

Stellus Capital Investment Corp
Form 497
August 15, 2014

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

Stellus Capital Investment Corporation

Supplement No. 1, dated August 15, 2014
to
Prospectus Supplement, dated June 5, 2014

This supplement contains information which amends, supplements or modifies certain information contained in the Prospectus of Stellus Capital Investment Corporation (the Company), dated January 30, 2014, as supplemented by the Prospectus Supplement, dated June 5, 2014. Capitalized terms used but not defined herein shall have the same meaning given them in the Prospectus Supplement or Prospectus, as applicable.

You should carefully consider the Risk Factors beginning on page S-13 the Prospectus Supplement and page 18 of the Prospectus before you decide to invest.

STATUS OF OUR OFFERING

On June 5, 2014, we established an at-the-market program to which this Supplement No. 1 and the Prospectus Supplement, dated June 5, 2014 relate, and through which we may sell, from time to time and at our sole discretion up to \$50 million of our common stock. The proceeds raised, the related underwriting fees, the offering expenses and the price at which these shares were issued from the period of June 5, 2014 through August 14, 2014 are as follows:

Fiscal Year 2014 Issuance of Common Stock	Number of Shares	Gross Proceeds	Sales Agent Commissions	Offering Expenses	Average Offering Price
Third Quarter (through August 14, 2014)	24,245	\$ 357,893	\$ 5,368	\$ 1,906	\$ 14.76
Second Quarter ended June 30, 2014	230,242	3,334,474	50,017	17,467	14.48
Total	254,487	\$3,692,367	\$ 55,385	\$ 19,373	\$ 14.51

FILING OF FORM 10-Q

On August 11, 2014, we filed our Quarterly Report on Form 10-Q (Form 10-Q) for the quarter ended June 30, 2014 with the Securities and Exchange Commission. We have attached the Form 10-Q to this supplement as Annex A.

TABLE OF CONTENTS

ANNEX A

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

FORM 10-Q

(Mark One)

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

OR

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

COMMISSION FILE NUMBER: 1-35730

STELLUS CAPITAL INVESTMENT CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Maryland
(State or other Jurisdiction of
Incorporation or Organization)

46-0937320
(I.R.S. Employer
Identification No.)

**4400 Post Oak Parkway, Suite 2200
Houston, Texas 77027**

(Address of Principal Executive Offices) (Zip Code)

(713) 292-5400

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(do not check if a smaller reporting company)

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

The number of shares of the issuer's Common Stock, \$.001 par value, outstanding as of August 1, 2014 was 12,370,099.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

<u>Item 1.</u>	1
<u>Financial Statements</u>	
<u>Consolidated Statements of Assets and Liabilities as of June 30, 2014 (unaudited) and December 31, 2013</u>	1
<u>Consolidated Statements of Operations for the three and six month periods ended June 30, 2014 and 2013 (unaudited)</u>	2
<u>Consolidated Statements of Changes in Net Assets for the six month periods ended June 30, 2014 and 2013 (unaudited)</u>	3
<u>Consolidated Statements of Cash Flows for the six month period ended June 30, 2014 and 2013 (unaudited)</u>	4
<u>Consolidated Schedules of Investments as of June 30, 2014 (unaudited) and December 31, 2013</u>	5
<u>Notes to Unaudited Consolidated Financial Statements</u>	11
<u>Item 2.</u>	33
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Item 3.</u>	46
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	
<u>Item 4.</u>	47
<u>Controls and Procedures</u>	
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1.</u>	48
<u>Legal Proceedings</u>	
<u>Item 1A.</u>	48
<u>Risk Factors</u>	
<u>Item 2</u>	51
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	
<u>Item 3.</u>	51
<u>Defaults Upon Senior Securities</u>	
<u>Item 4.</u>	51
<u>Mine Safety Disclosures</u>	
<u>Item 5.</u>	51

Other Information

Item 6.

51

Exhibits

SIGNATURES

52

i

TABLE OF CONTENTS**PART I FINANCIAL INFORMATION****STELLUS CAPITAL INVESTMENT CORPORATION****CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES**

	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Non-controlled, non-affiliated investments, at fair value (amortized cost of \$281,326,930 and \$277,004,466, respectively)	\$280,978,839	\$277,504,510
Cash and cash equivalents	10,165,883	13,663,542
Receivable for sales and repayments of investments	38,021	
Receivable for Fund shares sold	226,451	
Interest receivable	5,176,226	4,713,912
Deferred offering costs	241,617	205,165
Deferred financing costs	886,012	
Accounts receivable	31,013	
Receivable for affiliated transaction		43,450
Prepaid loan structure fees	1,367,982	1,586,405
Prepaid expenses	193,004	411,321
Total Assets	\$299,305,048	\$298,128,305
LIABILITIES		
Notes Payable	25,000,000	
Credit facility payable	91,000,000	110,000,000
Short-term loan		9,000,000
Dividends payable	1,396,677	
Base management fees payable	1,293,336	1,176,730
Incentive fees payable	2,179,258	1,056,942
Accrued offering costs	172,289	
Interest payable	397,508	234,051
Directors' fees payable		96,000
Unearned revenue	135,396	146,965
Administrative services payable	275,019	263,226
Other accrued expenses and liabilities	96,137	262,877
Total Liabilities	121,945,620	122,236,791
Commitments and contingencies (Note 7)		
Net Assets	\$177,359,428	\$175,891,514
NET ASSETS		
Common Stock, par value \$0.001 per share (100,000,000 shares authorized, 12,342,825 and 12,099,022 shares issued and outstanding,	\$12,343	\$12,099

Edgar Filing: Stellus Capital Investment Corp - Form 497

respectively)

Paid-in capital	179,068,976	175,614,738
Accumulated undistributed net realized gain	678,413	1,027,392
Distributions in excess of net investment income	(2,052,213)	(1,262,659)
Unrealized appreciation (depreciation) on investments and cash equivalents	(348,091)	499,944
Net Assets	\$177,359,428	\$175,891,514
Total Liabilities and Net Assets	\$299,305,048	\$298,128,305
Net Asset Value Per Share	\$14.37	\$14.54

See Notes to Unaudited Consolidated Financial Statements.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2014	2013	2014	2013
INVESTMENT INCOME				
Interest income	\$7,672,379	\$6,710,905	\$15,359,713	\$13,035,629
Other income	340,330	630,322	502,242	752,038
Total Investment Income	8,012,709	7,341,227	15,861,955	13,787,667
OPERATING EXPENSES				
Management fees	\$1,293,336	\$1,041,199	\$2,561,740	\$1,925,202
Valuation fees	64,498	113,710	216,137	203,710
Administrative services expenses	275,167	228,535	543,934	399,576
Incentive fees	934,740	1,068,939	1,763,832	2,055,443
Professional fees	66,038	107,516	284,027	223,462
Directors' fees	118,000	89,000	204,000	178,000
Insurance expense	120,407	118,268	239,490	235,238
Interest expense and other fees	1,352,967	718,219	2,431,922	1,284,759
Other general and administrative expenses	82,694	85,026	150,967	127,444
Total Operating Expenses	\$4,307,847	\$3,570,412	\$8,396,049	\$6,632,834
Waiver of Incentive Fees		(201,843)		(505,207)
Total expenses, net of fees waivers	4,307,847	3,368,569	8,396,049	6,127,627
Net Investment Income	\$3,704,862	\$3,972,658	\$7,465,906	\$7,660,040
Net Realized Gain on Investments and Cash Equivalents	\$325,385	\$99,995	\$437,457	\$1,002,917
Net Change in Unrealized Appreciation (Depreciation) on Investments and Cash Equivalents	\$(1,318,680)	\$404,942	\$(848,035)	\$1,346,756
Net Increase in Net Assets Resulting from Operations	\$2,711,567	\$4,477,595	\$7,055,328	\$10,009,713
Net Investment Income Per Share	\$0.31	\$0.33	\$0.62	\$0.64
Net Increase in Net Assets Resulting from Operations Per Share	\$0.22	\$0.37	\$0.58	\$0.83
Weighted Average Shares of Common Stock Outstanding	12,132,851	12,050,618	12,118,498	12,043,117
Distributions Per Share	\$0.34	\$0.34	\$0.74	\$0.68

See Notes to Unaudited Consolidated Financial Statements.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (unaudited)

	For the six months ended June 30, 2014	For the six months ended June 30, 2013
Increase in Net Assets Resulting from Operations		
Net investment income	\$7,465,906	\$7,660,040
Net realized gain on investments and cash equivalents	437,457	1,002,917
Net change in unrealized appreciation (depreciation) on investments and cash equivalents	(848,035)	1,346,756
Net Increase in Net Assets Resulting from Operations	7,055,328	10,009,713
Stockholder distributions	(9,041,896)	(8,189,000)
Capital share transactions		
Issuance of common stock	3,334,474	
Reinvestments of stockholder distributions	187,492	439,889
Sales load	(50,017)	
Offering costs	(17,467)	
Net increase in net assets resulting from capital share transactions	3,454,482	439,889
Total increase in net assets	1,467,914	2,260,602
Net assets at beginning of period	175,891,514	173,845,955
Net assets at end of period (includes \$2,061,991 and \$1,403,946 of distributions in excess of net investment income)	\$177,359,428	\$176,106,557

See Notes to Unaudited Consolidated Financial Statements.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	For the six months ended June 30, 2014	For the six months ended June 30, 2013
Cash flows from operating activities		
Net increase in net assets resulting from operations	\$7,055,328	\$ 10,009,713
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by (used in) operating activities:		
Purchases of investments	(51,538,484)	(112,467,250)
Proceeds from sales and repayments of investments	48,302,237	48,792,161
Net change in unrealized (appreciation) depreciation on investments	848,135	(1,345,238)
Increase in investments due to PIK	(363,565)	(523,926)
Amortization of premium and accretion of discount, net	(318,341)	(184,489)
Amortization of loan structure fees	296,169	
Net realized gain on investments	(442,332)	(1,005,830)
Changes in other assets and liabilities		
Increase in interest receivable	(462,314)	(1,536,774)
Amortization of deferred financing costs	28,558	
Decrease in receivable for affiliated transaction	43,450	
Increase in accounts receivable	(31,013)	
Decrease in prepaid expenses and fees	218,317	486,084
Decrease in payable for investments purchased		(4,750,000)
Increase in management fees payable	116,606	514,165
Increase (decrease) in directors' fees payable	(96,000)	59,548
Increase in incentive fees payable	1,122,316	1,250,375
Increase in administrative services payable	11,793	
Increase in interest payable	163,457	130,604
Decrease in unearned revenue	(11,569)	
Increase (decrease) in other accrued expenses and liabilities	(97,025)	319,447
Net cash provided by (used in) operating activities	4,845,723	(60,251,410)
Cash flows from financing activities		
Proceeds from notes issued	25,000,000	
Financing costs paid for notes issued	(889,742)	
Proceeds from the issuance of common stock	3,125,288	
Sales load for common stock issued	(50,017)	
Offering costs paid for common stock issued	(71,184)	(147,123)
Stockholder distributions paid	(7,457,727)	(7,749,111)

Edgar Filing: Stellus Capital Investment Corp - Form 497

Borrowings under credit facility	72,000,000	82,000,000
Repayments of credit facility	(91,000,000)	(29,000,000)
Repayments of short-term loan	(9,000,000)	(72,000,669)
Borrowings under short-term loan		35,999,625
Net cash provided by (used in) financing activities	(8,343,382)	9,102,722
Net decrease in cash and cash equivalents	(3,497,659)	(51,148,688)
Cash and cash equivalents balance at beginning of period	13,663,542	62,131,686
Cash and cash equivalents balance at end of period	\$ 10,165,883	\$ 10,982,998
Supplemental and non-cash financing activities		
Accrued deferred offering costs	172,289	
Shares issued pursuant to Dividend Reinvestment Plan	187,492	439,889
Interest expense paid	1,941,863	870,980

4

TABLE OF CONTENTS

Stellus Capital Investment Corporation

**Consolidated Schedule of Investments (unaudited)
June 30, 2014**

5

TABLE OF CONTENTS

Stellus Capital Investment Corporation

**Consolidated Schedule of Investments
(unaudited) (continued)
June 30, 2014**

6

TABLE OF CONTENTS

Stellus Capital Investment Corporation
Consolidated Schedule of Investments
(unaudited) (continued)
June 30, 2014

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

(2) The Company's obligations to the lenders of the Credit Facility are secured by a first priority security interest in all non-controlled non-affiliated investments and cash, but exclude cash equivalents, \$5,027,293 (at par) of the term loan of SQAD, LLC, \$9,750,000 (at par) of the term loan of Momentum Telecom, Inc., and \$9,750,000 (at par) of the term loan of Empirix, Inc.

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

(4) Represents a payment-in-kind security. At the option of the issuer, interest can be paid in cash or cash and PIK.

(5) The percentage of PIK shown is the maximum PIK that can be elected by the company.

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

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

(8) Security is non-income producing.

(9) Excluded from the investment above is an unfunded term loan commitment in an amount not to exceed \$4,000,000, which expires on December 31, 2014, with an interest rate of 12.25% and a maturity of May 31, 2018. This investment is accruing a commitment fee of 0.50% on the undrawn balance.

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

(11) On June 30, 2014, the interest rate on these loans was one month LIBOR of 0.16% plus the applicable spread.

(12) Excluded from the investment above is an undrawn commitment in an amount not to exceed \$900,000, an interest rate of LIBOR plus 7.50% and a maturity of September 30, 2018. This investment is accruing an unused commitment fee of 0.50% per annum.

(13) This investment also includes an unfunded equity commitment in an amount not to exceed \$145,696.

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

Abbreviation Legend

Euro Euro Dollar

L LIBOR

PIK Payment-In-Kind

TABLE OF CONTENTS

Stellus Capital Investment Corporation

**Consolidated Schedule of Investments
December 31, 2013**

8

TABLE OF CONTENTS

Stellus Capital Investment Corporation

Consolidated Schedule of Investments (continued) December 31, 2013

- (1) See Note 1 of the Notes to Financial Statements for a discussion of the methodologies used to value securities in the portfolio.
- (2) The Company's obligations to the lenders of the Credit Facility are secured by a first priority security interest in all non-controlled non-affiliated investments and cash, but exclude Cash Equivalents.
- (3) Represents a payment-in-kind security. At the option of the issuer, interest can be paid in cash or cash and PIK. The percentage of PIK shown is the maximum PIK that can be elected by the company.
- (4) The investment is not a qualifying asset under the Investment Company Act of 1940, as amended.

9

TABLE OF CONTENTS

Stellus Capital Investment Corporation

Consolidated Schedule of Investments (continued) December 31, 2013

(5) Security is non-income producing.

Excluded from the investment above is an unfunded term loan commitment in an amount not to exceed (6) \$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.

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

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

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

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

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

Abbreviation Legend

PIK Payment-In-Kind

L LIBOR

Euro Euro Dollar

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014
(Unaudited)

NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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

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

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

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

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

On June 14, 2013, we formed Stellus Capital SBIC LP or the SBIC subsidiary, and its general partner, Stellus Capital SBIC GP, LLC., as wholly owned subsidiaries of the Company, in Delaware. On June 20, 2014, the SBIC subsidiary received a license from the Small Business Administration, or SBA, to operate as a Small Business Investment Company (SBIC) under Section 301(c) of the Small Business Investment Company Act of 1958.

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

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

**NOTES TO THE CONSOLIDATED FINANCIAL
STATEMENTS**

June 30, 2014

(Unaudited)

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

debentures issued by the SBIC subsidiary upon an event of default. As of June 30, 2014, the SBIC subsidiary had not received a commitment letter from the SBA for any SBA-guaranteed debentures and, therefore, the SBIC subsidiary has not yet issued any SBA-guaranteed debentures. SBA regulations currently limit the amount that an SBIC may borrow to a maximum of \$150 million when it has at least \$75 million in regulatory capital, receives a capital commitment from the SBA and has been through an examination by the SBA subsequent to licensing. As of June 30, 2014, the SBIC subsidiary had \$31.8 million of regulatory capital, which implies a maximum borrowing of \$63.6 million, subject to the criteria discussed above.

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

Summary of Significant Accounting Policies

Basis of Presentation

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

In the opinion of management, the unaudited consolidated financial results included herein contain all adjustments, consisting solely of normal recurring accruals, considered necessary for the fair presentation of financial statements for the interim periods included herein. The results of operations for the six months ended June 30, 2014 and June 30,

2013 are not necessarily indicative of the operating results to be expected for the full year. Also, the unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2013. Certain reclassifications have been made to certain prior period balances to conform with current presentation.

In accordance with Regulation S-X under the Securities Act of 1933 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 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**.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

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

Cash and Cash Equivalents

At June 30, 2014, cash balances totaling \$9,915,883 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 Note 9).

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

Use of Estimates

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

Deferred Financing Costs

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

Deferred Offering Costs

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

Investments

As a business development company, the Company will generally invest in illiquid loans and securities including debt and equity securities of middle-market companies. Under procedures established by the board of directors, the Company intends to value investments for which market quotations are readily available at such market quotations. The Company will obtain these market values from an independent pricing service or at the 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. The Company will also engage independent valuation providers to review the valuation of each portfolio investment that does not have a readily available market quotation at least twice annually.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

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

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

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

available current market data, including relevant and applicable market trading and transaction comparables;

applicable market yields and multiples;

security covenants;

call protection provisions;

information rights;

the nature and realizable value of any collateral;

the portfolio company's ability to make payments, its earnings and discounted cash flows and the markets in which it does business;

comparisons of financial ratios of peer companies that are public;

comparable merger and acquisition transactions; and

the principal market and enterprise values.

Revenue Recognition

We record interest income on an accrual basis to the extent such interest is deemed collectible. For loans and debt securities with contractual payment-in-kind (PIK) interest, which represents contractual interest accrued and added to

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

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

**NOTES TO THE CONSOLIDATED FINANCIAL
STATEMENTS**

**June 30, 2014
(Unaudited)**

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

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

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

Payment-in-Kind Interest

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

Investment Transaction Costs

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

Receivables and Payables for Unsettled Securities Transaction

The Company records all investments on a trade date basis.

U.S. Federal Income Taxes

The Company has elected to be treated as a RIC under subchapter M of the 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 consolidated financial statements of the Company.

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

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

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

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

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

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

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

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

There was no such tax expense or benefit for the six months ended June 30, 2014 and June 30, 2013, respectively. In addition, there were no such tax assets or liabilities as of June 30, 2014 and June 30, 2013, respectively.

Earnings per Share

Basic per share calculations are computed utilizing the weighted average number of shares of common stock

outstanding for the period. The Company has no common stock equivalents. As a result, there is no difference between diluted earnings per share and basic per share amounts.

Paid In Capital

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

Recently Issued Accounting Standards

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (FASB) or other standards setting bodies that are adopted by the Company as of the specified effective date. ASU No. 2013-08 *Financial Services - Investment Companies (Topic 946): Amendments to the Scope, Measurement and Disclosure Requirements* was effective for an entity's interim and annual reporting periods in the fiscal years beginning after December 15, 2013. Accordingly, the Company has adopted the updated guidance and believes that the impact is limited to our disclosure requirements. The Company believes that the impact of recently issued standards that are not yet effective will not have a material impact on its consolidated financial statements upon adoption.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014
(Unaudited)

NOTE 2 RELATED PARTY ARRANGEMENTS

Investment Advisory Agreement

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

For the three months and six months ended June 30, 2014, the Company recorded an expense for base management fees of \$1,293,336 and \$2,561,740, respectively. For the three months and six months ended June 30, 2013, the Company recorded an expense for base management fees of \$1,041,199 and \$1,925,202, respectively. As of June 30, 2014 and December 31, 2013, respectively, \$1,293,336 and \$1,176,730, were payable to Stellus Capital.

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

Investment Income Incentive Fee

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

The foregoing incentive fee is subject to a total return requirement, which provides that no incentive fee in respect of the Company's pre-incentive fee net investment income is payable except to the extent 20.0% of the cumulative net increase in net assets resulting from operations over the then current and 11 preceding calendar quarters exceeds the cumulative incentive fees accrued and/or paid for the 11 preceding quarters. In other words, any Investment Income

Incentive Fee that is payable in a calendar quarter is limited to the lesser of (i) 20% of the amount by which the Company's pre-incentive fee net investment income for such calendar quarter exceeds the 2.0% hurdle, subject to the Catch-up, and (ii) (x) 20% of the cumulative net increase in net assets resulting from operations for the then current and 11 preceding quarters *minus* (y) the cumulative incentive fees accrued and/or paid for the 11 preceding calendar quarters. For the foregoing purpose, the cumulative net increase in net assets resulting from operations is the amount, if positive, of the sum of pre-incentive fee net investment income, realized gains and losses and unrealized appreciation and depreciation of the Company for the then current and 11 preceding calendar quarters. In addition, the Advisor is not paid the portion of such incentive fee that is attributable to deferred interest until the Company actually receives such interest in cash.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014
(Unaudited)

NOTE 2 RELATED PARTY ARRANGEMENTS (continued)

For the three and six months ended June 30, 2014, the Company incurred \$927,921 and \$1,845,948, respectively, of Investment Income Incentive Fees. As of June 30, 2014 and December 31, 2013, \$2,179,258 and \$1,056,942, respectively, of such incentive fees are payable to the Advisor, of which \$1,798,989 and \$641,516, respectively, are currently payable (as explained below). As of June 30, 2014 and December 31, 2013, \$156,918 and \$109,959, respectively, of incentive fees incurred but not paid by the Company were generated from deferred interest (i.e. PIK, certain discount accretion and deferred interest) and are not payable until such amounts are received in cash.

Capital Gains Incentive Fee

GAAP requires that the incentive fee accrual considers the cumulative aggregate realized gains and losses and unrealized capital appreciation or depreciation of investments or other financial instruments in the calculation, as an incentive fee would be payable if such realized gains and losses and unrealized capital appreciation or depreciation were realized, even though such realized gains and losses and unrealized capital appreciation or depreciation is not permitted to be considered in calculating the fee actually payable under the investment management agreement (the Capital Gains Incentive Fee). There can be no assurance that unrealized appreciation or depreciation will be realized in the future. Accordingly, such fee, as calculated and accrued, would not necessarily be payable under the investment management agreement, and may never be paid based upon the computation of incentive fees in subsequent periods.

For the three and six months ended June 30, 2014, the Company incurred \$6,819 and (\$82,116), respectively, of incentive fees related to the Capital Gains Incentive Fee. As of June 30, 2014 and December 31, 2013, \$223,351 and \$305,467 of Capital Gains Incentive Fees were payable to the Advisor, subject to the limitations set forth below.

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

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

Edgar Filing: Stellus Capital Investment Corp - Form 497

	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Investment Income Incentive Fees Incurred	\$ 927,921	\$ 967,951	\$ 1,845,948	\$ 1,586,695
Capital Gains Incentive Fee Incurred	6,819	100,988	(82,116)	468,748
Incentive Fees Incurred (before waiver)	\$ 934,740	\$ 1,068,939	\$ 1,763,832	\$ 2,055,443
Investment Income Incentive Fees Waived		(201,843)		(505,207)
Net Incentive Fee Expense	\$ 934,740	\$ 867,096	\$ 1,763,832	\$ 1,550,236

	June 30, 2014	December 31, 2013
Investment Income Incentive Fee Currently Payable	\$ 1,798,989	\$ 641,516
Investment Income Incentive Fee Deferred	156,918	109,959
Capital Gains Incentive Fee Payable	223,351	305,467
Incentive Fees Payable	\$ 2,179,258	\$ 1,056,942

18

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014
(Unaudited)

NOTE 2 RELATED PARTY ARRANGEMENTS (continued)

For the years ending December 31, 2012 and December 31, 2013, the Advisor agreed to waive its incentive fee to the extent required to support an annualized dividend yield of 9.0% (to be paid on a quarterly basis) based on the price per share of our common stock in connection with the Offering. The Advisor has entered into no such agreement with the Company for periods after December 31, 2013. While under no obligation to do so, the Advisor may, in its sole discretion, determine to waive incentive fees in future periods. For the three months and six months ended June 30, 2014, the Advisor waived Investment Income Incentive Fees of \$0 and \$0, respectively. For the three months and six months ended June 30, 2013, the Advisor waived Investment Income Incentive Fees of \$201,843 and \$505,207, respectively.

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

For the three months and six months ended June 30, 2014, the Company recorded an expense relating to director fees of \$118,000 and \$204,000, respectively. For the three months and six months ended June 30, 2013, the Company recorded an expense relating to director fees of \$89,000 and \$178,000, respectively. As of June 30, 2014 and December 31, 2013, \$0 and \$96,000, respectively, were payable relating to director fees.

We received exemptive relief from the SEC to co-invest with investment funds managed by Stellus Capital 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 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.

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.

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. For the three months and six months ended June 30, 2014 the

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

**June 30, 2014
(Unaudited)**

NOTE 2 RELATED PARTY ARRANGEMENTS (continued)

Company recorded expenses of \$148,488 and \$288,873, respectively, relating to the Administration Agreement. For the three months and six months ended June 30, 2013 the company recorded expenses of \$117,368 and \$188,799, respectively. As of June 30, 2014 and December 31, 2013, \$148,488 and \$135,170, respectively, remained payable relating to the Administration Agreement.

Indemnifications

The investment advisory agreement provides that, absent willful misfeasance, bad faith or gross negligence in the performance of its duties or by reason of the reckless disregard of its duties and obligations under the investment advisory agreement, Stellus Capital 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

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

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

Date Declared	Record Date	Payment Date	Amount Per Share
December 7, 2012 ⁽¹⁾	December 21, 2012	December 27, 2012	\$ 0.1800
March 7, 2013	March 21, 2013	March 28, 2013	\$ 0.3400
June 7, 2013	June 21, 2013	June 28, 2013	\$ 0.3400
August 21, 2013	September 5, 2013	September 27, 2013	\$ 0.3400

Edgar Filing: Stellus Capital Investment Corp - Form 497

November 22, 2013	December 9, 2013	December 23, 2013	\$ 0.3400
December 27, 2013	January 15, 2014	January 24, 2014	\$ 0.0650
January 20, 2014	January 31, 2014	February 14, 2014	\$ 0.1133
January 20, 2014	February 28, 2014	March 14, 2014	\$ 0.1133
January 20, 2014	March 31, 2014	April 15, 2014	\$ 0.1133
April 17, 2014	April 30, 2014	May 15, 2014	\$ 0.1133
April 17, 2014	May 30, 2014	June 16, 2014	\$ 0.1133
April 17, 2014	June 30, 2014	July 15, 2014	\$ 0.1133

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 the Offering and is proportionately reduced to reflect the number of days remaining in the quarter after completion of the Offering.

20

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

NOTE 3 DISTRIBUTIONS (continued)

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 \$9,041,896 made to shareholders through June 30, 2014, \$7,457,727 was made in cash, \$187,492 in 13,561 shares and the remainder of \$1,396,677 is accrued as of June 30, 2014.

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.

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2014
(Unaudited)****NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE
(continued)**

At June 30, 2014, the Company had investments in 27 portfolio companies. The total cost and fair value of the investments were \$281,326,930 and \$280,978,839, respectively. The composition of our investments as of June 30, 2014 is as follows:

	Cost	Fair Value
Senior Secured First Lien	\$ 51,503,683	\$ 51,674,288
Senior Secured Second Lien	98,851,897	100,490,139
Unsecured Debt	124,860,705	121,663,715
Equity	6,110,645	7,150,697
Total Investments	\$ 281,326,930	\$ 280,978,839

At December 31, 2013, the Company had investments in 26 portfolio companies. The total cost and fair value of the investments were \$277,004,466 and \$277,504,510, respectively. The composition of our investments as of December 31, 2013 is as follows:

	Cost	Fair Value
Senior Secured First Lien	\$ 48,341,121	\$ 48,745,767
Senior Secured Second Lien	117,166,001	118,171,725
Unsecured Debt	107,318,517	106,219,596
Equity	4,178,827	4,367,422
Total Investments	\$ 277,004,466	\$ 277,504,510

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 June 30, 2014 and December 31, 2013, the Company had four and three such investments with aggregate unfunded commitments of \$12,587,846 and \$20,942,150, 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 June 30, 2014 are as follows:

Edgar Filing: Stellus Capital Investment Corp - Form 497

		Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Senior Secured	First Lien	\$	\$	\$ 51,674,288	\$ 51,674,288
Senior Secured	Second Lien		15,553,487	84,936,652	100,490,139
Unsecured Debt				121,663,715	121,663,715
Equity				7,150,697	7,150,697
Total Investments		\$	\$ 15,553,487	\$ 265,425,352	\$ 280,978,839

22

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2014****(Unaudited)****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, 2013 are as follows:

	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Senior Secured First Lien	\$	\$ 12,104,672	\$ 36,641,095	\$ 48,745,767
Senior Secured Second Lien		21,084,272	97,087,453	118,171,725
Unsecured Debt			106,219,596	106,219,596
Equity			4,367,422	4,367,422
Total Investments	\$	\$ 33,188,944	\$ 244,315,566	\$ 277,504,510

The aggregate values of Level 3 portfolio investments changed during the six months ended June 30, 2014 are as follows:

	Senior Secured Loans First Lien	Senior Secured Loans Second Lien	Unsecured Debt	Equity	Total
Fair value at beginning of period	\$36,641,095	\$97,087,453	\$106,219,596	\$4,367,422	\$244,315,566
Purchases of investments	29,984,167	2,475,000	17,147,500	1,931,818	51,538,485
Payment-in-kind interest	54,219		309,346		363,565
Sales and Redemptions	(27,305,968)	(8,587,500)			(35,893,468)
Realized Gains	305,890	204,857			510,747
Change in unrealized depreciation included in earnings	(229,872)	674,443	(2,095,329)	851,457	(799,301)

Edgar Filing: Stellus Capital Investment Corp - Form 497

Amortization of premium and accretion of discount, net	120,085	95,182	82,602		297,869
Transfer from Level 2	12,104,672				12,104,672
Transfer to Level 2		(7,012,783)			(7,012,783)
Fair value at end of period	\$51,674,288	\$84,936,652	\$121,663,715	\$7,150,697	\$265,425,352
Change in unrealized depreciation on Level 3 investments still held as of June 30, 2014	\$18,256	\$849,661	\$(1,971,149)	\$747,127	\$(734,752)

During the six months ended June 30, 2014, there was one transfer from Level 2 to Level 3 due to the decrease in the availability of observable inputs in determining the fair value of this investment.

During the six months ended June 30, 2014, there was one transfer from Level 3 to Level 2 due to the increase in the availability of observable inputs in determining the fair value of this investment.

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

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2014
(Unaudited)****NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE
(continued)**

The aggregate values of Level 3 portfolio investments changed during the six months ended June 30, 2013 are as follows:

	Senior Secured Loans First Lien	Senior Secured Loans Second Lien	Unsecured 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	50,311,802	38,722,500			89,034,302
Payment-in-kind interest			12,692,587		12,692,587
Sales and Redemptions	(13,895,750)	(450,000)	(25,000,000)		(39,345,750)
Realized gains	6,492	6,552	903,322		916,366
Change in unrealized appreciation (depreciation) included in earnings	192,665	1,172,564	(204,884)		1,160,345
Amortization of premium and accretion of discount, net	104,550	23,592	58,200		186,342
Transfer from Level 2					
Transfer to Level 2		(12,576,571)			(12,576,571)
Fair value at end of period	\$80,733,973	\$53,376,259	\$99,574,359	\$1,714,286	\$235,398,877
Change in unrealized appreciation (depreciation) on Level 3 Investments still held as of June 30, 2013	\$192,665	\$1,172,564	\$(204,884)	\$	\$883,402

During the six months ended June 30, 2013, there were no transfers from Level 2 to Level 3.

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

The following is a summary of geographical concentration of our investment portfolio as of June 30, 2014:

Edgar Filing: Stellus Capital Investment Corp - Form 497

	Cost	Fair Value	% of Total Investments
New York	\$ 42,208,984	\$ 38,471,971	13.69 %
Colorado	32,553,026	33,287,806	11.85 %
Canada	31,101,590	31,335,162	11.15 %
Texas	24,495,762	25,011,920	8.90 %
Massachusetts	22,328,007	23,354,498	8.31 %
Minnesota	22,058,003	22,368,750	7.96 %
Alabama	17,172,755	17,298,344	6.16 %
Florida	16,910,423	16,910,423	6.02 %
Illinois	14,021,595	14,250,000	5.07 %
Indiana	14,168,790	14,210,785	5.06 %
Pennsylvania	9,690,923	9,850,000	3.51 %
New Jersey	9,972,850	9,653,574	3.44 %
Puerto Rico	8,697,439	8,554,666	3.04 %
Missouri	4,955,839	5,048,438	1.80 %
Kentucky	4,542,428	4,923,986	1.75 %
Virginia	3,972,061	3,972,061	1.41 %
Tennessee	2,476,455	2,476,455	0.88 %
	\$ 281,326,930	\$ 280,978,839	100.00 %

24

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2014****(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, 2013:

	Cost	Fair Value	% of Total Investments	
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	%
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 industry concentration of our investment portfolio as of June 30, 2014:

	Cost	Fair Value	% of Total Investments	
Software	\$ 37,124,865	\$ 38,354,498	13.65	%
Healthcare & Pharmaceuticals	35,732,282	36,146,222	12.86	%
High Tech Industries	35,439,534	35,667,939	12.69	%
Media: Broadcasting & Subscription	27,578,948	27,887,108	9.92	%
Finance	26,354,788	26,872,010	9.56	%

Edgar Filing: Stellus Capital Investment Corp - Form 497

Telecommunications	18,753,456	19,104,674	6.80	%
Transportation: Cargo	17,891,040	18,082,695	6.44	%
Services: Business	16,910,423	16,910,423	6.02	%
Beverage, Food, & Tobacco	12,779,328	13,065,000	4.65	%
Consumer Goods: Non-Durable	9,690,923	9,850,000	3.51	%
Retail	9,972,850	9,653,574	3.44	%
Services: Consumer	13,200,354	8,966,881	3.20	%
Transportation & Logistics	5,961,401	6,045,313	2.15	%
Metals & Mining	4,542,428	4,923,986	1.75	%
Services: Government	3,972,061	3,972,061	1.41	%
Energy: Oil & Gas	2,945,794	3,000,000	1.07	%
Construction & Building	2,476,455	2,476,455	0.88	%
	\$ 281,326,930	\$ 280,978,839	100.00	%

25

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2014****(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, 2013:

	Cost	Fair Value	% of Total 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	%
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	%

The following provides quantitative information about Level 3 fair value measurements as of June 30, 2014:

Description:	Fair Value	Valuation Technique	Unobservable Inputs	Range (Average) ⁽¹⁾⁽³⁾
First lien debt	\$51,674,288	Income/Market approach ⁽²⁾	HY credit spreads Risk free rates Market multiples	-1.89 to 1.41 (-0.26%) -0.37 to 0.08 (-0.11%) 8x to 17x (11x) ⁽⁴⁾
Second lien debt	\$84,936,652			

Edgar Filing: Stellus Capital Investment Corp - Form 497

		Income/Market approach ⁽²⁾	HY credit spreads Risk free rates Market multiples	-1.72 to 0.72 (-0.85%) -0.38 to 0.25 (-0.13%) 8x to 18x (14x) ⁽⁴⁾ -3.12 to 0.75 (-1.19%)
Unsecured debt	\$121,663,715	Income/Market approach ⁽²⁾	HY credit spreads Risk free rates Market multiples	-0.50 to 0.44 (-0.02%) 9x to 18x (12x) ⁽⁴⁾
Equity investments	\$7,150,697	Market approach ⁽⁵⁾	Underwriting multiple/ EBITDA Multiple	2x to 13x (9x)
Total Long Term Level 3 Investments	\$265,425,352			

(1) Weighted average based on fair value as of June 30, 2014.

- (2) Inclusive of but not limited to (a) the market approach which is used to determine sufficient enterprise value, and (b) the income approach which is based on discounting future cash flows using an appropriate market yield. 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 -1.89% (189 basis points) to 1.41% (141 basis points). The average of all changes was -0.26%.

26

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2014
(Unaudited)****NOTE 4 PORTFOLIO INVESTMENTS AND FAIR VALUE
(continued)**

(4) Median of LTM (last twelve months) EBITDA multiples of comparable companies.

The primary significant unobservable input used for 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

(5) 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, 2013:

Description:	Fair Value	Valuation Technique	Unobservable Inputs	Range (Average) ⁽¹⁾⁽³⁾
First lien debt	\$36,641,095	Income/Market approach ⁽²⁾	HY credit spreads Risk free rates Market multiples	-1.58% to .46% (-.95%) .00% to .17% (.04%) 8x to 14x (10x) ⁽⁴⁾ -1.41% to 1.40% (-.68%)
Second lien debt	\$97,087,453	Income/Market approach ⁽²⁾	HY credit spreads Risk free rates Market multiples	.04% to .81% (.21%) 8x to 18x (13x) ⁽⁴⁾ -1.27% to 2.79% (-.27%)
Unsecured debt	\$106,219,596	Income/Market approach ⁽²⁾	HY credit spreads Risk free rates Market multiples	-.42% to .62% (.15%) 8x to 23x (14x) ⁽⁴⁾
Equity investments	\$4,367,422			5x to 13x (12x)

	Market approach ⁽⁵⁾	Underwriting multiple/ EBITDA Multiple
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 (a) the market approach which is used to determine sufficient enterprise value, and (b) the income approach which is based on discounting future cash flows using an appropriate market yield. 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 High Yield spreads and the risk free rates 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% (-95 basis points).

(4) Median of LTM EBITDA multiples of comparable companies.

- 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
- (5) 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.

27

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2014
(Unaudited)****NOTE 5 EQUITY OFFERINGS AND RELATED EXPENSES**

On June 5, 2014, we established an at-the-market program through which we may sell, from time to time and at our sole discretion \$50 million of our common stock. The proceeds raised, the related underwriting fees, the offering expenses and the price at which these shares were issued from the period of June 5, 2014 through June 30, 2014 are as follows:

Issuance of Common Stock	Number of Shares	Gross Proceeds	Underwriting fees	Offering Expenses	Average Offering Price
Quarter ended June 30, 2014	230,242	\$ 3,334,474	\$ 50,017	\$ 17,467	\$ 14.48
Total	230,242	\$ 3,334,474	\$ 50,017	\$ 17,467	\$ 14.48

The Company issued 13,561 shares of common stock during the six months ended June 30, 2014 in connection with the stockholder distribution reinvestment.

Issuance of Common Stock	Number of Shares	Gross Proceeds	Share Price
January 24, 2014	2,603	\$ 36,619	\$ 14.07
February 14, 2014	4,646	64,121	13.80
March 14, 2014	3,257	45,233	13.89
June 16, 2014	3,055	41,519	13.59
Total	13,561	\$ 187,492	

The Company issued 30,996 shares of common stock during the six months ended June 30, 2013 in connection with the stockholder distribution reinvestment.

Issuance of Common Stock	Number of Shares	Gross Proceeds	Share Price
March 28, 2013	15,249	\$ 214,706	\$ 14.08
June 28, 2013	15,747	\$ 225,182	\$ 14.30
Total	30,996	\$ 439,888	

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 months ended and six months ended June 30, 2014 and June 30, 2013.

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Net increase in net assets resulting from operations	\$2,711,567	\$4,477,595	\$7,055,328	\$10,009,713
Average common shares	12,132,851	12,050,618	12,118,498	12,043,117
Basic and diluted earnings per common share	\$0.22	\$0.37	\$0.58	\$0.83

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.

TABLE OF CONTENTS**STELLUS CAPITAL INVESTMENT CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2014
(Unaudited)****NOTE 7 COMMITMENTS AND CONTINGENCIES (continued)**

As of June 30, 2014, the Company had \$12.6 million of unfunded commitments, \$12.4 million was to provide debt financing to three of our portfolio companies and \$0.2 million was to provide equity financing to one portfolio company. As of December 31, 2013 the Company had \$20.9 million of unfunded commitments, which was comprised of \$20.9 million to provide debt financing to three of our portfolio companies.

NOTE 8 FINANCIAL HIGHLIGHTS

	For the six months ended June 30, 2014 (unaudited)	For the six months ended June 30, 2013 (unaudited)
Per Share Data: ⁽¹⁾		
Net asset value at beginning of period	\$ 14.54	\$ 14.45
Net investment income	0.62	0.64
Change in unrealized appreciation (depreciation)	(0.07)	0.11
Realized gain	0.03	0.08
Total from investment operations	0.58	0.83
Issuance of common shares ⁽²⁾		
Reinvestments of stockholder distributions ⁽²⁾		
Sales load ⁽²⁾		
Offering costs ⁽²⁾		
Stockholder distributions	(0.74)	(0.68)
Other ⁽³⁾	(0.01)	
Net asset value at end of period	\$ 14.37	\$ 14.60
Per share market value at end of period	\$ 14.69	\$ 15.05
Total return based on market value ⁽⁴⁾	2.88 %	(3.66)%
Weighted average shares outstanding at end of period	12,118,498	12,043,117
Ratio/Supplemental Data:		
Net assets at end of period	\$ 177,359,428	\$ 176,106,557
Average net assets ⁽⁵⁾	\$ 175,695,028	\$ 174,715,502
Annualized ratio of gross operating expenses to net assets ⁽⁵⁾⁽⁸⁾	9.64 %	7.66 %

Edgar Filing: Stellus Capital Investment Corp - Form 497

Annualized ratio of net operating expenses to net assets ⁽⁵⁾⁽⁹⁾	9.64	%	7.07	%
Annualized ratio of interest expense and other fees to net assets ⁽⁵⁾	2.79	%	1.48	%
Annualized ratio of net investment income before fee waiver to net assets ⁽⁵⁾	8.56	%	8.26	%
Annualized ratio of net investment income to net assets ⁽⁵⁾	8.56	%	8.84	%
Portfolio Turnover ⁽⁶⁾	17	%	21	%
Notes payable	\$25,000,000			
Credit Facility payable	\$91,000,000		\$91,000,000	
Short-term loan			\$8,999,899	
Asset coverage ratio ⁽⁷⁾	2.53x		2.76x	

(1) Financial highlights are based on weighted average shares outstanding during the period.

(2) The per share impact of the Company's issuance of common shares, reinvestment of stockholder distributions, sales load and offering costs has an impact to net assets less than \$0.01 per share during the applicable period.

29

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014
(Unaudited)

NOTE 8 FINANCIAL HIGHLIGHTS (continued)

Includes the impact of different share amounts as a result of calculating certain per share data based on weighted (3) average shares outstanding during the period and certain per share data based on the shares outstanding as of period end or a transaction date.

(4) Total return on market value is based on the change in market price per share since the end of the prior year 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 (5) net assets, net investment income to average net assets and interest expense and other fees to net assets are adjusted accordingly.

(6) Calculated as payoffs divided by average portfolio balance and is not annualized.

(7) Asset coverage ratio is equal to (i) the sum of (a) net assets at the end of the period and (b) total debt outstanding at the end of the period, divided by (ii) total debt outstanding at the end of the period.

(8) Gross operating expenses represent operating expenses before waiver of incentive fees.

(9) Net Operating expenses represent total operating expenses net of waiver of incentive fees.

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. On May 16, 2014, the Company exercised the remainder of the accordion feature under its Credit Facility and received an additional commitments from a new participant in the bank group in the amount of \$15,000,000, which increased the total commitment to \$150,000,000 under the Credit Facility.

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 June 30, 2014, 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 June 30, 2014 and December 31, 2013, \$91,000,000 and \$110,000,000 was outstanding under the Credit Facility, respectively. The carrying amount of the amount outstanding under the Credit Facility approximates its fair value. During the year ended December 31, 2013, the Company incurred costs of \$113,384 in connection with the \$20,000,000 commitment increase. During the quarter ended June 30, 2014, the Company incurred additional costs of \$77,748 in connection with the final \$15,000,000 commitment increase. As of June 30, 2014 and December 31, 2013, \$1,367,982 and \$1,586,405 of such prepaid loan structure fees had yet to be amortized, respectively.

For the three months ended June 30, 2014, the weighted average effective interest rate under the Credit Facility was approximately 3.2% (approximately 3.9% including commitment fees and other loan fees).

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

**NOTES TO THE CONSOLIDATED FINANCIAL
STATEMENTS**

**June 30, 2014
(Unaudited)**

NOTE 9 CREDIT FACILITY (continued)

Interest is paid quarterly in arrears. The Company recorded interest and fee expense on the Credit Facility of \$1,071,632 for the three months ended June 30, 2014, of which \$876,204 was interest expense, \$138,814 was amortization of loan fees paid on the Credit Facility, \$44,182 related to commitment fees on the unused portion of the Credit Facility, and \$12,432 related to loan administration fees. The Company paid \$1,036,513 in interest expense and unused commitment fees for the three months ended June 30, 2014. The average borrowings under the Credit Facility for the three months ended June 30, 2014 were \$109,273,352.

For the six months ended June 30, 2014, the weighted average effective interest rate under the Credit Facility was approximately 3.2% (approximately 3.9% including commitment fees and other loan fees). Interest is paid quarterly in arrears. The Company recorded interest and fee expense on the credit facility of \$2,150,586 for the six months ended June 30, 2014, of which \$1,783,179 was interest expense, \$271,442 was amortization of loan fees paid on the Credit Facility, \$71,238 related to commitment fees on the unused portion of the Credit Facility, and \$24,727 related to loan administration fees. The Company paid \$1,941,863 in interest expense and unused commitment fees for the six months ended June 30, 2014. The average borrowings under the Credit Facility for the six months ended June 30, 2014 were \$111,303,177.

For the three months ended June 30, 2013 the weighted average effective interest rate under the Credit Facility was approximately 3.3% (approximately 4.7% including commitment fees and other loan fees). Interest is paid quarterly in arrears. The Company recorded interest and fee expense of \$718,219 for the three months ended June 30, 2013, of which \$512,790 was interest expense, \$125,532 was amortization of loan fees paid on the Credit Facility, \$67,430 related to commitment fees on the unused portion of the Credit Facility and \$12,467 related to loan administration fees.

For the six months ended June 30, 2013, weighted average the effective interest rate under the Credit Facility was approximately 3.3% (approximately 5.0% including commitment fees and other loan fees). Interest is paid quarterly in arrears. The Company recorded interest and fee expense of \$1,284,759 for the six months ended June 30, 2013, of which \$849,668 was interest expense, \$249,685 was amortization of loan fees paid on the Credit Facility, \$160,611 related to commitment fees on the unused portion of the Credit Facility, and \$24,795 related to loan administration fees. The Company paid \$548,126 and \$870,980 in interest expense and unused commitment fees for the three and six months ended June 30, 2013, respectively. The average borrowings under the Credit Facility for the three and six months ended June 30, 2013 were \$61,648,352 and \$51,110,497, respectively.

NOTE 10 NOTES

On May 5, 2014, the Company closed a public offering of \$25.0 million in aggregate principal amount of 6.50% notes (the Notes). The Notes mature on April 30, 2019, and may be redeemed in whole or in part at any time or from time to time at the Company's option on or after April 30, 2016. The Notes bear interest at a rate of 6.50% per year payable quarterly on February 15, May 15, August 15 and November 15, of each year, beginning August 15, 2014. The net proceeds to the Company from the sale of the Notes, after underwriting discounts and offering expenses, were approximately \$24.1 million. The Company used all of the net proceeds from this offering to repay a portion of the amount outstanding under the Credit Facility. As of June 30, 2014, the carrying amount of the Notes was approximately \$25.0 million. As of June 30, 2014 the fair value of the Notes was \$26.4 million. The Company has listed the Notes on New York Stock Exchange under the trading symbol SCQ. The fair value of the Notes are based on the closing price of the security, which is a Level 2 input under ASC 820 due to the trading volume.

In connection with the issuance of the Notes, we incurred \$914,570 of fees which are being amortized over the term of the notes of which \$886,012 remains to be amortized and is included within deferred financing costs on the consolidated statements of assets and liabilities.

TABLE OF CONTENTS

STELLUS CAPITAL INVESTMENT CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014
(Unaudited)

NOTE 10 NOTES (continued)

For the period from May 5, 2014 to June 30, 2014, the Company incurred interest and fee expense on the Notes of \$281,336, of which \$252,778 was interest expense, \$28,299 was amortization of loan fees paid on the Notes, and \$259 related to administration fees.

The indenture and supplements thereto relating to the Notes contain certain covenants, including but not limited to (i) a requirement that the Company comply with the asset coverage requirements of the 1940 Act or any successor provisions, and (ii) a requirement to provide financial information to the holders of the notes and the trustee under the indenture if the Company should no longer be subject to the reporting requirements under the Securities Exchange Act of 1934, as amended.

NOTE 11 SUBSEQUENT EVENTS

Investment Portfolio

On July 31, 2014, we invested \$2 million in the mezzanine debt and \$137,000 in the common stock of SQAD, LLC.

Credit Facility

The outstanding balance under the Credit Facility as of August 1, 2014 was \$87 million.

Dividends Declared

On July 7, 2014, the Company's board of directors declared a regular monthly dividend for each of July 2014, August 2014 and September 2014 as follows:

Description:	Ex-Dividend Date	Record Date	Payment Date	Amount per Share
7/7/2014	7/29/2014	7/31/2014	8/15/2014	\$ 0.1133
7/7/2014	8/27/2014	8/29/2014	9/15/2014	\$ 0.1133
7/7/2014	9/26/2014	9/30/2014	10/15/2014	\$ 0.1133

Equity Raised

During the period from July 1, 2014 to August 1, 2014, we sold 24,245 shares of our common stock at an average price of \$14.76 per share and raised \$357,893 of gross proceeds under the at-the-market program. Net proceeds were \$350,619 after 1.5% commission to the broker-dealer on shares sold and offering costs.

TABLE OF CONTENTS

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

Some of the statements in this quarterly report on Form 10-Q constitute forward-looking statements, which relate to future events or our future performance or financial condition. The forward-looking statements contained in this quarterly report on Form 10-Q 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 maintain our qualification as a RIC and as a BDC; 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 quarterly report on Form 10-Q on information available to us on the date of this quarterly report on Form 10-Q. 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 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.

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.

TABLE OF CONTENTS

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.

We have elected to be treated for tax purposes as a regulated investment company, or RIC, under Subchapter M of the Internal Revenue Code, or 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 June 30, 2014, 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 June 30, 2014, we had \$281.0 million (at fair value) invested in 27 companies. As of June 30, 2014, our portfolio included approximately 18% of first lien debt, 36% of second lien debt, 43% of mezzanine debt and 3% of equity investments at fair value. The composition of our investments at cost and fair value as of June 30, 2014 was as follows:

	Cost	Fair Value
Senior Secured First Lien	\$ 51,503,683	\$ 51,674,288
Senior Secured Second Lien	98,851,897	100,490,139
Unsecured Debt	124,860,705	121,663,715
Equity	6,110,645	7,150,697
Total Investments	\$ 281,326,930	\$ 280,978,839

As of December 31, 2013, we had \$277.5 million (at fair value) invested in 26 portfolio 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. The composition of our investments at cost and fair value as of December 31, 2013 was as follows:

	Cost	Fair Value
Senior Secured First Lien	\$ 48,341,121	\$ 48,745,767
Senior Secured Second Lien	117,166,001	118,171,725
Unsecured Debt	107,318,517	106,219,596
Equity	4,178,827	4,367,422
Total Investments	\$ 277,004,466	\$ 277,504,510

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 June 30, 2014 and December 31, 2013, the Company had four and three such investments with aggregate unfunded commitments of \$12.6 million and \$20.9 million, respectively.

TABLE OF CONTENTS

The following is a summary of geographical concentration of our investment portfolio as of June 30, 2014:

	Cost	Fair Value	% of Total Investments	
New York	\$ 42,208,984	\$ 38,471,971	13.69	%
Colorado	32,553,026	33,287,806	11.85	%
Canada	31,101,590	31,335,162	11.15	%
Texas	24,495,762	25,011,920	8.90	%
Massachusetts	22,328,007	23,354,498	8.31	%
Minnesota	22,058,003	22,368,750	7.96	%
Alabama	17,172,755	17,298,344	6.16	%
Florida	16,910,423	16,910,423	6.02	%
Illinois	14,021,595	14,250,000	5.07	%
Indiana	14,168,790	14,210,784	5.06	%
Pennsylvania	9,690,923	9,850,000	3.51	%
New Jersey	9,972,850	9,653,574	3.44	%
Puerto Rico	8,697,439	8,554,666	3.04	%
Missouri	4,955,839	5,048,438	1.80	%
Kentucky	4,542,428	4,923,986	1.75	%
Virginia	3,972,061	3,972,061	1.41	%
Tennessee	2,476,455	2,476,455	0.88	%
	\$ 281,326,930	\$ 280,978,839	100.00	%

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

	Cost	Fair Value	% of Total Investments	
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	%
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	%

TABLE OF CONTENTS

The following is a summary of industry concentration of our investment portfolio as of June 30, 2014:

	Cost	Fair Value	% of Total Investments	
Software	\$ 37,124,865	\$ 33,354,498	13.65	%
Healthcare & Pharmaceuticals	35,732,282	36,146,222	12.86	%
High Tech Industries	35,439,534	35,667,939	12.69	%
Media: Broadcasting and Subscription	27,578,948	27,887,108	9.92	%
Finance	26,354,788	26,872,010	9.56	%
Telecommunications	18,753,456	19,104,674	6.80	%
Transportation: Cargo	17,891,040	18,082,695	6.44	%
Services: Business	16,910,423	16,910,423	6.02	%
Beverage, Food, & Tobacco	12,779,328	13,065,000	4.65	%
Consumer goods: non-durable	9,690,923	9,850,000	3.51	%
Retail	9,972,850	9,653,574	3.44	%
Services: Consumer	13,200,354	8,966,881	3.20	%
Transportation & Logistics	5,961,401	6,045,313	2.15	%
Metals & Mining	4,542,428	4,923,986	1.75	%
Services: Government	3,972,061	3,972,061	1.41	%
Energy: Oil & Gas	2,945,794	3,000,000	1.07	%
Construction & Building	2,476,455	2,476,455	0.88	%
	\$ 281,326,930	\$ 280,978,839	100.00	%

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

	Cost	Fair Value	% of Total 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	%
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	%

At June 30, 2014, our average portfolio company investment at amortized cost and fair value was approximately \$10.4 million and \$10.4 million, respectively, and our largest portfolio company investment by amortized cost and fair value was approximately \$22.3 million and \$23.4 million, respectively. 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.

TABLE OF CONTENTS

At June 30, 2014, 53% of our debt investments bore interest based on floating rates (subject to interest rate floors), such as LIBOR, and 47% bore interest at fixed rates. 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.

The weighted average yield on all of our debt investments as of June 30, 2014 and December 31, 2013 was approximately 10.9% and 11.4%, 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 June 30, 2014 and December 31, 2013, we had cash of \$10.2 million and \$3.7 million, respectively, and United States Treasury securities of approximately \$0 million and \$10.0 million, respectively. The United States Treasury securities were purchased and temporarily held in 2013 in connection with complying with RIC diversification requirements under Subchapter M of the Code.

Investment Activity

During the quarter ended June 30, 2014, we made \$11.0 million of investments in one new portfolio company and four existing portfolio companies. During the six months ended June 30, 2014, we made \$51.5 million of investments in six new portfolio and four existing portfolio companies. During the quarter ended June 30, 2014, we received \$25.9 million in proceeds from repayments and sales of our investments, including \$0.3 million from amortization of certain other investments. During the six months ended June 30, 2014, we received \$48.3 million in proceeds from repayments and sales of our investments, including \$0.8 million from amortization of certain other investments.

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

37

TABLE OF CONTENTS

Investment Rating	As of June 30, 2014			As of December 31, 2013		
	Fair Value	% of Total Portfolio	Number of Portfolio Companies	Fair Value	% of Total Portfolio	Number of Portfolio Companies
1	\$	0 %		\$ 21.1	8 %	2
2	253.8	90 %	24	236.6	85 %	22
3	18.2	7 %	2	8.4	3 %	1
4	9.0	3 %	1	11.4	4 %	1
5		0 %			0 %	
Total	\$ 281.0	100 %	27	\$ 277.5	100 %	26

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 June 30, 2014, we had one loan on non-accrual status, which represents approximately 4.7% of the loan portfolio at cost and 3.2% at fair value. As of December 31, 2013, we had no loans on non-accrual status.

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 Three Months and Six Months ended June 30, 2014 and 2013**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.

Investment income for the three months ended June 30, 2014 totaled \$8.0 million and was primarily composed of interest income, including \$0.1 million of PIK income and \$0.3 million of miscellaneous fees. Investment income for the six months ended June 30, 2014 totaled \$15.9 million and was primarily composed of interest income, including

\$0.4 million of PIK income and \$0.5 million of miscellaneous fees.

Investment income for the three months ended June 30, 2013 totaled \$7.3 million and was primarily composed of interest income, including \$0.3 million of PIK income and \$0.6 million of miscellaneous fees. Investment income for the six months ended June 30, 2013 totaled \$13.8 million and was primarily composed of interest income, including \$0.5 million of PIK income and \$0.8 million of miscellaneous fees.

The increases in investment income from the respective periods were due to the growth in the overall investment portfolio.

Expenses

Our primary operating expenses include the payment of fees to Stellus Capital Management, LLC (Stellus Capital or the Adviser) under the investment advisory agreement, our allocable portion of

TABLE OF CONTENTS

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; 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 for the three and six months ended June 30, 2014 totaled \$4.3 million and \$8.4 million, respectively. Operating expenses, net of fee waiver totaled \$3.4 million and \$6.1 million for the three and six months ended June 30, 2013. Operating expenses, net of fee 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 increase in operating expenses resulted from an increase in interest expense due to increased borrowings under the Credit Facility and the issuance of the Notes.

For the three and six months ended June 30, 2014, the Company incurred base management fees payable to the Advisor of \$1.3 million and \$2.6 million, respectively, as provided for in the investment advisory agreement. For the three and six months ended June 30, 2013, the Company incurred base management fees payable to the Advisor of \$1.0 million and \$1.9 million, respectively.

For the three and six months ended June 30, 2014, the Company incurred incentive fees totaling \$0.9 million and \$1.8 million, respectively. For the three and six months ended June 30, 2013, the Company incurred incentive fees totaling \$1.1 million and \$2.1 million, respectively. The Company's incentive fee expense includes an accrual relating to the Capital Gains Incentive Fee, as defined in Note 2. For the three and six months ended June 30, 2014, the Company incurred \$7 thousand and (\$82) thousand, respectively, of incentive fees related to the Capital Gains Incentive Fee.

For the three and six months ended June 30, 2013, the Company incurred \$101 thousand and \$469 thousand, respectively, of incentive fees related to the Capital Gains Incentive Fee.

For the three and six months ending June 30, 2013, the Advisor agreed to waive its incentive fee to the extent required to support an annualized dividend yield of 9.0% based on the price per share of our common stock of \$15.00, the price to the public in our initial public offering. The Advisor has entered into no such agreement with the Company for periods subsequent to December 31, 2013. While under no obligation to do so, the Advisor may, in its sole discretion determine to waive incentive fees in future periods. For the three and six months ended June 30, 2014, the Advisor waived no incentive fees related to pre-incentive fee net

TABLE OF CONTENTS

income. For the three and six months ended June 30, 2013, the Advisor waived \$0.2 million and \$0.5 million of incentive fees related to pre-incentive fee net investment income, respectively.

Borrowings under the Credit Facility were \$91.0 million and \$110.0 million as of June 30, 2014 and December 31, 2013, respectively.

For the three months ended June 30, 2014, the Company recorded interest expense and other fees of \$1.4 million, of which \$0.9 million was interest and commitment fees on the Credit Facility, \$253 thousand was interest on the Notes, \$151 thousand was administration fees and amortization of the loan fees paid on the Credit Facility, and \$28 thousand was administration and amortization of the loan fees and paid on the Notes. The Company paid \$1.0 million in interest expense for the three months ended June 30, 2014.

For the six months ended June 30, 2014, the Company recorded interest expense and other fees of \$2.4 million, of which \$1.9 million was interest and commitment fees on the Credit Facility, \$253 thousand was interest on the Notes, \$296 thousand was administration fees and amortization of the loan fees paid on the Credit Facility, and \$28 thousand was amortization of the loan fees paid on the Notes. The Company paid \$1.9 million in interest expense for the six months ended June 30, 2014.

For the three months ended June 30, 2013, the Company recorded interest and fee expense of \$0.7 million for the three months ended June 30, 2014, of which \$0.6 million was interest and commitment fees on the Credit Facility and \$138 thousand was administration fees and amortization of loan fees paid on the Credit Facility. The Company paid \$0.5 million in interest expense for the three months ended June 30, 2014.

For the six months ended June 30, 2013, the Company recorded interest and fee expense of \$1.3 million for the six months ended June 30, 2014, of which \$1.0 million was interest and commitment fees on the Credit Facility and \$274 thousand was administration fees and amortization of loan fees paid on the Credit Facility. The Company paid \$0.9 million in interest expense for the six months ended June 30, 2014.

Administrative expenses for the three months ended June 30, 2014 totaled \$275 thousand, \$127 thousand of which was related to our third party administrator and \$148 thousand of which was allocated to us from Stellus Capital.

Administrative expenses for the six months ended June 30, 2014 totaled \$544 thousand, \$255 thousand of which was related to our third party administrator and \$289 thousand of which was allocated to us from Stellus Capital.

Administrative expenses for the three months ended June 30, 2013 totaled \$228 thousand, \$111 thousand of which was related to our third party administrator and \$117 million of which was allocated to us from Stellus Capital.

Expenses for valuation, professional fees, insurance expenses, and directors fees and other general and administrative expense for the three and six months ended June 30, 2014 totaled \$0.5 million and \$1.1 million, respectively.

Expenses for valuation, professional fees, insurance expenses, and directors fees and other general and administrative expense for both the three and six months ended June 30, 2013 totaled \$0.1 million.

Net Investment Income

For the three months ended June 30, 2014, net investment income was \$3.7 million, or \$0.31 per common share (based on 12,132,851 weighted-average common shares outstanding at June 30, 2014). Net investment income includes expense accruals of \$7 thousand of incentive fees related to realized and unrealized gains.

For the three months ended June 30, 2013, net investment income was \$4.0 million, or \$0.33 per common share (based on 12,050,618 weighted-average common shares outstanding at June 30, 2013). Net investment income included expense accruals of \$101 thousand of incentive fees related to realized and unrealized gains.

Edgar Filing: Stellus Capital Investment Corp - Form 497

For the six months ended June 30, 2014, net investment income was \$7.5 million, or \$0.62 per common share (based on 12,118,498 weighted-average shares outstanding at June 30, 2014). Net investment income includes expense accruals of (\$82) thousand of incentive fees related to realized and unrealized gains.

For the six months ended June 30, 2013, net investment income was \$7.7 million, or \$0.64 per common share (based on 12,043,117 weighted-average common shares outstanding at June 30, 2013). Net investment income included accruals of \$469 thousand of incentive fees related to realized and unrealized capital gains.

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 June 30, 2014 totaled \$25.9 million and net realized gains totaled \$0.3 million.

Repayments of investments and amortization of other certain investments for the three months ended June 30, 2013 totaled \$23.8 million and net realized gains totaled \$0.1 million.

Repayments of investments and amortization of other certain investments for the six months ended June 30, 2014 totaled \$48.3 million and net realized gains totaled \$0.4 million.

Repayments of investments and amortization of other certain investments for the six months ended June 30, 2013 totaled \$49.0 million and net realized gains totaled \$1.0 million.

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.

Net change in unrealized appreciation (depreciation) on investments and cash equivalents for the three months ended June 30, 2014 and 2013 totaled (\$1.3) million and \$0.4 million, respectively.

Net change in unrealized appreciation (depreciation) on investments and cash equivalents for the six months ended June 30, 2014 and 2013 totaled (\$0.8) million and \$1.3 million, respectively.

The change in unrealized appreciation (depreciation) was due primarily to unrealized depreciation on our one non-accrual investment and was partially offset by net unrealized appreciation on other investments in the portfolio due to a tightening of market interest rate spreads.

Net Increase in Net Assets Resulting from Operations

For the three months ended June 30, 2014, net increase in net assets resulting from operations totaled \$2.7 million, or \$0.22 per common share (based on 12,132,851 weighted-average common shares outstanding at June 30, 2014).

For the three months ended June 31, 2013, net increase in net assets resulting from operations totaled \$4.5 million, or \$0.37 per common share (based on 12,050,618 weighted-average common shares outstanding at June 30, 2013).

For the six months ended June 30, 2014, net increase in net assets resulting from operations totaled \$7.1 million, or \$0.58 per common share (based on 12,118,498 weighted-average common shares outstanding at June 30, 2013).

For the six months ended June 30, 2013, net increase in net assets resulting from operations totaled \$10.0 million, or \$0.83 per common share (based on 12,043,117 weighted-average common shares resulting from operations at June 30, 2013).

The decline in net increase in net assets resulting from operations was due primarily to unrealized depreciation on our one non-accrual investment which was partially offset by realized gains and unrealized appreciation on other investments in the portfolio due to a tightening of market interest rate spreads.

Financial condition, liquidity and capital resources

Cash Flows from Operating and Financing Activities

Our operating activities provided cash of \$4.8 million for the six months ended June 30, 2014, primarily in connection with cash interest received and the net repayment of our investments. Our financing activities for the six months ended June 30, 2014 used cash of \$8.3 million primarily from net repayments under the Credit Facility.

TABLE OF CONTENTS

Our operating activities used cash of \$60.3 million for the six months ended June 30, 2013, primarily in connection with purchase of portfolio investments. Our financing activities for the six months ended June 30, 2013 provided cash of \$9.1 million primarily from additional borrowings under the Credit Facility.

Our liquidity and capital resources are derived from the Credit Facility and Notes 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 2014 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) June 7, 2015, the one year anniversary of our 2014 Annual Meeting of Stockholders, or (ii) the date of our 2015 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.

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 June 30, 2014 and December 31, 2013 our asset coverage ratio was 253% and 248%, 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 June 30, 2014 and December 31, 2013, we had cash of \$10.2 million and \$13.6 million, respectively, and United States Treasury securities of approximately \$0 million and \$10.0 million, respectively.

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. On May 16, 2014, the Company exercised the remainder of the accordion feature under its Credit Facility and received an additional commitments from a new participant in the bank group in the amount of \$15,000,000 which increased the total commitment to \$150,000,000 under the facility.

TABLE OF CONTENTS

Borrowings under the Credit Facility generally bear interest at LIBOR plus 3.00%. 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.

As of June 30, 2014 and December 31, 2013, \$91 million and \$110 million was outstanding under the Credit Facility, respectively. 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. During the year ended December 31, 2013, the Company incurred costs of \$113,384 in connection with the \$20,000,000 commitment increase. During the quarter ended June 30, 2014 the Company incurred additional costs of \$77,748 in connection with the final \$15,000,000 commitment increase. As of June 30, 2014 and December 31, 2013, \$1.4 million and \$1.6 million of such prepaid loan structure fees had yet to be amortized, respectively.

For the three months ended June 30, 2014, the effective interest rate under the Credit Facility was approximately 3.2% (approximately 3.9% including commitment and other loan fees). Interest is paid quarterly in arrears. For the three months ended June 30, 2013, the effective interest rate under the Credit Facility was approximately 3.3% (approximately 4.7% including commitment and other loan fees). Interest is paid quarterly in arrears.

For the six months ended June 30, 2014, the effective interest rate under the Credit Facility was approximately 3.2% (approximately 3.9% including commitment and other loan fees). Interest is paid quarterly in arrears. For the six months ended June 30, 2013, the effective interest rate under the Credit Facility was approximately 3.3% (approximately 5.0% including commitment and other loan fees). Interest is paid quarterly in arrears.

Note Offering

On May 5, 2014, the Company closed a public offering of \$25.0 million in aggregate principal amount of 6.50% notes (the Notes). The Notes mature on April 30, 2019, and may be redeemed in whole or in part at any time or from time to time at the Company's option on or after April 30, 2016. The Notes bear interest at a rate of 6.50% per year payable quarterly on February 15, May 15, August 15 and November 15, of each year, beginning August 15, 2014. The net proceeds to the Company from the sale of the Notes, after underwriting discounts and offering expenses, were approximately \$24.1 million. The Company used all of the net proceeds from this offering to repay a portion of the amount outstanding under the Credit Facility. As of June 30, 2014 the carrying amount of the Notes was approximately \$25.0 million. As of June 30, 2014, the fair value of the Notes were \$26.4 million. The Company has listed the Notes on New York Stock Exchange under the trading symbol SCQ.

In connection with the issuance of the Notes, we incurred \$0.9 million of fees which are being amortized over the term of the notes of which \$0.9 million remains to be amortized and is included within deferred financing costs on the

consolidated statements of assets and liabilities.

Other

On June 20, 2014, the Company's wholly owned subsidiary, Stellus Capital SBIC LP (the SBIC subsidiary) received a license from the Small Business Administration, or SBA, to operate as a Small Business Investment Company (SBIC) under Section 301(c) of the Small Business Investment Company

43

TABLE OF CONTENTS

Act of 1958. As of June 30, 2014, the SBIC had \$31.8 million of regulatory capital, which implies a maximum borrowing of \$63.6 million, subject to the criteria discussed above.

The SBIC license allows the SBIC to obtain leverage by issuing SBA-guaranteed debentures, subject to the issuance of a capital commitment by the SBA and other customary procedures. SBA-guaranteed debentures are non-recourse, interest only debentures with interest payable semi-annually and have a ten year maturity. The principal amount of SBA-guaranteed debentures is not required to be paid prior to maturity but may be prepaid at any time without penalty. The interest rate of SBA-guaranteed debentures is fixed on a semi-annual basis at a market-driven spread over U.S. Treasury Notes with 10-year maturities. The SBA, as a creditor, will have a superior claim to the SBIC's assets over the Company's stockholders in the event the Company liquidates the SBIC or the SBA exercises its remedies under the SBA-guaranteed debentures issued by the SBIC upon an event of default. As of June 30, 2014, the SBIC has not received a commitment letter from the SBA for any SBA-guaranteed debentures and, therefore, the SBIC has not yet issued any SBA-guaranteed debentures. SBA regulations currently limit the amount that the SBIC may borrow to a maximum of \$150 million when it has at least \$75 million in regulatory capital, receives a capital commitment from the SBA and has been through an examination by the SBA subsequent to licensing.

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 June 30, 2014, our off-balance sheet arrangements consisted of \$12.6 million of unfunded commitments, which was comprised of \$12.4 million to provide debt financing to three of our portfolio companies and \$0.2 million to provide equity financing to one portfolio company. As of December 31, 2013, our 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.

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.

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.

TABLE OF CONTENTS

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 consolidated 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 twice annually. 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:

45

TABLE OF CONTENTS

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 twice annually, 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.

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.

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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to financial market risks, including changes in interest rates. At June 30, 2014 and June 30, 2013, 53% and 55%, or 20 and 17 of the loans in our portfolio bore interest at floating rates, respectively. At June 30, 2014, 17 of these 20 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 June 30, 2014 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 \$146 thousand 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 six months ended June 30, 2014 and June 30, 2013, we did not engage in hedging activities.

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 June 30, 2014, we had not entered into any interest rate hedging arrangements. At June 30, 2014, based on

TABLE OF CONTENTS

our applicable levels of our Credit Facility, a 1% increase in interest rates would have decreased our net investment income by approximately \$275 thousand and \$553 thousand for the three and six months ended June 30, 2014, respectively. The Notes bear interest at a fixed rate per year and would not be impacted by changes in interest rates.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company's management, under the supervision and with the participation of various members of management, including its Chief Executive Officer (CEO) and its Chief Financial Officer (CFO), has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the Company's CEO and CFO have concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report.

(b) Changes in Internal Control Over Financial Reporting

Management did not identify any change in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

TABLE OF CONTENTS

PART II OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently 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 financial condition or results of operations.

Item 1A. Risk Factors

Except as set forth below, there have been no other material changes in the information provided under the heading Risk Factors in our Annual Report on Form 10-K as of December 31, 2013. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may materially affect our business, financial condition and/or operating results.

The Notes are unsecured and therefore are effectively subordinated to any secured indebtedness we have incurred or may incur in the future.

The Notes are not and will not be secured by any of our assets or any of the assets of any future subsidiaries and 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 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 June 30, 2014 we had \$91.0 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 are 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 are or 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 are structurally subordinated to all indebtedness, including any future SBA-guaranteed debentures, and other liabilities of any of our subsidiaries and any 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 is issued contains limited protection for holders of the Notes.

The indenture under which the Notes is 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 do 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

48

TABLE OF CONTENTS

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;

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 does 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.

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 holders 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

TABLE OF CONTENTS

under which the Notes is 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. 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.

Although we have listed the Notes on the NYSE under the symbol SCQ, we cannot provide any assurances that an active trading market will develop or be maintained for the Notes. The Notes are not 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. To the extent an active trading market does not develop, the liquidity and trading price for the Notes may be harmed.

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, holders of the Notes may 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 a Noteholder's ability to sell the Notes as the optional redemption date or period approaches.

If we default on our obligations to pay our other indebtedness, we may not be able to make payments on the Notes.

As of June 30, 2014, we had approximately \$91.0 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

An active trading market for the Notes may not develop, which could limit the market price of the Notes. Moreover, t

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

TABLE OF CONTENTS

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 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.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended June 30, 2014, we issued 13,561 shares of our common stock under our dividend reinvestment plan pursuant to an exemption from the registration requirements of the Securities Act of 1933. The aggregate value for the shares of common stock issued during the three months ended June 30, 2014, under the dividend reinvestment plan was approximately \$187,492.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

The following exhibits are filed as part of this report or hereby incorporated by reference to exhibits previously filed with the SEC:

- 31.1* Certification of Chief Executive Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended.
- 31.2* Certification of Chief Financial Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended.
- 32.1* Certification of Chief Executive Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
- 32.2* Certification of Chief Financial Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.

*

Filed herewith

TABLE OF CONTENTS

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 11, 2014

STELLUS CAPITAL INVESTMENT
CORPORATION

By:

/s/ Robert T. Ladd

Name: Robert T. Ladd

Title: Chief Executive Officer and President

By:

/s/ W. Todd Huskinson

Name: Robert T. Ladd

Title: Chief Financial Officer