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

Form 10-Q

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

For the quarterly period ended March 31, 2017

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", "large accelerated filer", "non-accelerated filer", "smaller reporting company" and "emerging growth company" 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"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

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 2, 2017 was 37,225,664.

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

	As of March 31, 2017 (unaudited)	As of December 31, 2016
ASSETS		
Investments at fair value:		
Money market accounts (cost: 2017 - \$22,674,790; 2016 - \$28,699,269)	\$ 22,674,790	\$ 28,699,269
Debt securities (cost: 2017 - \$247,632,590; 2016 - \$249,520,234)	237,657,701	238,343,330
CLO Fund Securities managed by affiliates (cost: 2017 - \$71,906,949; 2016 - \$71,734,809)	50,827,938	51,908,784
CLO Fund Securities managed by non-affiliates (cost: 2017 - \$5,088,026; 2016 - \$5,116,508)	2,171,090	2,265,566
Equity securities (cost: 2017 - \$10,389,008; 2016 - \$10,389,007)	4,902,794	5,056,355
Asset Manager Affiliates (cost: 2017 - \$54,691,230; 2016 - \$55,341,230)	36,942,000	40,198,000
Total Investments at Fair Value (cost: 2017 - \$412,382,593; 2016 - \$420,801,057)	355,176,313	366,471,304
Cash	5,178,290	1,307,257
Restricted cash	7,986,487	8,528,298
Interest receivable	1,143,363	1,033,917
Receivable for open trades	—	2,950,658
Due from affiliates	378,731	612,854
Other assets	404,245	467,695
	\$ 370,267,429	\$ 381,371,983
LIABILITIES		
Notes issued by KCAP Senior Funding I, LLC (net of discount and offering costs of: 2017 - \$2,128,524 and \$2,289,547, respectively; 2016 - \$2,286,425 and \$2,459,156, respectively)		
	\$ 142,931,928	\$ 142,604,419
7.375% Notes Due 2019 (net of offering costs of: 2017 - \$505,488; 2016 - \$550,774)	33,025,437	32,980,151
Payable for open trades	1,000,000	7,884,943
Accounts payable and accrued expenses	932,301	2,047,405
Accrued interest payable	947,873	930,086
Due to affiliates	—	54
	178,837,539	186,447,058
COMMITMENTS AND CONTINGENCIES (Note 8)		
STOCKHOLDERS' EQUITY		
Common stock, par value \$0.01 per share, 100,000,000 common shares authorized; 37,313,651 issued, and 37,209,649 outstanding at March 31, 2017, and 37,282,296 issued, and 37,178,294 outstanding at December 31, 2016		
	372,096	371,783
Capital in excess of par value	353,955,039	353,404,155
Excess distribution of net investment income	(15,843,963)	(14,630,319)
Accumulated net realized losses	(88,447,958)	(88,491,896)
Net unrealized depreciation on investments	(58,605,324)	(55,728,798)
	191,429,890	194,924,925
Total Stockholders' Equity	191,429,890	194,924,925
Total Liabilities and Stockholders' Equity	\$ 370,267,429	\$ 381,371,983
NET ASSET VALUE PER COMMON SHARE	\$ 5.14	\$ 5.24

See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	March 31,	
	2017	2016
Investment Income:		
Interest from investments in debt securities	\$ 4,555,178	\$ 5,705,577
Interest from cash and time deposits	15,906	7,372
Investment income on CLO Fund Securities managed by affiliates	2,974,558	3,051,816
Investment income on CLO Fund Securities managed by non-affiliates	118,111	152,317
Dividends from Asset Manager Affiliates	—	550,000
Capital structuring service fees	110,644	43,239
Total investment income	7,774,397	9,510,321
Expenses:		
Interest and amortization of debt issuance costs	2,180,972	2,573,440
Compensation	1,225,735	966,588
Professional fees	549,281	651,939
Insurance	95,036	106,223
Administrative and other	505,234	447,361
Total expenses	4,556,258	4,745,551
Net Investment Income	3,218,139	4,764,770
Realized And Unrealized Gains (Losses) On Investments:		
Net realized gains (losses) from investment transactions	43,938	(7,811,888)
Net change in unrealized appreciation (depreciation) on:		
Debt securities	1,202,017	(1,731,990)
Equity securities	(153,562)	1,379,413
CLO Fund Securities managed by affiliates	(1,252,986)	3,270,541
CLO Fund Securities managed by non-affiliates	(65,994)	(180,545)
Asset Manager Affiliates investments	(2,606,000)	(6,533,000)
Total net change in unrealized depreciation	(2,876,525)	(3,795,581)
Net realized and unrealized loss on investments	(2,832,587)	(11,607,469)
Net Increase (Decrease) In Stockholders' Equity Resulting From Operations	\$ 385,552	\$ (6,842,699)
Net Increase (Decrease) In Stockholders' Equity Resulting from Operations per Common Share:		
Basic:	\$ 0.01	\$ (0.18)
Diluted:	\$ 0.01	\$ (0.18)
Net Investment Income Per Common Share:		
Basic:	\$ 0.09	\$ 0.13
Diluted:	\$ 0.09	\$ 0.13
Weighted Average Shares of Common Stock Outstanding—Basic	37,202,996	37,109,735
Weighted Average Shares of Common Stock Outstanding—Diluted	37,202,996	37,109,735

See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	March 31,	
	<u>2017</u>	<u>2016</u>
Operations:		
Net investment income	\$ 3,218,139	\$ 4,764,770
Net realized gains (losses) from investment transactions	43,938	(7,811,888)
Net change in unrealized depreciation on investments	<u>(2,876,525)</u>	<u>(3,795,581)</u>
Net increase (decrease) in stockholders' equity resulting from operations	385,552	(6,842,699)
Stockholder distributions	<u>(4,431,785)</u>	<u>(5,496,812)</u>
Capital share transactions:		
Issuance of common stock for:		
Dividend reinvestment plan	162,384	205,796
Stock based compensation	<u>388,814</u>	<u>420,973</u>
Net increase in net assets resulting from capital share transactions	551,198	626,769
Net assets at beginning of period	<u>194,924,925</u>	<u>216,100,470</u>
Net assets at end of period (including undistributed net investment income of \$0 in 2017 and \$0 in 2016)	<u>\$ 191,429,890</u>	<u>\$ 204,387,728</u>
Net asset value per common share	\$ 5.14	\$ 5.50
Common shares outstanding at end of period	37,209,649	37,130,433

See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	March 31,	
	2017	2016
OPERATING ACTIVITIES:		
Net increase (decrease) in stockholder's equity resulting from operations	\$ 385,552	\$ (6,842,699)
Adjustments to reconcile net increase (decrease) in stockholder's equity resulting from operations to net cash provided by operations:		
Net realized (gains) losses on investment transactions	(43,938)	7,811,888
Net change in unrealized depreciation from investments	2,876,525	3,795,581
Purchases of investments	(28,597,362)	(5,860,000)
Proceeds from sales and redemptions of investments	37,452,361	24,051,566
Net accretion of investments	(243,790)	1,826,450
Amortization of original issue discount on indebtedness	157,901	153,742
Amortization of debt issuance costs	214,894	238,882
Payment-in-kind interest income	(148,805)	(358,684)
Stock-based compensation	388,814	420,973
Changes in operating assets and liabilities:		
(Decrease) in payable for open trades	(6,884,943)	—
Decrease in receivable for open trades	2,950,658	—
(Increase) decrease in interest and dividends receivable	(109,446)	80,111
Decrease in other assets	63,450	60,745
Decrease (increase) in due from affiliates	234,123	(718,554)
(Decrease) in due to affiliates	(54)	(554,243)
(Decrease) in accounts payable and accrued expenses	(1,097,317)	(1,754,022)
Net cash provided by operating activities	7,598,623	22,351,736
FINANCING ACTIVITIES:		
Distributions to stockholders net of dividend reinvestment	(4,269,401)	(5,291,018)
Repayment/repurchase of Convertible Notes	—	(19,299,000)
Net cash (used in) financing activities	(4,269,401)	(24,590,018)
CHANGE IN CASH AND RESTRICTED CASH	3,329,222	(2,238,282)
CASH AND RESTRICTED CASH, BEGINNING OF PERIOD	9,835,555	7,138,272
CASH AND RESTRICTED CASH, END OF PERIOD	<u>\$ 13,164,777</u>	<u>\$ 4,899,990</u>
Supplemental Information:		
Interest paid during the period	\$ 1,790,390	\$ 2,567,401
Dividends paid during the period under the dividend reinvestment plan	\$ 162,384	\$ 205,796

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
As of March 31, 2017
(unaudited)

Debt Securities Portfolio

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
1A Smart Start LLC ^{8, 9} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.9% Cash, 1.0% Libor Floor, Due 2/22	\$ 2,962,500	\$ 2,940,096	\$ 2,958,353
4L Technologies Inc. (fka Clover Holdings, Inc.) ^{8, 9} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 5/20	2,713,465	2,699,414	2,637,217
Advanced Lighting Technologies, Inc. ^{8, 9, 14} <i>Consumer goods: Durable</i>	First Lien Bond — 12.500% - 6/2019 - 00753CAG7 5.3% Cash, 7.3% PIK, Due 6/19	3,157,500	3,054,338	1,089,338
Advantage Sales & Marketing Inc. ⁸ <i>Services: Business</i>	Junior Secured Loan — Term Loan (Second Lien) 7.5% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	1,001,676	990,200
Alere Inc. (fka IM US Holdings, LLC) ⁹ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — B Term Loan 4.3% Cash, 1.0% Libor Floor, Due 6/22	3,022,586	3,017,016	3,033,921
American Seafoods Group LLC ^{8, 9} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/21	3,683,704	3,670,208	3,696,597
Anaren, Inc. ^{8, 9} <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan (First Lien) 5.6% Cash, 1.0% Libor Floor, Due 2/21	1,862,112	1,851,738	1,850,195
Apco Holdings, Inc. ^{8, 9} <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan 7.0% Cash, 1.0% Libor Floor, Due 1/22	3,792,162	3,700,381	3,788,370
API Technologies Corp. ^{8, 9} <i>High Tech Industries</i>	Senior Secured Loan — Initial Term Loan 7.6% Cash, 1.0% Libor Floor, Due 4/22	3,473,750	3,414,914	3,472,013
Aristotle Corporation, The ^{8, 9} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.6% Cash, 1.0% Libor Floor, Due 6/21	3,656,556	3,643,560	3,648,146

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
Asurion, LLC (fka Asurion Corporation) ^{8, 9} <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Replacement B-2 Term Loan 4.2% Cash, 0.8% Libor Floor, Due 7/20	\$ 184,525	\$ 184,948	\$ 185,948
Avalign Technologies, Inc. ⁸ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 9.6% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	992,430	983,400
Avalign Technologies, Inc. ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 7/21	2,925,000	2,916,442	2,917,386
BarBri, Inc. (Gemini Holdings, Inc.) ^{8, 9} <i>Services: Consumer</i>	Senior Secured Loan — Term Loan 4.5% Cash, 1.0% Libor Floor, Due 7/19	2,465,308	2,460,567	2,434,738
BBB Industries US Holdings, Inc. ^{8, 9} <i>Automotive</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 11/21	2,947,500	2,908,792	2,831,369
Bestop, Inc. ^{8, 9} <i>Automotive</i>	Senior Secured Loan — Delayed Draw Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	63,260	61,478	63,184
Bestop, Inc. ^{8, 9} <i>Automotive</i>	Senior Secured Loan — First Amendment Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	493,566	489,167	492,974
Bestop, Inc. ^{8, 9} <i>Automotive</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	1,480,368	1,460,358	1,478,591
Carolina Beverage Group LLC ⁸ <i>Beverage, Food and Tobacco</i>	Senior Secured Bond — 10.625% - 08/2018 - 143818AA0 144A 10.6% Cash, Due 8/18	1,500,000	1,505,454	1,489,350
CCS Intermediate Holdings, LLC ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.1% Cash, 1.0% Libor Floor, Due 7/21	2,925,000	2,915,919	2,479,523
Cengage Learning, Inc. ^{8, 9} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — 2016 Refinancing Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/23	3,784,380	3,779,649	3,620,592
Checkout Holding Corp. (fka Catalina Marketing) ^{8, 9} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 4/21	955,000	952,250	864,275

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
CHS/Community Health Systems, Inc. ⁹ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Incremental 2021 Term H Loan 4.0% Cash, 1.0% Libor Floor, Due 1/21	\$ 2,878,621	\$ 2,854,616	\$ 2,844,264
Consolidated Communications, Inc. ⁹ <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.0% Cash, 1.0% Libor Floor, Due 10/23	2,062,263	2,057,462	2,075,337
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) ⁸ <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	3,010,709	2,475,000
CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) (aka HealthPort) ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — New Term Loan Facility 5.3% Cash, 1.0% Libor Floor, Due 12/21	2,932,763	2,911,439	2,783,778
Drew Marine Group Inc. ⁸ <i>Transportation: Cargo</i>	Junior Secured Loan — Term Loan (Second Lien) 8.1% Cash, 1.0% Libor Floor, Due 5/21	2,500,000	2,496,538	2,400,000
Eastern Power, LLC (Eastern Covert Midco, LLC) (aka TPF II LC, LLC) ^{8, 9} <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 10/23	2,796,756	2,815,456	2,813,187
ELO Touch Solutions, Inc. ^{8, 9} <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 6/18	1,398,040	1,378,666	1,364,347
Empower Payments Acquisition, Inc. ^{8, 9} <i>Services: Business</i>	Senior Secured Loan — Term Loan 6.5% Cash, 1.0% Libor Floor, Due 11/23	2,992,500	2,935,328	2,981,727
EWT Holdings III Corp. (fka WTG Holdings III Corp.) ^{8, 9} <i>Environmental Industries</i>	Senior Secured Loan — Term Loan (First Lien) 4.9% Cash, 1.0% Libor Floor, Due 1/21	1,741,003	1,737,060	1,724,985
FHC Health Systems, Inc. ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 5.0% Cash, 1.0% Libor Floor, Due 12/21	3,829,000	3,802,884	3,615,208
First American Payment Systems, L.P. ⁸ <i>Banking, Finance, Insurance & Real Estate</i>	Junior Secured Loan — Term Loan (Second Lien) 11.5% Cash, 1.0% Libor Floor, Due 7/24	1,500,000	1,456,303	1,408,350
Getty Images, Inc. ^{8, 9} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.3% Libor Floor, Due 10/19	2,134,995	2,141,472	1,875,465

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
GI Advo Opco, LLC ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.7% Cash, 1.0% Libor Floor, Due 11/21	\$ 246,875	\$ 244,956	\$ 223,471
GI Advo Opco, LLC ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.7% Cash, 1.0% Libor Floor, Due 11/21	2,715,625	2,694,524	2,458,184
GK Holdings, Inc. (aka Global Knowledge) ⁸ <i>Services: Business</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 11.4% Cash, 1.0% Libor Floor, Due 1/22	1,500,000	1,479,272	1,474,050
GK Holdings, Inc. (aka Global Knowledge) ^{8, 9} <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 7.1% Cash, 1.0% Libor Floor, Due 1/21	4,438,648	4,413,162	4,405,358
Global Tel*Link Corporation ⁸ <i>Telecommunications</i>	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, 1.3% Libor Floor, Due 11/20	4,000,000	3,960,194	3,911,600
Gold Standard Baking, Inc. ^{8, 9} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.4% Cash, 1.0% Libor Floor, Due 4/21	2,456,250	2,447,837	2,454,531
Grupo HIMA San Pablo, Inc. ⁸ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 1/18	2,880,000	2,870,374	2,764,800
Grupo HIMA San Pablo, Inc. ⁸ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,000,000	6,960,865	6,370,000
Gymboree Corporation., The ^{8, 9} <i>Retail</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.5% Libor Floor, Due 2/18	1,420,455	1,416,024	593,445
Hargray Communications Group, Inc. (HCP Acquisition LLC) ^{8, 9} <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Term B-1 Loan 4.9% Cash, 1.0% Libor Floor, Due 6/19	2,879,638	2,855,975	2,879,638
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ^{8, 9} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Tranche B-5 Term Loan 7.1% Cash, 1.0% Libor Floor, Due 12/21	1,334,704	1,318,965	1,348,886
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ^{8, 9} <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Tranche B-6 Term Loan 6.6% Cash, 1.0% Libor Floor, Due 2/22	2,917,761	2,889,214	2,944,021

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
Highland Acquisition Holdings, LLC (aka HealthSun Health Plans, Inc.) ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 6.5% Cash, 1.0% Libor Floor, Due 11/22	\$ 1,975,000	\$ 1,883,259	\$ 1,950,313
Highline Aftermarket Acquisition, LLC ^{8, 9} <i>Automotive</i>	Senior Secured Loan — Term Loan 5.3% Cash, 1.0% Libor Floor, Due 3/24	1,500,000	1,492,512	1,492,500
Hoffmaster Group, Inc. ⁸ <i>Forest Products & Paper</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.5% Cash, 1.0% Libor Floor, Due 11/24	1,600,000	1,554,026	1,548,000
Hoffmaster Group, Inc. ^{8, 9} <i>Forest Products & Paper</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 11/23	2,660,000	2,634,684	2,661,862
Industrial Services Acquisition, LLC (aka Evergreen / NAIC) ^{8, 9} <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.0% Cash, 1.0% Libor Floor, Due 6/22	2,887,500	2,862,271	2,887,500
Ivanti Software, Inc. (fka LANDesk Group, Inc.) ⁸ <i>High Tech Industries</i>	Junior Secured Loan — Loan (Second Lien) 10.0% Cash, 1.0% Libor Floor, Due 1/25	3,228,619	3,228,619	3,228,619
Kellermeyer Bergensons Services, LLC ^{8, 9} <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 10/21	3,950,120	3,927,591	3,890,868
Key Safety Systems, Inc. ^{8, 9} <i>Automotive</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 8/21	1,394,077	1,389,685	1,410,457
MB Aerospace ACP Holdings II Corp. ^{8, 9} <i>Aerospace and Defense</i>	Senior Secured Loan — Initial Term Loan 6.7% Cash, 1.0% Libor Floor, Due 12/22	1,339,110	1,328,548	1,339,646
Medrisk, Inc. ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 6.4% Cash, 1.0% Libor Floor, Due 2/23	1,980,000	1,963,205	1,980,000
National Home Health Care Corp. ⁸ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 10.0% Cash, 1.0% Libor Floor, Due 12/22	1,500,728	1,479,192	1,470,863
National Home Health Care Corp. ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 12/21	2,981,250	2,953,191	2,977,673

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
Nellson Nutraceutical, LLC ^{8, 9} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term A-1 Loan (First Lien) 6.1% Cash, 1.0% Libor Floor, Due 12/21	\$ 2,344,706	\$ 2,330,591	\$ 2,344,471
Nellson Nutraceutical, LLC ^{8, 9} <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term A-2 Loan (First Lien) 6.1% Cash, 1.0% Libor Floor, Due 12/21	2,066,562	2,053,576	2,066,355
Nielsen & Bainbridge, LLC ^{8, 9} <i>Consumer goods: Durable</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/20	5,361,360	5,328,534	5,361,360
NM Z Parent Inc. (aka Zep, Inc.) ^{8, 9} <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — 2016 Term Loan 5.0% Cash, 1.0% Libor Floor, Due 6/22	3,438,750	3,450,149	3,474,169
Novitex Acquisition, LLC (fka ARSloane Acquisition, LLC) ^{8, 9} <i>Services: Business</i>	Senior Secured Loan — Tranche B-2 Term Loan (First Lien) 8.1% Cash, 1.3% Libor Floor, Due 7/20	1,928,630	1,890,331	1,880,029
Onex Carestream Finance LP ⁸ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 9.6% Cash, 1.0% Libor Floor, Due 12/19	1,932,311	1,932,311	1,783,523
Onex Carestream Finance LP ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan (First Lien 2013) 5.1% Cash, 1.0% Libor Floor, Due 6/19	1,723,617	1,726,495	1,701,383
Otter Products, LLC (OtterBox Holdings, Inc.) ^{8, 9} <i>Consumer goods: Durable</i>	Senior Secured Loan — Term B Loan 5.8% Cash, 1.0% Libor Floor, Due 6/20	2,600,266	2,588,047	2,544,360
PGX Holdings, Inc. ^{8, 9} <i>Services: Consumer</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.3% Cash, 1.0% Libor Floor, Due 9/20	3,595,714	3,574,690	3,586,365
Playpower, Inc. ^{8, 9} <i>Construction & Building</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.9% Cash, 1.0% Libor Floor, Due 6/21	1,965,000	1,954,591	1,965,196
Power Products, LLC ^{8, 9} <i>Capital Equipment</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 12/22	2,000,000	1,990,243	1,990,000

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
PrimeLine Utility Services LLC (fka FR Utility Services LLC) ^{8, 9} <i>Energy: Electricity</i>	Senior Secured Loan — Initial Term Loan 6.5% Cash, 1.0% Libor Floor, Due 11/22	\$ 3,925,659	\$ 3,895,827	\$ 3,928,014
Priority Payment Systems Holdings LLC ^{8, 9} <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Initial Term Loan 7.0% Cash, 1.0% Libor Floor, Due 1/23	3,990,000	3,951,668	3,960,873
PSC Industrial Holdings Corp. ^{8, 9} <i>Environmental Industries</i>	Senior Secured Loan — Term Loan (First Lien) 5.9% Cash, 1.0% Libor Floor, Due 12/20	2,966,713	2,947,322	2,953,066
Q Holding Company (fka Lexington Precision Corporation) ^{8, 9} <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Term B Loan 6.1% Cash, 1.0% Libor Floor, Due 12/21	2,984,733	2,956,243	2,955,781
Quad-C JH Holdings Inc. (aka Joerns Healthcare) ^{8, 9} <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan A 6.2% Cash, 1.0% Libor Floor, Due 5/20	3,890,093	3,874,832	3,617,786
Ravn Air Group, Inc. ^{8, 9} <i>Transportation: Consumer</i>	Senior Secured Loan — Initial Term Loan 5.4% Cash, 1.0% Libor Floor, Due 7/21	2,406,250	2,397,545	2,317,219
Roscoe Medical, Inc. ⁸ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	6,700,000	6,669,733	6,499,000
Salient CRGT Inc. ^{8, 9} <i>High Tech Industries</i>	Senior Secured Loan — Initial Term Loan 6.8% Cash, 1.0% Libor Floor, Due 2/22	3,000,000	2,940,954	2,955,000
Sandy Creek Energy Associates, L.P. ^{8, 9} <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.1% Cash, 1.0% Libor Floor, Due 11/20	2,606,504	2,599,760	2,077,905
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ^{8, 9} <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 7.7% Cash, 1.0% Libor Floor, Due 8/21	2,709,639	2,695,021	2,439,488
Tank Partners Holdings, LLC ^{8, 14} <i>Energy: Oil & Gas</i>	Senior Secured Loan — Loan 10.3% Cash, 4.0% PIK, 3.0% Libor Floor, Due 8/19	11,049,279	10,820,492	7,819,575

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
Terra Millennium Corporation ^{8, 9} <i>Construction & Building</i>	Senior Secured Loan — First Out Term Loan 7.3% Cash, 1.0% Libor Floor, Due 10/22	\$ 3,975,000	\$ 3,937,126	\$ 3,975,000
Time Manufacturing Acquisition, LLC ^{8, 9} <i>Capital Equipment</i>	Senior Secured Loan — Term Loan 6.2% Cash, 1.0% Libor Floor, Due 2/23	1,500,000	1,492,672	1,500,000
TronAir Parent Inc. ^{8, 9} <i>Aerospace and Defense</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.9% Cash, 1.0% Libor Floor, Due 9/23	3,980,000	3,942,913	3,979,204
TRSO I, Inc. ⁸ <i>Energy: Oil & Gas</i>	Junior Secured Loan — Term Loan (Second Lien) 14.0% Cash, 1.0% Libor Floor, Due 12/19	1,000,000	992,199	1,000,000
U.S. Shipping Corp (fka U.S. Shipping Partners LP) ^{8, 9} <i>Transportation: Cargo</i>	Senior Secured Loan — Tranche B-2 Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/21	1,266,623	1,265,891	1,199,999
USJ-IMECO Holding Company, LLC ^{8, 9} <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 4/20	3,670,376	3,660,989	3,518,790
Verdesian Life Sciences, LLC ^{8, 9} <i>Environmental Industries</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 7/20	3,712,558	3,682,896	3,584,846
VIP Cinema Holdings, Inc. ^{8, 9} <i>Hotel, Gaming & Leisure</i>	Senior Secured Loan — Initial Term Loan (First Lien) 7.0% Cash, 1.0% Libor Floor, Due 3/23	2,000,000	1,990,110	1,990,000
Weiman Products, LLC ⁸ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.9% Cash, 1.0% Libor Floor, Due 11/18	832,018	829,219	819,371
Weiman Products, LLC ^{8, 9} <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.9% Cash, 1.0% Libor Floor, Due 11/18	4,148,678	4,134,948	4,085,618
WideOpenWest Finance, LLC ^{8, 9} <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — New Term B Loan 4.6% Cash, 1.0% Libor Floor, Due 8/23	2,985,000	2,985,000	3,004,477

Portfolio Company / Principal Business	Investment Interest Rate¹ / Maturity	Principal	Amortized Cost	Fair Value²
WireCo WorldGroup Inc. ⁸ <i>Capital Equipment</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, 1.0% Libor Floor, Due 9/24	\$ 3,000,000	\$ 2,957,746	\$ 3,002,700
WireCo WorldGroup Inc. (WireCo WorldGroup Finance LP) ^{8,9} <i>Capital Equipment</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 9/23	1,741,250	1,725,053	1,743,165
Total Investment in Debt Securities (124% of net asset value at fair value)		\$ 249,597,832	\$ 247,632,590	\$ 237,657,701

Equity Securities Portfolio

Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Amortized Cost	Fair Value ²
Advanced Lighting Technologies, Inc. ^{5, 8, 9} <i>Consumer goods: Durable</i>	Preferred Stock Series C	1.8%	\$ 1	\$ 1,000
Aerostructures Holdings L.P. ^{5, 8} <i>Aerospace and Defense</i>	Partnership Interests	1.2%	1,000,000	13,471
Aerostructures Holdings L.P. ^{5, 8} <i>Aerospace and Defense</i>	Series A Preferred Interests	1.2%	250,961	1,091,819
Caribe Media Inc. (fka Caribe Information Investments Incorporated) ^{5, 8} <i>Media: Advertising, Printing & Publishing</i>	Common	1.3%	359,765	554,067
DBI Holding LLC ^{5, 8} <i>Services: Business</i>	Class A Warrants	3.2%	1	1,000
eInstruction Acquisition, LLC ^{5, 8} <i>Services: Business</i>	Membership Units	1.1%	1,079,615	1,000
FP WRCA Coinvestment Fund VII, Ltd. ^{3, 5} <i>Capital Equipment</i>	Class A Shares	1,500	1,500,000	707,874
Perseus Holding Corp. ^{5, 8} <i>Hotel, Gaming & Leisure</i>	Common	0.2%	400,000	1,000
Roscoe Investors, LLC ^{5, 8} <i>Healthcare & Pharmaceuticals</i>	Class A Units	1.6%	1,000,000	1,169,000
Tank Partners Holdings, LLC ^{5, 8, 11} <i>Energy: Oil & Gas</i>	Class B Units	5.8%	980,000	1,000
Tank Partners Holdings, LLC ^{5, 8} <i>Energy: Oil & Gas</i>	Warrants	1.3%	185,205	1,000

Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Amortized Cost	Fair Value²
TRSO II, Inc. ^{5, 8} <i>Energy: Oil & Gas</i>	Common Stock	5.4%	\$ 1,680,161	\$ 1,359,563
New Millennium Holdco, Inc. (Millennium Health, LLC) ^{5, 8} <i>Healthcare & Pharmaceuticals</i>	Common	0.2%	1,953,299	1,000
Total Investment in Equity Securities (3% of net asset value at fair value)			\$ 10,389,008	\$ 4,902,794

CLO Fund Securities

CLO Subordinated Investments

Portfolio Company	Investment¹²	Percentage Ownership	Amortized Cost	Fair Value²
Grant Grove CLO, Ltd. ^{3, 13}	Subordinated Securities, effective interest N/M, 1/21 maturity	22.2%	\$ 2,485,886	\$ 1,000
Katonah III, Ltd. ^{3, 13}	Preferred Shares, effective interest N/M, 5/15 maturity	23.1%	1,287,155	369,000
Katonah 2007-I CLO Ltd. ^{3, 6}	Preferred Shares, effective interest 25.6%, 4/22 maturity	100.0%	29,101,810	20,847,854
Trimaran CLO VII, Ltd. ^{3, 6, 13}	Income Notes, effective interest N/M, 6/21 maturity	10.5%	934,010	565,000
Catamaran CLO 2012-1 Ltd. ^{3, 6}	Subordinated Notes, effective interest 8.3%, 12/23 maturity	24.9%	5,778,004	2,679,951
Catamaran CLO 2013-1 Ltd. ^{3, 6}	Subordinated Notes, effective interest 14.6%, 1/25 maturity	23.5%	5,067,975	4,613,262
Catamaran CLO 2014-1 Ltd. ^{3, 6}	Subordinated Notes, effective interest 9.8%, 4/26 maturity	24.9%	7,635,476	4,376,540
Dryden 30 Senior Loan Fund ³	Subordinated Notes, effective interest 35.2%, 11/25 maturity	7.5%	1,314,985	1,801,090
Catamaran CLO 2014-2 Ltd. ^{3, 6}	Subordinated Notes, effective interest 11.2%, 10/26 maturity	24.9%	6,972,176	4,879,005
Catamaran CLO 2015-1 Ltd. ^{3, 6}	Subordinated Notes, effective interest 9.8%, 4/27 maturity	9.9%	4,494,789	3,110,826
Catamaran CLO 2016-1 Ltd. ^{3, 6}	Subordinated Notes, effective interest 13.3%, 1/29 maturity	24.9%	10,478,346	8,365,500
Total Investment in CLO Subordinated Securities			\$ 75,550,612	\$ 51,609,028

CLO Rated-Note Investment

<u>Portfolio Company</u>	<u>Investment</u>	<u>Percentage Ownership</u>	<u>Amortized Cost</u>	<u>Fair Value²</u>
Catamaran CLO 2014-1 Ltd. ^{3, 6}	Float - 04/2026 - E - 14889FAC7	15.1%	\$ 1,444,363	\$ 1,390,000
Total Investment in CLO Rated-Note			<u>\$ 1,444,363</u>	<u>\$ 1,390,000</u>
Total Investment in CLO Fund Securities (28% of net asset value at fair value)			<u>\$ 76,994,975</u>	<u>\$ 52,999,028</u>

Asset Manager Affiliates

<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Ownership</u>	<u>Cost</u>	<u>Fair Value²</u>
Asset Manager Affiliates ^{8, 10}	Asset Management Company	100.0%	\$ 54,691,230	\$ 36,942,000
Total Investment in Asset Manager Affiliates (19% of net asset value at fair value)			<u>\$ 54,691,230</u>	<u>\$ 36,942,000</u>

Time Deposits and Money Market Account

<u>Time Deposit and Money Market Accounts</u>	<u>Investment</u>	<u>Yield</u>	<u>Amortized Cost</u>	<u>Fair Value²</u>
JP Morgan Business Money Market Account ^{7, 8}	Money Market Account	0.10%	\$ 14,268	\$ 14,268
US Bank Money Market Account ⁸	Money Market Account	0.02%	22,660,522	22,660,522
Total Investment in Time Deposit and Money Market Accounts (12% of net asset value at fair value)			<u>\$ 22,674,790</u>	<u>\$ 22,674,790</u>
Total Investments⁴ (186% of net asset value at fair value)			<u>\$ 412,382,593</u>	<u>\$ 355,176,313</u>

- 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, 2017. As noted in the table above, 93% (based on par) of debt securities contain LIBOR floors which range between 0.75% and 3.0%.
- 2 Reflects the fair market value of all investments as of March 31, 2017, 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 \$420 million. The aggregate gross unrealized appreciation is approximately \$2.2 million, the aggregate gross unrealized depreciation is approximately \$67.1 million, and the net unrealized depreciation is approximately \$64.9 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 Money market account holding restricted cash and security deposits for employee benefit plans.
- 8 Qualified asset for purposes of section 55(a) of the Investment Company Act of 1940.
- 9 As of March 31, 2017, this investment is owned by KCAP Senior Funding I, LLC and was pledged to secure KCAP Senior Funding I, LLC's debt obligation.
- 10 Other than the Asset Manager Affiliate, which we are deemed to "control", we do not "control" and are not an "affiliate" of any of our portfolio companies, each as defined in the Investment Company Act of 1940 (the "1940 Act"). In general, under the 1940 Act, we would be presumed to "control" a portfolio company if we owned 25% or more of its voting securities and would be an "affiliate" of a portfolio company if we owned 5% or more of its voting securities.
- 11 Non-voting.
- 12 CLO Subordinated Investments are entitled to periodic distributions which are generally equal to the remaining cash flow of the payments made by the underlying fund's investments less contractual payments to debt holders and fund expenses. The estimated annualized effective yield indicated is based upon a current projection of the amount and timing of these distributions. Such projections are updated on a quarterly basis and the estimated effective yield is adjusted prospectively.
- 13 Notice of redemption has been received for this transaction.
- 14 Loan or security was on partial non-accrual status, whereby we have recognized income on a portion of contractual PIK amounts due.

KCAP FINANCIAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS
As of December 31, 2016

Debt Securities Portfolio

Portfolio Company/Principal Business	Investment Interest Rate ⁽¹⁾ /Maturity	Principal	Amortized Cost	Fair Value ⁽²⁾
1A Smart Start LLC ⁽⁸⁾ , ⁽⁹⁾ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 2/22	\$ 2,970,000	\$ 2,946,408	\$ 2,919,807
4L Technologies Inc. (fka Clover Holdings, Inc.) ⁽⁸⁾ , ⁽⁹⁾ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 5/20	2,720,465	2,705,259	2,606,194
Advanced Lighting Technologies, Inc. ⁽⁸⁾ , ⁽⁹⁾ , ⁽¹⁴⁾ <i>Consumer goods: Durable</i>	First Lien Bond — 12.500% — 6/2019 — 00753CAG7 5.3% Cash, 7.3% PIK, Due 6/19	3,060,919	3,060,919	1,089,338
Advantage Sales & Marketing Inc. ⁽⁸⁾ <i>Services: Business</i>	Junior Secured Loan — Term Loan (Second Lien) 7.5% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	1,001,753	995,300
Alere Inc. (fka IM US Holdings, LLC) ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — B Term Loan 4.3% Cash, 1.0% Libor Floor, Due 6/22	3,030,277	3,024,429	3,034,489
American Seafoods Group LLC ⁽⁸⁾ , ⁽⁹⁾ <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/21	3,853,704	3,838,792	3,874,899
Anaren, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 2/21	1,871,912	1,860,822	1,864,237
Apco Holdings, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan 7.0% Cash, 1.0% Libor Floor, Due 1/22	3,867,838	3,769,454	3,900,714
API Technologies Corp. ⁽⁸⁾ , ⁽⁹⁾ <i>High Tech Industries</i>	Senior Secured Loan — Initial Term Loan 7.5% Cash, 1.0% Libor Floor, Due 4/22	3,482,500	3,420,642	3,480,759
Aristotle Corporation, The ⁽⁸⁾ , ⁽⁹⁾ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 6/21	3,665,860	3,652,075	3,604,274
Asurion, LLC (fka Asurion Corporation) ⁽⁸⁾ , ⁽⁹⁾ <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Incremental Tranche B-4 Term Loan 5.0% Cash, 1.0% Libor Floor, Due 8/22	876,911	873,399	889,736
Asurion, LLC (fka Asurion Corporation) ⁽⁸⁾ , ⁽⁹⁾ <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Replacement B-2 Term Loan 4.0% Cash, 0.8% Libor Floor, Due 7/20	187,812	188,275	189,719
Avalign Technologies, Inc. ⁽⁸⁾ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 9.5% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	992,078	985,000
Avalign Technologies, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 7/21	2,925,000	2,913,921	2,915,640
Bankruptcy Management Solutions, Inc. ⁽⁸⁾ <i>Services: Business</i>	Senior Secured Loan — Term B Loan 7.0% Cash, 1.0% Libor Floor, Due 6/18	665,654	665,654	655,935
BarBri, Inc. (Gemini Holdings, Inc.) ⁽⁸⁾ , ⁽⁹⁾ <i>Services: Consumer</i>	Senior Secured Loan — Term Loan 4.5% Cash, 1.0% Libor Floor, Due 7/19	2,619,636	2,614,056	2,578,508
BBB Industries US Holdings, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Automotive</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 11/21	2,947,500	2,906,715	2,800,125

Bestop, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Automotive</i>	Senior Secured Loan — Delayed Draw Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	34,660	32,776	34,466
Bestop, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Automotive</i>	Senior Secured Loan — First Amendment Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	500,000	495,290	497,200

See accompanying notes to financial statements.

Portfolio Company/Principal Business	Investment Interest Rate ⁽¹⁾ /Maturity	Principal	Amortized Cost	Fair Value ⁽²⁾
Bestop, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Automotive</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	\$ 1,520,000	\$ 1,498,330	\$ 1,452,512
Carolina Beverage Group LLC ⁽⁸⁾ <i>Beverage, Food and Tobacco</i>	Senior Secured Bond — 10.625% – 08/2018 – 143818AA0 144A 10.6% Cash, Due 8/18	1,500,000	1,506,461	1,487,400
CCS Intermediate Holdings, LLC ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 7/21	2,932,500	2,922,875	2,470,338
Cengage Learning, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — 2016 Refinancing Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/23	3,793,913	3,788,981	3,702,043
Checkout Holding Corp. (fka Catalina Marketing) ⁽⁸⁾ , ⁽⁹⁾ <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 4/21	975,000	972,021	853,125
CHS/Community Health Systems, Inc. ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Incremental 2021 Term H Loan 4.0% Cash, 1.0% Libor Floor, Due 1/21	2,878,621	2,853,070	2,796,465
Consolidated Communications, Inc. ⁽⁹⁾ <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.0% Cash, 1.0% Libor Floor, Due 10/23	2,067,444	2,062,450	2,067,444
CRGT Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>High Tech Industries</i>	Senior Secured Loan — Term Loan 7.5% Cash, 1.0% Libor Floor, Due 12/20	3,224,017	3,190,360	3,224,339
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) ⁽⁸⁾ <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	3,011,328	2,463,000
CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) (aka HealthPort) ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — New Term Loan Facility 5.3% Cash, 1.0% Libor Floor, Due 12/21	2,940,225	2,917,719	2,818,941
Drew Marine Group Inc. ⁽⁸⁾ <i>Transportation: Cargo</i>	Junior Secured Loan — Term Loan (Second Lien) 8.0% Cash, 1.0% Libor Floor, Due 5/21	2,500,000	2,496,331	2,380,000
Eastem Power, LLC (Eastem Covert Midco, LLC) (aka TPF II LC, LLC) ⁽⁸⁾ , ⁽⁹⁾ <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 10/21	2,796,756	2,814,422	2,826,122
Electric Lightwave Holdings, Inc. (f.k.a. Integra Telecom Holdings, Inc.) ⁽⁸⁾ , ⁽⁹⁾ <i>Telecommunications</i>	Senior Secured Loan — Term B-1 Loan 5.3% Cash, 1.0% Libor Floor, Due 8/20	2,932,538	2,924,968	2,945,734
ELO Touch Solutions, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 6/18	1,420,897	1,397,046	1,380,544
Empower Payments Acquisition, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Services: Business</i>	Senior Secured Loan — Term Loan 6.5% Cash, 1.0% Libor Floor, Due 11/23	3,000,000	2,940,565	2,940,000
EWT Holdings III Corp. (fka WTG Holdings III Corp.) ⁽⁸⁾ , ⁽⁹⁾ <i>Ecological</i>	Senior Secured Loan — Term Loan (First Lien) 4.8% Cash, 1.0% Libor Floor, Due 1/21	1,745,501	1,741,292	1,760,783
Fender Musical Instruments Corporation ⁽⁸⁾ , ⁽⁹⁾ <i>Consumer goods: Durable</i>	Senior Secured Loan — Initial Loan 5.8% Cash, 1.3% Libor Floor, Due 4/19	1,339,534	1,345,751	1,322,254
FHC Health Systems, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 5.0% Cash, 1.0% Libor Floor, Due 12/21	3,838,768	3,811,221	3,742,799
First American Payment Systems, L.P. ⁽⁸⁾ <i>Banking, Finance, Insurance & Real Estate</i>	Junior Secured Loan — Term Loan (Second Lien) 10.8% Cash, 1.3% Libor Floor, Due 4/19	1,796,448	1,783,840	1,742,555

Getty Images, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.3% Libor Floor, Due 10/19	2,140,569	2,147,692	1,874,775
GI Advo Opco, LLC ⁽⁸⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 11/21	247,500	245,474	223,913

See accompanying notes to financial statements.

Portfolio Company/Principal Business	Investment Interest Rate ⁽¹⁾ /Maturity	Principal	Amortized Cost	Fair Value ⁽²⁾
GI Advo Opco, LLC ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 11/21	\$ 2,722,500	\$ 2,700,224	\$ 2,463,046
GK Holdings, Inc. (aka Global Knowledge) ⁽⁸⁾ <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	1,478,209	1,465,650
GK Holdings, Inc. (aka Global Knowledge) ⁽⁸⁾ , ⁽⁹⁾ <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 1/21	2,450,000	2,433,329	2,446,080
Global Tel*Link Corporation ⁽⁸⁾ <i>Telecommunications</i>	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, 1.3% Libor Floor, Due 11/20	4,000,000	3,957,505	3,894,500
Gold Standard Baking, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.3% Cash, 1.0% Libor Floor, Due 4/21	2,462,500	2,453,554	2,461,269
Grande Communications Networks LLC ⁽⁸⁾ , ⁽⁹⁾ <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.5% Cash, 1.0% Libor Floor, Due 5/20	3,860,145	3,864,877	3,860,145
Grupo HIMA San Pablo, Inc. ⁽⁸⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 1/18	2,887,500	2,875,001	2,743,125
Grupo HIMA San Pablo, Inc. ⁽⁸⁾ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,000,000	6,953,618	6,370,000
Gymboree Corporation., The ⁽⁸⁾ , ⁽⁹⁾ <i>Retail</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.5% Libor Floor, Due 2/18	1,421,105	1,415,457	759,581
Hargray Communications Group, Inc. (HCP Acquisition LLC) ⁽⁸⁾ , ⁽⁹⁾ <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Term B-1 Loan 4.8% Cash, 1.0% Libor Floor, Due 6/19	2,887,075	2,860,733	2,926,166
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ⁽⁸⁾ , ⁽⁹⁾ <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Tranche B-3 Term Loan 7.0% Cash, 1.5% Libor Floor, Due 5/18	1,697,272	1,690,708	1,703,637
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ⁽⁸⁾ , ⁽⁹⁾ <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Tranche B-4 Term Loan 7.0% Cash, 1.0% Libor Floor, Due 8/19	1,387,500	1,384,229	1,391,545
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ⁽⁸⁾ , ⁽⁹⁾ <i>Media: Advertising, Printing & Publishing</i>	Senior Secured Loan — Tranche B-5 Term Loan 7.0% Cash, 1.0% Libor Floor, Due 12/19	1,385,417	1,369,287	1,395,980
Highland Acquisition Holdings, LLC (aka HealthSun Health Plans, Inc.) ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan B 6.5% Cash, 1.0% Libor Floor, Due 11/22	2,000,000	1,903,216	1,910,000
Hoffmaster Group, Inc. ⁽⁸⁾ <i>Forest Products & Paper</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.5% Cash, 1.0% Libor Floor, Due 11/24	1,600,000	1,552,544	1,524,640
Hoffmaster Group, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Forest Products & Paper</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 11/23	2,666,667	2,640,345	2,668,267
Industrial Services Acquisition, LLC (aka Evergreen/NAIC) ⁽⁸⁾ , ⁽⁹⁾ <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.0% Cash, 1.0% Libor Floor, Due 6/22	2,925,000	2,898,235	2,925,000
Kellemeyer Bergensons Services, LLC ⁽⁸⁾ , ⁽⁹⁾ <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 10/21	1,950,120	1,936,641	1,943,100

Key Safety Systems, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Automotive</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 8/21	1,394,077	1,389,440	1,411,851
Landslide Holdings, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 9/22	1,850,467	1,846,044	1,850,467
MB Aerospace ACP Holdings II Corp. ⁽⁸⁾ , ⁽⁹⁾ <i>Aerospace and Defense</i>	Senior Secured Loan — Initial Term Loan 6.5% Cash, 1.0% Libor Floor, Due 12/22	1,342,500	1,331,454	1,342,366

See accompanying notes to financial statements.

Portfolio Company/Principal Business	Investment Interest Rate ⁽¹⁾ /Maturity	Principal	Amortized Cost	Fair Value ⁽²⁾
Medrisk, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 2/23	\$ 1,985,000	\$ 1,967,461	\$ 1,985,000
MGOC, Inc. (fka Media General, Inc.) ⁽⁹⁾ <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — Term B Loan 4.0% Cash, 1.0% Libor Floor, Due 7/20	2,417,989	2,419,940	2,417,989
National Home Health Care Corp. ⁽⁸⁾ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.8% Cash, 1.0% Libor Floor, Due 12/22	1,500,000	1,477,675	1,477,500
National Home Health Care Corp. ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 12/21	3,000,000	2,970,280	2,970,000
Nellson Nutraceutical, LLC ⁽⁸⁾ , ⁽⁹⁾ <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	2,350,684	2,335,796	2,350,449
Nellson Nutraceutical, LLC ⁽⁸⁾ , ⁽⁹⁾ <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	2,066,562	2,052,899	2,066,355
Nielsen & Bainbridge, LLC ⁽⁸⁾ , ⁽⁹⁾ <i>Consumer goods: Durable</i>	Senior Secured Loan — Term Loan (First Lien) 6.2% Cash, 1.0% Libor Floor, Due 8/20	5,361,360	5,326,136	5,199,447
NM Z Parent Inc. (aka Zep, Inc.) ⁽⁸⁾ , ⁽⁹⁾ <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — 2016 Term Loan 5.0% Cash, 1.0% Libor Floor, Due 6/22	3,447,500	3,459,466	3,481,630
Novitex Acquisition, LLC (fka ARSloane Acquisition, LLC) ⁽⁸⁾ , ⁽⁹⁾ <i>Services: Business</i>	Senior Secured Loan — Tranche B-2 Term Loan (First Lien) 8.0% Cash, 1.3% Libor Floor, Due 7/20	1,941,336	1,899,875	1,882,707
Onex Carestream Finance LP ⁽⁸⁾ <i>Healthcare & 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	1,647,295
Onex Carestream Finance LP ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan (First Lien 2013) 5.0% Cash, 1.0% Libor Floor, Due 6/19	1,750,135	1,753,387	1,704,920
Otter Products, LLC (OtterBox Holdings, Inc.) ⁽⁸⁾ , ⁽⁹⁾ <i>Consumer goods: Durable</i>	Senior Secured Loan — Term B Loan 5.8% Cash, 1.0% Libor Floor, Due 6/20	2,600,266	2,587,099	2,507,697
PGX Holdings, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Services: Consumer</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.3% Cash, 1.0% Libor Floor, Due 9/20	3,620,714	3,598,052	3,626,381
Playpower, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Construction & Building</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 6/21	1,970,000	1,958,956	1,969,606
PrimeLine Utility Services LLC (fka FR Utility Services LLC) ⁽⁸⁾ , ⁽⁹⁾ <i>Energy: Electricity</i>	Senior Secured Loan — Initial Term Loan 6.5% Cash, 1.0% Libor Floor, Due 11/22	3,935,672	3,904,453	3,937,247
Priority Payment Systems Holdings, LLC ⁽⁸⁾ , ⁽⁹⁾ <i>Banking, Finance, Insurance & Real Estate</i>	Senior Secured Loan — Initial Term Loan 7.0% Cash, 1.0% Libor Floor, Due 1/23	4,000,000	3,960,000	3,960,000
PSC Industrial Holdings Corp. ⁽⁸⁾ , ⁽⁹⁾ <i>Environmental Industries</i>	Senior Secured Loan — Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 12/20	2,974,300	2,953,559	2,941,583
Q Holding Company (fka Lexington Precision Corporation) ⁽⁸⁾ , ⁽⁹⁾ <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Term B Loan 6.0% Cash, 1.0% Libor Floor, Due 12/21	2,992,366	2,962,443	2,962,443
Quad-C JH Holdings Inc. (aka Joerns Healthcare) ⁽⁸⁾ , ⁽⁹⁾ <i>Healthcare & Pharmaceuticals</i>	Senior Secured Loan — Term Loan A 6.0% Cash, 1.0% Libor Floor, Due 5/20	3,900,079	3,883,565	3,666,075

Ravn Air Group, Inc. ⁽⁸⁾ , ⁽⁹⁾ <i>Transportation: Consumer</i>	Senior Secured Loan — Initial Term Loan 5.3% Cash, 1.0% Libor Floor, Due 7/21	2,421,875	2,412,614	2,324,516
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See accompanying notes to financial statements.

Portfolio Company/Principal Business	Investment Interest Rate ⁽¹⁾/Maturity	Principal	Amortized Cost	Fair Value ⁽²⁾
Roscoe Medical, Inc. ⁽⁸⁾ <i>Healthcare & Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	6,700,000	6,666,733	6,499,000
Sandy Creek Energy Associates, L.P. ⁽⁸⁾ · ⁽⁹⁾ <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 11/20	2,613,239	2,606,016	2,204,921
Stafford Logistics, Inc. (dba Custom Ecology, Inc.) ⁽⁸⁾ · ⁽⁹⁾ <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 7.5% Cash, 1.0% Libor Floor, Due 8/21	\$ 2,709,639	\$ 2,694,201	\$ 2,677,395
Tank Partners Holdings, LLC ⁽⁸⁾ · ⁽¹⁴⁾ <i>Energy: Oil & Gas</i>	Senior Secured Loan — Loan 10.0% Cash, 4.0% PIK, 3.0% Libor Floor, Due 8/19	10,750,808	10,656,975	6,550,311
Terra Millennium Corporation ⁽⁸⁾ · ⁽⁹⁾ <i>Construction & Building</i>	Senior Secured Loan — First Out Term Loan 7.3% Cash, 1.0% Libor Floor, Due 10/22	4,000,000	3,960,202	3,960,000
TronAir Parent Inc. ⁽⁸⁾ · ⁽⁹⁾ <i>Aerospace and Defense</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 9/23	3,960,000	3,923,893	3,959,208
TRSO I, Inc. ⁽⁸⁾ <i>Energy: Oil & Gas</i>	Junior Secured Loan — Term Loan (Second Lien) 14.0% Cash, 1.0% Libor Floor, Due 12/19	1,000,000	991,495	1,000,000
U.S. Shipping Corp (fka U.S. Shipping Partners LP) ⁽⁸⁾ · ⁽⁹⁾ <i>Transportation: Cargo</i>	Senior Secured Loan — Tranche B-2 Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/21	1,392,213	1,391,361	1,312,857
USJ-IMECO Holding Company, LLC ⁽⁸⁾ · ⁽⁹⁾ <i>Transportation: Cargo</i>	Senior Secured Loan — Term Loan 7.0% Cash, 1.0% Libor Floor, Due 4/20	3,679,796	3,669,622	3,497,278
Verdesian Life Sciences, LLC ⁽⁸⁾ · ⁽⁹⁾ <i>Environmental Industries</i>	Senior Secured Loan — Initial Term Loan 6.0% Cash, 1.0% Libor Floor, Due 7/20	3,766,302	3,733,929	3,641,261
Weiman Products, LLC ⁽⁸⁾ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.8% Cash, 1.0% Libor Floor, Due 11/18	916,023	912,479	889,000
Weiman Products, LLC ⁽⁸⁾ · ⁽⁹⁾ <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.8% Cash, 1.0% Libor Floor, Due 11/18	4,567,552	4,550,168	4,432,809
WideOpenWest Finance, LLC ⁽⁸⁾ · ⁽⁹⁾ <i>Media: Broadcasting & Subscription</i>	Senior Secured Loan — New Term B Loan 4.5% Cash, 1.0% Libor Floor, Due 8/23	2,992,500	2,992,500	3,028,829
WireCo WorldGroup Inc. ⁽⁸⁾ <i>Capital Equipment</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, 1.0% Libor Floor, Due 9/24	3,000,000	2,956,358	3,000,000
WireCo WorldGroup Inc. (WireCo WorldGroup Finance LP) ⁽⁸⁾ · ⁽⁹⁾ <i>Capital Equipment</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 9/23	1,745,625	1,728,771	1,763,780
Total Investment in Debt Securities (122% of net asset value at fair value)		\$ 251,222,570	\$ 249,520,234	\$ 238,343,330

See accompanying notes to financial statements.

Equity Securities Portfolio

Portfolio Company/Principal Business	Investment	Percentage Interest/Shares	Amortized Cost	Fair Value ⁽²⁾
Aerostructures Holdings L.P. ^{(5), (8)} <i>Aerospace and Defense</i>	Partnership Interests	1.2%	\$ 1,000,000	\$ 100,549
Aerostructures Holdings L.P. ^{(5), (8)} <i>Aerospace and Defense</i>	Series A Preferred Interests	1.2%	250,960	1,183,746
Caribe Media Inc. (fka Caribe Information Investments Incorporated) ^{(5), (8)} <i>Media: Advertising, Printing & Publishing</i>	Common	1.3%	359,765	532,342
DBI Holding LLC ^{(5), (8)} <i>Services: Business</i>	Class A Warrants	3.2%	1	1,000
eInstruction Acquisition, LLC ^{(5), (8)} <i>Healthcare, Education and Childcare</i>	Membership Units	1.1%	1,079,617	1,000
FP WRCA Coinvestment Fund VII, Ltd. ^{(3), (5)} <i>Capital Equipment</i>	Class A Shares	1,500	1,500,000	811,268
Perseus Holding Corp. ^{(5), (8)} <i>Hotel, Gaming & Leisure</i>	Common	0.2%	400,000	1,000
Roscoe Investors, LLC ^{(5), (8)} <i>Healthcare & Pharmaceuticals</i>	Class A Units	1.6%	1,000,000	1,169,000
Tank Partners Holdings, LLC ^{(5), (8), (11)} <i>Energy: Oil & Gas</i>	Unit	5.8%	980,000	1,000
Tank Partners Holdings, LLC ^{(5), (8)} <i>Energy: Oil & Gas</i>	Warrants	1.3%	185,205	1,000
TRSO II, Inc. ^{(5), (8)} <i>Energy: Oil & Gas</i>	Common Stock	5.4%	1,680,161	1,253,450
New Millennium Holdco, Inc. (Millennium Health, LLC) ^{(5), (8)} <i>Healthcare & Pharmaceuticals</i>	Common	0.2%	1,953,299	1,000
Total Investment in Equity Securities (3% of net asset value at fair value)			<u>\$ 10,389,007</u>	<u>\$ 5,056,355</u>

See accompanying notes to financial statements.

CLO Fund Securities

CLO Subordinated Securities, Preferred Shares and Income Notes Investments

Portfolio Company	Investment ⁽¹²⁾	Percentage Ownership	Amortized Cost	Fair Value ⁽²⁾
Grant Grove CLO, Ltd. ⁽³⁾ , ⁽¹³⁾	Subordinated Securities, effective interest 0.1%, 1/21 maturity	22.2%	\$ 2,485,886	\$ 1,000
Katonah III, Ltd. ⁽³⁾ , ⁽¹³⁾	Preferred Shares, effective interest 0.1%, 5/15 maturity	23.1%	1,287,155	369,000
Katonah 2007-I CLO Ltd. ⁽³⁾ , ⁽⁶⁾	Preferred Shares, effective interest 30.8%, 4/22 maturity	100%	28,022,646	20,453,099
Trimaran CLO VII, Ltd. ⁽³⁾ , ⁽⁶⁾ , ⁽¹³⁾	Income Notes, effective interest 47.9%, 6/21 maturity	10.5%	1,643,920	1,195,152
Catamaran CLO 2012-1 Ltd. ⁽³⁾ , ⁽⁶⁾	Subordinated Notes, effective interest 3.1%, 12/23 maturity	24.9%	5,919,933	2,819,412
Catamaran CLO 2013- 1 Ltd. ⁽³⁾ , ⁽⁶⁾	Subordinated Notes, effective interest 14.9%, 1/25 maturity	23.5%	5,237,222	4,918,807
Catamaran CLO 2014-1 Ltd. ⁽³⁾ , ⁽⁶⁾	Subordinated Notes, effective interest 10.0%, 4/26 maturity	24.9%	7,818,484	4,546,682
Catamaran CLO 2014-2 Ltd. ⁽³⁾ , ⁽⁶⁾	Subordinated Notes, effective interest 10.9%, 10/26 maturity	24.9%	6,967,560	5,092,087
Dryden 30 Senior Loan Fund ⁽³⁾	Subordinated Notes, effective interest 36.2%, 11/25 maturity	7.5%	1,343,467	1,895,566
Catamaran CLO 2015-1 Ltd. ⁽³⁾ , ⁽⁶⁾	Subordinated Notes, effective interest 9.5%, 4/27 maturity	9.9%	4,543,317	3,223,255
Catamaran CLO 2016-1 Ltd. ⁽³⁾ , ⁽⁶⁾	Subordinated Notes, effective interest 13.9%, 1/29 maturity	24.9%	10,140,000	8,350,290
Total Investment in CLO Subordinated Securities			<u>\$ 75,409,590</u>	<u>\$ 52,864,350</u>

CLO Rated-Note Investments

Portfolio Company	Investment	Percentage Ownership	Amortized Cost	Fair Value ⁽²⁾
Catamaran CLO 2014-1 Ltd. ⁽³⁾ , ⁽⁶⁾	Float – 04/2026 – E – 14889FAC7, 6.6%, 4/26 maturity	15.1%	\$ 1,441,727	\$ 1,310,000
Total Investment in CLO Rated-Note			<u>\$ 1,441,727</u>	<u>\$ 1,310,000</u>
Total Investment in CLO Fund Securities (28% of net asset value at fair value)			<u>\$ 76,851,317</u>	<u>\$ 54,174,350</u>

Asset Manager Affiliates

Portfolio Company/Principal Business	Investment	Percentage Ownership	Cost	Fair Value ⁽²⁾
Asset Manager Affiliates ⁽⁸⁾ , ⁽¹⁰⁾	Asset Management Company	100%	\$ 55,341,230	\$ 40,198,000
Total Investment in Asset Manager Affiliates (21% of net asset value at fair value)			<u>\$ 55,341,230</u>	<u>\$ 40,198,000</u>

See accompanying notes to financial statements.

Time Deposits and Money Market Account

Time Deposit and Money Market Accounts	Investment	Yield	Par/Amortized Cost	Fair Value ⁽²⁾
JP Morgan Business Money Market Account (7), (8)	Money Market Account	0.1%	\$ 14,268	\$ 14,268
US Bank Money Market Account ⁽⁸⁾	Money Market Account	0.1%	<u>28,685,001</u>	<u>28,685,001</u>
Total Investment in Time Deposit and Money Market Accounts (15% of net asset value at fair value)			<u>\$ 28,699,269</u>	<u>\$ 28,699,269</u>
Total Investments ⁽⁴⁾ (188% of net asset value at fair value)			<u>\$ 420,801,057</u>	<u>\$ 366,471,304</u>

(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, 2016. As noted in the table above, 93% (based on par) of debt securities contain LIBOR floors which range between 0.75% and 3.0%.

(2) Reflects the fair market value of all investments as of December 31, 2016, 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 \$429 million. The aggregate gross unrealized appreciation is approximately \$2.1 million, the aggregate gross unrealized depreciation is approximately \$65.0 million, and the net unrealized depreciation is approximately \$62.9 million.

(5) Non-income producing.

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

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

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

(9) As of December 31, 2016, this investment is owned by KCAP Senior Funding I, LLC and was pledged to secure KCAP Senior Funding I, LLC's obligation.

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

(11) Non-voting.

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

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

(14) Loan or security was on partial non-accrual status, whereby we have recognized income on a portion of contractual PIK amounts due.

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.
CONSOLIDATED FINANCIAL HIGHLIGHTS
(unaudited)

	Three Months Ended	
	2017	2016
Per Share Data:		
Net asset value, at beginning of period	\$ 5.24	\$ 5.82
Net investment income ¹	0.09	0.13
Net realized gains from investments ¹	.4	(0.21)
Net change in unrealized (depreciation) on investments ¹	(0.08)	(0.10)
Net increase (decrease) in net assets resulting from operations	0.01	(0.18)
Net decrease in net assets resulting from distributions:	(0.12)	(0.15)
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	\$ 5.14	\$ 5.50
Total net asset value return ²	0.4%	(2.9)%
Ratio/Supplemental Data:		
Per share market value at beginning of period	\$ 3.98	\$ 4.07
Per share market value at end of period	\$ 4.07	\$ 3.60
Total market return ³	5.3%	(7.9)%
Shares outstanding at end of period	37,209,649	37,130,433
Net assets at end of period	\$ 191,429,890	\$ 204,387,728
Portfolio turnover rate	10.4%	1.8%
Average par debt outstanding	\$ 180,880,925	\$ 204,443,692
Asset coverage ratio	203%	205%
Ratio of net investment income to average net assets ⁵	6.7%	9.1%
Ratio of total expenses to average net assets ⁵	9.4%	9.0%
Ratio of interest expense to average net assets ⁵	4.5%	4.9%
Ratio of non-interest expenses to average net assets ⁵	4.9%	4.1%

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

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

³ 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.

⁴ Balance rounds to less than \$0.01.

⁵ Annualized.

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. ORGANIZATION

KCAP Financial, Inc. (“KCAP” or the “Company”) is an internally managed, non-diversified closed-end investment company that is regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (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 (collectively, “Katonah Debt Advisors”) and in securities issued by collateralized loan obligation funds (“CLO Funds”) managed by Katonah Debt Advisors and two other asset managers.

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

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

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

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

As of March 31, 2017, Katonah Debt Advisors and Trimaran Advisors, as well as affiliated management companies Katonah 2007-1 Management, L.L.C. and Trimaran Advisors Management, L.L.C. (collectively the “Asset Manager Affiliates”), had approximately \$2.8 billion of par value assets under management. The Asset Manager Affiliates are each managed independently from KCAP by a separate management team (however, certain of the Company’s executive officers also act in similar capacities for one or both of the Asset Manager Affiliates). The Asset Manager Affiliates provide investment management services to CLO Funds, making day-to-day investment decisions concerning the assets of the CLO Funds. The Asset Manager Affiliates do not have any investments in the CLO Funds they manage; however, KCAP holds investments in a portion of the securities issued by the CLO Funds managed by the Asset Manager Affiliates.

The Company has three principal areas of investment:

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

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

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

The Company may also invest in other investments such as loans to 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 U.S. generally accepted accounting principles (“U.S. 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, 2016, 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 the Company to make significant estimates and assumptions including with respect to the fair value of investments that do not have a readily available market value. Actual results could differ from those estimates, and the differences could be material. 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 Kolhberg Capital Funding LLC I, KCAP Senior Funding I, LLC and KCAP Senior Funding I Holdings, LLC in its consolidated financial statements as they are operated solely for investment activities of the Company. The creditors of KCAP Senior Funding I, LLC have received security interests in the assets owned by KCAP Senior Funding I, LLC and such assets are not intended to be available to the creditors of KCAP Financial, Inc., or any other affiliate.

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

Notwithstanding the foregoing, the Asset Manager Affiliates qualify as a “significant subsidiary” under Regulation S-X promulgated by the SEC and, as a result, the Company is required to include additional financial information regarding the Asset Manager Affiliates in its filings with the SEC. This additional financial information regarding the Asset Manager Affiliates does not directly impact the financial position or results of operations of the Company.

In addition, in accordance with 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 is set forth in Note 5 to these consolidated financial statements.

The determination of the tax character of stockholder distributions is made on an annual (full calendar-year) basis at the end of the year based upon our taxable income for the full year and the distributions paid during the full year. Therefore, an estimate of tax attributes made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year.

It is the Company's primary investment objective to generate current income and capital appreciation by lending directly to privately-held middle market companies. During the quarter ended March 31, 2017, the Company provided approximately \$36 million to portfolio companies to support their growth objectives. None of this support was contractually obligated. See also Note 8 – Commitments and Contingencies. As of March 31, 2017, the Company held loans it has made to 78 investee companies with aggregate principal amounts of approximately \$244.9 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, among other things, leading a syndicate of lenders to provide the investee companies with financing. During the three months month period ended March 31, 2017, the Company did not engage in any such or similar activities.

FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers, which updated accounting guidance for all revenue recognition arising from contracts with customers, and also affects entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other US GAAP requirements). This update provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. The FASB also issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date of the standard for one year. As a result, the guidance is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Management is still evaluating the effect of the new standard.

In March 2016, the FASB issued ASU 2016-09 Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). The amendments in ASU 2016-09 affect all entities that issue share-based payment awards to their employees and involve multiple aspects of the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public business entities, ASU 2016-09 is effective for annual periods beginning after December 15 2016, and interim periods within those annual periods. Early adoption is permitted. We adopted 2016-09 during the first quarter of 2017 and there was no impact from adoption.

In November 2016, the FASB issued Accounting Standards Update 2016-18, Restricted Cash ("ASU 2016-18") which requires entities to show the changes in the total cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted, and entities will be required to apply the guidance retrospectively when adopted. We have early adopted ASU 2016-18 retrospectively during the first quarter of 2017 and earlier periods were restated. The following table depicts the retroactive application of ASU 2016-18:

Consolidated Statements of Cash Flows

	Three Months Ended March 31, 2016
Net cash (used in) financing activities as reported	\$ (21,725,500)
Impact of Adoption	(2,864,518)
Net cash (used in) financing activities after adoption	\$ (24,590,018)

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 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 Securities fair value model relative to its functionality, model inputs and calculations as a reasonable method to determine fair values of CLO Securities, in the absence of Level I or Level II trading activity or observable market inputs. The independent valuation firm's 2016 annual review concluded that the Company's model appropriately factors in all the necessary inputs required to build an equity cash flow model for CLO Securities for fair value purposes and that the inputs were being employed correctly.

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

The Board of Directors may consider other methods of valuation than those set forth below to determine the fair value of Level III investments as appropriate in conformity with U.S. 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 be used to determine the fair value of the investments. 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 (as defined below). 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 (as defined below), 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 the amount 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 and quarterly interest and principal distribution (if any) to holders of notes issued by KCAP Senior Funding I, LLC.

Cash and Restricted Cash are comprised of:

	<u>As of</u> <u>March 31, 2017</u>	<u>As of</u> <u>December 31, 2016</u>
Cash	\$ 5,178,290	\$ 1,307,257
Restricted Cash	7,986,487	8,528,298
Total Cash and Restricted Cash	<u>\$ 13,164,777</u>	<u>\$ 9,835,555</u>

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 and also includes restricted cash held under employee benefit plans.

Interest Income. Interest income, including the amortization of premium and accretion of discount and accrual of payment-in-kind ("PIK") interest, 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 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. For investments with PIK interest, which represents contractual interest accrued and added to the principal balance that generally becomes due at maturity, we will not accrue PIK interest if the portfolio company valuation indicates that the PIK interest is not collectible (i.e. via a partial or full non-accrual). Loans which are on partial or full non-accrual 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, 2017, two of our investments were on partial non-accrual status, whereby we have recognized income on a portion of contractual PIK amounts due.

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

Investment Income on CLO Fund Securities. The Company generates investment income from its investments in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by the Asset Manager Affiliates and select 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.

U.S. 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 U.S. GAAP statement of operations differs from both the tax-basis investment income and from the cash distributions actually received by the Company during the period.

For non-junior class CLO Fund securities, such as the Company's investment in the Class E Notes of the Catamaran CLO 2014-1 Ltd., 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 expected term of the borrowing.

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

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

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

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

3. EARNINGS (LOSSES) PER SHARE

In accordance with the provisions of ASC 260, "Earnings per Share", 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, 2017 and 2016 (unaudited):

	(unaudited)	
	Three Months Ended March 31,	
	2017	2016
Net increase (decrease) in net assets resulting from operations	\$385,552	\$(6,842,699)
Net (decrease) increase in net assets allocated to unvested share awards	(4,238)	123,579
Net increase (decrease) in net assets available to common stockholders	\$ 381,314	\$ (6,719,120)
Weighted average number of common shares outstanding for basic shares computation	<u>37,202,996</u>	<u>37,109,735</u>
Weighted average number of common and common stock equivalent shares outstanding for diluted shares computation	<u>37,202,996</u>	<u>37,109,735</u>
Net increase in net assets per basic common shares:		
Net increase in net assets from operations	\$ 0.01	\$ (0.18)
Net increase in net assets per diluted shares:		
Net increase in net assets from operations	\$ 0.01	\$ (0.18)

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

There were 50,000 options to purchase shares of common stock considered for the computation of the diluted per share information for the three months ended March 31, 2017 and 2016. Since the effects are anti-dilutive for both periods, the options were not included in the computation.

The Company's Convertible Notes were 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" for periods when the Convertible Notes were outstanding. 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. The Convertible Notes matured and were repaid in March 2016.

4. INVESTMENTS

The following table shows the Company's portfolio by security type at March 31, 2017 and December 31, 2016:

Security Type	March 31, 2017 (unaudited)			December 31, 2016		
	Cost/Amortized Cost	Fair Value	% ¹	Cost/Amortized Cost	Fair Value	% ¹
Money Market Accounts ³	\$ 22,674,790	\$ 22,674,790	6	\$ 28,699,269	\$ 28,699,269	8
Senior Secured Loan	202,900,985	196,533,708	56	207,701,078	200,322,152	55
Junior Secured Loan	40,171,813	38,545,305	11	37,251,776	35,444,440	10
First Lien Bond	3,054,338	1,089,338	-	3,060,919	1,089,338	-
Senior Secured Bond	1,505,454	1,489,350	-	1,506,461	1,487,400	-
CLO Fund Securities	76,994,975	52,999,028	15	76,851,317	54,174,350	15
Equity Securities	10,389,008	4,902,794	2	10,389,007	5,056,355	1
Asset Manager Affiliates ²	54,691,230	36,942,000	10	55,341,230	40,198,000	11
Total	\$ 412,382,593	\$ 355,176,313	100%	\$ 420,801,057	\$ 366,471,304	100%

¹ Represents percentage of total portfolio at fair value.

² Represents the equity investment in the Asset Manager Affiliates.

³ Includes restricted cash held under employee benefit plans.

The industry concentrations based on the fair value of the Company's investment portfolio as of March 31, 2017 and December 31, 2016, were as follows:

Industry Classification	March 31, 2017 (unaudited)			December 31, 2016		
	Cost/Amortized		% ¹	Cost/Amortized		% ¹
	Cost	Fair Value		Cost	Fair Value	
Aerospace and Defense	\$ 8,374,160	\$ 8,274,335	2%	\$ 8,394,633	\$ 8,450,106	2%
Asset Management Company ²	54,691,230	36,942,000	10	55,341,230	40,198,000	11
Automotive	7,801,993	7,769,075	2	6,322,551	6,196,154	2
Banking, Finance, Insurance & Real Estate	5,592,918	5,555,171	2	6,805,514	6,782,010	2
Beverage, Food and Tobacco	15,018,374	14,526,304	4	15,198,830	14,703,372	4
Capital Equipment	9,665,714	8,943,739	3	6,185,129	5,575,048	2
Chemicals, Plastics and Rubber	6,406,392	6,429,950	2	6,421,909	6,444,073	2
CLO Fund Securities	76,994,975	52,999,028	15	76,851,317	54,174,350	15
Construction & Building	5,891,717	5,940,196	2	5,919,158	5,929,606	2
Consumer goods: Durable	10,970,920	8,996,058	2	12,319,905	10,118,736	3
Consumer goods: Non-durable	14,247,238	14,148,705	4	14,766,390	14,452,096	4
Ecological	-	-	-	1,741,292	1,760,783	-
Energy: Electricity	3,895,827	3,928,014	1	3,904,453	3,937,247	1
Energy: Oil & Gas	14,658,057	10,181,138	3	14,493,835	8,805,761	2
Environmental Industries	13,924,571	13,589,885	4	12,279,924	12,185,239	3
Forest Products & Paper	4,188,710	4,209,862	1	4,192,889	4,192,907	1
Healthcare & Pharmaceuticals	57,616,979	53,624,475	15	58,769,668	53,594,534	15
High Tech Industries	10,963,154	11,019,979	3	9,854,093	9,936,109	3
Hotel, Gaming & Leisure	2,390,110	1,991,000	1	400,000	1,000	-
Media: Advertising, Printing & Publishing	11,441,315	11,207,306	3	11,712,682	11,453,447	3
Media: Broadcasting & Subscription	5,840,975	5,884,115	2	8,273,174	8,372,984	2
Retail	1,416,024	593,445	-	1,415,457	759,581	-
Services: Business	20,427,358	19,412,602	5	16,125,481	16,230,486	4
Services: Consumer	6,035,256	6,021,103	2	6,212,108	6,204,889	2
Telecommunications	6,017,657	5,986,937	2	12,809,799	12,767,823	3
Time Deposit and Money Market Accounts ³	22,674,790	22,674,791	6	28,699,269	28,699,269	8
Transportation: Cargo	7,423,418	7,118,789	2	7,557,315	7,190,135	2
Transportation: Consumer	2,397,545	2,317,219	1	2,412,614	2,324,516	1
Utilities: Electric	5,415,216	4,891,092	1	5,420,438	5,031,043	1
Total	\$ 412,382,593	\$355,176,313	100%	\$ 420,801,057	\$366,471,304	100%

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

² Represents the equity investment in the Asset Manager Affiliates.

³ Includes restricted cash held under employee benefit plans.

The Company may invest up to 30% of the investment portfolio in “non-qualifying” opportunistic investments, including investments in debt and equity securities of CLO Funds, distressed debt or debt and equity securities of large cap public companies. 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, 2017 and December 31, 2016, the total amount of non-qualifying assets was approximately 17% of total assets, for both periods. The majority of non-qualifying assets were foreign investments which were approximately 15% and 14%, respectively, of the Company’s total assets (including the Company’s investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 14% of its total assets for both periods).

The following tables detail the ten largest portfolio investments (at fair value) as of March 31, 2017 and December 31, 2016, respectively:

Investment	March 31, 2017		
	Cost/Amortized Cost	Fair Value	% of FMV
Asset Manager Affiliates	\$ 54,691,230	\$ 36,942,000	10%
US Bank Money Market Account	22,660,522	22,660,522	6
Katonah 2007-I CLO Ltd.	29,101,810	20,847,854	6
Grupo HIMA San Pablo, Inc.	9,831,239	9,134,800	3
Catamaran CLO 2016-1 Ltd.	10,478,346	8,365,500	2
Tank Partners Holdings, LLC	11,985,697	7,821,575	2
Roscoe Medical, Inc.	6,669,733	6,499,000	2
GK Holdings, Inc. (aka Global Knowledge)	5,892,434	5,879,408	2
Nielsen & Bainbridge, LLC	5,328,534	5,361,360	2
Weiman Products, LLC	4,964,167	4,904,989	1
Total	\$ 161,603,712	\$ 128,417,008	36%

Investment	December 31, 2016		
	Cost/Amortized Cost	Fair Value	% of FMV
Asset Manager Affiliates	\$ 55,341,230	\$ 40,198,000	11%
US Bank Money Market Account	28,685,001	28,685,001	8
Katonah 2007-I CLO Ltd.	28,022,646	20,453,099	6
Grupo HIMA San Pablo, Inc.	9,828,619	9,113,125	2
Catamaran CLO 2016-1 Ltd.	10,140,000	8,350,290	2
Tank Partners Holdings, LLC	11,822,180	6,552,311	2
Roscoe Medical, Inc.	6,666,733	6,499,000	2
Weiman Products, LLC	5,462,647	5,321,809	1
Nielsen & Bainbridge, LLC	5,326,136	5,199,447	1
Catamaran CLO 2014-2 Ltd.	6,967,560	5,092,087	1
Total	\$ 168,262,752	\$ 135,464,169	36%

Excluding the Asset Manager Affiliates, CLO Fund securities and Money Market Accounts, the Company's ten largest portfolio companies represented approximately 16% and 13% of the total fair value of the Company's investments at March 31, 2017 and December 31, 2016, respectively.

Investments in CLO Fund Securities

The Company typically makes a minority investment in the most junior class of securities (typically preferred shares or subordinated securities) of CLO Funds managed by the Asset Manager Affiliates and may selectively invest in securities issued by CLO funds managed by other asset management companies. These 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 2016, the Company purchased \$10.1 million of the par value of the Subordinated Notes of Catamaran 2016-1 CLO ("Catamaran 2016-1") managed by Trimaran Advisors.

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

All CLO Funds managed by the Asset Manager Affiliates are currently making quarterly distributions to the Company with respect to its interests in the CLO Funds and are paying all senior and subordinate management fees to the Asset Manager Affiliates. In January 2017, the trustees of Trimaran CLO VII, Ltd. (Trimaran VII) received notice that the holders of a majority of the income notes issued by Trimaran VII had exercised their right of optional redemption. With the exception of Katonah III, Ltd. and Grant Grove CLO, Ltd. (both of which have been called), all third-party managed CLO Funds are making distributions to the Company.

Fair Value Measurements

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

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

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

Level II – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date. Such inputs may be quoted prices for similar assets or 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. The Company’s fair value determinations 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, 2017 (unaudited) and December 31, 2016, respectively:

	As of March 31, 2017 (unaudited)			
	Level I	Level II	Level III	Total
Money market accounts	\$ —	\$ 22,674,790	\$ —	\$ 22,674,790
Debt securities	—	60,373,139	177,284,562	237,657,701
CLO Fund securities	—	—	52,999,028	52,999,028
Equity securities	—	—	4,902,794	4,902,794
Asset Manager Affiliates	—	—	36,942,000	36,942,000
Total	\$ —	\$ 83,047,929	\$ 272,128,384	\$ 355,176,313

	As of December 31, 2016			
	Level I	Level II	Level III	Total
Money market accounts	\$ —	\$ 28,699,269	\$ —	\$ 28,699,269
Debt securities	—	84,601,585	153,741,745	238,343,330
CLO Fund securities	—	—	54,174,350	54,174,350
Equity securities	—	—	5,056,355	5,056,355
Asset Manager Affiliates	—	—	40,198,000	40,198,000
Total	\$ —	\$ 113,300,854	\$ 253,170,450	\$ 366,471,304

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. Certain information relating to investments measured at fair value for which the Company has used unobservable inputs to determine fair value is as follows:

	Three Months Ended March 31, 2017 (unaudited)				
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Total
Balance, December 31, 2016	\$ 153,741,745	\$ 54,174,350	\$ 5,056,355	\$ 40,198,000	\$ 253,170,450
Transfers out of Level III ¹	(9,588,627)	—	—	—	(9,588,627)
Transfers into Level III ²	35,280,388	—	—	—	35,280,388
Net accretion of discount	87,591	143,658	—	—	231,249
Purchases	3,125,048	—	1	—	3,125,049
Sales / Paydowns / Return of Capital	(6,742,543)	—	—	(650,000)	(7,392,543)
Total realized gain included in earnings	34,806	—	—	—	34,806
Total unrealized gain (loss) included in earnings	1,346,154	(1,318,980)	(153,562)	(2,606,000)	(2,732,388)
Balance, March 31, 2017	<u>\$ 177,284,562</u>	<u>\$ 52,999,028</u>	<u>\$ 4,902,794</u>	<u>\$ 36,942,000</u>	<u>\$ 272,128,384</u>
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	<u>\$ 1,360,306</u>	<u>\$ (1,318,980)</u>	<u>\$ (154,562)</u>	<u>\$ (2,606,000)</u>	<u>\$ (2,719,236)</u>

¹Transfers out of Level III represent a transfer of \$9,588,627 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were observable as of March 31, 2017

²Transfers into Level III represent a transfer of \$35,280,388 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of March 31, 2017

Year Ended December 31, 2016

	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Total
Balance, December 31, 2015	\$ 183,400,465	\$ 55,872,382	\$ 9,103,003	\$ 57,381,000	\$ 305,756,850
Transfers out of Level III ¹	(14,855,471)	—	—	—	(14,855,471)
Transfers into Level III ²	22,107,141	—	445,485	—	22,552,626
Net accretion of discount	318,999	(2,192,069)	—	—	(1,873,070)
Purchases	33,641,315	10,140,000	180,161	—	43,961,476
Sales/Paydowns/ Return of Capital	(66,559,349)	(4,200,000)	(4,743,682)	(1,250,000)	(76,753,031)
Total realized gain (loss) included in earnings	(366,924)	(10,111,560)	4,484,742	—	(5,993,742)
Total unrealized gain (loss) included in earnings	(3,944,431)	4,665,597	(4,413,354)	(15,933,000)	(19,625,188)
Balance, December 31, 2016	<u>\$ 153,741,745</u>	<u>\$ 54,174,350</u>	<u>\$ 5,056,355</u>	<u>\$ 40,198,000</u>	<u>\$ 253,170,450</u>
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	<u>\$ (6,969,509)</u>	<u>\$ 4,665,597</u>	<u>\$ (4,413,354)</u>	<u>\$ (15,933,000)</u>	<u>\$ (22,650,266)</u>

¹Transfers out of Level III represent a transfer of \$14,855,471 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were observable as of December 31, 2016.

²Transfers into Level III represent a transfer of \$22,107,141 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of December 31, 2016.

As of March 31, 2017 and December 31, 2016, 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 \$83,047,929 and \$113,300,854 as of March 31, 2017 and December 31, 2016, respectively.

As of March 31, 2017, the Company's Level III portfolio investments had the following valuation techniques and significant inputs:

Type	Fair Value	Primary Valuation Methodology	Unobservable Inputs	Range of Inputs (Weighted Average)
Debt Securities	\$ 8,908,912	Enterprise Value	Average EBITDA Multiple	5.3x
	\$ 168,375,650	Income Approach	Implied Discount Rate	5.7% – 22.6% (9.3)%
Equity Securities	\$ 4,895,794	Enterprise Value	Average EBITDA Multiple/WAAC	4.3x/6.7% – 15.5x/14.2% (9.5x/11.4)%
	\$ 7,000	Options Value	Qualitative Inputs ¹	
CLO Fund Securities	\$ 44,633,528	Discounted Cash Flow	Discount Rate	9.6% – 13.0% (13.0)%
			Probability of Default	2.0% – 2.5% (2.0)%
			Loss Severity	25.0% – 25.9% (25.9)%
			Recovery Rate	74.1% – 75% (74.1)%
			Prepayment Rate	25.0% – 29.1% (25.1)%
Asset Manager Affiliate	\$ 36,942,000	Market Approach	3rd Party Quote	82.5% (82.5)%
Total Level III Investments	<u>\$ 272,128,384</u>	Discounted Cash Flow	Discount Rate	2.5% – 13.0% (7.1)%

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

As of December 31, 2016, the Company's Level III portfolio investments had the following valuation techniques and significant inputs:

Type	Fair Value	Primary Valuation Methodology	Unobservable Inputs	Range of Inputs (Weighted Average)
Debt Securities	\$ 7,639,648	Enterprise Value	Average EBITDA Multiple	5.3x
	\$ 146,102,097	Income Approach	Implied Discount Rate	5.6% – 21.5% (9.15)%
Equity Securities	\$ 5,050,355	Enterprise Value	Average EBITDA Multiple/WAAC	4.8x/7.4% – 14.1x/13.9% (9.3x/12.0)%
	\$ 6,000	Options Value	Qualitative Inputs ¹	
CLO Fund Securities	\$ 45,824,060	Discounted Cash Flow	Discount Rate	11.8% – 13.0% (13.0)%
			Probability of Default	2.0% – 2.5% (2.0)%
			Loss Severity	25.0% – 25.9% (25.9)%
			Recovery Rate	74.1% – 75% (74.2)%
			Prepayment Rate	25.0% – 29.1% (25.1)%
Asset Manager Affiliate	\$ 8,350,290	Market Approach	3rd Party Quote	82.35% (82.35)%
Total Level III Investments	<u>\$ 40,198,000</u>	Discounted Cash Flow	Discount Rate	2.5% – 13.0% (7.6)%
	<u>\$ 253,170,450</u>			

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

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

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

Significant unobservable 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, 2017 and December 31, 2016, the Asset Manager Affiliates had approximately \$2.8 billion and \$3.0 billion of par value of assets under management, respectively, and the Company's 100% equity interest in the Asset Manager Affiliates had a fair value of approximately \$36.9 million and \$40.2 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. During the first quarter of 2017, the Asset Manager Affiliates recognized \$2.9 million of incentive fee revenue from Trimaran VII, which was called in January 2017. Currently, all CLO Funds managed by the Asset Manager Affiliates are paying both their senior and subordinated management fees on a current basis.

For the three months ended March 31, 2017 and 2016, the Asset Manager Affiliates declared cash distributions of \$650,000 and \$1.1 million to the Company, respectively. Any distributions from the Asset Manager Affiliates out of their estimated tax-basis earnings and profits are recorded as "Dividends from Asset Manager Affiliates" on the Company's statement of operations. The Company recognized \$550,000 of Dividends from Asset Manager Affiliates in the Statement of Operations in the first quarter of 2016. The difference between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e., tax-basis return of capital). For the quarters ended March 31, 2017 and 2016 the difference of \$650,000 and \$500,000, 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). 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.

On February 18, 2015, the FASB issued Accounting Standards Update 2015-2 ("ASU 2015-2"), which updated consolidation standards under ASC Topic 810, "Consolidation". Under this update, a new consolidation analysis is required for VIEs and will limit the circumstances in which investment managers and similar entities are required to consolidate the entities that they manage. The FASB decided to eliminate some of the criteria under which management 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 was effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2015, early adoption was permitted. The Asset Manager Affiliates adopted ASU 2015-2 in 2016 which resulted in the deconsolidation of the CLO Funds. In accordance with Regulation S-X, additional financial information with respect to the Asset Manager Affiliates and one of the CLO Funds in which the Company has an investment, Katonah 2007-I CLO, is required to be included in the Company's SEC Filings. This additional financial information regarding the Asset Manager Affiliates and Katonah 2007-1 CLO does not directly impact the financial position, results of operations, or cash flows of the Company.

Asset Manager Affiliates
Summarized Balance Sheet (unaudited)

	As of	As of
	March 31, 2017	December 31, 2016
Cash	\$ 2,467,358	\$ 3,425,709
Intangible Assets	22,830,000	23,157,541
Other Assets	4,717,333	5,024,174
Total Assets	\$ 30,014,691	\$ 31,607,424
Total Liabilities	\$ 4,407,706	\$ 6,619,619
Total Equity	25,606,985	24,987,805
Total Liabilities and Equity	\$ 30,014,691	\$ 31,607,424

Asset Manager Affiliates
Summarized Statements of Operations Information (unaudited)

	For the three months ended	
	March 31,	
	2017	2016
Fee Revenue	\$ 5,884,196	\$ 3,329,627
Interest Income	2,175	153,832
Total Income	5,886,371	3,483,459
Operating Expenses	2,761,453	2,728,445
Amortization of Intangibles	327,541	327,541
Interest Expense	188,851	489,835
Total Expenses	3,277,845	3,545,821
Pre-Tax Income (Loss)	2,608,526	(62,362)
Income Tax Expense (Benefit)	1,339,344	(361,132)
Net Income	\$ 1,269,182	\$ 298,770

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

	As of March 31, 2017	As of December 31, 2016
Total Investments at Fair Value	\$ 129,245,053	\$ 176,684,976
Cash	48,913,885	34,982,770
Total Assets	178,527,776	212,160,163
CLO Debt at Fair Value	176,055,774	208,812,164
Total Liabilities	177,418,430	210,463,954
Total Net Assets	1,109,346	1,696,209

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

	For the three months ended March 31,	
	2017	2016
Interest Income from Investments	\$ 1,778,115	\$ 2,539,074
Total Income	1,843,333	2,565,008
Interest Expense	1,526,307	2,122,315
Total Expenses	1,802,182	2,426,062
Net Realized and Unrealized (Losses) Gains	(628,014)	3,557,707
(Decrease) Increase in net assets resulting from operations	(586,863)	3,696,652

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

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

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

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, and tax-basis intangible assets of \$15.7 million, which are being amortized for tax purposes on a straight-line basis over 15 years.

During the second quarter of 2016, KCAP contributed 100% of its ownership interests in Katonah Debt Advisors and Trimaran Advisors Management to Commodore Holdings, a wholly-owned subsidiary of KCAP. These transactions simplify the tax structure of the AMAs and facilitate the consolidation of tax basis goodwill deductions for the AMAs, which may impact the tax character of distributions from the AMAs.

Related Party Transactions

On February 26, 2013, the Company entered into a senior credit agreement (the “Trimaran Credit Facility”) with Trimaran Advisors, pursuant to which Trimaran Advisors may borrow from time to time up to \$20 million from the Company in order to provide capital necessary to support one or more of Trimaran Advisors’ warehouse lines of credit and/or working capital in connection with Trimaran Advisors’ warehouse activities. The Trimaran Credit Facility expires on November 20, 2017 and bears interest at an annual rate of 9.0%. Outstanding borrowings on the Trimaran Credit Facility are callable by the Company at any time. On April 15, 2013, the Trimaran Credit Facility was amended and upsized from \$20 million to \$23 million. At March 31, 2017 and December 31, 2016, there were no loans outstanding under the Trimaran Credit Facility. For the three months ended March 31, 2017 and 2016, the Company recognized interest income of approximately \$180,000 and \$482,000 related to the Trimaran Credit Facility, respectively.

6. BORROWINGS

The Company’s debt obligations consist of the following:

	As of March 31, 2017 <u>(unaudited)</u>	As of December 31, 2016 <u></u>
Notes issued by KCAP Senior Funding I, LLC (net of discount and offering costs of: 2017 - \$2,128,524 and \$2,289,547, respectively; 2016 - \$2,286,425 and \$2,459,156, respectively)	\$ 142,931,928	\$ 142,604,419
7.375% Notes Due 2019 (net of offering costs of: 2017 - \$505,488; 2016 - \$550,774)	33,025,437	32,980,151
	<u>\$ 175,957,365</u>	<u>\$ 175,584,570</u>

The weighted average stated interest rate and weighted average maturity on all our debt outstanding as of March 31, 2017 were 4.0% and 6.5 years, respectively, and as of December 31, 2016 were 3.9% and 6.7 years, respectively.

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 on July 20, 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 (“Additional Issuance Securities”) in a \$56,000,000 increase to the collateralized loan obligation transaction that originally closed on June 18, 2013 (the “Original Closing Date”). The issuance of additional notes was proportional across all existing classes of notes issued on the Original Closing Date.

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

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

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, 2017, there were 75 investments in portfolio companies with a total fair value of approximately \$186 million plus cash of \$8.0 million, collateralizing the secured notes of the Issuer. At March 31, 2017, there were unamortized issuance costs of approximately \$2.3 million, and unamortized original issue discount, (“OID”) of approximately \$2.1 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, 2017, interest expense, including the amortization of deferred debt issuance costs and the discount on the face amount of the notes was approximately \$1.5 million, respectively consisting of stated interest expense of approximately \$1.2 million, respectively, accreted discount of approximately \$158,000, respectively, and amortization of deferred debt issuance costs of approximately \$170,000, respectively. As of March 31, 2017 the stated interest charged under the securitization was based on current three month LIBOR at the reset date, which was 1.15%. 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 (1)</u>
KCAP Senior Funding LLC Class A Notes	2.65%	150	\$ 675,509
KCAP Senior Funding LLC Class B Notes	4.40%	325	133,825
KCAP Senior Funding LLC Class C Notes	5.40%	425	183,704
KCAP Senior Funding LLC Class D Notes	6.40%	525	196,833
Total			\$ 1,189,871

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

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

<u>Description</u>	<u>Class A Notes</u>	<u>Class B Notes</u>	<u>Class C Notes</u>	<u>Class D Notes</u>
Type	Senior Secured Floating Rate	Senior Secured Floating Rate	Secured Deferrable Floating Rate	Secured Deferrable Floating Rate
Amount Outstanding	\$108,150,000	\$12,600,000	\$14,000,000	\$12,600,000
Moody's Rating (sf)	"Aaa"	"Aa2"	"A2"	"Baa2"
Standard & Poor's Rating (sf)	"AAA"	"AA"	"A"	"BBB"
Interest Rate	LIBOR + 1.50 %	LIBOR + 3.25 %	LIBOR + 4.25 %	LIBOR + 5.25 %
Stated Maturity	July, 2024 B, C, D	July, 2024 C, D	July, 2024 D and	July, 2024
Junior Classes	and Subordinated	and Subordinated	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, 2017 (unaudited)		
	Principal Amount	Carrying Value	Fair Value
KCAP Senior Funding LLC Class A Notes	\$ 108,150,000	\$ 104,907,281	\$ 108,150,000
KCAP Senior Funding LLC Class B Notes	12,600,000	12,222,208	12,615,750
KCAP Senior Funding LLC Class C Notes	14,000,000	13,580,231	14,017,500
KCAP Senior Funding LLC Class D Notes	12,600,000	12,222,208	12,600,000
Total	\$ 147,350,000	\$ 142,931,928	\$ 147,383,250

Fair Value of KCAP Senior Funding I. The Company carries the KCAP Senior Funding I Notes at cost, net of unamortized discount and offering costs of approximately \$2.1 million and \$2.3 million, respectively. The fair value of the KCAP Senior Funding I Notes was approximately \$147.4 million and \$146.3 million at March 31, 2017 and December 31, 2016, respectively. 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.

7.375% Notes Due 2019

On October 10, 2012, the Company issued \$41.4 million in aggregate principal amount of unsecured 7.375% Notes Due 2019. The net proceeds for these Notes, after the payment underwriting expenses, were approximately \$39.9 million. Interest on the 7.375% Notes Due 2019 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 7.375%, commencing December 30, 2012. The 7.375% Notes Due 2019 mature on September 30, 2019 and are unsecured obligations of the Company. The 7.375% Notes Due 2019 are subject to redemption in whole or in part at any time or from time to time, at the option of the Company, on or after September 30, 2015, at a redemption price per security equal to 100% of the 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, 2017, the Company was in compliance with all of its debt covenants.

For the three months ended March 31, 2017 and 2016, interest expense related to the 7.375% Notes Due 2019 was approximately \$618,000 and \$763,000, respectively.

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 expected term of the facility on an effective yield method, of which approximately \$505,000 remains to be amortized, and is included on the consolidated balance sheets as a reduction in the related debt liability.

During the second quarter of 2016, the Company repurchased approximately \$2.4 million par value of the 7.375% notes due 2019 at a weighted average price of \$25.23 per \$25.00 note, resulting in a realized loss on extinguishment of \$71,190. KCAP subsequently surrendered these notes to the Trustee for cancellation.

During the third quarter of 2016, \$5.0 million par value of the 7.375% notes due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of \$88,015.

During the fourth quarter of 2016, approximately \$469,000 par value of the 7.375% notes due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of \$15,006.

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 \$34.1 million and \$34.2 million at March 31, 2017 and December 31, 2016, respectively. The fair value was determined based on the closing price on March 31, 2017 for the 7.375% Notes Due 2019. The 7.375% Notes Due 2019 are categorized as Level I under the ASC 820: Fair Value.

Convertible Notes

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

In connection with the issuance of the Convertible Notes, the Company incurred approximately \$2.4 million of debt offering costs which were amortized over the term of the Convertible Notes on an effective yield method. 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 trustee for cancellation effective September 13, 2013. During 2015 the Company repurchased approximately \$19.3 million face value of its own Convertible Notes at a price ranging from \$101.500 to \$102.375. KCAP subsequently surrendered these notes to the Trustee for cancellation. Due to the cash conversion option embedded in the Convertible Notes, the Company applied the guidance in ASC 470-20-40, Debt with Conversion and Other Options and realized a loss on the extinguishment of this debt. 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. The Convertible Notes matured and were fully repaid on March 15, 2016.

For the three months ended March 31, 2016, interest expense related to the Convertible Notes was approximately \$378,000.

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 substantially all 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 2017). 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 following reconciles net increase (decrease) in net assets resulting from operations to taxable income for the three months ended March 31, 2017:

	Three Months Ended March 31,	
	2017	2016
	(unaudited)	(unaudited)
Net increase in net assets resulting from operations	\$ 385,552	\$ (6,842,699)
Net change in unrealized depreciation from investments	2,876,525	3,795,581
Excess capital gains over capital losses	(43,938)	7,811,888
Book/tax differences on CLO equity investments	(850,932)	795,651
Other book/tax differences	44,086	372,351
Taxable income before deductions for distributions	\$ 2,411,293	\$ 5,932,772
Taxable income before deductions for distributions per weighted average basic shares for the period	\$ 0.06	\$ 0.16
Taxable income before deductions for distributions per weighted average diluted shares for the period	\$ 0.06	\$ 0.16

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, 2017 and 2016, the Asset Manager Affiliates declared cash distributions of \$650,000 and \$1.1 million to the Company, respectively. The Company recognized \$550,000 of dividends from Asset Manager Affiliates in the Statement of Operations in the first quarter of 2016. For the quarters ended March 31, 2017 and 2016 the difference of \$650,000 and \$500,000, 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).

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

At March 31, 2017, the Company had a net capital loss carryforward of \$90.8 million to offset net capital gains, to the extent provided by federal tax law. \$0.6 million of net capital loss carryforward expired in 2016. \$13.5 million and \$17.9 million of net capital loss carryforward is subject to expiration in 2017 and 2018, respectively. \$59.7 million of the net capital loss carryforward is not subject to expiration under the RIC Modernization Act of 2010.

On March 21, 2017 the Company's Board of Directors declared a distribution to shareholders of \$0.12 per share for a total of \$4.4 million. The record date was April 7, 2017 and the distribution was paid on April 28, 2017.

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, 2017 and December 31, 2016, the Company had \$565,000 outstanding commitments for both periods.

9. STOCKHOLDERS' EQUITY

During the three months ended March 31, 2017 and 2016, the Company issued 40,903 and 61,801 shares, respectively, of common stock under its dividend reinvestment plan. For the three months ended March 31, 2017, there were no grants of restricted stock, 9,548 shares were forfeited, and no shares vested. The total number of shares of the Company's common stock outstanding as of March 31, 2017 and December 31, 2016 was 37,209,649 and 37,178,294, respectively.

10. EQUITY INCENTIVE PLAN

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

Stock Options

On June 20, 2014, the Company's Board of Directors approved the amended and restated the Non-Employee Director Plan (the "Non-Employee Director Plan"), which was approved by shareholders on June 10, 2014. 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, 2016 through March 31, 2017 is as follows:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Contractual Remaining Term (years)	Aggregate Intrinsic Value ¹
Options outstanding at January 1, 2016	50,000	\$ 7.72		
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Options outstanding at December 31, 2016	50,000	\$ 7.72	2.4	\$ -
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Outstanding at March 31, 2017	<u>50,000</u>	<u>\$ 7.72</u>	2.1	\$ -
Total vested at March 31, 2017	50,000	\$ 7.72	2.1	

¹ Represents the difference between the market value of shares of the Company on March 31, 2017 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, 2017 and 2016, the Company did not recognize any non-cash compensation expense related to stock options. At March 31, 2017, the Company had no remaining compensation costs related to unvested stock based awards.

Restricted Stock

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

- (i) the first anniversary of such grant, or
- (ii) the date immediately preceding the next annual meeting of shareholders.

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

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

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

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

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

On May 3, 2016, 6,000 shares of restricted stock were awarded to the Company’s Board of Directors.

On June 16, 2015, the Company received exemptive relief to repurchase shares of its common stock from its employees in connection with certain equity compensation plan arrangements. During the years ended December 31, 2016 and 2015, the Company repurchased 67,654 and 36,348 shares, respectively, of common stock at an aggregate cost of approximately \$248,000 and \$220,000, respectively, in connection with the vesting of employee’s restricted stock, which is reflected as Treasury Stock at cost on the Consolidated Balance Sheet. These shares are not available to be reissued under the Company’s Equity Incentive Plan.

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

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

Information with respect to restricted stock granted, exercised and forfeited under the Plan for the period January 1, 2016 through March 31, 2017 is as follows:

	Non-vested Restricted Shares
Non-vested shares outstanding at January 1, 2016	700,539
Granted	6,000
Vested	(260,607)
Forfeited	(34,453)
Non-vested shares outstanding at December 31, 2016	411,479
Granted	—
Vested	—
Forfeited	(9,548)
Non-Vested Outstanding at March 31, 2017	<u>401,931</u>

For the three months ended March 31, 2017, non-cash compensation expense related to restricted stock was approximately \$389,000; of this amount approximately \$159,000 was expensed at the Company, and approximately \$229,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the three months ended March 31, 2016, non-cash compensation expense related to restricted stock was approximately \$421,000; of this amount approximately \$172,000 was expensed at the Company and approximately \$249,000 was a reimbursable expense allocated to the Asset Manager Affiliates.

Distributions are paid on all outstanding shares of restricted stock, whether or not vested. In general, shares of unvested restricted stock are forfeited upon the recipient's termination of employment. As of March 31, 2017, the Company had approximately \$1.4 million of total unrecognized compensation cost related to non-vested restricted share awards, respectively. That cost is expected to be recognized over the remaining weighted average period of 1.2 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 \$17,000 and \$9,000 was expensed during the three months ended March 31, 2017 and 2016, 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 \$46,000 was expensed during the three months ended March 31, 2017 and 2016 for both periods, related to the Profit-Sharing Plan.

12. SUBSEQUENT EVENTS

In April 2017, the Company notified the Trustee of the 7.375% Notes Due 2019 of its intention to redeem \$6.5 million par value of such notes. The Company expects such redemption to be completed during the second quarter of 2017. Other than described above, the Company has evaluated events and transactions occurring subsequent to March 31, 2017 for items that should potentially be recognized or disclosed in these financial statements. Management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these consolidated financial statements.

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, 2016, as filed with the U.S. Securities and Exchange Commission (the "Commission" or the "SEC"). In addition, some of the statements in this report constitute forward-looking statements. The matters discussed in this Quarterly Report, as well as in future oral and written statements by management of KCAP Financial, that are forward-looking statements are based on current management expectations that involve substantial risks and uncertainties which could cause actual results to differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar words. Important assumptions include our ability to originate new investments, achieve certain margins and levels of profitability, the availability of additional capital, and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Quarterly Report should not be regarded as a representation by us that our plans or objectives will be achieved. The forward-looking statements contained in this Quarterly Report include statements as to:

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

There are a number of important risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward-looking statements. For a discussion of factors that could cause our actual results to differ from forward-looking statements contained in Part I, please see "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. 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 (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). We have three principal areas of investments:

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

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

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

The Company may also invest in other investments such as loans to 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 private companies or 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. We may also seek to monetize our investment in the Asset Manager Affiliates if and when business conditions warrant. The Asset Manager Affiliates manage CLO Funds that invest in broadly syndicated loans, high-yield bonds and other credit instruments. Collectively, the Asset Manager Affiliates have approximately \$2.8 billion of par value assets under management as of March 31, 2017. The Asset Manager Affiliates are registered under the Investment Advisers Act of 1940, and are each managed independently from KCAP by a separate management team (however, certain of the Company’s executive officers also act in similar capacities for one or both of the Asset Manager Affiliates).

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

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

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

PORTFOLIO AND INVESTMENT ACTIVITY

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

Total portfolio investment activity (excluding activity in time deposit and money market investments) for the three months ended March 31, 2017 (unaudited) and for the year ended December 31, 2016 was as follows:

	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliates	Total Portfolio
Fair Value at December 31, 2015	\$ 284,639,244	\$ 55,872,382	\$ 9,548,488	\$ 57,381,000	\$ 407,441,114
2016 Activity:					
Purchases / originations / draws	74,584,952	10,140,000	—	—	84,724,952
Pay-downs / pay-offs / sales	(123,240,416)	(4,200,000)	(4,563,521)	(1,250,000)	(133,253,937)
Net accretion of interest	407,492	(2,192,071)	—	—	(1,784,579)
Net realized losses	(540,649)	(10,111,560)	4,484,742	—	(6,167,467)
Increase (decrease) in fair value	2,492,707	4,665,599	(4,413,354)	(15,933,000)	(13,188,048)
Fair Value at December 31, 2016	238,343,330	54,174,350	5,056,355	40,198,000	337,772,035
Year to Date 2017 Activity:					
Purchases / originations / draws	28,746,165	—	1	—	28,746,166
Pay-downs / pay-offs / sales	(30,777,882)	—	—	(650,000)	(31,427,882)
Net accretion of interest	100,133	143,658	—	—	243,791
Net realized gains (losses)	43,938	—	—	—	43,938
Increase (decrease) in fair value	1,202,017	(1,318,980)	(153,562)	(2,606,000)	(2,876,525)
Fair Value at March 31, 2017	\$ 237,657,701	\$ 52,999,028	\$ 4,902,794	\$ 36,942,000	\$ 332,501,523

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, 2017 and December 31, 2016:

Security Type	March 31, 2017 (unaudited)			December 31, 2016		
	Cost/Amortized Cost	Fair Value	% ¹	Cost/Amortized Cost	Fair Value	% ¹
Money Market Accounts ³	22,674,790	22,674,790	6	28,699,269	28,699,269	8
Senior Secured Loan	202,900,985	196,533,708	56	207,701,078	200,322,152	55
Junior Secured Loan	40,171,813	38,545,305	11	37,251,776	35,444,440	10
First Lien Bond	3,054,338	1,089,338	-	3,060,919	1,089,338	-
Senior Secured Bond	1,505,454	1,489,350	-	1,506,461	1,487,400	-
CLO Fund Securities	76,994,975	52,999,028	15	76,851,317	54,174,350	15
Equity Securities	10,389,008	4,902,794	2	10,389,007	5,056,355	1
Asset Manager Affiliates ²	54,691,230	36,942,000	10	55,341,230	40,198,000	11
Total	\$ 412,382,593	\$ 355,176,313	100%	\$ 420,801,057	\$ 366,471,304	100%

¹ Represents percentage of total portfolio at fair value.

² Represents the equity investment in the Asset Manager Affiliates.

³ Includes restricted cash held under employee benefit plans.

The industry concentrations, based on the fair value of the Company's investment portfolio as of March 31, 2017 and December 31, 2016, were as follows:

Industry Classification	March 31, 2017 (unaudited)			December 31, 2016		
	Cost/Amortized		% ¹	Cost/Amortized		% ¹
	Cost	Fair Value		Cost	Fair Value	
Aerospace and Defense	\$ 8,374,160	\$ 8,274,335	2%	\$ 8,394,633	\$ 8,450,106	2%
Asset Management Company ²	54,691,230	36,942,000	10	55,341,230	40,198,000	11
Automotive	7,801,993	7,769,075	2	6,322,551	6,196,154	2
Banking, Finance, Insurance & Real Estate	5,592,918	5,555,171	2	6,805,514	6,782,010	2
Beverage, Food and Tobacco	15,018,374	14,526,304	4	15,198,830	14,703,372	4
Capital Equipment	9,665,714	8,943,739	3	6,185,129	5,575,048	2
Chemicals, Plastics and Rubber	6,406,392	6,429,950	2	6,421,909	6,444,073	2
CLO Fund Securities	76,994,975	52,999,028	15	76,851,317	54,174,350	15
Construction & Building	5,891,717	5,940,196	2	5,919,158	5,929,606	2
Consumer goods: Durable	10,970,920	8,996,058	2	12,319,905	10,118,736	3
Consumer goods: Non-durable	14,247,238	14,148,705	4	14,766,390	14,452,096	4
Ecological	-	-	-	1,741,292	1,760,783	-
Energy: Electricity	3,895,827	3,928,014	1	3,904,453	3,937,247	1
Energy: Oil & Gas	14,658,057	10,181,138	3	14,493,835	8,805,761	2
Environmental Industries	13,924,571	13,589,885	4	12,279,924	12,185,239	3
Forest Products & Paper	4,188,710	4,209,862	1	4,192,889	4,192,907	1
Healthcare & Pharmaceuticals	57,616,979	53,624,475	15	58,769,668	53,594,534	15
High Tech Industries	10,963,154	11,019,979	3	9,854,093	9,936,109	3
Hotel, Gaming & Leisure	2,390,110	1,991,000	1	400,000	1,000	-
Media: Advertising, Printing & Publishing	11,441,315	11,207,306	3	11,712,682	11,453,447	3
Media: Broadcasting & Subscription	5,840,975	5,884,115	2	8,273,174	8,372,984	2
Retail	1,416,024	593,445	-	1,415,457	759,581	-
Services: Business	20,427,358	19,412,602	5	16,125,481	16,230,486	4
Services: Consumer	6,035,256	6,021,103	2	6,212,108	6,204,889	2
Telecommunications	6,017,657	5,986,937	2	12,809,799	12,767,823	3
Time Deposit and Money Market Accounts ³	22,674,790	22,674,791	6	28,699,269	28,699,269	8
Transportation: Cargo	7,423,418	7,118,789	2	7,557,315	7,190,135	2
Transportation: Consumer	2,397,545	2,317,219	1	2,412,614	2,324,516	1
Utilities: Electric	5,415,216	4,891,092	1	5,420,438	5,031,043	1
Total	\$ 412,382,593	\$ 355,176,313	100%	\$ 420,801,057	\$ 366,471,304	100%

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

² Represents the equity investment in the Asset Manager Affiliates.

³ Includes restricted cash held under employee benefit plans.

Debt Securities Portfolio

At March 31, 2017 and December 31, 2016, our investments in income producing loans and debt securities, excluding CLO Fund Securities, had a weighted average interest rate of approximately 7.0% for both periods.

The investment portfolio (excluding the Company's investment in Asset Manager Affiliates and CLO Funds) at March 31, 2017 was spread across 25 different industries and 94 different entities with an average balance per entity of approximately \$2.5 million. As of March 31, 2017, all 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 large cap public companies. At March 31, 2017 and December 31, 2016, the total amount of non-qualifying assets was approximately 17%, for both periods. The majority of non-qualifying assets were foreign investments which were approximately 15% and 14%, respectively, of the Company's total assets (including the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 14% of its total assets on such dates). 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.

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, 2017 and December 31, 2016, our Asset Manager Affiliates had approximately \$2.8 billion and \$3.0 billion, respectively, of par value of assets under management on which they earn management fees, and were valued at approximately \$36.9 million and \$40.2 million, respectively..

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 2017 our Asset Manager Affiliates recognized \$2.9 million of incentive fees from one fund.

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, 2017 and December 31, 2016, we had approximately \$53.0 million and \$54.2 million, respectively, invested in CLO Fund Securities, issued primarily by funds managed by our Asset Manager Affiliates.

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

Our CLO Fund Securities as of March 31, 2017 and December 31, 2016 are as follows:

CLO Fund Securities	Investment	% ¹	March 31, 2017		December 31, 2016	
			Amortized Cost	Fair Value	Amortized Cost	Fair Value
Grant Grove CLO, Ltd. ³	Subordinated Securities	22.2%	\$ 2,485,886	\$ 1,000	\$ 2,485,886	\$ 1,000
Katonah III, Ltd. ³	Preferred Shares	23.1	1,287,155	369,000	1,287,155	369,000
Katonah 2007-I CLO Ltd. ²	Preferred Shares	100.0	29,101,810	20,847,854	28,022,646	20,453,099
Trimaran CLO VII, Ltd. ^{2, 3}	Income Notes	10.5	934,010	565,000	1,643,920	1,195,152
Catamaran CLO 2012-1 Ltd. ²	Subordinated Notes	24.9	5,778,004	2,679,951	5,919,933	2,819,412
Catamaran CLO 2013- 1 Ltd. ²	Subordinated Notes	23.5	5,067,975	4,613,262	5,237,222	4,918,807
Catamaran CLO 2014-1 Ltd. ²	Subordinated Notes	24.9	7,635,476	4,376,540	7,818,484	4,546,682
Catamaran CLO 2014-1 Ltd. ²	Class E Notes	15.1	1,444,363	1,390,000	1,441,727	1,310,000
Dryden 30 Senior Loan Fund	Subordinated Notes	7.5	1,314,985	1,801,090	1,343,467	1,895,566
Catamaran CLO 2014-2 Ltd. ²	Subordinated Notes	24.9	6,972,176	4,879,005	6,967,560	5,092,087
Catamaran CLO 2015-1 Ltd. ²	Subordinated Notes	9.9	4,494,789	3,110,826	4,543,317	3,223,255
Catamaran CLO 2016-1 Ltd. ²	Subordinated Notes	24.9	10,478,346	8,365,500	10,140,000	8,350,290
Total			\$ 76,994,975	\$ 52,999,028	\$ 76,851,317	\$ 54,174,350

¹ Represents percentage of class held.

² A CLO Fund managed by an Asset Manager Affiliate.

³ As of March 31, 2017, this CLO Fund security was not providing a taxable distribution.

The following tables detail the ten largest portfolio companies (at fair value) as of March 31, 2017 and December 31, 2016, respectively:

Investment	March 31, 2017		
	Cost/Amortized Cost	Fair Value	% of FMV
Asset Manager Affiliates	\$ 54,691,230	\$ 36,942,000	10%
US Bank Money Market Account	22,660,522	22,660,522	6
Katonah 2007-I CLO Ltd.	29,101,810	20,847,854	6
Grupo HIMA San Pablo, Inc.	9,831,239	9,134,800	3
Catamaran CLO 2016-1 Ltd.	10,478,346	8,365,500	2
Tank Partners Holdings, LLC	11,985,697	7,821,575	2
Roscoe Medical, Inc.	6,669,733	6,499,000	2
GK Holdings, Inc. (aka Global Knowledge)	5,892,434	5,879,408	2
Nielsen & Bainbridge, LLC	5,328,534	5,361,360	2
Weiman Products, LLC	4,964,167	4,904,989	1
Total	\$ 161,603,712	\$ 128,417,008	36%

Investment	December 31, 2016		
	Cost/Amortized Cost	Fair Value	% of FMV
Asset Manager Affiliates	\$ 55,341,230	\$ 40,198,000	11%
US Bank Money Market Account	28,685,001	28,685,001	8
Katonah 2007-I CLO Ltd.	28,022,646	20,453,099	6
Grupo HIMA San Pablo, Inc.	9,828,619	9,113,125	2
Catamaran CLO 2016-1 Ltd.	10,140,000	8,350,290	2
Tank Partners Holdings, LLC	11,822,180	6,552,311	2
Roscoe Medical, Inc.	6,666,733	6,499,000	2
Weiman Products, LLC	5,462,647	5,321,809	1
Nielsen & Bainbridge, LLC	5,326,136	5,199,447	1
Catamaran CLO 2014-2 Ltd.	6,967,560	5,092,087	1
Total	\$ 168,262,752	\$ 135,464,169	36%

Excluding the Asset Manager Affiliates, CLO Fund securities and Money Market Accounts, the Company's ten largest portfolio companies represented approximately 16% and 13% of the total fair value of the Company's investments at March 31, 2017 and December 31, 2016, respectively.

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, 2017 and 2016.

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 select 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 U.S. GAAP statement of operations differs from both the tax-basis investment income and from the cash distributions actually received by the Company during the period. As a RIC, the Company anticipates a timely distribution of its tax-basis taxable income.

For non-junior class CLO Fund securities, such as our investment in the Class E notes of Catamaran CLO 2014-1 Ltd., 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 future 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, 2017, the Asset Manager Affiliates received incentive fees from one fund.

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 related management 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. The fair value of our investment in our Asset Manager Affiliates was approximately \$36.9 million at March 31, 2017, with an unrealized depreciation for the period ending March 31, 2017 of approximately \$2.6 million. For the three months ended March 31, 2016, we recognized dividend income of \$550,000, from the Asset Manager Affiliates, while cash distributions received were approximately \$650,000 and \$1.1 million for the three months ended March 31, 2017 and 2016, respectively. The difference between cash distributions received and the tax-basis earnings and profits is recorded as an adjustment to the cost basis of the Asset Manager Affiliates investments. For interim periods, the Company estimates the tax attributes of any distributions as being either tax-basis earnings and profits (i.e. dividend income) or return of capital (i.e. adjustment to the Company’s cost basis in the Asset Manager Affiliates). The final determination of the tax attributes of distributions from our Asset Manager Affiliates is made on an annual (full calendar year) basis at the end of the year based upon taxable income and distributions for the full-year. Therefore, any estimate of tax attributes of distributions made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year. CLO Funds typically have automatic orderly wind-down features following an initial period of reinvestment. Thus, with all else being equal, as managed CLO Fund portfolios age, projected future assets under management (and associated management fees) will naturally decline, resulting in a reduction in fair value of our Asset Manager Affiliates. On the other hand, mandates to manage new CLO Fund portfolios will generally result in an increase in the fair value of our investment in our Asset Manager Affiliates. The aggregate of par value of assets under management by our Asset Manager Affiliates was \$2.8 billion and \$3.0 billion as of March 31, 2017 and December 31, 2016, 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, 2017 and 2016 was approximately \$7.8 million and \$9.5 million, respectively. Of these amounts, approximately \$4.6 million and \$5.7 million was attributable to interest income on our Debt Securities Portfolio.

The weighted average yield on our Debt Securities Portfolio was 7.0%, as of March 31, 2017 and December 31, 2016.

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, 2017 and 2016, approximately \$3.1 million and \$3.2 million, respectively, of investment income was attributable to investments in CLO Fund Securities. On a tax basis, the Company recognized \$2.2 million and \$4.0 million of taxable distributable income on distributions from our CLO Fund Securities during the three month periods ended March 31, 2017 and 2016, respectively. Distributions from CLO Fund Securities are dependent on the performance of the underlying assets in each CLO Fund; interest payments, principal amortization and prepayments of the underlying loans in each CLO Fund are primary factors which determine the level of distributions on our CLO Fund Securities. The level of excess spread from CLO Fund Securities can be impacted by the timing and level of the resetting of the benchmark interest rate for the underlying assets (which reset at various times throughout the quarter) in the CLO Fund and the related CLO Fund bond liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and distributions to us can vary significantly.

Expenses

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 expected 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, 2017 and 2016 were approximately \$4.6 million and \$4.7 million, respectively. Interest expense and amortization on debt issuance costs for the period was approximately \$2.2 million and \$2.6 million, respectively, on average debt outstanding of \$181 million and \$204 million, respectively.

For the three months ended March 31, 2017 and 2016, approximately \$1.2 million and \$967,000 of expenses were attributable to employee compensation, including salaries, bonuses, employee benefits, payroll taxes and stock-based compensation expense, respectively. For the three months ended March 31, 2017 and 2016, respectively, professional fees and insurance expenses totaled approximately \$644,000 and \$758,000. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately \$505,000 and \$447,000 for the three months ended March 31, 2017 and 2016, 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, 2017, net investment income and net realized gains were approximately \$3.3 million, or \$0.09 per share. For the three months ended March 31, 2016, net investment income and net realized losses were approximately \$3.0 million loss, or \$0.08 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. Investments are carried at fair value, with changes in fair value recorded as unrealized appreciation (depreciation) in the statement of operations. When an investment is sold or liquidated, any previously recognized unrealized appreciation/depreciation is reversed and a corresponding amount is recognized as realized gain (loss). For example, on February 29, 2016, Katonah X CLO Ltd. was fully liquidated and all of its outstanding obligations were satisfied. The Company received approximately \$1.0 million in connection therewith related to its investment in the subordinated securities issued by Katonah X CLO Ltd. Accordingly, the Company recorded a realized loss during the first quarter of 2016 of approximately \$6.6 million on its investment in Katonah X CLO Ltd. and a corresponding unrealized gain of the same amount in order to reverse the approximately \$6.6 million of previously recorded unrealized depreciation with respect to the investment. For the three months ended March 31, 2017, U.S. GAAP-basis net investment income was approximately \$3.2 million or \$0.09 per share, while tax-basis distributable income was approximately \$2.4 million or \$0.06 per share. For the three months ended March 31, 2016, U.S. GAAP-basis net investment income was approximately \$4.8 million or \$0.13 per basic share, while tax-basis distributable income was approximately \$5.9 million or \$0.16 per share.

Net Unrealized (Depreciation) Appreciation on Investments

During the three months ended March 31, 2017, our total investments had net unrealized depreciation of approximately \$2.9 million. Included in the net unrealized loss in 2017 are unrealized depreciation on CLO Fund Securities of approximately \$1.3 million, net unrealized depreciation on equity securities of approximately \$154,000, and net unrealized depreciation of the Asset Manager Affiliates of \$2.6 million, offset by unrealized appreciation on our debt securities of approximately \$1.2 million. During the three months ended March 31, 2016, our total investments had net unrealized depreciation of approximately \$3.8 million. Included in the net unrealized depreciation in 2016 are unrealized appreciation on CLO Fund Securities of approximately \$3.1 million unrealized appreciation and on equity securities of approximately \$1.4 million, as well as unrealized depreciation of the Asset Manager Affiliates of \$6.5 million, and unrealized depreciation on our debt securities of \$1.7 million.

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, 2017 was \$386,000, or \$0.01 per basic share. Net decrease in stockholders' equity resulting from operations for the three months ended March 31, 2016 was \$6.8 million, or \$0.18 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, 2017 and December 31, 2016 the fair value of investments and cash were as follows:

Security Type	Investments at Fair Value	
	March 31, 2017	December 31, 2016
Cash	\$ 5,178,290	\$ 1,307,257
Restricted Cash	7,986,487	8,528,298
Money Market Accounts	22,674,790	28,699,269
Senior Secured Loan	196,533,708	200,322,152
Junior Secured Loan	38,545,305	35,444,440
First Lien Bond	1,089,338	1,089,338
Senior Secured Bond	1,489,350	1,487,400
CLO Fund Securities	52,999,028	54,174,350
Equity Securities	4,902,794	5,056,355
Asset Manager Affiliates	36,942,000	40,198,000
Total	<u>\$ 368,341,090</u>	<u>\$ 376,306,859</u>

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, 2017, we had approximately \$181 million of par value of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 203%, 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 15, 2016, the Convertible Notes matured and were repaid in full.

On October 10, 2012, the Company issued \$41.4 million in aggregate principal amount of unsecured 7.375% Notes Due 2019. The net proceeds for the 7.375% Notes Due 2019, following underwriting expenses, were approximately \$39.9 million. Interest on the 7.375% Notes Due 2019 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 7.375%, commencing December 30, 2012. The 7.375% Notes Due 2019 mature on September, 30, 2019, and are senior unsecured obligations of the Company. In addition, due to the coverage test applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 7.375% Notes Due 2019, the Company is limited in its ability to make distributions if its asset coverage, as defined in the 1940 Act, is below 200% at the time of the declaration of the distribution. At March 31, 2017, 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. During the second quarter of 2016, the Company repurchased approximately \$2.4 million par value of the 7.375% notes due 2019 at a weighted average price of \$25.23 per \$25.00 note, resulting in a realized loss on extinguishment of \$71,190. KCAP subsequently surrendered these notes to the Trustee for cancellation. During the third quarter of 2016, \$5.0 million par value of the 7.375% notes due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of \$88,015. During the fourth quarter of 2016, \$469,000 par value of the 7.375% notes due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of \$15,000.

In April 2017, the Company notified the Trustee of the 7.375% Notes Due 2019 of its intention to redeem \$6.5 million par value of such notes. The Company expects such redemption to be completed during the second quarter of 2017.

On June 18, 2013, KCAP Senior Funding I, LLC, a specialty finance subsidiary of the Company, was capitalized through the issuance of \$140 million of notes (the “KCAP Senior Funding I Notes”). The KCAP Senior Funding I Notes are backed by a diversified portfolio of bank loans. The Company invested in the most junior class of the notes, issued in the approximate amount of \$35 million, representing the Company’s primary exposure to the performance of the assets acquired from the proceeds of the issuance of the KCAP Senior Funding I Notes. On December 8, 2014, the Company completed the sale of additional KCAP Senior Funding I Notes for \$56 million. The issuance of additional notes was pro-rata across all existing classes of notes originally issued. KCAP purchased an additional \$13.9 million in the most junior class of notes. As of March 31, 2017 and December 31, 2016, these junior notes eliminate in consolidation and the remaining notes with a par value of \$147.4 million are reflected on our consolidated balance sheet, net of \$2.1 million and \$2.3 million of unamortized discount and \$2.3 million and \$2.5 million of debt offering costs, respectively. The indenture governing the KCAP Senior Funding I Notes contains an event of default that is triggered in the event that certain coverage tests are not met.

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

Subject to prevailing market conditions, we intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. However, we may face difficulty in obtaining a new debt and equity financing as a result of current market conditions. In this regard, because our common stock has traded at a price below our current net asset value per share and we are limited in our ability to sell our common stock at a price below net asset value per share without stockholder approval (which we currently do not have), we have been and may continue to be limited in our ability to raise equity capital. See “Business — Regulation — Common Stock” in our annual report or Form 10-K for the year ended December 31, 2016. From time to time, we may seek to retire, repurchase, or exchange debt securities in open market purchases or by other means dependent on market conditions, liquidity, contractual obligations, and other matters. In addition, we evaluate strategic opportunities available to us and/or the Asset Manager Affiliates, including mergers, divestitures, spin-offs, joint ventures and other similar transactions from time to time.

Stockholder Distributions

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

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

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

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

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

The following table sets forth the quarterly distributions declared by us since 2015.

	Distribution	Declaration Date	Record Date	Pay Date
2017:				
First quarter	\$ 0.12	3/21/2017	4/7/2017	4/28/2017
Total declared in 2017	<u>\$ 0.12</u>			
2016:				
Fourth quarter	\$ 0.12	12/14/2016	1/6/2017 ¹	1/27/2017
Third quarter	0.15	9/20/2016	10/14/2016	10/27/2016
Second quarter	0.15	6/21/2016	7/7/2016	7/28/2016
First quarter	<u>\$ 0.15</u>	3/18/2016	4/7/2016	4/28/2016
Total declared in 2016	<u>\$ 0.57</u>			
2015:				
Fourth quarter	\$ 0.15	12/16/2015	1/6/2016 ¹	1/28/2016
Third quarter	0.21	9/22/2015	10/14/2015	10/27/2015
Second quarter	0.21	6/23/2015	7/6/2015	7/27/2015
First quarter	<u>0.21</u>	3/24/2015	4/6/2015	4/27/2015
Total declared in 2015	<u>\$ 0.78</u>			

¹ Since the record date of this distribution is subsequent to year-end, it is a subsequent year tax event.

OFF-BALANCE SHEET ARRANGEMENTS

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, 2017 and December 31, 2016, the Company had approximately \$565,000 commitments to fund investments for both periods.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual cash obligations and other commercial commitments as of March 31, 2017:

Contractual Obligations	Payments Due by Period				
	Total	Less than one year	1 - 3 years	3 - 5 years	More than 5 years
Long-term debt obligations	\$ 180,880,925	\$ —	\$ 33,530,925	\$ —	\$ 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 determined 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 hierarchical disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value and expands disclosures about assets and liabilities measured at fair value. ASC 820: Fair Value defines “fair value” as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This fair value definition focuses on an exit price in the principal, or most advantageous market, and prioritizes, within a measurement of fair value, the use of market-based inputs (which may be weighted or adjusted for relevance, reliability and specific attributes relative to the subject investment) over entity-specific inputs. Market price observability is affected by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. Subsequent to the adoption of ASC 820: Fair Value, the FASB has issued various staff positions clarifying the initial standard (see Note 2 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. The 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 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. The Company’s fair value determinations 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 and accrual of payment-in-kind (“PIK”) interest, 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. For investments with PIK interest, which represents contractual interest accrued and added to the principal balance that generally becomes due at maturity, we will not accrue PIK interest if the portfolio company valuation indicates that the PIK interest is not collectible (i.e. via a partial or full non-accrual). Loans which are on partial or full non-accrual 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, 2017 and December 31, 2016, two of our investments were on partial non-accrual status whereby we have recognized income on a portion of contractual PIK amounts due.

Investment Income on CLO Fund Securities

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

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

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

Distributions from Asset Manager Affiliates

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

Payment in Kind Interest

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

Fee Income

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

Management Compensation

We may, from time to time, issue stock options or restricted stock, under the Equity Incentive Plan, to officers and employees for services rendered to us. We follow Accounting Standards Codification 718, Compensation — Stock Compensation, a method by which the fair value of options or restricted stock is determined and expensed.

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 net investment income, distributable taxable income and the after-tax free cash flow from our Asset Manager Affiliates.

The following table sets forth the quarterly distributions declared by us for the 2017, 2016 and 2015 calendar years.

	Distribution	Declaration Date	Record Date	Pay Date
2017:				
First quarter	\$ 0.12	3/21/2017	4/7/2017	4/28/2017
Total declared in 2017	<u>\$ 0.12</u>			
2016:				
Fourth quarter	\$ 0.12	12/14/2016	1/6/2017 ¹	1/27/2017
Third quarter	0.15	9/20/2016	10/14/2016	10/27/2016
Second quarter	0.15	6/21/2016	7/7/2016	7/28/2016
First quarter	<u>0.15</u>	3/18/2016	4/7/2016	4/28/2016
Total declared in 2016	<u>\$ 0.57</u>			
2015:				
Fourth quarter	\$ 0.15	12/16/2015	1/6/2016 ¹	1/28/2016
Third quarter	0.21	9/22/2015	10/14/2015	10/27/2015
Second quarter	0.21	6/23/2015	7/6/2015	7/27/2015
First quarter	<u>0.21</u>	3/24/2015	4/6/2015	4/27/2015
Total declared in 2015	<u>\$ 0.78</u>			

¹ Since the record date of this distribution is subsequent to year-end, it is a subsequent year tax event.

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

	Quarter-ended March 31,	
	2017 ¹	2016 ¹
Net investment income	\$ 0.09	\$ 0.13
Tax Accounting Difference on CLO Equity Investments	(0.02)	0.02
Other Tax Accounting Differences	-	0.01
Taxable distributable income	0.06	0.16
Cash distributed to the Company by Asset Manager Affiliates in excess of their taxable earnings	0.02	0.01
Cash received from CLO Equity Investments in excess of taxable earnings	0.02	0.03
Available for distribution ²	0.10	0.20
Distributed	\$ 0.12	\$ 0.15
Difference	\$ (0.02)	\$ 0.05

¹ Table may not foot due to rounding.

² The "Available for distribution" financial measure is a non-GAAP financial measure that is calculated by including the cash distributed to the Company by the Asset Manager Affiliates in excess of their taxable earnings and cash received from CLO Equity Investments in excess of 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 \$0.02 and \$0.01 per share of cash distributed to the Company by the Asset Manager Affiliates in excess of their taxable earnings and the \$0.02 and \$0.03 per share of cash distributed to the Company from CLO Equity Investments in excess of taxable earnings, is subtracted from the "Available for distribution" financial measure for the three months ended March 31, 2017 and 2016, respectively. The Company's management believes that the presentation of the non-GAAP "Available for distribution" financial measure provides useful information to investors.

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, 2017, approximately 98.0% of our Debt Securities Portfolio were either fixed rate or floating rate with a spread to an interest rate index such as LIBOR or the prime rate. Most of these floating rate loans contain LIBOR floors ranging between 0.75% and 3.0%. We generally expect that future portfolio investments will predominately be floating rate investments. As of March 31, 2017, we had \$180.9 million of borrowings outstanding at a current weighted average rate of 4.0%.

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 7.375% Notes Due 2019 would remain the same at 7.375%, 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, 2017 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	\$ 760,367	\$ 1,504,028	\$ 2,247,688
Decrease in interest rate	\$ 1,308,608	\$ 1,352,516	\$ 1,352,516

As shown above, net investment income assuming a 1% increase in interest rates would increase by approximately \$760,000 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 \$1.5 million and \$2.2 million, respectively. Since LIBOR underlying certain investments, as well as certain of our borrowings, is currently low, it is unlikely that the underlying rate will decrease by 1% or 2% or even 3%. If the underlying rate decreased to 0%, it would result in approximately a \$1.3 million 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, 2017.

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

There have been no changes in our internal control over financial reporting since our last Annual Report filed on Form 10-K for the period ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016.

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, 2017, we issued a total of 40,903 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, 2017, the aggregate value of the shares of our common stock issued under our DRIP was approximately \$162,000.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Reference is made to the Exhibit List filed as a part of this report beginning on page E-1. Each of such exhibits is incorporated by reference herein.

Exhibit Index

Exhibit Number	Description of Document
31.1**	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2**	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer Pursuant to 18 U. S. C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer Pursuant to 18 U. S. C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
**	Submitted herewith.

**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, 2017 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 4, 2017

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

**CERTIFICATION PURSUANT TO
RULE 13a-14(a) and 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS AMENDED**

I, Edward U. Gilpin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 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 4, 2017

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

**CERTIFICATION PURSUANT TO
SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the accompanying Quarterly Report of KCAP Financial, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2017 (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 4, 2017

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

**CERTIFICATION PURSUANT TO
SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the accompanying Quarterly Report of KCAP Financial, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2017 (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 4, 2017

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