of income to foreign financial institutions that fail to enter into an agreement with the U.S. Treasury to report certain required information with respect to accounts held by U.S. persons (or held by foreign entities that have U.S. persons as substantial owners). The types of income subject to the tax include U.S. source interest and dividends paid after June 30, 2014, and the gross proceeds from the sale of any property that could produce U.S.-source interest or dividends paid after December 31, 2016. The information required to be reported includes the identity and taxpayer identification number of each account holder that is a U.S. person and transaction activity within the holder's account. In addition, subject to certain exceptions, a 30% withholding tax is also imposed on payments to foreign entities that are not financial institutions unless the foreign entity certifies that it does not have a greater than 10% U.S. owner or provides the withholding agent with identifying information on each greater than 10% U.S. owner. When these provisions become effective, depending on the status of a Non-U.S. stockholder and the status of the intermediaries through which they hold their shares, Non-U.S. stockholders could be subject to this 30% withholding tax with respect to distributions on their shares and proceeds from the sale of their shares. Under certain circumstances, a Non-U.S. stockholder might be eligible for refunds or credits of such taxes.

An investment in shares by a non-U.S. person may also be subject to U.S. estate tax. Non-U.S. persons should consult their tax advisors with respect to the U.S. federal income tax and withholding tax, U.S. estate tax and state, local and foreign tax consequences of an investment in the shares of our common stock.

TABLE OF CONTENTS**DESCRIPTION OF OUR COMMON STOCK**

*The following description is based on relevant portions of the Maryland General Corporation Law and our articles of incorporation and bylaws. This summary is not necessarily complete, and we refer you to the Maryland General Corporation Law and our articles of incorporation and bylaws for a more detailed description of the provisions summarized below.*

Our authorized stock consists of 100,000,000 shares of stock, par value \$0.001 per share, all of which are initially designated as common stock. Our common stock is listed on the New York Stock Exchange under the ticker symbol SCM. There are no outstanding options or warrants to purchase our stock. No stock has been authorized for issuance under any equity compensation plans. Our fiscal year-end is December 31<sup>st</sup>. Under Maryland law, our stockholders generally are not personally liable for our debts or obligations.

The following presents our outstanding classes of securities as of January 28, 2014.

| (1)Title of Class | (2)Amount<br>Authorized | (3)Amount<br>Held by Us or<br>for Our<br>Account | (4)Amount<br>Outstanding<br>Exclusive of<br>Amounts<br>Shown Under<br>(3) |
|-------------------|-------------------------|--|---|
| Common Stock      | 100,000,000             |  | 12,101,625  |

Under our charter, our board of directors is authorized to classify and reclassify any unissued shares of stock into other classes or series of stock without obtaining stockholder approval. As permitted by the Maryland General Corporation Law, our charter provides that the board of directors, without any action by our stockholders, may amend the charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have authority to issue.

All shares of our common stock have equal rights as to earnings, assets, voting, and distributions and, when they are issued, will be duly authorized, validly issued, fully paid and nonassessable. Distributions may be paid to the holders of our common stock if, as and when authorized by our board of directors and declared by us out of assets legally available therefor. Shares of our common stock have no preemptive, conversion or redemption rights and are freely transferable, except where their transfer is restricted by federal and state securities laws or by contract. In the event of our liquidation, dissolution or winding up, each share of our common stock would be entitled to share ratably in all of our assets that are legally available for distribution after we pay all debts and other liabilities and subject to any preferential rights of holders of our preferred stock, if any preferred stock is outstanding at such time. Each share of our common stock is entitled to one vote on all matters submitted to a vote of stockholders, including the election of directors. Except as provided with respect to any other class or series of stock, the holders of our common stock possess exclusive voting power. There is no cumulative voting in the election of directors, which means that holders of a majority of the outstanding shares of common stock can elect all of our directors, and holders of less than a majority of such shares will be unable to elect any director.

## **Limitation on Liability of Directors and Officers; Indemnification and Advance of Expenses**

Maryland law permits a Maryland corporation to include in its charter a provision limiting the liability of its directors and officers to the corporation and its stockholders for money damages except for liability resulting from (a) actual receipt of an improper benefit or profit in money, property or services or (b) active and deliberate dishonesty established by a final judgment and which is material to the cause of action. Our charter contains such a provision which eliminates directors and officers liability to the maximum extent permitted by Maryland law, subject to the requirements of the 1940 Act.

Our charter authorizes us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to indemnify any present or former director or officer or any individual who, while a director and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee, from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her status as a present or former director or officer and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. Our bylaws obligate us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to indemnify

## TABLE OF CONTENTS

any present or former director or officer or any individual who, while a director and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee and who is made a party to the proceeding by reason of his service in that capacity from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her status as a present or former director or officer and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. The charter and bylaws also permit us to indemnify and advance expenses to any person who served a predecessor of us in any of the capacities described above and any of our employees or agents or any employees or agents of our predecessor. In accordance with the 1940 Act, we will not indemnify any person for any liability to which such person would be subject by reason of such person's willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office.

Maryland law requires a corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful in the defense of any proceeding to which he or she is made a party by reason of his or her service in that capacity. Maryland law permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made a party by reason of their service in those or other capacities unless it is established that (a) the act or omission of the director or officer was material to the matter giving rise to the proceeding and (1) was committed in bad faith or (2) was the result of active and deliberate dishonesty, (b) the director or officer actually received an improper personal benefit in money, property or services or (c) in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. However, under Maryland law, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that a personal benefit was improperly received, unless in either case a court orders indemnification, and then only for expenses. In addition, Maryland law permits a corporation to advance reasonable expenses to a director or officer upon the corporation's receipt of (a) a written affirmation by the director or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification by the corporation and (b) a written undertaking by him or her or on his or her behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the standard of conduct was not met.

Our insurance policy does not currently provide coverage for claims, liabilities and expenses that may arise out of activities that our present or former directors or officers have performed for another entity at our request. There is no assurance that such entities will in fact carry such insurance. However, we note that we do not expect to request our present or former directors or officers to serve another entity as a director, officer, partner or trustee unless we can obtain insurance providing coverage for such persons for any claims, liabilities or expenses that may arise out of their activities while serving in such capacities.

## **Certain Provisions of the Maryland General Corporation Law and Our Charter and Bylaws**

The Maryland General Corporation Law and our charter and bylaws contain provisions that could make it more difficult for a potential acquirer to acquire us by means of a tender offer, proxy contest or otherwise. These provisions are expected to discourage certain coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us to negotiate first with our board of directors. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging any such acquisition proposals because, among other things, the negotiation of such proposals may improve their terms.

## **Classified Board of Directors**

Our board of directors are divided into three classes of directors serving staggered three-year terms. Upon expiration of their terms, directors of each class will be elected to serve for three-year terms and until their successors are duly elected and qualify and each year one class of directors will be elected by the stockholders. A classified board may render a change in control of us or removal of our incumbent management more difficult. We believe, however, that the longer time required to elect a majority of a classified board of directors will help to ensure the continuity and stability of our management and policies.

## TABLE OF CONTENTS

### **Election of Directors**

Our charter and bylaws provide that the affirmative vote of the holders of a plurality of the outstanding shares of stock entitled to vote in the election of directors cast at a meeting of stockholders duly called and at which a quorum is present will be required to elect a director. Pursuant to our charter our board of directors may amend the bylaws to alter the vote required to elect directors.

### **Number of Directors; Vacancies; Removal**

Our charter provides that the number of directors will be set only by the board of directors in accordance with our bylaws. Our bylaws provide that a majority of our entire board of directors may at any time increase or decrease the number of directors. However, unless our bylaws are amended, the number of directors may never be less than one nor more than nine. Our charter provides that, at such time as we have at least three independent directors and our common stock is registered under the Securities Exchange Act of 1934, as amended, we elect to be subject to the provision of Subtitle 8 of Title 3 of the Maryland General Corporation Law regarding the filling of vacancies on the board of directors. Accordingly, at such time, except as may be provided by the board of directors in setting the terms of any class or series of preferred stock, any and all vacancies on the board of directors may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term of the directorship in which the vacancy occurred and until a successor is elected and qualifies, subject to any applicable requirements of the 1940 Act.

Our charter provides that a director may be removed only for cause, as defined in our charter, and then only by the affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors.

### **Action by Stockholders**

Under the Maryland General Corporation Law, stockholder action can be taken only at an annual or special meeting of stockholders or (unless the charter provides for stockholder action by less than unanimous written consent, which our charter does not) by unanimous written consent in lieu of a meeting. These provisions, combined with the requirements of our bylaws regarding the calling of a stockholder-requested special meeting of stockholders discussed below, may have the effect of delaying consideration of a stockholder proposal until the next annual meeting.

### **Advance Notice Provisions for Stockholder Nominations and Stockholder Proposals**

Our bylaws provide that with respect to an annual meeting of stockholders, nominations of persons for election to the board of directors and the proposal of business to be considered by stockholders may be made only (a) pursuant to our notice of the meeting, (b) by the board of directors or (c) by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice procedures of our bylaws. With respect to special meetings of stockholders, only the business specified in our notice of the meeting may be brought before the meeting. Nominations of persons for election to the board of directors at a special meeting may be made only (1) pursuant to our notice of the meeting, (2) by the board of directors or (3) provided that the board of directors has determined that directors will be elected at the meeting, by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice provisions of the bylaws. The purpose of requiring stockholders to give us advance notice of nominations and other business is to afford our board of directors a meaningful opportunity to consider the qualifications of the proposed

nominees and the advisability of any other proposed business and, to the extent deemed necessary or desirable by our board of directors, to inform stockholders and make recommendations about such qualifications or business, as well as to provide a more orderly procedure for conducting meetings of stockholders. Although our bylaws do not give our board of directors any power to disapprove stockholder nominations for the election of directors or proposals recommending certain action, they may have the effect of precluding a contest for the election of directors or the consideration of stockholder proposals if proper procedures are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its own proposal without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our stockholders.

TABLE OF CONTENTS

## **Calling of Special Meetings of Stockholders**

Our bylaws provide that special meetings of stockholders may be called by our board of directors and certain of our officers. Additionally, our bylaws provide that, subject to the satisfaction of certain procedural and informational requirements by the stockholders requesting the meeting, a special meeting of stockholders will be called by the secretary of the corporation upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast at such meeting.

## **Approval of Extraordinary Corporate Action; Amendment of Charter and Bylaws**

Under Maryland law, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business, unless approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter. However, a Maryland corporation may provide in its charter for approval of these matters by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. Our charter generally provides for approval of charter amendments and extraordinary transactions by the stockholders entitled to cast at least a majority of the votes entitled to be cast on the matter. Our charter also provides that certain charter amendments, any proposal for our conversion, whether by charter amendment, merger or otherwise, from a closed-end company to an open-end company and any proposal for our liquidation or dissolution requires the approval of the stockholders entitled to cast at least 80% of the votes entitled to be cast on such matter. However, if such amendment or proposal is approved by a majority of our continuing directors (in addition to approval by our board of directors), such amendment or proposal may be approved by a majority of the votes entitled to be cast on such a matter. In either event, in accordance with the requirements of the 1940 Act, any such amendment or proposal that would have the effect of changing the nature of our business so as to cause us to cease to be, or to withdraw our election as, a business development company would be required to be approved by a majority of our outstanding voting securities, as defined under the 1940 Act. The continuing directors are defined in our charter as (a) our current directors, (b) those directors whose nomination for election by the stockholders or whose election by the directors to fill vacancies is approved by a majority of our current directors then on the board of directors or (c) any successor directors whose nomination for election by the stockholders or whose election by the directors to fill vacancies is approved by a majority of continuing directors or the successor continuing directors then in office.

Our charter and bylaws provide that the board of directors have the exclusive power to make, alter, amend or repeal any provision of our bylaws.

## **No Appraisal Rights**

Except with respect to appraisal rights arising in connection with the Control Share Act discussed below, as permitted by the Maryland General Corporation Law, our charter provides that stockholders will not be entitled to exercise appraisal rights unless a majority of the board of directors shall determine such rights apply.

## **Control Share Acquisitions**

The Maryland General Corporation Law provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter, or the Control Share Act. Shares owned by the acquirer, by officers or by directors who are

employees of the corporation are excluded from shares entitled to vote on the matter. Control shares are voting shares of stock which, if aggregated with all other shares of stock owned by the acquirer or in respect of which the acquirer is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquirer to exercise voting power in electing directors within one of the following ranges of voting power:

one-tenth or more but less than one-third;  
one-third or more but less than a majority; or  
a majority or more of all voting power.

119

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## TABLE OF CONTENTS

The requisite stockholder approval must be obtained each time an acquirer crosses one of the thresholds of voting power set forth above. Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel the board of directors of the corporation to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction of certain conditions, including an undertaking to pay the expenses of the meeting. If no request for a meeting is made, the corporation may itself present the question at any stockholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then the corporation may redeem for fair value any or all of the control shares, except those for which voting rights have previously been approved. The right of the corporation to redeem control shares is subject to certain conditions and limitations, including, as provided in our bylaws, compliance with the 1940 Act. Fair value is determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquirer or of any meeting of stockholders at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquirer becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of appraisal rights may not be less than the highest price per share paid by the acquirer in the control share acquisition.

The Control Share Act does not apply (a) to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction or (b) to acquisitions approved or exempted by the charter or bylaws of the corporation. Our bylaws contain a provision exempting from the Control Share Act any and all acquisitions by any person of our shares of stock. There can be no assurance that such provision will not be amended or eliminated at any time in the future. However, we will amend our bylaws to be subject to the Control Share Act only if the board of directors determines that it would be in our best interests and if the SEC staff does not object to our determination that our being subject to the Control Share Act does not conflict with the 1940 Act.

## **Business Combinations**

Under Maryland law, business combinations between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder, or the Business Combination Act. These business combinations include a merger, consolidation, share exchange or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested stockholder is defined as:

any person who beneficially owns 10% or more of the voting power of the corporation's outstanding voting stock; or an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of then outstanding voting stock of the corporation.

A person is not an interested stockholder under this statute if the board of directors approved in advance the transaction by which the stockholder otherwise would have become an interested stockholder. However, in approving a transaction, the board of directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the board.

After the five-year prohibition, any business combination between the Maryland corporation and an interested

stockholder generally must be recommended by the board of directors of the corporation and approved by the affirmative vote of at least:

80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation; and  
120

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TABLE OF CONTENTS

two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder.

These super-majority vote requirements do not apply if the corporation's common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares.

The statute permits various exemptions from its provisions, including business combinations that are exempted by the board of directors before the time that the interested stockholder becomes an interested stockholder. Our board of directors has adopted a resolution that any business combination between us and any other person is exempted from the provisions of the Business Combination Act, provided that the business combination is first approved by the board of directors, including a majority of the directors who are not interested persons as defined in the 1940 Act. This resolution may be altered or repealed in whole or in part at any time; however, our board of directors will adopt resolutions so as to make us subject to the provisions of the Business Combination Act only if the board of directors determines that it would be in our best interests and if the SEC staff does not object to our determination that our being subject to the Business Combination Act does not conflict with the 1940 Act. If this resolution is repealed, or the board of directors does not otherwise approve a business combination, the statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

**Conflict with 1940 Act**

Our bylaws provide that, if and to the extent that any provision of the Maryland General Corporation Law, including the Control Share Act (if we amend our bylaws to be subject to such Act) and the Business Combination Act, or any provision of our charter or bylaws conflicts with any provision of the 1940 Act, the applicable provision of the 1940 Act will control.

TABLE OF CONTENTS

## DESCRIPTION OF OUR PREFERRED STOCK

Our articles of incorporation authorize our board of directors to classify and reclassify any unissued shares of stock into other classes or series of stock, including preferred stock. Prior to issuance of shares of each class or series, the board of directors is required by Maryland law and by our articles of incorporation to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Thus, the board of directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our securities or otherwise be in their best interest. You should note, however, that any issuance of preferred stock must comply with the requirements of the 1940 Act. The 1940 Act requires, among other things, that (a) immediately after issuance and before any dividend or other distribution is made with respect to our securities and before any purchase of securities is made, such preferred stock together with all other senior securities must not exceed an amount equal to 50.0% of our total assets after deducting the amount of such dividend, distribution or purchase price, as the case may be, and (b) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if distributions on such preferred stock are in arrears by two years or more. Certain matters under the 1940 Act require the separate vote of the holders of any issued and outstanding preferred stock. For example, holders of preferred stock would vote separately from the holders of common stock on a proposal to cease operations as a business development company. Further, the 1940 Act requires that any distributions we make on preferred stock be cumulative. We believe that the availability for issuance of preferred stock will provide us with increased flexibility in structuring future financings and acquisitions.

For any series of preferred stock that we may issue, our board of directors will determine and the prospectus supplement relating to such series will describe:

- the designation and number of shares of such series;
- the rate and time at which, and the preferences and conditions under which, any dividends will be paid on shares of such series, as well as whether such dividends are participating or non-participating;
- any provisions relating to convertibility or exchangeability of the shares of such series;
- the rights and preferences, if any, of holders of shares of such series upon our liquidation, dissolution or winding up of our affairs;
- the voting powers, if any, of the holders of shares of such series;
- any provisions relating to the redemption of the shares of such series;
- any limitations on our ability to pay dividends or make distributions on, or acquire or redeem, other securities while shares of such series are outstanding;
- any conditions or restrictions on our ability to issue additional shares of such series or other securities;
- if applicable, a discussion of certain U.S. federal income tax considerations; and
- any other relative power, preferences and participating, optional or special rights of shares of such series, and the qualifications, limitations or restrictions thereof.

All shares of preferred stock that we may issue will be identical and of equal rank except as to the particular terms thereof that may be fixed by our board of directors, and all shares of each series of preferred stock will be identical and of equal rank except as to the dates from which cumulative dividends, if any, thereon will be cumulative.

TABLE OF CONTENTS

## **DESCRIPTION OF OUR SUBSCRIPTION RIGHTS**

We may issue subscription rights to purchase common stock. Subscription rights may be issued independently or together with any other offered security and may or may not be transferable by the person purchasing or receiving the subscription rights. In connection with any subscription rights offering to our stockholders, we may enter into a standby underwriting or other arrangement with one or more underwriters or other persons pursuant to which such underwriters or other persons would purchase any offered securities remaining unsubscribed for after such subscription rights offering. We will not offer transferable subscription rights to our stockholders at a price equivalent to less than the then current net asset value per share of common stock, excluding underwriting commissions, unless we first file a post-effective amendment that is declared effective by the SEC with respect to such issuance and the common stock to be purchased in connection with the rights represents no more than one-third of our outstanding common stock at the time such rights are issued. In connection with a subscription rights offering to our stockholders, we would distribute certificates evidencing the subscription rights and a prospectus supplement to our stockholders on the record date that we set for receiving subscription rights in such subscription rights offering. Our common stockholders will indirectly bear the expenses of such subscription rights offerings, regardless of whether our common stockholders exercise any subscription rights.

The applicable prospectus supplement would describe the following terms of subscription rights in respect of which this prospectus is being delivered:

- the title of such subscription rights;
- the exercise price or a formula for the determination of the exercise price for such subscription rights;
- the number or a formula for the determination of the number of such subscription rights issued to each stockholder;
- the extent to which such subscription rights are transferable;
- if applicable, a discussion of the material U.S. federal income tax considerations applicable to the issuance or exercise of such subscription rights;
- the date on which the right to exercise such subscription rights would commence, and the date on which such rights shall expire (subject to any extension);
- the extent to which such subscription rights include an over-subscription privilege with respect to unsubscribed securities;
- if applicable, the material terms of any standby underwriting or other purchase arrangement that we may enter into in connection with the subscription rights offering; and
- any other terms of such subscription rights, including terms, procedures and limitations relating to the exchange and exercise of such subscription rights.

### **Exercise of Subscription Rights**

Each subscription right would entitle the holder of the subscription right to purchase for cash such amount of shares of common stock or other securities at such exercise price as shall in each case be set forth in, or be determinable as set forth in, the prospectus supplement relating to the subscription rights offered thereby or another report filed with the SEC. Subscription rights may be exercised at any time up to the close of business on the expiration date for such subscription rights set forth in the applicable prospectus supplement. After the close of business on the expiration date, all unexercised subscription rights would become void. We have not previously completed such an offering of subscription rights.

Subscription rights may be exercised as set forth in the prospectus supplement relating to the subscription rights offered thereby. Upon receipt of payment and the subscription rights certificate properly completed and duly executed

at the corporate trust office of the subscription rights agent or any other office indicated in the prospectus supplement, we will forward, as soon as practicable, the shares of common stock or other securities purchasable upon such exercise. We may determine to offer any unsubscribed offered securities directly to stockholders, persons other than stockholders, to or through agents, underwriters or dealers or through a combination of such methods, including pursuant to standby underwriting or other arrangements, as set forth in the applicable prospectus supplement.

123

---

TABLE OF CONTENTS

## DESCRIPTION OF OUR DEBT SECURITIES

We may issue debt securities in one or more series. The specific terms of each series of debt securities will be described in the particular prospectus supplement relating to that series. The prospectus supplement may or may not modify the general terms found in this prospectus and will be filed with the SEC. For a complete description of the terms of a particular series of debt securities, you should read both this prospectus and the prospectus supplement relating to that particular series.

As required by federal law for all bonds and notes of companies that are publicly offered, the debt securities are governed by a document called an indenture. An indenture is a contract between us and the financial institution acting as trustee on your behalf, and is subject to and governed by the Trust Indenture Act of 1939, as amended. The trustee has two main roles. First, the trustee can enforce your rights against us if we default. There are some limitations on the extent to which the trustee acts on your behalf, described in the second paragraph under Events of Default Remedies if an Event of Default Occurs. Second, the trustee performs certain administrative duties for us with respect to our debt securities.

This section includes a description of the material provisions of the indenture. Because this section is a summary, however, it does not describe every aspect of the debt securities and the indenture. We urge you to read the indenture because it, and not this description, defines your rights as a holder of debt securities. A copy of the form of indenture is attached as an exhibit to the registration statement of which this prospectus is a part. We will file a supplemental indenture with the SEC in connection with any debt offering, at which time the supplemental indenture would be publicly available. See Available Information for information on how to obtain a copy of the indenture.

The prospectus supplement, which will accompany this prospectus, will describe the particular series of debt securities being offered by including:

- the designation or title of the series of debt securities;
- the total principal amount of the series of debt securities;
- the percentage of the principal amount at which the series of debt securities will be offered;
- the date or dates on which principal will be payable;
- the rate or rates (which may be either fixed or variable) and/or the method of determining such rate or rates of interest, if any;
- the date or dates from which any interest will accrue, or the method of determining such date or dates, and the date or dates on which any interest will be payable;
- whether any interest may be paid by issuing additional securities of the same series in lieu of cash (and the terms upon which any such interest may be paid by issuing additional securities);
  - the terms for redemption, extension or early repayment, if any;
  - the currencies in which the series of debt securities are issued and payable;
- whether the amount of payments of principal, premium or interest, if any, on a series of debt securities will be determined with reference to an index, formula or other method (which could be based on one or more currencies, commodities, equity indices or other indices) and how these amounts will be determined;
- the place or places, if any, other than or in addition to the Borough of Manhattan in the City of New York, of payment, transfer, conversion and/or exchange of the debt securities;
- the denominations in which the offered debt securities will be issued (if other than \$1,000 and any integral multiple thereof);
  - the provision for any sinking fund;
  - any restrictive covenants;

any Events of Default (as defined in Events of Default below);

124

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TABLE OF CONTENTS

whether the series of debt securities are issuable in certificated form;  
any provisions for defeasance or covenant defeasance;  
any special federal income tax implications, including, if applicable, federal income tax considerations relating to original issue discount;  
whether and under what circumstances we will pay additional amounts in respect of any tax, assessment or governmental charge and, if so, whether we will have the option to redeem the debt securities rather than pay the additional amounts (and the terms of this option);  
any provisions for convertibility or exchangeability of the debt securities into or for any other securities;  
whether the debt securities are subject to subordination and the terms of such subordination;  
whether the debt securities are secured and the terms of any security interest;  
the listing, if any, on a securities exchange; and  
any other terms.

The debt securities may be secured or unsecured obligations. Unless the prospectus supplement states otherwise, principal (and premium, if any) and interest, if any, will be paid by us in immediately available funds.

We are permitted, under specified conditions, to issue multiple classes of indebtedness if our asset coverage, as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance after giving effect to any exemptive relief granted to us by the SEC. In addition, while any indebtedness and senior securities remain outstanding, we must make provisions to prohibit the distribution to our stockholders or the repurchase of such securities or shares unless we meet the applicable asset coverage ratios at the time of the distribution or repurchase.

For a discussion of the risks associated with leverage, see Risk Factors Risks Relating to Our Business and Structure Regulations governing our operation as a business development company affect our ability to raise additional capital and the way in which we do so. As a business development company, the necessity of raising additional capital may expose us to risks, including the typical risks associated with leverage.

## General

The indenture provides that any debt securities proposed to be sold under this prospectus and the accompanying prospectus supplement ( offered debt securities ) and any debt securities issuable upon the exercise of warrants or upon conversion or exchange of other offered securities ( underlying debt securities ) may be issued under the indenture in one or more series.

For purposes of this prospectus, any reference to the payment of principal of, or premium or interest, if any, on, debt securities will include additional amounts if required by the terms of the debt securities.

The indenture does not limit the amount of debt securities that may be issued thereunder from time to time. Debt securities issued under the indenture, when a single trustee is acting for all debt securities issued under the indenture, are called the indenture securities. The indenture also provides that there may be more than one trustee thereunder, each with respect to one or more different series of indenture securities. See Resignation of Trustee below. At a time when two or more trustees are acting under the indenture, each with respect to only certain series, the term indenture securities means the one or more series of debt securities with respect to which each respective trustee is acting. In the event that there is more than one trustee under the indenture, the powers and trust obligations of each trustee described in this prospectus will extend only to the one or more series of indenture securities for which it is trustee. If two or more trustees are acting under the indenture, then the indenture securities for which each trustee is acting would be treated as if issued under separate indentures.

The indenture does not contain any provisions that give you protection in the event we issue a large amount of debt or we are acquired by another entity.

125

---

## TABLE OF CONTENTS

We refer you to the prospectus supplement for information with respect to any deletions from, modifications of or additions to the Events of Default or our covenants that are described below, including any addition of a covenant or other provision providing event risk protection or similar protection.

We have the ability to issue indenture securities with terms different from those of indenture securities previously issued and, without the consent of the holders thereof, to reopen a previous issue of a series of indenture securities and issue additional indenture securities of that series unless the reopening was restricted when that series was created.

## **Conversion and Exchange**

If any debt securities are convertible into or exchangeable for other securities, the prospectus supplement will explain the terms and conditions of the conversion or exchange, including the conversion price or exchange ratio (or the calculation method), the conversion or exchange period (or how the period will be determined), if conversion or exchange will be mandatory or at the option of the holder or us, provisions for adjusting the conversion price or the exchange ratio and provisions affecting conversion or exchange in the event of the redemption of the underlying debt securities. These terms may also include provisions under which the number or amount of other securities to be received by the holders of the debt securities upon conversion or exchange would be calculated according to the market price of the other securities as of a time stated in the prospectus supplement.

## **Issuance of Securities in Registered Form**

We may issue the debt securities in registered form, in which case we may issue them either in book-entry form only or in certificated form. Debt securities issued in book-entry form will be represented by global securities. We expect that we will usually issue debt securities in book-entry only form represented by global securities.

### **Book-Entry Holders**

We will issue registered debt securities in book-entry form only, unless we specify otherwise in the applicable prospectus supplement. This means debt securities will be represented by one or more global securities registered in the name of a depository that will hold them on behalf of financial institutions that participate in the depository's book-entry system. These participating institutions, in turn, hold beneficial interests in the debt securities held by the depository or its nominee. These institutions may hold these interests on behalf of themselves or customers.

Under the indenture, only the person in whose name a debt security is registered is recognized as the holder of that debt security. Consequently, for debt securities issued in book-entry form, we will recognize only the depository as the holder of the debt securities and we will make all payments on the debt securities to the depository. The depository will then pass along the payments it receives to its participants, which in turn will pass the payments along to their customers who are the beneficial owners. The depository and its participants do so under agreements they have made with one another or with their customers; they are not obligated to do so under the terms of the debt securities.

As a result, investors will not own debt securities directly. Instead, they will own beneficial interests in a global security, through a bank, broker or other financial institution that participates in the depository's book-entry system or holds an interest through a participant. As long as the debt securities are represented by one or more global securities, investors will be indirect holders, and not holders, of the debt securities.

### **Street Name Holders**

In the future, we may issue debt securities in certificated form or terminate a global security. In these cases, investors may choose to hold their debt securities in their own names or in street name. Debt securities held in street name are registered in the name of a bank, broker or other financial institution chosen by the investor, and the investor would hold a beneficial interest in those debt securities through the account he or she maintains at that institution.

For debt securities held in street name, we will recognize only the intermediary banks, brokers and other financial institutions in whose names the debt securities are registered as the holders of those debt securities,

## TABLE OF CONTENTS

and we will make all payments on those debt securities to them. These institutions will pass along the payments they receive to their customers who are the beneficial owners, but only because they agree to do so in their customer agreements or because they are legally required to do so. Investors who hold debt securities in street name will be indirect holders, and not holders, of the debt securities.

### **Legal Holders**

Our obligations, as well as the obligations of the applicable trustee and those of any third parties employed by us or the applicable trustee, run only to the legal holders of the debt securities. We do not have obligations to investors who hold beneficial interests in global securities, in street name or by any other indirect means. This will be the case whether an investor chooses to be an indirect holder of a debt security or has no choice because we are issuing the debt securities only in book-entry form.

For example, once we make a payment or give a notice to the holder, we have no further responsibility for the payment or notice even if that holder is required, under agreements with depositary participants or customers or by law, to pass it along to the indirect holders but does not do so. Similarly, if we want to obtain the approval of the holders for any purpose (for example, to amend an indenture or to relieve us of the consequences of a default or of our obligation to comply with a particular provision of an indenture), we would seek the approval only from the holders, and not the indirect holders, of the debt securities. Whether and how the holders contact the indirect holders is up to the holders.

When we refer to you in this Description of Our Debt Securities, we mean those who invest in the debt securities being offered by this prospectus, whether they are the holders or only indirect holders of those debt securities. When we refer to your debt securities, we mean the debt securities in which you hold a direct or indirect interest.

### **Special Considerations for Indirect Holders**

If you hold debt securities through a bank, broker or other financial institution, either in book-entry form or in street name, we urge you to check with that institution to find out:

how it handles securities payments and notices;  
whether it imposes fees or charges;

how it would handle a request for the holders' consent, if ever required;

whether and how you can instruct it to send you debt securities registered in your own name so you can be a holder, if that is permitted in the future for a particular series of debt securities;

how it would exercise rights under the debt securities if there were a default or other event triggering the need for holders to act to protect their interests; and

if the debt securities are in book-entry form, how the depositary's rules and procedures will affect these matters.

### **Global Securities**

As noted above, we usually will issue debt securities as registered securities in book-entry form only. A global security represents one or any other number of individual debt securities. Generally, all debt securities represented by the same global securities will have the same terms.

Each debt security issued in book-entry form will be represented by a global security that we deposit with and register in the name of a financial institution or its nominee that we select. The financial institution that we select for this purpose is called the depositary. Unless we specify otherwise in the applicable prospectus supplement, The Depositary

Trust Company, New York, New York, known as DTC, will be the depositary for all debt securities issued in book-entry form.

A global security may not be transferred to or registered in the name of anyone other than the depositary or its nominee, unless special termination situations arise. We describe those situations below under Termination of a Global Security. As a result of these arrangements, the depositary, or its nominee, will be the sole registered owner and holder of all debt securities represented by a global security, and investors

## TABLE OF CONTENTS

will be permitted to own only beneficial interests in a global security. Beneficial interests must be held by means of an account with a broker, bank or other financial institution that in turn has an account with the depository or with another institution that has an account with the depository. Thus, an investor whose security is represented by a global security will not be a holder of the debt security, but only an indirect holder of a beneficial interest in the global security.

### **Special Considerations for Global Securities**

As an indirect holder, an investor's rights relating to a global security will be governed by the account rules of the investor's financial institution and of the depository, as well as general laws relating to securities transfers. The depository that holds the global security will be considered the holder of the debt securities represented by the global security.

If debt securities are issued only in the form of a global security, an investor should be aware of the following:

- an investor cannot cause the debt securities to be registered in his or her name and cannot obtain certificates for his or her interest in the debt securities, except in the special situations we describe below;
- an investor will be an indirect holder and must look to his or her own bank or broker for payments on the debt securities and protection of his or her legal rights relating to the debt securities, as we describe under Issuance of Securities in Registered Form above;
- an investor may not be able to sell interests in the debt securities to some insurance companies and other institutions that are required by law to own their securities in non-book-entry form;
- an investor may not be able to pledge his or her interest in a global security in circumstances where certificates representing the debt securities must be delivered to the lender or other beneficiary of the pledge in order for the pledge to be effective;
- the depository's policies, which may change from time to time, will govern payments, transfers, exchanges and other matters relating to an investor's interest in a global security. We and the trustee have no responsibility for any aspect of the depository's actions or for its records of ownership interests in a global security. We and the trustee also do not supervise the depository in any way;
- if we redeem less than all the debt securities of a particular series being redeemed, DTC's practice is to determine by lot the amount to be redeemed from each of its participants holding that series;
- an investor is required to give notice of exercise of any option to elect repayment of its debt securities, through its participant, to the applicable trustee and to deliver the related debt securities by causing its participant to transfer its interest in those debt securities, on DTC's records, to the applicable trustee;
- DTC requires that those who purchase and sell interests in a global security deposited in its book-entry system use immediately available funds, your broker or bank may also require you to use immediately available funds when purchasing or selling interests in a global security; and
- financial institutions that participate in the depository's book-entry system, and through which an investor holds its interest in a global security, may also have their own policies affecting payments, notices and other matters relating to the debt securities; there may be more than one financial intermediary in the chain of ownership for an investor, we do not monitor and are not responsible for the actions of any of those intermediaries.

### **Termination of a Global Security**

If a global security is terminated for any reason, interests in it will be exchanged for certificates in non-book-entry form (certificated securities). After that exchange, the choice of whether to hold the certificated debt securities directly or in street name will be up to the investor. Investors must consult their own banks or brokers to find out how to have their interests in a global security transferred on termination to their own names, so that they will be holders. We have described the rights of legal holders and street name investors under Issuance of Securities in Registered Form above.



## TABLE OF CONTENTS

The prospectus supplement may list situations for terminating a global security that would apply only to the particular series of debt securities covered by the prospectus supplement. If a global security is terminated, only the depositary, and not we or the applicable trustee, is responsible for deciding the investors in whose names the debt securities represented by the global security will be registered and, therefore, who will be the holders of those debt securities.

## **Payment and Paying Agents**

We will pay interest to the person listed in the applicable trustee's records as the owner of the debt security at the close of business on a particular day in advance of each due date for interest, even if that person no longer owns the debt security on the interest due date. That day, usually about two weeks in advance of the interest due date, is called the record date. Because we will pay all the interest for an interest period to the holders on the record date, holders buying and selling debt securities must work out between themselves the appropriate purchase price. The most common manner is to adjust the sales price of the debt securities to prorate interest fairly between buyer and seller based on their respective ownership periods within the particular interest period. This prorated interest amount is called accrued interest.

### **Payments on Global Securities**

We will make payments on a global security in accordance with the applicable policies of the depositary as in effect from time to time. Under those policies, we will make payments directly to the depositary, or its nominee, and not to any indirect holders who own beneficial interests in the global security. An indirect holder's right to those payments will be governed by the rules and practices of the depositary and its participants, as described under Special Considerations for Global Securities.

### **Payments on Certificated Securities**

We will make payments on a certificated debt security as follows. We will pay interest that is due on an interest payment date to the holder of debt securities as shown on the trustee's records as of the close of business on the regular record date at our office and/or at other offices that may be specified in the prospectus supplement. We will make all payments of principal and premium, if any, by check at the office of the applicable trustee and/or at other offices that may be specified in the prospectus supplement or in a notice to holders against surrender of the debt security.

Alternatively, at our option, we may pay any cash interest that becomes due on the debt security by mailing a check to the holder at his, her or its address shown on the trustee's records as of the close of business on the regular record date or by transfer to an account at a bank in the United States, in either case, on the due date.

### **Payment When Offices Are Closed**

If any payment is due on a debt security on a day that is not a business day, we will make the payment on the next day that is a business day. Payments made on the next business day in this situation will be treated under the indenture as if they were made on the original due date, except as otherwise indicated in the attached prospectus supplement. Such payment will not result in a default under any debt security or the indenture, and no interest will accrue on the payment amount from the original due date to the next day that is a business day.

Book-entry and other indirect holders should consult their banks or brokers for information on how they will receive payments on their debt securities.

## Events of Default

You will have rights if an Event of Default occurs in respect of the debt securities of your series and is not cured, as described later in this subsection.

The term **Event of Default** in respect of the debt securities of your series means any of the following:

we do not pay the principal of, or any premium on, a debt security of the series within five days of its due date;  
we do not pay interest on a debt security of the series within 30 days of its due date;

129

---

## TABLE OF CONTENTS

we do not deposit any sinking fund payment in respect of debt securities of the series within five days of its due date; we remain in breach of a covenant in respect of debt securities of the series for 60 days after we receive a written notice of default stating we are in breach (the notice must be sent by either the trustee or holders of at least 25% of the principal amount of the outstanding debt securities of the series); we file for bankruptcy or certain other events of bankruptcy, insolvency or reorganization occur and remain undischarged or unstayed for a period of 90 days; the series of debt securities has an asset coverage, as such term is defined in the 1940 Act, of less than 100 per centum on the last business day of each of twenty-four consecutive calendar months, giving effect to any exemptive relief granted to the Company by the SEC; or any other Event of Default in respect of debt securities of the series described in the prospectus supplement occurs.

An Event of Default for a particular series of debt securities does not necessarily constitute an Event of Default for any other series of debt securities issued under the same or any other indenture. The trustee may withhold notice to the holders of debt securities of any default, except in the payment of principal, premium, interest, or sinking or purchase fund installment, if it in good faith considers the withholding of notice to be in the interest of the holders.

### **Remedies if an Event of Default Occurs**

If an Event of Default has occurred and is continuing, the trustee or the holders of not less than 25% in principal amount of the outstanding debt securities of the affected series may (and the trustee shall at the request of such holders) declare the entire principal amount of all the debt securities of that series to be due and immediately payable. This is called a declaration of acceleration of maturity. A declaration of acceleration of maturity may be canceled by the holders of a majority in principal amount of the outstanding debt securities of the affected series if (1) we have deposited with the trustee all amounts due and owing with respect to the securities (other than principal that has become due solely by reason of such acceleration) and certain other amounts, and (2) any other Events of Default have been cured or waived.

The trustee is not required to take any action under the indenture at the request of any holders unless the holders offer the trustee protection from expenses and liability reasonably satisfactory to it (called an indemnity). If indemnity reasonably satisfactory to it is provided, the holders of a majority in principal amount of the outstanding debt securities of the relevant series may direct the time, method and place of conducting any lawsuit or other formal legal action seeking any remedy available to the trustee. The trustee may refuse to follow those directions in certain circumstances. No delay or omission in exercising any right or remedy will be treated as a waiver of that right, remedy or Event of Default.

Before you are allowed to bypass your trustee and bring your own lawsuit or other formal legal action or take other steps to enforce your rights or protect your interests relating to the debt securities, the following must occur:

you must give the trustee written notice that an Event of Default with respect to the relevant series of debt securities has occurred and remains uncured; the holders of at least 25% in principal amount of all outstanding debt securities of the relevant series must make a written request that the trustee take action because of the default and must offer the trustee indemnity, security or both reasonably satisfactory to it against the costs, expenses and other liabilities of taking that action; the trustee must not have taken action for 60 days after receipt of the above notice and offer of indemnity and/or security; and the holders of a majority in principal amount of the outstanding debt securities of that series must not have given the trustee a direction inconsistent with the above notice during that 60-day period.



## TABLE OF CONTENTS

However, you are entitled at any time to bring a lawsuit for the payment of money due on your debt securities on or after the due date.

### **Book-entry and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and how to declare or cancel an acceleration of maturity.**

Each year, we will furnish to each trustee a written statement of certain of our officers certifying that to their knowledge we are in compliance with the indenture and the debt securities, or else specifying any default.

#### **Waiver of Default**

Holders of a majority in principal amount of the outstanding debt securities of the affected series may waive any past defaults other than

the payment of principal, any premium or interest; or  
in respect of a covenant that cannot be modified or amended without the consent of each holder.

### **Merger or Consolidation**

Under the terms of the indenture, we are generally permitted to consolidate or merge with another entity. We are also permitted to sell all or substantially all of our assets to another entity. However, we may not take any of these actions unless all the following conditions are met:

where we merge out of existence or sell substantially all our assets, the resulting entity or transferee must agree to be legally responsible for our obligations under the debt securities;

the merger or sale of assets must not cause a default on the debt securities and we must not already be in default (unless the merger or sale would cure the default). For purposes of this no-default test, a default would include an Event of Default that has occurred and has not been cured, as described under Events of Default above. A default for this purpose would also include any event that would be an Event of Default if the requirements for giving us a notice of default or our default having to exist for a specific period of time were disregarded;

we must deliver certain certificates and documents to the trustee; and

we must satisfy any other requirements specified in the prospectus supplement relating to a particular series of debt securities.

### **Modification or Waiver**

There are three types of changes we can make to the indenture and the debt securities issued thereunder.

#### **Changes Requiring Your Approval**

First, there are changes that we cannot make to your debt securities without your specific approval. The following is a list of those types of changes:

change the stated maturity of the principal of or interest on a debt security or the terms of any sinking fund with

respect to any security;

reduce any amounts due on a debt security;

reduce the amount of principal payable upon acceleration of the maturity of an original issue discount or indexed security following a default or upon the redemption thereof or the amount thereof provable in a bankruptcy proceeding;

adversely affect any right of repayment at the holder's option;

change the place or currency of payment on a debt security (except as otherwise described in the prospectus or prospectus supplement);

impair your right to sue for payment;

131

---

## TABLE OF CONTENTS

adversely affect any right to convert or exchange a debt security in accordance with its terms; modify the subordination provisions in the indenture in a manner that is adverse to outstanding holders of the debt securities;

reduce the percentage of holders of debt securities whose consent is needed to modify or amend the indenture; reduce the percentage of holders of debt securities whose consent is needed to waive compliance with certain provisions of the indenture or to waive certain defaults;

modify any other aspect of the provisions of the indenture dealing with supplemental indentures with the consent of holders, waiver of past defaults, changes to the quorum or voting requirements or the waiver of certain covenants; and change any obligation we have to pay additional amounts.

### **Changes Not Requiring Approval**

The second type of change does not require any vote by the holders of the debt securities. This type is limited to clarifications, establishment of the form or terms of new securities of any series as permitted by the indenture and certain other changes that would not adversely affect holders of the outstanding debt securities in any material respect. We also do not need any approval to make any change that affects only debt securities to be issued under the indenture after the change takes effect.

### **Changes Requiring Majority Approval**

Any other change to the indenture and the debt securities would require the following approval:

if the change affects only one series of debt securities, it must be approved by the holders of a majority in principal amount of that series; and

if the change affects more than one series of debt securities issued under the same indenture, it must be approved by the holders of a majority in principal amount of all of the series affected by the change, with all affected series voting together as one class for this purpose.

In each case, the required approval must be given by written consent.

The holders of a majority in principal amount of a series of debt securities issued under the indenture, voting together as one class for this purpose, may waive our compliance with some of our covenants applicable to that series of debt securities. However, we cannot obtain a waiver of a payment default or of any of the matters covered by the bullet points included above under Changes Requiring Your Approval.

### **Further Details Concerning Voting**

When taking a vote, we will use the following rules to decide how much principal to attribute to a debt security:

for original issue discount securities, we will use the principal amount that would be due and payable on the voting date if the maturity of these debt securities were accelerated to that date because of a default;

for debt securities whose principal amount is not known (for example, because it is based on an index), we will use the principal face amount at original issuance or a special rule for that debt security described in the prospectus supplement; and

for debt securities denominated in one or more foreign currencies, we will use the U.S. dollar equivalent.

Debt securities will not be considered outstanding, and therefore not eligible to vote, if we have deposited or set aside in trust money for their payment or redemption or if we, any other obligor, or any affiliate of us or any obligor own such debt securities. Debt securities will also not be eligible to vote if they have been fully defeased as described later under Defeasance Full Defeasance.



## TABLE OF CONTENTS

We will generally be entitled to set any day as a record date for the purpose of determining the holders of outstanding indenture securities that are entitled to vote or take other action under the indenture. However, the record date may not be more than 30 days before the date of the first solicitation of holders to vote on or take such action. If we set a record date for a vote or other action to be taken by holders of one or more series, that vote or action may be taken only by persons who are holders of outstanding indenture securities of those series on the record date and must be taken within eleven months following the record date.

**Book-entry and other indirect holders should consult their banks or brokers for information on how approval may be granted or denied if we seek to change the indenture or the debt securities or request a waiver.**

### **Defeasance**

The following provisions will be applicable to each series of debt securities unless we state in the applicable prospectus supplement that the provisions of covenant defeasance and full defeasance will not be applicable to that series.

#### **Covenant Defeasance**

Under current U.S. federal tax law and the indenture, we can make the deposit described below and be released from some of the restrictive covenants in the indenture under which the particular series was issued. This is called covenant defeasance. In that event, you would lose the protection of those restrictive covenants but would gain the protection of having money and government securities set aside in trust to repay your debt securities. If we achieved covenant defeasance and your debt securities were subordinated as described under Indenture Provisions Subordination below, such subordination would not prevent the trustee under the indenture from applying the funds available to it from the deposit described in the first bullet below to the payment of amounts due in respect of such debt securities for the benefit of the subordinated debt holders. In order to achieve covenant defeasance, we must do the following:

we must deposit in trust for the benefit of all holders of a series of debt securities a combination of cash (in such currency in which such securities are then specified as payable at stated maturity) or government obligations applicable to such securities (determined on the basis of the currency in which such securities are then specified as payable at stated maturity) that will generate enough cash to make interest, principal and any other payments on the debt securities on their various due dates and any mandatory sinking fund payments or analogous payments;

we must deliver to the trustee a legal opinion of our counsel confirming that, under current U.S. federal income tax law, we may make the above deposit without causing you to be taxed on the debt securities any differently than if we did not make the deposit;

we must deliver to the trustee a legal opinion of our counsel stating that the above deposit does not require registration by us under the 1940 Act, as amended, and a legal opinion and officers certificate stating that all conditions precedent to covenant defeasance have been complied with;

defeasance must not result in a breach or violation of, or result in a default under, of the indenture or any of our other material agreements or instruments;

no default or event of default with respect to such debt securities shall have occurred and be continuing and no defaults or events of default related to bankruptcy, insolvency or reorganization shall occur during the next 90 days;

and

Book-entry and other indirect holders should consult their banks or brokers for information on how approval may be

satisfy the conditions for covenant defeasance contained in any supplemental indentures.

If we accomplish covenant defeasance, you can still look to us for repayment of the debt securities if there were a shortfall in the trust deposit or the trustee is prevented from making payment. For example, if one of the remaining Events of Default occurred (such as our bankruptcy) and the debt securities became immediately due and payable, there might be such a shortfall. However, there is no assurance that we would have sufficient funds to make payment of the shortfall.

## TABLE OF CONTENTS

### **Full Defeasance**

If there is a change in U.S. federal tax law or we obtain an IRS ruling, as described in the second bullet below, we can legally release ourselves from all payment and other obligations on the debt securities of a particular series (called full defeasance ) if we put in place the following other arrangements for you to be repaid:

we must deposit in trust for the benefit of all holders of a series of debt securities a combination of cash (in such currency in which such securities are then specified as payable at stated maturity) or government obligations applicable to such securities (determined on the basis of the currency in which such securities are then specified as payable at stated maturity) that will generate enough cash to make interest, principal and any other payments on the debt securities on their various due dates and any mandatory sinking fund payments or analogous payments;

we must deliver to the trustee a legal opinion confirming that there has been a change in current U.S. federal tax law or an IRS ruling that allows us to make the above deposit without causing you to be taxed on the debt securities any differently than if we did not make the deposit. Under current U.S. federal tax law, the deposit and our legal release from the debt securities would be treated as though we paid you your share of the cash and notes or bonds at the time the cash and notes or bonds were deposited in trust in exchange for your debt securities and you would recognize gain or loss on the debt securities at the time of the deposit;

we must deliver to the trustee a legal opinion of our counsel stating that the above deposit does not require registration by us under the 1940 Act, as amended, and a legal opinion and officers certificate stating that all conditions precedent to defeasance have been complied with;

defeasance must not result in a breach or violation of, or constitute a default under, of the indenture or any of our other material agreements or instruments;

no default or event of default with respect to such debt securities shall have occurred and be continuing and no defaults or events of default related to bankruptcy, insolvency or reorganization shall occur during the next 90 days;

and

satisfy the conditions for full defeasance contained in any supplemental indentures.

If we ever did accomplish full defeasance, as described above, you would have to rely solely on the trust deposit for repayment of the debt securities. You could not look to us for repayment in the unlikely event of any shortfall. Conversely, the trust deposit would most likely be protected from claims of our lenders and other creditors if we ever became bankrupt or insolvent. If your debt securities were subordinated as described later under Indenture Provisions Subordination , such subordination would not prevent the trustee under the indenture from applying the funds available to it from the deposit referred to in the first bullet of the preceding paragraph to the payment of amounts due in respect of such debt securities for the benefit of the subordinated debt holders.

## **Form, Exchange and Transfer of Certificated Registered Securities**

If registered debt securities cease to be issued in book-entry form, they will be issued:

only in fully registered certificated form;  
without interest coupons; and

unless we indicate otherwise in the prospectus supplement, in denominations of \$1,000 and amounts that are multiples of \$1,000.

Holders may exchange their certificated securities for debt securities of smaller denominations or combined into fewer debt securities of larger denominations, as long as the total principal amount is not changed and as long as the denomination is greater than the minimum denomination for such securities.

Holders may exchange or transfer their certificated securities at the office of the trustee. We have appointed the trustee to act as our agent for registering debt securities in the names of holders transferring debt securities. We may appoint another entity to perform these functions or perform them ourselves.

## TABLE OF CONTENTS

Holders will not be required to pay a service charge to transfer or exchange their certificated securities, but they may be required to pay any tax or other governmental charge associated with the transfer or exchange. The transfer or exchange will be made only if our transfer agent is satisfied with the holder's proof of legal ownership.

If we have designated additional transfer agents for your debt security, they will be named in the prospectus supplement. We may appoint additional transfer agents or cancel the appointment of any particular transfer agent. We may also approve a change in the office through which any transfer agent acts.

If any certificated securities of a particular series are redeemable and we redeem less than all the debt securities of that series, we may block the transfer or exchange of those debt securities during the period beginning 15 days before the day we mail the notice of redemption and ending on the day of that mailing, in order to freeze the list of holders to prepare the mailing. We may also refuse to register transfers or exchanges of any certificated securities selected for redemption, except that we will continue to permit transfers and exchanges of the unredeemed portion of any debt security that will be partially redeemed.

If a registered debt security is issued in book-entry form, only the depository will be entitled to transfer and exchange the debt security as described in this subsection, since it will be the sole holder of the debt security.

## **Resignation of Trustee**

Each trustee may resign or be removed with respect to one or more series of indenture securities provided that a successor trustee is appointed to act with respect to these series and has accepted such appointment. In the event that two or more persons are acting as trustee with respect to different series of indenture securities under the indenture, each of the trustees will be a trustee of a trust separate and apart from the trust administered by any other trustee.

## **Indenture Provisions    Subordination**

Upon any distribution of our assets upon our dissolution, winding up, liquidation or reorganization, the payment of the principal of (and premium, if any) and interest, if any, on any indenture securities denominated as subordinated debt securities is to be subordinated to the extent provided in the indenture in right of payment to the prior payment in full of all Senior Indebtedness (as defined below), but our obligation to you to make payment of the principal of (and premium, if any) and interest, if any, on such subordinated debt securities will not otherwise be affected. In addition, no payment on account of principal (or premium, if any), sinking fund or interest, if any, may be made on such subordinated debt securities at any time unless full payment of all amounts due in respect of the principal (and premium, if any), sinking fund and interest on Senior Indebtedness has been made or duly provided for in money or money's worth.

In the event that, notwithstanding the foregoing, any payment by us is received by the trustee in respect of subordinated debt securities or by the holders of any of such subordinated debt securities, upon our dissolution, winding up, liquidation or reorganization before all Senior Indebtedness is paid in full, the payment or distribution must be paid over to the holders of the Senior Indebtedness or on their behalf for application to the payment of all the Senior Indebtedness remaining unpaid until all the Senior Indebtedness has been paid in full, after giving effect to any concurrent payment or distribution to the holders of the Senior Indebtedness. Subject to the payment in full of all Senior Indebtedness upon this distribution by us, the holders of such subordinated debt securities will be subrogated to the rights of the holders of the Senior Indebtedness to the extent of payments made to the holders of the Senior Indebtedness out of the distributive share of such subordinated debt securities.

By reason of this subordination, in the event of a distribution of our assets upon our insolvency, certain of our senior creditors may recover more, ratably, than holders of any subordinated debt securities or the holders of any indenture securities that are not Senior Indebtedness. The indenture provides that these subordination provisions will not apply to money and securities held in trust under the defeasance provisions of the indenture.

## TABLE OF CONTENTS

Senior Indebtedness is defined in the indenture as the principal of (and premium, if any) and unpaid interest on: our indebtedness (including indebtedness of others guaranteed by us), whenever created, incurred, assumed or guaranteed, for money borrowed, that we have designated as Senior Indebtedness for purposes of the indenture and in accordance with the terms of the indenture (including any indenture securities designated as Senior Indebtedness), and renewals, extensions, modifications and refinancings of any of this indebtedness. If this prospectus is being delivered in connection with the offering of a series of indenture securities denominated as subordinated debt securities, the accompanying prospectus supplement will set forth the approximate amount of our Senior Indebtedness and of our other Indebtedness outstanding as of a recent date.

## **Secured Indebtedness and Ranking**

Certain of our indebtedness, including certain series of indenture securities, may be secured. The prospectus supplement for each series of indenture securities will describe the terms of any security interest for such series and will indicate the approximate amount of our secured indebtedness as of a recent date. Any unsecured indenture securities will effectively rank junior to any secured indebtedness, including any secured indenture securities, that we incur in the future to the extent of the value of the assets securing such future secured indebtedness. The debt securities, whether secured or unsecured, of the Company will rank structurally junior to all existing and future indebtedness (including trade payables) incurred by our subsidiaries, financing vehicles or similar facilities.

In the event of our bankruptcy, liquidation, reorganization or other winding up, any of our assets that secure secured debt will be available to pay obligations on unsecured debt securities only after all indebtedness under such secured debt has been repaid in full from such assets. We advise you that there may not be sufficient assets remaining to pay amounts due on any or all unsecured debt securities then outstanding after fulfillment of this obligation. As a result, the holders of unsecured indenture securities may recover less, ratably, than holders of any of our secured indebtedness.

## **The Trustee under the Indenture**

We intend to use a nationally recognized financial institution to serve as the trustee under the indenture.

## **Certain Considerations Relating to Foreign Currencies**

Debt securities denominated or payable in foreign currencies may entail significant risks. These risks include the possibility of significant fluctuations in the foreign currency markets, the imposition or modification of foreign exchange controls and potential illiquidity in the secondary market. These risks will vary depending upon the currency or currencies involved and will be more fully described in the applicable prospectus supplement.

TABLE OF CONTENTS

## DESCRIPTION OF OUR WARRANTS

The following is a general description of the terms of the warrants we may issue from time to time. Particular terms of any warrants we offer will be described in the prospectus supplement relating to such warrants.

We may issue warrants to purchase shares of our common stock, shares of our preferred stock or debt securities. Such warrants may be issued independently or together with shares of common or preferred stock or a specified principal amount of debt securities and may be attached or separate from such securities. We will issue each series of warrants under a separate warrant agreement to be entered into between us and a warrant agent. The warrant agent will act solely as our agent and will not assume any obligation or relationship of agency for or with holders or beneficial owners of warrants.

A prospectus supplement will describe the particular terms of any series of warrants we may issue, including the following:

- the title of such warrants;
  - the aggregate number of such warrants;
  - the price or prices at which such warrants will be issued;
  - the currency or currencies, including composite currencies, in which the price of such warrants may be payable;
  - if applicable, the designation and terms of the securities with which the warrants are issued and the number of warrants issued with each such security or each principal amount of such security;
  - in the case of warrants to purchase debt securities, the principal amount of debt securities purchasable upon exercise of one warrant and the price at which and the currency or currencies, including composite currencies, in which this principal amount of debt securities may be purchased upon such exercise;
  - in the case of warrants to purchase common stock or preferred stock, the number of shares of common stock or preferred stock, as the case may be, purchasable upon exercise of one warrant and the price at which and the currency or currencies, including composite currencies, in which these shares may be purchased upon such exercise;
  - the date on which the right to exercise such warrants shall commence and the date on which such right will expire;
  - whether such warrants will be issued in registered form or bearer form;
  - if applicable, the minimum or maximum amount of such warrants which may be exercised at any one time;
  - if applicable, the date on and after which such warrants and the related securities will be separately transferable;
  - information with respect to book-entry procedures, if any;
  - the terms of the securities issuable upon exercise of the warrants;
  - if applicable, a discussion of certain U.S. federal income tax considerations; and
- any other terms of such warrants, including terms, procedures and limitations relating to the exchange and exercise of such warrants.

We and the warrant agent may amend or supplement the warrant agreement for a series of warrants without the consent of the holders of the warrants issued thereunder to effect changes that are not inconsistent with the provisions of the warrants and that do not materially and adversely affect the interests of the holders of the warrants.

TABLE OF CONTENTS

Prior to exercising their warrants, holders of warrants will not have any of the rights of holders of the securities purchasable upon such exercise, including, in the case of warrants to purchase debt securities, the right to receive principal, premium, if any, or interest payments, on the debt securities purchasable upon exercise or to enforce covenants in the applicable indenture or, in the case of warrants to purchase common stock or preferred stock, the right to receive distributions, if any, or payments upon our liquidation, dissolution or winding up or to exercise any voting rights.

Under the 1940 Act, we may generally only offer warrants provided that (1) the warrants expire by their terms within ten years; (2) the exercise or conversion price is not less than the current market value at the date of issuance; (3) our stockholders authorize the proposal to issue such warrants, and our board of directors approves such issuance on the basis that the issuance is in our best interests and our stockholders; and (4) if the warrants are accompanied by other securities, the warrants are not separately transferable unless no class of such warrants and the securities accompanying them has been publicly distributed.

138

---

TABLE OF CONTENTS

## **REGULATION**

We are a business development company under the 1940 Act that has elected to be treated as a RIC under the Code. The 1940 Act contains prohibitions and restrictions relating to transactions between business development companies and their affiliates (including any investment advisers), principal underwriters and affiliates of those affiliates or underwriters and requires that a majority of the directors be persons other than interested persons, as that term is defined in the 1940 Act. In addition, the 1940 Act provides that we may not change the nature of our business so as to cease to be, or to withdraw our election as, a business development company unless approved by a majority of our outstanding voting securities.

We may invest up to 100% of our assets in securities acquired directly from issuers in privately negotiated transactions. With respect to such securities, we may, for the purpose of public resale, be deemed an underwriter as that term is defined in the Securities Act. Our intention is to not write (sell) or buy put or call options to manage risks associated with the publicly traded securities of our portfolio companies, except that we may enter into hedging transactions to manage the risks associated with interest rate fluctuations. However, we may purchase or otherwise receive warrants to purchase the common stock of our portfolio companies in connection with acquisition financing or other investments. Similarly, in connection with an acquisition, we may acquire rights to require the issuers of acquired securities or their affiliates to repurchase them under certain circumstances. We also do not intend to acquire securities issued by any investment company that exceed the limits imposed by the 1940 Act. Under these limits, we generally cannot acquire more than 3% of the voting stock of any registered investment company, invest more than 5% of the value of our total assets in the securities of one investment company or invest more than 10% of the value of our total assets in the securities of more than one investment company. With regard to that portion of our portfolio invested in securities issued by investment companies, it should be noted that such investments might subject our stockholders to additional expenses. None of these policies is fundamental and may be changed without stockholder approval upon 60 days prior written notice to stockholders.

## **Qualifying Assets**

Under the 1940 Act, a business development company may not acquire any asset other than assets of the type listed in section 55(a) of the 1940 Act, which are referred to as qualifying assets, unless, at the time the acquisition is made, qualifying assets represent at least 70% of the company's total assets. The principal categories of qualifying assets relevant to our proposed business are the following:

- Securities purchased in transactions not involving any public offering from the issuer of such securities, which issuer (subject to certain limited exceptions) is an eligible portfolio company, or from any person who is, or has been during the preceding 13 months, an affiliated person of an eligible portfolio company, or from any other person, subject to such rules as may be prescribed by the SEC. Under the 1940 Act and the rules thereunder,
- (1) eligible portfolio companies include (1) private domestic operating companies, (2) public domestic operating companies whose securities are not listed on a national securities exchange (e.g., the New York Stock Exchange) or registered under the Exchange Act, and (3) public domestic operating companies having a market capitalization of less than \$250 million. Public domestic operating companies whose securities are quoted on the over-the-counter bulletin board or through Pink Sheets LLC are not listed on a national securities exchange and therefore are eligible portfolio companies.
  - (2) Securities of any eligible portfolio company which we control.
  - (3) Securities purchased in a private transaction from a U.S. issuer that is not an investment company or from an affiliated person of the issuer, or in transactions incident to such a private transaction, if the issuer is in bankruptcy

and subject to reorganization or if the issuer, immediately prior to the purchase of its securities, was unable to meet its obligations as they came due without material assistance other than conventional lending or financing arrangements.

- (4) Securities of an eligible portfolio company purchased from any person in a private transaction if there is no ready market for such securities and we already own 60% of the outstanding equity of the eligible portfolio company.

139

---

## TABLE OF CONTENTS

(5) Securities received in exchange for or distributed on or with respect to securities described above, or pursuant to the exercise of warrants or rights relating to such securities.

(6) Cash, cash equivalents, U.S. government securities or high-quality debt securities that mature in one year or less from the date of investment.

The regulations defining qualifying assets may change over time. We may adjust our investment focus as needed to comply with and/or take advantage of any regulatory, legislative, administrative or judicial actions in this area.

## **Managerial Assistance to Portfolio Companies**

In order to count portfolio securities as qualifying assets for the purpose of the 70% test, a business development company must either control the issuer of the securities or must offer to make available to the issuer of the securities significant managerial assistance. However, when the business development company purchases securities in conjunction with one or more other persons acting together, one of the other persons in the group may make available such managerial assistance. Making available managerial assistance means any arrangement whereby the business development company, through its directors, officers, employees or agents, offers to provide, and, if accepted, does so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company. Stellus Capital Management will provide such managerial assistance on our behalf to portfolio companies that request this assistance.

## **Temporary Investments**

Pending investment in other types of qualifying assets, as described above, our investments may consist of cash, cash equivalents, U.S. government securities, repurchase agreements and high-quality debt investments that mature in one year or less from the date of investment, which we refer to, collectively, as temporary investments, so that 70% of our assets are qualifying assets or temporary investments. Typically, we will invest in U.S. Treasury bills or in repurchase agreements, so long as the agreements are fully collateralized by cash or securities issued by the U.S. government or its agencies. A repurchase agreement involves the purchase by an investor, such as us, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed-upon future date and at a price that is greater than the purchase price by an amount that reflects an agreed-upon interest rate. There is no percentage restriction on the proportion of our assets that may be invested in such repurchase agreements. However, if more than 25% of our total assets constitute repurchase agreements from a single counterparty, we would not meet the Diversification Tests in order to maintain our qualification as a RIC for U.S. federal income tax purposes. Accordingly, we do not intend to enter into repurchase agreements with a single counterparty in excess of this limit. Stellus Capital Management will monitor the creditworthiness of the counterparties with which we enter into repurchase agreement transactions.

## **Senior Securities**

We are permitted, under specified conditions, to issue multiple classes of indebtedness and one class of stock senior to our common stock if our asset coverage, as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance. In addition, while any senior securities remain outstanding, we must make provisions to prohibit any distribution to our stockholders or the repurchase of such securities or shares unless we meet the applicable asset coverage ratios at the time of the distribution or repurchase. We may also borrow amounts up to 5% of the value of our total assets for temporary or emergency purposes without regard to asset coverage. For a discussion of the risks associated with leverage, see Risk Factors Risks Relating to our Business and Structure Regulations governing our operation as a business development company will affect our ability to, and the way in which we, raise additional capital. As a business development company, the necessity of raising additional capital may expose us to risks,

including the typical risks associated with leverage.

## TABLE OF CONTENTS

### **Common Stock**

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock at a price below the current net asset value of the common stock if our board of directors determines that such sale is in our best interests and that of our stockholders, and our stockholders approve such sale. In any such case, the price at which our securities are to be issued and sold may not be less than a price which, in the determination of our board of directors, closely approximates the market value of such securities (less any distributing commission or discount). A proposal, approved by our stockholders at our 2013 Annual Meeting of Stockholders, authorizes us to sell shares of our common stock below the then current net asset value per share of our common stock in one or more offerings for the period ending on the earlier of the one year anniversary of the date of the Company's 2013 Annual Meeting of Stockholders and the date of the Company's 2014 Annual Meeting of Stockholders, which is expected to be held in June 2014. We would need similar future approval from our stockholders to issue shares below the then current net asset value per share any time after the expiration of the current approval. We may also make rights offerings to our stockholders at prices per share less than the net asset value per share, subject to applicable requirements of the 1940 Act. See Risk Factors Risks Relating to this Offering Stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock.

### **Codes of Ethics**

We and Stellus Capital Management have each adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts certain personal securities transactions. Personnel subject to each such code may invest in securities for their personal investment accounts, including securities that may be purchased or held by us, so long as such investments are made in accordance with such code's requirements. You may read and copy our code of ethics at the SEC's Public Reference Room in Washington, D.C. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. In addition, each code of ethics is available on the EDGAR Database on the SEC's website at [www.sec.gov](http://www.sec.gov). You may also obtain copies of each code of ethics, after paying a duplicating fee, by electronic request at the following e-mail address: [publicinfo@sec.gov](mailto:publicinfo@sec.gov), or by writing the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549.

### **Proxy Voting Policies and Procedures**

We have delegated our proxy voting responsibility to Stellus Capital Management. The Proxy Voting Policies and Procedures of Stellus Capital Management are set out below. The guidelines will be reviewed periodically by Stellus Capital Management and our directors who are not interested persons, and, accordingly, are subject to change.

### **Introduction**

As an investment adviser registered under the Advisers Act, Stellus Capital Management has a fiduciary duty to act solely in our best interests. As part of this duty, Stellus Capital Management recognizes that it must vote our securities in a timely manner free of conflicts of interest and in our best interests.

Stellus Capital Management's policies and procedures for voting proxies for its investment advisory clients are intended to comply with Section 206 of, and Rule 206(4)-6 under, the Advisers Act.

## Proxy Policies

Stellus Capital Management votes proxies relating to our portfolio securities in what it perceives to be the best interest of our stockholders. Stellus Capital Management reviews on a case-by-case basis each proposal submitted to a stockholder vote to determine its effect on the portfolio securities we hold. In most cases Stellus Capital Management will vote in favor of proposals that Stellus Capital Management believes are likely to increase the value of the portfolio securities we hold. Although Stellus Capital Management will generally vote against proposals that may have a negative effect on our portfolio securities, Stellus Capital Management may vote for such a proposal if there exist compelling long-term reasons to do so.

Stellus Capital Management has established a proxy voting committee and adopted proxy voting guidelines and related procedures. The proxy voting committee establishes proxy voting guidelines and

141

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## TABLE OF CONTENTS

procedures, oversees the internal proxy voting process, and reviews proxy voting issues. To ensure that Stellus Capital Management's vote is not the product of a conflict of interest, Stellus Capital Management requires that (1) anyone involved in the decision-making process disclose to our Chief Compliance Officer any potential conflict that he or she is aware of and any contact that he or she has had with any interested party regarding a proxy vote; and (2) employees involved in the decision-making process or vote administration are prohibited from revealing how Stellus Capital Management intends to vote on a proposal in order to reduce any attempted influence from interested parties. Where conflicts of interest may be present, Stellus Capital Management will disclose such conflicts to us, including our independent directors and may request guidance from us on how to vote such proxies.

## **Proxy Voting Records**

You may obtain information about how Stellus Capital Management voted proxies by making a written request for proxy voting information to: Stellus Capital Investment Corporation, Attention: Investor Relations, 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027, or by calling us collect at (310) 235-5900. The SEC also maintains a website at [www.sec.gov](http://www.sec.gov) that contains this information.

## **Privacy Principles**

We are committed to maintaining the privacy of our stockholders and to safeguarding their nonpublic personal information. The following information is provided to help you understand what personal information we collect, how we protect that information and why, in certain cases, we may share information with select other parties.

Generally, we do not receive any nonpublic personal information relating to our stockholders, although certain nonpublic personal information of our stockholders may become available to us. We do not disclose any nonpublic personal information about our stockholders or former stockholders to anyone, except as permitted by law or as is necessary in order to service stockholder accounts (for example, to a transfer agent or third-party administrator).

We restrict access to nonpublic personal information about our stockholders to employees of Stellus Capital Management and its affiliates with a legitimate business need for the information. We intend to maintain physical, electronic and procedural safeguards designed to protect the nonpublic personal information of our stockholders.

## **Other**

We are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect us against larceny and embezzlement. Furthermore, as a business development company, we are prohibited from protecting any director or officer against any liability to us or our stockholders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office.

We and Stellus Capital Management are each required to adopt and implement written policies and procedures reasonably designed to prevent violation of relevant federal securities laws, review these policies and procedures annually for their adequacy and the effectiveness of their implementation, and designate a chief compliance officer to be responsible for administering the policies and procedures.

We may also be prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of our board of directors who are not interested persons and, in some cases, prior approval by the SEC. The SEC has interpreted the business development company prohibition on transactions with affiliates to

prohibit all joint transactions between entities that share a common investment adviser. The staff of the SEC has granted no-action relief permitting purchases of a single class of privately placed securities provided that the adviser negotiates no term other than price and certain other conditions are met. As a result, we only expect to co-invest on a concurrent basis with investment funds, accounts or investment vehicles managed by Stellus Capital Management when each of us and such investment fund, account or investment vehicle will own the same securities of the issuer and when no term is negotiated other than price. Any such investment would be made, subject to compliance with existing regulatory guidance, applicable regulations and our allocation procedures. If opportunities arise that would otherwise be appropriate

TABLE OF CONTENTS

for us and for an investment fund, account or investment vehicle managed by Stellus Capital Management to invest in different securities of the same issuer, Stellus Capital Management will need to decide which fund will proceed with the investment. Moreover, except in certain circumstances, we will be unable to invest in any issuer in which an investment fund, account or investment vehicle managed by Stellus Capital Management has previously invested.

## **Sarbanes-Oxley Act of 2002**

The Sarbanes-Oxley Act of 2002 imposes a wide variety of regulatory requirements on publicly held companies and their insiders. Many of these requirements affect us. For example:

pursuant to Rule 13a-14 under the Exchange Act, our principal executive officer and principal financial officer must certify the accuracy of the financial statements contained in our periodic reports;

pursuant to Item 307 under Regulation S-K, our periodic reports must disclose our conclusions about the effectiveness of our disclosure controls and procedures;

pursuant to Rule 13a-15 under the Exchange Act, our management must prepare an annual report regarding its assessment of our internal control over financial reporting; and

pursuant to Item 308 of Regulation S-K and Rule 13a-15 under the Exchange Act, our periodic reports must disclose whether there were significant changes in our internal controls over financial reporting or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

143

---

TABLE OF CONTENTS

## PLAN OF DISTRIBUTION

We may offer, from time to time, in one or more offerings or series, up to \$300,000,000 of our common stock, preferred stock, debt securities, subscription rights or warrants to purchase common stock, preferred stock or debt securities, in one or more underwritten public offerings, at-the-market offerings, negotiated transactions, block trades, best efforts offerings or a combination of these methods. We may sell the securities through underwriters or dealers, directly to one or more purchasers through agents or through a combination of any such methods of sale. Any underwriter or agent involved in the offer and sale of the securities will be named in the applicable prospectus supplement. In addition, this prospectus relates to 1,875,858 shares of our common stock (the Selling Stockholder Shares ) that may be sold by the selling stockholder identified under Selling Stockholder.

The distribution of our securities may be effected from time to time in one or more transactions at a fixed price or prices, which may be changed, at prevailing market prices at the time of sale, at prices related to such prevailing market prices, or at negotiated prices, provided, however, that the offering price per share of our securities less any underwriting commissions or discounts must equal or exceed the net asset value per share of our securities except that we may sell shares of our securities at a price below net asset value per share if holders of a majority of the number of shares of our stock have approved such a sale or if the following conditions are met: (i) holders of a majority of our stock and a majority of our stock not held by affiliated persons have approved issuance at less than net asset value per share during the one year period prior to such sale; (ii) a majority of our directors who have no financial interest in the sale and a majority of such directors who are not interested persons of us have determined that such sale would be in our best interest and in the best interests of our stockholders; and (iii) a majority of our directors who have no financial interest in the sale and a majority of such directors who are not interested persons of us, in consultation with the underwriter or underwriters of the offering if it is to be underwritten, have determined in good faith, and as of a time immediately prior to the first solicitation by or on behalf of us of firm commitments to purchase such securities or immediately prior to the issuance of such securities, that the price at which such securities are to be sold is not less than a price which closely approximates the market value of those securities, less any distributing commission or discount.

On July 29, 2013, our stockholders voted to allow us to issue common stock at a price below net asset value per share for the period ending on the earlier of the one year anniversary of the date of our 2013 Annual Meeting of Stockholders and the date of our 2014 Annual Meeting of Stockholders. Our stockholders did not specify a maximum discount below net asset value at which we are able to issue our common stock, although the number of shares sold in each offering may not exceed 25% of our outstanding common stock immediately prior to such sale. In addition, we cannot issue shares of our common stock below net asset value unless our board of directors determines that it would be in our and our stockholders best interests to do so.

In connection with the sale of our securities and the Selling Stockholder shares, underwriters or agents may receive compensation from us and/or the selling stockholder or from purchasers of our securities, for whom they may act as agents, in the form of discounts, concessions or commissions. Underwriters may sell our securities and the Selling Stockholder shares to or through dealers and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of our securities and the Selling Stockholder shares may be deemed to be underwriters under the Securities Act, and any discounts and commissions they receive from us and/or the selling stockholder and any profit realized by them on the resale of our securities may be deemed to be underwriting discounts and commissions under the Securities Act. Any such underwriter or agent will be identified and any such compensation received from us and/or the selling stockholder will be described in the applicable prospectus supplement.

We may enter into derivative transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement indicates, in connection with those derivatives, the third parties may sell securities covered by this prospectus and the applicable prospectus supplement, including in short sale transactions. If so, the third party may use securities pledged by us or borrowed from us or others to settle those sales or to close out any related open borrowings of stock, and may use securities received from us in settlement of those derivatives to close out

144

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TABLE OF CONTENTS

any related open borrowings of stock. The third parties in such sale transactions will be underwriters and, if not identified in this prospectus, will be identified in the applicable prospectus supplement (or a post-effective amendment).

Any of our common stock or the Selling Stockholder shares sold pursuant to a prospectus supplement will be listed on the New York Stock Exchange, or another exchange on which our common stock is traded.

Under agreements into which we or the selling stockholder may enter, underwriters, dealers and agents who participate in the distribution of our securities and/or the Selling Stockholder Shares may be entitled to indemnification by us or the selling stockholder against certain liabilities, including liabilities under the Securities Act. Underwriters, dealers and agents may engage in transactions with, or perform services for, us in the ordinary course of business.

If so indicated in the applicable prospectus supplement, we and/or the selling stockholder will authorize underwriters or other persons acting as our and/or the selling stockholder's agents to solicit offers by certain institutions to purchase our securities from us or the Selling Stockholder Shares from the selling stockholder pursuant to contracts providing for payment and delivery on a future date. Institutions with which such contracts may be made include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases such institutions must be approved by us and/or the selling stockholder. The obligations of any purchaser under any such contract will be subject to the condition that the purchase of our securities and/or the Selling Stockholder Shares shall not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and such other agents will not have any responsibility in respect of the validity or performance of such contracts. Such contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of such contracts.

In order to comply with the securities laws of certain states, if applicable, our securities and the Selling Stockholder Shares offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states, our securities and/or the Selling Stockholder Shares may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

The maximum commission or discount to be received by any member of the Financial Industry Regulatory Authority, Inc. will not be greater than 10.0% for the sale of any securities being registered.

We will pay customary costs and expenses of the registration of the shares of common stock pursuant to the registration rights agreement, including SEC filing fees and expenses of compliance with state securities or blue sky laws. However, the selling stockholder will pay all underwriting discounts and selling commissions, if any, attributable to sales of Selling Stockholder Shares. We will indemnify the selling stockholder against liabilities, including some liabilities under the Securities Act, or the selling stockholder will be entitled to contribution.

We may be indemnified by the selling stockholder against civil liabilities, including liabilities under the Securities Act, that may arise from any written information furnished to us by the selling stockholder specifically for use in this prospectus, or we may be entitled to contribution.

There can be no assurance that any selling stockholder will sell any or all of the Selling Stockholder Shares registered pursuant to the registration statement, of which this prospectus forms a part. Once sold under the registration statement, of which this prospectus forms a part, the Selling Stockholder Shares will be freely tradable in the hands of

persons other than our affiliates.

145

---

TABLE OF CONTENTS

## **CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR**

Our securities are held by State Street Bank and Trust Company pursuant to a custody agreement. State Street Bank and Trust Company will also serve as our transfer agent, distribution paying agent and registrar. The principal business address of State Street Bank and Trust Company is 225 Franklin Street, Boston, Massachusetts 02110.

## **BROKERAGE ALLOCATION AND OTHER PRACTICES**

Since we will acquire and dispose of many of our investments in privately negotiated transactions, many of the transactions that we engage in will not require the use of brokers or the payment of brokerage commissions. Subject to policies established by our board of directors, Stellus Capital Management will be primarily responsible for selecting brokers and dealers to execute transactions with respect to the publicly traded securities portion of our portfolio transactions and the allocation of brokerage commissions. Stellus Capital Management does not expect to execute transactions through any particular broker or dealer but will seek to obtain the best net results for us under the circumstances, taking into account such factors as price (including the applicable brokerage commission or dealer spread), size of order, difficulty of execution and operational facilities of the firm and the firm's risk and skill in positioning blocks of securities. Stellus Capital Management generally will seek reasonably competitive trade execution costs but will not necessarily pay the lowest spread or commission available. Subject to applicable legal requirements and consistent with Section 28(e) of the Exchange Act, Stellus Capital Management may select a broker based upon brokerage or research services provided to Stellus Capital Management and us and any other clients. In return for such services, we may pay a higher commission than other brokers would charge if Stellus Capital Management determines in good faith that such commission is reasonable in relation to the services provided.

146

---

TABLE OF CONTENTS

## LEGAL MATTERS

Certain legal matters regarding the securities offered by this prospectus will be passed upon for us by Sutherland Asbill & Brennan LLC, Washington, DC 20004. Certain legal matters will be passed upon for the underwriters, if any, by the counsel named in the prospectus supplement, if any.

## INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The financial statements, financial highlights and senior securities table of Stellus Capital Investment Corporation included in this prospectus and elsewhere in the registration statement have been so included in reliance upon the reports of Grant Thornton LLP, independent registered public accountants, upon the authority of said firm as experts in giving said reports. Grant Thornton LLP's principal business address is 175 W. Jackson Blvd., 20th Floor, Chicago, Illinois, 60604.

## AVAILABLE INFORMATION

We have filed with the SEC a registration statement on Form N-2, together with all amendments and related exhibits, under the Securities Act, with respect to our shares of common stock offered by this prospectus. The registration statement contains additional information about us and our shares of common stock being offered by this prospectus.

We also file with or submit to the SEC annual, quarterly and current reports, proxy statements and other information meeting the informational requirements of the Exchange Act. You may inspect and copy these reports, proxy statements and other information, as well as the registration statement and related exhibits and schedules, at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549-0102. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090.

We maintain a website at [www.stelluscapital.com](http://www.stelluscapital.com) and make all of our annual, quarterly and current reports, proxy statements and other publicly filed information available, free of charge, on or through our website. Information contained on our website is not incorporated into this prospectus, and you should not consider information on our website to be part of this prospectus. You may also obtain such information by contacting us in writing at 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027, Attention: Investor Relations. The SEC maintains a website that contains reports, proxy and information statements and other information we file with the SEC at [www.sec.gov](http://www.sec.gov). Copies of these reports, proxy and information statements and other information may also be obtained, after paying a duplicating fee, by electronic request at the following e-mail address: [publicinfo@sec.gov](mailto:publicinfo@sec.gov), or by writing the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-0102.

TABLE OF CONTENTS

## Index to Financial Statements

|  | Page        |
|--|-------------|
| Unaudited Financial Statements:  |             |
| <u>Statements of Assets and Liabilities as of September 30, 2013 (unaudited) and December 31, 2012</u>             | <u>F-2</u>  |
| <u>Statements of Operations for the three months and nine months ended September 30, 2013 and 2012 (unaudited)</u> | <u>F-3</u>  |
| <u>Statements of Changes in Net Assets for the nine months ended September 30, 2013 and 2012 (unaudited)</u>       | <u>F-4</u>  |
| <u>Statements of Cash Flows for the nine months ended September 30, 2013 and 2012 (unaudited)</u>                  | <u>F-5</u>  |
| <u>Schedules of Investments as of September 30, 2013 (unaudited) and December 31, 2012</u>                         | <u>F-6</u>  |
| <u>Notes to the Financial Statements</u>   | <u>F-10</u> |
| Audited Financial Statements:  |             |
| <u>Report of Independent Registered Public Accounting Firm</u>   | <u>F-26</u> |
| <u>Statements of Assets and Liabilities as of December 31, 2012</u>  | <u>F-27</u> |
| <u>Statements of Operations for the period from Inception (May 18, 2012) through December 31, 2012</u>             | <u>F-28</u> |
| <u>Statements of Changes in Net Assets for the period from Inception (May 18, 2012) through December 31, 2012</u>  | <u>F-29</u> |
| <u>Statements of Cash Flows for the period from Inception (May 18, 2012) through December 31, 2012</u>             | <u>F-30</u> |
| <u>Schedules of Investments as of December 31, 2012</u>  | <u>F-31</u> |
| <u>Notes to the Financial Statements</u>   | <u>F-33</u> |

F-1

---

TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## STATEMENTS OF ASSETS AND LIABILITIES

|  | September 30,<br>2013<br>(Unaudited) | December 31,<br>2012 |
|--|--------------------------------------|----------------------|
| <b>ASSETS</b>  |                                      |                      |
| Non-controlled, non-affiliated investments, at fair value (amortized cost of \$242,598,120 and \$195,455,671, respectively)                      | \$ 243,625,309                       | \$ 195,451,256       |
| Cash and cash equivalents  | 23,585,780                           | 62,131,686           |
| Interest receivable  | 4,150,618                            | 2,573,831            |
| Prepaid loan structure fees  | 1,684,565                            | 1,947,820            |
| Prepaid expenses   | 52,480                               | 438,384              |
| Total Assets   | 273,098,752                          | 262,542,977          |
| <b>LIABILITIES</b>   |                                      |                      |
| Payable for investments purchased  |                                      | 4,750,000            |
| Credit facility payable  | 85,000,000                           | 38,000,000           |
| Short-term loan  | 8,999,933                            | 45,000,943           |
| Base management fees payable   | 1,140,676                            | 527,034              |
| Incentive fees payable   | 1,262,914                            |                      |
| Accrued offering costs   |                                      | 147,123              |
| Interest payable   | 292,159                              | 66,477               |
| Directors' fees payable  | 76,000                               | 29,452               |
| Other accrued expenses and liabilities   | 267,625                              | 175,993              |
| Total Liabilities  | 97,039,307                           | 88,697,022           |
| Net Assets   | \$ 176,059,445                       | \$ 173,845,955       |
| <b>NET ASSETS</b>  |                                      |                      |
| Common Stock, par value \$0.001 per share (100,000,000 shares authorized, 12,082,222 and 12,035,023 shares issued and outstanding, respectively) | \$ 12,082                            | \$ 12,035            |
| Paid-in capital  | 175,384,594                          | 174,714,838          |
| Accumulated undistributed net realized gain  | 1,007,978                            |                      |
| Distributions in excess of net investment income   | (1,372,398 )                         | (874,986 )           |
| Unrealized appreciation (depreciation) on investments and cash equivalents   | 1,027,189                            | (5,932 )             |
| Net Assets   | \$ 176,059,445                       | \$ 173,845,955       |
| Total Liabilities and Net Assets   | \$ 273,098,752                       | \$ 262,542,977       |
| Net Asset Value Per Share  | \$ 14.57                             | \$ 14.45             |

See Notes to Unaudited Financial Statements.



TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****STATEMENTS OF OPERATIONS (unaudited)**

|  | For the three<br>months ended<br>September 30,<br>2013 | For the three<br>months<br>ended<br>September<br>30, 2012 | For the nine<br>months ended<br>September<br>30, 2013 | For the<br>period from<br>inception<br>(May 18,<br>2012)<br>through<br>September<br>30, 2012 |
|--|--|---|---|--|
| <b>INVESTMENT INCOME</b>   |  |   |   |  |
| Interest income  | \$7,604,636  | \$  | \$20,640,265  | \$   |
| Other income   | 312,995  |   | 1,065,033   |  |
| Total Investment Income  | 7,917,631  |   | 21,705,298  |  |
| <b>OPERATING EXPENSES</b>  |  |   |   |  |
| Management fees  | 1,140,675  |   | 3,065,877   |  |
| Valuation fees   | 154,785  |   | 358,495   |  |
| Administrative services expenses   | 220,249  |   | 619,825   |  |
| Incentive fees   | 746,637  |   | 2,296,873   |  |
| Professional fees  | 254,533  | 138,365   | 477,995   | 264,993  |
| Directors' fees  | 76,000   |   | 254,000   |  |
| Insurance expense  | 119,695  |   | 354,933   |  |
| Interest expense and other fees  | 968,674  |   | 2,253,433   |  |
| Other general and administrative expenses  | 102,388  |   | 229,832   |  |
| Total Operating Expenses   | 3,783,636  | 138,365   | 9,911,263   | 264,993  |
| Net Investment Income (Loss)   | 4,133,995  | (138,365 )  | 11,794,035  | (264,993 )   |
| Net Realized Gain on Investments and Cash<br>Equivalents                                       | 5,061  |   | 1,007,978   |  |
| Net Change in Unrealized Appreciation<br>(Depreciation) on Investments and Cash<br>Equivalents | (313,635 )   |   | 1,033,121   |  |
| Net Increase (Decrease) in Net Assets<br>Resulting from Operations                             | \$3,825,421  | \$(138,365 )  | \$13,835,134  | \$(264,993 )   |
| Net Investment Income Per Share  | \$0.34   | \$  | \$0.98  | \$   |
| Net Increase in Net Assets Resulting from<br>Operations Per Share                              | \$0.32   | \$  | \$1.15  | \$   |
| Weighted Average Shares of Common Stock<br>Outstanding   | 12,066,548   |   | 12,051,013  |  |

See Notes to Unaudited Financial Statements.



TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## STATEMENTS OF CHANGES IN NET ASSETS

|   | For the nine<br>months ended<br>September 30,<br>2013<br>(Unaudited) | For the Period<br>from<br>Inception<br>(May 18,<br>2012) through<br>September 30,<br>2012<br>(Unaudited) |
|---|--|--|
| Increase in Net Assets Resulting from Operations  |  |  |
| Net investment income (loss)  | \$ 11,794,035  | \$ (264,993 )  |
| Net realized gain on investments and cash equivalents   | 1,007,978  |  |
| Net change in unrealized appreciation on investments and cash equivalents                       | 1,033,121  |  |
| Net Increase (Decrease) in Net Assets Resulting from Operations                                 | 13,835,134   | (264,993 )   |
| Stockholder distributions   |  |  |
| Distributions   | (12,291,447 )  |  |
| Capital share transactions  |  |  |
| Issuance of common stock  | 669,803  |  |
| Net increase in net assets resulting from capital share transactions                            | 669,803  |  |
| Total increase (decrease) in net assets   | 2,213,490  | (264,993 )   |
| Net assets at beginning of period   | 173,845,955  |  |
| Net assets at end of period (includes \$869,640 and \$0 of undistributed net investment income) | \$ 176,059,445   | \$ (264,993 )  |

See Notes to Unaudited Financial Statements.

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****STATEMENTS OF CASH FLOWS**

|   | For the nine<br>months ended<br>September 30,<br>2013<br>(Unaudited) | For the Period<br>from<br>Inception<br>(May 18,<br>2012) through<br>September 30,<br>2012<br>(Unaudited) |
|---|--|--|
| Cash flows from operating activities  |  |  |
| Net increase (decrease) in net assets resulting from operations   | \$ 13,835,134  | \$ (264,993 )  |
| Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities: |  |  |
| Purchases of investments  | (129,073,679)  |  |
| Proceeds from sales and repayments of investments   | 84,105,057   |  |
| Net change in unrealized appreciation on investments  | (1,031,604 )   |  |
| Increase in investments due to PIK  | (854,644 )   |  |
| Accretion of discount   | (308,299 )   |  |
| Net realized gain on investments  | (1,010,884 )   |  |
| Changes in other assets and liabilities   |  |  |
| Increase in interest receivable   | (1,576,787 )   |  |
| Decrease in prepaid expenses and fees   | 649,159  |  |
| Decrease in payable for investments purchased   | (4,750,000 )   |  |
| Increase in management fees payable   | 613,642  |  |
| Increase in directors' fees payable   | 46,548   |  |
| Increase in incentive fees payable  | 1,262,914  |  |
| Increase in interest payable  | 225,682  |  |
| Increase in other accrued expenses and liabilities  | 91,632   | 264,993  |
| Net cash used in operating activities   | (37,776,129 )  |  |
| Cash flows from financing activities  |  |  |
| Offering costs paid   | (147,123 )   |  |
| Stockholder distributions paid  | (11,621,644 )  |  |
| Borrowings under credit facility  | 47,000,000   |  |
| Paydowns of short-term loan   | (36,001,010 )  |  |
| Net cash used in financing activities   | (769,777 )   |  |
| Net decrease in cash and cash equivalents   | (38,545,906 )  |  |
| Cash and cash equivalents balance at beginning of period  | 62,131,686   |  |
| Cash and cash equivalents balance at end of period  | \$ 23,585,780  | \$   |
| Non-cash items  |  |  |
| Shares issued pursuant to Dividend Reinvestment Plan  | \$ 669,803   | \$   |

See Notes to Unaudited Financial Statements.

F-5

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TABLE OF CONTENTS

**STELLUS CAPITAL INVESTMENT CORPORATION**

**SCHEDULE OF INVESTMENTS (unaudited)  
SEPTEMBER 30, 2013**

See Notes to Unaudited Financial Statements.

F-6

---

TABLE OF CONTENTS

- (1) See Note 1 of the Notes to Financial Statements for a discussion of the methodologies used to value securities in the portfolio.
- (2) 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.
- (3) The investment is not a qualifying asset under the Investment Company Act of 1940, as amended.
- (4) Security is non-income producing.
- This investment also includes a delayed draw 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.
- (5) This investment also includes an undrawn revolving loan commitment in an amount not to exceed \$2,000,000, an interest rate of LIBOR plus 7.5%, and a maturity of September 30, 2018. This investment is accruing an unused commitment fee of 0.50% per annum.
- (6) 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.
- (7) 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.
- (8) This investment amended its maturity to 9/30/18 on 9/30/13.
- (9) 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.
- (10)

**Abbreviation Legend**  
**PIK Payment-In-Kind**

See Notes to Unaudited Financial Statements.

TABLE OF CONTENTS

**Stellus Capital Investment Corporation**

**Schedule of Investments  
December 31, 2012**

See Notes to Unaudited Consolidated Financial Statements.

F-8

---

TABLE OF CONTENTS

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

(2) Coupon is subject to Prime and LIBOR floors.

(3) Represents a payment-in-kind security which pays a portion of interest in additional par.

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

(5) Security is non-income producing.

(6) Common shares position will settle after December 31, 2012.

(7) The loan will settle after December 31, 2012.

(8) This instrument also includes an undrawn revolving loan commitment in an amount not to exceed \$2,000,000, an interest rate of LIBOR plus 7.5%, and a maturity of March 23, 2016. This investment is accruing an unused fee of 0.50% per annum.

## **Abbreviation Legend**

**PIK Payment-In-Kind**

See Notes to Unaudited Consolidated Financial Statements.

TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS September 30, 2013 (Unaudited)

### NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

#### Nature of Operations

Stellus Capital Investment Corporation (the Company) was formed as a Maryland corporation on May 18, 2012 (Inception) and is an externally managed, closed-end, non-diversified management investment company. 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. As of September 30, 2013, 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'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 its investment adviser 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 are presented in conformity with U.S. 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. 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 three and nine months ended September 30, 2013 and September 30, 2012 are not necessarily indicative of the operating results to be expected for the full year. Also, the unaudited

F-10

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS September 30, 2013 (Unaudited)

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

financial statements and notes should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2012. Financial statements prepared on a U.S. GAAP basis require management to make estimates and assumptions that affect the amounts and disclosures reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

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

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

As of September 30, 2012, the Company had not yet begun investment operations. Stellus Capital Management purchased the initial 100 shares for \$500,010 in September 2012. As such any per share data is not calculable as of September 30, 2012.

#### **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.

#### **Cash and Cash Equivalents**

At September 30, 2013, cash balances totaling \$13,335,847 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, 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 footnote 9). On September 30, 2013, we held \$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 1%. On October 1, 2013, we sold the remaining 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 \$1,125).

On December 31, 2012, we held \$50 million of U.S. Treasury Bills with a 30 day maturity purchased using \$5 million in cash and the proceeds from a \$45 million short term loan from Raymond James. The loan had an effective annual interest rate of approximately 1%. On January 2, 2013, we sold the Treasury Bills, repaid the \$45 million loan from Raymond James and received back the \$5 million margin payment (net of fees and expenses of \$8,943).

### **Use of Estimates**

The preparation of the statement 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

F-11

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS September 30, 2013 (Unaudited)

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

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.

#### 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 mean 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, although 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 once quarterly. Investments purchased within 60 days of maturity will be valued at cost plus accreted discount, or minus amortized premium, which approximates value. With respect to unquoted securities, our board of directors, together with our independent valuation advisors, 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;

F-12

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TABLE OF CONTENTS

**STELLUS CAPITAL INVESTMENT CORPORATION**

**NOTES TO THE FINANCIAL STATEMENTS**  
**September 30, 2013**  
**(Unaudited)**

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

comparisons of financial ratios of peer companies that are public; comparable merger and acquisition transactions; and the principal market and enterprise values.

Determination of fair values involves subjective judgments and estimates not susceptible to substantiation by auditing procedures. Under current auditing standards, the notes to our financial statements refer to the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on our financial statements.

**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 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 interest income. Dividend income, if any, will be recognized on the ex-dividend date.

**Unrealized Gains Incentive Fee**

Under GAAP, the Company calculates the unrealized gains incentive fee payable to the Advisor as if the Company had realized all investments at their fair values as of the reporting date. Accordingly, the Company accrues a provisional unrealized gains incentive fee taking into account any unrealized gains or losses. As the provisional incentive fee is subject to the performance of investments until there is a realization event, the amount of provisional unrealized gains incentive fee accrued at a reporting date may vary from the incentive fee that is ultimately realized and the differences could be material.

**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.

### **Payable for Unsettled Securities Transaction**

The Company records all investments on a trade date basis.

TABLE OF CONTENTS

**STELLUS CAPITAL INVESTMENT CORPORATION**

**NOTES TO THE FINANCIAL STATEMENTS**  
**September 30, 2013**  
**(Unaudited)**

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

**U.S. Federal Income Taxes**

The Company has elected to be treated as a RIC under subchapter M of the Internal Revenue Code of 1986, as amended, 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 financial statements of the Company.

As of September 30, 2013 and December 31, 2012, the Company had \$869,640 and \$0, respectively, of undistributed ordinary income and gains. The character of the Company's distributions is determined annually, based upon its taxable income for the full year and based upon distributions made for the full year. A determination of the character of distributions made on an interim basis may not be representative of the final determination based upon taxable income computed for the full year.

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 federal tax year for the Company remains subject to examination by the Internal Revenue Service.

As of September 30, 2013 and December 31, 2012, 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 months and nine months ended September 30, 2013.

## **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 unvested shares as of September 30, 2013 or December 31, 2012. As a result, there is no difference between diluted earnings per share and basic per share amounts.

## **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. The Company believes that the impact of recently issued standards that are not yet effective will not have a material impact on its 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 consisting of two parts. The first part of the annual incentive fee,

TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS September 30, 2013 (Unaudited)

### NOTE 2 RELATED PARTY ARRANGEMENTS (continued)

which is calculated and payable quarterly in arrears, equals 20.0% of the pre-incentive fee net investment income (as defined in the agreement) for the immediately preceding quarter, subject to a hurdle rate of 2.0% per quarter (8.0% annualized) and a catch-up feature. The net pre-incentive fee investment income used to calculate this part of the incentive fee is also included in the amount of our gross assets used to calculate the 1.75% base management fee.

For the three months and nine months ended September 30, 2013, the Company incurred base management fees payable to the Advisor of \$1,140,675 and \$3,065,877, respectively.

For the three and nine months ended September 30, 2013, the Company incurred \$808,352 and \$1,889,838, respectively, of incentive fees related to pre-incentive fee net investment income. As of September 30, 2013, \$1,262,914 of such incentive fees are currently payable to the Advisor, and \$38,938 of pre-incentive fee net investment income incentive fees incurred by the Company were generated from deferred interest (i.e. PIK and certain discount accretion) and are not payable until such amounts are received in cash.

The second part of the annual incentive fee is calculated and payable in arrears as of the end of each calendar year (or, upon termination of the investment advisory agreement, as of the termination date) and equals 20.0% of the aggregate cumulative realized gains from inception through the end of each calendar year, computed net of aggregate cumulative realized losses and aggregate cumulative unrealized depreciation through the end of such year, less the aggregate amount of any previously paid realized gain incentive fees. The realized gains incentive fee consists of fees related to both realized gains and unrealized gains (described in more detail below). For the three and nine months ended September 30, 2013, the Company adjusted its realized gains incentive fee accrual related to realized gains by \$(69,639) and \$47,961, respectively and related to unrealized gains by \$7,925 and \$359,074, respectively.

The total realized gains incentive fee payable to the Company's Advisor under the investment management agreement as of September 30, 2013 and December 31, 2012 was \$407,305 and \$0, respectively. The realized gains incentive fee related to realized gains payable to the Company's Advisor under the investment management agreement as of September 30, 2013 and December 31, 2012 was \$47,961 and \$0, respectively.

With respect to the incentive fee expense accrual relating to the unrealized gains incentive fee, GAAP requires that the realized gains incentive fee accrual consider the cumulative aggregate unrealized appreciation in the calculation, as a realized gains incentive fee would be payable if such unrealized appreciation were realized, even though such unrealized appreciation is not permitted to be considered in calculating the fee actually payable under the investment management agreement. For accounting purposes in accordance with GAAP only, in order to reflect the potential realized gains incentive fee that would be payable for a given period as if all unrealized gains were realized, the Company's accrual for unrealized gains incentive fees includes an amount related to unrealized appreciation of

\$359,074 and \$0 as of September 30, 2013 and December 31, 2012, respectively. There can be no assurance that such unrealized appreciation 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 realized gains incentive fees in subsequent periods.

For the years ending December 31, 2012 and December 31, 2013, the Advisor has 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. For the three and nine months ended September 30, 2013, the advisor waived incentive fees related to pre-incentive fee net investment income of approximately \$0.5 million and \$1.3 million, respectively.

As of September 30, 2013 and December 31, 2012, the Company was not due any amount from Stellus Capital for reimbursement of expenses paid for by the Company that were the responsibility of Stellus Capital. Any such amounts due to the Company would be included in the Statement of Assets and Liabilities.

F-15

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS September 30, 2013 (Unaudited)

### NOTE 2 RELATED PARTY ARRANGEMENTS (continued)

As of September 30, 2013 and December 31, 2012, the Company owed its independent directors \$76,000 and \$29,452, respectively, in total for unpaid director fees.

As agreed to in the Amended and Restated Side Agreement made and entered into as of November 12, 2012 by and between Stellus Capital and Raymond James & Associates, Inc. and Stifel, Nicolaus & Company, Incorporated, Stellus Capital has agreed to pay on behalf of the Company, 2.41% of the 6% underwriters sales load, or \$3,320,280 in total, in connection with the Offering. Of this amount, \$1,940,280 was paid on November 14, 2012, \$460,000 was paid on March 25, 2013, \$460,000 was paid on June 28, 2013 and the remaining \$460,000 was paid on September 25, 2013.

### 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 adviser. 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.

### NOTE 3 DISTRIBUTIONS

The Company intends to make quarterly distributions of available net investment income to its stockholders. The Company intends to distribute net realized gains (*i.e.*, net realized gains in excess of net realized losses), if any, at least annually. The quarterly 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.

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 <sup>(1)</sup> | December 21, 2012 | December 27, 2012  | \$0.18           |
| March 7, 2013                   | March 21, 2013    | March 28, 2013     | \$0.34           |
| June 7, 2013                    | June 21, 2013     | June 28, 2013      | \$0.34           |
| August 21, 2013                 | September 5, 2013 | September 27, 2013 | \$0.34           |

The amount of the initial distribution was equal to an annualized dividend yield of 9.0% based on the price per (1) share of our common stock in connection with our initial public offering and is proportionately reduced to reflect the number of days remaining in the quarter after completion of the Offering.

Unless the stockholder elects to receive its distributions in cash, the Company intends to make such distributions in additional shares of the Company's common stock under the Company's dividend reinvestment plan. Although distributions paid in the form of additional shares of the Company's common stock will generally be subject to U.S. federal, state and local taxes in the same manner as cash distributions, investors participating in the Company's dividend reinvestment plan will not receive any corresponding cash distributions with which to pay any such applicable taxes. If a stockholder holds shares of the Company's common stock in the name of a broker or financial intermediary, the stockholder should contact such broker or financial intermediary regarding their election to receive distributions in cash in lieu of shares of the Company's common stock. Any distributions reinvested through the issuance of shares through the Company's dividend reinvestment plan will increase the Company's gross assets on which the base management fee and the incentive fee are determined and paid to Stellus Capital. Of the total distributions of \$12,291,447 made to shareholders through September 30, 2013, \$11,621,644 was made in cash and the remainder in shares.

F-16

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS September 30, 2013 (Unaudited)

### NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE

In accordance with the authoritative guidance on fair value measurements and disclosures under GAAP, the Company discloses the fair value of its investments in a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The guidance establishes three levels of the fair value hierarchy as follows:

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices in markets that are not considered to be active or financial instruments for which significant inputs are observable, either directly or indirectly;
- Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

The level of an asset or liability within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes observable requires significant judgment by management.

The Company considers whether the volume and level of activity for the asset or liability have significantly decreased and identifies transactions that are not orderly in determining fair value. Accordingly, if the Company determines that either the volume and/or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. Valuation techniques such as an income approach might be appropriate to supplement or replace a market approach in those circumstances.

At September 30, 2013, the Company had investments in 23 portfolio companies. The total cost and fair value of the investments were \$242,598,120 and \$243,625,309, respectively. The composition of our investments as of September 30, 2013 is as follows:

|                            | Cost          | Fair Value    |
|----------------------------|---------------|---------------|
| Senior Secured First Lien  | \$ 60,321,841 | \$ 60,606,097 |
| Senior Secured Second Lien | 78,381,468    | 79,195,140    |
| Unsecured Debt             | 102,180,525   | 101,914,951   |

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|                   |                |                |
|-------------------|----------------|----------------|
| Equity            | 1,714,286      | 1,909,121      |
| Total Investments | \$ 242,598,120 | \$ 243,625,309 |

At December 31, 2012, the Company had investments in 15 portfolio companies. The total cost and fair value of the investments were \$195,455,671 and \$195,451,256, respectively. The composition of our investments as of December 31, 2012 is as follows:

|                            | Cost           | Fair Value     |
|----------------------------|----------------|----------------|
| Senior Secured First Lien  | \$ 44,014,214  | \$ 44,014,214  |
| Senior Secured Second Lien | 38,597,293     | 38,597,622     |
| Unsecured Debt             | 111,129,878    | 111,125,134    |
| Equity                     | 1,714,286      | 1,714,286      |
| Total Investments          | \$ 195,455,671 | \$ 195,451,256 |

The Company's investment portfolio may contain loans that are in the form of lines of credit or revolving credit facilities, which require the Company to provide funding when requested by portfolio companies in

F-17

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION**

**NOTES TO THE FINANCIAL STATEMENTS**  
**September 30, 2013**  
**(Unaudited)**

**NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE**  
**(continued)**

accordance with the terms of the underlying loan agreements. As of September 30, 2013 and December 31, 2012, the Company had two and one such investments with aggregate unfunded commitments of \$14,500,000 and \$2,000,000, respectively. The Company maintains sufficient liquidity to fund such unfunded loan commitments should the need arise.

The fair values of our investments disaggregated into the three levels of the fair value hierarchy based upon the lowest level of significant input used in the valuation as of September 30, 2013 are as follows:

|                   |             | Quoted Prices<br>in<br>Active<br>Markets<br>for Identical<br>Securities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total          |
|-------------------|-------------|--|---|--|----------------|
| Senior Secured    | First Lien  | \$   | \$  | \$ 60,606,097                                      | \$ 60,606,097  |
| Senior Secured    | Second Lien |  | 26,625,590  | 52,569,550   | 79,195,140     |
| Unsecured Debt    |             |  |   | 101,914,951  | 101,914,951    |
| Equity            |             |  |   | 1,909,121  | 1,909,121      |
| Total Investments |             | \$   | \$ 26,625,590   | \$ 216,999,719                                     | \$ 243,625,309 |

The fair values of our investments disaggregated into the three levels of the fair value hierarchy based upon the lowest level of significant input used in the valuation as of December 31, 2012 are as follows:

|                |             | Quoted Prices<br>in<br>Active<br>Markets<br>for Identical<br>Securities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total         |
|----------------|-------------|--|---|--|---------------|
| Senior Secured | First Lien  | \$   | \$  | \$ 44,014,214                                      | \$ 44,014,214 |
| Senior Secured | Second Lien |  | 12,120,000  | 26,477,622   | 38,597,622    |

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|                   |    |               |                |                |
|-------------------|----|---------------|----------------|----------------|
| Unsecured Debt    |    |               | 111,125,134    | 111,125,134    |
| Equity            |    |               | 1,714,286      | 1,714,286      |
| Total Investments | \$ | \$ 12,120,000 | \$ 183,331,256 | \$ 195,451,256 |

The aggregate values of Level 3 portfolio investments changed during the nine months ended September 30, 2013 are as follows:

|  | Senior Secured<br>Loans First<br>Lien | Senior Secured<br>Loans Second<br>Lien | Unsecured<br>Debt | Equity       | Total          |
|--|---------------------------------------|--|-------------------|--------------|----------------|
| Fair value at beginning of period  | \$44,014,214                          | \$26,477,622                           | \$ 111,125,134    | \$ 1,714,286 | \$ 183,331,256 |
| Purchases of investments   | 37,536,081                            | 63,547,500                             | 15,054,742        |              | 116,138,323    |
| Sales and Redemptions  | (21,401,931)                          | (25,703,125)                           | (25,000,000)      |              | (72,105,056)   |
| Realized Gains   | 11,545                                | 209,677                                | 903,322           |              | 1,124,544      |
| Change in unrealized<br>appreciation/(depreciation)<br>included in earnings  | 284,255                               | 564,712                                | (260,830)         | 194,835      | 782,972        |
| Accretion of discount  | 161,933                               | 49,736                                 | 92,582            |              | 304,251        |
| Transfer from Level 2  |                                       |  |                   |              |                |
| Transfer to Level 2  |                                       | (12,576,571)                           |                   |              | (12,576,571)   |
| Fair value at end of period  | \$60,606,097                          | \$52,569,551                           | \$ 101,914,950    | \$ 1,909,121 | \$ 216,999,719 |
| Change in unrealized<br>appreciation/(depreciation) on<br>Level 3 investments still held as of<br>September 30, 2013 | \$284,255                             | \$501,232                              | \$(260,830)       | \$194,835    | \$719,492      |

F-18

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION**

**NOTES TO THE FINANCIAL STATEMENTS**  
**September 30, 2013**  
**(Unaudited)**

**NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE**  
**(continued)**

During the nine months ended September 30, 2013, there were no transfers from Level 2 to Level 3.

During the nine months ended September 30, 2013, there were two transfers from Level 3 to Level 2 due to quoted prices available for the financial instruments.

The aggregate values of Level 3 portfolio investments changed during the period from Inception through December 31, 2012 are as follows:

|   | Senior Secured<br>Loans First<br>Lien | Senior<br>Secured<br>Loans<br>Lien | Unsecured<br>Debt | Equity      | Total         |
|---|---------------------------------------|------------------------------------|-------------------|-------------|---------------|
| Fair value at beginning of period   | \$                                    | \$                                 | \$                | \$          | \$            |
| Purchases of investments  | 97,066,024                            | 16,477,500                         | 124,507,797       | 1,714,286   | 239,765,607   |
| Sales and Redemptions   | (53,057,372)                          |                                    | (13,400,740)      |             | (66,458,112)  |
| Change in unrealized appreciation<br>(depreciation) included in earnings  |                                       |                                    | (4,744)           |             | (4,744)       |
| Accretion of discount   | 5,562                                 | 122                                | 22,821            |             | 28,505        |
| Transfer from Level 2   |                                       | 10,000,000                         |                   |             | 10,000,000    |
| Transfer to Level 2   |                                       |                                    |                   |             |               |
| Fair value at end of period   | \$44,014,214                          | \$26,477,622                       | \$111,125,134     | \$1,714,286 | \$183,331,256 |
| Change in unrealized appreciation<br>(depreciation) on Level 3<br>investments still held as of<br>December 31, 2012 | \$                                    | \$                                 | \$(4,744)         | \$          | \$(4,744)     |

The following is a summary of geographical concentration of our investment portfolio as of September 30, 2013:

|           | Cost          | Fair Value    | % of Total<br>Investments |   |
|-----------|---------------|---------------|---------------------------|---|
| Colorado  | \$ 36,243,568 | \$ 36,870,097 | 15.13                     | % |
| Minnesota | 34,794,479    | 35,027,004    | 14.38                     | % |
| Canada    | 27,961,549    | 28,143,492    | 11.55                     | % |

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|               |                |                |        |   |
|---------------|----------------|----------------|--------|---|
| New York      | 25,298,910     | 25,298,910     | 10.38  | % |
| Kentucky      | 16,870,095     | 17,245,099     | 7.08   | % |
| Florida       | 16,893,530     | 16,893,530     | 6.93   | % |
| Texas         | 16,536,414     | 16,508,037     | 6.78   | % |
| Indiana       | 11,169,118     | 11,169,118     | 4.59   | % |
| Massachusetts | 10,000,000     | 10,088,000     | 4.14   | % |
| Pennsylvania  | 9,659,583      | 9,417,001      | 3.87   | % |
| New Jersey    | 9,161,316      | 9,161,316      | 3.76   | % |
| Puerto Rico   | 8,702,234      | 8,231,865      | 3.38   | % |
| Missouri      | 7,923,260      | 8,120,000      | 3.33   | % |
| Illinois      | 7,390,621      | 7,390,500      | 3.03   | % |
| Virginia      | 2,513,997      | 2,585,190      | 1.06   | % |
| Georgia       | 1,479,446      | 1,476,150      | 0.61   | % |
|               | \$ 242,598,120 | \$ 243,625,309 | 100.00 | % |

F-19

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION**

**NOTES TO THE FINANCIAL STATEMENTS**  
**September 30, 2013**  
**(Unaudited)**

**NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE**  
**(continued)**

The following is a summary of geographical concentration of our investment portfolio as of December 31, 2012:

|                | Cost           | Fair Value     | % of Total<br>Investments |   |
|----------------|----------------|----------------|---------------------------|---|
| Pennsylvania   | \$ 33,708,952  | \$ 33,704,209  | 17.24                     | % |
| Canada         | 20,778,456     | 20,778,456     | 10.63                     | % |
| Colorado       | 19,532,633     | 19,532,633     | 9.99                      | % |
| Kentucky       | 17,095,646     | 17,095,646     | 8.75                      | % |
| Florida        | 16,639,880     | 16,639,880     | 8.51                      | % |
| South Carolina | 15,000,000     | 15,000,000     | 7.67                      | % |
| New York       | 13,000,000     | 13,000,000     | 6.65                      | % |
| Texas          | 12,119,671     | 12,120,000     | 6.20                      | % |
| Massachusetts  | 10,000,000     | 10,000,000     | 5.12                      | % |
| Utah           | 9,902,063      | 9,902,062      | 5.07                      | % |
| New Jersey     | 9,879,189      | 9,879,189      | 5.05                      | % |
| Indiana        | 8,969,955      | 8,969,955      | 4.59                      | % |
| Connecticut    | 7,351,604      | 7,351,604      | 3.76                      | % |
| Georgia        | 1,477,622      | 1,477,622      | 0.77                      | % |
|                | \$ 195,455,671 | \$ 195,451,256 | 100.00                    | % |

The following is a summary of industry concentration of our investment portfolio as of September 30, 2013:

|                              | Cost          | Fair Value    | % of Total<br>Investments |   |
|------------------------------|---------------|---------------|---------------------------|---|
| Services: Business           | \$ 36,826,331 | \$ 37,008,274 | 15.19                     | % |
| Healthcare & Pharmaceuticals | 35,563,222    | 35,271,962    | 14.48                     | % |
| High Tech Industries         | 28,485,813    | 28,485,692    | 11.69                     | % |
| Software                     | 26,258,893    | 26,343,650    | 10.81                     | % |
| Telecommunications           | 22,165,027    | 22,311,794    | 9.16                      | % |
| Beverage, Food, & Tobacco    | 16,679,376    | 17,255,000    | 7.08                      | % |
| Automotive                   | 12,055,183    | 12,309,375    | 5.05                      | % |
| Finance                      | 12,232,466    | 12,232,466    | 5.02                      | % |
| Transportation: Cargo        | 11,169,118    | 11,169,118    | 4.59                      | % |

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|                                    |                |                |        |   |
|------------------------------------|----------------|----------------|--------|---|
| Energy: Oil & Gas                  | 9,603,620      | 9,603,937      | 3.94   | % |
| Consumer Goods: Non-Durable        | 9,659,583      | 9,417,001      | 3.87   | % |
| Retail                             | 9,161,316      | 9,161,316      | 3.76   | % |
| Media: Broadcasting & Subscription | 7,923,260      | 8,120,000      | 3.33   | % |
| Metals & Mining                    | 4,814,912      | 4,935,724      | 2.03   | % |
|                                    | \$ 242,598,120 | \$ 243,625,309 | 100.00 | % |

F-20

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE FINANCIAL STATEMENTS  
September 30, 2013  
(Unaudited)****NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE  
(continued)**

The following is a summary of industry concentration of our investment portfolio as of December 31, 2012:

|                                    | Cost           | Fair Value     | % of Total<br>Investments |   |
|------------------------------------|----------------|----------------|---------------------------|---|
| Consumer Goods: Non-Durable        | \$ 33,708,952  | \$ 33,704,209  | 17.24                     | % |
| Services: Business                 | 31,117,502     | 31,117,501     | 15.93                     | % |
| High Tech Industries               | 30,778,456     | 30,778,456     | 15.75                     | % |
| Health & Pharmaceuticals           | 26,884,237     | 26,884,237     | 13.75                     | % |
| Retail                             | 19,781,252     | 19,781,252     | 10.12                     | % |
| Media: Broadcasting & Subscription | 15,000,000     | 15,000,000     | 7.67                      | % |
| Automotive                         | 12,345,646     | 12,345,646     | 6.32                      | % |
| Telecommunications                 | 12,119,671     | 12,120,000     | 6.20                      | % |
| Transportation: Cargo              | 8,969,955      | 8,969,955      | 4.59                      | % |
| Metals & Mining                    | 4,750,000      | 4,750,000      | 2.43                      | % |
|                                    | \$ 195,455,671 | \$ 195,451,256 | 100.00                    | % |

The following provides quantitative information about Level 3 fair value measurements as of September 30, 2013:

| Description:       | Fair Value    | Valuation<br>Technique                   | Unobservable Inputs                                      | Range<br>(Average) <sup>(1)(3)</sup> |
|--------------------|---------------|--|--|--------------------------------------|
| First lien debt    | \$60,606,097  | Income/Market<br>approach <sup>(2)</sup> | HY credit spreads,<br>Risk free rates,<br>credit quality | - .75% to<br>1.29%<br>(-.22%)        |
| Second lien debt   | \$52,569,550  | Income/Market<br>approach <sup>(2)</sup> | HY credit spreads,<br>Risk free rates,<br>credit quality | - .77% to<br>2.43%<br>(.34%)         |
| Unsecured debt     | \$101,914,951 | Income/Market<br>approach <sup>(2)</sup> | HY credit spreads,<br>Risk free rates,<br>credit quality | - .46% to<br>3.11%<br>(.44%)         |
| Equity investments | \$1,909,121   | Market<br>approach <sup>(4)</sup>        | Underwriting<br>multiple/EBITDA<br>Multiple              | 5x to 13x                            |
|                    | \$216,999,719 |  |  |                                      |

Total Long Term Level 3  
Investments

(1) Weighted average based on fair value as of September 30, 2013.

(2) Inclusive of but not limited to the income approach (by discounting future cash flows using an appropriate yield) and the market approach (by ensuring sufficient enterprise value).

The Company calculates the price of the loan by discounting future cash flows using an appropriate yield calculated as of the valuation date. This yield is calculated based on the loan's yield at the original investment and is adjusted as of the valuation date based on: changes in comparable credit spreads (per Barclay's high yield indexes), (3) changes in risk free interest rates (per swap rates), and changes in credit quality (via an estimated shadow rating).

Significant movements in any of these factors would result in a significantly lower (higher) fair value measurement. As an example, the Range (Average) for first lien debt instruments in the table above indicates that the change in the HY spreads and the risk free rates

F-21

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE FINANCIAL STATEMENTS  
September 30, 2013  
(Unaudited)****NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE  
(continued)**

between the date a loan closed and the valuation date ranged from  $-.75\%$  (75 basis points) to  $1.29\%$  (129 basis points). The average of all changes was  $-.22\%$ .

The primary significant unobservable input used in the fair value measurement of the Company's equity investments is the EBITDA multiple, or the Multiple. Significant increases (decreases) in the Multiple in isolation would result in a significantly higher (lower) fair value measurement. To determine the Multiple for the market (4) approach, the Company considers current market trading and/or transaction multiple, portfolio company performance (financial ratios) relative to public and private peer companies and leverage levels, among other factors. Changes in one or more of these factors can have a similar directional change on other factors in determining the appropriate Multiple to use in the market approach.

The following provides quantitative information about Level 3 fair value measurements as of December 31, 2012:

| Description:                        | Fair Value    | Valuation Technique                   | Unobservable Inputs                                      | Range (Average) <sup>(1)(3)</sup>     |
|-------------------------------------|---------------|---------------------------------------|--|---------------------------------------|
| First lien debt                     | \$44,014,214  | Income/Market approach <sup>(2)</sup> | HY credit spreads,<br>Risk free rates,<br>credit quality | $-.22\%$ to<br>$.11\%$<br>$(-.12\%)$  |
| Second lien debt                    | \$26,477,622  | Income/Market approach <sup>(2)</sup> | HY credit spreads,<br>Risk free rates,<br>credit quality | $-.49\%$ to<br>$-.18\%$<br>$(-.30\%)$ |
| Unsecured debt                      | \$111,125,134 | Income/Market approach <sup>(2)</sup> | HY credit spreads,<br>Risk free rates,<br>credit quality | $-.31\%$ to<br>$.03\%$<br>$(-.20\%)$  |
| Equity investments                  | \$1,714,286   | Market approach <sup>(4)</sup>        | Underwriting<br>multiple/EBITDA<br>Multiple              | 5x to 12x                             |
| Total Long Term Level 3 Investments | \$183,331,256 |                                       |  |                                       |

(1) Weighted average based on fair value as of December 31, 2012.

(2) Inclusive of but not limited to the income approach (by discounting future cash flows using an appropriate yield) and the market approach (by ensuring sufficient enterprise value).

(3) The Company calculates the price of the loan by discounting future cash flows using an appropriate yield calculated as of the valuation date. This yield is calculated based on the loan's yield at the original investment and is

adjusted as of the valuation date based on: changes in comparable credit spreads (per Barclay's high yield indexes), changes in risk free interest rates (per swap rates), and changes in credit quality (via an estimated shadow rating). Significant movements in any of these factors would result in a significantly lower (higher) fair value measurement. As an example, the Range (Average) for first lien debt instruments in the table above indicates that the change in the HY spreads and the risk free rates between the date a loan closed and the valuation date ranged from -.22% (22 basis points) to .11% (11 basis points). The average of all changes was -.12%.

The primary significant unobservable input used in the fair value measurement of the Company's equity investments is the EBITDA multiple, or the Multiple. Significant increases (decreases) in the Multiple in isolation would result in a significantly higher (lower) fair value measurement. To determine the Multiple for the market (4) approach, the Company considers current market trading and/or transaction multiple, portfolio company performance (financial ratios) relative to public and private peer companies and leverage levels, among other factors. Changes in one or more of these factors can have a similar directional change on other factors in determining the appropriate Multiple to use in the market approach.

F-22

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TABLE OF CONTENTS

**STELLUS CAPITAL INVESTMENT CORPORATION**

**NOTES TO THE FINANCIAL STATEMENTS**  
**September 30, 2013**  
**(Unaudited)**

**NOTE 5 DIVIDEND REINVESTMENT PLAN ( DRIP )**

The Company issued 47,199 shares of common stock during the nine months ended September 30, 2013 in connection with the stockholder distribution reinvestment.

**NOTE 6 NET INCREASE (DECREASE) IN NET ASSETS PER COMMON SHARE**

The following information sets forth the computation of net increase (decrease) in net assets resulting from operations per common share for the three and nine months ended September 30, 2013.

|  | Three months<br>ended<br>September 30,<br>2013 | Nine months<br>ended<br>September 30,<br>2013 |
|--|--|---|
| Net increase in net assets resulting from operations | \$ 3,825,421                                   | \$ 13,835,134                                 |
| Average common shares                                | 12,066,548                                     | 12,051,013                                    |
| Basic and diluted earnings per common share          | \$ 0.32  | \$ 1.15                                       |

**NOTE 7 COMMITMENTS AND CONTINGENCIES**

The Company is currently not subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us. From time to time, we may be a party to certain legal proceedings in the ordinary course of business, including proceedings relating to the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings cannot be predicted with certainty, we do not expect that these proceedings will have a material effect upon our business, financial condition or results of operations.

**NOTE 8 FINANCIAL HIGHLIGHTS**

| Nine months<br>ended<br>September 30,<br>2013<br>(Unaudited) | Three months<br>ended<br>September 30,<br>2013<br>(Unaudited) |
|--|---|
|  |   |

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Per Share Data:<sup>(1)</sup>

|   |                |   |                |    |
|---|----------------|---|----------------|----|
| Net asset value at beginning of period                                  | \$ 14.45       |   | \$ 14.60       |    |
| Net investment income   | 0.98           |   | 0.34           |    |
| Change in unrealized appreciation (depreciation)                        | 0.08           |   | (0.03          | )  |
| Realized gain   | 0.08           |   | 0.00           |    |
| Total from investment operations  | 1.14           |   | 0.31           |    |
| Stockholder distributions   | (1.02          | ) | (0.34          | )  |
| Net asset value at end of period  | \$ 14.57       |   | \$ 14.57       |    |
| Per share market value at end of period                                 | \$ 14.98       |   | \$ 14.98       |    |
| Total return based on market value <sup>(2)</sup>                       | 1.91           | % | (2.38          | )% |
| Weighted average shares outstanding at end of period                    | 12,051,013     |   | 12,066,548     |    |
| Ratio/Supplemental Data:  |                |   |                |    |
| Net assets at end of period   | \$ 176,059,445 |   | \$ 176,059,445 |    |
| Average net assets <sup>(3)</sup>                                       | \$ 175,183,765 |   | \$ 176,105,021 |    |
| Annualized ratio of net operating expenses to net assets <sup>(3)</sup> | 7.53           | % | 8.53           | %  |
| Annualized ratio of net investment income to net assets <sup>(3)</sup>  | 8.96           | % | 9.32           | %  |
| Portfolio Turnover <sup>(4)</sup>                                       | 35             | % | 6              | %  |

(1) Financial highlights are based on shares outstanding as of September 30, 2013.

(2) Total return on market value is based on the change in market price per share since the end of the prior quarter and includes dividends paid. The total returns are not annualized.

F-23

TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS September 30, 2013 (Unaudited)

### NOTE 8 FINANCIAL HIGHLIGHTS (continued)

(3) Financial highlights for periods of less than one year are annualized and the ratios of operating expenses to average net assets and net investment income to average net assets are adjusted accordingly.

(4) Calculated as payoffs divided by average portfolio balance.

### NOTE 9 CREDIT FACILITY

On November 7, 2012, the Company entered into a revolving credit facility (the Credit Facility) with various lenders. SunTrust Bank is one of the lenders and serves as administrative agent under the Credit Facility. The Credit Facility originally provided for borrowings in an aggregate amount up to \$115,000,000 on a committed basis and an accordion for an additional \$35,000,000 for a total facility size of \$150,000,000. On July 30, 2013, the Company partially exercised the accordion feature under its Credit Facility and received additional commitments from the existing bank group in the amount of \$20,000,000 which increased the total commitment to \$135,000,000 under the facility. The exercise of the remaining accordion will require sufficient borrowing base and additional commitments from the existing lender group and/or new lenders.

The Company's obligations to the lenders are secured by a first priority security interest in its portfolio of securities and cash, but excluding short term investments. The Credit Facility contains certain affirmative and negative covenants, including but not limited to: (i) maintaining a minimum liquidity test of at least 85% of adjusted borrowing base, (ii) maintaining an asset coverage ratio of at least 2.0 to 1.0, and (iii) maintaining a minimum shareholder's equity. As of September 30, 2013, the Company was in compliance with these covenants.

Borrowings under the Credit Facility bear interest, subject to the Company's election, on a per annum basis equal to (i) LIBOR plus 3.00% with no LIBOR floor or (ii) 2.00% plus an alternate base rate based on the highest of the Prime Rate, Federal Funds Rate plus 0.5% or one month LIBOR plus 1.0%. The Company pays unused commitment fees of 0.50% per annum on the unused lender commitments under the Credit Facility. Interest is payable quarterly in arrears. Any amounts borrowed under the Credit Facility will mature, and all accrued and unpaid interest thereunder will be due and payable, on November 12, 2016.

As of September 30, 2013 and December 31, 2012, \$85,000,000 and \$38,000,000 was outstanding under the Credit Facility, respectively. The carrying amount of the amount outstanding under the Credit Facility approximates its fair value. The Company incurred costs of \$2,015,415 in connection with obtaining the Credit Facility, which the Company has recorded as prepaid loan structure fees on its statement of assets and liabilities and is amortizing these fees over the life of the Credit Facility. The Company incurred costs of \$113,384 in connection with the \$20,000,000 commitment increase. As of September 30, 2013 and December 31, 2012, \$1,684,565 and \$1,947,820 of such prepaid loan structure fees had yet to be amortized, respectively.

For the three months ended September 30, 2013 the effective interest rate under the Credit Facility was approximately 3.3% (approximately 3.6% including commitment fees on the unused portion of the Credit Facility). Interest is paid quarterly in arrears. The Company recorded interest and fee expense of \$968,674 for the three months ended September 30, 2013, of which \$732,140 was interest expense, \$171,224 was amortization of loan fees paid on the Credit Facility, \$52,708 related to commitment fees on the unused portion of the Credit Facility, and \$12,602 related to loan administration fees.

F-24

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS September 30, 2013 (Unaudited)

### NOTE 9 CREDIT FACILITY (continued)

For the nine months ended September 30, 2013 the effective interest rate under the Credit Facility was approximately 3.3% (approximately 3.8% including commitment fees on the unused portion of the Credit Facility). Interest is paid quarterly in arrears. The Company recorded interest and fee expense of \$2,253,433 for the nine months ended September 30, 2013, of which \$1,581,807 was interest expense, \$420,909 was amortization of loan fees paid on the Credit Facility, \$213,319 related to commitment fees on the unused portion of the Credit Facility, and \$37,397 related to loan administration fees. The Company paid \$688,832 and \$1,559,812 in interest expense and unused commitment fees for the three and nine months ended September 30, 2013, respectively. The average borrowings under the Credit Facility for the three and nine months ended September 30, 2013 were \$87,445,652 and \$63,355,311, respectively.

### NOTE 10 SUBSEQUENT EVENTS

#### Investment Portfolio

On October 24, 2013, we received full repayment on our first lien loan of Holley Performance Products at par plus a 2% prepayment premium resulting in total proceeds of \$12.3 million.

On October 31, 2013, we made a \$5.0 million investment in the unsecured term loan of SQUAD, LLC. We also invested \$0.5 million in the company's equity.

On November 1, 2013, we made a \$21.4 million investment in the second lien term loan of Empirix, Inc. We also invested \$1.3 million in the company's equity.

#### Credit Facility

The outstanding balance under the Credit Facility as of November 8, 2013 was \$84 million.

#### Exemptive Relief

We intend to co-invest with certain investment funds, accounts and investment vehicles managed by Stellus Capital Management (other than the D. E. Shaw group funds) where doing so is consistent with our investment strategy as well as applicable law (including the terms and conditions of any exemptive order issued by the SEC) and SEC staff interpretations. In this regard, we have received exemptive relief from the SEC to permit us to co-invest with certain investment funds, accounts and investment vehicles managed by Stellus Capital Management (other than the D. E. Shaw group funds).



TABLE OF CONTENTS

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders  
Stellus Capital Investment Corporation

We have audited the accompanying statement of assets and liabilities of Stellus Capital Investment Corporation (a Maryland corporation) (the Company), including the schedule of investments as of December 31, 2012, and the related statements of operations, changes in net assets, and cash flows for the period from inception (May 18, 2012) through December 31, 2012 and the financial highlights (see Note 8) for the period from inception (May 18, 2012) through December 31, 2012. These financial statements and financial highlights are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our procedures included verification by confirmation of securities as of December 31, 2012, or by other appropriate auditing procedures where replies were not received. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Stellus Capital Investment Corporation as of December 31, 2012, and the results of its operations and its cash flows for the period from inception (May 18, 2012) through December 31, 2012 and the financial highlights for the period from inception (May 18, 2012) through December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

/s/ Grant Thornton, LLP  
Houston, Texas  
March 11, 2013

TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## STATEMENT OF ASSETS AND LIABILITIES

|   | December 31,<br>2012 |
|---|----------------------|
| <b>ASSETS</b>   |                      |
| Non-controlled, non-affiliated investments, at fair value (amortized cost of \$195,455,671)                         | \$ 195,451,256       |
| Cash and cash equivalents   | 62,131,686           |
| Interest receivable   | 2,573,831            |
| Prepaid loan structure fees   | 1,947,820            |
| Prepaid expenses  | 438,384              |
| Total Assets  | 262,542,977          |
| <b>LIABILITIES</b>  |                      |
| Payable for investments purchased   | 4,750,000            |
| Credit facility payable   | 38,000,000           |
| Short-term loan   | 45,000,943           |
| Base management fees payable  | 527,034              |
| Accrued offering costs  | 147,123              |
| Interest payable  | 66,477               |
| Other accrued expenses and liabilities  | 205,445              |
| Total Liabilities   | 88,697,022           |
| Net Assets  | \$ 173,845,955       |
| <b>NET ASSETS</b>   |                      |
| Common Stock, par value \$0.001 per share (100,000,000 shares authorized, 12,035,023 shares issued and outstanding) | \$ 12,035            |
| Paid-in capital   | 174,714,838          |
| Distributions in excess of net investment income  | (874,986 )           |
| Unrealized depreciation on investments and cash equivalents   | (5,932 )             |
| Net Assets  | \$ 173,845,955       |
| Total Liabilities and Net Assets  | \$ 262,542,977       |
| Net Asset Value Per Share   | \$ 14.45             |

*See Notes to Financial Statements.*

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****STATEMENT OF OPERATIONS**

|   | For the Period<br>from<br>Inception<br>(May 18,<br>2012) through<br>December 31,<br>2012 |
|---|--|
| <b>INVESTMENT INCOME</b>  |  |
| Interest income   | \$3,696,432  |
| Total Investment Income   | 3,696,432  |
| <b>OPERATING EXPENSES</b>   |  |
| Management fees   | 527,034  |
| Valuation fees  | 184,500  |
| Administrative services expenses  | 103,482  |
| Professional fees   | 734,365  |
| Directors' fees   | 109,439  |
| Insurance expense   | 79,279   |
| Interest expense and other fees   | 282,629  |
| Credit facility fees  | 317,594  |
| Other general and administrative expenses                                 | 53,754   |
| Total Operating Expenses  | 2,392,076  |
| Net Investment Income   | 1,304,356  |
| Net Change in Unrealized Depreciation on Investments and Cash Equivalents | (5,932 )   |
| Net Increase in Net Assets Resulting from Operations                      | \$1,298,424  |
| Net Investment Income Per Share   | \$0.11   |
| Net Increase in Net Assets Resulting from Operations Per Share            | \$0.11   |
| Shares of Common Stock Outstanding  | 12,035,023   |

*See Notes to Financial Statements.*

TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## STATEMENT OF CHANGES IN NET ASSETS

|   | For the period<br>from Inception<br>(May 18, 2012)<br>through<br>December 31,<br>2012 |
|---|---|
| Increase in Net Assets Resulting from Operations                          |   |
| Net investment income   | \$1,304,356   |
| Net change in unrealized depreciation on investments and cash equivalents | (5,932 )  |
| Net Increase in Net Assets Resulting from Operations                      | 1,298,424   |
| Stockholder distributions   |   |
| Distributions from net investment income                                  | (2,179,342 )  |
| Capital share transactions  |   |
| Issuance of common stock  | 180,409,145   |
| Reinvestments of stockholder distributions                                | 112,948   |
| Sales load  | (4,959,720 )  |
| Offering costs  | (835,500 )  |
| Net increase in net assets resulting from capital share transactions      | 174,726,873   |
| Total increase in net assets  | 173,845,955   |
| Net assets at beginning of period   |   |
| Net assets at end of period   | \$173,845,955   |

*See Notes to Financial Statements.*

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****STATEMENT OF CASH FLOWS**

|   | For the period<br>from Inception<br>(May 18, 2012)<br>through<br>December 31,<br>2012 |
|---|---|
| Cash flows from operating activities  |   |
| Net increase in net assets resulting from operations  | \$1,298,424   |
| Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities: |   |
| Purchases of investments  | (232,708,419)   |
| Proceeds from sales and repayments of investments   | 66,458,112  |
| Net change in unrealized depreciation on investments  | 4,415   |
| Increase in investments due to PIK  | (18,044 )   |
| Accretion of discount   | (28,175 )   |
| Increase in interest receivable   | (2,573,831 )  |
| Increase in prepaid expenses and fees   | (2,386,204 )  |
| Increase in payable for investments purchased   | 4,750,000   |
| Increase in management fees payable   | 527,034   |
| Increase in interest payable  | 66,477  |
| Increase in other accrued expenses and liabilities  | 205,445   |
| Net cash used in operating activities   | (164,404,766)   |
| Cash flows from financing activities  |   |
| Net proceeds from common shares issued  | 151,250,000   |
| Borrowings on bridge note   | 156,000,000   |
| Payments on bridge note   | (156,000,000)   |
| Sales load  | (4,959,720 )  |
| Offering costs paid   | (688,377 )  |
| Stockholder distributions paid  | (2,066,394 )  |
| Borrowings under credit facility  | 38,000,000  |
| Borrowings under short term loan  | 45,000,943  |
| Net cash provided by financing activities   | 226,536,452   |
| Net increase in cash and cash equivalents   | 62,131,686  |
| Cash and cash equivalents balance at beginning of period  |   |
| Cash and cash equivalents balance at end of period  | \$62,131,686  |
| Non-cash items  |   |
| Purchase of portfolio companies through the issuance of common stock  | \$29,159,145  |
| Accrued deferred offering costs   | 147,123   |
| Common stock issued in connection with dividend reinvestments   | 112,948   |

*See Notes to Financial Statements.*

F-30

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****SCHEDULE OF INVESTMENTS  
DECEMBER 31, 2012**

| Investments  | Headquarters/Industry                               | Principal Amount/Shares | Cost         | Fair Value <sup>(1)</sup> | % of Net Assets |
|--|---|-------------------------|--------------|---------------------------|-----------------|
| Non-controlled, non-affiliated investments   |   |                         |              |                           |                 |
| <u>Aderant North America Inc.</u>  |   |                         |              |                           |                 |
| Term Loan-Second Lien, Prime + 7.75%, due 6/20/2019 <sup>(2)</sup>                       | Atlanta, GA<br>Services: Business                   | \$ 1,500,000            | \$ 1,477,622 | \$ 1,477,622              | 0.85 %          |
| <u>Ascend Learning, Inc.</u>   |   |                         |              |                           |                 |
| Term Loan-Second Lien, Euro + 10.00%, Euro 1.50%, due 12/6/2017 <sup>(2)</sup>           | Burlington, MA<br>High Tech Industries              | \$ 10,000,000           | 10,000,000   | 10,000,000                | 5.75 %          |
| <u>ATX Networks</u>  |   |                         |              |                           |                 |
| Term Loan-Unsecured, 12.00% cash, 2.00% PIK, due 5/12/2016 <sup>(2)(3)(4)</sup>          | West Ajax, Ontario<br>High Tech Industries          | \$ 20,778,456           | 20,778,456   | 20,778,456                | 11.95 %         |
| <u>Baja Broadband, LLC</u>   |   |                         |              |                           |                 |
| Term Loan-Second Lien, L + 11.00%, LIBOR 1.50%, due 12/20/2017 <sup>(2)</sup>            | Fort Mill, SC<br>Media: Broadcasting & Subscription | \$ 15,000,000           | 15,000,000   | 15,000,000                | 8.63 %          |
| <u>Binder and Binder</u>   |   |                         |              |                           |                 |
| Senior Subordinated Note-Unsecured, 13.00% cash, 2.00% PIK, due 2/27/2016 <sup>(3)</sup> | Hauppauge, New York<br>Services: Business           | \$ 13,000,000           | 13,000,000   | 13,000,000                | 7.48 %          |
| <u>Blackhawk Mining, LLC</u>   |   |                         |              |                           |                 |
| Term Loan-First Lien, 12.50%, due 10/5/2016 <sup>(7)</sup>                               | Lexington, KY<br>Metals & Mining                    | \$ 5,000,000            | 4,535,714    | 4,535,714                 | 2.61 %          |
| Common Shares, Class B <sup>(5)(6)</sup>   |   | 36 shares               | 214,286      | 214,286                   | 0.12 %          |
| Total  |   |                         | 4,750,000    | 4,750,000                 | 2.73 %          |
| <u>Eating Recovery Center, LLC</u>   |   |                         |              |                           |                 |
| Mezzanine Term Loan-Unsecured, 12.00% cash, 1.00% PIK, due 12/28/2018 <sup>(2)(3)</sup>  | Denver, CO<br>Healthcare & Pharmaceuticals          | \$ 18,400,000           | 18,032,633   | 18,032,633                | 10.37 %         |
| Common Shares, Series A <sup>(5)</sup>   |   | 86,667 shares           | 1,500,000    | 1,500,000                 | 0.86 %          |

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|   |   |               |            |            |       |   |
|---|---|---------------|------------|------------|-------|---|
| Total   |   |               | 19,532,633 | 19,532,633 | 11.23 | % |
| <u>Holley Performance Products</u>  |   |               |            |            |       |   |
| Term Loan-First Lien,<br>Prime + 6.00%, Prime 3.50%,<br>due 11/30/2017 <sup>(2)</sup>                 | Bowling Green, KY<br>Automotive         | \$ 12,500,000 | 12,345,646 | 12,345,646 | 7.10  | % |
| <u>Refac Optical Group<sup>(8)</sup></u>  |   |               |            |            |       |   |
| Term A Loan-First Lien,<br>L + 7.50%, LIBOR 0.2077%,<br>due 3/23/2016 <sup>(2)</sup>                  | Blackwood, NJ<br>Retail                 | \$ 3,780,408  | 3,780,408  | 3,780,408  | 2.18  | % |
| Term B Loan-First Lien,<br>L + 8.50%, LIBOR 0.2077%,<br>1.75% PIK, due<br>3/23/2016 <sup>(2)(3)</sup> |   | \$ 6,098,781  | 6,098,781  | 6,098,781  | 3.51  | % |
| Total   |   |               | 9,879,189  | 9,879,189  | 5.69  | % |
| <u>Securus Technologies</u>   |   |               |            |            |       |   |
| <u>Holdings</u>   |   |               |            |            |       |   |
| Term Loan-Second Lien,<br>Euro + 9.00%, Euro 1.75%,<br>due 6/1/2018 <sup>(2)</sup>                    | Dallas, TX<br>Telecommunications        | \$ 12,000,000 | 12,119,671 | 12,120,000 | 6.97  | % |
| <u>Snowman Holdings, LLC</u>  |   |               |            |            |       |   |
| Term Loan-Unsecured,<br>11.00% cash, 2.00% PIK,<br>due 1/11/2017 <sup>(3)</sup>                       | Lebanon, IN<br>Transportation:<br>Cargo | \$ 8,969,955  | 8,969,955  | 8,969,955  | 5.16% |   |

*See Notes to Financial Statements.*

TABLE OF CONTENTS

| Investments   | Headquarters/Industry                        | Principal Amount/Shares | Cost           | Fair Value <sup>(1)</sup> | % of Net Assets |
|---|--|-------------------------|----------------|---------------------------|-----------------|
| <u>SPM Capital, LLC</u>   |  |                         |                |                           |                 |
| Term Loan-First Lien, Euro + 5.50%, Euro 1.50%, due 10/31/2017 <sup>(2)</sup> | Stamford, CT<br>Capital Markets              | \$ 7,500,000            | 7,351,604      | 7,351,604                 | 4.23 %          |
| <u>Sportsmans Warehouse Holdings, Inc.</u>                                    |  |                         |                |                           |                 |
| Term Loan-First Lien, L + 7.00%, LIBOR 1.50%, due 11/13/2018 <sup>(2)</sup>   | Midvale, UT<br>Retail                        | \$ 10,000,000           | 9,902,063      | 9,902,062                 | 5.70 %          |
| <u>Studer Group, LLC (The)</u>  |  |                         |                |                           |                 |
| Term Loan-Unsecured, 12.00% cash, 2.00% PIK, due 3/29/2017 <sup>(3)</sup>     | Gulf Breeze, FL<br>Services:<br>Business     | \$ 16,639,880           | \$ 16,639,880  | \$ 16,639,880             | 9.57 %          |
| <u>Woodstream Corp.</u>   |  |                         |                |                           |                 |
| Subordinated Debt-Unsecured, 12.00%, due 2/27/2015 <sup>(2)</sup>             | Lititz, PA<br>Consumer Goods:<br>Non-Durable | \$ 3,017,977            | 2,910,987      | 2,906,244                 | 1.67 %          |
| <u>Woodstream Group, Inc.</u>   |  |                         |                |                           |                 |
| Senior Subordinated Note-Unsecured, 12.00%, due 2/27/2015                     | Lititz, PA<br>Consumer Goods:<br>Non-Durable | \$ 31,982,023           | 30,797,965     | 30,797,965                | 17.72 %         |
| Total Non-controlled, non-affiliated investments                              |  |                         | \$ 195,455,671 | \$ 195,451,256            | 112.43 %        |
| LIABILITIES IN EXCESS OF OTHER ASSETS   |  |                         |                | (21,605,301 )             | (12.43 )%       |
| NET ASSETS  |  |                         |                | \$ 173,845,955            | 100.00 %        |

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

(2) Coupon is subject to Prime and LIBOR floors.

(3) Represents a payment-in-kind security which pays a portion of interest in additional par.

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

(5) Security is non-income producing.

(6) Common shares position will settle after December 31, 2012.

(7) The loan will settle after December 31, 2012.

(8) This instrument also includes an undrawn revolving loan commitment in an amount not to exceed \$2,000,000, an interest rate of Libor plus 7.5%, and a maturity of March 23, 2016. This investment is accruing an unused fee of 0.50% per annum.

## Abbreviation Legend

**PIK** Payment-In-Kind

*See Notes to Financial Statements.*

F-32

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS December 31, 2012

### ***NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES***

#### **Nature of Operations**

Stellus Capital Investment Corporation (the Company) was formed as a Maryland corporation on May 18, 2012 (Inception) and is an externally managed, closed-end, non-diversified management investment company. The Company intends to elect 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) also 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. As of December 31, 2012 the Company has raised \$180,409,145 including (i) the Offering proceeds (ii) \$500,010 of seed capital contributed by Stellus Capital, (iii) \$12,749,990 in a private placement to certain purchasers, including persons and entities associated with Stellus Capital, and (iv) \$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's investment objective is to achieve a consistent payment of cash dividends and to maximize capital appreciation. The Company will seek 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, often times with a corresponding equity co-investment. It expects to source investments primarily through the extensive network of relationships that the principals of its investment adviser has 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 financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America ( GAAP ).

In accordance with Regulation S-X under the Securities Act of 1933 and Securities Exchange Act of 1934, 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

F-33

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS December 31, 2012

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

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 nor Affiliate Investments.

#### **Cash and Cash Equivalents**

Cash consists of bank demand deposits. We deem certain U.S. Treasury Bills, repurchase agreements and other high-quality, short-term debt securities as cash equivalents. At the end of each fiscal quarter, we may take proactive steps to preserve investment flexibility for the next quarter by investing in cash equivalents, 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, temporarily drawing down on the Credit Facility (see footnote 9), or utilizing repurchase agreements or other balance sheet transactions as are deemed appropriate for this purpose. On December 28, 2012, we purchased \$50 million of U.S. Treasury Bills with a 30 day maturity on margin using \$5 million in cash and the proceeds from a \$45 million short term loan from Raymond James. The loan had an effective annual interest rate of approximately 1%. On January 2, 2013, we sold the Treasury Bills, repaid the \$45 million loan from Raymond James and received back the \$5 million margin payment (net of fees and expenses of \$8,943).

#### **Use of Estimates**

The preparation of the statement 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.

#### **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 mean 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, although 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 once quarterly. Investments purchased within 60 days of maturity will be valued at cost plus accreted discount, or minus amortized premium, which approximates value. With respect to unquoted securities, our board of directors, together with our independent valuation advisors, 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.

F-34

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS December 31, 2012

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

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.

Determination of fair values involves subjective judgments and estimates not susceptible to substantiation by auditing procedures. Under current auditing standards, the notes to our financial statements refer to the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on our financial statements.

### **Revenue Recognition**

We record interest income on an accrual basis to the extent they are deemed collectible. For loans and debt securities with contractual 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 is recorded as interest income. We record prepayment premiums on loans and debt securities as interest income. Dividend income, if any, will be recognized on the ex-dividend date.

### **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.

F-35

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS December 31, 2012

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

#### **Investment Transaction Costs**

Costs 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.

#### **Payable for Unsettled Securities Transaction**

Payable for unsettled securities transaction relates to the purchase of the Blackhawk Mining, LLC term loan and Blackhawk Mining, LLC common shares that were unsettled at December 31, 2012, and settled subsequent to year-end.

#### **U.S. Federal Income Taxes**

The Company intends to elect to be treated as a regulated investment company ( RIC ) under subchapter M of the Internal Revenue Code of 1986, as amended, 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. As a part of maintaining RIC status, dividends pertaining to a given fiscal year may be distributed up to 12 months subsequent to the end of that fiscal year provided such dividends are declared prior to the filing of the Company's federal income tax return. 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 financial statements of the Company.

As of December 31, 2012 the Company had no undistributed long-term capital gains or capital loss carryforwards for federal income tax purposes.

The Company has estimated its taxable income for the period from Inception through December 31, 2012 to be approximately \$2.4 million which reflects book/tax differences of approximately \$1.1 million related to non-recurring expenses that are expensed for book purposes but deferred and amortized over 15 years for tax purposes. The Company declared and paid a dividend of \$2.2 million in December 2012 leaving approximately \$0.2 million of undistributed ordinary income at December 31, 2012. The Company expects to distribute the remaining amount to shareholders prior to the filing of its federal income tax return. The Company's taxable income for 2012 is an estimate and will not be finally determined until the Company files its 2012 tax return. Therefore, the final taxable income and the taxable income earned in 2012 and carried forward for distribution in 2013 may be different than this estimate.

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 federal tax year for the Company remains subject to examination by the Internal Revenue Service.

As of December 31, 2012, 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 year ended December 31, 2012.

F-36

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS December 31, 2012

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

#### **Organization Costs, Offering Costs and Sales Load**

Organization costs include costs relating to the formation and incorporation of the business. These costs were expensed as incurred. For the period from Inception through December 31, 2012, the Company has incurred and expensed organization costs of \$690,114. Offering costs include legal fees and other costs pertaining to the initial public offering. These costs have been offset against capital proceeds from the public offerings. For the period from Inception through December 31, 2012, these costs amount to \$835,500. Sales load represents the underwriting discounts and commissions related to the initial public offering. For the period from Inception through December 31, 2012 sales load totaled \$4,959,720.

#### **Recently Issued Accounting Pronouncements**

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. The Company believes that the impact of recently issued standards that are not yet effective will not have a material impact on its financial statements upon adoption.

### ***NOTE 2 RELATED PARTY ARRANGEMENTS***

#### **Investment Advisory Agreement**

The Company entered into an investment advisory agreement with Stellus Capital Management (Advisor). Pursuant to this agreement, the Company has agreed to pay to Stellus Capital Management 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 consisting of two parts. The first part, which is calculated and payable quarterly in arrears, equals 20.0% of the pre-incentive fee net investment income (as defined in the agreement) for the immediately preceding quarter, subject to a hurdle rate of 2.0% per quarter (8.0% annualized), and is subject to a catch-up feature.

The second part is calculated and payable in arrears as of the end of each calendar year (or, upon termination of the investment advisory agreement, as of the termination date) and equals 20.0% of the aggregate cumulative realized capital gains from inception through the end of each calendar year, computed net of aggregate cumulative realized capital losses and aggregate cumulative unrealized capital depreciation through the end of such year, less the aggregate amount of any previously paid capital gain incentive fees. The incentive fee is subject to a total return

requirement of 20%. The net pre-incentive fee investment income used to calculate this part of the incentive fee is also included in the amount of our gross assets used to calculate the 1.75% base management fee.

Stellus Capital Management has agreed to waive its incentive fee for the years ending December 31, 2012 and December 31, 2013 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. Stellus Capital earned \$527,034 in base management fees and no incentive fees for the period from Inception through December 31, 2012.

As of December 31, 2012, the Company was not due any amount from Stellus Capital for reimbursement of expenses paid for by the Company that were the responsibility of Stellus Capital. Any such amounts due to the Company would be included in the Statement of Assets and Liabilities.

As of December 31, 2012, the Company owed one director \$29,452 for unpaid director fees.

As agreed to in the Amended and Restated Side Agreement made and entered into as of November 12, 2012 by and between Stellus Capital Management, LLC (the Advisor ) and Raymond James & Associates, Inc. and Stifel, Nicolaus & Company, Incorporated, the Advisor has agreed to pay on behalf of the Company,

F-37

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS December 31, 2012

### **NOTE 2 RELATED PARTY ARRANGEMENTS (continued)**

2.41% of the 6% Underwriters sales load, or \$3,320,280 in total. Of this amount, \$1,940,280 was paid on November 14, 2012 and the remaining \$1,380,000 is due in equal, quarterly installments beginning March 31, 2013.

#### **Administration Agreement**

The Company entered into an administration agreement with Stellus Capital Management pursuant to which Stellus Capital Management will furnish the Company with office facilities and equipment and will provide the Company with the clerical, bookkeeping, recordkeeping and other administrative services necessary to conduct day-to-day operations. Under this administration agreement, Stellus Capital Management will perform, or oversee the performance of, its required administrative services, which includes, among other things, being responsible for the financial records which it is required to maintain and preparing reports to its stockholders and reports filed with the SEC. There were \$62,716 of such costs incurred under the Administration Agreement for the period from Inception through December 31, 2012, and are included in Administrative Services Expenses.

#### **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 Management 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 Management's services under the investment advisory agreement or otherwise as our investment adviser.

### **NOTE 3 DISTRIBUTIONS**

The Company intends to make quarterly distributions of available income to its stockholders. The Company intends to distribute net capital gains (*i.e.*, net long-term capital gains in excess of net short-term capital losses), if any, at least annually. The quarterly stockholder distributions, if any, will be determined by the board of directors. Any stockholder distribution to stockholders will be declared out of assets legally available for distribution. The amount of the initial distribution equates to an annualized dividend yield of 9.0% based on the price per share of our common stock in connection with the Offering (\$15.00 per share).

The following table reflects the distributions that the Company has declared and paid on its common stock through December 31, 2012:

|                 | Distribution |              |
|-----------------|--------------|--------------|
|                 | Per Share    | Amount       |
| Ordinary income | \$ 0.181     | \$ 2,179,342 |

Unless the stockholder elects to receive its distributions in cash, the Company intends to make such distributions in additional shares of the Company's common stock under the Company's dividend reinvestment plan. Although distributions paid in the form of additional shares of the Company's common stock will generally be subject to U.S. federal, state and local taxes in the same manner as cash distributions, investors participating in the Company's dividend reinvestment plan will not receive any corresponding cash distributions with which to pay any such applicable taxes. If a stockholder holds shares of the Company's common stock in the name of a broker or financial intermediary, the stockholder should contact such broker or financial intermediary regarding their election to receive distributions in cash in lieu of shares of the Company's common stock. Any distributions reinvested through the issuance of shares through the Company's dividend reinvestment plan will increase the Company's gross assets on which the base management fee and

F-38

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS December 31, 2012

### ***NOTE 3 DISTRIBUTIONS (continued)***

the incentive fee are determined and paid to Stellus Capital Management. Of the total distributions made to shareholders through December 31, 2012, \$2,066,394 were made in cash and the remainder in shares.

### ***NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE***

In accordance with the authoritative guidance on fair value measurements and disclosures under GAAP, the Company discloses the fair value of its investments in a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The guidance establishes three levels of the fair value hierarchy as follows:

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices in markets that are not considered to be active or financial instruments for which significant inputs are observable, either directly or indirectly;
- Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

The level of an asset or liability within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes observable requires significant judgment by management.

The Company considers whether the volume and level of activity for the asset or liability have significantly decreased and identifies transactions that are not orderly in determining fair value. Accordingly, if the Company determines that either the volume and/or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. Valuation techniques such as an income approach might be appropriate to supplement or replace a market approach in those circumstances.

At December 31, 2012, the Company had investments in 15 portfolio companies. The total cost and fair value of the 20 positions were \$195,455,671 and \$195,451,256, respectively. The composition of our investments as of December 31, 2012 is as follows:

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|                            | Cost           | Fair Value     |
|----------------------------|----------------|----------------|
| Senior Secured First Lien  | \$ 44,014,214  | \$ 44,014,214  |
| Senior Secured Second Lien | 38,597,293     | 38,597,622     |
| Unsecured Debt             | 111,129,878    | 111,125,134    |
| Equity                     | 1,714,286      | 1,714,286      |
| Total Investments          | \$ 195,455,671 | \$ 195,451,256 |

The Company's investment portfolio may contain loans that are in the form of lines of credit or revolving credit facilities, which require the Company to provide funding when requested by portfolio companies in accordance with the terms of the underlying loan agreements. As of December 31, 2012, the Company had one such investment which was a revolving loan agreement, with an aggregate unfunded commitment of \$2,000,000. The Company maintains sufficient cash on hand to fund such unfunded loan commitments should the need arise.

F-39

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2012****NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE  
(continued)**

The fair values of our investments disaggregated into the three levels of the fair value hierarchy based upon the lowest level of significant input used in the valuation as of December 31, 2012 are as follows:

|                            | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Securities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs (Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total          |
|----------------------------|---|--|--|----------------|
| Senior Secured First Lien  | \$  | \$   | \$ 44,014,214                                      | \$ 44,014,214  |
| Senior Secured Second Lien |   | 12,120,000   | 26,477,622   | 38,597,622     |
| Unsecured Debt             |   |  | 111,125,134  | 111,125,134    |
| Equity                     |   |  | 1,714,286  | 1,714,286      |
| Total Investments          | 0   | \$ 12,120,000  | \$ 183,331,256                                     | \$ 195,451,256 |

The aggregate values of Level 3 portfolio investments changed during the period from Inception through December 31, 2012 are as follows:

|   | Senior Secured<br>Loans -<br>First Lien | Senior<br>Secured<br>Loans -<br>Second Lien | Unsecured<br>Debt | Equity      | Total         |
|---|---|---|-------------------|-------------|---------------|
| Fair value at beginning of period   | \$                                      | \$  | \$                | \$          | \$            |
| Purchases of investments  | 97,066,024                              | 16,477,500                                  | 124,507,797       | 1,714,286   | 239,765,607   |
| Sales and Redemptions   | (53,057,372)                            |   | (13,400,740)      |             | (66,458,112)  |
| Change in unrealized depreciation<br>included in earnings   |   |   | (4,744)           | )           | (4,744)       |
| Accretion of discount   | 5,562                                   | 122   | 22,821            |             | 28,505        |
| Transfer from Level 2   |   | 10,000,000                                  |                   |             | 10,000,000    |
| Transfer to Level 2   |   |   |                   |             |               |
| Fair value at end of period   | \$44,014,214                            | \$26,477,622                                | \$111,125,134     | \$1,714,286 | \$183,331,256 |
| Change in unrealized depreciation<br>on Level 3 investments still held<br>as of December 31, 2012 | \$                                      | \$  | \$(4,744)         | ) \$        | \$(4,744)     |

During the period from Inception through December 31, 2012, there was one transfer from Level 2 to Level 3.

F-40

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2012****NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE  
(continued)**

The following is a summary of geographical concentration of our investment portfolio as of December 31, 2012:

|                | Cost           | Fair Value     | %<br>of Total<br>Investments |   |
|----------------|----------------|----------------|------------------------------|---|
| Pennsylvania   | \$ 33,708,952  | \$ 33,704,209  | 17.24                        | % |
| Canada         | 20,778,456     | 20,778,456     | 10.63                        | % |
| Colorado       | 19,532,633     | 19,532,633     | 9.99                         | % |
| Kentucky       | 17,095,646     | 17,095,646     | 8.75                         | % |
| Florida        | 16,639,880     | 16,639,880     | 8.51                         | % |
| New York       | 13,000,000     | 13,000,000     | 6.65                         | % |
| Texas          | 12,119,671     | 12,120,000     | 6.20                         | % |
| Massachusetts  | 10,000,000     | 10,000,000     | 5.12                         | % |
| South Carolina | 15,000,000     | 15,000,000     | 7.67                         | % |
| Utah           | 9,902,063      | 9,902,062      | 5.07                         | % |
| New Jersey     | 9,879,189      | 9,879,189      | 5.05                         | % |
| Indiana        | 8,969,955      | 8,969,955      | 4.59                         | % |
| Connecticut    | 7,351,604      | 7,351,604      | 3.76                         | % |
| Georgia        | 1,477,622      | 1,477,622      | 0.77                         | % |
|                | \$ 195,455,671 | \$ 195,451,256 | 100.00                       | % |

The following is a summary of industry concentration of our investment portfolio as of December 31, 2012:

|                                    | Cost          | Fair Value    | %<br>of Total<br>Investments |   |
|------------------------------------|---------------|---------------|------------------------------|---|
| Consumer Goods: Non-Durable        | \$ 33,708,952 | \$ 33,704,209 | 17.24                        | % |
| High Tech Industries               | 30,778,456    | 30,778,456    | 15.75                        | % |
| Retail                             | 19,781,252    | 19,781,252    | 10.12                        | % |
| Healthcare & Pharmaceuticals       | 19,532,633    | 19,532,633    | 9.99                         | % |
| Services: Business                 | 16,639,880    | 16,639,880    | 8.51                         | % |
| Media: Broadcasting & Subscription | 15,000,000    | 15,000,000    | 7.67                         | % |
| Services: Business                 | 13,000,000    | 13,000,000    | 6.65                         | % |
| Automotive                         | 12,345,646    | 12,345,646    | 6.32                         | % |

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|                       |                |                |        |   |
|-----------------------|----------------|----------------|--------|---|
| Telecommunications    | 12,119,671     | 12,120,000     | 6.20   | % |
| Transportation: Cargo | 8,969,955      | 8,969,955      | 4.59   | % |
| Capital Markets       | 7,351,604      | 7,351,604      | 3.76   | % |
| Metals & Mining       | 4,750,000      | 4,750,000      | 2.43   | % |
| Services: Business    | 1,477,622      | 1,477,622      | 0.77   | % |
|                       | \$ 195,455,671 | \$ 195,451,256 | 100.00 | % |

F-41

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2012****NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE  
(continued)**

The following table provides quantitative information about the Company's level 3 fair value measurements as of December 31, 2012:

| Description:                        | Fair Value    | Valuation Technique                   | Unobservable Inputs   | Range (Average) <sup>(1)(3)</sup> |
|-------------------------------------|---------------|---------------------------------------|---|-----------------------------------|
| First lien debt                     | \$44,014,214  | Income/Market approach <sup>(2)</sup> | HY credit spreads,<br>Risk free rates,<br>credit quality <sup>(3)</sup> | -.22% to<br>.11%<br>(-.12%)       |
| Second lien debt                    | \$26,477,622  | Income/Market approach                | HY credit spreads,<br>Risk free rates,<br>credit quality                | -.49% to<br>-.18%<br>(-.30%)      |
| Unsecured debt                      | \$111,125,134 | Income/Market approach                | HY credit spreads,<br>Risk free rates,<br>credit quality                | -.31% to<br>.03%<br>(-.20%)       |
| Equity investments                  | \$1,714,286   | Market approach <sup>(4)</sup>        | Underwriting multiple/EBITDA Multiple                                   | 5x to 12x                         |
| Total Long Term Level 3 Investments | \$183,331,256 |                                       |   |                                   |

(1) Weighted average based on fair value as of December 31, 2012.

(2) Inclusive of but not limited to the income approach (by discounting future cash flows using an appropriate yield) and the market approach (by ensuring sufficient enterprise value).

The Company calculates the price of the loan by discounting future cash flows using an appropriate yield calculated as of the valuation date. This yield is calculated based on the loan's yield at the original investment and is adjusted as of the valuation date based on: changes in comparable credit spreads (per Barclay's high yield indexes, changes in risk free interest rates (per swap rates), and changes in credit quality (via an estimated shadow (3)rating). Significant increases (decreases) in any of these factors would result in a significantly lower (higher) fair value measurement. As an example, the Range (Average) for first lien debt instruments in the table above indicates that the most negative change in the HY spreads and risk free rates between the date a loan closed and the valuation date was -.22% (22 basis points) and the largest position change was .11%. The average of all changes was -.12%.

(4) The primary significant unobservable input used in the fair value measurement of the Company's equity investments is the EBITDA multiple, or the Multiple. Significant increases (decreases) in the Multiple in isolation

would result in a significantly higher (lower) fair value measurement. To determine the Multiple for the market approach, the Company considers current market trading and/or transaction multiples, portfolio company performance (financial ratios) relative to public and private peer companies and leverage levels, among other factors. Changes in one or more of these factors can have a similar directional change on other factors in determining the appropriate Multiple to use in the market approach.

F-42

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2012****NOTE 5 EQUITY OFFERINGS AND RELATED EXPENSES**

The Company issued 12,035,023 shares of common stock during the period from Inception through December 31, 2012. The proceeds raised, the related sales load, the offering expenses and the prices at which these shares were issued are as follows:

| Issuance of Common Stock         | Number of Shares | Gross Proceeds | Sales Load   | Offering Expenses      | Offering Price |
|----------------------------------|------------------|----------------|--------------|------------------------|----------------|
| September 30, 2012               | 100              | \$ 500,010     | \$           | \$                     | \$ 5,000.10    |
| October 25, 2012 <sup>(1)</sup>  | 33,234           |                |              |                        |                |
| November 2, 2012 <sup>(2)</sup>  | 849,999          | 12,749,990     |              |                        | 15.00          |
| November 7, 2012 <sup>(3)</sup>  | 1,943,943        | 29,159,145     |              |                        | 15.00          |
| November 7, 2012                 | 9,200,000        | 138,000,000    | 4,959,720    | 835,500 <sup>(4)</sup> | 15.00          |
| December 28, 2012 <sup>(5)</sup> | 7,747            | 112,948        |              |                        | 14.58          |
| Total                            | 12,035,023       | \$ 180,522,093 | \$ 4,959,720 | 835,500                |                |

(1) Stock dividend of 33,234 shares issued on October 25, 2012 to stockholders of record on October 22, 2012. Results in average price per share of \$15.00.

(2) Issued in connection with the private placement on November 2, 2012.

(3) Issued in connection with the purchase and sale agreement with D. E. Shaw Direct Capital Portfolios, L.L.C dated November 2, 2012.

(4) Includes \$147,123 of offering expenses that were accrued on December 31, 2012.

(5) Issued in connection with stockholder distribution reinvestment.

**NOTE 6 NET INCREASE (DECREASE) IN NET ASSETS PER COMMON SHARE**

The following information sets forth the computation of net increase (decrease) in net assets resulting from operations per common share for the period from Inception through December 31, 2012.

For the period  
from May 18,  
2012  
(Inception)  
through  
December 31,  
2012

|  |              |
|--|--------------|
| Net increase in net assets resulting from operations | \$ 1,298,424 |
| Average common shares <sup>(1)</sup>                 | 12,035,023   |
| Basic and diluted earnings per common share          | \$ 0.11      |

(1) Average common shares for the period from Inception through December 31, 2012 represents the 12,035,023 shares outstanding at December 31, 2012.

## ***NOTE 7 COMMITMENTS AND CONTINGENCIES***

The Company is currently not subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us. From time to time, we may be a party to certain legal proceedings in the ordinary course of business, including proceedings relating to the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings cannot be predicted with certainty, we do not expect that these proceedings will have a material effect upon our business, financial condition or results of operations.

F-43

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2012****NOTE 8 FINANCIAL HIGHLIGHTS**

|  | For the period<br>from Inception<br>(May 18, 2012)<br>through<br>December 31,<br>2012 |
|--|---|
| Per Share Data: <sup>(1)</sup>   |   |
| Net asset value at beginning of period                                 | \$ 15.00  |
| Issuance of common shares <sup>(2)</sup>                               |   |
| Reinvestments of stockholder distributions                             | 0.01  |
| Sales load   | (0.41 )   |
| Offering costs   | (0.07 )   |
| Net investment income  | 0.11  |
| Change in unrealized depreciation                                      | (0.01 )   |
| Total from investment operations                                       | 0.10  |
| Stockholder distributions  | (0.18 )   |
| Net asset value at end of period                                       | \$ 14.45  |
| Per share market value at end of period                                | \$ 16.38  |
| Total return based on market value <sup>(3)</sup>                      | 10.48 %   |
| Shares outstanding at end of period <sup>(6)</sup>                     | 12,035,023  |
| Ratio/Supplemental Data:   |   |
| Net assets at end of period  | \$ 173,845,955  |
| Average net assets <sup>(4)</sup>                                      | \$ 173,845,955  |
| Annualized ratio of operating expenses to net assets <sup>(4)</sup>    | 5.50 %  |
| Annualized ratio of net investment income to net assets <sup>(4)</sup> | 4.99 %  |
| Portfolio Turnover <sup>(5)</sup>                                      | 35 %  |

(1) Financial highlights are based on shares outstanding as of December 31, 2012.

(2) Issuance of common shares is based on the weighted average offering price for the shares issued during the period.

(3) Total return based on market value is based on the change in market price per share assuming an investment at the initial public offering price of \$15.00 per share. Total return based on net asset value is based upon the change in net asset value per share between the opening and ending net asset values per share and the issuance of common shares in the period. The total returns are not annualized.

(4) Financial Highlights for periods of less than one year are annualized and the ratio of operating expenses to average net assets and net investment income to average net assets are adjusted accordingly. Non-recurring expenses were not annualized. For the period from Inception through December 31, 2012, the Company incurred \$1,123,518 of

non-recurring expenses. Average net assets for the period from Inception through December 31, 2012, are determined to be net assets at December 31, 2012.

(5) Calculated as payoffs divided by average portfolio balance using the periods 11/7/12, 11/30/12, and 12/31/12.

(6) Represents the shares outstanding at December 31, 2012.

## ***NOTE 9 CREDIT FACILITY***

On November 7, 2012 the Company entered into a \$156,000,000 credit facility (the Bridge Facility ) with SunTrust Bank in order to acquire the initial portfolio. To secure the Bridge Facility and certain rights and obligations under the purchase agreement for the initial portfolio, the parties entered into certain pledge and/or escrow arrangements which were pending the completion of the initial offering. Such arrangements

F-44

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TABLE OF CONTENTS

# STELLUS CAPITAL INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS December 31, 2012

### **NOTE 9 CREDIT FACILITY (continued)**

terminated upon completion of the initial offering and were replaced by the pledge and security arrangements entered into in connection with the Credit Facility described below. The Company acquired the initial portfolio for \$165,235,169 in cash and \$29,159,145 in shares of the Company's common stock based on the initial public offering price of \$15.00 per share, or \$194,394,314 in total. The Company financed the cash portion of the acquisition of the initial portfolio by (i) borrowing \$152,485,179 under the Bridge Facility and (ii) using the \$12,749,990 of proceeds received in connection with the sale of shares of our common stock in a private placement transaction to certain purchasers, including persons and entities associated with Stellus Capital, at a purchase per share equal to the initial public offering price per share. The outstanding borrowings under the Bridge Facility were repaid in full with the proceeds from the initial public offering and the facility matured on November 16, 2012 at which point it was terminated. Borrowings under the Bridge Facility accrued 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 recorded and paid interest expense of \$85,904 in total, which included \$83,115 of interest and \$2,780 of escrow and legal fees for the period ended December 31, 2012. The Company incurred and expensed costs of \$250,000 in connection with obtaining the Bridge Facility, which the Company has recorded as loan origination fees on the statement of operations for the period ended December 31, 2012.

On November 7, 2012, the Company entered into a revolving credit facility, or (the Credit Facility), with various lenders. SunTrust Bank is one of the lenders and serves as administrative agent under the Credit Facility. The Credit Facility provides for borrowings in an aggregate amount up to \$115,000,000 on a committed basis and an accordion for an additional \$35,000,000 for a total facility size of \$150,000,000. The exercise of the accordion will require sufficient borrowing base and additional commitments from the existing lender group and/or new lenders.

The Company's obligations to the lenders are secured by a first priority security interest in its portfolio of securities and cash, but excluding short term investments.

Borrowings under the Credit Facility bear interest, subject to the Company's election, on a per annum basis equal to (i) LIBOR plus 3.00% with no LIBOR floor or (ii) 2.00% plus an alternate base rate based on the highest of the Prime Rate, Federal Funds Rate plus 0.5% or one month LIBOR plus 1.0%. The Company pays unused commitment fees of 0.50% per annum on the unused lender commitments under the Credit Facility. Interest is payable quarterly in arrears. Any amounts borrowed under the Credit Facility will mature, and all accrued and unpaid interest thereunder will be due and payable, on November 12, 2016.

As of December 31, 2012, \$38,000,000 was outstanding under the Credit Facility. The carrying amount of the amount outstanding under the Credit Facility approximates its fair value. The Company incurred costs of \$2,015,415 in connection with obtaining the Credit Facility, which the Company has recorded as prepaid loan structure fees on its statement of assets and liabilities and is amortizing these fees over the life of the Credit Facility. As of December 31, 2012, \$1,947,820 of such prepaid loan structure fees have yet to be amortized.

For the period since Inception (May 18, 2012) the effective interest rate under the Credit Facility was approximately 3.6% (approximately 5.4% including commitment fees on the unused portion of the Credit Facility). Interest is paid quarterly in arrears and commenced November 30, 2012. The Company recorded interest expense of \$187,725 for the period ended December 31, 2012, of which \$61,264 related to commitment fees on the unused portion of the Credit Facility and \$6,712 related to other loan fees. The Company paid \$58,090 in interest expense for the period ended December 31, 2012. The average borrowings under the Credit Facility for the period ended December 31, 2012 were \$24,979,592.

F-45

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TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2012****NOTE 10 SELECTED QUARTERLY FINANCIAL DATA  
(UNAUDITED)**

The following table sets forth the results of operations for the period Inception through December 31, 2012. This information was derived from the Company's audited financial statements. Results for any quarter are not necessarily indicative of results for the full year or for any future quarter.

| Period Ended                     | Total Investment<br>Income (Loss) |                             | Net Investment<br>Income (Loss) |                             | Net Unrealized<br>Depreciation |                             | Net Increase in Net<br>Assets from Operations |                             |
|----------------------------------|-----------------------------------|-----------------------------|---------------------------------|-----------------------------|--------------------------------|-----------------------------|---|-----------------------------|
|                                  | Total                             | Per<br>Share <sup>(1)</sup> | Total                           | Per<br>Share <sup>(1)</sup> | Total                          | Per<br>Share <sup>(1)</sup> | Total   | Per<br>Share <sup>(1)</sup> |
| June 30, 2012                    | \$(126,628 )                      | n/a                         | \$(126,628 )                    | n/a                         |                                | n/a                         | \$(126,628 )                                  | n/a                         |
| September 31, 2012               | \$(264,993 )                      | \$(2,650)                   | \$(264,993 )                    | \$(2,650)                   |                                |                             | \$(264,993 )                                  | \$(2,650)                   |
| December 31, 2012 <sup>(2)</sup> | \$3,696,432                       | \$0.30                      | \$1,304,356                     | \$0.11                      | \$(5,932)                      | \$                          | \$1,298,424                                   | \$0.11                      |

(1) Per share amounts are calculated using shares outstanding during the period.

(2) For the period from Inception through December 31, 2012.

**NOTE 11 SUBSEQUENT EVENTS****Investment Portfolio**

Since December 31, 2012, we made investments totaling \$21.4 million in three new portfolio companies which brings the investment portfolio to \$217 million and the average investment per company to \$12 million.

**Credit Facility**

The outstanding balance under the Credit Facility as of March 5, 2013 was \$46 million due to additional borrowings subsequent to year end in order to fund new investments.

**Dividend declared**

On March 7, 2013, our board of directors declared a dividend of \$0.34 per share payable on March 28, 2013 to shareholders of record as of March 21, 2013.

TABLE OF CONTENTS

**Stellus Capital Investment Corporation**

**\$25,000,000**

**% Notes due 2019**

**PRELIMINARY PROSPECTUS**

**Keefe, Bruyette & Woods**  
*A Stifel Company*

**Janney Montgomery Scott**

**Oppenheimer & Co.**

**April , 2014**

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