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

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**Form 10-Q**

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- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 31, 2015
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 814-00735

**KCAP Financial, Inc.**  
(Exact name of Registrant as specified in its charter)

Delaware  
(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 May 4, 2015 was 36,875,942.

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**KCAP FINANCIAL, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	As of <b>March 31, 2015</b> (unaudited)	As of <b>December 31, 2014</b>
<b>ASSETS</b>		
Investments at fair value:		
Money market accounts (cost: 2015 - \$1,729,575; 2014 - \$1,602,741)	\$ 1,729,575	\$ 1,602,741
Debt securities (cost: 2015 - \$321,962,047; 2014 - \$322,884,934)	320,470,495	320,143,170
CLO Fund Securities managed by affiliates (cost: 2015 - \$94,330,773; 2014 - \$85,355,897)	82,455,704	74,139,696
CLO Fund Securities managed by non-affiliates (cost: 2015 - \$5,482,114; 2014 - \$5,533,293)	3,397,774	3,375,206
Equity securities (cost: 2015 - \$8,828,812; 2014 - \$8,828,812)	8,063,558	8,119,681
Asset Manager Affiliates (cost: 2015 - \$59,006,651; 2014 - \$60,292,677)	71,524,000	72,326,000
Total Investments at Fair Value (cost: 2015 - \$491,339,972; 2014 - \$484,498,354)	487,641,106	479,706,494
Cash	1,521,555	1,220,798
Restricted cash	3,962,192	19,325,550
Interest receivable	2,189,109	1,748,821
Due from affiliates	3,985,732	3,027,409
Other assets	5,453,839	5,417,725
Total Assets	<u>\$ 504,753,533</u>	<u>\$ 510,446,797</u>
<b>LIABILITIES</b>		
Convertible Notes	\$ 38,647,000	\$ 38,647,000
7.375% Notes Due 2019	41,400,000	41,400,000
Notes issued by KCAP Senior Funding I, LLC (net of discount: 2015 - \$3,362,714; 2014 - \$3,512,407)	143,987,286	143,837,593
Payable for open trades	11,952,000	18,293,725
Accounts payable and accrued expenses	1,606,701	2,274,150
Accrued interest payable	850,932	1,566,255
Due to affiliates	2,386,179	31,000
Shareholder distribution payable	—	9,080,373
Total Liabilities	<u>240,830,098</u>	<u>255,130,096</u>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$0.01 per share, 100,000,000 common shares authorized; 36,859,957 and 36,775,127 common shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively	368,600	367,751
Capital in excess of par value	363,345,425	362,411,830
Excess distribution of net investment income	(19,072,917)	(25,579,865)
Accumulated net realized losses	(75,439,778)	(75,512,134)
Net unrealized depreciation on investments	(5,277,895)	(6,370,881)
Total Stockholders' Equity	263,923,435	255,316,701
Total Liabilities and Stockholders' Equity	<u>\$ 504,753,533</u>	<u>\$ 510,446,797</u>
NET ASSET VALUE PER COMMON SHARE	<u>\$ 7.16</u>	<u>\$ 6.94</u>

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2015	2014
<b>Investment Income:</b>		
Interest from investments in debt securities	\$ 6,197,828	\$ 5,247,236
Interest from cash and time deposits	701	786
Investment income on CLO Fund Securities managed by affiliates	4,340,143	2,822,378
Investment income on CLO Fund Securities managed by non-affiliates	227,679	319,414
Dividends from Asset Manager Affiliates	1,413,975	1,378,466
Capital structuring service fees	161,803	227,083
Total investment income	12,342,129	9,995,363
<b>Expenses:</b>		
Interest and amortization of debt issuance costs	2,967,187	2,990,166
Compensation	1,072,822	1,262,437
Professional fees	1,171,441	671,210
Insurance	112,439	135,961
Administrative and other	511,292	468,283
Total expenses	5,835,181	5,528,057
<b>Net Investment Income</b>	<b>6,506,948</b>	<b>4,467,306</b>
<b>Realized And Unrealized Gains (Losses) On Investments:</b>		
Net realized gains from investment transactions	72,356	309,581
Net change in unrealized (depreciation) appreciation on:		
Debt securities	1,250,211	(603,315)
Equity securities	(56,123)	(327,661)
CLO Fund Securities managed by affiliates	(658,871)	933,828
CLO Fund Securities managed by non-affiliates	73,744	(340,705)
Asset Manager Affiliates investments	484,025	(997,444)
Total net change in unrealized (depreciation) appreciation	1,092,986	(1,335,297)
Net realized and unrealized (depreciation) appreciation on investments	1,165,342	(1,025,716)
<b>Net Increase In Stockholders' Equity Resulting From Operations</b>	<b>\$ 7,672,290</b>	<b>\$ 3,441,590</b>
Net Increase In Stockholders' Equity Resulting from Operations per Common Share:		
Basic:	\$ 0.21	\$ 0.10
Diluted:	\$ 0.20	\$ 0.10
Net Investment Income Per Common Share:		
Basic:	\$ 0.18	\$ 0.13
Diluted:	\$ 0.18	\$ 0.13
Weighted Average Shares of Common Stock Outstanding—Basic	36,834,266	33,337,967
Weighted Average Shares of Common Stock Outstanding—Diluted	36,843,382	33,349,916

See accompanying notes to consolidated financial statements.

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>Operations:</b>		
Net investment income	\$ 6,506,948	\$ 4,467,306
Net realized gains (losses) from investment transactions	72,356	309,581
Net change in unrealized (depreciation) appreciation on investments	1,092,986	(1,335,297)
Net increase in net assets resulting from operations	7,672,290	3,441,590
<b>Stockholder distributions:</b>		
Distributions of ordinary income	—	35,535
Net decrease in net assets resulting from stockholder distributions	—	35,535
<b>Capital transactions:</b>		
Issuance of common stock for:		
Dividend reinvestment plan	579,913	68,043
Stock based compensation	354,531	187,750
Net increase in net assets resulting from capital transactions	934,444	255,793
Net assets at beginning of period	255,316,701	250,369,693
Net assets at end of period (including undistributed net investment income of \$0 in 2015 and \$0 in 2014)	\$ 263,923,435	\$ 254,102,611
Net asset value per common share	\$ 7.16	\$ 7.62
Common shares outstanding at end of period	36,859,957	33,340,607

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2015	2014
<b>OPERATING ACTIVITIES:</b>		
Net increase in stockholder's equity resulting from operations	\$ 7,672,290	\$ 3,441,590
Adjustments to reconcile net increase in stockholder's equity resulting from operations to net cash (used in) provided by in operations:		
Net realized (gains) losses on investment transactions	(72,356)	(309,581)
Net change in unrealized (appreciation) depreciation on investments	(1,092,986)	1,335,297
Purchases of investments	(20,176,406)	(29,053,979)
Proceeds from sales and redemptions of investments	10,822,846	37,218,653
Net accretion of discount on debt securities	2,930,687	2,247,339
Amortization of original issue discount on indebtedness	149,693	108,877
Amortization of debt issuance costs	295,455	275,889
Payment-in-kind interest income	(346,395)	152,855
Amortization of stock-based compensation expense	354,531	187,750
Changes in operating assets and liabilities:		
Increase (decrease) in payable for open trades	(6,341,725)	3,980,000
Increase in receivable for open trades	—	(6,972,467)
Increase in interest and dividends receivable	(440,288)	(159,703)
Decrease in accounts receivable	—	125,259
Increase in other assets	(331,533)	(496,827)
Increase in due from affiliates	(958,341)	—
Increase in due to affiliates	2,355,179	—
Decrease in accounts payable and accrued expenses	(1,382,772)	(2,224,782)
Net cash (used in) provided by operating activities	(6,562,121)	9,856,170
<b>FINANCING ACTIVITIES:</b>		
Distributions to stockholders	(8,500,480)	(8,229,454)
Increase (Decrease) in restricted cash	15,363,358	(1,782,643)
Net cash provided by (used in) financing activities	6,862,878	(10,012,097)
<b>CHANGE IN CASH</b>	300,757	(155,927)
<b>CASH, BEGINNING OF PERIOD</b>	1,220,798	3,433,675
<b>CASH, END OF PERIOD</b>	\$ 1,521,555	\$ 3,277,748
<b>Supplemental Information:</b>		
Interest paid during the period	\$ 3,237,329	\$ 3,572,753
Dividends paid during the period under the dividend reinvestment plan	\$ 579,913	\$ 68,043

See accompanying notes to consolidated financial statements.

**KCAP FINANCIAL, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS**  
**As of March 31, 2015**

(unaudited)

**Debt Securities Portfolio**

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
4L Technologies Inc. (fka Clover Holdings, Inc.) <sup>9, 11</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 5/20	\$ 2,786,000	\$ 2,762,266	\$ 2,692,390
Advanced Lighting Technologies, Inc. <sup>9, 11</sup> <i>Consumer goods: Durable</i>	First Lien Bond — 10.5% - 06/2019 - 00753CAE2 10.5% Cash, Due 6/19	3,000,000	2,967,369	2,580,000
Advantage Sales & Marketing Inc. <sup>9</sup> <i>Services: Business</i>	Junior Secured Loan — Term Loan (Second Lien) 7.5% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	1,002,307	1,003,540
Alaska Communications Systems Holdings, Inc. <sup>9, 11</sup> <i>Telecommunications</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.5% Libor Floor, Due 10/16	1,309,993	1,307,890	1,310,126
Alere Inc. (fka IM US Holdings, LLC) <sup>11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — B Term Loan 4.3% Cash, 1.0% Libor Floor, Due 6/17	2,351,590	2,349,006	2,358,939
AmSurg Corp. <sup>11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 3.8% Cash, 0.8% Libor Floor, Due 7/21	2,984,962	2,984,962	2,995,992
Anaren, Inc. <sup>9, 11</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 2/21	1,975,000	1,958,328	1,975,000
Asurion, LLC (fka Asurion Corporation) <sup>9, 11</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — Incremental Tranche B-1 Term Loan 5.0% Cash, 1.3% Libor Floor, Due 5/19	1,907,705	1,920,804	1,915,784
AZ Chem US Inc. <sup>9, 11</sup> <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Initial Term Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 6/21	460,274	458,230	461,745
Bankruptcy Management Solutions, Inc. <sup>9</sup> <i>Services: Business</i>	Senior Secured Loan — Term B Loan 7.0% Cash, 1.0% Libor Floor, Due 6/18	695,795	695,795	634,774

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
BarBri, Inc. (Gemini Holdings, Inc.) <sup>9, 11</sup> <i>Services: Consumer</i>	Senior Secured Loan — Term Loan 4.5% Cash, 1.0% Libor Floor, Due 7/19	\$ 2,872,500	\$ 2,862,151	\$ 2,869,053
BBB Industries US Holdings, Inc. <sup>9, 11</sup> <i>Automotive</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 11/21	3,000,000	2,943,430	3,005,625
Bellisio Foods, Inc. <sup>9, 11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — U.S. Term B Loans 5.3% Cash, 1.0% Libor Floor, Due 8/19	2,233,881	2,225,420	2,197,469
Blue Coat Systems, Inc. <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — New Term Loan 4.0% Cash, 1.0% Libor Floor, Due 5/19	466,453	467,710	466,940
Carolina Beverage Group LLC <sup>9</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Bond — 10.625% - 08/2018 - 143818AA0 144A 10.6% Cash, Due 8/18	1,500,000	1,513,639	1,485,000
CCS Intermediate Holdings, LLC <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 7/21	2,985,000	2,971,429	2,947,688
Cengage Learning Acquisitions, Inc. (fka TL Acquisitions, Inc.) <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 3/20	2,979,950	2,973,574	2,996,190
Charter Communications Operating, LLC (aka CCO Safari LLC) <sup>11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Term G Loan 4.3% Cash, 0.8% Libor Floor, Due 9/21	3,000,000	3,021,583	3,029,175
Checkout Holding Corp. (fka Catalina Marketing) <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 4/21	992,500	988,220	870,090
Consolidated Communications, Inc. <sup>11</sup> <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.3% Cash, 1.0% Libor Floor, Due 12/20	2,984,887	2,995,545	3,001,214
CRGT Inc. <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term Loan 7.5% Cash, 1.0% Libor Floor, Due 12/20	2,981,250	2,923,930	2,978,269
Crowley Holdings Preferred, LLC <sup>9</sup> <i>Transportation: Cargo</i>	Preferred Stock — 12.000% - 12/2049 - Series A Income Preferred Securities 10.0% Cash, 2.0% PIK, Due 12/49	10,257,047	10,257,047	10,470,393



<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Crowne Group, LLC <sup>9, 11</sup> <i>Automotive</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 9/20	\$ 3,980,000	\$ 3,925,109	\$ 3,884,480
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) <sup>9</sup> <i>Beverage, Food and Tobacco</i>	Junior Secured Loan — Term Loan (Second Lien) 8.8% Cash, 1.0% Libor Floor, Due 7/21	3,000,000	3,015,737	2,857,500
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) <sup>9, 11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 7/20	2,616,742	2,615,868	2,616,742
CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 12/21	2,992,500	2,963,902	3,022,425
DBI Holding LLC <sup>9</sup> <i>Services: Business</i>	Senior Unsecured Bond — 09/2019 – PIK Note 0.0% Cash, 16.0% PIK, Due 9/19	3,590,248	3,368,751	3,482,540
DBI Holding LLC <sup>9</sup> <i>Services: Business</i>	Senior Subordinated Bond — 09/2019 - Senior Subordinated Note 12.0% Cash, 4.0% PIK, Due 9/19	4,347,911	4,330,633	4,295,736
DJO Finance LLC (ReAble Therapeutics Fin LLC) <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — New Tranche B Term Loan 4.3% Cash, 1.0% Libor Floor, Due 9/17	2,058,377	2,058,377	2,066,610
Drew Marine Group Inc. <sup>9</sup> <i>Transportation: Cargo</i>	Junior Secured Loan — Term Loan (Second Lien) 8.0% Cash, 1.0% Libor Floor, Due 5/21	2,500,000	2,494,861	2,500,000
ELO Touch Solutions, Inc. <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 8.0% Cash, 1.5% Libor Floor, Due 6/18	1,726,036	1,678,577	1,670,457
EWT Holdings III Corp. (fka WTG Holdings III Corp.) <sup>9</sup> <i>Environmental Industries</i>	Junior Secured Loan — Term Loan (Second Lien) 8.5% Cash, 1.0% Libor Floor, Due 1/22	4,000,000	3,983,007	3,935,000
Fender Musical Instruments Corporation <sup>9, 11</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Initial Loan 5.8% Cash, 1.3% Libor Floor, Due 4/19	1,846,934	1,856,268	1,847,118
FHC Health Systems, Inc. <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 5.0% Cash, 1.0% Libor Floor, Due 12/21	3,407,143	3,374,391	3,411,231

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
First American Payment Systems, L.P. <sup>9</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Junior Secured Loan — Term Loan (Second Lien) 10.8% Cash, 1.3% Libor Floor, Due 4/19	\$ 2,796,448	\$ 2,761,682	\$ 2,822,176
First Data Corporation <sup>9, 11</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — 2018 New Dollar Term Loan 3.7% Cash, Due 3/18	500,000	494,440	500,500
Getty Images, Inc. <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.3% Libor Floor, Due 10/19	2,179,590	2,183,139	1,845,295
GK Holdings, Inc. (aka Global Knowledge) <sup>9</sup> <i>Services: Business</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.5% Cash, 1.0% Libor Floor, Due 1/22	1,500,000	1,470,638	1,470,000
GK Holdings, Inc. (aka Global Knowledge) <sup>9, 11</sup> <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 1/21	2,493,750	2,469,432	2,499,984
Global Tel*Link Corporation <sup>9</sup> <i>Telecommunications</i>	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, 1.3% Libor Floor, Due 11/20	4,000,000	3,938,349	3,880,800
Grande Communications Networks LLC <sup>9, 11</sup> <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.5% Cash, 1.0% Libor Floor, Due 5/20	3,930,053	3,934,658	3,928,481
Grifols Worldwide Operations Limited <sup>11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — U.S. Tranche B Term Loan 3.2% Cash, Due 2/21	2,984,925	2,963,642	2,985,432
Grupo HIMA San Pablo, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 1/18	2,940,000	2,906,621	2,940,000
Grupo HIMA San Pablo, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,000,000	6,902,001	7,105,000
Gymboree Corporation., The <sup>9, 11</sup> <i>Retail</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.5% Libor Floor, Due 2/18	1,421,105	1,394,907	1,086,463
Hargray Communications Group, Inc. (HCP Acquisition LLC) <sup>9, 11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Initial Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/19	2,930,662	2,909,856	2,934,179

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Tranche B-3 Term Loan 7.0% Cash, 1.5% Libor Floor, Due 5/18	\$ 3,346,875	\$ 3,323,417	\$ 3,377,214
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Tranche B-4 Term Loan 6.0% Cash, 1.0% Libor Floor, Due 8/19	1,453,125	1,447,375	1,462,934
Hoffmaster Group, Inc. <sup>9</sup> <i>Forest Products &amp; Paper</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, 1.0% Libor Floor, Due 5/21	2,000,000	1,973,785	1,987,500
Hoffmaster Group, Inc. <sup>9, 11</sup> <i>Forest Products &amp; Paper</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.3% Cash, 1.0% Libor Floor, Due 5/20	3,970,000	3,936,052	3,994,813
Hunter Defense Technologies, Inc. <sup>9, 11</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 8/19	2,925,000	2,899,268	2,953,080
Integra Telecom Holdings, Inc. <sup>9, 11</sup> <i>Telecommunications</i>	Senior Secured Loan — Term B Loan 5.3% Cash, 1.3% Libor Floor, Due 2/19	2,984,772	2,973,885	2,988,503
International Architectural Products, Inc. <sup>7, 9</sup> <i>Metals &amp; 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
Kellermeier Bergensons Services, LLC <sup>9</sup> <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 10/21	1,995,000	1,976,185	1,990,013
Key Safety Systems, Inc. <sup>9, 11</sup> <i>Automotive</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.0% Libor Floor, Due 8/21	1,492,500	1,485,665	1,501,365
Kinetic Concepts, Inc. <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Dollar Term E-1 Loan 4.5% Cash, 1.0% Libor Floor, Due 5/18	2,984,886	2,977,946	2,999,811
Landslide Holdings, Inc. (Crimson Acquisition Corp.) <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — New Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 2/20	3,447,675	3,455,727	3,448,020
MB Aerospace ACP Holdings III Corp. <sup>9, 11</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Dollar Term Loan 5.0% Cash, 1.0% Libor Floor, Due 5/19	3,930,000	3,902,669	3,929,214

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Media General, Inc. <sup>11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Term B Loan 4.3% Cash, 1.0% Libor Floor, Due 7/20	\$ 2,938,272	\$ 2,941,805	\$ 2,955,901
Medical Specialties Distributors, LLC <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan 6.5% Cash, 1.0% Libor Floor, Due 12/19	3,950,000	3,919,145	3,845,325
Millennium Health, LLC (fka Millennium Laboratories, LLC) <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Tranche B Term Loan 5.3% Cash, 1.0% Libor Floor, Due 4/21	2,984,962	2,984,962	3,011,081
Nellson Nutraceutical, LLC <sup>9, 11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term A-1 Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 12/21	2,083,333	2,062,834	2,062,500
Nellson Nutraceutical, LLC <sup>9, 11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term A-2 Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 12/21	1,916,667	1,897,807	1,897,500
Nielsen & Bainbrige, LLC <sup>9</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/20	997,500	988,426	968,373
Nielsen & Bainbrige, LLC <sup>9</sup> <i>Consumer goods: Durable</i>	Junior Secured Loan — Term Loan (Second Lien) 10.3% Cash, 1.0% Libor Floor, Due 8/21	2,000,000	1,972,319	1,920,000
Nielsen & Bainbrige, LLC <sup>9, 11</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/20	2,992,500	2,965,279	2,905,119
Novetta, LLC <sup>9</sup> <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 10/20	2,736,250	2,710,440	2,708,340
Novitex Acquisition, LLC (fka ARSloane Acquisition, LLC) <sup>9, 11</sup> <i>Services: Business</i>	Senior Secured Loan — Tranche B-2 Term Loan (First Lien) 7.5% Cash, 1.3% Libor Floor, Due 7/20	987,538	978,870	936,778
Onex Carestream Finance LP <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 9.5% Cash, 1.0% Libor Floor, Due 12/19	1,932,311	1,932,311	1,932,794

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Onex Carestream Finance LP <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan (First Lien 2013) 5.0% Cash, 1.0% Libor Floor, Due 6/19	\$ 1,935,755	\$ 1,941,952	\$ 1,945,163
Orbitz Worldwide, Inc. <sup>11</sup> <i>Hotel, Gaming &amp; Leisure</i>	Senior Secured Loan — Tranche C Term Loan 4.5% Cash, 1.0% Libor Floor, Due 4/21	2,819,576	2,819,576	2,827,950
Otter Products, LLC (OtterBox Holdings, Inc.) <sup>9, 11</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Term B Loan 5.8% Cash, 1.0% Libor Floor, Due 6/20	2,984,962	2,962,089	2,895,712
Ozburn-Hessey Holding Company LLC <sup>9, 11</sup> <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 6.8% Cash, 1.3% Libor Floor, Due 5/19	3,503,511	3,495,769	3,537,145
PGX Holdings, Inc. <sup>9, 11</sup> <i>Services: Consumer</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.3% Cash, 1.0% Libor Floor, Due 9/20	3,950,000	3,913,683	3,959,875
Post Holdings, Inc. <sup>11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Series A Incremental Term Loan 3.8% Cash, 0.8% Libor Floor, Due 6/21	2,984,962	2,977,910	2,995,335
PQ Corporation <sup>9, 11</sup> <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — 2014 Term Loan 4.0% Cash, 1.0% Libor Floor, Due 8/17	2,984,733	2,984,733	2,979,136
PSC Industrial Holdings Corp. <sup>9, 11</sup> <i>Environmental Industries</i>	Senior Secured Loan — Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 12/20	1,995,000	1,975,993	2,011,958
Puerto Rico Cable Acquisition Company Inc. (D/B/A Choice TV) <sup>9</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/18	895,364	896,481	895,364
Puerto Rico Cable Acquisition Company Inc. (D/B/A Choice TV) <sup>9, 11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/18	2,686,092	2,677,062	2,686,092
QoL Meds, LLC <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/20	497,500	495,307	483,023

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Quad-C JH Holdings Inc. (aka Joerns Healthcare) <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan A 6.0% Cash, 1.0% Libor Floor, Due 5/20	\$ 3,970,000	\$ 3,944,386	\$ 3,837,005
Restorix Health, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Unsecured Loan — Delayed Draw 10.0% Cash, 1.5% PIK, Due 6/18	2,011,110	2,011,110	2,011,110
Restorix Health, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Unsecured Loan — Subordinated Term Loan 10.0% Cash, 1.5% PIK, Due 6/18	8,093,672	8,093,672	8,093,672
Reynolds Group Holdings Inc. <sup>9, 11</sup> <i>Containers, Packaging and Glass</i>	Senior Secured Loan — Incremental U.S. Term Loan 4.5% Cash, 1.0% Libor Floor, Due 12/18	2,916,649	2,916,649	2,933,055
Roscoe Medical, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	6,700,000	6,645,367	6,569,350
Rovi Solutions Corporation / Rovi Guides, Inc. <sup>11</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term B Loan 3.8% Cash, 0.8% Libor Floor, Due 7/21	2,984,962	2,948,543	2,984,664
Sandy Creek Energy Associates, L.P. <sup>9, 11</sup> <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 11/20	2,837,361	2,825,948	2,832,807
SGF Produce Holding Corp.(Frozsun, Inc.) <sup>9</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 3/19	2,185,755	2,171,061	2,185,755
SGF Produce Holding Corp.(Frozsun, Inc.) <sup>9, 11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 3/19	3,431,840	3,424,174	3,431,840
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) <sup>9, 11</sup> <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.8% Cash, 1.3% Libor Floor, Due 6/19	2,861,935	2,841,682	2,856,211
Sun Products Corporation, The (fka Huish Detergents Inc.) <sup>9, 11</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Tranche B Term Loan 5.5% Cash, 1.3% Libor Floor, Due 3/20	3,882,654	3,860,392	3,764,718

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Tank Partners Holdings, LLC <sup>9</sup> <i>Energy: Oil &amp; Gas</i>	Senior Secured Loan — Loan 9.8% Cash, 3.5% PIK, 3.0% Libor Floor, Due 8/19	\$ 10,477,484	\$ 10,314,187	\$ 9,953,609
TPF II Power, LLC (TPF II Covert Midco, LLC) <sup>9, 11</sup> <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 10/21	2,992,500	3,018,385	3,000,879
Trimaran Advisors, L.L.C. <sup>9, 10</sup> <i>Portfolio Company Loan</i>	Senior Unsecured Loan — Revolving Credit Facility 9.0% Cash, Due 11/17	23,000,000	23,000,000	23,000,000
TRSO I, Inc. <sup>9</sup> <i>Energy: Oil &amp; Gas</i>	Junior Secured Loan — Term Loan (Second Lien) 11.0% Cash, 1.0% Libor Floor, Due 12/17	1,000,000	989,084	960,000
TWCC Holding Corp. <sup>9</sup> <i>Media: Broadcasting &amp; Subscription</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0% Cash, 1.0% Libor Floor, Due 6/20	1,000,000	1,003,825	888,750
TWCC Holding Corp. <sup>9, 11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Term Loan 3.5% Cash, 0.8% Libor Floor, Due 2/17	888,574	891,750	854,617
Univar Inc. <sup>9, 11</sup> <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Term B Loan 5.0% Cash, 1.5% Libor Floor, Due 6/17	2,887,053	2,882,840	2,886,851
USJ-IMECO Holding Company, LLC <sup>9, 11</sup> <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 4/20	3,960,000	3,943,208	3,960,000

<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Amortized Cost</u>	<u>Value<sup>2</sup></u>
Vantiv, LLC (fka Fifth Third Processing Solutions, LLC) <sup>11</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — Term B Loan 3.8% Cash, 0.8% Libor Floor, Due 6/21	\$ 1,703,545	1,707,601	1,713,127
Verdesian Life Sciences, LLC <sup>9</sup> <i>Environmental Industries</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 7/20	962,525	949,834	937,018
Verdesian Life Sciences, LLC <sup>9, 11</sup> <i>Environmental Industries</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 7/20	3,179,987	3,139,235	3,095,717
Vestcom International, Inc. (fka Vector Investment Holdings, Inc.) <sup>9, 11</sup> <i>Retail</i>	Senior Secured Loan — Term Loan 5.3% Cash, 1.0% Libor Floor, Due 9/21	3,012,690	2,993,506	3,020,222
Weiman Products, LLC <sup>9</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 11/18	2,964,755	2,942,630	2,964,755
Weiman Products, LLC <sup>9, 11</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 11/18	3,953,007	3,924,193	3,953,007
WideOpenWest Finance, LLC <sup>9</sup> <i>Telecommunications</i>	Senior Secured Loan — Term B Loan 4.8% Cash, 1.0% Libor Floor, Due 4/19	2,947,368	2,962,880	2,954,280
WireCo WorldGroup Inc. <sup>9</sup> <i>Capital Equipment</i>	Senior Unsecured Bond — 9.000% - 05/2017 9.0% Cash, Due 5/17	5,000,000	4,996,959	5,000,000
WireCo WorldGroup Inc. <sup>9, 11</sup> <i>Capital Equipment</i>	Senior Unsecured Bond — 9.000% - 05/2017 9.0% Cash, Due 5/17	3,000,000	2,998,175	3,000,000
<b>Total Investment in Debt Securities (121% of net asset value at fair value)</b>		<u>\$ 323,806,894</u>	<u>\$ 321,962,047</u>	<u>\$ 320,470,495</u>



## Equity Securities Portfolio

<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Percentage Interest/Shares</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Aerostructures Holdings L.P. <sup>5, 9</sup>				
<i>Aerospace and Defense</i>	Partnership Interests	1.2%	\$ 1,000,000	\$ 1,000
Aerostructures Holdings L.P. <sup>5, 9</sup>				
<i>Aerospace and Defense</i>	Series A Preferred Interests	1.2%	250,960	659,435
Bankruptcy Management Solutions, Inc. <sup>5, 9</sup>				
<i>Services: Business</i>	Class A Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. <sup>5, 9</sup>				
<i>Services: Business</i>	Class B Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. <sup>5, 9</sup>				
<i>Services: Business</i>	Class C Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. <sup>5, 9</sup>				
<i>Services: Business</i>	Common Stock 2013	0.8%	314,325	540,619
Caribe Media Inc. (fka Caribe Information Investments Incorporated) <sup>5, 9</sup>				
<i>Media: Advertising, Printing &amp; Publishing</i>	Common	1.3%	359,765	593,555
DBI Holding LLC <sup>5, 9</sup>				
<i>Services: Business</i>	Class A Warrants	3.2%	258,940	1,008,240
eInstruction Acquisition, LLC <sup>5, 9</sup>				
<i>Services: Business</i>	Membership Units	1.1%	1,079,617	1,000
FP WRCA Coinvestment Fund VII, Ltd. <sup>3, 5</sup>				
<i>Capital Equipment</i>	Class A Shares	1,500	1,500,000	2,237,566
Perseus Holding Corp. <sup>5, 9</sup>				
<i>Hotel, Gaming &amp; Leisure</i>	Common	0.2%	400,000	1,000
<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Percentage Interest/Shares</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Roscoe Investors, LLC <sup>5, 9</sup>				
<i>Healthcare &amp; Pharmaceuticals</i>	Class A Units	1.6%	\$ 1,000,000	\$ 891,000
Tank Partners Holdings, LLC <sup>5, 9</sup>				
<i>Energy: Oil &amp; Gas</i>	Unit	5.8%	980,000	546,095
Tank Partners Holdings, LLC <sup>5, 9</sup>				
<i>Energy: Oil &amp; Gas</i>	Warrants	1.3%	185,205	131,448
TRSO II, Inc. <sup>5, 9</sup>				
<i>Energy: Oil &amp; Gas</i>	Common Stock	5.4%	1,500,000	1,452,600

**Total Investment in Equity Securities**  
**(3% of net asset value at fair value)**

\$ 8,828,812 \$ 8,063,558

## CLO Fund Securities

### CLO Subordinated Investments

Portfolio Company	Investment	Percentage Interest	Amortized Cost	Fair Value <sup>2</sup>
Grant Grove CLO, Ltd. <sup>3</sup>	Subordinated Securities	22.2%	\$ 2,534,223	\$ 515,049
Katonah III, Ltd. <sup>3</sup>	Preferred Shares	23.1%	1,160,437	350,000
Katonah VII CLO Ltd. <sup>3, 6</sup>	Subordinated Securities	16.4%	3,613,232	1,000
Katonah VIII CLO Ltd. <sup>3, 6</sup>	Subordinated Securities	10.3%	2,689,907	20,000
Katonah IX CLO Ltd. <sup>3, 6</sup>	Preferred Shares	6.9%	1,244,315	525,102
Katonah X CLO Ltd. <sup>3, 6</sup>	Subordinated Securities	33.3%	8,887,506	4,739,933
Katonah 2007-I CLO Ltd. <sup>3, 6</sup>	Preferred Shares	100.0%	23,553,162	25,101,770
Trimaran CLO IV, Ltd. <sup>3, 6</sup>	Preferred Shares	19.0%	4,276	250,000
Trimaran CLO V, Ltd. <sup>3, 6</sup>	Subordinate Notes	20.8%	1,345,117	1,802,607
Trimaran CLO VI, Ltd. <sup>3, 6</sup>	Income Notes	16.2%	39,078	50,000
Trimaran CLO VII, Ltd. <sup>3, 6</sup>	Income Notes	10.5%	1,353,943	2,088,764
Catamaran CLO 2012-1 Ltd. <sup>3, 6</sup>	Subordinated Notes	24.9%	7,717,181	5,753,784
Catamaran CLO 2013-1 Ltd. <sup>3, 6</sup>	Subordinated Notes	23.5%	7,200,636	7,531,200
Catamaran CLO 2014-1 Ltd. <sup>3, 6</sup>	Subordinated Notes	24.9%	10,075,468	8,545,844
Dryden 30 Senior Loan Fund <sup>3</sup>	Subordinated Notes	7.5%	1,787,454	2,532,725
Catamaran CLO 2014-2 Ltd. <sup>3, 6</sup>	Subordinated Notes	24.9%	9,299,928	8,543,700
Catamaran CLO 2015-1 Ltd. <sup>3, 6</sup>	Subordinated Notes	24.0%	11,952,000	11,952,000
<b>Total Investment in CLO Subordinated Securities</b>			<b>\$ 94,457,863</b>	<b>\$ 80,303,478</b>

### CLO Rated-Note Investment

Portfolio Company	Investment	Percentage Interest	Amortized Cost	Fair Value <sup>2</sup>
Catamaran CLO 2012-1 Ltd. <sup>3, 6</sup>	Float - 12/2023 - F - 14889CAE0	42.9%	\$ 3,935,339	\$ 4,180,000
Catamaran CLO 2014-1 Ltd. <sup>3, 6</sup>	Float - 04/2026 - E - 14889FAC7	15.1%	1,419,685	1,370,000
<b>Total Investment in CLO Rated-Note</b>			<b>\$ 5,355,024</b>	<b>\$ 5,550,000</b>
<b>Total Investment in CLO Fund Securities (33% of net asset value at fair value)</b>			<b>\$ 99,812,887</b>	<b>\$ 85,853,478</b>

## Asset Manager Affiliates

<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Fair Value<sup>2</sup></u>
Asset Manager Affiliates <sup>9</sup>	Asset Management Company	100.0%	\$ 59,006,651	\$ 71,524,000
<b>Total Investment in Asset Manager Affiliates</b> (27% of net asset value at fair value)			<u>\$ 59,006,651</u>	<u>\$ 71,524,000</u>

## Time Deposits and Money Market Account

<u>Time Deposit and Money Market Accounts</u>	<u>Investment</u>	<u>Yield</u>	<u>Par / Amortized Cost</u>	<u>Fair Value<sup>2</sup></u>
JP Morgan Business Money Market Account <sup>8, 9</sup>	Money Market Account	0.10%	\$ 249,154	\$ 249,154
US Bank Money Market Account <sup>9</sup>	Money Market Account	0.02%	1,480,421	1,480,421
<b>Total Investment in Time Deposit and Money Market Accounts</b> (1% of net asset value at fair value)			<u>\$ 1,729,575</u>	<u>\$ 1,729,575</u>
<b>Total Investments</b> (185% of net asset value at fair value)			<u>\$ 491,339,972</u>	<u>\$ 487,641,106</u>

See accompanying notes to consolidated financial statements.

- 1 A majority of the variable rate loans in the Company's investment portfolio bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly at the borrower's option. The Borrower may also elect to have multiple interest reset periods for each loan. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at March 31, 2015. As noted in the table above, 75% (based on par) of debt securities contain LIBOR floors which range between .75% and 3.00%.
- 2 Reflects the fair market value of all investments as of March 31, 2015, as determined by the Company's Board of Directors.
- 3 Non-U.S. company or principal place of business outside the U.S.
- 4 The aggregate cost of investments for federal income tax purposes is approximately \$509 million. The aggregate gross unrealized appreciation is approximately \$17 million, the aggregate gross unrealized depreciation is approximately \$38 million, and the net unrealized depreciation is approximately \$21 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 Affiliated portfolio company.
- 11 As of March 31, 2015, this investment is owned by KCAP Senior Funding I, LLC and was pledged to secure KCAP Senior Funding I, LLC's obligation.

**KCAP FINANCIAL, INC.**  
**SCHEDULE OF INVESTMENTS**  
**As of December 31, 2014**

**Debt Securities Portfolio**

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
4L Technologies Inc. (fka Clover Holdings, Inc.) <sup>9, 11</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 5/20	\$ 2,793,000	\$ 2,768,057	\$ 2,723,175
Advanced Lighting Technologies, Inc. <sup>9, 11</sup> <i>Consumer goods: Durable</i>	First Lien Bond — 10.5% Cash, Due 6/19	3,000,000	2,962,507	2,580,000
Advantage Sales & Marketing Inc. <sup>9</sup> <i>Services: Business</i>	Junior Secured Loan — Term Loan (Second Lien) 7.5% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	1,002,384	992,000
Alaska Communications Systems Holdings, Inc. <sup>9, 11</sup> <i>Telecommunications</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.5% Libor Floor, Due 10/16	5,200,227	5,193,935	5,200,227
Alere Inc. (fka IM US Holdings, LLC) <sup>11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — B Term Loan 4.3% Cash, 1.0% Libor Floor, Due 6/17	2,992,277	2,988,629	2,972,947
AmSurg Corp. <sup>11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 3.8% Cash, 0.8% Libor Floor, Due 7/21	2,992,481	2,992,481	2,975,020
Anaren, Inc. <sup>9, 11</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 2/21	1,980,000	1,962,587	1,955,250
Asurion, LLC (fka Asurion Corporation) <sup>9, 11</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — Incremental Tranche B-1 Term Loan 5.0% Cash, 1.3% Libor Floor, Due 5/19	1,917,430	1,932,331	1,896,549
AZ Chem US Inc. <sup>9, 11</sup> <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Initial Term Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 6/21	467,123	464,966	457,977
Bankruptcy Management Solutions, Inc. <sup>9</sup> <i>Services: Business</i>	Senior Secured Loan — Term B Loan 7.0% Cash, 1.0% Libor Floor, Due 6/18	700,227	700,227	624,463

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
BarBri, Inc. (Gemini Holdings, Inc.) <sup>9, 11</sup> <i>Services: Consumer</i>	Senior Secured Loan — Term Loan 4.5% Cash, 1.0% Libor Floor, Due 7/19	\$ 2,872,500	\$ 2,861,557	\$ 2,835,158
BBB Industries US Holdings, Inc. <sup>9, 11</sup> <i>Automotive</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 11/21	3,000,000	2,941,316	2,985,000
Bellisio Foods, Inc. <sup>9, 11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — U.S. Term B Loans 5.3% Cash, 1.0% Libor Floor, Due 8/19	2,239,551	2,230,586	2,235,071
Blue Coat Systems, Inc. <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — New Term Loan 4.0% Cash, 1.0% Libor Floor, Due 5/19	467,636	468,971	456,530
Carolina Beverage Group LLC <sup>9</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Bond — 10.6% Cash, Due 8/18	1,500,000	1,515,584	1,552,500
CCS Intermediate Holdings, LLC <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 7/21	2,992,500	2,978,364	2,940,131
Cengage Learning Acquisitions, Inc. (fka TL Acquisitions, Inc.) <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 3/20	2,987,475	2,980,768	2,963,829
Charter Communications Operating, LLC (aka CCO Safari LLC) <sup>11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Term G Loan 4.3% Cash, 0.8% Libor Floor, Due 9/21	3,000,000	3,022,408	3,022,980
Checkout Holding Corp. <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 4/21	995,000	990,534	951,474
Consolidated Communications, Inc. <sup>11</sup> <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.3% Cash, 1.0% Libor Floor, Due 12/20	2,992,443	3,003,588	2,976,538
CRGT Inc. <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term Loan 7.5% Cash, 1.0% Libor Floor, Due 12/20	3,000,000	2,940,000	2,955,000
Crowley Holdings Preferred, LLC <sup>9</sup> <i>Transportation: Cargo</i>	Preferred Stock — 10.0% Cash, 2.0% PIK, Due 12/49	10,206,016	10,206,016	10,418,302

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Crowne Group, LLC <sup>9, 11</sup> <i>Automotive</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 9/20	\$ 3,990,000	\$ 3,932,506	\$ 3,838,779
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) <sup>9</sup> <i>Beverage, Food and Tobacco</i>	Junior Secured Loan — Term Loan (Second Lien) 8.8% Cash, 1.0% Libor Floor, Due 7/21	3,000,000	3,016,357	2,910,000
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) <sup>9, 11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 7/20	2,623,371	2,622,454	2,570,903
CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 12/21	3,000,000	2,970,271	2,988,750
DBI Holding LLC <sup>9</sup> <i>Services: Business</i>	Senior Unsecured Bond — 13.0% PIK, Due 9/19	3,457,795	3,221,771	3,386,218
DBI Holding LLC <sup>9</sup> <i>Services: Business</i>	Senior Subordinated Bond — 12.0% Cash, 1.0% PIK, Due 9/19	4,314,949	4,295,544	4,240,301
DJO Finance LLC (ReAble Therapeutics Fin LLC) <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — New Tranche B Term Loan 4.3% Cash, 1.0% Libor Floor, Due 9/17	2,063,574	2,063,574	2,022,303
Drew Marine Group Inc. <sup>9</sup> <i>Transportation: Cargo</i>	Junior Secured Loan — Term Loan (Second Lien) 8.0% Cash, 1.0% Libor Floor, Due 5/21	2,500,000	2,494,654	2,523,250
ELO Touch Solutions, Inc. <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 8.0% Cash, 1.5% Libor Floor, Due 6/18	1,726,036	1,677,698	1,642,496
EWT Holdings III Corp. (fka WTG Holdings III Corp.) <sup>9</sup> <i>Environmental Industries</i>	Junior Secured Loan — Term Loan (Second Lien) 8.5% Cash, 1.0% Libor Floor, Due 1/22	4,000,000	3,982,390	4,033,200
Fender Musical Instruments Corporation <sup>9, 11</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Initial Loan 5.8% Cash, 1.3% Libor Floor, Due 4/19	2,002,536	2,012,321	1,982,110
FHC Health Systems, Inc. <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 5.0% Cash, 1.0% Libor Floor, Due 12/21	3,407,143	3,373,191	3,381,589

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
First American Payment Systems, L.P. <sup>9</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Junior Secured Loan — Term Loan (Second Lien) 10.8% Cash, 1.3% Libor Floor, Due 4/19	\$ 2,796,448	\$ 2,759,556	\$ 2,782,466
First Data Corporation <sup>9, 11</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — 2018 New Dollar Term Loan 3.7% Cash, Due 3/18	1,000,000	968,906	982,190
Getty Images, Inc. <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.3% Libor Floor, Due 10/19	2,185,164	2,187,551	2,012,165
Global Tel*Link Corporation <sup>9</sup> <i>Telecommunications</i>	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, 1.3% Libor Floor, Due 11/20	4,000,000	3,935,659	3,889,200
Grande Communications Networks LLC <sup>9, 11</sup> <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.5% Cash, 1.0% Libor Floor, Due 5/20	3,940,040	3,944,690	3,938,464
Grifols Worldwide Operations Limited <sup>11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — U.S. Tranche B Term Loan 3.2% Cash, Due 2/21	2,992,462	2,970,236	2,956,298
Grupo HIMA San Pablo, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 1/18	2,947,500	2,911,129	2,947,500
Grupo HIMA San Pablo, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,000,000	6,894,754	7,105,000
Gymboree Corporation., The <sup>9, 11</sup> <i>Retail</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.5% Libor Floor, Due 2/18	1,421,105	1,390,786	935,563
Hargray Communications Group, Inc. (HCP Acquisition LLC) <sup>9, 11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Initial Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/19	2,930,662	2,908,645	2,928,611
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Tranche B-3 Term Loan 7.0% Cash, 1.5% Libor Floor, Due 5/18	3,368,750	3,343,813	3,385,594
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>9, 11</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Tranche B-4 Term Loan 6.0% Cash, 1.0% Libor Floor, Due 8/19	1,462,500	1,456,384	1,458,661



<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Hoffmaster Group, Inc. <sup>9</sup> <i>Forest Products &amp; Paper</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, 1.0% Libor Floor, Due 5/21	\$ 2,000,000	\$ 1,972,727	\$ 1,999,000
Hoffmaster Group, Inc. <sup>9, 11</sup> <i>Forest Products &amp; Paper</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.3% Cash, 1.0% Libor Floor, Due 5/20	3,980,000	3,944,324	3,943,523
Hunter Defense Technologies, Inc. <sup>9, 11</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 8/19	2,962,500	2,934,961	2,988,866
Integra Telecom Holdings, Inc. <sup>9, 11</sup> <i>Telecommunications</i>	Senior Secured Loan — Term B Loan 5.3% Cash, 1.3% Libor Floor, Due 2/19	2,992,386	2,981,164	2,919,461
International Architectural Products, Inc. <sup>7, 9</sup> <i>Metals &amp; Mining</i>	Senior Secured Loan — Term Loan Due 5/15	247,636	228,563	1,000
Kellemeyer Bergensons Services, LLC <sup>9</sup> <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 10/21	2,000,000	1,980,432	1,990,000
Key Safety Systems, Inc. <sup>9, 11</sup> <i>Automotive</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.0% Libor Floor, Due 8/21	1,496,250	1,489,134	1,488,769
Kinetic Concepts, Inc. <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Dollar Term E-1 Loan 4.0% Cash, 1.0% Libor Floor, Due 5/18	2,992,443	2,984,962	2,956,279
Landslide Holdings, Inc. (Crimson Acquisition Corp.) <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — New Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 2/20	3,456,381	3,464,859	3,451,197
MB Aerospace ACP Holdings III Corp. <sup>9, 11</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Dollar Term Loan 5.0% Cash, 1.0% Libor Floor, Due 5/19	3,940,000	3,910,979	3,939,212
Media General, Inc. <sup>11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Term B Loan 4.3% Cash, 1.0% Libor Floor, Due 7/20	3,000,000	3,003,750	2,972,805
Medical Specialties Distributors, LLC <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan 6.5% Cash, 1.0% Libor Floor, Due 12/19	3,960,000	3,927,435	3,804,372

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Millennium Health, LLC (fka Millennium Laboratories, LLC) <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Tranche B Term Loan 5.3% Cash, 1.0% Libor Floor, Due 4/21	\$ 2,992,481	\$ 2,992,481	\$ 2,985,000
Nielsen & Bainbrige, LLC <sup>9</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/20	1,000,000	990,487	963,200
Nielsen & Bainbrige, LLC <sup>9</sup> <i>Consumer goods: Durable</i>	Junior Secured Loan — Term Loan (Second Lien) 10.3% Cash, 1.0% Libor Floor, Due 8/21	2,000,000	1,971,249	1,920,000
Nielsen & Bainbrige, LLC <sup>9, 11</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/20	3,000,000	2,971,460	2,889,600
Novetta, LLC <sup>9</sup> <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 10/20	2,743,125	2,716,093	2,743,125
Novitex Acquisition, LLC (fka ARSloane Acquisition, LLC) <sup>9, 11</sup> <i>Services: Business</i>	Senior Secured Loan — Tranche B-2 Term Loan (First Lien) 7.5% Cash, 1.3% Libor Floor, Due 7/20	990,019	980,923	950,418
Onex Carestream Finance LP <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 9.5% Cash, 1.0% Libor Floor, Due 12/19	2,000,000	2,000,000	1,992,920
Onex Carestream Finance LP <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan (First Lien 2013) 5.0% Cash, 1.0% Libor Floor, Due 6/19	1,973,333	1,980,022	1,969,219
Orbitz Worldwide, Inc. <sup>11</sup> <i>Hotel, Gaming &amp; Leisure</i>	Senior Secured Loan — Tranche C Term Loan 4.5% Cash, 1.0% Libor Floor, Due 4/21	2,992,481	2,992,481	2,961,315
Otter Products, LLC (OtterBox Holdings, Inc.) <sup>9, 11</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Term B Loan 5.8% Cash, 1.0% Libor Floor, Due 6/20	2,992,481	2,968,458	2,966,297
Ozburn-Hessey Holding Company LLC <sup>9, 11</sup> <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 6.8% Cash, 1.3% Libor Floor, Due 5/19	3,512,426	3,503,687	3,544,389

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
PGX Holdings, Inc. <sup>9, 11</sup> <i>Services: Consumer</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.3% Cash, 1.0% Libor Floor, Due 9/20	\$ 3,975,000	\$ 3,936,815	\$ 3,917,363
Post Holdings, Inc. <sup>11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Series A Incremental Term Loan 3.8% Cash, 0.8% Libor Floor, Due 6/21	2,992,481	2,985,129	2,983,130
PQ Corporation <sup>9, 11</sup> <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — 2014 Term Loan 4.0% Cash, 1.0% Libor Floor, Due 8/17	2,992,366	2,992,366	2,943,740
PSC Industrial Holdings Corp. <sup>9, 11</sup> <i>Environmental Industries</i>	Senior Secured Loan — Term Loan (First Lien) 7.0% Cash, 1.0% Libor Floor, Due 12/20	2,000,000	1,980,119	1,980,000
Puerto Rico Cable Acquisition Company Inc. (D/B/A Choice TV) <sup>9</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/18	909,069	910,287	909,069
Puerto Rico Cable Acquisition Company Inc. (D/B/A Choice TV) <sup>9, 11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/18	2,727,206	2,717,359	2,727,206
QoL Meds, LLC <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 7/20	498,750	496,449	480,296
Quad-C JH Holdings Inc. (aka Joerns Healthcare) <sup>9, 11</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan A 6.0% Cash, 1.0% Libor Floor, Due 5/20	3,980,000	3,953,083	3,786,174
Restorix Health, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Unsecured Loan — Delayed Draw 10.0% Cash, 1.5% PIK, Due 6/18	2,003,587	2,003,587	2,003,587
Restorix Health, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Unsecured Loan — Subordinated Term Loan 10.0% Cash, 1.5% PIK, Due 6/18	8,063,397	8,063,397	8,063,397
Reynolds Group Holdings Inc. <sup>9, 11</sup> <i>Containers, Packaging and Glass</i>	Senior Secured Loan — Incremental U.S. Term Loan 4.0% Cash, 1.0% Libor Floor, Due 12/18	2,992,443	2,992,443	2,946,734

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Roscoe Medical, Inc. <sup>9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	\$ 6,700,000	\$ 6,642,367	\$ 6,499,000
Rovi Solutions Corporation / Rovi Guides, Inc. <sup>11</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term B Loan 3.8% Cash, 0.8% Libor Floor, Due 7/21	2,992,481	2,954,531	2,936,387
Safenet, Inc. <sup>9, 11</sup> <i>High Tech Industries</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.8% Cash, 1.0% Libor Floor, Due 3/20	2,977,500	2,951,435	2,977,500
Sandy Creek Energy Associates, L.P. <sup>9, 11</sup> <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 11/20	2,844,544	2,832,599	2,794,053
SGF Produce Holding Corp.(Frozsun, Inc.) <sup>9</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 3/19	2,191,289	2,175,642	2,191,289
SGF Produce Holding Corp.(Frozsun, Inc.) <sup>9, 11</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 3/19	3,440,528	3,429,224	3,440,528
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) <sup>9, 11</sup> <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.8% Cash, 1.3% Libor Floor, Due 6/19	2,861,935	2,840,504	2,858,501
Sun Products Corporation, The (fka Huish Detergents Inc.) <sup>9, 11</sup> <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	3,887,178	3,656,515

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Tank Partners Holdings, LLC <sup>9</sup> <i>Energy: Oil &amp; Gas</i>	Senior Secured Loan — Loan 9.8% Cash, 3.5% PIK, 3.0% Libor Floor, Due 8/19	\$ 10,385,331	\$ 10,212,907	\$ 9,866,065
TPF II Power, LLC (TPF II Covert Midco, LLC) <sup>9, 11</sup> <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 10/21	3,000,000	3,026,933	3,009,375
Trimaran Advisors, L.L.C. <sup>9, 12</sup> <i>Portfolio Company Loan</i>	Senior Unsecured Loan — Revolving Credit Facility 9.0% Cash, Due 11/17	23,000,000	23,000,000	23,000,000
TRSO I, Inc. <sup>9</sup> <i>Energy: Oil &amp; Gas</i>	Junior Secured Loan — Term Loan (Second Lien) 11.0% Cash, 1.0% Libor Floor, Due 12/17	1,000,000	988,097	961,300
TWCC Holding Corp. <sup>9</sup> <i>Media: Broadcasting &amp; Subscription</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0% Cash, 1.0% Libor Floor, Due 6/20	1,000,000	1,004,005	961,670
TWCC Holding Corp. <sup>9, 11</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Term Loan 3.5% Cash, 0.8% Libor Floor, Due 2/17	906,653	910,624	887,060
Univar Inc. <sup>9, 11</sup> <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Term B Loan 5.0% Cash, 1.5% Libor Floor, Due 6/17	2,894,577	2,890,893	2,808,536
USJ-IMECO Holding Company, LLC <sup>9, 11</sup> <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 4/20	3,970,000	3,952,343	3,970,000

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Vantiv, LLC (fka Fifth Third Processing Solutions, LLC) <sup>11</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — Term B Loan 3.8% Cash, 0.8% Libor Floor, Due 6/21	\$ 1,994,987	\$ 1,999,927	\$ 1,978,160
Verdesian Life Sciences, LLC <sup>9</sup> <i>Environmental Industries</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 7/20	975,012	961,553	938,547
Verdesian Life Sciences, LLC <sup>9, 11</sup> <i>Environmental Industries</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 7/20	3,221,243	3,178,026	3,100,769
Vestcom International, Inc. (fka Vector Investment Holdings, Inc.) <sup>9, 11</sup> <i>Retail</i>	Senior Secured Loan — Term Loan 5.3% Cash, 1.0% Libor Floor, Due 9/21	2,866,953	2,843,300	2,838,284
Weiman Products, LLC <sup>9</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 11/18	2,972,255	2,948,574	2,972,255
Weiman Products, LLC <sup>9, 11</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 11/18	3,963,007	3,932,167	3,963,007
WideOpenWest Finance, LLC <sup>9</sup> <i>Telecommunications</i>	Senior Secured Loan — Term B Loan 4.8% Cash, 1.0% Libor Floor, Due 4/19	2,954,887	2,971,397	2,941,974
WireCo WorldGroup Inc. <sup>9</sup> <i>Capital Equipment</i>	Senior Unsecured Bond — 9.0% Cash, Due 5/17	5,000,000	4,991,504	5,000,000
WireCo WorldGroup Inc. <sup>9, 11</sup> <i>Capital Equipment</i>	Senior Unsecured Bond — 9.0% Cash, Due 5/17	3,000,000	2,994,903	3,000,000
<b>Total Investment in Debt Securities (125% of net asset value at fair value)</b>		<b>\$ 324,808,055</b>	<b>\$ 322,884,934</b>	<b>\$ 320,143,170</b>

## Equity Securities Portfolio

Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Amortized Cost	Fair Value <sup>2</sup>
Aerostructures Holdings L.P. <sup>5, 9</sup> <i>Aerospace and Defense</i>	Partnership Interests	1.2%	\$ 1,000,000	\$ 1,000
Aerostructures Holdings L.P. <sup>5, 9</sup> <i>Aerospace and Defense</i>	Series A Preferred Interests	1.2%	250,961	648,764
Bankruptcy Management Solutions, Inc. <sup>5, 9</sup> <i>Services: Business</i>	Class A Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. <sup>5, 9</sup> <i>Services: Business</i>	Class B Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. <sup>5, 9</sup> <i>Services: Business</i>	Class C Warrants	1.7%	-	-
Bankruptcy Management Solutions, Inc. <sup>5, 9</sup> <i>Services: Business</i>	Common Stock 2013	0.8%	314,325	391,932
Caribe Media Inc. (fka Caribe Information Investments Incorporated) <sup>5, 9</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Common	1.3%	359,765	624,304
DBI Holding LLC <sup>5, 9</sup> <i>Services: Business</i>	Class A Warrants	3.2%	258,940	746,964
eInstruction Acquisition, LLC <sup>5, 9</sup> <i>Services: Business</i>	Membership Units	1.1%	1,079,617	1,000
FP WRCA Coinvestment Fund VII, Ltd. <sup>3, 5,</sup> <i>Capital Equipment</i>	Class A Shares	1,500	1,500,000	2,351,329
Perseus Holding Corp. <sup>5, 9</sup> <i>Hotel, Gaming &amp; Leisure</i>	Common	0.2%	400,000	1,000

<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Percentage Interest/Shares</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Roscoe Investors, LLC <sup>5, 9</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Class A Units	1.6%	\$ 1,000,000	\$ 891,000
Tank Partners Holdings, LLC <sup>5, 9</sup> <i>Energy: Oil &amp; Gas</i>	Unit	5.8%	980,000	573,750
Tank Partners Holdings, LLC <sup>5, 9</sup> <i>Energy: Oil &amp; Gas</i>	Warrants	1.3%	185,204	99,752
TRSO II, Inc. <sup>5, 9</sup> <i>Energy: Oil &amp; Gas</i>	Common Stock	5.4%	1,500,000	1,788,886
<b>Total Investment in Equity Securities (3% of net asset value at fair value)</b>			<b>\$ 8,828,812</b>	<b>\$ 8,119,681</b>

### CLO Fund Securities

#### CLO Subordinated Securities, Preferred Shares and Income Notes Investments

<b>Portfolio Company</b>	<b>Investment</b>	<b>Percentage Interest</b>	<b>Amortized Cost</b>	<b>Fair Value<sup>2</sup></b>
Grant Grove CLO, Ltd. <sup>3</sup>	Subordinated Securities	22.2%	\$ 2,254,638	\$ 469,131
Katonah III, Ltd. <sup>3, 10</sup>	Preferred Shares	23.1%	1,015,334	400,000
Katonah VII CLO Ltd. <sup>3, 6</sup>	Subordinated Securities	16.4%	3,563,252	1,000
Katonah VIII CLO Ltd. <sup>3, 6</sup>	Subordinated Securities	10.3%	2,755,267	100,000
Katonah IX CLO Ltd. <sup>3, 6</sup>	Preferred Shares	6.9%	1,262,496	594,989
Katonah X CLO Ltd. <sup>3, 6</sup>	Subordinated Securities	33.3%	8,910,471	4,863,001
Katonah 2007-I CLO Ltd. <sup>3, 6</sup>	Preferred Shares	100.0%	23,471,779	25,191,782
Trimaran CLO IV, Ltd. <sup>3, 6</sup>	Preferred Shares	19.0%	11,094	900,000
Trimaran CLO V, Ltd. <sup>3, 6</sup>	Subordinate Notes	20.8%	1,292,698	1,657,020
Trimaran CLO VI, Ltd. <sup>3, 6</sup>	Income Notes	16.2%	1,531,142	1,950,000
Trimaran CLO VII, Ltd. <sup>3, 6</sup>	Income Notes	10.5%	1,399,074	2,084,394
Catamaran CLO 2012-1 Ltd. <sup>3, 6</sup>	Subordinated Notes	24.9%	7,994,677	5,793,924
Catamaran CLO 2013- 1 Ltd. <sup>3, 6</sup>	Subordinated Notes	23.5%	7,492,702	7,874,910
Catamaran CLO 2014-1 Ltd. <sup>3, 6</sup>	Subordinated Notes	24.9%	10,473,628	8,867,176
Dryden 30 Senior Loan Fund <sup>3</sup>	Subordinated Notes	7.5%	2,263,321	2,506,075
Catamaran CLO 2014-2 Ltd. <sup>3, 6</sup>	Subordinated Notes	24.9%	9,862,799	8,761,500
<b>Total Investment in CLO Subordinated Securities, Preferred Shares and Income Notes</b>			<b>\$ 85,554,372</b>	<b>\$ 72,014,902</b>



## CLO Rated-Note Investments

<u>Portfolio Company</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Amortized Cost</u>	<u>Fair Value<sup>2</sup></u>
Catamaran CLO 2012-1 Ltd. <sup>3, 6</sup>	Class F Notes Par Value of \$4,500,000 Due 12/23	42.9%	\$ 3,917,442	\$ 4,160,000
Catamaran CLO 2014-1 Ltd. <sup>3, 6</sup>	Class E Notes Par Value of \$1,525,000 Due 4/26	15.1%	1,417,376	1,340,000
<b>Total Investment in CLO Rated-Note</b>			<u>\$ 5,334,818</u>	<u>\$ 5,500,000</u>
<b>Total Investment in CLO Fund Securities</b> (30% of net asset value at fair value)			<u>\$ 90,889,190</u>	<u>\$ 77,514,902</u>

## Asset Manager Affiliates

<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Fair Value<sup>2</sup></u>
Asset Manager Affiliates <sup>9</sup>	Asset Management Company	100.0%	\$ 60,292,677	\$ 72,326,000
<b>Total Investment in Asset Manager Affiliates</b> (28% of net asset value at fair value)			<u>\$ 60,292,677</u>	<u>\$ 72,326,000</u>

## Time Deposits and Money Market Account

<u>Time Deposit and Money Market Accounts</u>	<u>Investment</u>	<u>Yield</u>	<u>Par / Amortized Cost</u>	<u>Fair Value<sup>2</sup></u>
JP Morgan Business Money Market Account <sup>8, 9</sup>	Money Market Account	0.10%	\$ 249,105	\$ 249,105
US Bank Money Market Account <sup>9</sup>	Money Market Account	0.02%	1,353,636	1,353,636
<b>Total Investment in Time Deposit and Money Market Accounts</b> (1% of net asset value at fair value)			<u>\$ 1,602,741</u>	<u>\$ 1,602,741</u>
<b>Total Investments<sup>4</sup></b> (188% of net asset value at fair value)			<u>\$ 484,498,354</u>	<u>\$ 479,706,494</u>

See accompanying notes to financial statements.

- 1 A majority of the variable rate loans in the Company's investment portfolio bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly at the borrower's option. The Borrower may also elect to have multiple interest reset periods for each loan. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at December 31, 2014. As noted in the table above, 75% (based on par) of debt securities contain LIBOR floors which range between 0.75% and 3.00%.
- 2 Reflects the fair market value of all investments as of December 31, 2014, as determined by the Company's Board of Directors.
- 3 Non-U.S. company or principal place of business outside the U.S.
- 4 The aggregate cost of investments for federal income tax purposes is approximately \$502 million. The aggregate gross unrealized appreciation is approximately \$15.7 million, the aggregate gross unrealized depreciation is approximately \$37.7 million, and the net unrealized depreciation is approximately \$22 million.
- 5 Non-income producing.
- 6 An affiliate CLO Fund managed by an Asset Manager Affiliate (as such term is defined in the notes to the 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, 2014, this CLO Fund Security was not providing a taxable distribution.
- 11 As of December 31, 2014, this investment is 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)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>Per Share Data:</b>		
Net asset value, at beginning of period	\$ 6.94	\$ 7.51
Net investment income <sup>1</sup>	0.18	0.13
Net realized gains from investments <sup>1</sup>	-4	0.01
Net change in unrealized appreciation (depreciation) on investments <sup>1</sup>	0.03	(0.04)
Net increase in net assets resulting from operations	0.21	0.10
<b>Net increase in net assets resulting from distributions:</b>		
Net increase in net assets relating to stock-based transactions:		
Issuance of common stock under dividend reinvestment plan	-4	-4
Stock based compensation expense	0.01	0.01
Net increase in net assets relating to stock-based transactions	0.01	0.01
Net asset value, end of period	\$ 7.16	\$ 7.62
Total net asset value return <sup>2</sup>	3.2%	1.5%
<b>Ratio/Supplemental Data:</b>		
Per share market value at beginning of period	\$ 6.82	\$ 8.07
Per share market value at end of period	\$ 6.73	\$ 8.66
Total market return <sup>3</sup>	(1.3)%	7.3%
Shares outstanding at end of period	36,859,957	33,340,607
Net assets at end of period	\$ 263,923,435	\$ 254,102,611
Portfolio turnover rate	2.2%	6.6%
Average par debt outstanding	\$ 227,397,000	\$ 195,658,000
Asset coverage ratio	215%	228%
Ratio of net investment income to average net assets <sup>5</sup>	10.0%	7.1%
Ratio of total expenses to average net assets <sup>5</sup>	9.0%	9.2%
Ratio of interest expense to average net assets <sup>5</sup>	4.6%	5.0%
Ratio of non-interest expenses to average net assets <sup>5</sup>	4.4%	4.2%

<sup>1</sup> Based on weighted average number of common shares outstanding-basic for the period.

<sup>2</sup> 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, divided by the beginning net asset value per share.

<sup>3</sup> Total market return (not annualized) equals the change in the ending market price, over the beginning of period price per share plus distributions, divided by the beginning market price.

<sup>4</sup> Balance rounds to less than \$0.01.

<sup>5</sup> 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”). The Company was formed as a Delaware limited liability company on August 8, 2006 and, prior to the issuance of shares of the Company’s common stock in its initial public offering (“IPO”), converted to a corporation incorporated in Delaware on December 11, 2006. Prior to its IPO, the Company did not have material operations. The Company’s IPO of 14,462,000 shares of common stock raised net proceeds of approximately \$200 million. Prior to the IPO, the Company issued 3,484,333 shares to affiliates of Kohlberg & Co., L.L.C., a leading middle market private equity firm, in exchange for the contribution to the Company of their ownership interests in Katonah Debt Advisors, L.L.C., and related affiliates controlled by the Company (collectively, “Katonah Debt Advisors”) and in securities issued by collateralized loan obligation funds (“CLO Funds”) managed by Katonah Debt Advisors and two other asset managers.

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

On February 29, 2012, the Company purchased Trimaran Advisors, L.L.C. (“Trimaran Advisors”), a CLO manager similar to Katonah Debt Advisors with assets under management of approximately \$1.5 billion, for total consideration of \$13.0 million in cash and 3,600,000 shares of the Company’s common stock. Contemporaneously with the acquisition of Trimaran Advisors, the Company acquired from Trimaran Advisors equity interests in certain CLO Funds managed by Trimaran Advisors for an aggregate purchase price of \$12.0 million in cash. As of March 31, 2015, Katonah Debt Advisors and Trimaran Advisors are wholly-owned portfolio companies (collectively, “Asset Manager Affiliates”) and have approximately \$2.9 billion of par value assets under management. 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.

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

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

The Company has three principal areas of investment:

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

Second, the Company has invested in Asset Manager Affiliates that manage collateralized loan obligation funds (“CLOs”).

Third, the Company invests in debt and subordinated securities issued by CLOs (“CLO Fund Securities”). These CLO Fund Securities are primarily managed by our Asset Manager Affiliates, but from time-to-time the Company makes investments in CLO Fund Securities managed by other asset managers. The 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 financial statements and notes thereto in the Company’s Form 10-K for the year ended December 31, 2014, 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 presentation.

The Company consolidates the financial statements of its wholly-owned special purpose financing subsidiaries KCAP Funding, Kolhberg Capital Funding I LLC, 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 United States Securities and Exchange Commission (“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 Rule 3-09 of Regulation S-X promulgated by the SEC, additional financial information with respect to one of the CLO Funds in which the Company has an investment, Katonah 2007-I CLO Ltd. (“Katonah 2007-I CLO”) is required to be included in the Company’s SEC filings. The additional financial information regarding the Asset Manager Affiliates and Katonah 2007-I CLO (pursuant to Rule 3-09) is set forth in Note 5 to these consolidated financial statements.

Stockholder distributions on the Statement of Changes in Net Assets reflect the estimated allocation, between net investment income and return of capital, of distributions made during the reporting period, excluding the distribution declared in a quarter with a record date occurring after the quarter-end. The tax character of distributions is made on an annual (full calendar-year) basis. The determination of the tax attributes 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.

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 first quarter of 2015, the Company provided \$27 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 March 31, 2015, the Company holds loans it has made to 86 investee companies with aggregate principal amounts of \$293 million. The details of such loans have been disclosed on the consolidated Schedule of Investments as well as in Note 4 – Investments. In addition to providing loans to investee companies, from time to time the Company assists investee companies in securing financing from other sources by introducing such investee companies to sponsors or by leading a syndicate of lenders to provide the investee companies with financing. During the three months month period ended March 31, 2015, the Company did not make any such introductions or lead any syndicates.

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

On February 18, 2015, the FASB issued Accounting Standards Update 2015-2, which updated consolidation standards under ASC Topic 810, "Consolidation". Under this update, a new consolidation analysis is required for variable interest entities ("VIEs") and will limit the circumstances in which investment managers and similar entities are required to consolidate the entities that they manage. The FASB decided to eliminate some of the criteria under which their fees are considered a variable interest and limit the circumstances in which variable interests in a VIE held by related parties of a reporting enterprise require the reporting enterprise to consolidate the VIE. The guidance is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2015.

In April 2015, the FASB issued Accounting Standards Update 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. Under this guidance, debt issuance costs related to a recognized debt liability are to be presented as a direct deduction from the debt liability rather than as an asset on the balance sheet, consistent with debt discounts. For public business entities, the final guidance will be effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. The Company intends to adopt the new guidance beginning the first quarter of 2016.

### **Investments**

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

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

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

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

The Company utilizes an independent valuation firm to provide an annual third-party review of the Company’s CLO fair value model relative to its functionality, model inputs and calculations as a reasonable method to determine CLO fair values, in the absence of Level I or Level II trading activity or observable market inputs. The independent valuation firm’s 2014 annual review concluded that the Company’s CLO model appropriately factors in all the necessary inputs required to build a CLO equity cash flow model for fair value purposes and that the inputs were being employed correctly.

The Company utilizes an independent valuation firm to provide third party valuation consulting services. Each quarter the independent valuation firm will perform third party valuations of the Company’s investments in material illiquid securities such that they are reviewed at least once during a trailing 12 month period. These third party valuation estimates are considered as one of the relevant data 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 that considers multiple levels of market and asset specific inputs, which may include historical and forecasted financial and operational performance of the individual investment, projected cash flows, market multiples, comparable market transactions, the priority of the security compared with those of other securities for such issuers, credit risk, interest rates, and independent valuations and reviews.

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

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

*Equity Securities.* The Company's equity securities in portfolio companies for which there is no liquid public market are carried at fair value based on the Enterprise Value of the portfolio company, which is determined using various factors, including EBITDA (earnings before interest, taxes, depreciation and amortization) and discounted cash flows from operations, less capital expenditures and other pertinent factors, such as recent offers to purchase a portfolio company's securities or other liquidation events. The determined fair values are generally discounted to account for restrictions on resale and minority ownership positions. In the event market quotations are readily available for the Company's equity securities in public companies, those investments may be valued using the Market Approach. In cases where the Company receives warrants to purchase equity securities, a market standard Black-Scholes model is utilized.

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

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

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

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



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

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

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

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

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

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

**Distributions from Asset Manager Affiliates.** The Company records distributions from our Asset Manager Affiliates on the declaration date, which represents the ex-dividend date. Distributions in excess of tax-basis earnings and profits of the distributing affiliate company are recognized as tax-basis return of capital.

**Investment Income on CLO Fund Securities.** The Company generates investment income from its investments in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by the Asset Manager Affiliates and selective investments in securities issued by funds managed by other asset management companies. The Company's CLO Fund junior class securities are subordinated to senior note holders who typically receive a stated interest rate of return based on a floating rate index, such as the London Interbank Offered Rate ("LIBOR") on their investment. The CLO Funds are leveraged funds and any excess cash flow or "excess spread" (interest earned by the underlying securities in the fund less payments made to senior note holders and less fund expenses and management fees) is paid to the holders of the CLO Fund's subordinated securities or preferred shares.

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

For non-junior class CLO Fund securities, such as the Company's investment in the Class F Notes of the Catamaran 2012-1 CLO and Class E Notes of the Catamaran 2014-1 CLO, interest is earned at a fixed spread relative to the LIBOR index.

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

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

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

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

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

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

### 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 months ended March 31, 2015 and 2014 (unaudited):

	(unaudited)	
	Three Months Ended March 31,	
	2015	2014
Net increase in net assets resulting from operations	\$ 7,672,290	\$ 3,441,590
Net decrease in net assets allocated to unvested share awards	(128,976)	(28,183)
Net increase in net assets available to common stockholders	<u>\$ 7,543,314</u>	<u>\$ 3,413,407</u>
Weighted average number of common shares outstanding for basic shares computation	36,834,266	33,337,967
Effect of dilutive securities – stock options	9,116	11,949
Weighted average number of common and common stock equivalent shares outstanding for diluted shares computation	<u>36,843,382</u>	<u>33,349,916</u>
Net increase in net assets per basic common shares:		
Net increase in net assets from operations	\$ 0.21	\$ 0.10
Net increase in net assets per diluted shares:		
Net increase in net assets from operations	\$ 0.20	\$ 0.10

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

There were 50,000 options to purchase shares of common stock for the three months ended March 31, 2015. For the three months ended March 31, 2015 and 2014, options to purchase 9,116 and 11,949 shares of common stock, respectively, were included in the computation of diluted earnings per share.

The Company's Convertible Notes are included in the computation of the diluted net increase or decrease in net assets resulting from operations per share by application of the "if-converted method." Under the if-converted method, interest charges applicable to the convertible notes for the period are added to reported net increase or decrease in net assets resulting from operations and the full amount of shares (pro-rata if not outstanding for the full period) that would be issued are added to weighted average basic shares. Convertible notes are considered anti-dilutive only when its interest per share upon conversion exceeds the basic net increase or decrease in net assets resulting from operations per share. For the three months ended March 31, 2015 and 2014, the effects of the convertible notes are anti-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 March 31, 2015 the current conversion rate of the Convertible Notes is approximately 132.7726 shares of our common stock per \$1,000 principal amount of the Convertible Notes, equivalent to a conversion price of approximately \$7.53 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 March 31, 2015 and December 31, 2014:

Security Type	March 31, 2015 (unaudited)			December 31, 2014		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Money Market Accounts <sup>3</sup>	\$ 1,729,575	\$ 1,729,575	1	\$ 1,602,741	\$ 1,602,741	1
Senior Secured Loan	218,339,421	217,219,634	81	220,965,922	218,329,860	86
Junior Secured Loan	40,085,271	39,832,410	15	38,664,199	38,569,006	15
Senior Unsecured Loan	33,104,782	33,104,782	13	33,066,984	33,066,984	13
First Lien Bond	2,967,369	2,580,000	1	2,962,507	2,580,000	1
Senior Subordinated Bond	4,330,633	4,295,736	2	4,295,544	4,240,301	2
Senior Unsecured Bond	11,363,885	11,482,540	4	11,208,178	11,386,218	4
Senior Secured Bond	1,513,639	1,485,000	1	1,515,584	1,552,500	1
CLO Fund Securities	99,812,887	85,853,478	33	90,889,190	77,514,901	30
Equity Securities	8,828,812	8,063,558	3	8,828,812	8,119,681	3
Preferred	10,257,047	10,470,393	4	10,206,016	10,418,302	4
Asset Manager Affiliates <sup>2</sup>	59,006,651	71,524,000	27	60,292,677	72,326,000	28
<b>Total</b>	<b>\$491,339,972</b>	<b>\$487,641,106</b>	<b>185%</b>	<b>\$484,498,354</b>	<b>\$479,706,494</b>	<b>188%</b>

<sup>1</sup> Calculated as a percentage of Net Asset Value.

<sup>2</sup> Represents the equity investment in the Asset Manager Affiliates.

<sup>3</sup> Includes restricted cash held under employee benefit plans.

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

Industry Classification	March 31, 2015 (unaudited)			December 31, 2014		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Aerospace and Defense	\$ 10,011,228	\$ 9,517,729	4%	\$ 10,059,487	\$ 9,533,092	4%
Asset Management Company <sup>2</sup>	59,006,651	71,524,000	27	60,292,677	72,326,000	28
Portfolio Company Loan	23,000,000	23,000,000	9	23,000,000	23,000,000	9
Automotive	8,354,204	8,391,470	3	8,362,956	8,312,548	3
Banking, Finance, Insurance & Real Estate	6,884,526	6,951,589	3	7,660,721	7,639,366	3
Beverage, Food and Tobacco	21,904,449	21,729,641	8	17,974,974	17,883,421	7
Capital Equipment	9,495,134	10,237,566	4	9,486,407	10,351,329	4
Chemicals, Plastics and Rubber	6,325,803	6,327,732	2	6,348,226	6,210,253	2
CLO Fund Securities	99,812,887	85,853,478	32	90,889,190	77,514,901	31
Consumer goods: Durable	13,711,750	13,116,322	5	13,876,482	13,301,207	5
Consumer goods: Non-durable	13,489,480	13,374,870	5	13,535,975	13,314,952	5
Containers, Packaging and Glass	2,916,649	2,933,055	1	2,992,443	2,946,734	1
Energy: Oil & Gas	13,968,476	13,043,752	5	13,866,208	13,289,753	5
Environmental Industries	12,889,751	12,835,904	5	12,942,593	12,911,017	5
Forest Products & Paper	5,909,837	5,982,313	2	5,917,051	5,942,523	2
Healthcare & Pharmaceuticals	65,420,489	65,452,651	25	66,186,412	65,720,782	27
High Tech Industries	11,474,486	11,548,350	4	14,457,495	14,419,110	6
Hotel, Gaming & Leisure	3,219,576	2,828,950	1	3,392,481	2,962,315	1
Media: Advertising, Printing & Publishing	11,275,490	11,145,278	4	11,318,815	11,396,027	4
Media: Broadcasting & Subscription	14,342,363	14,244,078	5	14,477,078	14,409,401	6
Metals & Mining	228,563	1,000	-	228,563	1,000	-
Retail	4,388,413	4,106,685	2	4,234,086	3,773,847	1
Services: Business	20,655,932	20,571,564	8	16,550,255	16,066,421	6
Services: Consumer	6,775,834	6,828,928	3	6,798,372	6,752,521	3
Telecommunications	18,113,209	18,063,402	7	22,030,434	21,865,864	9
Time Deposit and Money Market Accounts <sup>3</sup>	1,729,575	1,729,575	1	1,602,741	1,602,741	1
Transportation: Cargo	20,190,884	20,467,538	8	20,156,700	20,455,941	8
Utilities: Electric	5,844,333	5,833,686	2	5,859,532	5,803,428	2
<b>Total</b>	<b>\$491,339,972</b>	<b>\$487,641,106</b>	<b>185%</b>	<b>\$484,498,354</b>	<b>\$479,706,494</b>	<b>188%</b>

<sup>1</sup> Calculated as a percentage of Net Asset Value.

<sup>2</sup> Represents the equity investment in the Asset Manager Affiliates.

<sup>3</sup> 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 March 31, 2015 and December 31, 2014, the total amount of non-qualifying assets was approximately 23% and 21% of total assets, respectively. The majority of non-qualifying assets were foreign investments which were approximately 17% and 16% of the Company's total assets, respectively (primarily the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 17% and 16% of its total assets on such dates, respectively).

At March 31, 2015 and December 31, 2014, the Company's ten largest portfolio companies represented approximately 38%, for both periods, of the total fair value of its investments. The Company's largest investment, the equity of our Asset Manager Affiliates, represented 15% of the total fair value of the Company's investments at March 31, 2015 and December 31, 2014. This does not include a temporary loan provided by the Company to Trimaran for working capital purposes, which is callable and payable on demand. This Loan was \$23 million as of March 31, 2015, and was subsequently repaid on May 5, 2015 (see Subsequent Event Footnote 12). Excluding the Asset Manager Affiliates and CLO Fund securities, the Company's ten largest portfolio companies represented approximately 17% of the total fair value of the Company's investments at March 31, 2015 and December 31, 2014.

### **Investments in CLO Fund Securities**

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

In December 2012, the Company purchased \$4.5 million par value of the class F Notes and \$8.9 million par value of the Subordinated Notes of Catamaran 2012-1 CLO ("Catamaran 2012-1") managed by Trimaran Advisors.

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

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

In March 2015, the Company purchased approximately \$12 million of the par value of the Subordinated Notes of Catamaran 2015-1 CLO ("Catamaran 2015-1") managed by Trimaran Advisors.

All CLO Funds managed by the Asset Manager Affiliates are currently making quarterly distributions to the Company with respect to its interests in the CLO Funds.

### **Fair Value Measurements**

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

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

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

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

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

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

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

	As of March 31, 2015 (unaudited)			
	Level I	Level II	Level III	Total
Money market accounts	\$ —	\$ 1,729,575	\$ —	\$ 1,729,575
Debt securities	—	128,925,770	191,544,725	320,470,495
CLO Fund securities	—	—	85,853,478	85,853,478
Equity securities	—	—	8,063,558	8,063,558
Asset Manager Affiliates	—	—	71,524,000	71,524,000
Total	\$ —	\$ 130,655,345	\$ 356,985,761	\$ 487,641,106

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

As a BDC, the Company is required to invest primarily in the debt and equity of non-public companies for which there is little, if any, market-observable information. As a result, a significant portion of the Company's investments at any given time will likely be deemed Level III investments.

Investment values derived by a third party pricing service are generally deemed to be Level III values. For those that have observable trades, the Company considers them to be Level II.

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

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

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

	Three Months Ended March 31, 2015 (unaudited)				
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Total
Balance, December 31, 2014	\$ 171,018,343	\$ 77,514,902	\$ 8,119,681	\$ 72,326,000	\$ 328,978,926
Transfers out of Level III <sup>1</sup>	(7,470,702)	—	—	—	(7,470,702)
Transfers into Level III <sup>2</sup>	27,799,398	—	—	—	27,799,398
Net accretion of discount	62,772	(3,028,297)	—	—	(2,965,525)
Purchases	4,935,000	11,952,000	—	—	16,887,000
Sales / Paydowns	(4,355,406)	—	—	(1,286,025)	(5,641,431)
Total realized gain (loss) included in earnings	12,419	—	—	—	12,419
Total unrealized gain (loss) included in earnings	(457,099)	(585,127)	(56,123)	484,025	(614,324)
Balance, March 31, 2015	\$ 191,544,725	\$ 85,853,478	\$ 8,063,558	\$ 71,524,000	\$ 356,985,761
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	\$ (457,099)	\$ (585,126)	\$ (56,122)	\$ 484,026	\$ (614,324)

<sup>1</sup>Transfers out of Level III represent a transfer of \$7,470,702 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were observable as of March 31, 2015

<sup>2</sup>Transfers into Level III represent a transfer of \$27,799,398 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of March 31, 2015

**Year Ended December 31, 2014**

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

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

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

As of March 31, 2015, the Company's Level II portfolio investments were valued by a third party pricing services for which the prices are not adjusted and for which inputs are observable or can be corroborated by observable market data for substantially the full character of the financial instrument, or by inputs that are derived principally from, or corroborated by, observable market information. The fair value of the Company's Level II portfolio investments was \$130,655,345 as of March 31, 2015.

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

<b>Type</b>	<b>Fair Value</b>	<b>Primary Valuation Methodology</b>	<b>Unobservable Inputs</b>	<b>Range of Inputs (Weighted Average)</b>
<b>Debt Securities</b>	\$ 2,580,000	Enterprise Value	Average EBITDA Multiple	7.9x
	\$ 188,963,725	Income Approach	Implied Discount Rate	2.2% - 17.6% (8.3%)
	\$ 1,000	Options Value	Qualitative Inputs <sup>1</sup>	
<b>Equity Securities</b>	\$ 8,060,558	Enterprise Value	Average EBITDA Multiple/WAAC	4.4x/9.9% - 15.0x/15.3% (8.3x/12.9%)
	\$ 3,000	Options Value	Qualitative Inputs <sup>1</sup>	
<b>CLO Fund Securities</b>	\$ 73,901,478	Discounted Cash Flow	Discount Rate	11% - 12% (11.5%)
			Probability of Default	2.0% - 2.5% (2.2%)
			Loss Severity	25.0% - 25.9% (25.5%)
			Recovery Rate	74.1% - 75.0% (74.5%)
			Prepayment Rate	0% - 37.2% (25.9%)
\$ 11,952,000	Market Approach	Third Party Quote	100 (100)	
<b>Asset Manager Affiliate</b>	\$ 71,524,000	Discounted Cash Flow	Discount Rate	1.68% - 11.00% (6.93%)
<b>Total Level III Investments</b>	<u>\$ 356,985,761</u>			

<sup>1</sup> 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 input used in the fair value measurement of the Company's CLO Fund securities include default rates, recovery rates, prepayment rates, spreads, and the discount rate by which to value the resulting underlying cash flows. Such assumptions can vary significantly, depending on market data sources which often vary in depth and level of analysis, understanding of the CLO market, detailed or broad characterization of the CLO market and the application of such data to an appropriate framework for analysis. The application of data points are based on the specific attributes of each individual CLO Fund security's underlying assets, historic, current and prospective performance, vintage, and other quantitative and qualitative factors that would be evaluated by market participants. The Company evaluates the source of market data for reliability as an indicative market input, consistency amongst other inputs and results and also the context in which such data is presented. Significant increases or decreases in probability of default and loss severity inputs in isolation would result in a significantly lower or higher fair value measurement. In general, a change in the assumption of the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity in an event of default. Significant increases or decreases in the discount rate in isolation would result in a significantly lower or higher fair value measurement.

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

## **5. ASSET MANAGER AFFILIATES**

### *Wholly-Owned Asset Managers*

The Asset Manager Affiliates are wholly-owned portfolio companies. The Asset Manager Affiliates manage CLO Funds primarily for third party investors that invest in broadly syndicated loans, high yield bonds and other credit instruments issued by corporations. At March 31, 2015 and December 31, 2014, the Asset Manager Affiliates had approximately \$2.9 billion and \$3.0 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 \$72 million and \$72 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 income equal to the amount by which their fee income exceeds their operating expenses, including compensation of their employees and income taxes. The management fees the Asset Manager Affiliates receive have three components - a senior management fee, a subordinated management fee and an incentive fee. Currently, all CLO Funds managed by the Asset Manager Affiliates are paying both their senior and subordinated management fees on a current basis. Additionally, three managed funds made incentive fee distributions during the quarter ended March 31, 2015.

For the three months ended March 31, 2015 and 2014, the Asset Manager Affiliates declared cash distributions of \$2.7 million and \$3.0 million to the Company, respectively. Any distributions from the Asset Manager Affiliates out of the tax-basis earnings and profits are recorded as "Dividends from Asset Manager Affiliates" on the Company's statement of operations. The Company recognized \$1.4 million of Dividends from Asset Manager Affiliates in the Statement of Operations in the first quarter of 2015 and 2014. The difference of \$1.3 and \$1.6 million, respectively, between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e. tax-basis return of capital), for the quarters ended March 31, 2015 and 2014, respectively. Distributions receivable, if any, are reflected in the Due from Affiliates account on the consolidated balance sheets.

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

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

Effective January 1, 2010, the Asset Manager Affiliates adopted guidance encompassed in Accounting Standards Codification Topic 810, "Consolidation." The adoption of this new guidance had an impact on the disclosures relating to the Asset Manager Affiliates which had previously not been required, as its provisions require the Asset Manager Affiliates to consolidate certain of their managed CLO Funds that were not previously consolidated. As a result of the consolidation of 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)

	<b>As of</b>	<b>As of</b>
	<b>March 31, 2015</b>	<b>December 31, 2014</b>
Investments of CLO Funds, at fair value	\$ 2,796,273,645	\$ 2,846,659,635
Restricted cash of CLO Funds	102,965,441	182,224,205
<b>Total assets</b>	<b>2,939,800,245</b>	<b>3,092,592,939</b>
CLO Fund liabilities at fair value	2,845,411,582	2,990,211,629
<b>Total liabilities</b>	<b>2,912,228,647</b>	<b>3,060,837,388</b>
Total Asset Manager Affiliates equity	32,112,699	34,780,345
Appropriated retained earnings of consolidated VIEs	(4,541,101)	(3,024,793)

**Asset Manager Affiliates**

Summarized Statements of Operations Information (unaudited)

	<b>For the three months ended</b>	
	<b>March 31,</b>	
	<b>2015</b>	<b>2014</b>
Interest income - investments of CLO Funds	\$ 30,651,034	\$ 27,684,485
<b>Total income</b>	<b>30,851,962</b>	<b>30,388,785</b>
Interest expense of CLO Fund liabilities	43,757,032	24,525,198
<b>Total expenses</b>	<b>48,088,908</b>	<b>30,906,163</b>
Net realized and unrealized gains (losses)	16,319,356	(4,718,488)
Net loss attributable to noncontrolling interests in consolidated Variable Interest Entities	(1,516,308)	(7,458,418)
<b>Net income attributable to Asset Manager Affiliates</b>	<b>422,420</b>	<b>1,346,460</b>

**Katonah 2007-I CLO Ltd.**

Summarized Balance Sheet Information (unaudited)

	<b>As of</b>	<b>As of</b>
	<b>March 31, 2015</b>	<b>December 31, 2014</b>
Total investments at fair value	\$ 255,315,453	\$ 273,373,948
Cash	21,296,801	14,939,994
<b>Total assets</b>	<b>277,197,785</b>	<b>288,945,330</b>
CLO Debt at fair value	276,658,081	290,699,426
<b>Total liabilities</b>	<b>283,154,883</b>	<b>292,730,723</b>
<b>Total Net Assets</b>	<b>(5,957,098)</b>	<b>(3,785,393)</b>

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

	<b>For the three months ended</b>	
	<b>March 31,</b>	
	<b>2015</b>	<b>2014</b>
Interest income from investments	\$ 2,615,394	\$ 2,992,131
Total income	2,649,868	3,297,648
Interest expense	2,375,635	2,793,908
Total expenses	2,699,853	3,116,987
Net realized and unrealized losses	(2,121,720)	(1,669,100)
Decrease in net assets resulting from operations	(2,171,705)	(1,488,439)

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

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

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

*Related Party Transactions*

On February 26, 2013, the Company entered into a senior credit agreement (the "Trimaran Credit Facility") with Trimaran Advisors, pursuant to which Trimaran Advisors may borrow from time to time up to \$20 million from the Company for general corporate purposes and/or in order to provide capital necessary to support one or more of Trimaran Advisors' warehouse lines of credit and/or working capital in connection with Trimaran Advisors' warehouse activities. The Trimaran Credit Facility expires on November 20, 2017 and bears interest at an annual rate of 9.0%. Outstanding borrowings on the Trimaran Credit Facility are callable by the Company at any time. On April 15, 2013, the Trimaran Credit Facility was amended and upsized from \$20 million to \$23 million. At March 31, 2015, there was \$23 million outstanding under the Trimaran Credit Facility, which is included in the Company's Schedule of Investments. For the three months ended March 31, 2015, the Company recognized interest income of \$517,500 related to the Trimaran Credit Facility. As of March 31, 2015, Trimaran had a \$22 million investment in a CLO warehouse facility.

## 6. BORROWINGS

The Company's debt obligations consist of the following:

	As of March 31, 2015 (unaudited)	As of December 31, 2014
Convertible Notes, due March 15, 2016	\$ 38,647,000	\$ 38,647,000
7.375% Notes Due 2019	\$ 41,400,000	\$ 41,400,000
Notes Issued by KCAP Senior Funding I, LLC (net of discount: 2015 - \$3,362,714; 2014 - \$3,512,407)	\$ 143,987,286	\$ 143,837,593

The weighted average stated interest rate and weighted average maturity on all our debt outstanding as of March 31, 2015 were 4.43% and 6.99 years, respectively, and as of December 31, 2014 were 4.43% and 7.23 years, respectively.

### *Convertible Notes*

On March 16, 2011, the Company issued \$55 million in aggregate principal amount of unsecured 8.75% convertible notes due March 2016 ("Convertible Notes"). On March 23, 2011, pursuant to an over-allotment option, the Company issued an additional \$5 million of such Convertible Notes for a total of \$60 million in aggregate principal amount. The net proceeds from the sale of the Convertible Notes, 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 March 31, 2015 the conversion rate was 132.7726 shares of common stock per \$1,000 principal amount of Convertible Notes, which is equivalent to a conversion price of approximately \$7.53 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 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 \$332,000 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. On October 9, 2014, the Company purchased approximately \$10.4 million face value of its own Convertible Notes at \$114.875 plus accrued interest. KCAP subsequently surrendered these notes to the Trustee for cancellation. Due to the cash conversion option embedded in the Convertible Notes, the Company applied the guidance in ASC 470-40-20, *Debt with Conversion and Other Options* and realized a loss on the extinguishment of this debt. For the three months ended March 31, 2015 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 March 31, 2015 and 2014, interest expense related to the Convertible Notes was approximately \$845,000 and \$1.1 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 March 31, 2015, the Company was in compliance with all of its debt covenants.

*Fair Value of Convertible Notes.* The Company carries the Convertible Notes at cost. The Convertible Notes were issued in a private placement and there is no active trading of these notes. The estimated fair value of the Company's outstanding Convertible Notes was approximately \$40.4 million at March 31, 2015. The fair value was determined based on an indicative closing price as of March 31, 2015. The Convertible Notes are categorized as Level III following ASC 820: Fair Value.

#### *7.375% Notes Due 2019*

On October 10, 2012, the Company issued \$41.4 million in aggregate principal amount of unsecured 7.375% Notes due 2019. The net proceeds for these Notes, 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. The 7.375% Notes Due 2019 are subject to redemption in whole or in part at any time or from time to time, at the option of the Company, on or after September 30, 2015, at a redemption price per security equal to 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to the date fixed for redemption. In addition, due to the asset coverage test applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 7.375% Notes Due 2019, the Company is limited in its ability to make distributions in certain circumstances. The indenture governing the 7.375% Notes Due 2019 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. At March 31, 2015, the Company was in compliance with all of its debt covenants.

For both of the three month periods ended March 31, 2015 and 2014, interest expense related to the 7.375% Notes Due 2019 was approximately \$763,000.

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 \$1.0 million remains to be amortized, as recorded on the consolidated balance sheets in other assets.

*Fair Value of 7.375% Notes Due 2019.* The 7.375% Notes Due 2019 were issued in a public offering on October 10, 2012 and are carried at cost. The fair value of the Company's outstanding 7.375% Notes Due 2019 was approximately \$42.5 million at March 31, 2015. The fair value was determined based on the closing price on March 31, 2015 for the 7.375% Notes Due 2019. The 7.375% Notes Due 2019 are categorized as Level I under the ASC 820: Fair Value.

#### *KCAP Senior Funding I, LLC (Debt Securitization)*

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

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

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

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

The Additional Issuance Offered Securities were issued as Class A-2 senior secured floating rate notes which have an initial face amount of \$30,900,000, have a rating of AAA (sf)/Aaa (sf) by Standard & Poor’s Ratings Services and Moody’s Investors Service, Inc., respectively, and bear interest at the three-month LIBOR plus 1.50%, Class B-2 senior secured floating rate notes which have an initial face amount of \$3,600,000, a rating of AA (sf)/Aa2 (sf) by Standard & Poor’s Ratings Services and Moody’s Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 3.25%, Class C-2 secured deferrable floating rate notes which have an initial face amount of \$4,000,000, a rating of A (sf)/A2 (sf) by Standard & Poor’s Ratings Services and Moody’s Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 4.25%, and Class D-2 secured deferrable floating rate notes which have an initial face amount of \$3,600,000, a rating of BBB (sf)/Baa2 (sf) by Standard & Poor’s Ratings Services and Moody’s Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 5.25%. The Depositor retained all of the subordinated Additional Issuance Securities of the Issuer (the “Additional Issuance Subordinated Notes”), which have an initial face amount of \$13,900,000. The Additional Issuance Subordinated Notes do not bear interest and are not rated. The Additional Issuance Securities have a stated maturity date of July 20, 2024 and are subject to a non-call period until the payment date on the Additional Issuance Securities occurring in July 2015. The Issuer has a reinvestment period to and including the payment date on the Additional Issuance Securities occurring in July 2017, or such earlier date as is provided in the indenture relating to the Additional Issuance Securities. In connection with the Additional Issuance Offered Securities, the Company incurred issuance costs and OID costs of approximately \$584,000 and \$896,000, respectively, which is included in other assets on the accompanying balance sheet.

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

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

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

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

As of March 31, 2015, there were 74 investments in portfolio companies with a total fair value of approximately \$194 million, collateralizing the secured notes of the Issuer. At March 31, 2015, there were unamortized issuance costs of approximately \$3.6 million included in other assets, and unamortized original issue discount, ("OID") costs of approximately \$3.4 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 March 31, 2015, interest expense, including the amortization of deferred debt issuance costs and the discount on the face amount of the notes was approximately \$1.2 million consisting of stated interest expense of approximately \$913,000, accreted discount of approximately \$150,000, and deferred debt issuance costs of approximately \$160,000. As of March 31, 2015 the stated interest charged under the securitization was based on current three month LIBOR, which was 0.25%. The classes, stated interest rates, spread over LIBOR, and stated interest expense are as follows:

	<u>Stated Interest Rate (1)</u>	<u>LIBOR Spread (basis points)</u>	<u>Interest Expense</u>
KCAP Senior Funding LLC Class A Notes	1.75%	150	\$ 472,393
KCAP Senior Funding LLC Class B Notes	3.50%	325	110,161
KCAP Senior Funding LLC Class C Notes	4.50%	425	157,401
KCAP Senior Funding LLC Class D Notes	5.50%	525	173,161
<b>Total</b>			<b>\$ 913,116</b>

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

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

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

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



**As of  
March 31, 2015  
(unaudited)**

	<b>Principal Amount</b>	<b>Carrying Value</b>	<b>Fair Value</b>
KCAP Senior Funding LLC Class A Notes	\$ 108,150,000	\$ 105,681,880	\$ 105,482,129
KCAP Senior Funding LLC Class B Notes	12,600,000	12,312,452	12,463,288
KCAP Senior Funding LLC Class C Notes	14,000,000	13,680,502	13,966,960
KCAP Senior Funding LLC Class D Notes	12,600,000	12,312,452	12,285,000
<b>Total</b>	<b>\$ 147,350,000</b>	<b>\$ 143,987,286</b>	<b>\$ 144,197,377</b>

*Fair Value of KCAP Senior Funding I.* The Company carries the KCAP Senior Funding I Notes at cost, net of unamortized discount of \$3,362,714. The fair value of the KCAP Senior Funding I Notes was approximately \$144 million at March 31, 2015. The fair values were determined based on third party indicative values. The KCAP Senior Funding I L.L.C. Notes are categorized as Level III under ASC 820: Fair Value.

## 7. DISTRIBUTABLE TAXABLE INCOME

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

The following reconciles net increase in net assets resulting from operations to taxable income for the three months ended March 31, 2015:

	<b>Three Months Ended March 31, 2015 (unaudited)</b>
Net increase in net assets resulting from operations	\$ 7,672,290
Net change in unrealized depreciation from investments	(1,092,986)
Excess capital gains over capital losses	(72,356)
Book/tax differences on CLO equity investments	377,933
Other book/tax differences	159,504
Taxable income before deductions for distributions	\$ 7,044,385
Taxable income before deductions for distributions per weighted average basic shares for the period	\$ 0.19
Taxable income before deductions for distributions per weighted average diluted shares for the period	\$ 0.19

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) excess of capital losses over capital gains; (3) Book-to-tax differences on CLO equity investments; and (4) other non-deductible expenses including stock compensation expense that is not currently deductible for tax purposes.

Dividends from Asset Manager Affiliates are recorded based upon a quarterly estimate of tax-basis earnings and profits of each Asset Manager Affiliate. Distributions in excess of the estimated tax-basis quarterly earnings and profits of each distributing Asset Manager Affiliate are recognized as tax-basis return of capital. The actual tax-basis earnings and profits and resulting dividend and/or return of capital for the year will be determined at the end of the tax year for each distributing Asset Manager Affiliate. For the three months ended March 31, 2015 and 2014, the Asset Manager Affiliates declared cash distributions of \$2.7 million and \$3.0 million to the Company, respectively. The Company recognized \$1.4 million of Dividends from Asset Manager Affiliates in the Statement of Operations in the first quarter of 2015 and 2014. The difference of \$1.3 and \$1.6 million, respectively, between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e. tax-basis return of capital), for the quarters ended March 31, 2015 and 2014, respectively.

Distributions to shareholders that 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.

At March 31, 2015, the Company had a net capital loss carryforward of \$76.5 million to offset net capital gains, to the extent provided by federal tax law. Of the net capital loss carryforward, \$32.0 million will begin to expire in the tax year ending December 31, 2015. Of the net capital loss carryforward, \$44.5 million is not subject to expiration under the RIC Modernization Act of 2010.

On March 24, 2015 the Company's Board of Directors declared a distribution to shareholders of \$0.21 per share for a total of \$7.7 million. The record date was April 6, 2015 and the distribution was paid on April 27, 2015.

At March 31, 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 March 31, 2015 and 2014, the Company had no commitments. As of March 31, 2015 and 2014, the company had no outstanding commitments to make investments in delayed draw senior secured loans.

## 9. STOCKHOLDERS' EQUITY

During the three months ended March 31, 2015 and 2014, the Company issued 86,684 and 8,484 shares, respectively, of common stock under its dividend reinvestment plan. As of March 31, 2015 and December 31, 2014, there were 617,931 and 619,785 shares of unvested restricted shares, respectively. There were no grants, 1,854 forfeitures, and no vesting activity during the first quarter of 2015. On February 14, 2013, the Company completed a public offering of 5,232,500 shares of common stock, which included the underwriters' full exercise of their option to purchase up to 682,500 shares of common stock, at a price of \$9.75 per share. In conjunction with this offering, the Company also sold 200,000 shares of common stock to a member of its Board of Directors, at a price of \$9.31125 per share, raising approximately \$1.9 million in gross proceeds. On April 4, 2013, approximately \$9 million of the Company's 8.75% Convertible Notes were converted at a price basis per share of \$8.159 into 1,102,093 shares of KCAP common stock. On October 6, 2014, the Company priced a follow-on public offering of 3.0 million shares of its common stock at a price of \$8.02 per share. The offering raised net proceeds were approximately \$23.8 million, after deducting underwriting discounts and offering expenses. The total number of shares of the Company's common stock issued and outstanding as of March 31, 2015 and December 31, 2014 was 36,859,957 and 36,775,127, respectively.

## 10. EQUITY INCENTIVE PLAN

The Company has an equity incentive plan, established in 2006 and as amended in 2008 and most recently in June 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 granted under the Equity Incentive Plan are exercisable at a price equal to the fair market value (market closing price) of the shares on the day the option is granted. Restricted stock granted under the Equity Incentive Plan is granted at a price equal to the fair market value (market closing price) of the shares on the day such restricted stock is granted. Vesting of restricted stock awarded under the 2008 amendment of the Equity Incentive Plan will occur in two equal installments of 50%, on each of the third and fourth anniversaries of the grant date; vesting of restricted stock 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 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 and forfeited under the Equity Incentive Plan for the period January 1, 2014 through March 31, 2015 is as follows:

	<u>Shares</u>	<u>Weighted Average Exercise Price per Share</u>	<u>Weighted Average Contractual Remaining Term (years)</u>	<u>Aggregate Intrinsic Value<sup>1</sup></u>
Options outstanding at January 1, 2014	50,000	\$ 7.72		
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Options outstanding at December 31, 2014	50,000	\$ 7.72	4.4	\$ 77,600
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Outstanding at March 31, 2015	<u>50,000</u>	\$ 7.72	4.1	\$ 74,000
Total vested at March 31, 2015	50,000	\$ 7.72	4.1	

<sup>1</sup> Represents the difference between the market value of shares of the Company on March 31, 2015 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 three months ended March 31, 2015 and 2014, the Company did not recognize any non-cash compensation expense related to stock options. At March 31, 2015, the Company had no remaining compensation costs 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 grants 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 May 5, 2014, 5,000 shares of restricted stock were awarded to the Company’s Board of Directors.

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

During the three months ended March 31, 2015, no shares of restricted stock vested and 1,854 shares of restricted stock were forfeited. As of March 31, 2015, after giving effect to these restricted stock awards, there were 617,931 shares of restricted stock outstanding. Information with respect to restricted stock granted, exercised and forfeited under the Plan for the period period January 1, 2014 through March 31, 2015 is as follows:

	<b>Non-vested Restricted Shares</b>
Non-vested shares outstanding at January 1, 2014	272,998
Granted	360,289
Vested	(5,000)
Forfeited	(8,502)
Non-vested shares outstanding at December 31, 2014	619,785
Granted	—
Vested	—
Forfeited	(1,854)
Non-Vested Outstanding at March 31, 2015	617,931

For the three months ended March 31, 2015, non-cash compensation expense related to restricted stock was approximately \$355,000; of this amount approximately \$158,000 was expensed at the Company, and approximately \$197,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the three months ended March 31, 2014, non-cash compensation expense related to restricted stock was approximately \$188,000; of this amount approximately \$96,000 was expensed at the Company and approximately \$92,000 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 March 31, 2015, the company had approximately \$3.7 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 2.7 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 \$11,000 and \$20,000 was expensed during the three months ended March 31, 2015 and 2014, 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 \$53,000 and \$64,000 was expensed during the three months ended March 31, 2015 and 2014, respectively, related to the Profit-Sharing Plan.

#### **12. SUBSEQUENT EVENTS**

On April 27, 2015 the Company made a distribution of \$0.21 per share of common stock to its shareholders. This distribution was declared on March 24, 2015 with a record date of April 6, 2015.

On May 5th, 2015, Catamaran CLO 2015-1 Ltd. ("Catamaran 2015-1"), a \$464 million CLO managed by the Asset Manager Affiliates, closed. Upon closing, Trimaran repaid all of its outstanding obligations under the Trimaran Credit Facility to the Company, and the Company funded its investment of approximately \$12 million in the subordinated notes issued by Catamaran 2015-1.

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

## 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 financial statements and notes thereto in the Company's Form 10-K for the year ended December 31, 2014, 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 funds under our credit facility, 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 registered 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, 2014. 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 Company Act of 1940 (the “1940 Act”). We have three principal areas of investments:

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

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

Third, the Company invests in debt and subordinated securities issued by CLOs (“CLO Fund Securities”). These CLO Fund Securities are primarily managed by our Asset Manager Affiliates, but from time-to-time the Company makes investments in CLO Fund Securities managed by other asset managers. The 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.

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

From our Asset Manager Affiliates investment, we expect to receive recurring cash distributions and to generate capital appreciation through the addition of new CLO Funds managed by our Asset Manager Affiliates. The Asset Manager Affiliates manage CLO Funds that invest in broadly syndicated loans, high-yield bonds and other credit instruments. Collectively, the Asset Manager Affiliates have approximately \$2.9 billion of par value assets under management as of March 31, 2015. 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 RIC and intend to operate in a manner to maintain our RIC status. As a RIC, we intend to distribute to our stockholders substantially all of our net ordinary taxable income and the excess of realized net short-term capital gains over realized net long-term capital losses, if any, for each year. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements. Pursuant to this election, we generally will not have to pay corporate-level U.S. federal income taxes on any income that we timely distribute to our stockholders.

## PORTFOLIO AND INVESTMENT ACTIVITY

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

Total portfolio investment activity (excluding activity in time deposit and money market investments) for the three months ended March 31, 2015 (unaudited) and for the year ended December 31, 2014 was as follows:

	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliates	Total Portfolio
Fair Value at December 31, 2013	\$ 266,830,427	\$ 79,452,220	\$ 11,006,398	\$ 76,148,000	\$ 433,437,045
2014 Activity:					
Purchases / originations / draws	224,513,503	22,421,847	2,216,847	545,979	249,698,176
Pay-downs / pay-offs / sales	(168,429,374)	(10,132,500)	(5,007,311)	(6,432,086)	(190,001,271)
Net accretion of interest	410,718	(11,102,015)	—	—	(10,691,297)
Net realized losses	(8,823,507)	5,575,498	(7,136,408)	—	(10,384,417)
Increase (decrease) in fair value	5,641,403	(8,700,148)	7,040,155	2,064,107	6,045,517
Fair Value at December 31, 2014	320,143,170	77,514,902	8,119,681	72,326,000	478,103,753
Year to Date 2015 Activity:					
Purchases / originations / draws	8,443,967	11,952,000	—	—	20,395,967
Pay-downs / pay-offs / sales	(9,536,819)	—	—	(1,286,025)	(10,822,844)
Net accretion of interest	97,609	(3,028,297)	—	—	(2,930,688)
Net realized gains (losses)	72,357	—	—	—	72,357
Decrease in fair value	1,250,211	(585,127)	(56,123)	484,025	1,092,986
Fair Value at March 31, 2015	\$ 320,470,495	\$ 85,853,478	\$ 8,063,558	\$ 71,524,000	\$ 485,911,531

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 March 31, 2015 and December 31, 2014:

Security Type	March 31, 2015 (unaudited)			December 31, 2014		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Money Market Accounts <sup>3</sup>	1,729,575	1,729,575	1	1,602,741	1,602,741	1
Senior Secured Loan	218,339,421	217,219,634	81	220,965,922	218,329,860	85
Junior Secured Loan	40,085,271	39,832,410	15	38,664,199	38,569,006	15
Senior Unsecured Loan	33,104,782	33,104,782	13	33,066,984	33,066,984	13
First Lien Bond	2,967,369	2,580,000	1	2,962,507	2,580,000	1
Senior Subordinated Bond	4,330,633	4,295,736	2	4,295,544	4,240,301	2
Senior Unsecured Bond	11,363,885	11,482,540	4	11,208,178	11,386,218	4
Senior Secured Bond	1,513,639	1,485,000	1	1,515,584	1,552,500	1
CLO Fund Securities	99,812,887	85,853,478	33	90,889,190	77,514,901	31
Equity Securities	8,828,812	8,063,558	3	8,828,812	8,119,681	3
Preferred	10,257,047	10,470,393	4	10,206,016	10,418,302	4
Asset Manager Affiliates <sup>2</sup>	59,006,651	71,524,000	27	60,292,677	72,326,000	28
Total	\$ 491,339,972	\$ 487,641,106	185%	\$ 484,498,354	\$ 479,706,494	188%

<sup>1</sup> Represents percentage of Net Asset Value.

<sup>2</sup> Represents the equity investment in the Asset Manager Affiliates.

<sup>3</sup> Includes restricted cash held under employee benefit plans.



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

The investment portfolio (excluding the Company's investment in Asset Manager Affiliates and CLO Funds) at March 31, 2015 was spread across 25 different industries and 105 different entities with an average balance per entity of approximately \$3.1 million. As of March 31, 2015, all but one of our portfolio companies were current on their debt service obligations.

We may invest up to 30% of our investment portfolio in "Non-qualifying" opportunistic investments such as high-yield bonds, debt and equity securities of CLO Funds, foreign investments, and distressed debt or equity securities of public companies. At March 31, 2015 and December 31, 2014, the total amount of non-qualifying assets was approximately 23% and 21% of total assets, respectively. The majority of non-qualifying assets were foreign investments which were approximately 17% and 16% of the Company's total assets, respectively (primarily the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 17% and 16% of its total assets on such dates), respectively. The investments in our Debt Securities Portfolio are all or predominantly below investment grade, and therefore have speculative characteristics with respect to the issuer's capacity to pay interest and repay principal.

At March 31, 2015 and December 31, 2014, the Company's ten largest portfolio companies represented approximately 38%, for both periods, of the total fair value of its investments. The Company's largest investment, the equity of our Asset Manager Affiliates, represented 15% of the total fair value of the Company's investments at March 31, 2015 and December 31, 2014. This does not include a temporary loan provided by the Company to Trimaran for working capital purposes, which is callable and payable on demand. This Loan was \$23 million as of March 31, 2015, and was subsequently repaid on May 5, 2015 (see Subsequent Event Footnote 12). Excluding the Asset Manager Affiliates and CLO Fund securities, the Company's ten largest portfolio companies represented approximately 17% of the total fair value of the Company's investments at March 31, 2015 and December 31, 2014.

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

Industry Classification	March 31, 2015 (unaudited)			December 31, 2014		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Aerospace and Defense	\$ 10,011,228	\$ 9,517,729	4%	\$ 10,059,487	\$ 9,533,092	4%
Asset Management Company <sup>2</sup>	59,006,651	71,524,000	27	60,292,677	72,326,000	28
Portfolio Company Loan	23,000,000	23,000,000	9	23,000,000	23,000,000	9
Automotive	8,354,204	8,391,470	3	8,362,956	8,312,548	3
Banking, Finance, Insurance & Real Estate	6,884,526	6,951,589	3	7,660,721	7,639,366	3
Beverage, Food and Tobacco	21,904,449	21,729,641	8	17,974,974	17,883,421	7
Capital Equipment	9,495,134	10,237,566	4	9,486,407	10,351,329	4
Chemicals, Plastics and Rubber	6,325,803	6,327,732	2	6,348,226	6,210,253	2
CLO Fund Securities	99,812,887	85,853,478	32	90,889,190	77,514,901	31
Consumer goods: Durable	13,711,750	13,116,322	5	13,876,482	13,301,207	5
Consumer goods: Non-durable	13,489,480	13,374,870	5	13,535,975	13,314,952	5
Containers, Packaging and Glass	2,916,649	2,933,055	1	2,992,443	2,946,734	1
Energy: Oil & Gas	13,968,476	13,043,752	5	13,866,208	13,289,753	5
Environmental Industries	12,889,751	12,835,904	5	12,942,593	12,911,017	5
Forest Products & Paper	5,909,837	5,982,313	2	5,917,051	5,942,523	2
Healthcare & Pharmaceuticals	65,420,489	65,452,651	25	66,186,412	65,720,782	27
High Tech Industries	11,474,486	11,548,350	4	14,457,495	14,419,110	6
Hotel, Gaming & Leisure	3,219,576	2,828,950	1	3,392,481	2,962,315	1
Media: Advertising, Printing & Publishing	11,275,490	11,145,278	4	11,318,815	11,396,027	4
Media: Broadcasting & Subscription	14,342,363	14,244,078	5	14,477,078	14,409,401	6
Metals & Mining	228,563	1,000	-	228,563	1,000	-
Retail	4,388,413	4,106,685	2	4,234,086	3,773,847	1
Services: Business	20,655,932	20,571,564	8	16,550,255	16,066,421	6
Services: Consumer	6,775,834	6,828,928	3	6,798,372	6,752,521	3
Telecommunications	18,113,209	18,063,402	7	22,030,434	21,865,864	9
Time Deposit and Money Market						
Accounts <sup>3</sup>	1,729,575	1,729,575	1	1,602,741	1,602,741	1
Transportation: Cargo	20,190,884	20,467,538	8	20,156,700	20,455,941	8
Utilities: Electric	5,844,333	5,833,686	2	5,859,532	5,803,428	2
<b>Total</b>	<b>\$ 491,339,972</b>	<b>\$ 487,641,106</b>	<b>185%</b>	<b>\$ 484,498,354</b>	<b>\$ 479,706,494</b>	<b>188%</b>

<sup>1</sup> Calculated as a percentage of Net Asset Value.

<sup>2</sup> Represents the equity investment in the Asset Manager Affiliates.

<sup>3</sup> 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 March 31, 2015, we had approximately \$86 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 March 31, 2015 and December 31, 2014 are as follows:

CLO Fund Securities	Investment	% <sup>1</sup>	March 31, 2015		December 31, 2014	
			Amortized Cost	Fair Value	Amortized Cost	Fair Value
Grant Grove CLO, Ltd.	Subordinated Securities	22.2%	\$ 2,534,223	\$ 515,049	\$ 2,254,638	\$ 469,132
Katonah III, Ltd.	Preferred Shares	23.1	1,160,437	350,000	1,015,334	400,000
Katonah VII CLO Ltd. <sup>2</sup>	Subordinated Securities	16.4	3,613,232	1,000	3,563,252	1,000
Katonah VIII CLO Ltd. <sup>2</sup>	Subordinated Securities	10.3	2,689,907	20,000	2,755,267	100,000
Katonah IX CLO Ltd. <sup>2</sup>	Preferred Shares	6.9	1,244,315	525,102	1,262,496	594,988
Katonah X CLO Ltd. <sup>2</sup>	Subordinated Securities	33.3	8,887,506	4,739,933	8,910,471	4,863,001
Katonah 2007-I CLO Ltd. <sup>2</sup>	Preferred Shares	100.0	23,553,162	25,101,770	23,471,779	25,191,782
Trimaran CLO IV, Ltd. <sup>2</sup>	Preferred Shares	19.0	4,276	250,000	11,094	900,000
Trimaran CLO V, Ltd. <sup>2</sup>	Subordinate Notes	20.8	1,345,117	1,802,607	1,292,698	1,657,020
Trimaran CLO VI, Ltd. <sup>2</sup>	Income Notes	16.2	39,078	50,000	1,531,142	1,950,000
Trimaran CLO VII, Ltd. <sup>2</sup>	Income Notes	10.5	1,353,943	2,088,764	1,399,074	2,084,394
Catamaran CLO 2012-1 Ltd. <sup>2</sup>	Subordinated Notes	24.9	7,717,181	5,753,784	7,994,677	5,793,924
Catamaran CLO 2012-1 Ltd. <sup>2</sup>	Class F Notes	42.9	3,935,339	4,180,000	3,917,442	4,160,000
Catamaran CLO 2013- 1 Ltd. <sup>2</sup>	Subordinated Notes	23.5	7,200,636	7,531,200	7,492,702	7,874,910
Catamaran CLO 2014-1 Ltd. <sup>2</sup>	Subordinated Notes	24.9	10,075,468	8,545,844	10,473,628	8,867,176
Catamaran CLO 2014-1 Ltd. <sup>2</sup>	Class E Notes	15.1	1,419,685	1,370,000	1,417,376	1,340,000
Dryden 30 Senior Loan Fund	Subordinated Notes	7.5	1,787,454	2,532,725	2,263,321	2,506,075
Catamaran CLO 2014-2 Ltd. <sup>2</sup>	Subordinated Notes	24.9	9,299,928	8,543,700	9,862,799	8,761,500
Catamaran CLO 2015-1 Ltd. <sup>2</sup>	Subordinated Notes	24.0	11,952,000	11,952,000	—	—
Total			<u>\$ 99,812,887</u>	<u>\$ 85,853,478</u>	<u>\$ 90,889,190</u>	<u>\$ 77,514,902</u>

<sup>1</sup> Represents percentage of class held.

<sup>2</sup> A CLO Fund managed by an Asset Manager Affiliate.

## **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 March 31, 2015, our Asset Manager Affiliates had approximately \$2.9 billion of par value of assets under management on which they earn management fees, and were valued at approximately \$72 million.

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

## **RESULTS OF OPERATIONS**

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

Set forth below is a discussion of our results of operations for the three months ended March 31, 2015 and 2014.

### *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.

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

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

For non-junior class CLO Fund securities, such as our investment in the Class F notes of the Catamaran 2012-1 and the Class E notes of Catamaran 2014-1, interest is earned at a fixed spread relative to the LIBOR index.

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

The Asset Manager Affiliates are expected to pay future distributions to the Company based upon their after-tax free cash flow, which generally will be dependent upon the maintenance and growth in their assets under management and incentive fees. As a result of tax-basis goodwill amortization and certain other tax-related adjustments, portions of distributions received may be deemed return of capital. As amortizing funds which are paying incentive fees are redeemed, we expect incentive fees available for distribution to diminish. During the three months ended March 31, 2015, three CLO Funds have achieved the minimum investment return threshold and are paying the Asset Manager Affiliates incentive fees. The fair value of our investment in our Asset Manager Affiliates was approximately \$72 million at March 31, 2015, down by approximately \$802,000 from December 31, 2014. For the three months ended March 31, 2015 and 2014, we recognized dividend income of \$1.4 million from the Asset Manager Affiliates, for both periods, while cash distributions received were \$2.7 million and \$3.0 million for those periods, respectively. The difference between cash distributions received and the tax-basis earnings and profits is recorded as an adjustment to the cost basis of the Asset Manager Affiliates investments. CLO Funds typically have automatic orderly wind-down features following an initial period of reinvestment. Thus, with all else being equal, as managed CLO Fund portfolios age, projected future assets under management (and associated management fees) will naturally decline, resulting in a reduction in fair value of our Asset Manager Affiliates. On the other hand, mandates to manage new CLO Fund portfolios will generally result in an increase in the fair value of our investment in our Asset Manager Affiliates. The aggregate of par value of assets under management by our Asset Manager Affiliates was \$2.9 billion and \$3.0 billion as of March 31, 2015 and December 31, 2014, respectively.

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

#### *Investment Income*

Investment income for the three months ended March 31, 2015 and 2014 was approximately \$12 million and \$10 million, respectively. Of these amounts, approximately \$6.2 million and \$5.2 million was attributable to interest income on our debt securities portfolio. Increases in interest income from 2014 to 2015 were due to higher average invested assets stemming primarily from capital raising activities.

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

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 March 31, 2015 and 2014, approximately \$4.6 million and \$3.1 million, respectively, of investment income was attributable to investments in CLO Fund securities. On a tax-basis, the Company recognized \$4.8 million of taxable cash distributions during the three months ended March 31, 2015. Distributions from CLO Fund Securities are dependent on the performance of the underlying assets in each CLO Fund; interest payments, principal amortization and prepayments of the underlying loans in each CLO Fund are primary factors which determine the level of distributions on our CLO Fund Securities. The level of excess spread from CLO Fund Securities can be impacted by the timing and level of the resetting of the benchmark interest rate for the underlying assets (which reset at various times throughout the quarter) in the CLO Fund and the related CLO Fund bond liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and distributions to us can vary significantly.

#### **Expenses**

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

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

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

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

Total expenses for the three months ended March 31, 2015 and 2014 were approximately \$5.8 million and \$5.5 million, respectively. Interest expense and amortization on debt issuance costs for the periods, were approximately \$3.0 million, for both periods, on average debt outstanding of \$227 million and \$196 million, respectively.

For the three months ended March 31, 2015 and 2014, approximately \$1.1 million and \$1.3 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 March 31, 2015 and 2014, respectively, professional fees and insurance expenses totaled approximately \$1.3 million and \$807,000. The increase in professional fees is primarily due to costs incurred in connection with the restatement. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately \$511,000 and \$468,000 for the three months ended March 31, 2015 and 2014, 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 March 31, 2015, net investment income and net realized gains were approximately \$6.6 million, or \$0.18 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 March 31, 2014, GAAP-basis net investment income and net realized gains were approximately \$4.8 million or \$0.14 per share.

#### **Net Unrealized (Depreciation) Appreciation on Investments**

During the three months ended March 31, 2015, our total investments had net unrealized appreciation of approximately \$1.1 million. During the three months ended March 31, 2014, our total investments had net unrealized depreciation of approximately \$1.3 million. For the three months ended March 31, 2015, our Asset Manager Affiliates had net unrealized appreciation of approximately \$484,000. For the three months ended March 31, 2014, our Asset Manager Affiliates had net unrealized depreciation of approximately \$997,000. For the three months ended March 31, 2015, our middle market portfolio of debt securities and equity securities had net unrealized appreciation of approximately \$1.2 million, compared with net unrealized depreciation of \$931,000 during the first quarter of 2014. For the three months ended March 31, 2015, our CLO Fund securities had net unrealized depreciation of approximately \$585,000 compared with net unrealized appreciation of \$593,000 during the first quarter of 2014.

#### **Net Change in Stockholder's Equity Resulting From Operations**

The net increase in stockholders' equity resulting from operations for the three months ended March 31, 2015 was \$7.7 million, or \$0.21 per share. Net increase in stockholders' equity resulting from operations for the three months ended March 31, 2014 was \$3.4 million, or \$0.10 per share.

### **FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES**

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

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

<b>Security Type</b>	<b>Investments at Fair Value</b>	
	<b>March 31, 2015</b>	<b>December 31, 2014</b>
Cash	\$ 1,521,555	\$ 1,220,798
Money Market Accounts	1,729,575	1,602,741
Senior Secured Loan	217,219,634	218,329,860
Junior Secured Loan	39,832,410	38,569,006
Senior Unsecured Loan	33,104,782	33,066,984
First Lien Bond	2,580,000	2,580,000
Senior Subordinated Bond	4,295,736	4,240,301
Senior Secured Bond	1,485,000	1,552,500
Senior Unsecured Bond	11,482,540	11,386,218
CLO Fund Securities	85,853,478	77,514,902
Equity Securities	8,063,558	8,119,681
Preferred	10,470,393	10,418,302
Asset Manager Affiliates	71,524,000	72,326,000
<b>Total</b>	<b>\$ 489,162,661</b>	<b>\$ 480,927,293</b>

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 March 31, 2015, we had approximately \$224 million of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 215%, 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 March 31, 2015, the conversion rate was 132.7726 shares of common stock per \$1,000 principal amount of Convertible Notes, which is equivalent to a conversion price of approximately \$7.53 per share of common stock. The conversion rate is subject to adjustment upon certain events. Upon conversion, the Company would issue the full amount of common stock or settle the conversion in cash, at its option, and retire the full amount of debt outstanding.

On April 4, 2013, approximately \$9 million of the Company’s 8.75% Convertible Notes were converted at a price per share of \$8.159 into 1,102,093 shares of KCAP common stock. On September 4, 2013, the Company purchased \$2 million face value of its own Convertible Notes at a price of \$114.50, plus accrued interest. KCAP subsequently surrendered these notes to the note trustee for cancellation effective September 13, 2013. On October 9, 2014, the Company purchased approximately \$10.4 million face value of its own Convertible Notes at \$114.875 plus accrued interest. KCAP subsequently surrendered these notes to the trustee for cancellation. Due to the cash conversion option embedded in the Convertible Notes, the Company applied the guidance in ASC 470-40-20, Debt with Conversion and Other Options, and realized a loss on the extinguishment of this debt. For the three months ended March 31, 2015 and 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.

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 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. At March 31, 2015, the Company was in compliance with all of its debt covenants. The indenture governing the 7.375% Notes Due 2019 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends.

On 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, a specialty finance subsidiary of the Company, was capitalized through the issuance of \$140 million of notes (the "KCAP Senior Funding I Notes"). The KCAP Senior Funding I Notes are backed by a diversified portfolio of bank loans. The Company invested in the most junior class of the notes, issued in the approximate amount of \$35 million, representing the Company's primary exposure to the performance of the assets acquired from the proceeds of the issuance of the KCAP Senior Funding I Notes. On December 8, 2014, the Company completed the sale of additional KCAP Senior Funding I Notes for \$56 million. The issuance of additional notes was pro-rata across all existing classes of notes originally issued. KCAP purchased an additional \$13.9 million in the most junior class of notes. These junior notes eliminate in consolidation and the remaining notes with a par value of \$105 million, net of \$3.4 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.

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

Subject to prevailing market conditions, we intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. 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 make 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 primarily on our evaluation of distributable taxable income and after-tax free cash flow from our Asset Manager Affiliates.



The following table sets forth the quarterly distributions declared by us since the most recent completed calendar year.

	<u>Distribution</u>	<u>Declaration Date</u>	<u>Record Date</u>	<u>Pay Date</u>
<b>2015:</b>				
First quarter	\$ 0.21	3/24/2015	4/6/2015	4/27/2015
Total declared in 2015	<u>\$ 0.21</u>			
<b>2014:</b>				
Fourth quarter	0.25	12/17/2014	12/29/2014	1/29/2015
Third quarter	0.25	9/19/2014	10/14/2014	10/29/2014
Second quarter	0.25	6/20/2014	7/3/2014	7/25/2014
First quarter	\$ 0.25	3/21/2014	4/4/2014	4/25/2014
Total declared in 2014	<u>\$ 1.00</u>			
<b>2013:</b>				
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>			

#### 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 March 31, 2015 and December 31, 2014, we did not have any such outstanding commitments.

#### CONTRACTUAL OBLIGATIONS

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

<b>Contractual Obligations</b>	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less than one year</b>	<b>1 - 3 years</b>	<b>3 - 5 years</b>	<b>More than 5 years</b>
Long-term debt obligations	\$ 227,397,000	\$ 38,647,000	\$ —	\$ 41,400,000	\$ 147,350,000

#### CRITICAL ACCOUNTING POLICIES

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

##### *Valuation of Portfolio Investments*

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

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

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

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

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

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

- Level I – Unadjusted quoted prices are available in active markets for identical investments as of the reporting date. The type of investments included in Level I include listed equities and listed securities. As required by ASC 820: Fair Value, the Company does not adjust the quoted price for these investments, even in situations where the Company holds a large position and a sale could reasonably affect the quoted price.
- Level II – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date. Such inputs may be quoted prices for similar assets or liabilities, quoted markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full character of the financial instrument, or inputs that are derived principally from, or corroborated by, observable market information. Investments which are generally included in this category include illiquid debt securities and less liquid, privately held or restricted equity securities, for which some level of recent trading activity has been observed.
- Level III – Pricing inputs are unobservable for the investment and includes situations where there is little, if any, market activity for the investment. The inputs may be based on the Company's own assumptions about how market participants would price the asset or liability or may use Level II inputs, as adjusted, to reflect specific investment attributes relative to a broader market assumption. These inputs into the determination of fair value may require significant management judgment or estimation. Even if observable market data for comparable performance or valuation measures (earnings multiples, discount rates, other financial/valuation ratios, etc.) are available, such investments are grouped as Level III if any significant data point that is not also market observable (private company earnings, cash flows, etc.) is used in the valuation methodology.

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

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

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

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

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

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

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

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

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

#### ***Interest Income***

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

#### ***Investment Income on CLO Fund Securities***

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

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

For non-junior class CLO Fund Securities, such as our investment in the class F notes of Catamaran 2012-1 and the class E notes of Catamaran 2014-1, interest is earned at a fixed spread relative to the LIBOR index.

#### ***Distributions from Asset Manager Affiliates***

We record distributions from our Asset Manager Affiliates on the declaration date, which represents the ex-dividend date. Distributions in excess of tax-basis earnings and profits are recorded as tax-basis return of capital.

#### ***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.

### *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*

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

The following table sets forth the quarterly distributions declared by us since the most recent completed calendar year.

	<b>Distribution</b>	<b>Declaration Date</b>	<b>Record Date</b>	<b>Pay Date</b>
2015:				
First quarter	\$ 0.21	3/24/2015	4/6/2015	4/27/2015
Total declared in 2015	<u>\$ 0.21</u>			
2014:				
Fourth quarter	0.25	12/17/2014	12/29/2014	1/29/2015
Third quarter	0.25	9/19/2014	10/14/2014	10/29/2014
Second quarter	0.25	6/20/2014	7/3/2014	7/25/2014
First quarter	\$ 0.25	3/21/2014	4/4/2014	4/25/2014
Total declared in 2014	<u>\$ 1.00</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>			

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

	<b>Quarter-ended March 31,</b>	
	<b>2015<sup>1</sup></b>	<b>2014<sup>1</sup></b>
Net investment income	\$ 0.18	\$ 0.13
Tax Accounting Difference on CLO Equity Investments	0.01	0.05
Taxable distributable income	0.19	0.18
Cash distributed to the Company by Asset Manager Affiliates in excess of their taxable earnings	0.03	0.05
Available for distribution <sup>2</sup>	0.23	0.23
Distributed	\$ 0.21	\$ 0.25
Difference	\$ 0.02	\$ (0.02)

<sup>1</sup> Table may not foot due to rounding.

<sup>2</sup> The "Available for distribution" financial measure is a non-GAAP financial measure that is calculated by including the cash distributed to the Company by the Asset Manager Affiliates in excess of their taxable earnings to the Company's taxable distributable income, which is the most directly comparable GAAP financial measure. In order to reconcile the "Available for distribution" financial measure to taxable distributable income per share in accordance with GAAP, the \$0.03 per share of cash distributed to the Company by the Asset Manager Affiliates in excess of their taxable earnings is subtracted from the "Available for distribution" financial measure. The Company's management believes that the presentation of the non-GAAP "Available for distribution" financial measure provides useful information to investors because it shows the components of the Company's resources available for distribution.

### **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 March 31, 2015, approximately 97.5% 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 .75% and 3.0%. We generally expect that future portfolio investments will predominately be floating rate investments. As of March 31, 2015, we had \$227.4 million of borrowings outstanding at a weighted average rate of 4.43%.

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

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

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

	Impact on net investment income from a change in interest rates at:		
	1%	2%	3%
Increase in interest rate	\$ (830,689)	\$ 98,676	\$ 1,061,355
Decrease in interest rate	\$ 318,427	\$ 318,427	\$ 318,427

As shown above, net investment income assuming a 1% increase in interest rates would decrease by approximately \$831,000 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 \$99,000 and \$1.1 million, respectively. Since LIBOR 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 \$318,000 increase in net investment income.

Although management believes that this measure is indicative of sensitivity to interest rate changes on our Debt Securities Portfolio, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect a net change in assets resulting from operations or net income. Accordingly, no assurances can be given that actual results would not materially differ from the potential outcome simulated by this estimate.

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

#### **Portfolio Valuation**

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

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

#### **Item 4. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 5. 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***

As of the filing of this Quarterly Report on Form 10-Q, our management has completed the implementation of our remediation efforts related to the material weaknesses in the Internal Control over financial reporting as reported in our Form 10-K for the period ended December 31, 2014, which included the following:

- Engaged an internationally recognized accounting and tax consulting firm to assist and advise management on tax matters;
- Implemented new policies and procedures to highlight the identification, resolution and proper disposition of relevant tax issues that may arise in the context of the Company's business;

Management has completed its remediation efforts as of the date of this filing for these material weaknesses. Accordingly, management deems these material weaknesses remediated as of the date of the filing of this Quarterly Report on Form 10-Q.



## 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, 2014.

### 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 March 31, 2015, we issued a total of 86,684 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 March 31, 2015, the aggregate value of the shares of our common stock issued under our DRIP was approximately \$579,912.

### Item 3. *Defaults Upon Senior Securities*

None.

### Item 4. *Mine Safety Disclosures*

Not Applicable.

### Item 5. *Other Information*

The Company entered into revised employment agreements with:

- Dayl W. Pearson, President and Chief Executive Officer;
- Edward U. Gilpin, Chief Financial Officer, Treasurer and Secretary;
- R. Jon Corless, Chief Investment Officer;
- Jill Simeone, General Counsel and Chief Compliance Officer; and
- Daniel P. Gilligan, Vice President, Director of Portfolio Administration.

The employment agreements are effective as of May 5, 2015 and supersede and replace each executive's previous employment agreement. The employment agreements do not change the existing annual base salaries or target bonus opportunities of the executives disclosed in our definitive proxy statement on Schedule 14A dated April 7, 2015.

Under the terms of each employment agreement, in the event of an executive's termination of employment by the Company without cause (as defined in the employment agreement), by the executive for good reason (as defined in the employment agreement) (a "for cause" or "good reason" termination is referred to herein as a "covered termination"), or due to the executive's death or disability, the executive will, for 12 months following termination (the "severance period"), (i) continue to be paid his or her annual base salary, and (ii) receive a monthly payment equal to the after-tax amount of executive's monthly premium for COBRA continuation coverage under the Company's health benefit plan. In addition, the executive will receive a one-time payment equal to the prorated amount of executive's average annual bonus for the three calendar years preceding termination.

If the executive incurs a covered termination within 24 months following a change in control of the Company (as defined in the employment agreement), the executive will receive the above-described severance payments, except that the "severance period" will be 24 months instead of 12 months, and the executive will be fully vested in all outstanding equity and equity-based awards.

The employment agreements contain a provision for the protection of the Company's confidential information, and provide for a one-year non-compete period and a two-year non-solicit period following the executive's termination of employment for any reason. In the event of a covered termination, the executive may request that his or her one-year non-compete period be shortened, and if the Company grants such request, the Company will have no further obligation to make the salary continuation and COBRA premium severance payments.

The foregoing summary of the employment agreements is qualified in its entirety by reference to the form of executive employment agreement which is attached as Exhibit 10.1 to this Quarterly Report on Form 10-Q and is incorporated herein by reference.

### 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.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

KCAP Financial, Inc.

Date: May 6, 2015

By \_\_\_\_\_  
/s/ Dayl W. Pearson  
Dayl W. Pearson  
*President and Chief Executive Officer*  
*(Principal Executive Officer)*

Date: May 6, 2015

By \_\_\_\_\_  
/s/ Edward U. Gilpin  
Edward U. Gilpin  
*Chief Financial Officer*  
*(Principal Financial and Accounting Officer)*

\* \* \* \* \*

## Exhibit Index

<b>Exhibit Number</b>	<b>Description of Document</b>
10.1**	Form of Executive Employment 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.

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\*\* Submitted herewith.

## FORM OF EXECUTIVE EMPLOYMENT AGREEMENT

May 5, 2015

Dear [\_\_\_\_\_]:

This letter will confirm the terms of your employment with KCAP Financial, Inc. (the "Company") under the terms and conditions that follow. This letter shall be effective as of May 5, 2015 (the "Effective Date"), and supersedes in its entirety any prior verbal or written agreement between you and the Company.

1. Term, Position and Duties.

( a ) Subject to earlier termination as hereafter provided, your employment shall continue through December 31, 2015, and will be automatically extended for one year on January 1, 2016, and on each succeeding January 1 unless previously terminated by nonrenewal in writing by you or an expressly authorized representative of the Company, in either case, upon not less than thirty (30) days' written notice prior to the end of the then current year. The term of this agreement, as from time to time extended, is hereafter referred to as "the term of this agreement" or "the term hereof". You will be employed by the Company as its [\_\_\_\_\_]. You will report to the [\_\_\_\_\_] of the Company.

(b) You agree to perform the duties of your position as [\_\_\_\_\_] and such other duties as may reasonably be assigned to you from time to time. You also agree that you will (i) devote your business time, best efforts, business judgment, skill and knowledge to the advancement of the business and interests of the Company and its Affiliates, and (ii) comply with all Company Codes of Ethics, policies, procedures and handbooks, including without limitation any policies or procedures relating to securities laws compliance.

(c) From time to time, you may be employed by one or more Affiliates of the Company in a similar capacity to your employment with the Company. The terms and conditions of your employment by such Affiliates will be the same as the terms and conditions of your employment with the Company, as set forth herein (ie, not additional). In that regard, that portion of the compensation and benefits that are allocable to your services to an Affiliate shall be the responsibility of the Affiliate, though we note the Company intends to provide benefits provided to employees generally on a centralized basis among its Affiliates. To the extent that you are employed by an Affiliate, references in this agreement to the Company shall mean the Affiliate, where appropriate. To effectuate such employment with any Affiliate, the Affiliate will provide to you a letter confirming your employment status. The allocation of your working time between duties for the Company and any of the Affiliates may be adjusted from time to time by the Company as it determines appropriate. As a condition to your employment with the Company and the Affiliates, it is required that you keep complete and accurate records of the time you spend performing your duties under this agreement and the nature thereof.

2 . Compensation and Benefits. During your employment, as compensation for all services performed by you for the Company and its Affiliates, the Company will provide you the following pay and benefits:

(a) Annual Base Salary. The Company will pay you an annual base salary at the rate of [\_\_\_\_\_] Dollars (\$[\_\_\_\_\_] ) per year, payable in accordance with the regular payroll practices of the Company and subject to increase from time to time by the Board of Directors of the Company (the "Board") in its sole discretion.

(b) Annual Bonus Compensation. During each calendar year during the term of this Agreement, you will be eligible to receive such annual bonus as may be determined in the discretion of the Board; provided, however, it is contemplated that the target amount for each such annual discretionary bonus (assuming that all performance targets have been satisfied) will be [\_\_\_\_\_] Dollars (\$[\_\_\_\_\_] ). Annual discretionary bonus awards will be determined by the Board in its sole discretion, based on your performance and that of the Company against goals established annually by the Board (and consistent with those set forth in the Company's annual budget and/or strategic plan) and will be paid in the succeeding calendar year on or before January 31; provided, however, that if such annual bonus is intended to constitute performance-based compensation within the meaning of, and for purposes of, Section 162(m) of the Code, then such annual bonus will be payable only to the extent the applicable performance criteria have been satisfied as certified by a committee of the Board as required under Section 162(m) of the Code. The Board reserves the right in its sole discretion to reduce or eliminate such bonus based on the financial circumstances of the Company in addition to your performance against these goals.

(c) Restricted Stock. You shall be eligible for annual discretionary grants of restricted stock of the Company (or similar equity-based compensation). The amount of such grants, if any, shall be subject to the sole discretion of the Board. Such grants shall be subject to the applicable award agreement terms, equity plan terms, and any applicable shareholder agreements and other restrictions and limitations generally applicable to common stock of the Company or equity awards held by Company executives or otherwise imposed by law.

( d ) Purchased Equity. Subject to all policies (including any policies implemented by the Company which restrict the ability of officers, directors and other Affiliates to invest in the Company-advised funds), agreements, plans and conditions that are generally applicable to such investments, as determined by the Company, you will have the right, but not the obligation, to purchase equity of Company-advised funds on terms equivalent to those received by other investors.

( e ) Participation in Employee Benefit Plans. You will be entitled to participate in all employee benefit plans from time to time in effect for employees of the Company generally (including paid time off and vacation benefits), except to the extent such plans are duplicative of benefits otherwise provided you under this agreement. Your participation will be subject to the terms of the applicable plan documents and generally applicable Company policies.

(f) Reimbursement of Business Expenses. You will be entitled to reimbursement for reasonable business expenses incurred by you in accordance with the Company's policies. Any such reimbursement of expenses shall be made by the Company upon or as soon as practicable following receipt of supporting documentation reasonably satisfactory to the Company.

( g ) Indemnification. In a form to be determined by the Board in its sole discretion, the Company shall provide you with indemnification in your capacity as an officer and/or member of the Board as provided in a separate agreement between you and the Company.

3. Confidential Information and Restricted Activities.

( a ) Confidential Information. During the course of your employment with the Company or its Affiliates, you will learn of and have access to Confidential Information, and you may develop Confidential Information on behalf of the Company or its Affiliates. You agree that you will not use or disclose to any Person (except as required by applicable law or for the proper performance of your regular duties and responsibilities for the Company) any Confidential Information obtained by you incident to your employment or any other association with the Company or any of its Affiliates, whether prior or subsequent to the Effective Date. You understand that this restriction shall continue to apply after your employment terminates, regardless of the reason for such termination.

( b ) Protection of Documents. All documents, records and files, in any media of whatever kind and description, relating to the business, present or otherwise, of the Company or any of its Affiliates, and any copies, in whole or in part, thereof (the "Documents"), whether or not prepared by you shall be the sole and exclusive property of the Company, provided that, for the avoidance of doubt, any of your personal contacts (whether hard copy or electronic) and any personal files do not constitute "Documents" for purposes of this Section 3(b) and may be retained by you following your termination of employment. You agree to safeguard all Documents and to surrender to the Company, at the time your employment terminates or at such earlier time or times as the Board or its designee may specify, all Documents then in your possession or control.

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( c ) Non-Competition. You acknowledge that in your employment with the Company you will have access to Confidential Information which, if disclosed, would assist in competition against the Company and its Affiliates and that you also will generate goodwill for the Company and its Affiliates in the course of your employment. Therefore, you agree that the following restrictions on your activities during and after your employment are necessary to protect the goodwill, Confidential Information and other legitimate interests of the Company and its Affiliates:

( i ) Except as otherwise provided in paragraph (iii), below, while you are employed by the Company or its Affiliates and for the twelve (12) months after your employment (or service with an Affiliate, if later) terminates (in the aggregate, the “Non-Competition Period”), except as otherwise specifically provided in the last sentence of this Section 3(c)(i), you agree that you will not, without the prior written consent of the Company, directly or indirectly, own, manage, operate, join, control, finance, or participate in the ownership, marketing, management, operation, control, fundraising or financing of, or be connected as an officer, director, employee, partner, principal, agent, representative, consultant, or otherwise use or permit your name to be used in connection with any business or enterprise engaged in the United States in the business of structuring middle market lending vehicles, analyzing and acquiring loans and other assets to be held by such vehicles, arranging for the issuance of debt and preferred securities of such vehicles, act as collateral manager for such securitizations, structuring CDO or CLO securitization vehicles or funds that invest in corporate debt instruments. Notwithstanding the foregoing, nothing in this Section 3(c)(i) shall prevent you from working (whether as an employee or an independent contractor) for any business or enterprise that includes multiple lines of business, including lines of business that are described in this Section 3(c)(i), so long as the line of business for which you are working does not, directly or indirectly, include or otherwise conduct any of the activities described in this Section 3(c)(i). Further notwithstanding the foregoing, if you serve as legal counsel for the Company, this Section 3(c)(i) shall not prohibit you from working for any other company in the capacity as legal counsel for such company.

(ii) You agree that during your employment with the Company and its Affiliates and during the twenty-four (24) months after your termination of employment with the Company or its Affiliates, you will not, directly or through any other Person, (A) hire any employee of the Company or any of its Affiliates or seek to persuade any employee of the Company or any of its Affiliates to discontinue employment, other than as a result of a general advertisement or solicitation not targeted at any particular individual, or (B) solicit or encourage any customer or investor of the Company or any of its Affiliates or independent contractor providing services to the Company or any of its Affiliates to terminate or diminish its relationship with them.

(iii) If you are terminated by the Company without Cause, or you terminate your employment with the Company for Good Reason, you may request at any time that the Company shorten the duration of your post-termination Non-Competition Period to less than twelve (12) months; provided, that, if the Company grants your request, your Severance Period (as defined in Section 5(b)) shall be begin on your date of termination and end on the last day of your shortened post-termination Non-Competition Period.

( d ) Non-Disparagement. You and the Company each agree that during your employment with the Company and thereafter, neither party will disparage the other, including any products, services or practices, any affiliates, directors, officers, agents, representatives, stockholders or affiliates of the Company, either orally or in writing at any time.

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( e ) Reasonableness: Enforcement. In signing this agreement, you give the Company assurance that you have carefully read and considered all the terms and conditions of this agreement, including the restraints imposed on you under this Section 3. You agree without reservation that these restraints are necessary for the reasonable and proper protection of the Company and its Affiliates and that each and every one of the restraints is reasonable in respect to subject matter, length of time and geographic area. You further agree that, were you to breach any of the covenants contained in this Section 3, the damage to the Company and its Affiliates would be irreparable. You therefore agree that the Company, in addition to any other remedies available to it, shall be entitled to preliminary and permanent injunctive relief against any breach or threatened breach by you of any of those covenants, without having to post bond, and will additionally be entitled to an award of attorney's fees incurred in connection with securing any relief hereunder. You and the Company further agree that, in the event that any provision of this Section 3 is determined by any court of competent jurisdiction to be unenforceable by reason of its being extended over too great a time, too large a geographic area or too great a range of activities, that provision shall be deemed to be modified to permit its enforcement to the maximum extent permitted by law. You further agree that the Non-Competition Period shall be tolled, and shall not run, during any period of time in which you are in violation of the terms thereof, in order that the Company and its Affiliates shall have all of the agreed-upon temporal protection recited herein. No breach of any provision of this agreement by the Company, or any other claimed breach of contract or violation of law, or change in the nature or scope of your employment relationship with the Company, shall operate to extinguish your obligation to comply with Section 3 hereof. It is also agreed that each of the Company's Affiliates shall have the right to enforce all of your obligations to that Affiliate under this agreement, including without limitation pursuant to this Section 3.

4. Termination of Employment. Your employment under this agreement may be terminated prior to the expiration of the term hereof pursuant to this Section 4:

( a ) Resignation without Good Reason. You may resign your employment hereunder without Good Reason upon thirty (30) days' written notice to the Company. The Board may elect to waive such notice period or any portion thereof; but in that event, the Company shall pay you your base salary for that portion of the notice period so waived.

( b ) Resignation for Good Reason. You may resign your employment hereunder for Good Reason (as defined below) if all the following conditions are satisfied: (i) you provide prompt written notice to the Company of the condition giving rise to the Good Reason; (ii) the condition specified in the notice must remain uncorrected for thirty (30) days after the Company's receipt of such notice; and (iii) you terminate your employment within ten (10) days following the expiration of such thirty (30) day cure period.

(c) Termination without Cause. The Company may terminate your employment at any time without Cause upon written notice to you.

( d ) Termination for Cause. The Company may terminate your employment for Cause upon written notice to you setting forth in reasonable detail the nature of the cause in accordance with this Section 4(d). The following shall constitute "Cause" for termination: (i) your repeated material failure to perform (other than by reason of Disability), or gross negligence in the performance of, your 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 you; (ii) your material breach of this agreement or any other agreement between you 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 you; (iii) commission by you of a felony involving moral turpitude or fraud with respect to the Company or any of its Affiliates; (iv) your 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) your failure to comply with (A) any material Company policy, including without limitation, the Code of Ethics of the Company or any of its Affiliates to which you are bound, 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 you.

(e) Death. Your employment shall terminate upon your death.

(f) Disability. Your employment shall terminate upon your Disability.

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5. Company Obligations upon Termination of Employment.

(a) In General. Upon your termination of employment for any reason, you (or your estate, if applicable) shall be entitled to receive (i) any base salary earned but not paid through your date of termination, (ii) any accrued but unused vacation pay calculated through your date of termination, (iii) any accrued but unpaid expense reimbursements calculated through your date of termination, and (iv) any benefits as may be provided under the terms of any Company employee benefit plan or program. Except as otherwise provided in this Section 5, all of your rights to salary, bonus, fringe benefits and other compensation hereunder which accrue or become payable after the date of your termination of employment shall cease upon the date of such termination, other than those expressly required under applicable law (such as COBRA).

( b ) Termination as a Result of Death, Disability, By Company without Cause, or By You with Good Reason. In the event of termination of your employment by the Company without Cause, due to death or Disability, or a resignation of your employment by you for Good Reason, for a period of 12 months after your termination of employment (or such shorter period as provided pursuant to Section 3(c)(iii)), during such period (the "Severance Period"), the Company will continue to pay you your base salary (the "Severance Payments") and pay you an amount equal, on an after-tax basis, to the premium cost of your health insurance on the same terms and conditions as it contributes for active employees provided that you (or your beneficiaries) make a timely election under the federal law known as "COBRA" and provided further that you are entitled to continue participation in the Company's group health plan under applicable law and plan terms (the "Health Care Payments"). In addition, within sixty (60) days of your termination the Company will pay you a lump sum cash amount (the "Bonus Payment") equal to the product of (i) your average annual bonus for the prior three (3) calendar years, and (ii) the ratio of (A) the number of days you were employed by the Company during the calendar year in which occurs your termination, to (B) the number of days in such year.

(c) Termination without Cause or for Good Reason in Connection with a Change in Control. Notwithstanding the foregoing, if your employment is terminated by the Company without Cause or by you for Good Reason within twenty four (24) months following a Change in Control you shall (i) receive the Severance Payments, Health Care Payments and Bonus Payment provided in Section 5(b) hereof, provided that your Severance Period under such circumstances shall be twenty-four (24) months; and (ii) become fully vested in all equity and equity-based awards granted to you by the Company.

(i) Notwithstanding anything to the contrary contained in this agreement, to the extent that any amount, or benefits paid or distributed to you pursuant to this agreement or any other agreement or arrangement between the Company and you (collectively, the "280G Payments") (A) constitute a "parachute payment" within the meaning of Section 280G of the Code and (B) but for this Section 5(c), would be subject to the excise tax imposed by Section 4999 of the Code, then the 280G Payments shall be payable either (i) in full or (ii) in such lesser amount which would result in no portion of such 280G Payments being subject to excise tax under Section 4999 of the Code; whichever of the foregoing amounts, taking into account the applicable federal, state and local income or excise taxes (including the excise tax imposed by Section 4999) results in your receipt on an after-tax basis, of the greatest amount of benefits under this agreement, notwithstanding that all or some portion of such benefits may be taxable under Section 4999 of the Code. Unless you and the Company otherwise agree in writing, any determination required under this Section 5(c) shall be made in writing by an independent public accountant selected by the Company (the "Accountants"), whose determination shall be conclusive and binding upon you and the Company for all purposes. For purposes of making the calculations required by this Section 5(c), the Accountants may make reasonable assumptions and approximations concerning applicable taxes and may rely on reasonable, good faith interpretations concerning the application of Sections 280G and 4999 of the Code. The Company and you shall furnish to the Accountants such information and documents as the Accountants may reasonably request in order to make a determination under this Section. The Company shall bear all costs the Accountants may reasonably incur in connection with any calculations contemplated by this Section, as well as any reasonable legal or accountant expenses, or any additional taxes, that you may incur as a result of any calculation errors made by the Accountant and/or the Company in connection with the Code Section 4999 excise tax analysis contemplated by this Section 5(c).

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( i i ) If you receive reduced 280G Payments by reason of this Section 5(c) and it is established pursuant to a final determination of the court or an Internal Revenue Service proceeding that you could have received a greater amount without resulting in an excise tax, then the Company shall promptly thereafter pay you the aggregate additional amount which could have been paid without resulting in an excise tax as soon as practicable.

( i i i ) The parties agree to cooperate generally and in good faith with respect to (A) the review and determinations to be undertaken by the Accountants as set forth in this Section 5(c) and (B) any audit, claim or other proceeding brought by the Internal Revenue Service or similar state authority to review or contest or otherwise related to the determinations of the Accountants as provided for in this Section 5(c), including any claim or position taken by the Internal Revenue Service that, if successful, would require the payment by you of any additional excise tax, over and above the amounts of excise tax established under the procedure set forth in this Section 5(c).

( i v ) The reduction of 280G Payments, if applicable, shall be effected in the following order (unless you, to the extent permitted by Section 409A of the Code, elect another method of reduction by written notice to the Company prior to the Section 280G event): (A) any cash severance payments, (B) any other cash amounts payable to you, (C) any health and welfare or similar benefits valued as parachute payments, (D) acceleration of vesting of any stock options for which the exercise price exceeds the then fair market value of the underlying stock, in order of the option tranches with the largest Section 280G parachute value, (E) acceleration of vesting of any equity award that is not a stock option, (F) acceleration of vesting of any stock options for which the exercise price is less than the fair market value of the underlying stock in such manner as would net you the largest remaining spread value if the options were all exercised as of the Section 280G event, and (G) acceleration of vesting of any restricted stock or other non-option equity-based compensation in the order of the equity awards with the largest Section 280G parachute value.

( d ) Release and Cooperation. Any obligation of the Company to provide you Severance Payments, Health Care Payments and/or Bonus Payment under Section 5(b), (c) or (d) hereof is conditioned upon your signing and not revoking (and the expiration of any period of revocation associated therewith) a release of claims in the form provided by the Company (the "Employee Release") by the deadline specified by the Company (which shall be no later than sixty (60) days following your termination of employment). Any and all Severance Payments will be in the form of salary continuation, and the Severance Payments and Health Care Payments will be payable in accordance with the normal payroll practices of the Company, and will begin on the first payroll date following the sixtieth (60th) day following your termination of employment. The first of any such payments will include all Severance Payments and Health Care Payments that otherwise would have been due prior to such first payment date had such payments commenced immediately upon your termination of employment; any payments made thereafter will continue as otherwise provided herein.

(e) Survival. Provisions of this agreement shall survive any termination if so provided in this agreement or if necessary or desirable to accomplish the purposes of other surviving provisions, including without limitation your obligations under Section 3 of this agreement. The obligation of the Company (if any) to make payments to you under Sections 5(b) or (c) is expressly conditioned upon your continued full performance of obligations under Section 3 hereof. Upon termination by either you or the Company, all rights, duties and obligations of you and the Company to each other shall cease, except as otherwise expressly provided in this agreement.

6. Definitions. For purposes of this agreement, the following definitions apply:

( a ) "Affiliates" means all persons and entities directly or indirectly controlling, controlled by or under common control with the Company, where control may be by management authority, equity interest or otherwise.

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(b) “Change in Control” means:

(i) The acquisition by any person, entity or “group”, within the meaning of Section 13(d)(3) or 14(d)(2) of the 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 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) “Code” means the Internal Revenue Code of 1986, as amended.

(d) “Confidential Information” means any and all information of the Company and its Affiliates that is not generally available to the public and any and all material information not generally available to the public gained incident to your employment or any other association with the Company or any of its Affiliates. Confidential Information also includes any information received by the Company or any of its Affiliates from any Person with any understanding, express or implied, that it will not be disclosed. Confidential Information does not include information that enters the public domain, other than through your breach of your obligations under this agreement.

( e ) “Disability” means your inability to perform the essential duties, responsibilities and functions of your 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.

(f) “Good Reason” means, without your consent, the occurrence of one or more of the following events: (i) material diminution in the nature or scope of your responsibilities, duties or authority relating to the Company as contemplated by this agreement; (ii) material reduction in annual base salary; (iii) failure by the Company to provide a target bonus opportunity equal to the amount set out in Section 2(b) above; (iv) your being required to relocate to a principal place of employment outside of New York, New York; (v) the Company’s failure to renew this agreement in accordance with Section 1(a); or (vi) a change in reporting relationships resulting from a Change in Control that occurs in anticipation of or within twenty four (24) months after a Change in Control.

( g ) “Person” means an individual, a corporation, a limited liability company, an association, a partnership, an estate, a trust or any other entity or organization, other than the Company or any of its Affiliates.

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7 . Conflicting Agreements. You hereby represent and warrant that your signing of this agreement and the performance of your obligations under it will not breach or be in conflict with any other agreement to which you are a party or are bound and that you are not now subject to any covenants against competition or similar covenants or any court order that could affect the performance of your obligations under this agreement. You agree that you will not disclose to or use on behalf of the Company any proprietary information of a third party without that party's consent.

8 . Forfeiture and/or Repayment of Compensation. You hereby acknowledge and agree that you are subject to any compensation forfeiture or repayment obligations that may apply pursuant to the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and any applicable Company policy.

9 . Withholding. All payments made by the Company under this agreement shall be reduced by any tax or other amounts required to be withheld by the Company under applicable law.

10 . Assignment. Neither you nor the Company may make any assignment of this agreement or any interest in it, by operation of law or otherwise, without the prior written consent of the other; provided, however, that the Company may assign its rights and obligations under this agreement without your consent to one of its Affiliates or to any Person with whom the Company shall hereafter affect a reorganization, consolidate with, or merge into or to whom it transfers all or substantially all of its properties or assets. This agreement shall inure to the benefit of and be binding upon you and the Company, and each of your and its respective successors, executors, administrators, heirs and permitted assigns.

11 . Severability. If any portion or provision of this agreement shall to any extent be declared illegal or unenforceable by a court of competent jurisdiction, then the remainder of this agreement, or the application of such portion or provision in circumstances other than those as to which it is so declared illegal or unenforceable, shall not be affected thereby, and each portion and provision of this agreement shall be valid and enforceable to the fullest extent permitted by law.

12 . Resolution of Disputes. Except as provided in Section 3(e), any dispute or controversy arising with respect to this Agreement and your employment hereunder (whether based on contract or tort or upon any federal, state or local statute, including but not limited to claims asserted under the Age Discrimination in Employment Act, Title VII of the Civil Rights Act of 1964, as amended, any state Fair Employment Practices Act and/or the Americans with Disability Act) shall, at the election of either you or the Company, be submitted to JAMS for resolution in arbitration in accordance with the rules and procedures of JAMS. Either party shall make such election by delivering written notice thereof to the other party at any time (but not later than forty five (45) days after such party receives notice of the commencement of any administrative or regulatory proceeding or the filing of any lawsuit relating to any such dispute or controversy) and thereupon any such dispute or controversy shall be resolved only in accordance with the provisions of this Section 12. Any such proceedings shall take place in New York, New York before a single arbitrator (rather than a panel of arbitrators), pursuant to any streamlined or expedited (rather than a comprehensive) arbitration process, before a non-judicial (rather than a judicial) arbitrator, and in accordance with an arbitration process which, in the judgment of such arbitrator, shall have the effect of reasonably limiting or reducing the cost of such arbitration. The resolution of any such dispute or controversy by the arbitrator appointed in accordance with the procedures of JAMS shall be final and binding. Judgment upon the award rendered by such arbitrator may be entered in any court having jurisdiction thereof, and the parties consent to the jurisdiction of the New York courts for this purpose. If you shall be the prevailing party in such arbitration, the Company shall promptly pay, upon your demand, all reasonable legal fees, court costs and other reasonable costs and expenses incurred by you in any legal action seeking to enforce the award in any court.

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13. Miscellaneous.

( a ) This agreement sets forth the entire agreement between you and the Company and replaces all prior and contemporaneous communications, agreements and understandings, written or oral, with respect to the terms and conditions of your employment. This agreement may not be modified or amended, and no breach shall be deemed to be waived, unless agreed to in writing by you and an expressly authorized representative of the Board. The headings and captions in this agreement are for convenience only and in no way define or describe the scope or content of any provision of this agreement. This agreement may be executed in two or more counterparts, each of which shall be an original and all of which together shall constitute one and the same instrument. This is a New York contract and shall be governed and construed in accordance with the laws of the State of New York, without regard to the conflict of laws principles thereof. In the event of any alleged breach or threatened breach of this agreement, the parties hereby consent and submit to the jurisdiction of the federal and state courts in and of the State of New York and to service of legal process in the State of New York.

( b ) Notwithstanding any other payment schedule provided herein, if you are identified on the date of termination as a “specified employee” within the meaning of Section 409A(a)(2)(B) of the Code, then:

(i) Any payment that is considered nonqualified deferred compensation subject to Section 409A of the Code (including the regulations promulgated thereunder, “Section 409A”), as determined by the Company in its sole discretion, and payable on account of a “separation from service,” will be made on the date that is the earlier of (A) the expiration of the six (6)-month period beginning on the date of your “separation from service”, and (B) your death (the “Delay Period”) to the extent required under Section 409A. Upon the expiration of the Delay Period, all payments delayed pursuant to this subsection (whether they would have otherwise been payable in a single sum or in installments in the absence of such delay) will be paid to you in a lump sum, and all remaining payments due under this agreement will be paid or provided in accordance with the normal payment dates specified for them herein.

(ii) You shall pay the cost of any benefits to be provided during the Delay Period that are considered nonqualified deferred compensation subject to Section 409A, as determined by the Company in its sole discretion, and are provided on account of a “separation from service”; the Company shall reimburse you for that portion of the costs that the Company would otherwise have paid or would otherwise have provided upon expiration of the Delay Period, and any remaining benefits shall be reimbursed or provided by the Company in accordance with the procedures specified herein.

(c) For purposes of Section 409A, your right to receive any installment payment pursuant to this agreement will be treated as a right to receive a series of separate and distinct payments.

( d ) In no event whatsoever will the Company be liable for any additional tax, interest or penalty that may be imposed on you by Section 409A or damages for failing to comply with Section 409A.

(e) Whenever a payment under this agreement specifies a payment period with reference to a number of days (e.g., “payment will be made within thirty (30) days following the date of termination”), the actual date of payment within the specified period will be within the sole discretion of the Company.

14. Notices. Any notices provided for in this agreement shall be in writing and shall be effective when delivered in person or deposited in the United States mail, postage prepaid, and addressed to you at your last known address on the books of the Company or, in the case of the Company, to it at its principal place of business, attention of the Board, or to such other address as either party may specify by notice to the other actually received.

If the foregoing is acceptable to you, please sign this letter in the space provided and return it to me. We will provide a countersigned copy for your records.

Sincerely yours,

[ \_\_\_\_\_ ]

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Accepted and Agreed:

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[ ]  
Date: May 5, 2015

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**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 March 31, 2015 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: May 6, 2015

By: \_\_\_\_\_ / S / Dayl W. Pearson  
**Dayl W. Pearson**  
**President and Chief Executive Officer**  
**(Principal Executive Officer)**

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**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 March 31, 2015 of KCAP Financial, Inc. (the “registrant”);

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth 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: May 6, 2015

By: \_\_\_\_\_ / S / Edward U. Gilpin  
**Edward U. Gilpin**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

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**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 March 31, 2015 (the "Report"), I, Dayl W. Pearson, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 6, 2015

By: \_\_\_\_\_ / S / Dayl W. Pearson  
**Dayl W. Pearson**  
**President and Chief Executive Officer**  
**(Principal Executive Officer)**

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**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 March 31, 2015 (the "Report"), I, Edward U. Gilpin, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 6, 2015

By: \_\_\_\_\_ /s/ Edward U. Gilpin  
**Edward U. Gilpin**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

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