

FORM ADV PART 2A: FIRM BROCHURE



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This brochure provides information about the qualifications and business practices of Stellus Capital Management, LLC. If you have any questions regarding the contents of this brochure, please contact us at (713) 292-5400 or via email at thuskinson@stelluscapital.com. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority. Registration with the SEC or any state securities authority does not imply a certain level of skill or training. Additional information about Stellus Capital Management, LLC can also be found on the SEC's website at www.adviserinfo.sec.gov.

Item 2 Material Changes

Since we filed our last annual amendment on March 31, 2021:

- Stellus launched Stellus Credit Master Fund III, LLC and certain affiliated parallel funds to accommodate certain investors; and
- On December 14, 2021, and as discussed in Item 10, Stellus Capital Income PBDC, LLC, a related person, was granted registration by the Securities and Exchange Commission as an investment adviser pursuant to Section 203 of the Investment Advisers Act of 1940.

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Item 4 Advisory Business

Stellus Capital Management, LLC (“Stellus”), a Delaware limited liability company, is an investment advisory firm, which began operations on January 3, 2012. It is headquartered in Houston, Texas, with an office in Bethesda, Maryland and Charlotte, NC. There is one principal owner, Robert Ladd. As of December 31, 2021, Stellus had non-discretionary regulatory assets under management of \$17,594,156 and discretionary regulatory assets under management of \$2,396,968,674.

Stellus primarily provides investment strategies focused on direct credit investing by providing debt and equity capital to small and mid-sized businesses in all industry sectors throughout North America. The team provides capital solutions at all levels of the capital structure, including:

- Secured Debt
- First Lien Debt
- Second Lien Debt
- Mezzanine Debt
- Unitranche Debt
- Senior Unsecured Loans
- Subordinated Debt
- Equity Securities

Capital solutions can range from \$10 million to \$50 million for public and private entities seeking capital for various purposes, including:

- Acquisitions
- Recapitalizations
- Growth opportunities
- Leveraged buyouts
- Debtor-in-possession/exit financing
- Bridge loans

Stellus provides discretionary investment advisory and management services to Stellus Capital Investment Corporation (“SCIC”), a non-diversified, closed-end investment management company that has elected to be regulated as a business development company (“BDC”) under the Investment Company Act.

In addition, Stellus primarily provides discretionary investment advisory and management services to private funds (individually, a “Private Fund” and together, the “Private Funds”). The Private Funds are investment vehicles that are not registered or required to be registered under the Investment Company Act of 1940, as amended (the “Investment Company Act”). The securities of the Private Funds are not registered or required to be registered under the Securities Act of 1933, as amended (“the Securities Act”) and are privately placed to accredited and qualified investors. Certain of the Private Funds have the same broader credit focus as the BDC and invest across the capital stack (including junior capital) while a single Private Fund is primarily focused on unitranche and senior debt (the “Senior Credit Fund”) (collectively, the “Private Credit Funds”). While no longer actively investing in the energy space, Stellus is still advising certain Private Funds that have legacy positions, which will be liquidated over time. Stellus also provides non-discretionary advisory services to a private fund sponsored by an unaffiliated investment adviser.

SCIC, and the Private Funds will each be referred to herein as a “Client” and collectively, the “Clients”.

It should be noted that Stellus or an affiliate has entered into side letters or other similar agreements with certain investors in the Private Funds, and may do so again in the future, whereby such investors have been granted terms and conditions that are more favorable than other investors in the Private Funds, including but not limited to, lower fees. For a detailed discussion of side letters and other terms, investors should refer to each Private Fund’s offering documents.

Item 5 Fees and Compensation

All Clients may incur expenses in connection with custodial or brokerage services discussed in Item 12. In addition, Clients bear their own operating costs and expenses relating to their organization and operations, which may include, but are not limited to expenses incurred in identifying, assessing, acquiring, negotiating, structuring, and disposing of investment opportunities, including any financing, legal, accounting, management and consulting fees whether or not a Client actually invests in the specific investment opportunity or not; administrative expenses associated with an annual audit, financial and tax returns and tax reporting to a Client’s investors; registration and other investment costs; interest and fees associated with any permitted borrowings; costs of any litigation, D&O insurance and other types of insurance, indemnification or extraordinary expense or liability; meetings of Client investors; fees and disbursements to attorneys, consultants, accountants, fund administrators, service providers and any other professionals relating to Client matters.

To the extent any Clients are pooled investment vehicles, investors and eligible potential investors should consult each Client's official governing documents for a detailed discussion of the specific fees and expense associated with that Client.

Neither Stellus nor its supervised persons receive compensation for the sale of securities or other investment products to investors.

SCIC

The fee for investment advisory and management services provided to SCIC consists of two components; a base management fee of 1.75% and an incentive payment of 20%. The SCIC prospectus contains the calculation and payment method for the investment advisory and management services provided to SCIC. For additional information about the incentive payment, please refer to the section entitled "Performance-Based Fees".

Private Funds

Pursuant to the governing documents of each Private Fund, Stellus or an affiliate is paid an annual asset-based management fee which ranges between 0.5% and 2.0% and performance based fees which range between 10% and 20% of realized net profits calculated after non-Stellus affiliated Private Fund investors have first received the return of their capital and a specific annual cumulative compounded rate of return. The management fees may be reduced by any net fees paid to Stellus or its affiliates due to certain deal fees and breakup fees received from companies in which the Private Funds have or may invest. As discussed above, certain investors have entered into side letters whereby such investors have been granted terms and conditions that are more favorable than other investors in the Private Funds, including but not limited to, lower fees.

Item 6 Performance-Based Fees and Side-by-Side Management

Each of the accounts that Stellus manages has a performance-based fee and therefore Stellus does not manage accounts that have a performance-based fee side-by-side with accounts that do not have a performance-based fee.

If Stellus is paid a higher performance-based fee from one Client, it may have an incentive to devote more research and development or other activities, and/or to recommend the allocation of investment opportunities, to such higher fee-paying Client.

Stellus will always endeavor to recommend the allocation of investment opportunities in a fair and equitable manner.

SCIC received exemptive relief from the SEC to co-invest with the Private Credit Funds were doing so is consistent with SCIC's 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 SCIC to co-invest with other funds managed by Stellus, a "required majority" of SCIC's 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 SCIC's stockholders and do not involve overreaching of SCIC's stockholders on the part of any person concerned and (2) the transaction is consistent with the interests of SCIC's stockholders and is consistent with SCIC's investment objectives and strategies. SCIC does co-invest, subject to the conditions included in the exemptive order received from the SEC, with the Private Credit Funds. Such co-investments may afford both SCIC, and the Private Credit Funds additional investment opportunities and an ability to achieve greater portfolio diversification. The investments are allocated according to Stellus' allocation policy which in general provides that investments approved as outlined above are allocated between SCIC on the one hand and the Private Credit Funds on the other fairly and equitably over time, considering available capital and certain other parameters.

Item 7 Types of Clients

Stellus currently only provides advice to SCIC and the Private Funds SCIC is a non-diversified, closed-end investment management company that has elected to be regulated as a BDC under the Investment Company Act.

Item 8 Methods of Analysis, Investment Strategies, and Risk of Loss

Methods of Analysis and investment Strategies

Stellus will provide investment recommendations related to Clients' specific investment strategies.

The Private Credit Funds' and SCIC's focus will be on providing debt and equity capital to small and mid-sized businesses in all industry sectors throughout North America. The team provides capital solutions at all levels of the capital structure, including:

- Secured Debt
- First Lien Debt
- Second Lien Debt
- Mezzanine Debt
- Unitranche Debt

- Senior Unsecured Loans
- Subordinated Debt
- Equity Securities

Capital solutions can range from \$10 million to \$50 million for public and private entities seeking capital for various purposes, including:

- Acquisitions
- Recapitalizations
- Growth opportunities
- Leveraged buyouts
- Debtor-in-possession/exit financing
- Bridge loans

The Stellus credit team reviews the investment opportunities that pass an initial screening in detail, including a review of the company's historical financials, industry drivers and outlook, competitive threats, customer concentration, projected financials, credit metrics, management team, and private equity sponsor. The team presents its findings to the investment committee to discuss the transaction, merits and risks, diligence process, pricing and structure. If an opportunity warrants further review, the team will prepare a formal memorandum, including a financial model, to the investment committee for feedback. Based on that feedback, the deal team will continue to refine its diligence and ultimately prepare a credit approval memorandum for final approval from the Stellus investment committee.

Material Risks

The following analysis of risk factors refers to Stellus and discusses certain risks that may exist for investors in funds advised by Stellus.

Any investment involves substantial risks that should be carefully considered. Certain risk factors that may be considered applicable to an investment recommended by Stellus are outlined below. Additional risk factors are outlined in the offering documents for the applicable Client. It should be noted, however, that there may be other risk factors applicable to such an investment that are not identified but that might still result in material losses to investors. Prospective investors should also consult their own legal, investment, tax, and other advisers, and the applicable offering documents, as to whether an investment recommended by Stellus is appropriate for them. All investments in securities involve a risk of loss that investors should be prepared to bear.

It should be noted that many of the risks outlined under one caption or heading are applicable to one or more other captions and headings.

No Assurance of Investment Return

An investment advised by Stellus is not intended as a complete investment program. Such an investment should be regarded as speculative in nature and appropriate only for a sophisticated investor that can afford a loss of all of such investment and that is able to invest for an indefinite period. It should not be assumed that an investment in a fund will be profitable. In addition to the risk of loss on its investments, Client investments are subject to the direct and indirect fees and expenses or applicable offering documents, which will reduce returns and require that Stellus make a certain level of profit from its investing activities in order for an investment simply to break even.

Past performance of Stellus' strategies or the investment vehicles that it has advised and/or managed, or of any investment strategies operated within any such investment vehicle, is not indicative of the results that will be achieved by Stellus in the future and provides no assurance of the success of Stellus in achieving its investment objective.

Macroeconomic Risks

The prospects of an investment in a fund could be materially adversely affected by changes or instability in market, economic, political, technological, regulatory, and social conditions, and by numerous other factors outside the control of Stellus.

Disruptions in the global financial markets may have materially adverse, and in certain cases catastrophic, consequences for the values, liquidity, and stability of certain investments. Such disruptions may occur in the future, and the duration, severity, and ultimate effect of such disruptions are difficult to forecast.

In addition, some of Stellus' investment strategies and/or investments are likely to be exposed to risks relating to weaknesses in various global economies and risks relating to the economic cycle. Numerous factors affecting the performance of Stellus' investment strategies, such as interest rates, commodity prices, equity prices, availability, and terms of financing, demands from market participants, and deflationary and inflationary pressures, may be affected by the economic cycle and long-term economic trends. Predictions about financial market conditions and economic factors are highly uncertain, and the presence, duration, and impact of any market or economic conditions could have a material adverse effect on Stellus' investment strategies.

Availability of Investment Opportunities

Identification and consummation of investment opportunities and investment strategies by Stellus involve a high degree of uncertainty. There can be no assurance that Stellus will be able to identify and/or successfully take advantage of suitable investment opportunities. Even if Stellus takes advantage of an investment opportunity, there is a risk that such investment opportunity will result in losses. If Stellus is not able to identify and/or take advantage of suitable investment opportunities, it may change its risk parameters in order to deploy capital, which may have a material adverse effect on Stellus' investment strategies.

Origination Activities

The market for originating debt and equity financing is highly competitive, and Stellus may be unable to compete effectively with other market participants for origination opportunities. Price pressure from competitors (including market participants that are not directly originating loans) may cause Stellus to recommend a Client lower the interest rates that it charges borrowers, which consequently may lower the value of the loans. Further, if competitors adopt less stringent loan origination standards in order to maintain their loan origination volume, Stellus may cause Clients to do so as well. If Stellus adopts less stringent loan origination standards, a Client will bear increased risk for each loan originated under such less stringent standards, which may not be compensated by an increase in price.

Alternatively, Stellus may determine not to adopt less stringent origination standards in this competitive environment, which decision may result in a loss of market share. Increased pressure on pricing and origination opportunities likely would reduce the volume and quality of Stellus' origination activity and materially adversely affect Clients. Some competitors may have higher risk tolerances or different risk assessments than Stellus, thereby allowing such competitors to achieve a broad diversification of investments and to establish more relationships than Stellus. These competitive pressures could have a material adverse effect on Clients.

Limited Diversification; Concentration; Correlation

Investments recommended by Stellus may not be broadly diversified among particular issuers, issuances, companies, countries, industries, strategies, types of investments, or other shared characteristics. In general, less diversification may lead to greater risk than would be the case with a more broadly diversified portfolio. Even if investments in respect of which Stellus has provided advice are diversified, there can be no assurance that such diversification will reduce risk. In addition, a portfolio may be concentrated in particular issuers, issuances, companies, countries, industries,

strategies, types of investments, and/or other shared characteristics, without any limitation other than applicable law or regulation (if any). Such concentration would magnify the risks associated with such investments, including the risk of significant losses.

There can be no assurance that Stellus will achieve returns that are not closely correlated with various market indices or the returns of other investment vehicles. There can be no assurance that Stellus will value less-correlated returns more highly than any other factor in selecting the investments and strategies. In addition, certain of the strategies deployed by Stellus will maintain unhedged exposure for an indefinite period to various sources of equity, credit, interest-rate, and/or other risk, whether known or unknown. There can be no assurance that an investment with Stellus would improve the risk/return profile of any investor's portfolio or otherwise improve the performance of the investor's overall portfolio.

Private Equity-Related Investments Generally

Stellus may recommend that its Clients acquire controlling or non-controlling positions in privately held companies. Private equity-related investments are generally characterized by an extremely high degree of illiquidity, frequently lasting several years and possibly indefinitely. The realization of a private equity return, if any, generally occurs only upon the partial or complete monetization of an investment by means of a dividend, distribution, recapitalization, initial public offering, asset liquidation, sale, other disposition, or similar financial event. Contractual or legal restrictions may delay realization of a private equity-related investment beyond the occurrence of any such financial event. In addition, an investor generally is expected to earn little or no current cash income on such investments prior to any realization event. Private equity-related investments may be extremely difficult to value, particularly in the absence of a specific liquidity event, readily available comparables, or a material change in the company associated with such investment or the industry in which such company operates. Even if a valuation change is ultimately made, the change may be, by necessity, highly subjective.

The long time horizons of investing in private equity-related investments may expose an investor to shifts in market, economic, political, technological, regulatory, and/or social conditions to an unusual degree. Developments occurring after a private equity-related investment is acquired may fundamentally alter the anticipated market for such investment, preventing Stellus from disposing of the investment profitably or at all, or subjecting investors to risk of a potentially complete loss on such investment.

Stellus may become involved in the exercise of control of a particular privately held company, including in the form of representation on the boards of directors, equity holders' committees, or other groups (whether formal or informal) and participation in litigation.

Follow-on investments; Co-investments

Following an initial investment in a privately held company, Stellus may be presented with the opportunity to provide additional capital to such company. Even if such an investment is desired, it is possible that investors will have insufficient available capital to act. Any recommendation by Stellus not to make a follow-on investment or any inability by an investor to fund such an investment could have a material adverse effect on a privately held company in need of capital, potentially materially adversely affecting investors.

Stellus may recommend co-investing with third parties (including other investors advised by Stellus, or other Related Persons of Stellus) through consortiums of investors, partnerships, joint ventures, or other similar arrangements. Such investments may involve risks in connection with such third-party involvement, including the possibility that any such third party may have financial, legal, or regulatory difficulties that have a material adverse effect on such investment, may have economic or business interests or goals that are inconsistent with those of the relevant investor, may pursue interests inconsistent with those of the relevant investor, may default on their obligations, and/or may be in a position to take (or block) action in a manner contrary to the relevant investor's investment objective. In addition, an investor may in certain circumstances be liable for the actions of its co-investors. Such investments may involve performance charges, incentive compensation arrangements, and/or other fees payable to such third parties.

Illiquid and Long-Term Investments

Stellus may recommend that a Client make investments characterized by varying degrees of liquidity, such as investments for which there exists no actively traded secondary market and which are thus highly illiquid or for which there is an absence of readily ascertainable market values. Any illiquidity with respect to the investments recommended by Stellus may or may not be anticipated and/or may vary over time. Such investments may constitute a substantial portion of the Client's assets in respect of which Stellus provides investment recommendations and may involve significant transaction costs when they are purchased or disposed of, whether through adverse price movements (whether related to liquidity or otherwise), increased spreads between quotes and dealer mark-ups (which may already be material for such investments), and/or other transaction costs. Stellus may recommend liquidating

illiquid investments (quickly or otherwise) if it believes that such liquidations may be warranted by market conditions or other considerations.

In addition, Stellus may recommend that a Client make investments that are subject to resale restrictions due to regulatory, statutory, or contractual provisions that limit the ability of Stellus to liquidate such investments. Such regulatory, statutory, or contractual restrictions could cause liquidity-related losses, could result in exposure to unhedged positions, and could have other material adverse effects on Clients.

Our Clients will realize a portion of their returns on investments through various liquidity events such as a sale, merger or initial public offering or the refinancing of the Client's debt investments. Additionally, capital may not be readily available in the future to repay or refinance any of our Clients' debt investments. A prolonged slowdown could extend our Clients' investment time horizon by limiting their ability to achieve timely liquidity events and could ultimately impact their ability to realize anticipated investment returns.

Unfunded Commitments

The terms of certain loans or other forms of indebtedness held by Clients advised by Stellus may obligate such persons to extend to a borrower additional credit in the future, either at the request of the borrower or if certain other conditions are met. Any such additional extension of credit would increase such Client's exposure to the applicable borrower. In addition, if a Client does not have adequate available funds or chooses not to fund at the time additional credit is required, the borrower may seek to assert claims for damages against such Client.

Investments in Preferred Securities

Stellus will invest in preferred securities that are unrated or rated in the lower categories by the various credit rating agencies (or in comparable non-rated securities). Securities in the lower categories are subject to greater risk of loss of capital than higher-rated securities and are generally considered predominantly speculative with respect to the issuer's capacity to pay dividends and repay capital. They are also generally considered to be subject to greater risk than securities with higher ratings in the case of deterioration or general economic conditions. Because investors generally perceive that there are greater risks associated with the lower-rated securities, the yields and prices of such securities may tend to fluctuate more than those of higher-rated securities. The market for lower-rated securities is thinner and less active than that for higher-rated securities, which can adversely affect the prices at which these securities can be sold. In addition, adverse publicity and investor perceptions about lower-rated

securities, whether or not based on fundamental analysis, may be a contributing factor in a decrease in the value and liquidity of such lower-rated securities.

Valuation of Portfolio Securities

A readily available market value is not expected to exist for many of the investments in our Clients' portfolios, and we will value these portfolio investments at fair value as determined in good faith in our sole discretion (with respect to SCIC, such determination will be made by SCIC's board of directors). When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, we will consider the pricing indicated by the external event to corroborate the private investment valuation. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of the investments may differ significantly from the values that would have been used had a readily available market value existed for such investments, and the differences could be material. In addition, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different from the valuations currently assigned.

With respect to investments for which market quotations are not readily available, we will undertake a multi-step valuation process each quarter, as described below:

- The quarterly valuation process will begin with each portfolio company or investment being initially valued by the investment professionals responsible for the portfolio investment;
- Preliminary valuation conclusions will then be documented;
- Twice a year, the valuation for each portfolio investment will be reviewed by an independent valuation firm; and
- We will determine the fair value of each investment in good faith based on the input of the investment professionals and the respective independent valuation firm.

In following these approaches, the types of factors that may 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;
- liquidity;
- security covenants;
- call protection provisions;
- information rights;

- the nature and realizable value of any collateral;
- the portfolio company's performance, its earnings and discounted cash flows and the markets in which it does business;
- comparisons of financial ratios of peer companies that are public;
- comparable merger and acquisition transactions; and
- the principal market and enterprise values.

Determination of fair values involves subjective judgments and estimates not susceptible to substantiation by auditing procedures. The actual realized returns on unrealized investments will depend on, among other factors, future operating results, the value of assets and market conditions at the time of disposition, any related transaction costs and the timing and manner of sale, all of which may differ from the assumptions on which the valuations are based. Accordingly, the actual realized returns on unrealized investments may differ materially from the returns indicated herein.

Cyber Security Breaches and Identity Theft

Information and technology systems of Stellus, its service providers and applicable underlying portfolio companies may be vulnerable to damage or interruption from computer viruses, network failures, computer and telecommunication failures, infiltration by unauthorized persons and security breaches, usage errors by their respective professionals, power outages and catastrophic events such as fires, tornadoes, floods, hurricanes and earthquakes. Although Stellus has implemented various measures to manage risks relating to these types of events, if these systems are compromised, become inoperable for extended periods of time or cease to function properly, Stellus, its service providers and underlying portfolio companies may incur specific time or expense to fix or replace them and to seek to remedy the effects of such issues. The failure of these systems and/or of disaster recovery plans for any reason could cause significant interruptions in Stellus', its service providers' and/or portfolio companies' operations and result in a failure to maintain the security, confidentiality or privacy of sensitive data, including personal information relating to investors (and the beneficial owners of investors). Such a failure could harm Stellus', its service providers' and/or portfolio companies' reputation, subject them and their respective affiliates to legal claims or otherwise affect their business and financial performance.

Natural Disasters, Epidemics, Pandemics and Terrorist Attacks

Areas in which Stellus has offices or where it otherwise does business are susceptible to natural disasters (e.g., fire, flood, earthquake, storm and hurricane) and epidemics, pandemics or other outbreaks of serious contagious diseases (e.g., MERS, COVID-19, etc). The occurrence of a natural

disaster, epidemic or pandemic could adversely affect and severely disrupt the business operations, economies and financial markets of many countries (even beyond the site of the natural disaster or epidemic) and could adversely affect Stellus' investment program and its ability to do business. In addition, terrorist attacks, or the fear of or the precautions taken in anticipation of such attacks, could, directly or indirectly, materially and adversely affect certain industries in which Stellus invests or could affect the areas in which Stellus has offices or where its otherwise does business. Other acts of war (e.g., war, invasion, acts of foreign enemies, hostilities and insurrection, regardless of whether war is declared) could also have a material adverse impact on the financial condition of industries or countries in which the Fund invests.

Material Risks Specific to Credit Related Investments

Investments in Middle-Market Companies

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

Low Creditworthiness Investments

There is no minimum credit standard for any of Stellus' investment strategies, and a (possibly substantial) portion may, whether at the time of investment or at a later time, involve investments that

are unrated or rated below “investment grade” by recognized rating services. Unrated and sub-investment-grade investments generally involve greater risk of loss in either a short or a long position than do investment-grade investments. For example, the market values and yields of unrated and sub-investment-grade investments generally react more dramatically to changes in general economic conditions, in the levels of interest rates, and in the financial condition and prospects of their issuers than do those of more highly rated investments. During periods of economic downturn or rising interest rates, issuers of unrated and sub-investment-grade investments may experience, to a greater degree than issuers of more highly rated investments, certain forms of financial stress that could materially adversely affect such investments. Such issuers may be in early stages of development; may not have proven operating histories; may be operating at a loss or have significant variations in operating results; may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence; may require substantial additional capital to support their operations, to finance expansion, or to maintain their competitive position; or may otherwise have a weak financial condition. Additionally, such issuers may be highly leveraged, which may present greater risks to these companies.

Adverse publicity and investor perceptions, whether based on fundamental analysis, market rumors, distress of related issuers, or other sources, may materially adversely affect such low creditworthiness investments. Adverse effects on long positions in these investments include the increased probability of default, the decreased value of any recovery in connection with a reorganization proceeding, decreased secondary market prices (if any) for these investments, and general decreases in the liquidity of these investments. The secondary market for these investments is concentrated among relatively few market-makers or investors and may be expected to be less liquid than the secondary market for investments that have higher ratings or are issued by non-distressed issuers. In addition, the lower liquidity of unrated and sub-investment-grade investments, as well as other factors outlined above, could exacerbate the risks of short positions in these investments.

Certain forms of low creditworthiness investments may be issued pursuant to note indentures, promissory notes, or other indicia of indebtedness that contain fewer debt covenants, rights, and remedies compared to those afforded to lenders under a credit agreement. As a result, such investments may be more sensitive to certain risk factors as compared to similar debt instruments with greater debt covenants, rights, and remedies. Moreover, the lack of certain financial covenants with respect to such investments may result in a higher risk of loss and may hinder the ability of Stellus to restructure a problematic loan in order to mitigate its exposure to loss.

Portfolio Company Leverage

Our Clients' portfolio companies may have capital structures with significant leverage. Leveraged companies in which our Clients invest may have limited financial resources and may be unable to meet their obligations under their loans and debt securities that our Clients hold. Although Stellus will seek to structure transactions in an attempt to minimize these risks, such leverage may increase their exposure to adverse economic factors such as rising interest rates, downturns in the general economy or deterioration in the condition of the portfolio company or its sector in its particular industry. Such developments may be accompanied by deterioration in the value of any collateral and a reduction in the likelihood of our Clients realizing any guarantees that it may have obtained in connection with its investment. Smaller leveraged companies also may have less predictable operating results and may require substantial additional capital to support their operations, finance their expansion or maintain their competitive position.

Defaults by Portfolio Companies

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

Secured Loans; Second Lien Loans; Unsecured or Subordinated Loans

Measures taken by Stellus to protect investors' interests in loans in which they may invest, including the validity or enforceability of such loans and the creation and maintenance of the anticipated priority and perfection of applicable security interests, may prove to be inadequate. There can be no assurance that any collateral would be sufficient to cover the obligations being collateralized or the amount of an investor's investment. Any collateral may decline in value; may be subject to competing claims of creditors; may be difficult to recover or sell due to legal, regulatory, or other reasons; or otherwise, may be inadequate to allow an investor to recoup its investment.

Stellus may recommend an investment in certain loans ("Second Lien Loans") that are secured by a second priority interest or lien on collateral but are subordinated to other secured obligations. Second Lien Loans are subject to a risk that the cash flow of the related borrower and the property securing the Second Lien Loan may be insufficient to make scheduled payments on the Second Lien Loans after giving

effect to any obligations in respect of the senior secured loans of the borrower. Second Lien Loans are also expected to be less liquid than senior secured loans.

Finally, Stellus may recommend investments in various types of unsecured indebtedness (such as senior unsecured, subordinated, or general indebtedness) that would be junior in priority to the claims of secured creditors. The claims of secured or senior creditors may exhaust some or all of the assets of a borrower before unsecured, subordinated, or general creditors may participate in such assets.

Lender Liability; Equitable Subordination; Fraudulent Conveyance

Investments structured as loans or other forms of indebtedness may subject investors to claims of lender liability and/or may be subject to claims of equitable subordination or re-characterization.

The risk of such claims may be exacerbated if an investor holds a significant equity position and/or certain management positions (including representation on the board of directors) with respect to the applicable borrower. Under the concept of “equitable subordination,” a court may subordinate the claim of a lender or bondholder to the claims of other creditors in certain circumstances, such as if the court finds that such lender or bondholder engaged in inequitable conduct to the detriment of other creditors. In addition, under certain circumstances, a loan may be re-characterized as an equity contribution if a court determines that the loan was in substance a disguised equity contribution to a company. If a court re-characterizes a loan as an equity contribution, such loan would be made subordinate to the claims of all creditors. Any successful claims of lender liability against an investor or any successful claims of equitable subordination or re-characterization could have a material adverse effect on such investment held by such investor (possibly resulting in losses that exceed the value of such investment).

Investments structured as loans or other forms of indebtedness may also be subject to claims of fraudulent conveyance. Any claims of fraudulent conveyance or preferential payment with respect to an investment could have a material adverse effect on an investor, which could be required to return related payments.

Distressed Issuers

Stellus may recommend that a Client invest in companies that at the time of the applicable investment are experiencing, or subsequent to the applicable investment do experience, various forms of financial, business, operational, legal, and/or other distress or impairment, including companies involved in bankruptcy or other reorganization or liquidation proceedings (collectively, “Reorganization

Proceedings”), as well as those emerging from Reorganization Proceedings and those seeking financial restructurings or reorganizations outside such proceedings. These investments involve a high degree of risk and the total value of the applicable investment may be lost.

Stellus also may recommend that a Client purchase from banks, other financial institutions, or other investors bank loans (whether through assignment or participation transactions) and other forms of direct or indirect indebtedness (including revolving loans and letters of credit) of distressed companies.

Investments in loan participations would expose a Client to risks related to the creditworthiness of the banks or other financial institutions issuing such participations.

Stellus also may recommend that a Client purchase bankruptcy claims (including trade claims), which amounts are owed to creditors of a distressed company. Investments in bankruptcy claims are difficult to value. Moreover, bankruptcy claims generally are illiquid and non-interest-bearing, and there can be no assurance that a company will be able to satisfy its obligations under a claim.

Sophisticated financial and legal analysis is often necessary for successful investment in distressed companies. There is no assurance that Stellus will correctly evaluate the value of the collateral (if any) supporting the investments held by a Client or the prospects for a successful reorganization or similar action. Such investments may be subject to additional risks, such as significant volatility in the value of the investment; the involuntary exchange of such investments for cash, financial instruments, or other property (including illiquid investments) having substantially less value than the original investment; and/or delayed or extended payment for such investments.

In addition, Reorganization Proceedings, as well as other financial restructurings or reorganizations, are subject to a number of risks. For example, such proceedings may be of uncertain duration; may be subject to unanticipated and possibly lengthy delays; may involve substantial legal, professional, and administrative costs to the reorganizing company and its investors; may involve other factors that are beyond the control of the reorganizing company and its investors; and/or may result in the liquidation of the reorganizing company. Further, Stellus, on behalf of a Client, may decide to become involved in the restructuring of a particular distressed company, including through representation on creditors’ or equity holders’ committees or other groups (whether formal or informal) and participation in litigation or direct negotiations with the company’s management, each of which may involve special risks and/or conflicts of interest for a Client. The occurrence of any of these risks could have a material adverse effect on the value of the applicable investment or on Stellus’ ability to dispose of or to act to protect the value of such investment.

Leverage

Stellus may recommend that its Clients borrow or otherwise use leverage to increase profit potential while increasing risk of loss and volatility. If the interest expense on borrowings were to exceed the net return on the portfolio of securities purchased with borrowed funds, returns would be lower than if the investors were not leveraged. Additionally, the use of leverage, while providing the opportunity for higher returns, also increases volatility and the risk of loss. Stellus could realize additional fees when its Clients incur debt or use leverage, and Stellus controls the amount of debt or leverage used by its Clients. Stellus will only incur leverage if it is in the best interest of investors and not for its own financial benefit.

Risks Related to Changes in Interest Rates

To the extent our Clients borrow money to make investments their net investment income will depend, in part, upon the difference between the rate at which they borrow funds and the rate at which they invest those funds. As a result, a Client can be offered no assurance that a significant change in market interest rates would not have a material adverse effect on its net investment income in the event a Client uses debt to finance its investments. In periods of rising interest rates, a Client's cost of funds would increase, which could reduce its net investment income. Stellus may cause a Client to use interest rate risk management techniques in an effort to limit its exposure to interest rate fluctuations. In addition, a rise in the general level of interest rates typically leads to higher interest rates applicable to our Clients' debt investments.

Price Volatility

The price of investments increases or decreases due to among other things credit risk, interest rate risk or changes in market factors (market risk). Generally, the longer the portfolio duration is, the greater the degree of price fluctuation. Also, more concentrated portfolios may have greater potential volatility. Below investment-grade securities are more susceptible to market risk and general economic factors than investment-grade securities, and, thus, typically bear increased price volatility risk.

Bridge Investments

Investments may include bridge financing to portfolio companies. While a bridge financing is outstanding, the bridge lender bears the risk of changes in the capital markets. A portfolio company's inability to refinance a bridge loan may result in retaining a long-term investment in a junior security or having its bridge loan converted to equity.

Control Position and Participation on Creditors' Committees and Boards of Directors.

As part of its strategy for certain Clients, Stellus often seeks investment opportunities that allow it to control or exercise significant influence over management and the strategic direction of the companies in which it invests. The exercise of control over a portfolio company imposes additional risks on Clients of liability for environmental damage, product defects, failure to supervise management, labor disputes and other types of liability associated with a portfolio company's operations. The exercise of control over a portfolio company could expose Clients' assets to claims by such portfolio company or by its security holders and its creditors.

In other situations, where Stellus is not in a position to exercise control or significant influence, representatives of Stellus, on behalf of investors, may participate on committees formed by creditors to negotiate with the management of financially troubled companies that may or may not be in bankruptcy. Stellus may also seek to negotiate directly with debtors with respect to restructuring issues. In the situation where a representative of Stellus chooses to join a creditors' committee, the representative would likely be only one of many participants, each of whom would be interested in obtaining an outcome that is in its individual best interest. There can be no assurance that the representative would be successful in obtaining results most favorable to the investors advised by Stellus in such proceedings, although the representative may incur significant legal fees and other expenses in attempting to do so. As a result of participation by the representative on such committees, the representative may be deemed to have duties to other creditors represented by the committees, which might thereby expose the investors advised by Stellus to liability to such other creditors who disagree with the representative's actions. It is possible that Stellus or its affiliates will be represented on the boards of some of the companies in which investors advised by Stellus make investments. Such representation may have the effect of impairing the ability of Stellus to sell such investors' related investments when, and upon the terms they might otherwise desire, including as a result of applicable securities laws. If Stellus or any of Stellus' affiliates or employees earns compensation with regard to any such board representation, such compensation will generally be remitted to the applicable investors advised by Stellus.

Reliance on Key Personnel

The success of a Stellus Client depends upon the skill and expertise of key personnel of Stellus to identify, close and manage portfolio investments. The loss of their services could have material adverse effect on Stellus and its Clients.

Item 9 Disciplinary Information

Stellus believes there are no legal or disciplinary events that are material to a Client's evaluation of Stellus' advisory business or the integrity of its management.

Item 10 Other Financial Industry Activities and Affiliations

On December 14, 2021, Stellus Private BDC Advisor, LLC ("Stellus PBDC Adviser"), a related person, was granted registration by the Securities and Exchange Commission as an investment adviser pursuant to Section 203 of the Investment Advisers Act of 1940 ("Advisers Act"). Stellus and Stellus PBDC Adviser operate their respective business from the same office location and share certain employees. Stellus PBDC Adviser advises a private business development corporation ("Stellus PBDC") that invests primarily in the same investments as Stellus' clients. This creates certain conflicts of interest in the allocation of investment opportunities between Stellus' clients and Stellus PBDC. Stellus has adopted policies and procedures it believes reasonably address the conflicts of interest associated with the allocation of investment opportunities between its clients and Stellus PBDC.

Item 11 Code of Ethics, Participation or Interest in Clients Transactions, and Personal Trading

Stellus has adopted a code of ethics (the "Code") that establishes the standard of business conduct that must be followed by, among others, all partners, officers, and employees of Stellus (collectively "Supervised Persons"). The Code incorporates the following general principles, which all Supervised Persons are expected to uphold: act in the best interests of Clients; conduct personal securities transactions in a manner consistent with the Code, which seeks to address certain conflicts of interest in this regard; avoid taking any inappropriate advantage of one's position at Stellus; maintain confidentiality of information concerning Stellus' securities recommendations and portfolio holdings and transactions; and provide accurate disclosure in reports required by auditors, regulators, or government bodies.

Stellus believes that these general principles not only help Stellus fulfill its obligations undertaken as an investment adviser, but also protect Stellus' reputation and instill in employees Stellus' commitment to honesty, integrity, and professionalism.

The Code also provides guidelines for Supervised Persons regarding adherence to securities laws generally, transactions in personal accounts involving public and private securities and commodities, activities outside of the investment adviser's business, giving and receiving business-related gifts, and the maintenance and memorialization of certain family and/or close personal relationships. For example, the Code requires that all Supervised Persons obtain approval prior to affecting any securities

or commodities transaction in a personal or related account for which the employee has not granted discretion to a third party adviser. In addition, the Code requires that all Supervised Persons report Code violations and outlines potential sanctions for such violations. Stellus' Chief Compliance Officer is responsible for various aspects of the Code's administration, including without limitation the monitoring and review of personal securities and commodities transactions of Supervised Persons, and is available for any questions Supervised Persons have regarding the Code. Stellus will provide a copy of the Code to any Client or prospective Client upon request and may elect to provide a copy of the Code to investors in investment vehicles advised or sub-advised by Stellus.

Certain Potential Conflicts of Interest

Certain activities of Stellus may present a potential conflict of interest. These activities may include for example, advising other Clients of Stellus, sponsoring other investment vehicles (including those with investment objectives similar to or overlapping with those of current Clients), making investments for their own accounts, or engaging in other lines of business.

Although Stellus expects to devote a substantial amount of time and effort to the business and affairs of each Client, it will also devote some amount of its working time and effort to other activities, which may include generating new business. These other activities could require substantial commitments of time and resources by Stellus.

Stellus has no obligation to recommend for purchase or sale by Clients any securities that Stellus or any of its related persons may purchase for themselves or for any Client. In addition, the ability of Stellus to effect and/or recommend transactions for certain or all Clients may be restricted due to actual or perceived regulatory requirements in the United States or elsewhere, to Stellus' or a related person's internal policies designed to comply with such requirements, to actual or perceived conflicts of interest, to operational issues, and/or to other issues. Regulatory or contractual limitations related to effecting transactions for certain Clients may not apply to other Clients, resulting in differences in investments and returns.

To the extent permitted by applicable law and the applicable governing documents, Stellus may effect "cross transactions" between the Client Accounts. Stellus would only recommend Clients enter into such transactions if the transactions were consistent with the best interests of both Clients and at a price that Stellus and/or its related persons believe constitutes a fair valuation for both Clients. Neither Stellus nor any related party receives any commission or commission equivalent in connection with these transactions.

Disclosures regarding conflicts of interest and their resolution generally will be contained in the applicable offering documents, this brochure, and/or another document. Other documents, such as financial or periodic reports, furnished to investors may contain disclosure regarding conflicts of interest.

Item 12 Brokerage Practices

Stellus generally negotiates directly with the underlying companies with which it invests and does not ordinarily effect securities transactions through financial intermediaries. To the extent that Stellus did cause a Client account to transact in securities through a broker-dealer, with respect to its discretionary accounts, Stellus has the authority to determine the type and amount of securities to be bought or sold, the broker or dealer used and the commission rates paid. In making its decisions regarding brokerage transactions, Stellus will seek best execution of transactions under the circumstances, generally taking into account the following factors: (i) the quality of the broker's execution capabilities; (ii) the full range of services the broker/dealer offers; (iii) the trading costs paid; (iv) the liquidity/depth the broker/dealer is able to offer; and (v) any other aspects of the relationship that ultimately may provide an advantage or disadvantage to Clients.

In addition, to the extent it does effect transactions that involve a broker-dealer, it may effect transactions for a Client with broker-dealers who provide soft dollar items, provided the use of such broker-dealers is consistent with the Adviser's duty to seek best execution and only to the extent such research and services fall within Section 28(e) of the 1934 Act.

If investment recommendations were to be made contemporaneously for multiple Clients in the same instrument, Stellus may, if consistent with market conditions, portfolio characteristics, its Investment Allocation Policy, and applicable law, including but not limited to, the Investment Company Act, bunch or aggregate orders (including orders for Clients in which Stellus, its related persons, and/or its personnel have beneficial interests) for execution if, in Stellus' reasonable judgment, such aggregation is reasonably likely to result in an overall economic benefit to a Client and/or Stellus' other Clients based on an evaluation that the Client and/or Stellus' other Clients will be benefited by relatively better purchase or sale prices, lower commission expenses or beneficial timing of transactions, or a combination of these and other factors, and is permitted under the terms of each Client's advisory agreement. In addition, Stellus must determine that no Client is favored over any other Client, and the Adviser receives no compensation of any kind from third parties (e.g., brokers) for aggregating Client orders. Such bunched or aggregated orders might facilitate execution and may reduce brokerage and other costs. Stellus, however, is not required to bunch or aggregate orders. If Stellus is unable to or does not fully execute a bunched transaction or if Stellus determines that it would be impractical to

allocate a small number of positions among all of the accounts initially intended to participate in the transaction, Stellus may allocate such positions in a manner determined in good faith to be an appropriate allocation.

Stellus does not currently participate in directed brokerage.

Item 13 Review of Accounts

For the purposes of providing services to Clients, Stellus, through its investment committee provides continuous review of Client investments. Stellus' investment committees generally meet at least weekly to discuss existing Client investments as well as to review prospective investment opportunities. As part of its ongoing review process, Stellus regularly reviews certain documents prepared in the investment process, trade data, and other reports for overseeing the investment activity, trading activity, and loan origination performed on behalf of Clients.

Item 14 Client Referrals and Other Compensation

Stellus has engaged external placement agents for placement of new fund interests into certain of the Private Funds. The cost of using a placement agent is borne by Stellus and not by its Clients.

Item 15 Custody

Rule 206(4)-2, promulgated under the Advisers Act, (the "Custody Rule") imposes specific conditions on investment advisers who have actual or deemed custody of Client assets. Accordingly, Stellus has adopted policies and procedures governing compliance with the Custody Rule.

Stellus is not deemed under the Custody Rule to have custody of SCIC nor any assets advised on a non-discretionary basis.

Stellus is deemed to have custody of the funds and securities of its Private Fund Clients as defined by the Custody Rule. Pursuant to the Custody Rule, the funds and securities of Private Fund Clients are maintained at a financial institution meeting the definition of "qualified custodian" under the Advisers Act. State Street Bank and Trust Company and Amegy Bank currently serves as qualified custodians on behalf of the Private Funds. Private Fund investors do not receive account statements from the custodian. Stellus arranges for each Private Fund's financial statements to be prepared in accordance with U.S. generally accepted accounting principles ("GAAP") and audited at least annually by an independent public accountant that is registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the

Public Company Accounting Oversight Board in accordance with its rules. Stellus makes those audited financial statements available to all limited partners in each Private Fund within 120 days of the end of the Private Fund's fiscal year. Investors should carefully review those financial statements. Upon liquidation of a Private Fund, Stellus will distribute its audited financial statements prepared in accordance with GAAP to all Investors in the Private Fund promptly after the completion of such audit.

Item 16 Investment Discretion

Stellus provides its advice to on a discretionary basis to all Clients except for the private fund sponsored by an unaffiliated investment adviser, which is advised on a non-discretionary basis.

Item 17 Voting Client Securities

Stellus' strategies generally do not give rise to proxy voting; however, it may happen, and in certain circumstances, Stellus may be required to approve changes to governance items related to underlying investments whereby the consent of Stellus' Clients is required. Stellus recognizes that it must vote Client interests in a timely manner in the best interest of its Clients. Accordingly, Stellus has adopted proxy voting policies and procedures for voting proxies that are intended to comply with Section 206 of, and Rule 206(4)-6 under, the Advisers Act. In such cases, Stellus has adopted a proxy voting policy in which it seeks (i) to address conflicts of interest between Stellus and its Clients, and (ii) to vote proxies in the best interests of its Clients.

On the rare occasion a Client is asked to decide on matters involving voting its ownership interest in a portfolio investment, Stellus will seek to vote Client proxies in the best interest of the Client. It will review on a case-by-case basis each proposal submitted for a vote to determine its impact on the portfolio securities held by the Client. To ensure that a vote is not a product of a conflict of interest, Stellus requires that (a) anyone involved in the decision-making process disclose to the CCO any potential conflict that he or she is aware of and any contact that he or she has had with any interested party regarding a proxy vote, and (b) Supervised Persons involved in the decision-making and voting process are prohibited from disclosing how Stellus intends to vote, whether in favor or against, on a proposal in order to reduce the opportunity for any interested person to attempt to influence the vote.

Clients may obtain, without charge, information about how Stellus voted proxies and may obtain a copy of the Stellus proxy voting policies and procedures by making a written request to: Chief Compliance Officer, c/o Stellus Capital Management, LLC, 4400 Post Oak Parkway, Suite 2200, Houston, TX 77027.

Item 18 Financial Information

Stellus has not been the subject of a bankruptcy petition at any time during the past ten years.