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

Form 10-Q

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

**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
(State or other jurisdiction of
Incorporation or organization)**

**20-5951150
(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)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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

The number of outstanding shares of common stock of the registrant as of August 4, 2014 was 33,721,488.

TABLE OF CONTENTS

	<u>Page</u>
Part I. Financial Information	
Item 1. Consolidated Financial Statements	1
Consolidated Balance Sheets as of June 30, 2014 (unaudited) and December 31, 2013	1
Consolidated Statements of Operations (unaudited) for the three and six months ended June 30, 2014 and 2013	2
Consolidated Statements of Changes in Net Assets (unaudited) for the six months ended June 30, 2014 and 2013	3
Consolidated Statements of Cash Flows (unaudited) for the six months ended June 30, 2014 and 2013	4
Consolidated Schedules of Investments as of June 30, 2014 (unaudited) and December 31, 2013	5
Consolidated Financial Highlights (unaudited) for the six months ended June 30, 2014 and 2013	30
Notes to Consolidated Financial Statements (unaudited)	31
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	54
Item 3. Quantitative and Qualitative Disclosures About Market Risk	69
Item 4. Controls and Procedures	70
Part II. Other Information	
Item 1. Legal Proceedings	71
Item 1A. Risk Factors	71
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	71
Item 3. Defaults Upon Senior Securities	71
Item 4. Mine Safety Disclosures	71
Item 5. Other Information	71
Item 6. Exhibits	71
Signatures	72

KCAP FINANCIAL, INC.

CONSOLIDATED BALANCE SHEETS

	As of June 30, 2014 (unaudited)	As of December 31, 2013
ASSETS		
Investments at fair value:		
Money market accounts (cost: 2014 - \$5,610,941; 2013 - \$7,112,949)	\$ 5,610,941	\$ 7,112,949
Debt securities (cost: 2014 - \$263,906,927; 2013 - \$275,213,594)	256,023,078	266,830,427
CLO Fund securities managed by affiliates (cost: 2014 - \$101,293,076; 2013 - \$88,979,585)	87,549,239	75,100,306
CLO Fund securities managed by non-affiliates (cost: 2014 - \$12,455,827; 2013 - \$12,717,365)	4,181,659	4,351,914
Equity securities (cost: 2014 - \$16,289,233; 2013 - \$18,755,684)	8,758,971	11,006,398
Asset Manager Affiliates (cost: 2014 - \$83,924,720; 2013 - \$83,378,741)	75,302,000	76,148,000
Total Investments at Fair Value (cost: 2014 - \$483,480,724; 2013 - \$486,157,918)	437,425,888	440,549,994
Cash	2,310,589	3,433,675
Restricted cash	4,777,960	4,078,939
Interest receivable	2,040,077	2,032,559
Receivable for open trades	2,943,835	—
Due from affiliates	3,218,927	3,125,259
Other assets	5,853,972	5,951,962
Total Assets	<u>\$ 458,571,248</u>	<u>\$ 459,172,388</u>
LIABILITIES		
Convertible Notes	\$ 49,008,000	\$ 49,008,000
7.375% Notes Due 2019	41,400,000	41,400,000
Notes issued by KCAP Senior Funding I, LLC (net of discount: 2014 - \$2,847,139; 2013 - \$3,065,627)	102,402,861	102,184,373
Payable for open trades	3,940,000	3,980,000
Accounts payable and accrued expenses	3,306,332	3,897,291
Shareholder distribution payable	—	8,333,031
Total Liabilities	<u>200,057,193</u>	<u>208,802,695</u>
STOCKHOLDERS' EQUITY		
Common stock, par value \$0.01 per share, 100,000,000 common shares authorized; 33,725,223 and 33,332,123 common shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	337,252	333,472
Capital in excess of par value	371,640,022	370,929,615
Accumulated undistributed (excess distribution) net investment income	1,530,282	(6,102,017)
Accumulated net realized losses	(68,417,904)	(68,662,689)
Net unrealized depreciation on investments	(46,575,597)	(46,128,688)
Total Stockholders' Equity	258,514,055	250,369,693
Total Liabilities and Stockholders' Equity	<u>\$ 458,571,248</u>	<u>\$ 459,172,388</u>
NET ASSET VALUE PER COMMON SHARE	<u>\$ 7.67</u>	<u>\$ 7.51</u>

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Investment Income:				
Interest from investments in debt securities	\$ 5,173,514	\$ 2,997,246	\$ 10,420,750	\$ 5,475,265
Interest from cash and time deposits	724	3,026	1,510	7,738
Distributions from investments in CLO Fund securities managed by affiliates	4,451,626	4,557,531	9,087,864	10,038,183
Distributions from investments in CLO Fund securities managed by non-affiliates	464,734	323,790	740,304	747,664
Distributions from Asset Manager Affiliates	3,000,000	3,300,000	6,000,000	6,300,000
Capital structuring service fees	125,116	52,753	352,199	59,326
Total investment income	<u>13,215,714</u>	<u>11,234,346</u>	<u>26,602,627</u>	<u>22,628,176</u>
Expenses:				
Interest and amortization of debt issuance costs	2,893,806	2,250,063	5,883,972	4,510,309
Compensation	1,227,651	1,110,409	2,490,088	2,020,122
Professional fees	545,913	652,644	1,217,123	1,294,971
Insurance	111,507	126,632	247,467	255,348
Administrative and other	399,315	513,085	867,597	1,019,556
Total expenses	<u>5,178,192</u>	<u>4,652,833</u>	<u>10,706,247</u>	<u>9,100,306</u>
Net Investment Income	8,037,522	6,581,513	15,896,380	13,527,870
Realized And Unrealized Gains (Losses) On Investments:				
Net realized (losses) gains from investment transactions	(64,797)	(1,562,529)	244,785	(1,645,466)
Net change in unrealized (depreciation) appreciation on:				
Debt securities	1,102,632	124,466	499,319	2,410,992
Equity securities	546,686	1,064,379	219,023	998,942
CLO Fund securities managed by affiliates	1,015,474	(3,768,238)	135,445	(8,347,397)
CLO Fund securities managed by non-affiliates	388,145	(820,826)	91,283	(1,188,235)
Asset Manager Affiliates investments	1,227,000	6,910,060	(1,391,979)	9,985,399
Total net change in unrealized appreciation (depreciation)	<u>4,279,937</u>	<u>3,509,841</u>	<u>(446,909)</u>	<u>3,859,701</u>
Net realized and unrealized appreciation (depreciation) on investments	<u>4,215,140</u>	<u>1,947,312</u>	<u>(202,124)</u>	<u>2,214,235</u>
Net Increase In Stockholders' Equity Resulting From Operations	\$ 12,252,662	\$ 8,528,825	\$ 15,694,256	\$ 15,742,105
Net Increase In Stockholders' Equity Resulting from Operations per Common Share:				
Basic:	\$ 0.37	\$ 0.26	\$ 0.47	\$ 0.51
Diluted:	\$ 0.34	\$ 0.25	\$ 0.45	\$ 0.48
Net Investment Income Per Common Share:				
Basic:	\$ 0.24	\$ 0.20	\$ 0.48	\$ 0.43
Diluted:	\$ 0.24	\$ 0.20	\$ 0.46	\$ 0.42
Weighted Average Shares of Common Stock Outstanding—				
Basic	33,405,189	33,040,155	33,371,764	31,163,596
Weighted Average Shares of Common Stock Outstanding—				
Diluted	39,723,264	39,395,124	39,689,884	38,022,742

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(unaudited)

	Six Months Ended	
	June 30,	
	2014	2013
Operations:		
Net investment income	\$ 15,896,380	\$ 13,527,870
Net realized gains (losses) from investment transactions	244,785	(1,645,466)
Net change in unrealized (depreciation) appreciation on investments	(446,909)	3,859,701
Net increase in net assets resulting from operations	<u>15,694,256</u>	<u>15,742,105</u>
Stockholder distributions:		
Distribution of net investment income	(7,858,857)	(6,946,356)
Return of capital	(405,224)	(2,304,764)
Net decrease in net assets resulting from stockholder distributions	<u>(8,264,081)</u>	<u>(9,251,120)</u>
Capital transactions:		
Issuance of common stock for:		
Dividend reinvestment plan	300,813	394,275
Conversion of Convertible Notes	—	8,992,000
Issuance of Common Stock	—	50,404,236
Amortization of stock based compensation	413,375	150,687
Net increase in net assets resulting from capital transactions	<u>714,188</u>	<u>59,941,198</u>
Net assets at beginning of period	<u>250,369,692</u>	<u>207,875,656</u>
Net assets at end of period (including undistributed net investment income of \$1,530,282 in 2014 and \$4,380,234 in 2013)	<u>\$ 258,514,055</u>	<u>\$ 274,307,839</u>
Net asset value per common share	<u>\$ 7.67</u>	<u>\$ 8.24</u>
Common shares outstanding at end of period	33,725,223	33,298,674

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six Months Ended	
	June 30,	
	2014	2013
OPERATING ACTIVITIES:		
Net increase in stockholder's equity resulting from operations	\$ 15,694,256	\$ 15,742,105
Adjustments to reconcile net increase in stockholder's equity resulting from operations to net cash provided by (used in) in operating activities:		
Net realized (gains) losses on investment transactions	(244,785)	1,645,466
Net change in unrealized depreciation (appreciation) on investments	446,909	(3,859,701)
Net accretion of discount on debt securities	12,007	496,351
Amortization of original issue discount on indebtedness	218,488	—
Amortization of debt issuance costs	555,445	402,169
Payment-in-kind interest income	55,777	—
Stock-based compensation expense	413,375	150,687
Changes in operating assets and liabilities:		
Purchases of investments	(88,665,326)	(178,434,731)
Proceeds from sales and redemptions of investments	91,519,522	53,756,852
(Increase) in receivable for open trades	(2,943,835)	(3,515,052)
Increase (Decrease) in payable for open trades	(40,000)	66,840,035
(Increase) in interest and dividends receivable	(7,518)	(466,795)
Decrease in time deposit	—	1,942,834
(Increase) in other assets	(457,452)	(3,902,160)
(Increase) in due from affiliates	(93,668)	(1,091,273)
Increase (Decrease) in accounts payable and accrued expenses	(590,959)	111,180
Net cash provided by (used in) operating activities	<u>15,872,236</u>	<u>(50,182,033)</u>
FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	—	50,404,236
Distributions to stockholders	(16,296,300)	(16,260,229)
Proceeds from issuance of debt	—	101,954,525
(Increase) in restricted cash	(699,022)	(78,985,473)
Net cash (used in) provided by financing activities	<u>(16,995,322)</u>	<u>57,113,059</u>
CHANGE IN CASH	(1,123,086)	6,931,026
CASH, BEGINNING OF PERIOD	3,433,675	738,756
CASH, END OF PERIOD	\$ 2,310,589	\$ 7,669,782
Supplemental Information:		
Interest paid during the period	\$ 4,985,509	\$ 4,193,151
Dividends paid during the period under the dividend reinvestment plan	\$ 300,813	\$ 393,297

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
As of June 30, 2014

(unaudited)

Debt Securities Portfolio

Portfolio Company / Principal Business	Investment Interest Rate ¹ / Maturity	Principal	Cost	Fair Value ²
4L Technologies Inc. (fka Clover Holdings, Inc.) ^{9,11} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 5/20	\$ 2,800,000	\$ 2,772,640	\$ 2,805,502
Advanced Lighting Technologies, Inc. ^{9,11} <i>Consumer goods: Non-durable</i>	First Lien Bond — 10.5% Cash, Due 6/19	3,000,000	2,952,225	2,398,501
Alaska Communications Systems Holdings, Inc. ^{9,11} <i>Telecommunications</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.5% Libor Floor, Due 10/16	2,234,318	2,237,467	2,235,659
Anaren, Inc. ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 2/21	1,990,000	1,971,061	1,999,950
ARSloane Acquisition, LLC ^{9,11} <i>Services: Business</i>	Senior Secured Loan — Tranche B Term Loan (First Lien) 7.5% Cash, 1.3% Libor Floor, Due 10/19	992,500	983,783	982,576
Asurion, LLC (fka Asurion Corporation) ^{9,11} <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Incremental Tranche B-1 Term Loan 5.0% Cash, 1.3% Libor Floor, Due 5/19	1,936,879	1,955,615	1,951,609
AZ Chem US Inc. ^{9,11} <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Initial Term Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 6/21	492,466	490,014	490,003
Bankruptcy Management Solutions, Inc. ⁹ <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Term B Loan 7.0% Cash, 1.0% Libor Floor, Due 6/18	709,091	709,091	704,340
BarBri, Inc. (Gemini Holdings, Inc.) ^{9,11} <i>Services: Consumer</i>	Senior Secured Loan — Term Loan 4.5% Cash, 1.0% Libor Floor, Due 7/19	2,872,500	2,860,342	2,877,671
BBB Industries, LLC ^{9,11} <i>Automotive</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.3% Libor Floor, Due 3/19	2,812,500	2,804,487	2,813,626

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Bellisio Foods, Inc. ^{9,11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — U.S. Term B Loans 4.5% Cash, 1.0% Libor Floor, Due 8/19	\$ 3,754,678	\$ 3,737,995	\$ 3,754,302
Blue Coat Systems, Inc. ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — New Term Loan 4.0% Cash, 1.0% Libor Floor, Due 5/19	470,003	471,498	471,080
Caribe Media Inc. (fka Caribe Information Investments Incorporated) ⁹ <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Loan 10.0% Cash, 1.5% Libor Floor, Due 11/14	316,063	316,063	315,905
Carolina Beverage Group LLC ⁹ <i>Beverage, Food and Tobacco</i>	Senior Secured Bond — 10.625% - 08/2018 - 143818AA0 144A 10.6% Cash, Due 8/18	1,500,000	1,517,375	1,605,000
Cengage Learning Acquisitions, Inc. (fka TL Acquisitions, Inc.) ^{9,11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 3/20	997,500	1,011,940	1,010,128
Checkout Holding Corp. ^{9,11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 4/21	2,000,000	1,990,302	2,004,580
CoActive Technologies LLC (fka CoActive Technologies, Inc.) ^{7,9} <i>Capital Equipment</i>	Junior Secured Loan — Term Loan (Second Lien) 0.0% Cash, 7.0% PIK, Due 1/15	2,063,007	1,987,358	2,063,007
Crowley Holdings Preferred, LLC ⁹ <i>Transportation: Cargo</i>	Preferred Stock — 12.000% - 12/2049 - Series A Income Preferred Securities 10.0% Cash, 2.0% PIK, Due 12/49	10,104,717	10,104,717	10,711,000
CSM Bakery Supplies LLC ⁹ <i>Beverage, Food and Tobacco</i>	Junior Secured Loan — Term Loan (Second Lien) 8.5% Cash, 1.0% Libor Floor, Due 7/21	3,000,000	3,017,626	3,003,300
CSM Bakery Supplies LLC ^{9,11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan (First Lien) 4.8% Cash, 1.0% Libor Floor, Due 7/20	3,639,167	3,637,778	3,643,898
DBI Holding LLC ⁹ <i>Services: Business</i>	Senior Unsecured Bond — 13% - 09/2019 – PIK Note 0.0% Cash, 13.0% PIK, Due 9/19	3,240,138	2,980,027	3,240,138
DBI Holding LLC ⁹ <i>Services: Business</i>	Senior Subordinated Bond — 13% - 09/2019 - Senior Subordinated Note 12.0% Cash, 1.0% PIK, Due 9/19	4,293,098	4,272,110	4,293,098

Portfolio Company / Principal Business		Principal	Cost	Fair Value²
Drew Marine Group Inc. ⁹ <i>Transportation: Cargo</i>	Junior Secured Loan — Term Loan (Second Lien) 8.0% Cash, 1.0% Libor Floor, Due 5/21	\$ 2,500,000	\$ 2,494,232	\$ 2,502,000
ELO Touch Solutions, Inc. ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 8.0% Cash, 1.5% Libor Floor, Due 6/18	1,898,703	1,843,364	1,897,944
EWT Holdings III Corp. (fka WTG Holdings III Corp.) ⁹ <i>Environmental Industries</i>	Junior Secured Loan — Term Loan (Second Lien) 8.5% Cash, 1.0% Libor Floor, Due 1/22	4,000,000	3,981,130	4,002,800
Fender Musical Instruments Corporation ^{9,11} <i>Hotel, Gaming & Leisure</i>	Senior Secured Loan — Initial Loan 5.8% Cash, 1.3% Libor Floor, Due 4/19	2,408,456	2,419,674	2,409,660
FHC Health Systems, Inc. ^{9,11} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.8% Cash, 1.0% Libor Floor, Due 1/18	3,600,000	3,571,518	3,601,080
First American Payment Systems, L.P. ⁹ <i>Banking, Finance, Insurance & Real Estate</i>	Junior Secured Loan — Term Loan (Second Lien) 10.8% Cash, 1.3% Libor Floor, Due 4/19	3,000,000	2,955,760	3,002,400
First Data Corporation ^{9,11} <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — 2018 Dollar Term Loan 4.2% Cash, Due 3/18	2,000,000	1,887,486	2,005,750
Flexera Software LLC (fka Flexera Software, Inc.) ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 4/20	1,000,000	995,190	1,001,665
Fram Group Holdings Inc./Prestone Holdings Inc. ^{9,11} <i>Automotive</i>	Senior Secured Loan — Term Loan (First Lien) 6.5% Cash, 1.5% Libor Floor, Due 7/17	963,752	967,174	964,619
Getty Images, Inc. ^{9,11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.3% Libor Floor, Due 10/19	2,196,313	2,196,169	2,127,678
Ginn LA Conduit Lender, Inc. ^{7,9} <i>Construction & Building</i>	Senior Secured Loan — First Lien Tranche A Credit-Linked Deposit 7.8% Cash, Due 2/14	1,239,975	1,200,977	24,799
Ginn LA Conduit Lender, Inc. ^{7,9} <i>Construction & Building</i>	Senior Secured Loan — First Lien Tranche B Term Loan 7.8% Cash, Due 2/14	2,658,055	2,574,458	53,161

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Ginn LA Conduit Lender, Inc. ^{7,9} <i>Construction & Building</i>	Junior Secured Loan — Loan (Second Lien) 11.8% Cash, Due 6/12	\$ 3,000,000	\$ 2,715,997	\$ 30
Global Tel*Link Corporation ⁹ <i>Telecommunications</i>	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, 1.3% Libor Floor, Due 11/20	4,000,000	3,930,161	4,000,000
Grande Communications Networks LLC ^{9,11} <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.5% Cash, 1.0% Libor Floor, Due 5/20	3,960,013	3,964,740	3,960,013
Grupo HIMA San Pablo, Inc. ⁹ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 1/18	2,962,500	2,919,970	2,962,500
Grupo HIMA San Pablo, Inc. ⁹ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,000,000	6,879,938	6,982,500
Gymboree Corporation., The ^{9,11} <i>Retail</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.5% Libor Floor, Due 2/18	1,421,105	1,382,030	1,222,655
Hargray Communications Group, Inc. (HCP Acquisition LLC) ^{9,11} <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.0% Libor Floor, Due 6/19	2,970,000	2,945,180	2,973,564
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ^{9,11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Tranche B-3 Term Loan 7.0% Cash, 1.5% Libor Floor, Due 5/18	3,412,500	3,384,568	3,476,501
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ^{9,11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Tranche B-4 Term Loan 6.0% Cash, 1.0% Libor Floor, Due 8/19	1,481,250	1,474,376	1,492,952
Hoffmaster Group, Inc. ⁹ <i>Forest Products & Paper</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, 1.0% Libor Floor, Due 5/21	2,000,000	1,970,564	1,970,000
Hoffmaster Group, Inc. ^{9,11} <i>Forest Products & Paper</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.3% Cash, 1.0% Libor Floor, Due 5/20	4,000,000	3,960,770	3,960,000
Hunter Defense Technologies, Inc. ⁹ <i>Aerospace and Defense</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0% Cash, Due 2/15	4,074,074	4,060,248	4,074,074

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
International Architectural Products, Inc. ^{7,9} <i>Metals & Mining</i>	Senior Secured Loan — Term Loan 12.0% Cash, 3.3% PIK, 2.5% Libor Floor, Due 5/15	\$ 247,636	\$ 228,563	\$ 1,000
Jones Stephens Corp. ⁹ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 7.0% Cash, 2.0% Libor Floor, Due 9/15	1,193,615	1,193,615	1,193,615
Jones Stephens Corp. ^{9,11} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 7.0% Cash, 2.0% Libor Floor, Due 9/15	2,876,033	2,876,033	2,876,033
Key Safety Systems, Inc. ^{9,11} <i>Automotive</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.0% Libor Floor, Due 5/18	2,685,371	2,674,529	2,690,741
Landslide Holdings, Inc. (Crimson Acquisition Corp.) ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — New Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 2/20	3,473,794	3,483,148	3,479,004
LBREP/L-Suncal Master I LLC ^{7,9} <i>Construction & Building</i>	Senior Secured Loan — Term Loan (First Lien) 7.5% Cash, Due 1/10	3,034,968	3,034,968	40,669
MB Aerospace ACP Holdings III Corp. ^{9,11} <i>Aerospace and Defense</i>	Senior Secured Loan — Dollar Term Loan 5.0% Cash, 1.0% Libor Floor, Due 5/19	3,960,000	3,927,500	3,960,792
Medical Specialties Distributors, LLC ^{9,11} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 6.5% Cash, 1.0% Libor Floor, Due 12/19	3,980,000	3,943,918	3,979,204
Nellson Nutraceutical, LLC ^{9,11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.8% Cash, 1.3% Libor Floor, Due 8/18	1,990,000	1,977,573	1,990,000
Ozburn-Hessey Holding Company LLC ^{9,11} <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 6.8% Cash, 1.3% Libor Floor, Due 5/19	3,530,255	3,519,406	3,532,373
Puerto Rico Cable Acquisition Company Inc. (D/B/A Choice TV) ⁹ <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/18	942,080	943,520	942,174
Puerto Rico Cable Acquisition Company Inc. (D/B/A Choice TV) ^{9,11} <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/18	2,826,239	2,814,599	2,826,522

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Quad-C JH Holdings Inc. (aka Joerns Healthcare) ^{9,11} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan A 6.0% Cash, 1.0% Libor Floor, Due 5/20	\$ 3,000,000	\$ 2,970,401	\$ 2,970,000
Restorix Health, Inc. ⁹ <i>Healthcare & Pharmaceuticals</i>	Senior Unsecured Loan — Subordinated Term Loan 12.0% Cash, 2.0% PIK, Due 6/18	4,013,567	4,013,567	4,013,567
Roscoe Medical, Inc. ⁹ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	6,700,000	6,636,233	6,700,000
Safenet, Inc. ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 2/20	2,992,500	2,963,756	2,993,398
Sandy Creek Energy Associates, L.P. ^{9,11} <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 11/20	2,932,317	2,918,945	2,962,652
SGF Produce Holding Corp.(Frozsun, Inc.) ⁹ <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 3/19	2,202,356	2,184,748	2,202,356
SGF Produce Holding Corp.(Frozsun, Inc.) ^{9,11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 3/19	3,457,905	3,438,739	3,457,905
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ^{9,11} <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.8% Cash, 1.3% Libor Floor, Due 6/19	2,970,000	2,945,259	2,970,891
Sun Products Corporation, The (fka Huish Detergents Inc.) ^{9,11} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Tranche B Term Loan 5.5% Cash, 1.3% Libor Floor, Due 3/20	3,910,711	3,884,908	3,842,293
TPF II LC, LLC (TPF II Rolling Hills, LLC) ^{9,11} <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 6.5% Cash, 1.0% Libor Floor, Due 8/19	2,931,300	2,893,300	2,934,231
Trico Products Corporation ⁹ <i>Automotive</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.5% Libor Floor, Due 7/16	4,729,688	4,713,191	4,728,742

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Trico Products Corporation ^{9, 11} <i>Automotive</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.5% Libor Floor, Due 7/16	\$ 3,783,751	\$ 3,770,553	\$ 3,782,994
Trimaran Advisors, L.L.C. ⁹ <i>Banking, Finance, Insurance & Real Estate</i>	Senior Unsecured Loan — Revolving Credit Facility 9.0% Cash, Due 11/17	23,000,000	23,000,000	23,000,000
TriZetto Group, Inc. (TZ Merger Sub, Inc.) ^{9, 11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan 4.8% Cash, 1.3% Libor Floor, Due 5/18	3,544,969	3,551,273	3,544,969
TRSO I, Inc. ⁹ <i>Energy: Oil & Gas</i>	Junior Secured Loan — Term Loan (Second Lien) 11.0% Cash, 1.0% Libor Floor, Due 12/17	1,000,000	986,078	1,020,000
TUI University, LLC ⁹ <i>Services: Consumer</i>	Senior Secured Loan — Term Loan (First Lien) 8.3% Cash, 1.3% Libor Floor, Due 10/14	1,647,733	1,643,778	1,637,518
TWCC Holding Corp. ⁹ <i>Media: Broadcasting & Subscription</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0% Cash, 1.0% Libor Floor, Due 6/20	1,000,000	1,004,373	992,970
TWCC Holding Corp. ^{9, 11} <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Term Loan 3.5% Cash, 0.8% Libor Floor, Due 2/17	1,906,653	1,918,987	1,891,876
Univar Inc. ^{9, 11} <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Term B Loan 5.0% Cash, 1.5% Libor Floor, Due 6/17	2,909,626	2,907,252	2,925,760
USJ-IMECO Holding Company, LLC ^{9, 11} <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 4/20	3,990,000	3,970,564	3,990,000
Verdesian Life Sciences, LLC ⁹ <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.0% Cash, 1.0% Libor Floor, Due 6/20	1,000,000	985,000	985,000
Verdesian Life Sciences, LLC ^{9, 11} <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.0% Cash, 1.0% Libor Floor, Due 6/20	3,000,000	2,955,000	2,955,000

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Vestcom International, Inc. (fka Vector Investment Holdings, Inc.) ^{9, 11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 12/18	\$ 2,866,953	\$ 2,832,592	\$ 2,867,814
Weiman Products, LLC ⁹ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 11/18	2,987,255	2,960,373	2,987,255
Weiman Products, LLC ^{9, 11} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 11/18	3,983,007	3,947,998	3,983,007
Wholesome Sweeteners, Inc. ⁹ <i>Beverage, Food and Tobacco</i>	Junior Secured Loan — Subordinated Note (Second Lien) 14.0% Cash, Due 10/17	4,901,997	4,880,380	4,951,017
WideOpenWest Finance, LLC ⁹ <i>Telecommunications</i>	Senior Secured Loan — Term B Loan 4.8% Cash, 1.0% Libor Floor, Due 4/19	2,969,925	2,988,487	2,982,918
WireCo WorldGroup Inc. ⁹ <i>Capital Equipment</i>	Senior Unsecured Bond — 11.75% - 05/2017 11.8% Cash, Due 5/17	5,000,000	4,979,145	5,121,000
WireCo WorldGroup Inc. ^{9, 11} <i>Capital Equipment</i>	Senior Unsecured Bond — 11.75% - 05/2017 11.8% Cash, Due 5/17	<u>3,000,000</u>	<u>2,987,487</u>	<u>3,072,600</u>
Total Investment in Debt Securities (99% of net asset value at fair value)		<u>\$ 266,037,525</u>	<u>\$ 263,906,927</u>	<u>\$ 256,023,078</u>

Equity Securities Portfolio

Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Cost	Fair Value²
Aerostructures Holdings L.P. ^{5,9} <i>Aerospace and Defense</i>	Partnership Interests	1.2%	\$ 1,000,000	\$ 1,000
Aerostructures Holdings L.P. ^{5,9} <i>Aerospace and Defense</i>	Series A Preferred Interests	1.2%	250,961	295,379
Bankruptcy Management Solutions, Inc. ^{5,9} <i>Diversified/Conglomerate Service</i>	Class A Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. ^{5,9} <i>Diversified/Conglomerate Service</i>	Class B Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. ^{5,9} <i>Diversified/Conglomerate Service</i>	Class C Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. ^{5,9} <i>Diversified/Conglomerate Service</i>	Common Stock 2013	0.8%	314,325	244,088
Caribe Media Inc. (fka Caribe Information Investments Incorporated) ^{5,9} <i>Printing and Publishing</i>	Common	1.3%	359,765	546,336
Coastal Concrete Holding II, LLC ^{5,9} <i>Construction & Building</i>	Class A Units	10.8%	8,625,626	1,000
DBI Holding LLC ^{5,9} <i>Services: Business</i>	Class A Warrants	3.2%	258,940	354,554
eInstruction Acquisition, LLC ^{5,9} <i>Services: Consumer</i>	Membership Units	1.1%	1,079,616	1,000
FP WRCA Coinvestment Fund VII, Ltd. ^{3,5} <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Class A Shares	1,500	1,500,000	2,135,490

Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Cost	Fair Value²
Perseus Holding Corp. ^{5,9} <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Common	0.2%	\$ 400,000	\$ 1,000
Plumbing Holdings Corporation ^{5,9} <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Common	7.8%	-	1,382,237
Roscoe Investors, LLC ^{5,9} <i>Healthcare & Pharmaceuticals</i>	Class A Units	1.6%	1,000,000	1,000,000
TRSO II, Inc. ^{5,9} <i>Oil and Gas</i>	Common Stock	5.4%	<u>1,500,000</u>	<u>2,796,887</u>
Total Investment in Equity Securities (3% of net asset value at fair value)			<u>\$ 16,289,233</u>	<u>\$ 8,758,971</u>

CLO Fund Securities

CLO Subordinated Investments

Portfolio Company	Investment	Percentage Interest	Cost	Fair Value ²
Grant Grove CLO, Ltd. ³	Subordinated Securities	22.2%	\$ 4,701,455	\$ 738,158
Katonah III, Ltd. ^{3,10}	Preferred Shares	23.1%	1,398,172	550,000
Katonah V, Ltd. ^{3,10}	Preferred Shares	26.7%	3,320,000	1,000
Katonah VII CLO Ltd. ^{3,6}	Subordinated Securities	16.4%	4,484,693	1,579,404
Katonah VIII CLO Ltd. ^{3,6}	Subordinated Securities	10.3%	3,378,005	1,387,164
Katonah IX CLO Ltd. ^{3,6}	Preferred Shares	6.9%	2,008,087	777,822
Katonah X CLO Ltd. ^{3,6}	Subordinated Securities	33.3%	11,755,728	5,714,906
Katonah 2007-I CLO Ltd. ^{3,6}	Preferred Shares	100.0%	31,095,297	27,991,513
Trimaran CLO IV, Ltd. ^{3,6}	Preferred Shares	19.0%	3,524,200	2,733,495
Trimaran CLO V, Ltd. ^{3,6}	Subordinate Notes	20.8%	2,716,400	1,842,675
Trimaran CLO VI, Ltd. ^{3,6}	Income Notes	16.2%	2,761,700	1,925,496
Trimaran CLO VII, Ltd. ^{3,6}	Income Notes	10.5%	3,132,100	2,251,346
Catamaran CLO 2012-1 Ltd. ^{3,6}	Subordinated Notes	24.9%	8,987,000	6,969,478
Catamaran CLO 2013-1 Ltd. ^{3,6}	Subordinated Notes	23.5%	9,365,700	8,762,580
Dryden 30 Senior Loan Fund ³	Subordinated Notes	7.5%	3,036,200	2,892,500
Catamaran CLO 2014-1 Ltd. ^{3,6}	Subordinated Notes	24.9%	11,464,500	9,683,361
Total Investment in CLO Subordinated Securities			\$ 107,129,237	\$ 75,800,898

CLO Rated-Note Investment

Portfolio Company	Investment	Percentage Interest	Cost	Fair Value ²
Katonah 2007-I CLO Ltd. ^{3,6}	Floating - 04/2022 - B2L Par Value of \$10,500,000 Due 4/22	100.0%	\$ 1,327,169	\$ 10,300,000
Catamaran CLO 2012-1 Ltd. ^{3,6}	Float - 12/2023 - F Par Value of \$4,500,000 Due 12/23	42.9%	3,885,051	4,290,000
Catamaran CLO 2014-1 Ltd. ^{3,6}	Float - 04/2026 - E Par Value of \$1,525,000 Due 4/26	15.1%	1,407,446	1,340,000
Total Investment in CLO Rated-Note			\$ 6,619,666	\$ 15,930,000
Total Investment in CLO Fund Securities (35% of net asset value at fair value)			\$ 113,748,903	\$ 91,730,898

Asset Manager Affiliates

Portfolio Company / Principal Business	Investment	Percentage Interest	Cost	Fair Value ²
Asset Manager Affiliates ⁹	Asset Management Company	100.0%	\$ 83,924,720	\$ 75,302,000
Total Investment in Asset Manager Affiliates (29% of net asset value at fair value)			<u>\$ 83,924,720</u>	<u>\$ 75,302,000</u>

Time Deposits and Money Market Account

Time Deposit and Money Market Accounts	Investment	Yield	Par / Cost	Fair Value ²
JP Morgan Business Money Market Account ^{8,9}	Money Market Account	0.10%	\$ 248,980	\$ 248,980
US Bank Money Market Account ⁹	Money Market Account	0.30%	5,361,961	5,361,961
Total Investment in Time Deposit and Money Market Accounts (2% of net asset value at fair value)			<u>\$ 5,610,941</u>	<u>\$ 5,610,941</u>
Total Investments⁴ (169% of net asset value at fair value)			<u>\$ 483,480,724</u>	<u>\$ 437,425,888</u>

See accompanying notes to consolidated financial statements.

- 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 June 30, 2014. As noted in the table above, 65% (based on par) of debt securities contain LIBOR floors which range between 0.75% and 2.00%.
- 2 Reflects the fair market value of all investments as of June 30, 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 \$483 million. The aggregate gross unrealized appreciation is approximately \$16 million, the aggregate gross unrealized depreciation is approximately \$62 million, and the net unrealized depreciation is approximately \$46 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 consolidated 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 June 30, 2014, this CLO Fund Security was not providing a dividend distribution.
- 11 As of June 30, 2014, investment was owned by KCAP Senior Funding I, LLC and has been pledged to secure KCAP Senior Funding I, LLC's obligation.

KCAP FINANCIAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
As of December 31, 2013

Debt Securities Portfolio

Portfolio Company / Principal Business	Investment Interest Rate ¹ / Maturity	Principal	Cost	Fair Value ²
Advanced Lighting Technologies, Inc. ^{9,11} <i>Consumer goods: Non-durable</i>	First Lien Bond — 10.5% - 06/2019 - 00753CAE2 10.5% Cash, Due 6/19	\$ 3,000,000	\$ 2,948,332	\$ 2,546,400
Advantage Sales & Marketing Inc. ⁹ <i>Services: Business</i>	Senior Secured Loan — 2013 Term Loan (First Lien) 4.3% Cash, Due 12/17	1,989,952	1,996,642	2,001,892
Alaska Communications Systems Holdings, Inc. ^{9,11} <i>Telecommunications</i>	Senior Secured Loan — Term Loan 6.3% Cash, Due 10/16	2,358,409	2,362,064	2,357,702
Apria Healthcare Group Inc. ^{9,11} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 6.8% Cash, Due 4/20	2,985,000	2,997,209	2,985,000
Aramark Corporation <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — U.S. Term D Loan 4.0% Cash, Due 9/19	850,000	856,173	856,374
Aramark Corporation ¹¹ <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — LC-3 Facility 3.7% Cash, Due 7/16	61,707	61,967	61,861
Aramark Corporation ¹¹ <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — U.S. Term C Loan 3.7% Cash, Due 7/16	938,293	942,256	940,639
Aramark Corporation ¹¹ <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — U.S. Term D Loan 4.0% Cash, Due 9/19	1,150,000	1,158,352	1,158,625
ARSloane Acquisition, LLC ^{9,11} <i>Services: Business</i>	Senior Secured Loan — Tranche B Term Loan (First Lien) 7.5% Cash, Due 10/19	997,500	987,913	997,898
Asurion, LLC (fka Asurion Corporation) ^{9,11} <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Incremental Tranche B-1 Term Loan 4.5% Cash, Due 5/19	1,980,000	2,000,806	1,983,168

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Bankruptcy Management Solutions, Inc. ⁹ <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Term B Loan 7.0% Cash, Due 6/18	\$ 718,182	\$ 718,182	\$ 713,514
BarBri, Inc. (Gemini Holdings, Inc.) ^{9,11} <i>Services: Consumer</i>	Senior Secured Loan — Term Loan 5.3% Cash, Due 7/19	3,000,000	2,986,055	3,000,900
BBB Industries, LLC ^{9,11} <i>Automotive</i>	Senior Secured Loan — Term Loan B 5.5% Cash, Due 3/19	2,887,500	2,878,820	2,888,366
Bellisio Foods, Inc. ^{9,11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Delayed Draw Term Loan 6.5% Cash, Due 8/19	1,582,475	1,575,088	1,582,316
Bellisio Foods, Inc. ^{9,11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — U.S. Term B Loans 5.3% Cash, Due 8/19	2,191,119	2,180,891	2,190,900
Blue Coat Systems, Inc. ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — New Term Loan 4.5% Cash, Due 5/19	3,990,000	4,003,966	3,991,995
Caribe Media Inc. (fka Caribe Information Investments Incorporated) ⁹ <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Loan 10.0% Cash, Due 11/14	379,763	379,763	379,193
Carolina Beverage Group LLC ⁹ <i>Beverage, Food and Tobacco</i>	Senior Secured Bond — 10.625% - 08/2018 - 143818AA0 144A 10.6% Cash, Due 8/18	1,500,000	1,519,072	1,619,550
Catalina Marketing Corporation ^{9,11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Initial Term Loan 5.3% Cash, Due 10/20	1,995,000	1,983,766	2,025,553
Clover Technologies Group, LLC (Clover Holdings Inc.) ^{9,11} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.8% Cash, Due 5/18	2,850,292	2,883,914	2,850,291
CoActive Technologies LLC (fka CoActive Technologies, Inc.) ^{7,9} <i>Capital Equipment</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0% Cash, 7.0% PIK, Due 1/15	2,063,007	1,987,358	1,863,721
Crowley Holdings Preferred, LLC ⁹ <i>Transportation: Cargo</i>	Preferred Stock — 12.000% - 12/2049 - Series A Income Preferred Securities 10.0% Cash, 2.0% PIK, Due 12/49	10,000,000	10,000,000	10,600,000

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
CSM Bakery Supplies LLC ⁹ <i>Beverage, Food and Tobacco</i>	Junior Secured Loan — Term Loan (Second Lien) 8.5% Cash, Due 7/21	\$ 3,000,000	\$ 3,018,871	\$ 3,001,500
CSM Bakery Supplies LLC ^{9,11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 4.8% Cash, Due 7/20	3,657,500	3,655,989	3,659,329
Del Monte Foods Company ^{9,11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Initial Term Loan 4.0% Cash, Due 3/18	2,789,388	2,783,753	2,803,321
Drew Marine Group Inc. ⁹ <i>Transportation: Cargo</i>	Junior Secured Loan — Term Loan (Second Lien) 8.0% Cash, Due 5/21	2,500,000	2,493,817	2,493,750
ELO Touch Solutions, Inc. ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 8.0% Cash, Due 6/18	1,898,703	1,835,507	1,893,577
Fender Musical Instruments Corporation ^{9,11} <i>Hotel, Gaming & Leisure</i>	Senior Secured Loan — Initial Loan 5.8% Cash, Due 4/19	2,421,986	2,434,723	2,463,620
FHC Health Systems, Inc. ^{9,11} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.8% Cash, Due 1/18	3,900,000	3,864,809	3,900,000
First American Payment Systems, L.P. ⁹ <i>Banking, Finance, Insurance & Real Estate</i>	Junior Secured Loan — Term Loan (Second Lien) 10.8% Cash, Due 4/19	3,000,000	2,951,174	2,999,400
First Data Corporation ^{9,11} <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — 2018 Dollar Term Loan 4.2% Cash, Due 3/18	2,000,000	1,875,135	2,006,520
Flexera Software LLC (fka Flexera Software, Inc.) ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan 5.0% Cash, Due 3/19	2,722,955	2,734,588	2,725,133
Fram Group Holdings Inc./Prestone Holdings Inc. ^{9,11} <i>Automotive</i>	Senior Secured Loan — Term Loan (First Lien) 6.5% Cash, Due 7/17	966,900	970,557	966,610
Freescal Semiconductor, Inc. <i>High Tech Industries</i>	Senior Subordinated Bond — 10.125% - 12/2016 - 35687MAP2 10.1% Cash, Due 12/16	1,036,000	1,037,707	1,051,540

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Getty Images, Inc. ^{9,11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, Due 10/19	\$ 3,711,259	\$ 3,711,065	\$ 3,471,698
Ginn LA Conduit Lender, Inc. ^{7,9} <i>Construction & Building</i>	Senior Secured Loan — First Lien Tranche A Credit-Linked Deposit 7.8% Cash, Due 6/11	1,257,143	1,224,101	37,714
Ginn LA Conduit Lender, Inc. ^{7,9} <i>Construction & Building</i>	Senior Secured Loan — First Lien Tranche B Term Loan 7.8% Cash, Due 6/11	2,694,857	2,624,028	80,846
Ginn LA Conduit Lender, Inc. ^{7,9} <i>Construction & Building</i>	Junior Secured Loan — Loan (Second Lien) 11.8% Cash, Due 6/12	3,000,000	2,715,997	30,015
Global Tel*Link Corporation ⁹ <i>Telecommunications</i>	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, Due 11/20	4,000,000	3,924,752	3,991,600
Grande Communications Networks LLC ^{9,11} <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.5% Cash, Due 5/20	3,980,000	3,985,209	3,980,398
Grupo HIMA San Pablo, Inc. ⁹ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term B Loan (First Lien) 8.5% PIK, Due 1/18	2,977,500	2,928,848	2,813,738
Grupo HIMA San Pablo, Inc. ⁹ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 13.8% PIK, Due 7/18	7,000,000	6,865,363	6,817,300
Gymboree Corporation., The ^{9,11} <i>Retail</i>	Senior Secured Loan — Term Loan 5.0% Cash, Due 2/18	1,421,105	1,377,305	1,332,286
Hargray Communications Group, Inc. (HCP Acquisition LLC) ^{9,11} <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, Due 6/19	2,985,000	2,957,575	2,986,194
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ^{9,11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Tranche B-3 Term Loan 7.0% Cash, Due 5/18	3,456,250	3,424,170	3,488,341
Hunter Defense Technologies, Inc. ⁹ <i>Aerospace and Defense</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0% Cash, Due 2/15	4,074,074	4,049,553	3,911,111

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Iasis Healthcare LLC ⁹ <i>Healthcare, Education and Childcare</i>	Senior Unsecured Bond — 8.375% - 05/2019 - 45072PAD4 8.4% Cash, Due 5/19	3,000,000	2,892,521	3,187,500
International Architectural Products, Inc. ^{7,9} <i>Metals & Mining</i>	Senior Secured Loan — Term Loan 12.0% Cash, Due 5/15	247,636	228,563	1,000
Jones Stephens Corp. ⁹ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 7.0% Cash, Due 9/15	1,214,195	1,214,195	1,214,195
Jones Stephens Corp. ^{9,11} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 7.0% Cash, Due 9/15	2,925,620	2,925,620	2,925,620
Key Safety Systems, Inc. ^{9,11} <i>Automotive</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, Due 5/18	2,692,152	2,679,887	2,696,459
Kinetic Concepts, Inc. ⁹ <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Dollar Term D-1 Loan 4.5% Cash, Due 5/18	1,989,979	2,003,621	2,003,661
Kinetic Concepts, Inc. ^{9,11} <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Dollar Term D-1 Loan 4.5% Cash, Due 5/18	1,994,979	2,012,272	2,008,695
Landslide Holdings, Inc. (Crimson Acquisition Corp.) ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — Initial Term Loan 5.3% Cash, Due 8/19	3,482,500	3,492,130	3,483,893
LBREP/L-Suncal Master I LLC ^{7,9} <i>Construction & Building</i>	Senior Secured Loan — Term Loan (First Lien) 7.5% Cash, Due 1/10	3,034,968	3,034,968	40,669
LTS Buyer LLC (Sidera Networks, Inc.) ⁹ <i>Telecommunications</i>	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, Due 4/20	3,980,000	3,974,154	4,003,024
MB Aerospace ACP Holdings III Corp. ⁹ <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 6.0% Cash, Due 5/19	\$ 3,980,000	\$ 3,944,023	\$ 3,980,796
Medical Specialties Distributors, LLC ^{9,11} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 6.5% Cash, Due 12/19	4,000,000	3,960,421	3,999,200

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Michael Foods Group, Inc. (f/k/a M-Foods Holdings, Inc.) ^{9, 11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term B Facility 4.3% Cash, Due 2/18	1,751,716	1,761,555	1,753,116
Nellson Nutraceutical, LLC ^{9, 11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 6.8% Cash, Due 8/18	1,995,000	1,981,056	1,995,000
Ozburn-Hessey Holding Company LLC ^{9, 11} <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 6.8% Cash, Due 5/19	3,548,085	3,536,235	3,549,504
PetCo Animal Supplies, Inc. ^{9, 11} <i>Retail</i>	Senior Secured Loan — New Loans 4.0% Cash, Due 11/17	1,979,592	1,987,274	1,992,746
Pharmaceutical Product Development, Inc. (Jaguar Holdings, LLC) ⁹ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — 2013 Term Loan 4.0% Cash, Due 12/18	3,517,594	3,529,732	3,546,526
Puerto Rico Cable Acquisition Company Inc. ⁹ <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Term Loan 5.5% Cash, Due 7/18	980,693	982,374	981,086
Puerto Rico Cable Acquisition Company Inc. ^{9, 11} <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Term Loan 5.5% Cash, Due 7/18	2,942,080	2,928,491	2,943,257
Sandy Creek Energy Associates, L.P. ^{9, 11} <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, Due 11/20	3,000,000	2,985,253	3,005,625
SGF Produce Holding Corp.(Frozsun, Inc.) ⁹ <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.0% Cash, Due 3/19	2,213,423	2,193,867	2,213,645
SGF Produce Holding Corp.(Frozsun, Inc.) ^{9, 11} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.0% Cash, Due 3/19	3,475,281	3,454,967	3,475,629
Spin Holdco Inc. ⁹ <i>Consumer goods: Durable</i>	Senior Secured Loan — Initial Term Loan (First Lien) 4.3% Cash, Due 11/19	1,246,875	1,245,425	1,255,454

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
Spin Holdco Inc. ^{9,11} <i>Consumer goods: Durable</i>	Senior Secured Loan — Initial Term Loan (First Lien) 4.3% Cash, Due 11/19	\$ 2,743,125	2,742,255	2,761,998
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ^{9,11} <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.8% Cash, Due 6/19	2,985,000	2,957,663	2,985,896
Steinway Musical Instruments, Inc. ⁹ <i>Hotel, Gaming & Leisure</i>	Junior Secured Loan — Loan (Second Lien) 9.3% Cash, Due 9/20	1,000,000	990,403	1,001,900
Sun Products Corporation, The (fka Huish Detergents Inc.) ^{9,11} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Tranche B Term Loan 5.5% Cash, Due 3/20	3,970,000	3,941,540	3,780,433
TPF II LC, LLC (TPF II Rolling Hills, LLC) ^{9,11} <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 6.5% Cash, Due 8/19	2,985,000	2,942,573	2,987,985
Trico Products Corporation ⁹ <i>Automotive</i>	Senior Secured Loan — Term Loan 6.3% Cash, Due 7/16	4,864,844	4,843,792	4,863,871
Trico Products Corporation ^{9,11} <i>Automotive</i>	Senior Secured Loan — Term Loan 6.3% Cash, Due 7/16	3,891,875	3,875,033	3,891,097
Trimaran Advisors, L.L.C. ⁹ <i>Banking, Finance, Insurance & Real Estate</i>	Senior Unsecured Loan — Revolving Credit Facility 9.0% Cash, Due 11/17	23,000,000	23,000,000	23,000,000
TriZetto Group, Inc. (TZ Merger Sub, Inc.) ^{9,11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan 4.8% Cash, Due 5/18	3,676,604	3,684,234	3,639,857
TRSO I, Inc. ⁹ <i>Energy: Oil & Gas</i>	Junior Secured Loan — Term Loan (Second Lien) 11.0% Cash, Due 12/17	10,400,000	10,234,558	10,608,000
TUI University, LLC ⁹ <i>Services: Business</i>	Senior Secured Loan — Term Loan (First Lien) 7.3% Cash, Due 10/14	1,647,733	1,637,909	1,614,779

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
TWCC Holding Corp. ⁹ <i>Media: Broadcasting & Subscription</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0% Cash, Due 6/20	\$ 1,000,000	1,004,735	1,030,005
TWCC Holding Corp. ^{9, 11} <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Term Loan 3.5% Cash, Due 2/17	1,965,101	1,980,166	1,975,379
Univar Inc. ^{9, 11} <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Term B Loan 5.0% Cash, Due 6/17	2,924,675	2,921,597	2,906,601
Vertafore, Inc. ^{9, 11} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (2013) 4.3% Cash, Due 10/19	1,202,077	1,201,491	1,203,039
Vestcom International, Inc. (fka Vector Investment Holdings, Inc.) ^{9, 11} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Term Loan 7.0% Cash, Due 12/18	2,977,500	2,939,085	2,978,095
Weiman Products, LLC ⁹ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.3% Cash, Due 11/18	1,000,000	990,219	990,000
Weiman Products, LLC ^{9, 11} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.3% Cash, Due 11/18	4,000,000	3,960,876	3,960,000
Wholesome Sweeteners, Inc. ⁹ <i>Beverage, Food and Tobacco</i>	Junior Secured Loan — Subordinated Note (Second Lien) 14.0% Cash, Due 10/17	6,648,596	6,614,827	6,715,082

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Cost	Fair Value²
WideOpenWest Finance, LLC ⁹ <i>Telecommunications</i>	Senior Secured Loan — Term B Loan 4.8% Cash, Due 4/19	\$ 2,984,962	3,005,566	3,005,111
WireCo WorldGroup Inc. ⁹ <i>Capital Equipment</i>	Senior Unsecured Bond — 11.75% - 05/2017 11.8% Cash, Due 5/17	5,000,000	4,977,052	5,121,000
WireCo WorldGroup Inc. ^{9,11} <i>Capital Equipment</i>	Senior Unsecured Bond — 11.75% - 05/2017 11.8% Cash, Due 5/17	3,000,000	2,986,231	3,072,600
WTG Holdings III Corp. ⁹ <i>Environmental Industries</i>	Junior Secured Loan — Term Loan (Second Lien) 8.5% Cash, Due 1/22	4,000,000	3,980,000	3,980,000
Total Investment in Debt Securities (107% of net asset value at fair value)		\$ 276,978,279	\$ 275,213,594	\$ 266,830,427

Equity Securities Portfolio

Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Cost	Fair Value²
Aerostructures Holdings L.P. ^{5,9} <i>Aerospace and Defense</i>	Partnership Interests	1.2%	\$ 1,000,000	\$ 1,000
Aerostructures Holdings L.P. ^{5,9} <i>Aerospace and Defense</i>	Series A Preferred Interests	1.2%	250,961	207,988
Bankruptcy Management Solutions, Inc. ^{5,9} <i>Banking, Finance, Insurance & Real Estate</i>	Class A Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. ^{5,9} <i>Banking, Finance, Insurance & Real Estate</i>	Class B Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. ^{5,9} <i>Banking, Finance, Insurance & Real Estate</i>	Class C Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. ^{5,9} <i>Banking, Finance, Insurance & Real Estate</i>	Common Stock 2013	0.8%	314,325	309,363
Caribe Media Inc. (fka Caribe Information Investments Incorporated) ^{5,9} <i>Media: Advertising, Printing & Publishing</i>	Common	-	359,765	692,710
Coastal Concrete Holding II, LLC ^{5,9} <i>Construction & Building</i>	Class A Units	10.8%	8,625,626	1,000
eInstruction Acquisition, LLC ^{5,9} <i>Services: Consumer</i>	Membership Units	1.1%	1,079,617	1,000
FP WRCA Coinvestment Fund VII, Ltd. ^{3, 5,} <i>Capital Equipment</i>	Class A Shares	1,500	1,500,000	1,735,604
Perseus Holding Corp. ^{5,9} <i>Hotel, Gaming & Leisure</i>	Common	0.2%	400,000	1,000
Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Cost	Fair Value²
Plumbing Holdings Corporation ^{5,9} <i>Consumer goods: Durable</i>	Common	7.8%	\$ -	\$ 1,581,481
Plumbing Holdings Corporation ^{5,9} <i>Consumer goods: Durable</i>	Preferred	15.5%	3,725,390	4,152,689
TRSO II, Inc. ^{5,9} <i>Energy: Oil & Gas</i>	Common Stock	5.4%	1,500,000	2,322,563
Total Investment in Equity Securities (4% of net asset value at fair value)			\$ 18,755,684	\$ 11,006,398

CLO Fund Securities

CLO Equity Investments

Portfolio Company	Investment	Percentage Interest	Cost	Fair Value ²
Grant Grove CLO, Ltd. ³	Subordinated Securities	22.2%	\$ 4,715,553	\$ 1,052,164
Katonah III, Ltd. ^{3,10}	Preferred Shares	23.1%	1,618,611	325,000
Katonah V, Ltd. ^{3,10}	Preferred Shares	26.7%	3,320,000	1,000
Katonah VII CLO Ltd. ^{3,6}	Subordinated Securities	16.4%	4,499,793	1,478,978
Katonah VIII CLO Ltd. ^{3,6}	Subordinated Securities	10.3%	3,390,005	1,230,731
Katonah IX CLO Ltd. ^{3,6}	Preferred Shares	6.9%	2,023,287	829,739
Katonah X CLO Ltd. ^{3,6}	Subordinated Securities	33.3%	11,770,993	5,932,163
Katonah 2007-I CLO Ltd. ^{3,6}	Preferred Shares	100.0%	31,064,973	27,758,379
Trimaran CLO IV, Ltd. ^{3,6}	Preferred Shares	19.0%	3,542,300	2,519,210
Trimaran CLO V, Ltd. ^{3,6}	Subordinate Notes	20.8%	2,721,500	1,844,276
Trimaran CLO VI, Ltd. ^{3,6}	Income Notes	16.2%	2,784,200	1,981,948
Trimaran CLO VII, Ltd. ^{3,6}	Income Notes	10.5%	3,133,900	2,513,261
Catamaran CLO 2012-1 Ltd. ^{3,6}	Subordinated Notes	24.9%	8,943,900	6,846,520
Catamaran CLO 2013-1 Ltd. ^{3,6}	Subordinated Notes	23.5%	9,960,400	8,225,100
Dryden 30 Senior Loan Fund ³	Subordinated Notes	7.5%	3,063,200	2,973,750
Total Investment in CLO Equity Securities			\$ 96,552,615	\$ 65,512,219

CLO Rated-Note Investment

Portfolio Company	Investment	Percentage Interest	Cost	Fair Value ²
Katonah 2007-I CLO Ltd. ^{3,6}	Floating - 04/2022 - B2L - 48602NAA8 Par Value of \$10,500,000 .0%, Due 4/22	100.0%	\$ 1,300,937	\$ 9,740,000
	Float - 12/2023 - F - 14889CAE0 Par Value of \$4,500,000 .0%, Due 12/23			
Catamaran CLO 2012-1 Ltd. ^{3,6}		42.9%	3,843,398	4,200,001
Total Investment in CLO Rated-Note			\$ 5,144,335	\$ 13,940,001
Total Investment in CLO Fund Securities (32% of net asset value at fair value)			\$ 101,696,950	\$ 79,452,220

Asset Manager Affiliates

<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Fair Value²</u>
Asset Manager Affiliates ⁹	Asset Management Company	100.0%	\$ 83,378,741	\$ 76,148,000
Total Investment in Asset Manager Affiliates (30% of net asset value at fair value)			<u>\$ 83,378,741</u>	<u>\$ 76,148,000</u>

Time Deposits and Money Market Account

<u>Time Deposit and Money Market Accounts</u>	<u>Investment</u>	<u>Yield</u>	<u>Par / Cost</u>	<u>Fair Value²</u>
JP Morgan Business Money Market Account ^{8,9}	Money Market Account	0.15%	237,088	237,088
US Bank Money Market Account ⁹	Money Market Account	0.30%	<u>6,875,861</u>	<u>6,875,861</u>
Total Investment in Time Deposit and Money Market Accounts (3% of net asset value at fair value)			<u>\$ 7,112,949</u>	<u>\$ 7,112,949</u>
Total Investments⁴ (176% of net asset value at fair value)			<u>\$ 486,157,918</u>	<u>\$ 440,549,994</u>

See accompanying notes to consolidated financial statements.

- 1 A majority of the variable rate loans to the Company's portfolio companies 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. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at December 31, 2013.
- 2 Reflects the fair market value of all investments as of December 31, 2013, 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 \$486 million. The aggregate gross unrealized appreciation is approximately \$15 million, the aggregate gross unrealized depreciation is approximately \$61 million, and the net unrealized depreciation is approximately \$46 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 consolidated 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, 2013, this CLO Fund Security was not providing a dividend distribution.
- 11 As of December 31, 2013, investment was owned by KCAP Senior Funding I, LLC and has been pledged to secure KCAP Senior Funding I, LLC's obligations.

KCAP FINANCIAL, INC.
CONSOLIDATED FINANCIAL HIGHLIGHTS
(unaudited)

	Six Months Ended	
	June 30,	
	2014	2013
Per Share Data:		
Net asset value, at beginning of period	\$ 7.51	\$ 7.85
Net investment income ¹	0.48	0.43
Net realized gain (losses) from investments ¹	0.01	(0.05)
Net change in unrealized depreciation on investments ¹	(0.02)	0.12
Net increase in net assets resulting from operations	0.47	0.50
Net (decrease) in net assets resulting from distributions:		
Distribution of net investment income	(0.24)	(0.24)
Return of capital	(0.01)	(0.04)
Net decrease in net assets resulting from distributions	(0.25)	(0.28)
Net (decrease) increase in net assets relating to stock-based transactions:		
Offering of common stock	-	0.16
Issuance of common stock under dividend reinvestment plan	0.01	0.01
Stock based compensation	(0.07)	-
Net increase in net assets relating to stock-based transactions	(0.06)	0.17
Net asset value, end of period	<u>\$ 7.67</u>	<u>\$ 8.24</u>
Total net asset value return ²	5.5%	8.4%
Ratio/Supplemental Data:		
Per share market value at beginning of period	\$ 8.07	\$ 9.19
Per share market value at end of period	\$ 8.49	\$ 11.26
Total market return ³	8.3%	25.5%
Shares outstanding at end of period	33,725,223	33,298,674
Net assets at end of period	\$ 258,514,055	\$ 274,307,840
Portfolio turnover rate ⁴	21.2%	37.7%
Average par debt outstanding	\$ 195,658,000	\$ 104,537,912
Average par debt outstanding per share	5.8%	7.8%
Asset coverage ratio	231%	239%
Ratio of net investment income to average net assets ⁵	12.5%	10.9%
Ratio of total expenses to average net assets ⁵	8.4%	7.3%
Ratio of interest expense to average net assets ⁵	4.6%	3.6%
Ratio of non-interest expenses to average net assets ⁵	3.8%	3.7%

¹ Based on weighted average number of common shares outstanding-basic 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 distributions (including any return of capital), 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 distributions (including any return of capital), 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 consolidated financial statements.

KCAP FINANCIAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

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”).

We have three principal areas of investment:

First, we originate, structure, and invest 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 we may invest in the equity securities of privately held middle market companies.

Second, we have invested in asset management companies (Katonah Debt Advisors, L.L.C. and Trimaran Advisors, L.L.C., collectively the “Asset Manager Affiliates”) which manage collateralized loan obligations (“CLOs”).

Third, we invest 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 we make investments in CLO Fund Securities managed by other asset managers. The CLOs 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 unaudited consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information. Accordingly, they do not include all of the information and footnotes required for annual consolidated financial statements. The unaudited interim consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto in the Company’s Form 10-K for the year ended December 31, 2013, as filed with the U.S. Securities and Exchange Commission (the “Commission” or the “SEC”).

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 management 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. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for the full year. Certain prior period amounts have been reclassified to conform to the current year’s 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 regarding the Asset Manager Affiliates, Katonah 2007-I CLO (pursuant to Rule 3-09) and Katonah X CLO (pursuant to Rule 4-08(g)) is set forth in Note 5 to these consolidated financial statements.

In June 2013, the FASB issued Accounting Standards Update 2013-08 “Financial Services-Investment Companies (Topic 946) Amendments to the Scope, Measurement, and Disclosure Requirements” (“ASU 2013-08”). ASU 2013-08 clarifies the characteristics of an investment company and requires reporting entities to disclose information about the following items: (i) the type and amount of financial support provided to investee companies, including situations in which the Company assisted an investee in obtaining financial support, (ii) the primary reasons for providing the financial support, (iii) the type and amount of financial support the Company is contractually required to provide to an investee, but has not yet provided, and (iv) the primary reasons for the contractual requirement to provide the financial support. The Company adopted ASU 2013-08 during the six months ended June 30, 2014 as the amendments in ASU 2013-08 effective January 1, 2014.

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 six months ended June 30, 2014, the Company invested \$88 million in portfolio companies to support their growth objectives. None of this support was contractually obligated. See also Note 8 – Commitments and Contingencies. As of June 30, 2014, the Company holds loans it has made to 80 investee companies with aggregate principal amounts of \$236 million. The details of such loans have been disclosed on the consolidated schedule of investments as well as in Note 4 – Investments and Fair Value Measurements. 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 six month period ended June 30, 2014, the Company did not make any such introductions or lead any syndicates.

Investments

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

Investment Income. Interest income is recorded on an accrual basis and includes the accretion of discounts and amortization of premiums. Discounts from and premiums to par value on debt securities purchased are accreted into or amortized as a reduction of interest income over the life of the respective debt security using the effective yield method. The amortized cost of debt securities represents the original cost adjusted for the accretion of discounts and amortization of premiums, if any.

Generally, when interest and/or principal payments on a debt security become past due, or if the Company otherwise does not expect the borrower to be able to service its debt and other obligations, the Company will place the debt security on non-accrual status and will generally cease recognizing interest income on that debt security for financial reporting purposes until all principal and interest have been brought current through payment or due to restructuring such that the interest income is deemed to be collectible.

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 that have a market price 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 and approved by the Board of Directors 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. 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 third party valuation consulting services. Each quarter the independent valuation firm performs 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 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.

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 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 taking into account 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.

The Company relies on several techniques for valuing its portfolio of investments, including:

- "Enterprise Value" – when there is no liquid public market, the investment is carried at fair value based on the enterprise value of the portfolio company, which is determined using (i) valuation data from publicly traded comparables, and (ii) a discounted cash flow analysis based on projected performance of an investment.
- The "Income Approach" – 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 "Market Approach" – if market quotations are readily available, valuations are based upon the closing public market prices on the balance sheet date. Securities that carry certain restrictions on sale are typically valued at a discount from the public market value of the security.
- "Discounted Cash Flow" - a discounted cash flow model is based on the net present value of future cash flows, discounted at a rate appropriate for each cash flow.

Debt Securities. The Company values its debt securities using primarily Enterprise Value, Income Approach and Market Approach.

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 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 the two 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 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.

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, as described in Note 4 below, 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 (as described below). 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 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.

3. EARNINGS 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 three and six months ended June 30, 2014 and 2013 (unaudited):

	(unaudited)		(unaudited)	
	Three Months Ended June 30,	2013	Six Months Ended June 30,	2013
	2014		2014	
Net increase in net assets resulting from operations	\$ 12,252,662	\$ 8,528,825	\$ 15,694,256	\$ 15,742,105
Net decrease in net assets allocated to unvested share awards	(115,402)	(47,138)	(138,230)	(53,665)
Interest on Convertible Notes	1,072,050	1,122,357	2,144,100	2,434,857
Amortization of Capitalized Costs on Convertible Notes	104,430	92,360	206,867	198,475
Net increase in net assets available to common stockholders	<u>\$ 13,313,740</u>	<u>\$ 9,696,404</u>	<u>\$ 17,906,993</u>	<u>\$ 18,321,772</u>
Weighted average number of common shares outstanding for basic shares computation	33,405,189	33,040,155	33,371,764	31,163,596
Effect of dilutive securities - stock options	11,858	16,330	11,903	15,717
Effect of dilutive Convertible Notes	6,306,217	6,338,639	6,306,217	6,843,429
Weighted average number of common and common stock equivalent shares outstanding for diluted shares computation	<u>39,723,264</u>	<u>39,395,124</u>	<u>39,689,884</u>	<u>38,022,742</u>
Net increase in net assets per basic common shares:				
Net increase in net assets from operations	\$ 0.37	\$ 0.26	\$ 0.47	\$ 0.51
Net increase in net assets per diluted shares:				
Net increase in net assets from operations	\$ 0.34	\$ 0.25	\$ 0.45	\$ 0.48

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.

For the three months ended June 30, 2014 and 2013, options to purchase 11,858 and 16,330 shares of common stock, respectively, were included in the computation of diluted earnings per share. For the six months ended June 30, 2014 and 2013, options to purchase 11,903 and 15,717 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 the 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 three months and six months ended June 30, 2014, the effects of the convertible notes are dilutive.

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 June 30, 2014 the current conversion rate of the Convertible Notes is approximately 128.6773 shares of our common stock per \$1,000 principal amount of the conversion rate, equivalent to a conversion price of approximately \$7.77 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 June 30, 2014 and December 31, 2013:

Security Type	June 30, 2014 (unaudited)			December 31, 2013		
	Cost	Fair Value	% ¹	Cost	Fair Value	% ¹
Money Market Accounts ²	\$ 5,610,941	\$ 5,610,941	2	\$ 7,112,949	\$ 7,112,949	3
Senior Secured Loan	159,600,198	153,304,076	60	175,021,272	168,188,453	67
Junior Secured Loan	47,500,076	45,264,099	18	50,831,407	48,443,384	19
Senior Unsecured Loan	27,013,567	27,013,567	10	23,000,000	23,000,000	9
First Lien Bond	2,952,225	2,398,500	1	2,948,332	2,546,400	2
Senior Subordinated Bond	4,272,110	4,293,098	2	1,037,707	1,051,540	-
Senior Unsecured Bond	10,946,659	11,433,738	4	10,855,804	11,381,100	5
Senior Secured Bond	1,517,375	1,605,000	1	1,519,072	1,619,550	1
CLO Fund Securities	113,748,903	91,730,898	35	101,696,950	79,452,220	32
Equity Securities	16,289,233	8,758,971	3	18,755,684	11,006,398	4
Preferred	10,104,717	10,711,000	4	10,000,000	10,600,000	4
Asset Manager Affiliates	83,924,720	75,302,000	29	83,378,741	76,148,000	30
Total	\$ 483,480,724	\$ 437,425,888	169%	\$ 486,157,918	\$ 440,549,994	176%

¹ Calculated as a percentage of Net Asset Value.

² Includes restricted cash held under employee benefit plans.

The industry concentrations based on the fair value of the Company's investment portfolio as of June 30, 2014 and December 31, 2013, were as follows:

Industry Classification	June 30, 2014 (unaudited)			December 31, 2013 ³		
	Cost	Fair Value	% ¹	Cost	Fair Value	% ¹
Aerospace and Defense	\$ 9,238,709	\$ 8,331,245	3%	\$ 9,244,538	\$ 8,100,895	3%
Asset Management Company ²	83,924,720	75,302,000	30	83,378,741	76,148,000	30
Automotive	14,929,935	14,980,721	6	15,248,090	15,306,403	6
Banking, Finance, Insurance & Real Estate	30,822,276	30,908,188	12	30,859,620	31,011,964	12
Beverage, Food and Tobacco	24,392,212	24,607,779	10	33,758,684	34,026,889	14
Capital Equipment	11,453,990	12,392,098	5	11,450,641	11,792,925	5
Chemicals, Plastics and Rubber	3,397,266	3,415,763	1	2,921,597	2,906,601	1
CLO Fund Securities	113,748,903	91,730,898	36	101,696,950	79,452,220	33
Construction & Building	18,152,025	119,659	-	18,224,720	190,244	-
Consumer goods: Durable	-	1,382,237	1	7,713,071	9,751,622	4
Consumer goods: Non-durable	20,587,792	20,086,205	8	18,864,695	18,266,939	7
Energy: Oil & Gas	2,486,078	3,816,887	1	11,734,558	12,930,563	5
Environmental Industries	10,866,389	10,913,691	4	6,937,663	6,965,896	3
Forest Products & Paper	5,931,335	5,930,000	2	-	-	-
Healthcare & Pharmaceuticals	31,935,545	32,208,851	12	24,146,383	24,061,764	10
Healthcare, Education and Childcare	-	-	-	6,908,414	7,199,856	3
High Tech Industries	15,279,291	15,388,010	6	17,989,624	17,989,034	7
Hotel, Gaming & Leisure	2,819,674	2,410,660	1	3,825,126	3,466,520	1
Media: Advertising, Printing & Publishing	13,565,775	13,841,894	5	12,797,615	13,035,590	5
Media: Broadcasting & Subscription	9,626,659	9,627,106	4	9,853,341	9,915,921	4
Metals & Mining	228,563	1,000	-	228,563	1,000	-
Retail	1,382,030	1,222,655	-	3,364,579	3,325,032	1
Services: Business	8,494,861	8,870,365	3	2,984,555	2,999,791	1
Services: Consumer	5,583,736	4,516,189	2	5,703,581	4,616,678	2
Telecommunications	13,120,855	13,178,590	5	17,251,743	17,337,834	7
Time Deposit and Money Market Accounts ⁴	5,610,941	5,610,941	2	7,112,949	7,112,949	3
Transportation: Cargo	20,088,919	20,735,373	8	16,030,051	16,643,254	7
Utilities: Electric	5,812,245	5,896,883	2	5,927,826	5,993,610	2
Total	\$ 483,480,724	\$ 437,425,888	169%	\$ 486,157,918	\$ 440,549,994	176%

¹ Calculated as a percentage of Net Asset Value.

² Represents the Asset Manager Affiliates.

³ Certain prior year amounts have been reclassified to conform to the current year presentation.

⁴ Includes restricted cash held under employee benefit plans.

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 June 30, 2014 and December 31, 2013, the total amount of non-qualifying assets was approximately 20% and 19% of total assets, respectively. The majority of non-qualifying assets were foreign investments which were approximately 20% and 18% 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 20% and 18% of its total assets as of June 30, 2014 and December 31, 2013).

At June 30, 2014 and December 31, 2013, the Company's ten largest portfolio companies represented approximately 43% and 42%, respectively, of the total fair value of its investments. The Company's largest investment, the Asset Manager Affiliates, represented 17% of the total fair value of the Company's investments at both June 30, 2014 and December 31, 2013. Excluding the Asset Manager Affiliates and CLO Fund securities, the Company's ten largest portfolio companies represented approximately 17% and 18% of the total fair value of the Company's investments at June 30, 2014 and December 31, 2013, respectively.

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. With the exception of the Katonah III, Ltd. and Katonah V, Ltd. CLO Funds, all third-party managed CLO Funds are making dividend 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 hierarchical 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 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 hierarchy levels as of June 30, 2014 (unaudited) and December 31, 2013, respectively:

	As of June 30, 2014 (unaudited)			
	Level I	Level II	Level III	Total
Money market accounts	\$ —	\$ 5,610,941	\$ —	\$ 5,610,941
Debt securities	—	54,140,212	201,882,866	256,023,078
CLO Fund securities	—	—	91,730,898	91,730,898
Equity securities	—	—	8,758,971	8,758,971
Asset Manager Affiliates	—	—	75,302,000	75,302,000
Total	<u>\$ —</u>	<u>\$ 59,751,153</u>	<u>\$ 377,674,735</u>	<u>\$ 437,425,888</u>

	As of December 31, 2013			
	Level I	Level II	Level III	Total
Money market accounts	\$ —	\$ 7,112,949	\$ —	\$ 7,112,949
Debt securities	—	68,733,053	198,097,374	266,830,427
CLO Fund securities	—	—	79,452,220	79,452,220
Equity securities	—	—	11,006,398	11,006,398
Asset Manager Affiliates	—	—	76,148,000	76,148,000
Total	<u>\$ —</u>	<u>\$ 75,846,002</u>	<u>\$ 364,703,992</u>	<u>\$ 440,549,994</u>

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 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 generally 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:

Six Months Ended June 30, 2014 (unaudited)					
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Total
Balance, December 31, 2013	\$ 198,097,374	\$ 79,452,220	\$ 11,006,398	\$ 76,148,000	\$ 364,703,992
Transfers out of Level III	(14,625,005) ¹	—	—	—	(14,625,005)
Transfers into Level III	5,954,629 ²	—	—	—	5,954,629
Net accretion of discount	112,256	142,473	—	—	254,729
Purchases	60,173,502	12,521,847	1,051,643	545,979	74,292,971
Sales / Paydowns	(40,838,369)	(612,370)	(3,516,700)	—	(44,967,439)
Total realized gain (loss) included in earnings	391,753	—	(1,393)	—	390,360
Total unrealized gain (loss) included in earnings	(7,383,272)	226,728	219,023	(1,391,979)	(8,329,500)
Balance, June 30, 2014	<u>\$ 201,882,868</u>	<u>\$ 91,730,898</u>	<u>\$ 8,758,971</u>	<u>\$ 75,302,000</u>	<u>\$ 377,674,737</u>
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	<u>\$ (7,381,725)</u>	<u>\$ 226,728</u>	<u>\$ 646,322</u>	<u>\$ (1,391,979)</u>	<u>\$ (7,900,654)</u>

¹Transfers out of Level III represent a transfer of \$14,625,005 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were observable as of June 30, 2014

²Transfers into Level III represent a transfer of \$5,954,629 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of June 30, 2014

Year Ended December 31, 2013					
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Total
Balance, December 31, 2012	\$ 51,865,406	\$ 83,257,507	\$ 8,020,716	\$ 77,242,000	\$ 220,385,629
Transfers out of Level III	(2,783,195) ¹	—	—	—	(2,783,195)
Transfers into Level III	34,070,557 ²	—	—	—	34,070,557
Net accretion of discount	174,977	216,443	—	217,212	608,632
Purchases	192,112,854	11,957,500	3,813,838	—	207,884,192
Sales/Paydowns	(70,461,486)	(623,403)	(2,882,107)	—	(73,966,996)
Total realized gain (loss) included in earnings	2,972,071	—	(551,636)	—	2,420,435
Total unrealized gain (loss) included in earnings	(9,853,810)	(15,355,827)	2,605,588	(1,311,212)	(23,915,261)
Balance, December 31, 2013	<u>\$ 198,097,374</u>	<u>\$ 79,452,220</u>	<u>\$ 11,006,399</u>	<u>\$ 76,148,000</u>	<u>\$ 364,703,993</u>
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	<u>\$ (9,853,810)</u>	<u>\$ (15,355,827)</u>	<u>\$ 2,605,588</u>	<u>\$ (1,311,212)</u>	<u>\$ (23,915,261)</u>

¹Transfers out of Level III represent a transfer of \$2,783,195 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were observable as of December 31, 2013

²Transfers into Level III represent a transfer of \$34,070,557 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of December 31, 2013.

As of June 30, 2014, 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 \$59,751,153 as of June 30, 2014.

As of June 30, 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	\$ 4,461,507	Enterprise Value	Average EBITDA Multiple/WAAC	8.5x/6.7% (8.5x/6.7%)
	\$ 197,379,691	Income Approach	Implied Discount Rate	2.5% - 8.3% (3.7%)
	\$ 1,000	Options Value	Qualitative Inputs ¹	
	\$ 40,670	Recovery Approach	Qualitative Inputs ¹	
Equity Securities	\$ 8,754,971	Enterprise Value	Average EBITDA Multiple/WAAC	2.7x/10.2% - 7.8x/14.1% (6.2x/13.2%)
	\$ 4,000	Options Value	Qualitative Inputs ¹	
CLO Fund Securities	\$ 63,225,038	Discounted Cash Flow	Discount Rate	11% (11%)
			Probability of Default	2.0%-2.5% (2.4%)
			Loss Severity	20% (20%)
			Recovery Rate	80% (80%)
			Prepayment Rate	30% (30%)
	\$ 28,505,860	Market Approach	Third Party Quote	86 - 100 (93.1)
Asset Manager Affiliate	\$ 75,302,000	Discounted Cash Flow	Discount Rate	1.97 - 7.88 (6.92)
Total Level III Investments	<u>\$ 377,674,737</u>			

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.

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 inputs 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 input 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 June 30, 2014 and December 31, 2013, the Asset Manager Affiliates had approximately \$3.25 billion and \$3.2 billion, respectively, 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 \$75 million and \$76 million, respectively.

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 operating income equal to the amount by which their fee income exceeds their operating expenses, including compensation of their employees. 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 CLO Funds managed by the Asset Manager Affiliates are paying both their senior and subordinated management fees on a current basis. Additionally, five managed funds made incentive fee distributions during the quarter ended June 30, 2014.

Any distributions from the Asset Manager Affiliates are recorded as "Distributions from Asset Manager Affiliates" on the Company's statement of operations and are recorded as declared (where declaration date represents ex-dividend date) by the Asset Manager Affiliates. For the six months ended June 30, 2014 and 2013, the Asset Manager Affiliates declared distributions of \$6.0 million and \$6.3 million, respectively. Distributions receivable, if any, are reflected in the Due from Affiliates account on the consolidated balance sheet.

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.

As a result of the consolidation of the 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 the following additional disclosures. In addition, Katonah 2007-I CLO and Katonah X CLO qualify as “significant subsidiaries” of the Company and the Company is also required to make the additional disclosures about them below. These disclosures regarding the Asset Manager Affiliates and Katonah 2007-I CLO and Katonah X CLO do not directly impact the financial position, results of operations, or cash flows of the Company.

Asset Manager Affiliates
Summarized Balance Sheet Information (unaudited)

	As of June 30, 2014	As of December 31, 2013
Investments of CLO Funds, at fair value	\$3,076,953,468	\$ 2,964,229,086
Restricted cash of CLO Funds	225,963,662	278,813,923
Total assets	3,368,749,092	3,299,810,068
CLO Fund liabilities at fair value	3,167,945,251	3,079,835,713
Total liabilities	3,267,778,507	3,176,654,741
Total Asset Manager Affiliates equity	36,076,093	38,855,099
Appropriated retained earnings of consolidated VIEs	64,894,492	84,300,228

Asset Manager Affiliates
Summarized Statements of Operations Information (unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Interest income - investments of CLO Funds	\$ 30,880,597	\$ 30,590,388	\$ 58,565,082	\$ 63,857,815
Total income	31,293,058	34,157,203	61,681,843	70,468,474
Interest expense of CLO Fund liabilities	24,529,997	27,448,332	49,055,196	57,220,417
Total expenses	35,302,843	39,698,341	66,209,005	74,542,565
Net realized and unrealized gains (losses)	(4,955,179)	95,000,154	(9,673,667)	85,521,217
Net loss attributable to noncontrolling interests in consolidated Variable Interest Entities	(10,799,619)	87,206,075	(18,258,038)	78,034,934
Net income attributable to Asset Manager Affiliates	1,328,309	2,252,941	2,674,769	3,015,589

Katonah 2007-I CLO Ltd.
Summarized Balance Sheet Information (unaudited)

	As of June 30, 2014	As of December 31, 2013
Total investments at fair value	\$ 307,229,103	\$ 310,427,788
Cash	13,823,545	15,260,243
Total assets	321,722,372	326,362,942
CLO Debt at fair value	320,267,767	314,549,615
Total liabilities	322,514,852	320,828,003
Total Net Assets	(792,480)	5,534,939

Katonah 2007-I CLO Ltd.
Summarized Statements of Operations Information (unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Interest income from investments	\$ 3,027,364	\$ 3,090,911	\$ 6,019,495	\$ 6,316,598
Total income	3,086,962	3,378,618	6,384,610	6,765,226
Interest expense	2,727,556	2,849,391	5,521,464	5,843,283
Total expenses	3,078,583	3,213,437	6,195,570	6,484,434
Net realized and unrealized losses	(4,847,359)	(2,624,539)	(6,516,459)	(4,383,989)
Decrease in net assets resulting from operations	(4,838,980)	(2,459,358)	(6,327,420)	(4,103,197)

Katonah X CLO Ltd.
Summarized Balance Sheet Information (unaudited)

	As of June 30, 2014	As of December 31, 2013
Total investments at fair value	\$ 344,150,118	\$ 408,698,814
Cash	20,483,957	26,050,568
Total assets	365,753,659	435,799,911
CLO Debt at fair value	348,814,569	416,405,403
Total liabilities	349,975,725	417,800,701
Total Net Assets	15,777,934	17,999,210

Katonah X CLO Ltd.
Summarized Statements of Operations Information (unaudited)

	For the three months ended June 30,	
	2014	2013
Interest income from investments	\$ 3,254,365	\$ 4,598,724
Total income	3,374,038	5,210,516
Interest expense	2,327,518	4,012,485
Total expenses	3,334,510	4,981,842
Net realized and unrealized losses	(1,230,389)	(3,350,687)
Decrease in net assets resulting from operations	(1,190,861)	(3,122,012)

As separately regarded entities for tax purposes, the Asset Manager Affiliates are taxed at normal corporate rates. For tax purposes, any distributions by the Asset Manager Affiliates to the Company would generally need to be distributed to the Company's shareholders. Generally, such distributions of the Asset Manager Affiliates' income 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 depreciation, bonuses to employees and stock option expense, 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 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 KCAP Financial'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 by approximately \$1.5 million per year over such period.

Related Party Transactions

On February 26, 2013, the Company entered into a senior unsecured 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 upsized from \$20 million to \$23 million. At June 30, 2014, there was \$23 million outstanding under the Trimaran Credit Facility, which is included in the Company's Schedule of Investments. For the six months ended June 30, 2014, the Company recognized interest income of \$1.0 million related to the Trimaran Credit Facility.

6. BORROWINGS

The Company's debt obligations consist of the following:

	As of June 30, 2014 (unaudited)	As of December 31, 2013
Convertible Notes, due March 15, 2016	\$ 49,008,000	\$ 49,008,000
7.375% Notes Due 2019	\$ 41,400,000	\$ 41,400,000
Notes Issued by KCAP Senior Funding I, LLC (net of discount: 2014 - \$2,847,139; 2013 - \$3,065,627)	\$ 102,402,861	\$ 102,184,373

The weighted average stated interest rate and weighted average maturity on all our debt outstanding as of June 30, 2014 were 5.08% and 6.92 years, respectively, and as of December 31, 2013 were 5.08% and 7.43 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, 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 Company's common stock. As of June 30, 2014, the conversion rate was 128.6773 shares of common stock per \$1,000 principal amount of Convertible Notes, which is equivalent to a conversion price of approximately \$7.77 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 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 shall no longer apply following the effective date of any fundamental change.

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 Convertible 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 facility on an effective yield method, of which approximately \$742,000 remains to be amortized. 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 September 4, 2013, the Company purchased \$2.0 million face value of its own Convertible Notes at \$114.50 plus accrued interest. KCAP subsequently surrendered these notes to the Trustee for cancellation effective September 13, 2013. 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 six months ended June 30, 2014 there were no realized losses on extinguishment of debt. 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.

For the three months ended June 30, 2014 and 2013, interest expense related to the Convertible Notes was \$1.1 million for both periods. For the six months ended June 30, 2014 and 2013, interest expense related to the Convertible Notes was \$2.1 million and \$2.4 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 June 30, 2014, 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 \$57.5 million at June 30, 2014. The fair value was determined based on an indicative closing price as of June 30, 2014. 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, 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 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 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. At June 30, 2014, the Company was in compliance with all of its debt covenants.

For the three months ended June 30, 2014 and 2013, interest expense related to the 7.375% Notes Due 2019 was \$763,000 for both periods. For the six months ended June 30, 2014 and 2013, interest expense related to the 7.375% Notes Due 2019 was \$1.5 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 \$1.2 million remains to be amortized.

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. The fair value of the Company's outstanding 7.375% Notes Due 2019 was approximately \$43.6 million at June 30, 2014. The fair value was determined based on the closing price on June 30, 2014 for the 7.375% Notes Due 2019. The 7.375% Notes Due 2019 are categorized as Level I under 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-1 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-1 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 the three-month LIBOR plus 3.25%, Class C-1 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-1 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.

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.

The Company will serve 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 June 30, 2014, there were 51 investments in portfolio companies with a total fair value of approximately \$137 million, plus cash of \$4.8 million, collateralizing the secured notes of the Issuer. At June 30, 2014, there were unamortized issuance costs of approximately \$3.3 million included in other assets, and unamortized original issue discount, ("OID") costs of approximately \$2.8 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 period ended June 30, 2014, interest expense, including the amortization of deferred debt issuance costs and the discount on the face amount of the notes, was approximately \$1.9 million consisting of stated interest expense of approximately \$1.4 million, accreted discount of approximately \$218,000, and deferred debt issuance costs of approximately \$256,000. As of June 30, 2014, the stated interest charged under the securitization was based on current three month LIBOR, which was 0.23%. The classes, stated interest rates, spread over LIBOR, and stated interest expense are as follows:

	<u>Stated Interest Rate</u>	<u>LIBOR Spread (basis points)</u>	<u>Stated Interest Expense (1)</u>
KCAP Senior Funding LLC Class A-1 Notes	1.73%	150	\$ 263,245
KCAP Senior Funding LLC Class B-1 Notes	3.48%	325	61,732
KCAP Senior Funding LLC Class C-1 Notes	4.48%	425	88,313
KCAP Senior Funding LLC Class D-1 Notes	5.48%	525	97,232
Total			<u>\$ 510,522</u>

(1) Stated Interest Rate and Stated Interest Expense will vary based upon prevailing 3 month LIBOR as of the reset date. Stated Interest Expense amounts above represent the amounts accrued and payable at June 30, 2014 using prevailing rates.

The amounts, ratings and interest rates (expressed as a spread to LIBOR) of the Class A-1, B-1, C-1, and D-1 are as follows:

<u>Description</u>	<u>Class A-1 Notes</u>	<u>Class B-1 Notes</u>	<u>Class C-1 Notes</u>	<u>Class D-1 Notes</u>
Type	Senior Secured Floating Rate	Senior Secured Floating Rate	Secured Deferrable Floating Rate	Secured Deferrable Floating Rate
Amount Outstanding	\$ 77,250,000	\$9,000,000	\$10,000,000	\$9,000,000
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-1, C-1, D-1 and Subordinated	C-1, D-1 and Subordinated	D-1 and Subordinated	Subordinated

The Company's outstanding principal amounts, carrying values and fair values of the Class A-1, B-1, C-1 and D-1 Notes are as follows:

	As of June 30, 2014 (unaudited)		
	Principal Amount	Carrying Value	Fair Value
KCAP Senior Funding LLC Class A-1 Notes	\$ 77,250,000	\$ 75,160,295	\$ 76,129,875
KCAP Senior Funding LLC Class B-1 Notes	9,000,000	8,756,539	8,887,500
KCAP Senior Funding LLC Class C-1 Notes	10,000,000	9,729,488	9,850,000
KCAP Senior Funding LLC Class D-1 Notes	9,000,000	8,756,539	8,910,000
Total	\$ 105,250,000	\$ 102,402,861	\$103,777,375

Fair Value of KCAP Senior Funding I, LLC. The Company carries the KCAP Senior Funding-I Notes at cost, net of unamortized discount of \$2,847,139. The fair value of the KCAP Senior Funding I, LLC Notes was approximately \$103.8 million at June 30, 2014. The fair values were determined based on third party indicative values. The KCAP Senior Funding I, LLC 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 dividends, 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 corporate 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 2014). 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. The Company anticipates timely distribution of its taxable income within the tax rules, and the Company anticipates that it will not incur a US federal excise tax for the calendar year 2014.

The following reconciles net increase in net assets resulting from operations to taxable income for the six months ended June 30, 2014:

	Six Months Ended June 30, 2014 (unaudited)
Net increase in net assets resulting from operations	\$ 15,694,256
Net change in unrealized depreciation from investments	446,909
Excess capital gains over capital losses	(244,785)
Income not on GAAP books currently taxable	84,665
Income not currently taxable	(77,495)
Expenses not currently deductible	283,359
Taxable income before deductions for distributions	\$ 16,186,909
Taxable income before deductions for distributions per weighted average basic shares for the period	\$ 0.49

Tax-basis taxable income differs from net increase (decrease) in net assets resulting from operations primarily due to: (1) unrealized appreciation (depreciation) on investments, as investment gains and losses are not included in tax-basis taxable income until they are realized; (2) amortization of discount on CLO Fund securities; (3) non-deductible expenses; (4) stock compensation expense that is not currently deductible for tax purposes; (5) excess of capital losses over capital gains; and (6) amortization of intangible assets and recognition of interest income on certain loans.

Distributions to shareholders which exceed tax distributable income (tax 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.

In July 2014, the Company made a distribution of \$0.25 per share to shareholders. The estimated tax character of distributions paid during the six months ended June 30, 2014 and for the year ended December 31, 2013 was as follows:

	<u>Six months ended</u> <u>June 30,</u> <u>2014</u>	<u>Year ended December</u> <u>31,</u> <u>2013</u>
<i>Distributions paid from:</i>		
Ordinary income	\$ 16,186,909	\$ 29,296,146
Tax Return of Capital	353,107	5,864,993
Total	<u>\$ 16,540,016¹</u>	<u>\$ 35,161,139</u>

(1) Comprised of the first quarter distribution paid in April and the second quarter distribution paid in July.

As of June 30, 2014 and December 31, 2013, the components of accumulated earnings on a tax basis were as follows:

	<u>As of June 30,</u> <u>2014</u>	<u>As of December 31,</u> <u>2013</u>
Distributable ordinary income	\$ 932,532	\$ 1,223,060
Capital loss carryforward	66,116,923	66,361,708
Net unrealized depreciation	(46,054,836)	(45,607,926)

On June 20, 2014, the Company's Board of Directors declared a distribution to shareholders of \$0.25 per share for a total of \$8.4 million. The record date was July 3, 2014 and the distribution was made on July 25, 2014.

At June 30, 2014, the Company had a net capital loss carryforward of \$66 million to offset net capital gains, to the extent provided by federal tax law. The capital loss carryforward will begin to expire in the tax year ending December 31, 2015.

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 June 30, 2014, the Company had no outstanding commitments to make investments in delayed draw senior secured loans.

9. STOCKHOLDERS' EQUITY

During the six months ended June 30, 2014 and 2013, the Company issued 37,115 and 37,932 shares, respectively, of common stock under its dividend reinvestment plan. As of June 30, 2014 and December 31, 2013, there were 623,983 and 272,998 shares of unvested restricted shares, respectively. There were 357,281 grants, 1,296 forfeitures, and 5,000 vested shares during the second quarter of 2014. 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. The total number of shares of the Company's common stock issued and outstanding as of June 30, 2014 and December 31, 2013 was 33,725,223 and 33,332,123, respectively.

10. EQUITY INCENTIVE PLAN

The Company has an equity incentive plan established in 2006 and as amended in 2008 and most recently in 2014, (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 prospective employees of the Company with additional incentives and align the interests of its employees with those of its shareholders. Options that were 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 was 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 under the 2014 amended 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 the Non-Employee Director Plan (the "Non-Employee Director Plan") which was originally 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.

Information with respect to options granted, exercised or forfeited under the Equity Incentive Plan for the period January 1, 2013 through June 30, 2014 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, 2013	60,000	\$ 7.24		
Granted	—	—		
Exercised	(10,000)	—		
Forfeited	—	—		
Options outstanding at December 31, 2013	50,000	\$ 7.72	5.4	\$ 127,600
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Outstanding at June 30, 2014	50,000	\$ 7.72	4.9	\$ 144,400
Total vested at June 30, 2014	50,000	\$ 7.72	4.9	

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 six months ended June 30, 2014 and 2013, the Company did not recognize any non-cash compensation expense related to stock options. At June 30, 2014, the Company had no remaining compensation cost related to unvested stock based awards.

Restricted Stock

On June 10, 2011, pursuant to the Non-Employee Director Plan, the Board of Directors approved the grant of 4,000 shares of restricted stock to the non-employee directors of the Company as partial annual compensation for their services as director.

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 June 15, 2012, 5,000 shares of restricted stock were awarded to the Company's Board of Directors.

During 2012, the Company's Board of Directors approved the grant of 29,757 shares of restricted stock to employees of the Company as partial compensation for their services. 50% of such shares will vest on the third anniversary of the grant date and the remainder will vest on the fourth anniversary of the grant date.

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 June 20, 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 357,281 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. During the six months ended June 30, 2014, 5,000 shares of restricted stock vested and 1,296 shares of restricted stock were forfeited.

Information with respect to restricted stock granted, exercised and forfeited under the Plan for the period January 1, 2013 through June 30, 2014 is as follows:

	Non-vested Restricted Shares
Non-vested shares outstanding at January 1, 2014	32,257
Granted	245,741
Vested	(5,000)
Forfeited	—
Non-vested shares outstanding at December 31, 2013	272,998
Granted	357,281
Vested	(5,000)
Forfeited	(1,296)
Outstanding at June 30, 2014	<u>623,983</u>
Total non-vested shares at June 30, 2014	623,983

For the six months ended June 30, 2014, non-cash compensation expense related to restricted stock was approximately \$413,000; of this amount approximately \$218,000 was expensed at the Company, and approximately \$195,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the six months ended June 30, 2013, non-cash compensation expense related to restricted stock was approximately \$151,000; of this amount approximately \$82,000 was expensed at the Company and approximately \$69,000 was a reimbursable expense allocated to the Asset Manager Affiliates.

Dividends 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. As of June 30, 2014, the company had approximately \$4.8 million of total unrecognized compensation cost related to non-vested share-based awards. That cost is expected to be recognized over a weighted average period of 3.9 years.

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 \$35,000 and \$22,000 was expensed during the six months ended June 30, 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 \$124,000 and \$90,000 was expensed during the six months ended June 30, 2014 and 2013, respectively, related to the Profit-Sharing Plan.

12. SUBSEQUENT EVENTS

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2014 for items that should potentially be recognized or disclosed in these consolidated financial statements. Management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these consolidated financial statements.

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

In this Quarterly Report on Form 10-Q, "KCAP Financial," "Company," "we," "us," and "our" refer to KCAP Financial, Inc., and its wholly-owned subsidiaries.

The information contained in this section should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report and in conjunction with the consolidated financial statements and notes thereto in the Company's Form 10-K for the year ended December 31, 2013, as filed with the U.S. Securities and Exchange Commission (the "Commission" or the "SEC"). In addition, some of the statements in this report constitute forward-looking statements. The matters discussed in this Quarterly Report, as well as in future oral and written statements by management of KCAP Financial, 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," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar 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 Quarterly 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 Quarterly 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;
- the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;
- 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.

There are a number of important risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward-looking statements. For a discussion of factors that could cause our actual results to differ from forward-looking statements contained in this Quarterly Report, please see the discussion in Part II, "Item 1A. Risk Factors", and in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013. You should not place undue reliance on these forward-looking statements. The forward-looking statements made in this Quarterly 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 this Quarterly Report is filed with the SEC.

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 Act of 1940 (the “1940 Act”). We have three principal areas of investments:

First, we originate, structure, and invest in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies (the “Debt Securities Portfolio”).

Second, we have invested in wholly-owned asset management companies (Katonah Debt Advisors, L.L.C., and Trimaran Advisors, L.L.C., collectively the “Asset Manager Affiliates”).

Third, we invest in debt and equity securities issued by CLO Funds managed by our Asset Manager Affiliates or by other asset managers (the “CLO Fund Securities”).

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 companies with 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. 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 dividend distributions and to generate capital appreciation through the addition of new collateralized loan obligation funds (“CLO Funds”) to manage. The Asset Manager Affiliates manage CLO Funds which invest in broadly syndicated loans, high-yield bonds and other credit instruments. Collectively the Asset Manager Affiliates have approximately \$3.25 billion of par value assets under management as of June 30, 2014. The Asset Manager Affiliates are registered under the Investment Advisers Act of 1940, and are managed independently from the Company by a separate portfolio management team.

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.

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 Regulated Investment Company (“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 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. 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 June 30, 2014 was \$7.67. On June 30, 2014, the last reported sale price of a share of our common stock on The NASDAQ Global Select Market was \$8.49.

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 invest in 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 six months ended June 30, 2014 (unaudited) and for the year ended 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)	(623,403)	(2,882,106)	—	(83,595,046)
Net accretion of interest	238,554	216,444	—	—	454,998
Net realized losses	(11,538,868)	—	(551,636)	—	(12,090,504)
Increase (decrease) in fair value	14,956,101	(15,355,828)	2,605,586	(1,311,212)	894,647
Fair Value at December 31, 2013	266,830,427	79,452,220	11,006,398	76,148,000	433,437,045
Purchases / originations / draws	74,490,079	12,521,847	1,051,643	545,979	88,609,548
Pay-downs / pay-offs / sales	(86,280,373)	(612,370)	(3,516,700)	—	(90,409,443)
Net accretion of interest	237,449	142,473	—	—	379,922
Net realized gains (losses)	246,177	—	(1,393)	—	244,784
Increase (decrease) in fair value	499,319	226,728	219,023	(1,391,979)	(446,909)
Fair Value at June 30, 2014	<u>\$ 256,023,078</u>	<u>\$ 91,730,898</u>	<u>\$ 8,758,971</u>	<u>\$ 75,302,000</u>	<u>\$ 431,814,947</u>

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 June 30, 2014 and December 31, 2013:

Security Type	June 30, 2014 (unaudited)			December 31, 2013		
	Cost	Fair Value	% ¹	Cost	Fair Value	% ¹
Money Market Accounts ²	5,610,941	5,610,941	2	7,112,949	7,112,949	3
Senior Secured Loan	159,600,198	153,304,076	60	175,021,272	168,188,453	67
Junior Secured Loan	47,500,076	45,264,099	18	50,831,407	48,443,384	19
Senior Unsecured Loan	27,013,567	27,013,567	10	23,000,000	23,000,000	9
First Lien Bond	2,952,225	2,398,500	1	2,948,332	2,546,400	2
Senior Subordinated Bond	4,272,110	4,293,098	2	1,037,707	1,051,540	-
Senior Unsecured Bond	10,946,659	11,433,738	4	10,855,804	11,381,100	5
Senior Secured Bond	1,517,375	1,605,000	1	1,519,072	1,619,550	1
CLO Fund Securities	113,748,903	91,730,898	35	101,696,950	79,452,220	32
Equity Securities	16,289,233	8,758,971	3	18,755,684	11,006,398	4
Preferred	10,104,717	10,711,000	4	10,000,000	10,600,000	4
Asset Manager Affiliates	83,924,720	75,302,000	29	83,378,741	76,148,000	30
Total	<u>\$483,480,724</u>	<u>\$437,425,888</u>	<u>169%</u>	<u>\$486,157,918</u>	<u>\$440,549,994</u>	<u>176%</u>

¹ Calculated as a percentage of Net Asset Value.

² Includes restricted cash held under employee benefit plans.

Debt Securities Portfolio

At June 30, 2014 and December 31, 2013, our investments in income producing loans and debt securities, excluding CLO Fund securities, had a weighted average interest rate of approximately 7.7% and 7.3%, respectively.

The investment portfolio (excluding the Company's investment in Asset Manager Affiliates and CLO Funds) at June 30, 2014 was spread across 24 different industries and 86 different entities with an average balance per entity of approximately \$3.6 million. As of June 30, 2014, all but four 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. 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.

At June 30, 2014, our ten largest portfolio companies represented approximately 43% of the total fair value of our investments. Our largest investment, the Asset Manager Affiliates, which are our wholly-owned portfolio companies represented 17% of the total fair value of our investments. Excluding the Asset Manager Affiliates and CLO Fund Securities, our ten largest portfolio companies represent approximately 17% of the total fair value of our investments.

The industry concentrations based on the fair value of the Company's investment portfolio as of June 30, 2014 and December 31, 2013, were as follows:

Industry Classification	June 30, 2014 (unaudited)			December 31, 2013 ³		
	Cost	Fair Value	% ¹	Cost	Fair Value	% ¹
Aerospace and Defense	\$ 9,238,709	\$ 8,331,245	3%	\$ 9,244,538	\$ 8,100,895	3%
Asset Management Company ²	83,924,720	75,302,000	30	83,378,741	76,148,000	30
Automotive	14,929,935	14,980,721	6	15,248,090	15,306,403	6
Banking, Finance, Insurance & Real Estate	30,822,276	30,908,188	12	30,859,620	31,011,964	12
Beverage, Food and Tobacco	24,392,212	24,607,779	10	33,758,684	34,026,889	14
Capital Equipment	11,453,990	12,392,098	5	11,450,641	11,792,925	5
Chemicals, Plastics and Rubber	3,397,266	3,415,763	1	2,921,597	2,906,601	1
CLO Fund Securities	113,748,903	91,730,898	36	101,696,950	79,452,220	33
Construction & Building	18,152,025	119,659	-	18,224,720	190,244	-
Consumer goods: Durable	-	1,382,237	1	7,713,071	9,751,622	4
Consumer goods: Non-durable	20,587,792	20,086,205	8	18,864,695	18,266,939	7
Energy: Oil & Gas	2,486,078	3,816,887	1	11,734,558	12,930,563	5
Environmental Industries	10,866,389	10,913,691	4	6,937,663	6,965,896	3
Forest Products & Paper	5,931,335	5,930,000	2	-	-	-
Healthcare & Pharmaceuticals	31,935,545	32,208,851	12	24,146,383	24,061,764	10
Healthcare, Education and Childcare	-	-	-	6,908,414	7,199,856	3
High Tech Industries	15,279,291	15,388,010	6	17,989,624	17,989,034	7
Hotel, Gaming & Leisure	2,819,674	2,410,660	1	3,825,126	3,466,520	1
Media: Advertising, Printing & Publishing	13,565,775	13,841,894	5	12,797,615	13,035,590	5
Media: Broadcasting & Subscription	9,626,659	9,627,106	4	9,853,341	9,915,921	4
Metals & Mining	228,563	1,000	-	228,563	1,000	-
Retail	1,382,030	1,222,655	-	3,364,579	3,325,032	1
Services: Business	8,494,861	8,870,365	3	2,984,555	2,999,791	1
Services: Consumer	5,583,736	4,516,189	2	5,703,581	4,616,678	2
Telecommunications	13,120,855	13,178,590	5	17,251,743	17,337,834	7
Time Deposit and Money Market Accounts ⁴	5,610,941	5,610,941	2	7,112,949	7,112,949	3
Transportation: Cargo	20,088,919	20,735,373	8	16,030,051	16,643,254	7
Utilities: Electric	5,812,245	5,896,883	2	5,927,826	5,993,610	2
Total	\$483,480,724	\$437,425,888	169%	\$486,157,918	\$440,549,994	176%

- 1 Calculated as a percentage of net asset value.
2 Represents the Asset Manager Affiliates.
3 Certain prior year amounts have been reclassified to conform to the current year presentation.
4 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 June 30, 2014, we had approximately \$92 million invested in CLO Fund Securities, issued primarily by funds managed by our Asset Manager Affiliates.

The CLO Funds managed by our Asset Manager Affiliates 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 June 30, 2014 and December 31, 2013 are as follows:

CLO Fund Securities	Investment	% ¹	June 30, 2014		December 31, 2013	
			Cost	Fair Value	Cost	Fair Value
Grant Grove CLO, Ltd.	Subordinated Securities	22.2%	\$ 4,701,455	\$ 738,158	\$ 4,715,553	\$ 1,052,164
Katonah III, Ltd. ³	Preferred Shares	23.1	1,398,172	550,000	1,618,611	325,000
Katonah V, Ltd. ³	Preferred Shares	26.7	3,320,000	1,000	3,320,000	1,000
Katonah VII CLO Ltd. ²	Subordinated Securities	16.4	4,484,693	1,579,404	4,499,793	1,478,978
Katonah VIII CLO Ltd. ²	Subordinated Securities	10.3	3,378,005	1,387,164	3,390,005	1,230,731
Katonah IX CLO Ltd. ²	Preferred Shares	6.9	2,008,087	777,822	2,023,287	829,739
Katonah X CLO Ltd. ²	Subordinated Securities	33.3	11,755,728	5,714,906	11,770,993	5,932,163
Katonah 2007-I CLO Ltd. ²	Preferred Shares	100.0	31,095,297	27,991,513	31,064,973	27,758,379
Katonah 2007-I CLO Ltd. ²	Class B-2L Notes	100.0	1,327,169	10,300,000	1,300,937	9,740,000
Trimaran CLO IV, Ltd. ²	Preferred Shares	19.0	3,524,200	2,733,495	3,542,300	2,519,210
Trimaran CLO V, Ltd. ²	Subordinated Notes	20.8	2,716,400	1,842,675	2,721,500	1,844,276
Trimaran CLO VI, Ltd. ²	Income Notes	16.2	2,761,700	1,925,496	2,784,200	1,981,948
Trimaran CLO VII, Ltd. ²	Income Notes	10.5	3,132,100	2,251,346	3,133,900	2,513,261
Catamaran CLO 2012-1 Ltd. ²	Subordinated Notes	24.9	8,987,000	6,969,478	8,943,900	6,846,520
Catamaran CLO 2012-1 Ltd. ²	Class F Notes	42.9	3,885,051	4,290,000	3,843,398	4,200,001
Catamaran CLO 2013-1 Ltd. ²	Subordinated Notes	23.5	9,365,700	8,762,580	9,960,400	8,225,100
Dryden 30 Senior Loan Fund	Subordinated Notes	7.5	3,036,200	2,892,500	3,063,200	2,973,750
Catamaran CLO 2014-1 Ltd. ²	Subordinated Notes	24.9	11,464,500	9,683,361	—	—
Catamaran CLO 2014-1 Ltd. ²	Class E Notes	15.1	1,407,446	1,340,000	—	—
Total			<u>\$113,748,903</u>	<u>\$ 91,730,898</u>	<u>\$101,696,950</u>	<u>\$ 79,452,220</u>

¹ Represents percentage of class held.

² A CLO Fund managed by an Asset Manager Affiliate.

³ As of June 30, 2014, 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 June 30, 2014, our Asset Manager Affiliates had approximately \$3.25 billion of par value of assets under management on which they earn management fees, and were valued at approximately \$75 million.

All CLO Funds managed by the Asset Manager Affiliates are currently paying all senior and subordinate management fees. In addition our Asset Manager Affiliates are currently receiving incentive fees from five 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, dividends, 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 the three and six months ended June 30, 2014 and 2013.

Revenue

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.

Dividends and Interest from Investments in CLO Fund Securities. We generate dividend 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 consolidated financial 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 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.

For non-junior class CLO Fund securities, such as our investment in the class B-2L notes of the Katonah 2007-I CLO of Class F notes of the Catamaran 2012-1, interest is earned at a fixed spread relative to the LIBOR index.

Distributions from Asset Manager Affiliates. We receive 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 provided a first loss guaranty in connection with loan warehouse arrangements for their CLO Funds. Our Asset Manager Affiliates generate annual operating income equal to the amount by which their fee income exceeds their operating expenses. The annual management fees which 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 also 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.

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 three months ended June 30, 2014 and 2013 was approximately \$13.2 million and \$11.2 million, respectively. Of these amounts, approximately \$5.2 million and \$3.0 million was attributable to interest income on our Debt Securities Portfolio. Increases in interest income from 2013 to 2014 were due to higher average invested assets stemming primarily from capital raising activities.

Investment income for the six months ended June 30, 2014 and 2013 was approximately \$26.6 million and \$22.6 million, respectively. Of these amounts, approximately \$10.4 million and \$5.5 million was attributable to interest income on our Debt Securities Portfolio. Increases in interest income from 2013 to 2014 were due to higher average invested assets stemming primarily from capital raising activities.

The weighted average yield on the Debt Securities Portfolio was 7.7%, and 7.3%, as of June 30, 2014 and December 31, 2013, 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 three months ended June 30, 2014 and 2013, approximately \$4.9 million of dividend income was attributable to investments in CLO Fund securities. For the six months ended June 30, 2014 and 2013, approximately \$9.8 million and \$10.8 million, respectively, of dividend income was attributable to investments in CLO Fund securities. Dividends 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 income 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.

Distributions from our Asset Manager Affiliates are recorded as "Distributions from Asset Manager Affiliates" in our Statement of Operations. For the three months ended June 30, 2014 and 2013, we recognized distribution income of \$3.0 million and \$3.3 million from the Asset Manager Affiliates, respectively. For the six months ended June 30, 2014 and 2013, we recognized income of \$6.0 million and \$6.3 million from the Asset Manager Affiliates, respectively.

The Asset Manager Affiliates are expected to pay future dividends to the Company based upon their operating cash flow, which generally will be dependent upon the maintenance and growth in their assets under management. The fair value of our investment in our Asset Manager Affiliates decreased by \$1.4 million during the six months ended June 30, 2014 and increased by \$10.0 million during the six months ended June 30, 2013. 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 assets under management by our Asset Manager Affiliates was \$3.25 billion and \$3.2 billion as of June 30, 2014 and December 31, 2013, respectively.

Expenses

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 significant 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 three months ended June 30, 2014 and 2013 were approximately \$5.2 million and \$4.7 million, respectively. Interest expense and amortization on debt issuance costs for the periods, were approximately \$2.9 million and \$2.3 million, respectively, on average debt outstanding of \$196 million and \$108 million, respectively.

For the three months ended June 30, 2014 and 2013, approximately \$1.2 million and \$1.1 million, respectively, of expenses were attributable to employee compensation, including salaries, bonuses, employee benefits, payroll taxes and stock-based compensation expense. For the three months ended June 30, 2014 and 2013, respectively, professional fees and insurance expenses totaled approximately \$657,000 and \$779,000. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately \$399,000 and \$513,000 for the three months ended June 30, 2014 and 2013, respectively.

Total expenses for the six months ended June 30, 2014 and 2013 were approximately \$10.7 million and \$9.1 million, respectively. Interest expense and amortization on debt issuance costs for the periods, were approximately \$5.9 million and \$4.5 million, respectively, on average debt outstanding of \$196 million and \$105 million, respectively.

For the six months ended June 30, 2014 and 2013, approximately \$2.5 million and \$2 million, respectively, of expenses were attributable to employee compensation, including salaries, bonuses, employee benefits, payroll taxes and stock-based compensation expense. The increase in compensation expense results from higher performance-based compensation and benefit plan expenses, as well as an increase in employee headcount. For the six months ended June 30, 2014 and 2013, respectively, professional fees and insurance expenses totaled approximately \$1.5 million and \$1.6 million. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately \$868,000 and \$1 million for the six months ended June 30, 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 three months ended June 30, 2014, net investment income and net realized losses were approximately \$8.0 million, or \$0.24 per share. For the three months ended June 30, 2013, net investment income and net realized losses were approximately \$5.0 million or \$0.15 per share. For the six months ended June 30, 2014, net investment income and net realized gains were approximately \$16.1 million, or \$0.48 per share. For the six months ended June 30, 2013, net investment income and net realized losses were approximately \$11.9 million or \$0.38 per 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 three months ended June 30, 2014, net investment income was approximately \$8.0 million, or \$0.24 per share. For the six months ended June 30, 2014, net investment income was approximately \$15.9 million, or \$0.48 per share.

Generally, we seek to fund our distributions from net investment income. For the six months ended June 30, 2014, total distributions were \$16.2 million, or \$0.50 per share.

Net Unrealized (Depreciation) Appreciation on Investments

During the three months ended June 30, 2014, our total investments had net unrealized appreciation of approximately \$4.3 million. During the three months ended June 30, 2013, our total investments had net unrealized appreciation of approximately \$3.5 million. For the three months ended June 30, 2014, our Asset Manager Affiliates had net unrealized appreciation of approximately \$1.2 million. For the three months ended June 30, 2013, our Asset Manager Affiliates had net unrealized appreciation of approximately \$6.9 million. For the three months ended June 30, 2014, our middle market portfolio of debt securities and equity securities had net unrealized appreciation of approximately \$1.6 million, compared with net unrealized appreciation of \$1.2 million during the second quarter of 2013. For the three months ended June 30, 2014, our CLO Fund securities had net unrealized appreciation of approximately \$1.4 million compared with net unrealized depreciation of \$4.6 million during the second quarter of 2013.

During the six months ended June 30, 2014, our total investments had net unrealized depreciation of approximately \$447,000. During the six months ended June 30, 2013, our total investments had net unrealized appreciation of approximately \$3.9 million. For the six months ended June 30, 2014, our Asset Manager Affiliates had net unrealized depreciation of approximately \$1.4 million. For the six months ended June 30, 2013, our Asset Manager Affiliates had net unrealized appreciation of approximately \$10.0 million. For the six months ended June 30, 2014, our middle market portfolio of debt securities and equity securities had net unrealized appreciation of approximately \$718,000, compared with net unrealized appreciation of \$3.4 million during the six months ended June 30, 2013. For the six months ended June 30, 2014, our CLO Fund securities had net unrealized appreciation of approximately \$227,000 compared with net unrealized depreciation of \$9.5 million during the six months ended June 30, 2013.

Net Change in Stockholder's Equity Resulting From Operations

The net increase in stockholders' equity resulting from operations for the three months ended June 30, 2014 was \$12.3 million, or \$0.37 per share. Net increase in stockholders' equity resulting from operations for the three months ended June 30, 2013 was \$8.5 million, or \$0.26 per share.

The net increase in stockholders' equity resulting from operations for the six months ended June 30, 2014 was \$15.7 million, or \$0.47 per share. Net increase in stockholders' equity resulting from operations for the six months ended June 30, 2013 was \$15.7 million, or \$0.51 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 dividends 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 June 30, 2014 and December 31, 2013 the fair value of investments and cash were as follows:

Security Type	Investments at Fair Value	
	June 30, 2014	December 31, 2013
Cash	\$ 2,310,589	\$ 3,433,675
Money Market Accounts	5,610,941	7,112,949
Senior Secured Loan	153,304,076	168,188,453
Junior Secured Loan	45,264,099	48,443,384
Senior Unsecured Loan	27,013,567	23,000,000
First Lien Bond	2,398,500	2,546,400
Senior Subordinated Bond	4,293,098	1,051,540
Senior Secured Bond	1,605,000	1,619,550
Senior Unsecured Bond	11,433,738	11,381,100
CLO Fund Securities	91,730,898	79,452,220
Equity Securities	8,758,971	11,006,398
Preferred	10,711,000	10,600,000
Asset Manager Affiliates	75,302,000	76,148,000
Total	\$ 439,736,477	\$ 443,983,669

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 June 30, 2014, we had approximately \$195.7 million of par value of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 231%, 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 June 30, 2014, the conversion rate was 128.6773 shares of common stock per \$1,000 principal amount of Convertible Notes, which is equivalent to a conversion price of approximately \$7.77 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 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. 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 six months ended June 30, 2014, there were no realized losses on extinguishment of debt. For the year ended December 31, 2013 total realized losses on extinguishment of debt were approximately \$537,000. 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.

In February 2012, the Company entered into a Note Purchase Agreement, under which it was able to obtain up to \$30 million in financing (the “Facility”). The Facility was terminated on November 4, 2013 and remaining unamortized capitalized costs of approximately \$203,000 related to the Facility were written-off and are included in Realized Losses on Extinguishments of Debt.

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 tests 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. At June 30, 2014, 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 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 June 18, 2013, KCAP Senior Funding I, LLC, or Issuer, 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. These junior notes eliminate in consolidation and the remaining notes with a par value of \$105 million, net of \$2.8 million of unamortized discount, are reflected on our consolidated balance sheet. 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.

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. As a result, we may seek to enter into new agreements with other lenders or into other financing arrangements as market conditions permit. 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.

If our common stock trades below our net asset value per share, we will generally not be able to issue additional common stock at the market price unless our shareholders approve such a sale and our Board of Directors makes certain determinations. A proposal, approved by our stockholders (at a special stockholder meeting held on June 19, 2014 and continued on July 8, 2014) authorizes us to sell shares of our common stock below the then current net asset value per share of our common stock in one or more offerings for the period ending on the earlier of (i) July 8, 2015, or (ii) the date of our 2015 annual meeting of shareholders. For the same period, the Company adopted a policy that it will not seek approval from our Board of Directors to sell or otherwise issue more than 15% of the Company's then outstanding shares of common stock at a price below its then current net asset value. We would need similar future approval from our shareholders to issue shares below the then current net asset value per share any time after the expiration of the current approval.

Stockholder Distributions

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

- 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.

The amount of our declared distributions, as evaluated by management and approved by our Board of Directors, is based on our evaluation of both distributable income for tax purposes and GAAP net investment income (which excludes unrealized gains and losses). Generally, we seek to fund our distributions from GAAP current earnings, primarily from net interest and dividend income generated by our investment portfolio and without a return of capital or a high reliance on realized capital gains. Distributions to our stockholders during the years ended 2013 and 2012 included \$5.8 million and \$1.3 million, respectively, of tax-basis return of capital.

The following table sets forth the quarterly distributions declared by us for the two most recently completed fiscal years and the current fiscal year, including distributions from the Asset Manager Affiliates received by the Company, if any.

	<u>Distribution</u>	<u>Declaration Date</u>	<u>Record Date</u>	<u>Pay Date</u>
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	<u>\$ 0.50</u>			
2013:				
Fourth quarter	0.25	12/13/2013	12/27/2013	1/27/2014
Third quarter	0.25	9/13/2013	10/8/2013	10/29/2013
Second quarter	0.28	6/17/2013	7/5/2013	7/26/2013
First quarter	\$ 0.28	3/15/2013	4/5/2013	4/26/2013
Total declared in 2013	<u>\$ 1.06</u>			
2012:				
Fourth quarter	\$ 0.28	12/17/2012	12/28/2012	1/28/2013
Third quarter	0.24	9/17/2012	10/10/2012	10/29/2012
Second quarter	0.24	6/18/2012	7/6/2012	7/27/2012
First quarter	0.18	3/16/2012	4/6/2012	4/27/2012
Total declared in 2012	<u>\$ 0.94</u>			

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 June 30, 2014 and December 31, 2013, we did not have any such outstanding commitments.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual cash obligations and other commercial commitments as of June 30, 2014:

<u>Contractual Obligations</u>	<u>Payments Due by Period</u>				
	<u>Total</u>	<u>Less than one year</u>	<u>1 - 3 years</u>	<u>3 - 5 years</u>	<u>More than 5 years</u>
Long-term debt obligations ¹	\$192,810,861	\$ —	\$ 49,008,000	\$ —	\$143,802,861

(1) Represents approximately \$49.0 million of Convertible Notes, \$41.4 million of 7.375% Notes Due 2019 and \$102.4 Notes issued by KCAP Senior Funding I, L.L.C.

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

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.

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 June 30, 2014, four issuers representing less than 1% of our total investments at fair value were on non-accrual status. As of December 31, 2013, five issuers representing less than 1% of our total investments at fair value were on non-accrual status.

Distributions from 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. We make estimated interim accruals of such dividend income based on recent historical distributions and CLO Fund performance and adjust such accruals on a quarterly basis to reflect actual distributions.

For non-junior class CLO Fund Securities, such as our investment in the class B-2L notes of Katonah 2007-I CLO and the class F notes of Catamaran 2012-1, 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.

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 second quarter of 2014, the Board of Directors authorized a grant of restricted stock to officers and employees comprised of 357,281 shares of restricted stock with an aggregate fair value of approximately \$2.9 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

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.

Item 3. 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 June 30, 2014, approximately 95% 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 2.00%. We generally expect that future portfolio investments will predominately be floating rate investments.

As of June 30, 2014, we had \$195.7 million of borrowings outstanding at a weighted average rate of 5.08%.

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 proportion of our debt associated with our Convertible Notes or Retail Notes 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.

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). Accordingly, there can be no assurance that a significant change in market interest rates will not have a material effect on our net investment income.

We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that our balance sheet at June 30, 2014 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 for various hypothetical increases in interest rates:

	Impact on net investment income:		
	1%	2%	3%
Increase in interest rate	\$ (574,868)	\$ 212,087	\$ 1,105,241
Decrease in interest rate	\$ 189,710	\$ 189,710	\$ 189,710

As shown above, net investment income assuming a 1% increase in interest rates would decrease by approximately \$575,000 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 \$212,000 and \$1.1 million, respectively. Since the LIBOR rate underlying certain investments, as well as certain of our borrowings, is currently very 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 \$190,000 increase in net investment income.

Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect 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 June 30, 2014.

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 4. 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.

Changes in Internal Control Over Financial Reporting

Changes in Internal Control Over Financial Reporting

During the quarter ended June 30, 2014, the Company had no changes in its internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013.

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

While we did not engage in any sales of unregistered securities during the three months ended June 30, 2014, we issued a total of 28,631 shares of common stock under our dividend reinvestment plan ("DRIP"). This issuance was not subject to the registration requirements of the Securities Act of 1933. For the three months ended June 30, 2014, the aggregate value of the shares of our common stock issued under our DRIP was approximately \$232,770.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

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.

Exhibit Index

Exhibit Number	Description of Document
10.1	2006 Equity Incentive Plan as Amended and Restated Effective June 20, 2014.**
10.2	Non-Employee Director Plan as Amended and Restated Effective June 20, 2014.**
10.3	Form of Employee Restricted Stock Award Agreement.**
10.4	Form of Executive Restricted Stock Award Agreement.**
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**
32.1	Certification of Chief Executive Officer Pursuant to 18 U. S. C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2	Certification of Chief Financial Officer Pursuant to 18 U. S. C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

** Submitted herewith.

KCAP FINANCIAL, INC.

2006 EQUITY INCENTIVE PLAN
As Amended and Restated Effective June 20, 2014

1. PURPOSE AND CERTAIN DEFINED TERMS

The purpose of this 2006 Equity Incentive Plan, as Amended and Restated Effective June 20, 2014 (the "Plan") is to advance the interests of the Company (as defined below) by providing for the grant to employees and officers of Share-based awards, including without limitation options to acquire Shares (as defined below) and, to the extent permitted by exemptive or other relief that may be granted by the Securities and Exchange Commission (the "Commission") or its staff, Restricted Shares (as defined below) and options to acquire Restricted Shares (collectively, the "Awards"). At all times during such periods as the Company qualifies or intends to qualify as a "business development company" under the Investment Company Act of 1940, as amended (the "1940 Act"), the terms of the Plan shall be construed so as to conform to the share-based compensation requirements applicable to "business development companies" under the 1940 Act. Any employee or officer selected to receive an Award under the Plan is referred to as a "participant."

The following terms, when used in the Plan, will have the meanings and be subject to the provisions set forth below:

"Affiliate" means any corporation or other entity that stands in a relationship to the Company that would result in the Company and such corporation or other entity being treated as one employer under Section 414(b) or Section 414(c) of the Code, except that in determining eligibility for the grant of an Option by reason of service for an Affiliate, Sections 414(b) and 414(c) of the Code shall be applied by substituting "at least 50%" for "at least 80%" under Section 1563(a)(1), (2) and (3) of the Code and Treas. Regs. § 1.414(c)-2; provided, that to the extent permitted under Section 409A, "at least 20%" shall be used in lieu of "at least 50%"; and further provided, that the lower ownership threshold described in this definition (50% or 20% as the case may be) shall apply only if the same definition of affiliation is used consistently with respect to all compensatory stock options or stock awards (whether under the Plan or another plan). The Company may at any time by amendment provide that different ownership thresholds (consistent with Section 409A) apply. Notwithstanding the foregoing provisions of this definition, except as otherwise determined by the Board, a corporation or other entity shall be treated as an Affiliate only if its employees would be treated as employees of the Company for purposes of the rules promulgated under the Securities Act of 1933, as amended, with respect to the use of Form S-8.

"Board" means, prior to Conversion, the board of managers of the LLC and, at and after Conversion, the board of directors of the Corporation.

"Company" means, prior to Conversion, the board of managers of the LLC and, at and after Conversion, the Corporation.

“Conversion” means the conversion of the LLC, pursuant to Section 265 of the Delaware General Corporation Law and Section 216 of the Delaware Limited Liability Company Act, to the Corporation.

“Corporation” means KCAP Financial, Inc., a Delaware corporation. The Corporation was formerly known as Kohlberg Capital Corporation.

“Disability” means participant’s inability to perform his or her essential duties, responsibilities and functions of participant’s position with the Company (as determined by the Board in its good faith judgment, consistent with its policies and past practice) as a result of any mental or physical disability or incapacity even with responsible accommodations of such disability or incapacity provided by the Company or if providing such accommodations would be unreasonable.

“LLC” means Kohlberg Capital, LLC, a Delaware limited liability company.

“Non-Employee Director Plan” means the Company’s 2008 Non-Employee Director Plan, as amended from time to time.

“Performance Criteria” or, in the singular, “Performance Criterion,” means specified criteria, other than the mere continuation of employment or the mere passage of time, the satisfaction of which is a condition for the grant, exercisability, vesting or full enjoyment of an Award. For purposes of Awards that are intended to qualify for the performance-based compensation exception under Section 162(m) of the Code, a Performance Criterion will mean an objectively determinable measure of performance relating to any or any combination of the following (measured either absolutely or by reference to an index or indices and determined either on a consolidated basis or, as the context permits, on a divisional, subsidiary, line of business, project or geographical basis or in combinations thereof): sales; revenues; assets; expenses; earnings before or after deduction for all or any portion of interest, taxes, depreciation, or amortization, whether or not on a continuing operations or an aggregate or per share basis; return on equity, investment, capital or assets; one or more operating ratios; borrowing levels, leverage ratios or credit rating; market share; capital expenditures; cash flow; stock price; stockholder return; sales of particular products or services; customer acquisition or retention; acquisitions and divestitures (in whole or in part); joint ventures and strategic alliances; spin-offs, split-ups and the like; reorganizations; or recapitalizations, restructurings, financings (issuance of debt or equity) or refinancings. A Performance Criterion and any targets with respect thereto determined by the Administrator need not be based upon an increase, a positive or improved result or avoidance of loss. To the extent consistent with the requirements for satisfying the performance-based compensation exception under Section 162(m) of the Code, the Board may provide in the case of any Award intended to qualify for such exception that one or more of the Performance Criteria applicable to such Award will be adjusted in an objectively determinable manner to reflect events (for example, but without limitation, acquisitions or dispositions) occurring during the performance period that affect the applicable Performance Criterion or Criteria.

“Restricted Shares” means an award of Shares for so long as the Shares remain subject to restrictions requiring that they be forfeited to the Corporation if specified conditions are not satisfied.

“Shares” means, prior to Conversion, the common units of the LLC and, at and after Conversion, the common stock, \$.01 par value per share, of the Corporation.

“Shareholders” means, prior to Conversion, the members of the LLC and, at and after Conversion, the shareholders of the Corporation.

2. ADMINISTRATION

The Plan shall be administered by the Board unless and until it delegates administration to a committee as provided herein; provided that a “required majority,” as defined in Section 57(o) of the 1940 Act, must approve each issuance of Awards and Dividend Equivalent Rights in accordance with Section 61(a)(3)(A)(iv) of the 1940 Act. The Board shall have discretionary authority, subject to the express provisions of the Plan, (a) to grant Awards to such Eligible Persons (defined below in Section 5 hereof) as the Board may select; (b) to determine the time or times when Awards shall be granted and the number of Shares subject to each Award; (c) to determine the terms and conditions of each Award; (d) to prescribe the form or forms of any instruments evidencing Awards and any other instruments required under the Plan and to change such forms from time to time; (e) to adopt, amend, and rescind rules and regulations for the administration of the Plan; and (f) to interpret the Plan and to decide any questions and settle all controversies and disputes that may arise in connection with the Plan. Such determinations of the Board shall be conclusive and shall bind all parties. Subject to Section 9 hereof, the Board shall also have the authority, both generally and in particular instances, to waive compliance by a participant with any obligation to be performed by him or her under an Award, to waive any condition or provision of an Award, and to amend or cancel any Award (and if an Award is canceled, to grant a new Award on such terms as the Board shall specify), except that the Board may not take any action with respect to an outstanding Award that would adversely affect the rights of the participant under such Award without such participant’s consent. Nothing in the preceding sentence shall be construed as limiting the power of the Board to make adjustments required by Sections 4 (d) and 6(i) hereof or by applicable law. In the case of any Award intended to be eligible for the performance-based compensation exception under Section 162(m) of the Internal Revenue Code of 1986, as amended (the “Code”), the Board will exercise its discretion consistent with qualifying the Award for that exception.

The Board may, in its discretion, delegate some or all of its powers with respect to the Plan to a committee (the “Committee”), in which event all references (as appropriate) to the Board hereunder shall be deemed to refer to the Committee.

Determinations, interpretations and constructions made by the Board in good faith shall not be subject to review by any person and shall be final, binding and conclusive on all persons.

3. EFFECTIVE DATE AND TERM OF PLAN

The Board, including a "required majority" as defined in Section 57(o) of the 1940 Act, adopted the Plan on December 11, 2006, and amended and restated the Plan on February 5, 2008, and on June 20, 2014.

No Awards shall be granted under the Plan after February 5, 2018, but Awards previously granted may extend beyond that date.

4. SHARES SUBJECT TO THE PLAN

(a) *Number of Shares.* Subject to adjustment as provided in Section 4(d), the aggregate number of Shares that may be the subject of Awards granted under the Plan shall be 2,000,000. If an option Award granted under the Plan terminates without having been exercised in full, or upon exercise is satisfied other than by delivery of Shares, or if any Share Award is repurchased by the Company, the number of Shares as to which such Award was not exercised shall be available for future grants.

The maximum number of Shares for which any option Award may be granted to any person in any calendar year shall be 1,000,000. The maximum number of Shares that may be granted to any person under other Awards (if any and to the extent permitted under the 1940 Act) in any calendar year shall be 500,000. The foregoing provisions will be construed in a manner consistent with Section 162(m) of the Code (if applicable) and Section 61 of the 1940 Act.

(b) *Shares to be Delivered.* Shares delivered under the Plan shall be authorized but unissued Shares, or if the Board so decides in its sole discretion, previously issued Shares acquired by the Company and held in its treasury. Any Shares acquired by the Company will be acquired in accordance with the 1940 Act, including Section 23 of the 1940 Act. No fractional Shares shall be delivered under the Plan.

(c) *Limits on Number of Awards.* The combined maximum amount of Restricted Stock that may be issued under the Plan will be 10% of the outstanding Shares on February 5, 2008, plus 10% of the number of Shares issued or delivered by the Company (other than pursuant to compensation plans) during the term of the Plan. No one person shall be granted more than 25% of the Restricted Stock reserved for issuance under this Plan. 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 Shares issued pursuant to the Plan, at the time of issuance shall 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 Shares issued pursuant to the Plan, 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 Shares issued pursuant to the Plan, at the time of issuance shall not exceed 20% of the outstanding voting securities of the Company.

(d) *Changes in Shares.* In the event of a Share dividend, Share split or combination of Shares, recapitalization, or other change in the Shares, the number and kind of Shares or securities of the Company subject to Awards then outstanding or subsequently granted under the Plan, the exercise price of such Awards, the maximum number of Shares or securities that may be delivered under the Plan, and other relevant provisions shall be appropriately adjusted by the Board, whose determination shall be binding on all persons.

The Board may also adjust the number of Shares subject to outstanding Awards, the exercise price of outstanding Awards, and the terms of outstanding Awards, to take into consideration material changes in accounting practices or principles, extraordinary dividends, consolidations or mergers (except those described in Section 6(i)), acquisitions or dispositions of securities or property, or any other event if it is determined by the Board that such adjustment is appropriate to avoid distortion in the operation of the Plan; provided, however, that the exercise price of options granted under the Plan will not be adjusted unless the Company receives an exemptive order from the Commission or written confirmation from the staff of the Commission that the Company may do so. References in the Plan to Shares will be construed to include any units, any stock or any other securities resulting from an adjustment pursuant to this Section 4(d).

5. AWARDS; ETC.

Persons eligible to receive Awards under the Plan (“Eligible Persons”) shall be those key employees and officers of the Company and, to the extent permitted by exemptive or other relief that may be granted by the Commission or its staff, employees of wholly-owned consolidated subsidiaries of the Company who, in the opinion of the Board, are in a position to make a significant contribution to the success of the Company and its subsidiaries. A subsidiary for purposes of the Plan shall be a corporation, limited liability company or other entity in which the Company owns, directly or indirectly, equity securities possessing 50% or more of the total combined voting power of all classes of equity securities. Notwithstanding the foregoing, in the case of an Award that is an incentive option, an Eligible Person shall only be those employees of the Company or of a “parent corporation” or “subsidiary corporation” of the Company as those terms are defined in Section 424 of the Code.

In the case of an Award of Restricted Shares (to the extent such Awards are permitted by exemptive relief or other relief that may be granted by the Commission or its staff) that is intended to qualify as performance-based for the purposes of Section 162(m) of the Code, the Plan and such Award will be construed to the maximum extent permitted by law in a manner consistent with qualifying the Award for such exception. With respect to such Awards, the Board will pre-establish, in writing, one or more specific Performance Criteria no later than 90 days after the commencement of the period of service to which the performance relates (or at such earlier time as is required to qualify the Award as performance-based under Section 162(m) of the Code). The Performance Criteria so established shall serve as a condition to either the grant of the Award or the vesting of Shares subject to the Award, as determined by the Board. Prior to grant or vesting, as the case may be, the Board will certify whether the Performance Criteria have been attained and such determination will be final and conclusive. If the Performance Criteria with respect to the Award are not attained, no other Award will be provided in substitution. No Award of Restricted Shares that is intended to qualify as performance-based for the purposes of section 162(m) of the Code may be granted after the first meeting of the Shareholders of the Company held in 2010 until the Performance Criteria have been resubmitted to and reapproved by the Shareholders of the Company in accordance with the requirements of Section 162(m) of the Code, unless such grant is made contingent upon such approval.

6. TERMS AND CONDITIONS OF A WARDS

(a) *Code Section 409A Exemption.* Except as the Board otherwise determines, no option shall have deferral features, or shall be administered in a manner, that would cause such option to fail to qualify for exemption from Section 409A of the Code. Any option resulting in a deferral of compensation subject to Section 409A of the Code shall be construed to the maximum extent possible, as determined by the Board, consistent with the requirements of Section 409A of the Code.

(b) *Exercise Price of Options.* The exercise price of each option shall be determined by the Board. The exercise price of an option will not be less than the current market value of, or if no such market value exists, the current net asset value of, the Shares as determined in good faith by the Board on the date of grant. Current market value shall be the closing price of the Common Stock on the NASDAQ Global Select Market on the date of grant.

(c) *Duration of Options.* An option shall be exercisable during such period or periods as the Board may specify. The latest date on which an option may be exercised (the "Expiration Date") shall be the date that is ten years from the date the option was granted or such earlier date as may be specified by the Board at the time the option is granted.

(d) *Exercise of Options.*

- (1) An option shall vest or become exercisable at such time or times and upon such conditions as the Board shall specify. In the case of an option not immediately exercisable in full, the Board may at any time accelerate the time at which all or any part of the option may be exercised regardless of any adverse or potentially adverse tax consequences resulting from such acceleration.
- (2) Any exercise of an option shall be in writing, signed by the proper person and furnished to the Company, accompanied by (i) such documents as may be required by the Board and (ii) payment in full as specified below in Section 6(e) for the number of Shares for which the option is exercised.
- (3) The Board shall have the right to require that the participant exercising the option remit to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements (or make other arrangements satisfactory to the Company with regard to such taxes) arising in connection with the exercise of the option. If permitted by the Board and to the extent permitted under the 1940 Act, either at the time of the grant of the option or in connection with exercise, the participant may elect, at such time and in such manner as the Board may prescribe, to satisfy such withholding obligation by (i) delivering to the Company Shares owned by such individual having a fair market value equal to such withholding obligation, or (ii) requesting that the Company withhold from the Shares to be delivered upon the exercise a number of Shares having a fair market value equal to such withholding obligation.

- (4) If an option is exercised by the executor or administrator of a deceased participant, or by the person or persons to whom the option has been transferred by the participant's will or the applicable laws of descent and distribution, the Company shall be under no obligation to deliver Shares pursuant to such exercise until the Company is satisfied as to the authority of the person or persons exercising the option.

(e) *Payment for and Delivery of Shares.* Shares purchased upon exercise of an option under the Plan shall be paid for as follows: (i) in cash, check acceptable to the Company (determined in accordance with such guidelines as the Board may prescribe), or money order payable to the order of the Company, or (ii) if so permitted by the Board (which, in the case of an incentive option, shall specify such method of payment at the time of grant) and to the extent permitted by the 1940 Act and otherwise legally permissible, (A) by delivery of an unconditional and irrevocable undertaking by a broker to deliver promptly to the Company sufficient funds to pay the exercise price, or (B) by any combination of the permissible forms of payment.

(f) *Delivery of Shares.* A participant shall not have the rights of a Shareholder with regard to Awards under the Plan except as to Shares actually received by him or her under the Plan.

(g) *Dividend Equivalents, Etc.* To the extent permitted under the 1940 Act, the Board may provide for the payment of amounts in lieu of cash dividends or other cash distributions with respect to Shares subject to an Award; provided, however, that such grants must be approved by order of the Commission.

(h) *Non transferability of Awards.* No option, Share, or other Award may be transferred other than by will or by the laws of descent and distribution, and during a participant's lifetime an Award may be exercised only by him or her.

(i) *Mergers, etc.* To the extent permitted under the 1940 Act and except as otherwise provided in an Award agreement or an employment agreement between the participant and the Company or an Affiliate, the following provisions shall apply in the event of a Covered Transaction (as defined below).

- (1) Subject to subparagraph (2) below, all outstanding Awards requiring exercise will terminate and cease to be exercisable, and all other Awards to the extent not fully vested (including Awards subject to conditions not yet satisfied or determined) will be forfeited, as of the effective time of the Covered Transaction (as defined in subparagraph (3) herein), provided that the Board may in its sole discretion on or prior to the effective date of the Covered Transaction take any (or any combination of) the following actions: (i) make any outstanding option exercisable in full, (ii) remove any performance or other conditions or restrictions on any Award and (iii) in the event of a Covered Transaction under the terms of which holders of the Shares of the Company will receive upon consummation thereof a payment for each such Share surrendered in the Covered Transaction (whether cash, non-cash or a combination of the foregoing), make or provide for a payment (with respect to some or all of the Awards), to the participant equal in the case of each affected Award to the difference between (A) the fair market value of a Share times the numbers of Shares subject to such outstanding Award (to the extent then exercisable at prices not in excess of the fair market value) and (B) the aggregate exercise price of all Shares subject to such outstanding Award, in each case on such payment terms (which need not be the same as the terms of payment to holders of Shares) and other terms, and subject to such conditions, as the Committee determines; or

- (2) With respect to an outstanding Award held by a participant who, following the Covered Transaction, will be employed by or otherwise providing services to an entity which is a surviving or acquiring entity in the covered transaction or any affiliate of such an entity, the Board may at or prior to the effective time of the Covered Transaction, in its sole discretion and in lieu of the action described in subparagraph (1) above, arrange to have such surviving or acquiring entity or affiliate assume any Award held by such participant outstanding hereunder or grant a replacement Award which, in the judgment of the Board is substantially equivalent to any Award being replaced.
- (3) For purposes of this Section 6(i), a “Covered Transaction” is a (i) Share sale, consolidation, merger, or similar transaction or series of related transactions in which the Company is not the surviving corporation or which results in the acquisition of all or substantially all of the Company’s then outstanding Shares by a single person or entity or by a group of persons and/or entities acting in concert; (ii) a sale or transfer of all or substantially all the Company’s assets, or (iii) a dissolution or liquidation of the Company. Where a Covered Transaction involves a tender offer that is reasonably expected to be followed by a merger described in clause (i) (as determined by the Board), the Covered Transaction shall be deemed to have occurred upon consummation of the tender offer.

(j) *No Grants in Contravention of the 1940 Act.* At all times during such periods as the Company qualifies or intends to qualify as a “business development company,” no Award may be granted under the Plan if the grant or terms of such Award would cause the Company to violate Section 61 of the 1940 Act (or any other provision of the 1940 Act applicable to “business development companies”), and, if approved for grant, such an Award will be void and of no effect.

(k) *Tax Withholding.* The delivery of any Shares, or the lifting or lapse of restrictions on any Award, shall be subject to the participant’s satisfaction of all applicable federal, state and local income and employment tax withholding obligations. A participant may satisfy such obligation(s) in whole or in part, by (i) delivering to the Company a check for the amount required to be withheld, or (ii) if permitted under the 1940 Act and as the Board in its sole discretion approves in any specific or general case, having the Company withhold Shares issuable to the participant under the Plan or delivering to the Company already-owned Shares, in either case having a fair market value equal to the amount required to be withheld, as determined by the Company. In addition, to the extent that the Company so chooses, the Company can hold back 100% of the participant’s compensation earned after such obligations arose and such held back amount shall be applied by the Company to satisfy such obligations.

7. TERMINATION OF EMPLOYMENT

(a) Unless the Board expressly provides otherwise, and except as otherwise provided in an Award agreement or an employment agreement between the participant and the Company or an Affiliate, immediately upon the cessation of the participant's employment or services an Award requiring exercise will cease to be exercisable and will terminate, and all other Awards to the extent not already vested will be forfeited (and, in the case of an Award of Restricted Shares, such unvested Restricted Shares will be transferred to, and reacquired by, the Company), except that:

- (1) subject to (2) and (3) below, all vested options held by the participant immediately prior the cessation of the participant's employment, to the extent then exercisable, will remain exercisable for the less of (i) a period of 90 days or (ii) the period ending on the latest date on which such option could have been exercised without regard to this Section 7(a)(1), and will thereupon terminate;
- (2) all vested options held by a participant immediately prior to the participant's death, to the extent then exercisable, will remain exercisable for the lesser of (i) the 180 day period ending following the participant's death or (ii) the period ending on the latest date on which such option could have been exercised without regard to this Section 7(a), and will thereupon terminate;
- (3) all options (whether or not vested) held by a participant immediately prior to the cessation of the participant's employment or "Cause" will immediately terminate; for this purpose "Cause" shall have the same meaning as provided in the employment agreement between the participant and the Company or its Affiliate, provided that if the participant is not a party to any such agreement, "Cause" shall mean the participant's repeated material failure to perform (other than by reason of Disability), or gross negligence in the performance of, participant's duties and responsibilities to the Company or any of its Affiliates which failure is not cured within thirty (30) days after written notice of such failure or negligence is delivered to participant; (ii) participant's material breach of any written employment agreement between participant and the Company or any of its Affiliates which breach is not cured within thirty (30) days after written notice of such breach is delivered to participant; (iii) commission by participant of a felony involving moral turpitude or fraud with respect to the Company or any of its Affiliates; (iv) participant being sanctioned by a federal or state government or agency with violations of federal or state securities laws in any judicial or administrative process or proceeding, or having been found by any court to have committed any such violation; or (v) participant's failure to comply with (A) any material Company policy, including without limitation, all Company Codes of Ethics, policies, procedures and handbooks, applicable to such participant or (B) any legal or regulatory obligations or requirements of participant, including, without limitation, failure of participant to provide any certifications as may be required by law which is not cured within thirty (30) days after written notice of such violation is delivered to participant. and

- (4) Except as otherwise provided in an Award, after completion of the 90-day (or 180-day) period, such Awards shall terminate to the extent not previously exercised, expired, or terminated.

No option shall be exercised or surrendered in exchange for a cash payment after the Expiration Date.

(b) In particular but not in limitation of the foregoing, the Board may provide in the case of any Award for post-termination exercise provisions different from those expressly set forth in this Section 7, including without limitation terms allowing a later exercise by a former employee (or, in the case of a former employee who is deceased, the person or persons to whom the Award is transferred by will or the laws of descent and distribution) as to all or any portion of the Award not exercisable immediately prior to termination of employment or other service, but in no case may an Award be exercised after the Expiration Date.

8. EMPLOYMENT RIGHTS

Neither the adoption of the Plan nor the grant of Awards shall confer upon any participant any right to continue as an employee of the Company, its parent, or any subsidiary or affect in any way the right of the Company, its parent, or a subsidiary to terminate the participant's relationship at any time. Except as specifically provided by the Board in any particular case, the loss of existing or potential profit in Awards granted under this Plan shall not constitute an element of damages in the event of termination of the relationship of a participant even if the termination is in violation of an obligation of the Company to the participant by contract or otherwise.

9. DISCONTINUANCE, CANCELLATION, AMENDMENT, AND TERMINATION

The Board may at any time or times amend the Plan or any outstanding Award for any purpose which may at the time be permitted by law, and may at any time terminate the Plan as to any future grants of Awards; provided that, except as otherwise expressly provided in the Plan the Board may not, without the participant's consent, alter the terms of an Award so as to affect adversely the participant's rights under the Award, unless the Board expressly reserved the right to do so at the time of the Award. Any amendments to the Plan shall be conditioned upon Shareholder approval only to the extent, if any, such approval is required by law (including the Code), as determined by the Board.

10. LIMITATION OF LIABILITY

Notwithstanding anything to the contrary in the Plan, neither the Company, any subsidiary, nor the Board, nor any person acting on behalf of the Company, any subsidiary, or the Board, shall be liable to any participant or to the estate or beneficiary of any participant or to any other holder of an option by reason of any acceleration of income, or any additional tax, asserted by reason of the failure of an option to satisfy the requirements of Section 409 A or by reason of Section 4999 of the Code; provided, that nothing in this Section 10 shall limit the ability of the Board to provide by separate express written agreement with a participant for a gross-up payment or other payment in connection with any such tax or additional tax.

11. WAIVER OF JURY TRIAL

By accepting an Award under the Plan, each participant waives any right to a trial by jury in any action, proceeding or counterclaim concerning any rights under the Plan and any Award, or under any amendment, waiver, consent, instrument, document or other agreement delivered or which in the future may be delivered in connection therewith, and agrees that any such action, proceedings or counterclaim shall be tried before a court and not before a jury. By accepting an Award under the Plan, each participant certifies that no officer, representative, or attorney of the Company has represented, expressly or otherwise, that the Company would not, in the event of any action, proceeding or counterclaim, seek to enforce the foregoing waivers.

12. LEGAL CONDITIONS ON DELIVERY OF SHARES

The Company will not be obligated to deliver any Shares pursuant to the Plan or to remove any restriction from Shares previously delivered under the Plan until: (i) the Company is satisfied that all legal matters in connection with the issuance and delivery of such Shares have been addressed and resolved; (ii) if the outstanding Shares are at the time of delivery listed on any stock exchange or national market system, the Shares to be delivered have been listed or authorized to be listed on such exchange or system upon official notice of issuance; and (iii) all conditions of the Award have been satisfied or waived. If the sale of Shares has not been registered under the Securities Act of 1933, as amended (the "Securities Act"), the Company may require, as a condition to exercise of the Award, such representations or agreements as counsel for the Company may consider appropriate to avoid violation of the Securities Act. The Company may require that certificates evidencing Shares issued under the Plan bear an appropriate legend reflecting any restriction on transfer applicable to such Shares, and the Company may hold the certificates pending lapse of the applicable restrictions.

KCAP FINANCIAL, INC.
NON-EMPLOYEE DIRECTOR PLAN
As Amended and Restated June 20, 2014

1. Purpose and Certain Defined Terms

The purpose of this Non-Employee Director Plan, As Amended and Restated June 20, 2014 (the “Plan”) is to advance the interests of the Company (as defined below) by providing for the grant to Non-Employee Directors (as defined below) of Restricted Shares (as defined below) (the “Awards”) to the extent permitted by exemptive or other relief that may be granted by the Securities and Exchange Commission (the “Commission”). The Plan is an amendment and restatement of the 2008 Non-Employee Director Plan as adopted on February 5, 2008 (the “Prior Plan”), and amended and restated effective June 10, 2011. At all times during such periods as the Company qualifies or intends to qualify as a “business development company” under the Investment Company Act of 1940, as amended (the “1940 Act”), the terms of the Plan shall be construed so as to conform to the share-based compensation requirements applicable to “business development companies” under the 1940 Act. Any Non-Employee Director selected to receive an Award under the Plan is referred to as a “participant.”

The following terms, when used in the Plan, will have the meanings and be subject to the provisions set forth below:

“Board” means the board of directors of the Company.

“Company” means KCAP Financial, Inc., a Delaware corporation. The Company was formerly known as Kohlberg Capital Corporation.

“Continuous Service” means a participant’s uninterrupted service with the Company as a Non-Employee Director.

“Effective Date” means June 10, 2011, the date on which the Prior Plan was amended and restated in accordance with a resolution of the Board and approved by a vote of the Company’s shareholders.

“Employee Plan” means the Company’s 2006 Equity Incentive Plan, as amended from time to time.

“Executive Compensation Plans” means the Plan, together with any Company executive compensation plan that did, does, or may in the future, exist.

“Non-Employee Director” means any director of the Company who is not an employee or officer of the Company.

“Restricted Shares” means an award of Shares for so long as the Shares remain subject to restrictions requiring that they be forfeited to the Company if specified conditions are not satisfied.

“Shares” means the common stock, \$.01 par value per share, of the Company.

“Shareholders” means the shareholders of the Company.

2. Administration

The Plan shall be administered by the Board unless and until it delegates administration to a committee as provided herein. The Board shall have discretionary authority, subject to the express provisions of the Plan, (a) subject to Section 9(b), to grant Awards to such Eligible Persons (defined below in Section 5 hereof) as the Board may select; (b) to prescribe the form or forms of any instruments evidencing Awards and any other instruments required under the Plan and to change such forms from time to time; (c) to adopt, amend, and rescind rules and regulations for the administration of the Plan; and (d) to interpret the Plan and to decide any questions and settle all controversies and disputes that may arise in connection with the Plan. Such determinations of the Board shall be conclusive and shall bind all parties. Subject to Section 9(a) hereof, the Board shall also have the authority, both generally and in particular instances, to waive compliance by a participant with any obligation to be performed by him or her under an Award, to waive any condition or provision of an Award, and to amend or cancel any Award (and if an Award is canceled, to grant a new Award on such terms as the Board shall specify), provided that the Board may not take any action with respect to an outstanding Award that would adversely affect the rights of the participant under such Award without such participant's consent. Nothing in the preceding sentence shall be construed as limiting the power of the Board to make adjustments required by Sections 4(d) and 6(e) hereof or by applicable law.

The Board may, in its discretion, delegate some or all of its powers with respect to the Plan to a committee (the "Committee"), in which event all references (as appropriate) to the Board hereunder shall be deemed to refer to the Committee.

Determinations, interpretations and constructions made by the Board in good faith shall not be subject to review by any person and shall be final, binding and conclusive on all persons.

3. Effective Date and Term of Plan

The Plan is effective as of the Effective Date. For the avoidance of doubt, all option Awards made under the Prior Plan as in force prior to the Effective Date are governed in all respects by the terms of the Prior Plan and shall be construed accordingly.

No Awards shall be granted under the Plan after the fifth anniversary of the Effective Date, but Awards granted prior to the fifth anniversary of the Effective Date may extend beyond that date.

4. Shares Subject to the Plan

(a) *Number of Shares.* Subject to adjustment as provided in Section 4(d), the aggregate number of Shares that may be the subject of Awards granted under the Plan shall be 100,000. If any Restricted Share Award granted under the Plan is forfeited, the number of Shares as to which such Restricted Share Award was granted shall be available for future grants.

(b) *Shares to be Delivered.* Shares delivered under the Plan shall be authorized but unissued Shares, or if the Board so decides in its sole discretion, previously issued Shares acquired by the Company and held in its treasury. Any Shares acquired by the Company will be acquired in accordance with the 1940 Act, including Section 23 of the 1940 Act. No fractional Shares shall be delivered under the Plan.

(c) *Limits on Number of Awards.* The maximum amount of Restricted Shares that may be issued under the Executive Compensation Plans will be 10% of the outstanding Shares on the Effective Date, plus 10% of the number of Shares issued or delivered by the Company (other than pursuant to the Executive Compensation Plans) during the term of the Plan. No one person shall be granted more than 25% of the Restricted Shares reserved for issuance under this Plan. 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 Shares issued pursuant to the Executive Compensation Plans, at the time of issuance shall not exceed 25% of the outstanding voting securities of the Company (excluding the Restricted Shares), 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 (not including any warrants, options or rights issued to Shareholders of the Company generally), together with any Restricted Shares issued pursuant to the Executive Compensation Plans, would exceed 15% of the outstanding voting securities of the Company (excluding the Restricted Shares), then the total amount of voting securities that would result from the exercise of all outstanding warrants, options and rights, together with any Restricted Shares issued pursuant to the Executive Compensation Plans, at the time of issuance shall not exceed 20% of the outstanding voting securities of the Company (excluding the Restricted Shares).

(d) *Changes in Shares.* In the event of a Share dividend, Share split or combination of Shares, recapitalization, or other change in the Shares, the number and kind of Shares or securities of the Company subject to Awards then outstanding or subsequently granted under the Plan, the maximum number of Shares that may be delivered under the Plan, and other relevant provisions shall be appropriately adjusted by the Board, whose determination shall be binding on all persons.

The Board may also adjust the number of Shares subject to outstanding Awards and the terms of outstanding Awards, to take into consideration material changes in accounting practices or principles, extraordinary dividends, consolidations or mergers (except those described in Section 6(e)), acquisitions or dispositions of securities or property, or any other event if it is determined by the Board that such adjustment is appropriate to avoid distortion in the operation of the Plan. References in the Plan to Shares will be construed to include any units, any stock or any other securities resulting from an adjustment pursuant to this Section 4(d).

5. Eligibility for Awards

Persons eligible to receive Awards under the Plan ("Eligible Persons") shall be Non-Employee Directors.

6. Terms and Conditions of Awards

(a) *Awards.* Each Award shall contain such terms and conditions as the Board shall deem appropriate. No Awards of Restricted Shares shall be granted prior to the Effective Date.

(b) *Amounts; Vesting of Awards.*

(1) Subject to Section 9(b), on and after the Effective Date, each Non-Employee Director who is a director of the Company on the date of each annual meeting of Shareholders or meeting in lieu of the annual meeting of Shareholders, shall automatically be granted 1,000 Restricted Shares on the date of each such annual meeting of Shareholders during the term of the Plan, or if no such meeting be held in a year, then on the anniversary of the prior annual meeting or meeting in lieu of the annual meeting. Such Awards shall immediately vest as to one-half of the Restricted Share grant and as to the remaining one-half of the Restricted Share grant on the earlier of (i) the first anniversary of such grant, or (ii) the date immediately preceding the next annual meeting of Shareholders (or meeting in lieu of the annual meeting of Shareholders), provided that the participant is then and since the date of grant has continuously been a Non-Employee Director (subject to Section 7 hereof).

(2) Subject to Section 9(b), on and after the Effective Date, a Non-Employee Director who is appointed to serve on the Board outside of the annual election cycle shall automatically be granted a pro rata portion of the Restricted Share Award on the date of such appointment to the Board (i.e., such Non-Employee Director will receive a grant of Restricted Shares equal to the product of (x) the number of full months, if any, remaining until the next annual meeting of Shareholders (or the next annual meeting in lieu of the annual meeting of Shareholders) divided by twelve and (y) 1,000). One-half of such pro rata grant will vest immediately and the remaining one-half of such pro rata grant will vest on the earlier of (i) the first anniversary of the preceding annual meeting of Shareholders (or the preceding meeting in lieu of the annual meeting of Shareholders), or (ii) the date immediately preceding the next annual meeting of Shareholders (or meeting in lieu of the annual meeting of Shareholders), provided that the participant is then and since the date of such pro-rata grant has continuously been a Non-Employee Director (subject to Section 7 hereof).

(c) *Rights as Shareholder.* A participant shall not have the rights of a Shareholder with regard to an Award under the Plan except as to Shares actually received by him or her under the Plan. For this purpose, Shares are received by a participant on the date of record issuance of such Shares in the books of the Company or the issuance to participant of a stock certificate with respect to such Shares.

(d) *Nontransferability of Awards.* No unvested Restricted Shares may be transferred. Vested Restricted Shares may be sold, assigned, pledged, hypothecated, encumbered, or transferred or disposed of in any other manner, in whole or in part, only in compliance with the terms, conditions and restrictions as set forth in the governing instruments of the Company, applicable federal and state securities laws or any other applicable laws or regulations and the terms and conditions hereof.

(e) *Mergers, Etc.* To the extent permitted under the 1940 Act, the following provisions shall apply in the event of a Covered Transaction (as defined below).

(1) Subject to subparagraph (2) below, all outstanding Awards to the extent not fully vested (including Awards subject to conditions not yet satisfied or determined) will be forfeited, as of the effective time of the Covered Transaction (as defined in subparagraph (3) herein), provided that the Board may in its sole discretion on or prior to the effective date of the Covered Transaction remove any conditions or restrictions on any Award; or

(2) With respect to an outstanding Award held by a participant who, following the Covered Transaction, will be employed by or otherwise providing services to an entity which is a surviving or acquiring entity in the covered transaction or any affiliate of such an entity, the Board may at or prior to the effective time of the Covered Transaction, in its sole discretion and in lieu of the action described in subparagraph (1) above, arrange to have such surviving or acquiring entity or affiliate assume any Award held by such participant outstanding hereunder or grant a replacement Award which, in the judgment of the Board is substantially equivalent to any Award being replaced.

(3) For purposes of this Section 6(e), a "Covered Transaction" is a (i) Share sale, consolidation, merger, or similar transaction or series of related transactions in which the Company is not the surviving corporation or which results in the acquisition of all or substantially all of the Company's then outstanding Shares by a single person or entity or by a group of persons and/or entities acting in concert; (ii) a sale or transfer of all or substantially all the Company's assets, or (iii) a dissolution or liquidation of the Company. Where a Covered Transaction involves a tender offer that is reasonably expected to be followed by a merger described in clause (i) (as determined by the Board), the Covered Transaction shall be deemed to have occurred upon consummation of the tender offer.

(f) *Compliance with Law; Commission Approval.* At all times during such periods as the Company qualifies or intends to qualify as a “business development company,” no Award may be granted under the Plan if the grant or terms of such Award would cause the Company to violate any provision of the 1940 Act applicable to “business development companies,” and, if approved for grant, such an Award will be void and of no effect. Subject to Section 9(b), the grants of Awards under the Plan will be automatic and will not be changed without shareholder approval.

7. Termination of Continuous Service

Unless the Board expressly provides otherwise, immediately upon the cessation of the participant’s service as a Non-Employee Director (unless upon such termination or within 90 days thereafter the participant becomes an officer or employee of the Company or rejoins the Board as a Non-Employee Director) all Awards, to the extent not already vested, will be forfeited. If a participant ceases providing services as a Non-Employee Director but within 90 days of such cessation becomes an officer or employee of the Company or rejoins the Board as a Non-Employee Director, such participant shall vest in any unvested Restricted Shares on the later of (i) the next annual shareholders meeting (in accordance with Section 6(b) hereof) or (ii) the date on which such participant becomes an officer or employee of the Company or rejoins the Board as a Non-Employee Director.

8. Rights

Neither the adoption of the Plan nor the grant of Awards shall confer upon any participant any right to continue as a Non-Employee Director (or in any other capacity) of the Company, its parent, or any subsidiary or affect in any way the right of the Company, its parent, or a subsidiary to terminate the participant’s relationship at any time. Except as specifically provided by the Board in any particular case, the loss of existing or potential profit in Awards granted under this Plan shall not constitute an element of damages in the event of termination of the relationship of a participant even if the termination is in violation of an obligation of the Company to the participant by contract or otherwise.

9. Discontinuance, Cancellation, Amendment, and Termination; Board Review

(a) The Board may at any time or times amend the Plan or any outstanding Award for any purpose which may at the time be permitted by law, and may at any time terminate the Plan as to any future grants of Awards; provided that, except as otherwise expressly provided in the Plan the Board may not, without the participant’s consent, alter the terms of an Award so as to affect adversely the participant’s rights under the Award, unless the Board expressly reserved the right to do so at the time of the Award. Any amendments to the Plan shall be conditioned upon approval of Shareholders and the Commission only to the extent, if any, such approval is required by law (including the Code), as determined by the Board.

(b) The Board shall review the Plan from time to time and at least annually, its reviews to include an assessment of the potential impact that Awards made or scheduled to be made under the Plan may have on the Company’s earnings and net-asset value per Share. The Board is authorized to take appropriate steps to ensure that the granting of Awards would not have an effect contrary to the interests of Shareholders, including the authority to limit or eliminate the automatic granting of additional Awards pursuant to Section 6(b). The Board shall maintain adequate records of any reviews conducted pursuant to this Section 9(b). For the avoidance of doubt, any action by the Board pursuant to this Section 9(b) that would affect an already outstanding Award shall, to that extent, be subject to the limitations of Section 9(a).

10. Waiver of Jury Trial

By accepting an Award under the Plan, each participant waives any right to a trial by jury in any action, proceeding or counterclaim concerning any rights under the Plan and any Award, or under any amendment, waiver, consent, instrument, document or other agreement delivered or which in the future may be delivered in connection therewith, and agrees that any such action, proceedings or counterclaim shall be tried before a court and not before a jury. By accepting an Award under the Plan, each participant certifies that no officer, representative, or attorney of the Company has represented, expressly or otherwise, that the Company would not, in the event of any action, proceeding or counterclaim, seek to enforce the foregoing waivers.

11. Legal Conditions on Delivery of Shares

The Company will not be obligated to deliver any Shares pursuant to the Plan or to remove any restriction from Shares previously delivered under the Plan until: (i) the Company is satisfied that all legal matters in connection with the issuance and delivery of such Shares have been addressed and resolved; (ii) if the outstanding Shares are at the time of delivery listed on any stock exchange or national market system, the Shares to be delivered have been listed or authorized to be listed on such exchange or system upon official notice of issuance; and (iii) all conditions of the Award have been satisfied or waived. If the sale of Shares has not been registered under the Securities Act of 1933, as amended (the "Securities Act"), the Company may require, as a condition to exercise of the Award, such representations or agreements as counsel for the Company may consider appropriate to avoid violation of the Securities Act. The Company may require that certificates evidencing Shares issued under the Plan bear an appropriate legend reflecting any restriction on transfer applicable to such Shares, and the Company may hold the certificates pending lapse of the applicable restrictions.

KCAP Financial, Inc.
Employee Restricted Stock Award Agreement

KCAP FINANCIAL, INC. STRONGLY ENCOURAGES YOU TO SEEK THE ADVICE OF YOUR OWN LEGAL AND FINANCIAL ADVISORS WITH RESPECT TO YOUR AWARD AND ITS TAX CONSEQUENCES.

The undersigned Grantee (the "Grantee") (i) acknowledges receipt of an award (the "Award") of restricted stock from KCAP Financial, Inc., a Delaware corporation (the "Company"), under the Company's 2006 Equity Incentive Plan as Amended and Restated Effective June 20, 2014 (the "Plan"), subject to the terms set forth below and in the Plan; and (ii) agrees with the Company as follows:

1. Effective Date. This Restricted Stock Award Agreement (the "Award Agreement") shall take effect as of June 20, 2014, which is the grant date of the Award (the "Grant Date"). The Grantee shall be the record owner of the Shares on the Grant Date.
2. Shares Subject to Award. The Award consists of a total of _____ shares of Common Stock of the Company, par value \$0.01 per share (the "Shares").

The Grantee's rights to the Shares are subject to the restrictions described in this Award Agreement and the Plan (which is incorporated herein by reference with the same effect as if set forth herein in full) in addition to such other restrictions, if any, as may be imposed by law.

3. Nontransferability of Shares. Except as provided in this Award Agreement or the Plan, the Shares acquired by the Grantee pursuant to this Award Agreement shall not be sold, transferred, pledged, assigned or otherwise encumbered or disposed and are subject to a substantial risk of forfeiture.
4. Forfeiture Risk. If the Grantee's employment with the Company and its subsidiaries ceases for any reason, then, except as provided in Section 7, any and all outstanding and unvested Shares acquired by the Grantee hereunder shall be automatically and immediately forfeited.

The Grantee hereby (i) appoints the Company as the attorney-in-fact of the Grantee to take such actions as may be necessary or appropriate to effectuate a transfer of the record ownership of any Shares that are unvested and forfeited hereunder, (ii) agrees to deliver to the Company, as a precondition to the issuance of any certificate or certificates with respect to unvested Shares hereunder, one or more stock powers, endorsed in blank, with respect to such Shares, and (iii) agrees to sign such other powers and take such other actions as the Company may reasonably request to accomplish the transfer or forfeiture of any unvested Shares that are forfeited hereunder.

5. Book Entry Form. Unvested Shares are to be held in book entry form and the Grantee agrees that the Company may give stop transfer instructions to the depository, stock transfer agent or other keeper of the Company's stock records to ensure compliance with the provisions hereof.
6. Certificates for Unvested Shares. The Company may, upon request, issue the Grantee a certificate representing unvested Shares. The administrative costs and risk of loss of such certificated shares are the sole responsibility of the Grantee. In addition to any legend required by applicable law, any certificates issued representing Shares shall contain a legend substantially in the following form:

THE TRANSFERABILITY OF THIS CERTIFICATE AND THE SHARES OF STOCK REPRESENTED HEREBY ARE SUBJECT TO THE TERMS AND CONDITIONS (INCLUDING FORFEITURE) OF THE KCAP FINANCIAL, INC. 2006 EQUITY INCENTIVE PLAN AS AMENDED AND RESTATED EFFECTIVE JUNE 20, 2014, AND THE RESTRICTED STOCK AWARD AGREEMENT RELATING TO THE SHARES ENTERED INTO BETWEEN THE REGISTERED OWNER AND KCAP FINANCIAL, INC. COPIES OF SUCH PLAN AND AWARD AGREEMENT ARE ON FILE IN THE OFFICES OF KCAP FINANCIAL, INC.

7. Vesting of Shares. Unless earlier vested pursuant to the Plan, the restrictions on the Shares granted hereunder shall lapse, i.e., the Shares shall vest, during the Grantee's employment by the Company or a subsidiary thereof in accordance with the provisions of this Section 7 and applicable provisions of the Plan, as follows:
 - i. The Shares shall vest in four (4) equal annual installments beginning on the first anniversary of the Grant Date, provided that the Grantee remains in the continuous employment of the Company or a subsidiary through each vesting date.
 - ii. Notwithstanding the foregoing, if the Grantee's employment terminates for any reason, then all unvested Shares will be automatically and immediately forfeited back to the Company. (However, if Grantee has a written employment agreement with the Company with terms contrary to this provision 7(ii), the terms of the written employment agreement shall govern.)
8. Settlement of Vested Shares. Each Share that is vested in accordance with this Award Agreement shall be settled by the issuance of a whole share of Common Stock.

Unless a Section 83(b) election is made within 30 days of the Grant Date, vested Shares shall be treated as compensation and shall be taxed at normal federal, state and local income tax rates at the fair value of the Shares on the vesting date.

The Company's obligation to deliver a certificate upon vesting representing such vested Shares shall be subject to the Grantee's satisfaction of all applicable federal, state and local income and employment tax withholding obligations. The Grantee may satisfy such obligation(s), in whole or in part, by (i) delivering to the Company a check for the amount required to be withheld or (ii) if permitted under the 1940 Act and as the Board in its sole discretion approves in any specific or general case, having the Company withhold Shares or delivering to the Company already-owned shares of Common Stock, in either case having a fair market value equal to the amount required to be withheld, as determined by the Company. In addition, to the extent that the Company so chooses, the Company can hold back 100% of the Grantee's compensation earned after such obligations arose and such held back amount shall be applied by the Company to satisfy such obligations.

9. Delivery of Vested Shares. Delivery of vested Shares is conditioned on: (i) the Grantee's satisfaction of applicable tax withholding requirements as set forth in Section 8 of this Award Agreement; (ii) the completion of any administrative steps (for example, but without limitation, the transfer of certificates) that the Company may reasonably impose; and (iii) applicable requirements of federal and state securities laws.

For any vested Shares that have been requested to be settled by the Grantee, the Company will take such steps as it deems necessary or appropriate to record and manifest such Shares for delivery to the Grantee without restriction on transferability. At the direction of the Grantee, delivery may be either in book-entry form through the Depository Trust Company (or a nominee thereof) to an account at the Grantee's direction or certificated, without the aforesaid legend, and issued and delivered to the Grantee. The Grantee agrees to complete and execute any documents and to take any additional action that the Company may request to enable it to deliver the vested Shares to the Grantee.

10. Fractional Shares. Fractional shares shall not vest hereunder, and when any provision hereof may cause a fractional share to vest, any vesting in such fractional share shall be postponed until such fractional share and other fractional shares equal a vested whole share.
-

11. Dividends, etc. The Grantee shall be entitled to (i) receive any and all dividends or other distributions paid with respect to those vested and unvested Shares of which the Grantee is the record owner on the record date for such dividend or other distribution, whether or not vested at such time, in the same form and amount as any holder of Stock receives, and (ii) vote any Shares of which the Grantee is the record owner on the record date for such vote; *provided, however,* that any property (other than cash) distributed with respect to a share of Stock (the "Associated Share") acquired hereunder, by reason of a stock dividend, stock split or other similar adjustment to the Stock pursuant to Section 4(d) of the Plan, shall be subject to the restrictions of this Award Agreement in the same manner and for so long as the Associated Share remains subject to such restrictions, and shall be promptly forfeited if and when the Associated Share is so forfeited. Notwithstanding the foregoing, the Grantee shall elect, and hereby irrevocably appoints the Company's Chairman of the Board and the Company's Secretary as the Grantee's attorneys-in-fact to elect on Grantee's behalf in the absence of an election from Grantee, to receive cash distributions under the Company's dividend reinvestment plan in respect of all unvested Shares under this Award Agreement.
12. Sale of Vested Shares. The Grantee acknowledges and agrees that any Common Stock issued in respect of vested Shares hereunder may be traded only as permitted by the Company's Codes of Ethics, policies and procedures.
13. Provisions of the Plan. This Grant is subject in its entirety to the provisions of the Plan, which are incorporated herein by reference. A copy of the Plan as in effect on the date of the grant of this Award is available to the Grantee and the Grantee agrees to be bound by the terms of the Plan and this Award. In the event of any conflict between the terms of this Award and the Plan, the terms of this Award shall control.
14. Definitions. Capitalized terms defined in this Award Agreement are used herein as so defined. Capitalized terms used in this Award Agreement and not otherwise defined herein shall have the meaning provided in the Plan.
15. Change in Capital Structure. In accordance with Section 4(d) of the Plan, the terms of this Award Agreement shall be adjusted as the Board determines is equitably required in the event the Company effects one or more stock dividends, stock split-ups, subdivisions or consolidations of shares or other similar changes in capitalization.
16. No Employment Commitment; Tax Treatment. Nothing herein contained shall be deemed to be or constitute an agreement or commitment by the Company or any of its subsidiaries to continue the Grantee in its employ. The Company makes no representation about the tax treatment to the Grantee with respect to receipt or settlement of the restricted Shares or acquiring, holding or disposing of the Shares.
17. Grantee Bound by Plan. The Grantee hereby acknowledges that a copy of the Plan as in effect on the date hereof has been made available to the Grantee and agrees to be bound by all the terms and provisions thereof (as such Plan may be amended from time to time in accordance with the terms thereof).
18. General. For purposes of this Award Agreement and any determinations to be made by the Board or the Committee, as the case may be, hereunder, the determinations by the Board or the Committee, as the case may be, shall be binding upon the Grantee and any transferee.

Agreed as of the Grant Date Shown Above:

KCAP FINANCIAL, INC.

GRANTEE

Name: Edward U. Gilpin
Title: Chief Financial Officer

Print Name

Signature

KCAP Financial, Inc.

EXECUTIVE
Restricted Stock Award Agreement

KCAP FINANCIAL, INC. STRONGLY ENCOURAGES YOU TO SEEK THE ADVICE OF YOUR OWN LEGAL AND FINANCIAL ADVISORS WITH RESPECT TO YOUR AWARD AND ITS TAX CONSEQUENCES.

The undersigned Grantee (the "Grantee") (i) acknowledges receipt of an award (the "Award") of restricted stock from KCAP Financial, Inc., a Delaware corporation (the "Company"), under the Company's 2006 Equity Incentive Plan as Amended and Restated Effective June 20, 2014 (the "Plan"), subject to the terms set forth below and in the Plan; and (ii) agrees with the Company as follows:

1. Effective Date. This Restricted Stock Award Agreement (the "Award Agreement") shall take effect as of June 20, 2014, which is the grant date of the Award (the "Grant Date"). The Grantee shall be the record owner of the Shares on the Grant Date.
2. Shares Subject to Award. The Award consists of a total of _____ shares of Common Stock of the Company, par value \$0.01 per share (the "Shares").

The Grantee's rights to the Shares are subject to the restrictions described in this Award Agreement and the Plan (which is incorporated herein by reference with the same effect as if set forth herein in full) in addition to such other restrictions, if any, as may be imposed by law.

3. Nontransferability of Shares. Except as provided in this Award Agreement or the Plan, the Shares acquired by the Grantee pursuant to this Award Agreement shall not be sold, transferred, pledged, assigned or otherwise encumbered or disposed and are subject to a substantial risk of forfeiture.
4. Forfeiture Risk. If the Grantee's employment with the Company and its subsidiaries ceases for any reason, then, except as provided in Section 7, any and all outstanding and unvested Shares acquired by the Grantee hereunder shall be automatically and immediately forfeited.

The Grantee hereby (i) appoints the Company as the attorney-in-fact of the Grantee to take such actions as may be necessary or appropriate to effectuate a transfer of the record ownership of any Shares that are unvested and forfeited hereunder, (ii) agrees to deliver to the Company, as a precondition to the issuance of any certificate or certificates with respect to unvested Shares hereunder, one or more stock powers, endorsed in blank, with respect to such Shares, and (iii) agrees to sign such other powers and take such other actions as the Company may reasonably request to accomplish the transfer or forfeiture of any unvested Shares that are forfeited hereunder.

5. Book Entry Form. Unvested Shares are to be held in book entry form and the Grantee agrees that the Company may give stop transfer instructions to the depository, stock transfer agent or other keeper of the Company's stock records to ensure compliance with the provisions hereof.
6. Certificates for Unvested Shares. The Company may, upon request, issue the Grantee a certificate representing unvested Shares. The administrative costs and risk of loss of such certificated shares are the sole responsibility of the Grantee. In addition to any legend required by applicable law, any certificates issued representing Shares shall contain a legend substantially in the following form:

THE TRANSFERABILITY OF THIS CERTIFICATE AND THE SHARES OF STOCK REPRESENTED HEREBY ARE SUBJECT TO THE TERMS AND CONDITIONS (INCLUDING FORFEITURE) OF THE KCAP FINANCIAL, INC. 2006 EQUITY INCENTIVE PLAN AS AMENDED AND RESTATED EFFECTIVE JUNE 20, 2014, AND THE RESTRICTED STOCK AWARD AGREEMENT RELATING TO THE SHARES ENTERED INTO BETWEEN THE REGISTERED OWNER AND KCAP FINANCIAL, INC. COPIES OF SUCH PLAN AND AWARD AGREEMENT ARE ON FILE IN THE OFFICES OF KCAP FINANCIAL, INC.

7. Vesting of Shares. Unless earlier vested pursuant to the Plan, the restrictions on the Shares granted hereunder shall lapse, i.e., the Shares shall vest, during the Grantee's employment by the Company or a subsidiary thereof in accordance with the provisions of this Section 7 and applicable provisions of the Plan, as follows:
- i. The Shares shall vest in four (4) equal annual installments beginning on the first anniversary of the Grant Date, provided that the Grantee remains in the continuous employment of the Company or a subsidiary through each vesting date.
 - ii. Notwithstanding the foregoing, if the Grantee's employment is terminated by the Company without Cause or due to the Grantee's death or Disability, then the Shares that otherwise would have vested on the anniversary of the Grant Date that next follows the date of Grantee's termination (if not already vested) shall immediately vest, and all other unvested Shares will be automatically and immediately forfeited.
 - iii. Further notwithstanding the foregoing and except as otherwise provided in an employment agreement between the Grantee and the Company, if there is a Covered Transaction and (x) the successor or acquiring entity (if any) does not assume, convert or replace the Award with an equivalent award, then the Shares shall vest in full upon such Covered Transaction, or (y) the successor or acquiring entity (if any) does assume, convert or replace the Award with an equivalent award and the Grantee's employment is terminated by the Company (or any successor or acquiring entity) without Cause or the Grantee resigns from his or her employment with the Company (or any successor or acquiring entity) for Good Reason, in either case within twenty-four (24) months immediately following the Covered Transaction, then the Shares shall vest in full upon such termination of employment or resignation (as applicable).

Notwithstanding any provision to the contrary in the Plan or this Agreement, if any accelerated vesting of Shares pursuant to Section 7(iii), either alone or together with all other payments and benefits received or to be received by the Grantee from the Company or any of its affiliates would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code (or any successor thereto), and the net amount that would be retained by the Grantee after all taxes were paid would be less than if the accelerated vesting of Shares was limited to the greatest amount of acceleration that would result in no amounts being subject to such excise tax, then the accelerated vesting to which the Participant is entitled shall be so limited. The Company shall make all determinations under this paragraph, provided that if the Participant disagrees with any such determinations, the Company shall engage a national accounting firm selected by the Company to make such determinations, and such determinations shall be final and binding on the Participant. To the extent that Shares hereunder are not vested as a consequence of the limitation contained in this paragraph, then the Award (to the extent not so accelerated) shall be deemed to remain outstanding and shall be subject to the provisions hereof and of the Plan as if no acceleration of vesting had occurred.

For purposes of this Award Agreement:

- a) "Cause" shall mean (i) Grantee's repeated material failure to perform (other than by reason of Disability), or gross negligence in the performance of, his or her duties and responsibilities to the Company or any of its Affiliates which failure is not cured within thirty (30) days after written notice of such failure or negligence is delivered to Grantee; (ii) Grantee's material breach of any agreement between Grantee and the Company or any of its Affiliates which breach is not cured within thirty (30) days after written notice of such breach is delivered to Grantee; (iii) commission by Grantee of a felony involving moral turpitude or fraud with respect to the Company or any of its Affiliates; (iv) Grantee being sanctioned by a federal or state government or agency with violations of federal or state securities laws in any judicial or administrative process or proceeding, or having been found by any court to have committed any such violation; or (v) Grantee's failure to comply with (A) any material Company policy or procedure, including without limitation, the Codes of Ethics, policies and procedures of the Company, or (B) any legal or regulatory obligations or requirements, including, without limitation, failure to provide any certifications as may be required by law which is not cured within thirty (30) days after written notice of such violation is delivered to Grantee.
-

b) "Covered Transaction" shall mean the occurrence of one of the following events:

(i) The acquisition by any person, entity or "group", within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act (excluding, for this purpose, the Company or its Affiliates) of beneficial ownership of 33% or more of either the then outstanding shares of the Company's common stock or the combined voting power of the Company's then outstanding voting securities entitled to vote generally in the election of directors.

(ii) Individuals who, as of the date hereof, constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any person who first becomes a director subsequent to the date hereof whose recommendation, election or nomination for election by the Company's stockholders was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Company as described in Rule 14a-11 of Regulation 14A promulgated under the Securities Exchange Act) shall be, for the purposes of this agreement, considered as though such person were a member of the Incumbent Board; or

(iii) Approval by the stockholders of the Company of a reorganization, share exchange, merger or consolidation with respect to which, in any such case, the persons who were the stockholders of the Company immediately prior to such reorganization, share exchange, merger or consolidation do not, immediately thereafter, own more than 50% of the combined voting power entitled to vote in the election of directors of the reorganized, merged or consolidated company;

(iv) Approval by the stockholders of a plan of complete liquidation or dissolution of the Company; or

(v) A sale of all or substantially all of the assets of the Company.

c) "Disability" means Grantee's inability to perform the essential duties, responsibilities and functions of his or her position with the Company (as determined by the Board in its good faith judgment, consistent with its policies and past practice) as a result of any mental or physical disability or incapacity even with reasonable accommodations of such disability or incapacity provided by the Company or if providing such accommodations would be unreasonable..

d) "Good Reason" shall mean, without Grantee's consent, the occurrence of one or more of the following events: (i) material diminution in the nature or scope of Grantee's responsibilities, duties or authority; (ii) material reduction in Grantee's annual base salary or annual target bonus opportunity; (iii) Grantee being required to relocate to a principal place of employment outside of New York, New York; (iv) the Company's failure to renew any employment agreement with Grantee in accordance with the terms of such employment agreement; or (v) a change in Grantee's reporting relationships within the Company that occurs in anticipation of or within twenty four (24) months after a Covered Transaction.

e) "Payment" shall mean any transfer of property within the meaning of Section 280G of the Internal Revenue Code.

8. Settlement of Vested Shares. Each Share that is vested in accordance with this Award Agreement shall be settled by the issuance of a whole share of Common Stock.

Unless a Section 83(b) election is made within 30 days of the Grant Date, vested Shares shall be treated as compensation and shall be taxed at normal federal, state and local income tax rates at the fair value of the Shares on the vesting date.

The Company's obligation to deliver a certificate upon vesting representing such vested Shares shall be subject to the Grantee's satisfaction of all applicable federal, state and local income and employment tax withholding obligations. The Grantee may satisfy such obligation(s), in whole or in part, by (i) delivering to the Company a check for the amount required to be withheld or (ii) if permitted under the 1940 Act and as the Board in its sole discretion approves in any specific or general case, having the Company withhold Shares or delivering to the Company already-owned shares of Common Stock, in either case having a fair market value equal to the amount required to be withheld, as determined by the Company. In addition, to the extent that the Company so chooses, the Company can hold back 100% of the Grantee's compensation earned after such obligations arose and such held back amount shall be applied by the Company to satisfy such obligations.

9. Delivery of Vested Shares. Delivery of vested Shares is conditioned on: (i) the Grantee's satisfaction of applicable tax withholding requirements as set forth in Section 8 of this Award Agreement; (ii) the completion of any administrative steps (for example, but without limitation, the transfer of certificates) that the Company may reasonably impose; and (iii) applicable requirements of federal and state securities laws.

For any vested Shares that have been requested to be settled by the Grantee, the Company will take such steps as it deems necessary or appropriate to record and manifest such Shares for delivery to the Grantee without restriction on transferability. At the direction of the Grantee, delivery may be either in book-entry form through the Depository Trust Company (or a nominee thereof) to an account at the Grantee's direction or certificated, without the aforesaid legend, and issued and delivered to the Grantee. The Grantee agrees to complete and execute any documents and to take any additional action that the Company may request to enable it to deliver the vested Shares to the Grantee.

10. Fractional Shares. Fractional shares shall not vest hereunder, and when any provision hereof may cause a fractional share to vest, any vesting in such fractional share shall be postponed until such fractional share and other fractional shares equal a vested whole share.
11. Dividends, etc. The Grantee shall be entitled to (i) receive any and all dividends or other distributions paid with respect to those vested and unvested Shares of which the Grantee is the record owner on the record date for such dividend or other distribution, whether or not vested at such time, in the same form and amount as any holder of Stock receives, and (ii) vote any Shares of which the Grantee is the record owner on the record date for such vote; *provided, however,* that any property (other than cash) distributed with respect to a share of Stock (the "Associated Share") acquired hereunder, by reason of a stock dividend, stock split or other similar adjustment to the Stock pursuant to Section 4(d) of the Plan, shall be subject to the restrictions of this Award Agreement in the same manner and for so long as the Associated Share remains subject to such restrictions, and shall be promptly forfeited if and when the Associated Share is so forfeited. Notwithstanding the foregoing, the Grantee shall elect, and hereby irrevocably appoints the Company's Chairman of the Board and the Company's Secretary as the Grantee's attorneys-in-fact to elect on Grantee's behalf in the absence of an election from Grantee, to receive cash distributions under the Company's dividend reinvestment plan in respect of all unvested Shares under this Award Agreement.
12. Sale of Vested Shares. The Grantee acknowledges and agrees that any Common Stock issued in respect of vested Shares hereunder may be traded only as permitted by the Company's Codes of Ethics, policies and procedures.
13. Provisions of the Plan. This Grant is subject in its entirety to the provisions of the Plan, which are incorporated herein by reference. A copy of the Plan as in effect on the date of the grant of this Award is available to the Grantee and the Grantee agrees to be bound by the terms of the Plan and this Award. In the event of any conflict between the terms of this Award and the Plan, the terms of this Award shall control.
-

14. Definitions. Capitalized terms defined in this Award Agreement are used herein as so defined. Capitalized terms used in this Award Agreement and not otherwise defined herein shall have the meaning provided in the Plan.
15. Change in Capital Structure. In accordance with Section 4(d) of the Plan, the terms of this Award Agreement shall be adjusted as the Board determines is equitably required in the event the Company effects one or more stock dividends, stock split-ups, subdivisions or consolidations of shares or other similar changes in capitalization.
16. No Employment Commitment; Tax Treatment. Nothing herein contained shall be deemed to be or constitute an agreement or commitment by the Company or any of its subsidiaries to continue the Grantee in its employ. The Company makes no representation about the tax treatment to the Grantee with respect to receipt or settlement of the restricted Shares or acquiring, holding or disposing of the Shares.
17. Grantee Bound by Plan. The Grantee hereby acknowledges that a copy of the Plan as in effect on the date hereof has been made available to the Grantee and agrees to be bound by all the terms and provisions thereof (as such Plan may be amended from time to time in accordance with the terms thereof).
18. General. For purposes of this Award Agreement and any determinations to be made by the Board or the Committee, as the case may be, hereunder, the determinations by the Board or the Committee, as the case may be, shall be binding upon the Grantee and any transferee.

Agreed as of the Grant Date Shown Above:

KCAP FINANCIAL, INC.

GRANTEE

Name: Edward U. Gilpin
Title: Chief Financial Officer

Print Name

Signature

**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 Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 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 consolidated 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 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 consolidated 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 fiscal 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: August 6, 2014

By: _____ / s / Dayl W. Pearson
Dayl W. Pearson
President and Chief Executive Officer
(Principal Executive Officer)

**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 Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 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 consolidated 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 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 consolidated 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 fiscal 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: August 6, 2014

By: _____ / s / Edward U. Gilpin
Edward U. Gilpin
Chief Financial Officer
(Principal 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**

In connection with the accompanying Quarterly Report of KCAP Financial, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2014 (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: August 6, 2014

By: _____ / s / Dayl W. Pearson
Dayl W. Pearson
President and Chief Executive Officer
(Principal 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**

In connection with the accompanying Quarterly Report of KCAP Financial, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2014 (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: August 6, 2014

By: _____ / s / Edward U. Gilpin
Edward U. Gilpin
Chief Financial Officer
(Principal Financial Officer)
