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

FORM 10-K

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

For the fiscal year ended December 31, 2015

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

For the transition period from to

Commission File No. 814-00735

KCAP Financial, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**20-5951150**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

295 Madison Avenue, 6th Floor
New York, New York 10017

(Address of principal executive offices)

(212) 455-8300

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common Stock, par value $0.01 per share	**The NASDAQ Global Select Market**
7.375% Notes Due 2019	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☐	Accelerated filer ☒	Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller Reporting Company ☐

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

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2015 was approximately $221,456,294 based upon a closing price of $5.98 reported for such date by The NASDAQ Global Select Market. Common shares held by each executive officer and director and by each person who owns 5% or more of the outstanding common shares have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of common stock of the registrant as of March 8, 2016 was 37,130,433.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the 2016 annual meeting of stockholders to be filed with the Securities and Exchange Commission within 120 days following the end of the registrant's fiscal year-end are incorporated by reference into Part III of this report.

NOTE ABOUT REFERENCES TO KCAP FINANCIAL, INC.

In this Annual Report on Form 10-K (this "Annual Report"), the "Company", "KCAP", "we", "us" and "our" refer to KCAP Financial, Inc. and its wholly owned subsidiaries, KCAP Senior Funding I, LLC and KCAP Senior Funding I Holdings, LLC, unless the context otherwise requires.

NOTE ABOUT TRADEMARKS

KCAP Financial, Inc., our logo and other trademarks of KCAP Financial, Inc. are the property of KCAP Financial, Inc. All other trademarks or trade names referred to in this Annual Report are the property of their respective owners.

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Annual Report includes forward-looking statements. The matters discussed in this Annual Report, as well as in future oral and written statements by management of KCAP Financial, Inc., that are forward-looking statements are based on current management expectations that involve substantial risks and uncertainties which could cause actual results to differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar words, although not all forward-looking statements include these words. Important assumptions include our ability to originate new investments, achieve certain margins and levels of profitability, the availability of additional capital, and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Annual Report should not be regarded as a representation by us that our plans or objectives will be achieved. The forward-looking statements contained in this Annual Report include statements as to:

- our future operating results;
- our business prospects and the prospects of our existing and prospective portfolio companies;
- the return or impact of current and future investments;
- our contractual arrangements and other relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the financial condition and ability of our existing and prospective portfolio companies to achieve their objectives;
- our expected financings and investments;
- our regulatory structure and tax treatment;
- our ability to operate as a business development company and a regulated investment company, including the impact of changes in laws or regulations governing our operations or the operations of our portfolio companies, including Katonah Debt Advisors, L.L.C. and Trimaran Advisors, L.L.C. (the "Asset Manager Affiliates");
- the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies, including the Asset Manager Affiliates;
- the impact of a protracted decline in the liquidity of credit markets on our business;
- the impact of fluctuations in interest rates on our business;
- the valuation of our investments in portfolio companies, particularly those having no liquid trading market;
- our ability to recover unrealized losses;

- market conditions and our ability to access additional capital; and
- the timing, form and amount of any dividend distributions.

For a discussion of factors that could cause our actual results to differ from forward-looking statements contained in this Annual Report, please see the discussion under “Risk Factors” in Item 1A. You should not place undue reliance on these forward-looking statements. The forward-looking statements made in this Annual Report relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances occurring after the date of this Annual Report unless required by law.

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PART I

Item 1. *Business*

GENERAL

We are an internally managed, non-diversified closed-end investment company that is regulated as a Business Development Company, or BDC under the Investment Company Act of 1940 (the “1940 Act”). We have three principal areas of investments:

First, the Company originates, structures, and invests in senior secured term loans and mezzanine debt primarily in privately-held middle market companies (the “Debt Securities Portfolio”). In addition, from time to time the Company may invest in the equity securities of privately held middle market companies.

Second, the Company has invested in asset management companies (Katonah Debt Advisors and Trimaran Advisors, collectively the “Asset Manager Affiliates”) that manage collateralized loan obligation funds (“CLO Funds”).

Third, the Company invests in debt and subordinated securities issued by CLOs (“CLO Fund Securities”). These CLO Fund Securities are primarily managed by our Asset Manager Affiliates, but from time-to-time the Company makes investments in CLO Fund Securities managed by other asset managers. The CLO Funds typically invest in broadly syndicated loans, high-yield bonds and other credit instruments.

The Company may also invest in other investments such as loans to larger, publicly-traded companies, high-yield bonds and distressed debt securities. The Company may also receive warrants or options to purchase common stock in connection with its debt investments.

In our Debt Securities Portfolio, our investment objective is to generate current income and, to a lesser extent, capital appreciation from the investments in senior secured term loans, mezzanine debt and selected equity investments in privately-held middle market companies. We define the middle market as comprising companies with earnings before interest, taxes, depreciation and amortization (“EBITDA”) of $10 million to $50 million and/or total debt of $25 million to $150 million. We primarily invest in first and second lien term loans which, because of their priority in a company’s capital structure, we expect will have lower default rates and higher rates of recovery of principal if there is a default and which we expect will create a stable stream of interest income. The investments in our Debt Securities Portfolio are all or predominantly below investment grade, and have speculative characteristics with respect to the issuer’s capacity to pay interest and repay principal. While our primary investment focus is on making loans to, and selected equity investments in, privately-held middle market companies, we may also invest in other investments such as loans to smaller companies or larger, publicly-traded companies, high-yield bonds and distressed debt securities. We may also receive warrants or options to purchase common stock in connection with our debt investments.

From our Asset Manager Affiliates investment, we expect to receive recurring cash distributions and generate capital appreciation through the addition of new CLO Funds managed by our Asset Manager Affiliates. We may also seek to monetize our investment in the Asset Manager Affiliates if and when business conditions warrant. The Asset Manager Affiliates manage CLO Funds that invest in broadly syndicated loans, high-yield bonds and other credit instruments. The Asset Manager Affiliates are registered under the Investment Advisers Act of 1940 (the “Advisers Act”), and are each managed independently from KCAP by a separate management team (however, certain of the Company’s executive officers also act in similar capacities for one or both of the Asset Manager Affiliates).

In addition, our investments in CLO Fund Securities, which are primarily made up of minority investments in the subordinated securities or preferred stock of CLO Funds raised and managed by our Asset Manager Affiliates, are anticipated to provide the Company with recurring cash distributions and complement the growth of our investment in the Asset Manager Affiliates.

Because we are internally managed by our executive officers under the supervision of our Board of Directors and do not depend on a third party investment advisor, we do not pay investment advisory fees, but instead incur the operating costs associated with employing investment and portfolio management professionals.

As a BDC, we are required to comply with regulatory requirements, including limitations on our use of debt. We are permitted to, and expect to continue to, finance our investments through borrowings. However, as a BDC, we are only generally allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. The 1940 Act also generally prohibits us from declaring any cash dividend or distribution on any class of our capital stock if our asset coverage is below 200% at the time of the declaration of the dividend or distribution.

Subject to market conditions, we intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. Because we also recognize the need to have funds available for operating our business and to make investments, we seek to have adequate liquidity at all times to cover normal cyclical swings in funding availability and to allow us to meet abnormal and unexpected funding requirements. As a result, we may hold varying amounts of cash and other short-term investments from time-to-time for liquidity purposes.

We have elected to be treated for U.S. federal income tax purposes as a Regulated Investment Company ("RIC") under the Internal Revenue Code (the "Code") and intend to operate in a manner to maintain our RIC tax treatment. Accordingly, we generally will not pay corporate-level U.S. federal income taxes on any net ordinary tax-basis taxable income or capital gains that we timely distribute to our shareholders as dividends. To maintain our RIC tax treatment, we must meet the specified source-of-income and asset diversification requirements and distribute to our stockholders annually at least 90% of our net ordinary tax-basis taxable income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, for each year.

We were formed in August 2006, as Kohlberg Capital Corporation. In December 2006, we completed our initial public offering ("IPO"), which raised net proceeds of approximately $200 million after the exercise of the underwriters' over-allotment option. In connection with our IPO, we issued an additional 3,484,333 shares of our common stock in exchange for the ownership interests of Katonah Debt Advisors and certain CLO Fund Securities.

In April 2008, the Company completed a rights offering that resulted in the issuance of 3.1 million shares of our common stock, and net proceeds of $27 million.

On February 29, 2012, the Company purchased Trimaran Advisors, L.L.C. ("Trimaran Advisors"), a CLO manager similar to Katonah Debt Advisors, L.L.C. ("Katonah Debt Advisors"), with assets under management of approximately $1.5 billion, for total consideration of $13.0 million in cash and 3,600,000 shares of the Company's common stock. Contemporaneous with the acquisition of Trimaran Advisors, the Company acquired from Trimaran Advisors equity interests in certain CLO Funds managed by Trimaran Advisors for an aggregate purchase price of $12.0 million in cash. As of December 31, 2015, the Asset Manager Affiliates had approximately $2.7 billion of par value assets under management.

On July 11, 2012, we changed our name from Kohlberg Capital Corporation to KCAP Financial, Inc.

On February 14, 2013, the Company completed a public offering of 5,232,500 shares of common stock, which included the underwriters' full exercise of their option to purchase up to 682,500 shares of common stock, at a price of $9.75 per share, raising approximately $51.0 million in gross proceeds. In conjunction with this offering, the Company also sold 200,000 shares of common stock to a member of its Board of Directors, at a price of $9.31125 per share, raising approximately $1.9 million in gross proceeds.

On October 6, 2014, the Company priced a follow-on public offering of 3.0 million shares of its common stock at a price of $8.02 per share. The offering raised net proceeds of approximately $23.8 million, net of underwriting discounts and offering expenses.

Including employees of our Asset Manager Affiliates, we employ an experienced team of 18 investment professionals and 23 total staff members. Dayl W. Pearson, our President and Chief Executive Officer, and one of our directors, has been in the financial services industry for over 39 years. During the past 25 years, Mr. Pearson has focused almost exclusively on the middle market and has originated, structured and underwritten over $7 billion of debt and equity securities. R. Jon Corless, our Chief Investment Officer with primary responsibility for the Debt Securities Portfolio, has managed investment portfolios in excess of

$4 billion at several institutions and has been responsible for managing portfolios of leveraged loans, high-yield bonds, mezzanine securities and middle market loans. Dominick J. Mazzitelli is the President and portfolio manager of the Asset Manager Affiliates. He has over 20 years of experience within the credit markets, with most of his career focused on the leveraged finance markets. Edward U. Gilpin, our Chief Financial Officer, Secretary and Treasurer, has been in financial services for over 30 years, with significant experience in overseeing the financial operations and reporting for asset management businesses, including the fair value accounting of CLO securities owned by them.

Under the investment company rules and regulations pursuant to Article 6 of Regulation S-X and the Financial Standards Board Accounting Standards Codification 946, *Financial Services — Investment Companies* (ASC 946), we are precluded from consolidating portfolio company investments, including those in which we have a controlling interest, unless the portfolio company is another investment company. An exception to this general principle in ASC 946 occurs if we own a controlled operating company that provides all or substantially all of its services directly to us, or to an investment company of ours. Other than KCAP Funding, Kohlberg Capital Funding I LLC, KCAP Senior Funding I Holdings LLC and KCAP Senior Funding I LLC, none of the investments made by us qualify for this exception. Therefore, our portfolio investments, including our investments in the Asset Manager Affiliates, are carried on the balance sheet at fair value with any adjustments to fair value recognized as “Net Change in Unrealized Appreciation (Depreciation)” in our statement of operations until the investment is exited, at which point any gain or loss on exit is reclassified and recognized as a “Net Realized Gain (Loss) from Investments.”

Our common stock is traded on The NASDAQ Global Select Market under the symbol “KCAP.” The net asset value per share of our common stock at December 31, 2015 was $5.82. On December 31, 2015, the last reported sale price of a share of our common stock on The NASDAQ Global Select Market was $4.07. In addition, our 7.375% notes due 2019 (“7.375% Notes Due 2019”) are traded on the New York Stock Exchange under the symbol “KAP.”

Our Corporate Information

Our principal executive offices are located at 295 Madison Avenue, 6th Floor, New York, New York 10017, and our telephone number is (212) 455-8300. We maintain a website on the Internet at *http://www.kcapfinancial.com*. The information contained in our website is not incorporated by reference into this Annual Report. We make available on or through our website certain reports and amendments to those reports that we file with or furnish to the SEC in accordance with the Securities Exchange Act of 1934 (the “Exchange Act”). These include our annual reports on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K. We make this information available on our website free of charge as soon as reasonably practicable after we electronically file the information with, or furnish it to, the SEC.

Investment Portfolio

Our investment portfolio generates investment income, which is generally used to pay principal and interest on our borrowings, operating expenses, and to fund our distributions to our stockholders. Our investment portfolio consists of three primary components: the Debt Securities Portfolio, the CLO Fund Securities and our investment in our wholly owned Asset Manager Affiliates.

Debt Securities Portfolio. We target privately-held middle market companies that have strong historical cash flows, experienced management teams and identifiable and defendable market positions in industries with positive dynamics. We generally target companies that generate positive cash flows because we look to cash flows as the primary source for servicing debt.

We employ a disciplined approach in the selection and monitoring of our investments. Generally, we target investments that will generate a current return through interest income to provide for stability in our shareholder distributions and place less reliance on realized capital gains from our investments. Our investment philosophy is focused on preserving capital with an appropriate return profile relative to risk. Our investment due diligence and selection generally focuses on an underlying issuer’s net cash flow after capital expenditures to service its debt rather than on multiples of net income, valuations or other broad benchmarks which frequently miss the nuances of an issuer’s business and prospective financial performance. We also generally avoid concentrations in any one industry or issuer. We manage risk by following our internal credit policies and procedures.

When we extend senior and junior secured term loans, we will generally take a security interest in the available assets of the portfolio company, including the equity interests of its subsidiaries, which we expect to help mitigate the risk that we will not be repaid. Nonetheless, there is a possibility that our lien could be subordinated to claims of other creditors. Structurally, mezzanine debt ranks subordinate in priority of payment to senior term loans and is often unsecured. Relative to equity, mezzanine debt ranks senior to common and preferred equity in a borrower's capital structure. Typically, mezzanine debt has elements of both debt and equity instruments, offering the fixed returns in the form of interest payments associated with a loan, while providing an opportunity to participate in the capital appreciation of a borrower, if any, through an equity interest that is typically in the form of equity purchased at the time the mezzanine loan is repaid or warrants to purchase equity at a future date at a fixed cost. Mezzanine debt generally earns a higher return than senior secured debt due to its higher risk profile and usually less restrictive covenants. The warrants associated with mezzanine debt are typically detachable, which allows lenders to receive repayment of their principal on an agreed amortization schedule while retaining an equity interest in the borrower. Mezzanine debt also may include a "put" feature, which permits the holder to sell its equity interest back to the borrower at a price determined through an agreed formula.

Below are summary attributes for our Debt Securities Portfolio as of and for the year ended December 31, 2015:

- represented approximately 69% of total investment portfolio;
- contained credit instruments issued by corporate borrowers;
- primarily comprised of senior secured and junior secured loans (68% and 13% of debt securities, respectively);
- spread across 26 different industries and 87 different entities;
- average par balance per investment of approximately $3.3 million;
- all but 1 issuer (representing less than 1% of amortized cost of total investments) were current on their debt service obligations; and
- weighted average interest rate of 7.4% on income producing debt investments.

Our investments generally average between $1 million to $20 million, although particular investments may be larger or smaller. The size of individual investments will vary according to their priority in a company's capital structure, with larger investments in more secure positions in an effort to maximize capital preservation. The size of our investments and maturity dates may vary as follows:

- senior secured term loans from $2 to $20 million maturing in five to seven years;
- second lien term loans from $5 to $15 million maturing in six to eight years;
- senior unsecured loans from $5 to $23 million maturing in six to eight years;
- mezzanine loans from $5 to $15 million maturing in seven to ten years; and
- equity investments from $1 to $5 million.

Asset Manager Affiliates. We expect to receive recurring cash distributions and seek to generate capital appreciation from our investment in our Asset Manager Affiliates. We may also seek to monetize our investment the Asset Manager Affiliates if and when business conditions warrant. As a manager of the CLO Funds, our Asset Manager Affiliates receive contractual and recurring management fees from the CLO Funds for their management and advisory services. In addition, our Asset Manager Affiliates may also earn income related to net interest on assets accumulated for future CLO issuances on which they have provided a first loss guaranty in connection with loan warehouse arrangements for their CLO Funds.

The annual management fees that our Asset Manager Affiliates receive are generally based on a fixed percentage of the par value of assets under management and are recurring in nature for the term of the CLO Fund, so long as the Asset Manager Affiliate manages the fund. As a result, the management fees earned by our Asset Manager Affiliates are not subject to market value fluctuations in the underlying collateral. The management fees that our Asset Manager Affiliates receive generally have three contractual components: a senior management fee, a subordinated management fee and the possibility of an incentive management fee if certain conditions are met. Currently, all CLO Funds managed by the Asset Manager Affiliates are paying both their senior and subordinated management fees on a current basis. During 2015, three CLO Funds have achieved the minimum investment return threshold and our Asset Manager Affiliates received incentive fees from those CLO Funds.

Subject to the conditions of the capital markets, we expect to continue to make investments in CLO Funds managed by our Asset Manager Affiliates, which we believe will provide us with a current cash investment return. We believe that these investments will provide our Asset Manager Affiliates with greater opportunities to access new sources of capital, which will ultimately increase our Asset Manager Affiliates' assets under management and resulting management fee income. See "Item 1A. Risk Factors" for a discussion of the risks relating to our ability to access the capital markets and the impact of certain risk retention rules which require that we or our Asset Manager Affiliates make and maintain certain minimum investments in CLO Funds managed by the Asset Manager Affiliates.

The after-tax net free cash flow that our Asset Manager Affiliates generate through the fees they receive for managing CLO Funds and after paying their expenses pursuant to an overhead allocation agreement with the Company associated with their operations, including compensation of their employees, may be distributed to us. Distributions from our Asset Manager Affiliates' tax basis earnings and profits are recorded as "Dividends From Asset Manager Affiliates" in our financial statements when declared. From time to time our Asset Manager Affiliates may distribute cash in excess of tax basis earnings and profits. This excess is deemed a return of capital ("ROC") and is recorded in "unrealized gains (losses)" on the statement of operations.

Below are summary attributes for our Asset Manager Affiliates, as of and for the year ended December 31, 2015:

- represented approximately 14% of total investment portfolio;
- had approximately $2.7 billion par value of assets under management;
- receive contractual and recurring asset management fees based on par value of managed investments;
- may receive an incentive management fee from a CLO Fund, provided that the CLO Fund achieves a minimum designated return on investment. In 2015, three such funds paid incentive fees to our Asset Manager Affiliates;
- distributions paid by our Asset Manager Affiliates are an additional source of income to pay our distributions to our stockholders and service our debt obligations; and
- for the year ended December 31, 2015, we received cash distributions of approximately $9.1 million, of which $5.3 million was recognized as investment income from our Asset Manager Affiliates and the remaining amount as a return of capital.

CLO Fund Securities. Subject to the conditions of the capital markets, we expect to continue to make investments in the CLO Funds managed by our Asset Manager Affiliates, which we believe will provide us with a current cash investment return. We believe that these investments will provide our Asset Manager Affiliates with greater opportunities to access new sources of capital which will ultimately increase our Asset Manager Affiliates' assets under management and resulting management fee income.

Below are summary attributes for our CLO Fund Securities, as of and for the year-ended December 31, 2015, unless otherwise specified:

- CLO Fund Securities represented approximately 14% of total investment portfolio at December 31, 2015;
- 98% of CLO Fund Securities represented investments in subordinated securities or equity securities issued by CLO Funds and 2% of CLO Fund Securities was a rated note;

- all CLO Funds invested primarily in credit instruments issued by corporate borrowers;
- GAAP-basis investment income of $15.7 million; cash distributions received of approximately $24.9 million (approximately $14.7 million taxable distributable income).

Structure and Process

Structure

We are an internally managed BDC with 24 full-time employees (inclusive of employees of our Asset Manager Affiliates). The following are our key functional teams that execute our business strategy:

- Our BDC investment team consists of 7 professionals who originate, structure, and invest in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies as well as CLO Funds.
- Our Asset Manager Affiliates team consists of 8 professionals who structure, purchase and manage portfolios of primarily broadly syndicated corporate senior debt for CLOs.
- The remainder of the employees include senior management, operations, financial accounting, compliance and human resources.

Process

KCAP will review potential investment opportunities and conduct due diligence that will typically include a review of historical and prospective financial information, participation in a presentation held by the prospective portfolio company's management and/or the transaction sponsor, a review of the prospective portfolio company's product or service, an analysis and understanding of the drivers of the particular industry in which the prospective portfolio company operates, and an assessment of the debt service capabilities of the prospective portfolio company under a variety of assumed forecast scenarios.

Due to our ability to source transactions through multiple channels, we expect to continue to maintain a pipeline of opportunities to allow comparative risk return analysis and selectivity. By focusing on the drivers of revenue and cash flow, we develop our own underwriting cases, and multiple stress and event specific case scenarios for each company analyzed.

We focus on lending and investing opportunities in:

- companies with EBITDA of $10 to $50 million;
- companies with financing needs of $25 to $150 million;
- companies purchased by well-regarded private equity sponsors;
- non-sponsored companies with successful management and systems;
- high-yield bonds and broadly syndicated loans to larger companies on a selective basis; and
- equity co-investment in companies where we see substantial opportunity for capital appreciation.

We expect to continue to source investment opportunities from:

- private equity sponsors;
- regional investment banks for non-sponsored companies;
- other middle market lenders with whom we can participate in loans; and
- our Asset Manager Affiliates, with regard to high-yield bonds and syndicated loans.

In our experience, good credit judgment is based on a thorough understanding of both the qualitative and quantitative factors that determine a company's performance. Our analysis begins with an understanding of the fundamentals of the industry in which a company operates, including the current economic environment and the outlook for the industry. We also focus on the company's relative position within the industry and its historical ability to weather economic cycles. Other key qualitative factors include the experience and depth of the management team and the financial sponsor, if any.

Only after we have a comprehensive understanding of the qualitative factors do we focus on quantitative metrics. We believe that with the context provided by the qualitative analysis, we can gain a better understanding of a company's financial performance. We analyze a potential portfolio company's sales growth and margins in the context of its competition as well as its ability to manage its working capital requirements and its ability to generate consistent cash flow. Based upon this historical analysis, we develop a set of projections which represents a reasonable underwriting case of most likely outcomes for the company over the period of our investment. We also look at potential downside cases to determine a company's ability to service its debt in a stressed credit environment.

Elements of the *qualitative analysis* we use in evaluating investment opportunities include the following:

- industry fundamentals;
- competitive position and market share;
- past ability to work through historical down-cycles;
- quality of financial and technology infrastructure;
- sourcing risks and opportunities;
- labor and union strategy;
- technology risk;
- diversity of customer base and product lines;
- quality of financial sponsor (if applicable); and
- acquisition and integration history.

Elements of the *quantitative analysis* we use in evaluating investment opportunities include the following:

- income statement analysis of growth and margin trends;
- cash flow analysis of capital expenditures and free cash flow;
- financial ratio and market share standing among comparable companies;
- financial projections: underwriting versus stress case;
- event specific credit modeling;
- credit profile trend;
- future capital expenditure needs and asset sale plans;
- downside protection to limit losses in an event of default;
- risk adjusted returns and relative value analysis; and
- enterprise and asset valuations.

The origination, structuring and credit approval processes are fully integrated. Our credit team is directly involved in all due diligence and analysis prior to the formal credit approval process by the Investment Committee.

Investment Committee

The Investment Committee consists of the Chairman of the Board of Directors, the Chief Executive Officer, the Chief Investment Officer, and an additional member of the Board of Directors. The Investment Committee serves to provide investment consistency and adherence to our core investment philosophy and policies.

Upon completion of the due diligence investigation, the underwriting team of investment professionals/analysts will prepare a credit underwriting memorandum that will summarize the contemplated transaction, present the investment highlights, analyze the risk in the transaction and mitigating factors to those risks, analyze the prospective portfolio's historical financial statements, financial projections, industry and management team, and will then present this memorandum with its recommendations to the Investment Committee for review and approval.

The approval of a majority of the Investment Committee will be required for all investments of less than $15 million, and the unanimous approval of the Investment Committee will be required for investments of $15 million or greater.

Monitoring

Our management team has significant experience monitoring credit portfolios. Along with origination and credit analysis, portfolio management is one of the key elements of our business. Most of our investments will not be liquid and, therefore, we must prepare to act quickly if potential issues arise so that we can work closely with management and the private equity sponsor, if applicable, of the portfolio company to take any necessary remedial action. In addition, most of our senior management team, including the credit team at the Asset Manager Affiliates, has substantial workout and restructuring experience.

In order to assist us in detecting issues with our Debt Securities Portfolio companies as early as possible, we perform a financial analysis at least quarterly on each portfolio company. This analysis typically includes:

- A summary of the portfolio company's current total credit exposure as well as the KCAP portion of this exposure.
- A summary and update of the portfolio company's financial condition and performance, including but not limited to, performance versus plan, deterioration/improvement in market position, or industry fundamentals, management changes or additions, and ongoing business strategy.
- Reaffirmation of, or proposal to change, the risk rating of the underlying investment.
- A summary of the portfolio company's financial covenant results vis a vis financial covenant levels established in the credit agreement.

Watch list credits are followed closely and discussed periodically with the Chief Investment Officer, as appropriate.

DETERMINATION OF NET ASSET VALUE

We determine the net asset value per share of our common stock quarterly. The net asset value per share is equal to the value of our total assets minus liabilities and any preferred stock outstanding divided by the total number of shares of common stock outstanding.

Our net asset value per share was $5.82 and $6.94 as of December 31, 2015 and December 31, 2014, respectively. Since we report our assets at fair value for each reporting period, net asset value also represents the amount of stockholders' equity per share for the reporting period. Our net asset value is comprised mostly of investment assets less debt and other liabilities:

	December 31, 2015		December 31, 2014	
	Fair Value(1)	per Share(1)	Fair Value(1)	per Share(1)
Investments at fair value:				
Investments in money market accounts(2)	$ 2,129,381	$ 0.06	$ 1,602,741	$ 0.04
Investments in debt securities	284,639,244	7.67	320,143,170	8.70
Investments in CLO Fund Securities	55,872,382	1.51	77,514,903	2.11
Investments in equity securities	9,548,488	0.26	8,119,681	0.22
Investments in Asset Manager Affiliates	57,381,000	1.55	72,326,000	1.97
Cash	—	—	1,220,798	0.03
Restricted Cash(3)	7,138,272	0.19	19,325,550	0.53
All other assets	8,533,574	0.23	10,193,954	0.28
Total Assets	$425,242,341	$ 11.47	$510,446,797	$ 13.88
Convertible Notes	$ 19,299,000	$ 0.52	$ 38,647,000	$ 1.05
7.375% Notes Due 2019	41,400,000	1.12	41,400,000	1.13
Notes payable – KCAP Senior Funding I, LLC (net of discount)	144,442,405	3.90	143,837,593	3.91
Payable for open trades	—	—	18,293,725	0.50
Other liabilities	4,000,466	0.11	12,951,778	0.35
Total Liabilities	209,141,871	5.65	255,130,096	6.94
NET ASSET VALUE	$216,100,470	$ 5.82	$255,316,701	$ 6.94

(1) Our balance sheet at fair value and resultant net asset value are calculated on a basis consistent with accounting principles generally accepted in the United States of America ("GAAP"). Our per share presentation of such amounts (other than net asset value per share) is an internally derived non-GAAP performance measure calculated by dividing the applicable balance sheet amount by outstanding shares. We believe that the per share amounts for such balance sheet items are helpful in analyzing our balance sheet both quantitatively and qualitatively.

(2) Includes restricted cash held under employee benefit plans.

(3) Consists of cash held for quarterly interest and principal payments to the holders of notes Issued by KCAP Senior Funding I, LLC.

Valuation

As a BDC, we invest primarily in illiquid securities, including loans to and warrants of private companies and interests in other illiquid securities, such as interests in CLO Fund Securities. These portfolio investments may be subject to restrictions on resale and will generally have no established trading market. As a result, our Board of Directors determines in good faith the fair value of our portfolio investments pursuant to a valuation policy developed in accordance with the Financial Accounting Standards Board Accounting Standards Codification 820, Fair Value Measurements and Disclosures ("ASC 820: Fair Value"), and a valuation process approved by our Board of Directors and in accordance with the 1940 Act. Our valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio. Our Board of Directors is ultimately and solely responsible for making a good faith determination of the fair value of portfolio investments on a quarterly basis. The Company uses an independent valuation firm to provide third party valuation consulting services to the Company and the Board of Directors. For additional information concerning valuation, see

“Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations — Valuation of Portfolio Investments”; and Notes 2 and 4 to the financial statements.

Competition

Our primary competitors also provide financing to prospective portfolio companies. These include commercial banks, specialty finance companies, hedge funds, structured investment funds, other BDCs and investment banks. Our competitors may have a lower cost of funds, and many have access to funding sources that are not available to us. Many of these entities have greater managerial resources than we have, and the 1940 Act imposes certain regulatory restrictions on us as a BDC to which many of our competitors are not subject. For additional information concerning the competitive risks we face, see “Item 1A. Risk Factors — Risks Related to Our Business and Structure — We operate in a highly competitive market for investment opportunities.”

We believe that we provide a unique combination of an experienced middle market loan origination and a CLO management platform at the Asset Manager Affiliates that includes experienced lenders with broad industry expertise. We believe that this combination of resources provides us with a thorough credit process and multiple sources of investment opportunities that make us attractive within our market.

Employees

As of December 31, 2015, we and our Asset Manager Affiliates had 24 employees, including an experienced team of 15 investment professionals.

REGULATION

The following discussion is a general summary of some of the material prohibitions and restrictions governing BDCs generally. It does not purport to be a complete description of all the laws and regulations affecting BDCs.

A BDC is a unique kind of investment company that primarily focuses on investing in or lending to private or relatively small publicly traded companies and making managerial assistance available to them. The 1940 Act contains prohibitions and restrictions relating to transactions between BDCs and their directors and officers and certain other related persons and requires that a majority of the directors be persons other than “interested persons,” as that term is defined in the 1940 Act. We have implemented certain procedures to ensure that we do not engage in any prohibited transactions with any persons affiliated with us.

In addition, the 1940 Act provides that we may not change the nature of our business so as to cease to be, or to withdraw our election as, a BDC unless approved by a majority of our outstanding voting securities. A majority of the outstanding voting securities of a company is defined under the 1940 Act as the lesser of (i) 67% or more of such company’s shares present at a meeting or represented by proxy if more than 50% of the outstanding shares of such company are present or represented by proxy or (ii) more than 50% of the outstanding shares of such company.

Qualifying Assets

Under the 1940 Act, a BDC may not acquire any asset other than assets of the type listed in Section 55(a) of the 1940 Act, or “Qualifying Assets,” unless, at the time the acquisition is made, Qualifying Assets represent at least 70% of the company’s total assets. The principal categories of Qualifying Assets relevant to our business are the following:

- Securities of an “eligible portfolio company” purchased in transactions not involving any public offering. An “eligible portfolio company” is defined in the 1940 Act as any issuer which:

  (a) is organized under the laws of, and has its principal place of business in, the United States;

  (b) is not an investment company (other than a small business investment company wholly-owned by the BDC) or a company that would be an investment company but for certain exclusions under the 1940 Act; and

(c) satisfies any of the following:

(i) does not have any class of securities listed on a national securities exchange (or, if it has a class of securities listed on a national securities exchange, has an aggregate market value of outstanding voting and non-voting common equity of less than $250 million);

(ii) is controlled by a BDC or a group of companies including a BDC and the BDC has an affiliated person who is a director of the eligible portfolio company;

(iii)is a small and solvent company having total assets of not more than $4 million and capital and surplus of not less than $2 million; or

(iv)does not have outstanding any class of securities with respect to which a broker or dealer may extend margin credit.

- Securities of any eligible portfolio company that we control;
- Securities purchased in a private transaction from a U.S. issuer that is not an investment company and is in bankruptcy and subject to reorganization;
- Securities received in exchange for or distributed on or with respect to securities described above, or pursuant to the conversion of warrants or rights relating to such securities; and
- Cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment.

Significant Managerial Assistance

A BDC must be organized and have its principal place of business in the United States and must be operated for the purpose of making investments in the types of securities described above. In addition, BDCs must generally offer to make available to such issuer of the securities (other than small and solvent companies described above) significant managerial assistance; except that, where we purchase such securities in conjunction with one or more other persons acting together, one of the other persons is the group may make available such managerial assistance. Making available significant managerial assistance means, among other things, any arrangement whereby the BDC, through its directors, officers or employees, offers to provide, and, if accepted, does so provide, guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company through monitoring of portfolio company operations, selective participation in board and management meetings, consulting with and advising a portfolio company's officers or other organizational or financial guidance.

Temporary Investments

Pending investment in other types of "qualifying assets," as described above, our investments may consist of cash, cash equivalents, U.S. government securities or high quality debt securities maturing in one year or less from the time of investment, which we refer to, collectively, as temporary investments, so that at least 70% of our assets are "qualifying assets." Typically, we invest in U.S. treasury bills or in repurchase agreements, provided that such agreements are fully collateralized by cash or securities issued by the U.S. government or its agencies. A repurchase agreement involves the purchase by an investor, such as us, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed upon future date and at a price which is greater than the purchase price by an amount that reflects an agreed-upon interest rate. There is no percentage restriction on the proportion of our assets that may be invested in such repurchase agreements. However, if more than 25% of our total assets constitute repurchase agreements that are treated, under applicable tax rules, as being issued by a single counterparty, we would not meet the diversification tests imposed on us by the Code to qualify for tax treatment as a RIC for U.S. federal income tax purposes. Thus, we do not intend to enter into repurchase agreements treated as issued, under applicable tax rules, by a single counterparty in excess of this limit. We monitor the creditworthiness of the counterparties with which we enter into repurchase agreement transactions.

Indebtedness; Coverage Ratio

We are permitted, under specified conditions, to issue multiple classes of indebtedness and one class of stock senior to our common stock if our asset coverage, as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance. In addition, with respect to certain types of senior securities, we must make provisions to prohibit any dividend distribution to our stockholders or the repurchase of certain of our securities, unless we meet the applicable asset coverage ratios at the time of the dividend distribution or repurchase. We may also borrow amounts up to 5% of the value of our total assets for temporary purposes. For a discussion of the risks associated with the resulting leverage, see "Item 1A. Risk Factors — Risks Related to Our Business and Structure — We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us." As of December 31, 2015, our asset coverage ratio was 202%, above the minimum required asset coverage level of 200%.

Common Stock

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, at a price below the current net asset value of the common stock if our Board of Directors determines that such sale is in our best interests and that of our stockholders, and our stockholders approve such sale. In any such case, the price at which our common stock is to be issued and sold may not be less than a price which, in the determination of our Board of Directors, closely approximates the market value of such common stock (less any distributing commission or discount). We may also make rights offerings to our stockholders at prices per share less than the net asset value per share, subject to applicable requirements of the 1940 Act. See "Item 1A. Risk Factors — Risks Relating to Our Business and Structure — Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital."

Code of Ethics

We adopted and maintain a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts certain personal securities transactions. Personnel subject to the code may invest in securities for their personal investment accounts, including securities that may be purchased or held by us, so long as such investments are made in accordance with the code's requirements. A copy of the code of ethics is available on the Corporate Governance section of the Company's website at *http://www.kcapfinancial.com*. Our code of ethics may also be reviewed and copied at the Public Reference Room of the SEC at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Copies of the code of ethics may be obtained, after paying a duplicating fee, by electronic request at the following e-mail address: *publicinfo@sec.gov*, or by writing the SEC's Public Reference Section, Washington, D.C. 20549-0102. In addition, our code of ethics is available on the SEC's website at *http://www.sec.gov*.

Privacy Principles

We are committed to maintaining the privacy of our stockholders and safeguarding their non-public personal information. The following information is provided to help you understand what personal information we collect, how we protect that information and why, in certain cases, we may share information with select other parties.

Generally, we do not receive any non-public personal information relating to our stockholders, although some non-public personal information of our stockholders may become available to us. We do not disclose any non-public personal information about our stockholders or former stockholders to anyone, except as is necessary to service stockholder accounts, such as to a transfer agent, or as otherwise permitted by law.

We restrict access to non-public personal information about our stockholders to our employees with a legitimate business need for the information. We maintain safeguards designed to protect the non-public personal information of our stockholders.

Proxy Voting Policy and Procedures

Although the securities we hold are not typically voting securities, some of our investments could entitle us to voting rights. If this were to occur we would vote our portfolio securities in the best interest of our stockholders and we would review on a case-by-case basis each proposal submitted to a stockholder vote to determine its impact on the portfolio securities held by us. Although we would generally vote against proposals that we believe may have a negative impact on our portfolio securities, we may vote for such a proposal if we were to believe there exists a compelling long-term reason to do so.

Our voting decisions would be made by our Investment Committee. To ensure that our vote would not the product of a conflict of interest, we would require that (1) anyone involved in the decision making process disclose to our Chief Compliance Officer any potential conflict that he or she is aware of and any contact that he or she has had with any interested party regarding a vote; and (2) employees involved in the decision making process or vote administration are prohibited from revealing how we intend to vote on a proposal to reduce any attempted influence from interested parties.

Other

We are periodically examined by the SEC for compliance with the 1940 Act and the Securities Exchange Act of 1934.

We are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect us against larceny and embezzlement. Furthermore, as a BDC, we are prohibited from indemnifying any director or officer against any liability to our stockholders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office.

We are required to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws and to review these policies and procedures annually for their adequacy and the effectiveness of their implementation. We have a designated Chief Compliance Officer who is responsible for administering these policies and procedures.

TAXATION AS A REGULATED INVESTMENT COMPANY

We have elected to be treated for U.S. federal income tax purposes as a Regulated Investment Company ("RIC") under subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"), and intend to operate in a manner to maintain our RIC tax treatment. As a RIC, we generally will not have to pay corporate-level U.S. federal income taxes on any ordinary income or capital gains that we timely distribute to our stockholders as dividends. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, we must distribute to our stockholders, for each taxable year, at least 90% of our "investment company taxable income," which is generally our net ordinary taxable income plus the excess of our realized net short-term capital gains over our realized net long-term capital losses (the "Annual Distribution Requirement").

Taxation as a RIC

For any taxable year in which we qualify as a RIC and satisfy the Annual Distribution Requirement, we generally will not be subject to U.S. federal income tax on the portion of our investment company taxable income and net capital gain, defined as net long-term capital gains in excess of net short-term capital losses, we distribute to stockholders. We will be subject to U.S. federal income tax at the regular corporate rates on any net ordinary income or net capital gain not distributed (or deemed distributed) to our stockholders.

We will be subject to a 4% nondeductible U.S. federal excise tax on our undistributed income unless we distribute in a timely manner an amount at least equal to the sum of (a) 98% of our net ordinary income for each calendar year, (b) 98.2% of our capital gain net income for the one-year period ending October 31 in that calendar year and (c) any income or gains realized, but not distributed, in the preceding year and on which we paid no U.S. federal income tax (the "Excise Tax Avoidance Requirement"). For this purpose, however, any net ordinary income or capital gain net income retained by us that is subject to corporate-level U.S. federal income tax for the tax year ending in that calendar year will be considered to have been distributed by year end (or earlier if estimated taxes are paid). Although we generally endeavor to make sufficient distributions each taxable year to satisfy the Excise Tax Avoidance Requirement, we may incur a U.S. federal excise tax.

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

- qualify to be regulated as a business development company under the 1940 Act at all times during each taxable year;
- derive in each taxable year at least 90% of our gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale of stock or other securities, or other income derived with respect to our business of investing in such stock or securities, and net income derived from interests in "qualified publicly traded partnerships" (which generally are partnerships that are traded on an established securities market or tradable on a secondary market, other than partnerships that derive 90% of their income from interest, dividends and other permitted RIC income) (the "90% Income Test"); and
- diversify our holdings so that at the end of each quarter of the taxable year:
  - at least 50% of the value of our assets consists of cash, cash equivalents, U.S. government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer; and
  - no more than 25% of the value of our assets is invested in the securities, other than U.S. government securities or securities of other RICs, of one issuer or of two or more issuers that are controlled, as determined under applicable tax rules, by us and that are engaged in the same or similar or related trades or businesses or in the securities of one or more qualified publicly traded partnerships (the "Diversification Tests").

If we do not satisfy the requirements of the Diversification Tests as of the end of any quarter, we will not lose our status as RIC provided that (i) we satisfied the requirements in a prior quarter and (ii) our failure to satisfy the requirements in the current quarter is not due in whole or in part to an acquisition of any security or other property.

We may invest in partnerships, including qualified publicly traded partnerships, which may result in our being subject to state, local or foreign income, franchise or withholding liabilities.

Any underwriting fees paid by us are not deductible. We may be required to recognize taxable income in circumstances in which we do not receive cash. For example, if we hold debt obligations that are treated under applicable tax rules as having original issue discount (such as debt instruments with payment-in-kind ("PIK") interest or, in certain cases, with increasing interest rates or issued with warrants), we must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by us in the same taxable year. Because any original issue discount accrued will be included in our investment company taxable income for the year of accrual, we may be required to make a distribution to our stockholders in order to satisfy the Annual Distribution Requirement, even though we will not have received any corresponding cash amount. If we are not able to obtain sufficient cash from other sources to satisfy the Annual Distribution Requirement, we may fail to qualify as a RIC and become subject to corporate-level U.S. federal income taxes on all of our taxable income without the benefit of the dividends-paid deduction.

Although we do not presently expect to do so, we are authorized to borrow funds and to sell assets in order (i) to satisfy the Annual Distribution Requirement and to otherwise eliminate our liability for U.S. federal income and excise taxes and (ii) to satisfy the Diversification Tests. However, under the 1940 Act, we are not permitted to borrow additional funds or to make distributions to our stockholders while our debt obligations and other senior securities are outstanding unless a certain "asset coverage" test is met. See "Regulation — Indebtedness; Coverage Ratio." Moreover, our ability to dispose of assets to meet the Annual Distribution Requirement, the Excise Tax Avoidance Requirement or the Diversification Tests may be limited by (a) the illiquid nature of our portfolio and/or (b) other requirements relating to our qualification as a RIC. If we dispose of assets in order to meet the Annual Distribution Requirement, the Excise Tax Avoidance Requirement, or the Diversification Tests, we may make such dispositions at times that, from an investment standpoint, are not advantageous.

Certain of our investment practices may be subject to special and complex U.S. federal income tax provisions that may, among other things, (a) treat dividends that would otherwise constitute qualified dividend income as non-qualified dividend income, (b) treat dividends that would otherwise be eligible for the corporate dividends received deduction as ineligible for such treatment, (c) disallow, suspend or otherwise limit the allowance of certain losses or deductions, (d) convert lower-taxed long-term capital gain into higher-taxed short-term capital gain or ordinary income, (e) convert an ordinary loss or a deduction into a capital loss (the deductibility of which is more limited), (f) cause us to recognize income or gain without a corresponding receipt of cash, (g) adversely affect the time as to when a purchase or sale of stock or securities is deemed to occur, (h) adversely alter the characterization of certain complex financial transactions and (i) produce income that will not be qualifying income for purposes of the 90% Income Test. We intend to monitor our transactions and may make certain tax elections to mitigate the effect of these provisions and prevent our disqualification as a RIC.

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

Some of the income and fees that we may recognize will not satisfy the 90% Income Test. In order to ensure that such income and fees do not disqualify us as a RIC for a failure to satisfy the 90% Income Test, we may hold assets that generate such income and provide services that generate such fees indirectly through one or more entities treated as corporations for U.S. federal income tax purposes. Such corporations will be required to pay corporate-level U.S. federal income taxes on their earnings, which ultimately will reduce our return on such income and fees.

DIVIDEND REINVESTMENT PLAN

We have adopted a dividend reinvestment plan that provides for reinvestment of our distributions on behalf of our stockholders, unless a stockholder elects to receive cash as provided below. As a result, if our Board of Directors authorizes, and we declare, a cash distribution, then our stockholders who have not “opted out” of our dividend reinvestment plan will have their cash distributions automatically reinvested in additional shares of our common stock, rather than receiving the cash.

No action is required on the part of a registered stockholder to have such shareholder’s cash distribution reinvested in shares of our common stock. A registered stockholder may elect to receive an entire distribution in cash by notifying American Stock Transfer & Trust Company, the plan administrator and our transfer agent and registrar, in writing so that such notice is received by the plan administrator no later than the record date for distributions to stockholders. The plan administrator will set up an account for shares acquired through the plan for each stockholder who has not elected to receive distributions in cash and hold such shares in non-certificated form. Upon request by a stockholder participating in the plan, received in writing not less than ten days prior to the record date, the plan administrator will, instead of crediting shares to the participant’s account, issue a certificate registered in the participant’s name for the number of whole shares of our common stock and a check for any fractional share.

Those stockholders whose shares are held by a broker or other financial intermediary may receive distributions in cash by notifying their broker or other financial intermediary of their election.

We intend to use primarily newly issued shares to implement the plan, whether our shares are trading at a premium or at a discount to net asset value. However, we reserve the right to purchase shares in the open market in connection with our implementation of the plan. The number of shares to be issued to a stockholder is determined by dividing the total dollar amount of the dividend payable to such stockholder by the market price per share of our common stock at the close of regular trading on The NASDAQ Global Select Market on the dividend payment date. Market price per share on that date will be the closing price for such shares on The NASDAQ Global Select Market or, if no sale is reported for such day, at the average of their reported bid and asked prices. Shares purchased in open market transactions by the plan administrator of the dividend reinvestment plan will be allocated to a stockholder based upon the average purchase price, excluding any brokerage charges or other charges, of all shares of common stock purchased with respect to the distribution.

There are no brokerage charges or other charges to stockholders who participate in the plan. The plan administrator's fees under the plan are paid by us. If a participant elects by written notice to the plan administrator to have the plan administrator sell part or all of the shares held by the plan administrator in the participant's account and remit the proceeds to the participant, the plan administrator is authorized to deduct a $15.00 transaction fee plus a $0.10 per share brokerage commission from the proceeds.

If your distributions are reinvested, you will be required to pay tax on the distributions in the same manner as if the distributions were received in cash. The taxation of distributions will not be affected by the form in which you receive them.

Participants may terminate their accounts under the plan by notifying the plan administrator via its website at *www.amstock.com*, by filling out the transaction request form located at bottom of their statement and sending it to the plan administrator at the address set forth below or by calling the plan administrator at 1-866-668-8564.

The plan may be terminated by us upon notice in writing mailed to each participant at least 30 days prior to any record date for the payment of any dividend by us. All correspondence concerning the plan should be directed to, and additional information about the plan may be obtained from, the plan administrator by mail at American Stock Transfer & Trust Company, Attn. Dividend Reinvestment Department, P.O. Box 922, Wall Street Station, New York, NY 10269-0560 or by telephone at 1-866-668-8564.

Item 1A. ***Risk Factors***

Investing in our securities involves a high degree of risk. In addition to the other information contained in this annual report on Form 10-K, the following information should be carefully considered before making an investment in our securities. The risks set out below are not the only risks we face. Additional risks and uncertainties not presently known to us or not presently deemed material by us might also impair our operations and performance. If any of the following events occur, our business, financial condition and results of operations could be materially and adversely affected. In such case, our net asset value and the trading price of our securities could decline, and you may lose part or all of your investment.

Risks Related to Economic Conditions

Economic recessions or downturns may have a material adverse effect on our business, financial condition and results of operations, and could impair the ability of our portfolio companies to repay loans.

Economic recessions or downturns may result in a prolonged period of market illiquidity which could have a material adverse effect on our business, financial condition and results of operations. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could limit our investment originations, limit our ability to grow and negatively impact our operating results.

Although the market is not currently experiencing the same levels of disruption as during 2008 to 2009, recently, the debt markets have been experiencing substantial disruption, which may continue substantially into the future. To the extent that recessionary conditions return, the financial results of middle-market companies, like those in which we invest, will likely experience deterioration, which could ultimately lead to difficulty in meeting debt service requirements and an increase in defaults. Additionally, the end markets for certain of our portfolio companies' products and services would likely experience negative economic trends. The performances of certain of our portfolio companies have been, and may continue to be, negatively impacted by these economic or other conditions, which may ultimately result in our receipt of a reduced level of interest income from our portfolio companies and/or losses or charge offs related to our investments, and, in turn, may adversely affect distributable income. Further, adverse economic conditions may decrease the value of collateral securing some of our loans and the value of our equity investments. As a result, we may need to modify the payment terms of our investments, including changes in payment-in-kind interest provisions and/or cash interest rates. These factors may result in our receipt of a reduced level of interest income from our portfolio companies and/or losses or charge offs related to our investments, and, in turn, may adversely affect distributable income and have a material adverse effect on our results of operations.

The capital markets may experience periods of disruption and instability. Such market conditions may materially and adversely affect debt and equity capital markets in the United States, which may have a negative impact on our business and operations.

The U.S. capital markets experienced extreme volatility and disruption over the past several years, leading to recessionary conditions and depressed levels of consumer and commercial spending. Disruptions in the capital markets increased the spread between the yields realized on risk-free and higher risk securities, resulting in illiquidity in parts of the capital markets. While recent indicators suggest improvement in the capital markets, we cannot provide any assurance that these conditions will not worsen. If these conditions continue or worsen, the prolonged period of market illiquidity may have an adverse effect on our business, financial condition, and results of operations. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could limit our investment originations, limit our ability to grow and negatively impact our operating results.

In addition, significant changes or volatility in the capital markets may also have a negative effect on the valuations of our investments. While most of our investments are not publicly traded, applicable accounting standards require us to assume as part of our valuation process that our investments are sold in a principal market to market participants (even if we plan on holding an investment through its maturity). Significant changes in the capital markets may also affect the pace of our investment activity and the potential for liquidity events involving our investments. Thus, the illiquidity of our investments may make it difficult for us to sell such investments to access capital if required, and as a result, we could realize significantly less than the value at which we have recorded our investments if we were required to sell them for liquidity purposes. An inability to raise or access capital could have a material adverse effect on our business, financial condition or results of operations.

Uncertainty about the financial stability of the United States and other countries could have a significant adverse effect on our business, financial condition and results of operations.

The current worldwide financial market situation, as well as various social and political tensions in the United States and around the world, may continue to contribute to increased market volatility, may have long-term effects on the United States and worldwide financial markets, and may cause further economic uncertainties or deterioration in the United States and worldwide. Since 2010, several European Union ("EU") countries, including Greece, Ireland, Italy, Spain, and Portugal, have faced budget issues, some of which may have negative long-term effects for the economies of those countries and other EU countries. Growth in the EU's economy has continued to stagnate, as concerns over deflation and the effects of Russian sanctions on growth were added to longstanding issues with burdensome debt loads and high unemployment. Recently, the European Central Bank began employing more aggressive stimulus measures, with the initiation of full-scale quantitative easing that involves purchase of Eurozone sovereign debt. In addition to EU fiscal policy, the fiscal policy of foreign nations, such as Russia and China, may have a severe impact on the worldwide and United States financial markets. We do not know how long the financial markets will continue to be affected by these events and cannot predict the effects of these or similar events in the future on the United States economy and securities markets or on our investments. We monitor developments and seek to manage our investments in a manner consistent with achieving our investment objective, but there can be no assurance that we will be successful in doing so.

Risks Related to Our Business and Structure

We previously identified a material weakness in our internal control over financial reporting. Our failure to establish and maintain effective internal control over financial reporting could result in material misstatements in our financial statements, our failure to meet our reporting obligations and cause investors to lose confidence in our reported financial information, which in turn could cause the trading price of our securities to decline.

We previously identified a material weakness in our internal control over financial reporting relating to the review and oversight of tax-related matters and, as a result of such weakness, our management concluded that our disclosure controls and procedures and internal control over financial reporting were not effective as of December 31, 2014.

Although we remediated this material weakness in our internal control over financial reporting, any failure to improve our disclosure controls and procedures or internal control over financial reporting to address identified weaknesses in the future, if they were to occur, could prevent us from maintaining accurate accounting records and discovering material accounting errors. Any of these results could adversely affect our business and the value of our common stock.

We are dependent upon our senior management for our future success, and if we are unable to hire and retain qualified personnel or if we lose any member of our senior management team, our ability to achieve our investment objectives could be significantly harmed.

We depend on the members of our senior management as well as other key personnel for the identification, final selection, structuring, closing and monitoring of our investments. These employees have critical industry experience and relationships that we rely on to implement our business plan. Our future success depends on the continued service of our senior management team. The departure of any of the members of our senior management or a significant number of our senior personnel could have a material adverse effect on our ability to achieve our investment objective. As a result, we may not be able to operate our business as we expect, and our ability to compete could be harmed, which could cause our operating results to suffer.

Additionally, the management agreements governing some of the CLO funds managed by our Asset Manager Affiliates have "key person" provisions that provide certain CLO investors with rights upon the departure of a "key person", as defined in each agreement. As a result, the departure of a "key person" could trigger a material change in the Asset Manager Affiliate's role in managing the CLO Funds, and therefore KCAP's financial benefits from its investments in the Asset Manager Affiliates.

We operate in a highly competitive market for investment opportunities.

A large number of entities compete with us to make the types of investments that we plan to make in prospective portfolio companies. We compete with other BDCs, as well as a number of investment funds, investment banks and other sources of financing, including traditional financial services companies, such as commercial banks and finance companies. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. This may enable some of our competitors to make commercial loans with interest rates that are comparable to or lower than the rates we typically offer. We may lose prospective portfolio investments if we do not match our competitors' pricing, terms and structure. If we do match our competitors' pricing, terms or structure, we may experience decreased net interest income. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, establish more relationships and build their market shares. Furthermore, many of our potential competitors have greater experience operating under, or are not subject to, the regulatory restrictions that the 1940 Act imposes on us as a BDC. As a result of this competition, there can be no assurance that we will be able to identify and take advantage of attractive investment opportunities or that we will be able to fully invest our available capital. If we are not able to compete effectively, our business and financial condition and results of operations will be adversely affected.

If we are unable to source investments effectively, we may be unable to achieve our investment objectives and provide returns to stockholders.

Our ability to achieve our investment objective depends on our senior management team's ability to identify, evaluate and invest in suitable companies that meet our investment criteria. Accomplishing this result on a cost-effective basis is largely a function of our marketing capabilities, our management of the investment process, our ability to provide efficient services and our access to financing sources on acceptable terms. In addition to monitoring the performance of our existing investments, members of our management team may also be called upon to focus their attention on other aspects of our business, including strategic opportunities available to us and/or the Asset Manager Affiliates from time to time. These demands on their time may distract them or slow the rate of investment. To grow, we need to continue to hire, train, supervise and manage new employees and to implement computer and other systems capable of effectively accommodating our growth. However, we cannot provide assurance that any such employees will contribute to the success of our business or that we will implement such systems effectively. Failure to source investments effectively could have a material adverse effect on our business, financial condition and results of operations.

Our business model depends to a significant extent upon strong referral relationships, and our inability to maintain or develop these relationships, as well as the failure of these relationships to generate investment opportunities, could adversely affect our business.

We expect that members of our senior management team will maintain their relationships with intermediaries, financial institutions, investment bankers, commercial bankers, financial advisors, attorneys, accountants, consultants and other individuals within their networks, and we will rely to a significant extent upon these relationships to provide us with potential investment opportunities. If our senior management team fails to maintain its existing relationships or develop new relationships with sources of investment opportunities, we will not be able to grow our investment portfolio. In addition, individuals with whom members of our senior management team have relationships are not obligated to provide us with investment opportunities, and, therefore, there is no assurance that such relationships will generate investment opportunities for us.

We may have difficulty paying distributions required to maintain our RIC status if we recognize income before or without receiving cash equal to such income.

In accordance with the Code, we include in income certain amounts that we have not yet received in cash, such as contracted non-cash PIK interest, which represents contractual interest added to the loan balance and due at the end of the loan term. The increases in loan balances as a result of contracted non-cash PIK arrangements are included in income for the period in which such non-cash PIK interest was received, which is often in advance of receiving cash payment, and are separately identified on our statements of cash flows. We also may be required to include in income certain other amounts that we will not receive in cash. Any warrants that we receive in connection with our debt investments generally are valued as part of the negotiation process with the particular portfolio company. As a result, a portion of the aggregate purchase price for the debt investments and warrants is allocated to the warrants that we receive. This generally results in the associated debt investment having "original issue discount" for tax purposes, which we must recognize as ordinary income as it accrues. This increases the amounts we are required to distribute to maintain our qualification for tax treatment as a RIC. Because such original issue discount income might exceed the amount of cash received in a given year with respect to such investment, we might need to obtain cash from other sources to satisfy such distribution requirements. Other features of the debt instruments that we hold may also cause such instruments to generate original issue discount.

Since, in certain cases, we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the annual distribution requirement necessary to maintain RIC tax treatment under the Code. Accordingly, we may have to sell some of our investments at times and/or at prices we would not consider advantageous, raise additional debt or equity capital or forgo new investment opportunities for this purpose. If we are not able to obtain cash from other sources, we may fail to qualify for RIC tax treatment and thus become subject to corporate-level income tax. For additional discussion regarding the tax implications of a RIC, see "Business — Regulation — Taxation as a Regulated Investment Company."

Our Asset Manager Affiliates may incur losses as a result of "first loss" agreements that they may enter into from time-to-time in connection with warehousing credit arrangements which may be put in place prior to raising a CLO Fund and pursuant to which they would typically agree to reimburse credit providers for a portion of losses (if any) on warehouse investments.

Our Asset Manager Affiliates have in the past entered into, are currently entered into, and we and our Asset Manager Affiliates may in the future enter into "first loss" agreements in connection with warehouse credit lines established to fund the initial accumulation of loan investments for future CLO Funds that our Asset Manager Affiliates will manage. Under such agreements, our Asset Manager Affiliates generally make a junior investment in a warehouse facility, which serves as a loss buffer for the senior capital provider. Such junior investment may be subject to losses (either in whole or in part) that stem from factors including (i) losses as a result of individual loan or other investments being ineligible for purchase by the CLO Fund (typically due to a payment default on such loan or other investments) when such fund formation is completed or (ii) if the CLO Fund has not been completed before the expiration of the warehouse credit line, the loss (if any, and net of any accumulated interest income) on the resale of such loans funded by the warehouse credit line, or (iii) realized losses from trading activity within the warehouse facility. As a result, our Asset Manager Affiliates may incur losses if loans and debt obligations, if applicable, that had been purchased in the warehouse facility become ineligible for inclusion in the CLO Fund or if a planned CLO Fund does not close.

Any unrealized losses we experience on our loan portfolio may be an indication of future realized losses, which could reduce our income available to make distributions.

As a BDC, we are required to carry our investments at market value or, if no market value is ascertainable, at the fair value as determined in good faith by our Board of Directors pursuant to a valuation methodology approved by our Board of Directors. Decreases in the market values or fair values of our investments will be recorded as unrealized losses. An unrealized loss in our loan portfolio could be an indication of a portfolio company's inability to meet its repayment obligations with respect to the affected loans. This could result in realized losses in the future and ultimately in reductions of our income available to pay dividends or interest and principal on our securities and could cause you to lose all or part of your investment.

We may experience fluctuations in our quarterly and annual operating results and credit spreads.

We could experience fluctuations in our quarterly and annual operating results due to a number of factors, some of which are beyond our control, including our ability to make investments in companies that meet our investment criteria, the interest rate payable on the debt securities we acquire (which could stem from the general level of interest rates, credit spreads, or both), the default rate on such securities, prepayment upon the triggering of covenants in our middle market loans as well as our CLO Funds, our level of expenses, variations in and timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

We are exposed to risks associated with changes in interest rates and spreads.

Changes in interest rates may have a substantial negative impact on our investments, the value of our securities and our rate of return on invested capital. A reduction in the interest spreads on new investments could also have an adverse impact on our net interest income. An increase in interest rates could decrease the value of any investments we hold which earn fixed interest rates, including mezzanine securities and high-yield bonds, and also could increase our interest expense, thereby decreasing our net income. An increase in interest rates due to an increase in credit spreads, regardless of general interest rate fluctuations, could also negatively impact the value of any investments we hold in our portfolio.

In addition, an increase in interest rates available to investors could make an investment in our securities less attractive than alternative investments, a situation which could reduce the value of our securities. Conversely, a decrease in interest rates may have an adverse impact on our returns by requiring us to seek lower yields on our debt investments and by increasing the risk that our portfolio companies will prepay our debt investments, resulting in the need to redeploy capital at potentially lower rates. A decrease in market interest rates may also adversely impact our returns on idle funds, which would reduce our net investment income.

We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us.

Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in us. We have issued senior securities, and in the future may borrow from, or issue additional senior securities (such as preferred or convertible securities or debt securities) to, banks and other lenders and investors. Subject to prevailing market conditions, we intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. Lenders and holders of such senior securities would have fixed dollar claims on our assets that are superior to the claims of our common stockholders. Leverage is generally considered a speculative investment technique. Any increase in our income in excess of interest payable on our outstanding indebtedness would cause our net income to increase more than it would have had we not incurred leverage, while any decrease in our income would cause net income to decline more sharply than it would have had we not incurred leverage. Such a decline could negatively affect our ability to make distributions to our stockholders and service our debt obligations. In addition, our common stockholders will bear the burden of any increase in our expenses as a result of leverage. There can be no assurance that our leveraging strategy will be successful.

Our outstanding indebtedness imposes, and additional debt we may incur in the future will likely impose, financial and operating covenants that restrict our business activities, including limitations that could hinder our ability to finance additional loans and investments or to make the distributions required to maintain our status as a RIC. A failure to add new debt facilities or issue additional debt securities or other evidences of indebtedness in lieu of or in addition to existing indebtedness could have a material adverse effect on our business, financial condition or results of operations.

Our indebtedness could adversely affect our financial health and our ability to respond to changes in our business.

With certain limited exceptions, we are only allowed to borrow amounts or issue senior securities such that our asset coverage, as defined in the 1940 Act, is at least 200% immediately after such borrowing or issuance. As of December 31, 2015, our asset coverage ratio was 202%. The amount of leverage that we employ in the future will depend on our management's and our Board of Directors' assessment of market and other factors at the time of any proposed borrowing. There is no assurance that a leveraging strategy will be successful. As a result of the level of our leverage:

- our exposure to risk of loss is greater if we incur debt or issue senior securities to finance investments because a decrease in the value of our investments has a greater negative impact on our equity returns and, therefore, the value of our business if we did not use leverage;
- the decrease in our asset coverage ratio resulting from increased leverage and the covenants contained in documents governing our indebtedness (which may impose asset coverage or investment portfolio composition requirements that are more stringent than those imposed by the 1940 Act) limit our flexibility in planning for, or reacting to, changes in our business and industry, as a result of which we could be required to liquidate investments at an inopportune time;
- we are required to dedicate a portion of our cash flow to interest payments, limiting the availability of cash for dividends and other purposes; and
- our ability to obtain additional financing in the future may be impaired.

We cannot be sure that our leverage will not have a material adverse effect on us. In addition, we cannot be sure that additional financing will be available when required or, if available, will be on terms satisfactory to us. Further, even if we are able to obtain additional financing, we may be required to use some or all of the proceeds thereof to repay our outstanding indebtedness.

Because we intend to continue to distribute substantially all of our income and net realized capital gains to our stockholders, we will need additional capital to finance our growth.

In order to continue to qualify as a RIC, to avoid payment of excise taxes and to minimize or avoid payment of income taxes, we intend to continue to distribute to our stockholders substantially all of our net ordinary income and realized net capital gains except for certain net long-term capital gains (which we may retain, pay applicable income taxes with respect thereto, and elect to treat as deemed distributions to our stockholders). As a BDC, in order to incur new debt, we are generally required to meet a coverage ratio of total assets to total senior securities, which includes all of our borrowings and any preferred stock we may issue in the future, of at least 200%, as measured immediately after issuance of such security. This requirement limits the amount that we may borrow. Because we will continue to need capital to grow our loan and investment portfolio, this limitation may prevent us from incurring debt and require us to issue additional equity at a time when it may be disadvantageous to do so. We cannot assure you that debt and equity financing will be available to us on favorable terms, or at all, and debt financings may be restricted by the terms of such borrowings. Also, as a business development company, we generally are not permitted to issue equity securities priced below net asset value without stockholder approval. If additional funds are not available to us, we could be forced to curtail or cease new lending and investment activities.

We may from time to time expand our business through acquisitions, which could disrupt our business and harm our financial condition.

We may pursue potential acquisitions of, and investments in, businesses complementary to our business and from time to time engage in discussions regarding such possible acquisitions. For example, in February 2012, we completed the acquisition of Trimaran Advisors. Such acquisition and any other acquisitions we may undertake involve a number of risks, including:

- failure of the acquired businesses to achieve the results we expect;
- substantial cash expenditures;
- diversion of capital and management attention from operational matters;

- our inability to retain key personnel of the acquired businesses;
- incurrence of debt and contingent liabilities and risks associated with unanticipated events or liabilities; and
- the potential disruption and strain on our existing business and resources that could result from our planned growth and continuing integration of our acquisitions.

If we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of such acquisitions, we may incur costs in excess of what we anticipate, and management resources and attention may be diverted from other necessary or valuable activities. Any acquisition, including the Trimaran Advisors acquisition, may not result in short-term or long-term benefits to us. If we are unable to integrate or successfully manage any business that we acquire, we may not realize anticipated cost savings, improved efficiencies or revenue growth, which may result in reduced profitability or operating losses.

Our Board of Directors may change our investment objective, operating policies and strategies without prior notice or stockholder approval.

Our Board of Directors has the authority to modify or waive certain of our operating policies and strategies without prior notice and without stockholder approval. However, absent stockholder approval, we may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC. We cannot predict the effect any changes to our current operating policies and strategies would have on our business and operating results. Nevertheless, the effects may adversely affect our business and they could negatively impact our ability to pay you dividends and could cause you to lose all or part of your investment in our securities.

Pending legislation may allow us to incur additional leverage.

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

Our businesses may be adversely affected by litigation and regulatory proceedings.

From time to time, we may be subject to legal actions as well as various regulatory, governmental and law enforcement inquiries, investigations and subpoenas. In any such claims or actions, demands for substantial monetary damages may be asserted against us and may result in financial liability or an adverse effect on our reputation among investors. We may be unable to accurately estimate our exposure to litigation risk when we record balance sheet reserves for probable loss contingencies. As a result, any reserves we establish to cover any settlements or judgments may not be sufficient to cover our actual financial exposure, which may have a material impact on our results of operations or financial condition. In regulatory enforcement matters, claims for disgorgement, the imposition of penalties and the imposition of other remedial sanctions are possible.

Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital.

Our business requires a substantial amount of additional capital. We may acquire additional capital from the issuance of senior securities or other indebtedness, the issuance of additional shares of our common stock or from securitization transactions. However, we may not be able to raise additional capital in the future on favorable terms or at all. We may issue debt securities or preferred securities, which we refer to collectively as “senior securities,” and we may borrow money from banks or other financial institutions, up to the maximum amount permitted by the 1940 Act. The 1940 Act permits us to issue senior securities or incur indebtedness only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% immediately after such issuance or incurrence. With respect to certain types of senior securities, we must make provisions to prohibit any dividend distribution to our stockholders or the repurchase of certain of our securities, unless we meet the applicable asset coverage ratios at the time of the dividend distribution or repurchase. If the value of our assets declines, we may be unable to satisfy the asset coverage test. Furthermore, any amounts that we use to service our indebtedness would not be available for distributions to our common stockholders.

All of the costs of offering and servicing such debt or preferred stock (if issued by us in the future), including interest or preferential dividend payments thereon, will be borne by our common stockholders. The interests of the holders of any debt or preferred stock we may issue will not necessarily be aligned with the interests of our common stockholders. In particular, the rights of holders of our debt or preferred stock to receive interest, dividends or principal repayment will be senior to those of our common stockholders. Also, in the event we issue preferred stock, the holders of such preferred stock will have the ability to elect two members of our board of directors. In addition, we may grant a lender a security interest in a significant portion or all of our assets, even if the total amount we may borrow from such lender is less than the amount of such lender's security interest in our assets. In no event, however, will any lender to us have any veto power over, or any vote with respect to, any change in our, or approval of any new, investment objective or investment policies or strategies.

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock at a price below the then-current net asset value of our common stock if our board of directors determines that such sale is in the best interests of KCAP and its stockholders, and our stockholders approve giving us the authority to do so. Although we currently do not have such authorization, we previously sought and received such authorization from our stockholders in the past and may seek such authorization in the future. In any such case, the price at which our securities are to be issued and sold may not be less than a price which, in the determination of our board of directors, closely approximates the market value of such securities (less any distributing commission or discount). We are also generally prohibited under the 1940 Act from issuing securities convertible into voting securities without obtaining the approval of our existing stockholders. In addition to issuing securities to raise capital as described above; we may securitize a portion of the loans generate cash for funding new investments. If we are unable to successfully securitize our loan portfolio our ability to grow our business and fully execute our business strategy and our earnings (if any) may be adversely affected. Moreover, even successful securitization of our loan portfolio might expose us to losses, as the residual loans in which we do not sell interests tend to be those that are riskier and more apt to generate losses.

Changes in the laws or regulations governing our business and the business of our Asset Manager Affiliates, or changes in the interpretations thereof, and any failure by us or our Asset Manager Affiliates to comply with these laws or regulations, could negatively affect the profitability of our operations.

Changes in the laws or regulations or the interpretations of the laws and regulations that govern BDCs, Registered Investment Advisers (such as our Asset Manager Affiliates), RICs or non-depository commercial lenders could significantly affect our operations and our cost of doing business. We are subject to federal, state and local laws and regulations as well as the rules of the stock exchange on which our securities are listed, and are subject to judicial and administrative decisions that affect our operations, including our loan originations, maximum interest rates, fees and other charges, disclosures to portfolio companies, the terms of secured transactions, collection and foreclosure procedures and other trade practices. The various regulatory bodies, including the SEC and the NASDAQ Global Select Market, that administer these laws and regulations have issued a significant number of new and increasingly complex requirements and regulations over the course of the last several years and continue to develop additional regulations.

In addition, as registered investment advisers, the Asset Manager Affiliates are subject to new and existing regulations, regulatory risks, costs and expenses associated with operating as registered investment advisers that may limit their ability to operate, structure or expand their businesses in the future. If these laws, regulations or decisions change, or if we expand our business into jurisdictions that have adopted more stringent requirements than those in which we currently conduct business, we may have to incur significant expenses in order to comply or we might have to restrict our operations. In addition, if we do not comply with applicable laws, regulations and decisions, we may lose licenses needed for the conduct of our business and be subject to civil fines and criminal penalties, any of which could have a material adverse effect upon our business, results of operations or financial condition.

Moreover, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has increased and may significantly increase the regulation of the financial services industry. The Dodd-Frank Act contains a broad set of provisions designed to govern the practices and oversight of financial institutions and other participants in the financial markets. One such provision, Section 619 of the Dodd-Frank Act, commonly referred to as the Volcker Rule, contains certain prohibitions and restrictions on the ability of a "banking entity" — which includes insured depository institutions, bank holding companies, foreign banking entities regulated by the Federal Reserve Board and their respective affiliates — and nonbank financial company supervised by the Federal Reserve to engage in proprietary trading and have certain interests in, or relationships with certain private funds ("covered funds"). Under the final regulations implementing the Volcker Rule, which were adopted in December 2013, many CLOs will be covered funds if they invest, or are permitted to invest, in assets other than loans, certain cash equivalents and interest rate or currency hedges. As a result, many banking entities, including many U.S. and non-U.S. broker-dealers with affiliated banks, may be unable to invest in, or in some cases to make a market in, the securities of CLOs in which we have invested, which may reduce liquidity in these securities and have a material adverse effect on their valuation. Moreover, the Volcker Rule regulations may affect the market for CLOs such that our Asset Manager Affiliates may be unable to establish, or to obtain warehouse funding for, new CLOs that would be covered funds. If our Asset Manager Affiliates establish CLOs that are structured not to be covered funds and thus do not permit investments in customary assets such as corporate bonds, asset-backed securities or synthetic investments, and we invest in such CLOs, the ability of our Asset Manager Affiliates to manage such CLOs will be constrained by those limitations, which could materially adversely affect any investments we make in such CLOs.

In October 2014, the SEC, the FDIC, the Federal Reserve and certain other prudential banking regulators adopted final rules that will mandate risk retention for securitizations, including CLOs, beginning on December 24, 2016. Under the final risk-retentions rules, our Asset Manager Affiliates (or a majority-owned affiliate of such entities, including the Company) may be required to hold interests equal to 5% of the fair value of any CLO they sponsor (unless the CLO invests only in certain qualifying loans, which we do not expect to be the case) and would be prohibited from selling or hedging those interests in accordance with the limitations on such sales or hedges set forth in the final rule. Our Asset Manager Affiliates (or a majority-owned affiliate of such entities, including the Company) will need to have the requisite capital to hold such interests as a condition to their ability to sponsor new CLOs, and the restrictions on hedging such interests may create greater risk with respect to those interests.

Our Asset Manager Affiliates' (or a majority owned affiliate's) investments in such CLOs, or their inability to invest in such CLOs (and thus inability to sponsor them) could each have a material adverse effect upon our business, results of operations or financial condition.

In April 2010, the SEC proposed revised rules for asset-backed securities offerings ("Regulation AB II") that, if adopted, would substantially change the disclosure, reporting and offering process for public and private offerings of asset-backed securities, including CLOs. The proposed rules, if adopted, would have required significant additional disclosures and would have altered the safe-harbor standards for the private placement of asset-backed securities to impose informational requirements similar to those that would apply to registered public offerings of such securities. The application of such informational requirements to CLOs, which have not historically been publicly registered, was unclear. On August 27, 2014, the SEC adopted a set of Regulation AB II final rules that was limited to asset-backed securities that were publicly registered. These rules impose changes to the offering process for publicly registered asset-backed securities and require disclosure of loan-level data for a subset of classes addressed in the proposed rules, but do not at this time extend to privately offered CLOs. However, the SEC has indicated that many aspects of the rule proposals, including the expansion of loan-level or grouped data disclosure requirements to additional asset classes and the possible application of the rules to private offerings of securities, remain under active consideration. The timing of the adoption of any additional final rules, their application to privately offered securities in general and to CLOs in particular, the cost of compliance with such rules, and whether compliance would compromise proprietary methods or strategies of our Asset Manager Affiliates, is currently unclear.

Other financial reform regulations, including regulations requiring clearing and margining of swap transactions, which may affect our ability to enter into hedging transactions; changes in the definition and regulation of commodity pool operators and commodity trading advisors, which could subject our Asset Manager Affiliates to additional regulations; leveraged lending guidance that may affect the ways in which banking institutions originate the loans in which we and our affiliates invest; heightened regulatory capital and liquidity requirements for banks that may affect our ability to borrow on reasonable terms; and non-US regulations of financial market participants that may overlap, expand upon or be inconsistent with US regulations may all have material adverse effects on our business.

If we do not invest a sufficient portion of our assets in Qualifying Assets, we could be precluded from investing according to our current business strategy.

As a BDC, we may not acquire any assets other than Qualifying Assets for purposes of the 1940 Act unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are Qualifying Assets. See “Item 1: Business — Regulation”.

We believe that most of the senior loans and mezzanine investments that we acquire constitute “qualifying assets.” However, investments in the securities of CLO Funds generally do not constitute “qualifying assets,” and we may invest in other assets that are not “qualifying assets.” If we do not invest a sufficient portion of our assets in “qualifying assets,” we may be precluded from investing in what we believe are attractive investments, which would have a material adverse effect on our business, financial condition and results of operations. These restrictions could also prevent us from making investments in the equity securities of CLO Funds, which could limit our Asset Manager Affiliates’ ability to organize new CLO Funds. Similarly, these rules could prevent us from making follow-on investments in existing portfolio companies (which could result in the dilution of our position).

Our ability to enter into transactions with our affiliates is restricted.

We are prohibited under the 1940 Act from participating in certain transactions with certain of our affiliates without the prior approval of the members of our independent directors and, in some cases, the SEC. Any person that owns, directly or indirectly, 5% or more of our outstanding voting securities is our affiliate for purposes of the 1940 Act and we are generally prohibited from buying or selling any securities (other than our securities) from or to such affiliate, absent the prior approval of our independent directors. The 1940 Act also prohibits certain “joint” transactions with certain of our affiliates, which could include investments in the same portfolio company (whether at the same or different times), without prior approval of our independent directors and, in some cases, the SEC. If a person acquires more than 25% of our voting securities, we will be prohibited from buying or selling any security (other than any security of which we are the issuer) from or to such person or certain of that person’s affiliates, or entering into prohibited joint transactions with such person, absent the prior approval of the SEC. Similar restrictions limit our ability to transact business with our officers or directors or their affiliates. As a result of these restrictions, we may be prohibited from buying or selling any security (other than any security of which we are the issuer) from or to any portfolio company of a private equity fund managed by our investment adviser without the prior approval of the SEC, which may limit the scope of investment opportunities that would otherwise be available to us.

We have received certain exemptive relief from the SEC to permit us to co-invest, subject to the conditions of the relief granted by the SEC, with other funds managed by our Asset Manager Affiliates in a manner consistent with our investment objectives, positions, policies, strategies and restrictions as well as regulatory requirements and other pertinent factors. The conditions of such exemptive relief may limit our ability or the ability of our Asset Manager Affiliates, each a registered investment adviser, to operate, structure or expand their business in the future.

A failure on our part to maintain our status as a BDC would significantly reduce our operating flexibility.

If we fail to maintain our status as a BDC, we might be regulated as a closed-end investment company that is required to register under the Investment Company Act, which would subject us to additional regulatory restrictions and significantly decrease our operating flexibility. In addition, any such failure could cause an event of default under our outstanding indebtedness, which could have a material adverse effect on our business, financial condition or results of operations.

We will be subject to corporate-level U.S. federal income taxes if we are unable to qualify as a RIC under Subchapter M of the Code.

To maintain RIC tax treatment under the Code, we must meet the following annual distribution, income source and asset diversification requirements:

- The annual distribution requirement for a RIC will be satisfied if we distribute to our stockholders on an annual basis at least 90% of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any. Because we use debt financing, we are subject to certain asset coverage ratio requirements under the 1940 Act and are (and may in the future become) subject to certain financial covenants under loan and credit agreements that could, under certain circumstances, restrict us from making distributions necessary to satisfy the distribution requirement. If we are unable to obtain cash from other sources, we could fail to qualify for RIC tax treatment and thus become subject to corporate-level U.S. federal income taxes.
- The source income requirement will be satisfied if we obtain at least 90% of our income for each year from dividends, interest, gains from the sale of stock or securities or similar sources.
- The asset diversification requirement will be satisfied if we meet certain asset diversification requirements at the end of each quarter of our taxable year. To satisfy this requirement, at least 50% of the value of our assets must consist of cash, cash equivalents, U.S. Government securities, securities of other RICs, and other acceptable securities; and no more than 25% of the value of our assets can be invested in the securities, other than U.S. government securities or securities of other RICs, of one issuer, of two or more issuers that are controlled, as determined under applicable Code rules, by us and that are engaged in the same or similar or related trades or businesses or of certain "qualified publicly traded partnerships." If we do not satisfy the diversification requirements as of the end of any quarter, we will not lose our status as RIC provided that (i) we satisfied the requirements in a prior quarter and (ii) our failure to satisfy the requirements in the current quarter is not due in whole or in part to an acquisition of any security or other property.

Failure to meet these requirements may result in our having to dispose of certain investments quickly in order to prevent the loss of RIC status. Because most of our investments will be in private companies, and therefore will be illiquid, any such dispositions could be made at disadvantageous prices and could result in substantial losses. Moreover, if we fail to maintain RIC tax treatment for any reason and are subject to corporate-level U.S. federal income taxes, the resulting taxes could substantially reduce our net assets, the amount of income available for distribution and the amount of our distributions. Such a failure would have a material adverse effect on us and on our stockholders.

Risks Associated with Our Information Technology Systems

We rely on various information technology systems to manage our operations. Information technology systems are subject to numerous risks including unanticipated operating problems, system failures, rapid technological change, failure of the systems that operate as anticipated, reliance on third party computer hardware, software and IT service providers, computer viruses, telecommunication failures, data breaches, denial of service attacks, spamming, phishing attacks, computer hackers and other similar disruptions, any of which could materially adversely impact our consolidated financial condition and results of operations. Additional risks include, but are not limited to, the following:

Disruptions in current systems or difficulties in integrating new systems.

We regularly maintain, upgrade, enhance or replace our information technology systems to support our business strategies and provide business continuity. Replacing legacy systems with successor systems, making changes to existing systems or acquiring new systems with new functionality have inherent risks including disruptions, delays, or difficulties that may impair the effectiveness of our information technology systems.

If we are unable to maintain the availability of our electronic data systems and safeguard the security of our data, our ability to conduct business may be compromised, which impair our liquidity, disrupt our business, damage our reputation and cause losses.

Cybersecurity refers to the combination of technologies, processes, and procedures established to protect information technology systems and data from unauthorized access, attack, or damage. We are subject to cybersecurity risks. Information cyber security risks have significantly increased in recent years and, while we have not experienced any material losses relating to cyber attacks or other information security breaches, we could suffer such losses in the future. Our computer systems, software and networks may be vulnerable to unauthorized access, computer viruses or other malicious code and other events that could have a security impact. If one or more of such events occur, this potentially could jeopardize confidential and other information, including nonpublic personal information and sensitive business data, processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our operations or the operations of our customers or counterparties, which could result in significant losses or reputational damage. This could result in significant losses, reputational damage, litigation, regulatory fines or penalties, or otherwise adversely affect our business, financial condition or results of operations. Privacy and information security laws and regulation changes, and compliance with those changes, may result in cost increases due to system changes and the development of new administrative processes. In addition, we may be required to expend significant additional resources to modify our protective measures and to investigate and remediate vulnerabilities or other exposures arising from operational and security risks. We currently do not maintain insurance coverage relating to cybersecurity risks, and we may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are not fully insured.

Third parties with which we do business may also be sources of cybersecurity or other technological risks. We outsource certain functions and these relationships allow for the storage and processing of our information, as well as customer, counterparty, employee and borrower information. While we engage in actions to reduce our exposure resulting from outsourcing, ongoing threats may result in unauthorized access, loss, exposure or destruction of data, or other cybersecurity incidents, with increased costs and other consequences, including those described above.

Risks Related to Our Debt Securitization Financing Transactions

We are subject to certain risks as a result of our indirect interests in the subordinated notes and membership interests of KCAP Senior Funding I, LLC.

On June 18, 2013, KCAP Senior Funding I, LLC, a specialty finance subsidiary of the Company, was capitalized through the issuance of $140 million of notes (the "KCAP Senior Funding I Notes"). In December 2014, KCAP Senior Funding I, LLC, issued an additional $56 million of notes. The KCAP Senior Funding I Notes are backed by a diversified portfolio of bank loans.

Under the terms of the master loan sale agreement governing the debt securitization financing transaction, (1) we sold and/or contributed to KCAP Senior Funding I Holdings, LLC ("Holdings") all of our ownership interest in our portfolio loans and participations for the purchase price and other consideration set forth in the master loan sale agreement and (2) Holdings, in turn, sold and/or contributed to KCAP Senior Funding I, LLC (the "Issuer") all of its ownership interest in such portfolio loans and participations for the purchase price and the consideration set forth in the master loan sale agreement. Following these transfers, the Issuer, and not Holdings or us, held all of the ownership interest in such portfolio loans and participations. As a result of the debt securitization financing transaction, we hold indirectly through Holdings all of the subordinated notes and membership interests of the Issuer. As a result, we consolidate the financial statements of Holdings and the Issuer in our consolidated financial statements. Because Holdings and the Issuer are disregarded as entities separate from its owner for U.S. federal income tax purposes, each of the sale or contribution of portfolio loans by us to Holdings, and the sale of portfolio loans by Holdings to the Issuer, did not constitute a taxable event for U.S. federal income tax purposes. If the U.S. Internal Revenue Service were to take a contrary position, there could be a material adverse effect on our business, financial condition, results of operations or cash flows.

The subordinated notes and membership interests of the Issuer are subordinated obligations of the Issuer.

The subordinated notes of the Issuer are the junior class of notes issued by the Issuer, are subordinated in priority of payment to the secured notes issued by the Issuer and are subject to certain payment restrictions set forth in the indenture governing the notes of the Issuer. Therefore, Holdings only receives cash distributions on the subordinated notes if the Issuer has made all cash interest payments on the secured notes it has issued, and we only receive cash distributions in respect of our indirect ownership of the Issuer to the extent that Holdings receives any cash distributions in respect of its direct ownership of the Issuer. The subordinated notes of the Issuer are also unsecured and rank behind all of the secured creditors, known or unknown, of the Issuer, including the holders of the secured notes it has issued. Consequently, to the extent that the value of either the Issuer's portfolio of loan investments has been reduced as a result of conditions in the credit markets, or as a result of defaulted loans or individual fund assets, the value of the subordinated notes of such securitization issuer at their redemption could be reduced. Accordingly, our investment in the Issuer may be subject to complete loss.

The membership interests in the Issuer represent all of the residual economic interest in the Issuer. As such, the holder of the membership interests of the Issuer is the residual claimant on distributions, if any, made by the Issuer after holders of all classes of notes issued by the Issuer have been paid in full on each payment date or upon maturity of such notes under the debt securitization financing transaction documents.

If an event of default has occurred and acceleration occurs in accordance with the terms of the indenture governing the notes of the Issuer, the secured notes of the Issuer then outstanding will be paid in full before any further payment or distribution on the subordinated notes of the Issuer. In addition, if an event of default occurs, holders of a majority of the most senior class of secured notes then outstanding will be entitled to determine the remedies to be exercised under the indenture, subject to the terms of the indenture. For example, upon the occurrence of an event of default with respect to the notes issued by the Issuer, the trustee or holders of a majority of the most senior class of secured notes of the Issuer then outstanding may declare the principal, together with any accrued interest, of all the notes of such class and any junior classes to be immediately due and payable. This would have the effect of accelerating the principal on such notes, triggering a repayment obligation on the part of the Issuer. If at such time the portfolio loans of the Issuer were not performing well, the Issuer may not have sufficient proceeds available to enable the trustee under the indenture to repay the obligations of holders of the subordinated notes of the Securitization Issuer, or to pay a dividend to holders of the membership interests of the Issuer.

Remedies pursued by the holders of the secured notes of the Issuer could be adverse to the interests of the holders of the subordinated notes of the Issuer, and the holders of such secured notes will have no obligation to consider any possible adverse effect on such other interests. Thus, any remedies pursued by the holders of the secured notes of the Issuer may not be in our best interests and we may not receive payments or distributions upon an acceleration of the secured notes. Any failure of the Issuer to make distributions on the subordinated notes we hold, directly or indirectly, whether as a result of an event of default or otherwise, could have a material adverse effect on our business, financial condition, results of operations and cash flows and may result in an inability of us to make distributions sufficient to allow our qualification as a RIC.

The Issuer may fail to meet certain coverage tests.

Under the documents governing the debt securitization financing transaction, there are two coverage tests applicable to the secured notes. The first such test compares the amount of interest received on the portfolio loans held by the Issuer to the amount of interest payable in respect of the secured notes of the Issuer. To meet this test at any time, interest received on the portfolio loans must equal at least 127% to 150% (based upon a graduated scale for the most senior class of secured notes then outstanding as provided for in the indenture) of the interest payable in respect of the secured notes of the Issuer. The second such test compares the principal amount of the portfolio loans held by the Issuer to the aggregate outstanding principal amount of the secured notes of the Issuer. To meet this test at any time, the aggregate principal amount of the portfolio loans held by the Issuer must equal at least 124% to 147% (based upon a graduated scale for the most senior class of secured notes then outstanding as provided for in the indenture) of the outstanding principal amount of the secured notes of the Issuer. If either coverage test is not satisfied, interest and principal received by the Issuer are diverted on the following payment date to pay the most senior class or classes of secured notes to the extent necessary to cause all coverage tests to be satisfied on a pro forma basis after giving effect to all payments made in respect of the notes, which, with respect to the payment of any principal amount of the secured notes, we refer to as a mandatory redemption. If any coverage test with respect to the secured notes is not met, proceeds from the portfolio of loan investments that otherwise would have been distributed to the Issuer and the holders of its subordinated notes will instead be used to redeem first the secured notes of the Issuer, to the extent necessary to satisfy the applicable coverage tests.

We may not receive cash on our equity interests in the Issuer.

We receive cash from the Issuer only to the extent that we or Holdings, as applicable, receives payments on the subordinated notes or membership interests of the Issuer. The Issuer may only make payments on such securities to the extent permitted by the payment priority provisions of the indenture governing the notes, which generally provides that principal payments on the subordinated notes may not be made on any payment date unless all amounts owing under the secured notes issued under such indenture are paid in full. In addition, if the Issuer does not meet the coverage tests set forth in the documents governing the debt securitization financing transaction, cash would be diverted from the subordinated notes of the Issuer to first pay the secured notes of the Issuer in amounts sufficient to cause such tests to be satisfied. In the event that we fail to directly or indirectly receive cash from the Issuer, we could be unable to make distributions in amounts sufficient to maintain our status as a RIC, or at all. We also could be forced to sell investments in portfolio companies at less than their fair value in order to continue making such distributions. However, the indenture places significant restrictions on the Issuer's ability to sell investments. As a result, there may be times or circumstances during which the Issuer is unable to sell investments or take other actions that might be in our best interests.

A significant portion of the assets reflected on our financial statements are held by the Issuer and are subject to security interests under the senior secured notes issued by the Issuer and if it defaults on its obligations under the senior secured notes we and the Issuer may suffer adverse consequences, including foreclosure on those assets.

In connection with our debt securitization financing transaction, we transferred all of our interests in certain portfolio loans to the Issuer. In doing so, we transferred any right we previously had to the payments made on such portfolio loans in exchange for 100% of the residual interests in the Issuer. As a result, we face a heightened risk of loss due to the impact of leverage utilized by the Issuer, which would have the effect of magnifying the impact on us of a loss on any portfolio loan held by the Issuer. In addition, while we serve as the collateral manager for the Issuer, which provides us with the authority to enforce payment obligations and loan covenants of the portfolio loans that we transferred to the Issuer, we are required to exercise such authority for the interests of the Issuer, rather than for our own interests alone.

The structure of the debt securitization financing transaction is intended to prevent, in the event of our bankruptcy or the bankruptcy of Holdings, the consolidation for purposes of such bankruptcy proceedings of the Issuer with our operations or those of Holdings. If the true sale of these assets were not respected in the event of our insolvency, a trustee or debtor-in-possession might reclaim the assets of the Issuer for our estate. However, in doing so, we would become directly liable for all of the indebtedness then outstanding under the debt securitization financing transaction, which would equal the full amount of debt of the Issuer reflected on our consolidated balance sheet. In addition, we cannot assure that the recovery in the event we were consolidated with the Issuer for purposes of any bankruptcy proceeding would exceed the amount to which we would otherwise be entitled as a direct or indirect.

As of December 31, 2015, $183.8 million of the assets that are reflected on our financial statements were held by the Issuer and pledged as collateral under the senior secured notes issued by the Issuer. If the Issuer defaults on its obligations under the senior secured notes, the holders of the senior secured notes may have the right to foreclose upon and sell, or otherwise transfer, the collateral subject to their security interests. In such event, we and the Issuer may be forced to sell our investments to raise funds to repay the Issuer's outstanding borrowings in order to avoid foreclosure and these forced sales may be at times and at prices we and the Issuer would not consider advantageous. Moreover, such deleveraging of our company could significantly impair our ability to effectively operate our business in the manner in which we have historically operated. As a result, we could be forced to curtail or cease new investment activities and lower or eliminate the dividends that we have historically paid to our stockholders.

In addition, in certain limited circumstances in the event of default, if the holders of the senior secured notes exercise their right to sell the assets pledged by the Issuer, such sales may be completed at distressed sale prices, thereby diminishing or potentially eliminating the amount of cash available to the Issuer and us after repayment of the amounts outstanding under the senior secured notes.

Risks Related to Our Investments

Our investments may be risky, and you could lose all or part of your investment.

We invest primarily in senior secured term loans, mezzanine debt, selected equity investments issued by middle market companies, CLO Funds and our Asset Manager Affiliates. The investments in our Debt Securities Portfolio are all or predominantly below investment grade, may be highly leveraged, and therefore have speculative characteristics with respect to the issuer's capacity to pay interest and repay principal. Defaults by portfolio companies may harm our operating results.

Secured Loans. When we extend secured term loans, we generally take a security interest (either as a first lien position or as a second lien position) in the available assets of these portfolio companies, including the equity interests of their subsidiaries, which we expect to assist in mitigating the risk that we will not be repaid. However, there is a risk that the collateral securing our loans may decrease in value over time, may be difficult to sell in a timely manner, may be difficult to appraise and may fluctuate in value based upon the success of the business and market conditions, including as a result of the inability of the portfolio company to raise additional capital, and, in some circumstances, our lien could be subordinated to claims of other creditors. In addition, deterioration in a portfolio company's financial condition and prospects, including its inability to raise additional capital, may be accompanied by deterioration in the value of the collateral for the loan. Consequently, the fact that a loan is secured does not guarantee that we will receive principal and interest payments according to the loan's terms, or at all, or that we will be able to collect on the loan should we be forced to exercise our remedies.

Mezzanine Debt. Our mezzanine debt investments generally are subordinated to senior loans and generally are unsecured. This may result in an above average amount of risk and volatility or loss of principal.

These investments may entail additional risks that could adversely affect our investment returns. To the extent interest payments associated with such debt are deferred, such debt is subject to greater fluctuations in value based on changes in interest rates and such debt could subject us to phantom income. Since we generally do not receive any cash prior to maturity of the debt, the investment is of greater risk.

Equity Investments. We have made and expect to make selected equity investments in the middle market companies. In addition, when we invest in senior secured loans or mezzanine debt, we may acquire warrants in the equity of the portfolio company. Our goal is ultimately to dispose of such equity interests and realize gains upon our disposition of such interests. However, the equity interests we receive may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience.

Risks Associated with Middle Market Companies. Investments in middle market companies also involve a number of significant risks, including:

- limited financial resources and inability to meet their obligations, which may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of our realizing the value of any guarantees we may have obtained in connection with our investment;
- 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;

- dependence on 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 our portfolio company and, in turn, on us;
- less predictable operating results, being parties to litigation from time to time, engaging in rapidly changing businesses with products subject to a substantial risk of obsolescence and requiring substantial additional capital expenditures to support their operations, finance expansion or maintain their competitive position;
- difficulty accessing the capital markets to meet future capital needs; and
- generally less publicly available information about their businesses, operations and financial condition.

CLO Fund Investments. Investments in CLO Funds also involve a number of significant risks, including:

- CLOs typically are comprised of a portfolio of senior secured loans; payments on CLO investments are and will be payable solely from the cash-flows from such senior secured loans;
- CLO investments are exposed to leveraged credit risk;
- CLO Funds are highly leveraged;
- there is the potential for interruption and deferral of cash-flow from CLO investments;
- interest rates paid by corporate borrowers are subject to volatility;
- the inability of a CLO collateral manager to reinvest the proceeds of the prepayment of senior secured loans may adversely affect us;
- our CLO investments are subject to prepayments and calls, increasing re-investment risk;
- we have limited control of the administration and amendment of senior secured loans owned by the CLOs in which we invest;
- we have limited control of the administration and amendment of any CLO in which we invest;
- senior secured loans of CLOs may be sold and replaced resulting in a loss to us;
- our financial results may be affected adversely if one or more of our significant equity or junior debt investments in a CLO vehicle defaults on its payment obligations or fails to perform as we expect; and
- non-investment grade debt involves a greater risk of default and higher price volatility than investment grade debt.

Asset Manager Affiliates. We may not receive all or a portion of the cash distributions we expect to continue to receive from our Asset Manager Affiliates, including incentive fees.

We expect to receive cash distributions from our Asset Manager Affiliates. However, the existing asset management agreements pursuant to which our Asset Manager Affiliates receive fee income from the CLO Funds for which they serve as managers may be terminated for “cause” by the holders of a majority of the most senior class of securities issued by such CLO Funds and the holders of a majority of the subordinated securities issued by such CLO Funds. “Cause” is defined in the asset management agreements to include a material breach by our Asset Manager Affiliates of the indenture governing the applicable CLO Fund, breaches by our Asset Manager Affiliates of certain specified provisions of the indenture (including, in some cases, a “key person” provision), material breaches of representations or warranties made by our Asset Manager Affiliates, bankruptcy or insolvency of our Asset Manager Affiliates, fraud or criminal activity on the part of our Asset Manager Affiliates or an event of default under the indenture governing the CLO Funds. We expect that future asset management agreements will contain comparable provisions.

Further, a significant portion of the asset management fees payable to our Asset Manager Affiliates under the asset management agreements are subordinated to the prior payments of interest on the senior securities issued by the CLO Funds. If the asset management agreements are terminated, or the CLO Funds do not generate enough income (due to run-off of existing funds and de-leveraging), or otherwise have insufficient residual cash flow due to diversion of cash as a result of the failure by the CLO Funds to satisfy certain restrictive covenants contained in their indenture agreements to pay the subordinated management fees, the Asset Manager Affiliates will not receive the fee income that they expect to continue to receive which would reduce cash distributions available to us, and in turn reduce our ability to make distributions to our stockholders.

Our portfolio investments for which there is no readily available market, including our investment in our Asset Manager Affiliates and our investments in CLO Funds, are recorded at fair value as determined in good faith by our Board of Directors. As a result, there is uncertainty as to the value of these investments.

Our investments consist primarily of securities issued by privately-held companies, the fair value of which is not readily determinable. In addition, we are not permitted to maintain a general reserve for anticipated loan losses. Instead, we are required by the 1940 Act to specifically value each investment and record an unrealized gain or loss for any asset that we believe has increased or decreased in value. We value these securities at fair value as determined in good faith by our Board of Directors pursuant to a valuation methodology approved by our Board of Directors. These valuations are initially prepared by our management and reviewed by our Valuation Committee, which uses its best judgment in arriving at the fair value of these securities. However, the Board of Directors retains ultimate authority to determine the appropriate valuation for each investment.

The Company has engaged an independent valuation firm to provide third party valuation consulting services to the Company's Board of Directors. Each quarter, the independent valuation firm performs third party valuations on the Company's material investments in illiquid securities, such that they are reviewed at least once during a trailing 12 month period. These third party valuation estimates are one of the relevant data points in the Board of Director's determination of fair value. The Board of Directors intends to continue to engage an independent valuation firm in the future to provide certain valuation services, including the review of certain portfolio assets, as part of the quarterly and annual year-end valuation process. In addition to such third-party input, the types of factors that may be considered in valuing our investments include the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings, the markets in which the portfolio company does business, comparison to publicly-traded companies, discounted cash flow and other relevant factors. Our investment in our Asset Manager Affiliates is carried at fair value, which is determined after taking into consideration a percentage of assets under management and a discounted cash flow model incorporating different levels of discount rates depending on the hierarchy of fees earned (including the likelihood of realization of senior, subordinate and incentive fees) and prospective modeled performance. Such valuation includes an analysis of comparable asset management companies. Because such valuations, and particularly valuations of private investments and private companies, are inherently uncertain and may be based on estimates, our determinations of fair value may differ materially from the values that would be assessed if a ready market for these securities existed. Our net asset value could be adversely affected if our determinations regarding the fair value of our illiquid investments were materially higher than the values that we ultimately realize upon the disposal of such securities.

We are a non-diversified investment company within the meaning of the 1940 Act, and therefore we may invest a significant portion of our assets in a relatively small number of issuers, which subjects us to a risk of significant loss if any of these issuers defaults on its obligations under any of its debt instruments or as a result of a downturn in the particular industry.

We are classified as a non-diversified investment company within the meaning of the 1940 Act, and therefore we may invest a significant portion of our assets in a relatively small number of issuers in a limited number of industries. As of December 31, 2015, our largest investment, our 100% equity interest in our Asset Manager Affiliates, equaled approximately 14.0% of the fair value of our total investments. Beyond the asset diversification requirements associated with our qualification as a RIC, we do not have fixed guidelines for diversification, and while we are not targeting any specific industries, relatively few industries may become significantly represented among our investments. To the extent that we assume large positions in the securities of a small number of issuers, our net asset value may fluctuate to a greater extent than that of a diversified investment company as a result of changes in the financial condition or the market's assessment of the issuer, changes in fair value over time or a downturn in any particular industry. We may also be more susceptible to any single economic or regulatory occurrence than a diversified investment company.

Defaults by our portfolio companies could harm our operating results.

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other debt holders could lead to defaults and, potentially, acceleration of the time when the loans are due and foreclosure on its secured assets. Such events could trigger cross-defaults under other agreements and jeopardize a portfolio company's ability to meet its obligations under the debt that we hold and the value of any equity securities we own. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company.

When we are a debt or minority equity investor in a portfolio company, which generally is the case, we may not be in a position to control the entity, and its management may make decisions that could decrease the value of our investment.

Most of our investments are either debt or minority equity investments in our portfolio companies. Therefore, we are subject to the risk that a portfolio company may make business decisions with which we disagree, and the stockholders and management of such company may take risks or otherwise act in ways that do not serve our interests. As a result, a portfolio company may make decisions that could decrease the value of our portfolio holdings. In addition, we generally are not in a position to control any portfolio company by investing in its debt securities.

We may have limited access to information about privately held companies in which we invest.

We invest primarily in privately-held companies. Generally, little public information exists about these companies, and we are required to rely on the ability of our investment professionals to obtain adequate information to evaluate the potential returns from investing in these companies. These companies and their financial information are not subject to the Sarbanes-Oxley Act of 2002 and other rules that govern public companies. If we are unable to uncover all material information about these companies, we may not make a fully informed investment decision, and we may lose money on our investment.

Prepayments of our debt investments by our portfolio companies could negatively impact our operating results.

We are subject to the risk that the investments we make in our portfolio companies may be repaid prior to maturity. When this occurs, we generally reinvest these proceeds in temporary investments, pending their future investment in new portfolio companies. These temporary investments typically have substantially lower yields than the debt being prepaid and we could experience significant delays in reinvesting these amounts. Any future investment in a new portfolio company may also be at lower yields than the debt that was repaid. Consequently, our results of operations could be materially adversely affected if one or more of our portfolio companies elects to prepay amounts owed to us. Additionally, prepayments could negatively impact our return on equity, which could result in a decline in the market price of our common stock.

We may be unable to invest the net proceeds raised from offerings and repayments from investments on acceptable terms, which would harm our financial condition and operating results.

Until we identify new investment opportunities, we intend to either invest the net proceeds of future offerings and repayments from investments in interest-bearing deposits or other short-term instruments or use the net proceeds from such offerings to reduce then-outstanding obligations under our credit facility, if any. We cannot assure you that we will be able to find enough appropriate investments that meet our investment criteria or that any investment we complete using the proceeds from an offering will produce a sufficient return.

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

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

Second priority liens on collateral securing loans that we make to our portfolio companies may be subject to control by senior creditors with first priority liens. If there is a default, the value of the collateral may not be sufficient to repay in full both the first priority creditors and us.

Certain loans that we make are secured by a second priority security interest in the same collateral pledged by a portfolio company to secure senior debt owed by the portfolio company to commercial banks or other traditional lenders. Often the senior lender has procured covenants from the portfolio company prohibiting the incurrence of additional secured debt, without the senior lender’s consent. Prior to, and as a condition of, permitting the portfolio company to borrow money from us secured by the same collateral pledged to the senior lender, the senior lender will require assurances that it will control the disposition of any collateral in the event of bankruptcy or other default. In many such cases, the senior lender will require us to enter into an “intercreditor agreement” prior to permitting the portfolio company to borrow from us. Typically, the intercreditor agreements we are requested to execute expressly subordinate our debt instruments to those held by the senior lender and further provide that the senior lender shall control: (1) the commencement of foreclosure or other proceedings to liquidate and collect on the collateral; (2) the nature, timing and conduct of foreclosure or other collection proceedings; (3) the amendment of any collateral document; (4) the release of the security interests in respect of any collateral; and (5) the waiver of defaults under any security agreement. Because of the control we may cede to senior lenders under intercreditor agreements we may enter, we may be unable to realize the proceeds of any collateral securing some of our loans.

There may be circumstances where our debt investments could be subordinated to claims of other creditors or we could be subject to lender liability claims.

Even though we may have structured certain of our investments as senior loans, if one of our portfolio companies were to go bankrupt, depending on the facts and circumstances, including the size of our investment and the extent to which we actually provided managerial assistance to that portfolio company, a bankruptcy court might recharacterize our debt investment and subordinate all or a portion of our claim to that of other creditors. In addition, lenders can be subject to lender liability claims for actions taken by them where they become too involved in the borrower’s business or exercise control over the borrower. It is possible that we could become subject to a lender’s liability claim, including as a result of actions taken in rendering significant managerial assistance.

Our investments in equity securities involve a substantial degree of risk.

We may purchase common stock and other equity securities, including warrants. Although equity securities have historically generated higher average total returns than fixed-income securities over the long term, equity securities have also experienced significantly more volatility in those returns. The equity securities we acquire may fail to appreciate and may decline in value or become worthless, and our ability to recover our investment depends on our portfolio company’s success. Investments in equity securities involve a number of significant risks, including the risk of further dilution as a result of additional issuances, inability to access additional capital and failure to pay current distributions. Investments in preferred securities involve special risks, such as the risk of deferred distributions, credit risk, illiquidity and limited voting rights.

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

We may invest in securities issued by private companies. These securities may be subject to legal and other restrictions on resale or otherwise be less liquid than publicly-traded securities. The illiquidity of these investments may make it difficult for us to sell these investments when desired. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we had previously recorded these investments. Our investments are usually subject to contractual or legal restrictions on resale or are otherwise illiquid because there is usually no established trading market for such investments. The illiquidity of most of our investments may make it difficult for us to dispose of them at a favorable price, and, as a result, we may suffer losses.

We may not receive any return on our investment in the CLO Funds in which we have invested and the Asset Manager Affiliates may be unable to raise additional CLO Funds.

As of December 31, 2015, we had $55.9 million at fair value invested in the subordinated securities, preferred shares, or other securities issued by the CLO Funds managed by our Asset Manager Affiliates and certain other third party asset managers. Subject to market conditions and legal requirements applicable to us under the 1940 Act, we expect to continue to acquire subordinated securities in the future in CLO Funds managed by our Asset Manager Affiliates and/or third party managers. Subordinated securities are the most junior class of securities issued by the CLO Funds and are subordinated in priority of payment to every other class of securities issued by these CLO Funds. Therefore, they only receive cash distributions if the CLO Funds have made all cash interest payments to all other debt securities issued by the CLO Fund. The subordinated securities are also unsecured and rank behind all of the secured creditors, known or unknown, of the CLO Fund, including the holders of the senior securities issued by the CLO Fund. Consequently, to the extent that the value of a CLO Fund’s loan investments has been reduced as a result of conditions in the credit markets, or as a result of defaulted loans or individual fund assets, the value of the subordinated securities at their redemption could be reduced. Additionally, the Asset Manager Affiliates may not be able to continue to raise new CLO Funds due to prevailing CLO market conditions, regulatory requirements or other factors.

If our Asset Manager Affiliates do not meet certain risk retention requirements, they may not be able to sponsor and manage new CLOs, which would negatively impact our results of operations and financial conditions.

In October 2014, the SEC, the FDIC, the Federal Reserve and certain other prudential banking regulators finalized regulations that mandate risk retention for securitizations. The rules will be effective for CLOs beginning December 24, 2016. Under the final rules, our Asset Manager Affiliates (directly or through any of their majority-controlled affiliates, including the Company) may be required to hold interests equal to 5% of the credit risk of the assets of any CLO sponsored by our Asset Manager Affiliates (unless the CLO invests only in certain qualifying loans which we do not expect will be the case) and would be prohibited from selling or hedging those interests in accordance with the limitations on such sales or hedges set forth in the final rule. Thus, our Asset Manager Affiliates (or any of their majority-controlled affiliates, including the Company, permitted to retain risk on their behalf) will need to have the requisite capital to hold such interests as a condition to their ability to sponsor new CLOs, and the restrictions on selling or hedging such interests may create greater risk with respect to those interests, including, to the extent that we retain risk in the CLOs managed by the Asset Manager Affiliates on their behalf, our ability to sell CLO Fund Securities when advantageous for us to do so. These mandatory investments in such CLOs, or the inability to invest in such CLOs (and thus inability to sponsor them) could each have a material adverse effect upon our business, results of operations or financial condition of the Asset Manager Affiliates, which would, in turn, negatively impact our business results of operations and financial condition. In addition, the application of the risk retention rules to CLOs may have broader effects on the CLO and loan markets in general, potentially resulting in fewer or less desirable investment opportunities for the Company, our Asset Manager Affiliates, and any CLOs that our Asset Manager Affiliates sponsor or in which we otherwise invest.

On August 27, 2014, the SEC finalized revised rules for asset-backed securities offerings (“Regulation AB II”). Although the proposed rules would have substantially changed the disclosure, reporting and offering process for public and private offerings of asset-backed securities, including CLOs, the final rules only apply to public offerings of asset-backed securities and thus will not affect CLOs at this time. However, the SEC has indicated that it is continuing to consider the proposals that were not included in the final regulations, and may issue further rules in that regard. The timing and likelihood of the adoption of additional final rules, their application to privately offered securities in general and to CLOs in particular, the cost of compliance with such rules, and whether compliance would compromise proprietary methods or strategies of our Asset Manager Affiliates, is currently unclear.

Risks Related to Our Common Stock

We may not be able to pay distributions to our stockholders, our distributions may not grow over time, and a portion of distributions paid to our stockholders may be a return of capital.

We intend to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution. We may not be able to achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. Our ability to pay distributions might be adversely affected by, among other things, the impact of one or more of the risk factors described herein. In addition, the inability to satisfy the asset coverage test applicable to us as a BDC could limit our ability to pay distributions. In addition, due to the asset coverage test applicable to us as a BDC and a covenant that we agreed to in connection with the issuance of the 7.375% Notes Due 2019, we are limited in our ability to make distributions in certain circumstances. In this regard, we agreed in connection with our issuance of the 7.375% Notes Due 2019 that for the period of time during which the 7.375% Notes Due 2019 are outstanding, we will not violate (regardless of whether we are subject to) Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act. These provisions generally prohibit us from declaring any cash dividend or distribution upon our common stock, or purchasing any such common stock if our asset coverage, as defined in the 1940 Act, is 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. Further, if we invest a greater amount of assets in equity securities that do not pay current dividends, it could reduce the amount available for distribution.

All distributions will be paid at the discretion of our Board of Directors and will depend on our earnings and those of the Asset Manager Affiliates, our financial condition, maintenance of our RIC status, compliance with applicable BDC regulations and such other factors as our Board of Directors may deem relevant from time to time. We cannot assure you that we will pay distributions to our stockholders in the future.

When we make quarterly distributions, we will be required to determine the extent to which such distributions are paid out of current or accumulated earnings, recognized capital gains or capital. To the extent there is a return of capital, investors will be required to reduce their basis in our stock for U.S. federal income tax purposes, which may result in higher tax liability when the shares are sold, even if they have not increased in value or have lost value. Our distributions have over the last several years included a significant return of capital component. For more information about our distributions over the last several years that have included a return of capital component, see Note 8 — “Distributable Taxable Income” to our consolidated financial statements included elsewhere in this Annual Report.

Investing in shares of our common stock may involve an above average degree of risk.

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

Shares of closed-end investment companies, including BDCs, frequently trade at a discount to their net asset value, and we cannot assure you that the market price of our common stock will not decline following any offering of our common stock.

We cannot predict the price at which our common stock will trade. Shares of closed-end investment companies frequently trade at a discount to their net asset value and our stock may also be discounted in the market. This characteristic of closed-end investment companies is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether shares of our common stock will trade above, at or below our net asset value. The risk of loss associated with this characteristic of closed-end investment companies may be greater for investors expecting to sell shares of common stock soon after the purchase of such shares of common stock. In addition, if our common stock trades below its net asset value, we will generally not be able to issue additional shares of our common stock at its market price without first obtaining the approval of our stockholders and our independent directors.

Our share price may be volatile and may fluctuate substantially.

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

- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of securities of BDCs or other companies in our sector, which are not necessarily related to the operating performance of these companies or to us;
- our inability to deploy or invest our capital;
- fluctuations in interest rates;
- any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;
- operating performance of companies comparable to us;
- changes in regulatory policies or tax rules, particularly with respect to RICs or BDCs;
- inability to maintain our qualification as a RIC for U.S. federal income tax purposes;
- changes in earnings or variations in operating results;
- changes in the value of our portfolio;
- general economic conditions and trends; and
- departure of key personnel.

Certain provisions of the Delaware General Corporation Law and our certificate of incorporation and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.

The Delaware General Corporation Law, our certificate of incorporation and our bylaws contain provisions that may have the effect of discouraging a third party from making an acquisition proposal for us. These anti-takeover provisions may inhibit a change in control in circumstances that could give the holders of our common stock the opportunity to realize a premium over the market price of our common stock.

Our stockholders may experience dilution upon the conversion of our Convertible Notes.

Our 8.75% convertible notes due 2016 (the “Convertible Notes”) are convertible into shares of our common stock at any time prior to the end of business on the business day preceding the maturity date. Upon conversion, we will satisfy holder with shares of our common stock or cash, at our option. Our stockholders may experience dilution in their ownership percentage of common stock upon our issuance of common stock on any conversion of the Convertible Notes and any dividends paid on our common stock will also be paid on shares issued on any conversion, which may result in a reduction of the per share dividend.

Risks Related to Our 7.375% Notes Due 2019 and our Convertible Notes

Our 7.375% Notes Due 2019 and Convertible Notes are unsecured and therefore are effectively subordinated to any secured indebtedness we have currently incurred or may incur in the future.

Our 7.375% Notes Due 2019 and Convertible Notes are not secured by any of our assets or any of the assets of our subsidiaries or the Asset Manager Affiliates. As a result, the 7.375% Notes Due 2019 and Convertible Notes are effectively subordinated to any secured indebtedness we or they have currently incurred and may incur in the future (or any indebtedness that is initially unsecured to which we subsequently grant security) to the extent of the value of the assets securing such indebtedness. In any liquidation, dissolution, bankruptcy or other similar proceeding, the holders of any of our existing or future secured indebtedness and the secured indebtedness of our subsidiaries and the Asset Manager Affiliates 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 7.375% Notes Due 2019 or Convertible Notes.

The 7.375% Notes Due 2019 are structurally subordinated to the indebtedness and other liabilities of our subsidiaries and portfolio companies with respect to which we hold equity investments, including the Asset Manager Affiliates.

The 7.375% Notes Due 2019 are obligations exclusively of KCAP Financial, Inc., and not of any of our subsidiaries or the Asset Manager Affiliates. None of our subsidiaries or the Asset Manager Affiliates are guarantors of the 7.375% Notes Due 2019, and the 7.375% Notes Due 2019 will not be required to be guaranteed by any subsidiary or asset management firm we may acquire or create in the future. Any assets of our subsidiaries and the Asset Manager Affiliates will not be directly available to satisfy the claims of our creditors, including holders of the 7.375% Notes Due 2019. 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 entities (and therefore the claims of our creditors, including holders of the 7.375% Notes Due 2019) with respect to the assets of such entities. Even if we are recognized as a creditor of one or more of these entities, our claims would still be effectively subordinated to any security interests in the assets of any such entity and to any indebtedness or other liabilities of any such entity senior to our claims. Consequently, the 7.375% Notes Due 2019 are structurally subordinated to all indebtedness and other liabilities of any of our subsidiaries and portfolio companies with respect to which we hold equity investments, including the Asset Manager Affiliates and any subsidiaries of the Asset Manager Affiliates that we may in the future acquire or establish. These entities may incur substantial indebtedness in the future, all of which would be structurally senior to the 7.375% Notes Due 2019.

The indenture under which the 7.375% Notes Due 2019 are issued contains limited protection for holders of the 7.375% Notes Due 2019.

The indenture under which the 7.375% Notes Due 2019 are issued offers limited protection to holders of the 7.375% Notes Due 2019. The terms of the indenture and the 7.375% Notes Due 2019 do not restrict our or any of our subsidiaries or the Asset Manager Affiliates' ability to engage in, or otherwise be a party to, a variety of corporate transactions, circumstances or events that could have a material adverse impact on your investment in the 7.375% Notes Due 2019. In particular, the terms of the indenture and the 7.375% Notes Due 2019 do not place any restrictions on our or our subsidiaries or the Asset Manager Affiliates' 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 7.375% Notes Due 2019, (2) any indebtedness or other obligations that would be secured and therefore rank effectively senior in right of payment to the 7.375% Notes Due 2019 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 or the Asset Manager Affiliates and which therefore is structurally senior to the 7.375% Notes Due 2019 and (4) securities, indebtedness or obligations issued or incurred by our subsidiaries or the Asset Manager Affiliates that would be senior to our equity interests in those entities and therefore rank structurally senior to the 7.375% Notes Due 2019 with respect to the assets of our subsidiaries and the Asset Manager Affiliates, 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. 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 7.375% Notes Due 2019, 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 Section 61(a)(1) of the 1940 Act or any successor provisions. These provisions 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, is 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 7.375% Notes Due 2019 in connection with a change of control or any other event.

Furthermore, the terms of the indenture and the 7.375% Notes Due 2019 do not protect holders of the 7.375% Notes Due 2019 in the event that we experience changes (including significant adverse changes) in our financial condition, results of operations or credit ratings, if any, as they do not require that we adhere to any financial tests or ratios or specified levels of net worth, revenues, income, cash flow, or liquidity other than as described above. Any changes to the 200% asset coverage ratio in the 1940 Act could affect the 7.375% Notes Due 2019. See "Item 1A. Risk Factors — Risks Related to Our Business and Structure — Pending legislation may allow us to incur additional leverage."

Our ability to recapitalize, incur additional debt and take a number of other actions that are not limited by the terms of the 7.375% Notes Due 2019 may have important consequences for you as a holder of the 7.375% Notes Due 2019, including making it more difficult for us to satisfy our obligations with respect to the 7.375% Notes Due 2019 or negatively affecting the trading value of the 7.375% Notes Due 2019.

Other debt we issue or incur in the future could contain more protections for its holders than the indenture and the 7.375% Notes Due 2019, including additional covenants and events of default. The issuance or incurrence of any such debt with incremental protections could affect the market for and trading levels and prices of the 7.375% Notes Due 2019.

Even though the 7.375% Notes Due 2019 are listed on the NYSE, an active trading market for the 7.375% Notes Due 2019 may not develop, or if it does develop, it will be sustained, which could limit your ability to sell the 7.375% Notes Due 2019 or affect the market price of the 7.375% Notes Due 2019.

We cannot provide any assurances that an active trading market will develop for the 7.375% Notes Due 2019 or that, if it does develop, it will be sustained or that you will be able to sell your 7.375% Notes Due 2019. The 7.375% Notes Due 2019 may trade at a discount from the price paid for the notes depending on prevailing interest rates, the market for similar securities, our credit ratings, if any, general economic conditions, our financial condition, performance and prospects and other factors.

Accordingly, we cannot assure you that a liquid trading market will develop for the 7.375% Notes Due 2019, or that, if an active trading market for the 7.375% Notes Due 2019 does develop, it will be sustained, that you will be able to sell your 7.375% Notes Due 2019 at a particular time or that the price you receive when you sell will be favorable. To the extent an active trading market does not develop the liquidity and trading price for the 7.375% Notes Due 2019 may be harmed. Accordingly, you may be required to bear the financial risk of an investment in the 7.375% Notes Due 2019 for an indefinite period of time.

If we default on our obligations to pay our other indebtedness, we may not be able to make payments on the 7.375% Notes Due 2019 or Convertible Notes.

Any default under the agreements governing our indebtedness, including a default under the 7.375% Notes due 2019 or Convertible Notes and 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 Convertible Notes and substantially decrease the market value of the Convertible 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, 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 lender any debt we may incur in the future could elect to terminate its commitment, cease making further loans and institute foreclosure proceedings against our assets, and we could be forced into bankruptcy or liquidation. If our operating performance declines, we may in the future need to seek to obtain waivers from under any other debt that we may incur in the future to avoid being in default. If we breach our covenants under any 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 any debt, the lender could exercise its 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 7.375% Notes Due 2019 and Convertible Notes have, and any future debt we issue will likely have, customary cross-default provisions, if the indebtedness under the 7.375% Notes Due 2019 or Convertible Notes or any other debt we may issue is accelerated, we may be unable to repay or finance the amounts due.

We may not have, or have the ability to raise, the funds necessary to repurchase our Convertible Notes upon a fundamental change, and our debt may contain limitations on our ability to deliver shares of our common stock upon conversion or pay cash upon repurchase of our convertible notes.

Holders of our Convertible Notes will have the right to require us to repurchase their notes upon the occurrence of certain significant corporate events involving us, including if our common stock ceases to trade on any national securities exchange or we consolidate or merge into another entity in certain circumstances, at a repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, if any. We refer to such a corporate event as a “fundamental change.” However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of convertible notes surrendered therefor. In addition, our ability to repurchase our convertible notes or deliver shares of our common stock upon conversions of the convertible notes may be limited by law, by regulatory authority or by agreements governing our indebtedness. Our failure to repurchase the notes at a time when the repurchase is required by the indenture relating to the convertible notes or to deliver any shares of our common stock deliverable on future conversions of the convertible notes as required by the indenture would constitute a default under the indenture. A default under the indenture or the occurrence of a fundamental change itself could also lead to a default under agreements governing our indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase our convertible notes.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

We do not own any real estate or other real property. Our wholly-owned portfolio company, Katonah Debt Advisors, is the lessee for our principal headquarters at 295 Madison Avenue, 6^{th} Floor, New York, New York 10017. We have entered into an Overhead Allocation Agreement with Katonah Debt Advisors which provides for the sharing of the expenses under the lease agreement.

Item 3. ***Legal Proceedings***

The Company is not currently a party to any material legal proceedings.

Item 4. ***Mine Safety Disclosures***

Not applicable.

Item 5. ***Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

PRICE RANGE OF COMMON STOCK

Our common stock is quoted on The NASDAQ Global Select Market under the symbol "KCAP." We completed our initial public offering on December 11, 2006 at an initial public offering ("IPO") price of $15.00 per share. Prior to such date there was no public market for our common stock.

The following table sets forth the range of high and low closing sales prices per share of our common stock as reported on The NASDAQ Global Select Market in respect of the periods indicated. The stock quotations are interdealer quotations and do not include markups, markdowns or commissions and may not necessarily represent actual transactions.

Quarterly Stock Prices for 2015 and 2014

	During the Quarter		At Quarter End	
	High	**Low**	**Close**	**NAV(1)**
2015:				
Fourth quarter	$ 5.43	$ 3.78	$ 4.07	$ 5.82
Third quarter	$ 5.72	$ 4.40	$ 4.51	$ 6.33
Second quarter	$ 6.40	$ 5.56	$ 5.98	$ 6.96
First quarter	$ 7.61	$ 6.54	$ 6.73	$ 7.16
2014:				
Fourth quarter	$ 8.59	$ 6.63	$ 6.82	$ 6.94
Third quarter	$ 8.54	$ 7.87	$ 8.31	$ 7.67
Second quarter	$ 8.72	$ 7.84	$ 8.49	$ 7.67
First quarter	$ 8.66	$ 7.83	$ 8.66	$ 7.62

(1) Net Asset Value ("NAV") per share is determined as of the last day in the relevant quarter and therefore may not reflect the NAV per share on the date of the high and low closing sales prices.

We began paying quarterly distributions in our first full quarter of operations following our IPO. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 8 — "Distributable Tax Income" from our Notes to the Financial Statements included herein. The table below provides information relating to distributions we paid in respect of the periods indicated.

Stockholder Distributions

	Distributions	**Declaration Date**	**Record Date**	**Pay Date**
2015:				
Fourth quarter	$ 0.15	12/16/2015	1/6/2016(1)	1/28/2016
Third quarter	0.21	9/22/2015	10/14/2015	10/27/2015
Second quarter	0.21	6/23/2015	7/6/2015	7/27/2015
First quarter	0.21	3/24/2015	4/6/2015	4/27/2015
Total declared for 2015	$ 0.78			
2014:				
Fourth quarter	$ 0.25	12/17/2014	12/29/2014	1/29/2015
Third quarter	0.25	9/19/2014	10/14/2014	10/29/2014
Second quarter	0.25	6/20/2014	7/3/2014	7/25/2014
First quarter	0.25	3/21/2014	4/4/2014	4/25/2014
Total declared for 2014	$ 1.00			

(1) Since the record date of this distribution is in 2016, it is a 2016 tax event.

The determination of the tax attributes of our distributions is made annually, based upon our taxable income for the full year and distributions paid for the full year. Ordinary dividend distributions from a RIC do not qualify for the tax rate applicable to "qualified dividend income" from domestic corporations and qualified foreign corporations, except to the extent that the RIC received the income in the form of qualifying dividends from domestic corporations and qualified foreign corporations. For further information about the tax attributes, see Note 8 "Distributable Taxable Income" of our notes to the financial statements, which can be found elsewhere in this Annual Report.

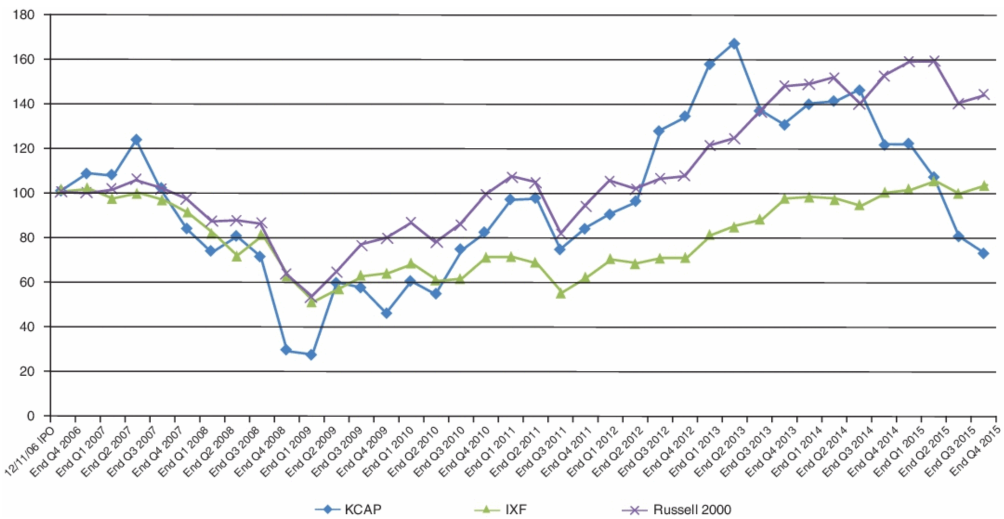
Performance Graph

The following graph compares the return on our common stock with that of the Russell 2000 Index and the Nasdaq Financial 100 Index (IXF), for the period December 11, 2006 (the date of our initial public offering) to December 31, 2015. The graph assumes that, on December 11, 2006, a person invested $100 in each of our common stock, the Russell 2000 Index, and the IFX. The graph measures total shareholder return, which takes into account both changes in stock price and dividends. It assumes that dividends are reinvested.

Shareholder Return Performance Graph

Cumulative Total Return Since Initial Public Offering(1)

(Through December 31, 2015)



(1) Total return includes reinvestment of distributions through December 31, 2015. The IXF is an index of diversified financial sector stocks and, as such, the Company believes that it is representative of our industry. The Russell 2000 is a broad based equity market index that tracks companies with a market capitalization that the Company believes are comparable to it.

HOLDERS

As of December 31, 2015, there were 48 shareholders of record of our common stock and approximately 16,243 beneficial shareholders of the Company.

SALES OF UNREGISTERED SECURITIES

During the year ended December 31, 2015, we issued 175,922 shares of common stock pursuant to a dividend reinvestment plan. This issuance was not subject to the registration requirements of the Securities Act. See Note 9 "Stockholders' Equity," of our Notes to the Consolidated Financial Statements included herein.

DIVIDEND POLICY

We intend to continue to make quarterly distributions to our stockholders. Our quarterly distributions, if any, will be determined by our Board of Directors. To maintain our RIC status, we must timely distribute an amount equal to at least 90% of our tax basis ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, reduced by deductible expenses, out of the assets legally available for distribution, for each year. To avoid certain excise taxes imposed on RICs, we are generally required to distribute during each calendar year an amount at least equal to the sum of (1) 98% of our ordinary income for the calendar year, (2) 98.2% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year and (3) any ordinary income and net capital gains for preceding years that were not distributed during such years and on which we paid no corporate tax. If this requirement is not met, we will be required to pay a nondeductible excise tax equal to 4% of the amount by which the required distribution amount exceeds the actual distribution for the year. The taxable income on which an excise tax is paid is generally carried forward and distributed to stockholders in the next tax year. Depending on the level of taxable income earned in a tax year, we may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4% excise tax on such income, to the extent required.

We cannot assure you that we will achieve results that will permit the payment of any cash distributions and, because we issued public senior securities, we are prohibited from making distributions if doing so causes us to fail to maintain the asset coverage ratio stipulated by the 1940 Act. Similarly, we may be prohibited from making distributions by the terms of any of our other borrowings.

We maintain an "opt out" dividend reinvestment plan for our common stockholders. As a result, if we declare distributions, then stockholders' cash distributions will be automatically reinvested in additional shares of our common stock, unless they specifically "opt out" of the dividend reinvestment plan so as to receive cash.

EQUITY COMPENSATION PLAN INFORMATION

The following table summarizes certain information regarding the Amended and Restated 2006 Equity Incentive Plan (the "Equity Incentive Plan") and the Amended and Restated Non-Employee Director Plan (the "Non-Employee Director Plan") as of December 31, 2015:

Plan Category	Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)
Equity Compensation Plans Approved by Security Holders(1)	50,000	$ 7.72	891,713(2)(3)
Equity Compensation Plans Not Approved by Security Holders	—	—	—
Total	50,000	7.72	891,713

(1) The Company's Equity Incentive Plan and Non-Employee Director Plan.

(2) Subject to the following additional limitations: The aggregate number of shares of restricted stock that may be issued under the Equity Incentive Plan may not exceed 10% of the outstanding shares on June 13, 2008, the effective date of the Equity Incentive Plan, plus 10% of the number of shares issued or delivered by the Company (other than pursuant to compensation plans) during the term of the Equity Incentive Plan. No one person may be granted more than 25% of the shares of restricted stock reserved for issuance under the Equity Incentive Plan. In addition, the amount of voting securities that would result from the exercise of all of the Company's outstanding warrants, options and rights, together with any restricted stock issued by the Company, at the time of issuance may not exceed 25% of the outstanding voting securities of the Company, except that if the amount of voting securities that would result from the exercise of all the Company's outstanding warrants, options and rights issued to the Company's directors, officers and employees, together with any restricted stock issued by the Company, would exceed 15% of the outstanding voting securities of the Company, the total amount of voting securities that would result from the exercise of all outstanding warrants, options and rights, together with

any restricted stock issued by the Company, at the time of issuance may not exceed 20% of the outstanding voting securities of the Company.

(3) The shares issuable under the Company's Equity Incentive Plan may be issued in the form of options, restricted stock or other stock-based awards. The shares issuable under the Company's Non-Employee Director Plan may currently be issued in the form of restricted stock.

Item 6. *Selected Financial Data*

The following selected consolidated financial data should be read in conjunction with Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and Part II, Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K. The following selected financial and other data for the years ended December 31, 2015, 2014, 2013, 2012 and 2011 is derived from the audited consolidated financial statements for such years, included in Part II, Item 8*, Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K.

KCAP FINANCIAL, INC.
SELECTED FINANCIAL DATA

	Year Ended December 31, 2015	Year Ended December 31, 2014	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Income Statement Data:					
Interest and related portfolio income:					
Interest and Dividends	$ 39,811,558	$ 34,802,690	$ 33,144,195	$29,821,676	$ 19,024,979
Fees and other income	366,859	934,871	305,376	304,882	86,057
Dividends from Asset Manager Affiliates	5,348,554	5,467,914	5,735,045	1,214,998	1,060,000
Other Income	—	—	—	—	2,000,000
Total interest and related portfolio income	45,526,971	41,205,475	39,184,616	31,341,556	22,171,036
Expenses:					
Interest and amortization of debt issuance costs	11,727,880	11,538,179	10,116,271	6,976,018	4,588,482
Compensation	3,843,799	4,951,745	4,630,481	3,172,814	3,907,900
Other	5,772,502	4,594,983	4,563,749	4,344,611	3,490,939
Total operating expenses	21,344,181	21,084,907	19,310,501	14,493,443	11,987,321
Net Investment Income	24,182,790	20,120,568	19,874,115	16,848,113	10,183,715
Realized and unrealized gains (losses) on investments:					
Net realized gains (losses)	(6,647,478)	(11,132,491)	(12,627,314)	(3,232,974)	(18,476,608)
Net change in unrealized gains (losses)	(36,169,870)	6,045,517	9,976,171	12,510,641	15,942,437
Total net gains (losses)	(42,817,348)	(5,086,974)	(2,651,143)	9,277,667	(2,534,171)
Net increase (decrease) in net assets resulting from operations	$(18,634,558)	$ 15,033,594	$ 17,222,972	$26,125,779	$ 7,649,544
Per Share:					
Earnings per common share – basic	$ (0.50)	$ 0.44	$ 0.53	$ 1.00	$ 0.33
Earnings per common share – diluted	$ (0.50)	$ 0.43	$ 0.53	$ 0.95	$ 0.33
Net investment income per share – basic	$ 0.65	$ 0.59	$ 0.62	$ 0.65	$ 0.45
Net investment income per share – diluted	$ 0.65	$ 0.58	$ 0.62	$ 0.64	$ 0.45
Distributions declared per common share	$ 0.78	$ 1.00	$ 1.06	$ 0.94	$ 0.69
Taxable Distributable Income per basic share	$ 0.63	$ 0.78	$ 0.70	$ 0.77	$ 0.65

	Year Ended December 31, 2015	Year Ended December 31, 2014	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Balance Sheet Data:					
Investment assets at fair value	$409,570,495	$479,706,494	$440,549,994	$312,044,763	$239,791,681
Total assets	$425,242,341	$510,446,797	$459,172,388	$319,260,473	$248,133,661
Total debt outstanding	$205,141,405	$223,884,593	$192,592,373	$101,400,000	$ 60,000,000
Stockholders' equity	$216,100,470	$255,316,701	$250,369,693	$207,875,659	$180,525,942
Net asset value per common share	$ 5.82	$ 6.94	$ 7.51	$ 7.85	$ 7.85
Common shares outstanding at end of year	37,100,005	36,775,127	33,332,123	26,470,408	22,992,211
Other Data:					
Investments funded(1)	130,954,741	235,905,130	243,966,586	123,165,150	85,541,809
Principal collections related to investment repayments or sales(1)	129,793,338	193,554,964	94,197,886	104,556,500	81,681,314
Number of portfolio investments at year end(1)	130	141	126	88	68
Weighted average yield of income producing debt investments(2)	7.4%	7.3%	7.3%	7.5%	8.4%

(1) Does not include investments in time deposits or money markets.

(2) Weighted average yield of income producing investments is calculated as the average yield to par outstanding balances for investments in loans, bonds, and mezzanine debt in our Debt Securities portfolio.

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with our financial statements and related notes and other financial information appearing elsewhere in this annual report. In addition to historical information, the following discussion and other parts of this annual report contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to the factors discussed under "Item 1A. Risk Factors" and "Note About Forward-Looking Statements" appearing elsewhere in this annual report.

GENERAL

We are an internally managed, non-diversified closed-end investment company that is regulated as a Business Development Company, or BDC under the Investment Company Act of 1940 (the "1940 Act"). We have three principal areas of investments:

First, the Company originates, structures, and invests in senior secured term loans and mezzanine debt primarily in privately-held middle market companies (the "Debt Securities Portfolio"). In addition, from time to time the Company may invest in the equity securities of privately held middle market companies.

Second, the Company have invested in asset management companies (Katonah Debt Advisors and Trimaran Advisors, collectively the "Asset Manager Affiliates") that manage CLO Funds.

Third, the Company invests in debt and subordinated securities issued by collateralized loan obligation funds CLOs ("CLO Fund Securities"). These CLO Fund Securities are primarily managed by our Asset Manager Affiliates, but from time-to-time the Company makes investments in CLO Fund Securities managed by other asset managers. The CLO Funds typically invest in broadly syndicated loans, high-yield bonds and other credit instruments

The Company may also invest in other investments such as loans to larger, publicly-traded companies, high-yield bonds and distressed debt securities. The Company may also receive warrants or options to purchase common stock in connection with its debt investments.

In our Debt Securities Portfolio, our investment objective is to generate current income and, to a lesser extent, capital appreciation from the investments made by our middle market business in senior secured term loans, mezzanine debt and selected equity investments in privately-held middle market companies. We define the middle market as comprising of companies with earnings before interest, taxes, depreciation and amortization ("EBITDA") of $10 million to $50 million and/or total debt of $25 million to $150 million. We primarily invest in first and second lien term loans which, because of their priority in a company's capital structure, we expect will have lower default rates and higher rates of recovery of principal if there is a default and which we expect will create a stable stream of interest income. The investments in our Debt Securities Portfolio are all or predominantly below investment grade, and have speculative characteristics with respect to the issuer's capacity to pay interest and repay principal. While our primary investment focus is on making loans to, and selected equity investments in, privately-held middle market companies, we may also invest in other investments such as loans to smaller companies or larger, publicly-traded companies, high-yield bonds and distressed debt securities. We may also receive warrants or options to purchase common stock in connection with our debt investments.

From our Asset Manager Affiliates investment, we expect to receive recurring cash distributions and to generate capital appreciation through the addition of new CLO Funds managed by our Asset Manager Affiliates. The Asset Manager Affiliates manage CLO Funds that invest in broadly syndicated loans, high-yield bonds and other credit instruments. Collectively, the Asset Manager Affiliates have approximately $2.7 billion of par value assets under management as of December 31, 2015. The Asset Manager Affiliates are registered under the Investment Advisers Act of 1940, and are each managed independently from KCAP by a separate management team (however, certain of the Company's executive officers also act in similar capacities for one or both of the Asset Manager Affiliates).

In addition, our investments in CLO Fund Securities, which are primarily made up of a minority investment in the subordinated securities or preferred stock of CLO Funds raised and managed by our Asset

Manager Affiliates, are anticipated to provide the Company with recurring cash distributions and complement the growth of our Asset Manager Affiliates.

Subject to market conditions, we intend to grow our entire portfolio of investments by raising additional capital, including through the prudent use of leverage available to us. As a BDC, we are limited in the amount of leverage we can incur under the 1940 Act. We are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing.

We have elected to be treated for U.S. federal income tax purposes as a RIC and intend to operate in a manner to maintain our RIC status. As a RIC, we intend to distribute to our stockholders substantially all of our net ordinary taxable income and the excess of realized net short-term capital gains over realized net long-term capital losses, if any, for each year. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements. Pursuant to this election, we generally will not have to pay corporate-level U.S. federal income taxes on any income that we timely distribute to our stockholders.

PORTFOLIO AND INVESTMENT ACTIVITY

Our primary investments are: (1) lending to and investing in middle-market businesses through investments in senior secured loans, junior secured loans, subordinated/mezzanine debt investments, and other equity investments, which may include warrants, (2) our investments in our Asset Manager Affiliates, which manage portfolios of broadly syndicated loans, high-yield bonds and other credit instruments, and (3) CLO Fund Securities.

Total portfolio investment activity (excluding activity in time deposit and money market investments) for the years ended December 31, 2015, December 31, 2014, and December 31, 2013 was as follows:

	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliates	Total Portfolio
Fair Value at December 31, 2012	$ 111,037,882	83,257,507	8,020,716	77,242,000	279,558,105
2013 Activity:					
Purchases/originations/draws	232,226,295	11,957,500	3,813,838	217,212	248,214,845
Pay-downs/pay-offs/sales	(80,089,537)	—	(2,882,106)	(7,014,955)	(89,986,598)
Net accretion (amortization)	238,554	(2,473,528)	—	—	(2,234,974)
Net realized losses	(11,538,868)	—	(551,636)	—	(12,090,504)
Net increase (decrease) in fair value	14,956,101	(13,289,259)	2,605,586	5,703,743	9,976,171
Fair Value at December 31, 2013	266,830,427	79,452,220	11,006,398	76,148,000	433,437,045
2014 Activity:					
Purchases/originations/draws	224,513,503	22,421,847	2,216,847	545,979	249,698,176
Pay-downs/pay-offs/sales	(168,429,374)	(10,132,500)	(5,007,311)	(6,432,086)	(190,001,271)
Net accretion (amortization)	410,718	(11,102,015)	—	—	(10,691,297)
Net realized gains (losses)	(8,823,507)	5,575,498	(7,136,408)	—	(10,384,417)
Net increase (decrease) in fair value	5,641,403	(8,700,148)	7,040,155	2,064,107	6,045,517
Fair Value at December 31, 2014	320,143,170	77,514,902	8,119,681	72,326,000	478,103,753
2015 Activity:					
Purchases/originations/draws	108,670,472	11,952,000	1,953,299	—	124,023,641
Pay-downs/pay-offs/sales	(135,328,386)	(3,872,700)	(317,340)	(3,701,446)	(143,219,872)
Net accretion (amortization)	1,860,670	(9,507,050)	—	—	(9,094,250)
Net realized gains (losses)	41,580	(6,246,883)	3,015	—	(6,202,288)
Net increase (decrease) in fair value	(10,748,262)	(13,967,887)	(210,167)	(11,243,554)	(36,169,870)
Fair Value at December 31, 2015	$ 284,639,244	$ 55,872,382	$ 9,548,488	$ 57,381,000	$ 407,441,114

The level of investment activity for investments funded and principal repayments for our investments can vary substantially from period to period depending on the number and size of investments that we invest in or divest of, and many other factors, including the amount and competition for the debt and equity securities available to middle market companies, the level of merger and acquisition activity for such companies and the general economic environment.

The following table shows the Company's portfolio by security type at December 31, 2015 and December 31, 2014:

	December 31, 2015			December 31, 2014		
Security Type	Amortized Cost	Fair Value	%(1)	Amortized Cost	Fair Value	%(1)
Money Market Accounts(3)	$ 2,129,381	$ 2,129,381	1	$ 1,602,741	$ 1,602,741	—%
Senior Secured Loan	203,819,074	194,123,223	46	220,965,922	218,329,859	46
Junior Secured Loan	40,221,557	37,591,900	9	38,664,199	38,569,006	8
Senior Unsecured Loan	23,000,000	23,000,000	6	33,066,984	33,066,984	7
First Lien Bond	3,000,000	2,216,700	1	2,962,507	2,580,000	1
Senior Subordinated Bond	4,466,793	4,615,569	1	4,295,544	4,240,301	1
Senior Unsecured Bond	11,879,187	10,551,724	3	11,208,178	11,386,218	2
Senior Secured Bond	1,510,560	1,503,755	—	1,515,584	1,552,500	—
CLO Fund Securities	83,214,947	55,872,382	14	90,889,190	77,514,902	16
Equity Securities	10,467,787	9,548,488	2	8,828,812	8,119,681	2
Preferred Securities	10,411,673	11,036,373	3	10,206,016	10,418,302	2
Asset Manager Affiliates(2)	56,591,230	57,381,000	14	60,292,677	72,326,000	15
Total	$450,712,189	$409,570,495	100%	$484,498,354	$479,706,494	100%

(1) Represents percentage of of total portfolio at fair value

(2) Represents the equity investment in the Asset Manager Affiliates.

(3) Includes restricted cash held under employee benefit plans.

Debt Securities Portfolio

At December 31, 2015 and December 31, 2014, our investments in income producing loans and debt securities, excluding CLO Fund Securities, had a weighted average interest rate of approximately 7.4% and 7.3%, respectively.

The investment portfolio (excluding the Company's investment in Asset Manager Affiliates and CLO Funds) at December 31, 2015 was spread across 27 different industries and 101 different entities with an average balance per entity of approximately $3.3 million. As of December 31, 2015, all but one of our portfolio companies were current on their debt service obligations.

We may invest up to 30% of our investment portfolio in "Non-qualifying" opportunistic investments such as high-yield bonds, debt and equity securities of CLO Funds, foreign investments, and distressed debt or equity securities of public companies. At December 31, 2015 and December 31, 2014, the total amount of non-qualifying assets was approximately 18% and 21%, respectively. The majority of non-qualifying assets were foreign investments which was approximately 13.5% and 15.6% of the Company's total assets, respectively (including the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 13% and 15% of its total assets on such dates, respectively). The investments in our Debt Securities Portfolio are all or predominantly below investment grade, and therefore have speculative characteristics with respect to the issuer's capacity to pay interest and repay principal.

The following tables detail the ten largest portfolio companies (at fair value) as of December 31, 2015:

Investment	December 31, 2015 Cost	Fair Value	% of FMV
Asset Manager Affiliates	$ 56,591,230	$ 57,381,000	14%
Trimaran Advisors, L.L.C.	23,000,000	23,000,000	6
Katonah 2007-I CLO Ltd.	24,312,424	20,295,677	5
DBI Holding, LLC	8,585,578	12,975,447	3
Crowley Holdings Preferred, LLC	10,411,673	11,036,373	3
Grupo HIMA San Pablo, Inc.	9,817,315	9,917,500	2
Catamaran CLO 2015-1 Ltd.	11,869,751	8,789,651	2
Tank Partners Holdings, LLC	10,624,515	8,177,538	2
Weiman Products, LLC	6,582,457	6,619,805	2
Nielsen & Bainbrige, LLC	6,803,605	6,510,157	2
Total	$ 168,598,548	$ 164,703,148	40%

Investment	December 31, 2014 Cost	Fair Value	% of FMV
Asset Manager Affiliates	$ 60,292,677	$ 72,326,000	15%
Katonah 2007-I CLO Ltd.	23,471,779	25,191,782	5
Trimaran Advisors, L.L.C.	23,000,000	23,000,000	5
Tank Partners Holdings, LLC	11,378,111	10,539,567	2
Crowley Holdings Preferred, LLC	10,206,016	10,418,302	2
Restorix Health, Inc.	10,066,984	10,066,984	2
Grupo HIMA San Pablo, Inc.	9,805,883	10,052,500	2
Catamaran CLO 2014-1 Ltd.	10,473,628	8,867,176	2
Catamaran CLO 2014-2 Ltd.	9,862,799	8,761,500	2
DBI Holding LLC	7,776,255	8,373,483	2
Total	$ 176,334,132	$ 187,597,293	39%

Excluding the Asset Manager Affiliates and CLO Fund securities, the Company's ten largest portfolio companies represented approximately 19% and 17% of the total fair value of the Company's investments at December 31, 2015 and December 31, 2014, respectively.

The industry concentrations, based on the fair value of the Company’s investment portfolio as of December 31, 2015 and December 31, 2014, were as follows:

	December 31, 2015			December 31, 2014[2]		
Industry Classification	**Cost**	**Fair Value**	**%[1]**	**Cost**	**Fair Value**	**%[1]**
Aerospace and Defense	$ 6,910,349	$ 6,383,724	2%	$ 10,059,487	$ 9,533,092	2%
Asset Management Company[2]	56,591,230	57,381,000	14	60,292,677	72,326,000	15
Related Party Loan	23,000,000	23,000,000	6	23,000,000	23,000,000	5
Automotive	9,898,494	9,440,866	2	8,362,956	8,312,548	2
Banking, Finance, Insurance & Real Estate	6,270,984	6,008,587	1	7,660,721	7,639,365	2
Beverage, Food and Tobacco	17,334,746	16,882,750	4	17,974,974	17,883,421	4
Capital Equipment	9,519,342	7,846,767	2	9,486,407	10,351,329	2
Chemicals, Plastics and Rubber	3,494,086	3,359,916	1	6,348,226	6,210,253	1
CLO Fund Securities	83,214,947	55,872,382	14	90,889,190	77,514,902	16
Construction & Building	1,976,345	1,907,614	—	—	—	—
Consumer goods: Durable	13,983,607	12,753,455	3	13,876,482	13,301,207	3
Consumer goods: Non-durable	20,124,355	19,646,576	5	13,535,975	13,314,952	3
Containers, Packaging and Glass	—	—	—	2,992,443	2,946,734	1
Energy: Oil & Gas	14,281,821	10,204,318	2	13,866,208	13,289,753	3
Energy: Electricity	3,465,576	3,465,000	1	—	—	—
Environmental Industries	13,735,492	13,179,657	3	12,942,593	12,911,017	3
Forest Products & Paper	5,888,294	5,883,080	1	5,917,051	5,942,523	1
Healthcare & Pharmaceuticals	58,649,512	55,417,827	14	66,186,412	65,720,782	13
High Tech Industries	11,727,898	11,662,995	3	14,457,495	14,419,110	3
Hotel, Gaming & Leisure	400,000	1,000	—	3,392,481	2,962,315	1
Media: Advertising, Printing & Publishing	11,167,950	10,340,449	3	11,318,815	11,396,027	2
Media: Broadcasting & Subscription	7,428,110	7,406,792	2	14,477,078	14,409,401	3
Metals & Mining	228,563	991	—	228,563	1,000	—
Retail	4,416,709	3,594,599	1	4,234,086	3,773,847	1
Services: Business	18,206,668	21,022,801	5	16,550,255	16,066,421	3
Services: Consumer	6,512,029	6,356,054	2	6,798,372	6,752,521	1
Telecommunications	13,776,871	12,425,489	3	22,030,434	21,865,864	5
Time Deposit and Money Market Accounts[3]	2,129,381	2,129,381	1	1,602,741	1,602,741	—
Transportation: Cargo	18,232,953	18,865,603	5	20,156,700	20,455,941	4
Transportation: Consumer	2,472,795	2,324,381	1	—	—	—
Utilities: Electric	5,673,082	4,806,441	1	5,859,532	5,803,428	1
Total	$450,712,189	$409,570,495	100%	$484,498,354	$479,706,494	100%

(1) Calculated as a percentage of total portfolio at fair value.

(2) Represents the equity investment in the Asset Manager Affiliates.

(3) Includes restricted cash held under employee benefit plans.

CLO Fund Securities

We typically make a minority investment in the subordinated securities or preferred stock of CLO Funds raised and managed by our Asset Manager Affiliates and may selectively invest in securities issued by CLO Funds managed by other asset management companies. As of December 31, 2015, we had approximately $56 million invested in CLO Fund Securities, issued primarily by funds managed by our Asset Manager Affiliates.

The CLO Funds invest primarily in broadly syndicated non-investment grade loans, high-yield bonds and other credit instruments of corporate issuers. The underlying assets in each of the CLO Fund Securities in which we have an investment are generally diversified secured or unsecured corporate debt.

Our CLO Fund Securities as of December 31, 2015 and December 31, 2014 are as follows:

			December 31, 2015		December 31, 2014	
CLO Fund Securities	**Investment**	**%[1]**	**Cost**	**Fair Value**	**Cost**	**Fair Value**
Grant Grove CLO, Ltd.	Subordinated Securities	22.2%	$ 2,484,943	$ 280,164	$ 2,254,638	$ 469,132
Katonah III, Ltd.[3]	Preferred Shares	23.1	1,373,132	400,000	1,015,334	400,000
Katonah VII CLO Ltd.[2]	Subordinated Securities	16.4	—	—	3,563,252	1,000
Katonah VIII CLO Ltd.[2]	Subordinated Securities	10.3	—	—	2,755,267	100,000
Katonah IX CLO Ltd.[2]	Preferred Shares	6.9	1,140,057	105,000	1,262,496	594,988
Katonah X CLO Ltd.[2]	Subordinated Securities	33.3	7,637,499	1,000,000	8,910,471	4,863,001
Katonah 2007-I CLO Ltd.[2]	Preferred Shares	100	24,312,424	20,295,677	23,471,779	25,191,782
Trimaran CLO IV, Ltd.[2]	Preferred Shares	19.0	—	—	11,094	900,000
Trimaran CLO V, Ltd.[2]	Subordinated Notes	20.8	—	—	1,292,698	1,657,020
Trimaran CLO VI, Ltd.[2]	Income Notes	16.2	—	—	1,531,142	1,950,000
Trimaran CLO VII, Ltd.[2]	Income Notes	10.5	1,375,013	1,647,272	1,399,074	2,084,394
Catamaran CLO 2012-1 Ltd.[2]	Subordinated Notes	24.9	6,791,980	3,312,940	7,994,677	5,793,924
Catamaran CLO 2012-1 Ltd.[2]	Class F Notes	42.9	—	—	3,917,442	4,160,000
Catamaran CLO 2013-1 Ltd.[2]	Subordinated Notes	23.5	6,256,090	5,639,106	7,492,702	7,874,910
Dryden 30 Senior Loan Fund	Subordinated Notes	7.5	1,592,303	1,634,647	2,263,321	2,506,075
Catamaran CLO 2014-1 Ltd.[2]	Subordinated Notes	24.9	8,928,790	5,846,325	10,473,628	8,867,176
Catamaran CLO 2014-1 Ltd.[2]	Class E Notes	15.1	1,428,797	1,170,000	1,417,376	1,340,000
Catamaran CLO 2014-2 Ltd.[2]	Subordinated Notes	24.9	8,024,168	5,751,600	9,862,799	8,761,500
Catamaran CLO 2015-1 Ltd.[2]	Subordinated Notes	24.0	11,869,751	8,789,651	—	—
Total			$83,214,947	$55,872,382	$90,889,190	$77,514,902

(1) Represents percentage of class held.

(2) A CLO Fund managed by an Asset Manager Affiliate.

(3) As of December 31, 2015, this CLO Fund Security was not providing a dividend distribution.

Asset Manager Affiliates

The Asset Manager Affiliates are our wholly-owned asset management companies that manage CLO Funds that invest in broadly syndicated loans, high yield bonds and other credit instruments. The CLO Funds managed by our Asset Manager Affiliates consist primarily of credit instruments issued by corporations. As of December 31, 2015, our Asset Manager Affiliates had approximately $2.7 billion of par value of assets under management on which they earn management fees, and were valued at approximately $57 million.

All CLO Funds managed by the Asset Manager Affiliates are currently paying all senior and subordinate management fees. In addition, during 2015, our Asset Manager Affiliates received incentive fees from three funds.

RESULTS OF OPERATIONS

The principal measure of our financial performance is the net increase (decrease) in stockholders' equity resulting from operations, which includes net investment income (loss) and net realized and unrealized appreciation (depreciation). Net investment income (loss) is the difference between our income from interest, distributions, fees, and other investment income and our operating expenses. Net realized gain (loss) on investments is the difference between the proceeds received from dispositions of portfolio investments and their amortized cost. Net change in unrealized appreciation (depreciation) on investments is the net change in the fair value of our investment portfolio.

Set forth below is a discussion of our results of operations for December 31, 2015, 2014, and 2013.

Revenue

	For the Years Ended December 31,		
	2015	2014	2013
Investment Income:			
Interest from investments in debt securities	$24,101,257	$21,386,432	$ 13,967,235
Interest from cash and time deposits	10,239	3,452	20,656
Investment income on CLO Fund Securities managed by affiliates	14,691,428	12,367,581	17,346,770
Investment income on CLO Fund Securities managed by non-affiliates	1,008,634	1,045,225	1,809,534
Dividends from Asset Manager Affiliates	5,348,554	5,467,914	5,735,045
Capital structuring service fees	366,859	934,871	305,376
Total investment income	$45,526,971	$41,205,475	$ 39,184,616

Revenues consist primarily of investment income from interest and dividends on our investment portfolio and various ancillary fees related to our investment holdings.

Interest from Investments in Debt Securities. We generate interest income from our investments in debt securities that consist primarily of senior and junior secured loans. Our Debt Securities Portfolio is spread across multiple industries and geographic locations, and as such, we are broadly exposed to market conditions and business environments. As a result, although our investments are exposed to market risks, we continuously seek to limit concentration of exposure in any particular sector or issuer.

Investment Income on Investments in CLO Fund Securities. We generate investment income from our investments in the securities (typically preferred shares or subordinated securities) of CLO Funds managed by our Asset Manager Affiliates and selective investments in securities issued by CLO Funds managed by other asset management companies. CLO Funds managed by our Asset Manager Affiliates and those managed by non-affiliates invest primarily in broadly syndicated non-investment grade loans, high-yield bonds and other credit instruments of corporate issuers. The Company distinguishes CLO Funds managed by its Asset Manager Affiliates as "CLO Fund Securities Managed by Affiliates", in its financial consolidated statements. The underlying assets in each of the CLO Funds in which we have an investment are generally diversified secured or unsecured corporate debt. Our CLO Fund Securities that are subordinated securities or preferred shares ("junior securities") are subordinated to senior note holders who typically receive a return on their investment at a fixed spread relative to the LIBOR index. The CLO Funds are leveraged funds and any excess cash flow or "excess spread" (interest earned by the underlying securities in the fund less payments made to senior bond holders and less fund expenses and management fees) is paid to the holders of the CLO Fund's subordinated securities or preferred shares. The level of excess spread from CLO Fund Securities can be impacted by the timing and level of the resetting of the benchmark interest rate for the underlying assets (which reset at various times throughout the quarter) in the CLO Fund and the related CLO Fund note liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and resulting cash distributions to us can vary significantly.

Interest income on investments in CLO equity investments is recorded using the effective interest method in accordance with the provisions of ASC 325-40, *Beneficial Interests in Securitized Financial Assets* ("ASC 325-40"), based on the anticipated yield and the estimated cash flows over the projected life of the investment. Yields are revised when there are changes in actual or estimated projected future cash flows due to changes in prepayments and/or re-investments, credit losses or asset pricing. Changes in estimated yield are recognized as an adjustment to the estimated yield prospectively over the remaining life of the investment from the date the estimated yield was changed. Accordingly, investment income recognized on CLO equity securities in the GAAP statement of operations differs from both the tax-basis investment income and from the cash distributions actually received by the Company during the period. As a RIC, the Company anticipates a timely distribution of its tax-basis taxable income.

For non-junior class CLO Fund securities, such as our investment in the Class E notes of Catamaran 2014-1, interest is earned at a fixed spread relative to the LIBOR index.

Distributions from Asset Manager Affiliates. We receive cash distributions from our investment in our Asset Manager Affiliates, which are wholly-owned and manage CLO Funds that invest primarily in broadly syndicated non-investment grade loans, high yield bonds and other credit instruments issued by corporations. As managers of CLO Funds, our Asset Manager Affiliates receive contractual and recurring management fees from the CLO Funds for their management and advisory services. In addition, our Asset Manager Affiliates may also earn income related to net interest on assets accumulated for future CLO issuances on which they have taken a first loss position in connection with loan warehouse arrangements for their CLO Funds. The annual management fees that our Asset Manager Affiliates receive are generally based on a fixed percentage of the par value of assets under management and are recurring in nature for the term of the CLO Fund so long as the Asset Manager Affiliates manage the fund. As a result, the annual management fees earned by our Asset Manager Affiliates generally are not subject to market value fluctuations in the underlying collateral. Our Asset Manager Affiliates may receive incentive fees provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares as per the terms of each CLO Fund management agreement. During the years ended December 31, 2015 and 2014, the Asset Manager Affiliates received incentive fees from three and five funds, respectively.

The Asset Manager Affiliates are expected to pay future distributions to the Company based upon their after-tax free cash flow, which generally will be dependent upon the maintenance and growth in their assets under management and incentive fees. As a result of tax-basis goodwill amortization and certain other tax-related adjustments, portions of distributions received may be deemed return of capital. As amortizing funds which are paying incentive fees are redeemed, we expect incentive fees available for distribution to diminish. During the years ended December 31, 2015 and 2014, three and five CLO Funds have achieved the minimum investment return threshold and are paying the Asset Manager Affiliates incentive fees, respectively. The fair value of our investment in our Asset Manager Affiliates was approximately $57 million at December 31, 2015, with an unrealized loss for the year ending December 31, 2015 of approximately $11 million. For the years ended December 31, 2015, 2014, and 2013, we recognized dividend income of $5.3 million, $5.5 million and $5.7 million, from the Asset Manager Affiliates, respectively, while cash distributions received were approximately $9.1 million, $11.9 million and $12.8 million for those years, respectively. The difference between cash distributions received and the tax-basis earnings and profits is recorded as an adjustment to the cost basis of the Asset Manager Affiliates investments. For interim periods, the Company estimates the tax attributes of any distributions as being either tax-basis earnings and profits (i.e. dividend income) or return of capital (i.e. adjustment to the Company's cost basis in the Asset Manager Affiliates). The final determination of the tax attributes of distributions from our Asset Manager Affiliates is made on an annual (full calendar year) basis at the end of the year based upon taxable income and distributions for the full-year. Therefore, any estimate of tax attributes of distributions made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year. CLO Funds typically have automatic orderly wind-down features following an initial period of reinvestment. Thus, with all else being equal, as managed CLO Fund portfolios age, projected future assets under management (and associated management fees) will naturally decline, resulting in a reduction in fair value of our Asset Manager Affiliates. On the other hand, mandates to manage new CLO Fund portfolios will generally result in an increase in the fair value of our investment in our Asset Manager Affiliates. The aggregate of par value of assets under management by our Asset Manager Affiliates was $2.7 billion and $3.0 billion as of December 31, 2015 and 2014, respectively.

Capital Structuring Service Fees. We may earn ancillary structuring and other fees related to the origination, investment, disposition or liquidation of debt and investment securities.

Investment Income

Investment income for the years ended December 31, 2015, 2014, and 2013 was approximately $46 million, $41 million, and $39 million, respectively. Of these amounts, approximately $24 million, $21 million and $14 million, respectively, was attributable to interest income on our Debt Securities Portfolio. Increases in interest income from 2013 to 2014 and 2014 to 2015 were due to higher yields and higher average invested assets stemming primarily from capital raising activities.

The weighted average yield on debt securities portfolio was 7.4% and 7.3% as of December 31, 2015 and 2014, respectively.

Investment income is primarily dependent on the composition and credit quality of our investment portfolio. Generally, our Debt Securities Portfolio is expected to generate predictable, recurring interest income in accordance with the contractual terms of each loan. Corporate equity securities may pay a dividend and may increase in value for which a gain may be recognized; generally such dividend payments and gains are less predictable than interest income on our loan portfolio.

For the years ended December 31, 2015, 2014, and 2013, approximately $15.7 million, $13.4 million and $19.2 million, respectively, of investment income was attributable to investments in CLO Fund Securities. On a tax-basis, the Company recognized $14.7 million, $19.4 million and $22.0 million of taxable distributable income on distributions from our CLO Fund Securities during the years ended December 31, 2015, 2014, and 2013, respectively. Distributions from CLO Fund Securities are dependent on the performance of the underlying assets in each CLO Fund; interest payments, principal amortization and prepayments of the underlying loans in each CLO Fund are primary factors which determine the level of distributions on our CLO Fund Securities. The level of excess spread from CLO Fund Securities can be impacted by the timing and level of the resetting of the benchmark interest rate for the underlying assets (which reset at various times throughout the quarter) in the CLO Fund and the related CLO Fund bond liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and distributions to us can vary significantly.

Expenses

	For the Years Ended December 31,		
	2015	**2014**	**2013**
Expenses:			
Interest and amortization of debt issuance costs	$11,727,880	$11,538,179	$ 10,116,271
Compensation	3,843,799	4,951,745	4,630,481
Professional fees	3,520,461	2,614,479	2,191,305
Insurance	433,561	471,276	552,568
Administrative and other	1,818,480	1,509,228	1,819,876
Total expenses	$21,344,181	$21,084,907	$ 19,310,501

Because we are internally managed, we directly incur the cost of management and operations. As a result, we pay no investment management fees or other fees to an external advisor. Our expenses consist primarily of interest expense on outstanding borrowings, compensation expense and general and administrative expenses, including professional fees. Interest and compensation expense are typically our largest expenses each period.

Interest and Amortization of Debt Issuance Costs. Interest expense is dependent on the average outstanding balance on our borrowings and the base index rate for the period. Debt issuance costs represent fees and other direct costs incurred in connection with the Company's borrowings. These amounts are capitalized and amortized ratably over the contractual term of the borrowing.

Compensation Expense. Compensation expense includes base salaries, bonuses, stock compensation, employee benefits and employer-related payroll costs. The largest components of total compensation costs are base salaries and bonuses; generally, base salaries are expensed as incurred and annual bonus expenses are estimated and accrued. Our compensation arrangements with our employees contain a profit sharing and/or performance based bonus component. Therefore, as our net revenues increase, our compensation costs may also rise. In addition, our compensation expenses may also increase to reflect increased investment in personnel as we grow our products and businesses.

Professional Fees and General and Administrative Expenses. The balance of our expenses includes professional fees (primarily legal, accounting, valuation and other professional services), occupancy costs and general administrative and other costs.

Total expenses for the years ended December 31, 2015, 2014, and 2013 were approximately $21 million, $21 million, and $19 million, respectively. Interest expense and amortization on debt issuance costs for the period was approximately $12 million, $12 million, and $10 million, respectively, on average debt outstanding of $224 million, $197 million, and $151 million, respectively.

For the years ended December 31, 2015, 2014, and 2013, approximately $3.8 million, $5.0 million, and $4.6 million, respectively, of expenses were attributable to employee compensation, including salaries, bonuses, employee benefits, payroll taxes and stock-based compensation expense. For the years ended December 31, 2015, 2014, and 2013, professional fees and insurance expenses totaled approximately $4.0 million, $3.1 million and $2.7 million, respectively. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately $1.8 million, $1.5 million and $1.8 million for the years ended December 31, 2015, 2014, and 2013, respectively.

Net Investment Income and Net Realized Gains (Losses)

Net investment income and net realized gains (losses) represents the stockholder's equity before net unrealized appreciation or depreciation on investments. For the year ended December 31, 2015, net investment income and net realized losses (including realized losses on extinguishment of debt) were approximately $18 million, or $0.47 per basic share. Net investment income represents the income earned on our investments less operating and interest expense before net realized gains or losses and unrealized appreciation or depreciation on investments. For the year ended December 31, 2015, GAAP-basis net investment income was approximately $24 million, or $0.65 per basic share, while tax-basis distributable income was approximately $23.3 million or $0.63 per share.

Net Unrealized (Depreciation) Appreciation on Investments

	For the Years Ended December 31,		
	2015	2014	2013
Unrealized Gains (Losses) On Investments:			
Net change in unrealized appreciation (depreciation) on:			
Debt securities	$(10,748,262)	$ 5,641,403	$ 14,956,103
Equity securities	(210,167)	7,040,155	2,605,586
CLO Fund Securities managed by affiliates	(12,990,404)	(11,584,257)	(11,195,901)
CLO Fund Securities managed by non-affiliates	(977,483)	2,884,109	(2,093,360)
Asset Manager Affiliates investments	(11,243,554)	2,064,107	5,703,743
Total net unrealized (loss) gain from investment transactions	$(36,169,870)	$ 6,045,517	$ 9,976,171

During the year ended December 31, 2015, our total investments had net unrealized depreciation of approximately $36 million. Included in the net unrealized loss in 2015 are unrealized depreciation on CLO Fund Securities of approximately $14 million and unrealized depreciation of the Asset Manager Affiliates of $11 million, as well as unrealized depreciation on our debt securities of $11 million and equity securities of approximately $210,000. During the year ended December 31, 2014, our total investments had net unrealized appreciation of approximately $6 million, including net unrealized losses of approximately $9 million on CLO Fund Securities, offset by net unrealized gains on debt securities of approximately $6 million, net unrealized gains of the Asset Manager Affiliates of approximately $2.1 million, and net unrealized gains on equity securities of $7 million. During the year ended December 31, 2013, our total investments had net unrealized appreciation of $10 million, including approximately $15 million of unrealized gains on debt securities, approximately $2.6 million of unrealized gains on equity securities, and approximately $5.7 million of unrealized gains on the Asset Manager Affiliates investments, offset by net unrealized losses of approximately $13 million related to CLO Fund Securities.

Net Change in Stockholder's Equity Resulting From Operations

The net decrease in stockholders' equity resulting from operations for the year ended December 31, 2015 was approximately $19 million, or $0.50 per basic share. Net increase in stockholders' equity resulting from operations for the year ended December 31, 2014 was approximately $15 million, or $0.44 per basic share, and the net increase in stockholders' equity resulting from operations for the year ended December 31, 2013 was approximately $17 million, or $0.53 per share.

FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain investments, pay distributions to our stockholders and other general business needs. We recognize the need to have funds available for operating our business and to make investments. We seek to have adequate liquidity at all times to cover normal cyclical swings in funding availability and to allow us to meet irregular and unexpected funding requirements. We plan to satisfy our liquidity needs through normal operations with the goal of avoiding unplanned sales of assets or emergency borrowing of funds.

As of December 31, 2015 and December 31, 2014 the fair value of investments and cash were as follows:

	Investments at Fair Value	
Security Type	**December 31, 2015**	**December 31, 2014**
Cash	$ —	$ 1,220,798
Money Market Accounts	2,129,381	1,602,741
Senior Secured Loan	194,123,223	218,329,860
Junior Secured Loan	37,591,900	38,569,005
Senior Unsecured Loan	23,000,000	33,066,984
First Lien Bond	2,216,700	2,580,000
Senior Subordinated Bond	4,615,569	4,240,301
Senior Unsecured Bond	10,551,724	11,386,218
Senior Secured Bond	1,503,755	1,552,500
CLO Fund Securities	55,872,382	77,514,902
Equity Securities	9,548,488	8,119,681
Preferred	11,036,373	10,418,302
Asset Manager Affiliates	57,381,000	72,326,000
Total	$409,570,495	$ 480,927,292

We use borrowed funds, known as "leverage," to make investments and to attempt to increase returns to our shareholders by reducing our overall cost of capital. As a BDC, we are limited in the amount of leverage we can incur under the 1940 Act. We are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. As of December 31, 2015, we had approximately $208 million of par value of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 202%, compliant with the minimum asset coverage level of 200% generally required for a BDC by the 1940 Act. We may also borrow amounts of up to 5% of the value of our total assets for temporary purposes.

On March 16, 2011, the Company issued $55 million in aggregate principal amount of unsecured 8.75% convertible notes due March 2016 ("Convertible Notes"). On March 23, 2011, pursuant to an over-allotment option, the Company issued an additional $5 million of such Convertible Notes for a total of $60 million in aggregate principal amount. The net proceeds from the sale of the Convertible Notes, following underwriting expenses, were approximately $57.7 million. Interest on the Convertible Notes is paid semi-annually in arrears on March 15 and September 15, at a rate of 8.75%, commencing September 15, 2011. The Convertible Notes mature on March 15, 2016 unless converted earlier. The Convertible Notes are senior unsecured obligations of the Company.

The Convertible Notes are convertible into shares of the Company's common stock. As of December 31, 2015, the conversion rate was 135.5441 shares of common stock per $1,000 principal amount of Convertible Notes, which is equivalent to a conversion price of approximately $7.38 per share of common stock. The conversion rate is subject to adjustment upon certain events. Upon conversion, the Company would issue the full amount of common stock or settle the conversion in cash, at its option, and retire the full amount of debt outstanding.

On April 4, 2013, approximately $9 million of the Company's 8.75% Convertible Notes were converted at a price per share of $8.159 into 1,102,093 shares of KCAP common stock. On September 4, 2013, the Company purchased $2 million face value of its own Convertible Notes at a price of $114.50, plus accrued interest. KCAP subsequently surrendered these notes to the note trustee for cancellation effective September 13, 2013. During 2015 the Company repurchased approximately $19.3 million of Convertible Notes at prices ranging between $101.5 to $102.375. KCAP subsequently surrendered these notes to the trustee for cancellation. Due to the cash conversion option embedded in the Convertible Notes, the Company applied the guidance in ASC 470-40-20, Debt with Conversion and Other Options, and realized a loss on the extinguishment of this debt. For the year ended December 31, 2015 total realized losses on extinguishment of debt were approximately $445,000. The indenture governing the Convertible Notes contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act and conditions governing the undertaking of new debt. As of December 31, 2015, there is approximately $19.3 million par value of Convertible Notes outstanding with a maturity date of March 15, 2016.

In early March 2016, the Company had sufficient liquid resources available to satisfy its obligation under the Convertible Notes due March 15, 2016.

On October 10, 2012, the Company issued $41.4 million in aggregate principal amount of unsecured 7.375% Notes Due 2019. The net proceeds for the 7.375% Notes Due 2019, following underwriting expenses, were approximately $39.9 million. Interest on the 7.375% Notes Due 2019 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 7.375%, commencing December 30, 2012. The 7.375% Notes Due 2019 mature on September, 30, 2019, and are senior unsecured obligations of the Company. In addition, due to the coverage test applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 7.375% Notes Due 2019, the Company is limited in its ability to make distributions if its asset coverage, as defined in the 1940 Act, is below 200% at the time of the declaration of the distribution. At December 31, 2015, the Company was in compliance with all of its debt covenants. The indenture governing the 7.375% Notes Due 2019 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends.

On June 18, 2013, KCAP Senior Funding I, LLC, a specialty finance subsidiary of the Company, was capitalized through the issuance of $140 million of notes (the "KCAP Senior Funding I Notes"). The KCAP Senior Funding I Notes are backed by a diversified portfolio of bank loans. The Company invested in the most junior class of the notes, issued in the approximate amount of $35 million, representing the Company's primary exposure to the performance of the assets acquired from the proceeds of the issuance of the KCAP Senior Funding I Notes. On December 8, 2014, the Company completed the sale of additional KCAP Senior Funding I Notes for $56 million. The issuance of additional notes was pro-rata across all existing classes of notes originally issued. KCAP purchased an additional $13.9 million in the most junior class of notes. As of December 31, 2015 and 2014, these junior notes eliminate in consolidation and the remaining notes with a par value of $147.4 million are reflected on our consolidated balance sheet, net of $2.9 million and $3.5 million of unamortized discount, respectively. The indenture governing the KCAP Senior Funding I Notes contains an event of default that is triggered in the event that certain coverage tests are not met.

On October 6, 2014, the Company priced a follow-on public offering of 3.0 million shares of its common stock at a price of $8.02 per share. The offering raised net proceeds were approximately $23.8 million, after deducting underwriting discounts and offering expenses.

Subject to prevailing market conditions, we intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. However, we may face difficulty in obtaining a new debt and equity financing as a result of current market conditions. In this regard, because our common stock has traded at a price below our current net asset value per share over the last year or so and we are limited in our ability to sell our common stock at a price below new asset value per share without stockholder approval (which we currently do not have), we have been and may continue to be limited in our ability to raise equity capital. See "Business — Regulation — Common Stock". From time to time, we may seek to retire, repurchase, or exchange debt securities in open market purchases or by other means dependent on market conditions, liquidity, contractual obligations, and other matters. In addition, we evaluate strategic opportunities available to us and/or the Asset Manager Affiliates, including mergers, divestures, spin-offs, joint ventures and other similar transactions from time to time.

Stockholder Distributions

We intend to continue to make quarterly distributions to our stockholders. To avoid certain excise taxes imposed on RICs, we generally endeavor to distribute during each calendar year an amount at least equal to the sum of:

- 98% of our ordinary net taxable income for the calendar year;
- 98.2% of our capital gains, if any, in excess of capital losses for the one-year period ending on October 31 of the calendar year; and
- any net ordinary income and net capital gains for the preceding year that were not distributed during such year and on which we do not pay corporate tax.

We may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4% excise tax on such income, to the extent required.

The amount of our declared distributions, as evaluated by management and approved by our Board of Directors, is based primarily on our evaluation of distributable taxable income and after-tax free cash flow from our Asset Manager Affiliates.

We will be prohibited by the 1940 Act and the indenture governing our 7.375% Notes from making distributions if our asset coverage, as defined in the 1940 Act, falls below 200%. In any such event, we would be prohibited from making distributions required in order to maintain our status as a RIC.

The following table sets forth the quarterly distributions declared by us since 2014.

	Distribution	Declaration Date	Record Date	Pay Date
2015:				
Fourth quarter	$ 0.15	12/16/2015	1/6/2016[1]	1/28/2016
Third quarter	0.21	9/22/2015	10/14/2015	10/27/2015
Second quarter	0.21	6/23/2015	7/6/2015	7/27/2015
First quarter	0.21	3/24/2015	4/6/2015	4/27/2015
Total declared in 2015	$ 0.78			
2014:				
Fourth quarter	$ 0.25	12/17/2014	12/29/2014	1/29/2015
Third quarter	0.25	9/19/2014	10/14/2014	10/29/2014
Second quarter	0.25	6/20/2014	7/3/2014	7/25/2014
First quarter	0.25	3/21/2014	4/4/2014	4/25/2014
Total declared in 2014	$ 1.00			

Since the record date of this distribution is in 2016, it is a 2016 tax event.

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The following table depicts the composition of shareholder distributions on a per share basis:

	Year Ended December 31,	
	2015[1]	2014[1]
Net investment income	$ 0.65	$ 0.59
Tax Accounting Difference on CLO Equity Investments	(0.03)	0.18
Other tax accounting differences	—	0.02
Taxable distributable income	0.63	0.78
Cash distributed to the Company by Asset Manager Affiliates in excess of their taxable earnings	0.10	0.19
Available for distribution[2]	0.73	0.97
Distributed	0.63	1.00
Difference	$ 0.10	$ (0.03)

(1) Table may not foot due to rounding.

(2) The “Available for distribution” financial measure is a non-GAAP financial measure that is calculated by including the cash distributed to the Company by the Asset Manager Affiliates in excess of their taxable earnings to the Company’s taxable distributable income, which is the most directly comparable GAAP financial measure. In order to reconcile the “Available for distribution financial measure to taxable distributable income per share in accordance with GAAP, the $0.10 and $0.19 per share of cash distributed to the Company by the Asset Manager Affiliates in excess of their taxable earnings is subtracted from the “Available for distribution” financial measure for the year-ended December 31, 2015 and 2014, respectively. The Company’s management believes that the presentation of the non-GAAP “Available for distribution” financial measure provides useful information to investors.

OFF-BALANCE SHEET ARRANGEMENTS

We are a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the needs of the Company’s investment objectives. Such instruments include commitments to extend credit and may involve, in varying degrees, elements of credit risk in excess of amounts recognized on our balance sheet. Prior to extending such credit, we attempt to limit our credit risk by conducting extensive due diligence, obtaining collateral where necessary and negotiating appropriate financial covenants. As of December 31, 2015 and December 31, 2014, the Company had $360,000 and $0 outstanding commitments to make such investments, respectively.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual cash obligations and other commercial commitments as of December 31, 2015:

	Payments Due by Period				
Contractual Obligations	Total	Less than one year	1 – 3 years	3 – 5 years	More than 5 years
Long-term debt obligations	$208,049,000	$ 19,299,000	$ —	$41,400,000	$147,350,000

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are based on the selection and application of critical accounting policies, which require management to make significant estimates and assumptions. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and require management’s most difficult, complex, or subjective judgments. Our critical accounting policies are those applicable to the basis of presentation, valuation of investments, and certain revenue recognition matters as discussed below. See Note 2 to our consolidated financial statements, contained elsewhere herein: Significant Accounting Policies — Investments.

Valuation of Portfolio Investments

The most significant estimate inherent in the preparation of our consolidated financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded.

Value, as defined in Section 2(a)(41) of 1940 Act, is (1) the market price for those securities for which a market quotation is readily available and (2) for all other securities and assets, fair value as determined in good faith by our Board of Directors pursuant to procedures approved by our Board of Directors. Our valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio based on the nature of the security, the market for the security and other considerations including the financial performance and enterprise value of the portfolio company. Because of the inherent uncertainty of valuation, the Board of Directors' determined values may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

Pursuant to the AICPA Guide, we reflect our investments on our balance sheet at their estimated fair value with unrealized gains and losses resulting from changes in fair value reflected as a component of unrealized gains or losses on our statements of operations. Fair value is the amount that would be received to sell the investments in an orderly transaction between market participants at the measurement date (i.e., the exit price).

See Note 4 to the consolidated financial statements for the additional information about the level of market observability associated with investments carried at fair value.

The Company follows the provisions of ASC 820: Fair Value, which among other matters, requires enhanced disclosures about investments that are measured and reported at fair value. This standard defines fair value and establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value and expands disclosures about assets and liabilities measured at fair value. ASC 820: Fair Value defines "fair value" as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This fair value definition focuses on an exit price in the principal, or most advantageous market, and prioritizes, within a measurement of fair value, the use of market-based inputs (which may be weighted or adjusted for relevance, reliability and specific attributes relative to the subject investment) over entity-specific inputs. Market price observability is affected by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. Subsequent to the adoption of ASC 820: Fair Value, the FASB has issued various staff positions clarifying the initial standard (see Note 2 to the consolidated financial statements: "Significant Accounting Policies — Investments").

ASC 820: Fair Value establishes the following three-level hierarchy, based upon the transparency of inputs to the fair value measurement of an asset or liability as of the measurement date:

Level I — Unadjusted quoted prices are available in active markets for identical investments as of the reporting date. The type of investments included in Level I include listed equities and listed securities. As required by ASC 820: Fair Value, the Company does not adjust the quoted price for these investments, even in situations where the Company holds a large position and a sale could reasonably affect the quoted price.

Level II — Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date. Such inputs may be quoted prices for similar assets or liabilities, quoted markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full character of the financial instrument, or inputs that are derived principally from, or corroborated by, observable market information. Investments which are generally included in this category include illiquid debt securities and less liquid, privately held or restricted equity securities, for which some level of recent trading activity has been observed.

Level III — Pricing inputs are unobservable for the investment and includes situations where there is little, if any, market activity for the investment. The inputs may be based on the Company's own assumptions about how market participants would price the asset or liability or may use Level II inputs, as adjusted, to reflect specific investment attributes relative to a broader market assumption. These inputs into the determination of fair value may require significant management judgment or estimation. Even if observable market data for comparable performance or valuation measures (earnings multiples, discount rates, other financial/valuation ratios, etc.) are available, such investments are grouped as Level III if any significant data point that is not also market observable (private company earnings, cash flows, etc.) is used in the valuation methodology.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and the Company considers factors specific to the investment. A majority all of the Company's investments are classified as Level III. The Company evaluates the source of inputs, including any markets in which its investments are trading, in determining fair value. Inputs that are backed by actual transactions, those that are highly correlated to the specific investment being valued and those derived from reliable or knowledgeable sources will tend to have a higher weighting in determining fair value. Ongoing reviews by the Company's investment analysts, Chief Investment Officer, Valuation Committee and independent valuation firms (if engaged) may include factors such as an assessment of each underlying investment, its current and prospective operating and financial performance, consideration of financing and sale transactions with third parties, expected cash flows and market-based information, including comparable transactions, performance factors, and other investment or industry specific market data, among other factors.

We have valued our investments, in the absence of observable market prices, using the valuation methodologies described below applied on a consistent basis. For some investments little market activity may exist; management's determination of fair value is then based on the best information available in the circumstances, and may incorporate management's own assumptions and involves a significant degree of management's judgment.

Our investments in CLO Fund Securities are carried at fair value, which is based either on (i) the present value of the net expected cash inflows for interest income and principal repayments from underlying assets and the cash outflows for interest expense, debt paydown and other fund costs for the CLO Funds which are approaching or past the end of their reinvestment period and therefore are selling assets and/or using principal repayments to pay-down CLO Fund debt, and for which there continue to be net cash distributions to the class of securities we own, or (ii) a discounted cash flow model that utilizes prepayment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar securities or preferred shares to those in which the Company has invested, or (iii) indicative prices provided by the underwriters or brokers who arrange CLO Funds. We recognize unrealized appreciation or depreciation on our investments in CLO Fund Securities as comparable yields in the market change and/or based on changes in net asset values or estimated cash flows resulting from changes in prepayment or loss assumptions in the underlying collateral pool. As each investment in CLO Fund Securities ages, the expected amount of losses and the expected timing of recognition of such losses in the underlying collateral pool are updated and the revised cash flows are used in determining the fair value of the CLO Fund Securities. We determine the fair value of our investments in CLO Fund Securities on a security-by-security basis.

The Company's investments in its wholly-owned Asset Manager Affiliates are carried at fair value, which is primarily determined utilizing a discounted cash flow model which incorporates different levels of discount rates depending on the hierarchy of fees earned (including the likelihood of realization of senior, subordinate and incentive fees) and prospective modeled performance ("Discounted Cash Flow"). Such valuation takes into consideration an analysis of comparable asset management companies and a percentage of assets under management. The Asset Manager Affiliates are classified as a Level III investment (as described above). Any change in value from period to period is recognized as net change in unrealized appreciation or depreciation.

Fair values of other investments for which market prices are not observable are determined by reference to public market or private transactions or valuations for comparable companies or assets in the relevant asset class and/or industry when such amounts are available. Generally these valuations are derived by multiplying a key performance metric of the investee company or asset (e.g., EBITDA) by the relevant valuation multiple observed for comparable companies or transactions, adjusted by management for differences between the investment and the referenced comparable. Such investments may also be valued at cost for a period of time after an acquisition as the best indicator of fair value. If the fair value of such investments cannot be valued by reference to observable valuation measures for comparable companies, then the primary analytical method used to estimate the fair value is a discounted cash flow method and/or cap rate analysis. A sensitivity analysis is applied to the estimated future cash flows using various factors depending on the investment, including assumed growth rates (in cash flows), capitalization rates (for determining terminal values) and appropriate discount rates to determine a range of reasonable values or to compute projected return on investment.

For bond rated note tranches of CLO Fund securities (those above the junior class) without transactions to support a fair value for the specific CLO Fund and tranche, fair value is based on discounting estimated bond payments at current market yields, which may reflect the adjusted yield on the leveraged loan index for similarly rated tranches, as well as prices for similar tranches for other CLO Funds and also other factors such as indicative prices provided by underwriters or brokers who arrange CLO Funds, and the default and recovery rates of underlying assets in the CLO Fund, as may be applicable. Such model assumptions may vary and incorporate adjustments for risk premiums and CLO Fund specific attributes.

We derive fair value for our illiquid loan investments that do not have indicative fair values based upon active trades primarily by using the Income Approach, and also consider recent loan amendments or other activity specific to the subject asset as described above. Other significant assumptions, such as coupon and maturity, are asset-specific and are noted for each investment in the Schedules of Investments.

The determination of fair value using this methodology takes into consideration a range of factors, including but not limited to the price at which the investment was acquired, the nature of the investment, local market conditions, trading values on public exchanges for comparable securities, current and projected operating performance and financing transactions subsequent to the acquisition of the investment. This valuation methodology involves a significant degree of Management's judgment.

Our Board of Directors may consider other methods of valuation to determine the fair value of investments as appropriate in conformity with GAAP.

Interest Income

Interest income, including amortization of premium and accretion of discount, is recorded on the accrual basis to the extent that such amounts are expected to be collected. We generally place a loan on non-accrual status and cease recognizing interest income on such loan or security when a loan or security becomes 90 days or more past due or if we otherwise do not expect the debtor to be able to service its debt obligations. Non-accrual loans remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due or such loans become current. As of December 31, 2015, there was one issuer (representing less than 1% of our total investments at fair value) was on non-accrual status. As of December 31, 2014, there was one issuers (representing less than 1% of our total investments at fair value) was on non-accrual status.

Investment Income on CLO Fund Securities

We receive distributions from our investments in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by the Asset Manager Affiliates and selective investments in securities issued by funds managed by other asset management companies. Our CLO Fund junior class securities are subordinated to senior note holders who typically receive a return on their investment at a fixed spread relative to the LIBOR index. The CLO Funds are leveraged funds and any excess cash flow or "excess spread" (interest earned by the underlying securities in the fund less payments made to senior note holders and less fund expenses and management fees) is paid to the holders of the CLO Fund's subordinated securities or preferred shares. The level of excess spread from CLO Fund securities can be impacted from the timing and level of the resetting of the benchmark interest rate for the underlying assets (which reset at various times throughout the quarter) in the CLO Fund and the related CLO Fund note liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and distributions to us can vary significantly. In addition, the failure of CLO Funds in which we invest to comply with certain financial covenants may lead to the temporary suspension or deferral of cash distributions to us.

GAAP-basis investment income on CLO equity investments is recorded using the effective interest method in accordance with the provisions of ASC 325-40, based on the anticipated yield and the estimated cash flows over the projected life of the investment. Yields are revised when there are changes in actual or estimated projected future cash flows due to changes in prepayments and/or re-investments, credit losses or asset pricing. Changes in estimated yield are recognized as an adjustment to the estimated yield prospectively over the remaining life of the investment from the date the estimated yield was changed. Accordingly, investment income recognized on CLO equity securities in the GAAP statement of operations differs from both the tax-basis investment income and from the cash distributions actually received by the Company during the period.

For non-junior class CLO Fund Securities, such as our investment in the class E notes of Catamaran 2014-1, interest is earned at a fixed spread relative to the LIBOR index.

Distributions from Asset Manager Affiliates

We record distributions from our Asset Manager Affiliates on the declaration date, which represents the ex-dividend date. Distributions in excess of tax-basis earnings and profits are recorded as tax-basis return of capital. For interim periods, the Company estimates the tax attributes of any distributions as being either tax-basis earnings and profits (i.e. dividend income) or return of capital (i.e. adjustment to the Company's cost basis in the Asset Manager Affiliates). The final determination of the tax attributes of distributions from our Asset Manager Affiliates is made on an annual (full calendar year) basis at the end of the year based upon taxable income and distributions for the full-year. Therefore, any estimate of tax attributes of distributions made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year.

Payment-in-Kind Interest

We may have loans in our portfolio that contain a payment-in-kind ("PIK") provision. PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as interest income. To maintain our RIC status, this non-cash source of income must be distributed to stockholders in the form of cash dividends, even though the Company has not yet collected any cash.

Fee Income

Fee income includes fees, if any, for due diligence, structuring, commitment and facility fees, and fees, if any, for transaction services and management services rendered by us to portfolio companies and other third parties. Commitment and facility fees are generally recognized as income over the life of the underlying loan, whereas due diligence, structuring, transaction service and management service fees are generally recognized as income when the services are rendered.

Management Compensation

We may, from time to time, issue stock options or restricted stock, under the Equity Incentive Plan, to officers and employees for services rendered to us. We follow Accounting Standards Codification 718, Compensation — Stock Compensation, a method by which the fair value of options or restricted stock is determined and expensed. During the year ended December 31, 2015, the Board of Directors approved a grant of restricted stock to officers and employees comprised of 190,166 shares of restricted stock with an aggregate fair value of approximately $1.2 million on the date of grant.

United States Federal Income Taxes

The Company has elected and intends to continue to qualify for the tax treatment applicable to RICs under Subchapter M of the Code and, among other things, intends to make the required distributions to its stockholders as specified therein. In order to qualify as a RIC, 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. Depending on the level of taxable income earned in a tax year, we may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4% excise tax on such income, to the extent required.

Distributions to Shareholders

Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount to be paid out is determined by the Board of Directors each quarter and is generally based upon the earnings estimated by management for the period and year.

Recent Accounting Pronouncements

See Note 2 to the financial statements included in this annual report, for a description of recent accounting pronouncements.

Item 7A. ***Quantitative and Qualitative Disclosures about Market Risk***

Our business activities contain elements of market risks. We consider our principal market risks to be fluctuations in interest rates and the valuations of our investment portfolio. Managing these risks is essential to our business. Accordingly, we have systems and procedures designed to identify and analyze our risks, to establish appropriate policies and thresholds and to continually monitor these risks and thresholds by means of administrative and information technology systems and other policies and processes.

Interest Rate Risk

Interest rate risk is defined as the sensitivity of our current and future earnings to interest rate volatility, variability of spread relationships, the difference in re-pricing intervals between our assets and liabilities and the effect that interest rates may have on our cash flows. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest earning assets and our interest expense incurred in connection with our interest bearing debt and liabilities. Changes in interest rates can also affect, among other things, our ability to acquire and originate loans and securities and the value of our investment portfolio.

Our investment income is affected by fluctuations in various interest rates, including LIBOR and prime rates. As of December 31, 2015, approximately 97% of our Debt Securities Portfolio were either fixed rate or floating rate with a spread to an interest rate index such as LIBOR or the prime rate. Most of these floating rate loans contain LIBOR floors ranging between 0.75% and 3.0%. We generally expect that future portfolio investments will predominately be floating rate investments. As of December 31, 2015, we had $208 million of borrowings outstanding at a current weighted average rate of 4.08%.

Because we borrow money to make investments, our net investment income is dependent upon the difference between our borrowing rate and the rate we earn on the invested proceeds borrowed. In periods of rising or lowering interest rates, the cost of the portion of our debt associated with our Convertible Notes or 7.375% Notes Due 2019 would remain the same at 8.75% and 7.375%, respectively, given that this debt is at a fixed rate. The Notes issued by KCAP Senior Funding are floating rate based upon a LIBOR index plus a spread, which serves as a floor should LIBOR decrease to zero. Accordingly, our interest costs associated with this debt will fluctuate with changes in LIBOR.

Generally we would expect that an increase in the base rate index for our floating rate investment assets would increase our gross investment income and that a decrease in the base rate index for such assets would decrease our gross investment income (in either case, such increase/decrease may be limited by interest rate floors/minimums for certain investment assets).

We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that our balance sheet at December 31, 2015 was to remain constant and no actions were taken to alter the existing interest rate sensitivity, the table below illustrates the impact on net investment income on our Debt Securities Portfolio for various hypothetical increases in interest rates:

	Impact on net investment income from a change in interest rates at:		
	1%	2%	3%
Increase in interest rate	$(171,611)	$ 577,955	$ 1,327,520
Decrease in interest rate	$ 458,184	$ 458,184	$ 458,184

As shown above, net investment income assuming a 1% increase in interest rates would decrease by approximately $172,000 on an annualized basis, reflecting the impact to investments in our portfolio that are either fixed rate or which have embedded floors that would be unaffected by a 1% change in the underlying interest rate while our interest expense would be increasing. However, if the increase in rates was more significant, such as 2% or 3%, the net effect on net investment income would be an increase of approximately $578,000 and $1.3 million, respectively. Since LIBOR underlying certain investments, as well as certain of our borrowings, is currently low, it is unlikely that the underlying rate will decrease by 1% or 2% or even 3%. If the underlying rate decreased to 0%, it would result in approximately a $458,000 increase in net investment income.

Although management believes that this measure is indicative of sensitivity to interest rate changes on our Debt Securities Portfolio, 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 a net change in assets resulting from operations or net income. Accordingly, no assurances can be given that actual results would not materially differ from the potential outcome simulated by this estimate.

We did not hold any derivative financial instruments for hedging purposes as of December 31, 2015.

Portfolio Valuation

We carry our investments at fair value, as determined in good faith by our Board of Directors pursuant to a valuation methodology approved by our Board of Directors. Investments for which market quotations are generally readily available are generally valued at such market quotations. Investments for which there is not a readily available market value are valued at fair value as determined in good faith by our Board of Directors under a valuation policy and consistently applied valuation process. However, due to the inherent uncertainty of determining the fair value of investments that cannot be marked to market, the fair value of our investments may differ materially from the values that would have been used had a ready market existed for such investments. In addition, changes in the market environment and other events that may occur over the life of the investments may cause the value realized on these investments to be different than the valuations that are assigned. The types of factors that we may take into account in fair value pricing of our investments include, as relevant, the nature and realizable value of any collateral, third party valuations, the portfolio company's ability to make payments and its earnings and discounted cash flow, the markets in which the portfolio company does business, comparison to publicly-traded securities, recent sales of or offers to buy comparable companies, and other relevant factors.

The Company has engaged an independent valuation firm to provide third party valuation consulting services to the Company's Board of Directors. Each quarter, the independent valuation firm will perform third party valuations on the Company's material investments in illiquid securities such that they are reviewed at least once during a trailing 12 month period. These third party valuation estimates were considered as one of the relevant data inputs in the Company's determination of fair value. The Company intends to continue to engage an independent valuation firm in the future to provide certain valuation services, including the review of certain portfolio assets, as part of the quarterly and annual year-end valuation process.

Item 8. ***Financial Statements and Supplementary Data***

Our financial statements are annexed to this Annual Report beginning on page F-1.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None

Item 9A. ***Controls and Procedures***

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.

Management's Report on Internal Control Over Financial Reporting.

General. The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) of the Exchange Act. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Scope of Management's Report on Internal Control Over Financial Reporting. The Company's internal control over financial reporting includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the Company's financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Conclusion. Management, including the Company's CEO and CFO, assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2015. In making this assessment, management used the criteria established in the 2013 Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on management's assessment, management concluded, subject to the limitations described under "Scope of Management's Report on Internal Control Over Financial Reporting" above, that the Company maintained effective internal control over financial reporting as of December 31, 2015.

Attestation Report of the Independent Registered Public Accounting Firm.

The Company's independent registered public accounting firm has audited and issued a report on the Company's internal control over financial reporting, which appears in Item 15 of this report.

Changes in Internal Control Over Financial Reporting.

There have been no changes in our internal control over financial reporting since our last Quarterly Report filed on Form 10-Q for the period ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. ***Other Information***

None.

PART III

Item 10. *Directors, Executive Officers and Corporate Governance*

The information required by this item will be contained in the Proxy Statement under the headings “Proposal 1: Election of Directors,” “Control Persons and Principal Stockholders” and “Corporate Governance Principles and Director Information”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2016, and is incorporated herein by reference.

We have adopted a Sarbanes-Oxley Code of Ethics that applies to directors, officers and employees of the Company. This code of ethics is published on our website at *www.kcapfinancial.com*. We intend to disclose any future amendments to, or waivers from, this code of ethics within four business days of the waiver or amendment through a website posting.

Item 11. *Executive Compensation*

The information required by this item will be contained in the Proxy Statement under the headings “Proposal 1: Election of Directors,” “Executive Compensation,” “Compensation Committee Interlocks and Insider Participation” and “Compensation Committee Report”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2016, and is incorporated herein by reference.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information required by this item will be contained in the Proxy Statement under the headings “Executive Compensation” and “Control Persons and Principal Stockholders”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2016, and is incorporated herein by reference.

Item 13. *Certain Relationships and Related Transactions, and Director Independence*

The information required by this item will be contained in the Proxy Statement under the headings “Transactions with Related Persons” and “Proposal 1: Election of Directors”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2016, and is incorporated herein by reference.

Item 14. *Principal Accountant Fees and Services*

The information required by this item will be contained in the Proxy Statement under the heading “Proposal 2: Ratification of Independent Registered Public Accounting Firm”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2016, and is incorporated herein by reference.

PART IV

Item 15. *Exhibits and Financial Statement Schedules*

(a) Documents filed as part of this report:

1. For a list of the consolidated financial information included herein, see Index to the Consolidated Financial Statements on page F-1.

2. For a list of the other financial statements and financial statement schedules included herein, see Index to Other Financial Statements and Financial Statement Schedules on page S-1.

3. For a list of other exhibits included herein, see Exhibit List on page E-1.

(b) Exhibits required by Item 601 of Regulation S-K. Reference is made to the Exhibit List filed as a part of this report beginning on page E-1. Each of such exhibits is incorporated by reference herein.

(c). Other financial statements and financial statement schedules. Reference is made to the Index to Other Financial Statements and Financial Statement Schedules on page S-1. Each of such documents is incorporated by reference herein.

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.

Date: March 9, 2016

KCAP Financial, Inc.
By /s/ Dayl W. Pearson
Dayl W. Pearson
President and Chief Executive Officer

* * * * *

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Dayl W. Pearson **Dayl W. Pearson**	President and Chief Executive Officer (principal executive officer) and Member of the Board of Directors	March 9, 2016
/s/ Edward U. Gilpin **Edward U. Gilpin**	Chief Financial Officer, Secretary and Treasurer (principal financial and accounting officer)	March 9, 2016
/s/ Christopher Lacovara **Christopher Lacovara**	Member of the Board of Directors	March 9, 2016
/s/ John Ward **John Ward**	Member of the Board of Directors	March 9, 2016
/s/ C. Michael Jacobi **C. Michael Jacobi**	Member of the Board of Directors	March 9, 2016
/s/ Albert G. Pastino **Albert G. Pastino**	Member of the Board of Directors	March 9, 2016
/s/ C. Turney Stevens, Jr. **C. Turney Stevens, Jr.**	Member of the Board of Directors	March 9, 2016
/s/ Dean C. Kehler **Dean C. Kehler**	Member of the Board of Directors	March 9, 2016

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
KCAP Financial, Inc.

We have audited the accompanying consolidated balance sheets of KCAP Financial, Inc. (the "Company"), including the consolidated schedules of investments, as of December 31, 2015 and 2014, and the related consolidated statements of operations, changes in net assets, and cash flows and the financial highlights for each of the two years in the period ended December 31, 2015. These financial statements and financial highlights are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and financial highlights. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our procedures included confirmation of securities owned as of December 31, 2015 and 2014, by correspondence with the custodians and management or agents of the underlying investments. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the consolidated financial position of KCAP Financial, Inc. at December 31, 2015 and 2014, and the consolidated results of their operations, changes in their net assets, and cash flows and the financial highlights for the each of the two years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), KCAP Financial, Inc.'s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 9, 2016 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

New York, New York
March 9, 2016

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
KCAP Financial, Inc.

We have audited KCAP Financial, Inc.'s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission "(2013 framework)," (the COSO criteria). KCAP Financial, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, KCAP Financial, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2015 and 2014 consolidated financial statements of KCAP Financial, Inc. and our report dated March 9, 2016 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

New York, New York
March 9, 2016

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
KCAP Financial, Inc.

We have audited the consolidated balance sheet of KCAP Financial, Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2013 (not included herein), and the related consolidated statements of operations, changes in net assets, and cash flows for the year ended December 31, 2013 and financial highlights for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our procedures included confirmation of investments owned as of December 31, 2013. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of KCAP Financial, Inc. and subsidiaries as of December 31, 2013, and the results of their operations, changes in their net assets, and their cash flows for the year ended December 31, 2013 and their financial highlights for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP

New York, New York
March 12, 2014 (except as to Note 2 in the previously filed 2014 consolidated financial statements, which is not presented herein and to which the date is March 31, 2015)

KCAP FINANCIAL, INC.

CONSOLIDATED BALANCE SHEETS

	As of December 31, 2015	As of December 31, 2014
ASSETS		
Investments at fair value:		
Money market accounts (cost: 2015 – $2,129,381; 2014 – $1,602,741)	$ 2,129,381	$ 1,602,741
Debt securities (amortized cost: 2015 – $298,308,845; 2014 – $322,884,934)	284,639,244	320,143,170
CLO Fund Securities managed by affiliates (amortized cost: 2015 – $77,764,568; 2014 – $85,355,897)	53,557,570	74,139,696
CLO Fund Securities managed by non-affiliates (amortized cost: 2015 – $5,450,379; 2014 – $5,533,293)	2,314,812	3,375,206
Equity securities (cost: 2015 – $10,467,786; 2014 – $8,828,812)	9,548,488	8,119,681
Asset Manager Affiliates (cost: 2015 – $56,591,230; 2014 – $60,292,677)	57,381,000	72,326,000
Total Investments at Fair Value (cost: 2015 – $450,712,189; 2014 – $484,498,354)	409,570,495	479,706,494
Cash	—	1,220,798
Restricted cash	7,138,272	19,325,550
Interest receivable	1,812,624	1,748,821
Due from affiliates	2,117,095	3,027,409
Other assets	4,603,855	5,417,725
Total Assets	$425,242,341	$510,446,797
LIABILITIES		
Convertible Notes	$ 19,299,000	$ 38,647,000
7.375% Notes Due 2019	41,400,000	41,400,000
Notes issued by KCAP Senior Funding I, LLC (net of discount: 2015 – $2,907,595; 2014 – $3,512,407)	144,442,405	143,837,593
Payable for open trades	—	18,293,725
Accounts payable and accrued expenses	2,218,065	2,274,150
Accrued interest payable	1,228,068	1,566,255
Due to affiliates	554,333	31,000
Dividend payable	—	9,080,373
Total Liabilities	209,141,871	255,130,096
COMMITMENTS AND CONTINGENCIES (Note 8)		
STOCKHOLDERS' EQUITY		
Common stock, par value $0.01 per share, 100,000,000 common shares authorized; 37,136,353 issued, and 37,100,005 outstanding at December 31, 2015, and 36,775,127 common shares issued and outstanding at December 31, 2014	371,000	367,751
Capital in excess of par value	361,962,511	362,411,830
Excess distribution of net investment income	(21,638,184)	(25,579,865)
Accumulated net realized losses	(82,054,107)	(75,512,134)
Net unrealized depreciation on investments	(42,540,750)	(6,370,881)
Total Stockholders' Equity	216,100,470	255,316,701
Total Liabilities and Stockholders' Equity	$425,242,341	$510,446,797
NET ASSET VALUE PER COMMON SHARE	$ 5.82	$ 6.94

See accompanying notes to financial statements.

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KCAP FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31, 2015	2014	2013
Investment Income:			
Interest from investments in debt securities	$ 24,101,257	$ 21,386,432	$ 13,967,235
Interest from cash and time deposits	10,239	3,452	20,656
Investment income on CLO Fund Securities managed by affiliates	14,691,428	12,367,581	17,346,770
Investment income on CLO Fund Securities managed by non-affiliates	1,008,634	1,045,225	1,809,534
Dividends from Asset Manager Affiliates	5,348,554	5,467,914	5,735,045
Capital structuring service fees	366,859	934,871	305,376
Total investment income	45,526,971	41,205,475	39,184,616
Expenses:			
Interest and amortization of debt issuance costs	11,727,880	11,538,179	10,116,271
Compensation	3,843,799	4,951,745	4,630,481
Professional fees	3,520,461	2,614,479	2,191,305
Insurance	433,561	471,276	552,568
Administrative and other	1,818,480	1,509,228	1,819,876
Total expenses	21,344,181	21,084,907	19,310,501
Net Investment Income	**24,182,790**	**20,120,568**	**19,874,115**
Realized And Unrealized Gains (Losses) On Investments:			
Net realized losses from investment transactions	(6,202,289)	(10,384,415)	(12,090,503)
Net change in unrealized (depreciation)/appreciation on:			
Debt securities	(10,748,262)	5,641,403	14,956,103
Equity securities	(210,167)	7,040,155	2,605,586
CLO Fund Securities managed by affiliates	(12,990,404)	(11,584,257)	(11,195,901)
CLO Fund Securities managed by non-affiliates	(977,483)	2,884,109	(2,093,360)
Asset Manager Affiliates investments	(11,243,554)	2,064,107	5,703,743
Total net (depreciation)/appreciation from investment transactions	(36,169,870)	6,045,517	9,976,171
Net realized and unrealized loss on investments	(42,372,159)	(4,338,898)	(2,114,332)
Realized losses on extinguishments of debt	(445,189)	(748,076)	(536,811)
Net (Decrease)/Increase In Stockholders' Equity Resulting From Operations	**$(18,634,558)**	**$ 15,033,594**	**$ 17,222,972**
Net (Decrease)/Increase in Stockholders' Equity Resulting from Operations per Common Share:			
Basic:	$ (0.50)	$ 0.44	$ 0.53
Diluted:	$ (0.50)	$ 0.43	$ 0.53
Net Investment Income Per Common Share:			
Basic:	$ 0.65	$ 0.59	$ 0.62
Diluted:	$ 0.65	$ 0.58	$ 0.62
Weighted Average Shares of Common Stock Outstanding – Basic	36,964,444	34,248,346	32,280,160
Weighted Average Shares of Common Stock Outstanding – Diluted	36,964,444	34,259,977	32,295,005

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

	Years Ended December 31,		
	2015	2014	2013
Operations:			
Net investment income	$ 24,182,790	$ 20,120,568	$ 19,874,115
Net realized losses from investment transactions	(6,202,289)	(10,384,415)	(12,090,503)
Realized losses from extinguishments of debt	(445,189)	(748,076)	(536,811)
Net change in unrealized (depreciation)/appreciation from investments	(36,169,870)	6,045,517	9,976,171
Net (decrease)/increase in stockholders' equity resulting from operations	(18,634,558)	15,033,594	17,222,972
Stockholder distributions:			
Distributions of ordinary income	(22,985,978)	(26,807,154)	(22,479,384)
Return of capital	—	(7,972,633)	(12,681,755)
Net decrease in net assets resulting from stockholder distributions	(22,985,978)	(34,779,787)	(35,161,139)
Capital share transactions:			
Issuance of common stock for:			
Common stock withheld for payroll taxes upon vesting of restricted stock	(220,301)	—	—
Dividend reinvestment plan	1,051,795	724,935	715,780
Conversion of Convertible Notes	—	—	8,786,000
Issuance of Common Stock	—	23,772,408	50,404,236
Repurchase of Convertible Notes	—	(927,413)	—
Stock based compensation	1,572,811	1,123,271	526,185
Net increase in net assets resulting from capital share transactions	2,404,305	24,693,201	60,432,201
Net assets at beginning of period	255,316,701	250,369,693	207,875,659
Net assets at end of period (including accumulated undistributed net investment income of $0, $0, and $0 in 2015, 2014, and 2013, respectively.	$216,100,470	$255,316,701	$250,369,693
Net asset value per common share	$ 5.82	$ 6.94	$ 7.51
Common shares outstanding at end of period	37,100,005	36,775,127	33,332,123

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2015	2014	2013
OPERATING ACTIVITIES:			
Net (decrease)/increase in stockholder's equity resulting from operations	$ (18,634,558)	$ 15,033,594	$ 17,222,972
Adjustments to reconcile net increase/(decrease) in stockholder's equity resulting from operations to net cash provided by/(used in) operating activities:			
Net realized losses on investment transactions	6,202,289	10,384,415	12,090,503
Net change in unrealized losses/(gains) from investments	36,169,870	(6,045,517)	(9,976,172)
Purchases of investments	(112,647,477)	(249,264,398)	(248,211,755)
Proceeds from sales and redemptions of investments	132,764,940	195,511,479	114,040,876
Net accretion of discount on debt securities	9,094,250	10,691,298	1,611,574
Amortization of original issue discount on indebtedness	604,811	449,568	229,848
Amortization of debt issuance costs	1,181,866	1,109,081	904,027
Realized losses on extinguishments of debt	445,189	748,076	536,811
Payment-in-kind interest income	(1,447,865)	(433,778)	(3,091)
Stock-based compensation expense	1,572,811	1,123,271	526,138
Changes in operating assets and liabilities:			
(Decrease)/Increase in payable for open trades	(18,293,725)	14,313,725	3,980,000
(Increase)/Decrease in interest and dividends receivable	(63,803)	283,737	(1,335,210)
(Increase)/Decrease in accounts receivable	(591)	325,259	(914,434)
Decrease in time deposits	—	—	1,942,834
(Increase)/Decrease in other assets	(793,461)	(644,715)	54,561
Decrease/(Increase) in due from affiliates	910,315	(227,409)	—
Increase in due to affiliates	523,333	31,000	—
(Decrease)/Increase in accounts payable and accrued expenses	(394,272)	(56,886)	1,315,858
Net cash provided by/(used in) operating activities	37,193,922	(6,668,200)	(105,984,660)
FINANCING ACTIVITIES:			
Proceeds from issuance of common stock	—	23,772,408	50,404,236
Debt issuance costs	(19,136)	(678,201)	(3,878,583)
Issuance of restricted shares	1,812	—	—
Distributions to stockholders	(31,016,373)	(33,307,511)	(33,515,661)
Proceeds from issuance of debt, net of discount	—	41,203,652	101,954,525
Repurchase of Convertible Notes	(19,348,000)	(11,288,413)	(2,206,000)
Common Stock withheld for payroll taxes upon vesting of restricted stock	(220,301)	—	—
Decrease/(Increase) in restricted cash	12,187,278	(15,246,612)	(4,078,939)
Net cash (used in)/provided by financing activities	(38,414,720)	4,455,323	108,679,578
CHANGE IN CASH	(1,220,798)	(2,212,877)	2,694,918
CASH, BEGINNING OF YEAR	1,220,798	3,433,675	738,757
CASH, END OF YEAR	$ —	$ 1,220,798	$ 3,433,675
Supplemental Information:			
Interest paid during the period	$ 10,279,221	$ 9,966,425	$ 8,884,945
Issuance of common stock under the dividend reinvestment plan	$ 1,051,795	$ 724,935	$ 715,768

See accompanying notes to financial statements.

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KCAP FINANCIAL, INC.

SCHEDULE OF INVESTMENTS
As of December 31, 2015

Debt Securities Portfolio

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
1A Smart Start LLC[9], [10] *Consumer goods: Non-durable*	Senior Secured Loan — Initial Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 2/22	$ 3,000,000	$ 2,971,523	$ 2,903,100
4L Technologies Inc. (fka Clover Holdings, Inc.)[9], [10] *Consumer goods: Non-durable*	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 5/20	2,765,000	2,744,921	2,596,059
Advanced Lighting Technologies, Inc.[9], [10] *Consumer goods: Durable*	First Lien Bond — 10.5% – 06/2019 – 00753CAE2 10.5% Cash, Due 6/19	3,000,000	3,000,000	2,216,700
Advantage Sales & Marketing Inc.[9] *Services: Business*	Junior Secured Loan — Term Loan (Second Lien) 7.5% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	1,002,069	915,700
Alere Inc. (fka IM US Holdings, LLC)[10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — B Term Loan 4.3% Cash, 1.0% Libor Floor, Due 6/22	2,553,466	2,555,910	2,536,179
American Seafoods Group LLC[9], [10] *Beverage, Food and Tobacco*	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/21	3,990,000	3,971,219	3,937,332
Anaren, Inc.[9], [10] *Aerospace and Defense*	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 2/21	1,891,210	1,877,288	1,839,202
Aristotle Corporation, The[9], [10] *Consumer goods: Non-durable*	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 6/21	3,980,000	3,961,696	3,870,152
Asurion, LLC (fka Asurion Corporation)[9], [10] *Banking, Finance, Insurance & Real Estate*	Senior Secured Loan — Incremental Tranche B-1 Term Loan 5.0% Cash, 1.3% Libor Floor, Due 5/19	917,632	918,953	862,290
Asurion, LLC (fka Asurion Corporation)[9], [10] *Banking, Finance, Insurance & Real Estate*	Senior Secured Loan — Incremental Tranche B-4 Term Loan 5.0% Cash, 1.0% Libor Floor, Due 8/22	896,048	891,815	821,676
Avalign Technologies, Inc.[9] *Healthcare & Pharmaceuticals*	Junior Secured Loan — Initial Term Loan (Second Lien) 9.3% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	990,643	952,400
Avalign Technologies, Inc.[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 7/21	2,925,000	2,911,472	2,831,108
Bankruptcy Management Solutions, Inc.[9] *Services: Business*	Senior Secured Loan — Term B Loan 7.0% Cash, 1.0% Libor Floor, Due 6/18	682,722	682,722	651,590
BarBri, Inc. (Gemini Holdings, Inc.)[9], [10] *Services: Consumer*	Senior Secured Loan — Term Loan 4.5% Cash, 1.0% Libor Floor, Due 7/19	2,731,875	2,723,758	2,542,829
BBB Industries US Holdings, Inc.[9], [10] *Automotive*	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 11/21	2,977,500	2,927,766	2,833,985

Bellisio Foods, Inc.[9], [10] *Beverage, Food and Tobacco*	Senior Secured Loan — U.S. Term B Loans 5.3% Cash, 1.0% Libor Floor, Due 8/19	1,936,011	1,929,952	1,886,836
Bestop, Inc.[9], [10] *Automotive*	Senior Secured Loan — Revolving Loan 6.3% Cash, 1.0% Libor Floor, Due 7/20	40,000	34,509	36,984

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
Bestop, Inc.[9], [10] *Automotive*	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	$ 1,580,000	$ 1,557,976	$ 1,460,868
Carolina Beverage Group LLC[9] *Beverage, Food and Tobacco*	Senior Secured Bond — 10.625% – 08/2018 – 143818AA0 144A 10.6% Cash, Due 8/18	1,500,000	1,510,560	1,503,752
CCS Intermediate Holdings, LLC[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Initial Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 7/21	2,962,500	2,950,638	2,549,824
Cengage Learning Acquisitions, Inc. (fka TL Acquisitions, Inc.)[9], [10] *Media: Advertising, Printing & Publishing*	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 3/20	2,979,950	2,974,534	2,912,901
Charter Communications Operating, LLC (aka CCO Safari LLC)[10] *Media: Broadcasting & Subscription*	Senior Secured Loan — Term I Loan 3.5% Cash, 0.8% Libor Floor, Due 1/23	1,000,000	1,001,223	1,000,420
Checkout Holding Corp. (fka Catalina Marketing)[9], [10] *Media: Advertising, Printing & Publishing*	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 4/21	985,000	981,284	792,925
CHS/Community Health Systems, Inc.[10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Incremental 2021 Term H Loan 4.0% Cash, 1.0% Libor Floor, Due 1/21	1,994,987	1,992,571	1,967,915
Consolidated Communications, Inc.[10] *Telecommunications*	Senior Secured Loan — Initial Term Loan 4.3% Cash, 1.0% Libor Floor, Due 12/20	2,962,217	2,971,404	2,947,421
CRGT Inc.[9], [10] *High Tech Industries*	Senior Secured Loan — Term Loan 7.5% Cash, 1.0% Libor Floor, Due 12/20	3,912,342	3,861,177	3,750,762
Crowley Holdings Preferred, LLC[9] *Transportation: Cargo*	Preferred Stock — 12.000% – 12/2049 – Series A Income Preferred Securities 10.0% Cash, 2.0% PIK, Due 12/49	10,411,673	10,411,673	11,036,373
Crowne Group, LLC[9], [10] *Automotive*	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 9/20	3,950,000	3,902,980	3,664,810
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited)[9] *Beverage, Food and Tobacco*	Junior Secured Loan — Term Loan (Second Lien) 8.8% Cash, 1.0% Libor Floor, Due 7/21	3,000,000	3,013,843	2,827,500
CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) (aka HealthPort)[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Term Loan 5.3% Cash, 1.0% Libor Floor, Due 12/21	2,970,075	2,942,705	2,877,260
DBI Holding LLC[9] *Services: Business*	Senior Unsecured Bond — 09/2019 – PIK Note 0.0% Cash, 16.0% PIK, Due 9/19	4,043,719	3,859,845	4,043,722
DBI Holding LLC[9] *Services: Business*	Senior Subordinated Bond — 09/2019 – Senior Subordinated Note 12.0% Cash, 4.0% PIK, Due 9/19	4,481,135	4,466,793	4,615,571
DJO Finance LLC[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Initial Term Loan 4.3% Cash, 1.0% Libor Floor, Due 6/20	1,500,000	1,490,906	1,464,375
Drew Marine Group Inc.[9] *Transportation: Cargo*	Junior Secured Loan — Term Loan (Second Lien) 8.0% Cash, 1.0% Libor Floor, Due 5/21	2,500,000	2,495,491	2,495,000

ELO Touch Solutions, Inc.[9], [10] *High Tech Industries*	Senior Secured Loan — Term Loan (First Lien) 8.0% Cash, 1.5% Libor Floor, Due 6/18	1,552,326	1,507,787	1,546,893
EWT Holdings III Corp. (fka WTG Holdings III Corp.)[9] *Environmental Industries*	Junior Secured Loan — Term Loan (Second Lien) 8.5% Cash, 1.0% Libor Floor, Due 1/22	4,000,000	3,984,890	3,658,400

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
Fender Musical Instruments Corporation[9], [10] *Consumer goods: Durable*	Senior Secured Loan — Initial Loan 5.8% Cash, 1.3% Libor Floor, Due 4/19	$ 1,434,249	$ 1,443,868	$ 1,421,699
FHC Health Systems, Inc.[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Initial Term Loan 5.0% Cash, 1.0% Libor Floor, Due 12/21	3,877,839	3,844,406	3,703,336
First American Payment Systems, L.P.[9] *Banking, Finance, Insurance & Real Estate*	Junior Secured Loan — Term Loan (Second Lien) 10.8% Cash, 1.3% Libor Floor, Due 4/19	2,796,448	2,768,177	2,639,288
Getty Images, Inc.[9], [10] *Media: Advertising, Printing & Publishing*	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.3% Libor Floor, Due 10/19	2,162,867	2,172,647	1,373,421
GI Advo Opco, LLC[9] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 11/21	250,000	247,534	247,500
GI Advo Opco, LLC[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 11/21	2,750,000	2,722,890	2,722,500
GK Holdings, Inc. (aka Global Knowledge)[9] *Services: Business*	Junior Secured Loan — Initial Term Loan (Second Lien) 10.5% Cash, 1.0% Libor Floor, Due 1/22	1,500,000	1,473,884	1,382,550
GK Holdings, Inc. (aka Global Knowledge)[9], [10] *Services: Business*	Senior Secured Loan — Initial Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 1/21	2,475,000	2,453,994	2,345,805
Global Tel*Link Corporation[9] *Telecommunications*	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, 1.3% Libor Floor, Due 11/20	4,000,000	3,946,567	2,760,000
Gold Standard Baking, Inc.[9], [10] *Beverage, Food and Tobacco*	Senior Secured Loan — Term Loan 5.3% Cash, 1.0% Libor Floor, Due 4/21	2,487,500	2,476,361	2,408,149
Grande Communications Networks LLC[9], [10] *Telecommunications*	Senior Secured Loan — Initial Term Loan 4.5% Cash, 1.0% Libor Floor, Due 5/20	3,900,092	3,906,280	3,841,591
Grifols Worldwide Operations Limited[10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — U.S. Tranche B Term Loan 3.4% Cash, Due 2/21	997,462	995,001	989,732
Grupo HIMA San Pablo, Inc.[9] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 1/18	2,917,500	2,893,169	2,917,500
Grupo HIMA San Pablo, Inc.[9] *Healthcare & Pharmaceuticals*	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,000,000	6,924,146	7,000,000
Gymboree Corporation., The[9], [10] *Retail*	Senior Secured Loan — Term Loan 5.0% Cash, 1.5% Libor Floor, Due 2/18	1,421,105	1,410,511	734,001
Hargray Communications Group, Inc. (HCP Acquisition LLC)[9], [10] *Media: Broadcasting & Subscription*	Senior Secured Loan — Initial Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/19	2,895,294	2,878,392	2,893,267
Harland Clarke Holdings Corp. (fka Clarke American Corp.)[9], [10] *Media: Advertising, Printing & Publishing*	Senior Secured Loan — Tranche B-3 Term Loan 7.0% Cash, 1.5% Libor Floor, Due 5/18	3,281,250	3,259,381	3,271,078
Harland Clarke Holdings Corp. (fka Clarke American Corp.)[9], [10] *Media: Advertising, Printing & Publishing*	Senior Secured Loan — Tranche B-4 Term Loan 6.0% Cash, 1.0% Libor Floor, Due 8/19	1,425,000	1,420,339	1,421,580

Hoffmaster Group, Inc.[9] *Forest Products & Paper*	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, 1.0% Libor Floor, Due 5/21	2,000,000	1,977,018	1,995,600

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
Hoffmaster Group, Inc.[9], [10] *Forest Products & Paper*	Senior Secured Loan — Initial Term Loan (First Lien) 5.3% Cash, 1.0% Libor Floor, Due 5/20	$ 3,940,000	$ 3,911,276	$ 3,887,480
Hunter Defense Technologies, Inc.[9], [10] *Aerospace and Defense*	Senior Secured Loan — Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 8/19	2,812,500	2,792,045	2,616,469
Integra Telecom Holdings, Inc.[9], [10] *Telecommunications*	Senior Secured Loan — Term B-1 Loan 5.3% Cash, 1.0% Libor Floor, Due 8/20	2,962,386	2,952,620	2,876,477
International Architectural Products, Inc.[7], [9] *Metals & Mining*	Senior Secured Loan — Term Loan 0.0% Cash, 3.3% PIK, 2.5% Libor Floor, Due 5/15	247,636	228,563	991
Kellermeyer Bergensons Services, LLC[9], [10] *Services: Business*	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 10/21	1,980,000	1,963,471	1,856,844
Key Safety Systems, Inc.[9], [10] *Automotive*	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.0% Libor Floor, Due 8/21	1,481,250	1,475,263	1,444,219
Kinetic Concepts, Inc.[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Dollar Term E-1 Loan 4.5% Cash, 1.0% Libor Floor, Due 5/18	2,962,216	2,957,007	2,864,700
Landslide Holdings, Inc. (Crimson Acquisition Corp.)[9], [10] *High Tech Industries*	Senior Secured Loan — New Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 2/20	3,421,556	3,428,320	3,417,450
MB Aerospace ACP Holdings II Corp.[9], [10] *Aerospace and Defense*	Senior Secured Loan — Initial Term Loan 6.5% Cash, 1.0% Libor Floor, Due 12/22	1,000,000	990,055	990,000
Medical Specialties Distributors, LLC[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Term Loan 6.5% Cash, 1.0% Libor Floor, Due 12/19	3,920,000	3,894,315	3,918,040
MGOC, Inc. (fka Media General, Inc.)[10] *Media: Broadcasting & Subscription*	Senior Secured Loan — Term B Loan 4.0% Cash, 1.0% Libor Floor, Due 7/20	2,717,813	2,720,620	2,690,635
Nellson Nutraceutical, LLC[9], [10] *Beverage, Food and Tobacco*	Senior Secured Loan — Term A-1 Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 12/21	2,374,598	2,356,528	2,295,761
Nellson Nutraceutical, LLC[9], [10] *Beverage, Food and Tobacco*	Senior Secured Loan — Term A-2 Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 12/21	2,092,907	2,076,283	2,023,422
New Millennium Holdco, Inc. (Millennium Health, LLC)[9] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Closing Date Term Loan 7.5% Cash, 1.0% Libor Floor, Due 12/20	1,016,626	1,016,626	889,548
Nielsen & Bainbrige, LLC[9] *Consumer goods: Durable*	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/20	990,004	982,260	943,870
Nielsen & Bainbrige, LLC[9] *Consumer goods: Durable*	Junior Secured Loan — Term Loan (Second Lien) 10.3% Cash, 1.0% Libor Floor, Due 8/21	2,091,954	2,065,884	1,956,814
Nielsen & Bainbrige, LLC[9], [10] *Consumer goods: Durable*	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/20	3,785,896	3,755,461	3,609,473
NM Z Parent Inc. (aka Zep, Inc.)[9], [10] *Chemicals, Plastics and Rubber*	Senior Secured Loan — Initial Term Loan 5.8% Cash, 1.0% Libor Floor, Due 6/22	3,482,500	3,494,086	3,359,916

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
Novitex Acquisition, LLC (fka ARSloane Acquisition, LLC)[9], [10] *Services: Business*	Senior Secured Loan — Tranche B-2 Term Loan (First Lien) 7.5% Cash, 1.3% Libor Floor, Due 7/20	$ 972,650	$ 965,333	$ 893,865
Onex Carestream Finance LP[9] *Healthcare & Pharmaceuticals*	Junior Secured Loan — Term Loan (Second Lien) 9.5% Cash, 1.0% Libor Floor, Due 12/19	1,932,311	1,932,311	1,823,329
Onex Carestream Finance LP[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Term Loan (First Lien 2013) 5.0% Cash, 1.0% Libor Floor, Due 6/19	1,856,203	1,861,076	1,681,414
Otter Products, LLC (OtterBox Holdings, Inc.)[9], [10] *Consumer goods: Durable*	Senior Secured Loan — Term B Loan 5.8% Cash, 1.0% Libor Floor, Due 6/20	2,754,168	2,736,134	2,604,892
PGX Holdings, Inc.[9], [10] *Services: Consumer*	Senior Secured Loan — Initial Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 9/20	3,818,571	3,788,271	3,813,225
Playpower, Inc.[9], [10] *Construction & Building*	Senior Secured Loan — Initial Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 6/21	1,990,000	1,976,345	1,907,614
PrimeLine Utility Services LLC (fka FR Utility Services LLC)[9], [10] *Energy: Electricity*	Senior Secured Loan — Initial Term Loan 6.5% Cash, 1.0% Libor Floor, Due 11/22	3,500,000	3,465,576	3,465,000
PSC Industrial Holdings Corp.[9], [10] *Environmental Industries*	Senior Secured Loan — Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 12/20	3,004,650	2,978,349	3,000,744
Quad-C JH Holdings Inc. (aka Joerns Healthcare)[9], [10] *Healthcare & Pharmaceuticals*	Senior Secured Loan — Term Loan A 6.0% Cash, 1.0% Libor Floor, Due 5/20	3,940,026	3,918,354	3,937,662
Ravn Air Group, Inc.[9], [10] *Transportation: Consumer*	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/21	2,484,375	2,472,795	2,324,381
Roscoe Medical, Inc.[9] *Healthcare & Pharmaceuticals*	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	6,700,000	6,654,533	6,235,020
Rovi Solutions Corporation/Rovi Guides, Inc.[10] *High Tech Industries*	Senior Secured Loan — Term B Loan 3.8% Cash, 0.8% Libor Floor, Due 7/21	2,962,406	2,930,614	2,947,890
Sandy Creek Energy Associates, L.P.[9], [10] *Utilities: Electric*	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 11/20	2,708,992	2,699,558	1,907,130
Stafford Logistics, Inc.(dba Custom Ecology, Inc.)[9], [10] *Environmental Industries*	Senior Secured Loan — Term Loan 7.5% Cash, 1.3% Libor Floor, Due 8/21	2,854,780	2,835,003	2,736,307
Sun Products Corporation, The (fka Huish Detergents Inc.)[9], [10] *Consumer goods: Non-durable*	Senior Secured Loan — Tranche B Term Loan 5.5% Cash, 1.3% Libor Floor, Due 3/20	3,882,654	3,863,759	3,657,460
Tank Partners Holdings, LLC[9] *Energy: Oil & Gas*	Senior Secured Loan — Loan 6.6% Cash, 3.5% PIK, 3.0% Libor Floor, Due 8/19	10,759,919	10,624,515	8,177,538
TPF II Power, LLC (TPF II Covert Midco, LLC)[9], [10] *Utilities: Electric*	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 10/21	2,950,953	2,973,524	2,899,311
Trimaran Advisors, L.L.C.[9] *Related Party Loan*	Senior Unsecured Loan — Revolving Credit Facility 9.0% Cash, Due 11/17	23,000,000	23,000,000	23,000,000

TRSO I, Inc.[9] *Energy: Oil & Gas*	Junior Secured Loan — Term Loan (Second Lien) 11.0% Cash, 1.0% Libor Floor, Due 12/17	1,000,000	992,101	950,300

See accompanying notes to financial statements.

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
TWCC Holding Corp.[9], [10] *Media: Broadcasting & Subscription*	Senior Secured Loan — Term B-1 Loan 5.8% Cash, 0.8% Libor Floor, Due 2/20	$ 822,470	$ 827,875	$ 822,470
U.S. Shipping Corp (fka U.S. Shipping Partners LP)[9], [10] *Transportation: Cargo*	Senior Secured Loan — Tranche B-2 Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/21	1,411,023	1,409,966	1,405,802
USJ-IMECO Holding Company, LLC[9], [10] *Transportation: Cargo*	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 4/20	3,930,000	3,915,823	3,928,428
Vantiv, LLC (fka Fifth Third Processing Solutions, LLC)[10] *Banking, Finance, Insurance & Real Estate*	Senior Secured Loan — Term B Loan 3.8% Cash, 0.8% Libor Floor, Due 6/21	1,688,507	1,692,039	1,685,333
Verdesian Life Sciences, LLC[9], [10] *Environmental Industries*	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 7/20	3,981,279	3,937,250	3,784,206
Vestcom International, Inc. (fka Vector Investment Holdings, Inc.)[9], [10] *Retail*	Senior Secured Loan — Term Loan 5.3% Cash, 1.0% Libor Floor, Due 9/21	2,989,755	3,006,198	2,860,598
Weiman Products, LLC[9] *Consumer goods: Non-durable*	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 11/18	1,106,050	1,099,501	1,105,829
Weiman Products, LLC[9], [10] *Consumer goods: Non-durable*	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 11/18	5,515,079	5,482,956	5,513,976
WireCo WorldGroup Inc.[9] *Capital Equipment*	Senior Unsecured Bond — 9.000% – 05/2017 9.0% Cash, Due 5/17	5,000,000	4,975,822	4,067,500
WireCo WorldGroup Inc.[9], [10] *Capital Equipment*	Senior Unsecured Bond — 9.000% – 05/2017 9.0% Cash, Due 5/17	3,000,000	3,043,520	2,440,500
Total Investment in Debt Securities (132% of net asset value at fair value)		$299,940,657	$298,308,845	$ 284,639,244

See accompanying notes to financial statements.

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Equity Securities Portfolio

Portfolio Company/Principal Business	Investment	Percentage Interest/Shares	Amortized Cost	Fair Value[2]
Aerostructures Holdings L.P.[5], [9] *Aerospace and Defense*	Partnership Interests	1.2%	$ 1,000,000	$ 1,000
Aerostructures Holdings L.P.[5], [9] *Aerospace and Defense*	Series A Preferred Interests	1.2%	250,960	937,053
Caribe Media Inc. (fka Caribe Information Investments Incorporated)[5], [9] *Media: Advertising, Printing & Publishing*	Common	1.3%	359,765	568,544
DBI Holding LLC[5], [9] *Services: Business*	Class A Warrants	3.2%	258,940	4,316,159
eInstruction Acquisition, LLC[5], [9] *Services: Business*	Membership Units	1.1%	1,079,617	1,000
FP WRCA Coinvestment Fund VII, Ltd.[3], [5] *Capital Equipment*	Class A Shares	1,500	1,500,000	1,338,767
Perseus Holding Corp.[5], [9] *Hotel, Gaming & Leisure*	Common	0.2%	400,000	1,000
Roscoe Investors, LLC[5], [9] *Healthcare & Pharmaceuticals*	Class A Units	1.6%	1,000,000	863,000
Tank Partners Holdings, LLC[5], [9], [12] *Energy: Oil & Gas*	Unit	5.8%	980,000	1,000
Tank Partners Holdings, LLC[5], [9] *Energy: Oil & Gas*	Warrants	1.3%	185,205	1,000
TRSO II, Inc.[5], [9] *Energy: Oil & Gas*	Common Stock	5.4%	1,500,000	1,074,480
New Millennium Holdco, Inc. (Millennium Health, LLC)[5], [9] *Healthcare & Pharmaceuticals*	Common	0.2%	$ 1,953,299	$ 445,485
Total Investment in Equity Securities (4% of net asset value at fair value)			$10,467,786	$ 9,548,488

See accompanying notes to financial statements.

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CLO Fund Securities

CLO Subordinated Securities, Preferred Shares and Income Notes Investments

Portfolio Company	Investment[13]	Percentage Ownership	Amortized Cost	Fair Value[2]
Grant Grove CLO, Ltd.[3]	Subordinated Securities, effective interest 9.6%, 1/21 maturity	22.2%	$ 2,484,943	$ 280,164
Katonah III, Ltd.[3]	Preferred Shares, effective interest N/M, 5/15 maturity	23.1%	1,373,132	400,000
Katonah IX CLO Ltd[3], [6], [14]	Preferred Shares, effective interest 2.2%, 1/19 maturity	6.9%	1,140,057	105,000
Katonah X CLO Ltd[3], [6], [14]	Subordinated Securities, effective interest 12.8%, 4/20 maturity	33.3%	7,637,499	1,000,000
Katonah 2007-I CLO Ltd.[3], [6]	Preferred Shares, effective interest 27.0%, 4/22 maturity	100%	24,312,424	20,295,677
Trimaran CLO VII, Ltd.[3], [6]	Income Notes, effective interest 50.8%, 6/21 maturity	10.5%	1,375,013	1,647,272
Catamaran CLO 2012-1 Ltd.[3], [6]	Subordinated Notes, effective interest 2.8%, 12/23 maturity	24.9%	6,791,980	3,312,940
Catamaran CLO 2013-1 Ltd.[3], [6]	Subordinated Notes, effective interest 12.9%, 1/25 maturity	23.5%	6,256,090	5,639,106
Catamaran CLO 2014-1 Ltd.[3], [6]	Subordinated Notes, effective interest 8.4%, 4/26 maturity	24.9%	8,928,790	5,846,325
Dryden 30 Senior Loan Fund[3]	Subordinated Notes, effective interest 29.4%, 11/25 maturity	7.5%	1,592,303	1,634,647
Catamaran CLO 2014-2 Ltd.[3], [6]	Subordinated Notes, effective interest 8.8%, 10/26 maturity	24.9%	8,024,168	5,751,600
Catamaran CLO 2015-1 Ltd.[3], [6]	Subordinated Notes, effective interest 10.1%, 4/27 maturity	24.0%	11,869,751	8,789,651
Total Investment in CLO Subordinated Securities			81,786,150	54,702,382

CLO Rated-Note Investments

Portfolio Company	Investment	Percentage Ownership	Amortized Cost	Fair Value[2]
Catamaran CLO 2014-1 Ltd.[3], [6]	Float – 04/2026 – E – 14889FAC7, Par Value of 1525000 6.1% Cash, 4/26 maturity	15%	1,428,797	1,170,000
Total Investment in CLO Rated-Note			1,428,797	1,170,000
Total Investment in CLO Fund Securities (26% of net asset value at fair value)			83,214,947	55,872,382

Asset Manager Affiliates

Portfolio Company/Principal Business	Investment	Percentage Ownership	Cost	Fair Value[2]
Asset Manager Affiliates[9], [11]	Asset Management Company	1%	56,591,230	57,381,000
Total Investment in Asset Manager Affiliates (27% of net asset value at fair value)			56,591,230	57,381,000

See accompanying notes to financial statements.

Time Deposits and Money Market Account

Time Deposit and Money Market Accounts	Investment	Yield	Amortized Cost	Fair Value[2]
JP Morgan Business Money Market Account[8], [9]	Money Market Account	0.1%	$ 249,247	$ 249,247
US Bank Money Market Account[9]	Money Market Account	0.02%	1,880,134	1,880,134
Total Investment in Time Deposit and Money Market Accounts (1% of net asset value at fair value)			2,129,381	2,129,381
Total Investments[4] (190% of net asset value at fair value)			$450,712,189	$409,570,495

(1) A majority of the variable rate loans in the Company's investment portfolio bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly at the borrower's option. The Borrower may also elect to have multiple interest reset periods for each loan. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at December 31, 2015. As noted in the table above, 77% (based on par) of debt securities contain LIBOR floors which range between 0.75% and 3.0%.

(2) Reflects the fair market value of all investments as of December 31, 2015, as determined by the Company's Board of Directors.

(3) Non-U.S. company or principal place of business outside the U.S.

(4) The aggregate cost of investments for federal income tax purposes is approximately $471 million. The aggregate gross unrealized appreciation is approximately $7.0 million, the aggregate gross unrealized depreciation is approximately $68.2 million, and the net unrealized depreciation is approximately $61.2 million.

(5) Non-income producing.

(6) An affiliate CLO Fund managed by an Asset Manager Affiliate (as such term is defined in the notes to the financial statements).

(7) Loan or debt security is on non-accrual status and therefore is considered non-income producing.

(8) Money market account holding restricted cash and security deposits for employee benefit plans.

(9) Qualified asset for purposes of section 55(a) of the Investment Company Act of 1940.

(10) As of December 31, 2015, this investment is owned by KCAP Senior Funding I, LLC and was pledged to secure KCAP Senior Funding I, LLC's obligation.

(11) Other than the Asset Manager Affiliate, which we are deemed to "control", we do not "control" and are not an "affiliate" of any of our portfolio companies, each as defined in the Investment Company Act of 1940 (the "1940 Act"). In general, under the 1940 Act, we would be presumed to "control" a portfolio company if we owned 25% or more of its voting securities and would be an "affiliate" of a portfolio company if we owned 5% or more of its voting securities.

(12) Non-voting.

(13) CLO Subordinated Investments are entitled to periodic distributions which are generally equal to the remaining cash flow of the payments made by the underlying fund's investments less contractual payments to debt holders and fund expenses. The estimated annualized effective yield indicated is based upon a current projection of the amount and timing of these distributions. Such projections are updated on a quarterly basis and the estimated effective yield is adjusted prospectively.

(14) Notice of redemption has been received for this transaction.

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

SCHEDULE OF INVESTMENTS
As of December 31, 2014

Debt Securities Portfolio

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
4L Technologies Inc. (fka Clover Holdings, Inc.) *Consumer goods: Non-durable*[9], [11]	Senior Secured Loan — Term Loan 5.5% Cash, Due 5/20	$ 2,793,000	$ 2,768,057	$ 2,723,175
Advanced Lighting Technologies, Inc. *Consumer goods: Durable*[9], [11]	First Lien Bond — 10.5% Cash, Due 6/19	3,000,000	2,962,507	2,580,000
Advantage Sales & Marketing Inc. *Services: Business*[9]	Junior Secured Loan — Term Loan (Second Lien) 7.5% Cash, Due 7/22	1,000,000	1,002,384	992,000
Alaska Communications Systems Holdings, Inc. *Telecommunications*[9], [11]	Senior Secured Loan — Term Loan 6.3% Cash, Due 10/16	5,200,227	5,193,935	5,200,227
Alere Inc. (fka IM US Holdings, LLC) *Healthcare & Pharmaceuticals*[11]	Senior Secured Loan — B Term Loan 4.3% Cash, Due 6/17	2,992,277	2,988,629	2,972,947
AmSurg Corp. *Healthcare & Pharmaceuticals*[11]	Senior Secured Loan — Initial Term Loan 3.8% Cash, Due 7/21	2,992,481	2,992,481	2,975,020
Anaren, Inc. *Aerospace and Defense*[9], [11]	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, Due 2/21	1,980,000	1,962,587	1,955,250
Asurion, LLC (fka Asurion Corporation) *Banking, Finance, Insurance & Real Estate*[9], [11]	Senior Secured Loan — Incremental Tranche B-1 Term Loan 5.0% Cash, Due 5/19	1,917,430	1,932,331	1,896,549
AZ Chem US Inc. *Chemicals, Plastics and Rubber*[9], [11]	Senior Secured Loan — Initial Term Loan (First Lien) 4.5% Cash, Due 6/21	467,123	464,966	457,977
Bankruptcy Management Solutions, Inc. *Services: Business*[9]	Senior Secured Loan — Term B Loan 7.0% Cash, Due 6/18	700,227	700,227	624,463
BarBri, Inc. (Gemini Holdings, Inc.) *Services: Consumer*[9], [11]	Senior Secured Loan — Term Loan 4.5% Cash, Due 7/19	2,872,500	2,861,557	2,835,158
BBB Industries US Holdings, Inc. *Automotive*[9], [11]	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, Due 11/21	3,000,000	2,941,316	2,985,000
Bellisio Foods, Inc. *Beverage, Food and Tobacco*[9], [11]	Senior Secured Loan — U.S. Term B Loans 5.3% Cash, Due 8/19	2,239,551	2,230,586	2,235,071
Blue Coat Systems, Inc. *High Tech Industries*[9], [11]	Senior Secured Loan — New Term Loan 4.0% Cash, Due 5/19	467,636	468,971	456,530
Carolina Beverage Group LLC *Beverage, Food and Tobacco*[9]	Senior Secured Bond — 10.6% Cash, Due 8/18	1,500,000	1,515,584	1,552,500
CCS Intermediate Holdings, LLC *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Initial Term Loan (First Lien) 5.0% Cash, Due 7/21	2,992,500	2,978,364	2,940,131
Cengage Learning Acquisitions, Inc. (fka TL Acquisitions, Inc.) *Media: Advertising, Printing & Publishing*[9], [11]	Senior Secured Loan — Term Loan 7.0% Cash, Due 3/20	2,987,475	2,980,768	2,963,829
Charter Communications Operating, LLC (aka CCO Safari LLC) *Media: Broadcasting & Subscription*[11]	Senior Secured Loan — Term G Loan 4.3% Cash, Due 9/21	3,000,000	3,022,408	3,022,980
Checkout Holding Corp. *Media: Advertising, Printing & Publishing*[9], [11]	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, Due 4/21	995,000	990,534	951,474
Consolidated Communications, Inc. *Telecommunications*[11]	Senior Secured Loan — Initial Term Loan 4.3% Cash, Due 12/20	2,992,443	3,003,588	2,976,538

See accompanying notes to financial statements.

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
CRGT Inc. *High Tech Industries*[9], [11]	Senior Secured Loan — Term Loan 7.5% Cash, Due 12/20	$ 3,000,000	$ 2,940,000	$ 2,955,000
Crowley Holdings Preferred, LLC *Transportation: Cargo*[9]	Preferred Stock — 10.0% Cash, 2.0% PIK, Due 12/49	10,206,016	10,206,016	10,418,302
Crowne Group, LLC *Automotive*[9], [11]	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, Due 9/20	3,990,000	3,932,506	3,838,779
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) *Beverage, Food and Tobacco*[9]	Junior Secured Loan — Term Loan (Second Lien) 8.8% Cash, Due 7/21	3,000,000	3,016,357	2,910,000
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) *Beverage, Food and Tobacco*[9], [11]	Senior Secured Loan — Term Loan (First Lien) 5.0% Cash, Due 7/20	2,623,371	2,622,454	2,570,903
CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Initial Term Loan 6.0% Cash, Due 12/21	3,000,000	2,970,271	2,988,750
DBI Holding LLC *Services: Business*[9]	Senior Unsecured Bond — .0% Cash, 13.0% PIK, Due 9/19	3,457,795	3,221,771	3,386,218
DBI Holding LLC *Services: Business*[9]	Senior Subordinated Bond — 12.0% Cash, 1.0% PIK, Due 9/19	4,314,949	4,295,544	4,240,301
DJO Finance LLC (ReAble Therapeutics Fin LLC) *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — New Tranche B Term Loan 4.3% Cash, Due 9/17	2,063,574	2,063,574	2,022,303
Drew Marine Group Inc. *Transportation: Cargo*[9]	Junior Secured Loan — Term Loan (Second Lien) 8.0% Cash, Due 5/21	2,500,000	2,494,654	2,523,250
ELO Touch Solutions, Inc. *High Tech Industries*[9], [11]	Senior Secured Loan — Term Loan (First Lien) 8.0% Cash, Due 6/18	1,726,036	1,677,698	1,642,496
EWT Holdings III Corp. (fka WTG Holdings III Corp.) *Environmental Industries*[9]	Junior Secured Loan — Term Loan (Second Lien) 8.5% Cash, Due 1/22	4,000,000	3,982,390	4,033,200
Fender Musical Instruments Corporation *Consumer goods: Durable*[9], [11]	Senior Secured Loan — Initial Loan 5.8% Cash, Due 4/19	2,002,536	2,012,321	1,982,110
FHC Health Systems, Inc. *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Initial Term Loan 5.0% Cash, Due 12/21	3,407,143	3,373,191	3,381,589
First American Payment Systems, L.P. *Banking, Finance, Insurance & Real Estate*[9]	Junior Secured Loan — Term Loan (Second Lien) 10.8% Cash, Due 4/19	2,796,448	2,759,556	2,782,466
First Data Corporation *Banking, Finance, Insurance & Real Estate*[9], [11]	Senior Secured Loan — 2018 New Dollar Term Loan 3.7% Cash, Due 3/18	1,000,000	968,906	982,190
Getty Images, Inc. *Media: Advertising, Printing & Publishing*[9], [11]	Senior Secured Loan — Initial Term Loan 4.8% Cash, Due 10/19	2,185,164	2,187,551	2,012,165
Global Tel*Link Corporation *Telecommunications*[9]	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, Due 11/20	4,000,000	3,935,659	3,889,200
Grande Communications Networks LLC *Telecommunications*[9], [11]	Senior Secured Loan — Initial Term Loan 4.5% Cash, Due 5/20	3,940,040	3,944,690	3,938,464
Grifols Worldwide Operations Limited *Healthcare & Pharmaceuticals*[11]	Senior Secured Loan — U.S. Tranche B Term Loam 3.2% Cash, Due 2/21	2,992,462	2,970,236	2,956,298
Grupo HIMA San Pablo, Inc. *Healthcare & Pharmaceuticals*[9]	Senior Secured Loan — Term B Loan (First Lien) 8.5% PIK, Due 1/18	2,947,500	2,911,129	2,947,500
Grupo HIMA San Pablo, Inc. *Healthcare & Pharmaceuticals*[9]	Junior Secured Loan — Term Loan (Second Lien) 13.8% PIK, Due 7/18	7,000,000	6,894,754	7,105,000
Gymboree Corporation., The *Retail*[9], [11]	Senior Secured Loan — Term Loan 5.0% Cash, Due 2/18	1,421,105	1,390,786	935,563

See accompanying notes to financial statements.

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
Hargray Communications Group, Inc. (HCP Acquisition LLC) *Media: Broadcasting & Subscription*[9], [11]	Senior Secured Loan — Initial Term Loan 5.3% Cash, Due 6/19	$ 2,930,662	$ 2,908,645	$ 2,928,611
Harland Clarke Holdings Corp. (fka Clarke American Corp.) *Media: Advertising, Printing & Publishing*[9], [11]	Senior Secured Loan — Tranche B-3 Term Loan 7.0% Cash, Due 5/18	3,368,750	3,343,813	3,385,594
Harland Clarke Holdings Corp. (fka Clarke American Corp.) *Media: Advertising, Printing & Publishing*[9], [11]	Senior Secured Loan — Tranche B-4 Term Loan 6.0% Cash, Due 8/19	1,462,500	1,456,384	1,458,661
Hoffmaster Group, Inc. *Forest Products & Paper*[9]	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, Due 5/21	2,000,000	1,972,727	1,999,000
Hoffmaster Group, Inc. *Forest Products & Paper*[9], [11]	Senior Secured Loan — Initial Term Loan (First Lien) 5.3% Cash, Due 5/20	3,980,000	3,944,324	3,943,523
Hunter Defense Technologies, Inc. *Aerospace and Defense*[9], [11]	Senior Secured Loan — Term Loan (First Lien) 6.5% Cash,, Due 8/19	2,962,500	2,934,961	2,988,866
Integra Telecom Holdings, Inc. *Telecommunications*[9], [11]	Senior Secured Loan — Term B Loan 5.3% Cash, Due 2/19	2,992,386	2,981,164	2,919,461
International Architectural Products, Inc. *Metals & Mining*[7], [9]	Senior Secured Loan — Term Loan .0% Cash, Due 5/15	247,636	228,563	1,000
Kellermeyer Bergensons Services, LLC *Services: Business*[9]	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, Due 10/21	2,000,000	1,980,432	1,990,000
Key Safety Systems, Inc. *Automotive*[9], [11]	Senior Secured Loan — Initial Term Loan 4.8% Cash, Due 8/21	1,496,250	1,489,134	1,488,769
Kinetic Concepts, Inc. *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Dollar Term E-1 Loan 4.0% Cash, Due 5/18	2,992,443	2,984,962	2,956,279
Landslide Holdings, Inc. (Crimson Acquisition Corp.) *High Tech Industries*[9], [11]	Senior Secured Loan — New Term Loan (First Lien) 5.0% Cash, Due 2/20	3,456,381	3,464,859	3,451,197
MB Aerospace ACP Holdings III Corp. *Aerospace and Defense*[9], [11]	Senior Secured Loan — Dollar Term Loan 5.0% Cash, Due 5/19	3,940,000	3,910,979	3,939,212
Media General, Inc. *Media: Broadcasting & Subscription*[11]	Senior Secured Loan — Term B Loan 4.3% Cash, Due 7/20	3,000,000	3,003,750	2,972,805
Medical Specialties Distributors, LLC *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Term Loan 6.5% Cash, Due 12/19	3,960,000	3,927,435	3,804,372
Millennium Health, LLC (fka Millennium Laboratories, LLC) *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Tranche B Term Loan 5.3% Cash, Due 4/21	2,992,481	2,992,481	2,985,000
Nielsen & Bainbrige, LLC *Consumer goods: Durable*[9]	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, Due 8/20	1,000,000	990,487	963,200
Nielsen & Bainbrige, LLC *Consumer goods: Durable*[9]	Junior Secured Loan — Term Loan (Second Lien) 10.3% Cash, Due 8/21	2,000,000	1,971,249	1,920,000
Nielsen & Bainbrige, LLC *Consumer goods: Durable*[9], [11]	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, Due 8/20	3,000,000	2,971,460	2,889,600

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
Novetta, LLC *Services: Business*[9]	Senior Secured Loan — Initial Term Loan 6.0% Cash, Due 10/20	$ 2,743,125	$ 2,716,093	$ 2,743,125
Novitex Acquisition, LLC (fka ARSloane Acquisition, LLC) *Services: Business*[9], [11]	Senior Secured Loan — Tranche B-2 Term Loan (First Lien) 7.5% Cash, Due 7/20	990,019	980,923	950,418
Onex Carestream Finance LP *Healthcare & Pharmaceuticals*[9]	Junior Secured Loan — Term Loan (Second Lien) 9.5% Cash,, Due 12/19	2,000,000	2,000,000	1,992,920
Onex Carestream Finance LP *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Term Loan (First Lien 2013) 5.0% Cash, Due 6/19	1,973,333	1,980,022	1,969,219
Orbitz Worldwide, Inc. *Hotel, Gaming & Leisure*[11]	Senior Secured Loan — Tranche C Term Loan 4.5% Cash, Due 4/21	2,992,481	2,992,481	2,961,315
Otter Products, LLC (OtterBox Holdings, Inc.) *Consumer goods: Durable*[9], [11]	Senior Secured Loan — Term B Loan 5.8% Cash,, Due 6/20	2,992,481	2,968,458	2,966,297
Ozburn-Hessey Holding Company LLC *Transportation: Cargo*[9], [11]	Senior Secured Loan — Term Loan 6.8% Cash,, Due 5/19	3,512,426	3,503,687	3,544,389
PGX Holdings, Inc. *Services: Consumer*[9], [11]	Senior Secured Loan — Initial Term Loan (First Lien) 6.3% Cash,, Due 9/20	3,975,000	3,936,815	3,917,363
Post Holdings, Inc. *Beverage, Food and Tobacco*[11]	Senior Secured Loan — Series A Incremental Term Loan 3.8% Cash,, Due 6/21	2,992,481	2,985,129	2,983,130
PQ Corporation *Chemicals, Plastics and Rubber*[9], [11]	Senior Secured Loan — 2014 Term Loan 4.0% Cash,, Due 8/17	2,992,366	2,992,366	2,943,740
PSC Industrial Holdings Corp. *Environmental Industries*[9], [11]	Senior Secured Loan — Term Loan (First Lien) 7.0% Cash,, Due 12/20	2,000,000	1,980,119	1,980,000
Puerto Rico Cable Acquisition Company Inc. (D/B/A Choice TV) *Media: Broadcasting & Subscription*[9]	Senior Secured Loan — Initial Term Loan 5.5% Cash,, Due 7/18	909,069	910,287	909,069
Puerto Rico Cable Acquisition Company Inc. (D/B/A Choice TV) *Media: Broadcasting & Subscription*[9], [11]	Senior Secured Loan — Initial Term Loan 5.5% Cash,, Due 7/18	2,727,206	2,717,359	2,727,206
QoL Meds, LLC *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Term Loan 5.5% Cash,, Due 7/20	498,750	496,449	480,296
Quad-C JH Holdings Inc. (aka Joerns Healthcare) *Healthcare & Pharmaceuticals*[9], [11]	Senior Secured Loan — Term Loan A 6.0% Cash,, Due 5/20	3,980,000	3,953,083	3,786,174
Restorix Health, Inc. *Healthcare & Pharmaceuticals*[9]	Senior Unsecured Loan — Delayed Draw 10.0% Cash, 1.5% PIK, Due 6/18	2,003,587	2,003,587	2,003,587
Restorix Health, Inc. *Healthcare & Pharmaceuticals*[9]	Senior Unsecured Loan — Subordinated Term Loan 10.0% Cash, 1.5% PIK, Due 6/18	8,063,397	8,063,397	8,063,397
Reynolds Group Holdings Inc. *Containers, Packaging and Glass*[9], [11]	Senior Secured Loan — Incremental U.S. Term Loan 4.0% Cash,, Due 12/18	2,992,443	2,992,443	2,946,734
Roscoe Medical, Inc. *Healthcare & Pharmaceuticals*[9]	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash,, Due 9/19	6,700,000	6,642,367	6,499,000
Rovi Solutions Corporation/Rovi Guides, Inc. *High Tech Industries*[11]	Senior Secured Loan — Term B Loan 3.8% Cash,, Due 7/21	2,992,481	2,954,531	2,936,387
Safenet, Inc. *High Tech Industries*[9], [11]	Senior Secured Loan — Initial Term Loan (First Lien) 6.8% Cash,, Due 3/20	2,977,500	2,951,435	2,977,500
Sandy Creek Energy Associates, L.P. *Utilities: Electric*[9], [11]	Senior Secured Loan — Term Loan 5.0% Cash,, Due 11/20	2,844,544	2,832,599	2,794,053

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Amortized Cost	Fair Value[2]
SGF Produce Holding Corp. (Frozsun, Inc.) *Beverage, Food and Tobacco*[9]	Senior Secured Loan — Term Loan 5.5% Cash,, Due 3/19	$ 2,191,289	$ 2,175,642	$ 2,191,289
SGF Produce Holding Corp. (Frozsun, Inc.) *Beverage, Food and Tobacco*[9], [11]	Senior Secured Loan — Term Loan 5.5% Cash,, Due 3/19	3,440,528	3,429,224	3,440,528
Stafford Logistics, Inc. (dba Custom Ecology, Inc.) *Environmental Industries*[9], [11]	Senior Secured Loan — Term Loan 6.8% Cash,, Due 6/19	2,861,935	2,840,504	2,858,501
Sun Products Corporation, The (fka Huish Detergents Inc.) *Consumer goods: Non-durable*[9], [11]	Senior Secured Loan — Tranche B Term Loan 5.5% Cash,, Due 3/20	3,910,711	3,887,178	3,656,515
Tank Partners Holdings, LLC *Energy: Oil & Gas*[9]	Senior Secured Loan — Loan 9.8% Cash, 3.5% PIK, Due 8/19	10,385,331	10,212,907	9,866,065
TPF II Power, LLC (TPF II Covert Midco, LLC) *Utilities: Electric*[9], [11]	Senior Secured Loan — Term Loan 5.5% Cash,, Due 10/21	3,000,000	3,026,933	3,009,375
Trimaran Advisors, L.L.C.[12] *Portfolio Company Loan*[9], [12]	Senior Unsecured Loan — Revolving Credit Facility 9.0% Cash,, Due 11/17	23,000,000	23,000,000	23,000,000
TRSO I, Inc. *Energy: Oil & Gas*[9]	Junior Secured Loan — Term Loan (Second Lien) 11.0% Cash,, Due 12/17	1,000,000	988,097	961,300
TWCC Holding Corp. *Media: Broadcasting & Subscription*[9]	Junior Secured Loan — Term Loan (Second Lien) 7.0% Cash,, Due 6/20	1,000,000	1,004,005	961,670
TWCC Holding Corp. *Media: Broadcasting & Subscription*[9], [11]	Senior Secured Loan — Term Loan 3.5% Cash,, Due 2/17	906,653	910,624	887,060
Univar Inc. *Chemicals, Plastics and Rubber*[9], [11]	Senior Secured Loan — Term B Loan 5.0% Cash,, Due 6/17	2,894,577	2,890,893	2,808,536
USJ-IMECO Holding Company, LLC *Transportation: Cargo*[9], [11]	Senior Secured Loan — Term Loan 7.0% Cash,, Due 4/20	3,970,000	3,952,343	3,970,000
Vantiv, LLC (fka Fifth Third Processing Solutions, LLC) *Banking, Finance, Insurance & Real Estate*[11]	Senior Secured Loan — Term B Loan 3.8% Cash,, Due 6/21	1,994,987	1,999,927	1,978,160
Verdesian Life Sciences, LLC *Environmental Industries*[9]	Senior Secured Loan — Initial Term Loan 6.0% Cash,, Due 7/20	975,012	961,553	938,547
Verdesian Life Sciences, LLC *Environmental Industries*[9], [11]	Senior Secured Loan — Initial Term Loan 6.0% Cash,, Due 7/20	3,221,243	3,178,026	3,100,769
Vestcom International, Inc. (fka Vector Investment Holdings, Inc.) *Retail*[9], [11]	Senior Secured Loan — Term Loan 5.3% Cash,, Due 9/21	2,866,953	2,843,300	2,838,284
Weiman Products, LLC *Consumer goods: Non-durable*[9]	Senior Secured Loan — Term Loan 6.3% Cash,, Due 11/18	2,972,255	2,948,574	2,972,255
Weiman Products, LLC *Consumer goods: Non-durable*[9], [11]	Senior Secured Loan — Term Loan 6.3% Cash,, Due 11/18	3,963,007	3,932,167	3,963,007
WideOpenWest Finance, LLC *Telecommunications*[9]	Senior Secured Loan — Term B Loan 4.8% Cash,, Due 4/19	2,954,887	2,971,397	2,941,974
WireCo WorldGroup Inc. *Capital Equipment*[9]	Senior Unsecured Bond — 9.0% Cash,, Due 5/17	5,000,000	4,991,504	5,000,000
WireCo WorldGroup Inc. *Capital Equipment*[9], [11]	Senior Unsecured Bond — 9.0% Cash,, Due 5/17	3,000,000	2,994,903	3,000,000
Total Investment in Debt Securities (125% of net asset value at fair value)		$324,808,055	$322,884,934	$ 320,143,170

See accompanying notes to financial statements.

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Equity Securities Portfolio

Portfolio Company/Principal Business	Investment	Percentage Interest/Shares	Amortized Cost	Fair Value[2]
Aerostructures Holdings L.P.[5], [9] *Aerospace and Defense*	Partnership Interests	1.2%	$ 1,000,000	$ 1,000
Aerostructures Holdings L.P.[5], [9] *Aerospace and Defense*	Series A Preferred Interests	1.2%	250,961	648,764
Bankruptcy Management Solutions, Inc.[5], [9] *Services: Business*	Class A Warrants	1.7%	—	—
Bankruptcy Management Solutions, Inc.[5], [9] *Services: Business*	Class B Warrants	1.7%	—	—
Bankruptcy Management Solutions, Inc.[5], [9] *Services: Business*	Class C Warrants	1.7%	—	—
Bankruptcy Management Solutions, Inc.[5], [9] *Services: Business*	Common Stock 2013	0.8%	314,325	391,932
Caribe Media Inc. (fka Caribe Information Investments Incorporated)[5], [9] *Media: Advertising, Printing & Publishing*	Common	1.3%	359,765	624,304
DBI Holding LLC[5], [9] *Services: Business*	Class A Warrants	3.2%	258,940	746,964
eInstruction Acquisition, LLC[5], [9] *Services: Business*	Membership Units	1.1%	1,079,617	1,000
FP WRCA Coinvestment Fund VII, Ltd.[3], [5] *Capital Equipment*	Class A Shares	1,500	1,500,000	2,351,329
Perseus Holding Corp.[5], [9] *Hotel, Gaming & Leisure*	Common	0.2%	400,000	1,000
Roscoe Investors, LLC[5], [9] *Healthcare & Pharmaceuticals*	Class A Units	1.6%	1,000,000	891,000
Tank Partners Holdings, LLC[5], [9] *Energy: Oil & Gas*	Unit	5.8%	980,000	573,750
Tank Partners Holdings, LLC[5], [9] *Energy: Oil & Gas*	Warrants	1.3%	185,204	99,752
TRSO II, Inc.[5], [9] *Energy: Oil & Gas*	Common Stock	5.4%	1,500,000	1,788,886
Total Investment in Equity Securities (3% of net asset value at fair value)			$ 8,828,812	$ 8,119,681

See accompanying notes to financial statements.

CLO Fund Securities

CLO Subordinated Securities, Preferred Shares and Income Notes Investments

Portfolio Company	Investment	Percentage Interest	Amortized Cost	Fair Value[2]
Grant Grove CLO, Ltd.[3]	Subordinated Securities	22.2%	$ 2,254,638	$ 469,131
Katonah III, Ltd.[3], [10]	Preferred Shares	23.1%	1,015,334	400,000
Katonah VII CLO Ltd.[3], [6]	Subordinated Securities	16.4%	3,563,252	1,000
Katonah VIII CLO Ltd[3], [6]	Subordinated Securities	10.3%	2,755,267	100,000
Katonah IX CLO Ltd[3], [6]	Preferred Shares	6.9%	1,262,496	594,989
Katonah X CLO Ltd[3], [6]	Subordinated Securities	33.3%	8,910,471	4,863,001
Katonah 2007-I CLO Ltd.[3], [6]	Preferred Shares	100.0%	23,471,779	25,191,782
Trimaran CLO IV, Ltd.[3], [6]	Preferred Shares	19.0%	11,094	900,000
Trimaran CLO V, Ltd.[3], [6]	Subordinate Notes	20.8%	1,292,698	1,657,020
Trimaran CLO VI, Ltd.[3], [6]	Income Notes	16.0%	1,531,142	1,950,000
Trimaran CLO VII, Ltd.[3], [6]	Income Notes	10.5%	1,399,074	2,084,394
Catamaran CLO 2012-1 Ltd.[3], [6]	Subordinated Notes	24.9%	7,994,677	5,793,924
Catamaran CLO 2013-1 Ltd.[3], [6]	Subordinated Notes	23.5%	7,492,702	7,874,910
Catamaran CLO 2014-1 Ltd.[3], [6]	Subordinated Notes	24.9%	10,473,628	8,867,176
Dryden 30 Senior Loan Fund[3]	Subordinated Notes	7.5%	2,263,321	2,506,075
Catamaran CLO 2014-2 Ltd.[3], [6]	Subordinated Notes	24.9%	9,862,799	8,761,500
Total Investment in CLO Subordinated Securities, Preferred Shares and Income Notes			85,554,372	72,014,902

CLO Rated-Note Investments

Portfolio Company	Investment	Percentage Interest	Amortized Cost	Fair Value[2]
Catamaran CLO 2012-1 Ltd.	Float – 12/2023 – F – 14889CAE0 Par Value of $4,500,000 42.9%, Due 12/23	42.9%	3,917,442	4,160,000
Catamaran CLO 2014-1 Ltd.	Float – 04/2026 – E – 14889FAC7 Par Value of $1,525,000 15.1%, Due 4/26	15.1%	1,417,376	1,340,000
Total Investment in CLO Rated-Note			5,334,818	5,500,000
Total Investment in CLO Fund Securities (30% of net asset value at fair value)			90,889,190	77,514,902

See accompanying notes to financial statements.

Asset Manager Affiliates

Portfolio Company/Principal Business	Investment	Percentage Interest	Cost	Fair Value[(2)]
Asset Manager Affiliates	Asset Management Company	100.0%	$60,292,677	$ 72,326,000
Total Investment in Asset Manager Affiliates (28% of net asset value at fair value)			60,292,677	72,326,000

Time Deposits and Money Market Account

Time Deposit and Money Market Accounts	Investment	Yield	Par/Amortized Cost	Fair Value[(2)]
JP Morgan Business Money Market Account	Money Market Account	0.10%	249,105	249,105
US Bank Money Market Account	Money Market Account	0.02%	1,353,636	1,353,636
Total Investment in Time Deposit and Money Market Accounts (1% of net asset value at fair value)			1,602,741	1,602,741
Total Investments[(4)] (188% of net asset value at fair value)			$484,498,354	$479,706,494

(1) A majority of the variable rate loans to the Company's investment portfolio bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly at the borrower's option. The Borrower may also elect to have multiple interest reset periods for each loan. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at December 31, 2014. As noted in the table above, 75% (based on par) of debt securities contain LIBOR floors which range between 0.75% and 3.00%.

(2) Reflects the fair market value of all investments as of December 31, 2014, as determined by the Company's Board of Directors.

(3) Non-U.S. company or principal place of business outside the U.S.

(4) The aggregate cost of investments for federal income tax purposes is approximately $502 million. The aggregate gross unrealized appreciation is approximately $15.7 million, the aggregate gross unrealized depreciation is approximately $37.7 million, and the net unrealized depreciation is approximately $22 million.

(5) Non-income producing.

(6) An affiliate CLO Fund managed by an Asset Manager Affiliate (as such term is defined in the notes to the financial statements).

(7) Loan or debt security is on non-accrual status and therefore is considered non-income producing.

(8) Money market account holding restricted cash and security deposits for employee benefit plans.

(9) Qualified asset for purposes of section 55(a) of the Investment Company Act of 1940.

(10)As of December 31, 2014, this CLO Fund Security was not providing a dividend distribution.

(11)As of December 31, 2014, investment was owned by KCAP Senior Funding I, LLC and has been pledged to secure KCAP Senior Funding I, LLC's obligation.

(12)Affiliated portfolio company.

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

FINANCIAL HIGHLIGHTS
($ per share)

	For the Years Ended December 31, 2015	2014	2013	2012	2011
Per Share Data:					
Net asset value, at beginning of period	$ 6.94	$ 7.51	$ 7.85	$ 7.85	$ 8.21
Net investment income(1)	0.65	0.59	0.62	0.65	0.45
Net realized losses from investment transactions(1)	(0.17)	(0.30)	(0.37)	(0.12)	(0.81)
Realized losses from extinguishments of debt(1)	(0.01)	(0.02)	(0.02)	—	—
Net change in unrealized (depreciation)/appreciation of investments(1)	(0.97)	0.17	0.31	0.39	0.62
Net (decrease)/increase in net assets resulting from operations	(0.50)	0.44	0.54	0.92	0.26
Net decrease in net assets resulting from distributions:					
Distribution of ordinary income	(0.63)	(0.78)	(0.62)	(0.65)	(0.45)
Return of capital	—	(0.22)	(0.43)	(0.29)	(0.24)
Net decrease in net assets resulting from stockholder distributions	(0.63)	(1.00)	(1.05)	(0.94)	(0.69)
Net increase/(decrease) in net assets resulting from capital share transactions					
Offering of common stock	—	0.02	0.14	—	—
Issuance of common stock under dividend reinvestment plan	—	—	0.02	0.02	0.04
Stock based compensation	0.01	(0.03)	0.01	—	0.03
Net increase (decrease) in net assets relating to capital share transactions	—	(0.01)	0.17	0.02	0.07
Net asset value, end of period	$ 5.82	$ 6.94	$ 7.51	$ 7.85	$ 7.85
Total net asset value return(2)	(7.2)%	5.7%	9.1%	11.9%	4.0%
Ratio/Supplemental Data:					
Per share market value at beginning of period	$ 6.82	$ 8.07	$ 9.19	$ 6.31	$ 6.97
Per share market value at end of period	$ 4.07	$ 6.82	$ 8.07	$ 9.19	$ 6.31
Total market return(3)	(31.2)%	(3.1)%	(0.7)%	60.5%	0.4%
Shares outstanding at end of period	37,100,005	36,775,127	33,332,123	26,470,408	22,992,211
Net assets at end of period	$216,100,470	$255,316,701	$250,369,693	$207,875,659	$180,525,942
Portfolio turnover rate(4)	32.5%	45.8%	45.5%	39.2%	24.5%
Average par debt outstanding	$224,498,433	$196,622,077	$150,828,586	$ 80,758,743	$ 53,974,098
Asset coverage ratio	202%	211%	226%	305%	401%
Ratio of net investment income to average net assets(5)	9.8%	7.9%	7.8%	8.3%	5.2%
Ratio of total expenses to average net assets(5)	8.6%	8.2%	7.5%	7.2%	6.0%
Ratio of interest expense to average net assets(5)	4.7%	4.5%	3.9%	3.4%	2.3%
Ratio of non-interest expenses to average net assets(5)	3.9%	3.7%	3.6%	3.7%	3.7%

(1) Based on weighted average number of common shares outstanding for the period.

(2) Total net asset value return (not annualized) equals the change in the net asset value per share over the beginning of period net asset value per share plus dividends, divided by the beginning net asset value per share.

(3) Total market return equals the change in the ending market price over the beginning of period price per share plus dividends, divided by the beginning price.

(4) Not annualized. Portfolio turnover rate equals the year-to-date sales and paydowns over the average of the invested assets at fair value.

(5) Annualized

See accompanying notes to financial statements.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION

KCAP Financial, Inc. (“KCAP” or the “Company”) is an internally managed, non-diversified closed-end investment company that is regulated as a business development company (“BDC”) under the Investment Company Act of 1940 (the “1940 Act”). The Company was formed as a Delaware limited liability company on August 8, 2006 and, prior to the issuance of shares of the Company’s common stock in its initial public offering (“IPO”), converted to a corporation incorporated in Delaware on December 11, 2006. Prior to its IPO, the Company did not have material operations. The Company’s IPO of 14,462,000 shares of common stock raised net proceeds of approximately $200 million. Prior to the IPO, the Company issued 3,484,333 shares to affiliates of Kohlberg & Co., L.L.C., a leading middle market private equity firm, in exchange for the contribution to the Company of their ownership interests in Katonah Debt Advisors, L.L.C., and related affiliates controlled by the Company (collectively, “Katonah Debt Advisors”) and in securities issued by collateralized loan obligation funds (“CLO Funds”) managed by Katonah Debt Advisors and two other asset managers.

On April 28, 2008, the Company completed a rights offering that resulted in the issuance of 3.1 million shares of the Company’s common stock, and net proceeds of $27 million.

On February 29, 2012, the Company purchased Trimaran Advisors, L.L.C. (“Trimaran Advisors”), a CLO manager similar to Katonah Debt Advisors with assets under management of approximately $1.5 billion, for total consideration of $13.0 million in cash and 3,600,000 shares of the Company’s common stock. Contemporaneously with the acquisition of Trimaran Advisors, the Company acquired from Trimaran Advisors equity interests in certain CLO Funds managed by Trimaran Advisors for an aggregate purchase price of $12.0 million in cash.

On February 14, 2013, the Company completed a public offering of 5,232,500 shares of common stock, which included the underwriters’ full exercise of their option to purchase up to 682,500 shares of common stock, at a price of $9.75 per share, raising approximately $51.0 million in gross proceeds. In conjunction with this offering, the Company also sold 200,000 shares of common stock to a member of its Board of Directors, at a price of $9.31125 per share, raising approximately $1.9 million in gross proceeds.

On October 6, 2014, the Company completed a follow-on public offering of 3.0 million shares of its common stock at a price of $8.02 per share. The offering raised net proceeds of approximately $23.8 million, after deducting underwriting discounts and offering expenses.

As of December 31, 2015, Katonah Debt Advisors and Trimaran Advisors, as well as affiliated management companies Katonah 2007-1 Management, L.L.C., Katonah X Management, L.L.C. and Trimaran Advisors Management, L.L.C. (collectively the “Asset Manager Affiliates”), had approximately $2.7 billion of par value assets under management. The Asset Manager Affiliates are each managed independently from KCAP by a separate management team (however, certain of the Company’s executive officers also act in similar capacities for one or both of the Asset Manager Affiliates). The Asset Manager Affiliates provide investment management services to CLO Funds, making day-to-day investment decisions concerning the assets of the CLO Funds. The Asset Manager Affiliates do not have an investment interest in the CLO Funds they manage; however, KCAP holds investments in a portion of the securities issued by the CLO Funds managed by the Asset Manager Affiliates.

The Company has three principal areas of investment:

First, the Company originates, structures, and invests in senior secured term loans and mezzanine debt primarily in privately-held middle market companies (the “Debt Securities Portfolio”). In addition, from time to time the Company may invest in the equity securities of privately held middle market companies.

Second, the Company has invested in the Asset Manager Affiliates, which manage CLO Funds.

Third, the Company invests in debt and subordinated securities issued by CLOs (“CLO Fund Securities”). These CLO Fund Securities are primarily managed by our Asset Manager Affiliates, but

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION – (continued)

from time-to-time the Company makes investments in CLO Fund Securities managed by other asset managers. The CLO Funds typically invest in broadly syndicated loans, high-yield bonds and other credit instruments.

The Company may also invest in other investments such as loans to larger, publicly-traded companies, high-yield bonds and distressed debt securities. The Company may also receive warrants or options to purchase common stock in connection with its debt investments.

The Company has elected to be treated as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"). To qualify as a RIC, the Company must, among other things, meet certain source-of-income, and asset diversification and annual distribution requirements. As a RIC, the Company generally will not have to pay corporate-level U.S. federal income taxes on any income that it distributes in a timely manner to its stockholders.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying 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").

The consolidated financial statements reflect all adjustments, both normal and recurring which, in the opinion of management, are necessary for the fair presentation of the Company's results of operations and financial condition for the periods presented. Furthermore, the preparation of the consolidated financial statements requires the Company to make significant estimates and assumptions including with respect to the fair value of investments that do not have a readily available market value. Actual results could differ from those estimates, and the differences could be material. Certain prior-year amounts have been reclassified to conform to the current year presentation.

The Company consolidates the financial statements of its wholly-owned special purpose financing subsidiaries KCAP Funding, Kolhberg Capital Funding LLC I, KCAP Senior Funding I, LLC and KCAP Senior Funding I Holdings, LLC in its consolidated financial statements as they are operated solely for investment activities of the Company. The creditors of KCAP Senior Funding I, LLC have received security interests in the assets owned by KCAP Senior Funding I, LLC and such assets are not intended to be available to the creditors of KCAP Financial, Inc., or any other affiliate.

In accordance with Article 6 of Regulation S-X under the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company does not consolidate portfolio company investments, including those in which it has a controlling interest (e.g., the Asset Manager Affiliates), unless the portfolio company is another investment company.

The Asset Manager Affiliates are subject to Accounting Standards Codification Topic 810, "Consolidation" and although the Company cannot consolidate the financial statements of portfolio company investments, this guidance impacts the required disclosures relating to the Asset Manager Affiliates, as it requires the Asset Manager Affiliates to consolidate the financial statements of managed CLO Funds. As a result of the consolidation of the financial statements of the CLOs into the financial statements of the Asset Manager Affiliates, the Asset Manager Affiliates qualify as a "significant subsidiary" and, as a result, the Company is required to include additional financial information regarding the Asset Manager Affiliates in its filings with the SEC. This additional financial information regarding the Asset Manager Affiliates does not directly impact the financial position or results of operations of the Company.

In addition, in accordance with Rules 3-09, Rule 4-08(g) and 1-02 of Regulation S-X promulgated by the SEC, additional financial information with respect to two of the CLO Funds in which the Company has an investment, Katonah 2007-I CLO Ltd. ("Katonah 2007-I CLO") and Katonah X CLO Ltd. ("Katonah X CLO") are required to be included in the Company's SEC filings. The additional financial information

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

regarding the Asset Manager Affiliates and Katonah 2007-I CLO (pursuant to Rule 3-09) immediately follows these consolidated financial statements, Summarized financial information regarding Katonah X CLO (pursuant to Rule 4-08(g)) is set forth in Note 5.

This additional financial information regarding the Asset Manager Affiliates, Katonah 2007-1 CLO and Katonah X CLO does not directly impact the financial position or results of operations of the Company.

Stockholder distributions on the Statement of Changes in Net Assets reflect the estimated allocation, between net investment income and return of capital, of distributions made during the reporting period, excluding the distribution declared in a quarter with a record date occurring after the quarter-end. The determination of the tax character of distributions is made on an annual (full calendar-year) basis at the end of the year based upon our taxable income for the full year and the distributions paid during the full year. Therefore, an estimate of tax attributes made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year.

It is the Company's primary investment objective to generate current income and capital appreciation by lending directly to privately-held middle market companies. During the year ended December 31, 2015, the Company provided approximately $131.0 million to portfolio companies to support their growth objectives. None of this support was contractually obligated. See also Note 8 — Commitments and Contingencies. As of December 31, 2015, the Company holds loans it has made to 95 investee companies with aggregate principal amounts of approximately $268.5 million. The details of such loans have been disclosed on the consolidated schedule of investments as well as in Note 4 — Investments. In addition to providing loans to investee companies, from time to time the Company assists investee companies in securing financing from other sources by introducing such investee companies to sponsors or by leading a syndicate of lenders to provide the investee companies with financing. During the year ended December 31, 2015, the Company did not make any such introductions or lead any syndicates.

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-15, "Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern" ("ASU 2014-15"). The standard requires management to evaluate, at each interim and annual reporting period, whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued, and provide related disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and for annual and interim periods thereafter, and early adoption is permitted. We do not expect to adopt ASU 2014-15 early, and we do not believe the standard will have a material impact on our financial statements, when adopted.

In February 2015, the FASB issued Accounting Standards Update 2015-2, which updated consolidation standards under ASC Topic 810, "Consolidation". Under this update, a new consolidation analysis is required for variable interest entities ("VIEs") and will limit the circumstances in which investment managers and similar entities are required to consolidate the entities that they manage. The FASB decided to eliminate some of the criteria under which their fees are considered a variable interest and limit the circumstances in which variable interests in a VIE held by related parties of a reporting enterprise require the reporting enterprise to consolidate the VIE. The guidance is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2015. We do not expect the adoption of ASU 2015-2 to have a material impact to the Company's financial statements.

In April 2015, the FASB issued Accounting Standards Update 2015-03, Interest — Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. Under this guidance, debt issuance costs related to a recognized debt liability are to be presented as a direct deduction from the debt liability rather than as an asset on the balance sheet, consistent with debt discounts. For public business entities, the

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

final guidance will be effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. The Company intends to adopt the new guidance beginning the first quarter of 2016.

Investments

Investment transactions are recorded on the applicable trade date. Realized gains or losses are determined using the specific identification method.

Valuation of Portfolio Investments. The Company's Board of Directors is ultimately and solely responsible for making a good faith determination of the fair value of portfolio investments on a quarterly basis. Debt and equity securities for which market quotations are readily available are generally valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued by the Board of Directors based on detailed analyses prepared by management, the Valuation Committee of the Board of Directors, and, in certain circumstances, third parties with valuation expertise. Valuations are conducted by management on 100% of the investment portfolio at the end of each quarter. The Company follows the provisions of ASC 820: Fair Value Measurements and Disclosures ("ASC 820: Fair Value"). This standard defines fair value, establishes a framework for measuring fair value, and expands disclosures about assets and liabilities measured at fair value. ASC 820: Fair Value defines "fair value" as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Subsequent to the adoption of ASC 820: Fair Value, the FASB has issued various staff positions clarifying the initial standard as noted below.

The FASB issued guidance that clarified and required disclosures about fair value measurements. These include requirements to disclose the amounts and reasons for significant transfers between Level I and Level II, as well as significant transfers in and out of Level III of the fair value hierarchy (see Note 4 — "Investments — Fair Value Measurements" for further information relating to Level I, Level II and Level III).. The guidance also required that purchases, sales, issuances and settlements be presented gross in the Level III reconciliation.

ASC 820: Fair Value requires the disclosure in interim and annual periods of the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period.

The Company utilizes an independent valuation firm to provide an annual third-party review of the Company's CLO fair value model relative to its functionality, model inputs and calculations as a reasonable method to determine CLO fair values, in the absence of Level I or Level II trading activity or observable market inputs. The independent valuation firm's 2015 annual review concluded that the Company's CLO model appropriately factors in all the necessary inputs required to build a CLO equity cash flow model for fair value purposes and that the inputs were being employed correctly.

The Company utilizes an independent valuation firm to provide third party valuation consulting services. Each quarter the independent valuation firm will perform third party valuations of the Company's investments in material illiquid securities such that they are reviewed at least once during a trailing 12-month period. These third party valuation estimates are considered as one of the relevant data points in the Company's determination of fair value. The Company intends to continue to engage an independent valuation firm in the future to provide certain valuation services, including the review of certain portfolio assets, as part of the quarterly and annual year-end valuation process.

The Board of Directors may consider other methods of valuation than those set forth below to determine the fair value of Level III investments as appropriate in conformity with GAAP. 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 Company's investments may differ materially from the values that would have been used had a readily available market existed for such investments. Further, such investments may be generally subject to

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

legal and other restrictions on resale or otherwise be less liquid than publicly traded securities. In addition, changes in the market environment and other events may occur over the life of the investments that may cause the value realized on such investments to be different from the currently assigned valuations.

The majority of the Company's investment portfolio is composed of debt and equity securities with unique contract terms and conditions and/or complexity that requires a valuation of each individual investment that considers multiple levels of market and asset specific inputs, which may include historical and forecasted financial and operational performance of the individual investment, projected cash flows, market multiples, comparable market transactions, the priority of the security compared with those of other securities for such issuers, credit risk, interest rates, and independent valuations and reviews.

Debt Securities. To the extent that the Company's investments are exchange traded and are priced or have sufficient price indications from normal course trading at or around the valuation date (financial reporting date), such pricing will determine fair value. Valuations from third party pricing services may be used as an indication of fair value, depending on the volume and reliability of the valuation, sufficient and reasonable correlation of bid and ask quotes, and, most importantly, the level of actual trading activity. However, if the Company has been unable to identify directly comparable market indices or other market guidance that correlate directly to the types of investments the Company owns, the Company will determine fair value using alternative methodologies such as available market data, as adjusted, to reflect the types of assets the Company owns, their structure, qualitative and credit attributes and other asset-specific characteristics.

The Company derives fair value for its illiquid investments that do not have indicative fair values based upon active trades primarily by using a present value technique that discounts the estimated contractual cash flows for the subject assets with discount rates imputed by broad market indices, bond spreads and yields for comparable issuers relative to the subject assets (the "Income Approach"). The Company also considers, among other things, recent loan amendments or other activity specific to the subject asset. Discount rates applied to estimated contractual cash flows for an underlying asset vary by specific investment, industry, priority and nature of the debt security (such as the seniority or security interest of the debt security) and are assessed relative to two indices, a leveraged loan index and a high-yield bond index, at the valuation date. The Company has identified these two indices as benchmarks for broad market information related to its loan and debt securities. Because the Company has not identified any market index that directly correlates to the loan and debt securities held by the Company and therefore uses these benchmark indices, these market indices may require significant adjustment to better correlate such market data for the calculation of fair value of the investment under the Income Approach. Such adjustments require judgment and may be material to the calculation of fair value. Further adjustments to the discount rate may be applied to reflect other market conditions or the perceived credit risk of the borrower. When broad market indices are used as part of the valuation methodology, their use is subject to adjustment for many factors, including priority, collateral used as security, structure, performance and other quantitative and qualitative attributes of the asset being valued. The resulting present value determination is then weighted along with any quotes from observable transactions and broker/pricing quotes. If such quotes are indicative of actual transactions with reasonable trading volume at or near the valuation date that are not liquidation or distressed sales, relatively more reliance will be put on such quotes to determine fair value. If such quotes are not indicative of market transactions or are insufficient as to volume, reliability, consistency or other relevant factors, such quotes will be compared with other fair value indications and given relatively less weight based on their relevancy. Other significant assumptions, such as coupon and maturity, are asset-specific and are noted for each investment in the Schedules of Investments.

Equity Securities. The Company's equity securities in portfolio companies for which there is no liquid public market are carried at fair value based on the enterprise value of the portfolio company, which is determined using various factors, including EBITDA (earnings before interest, taxes, depreciation and amortization) and discounted cash flows from operations, less capital expenditures and other pertinent factors, such as recent offers to purchase a portfolio company's securities or other liquidation events. The determined

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

fair values are generally discounted to account for restrictions on resale and minority ownership positions. In the event market quotations are readily available for the Company's equity securities in public companies, those investments may be valued using the Market Approach. In cases where the Company receives warrants to purchase equity securities, a market standard Black-Scholes model is utilized.

The significant inputs used to determine the fair value of equity securities include prices, EBITDA and cash flows after capital expenditures for similar peer comparables and the investment entity itself. Equity securities are classified as Level III, when there is limited activity or less transparency around inputs to the valuation given the lack of information related to such equity investments held in nonpublic companies. Significant assumptions observed for comparable companies are applied to relevant financial data for the specific investment. Such assumptions, such as model discount rates or price/earnings multiples, vary by the specific investment, equity position and industry and incorporate adjustments for risk premiums, liquidity and company specific attributes. Such adjustments require judgment and may be material to the calculation of fair value.

Asset Manager Affiliates. The Company's investments in its wholly-owned asset management companies, the Asset Manager Affiliates, are carried at fair value, which is primarily determined utilizing the Discounted Cash Flow approach, which incorporates different levels of discount rates depending on the hierarchy of fees earned (including the likelihood of realization of senior, subordinate and incentive fees) and prospective modeled performance. Such valuation takes into consideration an analysis of comparable asset management companies and a percentage of assets under management. The Asset Manager Affiliates are classified as a Level III investment. Any change in value from period to period is recognized as net change in unrealized appreciation or depreciation.

CLO Fund Securities. The Company typically makes a minority investment in the most junior class of securities of CLO Funds raised and managed by the Asset Manager Affiliates and may selectively invest in securities issued by funds managed by other asset management companies. The investments held by CLO Funds generally relate to non-investment grade credit instruments issued by corporations.

The Company's investments in CLO Fund securities are carried at fair value, which is based either on (i) the present value of the net expected cash inflows for interest income and principal repayments from underlying assets and cash outflows for interest expense, debt pay-down and other fund costs for the CLO Funds that are approaching or past the end of their reinvestment period and therefore are selling assets and/or using principal repayments to pay down CLO Fund debt (or will begin to do so shortly), and for which there continue to be net cash distributions to the class of securities owned by the Company, a Discounted Cash Flow approach, (ii) a discounted cash flow model that utilizes prepayment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar securities or preferred shares to those in which the Company has invested, or (iii) indicative prices provided by the underwriters or brokers who arrange CLO Funds, a Market Approach. The Company recognizes unrealized appreciation or depreciation on the Company's investments in CLO Fund securities as comparable yields in the market change and/or based on changes in net asset values or estimated cash flows resulting from changes in prepayment or loss assumptions in the underlying collateral pool. As each investment in CLO Fund securities ages, the expected amount of losses and the expected timing of recognition of such losses in the underlying collateral pool are updated and the revised cash flows are used in determining the fair value of the CLO Fund investment. The Company determines the fair value of its investments in CLO Fund securities on a security-by-security basis.

Due to the individual attributes of each CLO Fund security, they are classified as a Level III investment unless specific trading activity can be identified at or near the valuation date. When available, observable market information will be identified, evaluated and weighted accordingly in the application of such data to the present value models and fair value determination. Significant assumptions to the present value calculations include default rates, recovery rates, prepayment rates, investment/reinvestment rates and spreads and the discount rate by which to value the resulting underlying cash flows. Such assumptions can vary significantly, depending on market data sources which often vary in depth and level of analysis, understanding of the CLO market, detailed or broad characterization of the CLO market and the application of such data to an appropriate framework for analysis. The application of data points are based on the specific attributes of each individual CLO Fund security's underlying assets, historic, current and prospective performance, vintage, and other quantitative and qualitative factors that would be evaluated by market participants. The Company evaluates the source of market data for reliability as an indicative market input, consistency amongst other inputs and results and also the context in which such data is presented.

For rated note tranches of CLO Fund securities (those above the junior class) without transactions to support a fair value for the specific CLO Fund and tranche, fair value is based on discounting estimated bond payments at current market yields, which may reflect the adjusted yield on the leveraged loan index for similarly rated tranches, as well as prices for similar tranches for other CLO Funds and also other factors such as indicative prices provided by underwriters or brokers who arrange CLO Funds, and the default and recovery rates of underlying assets in the CLO Fund, as may be applicable. Such model assumptions may vary and incorporate adjustments for risk premiums and CLO Fund specific attributes.

Cash. The Company defines cash as demand deposits. The Company places its cash with financial institutions and, at times, cash held in checking accounts may exceed the Federal Deposit Insurance Corporation insured limit.

Restricted Cash. Restricted cash and cash equivalents (e.g., money market funds) consists of cash held for reinvestment, quarterly interest and principal distribution (if any) to holders of notes issued by KCAP Senior Funding I, LLC.

Time Deposits and Money Market Accounts. Time deposits primarily represent investments of cash held in demand deposit accounts. Money market accounts primarily represent short term interest-bearing deposit accounts. Also includes restricted cash held under employee benefit plans.

Interest Income. Interest income, including the amortization of premium and accretion of discount, is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company generally places a loan or security on non-accrual status and ceases recognizing cash interest income on such loan or security when a loan or security becomes 90 days or more past due or if the Company otherwise does not expect the debtor to be able to service its debt obligations. Non-accrual loans remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due or such loans become current. As of December 31, 2015, one issuer representing less than 1% of the Company's total investments at fair value was on a non-accrual status.

Distributions from Asset Manager Affiliates. The Company records distributions from our Asset Manager Affiliates on the declaration date, which represents the ex-dividend date. Distributions in excess of tax-basis earnings and profits of the distributing affiliate company are recognized as tax-basis return of capital. For interim periods, the Company estimates the tax attributes of any distributions as being either tax-basis earnings and profits (i.e., dividend income) or return of capital (i.e., adjustment to the Company's cost basis in the Asset Manager Affiliates). The final determination of the tax attributes of distributions from our Asset Manager Affiliates is made on an annual (full calendar year) basis at the end of the year based upon taxable income and distributions for the full-year. Therefore, any estimate of tax attributes of distributions made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year.

Investment Income on CLO Fund Securities. The Company generates investment income from its investments in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by the Asset Manager Affiliates and selective investments in securities issued by funds managed by other asset management companies. The Company's CLO Fund junior class securities are subordinated to senior note holders who typically receive a stated interest rate of return based on a floating

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

rate index, such as the London Interbank Offered Rate ("LIBOR") on their investment. The CLO Funds are leveraged funds and any excess cash flow or "excess spread" (interest earned by the underlying securities in the fund less payments made to senior note holders and less fund expenses and management fees) is paid to the holders of the CLO Fund's subordinated securities or preferred shares.

GAAP-basis investment income on CLO equity investments is recorded using the effective interest method in accordance with the provisions of ASC 325-40, based on the anticipated yield and the estimated cash flows over the projected life of the investment. Yields are revised when there are changes in actual or estimated projected future cash flows due to changes in prepayments and/or re-investments, credit losses or asset pricing. Changes in estimated yield are recognized as an adjustment to the estimated yield prospectively over the remaining life of the investment from the date the estimated yield was changed. Accordingly, investment income recognized on CLO equity securities in the GAAP statement of operations differs from both the tax-basis investment income and from the cash distributions actually received by the Company during the period.

For non-junior class CLO Fund securities, such as the Company's investment in the Class E Notes of the Catamaran 2014-1 CLO, interest is earned at a fixed spread relative to the LIBOR index.

Capital Structuring Service Fees. The Company may earn ancillary structuring and other fees related to the origination, investment, disposition or liquidation of debt and investment securities. Generally, the Company will capitalize loan origination fees, then amortize these fees into interest income over the term of the loan using the effective interest rate method, recognize prepayment and liquidation fees upon receipt and equity structuring fees as earned, which generally occurs when an investment transaction closes.

Debt Issuance Costs. Debt issuance costs represent fees and other direct costs incurred in connection with the Company's borrowings. These amounts are capitalized and amortized using the effective interest method over the contractual term of the borrowing.

Extinguishment of debt. The Company must derecognize a liability if and only if it has been extinguished through delivery of cash, delivery of other financial assets, delivery of goods or services, or reacquisition by the Company of its outstanding debt securities whether the securities are cancelled or held. If the debt contains a cash conversion option, the Company must allocate the consideration transferred and transaction costs incurred to the extinguishment of the liability component and the reacquisition of the equity component and recognize a gain or loss in the statement of operations.

Expenses. The Company is internally managed and expenses costs, as incurred, with regard to the running of its operations. Primary operating expenses include employee salaries and benefits, the costs of identifying, evaluating, negotiating, closing, monitoring and servicing the Company's investments and related overhead charges and expenses, including rental expense, and any interest expense incurred in connection with borrowings. The Company and the Asset Manager Affiliates share office space and certain other operating expenses. The Company has entered into an Overhead Allocation Agreement with the Asset Manager Affiliates which provides for the sharing of such expenses based on an allocation of office lease costs and the ratable usage of other shared resources.

Shareholder Distributions. Distributions to common stockholders are recorded on the ex-dividend date. The amount of distributions, if any, is determined by the Board of Directors each quarter.

The Company has adopted a dividend reinvestment plan that provides for reinvestment of its distributions on behalf of its stockholders, unless a stockholder "opts out" of the plan to receive cash in lieu of having their cash distributions automatically reinvested in additional shares of the Company's common stock.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. EARNINGS (LOSSES) PER SHARE

In accordance with the provisions of ASC 260, “Earnings per Share” (“ASC 260”), basic earnings per share is computed by dividing earnings available to common shareholders by the weighted average number of shares outstanding during the period. Other potentially dilutive common shares, and the related impact to earnings, are considered when calculating earnings per share on a diluted basis.

The following information sets forth the computation of basic and diluted net increase (decrease) in stockholders’ equity per share for the years ended December 31, 2015, 2014, and 2013:

	For the Years ended December 31,		
	2015	2014	2013
Net (decrease)/increase in net assets resulting from operations	$(18,634,558)	$15,033,594	$17,222,972
Net increase/(decrease) in net assets allocated to unvested share awards	332,869	(201,239)	(101,076)
Net (decrease)/increase in net assets available to common stockholders	$(18,301,689)	$14,832,355	$17,121,896
Weighted average number of common shares outstanding for basic shares computation	36,964,444	34,248,346	32,280,160
Effect of dilutive securities – stock options	—	11,631	14,845
Weighted average number of common and common stock equivalent shares outstanding for diluted shares computation	36,964,444	34,259,977	32,295,005
Net increase in net assets per basic common shares:			
Net increase in net assets from operations	$ (0.50)	$ 0.44	$ 0.53
Net increase in net assets per diluted shares:			
Net increase in net assets from operations	$ (0.50)	$ 0.43	$ 0.53

Share-based awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities and included in the computation of both basic and diluted earnings per share. Grants of restricted stock awards to the Company’s employees and directors are considered participating securities when there are earnings in the period and the earnings per share calculations include outstanding unvested restricted stock awards in the basic weighted average shares outstanding calculation.

There were 50,000 options to purchase shares of common stock outstanding for the year ended December 31, 2015. For the year ended December 31, 2015, the company purchased 36,348 shares of common stock in connection with the vesting of employee’s restricted stock, such shares are treated as treasury shares and reduce the weighted average shares outstanding in the computation of earnings per share. For the year ended December 31, 2015, options to purchase 4,089 shares of common stock were included in the computation of diluted earnings per share. For the years ended December 31, 2014 and 2013, options to purchase 11,631 and 14,845 shares of common stock, respectively, were included in the computation of diluted earnings per share.

The Company’s Convertible Notes are included in the computation of the diluted net increase or decrease in net assets resulting from operations per share by application of the “if-converted method.” Under the if-converted method, interest charges applicable to the convertible notes for the period are added to reported net increase or decrease in net assets resulting from operations and the full amount of shares (pro-rata if not outstanding for the full period) that would be issued are added to weighted average basic shares. Convertible notes are considered anti-dilutive only when its interest per share upon conversion exceeds the basic net increase or decrease in net assets resulting from operations per share. For the years ended December 31, 2015 and 2014, the effects of the Convertible Notes are anti-dilutive.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. EARNINGS (LOSSES) PER SHARE – (continued)

The if-converted method of computing the dilutive effects on Convertible Notes assumes a conversion even if the contracted conversion price exceeds the market value of the shares. As of December 31, 2015 the current conversion rate of the Convertible Notes is approximately 135.5441 shares of our common stock per $1,000 principal amount of the Convertible Notes, equivalent to a conversion price of approximately $7.38 per share of the Company's common stock. Upon conversion, the Company may issue the full amount of common stock and retire the full amount of debt outstanding or, at its option, settle the conversion in cash.

4. INVESTMENTS

The following table shows the Company's portfolio by security type at December 31, 2015 and December 31, 2014:

	December 31, 2015			December 31, 2014		
Security Type	Amortized Cost	Fair Value	%(1)	Amortized Cost	Fair Value	%(1)
Money Market Accounts(3)	2,129,381	2,129,381	1	1,602,741	1,602,741	—
Senior Secured Loan	203,819,074	194,123,223	46	220,965,922	218,329,860	46
Junior Secured Loan	40,221,557	37,591,900	9	38,664,199	38,569,006	8
Senior Unsecured Loan	23,000,000	23,000,000	6	33,066,984	33,066,984	7
First Lien Bond	3,000,000	2,216,700	1	2,962,507	2,580,000	1
Senior Subordinated Bond	4,466,793	4,615,569	1	4,295,544	4,240,301	1
Senior Unsecured Bond	11,879,187	10,551,724	3	11,208,178	11,386,217	2
Senior Secured Bond	1,510,560	1,503,755	—	1,515,584	1,552,500	—
CLO Fund Securities	83,214,947	55,872,382	14	90,889,190	77,514,902	16
Equity Securities	10,467,787	9,548,488	2	8,828,812	8,119,681	2
Preferred Securities	10,411,673	11,036,373	3	10,206,016	10,418,302	2
Asset Manager Affiliates(2)	56,591,230	57,381,000	14	60,292,677	72,326,000	15
Total	$450,712,189	$409,570,495	100%	$484,498,354	$479,706,494	100%

(1) Represents percentage of total portfolio at fair value.

(2) Represents the equity investment in the Asset Manager Affiliates.

(3) Includes restricted cash held under employee benefit plans.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

The industry concentrations based on the fair value of the Company's investment portfolio as of December 31, 2015 and December 31, 2014 were as follows:

	December 31, 2015			December 31, 2014(2)		
Industry Classification	**Amortized Cost**	**Fair Value**	**%(1)**	**Amortized Cost**	**Fair Value**	**%(1)**
Aerospace and Defense	$ 6,910,349	$ 6,383,724	2%	$ 10,059,487	$ 9,533,092	2%
Asset Management Company(2)	56,591,230	57,381,000	14	60,292,677	72,326,000	15
Related Party Loan	23,000,000	23,000,000	6	23,000,000	23,000,000	5
Automotive	9,898,494	9,440,866	2	8,362,956	8,312,548	2
Banking, Finance, Insurance & Real Estate	6,270,984	6,008,587	1	7,660,721	7,639,365	2
Beverage, Food and Tobacco	17,334,746	16,882,750	4	17,974,974	17,883,421	4
Capital Equipment	9,519,342	7,846,767	2	9,486,407	10,351,329	2
Chemicals, Plastics and Rubber	3,494,086	3,359,916	1	6,348,226	6,210,253	1
CLO Fund Securities	83,214,947	55,872,382	14	90,889,190	77,514,902	16
Construction & Building	1,976,345	1,907,614	—	—	—	—
Consumer goods: Durable	13,983,607	12,753,455	3	13,876,482	13,301,207	3
Consumer goods: Non-durable	20,124,355	19,646,576	5	13,535,975	13,314,952	3
Containers, Packaging and Glass	—	—	—	2,992,443	2,946,734	1
Energy: Oil & Gas	14,281,821	10,204,318	2	13,866,208	13,289,753	3
Energy: Electricity	3,465,576	3,465,000	1	—	—	—
Environmental Industries	13,735,492	13,179,657	3	12,942,593	12,911,017	3
Forest Products & Paper	5,888,294	5,883,080	1	5,917,051	5,942,523	1
Healthcare & Pharmaceuticals	58,649,512	55,417,827	14	66,186,412	65,720,782	13
High Tech Industries	11,727,898	11,662,995	3	14,457,495	14,419,110	3
Hotel, Gaming & Leisure	400,000	1,000	—	3,392,481	2,962,315	1
Media: Advertising, Printing & Publishing	11,167,950	10,340,449	3	11,318,815	11,396,027	2
Media: Broadcasting & Subscription	7,428,110	7,406,792	2	14,477,078	14,409,401	3
Metals & Mining	228,563	991	—	228,563	1,000	—
Retail	4,416,709	3,594,599	1	4,234,086	3,773,847	1
Services: Business	18,206,668	21,022,801	5	16,550,255	16,066,421	3
Services: Consumer	6,512,029	6,356,054	2	6,798,372	6,752,521	1
Telecommunications	13,776,871	12,425,489	3	22,030,434	21,865,864	5
Time Deposit and Money Market Accounts(3)	2,129,381	2,129,381	1	1,602,741	1,602,741	—
Transportation: Cargo	18,232,953	18,865,603	5	20,156,700	20,455,941	4
Transportation: Consumer	2,472,795	2,324,381	1	—	—	—
Utilities: Electric	5,673,082	4,806,441	1	5,859,532	5,803,428	1
Total	$450,712,189	$409,570,495	100%	$484,498,354	$479,706,494	100%

(1) Calculated as a percentage of total portfolio at fair value.

(2) Represents the equity investment in the Asset Manager Affiliates.

(3) Includes restricted cash held under employee benefit plans.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

The Company may invest up to 30% of the investment portfolio in "non-qualifying" opportunistic investments in debt and equity securities of CLO Funds, distressed debt or debt and equity securities of public companies. The Company expects that these public companies generally will have debt that is non-investment grade. Within this 30% of the portfolio, the Company also may invest in debt of middle market companies located outside of the United States.

At December 31, 2015 and December 31, 2014, the total amount of non-qualifying assets was approximately 18% and 21%, respectively. The majority of non-qualifying assets were foreign investments which were approximately 13% and 16% of the Company's total assets, respectively (including the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 13% and 16% of its total assets on such dates, respectively).

The following tables detail the ten largest portfolio investments (at fair value) as of December 31, 2015:

	December 31, 2015		
Investment	**Amortized Cost**	**Fair Value**	**% of FMV**
Asset Manager Affiliates	$ 56,591,230	$ 57,381,000	14%
Trimaran Advisors, L.L.C.	23,000,000	23,000,000	6
Katonah 2007-I CLO Ltd.	24,312,424	20,295,677	5
DBI Holding, LLC	8,585,578	12,975,447	3
Crowley Holdings Preferred, LLC	10,411,673	11,036,373	3
Grupo HIMA San Pablo, Inc.	9,817,315	9,917,500	2
Catamaran CLO 2015-1 Ltd.	11,869,751	8,789,651	2
Tank Partners Holdings, LLC	10,624,515	8,177,538	2
Weiman Products, LLC	6,582,457	6,619,805	2
Nielsen & Bainbrige, LLC	6,803,605	6,510,157	2
Total	$ 168,598,548	$ 164,703,148	40%

	December 31, 2014		
Investment	**Amortized Cost**	**Fair Value**	**% of FMV**
Asset Manager Affiliates	$ 60,292,677	$ 72,326,000	15%
Katonah 2007-I CLO Ltd.	23,471,779	25,191,782	5
Trimaran Advisors, L.L.C.	23,000,000	23,000,000	5
Tank Partners Holdings, LLC	11,378,111	10,539,567	2
Crowley Holdings Preferred, LLC	10,206,016	10,418,302	2
Restorix Health, Inc.	10,066,984	10,066,984	2
Grupo HIMA San Pablo, Inc.	9,805,883	10,052,500	2
Catamaran CLO 2014-1 Ltd.	10,473,628	8,867,176	2
Catamaran CLO 2014-2 Ltd.	9,862,799	8,761,500	2
DBI Holding LLC	7,776,255	8,373,483	2
Total	$ 176,334,132	$ 187,597,294	39%

Excluding the Asset Manager Affiliates and CLO Fund securities, the Company's ten largest portfolio companies represented approximately 19% and 17% of the total fair value of the Company's investments at December 31, 2015 and December 31, 2014, respectively.

Investments in CLO Fund Securities

The Company typically makes a minority investment in the most junior class of securities (typically preferred shares or subordinated securities) of CLO Funds managed by the Asset Manager Affiliates and may selectively invest in securities issued by CLO funds managed by other asset management companies. These

4. INVESTMENTS – (continued)

securities also are entitled to recurring distributions which generally equal the net remaining cash flow of the payments made by the underlying CLO Fund's securities less contractual payments to senior bond holders, management fees and CLO Fund expenses. CLO Funds invest primarily in broadly syndicated non-investment grade loans, high-yield bonds and other credit instruments of corporate issuers. The underlying assets in each of the CLO Funds in which the Company has an investment are generally diversified secured or unsecured corporate debt. The CLO Funds are leveraged funds and any excess cash flow or "excess spread" (interest earned by the underlying securities in the fund less payments made to senior bond holders, fund expenses and management fees) is paid to the holders of the CLO Fund's subordinated securities or preferred shares.

In June 2013, the Company purchased $9.0 million of the par value of the Subordinated Notes of Catamaran 2013-1 CLO ("Catamaran 2013-1") managed by Trimaran Advisors.

In May and August 2014, the Company purchased $11.1 million and $9.9 million of the par value of the Subordinated Notes of Catamaran 2014-1 CLO ("Catamaran 2014-1") and 2014-2 CLO ("Catamaran 2014-2"), respectively. Both are managed by Trimaran Advisors.

In May 2015, the Company purchased $11.9 million of the par value of the Subordinated Notes of Catamaran 2015-1 CLO ("Catamaran 2015-1") managed by Trimaran Advisors.

All CLO Funds managed by the Asset Manager Affiliates are currently making quarterly distributions to the Company with respect to its interests in the CLO Funds and are paying all senior and subordinate management fees to the Asset Manager Affiliates. Additionally, three managed funds made incentive fee distributions to the Asset Manager Affiliates during the year ended December 31, 2015. With the exception of Katonah III, Ltd., all third-party managed CLO Funds are making distributions to the Company.

Fair Value Measurements

The Company follows the provisions of ASC 820: Fair Value, which among other matters, requires enhanced disclosures about investments that are measured and reported at fair value. This standard defines fair value and establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value and expands disclosures about assets and liabilities measured at fair value. ASC 820: Fair Value defines "fair value" as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This fair value definition focuses on an exit price in the principal, or most advantageous market, and prioritizes, within a measurement of fair value, the use of market-based inputs (which may be weighted or adjusted for relevance, reliability and specific attributes relative to the subject investment) over entity-specific inputs. Market price observability is affected by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. Subsequent to the adoption of ASC 820: Fair Value, the FASB has issued various staff positions clarifying the initial standard (see Note 2. "Significant Accounting Policies — Investments").

ASC 820: Fair Value establishes the following three-level hierarchy, based upon the transparency of inputs to the fair value measurement of an asset or liability as of the measurement date:

Level I — Unadjusted quoted prices are available in active markets for identical investments as of the reporting date. The type of investments included in Level I include listed equities and listed securities. As required by ASC 820: Fair Value, the Company does not adjust the quoted price for these investments, even in situations where the Company holds a large position and a sale could reasonably affect the quoted price.

Level II — Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date. Such inputs may be quoted prices for similar assets or

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

liabilities, quoted markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full character of the financial instrument, or inputs that are derived principally from, or corroborated by, observable market information. Investments which are generally included in this category include illiquid debt securities and less liquid, privately held or restricted equity securities for which some level of recent trading activity has been observed.

Level III — Pricing inputs are unobservable for the investment and includes situations where there is little, if any, market activity for the investment. The inputs may be based on the Company's own assumptions about how market participants would price the asset or liability or may use Level II inputs, as adjusted, to reflect specific investment attributes relative to a broader market assumption. These inputs into the determination of fair value may require significant management judgment or estimation. Even if observable market data for comparable performance or valuation measures (earnings multiples, discount rates, other financial/valuation ratios, etc.) are available, such investments are grouped as Level III if any significant data point that is not also market observable (private company earnings, cash flows, etc.) is used in the valuation methodology.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and the Company considers factors specific to the investment. A majority of the Company's investments are classified as Level III. The Company evaluates the source of inputs, including any markets in which its investments are trading, in determining fair value. Inputs that are highly correlated to the specific investment being valued and those derived from reliable or knowledgeable sources will tend to have a higher weighting in determining fair value. Ongoing reviews by the Company's investment analysts, Chief Investment Officer, Valuation Committee and independent valuation firms (if engaged) may include factors such as an assessment of each underlying investment, its current and prospective operating and financial performance, consideration of financing and sale transactions with third parties, expected cash flows and market-based information, including comparable transactions, performance factors, and other investment or industry specific market data, among other factors.

The following table summarizes the fair value of investments by the above ASC 820: Fair Value fair value hierarchy levels as of December 31, 2015 and December 31, 2014, respectively:

	As of December 31, 2015			
	Level I	Level II	Level III	Total
Money market accounts	$ —	$ 2,129,381	$ —	$ 2,129,381
Debt securities	—	101,238,779	183,400,465	284,639,244
CLO fund securities	—	—	55,872,382	55,872,382
Equity securities	—	445,485	9,103,003	9,548,488
Asset Manager Affiliates	—	—	57,381,000	57,381,000
Total	$ —	$103,813,645	$305,756,850	$ 409,570,495

	As of December 31, 2014			
	Level I	Level II	Level III	Total
Money market accounts	$ —	$ 1,602,741	$ —	$ 1,602,741
Debt securities	—	149,124,827	171,018,343	320,143,170
CLO fund securities	—	—	77,514,902	77,514,902
Equity securities	—	—	8,119,681	8,119,681
Asset Manager Affiliates	—	—	72,326,000	72,326,000
Total	$ —	$150,727,568	$328,978,926	$ 479,706,494

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

As a BDC, the Company is required to invest primarily in the debt and equity of non-public companies for which there is little, if any, market-observable information. As a result a significant portion of the Company's investments at any given time will likely be deemed Level III investments. Investment values derived by a third party pricing service are generally deemed to be Level III values. For those that have observable trades, the Company considers them to be Level II.

Values derived for debt and equity securities using comparable public/private companies generally utilize market-observable data from such comparables and specific, non-public and non-observable financial measures (such as earnings or cash flows) for the private, underlying company/issuer. Such non-observable company/issuer data is typically provided on a monthly or quarterly basis, is certified as correct by the management of the company/issuer and/or audited by an independent accounting firm on an annual basis. Since such private company/issuer data is not publicly available it is not deemed market-observable data and, as a result, such investment values are grouped as Level III assets.

Values derived for the Asset Manager Affiliates using comparable public/private companies utilize market-observable data and specific, non-public and non-observable financial measures (such as assets under management, historical and prospective earnings) for the Asset Manager Affiliates. The Company recognizes that comparable asset managers may not be fully comparable to the Asset Manager Affiliates and typically identifies a range of performance measures and/or adjustments within the comparable population with which to determine value. Since any such ranges and adjustments are entity specific they are not considered market-observable data and thus require a Level III grouping. Illiquid investments that have values derived through the use of discounted cash flow models and residual enterprise value models are grouped as Level III assets.

The Company's policy for determining transfers between levels is based solely on the previously defined three-level hierarchy for fair value measurement. Transfers between the levels of the fair value hierarchy are separately noted in the tables below and the reason for such transfer described in each table's respective footnotes. Investments measured at fair value for which the Company has used unobservable inputs to determine fair value are as follows:

	Year Ended December 31, 2015				
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Total
Balance, December 31, 2014	$171,018,343	$ 77,514,902	$8,119,681	$ 72,326,000	$328,978,926
Transfers out of Level III[1]	(30,472,595)	—	—	—	(30,472,595)
Transfers into Level III[2]	34,013,134	—	—	—	34,013,134
Net accretion of discount	300,255	(9,507,048)	—	—	(9,206,793)
Purchases	990,000	11,952,000	—	—	12,942,000
Sales/Paydowns/Return of Capital	—	(3,872,700)	(317,340)	(3,701,446)	(7,891,486)
Total realized gain/(loss) included in earnings	99,145	(6,246,883)	3,015	—	(6,144,723)
Total unrealized gain (loss) included in earnings	7,452,183	(13,967,889)	1,297,647	(11,243,554)	(16,461,613)
Balance, December 31, 2015	$183,400,465	$ 55,872,382	$9,103,003	$ 57,381,000	$305,756,850
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	$ (7,109,531)	$(20,760,499)	$1,297,647	$(11,243,554)	$ (23,254,223)

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4. INVESTMENTS – (continued)

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(1) Transfers out of Level III represent a transfer of $30,472,595 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were observable as of December 31, 2015.

(2) Transfers into Level III represent a transfer of $34,013,134 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of December 31, 2015.

	Year Ended December 31, 2014				
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Total
Balance, December 31, 2013	$ 198,097,374	$ 79,452,220	$11,006,399	$76,148,000	$ 364,703,993
Transfers out of Level III[1]	(38,990,152)	—	—	—	(38,990,152)
Transfers into Level III[2]	1,982,110	—	—	—	1,982,110
Net accretion of discount	198,600	(11,102,015)	—	—	(10,903,415)
Purchases	132,079,152	22,421,847	2,216,847	545,979	157,263,825
Sales/Paydowns/Return of Capital	(121,242,093)	(10,132,500)	(5,007,311)	(6,432,086)	(142,813,990)
Total realized gain included in earnings	(9,069,550)	5,575,498	(7,136,407)	—	(10,630,459)
Total unrealized gain (loss) included in earnings	7,962,902	(8,700,148)	7,040,153	2,064,107	8,367,014
Balance, December 31, 2014	$ 171,018,343	$ 77,514,902	$ 8,119,681	$72,326,000	$ 328,978,926
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	$ (1,448,794)	$ (4,908,278)	$ 424,306	$ 2,064,107	$ (3,868,659)

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(1) Transfers out of Level III represent a transfer of $38,990,152 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were observable as of December 31, 2014.

(2) Transfers into Level III represent a transfer of $1,982,110 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of December 31, 2014.

As of December 31, 2015, the Company's Level II portfolio investments were valued by a third party pricing services for which the prices are not adjusted and for which inputs are observable or can be corroborated by observable market data for substantially the full character of the financial instrument, or by inputs that are derived principally from, or corroborated by, observable market information. The fair value of the Company's Level II portfolio investments was $103,813,645 as of December 31, 2015.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

As of December 31, 2015, the Company's Level III portfolio investments had the following valuation techniques and significant inputs:

Type	Fair Value	Primary Valuation Methodology	Unobservable Inputs	Range of Inputs (Weighted Average)
Debt Securities	$ 2,216,700	Enterprise Value	Average EBITDA Multiple	7.2x
	$181,182,774	Income Approach	Implied Discount Rate	4.9% – 27.1% (10.46)%
	$ 991	Options Value	Qualitative Inputs(1)	
Equity Securities	$ 9,100,003	Enterprise Value	Average EBITDA Multiple/WAAC	4.8x/6.9% – 12.9x/13.4% (6.8x/12.0)%
	$ 3,000	Options Value	Qualitative Inputs(1)	
CLO Fund Securities	$ 55,872,382	Discounted Cash Flow	Discount Rate	11.3% – 15.0% (14.9)%
			Probability of Default	2.0% – 2.5% (2.1)%
			Loss Severity	25.0% – 25.9% (25.7)%
			Recovery Rate	74.1% – 75% (74.3)%
			Prepayment Rate	7.9% – 32.0% (25.3)%
Asset Manager Affiliate	$ 57,381,000	Discounted Cash Flow	Discount Rate	2.4% – 15.0% (8.6)%
Total Level III Investments	$305,756,850			

(1) The qualitative inputs used in the fair value measurements of the Debt Securities include estimates of the distressed liquidation value of the pledged collateral.

As of December 31, 2014, the Company's Level III portfolio investments had the following valuation techniques and significant inputs:

Type	Fair Value	Primary Valuation Methodology	Unobservable Inputs	Range of Inputs (Weighted Average)
Debt Securities	$ 2,580,000	Enterprise Value	Average EBITDA Multiple/WAAC	7.9x
	$168,437,343	Income Approach	Implied Discount Rate	2.8% – 18.3% (9.0)%
	$ 1,000	Options Value	Qualitative Inputs(1)	
Equity Securities	$ 8,116,681	Enterprise Value	Average EBITDA Multiple/WAAC	4.3x/10.4% – 12.6x/15.8% (8.1x/13.2)%
	$ 3,000	Options Value	Qualitative Inputs(1)	
CLO Fund Securities	$ 68,753,402	Discounted Cash Flow	Discount Rate	11% – 12% (11.5)%
			Probability of Default	2.0% – 2.5% (2.3)%
			Loss Severity	25.0% – 25.9% (25.5)%
			Recovery Rate	74.1% – 75% (74.6)%
			Prepayment Rate	0% – 37.8% (31.1)%
	$ 8,761,500	Market Approach	Third Party Quote	88.5 (88.5)
Asset Manager Affiliate	$ 72,326,000	Discounted Cash Flow	Discount Rate	1.76 – 8.75 (6.65)
Total Level III Investments	$328,978,926			

(1) The qualitative inputs used in the fair value measurements of the Debt Securities include estimates of the distressed liquidation value of the pledged collateral.

4. INVESTMENTS – (continued)

The significant unobservable inputs used in the fair value measurement of the Company's debt securities may include, among other things, broad market indices, the comparable yields of similar investments in similar industries, effective discount rates, average EBITDA multiples, and weighted average cost of capital. Significant increases or decreases in such comparable yields would result in a significantly lower or higher fair value measurement.

The significant unobservable inputs used in the fair value measurement of the Company's equity securities include the EBITDA multiple of similar investments in similar industries and the weighted average cost of capital. Significant increases or decreases in such inputs would result in a significantly lower or higher fair value measurement.

Significant unobservable input used in the fair value measurement of the Company's CLO Fund securities include default rates, recovery rates, prepayment rates, spreads, and the discount rate by which to value the resulting underlying cash flows. Such assumptions can vary significantly, depending on market data sources which often vary in depth and level of analysis, understanding of the CLO market, detailed or broad characterization of the CLO market and the application of such data to an appropriate framework for analysis. The application of data points are based on the specific attributes of each individual CLO Fund security's underlying assets, historic, current and prospective performance, vintage, and other quantitative and qualitative factors that would be evaluated by market participants. The Company evaluates the source of market data for reliability as an indicative market input, consistency amongst other inputs and results and also the context in which such data is presented. Significant increases or decreases in probability of default and loss severity inputs in isolation would result in a significantly lower or higher fair value measurement. In general, a change in the assumption of the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity in an event of default. Significant increases or decreases in the discount rate in isolation would result in a significantly lower or higher fair value measurement.

The significant unobservable inputs used in the fair value measurement of the Asset Manager Affiliates is the discount rate used to present value prospective cash flows. Prospective revenues are generally based on a fixed percentage of the par value of CLO Fund assets under management and are recurring in nature for the term of the CLO Fund so long as the Asset Manager Affiliates manage the fund. As a result, the fees earned by the Asset Manager Affiliates are generally not subject to market value fluctuations in the underlying collateral. The discounted cash flow model incorporates different levels of discount rates depending on the hierarchy of fees earned (including the likelihood of realization of senior, subordinate and incentive fees) and prospective modeled performance. Significant increases or decreases in such discount rate would result in a significantly lower or higher fair value measurement.

5. ASSET MANAGER AFFILIATES

Wholly-Owned Asset Managers

The Asset Manager Affiliates are wholly-owned portfolio companies. The Asset Manager Affiliates manage CLO Funds primarily for third party investors that invest in broadly syndicated loans, high yield bonds and other credit instruments issued by corporations. At December 31, 2015, the Asset Manager Affiliates had approximately $2.7 billion of par value of assets under management, and the Company's 100% equity interest in the Asset Manager Affiliates had a fair value of approximately $57 million.

As a manager of the CLO Funds, the Asset Manager Affiliates receive contractual and recurring management fees from the CLO Funds for their management and advisory services. The annual fees which the Asset Manager Affiliates receive are generally based on a fixed percentage of assets under management (at par value and not subject to changes in market value), and the Asset Manager Affiliates generate net income equal to the amount by which their fee income exceeds their operating expenses, including compensation of their employees and income taxes. The management fees the Asset Manager Affiliates receive have three components — a senior management fee, a subordinated management fee and an incentive fee. Currently, all

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. ASSET MANAGER AFFILIATES – (continued)

CLO Funds managed by the Asset Manager Affiliates are paying both their senior and subordinated management fees on a current basis. Additionally, three managed funds made incentive fee distributions during the year ended December 31, 2015.

For the years ended December 31, 2015, 2014, and 2013, the Asset Manager Affiliates declared cash distributions of $9.1 million, $11.9 million, and $12.8 million to the Company, respectively. Any distributions from the Asset Manager Affiliates out of the estimated tax-basis earnings and profits are recorded as "Dividends from Asset Manager Affiliates" on the Company's statement of operations. The Company recognized $5.3 million, $5.5 million, and $5.7 million of Dividends from Asset Manager Affiliates in the Statement of Operations in 2015, 2014, and 2013, respectively. The difference between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e., tax-basis return of capital). Distributions receivable, if any, are reflected in the Due from Affiliates account on the consolidated balance sheets.

The tax attributes of distributions received from the Asset Manager Affiliates are determined on an annual basis. The Company makes an estimate of the tax-basis earnings and profits of the Asset Manager Affiliates on a quarterly basis, and any quarterly distributions received in excess of the estimated earnings and profits are recorded as return of capital (reduction in the cost basis of the investment in Asset Manager Affiliate).

The Asset Manager Affiliates' fair value is determined quarterly. The valuation is primarily determined utilizing a discounted cash flow model. (See Note 2 — "Significant Accounting Policies" and Note 4 — "Investments" for further information relating to the Company's valuation methodology.)

Effective January 1, 2010, the Asset Manager Affiliates adopted guidance encompassed in Accounting Standards Codification Topic 810, "Consolidation." The adoption of this new guidance had an impact on the disclosures relating to the Asset Manager Affiliates in the Company's SEC Filings which had previously not been required, as its provisions require the Asset Manager Affiliates to consolidate certain of their managed CLO Funds that were not previously consolidated. As a result of the consolidation of these CLO Funds into the Asset Manager Affiliates, the financial results of the Asset Manager Affiliates indicate that they qualify as a "significant subsidiary" of the Company requiring additional disclosures. In addition, in accordance with Rules 3-09, Rule 4-08(g) and 1-02 of Regulation S-X, additional financial information with respect to two of the CLO Funds in which the Company has an investment, Katonah 2007-I CLO and Katonah X CLO are required to be included in the Company's SEC filings. The additional financial information regarding the Asset Manager Affiliates and Katonah 2007-I CLO (pursuant to Rule 3-09) immediately follow these financial statements. The additional financial information regarding Katonah X CLO (pursuant to Rule 4-08(g)) is set forth below. This additional financial information regarding the Asset Manager Affiliates, Katonah 2007-1 CLO and Katonah X CLO does not directly impact the financial position, results of operations, or cash flows of the Company.

Katonah X CLO Ltd.

Summarized Balance Sheet Information

	As of December 31, 2015	As of December 31, 2014
Total investments at fair value	$ —	$ 294,519,583
Cash	198,102	13,826,334
Receivable for investments sold	4,178,443	—
Total assets	4,816,030	309,087,239
CLO Debt at fair value(1)	3,000,000	301,099,336
Total liabilities	4,816,030	302,052,535
Total Net Assets	—	7,034,704

(1) Includes subordinated securities of approximately $3.0 million and $14.6 million, as of December 31, 2015 and 2014, respectively.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. ASSET MANAGER AFFILIATES – (continued)

Katonah X CLO Ltd.

Summarized Statements of Operations Information

	Year Ended December 31, 2015	Year Ended December 31, 2014
Interest income from investments	$ 7,619,817	$ 12,441,502
Total income	7,823,471	13,170,483
Interest expense	10,194,889	8,945,449
Total expenses	16,241,895	13,136,542
Net realized and unrealized losses	1,383,719	(10,998,445)
Decrease in net assets resulting from operations	(7,034,705)	(10,964,505)

Please refer to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014 which includes audited financial statements as of and for the fiscal year ended December 31, 2013 for the Katonah X CLO.

As separately regarded entities for tax purposes, the Asset Manager Affiliates are taxed at normal corporate rates. In order to maintain the Company's RIC status, any tax-basis dividends paid by the Asset Manager Affiliates to the Company would generally need to be distributed to the Company's shareholders. Generally, such tax-basis dividends of the Asset Manager Affiliates' income which was distributed to the Company's shareholders will be considered as qualified dividends for tax purposes. The Asset Manager Affiliates' taxable net income will differ from U.S. GAAP net income because of deferred tax temporary differences and permanent tax adjustments. Deferred tax temporary differences may include differences for the recognition and timing of amortization and depreciation, compensation related expenses, and net loss carryforward, among other things. Permanent differences may include adjustments, limitations or disallowances for meals and entertainment expenses, penalties, tax goodwill amortization and net operating loss carryforward.

Goodwill amortization for tax purposes was created upon the purchase of 100% of the equity interests in Katonah Debt Advisors prior to the Company's IPO in exchange for shares of the Company's stock valued at $33 million. Although this transaction was a stock transaction rather than an asset purchase and thus no goodwill was recognized for U.S. GAAP purposes, such exchange was considered an asset purchase under Section 351(a) of the Code. At the time of the transfer, Katonah Debt Advisors had equity of approximately $1 million resulting in tax goodwill of approximately $32 million which is being amortized for tax purposes on a straight-line basis over 15 years, which accounts for an annual difference between U.S. GAAP income and taxable income by approximately $2.1 million per year over such period.

Additional goodwill amortization for tax purposes was created upon the purchase of 100% of the equity interests in Trimaran Advisors by one of KCAP's affiliates, in exchange for shares of the Company's stock valued at $25.5 million and cash of $13.0 million. The transaction was considered an asset purchase under Section 351(a) of the code and resulted in tax goodwill of approximately $22.8 million which is being amortized for tax purposes on a straight-line basis over 15 years, which accounts for an annual difference between GAAP income and taxable income of approximately $1.5 million per year over such period.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. ASSET MANAGER AFFILIATES – (continued)

Related Party Transactions

On February 26, 2013, the Company entered into a senior credit agreement (the "Trimaran Credit Facility") with Trimaran Advisors, pursuant to which Trimaran Advisors may borrow from time to time up to $20 million from the Company in order to provide capital necessary to support one or more of Trimaran Advisors' warehouse lines of credit and/or working capital in connection with Trimaran Advisors' warehouse activities. The Trimaran Credit Facility expires on November 20, 2017 and bears interest at an annual rate of 9.0%. Outstanding borrowings on the Trimaran Credit Facility are callable by the Company at any time. On April 15, 2013, the Trimaran Credit Facility was amended and upsized from $20 million to $23 million. At both December 31, 2015 and 2014, the par value of the outstanding loan was $23 million. For the years ended December 31, 2015 and 2014, the Company recognized interest income of approximately $1.7 million and $2 million related to the Trimaran Credit Facility, respectively.

6. BORROWINGS

The Company's debt obligations consist of the following:

	As of December 31, 2015	As of December 31, 2014
Convertible Notes due March 15, 2016	$ 19,299,000	$ 38,647,000
7.375% Notes due 2019	41,400,000	41,400,000
Notes Issued by KCAP Senior Funding I, LLC (net of discount: 2015 – $2,907,595; and 2014 – $3,512,407)	144,442,405	143,837,593
	$ 205,141,405	$ 223,884,593

The weighted average stated interest rate and weighted average maturity on all our debt outstanding as of December 31, 2015 were 4.08% and 6.8 years, respectively, and as of December 31, 2014 were 4.43% and 7.23 years, respectively.

Convertible Notes

On March 16, 2011, the Company issued $55 million in aggregate principal amount of unsecured 8.75% convertible notes due March 2016 ("Convertible Notes"). On March 23, 2011, pursuant to an over-allotment option, the Company issued an additional $5 million of such Convertible Notes for a total of $60 million in aggregate principal amount. The net proceeds from the sale of the Convertible Notes, after the payment of underwriting expenses, were approximately $57.7 million. Interest on the Convertible Notes is paid semi-annually in arrears on March 15 and September 15, at a rate of 8.75%, commencing September 15, 2011. The Convertible Notes mature on March 15, 2016 unless converted earlier. The Convertible Notes are senior unsecured obligations of the Company.

The Convertible Notes are convertible into shares of Company's common stock. As of December 31, 2015 the conversion rate was 135.5441 shares of common stock per $1,000 principal amount of Convertible Notes, which is equivalent to a conversion price of approximately $7.38 per share of common stock. Upon conversion, the Company would issue the full amount of common stock or settle the conversion in cash, at its option, and retire the full amount of debt outstanding

Upon conversion, unless a holder converts after a record date for an interest payment but prior to the corresponding interest payment date, the holder will receive a separate cash payment with respect to the Convertible Notes surrendered for conversion representing accrued and unpaid interest to, but not including the conversion date. Any such payment will be made on the settlement date applicable to the relevant conversion on the Convertible Notes.

No holder of Convertible Notes will be entitled to receive shares of the Company's common stock upon conversion to the extent (but only to the extent) that such receipt would cause such converting holder to become, directly or indirectly, a beneficial owner (within the meaning of Section 13(d) of the Securities

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. BORROWINGS – (continued)

Exchange Act of 1934 and the rules and regulations promulgated thereunder) of more than 5.0% of the shares of the Company's common stock outstanding at such time. The 5.0% limitation will no longer apply following the effective date of any fundamental change (as defined in the indenture governing the Convertible Notes).

Subject to certain exceptions, holders may require us to repurchase, for cash, all or part of their Convertible Notes upon a fundamental change at a price equal to 100% of the principal amount of the Convertible Notes being repurchased plus any accrued and unpaid interest up to, but excluding, the fundamental change repurchase date. In addition, in the case of certain fundamental changes and without duplication of the foregoing amount, the Company will also pay holders an amount in cash (or, in certain circumstances, shares of the Company's common stock) equal to the present value of the remaining interest payments on such notes through, and including, the maturity date.

In connection with the issuance of the Convertible Notes, the Company incurred approximately $2.4 million of debt offering costs which are being amortized over the term of the Convertible Notes on an effective yield method, of which approximately $21,000 remains to be amortized, and is included in other assets in the consolidated balance sheets. On April 4, 2013, approximately $9 million of the Company's 8.75% Convertible Notes were converted at a price per share of $8.159 into 1,102,093 shares of KCAP common stock. On September 4, 2013, the Company purchased $2 million face value of its own Convertible Notes at a price of $114.50, plus accrued interest. KCAP subsequently surrendered these notes to the note trustee for cancellation effective September 13, 2013. During 2015 the Company repurchased approximately $19.3 million of Convertible Notes at a price ranging from $101.500 to $102.375. KCAP subsequently surrendered these notes to the Trustee for cancellation. Due to the cash conversion option embedded in the Convertible Notes, the Company applied the guidance in ASC 470-20-40, Debt with Conversion and Other Options and realized a loss on the extinguishment of this debt. For the year ended December 31, 2015, 2014 and 2013 total realized losses on extinguishment of debt was approximately $445,000, $748,000 and $537,000, respectively. The indenture governing the Convertible Notes contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act and conditions governing the undertaking of new debt. As of December 31, 2015, there is approximately $19.3 million par value of Convertible Notes outstanding with a maturity date of March 15, 2016.

For the years ended the years ended December 31, 2015, 2014, and 2013, interest expense related to the Convertible Notes was $3.1 million, $4.1 million and $4.6 million, respectively.

The Convertible Notes have been analyzed for any features that would require its accounting to be bifurcated. There are no features that require accounting to be bifurcated, and as a result, they are recorded as a liability at their contractual amounts. At December 31, 2015, the Company was in compliance with all of its debt covenants.

Fair Value of Convertible Notes. The Company carries the Convertible Notes at cost. The Convertible Notes were issued in a private placement and there is no active trading of these notes. The estimated fair value of the Company's outstanding Convertible Notes was approximately $19.5 million at December 31, 2015. The fair value was determined based on an indicative closing price as of December 31, 2015. The Convertible Notes are categorized as Level III following ASC 820: Fair Value.

7.375% Notes Due 2019

On October 10, 2012, the Company issued $41.4 million in aggregate principal amount of unsecured 7.375% Notes Due 2019. The net proceeds for these Notes, after the payment underwriting expenses, were approximately $39.9 million. Interest on the 7.375% Notes Due 2019 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 7.375%, commencing December 30, 2012. The 7.375% Notes Due 2019 mature on September, 30, 2019 and are unsecured obligations of the Company. The 7.375% Notes Due 2019 are subject to redemption in whole or in part at any time or from time to time, at the option of the Company, on or after September 30, 2015, at a redemption price per security equal to 100% of the

6. BORROWINGS – (continued)

outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to the date fixed for redemption. In addition, due to the asset coverage test applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 7.375% Notes Due 2019, the Company is limited in its ability to make distributions in certain circumstances. The indenture governing the 7.375% Notes Due 2019 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. At December 31, 2015, the Company was in compliance with all of its debt covenants.

For the years ended December 31, 2015 and 2014 interest expense related to the 7.375% Notes Due 2019 was $3.1 million for both periods.

In connection with the issuance of the 7.375% Notes Due 2019, the Company incurred approximately $1.5 million of debt offering costs which are being amortized over the term of the facility on an effective yield method, of which approximately $890,000 remains to be amortized, and is recorded on the consolidated balance sheets in other assets.

Fair Value of 7.375% Notes Due 2019. The 7.375% Notes Due 2019 were issued in a public offering on October 10, 2012 and are carried at cost. For the years ended December 31, 2015 and 2014 the fair value of the Company's outstanding 7.375% Notes Due 2019 was approximately $41.1 million and $41.4 million, respectively. The fair value was determined based on the closing price on December 31, 2015 and 2014 for the 7.375% Notes Due 2019. The 7.375% Notes Due 2019 are categorized as Level I under the ASC 820: Fair Value.

KCAP Senior Funding I, LLC (Debt Securitization)

On June 18, 2013, the Company completed the sale of notes in a $140,000,000 debt securitization financing transaction. The notes offered in this transaction (the "KCAP Senior Funding I Notes") were issued by KCAP Senior Funding I, LLC, a newly formed special purpose vehicle (the "Issuer"), in which KCAP Senior Funding I Holdings, LLC, a wholly-owned subsidiary of the Company (the "Depositor"), owns all of the KCAP Senior Funding I Subordinated Notes (as defined below), and are backed by a diversified portfolio of bank loans. The indenture governing the KCAP Senior Funding I Notes contains an event of default that is triggered in the event that certain coverage tests are not met.

The secured notes (the "KCAP Senior Funding I Secured Notes") were issued as Class A senior secured floating rate notes which have an initial face amount of $77,250,000, are rated AAA (sf)/Aaa (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at the three-month LIBOR plus 1.50%, Class B senior secured floating rate notes which have an initial face amount of $9,000,000, are rated AA (sf)/Aa2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus the 3.25%, Class C secured deferrable floating rate notes which have an initial face amount of $10,000,000, are rated A (sf)/A2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 4.25%, and Class D secured deferrable floating rate notes which have an initial face amount of $9,000,000, are rated BBB (sf)/Baa2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 5.25%. The Depositor retained all of the subordinated notes of the Issuer (the "KCAP Senior Funding I Subordinated Notes"), which have an initial face amount of $34,750,000. The KCAP Senior Funding I Subordinated Notes do not bear interest and are not rated. Both the KCAP Senior Funding I Secured Notes and the KCAP Senior Funding I Subordinated Notes have a stated maturity on the payment date occurring in July, 2024, and are subject to a two year non-call period. The Issuer has a four year reinvestment period. The stated interest rate re-sets on a quarterly basis based upon the then-current level of the benchmark three-month LIBOR.

6. BORROWINGS – (continued)

On December 8, 2014, the Company completed the sale of additional notes ("Additional Issuance Securities") in a $56,000,000 increase to the collateralized loan obligation transaction that originally closed on June 18, 2013 (the "Original Closing Date"). The issuance of additional notes was proportional across all existing classes of notes issued on the Original Closing Date.

Each class of secured Additional Issuance Securities (all such classes, collectively, the "Additional Issuance Offered Securities") was issued as a pari passu sub-class of an existing class of notes issued on the Original Closing Date. Accordingly, the ratings given by Standard & Poor's Ratings Services and Moody's Investors Service, Inc. to each existing class of notes issued on the Original Closing Date will apply to each class of Additional Issuance Offered Securities that constitutes a related pari passu sub-class of such existing class of notes issued on the Original Closing Date.

The Additional Issuance Offered Securities were issued as Class A-2 senior secured floating rate notes which have an initial face amount of $30,900,000, have a rating of AAA (sf)/Aaa (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at the three-month LIBOR plus 1.50%, Class B-2 senior secured floating rate notes which have an initial face amount of $3,600,000, a rating of AA (sf)/Aa2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 3.25%, Class C-2 secured deferrable floating rate notes which have an initial face amount of $4,000,000, a rating of A (sf)/A2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 4.25%, and Class D-2 secured deferrable floating rate notes which have an initial face amount of $3,600,000, a rating of BBB (sf)/Baa2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 5.25%. The Depositor retained all of the subordinated Additional Issuance Securities of the Issuer (the "Additional Issuance Subordinated Notes"), which have an initial face amount of $13,900,000. The Additional Issuance Subordinated Notes do not bear interest and are not rated. The Additional Issuance Securities have a stated maturity date of July 20, 2024 and are subject to a non-call period until the payment date on the Additional Issuance Securities occurring in July 2015. The Issuer has a reinvestment period to and including the payment date on the Additional Issuance Securities occurring in July 2017, or such earlier date as is provided in the indenture relating to the Additional Issuance Securities. In connection with the Additional Issuance Offered Securities, the Company incurred issuance costs and OID costs of approximately $679,000 and $896,000, respectively, which is included in other assets on the accompanying balance sheet.

As part of this transaction, the Company entered into a master loan sale agreement with the Depositor and the Issuer under which the Company sold or contributed certain bank loans to the Depositor, and the Depositor sold such loans to the Issuer in exchange for a combination of cash and the issuance of the KCAP Senior Funding I Subordinated Notes to the Depositor.

In connection with the issuance and sale of the KCAP Senior Funding I Notes, the Company has made customary representations, warranties and covenants in the purchase agreement by and between the Company, the Depositor, the Issuer and Guggenheim Securities, LLC, which served as the initial purchaser of the KCAP Senior Funding I Secured Notes. The KCAP Senior Funding I Secured Notes are the secured obligations of the Issuer, and an indenture governing the KCAP Senior Funding I Notes includes customary covenants and events of default. The KCAP Senior Funding I Notes were sold in a private placement transaction and have not been, and will not be, registered under the Securities Act of 1933, as amended, or any state "blue sky" laws and may not be offered or sold in the United States absent registration with the Securities and Exchange Commission or an applicable exemption from registration.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. BORROWINGS – (continued)

The Company serves as collateral manager to the Issuer under a collateral management agreement, which contains customary representations, warranties and covenants. Under the collateral management agreement, the Company will perform certain investment management functions, including supervising and directing the investment and reinvestment of the Issuer's assets, as well as perform certain administrative and advisory functions.

In addition, because each of the Issuer and the Depositor are consolidated subsidiaries, the Company did not recognize any gain or loss on the transfer of any of our portfolio assets to such vehicles in connection with the issuance and sale of the KCAP Senior Funding I Notes.

As of December 31, 2015, there were 74 investments in portfolio companies with a total fair value of approximately $184 million plus cash of $7.1 million, collateralizing the secured notes of the Issuer. At December 31, 2015, there were unamortized issuance costs of approximately $3.1 million included in other assets, and unamortized original issue discount, ("OID") costs of approximately $2.9 million included in Notes issued by KCAP Senior Funding I, LLC liabilities in the accompanying consolidated balance sheet. The pool of loans in the securitization must meet certain requirements, including asset mix and concentration, collateral coverage, term, agency rating, minimum coupon, minimum spread and sector diversity requirements.

For the year ended December 31, 2015, interest expense, including the amortization of deferred debt issuance costs and the discount on the face amount of the notes was approximately $5 million consisting of stated interest expense of approximately $3.8 million, accreted discount of approximately $605,000, and deferred debt issuance costs of approximately $649,000. As of December 31, 2015 the stated interest charged under the securitization was based on current three month LIBOR at the reset date, which was 0.32%. The classes, stated interest rates, spread over LIBOR, and stated interest expense are as follows:

	Stated Interest Rate[(1)]	LIBOR Spread (basis points)	Interest Expense[(1)]
KCAP Senior Funding LLC Class A Notes	1.82%	150	$ 1,965,248
KCAP Senior Funding LLC Class B Notes	3.57%	325	449,461
KCAP Senior Funding LLC Class C Notes	4.57%	425	639,401
KCAP Senior Funding LLC Class D Notes	5.57%	525	701,461
Total			$ 3,755,571

(1) Stated Interest Rate (and thus periodic interest expense), will vary based upon prevailing 3 month LIBOR as of the reset date.

The amounts, ratings and interest rates (expressed as a spread to LIBOR) of the Class A, B, C, and D are as follows:

Description	Class A Notes	Class B Notes	Class C Notes	Class D Notes
Type	Senior Secured Floating Rate	Senior Secured Floating Rate	Secured Deferrable Floating Rate	Secured Deferrable Floating Rate
Amount Outstanding	$108,150,000	$12,600,000	$14,000,000	$12,600,000
Moody's Rating (*sf*)	"Aaa"	"Aa2"	"A2"	"Baa2"
Standard & Poor's Rating (*sf*)	"AAA"	"AA"	"A"	"BBB"
Interest Rate	LIBOR + 1.50%	LIBOR + 3.25%	LIBOR + 4.25%	LIBOR + 5.25%
Stated Maturity	July, 2024	July, 2024	July, 2024	July, 2024
Junior Classes	B, C, D and Subordinated	C, D and Subordinated	D and Subordinated	Subordinated

(1) Three month LIBOR, which was 0.32% as of the last reset date.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. BORROWINGS – (continued)

The Company's outstanding principal amounts, carrying values and fair values of the Class A, B, C and D Notes are as follows:

	As of December 31, 2015		
	Principal Amount	Carrying Value	Fair Value
KCAP Senior Funding I, LLC Class A Notes	$ 108,150,000	$ 106,015,921	$ 106,257,375
KCAP Senior Funding I, LLC Class B Notes	12,600,000	12,351,369	12,316,500
KCAP Senior Funding I, LLC Class C Notes	14,000,000	13,723,744	13,510,000
KCAP Senior Funding I, LLC Class D Notes	12,600,000	12,351,371	11,718,000
Total	$ 147,350,000	$ 144,442,405	$ 143,801,875

Fair Value of KCAP Senior Funding I. The Company carries the KCAP Senior Funding I Notes at cost, net of unamortized discount of approximately $2.9 million. The fair value of the KCAP Senior Funding I Notes was approximately $143.8 million at December 31, 2015. The fair values were determined based on third party indicative values. The KCAP Senior Funding I, L.L.C. Notes are categorized as Level III under ASC 820: Fair Value.

7. DISTRIBUTABLE TAXABLE INCOME

Effective December 11, 2006, the Company elected to be treated as a RIC under the Code and adopted a December 31 tax-calendar year end. As a RIC, the Company is not subject to federal income tax on the portion of its taxable income and gains distributed currently to its stockholders as a dividend. The Company's quarterly distributions, if any, are determined by the Board of Directors. The Company anticipates distributing at least 90% of its taxable income and gains, within the Subchapter M rules, and thus the Company anticipates that it will not incur any federal or state income tax at the RIC level. As a RIC, the Company is also subject to a federal excise tax based on distributive requirements of its taxable income on a calendar year basis (e.g., calendar year 2015). Depending on the level of taxable income earned in a tax year, the Company may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4% excise tax on such income, to the extent required.

Book and tax basis differences relating to stockholder dividends and distributions and other permanent book and tax differences are typically reclassified among the Company's capital accounts. In addition, the character of income and gains to be distributed is determined in accordance with income tax regulations that may differ from GAAP; accordingly at calendar years ended December 31, 2015 and 2014, the Company reclassified for book purposes amounts arising from permanent book/tax differences related to the tax treatment of return of capital distributions and non-deductible expenses, as follows:

	Year Ended December 31,	
	2015	2014
Capital in excess of par value	$ (2,850,376)	$(7,987,965)
Accumulated undistributed net investment income	$ 2,744,870	$ 7,987,965
Accumulated net realized losses	$ 105,506	$ —

Total earnings and net asset value are not affected by the reclassifications.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. DISTRIBUTABLE TAXABLE INCOME – (continued)

The following reconciles net increase in net assets resulting from operations to taxable income for the year ended December 31, 2015 and 2014:

	Year Ended December 31, 2015	Year Ended December 31, 2014
Net (decrease)/increase in net assets resulting from operations	$(18,634,558)	$ 15,033,594
Net change in unrealized appreciation/(depreciation) from investments	36,169,870	(6,045,517)
Net realized losses	6,647,477	11,132,492
Book/tax differences on CLO equity investments	(991,297)	6,155,685
Other book/tax differences	142,721	570,900
Taxable income before deductions for distributions	$ 23,334,213	$ 26,847,154
Taxable income before deductions for distributions per weighted average basic shares for the period	$ 0.63	$ 0.78

Dividends from Asset Manager Affiliates are recorded based upon a quarterly estimate of tax-basis earnings and profits of each Asset Manager Affiliate. Distributions in excess of the estimated tax-basis quarterly earnings and profits of each distributing Asset Manager Affiliate are recognized as tax-basis return of capital. The actual tax-basis earnings and profits and resulting dividend and/or return of capital for the year will be determined at the end of the tax year for each distributing Asset Manager Affiliate. For years ended the years ended December 31, 2015, 2014, and 2013, the Asset Manager Affiliates declared cash distributions of approximately $9.1 million $11.9 million, and $12.8 million to the Company, respectively. The Company recognized approximately $5.3 million, $5.5 million, and $5.7 million, respectively, of dividends from Asset Manager Affiliates in the Statement of Operations for the years ended the years ended December 31, 2015, 2014, and 2013. The difference of approximately $3.8 million, $6.4 million, and $7.1 million, respectively, between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e. tax-basis return of capital), for the years ended the years ended December 31, 2015, 2014, and 2013, respectively.

Distributions to shareholders that exceed tax-basis distributable income (tax-basis net investment income and realized gains, if any) are reported as distributions of paid-in capital (i.e. return of capital). The tax character of distributions is made on an annual (full calendar-year) basis. The determination of the tax attributes of our distributions is made at the end of the year based upon our taxable income for the full year and the distributions paid during the full year. Therefore, a determination of tax attributes made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year.

	Year Ended December 31,		
	2015	2014	2013
Distributions paid from:			
Ordinary income	$22,985,978	$26,807,154	$ 22,479,384
Return of Capital	—	7,972,633	12,681,755
Total	$22,985,978	$34,779,787	$ 35,161,139

7. DISTRIBUTABLE TAXABLE INCOME – (continued)

As of December 31, 2015 and 2014, the components of accumulated earnings on a tax basis were as follows:

	Year Ended December 31, 2015	Year Ended December 31, 2014
Distributable ordinary income	$ 348,235	$ —
Capital loss carryforward	$(83,133,721)	$(76,591,751)
Other temporary differences	$ (1,609,485)	$ (1,575,184)
Net unrealized depreciation	$(61,838,068)	$(29,295,943)

At December 31, 2015, the Company had a net capital loss carryforward of $83.0 million to offset net capital gains, to the extent provided by federal tax law. A capital loss carryforward of $105,508 expired in 2015. Of the net capital loss carryforward, $51.1 million is not subject to expiration under the RIC Modernization Act of 2010.

On December 16, 2015, the Company's Board of Directors declared a distribution to shareholders of $0.15 per share for a total of approximately $5.3 million. The record date was January 6, 2016 and the distribution was paid on January 28, 2016.

The Company adopted Financial Accounting Standards Board ASC Topic 740 Accounting for Uncertainty in Income Taxes ("ASC 740") as of January 1, 2007. ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the consolidated financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. The Company recognizes the tax benefits of uncertain tax positions only where the position is "more likely than not" to be sustained assuming examination by tax authorities. Management has analyzed the Company's tax positions, and has concluded that no liability for unrecognized tax benefits should be recorded related to uncertain tax positions taken on returns filed for open tax years (the last three fiscal years) or expected to be taken in the Company's current year tax return. The Company identifies its major tax jurisdictions as U.S. Federal and New York State, and the Company is not aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will change materially in the next 12 months. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an ongoing analysis of tax laws, regulations and interpretations thereof.

8. COMMITMENTS AND CONTINGENCIES

From time-to-time the Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the needs of the Company's investment in portfolio companies. Such instruments include commitments to extend credit and may involve, in varying degrees, elements of credit risk in excess of amounts recognized on the Company's balance sheet. Prior to extending such credit, the Company attempts to limit its credit risk by conducting extensive due diligence, obtaining collateral where necessary and negotiating appropriate financial covenants. As of December 31, 2015 and December 31, 2014, the Trimaran Credit Facility was fully drawn and there was no remaining unfunded commitment thereunder. As of December 31, 2015, the Company had $360,000 of commitments and no commitments as of December 31, 2014.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. STOCKHOLDERS' EQUITY

During the years ended December 31, 2015 and December 31, 2014, the Company issued 175,922 and 91,217 shares, respectively, of common stock under its dividend reinvestment plan. For the year ended December 31, 2015, the Company issued 196,166 shares of restricted stock, 10,862 shares were forfeited, and 104,550 shares were vested. On February 14, 2013, the Company completed a public offering of 5,232,500 shares of common stock, which included the underwriters' full exercise of their option to purchase up to 682,500 shares of common stock, at a price of $9.75 per share. In conjunction with this offering, the Company also sold 200,000 shares of common stock to a member of its Board of Directors, at a price of $9.31125 per share, raising approximately $1.9 million in gross proceeds. On April 4, 2013, approximately $9 million of the Company's 8.75% Convertible Notes were converted at a price basis per share of $8.159 into 1,102,093 shares of KCAP common stock. On October 6, 2014, the Company priced a follow-on public offering of 3.0 million shares of its common stock at a price of $8.02 per share. The offering raised net proceeds were approximately $23.8 million, after deducting underwriting discounts and offering expenses. The total number of shares of the Company's common stock outstanding as of December 31, 2015 was 37,100,005, and the total number of shares issued and outstanding as of December 31, 2014 was 36,775,127.

10. EQUITY INCENTIVE PLAN

The Company has an equity incentive plan, established in 2006 and as amended in 2008, 2014 and most recently in June 2015 (the "Equity Incentive Plan"). The Company reserved 2,000,000 shares of common stock for issuance under the Equity Incentive Plan. The purpose of the Equity Incentive Plan is to provide officers and employees of the Company with additional incentives and align the interests of its employees with those of its shareholders. Options granted under the Equity Incentive Plan are exercisable at a price equal to the fair market value (market closing price) of the shares on the day the option is granted. Restricted stock granted under the Equity Incentive Plan is granted at a price equal to the fair market value (market closing price) of the shares on the day such restricted stock is granted. Vesting of restricted stock awarded under the 2008 amendment of the Equity Incentive Plan will occur in two equal installments of 50%, on each of the third and fourth anniversaries of the grant date; vesting of restricted stock subsequent to the 2014 amendment of the Equity Incentive Plan will vest in four equal installments of 25%, on each of the first four anniversaries of the grant date.

Stock Options

On June 20, 2014, the Company's Board of Directors approved the amended and restated Non-Employee Director Plan (the "Non-Employee Director Plan"), which was approved by shareholders on June 10, 2011. Accordingly, the annual grant of options to non-employee directors has been discontinued and replaced with an annual grant of shares of restricted stock as partial annual compensation for the services of the non-employee directors.

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. EQUITY INCENTIVE PLAN – (continued)

Information with respect to options granted, exercised and forfeited under the Equity Incentive Plan for the period January 1, 2014 through December 31, 2015 is as follows:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Contractual Remaining Term (years)	Aggregate Intrinsic Value[1]
Options outstanding at January 1, 2014	50,000	$ 7.72		
Granted	—	$ —		
Exercised	—	$ —		
Forfeited	—	$ —		
Options outstanding at December 31, 2014	50,000	$ 7.72		
Granted	—	$ —		
Exercised	—	$ —		
Forfeited	—	$ —		
Outstanding at December 31, 2015	50,000	$ —	3.4	$ —
Total vested at December 31, 2015	50,000	$ 7.72	3.4	

(1) Represents the difference between the market value of shares of the Company and the exercise price of the options.

The Company uses a Binary Option Pricing Model (American, call option) to establish the expected value of all stock option grants. For the years ended December 31, 2015, 2014 and 2013 the Company did not recognize any non-cash compensation expense related to stock options. At December 31, 2015, the Company had no remaining compensation costs related to unvested stock option awards.

Restricted Stock

Awards of restricted stock granted under the Non-Employee Director Plan vest as follows: 50% of the shares vest on the grant date and the remaining 50% of the shares vest on the earlier of:

(i) the first anniversary of such grant, or

(ii) the date immediately preceding the next annual meeting of shareholders.

On May 5, 2013, the Company’s Board of Directors approved the grant of 240,741 shares of restricted stock to the employees of the Company as partial compensation for their services. 50% of such awards will vest on the third anniversary of the grant date and the remaining 50% of the shares will vest on the fourth anniversary of the grant date.

On June 14, 2013, 5,000 shares of restricted stock were awarded to the Company’s Board of Directors.

On May 5, 2014, 5,000 shares of restricted stock were awarded to the Company’s Board of Directors.

On June 20, 2014, the Company’s Board of Directors approved the grant of 355,289 shares of restricted stock to the employees of the Company as partial compensation for their services. 25% of such awards will vest on each of the first four anniversaries of the grant date.

On May 21, 2015, 6,000 shares of restricted stock were awarded to the Company’s Board of Directors.

On June 16, 2015, the Company received exemptive relief to repurchase shares of its common stock from its employees in connection with certain equity compensation plan arrangements. During the year ended December 31, 2015, the Company repurchased 36,348 shares of common stock at an aggregate cost of

10. EQUITY INCENTIVE PLAN – (continued)

approximately $220,000 in connection with the vesting of employee's restricted stock, which is reflected as Treasury Stock at cost on the Consolidated Balance Sheet. These shares are not available to be reissued under the Company's Equity Incentive Plan.

On June 23, 2015, the Company's Board of Directors approved the grant of 190,166 shares, with a fair value of approximately $1.2 million, of restricted stock to the employees of the Company as partial compensation for their services. 25% of such awards will vest on each of the first four anniversaries of the grant date.

On June 23, 2015, the Company's Board of Directors also voted to amend the Equity Incentive Plan to specify that shares repurchased by the Company to satisfy employee tax withholding requirements would not be returned to the plan reserve and could not be reissued under the Company's Equity Incentive Plan.

During the year ended December 31, 2015, the Company issued 196,166 shares of restricted stock, 104,550 shares of restricted stock vested and 10,862 shares of restricted stock were forfeited. As of December 31, 2015, after giving effect to these restricted stock awards, there were 700,539 shares of restricted stock outstanding. Information with respect to restricted stock granted, exercised and forfeited under the Plan for the period January 1, 2014 through December 31, 2015 is as follows:

	Non-Vested Restricted Shares
Non-vested shares outstanding at January 1, 2014	272,998
Granted	360,289
Vested	(5,000)
Forfeited	(8,502)
Non-vested shares outstanding at December 31, 2014	619,785
Granted	196,166
Vested	(104,550)
Forfeited	(10,862)
Non-vested shares outstanding at December 31, 2015	700,539

For the year ended December 31, 2015, non-cash compensation expense related to restricted stock was approximately $1.6 million; of this amount approximately $676,000 was expensed at the Company and approximately $897,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the year ended December 31, 2014, non-cash compensation expense related to restricted stock was approximately $1.1 million; of this amount approximately $534,000 was expensed at the Company and approximately $589,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the year ended December 31, 2013, non-cash compensation expense related to restricted stock was approximately $526,000; of this amount approximately $273,000 was expensed by the Company and approximately $253,000 was a reimbursable expense allocated to the Asset Manager Affiliates.

Distributions are paid on all outstanding shares of restricted stock, whether or not vested. In general, shares of unvested restricted stock are forfeited upon the recipient's termination of employment. At December 31, 2015 and 2014, the Company had approximately $3.6 million and $4.1 million of total unrecognized compensation cost related to non-vested restricted share awards, respectively. That cost is expected to be recognized over the remaining weighted average period of 2.3 years.

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11. OTHER EMPLOYEE COMPENSATION

The Company adopted a 401(k) plan ("401K Plan") effective January 1, 2007. The 401K Plan is open to all full time employees. The 401K Plan permits an employee to defer a portion of their total annual compensation up to the Internal Revenue Service annual maximum based on age and eligibility. The Company makes contributions to the 401K Plan of up to 2% of the Internal Revenue Service's annual maximum eligible compensation, which fully vests at the time of contribution. Approximately $25,000, $38,000 and $50,000 was expensed during the years ended December 31, 2015, 2014, and 2013, respectively, related to the 401K Plan.

The Company has also adopted a deferred compensation plan ("Profit-Sharing Plan") effective January 1, 2007. Employees are eligible for the Profit-Sharing Plan provided that they are employed and working with the Company to participate in at least 100 days during the year and remain employed as of the last day of the year. Employees do not make contributions to the Profit-Sharing Plan. On behalf of the employee, the Company may contribute to the Profit-Sharing Plan 1) up to 8.0% of all compensation up to the Internal Revenue Service annual maximum and 2) up to 5.7% excess contributions on any incremental amounts above the social security wage base limitation and up to the Internal Revenue Service annual maximum. Employees vest 100% in the Profit-Sharing Plan after five years of service. Approximately $151,000, $244,000 and $180,000 was expensed during the years ended December 31, 2015, 2014, and 2013, respectively, related to the Profit-Sharing Plan.

12. SELECTED QUARTERLY DATA (Unaudited)

	Q1 2015	Q2 2015	Q3 2015	Q4 2015
Total interest and related portfolio income	$12,342,129	$11,171,386	$ 11,779,348	$ 10,234,108
Net investment income	$ 6,506,948	$ 5,832,252	$ 6,541,080	$ 5,302,509
Net increase (decrease) in net assets resulting from operations	$ 7,672,290	$ 1,232,705	$(16,050,865)	$(11,488,691)
Net increase (decrease) in net assets resulting from operations per share – basic	$ 0.21	$ 0.03	$ (0.43)	$ (0.31)
Net increase (decrease) in net assets resulting from operations per share – diluted	$ 0.20	$ 0.03	$ (0.43)	$ (0.31)
Net investment income per share – basic	$ 0.18	$ 0.16	$ 0.18	$ 0.14
Net investment income per share – diluted	$ 0.18	$ 0.16	$ 0.18	$ 0.14

	Q1 2014	Q2 2014	Q3 2014	Q4 2014
Total interest and related portfolio income	$ 9,995,363	$ 9,773,830	$10,835,248	$10,601,034
Net investment income	$ 4,467,306	$ 4,595,638	$ 5,517,501	$ 5,540,123
Net increase (decrease) in net assets resulting from operations	$ 3,441,590	$12,252,662	$ 8,236,473	$ (8,897,131)
Net increase in net assets resulting from operations per share – basic and diluted	$ 0.10	$ 0.37	$ 0.24	$ (0.24)
Net increase in net assets resulting from operations per share – diluted	$ 0.10	$ 0.37	$ 0.24	$ (0.24)
Net investment income per share – basic	$ 0.13	$ 0.14	$ 0.16	$ 0.15
Net investment income per share – diluted	$ 0.13	$ 0.14	$ 0.16	$ 0.15

13. SUBSEQUENT EVENTS

On February 29, 2016, Katonah X CLO Ltd. was fully liquidated and all of its outstanding obligations were satisfied. The Company received approximately $1.0 million in connection therewith related to its investment in the subordinated securities issued by Katonah X CLO Ltd. Accordingly, the Company will record a realized loss during the first quarter of 2016 of approximately $6.6 million on its investment in Katonah X CLO Ltd. and a corresponding unrealized gain of the same amount in order to reverse the approximately $6.6 million of previously recorded unrealized depreciation with respect to the investment.

On March 7, 2016, Trimaran Advisors, LLC repaid $7.0 million of principal value of borrowings under the Trimaran Credit Facility.

The Company has evaluated events and transactions occurring subsequent to December 31, 2015 for items that should potentially be recognized or disclosed in these financial statements. Other than described above, management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these consolidated financial statements.

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ASSET MANAGER AFFILIATES

KATONAH 2007-I CLO LTD.

IMPORTANT NOTE

In accordance with certain SEC rules, KCAP Financial, Inc. (the "Company") is providing additional information regarding the following portfolio companies: Katonah Debt Advisers, L.L.C., Trimaran Advisors, L.L.C. (collectively the Asset Manager Affiliates), and Katonah 2007-I CLO Ltd. However, pursuant to SEC rules, the Company does not consolidate portfolio company investments, including those in which it has a controlling interest. As a result, the additional financial information regarding these entities does not directly impact the Company's financial position, results of operations or cash flows.

Report of Independent Auditors

The Board of Directors and Shareholders of
Asset Manager Affiliates

We have audited the accompanying combined financial statements of Asset Manager Affiliates (the "Company"), which comprise the combined balance sheets, as of December 31, 2015 and 2014, and the related combined statements of operations, changes in member's equity, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of Asset Manager Affiliates at December 31, 2015 and 2014, and the combined results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

New York, NY
March 9, 2016

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Shareholders
KCAP Financial, Inc.

We have audited the combined financial statements of Asset Manager Affiliates, which comprise the combined balance sheet as of December 31, 2013 (not included herein), and the related combined statements of operations, changes in member's equity, and cash flows for the year then ended, and the related notes to the combined financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Asset Manager Affiliates as of December 31, 2013, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP
New York, New York
March 12, 2014

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ASSET MANAGER AFFILIATES

COMBINED BALANCE SHEETS

	As of December 31, 2015	As of December 31, 2014
ASSETS		
Investments at fair value	$2,563,665,915	$ 2,846,659,635
Cash	3,601,156	6,778,774
Restricted cash of CLO Funds	115,799,359	182,224,205
Accrued interest receivable	6,551,857	6,655,821
Receivable for open trades	7,549,991	18,451,278
Due from affiliates	554,333	31,000
Deferred tax asset	—	3,576,148
Intangible assets	24,467,705	26,775,828
Other assets	1,178,931	1,440,250
Total assets	$2,723,369,247	$ 3,092,592,939
LIABILITIES		
CLO Funds' liabilities at fair value	$2,649,104,285	$ 2,990,211,629
Accrued interest payable	16,833,565	17,245,940
Payable for open trades	67,887,112	20,200,844
Accounts payable and accrued expenses	3,037,338	9,951,588
Due to affiliates	25,117,095	23,227,387
Deferred tax liability	649,970	—
Total liabilities	2,762,629,365	3,060,837,388
Commitments and Contingencies	—	—
MEMBER'S EQUITY		
Member's contributions	52,519,916	52,519,916
Accumulated deficit	(24,248,496)	(17,739,571)
Total Asset Manager Affiliates equity	28,271,420	34,780,345
Appropriated accumulated deficit of Consolidated Variable Interest Entities	(67,531,538)	(3,024,794)
Total member's equity	(39,260,118)	31,755,551
Total liabilities and member's equity	$2,723,369,247	$ 3,092,592,939

See accompanying notes to combined financial statements.

ASSET MANAGER AFFILIATES

COMBINED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2015	2014	2013
Income			
Interest income	$130,210,674	$120,740,895	$ 125,889,874
Interest income – cash and time deposits	15,251	322,219	332,775
Fee income	3,392,091	5,137,190	8,489,809
Other income	—	—	92,624
Total income	133,618,016	126,200,304	134,805,082
Expenses			
Interest expense of CLO Fund liabilities	143,917,372	136,240,383	107,760,918
Other interest expense	1,716,722	2,033,465	627,903
Compensation	9,441,607	8,921,240	8,384,972
Insurance	450,460	460,969	513,023
Professional fees	13,064,261	17,779,416	10,009,084
Administrative and other	5,281,646	8,632,640	6,014,316
Trustee fees	839,560	825,526	948,898
Total expenses	174,711,628	174,893,639	134,259,114
Net realized and unrealized losses	(15,229,831)	(27,188,644)	(13,899,200)
Loss before tax	(56,323,443)	(75,881,979)	(13,353,232)
Income tax expense (benefit)	5,642,225	4,153,598	(657,334)
Net loss	(61,965,668)	(80,035,577)	(12,695,898)
Net loss attributable to noncontrolling interests in consolidated Variable Interest Entities	(64,506,744)	(87,325,023)	(20,570,766)
Net income attributable to Asset Manager Affiliates	$ 2,541,075	$ 7,289,446	$ 7,874,868

See accompanying notes to combined financial statements.

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ASSET MANAGER AFFILIATES

COMBINED STATEMENTS OF CHANGES IN MEMBER'S EQUITY

	Member's Contributions	Accumulated Earnings (Deficit)	Appropriated Retained Earnings (Accumulated Deficit) of Variable Interest Entities	Total Member's Equity
Total at January 1, 2013	**$51,754,920**	**$ (8,244,102)**	**$ 104,870,995**	**$148,381,813**
Net income	—	7,874,869	—	7,874,869
Distributions	—	(12,759,784)	—	(12,759,784)
Contributions	229,196	—	—	229,196
Net loss classified to appropriated retained earnings	—	—	(20,570,766)	(20,570,766)
Total at December 31, 2013	**51,984,116**	**(13,129,017)**	**84,300,229**	**123,155,328**
Net income	—	7,289,446	—	7,289,446
Distributions	—	(11,900,000)	—	(11,900,000)
Contributions	535,800	—	—	535,800
Net loss classified to appropriated retained earnings	—	—	(87,325,023)	(87,325,023)
Total at December 31, 2014	**52,519,916**	**(17,739,571)**	**(3,024,794)**	**31,755,551**
Net income	—	2,541,075	—	2,541,075
Distributions	—	(9,050,000)	—	(9,050,000)
Net loss classified to appropriated retained earnings	—	—	(64,506,744)	(64,506,744)
Total at December 31, 2015	**$52,519,916**	**$ (24,248,496)**	**$ (67,531,538)**	**$ (39,260,118)**

See accompanying notes to combined financial statements.

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ASSET MANAGER AFFILIATES

COMBINED STATEMENTS OF CASH FLOWS

	Years Ended December 31,					
	2015		2014		2013	
	Asset Manager Affiliates Cash	CLO Restricted Cash	Asset Manager Affiliates Cash	CLO Restricted Cash	Asset Manager Affiliates Cash	CLO Restricted Cash
OPERATING ACTIVITIES:						
Net income attributable to Asset Manager Affiliates	$ 2,541,075	$ —	$ 7,289,446	$ —	$ 7,874,870	$ —
Net loss attributable to Variable Interest Entities	—	(64,506,744)	—	(87,325,023)	—	(20,570,767)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:						
Net change in deferred tax assets	4,226,118	—	(1,008,957)	—	(1,458,743)	—
Net realized and unrealized losses	—	15,229,831	—	27,188,644	—	13,899,200
Amortization of intangible assets	2,308,123	—	5,290,437	—	3,542,037	—
Changes in operating assets and liabilities:						
Decrease (increase) in accrued management fees	3,236,504	(3,236,504)	(3,536,430)	3,536,430	(672,200)	672,200
Decrease (increase) in accrued interest receivable	—	103,960	—	1,031,534	—	2,533,891
Decrease (increase) in other accounts receivable	(89,675)	—	662	—	(755)	—
Decrease (increase) in other assets	(481,966)	(640,339)	79,435	(345,696)	360,812	(249,079)
Increase (decrease) in accounts payable and accrued expenses	(5,867,797)	703,547	2,517,777	(85,438)	4,207,236	43,500
Increase (decrease) in accrued interest payable	—	(412,377)	11,333	991,471	166,916	4,368,264
Purchase of investments	—	(1,033,244,765)	—	(1,262,264,671)	—	(1,256,323,341)
Proceeds from sale and redemption of investments	—	1,195,190,728	—	1,318,852,412	—	1,571,177,633
Decrease in receivable for open trades	—	10,901,287	—	(12,482,566)	—	(1,725,775)
Increase (decrease) in payable for open trades	—	47,686,268	—	(29,855,797)	—	(174,353,152)
Net cash provided by (used in) operating activities	5,872,382	167,774,892	10,643,703	(40,758,700)	14,020,173	139,472,574
Investing activities:						
Purchase of investment	(23,000,000)	—	(23,000,000)	—	(23,000,000)	—
Proceeds from sale of investment	23,000,000	—	23,000,000	—	—	—
Net cash investing activities	—	—	—	—	(23,000,000)	—
Financing Activities:						
Member's contributions	—	—	535,800	—	229,196	—
Member's distributions	(9,050,000)	—	(11,900,000)	—	(12,750,000)	—
Debt offering proceeds	36,000,000	460,383,490	47,500,000	918,652,705	46,000,000	465,000,000
Repayments of Debt	(36,000,000)	(694,583,228)	(47,500,000)	(974,483,723)	(23,000,000)	(858,880,917)
Net cash (used in) provided by financing activities	(9,050,000)	(234,199,738)	(11,364,200)	(55,831,018)	10,479,196	(393,880,917)
CHANGE IN CASH	(3,177,618)	(66,424,846)	(720,497)	(96,589,718)	1,499,369	(254,408,343)
CASH, BEGINNING OF YEAR	6,778,774	182,224,205	7,499,271	278,813,923	5,999,902	533,222,266
CASH, END OF YEAR	$ 3,601,156	$ 115,799,359	$ 6,778,774	$ 182,224,205	$ 7,499,271	$ 278,813,923
Supplemental Information:						
Cash paid for interest	$ 1,817,480	$ 144,826,512	$ 2,022,132	$ 135,255,155	$ —	103,392,654
Cash paid for taxes	$ 5,477,493	$ —	$ 2,978,613	$ —	$ 432,500	—
Non-cash transactions:						
Member's contributions	$ —	$ —	$ 535,800	$ —	$ 229,196	—

See accompanying notes to combined financial statements.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION

Katonah Debt Advisors, L.L.C. ("Katonah Debt Advisors"), a registered investment adviser under the Investment Advisors Act of 1940 ("the IA Act of 1940"), is a wholly-owned portfolio company of KCAP Financial, Inc. ("KCAP Financial", the "Company"), which is an internally managed, non-diversified closed-end publicly traded investment company that is regulated as a business development company ("BDC") under the Investment Company Act of 1940 (the "1940 Act"). Katonah Debt Advisors manages collateralized loan obligation funds ("CLO Funds") which invest in broadly syndicated loans, high-yield bonds and other credit instruments. On February 29, 2012, KCAP Financial, through its newly formed wholly-owned subsidiary Commodore Holdings LLC purchased Trimaran Advisors, L.L.C. ("Trimaran Advisors"), a registered investment adviser and CLO manager similar to Katonah Debt Advisors, for total consideration of $13.0 million in cash and 3,600,000 shares of KCAP Financial's common stock. Contemporaneous with the acquisition of Trimaran Advisors, KCAP Financial acquired from Trimaran Advisors equity interests in certain CLO Funds managed by Trimaran Advisors for an aggregate purchase price of $12.0 million in cash. As of December 31, 2015, Katonah Debt Advisors and Trimaran Advisors, as well as affiliated management companies Katonah 2007-1 Management, L.L.C., Katonah X Management, L.L.C. and Trimaran Advisors Management, L.L.C. (collectively, the "Asset Manager Affiliates") have approximately $2.7 billion of par value assets under management. Katonah Debt Advisors and Trimaran Advisors are each managed independently from KCAP Financial by a separate management team. The Asset Manager Affiliates provide investment management services to CLO Funds, making day-to-day investment decisions concerning the assets of the CLO Funds. The Asset Manager Affiliates do not have any investment interests in the CLO Funds they manage; however, KCAP Financial holds investments in a portion of the securities issued by the CLO Funds managed by the Asset Manager Affiliates.

All of the CLO funds managed by the Asset Manager Affiliates are considered to be variable interest entities ("VIEs") for which the Asset Manager Affiliates are the primary beneficiary and, as a result, are required to be consolidated into the financial statements of the Asset Manager Affiliates as discussed in Note 3 — CLO Funds. The CLO funds considered to be VIEs are as follows: KATONAH IX CLO LTD.; KATONAH X CLO LTD.; KATONAH 2007-I CLO LTD.; TRIMARAN CLO IV LTD.; TRIMARAN CLO V LTD.; TRIMARAN CLO VI LTD.; TRIMARAN CLO VII LTD.; CATAMARAN CLO 2012-1 LTD.; CATAMARAN CLO 2013-1 LTD.; CATAMARAN 2014-1 LTD., CATAMARAN 2014-2 LTD., and CATAMARAN 2015-1 LTD.

During 2015, the following CLO Funds were fully redeemed, with all of their assets disposed and the proceeds therefrom distributed to their investors with no assets remaining at December 31, 2015; TRIMARAN CLO IV LTD.; TRIMARAN CLO V LTD.; TRIMARAN CLO VI LTD.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Presentation

The combined financial statements have been prepared in accordance with U.S. GAAP ("Accounting Principles Generally Accepted in the United States") and include the financial statements of the Asset Manager Affiliates and any VIEs required to be consolidated. The Asset Manager Affiliates provide investment management services to various CLO Funds, making day-to-day investment decisions concerning the assets of the CLO Funds. All of the CLO Funds managed by the Asset Manager Affiliates are VIEs that are required to be consolidated. Certain prior-year amounts have been reclassified to conform to the current year presentation.

Although the Asset Manager Affiliates have no ownership interests in the CLO Funds they manage, the Asset Manager Affiliates follow the provisions of Accounting Standards Codification ASC Topic 810, "Consolidation," when accounting for VIEs as further detailed below. Pursuant to ASC 810, VIEs, or entities in which the risks and rewards of ownership are not directly linked to voting interests, for which the Asset Manager Affiliates are the primary beneficiary, are consolidated.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

For CLO Funds, if the Asset Manager Affiliates are deemed to have the power to direct the activities of the CLO that most significantly impact the CLO's economic performance, and the obligation to absorb losses/right to receive benefits (management fees and potential incentive fees) from the CLO that could potentially be significant to the CLO, then the Asset Manager Affiliates are deemed to be the CLO's primary beneficiary and are required to consolidate the CLO.

All of the investments held and notes issued by CLO Funds considered to be VIEs are presented at fair value in the Asset Manager Affiliates' Combined Balance Sheets and interest income and expense of consolidated CLO Funds are presented in the Asset Manager Affiliates' Combined Statements of Operations.

In the opinion of management, the combined financial statements reflect all adjustments, consisting of normal recurring accruals, which are necessary for the fair presentation of the financial condition and results of operations for the periods presented. All significant intercompany transactions, balances, revenues and expenses are eliminated upon combination. Certain prior-year amounts have been reclassified to conform to the current year presentation. Furthermore, the preparation of the financial statements requires management to make significant estimates and assumptions including the fair value of investments that do not have a readily available market value. Actual results could differ from those estimates, and the differences could be material.

On February 18, 2015, the FASB issued Accounting Standards Update 2015-2 ("ASU 2015-2"), which updated consolidation standards under ASC Topic 810, "Consolidation". Under this update, a new consolidation analysis is required for VIEs and will limit the circumstances in which investment managers and similar entities are required to consolidate the entities that they manage. The FASB decided to eliminate some of the criteria under which their fees are considered a variable interest and limit the circumstances in which variable interests in a VIE held by related parties of a reporting enterprise require the reporting enterprise to consolidate the VIE. The guidance is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2015, early adoption is permitted. The Company will adopt ASU 2015-2 in 2016 which will result in the deconsolidation of the CLO Funds.

Investments at Fair Value. Investment transactions are recorded on the applicable trade date. Realized gains or losses are determined using the specific identification method. Investments held by the CLO Funds are stated at fair value. ASC 820 — Fair Value Measurements and Disclosures ("ASC 820: Fair Value"), requires, among other things, disclosures about assets and liabilities that are measured and reported at fair value. At December 31, 2015, there was a $23 million loan outstanding from Trimaran Advisors, which is being used to fund warehouse assets for a new CLO and is included in investments at fair value.

Hierarchy of Fair Value Inputs. The provisions of ASC 820: Fair Value establish a hierarchy that prioritizes inputs to valuation techniques used to measure fair value and require companies to disclose the fair value of their financial instruments according to the fair value hierarchy (i.e., Level I, II and III inputs, as defined). The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Additionally, companies are required to provide additional disclosure regarding instruments in the Level III category (which have inputs to the valuation techniques that are unobservable and require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities.

Assets and liabilities measured and reported at fair value are classified and disclosed in one of the following categories:

<u>Level I Inputs:</u>

Quoted prices (unadjusted) in active markets for identical assets or liabilities at the reporting date.

- Level I assets may include listed mutual funds, ETFs, equities and certain derivatives.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

Level II Inputs:

Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; quotes from pricing services or brokers, for which the Asset Manager Affiliates can determine that orderly transactions took place at the quoted price or that the inputs used to arrive at the price were observable; and inputs other than quoted prices that are observable, such as models or other valuation methodologies.

- Level II assets in this category may include debt securities, bank loans, short-term floating rate notes and asset-backed securities, restricted public securities valued at a discount, as well as over the counter derivatives, including interest and inflation rate swaps and foreign currency exchange contracts that have inputs to the valuations that generally can be corroborated by observable market data.

Level III Inputs:

Unobservable inputs for the valuation of the asset or liability, which may include non-binding broker quotes. Level III assets include investments for which there is little, if any, market activity. These inputs require significant management judgment or estimation.

- Level III assets in this category may include general and limited partnership interests in private equity funds, funds of private equity funds, real estate funds, hedge funds, and funds of hedge funds, direct private equity investments held within consolidated funds, bank loans, bonds issued by CLO Funds and certain held for sale real estate disposal assets.
- Level III liabilities included in this category include borrowings of consolidated collateralized loan obligation funds and are valued based upon non-binding broker quotes or discounted cash flow models based on a discount margin calculation.

Significance of Inputs:

The Asset Manager Affiliates' assessment of the significance of a particular input to the Fair Value measurement in its entirety requires judgment and considers factors specific to the financial instrument.

Valuation of Portfolio Investments. Debt and equity securities for which market quotations are readily available are generally valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued based on detailed analyses prepared by management, and, in certain circumstances, may utilize third parties with valuation expertise. The Asset Manager Affiliates follow the provisions of ASC 820: Fair Value which defines fair value, establishes a framework for measuring fair value, and expands disclosures about assets and liabilities measured at fair value. ASC 820: Fair Value defines "fair value" as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Subsequent to the adoption of ASC 820: Fair Value, the FASB has issued various staff positions clarifying the initial standard as noted below.

Fair Value Measurements and Disclosures requires the disclosure of the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

The Asset Manager Affiliates' valuation methodology and procedures for investments held by the CLO Funds are generally as follows:

For Debt Securities:

1. For any asset which is also held by KCAP Financial on the applicable date, the KCAP Financial fair value mark as of such applicable date is used.
2. Fair value for all assets which a Fund has committed to purchase but yet to settle will be the most recent mark produced by Markit (or other third party pricing service, as may be available). If the asset has not received a mark from Markit, the purchase price is deemed to be the fair value.
3. For performing loan and bond assets, the fair value is determined in accordance with the following procedure. First, if the asset was marked by Markit (or other third party pricing service, as may be available) within one month of applicable date, then the most recent Markit mark will be the fair value. Next, if the most recent Markit mark is aged beyond one month but less than one year, then the fair value will be the lower of the most recent Markit mark and the average price on the applicable rating bucket on the CSFB Loan Index produced on the date closest to the applicable date. Lastly, if the asset has not received a Markit mark within the last year, the fair value will be produced by haircutting (in percentage terms) the mark on the applicable rating bucket of the CSFB Loan Index produced on the date closest to the applicable date by said CSFB Loan Index value.
4. For loan and bond assets in payment default, the fair value is determined in accordance with the following procedure. First, if the asset was marked by Markit (or other third party pricing service, as may be available) within one month of applicable date, then the most recent Markit mark will be the fair value. Next, if the most recent Markit mark is aged beyond one month but less than one year, then the fair value will be the lower of most recent Markit mark and the average price on the Distressed/Defaulted bucket of the CSFB Distressed Loan Index produced on the date closet to the applicable date. Lastly, if the asset has not received a Markit mark within the last year, the fair value will be deemed to be zero.

For Equity Securities:

1. If the asset is a publicly-traded equity, the fair value will be based upon the closing price per share as of the applicable date. If the asset was marked by Markit (or other third party pricing service, as may be available) within one month of the applicable date, then the Fair value will be based on the most recent Markit price per share.

For CLO Securities:

1. For any asset which is also held by KCAP Financial on the applicable date, the KCAP Financial fair value mark as of such applicable date is used.
2. Fair value for all assets which a Fund has committed to purchase but yet to settle will be deemed to be the purchase price.
3. For performing assets, a Present Value is determined in accordance with the following procedure. First, the Asset Manager Affiliates amalgamate Discount Margin (DM) data from the most recent reports published by the CLO Research and Secondary Trading desks of sell side broker dealers. The DM data is averaged across each original rating bucket of the CLO capital structure. For each asset, future cash flows are produced based upon the three month LIBOR rate as of the applicable date and the contractually mandated spread each asset is required to pay in a no-loss scenario. The present value of the future cash flows is then calculated by using a discount rate equal to the applicable DM for the asset's original rating bucket plus the three month LIBOR rate as of the applicable date.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

4. Next, the Asset Manager Affiliates inquire with the sell-side institution from which they purchased each asset to provide indicative pricing as of the applicable date. The fair value is determined by an equal weight average of the Present Value determined from the cash flow model and the indicative price provided by the sell side broker dealer from which the asset was purchased. In the event there is no indicative price produced by a sell side broker dealer, then the Fair Value will be the Present Value determined from the cash flow model.
5. If the bond is a non-performing bond, it will be necessary to use a more detailed cash flow model. Such a model may be one that is commercially available (e.g. Intex) or one that is a spreadsheet-based CLO cash flow model which has been set up to replicate the deal in question, with specific prepayment, default, and severity inputs as appropriate to the bond in question.

Debt Securities. Most of the CLO Funds' investment portfolio is composed of broadly syndicated bank loans or other corporate debt securities for which an independent pricing service quote is available. To the extent that the investments are exchange traded and are priced or have sufficient price indications from normal course trading at or around the valuation date (financial reporting date), such pricing will determine fair value. Pricing service marks from third party pricing services may be used as an indication of fair value, depending on the volume and reliability of the marks, sufficient and reasonable correlation of bid and ask quotes, and, most importantly, the level of actual trading activity.

CLO Fund Securities. The CLO Funds managed by the Asset Manager Affiliates may selectively invest in securities issued by funds managed by other asset management companies. For bond rated tranches of CLO Funds (those above the junior class) without transactions to support a fair value for the specific CLO Fund and tranche, fair value is based on discounting estimated bond payments at current market yields, which may reflect the adjusted yield on the leveraged loan index for similarly rated tranches, as well as prices for similar tranches for other CLO Funds and also other factors such as the default and recovery rates of underlying assets in the CLO Fund, as may be applicable. Such model assumptions may vary and incorporate adjustments for risk premiums and CLO Fund specific attributes. Such adjustments require judgment and may be material to the calculation of fair value.

Equity Securities. From time to time, the CLO Funds may receive equity in connection with a default or restructuring of collateral obligations.

Cash. The Asset Manager Affiliates define cash as demand deposits. The Asset Manager Affiliates place their cash with financial institutions and, at times, cash held in these accounts may exceed the Federal Deposit Insurance Corporation insured limit.

Restricted Cash of CLO Funds. Restricted cash consists of cash held for reinvestment, quarterly interest and principal distributions (if any) to holders of CLO Fund liabilities, and for payment of CLO Fund expenses.

CLO Fund Liabilities at Fair Value. The CLO Funds managed by the Asset manager Affiliates and that are consolidated herein, have issued rated and unrated securities to finance their operations. CLO Fund liabilities, including the junior-most tranches of securities issued by each CLO Fund, are presented at fair value.

The Asset Manager Affiliates have determined that, although the junior tranches have certain characteristics of equity, they should be accounted for and disclosed as debt on the Combined Balance Sheets, as the subordinated and income notes and preferred shares have a stated maturity indicating a date for which they are mandatorily redeemable. The preference shares are also classified as debt, as they are mandatorily redeemable upon liquidation or termination of the CLO.

Interest Income. Interest income is recorded on the accrual basis on interest-bearing assets. The CLO Funds generally place a loan or security on non-accrual status and cease recognizing interest income on such

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

loan or security when a loan or security becomes 90 days or more past due or if the Asset Manager Affiliates otherwise do not expect the debtor to be able to service its debt obligations. Non-accrual loans represented less than 1% of investments of CLO Funds at fair value as of December 31, 2015 and December 31, 2014. The aggregate unpaid principal value of loans past due as of December 31, 2015 was approximately $1.1 million and the difference between fair value and the unpaid principal balance was approximately $934,000. The aggregate unpaid principal value of loans past due as of December 31, 2014 was approximately $29.6 million and the difference between fair value and the unpaid principal balance was approximately $12.9 million.

Management Fees. As a manager of CLO Funds, the Asset Manager Affiliates receive contractual and recurring management fees (and may receive a one-time structuring fee) from the CLO Funds for their management and advisory services. The annual fees which the Asset Manager Affiliates receive are generally based on a fixed percentage of assets under management (at par value and not subject to changes in market value), and the Asset Manager Affiliates generate annual operating income equal to the amount by which their fee income exceeds their operating expenses. The annual management fees the Asset Manager Affiliates receive have two components — a senior management fee and a subordinated management fee.

Incentive Fees. As a manager of CLO Funds, the Asset Manager Affiliates may receive incentive fees upon exceeding specified relative and/or absolute investment return thresholds. Such fees are recorded upon completion of the measurement period which varies by CLO Fund.

Distributions to Member. Distributions to the Asset Manager Affiliates' sole member are recognized on the ex-dividend date. Generally, dividends are declared and paid on a quarterly basis.

Expenses. The Asset Manager Affiliates expense costs, as incurred, with regard to the running of their operations. Primary operating expenses include employee compensation and benefits, the costs of identifying, evaluating, monitoring and servicing the CLO Fund investments managed by the Asset Manager Affiliates, and related overhead charges and expenses, including rental expense. The Asset Manager Affiliates share office space and certain other operating expenses. Katonah Debt Advisors has entered into an Overhead Allocation Agreement with its sole member, KCAP Financial. Trimaran Advisors has entered into such an allocation agreement with Katonah Debt Advisors. The Agreements provide for the sharing of such expenses based on an equal sharing of office lease costs and the ratable usage of other shared resources. Katonah Debt Advisors accounts for its operating leases, which may include escalations, in accordance with ASC 840-10, Leases, and expenses the lease payments associated with operating leases evenly during the lease term (including rent-free periods), beginning on the commencement of the lease term.

Interest Expenses. Interest expense related to borrowings of the Asset Manager Affiliates is recorded on an accrual basis pursuant to the terms of the related borrowing agreements, however the CLO Funds they manage that are consolidated herein have issued rated and unrated bonds to finance their operations. Interest on CLO Fund liabilities is calculated by the third party trustee of the CLO Funds. Interest is accrued and generally paid quarterly. Distributions on the junior-most tranches of securities issued by each CLO Fund are recorded as an interest expense.

Trustee Fees. Each CLO Fund has a third party trustee that is the custodian for all cash and investments of the CLO Funds and receives and disburses all cash in accordance to the trustee and custodial agreements. Trustee fees are accrued and paid quarterly by the CLO Funds.

Income Taxes. The Asset Manager Affiliates account for income taxes under the liability method prescribed by ASC 740-10, Income Taxes ("ASC 740-10"). Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases using currently

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred income tax assets and liabilities is recognized in income in the period that includes the enactment date.

Management periodically assesses the recoverability of its deferred income tax assets based upon expected future earnings, taxable income in prior carryback years, future deductibility of the asset, changes in applicable tax laws and other factors. If management determines that it is not more likely than not that the deferred tax asset will be fully recoverable in the future, a valuation allowance will be established for the difference between the asset balance and the amount expected to be recoverable in the future. This allowance will result in a charge to income tax expense on the combined statements of operations. The Asset Manager Affiliate record their income taxes receivables and payables based upon their estimated income tax liability.

ASC 740-10 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements by prescribing a threshold for measurement and recognition in the financial statements of an asset or liability resulting from a tax position taken or expected to be taken in an income tax return. ASC 740-10 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

3. CLO FUNDS

A CLO Fund generally refers to a special purpose vehicle that owns a portfolio of investments and issues various tranches of debt and subordinated securities to finance the purchase of those investments. Investments purchased by the CLO Funds are governed by extensive investment guidelines, including limits on exposure to any single industry or issuer and limits on the ratings of the CLO Fund's assets. The CLO Funds managed by the Asset Manager Affiliates have a defined investment period during which they are allowed to make investments or reinvest capital as it becomes available.

The Asset Manager Affiliates manage CLO Funds primarily for third party investors. The CLO Funds invest in broadly syndicated loans, high yield bonds and other credit instruments issued by corporations. At December 31, 2015 and December 31, 2014, the Asset Manager Affiliates had approximately $2.7 billion and $3.0 billion of par value of assets under management, respectively.

CLO Funds typically issue multiple tranches of debt and subordinated securities with varying ratings and levels of subordination to finance the purchase of their underlying investments. Interest and principal payments (net of designated CLO Fund expenses) from the CLO Fund are paid to each issued security in accordance with an agreed upon priority of payments, commonly referred to as the "waterfall." The most senior notes, generally rated AAA/Aaa, commonly represent the majority of the total liabilities of the CLO Fund. AAA/Aaa notes are issued at a specified spread over LIBOR and normally have the first claim on the earnings on the CLO Fund's investments after payment of certain fees and expenses. Lower subordinated "mezzanine" tranches of rated notes generally have ratings ranging from AA/Aa to BB/Ba and are usually issued at a specified spread over LIBOR with higher spreads paid on the tranches with lower ratings. Each tranche is typically only entitled to a share of the earnings on the CLO Fund's investments if the required interest and principal payments have been made on the more senior tranches in the waterfall. The subordinated securities are the most junior tranche and can take the form of either subordinated notes, income notes or preferred shares. The subordinated notes, income notes or preferred shares generally do not have a stated coupon but are entitled to residual cash flows from the CLO Fund's investments after all of the other tranches of notes and certain other fees and expenses are paid.

The CLO Funds are primarily financed via capital contributed by subordinated noteholders and debt holders. Other than any investment in warehouse facilities in connection with the formation of a new CLO Fund, the Asset Manager Affiliates' risk with respect to each investment in the CLO Funds they manage is limited to any uncollected management fees (as the Asset Manager Affiliates have no investment in the CLO Funds they have no exposure or benefits in the ownership of the CLO Funds securities). Therefore, the gains

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

3. CLO FUNDS – (continued)

or losses of the CLO Funds have not had a significant impact on the Asset Manager Affiliates' financial position, results of operations or cash flows. The Asset Manager Affiliates have no right to the benefits from, nor do they bear the risks associated with, these investments, beyond the management fees generated from the CLO Funds. If the Asset Manager Affiliates were to liquidate, these investments would not be available to any general creditors of the Asset Manager Affiliates. Additionally, the collateral assets of consolidated CLO Funds are held solely to satisfy the obligations of the CLO Funds, and the investors in the consolidated CLO Funds have no recourse to the general credit of the Asset Manager Affiliates for the notes issued by the CLO Funds.

CLO Funds are investment vehicles created for the sole purpose of issuing collateralized loan instruments that offer investors the opportunity for returns that vary with the risk level of their investment. The securities issued by the CLO Funds are backed by diversified collateral asset portfolios consisting primarily of loans. For managing the collateral for the CLO Fund entities, the Asset Manager Affiliates earn investment management fees, including senior subordinated management fees, as well as contingent incentive fees. The Asset Manager Affiliates have no investment in the CLO Funds they manage. However, their sole direct or indirect shareholder, KCAP Financial, has invested in certain of the CLO Funds, generally taking a portion of the unrated, junior subordinated position (generally subordinated to other interests in the entities and entitle KCAP Financial and other subordinated tranche investors to receive the residual cash flows, if any, from the entities).

Upon adoption of guidance encompassed in ASC Topic 810, the Asset Manager Affiliates determined that they were the primary beneficiary of these CLO Funds, as they have the power to direct the activities of the CLO Funds that most significantly impact the CLO Funds' economic performance, and the obligation to absorb losses/right to receive benefits (in the form of senior and subordinate management fees as well as the potential to earn an incentive fee) from the CLO Funds that could potentially be significant to the CLO Funds. The primary beneficiary assessment includes an analysis of the rights of the Asset Manager Affiliates in their capacity as investment manager. In certain CLOs, the Asset Manager Affiliates' role as investment manager provides that the Asset Manager Affiliates contractually have the power, as defined in ASC Topic 810, to direct the activities of the CLO Funds that most significantly impact the CLO Funds' economic performance, such as managing the collateral portfolio and its credit risk. Additionally, the primary beneficiary assessment includes an analysis of the Asset Manager Affiliates' rights to receive benefits and obligations to absorb losses associated with its management/incentive fees.

As a manager of the CLO Funds, the Asset Manager Affiliates receive contractual and recurring management fees and may receive a one-time structuring fee from the CLO Funds for their management and advisory services. The annual fees which the Asset Manager Affiliates receive are generally based on a fixed percentage of assets under management (at par value and not subject to changes in market value), and the Asset Manager Affiliates generate annual operating income equal to the amount by which their fee income exceeds their operating expenses. The management fees the Asset Manager Affiliates receive may have three components — a senior management fee, a subordinated management fee and an incentive fee.

Fair value of consolidated CLO Funds

The investments held by consolidated CLO Funds are primarily invested in senior secured bank loans (typically syndicated by banks), bonds, and equity securities. Bank loan investments, which comprise the majority of consolidated CLO Fund portfolio collateral, are senior secured corporate loans from a variety of industries, including but not limited to the aerospace and defense, broadcasting, technology, utilities, household products, healthcare, oil and gas, and finance industries. These investments mature at various dates between 2016 and 2023, pay interest at LIBOR plus a spread of up to 10%, and typically range in credit rating categories from AA down to unrated. At December 31, 2015, the unpaid par principal balance exceeded the fair value by approximately $152.7 million. Less than 1% of the collateral assets are in default as of December 31, 2015. At December 31, 2014, the unpaid par principal balance exceeded the fair value by approximately $71.4 million. Less than 1% of the collateral assets were in default as of December 31, 2014.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

3. CLO FUNDS – (continued)

CLO Fund investments are valued based on price quotations provided by an independent third-party pricing source which are indicative of traded prices and/or dealer price quotations. In the event that a third-party pricing source is unable to price an investment, other relevant factors, data and information are considered, including: i) information relating to the market for the investment, including price quotations for and trading in the investment and interests in similar investments and the market environment and investor attitudes towards the investment and interests in similar investments; ii) the characteristics of and fundamental analytical data relating to the investment, including the cost, size, current interest rate, period until next interest rate reset, maturity and base lending rate, the terms and conditions of the loan and any related agreements, and the position of the loan in the issuer's debt structure; iii) the nature, adequacy and value of the senior secured corporate loan's collateral, including the CLO's rights, remedies and interests with respect to the collateral; iv) the creditworthiness of the borrower, based on an evaluation of its financial condition, financial statements and information about the business, cash flows, capital structure and future prospects; v) the reputation and financial condition of the agent and any intermediate participants in the senior secured corporate loan; and vi) general economic and market conditions affecting the fair value of the senior secured corporate loan.

CLO Fund liabilities issued by consolidated CLO Funds have stated maturity dates between 2021 and 2027. The CLO Fund liabilities are issued in various tranches with different risk profiles and ratings. The interest rates are generally variable rates based on LIBOR plus a pre-defined spread, which varies from 0.25% for the more senior tranches to 6.25% for the more subordinated tranches. At December 31, 2015, the outstanding par balance on the CLO Fund liabilities issued by consolidated CLO Funds exceeded their fair value by approximately $232 million. At December 31, 2014, the outstanding par balance on the CLO Fund liabilities issued by consolidated CLO Funds exceeded their fair value by approximately $257 million. The investors in the CLO Fund liabilities have no recourse to the general credit of the Asset Manager Affiliates. CLO Fund liabilities are recorded at fair value using an income approach, driven by cash flows expected to be received from the portfolio collateral assets. Market yields, default rates and recovery rates used in the Asset Manager Affiliates' estimate of fair value vary based on the nature of the investments in the underlying collateral pools. In periods of rising market yields, default rates and lower debt recovery rates, the fair value, and therefore the carrying value, of the liabilities may be adversely affected. Once the undiscounted cash flows of the collateral assets have been determined, the Asset Manager Affiliates apply appropriate discount rates that a market participant would use, to determine the discounted cash flow valuation of the notes.

The carrying value of investments held and CLO Fund liabilities issued by CLO Funds is also their fair value. The following table presents the fair value hierarchy levels of investments held and CLO Fund liabilities issued by the CLO Funds, which are measured at fair value as of December 31, 2015 and December 31, 2014:

	December 31, 2015			
($ in millions)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
Assets:				
Investments of CLO Funds	$ 2,563.7	$ —	$ —	$ 2,563.7
Liabilities:				
CLO Fund Liabilities	$ 2,649.1	$ —	$ —	$ 2,649.1

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ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

3. CLO FUNDS – (continued)

($ in millions)	December 31, 2014 Fair Value	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
Assets:				
Investments of CLO Funds	$ 2,846.7	$ —	$ —	$ 2,846.7
Liabilities:				
CLO Fund Liabilities	$ 2,990.2	$ —	$ —	$ 2,990.2

The following table shows a reconciliation of the beginning and ending fair value measurements for Level 3 assets using significant unobservable inputs:

($ in millions)	For the year ended December 31, 2015	2014
Beginning balance	$ 2,846.7	$ 2,964.2
Purchase of investments	1,033.2	1,262.3
Proceeds from sale and redemption of investments	(1,195.2)	(1,318.9)
Realized and unrealized losses, net	(121.0)	(60.9)
Ending balance	$ 2,563.7	$ 2,846.7
Changes in unrealized appreciation (depreciation) included in earnings related to investments still held at reporting date	$ (95.4)	$ (62.2)

As of December 31, 2015, the Asset Manager Affiliates' Level III portfolio investments had the following valuation techniques and significant inputs:

Type	Fair Value	Valuation Technique	Unobservable inputs	Range of Inputs
Debt Securities				
	$ 49,843,198	Income Approach	Implied Effective Discount Rate	4.93% – 11.43%
	$2,497,983,775	Market Quote	Third-Party Bid-Ask Mid	10.8% – 101.0%
	$ 326		Option Value	0.4%
Equity Securities	$ 3,478,091	Market Quote	Third-Party Bid-Ask Mid	$0.128 – $23.505
CLO Fund Securities	$ 12,360,525	Discounted Cash Flow	Discount Rate	3.82% – 5.89%

The following table shows a reconciliation of the beginning and ending fair value measurements for Level III liabilities using significant unobservable inputs:

($ in millions)	For the year ended December 31, 2015	2014
Beginning balance	$ 2,990.2	$ 3,079.8
Issuance of CLO Fund Liabilities	460.4	918.7
Prepayments, amortization, net	(694.6)	(974.5)
Unrealized depreciation	(106.9)	(33.8)
Ending balance	$ 2,649.1	$ 2,990.2
Changes in unrealized appreciation (depreciation) included in earnings related to liabilities still held at reporting date	$ 70.7	$ (40.0)

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

3. CLO FUNDS – (continued)

As of December 31, 2015, the Asset Manager Affiliates' Level III liabilities had the following valuation technique and significant inputs:

Asset Type	Fair Value	Valuation Technique	Unobservable Inputs	Range of Inputs
CLO Fund Liabilities	$2,649,104,285	Discounted Cash Flow	Discount Rate	2.10% – 11.25%

Transfers between levels, if any, are recognized at the beginning of the year in which the transfers occur. ASC 820-10 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable.

The CLO Funds managed by the Asset Manager Affiliate and that are consolidated herein, have issued rated and unrated securities to finance their operations. CLO Fund Liabilities are presented at fair value with the difference between principal and fair value recorded as unrealized gain/loss. The par amount of CLO Fund liabilities is approximately $2.9 billion and $3.2 billion respectively as of December 31, 2015 and December 31, 2014.

The Asset Manager Affiliates have determined that, although the junior tranches have certain characteristics of equity, they should be accounted for and disclosed as debt on the its Combined Balance Sheet, as the subordinated and income notes and preferred shares have a stated maturity indicating a date for which they are mandatorily redeemable. The preference shares are also classified as debt, as they are mandatorily redeemable upon liquidation or termination of the CLO.

The Asset Manager Affiliates' risk with respect to the CLO Funds is limited to any uncollected management fees. The Asset Manager Affiliates have no right to the benefits from, nor do they bear the risks associated with, the CLO Funds, beyond the management fees generated by the CLO Funds. If the Asset Manager Affiliates were to liquidate, the CLO Funds would not be available to the general creditors of the Asset Manager Affiliates. Additionally, the Investments of the CLO Funds are held solely to satisfy the obligations of the CLO Funds, and the investors in the consolidated CLO Funds have no recourse to the general credit of the Asset Manager Affiliates for the CO Fund liabilities.

4. BUSINESS COMBINATION

On February 29, 2012, KCAP Financial, Inc. (the "Company") and Commodore Holdings, L.L.C., a newly-formed, wholly-owned subsidiary of the Company ("Commodore"), acquired all of the outstanding equity interests in Trimaran for $13.0 million in cash and 3,600,000 shares of the Company's common stock, par value $0.01 per share, which were valued at the opening price on the closing date of the acquisition. Contemporaneously with the acquisition, the Company acquired the equity interests in four CLO Funds sponsored by Trimaran, at fair value, for $12.0 million in cash. The aggregate purchase price was $50.6 million.

In accordance with the purchase agreement, Commodore was deemed the acquirer of Trimaran and accounted for the acquisition as a business combination. The assets acquired (no liabilities were assumed) by Commodore through this acquisition were "pushed-down" to Trimaran. The purchase price allocation included the fair value of the identifiable intangible assets acquired, which consist of four CLO management contracts, of approximately $15.7 million, resulting in goodwill of $22.8 million. The CLO management contracts are being amortized over the estimated lives of the contracts (3-5 years). For the years ended December 31, 2015, 2014 and 2013, the Company recognized amortization expense of approximately $2.3 million, $5.3 million and $3.5 million, respectively, relating to the management contracts, which resulted in a net carrying amount of $1.6 million, $3.9 million and $9.2 million as of December 31, 2015, 2014 and 2013, respectively. Additionally, one managed CLO Fund was called in 2015 and as a result, the remaining unamortized intangible asset of $599,000 was fully expensed. During 2014, two managed CLO Funds were called, and as a

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

4. BUSINESS COMBINATION – (continued)

result the remaining unamortized intangible asset of $1.7 million was fully expensed. The following table summarizes future amortization amounts relating to the Trimaran VII management contract as of December 31, 2015:

Year	Expected Amortization
2016	$ 1,310,164
2017	327,541
Total	$ 1,637,705

Trimaran, a taxable entity (corporation), has recognized the acquisition as an asset acquisition for tax purposes. The book and tax basis of the intangible assets and goodwill were identical; accordingly, Trimaran did not provide for any deferred taxes at the closing date of the acquisition. The tax basis of the intangible assets and goodwill will be amortized over 15 years, which gives rise to deferred taxes.

Trimaran will continue operating as a stand-alone entity and serve as collateral manager under its CLO management contracts. KDA is a 100% owned asset manager subsidiary of the Company. KDA and Trimaran are both under common control of the Company and have similar business characteristics; therefore they report on a combined basis for financial reporting purposes.

5. INCOME TAXES

As separately regarded entities for tax purposes, the Asset Manager Affiliates are taxed at normal corporate rates. The CLO Funds are not generally taxed.

For tax purposes, the Asset Manager Affiliates taxable net income will differ from GAAP net income because of deferred tax timing adjustments and permanent tax adjustments. Deferred tax timing adjustments may include differences for the recognition and timing of depreciation, bonuses to employees and restricted stock expense. Permanent differences may include adjustments, limitations or disallowances for meals and entertainment expenses, penalties, and tax goodwill amortization.

Goodwill amortization for tax purposes was created upon the purchase of 100% of the equity interests in Katonah Debt Advisors by its sole member, KCAP Financial, in exchange for shares of the KCAP Financial's stock valued at $33 million. Although this transaction was a stock transaction rather than an asset purchase and thus no goodwill was recognized for GAAP purposes, such exchange was considered an asset purchase under Section 351(a) of the Code. At the time of the transfer, Katonah Debt Advisors had equity of approximately $1 million resulting in tax goodwill of approximately $32 million which is being amortized for tax purposes on a straight-line basis over 15 years, which accounts for an annual difference between GAAP income and taxable income by approximately $2 million per year over such period.

As discussed in Note 4, additional goodwill amortization for tax purposes was created upon the purchase of Trimaran Advisors by its sole member. The transaction was considered an asset purchase and resulted in tax goodwill of approximately $22.8 million which is being amortized for tax purposes on a straight-line basis over 15 years, which accounts for an annual difference between GAAP income and taxable income by approximately $1.5 million per year over such period.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

5. INCOME TAXES – (continued)

The components of income tax expense (benefit) for the years ended December 31, 2015, 2014, and 2013 are as follows:

	For the year ended December 31,		
	2015	2014	2013
Current income tax expense:			
Federal	$ 1,290,664	$ 2,792,440	$ 508,874
State & local	125,443	2,370,115	292,533
Total net current income tax expense	1,416,107	5,162,555	801,407
Deferred income tax expense (benefit):			
Federal	3,250,138	(590,934)	(1,883,479)
State & local	975,980	(418,023)	424,735
Total net deferred income tax expense (benefit)	4,226,118	(1,008,957)	(1,458,744)
Total income tax expense (benefit)	$ 5,642,225	$ 4,153,598	$ (657,337)

The Asset Manager Affiliates' effective income tax rate was (11.2)%, 5.6% and (4.8)% for tax years 2015, 2014 and 2013, respectively. The difference between the Company's reported provision for income taxes and the U.S. federal statutory rate of 35% is primarily due to tax goodwill amortization, the CLO funds having no tax consequences, and a valuation allowance was established during the year.

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the combined financial statements. These temporary differences result in taxable or deductible amounts in future years.

The components of deferred income tax assets and liabilities are shown below:

	For the year ended December 31,	
	2015	2014
Deferred income tax assets:		
Restricted stock	$ 481,847	$ 380,138
Intangible depreciation/amortization	3,524,376	1,887,774
Compensation	1,092,024	1,505,045
Other	79,399	102,335
Less: Valuation allowance	(3,630,872)	—
Total deferred tax assets	(1,546,775)	3,875,292
Deferred income tax liabilities:		
Amortization of Goodwill	(2,144,287)	
Other	(52,457)	(299,144)
Total deferred tax liabilities	(2,196,745)	(299,144)
Net deferred tax (liabilities) assets	$ (649,970)	$ 3,576,148

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible. If it is not more likely than not that some portion or all of the gross deferred income tax assets will be realized in future years, a valuation allowance is recorded.

At December 31, 2015 and 2014 the Asset Manager Affiliates had no federal or state net loss carryovers available to offset future taxable income.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

5. INCOME TAXES – (continued)

Asset Manager Affiliates adopted Financial Accounting Standards Board ASC Topic 740 Accounting for Uncertainty in Income Taxes (“ASC 740”) as of January 1, 2009. ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the tax returns to determine whether the tax positions are “more-likely-than-not” of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. The Asset Manager Affiliates has not recorded a liability for any unrecognized tax benefits nor are they aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will change materially in the next 12 months.

Management’s determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an ongoing analysis of tax laws, regulations and interpretations thereof. With a few exceptions, the Asset Manager Affiliates are no longer subject to U.S. federal, state and local tax examinations by tax authorities for years prior to 2012.

6. COMMITMENTS AND CONTINGENCIES

The CLO Funds have no commitments to fund investments as of December 31, 2015, and had approximately $1.1 million as of December 31, 2014, respectively. The Asset Manager Affiliates have commitments under lease obligations.

Rent expense was approximately $360,000, $277,000 and $346,000 for the years ended December 31, 2015, 2014 and 2013, respectively.

The following table summarizes minimum future lease payments as of December 31, 2015:

Contractual Obligations	2016	2017	2018	2019	2020	More than 5 years
Operating lease obligations	$ 369,432	$ 369,432	$ 369,432	$ 387,391	$ 400,218	$ 1,367,412

The following table summarizes our long-term debt as of 2015:

Consolidated Variable Interest Entities Debt:	Carrying Value	Current Weighted Average Borrowing Rate	Weighted Average Remaining Maturity (In years)
CLO Debt(1)	$ 2,649,104,285	2.19%	9.18

The following table summarizes our long-term debt as of 2014:

Consolidated Variable Interest Entities Debt:	Carrying Value	Current Weighted Average Borrowing Rate	Weighted Average Remaining Maturity (In years)
CLO Debt(1)	$ 2,990,211,629	1.77%	8.32

(1) Long-term debt of the VIEs is recorded at fair value. This includes the fair value of the subordinated notes issued by the VIEs. However, the subordinated notes do not have a stated interest rate and are therefore excluded from the calculation of the weighted average borrowing rate. The par value of the VIEs debt (excluding subordinated notes) was $2.7 billion and $2.8 billion as of December 31, 2015 and 2014, respectively.

7. MEMBER’S EQUITY

The member interests of the Asset Manager Affiliates is held solely by KCAP Financial. KCAP Financial owns 100% of Katonah Debt Advisors, Katonah 2007-1 Management, LLC, Katonah X Management, LLC and Commodore Holdings, which wholly owns Trimaran Advisors, and Trimaran Advisors Management.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

8. OTHER EMPLOYEE COMPENSATION

The Asset Manager Affiliates adopted a 401(k) plan (“401K Plan”) effective January 1, 2007 that it shares with its sole shareholder, KCAP Financial. The 401K Plan is open to all full time employees. The Plan permits an employee to defer a portion of their total annual compensation up to the Internal Revenue Service annual maximum based on age and eligibility. The Asset Manager Affiliates make contributions to the 401K Plan of up to 2.67% of the employee’s first 74.9% of maximum eligible compensation, which vests 20% per year over five years. For the year ended December 31, 2015, 2014 and 2013, Asset Manager Affiliates made contributions to the 401K Plan of approximately $38,000, $38,000 and $102,000 respectively.

The Asset Manager Affiliates also adopted a deferred compensation plan (“Profit-Sharing Plan”) effective January 1, 2007. Employees are eligible for the Profit-Sharing Plan provided that they are employed and working with the Asset Manager Affiliates for at least 100 days during the year and remain employed as of the last day of the year. Employees do not make contributions to the Profit-Sharing Plan. The Asset Manager Affiliates may contribute to the Profit-Sharing Plan 1) up to 8.0% of all compensation up to the Internal Revenue Service annual maximum and 2) up to 5.7% excess contributions on any incremental amounts above the social security wage base limitation and up to the Internal Revenue Service annual maximum. Employees vest 100% in the Profit-Sharing Plan after five years of service. For the years ended December 31, 2015, 2014 and 2013, the Asset Manager Affiliates made contributions of approximately $394,000, $396,000 and $315,000 to the Profit-Sharing Plan, respectively.

Certain employees of Asset Manager Affiliates may receive restricted stock grants in the stock of Asset Manager Affiliates’ sole member, KCAP Financial. For the years ended December 31, 2015, 2014 and 2013, non-cash compensation expense of approximately $897,000, $589,000 and $252,000 respectively, was expensed at Asset Manager Affiliates related to an allocated reimbursable expense for a grant of restricted stock of KCAP Financial.

9. RELATED PARTY TRANSACTION

On February 26, 2013, the Company entered into a senior credit agreement (the “Trimaran Credit Facility”) with Trimaran Advisors, pursuant to which Trimaran Advisors may borrow from time to time up to $20 million from the Company in order to provide capital necessary to support one or more of Trimaran Advisors’ warehouse lines of credit and/or working capital in connection with Trimaran Advisors’ warehouse activities. The Trimaran Credit Facility expires on November 20, 2017 and bears interest at an annual rate of 9.0%. On April 15, 2013, the Trimaran Credit Facility was amended and increased from $20 million to $23 million. At both December 31, 2015 and 2014, there was $23 million outstanding under the Trimaran Credit Facility. Interest expense on this facility was $1.7 million, $2.0 million and $1.5 million for the years ending December 31, 2015, 2014 and 2013, respectively.

10. SUBSEQUENT EVENTS

On March 7, 2016, Trimaran Advisors, LLC repaid $7.0 million of principal value of borrowings under the Trimaran Credit Facility.

The Company has evaluated events and transactions through March 9, 2016, which is the date the financial statements were issued for items that should potentially be recognized or disclosed in these financial statements. Other than described above, management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these consolidated financial statements.

Report of Independent Auditors

The Board of Directors and Shareholders of
Katonah 2007-I CLO Ltd.

We have audited the accompanying financial statements of Katonah 2007-I CLO Ltd. (the "Fund"), which comprise the statements of net assets, including the schedules of investments, as of December 31, 2015 and 2014, and the related statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Katonah 2007-I CLO Ltd. at December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

New York, NY
March 9, 2016

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Shareholders
KCAP Financial, Inc.

We have audited the accompanying financial statements of Katonah 2007-I CLO Ltd., which comprise the statement of net assets, including the schedule of investments, as of December 31, 2013 (not included herein), and the related statements of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Katonah 2007-I CLO Ltd. as of December 31, 2013 and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP

New York, New York
March 12, 2014

KATONAH 2007-I CLO LTD.

STATEMENTS OF NET ASSETS

	As of December 31, 2015	As of December 31, 2014
ASSETS		
Investments at fair value:		
Debt securities	$234,403,150	$ 259,163,759
Equity securities	2,830	1,649
CLO rated notes	12,360,525	14,208,540
Total investments at fair value	246,766,505	273,373,948
Cash	17,301,178	14,939,994
Accrued interest receivable	501,574	631,388
Receivable for open trades	820,593	—
Total assets	$265,389,850	$ 288,945,330
LIABILITIES		
CLO Fund liabilities at fair value	$261,433,473	$ 290,699,426
Accrued interest payable	1,565,632	1,835,809
Payable for open trades	6,006,038	—
Accounts payable and accrued expenses	154,079	184,636
Due to affiliates	3,889	10,852
Total liabilities	269,163,111	292,730,723
Commitments and Contingencies	—	—
NET ASSETS		
Total net assets	$ (3,773,261)	$ (3,785,393)

See accompanying notes to the financial statements.

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KATONAH 2007-I CLO LTD.

STATEMENTS OF OPERATIONS

	For the Years Ended December 31, 2015	2014	2013
Income			
Interest income from investments	$ 10,178,631	$ 11,690,586	$ 12,591,277
Interest income from cash and time deposits	1,288	1,922	2,761
Other income	425,490	32,346	652,959
Total income	10,605,409	11,724,854	13,246,997
Expenses			
Interest expense	9,146,858	10,736,878	11,758,985
Management fees	714,061	805,526	811,758
Trustee fees	77,443	109,164	89,309
Professional fees	180,463	178,954	143,068
Administrative and other	86,528	125,224	73,964
Total expenses	10,205,353	11,955,746	12,877,084
Net realized and unrealized losses	(387,924)	(9,089,440)	(3,169,825)
Increase/(Decrease) in net assets resulting from operations	$ 12,132	$ (9,320,332)	$ (2,799,912)

See accompanying notes to the financial statements.

KATONAH 2007-I CLO LTD.

STATEMENTS OF CHANGES IN NET ASSETS

	Net Assets
Balance at January 1, 2013	**$ 8,334,851**
Decrease in net assets resulting from operations	(2,799,912)
Balance at January 1, 2014	**5,534,939**
Decrease in net assets resulting from operations	(9,320,332)
Balance at December 31, 2014	**(3,785,393)**
Increase in net assets resulting from operations	12,132
Balance at December 31, 2015	**$(3,773,261)**

See accompanying notes to the financial statements.

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KATONAH 2007-I CLO LTD.

STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2015	2014	2013
OPERATING ACTIVITIES:			
Increase/(Decrease) in net assets resulting from operations	$ 12,132	(9,320,332)	$ (2,799,912)
Adjustments to reconcile increase/(decrease) in net assets resulting from operations to net cash provided by operating activities:			
Net realized and unrealized losses (gains) on investments	6,651,428	5,807,622	(909,471)
Change in unrealized (gains) loss on debt	(6,263,504)	3,281,818	4,079,296
Purchase of investments	(93,243,381)	(29,960,071)	(116,281,142)
Proceeds from sale and redemption of investments	113,199,395	61,206,288	117,165,606
Changes in operating assets and liabilities:			
Decrease in accrued interest receivable	129,814	43,523	62,712
(Decrease)/increase in accounts payable and accrued expenses	(37,520)	10,366	(10,580)
Increase in receivable for open trades	(820,593)	—	—
Decrease in due from affiliates	—	10,852	—
Increase/(decrease) in payable for open trades	6,006,038	(4,013,750)	1,043,750
Decrease in accrued interest expense	(270,176)	(254,559)	(108,626)
Net cash provided by operating activities	25,363,633	26,811,757	2,241,633
Cash used in Financing Activities:			
Repayments of Debt	(23,002,449)	(27,132,006)	—
	(23,002,449)	(27,132,006)	—
CHANGE IN CASH	2,361,184	(320,249)	2,241,633
CASH, BEGINNING OF YEAR	14,939,994	15,260,243	13,018,610
CASH, END OF YEAR	$ 17,301,178	14,939,994	$ 15,260,243
Supplemental Information:			
Interest paid	$ 9,417,035	10,991,437	$ 11,867,611

See accompanying notes to the financial statements.

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Katonah 2007-I CLO Ltd.

SCHEDULE OF INVESTMENTS
As of December 31, 2015

Debt Securities Portfolio

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
AdvancePierre Foods, Inc. *Beverage, Food and Tobacco*	Term Loan (First Lien) — 5.8% Cash, Due 7/17	$2,469,655	$2,484,379	$ 2,465,790
Allison Transmission, Inc. *Automobile*	Term B-3 Loan — 3.5% Cash, Due 8/19	4,720,274	4,688,227	4,698,160
Aramark Corporation *Diversified/Conglomerate Service*	U.S. Term F Loan — 3.3% Cash, Due 2/21	2,526,481	2,443,445	2,506,484
Armstrong World Industries, Inc.[3] *Buildings and Real Estate*[3]	Term Loan B — 3.5% Cash, Due 3/20	972,500	972,500	967,638
Ascena Retail Group, Inc. (Anntaylor Retail, Inc.) *Retail Stores*	Tranche B Term Loan — 5.3% Cash, Due 8/22	2,000,000	1,846,016	1,880,000
Asurion, LLC (fka Asurion Corporation) *Insurance*	Incremental Tranche B-1 Term Loan — 5.0% Cash, Due 5/19	1,121,067	1,095,258	1,053,456
Avis Budget Car Rental, LLC *Personal Transportation*	Tranche B Term Loan — 3.0% Cash, Due 3/19	1,544,939	1,534,683	1,543,324
Belfor USA Group Inc. *Ecological*	Tranche B Term Loan — 3.8% Cash, Due 4/19	1,611,699	1,615,203	1,601,626
Berry Plastics Corporation *Containers, Packaging and Glass*	Term E Loan — 3.8% Cash, Due 1/21	2,591,612	2,507,141	2,559,386
Burlington Coat Factory Warehouse Corporation *Retail Stores*	Term B-3 Loan — 4.3% Cash, Due 8/21	2,321,888	2,290,743	2,298,669
Capital Automotive L.P. *Finance*	Tranche B-1 Term Loan Facility — 4.0% Cash, Due 4/19	1,267,378	1,260,465	1,268,170
Capsugel Holdings US, Inc. *Healthcare, Education and Childcare*	Initial Term Loan — 3.5% Cash, Due 8/18	721,164	719,601	710,123
Cedar Fair, L.P. *Leisure, Amusement, Motion Pictures, Entertainment*	U.S. Term Facility — 3.3% Cash, Due 3/20	966,429	964,983	969,449
Celanese US Holdings LLC *Chemicals, Plastics and Rubber*	Dollar Term C-3 Loan — 2.5% Cash, Due 10/18	1,251,599	1,214,068	1,254,509
Cequel Communications, LLC *Broadcasting and Entertainment*	Term Loan — 3.8% Cash, Due 2/19	1,879,918	1,871,491	1,854,070
Charter Communications Operating, LLC (aka CCO Safari LLC) *Broadcasting and Entertainment*	Term F Loan — 3.0% Cash, Due 1/21	1,483,706	1,475,779	1,457,370
CHS/Community Health Systems, Inc. *Healthcare, Education and Childcare*	Incremental 2018 Term F Loans — 3.7% Cash, Due 12/18	1,209,226	258,686	1,195,368
CHS/Community Health Systems, Inc. *Healthcare & Pharmaceuticals*	Incremental 2019 Term G Loan — 3.8% Cash, Due 12/19	1,062,209	1,059,907	1,038,145
CHS/Community Health Systems, Inc. *Healthcare, Education and Childcare*	Incremental 2021 Term H Loan — 4.0% Cash, Due 1/21	2,160,738	2,137,064	2,131,415
Ciena Corporation *Electronics*	Term Loan — 3.8% Cash, Due 7/19	2,977,387	2,992,956	2,953,195
Commscope, Inc. *Telecommunications*	Tranche 4 Term Loan — 3.3% Cash, Due 1/18	261,875	262,083	261,057
Consolidated Communications, Inc. *Telecommunications*	Initial Term Loan — 4.3% Cash, Due 12/20	2,917,802	2,898,785	2,903,227
Container Store, Inc., The *Retail Stores*	Term Facility — 4.3% Cash, Due 4/19	1,678,935	1,682,649	1,553,015
ConvaTec Inc. *Healthcare, Education and Childcare*	Dollar Term Loan — 4.3% Cash, Due 6/20	1,162,658	1,165,259	1,145,223
Crown Castle Operating Company[3] *Buildings and Real Estate*[3]	Extended Incremental Tranche B-2 Term Loan — 3.0% Cash, Due 1/21	2,888,746	2,878,350	2,881,235
David's Bridal, Inc. *Retail Stores*	Initial Term Loan — 5.3% Cash, Due 10/19	477,723	475,142	397,942

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
Dealer Computer Services, Inc. (Reynolds & Reynolds) *Electronics*	Tranche B Term Loan Retired 02/10/2016 — 2.4% Cash, Due 4/16	$2,242,828	$2,242,828	$ 2,242,827
Delta 2 (Lux) S.a r.l (aka Formula One) *Leisure, Amusement, Motion Pictures, Entertainment*	Facility B3 (USD) — 4.8% Cash, Due 7/21	3,421,774	3,400,280	3,319,121
Delta Air Lines, Inc. *Personal Transportation*	2014 Term B-2 Loan — 2.7% Cash, Due 4/16	3,402,908	3,406,970	3,397,583
Dex Media West LLC *Printing and Publishing*	New Term Loan — 8.0% Cash, Due 12/16	695,444	692,438	379,017
DJO Finance LLC *Healthcare, Education and Childcare*	Initial Term Loan — 4.3% Cash, Due 6/20	1,955,250	1,980,808	1,908,813
Drumm Investors LLC (aka Golden Living) *Healthcare, Education and Childcare*	Term Loan — 6.8% Cash, Due 5/18	3,731,318	3,718,832	3,689,341
Education Management II LLC[2] *Healthcare, Education and Childcare*	Tranche A Term Loan — 5.5% Cash, Due 7/20	200,289	201,304	50,071
Education Management II LLC[2] *Healthcare, Education and Childcare*	Tranche B Term Loan — 8.5% Cash, Due 7/20	350,666	352,357	37,872
Envigo Laboratories, Inc. (fka BPA Laboratories Inc.) *Healthcare, Education and Childcare*	Term Loan (First Lien) — 2.8% Cash, Due 7/17	1,743,896	1,663,494	1,409,286
Envigo Laboratories, Inc. (fka BPA Laboratories Inc.) *Healthcare, Education and Childcare*	Term Loan (Second Lien) — 2.8% Cash, Due 7/17	1,516,318	1,446,409	1,232,009
Essential Power, LLC *Utilities*	Term Loan — 4.8% Cash, Due 8/19	932,448	925,235	921,668
FCA US LLC (fka Chrysler Group LLC) *Automobile*	Term Loan B — 3.5% Cash, Due 5/17	3,067,549	2,960,527	3,061,797
Federal-Mogul Corporation *Automobile*	Tranche B Term Loan (2014) — 4.0% Cash, Due 4/18	1,566,456	1,529,147	1,415,191
Fender Musical Instruments Corporation *Personal and Non Durable Consumer Products (Mfg. Only)*	Initial Loan — 5.8% Cash, Due 4/19	1,884,150	1,874,862	1,867,664
First Data Corporation *Banking, Finance, Insurance & Real Estate*	2018 New Dollar Term Loan — 3.9% Cash, Due 3/18	2,903,500	2,900,493	2,870,632
First Data Corporation *Banking, Finance, Insurance & Real Estate*	New 2022B Dollar Term Loan — 4.2% Cash, Due 7/22	2,546,500	2,546,500	2,513,714
Gardner Denver, Inc. *Machinery (Non-Agriculture, Non-Construction, Non-Electronic)*	Initial Dollar Term Loan — 4.3% Cash, Due 7/20	2,232,868	2,184,383	2,016,838
General Nutrition Centers, Inc. *Retail Stores*	Amended Tranche B Term Loan — 3.3% Cash, Due 3/19	870,762	873,222	848,997
Getty Images, Inc. *Printing and Publishing*	Initial Term Loan — 4.8% Cash, Due 10/19	2,910,000	2,894,196	1,847,850
Harland Clarke Holdings Corp. (fka Clarke American Corp.) *Printing and Publishing*	Tranche B-2 Term Loan — 5.9% Cash, Due 6/17	2,414,520	2,417,333	2,342,084
Harland Clarke Holdings Corp. (fka Clarke American Corp.) *Printing and Publishing*	Tranche B-3 Term Loan — 7.0% Cash, Due 5/18	943,396	943,396	940,472
HCA Inc. *Healthcare, Education and Childcare*	Tranche B-4 Term Loan — 3.4% Cash, Due 5/18	2,932,500	2,893,337	2,932,515
HCR Healthcare, LLC *Healthcare, Education and Childcare*	Initial Term Loan — 5.0% Cash, Due 4/18	476,250	474,710	452,142
Hertz Corporation, The *Personal Transportation*	Tranche B-1 Term Loan — 3.8% Cash, Due 3/18	3,894,660	3,894,343	3,891,252
Hertz Corporation, The *Personal Transportation*	Tranche B-2 Term Loan — 3.0% Cash, Due 3/18	953,050	950,930	946,198
Huntsman International LLC *Chemicals, Plastics and Rubber*	2015 Extended Term B Dollar Loan — 3.3% Cash, Due 4/19	2,719,781	2,610,970	2,678,304
Ineos US Finance LLC *Chemicals, Plastics and Rubber*	2020 Dollar Term Loan — 3.8% Cash, Due 12/20	6,376,839	6,398,337	6,137,707
Infor (US), Inc. (fka Lawson Software Inc.) *Electronics*	Tranche B-5 Term Loan — 3.8% Cash, Due 6/20	2,352,008	2,363,429	2,214,321

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
Integra Telecom Holdings, Inc. *Telecommunications*	Term B-1 Loan — 5.3% Cash, Due 8/20	$ 416,454	$ 417,393	$ 404,377
International Architectural Products, Inc.[2] *Mining, Steel, Iron and Non-Precious Metals*	Term Loan — 0.0% Cash, Due 5/15	81,467	81,467	326
J. Crew Group, Inc. *Retail Stores*	Initial Loan — 4.0% Cash, Due 3/21	3,880,774	3,883,610	2,528,324
Jarden Corporation *Personal and Non Durable Consumer Products (Mfg. Only)*	New Tranche B Term Loan — 3.0% Cash, Due 3/18	4,769,734	4,749,934	4,773,216
JBS USA, LLC *Beverage, Food and Tobacco*	Initial Term Loan — 3.8% Cash, Due 5/18	861,507	860,028	859,353
JMC Steel Group, Inc. *Mining, Steel, Iron and Non-Precious Metals*	Term Loan — 4.8% Cash, Due 4/17	1,293,564	1,291,965	1,251,524
Jo-Ann Stores, Inc. *Retail Stores*	Term B Loan — 4.0% Cash, Due 3/18	941,546	943,733	885,054
KAR Auction Services, Inc. *Automobile*	Tranche B-1 Term Loan — 3.1% Cash, Due 3/17	679,145	680,354	679,430
KAR Auction Services, Inc. *Automobile*	Tranche B-2 Term Loan — 3.5% Cash, Due 3/21	3,407,047	3,453,066	3,402,788
Key Safety Systems, Inc. *Automobile*	Initial Term Loan — 4.8% Cash, Due 8/21	1,364,058	1,340,031	1,329,956
Kronos Incorporated *Diversified/Conglomerate Service*	Incremental Term Loan (First Lien) — 4.5% Cash, Due 10/19	978,389	975,600	964,941
Landry’s Inc. (fka Landry’s Restaurants, Inc.) *Beverage, Food and Tobacco*	B Term Loan — 4.0% Cash, Due 4/18	1,538,848	1,548,166	1,533,324
Las Vegas Sands, LLC *Hotels, Motels, Inns, and Gaming*	Term B Loan — 3.3% Cash, Due 12/20	3,201,595	3,172,481	3,174,782
Live Nation Entertainment, Inc. *Leisure, Amusement, Motion Pictures, Entertainment*	Term B-1 Loan — 3.5% Cash, Due 8/20	472,878	471,316	472,434
LPL Holdings, Inc. *Finance*	2021 Tranche B Term Loan — 4.3% Cash, Due 3/21	1,930,500	1,921,055	1,901,543
MCC Iowa LLC *Broadcasting and Entertainment*	Tranche J Term Loan — 3.8% Cash, Due 6/21	690,439	680,992	685,046
Mediacom Illinois, LLC (fka Mediacom Communications, LLC) *Broadcasting and Entertainment*	Tranche F Term Loan — 2.9% Cash, Due 3/18	5,895,000	5,886,840	5,801,063
National CineMedia, LLC *Leisure, Amusement, Motion Pictures, Entertainment*	Term Loan (2013) — 3.2% Cash, Due 11/19	1,000,000	995,545	996,250
NBTY, INC. *Personal and Non Durable Consumer Products (Mfg. Only)*	Term B-2 Loan — 3.5% Cash, Due 10/17	3,391,643	3,392,700	3,351,791
NEP/NCP Holdco, Inc. *Broadcasting and Entertainment*	Amendment No. 4 Incremental Term Loan (First Lien) — 4.3% Cash, Due 1/20	2,454,312	2,435,744	2,313,189
Newsday, LLC *Printing and Publishing*	Term Loan — 3.9% Cash, Due 10/16	3,984,627	3,989,720	3,989,608
Nielsen Finance LLC (VNU, Inc.) *Broadcasting and Entertainment*	Class B-1 Term Loan — 2.5% Cash, Due 5/17	5,402,525	5,407,617	5,400,283
NRG Energy, Inc. *Utilities*	Term Loan (2013) — 2.8% Cash, Due 7/18	955,481	954,306	932,191
OCI Beaumont LLC *Chemicals, Plastics and Rubber*	Term B-3 Loan — 6.5% Cash, Due 8/19	2,486,113	2,518,346	2,510,974
Omnova Solutions, Inc. *Chemicals, Plastics and Rubber*	Term B-1 Loan — 4.3% Cash, Due 5/18	359,276	358,928	358,827
Onex Carestream Finance LP *Healthcare, Education and Childcare*	Term Loan (First Lien 2013) — 5.0% Cash, Due 6/19	2,429,369	2,445,779	2,200,608
Pacific Drilling S.A *Oil and Gas*	Term Loan — 4.5% Cash, Due 6/18	2,185,768	2,189,041	961,738
PetCo Animal Supplies, Inc. *Retail Stores*	New Loan Retired 01/26/2016 — 4.0% Cash, Due 11/17	5,328,526	5,297,286	5,321,359

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
Petroleum GEO-Services ASA (PGS Finance, Inc) *Oil and Gas*	Extended Term Loan — 3.3% Cash, Due 3/21	$4,912,500	$4,912,500	$ 3,468,225
PQ Corporation *Chemicals, Plastics and Rubber*	2014 Term Loan — 4.0% Cash, Due 8/17	4,916,982	4,915,840	4,887,013
QCE, LLC (Quiznos)[2] *Personal, Food and Miscellaneous Services*	Existing Term Loan — 0.0% Cash, Due 9/20	449,499	449,486	59,932
Quikrete Holdings, Inc.[3] *Buildings and Real Estate*[3]	Initial Loan (First Lien) — 3.0% Cash, Due 9/20	2,230,000	2,218,850	2,208,748
R.H. Donnelley Inc. *Printing and Publishing*	Loan — 9.8% Cash, Due 4/22	421,935	420,869	181,565
Regal Cinemas Corporation *Leisure, Amusement, Motion Pictures, Entertainment*	Term Loan — 3.8% Cash, Due 11/17	963,677	969,660	962,728
Revlon Consumer Products Corporation *Personal and Non Durable Consumer Products (Mfg. Only)*	Replacement Term Loan — 3.3% Cash, Due 12/18	4,480,361	4,498,987	4,476,150
Reynolds Group Holdings Inc. *Containers, Packaging and Glass*	Incremental U.S. Term Loan — 4.5% Cash, Due 10/17	2,058,619	2,058,619	2,042,109
RGIS Services, LLC *Diversified/Conglomerate Service*	Tranche C Term Loan — 5.5% Cash, Due 11/18	2,597,871	2,569,219	1,850,983
RPI Finance Trust *Healthcare, Education and Childcare*	Term B-3 Term Loan — 3.3% Cash, Due 6/18	2,487,277	2,506,353	2,483,385
Schaeffler AG (formerly named INA Beteiligungsgesellschaft mit beschränkter Haftung) *Automobile*	Facility B-USD — 4.3% Cash, Due 5/20	1,015,385	1,020,391	1,018,685
Select Medical Corporation *Healthcare, Education and Childcare*	Series E Tranche B Term Loan — 5.0% Cash, Due 1/18	2,104,406	2,092,431	2,091,254
Semiconductor Components Industries, LLC (On Semiconductor) *Electronics*	Term Loan — 2.1% Cash, Due 10/21	4,593,750	4,537,373	4,455,938
Sensata Technologies B.V. (Sensata Technologies Finance Company, LLC) *Electronics*	Sixth Amendment Term Loan — 3.0% Cash, Due 4/20	560,135	556,355	551,851
Sinclair Television Group, Inc. *Broadcasting and Entertainment*	New Tranche B Term Loan — 3.0% Cash, Due 9/19	66,983	66,865	65,978
Steinway Musical Instruments, Inc. *Personal and Non Durable Consumer Products (Mfg. Only)*	Loan (First Lien) — 4.8% Cash, Due 3/19	2,000,000	1,985,239	1,972,500
Telesat Canada *Telecommunications*	U.S. Term B-2 Loan — 3.5% Cash, Due 12/17	2,960,078	2,937,884	2,920,605
TPF Generation Holdings, LLC *Utilities*	Term Loan — 4.8% Cash, Due 2/20	188,393	182,268	168,611
TransDigm Inc. *Aerospace and Defense*	Tranche C Term Loan — 3.8% Cash, Due 3/20	3,791,455	3,742,603	3,708,251
Tronox Pigments (Netherlands) B. V. *Chemicals, Plastics and Rubber*	New Term Loan — 4.5% Cash, Due 2/20	$2,499,471	$2,487,925	$ 2,224,005
TWCC Holding Corp. *Broadcasting and Entertainment*	Term B-1 Loan Retired 01/29/2016 — 5.8% Cash, Due 3/20	2,924,754	2,905,902	2,926,318
Univision Communications Inc. *Broadcasting and Entertainment*	Replacement First-Lien Term Loan — 4.0% Cash, Due 12/19	3,239,279	3,218,251	3,176,113
UPC Financing Partnership *Broadcasting and Entertainment*	Facility AH — 3.3% Cash, Due 6/21	700,000	704,142	688,517
Valeant Pharmaceuticals International, Inc. *Healthcare, Education and Childcare*	Series C-2 Tranche B Term Loan — 3.8% Cash, Due 10/19	1,389,000	1,343,190	1,344,205
Vertafore, Inc. *Electronics*	Term Loan (2013) — 4.3% Cash, Due 11/19	892,097	892,097	885,964
VFH Parent LLC *Finance*	Term Loan (2013) — 5.3% Cash, Due 12/20	985,103	994,592	980,177
Walter Investment Management Corp. *Finance*	Tranche B Term Loan — 4.8% Cash, Due 12/19	2,454,158	2,445,426	2,124,393

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
WESCO Distribution, Inc. *Machinery (Non-Agriculture, Non-Construction, Non-Electronic)*	Tranche B-1 Loan — 3.8% Cash, Due 6/18	$ 249,643	$ 248,233	$ 248,551
West Corporation *Diversified/Conglomerate Service*	Term B-10 Loan — 3.3% Cash, Due 7/17	3,776,796	3,756,691	3,722,844
WideOpenWest Finance, LLC *Telecommunications*	Term B-1 Loan 2013 — 3.8% Cash, Due 8/19	4,724,229	4,740,543	4,598,234
Windstream Services, LLC (fka Windstream Corporation) *Telecommunications*	Tranche B-5 Term Loan — 3.5% Cash, Due 2/17	5,954,430	5,954,430	5,801,848
WireCo WorldGroup Inc. *Machinery (Non-Agriculture, Non-Construction, Non-Electronic)*	Term Loan — 6.0% Cash, Due 2/20	1,829,576	1,825,076	1,767,828
Zuffa, LLC *Leisure, Amusement, Motion Pictures, Entertainment*	Initial Term Loan — 3.8% Cash, Due 6/19	2,294,791	2,287,980	2,242,011
Total Investment in Debt Securities		246,578,754	244,325,246	234,403,150

Equity Securities Portfolio

Portfolio Company/Principal Business	Equity Investment	Shares	Cost	Value[2]
Education Management Corporation[2]	Series A-1 Preferred Shares	2,670	$ —	$ 2,670
QCE, LLC (Quiznos)[2]	New Common Stock	1,256	—	160
Total Investment in Equity Securities (100% of net asset value at fair value)			$ —	$ 2,830

CLO Securities Portfolio

Portfolio Company	CLO Investment	Principal	Cost	Value
APID 2007-5A[1] *CLO Rated Notes*	Floating – 04/2021 – D – 03761XAG5	$ 1,000,000	$ 1,000,000	$ 963,108
HLCNL 2007-2A[1] *CLO Rated Notes*	Floating – 04/2021 – D – 40537AAA3	3,000,000	2,968,134	2,902,077
MDPK 2007-4A[1] *CLO Rated Notes*	Floating – 03/2021 – D – 55817UAF7	2,000,000	2,000,000	1,869,623
NAVIG 2007-2A[1] *CLO Rated Notes*	Floating – 04/2021 – D – 63937HAD0	3,000,000	3,000,000	2,910,373
TRAL 2007-1A[1] *CLO Rated Notes*	Floating – 04/2022 – C – 89288BAG6	3,000,000	3,000,000	2,778,118
TRAL 2007-1A[1] *CLO Rated Notes*	Floating – 04/2022 – D – 89288AAA1	1,000,000	1,000,000	937,226
Total Investment in CLO Rated Notes		13,000,000	12,968,134	12,360,525
Total Investments		$ 259,578,754	$257,293,380	$ 246,766,505

(1) Investment in a Collateralized Loan Obligation Fund

(2) Loan on non-accrual status

(3) Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators.

See accompanying notes to the financial statements.

Katonah 2007-I CLO Ltd.

SCHEDULE OF INVESTMENTS
As of December 31, 2014

Debt Securities Portfolio

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
AdvancePierre Foods, Inc. *Beverage, Food and Tobacco*	Term Loan (First Lien) — 5.8% Cash, Due 7/17	$ 490,000	$ 488,041	$ 487,244
Alaska Communications Systems Holdings, Inc. *Telecommunications*	Term Loan — 6.3% Cash, Due 10/16	2,872,467	2,860,913	2,872,467
Allison Transmission, Inc. *Automobile*	Term B-2 Loan — 2.9% Cash, Due 8/17	136,863	132,975	136,755
Allison Transmission, Inc. *Automobile*	Term B-3 Loan — 3.8% Cash, Due 8/19	3,046,843	3,013,146	3,019,633
AMC Entertainment Inc. *Leisure, Amusement, Motion Pictures, Entertainment*	Initial Term Loan — 3.5% Cash, Due 4/20	6,586,942	6,593,496	6,496,371
Aramark Corporation *Diversified/Conglomerate Service*	U.S. Term F Loan — 3.3% Cash, Due 2/21	2,552,196	2,452,038	2,517,907
Armored AutoGroup Inc. (fka Viking Acquisition Inc.) *Personal and Non Durable Consumer Products (Mfg. Only)*	New Term Loan — 6.0% Cash, Due 11/16	465,000	463,479	461,317
Armstrong World Industries, Inc. *Buildings and Real Estate*	Term Loan B — 3.5% Cash, Due 3/20	982,500	982,500	973,599
Asurion, LLC (fka Asurion Corporation) *Insurance*	Incremental Tranche B-1 Term Loan — 5.0% Cash, Due 5/19	958,715	962,083	948,275
Asurion, LLC (fka Asurion Corporation) *Insurance*	Non-Amortizing Term Loan (First Lien) — 3.8% Cash, Due 3/17	2,500,000	2,490,892	2,478,138
Avis Budget Car Rental, LLC *Personal Transportation*	Tranche B Term Loan — 3.0% Cash, Due 3/19	1,560,825	1,547,229	1,543,266
Berry Plastics Corporation *Containers, Packaging and Glass*	Term E Loan — 3.8% Cash, Due 1/21	2,591,612	2,490,312	2,529,142
Big Heart Pet Brands (fka Del Monte Corporation) *Beverage, Food and Tobacco*	Initial Term Loan — 3.5% Cash, Due 3/20	2,740,772	2,744,696	2,637,993
Biomet, Inc. *Healthcare, Education and Childcare*	Dollar Term B-2 Loan — 3.7% Cash, Due 7/17	2,690,775	2,673,717	2,682,366
BPA Laboratories Inc. *Healthcare, Education and Childcare*	Term Loan (First Lien) — 2.7% Cash, Due 7/17	1,743,896	1,610,040	1,572,410
BPA Laboratories Inc. *Healthcare, Education and Childcare*	Term Loan (Second Lien) — 2.7% Cash, Due 7/17	1,516,318	1,399,930	1,344,474
Bragg Communications Incorporated *Broadcasting and Entertainment*	Term Loan B — 3.5% Cash, Due 2/18	5,658,331	5,697,763	5,658,331
Burlington Coat Factory Warehouse Corporation *Retail Stores*	Term B-3 Loan — 4.3% Cash, Due 8/21	2,488,182	2,448,868	2,459,158
Calpine Corporation *Utilities*	Term Loan (3/11) — 4.0% Cash, Due 4/18	962,500	962,500	955,281
Calpine Corporation *Utilities*	Term Loan (6/11) — 4.0% Cash, Due 4/18	2,895,000	2,884,566	2,873,288
Capital Automotive L.P. *Finance*	Tranche B-1 Term Loan Facility — 4.0% Cash, Due 4/19	1,284,355	1,275,210	1,261,879
Capsugel Holdings US, Inc. *Healthcare, Education and Childcare*	Initial Term Loan — 3.5% Cash, Due 8/18	729,906	727,712	715,081
CBRE Services, Inc. (fka CB Richard Ellis Services, Inc.). *Buildings and Real Estate*	Tranche B Term Loan — 2.9% Cash, Due 3/21	1,572,000	1,565,872	1,567,088
Cedar Fair, L.P. *Leisure, Amusement, Motion Pictures, Entertainment*	U.S. Term Facility — 3.3% Cash, Due 3/20	966,429	964,638	967,153
Celanese US Holdings LLC *Chemicals, Plastics and Rubber*	Dollar Term C-3 Loan — 2.5% Cash, Due 10/18	1,264,273	1,212,980	1,264,962

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
Cequel Communications, LLC *Broadcasting and Entertainment*	Term Loan — 3.5% Cash, Due 2/19	$1,899,929	$1,888,684	$ 1,874,337
Charter Communications Operating, LLC (aka CCO Safari LLC) *Broadcasting and Entertainment*	Term F Loan — 3.0% Cash, Due 1/21	1,498,923	1,489,318	1,472,385
CHS/Community Health Systems, Inc. *Healthcare, Education and Childcare*	2017 Term E Loan — 3.5% Cash, Due 1/17	1,218,364	1,212,543	1,213,368
CHS/Community Health Systems, Inc. *Healthcare, Education and Childcare*	2021 Term D Loan — 4.3% Cash, Due 1/21	3,247,343	3,212,683	3,244,972
Cinemark USA, Inc. *Leisure, Amusement, Motion Pictures, Entertainment*	Term Loan — 3.2% Cash, Due 12/19	2,940,000	2,947,059	2,918,685
Consolidated Communications, Inc. *Telecommunications*	Initial Term Loan — 4.3% Cash, Due 12/20	2,947,575	2,924,508	2,931,909
Covanta Energy Corporation *Ecological*	Term Loan — 3.3% Cash, Due 3/19	660,000	657,997	658,970
Crown Castle Operating Company *Buildings and Real Estate*	Extended Incremental Tranche B-2 Term Loan — 3.0% Cash, Due 1/21	2,918,223	2,905,656	2,876,886
David's Bridal, Inc. *Retail Stores*	Initial Term Loan — 5.3% Cash, Due 10/19	477,723	474,458	456,424
Delta 2 (Lux) S.a r.l *Leisure, Amusement, Motion Pictures, Entertainment*	Facility B3 (USD) — 4.8% Cash, Due 7/21	3,421,774	3,396,429	3,349,780
Dex Media West LLC *Printing and Publishing*	New Term Loan — 8.0% Cash, Due 12/16	802,692	795,745	705,566
DJO Finance LLC (ReAble Therapeutics Fin LLC) *Healthcare, Education and Childcare*	New Tranche B Term Loan — 4.3% Cash, Due 9/17	1,965,100	1,988,287	1,925,798
Drumm Investors LLC (aka Golden Living) *Healthcare, Education and Childcare*	Term Loan — 6.8% Cash, Due 5/18	3,778,528	3,760,479	3,797,421
Dunkin' Brands, Inc. *Personal, Food and Miscellaneous Services*	Term B-4 Loan — 3.3% Cash, Due 2/21	2,131,738	2,100,720	2,081,120
Education Management LLC[3] *Healthcare, Education and Childcare*	Tranche C-2 Term Loan — 0.0% Cash, Due 6/16	1,558,253	1,560,738	708,226
Epicor Software Corporation (fka Eagle Parent Inc.) *Electronics*	Term B-2 Loan — 4.0% Cash, Due 5/18	1,864,054	1,849,531	1,844,249
EquiPower Resources Holdings, LLC *Utilities*	Term B Advance (First Lien) — 4.3% Cash, Due 12/18	1,380,022	1,367,347	1,374,274
Essential Power, LLC *Utilities*	Term Loan — 4.8% Cash, Due 8/19	942,322	933,009	925,831
FCA US LLC (fka Chrysler Group LLC) *Automobile*	Term Loan B — 3.5% Cash, Due 5/17	2,899,837	2,714,079	2,890,007
Federal-Mogul Corporation *Automobile*	Tranche B Term Loan (2014) — 4.0% Cash, Due 4/18	1,582,319	1,528,157	1,562,050
General Nutrition Centers, Inc. *Retail Stores*	Amended Tranche B Term Loan — 3.3% Cash, Due 3/19	995,722	999,421	971,248
Genpact Limited *Diversified/Conglomerate Service*	Term Loan — 3.5% Cash, Due 8/19	490,038	488,398	485,955
Gentiva Health Services, Inc. *Healthcare, Education and Childcare*	Initial Term B Loan — 6.5% Cash, Due 10/19	3,390,400	3,219,451	3,388,298
Getty Images, Inc. *Printing and Publishing*	Initial Term Loan — 4.8% Cash, Due 10/19	2,940,000	2,919,828	2,707,240
Graceway Pharmaceuticals, LLC[3] *Healthcare, Education and Childcare*	Term B Loan (First Lien) Sold Out 09/28/2012 — 0.0% Cash, Due 5/12	29,332	29,309	29,625
Hamilton Lane Advisors, L.L.C. *Finance*	Loan — 4.0% Cash, Due 2/18	700,022	696,321	686,022
Harland Clarke Holdings Corp. (fka Clarke American Corp.) *Printing and Publishing*	Tranche B-2 Term Loan — 5.5% Cash, Due 6/17	1,684,377	1,684,377	1,680,873
Harland Clarke Holdings Corp. (fka Clarke American Corp.) *Printing and Publishing*	Tranche B-3 Term Loan — 7.0% Cash, Due 5/18	968,553	968,553	973,396

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
HCA Inc. *Healthcare, Education and Childcare*	Tranche B-4 Term Loan — 3.0% Cash, Due 5/18	$2,962,500	$2,905,967	$ 2,942,829
HCR ManorCare, Inc. (fka HCR Healthcare, LLC) *Healthcare, Education and Childcare*	Initial Term Loan — 5.0% Cash, Due 4/18	481,250	479,007	463,504
Hertz Corporation, The *Personal Transportation*	Tranche B-1 Term Loan — 4.0% Cash, Due 3/18	3,934,811	3,934,345	3,861,033
Hertz Corporation, The *Personal Transportation*	Tranche B-2 Term Loan — 3.5% Cash, Due 3/18	962,850	959,731	939,583
Huntsman International LLC *Chemicals, Plastics and Rubber*	Extended Term B Loan — 2.7% Cash, Due 4/17	2,266,992	2,220,325	2,230,154
Ineos US Finance LLC *Chemicals, Plastics and Rubber*	Cash Dollar Term Loan — 3.8% Cash, Due 5/18	3,935,059	3,945,080	3,825,959
Infor (US), Inc. (fka Lawson Software Inc.) *Electronics*	Tranche B-5 Term Loan — 3.8% Cash, Due 6/20	2,376,449	2,390,597	2,310,621
International Architectural Products, Inc.[3] *Mining, Steel, Iron and Non-Precious Metals*	Term Loan — 0.0% Cash, Due 5/15	81,467	81,467	—
J. Crew Group, Inc. *Retail Stores*	Initial Loan — 4.0% Cash, Due 3/21	3,920,172	3,923,591	3,704,563
Jarden Corporation *Personal and Non Durable Consumer Products (Mfg. Only)*	New Tranche B Term Loan — 2.7% Cash, Due 3/18	1,925,036	1,875,187	1,923,236
Jazz Pharmaceuticals, Inc. *Healthcare, Education and Childcare*	Tranche 2 Term Loan — 3.3% Cash, Due 6/18	1,980,000	1,972,187	1,959,378
JBS USA, LLC *Beverage, Food and Tobacco*	Initial Term Loan — 3.8% Cash, Due 5/18	861,507	859,411	855,045
JMC Steel Group, Inc. *Mining, Steel, Iron and Non-Precious Metals*	Term Loan — 4.8% Cash, Due 4/17	1,454,728	1,451,490	1,431,998
Jo-Ann Stores, Inc. *Retail Stores*	Term B Loan — 4.0% Cash, Due 3/18	984,962	988,287	959,107
KAR Auction Services, Inc. *Automobile*	Tranche B-2 Term Loan — 3.5% Cash, Due 3/21	3,449,234	3,504,791	3,397,495
Key Safety Systems, Inc. *Automobile*	Initial Term Loan — 4.8% Cash, Due 8/21	1,377,871	1,349,316	1,370,982
Kronos Incorporated *Diversified/Conglomerate Service*	Incremental Term Loan (First Lien) — 4.5% Cash, Due 10/19	981,362	977,834	975,886
Landry's Inc. (fka Landry's Restaurants, Inc.) *Beverage, Food and Tobacco*	B Term Loan — 4.0% Cash, Due 4/18	2,666,667	2,691,051	2,654,000
Las Vegas Sands, LLC *Hotels, Motels, Inns, and Gaming*	Term B Loan — 3.3% Cash, Due 12/20	3,234,265	3,198,929	3,220,794
Live Nation Entertainment, Inc. *Leisure, Amusement, Motion Pictures, Entertainment*	Term B-1 Loan — 3.5% Cash, Due 8/20	477,716	475,797	474,133
Longview Power, LLC[3] *Utilities*	2017 Term Loan — 0.0% Cash, Due 10/17	828,079	760,275	538,252
Longview Power, LLC *Utilities*	DIP Delayed Term Loan — 5.6% Cash, Due 11/15	2,821,995	1,749,637	2,821,995
LPL Holdings, Inc. *Finance*	2013 Incremental Tranche B Term Loan — 3.3% Cash, Due 3/19	1,945,350	1,938,334	1,928,328
MCC Iowa LLC *Broadcasting and Entertainment*	Tranche J Term Loan — 3.8% Cash, Due 6/21	697,448	686,170	684,078
Mediacom Illinois, LLC (fka Mediacom Communications, LLC) *Broadcasting and Entertainment*	Tranche F Term Loan — 2.6% Cash, Due 3/18	5,955,000	5,943,088	5,843,344
National CineMedia, LLC *Leisure, Amusement, Motion Pictures, Entertainment*	Term Loan (2013) — 2.9% Cash, Due 11/19	1,000,000	994,404	953,125
NBTY, INC. *Personal and Non Durable Consumer Products (Mfg. Only)*	Term B-2 Loan — 3.5% Cash, Due 10/17	1,342,239	1,350,922	1,307,569
Newsday, LLC *Printing and Publishing*	Term Loan — 3.7% Cash, Due 10/16	2,250,000	2,258,527	2,242,969

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
Novelis, Inc. *Mining, Steel, Iron and Non-Precious Metals*	Initial Term Loan — 3.8% Cash, Due 3/17	$2,918,047	$2,923,391	$ 2,890,325
NRG Energy, Inc. *Utilities*	Term Loan (2013) — 2.8% Cash, Due 7/18	965,306	963,643	948,539
Ocwen Loan Servicing *Finance*	Initial Term Loan — 5.0% Cash, Due 2/18	1,550,821	1,566,745	1,462,223
Onex Carestream Finance LP *Healthcare, Education and Childcare*	Term Loan (First Lien 2013) — 5.0% Cash, Due 6/19	2,582,667	2,605,194	2,577,282
OSI Restaurant Partners, LLC *Personal, Food and Miscellaneous Services*	2013 Replacement Term Loan — 3.5% Cash, Due 10/19	337,500	335,015	334,653
Pacific Drilling S.A *Oil and Gas*	Term Loan — 4.5% Cash, Due 6/18	2,208,186	2,212,858	1,836,482
Pantry, Inc., The *Grocery*	Term Loan — 4.8% Cash, Due 8/19	2,930,559	2,911,264	2,928,112
Party City Holdings Inc. *Retail Stores*	2014 Replacement Term Loan — 4.0% Cash, Due 7/19	488,825	484,699	479,293
PetCo Animal Supplies, Inc. *Retail Stores*	New Loans — 4.0% Cash, Due 11/17	3,379,394	3,325,259	3,348,405
Petroleum GEO-Services ASA (PGS Finance, Inc) *Oil and Gas*	Extended Term Loan — 3.3% Cash, Due 3/21	4,962,500	4,962,500	4,193,313
PQ Corporation *Chemicals, Plastics and Rubber*	2014 Term Loan — 4.0% Cash, Due 8/17	1,960,000	1,948,649	1,928,150
Progressive Waste Solutions Ltd. *Ecological*	Term B Loan — 3.0% Cash, Due 10/19	735,000	732,465	739,597
QCE, LLC (Quiznos) *Personal, Food and Miscellaneous Services*	Existing Term Loan — 7.5% Cash, Due 6/19	387,172	387,160	167,452
R.H. Donnelley Inc. *Printing and Publishing*	Loan — 9.8% Cash, Due 12/16	448,594	446,327	324,298
Regal Cinemas Corporation *Leisure, Amusement, Motion Pictures, Entertainment*	Term Loan — 2.7% Cash, Due 8/17	971,049	975,191	950,414
Remy International, Inc. *Automobile*	Term B Loan 2013 — 4.3% Cash, Due 3/20	532,537	531,551	528,543
Revlon Consumer Products Corporation *Personal and Non Durable Consumer Products (Mfg. Only)*	Replacement Term Loan — 3.3% Cash, Due 11/17	3,500,000	3,527,549	3,477,040
Reynolds Group Holdings Inc. *Containers, Packaging and Glass*	Incremental U.S. Term Loan — 4.0% Cash, Due 12/18	2,112,116	2,112,116	2,079,853
RGIS Services, LLC *Diversified/Conglomerate Service*	Tranche C Term Loan — 5.5% Cash, Due 10/17	2,624,862	2,579,805	2,408,310
Roundy's Supermarkets, Inc. *Grocery*	Tranche B Term Loan — 5.8% Cash, Due 3/21	2,220,164	2,190,821	2,094,347
RPI Finance Trust *Healthcare, Education and Childcare*	Term B-2 Term Loan — 3.3% Cash, Due 5/18	1,893,611	1,886,527	1,892,030
Schaeffler AG (formerly named INA Beteiligungsgesellschaft mit beschränkter Haftung) *Automobile*	Facility B-USD — 4.3% Cash, Due 5/20	3,000,000	3,018,175	3,004,500
Seaworld Parks & Entertainment, Inc. (f/k/a SW Acquisitions Co., Inc.) *Leisure, Amusement, Motion Pictures, Entertainment*	Term B-2 Loan — 3.0% Cash, Due 5/20	897,686	889,092	853,699
Select Medical Corporation *Healthcare, Education and Childcare*	Series E Tranche B Term Loan — 3.8% Cash, Due 6/18	2,179,511	2,161,977	2,149,543
Semiconductor Components Industries, LLC (On Semiconductor) *Electronics*	Term Loan — 2.0% Cash, Due 1/18	5,468,750	5,368,168	5,277,344
Seminole Tribe of Florida *Hotels, Motels, Inns, and Gaming*	Initial Term Loan — 3.0% Cash, Due 4/20	2,632,500	2,632,500	2,625,919
Sensata Technologies B.V. (Sensata Technologies Finance Company, LLC) *Electronics*	Term Loan — 3.3% Cash, Due 5/19	673,744	670,900	674,408

See accompanying notes to the financial statements.

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
Sinclair Television Group, Inc. *Broadcasting and Entertainment*	New Tranche B Term Loan — 3.0% Cash, Due 4/20	$ 67,671	$ 67,406	$ 66,191
Six Flags Theme Parks, Inc. *Leisure, Amusement, Motion Pictures, Entertainment*	Tranche B Term Loan — 3.5% Cash, Due 12/18	1,658,557	1,667,416	1,652,338
Skilled Healthcare Group, Inc. *Healthcare, Education and Childcare*	Term Loan — 7.0% Cash, Due 4/16	848,943	853,886	848,943
Spectrum Brands, Inc. *Personal and Non Durable Consumer Products (Mfg. Only)*	Tranche A Term Loan — 3.0% Cash, Due 9/17	2,242,023	2,234,500	2,237,819
Spirit Aerosystems, Inc. (fka Mid-Western Aircraft Systems, Inc and Onex Wind Finance LP.) *Aerospace and Defense*	Term Loan B — 3.3% Cash, Due 9/20	2,431,250	2,420,574	2,401,868
SRAM, LLC *Leisure, Amusement, Motion Pictures, Entertainment*	Term Loan (First Lien) — 4.0% Cash, Due 4/20	742,374	740,159	721,959
SS&C Technologies Holdings Europe S.A.R.L. *Electronics*	2013 Replacement Term B-2 Loan — 3.3% Cash, Due 6/19	49,243	48,879	49,159
SS&C Technologies, Inc., /Sunshine Acquisition II, Inc. *Electronics*	2013 Replacement Term B-1 Loan — 3.3% Cash, Due 6/19	476,020	472,500	475,204
SunGard Data Systems Inc (Solar Capital Corp.) *Electronics*	Tranche E Term Loan — 4.0% Cash, Due 3/20	3,986,225	3,886,804	3,956,328
Telesat Canada *Telecommunications*	U.S. Term B-2 Loan — 3.5% Cash, Due 3/19	975,131	972,162	964,166
Tesoro Corporation *Oil and Gas*	Initial Term Loan — 2.4% Cash, Due 5/16	198,750	198,750	198,502
TPF Generation Holdings, LLC *Utilities*	Term Loan — 4.8% Cash, Due 12/17	190,325	181,043	173,196
TransDigm Inc. *Aerospace and Defense*	Tranche C Term Loan — 3.8% Cash, Due 2/20	1,925,626	1,888,275	1,897,425
Tronox Pigments (Netherlands) B. V. *Chemicals, Plastics and Rubber*	New Term Loan — 4.0% Cash, Due 3/20	2,525,107	2,507,905	2,489,869
TWCC Holding Corp. *Broadcasting and Entertainment*	Term Loan — 3.5% Cash, Due 2/17	3,224,114	3,211,534	3,154,441
Univar Inc. *Chemicals, Plastics and Rubber*	Term B Loan — 5.0% Cash, Due 6/17	3,125,113	3,018,493	3,032,219
Univision Communications Inc. *Broadcasting and Entertainment*	Replacement First-Lien Term Loan — 4.0% Cash, Due 3/20	3,273,587	3,247,237	3,208,115
UPC Financing Partnership *Broadcasting and Entertainment*	Facility AH — 3.3% Cash, Due 6/21	700,000	704,895	684,541
Vertafore, Inc. *Electronics*	Term Loan (2013) — 4.3% Cash, Due 10/19	945,935	945,935	938,131
VFH Parent LLC *Finance*	Term Loan (2013) — 5.8% Cash, Due 11/19	990,846	1,002,866	983,414
Walter Investment Management Corp. *Finance*	Tranche B Term Loan — 4.8% Cash, Due 12/20	2,559,736	2,548,795	2,316,561
Wendy's International, Inc *Personal, Food and Miscellaneous Services*	Term B Loan — 3.3% Cash, Due 5/19	1,347,261	1,337,449	1,339,407
WESCO Distribution, Inc. *Machinery (Non-Agriculture, Non-Construction, Non-Electronic)*	Tranche B-1 Loan — 3.8% Cash, Due 12/19	249,643	247,875	248,707
West Corporation *Diversified/Conglomerate Service*	Term B-10 Loan — 3.3% Cash, Due 6/18	1,776,796	1,786,986	1,748,811
West Corporation *Diversified/Conglomerate Service*	Term B-9 Loan — 2.8% Cash, Due 7/16	1,958,994	1,958,994	1,946,750
WideOpenWest Finance, LLC *Telecommunications*	Term B-1 Loan 2013 — 3.8% Cash, Due 7/17	5,170,755	5,200,187	5,131,975

See accompanying notes to the financial statements.

Portfolio Company/Principal Business	Investment Interest Rate[1]/Maturity	Principal	Cost	Fair Value
Windstream Corporation *Telecommunications*	Tranche B-4 Term Loan — 3.5% Cash, Due 1/20	$ 3,430,000	$ 3,443,539	$ 3,398,564
WireCo WorldGroup Inc. *Machinery (Non-Agriculture, Non-Construction, Non-Electronic)*	Term Loan — 6.0% Cash, Due 2/17	1,936,491	1,927,498	1,938,911
Zuffa, LLC *Leisure, Amusement, Motion Pictures, Entertainment*	Initial Term Loan (2013) — 3.8% Cash, Due 2/20	2,940,019	2,929,192	2,807,718
Total Investment in Debt Securities		266,252,508	263,225,703	259,163,759

Equity Securities Portfolio

Portfolio Company/Principal Business	Equity Investment	Shares	Cost	Fair Value
QCE, LLC (Quiznos)[2] *Retail Stores*	New Common Stock	—	$ 1,256.00	$ 1,649.00
Total Investment in Equity Securities			1,256	1,649

CLO Securities Portfolio

Portfolio Company	CLO Investment	Principal	Cost	Fair Value
APID 2007-5A[1] *CLO Rated Notes*	Floating – 04/2021 – D – 03761XAG5	$ 1,000,000	$ 1,000,000	$ 947,481
HLCNL 2007-2A[1] *CLO Rated Notes*	Floating – 04/2021 – D – 40537AAA3	3,000,000	2,962,139	2,854,478
MACCL 2007-1A[1] *CLO Rated Notes*	Floating – 07/2023 – B1L – 55265AAL5	2,000,000	2,000,000	1,901,675
MDPK 2007-4A[1] *CLO Rated Notes*	Floating – 03/2021 – D – 55817UAF7	2,000,000	2,000,000	1,871,637
NAVIG 2007-2A[1] *CLO Rated Notes*	Floating – 04/2021 – D – 63937HAD0	3,000,000	3,000,000	2,900,007
TRAL 2007-1A[1] *CLO Rated Notes*	Floating – 04/2022 – C – 89288BAG6	3,000,000	3,000,000	2,784,073
TRAL 2007-1A[1] *CLO Rated Notes*	Floating – 04/2022 – D – 89288AAA1	1,000,000	1,000,000	949,189
Total Investment in CLO Rated Notes		15,000,000	14,962,139	14,208,540
Total Investments		$281,252,508	$278,189,098	$273,373,948

(1) Investment in a Collateralized Loan Obligation Fund

(2) Equity investment in common stock

(3) Loan on non-accrual status

See accompanying notes to the financial statements.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION

Katonah 2007-I CLO LTD. (the "Fund") is an exempted company incorporated in November 15, 2006 with limited liability under the laws of the Cayman Islands for the sole purpose of investing in broadly syndicated loans, high-yield bonds and other credit instruments. The Fund is what is commonly known as a collateralized loan obligation fund ("CLO Fund").

A CLO Fund generally refers to a special purpose vehicle that owns a portfolio of investments and issues various tranches of debt and subordinated note securities to finance the purchase of those investments. Investments purchased by a CLO Fund are governed by extensive investment guidelines, including limits on exposure to any single industry or issuer and limits on the ratings of the CLO Fund's assets. A CLO Fund has a defined investment period during which it is allowed to make investments or reinvest capital as it becomes available.

A CLO Fund typically issues multiple tranches of debt and subordinated note securities with varying ratings and levels of subordination to finance the purchase of their underlying investments. Interest and principal payments (net of designated CLO Fund expenses) from the CLO Fund are paid to each issued security in accordance with an agreed upon priority of payments, commonly referred to as the "waterfall." The most senior notes, generally rated AAA/Aaa, commonly represent the majority of the total liabilities of the CLO Fund. AAA/Aaa notes are issued at a specified spread over LIBOR and normally have the first claim on the earnings on the CLO Fund's investments after payment of certain fees and expenses. Lower subordinated "mezzanine" tranches of rated notes generally have ratings ranging from AA/Aa to BB/Ba and are usually issued at a specified spread over LIBOR with higher spreads paid on the tranches with lower ratings. Each tranche is typically only entitled to a share of the earnings on the CLO Fund's investments if the required interest and principal payments have been made on the more senior tranches in the waterfall. The most junior tranche can take the form of either subordinated notes or preferred shares. The subordinated notes or preferred shares generally do not have a stated coupon but are entitled to residual cash flows from the CLO Fund's investments after all of the other tranches of notes and certain other fees and expenses are paid.

On January 23, 2008, the Fund sold $323.9 million of notes or debt securities, consisting of Class A-1L Floating Rate Notes, Class A-2L Floating Rate Notes, Class A-3L Floating Rate Notes, Class B-1L Floating Rate Notes, Class B-2L Floating Rate Notes ("Class B-2L Notes") and preferred shares. The notes were issued pursuant to an indenture, dated January 23, 2008 (the "Indenture"), with U.S. Bank National Association servicing as the trustee thereunder. KCAP Financial, Inc. ("KCAP Financial") owns all of the preferred shares of Katonah 2007-I CLO LTD. The Fund's defined investment period ended on April 22, 2014. Following the defined investment period, proceeds from principal payments in the investment portfolio of the Fund are used to pay down its outstanding notes, starting with Class A notes.

Pursuant to a collateral management agreement (the "Collateral Management Agreement"), Katonah 2007-1 Management, L.L.C. (the "Manager"), which is a wholly-owned portfolio company of KCAP Financial, provides investment management services to the Fund, and makes day-to-day investment decisions concerning the assets of the Fund. The Manager also performs certain administrative services on behalf of the Fund under the Collateral Management Agreement. The Manager is a registered investment adviser under the Investment Advisers Act of 1940.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Combination

The financial statements of the Fund have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). In the opinion of the Manager's management, the financial statements of the Fund reflect all adjustments, consisting of normal recurring accruals, which are necessary for the fair presentation of the financial condition and results of operations for the periods presented. Furthermore, the preparation of the financial statements requires management to make significant estimates and assumptions including the fair value of investments that do not have a readily available market value. Actual results could differ from those estimates, and the differences could be material.

All of the investments held and notes issued by the Fund are presented at fair value in the Fund's Statements of Net Assets.

Investments of the Fund at Fair Value. Investment transactions are recorded on the applicable trade date. Realized gains or losses are determined using the specific identification method. Investments held by the Fund are stated at fair value. ASC 820-10, Fair Value Measurements and Disclosures ("ASC 820-10"), requires among other things, disclosures about assets and liabilities that are measured and reported at fair value.

Hierarchy of Fair Value Inputs. The provisions of ASC 820-10 establish a hierarchy that prioritizes inputs to valuation techniques used to measure fair value and require companies to disclose the fair value of their financial instruments according to the fair value hierarchy (i.e., Level 1, 2 and 3 inputs, as defined). The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Additionally, companies are required to provide additional disclosure regarding instruments in the Level 3 category (which have inputs to the valuation techniques that are unobservable and require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities.

Assets and liabilities measured and reported at fair value are classified and disclosed in one of the following categories:

<u>Level 1 Inputs:</u>

Quoted prices (unadjusted) in active markets for identical assets or liabilities at the reporting date.

- Level 1 assets may include listed mutual funds, ETFs, equities and certain derivatives.

<u>Level 2 Inputs:</u>

Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; quotes from pricing services or brokers, for which the Manager can determine that orderly transactions took place at the quoted price or that the inputs used to arrive at the price were observable; and inputs other than quoted prices that are observable, such as models or other valuation methodologies.

- Level 2 assets in this category may include debt securities, bank loans, short-term floating rate notes and asset-backed securities, restricted public securities valued at a discount, as well as over the counter derivatives, including interest and inflation rate swaps and foreign currency exchange contracts that have inputs to the valuations that generally can be corroborated by observable market data.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

Level 3 Inputs:

Unobservable inputs for the valuation of the asset or liability, which may include non-binding broker quotes. Level 3 assets include investments for which there is little, if any, market activity. These inputs require significant management judgment or estimation.

- Level 3 assets in this category may include general and limited partnership interests in private equity funds, funds of private equity funds, real estate funds, hedge funds, and funds of hedge funds, direct private equity investments held within consolidated funds, bank loans, bonds issued by CLO Funds and certain held for sale real estate disposal assets.
- Level 3 liabilities included in this category include borrowings of consolidated collateralized loan obligations valued based upon non-binding broker quotes or discounted cash flow model based on a discount margin calculation.

Significance of Inputs:

The Manager's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument.

Valuation of Portfolio Investments. Debt and equity securities for which market quotations are readily available are generally valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued based on detailed analyses prepared by management, and, in certain circumstances, may utilize third parties with valuation expertise. The Manager follows the provisions of ASC 820-10 with respect to preparing the Fund's financial statements. This standard defines fair value, establishes a framework for measuring fair value, and expands disclosures about assets and liabilities measured at fair value. ASC 820-10 defines "fair value" as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Subsequent to the adoption of ASC 820-10, the FASB has issued various staff positions clarifying the initial standard as noted below.

Fair Value Measurements and Disclosures requires the disclosure of the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period.

The Manager's valuation methodology and procedures for investments held by the Fund are generally as follows:

1. For any asset which is also held by KCAP Financial on the applicable date, the KCAP Financial fair value mark as of such applicable date is used.
2. Each portfolio company or investment is cross-referenced to an independent pricing service to determine if a current market quote is available. The nature and quality of such quote is reviewed to determine reliability and relevance of the quote. Factors considered in this determination include whether the quote is from a transaction or is a broker quote, the date and aging of such quote, whether the transaction is arms-length, whether it is of a liquidation or distressed nature and certain other factors judged to be relevant by the Manager's management within the framework of ASC 820-10.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

3. If an investment does not have a market quotation on either a broad market exchange or from an independent pricing service, the investment is initially valued by the Manager's investment professionals responsible for the portfolio investment in conjunction with the portfolio management team. Generally, such fair values are determined by reference to public market or private transactions or valuations for comparable companies or assets in the relevant asset class and or industry when such amounts are available. Generally these valuations are derived by multiplying a key performance metric of the investee company or asset (e.g., EBITDA) by the relevant valuation multiple observed for comparable companies or transactions, adjusted by management for differences between the investment and the referenced comparable. If the fair value of such investments cannot be valued by reference to observable valuation measures for comparable companies, then the primary analytical method used to estimate the fair value is a discounted cash flow method and/or cap rate analysis. A sensitivity analysis is applied to the estimated future cash flows using various factors depending on the investment, including assumed growth rates (in cash flows), capitalization rates (for determining terminal values) and appropriate discount rates to determine a range of reasonable values or to compute projected return on investment.
4. Preliminary valuation conclusions are discussed and documented by the Manager's management.
5. Illiquid loans, junior and mezzanine securities and investments in other CLO bonds are fair valued using models developed by the Manager's management with applicable market assumptions.
6. The Manager's management discusses the valuations and determines in good faith that the fair values of each investment in the portfolio is reasonable based upon any applicable independent pricing service, input of management, and estimates from independent valuation firms (if any).

Debt Securities. Most of the Fund's investment portfolio is composed of broadly syndicated debt securities for which an independent pricing service quote is available. To the extent that the investments are exchange traded and are priced or have sufficient price indications from normal course trading at or around the valuation date (financial reporting date), such pricing will determine fair value. Pricing service marks from third party pricing services may be used as an indication of fair value, depending on the volume and reliability of the marks, sufficient and reasonable correlation of bid and ask quotes, and, most importantly, the level of actual trading activity.

CLO Fund Securities. The Fund may selectively invest in securities issued by CLO Funds managed by other asset management companies. For bond rated tranches of CLO Funds (those above the junior class) without transactions to support a fair value for the specific CLO Fund and tranche, fair value is based on discounting estimated bond payments at current market yields, which may reflect the adjusted yield on the leveraged loan index for similarly rated tranches, as well as prices for similar tranches for other CLO Funds and also other factors such as the default and recovery rates of underlying assets in the CLO Fund, as may be applicable. Such model assumptions may vary and incorporate adjustments for risk premiums and CLO Fund specific attributes. Such adjustments require judgment and may be material to the calculation of fair value.

Cash. Cash is defined as demand deposits. The Fund holds its cash with financial institutions and, at times, cash held in checking accounts may exceed the Federal Deposit Insurance Corporation insured limit.

Debt at Fair Value. The Fund has issued rated and unrated bonds to finance its operations. Debt is presented at fair value.

Interest Income. Interest income is recorded on the accrual basis on interest-bearing assets. The Fund generally places a loan or security on non-accrual status and ceases recognizing cash interest income on such loan or security when a loan or security becomes 90 days or more past due or if Manager otherwise does not expect the debtor to be able to service its debt obligations.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

Management Fees. The Fund is externally managed by the Manager pursuant to the Collateral Management Agreement. As compensation for the performance of its obligations under the Collateral Management Agreement, the Manager is entitled to receive from the Fund a senior collateral management fee (the "Senior Collateral Management Fee"), a subordinated collateral management fee (the "Subordinated Collateral Management Fee") and an incentive collateral management fee (the "Incentive Collateral Management Fee"). The Senior Collateral Management Fee is payable in arrears quarterly (subject to availability of funds and to the satisfaction of payment obligations on the debt obligations of the Fund (the "Priority of Payments")) in an amount equal to 0.10% per annum of the aggregate principal amount of the Fund's investments. The Subordinated Collateral Management Fee is payable in arrears quarterly (subject to availability of funds and to the Priority of Payments) in an amount equal to 0.15% per annum of the aggregate principal amount of the Fund's investments. The Incentive Collateral Management Fee equals 20% of the amount of interest and principal payments remaining available for distribution to the holders of the Fund's preferred shares under the Priority of Payments at which the Incentive Collateral Management Fee may be paid. For the years ended December 31, 2015 and 2014, there were no Incentive Fees incurred by the Fund.

Interest Expenses. The Fund has issued rated and unrated bonds to finance its operations. Interest on debt is calculated by the third party trustee of the Fund. Interest is accrued and generally paid quarterly.

Trustee Fees. The Fund has a third party trustee that is the custodian for all investments of the Fund and receives and disburses all cash in accordance to the trustee and custodial agreements. Trustee fees are accrued and paid quarterly by the Fund.

Income Taxes. The Fund is not subject to net income taxation in the United States or the Cayman Islands. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

3. INVESTMENTS

The investments held by the Fund are primarily invested in senior secured bank loans (typically syndicated by banks), bonds, and equity securities. Bank loan investments, which comprise the majority of the Fund's portfolio, are senior secured corporate loans from a variety of industries, including but not limited to the aerospace and defense, broadcasting, technology, utilities, household products, healthcare, oil and gas, and finance industries. The investments mature at various dates between 2016 and 2022, pay interest at Libor or Prime plus a spread of up to 3.0%, and typically range in credit rating categories from BBB down to unrated. Non-accrual loans represented less than 1% of investments at fair value as of December 31, 2015 and December 31, 2014. The aggregate unpaid principal value of loans past due as of December 31, 2015 and December 31, 2014 was approximately $1.1 million and $2.9 million, respectively and the difference between fair value and the unpaid principal balance was approximately $934,000 and $1.4 million, respectively. The Fund's investments are valued based on price quotations provided by an independent third-party pricing source which are indicative of traded prices and/or dealer price quotations. In the event that a third-party pricing source is unable to price an investment, other relevant factors, data and information are considered, including: i) information relating to the market for the investment, including price quotations for and trading in the investment and interest in similar investments and the market environment and investor attitudes towards the investment and interests in similar investments; ii) the characteristics of and fundamental analytical data relating to the investment, including the cost, size, current interest rate, period until next interest rate reset, maturity and base lending rate, the terms and conditions of the loan and any related agreements, and the position of the loan in the issuer's debt structure; iii) the nature, adequacy and value of the senior secured corporate loan's collateral, including the CLO's rights, remedies and interests with respect to the collateral; iv) the creditworthiness of the borrower, based on an evaluation of its financial condition, financial statements and information about the business, cash flows, capital structure and future prospects; v) the reputation and financial condition of the agent and any intermediate participants in the senior secured corporate loan; and vi) general economic and market conditions affecting the fair value of the senior secured corporate loan.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

3. INVESTMENTS – (continued)

The debt issued by the Fund has a stated maturity date of April 23, 2022. The Fund's debt was issued in various tranches with different risk profiles and ratings. The interest rates are variable rates based on Libor plus a pre-defined spread, which varies from 0.85% for the more senior tranches to 5% for the more subordinated tranches. The debt issued by the Fund is recorded at fair value using an income approach, driven by cash flows expected to be received from the portfolio collateral assets. Fair value is determined using current information, notably market yields and projected cash flows of collateral assets based on forecasted default and recovery rates that a market participant would use in determining the current fair value of the liabilities, taking into account the overall credit quality of the issuers and the Manager's past experience in managing similar securities. Market yields, default rates and recovery rates used in the Manager's estimate of fair value vary based on the nature of the investments in the underlying collateral pools. In periods of rising market yields, default rates and lower debt recovery rates, the fair value, and therefore the carrying value, of the liabilities may be adversely affected. Once the undiscounted cash flows of the collateral assets have been determined, the Manager applies appropriate discount rates that a market participant would use to determine the discounted cash flow valuation of the notes.

The carrying value of investments held and debt issued by the Fund is also their fair value. The following tables present the fair value hierarchy levels of investments held and debt issued by the Fund, which are measured at fair value as of December 31, 2015 and December 31, 2014:

December 31, 2015				
($ in millions)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Investments	$ 246,766,505	—	—	$ 246,766,505
Liabilities:				
CLO Fund Liabilities	$ 261,433,473	—	—	$ 261,433,473

December 31, 2014				
($ in millions)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Investments	$ 273,373,948	—	—	$ 273,373,948
Liabilities:				
CLO Fund Liabilities	$ 290,699,426	—	—	$ 290,699,426

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

3. INVESTMENTS – (continued)

The following tables show a reconciliation of the beginning and ending fair value measurements for Level 3 assets using significant unobservable inputs:

	For the year ended December 31, 2015
Beginning balance	$ 273,373,948
Purchase of investments	93,243,381
Proceeds from sale and redemption of investments	(113,199,395)
Net Realized and Unrealized (losses)	(6,651,429)
Ending balance	$ 246,766,505
Changes in unrealized appreciation (depreciation) included in earnings related to investments still held at reporting date	(5,313,969)

	For the year ended December 31, 2014
Beginning balance	$ 310,427,788
Purchase of investments	29,960,070
Proceeds from sale and redemption of investments	(61,206,288)
Net realized and unrealized (losses)	(5,807,622)
Ending balance	$ 273,373,948
Changes in unrealized appreciation (depreciation) included in earnings related to investments still held at reporting date	(5,924,816)

As of December 31, 2015, the Manager's Level 3 portfolio investments had the following valuation techniques and significant inputs:

Type	Fair Value	Valuation Technique	Unobservable inputs	Range of Inputs
Debt Securities	234,403,150	Market Quote	Third-Party Bid-Ask Mid	10.8% – 101%
Equity Securities	2,830	Market Quote	Third-Party Bid-Ask Mid	0.13 – 1.0
CLO Fund Securities	12,360,525	Discounted Cash Flow	Discount Rate	3.82% – 5.89%

The following tables show a reconciliation of the beginning and ending fair value measurements for Level 3 liabilities using significant unobservable inputs:

	For the year ended December 31, 2015
Beginning balance	$ 290,699,426
Prepayments, amortization, net	(23,002,449)
Unrealized depreciation	(6,263,504)
Ending balance	$ 261,433,473
Changes in unrealized appreciation (depreciation) included in earnings related to liabilities still held at reporting date	$ (6,263,504)

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3. INVESTMENTS – (continued)

	For the year ended December 31, 2014
Beginning balance	$ 314,549,615
Prepayments, amortization, net	(27,132,006)
Unrealized depreciation	3,281,817
Ending balance	$ 290,699,426
Changes in unrealized appreciation included in earnings related to liabilities still held at reporting date	$ 3,281,818

Transfers between levels, if any, are recognized at the beginning of the quarter in which the transfers occur. ASC 820-10 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. In accordance with ASC 820-10, these inputs are summarized in the three broad levels listed below.

- Level 1 — Valuations based on quoted prices in active markets for identical assets or liabilities that the Fund has the ability to access.
- Level 2 — Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly
- Level 3 — Valuations based on inputs that are unobservable and significant to the overall fair value measurement

The Fund’s debt is presented at fair value with the difference between principal and fair value recorded as unrealized gain/loss. The par amount of the Fund’s debt is approximately $274 million and $297 million as of December 31, 2015 and December 31, 2014, respectively.

The Manager has determined that, although the junior tranches have certain characteristics of equity, they should be accounted for and disclosed as debt on the Fund’s Statement of Net Assets, as the subordinated and income notes have a stated maturity indicating a date for which they are mandatorily redeemable. The preference shares are also classified as debt, as they are mandatorily redeemable upon liquidation or termination of the Fund.

4. INCOME TAXES

Under the current laws, the Fund is not subject to net income taxation in the United States or the Cayman Islands. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

Pursuant to ASC Topic 740, *Accounting for Uncertainty in Income Taxes*, the Fund adopted the provisions of Financial Accounting Standards Board (“FASB”) relating to accounting for uncertainty in income taxes which clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position must meet before being recognized in the financial statements and applies to all open tax years as of the effective date. As of December 31, 2015 and 2014 there was no impact to the financial statements as a result of the Fund’s accounting for uncertainty in income taxes. The Fund does not have any unrecognized tax benefits or liabilities for the years ended December 31, 2015, 2014 and 2013. Also, the Fund recognizes interest and, if applicable, penalties for any uncertain tax positions, as a component of income tax expense. No interest or penalty expense was recorded by the Fund for the years ended December 31, 2015, 2014 and 2013.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

5. DEBT

On January 23, 2008, the Fund issued $323.9 million of notes or debt securities, consisting of the Class A-1L Floating Rate Notes, the Class A-2L Floating Rate Notes, the Class A-3L Floating Rate Notes, the Class B-1L Floating Rate Notes, the Class B-2L Floating Rate Notes and the preferred shares. The notes were issued pursuant to the Indenture.

The table below sets forth certain information for each outstanding class of debt securities issued pursuant to the Indenture.

Title of Debt Security	Principal Amount	Amount Outstanding	Interest Rate	Maturity	Fair Value
Class A-1L Floating Rate Notes	$176,865,554	$176,865,554	LIBOR + 0.85%	April 23, 2022	$175,944,253
Class A-2L Floating Rate Notes	$ 26,000,000	$ 26,000,000	LIBOR + 1.50%	April 23, 2022	$ 25,857,350
Class A-3L Floating Rate Notes	$ 18,000,000	$ 18,000,000	LIBOR + 2.00%	April 23, 2022	$ 17,902,126
Class B-1L Floating Rate Notes	$ 11,000,000	$ 11,000,000	LIBOR + 3.00%	April 23, 2022	$ 10,970,532
Class B-2L Floating Rate Notes	$ 10,500,000	$ 10,500,000	LIBOR + 5.00%	April 23, 2022	$ 10,463,534
Preferred Shares	$ 31,411,736	$ 31,411,736	N/A	April 23, 2022	$ 20,295,678

During 2015 and 2014, approximately $23 million and $27 million of the Class A-1L Floating Rate Notes was repaid in the normal course of business of the Fund, respectively.

6. COMMITMENTS AND CONTINGENCIES

The Fund had no commitments to fund investments as of December 31, 2015. As of December 31, 2014 the Fund had commitments of approximately $2.8 million to fund investments, of which approximately $1.1 million was unfunded.

7. CAPITALIZATION

The authorized share capital of the Fund is $32,250, consisting of 250 ordinary shares of $1.00 par value, each of which are issued and fully paid, and 32,000,000 preferred shares, 31,411,736 of which are issued and fully paid. The ordinary shares that have been issued are held by Maples Finance Limited, a licensed trust company incorporated in the Cayman Islands, as the trustee pursuant to the terms of a charitable trust. The preferred shares that have been issued by the Fund are owned by KCAP Financial. The preferred shares are classified as debt in the Fund's financial statements, as they are mandatorily redeemable upon liquidation or termination of the Fund.

8. SUBSEQUENT EVENTS

The Fund has evaluated events and transactions through March 9, 2016, which is the date the financial statements were issued for items that should potentially be recognized or disclosed in these financial statements. Management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these consolidated financial statements.

EXHIBIT INDEX

Exhibit Number	Description
2.1	Purchase and Sale Agreement, dated February 29, 2012, by and among Kohlberg Capital Corporation (the "Company"), Commodore Holdings, L.L.C., Trimaran Advisors, L.L.C., HBK Caravelle, L.L.C., Trimaran Fund Management, L.L.C., Jay R. Bloom, and Dean C. Kehler.(1)
3.1	Form of Certificate of Incorporation of the Company.(3)
3.2	Form of Bylaws of the Company, as amended and restated effective February 29, 2012.(4)
4.1	Specimen certificate of the Company's common stock, par value $0.01 per share.(3)
4.2	Form of Dividend Reinvestment Plan.(5)
4.4(a)	Form of Base Indenture between the Company and U.S. Bank National Association relating to the 7.375% Senior Notes Due 2019(19)
4.4(b)	Form of First Supplemental Indenture between the Company and U.S. Bank National Association relating to the 7.375% Senior Notes Due 2019(19)
4.5	Form of Note relating to the 7.375% Senior Notes Due 2019 (included as part of Exhibit 4.4)
4.6	Indenture dated as of March 16, 2011, by and between the Company and U.S. Bank National Association, as trustee relating to the 8.75% Convertible Senior Notes Due 2016.(6)
4.7	Form of 8.75% Convertible Senior Notes Due 2016 (included as part of Exhibit 4.6).
10.1	Form of the Amended and Restated 2006 Equity Incentive Plan.(7)*
10.2	Form of Company Non-Qualified Stock Option Certificate.(5)*
10.3	Form of Custodian Agreement.(5)
10.5	Form of Overhead Allocation Agreement between the Company and Katonah Debt Advisors, L.L.C.(5)
10.6	Form of Employment Agreement between the Company and Dayl W. Pearson.(20)*
10.7	Form of Employment Agreement between the Company and Edward U. Gilpin.(21)*
10.8	Form of Employment Agreement between the Company and R. Jon Corless.(20)*
10.13	Form of Employment Agreement between Katonah Debt Advisors and Daniel P. Gilligan.(20)*
10.14	Form of Indemnification Agreement for Officers and Directors of the Company.(11)
10.20	Amended and Restated Non-Employee Director Plan.(13)*
10.21	Purchase Agreement, dated June 16, 2013, by and among KCAP Financial, Inc., KCAP Senior Funding I Holdings, LLC, KCAP Senior Funding I, LLC and Guggenheim Securities, LLC.(22)
10.22	Master Loan Sale Agreement, dated June 18, 2013, by and among KCAP Financial, Inc., KCAP Senior Funding I Holdings, LLC and KCAP Senior Funding I, LLC.(23)
10.23	Indenture, dated June 18, 2013, by and between KCAP Senior Funding I, LLC and U.S. Bank National Association.(24)
10.24	Collateral Management Agreement, dated June 18, 2013, by and between KCAP Senior Funding I, LLC and KCAP Financial, Inc.(25)
10.25	Collateral Administration Agreement, dated June 18, 2013, by and among KCAP Senior Funding I, LLC and U.S. Bank National Association and U.S. Bank National Association.(26)
10.27	Employment Agreement, dated February 29, 2012, by and among, Dean C. Kehler and Trimaran Advisors, L.L.C., and, solely as to the last three sentences of Section 1(a) and Section 2(d), the Company.(17)*
11.1	Computation of Per Share Earnings (included in the notes to the audited financial statements contained in this report).
21.1	List of Subsidiaries.**

Exhibit Number	Description
31.1	Chief Executive Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**
31.2	Chief Financial Officer Certification Pursuant to Rule 13a-14 of the Securities Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**
32.1	Chief Executive Officer Certification pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2	Chief Financial Officer Certification pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

(1) Incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).

(2) Incorporated by reference to Exhibit 2.2 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).

(3) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 1 on Form N-2, as filed on October 6, 2006 (File No. 333-136714).

(4) Incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).

(5) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 2 on Form N-2, as filed on November 20, 2006 (File No. 333-136714).

(6) Incorporated by reference to Exhibit 4.1 of the Current Report on Form 8-K, as filed on March 16, 2011 (File No. 814-00735).

(7) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, as filed on June 19, 2008 (File No. 814-00735).

(8) Incorporated by reference to Exhibit 10.11 of the Annual Report on Form 10-K, as filed on March 4, 2011 (File No. 814-00735).

(9) Incorporated by reference to Exhibit 10.12 of the Annual Report on Form 10-K, as filed on March 4, 2011 (File No. 814-00735).

(10)Incorporated by reference to Exhibit 10.13 of the Annual Report on Form 10-K, as filed on March 4, 2011 (File No. 814-00735).

(11)Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 3 on Form N-2, as filed on November 24, 2006 (File No. 333-136714).

(12)Incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q, as filed on November 8, 2010 (File No. 333-814-00735).

(13)Incorporated by reference to Exhibit 4.1 included in the Registration Statement on form S-8, as filed on July 28, 2011 (File No. 333-175838)..

(14)Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).

(15)Incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).

(17)Incorporated by reference to Exhibit 10.4 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).

(18)Incorporated by reference to Exhibit d.2 included in the Registration Statement in Form N-2, as filed on October 3, 2012 (File No. 333-183032).

(19)Incorporated by reference to exhibit included in the Registration Statement in Form N-2, as filed on October 3, 2012 (File No. 333-183032).

(20)Incorporated by reference to exhibit included in the Registration Statement on Form N-2, as filed on August 2, 2012 (File No. 333-183032).

(21)Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, as filed on June 5, 2012 (File No. 814-00735).

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(22)Incorporated by reference to Exhibit 10.1 of Current Report on Form 8-K, as filed on June 18, 2013.

(23)Incorporated by reference to Exhibit 10.2 of Current Report on Form 8-K, as filed on June 18, 2013.

(24)Incorporated by reference to Exhibit 10.3 of Current Report on Form 8-K, as filed on June 18, 2013.

(25)Incorporated by reference to Exhibit 10.4 of Current Report on Form 8-K, as filed on June 18, 2013.

(26)Incorporated by reference to Exhibit 10.5 of Current Report on Form 8-K, as filed on June 18, 2013.

* Indicates a management contract or compensatory plan, contract or agreement.

** Filed herewith.

Exhibit 21.1

List of Subsidiaries	Jurisdiction
Katonah Debt Advisors, L.L.C.(1)	Delaware
Kohlberg Capital Funding LLC I	Delaware
Trimaran Advisors Management, L.L.C.	Delaware
KCAP Senior Funding I Holdings, LLC	Delaware
KCAP Senior Funding I, LLC(4)	Delaware
Katonah Management Holdings LLC(1)	Delaware
Katonah X Management LLC(1)(2)	Delaware
Katonah 2007-I Management LLC(1)(2)	Delaware
Commodore Holdings, L.L.C.(1)	Delaware
Trimaran Advisors, L.L.C.(1)(3)	Delaware

(1) Represents a wholly-owned portfolio company that is not consolidated for financial reporting purposes.

(2) A wholly-owned subsidiary of Katonah Management Holdings LLC.

(3) A wholly-owned subsidiary of Commodore Holdings, L.L.C.

(4) A wholly-owned subsidiary of KCAP Senior Funding I Holdings, LLC.

Exhibit 31.1

CERTIFICATION PURSUANT TO
RULE 13a-14(a) and 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS AMENDED

I, Dayl W. Pearson, certify that:

1. I have reviewed this annual report on Form 10-K of KCAP Financial, Inc. (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 9, 2016

By: /s/ Dayl W. Pearson
Dayl W. Pearson
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION PURSUANT TO
RULE 13a-14(a) and 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS AMENDED

I, Edward U. Gilpin, certify that:

1. I have reviewed this annual report on Form 10-K of KCAP Financial, Inc.(the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date:March 9, 2016

By: /s/ Edward U. Gilpin
Edward U. Gilpin
Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.1

**CERTIFICATION PURSUANT TO
SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the accompanying Annual Report of KCAP Financial, Inc.(the “Company”) on Form 10-K for the year ended December 31, 2015 (the “Report”), I, Dayl W. Pearson, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 9, 2016

By: /s/ Dayl W. Pearson
Dayl W. Pearson
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

CERTIFICATION PURSUANT TO
SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the accompanying Annual Report of KCAP Financial, Inc.(the “Company”) on Form 10-K for the year ended December 31, 2015 (the “Report”), I, Edward U. Gilpin, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 9, 2016

By: /s/ Edward U. Gilpin
Edward U. Gilpin
Chief Financial Officer
(Principal Financial Officer)