

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 September 30, 2018
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File No. 814-00735

KCAP Financial, Inc.

(Exact name of Registrant as specified in its charter)

Delaware

20-5951150

(State or other jurisdiction of
Incorporation or organization)

(I.R.S. Employer
Identification Number)

295 Madison Avenue, 6th Floor
New York, New York 10017
(Address of principal executive offices)

(212) 455-8300

(Registrant's telephone number, including area code)

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 every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.:

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	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 November 5, 2018 was 37,366,953.

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KCAP FINANCIAL, INC.

CONSOLIDATED BALANCE SHEETS

	As of September 30, 2018 (unaudited)	As of December 31, 2017
ASSETS		
Investments at fair value:		
Short-term investments (cost: 2018 - \$24,431,512; 2017 - \$77,300,320)	\$ 24,431,512	\$ 77,300,320
Debt securities (amortized cost: 2018 - \$149,138,595; 2017 - \$125,179,470)	139,799,027	118,197,479
CLO Fund Securities managed by affiliates (amortized cost: 2018 - \$63,580,483; 2017 - \$67,212,139)	45,531,058	49,488,393
CLO Fund Securities managed by non-affiliates (amortized cost: 2018 - \$5,188,762; 2017 - \$5,126,893)	2,452,873	2,190,280
Equity securities (cost: 2018 - \$10,571,007; 2017 - \$10,571,007)	4,079,336	4,414,684
Asset Manager Affiliates (cost: 2018 - \$51,591,230; 2017 - \$52,591,230)	35,818,000	38,849,000
Joint Venture (cost: 2018 - \$24,914,858; 2017 - \$24,914,858)	21,373,570	21,516,000
Total Investments at Fair Value (cost: 2018 - \$329,416,447; 2017 - \$362,895,917)	<u>273,485,375</u>	<u>311,956,156</u>
Cash	1,713,906	2,034,095
Restricted cash	987,818	—
Interest receivable	2,276,162	1,051,271
Receivable for open trades	—	2,993,750
Due from affiliates	935,120	1,243,493
Other assets	340,472	530,209
Total Assets	<u>\$ 279,738,854</u>	<u>\$ 319,808,974</u>
LIABILITIES		
6.125% Notes Due 2022 (net of offering costs of: 2018 - \$2,341,686; 2017 - \$2,734,248)	\$ 75,065,514	\$ 74,672,952
7.375% Notes Due 2019 (net of offering costs of: 2018 - \$31,173; 2017 - \$259,635)	6,968,827	26,740,365
KCAP Funding I, LLC Revolving Credit Facility (net of offering costs of: 2018 - \$1,246,998)	21,701,195	—
Payable for open trades	—	34,215,195
Accounts payable and accrued expenses	2,008,553	2,350,803
Accrued interest payable	86,133	—
Due to affiliates	127	25,083
Total Liabilities	<u>105,830,349</u>	<u>138,004,398</u>
COMMITMENTS AND CONTINGENCIES (Note 8)		
STOCKHOLDERS' EQUITY		
Common stock, par value \$0.01 per share, 100,000,000 common shares authorized; 37,544,083 issued, and 37,349,224 outstanding at September 30, 2018, and 37,507,402 issued, and 37,339,224 outstanding at December 31, 2017	373,492	373,392
Capital in excess of par value	330,404,400	329,789,716
Excess distribution of net investment income	(13,201,062)	(9,987,928)
Accumulated net realized losses	(86,338,209)	(86,031,799)
Net unrealized depreciation on investments	<u>(57,330,116)</u>	<u>(52,338,805)</u>
Total Stockholders' Equity	<u>173,908,505</u>	<u>181,804,576</u>
Total Liabilities and Stockholders' Equity	<u>\$ 279,738,854</u>	<u>\$ 319,808,974</u>
NET ASSET VALUE PER COMMON SHARE	<u>\$ 4.66</u>	<u>\$ 4.87</u>

See accompanying notes to financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Investment Income:				
Interest from investments in debt securities	\$ 4,487,575	\$ 2,033,813	\$ 11,796,245	\$ 10,934,928
Payment-in-kind investment income	329,365	405,858	1,061,419	829,773
Interest from cash and time deposits	9,767	21,043	71,183	51,250
Investment income on CLO Fund Securities managed by affiliates	1,179,463	2,693,547	4,428,032	8,378,785
Investment income on CLO Fund Securities managed by non-affiliates	94,992	99,578	292,694	329,108
Dividends from Asset Manager Affiliates	300,000	180,000	920,000	180,000
Investment income - Joint Venture	750,000	685,000	2,150,000	685,000
Capital structuring service fees	7,588	134,504	114,097	298,628
Total investment income	<u>7,158,750</u>	<u>6,253,343</u>	<u>20,833,670</u>	<u>21,687,472</u>
Expenses:				
Interest and amortization of debt issuance costs	1,871,187	1,371,953	5,582,467	5,790,242
Compensation	1,004,323	1,072,812	3,216,710	3,473,841
Professional fees	867,724	802,507	2,489,098	2,545,195
Insurance	79,152	80,794	236,900	256,473
Administrative and other	381,835	395,782	1,364,302	1,265,317
Total expenses	<u>4,204,221</u>	<u>3,723,848</u>	<u>12,889,477</u>	<u>13,331,068</u>
Net Investment Income	<u>2,954,529</u>	<u>2,529,495</u>	<u>7,944,193</u>	<u>8,356,404</u>
Realized And Unrealized Gains (Losses) On Investments:				
Net realized losses from investment transactions	(136,766)	(1,906,537)	(137,336)	(2,871,941)
Net change in unrealized (depreciation) appreciation on:				
Debt securities	(1,232,216)	1,759,152	(2,357,578)	4,172,723
Equity securities	(171,775)	(186,368)	(335,348)	(606,179)
CLO Fund Securities managed by affiliates	682,574	(1,590,062)	(325,678)	(3,695,876)
CLO Fund Securities managed by non-affiliates	5,427	(34,655)	200,723	(328,552)
Asset Manager Affiliates investments	(1,035,000)	2,922,000	(2,031,000)	1,481,000
Joint Venture Investment	282,076	(147,751)	(142,430)	(147,751)
Total net change in unrealized appreciation (depreciation)	<u>(1,468,914)</u>	<u>2,722,316</u>	<u>(4,991,311)</u>	<u>875,365</u>
Net realized and unrealized appreciation (depreciation) on investments	<u>(1,605,680)</u>	<u>815,779</u>	<u>(5,128,647)</u>	<u>(1,996,576)</u>
Realized losses on extinguishments of Debt	—	(4,014,723)	(169,074)	(4,121,998)
Net Increase (Decrease) In Stockholders' Equity Resulting From Operations	<u>\$ 1,348,849</u>	<u>\$ (669,449)</u>	<u>\$ 2,646,472</u>	<u>\$ 2,237,830</u>
Net Increase (Decrease) In Stockholders' Equity Resulting from Operations per Common Share:				
Basic:	\$ 0.04	\$ (0.02)	\$ 0.07	\$ 0.06
Diluted:	\$ 0.04	\$ (0.02)	\$ 0.07	\$ 0.06
Net Investment Income Per Common Share:				
Basic:	\$ 0.08	\$ 0.07	\$ 0.21	\$ 0.23
Diluted:	\$ 0.08	\$ 0.07	\$ 0.21	\$ 0.23
Weighted Average Shares of Common Stock Outstanding—Basic	37,349,904	37,196,621	37,354,449	37,202,011
Weighted Average Shares of Common Stock Outstanding—Diluted	37,349,904	37,196,621	37,354,449	37,202,011

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(unaudited)

	Nine Months Ended September 30,	
	2018	2017
Operations:		
Net investment income	\$ 7,944,193	\$ 8,356,404
Net realized losses from investment transactions	(137,336)	(2,871,941)
Realized losses from extinguishments of Debt	(169,074)	(4,121,998)
Net change in unrealized (depreciation) appreciation on investments	(4,991,311)	875,365
Net increase in stockholders' equity resulting from operations	<u>2,646,472</u>	<u>2,237,830</u>
Stockholder distributions:	(11,157,327)	(13,315,561)
Capital share transactions:		
Dividend reinvestment plan	154,600	288,192
Common stock withheld for payroll taxes upon vesting of restricted stock	(86,743)	(224,944)
Stock based compensation	546,927	875,002
Net increase in net assets resulting from capital share transactions	<u>614,784</u>	<u>938,250</u>
Net assets at beginning of period	<u>181,804,576</u>	<u>194,924,925</u>
Net assets at end of period (including undistributed net investment income of \$0 in 2018 and \$0 in 2017)	<u>\$ 173,908,505</u>	<u>\$ 184,785,444</u>
Net asset value per common share	\$ 4.66	\$ 4.95
Common shares outstanding at end of period	37,349,224	37,317,815

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended September 30,	
	2018	2017
OPERATING ACTIVITIES:		
Net increase in stockholder's equity resulting from operations	\$ 2,646,472	\$ 2,237,830
Adjustments to reconcile net increase in stockholder's equity resulting from operations to net cash provided by operations:		
Net realized losses on investment transactions	137,336	2,871,941
Net change in unrealized depreciation from investments	4,991,311	(875,365)
Purchases of investments	(75,550,935)	(202,774,326)
Proceeds from sales and redemptions of investments	115,362,645	252,169,877
Net accretion of investments	(5,408,308)	(707,654)
Amortization of original issue discount on indebtedness	—	352,340
Amortization of debt issuance costs	665,000	557,527
Realized losses on extinguishments of debt	169,074	4,121,998
Payment-in-kind interest income	(1,061,419)	(829,774)
Stock-based compensation	546,927	875,002
Changes in operating assets and liabilities:		
Decrease (increase) in payable for open trades	(34,215,195)	27,065,785
Decrease in receivable for open trades	2,993,750	2,950,658
(Increase) decrease in interest and dividends receivable	(1,224,891)	110,574
Increase in accounts receivable	—	(2,000,021)
Increase (decrease) in accrued interest payable	86,133	(930,086)
Decrease in other assets	189,737	294,509
Decrease (increase) in due from affiliates	308,373	(546,905)
(Decrease) increase in due to affiliates	(24,956)	78,384
Decrease in accounts payable and accrued expenses	(342,250)	(397,876)
Net cash provided by operating activities	10,268,804	84,624,418
FINANCING ACTIVITIES:		
Issuance (forfeitures) of restricted shares	(103)	1,303
Debt issuance costs	(1,459,899)	(2,798,940)
Distributions to stockholders	(11,002,623)	(13,027,367)
Common stock withheld for payroll taxes upon vesting of restricted stock	(86,743)	(224,944)
Repayment 7.375% Notes Due 2019	(20,000,000)	(6,530,925)
Issuance of 6.125% Notes Due 2022	—	77,407,200
Repayment of Senior Funding Notes	—	(147,350,000)
Borrowings under KCAP Funding LLC, Revolving Credit Facility	31,000,000	—
Repayments of KCAP Funding LLC, Revolving Credit Facility	(8,051,807)	—
Net cash used in financing activities	(9,601,175)	(92,523,673)
CHANGE IN CASH AND RESTRICTED CASH	667,629	(7,899,255)
CASH AND RESTRICTED CASH, BEGINNING OF PERIOD	2,034,095	9,835,555
CASH AND RESTRICTED CASH, END OF PERIOD	\$ 2,701,724	\$ 1,936,300
Supplemental Information:		
Interest paid during the period	\$ 4,830,690	\$ 5,810,461
Dividends paid during the period under the dividend reinvestment plan	\$ 154,601	\$ 289,478

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
As of September 30, 2018

Debt Securities Portfolio

Portfolio Company / Principal Business	Investment ¹⁶ Interest Rate ¹ / Maturity	Initial Acquisition Date	Principal	Amortized Cost	Fair Value ²
Advanced Lighting Technologies, Inc. ⁽⁸⁾⁽¹³⁾ (14) Consumer goods: Durable	Junior Secured Loan — Second Lien Notes 9.4% Cash, 10.0% PIK, 3 month LIBOR(2.41%) + 7.00%; LIBOR Floor 1.00% , Due 10/23	6/13/2012	\$ 955,491	\$ 955,490	\$ 394,355
Avalign Technologies, Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Initial Term Loan (First Lien) 6.8% Cash, 1 month LIBOR(2.25%) + 4.50%; LIBOR Floor 1.00% , Due 7/21	7/16/2015	1,004,411	1,002,658	1,000,895
Avalign Technologies, Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Initial Term Loan (Second Lien) 10.6% Cash, 3 month LIBOR(2.31%) + 8.25%; LIBOR Floor 1.00% , Due 7/22	7/16/2015	1,500,000	1,490,789	1,474,200
BMC Acquisition, Inc. (aka BenefitMall) ⁽⁸⁾⁽¹⁴⁾ (15) Banking, Finance, Insurance & Real Estate	Senior Secured Loan — Initial Term Loan 7.8% Cash, 6 month LIBOR(2.50%) + 5.25%; LIBOR Floor 1.00% , Due 12/24	1/2/2018	2,977,500	2,975,935	2,950,405
BW NHHH Holdco Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Initial Term Loan (First Lien) 7.2% Cash, 1 month LIBOR(2.16%) + 5.00% , Due 5/25	5/16/2018	1,995,000	1,966,602	1,965,075
Child Development Schools, Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Services: Business	Senior Secured Loan — Term Loan 6.4% Cash, 3 month LIBOR(2.20%) + 4.25% , Due 5/23	6/6/2018	4,863,014	4,851,642	4,850,856
Community Care Health Network, Inc. (aka Matrix Medical Network) ⁽⁸⁾⁽¹⁵⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Closing Date Term Loan 7.0% Cash, 3 month LIBOR(2.29%) + 4.75%; LIBOR Floor 1.00% , Due 2/25	2/9/2018	1,995,000	1,990,444	2,010,591
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) ⁽⁸⁾ Beverage, Food and Tobacco	Junior Secured Loan — Term Loan (Second Lien) 10.1% Cash, 3 month LIBOR(2.34%) + 7.75%; LIBOR Floor 1.00% , Due 7/21	5/23/2013	3,000,000	3,006,937	2,892,600
CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) (aka HealthPort) ⁽⁸⁾⁽¹⁵⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — New Term Loan Facility 6.5% Cash, 1 month LIBOR(2.24%) + 4.25%; LIBOR Floor 1.00% , Due 12/21	11/19/2014	3,974,333	3,967,730	3,750,776
Cyanco Intermediate 2 Corp. ⁽⁸⁾ Chemicals, Plastics and Rubber	Junior Secured Loan — Initial Term Loan (Second Lien) 9.7% Cash, 1 month LIBOR(2.24%) + 7.50%; , Due 3/26	3/9/2018	4,681,250	4,637,310	4,635,842

See accompanying notes to financial statements.

Portfolio Company / Principal Business	Investment ¹⁶ Interest Rate ¹ / Maturity	Initial Acquisition Date	Principal	Amortized Cost	Fair Value
Decolin Inc. ⁽³⁾⁽¹⁴⁾⁽¹⁵⁾ Textiles and Leather	Senior Secured Loan — Initial Term Loan 6.7% Cash, 1 month LIBOR(2.21%) + 4.50%; LIBOR Floor 1.00% , Due 12/23	1/26/2018	2,190,363	2,180,627	2,191,239
Drew Marine Group Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Transportation: Cargo	Junior Secured Loan — Term Loan (Second Lien) 9.2% Cash, 1 month LIBOR(2.24%) + 7.00%; LIBOR Floor 1.00% , Due 5/21	11/19/2013	4,000,000	4,000,701	4,000,400
EagleTree-Carbide Acquisition Corp. (aka Corsair Components, Inc.) ⁽⁸⁾⁽¹⁴⁾ High Tech Industries	Junior Secured Loan — Term Loan (Second Lien) 10.9% Cash, 3 month LIBOR(2.39%) + 8.50%; LIBOR Floor 1.00% , Due 8/25	9/29/2017	5,000,000	4,934,137	5,003,000
EagleTree-Carbide Acquisition Corp. (aka Corsair Components, Inc.) ⁽⁸⁾⁽¹⁵⁾ High Tech Industries	Senior Secured Loan — Term Loan (First Lien) 7.1% Cash, 3 month LIBOR(2.39%) + 4.75%; LIBOR Floor 1.00% , Due 8/24	9/29/2017	994,981	990,374	994,981
Evergreen North America Acquisition, LLC (f/k/a Industrial Services Acquisition, LLC) ⁽⁸⁾ (14)(15) Environmental Industries	Senior Secured Loan — Term Loan 7.4% Cash, 3 month LIBOR(2.44%) + 5.00%; LIBOR Floor 1.00% , Due 6/22	6/21/2016	1,119,774	1,124,156	1,119,774
First American Payment Systems, L.P. ⁽⁸⁾⁽¹⁴⁾ (15) Banking, Finance, Insurance & Real Estate	Junior Secured Loan — Term Loan (Second Lien) 12.6% Cash, 1 month LIBOR(2.12%) + 10.50%; LIBOR Floor 1.00% , Due 7/24	1/4/2017	1,500,000	1,465,354	1,448,700
Flexera Software LLC (fka Flexera Software, Inc.) ⁽⁸⁾ High Tech Industries	Junior Secured Loan — Initial Term Loan (Second Lien) 9.5% Cash, 1 month LIBOR(2.25%) + 7.25%; LIBOR Floor 1.00% , Due 2/26	1/25/2018	100,000	99,536	97,180
GI Advo Opco, LLC ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Term Loan 11.0% Cash, 1 month LIBOR(7.00%) + 4.00%; LIBOR Floor 1.00% , Due 11/21	11/19/2015	180,304	179,356	180,250
GK Holdings, Inc. (aka Global Knowledge) ⁽⁸⁾ (14) Services: Business	Junior Secured Loan — Initial Term Loan (Second Lien) 12.6% Cash, 3 month LIBOR(2.39%) + 10.25%; LIBOR Floor 1.00% , Due 1/22	1/30/2015	1,500,000	1,485,744	1,376,250
Global Tel*Link Corporation ⁽⁸⁾⁽¹⁴⁾ Telecommunications	Junior Secured Loan — Term Loan (Second Lien) 10.6% Cash, 3 month LIBOR(2.39%) + 8.25%; LIBOR Floor 1.25% , Due 11/20	5/21/2013	5,000,000	4,972,904	4,960,500
Global Tel*Link Corporation ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Telecommunications	Senior Secured Loan — Term Loan (First Lien) 6.4% Cash, 3 month LIBOR(2.39%) + 4.00%; LIBOR Floor 1.25% , Due 5/20	12/7/2017	1,473,788	1,471,308	1,477,473

See accompanying notes to financial statements.

Portfolio Company / Principal Business	Investment ¹⁶ Interest Rate ¹ / Maturity	Initial Acquisition Date	Principal	Amortized Cost	Fair Value
Grupo HIMA San Pablo, Inc. ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Term B Loan (First Lien) 9.3% Cash, 3 month LIBOR(2.34%) + 7.00%; LIBOR Floor 1.50% , Due 1/18	1/30/2013	2,850,000	2,850,000	2,750,250
Grupo HIMA San Pablo, Inc. ⁽⁵⁾⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	1/30/2013	7,191,667	7,169,109	4,350,959
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Media: Advertising, Printing & Publishing	Senior Secured Loan — Initial Term Loan 7.1% Cash, 3 month LIBOR(2.39%) + 4.75%; LIBOR Floor 1.00% , Due 11/23	6/18/2013	2,859,503	2,880,231	2,754,059
Hoffmaster Group, Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Forest Products & Paper	Junior Secured Loan — Initial Term Loan (Second Lien) 11.7% Cash, 1 month LIBOR(2.24%) + 9.50%; LIBOR Floor 1.00% , Due 11/24	5/6/2014	1,600,000	1,563,068	1,600,960
Infobase Holdings, Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ High Tech Industries	Senior Secured Loan — Term Loan 6.9% Cash, 3 month LIBOR(2.39%) + 4.50%; LIBOR Floor 1.00% , Due 12/22	12/13/2017	1,962,500	1,945,775	1,962,500
Ivanti Software, Inc. (fka LANDesk Group, Inc.) ⁽⁸⁾⁽¹⁴⁾ High Tech Industries	Junior Secured Loan — Loan (Second Lien) 11.1% Cash, 1 month LIBOR(2.08%) + 9.00%; LIBOR Floor 1.00% , Due 1/25	3/10/2017	3,228,619	3,228,619	3,174,378
Kellermeyer Bergensons Services, LLC ⁽⁸⁾ Services: Business	Senior Secured Loan — Initial Term Loan (First Lien) 7.3% Cash, 3 month LIBOR(2.32%) + 5.00%; LIBOR Floor 1.00% , Due 10/21	10/31/2014	992,268	992,268	992,466
MB Aerospace Holdings II Corp. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Aerospace and Defense	Senior Secured Loan — Initial Term Loan (First Lien) 5.7% Cash, 1 month LIBOR(2.24%) + 3.50%; LIBOR Floor 1.00% , Due 1/25	5/10/2013	1,240,625	1,235,005	1,205,763
Onex Carestream Finance LP ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 10.7% Cash, 1 month LIBOR(2.24%) + 8.50%; LIBOR Floor 1.00% , Due 12/19	10/7/2014	1,495,995	1,495,995	1,493,602
PVHC Holding Corp. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Chemicals, Plastics and Rubber	Senior Secured Loan — Initial Term Loan 7.1% Cash, 3 month LIBOR(2.39%) + 4.75%; LIBOR Floor 1.00% , Due 8/24	8/10/2018	2,880,000	2,865,898	2,865,600
Playpower, Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Construction & Building	Senior Secured Loan — Initial Term Loan (First Lien) 7.1% Cash, 3 month LIBOR(2.39%) + 4.75%; LIBOR Floor 1.00% , Due 6/21	6/23/2015	1,397,347	1,404,511	1,397,347

See accompanying notes to financial statements.

Portfolio Company / Principal Business	Investment ¹⁶ Interest Rate ¹ / Maturity	Initial Acquisition Date	Principal	Amortized Cost	Fair Value
PSC Industrial Holdings Corp. ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Junior Secured Loan — Initial Term Loan (Second Lien) 10.7% Cash, 1 month LIBOR(2.16%) + 8.50%; LIBOR Floor 1.00% , Due 10/25	10/5/2017	3,000,000	2,947,145	2,943,000
Q Holding Company (fka Lexington Precision Corporation) ⁽⁸⁾⁽¹⁵⁾ Chemicals, Plastics and Rubber	Senior Secured Loan — Term B Loan 7.2% Cash, 1 month LIBOR(2.24%) + 5.00%; LIBOR Floor 1.00% , Due 12/21	12/16/2016	1,984,536	2,009,931	1,985,727
Ravn Air Group, Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Aerospace and Defense	Senior Secured Loan — Initial Term Loan 7.4% Cash, 3 month LIBOR(2.39%) + 5.00%; LIBOR Floor 1.00% , Due 7/21	7/29/2015	1,921,233	1,921,233	1,880,119
Robertshaw US Holding Corp. (fka Fox US Bidco Corp.) ⁽⁸⁾⁽¹⁴⁾ Capital Equipment	Junior Secured Loan — Initial Term Loan (Second Lien) 10.3% Cash, 1 month LIBOR(2.25%) + 8.00%; LIBOR Floor 1.00% , Due 2/26	2/15/2018	3,000,000	2,972,150	2,967,900
Roscoe Medical, Inc. ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 11.25% Cash, Due 9/19	3/26/2014	1,700,000	1,696,955	1,598,000
Roscoe Medical, Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 11.25% Cash, Due 9/19	3/26/2014	5,000,000	4,991,060	4,700,000
Salient CRGT Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ High Tech Industries	Senior Secured Loan — Initial Term Loan 8.0% Cash, 1 month LIBOR(2.24%) + 5.75%; LIBOR Floor 1.00% , Due 2/22	2/27/2017	1,854,534	1,873,765	1,822,822
SCSG EA Acquisition Company, Inc. ⁽⁸⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Initial Term Loan (Second Lien) 10.6% Cash, 3 month LIBOR(2.34%) + 8.25%; LIBOR Floor 1.00% , Due 9/24	8/18/2017	1,000,000	990,804	990,600
SCSG EA Acquisition Company, Inc. ⁽⁸⁾⁽¹⁵⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Initial Term Loan (Second Lien) 10.6% Cash, 3 month LIBOR(2.34%) + 8.25%; LIBOR Floor 1.00% , Due 9/24	8/18/2017	5,000,000	4,957,642	4,953,000
Sierra Enterprises, LLC (aka Lyons Magnus) ⁽⁸⁾ ⁽¹⁴⁾⁽¹⁵⁾ Beverage, Food and Tobacco	Senior Secured Loan — Tranche B-1 Term Loan (First Lien) 6.0% Cash, 1 month LIBOR(2.24%) + 3.75%; LIBOR Floor 1.00% , Due 11/24	11/3/2017	2,977,538	2,963,917	2,996,296
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ⁽⁸⁾⁽¹³⁾⁽¹⁴⁾ Environmental Industries	Junior Secured Loan — Restructured Term Loan 1.0% Cash, 7.8% PIK, Due 10/22	6/25/2013	1,955,980	1,935,721	779,067

See accompanying notes to financial statements.

Portfolio Company / Principal Business	Investment ¹⁶ Interest Rate ¹ / Maturity	Initial Acquisition Date	Principal	Amortized Cost	Fair Value
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Senior Secured Loan — Term Loan 14.3% Cash, Due 10/22	6/25/2013	339,788	339,788	339,788
Tank Partners Holdings, LLC ⁽⁸⁾⁽¹³⁾⁽¹⁴⁾ Energy: Oil & Gas	Senior Secured Loan — Loan 3.0% Cash, 12.5% PIK, 1 month PRIME(5.00%) + 10.5%; PRIME Floor 3.00% , Due 8/19	8/28/2014	14,653,914	13,859,091	10,250,413
Tex-Tech Industries, Inc. ⁽⁸⁾⁽¹⁴⁾ Textiles and Leather	Junior Secured Loan — Term Loan (Second Lien) 11.1% Cash, 1 month LIBOR(2.08%) + 9.00%; LIBOR Floor 1.00% , Due 8/24	8/24/2017	8,008,000	7,957,406	7,947,940
Time Manufacturing Acquisition, LLC ⁽⁸⁾⁽¹⁴⁾ (15) Capital Equipment	Senior Secured Loan — Term Loan 7.6% Cash, 6 month LIBOR(2.63%) + 5.00%; LIBOR Floor 1.00% , Due 2/23	2/3/2017	1,979,912	1,982,187	1,970,012
Trimaran Advisors, L.L.C. ⁽⁸⁾⁽⁹⁾⁽¹⁴⁾ Related Party Loan	Senior Unsecured Loan — Term Loan Series 1 10.5% Cash, Due 4/30	10/30/2017	6,277,283	6,277,283	6,277,283
TronAir Parent Inc. ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Aerospace and Defense	Senior Secured Loan — Initial Term Loan (First Lien) 7.6% Cash, 12 month LIBOR(2.82%) + 4.75%; LIBOR Floor 1.00% , Due 9/23	9/30/2016	989,899	987,748	989,404
TRSO I, Inc. ⁽⁸⁾⁽¹⁴⁾ Energy: Oil & Gas	Junior Secured Loan — Term Loan (Second Lien) 14.0% Cash, Due 12/19	12/24/2012	1,000,000	996,487	1,000,000
Verdesian Life Sciences, LLC ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Environmental Industries	Senior Secured Loan — Initial Term Loan 7.3% Cash, 3 month LIBOR(2.34%) + 5.00%; LIBOR Floor 1.00% , Due 7/20	6/25/2014	2,108,735	2,058,968	2,044,419
Weiman Products, LLC ⁽⁸⁾⁽¹⁴⁾⁽¹⁵⁾ Consumer goods: Non-durable	Senior Secured Loan — Term Loan 6.6% Cash, 3 month LIBOR(2.39%) + 4.25%; LIBOR Floor 1.00% , Due 11/21	11/22/2013	1,601,066	1,593,869	1,593,061
WireCo WorldGroup Inc. ⁽⁸⁾⁽¹⁴⁾ Capital Equipment	Junior Secured Loan — Initial Term Loan (Second Lien) 11.2% Cash, 1 month LIBOR(2.24%) + 9.00%; LIBOR Floor 1.00% , Due 9/24	8/9/2016	3,000,000	2,966,200	2,981,250
Zest Acquisition Corp. ⁽⁸⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Initial Term Loan (Second Lien) 9.8% Cash, 3 month LIBOR(2.34%) + 7.50%; LIBOR Floor 1.00% , Due 3/26	3/8/2018	3,500,000	3,479,032	3,465,700
Total Investment in Debt Securities (80% of net asset value at fair value)			\$ 150,556,151	\$ 149,138,595	\$ 139,799,027

See accompanying notes to financial statements.

Equity Securities Portfolio

Portfolio Company / Principal Business	Investment ¹⁶	Initial Acquisition Date	Percentage Ownership/Shares	Cost	Fair Value ²
Advanced Lighting Technologies, Inc. ⁽⁸⁾⁽¹⁴⁾ Consumer goods: Durable	Warrants	6/13/2012	1.90%	\$ -	\$ 1,000
Advanced Lighting Technologies, Inc. ⁽⁸⁾⁽¹⁴⁾ Consumer goods: Durable	Membership Interests	6/13/2012	0.40%	181,999	1,000
Aerostructures Holdings L.P. ⁽⁸⁾⁽¹⁴⁾ Aerospace and Defense	Partnership Interests	2/28/2007	1.16%	1,000,000	892,283
Aerostructures Holdings L.P. ⁽⁸⁾⁽¹⁴⁾ Aerospace and Defense	Series A Preferred Interests	10/23/2008	1.16%	250,961	250,000
elInstruction Acquisition, LLC ⁽⁸⁾⁽¹⁴⁾ Services: Business	Membership Units	7/2/2007	1.10%	1,079,617	1,000
FP WRCA Coinvestment Fund VII, Ltd. ⁽³⁾⁽¹⁴⁾ Capital Equipment	Class A Shares	2/2/2007	0.41%	1,500,000	655,500
New Millennium Holdco, Inc. (Millennium Health, LLC) ⁽¹⁴⁾ Healthcare & Pharmaceuticals	Common	10/7/2014	0.20%	1,953,299	1,000
Perseus Holding Corp. ⁽¹⁴⁾ Hotel, Gaming & Leisure	Common	4/5/2007	0.19%	400,000	1,000
Roscoe Investors, LLC ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Class A Units	3/26/2014	1.56%	1,000,000	1,086,000
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Class B Units	6/25/2013	1.56%	-	1,000
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Class B Equity	6/25/2013	1.56%	-	1,000
Tank Partners Holdings, LLC ⁽⁸⁾⁽¹⁰⁾⁽¹⁴⁾ Energy: Oil & Gas	Unit	8/28/2014	10.68%	980,000	1,000
Tank Partners Holdings, LLC ⁽⁸⁾⁽¹⁴⁾ Energy: Oil & Gas	Warrants	8/28/2014	1.04%	185,205	1,000
TRSO II, Inc. ⁽⁸⁾⁽¹⁴⁾ Energy: Oil & Gas	Common Stock	10/23/2008	5.40%	1,680,161	1,029,417
Caribe Media Inc. (fka Caribe Information Investments Incorporated) ⁽⁸⁾⁽¹⁴⁾ Media: Advertising, Printing & Publishing	Common	7/2/2007	1.17%	359,765	157,136
Total Investment in Equity Securities (2% of net asset value at fair value)				\$ 10,571,007	\$ 4,079,336

See accompanying notes to financial statements.

CLO Fund Securities

CLO Subordinated Investments

Portfolio Company	Investment ^{16,11}	Initial Acquisition Date	Percentage Ownership	Amortized Cost	Fair Value
Grant Grove CLO, Ltd. ⁽³⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest N/M, ¹⁷ 1/21 maturity	3/13/2007	22.2%	\$ 2,485,886	\$ 1,000
Katonah III, Ltd. ⁽³⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest N/M, ¹⁷ 5/15 maturity	12/11/2006	23.1%	1,287,155	369,280
Katonah 2007-I CLO Ltd. ⁽³⁾⁽⁶⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest N/M, ¹⁷ 4/22 maturity	1/23/2008	100.0%	10,309,141	150,000
Trimaran CLO VII, Ltd. ⁽³⁾⁽⁶⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest N/M, ¹⁷ 6/21 maturity	2/29/2012	10.5%	379,830	10,000
Catamaran CLO 2012-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest N/M, ¹⁷ 12/23 maturity	12/20/2012	24.9%	3,534,069	10,000
Catamaran CLO 2013- 1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 21.3%, 1/28 maturity	6/4/2013	18.3%	4,976,307	6,072,051
Catamaran CLO 2014-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 13.3%, 4/30 maturity	5/6/2014	20.1%	9,863,503	9,709,699
Dryden 30 Senior Loan Fund ⁽³⁾⁽¹⁴⁾	Subordinated Securities, effective interest 27.2%, 12/29 maturity	10/10/2013	6.8%	1,415,721	2,082,593
Catamaran CLO 2014-2 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 7.8%, 11/25 maturity	8/15/2014	24.9%	6,372,132	4,262,959
Catamaran CLO 2015-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 10.4%, 10/26 maturity	5/5/2015	9.9%	4,414,389	3,492,190
Catamaran CLO 2016-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 8.7%, 4/27 maturity	12/21/2016	24.9%	9,835,446	8,132,726
Catamaran CLO 2018-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 15.0%, 10/31 maturity	9/27/2018	24.8%	9,500,000	9,000,000
Total Investment in CLO Subordinated Securities				\$ 64,373,579	\$ 43,292,498

CLO Rated-Note Investment

Portfolio Company	Investment ¹⁶	Initial Acquisition Date	Percentage Ownership	Amortized Cost	Fair Value
KCAP F3C Senior Funding LLC ⁽⁶⁾⁽¹⁴⁾	Class E Notes, 9.8% Cash, 3 month LIBOR (2.34%) + 7.50%, Due 12/29	10/24/2017	27.2%	4,395,666	4,691,433
Total Investment in CLO Rated-Note				\$ 4,395,666	\$ 4,691,433
Total Investment in CLO Fund Securities (28% of net asset value at fair value)				\$ 68,769,245	\$ 47,983,931

See accompanying notes to consolidated financial statements.

Asset Manager Affiliates

<u>Portfolio Company / Principal Business</u>	<u>Investment¹⁶</u>	<u>Initial Acquisition Date</u>	<u>Percentage Ownership</u>	<u>Cost</u>	<u>Fair Value²</u>
Asset Manager Affiliates ⁽⁸⁾⁽⁹⁾⁽¹⁴⁾	Asset Management Company	12/11/2006	100%	\$ 51,591,230	\$ 35,818,000
Total Investment in Asset Manager Affiliates (21% of net asset value at fair value)				\$ 51,591,230	\$ 35,818,000

Joint Ventures

<u>Portfolio Company / Principal Business</u>	<u>Investment¹⁶</u>	<u>Initial Acquisition Date</u>	<u>Percentage Ownership</u>	<u>Cost</u>	<u>Fair Value</u>
KCAP Freedom 3 LLC ⁽⁹⁾⁽¹⁴⁾	Joint Venture	7/19/2017	60%	\$ 24,914,858	\$ 21,373,570
Total Investment in Joint Ventures (12% of net asset value at fair value)				\$ 24,914,858	\$ 21,373,570

Short-term Investments

<u>Short-term Investments</u>	<u>Investment¹⁶</u>	<u>Initial Acquisition Date</u>	<u>Yield</u>	<u>Par /Amortized Cost</u>	<u>Fair Value²</u>
US Bank Money Market Account ⁽⁷⁾⁽⁸⁾	Money Market Account	N/A	0.20%	\$ 24,431,512	\$ 24,431,512
Total Short-term Investments (14% of net asset value at fair value)				\$ 24,431,512	\$ 24,431,512
Total Investments⁴				\$ 329,416,447	\$ 273,485,375

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 September 30, 2018. As noted in the table above, 77% (based on par) of debt securities contain floors which range between 1.00% and 3.00%.

2 Reflects the fair market value of all investments as of September 30, 2018, 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 \$329 million. The aggregate gross unrealized appreciation is approximately \$0.3 million, the aggregate gross unrealized depreciation is approximately \$56.2 million, and the net unrealized depreciation is approximately \$55.9 million.

5 Loan or debt security is on non-accrual status and therefore is considered 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.

8 Qualified asset for purposes of section 55(a) of the Investment Company Act of 1940, as amended (the "1940 Act"). Qualifying assets represent approximately 74% of the total investments at September 30, 2018.

See accompanying notes to consolidated financial statements.

- 9 As defined in the 1940 Act, the Company is deemed to be both an “Affiliated Person” and has “Control” of this portfolio company as the Company owns more than 25% of the portfolio company’s outstanding voting securities or has the power to exercise control over management or policies of such portfolio company (including through a management agreement). Other than for purposes of the 1940 Act, the Company does not believe that it has control over this portfolio company.
- 10 Non-voting.
- 11 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.
- 12 Notice of redemption has been received for this security.
- 13 Loan or security was on partial nonaccrual status, whereby we have recognized income on a portion of contractual PIK amounts due.
- 14 Fair value of this investment was determined using significant unobservable inputs.
- 15 As of September 30, 2018, this investment is owned by KCAP Funding I, LLC and was pledged to secure KCAP Funding I, LLC’s debt obligation pursuant to its senior secured revolving credit facility (the “Revolving Credit Facility”) with the Company, as the servicer, certain institutional lenders, State Bank and Trust Company, as the administrative agent, lead arranger and bookrunner, and CIBC Bank USA, as documentation agent.
- 16 The Company’s investments are generally acquired in private transactions exempt from registration under the Securities Act of 1933, as amended (the “Securities Act”) and, therefore, are generally subject to limitations on resale, and may be deemed to be “restricted securities” under the Securities Act of 1933.
- 17 The remaining collateral in these CLO Fund portfolios are illiquid and not producing meaningful cash flows, and thus, the Company’s investment in the CLO Subordinated securities are not currently receiving periodic cash distributions. Accordingly, the Company is no longer recording any investment income from these investments, and has thus noted the effective interest as not meaningful, or N/M. The fair value of the investment reflects the Company’s estimated share of the fair value of the underlying collateral.

See accompanying notes to consolidated financial statements.

KCAP FINANCIAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
As of December 31, 2017

Debt Securities Portfolio

Portfolio Company / Principal Business	Investment Interest Rate ¹ / Maturity	Principal	Amortized Cost	Fair Value ²
Advanced Lighting Technologies, Inc. ⁽⁸⁾⁽¹⁴⁾ Consumer goods: Durable	Junior Secured Loan — Second Lien Notes 8.7% Cash, 10.0% PIK, 3 month LIBOR(1.70%) + 17.00%; LIBOR Floor 1.00% , Due 10/23	\$ 889,340	\$ 889,338	\$ 803,598
Advantage Sales & Marketing Inc. ⁽⁸⁾⁽¹⁴⁾ Services: Business	Junior Secured Loan — Term Loan (Second Lien) 7.9% Cash, 3 month LIBOR(1.38%) + 6.50%; LIBOR Floor 1.00% , Due 7/22	1,000,000	1,001,438	988,000
API Technologies Corp. ⁽⁸⁾ High Tech Industries	Senior Secured Loan — Initial Term Loan 8.2% Cash, 3 month LIBOR(1.69%) + 6.50%; LIBOR Floor 1.00% , Due 4/22	3,080,305	3,110,759	3,111,108
Avalign Technologies, Inc. ⁽⁸⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Initial Term Loan (First Lien) 6.1% Cash, 1 month LIBOR(1.57%) + 4.50%; LIBOR Floor 1.00% , Due 7/21	1,065,342	1,062,983	1,054,689
Avalign Technologies, Inc. ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Initial Term Loan (Second Lien) 9.7% Cash, 6 month LIBOR(1.46%) + 8.25%; LIBOR Floor 1.00% , Due 7/22	1,500,000	1,488,964	1,467,300
BMC Acquisition, Inc. (aka BenefitMall) ⁽⁸⁾⁽¹⁴⁾ Banking, Finance, Insurance & Real Estate	Senior Secured Loan — Initial Term Loan 7.0% Cash, 3 month LIBOR(1.84%) + 5.17%; LIBOR Floor 1.00% , Due 12/24	3,000,000	2,998,125	2,970,000
Carolina Beverage Group LLC ⁽⁸⁾⁽¹⁴⁾ Beverage, Food and Tobacco	Senior Secured Bond — 10.625% - 08/2018 - 143818AA0 144A 10.6% Cash, Due 8/18	1,500,000	1,502,374	1,518,750
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) ⁽⁸⁾⁽¹⁴⁾ Beverage, Food and Tobacco	Junior Secured Loan — Term Loan (Second Lien) 9.1% Cash, 3 month LIBOR(1.33%) + 7.75%; LIBOR Floor 1.00% , Due 7/21	3,000,000	3,008,816	2,914,800
DigiCert, Inc. ⁽⁸⁾ High Tech Industries	Junior Secured Loan — Initial Loan (Second Lien) 9.4% Cash, 3 month LIBOR(1.38%) + 8.00%; LIBOR Floor 1.00% , Due 10/25	1,000,000	995,059	979,100
Drew Marine Group Inc. ⁽⁸⁾ Transportation: Cargo	Junior Secured Loan — Term Loan (Second Lien) 8.6% Cash, 1 month LIBOR(1.57%) + 7.00%; LIBOR Floor 1.00% , Due 5/21	4,000,000	4,000,901	4,010,000

Portfolio Company/ Principal Business	Investment⁵ Interest Rate¹/Maturity	Principal	Amortized Cost	Fair Value
EagleTree-Carbide Acquisition Corp. (aka Corsair Components, Inc.) ⁽⁸⁾⁽¹⁴⁾ High Tech Industries	Junior Secured Loan — Term Loan (Second Lien) 10.2% Cash, 3 month LIBOR(1.69%) + 8.50%; LIBOR Floor 1.00% , Due 8/25	5,000,000	4,927,010	4,997,500
First American Payment Systems, L.P. ⁽⁸⁾ Banking, Finance, Insurance & Real Estate	Junior Secured Loan — Term Loan (Second Lien) 11.9% Cash, 1 month LIBOR(1.39%) + 10.50%; LIBOR Floor 1.00% , Due 7/24	1,500,000	1,460,837	1,448,400
Flexera Software LLC (fka Flexera Software, Inc.) ⁽⁸⁾ High Tech Industries	Senior Secured Loan — Term Loan (First Lien) 5.1% Cash, 1 month LIBOR(1.57%) + 3.50%; LIBOR Floor 1.00% , Due 4/20	2,000,000	1,995,443	2,000,000
GI Advo Opco, LLC ⁽⁸⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Term Loan 6.2% Cash, 3 month LIBOR(1.69%) + 4.50%; LIBOR Floor 1.00% , Due 11/21	230,756	229,252	230,732
GK Holdings, Inc. (aka Global Knowledge) ⁽⁸⁾ Services: Business	Junior Secured Loan — Initial Term Loan (Second Lien) 11.9% Cash, 3 month LIBOR(1.69%) + 10.25%; LIBOR Floor 1.00% , Due 1/22	1,500,000	1,482,520	1,376,400
Global Tel*Link Corporation ⁽⁸⁾ Telecommunications	Senior Secured Loan — Term Loan (First Lien) 5.7% Cash, 3 month LIBOR(1.69%) + 4.00%; LIBOR Floor 1.25% , Due 5/20	1,495,689	1,492,021	1,491,949
Global Tel*Link Corporation ⁽⁸⁾⁽¹⁴⁾ Telecommunications	Junior Secured Loan — Term Loan (Second Lien) 9.9% Cash, 3 month LIBOR(1.69%) + 8.25%; LIBOR Floor 1.25% , Due 11/20	5,000,000	4,963,469	4,975,000
Grupo HIMA San Pablo, Inc. ⁽⁸⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 3 month LIBOR(1.50%) + 7.00%; LIBOR Floor 1.50% , Due 1/18	2,850,000	2,849,063	2,593,500
Grupo HIMA San Pablo, Inc. ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,191,667	7,174,676	4,566,708
Harland Clarke Holdings Corp. (fka Clarke American Corp.) ⁽⁸⁾⁽¹⁴⁾ Media: Advertising, Printing & Publishing	Senior Secured Loan — Initial Term Loan 6.4% Cash, 3 month LIBOR(1.69%) + 4.75%; LIBOR Floor 1.00% , Due 11/23	2,986,482	3,011,321	3,003,281
Hoffmaster Group, Inc. ⁽⁸⁾⁽¹⁴⁾ Forest Products & Paper	Junior Secured Loan — Initial Term Loan (Second Lien) 11.2% Cash, 3 month LIBOR(1.69%) + 9.50%; LIBOR Floor 1.00% , Due 11/24	1,600,000	1,558,556	1,600,960
Industrial Services Acquisition, LLC (aka Evergreen / NAIC) ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Senior Secured Loan — Term Loan 6.6% Cash, 1 month LIBOR(1.63%) + 5.00%; LIBOR Floor 1.00% , Due 6/22	1,167,909	1,173,405	1,167,909

Portfolio Company/ Principal Business	Investment⁵ Interest Rate¹/Maturity	Principal	Amortized Cost	Fair Value
Infobase Holdings, Inc. ⁽⁸⁾⁽¹⁴⁾ High Tech Industries	Senior Secured Loan — Term Loan 8.0% Cash, Prime LIBOR(0.00%) + 8.00%; LIBOR Floor 0.00% , Due 12/22	2,000,000	1,980,000	1,980,000
Ivanti Software, Inc. (fka LANDesk Group, Inc.) ⁽⁸⁾ High Tech Industries	Junior Secured Loan — Loan (Second Lien) 10.6% Cash, 1 month LIBOR(1.57%) + 9.00%; LIBOR Floor 1.00% , Due 1/25	3,228,619	3,228,619	3,200,530
MB Aerospace ACP Holdings II Corp. ⁽⁸⁾⁽¹⁴⁾ Aerospace and Defense	Senior Secured Loan — Initial Term Loan 7.1% Cash, 1 month LIBOR(1.63%) + 5.50%; LIBOR Floor 1.00% , Due 12/22	980,000	981,158	980,000
MB Aerospace ACP Holdings III Corp. ⁽⁸⁾⁽¹⁴⁾ Aerospace and Defense	Senior Secured Loan — Term Loan 5.1% Cash, 1 month LIBOR(1.58%) + 3.50%; LIBOR Floor 1.00% , Due 1/25	1,250,000	1,243,750	1,243,750
National Home Health Care Corp. ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 10.4% Cash, 1 month LIBOR(1.43%) + 9.00%; LIBOR Floor 1.00% , Due 12/22	1,500,728	1,482,044	1,458,257
Onex Carestream Finance Lp ⁽⁸⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 10.2% Cash, 3 month LIBOR(1.69%) + 8.50%; LIBOR Floor 1.00% , Due 12/19	1,495,995	1,495,995	1,487,618
Playpower, Inc. ⁽⁸⁾⁽¹⁴⁾ Construction & Building	Senior Secured Loan — Initial Term Loan (First Lien) 6.4% Cash, 3 month LIBOR(1.69%) + 4.75%; LIBOR Floor 1.00% , Due 6/21	994,898	1,004,093	999,872
PSC Industrial Holdings Corp. ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, 1 month LIBOR(1.46%) + 8.50%; LIBOR Floor 1.00% , Due 10/25	3,000,000	2,941,524	2,940,000
RESIC Enterprises, LLC (aka Lyons Magnus) ⁽⁸⁾ Beverage, Food and Tobacco	Senior Secured Loan — Initial Term Loan (First Lien) 5.7% Cash, 1 month LIBOR(1.43%) + 4.25%; LIBOR Floor 1.00% , Due 11/24	3,000,000	2,985,247	3,001,500
Roscoe Medical, Inc. ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	6,700,000	6,678,900	6,468,850
Salient CRGT Inc. ⁽⁸⁾ High Tech Industries	Senior Secured Loan — Initial Term Loan 7.3% Cash, 1 month LIBOR(1.57%) + 5.75%; LIBOR Floor 1.00% , Due 2/22	1,967,742	1,992,339	1,992,339

Portfolio Company/ Principal Business	Investment⁵ Interest Rate¹/Maturity	Principal	Amortized Cost	Fair Value
SCSG EA Acquisition Company, Inc. ⁽⁸⁾ Healthcare & Pharmaceuticals	Senior Secured Loan — Initial Term Loan (Second Lien) 9.7% Cash, 3 month LIBOR(1.48%) + 8.25%; LIBOR Floor 1.00% , Due 9/24	5,000,000	4,952,274	4,955,000
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ⁽⁸⁾⁽¹³⁾⁽¹⁴⁾ Environmental Industries	Junior Secured Loan — Restructured Term Loan 8.2% Cash, 7.2% PIK, 3 month LIBOR(1.57%) + 6.62%; LIBOR Floor 1.00% , Due 10/22	1,883,914	1,875,914	1,318,740
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Senior Secured Loan — Term Loan 13.7% Cash, 3 month LIBOR(1.69%) + 12.00%; LIBOR Floor 1.00% , Due 10/22	339,788	339,788	339,788
Tank Partners Holdings, LLC ⁽⁸⁾⁽¹³⁾ Energy: Oil & Gas	Senior Secured Loan — Loan 2.0% Cash, 12.8% PIK, Base Rate (4.25%) + 10.5% , Due 8/19	12,739,078	12,258,031	9,153,028
Tex-Tech Industries, Inc. ⁽⁸⁾ Textiles and Leather	Junior Secured Loan — Term Loan (Second Lien) 10.6% Cash, 1 month LIBOR(1.57%) + 9.00%; LIBOR Floor 1.00% , Due 8/24	8,008,000	7,950,994	7,947,940
Time Manufacturing Acquisition, LLC ⁽⁸⁾ Capital Equipment	Senior Secured Loan — Term Loan 6.8% Cash, 3 month LIBOR(1.75%) + 5.00%; LIBOR Floor 1.00% , Due 2/23	994,987	992,633	999,962
Trimaran Advisors, L.L.C. ⁽⁸⁾⁽⁹⁾⁽¹⁴⁾ Related Party Loan	Senior Unsecured Loan — Term Loan Series 1 10.5% Cash, Due 4/30	8,359,051	8,359,051	8,359,051
Trimaran Advisors, L.L.C. ⁽⁸⁾⁽⁹⁾⁽¹⁴⁾ Related Party Loan	Senior Unsecured Loan — Term Loan Series 2 10.5% Cash, Due 1/28	4,418,232	4,418,232	4,418,232
TronAir Parent Inc. ⁽⁸⁾⁽¹⁴⁾ Aerospace and Defense	Senior Secured Loan — Initial Term Loan (First Lien) 6.2% Cash, 1 month LIBOR(1.41%) + 4.75%; LIBOR Floor 1.00% , Due 9/23	997,475	994,981	997,076
TRSO I, Inc. ⁽⁸⁾⁽¹⁴⁾ Energy: Oil & Gas	Junior Secured Loan — Term Loan (Second Lien) 14.0% Cash, 3 month LIBOR(1.00%) + 13.00%; LIBOR Floor 1.00% , Due 12/19	1,000,000	994,351	1,000,000
Weiman Products, LLC ⁽⁸⁾⁽¹⁴⁾ Consumer goods: Non-durable	Senior Secured Loan — Term Loan (2013) 6.2% Cash, 3 month LIBOR(1.69%) + 4.50%; LIBOR Floor 1.00% , Due 11/21	694,662	691,234	694,662

Portfolio Company/ Principal Business	Investment⁵ Interest Rate¹/Maturity	Principal	Amortized Cost	Fair Value
WireCo WorldGroup Inc. ⁽⁸⁾⁽¹⁴⁾ Capital Equipment	Junior Secured Loan — Initial Term Loan (Second Lien) 10.5% Cash, 3 month LIBOR(1.48%) + 9.00%; LIBOR Floor 1.00% , Due 9/24	3,000,000	2,961,988	2,991,600
Total Investment in Debt Securities (65% of net asset value at fair value)		\$ 126,110,659	\$ 125,179,470	\$ 118,197,479

Equity Securities Portfolio

Portfolio Company / Principal Business	Investment	Percentage Ownership/Shares	Cost	Fair Value ²
Aerostructures Holdings L.P. ⁽⁸⁾⁽¹⁴⁾ Aerospace and Defense	Partnership Interests	1.2%	\$ 1,000,000	\$ 1,000
Aerostructures Holdings L.P. ⁽⁸⁾⁽¹⁴⁾ Aerospace and Defense	Series A Preferred Interests	1.2%	250,960	891,661
DBI Holding LLC ⁽⁸⁾⁽¹⁴⁾ Services: Business	Warrants	3.2%	-	1,000
eInstruction Acquisition, LLC ⁽⁸⁾⁽¹⁴⁾ Services: Business	Membership Units	1.1%	1,079,617	1,000
FP WRCA Coinvestment Fund VII, Ltd. ⁽³⁾⁽¹⁴⁾ Capital Equipment	Class A Shares	0.0%	1,500,000	689,259
New Millennium Holdco, Inc. (Millennium Health, LLC) ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Common	0.2%	1,953,299	1,000
Perseus Holding Corp. ⁽¹⁴⁾ Hotel, Gaming & Leisure	Common	-	400,000	1,000
Roscoe Investors, LLC ⁽⁸⁾⁽¹⁴⁾ Healthcare & Pharmaceuticals	Class A Units	1.6%	1,000,000	1,229,000
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Class A Equity	1.6%	-	-
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) ⁽⁸⁾⁽¹⁴⁾ Environmental Industries	Class B Units	1.5%	-	-
Tank Partners Holdings, LLC ⁽⁸⁾⁽¹⁰⁾⁽¹⁴⁾ Energy: Oil & Gas	Unit	1.3%	980,000	1,000
Tank Partners Holdings, LLC ⁽⁸⁾⁽¹⁴⁾ Energy: Oil & Gas	Warrants	1.3%	185,205	1,000
TRSO II, Inc. ⁽⁸⁾⁽¹⁴⁾ Energy: Oil & Gas	Common Stock	5.4%	1,680,161	1,280,749
Advanced Lighting Technologies, Inc. ⁽⁸⁾⁽¹⁴⁾ Consumer goods: Durable	Warrants	1.9%	-	1,000
Advanced Lighting Technologies, Inc. ⁽⁸⁾⁽¹⁴⁾ Consumer goods: Durable	Membership Interests	0.4%	182,000	1,000
Caribe Media Inc. (fka Caribe Information Investments Incorporated) ⁽⁸⁾⁽¹⁴⁾ Media: Advertising, Printing & Publishing	Common	1.2%	359,765	315,015
Total Investment in Equity Securities (2% of net asset value at fair value)			\$ 10,571,007	\$ 4,414,684

CLO Fund Securities**CLO Subordinated Investments**

Portfolio Company	Investment⁽¹¹⁾	Percentage Ownership	Amortized Cost	Fair Value
Grant Grove CLO, Ltd. ⁽³⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest N/M, 1/21 maturity	22.2%	\$ 2,485,886	\$ 1,000
Katonah III, Ltd. ⁽³⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest N/M, 5/15 maturity	23.1%	1,287,155	369,280
Katonah 2007-I CLO Ltd. ⁽³⁾⁽⁶⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest 9.2%, 4/22 maturity	100.0%	20,524,908	10,770,486
Trimaran CLO VII, Ltd. ⁽³⁾⁽⁶⁾⁽¹²⁾⁽¹⁴⁾	Subordinated Securities, effective interest N/M, 6/21 maturity	10.5%	379,830	10,000
Catamaran CLO 2012-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 15.5%, 12/23 maturity	24.9%	5,847,802	2,320,783
Catamaran CLO 2013- 1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 25.1%, 1/28 maturity	18.3%	5,017,307	6,923,699
Catamaran CLO 2014-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 28.4%, 4/30 maturity	20.1%	9,858,073	8,230,178
Dryden 30 Senior Loan Fund ⁽³⁾⁽¹⁴⁾	Subordinated Securities, effective interest 28.7%, 12/29 maturity	6.8%	1,353,852	1,820,000
Catamaran CLO 2014-2 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 11.5%, 11/25 maturity	24.9%	6,642,805	4,500,962
Catamaran CLO 2015-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 11.8%, 10/26 maturity	9.9%	4,418,647	3,569,600
Catamaran CLO 2016-1 Ltd. ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Subordinated Securities, effective interest 9.6%, 4/27 maturity	24.9%	10,086,802	8,530,685
Total Investment in CLO Subordinated Securities			\$ 67,903,067	\$ 47,046,673

CLO Rated-Note Investment

Portfolio Company	Investment	Percentage Ownership	Amortized Cost	Fair Value
KCAP F3C Senior Funding LLC ⁽³⁾⁽⁶⁾⁽¹⁴⁾	Class E Notes, 8.9% Cash, 3 month LIBOR (1.40%) + 7.50%, Due 12/29	27.4%	4,435,965	4,632,000
Total Investment in CLO Rated-Note			\$ 4,435,965	\$ 4,632,000
Total Investment in CLO Fund Securities (28% of net asset value at fair value)			\$ 72,339,032	\$ 51,678,673

Asset Manager Affiliates

Portfolio Company / Principal Business	Investment	Percentage Ownership	Cost	Fair Value ²
Asset Manager Affiliates ⁽⁸⁾⁽⁹⁾⁽¹⁴⁾	Asset Management Company	100%	\$ 52,591,230	\$ 38,849,000
Total Investment in Asset Manager Affiliates (21% of net asset value at fair value)			\$ 52,591,230	\$ 38,849,000

Joint Ventures

Portfolio Company / Principal Business	Investment	Percentage Ownership	Cost	Fair Value
KCAP Freedom 3 LLC ⁽⁹⁾⁽¹⁴⁾	Joint Venture	60%	\$ 24,914,858	\$ 21,516,000
Total Investment in Joint Ventures (12% of net asset value at fair value)			\$ 24,914,858	\$ 21,516,000

Short-term Investments

Short-term Investments	Investment	Yield	Par /Amortized Cost	Fair Value ²
US Bank Money Market Account ⁽⁷⁾⁽⁸⁾	Money Market Account	0.20%	\$ 52,293,570	\$ 52,293,570
U.S Treasury Bills - CUSIP: 912796MLO ⁽⁸⁾	U.S. Government Obligation	1.04%	25,006,750	25,006,750
Total Short-term Investments (43% of net asset value at fair value)			\$ 77,300,320	\$ 77,300,320
Total Investments⁴			\$ 362,895,917	\$ 311,956,156

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, 2017. As noted in the table above, 74% (based on par) of debt securities contain LIBOR floors which range between 1.00% and 3.0%.

2 Reflects the fair market value of all investments as of December 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 \$363 million. The aggregate gross unrealized appreciation is approximately \$1.1 million, the aggregate gross unrealized depreciation is approximately \$52.0 million, and the net unrealized depreciation is approximately \$50.9 million.

5 No loan or debt securities were on non-accrual status as of December 31, 2017.

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 cash.

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

9 As defined in the 1940 Act, the Company is deemed to be both an "Affiliated Person" and has "Control" of this portfolio company as the Company owns more than 25% of the portfolio company's outstanding voting securities or has the power to exercise control over management or policies of such portfolio company (including through a management agreement). Other than for purposes of the 1940 Act, the Company does not believe that it has control over this portfolio company.

10 Non-voting.

11 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.

12 Notice of redemption has been received for this security.

13 Loan or security was on partial nonaccrual status, whereby we have recognized income on a portion of contractual PIK amounts due.

14 Fair value of this investment was determined using significant unobservable inputs.

KCAP FINANCIAL, INC.
CONSOLIDATED FINANCIAL HIGHLIGHTS
(unaudited)

	Nine Months Ended September 30,	
	2018	2017
Per Share Data:		
Net asset value, at beginning of period	\$ 4.87	\$ 5.24
Net investment income ¹	0.21	0.23
Net realized gains (losses) from investments ¹	-	(0.08)
Realized losses from extinguishment of debt ¹	-	(0.11)
Net change in unrealized depreciation on investments ¹	(0.13)	0.02
Net increase in net assets resulting from operations ⁴	0.07	0.06
Net decrease in net assets resulting from stockholder distributions	(0.30)	(0.36)
Net increase in net assets relating to stock-based transactions:		
Dividend reinvestment plan	-	(0.01)
Common stock withheld for payroll taxes upon vesting of restricted stock	-	0.01
Stock based compensation	0.02	-
Net increase in net assets relating to stock-based transactions ⁴	0.02	-
Net asset value, end of period ⁴	\$ 4.66	\$ 4.95
Total net asset value return ²	1.8%	1.3%
Ratio/Supplemental Data:		
Per share market value at beginning of period	\$ 3.41	\$ 3.98
Per share market value at end of period	\$ 3.31	\$ 3.65
Total market return ³	5.9%	0.7%
Shares outstanding at end of period	37,349,224	37,317,815
Net assets at end of period	\$ 173,908,505	\$ 184,785,444
Portfolio turnover rate ⁶	39.4%	73.8%
Average par debt outstanding	\$ 105,719,241	\$ 144,298,499
Asset coverage ratio	259%	274%
Ratio of net investment income to average net assets ⁵	6.0%%	5.9%
Ratio of total expenses to average net assets ⁵	9.7%%	9.4%
Ratio of interest expense to average net assets ⁵	4.2%%	4.1%
Ratio of non-interest expenses to average net assets ⁵	5.5%%	5.3%

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 Totals may not sum due to rounding.

5 Annualized.

6 Portfolio turnover rate equals the year-to-date sales and paydowns over the average of the invested assets at fair value.

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 ("CLO") 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 September 30, 2018, Katonah Debt Advisors and Trimaran Advisors, as well as affiliated management companies Katonah 2007-1 Management, L.L.C., Trimaran Advisors Management, L.L.C. and KCAP Management, L.L.C. (collectively the "Asset Manager Affiliates"), had approximately \$3.2 billion of par value assets under management. Katonah Debt Advisors and Trimaran Advisors are registered under the Investment Advisers Act of 1940, as amended, and are each managed independently from the Company by a separate management team (however, certain of the Company's executive officers also act in similar capacities for one or more 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, either directly or through their subsidiaries, may make investments in the CLO Funds they manage. In addition, the Company holds investments in a portion of the securities issued by the CLO Funds managed by the Asset Manager Affiliates.

During the third quarter of 2017, the Company formed a joint venture with Freedom 3 Opportunities LLC ("Freedom 3 Opportunities"), an affiliate of Freedom 3 Capital LLC, to create KCAP Freedom 3 LLC (the "Joint Venture"). The Company and Freedom 3 Opportunities LLC contributed approximately \$37 million and \$25 million, respectively, in assets to the Joint Venture, which in turn used the assets to capitalize a new fund (KCAP F3C Senior Funding, L.L.C. or the "Fund") managed by KCAP Management, LLC, one of the Company's indirectly wholly-owned Asset Manager Affiliate subsidiaries. In addition, the Fund used cash on hand and borrowings under a credit facility to purchase approximately \$184 million of loans from the Company and the Company used the proceeds from such sale to redeem approximately \$147 million in debt issued by KCAP Senior Funding. The Joint Venture may originate loans from time to time and sell them to the Fund.

During the fourth quarter of 2017, the Fund was refinanced through the issuance of senior and subordinated notes. The Joint Venture purchased 100% of the subordinated notes issued by the Fund. In connection with the refinancing, the Company received a cash distribution of \$12.6 million, \$11.8 million of which was a return of capital.

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, joint venture 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.

On March 29, 2018, the Company’s Board of Directors, including a “required majority” (as such term is defined in Section 57(o) of the 1940 Act) of the Board, approved the modified asset coverage requirements set forth in Section 61(a)(2) of the 1940 Act, as amended by the Small Business Credit Availability Act (“SBCA”). As a result, the Company’s asset coverage requirement for senior securities will be changed from 200% to 150%, effective as of March 29, 2019. However, despite the SBCA, we will continue to be prohibited by the indentures governing our 7.375% Notes and 6.125% Notes (each, as defined and discussed in Note 6- “Borrowings” below) 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.

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 (“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, 2017, 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 KCAP Funding, Kollberg Capital Funding LLC I, KCAP Senior Funding I, LLC, KCAP Senior Funding I Holdings, LLC and KCAP Funding I, LLC in its consolidated financial statements as they are operated solely for investment activities of the Company. The creditors of KCAP Funding I, LLC received security interests in the assets which owned by KCAP Funding I, LLC and such assets are not intended to be available to the creditors of the Company, or any other affiliate. All of the borrowings of KCAP Funding, Kollberg Capital Funding LLC I, and KCAP Senior Funding I, LLC have been fully repaid.

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

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

In addition, in accordance with 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 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 September 30, 2018, the Company provided approximately \$66.0 million to portfolio companies to support their growth objectives. None of this support was contractually obligated. See also Note 8 – Commitments and Contingencies. As of September 30, 2018, the Company held loans it has made to 47 investee companies with aggregate principal amounts of approximately \$150.6 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 nine months ended September 30, 2018, the Company did not engage in any such or similar activities.

Recently adopted accounting pronouncements

The Financial Accounting Standards Board (the “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 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 has concluded that the majority of its revenues associated with the financial instruments are scoped out of ASC 606, and therefore, there was no material impact from adoption.

Pending accounting pronouncements

In March 2017, the FASB issued an Accounting Standards Update, ASU 2017-08, Receivables — Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities (“ASU 2017-08”) which amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. ASU 2017-08 does not require any accounting change for debt securities held at a discount; the discount continues to be amortized to maturity. ASU 2017-08 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. At this time, management is evaluating the implications of these changes on the financial statements.

In August 2018, the FASB issued Accounting Standards Update 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement (“ASU 2018-13”). The standard will modify the disclosure requirements for fair value measurements by removing, modifying, or adding certain disclosures. ASU 2018-13 is effective for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period. Early adoption is permitted upon issuance of this ASU 2018-13. We are permitted to early adopt any removed or modified disclosures upon issuance of ASU 2018-13 and delay adoption of the additional disclosures until their effective date. We are currently evaluating the impact of adopting ASU 2018-13 on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, and several amendments (collectively, “ASU 2016-02”), which requires lessees to recognize assets and liabilities arising from most operating leases on the consolidated statements of financial condition. For operating leases, a lessee is required to do the following: (a) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial condition; (b) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis and (c) classify all cash payments within operating activities in the statement of cash flows. The guidance is effective for fiscal periods beginning after December 15, 2018. Early application is permitted. The Company is currently evaluating the impact of this guidance and expects to record assets and liabilities for its current operating leases upon adoption of ASU 2016-02. The Company does not expect the adoption of ASU 2016-02 to have a material impact on its results of operations or cash flows.

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.

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

The Board of Directors may consider other methods of valuation than those set forth below to determine the fair value of Level III investments as appropriate in conformity with GAAP. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of the Company’s investments may differ materially from the values that would have been used had a readily available market existed for such investments. Further, such investments may be generally subject to 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 Consolidated 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, 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.

Joint Venture. The Company carries investments in joint ventures at fair value based upon the fair value of the investments held by the joint venture. See Note 4 below, for more information regarding the Joint Venture.

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 Funding I, LLC and/or KCAP Senior Funding I, LLC.

Short-term investments. Short-term investments are generally comprised of money market accounts, time deposits, and U.S. treasury bills.

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 September 30, 2018, one of our investments was on non-accrual status, and three 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.

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

For non-junior class CLO Fund Securities, such as the Company's investment in the Class E Notes of the KCAP F3C Senior Funding, LLC, interest is earned at a fixed spread relative to the LIBOR index.

Investment in Joint Venture. For the three months and nine months ended September 30, 2018, the Company recognized \$750,000 and \$2.2 million in investment income from its investment in the Joint Venture. As of September 30, 2018 and December 31, 2017, the fair value of the Company's investment in the Joint Venture was approximately \$21.4 and \$21.5 million, respectively. For interim periods, the Company recognizes investment income on its investment in the Joint Venture based upon its share of the estimated tax-basis earnings and profits of the Joint Venture. Any distributions in excess of tax-basis earnings and profits are recognized as a return of capital (adjustment to the Company's cost basis in the investment). The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at year-end based upon taxable income and distributions for the full year. Therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

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 (the “DRIP”) that provides for reinvestment of its distributions on behalf of its stockholders, unless a stockholder “opts out” of the DRIP 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” (“ASC 260”), basic earnings per share is computed by dividing earnings available to common shareholders by the weighted average number of shares outstanding during the period. Other potentially dilutive common shares, and the related impact to earnings, are considered when calculating earnings per share on a diluted basis.

The following information sets forth the computation of basic and diluted net increase (decrease) in stockholders’ equity per share for the three and nine months ended September 30, 2018 and 2017:

	(unaudited)		(unaudited)	
	<u>Three Months Ended September 30,</u> <u>2018</u>	<u>2017</u>	<u>Nine Months Ended September 30,</u> <u>2018</u>	<u>2017</u>
Net increase (decrease) in net assets resulting from operations	\$ 1,348,849	\$ (669,449)	\$ 2,646,472	\$ 2,237,830
Net (increase) decrease in net assets allocated to unvested share awards	(10,133)	3,260	(17,606)	(18,094)
Net increase (decrease) in net assets available to common stockholders	<u>\$ 1,338,716</u>	<u>\$ (666,189)</u>	<u>\$ 2,628,866</u>	<u>\$ 2,219,736</u>
Weighted average number of common and common stock equivalent shares outstanding for diluted shares computation	<u>37,349,904</u>	<u>37,196,621</u>	<u>37,354,449</u>	<u>37,202,011</u>
Net increase (decrease) in net assets per basic common shares:				
Net increase (decrease) in net assets from operations	\$ 0.04	\$ (0.02)	\$ 0.07	\$ 0.06
Net increase (decrease) in net assets per diluted shares:				
Net increase (decrease) in net assets from operations	\$ 0.04	\$ (0.02)	\$ 0.07	\$ 0.06

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 30,000 options to purchase shares of common stock considered for the computation of the diluted per share information for the three and nine months ended September 30, 2018. There were 50,000 options to purchase shares of common stock considered for the computation of the diluted per share information for the three and nine months ended September 30, 2017. Since the effects are anti-dilutive for both periods, the options were not included in the computation.

4. INVESTMENTS

The following table shows the Company's portfolio by security type at September 30, 2018 and December 31, 2017:

Security Type	September 30, 2018 (unaudited)			December 31, 2017		
	Cost/Amortized		% ¹	Cost/Amortized		% ¹
	Cost	Fair Value		Cost	Fair Value	
Short-term investments ²	\$ 24,431,512	\$ 24,431,512	9	\$ 77,300,320	\$ 77,300,320	26
Senior Secured Loan	66,465,014	62,292,360	23	48,337,900	44,960,146	14
Junior Secured Loan	76,396,298	71,229,383	26	62,561,913	58,941,300	19
Senior Unsecured Loan	6,277,283	6,277,283	2	12,777,283	12,777,283	4
Senior Secured Bond	—	—	-	1,502,374	1,518,750	-
CLO Fund Securities	68,769,245	47,983,931	18	72,339,032	51,678,673	17
Equity Securities	10,571,007	4,079,336	1	10,571,007	4,414,684	1
Asset Manager Affiliates ³	51,591,230	35,818,000	13	52,591,230	38,849,000	12
Joint Venture	24,914,858	21,373,570	8	24,914,858	21,516,000	7
Total	\$ 329,416,447	\$ 273,485,375	100%	\$ 362,895,917	\$ 311,956,156	100%

¹ Represents percentage of total portfolio at fair value.

² Includes money market accounts and U.S. treasury bills.

³ Represents the equity investment in the Asset Manager Affiliates.

The industry concentrations based on the fair value of the Company's investment portfolio as of September 30, 2018 and December 31, 2017, were as follows:

Industry Classification	September 30, 2018 (unaudited)			December 31, 2017		
	Cost/Amortized Cost	Fair Value	% ¹	Cost/Amortized Cost	Fair Value	%
Aerospace and Defense	\$ 5,394,947	\$ 5,217,569	2%	\$ 5,636,056	\$ 4,115,487	1%
Asset Management Company ²	51,591,230	35,818,000	13	52,591,230	38,849,000	12
Banking, Finance, Insurance & Real Estate	4,441,289	4,399,103	1	4,458,962	4,418,391	1
Beverage, Food and Tobacco	5,970,854	5,888,896	2	7,496,438	7,435,050	2
Capital Equipment	9,420,537	8,574,662	3	5,454,621	4,680,821	2
Chemicals, Plastics and Rubber	9,513,138	9,487,169	3	—	—	—
CLO Fund Securities	68,769,245	47,983,931	18	72,339,032	51,678,673	17
Construction & Building	1,404,511	1,397,347	1	1,004,093	999,872	-
Consumer goods: Durable	1,137,491	396,355	—	1,071,340	805,607	-
Consumer goods: Non-durable	1,593,869	1,593,061	1	691,234	694,662	-
Energy: Oil & Gas	17,700,944	12,281,830	4	14,932,542	11,433,777	4
Environmental Industries	8,405,778	7,228,048	3	6,330,630	5,766,437	2
Forest Products & Paper	1,563,068	1,600,960	1	1,558,556	1,600,960	1
Healthcare & Pharmaceuticals	41,181,476	35,770,898	13	30,367,449	25,512,654	8
High Tech Industries	13,072,205	13,054,861	5	18,229,229	18,260,577	6
Hotel, Gaming & Leisure	400,000	1,000	—	400,000	1,000	-
Joint Venture	24,914,858	21,373,570	8	24,914,858	21,516,000	7
Media: Advertising, Printing & Publishing	3,239,996	2,911,195	1	3,371,086	3,318,296	1
Related Party Loans	6,277,283	6,277,283	2	12,777,283	12,777,283	4
Services: Business	8,409,271	7,220,573	3	3,563,574	2,366,400	1
Telecommunications	6,444,211	6,437,973	2	6,455,489	6,466,949	2
Textiles and Leather	10,138,033	10,139,179	4	7,950,994	7,947,940	3
Money Market Accounts	24,431,512	24,431,512	9	52,293,570	52,293,570	17
Transportation: Cargo	4,000,701	4,000,400	1	4,000,901	4,010,000	1
U.S. Government Obligations	—	—	—	25,006,750	25,006,750	8
Total	\$ 329,416,447	\$ 273,485,375	100%	\$ 362,895,917	\$ 311,956,156	100%

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

² Represents the equity investment in the Asset Manager Affiliates.

The Company may invest up to 30% of its 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 September 30, 2018 and December 31, 2017, the total amount of non-qualifying assets was approximately 26% and 23% of total assets, respectively. The majority of non-qualifying assets were foreign investments which were approximately 18% and 16%, 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 17% and 16% of its total assets on such dates, 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.

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.

In June 2016, the Company sold \$7.0 million par value of the Subordinated Notes of Catamaran 2015-1 for \$4.2 million.

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 October 31, 2017, the Company purchased an additional \$4.3 million of notional amount of Subordinated Notes issued by Catamaran CLO 2014-1 at a cost of \$5.4 million.

In December 2017, the Company purchased an additional \$201,000 of notional amount of Subordinated Notes issued by Catamaran CLO 2013-1 at a cost of \$201,000.

In December 2017, the Company sold \$5.0 million par value of the Subordinated Notes of Catamaran CLO 2014-1 for \$3.0 million.

In January 2018, the trustees of Catamaran CLO 2012-1, Ltd received notice that the holders of a majority of the income notes issued by Catamaran CLO 2012-1, Ltd had exercised their right of optional redemption.

In September 2018, the Company purchased \$10 million par value of the Subordinated Notes of Catamaran CLO 2018-1 at a cost of \$9.5 million.

On December 19, 2017, the Company, in its capacity as the holder of all of the outstanding preferred shares of Katonah 2007-1, exercised its right to cause Katonah 2007-1 to redeem all of its outstanding indebtedness through the sale of its investments and otherwise wind up its business. As of September 30, 2018, Katonah 2007-1 had paid off all of its outstanding indebtedness and had approximately \$319,000 in total assets. It is expected that Katonah 2007-1 will be fully liquidated and dissolved in 2018. The Company received approximately \$10.5 million on its investment in Katonah 2007-1 during the first quarter of 2018 in connection with the continuing liquidation of Katonah 2007-1. The Company expects to record a realized loss during 2018 of approximately \$10 million on its investment in Katonah 2007-1 and a corresponding unrealized gain of the same amount in order to reverse the previously recorded unrealized depreciation with respect to the investment.

Except for Katonah 2007-1 CLO Ltd, ("Katonah 2007-1"), Trimaran VII CLO Ltd, and Catamaran 2012-1 CLO, Ltd, all of which have been called, CLO Funds managed by the Asset Manager Affiliates are currently making quarterly distributions to the Company with respect to its interests in the CLO Funds and are paying all senior and subordinate management fees to the Asset Manager Affiliates. With the exception of Katonah III, Ltd. and Grant Grove CLO, Ltd. (both of which have been called), the remaining third-party managed CLO Fund is making distributions to the Company.

Affiliate Investments

The following table details investments in affiliates at September 30, 2018 (unaudited) and December 31, 2017:

	Industry Classification	Fair Value at of December 31, 2017	Purchases/ (Sales) of or Advances/ (Distributions)	Net Accretion	Unrealized Gain/(Loss)	Realized Gain/(Loss)	Fair Value at of September 30, 2018 (unaudited)	Interest Income	Dividend Income
Asset Manager Affiliates ⁽⁴⁾⁽⁵⁾⁽⁶⁾	Asset Management Company	\$ 38,849,000	\$ (1,000,000)	-	(2,031,000)	\$ -	\$ 35,818,000	\$ -	\$ 920,000
Trimaran Advisors, LLC Revolving Credit Facility ⁽⁴⁾⁽⁵⁾⁽⁶⁾	Related Party Loans	-	-	-	-	-	-	1,151,339	-
Trimaran Advisors, LLC Related Party Loan ⁽⁴⁾⁽⁵⁾⁽⁶⁾	Related Party Loans	8,359,051	(2,081,769)	-	-	-	6,277,282	621,761	-
Trimaran Advisors, LLC Related Party Loan ⁽⁴⁾⁽⁵⁾⁽⁶⁾	Related Party Loans	4,418,232	(4,418,232)	-	-	-	-	229,380	-
Katonah 2007-I CLO, Ltd. ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	CLO Fund Securities	10,770,486	(10,487,425)	271,657	(404,718)	-	150,000	271,658	-
Trimaran CLO VII, Ltd. ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	CLO Fund Securities	10,000	-	-	-	-	10,000	-	-
Catamaran CLO 2012-1, Ltd. ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	CLO Fund Securities	2,320,783	(2,578,480)	264,748	2,949	-	10,000	264,748	-
Catamaran CLO 2013-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	6,923,699	(982,527)	941,526	(810,647)	-	6,072,051	941,526	-
Catamaran CLO 2014-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	8,230,178	(1,006,933)	1,012,363	1,474,091	-	9,709,699	1,012,363	-
Catamaran CLO 2014-2, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	4,500,962	(762,433)	491,759	32,671	-	4,262,959	491,759	-
Catamaran CLO 2015-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	3,569,600	(386,595)	382,338	(73,153)	-	3,492,190	382,338	-
Catamaran CLO 2016-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	8,530,685	(939,746)	688,390	(146,603)	-	8,132,726	688,391	-
Catamaran CLO 2018-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	-	9,500,000	-	(500,000)	-	9,000,000	-	-
KCAP F3C Senior Funding Rated Notes ⁽²⁾⁽⁴⁾	CLO Fund Securities	4,632,000	-	27,897	31,536	-	4,691,433	375,252	-
KCAP Freedom 3, LLC ⁽⁴⁾⁽⁶⁾	Joint Venture	21,516,000	-	-	(142,430)	-	21,373,570	-	2,150,000
Total Affiliated Investments		\$ 122,630,676	\$ (15,144,140)	\$ 4,080,678	\$ (2,567,304)	\$ -	\$ 108,999,910	\$ 6,430,515	\$ 3,070,000
	Industry Classification	Fair Value at of December 31, 2016	Purchases/ (Sales) of or Advances/ (Distributions)	Net Accretion	Unrealized Gain/(Loss)	Realized Gain/(Loss)	Fair Value at of December 31, 2017	Interest Income	Dividend Income
Asset Manager Affiliates ⁽⁴⁾⁽⁵⁾⁽⁶⁾	Asset Management Company	\$ 40,198,000	\$ (2,750,000)	\$ -	\$ 1,401,000	\$ -	\$ 38,849,000	\$ -	\$ 460,000
Trimaran Advisors, LLC Revolving Credit Facility ⁽⁴⁾⁽⁵⁾⁽⁶⁾	Related Party Loans	-	-	-	-	-	-	916,765	-
Trimaran Advisors, LLC Related Party Loan ⁽⁴⁾⁽⁵⁾⁽⁶⁾	Related Party Loans	-	8,359,051	-	-	-	8,359,051	148,721	-
Trimaran Advisors, LLC Related Party Loan ⁽⁴⁾⁽⁵⁾⁽⁶⁾	Related Party Loans	-	4,418,232	-	-	-	4,418,232	16,752	-
Katonah 2007-I CLO, Ltd. ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	CLO Fund Securities	20,453,099	(13,157,760)	5,660,026	(2,184,878)	-	10,770,486	5,660,026	-
Trimaran CLO VII, Ltd. ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	CLO Fund Securities	1,195,152	(1,264,090)	-	78,938	-	10,000	-	-
Catamaran CLO 2012-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	2,819,412	(771,743)	699,611	(426,497)	-	2,320,783	699,611	-
Catamaran CLO 2013-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	4,918,807	(1,054,362)	834,448	2,224,807	-	6,923,699	834,448	-
Catamaran CLO 2014-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	4,546,682	2,319,047	1,079,850	1,643,907	(1,359,309)	8,230,178	1,079,850	-
Catamaran CLO 2014-2, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	5,092,087	(1,130,813)	806,058	(266,370)	-	4,500,962	806,058	-
Catamaran CLO 2015-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	3,223,255	(571,562)	446,893	471,017	-	3,569,600	446,893	-
Catamaran CLO 2016-1, Ltd. ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	8,350,290	(1,146,242)	1,093,043	233,593	-	8,530,685	1,093,043	-
CRMN 2014-1A ⁽¹⁾⁽²⁾⁽⁴⁾	CLO Fund Securities	1,310,000	(1,545,506)	9,259	131,727	94,520	-	97,885	-
KCAP F3C Senior Funding Rated Notes ⁽²⁾⁽⁴⁾	CLO Fund Securities	-	4,346,290	89,676	196,035	-	4,632,000	89,676	-
KCAP Freedom 3, LLC ⁽⁴⁾⁽⁶⁾	Joint Venture	-	24,914,858	-	(3,398,858)	-	21,516,000	-	949,037
Total Affiliated Investments		\$ 92,106,784	\$ 20,965,400	\$ 10,718,864	\$ 104,421	\$ (1,264,789)	\$ 122,630,676	\$ 11,889,728	\$ 1,409,037

1 Non-U.S. company or principal place of business outside the U.S.

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

3 Notice of redemption has been received for this security.

4 Fair value of this investment was determined using significant unobservable inputs.

5 Qualified asset for purposes of section 55(a) of the 1940 Act.

6 As defined in the 1940 Act, the Company is deemed to be both an "Affiliated Person" and has "Control" of this portfolio company as the Company owns more than 25% of the portfolio company's outstanding voting securities or has the power to exercise control over management or policies of such portfolio company (including through a management agreement). Other than for purposes of the 1940 Act, the Company does not believe that it has control over this portfolio company.

Investment in Joint Venture

During the third quarter of 2017, the Company and Freedom 3 Opportunities LLC (“Freedom 3 Opportunities”), an affiliate of Freedom 3 Capital LLC, entered into an agreement to create KCAP Freedom 3 LLC (the “Joint Venture”). The Company and Freedom 3 Opportunities contributed approximately \$37 million and \$25 million, respectively, in assets to the Joint Venture, which in turn used the assets to capitalize a new fund, KCAP F3C Senior Funding, L.L.C. (the “Fund”) managed by KCAP Management, LLC, one of the Asset Manager Affiliates. In addition, the Fund used cash on hand and borrowings under a credit facility to purchase approximately \$184 million of loans from the Company and the Company used the proceeds from such sale to redeem approximately \$147 million in debt issued by KCAP Senior Funding I, LLC (“KCAP Senior Funding”). The Joint Venture may originate loans from time to time and sell them to the Fund.

During the fourth quarter of 2017, the Fund was refinanced through the issuance of senior and subordinated notes. The Joint Venture purchased 100% of the subordinated notes issued by the Fund. In connection with the refinancing, the Joint Venture made a cash distribution to the Company of approximately \$12.6 million. Approximately \$11.2 million of this distribution was a reduction in the cost basis of the Company's investment in the Joint Venture. The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at the end of the year, therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

The Company owns a 60% equity investment in the Joint Venture. The Joint Venture is structured as an unconsolidated Delaware limited liability company. All portfolio and other material decisions regarding the Joint Venture must be submitted to its board of managers, which is comprised of four members, two of whom were selected by the Company and two of whom were selected by Freedom 3 Opportunities, and must be approved by at least one member appointed by the Company and one appointed by Freedom 3 Opportunities. In addition, certain matters may be approved by the Joint Venture's investment committee, which is comprised of one member appointed by the Company and one member appointed by Freedom 3 Opportunities.

The Company has determined that the Joint Venture is an investment company under Accounting Standards Codification ("ASC"), Financial Services — Investment Companies ("ASC 946"), however, in accordance with such guidance, the Company will generally not consolidate its investment in a company other than a wholly owned investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. The Company does not consolidate its interest in the Joint Venture because the Company does not control the Joint Venture due to allocation of the voting rights among the Joint Venture partners.

KCAP Freedom 3 LLC

Summarized Statement of Financial Condition

	As of September 30, 2018 (unaudited)	As of December 31, 2017
Cash	\$ -	\$ 1,717
Investment at fair value	37,861,178	37,080,000
Total Assets	\$ 37,861,178	\$ 37,081,717
Total Liabilities	\$ 2,238,561	\$ 1,221,916
Total Equity	35,622,617	35,859,801
Total Liabilities and Equity	\$ 37,861,178	\$ 37,081,717

KCAP Freedom 3 LLCSummarized Statement of Operations
(unaudited)

	For the three months ended September 30, 2018	For the three months ended September 30, 2017	For the nine months ended September 30, 2018	For the nine months ended September 30, 2017
Investment income	\$ 1,148,571	\$ 1,026,962	\$ 3,566,385	\$ 1,026,962
Operating expenses	56,512	10,000	110,273	10,000
Net investment income	1,092,059	1,016,962	3,456,112	1,016,962
Unrealized appreciation (depreciation) on investments	529,662	79,258	(35,274)	79,258
Net income	\$ 1,621,721	\$ 1,096,220	\$ 3,420,838	\$ 1,096,220

KCAP Freedom 3 LLC
Schedule of Investments
September 30, 2018
(unaudited)

Portfolio Company	Investment	Percentage Ownership by Joint Venture	Amortized Cost	Fair Value
KCAP F3C Senior Funding, LLC ⁽¹⁾⁽²⁾	Subordinated Securities, effective interest 10.7%, 12/29 maturity	100.0%	\$ 42,959,706	\$ 37,861,178
Total Investments			\$ 42,959,706	\$ 37,861,178

(1) 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.

(2) Fair value of this investment was determined using significant unobservable inputs, including default rates, prepayment rates, spreads, and the discount rate by which to value the resulting cash flows.

Schedule of Investments
December 31, 2017

Portfolio Company	Investment	Percentage Ownership by Joint Venture	Amortized Cost	Fair Value
KCAP F3C Senior Funding, LLC ⁽¹⁾⁽²⁾	Subordinated Securities, effective interest 12.1%, 12/29 maturity	100.0%	\$ 42,143,254	\$ 37,080,000
Total Investments			\$ 42,143,254	\$ 37,080,000

(1) 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.

(2) Fair value of this investment was determined using significant unobservable inputs, including a third party broker quote.

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.

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 hierarchy levels as of September 30, 2018 (unaudited) and December 31, 2017, respectively:

	As of September 30, 2018 (unaudited)			
	Level I	Level II	Level III	Total
Short Term investments	\$ —	\$ 24,431,512	\$ —	\$ 24,431,512
Debt securities	—	28,572,507	111,226,520	139,799,027
CLO Fund Securities	—	—	47,983,931	47,983,931
Equity securities	—	1,142,283	2,937,053	4,079,336
Asset Manager Affiliates	—	—	35,818,000	35,818,000
Joint Venture	—	—	21,373,570	21,373,570
Total	\$ —	\$ 54,146,302	\$ 219,339,074	\$ 273,485,376

	As of December 31, 2017			
	Level I	Level II	Level III	Total
Short Term investments	\$ 25,006,750	\$ 52,293,570	\$ —	\$ 77,300,320
Debt securities	—	48,312,024	69,885,455	118,197,479
CLO Fund Securities	—	—	51,678,673	51,678,673
Equity securities	—	—	4,414,684	4,414,684
Asset Manager Affiliates	—	—	38,849,000	38,849,000
Joint Venture	—	—	21,516,000	21,516,000
Total	\$ 25,006,750	\$ 100,605,594	\$ 186,343,812	\$ 311,956,156

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:

Nine Months Ended September 30, 2018

	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Joint Venture	Total
Balance, December 31, 2017	\$ 69,885,455	\$ 51,678,673	\$ 4,414,684	\$ 38,849,000	\$ 21,516,000	\$ 186,343,812
Transfers out of Level III ¹	(694,662)	—	(1,142,283)	—	—	(1,836,945)
Transfers into Level III ²	20,941,778	—	—	—	—	20,941,778
Net accretion	135,616	4,305,175	—	—	—	4,440,791
Purchases	34,761,038	9,500,000	—	—	—	44,261,038
Sales/Paydowns/Return of Capital	(8,641,522)	(17,374,962)	—	(1,000,000)	—	(27,016,484)
Total realized loss included in earnings	(56,873)	—	—	—	—	(56,873)
Change in unrealized loss included in earnings	(5,104,310)	(124,955)	(335,348)	(2,031,000)	(142,430)	(7,738,043)
Balance, September 30, 2018	<u>\$ 111,226,520</u>	<u>\$ 47,983,931</u>	<u>\$ 2,937,053</u>	<u>\$ 35,818,000</u>	<u>\$ 21,373,570</u>	<u>\$ 219,339,074</u>
Changes in unrealized losses included in earnings related to investments still held at reporting date	<u>\$ (1,693,491)</u>	<u>\$ (124,955)</u>	<u>\$ (335,348)</u>	<u>\$ (2,031,000)</u>	<u>\$ (142,430)</u>	<u>\$ (4,327,224)</u>

¹Transfers out of Level III represent a transfer of \$1,836,945 relating to securities for which pricing inputs, other than their quoted prices in active markets were observable as of September 30, 2018.

²Transfers into Level III represent a transfer of \$20,941,778 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of September, 2018.

Year Ended December 31, 2017

	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Joint Venture	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	(3,867,400)	—	—	—	—	(3,867,400)
Transfers into Level III ²	2,477,500	—	—	—	—	2,477,500
Net accretion	246,238	11,139,633	—	—	—	11,385,871
Purchases	53,219,762	11,211,368	182,000	—	36,738,873	101,352,003
Sales/Paydowns/Return of Capital	(136,020,685)	(25,598,497)	—	(2,750,000)	(11,824,015)	(176,193,197)
Total realized gain included in earnings	(2,121,907)	(1,264,789)	—	—	—	(3,386,696)
Total unrealized gain (loss) included in earnings	2,210,202	2,016,608	(823,671)	1,401,000	(3,398,858)	1,405,281
Balance, December 31, 2017	<u>\$ 69,885,455</u>	<u>\$ 51,678,673</u>	<u>\$ 4,414,684</u>	<u>\$ 38,849,000</u>	<u>\$ 21,516,000</u>	<u>\$ 186,343,812</u>
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	<u>\$ (479,087)</u>	<u>\$ 2,016,608</u>	<u>\$ (823,671)</u>	<u>\$ 1,401,000</u>	<u>\$ (3,398,858)</u>	<u>\$ (1,284,008)</u>

¹Transfers out of Level III represent a transfer of \$3,867,400 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were observable as of December 31, 2017.

²Transfers into Level III represent a transfer of \$2,477,500 relating to debt securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of December 31, 2017.

As of September 30, 2018 and December 31, 2017, 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.

As of September 30, 2018, 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	\$ 11,763,622	Enterprise Value	Average EBITDA Multiple	5.8x– 8.3x (5.9x)
	99,462,898	Income Approach	Implied Discount Rate	7.0% – 27.3% (12.0%)
Equity Securities	2,928,053	Enterprise Value	Average EBITDA Multiple	4.5x – 11.3x (10.0x)
	9,000	Options Value	Qualitative Inputs ⁽¹⁾	
CLO Fund Securities	38,443,651	Discounted Cash Flow	Discount Rate	10.4%-12.0% (11.80%)
			Probability of Default	2.0%
			Loss Severity	25.9%
			Recovery Rate	74.1%
	Prepayment Rate	25.0%		
9,000,000	Market Approach	3 rd Party Quote	90.0%	
540,280	Liquidation Value	Qualitative Inputs ⁽²⁾		
Asset Manager Affiliate	35,818,000	Discounted Cash Flow	Discount Rate	3.33% - 12.0% (7.14%)
Joint Venture	21,373,570	Enterprise Value	Underlying NAV of the CLO	
Total Level III Investments	\$ 219,339,074			

¹ The qualitative inputs used in the fair value measurements of Equity Securities include estimates of the distressed liquidation value of the pledged collateral. In cases where KCAP's analysis ascribes no residual value to a portfolio company's equity, KCAP typically elects to mark its position at a nominal amount to account for the investment's option value.

² The qualitative inputs used in the fair value measurements include the value of the pledged collateral.

As of December 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	\$ 14,059,524	Enterprise Value	Average EBITDA Multiple / WACC	5.1x - 6.1x (5.2x) 15.2% - 18.5% (17.4%)
	\$55,825,931	Income Approach	Implied Discount Rate	6.4% - 23.5% (12.0%)
Equity Securities	\$4,405,684	Enterprise Value	Average EBITDA Multiple / WACC	4.5x - 15.2x (9.8x) 10.8% - 15.1% (12.2%)
	9,000	Options Value	Qualitative Inputs ⁽¹⁾	
CLO Fund Securities	18,922,030	Discounted Cash Flow	Discount Rate	12.0%
			Probability of Default	2.0%
			Loss Severity	25.9%
			Recovery Rate	74.1%
	Prepayment Rate	25.0%		
11,150,766	Liquidation Value	Qualitative Inputs ⁽²⁾		
21,605,877	Market Approach	Third Party Quote	56.0%-96.5% (69.7%)	
Asset Manager Affiliate	38,849,000	Discounted Cash Flow	Discount Rate	2.66% - 12.0% (6.56%)
Joint Venture	21,516,000	Market Approach	Third Party Quote	90%
Total Level III Investments	\$ 186,343,812			

¹ The qualitative inputs used in the fair value measurements of Equity Securities include estimates of the distressed liquidation value of the pledged collateral. In cases where KCAP's analysis ascribes no residual value to a portfolio company's equity, KCAP typically elects to mark its position at a nominal amount to account for the investment's option value.

² The qualitative inputs used in the fair value measurements include the 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.

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

The Company's investment in the Joint Venture is carried at fair value based upon the fair value of the investments held by the Joint Venture.

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 September 30, 2018 and December 31, 2017, the Asset Manager Affiliates had approximately \$3.2 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 \$35.8 million and \$38.8 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 three quarters of 2018, the Asset Manager Affiliates did not recognize any incentive fee revenue. During the first three quarters 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. As of September 30, 2018, none of the CLO Funds managed by the Asset Manager Affiliates were paying incentive fees.

Certain investments, and the future management fees of certain managed CLO Funds, have been pledged by the Asset Manager Affiliates to third-party lenders under borrowing arrangements undertaken to satisfy the U.S. risk retention rules formerly required by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") applicable to asset managers. In addition, certain of the Asset Manager Affiliates have provided a make-whole guaranty to these lenders in the event that the pledged assets and management fees are insufficient to satisfy the repayment of these borrowings. So long as the underlying managed CLO Funds' rated notes are making regular quarterly distributions, the management fees are available to the Asset Manager Affiliates. A recent court ruling has vacated the application of the U.S. risk retention rules insofar as they apply to managers of "open market CLOs," such as the Asset Manager Affiliates.

For the three months ended September 30, 2018 and 2017, the Asset Manager Affiliates declared cash distributions of \$300,000 and \$880,000 to the Company, respectively. For the nine months ended September 30, 2018 and 2017, the Asset Manager Affiliates declared cash distributions of approximately \$1.9 million and \$2.2 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 \$300,000 and \$180,000 of Dividends from Asset Manager Affiliates, as reflected in the Company's Statement of Operations three months ended 2018 and 2017, respectively. The Company recognized \$920,000 and \$180,000 Dividends from Asset Manager Affiliates, as reflected in the Company's Statement of Operations for the nine months ended September 30, 2018 and 2017, respectively. The difference between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e., tax-basis return of capital). For the nine months ended September 30, 2018 and 2017 the difference of \$1.0 million and \$2.0 million, respectively, between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e. tax-basis return of capital). 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 the Asset Manager Affiliates).

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.

In accordance with Rules 3-09, Rule 4-08(g) and 1-02 of Regulation S-X, additional financial information with respect to the Asset Manager Affiliates and with respect to 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. The additional financial information regarding the Asset Manager Affiliates (pursuant to Rule 3-09) and Katonah 2007-I CLO (pursuant to Rule 4-08(g)) is set forth below. 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 September 30, 2018	As of December 31, 2017
Cash	\$ 3,348,249	\$ 4,655,662
Investments	23,642,448	79,901,209
Intangible Assets	22,830,000	22,830,000
Other Assets	2,498,125	4,471,250
Total Assets	\$ 52,318,822	\$ 111,858,121
Borrowings	\$ 19,685,000	\$ 69,802,500
Borrowings from related parties	6,277,282	12,792,218
Other Liabilities	4,259,976	6,789,433
Total Liabilities	30,222,258	89,384,151
Total Equity	22,096,564	22,473,970
Total Liabilities and Equity	\$ 52,318,822	\$ 111,858,121

Asset Manager Affiliates
Summarized Statements of Operations Information (unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Fee Revenue	\$ 2,712,405	\$ 3,027,460	\$ 8,662,932	\$ 12,000,010
Interest Income	645,795	25,298	2,914,386	31,208
Total Income	3,358,200	3,052,758	11,577,318	12,031,218
Operating Expenses	1,941,795	2,547,545	7,287,001	7,852,377
Amortization of Intangibles	-	-	-	327,541
Interest Expense	935,654	121,468	3,648,760	525,034
Total Expenses	2,877,449	2,669,013	10,935,761	8,704,952
Income before unrealized gains on investments and income taxes	480,751	383,745	641,557	3,326,266
Net realized and unrealized gains on investments	207,427	-	410,888	-
Income before income taxes	688,178	383,745	1,052,445	3,326,266
Income Tax (Benefit) Expense	(161,584)	(79,791)	(490,150)	978,769
Net Income	\$ 849,762	\$ 463,536	\$ 1,542,595	\$ 2,347,497

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

	As of September 30, 2018	As of December 31, 2017
Total Investments at Fair Value	\$ 89,606	\$ 778,828
Cash	229,107	1,673,789
Receivable for investments sold	-	8,750,934
Total assets	318,713	11,203,551
CLO Debt at Fair Value	-	10,770,486
Total Liabilities	89,608	10,854,495
Total Net Assets	229,105	349,056

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Interest Income from Investments	\$ -	\$ 1,185,765	\$ -	\$ 4,336,891
Total Income	-	1,203,940	6,505	4,392,101
Interest Expense	-	1,275,068	10,487,425	4,289,994
Total Expenses	4,184	1,401,622	10,631,098	4,885,278
Net Realized and Unrealized Gains (Losses)	-	(48,669)	10,504,641	(1,207,183)
Increase (Decrease) in net assets resulting from operations	(4,184)	(246,351)	(119,952)	(1,700,360)

On December 19, 2017, the Company, in its capacity as the holder of all of the outstanding preferred shares of Katonah 2007-1, exercised its right to cause Katonah 2007-1 to redeem all of its outstanding indebtedness through the sale of its investments and otherwise wind up its business. As of December 31, 2017, Katonah 2007-1 had paid off all of its outstanding indebtedness and had approximately \$10.8 million in total assets. It is expected that Katonah 2007-1 will be fully liquidated and dissolved in 2018. The Company received approximately \$11.3 million on its investment in Katonah 2007-1 during the fourth quarter of 2017 in connection with the liquidation of Katonah 2007-1, and received an additional \$10.5 million in the first half of 2018. Upon receipt of the final liquidating distribution from Katonah 2007-1, the Company expects to record a realized loss of approximately \$10 million on its investment in Katonah 2007-1 and a corresponding unrealized gain of the same amount, in order to reverse the previously recorded unrealized depreciation with respect to the investment.

Similarly, it is expected that Trimaran CLO VII, Ltd. and Catamaran CLO 2012-1 Ltd. will be fully liquidated in 2018, whereupon any previously recognized unrealized losses will be reversed and recognized as realized losses in the statement of operations.

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.

Except for KCAP Management, LLC, which is a disregarded entity whose tax results are included with the Company's tax results, 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 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 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, both of which are being amortized for tax purposes on a straight-line basis over 15 years.

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. On April 15, 2013, the Trimaran Credit Facility was amended and upsized from \$20 million to \$23 million. On November 17, 2017, the Trimaran Credit Facility was amended to extend the maturity date to November 17, 2022 and bears interest at an annual rate of 9.0%. At September 30, 2018, and December 31, 2017 there were no loans outstanding under the Trimaran Credit Facility. For the three months ended September 30, 2018 and 2017, the Company recognized interest income of approximately \$512,000 and \$126,000, respectively, related to the Trimaran Credit Facility. For the nine months ended September 30, 2018 and 2017, the Company recognized interest income of approximately \$1.2 million and \$529,000, respectively, related to the Trimaran Credit Facility.

On October 30, 2017, the Company entered into a term loan agreement with Trimaran Advisors, one of the Asset Manager Affiliates. Trimaran Advisors borrowed \$8.4 million under this agreement, which bears interest at a rate of 10.5% annually, payable quarterly. The loan matures on April 30, 2030, can be repaid at any time, and must be repaid upon the occurrence of certain events. For the nine months ended September 30, 2018, \$2.1 million of the principal on this loan was repaid by Trimaran Advisors. During the three and nine months ended September 30, 2018, the Company recognized interest income of approximately \$182,000 and \$622,000, respectively, related to this loan.

On October 31, 2017, Trimaran Advisors capitalized Trimaran Risk Retention Holdings, LLC, a newly-formed wholly-owned subsidiary, with \$8.4 million of equity capital. In turn, Trimaran Risk Retention Holdings, LLC capitalized Trimaran RR I, LLC, a wholly-owned subsidiary of Trimaran Risk Retention Holdings, LLC, with \$8.4 million of equity capital. With this equity contribution and other borrowed funds, Trimaran RR I, LLC purchased \$34.8 million notional amount of notes issued by Catamaran CLO 2014-1, Ltd. for aggregate consideration of \$35.5 million. On December 21, 2017, the Company entered into another term loan agreement with Trimaran Advisors. Trimaran Advisors borrowed \$4.4 million, which also bears interest at a rate of 10.5% annually, payable quarterly. During the second quarter of 2018, this loan was repaid in full by Trimaran Advisors. During the three and nine months ended September 30, 2018, the Company recognized interest income of approximately \$0 and \$229,000, respectively, related to this loan.

On December 21, 2017, Trimaran Advisors contributed \$4.4 million of equity capital to Trimaran Risk Retention Holdings, LLC. In turn, Trimaran Risk Retention Holdings, LLC contributed \$4.4 million of equity capital to Trimaran RR I, LLC. With this equity contribution and other borrowed funds, Trimaran RR I, LLC purchased \$27.4 million notional amount of notes issued by Catamaran CLO 2013-1, Ltd. for aggregate consideration of \$27.4 million.

On April 5, 2018, the D.C. District Court entered an order implementing the Appellate Court Ruling and thereby vacated the U.S. risk retention rules insofar as they apply to CLO managers of "open market CLOs." In addition, the Applicable Governmental Agencies did not request that the case be heard by the United States Supreme Court. Since the Applicable Governmental Agencies have not successfully challenged the Appellate Court Ruling and the D.C. District Court has issued the above described order implementing the Appellate Court Ruling, collateral managers of open market CLOs are no longer required to comply with the U.S. risk retention rules at this time. As such, it is possible that some collateral managers of open market CLOs will decide to dispose of the notes constituting the "eligible vertical interest" or "eligible horizontal interest" they were previously required to retain, or decide to take other action with respect to such notes that is not otherwise permitted by the U.S. risk retention rules. As a result of this decision, certain CLO managers of "open market CLOs" will no longer be required to comply with the U.S. risk retention rules solely because of their roles as managers of "open market CLOs", and there may be no "sponsor" of such securitization transactions and no party may be required to acquire and retain an economic interest in the credit risk of the securitized assets of such transactions.

There can be no assurance or representation that any of the transactions, structures or arrangements currently under consideration by or currently used by CLO market participants will comply with the U.S. risk retention rules to the extent such rules are reinstated or otherwise become applicable to open market CLOs. The ultimate impact of the U.S. risk retention rules on the loan securitization market and the leveraged loan market generally remains uncertain, and any negative impact on secondary market liquidity for securities comprising a CLO may be experienced due to the effects of the U.S. risk retention rules on market expectations or uncertainty, the relative appeal of other investments not impacted by the U.S. risk retention rules and other factors.

On June 4, 2018, Trimaran RR I, LLC. sold \$31.4 million and \$24.9 million, of notional amount of notes issued by Catamaran CLO 2014-1, Ltd and Catamaran 2013-1, Ltd, respectively.

6. BORROWINGS

The Company's debt obligations consist of the following:

	As of September 30, 2018 (unaudited)	As of December 31, 2017
6.125% Notes Due 2022 (net of offering costs of: 2018-\$2,341,686; 2017 - \$2,734,248)	\$ 75,065,514	\$ 74,672,952
7.375% Notes Due 2019 (net of offering costs of: 2018 - \$31,173; 2017 - \$259,635)	6,968,827	26,740,365
KCAP Funding I, LLC Revolving Credit Facility (net of offering costs of: 2018 - \$1,246,998)	21,701,195	-
	<u>\$ 103,735,536</u>	<u>\$ 101,413,317</u>

The weighted average stated interest rate and weighted average maturity on all our debt outstanding as of September 30, 2018 were 6.1% and 3.7 years, respectively, and as of December 31, 2017 were 6.4% and 3.9 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.

All of the KCAP Senior Funding I Class A, B, C and D notes were repaid in the third quarter of 2017. In connection therewith, the Company recorded a realized loss from the extinguishment of debt of approximately \$4.0 million in the third quarter of 2017.

For the three months ended September 30, 2017, interest expense, including the amortization of deferred debt issuance costs and the OID was approximately \$337,000 consisting of stated interest expense of approximately \$263,000, accreted discount of approximately \$35,000, and deferred debt issuance costs of approximately \$38,000. For the nine months ended September 30, 2017, interest expense, including the amortization of deferred debt issuance costs and the discount on the face amount of the notes, was approximately \$3.4 million consisting of stated interest expense of approximately \$2.7 million, accreted discount of approximately \$352,000, and deferred debt issuance costs of approximately \$379,000.

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 “7.375% Notes Due 2019”). The net proceeds for these Notes, after the payment of 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 requirement 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 September 30, 2018, the Company was in compliance with all of its debt covenants.

For the three months ended September 30, 2018 and 2017, interest expense related to the 7.375% Notes Due 2019 was approximately, \$129,000 and \$498,000, respectively. For the nine months ended September 30, 2018 and 2017, interest expense related to the 7.375% Notes Due 2019 was approximately \$694,000 and \$1.7 million, 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 \$32,000 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. The Company 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. The Company subsequently surrendered these notes to the Trustee for cancellation.

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 approximately \$15,000. The Company subsequently surrendered these notes to the Trustee for cancellation.

During the second quarter of 2017, approximately \$6.5 million par value of the 7.375% Notes Due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of approximately \$107,000. The Company subsequently surrendered these notes to the Trustee for cancellation.

During the first quarter of 2018, approximately \$20 million par value of the 7.375% Notes Due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of approximately \$169,000. The Company subsequently surrendered these notes to the Trustee for cancellation.

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. As of September 30, 2018 and December 31, 2017, the fair value of the Company’s outstanding 7.375% Notes Due 2019 was approximately \$7.2 million and \$27.3 million, respectively. The fair value was determined based on the closing price on September 28, 2018 and December 29, 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.

6.125% Notes Due 2022

During the third quarter of 2017, the Company issued \$77.4 million in aggregate principal amount of unsecured 6.125% Notes due 2022 (the “6.125% Notes Due 2022”). The net proceeds for these Notes, after the payment of underwriting expenses, were approximately \$74.6 million. Interest on the 6.125% Notes Due 2022 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 6.125%. The 6.125% Notes Due 2022 mature on September 30, 2022 and are unsecured obligations of the Company. The 6.125% Notes Due 2022 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, 2019, 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 requirement applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 6.125% Notes Due 2022, the Company is limited in its ability to make distributions in certain circumstances. The indenture governing the 6.125% Notes Due 2022 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. At September 30, 2018, the Company was in compliance with all of its debt covenants.

For the three months ended September 30, 2018 and 2017, interest expense related to the 6.125% Notes Due 2022 was approximately \$1.2 million and \$450,000, respectively. For the nine months ended September 30, 2018 and 2017, interest expense related to the 6.125% Notes Due 2022 was approximately \$3.6 million and \$450,000, respectively.

In connection with the issuance of the 6.125% Notes Due 2022, the Company incurred approximately \$2.9 million of debt offering costs which are being amortized over the expected term of the facility on an effective yield method, of which approximately \$2.3 million remains to be amortized as of September 30, 2018, and is included on the consolidated balance sheets as a reduction in the related debt liability.

Fair Value of 6.125% Notes Due 2022. The 6.125% Notes Due 2022 were issued via public offering during the third quarter of 2017 and are carried at cost, net of offering costs of \$2.3 million at September 30, 2018. The fair value of the Company’s outstanding 6.125% Notes Due 2022 was approximately \$78.0 million and \$77.7 million at September 30, 2018 and December 31, 2017. The fair value was determined based on the closing price on September 28, 2018 and December 29, 2017 for the 6.125% Notes Due 2022. The 6.125% Notes Due 2022 are categorized as Level I under the ASC 820 Fair Value.

KCAP Funding I, LLC

On March 1, 2018, KCAP Funding I, LLC (“Funding”), a wholly owned subsidiary of the Company, entered into a senior secured revolving credit facility (the “Revolving Credit Facility”) with certain institutional lenders, State Bank and Trust Company, as the administrative agent, lead arranger and bookrunner, CIBC Bank USA, as documentation agent and the Company, as the servicer.

The maximum commitment amount of the Revolving Credit Facility is \$50 million, subject to availability under the borrowing base. Borrowings under the Revolving Credit Facility bear interest at a rate per annum equal to (i) in the case of LIBOR rate loans, an adjusted LIBOR rate for the applicable interest period plus 3.25% or (ii) in the case of base rate loans, the prime rate plus 3.25%. Funding will pay a fee on any undrawn amounts of 0.375% per annum; provided that if 50% or less of the Revolving Credit Facility is drawn, the fee will be 0.50% per annum.

The Company intends to use the proceeds from borrowings under the Revolving Credit Facility for general corporate purposes, including to acquire certain qualifying loans, and such other uses as permitted under the Loan and Security Agreement (the “Revolving Credit Agreement”).

The maturity date is the earliest of: (a) March 1, 2022 and (b) the date upon which all loans shall become due and payable in full, whether by acceleration or otherwise, as a result of a default by the Company, as defined in the Revolving Credit Facility.

Borrowings under the Revolving Credit Facility are repayable by the Company at any time.

The Revolving Credit Facility is secured by all of the assets held by Funding, and the Company has pledged its interests in Funding as collateral to State Bank and Trust Company, as the administrative agent, to secure the obligations of Funding under the Revolving Credit Facility. The Revolving Credit Agreement includes customary affirmative and negative covenants, including certain limitations on the incurrence of additional indebtedness and liens, as well as usual and customary events of default for revolving credit facilities of this nature. At September 30, 2018, Funding was in compliance with all of its debt covenants.

As of September 30, 2018, \$22.9 million principal amount of borrowings was outstanding under the Revolving Credit Facility.

Interest on borrowings under the Revolving Credit Facility is paid monthly. Borrowings under the Revolving Credit Facility are subject to redemption in whole or in part at any time or from time to time, at the option of the Funding. Concurrently with any termination of the Revolving Credit Facility before March 1, 2019, Funding will pay to agent an amount equal to 1% of the Revolver Commitments.

For the three months ended September 30, 2018, interest expense related to the Revolving Credit Facility was approximately \$317,000. For the nine months ended September 30, 2018, interest expense related to the Revolving Credit Facility was approximately \$667,000.

The Company incurred approximately \$1.5 million of debt offering costs in connection with the issuance of the Revolving Credit Facility, which are being amortized over the expected term of the Revolving Credit Facility, of which approximately \$1.2 million remains to be amortized as of September 30, 2018, and is included on the consolidated balance sheets as a reduction in the related debt liability.

Fair Value of the Revolving Credit Facility. Borrowings under the Revolving Credit Facility are carried at cost, net of unamortized debt offering costs of \$1.2 million at September 30, 2018. The fair value of the Revolving Credit Facility borrowings was approximately \$22.9 million at September 30, 2018. The fair value was determined based on an analysis of the value of the pledged collateral and the amount of over-collateralization supporting the repayment of these borrowings. The Revolving Credit Facility borrowings are categorized as Level III under the ASC 820 Fair Value.

7. DISTRIBUTABLE TAXABLE INCOME

Effective December 11, 2006, the Company elected to be treated as a RIC under the Code and adopted a December 31 tax-calendar year end. As a RIC, the Company is not subject to federal income tax on the portion of its taxable income and gains distributed currently to its stockholders as a dividend. The Company's quarterly distributions, if any, are determined by the Board of Directors. The Company anticipates distributing 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 2018). 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 in net assets resulting from operations to taxable income for the nine months ended September 30, 2018:

	Nine Months Ended September 30,	
	2018	2017
	(unaudited)	(unaudited)
Net increase in net assets resulting from operations	\$ 2,646,472	\$ 2,237,830
Net change in unrealized depreciation (appreciation) from investments	4,991,311	(875,365)
Excess capital losses over capital gains	306,410	6,993,940
Book/tax differences on CLO equity investments	(36,416)	(1,697,865)
Other book/tax differences	924,707	224,785
Taxable income before deductions for distributions	<u>\$ 8,832,484</u>	<u>\$ 6,883,325</u>
Taxable income before deductions for distributions per weighted average basic shares for the period	\$ 0.24	\$ 0.19
Taxable income before deductions for distributions per weighted average diluted shares for the period	\$ 0.24	\$ 0.19

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 nine months ended September 30, 2018 and 2017, the Asset Manager Affiliates declared cash distributions of \$1.9 million and \$2.2 million respectively, to the Company. For the nine months ended September 30, 2018 and 2017, the Company recognized \$920,000 and \$180,000 of dividends from the Asset Manager Affiliates, as reflected in the Company's Statement of Operations. For the nine months ended September 30, 2018 and 2017, the differences of \$1.0 million and \$2.0 million, respectively, between cash distributions received and the estimated tax-basis earnings and profits of the distributing affiliate, are recorded as adjustments to the cost basis in the Asset Manager Affiliates (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 September 30, 2018, the Company had a net capital loss carryforward of \$88.6 million to offset net capital gains, to the extent provided by federal tax law. \$13.5 million of net capital loss carryforward expired in 2017. \$17.9 million of net capital loss carryforward is subject to expiration in 2018. \$70.7 million of the net capital loss carryforward is not subject to expiration under the RIC Modernization Act of 2010.

On September 18, 2018, the Company's Board of Directors declared a distribution to shareholders of \$0.10 per share for a total of approximately \$3.7 million. The record date was October 9, 2018 and the distribution was paid on October 29, 2018.

ASC Topic 740 Accounting for Uncertainty in Income Taxes ("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 September 30, 2018 and December 31, 2017, the Company had \$370,000 and \$0 outstanding commitments, respectively.

9. STOCKHOLDERS' EQUITY

During the nine months ended September 30, 2018 and 2017, the Company issued 46,942 and 75,059 shares, respectively, of common stock under its dividend reinvestment plan. For the nine months ended September 30, 2018, there were 6,000 grants of restricted stock, 16,261 shares were forfeited, and 122,878 shares vested. The total number of shares of the Company's common stock outstanding as of September 30, 2018 and December 31, 2017 was 37,349,224 and 37,339,224, respectively. During the nine months ended September 30, 2018 and 2017, the Company repurchased 26,681 and 64,176, respectively shares at an aggregate cost of approximately \$87,000 and \$225,000, respectively, in connection with the vesting of restricted stock awards.

10. EQUITY COMPENSATION PLANS

The Company has an equity incentive plan, established in 2006 and most recently amended, following approval by the Company's Board of Directors and shareholders, on May 4, 2017 (the "Equity Incentive Plan"). The Company reserved 2,000,000 shares of common stock for issuance under the Equity Incentive Plan. Pursuant to the Equity Incentive Plan and in accordance with the terms of the exemptive relief granted to the Company in August 2008, the Company aims to provide officers and employees of the Company with additional incentives and align the interests of its employees with those of its shareholders. 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. 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 pursuant to the Equity Incentive Plan in 2013 vested in two equal installments of 50% on each of the third and the fourth anniversaries of the grant date. Restricted Stock granted pursuant to the Equity Incentive Plan in 2014 and 2015 vests in four equal installments of 25% on each of the first four anniversaries of the grant date. Restricted Stock granted pursuant to the Equity Incentive Plan in 2017 will vest in two equal installments of 50% on each of the third and the fourth anniversaries of the grant date.

Stock Options

The 2008 Non-Employee Director Plan was originally adopted by the Board and was approved by a vote of the Company's shareholders at the 2008 Annual Shareholder Meeting (the "2008 Plan"). Effective June 10, 2011, the 2008 Plan was amended and restated in accordance with a resolution of the Board and approved by a vote of the Company's shareholders at the 2011 Annual Shareholder Meeting (the "2011 Plan"). Effective May 4, 2017, the 2011 Plan was amended and restated in accordance with a resolution of the Board and approved by the Company's shareholders at the 2017 Annual Shareholder Meeting (the "Non-Employee Director Plan"). Pursuant to the Non-Employee Director Plan, the Company's independent directors and other directors who are not officers or employees of the Company ("Non-Employee Directors") may be issued restricted stock as a portion of their compensation for service on the Company's Board of Directors in accordance with the terms of exemptive relief granted by the SEC in August 2008. Since implementation of the 2011 Plan, the Company is permitted to issue restricted stock, and is no longer permitted to issue any options for common stock, of the Company to Non-Employee Directors. Any options outstanding as of the date of the 2011 Annual Shareholder Meeting are governed in all respects by the terms of the 2008 Plan. Under the Non-Employee Director Plan, the Non-Employee Directors automatically receive 1,000 shares of restricted stock on the date of each annual meeting of shareholders during the term of the plan.

Information with respect to options granted, exercised and forfeited under the Equity Incentive Plan for the period January 1, 2017 through September 30, 2018 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, 2017	50,000	\$ 7.72	2.4	\$ -
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Options outstanding at December 31, 2017	50,000	\$ 7.72	1.4	\$ -
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Expired Unexercised	(5,000)	11.97		
Cancelled	(15,000)	11.97		
Outstanding at September 30, 2018	<u>30,000</u>	\$ 4.88	1.2	\$ -
Total vested at September 30, 2018	30,000	\$ 4.88	1.2	

¹ Represents the difference between the market value of shares of the Company on September 30, 2018 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 nine months ended September 30, 2018 and 2017, the Company did not recognize any non-cash compensation expense related to stock options. At September 30, 2018, the Company had no remaining compensation costs related to unvested stock option awards.

Restricted Stock

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

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

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

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

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

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

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

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

On May 4, 2017, 6,000 shares of restricted stock were awarded to the Company's Board of Directors.

On May 3, 2018, 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.

On September 19, 2017, the Company's Board of Directors approved the grant of 133,620 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.

Information with respect to restricted stock granted, exercised and forfeited under the Plan for the period January 1, 2017 through September 30, 2018 is as follows:

	Non-vested Restricted Shares
Non-vested shares outstanding at January 1, 2017	411,479
Granted	139,620
Vested	(242,918)
Forfeited	(10,982)
Non-vested shares outstanding at December 31, 2017	297,199
Granted	6,000
Vested	(122,878)
Forfeited	(16,261)
Non-Vested Outstanding at September 30, 2018	<u>164,060</u>

For the three months ended September 30, 2018, non-cash compensation expense related to restricted stock was approximately \$87,000; of this amount approximately \$32,000 was expensed at the Company, and approximately \$55,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the three months ended September 30, 2017, non-cash compensation expense related to restricted stock was approximately \$226,000; of this amount approximately \$83,000 was expensed at the Company, and approximately \$143,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the nine months ended September 30, 2018, non-cash compensation expense related to restricted stock was approximately \$574,000; of this amount approximately \$217,000 was expensed at the Company, and approximately \$357,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the nine months ended September 30, 2017, non-cash compensation expense related to restricted stock was approximately \$878,000; of this amount approximately \$330,000 was expensed at the Company and approximately \$548,000 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 September 30, 2018, the Company had approximately \$483,000 of total unrecognized compensation cost related to non-vested restricted share awards; of this amount approximately \$208,000 will be expensed at the Company, and approximately \$275,000 is a reimbursable expense allocated to the Asset Manager Affiliates. That cost is expected to be recognized over the remaining weighted average period of 2.1 years. As of September 30, 2017, the Company had approximately \$1.4 million of total unrecognized compensation cost related to non-vested restricted share awards, respectively.

11. OTHER EMPLOYEE COMPENSATION

The Company adopted a 401(k) plan ("401K Plan") effective January 1, 2007. The 401K Plan is open to all full time employees. The 401K Plan permits an employee to defer a portion of their total annual compensation up to the Internal Revenue Service annual maximum based on age and eligibility. The Company makes contributions to the 401K Plan of up to 2% of the Internal Revenue Service's annual maximum eligible compensation, which fully vests at the time of contribution. Approximately \$11,000 and \$1,000 was expensed during the three months ended September 30, 2018 and 2017, respectively, related to the 401K Plan. Approximately \$31,000 and \$35,000 was expensed during the nine months ended September 30, 2018 and 2017, 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 \$21,000 and \$46,000 was expensed during the three months ended September 30, 2018 and 2017, respectively, related to the Profit-Sharing Plan. Approximately \$93,000 and \$139,000 was expensed during the nine months ended September 30, 2018 and 2017, respectively, related to the Profit-Sharing Plan.

12. SUBSEQUENT EVENTS

On October 24, 2018, the Company caused notices to be issued to the holders of the 7.375% Notes Due 2019 regarding the Company's exercise of its option to redeem all of the issued and outstanding 7.375% Notes Due 2019. The Company will redeem all \$7.0 million in aggregate principal amount of the 7.375% Notes Due 2019 on November 26, 2018 at a cost of \$7.0 million. The Company expects to record a realized loss on early extinguishment of debt of approximately \$30,000 during the fourth quarter of 2018.

The Company has evaluated events and transactions occurring subsequent to September 30, 2018 for items that should potentially be recognized or disclosed in these financial statements. Other than noted above, management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these consolidated financial statements.

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

In this Quarterly Report on Form 10-Q, “KCAP,” “Company,” “we,” “us,” and “our” refer to KCAP Financial, Inc., and its wholly-owned subsidiaries, KCAP Funding I, LLC, KCAP Senior Funding I, LLC and KCAP Senior Funding I Holdings, LLC, unless the context otherwise requires.

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, 2017, 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 wholly-owned portfolio companies, including Katonah Debt Advisors, L.L.C. and Trimaran Advisors, L.L.C.;
- the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies, including the Asset Manager Affiliates;
- the impact of a protracted decline in the liquidity of credit markets on our business;
- the impact of fluctuations in interest rates on our business;
- the valuation of our investments in portfolio companies, particularly those having no liquid trading market;
- our ability to recover unrealized losses;
- market conditions and our ability to access additional capital; and
- the timing, form and amount of any distributions.

There are a number of important risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward-looking statements. For a discussion of factors that could cause our actual results to differ from forward-looking statements contained in this Quarterly Report, please see the discussion in Part II, “Item 1A. Risk Factors”, and in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. 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 our wholly owned asset management companies including Katonah Debt Advisors (“Katonah Debt Advisors”) and Trimaran Advisors L.L.C. (“Trimaran Advisors”), which manage collateralized loan obligation funds (“CLO Funds”).

Third, the Company invests in debt and subordinated securities issued by CLOs (“CLO Fund Securities”). These CLO Fund Securities are primarily managed by Katonah Debt Advisors and Trimaran Advisors, as well as affiliated management companies Katonah 2007-1 Management, L.L.C., Trimaran Advisors Management, L.L.C. and KCAP Management, LLC (collectively, the “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, joint venture 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 \$3.2 billion of par value assets under management as of September 30, 2018. Katonah Debt Advisors and Trimaran Advisors are registered under the Investment Advisers Act of 1940, as amended, and each is managed independently from us by a separate management team. Certain of the Company’s executive officers also act in similar capacities for one or more 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 portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. Because we also recognize the need to have funds available for operating our business and to make investments, we seek to have adequate liquidity at all times to cover normal cyclical swings in funding availability and to allow us to meet abnormal and unexpected funding requirements. As a result, we may hold varying amounts of cash and other short-term investments from time-to-time for liquidity purposes.

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

On March 29, 2018, our Board of Directors, including a “required majority” (as such term is defined in Section 57(o) of the 1940 Act) of the Board, approved the modified asset coverage requirements set forth in Section 61(a)(2) of the 1940 Act, as amended by the Small Business Credit Availability Act (the “SBCA”). As a result, our asset coverage requirement for senior securities will be changed from 200% to 150%, effective as of March 29, 2019. However, despite the SBCA, we will continue to be prohibited by the indentures governing our 7.375% Notes and 6.125% 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.

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 nine months ended September 30, 2018 (unaudited) and for the year ended December 31, 2017 was as follows:

	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliates	Joint Venture	Total Portfolio
Fair Value at December 31, 2016	\$ 238,343,330	\$ 54,174,350	\$ 5,056,355	\$ 40,198,000	\$ —	\$ 337,772,035
2017 Activity:						
Purchases / originations / draws	181,613,690	11,211,368	182,000	—	36,738,873	229,745,931
Pay-downs / pay-offs / sales	(300,625,104)	(25,598,497)	—	(2,750,000)	(11,824,015)	(340,797,616)
Net accretion of interest	304,904	11,139,633	—	—	—	11,444,537
Net realized losses	(5,634,255)	(1,264,789)	—	—	—	(6,899,044)
Increase (decrease) in fair value	<u>4,194,914</u>	<u>2,016,608</u>	<u>(823,671)</u>	<u>1,401,000</u>	<u>(3,398,858)</u>	<u>3,389,993</u>
Fair Value at December 31, 2017	118,197,479	51,678,673	4,414,684	38,849,000	21,516,000	234,655,836
2018 Activity:						
Purchases / originations / draws	66,050,935	9,500,000	—	—	—	75,550,935
Pay-downs / pay-offs / sales	(43,057,606)	(17,374,962)	—	(1,000,000)	—	(61,432,568)
Net accretion of interest	1,103,133	4,305,175	—	—	—	5,408,308
Net realized losses	(137,336)	—	—	—	—	(137,336)
Decrease in fair value	<u>(2,357,578)</u>	<u>(124,955)</u>	<u>(335,348)</u>	<u>(2,031,000)</u>	<u>(142,430)</u>	<u>(4,991,311)</u>
Fair Value at September 30, 2018	<u>\$ 139,799,027</u>	<u>\$ 47,983,931</u>	<u>\$ 4,079,336</u>	<u>\$ 35,818,000</u>	<u>\$ 21,373,570</u>	<u>\$ 249,053,864</u>

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

The following table shows the Company's portfolio by security type at September 30, 2018 and December 31, 2017:

Security Type	September 30, 2018 (unaudited)			December 31, 2017		
	Cost/Amortized		% ¹	Cost/Amortized		% ¹
	Cost	Fair Value		Cost	Fair Value	
Short-term investments ²	\$ 24,431,512	\$ 24,431,512	9	\$ 77,300,320	\$ 77,300,320	26
Senior Secured Loan	66,465,014	62,292,360	23	48,337,900	44,960,146	14
Junior Secured Loan	76,396,298	71,229,383	26	62,561,913	58,941,300	19
Senior Unsecured Loan	6,277,283	6,277,283	2	12,777,283	12,777,283	4
Senior Secured Bond	—	—	-	1,502,374	1,518,750	-
CLO Fund Securities	68,769,245	47,983,931	18	72,339,032	51,678,673	17
Equity Securities	10,571,007	4,079,336	1	10,571,007	4,414,684	1
Asset Manager Affiliates ³	51,591,230	35,818,000	13	52,591,230	38,849,000	12
Joint Venture	24,914,858	21,373,570	8	24,914,858	21,516,000	7
Total	\$ 329,416,447	\$ 273,485,375	100%	\$ 362,895,917	\$ 311,956,156	100%

¹ Represents percentage of total portfolio at fair value.

² Includes money market accounts and U.S. treasury bills.

³ Represents the equity investment in the Asset Manager Affiliates.

The industry concentrations, based on the fair value of the Company's investment portfolio as of September 30, 2018 and December 31, 2017, were as follows:

Industry Classification	September 30, 2018 (unaudited)			December 31, 2017		
	Cost/Amortized Cost	Fair Value	% ¹	Cost/Amortized Cost	Fair Value	%
Aerospace and Defense	\$ 5,394,947	\$ 5,217,569	2%	\$ 5,636,056	\$ 4,115,487	1%
Asset Management Company ²	51,591,230	35,818,000	13	52,591,230	38,849,000	12
Banking, Finance, Insurance & Real Estate	4,441,289	4,399,103	1	4,458,962	4,418,391	1
Beverage, Food and Tobacco	5,970,854	5,888,896	2	7,496,438	7,435,050	2
Capital Equipment	9,420,537	8,574,662	3	5,454,621	4,680,821	2
Chemicals, Plastics and Rubber	9,513,138	9,487,169	3	—	—	—
CLO Fund Securities	68,769,245	47,983,931	18	72,339,032	51,678,673	17
Construction & Building	1,404,511	1,397,347	1	1,004,093	999,872	-
Consumer goods: Durable	1,137,491	396,355	—	1,071,340	805,607	-
Consumer goods: Non-durable	1,593,869	1,593,061	1	691,234	694,662	-
Energy: Oil & Gas	17,700,944	12,281,830	4	14,932,542	11,433,777	4
Environmental Industries	8,405,778	7,228,048	3	6,330,630	5,766,437	2
Forest Products & Paper	1,563,068	1,600,960	1	1,558,556	1,600,960	1
Healthcare & Pharmaceuticals	41,181,476	35,770,898	13	30,367,449	25,512,654	8
High Tech Industries	13,072,205	13,054,861	5	18,229,229	18,260,577	6
Hotel, Gaming & Leisure	400,000	1,000	—	400,000	1,000	-
Joint Venture	24,914,858	21,373,570	8	24,914,858	21,516,000	7
Media: Advertising, Printing & Publishing	3,239,996	2,911,195	1	3,371,086	3,318,296	1
Related Party Loans	6,277,283	6,277,283	2	12,777,283	12,777,283	4
Services: Business	8,409,271	7,220,573	3	3,563,574	2,366,400	1
Telecommunications	6,444,211	6,437,973	2	6,455,489	6,466,949	2
Textiles and Leather	10,138,033	10,139,179	4	7,950,994	7,947,940	3
Money Market Accounts	24,431,512	24,431,512	9	52,293,570	52,293,570	17
Transportation: Cargo	4,000,701	4,000,400	1	4,000,901	4,010,000	1
U.S. Government Obligations	—	—	—	25,006,750	25,006,750	8
Total	\$ 329,416,447	\$ 273,485,375	100%	\$ 362,895,917	\$ 311,956,156	100%

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

² Represents the equity investment in the Asset Manager Affiliates.

Debt Securities Portfolio

At both September 30, 2018 and December 31, 2017, the weighted average contractual interest rate on our loans and debt securities was approximately 10.1% and 9.9%. At September 30, 2018 and December 31, 2017, the weighted average rate on our loans and debt securities, adjusted for non-accrual and partial non-accrual investments, was approximately 8.9% and 9.6%, respectively.

The investment portfolio (excluding the Company's investment in the Asset Manager Affiliates, CLO Fund Securities, Money Market accounts, and Joint Venture) at September 30, 2018 was spread across 20 different industries and 47 different entities with an average notional balance per entity of approximately \$3.2 million. As of September 30, 2018, one of our investments was on non-accrual status, and three of our investments were on partial non-accrual status, whereby we have recognized income on a portion of contractual PIK amounts due.

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 September 30, 2018 and December 31, 2017, the total amount of non-qualifying assets was approximately 26% and 23%, respectively. The majority of non-qualifying assets were foreign investments which were approximately 18% and 16%, 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 17% and 16% of its total assets, respectively). The investments in our Debt Securities Portfolio are all or predominantly below investment grade, and therefore have speculative characteristics with respect to the issuer’s capacity to pay interest and repay principal.

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 September 30, 2018 and December 31, 2017, our Asset Manager Affiliates had approximately \$3.2 billion and \$3.0 billion, respectively, of par value of assets under management on which they earn management fees, and were valued at approximately \$35.8 million and \$38.8 million, respectively.

All CLO Funds managed by the Asset Manager Affiliates are currently paying all senior and subordinate management fees. As of September 30, 2018 and December 31, 2017, none of the CLO Funds managed by the Asset Manager Affiliates were paying incentive fees.

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 September 30, 2018 and December 31, 2017, we had approximately \$48 million and \$52 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.

The structure of CLO Funds, which are highly levered, is extremely complicated. Since we primarily invest in securities representing the residual interests of CLO Funds, our investments are much riskier than the risk profile of the loans by which such CLO Funds are collateralized. Our investments in CLO Funds may be riskier and less transparent to us and our stockholders than direct investments in the underlying loans. The CLO Funds in which we invest have debt that ranks senior to our investment.

Our CLO Fund Securities as of September 30, 2018 and December 31, 2017 are as follows:

CLO Fund Securities	Investment	% ¹	September 30, 2018		December 31, 2017	
			Amortized Cost	Fair Value	Amortized Cost	Fair Value
Grant Grove CLO, Ltd. ³	Preferred Shares	22.2%	\$ 2,485,886	\$ 1,000	\$ 2,485,886	\$ 1,000
Katonah III, Ltd. ³	Income Notes	23.1	1,287,155	369,280	1,287,155	369,280
Katonah 2007-I CLO Ltd. ^{2,3}	Subordinated Notes	100.0	10,309,141	150,000	20,524,908	10,770,486
Trimaran CLO VII, Ltd. ^{2,3}	Subordinated Notes	10.5	379,830	10,000	379,830	10,000
Catamaran CLO 2012-1 Ltd. ^{2,3}	Subordinated Notes	24.9	3,534,069	10,000	5,847,802	2,320,783
Catamaran CLO 2013- 1 Ltd. ²	Subordinated Notes	18.3	4,976,307	6,072,051	5,017,307	6,923,699
Catamaran CLO 2014-1 Ltd. ²	Subordinated Notes	20.1	9,863,503	9,709,699	9,858,073	8,230,178
KCAP F3C Senior Funding LLC ²	Class E Notes	27.2	4,395,666	4,691,433	4,435,965	4,632,000
Dryden 30 Senior Loan Fund	Subordinated Notes	6.8	1,415,721	2,082,593	1,353,852	1,820,000
Catamaran CLO 2014-2 Ltd. ²	Subordinated Notes	24.9	6,372,132	4,262,959	6,642,805	4,500,962
Catamaran CLO 2015-1 Ltd. ²	Subordinated Notes	9.9	4,414,389	3,492,190	4,418,647	3,569,600
Catamaran CLO 2016-1 Ltd. ²	Subordinated Notes	24.9	9,835,446	8,132,726	10,086,802	8,530,685
Catamaran CLO 2018-1 Ltd. ²	Subordinated Notes	24.8	9,500,000	9,000,000	—	—
Total			<u>\$ 68,769,245</u>	<u>\$ 47,983,931</u>	<u>\$ 72,339,032</u>	<u>\$ 51,678,673</u>

¹ Represents percentage of class held.

² A CLO Fund managed by an Asset Manager Affiliate.

³ As of September 30, 2018, this CLO Fund security was not providing a taxable distribution.

Investment in Joint Venture

During the third quarter of 2017, the Company and Freedom 3 Opportunities LLC (“Freedom 3 Opportunities”), an affiliate of Freedom 3 Capital LLC, entered into an agreement to create KCAP Freedom 3 LLC (the “Joint Venture”). The Company and Freedom 3 Opportunities contributed approximately \$37 million and \$25 million, respectively, in assets to the Joint Venture, which in turn used the assets to capitalize a new fund, KCAP F3C Senior Funding, L.L.C. (the “Fund”) managed by KCAP Management, LLC, one of the Asset Manager Affiliates. In addition, the Fund used cash on hand and borrowings under a credit facility to purchase approximately \$184 million of loans from the Company and the Company used the proceeds from such sale to redeem approximately \$147 million in debt issued by KCAP Senior Funding I, LLC (“KCAP Senior Funding”). The Joint Venture may originate loans from time to time and sell them to the Fund.

During the fourth quarter of 2017, the Fund was refinanced through the issuance of senior and subordinated notes. The Joint Venture purchased 100% of the subordinated notes issued by the Fund. In connection with the refinancing, the Joint Venture made a cash distribution to the Company of approximately \$12.6 million. Approximately \$11.2 million of this distribution was a reduction in the cost basis of the Company’s investment in the Joint Venture. The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at the end of the year, therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

The Company owns a 60% equity investment in the Joint Venture. The Joint Venture is structured as an unconsolidated Delaware limited liability company. All portfolio and other material decisions regarding the Joint Venture must be submitted to its board of managers, which is comprised of four members, two of whom were selected by the Company and two of whom were selected by Freedom 3 Opportunities, and must be approved by at least one member appointed by the Company and one appointed by Freedom 3 Opportunities. In addition, certain matters may be approved by the Joint Venture’s investment committee, which is comprised of one member appointed by the Company and one member appointed by Freedom 3 Opportunities.

The Company has determined that the Joint Venture is an investment company under Accounting Standards Codification (“ASC”), Financial Services — Investment Companies (“ASC 946”), however, in accordance with such guidance, the Company will generally not consolidate its investment in a company other than a wholly owned investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. The Company does not consolidate its interest in the Joint Venture because the Company does not control the Joint Venture due to allocation of the voting rights among the Joint Venture partners.

KCAP Freedom 3 LLC

Summarized Statement of Financial Condition

	As of September 30, 2018 (unaudited)	As of December 31, 2017
Cash	\$ -	\$ 1,717
Investment at fair value	37,861,178	37,080,000
Total Assets	\$ 37,861,178	\$ 37,081,717
Total Liabilities	\$ 2,238,561	\$ 1,221,916
Total Equity	35,622,617	35,859,801
Total Liabilities and Equity	\$ 37,861,178	\$ 37,081,717

KCAP Freedom 3 LLC

Summarized Statement of Operations (unaudited)

	For the three months ended September 30, 2018	For the three months ended September 30, 2017	For the nine months ended September 30, 2018	For the nine months ended September 30, 2017
Investment income	\$ 1,148,571	\$ 1,026,962	\$ 3,566,385	\$ 1,026,962
Operating expenses	56,512	10,000	110,273	10,000
Net investment income	1,092,059	1,016,962	3,456,112	1,016,962
Unrealized appreciation (depreciation) on investments	529,662	79,258	(35,274)	79,258
Net income	\$ 1,621,721	\$ 1,096,220	\$ 3,420,838	\$ 1,096,220

KCAP Freedom 3 LLC
Schedule of Investments
September 30, 2018
(unaudited)

Portfolio Company	Investment	Percentage Ownership by Joint Venture	Amortized Cost	Fair Value
KCAP F3C Senior Funding, LLC ⁽¹⁾⁽²⁾	Subordinated Securities, effective interest 10.7%, 12/29 maturity	100.0%	\$ 42,959,706	\$37,861,178
Total Investments			\$ 42,959,706	\$37,861,178

(1) 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.

(2) Fair value of this investment was determined using significant unobservable inputs, including default rates, prepayment rates, spreads, and the discount rate by which to value the resulting cash flows.

Schedule of Investments
December 31, 2017

Portfolio Company	Investment	Percentage Ownership by Joint Venture	Amortized Cost	Fair Value
KCAP F3C Senior Funding, LLC ⁽¹⁾⁽²⁾	Subordinated Securities, effective interest 12.1%, 12/29 maturity	100.0%	\$ 42,143,254	\$37,080,000
Total Investments			\$ 42,143,254	\$37,080,000

(1) 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.

(2) Fair value of this investment was determined using significant unobservable inputs, including a third party broker quote.

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 and nine months ended September 30, 2018 and 2017.

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. generally accepted accounting principles (“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 KCAP F3C Senior Funding, LLC, interest is earned at a fixed spread relative to the LIBOR index.

Distributions from Asset Manager Affiliates. We may 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 nine months ended September 30, 2018, the Asset Manager Affiliates did not receive any incentive fees.

Certain investments, and the future management fees of certain managed CLO Funds, have been pledged by the Asset Manager Affiliates to third-party lenders under borrowing arrangements undertaken to satisfy the risk retention U.S. risk retention rules formerly required by Section 941 of the of the Dodd-Frank Act applicable to asset managers. In addition, certain of the Asset Manager Affiliates have provided a make-whole guaranty to these lenders in the event that the pledged assets and management fees are insufficient to satisfy the repayment of these borrowings. So long as the underlying managed CLO Funds' rated notes are making regular quarterly distributions, the management fees are available to the Asset Manager Affiliates. A recent court ruling has vacated the application of the U.S. risk retention rules insofar as they apply to managers of "open market CLOs," such as the Asset Manager Affiliates.

The Asset Manager Affiliates may 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 do not expect incentive fees available for distribution to be significant. The fair value of our investment in our Asset Manager Affiliates was approximately \$35.8 million at September 30, 2018, with an unrealized depreciation for the nine months ended September 30, 2018 of approximately \$2.0 million. For the nine months ended September 30, 2018 and 2017, we recognized dividend income of \$920,000 and \$180,000, respectively from the Asset Manager Affiliates, while cash distributions received were approximately \$1.9 million and \$2.2 million, respectively for the nine months ended September 30, 2018 and 2017. 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 \$3.2 billion and \$3.0 billion as of September 30, 2018 and December 31, 2017, respectively.

Investment in Joint Venture. For the three and nine months ended September 30, 2018, the Company recognized \$750,000 and \$2.2 million, respectively in investment income from its investment in the Joint Venture. For the three and nine months ended September 30, 2017 the Company recognized \$685,000, respectively in investment income from its investment in the Joint Venture. As of September 30, 2018 and December 31, 2017, the fair value of the Company's investment in the Joint Venture was \$21.4 million and \$21.5 million, respectively. For interim periods, the Company recognizes investment income on its investment in the Joint Venture based upon its share of the estimated tax-basis earnings and profits of the Joint Venture. Any distributions in excess of tax-basis earnings and profits are recognized as a return of capital (adjustment to the Company's cost basis in the investment). The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at year-end of the year based upon taxable income and distributions for the full year. Therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

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 September 30, 2018 and 2017 was approximately \$7.2 million and \$6.3 million, respectively. Of these amounts, approximately \$4.8 million and \$2.4 million was attributable to interest income on our Debt Securities Portfolio. Investment income for the nine months ended September 30, 2018 and 2017 was approximately \$20.8 million and \$21.7 million, respectively. Of these amounts, approximately \$12.9 million and \$11.8 million was attributable to interest income on our Debt Securities Portfolio.

At both September 30, 2018 and December 31, 2017, the weighted average contractual interest rate on our loans and debt securities was approximately 10.1% and 9.9%. At September 30, 2018 and December 31, 2017, the weighted average rate on our loans and debt securities, adjusted for non-accrual and partial non-accrual investments, was approximately 8.9% and 9.6%, respectively.

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

For the three months ended September 30, 2018 and 2017, approximately \$1.3 million and \$2.8 million, respectively, of investment income was attributable to investments in CLO Fund Securities. For the nine months ended September 30, 2018 and 2017, approximately \$4.7 million and \$8.7 million, respectively, of investment income was attributable to investments in CLO Fund Securities. On a tax basis, the Company recognized \$4.7 million and \$7.0 million of taxable distributable income on distributions from our CLO Fund Securities during the nine months ended September 30, 2018 and 2017, 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 September 30, 2018 and 2017 were approximately \$4.2 million and \$3.7 million, respectively. Interest expense and amortization on debt issuance costs for the three months ended September 30, 2018 and 2017 was approximately \$1.9 million and \$1.4 million, respectively, on average debt outstanding of \$103 million and \$34 million, respectively.

Total expenses for the nine months ended September 30, 2018 and 2017 were approximately \$12.9 million and \$13.3 million, respectively. Interest expense and amortization on debt issuance costs for the nine months ended September 30, 2018 and 2017 were approximately \$5.6 million and \$5.8 million, respectively, on average debt outstanding of \$106 million and \$131 million, respectively.

For the three months ended September 30, 2018 and 2017, approximately \$1.0 million and \$1.1 million of expenses were attributable to employee compensation, including salaries, bonuses, employee benefits, payroll taxes and stock-based compensation expense, respectively. For the nine months ended September 30, 2018 and 2017, approximately \$3.2 million and \$3.5 million 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 September 30, 2018 and 2017, respectively, professional fees and insurance expenses totaled approximately \$1.0 million and \$1.0 million. For the nine months ended September 30, 2018 and 2017, respectively, professional fees and insurance expenses totaled approximately \$2.7 million and \$2.8 million. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately \$382,000 and \$396,000 for the three months ended September 30, 2018 and 2017, respectively. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately \$1.4 million and \$1.3 million for the nine months ended September 30, 2018 and 2017, respectively.

Net Investment Income and Net Realized Gains (Losses)

Net investment income and net realized gains (losses) represents the stockholder's equity before net change in unrealized appreciation or depreciation on investments. For the three months ended September 30, 2018, net investment income and net realized losses were approximately \$2.8 million, or \$0.08 per share. For the three months ended September 30, 2017, net investment income and net realized losses were approximately \$623,000, or \$0.02 per share. For the nine months ended September 30, 2018, net investment income and net realized losses were approximately \$7.8 million, or \$0.21 per share. For the nine months ended September 30, 2017, net investment income and net realized losses were approximately \$5.5 million, or \$0.15 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 nine months ended September 30, 2018, GAAP-basis net investment income was approximately \$7.9 million or \$0.21 per basic share, while tax-basis distributable income was approximately \$8.8 million or \$0.24 per basic share. For the nine months ended September 30, 2017, GAAP-basis net investment income was approximately \$8.4 million or \$0.22 per basic share, while tax-basis distributable income was approximately \$6.9 million or \$0.19 per basic share.

Net Unrealized (Depreciation) Appreciation on Investments

During the three months ended September 30, 2018, our total investments had net unrealized depreciation of approximately \$1.5 million. Included in the net unrealized loss for the three months ended September 30, 2018 are unrealized appreciation on CLO Fund Securities of approximately \$688,000, net unrealized depreciation on equity securities of approximately \$172,000, net unrealized depreciation on the Asset Manager Affiliates of \$1.0 million, net unrealized depreciation on our debt securities of approximately \$1.2 million, and unrealized appreciation on our Joint Venture investment of \$282,000. During the three months ended September 30, 2017, our total investments had net unrealized appreciation of approximately \$2.7 million. Included in the net unrealized appreciation for the three months ended September 30, 2017 are unrealized depreciation on CLO Fund Securities of approximately \$1.6 million, unrealized depreciation and on equity securities of approximately \$186,000, unrealized appreciation on the Asset Manager Affiliates of \$2.9 million, and net unrealized appreciation on our debt securities of \$1.8 million.

During the nine months ended September 30, 2018, our total investments had net unrealized depreciation of approximately \$5.0 million. Included in the net unrealized loss in 2018 are unrealized depreciation on CLO Fund Securities of approximately \$125,000, net unrealized depreciation on equity securities of approximately \$335,000, net unrealized depreciation on the Asset Manager Affiliates of \$2.0 million, net unrealized depreciation on our debt securities of approximately \$2.4 million, and unrealized depreciation on our Joint Venture investment of \$142,000. During the nine months ended September 30, 2017, our total investments had net unrealized appreciation of approximately \$875,000. Included in the net unrealized appreciation for the nine months ended September 30, 2017 are net unrealized depreciation on CLO Fund Securities of approximately \$4.0 million net unrealized depreciation and on equity securities of approximately \$606,000, net unrealized appreciation on the Asset Manager Affiliates of \$1.5 million, and net unrealized appreciation on our debt securities of \$4.2 million.

Net Change in Stockholder's Equity Resulting from Operations

The net increase in stockholders' equity resulting from operations for the three months ended September 30, 2018 was \$1.3 million, or \$0.04 per basic share. Net decrease in stockholders' equity resulting from operations for the three months ended September 30, 2017 was \$669,000, or \$0.02 per basic share.

The net increase in stockholders' equity resulting from operations for the nine months ended September 30, 2018 was \$2.6 million, or \$0.07 per basic share. Net increase in stockholders' equity resulting from operations for the nine months ended September 30, 2017 was \$2.2 million, or \$0.06 per basic 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 September 30, 2018 and December 31, 2017 the fair value of investments and cash were as follows:

Security Type	Investments at Fair Value	
	September 30, 2018	December 31, 2017
Cash	\$ 1,713,906	\$ 2,034,095
Restricted Cash	987,818	—
Short-term investments	24,431,512	77,300,320
Senior Secured Loan	62,292,361	44,960,146
Junior Secured Loan	71,229,383	58,941,300
Senior Unsecured Loan	6,277,283	12,777,283
Senior Secured Bond	—	1,518,750
CLO Fund Securities	47,983,931	51,678,673
Equity Securities	4,079,336	4,414,684
Joint Venture	21,373,570	21,516,000
Asset Manager Affiliates	35,818,000	38,849,000
Total	<u>\$ 276,187,100</u>	<u>\$ 313,990,251</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 generally are required to meet a coverage ratio of total assets to total borrowings and other senior securities, which include all of our borrowings and any preferred stock that we may issue in the future, of at least 200% (or 150% beginning on March 29, 2019). As of September 30, 2018, we had approximately \$107.4 million of par value of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 259%. We may also generally borrow amounts of up to 5% of the value of our total assets for temporary purposes.

On March 29, 2018, our Board of Directors, including a “required majority” (as such term is defined in Section 57(o) of the 1940 Act) of the Board, approved the modified asset coverage requirements set forth in Section 61(a)(2) of the 1940 Act, as amended by the SBCA. As a result, our asset coverage requirement for senior securities will be changed from 200% to 150%, effective as of March 29, 2019. However, despite the SBCA, we will continue to be prohibited by the indentures governing our 7.375% Notes and 6.125% 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.

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 asset coverage requirement currently 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. As a result, despite the SBCA, the Company will continue to be prohibited by the indenture governing the 7.375% Notes Due 2019 from making distributions on its common stock if its asset coverage, as defined in the 1940 Act, falls below 200%. At September 30, 2018 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. During the second quarter of 2017, the Company redeemed \$6.5 million par value of the 7.375% Notes Due 2019 resulting in a realized loss on extinguishment of debt of \$107,276. KCAP subsequently surrendered all of these Notes to the Trustee for cancellation. During the first quarter of 2018, approximately \$20 million par value of the 7.375% Notes Due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of approximately \$169,000. The Company subsequently surrendered these notes to the Trustee for cancellation.

During the third quarter of 2017, the company issued \$77.4 million aggregate principal amount of 6.125% Notes due 2022 (the “6.125% Notes Due 2022”). The net proceeds for the 6.125% Notes Due 2022, after the payment of underwriting expenses, were approximately \$74.6 million. Interest on the 6.125% Notes Due 2022 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 6.125% commencing September 30, 2017. The 6.125% Notes Due 2022 mature on September 30, 2022, and are senior unsecured obligations of the Company. In addition, due to the asset coverage requirement currently applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 6.125% Notes Due 2022, 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. As a result, despite the SBCA, the Company will continue to be prohibited by the indenture governing the 6.125% Notes Due 2022 from making distributions on its common stock if its asset coverage, as defined in the 1940 Act, falls below 200%. At December 31, 2017, the Company was in compliance with all of its debt covenants. The indenture governing the 6.125% Notes Due 2022 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends.

On March 1, 2018, KCAP Funding I, LLC (“Funding”), a wholly owned subsidiary of the Company, entered into a senior secured revolving credit facility (the “Revolving Credit Facility”) with certain institutional lenders, State Bank and Trust Company, as the administrative agent, lead arranger and bookrunner, CIBC Bank USA, as documentation agent and the Company, as the servicer. The maximum commitment amount of the Revolving Credit Facility is \$50 million, subject to availability under the borrowing base. Borrowings under the Revolving Credit Facility bear interest at a rate per annum equal to (i) in the case of LIBOR rate loans, an adjusted LIBOR rate for the applicable interest period plus 3.25% or (ii) in the case of base rate loans, the prime rate plus 3.25%. Funding will pay a fee on any undrawn amounts of 0.375% per annum; provided that if 50% or less of the Revolving Credit Facility is drawn, the fee will be 0.50% per annum. The Company intends to use the proceeds from borrowings under the Revolving Credit Facility for general corporate purposes, including to acquire certain qualifying loans, and such other uses as permitted under the Loan and Security Agreement (the “Revolving Credit Agreement”).

The maturity date is the earliest of: (a) March 1, 2022 and (b) the date upon which all loans shall become due and payable in full, whether by acceleration or otherwise, as a result of a default by the Company, as defined in the Revolving Credit Facility. The Revolving Credit Facility is secured by all of the assets held by Funding, and the Company has pledged its interests in Funding as collateral to State Bank and Trust Company, as the administrative agent, to secure the obligations of Funding under the Revolving Credit Facility. The Revolving Credit Agreement includes customary affirmative and negative covenants, including certain limitations on the incurrence of additional indebtedness and liens, as well as usual and customary events of default for revolving credit facilities of this nature. At September 30, 2018, Funding was in compliance with all of its debt covenants. During the first nine months of 2018, Funding borrowed \$31 million under the Revolving Credit Facility. As of September 30, 2018, \$22.9 million principal amount of borrowings was outstanding under the Revolving Credit Facility. Interest on borrowings under the Revolving Credit Facility is paid monthly. Borrowings under the Revolving Credit Facility are subject to redemption in whole or in part at any time or from time to time, at the option of the Funding. Concurrently with any termination of the Revolving Credit Facility before March 1, 2019 Funding will pay to agent an amount equal to 1% of the Revolver Commitments.

Investment in Joint Venture

During the third quarter of 2017, the Company and Freedom 3 Opportunities entered into an agreement to create the Joint Venture. The Company and Freedom 3 Opportunities contributed approximately \$37 million and \$25 million, respectively, in assets to the Joint Venture, which in turn used the assets to capitalize the Fund, which is managed by KCAP Management, LLC, one of the Company's Asset Manager Affiliates. In addition, the Fund used cash on hand and borrowings under a credit facility to purchase approximately \$184 million of loans from the Company and the Company used the proceeds from such sale to redeem approximately \$147 million in debt issued by KCAP Senior Funding. The Joint Venture may originate loans from time to time and sell them to the Fund.

During the fourth quarter of 2017, the Fund was refinanced through the issuance of senior and subordinated notes. The Joint Venture purchased 100% of the subordinated notes issued by the Fund. In connection with the refinancing, KCAP received a cash distribution of \$12.6 million, \$11.2 million of which was a return of capital.

On July 20, 2017 \$147.4 million par value of notes issued by KCAP Senior Funding were repaid in full, resulting in a realized loss on extinguishment of debt of \$4.1 million.

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". From time to time, we may seek to retire, repurchase, or exchange debt securities in open market purchases or by other means dependent on market conditions, liquidity, contractual obligations, and other matters. In addition, we evaluate strategic opportunities available to us and/or the Asset Manager Affiliates, including mergers, divestures, spin-offs, joint ventures and other similar transactions from time to time.

Stockholder Distributions

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

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

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

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

On March 29, 2018, our Board of Directors, including a "required majority" (as such term is defined in Section 57(o) of the 1940 Act) of the Board, approved the modified asset coverage requirements set forth in Section 61(a)(2) of the 1940 Act, as amended by the SBCA. As a result, our asset coverage requirement for senior securities will be changed from 200% to 150%, effective as of March 29, 2019. However, despite the SBCA, we will continue to be prohibited by the indentures governing our 7.375% Notes and 6.125% 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 2016.

	Distribution	Declaration Date	Record Date	Pay Date
2018:				
Third quarter	0.10	9/18/2018	10/9/2018	10/29/2018
Second quarter	0.10	6/19/2018	7/6/2018	7/26/2018
First quarter	\$ 0.10	3/20/2018	4/6/2018	4/27/2018
Total declared in 2018	<u>\$ 0.30</u>			
2017:				
Fourth quarter	\$ 0.10	12/13/2017	1/5/2018 ¹	1/25/2018
Third quarter	0.12	9/22/2017	10/10/2017	10/26/2017
Second quarter	0.12	6/20/2017	7/7/2017	7/27/2017
First quarter	\$ 0.12	3/21/2017	4/7/2017	4/28/2017
Total declared in 2017	<u>\$ 0.46</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	\$ 0.15	3/18/2016	4/7/2016	4/28/2016
Total declared in 2016	<u>\$ 0.57</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 September 30, 2018 and December 31, 2017, the Company had \$370,000 and \$0 commitments to fund investments, respectively.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual cash obligations and other commercial commitments as of September 30, 2018:

Contractual Obligations	Total	Payments Due by Period			More than 5 years
		Less than one year	1 - 3 years	3 - 5 years	
Long-term debt obligations	\$ 107,355,393	\$ —	\$ 7,000,000	\$ 100,355,393	\$ —

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 Measurements and Disclosures ("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.

The Company carries investments in joint ventures at fair value based upon the fair value of the investments held by the joint venture.

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 September 30, 2018, one of our investments was on non-accrual status. As of September 30, 2018, three 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 KCAP F3C Senior Funding, L.L.C., 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 2018, 2017 and 2016 calendar years.

	Distribution	Declaration Date	Record Date	Pay Date
2018:				
Third quarter	0.10	9/18/2018	10/9/2018	10/29/2018
Second quarter	0.10	6/19/2018	7/6/2018	7/26/2018
First quarter	\$ 0.10	3/20/2018	4/6/2018	4/27/2018
Total declared in 2018	<u>\$ 0.30</u>			
2017:				
Fourth quarter	\$ 0.10	12/13/2017	1/5/2018 ¹	1/25/2018
Third quarter	0.12	9/22/2017	10/10/2017	10/26/2017
Second quarter	0.12	6/20/2017	7/7/2017	7/27/2017
First quarter	\$ 0.12	3/21/2017	4/7/2017	4/28/2017
Total declared in 2017	<u>\$ 0.46</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	\$ 0.15	3/18/2016	4/7/2016	4/28/2016
Total declared in 2016	<u>\$ 0.57</u>			

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

Recent Developments

On October 24, 2018, the Company caused notices to be issued to the holders of the 7.375% Notes Due 2019 regarding the Company's exercise of its option to redeem all of the issued and outstanding 7.375% Notes Due 2019. The Company will redeem all \$7.0 million in aggregate principal amount of the 7.375% Notes Due 2019 on November 26, 2018 at a cost of \$7.0 million. The Company expects to record a realized loss on early extinguishment of debt of approximately \$30,000 during the fourth quarter of 2018.

On November 6, 2018, C. Michael Jacobi stepped down from his role as a member of the Audit Committee of the Board and the Company's remaining directors appointed Christopher Lacovara, an existing director, to fill the vacancy on the Audit Committee of the Board.

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 September 30, 2018, approximately 77% of our Debt Securities Portfolio were floating rate with a spread to an interest rate index such as LIBOR or the prime rate. Most of these floating rate loans contain floors ranging between 1.00% and 3.00%. We generally expect that future portfolio investments will predominately be floating rate investments. As of September 30, 2018, we had \$107.4 million (par value) of borrowings outstanding at a current weighted average rate of 6.1%.

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 and 6.125% Notes Due 2022 would remain the same, given that this debt is at a fixed rate, while the interest rate on borrowings under the KCAP Funding I, LLC Revolving Credit Facility would fluctuate with changes in interest rates.

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 September 30, 2018 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	\$ 1,073,927	\$ 2,038,425	\$ 3,004,275
Decrease in interest rate	\$ (961,379)	\$ (1,191,035)	\$ (1,182,780)

As shown above, net investment income assuming a 1% increase in interest rates would increase by approximately \$1.1 million 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 \$2.0 million and \$3.0 million, respectively.

On an annualized basis, a decrease in interest rates of 1%, 2% and 3% would result in a decrease in net investment income of approximately \$961,000, \$1,191,000 and \$1,183,000, respectively. The negative impact of a 3% decline in interest rates is less severe than the impact of a 2% decline in interest rates due to the impact of interest rate floors on certain of our floating rate investments, as there is no floor on our floating rate debt facility.

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 September 30, 2018.

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, 2017 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

Since May 2015, the staff of the Division of Enforcement of the U.S. Securities and Exchange Commission (the “Staff”) has been conducting an informal investigation primarily concerning the restatement disclosed by the Company in its Form 10-K for the year ended December 31, 2014. The Company has cooperated with the Staff’s investigation and recently has engaged in discussions with the Staff about a potential resolution of the investigation. Based on these discussions, the Company does not expect that any settlement would have a material adverse impact on the Company’s financial condition or results of operations.

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, 2017 and Part II, “Item 1A. Risk Factors” in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, except as described below.

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

While we did not engage in any sales of unregistered securities during the nine months ended September 30, 2018, we issued a total of 46,942 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 nine months ended September 30, 2018, the aggregate value of the shares of our common stock issued under our DRIP was approximately \$155,000.

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
2.1	Purchase and Sale Agreement, dated February 29, 2012, by and among Kohlberg Capital Corporation (the “Company”), Commodore Holdings, L.L.C., Trimaran Advisors, L.L.C., HBK Caravelle, L.L.C., Trimaran Fund Management, L.L.C., Jay R. Bloom, and Dean C. Kehler. ⁽¹⁾
3.1	Form of Certificate of Incorporation of the Company. ⁽²⁾
3.2	Form of Bylaws of the Company, as amended and restated effective February 29, 2012. ⁽³⁾
4.1	Form of Dividend Reinvestment Plan. ⁽⁴⁾
4.2	Form of Base Indenture between the Company, as Issuer, and U.S. Bank National Association, as Trustee. ⁽⁵⁾
4.3	Form of First Supplemental Indenture between the Company and U.S. Bank National Association relating to the 7.375% Senior Notes Due 2019. ⁽⁵⁾
4.4	Form of Note relating to the 7.375% Senior Notes Due 2019 (included as part of Exhibit 4.3). ⁽⁵⁾
4.5	Second Supplemental Indenture between the Company and U.S. Bank National Association relating to the 6.125% Notes Due 2022. ⁽⁶⁾
4.6	Form of 6.125% Notes Due 2022 (included as part of Exhibit 4.5). ⁽⁶⁾
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.

- (1) Incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).
- (2) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 1 on Form N-2, as filed on October 6, 2006 (File No. 333-136714).
- (3) Incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).
- (4) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 2 on Form N-2, as filed on November 20, 2006 (File No. 333-136714).
- (5) Incorporated by reference to exhibit included in the Registration Statement in Form N-2, as filed on October 3, 2012 (File No. 333-183032).
- (6) Incorporated by reference to the exhibit included in Post-Effective Amendment No. 1 on Form N-2, as filed on August 14, 2017 (File No. 333-218596).

**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 September 30, 2018 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: November 6, 2018

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 September 30, 2018 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: November 6, 2018

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 September 30, 2018 (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: November 6, 2018

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 September 30, 2018 (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: November 6, 2018

By: _____ / S / EDWARD U. GILPIN
Edward U. Gilpin
Chief Financial Officer
(Principal Financial Officer)
