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

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**FORM 10-Q**

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

For the quarterly period ended March 31, 2010

**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

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**Kohlberg Capital Corporation**

(Exact name of Registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-5951150**  
(I.R.S. Employer  
Identification Number)

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

**(212) 455-8300**  
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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

The number of outstanding shares of common stock of the registrant as of May 7, 2010 was **22,549,235**.

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## EXPLANATORY NOTE

This Quarterly Report on Form 10-Q for the three months ended March 31, 2010 contains restated financial information for the comparative period of 2009. Concurrent with the filing of this Form 10-Q, the Company is filing with the Securities and Exchange Commission (1) amended Quarterly Reports on Form 10-Q/A for the quarterly periods ended March 31, 2009 (the “Q1 2009 10-Q/A”) and June 30, 2009 (the “Q2 2009 10-Q/A”), (2) a Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009 (the “Q3 2009 10-Q”), and (3) an Annual Report on Form 10-K for the year ended December 31, 2009 (the “2009 10-K”). The Q1 2009 10-Q/A contains restated financial information for the three months ended March 31, 2009 (as well as for the comparative period of 2008) and for the year ended December 31, 2008. The Q2 2009 10-Q/A contain restated financial information for the three and six months ended June 30, 2009 (as well as for the comparative periods of 2008) and for the year ended December 31, 2008. The Q3 2009 10-Q contains restated financial information for the year ended December 31, 2008 (as well as for the comparative periods ended September 30, 2008) and the 2009 10-K contains restated financial information for the year ended December 31, 2008 (as well as restated unaudited financial information for each of the four quarters of 2008 and the first two quarters of 2009). The Company’s previously filed Annual Report on Form 10-K for the year ended December 31, 2008 and previously filed Quarterly Reports on Form 10-Q for the quarterly periods in 2008 have not been amended for the restatement affecting 2008 and should not be relied upon.

In addition, management has concluded that the Company had material weaknesses in its internal control over financial reporting related to errors in the application of accounting for the fair value of the Company’s illiquid investments and the revenue recognition for certain non-cash payment-in-kind (“PIK”) investments as of the end of each of the years ended December 31, 2009 and December 31, 2008 and each of the quarterly periods included in such years. As described in more detail in Item 9A of the Company’s 2009 10-K, the Company is implementing measures designed to remediate the identified material weaknesses and believes that these measures will effectively remediate these material weaknesses. As of the date of filing of this Quarterly Report, the Company believes that it has corrected its accounting for the fair value of its illiquid investments and its accounting for the revenue recognition for its non-cash PIK investments to the extent necessary to prepare the financial statements and the other financial information contained herein.

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**KOHLBERG CAPITAL CORPORATION**  
**BALANCE SHEETS**

	As of <u>March 31, 2010</u> (unaudited)	As of <u>December 31, 2009</u>
<b>ASSETS</b>		
Investments at fair value:		
Time deposits (cost: 2010 - \$20,055,211; 2009 - \$126)	\$ 20,055,211	\$ 126
Money market account (cost: 2010 - \$216,099; 2009 - \$0)	216,099	—
Debt securities (cost: 2010 - \$317,483,699; 2009 - \$342,056,023)	276,453,163	297,356,529
CLO fund securities managed by non-affiliates (cost: 2010 - \$15,686,805; 2009 - \$15,685,858)	4,661,000	4,021,000
CLO fund securities managed by affiliate (cost: 2010 - \$52,528,857; 2009 - \$52,509,191)	47,020,000	44,950,000
Equity securities (cost: 2010 - \$13,543,343; 2009 - \$12,365,603)	5,901,400	4,713,246
Asset manager affiliates (cost: 2010 - \$43,308,942; 2009 - \$40,751,511)	55,541,948	58,064,720
Total Investments at fair value	409,848,821	409,105,621
Cash	492,255	4,140,408
Restricted cash	2,474,052	18,696,023
Interest and dividends receivable	3,700,553	3,836,031
Receivable for open trades	—	2,953,500
Due from affiliates	—	44,274
Other assets	564,039	640,200
Total assets	<u>\$417,079,720</u>	<u>\$ 439,416,057</u>
<b>LIABILITIES</b>		
Borrowings	\$198,648,255	\$ 218,050,363
Accounts payable and accrued expenses	2,220,657	3,057,742
Dividend payable	—	4,412,228
Total liabilities	<u>\$200,868,912</u>	<u>\$ 225,520,333</u>
Commitments and contingencies (note 8)		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$0.01 per share, 100,000,000 common shares authorized; 22,475,339 and 22,363,281 common shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively	\$ 221,732	\$ 220,611
Capital in excess of par value	283,793,286	283,074,233
Accumulated undistributed net investment income	3,904,874	1,326,380
Accumulated net realized losses	(18,734,949)	(16,462,808)
Net unrealized depreciation on investments	(52,974,135)	(54,262,692)
Total stockholders' equity	<u>\$216,210,808</u>	<u>\$ 213,895,724</u>
Total liabilities and stockholders' equity	<u>\$417,079,720</u>	<u>\$ 439,416,057</u>
NET ASSET VALUE PER COMMON SHARE	<u>\$ 9.62</u>	<u>\$ 9.56</u>

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**  
**STATEMENTS OF OPERATIONS**  
**(unaudited)**

	Three Months Ended March 31,	
	2010	2009 (as restated)
<b>Investment Income:</b>		
Interest from investments in debt securities	\$ 4,782,363	\$ 6,723,130
Interest from cash and time deposits	6,083	4,670
Dividends from investments in CLO fund securities managed by non-affiliates	348,874	480,392
Dividends from investments in CLO fund securities managed by affiliate	1,811,894	2,127,326
Capital structuring service fees (expense)	14,612	116,735
Total investment income	<u>6,963,826</u>	<u>9,452,253</u>
<b>Expenses:</b>		
Interest and amortization of debt issuance costs	2,696,351	1,508,011
Compensation	787,691	800,968
Professional fees	508,518	336,329
Insurance	102,318	91,763
Administrative and other	290,454	261,559
Total expenses	<u>4,385,332</u>	<u>2,998,630</u>
<b>Net Investment Income</b>	<b>2,578,494</b>	<b>6,453,623</b>
<b>Realized And Unrealized Gains (Losses) On Investments:</b>		
Net realized gains (losses) from investment transactions	(2,272,141)	(2,007,373)
Net change in unrealized appreciation (depreciation) on:		
Debt securities	3,668,958	651,599
Equity securities	10,414	(325,229)
CLO fund securities managed by affiliate	2,050,333	2,988,956
CLO fund securities managed by non-affiliate	639,054	32,684
Affiliate asset manager investments	<u>(5,080,203)</u>	<u>1,101,238</u>
Net realized and unrealized depreciation on investments	<u>(983,585)</u>	<u>2,441,875</u>
<b>Net Increase (Decrease) In Net Assets Resulting From Operations</b>	<b>\$ 1,594,909</b>	<b>\$ 8,895,498</b>
Net Increase In Net Assets Resulting from Operations per Common Share—Basic and Diluted	\$ 0.07	\$ 0.41
Net Investment Income Per Common Share—Basic and Diluted	\$ 0.11	\$ 0.30
Net Investment Income and Net Realized Gains/Losses Per Common Share—Basic and Diluted	\$ 0.01	\$ 0.20
Weighted Average Shares of Common Stock Outstanding—Basic and Diluted	22,445,457	21,867,006

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**  
**STATEMENTS OF CHANGES IN NET ASSETS**  
**(unaudited)**

	Three Months Ended	
	March 31,	
	2010	2009
		(as restated)
<b>Operations:</b>		
Net investment income	\$ 2,578,494	\$ 6,453,623
Net realized loss from investment transactions	(2,272,141)	(2,007,373)
Net change in unrealized depreciation on investments	1,288,556	4,449,248
Net increase (decrease) in net assets resulting from operations	<u>1,594,909</u>	<u>8,895,498</u>
<b>Stockholder distributions:</b>		
Dividends from net investment income to restricted stockholders	—	(41,604)
Net decrease in net assets resulting from stockholder distributions	<u>—</u>	<u>(41,604)</u>
<b>Capital transactions:</b>		
Issuance of common stock for dividend reinvestment plan	499,779	464,749
Vesting of restricted stock	—	53
Stock based compensation	220,397	235,556
Net increase in net assets resulting from capital transactions	<u>720,176</u>	<u>700,358</u>
Net assets at beginning of period	<u>213,895,723</u>	<u>196,566,018</u>
Net assets at end of period (including undistributed net investment income of 3,904,874, and 9,277,453 in 2010 and 2009, respectively)	<u>\$216,210,808</u>	<u>\$206,120,270</u>
Net asset value per common share	\$ 9.62	\$ 9.41
Common shares outstanding at end of period	22,475,339	21,910,452

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**  
**STATEMENTS OF CASH FLOWS**  
**(unaudited)**

	Three Months Ended	
	March 31,	
	2010	2009
		(as restated)
<b>OPERATING ACTIVITIES:</b>		
Net increase (decrease) in stockholders' equity resulting from operations	\$ 1,594,909	\$ 8,895,498
Adjustments to reconcile net increase (decrease) in stockholders' equity resulting from operations to net cash provided by (used in) operations:		
Net realized losses on investment transactions	2,272,141	2,007,373
Net change in unrealized depreciation on investments	(1,288,556)	(4,449,248)
Net accretion of discount on securities	(142,555)	(649,944)
Amortization of debt issuance cost	206,174	206,174
Purchases of investments	(23,681,703)	(2,684,007)
Capital contribution to affiliate asset manager	(2,557,431)	—
Payment-in-kind interest	(187,842)	—
Proceeds from sale and redemption of investments	27,796,246	31,886,065
Stock based compensation expense	220,396	235,556
Changes in operating assets and liabilities:		
Decrease in interest and dividends receivable	135,478	613,852
(Increase) decrease in other assets	(130,012)	(257,139)
Decrease (increase) in due from affiliates	44,274	(1,812,651)
Increase (decrease) in accounts payable and accrued expenses	(837,085)	(1,125,413)
Net cash provided by (used in) operating activities	<u>3,444,434</u>	<u>32,866,116</u>
<b>FINANCING ACTIVITIES:</b>		
Issuance of stock (net of offering costs)	—	53
Dividends paid in cash	(3,912,450)	(5,456,517)
Cash paid on repayment of debt	(19,402,108)	(16,645,264)
Decrease (increase) in restricted cash	16,221,971	(6,796,728)
Net cash (used in) provided by financing activities	<u>(7,092,587)</u>	<u>(28,898,456)</u>
<b>CHANGE IN CASH</b>	<b>(3,648,153)</b>	<b>3,967,660</b>
<b>CASH, BEGINNING OF PERIOD</b>	<b>4,140,408</b>	<b>251,412</b>
<b>CASH, END OF PERIOD</b>	<b><u>\$ 492,255</u></b>	<b><u>\$ 4,219,072</u></b>
<b>Supplemental Information:</b>		
Interest paid during the period	\$ 2,336,077	\$ 1,722,797
Non-cash dividends paid during the period under the dividend reinvestment plan	\$ 499,779	\$ 464,747

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**  
**SCHEDULE OF INVESTMENTS**  
**As of March 31, 2010**  
**(unaudited)**

**Debt Securities Portfolio**

<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Advanced Lighting Technologies, Inc. <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Revolving Loan 3.0%, Due 6/13	\$ 640,000	\$ 634,678	\$ 638,720
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Deferred Draw Term Loan (First Lien) 3.0%, Due 6/13	322,772	322,772	322,126
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Junior Secured Loan — Second Lien Term Loan Note 6.3%, Due 6/14	5,000,000	5,000,000	5,000,000
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan (First Lien) 3.0%, Due 6/13	1,576,507	1,576,507	1,573,354
Aero Products International, Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 9.5%, Due 4/12	3,118,560	3,118,560	1,715,208
Aerostructures Acquisition LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Delayed Draw Term Loan 7.3%, Due 3/13	354,265	354,265	354,265
Aerostructures Acquisition LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 7.3%, Due 3/13	4,477,268	4,477,268	4,477,268
AGA Medical Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Tranche B Term Loan 2.3%, Due 4/13	1,832,209	1,831,418	1,832,209
AGS LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Delayed Draw Term Loan 3.3%, Due 5/13	425,691	422,094	397,170
AGS LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Initial Term Loan 3.3%, Due 5/13	3,042,646	3,016,937	2,838,789
AmerCable Incorporated <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Senior Secured Loan — Initial Term Loan 3.8%, Due 6/14	5,825,238	5,825,238	5,825,238
Astoria Generating Company Acquisitions, L.L.C. <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Term C 4.0%, Due 8/13	4,000,000	4,029,740	4,000,000

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Atlantic Marine Holding Company <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Term Loan 4.6%, Due 3/14	\$ 1,676,965	\$ 1,683,819	\$1,676,965
Aurora Diagnostics, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Tranche A Term Loan (First Lien) 4.5%, Due 12/12	3,950,485	3,929,173	3,950,485
Awesome Acquisition Company (CiCi's Pizza) <sup>6</sup> <i>Personal, Food and Miscellaneous Services</i>	Junior Secured Loan — Term Loan (Second Lien) 5.3%, Due 6/14	4,000,000	3,982,742	4,000,000
AZ Chem US Inc. <sup>6</sup> <i>Chemicals, Plastics and Rubber</i>	Junior Secured Loan — Second Lien Term Loan 5.8%, Due 2/14	4,000,000	3,972,425	4,000,000
Bankruptcy Management Solutions, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Junior Secured Loan — Loan (Second Lien) 6.5%, Due 7/13	2,412,500	2,434,033	1,428,200
Bankruptcy Management Solutions, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Senior Secured Loan — Term Loan (First Lien) 4.3%, Due 7/12	1,870,497	1,876,318	1,539,419
Bicent Power LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Advance (Second Lien) 4.3%, Due 12/14	4,000,000	4,000,000	3,364,000
BP Metals, LLC (fka Constellation Enterprises) <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Term Loan 10.1%, Due 6/13	4,297,832	4,297,832	4,297,832
Caribe Information Investments Incorporated <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan 2.5%, Due 3/13	1,671,535	1,667,345	1,562,885
Cast & Crew Payroll, LLC (Payroll Acquisition) <sup>6</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Secured Loan — Initial Term Loan 3.2%, Due 9/12	6,373,290	6,385,638	6,373,290
CEI Holdings, Inc. (Cosmetic Essence) <sup>6,9</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 8.1%, Due 3/13	1,450,629	1,407,147	735,291
Charlie Acquisition Corp. <sup>9</sup> <i>Personal, Food and Miscellaneous Services</i>	Mezzanine Investment — Senior Subordinated Notes 15.5%, Due 6/13	10,893,401	10,786,010	528,492
CoActive Technologies, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Senior Secured Loan — Term Loan (First Lien) 3.3%, Due 7/14	3,905,083	3,892,878	2,874,141
CoActive Technologies, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0%, Due 1/15	2,000,000	1,973,568	1,062,000

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Dealer Computer Services, Inc. (Reynolds & Reynolds) <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Term Loan (Second Lien) 5.7%, Due 10/13	\$ 1,000,000	\$ 1,005,856	\$ 1,000,000
Dealer Computer Services, Inc. (Reynolds & Reynolds) <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Term Loan (Third Lien) 7.7%, Due 4/14	7,700,000	7,547,830	7,700,000
Delta Educational Systems, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan 6.0%, Due 6/12	2,301,996	2,301,996	2,301,996
Dex Media West LLC <i>Printing and Publishing</i>	Senior Secured Loan — New Term Loan 7.5%, Due 10/14	3,617,543	3,337,037	3,463,798
Dresser, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Term Loan (Second Lien) 6.0%, Due 5/15	3,000,000	2,971,581	3,000,000
DRI Holdings, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — US Term Loan (Second Lien) 6.5%, Due 7/15	6,000,000	5,524,522	6,000,000
Edgestone CD Acquisition Corp. (Custom Direct) <sup>6</sup> <i>Printing and Publishing</i>	Junior Secured Loan — Loan (Second Lien) Retired 04/09/2010 6.3%, Due 12/14	5,000,000	5,000,000	5,000,000
Edgestone CD Acquisition Corp. (Custom Direct) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan (First Lien) 3.1%, Due 12/13	3,862,408	3,865,237	3,862,408
eInstruction Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Initial Term Loan 4.3%, Due 7/13	4,007,041	4,007,041	4,007,041
eInstruction Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — Term Loan (Second Lien) 7.8%, Due 7/14	10,000,000	10,000,000	10,000,000
Endeavor Energy Resources, L.P. <sup>6</sup> <i>Oil and Gas</i>	Junior Secured Loan — Initial Loan (Second Lien) 5.8%, Due 4/12	4,000,000	4,000,000	4,000,000
Fasteners For Retail, Inc. <sup>6</sup> <i>Diversified/Conglomerate Manufacturing</i>	Senior Secured Loan — Term Loan 4.8%, Due 12/12	4,031,772	4,035,783	4,031,772
FD Alpha Acquisition LLC (Fort Dearborn) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — US Term Loan 3.3%, Due 11/12	1,459,110	1,392,939	1,459,110
First American Payment Systems, L.P. <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Term Loan 3.3%, Due 10/13	3,188,000	3,188,000	3,188,000

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<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Cost</b>	<b>Value<sup>2</sup></b>
First Data Corporation <i>Finance</i>	Senior Secured Loan — Initial Tranche B-2 Term Loan 3.0%, Due 9/14	\$ 938,537	\$ 873,481	\$ 831,544
Ford Motor Company <sup>6</sup> <i>Automobile</i>	Senior Secured Loan — Tranche B-1 Term Loan 3.3%, Due 12/13	1,934,939	1,933,489	1,876,891
Freescale Semiconductor, Inc. <i>Electronics</i>	Senior Subordinated Bond — 10.1%, Due 12/16	3,000,000	3,006,913	2,670,000
Frontier Drilling USA, Inc. <sup>6</sup> <i>Oil and Gas</i>	Senior Secured Loan — Term B Advance 9.3%, Due 6/13	2,000,000	1,998,747	2,000,000
Ginn LA Conduit Lender, Inc. <sup>9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — First Lien Tranche A Credit-Linked Deposit 7.8%, Due 6/11	1,257,143	1,224,101	89,634
Ginn LA Conduit Lender, Inc. <sup>9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — First Lien Tranche B Term Loan 7.8%, Due 6/11	2,694,857	2,624,028	195,377
Ginn LA Conduit Lender, Inc. <sup>9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Junior Secured Loan — Loan (Second Lien) 11.8%, Due 6/12	3,000,000	2,715,997	60,000
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Tranche B Term Loan 2.8%, Due 6/14	2,917,500	2,917,500	2,675,348
HMSC Corporation (aka Swett and Crawford) <sup>6</sup> <i>Insurance</i>	Junior Secured Loan — Loan (Second Lien) 5.7%, Due 10/14	5,000,000	4,868,323	3,735,000
Huish Detergents Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Junior Secured Loan — Loan (Second Lien) 4.5%, Due 10/14	1,000,000	1,000,000	1,000,000
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Initial Term Loan (First Lien) 2.7%, Due 4/14	3,690,443	3,579,842	3,657,229
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Junior Secured Loan — Loan (Second Lien) 7.0%, Due 10/14	3,000,000	3,000,000	3,000,000
Infiltrator Systems, Inc. <sup>6</sup> <i>Ecological</i>	Senior Secured Loan — Term Loan 8.5%, Due 9/12	2,692,930	2,688,569	2,692,930
Inmar, Inc. <sup>6</sup> <i>Retail Stores</i>	Senior Secured Loan — Term Loan 2.5%, Due 4/13	3,543,046	3,543,046	3,543,046

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
International Aluminum Corporation (IAL Acquisition Co.) <sup>6,9</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Term Loan 5.0%, Due 3/13	\$2,973,711	\$2,973,711	\$1,864,517
Intrapac Corporation/Corona Holdco <sup>6</sup> <i>Containers, Packaging and Glass</i>	Senior Secured Loan — First Lien Term Loan 3.8%, Due 5/12	4,031,548	4,039,311	4,027,516
Intrapac Corporation/Corona Holdco <sup>6</sup> <i>Containers, Packaging and Glass</i>	Junior Secured Loan — Term Loans (Second Lien) 7.8%, Due 5/13	3,000,000	3,012,749	3,000,000
Jones Stephens Corp. <sup>6,9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — Term Loan 7.8%, Due 9/12	9,541,180	9,527,537	8,491,650
KIK Custom Products Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Junior Secured Loan — Loan (Second Lien) 5.2%, Due 12/14	5,000,000	5,000,000	3,060,000
La Paloma Generating Company, LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Loan (Second Lien) 3.8%, Due 8/13	2,000,000	2,010,326	1,650,000
LBREP/L-Suncal Master I LLC <sup>9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Junior Secured Loan — Term Loan (Third Lien) 15.0%, Due 2/12	2,332,868	2,332,868	933
LBREP/L-Suncal Master I LLC <sup>6,9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — Term Loan (First Lien) 5.5%, Due 1/10	3,875,156	3,875,156	116,255
LBREP/L-Suncal Master I LLC <sup>6,9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Junior Secured Loan — Term Loan (Second Lien) 9.5%, Due 1/11	2,000,000	1,920,211	7,600
Legacy Cabinets, Inc. <sup>6,9</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan 6.6%, Due 8/12	2,258,184	2,258,184	540,177
Levlad, LLC & Arbonne International, LLC <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan (Exit) 10.0%, Due 3/15	626,959	626,959	234,483
LN Acquisition Corp. (Lincoln Industrial) <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 6.0%, Due 1/15	2,000,000	2,000,000	2,000,000
MCCI Group Holdings, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 4.3%, Due 12/12	5,259,082	5,249,407	5,259,082
MCCI Group Holdings, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — Term Loan (Second Lien) 7.5%, Due 6/13	1,000,000	1,000,000	1,000,000

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
PAS Technologies Inc. <i>Aerospace and Defense</i>	Senior Secured Loan — Incremental Term Loan Add On 4.3%, Due 6/11	\$ 603,932	\$ 603,932	\$ 603,932
PAS Technologies Inc. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 4.3%, Due 6/11	2,986,111	2,979,960	2,986,111
Pegasus Solutions, Inc. <sup>12</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Subordinated Bond — Senior Subordinated Second Lien PIK Notes 13.0%, Due 4/14	1,200,000	1,200,000	1,200,000
Pegasus Solutions, Inc. <sup>6</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Secured Loan — Term Loan 7.8%, Due 4/13	4,823,583	4,823,583	4,823,583
Perseus Holding Corp. <sup>12</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Preferred Stock — Preferred Stock 14.0%, Due 4/14	400,000	400,000	381,600
Primus International Inc. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 2.9%, Due 6/12	1,083,854	1,084,936	1,083,854
QA Direct Holdings, LLC <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan 8.3%, Due 8/14	4,446,604	4,417,851	4,446,604
Resco Products, Inc. <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Junior Secured Loan — Term Loan (Second Lien) 20.0%, Due 6/14	6,771,178	6,633,090	6,771,178
Rhodes Companies, LLC, The <sup>6, 9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — First Lien Term Loan 11.8%, Due 11/10	1,685,674	1,636,741	452,624
Rhodes Companies, LLC, The <sup>6, 9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Junior Secured Loan — Second Lien Term Loan 13.0%, Due 11/11	2,013,977	2,018,695	12,720
San Juan Cable, LLC <sup>6</sup> <i>Broadcasting and Entertainment</i>	Junior Secured Loan — Loan (Second Lien) 5.8%, Due 10/13	3,000,000	2,987,094	2,943,000
Schneller LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 3.7%, Due 6/13	4,293,137	4,269,127	4,293,137
Seismic Micro-Technology, Inc. (SMT) <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan 2.6%, Due 6/12	838,694	837,659	838,694
Seismic Micro-Technology, Inc. (SMT) <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan 2.6%, Due 6/12	1,258,041	1,256,489	1,258,041

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Specialized Technology Resources, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Junior Secured Loan — Loan (Second Lien) 7.2%, Due 12/14	\$7,500,000	\$7,500,000	\$7,500,000
Specialized Technology Resources, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Senior Secured Loan — Term Loan (First Lien) 2.7%, Due 6/14	3,553,201	3,553,201	3,553,201
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Delayed Draw Term Loan 8.3%, Due 7/12	736,412	738,923	736,412
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Initial Term Loan 9.0%, Due 7/12	3,653,580	3,666,039	3,653,580
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Loan (Second Lien) 13.8%, Due 7/13	1,750,000	1,756,053	1,750,000
TPF Generation Holdings, LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Loan (Second Lien) 4.5%, Due 12/14	2,000,000	2,022,398	1,970,000
TUI University, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 3.2%, Due 10/14	3,590,407	3,472,139	3,590,407
Twin-Star International, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan 4.3%, Due 4/13	4,156,168	4,156,168	4,156,168
Walker Group Holdings LLC <i>Cargo Transport</i>	Junior Secured Loan — Term Loan B 12.5%, Due 12/12	470,643	470,643	470,643
Walker Group Holdings LLC <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Term Loan B 12.5%, Due 12/12	4,469,539	4,469,539	4,469,539
Water PIK, Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Loan (First Lien) 3.5%, Due 6/13	1,243,577	1,238,869	1,243,577
Wesco Aircraft Hardware Corp. <i>Aerospace and Defense</i>	Junior Secured Loan — Loan (Second Lien) 6.0%, Due 3/14	2,000,000	1,941,662	2,000,000
Wesco Aircraft Hardware Corp. <sup>6</sup> <i>Aerospace and Defense</i>	Junior Secured Loan — Loan (Second Lien) 6.0%, Due 3/14	4,132,887	4,154,352	4,132,887
WireCo WorldGroup Inc. <sup>12</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non- Electronic)</i>	Mezzanine Investment — 11.0%, Due 2/15	5,000,000	4,837,307	5,000,000

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
WireCo WorldGroup Inc. <sup>6, 12</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Mezzanine Investment — 11.0%, Due 2/15	\$ 10,000,000	\$ 10,000,000	\$ 10,000,000
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Acquisition Term Loan 2.5%, Due 6/12	765,180	759,767	763,650
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Synthetic Letter of Credit 2.5%, Due 6/12	668,412	663,683	667,075
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Synthetic Revolver Deposit 2.5%, Due 6/12	167,103	165,921	166,769
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Term Loan (Second Lien) 4.8%, Due 12/12	2,683,177	2,686,218	2,667,078
X-Rite, Incorporated <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Loan (Second Lien) 14.4%, Due 10/13	649,162	649,162	649,162
X-Rite, Incorporated <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan (First Lien) 8.0%, Due 10/12	557,254	555,816	557,253
<b>Total Investment in Debt Securities (128% of net asset value at fair value)</b>		<b>\$320,004,813</b>	<b>\$317,483,699</b>	<b>\$276,453,163</b>

## Equity Portfolio

<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Interest/Shares</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Aerostructures Holdings L.P. <sup>7</sup> <i>Aerospace and Defense</i>	Partnership Interests	1.2%	\$ 1,000,000	\$ 297,574
Aerostructures Holdings L.P. <sup>7</sup> <i>Aerospace and Defense</i>	Series A Preferred Interests	1.2%	250,960	303,116
Coastal Concrete Holding II, LLC <sup>7</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Class A Units	10.8%	8,625,626	568,570
eInstruction Acquisition, LLC <sup>7</sup> <i>Healthcare, Education and Childcare</i>	Membership Units	1.1%	1,079,617	1,510,000
FP WRCA Coinvestment Fund VII, Ltd. <sup>3, 7</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Class A Shares	15,000	1,500,000	2,135,000

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<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Interest/ Shares</u>	<u>Cost</u>	<u>Value</u>
Perseus Holding Corp. <sup>7</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Common	0.2%	400,000	400,000
Natural Products Group, Inc. <sup>7</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Series A-1 Common Stock	0.5%	687,140	687,140
<b>Total Investment in Equity Securities</b> <b>(3% of net asset value at fair value)</b>			<b>\$13,543,343</b>	<b>\$ 5,901,400</b>

### CLO Fund Securities

#### CLO Equity Investments

<u>Portfolio Company</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Grant Grove CLO, Ltd. <sup>3, 12, 13</sup>	Subordinated Securities, Due 1/21	22.2%	\$ 4,716,805	\$ 3,210,000
Katonah III, Ltd. <sup>3, 12</sup>	Preferred Shares, Due 5/15	23.1%	4,500,000	960,000
Katonah IV, Ltd. <sup>3, 12, 13</sup>	Preferred Shares, Due 2/15	17.1%	3,150,000	490,000
Katonah V, Ltd. <sup>3, 12, 13</sup>	Preferred Shares, Due 5/15	26.7%	3,320,000	1,000
Katonah VII CLO Ltd. <sup>3, 8, 12, 13</sup>	Subordinated Securities, Due 11/17	16.4%	4,500,000	2,190,000
Katonah VIII CLO Ltd. <sup>3, 8, 12, 13</sup>	Subordinated Securities, Due 5/18	10.3%	3,400,000	2,000,000
Katonah IX CLO Ltd. <sup>3, 8, 12, 13</sup>	Preferred Shares, Due 1/19	6.9%	2,000,000	1,700,000
Katonah X CLO Ltd. <sup>3, 8, 12</sup>	Subordinated Securities, Due 4/20	33.3%	11,595,274	8,480,000
Katonah 2007-I CLO Ltd. <sup>3, 8, 12</sup>	Preferred Shares, Due 4/22	100.0%	29,953,189	26,350,000
<b>Total Investment in CLO Equity Securities</b>			<b>\$67,135,268</b>	<b>\$45,381,000</b>

#### CLO Rated-Note Investment

<u>Portfolio Company</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Katonah 2007-I CLO Ltd. <sup>3, 8, 12</sup>	Class B-2L Notes Par Value of \$10,500,000 5.5%, Due 4/22	100.0%	\$ 1,080,394	\$ 6,300,000
<b>Total Investment in CLO Rated-Note</b>			<b>\$ 1,080,394</b>	<b>\$ 6,300,000</b>
<b>Total Investment in CLO Fund Securities</b> <b>(24% of net asset value at fair value)</b>			<b>\$68,215,662</b>	<b>\$51,681,000</b>

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**Asset Manager Affiliate**

<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Katonah Debt Advisors, L.L.C.	Membership Interests	100%	\$ 43,308,942	\$ 55,541,948
<b>Total Investment in Asset Manager Affiliate</b> (26% of net asset value at fair value)			<u>\$ 43,308,942</u>	<u>\$ 55,541,948</u>

**Time Deposits and Money Market Account**

<u>Time Deposits and Money Market Account</u>	<u>Investment</u>	<u>Yield</u>	<u>Par / Cost</u>	<u>Value<sup>2</sup></u>
US Bank Eurodollar Sweep CL <sup>2, 3, 10</sup>	Time Deposit	0.10%	\$ 20,054,652	\$ 20,054,652
JP Morgan Asset Account	Time Deposit	0.07%	559	559
JP Morgan Business Money Market Account <sup>11</sup>	Money Market Account	0.15%	<u>216,099</u>	<u>216,099</u>
<b>Total Investment in Time Deposit and Money Market Accounts</b> (9% of net asset value at fair value)			<u>\$ 20,271,310</u>	<u>\$ 20,271,310</u>
<b>Total Investments<sup>5</sup></b> (190% of net asset value at fair value)			<u>\$462,822,956</u>	<u>\$409,848,821</u>

See accompanying notes to financial statements.

- <sup>1</sup> A majority of the variable rate loans to the Company's portfolio companies bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at March 31, 2010.
- <sup>2</sup> Reflects the fair market value of all existing investments as of March 31, 2010, as determined by the Company's Board of Directors.
- <sup>3</sup> Non-U.S. company or principal place of business outside the U.S.
- <sup>4</sup> Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators. As of March 31, 2010, the Company had no exposure to mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset backed securities), companies providing mortgage lending or emerging markets investments either directly or through the Company's investments in collateralized loan obligation funds ("CLO Funds").
- <sup>5</sup> The aggregate cost of investments for federal income tax purposes is approximately \$463 million. The aggregate gross unrealized appreciation is approximately \$20 million and the aggregate gross unrealized depreciation is approximately \$73 million.
- <sup>6</sup> Pledged as collateral for the secured revolving credit facility (see Note 6 to the financial statements).
- <sup>7</sup> Non-income producing.
- <sup>8</sup> An affiliate CLO Fund managed by Katonah Debt Advisors, L.L.C. or its affiliate.

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- 9 Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- 10 Time deposit investment partially restricted under terms of the secured credit facility (see Note 6 to financial statements).
- 11 Money market account holding restricted cash for employee flexible spending accounts.
- 12 These securities were acquired in a transaction that was exempt from the registration requirements of the Securities Act of 1933, as amended (the “Securities Act”), pursuant to Rule 144A thereunder. These securities may be resold only in transactions that are exempt from the registration requirements of the Securities Act, normally to qualified institutional buyers.
- 13 As of March 31, 2010, these CLO Fund securities were not providing a dividend distribution.

**KOHLBERG CAPITAL CORPORATION**  
**SCHEDULE OF INVESTMENTS**  
**As of December 31, 2009**

**Debt Securities Portfolio**

<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Advanced Lighting Technologies, Inc. <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Revolving Loan 5.0%, Due 6/13	\$ 640,000	\$ 634,264	\$ 637,440
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Deferred Draw Term Loan (First Lien) 3.0%, Due 6/13	323,595	323,595	322,301
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Junior Secured Loan — Second Lien Term Loan Note 6.2%, Due 6/14	5,000,000	5,000,000	5,000,000
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan (First Lien) 3.0%, Due 6/13	1,580,565	1,580,565	1,574,242
Aero Products International, Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 9.5%, Due 4/12	3,118,560	3,118,560	1,721,445
Aerostructures Acquisition LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Delayed Draw Term Loan 6.8%, Due 3/13	412,667	412,667	412,667
Aerostructures Acquisition LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 6.8%, Due 3/13	5,219,471	5,219,471	5,219,471
AGA Medical Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Tranche B Term Loan 2.3%, Due 4/13	1,832,209	1,831,354	1,799,230
AGS LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Delayed Draw Term Loan 3.2%, Due 5/13	425,866	421,983	389,241
AGS LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Initial Term Loan 3.2%, Due 5/13	3,043,896	3,016,145	2,782,121
AmerCable Incorporated <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Senior Secured Loan — Initial Term Loan 3.8%, Due 6/14	5,840,213	5,840,213	5,606,605
Astoria Generating Company Acquisitions, L.L.C. <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Term C 4.0%, Due 8/13	4,000,000	4,031,898	3,800,000

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Atlantic Marine Holding Company <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Term Loan 4.6%, Due 3/14	\$ 1,681,287	\$ 1,688,586	\$1,681,287
Aurora Diagnostics, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Tranche A Term Loan (First Lien) 4.5%, Due 12/12	4,017,152	3,993,498	4,017,152
Awesome Acquisition Company (CiCi's Pizza) <sup>6</sup> <i>Personal, Food and Miscellaneous Services</i>	Junior Secured Loan — Term Loan (Second Lien) 5.3%, Due 6/14	4,000,000	3,981,723	3,924,000
AZ Chem US Inc. <sup>6</sup> <i>Chemicals, Plastics and Rubber</i>	Junior Secured Loan — Second Lien Term Loan 5.7%, Due 2/14	4,000,000	3,970,688	4,000,000
Bankruptcy Management Solutions, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Junior Secured Loan — Loan (Second Lien) 6.5%, Due 7/13	2,418,750	2,441,936	1,777,781
Bankruptcy Management Solutions, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Senior Secured Loan — Term Loan (First Lien) 4.2%, Due 7/12	1,870,497	1,876,933	1,509,491
Bicent Power LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Advance (Second Lien) 4.3%, Due 12/14	4,000,000	4,000,000	3,528,000
BP Metals, LLC (fka Constellation Enterprises) <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Term Loan 10.0%, Due 6/13	4,383,929	4,383,929	4,383,929
Broadlane, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan 8.5%, Due 8/13	2,741,832	2,711,990	2,741,832
Caribe Information Investments Incorporated <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan 2.5%, Due 3/13	1,676,743	1,672,195	1,653,269
Cast & Crew Payroll, LLC (Payroll Acquisition) <sup>6</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Secured Loan — Initial Term Loan 3.2%, Due 9/12	7,693,290	7,709,678	7,654,824
CEI Holdings, Inc. (Cosmetic Essence) <sup>6, 9</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 8.1%, Due 3/13	1,454,368	1,407,135	780,116
Charlie Acquisition Corp. <sup>9</sup> <i>Personal, Food and Miscellaneous Services</i>	Mezzanine Investment — Senior Subordinated Notes 15.5%, Due 6/13	10,893,401	10,777,799	635,444
CoActive Technologies, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Senior Secured Loan — Term Loan (First Lien) 3.3%, Due 7/14	3,916,722	3,903,782	2,882,707

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
CoActive Technologies, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Term Loan (Second Lien) 7.0%, Due 1/15	\$ 2,000,000	\$ 1,972,218	\$ 1,062,000
Dealer Computer Services, Inc. (Reynolds & Reynolds) <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Term Loan (Second Lien) 5.8%, Due 10/13	1,000,000	1,006,261	1,000,000
Dealer Computer Services, Inc. (Reynolds & Reynolds) <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Term Loan (Third Lien) 7.8%, Due 4/14	7,700,000	7,538,614	7,700,000
Delta Educational Systems, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan 6.0%, Due 6/12	2,301,996	2,301,996	2,281,278
Dex Media West LLC <i>Printing and Publishing</i>	Senior Secured Loan — Tranche B Term Loan 7.0%, Due 10/14	4,696,402	4,312,579	4,348,868
Dresser, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Term Loan (Second Lien) 6.0%, Due 5/15	3,000,000	2,970,206	2,991,000
DRI Holdings, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — US Term Loan (Second Lien) 6.5%, Due 7/15	6,000,000	5,502,222	5,700,000
Edgestone CD Acquisition Corp. (Custom Direct) <sup>6</sup> <i>Printing and Publishing</i>	Junior Secured Loan — Loan (Second Lien) 6.3%, Due 12/14	5,000,000	5,000,000	5,000,000
Edgestone CD Acquisition Corp. (Custom Direct) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan (First Lien) 3.1%, Due 12/13	3,982,724	3,985,832	3,982,724
eInstruction Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Initial Term Loan 4.3%, Due 7/13	4,017,321	4,017,321	3,969,113
eInstruction Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — Term Loan (Second Lien) 7.8%, Due 7/14	10,000,000	10,000,000	10,000,000
Endeavor Energy Resources, L.P. <sup>6</sup> <i>Oil and Gas</i>	Junior Secured Loan — Initial Loan (Second Lien) 5.3%, Due 4/12	4,000,000	4,000,000	4,000,000
Fasteners For Retail, Inc. <sup>6</sup> <i>Diversified/Conglomerate Manufacturing</i>	Senior Secured Loan — Term Loan 4.8%, Due 12/12	4,042,346	4,046,728	4,042,346
FD Alpha Acquisition LLC (Fort Dearborn) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — US Term Loan 3.2%, Due 11/12	1,538,635	1,462,409	1,538,635

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<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Cost</b>	<b>Value<sup>2</sup></b>
First American Payment Systems, L.P. <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Term Loan 3.3%, Due 10/13	\$3,198,000	\$3,198,000	\$3,198,000
First Data Corporation <i>Finance</i>	Senior Secured Loan — Initial Tranche B-2 Term Loan 3.0%, Due 9/14	2,440,944	2,262,445	2,174,881
Ford Motor Company <sup>6</sup> <i>Automobile</i>	Senior Secured Loan — Tranche B-1 Term Loan 3.3%, Due 12/13	1,942,429	1,940,876	1,800,631
Freescale Semiconductor, Inc. <i>Electronics</i>	Senior Subordinated Bond — 10.1%, Due 12/16	3,000,000	3,007,167	2,415,000
Frontier Drilling USA, Inc. <sup>6</sup> <i>Oil and Gas</i>	Senior Secured Loan — Term B Advance 9.3%, Due 6/13	2,000,000	1,998,652	2,000,000
Ginn LA Conduit Lender, Inc. <sup>9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — First Lien Tranche A Credit- Linked Deposit 7.8%, Due 6/11	1,257,143	1,224,101	89,634
Ginn LA Conduit Lender, Inc. <sup>9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — First Lien Tranche B Term Loan 7.8%, Due 6/11	2,694,857	2,624,028	195,377
Ginn LA Conduit Lender, Inc. <sup>9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Junior Secured Loan — Loan (Second Lien) 11.8%, Due 6/12	3,000,000	2,715,997	60,000
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Tranche B Term Loan 2.7%, Due 6/14	2,925,000	2,925,000	2,442,375
HMSC Corporation (aka Swett and Crawford) <sup>6</sup> <i>Insurance</i>	Junior Secured Loan — Loan (Second Lien) 5.8%, Due 10/14	5,000,000	4,861,123	4,490,000
Huish Detergents Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Junior Secured Loan — Loan (Second Lien) 4.5%, Due 10/14	1,000,000	1,000,000	1,000,000
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Initial Term Loan (First Lien) 2.7%, Due 4/14	3,723,929	3,605,519	3,239,818
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Junior Secured Loan — Loan (Second Lien) 7.0%, Due 10/14	3,000,000	3,000,000	2,550,000
Infiltrator Systems, Inc. <sup>6</sup> <i>Ecological</i>	Senior Secured Loan — Term Loan 8.5%, Due 9/12	2,699,907	2,695,103	2,699,907

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Inmar, Inc. <sup>6</sup> <i>Retail Stores</i>	Senior Secured Loan — Term Loan 2.5%, Due 4/13	\$3,543,046	\$3,543,046	\$3,521,787
International Aluminum Corporation (IAL Acquisition Co.) <sup>6,9</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Term Loan 5.0%, Due 3/13	2,973,711	2,973,711	1,987,926
Intrapac Corporation/Corona Holdco <sup>6</sup> <i>Containers, Packaging and Glass</i>	Senior Secured Loan — First Lien Term Loan 3.8%, Due 5/12	4,034,281	4,042,948	3,852,738
Intrapac Corporation/Corona Holdco <sup>6</sup> <i>Containers, Packaging and Glass</i>	Junior Secured Loan — Term Loans (Second Lien) 7.8%, Due 5/13	3,000,000	3,013,753	3,000,000
Jones Stephens Corp. <sup>6</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — Term Loan 7.8%, Due 9/12	9,541,180	9,526,158	8,491,650
KIK Custom Products Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Junior Secured Loan — Loan (Second Lien) 5.3%, Due 12/14	5,000,000	5,000,000	3,060,000
La Paloma Generating Company, LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Loan (Second Lien) 3.8%, Due 8/13	2,000,000	2,011,080	1,622,000
LBREP/L-Suncal Master I LLC <sup>9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Junior Secured Loan — Term Loan (Third Lien) 15.0%, Due 2/12	2,332,868	2,332,868	1,000
LBREP/L-Suncal Master I LLC <sup>6,9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — Term Loan (First Lien) 5.5%, Due 1/10	3,875,156	3,873,404	116,255
LBREP/L-Suncal Master I LLC <sup>6,9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Junior Secured Loan — Term Loan (Second Lien) 9.5%, Due 1/11	2,000,000	1,920,211	7,500
Legacy Cabinets, Inc. <sup>6,9</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan 6.6%, Due 8/12	2,258,184	2,258,184	537,416
Levlad, LLC & Arbonne International, LLC <sup>6,9</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 7.8%, Due 3/14	2,660,729	2,660,729	1,341,007
LN Acquisition Corp. (Lincoln Industrial) <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 6.0%, Due 1/15	2,000,000	2,000,000	1,978,000
MCCI Group Holdings, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 4.3%, Due 12/12	5,754,849	5,743,304	5,622,487

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
MCCI Group Holdings, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — Term Loan (Second Lien) 7.5%, Due 6/13	\$1,000,000	\$1,000,000	\$1,000,000
National Interest Security Company, L.L.C. <i>Aerospace and Defense</i>	Mezzanine Investment — Mezzanine Facility 15.0%, Due 6/13	3,000,000	3,000,000	3,300,000
National Interest Security Company, L.L.C. <i>Aerospace and Defense</i>	Junior Secured Loan — Second Lien Term Loan 15.0%, Due 6/13	1,000,000	1,000,000	1,100,000
National Interest Security Company, L.L.C. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan - First Lien 7.8%, Due 12/12	7,650,000	7,650,000	7,650,000
Northeast Biofuels, LP <sup>6,9</sup> <i>Farming and Agriculture</i>	Senior Secured Loan — Construction Term Loan 8.8%, Due 6/13	1,382,120	1,383,944	208,369
Northeast Biofuels, LP <sup>6,9</sup> <i>Farming and Agriculture</i>	Senior Secured Loan — Synthetic LC Term Loan 8.8%, Due 6/13	57,257	57,333	8,632
PAS Technologies Inc. <i>Aerospace and Defense</i>	Senior Secured Loan — Incremental Term Loan Add On 4.3%, Due 6/11	632,022	632,022	632,022
PAS Technologies Inc. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 4.3%, Due 6/11	3,125,000	3,117,290	3,125,000
Pegasus Solutions, Inc. <sup>9,10</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Unsecured Bond — 10.5%, Due 4/15	2,000,000	2,000,000	1,710,000
Pegasus Solutions, Inc. <sup>6</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Secured Loan — Term Loan 7.8%, Due 4/13	4,863,083	4,863,083	4,863,083
Primus International Inc. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 2.7%, Due 6/12	1,087,032	1,088,240	1,060,944
QA Direct Holdings, LLC <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan 8.3%, Due 8/14	4,540,186	4,509,168	4,540,186
Resco Products, Inc. <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Junior Secured Loan — Term Loan (Second Lien) 12.0%, Due 6/14	6,650,000	6,503,858	6,650,000
Rhodes Companies, LLC, The <sup>6,9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Senior Secured Loan — First Lien Term Loan 11.8%, Due 11/10	1,685,674	1,636,741	298,241

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<u>Portfolio Company / Principal Business</u>	<u>Investment Interest Rate<sup>1</sup> / Maturity</u>	<u>Principal</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Rhodes Companies, LLC, The <sup>6, 9</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Junior Secured Loan — Second Lien Term Loan 13.0%, Due 11/11	\$2,013,977	\$2,019,403	\$ 12,720
San Juan Cable, LLC <sup>6</sup> <i>Broadcasting and Entertainment</i>	Junior Secured Loan — Loan (Second Lien) 5.8%, Due 10/13	3,000,000	2,986,206	2,862,000
Schneller LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 3.7%, Due 6/13	4,304,174	4,278,271	4,231,003
Seismic Micro-Technology, Inc. (SMT) <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan 3.2%, Due 6/12	838,694	837,545	829,469
Seismic Micro-Technology, Inc. (SMT) <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan 3.2%, Due 6/12	1,258,041	1,256,317	1,244,203
Specialized Technology Resources, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Junior Secured Loan — Loan (Second Lien) 7.2%, Due 12/14	7,500,000	7,500,000	7,500,000
Specialized Technology Resources, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Senior Secured Loan — Term Loan (First Lien) 2.7%, Due 6/14	3,563,166	3,563,166	3,563,166
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Delayed Draw Term Loan 8.3%, Due 7/12	738,349	741,143	738,349
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Initial Term Loan 9.0%, Due 7/12	3,663,267	3,677,125	3,663,267
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Loan (Second Lien) 13.8%, Due 7/13	1,750,000	1,756,512	1,750,000
TPF Generation Holdings, LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Loan (Second Lien) 4.5%, Due 12/14	2,000,000	2,023,571	1,894,000
TUI University, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 3.2%, Due 10/14	3,590,407	3,465,781	3,590,407
Twin-Star International, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan 4.3%, Due 4/13	4,291,879	4,291,879	4,218,917
Walker Group Holdings LLC <i>Cargo Transport</i>	Junior Secured Loan — Term Loan B 12.5%, Due 12/12	526,500	526,500	526,500

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Portfolio Company / Principal Business	Investment Interest Rate <sup>1</sup> / Maturity	Principal	Cost	Value <sup>2</sup>
Walker Group Holdings LLC <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Term Loan B 12.8%, Due 12/12	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000
Water PIK, Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Loan (First Lien) 3.5%, Due 6/13	1,243,577	1,238,507	1,243,577
Wesco Aircraft Hardware Corp. <i>Aerospace and Defense</i>	Junior Secured Loan — Loan (Second Lien) 6.0%, Due 3/14	2,000,000	1,938,058	2,000,000
Wesco Aircraft Hardware Corp. <sup>6</sup> <i>Aerospace and Defense</i>	Junior Secured Loan — Loan (Second Lien) 6.0%, Due 3/14	4,132,887	4,155,678	4,132,887
WireCo WorldGroup Inc. <sup>10</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Mezzanine Investment — 11.0%, Due 2/15	5,000,000	4,829,054	5,100,000
WireCo WorldGroup Inc. <sup>6, 10</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Mezzanine Investment — 11.0%, Due 2/15	10,000,000	10,000,000	10,200,000
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Acquisition Term Loan 2.5%, Due 6/12	767,269	761,240	743,484
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Synthetic Letter of Credit 0.1%, Due 6/12	668,412	663,160	647,691
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Synthetic Revolver Deposit 1.2%, Due 6/12	167,103	165,790	161,923
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Term Loan (Second Lien) 4.8%, Due 12/12	2,683,177	2,686,492	2,591,949
X-Rite, Incorporated <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Loan (Second Lien) 14.4%, Due 10/13	649,162	649,162	649,162
X-Rite, Incorporated <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan (First Lien) 7.5%, Due 10/12	581,053	579,407	569,432
<b>Total Investment in Debt Securities (138% of net asset value at fair value)</b>		<b>\$ 344,924,114</b>	<b>\$ 342,056,023</b>	<b>\$ 297,356,529</b>

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**Equity Portfolio**

<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Interest/Shares</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Aerostructures Holdings L.P. <sup>7</sup> <i>Aerospace and Defense</i>	Partnership Interests	1.2%	\$ 1,000,000	\$ 350,280
Aerostructures Holdings L.P. <sup>7</sup> <i>Aerospace and Defense</i>	Series A Preferred Interests	1.2%	160,361	202,396
Coastal Concrete Holding II, LLC <sup>7</sup> <i>Buildings and Real Estate<sup>4</sup></i>	Class A Units	10.8%	8,625,625	568,570
eInstruction Acquisition, LLC <sup>7</sup> <i>Healthcare, Education and Childcare</i>	Membership Units	1.1%	1,079,617	1,456,000
FP WRCA Coinvestment Fund VII, Ltd. <sup>3,7</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Class A Shares	15,000	<u>1,500,000</u>	<u>2,136,000</u>
<b>Total Investment in Equity Securities</b> <b>(2% of net asset value at fair value)</b>			<u>\$12,365,603</u>	<u>\$4,713,246</u>

**CLO Fund Securities**

**CLO Equity Investments**

<u>Portfolio Company</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Grant Grove CLO, Ltd. <sup>3, 10, 11</sup>	Subordinated Securities, Due 1/21	22.2%	\$ 4,715,858	\$ 2,780,000
Katonah III, Ltd. <sup>3, 10</sup>	Preferred Shares, Due 5/15	23.1%	4,500,000	950,000
Katonah IV, Ltd. <sup>3, 10, 11</sup>	Preferred Shares, Due 2/15	17.1%	3,150,000	290,000
Katonah V, Ltd. <sup>3, 10, 11</sup>	Preferred Shares, Due 5/15	26.7%	3,320,000	1,000
Katonah VII CLO Ltd. <sup>3, 8, 10, 11</sup>	Subordinated Securities, Due 11/17	16.4%	4,500,000	1,840,000
Katonah VIII CLO Ltd. <sup>3, 8, 10, 11</sup>	Subordinated Securities, Due 5/18	10.3%	3,400,000	1,760,000
Katonah IX CLO Ltd. <sup>3, 8, 10, 11</sup>	Preferred Shares, Due 1/19	6.9%	2,000,000	1,560,000
Katonah X CLO Ltd. <sup>3, 8, 10</sup>	Subordinated Securities, Due 4/20	33.3%	11,589,830	8,280,000
Katonah 2007-I CLO Ltd. <sup>3, 8, 10</sup>	Preferred Shares, Due 4/22	100.0%	<u>29,940,867</u>	<u>27,100,000</u>
<b>Total Investment in CLO Equity Securities</b>			<u>\$67,116,555</u>	<u>\$44,561,000</u>

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**CLO Rated-Note Investment**

<u>Portfolio Company</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Katonah 2007-I CLO Ltd. <sup>3, 8, 10</sup>	Class B-2L Notes Par Value of \$10,500,000 5.3%, Due 4/22	100.0%	\$ 1,078,494	\$ 4,410,000
<b>Total Investment in CLO Rated-Note</b>			<u>\$ 1,078,494</u>	<u>\$ 4,410,000</u>
<b>Total Investment in CLO Fund Securities</b> (23% of net asset value at fair value)			<u>\$68,195,049</u>	<u>\$48,971,000</u>

**Asset Manager Affiliate**

<u>Portfolio Company / Principal Business</u>	<u>Investment</u>	<u>Percentage Interest</u>	<u>Cost</u>	<u>Value<sup>2</sup></u>
Katonah Debt Advisors, L.L.C.	Membership Interests	100%	\$40,751,511	\$58,064,720
<b>Total Investment in Asset Manager Affiliate</b> (27% of net asset value at fair value)			<u>\$40,751,511</u>	<u>\$58,064,720</u>

<u>Time Deposits and Money Market Account</u>	<u>Investment</u>	<u>Yield</u>	<u>Par / Cost</u>	<u>Value<sup>2</sup></u>
<b>Time Deposits and Money Market Account</b>				
JP Morgan Asset Account	Time Deposit	0.07%	\$ 126	\$ 126
<b>Total Investment in Time Deposit and Money Market Accounts</b> (0% of net asset value at fair value)			<u>\$ 126</u>	<u>\$ 126</u>

<b>Total Investments<sup>5</sup></b> (189% of net asset value at fair value)			<u>\$463,368,312</u>	<u>\$409,105,621</u>
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<sup>1</sup> A majority of the variable rate loans to the Company's portfolio companies bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at December 31, 2009.

<sup>2</sup> Reflects the fair market value of all existing investments as of December 31, 2009, as determined by the Company's Board of Directors.

<sup>3</sup> Non-U.S. company or principal place of business outside the U.S.

See accompanying notes to financial statements.

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- 4 Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators. As of December 31, 2009, the Company had no exposure to mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities), companies providing mortgage lending or emerging markets investments either directly or through the Company's investments in CLO Funds.
- 5 The aggregate cost of investments for federal income tax purposes is approximately \$547 million. The aggregate gross unrealized appreciation is approximately \$79 million and the aggregate gross unrealized depreciation is approximately \$363 million.
- 6 Pledged as collateral for the secured revolving credit facility (see Note 6 to the financial statements).
- 7 Non-income producing.
- 8 An affiliate CLO Fund managed by Katonah Debt Advisors, L.L.C. or its affiliate.
- 9 Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- 10 These securities were acquired in a transaction that was exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Rule 144A thereunder. These securities may be resold in transactions that are exempt from the registration requirements of the Securities Act of 1933, as amended, normally to qualified institutional buyers.
- 11 As of December 31, 2009, these CLO Fund securities were not providing a dividend distribution.

**KOHLBERG CAPITAL CORPORATION**  
**FINANCIAL HIGHLIGHTS**  
**(unaudited)**  
**(\$ per share)**

	Three Months Ended March 31,	
	2010	2009 (as restated)
<b>Per Share Data:</b>		
Net asset value, at beginning of period	\$ 9.56	\$ 9.03
Net income (loss)		
Net investment income <sup>1</sup>	0.11	0.30
Net realized losses <sup>1</sup>	(0.10)	(0.09)
Net change in unrealized appreciation/depreciation on investments <sup>1</sup>	0.02	0.14
Net income	0.03	0.35
Net increase in net assets relating to stock-based transactions		
Issuance of common stock under dividend reinvestment plan	0.02	0.02
Stock based compensation expense	0.01	0.01
Net increase in net assets relating to stock-based transactions	0.03	0.03
Net asset value, end of period	\$ 9.62	\$ 9.41
Total net asset value return <sup>2</sup>	6.5 %	4.2 %
<b>Ratio/Supplemental Data:</b>		
Per share market value at beginning of period	\$ 3.64	\$ 3.64
Per share market value at end of period	\$ 5.66	\$ 3.06
Total market return <sup>3</sup>	55.5 %	(15.9)%
Shares outstanding at end of period	22,475,339	21,910,452
Net assets at end of period	\$216,210,807	\$206,120,270
Portfolio turnover rate <sup>4</sup>	0.9 %	0.6 %
Average debt outstanding	\$203,292,118	\$254,278,940
Asset coverage ratio	209 %	184 %
Ratio of net investment income to average net assets <sup>5</sup>	4.8 %	12.8 %
Ratio of total expenses to average net assets <sup>5</sup>	8.2 %	6.0 %
Ratio of interest expense to average net assets <sup>5</sup>	5.0 %	3.0 %
Ratio of non-interest expenses to average net assets <sup>5</sup>	3.1 %	3.0 %

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

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

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

<sup>4</sup> Not annualized

<sup>5</sup> Annualized

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**(unaudited)**

**1. ORGANIZATION**

Kohlberg Capital Corporation (“Kohlberg Capital” 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 (“1940 Act”). The Company originates, structures and invests in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies. The Company defines the middle market as comprising companies with earnings before interest, taxes, depreciation and amortization (“EBITDA”), of \$10 million to \$50 million and/or total debt of \$25 million to \$150 million. The Company was formed as a Delaware LLC 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., LLC (“Kohlberg & Co.”), a leading middle market private equity firm, in exchange for the contribution of their ownership interests in Katonah Debt Advisors, L.L.C. (“Katonah Debt Advisors”) and in securities issued by collateralized loan obligation funds (“CLO Funds”) managed by Katonah Debt Advisors and two other asset managers to the Company. As of March 31, 2010, Katonah Debt Advisors had approximately \$2.1 billion of assets under management.

The Company’s investment objective is to generate current income and capital appreciation from investments made in senior secured term loans, mezzanine debt and selected equity investments in privately-held middle market companies. The Company also expects to receive distributions of recurring fee income and to generate capital appreciation from its investment in the asset management business of Katonah Debt Advisors. Katonah Debt Advisors manages CLO Funds which invest in broadly syndicated loans, high-yield bonds and other credit instruments. The Company’s investment portfolio as well as the investment portfolios of the CLO Funds in which it has invested and the investment portfolios of the CLO Funds managed by Katonah Debt Advisors consist exclusively of credit instruments and other securities issued by corporations and do not include any asset-backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings.

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 requirements. Pursuant to this election, the Company generally does not have to pay corporate-level taxes on any income that it distributes to its stockholders.

**2. SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation***

The financial statements include the accounts of the Company and the accounts of its special purpose financing subsidiary, Kohlberg Capital Funding LLC I (“KCAP Funding” or the “Borrower”). In accordance with Article 6 of Regulation S-X under the Securities Act of 1933 and Securities Exchange Act of 1934, the Company does not consolidate portfolio company investments, including those in which it has a controlling interest (Katonah Debt Advisors currently is the only company in which the Company has a controlling interest).

The accompanying unaudited condensed financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information. Accordingly, they do not include all of the information and footnotes required for annual financial statements. The unaudited interim 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, 2009, as filed with the Securities and Exchange Commission (the “Commission” or the “SEC”).

The financial statements reflect all adjustments, both normal and recurring as well as restatement adjustments and reclassifications 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 financial statements requires management to

**KOHLBERG CAPITAL CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS—(Continued)**  
**(unaudited)**

make significant estimates and assumptions including the fair value of investments that do not have a readily available market value. Actual results could differ from those estimates, and the differences could be material. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for the full year.

*Accounting Standards Codification.* In June 2009, the Financial Accounting Standards Board (“FASB”) issued a pronouncement establishing the FASB Accounting Standards Codification (“ASC”) as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with GAAP. The ASC reorganized existing U.S. accounting and reporting standards issued by the FASB and other related private sector standard setters into a single source of authoritative accounting principles arranged by topic. The standard explicitly recognizes rules and interpretive releases of the Commission under federal securities laws as authoritative GAAP for SEC registrants. The ASC supersedes all existing U.S. accounting standards; all other accounting literature not included in the ASC (other than SEC guidance for publicly-traded companies) is considered non-authoritative. The ASC was effective on a prospective basis for interim and annual reporting periods ending after September 15, 2009. The adoption of the ASC changed the Company’s references to U.S. GAAP accounting standards but did not impact its results of operations, financial position or liquidity.

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

In January 2010, the FASB issued guidance that clarifies and requires new disclosures about fair value measurements. The clarifications and requirement to disclose the amounts and reasons for significant transfers between Level I and Level II, as well as significant transfers in and out of Level III of the fair value hierarchy, were adopted by the Company in the first quarter of 2010. Note 4 reflects the amended disclosure requirements. The new guidance also requires that purchases, sales, issuances and settlements be presented gross in the Level III reconciliation and that requirement is effective for fiscal years beginning after December 15, 2010 and for interim periods within those years. The Company is evaluating the increased disclosure requirements for implementation by the effective date. Since this new guidance only amends the disclosures requirements, it did not impact our statements of financial position, statements of operations, or cash flow statements.

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

The Company engaged Valuation Research Corporation (“VRC”), an independent valuation firm, to provide third-party valuation estimates for approximately 39% and 40% of its portfolio at fair value as of December 31, 2009 and December 31, 2008, respectively. VRC’s valuation estimates were considered as one of the relevant data inputs in the Company’s determination of fair value. The Board of Directors intends to continue to engage an independent valuation firm in the future to provide certain valuation services, including the review of certain portfolio assets, as part of the Company’s annual year end valuation process.

The Board of Directors may consider other methods of valuation than those set forth above to determine the fair value of 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 ready market existed for such investments. Further, such investments may be generally subject to legal

**KOHLBERG CAPITAL CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS—(Continued)**  
**(unaudited)**

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 Company's valuation methodology and procedures are as follows:

- 1) Each portfolio company or investment is cross-referenced to an independent pricing service to determine if a current market quote is available. The nature and quality of such quote is reviewed to determine reliability and relevance of the quote. Factors considered in this determination include if the quote is from a transaction or is a broker quote, the date and aging of such quote, if the transaction is arms-length, whether it is of a liquidation or distressed nature and certain other factors judged to be relevant by management within the framework of *Fair Value Measurements and Disclosures*.
- 2) If an investment does not have a market quotation on either a broad market exchange or from an independent pricing service, the investment is initially valued by the Company's investment professionals responsible for the portfolio investment in conjunction with the portfolio management team.
- 3) Preliminary valuation conclusions are discussed and documented by management.
- 4) Katonah Debt Advisors and other illiquid junior and mezzanine securities may be selected for review by an independent valuation firm, which is engaged by the Company's Board of Directors. Such independent valuation firm reviews management's preliminary valuations and makes their own independent valuation assessment.
- 5) The Valuation Committee of the Board of Directors reviews the portfolio valuations, as well as the input and report of such independent valuation firm, as applicable.
- 6) Upon approval of the investment valuations by the Valuation Committee of the Board of Directors, the Audit Committee of the Board of Directors reviews the results for inclusion in the Company's quarterly and annual financial statements, as applicable.
- 7) The Board of Directors discusses the valuations and determines in good faith that the fair values of each investment in the portfolio is reasonable based upon any applicable independent pricing service, input of management, estimates from independent valuation firms (if any) and the recommendations of the Valuation Committee of the Board of Directors.

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, including 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

*Loans and Debt Securities.* To the extent that the Company's investments are exchange traded and are priced or have sufficient price indications from normal course trading at or around the valuation date (financial reporting date), such pricing will determine fair value. Pricing service marks from third party pricing services may be used as an indication of fair value, depending on the volume and reliability of the marks, sufficient and reasonable correlation of bid and ask quotes, and, most importantly, the level of actual trading activity. However, most of the Company's investments are illiquid investments with little or no trading activity. Further, 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. As a result, for most of its assets, the Company determines fair value using alternative methodologies using 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 underlying assets with discount rates imputed by broad market indices, bond spreads and yields for comparable issuers relative to the subject assets (the "Market Yield Approach") and also considers 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 investments. Because the Company has not identified any market index that directly correlates to the loan and debt investments held by the Company and therefore uses the two benchmark indices, these market indices

**KOHLBERG CAPITAL CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS—(Continued)**  
**(unaudited)**

may require significant adjustment to better correlate such market data for the calculation of fair value of the investment under the Market Yield Approach. Such adjustments require judgment and may be material to the calculation of fair value. Further adjustments to the discount rate may be applied to reflect other market conditions or the perceived credit risk of the borrower. When broad market indices are used as part of the valuation methodology, their use is subject to adjustment for many factors, including priority, collateral used as security, structure, performance and other quantitative and qualitative attributes of the asset being valued. The resulting present value determination is then weighted along with any quotes from observable transactions and broker/pricing quotes. If such quotes are indicative of actual transactions with reasonable trading volume at or near the valuation date that are not liquidation or distressed sales, relatively more reliance will be put on such quotes to determine fair value. If such quotes are not indicative of market transactions or are insufficient as to volume, reliability, consistency or other relevant factors, such quotes will be compared with other fair value indications and given relatively less weight based on their relevancy. Other significant assumptions, such as coupon and maturity, are asset-specific and are noted for each investment in the Schedules of Investments.

*Equity and Equity-Related Securities.* The Company's equity and equity-related 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 and 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. The values of the Company's equity and equity-related securities in public companies for which market quotations are readily available are based upon the closing public market prices on the balance sheet date. Securities that carry certain restrictions on sale are typically valued at a discount from the public market value of the security.

The significant inputs used to determine the fair value of equity and equity-related securities include prices, earnings, EBITDA and cash flows after capital expenditures for similar peer comparables and the investment entity itself. Equity and equity related securities are classified as Level III, as described in Note 4, "Investments" below, when there is limited activity or less transparency around inputs to the valuation given the lack of information related to such equity investments held in nonpublic companies. Significant assumptions observed for comparable companies are applied to relevant financial data for the specific investment. Such assumptions, such as model discount rates or price/earnings multiples, vary by the specific investment, equity position and industry and incorporate adjustments for risk premiums, liquidity and company specific attributes. Such adjustments require judgment and may be material to the calculation of fair value.

*Affiliate Asset Manager.* The Company's investment in its wholly-owned asset management company, Katonah Debt Advisors, is carried at fair value, which is determined after taking into consideration a percentage of assets under management and a discounted cash flow model incorporating different levels of discount rates depending on the hierarchy of fees earned (including the likelihood of realization of senior, subordinate and incentive fees) and prospective modeled performance. Such valuation includes an analysis of comparable asset management companies. Katonah Debt Advisors is classified as a Level III investment (as described below). Any change in value from period to period is recognized as net change in unrealized appreciation or depreciation.

*CLO Fund Securities.* The Company typically makes a minority investment in the most junior class of securities of CLO Funds raised and managed by Katonah Debt Advisors and may selectively invest in securities issued by funds managed by other asset management companies (collectively "CLO Fund securities"). The Company's CLO Fund securities relate exclusively to credit instruments issued by corporations and do not include any asset-backed securities secured by commercial mortgages, residential mortgages, or consumer borrowings.

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 paydown 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, or (ii) the net asset value ("NAV") of the CLO Fund for 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 are negligible net cash distributions to the class of securities owned by the Company, or (iii) a discounted cash flow model for more recent CLO Funds 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. 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 NAVs 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 an individual security-by-security basis.

**KOHLBERG CAPITAL CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS—(Continued)**  
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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 bond rated 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 the default and recovery rates of underlying assets in the CLO Fund, as may be applicable. Such model assumptions may vary and incorporate adjustments for risk premiums and CLO Fund specific attributes. Such adjustments require judgment and may be material to the calculation of fair value.

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

**Restricted Cash.** Restricted cash consists mostly of cash held in an operating account pursuant to the Company's secured credit facility agreement with its lender.

**Time Deposits and Money Market Accounts.** Time deposits primarily represent overnight Eurodollar investments of cash held in non-demand deposit accounts. Such time deposits are partially restricted under terms of the secured credit facility. The money market account contains restricted cash held for employee flexible spending accounts.

**Interest Income.** Interest income, including amortization of premium and accretion of discount, is recorded on the accrual basis to the extent that such amounts are expected to be collected. 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. Non-accrual loans remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due or such loans become current. As of March 31, 2010, eight issuers representing approximately 3% of total investments at fair value were considered in default.

**Dividends from Affiliate Asset Manager.** The Company records dividend income from its affiliate asset manager on the declaration date, which represents the ex-dividend date.

**Dividend Income from CLO Fund Securities.** The Company generates dividend income from its investments in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by Katonah Debt Advisors and selective investments in securities issued by funds managed by other asset management companies. The Company's CLO Fund junior class securities are subordinate to senior bond holders who typically receive a fixed rate of return 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 bond holders, fund expenses and management fees) is paid to the holders of the CLO Fund's subordinated securities or preferred shares. The Company makes estimated interim accruals of such dividend income based on recent historical distributions and CLO Fund performance and adjusts such accruals on a quarterly basis to reflect actual distributions.

For non-junior class CLO Fund securities, such as the Company's investment in the Class B-2L Notes of the Katonah 2007-1 CLO, interest is earned at a fixed spread relative to the LIBOR index.

**Capital Structuring Service Fees.** The Company may earn ancillary structuring and other fees related to the origination and/or investment in debt and investment securities.

**KOHLBERG CAPITAL CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS—(Continued)**  
**(unaudited)**

**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 ratably over the contractual term of the borrowing as a component of interest expense. At March 31, 2010, there was an unamortized debt issuance cost of approximately \$412,000 included in other assets in the accompanying balance sheet. Amortization expense for the three months ended March 31, 2010 and 2009 was approximately \$206,000 for each period.

**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 its asset manager affiliates share office space and certain other shared operating expenses. The Company has entered into an Overhead Allocation Agreement with its asset manager affiliates which provides for the sharing of such expenses based on an equal sharing of office lease costs and the ratable usage of other shared resources. The aggregate net payments of such expenses under the Overhead Allocation Agreement are not material.

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

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

**Recent Accounting Pronouncements**

Two-Class Method of Presenting Earnings Per Share. In June 2008, Accounting Standards Codification—*Determining Whether Instruments Granted in Share-based Payment Transactions are Participating Securities* was issued. This standard requires companies to include unvested share-based payment awards that contain non-forfeitable rights to dividends in the computation of earnings per share pursuant to the two-class method. This standard is effective for financial statements issued for years beginning after December 15, 2008, and interim periods within those years. The Company adopted this standard beginning with its financial statements ended March 31, 2009 and, as required, applied this standard retroactively to all reported periods. The adoption of this standard did not have a material impact on the Company's calculations of earnings per share.

**3. EARNINGS PER SHARE**

The following information sets forth the computation of basic and diluted net increase in stockholders' equity per share for the three months ended March 31, 2010 and 2009:

	<b>For the Three Months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Net increase (decrease) in stockholders' equity from operations	\$ 1,594,909	\$ 8,895,499
Net income (loss) from operations allocated to non-vested share awards	21,469	135,973
Distributable earnings available to common stockholders	<u>\$ 1,573,440</u>	<u>\$ 8,759,526</u>
Weighted average number of common shares outstanding for basic EPS computation	22,445,457	21,867,006
Effect of dilutive securities - stock options	—	—
Weighted average number of common and common stock equivalent shares outstanding for diluted EPS computation	<u>22,445,457</u>	<u>21,867,006</u>
<b>Basic and diluted earnings per common shares:</b>		
Net income (loss) from operations	\$ 0.07	\$ 0.40
Net income (loss) from operations allocated to non-vested share awards	—	0.01
Net increase (decrease) in stockholders' equity from operations	<u>\$ 0.07</u>	<u>\$ 0.41</u>

Effective January 1, 2008, the accounting for unvested share-based payment awards included in the calculation of earnings per share changed. Share-based awards that contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are now participating securities and included in the computation of both basic and diluted earnings per share. Our grants of restricted stock awards to our employees and directors are considered participating securities and we have prepared our earnings per share calculations to include outstanding unvested restricted stock awards in the basic weighted average shares outstanding calculation. The unvested restricted shares were excluded from the calculation of diluted EPS for the year ended December 31, 2008 because their inclusion would have been anti-dilutive.

Options to purchase 40,000 and 20,000 shares were not included in the computation of diluted earnings per share for the periods ended March 31, 2010 and 2009, respectively, because the effect would be antidilutive as the exercise prices exceeded the average market price of the common shares.

**KOHLBERG CAPITAL CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS—(Continued)**  
**(unaudited)**

**4. INVESTMENTS**

The Company invests in senior secured loans, mezzanine debt and, to a lesser extent, equity of middle market companies in a variety of industries. The Company generally targets companies that generate positive cash flows because the Company looks to cash flow as the primary source for servicing debt. However, the Company may invest in industries in which it currently has little or no investment if it is presented with attractive opportunities.

The following table shows the Company's portfolio by security type at March 31, 2010 and December 31, 2009:

Security Type	March 31, 2010			December 31, 2009		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Time Deposits	\$ 20,055,211	\$ 20,055,211	9 %	\$ 126	\$ 126	— %
Money Market Account	216,099	216,099	—	—	—	—
Senior Secured Loan	159,661,792	143,269,131	67	179,425,767	159,075,586	74
Junior Secured Loan	127,591,676	113,403,940	52	129,016,237	114,920,499	54
Mezzanine Investment	25,623,318	15,528,492	7	28,606,852	19,235,444	9
Senior Subordinated Bond	4,206,913	3,870,000	2	3,007,167	2,415,000	1
Senior Unsecured Bond	—	—	—	2,000,000	1,710,000	1
Preferred Stock	400,000	381,600	—	—	—	—
CLO Fund Securities	68,215,662	51,681,000	24	68,195,049	48,971,000	23
Equity Securities	13,543,343	5,901,400	3	12,365,603	4,713,246	2
Affiliate Asset Managers	43,308,942	55,541,948	26	40,751,511	58,064,720	27
Total	<u>\$462,822,956</u>	<u>\$409,848,821</u>	<u>190 %</u>	<u>\$463,368,312</u>	<u>\$409,105,621</u>	<u>191 %</u>

<sup>1</sup> Calculated as a percentage of NAV.

**KOHLBERG CAPITAL CORPORATION**  
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The unaudited industry concentrations, based on the fair value of the Company's investment portfolio as of March 31, 2010 and December 31, 2009, were as follows:

Industry Classification	March 31, 2010 (unaudited)			December 31, 2009		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Aerospace and Defense	\$ 21,116,462	\$ 20,532,146	9 %	\$ 33,652,058	\$ 33,416,670	16 %
Asset Management Companies <sup>2</sup>	43,308,942	55,541,948	26	40,751,511	58,064,720	27
Automobile	1,933,489	1,876,891	1	1,940,876	1,800,631	1
Broadcasting and Entertainment	2,987,094	2,943,000	1	2,986,206	2,862,000	1
Buildings and Real Estate <sup>3</sup>	36,500,960	9,995,363	5	36,498,537	9,840,946	5
Cargo Transport	12,785,017	12,757,139	6	13,389,865	13,359,403	6
Chemicals, Plastics and Rubber	3,972,425	4,000,000	2	3,970,688	4,000,000	2
CLO Fund Securities	68,215,662	51,681,000	24	68,195,049	48,971,000	23
Containers, Packaging and Glass	7,052,060	7,027,516	3	7,056,701	6,852,738	3
Diversified/Conglomerate Manufacturing	4,035,783	4,031,772	2	4,046,728	4,042,346	2
Diversified/Conglomerate Service	15,363,552	14,020,819	6	15,382,035	14,350,438	7
Ecological	2,688,569	2,692,930	1	2,695,103	2,699,907	1
Electronics	14,859,724	14,673,152	7	14,874,472	14,407,265	7
Farming and Agriculture	—	—	—	1,441,277	217,001	—
Finance	4,061,481	4,019,544	2	5,460,445	5,372,881	3
Healthcare, Education and Childcare	38,395,313	39,451,220	18	41,647,084	42,177,498	20
Home and Office Furnishings, Housewares, and Durable Consumer Goods	20,528,151	18,887,774	9	20,694,006	18,080,134	8
Hotels, Motels, Inns and Gaming	3,439,031	3,235,959	1	3,438,128	3,171,363	1
Insurance	4,868,323	3,735,000	2	4,861,123	4,490,000	2
Leisure, Amusement, Motion Pictures, Entertainment	13,209,222	13,178,473	6	14,572,761	14,227,907	7
Machinery (Non-Agriculture, Non-Construction, Non-Electronic)	33,000,574	31,896,379	15	33,015,472	31,956,312	15
Mining, Steel, Iron and Non-Precious Metals	13,904,633	12,933,526	6	13,861,498	13,021,854	6
Oil and Gas	5,998,747	6,000,000	3	5,998,652	6,000,000	3
Personal and Non Durable Consumer Products (Mfg. Only)	13,078,674	8,675,698	4	14,424,931	9,146,146	4
Personal, Food and Miscellaneous Services	14,768,752	4,528,492	2	14,759,522	4,559,444	2
Printing and Publishing	22,597,908	22,470,153	10	23,867,184	23,506,057	11
Retail Stores	3,543,046	3,543,046	2	3,543,046	3,521,787	2
Time Deposits and Money Market Account	20,271,310	20,271,310	9	126	127	—
Utilities	16,338,052	15,248,571	8	16,343,228	14,989,047	6
<b>Total</b>	<b>\$462,822,956</b>	<b>\$409,848,821</b>	<b>190 %</b>	<b>\$463,368,312</b>	<b>\$409,105,621</b>	<b>191 %</b>

<sup>1</sup> Calculated as a percentage of NAV.

<sup>2</sup> Represents Katonah Debt Advisors and related asset manager affiliates.

<sup>3</sup> Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators. As of March 31, 2010 and December 31, 2009, the Company had no exposure to mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities) or companies providing mortgage lending.

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The Company may invest up to 30% of the investment portfolio in opportunistic investments in high-yield bonds, debt and equity securities of CLO Funds, distressed debt or equity securities of public companies. However, the Company's investment strategy is to limit the value of its investments in debt or equity securities issued by CLO Funds to not more than 15% of the value of its total investment portfolio at the time of investment. The Company expects that these public companies generally will have debt that is non-investment grade. The Company also may invest in debt of middle market companies located outside of the United States, which investments (excluding the Company's investments in CLO Funds) are generally not anticipated to be in excess of 10% of the investment portfolio at the time such investments are made. The Company is generally prohibited from buying or selling any security from or to any portfolio company of a private equity fund managed by Kohlberg & Co. without the prior approval of the SEC. In addition, the Company may co-invest on a concurrent basis with Kohlberg & Co. or any of its affiliates, subject to compliance with existing regulatory guidance, applicable regulations and its allocation procedures. Certain types of negotiated co-investments may be made only if the Company receives an order from the SEC permitting it to do so. There can be no assurance that any such order will be applied for or, if applied for, obtained.

At March 31, 2010 and December 31, 2009, approximately 18% and 12%, respectively, of the Company's investments were foreign assets (which includes the Company's investments in CLO Funds, which are typically domiciled outside the U.S., the Company's investments in foreign assets, represented approximately 13% and 12% of its portfolio on such dates, respectively).

At March 31, 2010 and December 31, 2009, the Company's ten largest portfolio companies represented approximately 39% and 37%, respectively, of the total fair value of its investments. The Company's largest investment, Katonah Debt Advisors, which is its wholly-owned portfolio company, represented 14% and 14% of the total fair value of the Company's investments at March 31, 2010 and December 31, 2009, respectively. Excluding Katonah Debt Advisors and CLO Fund securities, the Company's ten largest portfolio companies represented approximately 19% and 19% of the total fair value of its investments at March 31, 2010 and December 31, 2009, respectively.

***Investment in CLO Fund Securities***

The Company typically makes a minority investment in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by Katonah Debt Advisors and may selectively invest in securities issued by funds managed by other asset management companies. However, as noted above, the Company's investment strategy is to limit the value of its investments in the debt or equity securities issued by CLO Funds to not more than 15% of the value of its total investment portfolio at the time of investment. Preferred shares or subordinated securities issued by CLO Funds are entitled to recurring dividend 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 and CLO Fund expenses. CLO Funds managed by Katonah Debt Advisors ("CLO fund securities managed by affiliate") 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 and exclude mortgage pools or mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities), debt to companies providing mortgage lending and emerging markets investments. 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 January 23, 2008, the Company's wholly-owned asset management company, Katonah Debt Advisors, closed a \$315 million CLO Fund. The Company received a structuring fee upon closing and Katonah Debt Advisors earns an ongoing asset management fee based on the par amount of the underlying investments in the CLO Fund. Securities issued by CLO Funds managed by Katonah Debt Advisors are primarily held by third parties. Kohlberg Capital invested approximately \$29 million to acquire all of the shares of the most junior class of securities of this latest CLO Fund.

The subordinated securities and preferred share securities are considered equity positions in the CLO Funds and, as of March 31, 2010 and December 31, 2009, the Company had approximately \$45 million and \$45 million, respectively, of such CLO equity investments at fair value. The cost basis of the Company's investment in CLO Fund equity securities as of March 31, 2010 was approximately \$67 million and aggregate unrealized depreciation on the CLO Fund securities totaled approximately \$22 million. The cost basis of the Company's investment in CLO Fund equity securities as of December 31, 2009 was approximately \$67 million, and aggregate unrealized depreciation on the CLO Fund securities totaled approximately \$23 million.

In May 2009 the Company purchased the class B-2L notes of the Katonah 2007-1 CLO investment managed by Katonah Debt Advisors ("Katonah 2007-1 B-2L"). The Company purchased the Katonah 2007-1 B-2L for 10% of the par value. The fair value, cost basis, and aggregate unrealized appreciation of the Katonah 2007-1 B-2L investment as of March 31, 2010 were approximately \$6 million, \$1 million, and \$5 million, respectively, and at December 31, 2009, the fair value, cost basis, and aggregate unrealized appreciation of the Katonah 2007-1 B-2L investment were \$4 million, \$1 million, and \$3 million, respectively. Both the B-2L notes and preferred shares of Katonah 2007-1 are owned 100% by the Company and Katonah 2007-1 is current in the payment of all quarterly distributions in respect of the B-2L notes and the preferred shares.

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***Fair Value Measurements***

The Company follows the provisions of *Fair Value Measurements and Disclosures*, 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. *Fair Value Measurements and Disclosures* 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 *Fair Value Measurements and Disclosures*, the FASB has issued various staff positions clarifying the initial standard (see Note 2. “Significant Accounting Policies—Investments”).

*Fair Value Measurements and Disclosures* 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 *Fair Value Measurements and Disclosures*, 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 corporate loans and bonds 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. Substantially all of the Company’s investments are classified as Level III. The Company evaluates the source of inputs, including any markets in which its investments are trading, in determining fair value. Inputs that are backed by actual transactions, those that are highly correlated to the specific investment being valued and those derived from reliable or knowledgeable sources will tend to have a higher weighting in determining fair value. Ongoing reviews by the Company’s investment analysts, Chief Investment Officer, Valuation Committee and independent valuation firms (if engaged) are based on 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.

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The following table summarizes the fair value of investments by the above *Fair Value Measurements and Disclosures* fair value hierarchy levels as of March 31, 2010 (unaudited) and December 31, 2009, respectively:

	As of March 31, 2010 (unaudited)			
	Level I	Level II	Level III	Total
Time deposits and money market account	\$ —	\$20,271,310	\$ —	\$ 20,271,310
Debt securities	—	—	276,453,163	276,453,163
CLO fund securities	—	—	51,681,000	51,681,000
Equity securities	—	—	5,901,400	5,901,400
Asset manager affiliates	—	—	55,541,948	55,541,948

  

	As of December 31, 2009			
	Level I	Level II	Level III	Total
Time deposits and money market account	\$ —	\$ 126	\$ —	\$ 126
Debt securities	—	—	297,356,529	297,356,529
CLO fund securities	—	—	48,971,000	48,971,000
Equity securities	—	—	4,713,246	4,713,246
Asset manager affiliates	—	—	58,064,720	58,064,720

The following tables summarize the Level III investments by valuation procedure as of March 31, 2010 (unaudited) and December 31, 2009, respectively:

	As of March 31, 2010 (unaudited)				
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliates	Total
<b>Fair Value Based on</b>					
Third party pricing service	— %	— %	— %	— %	— %
Public / private company comparables	71	—	—	14	85
Discounted cash flow	—	13	—	—	13
Residual enterprise value	—	—	2	—	2
<b>Total</b>	<u>71%</u>	<u>13 %</u>	<u>2 %</u>	<u>14 %</u>	<u>100 %</u>

  

	As of December 31, 2009				
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliates	Total
<b>Fair Value Based on</b>					
Third party pricing service	— %	— %	— %	— %	— %
Public / private company comparables	73	—	—	14	87
Discounted cash flow	—	12	—	—	12
Residual enterprise value	—	—	1	—	1
<b>Total</b>	<u>73%</u>	<u>12 %</u>	<u>1 %</u>	<u>14 %</u>	<u>100 %</u>

As a BDC, the Company is required to invest primarily in the debt and equity of non-public companies for which there is little, if any, market-observable information. As a result, most, if not all, of the Company's investments at any given time will most likely be deemed Level III investments. The Company believes that investments classified as Level III for *Fair Value Measurements and Disclosures* have a further hierarchal framework which prioritizes and ranks such valuations based on the degree of independent and observable inputs, objectivity of data and models and the level of judgment required to adjust comparable data. The hierarchy of such methodologies are presented in the above table and discussed below in descending rank.

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Investment values derived by a third party pricing service are deemed Level III values since such values are not traded on an active public exchange and may represent a traded or broker quote on an asset that is infrequently traded.

The Company derives fair value for its illiquid investments that do not have indicative fair values based upon active trades primarily by using the Market Yield Approach and also considers 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 investments. Because the Company has not identified any market index that directly correlates to the loan and debt investments held by the Company and therefore uses the two benchmark indices, these market indices may require significant adjustment to better correlate such market data for the calculation of fair value of the investment under the Market Yield 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. The appropriateness of specific valuation methods and techniques may change as market conditions and available data change.

The Company engaged VRC, an independent valuation firm, to provide third-party valuation estimates for approximately 39% and 40% of its portfolio at fair value as of December 31, 2009 and December 31, 2008, respectively. VRC's valuation estimates were considered as one of the relevant data inputs in the Company's determination of fair value. The Board of Directors intends to continue to engage an independent valuation firm in the future to provide certain valuation services, including the review of certain portfolio assets, as part of the Company's annual year end valuation process.

Values derived for debt securities using public/private company comparables 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 basis, is certified as correct by the management of the company/issuer and 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 asset manager affiliates using public/private company comparables generally utilize market-observable data from such comparables and specific, non-public and non-observable financial measures (such as assets under management, historical and prospective earnings) for the asset manager affiliate. The Company recognizes that comparable asset managers may not be fully comparable to its 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 changes in investments measured at fair value for which the Company has used unobservable inputs to determine fair value are as follows:

	<b>Three Months Ended March 31, 2010 (unaudited)</b>				<b>Total</b>
	<b>Debt Securities</b>	<b>CLO Fund Securities</b>	<b>Equity Securities</b>	<b>Asset Manager Affiliates</b>	
Balance, December 31, 2009	\$297,356,529	\$48,971,000	\$4,713,246	\$58,064,720	\$409,105,495
Transfers in/out of Level 3	—	—	—	—	—
Net accretion of discount	121,942	20,613	—	—	142,555
Purchases (sales), net	(22,422,125)	—	1,177,740	2,557,431	(18,686,954)
Total loss realized and unrealized included in earnings	1,396,817	2,689,387	10,414	(5,080,203)	(983,585)
Balance, March 31, 2010	<u>\$276,453,163</u>	<u>\$51,681,000</u>	<u>\$5,901,400</u>	<u>\$55,541,948</u>	<u>\$389,577,511</u>
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	<u>\$ 3,668,958</u>	<u>\$ 2,689,387</u>	<u>\$ 10,414</u>	<u>\$ (5,080,203)</u>	<u>\$ 1,288,556</u>

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	Year Ended December 31, 2009				
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliates	Total
Balance, December 31, 2008 (as restated)	\$353,859,007	\$34,640,000	\$ 5,087,512	\$54,734,812	\$448,321,331
Transfers in/out of Level 3	—	—	—	—	—
Net accretion of discount	964,724	742,204	—	—	1,706,928
Purchases (sales), net	(70,717,418)	1,076,250	8,625,625	4,018,309	(56,997,234)
Total loss realized and unrealized included in earnings	13,250,216	12,512,546	(8,999,891)	(688,401)	16,074,470
Balance, December 31, 2009	<u>\$297,356,529</u>	<u>\$48,971,000</u>	<u>\$ 4,713,246</u>	<u>\$58,064,720</u>	<u>\$409,105,495</u>
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	<u>\$ 25,300,586</u>	<u>\$12,512,546</u>	<u>\$(7,485,064)</u>	<u>\$ 1,526,668</u>	<u>\$ 31,854,736</u>

## 5. AFFILIATE ASSET MANAGERS

### *Wholly-Owned Asset Manager*

Prior to its IPO, the Company issued an aggregate of 2,226,333 common shares, having a value of approximately \$33 million, to affiliates of Kohlberg & Co. to acquire Katonah Debt Advisors. As a result, Katonah Debt Advisors is a wholly-owned portfolio company. As of March 31, 2010, Katonah Debt Advisors and its affiliates had approximately \$2.1 billion of assets under management.

Katonah Debt Advisors manages CLO Funds primarily for third party investors that invest in broadly syndicated loans, high yield bonds and other credit instruments issued by corporations. These CLO Funds do not invest in asset-backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings. At March 31, 2010, Katonah Debt Advisors had approximately \$2.1 billion of assets under management, and the Company's 100% equity interest in Katonah Debt Advisors was valued at approximately \$56 million.

As a manager of the CLO Funds, Katonah Debt Advisors receives contractual and recurring management fees and may receive a one-time structuring fee from the CLO Funds for its management and advisory services. The annual fees which Katonah Debt Advisors receives are generally based on a fixed percentage of assets under management (at par value and not subject to changes in market value), and Katonah Debt Advisors generates annual operating income equal to the amount by which its fee income exceeds its operating expenses. The annual management fees Katonah Debt Advisors receives have two components—a senior management fee and a subordinated management fee. At March 31, 2010, Katonah Debt Advisors continued to receive all senior management fees payable by the CLO Funds managed by it. However, certain CLO Funds (representing approximately \$1.2 billion of the \$2.1 billion of Katonah Debt Advisors' assets under management) are not paying their subordinated management fee. These subordinated management fees, totaling approximately \$4 million per year, have been restricted from being paid as a result of the failure by the CLO Funds to satisfy certain restrictive covenants contained in their indenture agreements. Such subordinated management fees continue to be accrued by the applicable CLO Fund and will be payable to Katonah Debt Advisors if and when such CLO Fund becomes compliant with the applicable covenants. As of March 31, 2010, approximately \$6 million of subordinated management fees have been accrued and Katonah Debt Advisors currently expects a portion of such fees to be paid to it within the next year. However, there can be no assurance that these fees will become payable or, if they do become payable, that the applicable CLO Fund will have sufficient cash to make the payments to Katonah Debt Advisors. In future years, Katonah Debt Advisors may receive accrued incentive fees upon the liquidation of CLO Funds it manages, provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares.

On January 2, 2008, the Katonah Debt Advisors platform acquired substantially all of the assets of Scott's Cove Capital Management LLC ("Scott's Cove"), an asset manager focused on an event-driven credit long short investment strategy. As a result of the acquisition, approximately \$60 million of fee paying assets under management were integrated within the Katonah Debt Advisors asset management platform. In connection with the acquisition, Katonah Debt Advisors entered into employment agreements with

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three Scott's Cove investment professionals, and expects these individuals will assist in structuring, raising and investing new funds to be managed by Katonah Debt Advisors. As of March 31, 2010, Scott's Cove had approximately \$131 million of assets under management.

The revenue that Katonah Debt Advisors generates through the fees it receives for managing CLO Funds and after paying the expenses associated with its operations, including compensation of its employees, may be distributed to the Company. Any distributions of Katonah Debt Advisors' net income are recorded as dividends from affiliate asset manager. As with all other investments, Katonah Debt Advisors' fair value is periodically determined. The valuation is primarily based on an analysis of both a percentage of its assets under management and Katonah Debt Advisors' estimated operating income. Any change in value from period to period is recognized as unrealized gain or loss. See Note 2, "Significant Accounting Policies" and Note 4, "Investments" for further information relating to the Company's valuation methodology.

As a separately regarded entity for tax purposes, Katonah Debt Advisors is taxed at normal corporate rates. For tax purposes, any distributions of taxable net income earned by Katonah Debt Advisors to the Company would generally need to be distributed to the Company's shareholders. Generally, such distributions of Katonah Debt Advisors' income to the Company's shareholders will be considered as qualified dividends for tax purposes. Katonah Debt Advisors' taxable net income will differ from GAAP net income because of deferred tax timing adjustments and permanent tax adjustments. Deferred tax timing adjustments may include differences for the recognition and timing of depreciation, bonuses to employees and stock option expense. Permanent differences may include adjustments, limitations or disallowances for meals and entertainment expenses, penalties and tax goodwill amortization.

Goodwill amortization for tax purposes was created upon the purchase of 100% of the equity interests in Katonah Debt Advisors 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 will be amortized for tax purposes on a straight-line basis over 15 years, which accounts for an annual difference between GAAP income and taxable income by approximately \$2 million per year over such period.

At March 31, 2010 there were no intercompany balances with our affiliates, and at December 31, 2009 a net amount due from affiliates totaled approximately \$44,000.

#### ***Distressed Debt Platform***

In December 2007, a wholly-owned subsidiary of the Company committed to make an investment in a new distressed debt investment platform organized by Steven Panagos and Jonathan Katz named PKSIL LLC ("PKSIL"). The Company committed to invest up to \$2.5 million to fund the operation of PKSIL and to invest in an investment fund to be raised and managed by PKSIL. Due to unfavorable global financial market conditions in 2008, PKSIL was not able to raise the planned fund. During the quarter ended June 30, 2009, both Messrs. Panagos and Katz terminated their employment with PKSIL and PKSIL ceased operations. In connection therewith, the Company recognized a loss of approximately \$2.2 million.

## **6. BORROWINGS**

The Company's debt obligations consist of the following:

	<u>As of</u> <u>March 31, 2010</u>	<u>As of</u> <u>December 31, 2009</u>
Secured revolving credit facility, \$275 million commitment due September 29, 2010 <sup>1</sup>	\$198,648,255	\$ 218,050,363

<sup>1</sup> September 29, 2010 is the last day of the amortization period that the Company has challenged as being wrongfully commenced.

On February 14, 2007, the Company entered into an arrangement under which the Company may obtain up to \$200 million in financing (the "Facility"). On October 1, 2007, the Company amended the Facility to increase the Company's borrowing capacity from \$200 million to \$275 million, extend the maturity date from February 12, 2012 to October 1, 2012 and increase the interest spread charged on outstanding borrowings by 15 basis points to 0.85%. The interest rate is based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. Interest is payable monthly. As a result of the assertion of BMO Capital Markets Corp., as the agent (the "Agent"), that a Termination Event occurred under the LFSA, since June 2009 interest under the LFSA has been calculated at a higher default rate (equal to 0.85% above the prime rate plus 0.75%).

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*Fair Value of Debt.* The Company records debt at cost. The fair value of the Company's outstanding debt was approximately \$200 million and \$218 million at March 31, 2010 and December 31, 2009, respectively. The fair value of the Company's debt was determined based on market interest rates for similar instruments as of the balance sheet dates.

Advances under the Facility (to the extent available to the Company) are used by the Company primarily to make additional investments. The Facility is secured by loans acquired by the Company with the advances under the Facility. The Company borrows under the Facility through its wholly-owned, special-purpose bankruptcy remote subsidiary, KCAP Funding.

In connection with the Facility, the Company is party to a Loan Funding and Servicing Agreement, dated as of February 14, 2007 (as amended, the "LFSA"), by and among the Company, as the servicer, our wholly-owned, special-purpose bankruptcy remote subsidiary, Kohlberg Capital Funding LLC I, as the borrower ("KCAP Funding" or the "Borrower"), the Agent, U.S. Bank National Association, a national banking association, as the trustee (the "Trustee") and the other lender parties and other parties thereto.

In August 2008, the Company was notified by the lenders that the banks providing the underlying funding for the Facility did not intend to renew their liquidity facility to the lenders unless the Company agreed to certain revised terms for the Facility. The lenders proposed new terms to the Company as a condition to extending the underlying liquidity purchase agreements. The Company viewed such proposed terms as unfavorable and did not agree to such new terms, which caused the lenders to declare a Termination Date based upon their contention that the underlying liquidity purchase agreements had expired, thereby terminating our ability to obtain revolving advances and commencing the amortization of existing borrowings under the Facility. Since September 2008, all principal and excess interest collected from the assets securing the Facility have been and continue to be used to amortize the Facility through a maturity date of September 29, 2010 (the last day of the amortization period that the Company has challenged as being wrongfully commenced). Since June 2009, based on the Agent's assertion (despite our disagreement with such assertion) that a Termination Event had occurred, the interest payable under the LFSA has been calculated at an elevated rate (equal to 0.85% above the prime rate plus 0.75%), and the Company has been paying such higher interest under protest. Also, despite its belief that the amortization period has been wrongfully imposed, the Company believes it has sufficient cash and liquid assets which could be sold, potentially at a loss, to generate cash to fund normal operations and dividend distributions. At the end of the amortization period, the Company may be required to sell the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings or the Company may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

Under the Facility, the Company is subject to various covenants including a leverage ratio covenant pursuant to which it must maintain a leverage ratio of no more than one to one based on the ratio of the Facility outstanding balance to the Company's GAAP stockholders' equity balance. As of April 30, 2010, the Company's leverage ratio did not exceed 1:1.

As of the date of filing of this Quarterly Report, the Company believes that it is not in material breach of its obligations under the LFSA, including the leverage ratio. However, as described above, the Company and the Borrower are plaintiffs in a pending lawsuit against the Agent and the lenders involving the LFSA. There can be no assurance that in connection with such lawsuit or otherwise the Agent and the lenders will not assert additional breaches of the LFSA, including breaches relating to the restatement referred to elsewhere in this Quarterly Report, and there can be no assurance that the Agent and the lenders will not assert that any such breaches give rise to a Termination Event. While the Company and the Borrower believe that they have meritorious claims against the Agent and the lenders in the pending lawsuit and, as a result, the breaches alleged by the Agent and the lenders are not valid in accordance with the terms of the LFSA, there is no assurance that the Company and the Borrower will prevail in such litigation. If the Company and the Borrower do not prevail, the Agent and the lenders may seek to pursue claims based on the alleged breaches, including claims involving alleged Termination Events. If the Agent and the lenders were to seek to accelerate and seize the collateral either at the end of the amortization period (which the Company has challenged as being wrongfully commenced) or otherwise, and the Company and the Borrower were unsuccessful in obtaining court relief, they could be forced to pay the remaining balance of the Facility (approximately \$187 million as of April 30, 2010), which would adversely affect the Company's business, liquidity, financial condition and results of operations.

The Company estimates that the portfolio of loans securing the Facility will be required to generate an annual rate of return of approximately 3% to cover annual interest payments on obligations incurred under the Facility.

The weighted average daily debt balance for the three months ended March 31, 2010 and 2009 was approximately \$203 million and \$254 million, respectively. For the three months ended March 31, 2010 and 2009, the weighted average interest rate on weighted

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average outstanding borrowings was approximately 5% and 2%, respectively, which excludes the amortization of deferred financing costs and facility and program fees on unfunded balances. As of March 31, 2010, the Company had restricted cash and time deposit balances of approximately \$15 million which it maintained in accordance with the terms of the Facility.

## 7. DISTRIBUTABLE TAX INCOME

Effective December 11, 2006, the Company elected to be treated as a RIC under the Code and adopted a December 31 calendar year end. As a RIC, the Company is not subject to federal income tax on the portion of its taxable income and gains distributed currently to its stockholders as a dividend. The Company's quarterly dividends, if any, are determined by the Board of Directors. The Company anticipates distributing at least 90% of its taxable income and gains, within the Subchapter M rules, and thus the Company anticipates that it will not incur any federal or state income tax at the 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 2010). Depending on the level of taxable income earned in a tax year, the Company may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4% excise tax on such income, to the extent required. The Company anticipates timely distribution of its taxable income within the tax rules, however, the Company may incur a U.S. federal excise for the calendar year 2009.

The following reconciles net increase in stockholders' equity resulting from operations to taxable income for the nine months ended March 31, 2010:

	<u>Three Months Ended</u> <u>March 31, 2010</u> <u>(unaudited)</u>
Net increase in stockholders' equity resulting from operations	\$ 1,594,909
Net change in unrealized (appreciation) on investments	(1,288,556)
Excess capital losses over capital gains	2,272,141
Income not on GAAP books currently taxable	503,413
Income not currently taxable	(19,217)
Expenses not currently deductible	150,316
Expenses not on GAAP books currently deductible	(3,667)
Taxable income before deductions for distributions	<u>\$ 3,209,339</u>
Taxable income before deductions for distributions per weighted average shares for the period	<u>\$ 0.14</u>

Distributable income (loss) differs from GAAP net investment income primarily due to: (1) unrealized appreciation (depreciation) on investments, as investment gains and losses are not included in taxable income until they are realized; (2) amortization of discount on CLO Fund Securities; (3) amortization of organizational costs; (4) non-deductible expenses; (5) stock compensation expense that is not currently deductible for tax purposes; (6) excess of capital losses over capital gains; and (7) recognition of interest income on certain loans.

At March 31, 2010, the Company had a net capital loss carryforward of \$18.7 million to offset net capital gains, to the extent provided by federal tax law. The capital loss carryforward will begin to expire in the tax year ending December 31, 2015.

For the quarter ended March 31, 2010, the Company declared a dividend on March 19, 2010 of \$0.17 per share for a total of approximately \$4 million. The record date was April 7, 2010 and the dividend was distributed on April 29, 2010.

The Company adopted Financial Accounting Standards Board ASC Topic 740 Accounting for Uncertainty in Income Taxes ("ASC 740") as of January 1, 2007. ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the 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. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open taxable years as of the effective date. The adoption of ASC 740 did not have an effect on the financial position or results of operations of the Company as there was no liability for unrecognized tax benefits and no change to the beginning capital of the Company. 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.

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**8. COMMITMENTS AND CONTINGENCIES**

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 both March 31, 2010 and December 31, 2009, the Company had committed to make a total of approximately \$2 million of investments in various revolving senior secured loans, of which approximately \$640,000 was funded as of March 31, 2010 and \$640,000 was funded as of December 31, 2009.

In October 2007, Katonah Debt Advisors entered into a letter agreement (the "Letter Agreement") with Bear Stearns & Co. Inc. ("Bear Stearns") in connection with a warehouse credit line established to fund the initial accumulation of assets for three CLO Funds, pursuant to which agreement Katonah Debt Advisors undertook certain "first loss" commitments with respect to potential losses on assets purchased using the warehouse credit line. Such "first loss" commitments relate to (i) losses (if any) as a result of individual loan investments being ineligible for purchase by a new CLO Fund (typically due to a payment default on such loan) when such fund formation is completed or (ii) if a new CLO Fund has not been completed before the expiration of the related warehouse credit line, the loss (if any, and net of any accumulated interest income) on the resale of loans and debt securities funded by such warehouse credit line.

Under the Letter Agreement, Katonah Debt Advisors also engaged Bear Stearns to structure and raise three CLO Funds to be managed by Katonah Debt Advisors (directly or indirectly through a services contract with an affiliate of Katonah Debt Advisors). While one of these funds, the Katonah 2007-1 CLO Fund, in which the Company invested approximately \$29 million to acquire all of the shares of the most junior class of securities was completed, neither of the other 2008 CLO Funds were successfully raised.

As a result, pursuant to the Letter Agreement, both Katonah Debt Advisors and J.P. Morgan Securities Inc. ("JPMorgan") (f/k/a Bear Stearns & Co. Inc.) asserted claims against each other and defenses thereto with respect to potential "first loss" payments. Without admitting any liability or wrongdoing, Katonah Debt Advisors and JPMorgan agreed to compromise and settle all of the disputes, issues and claims between them relating to the agreements in exchange for an agreement to terminate all obligations and liabilities of Katonah Debt Advisors and JPMorgan under the existing agreements relating to the 2008 CLO Funds, payment by Katonah Debt Advisors of an aggregate of \$6 million in installments over a period of one year and the forfeiture by Katonah Debt Advisors of the net interest income earned through the settlement date on the warehoused assets. In December 2008, Katonah Debt Advisors entered into a settlement and termination agreement with JPMorgan reflecting the settlement terms described above.

As a result of this settlement, Katonah Debt Advisors recognized a \$6 million settlement cost and write-off of previously accrued net interest income on warehoused assets of approximately \$4 million for the year ended December 31, 2008. The Company recognized the impact of this settlement and forfeiture of warehouse income as a reduction to the unrealized appreciation of the value of its investment in Katonah Debt Advisors and contributed additional equity to Katonah Debt Advisors. Consequently, this settlement did not have a material impact on Kohlberg Capital's net investment income or quarterly dividend.

The Company and certain directors and officers are named as defendants in three putative class actions pending in the Southern District of New York brought by shareholders of the Company and filed in December 2009 and January 2010. The complaints in these three actions allege violations of Sections 10 and 20 of the Exchange Act based on the Company's disclosures of its year-end 2008 and first- and second-quarter 2009 financial statements. In addition, the Company and certain directors and officers are also named as defendants in a derivative action filed on March 2, 2010 pending in the Supreme Court of New York, County of New York. The complaint in this action purports to state causes of action for breaches of fiduciary duties, unjust enrichment, abuse of control, gross mismanagement, and corporate waste. The Company believes that each of the above-mentioned suits is without merit and will defend each vigorously.

**9. LIQUIDITY**

As discussed in Note 6, the Company is currently using any income generated by the assets collateralizing its secured credit Facility to pay principal, interest and other expenses of the Facility – despite the fact that, if it wants to remain a RIC and continue to be afforded favorable tax treatment for U.S. federal income tax purposes, it is required to distribute to the shareholders substantially

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all of its investment company taxable income, including the net amounts generated by the collateralized assets. These collateralized assets with a market value of approximately \$273 million represent approximately 65% of the Company's total assets (at fair value) at March 30, 2010 and contributed approximately 62% of the Company's investment income for the quarter ended March 31, 2010. Because the Company is using net interest income earned on the assets securing the Facility to amortize the Facility during the amortization period, the Company may need to sell other assets not pledged to the Facility, potentially at a loss, in order to generate sufficient cash to make the required dividend distributions necessary to maintain its RIC status. In addition, at the end of the amortization period (which the Company has challenged as being wrongfully commenced), the Company may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings. Any such asset sale could adversely affect the Company's business, liquidity, financial condition and results of operations. The Company expects that its cash on hand, liquid investments, and cash generated from operations, including income earned from investments and any income distributions made by Katonah Debt Advisors, the Company's wholly-owned portfolio company, will be adequate to meet the Company's liquidity needs and distribution requirements over the next twelve months.

If the Company is unable to renew or replace the Facility, the Company's liquidity may be significantly reduced. If these conditions continue for a prolonged period of time, or worsen in the future, the Company could lose key employees and its business prospects could be negatively impacted. Even if the Company is able to renew or replace the Facility, such new debt capital may be at a higher cost and/or on less favorable terms and conditions than the Facility. In addition, equity capital is, and may continue to be, difficult to raise because, subject to limited exceptions, the Company may not issue and sell shares of its common stock at a price below NAV without stockholder approval and issuing equity at depressed stock prices can be dilutive to the Company's stockholders. These factors and the Company's inability to raise additional capital to date have resulted in a reduction in new originations, curtailed the Company's ability to grow and have had a negative impact on the Company's liquidity and operating results. The continued inability to raise additional capital could further constrain the Company's liquidity, negatively impact the Company's business prospects, cause the departure of key employees and negatively impact the Company's operating results.

#### **10. STOCKHOLDERS' EQUITY**

On April 28, 2008, the Company completed a rights offering which resulted in the issuance of 3.1 million common shares and net proceeds of approximately \$27 million. For the year ended December 31, 2008, the Company issued 359,250 shares of restricted stock for which 16,667 shares were forfeited and 3,000 shares were converted to common stock during the year due to vesting. During the year ended December 31, 2009, the Company issued 501,873 shares under DRIP and 122,333 shares of restricted stock were exercised and converted to common stock. During the three months ended March 31, 2010, the Company issued 112,058 shares of common stock under its dividend reinvestment plan. The total number of shares issued and outstanding as of March 31, 2010 and December 31, 2009 was 22,475,339 and 22,363,281, respectively.

#### **11. EQUITY INCENTIVE PLAN**

During 2006 and as amended in 2008, the Company established an equity incentive plan (the "Plan") and reserved 2,000,000 shares of common stock for issuance under the Plan. The purpose of the Plan is to provide officers and prospective employees of the Company with additional incentives and align the interests of its employees with those of its shareholders. Options granted under the Plan are exercisable at a price equal to the fair market value (market closing price) of the shares on the day the option is granted. Restricted stock granted under the 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.

##### ***Stock Options***

On December 11, 2006, concurrent with the completion of the Company's IPO, options to purchase a total of 910,000 shares of common stock were granted to the Company's executive officers and directors with an exercise price per share of \$15.00 (the public offering price of the common stock). Such options vest equally over two, three or four years from the date of grant and have a ten-year exercise period. During the year ended December 31, 2007, the Company granted 495,000 options to its employees with a weighted average exercise price per share of \$16.63, with a risk-free rate ranging between 4.6% to 5.3%, with volatility rates ranging between 20.5% to 22.4% and for which 25% of such options vest on each of the subsequent four grant date anniversaries and have a ten-year exercise period. During the year ended December 31, 2008, and as approved by shareholders during the annual shareholders' meeting on June 13, 2008, 20,000 options were granted to non-employee directors as partial annual compensation for their services as director. These grants were made with a ten-year exercise period with an exercise price of \$11.97, with a risk free rate of 4.6% with a volatility rate of 28% and for which 50% of such options vest upon grant date and 50% vest on the first grant date anniversary. During the year ended December 31, 2009, 20,000 additional options were granted to non-employee directors as partial annual compensation for their services as director. These grants were made with a ten-year exercise period with an exercise price of \$4.93, with a risk free rate of 4.3% with a volatility rate of 41% and for which 50% of such options vest upon grant date and 50% vest on the first grant date anniversary.

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On June 13, 2008, the Company's Board of Directors authorized the Company to allow employees who agree to cancel options that they hold to receive one share of restricted stock for every five options so cancelled. The shares of restricted stock received by employees through any such transaction will vest annually generally over the remaining vesting schedule as was applicable to the cancelled options. During the year ended December 31, 2008, employees holding options to purchase 1,295,000 shares individually entered into agreements to cancel such options and to receive 259,000 shares of restricted stock. As a result, as of December 31, 2008, all options granted to employees had been converted to restricted stock.

As of December 31, 2009, 40,000 options to non-employee directors remained outstanding. During the three months ended March 31, 2010, no such options were forfeited. As of March 31, 2010, 40,000 total options were outstanding, 30,000 of which were exercisable. The options have an estimated remaining contractual life of 8 years and 8 months.

Information with respect to options granted, exercised and forfeited under the Plan for the three months ended March 31, 2010 is as follows:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Contractual Remaining Term (years)	Aggregate Intrinsic Value at March 31, 2010 <sup>1</sup>
Options outstanding at January 1, 2008	1,315,000	\$ 15.52		
Granted	20,000	\$ 11.97		
Exercised	—	\$ —		
Forfeited	(1,315,000)	\$ 15.52		
Outstanding at December 31, 2008	20,000	\$ 11.97		
Granted	20,000	\$ 4.93		
Exercised	—	\$ —		
Forfeited	—	\$ —		
Outstanding at December 31, 2009	40,000	\$ 8.45		
Granted	—	\$ —		
Exercised	—	\$ —		
Forfeited	—	\$ —		
Outstanding at March 31, 2010	<u>40,000</u>	\$ 8.45	8.7	\$ —
Total vested at March 31, 2010	30,000	\$ 9.62	8.5	

<sup>1</sup> Represents the difference between the market value of the options at March 31, 2010 and the cost for the option holders to exercise the options.

The Company uses a Binary Option Pricing Model (American, call option) as its valuation model to establish the expected value of all stock option grants. For the three months ended March 31, 2010 and March 31, 2009, the Company recognized non-cash compensation expense related to stock options of approximately \$2,000 and \$3,750, respectively. At March 31, 2010, the Company had approximately \$2,000 of compensation cost related to unvested stock-based awards, the cost for which is expected to be recognized over a weighted average period of 3 months.

**Restricted Stock**

On June 13, 2008, the Company's shareholders approved the Company's 2006 Equity Incentive Plan, as amended and the board of directors approved the grant of awards of 100,250 shares of restricted stock to certain executive officers of the Company. On

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August 5, 2009, the board of directors approved the grant of an additional 84,889 shares of restricted stock to a certain executive officer of the Company. Such awards of restricted stock will vest as to 50% of the shares on the third anniversary of the grant date and the remaining 50% of the shares on the fourth anniversary of the grant date.

On June 13, 2008, the Company's Board of Directors authorized the Company to allow employees who agree to cancel options that they hold to receive shares of the Company's common stock to receive one share of restricted stock for every five options so cancelled. The shares of restricted stock received by employees through any such transaction will vest annually generally over the remaining vesting schedule as was applicable to the cancelled options. Subsequently, employees holding options to purchase 1,295,000 shares individually entered into agreements to cancel such options and to receive 259,000 shares of restricted stock. As of March 31, 2010, 125,333 of such shares were vested and converted to common shares, and 117,000 of such shares had yet to vest. The remaining 16,667 shares have been forfeited.

During the three months ended March 31, 2010, no shares of restricted stock were vested and converted to common shares. As of March 31, 2010, after giving effect to these option cancellations and restricted stock awards, there were options to purchase 40,000 shares of common stock outstanding and there were 302,139 shares of restricted stock outstanding. Information with respect to restricted stock granted, exercised and forfeited under the Plan for the three months ended March 31, 2010 is as follows:

	<u>Non-Vested Restricted Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Non-vested shares outstanding at December 31, 2008	339,583	\$ 10.83
Granted	84,889	\$ 5.89
Vested	(122,333)	\$ 10.37
Forfeited	—	\$ —
Non-vested shares outstanding at December 31, 2009	302,139	\$ 9.63
Granted	—	\$ —
Vested	—	\$ —
Forfeited	—	\$ —
Outstanding at March 31, 2010	<u>302,139</u>	<u>\$ 9.63</u>
Total non-vested shares at March 31, 2010	302,139	\$ 9.63

For the three months ended March 31, 2010, non-cash compensation expense related to restricted stock was approximately \$218,000; of this amount approximately \$148,000 was expensed at the Company and approximately \$70,000 was a reimbursable expense allocated to Katonah Debt Advisors. For the three months ended March 31, 2009, non-cash compensation expense related to restricted stock was approximately \$232,000; of this amount approximately \$162,000 was expensed at the Company and approximately \$70,000 was a reimbursable expense allocated to Katonah Debt Advisors. Dividends are paid on all outstanding shares of restricted stock, whether or not vested. In general, shares of unvested restricted stock are forfeited upon the recipient's termination of employment. As of March 31, 2010, there was approximately \$1 million of total unrecognized compensation cost related to nonvested share-based awards. That cost is expected to be recognized over a weighted average period of 2.1 years.

## 12. 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 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 2.67% of the employee's first 74.9% of maximum eligible compensation, which fully vest at the time of contribution. For the three months ended March 31, 2010 and 2009 the Company made contributions to the 401K Plan of approximately \$14,000 and \$6,000, respectively. At March 31, 2010, the Company had approximately \$1 million of compensation cost related to unvested restricted stock based awards, the cost for which is expected to be recognized by the Company over a weighted average period of 2.1 years.

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The Company has also adopted a deferred compensation plan (“Pension Plan”) effective January 1, 2007. Employees are eligible for the Pension Plan provided that they are employed and working with the Company for at least 100 days during the year and remain employed as of the last day of the year. Employees do not make contributions to the Pension Plan. On behalf of the employee, the Company may contribute to the Pension 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 Pension Plan after five years of service. For the three months ended March 31, 2010 and March 31, 2009, the Company made no contributions to the Pension Plan.

**13. SUBSEQUENT EVENTS**

On March 19, 2010, the Company declared a cash dividend of \$0.17 per share of common stock. The dividends were paid on April 29, 2010 to the stockholders of record as of the close of business on April 7, 2010.

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

In this Quarterly Report on Form 10-Q, “Kohlberg Capital,” “Company,” “we,” “us,” and “our” refer to Kohlberg Capital Corporation, its subsidiaries and its wholly-owned portfolio company, Katonah Debt Advisors, L.L.C. (collectively with its affiliates, “Katonah Debt Advisors”), and related companies, unless the context otherwise requires.

The information contained in this section should be read in conjunction with our financial statements and notes thereto appearing elsewhere in this Quarterly Report. In addition, some of the statements in this report constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The matters discussed in this Quarterly Report, as well as in future oral and written statements by management of Kohlberg Capital, 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 impact of the restatement referred to in this Quarterly Report;
- the impact of material weaknesses and significant deficiencies, including the material weaknesses referred to in this Quarterly Report, or our ability to report our financial condition and results of operations accurately or on a timely basis;
- our informal 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 impact investments that we expect to make;
- the ability of our 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;
- the adequacy of our cash resources and working capital; and
- the timing of cash flows, if any, from the operations of our portfolio companies, including Katonah Debt Advisors.

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 “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2009. 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 of this Quarterly Report.

### GENERAL

We are an internally managed, non-diversified closed-end investment company that has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). We originate, structure and invest in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies. We define the middle market as comprising companies with earnings before interest, taxes, depreciation and amortization, which we refer to as “EBITDA,” of \$10 million to \$50 million and/or total debt of \$25 million to \$150 million. In addition to our

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middle market investment business, our wholly-owned portfolio company, Katonah Debt Advisors, manages collateralized loan obligation funds (“CLO Funds”) that invest in broadly syndicated loans, high-yield bonds and other corporate credit instruments. We acquired Katonah Debt Advisors and certain related assets prior to our initial public offering from affiliates of Kohlberg & Co., LLC (“Kohlberg & Co.”), a leading private equity firm focused on middle market investing. As of March 31, 2010, Katonah Debt Advisors had approximately \$2.1 billion of assets under management.

Our investment objective is to generate current income and capital appreciation from our investments. We also expect to continue to receive distributions of recurring fee income and to generate capital appreciation from our investment in the asset management business of Katonah Debt Advisors. Our investment portfolio as well as the investment portfolios of the CLO Funds in which we have invested and the investment portfolios of the CLO Funds managed by Katonah Debt Advisors consist exclusively of credit instruments and other securities issued by corporations and do not include any asset-backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings.

As a Regulated Investment Company (“RIC”), we intend to distribute to our stockholders substantially all of our net taxable income and the excess of realized net short-term capital gains over realized net long-term capital losses. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements. Pursuant to these elections, we generally will not have to pay corporate-level taxes on any income that we distribute to our stockholders.

Our common stock is traded on The NASDAQ Global Select Market under the symbol “KCAP.” The net asset value (“NAV”) per share of our common stock at March 31, 2010 was \$9.62. On March 31, 2010, the last reported sale price of a share of our common stock on The NASDAQ Global Select Market was \$5.66.

## KEY QUANTITATIVE AND QUALITATIVE FINANCIAL MEASURES AND INDICATORS

### *Net Asset Value*

Our NAV per share was \$9.62 and \$9.56 as of March 31, 2010 and December 31, 2009, respectively. As we must report our assets at fair value for each reporting period, NAV also represents the amount of equity per share for the reporting period. Our NAV is comprised mostly of investment assets less debt and other liabilities:

	March 31, 2010		December 31, 2009	
	Fair Value <sup>1</sup>	Per Share <sup>1</sup>	Fair Value <sup>1</sup>	Per Share <sup>1</sup>
Investments at fair value:				
Investments in time deposits	\$ 20,055,211	\$ 0.89	\$ 126	\$ —
Investments in money market accounts	216,099	0.01	—	—
Investments in debt securities	276,453,163	12.30	297,356,529	13.30
Investments in CLO Fund securities	51,681,000	2.30	48,971,000	2.19
Investments in equity securities	5,901,400	0.26	4,713,246	0.21
Investments in asset manager affiliates	55,541,948	2.47	58,064,720	2.60
Cash	492,255	0.02	4,140,408	0.18
Restricted Cash	2,474,052	0.12	18,696,023	0.84
Other assets	4,264,592	0.19	7,474,005	0.33
<b>Total Assets</b>	<b>\$417,079,720</b>	<b>\$ 18.56</b>	<b>\$439,416,057</b>	<b>\$ 19.65</b>
Borrowings	\$198,648,255	\$ 8.84	\$218,050,363	\$ 9.75
Other liabilities	2,220,657	0.10	7,469,970	0.34
<b>Total Liabilities</b>	<b>\$200,868,912</b>	<b>\$ 8.94</b>	<b>\$225,520,333</b>	<b>\$ 10.09</b>
<b>NET ASSET VALUE</b>	<b>\$216,210,808</b>	<b>\$ 9.62</b>	<b>\$213,895,724</b>	<b>\$ 9.56</b>

<sup>1</sup> Our balance sheet at fair value and resulting NAV are calculated on a basis consistent with accounting principles generally accepted in the United States of America (“GAAP”). Our per share presentation of such amounts (other than NAV per share) is an internally derived non-GAAP performance measure calculated by dividing the applicable balance sheet amount by outstanding shares. We believe that the per share amounts for such balance sheet items are helpful in analyzing our balance sheet both quantitatively and qualitatively in that our shares may trade based on a percentage of NAV and individual investors may weight certain balance sheet items differently in performing an analysis of the Company.

Please refer to the “—Investment Portfolio” below for a further description of our investment portfolio and the fair value thereof.

### **Leverage**

We use borrowed funds, known as “leverage,” to make investments in an attempt to increase returns to our shareholders by reducing our overall cost of capital. As a BDC, we are limited in the amount of leverage we can incur under the 1940 Act. We are only allowed to borrow amounts if our asset coverage, as defined in the 1940 Act, equals at least 200% immediately after such borrowing. As of March 31, 2010, we had approximately \$199 million of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 209%, above the minimum asset coverage level generally required for a BDC by the 1940 Act. We may also borrow amounts of up to 5% of the value of our total assets for temporary purposes.

Our borrowings are through a secured financing facility (the “Facility”). In connection with the Facility, we are party to a Loan Funding and Servicing Agreement, dated as of February 14, 2007 (as amended, the “LFSA”), by and among us, as the servicer, our wholly-owned, special-purpose bankruptcy remote subsidiary, Kohlberg Capital Funding LLC I, as the borrower (“KCAP Funding” or the “Borrower”), BMO Capital Markets Corp, as the agent (the “Agent”), U.S. Bank National Association, a national banking association, as the trustee (the “Trustee”) and the other lender parties and other parties thereto. In August 2008, we were notified by the lenders that the banks providing the underlying liquidity for the Facility did not intend to renew their liquidity facility to the lenders unless we agreed to certain revised terms for the Facility. The lenders proposed new terms to us as a condition to extending the underlying liquidity purchase agreements. We viewed such proposed terms as unfavorable and did not agree to such new terms, causing the Agent and the lenders to declare a Termination Date based upon their contention that the underlying liquidity purchase agreements had expired, thereby terminating our ability to obtain revolving advances and commencing the amortization of existing borrowings under the Facility. On June 9, 2009, we received a letter from a representative of the lenders alleging that our failure to determine ratings on certain pledged loans and our alleged breach of certain covenants had resulted in the occurrence of a Termination Event under the LFSA and that, as a result, the interest payable under the LFSA would be calculated at the higher default rate (equal to 0.85% above the prime rate plus 0.75%) applicable to periods during which a Termination Event had occurred and was continuing. In a letter dated June 11, 2009, we rejected the alleged breaches and the alleged occurrence of a Termination Event and also asserted that the termination of the revolving period and commencement of the amortization period under the LFSA were wrongful. On August 28, 2009, we filed a complaint in the Supreme Court of the State of New York against the Agent and other lender parties to the LFSA. The complaint reflects our beliefs that the termination of the revolving period and commencement of the amortization period under the LFSA were wrongful and that the assertions of alleged breaches of our obligations under the LFSA and the alleged occurrence of Termination Event(s) were without merit. The complaint also seeks to clarify our rights and obligations under the LFSA.

Since the time the complaint was filed, the Agent, the lenders, and the lender agent parties to the LFSA have served answers seeking dismissal of the complaint and recovery of the defendants’ attorneys’ fees and costs in the action and discovery has commenced. The Agent has sent additional notices of Termination Events, which we believe and have asserted are without merit, based on our alleged inability to comply with certain covenants under the Facility due to the wrongful declaration of a Termination Date, the accompanying termination of the revolving period and commencement of the amortization period. In addition, on April 2, 2010 the Agent sent a notice alleging that our failure to timely deliver annual audited financial statements for the year ended December 31, 2009 would, unless cured within 30 days of the date of the notice, constitute a Termination Event, which we also believe and have asserted is without merit based upon a non-material delay.

Since September 2008, all principal and excess interest collected from the assets securing the Facility have been and continue to be used to amortize the Facility through a maturity date of September 29, 2010 (the last day of the amortization period that the Company has challenged as being wrongfully commenced). Since June 2009, based on the Agent’s assertion (despite our disagreement with such assertion) that a Termination Event occurred, the interest payable under the LFSA has been calculated at an elevated rate (equal to 0.85% above the prime rate plus 0.75%), and we have been paying interest calculated at such higher rate under protest. Also, despite our belief that the amortization period has been wrongfully imposed, we believe we have sufficient cash and liquid assets which could be sold, potentially at a loss, to generate cash to fund normal operations and dividend distributions during the amortization period. At the end of the amortization period, we may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings or we may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

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Under the Facility, we are subject to various covenants including a leverage ratio covenant pursuant to which it must maintain a leverage ratio of no more than one to one based on the ratio of the Facility outstanding balance to our GAAP stockholders' equity balance. As of April 30, 2010, our leverage ratio did not exceed 1:1.

As of the date of filing of this Quarterly Report, the Company believes that it is not in material breach of its obligations under the LFSA, including the financial covenants. However, as described above and further in Part I, "Item 1. Legal Proceedings," the Company and the Borrower are plaintiffs in a pending lawsuit against the Agent and the lenders involving the LFSA. While the Company and the Borrower intend to vigorously pursue the claims set forth in the complaint, neither the outcome of this litigation nor the amount and range of potential damages recoverable by the Company and the Borrower or their exposure associated with this litigation can be determined at this time. There can be no assurance that in connection with such lawsuit or otherwise the Agent and the lenders will not assert additional breaches of the LFSA, including breaches relating to the restatement referred to elsewhere in this Quarterly Report, and there can be no assurance that the Agent and the lenders will not assert that any such breaches give rise to a Termination Event. While the Company and the Borrower believe that they have meritorious claims against the Agent and the lenders in the pending lawsuit and, as a result, the breaches alleged by the Agent and the lenders are not valid in accordance with the terms of the LFSA, there is no assurance that the Company and the Borrower will prevail in such litigation. If the Company and the Borrower do not prevail, the Agent and the lenders may seek to pursue claims based on the alleged breaches, including claims involving a Termination Event. If the Agent and the lenders were to seek to accelerate and seize the collateral either at the end of the amortization period (which the Company has challenged as being wrongfully commenced) or otherwise, and the Company was unsuccessful in obtaining court relief, the Company could be forced to pay the remaining balance of the Facility (approximately \$187 million as of April 30, 2010), which would adversely affect the Company's business, liquidity, financial condition and results of operations.

We estimate that the portfolio of loans securing the Facility will be required to generate an annual rate of return of approximately 3% to cover annual interest payments on obligations incurred under the Facility.

### ***Investment Portfolio Summary Attributes as of and for the Three Months Ended March 31, 2010***

Our investment portfolio generates net investment income which is generally used to fund our dividend. Our investment portfolio consists of three primary components: debt securities, CLO Fund securities and our investment in our wholly owned asset manager, Katonah Debt Advisors. We also have investments in equity securities of approximately \$6 million, which comprises approximately 1% of our investment portfolio. Below are summary attributes for each of our primary investment portfolio components (see "—Investment Portfolio" and "—Results of Operations" for a more detailed description) as of and for the three months ended March 31, 2010:

#### ***Debt Securities***

- represent approximately 68% of total investment portfolio;
- represent credit instruments issued by corporate borrowers;
- no asset-backed securities such as those secured by commercial mortgages or residential mortgages and no consumer borrowings;
- primarily senior secured and junior secured loans (52% and 41% of debt securities, respectively);
- spread across 25 different industries and 71 different entities;
- average balance per investment of approximately \$4 million;
- all but eight issuers are current on their debt service obligations; and
- weighted average interest rate of 5.5%.

#### ***CLO Fund Securities*** (as of the last monthly trustee report prior to March 31, 2010 unless otherwise specified)

- represent approximately 13% of total investment portfolio at March 31, 2010;
- 88% of CLO Fund Securities represent investments in subordinated securities or equity securities issued by CLO Funds and 12% of CLO Fund Securities are rated notes;
- all CLO Funds invest primarily in credit instruments issued by corporate borrowers;
- no asset-backed securities such as those secured by commercial mortgages or residential mortgages and no consumer borrowings;
- ten different CLO Fund securities; six of such CLO Fund securities are managed by Katonah Debt Advisors; and
- six CLO Fund securities, representing 19% of all such securities at fair value or 2% of total investments at fair value, are not currently providing a dividend payment to the Company.

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### *Katonah Debt Advisors*

- represents approximately 14% of total investment portfolio;
- represents our 100% ownership of a CLO Fund manager focused on corporate credit investing;
- has approximately \$2.1 billion of assets under management;
- receives contractual and recurring asset management fees based on par value of managed investments;
- typically receives a one-time structuring fee upon completion of a new CLO Fund;
- may receive an incentive fee upon liquidation of a CLO Fund provided that the CLO Fund achieves a minimum designated return on investment;
- dividends paid by Katonah Debt Advisors are recognized as dividend income from affiliate asset manager on our statement of operations and are an additional source of income to pay our dividend;
- for the three months ended March 31, 2010, Katonah Debt Advisors had pre-tax net income of approximately \$693,000; and
- for the three months ended March 31, 2010, Katonah Debt Advisors made no distributions in the form of a dividend which is recognized as current earnings by the Company.

### **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 which consist primarily of senior and junior secured loans. Our debt securities portfolio is spread across multiple industries and geographic locations, and as such, we are broadly exposed to market conditions and business environments. As a result, although our investments are exposed to market risks, we continuously seek to limit concentration of exposure in any particular sector or issuer.

*Dividends from Investments in CLO Fund Securities.* We generate dividend income from our investments in the securities of CLO Funds (typically preferred shares or subordinated securities) managed by Katonah Debt Advisors and selective investments in securities issued by funds managed by other asset management companies. CLO Funds managed by Katonah Debt Advisors 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 Katonah Debt Advisors as “CLO fund securities managed by affiliate.” The underlying assets in each of the CLO Funds in which we have an investment are generally diversified secured or unsecured corporate debt and exclude mortgage pools or mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities), debt to companies providing mortgage lending and emerging markets investments. Our CLO Fund securities are subordinate to senior bond holders who typically receive a fixed spread over 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 bond holders, 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 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. 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.

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

*Dividends from Affiliate Asset Manager.* We generate dividend income from our investment in Katonah Debt Advisors, an asset management company, which is a wholly-owned portfolio company that primarily manages CLO Funds that invest mainly in broadly syndicated non-investment grade loans, high-yield bonds and other credit instruments issued by corporations. As a manager of CLO Funds, Katonah Debt Advisors receives contractual and recurring management fees as well as an expected one-time structuring fee from the CLO Funds for its management and advisory services. In addition, Katonah Debt Advisors may also earn income related to net interest on assets accumulated for future CLO issuances on which it has provided a first loss guaranty in connection with loan warehouse arrangements for its CLO Funds. Katonah Debt Advisors generates annual operating income equal to the amount by which its fee income exceeds its operating expenses. The annual management fees which Katonah Debt Advisors receives are generally based

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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 Katonah Debt Advisors manages the fund. As a result, the annual management fees earned by Katonah Debt Advisors generally are not subject to market value fluctuations in the underlying collateral. In future years, Katonah Debt Advisors may receive incentive fees upon the liquidation of CLO Funds it manages, provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares.

*Capital Structuring Service Fees.* We may earn ancillary structuring and other fees related to the origination and/or investment in debt and investment securities.

### **Expenses**

Expenses consist primarily of interest expense on outstanding borrowings, compensation expense and general and administrative expenses, including professional fees.

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

*Compensation Expense.* Compensation expense includes base salaries, bonuses, stock compensation, employee benefits and employer related payroll costs. The largest components of total compensation costs are base salaries and bonuses; generally, base salaries are expensed as incurred and annual bonus expenses are estimated and accrued. Our compensation arrangements with our employees contain a significant 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 include professional fees, occupancy costs and general administrative and other costs.

### **Net Change in Unrealized Depreciation on Investments**

During the three months ended March 31, 2010, our investments had a net change in unrealized appreciation of approximately \$1 million. The net change in unrealized appreciation for the three months ended March 31, 2010 is primarily due to (i) an approximate \$4 million net increase in the market value of certain broadly syndicated loans as a result of current market conditions; (ii) an approximate \$3 million increase in the net value of CLO Fund securities; and (iii) an approximate \$5 million decrease in the unrealized appreciation of Katonah Debt Advisors.

### **Net Change in Stockholders' Equity Resulting From Operations**

The net change in stockholders' equity resulting from operations for the three months ended March 31, 2010 and 2009 was an increase of approximately \$2 million and \$9 million, respectively, or an increase of \$0.07 and \$0.40 per share, respectively.

### **Net Investment Income and Net Realized Gains (Losses)**

Net investment income and net realized gains (losses) represents the net change in stockholders' equity before net unrealized appreciation or depreciation on investments. For the three months ended March 31, 2010 and 2009, net investment income and realized gains (losses) was approximately \$306,000 and \$4 million, respectively, or \$0.01 and \$0.20, per share, respectively.

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### **Dividends**

For the three months ended March 31, 2010, we declared a \$0.17 dividend per share. As a result, there was a dividend distribution of approximately \$5 million for the first quarter declaration, which was booked in the second quarter.

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

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

The amount of our declared dividends, as evaluated by management and approved by our Board of Directors, is based on our evaluation of both distributable income for tax purposes and GAAP net investment income (which excludes unrealized gains and losses). Generally, we seek to fund our dividends from GAAP current earnings, primarily from net interest and dividend income generated by our investment portfolio and without a return of capital or a high reliance on realized capital gains. The following table sets forth the quarterly dividends declared by us in the two most recently completed years, which represent an amount equal to our estimated net investment income for the specified quarter, including income distributed from Katonah Debt Advisors received by the Company, plus a portion of any prior year undistributed amounts of net investment income distributed in subsequent years:

	<u>Dividend</u>	<u>Declaration Date</u>	<u>Record Date</u>	<u>Pay Date</u>
2010:				
First quarter	\$ 0.17	3/19/2010	4/7/2010	4/29/2010
2009:				
Fourth quarter	\$ 0.20	12/15/2009	12/28/2009	1/25/2010
Third quarter	0.24	9/24/2009	10/9/2009	10/29/2009
Second quarter	0.24	6/12/2009	7/9/2009	7/29/2009
First quarter	0.24	3/23/2009	4/8/2009	4/29/2009
Total declared for 2009	<u>\$ 0.92</u>			
2008:				
Fourth quarter	\$ 0.27	12/19/2008	12/31/2008	1/29/2009
Third quarter	0.35	9/19/2008	10/9/2008	10/28/2008
Second quarter	0.41	6/13/2008	7/9/2008	7/28/2008
First quarter	<u>0.41</u>	3/14/2008	4/8/2008	4/28/2008
Total declared for 2008	<u>\$ 1.44</u>			

Due to our ownership of Katonah Debt Advisors and certain timing, structural and tax considerations, our dividend distributions may include a return of capital for tax purposes. For the three months ended March 31, 2010, Katonah Debt Advisors had pre-tax net income of approximately \$693,000 and made no distributions to us. For the three months ended March 31, 2009, Katonah Debt Advisors had an approximate \$139,000 pre-tax net income and made no distributions to us; dividends are recorded as declared by Katonah Debt Advisors as income on our statement of operations.

## INVESTMENT PORTFOLIO

### *Investment Objective*

Our investment objective is to generate current income and 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, and from our investment in Katonah Debt Advisors. We intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. We primarily invest in first and second lien term loans which, because of their priority in a company's capital structure, we expect will have lower default rates and higher rates of recovery of principal if there is a default and which we expect will create a stable stream of interest income. While our primary investment focus is on making loans to, and selected equity investments in, privately-held middle market companies, we may also invest in other investments such as loans to larger, publicly-traded companies, high-yield bonds and distressed debt securities. We may also receive warrants or options to purchase common stock in connection with our debt investments. In addition, we may also invest in debt and equity securities issued by CLO Funds managed by Katonah Debt Advisors or by other asset managers. However, our investment strategy is to limit the value of our investments in the debt or equity securities issued by CLO Funds to not more than 15% of the value of our total investment portfolio at the time of investment. We invest almost exclusively in credit instruments issued by corporations and do not invest in asset-backed securities such as those secured by commercial mortgages, residential mortgages or other consumer borrowings.

The following table shows the Company's portfolio by security type at March 31, 2010 and December 31, 2009:

Security Type	March 31, 2010			December 31, 2009		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Time Deposits	\$ 20,055,211	\$ 20,055,211	5 %	\$ 126	\$ 126	— %
Money Market Account	216,099	216,099	—	—	—	—
Senior Secured Loan	159,661,792	143,269,131	35	179,425,767	159,075,586	39
Junior Secured Loan	127,591,676	113,403,940	28	129,016,237	114,920,499	28
Mezzanine Investment	25,623,318	15,528,492	4	28,606,852	19,235,444	5
Senior Subordinated Bond	4,206,913	3,870,000	1	3,007,167	2,415,000	1
Senior Unsecured Bond	—	—	—	2,000,000	1,710,000	—
Preferred Stock	400,000	381,600	—	—	—	—
CLO Fund Securities	68,215,662	51,681,000	13	68,195,049	48,971,000	12
Equity Securities	13,543,343	5,901,400	1	12,365,603	4,713,246	1
Affiliate Asset Managers	43,308,942	55,541,948	13	40,751,511	58,064,720	14
Total	<u>\$462,822,956</u>	<u>\$409,848,821</u>	<u>100 %</u>	<u>\$463,368,312</u>	<u>\$409,105,621</u>	<u>100 %</u>

<sup>1</sup> Represents percentage of total portfolio at fair value.

### *Investment Securities*

We invest in senior secured loans, mezzanine debt and, to a lesser extent, equity, of middle market companies in a variety of industries. We generally target companies that generate positive cash flows because we look to cash flows as the primary source for servicing debt. However, we may invest in other industries if we are presented with attractive opportunities.

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

Kohlberg Capital's Board of Directors is ultimately and solely responsible for making a good faith determination of the fair value of portfolio investments on a quarterly basis. Debt and equity securities for which market quotations are readily available are generally valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued by the Board of Directors based on detailed analyses prepared by management, the Valuation Committee of the Board of Directors, and, in certain circumstances, third parties with valuation expertise. Valuations are conducted by management on 100% of the investment portfolio at the end of each quarter. Due to the inherent uncertainty of determining the fair value of

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investments that do not have a readily available market value, the fair value of our investments may differ materially from the values that would have existed had a ready market existed for such investments. Further, such investments may be generally subject to legal and other restrictions on resale or otherwise 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.

We derive fair value for our 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 underlying assets with discount rates imputed by broad market indices, bond spreads and yields for comparable issuers relative to the subject assets (the "Market Yield Approach") and also consider 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. We have identified these two indices as benchmarks for broad market information related to our loan and debt investments. Because we have not identified any market index that directly correlates to the loan and debt investments held by us and therefore use the two benchmark indices, these market indices may require significant adjustment to better correlate such market data for the calculation of fair value of the investment under the Market Yield 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. The appropriateness of specific valuation methods and techniques may change as market conditions and available data change.

In January 2010, the Financial Accounting Standards Board ("FASB") issued guidance that clarifies and requires new disclosures about fair value measurements. The clarifications and requirement to disclose the amounts and reasons for significant transfers between Level I and Level II, as well as significant transfers in and out of Level III of the fair value hierarchy, were adopted by us in the first quarter of 2010. Note 4 – Investments reflects the amended disclosure requirements. The new guidance also requires that purchases, sales, issuances and settlements be presented gross in the Level III reconciliation and that requirement is effective for fiscal years beginning after December 15, 2010 and for interim periods within those years, with early adoption permitted. The Company is evaluating the increased disclosure requirements for implementation by the effective date. Since this new guidance only amends the disclosures requirements, it did not impact our statements of financial position, statements of operations, or cash flow statements.

ASC Fair Value Measurements and Disclosures ("*Fair Value Measurements and Disclosures*") requires the disclosure in interim and annual periods of the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period.

We engaged Valuation Research Corporation ("VRC"), an independent valuation firm, to provide third-party valuation estimates for approximately 39% and 40% of investments at fair value as of December 31, 2009 and December 31, 2008, respectively. VRC's valuation estimates were considered as one of the relevant data inputs in the Company's determination of fair value. The Board of Directors intends to continue to engage an independent valuation firm in the future to provide certain valuation services, including the review of certain portfolio assets, as part of our annual year end valuation process.

The majority of our 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, including 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.

### ***Loans and Debt Securities.***

To the extent that our investments are exchange traded and are priced or have sufficient price indications from normal course trading at or around the valuation date (financial reporting date), such pricing will determine fair value. Pricing service marks from third party pricing services may be used as an indication of fair value, depending on the volume and reliability of the marks, sufficient and reasonable correlation of bid and ask quotes, and, most importantly, the level of actual trading activity. However, most of our

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investments are illiquid investments with little or no trading activity. Further, we have been unable to identify directly comparable market indices or other market guidance that correlate directly to the types of investments we own. As a result, for most of our assets, we determine fair value using alternative methodologies and models using available market data, as adjusted, to reflect the types of assets we own, their structure, qualitative and credit attributes and other asset specific characteristics.

We derive fair value for our illiquid investments that do not have indicative fair values based upon active trades primarily by using the Market Yield Approach and also consider 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. We have identified these two indices as benchmarks for broad market information related to our loan and debt investments. Because we have not identified any market index that directly correlates to the loan and debt investments held by us and therefore use the two benchmark indices, these market indices may require significant adjustment to better correlate such market data for the calculation of fair value of the investment under the Market Yield 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.

### ***Equity and Equity-Related Securities.***

Our equity and equity-related 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, 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. The values of our equity and equity-related securities in public companies for which market quotations are readily available are based upon the closing public market price on the balance sheet date. Securities that carry certain restrictions on sale are typically valued at a discount from the public market value of the security.

The significant inputs used to determine the fair value of equity and equity-related securities include prices, earnings, EBITDA and cash flows after capital expenditures for similar peer comparables and the investment entity itself. Equity and equity related 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 as 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.

At March 31, 2010, the our investments in loans and debt securities, excluding CLO Fund securities, had a weighted average interest rate of approximately 5.5%.

The investment portfolio (excluding our investment in asset manager affiliates and CLO Funds) at March 31, 2010 was spread across 25 different industries and 72 different entities with an average balance per entity of approximately \$4 million. As of March 31, 2010, all but six of our portfolio companies were current on their debt service obligations. Our portfolio, including the CLO Funds in which it invests, and the CLO Funds managed by Katonah Debt Advisors consist almost exclusively of credit instruments issued by corporations and do not include investments in asset-backed securities, such as those secured by commercial mortgages, residential mortgages or other consumer borrowings.

We may invest up to 30% of our investment portfolio in opportunistic investments in high-yield bonds, debt and equity securities of CLO Funds, distressed debt or equity securities of public companies. However, our investment strategy is to limit the value of our investments in the debt or equity securities issued by CLO Funds to not more than 15% of the value of our total investment portfolio at the time of investment. We expect that these public companies generally will have debt that is non-investment grade. We also may invest in debt of middle market companies located outside of the United States, which investments are generally not anticipated to be in excess of 10% of our investment portfolio at the time such investments are made. At March 31, 2010, approximately 18% of our

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investments were foreign assets (which includes our investments in CLO Funds, which are typically domiciled outside the U.S. and represent approximately 13% of our portfolio). We are generally prohibited from buying or selling any security from or to any portfolio company of a private equity fund managed by Kohlberg & Co. without the prior approval of the U.S. Securities and Exchange Commission (the "Commission" or the "SEC"). However, we may co-invest on a concurrent basis with Kohlberg & Co. or any of our affiliates, subject to compliance with existing regulatory guidance, applicable regulations and our allocation procedures. Certain types of negotiated co-investments may be made only if we receive an order from the SEC permitting us to do so. There can be no assurance that any such order will be applied for or, if applied for, obtained.

At March 31, 2010, our ten largest portfolio companies represented approximately 39% of the total fair value of our investments. Our largest investment, Katonah Debt Advisors which is our wholly-owned portfolio company, represented 14% of the total fair value of our investments. Excluding Katonah Debt Advisors and CLO Fund securities, our ten largest portfolio companies represent approximately 19% of the total fair value of our investments.

### **CLO Fund Securities**

We typically make a minority investment in the subordinated securities or preferred stock of CLO Funds raised and managed by Katonah Debt Advisors and may selectively invest in securities issued by CLO Funds managed by other asset management companies. As of March 31, 2010, we had approximately \$52 million invested in CLO Fund securities, including those issued by funds managed by Katonah Debt Advisors.

The CLO Funds managed by Katonah Debt Advisors 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 we have an investment are generally diversified secured or unsecured corporate debt. The underlying assets in our CLO Funds exclude mortgage pools or mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities), debt to companies providing mortgage lending and emerging markets investments.

Our CLO Fund securities as of March 31, 2010 and December 31, 2009 are as follows:

CLO Fund Securities	Investment	% <sup>1</sup>	March 31, 2010		December 31, 2009	
			Cost	Fair Value	Cost	Fair Value
Grant Grove CLO, Ltd. <sup>3</sup>	Subordinated Securities	22.2 %	\$ 4,716,805	\$ 3,210,000	\$ 4,715,858	\$ 2,780,000
Katonah III, Ltd.	Preferred Shares	23.1	4,500,000	960,000	4,500,000	950,000
Katonah IV, Ltd. <sup>3</sup>	Preferred Shares	17.1	3,150,000	490,000	3,150,000	290,000
Katonah V, Ltd. <sup>3</sup>	Preferred Shares	26.7	3,320,000	1,000	3,320,000	1,000
Katonah VII CLO Ltd. <sup>2,3</sup>	Subordinated Securities	16.4	4,500,000	2,190,000	4,500,000	1,840,000
Katonah VIII CLO Ltd. <sup>2,3</sup>	Subordinated Securities	10.3	3,400,000	2,000,000	3,400,000	1,760,000
Katonah IX CLO Ltd. <sup>2,3</sup>	Preferred Shares	6.9	2,000,000	1,700,000	2,000,000	1,560,000
Katonah X CLO Ltd. <sup>2</sup>	Subordinated Securities	33.3	11,595,274	8,480,000	11,589,830	8,280,000
Katonah 2007-1 CLO Ltd. <sup>2</sup>	Preferred Shares	100.0	29,953,189	26,350,000	29,940,867	27,100,000
Katonah 2007-1 CLO Ltd. <sup>2</sup>	Class B-2L Notes	100.0	1,080,394	6,300,000	1,078,494	4,410,000
<b>Total</b>			<b>\$ 68,215,662</b>	<b>\$ 51,681,000</b>	<b>\$ 68,195,049</b>	<b>\$ 48,971,000</b>

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

<sup>2</sup> An affiliate CLO Fund managed by Katonah Debt Advisors.

<sup>3</sup> As of March 31, 2010, these CLO Fund securities were not providing a dividend distribution.

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 cash outflows for interest expense, debt paydown 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 us, (ii) the NAV of the CLO Fund for 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 are negligible net cash distributions to the class of securities

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owned by us, or (iii) a discounted cash flow model for more recent CLO Funds 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 we have invested. 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 NAVs 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 investments. We determine the fair value of our investments in CLO Fund securities on an individual security-by-security basis.

Due to the individual attributes of each CLO Fund security, they are classified as a Level III (as described in “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies—Valuation Of Portfolio Investments”) investment unless specific trading activity can be identified at or near the valuation date. When available, Level II (as described in “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies—Valuation Of Portfolio Investments”) 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 characterizations 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. We evaluate 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 bond rated 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 considers other factors such as the default and recovery rates of underlying assets in the CLO Fund, as may be applicable. Such model assumptions may vary and incorporate adjustments for risk premiums and CLO Fund specific attributes. Such adjustments require judgment and may be material to the calculation of fair value.

The unaudited table below summarizes certain attributes of each CLO Fund as per their most recent trustee report as of March 31, 2010:

<u>CLO Fund Securities<sup>1</sup></u>	<u>Number of Securities</u>	<u>Number of Issuers</u>	<u>Number of Industries</u>	<u>Average Security Position Size</u>	<u>Average Issuer Position Size</u>
Grant Grove CLO, Ltd.	228	169	32	\$ 1,208,828	\$ 1,630,845
Katonah III, Ltd.	278	170	30	1,269,369	2,075,792
Katonah IV, Ltd.	247	164	27	1,001,737	1,508,714
Katonah V, Ltd.	281	189	30	573,517	852,689
Katonah VII CLO Ltd.	258	197	33	1,307,892	1,712,874
Katonah VIII CLO Ltd.	273	201	33	1,378,528	1,872,329
Katonah IX CLO Ltd.	266	204	33	1,542,124	2,010,808
Katonah X CLO Ltd.	256	200	32	1,879,876	2,406,242
Katonah 2007-1 CLO Ltd.	217	174	31	1,414,304	1,763,816

<sup>1</sup> All data from most recent trustee reports as of March 31, 2010.

In May 2009, we purchased the class B-2L notes of the Katonah 2007-1 CLO investment managed by Katonah Debt Advisors (“Katonah 2007-1 B-2L”). We purchased the Katonah 2007-1 B-2L for 10% of the par value. The fair value, cost basis, and aggregate unrealized appreciation of the Katonah 2007-1 B-2L investment as of March 31, 2010 were approximately \$6 million, \$1 million, and \$5 million, respectively, and at December 31, 2009, the fair value, cost basis, and aggregate unrealized appreciation of the Katonah 2007-1 B-2L investment were \$4 million, \$1 million, and \$3 million, respectively. Both the B-2L notes and preferred shares of Katonah 2007-1 are owned 100% by us and Katonah 2007-1 is current in the payment of all quarterly distributions in respect of the B-2L notes and the preferred shares.

### ***Katonah Debt Advisors***

Katonah Debt Advisors is our wholly-owned asset management company that manages CLO Funds that invest in broadly syndicated loans, high yield bonds and other credit instruments. The CLO Funds managed by Katonah Debt Advisors consist exclusively of credit instruments issued by corporations and do not invest in asset-backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings. As of March 31, 2010, Katonah Debt Advisors had approximately \$2.1 billion of par value of assets under management on which it earns management fees, and was valued at approximately \$56 million.

As a manager of the CLO Funds, Katonah Debt Advisors receives contractual and recurring management fees as well as an expected one-time structuring fee from the CLO Funds for its management and advisory services. In addition, Katonah Debt Advisors may also earn income related to net interest on assets accumulated for future CLO issuances on which it has provided a first loss guaranty in connection with loan warehouse arrangements for its CLO Funds. Katonah Debt Advisors generates annual operating income equal to the amount by which its fee income exceeds its operating expenses.

The annual management fees which Katonah Debt Advisors receives 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 Katonah Debt Advisors manages the fund. As a result, the annual management fees earned by Katonah Debt Advisors are not subject to market value fluctuations in the underlying collateral. The annual management fees Katonah Debt Advisors receives have two components - a senior management fee and a subordinated management fee. At March 31, 2010, Katonah Debt Advisors continued to receive all senior management fees payable by the CLO Funds managed by it. However, certain CLO Funds (representing approximately \$1.2 billion of the \$2.1 billion of Katonah Debt Advisors' assets under management), are not paying their subordinated management fee. These subordinated management fees, totaling approximately \$4 million per year, have been restricted from being paid as a result of the failure by the CLO Funds to satisfy certain restrictive covenants contained in their indenture agreements. Such subordinated management fees continue to be accrued by the applicable CLO Fund (and on the books of Katonah Debt Advisors), and will be payable to Katonah Debt Advisors if and when such CLO Fund becomes compliant with the applicable covenants. As of March 31, 2010, approximately \$6 million of subordinated management fees have been accrued and Katonah Debt Advisors currently expects a portion of such fees to become payable to it within the next year. However, there can be no assurance that these fees will become payable or, if they do become payable, that the applicable CLO Fund will have sufficient cash to make the payments to Katonah Debt Advisors.

In future years, Katonah Debt Advisors may receive incentive fees upon the liquidation of CLO Funds it manages, provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares.

Subject to market conditions, we expect to continue to make investments in CLO Funds managed by Katonah Debt Advisors, which we believe will provide us with a current cash investment return. We believe that these investments will provide Katonah Debt Advisors with greater opportunities to access new sources of capital which will ultimately increase Katonah Debt Advisors' assets under management and resulting management fee income. We also expect to receive distributions of recurring fee income and, if debt markets stabilize and recover, to generate capital appreciation from our investment in the asset management business of Katonah Debt Advisors.

The revenue that Katonah Debt Advisors generates through the fees it receives for managing CLO Funds and after paying the expenses pursuant to an overhead allocation agreement with the Company associated with its operations, including compensation of its employees, may be distributed to Kohlberg Capital. Cash distributions of Katonah Debt Advisors' net income are recorded as dividends from an affiliate asset manager when declared. As with all other investments, Katonah Debt Advisors' fair value is periodically determined. Our investment in Katonah Debt Advisors is carried at fair value, which is determined after taking into consideration a percentage of assets under management and a discounted cash flow model incorporating different levels of discount rates depending on the hierarchy of fees earned (including the likelihood of realization of senior, subordinate and incentive fees) and prospective modeled performance. Such valuation includes an analysis of comparable asset management companies. Katonah Debt Advisors is classified as a Level III investment. Any change in value from period to period is recognized as net change in unrealized appreciation or depreciation.

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### PORTFOLIO AND INVESTMENT ACTIVITY

Our primary business is lending to and investing in middle-market businesses through investments in senior secured loans, junior secured loans, subordinated/mezzanine debt investments, CLO equity investments and other equity-based investments, which may include warrants.

Total portfolio investment activity (excluding activity in time deposit and money market investments) for the three months ended March 31, 2010 and for the year ended December 31, 2009 was as follows:

	<u>Debt Securities</u>	<u>CLO Fund Securities</u>	<u>Equity Securities</u>	<u>Affiliate Asset Managers</u>	<u>Total Portfolio</u>
Fair Value at December 31, 2008 (as restated)	\$353,859,007	\$34,640,000	\$ 5,089,365	\$54,734,812	\$448,323,184
2009 Activity:					
Purchases / originations / draws	\$ 4,369,834	\$ 1,076,250	\$ 8,625,627	\$ 4,018,309	\$ 18,940,558
Pay-downs / pay-offs / sales	(72,227,405)	—	—	—	(72,227,405)
Net accretion of discount	964,724	742,204	—	—	1,706,928
Net realized losses	(12,050,370)	—	(1,516,682)	(2,215,069)	(15,782,121)
Increase (decrease) in fair value	<u>25,300,586</u>	<u>12,512,546</u>	<u>(7,485,064)</u>	<u>1,526,668</u>	<u>31,854,736</u>
Fair Value at December 31, 2009	297,356,529	48,971,000	4,713,246	58,064,720	409,105,495
Year to Date 2010 Activity:					
Purchases / originations / draws	2,420,620	—	1,177,740	2,557,431	6,155,791
Pay-downs / pay-offs / sales	(24,842,746)	—	—	—	(24,842,746)
Net accretion of discount	121,943	20,613	—	—	142,556
Net realized losses	(2,272,141)	—	—	—	(2,272,141)
Increase (decrease) in fair value	<u>3,668,958</u>	<u>2,689,387</u>	<u>10,414</u>	<u>(5,080,203)</u>	<u>1,288,556</u>
Fair Value at March 31, 2010	<u>\$276,453,163</u>	<u>\$51,681,000</u>	<u>\$ 5,901,400</u>	<u>\$55,541,948</u>	<u>\$389,577,511</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.

### RESULTS OF OPERATIONS

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

Set forth below is a discussion of our results of operations for the three months ended March 31, 2010 and 2009 as restated.

#### **Investment Income**

Investment income for the three months ended March 31, 2010 and 2009 was approximately \$7 million and \$9 million, respectively. Of this amount, approximately \$5 million and \$7 million, respectively, was attributable to interest income on our loan and bond investments. For the three months ended March 31, 2010 and 2009, approximately \$2 million and \$3 million, respectively, of investment income was attributable to dividends earned on CLO equity investments.

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.

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Dividends from CLO Fund securities are dependent on the performance of the underlying assets in each CLO Fund; interest payments, principal amortization and prepayments of the underlying loans in each CLO Fund are primary factors which determine the level of income on our CLO Fund securities. The level of excess spread from CLO Fund securities can be impacted by the timing and level of the resetting of the benchmark interest rate for the underlying assets (which reset at various times throughout the quarter) in the CLO Fund and the related CLO Fund bond liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and distributions to us can vary significantly.

### ***Dividends from Affiliate Asset Manager***

As of March 31, 2010, our investment in Katonah Debt Advisors was approximately \$56 million. For the three months ended March 31, 2010 and 2009, Katonah Debt Advisors had pre-tax net income of approximately \$693,000 and net loss of \$9,000, respectively. For the three months ended March 31, 2010 and 2009, Katonah Debt Advisors made no distributions of net income.

Distributions of Katonah Debt Advisors' net income are recorded as dividends from affiliate asset manager. The Company intends to distribute the accumulated undistributed net income of Katonah Debt Advisors in the future. For purposes of calculating distributable tax income for required quarterly dividends as a RIC, Katonah Debt Advisors' net income is further reduced by approximately \$2 million per annum for tax goodwill amortization resulting from its acquisition by us prior to our initial public offering ("IPO"). As a result, the amount of our declared dividends, as evaluated by management and approved by our Board of Directors, is based on our evaluation of both distributable income for tax purposes and GAAP net investment income (which excludes unrealized gains and losses).

### ***Expenses***

Total expenses for the three months ended March 31, 2010 and 2009 were approximately \$4 million and \$3 million, respectively. Interest expense and amortization on debt issuance costs for the period, which includes facility and program fees on the unused loan balance, were approximately \$3 million and \$2 million on average debt outstanding of \$203 million and \$254 million, respectively. Approximately \$788,000 and \$801,000, respectively, of expenses were attributable to employment compensation, including salaries, bonuses and stock option expense for the three months ended March 31, 2010 and 2009. For the three months ended March 31, 2010 and 2009, other expenses included approximately \$901,000 and \$690,000, respectively, for professional fees, insurance, administrative and other. For the three months ended March 31, 2010 and 2009, administrative and other costs totaled approximately \$290,000 and \$262,000, respectively, and include occupancy expense, insurance, technology and other office expenses.

Interest and compensation expense are generally expected to be our largest expenses each period. Interest expense is dependent on the average outstanding principal balance on our Facility and the base index rate for the period. 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 bonus expenses are estimated and accrued since bonuses are paid annually.

### ***Net Unrealized Appreciation on Investments***

During the three months ended March 31, 2010 and 2009, our total investments had a change in net unrealized appreciation of approximately \$1 million and \$4 million, respectively. For the three months ended March 31, 2010, Katonah Debt Advisors had a change in unrealized depreciation of approximately \$5 million, offset by our middle market portfolio of debt securities, equity securities and CLO Fund securities, which had a change in unrealized appreciation of approximately \$6 million. For the three months ended March 31, 2009, Katonah Debt Advisors had a change in unrealized appreciation of approximately \$1 million and our middle market portfolio of debt securities, equity securities and CLO Fund securities had a change in unrealized appreciation of approximately \$3 million.

### ***Net Increase in Stockholders' Equity Resulting From Operations***

The net increase in stockholders' equity resulting from operations for the three months ended March 31, 2010 was approximately \$2 million, or \$0.07, per share. The net increase in stockholders' equity resulting from operations for the three months ended March 31, 2009 was approximately \$9 million or \$0.41, per share.

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

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain investments, pay dividends to our stockholders and other general business needs. We recognize the need to have funds available for operating our business and to make investments. We seek to have adequate liquidity at all times to cover normal cyclical swings in funding availability and to allow us to meet abnormal 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.

In addition to the traditional sources of available funds (issuance of new equity, debt or undrawn warehouse facility capacity), we also have the ability to raise additional cash funds through the securitization of assets on our balance sheet through our wholly-owned asset manager, Katonah Debt Advisors. Such a securitization would provide cash for new investments on our balance sheet as well as additional management fee income and potentially increased value (as a result of increased assets under management) for Katonah Debt Advisors. No new securitizations by Katonah Debt Advisors have closed since January 2008.

As a BDC, we are limited in the amount of leverage we can incur to finance our investment portfolio. In order to incur new debt, we are required to meet a coverage ratio of total assets to total senior securities of at least 200%. For this purpose, senior securities include all borrowings and any preferred stock. As a result, our ability to utilize leverage as a means of financing our portfolio of investments is limited by this asset coverage test. As of March 31, 2010, we had \$199 million of outstanding borrowings and our asset coverage was 209%, which is above the minimum asset coverage level generally required by the 1940 Act for a BDC to incur new debt.

As of March 31, 2010 and December 31, 2009, the fair value of investments and cash were as follows:

<u>Security Type</u>	<u>Investments at Fair Value</u>	
	<u>March 31, 2010</u>	<u>December 31, 2009</u>
Cash	\$ 492,255	\$ 4,140,408
Time Deposits	20,055,211	126
Money Market Accounts	216,099	—
Senior Secured Loan	143,269,131	159,075,586
Junior Secured Loan	113,403,940	114,920,499
Mezzanine Investment	15,528,492	19,235,444
Senior Subordinated Bond	3,870,000	2,415,000
Senior Unsecured Bond	—	1,710,000
CLO Fund Securities	51,681,000	48,971,000
Equity Securities	5,901,400	4,713,246
Affiliate Asset Managers	55,541,948	58,064,720
Total	<u>\$409,959,476</u>	<u>\$ 413,246,029</u>

On February 14, 2007, we entered into the Facility under which we may obtain up to \$200 million in financing. On October 1, 2007, we amended the Facility to increase our borrowing capacity from \$200 million to \$275 million, extend the maturity date from February 12, 2012 to October 1, 2012 and increase the interest spread charged on outstanding borrowings by 15 basis points to 0.85%. The interest rate is based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. Interest is payable monthly. As disclosed above, as a result of the Agent's assertion that a Termination Event occurred under the LFSA, since June 2009 interest under the LFSA has been calculated at a higher default rate (equal to 0.85% above the prime rate plus 0.75%).

Advances under the Facility (to the extent available to us) are used by us primarily to make additional investments. The Facility is secured by loans acquired by us with the advances under the Facility. We borrow under the Facility through our wholly-owned, special-purpose bankruptcy remote subsidiary, KCAP Funding. As described further below, we have not drawn on the Facility since August 2008.

In connection with the Facility, we are party to the LFSA, by and among us as the servicer, KCAP Funding, as the borrower, the Agent, the Trustee, and the

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other lender parties and other parties thereto. As of March 31, 2010 there were outstanding borrowings of approximately \$199 million under the LFSA. In accordance with the terms of the LFSA, the financial assets acquired with the proceeds of borrowings under the LFSA are held in a securities account and are subject to a securities account control agreement granting the Agent certain rights in respect of such securities account and the financial assets held therein. As of March 31, 2010 there were financial assets held in the securities account with a market value of approximately \$273 million. Borrowings under the Facility are secured only by these assets and amounts in respect of such assets on deposit in a concentration account that is subject to an intercreditor and concentration account administration agreement, and the Facility lenders do not have recourse to any other of our assets or the investment income associated with any such other assets. The assets securing the Facility represent approximately 65% of our total assets (at fair value) at March 31, 2010 and contributed approximately 62% of our investment income for the three months ended March 31, 2010.

In August 2008, we were notified by the lenders that the banks providing the underlying liquidity for the Facility did not intend to renew their liquidity facility to the lenders unless we agreed to certain revised terms for the Facility. The lenders proposed new terms to us as a condition to extending the underlying liquidity purchase agreements. We viewed such proposed terms as unfavorable and did not agree to such new terms, causing the Agent and the lenders to declare a Termination Date based upon their contention that the underlying liquidity purchase agreements had expired, thereby terminating our ability to obtain revolving advances and commencing the amortization of existing borrowings under the Facility. On June 9, 2009, we received a letter from a representative of the lenders alleging that our failure to determine ratings on certain pledged loans and our alleged breach of certain covenants had resulted in the occurrence of a Termination Event under the LFSA and that, as a result, the interest payable under the LFSA would be calculated at the higher default rate (equal to 0.85% above the prime rate plus 0.75%) applicable to periods during which a Termination Event had occurred and was continuing. In a letter dated June 11, 2009, we rejected the alleged breaches and the alleged occurrence of a Termination Event and also asserted that the termination of the revolving period and commencement of the amortization period under the LFSA were wrongful. On August 28, 2009, we filed a complaint in the Supreme Court of the State of New York against the Agent and other lender parties to the LFSA. The complaint reflects our beliefs that the termination of the revolving period and commencement of the amortization period under the LFSA were wrongful and that the assertions of alleged breaches of our obligations under the LFSA and the alleged occurrence of Termination Event(s) were without merit. The complaint also seeks to clarify our rights and obligations under the LFSA.

Since the time the complaint was filed, the Agent, the lenders, and the lender agent parties to the LFSA have served answers seeking dismissal of the complaint and recovery of the defendants' attorneys' fees and costs in the action and discovery has commenced. The Agent has sent additional notices of Termination Events, which we believe and have asserted are without merit, based on our alleged inability to comply with certain covenants under the Facility due to the wrongful declaration of a Termination Date, the accompanying termination of the revolving period and commencement of the amortization period. In addition, on April 2, 2010 the Agent sent a notice alleging that our failure to timely deliver annual audited financial statements for the year ended December 31, 2009 would, unless cured within 30 days of the date of the notice, constitute a Termination Event, which we also believe and have asserted is without merit based upon a non-material delay.

Since September 2008, all principal and excess interest collected from the assets securing the Facility have been and continue to be used to amortize the Facility through a maturity date of September 29, 2010 (the last day of the amortization period that the Company has challenged as being wrongfully commenced). Since June 2009, based on the Agent's assertion (despite our disagreement with such assertion) that a Termination Event occurred, the interest payable under the LFSA has been calculated at an elevated rate (equal to 0.85 % above the prime rate plus 0.75%), and we have been paying interest calculated at such higher rate under protest. Also, despite our belief that the amortization period has been wrongfully imposed, we believe we have sufficient cash and liquid assets which could be sold, potentially at a loss, to generate cash to fund normal operations and dividend distributions during the amortization period. At the end of the amortization period, we may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings or we may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

Under the Facility, the Company is subject to various covenants including a leverage ratio covenant pursuant to which it must maintain a leverage ratio of no more than one to one based on the ratio of the Facility's outstanding balance to the Company's GAAP stockholders' equity balance. As of April 30, 2010, the Company's leverage ratio did not exceed 1:1.

As of the date of filing of this Quarterly Report, the Company believes that it is not in material breach of its obligations under the LFSA, including the financial covenants. However, as described above and further in Part II, "Item 1. Legal Proceedings," the Company and the Borrower are plaintiffs in a pending lawsuit against the Agent and the lenders involving the LFSA. While the Company and the Borrower intend to vigorously pursue the claims set forth in the complaint, neither the outcome of this litigation nor the amount and range of potential damages recoverable by the Company and the Borrower or their exposure associated with this litigation can be determined at this time. There can be no assurance that in connection with such lawsuit or otherwise the Agent and the lenders will not assert additional breaches of the LFSA, including breaches relating to the restatement referred to elsewhere in this Quarterly Report, and there can be no assurance that the Agent and the lenders will not assert that any such breaches give rise to a Termination Event. While the Company and the Borrower believe that they have meritorious claims against the Agent and the lenders

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in the pending lawsuit and, as a result, the breaches alleged by the Agent and the lenders are not valid in accordance with the terms of the LFSA, there is no assurance that the Company and the Borrower will prevail in such litigation. If the Company and the Borrower do not prevail, the Agent and the lenders may seek to pursue claims based on the alleged breaches, including claims involving a Termination Event. If the Agent and the lenders were to seek to accelerate and seize the collateral either at the end of the amortization period (which the Company has challenged as being wrongfully commenced) or otherwise, and the Company was unsuccessful in obtaining court relief, the Company could be forced to pay the remaining balance of the Facility (approximately \$187 million as of April 30, 2010), which would adversely affect our business, liquidity, financial condition and results of operations. We estimate that the portfolio of loans securing the Facility will be required to generate an annual rate of return of approximately 3% to cover annual interest payments on obligations incurred under the Facility.

The weighted average daily debt balance for the three months ended March 31, 2010 and 2009 was approximately \$203 million and \$254 million, respectively. For the three months ended March 31, 2010 and 2009, the weighted average interest rate on weighted average outstanding borrowings was approximately 5% and 2% respectively, which excludes the amortization of deferred financing costs and facility and program fees on unfunded balances. As of March 31, 2010, we had restricted cash balances of approximately \$15 million which we maintained in accordance with the terms of the Facility. The Facility contains collateral requirements, including, but not limited to, minimum diversity, rating and yield, and limitations on loan size.

We are currently using any income generated by the assets collateralizing the Facility to pay principal, interest and other expenses of the Facility – despite the fact that, if we want to remain a RIC and continue to be afforded favorable tax treatment for U.S. federal income tax purposes, we are required to distribute to the shareholders substantially all of our investment company taxable income, including the net amounts generated by the collateralized assets. These collateralized assets with a market value of approximately \$273 million represent approximately 65% of our total assets (at fair value) at March 31, 2010 and contributed approximately 62% of the Company's investment income for the quarter ended March 31, 2010. Because we are using net interest income earned on the assets securing the Facility to amortize the Facility during the amortization period (which the Company has challenged as being wrongfully commenced), we may need to sell other assets not pledged to the Facility, potentially at a loss, in order to generate sufficient cash to make the required dividend distributions necessary to maintain our RIC status. In addition, at the end of the amortization period, we may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings. Any such asset sale could adversely affect our business, liquidity, financial condition and results of operations. We expect that our cash on hand, liquid investments, and cash generated from operations, including income earned from investments and any income distributions made by Katonah Debt Advisors, our wholly-owned portfolio company, will be adequate to meet our liquidity needs and distribution requirements over the next twelve months.

If we are unable to renew or replace the Facility, our liquidity may be significantly reduced. If these conditions continue for a prolonged period of time, or worsen in the future, we could lose key employees and our business prospects could be negatively impacted. Even if we are able to renew or replace the Facility, such new debt capital may be at a higher cost and/or on less favorable terms and conditions than the Facility. In addition, equity capital is, and may continue to be, difficult to raise because, subject to limited exceptions, we may not issue and sell shares of our common stock at a price below NAV without stockholder approval and issuing equity at depressed stock prices can be dilutive to our stockholders. These factors and our inability to raise additional capital to date have resulted in a reduction in new originations, curtailed our ability to grow and have had a negative impact on our liquidity and operating results. The continued inability to raise additional capital could further constrain our liquidity, negatively impact our business prospects, cause the departure of key employees and negatively impact our operating results.

## **COMMITMENTS**

We are a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the needs of our 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 our balance sheet. Prior to extending such credit, we attempt to limit our credit risk by conducting extensive due diligence, obtaining collateral where necessary and negotiating appropriate financial covenants. As of both March 31, 2010 and December 31, 2009, we had committed to make a total of approximately \$2 million and \$2 million, respectively, of investments in various revolving senior secured loans, of which approximately \$640,000 had been funded as of March 31, 2010 and \$640,000 had been funded as of December 31, 2009. As of March 31, 2010 and December 31, 2009, we had no investments in delayed draw senior secured loans.

In October 2007, Katonah Debt Advisors entered into a letter agreement (the "Letter Agreement") with Bear Stearns & Co. Inc. ("Bear Stearns") in connection with a warehouse credit line established to fund the initial accumulation of assets for three CLO Funds, pursuant to which agreement Katonah Debt Advisors undertook certain "first loss" commitments with respect to potential losses on assets purchased using the warehouse credit line. Such "first loss" commitments relate to (i) losses (if any) as a result of individual

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loan investments being ineligible for purchase by a new CLO Fund (typically due to a payment default on such loan) when such fund formation is completed or (ii) if a new CLO Fund has not been completed before the expiration of the related warehouse credit line, the loss (if any, and net of any accumulated interest income) on the resale of loans and debt securities funded by such warehouse credit line.

Under the Letter Agreement, Katonah Debt Advisors also engaged Bear Stearns to structure and raise three CLO Funds to be managed by Katonah Debt Advisors (directly or indirectly through a services contract with an affiliate of Katonah Debt Advisors). While one of these funds, the Katonah 2007-1 CLO Fund, in which Kohlberg Capital invested approximately \$29 million to acquire all of the shares of the most junior class of securities, was completed, neither of the other 2008 CLO Funds were successfully raised.

As a result, pursuant to the Letter Agreement, both Katonah Debt Advisors and J.P. Morgan Securities Inc. (“JPMorgan”) (f/k/a Bear Stearns & Co. Inc.) asserted claims against each other and defenses thereto with respect to potential “first loss” payments. Without admitting any liability or wrongdoing, Katonah Debt Advisors and JPMorgan agreed to compromise and settle all of the disputes, issues and claims between them relating to the agreements in exchange for an agreement to terminate all obligations and liabilities of Katonah Debt Advisors and JPMorgan under the existing agreements relating to the 2008 CLO Funds, payment by Katonah Debt Advisors of an aggregate of \$6 million in installments over a period of one year and the forfeiture by Katonah Debt Advisors of the net interest income earned through the settlement date on the warehoused assets. In December 2008, Katonah Debt Advisors entered into a settlement and termination agreement with JPMorgan reflecting the settlement terms described above.

As a result of this settlement, Katonah Debt Advisors recognized a \$6 million settlement cost and write-off of previously accrued net interest income on warehoused assets of approximately \$4 million for the year ended December 31, 2008. We recognized the impact of this settlement and forfeiture of warehouse income as a non-cash reduction to the unrealized appreciation of our value of the investment in Katonah Debt Advisors and contributed additional equity to Katonah Debt Advisors. Consequently, this settlement is not expected to have a material impact on Kohlberg Capital’s net investment income or quarterly dividend.

## **CRITICAL ACCOUNTING POLICIES**

The 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.

### ***Basis of Presentation***

The accompanying unaudited condensed financial statements have been prepared on the accrual basis of accounting in conformity with GAAP for interim financial information. Accordingly, they do not include all of the information and footnotes required for annual financial statements. The unaudited interim 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 fiscal year ended December 31, 2009, as filed with the Commission.

*Accounting Standards Codification.* In June 2009, the FASB issued a pronouncement establishing the FASB Accounting Standards Codification (“ASC”) as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with GAAP. The ASC reorganized existing U.S. accounting and reporting standards issued by the FASB and other related private sector standard setters into a single source of authoritative accounting principles arranged by topic. The standard explicitly recognizes rules and interpretive releases of the SEC under federal securities laws as authoritative GAAP for SEC registrants. The ASC supersedes all existing U.S. accounting standards; all other accounting literature not included in the ASC (other than SEC guidance for publicly-traded companies) is considered non-authoritative. The ASC was effective on a prospective basis for interim and annual reporting periods ending after September 15, 2009. The adoption of the ASC changed our references to U.S. GAAP accounting standards but did not impact our results of operations, financial position or liquidity.

### **Valuation of Portfolio Investments**

The most significant estimate inherent in the preparation of our 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 generally (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 a valuation methodology 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 of the portfolio company. Because of the inherent uncertainty of valuation, the Board of Directors' determined values may differ materially from the values that would have been used had a ready market existed for the investments.

We are, for GAAP purposes, an investment company under the AICPA Audit and Accounting Guide for Investment Companies. As a result, we reflect our investments on our balance sheet at their estimated fair value with unrealized gains and losses resulting from changes in fair value reflected as a component of unrealized gains or losses on our statements of operations. Fair value is the amount that would be received to sell the investments in an orderly transaction between market participants at the measurement date (i.e., the exit price). Additionally, we do not consolidate majority or wholly-owned and controlled investments.

Effective January 1, 2008 we adopted *Fair Value Measurements and Disclosures*. Among other things, this standard requires enhanced disclosures about financial instruments carried at fair value. See Note 4 to the financial statements for the additional information about the level of market observability associated with investments carried at fair value.

We have valued our investments, in the absence of observable market prices, using the valuation methodology 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 cash outflows for interest expense, debt paydown and other fund costs for the CLO Funds which are approaching or are 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 us, or (ii) the NAV of the CLO Funds which are approaching or are 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 are negligible net cash distributions to the class of securities owned by us, or (iii) a discounted cash flow model for more recent CLO Funds 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 we have invested. 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 NAVs 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 investments. We determine the fair value of our investments in CLO Fund securities on an individual security-by-security basis.

Our investment in Katonah Debt Advisors is carried at fair value, which is determined after taking into consideration a percentage of assets under management and a discounted cash flow model incorporating different levels of discount rates depending on the hierarchy of fees earned (including the likelihood of realization of senior, subordinate and incentive fees) and prospective modeled performance. Such valuation includes an analysis of comparable asset management companies. Katonah Debt Advisors is classified as a Level III investment (as described below). Any change in value from period to period is recognized as net change in unrealized appreciation or depreciation.

Fair values of other equity 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. 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.

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

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

After our adoption of *Fair Value Measurements and Disclosures*, investments measured and reported at fair value are classified and disclosed in one of the following categories:

- 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 *Fair Value Measurements and Disclosures*, 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 corporate loans and bonds 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. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and it considers factors specific to the investment. Substantially all of our investments are classified as Level III.

### ***Interest Income***

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on the accrual basis to the extent that such amounts are expected to be collected. We generally place a loan on non-accrual status and cease recognizing interest income on such loan or security when a loan or security becomes 90 days or more past due or if we otherwise do not expect the debtor to be able to service its debt obligations. Non-accrual loans remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due or such loans become current. As of March 31, 2010, eight issuers representing 3% of our total investments were on non-accrual status. As of December 31, 2009, eight issuers representing 2% of our total investments were on non-accrual status.

### ***Dividend Income from CLO Fund Securities***

We generate dividend income from our investments in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by Katonah Debt Advisors and selective investments in securities issued by funds managed by other asset management companies. Our CLO Fund securities are subordinate to senior bond holders who typically receive a fixed rate of return on their investment. The CLO Funds are leveraged funds and any excess cash flow or "excess spread" (interest earned by the

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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. 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. In addition, the failure of CLO Funds in which we invest to comply with certain financial covenants may lead to the temporary suspension or deferral of cash distributions to us. We make estimated interim accruals of such dividend income based on recent historical distributions and CLO Fund performance and adjust such accruals on a quarterly basis to reflect actual distributions.

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

### ***Dividends from Affiliate Asset Manager***

We record dividend income from our affiliate asset manager on the declaration date, which represents the ex-dividend date.

### ***Payment in Kind Interest***

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

### ***Fee Income***

Fee income includes fees, if any, for due diligence, structuring, commitment and facility fees, and, 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 Kohlberg Capital Amended and Restated 2006 Equity Incentive Plan to officers and employees for services rendered to us. We follow *Compensation-Stock Compensation*, a method by which the fair value of options or restricted stock is determined and expensed. We use a Binary Option Pricing Model (American, call option) to establish the expected value of all stock option grants.

We are internally managed and therefore do not incur management fees payable to third parties.

### ***United States Federal Income Taxes***

We have elected and intend to continue to qualify for the tax treatment applicable to RICs under Subchapter M of the Internal Revenue Code ("Code") and, among other things, intend to make the required distributions to our stockholders as specified therein. In order to qualify as a RIC, we are required to timely distribute to our 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.

### ***Dividends***

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

We have adopted a dividend reinvestment plan that provides for reinvestment of our distributions on behalf of our stockholders, unless a stockholder "opts out" of the plan to receive cash in lieu of having their dividends automatically reinvested in additional shares of our common stock.

**Recent Accounting Pronouncements**

On April 9, 2009, Accounting Standards Codification — *Interim Disclosures about Fair Value of Financial Instruments* was issued. This standard requires disclosures about financial instruments, including fair value, carrying amount, and method and significant assumptions used to estimate the fair value. We adopted this standard as of June 30, 2009 and the adoption of this standard did not affect our financial statement disclosures.

*Two-Class Method of Presenting Earnings Per Share*. In June 2008, Accounting Standards Codification – *Determining Whether Instruments Granted in Share-based Payment Transactions are Participating Securities* was issued. This standard requires companies to include unvested share-based payment awards that contain non-forfeitable rights to dividends in the computation of earnings per share pursuant to the two-class method. This standard is effective for financial statements issued for the years beginning after December 15, 2008, and interim periods within those years. We adopted this standard beginning with our financial statements ended March 31, 2009 and, as required, applied this standard retroactively to all reported periods. The adoption of this standard did not have a material impact on our calculations of earnings per share.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

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

***Interest Rate Risk***

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

Our investment income is affected by fluctuations in various interest rates, including LIBOR and prime rates. As of March 31, 2010, approximately 91% of our loans at fair value in our portfolio were at floating rates with a spread to an interest rate index such as LIBOR or the prime rate. We generally expect that future portfolio investments will predominately be floating rate investments. As of March 31, 2010, we had \$199 million of borrowings outstanding at a floating rate tied to prevailing commercial paper rates plus a margin of 0.85%. However, we are currently required to pay interest on our borrowings under the Facility at the higher default rate equal to 0.85% above the prime rate plus 0.75% due to the alleged breach of our obligations under the Facility asserted by the Agent, which we believe to be without merit.

Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest the funds borrowed. Accordingly, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of funds would increase, which could reduce our net investment income if there is not a corresponding increase in interest income generated by floating rate assets in our investment portfolio.

We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that our balance sheet at March 31, 2010 were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical increase or decrease of 1% in interest rates would correspondingly affect net interest income proportionately by approximately \$1.5 million over a one-year period. Correspondingly, a hypothetical increase or decrease of 1% in interest rates would correspondingly affect net interest expense proportionately by approximately \$1.5 million over a one-year period. Because most of our investments at March 31, 2010 were floating rate with a spread to an index similar to our Facility, we would not expect a significant impact on our net interest spread or NAV.

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

We did not hold any derivative financial instruments for hedging purposes as of March 31, 2010. In connection with the Facility established on February 14, 2007 and as amended on October 1, 2007, our special purpose subsidiary may be required under certain circumstances to enter into interest rate swap agreements or other interest rate hedging transactions.

### ***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.

We engaged VRC, an independent valuation firm, to provide third-party valuation estimates for approximately 39% and 40% of our investments at fair value as of December 31, 2009 and December 31, 2008, respectively. VRC's valuation estimates were considered as one of the relevant data inputs in our determination of fair value. The Board of Directors intends to continue to engage an independent valuation firm in the future to provide certain valuation services, including the review of certain portfolio assets, as part of our annual year end valuation process.

## **Item 4. Controls and Procedures**

### ***Evaluation of Disclosure Controls and Procedures***

As required by Rule 13a-15 under the Exchange Act, management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding our required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures.

Management conducted its evaluation of disclosure controls and procedures under the supervision of the Chief Executive Officer and the Chief Financial Officer. Pursuant to its evaluation, management determined that we did not maintain effective disclosure controls and procedures as of the end of the period covered by this report. We have not filed periodic reports on a timely basis, as required by the rules of the SEC and the Nasdaq Stock Market, since August 10, 2009. Our review of our accounting policies and practices in 2009 and 2010, and the restatement of our financial statements for the year ended December 31, 2008 (and the quarterly periods included in such year) as well as the quarterly periods ended March 31, 2009 and June 30, 2009, resulted in an inability to timely file our Annual Report on Form 10-K for the year ended December 31, 2009 and our Quarterly Reports on Form 10-Q for the quarterly periods ended September 30, 2009 and March 31, 2010. We continue to strive to improve our processes to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the applicable time periods.

### ***Changes in Internal Control Over Financial Reporting***

There have been no changes in the Company's internal control over financial reporting that occurred during the three months ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. There have been no changes to the Company's internal control over financial reporting, other than as described in Item 9A of the 2009 10-K regarding the material weaknesses described therein and related remediation efforts, subsequent to March 31, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. Other Information

### Item 1. Legal Proceedings

#### *Legal Action against Lenders under the Loan Funding and Servicing Agreement Governing The Facility*

On August 28, 2009 the Company and KCAP Funding (the Borrower under the LFSA) filed a complaint in the Supreme Court of the State of New York against the Agent and the other lender parties to the LFSA. The Company's discussions with the Agent to reach a mutually agreeable amendment to the LFSA were terminated prior to the filing of the complaint. The complaint reflects the Company's and the Borrower's beliefs that the Agent's declaration of a Termination Date (which ended the revolving period and commenced the amortization period) was wrongful and the Agent's assertion of the occurrence of a Termination Event based upon certain alleged breaches by the Company and the Borrower of their obligations under the LFSA is without merit. The complaint also seeks to clarify the Company's and the Borrower's rights and obligation under the LFSA.

In particular, the complaint alleges that the defendants improperly failed to make advances to the Borrower in violation of the terms of the LFSA; that the defendants' termination of the revolving period was wrongful and improperly triggered the amortization period and default interest rate under the LFSA; that the defendants' failure to provide relevant documents and disclose information to enable the Company and the Borrower to cure the alleged defaults constitutes material breaches of their obligations under the LFSA; and that the defendants' actions amount to a scheme to avoid their obligations owed to the Company and the Borrower under the LFSA (*i.e.*, their obligation to lend money on the terms specified in the LFSA) and an anticipatory repudiation of such obligations, thus resulting in extensive and irreparable harm to the Company and the Borrower and a suspension and/or discharge of the Company and the Borrower's obligations under the LFSA. Based on the foregoing, the complaint requests the court to, among other things:

- render a declaration that the termination notices were unlawful and invalid and that neither a termination date nor a termination event occurred under the LFSA;
- order specific performance of the defendants' obligations to make further advances under the LFSA, to withdraw the termination notices and to refrain from charging the default rate of interest;
- award the Company and the Borrower a judgment suspending and/or discharging their obligations under the LFSA (as appropriate) as well as a judgment against the defendants in an amount to be determined at trial (but no less than \$5,000,000); and
- award the Company and the Borrower the costs, disbursements and attorneys' fees of the action.

Since the time the complaint was filed, the Agent, the lenders, and the lender agent parties to the LFSA have served answers seeking dismissal of the complaint and recovery of the defendants' attorneys' fees and costs in the action, the Trustee has been voluntarily dismissed without prejudice from the lawsuit; and discovery has commenced.

While the Company and the Borrower intend to vigorously litigate the claims set forth in the complaint, neither the outcome of this litigation nor the amount and range of potential damages recoverable by the Company and the Borrower or their exposure associated with this litigation can be determined at this time. There can be no assurance that in connection with such lawsuit or otherwise the Agent and the lenders will not assert additional breaches of the LFSA, including breaches relating to the restatement referred to elsewhere in this Quarterly Report, and there can be no assurance that the Agent and the lenders will not assert that any such breaches give rise to a Termination Event. Pursuant to the LFSA, the Company and the Borrower are obligated to indemnify the defendants and their respective affiliates, officers, directors, employees and agents against all of their losses, expenses (including reasonable attorneys' fees) and non-monetary damages arising out of or as a result of the LFSA, except to the extent resulting from their fraud, gross negligence or willful misconduct. The Company and the Borrower have asserted that no indemnity obligation has been triggered.

The Agent has sent additional notices of Termination Events, which the Company believes and has asserted are without merit, based on its alleged inability to comply with certain covenants under the Facility due to the wrongful declaration of a Termination Date, the accompanying termination of the revolving period and commencement of the amortization period. In addition, on April 2, 2010 the Agent sent a notice alleging that the Company's failure to timely deliver annual audited financial statements for the year ended December 31, 2009 would, unless cured within 30 days of the date of the notice, constitute a Termination Event, which the Company also believes and has asserted is without merit based upon a non-material delay.

#### *Class Actions against the Company and Certain Directors and Officers*

The Company and certain directors and officers are named as defendants in three putative class actions pending in the Southern District of New York brought by shareholders of the Company and filed in December 2009 and January 2010. The complaints in these three actions allege violations of Sections 10 and 20 of the Exchange Act based on the Company's disclosures of its year-end 2008 and first- and second-quarter 2009 financial statements.

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The Company and certain directors and officers are also named as defendants in a derivative action filed on March 2, 2010 pending in the Supreme Court of New York, County of New York. The complaint in this action purports to state causes of action for breaches of fiduciary duties, unjust enrichment, abuse of control, gross mismanagement, and corporate waste. The Company believes that each of the above-mentioned suits is without merit and will defend each vigorously.

### **SEC Investigation**

On January 11, 2010, the staff of the SEC's Division of Enforcement informed the Company that it was conducting an informal inquiry. The focus of the inquiry concerns the valuation methodology and procedures used by the Company to value its investments. On April 30, 2010, the SEC Staff advised the Company that a formal order of private investigation had been issued and that the informal inquiry was now a formal investigation. A subpoena has been issued to the Company in connection with the formal investigation. The subpoena requests that the Company produce documents and/or testimony that primarily relates to the valuation methodology and procedures used by the Company to value its investments. Since January 2010, the Company has been providing documents in response to the informal inquiry and the subpoena. The Company is cooperating fully with the SEC Staff's investigation. The Company cannot predict the outcome of, or the timeframe for, the conclusion of this investigation.

Except as set forth above, neither the Company, nor any of its subsidiaries, is currently a party to any material legal proceedings, other than routine litigation and administrative proceedings arising in the ordinary course of business. Such proceedings are not expected to have a material adverse effect on the business, financial condition, or results of the Company's operations.

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

Investing in our common stock involves a high degree of risk. Our Annual Report on Form 10-K for the year ended December 31, 2009 contains important risk factors that could cause our actual results to differ materially from our historical experience or our present expectations and projections. If any such risks (or any risks we face) occur, our business, financial condition and results of our operations could be materially adversely affected. In such case, the NAV and trading price of our common stock could decline, and you may lose all or part of your investment. 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, 2009, which should be read together with the other risk factors and information disclosed elsewhere in this Quarterly Report on Form 10-Q, in our Annual Report on Form 10-K for the year ended December 31, 2009 and our other reports filed with the SEC.

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

None.

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

None.

### **Item 5. Other Information**

None.

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**Item 6. Exhibits**

<u>Exhibit Number</u>	<u>Description of Document</u>
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.

**SIGNATURES**

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

KOHLBERG CAPITAL CORPORATION

Date: May 28, 2010

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

Date: May 28, 2010

By \_\_\_\_\_ /S/ MICHAEL I. WIRTH  
Michael I. Wirth  
Chief Financial Officer, Chief Compliance Officer,  
Secretary and Treasurer  
(Principal Financial and Accounting Officer)

\* \* \* \* \*

**Exhibit Index**

<u>Exhibit Number</u>	<u>Description of Document</u>
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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.

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

I, Dayl W. Pearson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 of Kohlberg Capital Corporation (the "registrant");

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

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

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

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

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

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

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 28, 2010

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, Michael I. Wirth, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 of Kohlberg Capital Corporation (the "registrant");

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

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

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

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

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

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

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 28, 2010

By: \_\_\_\_\_ / s / MICHAEL I. WIRTH

**Michael I. Wirth**  
**Chief Financial Officer and Chief Compliance 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 Kohlberg Capital Corporation (the "Company") on Form 10-Q for the quarter ended March 31, 2010 (the "Report"), I, Dayl W. Pearson, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: May 28, 2010

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 Kohlberg Capital Corporation (the "Company") on Form 10-Q for the quarter ended March 31, 2010 (the "Report"), I, Michael I. Wirth, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: May 28, 2010

By:

/ s / MICHAEL I. WIRTH

\_\_\_\_\_  
Michael I. Wirth  
Chief Financial Officer and Chief Compliance Officer  
(Principal Financial Officer)