

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

FORM 10-K

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

For the fiscal year ended December 31, 2017

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 814-00735

**KCAP Financial, Inc.**

(Exact name of Registrant as specified in its charter)

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

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

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

**(212) 455-8300**

(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

<u>Title of each class</u>	<u>Name of exchange on which registered</u>
<b>Common Stock, par value \$0.01 per share</b>	<b>The NASDAQ Global Select Market</b>
<b>7.375% Notes Due 2019</b>	<b>New York Stock Exchange</b>
<b>6.125% Notes Due 2022</b>	<b>The NASDAQ Global Select Market</b>

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller Reporting Company   
Emerging Growth Company       (Do not check if a smaller reporting company)

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

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

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2017 was approximately \$120,799,251 based upon a closing price of \$3.53 reported for such date by The NASDAQ Global Select Market. Common shares held by each executive officer and director and by each person who owns 5% or more of the outstanding common shares have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of common stock of the registrant as of March 5, 2018 was 37,354,479.

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### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for the 2018 annual meeting of stockholders to be filed with the Securities and Exchange Commission within 120 days following the end of the registrant's fiscal year-end are incorporated by reference into Part III of this report.

### **NOTE ABOUT REFERENCES TO KCAP FINANCIAL, INC.**

In this Annual Report on Form 10-K (this "Annual Report"), the "Company", "KCAP", "we", "us" and "our" refer to KCAP Financial, Inc. and its wholly owned subsidiaries, KCAP Senior Funding I, LLC and KCAP Senior Funding I Holdings, LLC, unless the context otherwise requires.

### **NOTE ABOUT TRADEMARKS**

KCAP Financial, Inc., our logo and other trademarks of KCAP Financial, Inc. are the property of KCAP Financial, Inc. All other trademarks or trade names referred to in this Annual Report are the property of their respective owners.

### **NOTE ABOUT FORWARD-LOOKING STATEMENTS**

This Annual Report includes forward-looking statements. The matters discussed in this Annual Report, as well as in future oral and written statements by management of KCAP Financial, Inc., 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," "contemplates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar words, although not all forward-looking statements include these 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 Annual 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 Annual Report include statements as to:

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

For a discussion of factors that could cause our actual results to differ from forward-looking statements contained in this Annual Report, please see the discussion under “Risk Factors” in Item 1A. You should not place undue reliance on these forward-looking statements. The forward-looking statements made in this Annual 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 Annual Report unless required by law.

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**PART I**

**Item 1. Business**

**GENERAL**

We are an internally managed, non-diversified closed-end investment company that is regulated as business development company, (“BDC”), under the Investment Company Act of 1940, as amended (the “1940 Act”). We have three principal areas of investments:

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

Second, the Company has invested in our wholly owned asset management companies including Katonah Debt Advisors (“Katonah Debt Advisors”) and Trimaran Advisors L.L.C. (“Trimaran Advisors”), which manage collateralized loan obligation funds (“CLO Funds”).

Third, the Company invests in debt and subordinated securities issued by CLOs (“CLO Fund Securities”). These CLO Fund Securities are primarily managed by Katonah Debt Advisors and Trimaran Advisors, as well as affiliated management companies Katonah 2007-1 Management, L.L.C., Trimaran Advisors Management, L.L.C. and KCAP Management, LLC (collectively, the “Asset Manager Affiliates”), but from time-to-time the Company makes investments in CLO Fund Securities managed by other asset managers. The CLO Funds typically invest in broadly syndicated loans, high-yield bonds and other credit instruments.

The Company may also invest in other investments such as loans to publicly-traded companies, high-yield bonds, joint venture and distressed debt securities. The Company may also receive warrants or options to purchase common stock in connection with its debt investments.

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

From our Asset Manager Affiliates investment, we expect to receive recurring cash distributions and generate capital appreciation through the addition of new CLO Funds managed by our Asset Manager Affiliates. We may also seek to monetize our investment in the Asset Manager Affiliates if and when business conditions warrant. The Asset Manager Affiliates manage CLO Funds that invest in broadly syndicated loans, high-yield bonds and other credit instruments. Katonah Debt Advisors and Trimaran Advisors are registered under the Investment Advisers Act of 1940, as amended, and are each managed independently from us by a separate management team. Certain of the Company’s executive officers also act in similar capacities for one or more of the Asset Manager Affiliates).

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

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Because we are internally managed by our executive officers under the supervision of our Board of Directors and do not depend on a third party investment advisor, we do not pay investment advisory fees, but instead incur the operating costs associated with employing investment and portfolio management professionals.

As a BDC, we are required to comply with regulatory requirements, including limitations on our use of debt. We are permitted to, and expect to continue to, finance our investments through borrowings. However, as a BDC, we are only generally allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. The 1940 Act also generally prohibits us from declaring any cash dividend or distribution on any class of our capital stock if our asset coverage is below 200% at the time of the declaration of the dividend or distribution.

Subject to market conditions, we intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. Because we also recognize the need to have funds available for operating our business and to make investments, we seek to have adequate liquidity at all times to cover normal cyclical swings in funding availability and to allow us to meet abnormal and unexpected funding requirements. As a result, we may hold varying amounts of cash and other short-term investments from time-to-time for liquidity purposes.

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

We were formed in August 2006, as Kohlberg Capital Corporation. In December 2006, we completed our initial public offering (“IPO”), which raised net proceeds of approximately \$200 million after the exercise of the underwriters’ over-allotment option. In connection with our IPO, we issued an additional 3,484,333 shares of our common stock in exchange for the ownership interests of Katonah Debt Advisors and certain CLO Fund Securities.

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

On February 29, 2012, the Company purchased Trimaran Advisors for total consideration of \$13.0 million in cash and 3,600,000 shares of the Company’s common stock. Contemporaneous with the acquisition of Trimaran Advisors, the Company acquired from Trimaran Advisors equity interests in certain CLO Funds managed by Trimaran Advisors for an aggregate purchase price of \$12.0 million in cash. As of December 31, 2017, the Asset Manager Affiliates had approximately \$3.0 billion of par value assets under management.

On July 11, 2012, we changed our name from Kohlberg Capital Corporation to KCAP Financial, Inc.

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

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

Including employees of our Asset Manager Affiliates, we employ an experienced team of 15 investment professionals and 26 total staff members. Dayl W. Pearson, our President and Chief Executive Officer, and one of our directors, has been in the financial services industry for nearly 40 years. During the past 26 years,

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Mr. Pearson has focused almost exclusively on the middle market and has originated, structured and underwritten over \$7 billion of debt and equity securities. R. Jon Corless, our Chief Investment Officer with primary responsibility for the Debt Securities Portfolio, has managed investment portfolios in excess of \$4 billion at several institutions and has been responsible for managing portfolios of leveraged loans, high-yield bonds, mezzanine securities and middle market loans. Dominick J. Mazzitelli is the President and portfolio manager of the Asset Manager Affiliates. He has over 20 years of experience within the credit markets, with most of his career focused on the leveraged finance markets. Edward U. Gilpin, our Chief Financial Officer, Secretary and Treasurer, has been in financial services for over 30 years, with significant experience in overseeing the financial operations and reporting for asset management businesses, including the fair value accounting of CLO securities owned by them.

Under the investment company rules and regulations pursuant to Article 6 of Regulation S-X and the Financial Standards Board Accounting Standards Codification 946, *Financial Services — Investment Companies* (ASC 946), we are precluded from consolidating portfolio company investments, including those in which we have a controlling interest, unless the portfolio company is another investment company. An exception to this general principle in ASC 946 occurs if we own a controlled operating company that provides all or substantially all of its services directly to us, or to an investment company of ours. Other than KCAP Funding, Kohlberg Capital Funding I LLC, KCAP Senior Funding I Holdings LLC and KCAP Senior Funding I LLC, none of the investments made by us qualify for this exception. Therefore, our portfolio investments, including our investments in the Asset Manager Affiliates and the Joint Venture, are carried on the balance sheet at fair value with any adjustments to fair value recognized as “Net Change in Unrealized Appreciation (Depreciation)” in our statement of operations until the investment is exited, at which point any gain or loss on exit is reclassified and recognized as a “Net Realized Gain (Loss) from Investments.”

Our common stock is traded on The NASDAQ Global Select Market under the symbol “KCAP.” The net asset value per share of our common stock at December 31, 2017 was \$4.87. On December 31, 2017, the last reported sale price of a share of our common stock on The NASDAQ Global Select Market was \$3.41. Our 7.375% notes due 2019 (“7.375% Notes Due 2019”) are traded on the New York Stock Exchange under the symbol “KAP.” On December 31, 2017, the last reported price of our 7.375% Notes Due 2019, which have a par value of \$25.00, was \$25.29. In addition, our 6.125% notes due 2022 (“6.125% Notes Due 2022”) are traded on the NASDAQ Global Select Market under the symbol “KCAPL.” On December 31, 2017, the last reported price of our 6.125% Notes Due 2022, which have a par value of \$25.00, was \$25.10.

### **Our Corporate Information**

Our principal executive offices are located at 295 Madison Avenue, 6<sup>th</sup> Floor, New York, New York 10017, and our telephone number is (212) 455-8300. We maintain a website on the Internet at <http://www.kcapfinancial.com>. The information contained in our website is not incorporated by reference into this Annual Report. We make available on or through our website certain reports and amendments to those reports that we file with or furnish to the SEC in accordance with the Securities Exchange Act of 1934 (the “Exchange Act”). These include our annual reports on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K. We make this information available on our website free of charge as soon as reasonably practicable after we electronically file the information with, or furnish it to, the SEC.

### **Investment Portfolio**

Our investment portfolio generates investment income, which is generally used to pay principal and interest on our borrowings, operating expenses, and to fund our distributions to our stockholders. Our investment portfolio consists of three primary components: the Debt Securities Portfolio, the CLO Fund Securities and our investment in our wholly owned Asset Manager Affiliates.

*Debt Securities Portfolio.* We target privately-held middle market companies that have strong historical cash flows, experienced management teams and identifiable and defensible market positions in industries with positive dynamics. We generally target companies that generate positive cash flows because we look to cash flows as the primary source for servicing debt.

We employ a disciplined approach in the selection and monitoring of our investments. Generally, we target investments that will generate a current return through interest income to provide for stability in our



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shareholder distributions 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 generally avoid concentrations in any one industry or issuer. We manage risk by following our internal credit policies and procedures.

When we extend senior and junior secured term loans, we will generally take a security interest in the available assets of the portfolio company, including the equity interests of its subsidiaries, which we expect to help mitigate the risk that we will not be repaid. Nonetheless, there is a possibility that our lien could be subordinated to claims of other creditors. Structurally, mezzanine debt ranks subordinate in priority of payment to senior term loans and is often unsecured. Relative to equity, mezzanine debt ranks senior to common and preferred equity in a borrower's capital structure. Typically, mezzanine debt has elements of both debt and equity instruments, offering the fixed returns in the form of interest payments associated with a loan, while providing an opportunity to participate in the capital appreciation of a borrower, if any, through an equity interest that is typically in the form of equity purchased at the time the mezzanine loan is originated or warrants to purchase equity at a future date at a fixed cost. Mezzanine debt generally earns a higher return than senior secured debt due to its higher risk profile and usually less restrictive covenants. The warrants associated with mezzanine debt are typically detachable, which allows lenders to receive repayment of their principal on an agreed amortization schedule while retaining an equity interest in the borrower. Mezzanine debt also may include a "put" feature, which permits the holder to sell its equity interest back to the borrower at a price determined through an agreed formula.

Below are summary attributes for our Debt Securities Portfolio as of and for the year ended December 31, 2017:

- represented approximately 38% of total investment portfolio;
- contained credit instruments issued by corporate borrowers;
- primarily comprised of senior secured and junior secured loans (38% and 50% of Debt Securities Portfolio, respectively);
- spread across 19 different industries and 40 different entities;
- average par balance per investment of approximately \$2.8 million;
- all issuers were current on their debt service obligations; and
- weighted average interest rate of 10.1% on income producing debt investments.

Our investments generally average between \$1 million to \$20 million, although particular investments may be larger or smaller. The size of individual investments will vary according to their priority in a company's capital structure, with larger investments in more secure positions in an effort to maximize capital preservation. The size of our investments and maturity dates may vary as follows:

- senior secured term loans from \$2 to \$20 million maturing in five to seven years;
- second lien term loans from \$5 to \$15 million maturing in six to eight years;
- senior unsecured loans from \$5 to \$23 million maturing in six to eight years;
- mezzanine loans from \$5 to \$15 million maturing in seven to ten years; and
- equity investments from \$1 to \$5 million.

*Asset Manager Affiliates.* We expect to receive recurring cash distributions and seek to generate capital appreciation from our investment in our Asset Manager Affiliates. We may also seek to monetize our investment the Asset Manager Affiliates if and when business conditions warrant. As a manager of CLO Funds, our Asset Manager Affiliates receive contractual and recurring management fees from the CLO Funds for their management and advisory services. In addition, our Asset Manager Affiliates may also earn income

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related to net interest on assets accumulated for future CLO issuances on which they have provided a first loss guaranty in connection with loan warehouse arrangements for their future CLO Funds.

The periodic management fees that our Asset Manager Affiliates receive are generally based on a fixed percentage of the par value of assets under management and are recurring in nature for the term of the CLO Fund, so long as the Asset Manager Affiliate manages the fund. As a result, the management fees earned by our Asset Manager Affiliates are not subject to market value fluctuations in the underlying collateral. The management fees that our Asset Manager Affiliates receive generally have three contractual components: a senior management fee, a subordinated management fee and the possibility of an incentive management fee if certain conditions are met. Currently, all CLO Funds managed by the Asset Manager Affiliates are paying both their senior and subordinated management fees on a current basis. During 2017, our Asset Manager Affiliates recognized \$3.0 million in incentive fees from one CLO Fund. As of December 31, 2017, none of the CLO Funds managed by the Asset Manager Affiliates were paying incentive fees.

Subject to the conditions of the capital markets, we expect to continue to make investments in CLO Funds managed by our Asset Manager Affiliates, which we believe will provide us with a current cash investment return. We believe that these investments will provide our Asset Manager Affiliates with greater opportunities to access new sources of capital, which will ultimately increase our Asset Manager Affiliates' assets under management and resulting management fee income. See "Item 1A. Risk Factors" for a discussion of the risks relating to our ability to access the capital markets and the impact of certain risk retention rules which require that we or our Asset Manager Affiliates make and maintain certain minimum investments in CLO Funds managed by the Asset Manager Affiliates.

The after-tax net free cash flow that our Asset Manager Affiliates generate through the fees they receive for managing CLO Funds and after paying their expenses pursuant to an overhead allocation agreement with the Company associated with their operations, including compensation of their employees, may be distributed to us. Distributions from our Asset Manager Affiliates' tax basis earnings and profits are recorded as "Dividends From Asset Manager Affiliates" in our financial statements when declared. From time to time our Asset Manager Affiliates may distribute cash in excess of tax basis earnings and profits. This excess is deemed a return of capital ("ROC") and is recorded in "unrealized gains (losses)" on the statement of operations.

Below are summary attributes for our Asset Manager Affiliates, as of and for the year ended December 31, 2017:

- represented approximately 12% of total investment portfolio;
- had approximately \$3.0 billion par value of assets under management;
- receive contractual and recurring asset management fees based on par value of managed investments;
- may receive an incentive management fee from a CLO Fund, provided that the CLO Fund achieves a minimum designated return on investment. In fiscal year ended December 31, 2017, one such CLO Fund paid incentive fees to our Asset Manager Affiliates;
- distributions paid by our Asset Manager Affiliates are an additional source of cash to pay our distributions to our stockholders and service our debt obligations; and
- for the year ended December 31, 2017, we received cash distributions of approximately \$3.2 million, of which \$460,000 was recognized as investment income from our Asset Manager Affiliates and the remaining amount as a return of capital.

*CLO Fund Securities.* Subject to the conditions of the capital markets, we expect to continue to make investments in the CLO Funds managed by our Asset Manager Affiliates, which we believe will provide us with a current cash investment return. We believe that these investments will provide our Asset Manager Affiliates with greater opportunities to access new sources of capital which will ultimately increase our Asset Manager Affiliates' assets under management and resulting management fee income.

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Below are summary attributes for our CLO Fund Securities, as of and for the year-ended December 31, 2017, unless otherwise specified:

- CLO Fund Securities represented approximately 17% of total investment portfolio at December 31, 2017;
- 91% of CLO Fund Securities Portfolio represented investments in subordinated securities or equity securities issued by CLO Funds and 9% of CLO Fund Securities Portfolio was a rated note;
- all CLO Funds invested primarily in credit instruments issued by corporate borrowers;
- U.S. generally accepted accounting principles (“GAAP”) basis investment income of \$11.2 million; cash distributions received of approximately \$21.2 million (approximately \$5.3 million taxable distributable income, \$15.9 million tax return of capital to KCAP).

### **Structure and Process**

#### ***Structure***

We are an internally managed BDC with 26 full-time employees (inclusive of employees of our Asset Manager Affiliates). The following are our key functional teams that execute our business strategy:

- Our BDC investment team consists of seven professionals who originate, structure, and invest in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies as well as CLO Funds.
- Our Asset Manager Affiliates team consists of eight professionals who structure, purchase and manage portfolios of primarily broadly syndicated corporate senior debt for CLOs.
- The remainder of the employees include senior management, operations, financial accounting, compliance and human resource personnel.

#### ***Process***

The Company will review potential investment opportunities and conduct due diligence that typically includes a review of historical and prospective financial information, participation in a presentation held by the prospective portfolio company’s management and/or the transaction sponsor, a review of the prospective portfolio company’s product or service, an analysis and understanding of the drivers of the particular industry in which the prospective portfolio company operates, and an assessment of the debt service capabilities of the prospective portfolio company under a variety of assumed forecast scenarios.

Due to our ability to source transactions through multiple channels, we expect to continue to maintain a pipeline of opportunities to allow comparative risk return analysis and selectivity. By focusing on the drivers of revenue and cash flow, we develop our own underwriting cases, and multiple stress and event specific case scenarios for each company analyzed.

We focus on lending and investing opportunities in:

- companies with EBITDA of \$10 to \$50 million;
- companies with financing needs of \$25 to \$150 million;
- companies purchased by well-regarded private equity sponsors;
- non-sponsored companies with successful management and systems;
- high-yield bonds and broadly syndicated loans to larger companies on a selective basis; and
- equity co-investment in companies where we see substantial opportunity for capital appreciation.

We expect to continue to source investment opportunities from:

- private equity sponsors;
- regional investment banks for non-sponsored companies;

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- other middle market lenders with whom we can participate in loans; and
- our Asset Manager Affiliates, with regard to high-yield bonds and syndicated loans.

In our experience, good credit judgment is based on a thorough understanding of both the qualitative and quantitative factors that determine a company's performance. Our analysis begins with an understanding of the fundamentals of the industry in which a company operates, including the current economic environment and the outlook for the industry. We also focus on the company's relative position within the industry and its historical ability to weather economic cycles. Other key qualitative factors include the experience and depth of the management team and the financial sponsor, if any.

Only after we have a comprehensive understanding of the qualitative factors do we focus on quantitative metrics. We believe that with the context provided by the qualitative analysis, we can gain a better understanding of a company's financial performance. We analyze a potential portfolio company's sales growth and margins in the context of its competition as well as its ability to manage its working capital requirements and its ability to generate consistent cash flow. Based upon this historical analysis, we develop a set of projections which represents a reasonable underwriting case of most likely outcomes for the company over the period of our investment. We also look at potential downside cases to determine a company's ability to service its debt in a stressed credit environment.

Elements of the *qualitative analysis* we use in evaluating investment opportunities include the following:

- industry fundamentals;
- competitive position and market share;
- past ability to work through historical down-cycles;
- quality of financial and technology infrastructure;
- sourcing risks and opportunities;
- labor and union strategy;
- technology risk;
- diversity of customer base and product lines;
- quality of financial sponsor (if applicable); and
- acquisition and integration history.

Elements of the *quantitative analysis* we use in evaluating investment opportunities include the following:

- income statement analysis of growth and margin trends;
- cash flow analysis of capital expenditures and free cash flow;
- financial ratio and market share standing among comparable companies;
- financial projections: underwriting versus stress case;
- event specific credit modeling;
- credit profile trend;
- future capital expenditure needs and asset sale plans;
- downside protection to limit losses in an event of default;
- risk adjusted returns and relative value analysis; and
- enterprise and asset valuations.

The origination, structuring and credit approval processes are fully integrated. Our credit team is directly involved in all due diligence and analysis prior to the formal credit approval process by the Investment Committee.

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### ***Investment Committee***

The Investment Committee consists of the Chairman of the Board of Directors, the Chief Executive Officer, the Chief Investment Officer, and an additional member of the Board of Directors. The Investment Committee serves to provide investment consistency and adherence to our core investment philosophy and policies.

Upon completion of the due diligence investigation, the underwriting team of investment professionals/analysts will prepare a credit underwriting memorandum that will summarize the contemplated transaction, present the investment highlights, analyze the risk in the transaction and mitigating factors to those risks, analyze the prospective portfolio's historical financial statements, financial projections, industry and management team, and will then present this memorandum with its recommendations to the Investment Committee for review and approval.

The approval of a majority of the Investment Committee is required for all investments of less than \$15 million, and the unanimous approval of the Investment Committee is required for investments of \$15 million or greater.

### **Monitoring**

Our management team has significant experience monitoring credit portfolios. Along with origination and credit analysis, portfolio management is one of the key elements of our business. Most of our investments will not be liquid and, therefore, we must prepare to act quickly if potential issues arise so that we can work closely with management and the private equity sponsor, if applicable, of the portfolio company to take any necessary remedial action. In addition, most of our senior management team, including the credit team at the Asset Manager Affiliates, has substantial workout and restructuring experience.

In order to assist us in detecting issues with our Debt Securities Portfolio companies as early as possible, we perform a financial analysis at least quarterly on each portfolio company. This analysis typically includes:

- A summary of the portfolio company's current total credit exposure as well as the KCAP portion of this exposure.
- A summary and update of the portfolio company's financial condition and performance, including but not limited to, performance versus plan, deterioration/improvement in market position, or industry fundamentals, management changes or additions, and ongoing business strategy.
- Reaffirmation of, or proposal to change, the risk rating of the underlying investment.
- A summary of the portfolio company's financial covenant results vis a vis financial covenant levels established in the credit agreement.

Watch list credits are followed closely and discussed periodically with the Chief Investment Officer, as appropriate.

### **DETERMINATION OF NET ASSET VALUE**

We determine the net asset value per share of our common stock quarterly. The net asset value per share is equal to the value of our total assets minus liabilities and any preferred stock outstanding divided by the total number of shares of common stock outstanding.

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Our net asset value per share was \$4.87 and \$5.24 as of December 31, 2017 and December 31, 2016, respectively. Since we report our assets at fair value for each reporting period, net asset value also represents the amount of stockholders' equity per share for the reporting period. Our net asset value is comprised mostly of investment assets less debt and other liabilities:

	December 31, 2017		December 31, 2016	
	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 short-term investments <sup>(2)</sup>	\$ 77,300,320	\$ 2.07	\$ 28,699,269	\$ 0.77
Investments in debt securities	118,197,479	3.17	238,343,330	6.41
Investments in CLO Fund Securities	51,678,673	1.38	54,174,350	1.46
Investments in equity securities	4,414,684	0.12	5,056,355	0.14
Investments in Asset Manager Affiliates	38,849,000	1.04	40,198,000	1.08
Investments in Joint Venture	21,516,000	0.58	—	—
Cash	2,034,095	0.05	1,307,257	0.03
Restricted Cash <sup>(3)</sup>	—	—	8,528,298	0.23
All other assets	5,818,723	0.16	5,065,124	0.14
Total Assets	<u>\$ 319,808,974</u>	<u>\$ 8.57</u>	<u>\$ 381,371,983</u>	<u>\$ 10.26</u>
Notes payable – KCAP Senior Funding I, LLC (net of discount and offering costs)	\$ —	\$ —	\$ 142,604,419	\$ 3.84
7.375% Notes Due 2019 (net of offering costs)	26,740,365	0.72	32,980,151	0.89
6.125% Notes Due 2022 (net of offering costs)	74,672,952	2.00	—	—
Payable for open trades	34,215,195	0.92	7,884,943	0.21
Other liabilities	2,375,886	0.06	2,977,545	0.08
Total Liabilities	<u>138,004,398</u>	<u>3.70</u>	<u>186,447,058</u>	<u>5.02</u>
NET ASSET VALUE	<u>\$ 181,804,577</u>	<u>\$ 4.87</u>	<u>\$ 194,924,925</u>	<u>\$ 5.24</u>

(1) Our balance sheet at fair value and resultant net asset value are calculated on a basis consistent with GAAP. Our per share presentation of such amounts (other than net asset value 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.

(2) Includes money market accounts and short-term obligations.

(3) Consists of cash held for quarterly interest and principal payments to the holders of notes issued by KCAP Senior Funding I, LLC, our wholly owned subsidiary. During the fiscal year ended December 31, 2017, all of the notes issued by KCAP Senior Funding, LLC were repaid.

### Valuation

As a BDC, we invest primarily in illiquid securities, including loans to and warrants of private companies and interests in other illiquid securities, such as interests in CLO Fund Securities. These portfolio investments may be subject to restrictions on resale and will generally have no established trading market. As a result, our Board of Directors determines in good faith the fair value of our portfolio investments pursuant to a valuation policy developed in accordance with the Financial Accounting Standards Board Accounting Standards Codification 820, Fair Value Measurements and Disclosures (“ASC 820: Fair Value”), and a valuation process approved by our Board of Directors and in accordance with the 1940 Act. Our valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio. Our 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. The Company uses an independent valuation firm to provide third party valuation consulting services to the Company and the Board of Directors. For additional information concerning valuation, see “Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations — Valuation of Portfolio Investments”; and Notes 2 and 4 to the financial statements.

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### **Competition**

Our primary competitors also provide financing to prospective portfolio companies. These include commercial banks, specialty finance companies, hedge funds, structured investment funds, other BDCs and investment banks. Our competitors may have a lower cost of funds, and many have access to funding sources that are not available to us. Many of these entities have greater managerial resources than we have, and the 1940 Act imposes certain regulatory restrictions on us as a BDC to which many of our competitors are not subject. For additional information concerning the competitive risks we face, see “Item 1A. Risk Factors — Risks Related to Our Business and Structure — We operate in a highly competitive market for investment opportunities.”

We believe that we provide a unique combination of an experienced middle market loan origination and a CLO management platform at the Asset Manager Affiliates that includes experienced lenders with broad industry expertise. We believe that this combination of resources provides us with a thorough credit process and multiple sources of investment opportunities that make us attractive within our market.

### **Employees**

As of December 31, 2017, we and our Asset Manager Affiliates had 26 employees, including an experienced team of 15 investment professionals.

### **REGULATION**

The following discussion is a general summary of some of the material prohibitions and restrictions governing BDCs generally. It does not purport to be a complete description of all the laws and regulations affecting BDCs.

A BDC is a unique kind of investment company that primarily focuses on investing in or lending to private or relatively small publicly traded companies and making managerial assistance available to them. The 1940 Act contains prohibitions and restrictions relating to transactions between BDCs and their directors and officers and certain other related persons and requires that a majority of the directors be persons other than “interested persons,” as that term is defined in the 1940 Act. We have implemented certain procedures to ensure that we do not engage in any prohibited transactions with any persons affiliated with us.

In addition, the 1940 Act provides that we may not change the nature of our business so as to cease to be, or to withdraw our election as, a BDC unless approved by a majority of our outstanding voting securities. A majority of the outstanding voting securities of a company is defined under the 1940 Act as the lesser of (i) 67% or more of such company’s shares present at a meeting or represented by proxy if more than 50% of the outstanding shares of such company are present or represented by proxy or (ii) more than 50% of the outstanding shares of such company.

### **Qualifying Assets**

Under the 1940 Act, a BDC may not acquire any asset other than assets of the type listed in Section 55(a) of the 1940 Act, or “Qualifying Assets,” unless, at the time the acquisition is made, Qualifying Assets represent at least 70% of the company’s total assets. The principal categories of Qualifying Assets relevant to our business are the following:

- Securities of an “eligible portfolio company” purchased in transactions not involving any public offering. An “eligible portfolio company” is defined in the 1940 Act as any issuer which:
  - (a) is organized under the laws of, and has its principal place of business in, the United States;
  - (b) is not an investment company (other than a small business investment company wholly-owned by the BDC) or a company that would be an investment company but for certain exclusions under the 1940 Act; and
  - (c) satisfies any of the following:
    - (i) does not have any class of securities listed on a national securities exchange (or, if it has a class of securities listed on a national securities exchange, has an aggregate market value of outstanding voting and non-voting common equity of less than \$250 million);

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(ii) is controlled by a BDC or a group of companies including a BDC and the BDC has an affiliated person who is a director of the eligible portfolio company;

(iii) is a small and solvent company having total assets of not more than \$4 million and capital and surplus of not less than \$2 million; or

(iv) does not have outstanding any class of securities with respect to which a broker or dealer may extend margin credit.

- Securities of any eligible portfolio company that we control;
- Securities purchased in a private transaction from a U.S. issuer that is not an investment company and is in bankruptcy and subject to reorganization;
- Securities received in exchange for or distributed on or with respect to securities described above, or pursuant to the conversion of warrants or rights relating to such securities; and
- Cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment.

### **Significant Managerial Assistance**

A BDC must be organized and have its principal place of business in the United States and must be operated for the purpose of making investments in the types of securities described above. In addition, BDCs must generally offer to make available to such issuer of the securities (other than small and solvent companies described above) significant managerial assistance; except that, where we purchase such securities in conjunction with one or more other persons acting together, one of the other persons is the group may make available such managerial assistance. Making available significant managerial assistance means, among other things, any arrangement whereby the BDC, through its directors, officers or employees, offers to provide, and, if accepted, does so provide, guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company through monitoring of portfolio company operations, selective participation in board and management meetings, consulting with and advising a portfolio company's officers or other organizational or financial guidance.

### **Temporary Investments**

Pending investment in other types of "Qualifying Assets," as described above, our investments may consist of cash, cash equivalents, U.S. government securities or high quality debt securities maturing in one year or less from the time of investment, which we refer to, collectively, as temporary investments, so that at least 70% of our assets are "Qualifying Assets." Typically, we invest in U.S. treasury bills or in repurchase agreements, provided that such agreements are fully collateralized by cash or securities issued by the U.S. government or its agencies. A repurchase agreement involves the purchase by an investor, such as us, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed upon future date and at a price which is greater than the purchase price by an amount that reflects an agreed-upon interest rate. There is no percentage restriction on the proportion of our assets that may be invested in such repurchase agreements. However, if more than 25% of our total assets constitute repurchase agreements that are treated, under applicable tax rules, as being issued by a single counterparty, we would not meet the diversification tests imposed on us by the Code to qualify for tax treatment as a RIC for U.S. federal income tax purposes. Thus, we do not intend to enter into repurchase agreements treated as issued, under applicable tax rules, by a single counterparty in excess of this limit. We monitor the creditworthiness of the counterparties with which we enter into repurchase agreement transactions.

### **Indebtedness; Coverage Ratio**

We are permitted, under specified conditions, to issue multiple classes of indebtedness and one class of stock senior to our common stock if our asset coverage, as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance. In addition, with respect to certain types of senior securities, we must make provisions to prohibit any dividend distribution to our stockholders or the repurchase of certain of our securities, unless we meet the applicable asset coverage ratios at the time of the dividend distribution or repurchase. We may also borrow amounts up to 5% of the value of our total assets for temporary purposes.



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For a discussion of the risks associated with the resulting leverage, see “Item 1A. Risk Factors — Risks Related to Our Business and Structure — We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us.” As of December 31, 2017, our asset coverage ratio was 271%, above the minimum required asset coverage level of 200%.

### **Common Stock**

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, at a price below the current net asset value of the common stock if our Board of Directors determines that such sale is in our best interests and that of our stockholders, and our stockholders approve such sale. In any such case, the price at which our common stock is to be issued and sold may not be less than a price which, in the determination of our Board of Directors, closely approximates the market value of such common stock (less any distributing commission or discount). We may also make rights offerings to our stockholders at prices per share less than the net asset value per share, subject to applicable requirements of the 1940 Act. See “Item 1A. Risk Factors — Risks Relating to Our Business and Structure — Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital.”

### **Code of Ethics**

We adopted and maintain a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts certain personal securities transactions. Personnel subject to the code may invest in securities for their personal investment accounts, including securities that may be purchased or held by us, so long as such investments are made in accordance with the code’s requirements. A copy of the code of ethics is available on the Corporate Governance section of the Company’s website at <http://www.kcapfinancial.com>. Our code of ethics may also be reviewed and copied at the Public Reference Room of the SEC at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Copies of the code of ethics may be obtained, after paying a duplicating fee, by electronic request at the following e-mail address: [publicinfo@sec.gov](mailto:publicinfo@sec.gov), or by writing the SEC’s Public Reference Section, Washington, D.C. 20549-0102. In addition, our code of ethics is available on the SEC’s website at <http://www.sec.gov>.

### **Privacy Principles**

We are committed to maintaining the privacy of our stockholders and safeguarding their non-public personal information. The following information is provided to help you understand what personal information we collect, how we protect that information and why, in certain cases, we may share information with select other parties.

Generally, we do not receive any non-public personal information relating to our stockholders, although some non-public personal information of our stockholders may become available to us. We do not disclose any non-public personal information about our stockholders or former stockholders to anyone, except as is necessary to service stockholder accounts, such as to a transfer agent, or as otherwise permitted by law.

We restrict access to non-public personal information about our stockholders to our employees with a legitimate business need for the information. We maintain safeguards designed to protect the non-public personal information of our stockholders.

### **Proxy Voting Policy and Procedures**

Although the securities we hold are not typically voting securities, some of our investments could entitle us to voting rights. If this were to occur we would vote our portfolio securities in the best interest of our stockholders and we would review on a case-by-case basis each proposal submitted to a stockholder vote to determine its impact on the portfolio securities held by us. Although we would generally vote against proposals that we believe may have a negative impact on our portfolio securities, we may vote for such a proposal if we were to believe there exists a compelling long-term reason to do so.

Our voting decisions would be made by our Investment Committee. To ensure that our vote would not be the product of a conflict of interest, we would require that (1) anyone involved in the decision making process

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disclose to our Chief Compliance Officer any potential conflict that he or she is aware of and any contact that he or she has had with any interested party regarding a vote; and (2) employees involved in the decision making process or vote administration are prohibited from revealing how we intend to vote on a proposal to reduce any attempted influence from interested parties.

### **Other**

We are periodically examined by the SEC for compliance with the 1940 Act.

We are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect us against larceny and embezzlement. Furthermore, as a BDC, we are prohibited from indemnifying any director or officer against any liability to our stockholders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office.

We are required to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws and to review these policies and procedures annually for their adequacy and the effectiveness of their implementation. We have a designated Chief Compliance Officer who is responsible for administering these policies and procedures.

### **TAXATION AS A REGULATED INVESTMENT COMPANY**

We have elected to be treated for U.S. federal income tax purposes as a Regulated Investment Company ("RIC") under subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"), and intend to operate in a manner to maintain our RIC tax treatment. As a RIC, we generally will not have to pay corporate-level U.S. federal income taxes on any ordinary income or capital gains that we timely distribute to our stockholders as dividends. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, we must distribute to our stockholders, for each taxable year, at least 90% of our "investment company taxable income," which is generally our net ordinary taxable income plus the excess of our realized net short-term capital gains over our realized net long-term capital losses (the "Annual Distribution Requirement").

#### ***Taxation as a RIC***

For any taxable year in which we qualify as a RIC and satisfy the Annual Distribution Requirement, we generally will not be subject to U.S. federal income tax on the portion of our investment company taxable income and net capital gain, defined as net long-term capital gains in excess of net short-term capital losses, we distribute to stockholders. We will be subject to U.S. federal income tax at the regular corporate rates on any net ordinary income or net capital gain not distributed (or deemed distributed) to our stockholders.

We will be subject to a 4% nondeductible U.S. federal excise tax on our undistributed income unless we distribute in a timely manner an amount at least equal to the sum of (a) 98% of our net ordinary income for each calendar year, (b) 98.2% of our capital gain net income for the one-year period ending October 31 in that calendar year and (c) any income or gains realized, but not distributed, in the preceding year and on which we paid no U.S. federal income tax (the "Excise Tax Avoidance Requirement"). For this purpose, however, any net ordinary income or capital gain net income retained by us that is subject to corporate-level U.S. federal income tax for the tax year ending in that calendar year will be considered to have been distributed by year end (or earlier if estimated taxes are paid). Although we generally endeavor to make sufficient distributions each taxable year to satisfy the Excise Tax Avoidance Requirement, we may incur a U.S. federal excise tax.

To qualify as a RIC for U.S. federal income tax purposes, we must, among other things:

- qualify to be regulated as a business development company under the 1940 Act at all times during each taxable year;
- derive in each taxable year at least 90% of our gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale of stock or other securities, or other income derived with respect to our business of investing in such stock or securities, and net income derived

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from interests in “qualified publicly traded partnerships” (which generally are partnerships that are traded on an established securities market or tradable on a secondary market, other than partnerships that derive 90% of their income from interest, dividends and other permitted RIC income) (the “90% Income Test”); and

- diversify our holdings so that at the end of each quarter of the taxable year:
  - at least 50% of the value of our assets consists of cash, cash equivalents, U.S. government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer; and
  - no more than 25% of the value of our assets is invested in the securities, other than U.S. government securities or securities of other RICs, of one issuer or of two or more issuers that are controlled, as determined under applicable tax rules, by us and that are engaged in the same or similar or related trades or businesses or in the securities of one or more qualified publicly traded partnerships (the “Diversification Tests”).

If we do not satisfy the requirements of the Diversification Tests as of the end of any quarter, we will not lose our status as RIC provided that (i) we satisfied the requirements in a prior quarter and (ii) our failure to satisfy the requirements in the current quarter is not due in whole or in part to an acquisition of any security or other property.

We may invest in partnerships, including qualified publicly traded partnerships, which may result in our being subject to state, local or foreign income, franchise or withholding liabilities.

We may be required to recognize taxable income in circumstances in which we do not receive cash. For example, if we hold debt obligations that are treated under applicable tax rules as having original issue discount (such as debt instruments with payment-in-kind (“PIK”) interest or, in certain cases, with increasing interest rates or issued with warrants), we must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by us in the same taxable year. Because any original issue discount accrued will be included in our investment company taxable income for the year of accrual, we may be required to make a distribution to our stockholders in order to satisfy the Annual Distribution Requirement, even though we will not have received any corresponding cash amount. If we are not able to obtain sufficient cash from other sources to satisfy the Annual Distribution Requirement, we may fail to qualify as a RIC and become subject to corporate-level U.S. federal income taxes on all of our taxable income without the benefit of the dividends-paid deduction.

Although we do not presently expect to do so, we are authorized to borrow funds and to sell assets in order (i) to satisfy the Annual Distribution Requirement and to otherwise eliminate our liability for U.S. federal income and excise taxes and (ii) to satisfy the Diversification Tests. However, under the 1940 Act, we are not permitted to borrow additional funds or to make distributions to our stockholders while our debt obligations and other senior securities are outstanding unless a certain “asset coverage” test is met. See “Regulation — Indebtedness; Coverage Ratio.” Moreover, our ability to dispose of assets to meet the Annual Distribution Requirement, the Excise Tax Avoidance Requirement or the Diversification Tests may be limited by (a) the illiquid nature of our portfolio and/or (b) other requirements relating to our qualification as a RIC. If we dispose of assets in order to meet the Annual Distribution Requirement, the Excise Tax Avoidance Requirement, or the Diversification Tests, we may make such dispositions at times that, from an investment standpoint, are not advantageous.

Certain of our investment practices may be subject to special and complex U.S. federal income tax provisions that may, among other things, (a) treat dividends that would otherwise constitute qualified dividend income as non-qualified dividend income, (b) treat dividends that would otherwise be eligible for the corporate dividends received deduction as ineligible for such treatment, (c) disallow, suspend or otherwise limit the allowance of certain losses or deductions, (d) convert lower-taxed long-term capital gain into higher-taxed short-term capital gain or ordinary income, (e) convert an ordinary loss or a deduction into a capital loss (the deductibility of which is more limited), (f) cause us to recognize income or gain without a corresponding receipt of cash, (g) adversely affect the time as to when a purchase or sale of stock or securities

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is deemed to occur, (h) adversely alter the characterization of certain complex financial transactions and (i) produce income that will not be qualifying income for purposes of the 90% Income Test. We intend to monitor our transactions and may make certain tax elections to mitigate the effect of these provisions and prevent our disqualification as a RIC.

Gain or loss realized by us from warrants acquired by us as well as any loss attributable to the lapse of such warrants generally will be treated as capital gain or loss. Such capital gain or loss generally will be long-term or short-term, depending on how long we held a particular warrant.

Some of the income and fees that we may recognize will not satisfy the 90% Income Test. In order to ensure that such income and fees do not disqualify us as a RIC for a failure to satisfy the 90% Income Test, we may hold assets that generate such income and provide services that generate such fees indirectly through one or more entities treated as corporations for U.S. federal income tax purposes. Such corporations will be required to pay corporate-level U.S. federal income taxes on their earnings, which ultimately will reduce our return on such income and fees.

### ***Failure to Qualify as a Regulated Investment Company***

If we were unable to qualify for treatment as a RIC, we would be subject to tax on all of our taxable income at regular corporate rates, regardless of whether we make any distributions to our stockholders. Distributions would not be required, and any distributions made would be taxable to our stockholders as ordinary dividend income that, subject to certain limitations, may be eligible for the 20.0% maximum rate to the extent of our current and accumulated earnings and profits. Subject to certain limitations under the Code, corporate distributees would be eligible for the dividends-received deduction. Distributions in excess of our current and accumulated earnings and profits would be treated first as a return of capital to the extent of the stockholder's tax basis, and any remaining distributions would be treated as a capital gain. If we fail to qualify as a RIC for a period greater than two taxable years, to qualify as a RIC in a subsequent year we may be subject to regular corporate tax on any net built-in gains with respect to certain of our assets (i.e., the excess of the aggregate gains, including items of income, over aggregate losses that would have been realized with respect to such assets if we had been liquidated) that we elect to recognize on requalification or when recognized over the next five years.

### **DIVIDEND REINVESTMENT PLAN**

We have adopted a dividend reinvestment plan that provides for reinvestment of our distributions on behalf of our stockholders, unless a stockholder elects to receive cash as provided below. As a result, if our Board of Directors authorizes, and we declare, a cash distribution, then our stockholders who have not "opted out" of our dividend reinvestment plan will have their cash distributions automatically reinvested in additional shares of our common stock, rather than receiving the cash.

No action is required on the part of a registered stockholder to have such shareholder's cash distribution reinvested in shares of our common stock. A registered stockholder may elect to receive an entire distribution in cash by notifying American Stock Transfer & Trust Company, the plan administrator and our transfer agent and registrar, in writing so that such notice is received by the plan administrator no later than the record date for distributions to stockholders. The plan administrator will set up an account for shares acquired through the plan for each stockholder who has not elected to receive distributions in cash and hold such shares in non-certificated form. Upon request by a stockholder participating in the plan, received in writing not less than ten days prior to the record date, the plan administrator will, instead of crediting shares to the participant's account, issue a certificate registered in the participant's name for the number of whole shares of our common stock and a check for any fractional share.

Those stockholders whose shares are held by a broker or other financial intermediary may receive distributions in cash by notifying their broker or other financial intermediary of their election.

We intend to use primarily newly issued shares to implement the plan, whether our shares are trading at a premium or at a discount to net asset value. However, we reserve the right to purchase shares in the open market in connection with our implementation of the plan. The number of shares to be issued to a stockholder is determined by dividing the total dollar amount of the dividend payable to such stockholder by the market price per share of our common stock at the close of regular trading on The NASDAQ Global Select Market

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on the dividend payment date. Market price per share on that date will be the closing price for such shares on The NASDAQ Global Select Market or, if no sale is reported for such day, at the average of their reported bid and asked prices. Shares purchased in open market transactions by the plan administrator of the dividend reinvestment plan will be allocated to a stockholder based upon the average purchase price, excluding any brokerage charges or other charges, of all shares of common stock purchased with respect to the distribution.

There are no brokerage charges or other charges to stockholders who participate in the plan. The plan administrator's fees under the plan are paid by us. If a participant elects by written notice to the plan administrator to have the plan administrator sell part or all of the shares held by the plan administrator in the participant's account and remit the proceeds to the participant, the plan administrator is authorized to deduct a \$15.00 transaction fee plus a \$0.10 per share brokerage commission from the proceeds.

If your distributions are reinvested, you will be required to pay tax on the distributions in the same manner as if the distributions were received in cash. The taxation of distributions will not be affected by the form in which you receive them.

Participants may terminate their accounts under the plan by notifying the plan administrator via its website at [www.amstock.com](http://www.amstock.com), by filling out the transaction request form located at bottom of their statement and sending it to the plan administrator at the address set forth below or by calling the plan administrator at 1-866-668-8564.

The plan may be terminated by us upon notice in writing mailed to each participant at least 30 days prior to any record date for the payment of any dividend by us. All correspondence concerning the plan should be directed to, and additional information about the plan may be obtained from, the plan administrator by mail at American Stock Transfer & Trust Company, Attn. Dividend Reinvestment Department, P.O. Box 922, Wall Street Station, New York, NY 10269-0560 or by telephone at 1-866-668-8564.

**Item 1A. Risk Factors**

*Investing in our securities involves a high degree of risk. In addition to the other information contained in this annual report on Form 10-K, the following information should be carefully considered before making an investment in our securities. The risks set out below are not the only risks we face. Additional risks and uncertainties not presently known to us or not presently deemed material by us might also impair our operations and performance. If any of the following events occur, our business, financial condition and results of operations could be materially and adversely affected. In such case, our net asset value and the trading price of our securities could decline, and you may lose part or all of your investment.*

**Risks Related to Economic Conditions**

***Economic recessions or downturns may have a material adverse effect on our business, financial condition and results of operations, and could impair the ability of our portfolio companies to repay loans.***

Economic recessions or downturns may result in a prolonged period of market illiquidity which could have a material adverse effect on our business, financial condition and results of operations. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could limit our investment originations, limit our ability to grow and negatively impact our operating results.

In the event of economic recessions and downturns, the financial results of middle-market companies, like those in which we invest, will likely experience deterioration, which could ultimately lead to difficulty in meeting debt service requirements and an increase in defaults. Additionally, the end markets for certain of our portfolio companies' products and services would likely experience negative financial trends. The performances of certain of our portfolio companies have been, and may continue to be, negatively impacted by these economic or other conditions, which may ultimately result in our receipt of a reduced level of interest income from our portfolio companies and/or losses or charge offs related to our investments, and, in turn, may adversely affect distributable income. Further, adverse economic conditions may decrease the value of collateral securing some of our loans and the value of our equity investments. As a result, we may need to modify the payment terms of our investments, including changes in payment-in-kind interest provisions and/or cash interest rates. These factors may result in our receipt of a reduced level of interest income from our portfolio companies and/or losses or charge offs related to our investments, and, in turn, may adversely affect distributable income and have a material adverse effect on our results of operations.

***Capital markets may experience periods of disruption and instability and we cannot predict when these conditions will occur. Such market conditions could materially and adversely affect debt and equity capital markets in the United States and abroad, which could have a negative impact on our business, financial condition and results of operations.***

The U.S. and global capital markets experienced extreme volatility and disruption during the economic downturn that began in mid-2007, and the U.S. economy was in a recession for several consecutive calendar quarters during the same period. In 2010, a financial crisis emerged in Europe, triggered by high budget deficits and rising direct and contingent sovereign debt, which created concerns about the ability of certain nations to continue to service their sovereign debt obligations. Risks resulting from such debt crisis and any future debt crisis in Europe or any similar crisis elsewhere could have a detrimental impact on the global economic recovery, sovereign and non-sovereign debt in certain countries and the financial condition of financial institutions generally. In July and August 2015, Greece reached agreements with its creditors for bailouts that provide aid in exchange for certain austerity measures. These and similar austerity measures may adversely affect world economic conditions and have an adverse impact on our business and that of our portfolio companies. In the second quarter of 2015, stock prices in China experienced a significant drop, resulting primarily from continued sell-off of shares trading in Chinese markets. In August 2015, Chinese authorities sharply devalued China's currency. These market and economic disruptions adversely affected, and these and other similar market and economic disruptions may in the future affect, the U.S. capital markets, which could adversely affect our business and that of our portfolio companies. These market disruptions materially and adversely affected, and may in the future affect, the broader financial and credit markets and has reduced the availability of debt and equity capital for the market as a whole and to financial firms, in

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particular. Additionally, throughout 2017, the Federal Reserve continued to raise its federal funds target rate. However, if key economic indicators, such as the unemployment rate or inflation, do not progress at a rate consistent with the Federal Reserve's objectives, the target range for the federal funds rate may further increase and cause interest rates and borrowing costs to rise, which may negatively impact our ability to access the debt markets on favorable terms and may also increase the costs of our borrowers, hampering their ability to repay us.

At various times, these disruptions resulted in, and may in the future result, a lack of liquidity in parts of the debt capital markets, significant write-offs in the financial services sector and the repricing of credit risk. These conditions may reoccur for a prolonged period of time again or materially worsen in the future, including as a result of further downgrades to the U.S. government's sovereign credit rating or the perceived credit worthiness of the United States or other large global economies. Unfavorable economic conditions, including future recessions, also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. We may in the future have difficulty accessing debt and equity capital on attractive terms, or at all, and a severe disruption and instability in the global financial markets or deteriorations in credit and financing conditions may cause us to reduce the volume of loans we originate and/or fund, adversely affect the value of our portfolio investments or otherwise have a material adverse effect on our business, financial condition, results of operations and cash flows.

### ***The United Kingdom referendum decision to leave the European Union may create significant risks and uncertainty for global markets and our investments.***

The 2016 decision made in the United Kingdom referendum to leave the European Union has led to volatility in global financial markets, and in particular in the markets of the United Kingdom and across Europe, and may also lead to weakening in consumer, corporate and financial confidence in the United Kingdom and Europe. The extent and process by which the United Kingdom will exit the European Union, and the longer term economic, legal, political and social framework to be put in place between the United Kingdom and the European Union are unclear at this stage and are likely to lead to ongoing political and economic uncertainty and periods of exacerbated volatility in both the United Kingdom and in wider European markets for some time. In particular, the decision made in the United Kingdom referendum may lead to a call for similar referenda in other European jurisdictions which may cause increased economic volatility and uncertainty in the European and global markets. This volatility and uncertainty may have an adverse effect on the economy generally and on our ability and the ability of our portfolio companies to execute our respective strategies and to receive attractive returns.

## **Risks Related to Our Business and Structure**

### ***Ineffective internal controls could impact our business and operating results.***

Our internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal controls, including any failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business and operating results could be harmed and we could fail to meet our financial reporting obligations.

### ***We are dependent upon our senior management for our future success, and if we are unable to hire and retain qualified personnel or if we lose any member of our senior management team, our ability to achieve our investment objectives could be significantly harmed.***

We depend on the members of our senior management as well as other key personnel for the identification, final selection, structuring, closing and monitoring of our investments. These employees have critical industry experience and relationships that we rely on to implement our business plan. Our future success depends on the continued service of our senior management team. The departure of any of the members of our senior management or a significant number of our senior personnel could have a material



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adverse effect on our ability to achieve our investment objective. As a result, we may not be able to operate our business as we expect, and our ability to compete could be harmed, which could cause our operating results to suffer.

Additionally, the management agreements governing some of the CLO funds managed by our Asset Manager Affiliates have “key person” provisions that provide certain CLO investors with rights upon the departure of a “key person”, as defined in each agreement. As a result, the departure of a “key person” could trigger a material change in the Asset Manager Affiliate’s role in managing the CLO Funds, and therefore KCAP’s financial benefits from its investments in the Asset Manager Affiliates.

### ***We operate in a highly competitive market for investment opportunities.***

A large number of entities compete with us to make the types of investments that we make. We compete with other BDCs, as well as a number of investment funds, investment banks and other sources of financing, including traditional financial services companies, such as commercial banks and finance companies. Many of our competitors are substantially larger and have considerably greater financial, marketing and other resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. This may enable some of our competitors to make commercial loans with interest rates that are lower than the rates we typically offer. We may lose prospective portfolio investments if we do not match our competitors’ pricing, terms and structure. If we do match our competitors’ pricing, terms or structure, we may experience decreased net interest income. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, establish more relationships and build their market shares. Furthermore, many of our potential competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC. As a result of this competition, there can be no assurance that we will be able to identify and take advantage of attractive investment opportunities or that we will be able to fully invest our available capital. If we are not able to compete effectively, our business and financial condition and results of operations will be adversely affected.

### ***If we are unable to source investments effectively, we may be unable to achieve our investment objectives and provide returns to stockholders.***

Our ability to achieve our investment objective depends on our senior management team’s ability to identify, evaluate and invest in suitable companies that meet our investment criteria. Accomplishing this result on a cost-effective basis is largely a function of our marketing capabilities, our management of the investment process, our ability to provide efficient services and our access to financing sources on acceptable terms. In addition to monitoring the performance of our existing investments, members of our management team may also be called upon to focus their attention on other aspects of our business, including strategic opportunities available to us and/or the Asset Manager Affiliates from time to time. These demands on their time may distract them or slow the rate of investment. To grow, we need to continue to hire, train, supervise and manage new employees and to implement computer and other systems capable of effectively accommodating our growth. However, we cannot provide assurance that any such employees will contribute to the success of our business or that we will implement such systems effectively. Failure to source investments effectively could have a material adverse effect on our business, financial condition and results of operations.

### ***Our business model depends to a significant extent upon strong referral relationships, and our inability to maintain or develop these relationships, as well as the failure of these relationships to generate investment opportunities, could adversely affect our business.***

We expect that members of our senior management team will maintain their relationships with intermediaries, financial institutions, investment bankers, commercial bankers, financial advisors, attorneys, accountants, consultants and other individuals within their networks, and we will rely to a significant extent upon these relationships to provide us with potential investment opportunities. If our senior management team fails to maintain its existing relationships or develop new relationships with sources of investment opportunities, we will not be able to grow our investment portfolio. In addition, individuals with whom members of our senior management team have relationships are not obligated to provide us with investment opportunities, and, therefore, there is no assurance that such relationships will generate investment opportunities for us.



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***We may have difficulty paying distributions required to maintain our RIC status if we recognize income before or without receiving cash equal to such income.***

In accordance with the Code, we include in income certain amounts that we have not yet received in cash, such as contracted non-cash PIK interest, which represents contractual interest added to the loan balance and due at the end of the loan term. The increases in loan balances as a result of contracted non-cash PIK arrangements are included in income for the period in which such non-cash PIK interest was received, which is often in advance of receiving cash payment, and are separately identified on our statements of cash flows. We also may be required to include in income certain other amounts that we will not receive in cash. Any warrants that we receive in connection with our debt investments generally are valued as part of the negotiation process with the particular portfolio company. As a result, a portion of the aggregate purchase price for the debt investments and warrants is allocated to the warrants that we receive. This generally results in the associated debt investment having “original issue discount” for tax purposes, which we must recognize as ordinary income as it accrues. This increases the amounts we are required to distribute to maintain our qualification for tax treatment as a RIC. Because such original issue discount income might exceed the amount of cash received in a given year with respect to such investment, we might need to obtain cash from other sources to satisfy such distribution requirements. Other features of the debt instruments that we hold may also cause such instruments to generate original issue discount.

Since, in certain cases, we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the annual distribution requirement necessary to maintain RIC tax treatment under the Code. Accordingly, we may have to sell some of our investments at times and/or at prices we would not consider advantageous, raise additional debt or equity capital or forgo new investment opportunities for this purpose. If we are not able to obtain cash from other sources, we may fail to qualify for RIC tax treatment and thus become subject to corporate-level U.S. federal income tax. For additional discussion regarding the tax implications of a RIC, see “Business — Regulation — Taxation as a Regulated Investment Company.”

***Our Asset Manager Affiliates may incur losses as a result of “first loss” agreements that they may enter into from time-to-time in connection with warehousing credit arrangements which may be put in place prior to raising a CLO Fund and pursuant to which they would typically agree to reimburse credit providers for a portion of losses (if any) on warehouse investments.***

Our Asset Manager Affiliates enter into “first loss” agreements in connection with warehouse credit lines established to fund the initial accumulation of loan investments for future CLO Funds that our Asset Manager Affiliates will manage. Under such agreements, our Asset Manager Affiliates generally make a junior investment in a warehouse facility, which serves as a loss buffer for the senior capital provider. Such junior investment may be subject to losses (either in whole or in part) that stem from factors including (i) losses as a result of individual loan or other investments being ineligible for purchase by the CLO Fund (typically due to a payment default on such loan or other investments) when such fund formation is completed or (ii) if the CLO Fund has not been completed before the expiration of the warehouse credit line, the loss (if any, and net of any accumulated interest income) on the resale of such loans funded by the warehouse credit line, or (iii) realized losses from trading activity within the warehouse facility. As a result, our Asset Manager Affiliates may incur losses if loans and debt obligations that had been purchased in the warehouse facility become ineligible for inclusion in the CLO Fund or if a planned CLO Fund does not close.

***Any unrealized losses we experience on our loan portfolio may be an indication of future realized losses, which could reduce our resources available to make distributions.***

As a BDC, we are required to carry our investments at market value or, if no market value is ascertainable, at the fair value as determined in good faith by our Board of Directors pursuant to a valuation methodology approved by our Board of Directors. Decreases in the market values or fair values of our investments will be recorded as unrealized losses. An unrealized loss in our loan portfolio could be an indication of a portfolio company’s inability to meet its repayment obligations with respect to the affected loans. This could result in realized losses in the future and ultimately in reductions of our resources available to pay dividends or interest and principal on our securities and could cause you to lose all or part of your investment.

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### ***We may experience fluctuations in our quarterly and annual operating results and credit spreads.***

We could experience fluctuations in our quarterly and annual operating results due to a number of factors, some of which are beyond our control, including our ability to make investments in companies that meet our investment criteria, the interest rate payable on the debt securities we acquire (which could stem from the general level of interest rates, credit spreads, or both), the default rate on such securities, prepayment upon the triggering of covenants in our middle market loans as well as our CLO Funds, our level of expenses, variations in and timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

### ***We are exposed to risks associated with changes in interest rates and spreads.***

Changes in interest rates may have a substantial negative impact on our investments, the value of our securities and our rate of return on invested capital. A reduction in the interest spreads on new investments could also have an adverse impact on our net interest income. An increase in interest rates could decrease the value of any investments we hold which earn fixed interest rates, including mezzanine securities and high-yield bonds, and also could increase our interest expense, thereby decreasing our net income. An increase in interest rates due to an increase in credit spreads, regardless of general interest rate fluctuations, could also negatively impact the value of any investments we hold in our portfolio.

In addition, an increase in interest rates available to investors could make an investment in our securities less attractive than alternative investments, a situation which could reduce the value of our securities. Conversely, a decrease in interest rates may have an adverse impact on our returns by requiring us to seek lower yields on our debt investments and by increasing the risk that our portfolio companies will prepay our debt investments, resulting in the need to redeploy capital at potentially lower rates. A decrease in market interest rates may also adversely impact our returns on idle funds, which would reduce our net investment income.

### ***The interest rates of our term loans to our portfolio companies that extend beyond 2021 might be subject to change based on recent regulatory changes.***

LIBOR, the London interbank offered rate, is the basic rate of interest used in lending between banks on the London interbank market and is widely used as a reference for setting the interest rate on loans globally. We typically use LIBOR as a reference rate in term loans we extend to portfolio companies such that the interest due to us pursuant to a term loan extended to a partner company is calculated using LIBOR. Some of our term loan agreements with partner companies contain a stated minimum value for LIBOR.

On July 27, 2017, the United Kingdom's Financial Conduct Authority, which regulates LIBOR, announced that it intends to phase out LIBOR by the end of 2021. It is unclear if at that time whether or not LIBOR will cease to exist or if new methods of calculating LIBOR will be established such that it continues to exist after 2021. The U.S. Federal Reserve, in conjunction with the Alternative Reference Rates Committee, a steering committee comprised of large US financial institutions, is considering replacing U.S. dollar LIBOR with a new index calculated by short term repurchase agreements, backed by Treasury securities. The future of LIBOR at this time is uncertain. Uncertainty as to a LIBOR replacement, or the treatment of securities currently benchmarked to LIBOR, may adversely affect the market for LIBOR-based securities, including our portfolio of LIBOR-indexed, floating-rate debt securities.

### ***We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us.***

Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in us. We have issued senior securities, and in the future may borrow from, or issue additional senior securities (such as preferred or convertible securities or debt securities) to, banks and other lenders and investors. Subject to prevailing market conditions, we intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. Lenders and holders of such senior securities would have fixed dollar claims on our assets that are superior to the claims of our common stockholders. Leverage is generally considered a speculative

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investment technique. Any increase in our income in excess of interest payable on our outstanding indebtedness would cause our net income to increase more than it would have had we not incurred leverage, while any decrease in our income would cause net income to decline more sharply than it would have had we not incurred leverage. Such a decline could negatively affect our ability to make distributions to our stockholders and service our debt obligations. In addition, our common stockholders will bear the burden of any increase in our expenses as a result of leverage. There can be no assurance that our leveraging strategy will be successful.

Our outstanding indebtedness imposes, and additional debt we may incur in the future will likely impose, financial and operating covenants that restrict our business activities, including limitations that could hinder our ability to finance additional loans and investments or to make the distributions required to maintain our status as a RIC. A failure to add new debt facilities or issue additional debt securities or other evidences of indebtedness in lieu of or in addition to existing indebtedness could have a material adverse effect on our business, financial condition or results of operations.

### ***Our indebtedness could adversely affect our financial health and our ability to respond to changes in our business.***

With certain limited exceptions, we are only allowed to borrow amounts or issue senior securities such that our asset coverage, as defined in the 1940 Act, is at least 200% immediately after such borrowing or issuance. The amount of leverage that we employ in the future will depend on our management's and our Board of Directors' assessment of market and other factors at the time of any proposed borrowing. There is no assurance that a leveraging strategy will be successful. As a result of the level of our leverage:

- our exposure to risk of loss is greater if we incur debt or issue senior securities to finance investments because a decrease in the value of our investments has a greater negative impact on our equity returns and, therefore, the value of our business if we did not use leverage;
- the decrease in our asset coverage ratio resulting from increased leverage and the covenants contained in documents governing our indebtedness (which may impose asset coverage or investment portfolio composition requirements that are more stringent than those imposed by the 1940 Act) limit our flexibility in planning for, or reacting to, changes in our business and industry, as a result of which we could be required to liquidate investments at an inopportune time;
- we are required to dedicate a portion of our cash flow to interest payments, limiting the availability of cash for dividends and other purposes; and
- our ability to obtain additional financing in the future may be impaired.

We cannot be sure that our leverage will not have a material adverse effect on us. In addition, we cannot be sure that additional financing will be available when required or, if available, will be on terms satisfactory to us. Further, even if we are able to obtain additional financing, we may be required to use some or all of the proceeds thereof to repay our outstanding indebtedness.

### ***Because we intend to continue to distribute substantially all of our income and net realized capital gains to our stockholders, we will need additional capital to finance our growth.***

In order to continue to qualify as a RIC, to avoid payment of excise taxes and to minimize or avoid payment of U.S. federal income taxes, we intend to continue to distribute to our stockholders substantially all of our net ordinary income and realized net capital gains except for certain net long-term capital gains (which we may retain, pay applicable U.S. federal income taxes with respect thereto, and elect to treat as deemed distributions to our stockholders). As a BDC, in order to incur new debt, we are generally required to meet a coverage ratio of total assets to total senior securities, which includes all of our borrowings and any preferred stock we may issue in the future, of at least 200%, as measured immediately after issuance of such security. This requirement limits the amount that we may borrow. Because we will continue to need capital to grow our loan and investment portfolio, this limitation may prevent us from incurring debt and require us to issue additional equity at a time when it may be disadvantageous to do so. We cannot assure you that debt and equity financing will be available to us on favorable terms, or at all, and debt financings may be restricted by the terms of such borrowings. Also, as a business development company, we generally are not permitted to

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issue equity securities priced below net asset value without stockholder approval. If additional funds are not available to us, we could be forced to curtail or cease new lending and investment activities.

### ***Legislative or other actions relating to taxes could have a negative effect on us.***

Legislative or other actions relating to taxes could have a negative effect on the Company. The rules dealing with U.S. federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Treasury Department. On December 20, 2017, the U.S. House of Representatives and the U.S. Senate each voted to approve H.R. 1 (the “Tax Cuts and Jobs Act”) and, on December 22, 2017, President Trump signed the Tax Cuts and Jobs Act into law. The Tax Cuts and Jobs Act makes many changes to the Code, including, among other things, significant changes to the taxation of business entities, the deductibility of interest expense, and the tax treatment of capital investment. We cannot predict with certainty how any changes in the tax laws might affect the Company, investors, or the Company’s portfolio investments. New legislation and any U.S. Treasury regulations, administrative interpretations or court decisions interpreting such legislation could significantly and negatively affect the Company’s ability to qualify for tax treatment as a RIC or the U.S. federal income tax consequences to the Company and its investors of such qualification, or could have other adverse consequences. Investors are urged to consult with their tax advisor regarding tax legislative, regulatory, or administrative developments and proposals and their potential effect on an investment in the Company’s securities.

### ***We may from time to time expand our business through acquisitions, which could disrupt our business and harm our financial condition.***

We may pursue potential acquisitions of, and investments in, businesses complementary to our business and from time to time engage in discussions regarding such possible acquisitions. For example, in February 2012, we completed the acquisition of Trimaran Advisors. Such acquisition and any other acquisitions we may undertake involve a number of risks, including:

- failure of the acquired businesses to achieve the results we expect;
- substantial cash expenditures;
- diversion of capital and management attention from operational matters;
- our inability to retain key personnel of the acquired businesses
- incurrence of debt and contingent liabilities and risks associated with unanticipated events or liabilities; and
- the potential disruption and strain on our existing business and resources that could result from our planned growth and continuing integration of our acquisitions.

If we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of such acquisitions, we may incur costs in excess of what we anticipate, and management resources and attention may be diverted from other necessary or valuable activities. Any acquisition, including the Trimaran Advisors acquisition, may not result in short-term or long-term benefits to us. If we are unable to integrate or successfully manage any business that we acquire, we may not realize anticipated cost savings, improved efficiencies or revenue growth, which may result in reduced profitability or operating losses.

### ***We may invest through joint ventures, partnerships or other special purpose vehicles and our investments through these vehicles may entail greater risks, or risks that we otherwise would not incur, if we otherwise made such investments directly.***

We may make indirect investments in portfolio companies through joint ventures, partnerships or other special purpose vehicles (“Investment Vehicles”). In general, the risks associated with indirect investments in portfolio companies through a joint venture, partnership or other special purpose vehicle are similar to those associated with a direct investment in a portfolio company. While we intend to analyze the credit and business of a potential portfolio company in determining whether or not to make an investment in an Investment Vehicle, we will nonetheless be exposed to the creditworthiness of the Investment Vehicle. In the event of a bankruptcy proceeding against the portfolio company, the assets of the portfolio company may be used to

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satisfy its obligations prior to the satisfaction of our investment in the Investment Vehicle (i.e., our investment in the Investment Vehicle could be structurally subordinated to the other obligations of the portfolio company). In addition, if we are to invest in an Investment Vehicle, we may be required to rely on our partners in the Investment Vehicle when making decisions regarding the such Investment Vehicle's investments, accordingly, the value of the investment could be adversely affected if our interests diverge from those of our partners in the Investment Vehicle.

### ***Our Board of Directors may change our investment objective, operating policies and strategies without prior notice or stockholder approval.***

Our Board of Directors has the authority to modify or waive certain of our operating policies and strategies without prior notice and without stockholder approval. However, absent stockholder approval, we may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC. We cannot predict the effect any changes to our current operating policies and strategies would have on our business and operating results. Nevertheless, the effects may adversely affect our business and they could negatively impact our ability to pay you dividends and could cause you to lose all or part of your investment in our securities.

### ***Pending legislation may allow us to incur additional leverage.***

As a BDC, under the 1940 Act we generally are not permitted to incur indebtedness unless immediately after such borrowing we have an asset coverage for total borrowings of at least 200% (i.e., the amount of debt may not exceed 50% of the value of our total assets or we may borrow an amount equal to 100% of net assets).

Either of the Financial CHOICE Act of 2017, which was passed by the U.S House of Representatives in June 2017, or the Small Business Credit Availability Act, which was passed by the Financial Services Committee of the U.S. House of Representatives in November 2017, would modify this section of the 1940 Act and increase the amount of debt that BDCs may incur by modifying the asset coverage percentage from 200% to 150%. As a result, we may be able to incur additional indebtedness in the future and therefore your risk of an investment in us may increase.

### ***Our businesses may be adversely affected by litigation and regulatory proceedings.***

From time to time, we may be subject to legal actions as well as various regulatory, governmental and law enforcement inquiries, investigations and subpoenas. In any such claims or actions, demands for substantial monetary damages may be asserted against us and may result in financial liability or an adverse effect on our reputation among investors. We may be unable to accurately estimate our exposure to litigation risk when we record balance sheet reserves for probable loss contingencies. As a result, any reserves we establish to cover any settlements or judgments may not be sufficient to cover our actual financial exposure, which may have a material impact on our results of operations or financial condition. In regulatory enforcement matters, claims for disgorgement, the imposition of penalties and the imposition of other remedial sanctions are possible.

### ***Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital.***

Our business requires a substantial amount of additional capital. We may acquire additional capital from the issuance of senior securities or other indebtedness, the issuance of additional shares of our common stock or from securitization transactions. However, we may not be able to raise additional capital in the future on favorable terms or at all. We may issue debt securities or preferred securities, which we refer to collectively as "senior securities," and we may borrow money from banks or other financial institutions, up to the maximum amount permitted by the 1940 Act. The 1940 Act permits us to issue senior securities or incur indebtedness only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% immediately after such issuance or incurrence. With respect to certain types of senior securities, we must make provisions to prohibit any dividend distribution to our stockholders or the repurchase of certain of our securities, unless we meet the applicable asset coverage ratios at the time of the dividend distribution or repurchase. If the value of our assets declines, we may be unable to satisfy the asset coverage test. Furthermore, any amounts that we use to service our indebtedness would not be available for distributions to our common stockholders.

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All of the costs of offering and servicing such debt or preferred stock (if issued by us in the future), including interest or preferential dividend payments thereon, will be borne by our common stockholders. The interests of the holders of any debt or preferred stock we may issue will not necessarily be aligned with the interests of our common stockholders. In particular, the rights of holders of our debt or preferred stock to receive interest, dividends or principal repayment will be senior to those of our common stockholders. Also, in the event we issue preferred stock, the holders of such preferred stock will have the ability to elect two members of our board of directors. In addition, we may grant a lender a security interest in a significant portion or all of our assets, even if the total amount we may borrow from such lender is less than the amount of such lender's security interest in our assets.

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock at a price below the then-current net asset value of our common stock if our board of directors determines that such sale is in the best interests of KCAP and its stockholders, and our stockholders approve, giving us the authority to do so. Although we currently do not have such authorization, we previously sought and received such authorization from our stockholders in the past and may seek such authorization in the future. In any such case, the price at which our securities are to be issued and sold may not be less than a price which, in the determination of our board of directors, closely approximates the market value of such securities (less any distributing commission or discount). We are also generally prohibited under the 1940 Act from issuing securities convertible into voting securities without obtaining the approval of our existing stockholders. Sales of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share. In addition to issuing securities to raise capital as described above; we may securitize a portion of the loans generate cash for funding new investments. If we are unable to successfully securitize our loan portfolio our ability to grow our business and fully execute our business strategy and our earnings (if any) may be adversely affected. Moreover, even successful securitization of our loan portfolio might expose us to losses, as the residual loans in which we do not sell interests tend to be those that are riskier and more apt to generate losses.

***Changes in the laws or regulations governing our business and the business of our Asset Manager Affiliates, or changes in the interpretations thereof, and any failure by us or our Asset Manager Affiliates to comply with these laws or regulations, could negatively affect the profitability of our operations.***

Changes in the laws or regulations or the interpretations of the laws and regulations that govern BDCs, Registered Investment Advisers (such as our Asset Manager Affiliates), RICs or non-depository commercial lenders could significantly affect our operations and our cost of doing business. We are subject to federal, state and local laws and regulations as well as the rules of the stock exchange on which our securities are listed, and are subject to judicial and administrative decisions that affect our operations, including our loan originations, maximum interest rates, fees and other charges, disclosures to portfolio companies, the terms of secured transactions, collection and foreclosure procedures and other trade practices. The various regulatory bodies, including the SEC and the NASDAQ Global Select Market, that administer these laws and regulations have issued a significant number of new and increasingly complex requirements and regulations over the course of the last several years and continue to develop additional regulations.

In addition, as registered investment advisers, the Asset Manager Affiliates are subject to new and existing regulations, regulatory risks, costs and expenses associated with operating as registered investment advisers that may limit their ability to operate, structure or expand their businesses in the future. If these laws, regulations or decisions change, or if we expand our business into jurisdictions that have adopted more stringent requirements than those in which we currently conduct business, we may have to incur significant expenses in order to comply or we might have to restrict our operations. In addition, if we do not comply with applicable laws, regulations and decisions, we may lose licenses needed for the conduct of our business and be subject to civil fines and criminal penalties, any of which could have a material adverse effect upon our business, results of operations or financial condition.

Moreover, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has increased and may significantly increase the regulation of the financial services industry. The Dodd-Frank Act contains a broad set of provisions designed to govern the practices and oversight of financial institutions and other participants in the financial markets. One such provision, Section 619 of the Dodd-Frank Act, commonly

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referred to as the Volcker Rule, contains certain prohibitions and restrictions on the ability of a “banking entity” — which includes insured depository institutions, bank holding companies, foreign banking entities regulated by the Federal Reserve Board and their respective affiliates — and nonbank financial company supervised by the Federal Reserve to engage in proprietary trading and have certain interests in, or relationships with certain private funds (“covered funds”). Under the final regulations implementing the Volcker Rule, which were adopted in December 2013, many CLOs will be covered funds if they invest, or are permitted to invest, in assets other than loans, certain cash equivalents and interest rate or currency hedges. As a result, many banking entities, including many U.S. and non-U.S. broker-dealers with affiliated banks, may be unable to invest in, or in some cases to make a market in, the securities of CLOs in which we have invested, which may reduce liquidity in these securities and have a material adverse effect on their valuation. Moreover, the Volcker Rule regulations may affect the market for CLOs such that our Asset Manager Affiliates may be unable to establish, or to obtain warehouse funding for, new CLOs that would be covered funds. If our Asset Manager Affiliates establish CLOs that are structured not to be covered funds and thus do not permit investments in customary assets such as corporate bonds, asset-backed securities or synthetic investments, and we invest in such CLOs, the ability of our Asset Manager Affiliates to manage such CLOs will be constrained by those limitations, which could materially adversely affect any investments we make in such CLOs.

In October 2014, the SEC, the FDIC, the Federal Reserve and certain other prudential banking regulators adopted final rules mandating risk retention for securitizations, including CLOs, which became effective on December 24, 2016. Under the final risk-retentions rules, our Asset Manager Affiliates (or a majority-owned affiliate of such entities, including the Company) will be required to hold interests equal to 5% of the fair value of any CLO they sponsor (unless the CLO invests only in certain qualifying loans, which we do not expect to be the case) and would be prohibited from selling or hedging those interests in accordance with the limitations on such sales or hedges set forth in the final rule. Our Asset Manager Affiliates (or a majority-owned affiliate of such entities, including the Company) will need to have the requisite capital to hold such interests as a condition to their ability to sponsor new CLOs, and the restrictions on hedging such interests may create greater risk with respect to those interests. Our Asset Manager Affiliates’ (or a majority owned affiliate’s) investments in such CLOs, or their inability to invest in such CLOs (and thus inability to sponsor them) could each have a material adverse effect upon our business, results of operations or financial condition.

On February 9, 2018, the United States Court of Appeals for the District of Columbia (the “DC Circuit Court”) ruled in favor of an appeal brought by the Loan Syndications and Trading Association (the “LSTA”) from a district court (“District Court”) ruling granting summary judgment to the SEC and the Board of Governors of the Federal Reserve System. As part of its ruling, the DC Circuit Court remanded the case to the district court with instructions to grant summary judgment to the LSTA on whether application of the risk retention rules to CLO managers is valid under Section 941 of the Dodd-Frank Act. If the decision stands, CLO managers of “open-market CLOs” (described in the ruling as CLOs where assets are acquired from “arms-length negotiations and trading on an open market”) will no longer be required to comply with the risk retention rules, and no party to such “open-market CLOs” would be required to acquire and retain an economic interest in the credit risk of the securitized assets. However, the DC Circuit Court’s decision remains subject to further appeal for a period of time. See “Item 1A. Risk Factors — Risks Related to Our Investments — If our Asset Manager Affiliates do not meet certain risk retention requirements, they may not be able to sponsor and manage new CLOs, which would negatively impact our results of operations and financial conditions.”

In April 2010, the SEC proposed revised rules for asset-backed securities offerings (“Regulation AB II”) that, if adopted, would substantially change the disclosure, reporting and offering process for public and private offerings of asset-backed securities, including CLOs. The proposed rules, if adopted, would have required significant additional disclosures and would have altered the safe-harbor standards for the private placement of asset-backed securities to impose informational requirements similar to those that would apply to registered public offerings of such securities. The application of such informational requirements to CLOs, which have not historically been publicly registered, was unclear. On August 27, 2014, the SEC adopted a set of Regulation AB II final rules that was limited to asset-backed securities that were publicly registered. These rules impose changes to the offering process for publicly registered asset-backed securities and require



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disclosure of loan-level data for a subset of classes addressed in the proposed rules, but do not at this time extend to privately offered CLOs. However, the SEC has indicated that many aspects of the rule proposals, including the expansion of loan-level or grouped data disclosure requirements to additional asset classes and the possible application of the rules to private offerings of securities, remain under active consideration. The timing of the adoption of any additional final rules, their application to privately offered securities in general and to CLOs in particular, the cost of compliance with such rules, and whether compliance would compromise proprietary methods or strategies of our Asset Manager Affiliates, is currently unclear.

Other financial reform regulations, including regulations requiring clearing and margining of swap transactions, which may affect our ability to enter into hedging transactions; changes in the definition and regulation of commodity pool operators and commodity trading advisors, which could subject our Asset Manager Affiliates to additional regulations; leveraged lending guidance that may affect the ways in which banking institutions originate the loans in which we and our affiliates invest; heightened regulatory capital and liquidity requirements for banks that may affect our ability to borrow on reasonable terms; and non-US regulations of financial market participants that may overlap, expand upon or be inconsistent with US regulations may all have material adverse effects on our business.

### ***If we do not invest a sufficient portion of our assets in Qualifying Assets, we could be precluded from investing according to our current business strategy.***

As a BDC, we may not acquire any assets other than Qualifying Assets for purposes of the 1940 Act unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are “qualifying assets”. See “Item 1: Business — Regulation”.

We believe that most of the senior loans and mezzanine investments that we acquire constitute “qualifying assets.” However, investments in the securities of CLO Funds generally do not constitute “qualifying assets,” and we may invest in other assets that are not “qualifying assets.” If we do not invest a sufficient portion of our assets in “qualifying assets,” we may be precluded from investing in what we believe are attractive investments, which would have a material adverse effect on our business, financial condition and results of operations. These restrictions could also prevent us from making investments in the equity securities of CLO Funds, which could limit our Asset Manager Affiliates’ ability to organize new CLO Funds. Similarly, these rules could prevent us from making follow-on investments in existing portfolio companies (which could result in the dilution of our position).

### ***Our ability to enter into transactions with our affiliates is restricted.***

We are prohibited under the 1940 Act from participating in certain transactions with certain of our affiliates without the prior approval of the members of our independent directors and, in some cases, the SEC. Any person that owns, directly or indirectly, 5% or more of our outstanding voting securities is our affiliate for purposes of the 1940 Act and we are generally prohibited from buying or selling any securities (other than our securities) from or to such affiliate, absent the prior approval of our independent directors. The 1940 Act also prohibits certain “joint” transactions with certain of our affiliates, which could include investments in the same portfolio company (whether at the same or different times), without prior approval of our independent directors and, in some cases, the SEC. If a person acquires more than 25% of our voting securities, we will be prohibited from buying or selling any security (other than any security of which we are the issuer) from or to such person or certain of that person’s affiliates, or entering into prohibited joint transactions with such person, absent the prior approval of the SEC. Similar restrictions limit our ability to transact business with our officers or directors or their affiliates.

### ***A failure on our part to maintain our status as a BDC would significantly reduce our operating flexibility.***

If we fail to maintain our status as a BDC, we might be regulated as a closed-end investment company that is required to register under the 1940 Act, which would subject us to additional regulatory restrictions and significantly decrease our operating flexibility. In addition, any such failure could cause an event of default under our outstanding indebtedness, which could have a material adverse effect on our business, financial condition or results of operations.



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***Our business and operations could be negatively affected if we become subject to any securities litigation or stockholder activism, which could cause us to incur significant expense, hinder execution of investment strategy and impact our stock price.***

In the past, following periods of volatility in the market price of a company's securities, securities class-action litigation has often been brought against that company. Stockholder activism, which could take many forms or arise in a variety of situations, has been increasing in the BDC space recently. While we are currently not subject to any securities litigation or stockholder activism, we may in the future become the target of securities litigation or stockholder activism. Securities litigation and stockholder activism, including potential proxy contests, could result in substantial costs and divert management's and our board of directors' attention and resources from our business. Additionally, such securities litigation and stockholder activism could give rise to perceived uncertainties as to our future, adversely affect our relationships with service providers and make it more difficult to attract and retain qualified personnel. Also, we may be required to incur significant legal fees and other expenses related to any securities litigation and activist stockholder matters. Further, our stock price could be subject to significant fluctuation or otherwise be adversely affected by the events, risks and uncertainties of any securities litigation and stockholder activism.

***We will be subject to corporate-level U.S. federal income taxes if we are unable to qualify as a RIC under Subchapter M of the Code.***

To maintain RIC tax treatment under the Code, we must meet the following annual distribution, income source and asset diversification requirements:

- The annual distribution requirement for a RIC will be satisfied if we distribute to our stockholders on an annual basis at least 90% of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any. Because we use debt financing, we are subject to certain asset coverage ratio requirements under the 1940 Act and are (and may in the future become) subject to certain financial covenants under loan, indenture and credit agreements that could, under certain circumstances, restrict us from making distributions necessary to satisfy the distribution requirement. If we are unable to obtain cash from other sources, we could fail to qualify for RIC tax treatment and thus become subject to corporate-level U.S. federal income taxes.
- The source income requirement will be satisfied if we obtain at least 90% of our income for each year from dividends, interest, gains from the sale of stock or securities or similar sources.
- The asset diversification requirement will be satisfied if we meet certain asset diversification requirements at the end of each quarter of our taxable year. To satisfy this requirement, at least 50% of the value of our assets must consist of cash, cash equivalents, U.S. Government securities, securities of other RICs, and other acceptable securities; and no more than 25% of the value of our assets can be invested in the securities, other than U.S. government securities or securities of other RICs, of one issuer, of two or more issuers that are controlled, as determined under applicable Code rules, by us and that are engaged in the same or similar or related trades or businesses or of certain "qualified publicly traded partnerships." If we do not satisfy the diversification requirements as of the end of any quarter, we will not lose our status as RIC provided that (i) we satisfied the requirements in a prior quarter and (ii) our failure to satisfy the requirements in the current quarter is not due in whole or in part to an acquisition of any security or other property.

Failure to meet these requirements may result in our having to dispose of certain investments quickly in order to prevent the loss of RIC status. Because most of our investments will be in private companies, and therefore will be illiquid, any such dispositions could be made at disadvantageous prices and could result in substantial losses. Moreover, if we fail to maintain RIC tax treatment for any reason and are subject to corporate-level U.S. federal income taxes, the resulting taxes could substantially reduce our net assets, the amount of income available for distribution and the amount of our distributions. Such a failure would have a material adverse effect on us and on our stockholders.

***Proposed regulations may impact our ability to qualify as a RIC if we do not receive timely distributions from our CLO investments.***

We may be required to include in our income our proportionate share of the income of certain CLO investments to the extent that such CLOs are PFICs for which we have made a qualifying electing fund (“QEF”) election or are CFCs. To qualify as a RIC, we must, among other things, derive in each taxable year at least 90% of our gross income from certain sources specified in the Code (the “90% Income Test”). Although the Code generally provides that the income inclusions from a QEF or a CFC will be “good income” for purposes of this 90% Income Test to the extent that the QEF or the CFC distribute such income to us in the same taxable year to which the income is included in our income, the Code does not specifically provide whether these income inclusions would be “good income” for this 90% Income Test if we do not receive distributions from the QEF or CFC during such taxable year. The IRS has issued a series of private rulings in which it has concluded that all income inclusions from a QEF or a CFC included in a RIC’s gross income would constitute “good income” for purposes of the 90% Income Test. Such rulings are not binding on the IRS except with respect to the taxpayers to whom such rulings were issued. Nonetheless, under current law, we believe that the income inclusions from a CLO that is a QEF or a CFC would be “good income” for purposes of the 90% Income Test. Recently, the IRS and U.S. Treasury Department issued proposed regulations that provide that the income inclusions from a QEF or a CFC would not be good income for purposes of the 90% Income Test unless we receive a cash distribution from such entity in the same year attributable to the included income. If such income were not considered “good income” for purposes of the 90% Income Test, we may fail to qualify as a RIC.

**Risks Associated with Our Information Technology Systems**

We rely on various information technology systems to manage our operations. Information technology systems are subject to numerous risks including unanticipated operating problems, system failures, rapid technological change, failure of the systems that operate as anticipated, reliance on third party computer hardware, software and IT service providers, computer viruses, telecommunication failures, data breaches, denial of service attacks, spamming, phishing attacks, computer hackers and other similar disruptions, any of which could materially adversely impact our consolidated financial condition and results of operations. Additional risks include, but are not limited to, the following:

***Disruptions in current systems or difficulties in integrating new systems.***

We regularly maintain, upgrade, enhance or replace our information technology systems to support our business strategies and provide business continuity. Replacing legacy systems with successor systems, making changes to existing systems or acquiring new systems with new functionality have inherent risks including disruptions, delays, or difficulties that may impair the effectiveness of our information technology systems.

***Internal and external cyber threats, as well as other disasters, could impair our ability to conduct business effectively.***

The occurrence of a disaster, such as a cyber-attack against us or against a third-party that has access to our data or networks, a natural catastrophe, an industrial accident, failure of our disaster recovery systems, or consequential employee error, could have an adverse effect on our ability to communicate or conduct business, negatively impacting our operations and financial condition. This adverse effect can become particularly acute if those events affect our electronic data processing, transmission, storage, and retrieval systems, or impact the availability, integrity, or confidentiality of our data.

We depend heavily upon computer systems to perform necessary business functions. Despite our implementation of a variety of security measures, our computer systems, networks, and data, like those of other companies, could be subject to cyber-attacks and unauthorized access, use, alteration, or destruction, such as from physical and electronic break-ins or unauthorized tampering. If one or more of these events occurs, it could potentially jeopardize the confidential, proprietary, and other information processed, stored in, and transmitted through our computer systems and networks. Such an attack could cause interruptions or malfunctions in our operations, which could result in financial losses, litigation, regulatory penalties, client dissatisfaction or loss, reputational damage, and increased costs associated with mitigation of damages and remediation.

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Third parties with which we do business may also be sources of cybersecurity or other technological risk. We outsource certain functions and these relationships allow for the storage and processing of our information, as well as client, counterparty, employee, and borrower information. While we engage in actions to reduce our exposure resulting from outsourcing, ongoing threats may result in unauthorized access, loss, exposure, destruction, or other cybersecurity incident that affects our data, resulting in increased costs and other consequences as described above.

### **Risks Related to Our Investments**

#### ***Our investments may be risky, and you could lose all or part of your investment.***

We invest primarily in senior secured term loans, mezzanine debt, selected equity investments issued by middle market companies, CLO Funds and our Asset Manager Affiliates. The investments in our Debt Securities Portfolio are all or predominantly below investment grade, may be highly leveraged, and therefore have speculative characteristics with respect to the issuer's capacity to pay interest and repay principal. Defaults by portfolio companies may harm our operating results.

*Secured Loans.* When we extend secured term loans, we generally take a security interest (either as a first lien position or as a second lien position) in the available assets of these portfolio companies, including the equity interests of their subsidiaries, which we expect to assist in mitigating the risk that we will not be repaid. However, there is a risk that the collateral securing our loans may decrease in value over time, may be difficult to sell in a timely manner, may be difficult to appraise and may fluctuate in value based upon the success of the business and market conditions, including as a result of the inability of the portfolio company to raise additional capital, and, in some circumstances, our lien could be subordinated to claims of other creditors. In addition, deterioration in a portfolio company's financial condition and prospects, including its inability to raise additional capital, may be accompanied by deterioration in the value of the collateral for the loan. Consequently, the fact that a loan is secured does not guarantee that we will receive principal and interest payments according to the loan's terms, or at all, or that we will be able to collect on the loan should we be forced to exercise our remedies.

*Mezzanine Debt.* Our mezzanine debt investments generally are subordinated to senior loans and generally are unsecured. This may result in an above average amount of risk and volatility or loss of principal.

These investments may entail additional risks that could adversely affect our investment returns. To the extent interest payments associated with such debt are deferred, such debt is subject to greater fluctuations in value based on changes in interest rates and such debt could subject us to phantom income. Since we generally do not receive any cash prior to maturity of the debt, the investment is of greater risk.

*Equity Investments.* We have made and expect to make selected equity investments in the middle market companies. In addition, when we invest in senior secured loans or mezzanine debt, we may acquire warrants in the equity of the portfolio company. Our goal is ultimately to dispose of such equity interests and realize gains upon our disposition of such interests. However, the equity interests we receive may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience.

*Risks Associated with Middle Market Companies.* Investments in middle market companies also involve a number of significant risks, including:

- limited financial resources and inability to meet their obligations, which may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of our realizing the value of any guarantees we may have obtained in connection with our investment;
- shorter operating histories, narrower product lines and smaller market shares than larger businesses, which tend to render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns;
- dependence on management talents and efforts of a small group of persons; therefore, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on our portfolio company and, in turn, on us;

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- less predictable operating results, being parties to litigation from time to time, engaging in rapidly changing businesses with products subject to a substantial risk of obsolescence and requiring substantial additional capital expenditures to support their operations, finance expansion or maintain their competitive position;
- difficulty accessing the capital markets to meet future capital needs; and
- generally less publicly available information about their businesses, operations and financial condition.

*CLO Fund Investments.* Investments in CLO Funds also involve a number of significant risks, including:

- CLOs typically are comprised of a portfolio of senior secured loans; payments on CLO investments are and will be payable solely from the cash-flows from such senior secured loans;
- CLO investments are exposed to leveraged credit risk;
- CLO Funds are highly leveraged;
- there is the potential for interruption and deferral of cash-flow from CLO investments;
- interest rates paid by corporate borrowers are subject to volatility;
- the inability of a CLO collateral manager to reinvest the proceeds of the prepayment of senior secured loans may adversely affect us;
- our CLO investments are subject to prepayments and calls, increasing re-investment risk;
- we have limited control of the administration and amendment of any CLO in which we invest;
- senior secured loans of CLOs may be sold and replaced resulting in a loss to us;
- our financial results may be affected adversely if one or more of our significant equity or junior debt investments in a CLO vehicle defaults on its payment obligations or fails to perform as we expect; and
- non-investment grade debt involves a greater risk of default and higher price volatility than investment grade debt.

*Asset Manager Affiliates.* We may not receive all or a portion of the cash distributions we expect to continue to receive from our Asset Manager Affiliates, including from their receipt of incentive fees.

We expect to receive cash distributions from our Asset Manager Affiliates. However, the existing asset management agreements pursuant to which our Asset Manager Affiliates receive fee income from the CLO Funds for which they serve as managers may be terminated for “cause” by the holders of a majority of the most senior class of securities issued by such CLO Funds and the holders of a majority of the subordinated securities issued by such CLO Funds. “Cause” is defined in the asset management agreements to include a material breach by our Asset Manager Affiliates of the indenture governing the applicable CLO Fund, breaches by our Asset Manager Affiliates of certain specified provisions of the indenture (including, in some cases, a “key person” provision), material breaches of representations or warranties made by our Asset Manager Affiliates, bankruptcy or insolvency of our Asset Manager Affiliates, fraud or criminal activity on the part of our Asset Manager Affiliates or an event of default under the indenture governing the CLO Funds. We expect that future asset management agreements will contain comparable provisions.

Further, a significant portion of the asset management fees payable to our Asset Manager Affiliates under the asset management agreements are subordinated to the prior payments of interest on the senior securities issued by the CLO Funds. If the asset management agreements are terminated, or the CLO Funds do not generate enough income (due to run-off of existing funds and deleveraging), or otherwise have insufficient residual cash flow due to diversion of cash as a result of the failure by the CLO Funds to satisfy certain restrictive covenants contained in their indenture agreements to pay the subordinated management fees, the

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Asset Manager Affiliates will not receive the fee income that they expect to continue to receive which would reduce cash distributions available to us, and in turn reduce our ability to make distributions to our stockholders.

***Our portfolio investments for which there is no readily available market, including our investment in our Asset Manager Affiliates, our Joint Venture and our investments in CLO Funds, are recorded at fair value as determined in good faith by our Board of Directors. As a result, there is uncertainty as to the value of these investments.***

Our investments consist primarily of securities issued by privately-held companies, the fair value of which is not readily determinable. In addition, we are not permitted to maintain a general reserve for anticipated loan losses. Instead, we are required by the 1940 Act to specifically value each investment and record an unrealized gain or loss for any asset that we believe has increased or decreased in value. We value these securities at fair value as determined in good faith by our Board of Directors pursuant to a valuation methodology approved by our Board of Directors. These valuations are initially prepared by our management and reviewed by our Valuation Committee, which uses its best judgment in arriving at the fair value of these securities. However, the Board of Directors retains ultimate authority to determine the appropriate valuation for each investment.

The Company has engaged an independent valuation firm to provide third party valuation consulting services to the Company's Board of Directors. Each quarter, the independent valuation firm performs third party valuations on the Company's material investments in illiquid securities, such that they are reviewed at least once during a trailing 12 month period. These third party valuation estimates are one of the relevant data points in the Board of Director'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 quarterly and annual year-end valuation process. In addition to such third-party input, the types of factors that may be considered in valuing our investments include the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings, the markets in which the portfolio company does business, comparison to publicly-traded companies, discounted cash flow and other relevant factors. Our investment in our Asset Manager Affiliates 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. In addition, our investment in our Joint Venture is carried at fair value, which is determined based on the fair value of the investments held by the Joint Venture. Because such valuations, and particularly valuations of private investments and private companies, are inherently uncertain and may be based on estimates, our determinations of fair value may differ materially from the values that would be assessed if a ready market for these securities existed. Our net asset value could be adversely affected if our determinations regarding the fair value of our illiquid investments were materially higher than the values that we ultimately realize upon the disposal of such securities.

***We are a non-diversified investment company within the meaning of the 1940 Act, and therefore we may invest a significant portion of our assets in a relatively small number of issuers, which subjects us to a risk of significant loss if any of these issuers defaults on its obligations under any of its debt instruments or as a result of a downturn in the particular industry.***

We are classified as a non-diversified investment company within the meaning of the 1940 Act, and therefore we may invest a significant portion of our assets in a relatively small number of issuers in a limited number of industries. As of December 31, 2017, our largest investment, our 100% equity interest in our Asset Manager Affiliates, equaled approximately 12% of the fair value of our total investments. Beyond the asset diversification requirements associated with our qualification as a RIC, we do not have fixed guidelines for diversification, and while we are not targeting any specific industries, relatively few industries may become significantly represented among our investments. To the extent that we assume large positions in the securities of a small number of issuers, our net asset value may fluctuate to a greater extent than that of a diversified investment company as a result of changes in the financial condition or the market's assessment of the issuer,

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changes in fair value over time or a downturn in any particular industry. We may also be more susceptible to any single economic or regulatory occurrence than a diversified investment company.

### ***Defaults by our portfolio companies could harm our operating results.***

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other debt holders could lead to defaults and, potentially, acceleration of the time when the loans are due and foreclosure on its secured assets. Such events could trigger cross-defaults under other agreements and jeopardize a portfolio company's ability to meet its obligations under the debt that we hold and the value of any equity securities we own. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company.

### ***When we are a debt or minority equity investor in a portfolio company, which generally is the case, we may not be in a position to control the entity, and its management may make decisions that could decrease the value of our investment.***

Most of our investments are either debt or minority equity investments in our portfolio companies. Therefore, we are subject to the risk that a portfolio company may make business decisions with which we disagree, and the stockholders and management of such company may take risks or otherwise act in ways that do not serve our interests. As a result, a portfolio company may make decisions that could decrease the value of our portfolio holdings. In addition, we generally are not in a position to control any portfolio company by investing in its debt securities.

### ***We may have limited access to information about privately held companies in which we invest.***

We invest primarily in privately-held companies. Generally, little public information exists about these companies, and we are required to rely on the ability of our investment professionals to obtain adequate information to evaluate the potential returns from investing in these companies. These companies and their financial information are not subject to the Sarbanes-Oxley Act of 2002 and other rules that govern public companies. If we are unable to uncover all material information about these companies, we may not make a fully informed investment decision, and we may lose money on our investment.

### ***Prepayments of our debt investments by our portfolio companies could negatively impact our operating results.***

We are subject to the risk that the investments we make in our portfolio companies may be repaid prior to maturity. When this occurs, we generally reinvest these proceeds in temporary investments, pending their future investment in new portfolio companies. These temporary investments typically have substantially lower yields than the debt being prepaid and we could experience significant delays in reinvesting these amounts. Any future investment in a new portfolio company may also be at lower yields than the debt that was repaid. Consequently, our results of operations could be materially adversely affected if one or more of our portfolio companies elects to prepay amounts owed to us. Additionally, prepayments could negatively impact our return on equity, which could result in a decline in the market price of our common stock.

### ***We may be unable to invest the net proceeds raised from offerings and repayments from investments on acceptable terms, which would harm our financial condition and operating results.***

Until we identify new investment opportunities, we intend to either invest the net proceeds of future offerings and repayments from investments in interest-bearing deposits or other short-term instruments or use the net proceeds from such offerings to reduce then-outstanding debt obligations. We cannot assure you that we will be able to find enough appropriate investments that meet our investment criteria or that any investment we complete using the proceeds from an offering will produce a sufficient return.

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### ***Our portfolio companies may incur debt that ranks equal with, or senior to, our investments in such companies.***

We invest primarily in debt securities issued by our portfolio companies. In some cases portfolio companies are permitted to have other debt that ranks equal with, or senior to, the debt securities in which we invest. By their terms, such debt instruments may provide that the holders thereof are entitled to receive payment of interest or principal on or before the dates on which we are entitled to receive payments in respect of the debt securities in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of debt instruments ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution in respect of our investment. After repaying such senior creditors, such portfolio company may not have any remaining assets to use for repaying its obligation to us. In the case of debt ranking equal with debt securities in which we invest, we would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company.

### ***Second priority liens on collateral securing loans that we make to our portfolio companies may be subject to control by senior creditors with first priority liens. If there is a default, the value of the collateral may not be sufficient to repay in full both the first priority creditors and us.***

Certain loans that we make are secured by a second priority security interest in the same collateral pledged by a portfolio company to secure senior debt owed by the portfolio company to other traditional lenders. Often the senior lender has procured covenants from the portfolio company prohibiting the incurrence of additional secured debt, without the senior lender's consent. Prior to, and as a condition of, permitting the portfolio company to borrow money from us secured by the same collateral pledged to the senior lender, the senior lender will require assurances that it will control the disposition of any collateral in the event of bankruptcy or other default. In many such cases, the senior lender will require us to enter into an "intercreditor agreement" prior to permitting the portfolio company to borrow from us. Typically, the intercreditor agreements we are requested to execute expressly subordinate our debt instruments to those held by the senior lender and further provide that the senior lender shall control: (1) the commencement of foreclosure or other proceedings to liquidate and collect on the collateral; (2) the nature, timing and conduct of foreclosure or other collection proceedings; (3) the amendment of any collateral document; (4) the release of the security interests in respect of any collateral; and (5) the waiver of defaults under any security agreement. Because of the control we may cede to senior lenders under intercreditor agreements we may enter, we may be unable to realize the proceeds of any collateral securing some of our loans.

### ***There may be circumstances where our debt investments could be subordinated to claims of other creditors or we could be subject to lender liability claims.***

Even though we may have structured certain of our investments as senior loans, if one of our portfolio companies were to go bankrupt, depending on the facts and circumstances, including the size of our investment and the extent to which we actually provided managerial assistance to that portfolio company, a bankruptcy court might recharacterize our debt investment and subordinate all or a portion of our claim to that of other creditors. In addition, lenders can be subject to lender liability claims for actions taken by them where they become too involved in the borrower's business or exercise control over the borrower. It is possible that we could become subject to a lender's liability claim, including as a result of actions taken in rendering significant managerial assistance.

### ***Our investments in equity securities involve a substantial degree of risk.***

We purchase common stock and other equity securities, including warrants. Although equity securities have historically generated higher average total returns than fixed-income securities over the long term, equity securities have also experienced significantly more volatility in those returns. The equity securities we acquire may fail to appreciate and may decline in value or become worthless, and our ability to recover our investment depends on our portfolio company's success. Investments in equity securities involve a number of significant risks, including the risk of further dilution as a result of additional issuances, inability to access additional capital and failure to pay current distributions. Investments in preferred securities involve special risks, such as the risk of deferred distributions, credit risk, illiquidity and limited voting rights.



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### ***The lack of liquidity in our investments may adversely affect our business.***

We may invest in securities issued by private companies. These securities may be subject to legal and other restrictions on resale or otherwise be less liquid than publicly-traded securities. The illiquidity of these investments may make it difficult for us to sell these investments when desired. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we had previously recorded these investments. Our investments are usually subject to contractual or legal restrictions on resale or are otherwise illiquid because there is usually no established trading market for such investments. The illiquidity of most of our investments may make it difficult for us to dispose of them at a favorable price, and, as a result, we may suffer losses.

### ***Our investments in foreign securities may involve significant risks in addition to the risks inherent in U.S. investments.***

Our investment strategy contemplates that a portion of our investments may be in securities of foreign companies. Investing in foreign companies may expose us to additional risks not typically associated with investing in U.S. companies. These risks include changes in exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets and less available information than is generally the case in the United States, higher transaction costs, less government supervision of exchanges, brokers and issuers, less developed bankruptcy laws, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

Although it is anticipated that most of our investments will be denominated in U.S. dollars, our investments that are denominated in a foreign currency will be subject to the risk that the value of a particular currency may change in relation to the U.S. dollar. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments.

### ***The disposition of our investments may result in contingent liabilities.***

We currently expect that a significant portion of our investments will involve lending directly to private companies. In connection with the disposition of an investment in private securities, we may be required to make representations about the business and financial affairs of the portfolio company typical of those made in connection with the sale of a business. We may also be required to indemnify the purchasers of such investment to the extent that any such representations turn out to be inaccurate or with respect to certain potential liabilities. These arrangements may result in contingent liabilities that ultimately yield funding obligations that must be satisfied through our return of certain distributions previously made to us.

### ***We may not receive any return on our investment in the CLO Funds in which we have invested and the Asset Manager Affiliates may be unable to raise additional CLO Funds.***

As of December 31, 2017, we had \$51.7 million at fair value invested in the subordinated securities, preferred shares, or other securities issued by the CLO Funds managed by our Asset Manager Affiliates and certain other third party asset managers, and through the Joint Venture. Subject to market conditions and legal requirements applicable to us under the 1940 Act, we expect to continue to acquire subordinated securities in the future in CLO Funds managed by our Asset Manager Affiliates and/or third party managers. Subordinated securities are the most junior class of securities issued by the CLO Funds and are subordinated in priority of payment to every other class of securities issued by these CLO Funds. Therefore, they only receive cash distributions if the CLO Funds have made all cash interest payments to all other debt securities issued by the CLO Fund. The subordinated securities are also unsecured and rank behind all of the secured creditors, known or unknown, of the CLO Fund, including the holders of the senior securities issued by the CLO Fund. Consequently, to the extent that the value of a CLO Fund's loan investments has been reduced as a result of conditions in the credit markets, or as a result of defaulted loans or individual fund assets, the value of the subordinated securities at their redemption could be reduced. Additionally, the Asset Manager Affiliates may not be able to continue to raise new CLO Funds due to prevailing CLO market conditions, regulatory requirements or other factors.



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***If our Asset Manager Affiliates do not meet certain risk retention requirements, they may not be able to sponsor and manage new CLOs, which would negatively impact our results of operations and financial conditions.***

In October 2014, the SEC, the FDIC, the Federal Reserve and certain other prudential banking regulators finalized regulations that mandate risk retention for securitizations. The rules became effective for CLOs on December 24, 2016. Under the final rules, our Asset Manager Affiliates (directly or through any of their majority-controlled affiliates, including the Company) will be required to hold interests equal to 5% of the fair value of the assets of any CLO sponsored by our Asset Manager Affiliates (unless the CLO invests only in certain qualifying loans which we do not expect will be the case) and would be prohibited from selling or hedging those interests in accordance with the limitations on such sales or hedges set forth in the final rule. Thus, our Asset Manager Affiliates (or any of their majority-controlled affiliates, including the Company, permitted to retain risk on their behalf) will need to have the requisite capital to hold such interests as a condition to their ability to sponsor new CLOs, and the restrictions on selling or hedging such interests may create greater risk with respect to those interests, including, to the extent that we retain risk in the CLOs managed by the Asset Manager Affiliates on their behalf, our ability to sell CLO Fund Securities when advantageous for us to do so. These mandatory investments in such CLOs, or the inability to invest in such CLOs (and thus inability to sponsor them) could each have a material adverse effect upon our business, results of operations or financial condition of the Asset Manager Affiliates, which would, in turn, negatively impact the business results of operations and financial condition. In addition, the application of the risk retention rules to CLOs may have broader effects on the CLO and loan markets in general, potentially resulting in fewer or less desirable investment opportunities for the Company, our Asset Manager Affiliates, and any CLOs that our Asset Manager Affiliates sponsor or in which we otherwise invest.

On February 9, 2018, the DC Circuit Court ruled in favor of an appeal brought by the LSTA from a District Court ruling granting summary judgment to the SEC and the Board of Governors of the Federal Reserve System. As part of its ruling, the DC Circuit Court remanded the case to the district court with instructions to grant summary judgment to the LSTA on whether application of the U.S. Risk Retention Rules to CLO managers is valid under Section 941 of the Dodd-Frank Act. If the decision stands, CLO managers of “open-market CLOs” (described in the ruling as CLOs where assets are acquired from “arms-length negotiations and trading on an open market”) will no longer be required to comply with the risk retention rules, and no party to such “open-market CLOs” would be required to acquire and retain an economic interest in the credit risk of the securitized assets.

However, the implementation and effectiveness of the ruling could be delayed, modified or reversed. In particular, the applicable government authorities will have the right to (a) petition for en banc review of the decision by the entire court or (b) file a petition for certiorari requesting the case to be heard by the United States Supreme Court. The risk retention rules will remain in effect until a new judgment is entered in the District Court, which will not occur until the DC Circuit Court issues a mandate to the District Court to do so (which will occur within one week after the deadline for a petition for rehearing has passed). That will not occur if a petition for rehearing is filed; the deadline for a rehearing is 45 days from the issuance of the decision by the DC Circuit Court. If a petition for rehearing is filed, the DC Circuit Court will not issue a mandate to the District Court to issue such judgment during the consideration of the petition. If the petition for rehearing is denied, the mandate from the DC Circuit Court must be issued within a week from such denial unless a motion to stay the mandate is also filed pending a petition for writ of certiorari to the United States Supreme Court. Although the granting of such a motion is not automatic, it is also not rare. If the motion to stay the mandate is granted and a petition for a writ of certiorari filed in the United States Supreme Court, the stay will remain in effect until the Supreme Court’s work on the matter (either through a denial of certiorari or a ruling on the merits) is complete.

## Risks Related to Our Common Stock

***We may not be able to pay distributions to our stockholders, our distributions may not grow over time, and a portion of distributions paid to our stockholders may be a return of capital.***

We intend to continue to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution. We may not be able to achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. Our ability to pay distributions might be adversely affected by, among other things, the impact of one or more of the risk factors described herein. In addition, the inability to satisfy the asset coverage test applicable to us as a BDC could limit our ability to pay distributions. In addition, due to the asset coverage test applicable to us as a BDC and covenants that we agreed to in connection with the issuance of the 7.375% Notes Due 2019 and the 6.125% Notes Due 2022 (together, the “Notes”) we are limited in our ability to make distributions in certain circumstances. In this regard, we agreed in connection with our issuance of the Notes that for the period of time during which the Notes are outstanding, we will not violate (regardless of whether we are subject to) Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act. These provisions generally prohibit us from declaring any cash dividend or distribution upon our common stock, or purchasing any such common stock if our asset coverage, as defined in the 1940 Act, is below 200% at the time of the declaration of the dividend or distribution or the purchase and after deducting the amount of such dividend, distribution or purchase. Further, if we invest a greater amount of assets in equity securities that do not pay current dividends, it could reduce the amount available for distribution.

All distributions will be paid at the discretion of our Board of Directors and will depend on our earnings and those of the Asset Manager Affiliates, our financial condition, maintenance of our RIC status, compliance with applicable BDC regulations and such other factors as our Board of Directors may deem relevant from time to time. We cannot assure you that we will pay distributions to our stockholders in the future.

When we make quarterly distributions, we will be required to determine the extent to which such distributions are paid out of current or accumulated earnings, recognized capital gains or capital. To the extent there is a return of capital, investors will be required to reduce their basis in our stock for U.S. federal income tax purposes, which may result in higher tax liability when the shares are sold, even if they have not increased in value or have lost value. Our distributions have over the last several years included a significant return of capital component. For more information about our distributions over the last several years that have included a return of capital component, see Note 7 — “Distributable Taxable Income” to our consolidated financial statements included elsewhere in this Annual Report.

***Investing in shares of our common stock may involve an above average degree of risk.***

The investments we make in accordance with our investment objective may result in a higher amount of risk, volatility or loss of principal than alternative investment options. Our investments in portfolio companies may be highly speculative, and therefore, an investment in our common stock may not be suitable for investors with lower risk tolerance.

***Shares of closed-end investment companies, including BDCs, frequently trade at a discount to their net asset value, and we cannot assure you that the market price of our common stock will not decline below the net asset value of the stock.***

We cannot predict the price at which our common stock will trade. Shares of closed-end investment companies frequently trade at a discount to their net asset value and our stock may also be discounted in the market. This characteristic of closed-end investment companies is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether shares of our common stock will trade above, at or below our net asset value. The risk of loss associated with this characteristic of closed-end investment companies may be greater for investors expecting to sell shares of common stock soon after the purchase of such shares of common stock. In addition, if our common stock trades below its net asset value, we will generally not be able to issue additional shares of our common stock at its market price without first obtaining the approval of our stockholders and our independent directors.

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### ***Our share price may be volatile and may fluctuate substantially.***

The market price and liquidity of the market for shares of our common stock may be significantly affected by numerous factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include:

- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of securities of BDCs or other companies in our sector, which are not necessarily related to the operating performance of these companies or to us;
- our inability to deploy or invest our capital;
- fluctuations in interest rates;
- any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;
- operating performance of companies comparable to us;
- changes in regulatory policies or tax rules, particularly with respect to RICs or BDCs;
- inability to maintain our qualification as a RIC for U.S. federal income tax purposes;
- changes in earnings or variations in operating results;
- changes in the value of our portfolio;
- general economic conditions and trends; and
- departure of key personnel.

### ***Certain provisions of the Delaware General Corporation Law and our certificate of incorporation and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.***

The Delaware General Corporation Law, our certificate of incorporation and our bylaws contain provisions that may have the effect of discouraging a third party from making an acquisition proposal for us. These anti-takeover provisions may inhibit a change in control in circumstances that could give the holders of our common stock the opportunity to realize a premium over the market price of our common stock.

## **Risks Related to Our Notes**

### ***Our Notes are unsecured and therefore are effectively subordinated to any secured indebtedness we have currently incurred or may incur in the future.***

Our Notes are not secured by any of our assets or any of the assets of our subsidiaries or the Asset Manager Affiliates. As a result, the Notes are effectively subordinated to any secured indebtedness we or they have currently incurred and may incur in the future (or any indebtedness that is initially unsecured to which we subsequently grant security) to the extent of the value of the assets securing such indebtedness. In any liquidation, dissolution, bankruptcy or other similar proceeding, the holders of any of our existing or future secured indebtedness and the secured indebtedness of our subsidiaries and the Asset Manager Affiliates may assert rights against the assets pledged to secure that indebtedness in order to receive full payment of their indebtedness before the assets may be used to pay other creditors, including the holders of the Notes.

### ***The Notes are structurally subordinated to the indebtedness and other liabilities of our subsidiaries and portfolio companies with respect to which we hold equity investments, including the Asset Manager Affiliates.***

The Notes are obligations exclusively of KCAP Financial, Inc., and not of any of our subsidiaries or the Asset Manager Affiliates. None of our subsidiaries or the Asset Manager Affiliates are guarantors of the Notes, and the Notes will not be required to be guaranteed by any subsidiary or asset management firm we may acquire or create in the future. Any assets of our subsidiaries and the Asset Manager Affiliates will not be

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directly available to satisfy the claims of our creditors, including holders of the Notes. Except to the extent we are a creditor with recognized claims against our subsidiaries, all claims of creditors of our subsidiaries will have priority over our equity interests in such entities (and therefore the claims of our creditors, including holders of the Notes) with respect to the assets of such entities. Even if we are recognized as a creditor of one or more of these entities, our claims would still be effectively subordinated to any security interests in the assets of any such entity and to any indebtedness or other liabilities of any such entity senior to our claims. Consequently, the Notes are structurally subordinated to all indebtedness and other liabilities of any of our subsidiaries and portfolio companies with respect to which we hold equity investments, including the Asset Manager Affiliates and any subsidiaries of the Asset Manager Affiliates that we may in the future acquire or establish. These entities may incur substantial indebtedness in the future, all of which would be structurally senior to the Notes.

### ***The indentures under which the Notes are issued contain limited protection for holders of the Notes.***

The indentures under which the Notes are issued offer limited protection to holders of the Notes. The terms of the indentures and the Notes do not restrict our or any of our subsidiaries or the Asset Manager Affiliates' ability to engage in, or otherwise be a party to, a variety of corporate transactions, circumstances or events that could have a material adverse impact on your investment in the Notes. In particular, the terms of the indenture and the Notes do not place any restrictions on our or our subsidiaries or the Asset Manager Affiliates' ability to:

- issue securities or otherwise incur additional indebtedness or other obligations, including (1) any indebtedness or other obligations that would be equal in right of payment to the Notes, (2) any indebtedness or other obligations that would be secured and therefore rank effectively senior in right of payment to the Notes to the extent of the values of the assets securing such debt, (3) indebtedness of ours that is guaranteed by one or more of our subsidiaries or the Asset Manager Affiliates and which therefore is structurally senior to the Notes and (4) securities, indebtedness or obligations issued or incurred by our subsidiaries or the Asset Manager Affiliates that would be senior to our equity interests in those entities and therefore rank structurally senior to the Notes with respect to the assets of our subsidiaries and the Asset Manager Affiliates, in each case other than an incurrence of indebtedness or other obligation that would cause a violation of Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act or any successor provisions. These provisions generally prohibit us from making additional borrowings, including through the issuance of additional debt or the sale of additional debt securities, unless our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowings;
- pay dividends on, or purchase or redeem or make any payments in respect of, capital stock or other securities ranking junior in right of payment to the Notes, including subordinated indebtedness, in each case other than dividends, purchases, redemptions or payments that would cause a violation of Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act or any successor provisions. These provisions generally prohibit us from declaring any cash dividend or distribution upon any class of our capital stock, or purchasing any such capital stock if our asset coverage, as defined in the 1940 Act, is below 200% at the time of the declaration of the dividend or distribution or the purchase and after deducting the amount of such dividend, distribution or purchase;
- sell assets (other than certain limited restrictions on our ability to consolidate, merge or sell all or substantially all of our assets);
- enter into transactions with affiliates;
- create liens (including liens on the shares of our subsidiaries) or enter into sale and leaseback transactions;
- make investments; or
- create restrictions on the payment of dividends or other amounts to us from our subsidiaries.

In addition, the indenture does not require us to offer to purchase the Notes in connection with a change of control or any other event.

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Furthermore, the terms of the indentures and the Notes do not protect holders of the Notes in the event that we experience changes (including significant adverse changes) in our financial condition, results of operations or credit ratings, if any, as they do not require that we adhere to any financial tests or ratios or specified levels of net worth, revenues, income, cash flow, or liquidity other than as described above. Any changes to the 200% asset coverage ratio in the 1940 Act could affect the Notes. See “Item 1A. Risk Factors — Risks Related to Our Business and Structure — Pending legislation may allow us to incur additional leverage.”

Our ability to recapitalize, incur additional debt and take a number of other actions that are not limited by the terms of the Notes may have important consequences for you as a holder of the Notes, including making it more difficult for us to satisfy our obligations with respect to the Notes or negatively affecting the trading value of the Notes.

Other debt we issue or incur in the future could contain more protections for its holders than the indentures and the Notes, including additional covenants and events of default. The issuance or incurrence of any such debt with incremental protections could affect the market for and trading levels and prices of the Notes.

***Even though the 7.375% Notes Due 2019 and the 6.125% Notes Due 2022 are listed on the NYSE and the NASDAQ Global Select Market, respectively, an active trading market for the Notes may not develop, or if it does develop, it will be sustained, which could limit your ability to sell the Notes or affect the market price of the Notes.***

We cannot provide any assurances that an active trading market will develop for the Notes, or that, if it does develop, it will be sustained or that you will be able to sell your Notes. The Notes may trade at a discount from the price paid for the notes depending on prevailing interest rates, the market for similar securities, our credit ratings, if any, general economic conditions, our financial condition, performance and prospects and other factors.

Accordingly, we cannot assure you that a liquid trading market will develop for the Notes or that, if an active trading market for the Notes does develop, it will be sustained, that you will be able to sell your Notes at a particular time or that the price you receive when you sell will be favorable. To the extent an active trading market does not develop, the liquidity and trading price for the Notes may be harmed. Accordingly, you may be required to bear the financial risk of an investment in the Notes for an indefinite period of time.

***If we default on our obligations to pay our other indebtedness, we may not be able to make payments on the Notes.***

Any default under the agreements governing our indebtedness, that is not waived by the required lenders, and the remedies sought by the holders of such indebtedness could make us unable to pay principal, premium, if any, and interest on the Notes and substantially decrease the market value of the Notes. If we are unable to generate sufficient cash flow and are otherwise unable to obtain funds necessary to meet required payments of principal, premium, if any, and interest on our indebtedness, or if we otherwise fail to comply with the various covenants, including financial and operating covenants, in the instruments governing our indebtedness, we could be in default under the terms of the agreements governing such indebtedness. In the event of such default, the holders of such indebtedness could elect to declare all the funds borrowed thereunder to be due and payable, together with accrued and unpaid interest, the lender any debt we may incur in the future could elect to terminate its commitment, cease making further loans and institute foreclosure proceedings against our assets, and we could be forced into bankruptcy or liquidation. If our operating performance declines, we may in the future need to seek to obtain waivers from under any other debt that we may incur in the future to avoid being in default. If we breach our covenants under any debt and seek a waiver, we may not be able to obtain a waiver from the required lenders. If this occurs, we would be in default under any debt, the lender could exercise its rights as described above, and we could be forced into bankruptcy or liquidation. If we are unable to repay debt, lenders having secured obligations could proceed against the collateral securing the debt. Because any future debt we issue will likely have customary cross-default provisions, if such other debt is accelerated, we may be unable to repay or finance the amounts due.

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**Item 1B. *Unresolved Staff Comments***

None.

**Item 2. *Properties***

We do not own any real estate or other real property. Our wholly-owned portfolio company, Katonah Debt Advisors, is the lessee for our principal headquarters at 295 Madison Avenue, 6<sup>th</sup> Floor, New York, New York 10017. We have entered into an Overhead Allocation Agreement with Katonah Debt Advisors which provides for the sharing of the expenses under the lease agreement.

**Item 3. *Legal Proceedings***

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

**Item 4. *Mine Safety Disclosures***

Not applicable.

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Our common stock is quoted on The NASDAQ Global Select Market under the symbol "KCAP." We completed our initial public offering on December 11, 2006 at an initial public offering ("IPO") price of \$15.00 per share. Prior to such date there was no public market for our common stock.

The following table sets forth the range of high and low closing sales prices per share of our common stock as reported on The NASDAQ Global Select Market in respect of the periods indicated. The stock quotations are interdealer quotations and do not include markups, markdowns or commissions and may not necessarily represent actual transactions.

**Quarterly Stock Prices for 2017 and 2016:**

	<u>During the Quarter</u>		<u>At Quarter End</u>	
	<u>High</u>	<u>Low</u>	<u>Close</u>	<u>NAV<sup>(1)</sup></u>
2017:				
Fourth quarter	\$ 3.98	\$ 3.34	\$ 3.41	\$ 4.87
Third quarter	\$ 3.67	\$ 3.32	\$ 3.65	\$ 4.93
Second quarter	\$ 4.04	\$ 3.37	\$ 3.53	\$ 5.08
First quarter	\$ 4.12	\$ 3.93	\$ 4.07	\$ 5.14
2016:				
Fourth quarter	\$ 4.80	\$ 3.66	\$ 3.98	\$ 5.24
Third quarter	\$ 4.72	\$ 3.84	\$ 4.63	\$ 5.38
Second quarter	\$ 3.92	\$ 3.19	\$ 3.92	\$ 5.45
First quarter	\$ 4.02	\$ 2.68	\$ 3.60	\$ 5.50

(1) Net Asset Value ("NAV") per share is determined as of the last day in the relevant quarter and therefore may not reflect the NAV per share on the date of the high and low closing sales prices.

We began paying quarterly distributions in our first full quarter of operations following our IPO. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 8 — "Distributable Tax Income" from our Notes to the Financial Statements included herein. The table below provides information relating to distributions we paid in respect of the periods indicated.

**Stockholder Distributions**

	<u>Distributions</u>	<u>Declaration Date</u>	<u>Record Date</u>	<u>Pay Date</u>
2017:				
Fourth quarter	\$ 0.10	12/13/2017	1/5/2018 <sup>(1)</sup>	1/25/2018
Third quarter	0.12	9/22/2017	10/10/2017	10/26/2017
Second quarter	0.12	6/20/2017	7/7/2017	7/27/2017
First quarter	0.12	3/21/2017	4/7/2017	4/28/2017
Total declared for 2017	<u>\$ 0.46</u>			
2016:				
Fourth quarter	\$ 0.12	12/14/2016	1/6/2017 <sup>(1)</sup>	1/27/2017
Third quarter	0.15	9/20/2016	10/14/2016	10/27/2016
Second quarter	0.15	6/21/2016	7/7/2016	7/28/2016
First quarter	0.15	3/18/2016	4/7/2016	4/28/2016
Total declared for 2016	<u>\$ 0.57</u>			

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

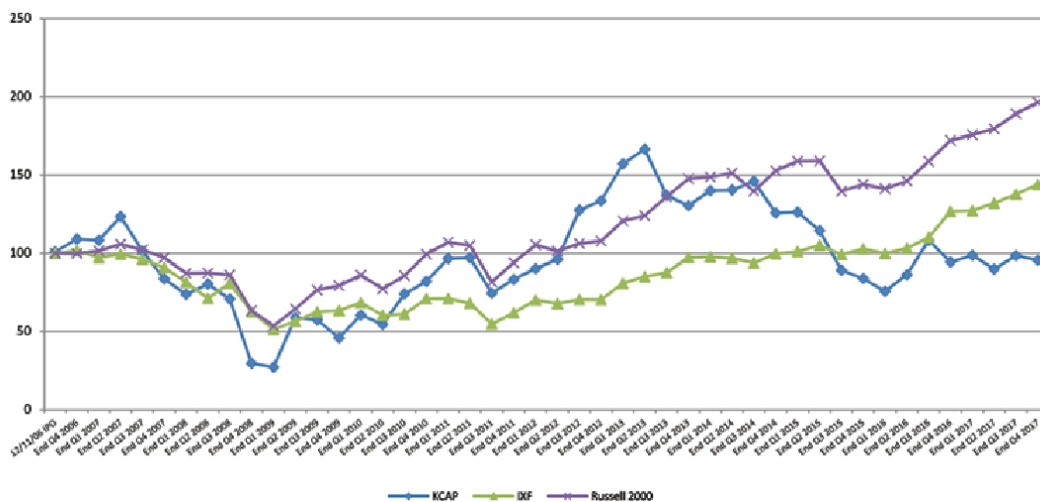
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The determination of the tax attributes of our distributions is made annually, based upon our taxable income for the full year and distributions paid for the full year. Ordinary dividend distributions from a RIC do not qualify for the tax rate applicable to “qualified dividend income” from domestic corporations and qualified foreign corporations, except to the extent that the RIC received the income in the form of qualifying dividends from domestic corporations and qualified foreign corporations. For further information about the tax attributes, see Note 8 “Distributable Taxable Income” of our notes to the financial statements, which can be found elsewhere in this Annual Report.

### Performance Graph

The following graph compares the return on our common stock with that of the Russell 2000 Index and the Nasdaq Financial 100 Index (IXF), for the period December 11, 2006 (the date of our initial public offering) to December 31, 2017. The graph assumes that, on December 11, 2006, a person invested \$100 in each of our common stock, the Russell 2000 Index, and the IFX. The graph measures total shareholder return, which takes into account both changes in stock price and dividends. It assumes that dividends are reinvested.

**Shareholder Return Performance Graph**  
**Cumulative Total Return Since Initial Public Offering<sup>(1)</sup>**  
**(Through December 31, 2017)**



(1) Total return includes reinvestment of distributions through December 31, 2017. The IXF is an index of diversified financial sector stocks and, as such, the Company believes that it is representative of our industry. The Russell 2000 is a broad based equity market index that tracks companies with a market capitalization that the Company believes are comparable to it.

### HOLDERS

As of March 7, 2018, there were approximately 51 holders of record of our common stock. This number does not include shareholders for whom shares are held in “nominee” or “street name.”

### SALES OF UNREGISTERED SECURITIES

During the fiscal year ended December 31, 2017, we issued 96,468 shares of common stock pursuant to a dividend reinvestment plan. This issuance was not subject to the registration requirements of the Securities Act. See Note 9 “Stockholders’ Equity,” of our Notes to the Consolidated Financial Statements included herein.



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### **DIVIDEND POLICY**

We intend to continue to make quarterly distributions to our stockholders. Our quarterly distributions, if any, will be determined by our Board of Directors. To maintain our RIC status, we must timely distribute an amount equal to at least 90% of our tax basis ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, reduced by deductible expenses, out of the assets legally available for distribution, for each year. To avoid certain excise taxes imposed on RICs, we are generally required to distribute during each calendar year an amount at least equal to the sum of (1) 98% of our ordinary income for the calendar year, (2) 98.2% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year and (3) any ordinary income and net capital gains for preceding years that were not distributed during such years and on which we paid no corporate tax. If this requirement is not met, we will be required to pay a nondeductible excise tax equal to 4% of the amount by which the required distribution amount exceeds the actual distribution for the year. The taxable income on which an excise tax is paid is generally carried forward and distributed to stockholders in the next tax 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.

We cannot assure you that we will achieve results that will permit the payment of any cash distributions and, because we issued public senior securities, we are prohibited from making distributions if doing so causes us to fail to maintain the asset coverage ratio stipulated by the 1940 Act. Similarly, we may be prohibited from making distributions by the terms of any of our other borrowings.

We maintain an “opt out” dividend reinvestment plan for our common stockholders. As a result, if we declare distributions, then stockholders’ cash distributions will be automatically reinvested in additional shares of our common stock, unless they specifically “opt out” of the dividend reinvestment plan so as to receive cash.

### **EQUITY COMPENSATION PLAN INFORMATION**

The following table summarizes certain information regarding the 2017 Equity Incentive Plan (the “Equity Incentive Plan”) and the 2017 Non-Employee Director Plan (the “Non-Employee Director Plan”) as of December 31, 2017:

<u>Plan Category</u>	<u>Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights</u>	<u>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights</u>	<u>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))</u>
	(a)	(b)	(c)
Equity Compensation Plans Approved by Security Holders <sup>(1)</sup>	50,000	\$ 7.72	934,334 <sup>(2)(3)</sup>
Equity Compensation Plans Not Approved by Security Holders	—	—	—
<b>Total</b>	<b>50,000</b>	<b>7.72</b>	<b>934,334</b>

(1) The Company’s Equity Incentive Plan and Non-Employee Director Plan.

(2) Subject to the following additional limitations: The aggregate number of shares of restricted stock that may be issued under the Equity Incentive Plan, the Non-Employee Director Plan, and any other Company executive compensation plan, collectively, may not exceed 10% of the outstanding shares of the Company on May 4, 2017, the effective date of the Equity Incentive Plan and the Non-Employee Director Plan, plus 10% of the number of shares of the Company’s common stock issued or delivered by the Company (other than pursuant to compensation plans) during the term of the Equity Incentive Plan and the Non-Employee Director Plan, as applicable. No one person may be granted more than 25% of the shares of restricted stock reserved for issuance under the Equity Incentive Plan or the Non-Employee Director Plan. For purposes of calculating compliance with this limit, the Company will count as restricted stock all shares of the Company’s common stock that are issued pursuant to the Non-Employee

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Director Plan less any shares that are forfeited back to the Company and cancelled as a result of forfeiture restrictions not lapsing. In addition, the amount of voting securities that would result from the exercise of all of the Company's outstanding warrants, options and rights, together with any restricted stock issued by the Company pursuant to the Equity and Incentive Plan, the Non-Employee Director Plan and any other KCAP Financial compensation plan, will not exceed 25%, at the time of issuance, of the outstanding voting securities of the Company, except that if the amount of voting securities that would result from the exercise of all the Company's outstanding warrants, options and rights issued to the Company's directors, officers and employees, together with any restricted stock issued by the Company, would exceed 15% of the outstanding voting securities of the Company, the total amount of voting securities that would result from the exercise of all outstanding warrants, options and rights, together with any restricted stock issued by the Company, at the time of issuance may not exceed 20% of the outstanding voting securities of the Company.

- (3) The shares issuable under the Company's Equity Incentive Plan may be issued in the form of options, restricted stock or other stock-based awards. The shares issuable under the Company's Non-Employee Director Plan may currently be issued in the form of restricted stock.

### Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and Part II, Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K. The following selected financial and other data for the years ended December 31, 2017, 2016, 2015, 2014 and 2013 is derived from the audited consolidated financial statements for such years, included in Part II, Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K.

#### KCAP FINANCIAL, INC. SELECTED FINANCIAL DATA

	Year Ended December 31, 2017	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2014	Year Ended December 31, 2013
<b>Income Statement Data:</b>					
Interest and related portfolio income:					
Interest and Dividends	\$ 26,363,383	\$ 34,131,571	\$ 39,811,558	\$ 34,802,690	\$ 33,144,195
Fees and other income	491,279	668,527	366,859	934,871	305,376
Dividends from Asset Manager Affiliates	460,000	1,400,000	5,348,554	5,467,914	5,735,045
Investment income – Joint Venture	949,037	—	—	—	—
Total interest and related portfolio income	28,263,699	36,200,098	45,526,971	41,205,475	39,184,616
Expenses:					
Interest and amortization of debt issuance costs	7,661,407	9,110,603	11,727,880	11,538,179	10,116,271
Compensation	4,571,309	4,103,558	3,843,799	4,951,745	4,630,481
Other	5,011,852	4,495,942	5,772,502	4,594,983	4,563,749
Total operating expenses	17,244,568	17,710,103	21,344,181	21,084,907	19,310,501
<b>Net Investment Income</b>	<b>11,019,131</b>	<b>18,489,995</b>	<b>24,182,790</b>	<b>20,120,568</b>	<b>19,874,115</b>
Realized and unrealized (losses) gains on investments:					
Net realized (losses) gains	(11,021,042)	(6,341,678)	(6,647,478)	(11,132,491)	(12,627,314)
Net change in unrealized (losses) gains	3,389,993	(13,188,048)	(36,169,870)	6,045,517	9,976,171
Total net (losses) gains	(7,631,049)	(19,529,726)	(42,817,348)	(5,086,974)	(2,651,143)
Net (decrease) increase in net assets resulting from operations	<u>\$ 3,388,082</u>	<u>\$ (1,039,731)</u>	<u>\$(18,634,558)</u>	<u>\$ 15,033,594</u>	<u>\$ 17,222,972</u>

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	Year Ended December 31, 2017	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2014	Year Ended December 31, 2013
<b>Per Share:</b>					
Earnings per common share – basic	\$ 0.09	\$ (0.03)	\$ (0.50)	\$ 0.44	\$ 0.53
Earnings per common share – diluted	\$ 0.09	\$ (0.03)	\$ (0.50)	\$ 0.43	\$ 0.53
Net investment income per share – basic	\$ 0.30	\$ 0.50	\$ 0.65	\$ 0.59	\$ 0.62
Net investment income per share – diluted	\$ 0.30	\$ 0.50	\$ 0.65	\$ 0.58	\$ 0.62
Distributions declared per common share	\$ 0.46	\$ 0.57	\$ 0.78	\$ 1.00	\$ 1.06
Taxable Distributable Income per basic share	\$ 0.16	\$ 0.40	\$ 0.63	\$ 0.78	\$ 0.70
<b>Balance Sheet Data:</b>					
Investment assets at fair value	\$311,956,156	\$366,471,304	\$409,570,495	\$479,706,494	\$440,549,994
Total assets	\$319,808,974	\$381,371,983	\$421,204,697	\$505,180,218	\$453,340,638
Total debt outstanding	\$101,413,317	\$175,548,570	\$201,103,761	\$218,618,014	\$186,760,623
Stockholders' equity	\$181,804,756	\$194,924,925	\$216,100,470	\$255,316,701	\$250,369,693
Net asset value per common share	\$ 4.87	\$ 5.24	\$ 5.82	\$ 6.94	\$ 7.51
Common shares outstanding at end of year	37,339,224	37,178,294	37,100,005	36,775,127	33,332,123
<b>Other Data:</b>					
Investments funded <sup>(1)</sup>	227,722,823	75,724,590	130,954,741	235,905,130	243,966,586
Principal collections related to investment repayments or sales <sup>(1)</sup>	323,531,633	129,191,854	129,793,338	193,554,964	94,197,886
Number of portfolio investments at year end <sup>(1)</sup>	77	125	130	141	126
Weighted average yield of income producing debt investments <sup>(2)</sup>	10.1%	7.0%	7.4%	7.3%	7.3%

(1) Does not include investments in time deposits or money markets.

(2) Weighted average yield of income producing investments is calculated as the average yield to par outstanding balances for investments in loans, bonds, and mezzanine debt in our Debt Securities portfolio.

**Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with our financial statements and related notes and other financial information appearing elsewhere in this annual report. In addition to historical information, the following discussion and other parts of this annual report contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to the factors discussed under “Item 1A. Risk Factors” and “Note About Forward-Looking Statements” appearing elsewhere in this annual report.*

**GENERAL**

We are an internally managed, non-diversified closed-end investment company that is regulated as a business development company, (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). We have three principal areas of investment:

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

Second, the Company has invested in our wholly-owned asset management companies including Katonah Debt Advisors L.L.C. (“Katonah Debt Advisors”) and Trimaran Advisors L.L.C. (“Trimaran Advisors”), which manage collateralized loan obligation funds (“CLO Funds”).

Third, the Company invests in debt and subordinated securities issued by collateralized loan obligation funds (“CLO Fund Securities”). These CLO Fund Securities are primarily managed by Katonah Debt Advisors and Trimaran Advisors, as well as our affiliated management companies Katonah 2007-1 Management, L.L.C., Trimaran Advisors Management, L.L.C. and KCAP Management, LLC (collectively, the “Asset Manager Affiliates”), but from time-to-time the Company makes investments in CLO Fund Securities managed by other asset managers. The CLO Funds typically invest in broadly syndicated loans, high-yield bonds and other credit instruments.

We may also invest in other investments such as loans to publicly-traded companies, high-yield bonds, joint venture and distressed debt securities. We may also receive warrants or options to purchase common stock in connection with its debt investments.

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

From our Asset Manager Affiliates investment, we expect to receive recurring cash distributions and to generate capital appreciation through the addition of new CLO Funds managed by our Asset Manager Affiliates. We may also seek to monetize our investment in the Asset Manager Affiliates if and when business conditions warrant. The Asset Manager Affiliates manage CLO Funds that invest in broadly syndicated loans, high-yield bonds and other credit instruments. Collectively, the Asset Manager Affiliates have approximately \$3.0 billion of par value assets under management as of December 31, 2017. The Asset Manager Affiliates are registered under the Investment Advisers Act of 1940, as amended. Certain of the Company’s executive officers also act in similar capacities for one or more of the Asset Manager Affiliates.

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

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

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

## PORTFOLIO AND INVESTMENT ACTIVITY

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

Total portfolio investment activity (excluding activity in time deposit and money market investments) for the years ended December 31, 2017, December 31, 2016, and December 31, 2015 was as follows:

	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliates	Joint Venture	Total Portfolio
Fair Value at December 31, 2014	\$ 320,143,170	\$ 77,514,902	8,119,681	\$ 72,326,000	\$ —	\$ 478,103,753
2015 Activity:						
Purchases/originations/draws	108,670,472	11,952,000	1,953,299	—	—	124,023,641
Pay-downs/pay-offs/sales	(135,328,386)	(3,872,700)	(317,340)	(3,701,446)	—	(143,219,872)
Net accretion (amortization)	1,860,670	(9,507,050)	—	—	—	(9,094,250)
Net realized losses	41,580	(6,246,883)	3,015	—	—	(6,202,288)
Net increase (decrease) in fair value	(10,748,262)	(13,967,887)	(210,167)	(11,243,554)	—	(36,169,870)
Fair Value at December 31, 2015	284,639,244	55,872,382	9,548,488	57,381,000	—	407,441,114
2016 Activity:						
Purchases/originations/draws	74,584,952	10,140,000	—	—	—	84,724,952
Pay-downs/pay-offs/sales	(123,240,416)	(4,200,000)	(4,563,521)	—	—	(132,003,937)
Net accretion (amortization)	407,492	(2,192,071)	—	(1,250,000)	—	(3,034,579)
Net realized gains (losses)	(540,649)	(10,111,560)	4,484,742	—	—	(6,167,467)
Net increase (decrease) in fair value	2,492,707	4,665,599	(4,413,354)	(15,933,000)	—	(13,188,048)
Fair Value at December 31, 2016	238,343,330	54,174,350	5,056,355	40,198,000	—	337,772,035
2017 Activity:						
Purchases/originations/draws	181,613,690	11,211,368	182,000	—	36,738,873	229,745,931
Pay-downs/pay-offs/sales	(300,625,104)	(25,598,497)	—	(2,750,000)	(11,824,015)	(340,797,616)
Net accretion (amortization)	304,904	11,139,633	—	—	—	11,444,537
Net realized gains (losses)	(5,634,255)	(1,264,789)	—	—	—	(6,899,044)
Net increase (decrease) in fair value	4,194,914	2,016,608	(823,671)	1,401,000	(3,398,858)	3,389,993
Fair Value at December 31, 2017	\$ 118,197,479	\$ 51,678,673	\$ 4,414,684	\$ 38,849,000	\$ 21,516,000	\$ 234,655,836

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

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

Security Type	December 31, 2017			December 31, 2016		
	Cost/Amortized Cost	Fair Value	% <sup>(1)</sup>	Cost/Amortized Cost	Fair Value	% <sup>(1)</sup>
Short-term investments <sup>(2)</sup>	\$ 77,300,320	\$ 77,300,320	26	\$ 28,699,269	\$ 28,699,269	8%
Senior Secured Loan	48,337,900	44,960,146	14	207,701,078	200,322,152	55
Junior Secured Loan	62,561,913	58,941,300	19	37,251,776	35,444,440	10
Senior Unsecured Loan	12,777,283	12,777,283	4	—	—	—
First Lien Bond	—	—	—	3,060,919	1,089,338	—
Senior Secured Bond	1,502,374	1,518,750	—	1,506,461	1,487,400	—
CLO Fund Securities	72,339,032	51,678,673	17	76,851,317	54,174,350	15
Equity Securities	10,571,007	4,414,684	1	10,389,007	5,056,355	1
Asset Manager Affiliates <sup>(3)</sup>	52,591,230	38,849,000	12	55,341,230	40,198,000	11
Joint Venture	24,914,858	21,516,000	7	—	—	—
Total	<u>\$362,895,917</u>	<u>\$311,956,156</u>	<u>100%</u>	<u>\$420,801,057</u>	<u>\$366,471,304</u>	<u>100%</u>

(1) Represents percentage of total portfolio at fair value.

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

(3) Represents the equity investment in the Asset Manager Affiliates.

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The industry related information, based on the fair value of the Company's investment portfolio as of December 31, 2017 and December 31, 2016, for our investment portfolio was as follows:

Industry Classification	December 31, 2017			December 31, 2016		
	Cost/Amortized Cost	Fair Value	% <sup>(1)</sup>	Cost/Amortized Cost	Fair Value	% <sup>(1)</sup>
Aerospace and Defense	\$ 5,636,056	\$ 4,115,487	1%	\$ 8,394,633	\$ 8,450,106	2%
Asset Management						
Company <sup>(2)</sup>	52,591,230	38,849,000	12	55,341,230	40,198,000	11
Automotive	—	—	—	6,322,551	6,196,154	2
Banking, Finance, Insurance & Real Estate	4,458,962	4,418,391	1	6,805,514	6,782,010	2
Beverage, Food and Tobacco	7,496,438	7,435,050	2	15,198,830	14,703,372	4
Capital Equipment	5,454,621	4,680,821	2	6,185,129	5,575,048	2
Chemicals, Plastics and Rubber	—	—	—	6,421,909	6,444,073	2
CLO Fund Securities	72,339,032	51,678,673	17	76,851,317	54,174,350	15
Construction & Building	1,004,093	999,872	—	5,919,158	5,929,606	2
Consumer goods: Durable	1,071,340	805,607	—	12,319,905	10,118,736	3
Consumer goods: Non-durable	691,234	694,662	—	14,766,390	14,452,096	4
Ecological	—	—	—	1,741,292	1,760,783	—
Energy: Electricity	—	—	—	3,904,453	3,937,247	1
Energy: Oil & Gas	14,932,542	11,433,777	4	14,493,835	8,805,761	2
Environmental Industries	6,330,630	5,766,437	2	12,279,924	12,185,239	3
Forest Products & Paper	1,558,556	1,600,960	1	4,192,889	4,192,907	1
Healthcare & Pharmaceuticals	30,367,449	25,512,654	8	58,769,668	53,594,534	15
High Tech Industries	18,229,229	18,260,577	6	9,854,093	9,936,109	3
Hotel, Gaming & Leisure	400,000	1,000	—	400,000	1,000	—
Joint Venture	24,914,858	21,516,000	7	—	—	—
Media: Advertising, Printing & Publishing	3,371,086	3,318,296	1	11,712,682	11,453,447	3
Media: Broadcasting & Subscription	—	—	—	8,273,174	8,372,984	2
Related Party Loans	12,777,283	12,777,283	4	—	—	—
Retail	—	—	—	1,415,457	759,581	—
Services: Business	3,563,574	2,366,400	1	16,125,481	16,230,486	4
Services: Consumer	—	—	—	6,212,108	6,204,889	2
Telecommunications	6,455,489	6,466,949	2	12,809,799	12,767,823	3
Textiles and Leather	7,950,994	7,947,940	3	—	—	—
Money Market Accounts	52,293,570	52,293,570	17	28,699,269	28,699,269	8
Transportation: Cargo	4,000,901	4,010,000	1	7,557,315	7,190,135	2
Transportation: Consumer	—	—	—	2,412,614	2,324,516	1
U.S. Government Obligations	25,006,750	25,006,750	8	—	—	—
Utilities: Electric	—	—	—	5,420,438	5,031,043	1
<b>Total</b>	<b>\$ 362,895,917</b>	<b>\$ 311,956,156</b>	<b>100%</b>	<b>\$ 420,801,057</b>	<b>\$ 366,471,304</b>	<b>100%</b>

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

(2) Represents the equity investment in the Asset Manager Affiliates.

### **Debt Securities Portfolio**

At December 31, 2017 and December 31, 2016, our investments in income producing loans and debt securities, excluding CLO Fund Securities, had a weighted average interest rate of approximately 10.1% and 7.0%, respectively.

The investment portfolio (excluding the Company's investment in Asset Manager Affiliates, CLO Funds, Joint Venture and short-term investments) at December 31, 2017 was spread across 19 different industries and 54 different entities with an average balance per entity of approximately \$2.8 million. As of December 31, 2017, all of our portfolio companies were current on their debt service obligations.

We may invest up to 30% of our investment portfolio in "Non-qualifying" opportunistic investments such as high-yield bonds, debt and equity securities of CLO Funds, foreign investments, and distressed debt or equity securities of large cap public companies. At December 31, 2017 and December 31, 2016, the total amount of non-qualifying assets was approximately 23% and 17%, respectively. The majority of non-qualifying assets were foreign investments which were approximately 16% and 14% of the Company's total assets, respectively (including the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 16% and 14% of its total assets on such dates, respectively). The investments in our Debt Securities Portfolio are all or predominantly below investment grade, and therefore have speculative characteristics with respect to the issuer's capacity to pay interest and repay principal.

### **Asset Manager Affiliates**

The Asset Manager Affiliates are our wholly-owned asset management companies that manage CLO Funds that invest in broadly syndicated loans, high yield bonds and other credit instruments. The CLO Funds managed by our Asset Manager Affiliates consist primarily of credit instruments issued by corporations. As of December 31, 2017, our Asset Manager Affiliates had approximately \$3.0 billion of par value of assets under management on which they earn management fees, and were valued at approximately \$38.8 million.

All CLO Funds managed by the Asset Manager Affiliates are currently paying all senior and subordinate management fees. In addition, for the year-ended December 31, 2017, our Asset Manager Affiliates recognized \$3.0 million of incentive fees from one fund. As of December 31, 2017, none of the CLO Funds managed by the Asset Manager Affiliates were paying incentive fees.

### **CLO Fund Securities**

We typically make a minority investment in the subordinated securities or preferred stock of CLO Funds managed by our Asset Manager Affiliates and may selectively invest in securities issued by CLO Funds managed by other asset management companies. As of December 31, 2017 and December 31, 2016, we had approximately \$52 million and \$54 million, respectively invested in CLO Fund Securities, issued primarily by funds managed by our Asset Manager Affiliates.

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

The structure of CLO Funds, which are highly levered, is extremely complicated. Since we primarily invest in securities representing the residual interests of CLO Funds, our investments are much riskier than the risk profile of the loans by which such CLO Funds are collateralized. Our investments in CLO Funds may be riskier and less transparent to us and our stockholders than direct investments in the underlying loans. The CLO Funds in which we invest have debt that ranks senior to our investment. For a more detailed discussion of the risks related to our investments in CLO Funds, please see "Risk Factors — Risks Related to Our Investments — Our investments may be risky, and you could lose all or part of your investment."



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

CLO Fund Securities	Investment	%(1)	December 31, 2017		December 31, 2016	
			Cost/ Amortized Cost	Fair Value	Cost/ Amortized Cost	Fair Value
Grant Grove CLO, Ltd. <sup>(3)</sup>	Subordinated Securities	22.2%	\$ 2,485,886	\$ 1,000	\$ 2,485,886	\$ 1,000
Katonah III, Ltd. <sup>(3)</sup>	Preferred Shares	23.1	1,287,155	369,280	1,287,155	369,000
Katonah 2007-I CLO Ltd. <sup>(2)</sup>	Preferred Shares	100.0	20,524,908	10,770,486	28,022,646	20,453,099
Trimaran CLO VII, Ltd. <sup>(2)</sup>	Income Notes	10.5	379,830	10,000	1,643,920	1,195,152
Catamaran CLO 2012-1 Ltd. <sup>(2)</sup>	Subordinated Notes	24.9	5,847,802	2,320,783	5,919,933	2,819,412
Catamaran CLO 2013-1 Ltd. <sup>(2)</sup>	Subordinated Notes	18.3	5,017,307	6,923,699	5,237,222	4,918,807
Dryden 30 Senior Loan Fund	Subordinated Notes	6.8	1,353,852	1,820,000	1,343,467	1,895,566
Catamaran CLO 2014-1 Ltd. <sup>(2)</sup>	Subordinated Notes	20.1	9,858,073	8,230,178	7,818,484	4,546,682
Catamaran CLO 2014-1 Ltd. <sup>(2)</sup>	Class E Notes	—	—	—	1,441,727	1,310,000
KCAP F3C Senior Funding LLC <sup>(2)</sup>	Class E Notes	27.4	4,435,965	4,632,000	—	—
Catamaran CLO 2014-2 Ltd. <sup>(2)</sup>	Subordinated Notes	24.9	6,642,805	4,500,962	6,967,560	5,092,087
Catamaran CLO 2015-1 Ltd. <sup>(2)</sup>	Subordinated Notes	9.9	4,418,647	3,569,600	4,543,317	3,223,255
Catamaran CLO 2016-1 Ltd. <sup>(2)</sup>	Subordinated Notes	24.9	10,086,802	8,530,685	10,140,000	8,350,290
<b>Total</b>			<b>\$72,339,032</b>	<b>\$51,678,673</b>	<b>\$76,851,317</b>	<b>\$54,174,350</b>

(1) Represents percentage of class held as of December 31, 2017.

(2) A CLO Fund managed by an Asset Manager Affiliate.

(3) As of December 31, 2017, this CLO Fund Security was not providing a distribution.

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

### Investment in Joint Venture:

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

During the fourth quarter of 2017, the Fund was refinanced through the issuance of senior and subordinated notes. The Joint Venture purchased 100% of the subordinated notes issued by the Fund. In connection with the refinancing, the Joint Venture made a cash distribution to the Company of approximately \$12.6 million. The Company expects that approximately \$11.8 million of this distribution will be return of capital, reducing the cost basis of its investment in the Joint Venture by that amount. The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at

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the end of the year, therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

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

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

**KCAP Freedom 3 LLC**

Summarized Statement of Financial Consolidation

	<b>As of December 31, 2017</b>
Cash	\$ 1,717
Investment at fair value	37,080,000
<b>Total Assets</b>	<b>\$ 37,081,717</b>
Total Liabilities	\$ 1,221,916
<b>Total Equity</b>	<b>35,859,801</b>
Total Liabilities and Equity	\$ 37,081,717

**KCAP Freedom 3 LLC**

Summarized Statement of Operations

	<b>For the period from July 20, 2017 (date of inception) to December 31, 2017</b>
Investment income	\$ 2,531,331
Operating expenses	(435,757)
<b>Net investment income</b>	<b>2,095,574</b>
Unrealized depreciation on investments	(5,063,254)
<b>Net loss</b>	<b>\$ (2,096,166)</b>

**KCAP Freedom 3 LLC**

Schedule of Investments

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

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

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

**RESULTS OF OPERATIONS**

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

Set forth below is a discussion of our results of operations for December 31, 2017, 2016, and 2015.

**Revenue**

	<u>For the Years Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Investment Income:</b>			
Interest from investments in debt securities	\$ 15,063,193	\$ 20,828,916	\$ 24,101,257
Interest from cash and time deposits	71,934	29,383	10,239
Investment income on CLO Fund Securities managed by affiliates	10,807,490	12,642,625	14,691,428
Investment income on CLO Fund Securities managed by non-affiliates	420,766	630,647	1,008,634
Dividends from Asset Manager Affiliates	460,000	1,400,000	5,348,554
Investment income from Joint Venture	949,037	—	—
Capital structuring service fees	491,279	668,527	366,859
Total investment income	<u>\$ 28,263,699</u>	<u>\$ 36,200,098</u>	<u>\$ 45,526,971</u>

Revenues consist primarily of investment income from interest and dividends on our investment portfolio and various ancillary fees related to our investment holdings.

*Interest from Investments in Debt Securities.* We generate interest income from our investments in debt securities that consist primarily of senior and junior secured loans. Our Debt Securities Portfolio is spread across multiple industries and geographic locations and, as such, we are broadly exposed to market conditions and business environments. As a result, although our investments are exposed to market risks, we continuously seek to limit concentration of exposure in any particular sector or issuer.

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

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

For non-junior class CLO Fund Securities, such as our investment in the Class E notes of KCAP F3C Senior Funding, L.L.C., interest is earned at a fixed spread relative to the LIBOR index.

*Distributions from Asset Manager Affiliates.* We receive cash distributions from our investment in our Asset Manager Affiliates, which are wholly-owned and manage CLO Funds that invest primarily in broadly syndicated non-investment grade loans, high yield bonds and other credit instruments issued by corporations. As managers of CLO Funds, our Asset Manager Affiliates receive contractual and recurring management fees from the CLO Funds for their management and advisory services. In addition, our Asset Manager Affiliates may also earn income related to net interest on assets accumulated for future CLO issuances on which they have taken a first loss position in connection with loan warehouse arrangements for their future CLO Funds. The annual management fees that our Asset Manager Affiliates receive are generally based on a fixed percentage of the par value of assets under management and are recurring in nature for the term of the CLO Fund so long as the Asset Manager Affiliates manage the fund. As a result, the annual management fees earned by our Asset Manager Affiliates generally are not subject to market value fluctuations in the underlying collateral. Our Asset Manager Affiliates may receive incentive fees provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares as per the terms of each CLO Fund management agreement. During the years ended December 31, 2017 and 2016, the Asset Manager Affiliates received incentive fees from one and two funds, respectively. As of December 31, 2017, none of the CLO Funds managed by the Asset Manager Affiliates were paying incentive fees.

Certain investments, and the future management fees of certain managed CLO Funds, have been pledged by the Asset Manager Affiliates to third-party lenders under borrowing arrangements undertaken to satisfy the risk retention requirements of the Dodd-Frank Act applicable to asset managers. In addition, certain of the Asset Manager Affiliates have provided a make-whole guaranty to these lenders in the event that the pledged assets and management fees are insufficient to satisfy the repayment of these borrowings. So long as the

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underlying managed CLO Funds' rated notes are making regular quarterly distributions, the management fees are available to the Asset Manager Affiliates.

The Asset Manager Affiliates are expected to pay future distributions to the Company based upon their after-tax free cash flow, which generally will be dependent upon the maintenance and growth in their assets under management and related management fees. As a result of tax-basis goodwill amortization and certain other tax-related adjustments, portions of distributions received may be deemed return of capital. As amortizing funds which are paying incentive fees are redeemed, we expect incentive fees available for distribution to diminish. The fair value of our investment in our Asset Manager Affiliates was approximately \$38.8 million at December 31, 2017, with an unrealized appreciation for the year ending December 31, 2017 of approximately \$1.4 million. For the years ended December 31, 2017, 2016, and 2015, we recognized dividend income of \$460,000, \$1.4 million and \$5.3 million, from the Asset Manager Affiliates, respectively, while cash distributions received were approximately \$3.2 million, \$2.7 million and \$9.1 million for those years, respectively. The difference between cash distributions received and the tax-basis earnings and profits is recorded as an adjustment to the cost basis of the Asset Manager Affiliates investments. For interim periods, the Company estimates the tax attributes of any distributions as being either tax-basis earnings and profits (i.e., dividend income) or return of capital (i.e., adjustment to the Company's cost basis in the Asset Manager Affiliates). The final determination of the tax attributes of distributions from our Asset Manager Affiliates is made on an annual (full calendar year) basis at the end of the year based upon taxable income and distributions for the full-year. Therefore, any estimate of tax attributes of distributions made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year. CLO Funds typically have automatic orderly wind-down features following an initial period of reinvestment. Thus, with all else being equal, as managed CLO Fund portfolios age, projected future assets under management (and associated management fees) will naturally decline, resulting in a reduction in fair value of our Asset Manager Affiliates. On the other hand, mandates to manage new CLO Fund portfolios will generally result in an increase in the fair value of our investment in our Asset Manager Affiliates. The aggregate of par value of assets under management by our Asset Manager Affiliates was \$3.0 billion and \$3.0 billion as of December 31, 2017 and 2016, respectively.

*Investment in Joint Venture.* For the three months ended December 31, 2017, the Company recognized \$949,000 in investment income from its investment in the Joint Venture. As of December 31, 2017, the fair value of the Company's investment in Joint venture was \$21.5 million. For interim periods, the Company recognizes investment income on its investment in the Joint Venture based upon its share of the estimated tax-basis earnings and profits of the Joint Venture. Any distributions in excess of tax-basis earnings and profits are recognized as a return of capital (adjustment to the Company's cost basis in the investment). The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at year-end of the year based upon taxable income and distributions for the full year. Therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

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

### **Investment Income**

Investment income for the years ended December 31, 2017, 2016, and 2015 was approximately \$28 million, \$36 million, and \$46 million, respectively. Of these amounts, approximately \$15 million, \$21 million and \$24 million, was attributable to interest income on our Debt Securities Portfolio for the years ended December 31, 2017, 2016 and 2015, respectively.

The weighted average interest rate on our income producing Debt Securities Portfolio was 10.1% and 7.0% as of December 31, 2017 and December 31, 2016, respectively. For the year ended December 31, 2017, our total net asset value return per share was 2.0% and our total market return based on stock price was (2.3)%. For the year ended December 31, 2016, our total net asset value return per share was 0.2% and our total market return based on stock price was 12.3%. Total net asset value return per share and total market return based on stock price do not reflect the sales load paid by stockholders.

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

For the years ended December 31, 2017, 2016, and 2015, approximately \$11.2 million, \$13.3 million and \$15.7 million, respectively, of investment income was attributable to investments in CLO Fund Securities. On a tax basis, the Company recognized \$5.3 million, \$10.1 million and \$14.7 million of taxable distributable income on distributions from our CLO Fund Securities during the years ended December 31, 2017, 2016, and 2015, respectively. Investment income, tax-basis earnings and cash distributions from CLO Fund Securities are dependent on the performance of the underlying assets in each CLO Fund; interest payments, principal amortization and prepayments of the underlying loans in each CLO Fund are primary factors which determine the level of distributions on our CLO Fund Securities. The level of excess spread from CLO Fund Securities can be impacted by the timing and level of the resetting of the benchmark interest rate for the underlying assets (which reset at various times throughout the quarter) in the CLO Fund and the related CLO Fund bond liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and distributions to us can vary significantly.

### Expenses

	For the Years Ended December 31,		
	2017	2016	2015
<b>Expenses:</b>			
Interest and amortization of debt issuance costs	\$ 7,661,407	\$ 9,110,603	\$ 11,727,880
Compensation	4,571,309	4,103,558	3,843,799
Professional fees	2,942,059	2,391,038	3,520,461
Insurance	347,175	412,764	433,561
Administrative and other	1,722,618	1,692,140	1,818,480
Total expenses	<u>\$ 17,244,568</u>	<u>\$ 17,710,103</u>	<u>\$ 21,344,181</u>

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

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

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

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

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Total expenses for the years ended December 31, 2017, 2016, and 2015 were approximately \$17.2 million, \$17.7 million, and \$21.3 million, respectively. Interest expense and amortization on debt issuance costs for the years ended December 31, 2017, 2016, and 2015 was approximately \$7.7 million, \$9.1 million, and \$11.7 million, respectively, on average debt outstanding of \$134 million, \$190 million, and \$224 million, respectively.

For the years ended December 31, 2017, 2016, and 2015, approximately \$4.6 million, \$4.1 million, and \$3.8 million, respectively, of expenses were attributable to employee compensation, including salaries, bonuses, employee benefits, payroll taxes and stock-based compensation expense. For the years ended December 31, 2017, 2016, and 2015, professional fees and insurance expenses totaled approximately \$3.3 million, \$2.8 million and \$4.0 million, respectively. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately \$1.7 million, \$1.7 million and \$1.8 million for the years ended December 31, 2017, 2016, and 2015, respectively.

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

Net investment income and net realized gains (losses) represents the stockholder's equity before net unrealized appreciation or depreciation on investments. For the years ended December 31, 2017, 2016, and 2015, net investment income and net realized losses were approximately \$4.1 million, \$12.2 million and \$17.5 million, respectively, or \$0.11, \$0.33, and \$0.47 per basic share, respectively. Net investment income represents the income earned on our investments less operating and interest expense before net realized gains or losses and unrealized appreciation or depreciation on investments. Investments are carried at fair value, with changes in fair value recorded as unrealized appreciation (depreciation) in the statement of operations. When an investment is sold or liquidated, any previously recognized unrealized appreciation/depreciation is reversed and a corresponding amount is recognized as realized gain (loss). On February 29, 2016, Katonah X CLO Ltd. was fully liquidated and all of its outstanding obligations were satisfied. The Company received approximately \$1.0 million in connection therewith related to its investment in the subordinated securities issued by Katonah X CLO Ltd. Accordingly, the Company recorded a realized loss during the first quarter of 2016 of approximately \$6.6 million on its investment in Katonah X CLO Ltd. and a corresponding unrealized gain of the same amount in order to reverse the approximately \$6.6 million of previously recorded unrealized depreciation with respect to the investment. For the year ended December 31, 2017, GAAP-basis net investment income was approximately \$11.0 million, or \$0.30 per basic share, while tax-basis distributable income was approximately \$6 million or \$0.16 per share, respectively.

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

	<u>For the Years Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Unrealized Gains (Losses) On Investments:</b>			
Net change in unrealized appreciation (depreciation) on:			
Debt securities	\$ 4,194,914	\$ 2,492,707	\$(10,748,262)
Equity securities	(823,671)	(4,413,354)	(210,167)
CLO Fund Securities managed by affiliates	2,102,279	4,380,974	(12,990,404)
CLO Fund Securities managed by non-affiliates	(85,671)	284,625	(977,483)
Asset Manager Affiliates investments	1,401,000	(15,933,000)	(11,243,554)
Joint Venture Investment	(3,398,858)		
Total net unrealized gain (loss) from investment transactions	<u>\$ 3,389,993</u>	<u>\$(13,188,048)</u>	<u>\$(36,169,870)</u>

During the year ended December 31, 2017, our total investments had net unrealized appreciation of approximately \$3.4 million. Included in the net unrealized gain in 2017 are unrealized appreciation on CLO Fund Securities of approximately \$2.0 million, and unrealized appreciation of the Asset Manager Affiliates of \$1.4 million, as well as unrealized appreciation on our Debt Securities Portfolio of \$4.2 million, unrealized depreciation on equity securities of approximately \$824,000 and unrealized depreciation on our Joint Venture investment of approximately \$3.4 million. During the year ended December 31, 2016, our total investments had net unrealized depreciation of approximately \$13.2 million, including net unrealized gains of



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approximately \$4.7 million on CLO Fund Securities and unrealized depreciation of the Asset Manager Affiliates of approximately \$15.9 million, net unrealized appreciation on the Debt Securities Portfolio of approximately \$2.5 million and net unrealized losses on equity securities of \$4.4 million. During the year ended December 31, 2015, our total investments had net unrealized depreciation of \$36 million, including approximately \$10.8 million of unrealized losses on the Debt Securities Portfolio, net unrealized loss of the Asset Manager Affiliates of approximately \$11.2 million, and net unrealized losses on equity securities of \$210,000, and net unrealized losses of approximately \$14.0 million related to CLO Fund Securities.

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

The net increase in stockholders' equity resulting from operations for the year ended December 31, 2017 was approximately \$3.4 million, or \$0.09 per basic share. Net decrease in stockholders' equity resulting from operations for the year ended December 31, 2016 was approximately \$1.0 million, or \$0.03 per basic share, and the net decrease in stockholders' equity resulting from operations for the year ended December 31, 2015 was approximately \$18.6 million, or \$0.50 per basic share.

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

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

As of December 31, 2017 and December 31, 2016, the fair value of investments and cash were as follows:

<u>Security Type</u>	<u>Investments at Fair Value</u>	
	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Cash	\$ 2,034,095	\$ 1,307,257
Restricted Cash	—	8,528,298
Short-term investments	77,300,320	28,699,269
Senior Secured Loan	44,960,146	200,322,152
Junior Secured Loan	58,941,300	35,444,440
Senior Unsecured Loan	12,777,283	—
First Lien Bond	—	1,089,338
Senior Secured Bond	1,518,750	1,487,400
CLO Fund Securities	51,678,673	54,174,350
Equity Securities	4,414,684	5,056,355
Joint Venture	21,516,000	—
Asset Manager Affiliates	38,849,000	40,198,000
Total	<u>\$ 313,990,251</u>	<u>\$ 376,306,859</u>

We use borrowed funds, known as "leverage," to make investments and to attempt to increase returns to our shareholders by reducing our overall cost of capital. As a BDC, we are limited in the amount of leverage we can incur under the 1940 Act. We are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. As of December 31, 2017, we had approximately \$104 million of par value of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 271%, compliant with the minimum asset coverage level of 200% required for a BDC by the 1940 Act. We may also borrow amounts of up to 5% of the value of our total assets for temporary purposes.

On March 15, 2016, the Convertible Notes matured and were repaid in full.



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On October 10, 2012, the Company issued \$41.4 million in aggregate principal amount of unsecured 7.375% Notes due 2019 (the “7.375% Notes Due 2019”). The net proceeds for the 7.375% Notes Due 2019, following underwriting expenses, were approximately \$39.9 million. Interest on the 7.375% Notes Due 2019 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 7.375%, commencing December 30, 2012. The 7.375% Notes Due 2019 mature on September 30, 2019, and are senior unsecured obligations of the Company. In addition, due to the asset coverage requirement applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 7.375% Notes Due 2019, the Company is limited in its ability to make distributions if its asset coverage, as defined in the 1940 Act, is below 200% at the time of the declaration of the distribution. At December 31, 2017, the Company was in compliance with all of its debt covenants. The indenture governing the 7.375% Notes Due 2019 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. During the second quarter of 2016, the Company repurchased approximately \$2.4 million par value of the 7.375% Notes Due 2019 at a weighted average price of \$25.23 per \$25.00 note, resulting in a realized loss on extinguishment of \$71,190. The Company subsequently surrendered these Notes to U.S. Bank National Association, as trustee (the “Trustee”) for cancellation. During the third quarter of 2016, the Company redeemed \$5.0 million par value of the 7.375% Notes Due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of \$88,015. During the fourth quarter of 2016, the Company redeemed \$469,000 par value of the 7.375% Notes Due 2019, resulting in a realized loss on extinguishment of \$15,000. During the second quarter of 2017, the Company redeemed \$6.5 million par value of the 7.375% Notes Due 2019 resulting in a realized loss on extinguishment of debt of \$107,276. KCAP subsequently surrendered all of these Notes to the Trustee for cancellation.

### **Investment in Joint Venture:**

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

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

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

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

Subject to prevailing market conditions, we intend to grow our portfolio of assets by raising additional capital, including through the prudent use of leverage available to us. However, we may face difficulty in obtaining a new debt and equity financing as a result of current market conditions. In this regard, because our

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common stock has traded at a price below our current net asset value per share and we are limited in our ability to sell our common stock at a price below net asset value per share without stockholder approval (which we currently do not have), we have been and may continue to be limited in our ability to raise equity capital. See “Business — Regulation — Common Stock”. From time to time, we may seek to retire, repurchase, or exchange debt securities in open market purchases or by other means dependent on market conditions, liquidity, contractual obligations, and other matters. In addition, we evaluate strategic opportunities available to us and/or the Asset Manager Affiliates, including mergers, divestitures, spin-offs, joint ventures and other similar transactions from time to time.

### **Stockholder Distributions**

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

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

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

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

We will be prohibited by the 1940 Act and the indenture governing our 7.375% Notes Due 2019 and our 6.125% Notes Due 2022 from making distributions on our common stock if our asset coverage, as defined in the 1940 Act, falls below 200%. In any such event, we would be prohibited from making distributions required in order to maintain our status as a RIC.

The following table sets forth the quarterly distributions declared by us since 2016.

	<u>Distributions</u>	<u>Declaration Date</u>	<u>Record Date</u>	<u>Pay Date</u>
<b>2017:</b>				
Fourth quarter	\$ 0.10	12/13/2017	1/5/2018 <sup>(1)</sup>	1/25/2018
Third quarter	0.12	9/22/2017	10/10/2017	10/26/2017
Second quarter	0.12	6/20/2017	7/7/2017	7/27/2017
First quarter	0.12	3/21/2017	4/7/2017	4/28/2017
Total declared for 2017	<u>\$ 0.46</u>			
<b>2016:</b>				
Fourth quarter	\$ 0.12	12/14/2016	1/6/2017 <sup>(1)</sup>	1/27/2017
Third quarter	0.15	9/20/2016	10/14/2016	10/27/2016
Second quarter	0.15	6/21/2016	7/7/2016	7/28/2016
First quarter	0.15	3/18/2016	4/7/2016	4/28/2016
Total declared for 2016	<u>\$ 0.57</u>			

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

## OFF-BALANCE SHEET ARRANGEMENTS

From time-to-time, the Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the needs of the Company's investment in portfolio companies. Such instruments include commitments to extend credit and may involve, in varying degrees, elements of credit risk in excess of amounts recognized on the Company's balance sheet. Prior to extending such credit, the Company attempts to limit its credit risk by conducting extensive due diligence, obtaining collateral where necessary and negotiating appropriate financial covenants. As of December 31, 2017 and December 31, 2016, the Company had \$0 and \$565,000 commitments to fund investments, respectively.

## CONTRACTUAL OBLIGATIONS

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

Contractual Obligations	Payments Due by Period				
	Total	Less than one year	1 – 3 years	3 – 5 years	More than 5 years
Long-term debt obligations	<u>\$ 104,407,200</u>	<u>\$ —</u>	<u>\$ 27,000,000</u>	<u>\$ 77,407,200</u>	<u>\$ —</u>

## CRITICAL ACCOUNTING POLICIES

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

### Valuation of Portfolio Investments

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

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

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

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

The Company follows the provisions of ASC Topic 820: Fair Value Measurements and Disclosures ("ASC 820: Fair Value"), which among other matters, requires enhanced disclosures about investments that are measured and reported at fair value. This standard defines fair value and establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value and expands disclosures about assets and liabilities measured at fair value. ASC 820: Fair Value defines "fair value" as the price that would be received to sell an asset or paid to transfer a liability in an

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orderly transaction between market participants at the measurement date. This fair value definition focuses on an exit price in the principal, or most advantageous market, and prioritizes, within a measurement of fair value, the use of market-based inputs (which may be weighted or adjusted for relevance, reliability and specific attributes relative to the subject investment) over entity-specific inputs. Market price observability is affected by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. Subsequent to the adoption of ASC 820: Fair Value, the FASB has issued various staff positions clarifying the initial standard (see Note 2 to the consolidated financial statements: “Significant Accounting Policies — Investments”).

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

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

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

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

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

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

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

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

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

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

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

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

The determination of fair value using this methodology takes into consideration a range of factors, including but not limited to the price at which the investment was acquired, the nature of the investment, local market conditions, trading values on public exchanges for comparable securities, current and projected

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operating performance and financing transactions subsequent to the acquisition of the investment. This valuation methodology involves a significant degree of Management's judgment.

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

### **Interest Income**

Interest income, including amortization of premium and accretion of discount and accrual of payment-in-kind ("PIK") interest, is recorded on the accrual basis to the extent that such amounts are expected to be collected. We generally place a loan on non-accrual status and cease recognizing interest income on such loan or security when a loan or security becomes 90 days or more past due or if we otherwise do not expect the debtor to be able to service its debt obligations. For investments with PIK interest, which represents contractual interest accrued and added to the principal balance that generally becomes due at maturity, we will not accrue PIK interest if the portfolio company valuation indicates that the PIK interest is not collectible (i.e. via a partial or full non-accrual). Loans which are on partial or full non-accrual remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due, or such loans become current. As of December 31, 2017, two of our investments were on partial non-accrual status, whereby we have recognized income on a portion of contractual PIK amounts due. As of December 31, 2016, there were two issuers on partial non-accrual status.

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

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

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

For non-junior class CLO Fund Securities, such as our investment in the class E notes of KCAP F3C Senior Funding, L.L.C., interest is earned at a fixed spread relative to the LIBOR index.

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

We record distributions from our Asset Manager Affiliates on the declaration date, which represents the ex-dividend date. Distributions in excess of tax-basis earnings and profits are recorded as tax-basis return of capital. For interim periods, the Company estimates the tax attributes of any distributions as being either tax-basis earnings and profits (i.e. dividend income) or return of capital (i.e. adjustment to the Company's cost basis in the Asset Manager Affiliates). The final determination of the tax attributes of distributions from our

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Asset Manager Affiliates is made on an annual (full calendar year) basis at the end of the year based upon taxable income and distributions for the full-year. Therefore, any estimate of tax attributes of distributions made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year.

### **Payment in Kind Interest**

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

### **Fee Income**

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

### **Management Compensation**

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

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

The Company has elected and intends to continue to qualify for the tax treatment applicable to RICs under Subchapter M of the Code and, among other things, intends to make the required distributions to its stockholders as specified therein. In order to qualify as a RIC, the Company is required to timely distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code, for each year. Depending on the level of taxable income earned in a tax year, we may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4% excise tax on such income, to the extent required.

### **Distributions to Shareholders**

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

### **Recent Accounting Pronouncements**

See Note 2 to the financial statements included in this annual report, for a description of recent accounting pronouncements.

### **Recent Developments**

In January 2018 the Trustee for Catamaran 2012-1 CLO received notice that the holders of a majority of the Subordinated Securities had exercised their right of optional redemption. It is expected the optional redemption will be effective on the March 2018 payment.

In February 2018, the Company provided a notice of redemption to the Trustee of the 7.375% Notes Due 2019 for \$20.0 million par value, which will result in a realized loss on extinguishment of debt of approximately \$192,000.

On February 9, 2018, the United States Court of Appeals for the District of Columbia (the “DC Circuit Court”) ruled in favor of an appeal brought by the Loan Syndications and Trading Association (the “LSTA”) on whether application of the risk retention rules to CLO managers is valid under Section 941 of the



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Dodd-Frank Act. If the decision stands, CLO managers of “open-market CLOs” (described in the ruling as CLOs where assets are acquired from “arms-length negotiations and trading on an open market”) will no longer be required to comply with the risk retention rules, and no party to such “open-market CLOs” would be required to acquire and retain an economic interest in the credit risk of the securitized assets. However, the DC Circuit Court’s decision remains subject to further appeal for a period of time.

On March 1, 2018, KCAP Funding I, LLC (“Funding”), a wholly owned subsidiary of the Company, entered into a \$50 million senior secured revolving credit facility (the “Revolving Credit Facility”) with the Company, as the servicer, certain institutional lenders, State Bank and Trust Company, as the administrative agent, lead arranger and bookrunner, and CIBC Bank USA, as documentation agent. For a more detailed discussion of the Revolving Credit Facility, please see “Item 9B. Other Information.”

### **Item 7A. 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 December 31, 2017, approximately 90% of our Debt Securities Portfolio were floating rate with a spread to an interest rate index such as LIBOR or the prime rate. Most of these floating rate loans contain LIBOR floors ranging between 1.0% and 3.0%. We generally expect that future portfolio investments will predominately be floating rate investments. As of December 31, 2017, we had \$104 million (par value) of borrowings outstanding at a current weighted average rate of 6.4%.

Because we borrow money to make investments, our net investment income is dependent upon the difference between our borrowing rate and the rate we earn on the invested proceeds borrowed. In periods of rising or lowering interest rates, the cost of the portion of our debt associated with our 7.375% Notes Due 2019 and 6.125% Notes Due 2022 would remain the same, given that this debt is at a fixed rate.

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

We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that our balance sheet at December 31, 2017 was to remain constant and no actions were taken to alter the existing interest rate sensitivity, the table below illustrates the impact on net investment income on our Debt Securities Portfolio for various hypothetical increases in interest rates:

	<b>Impact on net investment income from a change in interest rates at:</b>		
	<b>1%</b>	<b>2%</b>	<b>3%</b>
Increase in interest rate	\$ 953,623	\$ 1,821,413	\$ 2,689,202
Decrease in interest rate	\$(447,893)	\$ (447,893)	\$ (447,893)



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As shown above, net investment income assuming a 1% increase in interest rates would increase by approximately \$954,000 on an annualized basis, reflecting the impact to investments in our portfolio that are either fixed rate or which have embedded floors that would be unaffected by a 1% change in the underlying interest rate while our interest expense would be increasing. However, if the increase in rates was more significant, such as 2% or 3%, the net effect on net investment income would be an increase of approximately \$1.8 million and \$2.7 million, respectively.

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

We did not hold any derivative financial instruments for hedging purposes as of December 31, 2017.

### **Portfolio Valuation**

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

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

### **Item 8. Financial Statements and Supplementary Data**

Our financial statements are annexed to this Annual Report beginning on page F-1.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

### **Item 9A. Controls and Procedures**

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

The Company's management, under the supervision and with the participation of various members of management, including its Chief Executive Officer ("CEO") and its Chief Financial Officer ("CFO"), has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the Company's CEO and CFO have concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report.

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### ***Management's Report on Internal Control Over Financial Reporting.***

*General.* The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) of the Exchange Act. The Company's internal control over financial reporting is designed 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.

*Scope of Management's Report on Internal Control Over Financial Reporting.* The Company's internal control over financial reporting includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the Company's financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Conclusion.* Management, including the Company's CEO and CFO, assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2017. In making this assessment, management used the criteria established in the 2013 Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on management's assessment, management concluded, subject to the limitations described under "Scope of Management's Report on Internal Control Over Financial Reporting" above, that the Company maintained effective internal control over financial reporting as of December 31, 2017.

### ***Attestation Report of the Independent Registered Public Accounting Firm.***

The Company's independent registered public accounting firm has audited and issued a report on the Company's internal control over financial reporting, which appears in Item 15 of this report.

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

There have been no changes in our internal control over financial reporting during the fourth quarter of 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Item 9B. Other Information**

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

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

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

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

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

The description above is only a summary of the material provisions of the Revolving Credit Agreement and is qualified in its entirety by reference to a copy of the Revolving Credit Agreement, which is included as Exhibit 10.9 to this Annual Report.

**PART III**

**Item 10. *Directors, Executive Officers and Corporate Governance***

The information required by this item will be contained in the Proxy Statement under the headings “Proposal 1: Election of Directors,” “Control Persons and Principal Stockholders” and “Corporate Governance Principles and Director Information”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2018, and is incorporated herein by reference.

We have adopted a Sarbanes-Oxley Code of Ethics that applies to directors, officers and employees of the Company. This code of ethics is published on our website at [www.kcapfinancial.com](http://www.kcapfinancial.com). We intend to disclose any future amendments to, or waivers from, this code of ethics within four business days of the waiver or amendment through a website posting.

**Item 11. *Executive Compensation***

The information required by this item will be contained in the Proxy Statement under the headings “Proposal 1: Election of Directors,” “Executive Compensation,” “Compensation Committee Interlocks and Insider Participation” and “Compensation Committee Report”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2018, and is incorporated herein by reference.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this item will be contained in the Proxy Statement under the headings “Executive Compensation” and “Control Persons and Principal Stockholders”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2018, and is incorporated herein by reference.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

The information required by this item will be contained in the Proxy Statement under the headings “Transactions with Related Persons” and “Proposal 1: Election of Directors”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2018, and is incorporated herein by reference.

**Item 14. *Principal Accountant Fees and Services***

The information required by this item will be contained in the Proxy Statement under the heading “Proposal 2: Ratification of Independent Registered Public Accounting Firm”, to be filed with the Securities and Exchange Commission on or prior to April 30, 2018, and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

*(a) Documents filed as part of this report:*

1. For a list of the consolidated financial information included herein, see Index to the Consolidated Financial Statements on page F-[1](#).

2. For a list of the other financial statements and financial statement schedules included herein, see Index to Other Financial Statements and Financial Statement Schedules on page S-1.

3. For a list of other exhibits included herein, see Exhibit List on page E-[1](#).

*(b) Exhibits required by Item 601 of Regulation S-K.* Reference is made to the Exhibit List filed as a part of this report beginning on page E-[1](#). Each of such exhibits is incorporated by reference herein.

*(c) Other financial statements and financial statement schedules.* Reference is made to the Index to Other Financial Statements and Financial Statement Schedules on page S-1. Each of such documents is incorporated by reference herein.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: March 7, 2018

KCAP Financial, Inc.  
By /s/ DAYL W. PEARSON  
**Dayl W. Pearson**  
**President and Chief Executive Officer**

\* \* \* \* \*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ DAYL W. PEARSON</u> <b>DAYL W. PEARSON</b>	President and Chief Executive Officer (principal executive officer) and Member of the Board of Directors	March 7, 2018
<u>/s/ EDWARD U. GILPIN</u> <b>EDWARD U. GILPIN</b>	Chief Financial Officer, Secretary and Treasurer (principal financial and accounting officer)	March 7, 2018
<u>/s/ CHRISTOPHER LACOVARA</u> <b>CHRISTOPHER LACOVARA</b>	Member of the Board of Directors	March 7, 2018
<u>/s/ JOHN WARD</u> <b>JOHN WARD</b>	Member of the Board of Directors	March 7, 2018
<u>/s/ C. MICHAEL JACOBI</u> <b>C. MICHAEL JACOBI</b>	Member of the Board of Directors	March 7, 2018
<u>/s/ ALBERT G. PASTINO</u> <b>ALBERT G. PASTINO</b>	Member of the Board of Directors	March 7, 2018
<u>/s/ C. TURNEY STEVENS, JR.</u> <b>C. TURNEY STEVENS, JR.</b>	Member of the Board of Directors	March 7, 2018
<u>/s/ DEAN C. KEHLER</u> <b>DEAN C. KEHLER</b>	Member of the Board of Directors	March 7, 2018

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**Report of Independent Registered Public Accounting Firm**

The Shareholders and the Board of Directors of  
KCAP Financial, Inc.

**Opinion on the financial statements**

We have audited the accompanying consolidated balance sheets of KCAP Financial, Inc. (the “Company”), including the consolidated schedules of investments, as of December 31, 2017 and 2016, the related consolidated statements of operations, changes in net assets, and cash flows for each of the three years in the period ended December 31, 2017, and the financial highlights for each of the four years in the period ended December 31, 2017 and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the consolidated results of their operations, changes in their net assets and their cash flows for each of the three years in the period ended December 31, 2017, and their consolidated financial highlights for each of the four years in the period ended December 31, 2017, in conformity with US generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 7, 2018 expressed an unqualified opinion thereon.

**Basis for opinion**

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the US federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of December 31, 2017 and 2016, by correspondence with the custodians. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company’s auditor since 2014.

New York, New York  
March 7, 2018



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders and the Board of Directors of KCAP Financial, Inc.

**Opinion on Internal Control over Financial Reporting**

We have audited KCAP Financial, Inc.'s internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission "(2013 framework)," (the COSO criteria). In our opinion, KCAP Financial Inc. (the "Company") maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the 2017 consolidated financial statements of the Company and our report dated March 7, 2018 expressed an unqualified opinion thereon.

**Basis for Opinion**

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

**Definition and Limitations of Internal Control Over Financial Reporting**

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

New York, New York  
March 7, 2018

KCAP FINANCIAL, INC.

CONSOLIDATED BALANCE SHEETS

	As of December 31, 2017	As of December 31, 2016
<b>ASSETS</b>		
Investments at fair value:		
Short-term investments (cost: 2017 – \$77,300,320; 2016 – \$28,699,269)	\$ 77,300,320	\$ 28,699,269
Debt securities (amortized cost: 2017 – \$125,179,470; 2016 – \$249,520,234)	118,197,479	238,343,330
CLO Fund Securities managed by affiliates (amortized cost: 2017 – \$67,212,139; 2016 – \$71,734,809)	49,488,393	51,908,784
CLO Fund Securities managed by non-affiliates (amortized cost: 2017 – \$5,126,893; 2016 – \$5,116,508)	2,190,280	2,265,566
Equity securities (cost: 2017 – \$10,571,007; 2016 – \$10,389,007)	4,414,684	5,056,355
Asset Manager Affiliates (cost: 2017 – \$52,591,230; 2016 – \$55,341,230)	38,849,000	40,198,000
Joint Venture (cost: 2017 – \$24,914,858)	21,516,000	—
Total Investments at Fair Value (cost: 2017 – \$362,895,917; 2016 – \$420,801,057)	311,956,156	366,471,304
Cash	2,034,095	1,307,257
Restricted cash	—	8,528,298
Interest receivable	1,051,271	1,033,917
Receivable for open trades	2,993,750	2,950,658
Due from affiliates	1,243,493	612,854
Other assets	530,209	467,695
<b>Total Assets</b>	<b>\$319,808,974</b>	<b>\$381,371,983</b>
<b>LIABILITIES</b>		
6.125% Notes Due 2022 (net of offering costs of: 2017 – \$2,734,248)	\$ 74,672,952	\$ —
7.375% Notes Due 2019 (net of offering costs of: 2017 – \$259,635; 2016 – \$550,774)	26,740,365	32,980,151
Notes issued by KCAP Senior Funding I, LLC (net of discount and offering costs of: \$2,286,425 and \$2,459,156, respectively)	—	142,604,419
Payable for open trades	34,215,195	7,884,943
Accounts payable and accrued expenses	2,350,803	2,047,405
Accrued interest payable	—	930,086
Due to affiliates	25,083	54
<b>Total Liabilities</b>	<b>138,004,398</b>	<b>186,447,058</b>
<b>COMMITMENTS AND CONTINGENCIES (Note 8)</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$0.01 per share, 100,000,000 common shares authorized; 37,507,402 issued, and 37,339,224 outstanding at December 31, 2017, and 37,282,296 issued, and 37,178,294 outstanding at December 31, 2016	373,392	371,783
Capital in excess of par value	329,789,716	353,404,155
Excess distribution of net investment income	(9,987,928)	(14,630,319)
Accumulated net realized losses	(86,031,799)	(88,491,896)
Net unrealized depreciation on investments	(52,338,805)	(55,728,798)
<b>Total Stockholders' Equity</b>	<b>181,804,576</b>	<b>194,924,925</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$319,808,974</b>	<b>\$381,371,983</b>
<b>NET ASSET VALUE PER COMMON SHARE</b>	<b>\$ 4.87</b>	<b>\$ 5.24</b>

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2017	2016	2015
<b>Investment Income:</b>			
Interest from investments in debt securities	\$ 15,063,193	\$ 20,828,916	\$ 24,101,257
Interest from cash and time deposits	71,934	29,383	10,239
Investment income on CLO Fund Securities managed by affiliates	10,807,490	12,642,625	14,691,428
Investment income on CLO Fund Securities managed by non-affiliates	420,766	630,647	1,008,634
Dividends from Asset Manager Affiliates	460,000	1,400,000	5,348,554
Investment income from Joint Venture	949,037	—	—
Capital structuring service fees	491,279	668,527	366,859
Total investment income	<u>28,263,699</u>	<u>36,200,098</u>	<u>45,526,971</u>
<b>Expenses:</b>			
Interest and amortization of debt issuance costs	7,661,407	9,110,603	11,727,880
Compensation	4,571,309	4,103,558	3,843,799
Professional fees	2,942,059	2,391,038	3,520,461
Insurance	347,175	412,764	433,561
Administrative and other	1,722,618	1,692,140	1,818,480
Total expenses	<u>17,244,568</u>	<u>17,710,103</u>	<u>21,344,181</u>
<b>Net Investment Income</b>	<b>11,019,131</b>	<b>18,489,995</b>	<b>24,182,790</b>
<b>Realized And Unrealized Gains (Losses) On Investments:</b>			
Net realized losses from investment transactions	(6,899,044)	(6,167,467)	(6,202,290)
Net change in unrealized appreciation (depreciation) on:			
Debt securities	4,194,914	2,492,707	(10,748,262)
Equity securities	(823,671)	(4,413,354)	(210,167)
CLO Fund Securities managed by affiliates	2,102,279	4,380,974	(12,990,404)
CLO Fund Securities managed by non-affiliates	(85,671)	284,625	(977,483)
Asset Manager Affiliates investments	1,401,000	(15,933,000)	(11,243,554)
Joint Venture investment	(3,398,858)	—	—
Total net appreciation (depreciation) from investment transactions	<u>3,389,993</u>	<u>(13,188,048)</u>	<u>(36,169,870)</u>
Net realized and unrealized loss on investments	<u>(3,509,051)</u>	<u>(19,355,515)</u>	<u>(42,372,160)</u>
Realized losses on extinguishments of debt	(4,121,998)	(174,211)	(445,189)
<b>Net (Decrease) Increase In Stockholders' Equity Resulting From Operations</b>	<b>\$ 3,388,082</b>	<b>\$ (1,039,731)</b>	<b>\$ (18,634,559)</b>
Net Increase (Decrease) in Stockholders' Equity Resulting from Operations per Common Share:			
Basic:	\$ 0.09	\$ (0.03)	\$ (0.50)
Diluted:	\$ 0.09	\$ (0.03)	\$ (0.50)
Net Investment Income Per Common Share:			
Basic:	\$ 0.30	\$ 0.50	\$ 0.65
Diluted:	\$ 0.30	\$ 0.50	\$ 0.65
Weighted Average Shares of Common Stock Outstanding –			
Basic	37,235,130	37,149,663	36,964,444
Weighted Average Shares of Common Stock Outstanding –			
Diluted	37,235,130	37,149,663	36,964,444

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

	Years Ended December 31,		
	2017	2016	2015
<b>Operations:</b>			
Net investment income	\$ 11,019,131	\$ 18,489,995	\$ 24,182,790
Net realized losses from investment transactions	(6,899,044)	(6,167,467)	(6,202,290)
Realized losses from extinguishments of debt	(4,121,998)	(174,211)	(445,189)
Net change in unrealized appreciation (depreciation) from investments	3,389,993	(13,188,048)	(36,169,870)
Net increase (decrease) in stockholders' equity resulting from operations	3,388,082	(1,039,731)	(18,634,559)
<b>Stockholder distributions:</b>			
Distributions of ordinary income	(6,035,683)	(14,761,679)	(22,985,978)
Return of capital	(11,736,777)	(7,307,578)	—
Net decrease in net assets resulting from stockholder distributions	(17,772,460)	(22,069,257)	(22,985,978)
<b>Capital share transactions:</b>			
Issuance of common stock for:			
Common stock withheld for payroll taxes upon vesting of restricted stock	(224,944)	(247,926)	(220,301)
Dividend reinvestment plan	360,981	638,016	1,051,795
Stock based compensation	1,127,992	1,543,353	1,572,811
Net increase in net assets resulting from capital share transactions	1,264,029	1,933,443	2,404,305
Net assets at beginning of period	194,924,925	216,100,470	255,316,701
Net assets at end of period (including accumulated undistributed net investment income of \$0, \$0, and \$0 in 2017, 2016, and 2015, respectively.	\$181,804,576	\$194,924,925	\$216,100,470
Net asset value per common share	\$ 4.87	\$ 5.24	\$ 5.82
Common shares outstanding at end of period	37,339,224	37,178,294	37,100,005

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2017	2016	2015
<b>OPERATING ACTIVITIES:</b>			
Net increase (decrease) in stockholder's equity resulting from operations	\$ 3,388,082	\$ (1,039,731)	\$ (18,634,558)
Adjustments to reconcile net increase (decrease) in stockholder's equity resulting from operations to net cash provided by operating activities:			
Net realized losses on investment transactions	6,899,044	6,167,467	6,202,289
Net change in unrealized (gains) losses from investments	(3,389,993)	13,188,048	36,169,870
Purchases of investments	(277,367,657)	(110,229,217)	(112,647,477)
Proceeds from sales and redemptions of investments	340,797,616	133,253,936	132,764,940
Net accretion/amortization on investments	(11,444,537)	1,784,579	9,094,250
Amortization of original issue discount on indebtedness	352,340	621,171	604,811
Amortization of debt issuance costs	745,581	845,793	1,181,866
Realized losses on extinguishments of debt	4,121,998	174,211	445,189
Payment-in-kind interest income	(1,099,223)	(1,065,339)	(1,447,865)
Stock-based compensation expense	1,127,992	1,543,353	1,572,811
Changes in operating assets and liabilities:			
Increase (Decrease) in payable for open trades	26,330,252	7,884,943	(18,293,725)
(Increase) Decrease in interest and dividends receivable	(17,354)	778,707	(63,803)
(Increase) in accounts receivable	—	—	(591)
(Increase) in receivable for open trades	(43,092)	(2,950,658)	—
Decrease (Increase) in other assets	(62,513)	98,516	(793,461)
(Increase) Decrease in due from affiliates	(630,639)	1,504,241	910,315
Increase (Decrease) in due to affiliates	25,083	(554,279)	523,333
Increase (Decrease) in accounts payable and accrued expenses	303,431	(170,660)	(56,086)
(Decrease) in accrued interest payable	(930,086)	(297,982)	(338,186)
Net cash provided by operating activities	89,106,325	51,537,099	37,193,922
<b>FINANCING ACTIVITIES:</b>			
Issuance of 6.125% Notes Due 2022	77,407,200	—	—
Debt issuance costs	(2,798,940)	—	(19,136)
Issuance of restricted shares	1,396	60	1,921
Forfeitures of restricted shares	(93)	(345)	(109)
Distributions to stockholders	(17,411,479)	(21,431,241)	(31,016,373)
Repayment of Senior Funding Notes	(147,350,000)	(19,299,000)	(19,348,000)
Repurchase of 7.375% Notes Due 2019	(6,530,925)	(7,861,364)	—
Common Stock withheld for payroll taxes upon vesting of restricted stock	(224,944)	(247,926)	(220,301)
Net cash used in financing activities	(96,907,785)	(48,839,816)	(50,601,998)
CHANGE IN CASH AND RESTRICTED CASH	(7,801,460)	2,697,283	(13,408,076)
CASH AND RESTRICTED CASH, BEGINNING OF YEAR	9,835,555	7,138,272	20,546,348
CASH AND RESTRICTED CASH, END OF YEAR	<u>\$ 2,034,095</u>	<u>\$ 9,835,555</u>	<u>\$ 7,138,272</u>
<b>Supplemental Information:</b>			
Interest paid during the period	\$ 6,563,486	\$ 7,902,774	\$ 10,279,221
Issuance of common stock under the dividend reinvestment plan	\$ 360,981	\$ 638,016	\$ 1,051,795

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS  
As of December 31, 2017

Debt Securities Portfolio

Portfolio Company/Principal Business	Investment Interest Rate <sup>(1)</sup> /Maturity	Principal	Amortized Cost	Fair Value <sup>(2)</sup>
Advanced Lighting Technologies, Inc. <sup>(8)</sup> (14) Consumer goods: Durable	Junior Secured Loan — Second Lien Notes 18.7% Cash 8.7% PIK 10%, 3 month LIBOR (1.70%) + 17.00%; LIBOR Floor 1.00%, Due 10/23	\$ 889,340	\$ 889,338	\$ 803,598
Advantage Sales & Marketing Inc. <sup>(8)(14)</sup> Services: Business	Junior Secured Loan — Term Loan (Second Lien) 7.9% Cash, 3 month LIBOR (1.38%) + 6.50%; LIBOR Floor 1.00%, Due 7/22	1,000,000	1,001,438	988,000
API Technologies Corp. <sup>(8)</sup> High Tech Industries	Senior Secured Loan — Initial Term Loan 8.2% Cash, 3 month LIBOR (1.69%) + 6.50%; LIBOR Floor 1.00%, Due 4/22	3,080,305	3,110,759	3,111,108
Avalign Technologies, Inc. <sup>(8)</sup> Healthcare & Pharmaceuticals	Senior Secured Loan — Initial Term Loan (First Lien) 6.1% Cash, 1 month LIBOR (1.57%) + 4.50%; LIBOR Floor 1.00%, Due 7/21	1,065,342	1,062,983	1,054,689
Avalign Technologies, Inc. <sup>(8)(14)</sup> Healthcare & Pharmaceuticals	Junior Secured Loan — Initial Term Loan (Second Lien) 9.7% Cash, 6 month LIBOR (1.46%) + 8.25%; LIBOR Floor 1.00%, Due 7/22	1,500,000	1,488,964	1,467,300
BMC Acquisition, Inc. (aka BenefitMall) <sup>(8)(14)</sup> Banking, Finance, Insurance & Real Estate	Senior Secured Loan — Initial Term Loan 7.0% Cash, 3 month LIBOR (1.84%) + 5.25%; LIBOR Floor 1.00%, Due 12/24	3,000,000	2,998,125	2,970,000
Carolina Beverage Group LLC <sup>(8)(14)</sup> Beverage, Food and Tobacco	Senior Secured Bond — 10.625% – 08/2018 – 143818AAA0 144A 10.6% Cash, Due 8/18	1,500,000	1,502,374	1,518,750
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) <sup>(8)(14)</sup> Beverage, Food and Tobacco	Junior Secured Loan — Term Loan (Second Lien) 9.1% Cash, 3 month LIBOR (1.33%) + 7.75%; LIBOR Floor 1.00%, Due 7/21	3,000,000	3,008,816	2,914,800
DigiCert, Inc. <sup>(8)</sup> High Tech Industries	Junior Secured Loan — Initial Loan (Second Lien) 9.4% Cash, 3 month LIBOR (1.38%) + 8.00%; LIBOR Floor 1.00%, Due 10/25	1,000,000	995,059	979,100
Drew Marine Group Inc. <sup>(8)</sup> Transportation: Cargo	Junior Secured Loan — Term Loan (Second Lien) 8.6% Cash, 1 month LIBOR (1.57%) + 7.00%; LIBOR Floor 1.00%, Due 5/21	4,000,000	4,000,901	4,010,000
EagleTree-Carbide Acquisition Corp. (aka Corsair Components, Inc.) <sup>(8)(14)</sup> High Tech Industries	Junior Secured Loan — Term Loan (Second Lien) 10.2% Cash, 3 month LIBOR (1.69%) + 8.50%; LIBOR Floor 1.00%, Due 8/25	5,000,000	4,927,010	4,997,500
First American Payment Systems, L.P. <sup>(8)</sup> Banking, Finance, Insurance & Real Estate	Junior Secured Loan — Term Loan (Second Lien) 11.9% Cash, 1 month LIBOR (1.39%) + 10.50%; LIBOR Floor 1.00%, Due 7/24	1,500,000	1,460,837	1,448,400
Flexera Software LLC (fka Flexera Software, Inc.) <sup>(8)</sup> High Tech Industries	Senior Secured Loan — Term Loan (First Lien) 5.1% Cash, 1 month LIBOR (1.57%) + 3.50%; LIBOR Floor 1.00%, Due 4/20	2,000,000	1,995,443	2,000,000
GI Advo Opco, LLC <sup>(8)</sup> Healthcare & Pharmaceuticals	Senior Secured Loan — Term Loan 6.2% Cash, 3 month LIBOR (1.69%) + 4.50%; LIBOR Floor 1.00%, Due 11/21	230,756	229,252	230,732
GK Holdings, Inc. (aka Global Knowledge) <sup>(8)</sup> Services: Business	Junior Secured Loan — Initial Term Loan (Second Lien) 11.9% Cash, 3 month LIBOR (1.69%) + 10.25%; LIBOR Floor 1.00%, Due 1/22	1,500,000	1,482,520	1,376,400
Global Tel*Link Corporation <sup>(8)</sup> Telecommunications	Senior Secured Loan — Term Loan (First Lien) 5.7% Cash, 3 month LIBOR (1.69%) + 4.00%; LIBOR Floor 1.25%, Due 5/20	1,495,689	1,492,021	1,491,949

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment	Principal	Amortized Cost	Fair Value <sup>(2)</sup>
	Interest Rate <sup>(1)</sup> /Maturity			
Global Tel*Link Corporation <sup>(8)(14)</sup> Telecommunications	Junior Secured Loan — Term Loan (Second Lien) 9.9% Cash, 3 month LIBOR (1.69%) + 8.25%; LIBOR Floor 1.25%, Due 11/20	\$ 5,000,000	\$ 4,963,469	\$ 4,975,000
Grupo HIMA San Pablo, Inc. <sup>(8)</sup> Healthcare & Pharmaceuticals	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 3 month LIBOR (1.50%) + 7.00%; LIBOR Floor 1.50%, Due 1/18	2,850,000	2,849,063	2,593,500
Grupo HIMA San Pablo, Inc. <sup>(8)(14)</sup> Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,191,667	7,174,676	4,566,708
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>(8)(14)</sup> Media: Advertising, Printing & Publishing	Senior Secured Loan — Initial Term Loan 6.4% Cash, 3 month LIBOR (1.69%) + 4.75%; LIBOR Floor 1.00%, Due 11/23	2,986,482	3,011,321	3,003,281
Hoffmaster Group, Inc. <sup>(8)(14)</sup> Forest Products & Paper	Junior Secured Loan — Initial Term Loan (Second Lien) 11.2% Cash, 3 month LIBOR (1.69%) + 9.50%; LIBOR Floor 1.00%, Due 11/24	1,600,000	1,558,556	1,600,960
Industrial Services Acquisition, LLC (aka Evergreen/NAIC) <sup>(8)(14)</sup> Environmental Industries	Senior Secured Loan — Term Loan 6.6% Cash, 1 month LIBOR (1.63%) + 5.00%; LIBOR Floor 1.00%, Due 6/22	1,167,909	1,173,405	1,167,909
Infobase Holdings, Inc. <sup>(8)(14)</sup> High Tech Industries	Senior Secured Loan — Term Loan 8.0% Cash, Prime LIBOR (0.00%) + 8.00%; LIBOR Floor 0.00%, Due 12/22	2,000,000	1,980,000	1,980,000
Ivanti Software, Inc. (fka LANDesk Group, Inc.) <sup>(8)</sup> High Tech Industries	Junior Secured Loan — Loan (Second Lien) 10.6% Cash, 1 month LIBOR (1.57%) + 9.00%; LIBOR Floor 1.00%, Due 1/25	3,228,619	3,228,619	3,200,530
MB Aerospace ACP Holdings II Corp. <sup>(8)(14)</sup> Aerospace and Defense	Senior Secured Loan — Initial Term Loan 7.1% Cash, 1 month LIBOR (1.63%) + 5.50%; LIBOR Floor 1.00%, Due 12/22	980,000	981,158	980,000
MB Aerospace ACP Holdings III Corp. <sup>(8)(14)</sup> Aerospace and Defense	Senior Secured Loan — Term Loan 5.1% Cash, 1 month LIBOR (1.58%) + 3.50%; LIBOR Floor 1.00%, Due 1/25	1,250,000	1,243,750	1,243,750
National Home Health Care Corp. <sup>(8)(14)</sup> Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 10.4% Cash, 1 month LIBOR (1.43%) + 9.00%; LIBOR Floor 1.00%, Due 12/22	1,500,728	1,482,044	1,458,257
Onex Carestream Finance LP <sup>(8)</sup> Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 10.2% Cash, 3 month LIBOR (1.69%) + 8.50%; LIBOR Floor 1.00%, Due 12/19	1,495,995	1,495,995	1,487,618
Playpower, Inc. <sup>(8)(14)</sup> Construction & Building	Senior Secured Loan — Initial Term Loan (First Lien) 6.4% Cash, 3 month LIBOR (1.69%) + 4.75%; LIBOR Floor 1.00%, Due 6/21	994,898	1,004,093	999,872
PSC Industrial Holdings Corp. <sup>(8)(14)</sup> Environmental Industries	Junior Secured Loan — Initial Term Loan (Second Lien) 10.0% Cash, 1 month LIBOR (1.46%) + 8.50%; LIBOR Floor 1.00%, Due 10/25	3,000,000	2,941,524	2,940,000
RESIC Enterprises, LLC (aka Lyons Magnus) <sup>(8)</sup> Beverage, Food and Tobacco	Senior Secured Loan — Initial Term Loan (First Lien) 5.7% Cash, 1 month LIBOR (1.43%) + 4.25%; LIBOR Floor 1.00%, Due 11/24	3,000,000	2,985,247	3,001,500
Roscoe Medical, Inc. <sup>(8)(14)</sup> Healthcare & Pharmaceuticals	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	6,700,000	6,678,900	6,468,850
Salient CRGT Inc. <sup>(8)</sup> High Tech Industries	Senior Secured Loan — Initial Term Loan 7.3% Cash, 1 month LIBOR (1.57%) + 5.75%; LIBOR Floor 1.00%, Due 2/22	1,967,742	1,992,339	1,992,339
SCSG EA Acquisition Company, Inc. <sup>(8)</sup> Healthcare & Pharmaceuticals	Senior Secured Loan — Initial Term Loan (Second Lien) 9.7% Cash, 3 month LIBOR (1.48%) + 8.25%; LIBOR Floor 1.00%, Due 9/24	5,000,000	4,952,274	4,955,000

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate <sup>(1)</sup> /Maturity	Principal	Amortized Cost	Fair Value <sup>(2)</sup>
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) <sup>(8)(13)(14)</sup> Environmental Industries	Junior Secured Loan — Restructured Term Loan 8.2% Cash, 7.2% PIK, 3 month LIBOR (1.57%) + 6.62%; LIBOR Floor 1.00%, Due 10/22	\$ 1,883,914	\$ 1,875,914	\$ 1,318,740
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) <sup>(8)(14)</sup> Environmental Industries	Senior Secured Loan — Term Loan 13.7% Cash, 3 month LIBOR (1.69%) + 12.00%; LIBOR Floor 1.00%, Due 10/22	339,788	339,788	339,788
Tank Partners Holdings, LLC <sup>(8)(13)</sup> Energy: Oil & Gas	Senior Secured Loan — Loan 14.8% Cash, 12.8% PIK, Base Rate (4.25%) + 10.5%, Due 8/19	12,739,078	12,258,031	9,153,028
Tex-Tech Industries, Inc. <sup>(8)</sup> Textiles and Leather	Junior Secured Loan — Term Loan (Second Lien) 10.6% Cash, 1 month LIBOR (1.57%) + 9.00%; LIBOR Floor 1.00%, Due 8/24	8,008,000	7,950,994	7,947,940
Time Manufacturing Acquisition, LLC <sup>(8)</sup> Capital Equipment	Senior Secured Loan — Term Loan 6.8% Cash, 3 month LIBOR (1.75%) + 5.00%; LIBOR Floor 1.00%, Due 2/23	994,987	992,633	999,962
Trimaran Advisors, L.L.C. <sup>(8)(9)(14)</sup> Related Party Loan	Senior Unsecured Loan — Term Loan Series 1 10.5% Cash, Due 4/30	8,359,051	8,359,051	8,359,051
Trimaran Advisors, L.L.C. <sup>(8)(9)(14)</sup> Related Party Loan	Senior Unsecured Loan — Term Loan Series 2 10.5% Cash, Due 1/28	4,418,232	4,418,232	4,418,232
TronAir Parent Inc. <sup>(8)(14)</sup> Aerospace and Defense	Senior Secured Loan — Initial Term Loan (First Lien) 6.2% Cash, 1 month LIBOR (1.41%) + 4.75%; LIBOR Floor 1.00%, Due 9/23	997,475	994,981	997,076
TRSO I, Inc. <sup>(8)(14)</sup> Energy: Oil & Gas	Junior Secured Loan — Term Loan (Second Lien) 14.0% Cash, 3 month LIBOR (1.00%) + 13.00%; LIBOR Floor 1.00%, Due 12/19	1,000,000	994,351	1,000,000
Weiman Products, LLC <sup>(8)(14)</sup> Consumer goods: Non-durable	Senior Secured Loan — Term Loan (2013) 6.2% Cash, 3 month LIBOR (1.69%) + 4.50%; LIBOR Floor 1.00%, Due 11/21	694,662	691,234	694,662
WireCo WorldGroup Inc. <sup>(8)(14)</sup> Capital Equipment	Junior Secured Loan — Initial Term Loan (Second Lien) 10.5% Cash, 3 month LIBOR (1.48%) + 9.00%; LIBOR Floor 1.00%, Due 9/24	3,000,000	2,961,988	2,991,600
<b>Total Investment in Debt Securities (65% of net asset value at fair value)</b>		<b><u>\$ 126,110,659</u></b>	<b><u>\$ 125,179,470</u></b>	<b><u>\$ 118,197,479</u></b>

See accompanying notes to financial statements.



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**Equity Securities Portfolio**

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

See accompanying notes to financial statements.

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**CLO Fund Securities**

**CLO Subordinated Investments**

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

**CLO Rated-Note Investment**

<b>Portfolio Company</b>	<b>Investment</b>	<b>Percentage Ownership</b>	<b>Amortized Cost</b>	<b>Fair Value</b>
KCAP F3C Senior Funding L.L.C. (3)(6)(14)	Float – 12/2029 – E – 48669RAE1	27.4%	4,435,965	4,632,000
Total Investment in CLO Rated-Note			\$ 4,435,965	\$ 4,632,000
<b>Total Investment in CLO Fund Securities (28% of net asset value at fair value)</b>			<b><u>\$72,339,032</u></b>	<b><u>\$ 51,678,673</u></b>

See accompanying notes to financial statements.

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**Asset Manager Affiliates**

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

**Joint Ventures**

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

**Short-term Investments**

<u>Short-term Investments</u>	<u>Investment</u>	<u>Yield</u>	<u>Par/Amortized Cost</u>	<u>Fair Value<sup>(2)</sup></u>
US Bank Money Market Account <sup>(7)</sup> (8)	Money Market Account	0.20%	\$ 52,293,570	\$ 52,293,570
U.S Treasury Bills – CUSIP: 912796MLO <sup>(8)</sup>	U.S. Government Obligation	1.04%	25,006,750	25,006,750
<b>Total Short-term Investments (43% of net asset value at fair value)</b>			<b>\$ 77,300,320</b>	<b>\$ 77,300,320</b>
Total Investments <sup>(4)</sup>			<b>\$362,895,917</b>	<b>\$311,956,156</b>

(1) A majority of the variable rate loans in the Company’s investment portfolio bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly at the borrower’s option. The Borrower may also elect to have multiple interest reset periods for each loan. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at December 31, 2017. As noted in the table above, 74% (based on par) of debt securities contain LIBOR floors which range between 1.00% and 3.0%.

(2) Reflects the fair market value of all investments as of December 31, 2017, as determined by the Company’s Board of Directors.

(3) Non-U.S. company or principal place of business outside the U.S.

(4) The aggregate cost of investments for federal income tax purposes is approximately \$363 million. The aggregate gross unrealized appreciation is approximately \$1.1 million, the aggregate gross unrealized depreciation is approximately \$52.0 million, and the net unrealized depreciation is approximately \$50.9 million.

(5) Loan or debt security is on non-accrual status and therefore is considered non-income producing.

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

(7) Money market account holding cash.

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

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

(10) Non-voting.

See accompanying notes to financial statements.

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- (11)CLO Subordinated Investments are entitled to periodic distributions which are generally equal to the remaining cash flow of the payments made by the underlying fund's investments less contractual payments to debt holders and fund expenses. The estimated annualized effective yield indicated is based upon a current projection of the amount and timing of these distributions. Such projections are updated on a quarterly basis and the estimated effective yield is adjusted prospectively.
- (12)Notice of redemption has been received for this security.
- (13)Loan or security was on partial nonaccrual status, whereby we have recognized income on a portion of contractual PIK amounts due.
- (14)Fair value of this investment was determined using significant unobservable inputs.

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS  
As of December 31, 2016

Debt Securities Portfolio

Portfolio Company/Principal Business	Investment Interest Rate <sup>(1)</sup> /Maturity	Principal	Amortized Cost	Fair Value <sup>(2)</sup>
1A Smart Start LLC <sup>(8), (9)</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 2/22	\$ 2,970,000	\$ 2,946,408	\$ 2,919,807
4L Technologies Inc. (fka Clover Holdings, Inc.) <sup>(8), (9)</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 5/20	2,720,465	2,705,259	2,606,194
Advanced Lighting Technologies, Inc. <sup>(8), (9), (14)</sup> <i>Consumer goods: Durable</i>	First Lien Bond — 12.500% – 6/2019 — 00753CAG7 5.3% Cash, 7.3% PIK, Due 6/19	3,060,919	3,060,919	1,089,338
Advantage Sales & Marketing Inc. <sup>(8)</sup> <i>Services: Business</i>	Junior Secured Loan — Term Loan (Second Lien) 7.5% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	1,001,753	995,300
Alere Inc. (fka IM US Holdings, LLC) <sup>(9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — B Term Loan 4.3% Cash, 1.0% Libor Floor, Due 6/22	3,030,277	3,024,429	3,034,489
American Seafoods Group LLC <sup>(8), (9)</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 8/21	3,853,704	3,838,792	3,874,899
Anaren, Inc. <sup>(8), (9)</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 2/21	1,871,912	1,860,822	1,864,237
Apco Holdings, Inc. <sup>(8), (9)</sup> <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan 7.0% Cash, 1.0% Libor Floor, Due 1/22	3,867,838	3,769,454	3,900,714
API Technologies Corp. <sup>(8), (9)</sup> <i>High Tech Industries</i>	Senior Secured Loan — Initial Term Loan 7.5% Cash, 1.0% Libor Floor, Due 4/22	3,482,500	3,420,642	3,480,759
Aristotle Corporation, The <sup>(8), (9)</sup> <i>Consumer goods: Non-durable</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 6/21	3,665,860	3,652,075	3,604,274
Asurion, LLC (fka Asurion Corporation) <sup>(8), (9)</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — Incremental Tranche B-4 Term Loan 5.0% Cash, 1.0% Libor Floor, Due 8/22	876,911	873,399	889,736
Asurion, LLC (fka Asurion Corporation) <sup>(8), (9)</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — Replacement B-2 Term Loan 4.0% Cash, 0.8% Libor Floor, Due 7/20	187,812	188,275	189,719
Avalign Technologies, Inc. <sup>(8)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 9.5% Cash, 1.0% Libor Floor, Due 7/22	1,000,000	992,078	985,000
Avalign Technologies, Inc. <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 7/21	2,925,000	2,913,921	2,915,640
Bankruptcy Management Solutions, Inc. <sup>(8)</sup> <i>Services: Business</i>	Senior Secured Loan — Term B Loan 7.0% Cash, 1.0% Libor Floor, Due 6/18	665,654	665,654	655,935
BarBri, Inc. (Gemini Holdings, Inc.) <sup>(8), (9)</sup> <i>Services: Consumer</i>	Senior Secured Loan — Term Loan 4.5% Cash, 1.0% Libor Floor, Due 7/19	2,619,636	2,614,056	2,578,508
BBB Industries US Holdings, Inc. <sup>(8), (9)</sup> <i>Automotive</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 11/21	2,947,500	2,906,715	2,800,125
Bestop, Inc. <sup>(8), (9)</sup> <i>Automotive</i>	Senior Secured Loan — Delayed Draw Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	34,660	32,776	34,466
Bestop, Inc. <sup>(8), (9)</sup> <i>Automotive</i>	Senior Secured Loan — First Amendment Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	500,000	495,290	497,200

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate <sup>(1)</sup> /Maturity	Principal	Amortized Cost	Fair Value <sup>(2)</sup>
Bestop, Inc. <sup>(8), (9)</sup> <i>Automotive</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 7/21	\$ 1,520,000	\$ 1,498,330	\$ 1,452,512
Carolina Beverage Group LLC <sup>(8)</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Bond — 10.625% – 08/2018 – 143818AA0 144A 10.6% Cash, Due 8/18	1,500,000	1,506,461	1,487,400
CCS Intermediate Holdings, LLC <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.0% Cash, 1.0% Libor Floor, Due 7/21	2,932,500	2,922,875	2,470,338
Cengage Learning, Inc. <sup>(8), (9)</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — 2016 Refinancing Term Loan 5.3% Cash, 1.0% Libor Floor, Due 6/23	3,793,913	3,788,981	3,702,043
Checkout Holding Corp. (fka Catalina Marketing) <sup>(8), (9)</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Term B Loan (First Lien) 4.5% Cash, 1.0% Libor Floor, Due 4/21	975,000	972,021	853,125
CHS/Community Health Systems, Inc. <sup>(9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Incremental 2021 Term H Loan 4.0% Cash, 1.0% Libor Floor, Due 1/21	2,878,621	2,853,070	2,796,465
Consolidated Communications, Inc. <sup>(9)</sup> <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.0% Cash, 1.0% Libor Floor, Due 10/23	2,067,444	2,062,450	2,067,444
CRGT Inc. <sup>(8), (9)</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term Loan 7.5% Cash, 1.0% Libor Floor, Due 12/20	3,224,017	3,190,360	3,224,339
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) <sup>(8)</sup> <i>Beverage, Food and Tobacco</i>	Junior Secured Loan — Term Loan (Second Lien) 8.8% Cash, 1.0% Libor Floor, Due 7/21	3,000,000	3,011,328	2,463,000
CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) (aka HealthPort) <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — New Term Loan Facility 5.3% Cash, 1.0% Libor Floor, Due 12/21	2,940,225	2,917,719	2,818,941
Drew Marine Group Inc. <sup>(8)</sup> <i>Transportation: Cargo</i>	Junior Secured Loan — Term Loan (Second Lien) 8.0% Cash, 1.0% Libor Floor, Due 5/21	2,500,000	2,496,331	2,380,000
Eastern Power, LLC (Eastern Covert Midco, LLC) (aka TPF II LC, LLC) <sup>(8), (9)</sup> <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 10/21	2,796,756	2,814,422	2,826,122
Electric Lightwave Holdings, Inc. (f.k.a. Integra Telecom Holdings, Inc.) <sup>(8), (9)</sup> <i>Telecommunications</i>	Senior Secured Loan — Term B-1 Loan 5.3% Cash, 1.0% Libor Floor, Due 8/20	2,932,538	2,924,968	2,945,734
ELO Touch Solutions, Inc. <sup>(8), (9)</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 6/18	1,420,897	1,397,046	1,380,544
Empower Payments Acquisition, Inc. <sup>(8), (9)</sup> <i>Services: Business</i>	Senior Secured Loan — Term Loan 6.5% Cash, 1.0% Libor Floor, Due 11/23	3,000,000	2,940,565	2,940,000
EWT Holdings III Corp. (fka WTG Holdings III Corp.) <sup>(8), (9)</sup> <i>Ecological</i>	Senior Secured Loan — Term Loan (First Lien) 4.8% Cash, 1.0% Libor Floor, Due 1/21	1,745,501	1,741,292	1,760,783
Fender Musical Instruments Corporation <sup>(8), (9)</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Initial Loan 5.8% Cash, 1.3% Libor Floor, Due 4/19	1,339,534	1,345,751	1,322,254
FHC Health Systems, Inc. <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Initial Term Loan 5.0% Cash, 1.0% Libor Floor, Due 12/21	3,838,768	3,811,221	3,742,799
First American Payment Systems, L.P. <sup>(8)</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Junior Secured Loan — Term Loan (Second Lien) 10.8% Cash, 1.3% Libor Floor, Due 4/19	1,796,448	1,783,840	1,742,555
Getty Images, Inc. <sup>(8), (9)</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Initial Term Loan 4.8% Cash, 1.3% Libor Floor, Due 10/19	2,140,569	2,147,692	1,874,775
GI Advo Opco, LLC <sup>(8)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 11/21	247,500	245,474	223,913

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate <sup>(1)</sup> /Maturity	Principal	Amortized Cost	Fair Value <sup>(2)</sup>
GI Advo Opco, LLC <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan 5.5% Cash, 1.0% Libor Floor, Due 11/21	\$ 2,722,500	\$ 2,700,224	\$ 2,463,046
GK Holdings, Inc. (aka Global Knowledge) <sup>(8)</sup> <i>Services: Business</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.5% Cash, 1.0% Libor Floor, Due 1/22	1,500,000	1,478,209	1,465,650
GK Holdings, Inc. (aka Global Knowledge) <sup>(8), (9)</sup> <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.5% Cash, 1.0% Libor Floor, Due 1/21	2,450,000	2,433,329	2,446,080
Global Tel*Link Corporation <sup>(8)</sup> <i>Telecommunications</i>	Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, 1.3% Libor Floor, Due 11/20	4,000,000	3,957,505	3,894,500
Gold Standard Baking, Inc. <sup>(8), (9)</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term Loan 5.3% Cash, 1.0% Libor Floor, Due 4/21	2,462,500	2,453,554	2,461,269
Grande Communications Networks LLC <sup>(8), (9)</sup> <i>Telecommunications</i>	Senior Secured Loan — Initial Term Loan 4.5% Cash, 1.0% Libor Floor, Due 5/20	3,860,145	3,864,877	3,860,145
Grupo HIMA San Pablo, Inc. <sup>(8)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 1.5% Libor Floor, Due 1/18	2,887,500	2,875,001	2,743,125
Grupo HIMA San Pablo, Inc. <sup>(8)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, Due 7/18	7,000,000	6,953,618	6,370,000
Gymboree Corporation., The <sup>(8), (9)</sup> <i>Retail</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.5% Libor Floor, Due 2/18	1,421,105	1,415,457	759,581
Hargray Communications Group, Inc. (HCP Acquisition LLC) <sup>(8), (9)</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Term B-1 Loan 4.8% Cash, 1.0% Libor Floor, Due 6/19	2,887,075	2,860,733	2,926,166
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>(8), (9)</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Tranche B-3 Term Loan 7.0% Cash, 1.5% Libor Floor, Due 5/18	1,697,272	1,690,708	1,703,637
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>(8), (9)</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Tranche B-4 Term Loan 7.0% Cash, 1.0% Libor Floor, Due 8/19	1,387,500	1,384,229	1,391,545
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <sup>(8), (9)</sup> <i>Media: Advertising, Printing &amp; Publishing</i>	Senior Secured Loan — Tranche B-5 Term Loan 7.0% Cash, 1.0% Libor Floor, Due 12/19	1,385,417	1,369,287	1,395,980
Highland Acquisition Holdings, LLC (aka HealthSun Health Plans, Inc.) <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan B 6.5% Cash, 1.0% Libor Floor, Due 11/22	2,000,000	1,903,216	1,910,000
Hoffmaster Group, Inc. <sup>(8)</sup> <i>Forest Products &amp; Paper</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.5% Cash, 1.0% Libor Floor, Due 11/24	1,600,000	1,552,544	1,524,640
Hoffmaster Group, Inc. <sup>(8), (9)</sup> <i>Forest Products &amp; Paper</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 11/23	2,666,667	2,640,345	2,668,267
Industrial Services Acquisition, LLC (aka Evergreen/NAIC) <sup>(8), (9)</sup> <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 6.0% Cash, 1.0% Libor Floor, Due 6/22	2,925,000	2,898,235	2,925,000
Kellermeyer Bergensons Services, LLC <sup>(8), (9)</sup> <i>Services: Business</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 10/21	1,950,120	1,936,641	1,943,100
Key Safety Systems, Inc. <sup>(8), (9)</sup> <i>Automotive</i>	Senior Secured Loan — Initial Term Loan 5.5% Cash, 1.0% Libor Floor, Due 8/21	1,394,077	1,389,440	1,411,851
Landslide Holdings, Inc. <sup>(8), (9)</sup> <i>High Tech Industries</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 9/22	1,850,467	1,846,044	1,850,467
MB Aerospace ACP Holdings II Corp. <sup>(8), (9)</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Initial Term Loan 6.5% Cash, 1.0% Libor Floor, Due 12/22	1,342,500	1,331,454	1,342,366

See accompanying notes to financial statements.

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Portfolio Company/Principal Business	Investment Interest Rate <sup>(1)</sup> /Maturity	Principal	Amortized Cost	Fair Value <sup>(2)</sup>
Medrisk, Inc. <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan 6.3% Cash, 1.0% Libor Floor, Due 2/23	\$ 1,985,000	\$ 1,967,461	\$ 1,985,000
MGOC, Inc. (fka Media General, Inc.) <sup>(9)</sup> <i>Media: Broadcasting &amp; Subscription</i>	Senior Secured Loan — Term B Loan 4.0% Cash, 1.0% Libor Floor, Due 7/20	2,417,989	2,419,940	2,417,989
National Home Health Care Corp. <sup>(8)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.8% Cash, 1.0% Libor Floor, Due 12/22	1,500,000	1,477,675	1,477,500
National Home Health Care Corp. <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan (First Lien) 5.5% Cash, 1.0% Libor Floor, Due 12/21	3,000,000	2,970,280	2,970,000
Nelson Nutraceutical, LLC <sup>(8), (9)</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term A-1 Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 12/21	2,350,684	2,335,796	2,350,449
Nelson Nutraceutical, LLC <sup>(8), (9)</sup> <i>Beverage, Food and Tobacco</i>	Senior Secured Loan — Term A-2 Loan (First Lien) 6.0% Cash, 1.0% Libor Floor, Due 12/21	2,066,562	2,052,899	2,066,355
Nielsen & Bainbridge, LLC <sup>(8), (9)</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Term Loan (First Lien) 6.2% Cash, 1.0% Libor Floor, Due 8/20	5,361,360	5,326,136	5,199,447
NM Z Parent Inc. (aka Zep, Inc.) <sup>(8), (9)</sup> <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — 2016 Term Loan 5.0% Cash, 1.0% Libor Floor, Due 6/22	3,447,500	3,459,466	3,481,630
Novitex Acquisition, LLC (fka ARSloane Acquisition, LLC) <sup>(8), (9)</sup> <i>Services: Business</i>	Senior Secured Loan — Tranche B-2 Term Loan (First Lien) 8.0% Cash, 1.3% Libor Floor, Due 7/20	1,941,336	1,899,875	1,882,707
Onex Carestream Finance LP <sup>(8)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 9.5% Cash, 1.0% Libor Floor, Due 12/19	1,932,311	1,932,311	1,647,295
Onex Carestream Finance LP <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan (First Lien 2013) 5.0% Cash, 1.0% Libor Floor, Due 6/19	1,750,135	1,753,387	1,704,920
Otter Products, LLC (OtterBox Holdings, Inc.) <sup>(8), (9)</sup> <i>Consumer goods: Durable</i>	Senior Secured Loan — Term B Loan 5.8% Cash, 1.0% Libor Floor, Due 6/20	2,600,266	2,587,099	2,507,697
PGX Holdings, Inc. <sup>(8), (9)</sup> <i>Services: Consumer</i>	Senior Secured Loan — Initial Term Loan (First Lien) 6.3% Cash, 1.0% Libor Floor, Due 9/20	3,620,714	3,598,052	3,626,381
Playpower, Inc. <sup>(8), (9)</sup> <i>Construction &amp; Building</i>	Senior Secured Loan — Initial Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 6/21	1,970,000	1,958,956	1,969,606
PrimeLine Utility Services LLC (fka FR Utility Services LLC) <sup>(8), (9)</sup> <i>Energy: Electricity</i>	Senior Secured Loan — Initial Term Loan 6.5% Cash, 1.0% Libor Floor, Due 11/22	3,935,672	3,904,453	3,937,247
Priority Payment Systems Holdings, LLC <sup>(8), (9)</sup> <i>Banking, Finance, Insurance &amp; Real Estate</i>	Senior Secured Loan — Initial Term Loan 7.0% Cash, 1.0% Libor Floor, Due 1/23	4,000,000	3,960,000	3,960,000
PSC Industrial Holdings Corp. <sup>(8), (9)</sup> <i>Environmental Industries</i>	Senior Secured Loan — Term Loan (First Lien) 5.8% Cash, 1.0% Libor Floor, Due 12/20	2,974,300	2,953,559	2,941,583
Q Holding Company (fka Lexington Precision Corporation) <sup>(8), (9)</sup> <i>Chemicals, Plastics and Rubber</i>	Senior Secured Loan — Term B Loan 6.0% Cash, 1.0% Libor Floor, Due 12/21	2,992,366	2,962,443	2,962,443
Quad-C JH Holdings Inc. (aka Joerns Healthcare) <sup>(8), (9)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Senior Secured Loan — Term Loan A 6.0% Cash, 1.0% Libor Floor, Due 5/20	3,900,079	3,883,565	3,666,075
Ravn Air Group, Inc. <sup>(8), (9)</sup> <i>Transportation: Consumer</i>	Senior Secured Loan — Initial Term Loan 5.3% Cash, 1.0% Libor Floor, Due 7/21	2,421,875	2,412,614	2,324,516
Roscoe Medical, Inc. <sup>(8)</sup> <i>Healthcare &amp; Pharmaceuticals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, Due 9/19	6,700,000	6,666,733	6,499,000
Sandy Creek Energy Associates, L.P. <sup>(8), (9)</sup> <i>Utilities: Electric</i>	Senior Secured Loan — Term Loan 5.0% Cash, 1.0% Libor Floor, Due 11/20	2,613,239	2,606,016	2,204,921
Stafford Logistics, Inc.(dba Custom Ecology, Inc.) <sup>(8), (9)</sup> <i>Environmental Industries</i>	Senior Secured Loan — Term Loan 7.5% Cash, 1.0% Libor Floor, Due 8/21	\$ 2,709,639	\$ 2,694,201	\$ 2,677,395

See accompanying notes to financial statements.



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

See accompanying notes to financial statements.

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

See accompanying notes to financial statements.

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**CLO Fund Securities**

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

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

**CLO Rated-Note Investments**

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

**Asset Manager Affiliates**

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

See accompanying notes to financial statements.

**Time Deposits and Money Market Account**

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

- (1) A majority of the variable rate loans in the Company’s investment portfolio bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly at the borrower’s option. The Borrower may also elect to have multiple interest reset periods for each loan. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at December 31, 2016. As noted in the table above, 93% (based on par) of debt securities contain LIBOR floors which range between 0.75% and 3.0%.
- (2) Reflects the fair market value of all investments as of December 31, 2016, as determined by the Company’s Board of Directors.
- (3) Non-U.S. company or principal place of business outside the U.S.
- (4) The aggregate cost of investments for federal income tax purposes is approximately \$429 million. The aggregate gross unrealized appreciation is approximately \$2.1 million, the aggregate gross unrealized depreciation is approximately \$65.0 million, and the net unrealized depreciation is approximately \$62.9 million.
- (5) Non-income producing.
- (6) An affiliate CLO Fund managed by an Asset Manager Affiliate (as such term is defined in the notes to the financial statements).
- (7) Money market account holding restricted cash and security deposits for employee benefit plans.
- (8) Qualified asset for purposes of section 55(a) of the Investment Company Act of 1940.
- (9) As of December 31, 2016, this investment is owned by KCAP Senior Funding I, LLC and was pledged to secure KCAP Senior Funding I, LLC’s obligation.
- (10) Other than the Asset Manager Affiliate, which we are deemed to “control”, we do not “control” and are not an “affiliate” of any of our portfolio companies, each as defined in the Investment Company Act of 1940 (the “1940 Act”). In general, under the 1940 Act, we would be presumed to “control” a portfolio company if we owned 25% or more of its voting securities and would be an “affiliate” of a portfolio company if we owned 5% or more of its voting securities.
- (11) Non-voting.
- (12) CLO Subordinated Investments are entitled to periodic distributions which are generally equal to the remaining cash flow of the payments made by the underlying fund’s investments less contractual payments to debt holders and fund expenses. The estimated annualized effective yield indicated is based upon a current projection of the amount and timing of these distributions. Such projections are updated on a quarterly basis and the estimated effective yield is adjusted prospectively.
- (13) Notice of redemption has been received for this transaction.
- (14) Loan or security was on partial non-accrual status, whereby we have recognized income on a portion of contractual PIK amounts due.

See accompanying notes to financial statements.

KCAP FINANCIAL, INC.

FINANCIAL HIGHLIGHTS  
(\$ per share)

	For the Years Ended December 31,				
	2017	2016	2015	2014	2013
<b>Per Share Data:</b>					
Net asset value, at beginning of period	\$ 5.24	\$ 5.82	\$ 6.94	\$ 7.51	\$ 7.85
Net investment income <sup>(1)</sup>	0.30	0.50	0.65	0.59	0.62
Net realized losses from investment transactions <sup>(1)</sup>	(0.19)	(0.17)	(0.17)	(0.30)	(0.37)
Realized losses from extinguishments of debt <sup>(1)</sup>	(0.11)	—	(0.01)	(0.02)	(0.02)
Net change in unrealized appreciation (depreciation) of investments <sup>(1)</sup>	0.09	(0.36)	(0.97)	0.17	0.31
Net increase (decrease) in net assets resulting from operations	0.09	(0.03)	(0.50)	0.44	0.54
Net decrease in net assets resulting from distributions:					
Distribution of ordinary income	(0.16)	(0.40)	(0.63)	(0.78)	(0.62)
Return of capital	(0.32)	(0.19)	—	(0.22)	(0.43)
Net decrease in net assets resulting from stockholder distributions	(0.48)	(0.59)	(0.63)	(1.00)	(1.05)
Net increase/(decrease) in net assets relating to capital share transactions					
Offering of common stock	—	—	—	0.02	0.14
Common stock withheld for payroll taxes upon vesting of restricted stock	(0.01)	0.01	—	—	—
Dividend reinvestment plan	0.01	(0.01)	—	—	0.02
Stock based compensation	0.02	0.04	0.01	(0.03)	0.01
Net increase (decrease) in net assets relating to capital share transactions	0.02	0.04	0.01	(0.01)	0.17
Net asset value, end of period	\$ 4.87	\$ 5.24	\$ 5.82	\$ 6.94	\$ 7.51
Total net asset value return <sup>(2)</sup>	2.0%	0.2%	(7.2)%	5.7%	9.1%
<b>Ratio/Supplemental Data:</b>					
Per share market value at beginning of period	\$ 3.98	\$ 4.07	\$ 6.82	\$ 8.07	\$ 9.19
Per share market value at end of period	\$ 3.41	\$ 3.98	\$ 4.07	\$ 6.82	\$ 8.07
Total market return <sup>(3)</sup>	(2.3)%	12.3%	(31.2)%	(3.1)%	(0.7)%
Shares outstanding at end of period	37,339,224	37,178,294	37,100,005	36,775,127	33,332,123
Net assets at end of period	\$ 181,804,576	\$ 194,924,925	\$ 216,100,470	\$ 255,316,701	\$ 250,369,693
Portfolio turnover rate <sup>(4)</sup>	100.5%	34.3%	32.5%	45.8%	45.5%
Average par debt outstanding	\$ 134,020,367	\$ 189,836,675	\$ 224,498,433	\$ 196,622,077	\$ 150,828,586
Asset coverage ratio	271%	205%	202%	211%	226%
Ratio of net investment income to average net assets	5.8%	9.0%	9.8%	7.9%	7.8%
Ratio of total expenses to average net assets	9.2%	8.6%	8.6%	8.2%	7.5%
Ratio of interest expense to average net assets	4.1%	4.3%	4.7%	4.5%	3.9%
Ratio of non-interest expenses to average net assets	5.1%	4.2%	3.9%	3.7%	3.6%

(1) Based on weighted average number of common shares outstanding for the period.

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

(3) Total market return equals the change in the ending of period market price per share over the beginning of period price per share plus distributions (including any return of capital), divided by the beginning of period market price per share.

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

(5) Totals may not sum due to rounding.

See accompanying notes to financial statements.

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. ORGANIZATION**

KCAP Financial, Inc. (“KCAP” or the “Company”) is an internally managed, non-diversified closed-end investment company that is regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). The Company was formed as a Delaware limited liability company on August 8, 2006 and, prior to the issuance of shares of the Company’s common stock in its initial public offering (“IPO”), converted to a corporation incorporated in Delaware on December 11, 2006. Prior to its IPO, the Company did not have material operations. The Company’s IPO of 14,462,000 shares of common stock raised net proceeds of approximately \$200 million. Prior to the IPO, the Company issued 3,484,333 shares to affiliates of Kohlberg & Co., L.L.C., a leading middle market private equity firm, in exchange for the contribution to the Company of their ownership interests in Katonah Debt Advisors, L.L.C., and related affiliates (collectively, “Katonah Debt Advisors”) and in securities issued by collateralized loan obligation funds (“CLO Funds”) managed by Katonah Debt Advisors and two other asset managers.

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

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

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

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

As of December 31, 2017, Katonah Debt Advisors and Trimaran Advisors, as well as affiliated management companies Katonah 2007-1 Management, L.L.C., Trimaran Advisors Management, L.L.C. and KCAP Management, L.L.C., (collectively the “Asset Manager Affiliates”), had approximately \$3.0 billion of par value assets under management. Katonah Debt Advisors and Trimaran Advisors are registered under the Investment Advisers Act of 1940, as amended, and are each managed independently from the Company by a separate management team (however, certain of the Company’s executive officers also act in similar capacities for one or more of the Asset Manager Affiliates). The Asset Manager Affiliates provide investment management services to CLO Funds, making day-to-day investment decisions concerning the assets of the CLO Funds. The Asset Manager Affiliates, either directly or through its subsidiaries, may make investments in the CLO Funds they manage. In addition, the Company holds investments in a portion of the securities issued by the CLO Funds managed by the Asset Manager Affiliates.

During the third quarter of 2017, the Company formed a joint venture with Freedom 3 Opportunities LLC (“Freedom 3 Opportunities”), an affiliate of Freedom 3 Capital LLC, to create KCAP Freedom 3 LLC (the “Joint Venture”). The Company and Freedom 3 Opportunities LLC contributed approximately \$37 million and \$25 million, respectively, in assets to the Joint Venture, which in turn used the assets to capitalize a new fund (KCAP FC3 Senior Funding, L.L.C. or the “Fund”) managed by KCAP Management, LLC, one of the Company’s indirectly wholly-owned Asset Manager Affiliate subsidiaries. In addition, the Fund used cash on hand and borrowings under a credit facility to purchase approximately \$184 million of

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. ORGANIZATION – (continued)**

loans from the Company and the Company used the proceeds from such sale to redeem approximately \$147 million in debt issued by KCAP Senior Funding. The Joint Venture may originate loans from time to time and sell them to the Fund.

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

The Company has three principal areas of investment:

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

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

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

The Company may also invest in other investments such as loans to publicly-traded companies, high-yield bonds, joint venture and distressed debt securities. The Company may also receive warrants or options to purchase common stock in connection with its debt investments.

The Company has elected to be treated as a regulated investment company (“RIC”) under Subchapter M of the Internal Revenue Code of 1986, as amended (the “Code”). To qualify as a RIC, the Company must, among other things, meet certain source-of-income, and asset diversification and annual distribution requirements. As a RIC, the Company generally will not have to pay corporate-level U.S. federal income taxes on any income that it distributes in a timely manner to its stockholders.

**2. SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles (“GAAP”).

The consolidated financial statements reflect all adjustments, both normal and recurring which, in the opinion of management, are necessary for the fair presentation of the Company’s results of operations and financial condition for the periods presented. Furthermore, the preparation of the consolidated financial statements requires the Company to make significant estimates and assumptions including with respect to the fair value of investments that do not have a readily available market value. Actual results could differ from those estimates, and the differences could be material. Certain prior-year amounts have been reclassified to conform to the current year presentation.

The Company consolidates the financial statements of its wholly-owned special purpose financing subsidiaries KCAP Funding, Kolhberg Capital Funding LLC I, KCAP Senior Funding I, LLC and KCAP Senior Funding I Holdings, LLC in its consolidated financial statements as they are operated solely for investment activities of the Company. The creditors of KCAP Senior Funding I, LLC received security interests in the assets which were owned by KCAP Senior Funding I, LLC and such assets were not intended to be available to the creditors of KCAP Financial, Inc., or any other affiliate. All of the borrowings of KCAP Funding, Kolhberg Capital Funding LLC I, and KCAP Senior Funding I, LLC have been fully repaid.

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. SIGNIFICANT ACCOUNTING POLICIES – (continued)**

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

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

On February 18, 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update 2015-2 (“ASU 2015-2”), which updated consolidation standards under ASC Topic 810, “Consolidation”. Under this update, a new consolidation analysis is required for variable interest entities (“VIEs”) and will limit the circumstances in which investment managers and similar entities are required to consolidate the entities that they manage. The FASB decided to eliminate some of the criteria under which their management fees are considered a variable interest and limit the circumstances in which variable interests in a VIE held by related parties of a reporting enterprise require the reporting enterprise to consolidate the VIE. The guidance is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2015. The Asset Manager Affiliates adopted ASU 2015-2 in 2016 which resulted in the deconsolidation of the CLO Funds managed by them.

In addition, in accordance with Regulation S-X promulgated by the SEC, additional financial information with respect to one of the CLO Funds in which the Company has an investment, Katonah 2007-I CLO Ltd. (“Katonah 2007-I CLO”), is required to be included in the Company’s SEC filings. The additional financial information regarding the Asset Manager Affiliates (pursuant to Rule 3-09), immediately follows these consolidated financial statements. Summarized financial information regarding Katonah 2007-I CLO (pursuant to Rule 4-08 (g)) is set forth in Note 5.

Stockholder distributions on the Statement of Changes in Net Assets reflect the estimated allocation, between net investment income and return of capital, of distributions made during the reporting period, excluding the distribution declared in a quarter with a record date occurring after the quarter-end. The determination of the tax character of distributions is made on an annual (full calendar-year) basis at the end of the year based upon our taxable income for the full year and the distributions paid during the full year. Therefore, an estimate of tax attributes made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year.

It is the Company’s primary investment objective to generate current income and, to a lesser extent, capital appreciation by lending directly to privately-held middle market companies. During the year ended December 31, 2017, the Company provided approximately \$227.7 million to portfolio companies to support their growth objectives, none of this support was contractually obligated. See also Note 8 — Commitments and Contingencies. As of December 31, 2017, the Company held loans it made to 39 investee companies with aggregate principal amounts of approximately \$124.6 million. The details of such loans have been disclosed on the consolidated schedule of investments as well as in Note 4 — Investments. In addition to providing loans to investee companies, from time to time the Company assists investee companies in securing financing from other sources by introducing such investee companies to sponsors or by, among other things, leading a syndicate of lenders to provide the investee companies with financing. During the year ended December 31, 2017, the Company did not engage in any such or similar activities.



**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. SIGNIFICANT ACCOUNTING POLICIES – (continued)**

*Recently adopted accounting pronouncements*

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

**Consolidated Statements of Cash Flows**

	<b>Year Ended December 31, 2016</b>	<b>Year Ended December 31, 2015</b>
Net cash (used in) financing activities as reported	\$ (50,229,842)	\$ (38,414,720)
Impact of Adoption	1,390,026	(12,187,278)
Net cash (used in) financing activities after adoption	<u>\$ (48,839,816)</u>	<u>\$ (50,601,998)</u>

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

*Pending accounting pronouncements*

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

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

**Investments**

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

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. SIGNIFICANT ACCOUNTING POLICIES – (continued)**

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

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

The Board of Directors may consider other methods of valuation than those set forth below to determine the fair value of Level III investments as appropriate in conformity with GAAP. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of the Company's investments may differ materially from the values that would have been used had a readily available market existed for such investments. Further, such investments may be generally subject to legal and other restrictions on resale or otherwise be less liquid than publicly traded securities. In addition, changes in the market environment and other events may occur over the life of the investments that may cause the value realized on such investments to be different from the currently assigned valuations.

The majority of the Company's investment portfolio is composed of debt and equity securities with unique contract terms and conditions and/or complexity that requires a valuation of each individual investment that considers multiple levels of market and asset specific inputs, which may include historical and forecasted financial and operational performance of the individual investment, projected cash flows, market multiples, comparable market transactions, the priority of the security compared with those of other securities for such issuers, credit risk, interest rates, and independent valuations and reviews.

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

The Company derives fair value for its illiquid investments that do not have indicative fair values based upon active trades primarily by using a present value technique that discounts the estimated contractual cash flows for the subject assets with discount rates imputed by broad market indices, bond spreads and yields for comparable issuers relative to the subject assets (the "Income Approach"). The Company also considers,

**KCAP Financial, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****2. SIGNIFICANT ACCOUNTING POLICIES – (continued)**

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

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

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

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

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. SIGNIFICANT ACCOUNTING POLICIES – (continued)**

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

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

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

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

*Joint Venture.* The Company's investment in KCAP Freedom 3 LLC ("Joint Venture") is a joint venture with Freedom 3 Opportunities. The Company carries investments in joint ventures at fair value based upon the fair value of the investments held by the joint venture. See Note 4 below, for more information regarding the Joint Venture.

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. SIGNIFICANT ACCOUNTING POLICIES – (continued)**

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

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

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

*Interest Income.* Interest income, including the amortization of premium and accretion of discount, is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company generally places a loan or security on non-accrual status and ceases recognizing cash interest income on such loan or security when a loan or security becomes 90 days or more past due or if the Company otherwise does not expect the debtor to be able to service its debt obligations. Non-accrual loans remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due or such loans become current. As of December 31, 2017, two issuers representing 3.3% of the Company's total investments at fair value were on partial non-accrual status, whereby we have recognized income on a portion of contractual payment-in-kind (PIK) amounts due. As of December 31, 2016, two of our investments were on partial non-accrual status.

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

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

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

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. SIGNIFICANT ACCOUNTING POLICIES – (continued)**

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

*Joint Venture.* The Company recognizes investment income on its investment in the Joint Venture based upon its share of the estimated tax-basis earnings and profits of the Joint Venture. Any distributions in excess of tax-basis earnings and profits are recognized as a return of capital (adjustment to the Company's cost basis in the investment). The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at year-end of the year based upon taxable income and distributions for the full year. Therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

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

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

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

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

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

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

**3. EARNINGS (LOSSES) PER SHARE**

In accordance with the provisions of ASC 260, "Earnings per Share" ("ASC 260"), basic earnings per share is computed by dividing earnings available to common shareholders by the weighted average number of shares outstanding during the period. Other potentially dilutive common shares, and the related impact to earnings, are considered when calculating earnings per share on a diluted basis.

**KCAP Financial, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****3. EARNINGS (LOSSES) PER SHARE – (continued)**

The following information sets forth the computation of basic and diluted net increase (decrease) in stockholders' equity per share for the years ended December 31, 2017, 2016, and 2015:

	For the Years ended December 31,		
	2017	2016	2015
Net increase (decrease) in net assets resulting from operations	\$ 3,388,082	\$ (1,039,731)	\$ (18,634,558)
Net (decrease) increase in net assets allocated to unvested share awards	(27,288)	14,520	332,869
Net increase (decrease) in net assets available to common stockholders	<u>\$ 3,360,794</u>	<u>\$ (1,025,211)</u>	<u>\$ (18,301,689)</u>
Weighted average number of common and common stock equivalent shares outstanding for diluted shares computation	<u>37,235,130</u>	<u>37,149,663</u>	<u>36,964,444</u>
Net increase in net assets per basic common shares:			
Net increase in net assets from operations	\$ 0.09	\$ (0.03)	\$ (0.50)
Net increase in net assets per diluted shares:			
Net increase in net assets from operations	\$ 0.09	\$ (0.03)	\$ (0.50)

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

There were 50,000 options to purchase shares of common stock considered for the computation of the diluted per share information for the year ended December 31, 2017. Since the effects are anti-dilutive for all periods, the options were not included in the computation. For the year ended December 31, 2017 and 2016, the company purchased 64,176 and 67,654 shares, respectively, of common stock in connection with the vesting of employee's restricted stock, such shares are treated as treasury shares and reduce the weighted average shares outstanding in the computation of earnings per share.

The Company's Convertible Notes were included in the computation of the diluted net increase or decrease in net assets resulting from operations per share by application of the "if-converted method" for periods when the Convertible Notes were outstanding. Under the if-converted method, interest charges applicable to the convertible notes for the period are added to reported net increase or decrease in net assets resulting from operations and the full amount of shares (pro-rata if not outstanding for the full period) that would be issued are added to weighted average basic shares. Convertible notes are considered anti-dilutive only when its interest per share upon conversion exceeds the basic net increase or decrease in net assets resulting from operations per share. For the year ended December 31, 2017, 2016 and 2015, the effects of the Convertible Notes were anti-dilutive. The Convertible Notes matured and were repaid in March 2016.

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. INVESTMENTS**

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

Security Type	December 31, 2017			December 31, 2016		
	Cost/Amortized Cost	Fair Value	% <sup>(1)</sup>	Cost/Amortized Cost	Fair Value	% <sup>(1)</sup>
Short-term investments <sup>(2)</sup>	\$ 77,300,320	\$ 77,300,320	26	\$ 28,699,269	\$ 28,699,269	8%
Senior Secured Loan	48,337,900	44,960,146	14	207,701,078	200,322,152	55
Junior Secured Loan	62,561,913	58,941,300	19	37,251,776	35,444,440	10
Senior Unsecured Loan	12,777,283	12,777,283	4	—	—	—
First Lien Bond	—	—	—	3,060,919	1,089,338	—
Senior Secured Bond	1,502,374	1,518,750	—	1,506,461	1,487,400	—
CLO Fund Securities	72,339,032	51,678,673	17	76,851,317	54,174,350	15
Equity Securities	10,571,007	4,414,684	1	10,389,007	5,056,355	1
Asset Manager Affiliates <sup>(3)</sup>	52,591,230	38,849,000	12	55,341,230	40,198,000	11
Joint Venture	24,914,858	21,516,000	7	—	—	—
Total	<u>\$ 362,895,917</u>	<u>\$ 311,956,156</u>	<u>100%</u>	<u>\$ 420,801,057</u>	<u>\$ 366,471,304</u>	<u>100%</u>

(1) Represents percentage of total portfolio at fair value.

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

(3) Represents the equity investment in the Asset Manager Affiliates.



KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

The industry related information, based on the fair value of the Company’s investment portfolio as of December 31, 2017 and December 31, 2016 for the Company’s investment portfolio was as follows:

Industry Classification	December 31, 2017			December 31, 2016		
	Cost/Amortized Cost	Fair Value	% <sup>(1)</sup>	Cost/Amortized Cost	Fair Value	% <sup>(1)</sup>
Aerospace and Defense	\$ 5,636,056	\$ 4,115,487	1%	\$ 8,394,633	\$ 8,450,106	2%
Asset Management Company <sup>(2)</sup>	52,591,230	38,849,000	12	55,341,230	40,198,000	11
Automotive	—	—	—	6,322,551	6,196,154	2
Banking, Finance, Insurance & Real Estate	4,458,962	4,418,391	1	6,805,514	6,782,010	2
Beverage, Food and Tobacco	7,496,438	7,435,050	2	15,198,830	14,703,372	4
Capital Equipment	5,454,621	4,680,821	2	6,185,129	5,575,048	2
Chemicals, Plastics and Rubber	—	—	—	6,421,909	6,444,073	2
CLO Fund Securities	72,339,032	51,678,673	17	76,851,317	54,174,350	15
Construction & Building	1,004,093	999,872	—	5,919,158	5,929,606	2
Consumer goods: Durable	1,071,340	805,607	—	12,319,905	10,118,736	3
Consumer goods: Non-durable	691,234	694,662	—	14,766,390	14,452,096	4
Ecological	—	—	—	1,741,292	1,760,783	—
Energy: Electricity	—	—	—	3,904,453	3,937,247	1
Energy: Oil & Gas	14,932,542	11,433,777	4	14,493,835	8,805,761	2
Environmental Industries	6,330,630	5,766,437	2	12,279,924	12,185,239	3
Forest Products & Paper	1,558,556	1,600,960	1	4,192,889	4,192,907	1
Healthcare & Pharmaceuticals	30,367,449	25,512,654	8	58,769,668	53,594,534	15
High Tech Industries	18,229,229	18,260,577	6	9,854,093	9,936,109	3
Hotel, Gaming & Leisure	400,000	1,000	—	400,000	1,000	—
Joint Venture	24,914,858	21,516,000	7	—	—	—
Media: Advertising, Printing & Publishing	3,371,086	3,318,296	1	11,712,682	11,453,447	3
Media: Broadcasting & Subscription	—	—	—	8,273,174	8,372,984	2
Related Party Loans	12,777,283	12,777,283	4	—	—	—
Retail	—	—	—	1,415,457	759,581	—
Services: Business	3,563,574	2,366,400	1	16,125,481	16,230,486	4
Services: Consumer	—	—	—	6,212,108	6,204,889	2
Telecommunications	6,455,489	6,466,949	2	12,809,799	12,767,823	3
Textiles and Leather	7,950,994	7,947,940	3	—	—	—
Money Market Accounts	52,293,570	52,293,570	17	28,699,269	28,699,269	8
Transportation: Cargo	4,000,901	4,010,000	1	7,557,315	7,190,135	2
Transportation: Consumer	—	—	—	2,412,614	2,324,516	1
U.S. Government Obligations	25,006,750	25,006,750	8	—	—	—
Utilities: Electric	—	—	—	5,420,438	5,031,043	1
<b>Total</b>	<b>\$362,895,917</b>	<b>\$311,956,156</b>	<b>100%</b>	<b>\$420,801,057</b>	<b>\$366,471,304</b>	<b>100%</b>

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

(2) Represents the equity investment in the Asset Manager Affiliates.

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. INVESTMENTS – (continued)**

The Company may invest up to 30% of the investment portfolio in “non-qualifying” opportunistic investments, including investments in debt and equity securities of CLO Funds, distressed debt or debt and equity securities of large cap public companies. Within this 30% of the portfolio, the Company also may invest in debt of middle market companies located outside of the United States.

At December 31, 2017 and December 31, 2016, the total amount of non-qualifying assets was approximately 23% and 17% of total assets, respectively. The majority of non-qualifying assets were foreign investments which were approximately 16% and 14% of the Company’s total assets, respectively (including the Company’s investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 16% and 16% of its total assets on such dates, respectively).

**Investments in CLO Fund Securities**

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

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

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

In December 2016, the Company purchased \$10.1 million of the par value of the Subordinated Notes of Catamaran 2016-1 CLO (“Catamaran 2016-1”) managed by Trimaran Advisors.

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

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

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

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

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

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

Affiliate Investments

The following table details investments in affiliates at December 31, 2017:

Asset Manager	Industry Classification	Fair Value at December 31, 2016	Purchases/ (Sales) of or Advances/ (Distributions)	Net Accretion	Transfers In/(Out) of Affiliates	Unrealized Gain/ (Loss)	Realized Gain/ (Loss)	Fair Value at of December 31, 2017	Interest Income	Dividend/ Investment Income
Asset Manager Affiliates <sup>(4)(5)(6)</sup>	Asset Management Company	\$40,198,000	\$ (3,210,000)	\$ —	\$ —	\$ 1,401,000	\$ —	\$ 38,849,000	\$ —	\$ 460,000
Trimaran Advisors, LLC Revolving Credit Facility <sup>(4)(5)(6)</sup>	Related Party Loans	—	—	—	—	—	—	—	916,765	—
Trimaran Advisors, LLC Related Party Loan <sup>(4)(5)(6)</sup>	Related Party Loans	—	8,359,051	—	—	—	—	8,359,051	148,721	—
Trimaran Advisors, LLC Related Party Loan <sup>(4)(5)(6)</sup>	Related Party Loans	—	4,418,232	—	—	—	—	4,418,232	16,752	—
Katonah 2007-1 CLO, Ltd. <sup>(1)(2)(3)(4)</sup>	CLO Fund Securities	20,453,099	(13,157,760)	5,660,026	—	(2,184,878)	—	10,770,486	5,660,026	—
Trimaran CLO VII, Ltd. <sup>(1)(2)(3)(4)</sup>	CLO Fund Securities	1,195,152	(1,264,090)	—	—	78,938	—	10,000	—	—
Catamaran CLO 2012-1, Ltd. <sup>(1)(2)(4)</sup>	CLO Fund Securities	2,819,412	(771,743)	699,611	—	(426,497)	—	2,320,783	699,611	—
Catamaran CLO 2013-1, Ltd. <sup>(1)(2)(4)</sup>	CLO Fund Securities	4,918,807	(1,054,362)	834,448	—	2,224,807	—	6,923,699	834,448	—
Catamaran CLO 2014-1, Ltd. <sup>(1)(2)(4)</sup>	CLO Fund Securities	4,546,682	2,319,047	1,079,850	—	1,643,907	(1,359,309)	8,230,178	1,079,850	—
Catamaran CLO 2014-2, Ltd. <sup>(1)(2)(4)</sup>	CLO Fund Securities	5,092,087	(1,130,813)	806,058	—	(266,370)	—	4,500,962	806,058	—
Catamaran CLO 2015-1, Ltd. <sup>(1)(2)(4)</sup>	CLO Fund Securities	3,223,255	(571,562)	446,893	—	471,017	—	3,569,600	446,893	—
Catamaran CLO 2016-1, Ltd. <sup>(1)(2)(4)</sup>	CLO Fund Securities	8,350,290	(1,146,242)	1,093,043	—	233,593	—	8,530,685	1,093,043	—
CRMN 2014-1A <sup>(1)(2)(4)</sup>	CLO Fund Securities	1,310,000	(1,545,506)	9,259	—	131,727	94,520	—	97,885	—
KCAP F3C Senior Funding Rated Notes <sup>(1)(2)(4)</sup>	CLO Fund Securities	—	4,346,290	89,676	—	196,035	—	4,632,000	89,676	—
KCAP Freedom 3, LLC <sup>(4)</sup>	Joint Venture	—	24,914,858	—	—	(3,398,858)	—	21,516,000	—	949,037
<b>Total Affiliated Investments</b>		<b>\$92,106,784</b>	<b>\$ 20,505,400</b>	<b>\$10,718,864</b>	<b>\$ —</b>	<b>\$ 104,421</b>	<b>\$(1,264,789)</b>	<b>\$122,630,676</b>	<b>\$11,889,728</b>	<b>\$1,409,037</b>

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

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

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. INVESTMENTS – (continued)**

- (3) Notice of redemption has been received for this security.
- (4) Fair value of this investment was determined using significant unobservable inputs.
- (5) Qualified asset for purposes of section 55(a) of the Investment Company Act of 1940.
- (6) Other than the Asset Manager Affiliate, which we are deemed to “control”, we do not “control” and are not an “affiliate” of any of our portfolio companies, each as defined in the Investment Company Act of 1940 (the “1940 Act”). In general, under the 1940 Act, we would be presumed to “control” a portfolio company if we owned 25% or more of its voting securities and would be an “affiliate” of a portfolio company if we owned 5% or more of its voting securities.

**Investment in Joint Venture:**

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

During the fourth quarter of 2017, the Fund was refinanced through the issuance of senior and subordinated notes. The Joint Venture purchased 100% of the subordinated notes issued by the Fund. In connection with the refinancing, the Joint Venture made a cash distribution to the Company of approximately \$12.6 million. The Company expects that approximately \$11.8 million of this distribution will be return of capital, reducing the cost basis of its investment in the Joint Venture by that amount. The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at the end of the year, therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

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

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

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. INVESTMENTS – (continued)**

**KCAP Freedom 3 LLC**

Summarized Statement of Financial Consolidation

	As of December 31, 2017
Cash	\$ 1,717
Investment at fair value	37,080,000
<b>Total Assets</b>	<b>\$ 37,081,717</b>
Total Liabilities	\$ 1,221,916
Total Equity	35,859,801
<b>Total Liabilities and Equity</b>	<b>\$ 37,081,717</b>

**KCAP Freedom 3 LLC**

Summarized Statement of Operations

	For the period from July 20, 2017 (date of inception) to December 31, 2017
Investment income	\$ 2,531,331
Operating expenses	(435,757)
Net investment income	2,095,574
Unrealized depreciation on investments	(5,063,254)
<b>Net loss</b>	<b>\$ (2,096,166)</b>

**KCAP Freedom 3 LLC**

Schedule of Investments

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

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

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

**Fair Value Measurements**

The Company follows the provisions of ASC 820: Fair Value, which among other matters, requires 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

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. INVESTMENTS – (continued)**

measured at fair value. ASC 820: Fair Value defines “fair value” as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This fair value definition focuses on an exit price in the principal, or most advantageous market, and prioritizes, within a measurement of fair value, the use of market-based inputs (which may be weighted or adjusted for relevance, reliability and specific attributes relative to the subject investment) over entity-specific inputs. Market price observability is affected by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

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

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

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

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

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

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. INVESTMENTS – (continued)**

The following table summarizes the fair value of investments by the above ASC 820: Fair Value fair value hierarchy levels as of December 31, 2017 and December 31, 2016, respectively:

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

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

As a BDC, the Company is required to invest primarily in the debt and equity of non-public companies for which there is little, if any, market-observable information. As a result, a significant portion of the Company's investments at any given time will likely be deemed Level III investments. Investment values derived by a third party pricing service are generally deemed to be Level III values. For those that have observable trades, the Company considers them to be Level II.

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

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

The Company's policy for determining transfers between levels is based solely on the previously defined three-level hierarchy for fair value measurement. Transfers between the levels of the fair value hierarchy are separately noted in the tables below and the reason for such transfer described in each table's respective

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

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

	Year Ended December 31, 2017					
	Debt Securities	CLO Fund Securities	Equity Securities	Asset Manager Affiliate	Joint Venture	Total
Balance, December 31, 2016	\$ 153,741,745	\$ 54,174,350	\$ 5,056,355	\$ 40,198,000	\$ —	\$ 253,170,450
Transfers out of Level III <sup>(1)</sup>	(3,867,400)	—	—	—	—	(3,867,400)
Transfers into Level III <sup>(2)</sup>	2,477,500	—	—	—	—	2,477,500
Net accretion	246,238	11,139,633	—	—	—	11,385,871
Purchases	53,219,762	11,211,368	182,000	—	36,738,873	101,352,002
Sales/Paydowns/Return of Capital	(136,020,685)	(25,598,497)	—	(2,750,000)	(11,824,015)	(176,193,197)
Total realized loss included in earnings	(2,121,907)	(1,264,789)	—	—	—	(3,386,696)
Change in unrealized gain (loss) included in earnings	2,210,202	2,016,608	(823,671)	1,401,000	(3,398,858)	1,405,281
Balance, December 31, 2017	\$ 69,885,455	\$ 51,678,673	\$ 4,414,684	\$ 38,849,000	\$ 21,516,000	\$ 186,343,812
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	\$ (479,087)	\$ 2,016,608	\$ (823,671)	\$ 1,401,000	\$ (3,398,858)	\$ (1,284,008)

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

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

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

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

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

As of December 31, 2017, the Company's Level II portfolio investments were valued by a third party pricing services for which the prices are not adjusted and for which inputs are observable or can be corroborated by observable market data for substantially the full character of the financial instrument, or by inputs that are derived principally from, or corroborated by, observable market information. The fair value of the Company's Level II portfolio investments was \$100.6 million as of December 31, 2017.



KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

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

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

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

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

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

Type	Fair Value	Primary Valuation Methodology	Unobservable Inputs	Range of Inputs (Weighted Average)
Debt Securities	\$ 7,639,648	Enterprise Value	Average EBITDA Multiple	5.3x
	146,102,097	Income Approach	Implied Discount Rate	5.6% – 21.5% (9.15)%
Equity Securities	5,050,355	Enterprise Value	Average EBITDA Multiple/WACC	4.8x/7.4% – 14.1x/13.9% (9.3x/12.0)%
	6,000	Options Value	Qualitative Inputs <sup>(1)</sup>	
CLO Fund Securities	45,824,060	Discounted Cash Flow	Discount Rate	11.8% – 13.0% (13.0)%
			Probability of Default	2.0% – 2.5% (2.0)%
			Loss Severity	25.0% – 25.9% (25.9)%
			Recovery Rate	74.1% – 75.0% (74.2)%
	8,350,290	Market Approach	3 <sup>rd</sup> Party Quote	82.35% (82.35)%
Asset Manager Affiliate	40,198,000	Discounted Cash Flow	Discount Rate	2.5% – 13.0% (7.6)%
<b>Total Level III Investments</b>	<b>\$253,170,450</b>			

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

The significant unobservable inputs used in the fair value measurement of the Company’s debt securities may include, among other things, broad market indices, the comparable yields of similar investments in



**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. INVESTMENTS – (continued)**

similar industries, effective discount rates, average EBITDA multiples, and weighted average cost of capital. Significant increases or decreases in such comparable yields would result in a significantly lower or higher fair value measurement.

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

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

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

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

**5. ASSET MANAGER AFFILIATES**

*Wholly-Owned Asset Managers*

The Asset Manager Affiliates are wholly-owned portfolio companies. The Asset Manager Affiliates manage CLO Funds primarily for third party investors that invest primarily in broadly syndicated loans, high yield bonds and other credit instruments issued by corporations. At December 31, 2017 and 2016, the Asset Manager Affiliates had approximately \$3.0 billion and \$3.0 billion of par value of assets under management, respectively, and the Company's 100% equity interest in the Asset Manager Affiliates had a fair value of approximately \$38.8 million and \$40.2 million, respectively.

As a manager of the CLO Funds, the Asset Manager Affiliates receive contractual and recurring management fees from the CLO Funds for their management and advisory services. The annual fees which the Asset Manager Affiliates receive are generally based on a fixed percentage of assets under management (at par value and not subject to changes in market value), and the Asset Manager Affiliates generate net income equal to the amount by which their fee income exceeds their operating expenses, including compensation of

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. ASSET MANAGER AFFILIATES – (continued)**

their employees and income taxes. The management fees the Asset Manager Affiliates receive have three components — a senior management fee, a subordinated management fee and an incentive fee. Currently, all CLO Funds managed by the Asset Manager Affiliates are paying both their senior and subordinated management fees on a current basis. In addition, for the year ended December 31, 2017, our Asset Manager Affiliates recognized \$3.0 million of incentive fees from one fund. As of December 31, 2017, none of the CLO Funds managed by the Asset Manager Affiliates were paying incentive fees.

Certain investments, and the future management fees of certain managed CLO Funds, have been pledged by the Asset Manager Affiliates to third-party lenders under borrowing arrangements undertaken to satisfy the risk retention requirements of the Dodd-Frank Act applicable to asset managers. In addition, certain of the Asset Manager Affiliates have provided a make-whole guaranty to these lenders in the event that the pledged assets and management fees are insufficient to satisfy the repayment of these borrowings. So long as the underlying managed CLO Funds' rated notes are making regular quarterly distributions, the management fees are available to the Asset Manager Affiliates.

For the years ended December 31, 2017, 2016, and 2015, the Asset Manager Affiliates declared cash distributions of \$3.2 million, \$2.7 million, and \$9.1 million to the Company, respectively. Any distributions from the Asset Manager Affiliates out of their estimated tax-basis earnings and profits are recorded as "Dividends from Asset Manager Affiliates" on the Company's statement of operations. The Company recognized \$460,000, \$1.4 million, and \$5.3 million of Dividends from Asset Manager Affiliates in the Statement of Operations in 2017, 2016, and 2015, respectively. The difference between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e., tax-basis return of capital). Distributions receivable, if any, are reflected in the "due from affiliates" account on the consolidated balance sheets.

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

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

In accordance with Rules 3-09, Rule 4-08(g) and 1-02 of Regulation S-X, additional financial information with respect to the Asset Manager Affiliates and with respect to one of the CLO Funds in which the Company had an investment, Katonah 2007-I CLO are required to be included in the Company's SEC filings. The additional financial information regarding the Asset Manager Affiliates (pursuant to Rule 3-09) immediately follow these financial statements. The additional information regarding Katonah 2007-I CLO (pursuant to Rule 4-08(g)) is set forth below. This additional financial information regarding the Asset Manager Affiliates and Katonah 2007-1 does not directly impact the financial position, results of operations, or cash flows of the Company.

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. ASSET MANAGER AFFILIATES – (continued)**

**Katonah 2007-I CLO Ltd.**

Summarized Balance Sheet Information

	<u>As of</u> <u>December 31, 2017</u>	<u>As of</u> <u>December 31, 2016</u>
Total investments at fair value	\$ 778,828	\$ 176,684,976
Cash	1,673,789	34,982,770
Receivable for investments sold	8,750,934	492,417
Total assets	11,203,551	212,160,163
CLO Debt at fair value	10,770,486	208,812,164
Total liabilities	10,854,495	210,463,954
Total Net Assets	349,056	1,696,209

**Katonah 2007-I CLO Ltd.**

Summarized Statements of Operations Information

	<u>Year Ended</u> <u>December 31, 2017</u>	<u>Year Ended</u> <u>December 31, 2016</u>	<u>Year Ended</u> <u>December 31, 2015</u>
Interest income from investments	\$ 4,829,636	\$ 9,381,680	\$ 10,178,631
Total income	4,866,033	9,767,270	10,605,409
Interest expense	15,704,243	8,798,483	9,146,858
Total expenses	(16,425,383)	(9,780,406)	(10,205,353)
Net realized and unrealized losses	10,212,198	5,482,606	(387,924)
(Decrease) increase in net assets resulting from operations	(1,347,151)	5,469,470	12,132

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

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

Except for KCAP Management, LLC, which is a disregarded entity whose tax results are included with the Company's tax results, as separately regarded entities for tax purposes, the Asset Manager Affiliates are taxed at normal corporate rates. In order to maintain the Company's RIC status, any tax-basis dividends paid by the Asset Manager Affiliates to the Company would generally need to be distributed to the Company's shareholders. Generally, such tax-basis dividends of the Asset Manager Affiliates' income which was distributed to the Company's shareholders will be considered as qualified dividends for tax purposes. The Asset Manager Affiliates' taxable net income will differ from GAAP net income because of deferred tax

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. ASSET MANAGER AFFILIATES – (continued)**

temporary differences and permanent tax adjustments. Deferred tax temporary differences may include differences for the recognition and timing of amortization and depreciation, compensation related expenses, and net loss carryforward, among other things. Permanent differences may include adjustments, limitations or disallowances for meals and entertainment expenses, penalties, tax goodwill amortization and net operating loss carryforward.

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

Additional goodwill amortization for tax purposes was created upon the purchase of 100% of the equity interests in Trimaran Advisors by one of KCAP's affiliates, in exchange for shares of the Company's stock valued at \$25.5 million and cash of \$13.0 million. The transaction was considered an asset purchase under Section 351(a) of the Code and resulted in tax goodwill of approximately \$22.8 million, and tax basis intangible assets of \$15.7 million, both of which are being amortized for tax purposes on a straight-line basis over 15 years.

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

*Related Party Transactions*

On February 26, 2013, the Company entered into a senior credit agreement (the "Trimaran Credit Facility") with Trimaran Advisors, pursuant to which Trimaran Advisors may borrow from time to time up to \$20 million from the Company in order to provide capital necessary to support one or more of Trimaran Advisors' warehouse lines of credit and/or working capital in connection with Trimaran Advisors' warehouse activities. On April 15, 2013, the Trimaran Credit Facility was amended and upsized from \$20 million to \$23 million. On November 17, 2017, the Trimaran Credit Facility was amended to extend the maturity date to November 17, 2022 and bears interest at an annual rate of 9.0%. Outstanding borrowings on the Trimaran Credit Facility are callable by the Company at any time. At December 31, 2017 and December 31, 2016 there were no loans outstanding under the Trimaran Credit Facility. For the years ended December 31, 2017, 2016 and 2015, the Company recognized interest income of approximately \$918,000, \$1.8 million and \$1.7 million, respectively, related to the Trimaran Credit Facility.

On October 30, 2017, the Company entered into a new term loan agreement with Trimaran Advisors, one of the Asset Manager Affiliates. Trimaran Advisors borrowed \$8.4 million under this agreement, which bears interest at a rate of 10.5% annually, payable quarterly. The loan matures on April 30, 2030, can be repaid at any time, and must be repaid upon the occurrence of certain events.

On October 31, 2017, Trimaran Advisors capitalized Trimaran Risk Retention Holdings, LLC, a newly-formed wholly-owned subsidiary, with \$8.4 million of equity capital. In turn, Trimaran Risk Retention Holdings capitalized Trimaran RR I, LLC, a wholly-owned subsidiary of Trimaran Risk Retention Holdings, LLC, with \$8.4 million of equity capital. With this equity contribution and other borrowed funds, Trimaran RR I, LLC purchased \$34.8 million notional amount of notes issued by Catamaran CLO 2014-1, Ltd. for aggregate consideration of \$35.5 million.

On December 21, 2017, the Company entered into another new term loan agreement with Trimaran Advisors, under which Trimaran Advisors borrowed \$4.4 million, which also bears interest at a rate of 10.5%

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. ASSET MANAGER AFFILIATES – (continued)**

annually, payable quarterly. The loan matures on January 27, 2028, can be repaid at any time, and must be repaid upon the occurrence of certain events.

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

**6. BORROWINGS**

The Company's debt obligations consist of the following:

	As of <u>December 31, 2017</u>	As of <u>December 31, 2016</u>
6.125% Notes Due 2022 (net of offering costs of: \$2,734,248	\$ 74,672,952	\$ —
7.375% Notes Due 2019 (net of offering costs of: 2017 – \$259,635; 2016 – \$550,774)	26,740,365	32,980,151
Notes issued by KCAP Senior Funding I, LLC (net of discount and offering costs of: \$2,286,425 and \$2,459,156, respectively)	—	142,604,419
	<u>\$ 101,413,317</u>	<u>\$ 175,584,570</u>

The weighted average stated interest rate and weighted average maturity on all our debt outstanding as of December 31, 2017 were 6.4% and 3.9 years, respectively, and as of December 31, 2016 were 3.9% and 6.7 years, respectively.

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

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

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

For the years ended December 31, 2017, 2016, and 2015, interest expense related to KCAP Senior Funding I notes, including the amortization of deferred debt issuance costs and the discount on the face amount of the notes was approximately \$3.4 million, \$5.6 million and \$5.0 million, respectively, consisting of stated interest expense of approximately \$2.7 million, \$3.8 million and \$2.8 million, respectively, accreted discount of approximately \$352,000, \$621,000 and \$605,000, respectively, and deferred debt issuance costs of approximately \$379,000, \$667,000 and \$649,000, respectively.

*Fair Value of KCAP Senior Funding I.* The Company carried the KCAP Senior Funding I Notes at cost, net of unamortized discount and offering costs. The aggregate fair values of the KCAP Senior Funding I Notes were approximately \$146.3 million at December 31, 2016. The fair values were determined based on third party indicative values. The KCAP Senior Funding I L.L.C. Notes were categorized as Level III under ASC 820: Fair Value.

**KCAP Financial, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****6. BORROWINGS – (continued)***7.375% Notes Due 2019*

On October 10, 2012, the Company issued \$41.4 million in aggregate principal amount of unsecured 7.375% Notes due 2019 (the “7.375% Notes Due 2019”). The net proceeds for these Notes, after the payment of underwriting expenses, were approximately \$39.9 million. Interest on the 7.375% Notes Due 2019 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 7.375%, commencing December 30, 2012. The 7.375% Notes Due 2019 mature on September 30, 2019 and are unsecured obligations of the Company. The 7.375% Notes Due 2019 are subject to redemption in whole or in part at any time or from time to time, at the option of the Company, on or after September 30, 2015, at a redemption price per security equal to 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to the date fixed for redemption. In addition, due to the asset coverage test applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 7.375% Notes Due 2019, the Company is limited in its ability to make distributions in certain circumstances. The indenture governing the 7.375% Notes Due 2019 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. At December 31, 2017, the Company was in compliance with all of its debt covenants.

For the years ended the years ended December 31, 2017, 2016, and 2015, interest expense related to the 7.375% Notes Due 2019 was approximately \$2.2 million, \$3.1 million and \$3.1 million, respectively.

In connection with the issuance of the 7.375% Notes Due 2019, the Company incurred approximately \$1.5 million of debt offering costs which are being amortized over the expected term of the facility on an effective yield method, of which approximately \$260,000 remains to be amortized, and is included on the consolidated balance sheets as a reduction in the related debt liability.

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

During the third quarter of 2016, \$5.0 million par value of the 7.375% Notes Due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of \$88,015. The Company subsequently surrendered these notes to the Trustee for cancellation.

During the fourth quarter of 2016, approximately \$469,000 par value of the 7.375% Notes Due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of approximately \$15,000. The Company subsequently surrendered these notes to the Trustee for cancellation.

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

*Fair Value of 7.375% Notes Due 2019.* The 7.375% Notes Due 2019 were issued in a public offering on October 10, 2012 and are carried at cost, net of offering costs of December 31, 2017 and 2016 of approximately \$260,000 and \$551,000 respectively. As of December 31, 2017 and 2016, the fair value of the Company’s outstanding 7.375% Notes Due 2019 was approximately \$27.3 million and \$34.2 million, respectively. The fair value was determined based on the closing price on December 31, 2017 and 2016 for the 7.375% Notes Due 2019. The 7.375% Notes Due 2019 are categorized as Level I under the ASC 820 Fair Value.

*6.125% Notes Due 2022*

During the third quarter of 2017, the Company issued \$77.4 million in aggregate principal amount of unsecured 6.125% Notes due 2022 (the 6.125% “Notes Due 2022”). The net proceeds for these Notes, after the payment of underwriting expenses, were approximately \$74.6 million. Interest on the 6.125% Notes Due



KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**6. BORROWINGS – (continued)**

2022 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 6.125%. The 6.125% Notes Due 2022 mature on September 30, 2022 and are unsecured obligations of the Company. The 6.125% Notes Due 2022 are subject to redemption in whole or in part at any time or from time to time, at the option of the Company, on or after September 30, 2019, at a redemption price per security equal to 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to the date fixed for redemption. In addition, Due to the asset coverage test applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 6.125% Notes Due 2022, the Company is limited in its ability to make distributions in certain circumstances. The indenture governing the 6.125% Notes Due 2022 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. At December 31, 2017, the Company was in compliance with all of its debt covenants.

For the year ended December 31, 2017 interest expense related to the 6.125% Notes Due 2022 was approximately \$1.6 million.

In connection with the issuance of the 6.125% Notes Due 2022, the Company incurred approximately \$2.9 million of debt offering costs which are being amortized over the expected term of the facility on an effective yield method, of which approximately \$2.7 million remains to be amortized as of December 31, 2017, and is included on the consolidated balance sheets as a reduction in the related debt liability.

*Fair Value of 6.125% Notes Due 2022.* The 6.125% Notes Due 2022 were issued via public offering during the third quarter of 2017 and are carried at cost, net of offering costs of \$2.7 million at December 31, 2017. The fair value of the Company's outstanding 6.125% Notes Due 2022 was approximately \$77.7 million at December 31, 2017. The fair value was determined based on the closing price on December 31, 2017 for the 6.125% Notes Due 2022. The 6.125% Notes Due 2022 are categorized as Level I under the ASC 820 Fair Value.

*Convertible Notes*

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

In connection with the issuance of the Convertible Notes, the Company incurred approximately \$2.4 million of debt offering costs, which were amortized over the term of the Convertible Notes on an effective yield method. On April 4, 2013, approximately \$9 million of the Company's 8.75% Convertible Notes were converted at a price per share of \$8.159 into 1,102,093 shares of KCAP common stock. On September 4, 2013, the Company purchased \$2.0 million face value of its own Convertible Notes at a price of \$114.50, plus accrued interest. KCAP subsequently surrendered these notes to the Trustee for cancellation effective September 13, 2013. During 2015, the Company repurchased approximately \$19.3 million face value of its own Convertible Notes at a price ranging from \$101.500 to \$102.375. KCAP subsequently surrendered these notes to the Trustee for cancellation. Due to the cash conversion option embedded in the Convertible Notes, the Company applied the guidance in ASC 470-20-40, Debt with Conversion and Other Options and realized a loss on the extinguishment of this debt. The indenture governing the Convertible Notes contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act and conditions governing the undertaking of new debt.

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**6. BORROWINGS – (continued)**

The Convertible Notes matured and were fully repaid on March 15, 2016.

For the years ended December 31, 2016 and 2015, interest expense related to the Convertible Notes was \$378,000 and \$3.1 million, respectively.

**7. DISTRIBUTABLE TAXABLE INCOME**

Effective December 11, 2006, the Company elected to be treated as a RIC under the Code and adopted a December 31 tax-calendar year end. As a RIC, the Company is not subject to federal income tax on the portion of its taxable income and gains distributed currently to its stockholders as a dividend. The Company's quarterly distributions, if any, are determined by the Board of Directors. The Company anticipates distributing substantially all of its taxable income and gains, within the Subchapter M rules, and thus the Company anticipates that it will not incur any federal or state income tax at the RIC level. As a RIC, the Company is also subject to a federal excise tax based on distributive requirements of its taxable income on a calendar year basis (e.g., calendar year 2017). Depending on the level of taxable income earned in a tax year, the Company may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4% excise tax on such income, to the extent required.

Book and tax basis differences relating to stockholder dividends and distributions and other permanent book and tax differences are typically reclassified among the Company's capital accounts. In addition, the character of income and gains to be distributed is determined in accordance with income tax regulations that may differ from GAAP; accordingly at calendar years ended December 31, 2017 and 2016, the Company reclassified for book purposes amounts arising from permanent book/tax differences related to the expiration of capital loss carryforwards, and non-deductible expenses, as follows:

	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
Capital in excess of par value	\$(13,199,386)	\$(10,491,016)
Accumulated undistributed net investment income	\$ (281,754)	\$ 10,587,127
Accumulated net realized losses	\$ 13,481,140	\$ (96,111)

The following reconciles net increase in net assets resulting from operations to taxable income for the year ended December 31, 2017 and 2016:

	<u>Year Ended December 31, 2017</u>	<u>Year Ended December 31, 2016</u>
Net increase (decrease) in net assets resulting from operations	\$ 3,388,082	\$ (1,039,731)
Net change in unrealized appreciation from investments	(3,389,993)	13,188,048
Net realized losses	11,021,043	6,341,678
Book tax differences on CLO equity investments	(5,915,827)	(3,193,602)
Other book tax differences	932,378	(534,714)
Taxable income before deductions for distributions	<u>\$ 6,035,683</u>	<u>\$14,761,679</u>
Taxable income before deductions for distributions per weighted average basic shares for the period	\$ 0.16	\$ 0.40
Taxable income before deductions for distributions per weighted average diluted shares for the period	\$ 0.16	\$ 0.40

Dividends from Asset Manager Affiliates are recorded based upon a quarterly estimate of tax-basis earnings and profits of each Asset Manager Affiliate. Distributions in excess of the estimated tax-basis quarterly earnings and profits of each distributing Asset Manager Affiliate are recognized as tax-basis return of capital. The actual tax-basis earnings and profits and resulting dividend and/or return of capital for the year will be determined at the end of the tax year for each distributing Asset Manager Affiliate. For years ended

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. DISTRIBUTABLE TAXABLE INCOME – (continued)

the years ended December 31, 2017, 2016, and 2015, the Asset Manager Affiliates declared cash distributions of approximately \$3.2 million \$2.7 million, and \$9.1 million to the Company, respectively. The Company recognized approximately \$460,000, \$1.4 million and \$5.3 million, respectively, of dividends from Asset Manager Affiliates in the Consolidated Statement of Operations for the years ended the years ended December 31, 2017, 2016, and 2015. The difference of \$2.8 million, \$1.3 million, and \$3.8 million, respectively, between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e. tax-basis return of capital), for the years ended the years ended December 31, 2017, 2016, and 2015, respectively.

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

	Year Ended December 31,		
	2017	2016	2015
<i>Distributions paid from:</i>			
Ordinary income	\$ 6,035,683	\$ 14,761,679	\$ 22,985,978
Return of Capital	11,736,777	7,307,578	—
<b>Total</b>	<b>\$ 17,772,460</b>	<b>\$ 22,069,257</b>	<b>\$ 22,985,978</b>

As of December 31, 2017 and 2016, the components of accumulated earnings on a tax basis were as follows:

	Year Ended December 31,	
	2017	2016
Capital loss carryforward	\$(88,590,153)	\$(91,050,249)
Other temporary differences	\$ (1,155,193)	\$ (1,059,735)
Net unrealized depreciation	\$(58,613,185)	\$(66,741,029)

At December 31, 2017, the Company had a net capital loss carryforward of approximately \$88.5 million to offset net capital gains, to the extent provided by federal tax law. \$13.5 million of net capital loss carryforward expired in 2017. \$17.9 million of net capital loss carryforward is subject to expiration in 2018. \$70.7 million of the net capital loss carryforward is not subject to expiration under the RIC Modernization Act of 2010.

On December 13, 2017, the Company’s Board of Directors declared a distribution to shareholders of \$0.10 per share for a total of approximately \$3.7 million. The record date was January 5, 2018 and the distribution was paid on January 25, 2018.

ASC Topic 740 Accounting for Uncertainty in Income Taxes (“ASC 740”) provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the consolidated financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company’s tax returns to determine whether the tax positions are “more-likely-than-not” of being sustained by the applicable tax authority. The Company recognizes the tax benefits of uncertain tax positions only where the position is “more likely than not” to be sustained assuming examination by tax authorities. Management has analyzed the Company’s tax positions, and has concluded that no liability for unrecognized tax benefits should be recorded related to uncertain tax positions taken on returns filed for open tax years (the last three fiscal years) or expected to be taken in the Company’s current year tax return. The Company identifies its major tax jurisdictions as U.S. Federal and New York State, and the Company is not

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**7. DISTRIBUTABLE TAXABLE INCOME – (continued)**

aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will change materially in the next 12 months. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an ongoing analysis of tax laws, regulations and interpretations thereof.

**8. COMMITMENTS AND CONTINGENCIES**

From time-to-time the Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the needs of the Company's investment in portfolio companies. Such instruments include commitments to extend credit and may involve, in varying degrees, elements of credit risk in excess of amounts recognized on the Company's balance sheet. Prior to extending such credit, the Company attempts to limit its credit risk by conducting extensive due diligence, obtaining collateral where necessary and negotiating appropriate financial covenants. As of December 31, 2017 and December 31, 2016, the Company had \$0 and \$565,000 commitments to fund investments, respectively.

**9. STOCKHOLDERS' EQUITY**

During the years ended December 31, 2017, 2016 and 2015 the Company issued 96,468, 174,396 and 175,922 shares, respectively, of common stock under its dividend reinvestment plan. For the year ended December 31, 2017, the Company issued 139,620 shares of restricted stock, 10,982 shares were forfeited, and 242,918 shares vested. The total number of shares of the Company's common stock outstanding as of December 31, 2017 and 2016 was 37,339,224 and 37,178,294, respectively. During the year ended December 31, 2017, 2016 and 2015, the Company repurchased 64,176, 67,654 and 36,348 shares at an aggregate cost of approximately \$225,000, 248,000 and \$220,000 in connection with the vesting of restricted stock awards.

**10. EQUITY COMPENSATION PLANS**

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

*Stock Options*

The 2008 Non-Employee Director Plan was originally adopted by the Board and was approved by a vote of the Company's shareholders at the 2008 Annual Shareholder Meeting (the "2008 Plan"). Effective June 10, 2011, the 2008 Plan was amended and restated in accordance with a resolution of the Board and approved by a vote of the Company's shareholders at the 2011 Annual Shareholder Meeting (the "2011 Plan"). Effective May 4, 2017, the 2011 Plan was amended and restated in accordance with a resolution of the Board and approved by the Company's shareholders at the 2017 Annual Shareholder Meeting (the "Non-Employee Director Plan"). Pursuant to the Non-Employee Director Plan, the Company's independent directors and other directors who are not officers or employees of the Company ("Non-Employee Directors") may be issued

KCAP Financial, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. EQUITY COMPENSATION PLANS – (continued)

restricted stock as a portion of their compensation for service on the Company’s Board of Directors in accordance with the terms of exemptive relief granted by the SEC in August 2008. Since implementation of the 2011 Plan, the Company is permitted to issue restricted stock, and is no longer permitted to issue any options for common stock, of the Company to Non-Employee Directors. Any options outstanding as of the date of the 2011 Annual Shareholder Meeting are governed in all respects by the terms of the 2008 Plan. Under the Non-Employee Director Plan, the Non-Employee Directors automatically receive 1,000 shares of restricted stock on the date of each annual meeting of shareholders during the term of the plan.

Information with respect to options granted, exercised and forfeited under the Non-Employee Director Plan for the period January 1, 2016 through December 31, 2017 is as follows:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Contractual Remaining Term (years)	Aggregate Intrinsic Value <sup>(1)</sup>
Options outstanding at January 1, 2016	50,000	\$ 7.72	3.4	
Granted	—	\$ —		
Exercised	—	\$ —		
Forfeited	—	\$ —		
Options outstanding at December 31, 2016	50,000	\$ 7.72	2.4	
Granted	—	\$ —		
Exercised	—	\$ —		
Forfeited	—	\$ —		
Outstanding at December 31, 2017	50,000	\$ 7.72	1.4	\$ —
Total vested at December 31, 2017	50,000	\$ 7.72	1.4	

(1) Represents the difference between the market value of shares of the Company and the exercise price of the options.

The Company uses a Binary Option Pricing Model (American, call option) to establish the expected value of all stock option grants. For the years ended December 31, 2017, 2016 and 2015 the Company did not recognize any non-cash compensation expense related to stock options. At December 31, 2017, the Company had no remaining compensation costs related to unvested stock based awards.

*Restricted Stock*

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

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

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

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

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

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

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

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**10. EQUITY COMPENSATION PLANS – (continued)**

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

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

Awards of restricted stock granted under the Equity Incentive Plan vest in accordance with the terms and conditions of each grant, as determined by the Company’s Board of Directors.

On June 16, 2015, the Company received exemptive relief to repurchase shares of its common stock from its employees in connection with certain equity compensation plan arrangements. During the years ended December 31, 2017, 2016 and 2015, the Company repurchased 64,176, 67,654 and 36,348 shares, respectively, of common stock at an aggregate cost of approximately \$225,000, \$248,000 and \$220,000, respectively, in connection with the vesting of employee’s restricted stock. These shares are not available to be reissued under the Equity Incentive Plan.

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

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

On September 19, 2017, the Company’s Board of Directors approved the grant of 133,620 shares of restricted stock to the employees of the Company as partial compensation for their services. 50% of such awards will vest on the third anniversary of the grant date and the remaining 50% of the shares will vest on the fourth anniversary of the grant date.

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

	<b>Non-Vested Restricted Shares</b>
Non-vested shares outstanding at January 1, 2016	700,539
Granted	6,000
Vested	(260,607)
Forfeited	(34,453)
Non-vested shares outstanding at December 31, 2016	411,479
Granted	139,620
Vested	(242,918)
Forfeited	(10,982)
Non-vested shares outstanding at December 31, 2017	<u>297,199</u>

For the year ended December 31, 2017, non-cash compensation expense related to restricted stock was approximately \$1.1 million; of this amount approximately \$425,000 was expensed at the Company and approximately \$704,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the year ended December 31, 2016, non-cash compensation expense related to restricted stock was approximately \$1.6 million; of this amount approximately \$659,000 was expensed at the Company and approximately \$909,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the year ended December 31, 2015, non-cash compensation expense related to restricted stock was approximately \$1.6 million; of this amount approximately \$676,000 was expensed at the Company and approximately \$897,000 was a reimbursable expense allocated to the Asset Manager Affiliates.

**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**10. EQUITY COMPENSATION PLANS – (continued)**

Distributions are paid on all outstanding shares of restricted stock, whether or not vested. In general, shares of unvested restricted stock are forfeited upon the recipient’s termination of employment. At December 31, 2017 and 2016, the Company had approximately \$1.1 million and \$1.8 million of total unrecognized compensation cost related to non-vested restricted share awards, respectively. That cost is expected to be recognized over the remaining weighted average period of 1 year.

**11. OTHER EMPLOYEE COMPENSATION**

The Company adopted a 401(k) plan (“401K Plan”) effective January 1, 2007. The 401K Plan is open to all full time employees. The 401K Plan permits an employee to defer a portion of their total annual compensation up to the Internal Revenue Service annual maximum based on age and eligibility. The Company makes contributions to the 401K Plan of up to 2% of the Internal Revenue Service’s annual maximum eligible compensation, which fully vests at the time of contribution. Approximately \$65,000, \$19,000, and \$25,000 was expensed during the years ended December 31, 2017, 2016, and 2015, respectively, related to the 401K Plan.

The Company has also adopted a deferred compensation plan (“Profit-Sharing Plan”) effective January 1, 2007. Employees are eligible for the Profit-Sharing Plan provided that they are employed and working with the Company to participate in at least 100 days during the year and remain employed as of the last day of the year. Employees do not make contributions to the Profit-Sharing Plan. On behalf of the employee, the Company may contribute to the Profit-Sharing Plan 1) up to 8.0% of all compensation up to the Internal Revenue Service annual maximum and 2) up to 5.7% excess contributions on any incremental amounts above the social security wage base limitation and up to the Internal Revenue Service annual maximum. Employees vest 100% in the Profit-Sharing Plan after five years of service. Approximately \$185,000, \$184,000 and \$151,000 was expensed during the years ended December 31, 2017, 2016, and 2015, respectively, related to the Profit-Sharing Plan.

**12. SELECTED QUARTERLY DATA (Unaudited)**

	<u>Q1 2017</u>	<u>Q2 2017</u>	<u>Q3 2017</u>	<u>Q4 2017</u>
Total interest and related portfolio income	\$ 7,774,397	\$ 7,659,732	\$ 6,253,343	\$ 6,576,226
Net investment income	\$ 3,218,139	\$ 2,608,770	\$ 2,529,495	\$ 2,662,728
Net (decrease) increase in net assets resulting from operations	\$ 385,552	\$ 2,521,725	\$ (669,449)	\$ 1,150,252
Net (decrease) increase in net assets resulting from operations per share – basic	\$ 0.01	\$ 0.07	\$ (0.02)	\$ 0.03
Net (decrease) increase in net assets resulting from operations per share – diluted	\$ 0.01	\$ 0.07	\$ (0.02)	\$ 0.03
Net investment income per share – basic	\$ 0.09	\$ 0.07	\$ 0.07	\$ 0.07
Net investment income per share – diluted	\$ 0.09	\$ 0.07	\$ 0.07	\$ 0.07
	<u>Q1 2016</u>	<u>Q2 2016</u>	<u>Q3 2016</u>	<u>Q4 2016</u>
Total interest and related portfolio income	\$ 9,510,321	\$ 9,579,400	\$ 9,018,789	\$ 8,091,587
Net investment income	\$ 4,764,770	\$ 5,108,020	\$ 4,523,027	\$ 4,094,177
Net increase (decrease) in net assets resulting from operations	\$(6,842,699)	\$ 3,007,484	\$ 2,716,613	\$ 78,869
Net increase (decrease) in net assets resulting from operations per share – basic and diluted	\$ (0.18)	\$ 0.08	\$ 0.07	\$ —
Net increase (decrease) in net assets resulting from operations per share – diluted	\$ (0.18)	\$ 0.08	\$ 0.07	\$ —
Net investment income per share – basic	\$ 0.13	\$ 0.14	\$ 0.12	\$ 0.11
Net investment income per share – diluted	\$ 0.13	\$ 0.14	\$ 0.12	\$ 0.11



**KCAP Financial, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**13. SUBSEQUENT EVENTS**

In January 2018 the Trustee for Catamaran 2012-1 CLO received notice that the holders of a majority of the Subordinated Securities had exercised their right of optional redemption. It is expected the optional redemption will be effective on the March 2018 payment.

In February 2018, the Company provided a notice of redemption to the Trustee of the 7.375% Notes Due 2019 for \$20.0 million par value, which will result in a realized loss on extinguishment of debt of approximately \$192,000.

On February 9, 2018, the United States Court of Appeals for the District of Columbia (the “DC Circuit Court”) ruled in favor of an appeal brought by the Loan Syndications and Trading Association (the “LSTA”) on whether application of the risk retention rules to CLO managers is valid under Section 941 of the Dodd-Frank Act. If the decision stands, CLO managers of “open-market CLOs” (described in the ruling as CLOs where assets are acquired from “arms-length negotiations and trading on an open market”) will no longer be required to comply with the risk retention rules, and no party to such “open-market CLOs” would be required to acquire and retain an economic interest in the credit risk of the securitized assets. However, the DC Circuit Court’s decision remains subject to further appeal for a period of time.

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

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

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

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

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

The Company has evaluated events and transactions occurring subsequent to December 31, 2017 for items that should potentially be recognized or disclosed in these financial statements. Other than described above, management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these consolidated financial statements.



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**KATONAH 2007-I CLO LTD.**

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**IMPORTANT NOTE**

In accordance with certain SEC rules, KCAP Financial, Inc. (the "Company") is providing additional information regarding the following three portfolio companies: Katonah Debt Advisers, L.L.C., Trimaran Advisors, L.L.C. (collectively the Asset Manager Affiliates) and Katonah 2007-I CLO Ltd. However, pursuant to SEC rules, the Company does not consolidate portfolio company investments, including those in which it has a controlling interest. As a result, the additional financial information regarding these entities does not directly impact the Company's financial position, results of operations or cash flows.

## **Report of Independent Auditors**

The Board of Directors and Shareholder of  
Asset Manager Affiliates

We have audited the accompanying combined financial statements of Asset Manager Affiliates, which comprise the combined balance sheets, as of December 31, 2017 and 2016, and the related combined statements of operations, changes in member's equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes to the combined financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of Asset Manager Affiliates at December 31, 2017 and 2016, and the combined results of their operations and their cash flows for each of the three years in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

New York, New York  
March 7, 2018

**ASSET MANAGER AFFILIATES****COMBINED BALANCE SHEETS**

	As of December 31, 2017	As of December 31, 2016
<b>ASSETS</b>		
Investments, at fair value (cost: 2017 – \$82,576,095; 2016 – \$0)	\$ 79,901,209	\$ —
Cash	4,655,662	3,425,709
Accrued management fees receivable	2,346,490	2,176,833
Due from affiliates	146,838	86,615
Intangible assets	22,830,000	23,157,541
Other assets	1,977,922	2,760,726
Total assets	<u>\$111,858,121</u>	<u>\$ 31,607,424</u>
<b>LIABILITIES</b>		
Borrowings	\$ 69,802,500	\$ —
Borrowings from related parties	12,792,218	—
Accrued interest payable	230,034	—
Accounts payable and accrued expenses	3,724,943	3,431,496
Due to affiliates	943,557	612,983
Deferred tax liability	1,890,899	2,575,140
Total liabilities	<u>89,384,151</u>	<u>6,619,619</u>
Commitments and Contingencies	—	—
<b>MEMBER'S EQUITY</b>		
Member's contributions	52,519,916	52,519,916
Accumulated deficit	<u>(30,045,946)</u>	<u>(27,532,111)</u>
Total member's equity	22,473,970	24,987,805
Total liabilities and member's equity	<u>\$111,858,121</u>	<u>\$ 31,607,424</u>

See accompanying notes to combined financial statements.

**ASSET MANAGER AFFILIATES**  
**COMBINED STATEMENTS OF OPERATIONS**

	<u>For the Years Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Revenues</b>			
Management and incentive fee revenues	\$15,283,064	\$12,835,603	\$ 22,617,240
Investment income	232,300	1,024,760	2,787,334
<b>Total revenues</b>	<u>15,515,364</u>	<u>13,860,363</u>	<u>25,404,574</u>
<b>Expenses</b>			
Interest expense	1,044,242	1,821,517	1,726,781
Compensation	7,470,218	7,596,726	9,441,607
Insurance	354,466	408,959	450,460
Professional fees	575,067	980,605	903,119
Amortization of intangible assets	327,541	1,310,164	2,308,123
Administrative and other	2,538,229	2,457,029	2,391,184
<b>Total expenses</b>	<u>12,309,763</u>	<u>14,575,000</u>	<u>17,221,274</u>
<b>Income (loss) before unrealized losses on investments and income taxes</b>	3,205,601	(714,637)	8,183,300
Unrealized losses on investments	(2,674,885)	—	—
<b>Income (loss) before income taxes</b>	530,716	(714,637)	8,183,300
Income tax (benefit) expense	(165,449)	(81,022)	5,642,225
<b>Net income (loss)</b>	<u>\$ 696,165</u>	<u>\$ (633,615)</u>	<u>\$ 2,541,075</u>

See accompanying notes to combined financial statements.

## ASSET MANAGER AFFILIATES

## COMBINED STATEMENTS OF CHANGES IN MEMBER'S EQUITY

	Member's Contributions	Accumulated Earnings (Deficit)	Total Member's Equity
<b>Total at January 1, 2015</b>	<b>\$ 52,519,916</b>	<b>\$ (17,739,571)</b>	<b>\$ 34,780,345</b>
Net income	—	2,541,075	2,541,075
Distributions	—	(9,050,000)	(9,050,000)
<b>Total at December 31, 2015</b>	<b>52,519,916</b>	<b>(24,248,496)</b>	<b>28,271,420</b>
Net loss	—	(633,615)	(633,615)
Distributions	—	(2,650,000)	(2,650,000)
<b>Total at December 31, 2016</b>	<b>52,519,916</b>	<b>(27,532,111)</b>	<b>24,987,805</b>
Net income	—	696,165	696,165
Distributions	—	(3,210,000)	(3,210,000)
<b>Total at December 31, 2017</b>	<b>\$ 52,519,916</b>	<b>\$ (30,045,946)</b>	<b>\$ 22,473,970</b>

See accompanying notes to combined financial statements.

**ASSET MANAGER AFFILIATES**  
**COMBINED STATEMENTS OF CASH FLOWS**

	Years Ended December 31,		
	2017	2016	2015
<b>OPERATING ACTIVITIES:</b>			
Net income (loss)	\$ 696,165	\$ (633,615)	\$ 2,541,075
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>			
Deferred taxes	(684,241)	1,925,170	4,226,118
Amortization of intangible assets	327,541	1,310,164	2,308,123
Accretion of interest income	(2,687)	(1,016,614)	(1,089,679)
Unrealized depreciation	2,674,885	—	—
<b>Changes in operating assets and liabilities:</b>			
(Increase) decrease in accrued management fees	(169,657)	1,245,576	3,236,504
(Increase) decrease in due from affiliates	(60,223)	556,737	(389,848)
Decrease (increase) in other assets	782,805	45,251	(2,341,414)
Decrease (increase) in accounts payable and accrued expenses	293,447	(866,355)	(5,505,086)
Increase (decrease) in accrued interest payable	230,034	(178,250)	—
Increase (decrease) in due to affiliates	330,574	(1,504,112)	1,889,707
Net cash provided by operating activities	<u>4,418,643</u>	<u>883,952</u>	<u>4,875,500</u>
<b>Investing activities:</b>			
Purchases of investment	(102,573,408)	(7,000,000)	(22,000,000)
Proceeds from sales/redemptions/maturities of investments	20,000,000	31,106,293	22,506,850
Net cash (used in) provided by investing activities	<u>(82,573,408)</u>	<u>24,106,293</u>	<u>506,850</u>
<b>Financing Activities:</b>			
Member's distributions	(3,210,000)	(2,650,000)	(9,050,000)
Debt offering proceeds	127,594,718	7,000,000	36,000,000
Repayments of Debt	(45,000,000)	(30,000,000)	(36,000,000)
Net cash provided by (used in) financing activities	<u>79,384,718</u>	<u>(25,650,000)</u>	<u>(9,050,000)</u>
CHANGE IN CASH	1,229,953	(659,755)	(3,667,650)
CASH, BEGINNING OF YEAR	<u>3,425,709</u>	<u>4,085,464</u>	<u>7,753,114</u>
CASH, END OF YEAR	<u>\$ 4,655,662</u>	<u>\$ 3,425,709</u>	<u>\$ 4,085,464</u>
<b>Supplemental Information:</b>			
Cash paid for interest	\$ 918,000	\$ 1,999,767	\$ 1,817,480
Cash paid for taxes	\$ 17,526	\$ 170,000	\$ 5,477,493

See accompanying notes to combined financial statements.

**ASSET MANAGER AFFILIATES**

**NOTES TO FINANCIAL STATEMENTS**

**1. ORGANIZATION**

Katonah Debt Advisors, L.L.C. (“Katonah Debt Advisors”), a registered investment adviser under the Investment Advisors Act of 1940 (“the IA Act of 1940”), is a wholly-owned portfolio company of KCAP Financial, Inc. (“KCAP Financial” or the “Company”), which is an internally managed, non-diversified closed-end publicly traded investment company that is regulated as a business development company (“BDC”) under the Investment Company Act of 1940 (the “1940 Act”). Katonah Debt Advisors manages collateralized loan obligation funds (“CLO Funds”) which invest in broadly syndicated loans, high-yield bonds and other credit instruments. On February 29, 2012, KCAP Financial, through its newly formed wholly-owned subsidiary Commodore Holdings LLC (“Commodore”) purchased Trimaran Advisors, L.L.C. (“Trimaran Advisors”), a registered investment adviser and CLO manager similar to Katonah Debt Advisors, for total consideration of \$13.0 million in cash and 3,600,000 shares of KCAP Financial’s common stock. Contemporaneous with the acquisition of Trimaran Advisors, KCAP Financial acquired from Trimaran Advisors equity interests in certain CLO Funds managed by Trimaran Advisors for an aggregate purchase price of \$12.0 million in cash. As of December 31, 2017, Commodore and its wholly-owned subsidiaries Katonah Debt Advisors, Trimaran Advisors and Trimaran Advisors Management, L.L.C., as well as affiliated management companies Katonah 2007-1 Management, L.L.C., Katonah X Management, L.L.C. and KCAP Management, L.L.C. (collectively, the “Asset Manager Affiliates”) had approximately \$3.0 billion of par value assets under management. The Asset Manager Affiliates provide investment management services to CLO Funds, making day-to-day investment decisions concerning the assets of the CLO Funds. In 2017, Trimaran formed and capitalized Trimaran Risk Retention Holdings, LLC, Trimaran RR I, LLC, and Trimaran RR II, LLC, in order to satisfy certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The Asset Manager Affiliates have investment interests in certain of the CLO Funds they manage. In addition, KCAP Financial holds investments in a portion of the securities issued by the CLO Funds managed by the Asset Manager Affiliates.

**2. SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Accounting and Presentation**

The combined financial statements have been prepared in accordance with Accounting Principles Generally Accepted in the United States (“U.S. GAAP”) and include the financial statements of the Asset Manager Affiliates. The Asset Manager Affiliates provide investment management services to various CLO Funds, making day-to-day investment decisions concerning the assets of the CLO Funds. The Asset Manager Affiliates are all under the common control of the Company and have similar business characteristics; therefore they report on a combined basis for financial reporting purposes.

In the opinion of management, the combined financial statements reflect all adjustments, consisting of normal recurring accruals, which are necessary for the fair presentation of the financial condition and results of operations for the periods presented. All significant intercompany transactions, balances, revenues and expenses are eliminated upon combination. Certain prior-year amounts have been reclassified to conform to the current year presentation. Furthermore, the preparation of the financial statements requires management to 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.

On February 18, 2015, the FASB issued Accounting Standards Update 2015-2 (“ASU 2015-2”), which updated consolidation standards under ASC Topic 810, “Consolidation”. Under this update, a new consolidation analysis is required for variable interest entities (“VIEs”), which limits the circumstances in which investment managers and similar entities are required to consolidate the entities that they manage. ASU 2015-02 eliminates some of the criteria under which the fees of investment managers and similar entities are considered a variable interest and limit the circumstances in which variable interests in a VIE held by related parties of a reporting enterprise require the reporting enterprise to consolidate the VIE. During 2016, the Asset Manager Affiliates adopted ASU 2015-02 on a retrospective basis for all periods presented. The

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

consolidated financial statements and related note disclosures have been adjusted for the impact of the adoption. The adoption did not result in a cumulative effect adjustment to the Asset Manager Affiliates' accumulated deficit.

FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers, which updated accounting guidance for all revenue recognition arising from contracts with customers, and also affects entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other US GAAP requirements). This update provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. The FASB also issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date of the standard for one year. As a result, the guidance is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2018. Management has concluded that there will be no material impact from the adoption of ASU 2015-14. Management does not believe that the adoption of ASU 2014-09 will have a material impact to the Asset Manager Affiliates' financial statements.

On February 25, 2016, the FASB issued Accounting Standards Update 2016-02, Leases (Topic 842). This update will require organizations to recognize leased assets and liabilities on the balance sheet for the rights and obligations created by those leases. The recognition, measurement, presentation and cash flows arising from a lease by a lessee will primarily depend on its classification as a finance or operating lease. The ASU will require that both types of leases to be recognized on the balance sheet. For public business entities, this guidance is effective for fiscal years beginning after December 15, 2018. Management is still evaluating the effect of the new standard.

**Investments at Fair Value.** Investment transactions are recorded on the applicable trade date. Realized gains or losses are determined using the specific identification method. Investments held by the Asset Manager Affiliates are stated at fair value. Accounting Standards Codification ("ASC") 820 — Fair Value Measurements and Disclosures ("ASC 820: Fair Value"), requires, among other things, disclosures about assets and liabilities that are measured and reported at fair value. Investments are generally comprised of investments in first loss position in facilities which warehouse assets for a new CLO and certain investments in CLO Funds managed by the Asset Manager Affiliates. The Asset Manager Affiliates' assessment of the significance of a particular input to the Fair Value measurement in its entirety requires judgment and considers factors specific to the financial instrument.

**Hierarchy of Fair Value Inputs.** The provisions of ASC 820: Fair Value establish a hierarchy that prioritizes inputs to valuation techniques used to measure fair value and require companies to disclose the fair value of their financial instruments according to the fair value hierarchy (i.e., Level I, II and III inputs, as defined). The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Additionally, companies are required to provide additional disclosure regarding instruments in the Level III category (which have inputs to the valuation techniques that are unobservable and require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities.

Assets and liabilities measured and reported at fair value are classified and disclosed in one of the following categories:

Level I Inputs:

Quoted prices (unadjusted) in active markets for identical assets or liabilities at the reporting date.



ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

Level II Inputs:

Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; quotes from pricing services or brokers, for which the Asset Manager Affiliates can determine that orderly transactions took place at the quoted price or that the inputs used to arrive at the price were observable; and inputs other than quoted prices that are observable, such as models or other valuation methodologies.

- Level II assets in this category may include debt securities, bank loans, short-term floating rate notes and asset-backed securities, restricted public securities valued at a discount, as well as over-the-counter derivatives, including interest and inflation rate swaps and foreign currency exchange contracts that have inputs to the valuations that generally can be corroborated by observable market data.

Level III Inputs:

Unobservable inputs may include non-binding broker quotes. Level III assets include investments for which there is little, if any, market activity. These inputs require significant management judgment or estimation.

- Level III assets in this category include, securities issued by CLO Funds.

Significance of Inputs:

The Asset Manager Affiliates' assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument.

**Cash.** The Asset Manager Affiliates define cash as demand deposits. The Asset Manager Affiliates place their cash with financial institutions and, at times, cash held in these accounts may exceed the Federal Deposit Insurance Corporation insured limit.

**Other Assets.** Other assets are generally comprised of prepaid expenses and current income taxes receivable (if any). Prepaid expenses are amortized over their terms or expected useful life.

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

**Management Fees.** As a manager of CLO Funds, the Asset Manager Affiliates receive contractual and recurring management fees (and may receive one-time structuring fees) from the CLO Funds for their management and advisory services. The periodic fees which the Asset Manager Affiliates are generally based on a fixed percentage of assets under management (at par value and not subject to changes in market value). The periodic management fees the Asset Manager Affiliates receive have two components — a senior management fee and a subordinated management fee.

**Incentive Fees.** As a manager of CLO Funds, the Asset Manager Affiliates may receive incentive fees upon exceeding specified relative and/or absolute investment return thresholds. Such fees are recorded upon completion of the measurement period, which varies by CLO Fund.

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

**Distributions to Member.** Distributions to the Asset Manager Affiliates' sole member are recognized on the ex-dividend date. Generally, distributions have been declared and paid on a quarterly basis.

**Expenses.** The Asset Manager Affiliates expense costs, as incurred, with regard to the running of their operations. Primary operating expenses include employee compensation and benefits, the costs of identifying, evaluating, monitoring and servicing the CLO Fund investments managed by the Asset Manager Affiliates, and related overhead charges and expenses, including rental expense. The Asset Manager Affiliates share office space and certain other operating expenses. Katonah Debt Advisors has entered into an Overhead Allocation Agreement with its sole member, KCAP Financial. Trimaran Advisors has entered into such an allocation agreement with Katonah Debt Advisors. The Agreements provide for the sharing of such expenses based on an equal sharing of office lease costs and the ratable usage of other shared resources. Katonah Debt Advisors accounts for its operating leases, which may include escalations, in accordance with ASC 840-10, Leases, and expenses the lease payments associated with operating leases evenly during the lease term (including rent-free periods), beginning on the commencement of the lease term.

**Interest Expenses.** Interest expense related to borrowings of the Asset Manager Affiliates is recorded on an accrual basis pursuant to the terms of the related borrowing agreements. Interest is accrued and generally paid quarterly.

**Income Taxes.** The Asset Manager Affiliates account for income taxes under the liability method prescribed by ASC 740, Income Taxes ("ASC 740"). Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases using currently enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred income tax assets and liabilities is recognized in income in the period that includes the enactment date.

Management periodically assesses the recoverability of its deferred income tax assets based upon expected future earnings, taxable income in prior carryback years, future deductibility of the asset, changes in applicable tax laws and other factors. If management determines that it is not more likely than not that the deferred tax asset will be fully recoverable in the future, a valuation allowance will be established for the difference between the asset balance and the amount expected to be recoverable in the future. This allowance will result in a charge to income tax expense on the combined statements of operations. The Asset Manager Affiliate record their income taxes receivables and payables based upon their estimated income tax liability.

ASC 740 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements by prescribing a threshold for measurement and recognition in the financial statements of an asset or liability resulting from a tax position taken or expected to be taken in an income tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

3. CLO FUNDS

A CLO Fund generally refers to a special purpose vehicle that owns a portfolio of investments and issues various tranches of debt and subordinated securities to finance the purchase of those investments. Investments purchased by the CLO Funds are governed by extensive investment guidelines, including limits on exposure to any single industry or issuer and limits on the ratings of the CLO Fund's assets. The CLO Funds managed by the Asset Manager Affiliates have a defined investment period during which they are allowed to make investments or reinvest capital as it becomes available.

**ASSET MANAGER AFFILIATES**

**NOTES TO FINANCIAL STATEMENTS**

**3. CLO FUNDS – (continued)**

The Asset Manager Affiliates manage CLO Funds primarily for third party investors. The CLO Funds generally invest in syndicated loans and other credit instruments issued by corporations. At December 31, 2017 and 2016, the Asset Manager Affiliates had approximately \$3.0 billion and \$3.0 billion of par value of assets under management, respectively.

The CLO Funds are primarily financed via capital contributed by subordinated noteholders and debt holders. CLO Funds are investment vehicles created for the sole purpose of issuing collateralized loan instruments that offer investors the opportunity for returns that vary with the risk level of their investment. The securities issued by the CLO Funds are backed by diversified collateral asset portfolios consisting primarily of loans. For managing the collateral for the CLO Fund entities, the Asset Manager Affiliates earn investment management fees, including senior and subordinated management fees, as well as contingent incentive fees. For the years ending December 31, 2017, 2016 and 2015, management fee revenues included incentive fees earned of approximately \$3.0 million, \$983,000, and \$8.0 million, respectively.

**4. INVESTMENTS**

The Asset Manager Affiliates may also make investments in the CLO Funds they manage in order to comply with the risk retention requirements of Dodd-Frank. As of December 31, 2017, the Asset Manager Affiliates have investments in various classes of debt securities and residual interests of the following managed CLO Funds:

	<u>Fair Value</u>
	(in millions)
Catamaran 2013-1	\$ 26.7
Catamaran 2014-1	33.5
Catamaran 2015-1	19.7
	<u>\$ 79.9</u>

In addition, their sole direct or indirect shareholder, KCAP Financial, has invested in certain of the CLO Funds, generally taking a portion of the unrated, junior subordinated position (generally subordinated to other interests) in the entities and entitle KCAP Financial and other subordinated tranche investors to receive the residual cash flows, if any, from the CLO Funds.

The following table shows the investments owned by the Asset Manager Affiliates by security type at December 31, 2017:

<u>Security Type</u>	<u>Cost/ Amortized Cost</u>	<u>Fair Value</u>
Short-term investments	\$ —	\$ —
Debt securities	75,735,482	75,960,178
Residual interests in CLO Fund Securities	6,840,613	3,941,031
Total	<u>\$82,576,095</u>	<u>\$ 79,901,209</u>

ASSET MANAGER AFFILIATES

NOTES TO FINANCIAL STATEMENTS

4. INVESTMENTS – (continued)

Fair Value Measurements

The following table summarizes the fair value of investments by the above ASC 820: Fair Value hierarchy levels as of December 31, 2017 and 2016, respectively:

	As of December 31, 2017			
	Level I	Level II	Level III	Total
Debt securities	\$ —	\$ —	\$75,960,178	\$ 75,960,178
Residual interests in CLO Fund Securities	—	—	3,941,031	3,941,031
Total	\$ —	\$ —	\$79,901,209	\$ 79,901,209

The Asset Manager Affiliates invest primarily in the debt and residual interests in CLO Fund Securities which are non-public companies for which there is little, if any, market-observable information. As a result, a significant portion of The Asset Manager Affiliates investments at any given time will likely be deemed Level III investments.

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

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

	Year Ended December 31, 2017		
	Debt Securities	Beneficial residual interests in CLO Fund Securities	Total
Purchases	\$75,735,481	\$ 26,837,926	\$102,573,407
Proceeds from sales/redemptions/maturities	—	(20,000,000)	(20,000,000)
Net accretion (amortization)	—	2,687	2,687
Total unrealized gain (loss) included in earnings	224,697	(2,899,582)	(2,674,885)
Balance, December 31, 2017	\$75,960,178	\$ 3,941,031	\$ 79,901,209
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	\$ 224,697	\$ (2,899,582)	\$ (2,674,885)

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

Type	Fair Value	Primary Valuation Methodology	Unobservable Inputs	Significant Inputs or Range of Inputs and (Weighted Average)
Debt Securities	\$ 75,960,178	Market Approach	3 <sup>rd</sup> party quote	93.1% – 100.5% (100.0%)
Residual interests in CLO Fund Securities	3,941,031	Market Approach	3 <sup>rd</sup> party quote	59.9% – 75.3%
Total Level III Investments	\$ 79,901,209			

**ASSET MANAGER AFFILIATES****NOTES TO FINANCIAL STATEMENTS****5. BORROWINGS**

The Asset Management Affiliates' debt obligations outstanding as of December 31, 2017 consist of the following:

<b>Description</b>	<b>Principal</b>
KCAP Term Loan 1	\$ 8,359,051
KCAP Term Loan 2	4,433,167
Third Party Borrowing I	50,117,500
Third Party Borrowing II	19,685,000
<b>Total</b>	<b>\$ 82,594,718</b>

During 2017, Trimaran borrowed funds from KCAP under two term loan agreements. The KCAP Term Loan I bears interest at a fixed rate of 10.5% and matures on April 30, 2030. The KCAP Term Loan II also bears interest at a fixed rate of 10.5%, and matures on January 27, 2028. All amounts under these loans shall become due and payable in the event of default, as defined in the borrowing agreements, and Trimaran has the right to prepay these loans, in whole or in part, at any time or from time-to-time without penalty or premium.

In addition, during 2017, Trimaran Risk Retention I, LLC and Trimaran Risk Retention II, LLC borrowed funds from third parties under two facility agreements. Interest accrues on amounts outstanding under these third party borrowings at variable (floating) rates, generally based upon 3 month LIBOR plus a margin. The margins for the Third Party borrowings range from between 1.70% to 3.90%, with a weighted average all-in rate as of December 31, 2017 of 3.72%.

The Third Party borrowings are subject to various non-call provisions, and become immediately due and payable in the event of default, as defined in the underlying agreements.

The repayment of the third party borrowings of Trimaran Risk Retention I, LLC and Trimaran Risk Retention II, LLC, have been guaranteed by Trimaran Advisors.

**6. GOODWILL AND INTANGIBLE ASSETS**

On February 29, 2012, KCAP Financial and Commodore Holdings, L.L.C. ("Commodore"), a newly-formed, wholly-owned subsidiary of KCAP Financial, acquired all of the outstanding equity interests in Trimaran Advisors for \$13.0 million in cash and 3,600,000 shares of KCAP Financial's common stock, which were valued at the opening price on the closing date of the acquisition. Contemporaneously with the acquisition, KCAP Financial acquired the equity interests in four CLO Funds managed by Trimaran Advisors, at fair value, for \$12.0 million in cash. The aggregate purchase price was \$50.6 million.

In accordance with the purchase agreement, Commodore was deemed the acquirer of Trimaran Advisors and accounted for the acquisition as a business combination. The assets acquired (no liabilities were assumed) by Commodore through this acquisition were "pushed-down" to Trimaran. The purchase price allocation included the fair value of the identifiable intangible assets acquired, which consisted of four CLO management contracts, of approximately \$15.7 million and goodwill of \$22.8 million. The CLO management contracts were amortized over the estimated lives of the contracts (3 – 5 years). For the years ended December 31, 2017, 2016 and 2015, the Company recognized amortization expense of approximately \$328,000, \$1.3 million and \$2.3 million, respectively, relating to the management contracts. The unamortized balance as of December 31, 2016 approximately \$328,000 relating to Trimaran VII CLO Ltd., was amortized in 2017 in connection with its full liquidation.

Commodore, a taxable entity, has recognized the acquisition as an asset acquisition for tax purposes. The book and tax basis of the intangible assets and goodwill were identical; accordingly, Trimaran did not provide for any deferred taxes at the closing date of the acquisition. The tax basis of the intangible assets and goodwill are being amortized over 15 years, which gives rise to deferred taxes.

**ASSET MANAGER AFFILIATES**

**NOTES TO FINANCIAL STATEMENTS**

**7. INCOME TAXES**

The Asset Manager Affiliates are taxed at normal corporate rates.

For tax purposes, the Asset Manager Affiliates 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 restricted stock 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 by its sole member, KCAP Financial, in exchange for shares of the KCAP Financial'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 Internal Revenue Code (the "Code"). At the time of the transfer, Katonah Debt Advisors had equity of approximately \$1 million resulting in tax goodwill of approximately \$32 million which is being amortized for tax purposes on a straight-line basis over 15 years, which accounts for an annual difference between GAAP income and taxable income by approximately \$2 million per year over such period. As of December 31, 2017 and 2016, there was approximately \$8.8 million and \$10.8 million of remaining unamortized tax-basis goodwill from the KDA acquisition.

As discussed in Note 6, additional goodwill amortization for tax purposes was created upon the purchase of Trimaran Advisors. The transaction was considered an asset purchase and resulted in tax goodwill of approximately \$22.8 million which is being amortized for tax purposes on a straight-line basis over 15 years, which accounts for an annual difference between GAAP income and taxable income by approximately \$1.5 million per year over such period. As of December 31, 2017 and 2016, there was approximately \$6.0 million and \$7.5 million of remaining unamortized tax-basis goodwill from the Trimaran Advisors acquisition.

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

KCAP Management, LLC is a disregarded entity for U.S. federal income tax purposes. Its taxable results are included in the tax returns of KCAP Financial. Trimaran Risk Retention Holdings, LLC, Trimaran RR I, LLC and Trimaran RR II, LLC are disregarded entities for U.S. federal income tax purposes. Their taxable results are included in the tax returns of Commodore Holdings.

The components of income tax expense (benefit) for the years ended December 31, 2017, 2016, and 2015 are as follows:

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Current income tax (benefit) expense:			
Federal	\$ 518,921	\$(1,957,900)	\$ 1,290,664
State & local	(129)	(48,292)	125,443
<b>Total net current income tax (benefit) expense</b>	<b>518,792</b>	<b>(2,006,192)</b>	<b>1,416,107</b>
Deferred income tax expense (benefit):			
Federal	(661,770)	2,011,068	3,250,138
State & local	(22,471)	(85,898)	975,980
<b>Total net deferred income tax expense (benefit)</b>	<b>(684,241)</b>	<b>1,925,170</b>	<b>4,226,118</b>
<b>Total income tax (benefit) expense</b>	<b><u>\$(165,449)</u></b>	<b><u>\$ (81,022)</u></b>	<b><u>\$ 5,642,225</u></b>

## ASSET MANAGER AFFILIATES

## NOTES TO FINANCIAL STATEMENTS

## 7. INCOME TAXES – (continued)

The Asset Manager Affiliates' effective income tax rate was (31.2)%, (11.3)%, and 68.9% for tax years 2017, 2016 and 2015, respectively. For the year ended December 31, 2017 difference between the Company's reported provision for income taxes and the U.S. federal statutory rate of 35% was significantly impacted by the Tax Cuts and Jobs Act (the "Tax Act") signed into law on December 22, 2017. The Tax Act makes significant modifications to the federal tax code including, among other changes, a decrease in the current federal corporate income tax rate from a maximum of 35% to a flat 21%, effective January 1, 2018. As a result of this rate change, the Company's 2017 results include a \$931 thousand increase to the income tax provision resulting from the revaluation of its net deferred tax asset, before valuation allowance. This represents a provisional estimate based on management's initial analysis and interpretation of the legislation. Given the complexity of the legislation, anticipated guidance from the Treasury Department and the potential for additional guidance from the FASB, this estimate may be adjusted during 2018.

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the combined financial statements. These temporary differences result in taxable or deductible amounts in future years.

The components of deferred income tax assets and liabilities are shown below:

	For the year ended December 31,	
	2017	2016
Deferred income tax assets:		
Net operating loss and tax credit carryforward	\$ 213,152	\$ 44,125
Restricted stock	80,705	322,008
Intangible depreciation/amortization	2,005,236	3,522,391
Compensation	464,736	715,400
Unrealized loss	564,219	—
Other	75,450	73,228
Less: Valuation allowance	(3,403,497)	(4,677,152)
Total deferred tax assets	—	—
Deferred income tax liabilities:		
Goodwill amortization	(1,899,477)	(2,575,140)
Other	8,578	—
Total deferred tax liabilities	(1,890,899)	(2,575,140)
Net deferred tax liabilities	<u>\$(1,890,899)</u>	<u>\$ (2,575,140)</u>

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible. If it is not more likely than not that some portion or all of the gross deferred income tax assets will be realized in future years, a valuation allowance is recorded.

**ASSET MANAGER AFFILIATES**

**NOTES TO FINANCIAL STATEMENTS**

**7. INCOME TAXES – (continued)**

At December 31, 2017, the Asset Manager Affiliates had net operating loss carryforwards available of \$981,022 available to offset future Federal taxable income. In addition, the Asset Manager Affiliates had net operating loss carryforwards of \$42,578 and \$65,446 available to offset future state and local taxable income, respectively. The following table sets forth a schedule of the years in which the net operating loss carry-forwards would expire if not previously utilized:

Year Ending December 31:	Federal	State	Local
2036	\$ —	\$ 36,699	\$ —
2037	981,022	5,879	65,446
	<u>\$ 981,022</u>	<u>\$ 42,578</u>	<u>\$ 65,446</u>

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 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. The Asset Manager Affiliates has not recorded a liability for any unrecognized tax benefits nor are they aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will change materially in the next 12 months.

Management’s determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an ongoing analysis of tax laws, regulations and interpretations thereof. With a few exceptions, the Asset Manager Affiliates are no longer subject to U.S. federal, state and local tax examinations by tax authorities for years prior to 2014.

**8. COMMITMENTS AND CONTINGENCIES**

The Asset Manager Affiliates have commitments under lease obligations and have entered into Overhead Allocation agreement with KCAP Financial and Trimaran Advisors.

The repayment of the third party borrowings of Trimaran Risk Retention I, LLC and Trimaran Risk Retention II, LLC, have been guaranteed by Trimaran Advisors.

Rent expense, net of expense allocated to affiliates, was approximately \$379,000, \$361,000, and \$360,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

The following table summarizes minimum future lease payments as of December 31, 2017:

Contractual Obligations	2018	2019	2020	2021	2022	More than 5 years
Operating lease obligations	\$ 738,864	\$ 774,7811	\$ 800,436	\$ 800,436	\$ 800,436	\$ 1,133,951

**9. MEMBER’S EQUITY**

As of December 31, 2017, the membership interests of the Asset Manager Affiliates are held solely by KCAP Financial. KCAP Financial owns 100% of Commodore Holdings, which wholly owns Katonah Debt Advisors, Trimaran Advisors and its subsidiaries, and Trimaran Advisors Management. KCAP Management, LLC, Katonah 2007-1 Management, LLC, and Katonah X Management, LLC are wholly-owned by Katonah Management Holdings, LLC, which is wholly-owned by KCAP Financial.



**ASSET MANAGER AFFILIATES**

**NOTES TO FINANCIAL STATEMENTS**

**10. OTHER EMPLOYEE COMPENSATION**

The Asset Manager Affiliates adopted a 401(k) plan (“401K Plan”) effective January 1, 2007 that it shares with its sole shareholder, KCAP Financial. The 401K Plan is open to all full time employees. The 401K Plan permits an employee to defer a portion of his or her total annual compensation up to the Internal Revenue Service annual maximum based on age and eligibility. The Asset Manager Affiliates make contributions to the 401K Plan of up to 2.67% of the employee’s first 74.9% of maximum eligible compensation, which vests 20% per year over five years. For the year ended December 31, 2017, 2016 and 2015, Asset Manager Affiliates made contributions to the 401K Plan of approximately \$67,000, \$36,000 and \$38,000 respectively.

The Asset Manager Affiliates also adopted a deferred compensation plan (“Profit-Sharing Plan”) effective January 1, 2007. Employees are eligible for the Profit-Sharing Plan provided that they are employed and working with the Asset Manager Affiliates 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 Profit-Sharing Plan. The Asset Manager Affiliates may contribute to the Profit-Sharing Plan 1) up to 8.0% of all compensation up to the Internal Revenue Service annual maximum and 2) up to 5.7% excess contributions on any incremental amounts above the social security wage base limitation and up to the Internal Revenue Service annual maximum. Employees vest 100% in the Profit-Sharing Plan after five years of service. For the years ended December 31, 2017, 2016 and 2015, the Asset Manager Affiliates made contributions of approximately \$342,000, \$371,000 and \$394,000 to the Profit-Sharing Plan, respectively.

Certain employees of Asset Manager Affiliates may receive restricted stock grants in the stock of Asset Manager Affiliates’ sole member, KCAP Financial. For the years ended December 31, 2017, 2016 and 2015, compensation expense of approximately \$703,000, \$909,000 and \$897,000, respectively, was recorded as expense in the Combined Statement of Operations related to an allocated expense for a grant of restricted stock of KCAP Financial.

**11. RELATED PARTY TRANSACTIONS**

All of the management and incentive fee revenues earned by the Asset Manager Affiliates is derived from the CLO funds which are considered affiliates.

On February 26, 2013, the KCAP Financial entered into a senior credit agreement (the “Trimaran Credit Facility”) with Trimaran Advisors, pursuant to which Trimaran Advisors may borrow from time to time up to \$20 million from KCAP Financial in order to provide capital necessary to support one or more of Trimaran Advisors’ warehouse lines of credit and/or working capital in connection with Trimaran Advisors’ warehouse activities. The Trimaran Credit Facility was extended in November 2017 and now matures in November 2022 and bears interest at an annual rate of 9.0%. On April 15, 2013, the Trimaran Credit Facility was amended and increased from \$20 million to \$23 million. At December 31, 2017 and 2016, there was no loan outstanding under the Trimaran Credit Facility. Interest expense on this facility was \$918,100, \$1.8 million and \$1.7 million for the years ending December 31, 2017, 2016 and 2015, respectively.

October 30, 2017, the Trimaran Advisors and KCAP Financial executed a Promissory Note under which Trimaran Advisors borrowed \$8.4 million from KCAP Financial Borrowings under this agreement bear interest at a rate of 10.5% per annum, payable quarterly. The maturity date for this borrowing is April 30, 2030, unless there is an occurrence of an event in default, as defined in the Promissory Note, in which case KCAP Financial has the option to declare all of the amounts outstanding to be immediately due and payable.

December 19, 2017, the Trimaran Advisors and KCAP Financial executed a Promissory Note under which Trimaran Advisors borrowed \$4.5 million from KCAP Financial Borrowings under this agreement bear interest at a rate of 10.5% per annum, payable quarterly. The maturity date for this borrowing is January 27, 2028, unless there is an occurrence of an event in default, as defined in the Promissory Note, in which case KCAP Financial has the option to declare all of the amounts outstanding to be immediately due and payable.

**ASSET MANAGER AFFILIATES**

**NOTES TO FINANCIAL STATEMENTS**

**11. RELATED PARTY TRANSACTIONS – (continued)**

All of these borrowings were contributed as equity capital to Trimaran Advisor's wholly-owned subsidiary Trimaran Risk Retention Holdings, LLC, which contributed the proceeds to its wholly-owned subsidiaries Trimaran RR I, LLC and Trimaran RR II, LLC.

**12. SUBSEQUENT EVENTS**

In January 2018, the trustee of Catamaran 2012-1 CLO received notice that the holders of a majority of the Subordinated Securities had exercised their right of optional redemption. It is expected the optional redemption will be effective on the March 2018 payment.

On February 9, 2018, the United States Court of Appeals for the District of Columbia (the "DC Circuit Court") ruled in favor of an appeal brought by the Loan Syndications and Trading Association (the "LSTA") on whether application of the risk retention rules to CLO managers is valid under Section 941 of the Dodd-Frank Act. If the decision stands, CLO managers of "open-market CLOs" (described in the ruling as CLOs where assets are acquired from "arms-length negotiations and trading on an open market") will no longer be required to comply with the risk retention rules, and no party to such "open-market CLOs" would be required to acquire and retain an economic interest in the credit risk of the securitized assets. However, the DC Circuit Court's decision remains subject to further appeal for a period of time.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2017 for items that should potentially be recognized or disclosed in these financial statements. Other than described above, management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these combined financial statements.

## Report of Independent Auditors

The Board of Directors and Shareholders of  
Katonah 2007-I CLO Ltd.

We have audited the accompanying financial statements of Katonah 2007-I CLO Ltd. (the “Fund”), which comprise the statements of net assets, including the schedules of investments, as of December 31, 2016 and 2015, and the related statements of operations, changes in net assets, and cash flows for each of the three years in the period ended December 31, 2016, and the related notes to the financial statements.

### Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

### Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Katonah 2007-I CLO Ltd. at December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

New York, NY  
March 9, 2017

**KATONAH 2007-I CLO LTD.****STATEMENTS OF NET ASSETS**

	As of December 31, 2016	As of December 31, 2015
<b>ASSETS</b>		
Investments at fair value:		
Debt securities	\$ 170,702,652	\$ 234,403,150
Equity securities	150,524	2,830
CLO rated notes	5,831,800	12,360,525
Total investments at fair value	176,684,976	246,766,505
Cash	34,982,770	17,301,178
Accrued interest receivable	492,417	501,574
Receivable for open trades	—	820,593
Total assets	<u>\$ 212,160,163</u>	<u>\$ 265,389,850</u>
<b>LIABILITIES</b>		
CLO Fund liabilities at fair value	\$ 208,812,164	\$ 261,433,473
Accrued interest payable	1,518,793	1,565,632
Payable for open trades	—	6,006,038
Accounts payable and accrued expenses	132,967	154,079
Due to affiliates	30	3,889
Total liabilities	210,463,954	269,163,111
Commitments and Contingencies	—	—
<b>NET ASSETS</b>		
Total net assets	<u>\$ 1,696,209</u>	<u>\$ (3,773,261)</u>

See accompanying notes to the financial statements.

**KATONAH 2007-I CLO LTD.**  
**STATEMENTS OF OPERATIONS**

	<u>For the Years Ended December 31,</u>		
	<u>2016</u>	<u>2015</u>	<u>2014</u>
<b>Income</b>			
Interest income from investments	\$ 9,381,680	\$ 10,178,631	\$ 11,690,586
Interest income from cash and time deposits	18,324	1,288	1,922
Other income	367,266	425,490	32,346
<b>Total income</b>	<u>9,767,270</u>	<u>10,605,409</u>	<u>11,724,854</u>
<b>Expenses</b>			
Interest expense	8,798,483	9,146,858	10,736,878
Management fees	659,347	714,061	805,526
Trustee fees	75,663	77,443	109,164
Professional fees	166,488	180,463	178,954
Administrative and other	80,425	86,528	125,224
<b>Total expenses</b>	<u>9,780,406</u>	<u>10,205,353</u>	<u>11,955,746</u>
Net realized and unrealized gains (losses)	<u>5,482,606</u>	<u>(387,924)</u>	<u>(9,089,440)</u>
<b>Increase (Decrease) in net assets resulting from operations</b>	<u>\$ 5,469,470</u>	<u>\$ 12,132</u>	<u>\$ (9,320,332)</u>

See accompanying notes to the financial statements.

KATONAH 2007-I CLO LTD.

STATEMENTS OF CHANGES IN NET ASSETS

	<u>Net Assets</u>
<b>Balance at January 1, 2014</b>	<b>\$ 5,534,939</b>
Decrease in net assets resulting from operations	(9,320,332)
<b>Balance at December 31, 2014</b>	<b>(3,785,393)</b>
Increase in net assets resulting from operations	12,132
<b>Balance at December 31, 2015</b>	<b>(3,773,261)</b>
Increase in net assets resulting from operations	5,469,470
<b>Balance at December 31, 2016</b>	<b>\$ 1,696,209</b>

See accompanying notes to the financial statements.

**KATONAH 2007-I CLO LTD.**  
**STATEMENTS OF CASH FLOWS**

	Years Ended December 31,		
	2016	2015	2014
<b>OPERATING ACTIVITIES:</b>			
Increase (Decrease) in net assets resulting from operations	\$ 5,469,470	12,132	\$ (9,320,332)
<b>Adjustments to reconcile increase (decrease) in net assets resulting from operations to net cash provided by operating activities:</b>			
Net realized and unrealized (gains) losses on investments	(7,040,542)	6,651,428	5,807,622
Change in unrealized losses (gains) on debt	1,557,935	(6,263,504)	3,281,818
Purchase of investments	(82,554,227)	(93,243,381)	(29,960,071)
Proceeds from sale and redemption of investments	159,676,298	113,199,395	61,206,288
<b>Changes in operating assets and liabilities:</b>			
Decrease in accrued interest receivable	9,157	129,814	43,523
(Decrease) increase in accounts payable and accrued expenses	(21,112)	(30,556)	3,621
Decrease (increase) in receivable for open trades	820,593	(820,593)	—
(Decrease) increase in due to affiliates	(3,859)	(6,964)	6,745
Decrease in due from affiliates	—	—	10,852
(Decrease) increase in payable for open trades	(6,006,038)	6,006,038	(4,013,750)
Decrease in accrued interest payable	(46,839)	(270,176)	(254,559)
Net cash provided by operating activities	<u>71,860,836</u>	<u>25,363,633</u>	<u>26,811,757</u>
<b>Cash used in Financing Activities:</b>			
Repayments of Debt	(54,179,244)	(23,002,449)	(27,132,006)
	(54,179,244)	(23,002,449)	(27,132,006)
<b>CHANGE IN CASH</b>	17,681,592	2,361,184	(320,249)
<b>CASH, BEGINNING OF YEAR</b>	17,301,178	14,939,994	15,260,243
<b>CASH, END OF YEAR</b>	<u>\$ 34,982,770</u>	<u>17,301,178</u>	<u>\$ 14,939,994</u>
<b>Supplemental Information:</b>			
Interest paid	\$ 8,751,644	9,417,035	\$ 10,991,437

See accompanying notes to the financial statements.

**Katonah 2007-I CLO Ltd.**

**SCHEDULE OF INVESTMENTS  
As of December 31, 2016**

**Debt Securities Portfolio**

Portfolio Company/Principal Business	Investment Interest Rate/Maturity	Principal	Cost	Fair Value
Advantage Sales & Marketing Inc. <i>Services: Business</i>	Initial Term Loan (First Lien) — 4.3% Cash, Due 7/21	\$ 1,478,170	\$ 1,465,743	\$ 1,485,930
Aramark Corporation <i>Diversified/Conglomerate Service</i>	U.S. Term F Loan — 3.5% Cash, Due 2/21	2,500,766	2,434,568	2,527,775
Ascena Retail Group, Inc. (Anntaylor Retail, Inc.) <i>Retail Stores</i>	Tranche B Term Loan — 5.3% Cash, Due 8/22	1,847,840	1,727,053	1,807,880
Aspect Software, Inc. <i>Electronics</i>	Term Loan (First Lien) — 11.3% Cash, Due 5/20	1,987,421	1,982,675	1,990,730
Asurion, LLC (fka Asurion Corporation) <i>Insurance</i>	Replacement B-2 Term Loan — 4.0% Cash, Due 7/20	434,119	417,800	438,528
Avis Budget Car Rental, LLC <i>Personal Transportation</i>	Tranche B Term Loan — 3.3% Cash, Due 3/19	4,747,663	4,764,002	4,761,527
Berry Plastics Corporation <i>Containers, Packaging and Glass</i>	Term G Loan — 3.5% Cash, Due 1/21	2,591,612	2,487,866	2,612,138
Burlington Coat Factory Warehouse Corporation <i>Retail Stores</i>	Term B-4 Loan — 3.5% Cash, Due 8/21	2,321,888	2,286,350	2,342,611
Capital Automotive L.P. <i>Finance</i>	Tranche B-1 Term Loan Facility — 4.0% Cash, Due 4/19	1,447,883	1,444,407	1,464,852
Capsugel Holdings US, Inc. <i>Healthcare, Education and Childcare</i>	New Dollar Term Loan — 4.0% Cash, Due 7/21	713,586	712,640	716,783
Cedar Fair, L.P. <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	U.S. Term Facility — 3.3% Cash, Due 3/20	956,905	955,817	964,383
Change Healthcare Holdings, Inc. (fka Emdeon Inc.) <i>Electronics</i>	Term B-2 Loan — 3.8% Cash, Due 11/18	173,151	173,481	173,692
Charter Communications Operating, LLC (aka CCO Safari LLC) <i>Broadcasting and Entertainment</i>	Term F Loan — 3.0% Cash, Due 1/21	1,468,488	1,462,213	1,477,461
CHS/Community Health Systems, Inc. <i>Healthcare, Education and Childcare</i>	Incremental 2018 Term F Loan — 4.2% Cash, Due 12/18	1,034,498	493,113	1,020,057
CHS/Community Health Systems, Inc. <i>Healthcare, Education and Childcare</i>	Incremental 2019 Term G Loan — 3.8% Cash, Due 12/19	1,019,212	1,017,557	991,505
CHS/Community Health Systems, Inc. <i>Healthcare, Education and Childcare</i>	Incremental 2021 Term H Loan — 4.0% Cash, Due 1/21	2,073,288	2,055,059	2,014,117
Ciena Corporation <i>Electronics</i>	Term Loan — 3.8% Cash, Due 7/19	2,947,236	2,958,279	2,965,656
Commscope, Inc. <i>Telecommunications</i>	Tranche 4 Term Loan — 3.3% Cash, Due 1/18	111,875	111,920	112,679
Container Store, Inc., The <i>Retail Stores</i>	Term Facility — 4.3% Cash, Due 4/19	1,660,005	1,662,549	1,524,441
CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited) <i>Beverage, Food and Tobacco</i>	Term Loan (First Lien) — 5.0% Cash, Due 7/20	3,000,000	2,914,353	2,725,500
Cyanco Intermediate Corp. <i>Chemicals, Plastics and Rubber</i>	Term Loan — 5.5% Cash, Due 5/20	621,075	627,103	624,569
David's Bridal, Inc. <i>Retail Stores</i>	Initial Term Loan — 5.3% Cash, Due 10/19	473,111	471,233	419,690
Delta 2 (Lux) S.a.r.l (aka Formula One) <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Facility B3 (USD) — 5.1% Cash, Due 7/21	3,421,774	3,404,142	3,461,603
Dex Media, Inc. <i>Printing and Publishing</i>	Loan — 11.0% Cash, Due 7/21	217,160	212,886	217,974
E.W. Scripps Company, The <i>Broadcasting and Entertainment</i>	Tranche B Term Loan — 3.3% Cash, Due 11/20	2,575,710	2,553,469	2,588,048
Education Management II LLC <i>Healthcare, Education and Childcare</i>	Tranche A Term Loan — 5.5% Cash, Due 7/20	200,289	201,078	50,386

See accompanying notes to the financial statements.



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<b>Portfolio Company/Principal Business</b>	<b>Investment Interest Rate/Maturity</b>	<b>Principal</b>	<b>Cost</b>	<b>Fair Value</b>
Education Management II LLC <i>Healthcare, Education and Childcare</i>	Tranche B Term Loan — 2.0% Cash, Due 7/20	\$ 374,420	\$ 375,734	\$ 18,347
Electric Lightwave Holdings, Inc. (f.k.a. Integra Telecom Holdings, Inc.) <i>Telecommunications</i>	Term B-1 Loan — 5.3% Cash, Due 8/20	2,392,107	2,325,632	2,402,872
EnergySolutions, LLC (aka Envirocare of Utah, LLC) <i>Ecological</i>	Term Advance — 6.8% Cash, Due 5/20	918,742	920,945	927,930
Envigo Laboratories, Inc. (fka BPA Laboratories Inc.) <i>Healthcare, Education and Childcare</i>	Term Loan (First Lien) — 3.4% Cash, Due 4/20	1,743,896	1,649,728	1,534,628
Envigo Laboratories, Inc. (fka BPA Laboratories Inc.) <i>Healthcare, Education and Childcare</i>	Term Loan (Second Lien) — 3.4% Cash, Due 7/17	1,516,318	1,493,015	1,048,784
Essential Power, LLC <i>Utilities</i>	Term Loan — 4.8% Cash, Due 8/19	856,721	851,938	869,572
Evertec Group, LLC (fka Evertec, LLC) <i>Banking, Finance, Insurance &amp; Real Estate</i>	Term A Loan — 2.9% Cash, Due 4/18	1,380,234	1,366,553	1,373,767
EWT Holdings III Corp. (fka WTG Holdings III Corp.) <i>Ecological</i>	Incremental 2016 First Lien Term Loan — 5.5% Cash, Due 1/21	2,274,670	2,285,613	2,301,693
EWT Holdings III Corp. (fka WTG Holdings III Corp.) <i>Ecological</i>	Term Loan (First Lien) — 4.8% Cash, Due 1/21	970,000	972,349	978,492
FCA US LLC (fka Chrysler Group LLC) <i>Automobile</i>	Term Loan B — 3.5% Cash, Due 5/17	4,172,621	4,156,392	4,189,562
Federal-Mogul Corporation <i>Automobile</i>	Tranche B Term Loan (2014) — 4.0% Cash, Due 4/18	1,550,593	1,529,850	1,550,981
Fender Musical Instruments Corporation <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Initial Loan — 5.8% Cash, Due 4/19	1,759,725	1,753,723	1,737,025
Filtration Group Corporation <i>Ecological</i>	Term Loan (First Lien) — 4.3% Cash, Due 11/20	624,502	626,008	630,160
First Data Corporation <i>Banking, Finance, Insurance &amp; Real Estate</i>	2021C New Dollar Term Loan — 3.8% Cash, Due 3/21	2,095,106	2,092,615	2,122,018
Gardner Denver, Inc. <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Initial Dollar Term Loan — 4.6% Cash, Due 7/20	2,210,025	2,172,541	2,191,439
General Nutrition Centers, Inc. <i>Retail Stores</i>	Amended Tranche B Term Loan — 3.3% Cash, Due 3/19	4,364,001	4,365,677	4,113,071
Getty Images, Inc. <i>Printing and Publishing</i>	Initial Term Loan — 4.8% Cash, Due 10/19	2,601,451	2,591,053	2,278,429
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <i>Printing and Publishing</i>	Tranche B-3 Term Loan — 7.0% Cash, Due 5/18	487,985	487,985	489,815
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <i>Printing and Publishing</i>	Tranche B-5 Term Loan — 7.0% Cash, Due 12/19	4,450,523	4,451,323	4,484,458
HCR Healthcare, LLC <i>Healthcare, Education and Childcare</i>	Initial Term Loan — 5.0% Cash, Due 4/18	471,250	470,402	413,647
Hercules Achievement, Inc. (aka Varsity Brands, Inc.) <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Initial Term Loan (First Lien) — 5.0% Cash, Due 12/21	997,455	1,007,140	1,013,913
Huntsman International LLC <i>Chemicals, Plastics and Rubber</i>	2015 Extended Term B Dollar Loan — 3.7% Cash, Due 4/19	1,075,034	1,045,099	1,081,081
Ineos US Finance LLC <i>Chemicals, Plastics and Rubber</i>	2020 Dollar Term Loan — 3.8% Cash, Due 12/20	3,944,682	3,955,292	3,969,751
Infor (US), Inc. (fka Lawson Software Inc.) <i>Electronics</i>	Tranche B-5 Term Loan — 3.8% Cash, Due 6/20	2,287,677	2,296,269	2,294,586
J. Crew Group, Inc. <i>Retail Stores</i>	Initial Loan — 4.0% Cash, Due 3/21	3,841,375	3,843,639	2,203,989

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment			
	Interest Rate/Maturity	Principal	Cost	Fair Value
JBS USA Lux S.A. (fka JBS USA, LLC) <i>Beverage, Food and Tobacco</i>	Initial Term Loan — 3.8% Cash, Due 5/18	\$ 4,711,566	\$ 4,720,855	\$ 4,729,235
KAR Auction Services, Inc. <i>Automobile</i>	Tranche B-2 Term Loan — 4.2% Cash, Due 3/21	243,611	246,267	246,048
Key Safety Systems, Inc. <i>Automobile</i>	Initial Term Loan — 5.5% Cash, Due 8/21	1,283,781	1,265,173	1,300,150
Kronos Worldwide, Inc. <i>Diversified/Conglomerate Service</i>	2015 Refinancing Term Loan — 4.0% Cash, Due 2/20	778,000	766,847	787,725
Las Vegas Sands, LLC <i>Hotels, Motels, Inns, and Gaming</i>	Refinancing Term Loan — 3.0% Cash, Due 12/20	3,168,926	3,128,432	3,189,968
LPL Holdings, Inc. <i>Finance</i>	2021 Tranche B Term Loan — 4.3% Cash, Due 3/21	1,911,195	1,903,632	1,933,900
MCC Iowa LLC <i>Broadcasting and Entertainment</i>	Tranche J Term Loan — 3.5% Cash, Due 6/21	683,429	675,784	689,836
Mediacom Illinois, LLC (fka Mediacom Communications, LLC) <i>Broadcasting and Entertainment</i>	Tranche F Term Loan — 3.2% Cash, Due 3/18	5,835,000	5,830,528	5,860,557
Mitchell International, Inc. <i>Electronics</i>	Initial Term Loan — 4.5% Cash, Due 10/20	1,979,675	1,836,869	1,986,069
National CineMedia, LLC <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Term Loan (2013) — 3.5% Cash, Due 11/19	1,000,000	996,689	1,009,065
NEP/NCP Holdco, Inc. <i>Broadcasting and Entertainment</i>	Amendment No. 4 Incremental Term Loan (First Lien) — 4.3% Cash, Due 1/20	4,211,244	4,190,414	4,237,564
OCI Beaumont LLC <i>Chemicals, Plastics and Rubber</i>	Term B-3 Loan — 8.0% Cash, Due 8/19	2,393,807	2,407,888	2,441,684
Onex Carestream Finance LP <i>Healthcare, Education and Childcare</i>	Term Loan (First Lien 2013) — 5.0% Cash, Due 6/19	2,290,548	2,301,501	2,231,372
Otter Products, LLC (OtterBox Holdings, Inc.) <i>Consumer goods: Durable</i>	Term B Loan — 5.8% Cash, Due 6/20	2,125,900	1,914,366	2,050,218
Pacific Drilling S.A. <i>Oil and Gas</i>	Term Loan — 4.5% Cash, Due 6/18	2,163,350	2,165,248	784,214
Petroleum GEO-Services ASA (PGS Finance, Inc.) <i>Oil and Gas</i>	Extended Term Loan — 3.5% Cash, Due 3/21	4,862,500	4,862,500	3,954,841
QCE, LLC (Quiznos) <sup>(2)</sup> <i>Personal, Food and Miscellaneous Services</i>	Existing Term Loan — 0.0% Cash, Due 6/19	449,499	449,486	36,522
Quad/Graphics, Inc. <i>Printing and Publishing</i>	Term B Loan — 4.3% Cash, Due 4/21	1,484,772	1,383,304	1,495,907
Regal Cinemas Corporation <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Refinancing Term Loan — 3.3% Cash, Due 4/22	958,853	965,417	967,756
RGIS Services, LLC <i>Diversified/Conglomerate Service</i>	Tranche C Term Loan — 5.5% Cash, Due 10/17	2,559,107	2,546,630	2,367,174
Select Medical Corporation <i>Healthcare, Education and Childcare</i>	Series E Tranche B Term Loan — 6.0% Cash, Due 6/18	2,075,986	2,069,075	2,110,582
Semiconductor Components Industries, LLC (On Semiconductor) <i>Electronics</i>	Term Loan — 2.6% Cash, Due 1/18	3,718,750	3,695,931	3,718,750
Sensata Technologies B.V. (Sensata Technologies Finance Company, LLC) <i>Electronics</i>	Sixth Amendment Term Loan — 3.0% Cash, Due 10/21	534,542	531,559	538,885
SGS Cayman, L.P. <i>Diversified/Conglomerate Service</i>	Initial Cayman Term Loan — 6.0% Cash, Due 4/21	132,834	131,878	131,090
Sinclair Television Group, Inc. <i>Broadcasting and Entertainment</i>	New Tranche B Term Loan — 3.0% Cash, Due 4/20	66,296	66,296	66,379
Steinway Musical Instruments, Inc. <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Loan (First Lien) — 4.8% Cash, Due 9/19	1,991,985	1,981,249	1,922,265
Sutherland Global Services Inc. <i>Diversified/Conglomerate Service</i>	Initial U.S. Term Loan — 6.0% Cash, Due 4/21	570,647	566,540	563,157
Toys 'R' US-Delaware, Inc. <i>Retail Stores</i>	Term B-2 Loan — 5.3% Cash, Due 5/18	1,488,194	1,428,809	1,406,716

See accompanying notes to the financial statements.

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<b>Portfolio Company/Principal Business</b>	<b>Investment Interest Rate/Maturity</b>	<b>Principal</b>	<b>Cost</b>	<b>Fair Value</b>
Transdigm Inc. <i>Aerospace and Defense</i>	Tranche C Term Loan — 4.0% Cash, Due 2/20	\$ 3,752,368	\$ 3,715,669	\$ 3,785,782
Tribune Media Company (fka Tribune Company) <i>Broadcasting and Entertainment</i>	Term B Loan — 3.8% Cash, Due 12/20	2,078,894	2,066,155	2,099,943
Tronox Pigments (Netherlands) B. V. <i>Chemicals, Plastics and Rubber</i>	New Term Loan — 4.5% Cash, Due 3/20	2,473,836	2,467,847	2,487,058
United Air Lines, Inc. (fka Continental Airlines, Inc.) <i>Personal Transportation</i>	Class B Term Loan — 3.3% Cash, Due 4/19	2,034,432	2,036,638	2,049,374
Univision Communications Inc. <i>Broadcasting and Entertainment</i>	Replacement First-Lien Term Loan (C-4) — 4.0% Cash, Due 3/20	3,204,971	3,189,172	3,226,716
Valeant Pharmaceuticals International, Inc. <i>Healthcare, Education and Childcare</i>	Series C-2 Tranche B Term Loan — 5.3% Cash, Due 12/19	1,339,121	1,306,042	1,339,241
Walter Investment Management Corp. <i>Finance</i>	Tranche B Term Loan — 4.8% Cash, Due 12/20	2,454,158	2,447,189	2,349,243
WESCO Distribution, Inc. <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Tranche B-1 Loan — 4.0% Cash, Due 12/19	206,786	205,914	207,497
West Corporation <i>Diversified/Conglomerate Service</i>	Refinanced Term B-14 Loan — 3.3% Cash, Due 6/21	5,472,534	5,451,789	5,489,663
Windstream Services, LLC (fka Windstream Corporation) <i>Telecommunications</i>	Tranche B-5 Term Loan — 3.5% Cash, Due 8/19	5,893,671	5,893,671	5,908,405
Zekelman Industries, Inc. (fka JMC Steel Group, Inc.) <i>Mining, Steel, Iron and Non-Precious Metals</i>	Term Loan — 6.0% Cash, Due 6/21	1,287,097	1,281,369	1,301,576
<b>Total Investment in Debt Securities</b>		<u>177,257,703</u>	<u>175,174,493</u>	<u>170,702,652</u>

**Equity Securities Portfolio**

<b>Portfolio Company/Principal Business</b>	<b>Equity Investment</b>	<b>Shares</b>	<b>Cost</b>	<b>Fair Value</b>
Education Management Corporation <i>Healthcare, Education and Childcare</i>	Series A-1 Preferred Shares	2,670	—	748
Dex Media, Inc. <i>Printing and Publishing</i>	Common Stock	59,785	—	149,462
QCE, LLC (Quiznos) <i>Retail Stores</i>	New Common Stock	1,256	—	314
<b>Total Investment in Equity Securities</b>			<u>—</u>	<u>150,524</u>

**CLO Securities Portfolio**

<b>Portfolio Company</b>	<b>CLO Investment</b>	<b>Principal</b>	<b>Cost</b>	<b>Fair Value</b>
MDPK 2007-4A <sup>(1)</sup> <i>CLO Rated Notes</i>	Floating – 03/2021 – D – 55817UAF7	2,000,000	2,000,000	1,931,600
TRAL 2007-1A <sup>(1)</sup> <i>CLO Rated Notes</i>	Floating – 04/2022 – C – 89288BAG6	3,000,000	3,000,000	2,924,700
TRAL 2007-1A <sup>(1)</sup> <i>CLO Rated Notes</i>	Floating – 04/2022 – D – 89288AAA1	1,000,000	1,000,000	975,500
<b>Total Investment in CLO Rated Notes</b>		<u>6,000,000</u>	<u>6,000,000</u>	<u>5,831,800</u>
<b>Total Investments</b>			<u>\$ 181,174,493</u>	<u>\$ 176,684,976</u>

(1) Investment in a Collateralized Loan Obligation Fund

(2) Loan on non-accrual status

See accompanying notes to the financial statements.

**Katonah 2007-I CLO Ltd.**

**SCHEDULE OF INVESTMENTS  
As of December 31, 2015**

**Debt Securities Portfolio**

Portfolio Company/Principal Business	Investment Interest Rate <sup>(1)</sup> /Maturity	Principal	Cost	Fair Value
AdvancePierre Foods, Inc. <i>Beverage, Food and Tobacco</i>	Term Loan (First Lien) — 5.8% Cash, Due 7/17	\$ 2,469,655	\$ 2,484,379	\$ 2,465,790
Allison Transmission, Inc. <i>Automobile</i>	Term B-3 Loan — 3.5% Cash, Due 8/19	4,720,274	4,688,227	4,698,160
Aramark Corporation <i>Diversified/Conglomerate Service</i>	U.S. Term F Loan — 3.3% Cash, Due 2/21	2,526,481	2,443,445	2,506,484
Armstrong World Industries, Inc. <sup>(3)</sup> <i>Buildings and Real Estate</i> <sup>(3)</sup>	Term Loan B — 3.5% Cash, Due 3/20	972,500	972,500	967,638
Ascena Retail Group, Inc. (Anntaylor Retail, Inc.) <i>Retail Stores</i>	Tranche B Term Loan — 5.3% Cash, Due 8/22	2,000,000	1,846,016	1,880,000
Asurion, LLC (fka Asurion Corporation) <i>Insurance</i>	Incremental Tranche B-1 Term Loan — 5.0% Cash, Due 5/19	1,121,067	1,095,258	1,053,456
Avis Budget Car Rental, LLC <i>Personal Transportation</i>	Tranche B Term Loan — 3.0% Cash, Due 3/19	1,544,939	1,534,683	1,543,324
Belfor USA Group Inc. <i>Ecological</i>	Tranche B Term Loan — 3.8% Cash, Due 4/19	1,611,699	1,615,203	1,601,626
Berry Plastics Corporation <i>Containers, Packaging and Glass</i>	Term E Loan — 3.8% Cash, Due 1/21	2,591,612	2,507,141	2,559,386
Burlington Coat Factory Warehouse Corporation <i>Retail Stores</i>	Term B-3 Loan — 4.3% Cash, Due 8/21	2,321,888	2,290,743	2,298,669
Capital Automotive L.P. <i>Finance</i>	Tranche B-1 Term Loan Facility — 4.0% Cash, Due 4/19	1,267,378	1,260,465	1,268,170
Capsugel Holdings US, Inc. <i>Healthcare, Education and Childcare</i>	Initial Term Loan — 3.5% Cash, Due 8/18	721,164	719,601	710,123
Cedar Fair, L.P. <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	U.S. Term Facility — 3.3% Cash, Due 3/20	966,429	964,983	969,449
Celanese US Holdings LLC <i>Chemicals, Plastics and Rubber</i>	Dollar Term C-3 Loan — 2.5% Cash, Due 10/18	1,251,599	1,214,068	1,254,509
Cequel Communications, LLC <i>Broadcasting and Entertainment</i>	Term Loan — 3.8% Cash, Due 2/19	1,879,918	1,871,491	1,854,070
Charter Communications Operating, LLC (aka CCO Safari LLC) <i>Broadcasting and Entertainment</i>	Term F Loan — 3.0% Cash, Due 1/21	1,483,706	1,475,779	1,457,370
CHS/Community Health Systems, Inc. <i>Healthcare, Education and Childcare</i>	Incremental 2018 Term F Loans — 3.7% Cash, Due 12/18	1,209,226	258,686	1,195,368
CHS/Community Health Systems, Inc. <i>Healthcare &amp; Pharmaceuticals</i>	Incremental 2019 Term G Loan — 3.8% Cash, Due 12/19	1,062,209	1,059,907	1,038,145
CHS/Community Health Systems, Inc. <i>Healthcare, Education and Childcare</i>	Incremental 2021 Term H Loan — 4.0% Cash, Due 1/21	2,160,738	2,137,064	2,131,415
Ciena Corporation <i>Electronics</i>	Term Loan — 3.8% Cash, Due 7/19	2,977,387	2,992,956	2,953,195
Commscope, Inc. <i>Telecommunications</i>	Tranche 4 Term Loan — 3.3% Cash, Due 1/18	261,875	262,083	261,057
Consolidated Communications, Inc. <i>Telecommunications</i>	Initial Term Loan — 4.3% Cash, Due 12/20	2,917,802	2,898,785	2,903,227
Container Store, Inc., The <i>Retail Stores</i>	Term Facility — 4.3% Cash, Due 4/19	1,678,935	1,682,649	1,553,015
ConvaTec Inc. <i>Healthcare, Education and Childcare</i>	Dollar Term Loan — 4.3% Cash, Due 6/20	1,162,658	1,165,259	1,145,223
Crown Castle Operating Company <sup>(3)</sup> <i>Buildings and Real Estate</i> <sup>(3)</sup>	Extended Incremental Tranche B-2 Term Loan — 3.0% Cash, Due 1/21	2,888,746	2,878,350	2,881,235
David's Bridal, Inc. <i>Retail Stores</i>	Initial Term Loan — 5.3% Cash, Due 10/19	477,723	475,142	397,942

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment			
	Interest Rate <sup>(1)</sup> /Maturity	Principal	Cost	Fair Value
Dealer Computer Services, Inc. (Reynolds & Reynolds) <i>Electronics</i>	Tranche B Term Loan — 2.4% Cash, Due 4/16	\$ 2,242,828	\$ 2,242,828	\$ 2,242,827
Delta 2 (Lux) S.a r.l (aka Formula One) <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Facility B3 (USD) — 4.8% Cash, Due 7/21	3,421,774	3,400,280	3,319,121
Delta Air Lines, Inc. <i>Personal Transportation</i>	2014 Term B-2 Loan — 2.7% Cash, Due 4/16	3,402,908	3,406,970	3,397,583
Dex Media West LLC <i>Printing and Publishing</i>	New Term Loan — 8.0% Cash, Due 12/16	695,444	692,438	379,017
DJO Finance LLC <i>Healthcare, Education and Childcare</i>	Initial Term Loan — 4.3% Cash, Due 6/20	1,955,250	1,980,808	1,908,813
Drumm Investors LLC (aka Golden Living) <i>Healthcare, Education and Childcare</i>	Term Loan — 6.8% Cash, Due 5/18	3,731,318	3,718,832	3,689,341
Education Management II LLC <sup>(2)</sup> <i>Healthcare, Education and Childcare</i>	Tranche A Term Loan — 5.5% Cash, Due 7/20	200,289	201,304	50,071
Education Management II LLC <sup>(2)</sup> <i>Healthcare, Education and Childcare</i>	Tranche B Term Loan — 8.5% Cash, Due 7/20	350,666	352,357	37,872
Envigo Laboratories, Inc. (fka BPA Laboratories Inc.) <i>Healthcare, Education and Childcare</i>	Term Loan (First Lien) — 2.8% Cash, Due 7/17	1,743,896	1,663,494	1,409,286
Envigo Laboratories, Inc. (fka BPA Laboratories Inc.) <i>Healthcare, Education and Childcare</i>	Term Loan (Second Lien) — 2.8% Cash, Due 7/17	1,516,318	1,446,409	1,232,009
Essential Power, LLC <i>Utilities</i>	Term Loan — 4.8% Cash, Due 8/19	932,448	925,235	921,668
FCA US LLC (fka Chrysler Group LLC) <i>Automobile</i>	Term Loan B — 3.5% Cash, Due 5/17	3,067,549	2,960,527	3,061,797
Federal-Mogul Corporation <i>Automobile</i>	Tranche B Term Loan (2014) — 4.0% Cash, Due 4/18	1,566,456	1,529,147	1,415,191
Fender Musical Instruments Corporation <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Initial Loan — 5.8% Cash, Due 4/19	1,884,150	1,874,862	1,867,664
First Data Corporation <i>Banking, Finance, Insurance &amp; Real Estate</i>	2018 New Dollar Term Loan — 3.9% Cash, Due 3/18	2,903,500	2,900,493	2,870,632
First Data Corporation <i>Banking, Finance, Insurance &amp; Real Estate</i>	New 2022B Dollar Term Loan — 4.2% Cash, Due 7/22	2,546,500	2,546,500	2,513,714
Gardner Denver, Inc. <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Initial Dollar Term Loan — 4.3% Cash, Due 7/20	2,232,868	2,184,383	2,016,838
General Nutrition Centers, Inc. <i>Retail Stores</i>	Amended Tranche B Term Loan — 3.3% Cash, Due 3/19	870,762	873,222	848,997
Getty Images, Inc. <i>Printing and Publishing</i>	Initial Term Loan — 4.8% Cash, Due 10/19	2,910,000	2,894,196	1,847,850
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <i>Printing and Publishing</i>	Tranche B-2 Term Loan — 5.9% Cash, Due 6/17	2,414,520	2,417,333	2,342,084
Harland Clarke Holdings Corp. (fka Clarke American Corp.) <i>Printing and Publishing</i>	Tranche B-3 Term Loan — 7.0% Cash, Due 5/18	943,396	943,396	940,472
HCA Inc. <i>Healthcare, Education and Childcare</i>	Tranche B-4 Term Loan — 3.4% Cash, Due 5/18	2,932,500	2,893,337	2,932,515
HCR Healthcare, LLC <i>Healthcare, Education and Childcare</i>	Initial Term Loan — 5.0% Cash, Due 4/18	476,250	474,710	452,142
Hertz Corporation, The <i>Personal Transportation</i>	Tranche B-1 Term Loan — 3.8% Cash, Due 3/18	3,894,660	3,894,343	3,891,252
Hertz Corporation, The <i>Personal Transportation</i>	Tranche B-2 Term Loan — 3.0% Cash, Due 3/18	953,050	950,930	946,198
Huntsman International LLC <i>Chemicals, Plastics and Rubber</i>	2015 Extended Term B Dollar Loan — 3.3% Cash, Due 4/19	2,719,781	2,610,970	2,678,304
Ineos US Finance LLC <i>Chemicals, Plastics and Rubber</i>	2020 Dollar Term Loan — 3.8% Cash, Due 12/20	6,376,839	6,398,337	6,137,707
Infor (US), Inc. (fka Lawson Software Inc.) <i>Electronics</i>	Tranche B-5 Term Loan — 3.8% Cash, Due 6/20	2,352,008	2,363,429	2,214,321

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment			
	Interest Rate <sup>(1)</sup> /Maturity	Principal	Cost	Fair Value
Integra Telecom Holdings, Inc. Telecommunications	Term B-1 Loan — 5.3% Cash, Due 8/20	\$ 416,454	\$ 417,393	\$ 404,377
International Architectural Products, Inc. <sup>(2)</sup> Mining, Steel, Iron and Non-Precious Metals	Term Loan — 0.0% Cash, Due 5/15	81,467	81,467	326
J. Crew Group, Inc. Retail Stores	Initial Loan — 4.0% Cash, Due 3/21	3,880,774	3,883,610	2,528,324
Jarden Corporation Personal and Non Durable Consumer Products (Mfg. Only)	New Tranche B Term Loan — 3.0% Cash, Due 3/18	4,769,734	4,749,934	4,773,216
JBS USA, LLC Beverage, Food and Tobacco	Initial Term Loan — 3.8% Cash, Due 5/18	861,507	860,028	859,353
JMC Steel Group, Inc. Mining, Steel, Iron and Non-Precious Metals	Term Loan — 4.8% Cash, Due 4/17	1,293,564	1,291,965	1,251,524
Jo-Ann Stores, Inc. Retail Stores	Term B Loan — 4.0% Cash, Due 3/18	941,546	943,733	885,054
KAR Auction Services, Inc. Automobile	Tranche B-1 Term Loan — 3.1% Cash, Due 3/17	679,145	680,354	679,430
KAR Auction Services, Inc. Automobile	Tranche B-2 Term Loan — 3.5% Cash, Due 3/21	3,407,047	3,453,066	3,402,788
Key Safety Systems, Inc. Automobile	Initial Term Loan — 4.8% Cash, Due 8/21	1,364,058	1,340,031	1,329,956
Kronos Incorporated Diversified/Conglomerate Service	Incremental Term Loan (First Lien) — 4.5% Cash, Due 10/19	978,389	975,600	964,941
Landry's Inc. (fka Landry's Restaurants, Inc.) Beverage, Food and Tobacco	B Term Loan — 4.0% Cash, Due 4/18	1,538,848	1,548,166	1,533,324
Las Vegas Sands, LLC Hotels, Motels, Inns, and Gaming	Term B Loan — 3.3% Cash, Due 12/20	3,201,595	3,172,481	3,174,782
Live Nation Entertainment, Inc. Leisure, Amusement, Motion Pictures, Entertainment	Term B-1 Loan — 3.5% Cash, Due 8/20	472,878	471,316	472,434
LPL Holdings, Inc. Finance	2021 Tranche B Term Loan — 4.3% Cash, Due 3/21	1,930,500	1,921,055	1,901,543
MCC Iowa LLC Broadcasting and Entertainment	Tranche J Term Loan — 3.8% Cash, Due 6/21	690,439	680,992	685,046
Mediacom Illinois, LLC (fka Mediacom Communications, LLC) Broadcasting and Entertainment	Tranche F Term Loan — 2.9% Cash, Due 3/18	5,895,000	5,886,840	5,801,063
National CineMedia, LLC Leisure, Amusement, Motion Pictures, Entertainment	Term Loan (2013) — 3.2% Cash, Due 11/19	1,000,000	995,545	996,250
NBTY, INC. Personal and Non Durable Consumer Products (Mfg. Only)	Term B-2 Loan — 3.5% Cash, Due 10/17	3,391,643	3,392,700	3,351,791
NEP/NCP Holdco, Inc. Broadcasting and Entertainment	Amendment No. 4 Incremental Term Loan (First Lien) — 4.3% Cash, Due 1/20	2,454,312	2,435,744	2,313,189
Newsday, LLC Printing and Publishing	Term Loan — 3.9% Cash, Due 10/16	3,984,627	3,989,720	3,989,608
Nielsen Finance LLC (VNU, Inc.) Broadcasting and Entertainment	Class B-1 Term Loan — 2.5% Cash, Due 5/17	5,402,525	5,407,617	5,400,283
NRG Energy, Inc. Utilities	Term Loan (2013) — 2.8% Cash, Due 7/18	955,481	954,306	932,191
OCI Beaumont LLC Chemicals, Plastics and Rubber	Term B-3 Loan — 6.5% Cash, Due 8/19	2,486,113	2,518,346	2,510,974
Omnova Solutions, Inc. Chemicals, Plastics and Rubber	Term B-1 Loan — 4.3% Cash, Due 5/18	359,276	358,928	358,827
Onex Carestream Finance LP Healthcare, Education and Childcare	Term Loan (First Lien 2013) — 5.0% Cash, Due 6/19	2,429,369	2,445,779	2,200,608
Pacific Drilling S.A. Oil and Gas	Term Loan — 4.5% Cash, Due 6/18	2,185,768	2,189,041	961,738
PetCo Animal Supplies, Inc. Retail Stores	New Loan — 4.0% Cash, Due 11/17	5,328,526	5,297,286	5,321,359

See accompanying notes to the financial statements.

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Portfolio Company/Principal Business	Investment			
	Interest Rate <sup>(1)</sup> /Maturity	Principal	Cost	Fair Value
Petroleum GEO-Services ASA (PGS Finance, Inc) <i>Oil and Gas</i>	Extended Term Loan — 3.3% Cash, Due 3/21	\$ 4,912,500	\$ 4,912,500	\$ 3,468,225
PQ Corporation <i>Chemicals, Plastics and Rubber</i>	2014 Term Loan — 4.0% Cash, Due 8/17	4,916,982	4,915,840	4,887,013
QCE, LLC (Quiznos) <sup>(2)</sup> <i>Personal, Food and Miscellaneous Services</i>	Existing Term Loan — 0.0% Cash, Due 9/20	449,499	449,486	59,932
Quikrete Holdings, Inc. <sup>(3)</sup> <i>Buildings and Real Estate</i> <sup>(3)</sup>	Initial Loan (First Lien) — 3.0% Cash, Due 9/20	2,230,000	2,218,850	2,208,748
R.H. Donnelley Inc. <i>Printing and Publishing</i>	Loan — 9.8% Cash, Due 4/22	421,935	420,869	181,565
Regal Cinemas Corporation <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Term Loan — 3.8% Cash, Due 11/17	963,677	969,660	962,728
Revlon Consumer Products Corporation <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Replacement Term Loan — 3.3% Cash, Due 12/18	4,480,361	4,498,987	4,476,150
Reynolds Group Holdings Inc. <i>Containers, Packaging and Glass</i>	Incremental U.S. Term Loan — 4.5% Cash, Due 10/17	2,058,619	2,058,619	2,042,109
RGIS Services, LLC <i>Diversified/Conglomerate Service</i>	Tranche C Term Loan — 5.5% Cash, Due 11/18	2,597,871	2,569,219	1,850,983
RPI Finance Trust <i>Healthcare, Education and Childcare</i>	Term B-3 Term Loan — 3.3% Cash, Due 6/18	2,487,277	2,506,353	2,483,385
Schaeffler AG (formerly named INA Beteiligungsgesellschaft mit beschränkter Haftung) <i>Automobile</i>	Facility B-USD — 4.3% Cash, Due 5/20	1,015,385	1,020,391	1,018,685
Select Medical Corporation <i>Healthcare, Education and Childcare</i>	Series E Tranche B Term Loan — 5.0% Cash, Due 1/18	2,104,406	2,092,431	2,091,254
Semiconductor Components Industries, LLC (On Semiconductor) <i>Electronics</i>	Term Loan — 2.1% Cash, Due 10/21	4,593,750	4,537,373	4,455,938
Sensata Technologies B.V. (Sensata Technologies Finance Company, LLC) <i>Electronics</i>	Sixth Amendment Term Loan — 3.0% Cash, Due 4/20	560,135	556,355	551,851
Sinclair Television Group, Inc. <i>Broadcasting and Entertainment</i>	New Tranche B Term Loan — 3.0% Cash, Due 9/19	66,983	66,865	65,978
Steinway Musical Instruments, Inc. <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Loan (First Lien) — 4.8% Cash, Due 3/19	2,000,000	1,985,239	1,972,500
Telesat Canada <i>Telecommunications</i>	U.S. Term B-2 Loan — 3.5% Cash, Due 12/17	2,960,078	2,937,884	2,920,605
TPF Generation Holdings, LLC <i>Utilities</i>	Term Loan — 4.8% Cash, Due 2/20	188,393	182,268	168,611
TransDigm Inc. <i>Aerospace and Defense</i>	Tranche C Term Loan — 3.8% Cash, Due 3/20	3,791,455	3,742,603	3,708,251
Tronox Pigments (Netherlands) B. V. <i>Chemicals, Plastics and Rubber</i>	New Term Loan — 4.5% Cash, Due 2/20	2,499,471	2,487,925	2,224,005
TWCC Holding Corp. <i>Broadcasting and Entertainment</i>	Term B-1 Loan — 5.8% Cash, Due 3/20	2,924,754	2,905,902	2,926,318
Univision Communications Inc. <i>Broadcasting and Entertainment</i>	Replacement First-Lien Term Loan — 4.0% Cash, Due 12/19	3,239,279	3,218,251	3,176,113
UPC Financing Partnership <i>Broadcasting and Entertainment</i>	Facility AH — 3.3% Cash, Due 6/21	700,000	704,142	688,517
Valeant Pharmaceuticals International, Inc. <i>Healthcare, Education and Childcare</i>	Series C-2 Tranche B Term Loan — 3.8% Cash, Due 10/19	1,389,000	1,343,190	1,344,205
Vertafore, Inc. <i>Electronics</i>	Term Loan (2013) — 4.3% Cash, Due 11/19	892,097	892,097	885,964
VFH Parent LLC <i>Finance</i>	Term Loan (2013) — 5.3% Cash, Due 12/20	985,103	994,592	980,177
Walter Investment Management Corp. <i>Finance</i>	Tranche B Term Loan — 4.8% Cash, Due 12/19	2,454,158	2,445,426	2,124,393
WESCO Distribution, Inc. <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Tranche B-1 Loan — 3.8% Cash, Due 6/18	\$ 249,643	\$ 248,233	\$ 248,551

See accompanying notes to the financial statements.



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Portfolio Company/Principal Business	Investment		Principal	Cost	Fair Value
	Interest Rate <sup>(1)</sup> /Maturity				
West Corporation	Term B-10 Loan —				
Diversified/Conglomerate Service	3.3% Cash, Due 7/17		3,776,796	3,756,691	3,722,844
WideOpenWest Finance, LLC	Term B-1 Loan 2013 —				
Telecommunications	3.8% Cash, Due 8/19		4,724,229	4,740,543	4,598,234
Windstream Services, LLC (fka Windstream Corporation)	Tranche B-5 Term Loan —				
Telecommunications	3.5% Cash, Due 2/17		5,954,430	5,954,430	5,801,848
WireCo WorldGroup Inc.	Term Loan —				
Machinery (Non-Agriculture, Non-Construction, Non-Electronic)	6.0% Cash, Due 2/20		1,829,576	1,825,076	1,767,828
Zuffa, LLC	Initial Term Loan —				
Leisure, Amusement, Motion Pictures, Entertainment	3.8% Cash, Due 6/19		2,294,791	2,287,980	2,242,011
<b>Total Investment in Debt Securities</b>			<u>246,578,754</u>	<u>244,325,246</u>	<u>234,403,150</u>

**Equity Securities Portfolio**

Portfolio Company/Principal Business	Equity Investment	Shares	Cost	Value <sup>(2)</sup>
Education Management Corporation <sup>(2)</sup>	Series A-1 Preferred Shares	2,670	\$ —	\$ 2,670
QCE, LLC (Quiznos) <sup>(2)</sup>	New Common Stock	1,256	—	160
<b>Total Investment in Equity Securities (100% of net asset value at fair value)</b>			<u>\$ —</u>	<u>\$ 2,830</u>

**CLO Securities Portfolio**

Portfolio Company	CLO Investment	Principal	Cost	Value
APID 2007-5A <sup>(1)</sup>				
CLO Rated Notes	Floating – 04/2021 – D – 03761XAG5	\$ 1,000,000	\$ 1,000,000	\$ 963,108
HLCNL 2007-2A <sup>(1)</sup>				
CLO Rated Notes	Floating – 04/2021 – D – 40537AAA3	3,000,000	2,968,134	2,902,077
MDPK 2007-4A <sup>(1)</sup>				
CLO Rated Notes	Floating – 03/2021 – D – 55817UAF7	2,000,000	2,000,000	1,869,623
NAVIG 2007-2A <sup>(1)</sup>				
CLO Rated Notes	Floating – 04/2021 – D – 63937HAD0	3,000,000	3,000,000	2,910,373
TRAL 2007-1A <sup>(1)</sup>				
CLO Rated Notes	Floating – 04/2022 – C – 89288BAG6	3,000,000	3,000,000	2,778,118
TRAL 2007-1A <sup>(1)</sup>				
CLO Rated Notes	Floating – 04/2022 – D – 89288AAA1	1,000,000	1,000,000	937,226
<b>Total Investment in CLO Rated Notes</b>		<u>13,000,000</u>	<u>12,968,134</u>	<u>12,360,525</u>
<b>Total Investments</b>		<u>\$ 259,578,754</u>	<u>\$ 257,293,380</u>	<u>\$ 246,766,505</u>

(1) Investment in a Collateralized Loan Obligation Fund

(2) Loan on non-accrual status

(3) Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators.

See accompanying notes to the financial statements.



**KATONAH 2007-I CLO LTD.**

**NOTES TO FINANCIAL STATEMENTS**

**1. ORGANIZATION**

Katonah 2007-I CLO LTD. (the “Fund”) is an exempted company incorporated in November 15, 2006 with limited liability under the laws of the Cayman Islands for the sole purpose of investing in broadly syndicated loans, high-yield bonds and other credit instruments. The Fund is what is commonly known as a collateralized loan obligation fund (“CLO Fund”).

A CLO Fund generally refers to a special purpose vehicle that owns a portfolio of investments and issues various tranches of debt and subordinated note securities to finance the purchase of those investments. Investments purchased by a CLO Fund are governed by extensive investment guidelines, including limits on exposure to any single industry or issuer and limits on the ratings of the CLO Fund’s assets. A CLO Fund has a defined investment period during which it is allowed to make investments or reinvest capital as it becomes available.

A CLO Fund typically issues multiple tranches of debt and subordinated note securities with varying ratings and levels of subordination to finance the purchase of their underlying investments. Interest and principal payments (net of designated CLO Fund expenses) from the CLO Fund are paid to each issued security in accordance with an agreed upon priority of payments, commonly referred to as the “waterfall.” The most senior notes, generally rated AAA/Aaa, commonly represent the majority of the total liabilities of the CLO Fund. AAA/Aaa notes are issued at a specified spread over LIBOR and normally have the first claim on the earnings on the CLO Fund’s investments after payment of certain fees and expenses. Lower subordinated “mezzanine” tranches of rated notes generally have ratings ranging from AA/Aa to BB/Ba and are usually issued at a specified spread over LIBOR with higher spreads paid on the tranches with lower ratings. Each tranche is typically only entitled to a share of the earnings on the CLO Fund’s investments if the required interest and principal payments have been made on the more senior tranches in the waterfall. The most junior tranche can take the form of either subordinated notes or preferred shares. The subordinated notes or preferred shares generally do not have a stated coupon but are entitled to residual cash flows from the CLO Fund’s investments after all of the other tranches of notes and certain other fees and expenses are paid.

On January 23, 2008, the Fund sold \$323.9 million of notes or debt securities, consisting of Class A-1L Floating Rate Notes, Class A-2L Floating Rate Notes, Class A-3L Floating Rate Notes, Class B-1L Floating Rate Notes, Class B-2L Floating Rate Notes (“Class B-2L Notes”) and preferred shares. The notes were issued pursuant to an indenture, dated January 23, 2008 (the “Indenture”), with U.S. Bank National Association servicing as the trustee thereunder. KCAP Financial, Inc. (“KCAP Financial”) owns all of the preferred shares of Katonah 2007-I CLO LTD. The Fund’s defined investment period ended on April 22, 2014. Following the defined investment period, proceeds from principal payments in the investment portfolio of the Fund are used to pay down its outstanding notes, starting with Class A notes.

Pursuant to a collateral management agreement (the “Collateral Management Agreement”), Katonah 2007-1 Management, L.L.C. (the “Manager”), which is an indirect wholly-owned portfolio company of KCAP Financial, provides investment management services to the Fund, and makes day-to-day investment decisions concerning the assets of the Fund. The Manager also performs certain administrative services on behalf of the Fund under the Collateral Management Agreement. The Manager is a registered investment adviser under the Investment Advisers Act of 1940.

**2. SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Accounting and Combination**

The financial statements of the Fund have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”). In the opinion of the Manager’s management, the financial statements of the Fund reflect all adjustments, consisting of normal recurring accruals, which are necessary for the fair presentation of the financial condition and results of operations for the periods presented. Furthermore, the preparation of the financial statements requires management to make significant estimates and assumptions

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

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.

All of the investments held and notes issued by the Fund are presented at fair value in the Fund's Statements of Net Assets.

*Investments of the Fund at Fair Value.* Investment transactions are recorded on the applicable trade date. Realized gains or losses are determined using the specific identification method. Investments held by the Fund are stated at fair value. ASC 820-10, Fair Value Measurements and Disclosures ("ASC 820-10"), requires among other things, disclosures about assets and liabilities that are measured and reported at fair value.

*Hierarchy of Fair Value Inputs.* The provisions of ASC 820-10 establish a hierarchy that prioritizes inputs to valuation techniques used to measure fair value and require companies to disclose the fair value of their financial instruments according to the fair value hierarchy (i.e., Level 1, 2 and 3 inputs, as defined). The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Additionally, companies are required to provide additional disclosure regarding instruments in the Level 3 category (which have inputs to the valuation techniques that are unobservable and require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities.

Assets and liabilities measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1 Inputs:

Quoted prices (unadjusted) in active markets for identical assets or liabilities at the reporting date.

- Level 1 assets may include listed mutual funds, ETFs, equities and certain derivatives.

Level 2 Inputs:

Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; quotes from pricing services or brokers, for which the Manager can determine that orderly transactions took place at the quoted price or that the inputs used to arrive at the price were observable; and inputs other than quoted prices that are observable, such as models or other valuation methodologies.

- Level 2 assets in this category may include debt securities, bank loans, short-term floating rate notes and asset-backed securities, restricted public securities valued at a discount, as well as over the counter derivatives, including interest and inflation rate swaps and foreign currency exchange contracts that have inputs to the valuations that generally can be corroborated by observable market data.

Level 3 Inputs:

Unobservable inputs for the valuation of the asset or liability, which may include non-binding broker quotes. Level 3 assets include investments for which there is little, if any, market activity. These inputs require significant management judgment or estimation.

- Level 3 assets in this category may include general and limited partnership interests in private equity funds, funds of private equity funds, real estate funds, hedge funds, and funds of hedge funds, direct private equity investments held within consolidated funds, bank loans, bonds issued by CLO Funds and certain held for sale real estate disposal assets.
- Level 3 liabilities included in this category include borrowings of consolidated collateralized loan obligations valued based upon non-binding broker quotes or discounted cash flow model based on a discount margin calculation.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

Significance of Inputs:

The Manager's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument.

*Valuation of Portfolio Investments.* 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 based on detailed analyses prepared by management, and, in certain circumstances, may utilize third parties with valuation expertise. The Manager follows the provisions of ASC 820-10 with respect to preparing the Fund's financial statements. This standard defines fair value, establishes a framework for measuring fair value, and expands disclosures about assets and liabilities measured at fair value. ASC 820-10 defines "fair value" as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Subsequent to the adoption of ASC 820-10, the FASB has issued various staff positions clarifying the initial standard as noted below.

*Fair Value Measurements and Disclosures* requires the disclosure 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 Manager's valuation methodology and procedures for investments held by the Fund are generally as follows:

1. For any asset which is also held by KCAP Financial on the applicable date, the KCAP Financial fair value mark as of such applicable date is used.
2. 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 whether the quote is from a transaction or is a broker quote, the date and aging of such quote, whether the transaction is arms-length, whether it is of a liquidation or distressed nature and certain other factors judged to be relevant by the Manager's management within the framework of ASC 820-10.
3. 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 Manager's investment professionals responsible for the portfolio investment in conjunction with the portfolio management team. Generally, such fair values 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.
4. Preliminary valuation conclusions are discussed and documented by the Manager's management.

KATONAH 2007-I CLO LTD.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES – (continued)

5. Illiquid loans, junior and mezzanine securities and investments in other CLO bonds are fair valued using models developed by the Manager's management with applicable market assumptions.
6. The Manager's management 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, and estimates from independent valuation firms (if any).

*Debt Securities.* Most of the Fund's investment portfolio is composed of broadly syndicated debt securities for which an independent pricing service quote is available. To the extent that the 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.

*CLO Fund Securities.* The Fund may selectively invest in securities issued by CLO Funds managed by other asset management companies. For bond rated tranches of CLO Funds (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.* Cash is defined as demand deposits. The Fund holds its cash with financial institutions and, at times, cash held in checking accounts may exceed the Federal Deposit Insurance Corporation insured limit.

*Debt at Fair Value.* The Fund has issued rated and unrated bonds to finance its operations. Debt is presented at fair value.

*Interest Income.* Interest income is recorded on the accrual basis on interest-bearing assets. The Fund generally places a loan or security on non-accrual status and ceases recognizing cash interest income on such loan or security when a loan or security becomes 90 days or more past due or if Manager otherwise does not expect the debtor to be able to service its debt obligations.

*Management Fees.* The Fund is externally managed by the Manager pursuant to the Collateral Management Agreement. As compensation for the performance of its obligations under the Collateral Management Agreement, the Manager is entitled to receive from the Fund a senior collateral management fee (the "Senior Collateral Management Fee"), a subordinated collateral management fee (the "Subordinated Collateral Management Fee") and an incentive collateral management fee (the "Incentive Collateral Management Fee"). The Senior Collateral Management Fee is payable in arrears quarterly (subject to availability of funds and to the satisfaction of payment obligations on the debt obligations of the Fund (the "Priority of Payments")) in an amount equal to 0.10% per annum of the aggregate principal amount of the Fund's investments. The Subordinated Collateral Management Fee is payable in arrears quarterly (subject to availability of funds and to the Priority of Payments) in an amount equal to 0.15% per annum of the aggregate principal amount of the Fund's investments. The Incentive Collateral Management Fee equals 20% of the amount of interest and principal payments remaining available for distribution to the holders of the Fund's preferred shares under the Priority of Payments at which the Incentive Collateral Management Fee may be paid. For the years ended December 31, 2016, 2015 and 2014, there were no Incentive Fees incurred by the Fund.

**KATONAH 2007-I CLO LTD.**

**NOTES TO FINANCIAL STATEMENTS**

**2. SIGNIFICANT ACCOUNTING POLICIES – (continued)**

*Interest Expenses.* The Fund has issued rated and unrated bonds to finance its operations. Interest on debt is calculated by the third party trustee of the Fund. Interest is accrued and generally paid quarterly.

*Trustee Fees.* The Fund has a third party trustee that is the custodian for all investments of the Fund and receives and disburses all cash in accordance to the trustee and custodial agreements. Trustee fees are accrued and paid quarterly by the Fund.

*Income Taxes.* The Fund is not subject to net income taxation in the United States or the Cayman Islands. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

**3. INVESTMENTS**

The investments held by the Fund are primarily invested in senior secured bank loans (typically syndicated by banks), bonds, and equity securities. Bank loan investments, which comprise the majority of the Fund's portfolio, are senior secured corporate loans from a variety of industries, including but not limited to the aerospace and defense, broadcasting, technology, utilities, household products, healthcare, oil and gas, and finance industries. The investments mature at various dates between 2017 and 2022, pay interest at Libor or Prime plus a spread of up to 1.5%, and typically range in credit rating categories from BBB down to unrated. Non-accrual loans represented less than 1% of investments at fair value as of December 31, 2016 and December 31, 2015. The aggregate unpaid principal value of loans past due as of December 31, 2016 and December 31, 2015 was approximately \$449,000 and \$1.1 million, respectively and the difference between fair value and the unpaid principal balance was approximately \$413,000 and \$934,000, respectively. The Fund's investments are valued based on price quotations provided by an independent third-party pricing source which are indicative of traded prices and/or dealer price quotations. In the event that a third-party pricing source is unable to price an investment, other relevant factors, data and information are considered, including: i) information relating to the market for the investment, including price quotations for and trading in the investment and interest in similar investments and the market environment and investor attitudes towards the investment and interests in similar investments; ii) the characteristics of and fundamental analytical data relating to the investment, including the cost, size, current interest rate, period until next interest rate reset, maturity and base lending rate, the terms and conditions of the loan and any related agreements, and the position of the loan in the issuer's debt structure; iii) the nature, adequacy and value of the senior secured corporate loan's collateral, including the CLO's rights, remedies and interests with respect to the collateral; iv) the creditworthiness of the borrower, based on an evaluation of its financial condition, financial statements and information about the business, cash flows, capital structure and future prospects; v) the reputation and financial condition of the agent and any intermediate participants in the senior secured corporate loan; and vi) general economic and market conditions affecting the fair value of the senior secured corporate loan.

The debt issued by the Fund has a stated maturity date of April 23, 2022. The Fund's debt was issued in various tranches with different risk profiles and ratings. The interest rates are variable rates based on Libor plus a pre-defined spread, which varies from 0.85% for the more senior tranches to 5% for the more subordinated tranches. The debt issued by the Fund is recorded at fair value using an income approach, driven by cash flows expected to be received from the portfolio collateral assets. Fair value is determined using current information, notably market yields and projected cash flows of collateral assets based on forecasted default and recovery rates that a market participant would use in determining the current fair value of the liabilities, taking into account the overall credit quality of the issuers and the Manager's past experience in managing similar securities. Market yields, default rates and recovery rates used in the Manager's estimate of fair value vary based on the nature of the investments in the underlying collateral pools. In periods of rising market yields, default rates and lower debt recovery rates, the fair value, and therefore the carrying value, of the liabilities may be adversely affected. Once the undiscounted cash flows of the collateral assets have been determined, the Manager applies appropriate discount rates that a market participant would use to determine the discounted cash flow valuation of the notes.

**KATONAH 2007-I CLO LTD.**

**NOTES TO FINANCIAL STATEMENTS**

**3. INVESTMENTS – (continued)**

The carrying value of investments held and debt issued by the Fund is also their fair value. The following tables present the fair value hierarchy levels of investments held and debt issued by the Fund, which are measured at fair value as of December 31, 2016 and December 31, 2015:

<b>December 31, 2016</b>				
(\$ in millions)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Investments	\$ 176,684,976	—	—	\$ 176,684,976
<b>Liabilities:</b>				
CLO Fund Liabilities	\$ 208,812,164	—	—	\$ 208,812,164
<b>December 31, 2015</b>				
(\$ in millions)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Investments	\$ 246,766,505	—	—	\$ 246,766,505
<b>Liabilities:</b>				
CLO Fund Liabilities	\$ 261,433,473	—	—	\$ 261,433,473

The following tables show a reconciliation of the beginning and ending fair value measurements for Level 3 assets using significant unobservable inputs:

	<b>For the year ended December 31, 2016</b>
Beginning balance	\$ 246,766,505
Purchase of investments	82,554,227
Proceeds from sale and redemption of investments	(159,676,298)
Net Realized and Unrealized (losses)	7,040,542
Ending balance	<u>\$ 176,684,976</u>
Changes in unrealized appreciation (depreciation) included in earnings related to investments still held at reporting date	\$ 3,636,405
	<b>For the year ended December 31, 2015</b>
Beginning balance	\$ 273,373,948
Purchase of investments	93,243,381
Proceeds from sale and redemption of investments	(113,199,395)
Net realized and unrealized (losses)	(6,651,429)
Ending balance	<u>\$ 246,766,505</u>
Changes in unrealized appreciation (depreciation) included in earnings related to investments still held at reporting date	\$ (5,313,969)

**KATONAH 2007-I CLO LTD.**

**NOTES TO FINANCIAL STATEMENTS**

**3. INVESTMENTS – (continued)**

As of December 31, 2016, the Manager’s Level 3 portfolio investments had the following valuation techniques and significant inputs:

<u>Type</u>	<u>Fair Value</u>	<u>Valuation Technique</u>	<u>Unobservable inputs</u>	<u>Range of Inputs</u>
Debt Securities			Implied Effective	
	\$ 3,787,243	Income Approach	Discount Rate	6.72% – 7.89%
	166,915,409	Market Quote	Third-Party Bid-Ask Mid	4.9% – 102.0%
Equity Securities	150,524	Market Quote	Third-Party Bid-Ask Mid	0.25 – 2.50
CLO Fund Securities	5,831,800	Discounted Cash Flow	Discount Rate	3.52% – 5.57%
	<u>\$176,684,976</u>			

As of December 31, 2015, the Manager’s Level 3 portfolio investments had the following valuation techniques and significant inputs:

<u>Type</u>	<u>Fair Value</u>	<u>Valuation Technique</u>	<u>Unobservable inputs</u>	<u>Range of Inputs</u>
Debt Securities			Third-Party Bid-Ask Mid	10.8% – 101.0%
Equity Securities	2,830	Market Quote	Third-Party Bid-Ask Mid	0.13 – 1.0
CLO Fund Securities	12,360,525	Discounted Cash Flow	Discount Rate	3.82% – 5.89%
	<u>\$246,766,505</u>			

The following tables show a reconciliation of the beginning and ending fair value measurements for Level 3 liabilities using significant unobservable inputs:

	<b>For the year ended December 31, 2016</b>
Beginning balance	\$ 261,433,473
Repayments	(54,179,244)
Unrealized depreciation	1,557,935
Ending balance	<u>\$ 208,812,164</u>
Changes in unrealized appreciation (depreciation) included in earnings related to liabilities still held at reporting date	\$ 1,557,935
	<b>For the year ended December 31, 2015</b>
Beginning balance	\$ 290,699,426
Repayments	(23,002,449)
Unrealized depreciation	(6,263,504)
Ending balance	<u>\$ 261,433,473</u>
Changes in unrealized appreciation included in earnings related to liabilities still held at reporting date	\$ (6,263,504)

**KATONAH 2007-I CLO LTD.**

**NOTES TO FINANCIAL STATEMENTS**

**3. INVESTMENTS – (continued)**

Transfers between levels, if any, are recognized at the beginning of the quarter in which the transfers occur. ASC 820-10 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. In accordance with ASC 820-10, these inputs are summarized in the three broad levels listed below.

- Level 1 — Valuations based on quoted prices in active markets for identical assets or liabilities that the Fund has the ability to access.
- Level 2 — Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly
- Level 3 — Valuations based on inputs that are unobservable and significant to the overall fair value measurement

The Fund's debt is presented at fair value with the difference between principal and fair value recorded as unrealized gain/loss. The par amount of the Fund's debt is approximately \$220 million and \$274 million as of December 31, 2016 and December 31, 2015, respectively.

The Manager has determined that, although the junior tranches have certain characteristics of equity, they should be accounted for and disclosed as debt on the Fund's Statement of Net Assets, as the subordinated and income notes have a stated maturity indicating a date for which they are mandatorily redeemable. The preference shares are also classified as debt, as they are mandatorily redeemable upon liquidation or termination of the Fund.

**4. INCOME TAXES**

Under the current laws, the Fund is not subject to net income taxation in the United States or the Cayman Islands. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

Pursuant to ASC Topic 740, *Accounting for Uncertainty in Income Taxes*, the Fund adopted the provisions of Financial Accounting Standards Board ("FASB") relating to accounting for uncertainty in income taxes which clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position must meet before being recognized in the financial statements and applies to all open tax years as of the effective date. As of December 31, 2016 and 2015 there was no impact to the financial statements as a result of the Fund's accounting for uncertainty in income taxes. The Fund does not have any unrecognized tax benefits or liabilities for the years ended December 31, 2016, 2015 and 2014. Also, the Fund recognizes interest and, if applicable, penalties for any uncertain tax positions, as a component of income tax expense. No interest or penalty expense was recorded by the Fund for the years ended December 31, 2016, 2015 and 2014.



**KATONAH 2007-I CLO LTD.****NOTES TO FINANCIAL STATEMENTS****5. DEBT**

On January 23, 2008, the Fund issued \$323.9 million of notes or debt securities, consisting of the Class A-1L Floating Rate Notes, the Class A-2L Floating Rate Notes, the Class A-3L Floating Rate Notes, the Class B-1L Floating Rate Notes, the Class B-2L Floating Rate Notes and the preferred shares. The notes were issued pursuant to the Indenture. The table below sets forth certain information for each outstanding class of debt securities issued pursuant to the Indenture.

<u>Title of Debt Security</u>	<u>Principal Amount</u>	<u>Amount Outstanding</u>	<u>Interest Rate</u>	<u>Maturity</u>	<u>Fair Value</u>
Class A-1L Floating Rate Notes	\$122,686,300	\$122,686,300	LIBOR + 0.85%	April 23, 2022	\$ 122,673,114
Class A-2L Floating Rate Notes	26,000,000	26,000,000	LIBOR + 1.50%	April 23, 2022	26,062,401
Class A-3L Floating Rate Notes	18,000,000	18,000,000	LIBOR + 2.00%	April 23, 2022	18,059,400
Class B-1L Floating Rate Notes	11,000,000	11,000,000	LIBOR + 3.00%	April 23, 2022	11,025,300
Class B-2L Floating Rate Notes	10,500,000	10,500,000	LIBOR + 5.00%	April 23, 2022	10,538,850
Preferred Shares	31,411,736	31,411,736	N/A	April 23, 2022	20,453,099
	<u>\$219,598,036</u>	<u>\$219,598,036</u>			<u>\$ 208,812,164</u>

During 2016 and 2015, approximately \$54 million and \$23 million of the Class A-1L Floating Rate Notes was repaid in the normal course of business of the Fund, respectively.

**6. COMMITMENTS AND CONTINGENCIES**

As of December 31, 2016 and 2015 the Fund had no commitments to fund investments.

**7. CAPITALIZATION**

The authorized share capital of the Fund is \$32,250, consisting of 250 ordinary shares of \$1.00 par value, each of which are issued and fully paid, and 32,000,000 preferred shares, 31,411,736 of which are issued and fully paid. The ordinary shares that have been issued are held by Maples Finance Limited, a licensed trust company incorporated in the Cayman Islands, as the trustee pursuant to the terms of a charitable trust. The preferred shares that have been issued by the Fund are owned by KCAP Financial. The preferred shares are classified as debt in the Fund's financial statements, as they are mandatorily redeemable upon liquidation or termination of the Fund.

**8. SUBSEQUENT EVENTS**

The Fund has evaluated events and transactions occurring subsequent to December 31, 2016 for items that should potentially be recognized or disclosed in these financial statements. Management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these financial statements.

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EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
<u>3.1</u>	<u>Form of Certificate of Incorporation of the Company.<sup>(1)</sup></u>
<u>3.2</u>	<u>Form of Bylaws of the Company, as amended and restated effective February 29, 2012.<sup>(2)</sup></u>
<u>4.1</u>	<u>Specimen certificate of the Company's common stock, par value \$0.01 per share.<sup>(1)</sup></u>
<u>4.2</u>	<u>Form of Dividend Reinvestment Plan.<sup>(3)</sup></u>
<u>4.3</u>	<u>Form of Base Indenture between the Company and U.S. Bank National Association relating to the 7.375% Senior Notes Due 2019<sup>(4)</sup></u>
<u>4.4</u>	<u>Form of First Supplemental Indenture between the Company and U.S. Bank National Association relating to the 7.375% Senior Notes Due 2019<sup>(4)</sup></u>
<u>4.5</u>	<u>Form of Note relating to the 7.375% Senior Notes Due 2019 (included as part of Exhibit 4.4)</u>
<u>4.6</u>	<u>Second Supplemental Indenture between the Company and U.S. Bank National Association relating to the 6.125% Notes Due 2022<sup>(8)</sup></u>
<u>4.7</u>	<u>Form of 6.125% Notes Due 2022 (included as part of Exhibit 4.6).<sup>(8)</sup></u>
<u>10.1</u>	<u>KCAP Financial, Inc. 2017 Equity Incentive Plan.<sup>(9)*</sup></u>
<u>10.2</u>	<u>KCAP Financial, Inc. 2017 Non-Employee Director Plan.<sup>(10)*</sup></u>
<u>10.3</u>	<u>Form of Company Non-Qualified Stock Option Certificate.<sup>(3)*</sup></u>
<u>10.4</u>	<u>Form of Custodian Agreement.<sup>(3)</sup></u>
<u>10.5</u>	<u>Form of Overhead Allocation Agreement between the Company and Katonah Debt Advisors, L.L.C.<sup>(3)</sup></u>
<u>10.6</u>	<u>Form of Executive Employment Agreement.<sup>(6)*</sup></u>
<u>10.7</u>	<u>Form of Indemnification Agreement for Officers and Directors of the Company.<sup>(7)</sup></u>
<u>10.8</u>	<u>Amended and Restated Limited Liability Company Agreement of KCAP Freedom 3 LLC, dated July 19, 2017, by and between KCAP Financial, Inc. and Freedom 3 Opportunities LLC<sup>(11)</sup></u>
<u>10.9</u>	<u>Loan and Security Agreement, dated as of March 1, 2018, by and among KCAP Funding I, LLC, KCAP Financial, Inc., the financial institutions party to the Agreement from time to time as lenders, State Bank and Trust Company, CIBC Bank USA**</u>
<u>11.1</u>	<u>Computation of Per Share Earnings (included in the notes to the audited financial statements contained in this report).</u>
<u>21.1</u>	<u>List of Subsidiaries.**</u>
<u>23.1</u>	<u>Consent of Ernst &amp; Young LLP, Independent Registered Public Accounting Firm relating to KCAP Financial, Inc.**</u>
<u>23.2</u>	<u>Consent of Ernst &amp; Young LLP, Independent Auditors relating to the Asset Manager Affiliates.**</u>
<u>23.3</u>	<u>Consent of Ernst &amp; Young LLP, Independent Auditors relating to Katonah 2007-I CLO.**</u>
<u>31.1</u>	<u>Chief Executive Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**</u>
<u>31.2</u>	<u>Chief Financial Officer Certification Pursuant to Rule 13a-14 of the Securities Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**</u>
<u>32.1</u>	<u>Chief 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.**</u>
<u>32.2</u>	<u>Chief 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.**</u>

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(1) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 1 on Form N-2, as filed on October 6, 2006 (File No. 333-136714).

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- (2) Incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).
- (3) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 2 to the Registration Statement on Form N-2, as filed on November 20, 2006 (File No. 333-136714).
- (4) Incorporated by reference to exhibit included in the Registration Statement in Form N-2, as filed on October 3, 2012 (File No. 333-183032).
- (5) Incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q, as filed on August 5, 2015 (File No. 814-00735).
- (6) Incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q, as filed on May 6, 2015 (File No. 814-00735).
- (7) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2, as filed on November 24, 2006 (File No. 333-136714).
- (8) Incorporated by reference to exhibit included in Post-Effective Amendment No. 1 to the Registration Statement in Form N-2, as filed on August 14, 2017 (File No. 333-218596).
- (9) Incorporated by reference to Exhibit 4.1 included in the Registration Statement on Form S-8, as filed on June 8, 2017 (File No. 333-218594).
- (10) Incorporated by reference to Exhibit 4.4 included in the Registration Statement on Form S-8, as filed on June 8, 2017 (File No. 333-218594)
- (11) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, as filed on July 20, 2017 (File No. 814-00735).

\* Indicates a management contract or compensatory plan, contract or agreement.

\*\* Filed herewith.

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**KCAP FUNDING I, LLC,**

as Borrower

**KCAP FINANCIAL, INC.,** as Servicer

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**LOAN AND SECURITY AGREEMENT**

Dated as of March 1, 2018

\$50,000,000

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**CERTAIN FINANCIAL INSTITUTIONS,**

as Lenders

**STATE BANK AND TRUST COMPANY,**

as Administrative Agent, Lead Arranger, and Bookrunner

and

**CIBC BANK USA,** as Documentation Agent

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Exhibit B	Compliance Certificate
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Schedule 1	Commitments of Lenders
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Schedule 13	Industry Classification Groups

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## LOAN AND SECURITY AGREEMENT

**THIS LOAN AND SECURITY AGREEMENT** is dated as of March 1, 2018, among **KCAP FUNDING I, LLC**, a Delaware limited liability company (“Borrower”), **KCAP FINANCIAL, INC.**, a Delaware corporation (“Servicer”), the financial institutions party to this Agreement from time to time as lenders (collectively, “Lenders”), and **STATE BANK AND TRUST COMPANY**, a state banking institution incorporated or otherwise organized under the laws of the State of Georgia, as agent for the Lenders (in such capacity, “Agent”).

### RECITALS:

Borrower has requested that Lenders make available a revolving credit facility to Borrower, which shall be used by Borrower to finance its general working capital and corporate needs. Lenders will make loans to Borrower under the revolving credit facility in accordance with the provisions hereinafter set forth.

**NOW, THEREFORE**, for valuable consideration hereby acknowledged, the parties agree as follows:

### **SECTION 1. DEFINITIONS; RULES OF CONSTRUCTION**

1.1 **Definitions.** As used herein, the following terms have the meanings set forth below:

“Adjusted Interest Expense” means the sum of (x) cash interest paid in respect of the stated rate of interest (including any Default Rate, if applicable) applicable to any Indebtedness plus (y) the net amount paid in cash (or minus the net amount received in cash) under Hedging Agreements permitted hereunder relating to interest during such period and to the extent not already taken into account under clause (x).

“Administrative Expenses” means (a) fees and expenses (including indemnities) and other amounts owed by the Borrower or any Subsidiary paid or payable to the Custodian or the Backup Servicer, and (b) expenses incurred by the Servicer in connection with the Services provided under the Servicing Agreement.

“Advance Rate” means, as to any Eligible Portfolio Investment and subject to adjustment as provided above, the following percentages with respect to such Eligible Portfolio Investment:

<u>Eligible Portfolio Investment</u>	<u>Unquoted Investments</u>	<u>Quoted Investments</u>
Cash and Cash Equivalents (including Short-Term U.S. Government Securities)	n/a	100%
Long-Term U.S. Government Securities	n/a	85%
Performing First Lien Bank Loans	65%	75%
Performing Last Out Loans	55%	65%
Performing Second Lien Bank Loans	50%	60%
Performing High Yield Securities	45%	55%
Performing Mezzanine Investments	40%	50%

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“Affiliate” means a Person: (a) which directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, another Person; (b) which beneficially owns or holds 10% or more of any class of the Equity Interests of a Person; or (c) 10% or more of the Equity Interests with power to vote of which is beneficially owned or held by another Person or a Subsidiary of another Person. For purposes hereof, “control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of any Equity Interest, by contract or otherwise.

“Agent Indemnitees” means Agent and all of Agent’s officers, directors, employees, Affiliates, agents and attorneys.

“Anti-Corruption Laws” means all laws, rules and regulations of any jurisdiction applicable to Borrower or any of its Subsidiaries from time to time concerning or relating to bribery or corruption.

“AloStar” means State Bank and Trust Company, a state banking institution incorporated or otherwise organized under the laws of the State of Georgia, and its successors and assigns.

“Anti-Terrorism Law” means any law relating to terrorism or money laundering, including the PATRIOT Act.

“Applicable Law” means all laws, rules, regulations and governmental guidelines applicable to the Person, conduct, transaction, agreement or matter in question, including all applicable statutory law ordinances, common law and equitable principles, and all provisions of constitutions, treaties, statutes, rules, regulations, orders and decrees of all governmental authorities, including all Environmental Laws, the Occupational Safety and Hazard Act of 1970, ERISA, the Fair Labor Standards Act of 1938, and any other laws regarding the collection, payment and deposit of Taxes.

“Applicable Margin” means 3.25% per annum.

“Approved Dealer” means (a) in the case of any Eligible Portfolio Investment that is not a U.S. Government Security, a bank or a broker-dealer registered under the Securities Exchange Act of 1934 of nationally recognized standing or an Affiliate thereof and (b) in the case of a U.S. Government Security, any primary dealer in U.S. Government Securities, in the case of each of clauses (a) and (b) above, as set forth on Schedule 11, or (c) any other bank or broker-dealer acceptable to the Agent in its Permitted Discretion

“Approved Fund” means any Fund that is administered or managed by (a) a Lender, (b) an Affiliate of a Lender (c) an entity or an Affiliate of an entity that administers or manages a Lender, or (d) the same investment advisor or an advisor under common control with such Lender, Affiliate or advisor, as applicable.

“Approved Pricing Service” means (a) a pricing or quotation service as set forth in Schedule 11 or (b) any other pricing or quotation service (i) approved by the Borrower, (ii) designated in writing by Borrower to the Agent, and (iii) acceptable to the Agent in its Permitted Discretion.

“Approved Third-Party Appraiser” means any Independent nationally recognized third-party appraisal firm engaged by the Borrower, at its own expense, as part of its valuation procedures or any other third-party appraisal firm selected by the Borrower and acceptable to the Agent; provided that, if any proposed appraiser requests or requires a non-reliance letter, confidentiality agreement or similar agreement prior to allowing the Agent to review any written valuation report, such Person shall only be deemed an Approved Third-Party Appraiser if the Agent and such Approved Third-Party Appraiser shall have entered into such a letter or agreement. Subject to the foregoing, it is understood and agreed that each of Duff & Phelps LLC, Murray, Devine and Company, Lincoln Partners Advisors, LLC, Houlihan Lokey, Stout Risius Ross, Inc., Valuation Research Corporation and Alvarez & Marsal are acceptable to the Agent solely to the extent they are not serving as the Independent Valuation Provider.

“Asset Coverage Ratio” means the ratio, determined on a consolidated basis, without duplication, in accordance with GAAP, of (a) the value of total assets of Borrower (excluding any Investment constituting the Equity Interest in any other Person to the extent such Equity Interest (x) is not pledged as Collateral or (y) is not subject to a first priority perfected lien in favor of the Agent), less all liabilities not constituting Indebtedness of Borrower to (b) the aggregate amount of Indebtedness of Borrower.

“Assignment and Acceptance” means an assignment agreement between a Lender and Eligible Assignee, and accepted by Agent, in the form of **Exhibit A**.

“Availability” means an amount equal to the Borrowing Base minus the principal balance of all Revolver Loans, provided, that on and after the Commitment Termination Date, Availability shall be zero.

“Backup Servicer” means a backup servicer appointed by Borrower after the Closing Date and acceptable to Agent, its successor in interest pursuant to **Section 14.5** or such Person as shall have been appointed as Backup Servicer pursuant to **Section 14.7**.

“Backup Servicer Termination Notice” has the meaning specified in **Section 14.7**.

“Bank Loans” means commercial loans (including term loans, revolving loans, debtor-in-possession financings, the funded portion of revolving credit lines and letter of credit facilities and other similar loans and investments including interim loans, bridge loans and senior subordinated loans and Participation Interests in any of the foregoing) that are generally provided under a syndicated loan or credit facility or pursuant to any loan agreement or other similar credit facility, whether or not syndicated.

“Bank Product” means any of the following products, services or facilities extended to Borrower by a Lender or any of its Affiliates: (a) Cash Management Services; (b) products under Hedging Agreements; (c) commercial credit card and merchant card services; and (d) leases and other banking products or services as may be requested by Borrower.

“Bank Product Reserve” means the aggregate amount of reserves established by Agent from time to time in its discretion in respect of Secured Bank Product Obligations.

“Bankruptcy Code” means Title 11 of the United States Code.

“Base Rate” means, on any day, a per annum rate equal to the U.S. prime rate as shown in The Wall Street Journal on such day, or, if such day is not a Business Day, on the immediately preceding Business Day. If The Wall Street Journal for any reason ceases to publish a U.S. prime rate, then the Base Rate shall be such prime rate as published from time to time in any other publication or reference source designated by Agent in its discretion. The prime rate is a reference rate and does not necessarily represent the best or lowest rate charged by any Lender.

“Base Rate Loan” means a Loan, or portion thereof, during any period in which it bears interest at a rate based upon the Base Rate.

“Base Rate Revolver Loan” means a Revolver Loan, or portion thereof, during any period in which it bears interest at a rate based upon the Base Rate.

“Board of Governors” means the Board of Governors of the Federal Reserve System.

“Borrowed Money” means with respect to any Person, without duplication, its (a) Debt that (i) arises from the lending of money by any other Person to such Person, (ii) is evidenced by notes, drafts, bonds, debentures, credit documents or similar instruments, (iii) accrues interest or is a type upon which interest charges are customarily paid (excluding trade payables owing in the Ordinary Course of Business), or (iv) was issued or assumed as full or partial payment for Property; (b) Capitalized Lease Obligations and Debt for the deferred payment by one year or more of any purchase money obligation; (c) reimbursement obligations with respect to letters of credit; and (d) guaranties of any Debt of the foregoing types owing by another Person: and (e) any Debt payable by such Person which is subordinate in right of payment to the Obligations or with respect to which the Liens securing such Debt are subordinated to Agent’s Liens.

“Borrower Expenses” means (a) taxes, registration, registered office and filing fees, if any, of the Borrower or any Subsidiary, (b) indemnification obligations paid or payable by Borrower or any Subsidiary to Borrower’s or any Subsidiary’s directors or managers under its Organic Documents, and (c) any other fees or expenses (including indemnities) paid or payable by Borrower or any Subsidiary to any other Person and not prohibited under, or incurred pursuant to or in connection with, the Transaction Documents.

“Borrowing” means a borrowing consisting of Loans made on the same day by Lenders (or by Agent in the case of a Borrowing funded by Swingline Loans).

“Borrowing Base” has the meaning set forth in **Section 9.1.10** hereto.

“Borrowing Base Certificate” means a certificate, in the form of **Exhibit E** attached hereto, by which Borrower certifies calculation of the Borrowing Base, with appropriate insertions, and which is submitted to Agent by Borrower pursuant to this Agreement and certified as true and correct by a Senior Officer (which certificate may be submitted electronically subject to the limitations set forth in **Section 13.2.2**).

“Business Day” means any day other than a Saturday, Sunday, each day on which Agent is otherwise closed for transacting business with the public or other day on which commercial banks are authorized to close under the laws of, or are in fact closed in, Georgia or Massachusetts, and if such day relates to a LIBOR Index Loan, any such day on which dealings in Dollar deposits are conducted between banks in the London interbank Eurodollar market.

“Capitalized Lease Obligation” means any Debt represented by obligations under a lease that is required to be capitalized for financial reporting purposes in accordance with GAAP.

“Cash” means any immediately available funds in Dollars.

“Cash Collateral” means cash, and any interest or other income earned thereon, that is delivered to Agent to Cash Collateralize any Obligations and all interest and other income earned (if any) on such cash.

“Cash Collateral Account” means a demand deposit, money market or other account maintained with Agent and subject to Agent's Liens.

“Cash Collateralize” means the delivery of cash to Agent, as security for the payment of Obligations, in an amount equal to Agent's good faith estimate of the amount that is due or could become due, including all fees and other amounts relating to such Obligations. “Cash Collateralization” has a correlative meaning.

“Cash Equivalents” means investments (other than Cash) that are one or more of the following obligations:

- (a) Short-Term U.S. Government Securities;
- (b) investments in commercial paper maturing within 180 days from the date of acquisition thereof and having, at such date of acquisition, a credit rating of at least A-1 from S&P and at least P-1 from Moody's;
- (c) investments in certificates of deposit, banker's acceptances and time deposits maturing within 180 days from the date of acquisition thereof (i) issued or guaranteed by or placed with, and money market deposit accounts issued or offered by, any domestic office of any commercial bank organized under the laws of the United States of America or any State thereof; provided that such certificates of deposit, banker's acceptances and time deposits are held in a securities account (as defined in the Uniform Commercial Code) through which the Agent can perfect a security interest therein and (ii) having, at such date of acquisition, a credit rating of at least A-1 from S&P and at least P-1 from Moody's;
- (d) fully collateralized repurchase agreements with a term of not more than 30 days from the date of acquisition thereof for U.S. Government Securities and entered into with (i) a financial institution satisfying the criteria described in clause (c) of this definition or (ii) an Approved Dealer having (or being a member of a consolidated group having) at such date of acquisition, a credit rating of at least A-1 from S&P and at least P-1 from Moody's;
- (e) certificates of deposit or bankers' acceptances with a maturity of ninety (90) days or less of any Lender or any other financial institution that is a member of the Federal Reserve System having combined capital and surplus and undivided profits of not less than \$1,000,000,000; and
- (f) investments in money market funds and mutual funds, which invest substantially all of their assets in Cash or assets of the types described in clauses (a) through (e) above;

provided, that (i) in no event shall Cash Equivalents include any obligation that provides for the payment of interest alone (for example, interest-only securities or “IOs”); (ii) if any of Moody's or S&P changes its rating system, then any ratings included in this definition shall be deemed to be an equivalent rating in a successor rating category of Moody's or S&P, as the case may be; (iii) Cash Equivalents (other than U.S. Government Securities, certificates of deposit or repurchase agreements) shall not include any such investment representing more than 25% of total assets of Borrower in any single issuer; and (iv) in no event shall Cash Equivalents include any obligation that is not denominated in Dollars.

“Cash Management Services” means any services provided from time to time by AloStar or any of its Affiliates to Borrower in connection with operating, collections, payroll, trust, or other depository or disbursement accounts, including automated clearinghouse, e-payable, electronic funds transfer, wire transfer, controlled disbursement, overdraft, depository, information reporting, lockbox and stop payment services.

“Change in Law” means (i) the adoption of any applicable law, rule or regulation after the date of this Agreement, (ii) any change in any applicable law, rule or regulation, or any change in the interpretation, implementation or application thereof, by any governmental authority after the date of this Agreement, or (iii) compliance by Lender with any request, guideline or directive (whether or not having the force of law) of any governmental authority made or issued after the date of this Agreement; provided that for purposes of this Agreement, (x) the Dodd-Frank Wall Street Reform and Consumer Protection Act and all requests, rules, guidelines or directives in connection therewith and (y) all requests, rules, guidelines or directives promulgated by the Bank for International Settlements, the Basel Committee on Banking Supervision (or any successor or similar authority) or the United States or foreign regulatory authorities, in each case pursuant to Basel III, shall in each case be deemed to be a “Change in Law”, regardless of the date enacted, adopted or issued.

“Change of Control” means (a) Parent ceases to own and control, beneficially and of record, directly or indirectly, all Equity Interests in Borrower; (b) the acquisition of ownership, directly or indirectly, beneficially or of record, by any Person or group (within the meaning of the Securities Exchange Act of 1934 and the rules of the SEC thereunder as in effect on the date hereof) of shares representing more than 35% of the aggregate ordinary voting power represented by the issued and outstanding capital stock of the Parent; (c) a change in the majority of directors of Parent during any 24 month period, unless such new directors were either approved or nominated by the majority of directors serving at the beginning of such period; (d) the sale or transfer of all or substantially all of Parent’s or Borrower’s assets; or (e) Borrower ceases to own and control, beneficially and of record, directly, all Equity Interests in all of its Subsidiaries existing as of the Closing Date or formed after the Closing Date in accordance with the Transaction Documents..

“Closing Date” is as defined in **Section 6.1**.

“Code” means the Internal Revenue Code of 1986.

“Collateral” means all Property described in **Section 7.1**, all Property described in any Security Documents as security for any Obligations, and all other Property that now or hereafter secures (or is intended to secure) any Obligations.

“Commitment” means for any Lender, the aggregate amount of such Lender’s Revolver Commitment. “Commitments” means the aggregate amount of all Revolver Commitments. The initial aggregate amount of the Commitments shall not exceed \$50,000,000.

“Commitment Termination Date” means the earliest to occur of (a) the Scheduled Revolving Period End Date; (b) the date on which Borrower terminates the Revolver Commitments pursuant to **Section 2.1.4**; or (c) the date on which the Revolver Commitments are terminated pursuant to **Section 10.2**.

“Commodity Exchange Act” means the Commodity Exchange Act (7 U.S.C. § 1 et seq.).

“Compliance Certificate” means a compliance certificate, in the form of **Exhibit B** attached hereto, with appropriate insertions, to be submitted to Agent by Borrower pursuant to this Agreement and certified as true and correct by a Senior Officer.

“Contingent Obligation” means with respect to any Person, any obligation of such Person arising from any guaranty, indemnity or other assurance of payment or performance of any Debt, lease, dividend or other obligation of any other Person in any manner, whether directly or indirectly.

“Covenant-Lite Loan” means a Bank Loan that does not require the Portfolio Company thereunder to comply with at least one financial covenant (including any covenant relating to a borrowing base, asset valuation or similar asset-based requirement) on at least a quarterly basis, in each case, regardless of whether compliance with one or more incurrence covenants is otherwise required by such Bank Loan.

“Custodian” means U.S. Bank National Association acting in the role of custodian under the Custodian Agreement.

“Custodian Agreement” means, collectively, (a) the Custody Agreement, dated as of the Closing Date, between the Custodian and Borrower, and (b) the Custody Agreement, dated as of the Closing Date, among the Custodian, Borrower, Servicer, and Agent, each as amended, modified, waived, supplemented, restated or replaced from time to time.

“Daily LIBOR Rate” means, on any day the LIBOR Rate as shown in the Wall Street Journal on such day for United States dollar deposits for the one month delivery of funds in amounts approximately equal to the principal amount of the Loan for which such rate is being determined or, if such day is not a Business Day on the immediately preceding Business Day. If The Wall Street Journal for any reason ceases to publish a LIBOR Rate, then the Daily LIBOR Rate shall be as published from time to time and any other publication or reference source designated by Agent in its discretion. The Daily LIBOR Rate is a reference rate and does not necessarily represent the best or lowest rate charged by Lender.

“Debt” means, as applied to any Person, without duplication, (a) all items that would be included as liabilities on a balance sheet in accordance with GAAP, including Capitalized Lease Obligations; (b) all Contingent Obligations; (c) all reimbursement obligations in connection with letters of credit issued for the account of such Person; and (d) in the case of Borrower, the Obligations. The Debt of a Person shall include any recourse Debt of any partnership in which such Person is a general partner or joint venturer.

“Default” means an event or condition that, with the lapse of time or giving of notice, or both, would constitute an Event of Default.

“Default Rate” means for any Obligation (including, to the extent permitted by law, interest not paid when due), two percent (2%) plus the interest rate otherwise applicable thereto.

“Defaulted Obligation” means any Investment in Indebtedness (i) as to which, (x) a default as to the payment of principal and/or interest has occurred and is continuing for a period of thirty-two (32) consecutive days with respect to such Indebtedness (without regard to any grace period applicable thereto, or waiver thereof) or (y) a default not set forth in clause (x) has occurred and the holders of such Indebtedness have accelerated all or a portion of the principal amount thereof as a result of such default; (ii) as to which a default as to the payment of principal and/or interest has occurred and is continuing beyond any applicable grace period on another material debt obligation of the Portfolio Company under such Indebtedness which is senior or pari passu in right of payment to such Indebtedness; (iii) such Portfolio Company has filed for protection under the Bankruptcy Code or has been adjudicated bankrupt or insolvent or placed into receivership, or an involuntary petition has been filed against such Portfolio Company under the Bankruptcy Code and either an order for relief is entered on such petition or such petition has not been dismissed within sixty (60) days from the date such petition was filed or; (iv) as to which Borrower has delivered written notice to the Portfolio Company declaring such Indebtedness in default; or (v) which has (A) a rating by S&P of “CC” or below or “SD” or (B) a Moody’s probability of default rating (as published by Moody’s) of “D” or “LD” or, in each case, had such ratings before they were withdrawn by S&P or Moody’s, as applicable.

“Defaulting Lender” means any Lender that, as determined by Agent, (a) has failed to perform any funding obligations hereunder, and such failure is not cured within three Business Days; (b) has notified Agent or Borrower that such Lender does not intend to comply with its funding obligations hereunder or has made a public statement to the effect that it does not intend to comply with its funding obligations hereunder or under any other credit facility; (c) has failed, within three Business Days following request by Agent, to confirm in a manner satisfactory to Agent that such Lender will comply with its funding obligations hereunder; or (d) has, or has a direct or indirect parent company that has, become the subject of an Insolvency Proceeding or taken any action in furtherance thereof; provided, however, that a Lender shall not be a Defaulting Lender solely by virtue of a governmental authority’s ownership of an equity interest in such Lender or parent company.

“Delayed Draw Loan” means a Bank Loan that requires one or more future advances to be made to the Portfolio Company by Borrower and which does not permit the re-borrowing of any amount previously repaid by the Portfolio Company; provided that such loan shall only be considered a Delayed Draw Loan for so long as any future funding obligations remain in effect and only with respect to any portion which constitutes a future funding obligation.

“Distribution” means any declaration or payment of a distribution, interest or dividend on any Equity Interest (other than payment-in-kind); any distribution, advance or repayment of Debt to a holder of Equity Interests; or any purchase, redemption, or other acquisition, surrender or retirement for value of any Equity Interest, sinking fund or similar payment.

“Dollars” and the sign “\$” mean lawful money of the United States.

“Dominion Account” means a special account established by Borrower and maintained with the Custodian or another bank acceptable to Agent, which account is subject to withdrawal limitations that permit only payments to Agent in accordance with **Section 5.8.1**.

“Eligible Assignee” means a Person that is (a) a Lender or an Affiliate of a Lender; (b) an Approved Fund; (c) any Person to whom a Lender assigns its rights and obligations under this Agreement as part of an assignment and transfer of such Lender’s rights in and to a material portion of such Lender’s portfolio of asset based credit facilities; (d) any other financial institution approved by Agent and, unless an Event of Default has occurred, Borrower (which approval by Borrower shall not be unreasonably withheld or delayed, and shall be deemed given if no objection is made within five Business Days after notice of the proposed assignment); and (e) during any Event of Default, any Person acceptable to Agent in its discretion; provided, that in no event shall (i) Parent, Borrower or an Affiliate of Borrower or Parent, or (ii) any Defaulting Lender or any of its Subsidiaries, or any Person who, upon becoming a Lender hereunder, would constitute a Defaulting Lender or a Subsidiary thereof, be deemed to be an Eligible Assignee.



“Eligible Portfolio Investment” means any Portfolio Investment held by Borrower (and solely for purposes of determining the Borrowing Base, Cash and Cash Equivalents held by Borrower) that, in each case, meets all of the criteria set forth on Schedule 12 hereto; provided, that no Portfolio Investment, Cash or Cash Equivalent shall constitute an Eligible Portfolio Investment or be included in the Borrowing Base if the Agent does not at all times maintain a first priority, perfected Lien (subject to no other Liens other than Permitted Liens) on such Portfolio Investment, Cash or Cash Equivalent. Notwithstanding the foregoing, nothing herein shall limit the provisions of **Section 9.1.11(b)(i)**, which provide that, for purposes of this Agreement, all determinations of whether an Investment is to be included as an Eligible Portfolio Investment shall be determined on a Settlement-Date Basis, provided that no such Investment shall be included as an Eligible Portfolio Investment to the extent it has not been paid for in full.

“Environmental Laws” means all Applicable Laws (including all programs, permits and guidance promulgated by regulatory agencies and all implementing regulations), relating to public health (but excluding occupational safety and health, to the extent regulated by the Occupational Safety and Hazard Act of 1970) or the protection or pollution of the environment, including the Clean Water Act (33 U.S.C. §§ 1251 et seq.), the Comprehensive Environmental Response Compensation and Liability Act (42 U.S.C. § 9601 et seq.) and the Resource Conservation and Recovery Act (42 U.S.C. §§ 6991-6991i).

“Equity Interest” means the interest of any (a) shareholder in a corporation; (b) partner in a partnership (whether general, limited, limited liability or joint venture); (c) member in a limited liability company; or (d) other Person having any other form of equity security or ownership interest in any other type of legal entity.

“ERISA” means the Employee Retirement Income Security Act of 1974 and all rules and regulations from time to time promulgated thereunder.

“ERISA Affiliate” means any trade or business (whether or not incorporated) under common control with Parent or Borrower within the meaning of Section 414(b) or (c) of the Code (and Sections 414(m) and (o) of the Code for purposes of provisions relating to Section 412 of the Code).

“Event of Default” is as defined in **Section 10**.

“Excluded Tax” means any of the following Taxes imposed on or with respect to a Lender or required to be withheld or deducted from a payment to a Lender, (a) Taxes imposed on or measured by net income (however denominated), franchise Taxes, and branch profits Taxes, in each case, (i) imposed as a result of such Lender being organized under the laws of, or having its principal office or, in the case of any Lender, its applicable lending office located in, the jurisdiction imposing such Tax (or any political subdivision thereof) or (ii) that are Other Connection Taxes, (b) in the case of a Lender, U.S. federal withholding Taxes imposed on amounts payable to or for the account of such Lender with respect to an applicable interest in a Loan or Commitment pursuant to a law in effect on the date on which (i) such Lender acquires such interest in the Loan or Commitment (other than pursuant to an assignment request by the Borrower under Section 12.4) or (ii) such Lender changes its lending office, except in each case to the extent that, pursuant to Section 5.10, amounts with respect to such Taxes were payable either to such Lender's assignor immediately before such Lender became a party hereto or to such Lender immediately before it changed its lending office, (c) Taxes attributable to such Lender's failure to comply with Sections 5.11.1 and 5.11.2, and (d) any U.S. federal withholding Taxes imposed under FATCA.

“Executive Order No. 13224” means Executive Order No. 13224 on Terrorist Financing, effective September 24, 2001, as the same has been, or shall hereafter be, renewed, extended, amended or replaced.

“External Quoted Value” has the meaning assigned to such term in **Section 9.1.11(b)(ii)(A)**.

“Extraordinary Expenses” means all costs, expenses or advances that Agent or Lenders may suffer or incur during a Default or Event of Default, or during the pendency of an Insolvency Proceeding of Parent or Borrower, including those relating to (a) any audit, inspection, repossession, storage, repair, appraisal, insurance, manufacture, preparation or advertising for sale, sale, collection, or other preservation of or realization upon any Collateral; (b) subject to the same limitations in respect of Borrower’s indemnification obligations under **Section 13.2**, any action, arbitration or other proceeding (whether instituted by or against Agent, any Lender, Parent, Borrower, any representative of creditors of Parent or Borrower or any other Person) in any way relating to any Collateral (including the validity, perfection, priority or avoidability of Agent’s Liens with respect to any Collateral), Transaction Documents, or Obligations, including any lender liability and all other claims, liabilities, costs, expenses and other amounts of any kind in any way related to the Transaction Documents or Collateral at any time; (c) the exercise, protection or enforcement of any rights or remedies of Agent and Lenders, in, or the monitoring of, any Insolvency Proceeding; (d) settlement or satisfaction of any taxes, charges or Liens with respect to any Collateral; (e) any enforcement action or exercise of rights or remedies, of any kind, in connection with the Obligations, the Collateral or the Transaction Documents; (f) negotiation and documentation of any modification, waiver, workout, restructuring or forbearance with respect to any Transaction Documents or Obligations; and (g) Protective Advances. Such costs, expenses and advances include transfer fees, Other Taxes, storage fees, insurance costs, permit fees, utility reservation and standby fees, legal fees and expenses of counsel for Agent and Lenders, appraisal fees, brokers’ fees and commissions, auctioneers’ fees and commissions, accountants’ fees, environmental study fees, wages and salaries paid to employees of Borrower or independent contractors in liquidating any Collateral, and travel expenses.

“FATCA” means Sections 1471 through 1474 of the Code, as of the date of this Agreement (or any amended or successor version that is substantively comparable and not materially more onerous to comply with), any current or future regulations or official interpretations thereof, any agreements entered into pursuant to Section 1471(b)(1) of the Code and any fiscal or regulatory legislation, rules or practices adopted pursuant to any intergovernmental agreement, treaty or convention among governmental authorities and implementing such Sections of the Code.

“Fee Letter” means the Fee Letter dated as of the Closing Date between Borrower and AloStar.

“First Lien Bank Loan” means a Bank Loan (a) that is entitled to the benefit of a first lien and first priority perfected security interest on a portion of the assets of a Portfolio Company, (b) for which the Servicer determines in good faith that the value of the collateral securing the Bank Loan on or about the time of origination equals or exceeds the outstanding principal balance of the Bank Loan plus the aggregate outstanding balances of all other loans of equal or higher seniority secured by the same collateral, (c) that is not (and cannot by its terms become) subordinate in right of payment to any obligation of the Portfolio Company in any bankruptcy, reorganization, arrangement, insolvency, moratorium or liquidation proceedings and (d) that is not (and cannot by its terms become) subject to any payment blockage or standstill provisions. For the avoidance of doubt, in no event shall a First Lien Bank Loan include a Last Out Loan.

“Fiscal Quarter” means each period of three months, commencing on the first day of a Fiscal Year.

“Fiscal Year” means the fiscal year of Parent, Borrower and Borrower’s Subsidiaries for accounting and tax purposes, ending on December 31 of each year.

“Foreign Lender” means (a) if the Borrower is a U.S. Person, a Lender that is not a U.S. Person, and (b) if the Borrower is not a U.S. Person, a Lender that is resident or organized under the laws of a jurisdiction other than that in which the Borrower is resident for Tax purposes.

“Full Payment” means with respect to any Obligations, (a) the full and indefeasible cash payment thereof, including any interest, fees and other charges accruing during an Insolvency Proceeding (whether or not allowed in the proceeding); (b) if such Obligations are inchoate or contingent in nature, Cash Collateralization thereof (or delivery of a standby letter of credit acceptable to Agent in its discretion, in the amount of required Cash Collateral); and (c) termination of the Commitments and release by Borrower (and by any representative of creditors of Borrower in any Insolvency Proceeding of Borrower) of any claims that Borrower has or asserts to have against Agent, Lenders or any of their Affiliates. No Loans shall be deemed to have been paid in full until all Commitments related to such Loans have expired or been terminated.

“Fund” means any Person (other than a natural person) that is (or will be) engaged in making, purchasing, holding or otherwise investing in commercial loans and similar extensions of credit in the Ordinary Course of its Business.

“GAAP” means generally accepted accounting principles in effect in the United States from time to time.

“Guarantors” means each Subsidiary of Borrower who guarantees (or has pledged assets to secure) payment or performance of any Obligations.

“Guaranty” means each guaranty agreement executed by a Guarantor in favor of Agent.

“Hedging Agreement” means any “swap agreement” as defined in Section 101(53B)(A) of the Bankruptcy Code.

“High Yield Securities” means debt Securities, in each case (a) issued by public or private issuers, (b) issued pursuant to an effective registration statement or pursuant to Rule 144A under the Securities Act (or any successor provision thereunder) and (c) that are not Cash Equivalents, Mezzanine Investments (described under clause (i) of the definition thereof) or Bank Loans.

“Indebtedness” of any Person means at any date without duplication, (a) all indebtedness of such Person for borrowed money (whether by loan or the issuance and sale of debt securities) or for the deferred purchase price of Property or services (other than current trade liabilities incurred in the ordinary course of business and payable in accordance with customary practices), (b) any other indebtedness of such Person which is evidenced by a note, bond, debenture or similar instrument, (c) all obligations of such Person in respect of letters of credit, acceptances or similar instruments issued or created for the account of such Person, (d) all liabilities secured by (or for which the holder of such obligations has an existing right, contingent or otherwise, to be secured by) any Lien on any Property owned by such Person even though such Person has not assumed or otherwise become liable for the payment thereof, (e) any guaranty of payment by such Person in respect of obligations of the kind referred to in clauses (a) through (d) above. The amount of any Indebtedness under clause (d) shall be equal to the lesser of (A) the stated amount of the relevant obligations and (B) the fair market value of the Property subject to the relevant Lien. The amount of any Indebtedness of any Person shall include the Indebtedness of any other entity (including any partnership in which such Person is a general partner) to the extent such Person is liable therefor as a result of such Person’s ownership interest in or other relationship with such entity, except to the extent the terms of such Indebtedness expressly provide that such Person is not liable therefor.

“Indemnified Taxes” means (a) Taxes, other than Excluded Taxes, imposed on or with respect to any payment made by or on account of any obligation of the Borrower under any Transaction Document and (b) to the extent not otherwise described in (a), Other Taxes.

“Indemnitees” means (i) Agent Indemnitees and (ii) the Lenders and AloStar and each of their respective officers, directors, employees, Affiliates, agents and attorneys.

“Independent” when used with respect to any specified Person means the more restrictive of the following: (a) that such Person (i) does not have any direct financial interest or any material indirect financial interest in Borrower or any of its Subsidiaries or Affiliates (including its investment adviser or any Affiliate thereof) other than ownership of publicly traded stock, as applicable, of Borrower or any such Subsidiary or Affiliate with a market value not to exceed \$1,000,000 and (ii) is not an officer, employee, promoter, underwriter, trustee, partner, director or a Person performing similar functions of Borrower or of its Subsidiaries or Affiliates (including its investment advisor or any Affiliate thereof), (b) the definition of “disinterested” as defined in the Investment Company Act, (c) that such Person is not an “interested person” as defined in Section 2(a)(19) of the Investment Company Act or (d) the definition of “independent” as defined in the Exchange Act.

“Industry Classification Group” means any of the classification groups set forth on Schedule 13 hereto on the Closing Date, as such classifications may be updated at the option of the Servicer if Standard and Poors publishes revised industry classifications.

“Insolvency Proceeding” means any action, case or proceeding commenced by or against a Person under any state, federal or foreign law for, or any agreement of such Person to, (a) the entry of an order for relief under the Bankruptcy Code, or any other insolvency, debtor relief or debt adjustment law, (b) any involuntary petition for relief under the Bankruptcy Code where either an order for relief is entered or such petition is not dismissed within sixty (60) days after the date such petition is filed; (b) the appointment of a receiver, trustee, liquidator, administrator, conservator or other custodian for such Person or any part of its Property; (c) an assignment or trust mortgage for the benefit of creditors; or (d) the liquidation, dissolution or winding up of the affairs of such Person.

“Intellectual Property” means all intellectual and similar Property of a Person, including inventions, designs, patents, copyrights, trademarks, service marks, trade names, trade secrets, confidential or proprietary information, customer lists, know-how, software and databases; all embodiments or fixations thereof and all related documentation, applications, registrations and franchises; all licenses or other rights to use any of the foregoing; and all books and records relating to the foregoing.

“Interest Coverage Ratio” means the ratio as of the last day of any fiscal quarter of Borrower of (a) Interest Proceeds received by Borrower during the four fiscal quarter period then ending, to (b) Adjusted Interest Expense for such four fiscal quarter period.

“Interest Proceeds” means the sum of: (a) all payments of interest and other income received by Borrower on the Portfolio Investments (including accrued interest received in connection with a sale of any such Portfolio Investment); (b) all interest and other income received by Borrower in respect of Investments in Cash Equivalents; (c) all amendment and waiver fees, late payment fees (including compensation for delayed settlement or trades), and all protection fees and other fees and commissions received by Borrower in respect of the Portfolio Investments; and (d) commitment fees, facility fees, anniversary fees, ticking fees and other similar fees received by Borrower in respect of the Portfolio Investments.

“Investment” means, for any Person: (a) Equity Interests, bonds, notes, debentures or other securities of any other Person (including convertible securities) or any agreement to acquire any Equity Interests, bonds, notes, debentures or other securities of any other Person (including any “short sale” or any sale of any securities at a time when such securities are not owned by the Person entering into such sale); (b) deposits, advances, loans or other extensions of credit made to any other Person (including purchases of property from another Person subject to an understanding or agreement, contingent or otherwise, to resell such property to such Person); or (c) Hedging Agreements.

“Investment Company Act” means the Investment Company Act of 1940, as amended from time to time.

“Investment and Valuation Policies” means Parent’s investment objectives and strategy as set forth in Parent’s (a) Credit Policies and Procedures dated December 14, 2016, and (b) Valuation Policy, Procedure and Methodology dated December 14, 2016, and each delivered to the Agent on or prior to the Closing Date, as amended from time to time in accordance with the terms and conditions of this Agreement.

“IRS” means the United States Internal Revenue Service.

“KCAP Participation Interests” means any Participation Interests granted by Parent to the Borrower in and to a Portfolio Investment pursuant to the Sale Agreement (to the extent constituting a Participation Interest pending completion of the assignment thereof in accordance with Section 2.4 of the Sale Agreement) and in which a Lien is granted therein by the Borrower to the Agent pursuant to this Agreement.

“Last Out Loan” shall mean any Bank Loan that would otherwise be a First Lien Bank Loan except that, in the case of an event of default under the applicable underlying documents, any portion of such Bank Loan will be repaid after one or more tranches of other first lien loans issued by the same Portfolio Company have been paid in accordance with a specific waterfall of payments, including by reason of a payment blockage or a standstill period with respect to the exercise of remedies that does not, in either case, exceed 180 days.

“Lenders” is as defined in the preamble to this Agreement, including Agent in its capacity as a provider of Swingline Loans and any other Person who hereafter becomes a “Lender” pursuant to an Assignment and Acceptance.

“Lending Office” means the office designated as such by the applicable Lender at the time it becomes party to this Agreement or thereafter by notice to Agent and Borrower.

“LIBOR Index Loan” means a Loan, or portion thereof, during any period in which it bears interest at a rate based upon the Daily LIBOR Rate.

“LIBOR Index Revolver Loan” means a Revolver Loan, or portion thereof, during any period in which it bears interest at a rate based upon the Daily LIBOR Rate.

“Lien” means any Person’s interest in Property securing an obligation owed to, or a claim by, such Person, including any lien, security interest, pledge, hypothecation, trust, reservation, encroachment, easement, right-of-way, covenant, condition, restriction, leases, or other title exception or encumbrance.

“Loan” means a Revolver Loan or a Base Rate Loan.

“Loan Account” is as defined in **Section 5.8.1**.

“Loan Year” means each 12 month period commencing on the Closing Date and on each anniversary of the Closing Date.

“Long-Term U.S. Government Securities” means U.S. Government Securities maturing more than three months from the applicable date of determination.

“Margin Stock” is as defined in Regulation U of the Board of Governors.

“Material Adverse Effect” means the effect of any event or circumstance that, taken alone or in conjunction with other events or circumstances, (a) has or could be reasonably expected to have a material adverse effect on the business, operations, Properties, assets, liabilities or financial condition of Borrower or the Servicer, both individually or taken as a whole, on the value of any material Collateral, on the enforceability of any Transaction Documents, or on the validity or priority of Agent’s Liens on any Collateral; (b) impairs the ability of Servicer or Borrower to perform its respective obligations under the Transaction Documents, including repayment of any Obligations; or (c) otherwise impairs the ability of Agent or any Lender to enforce or collect any Obligations or to realize upon any Collateral.

“Material Contract” means any agreement or arrangement to which Borrower is party (other than the Transaction Documents) (a) that is deemed to be a material contract under any securities law applicable to such Person, including the Securities Act of 1933; or (b) for which breach, termination, nonperformance or failure to renew could reasonably be expected to have a Material Adverse Effect.

“Maturity Date” means the earliest of (a) the date that is four (4) years from the Closing Date, (b) the date on which Borrower terminates the Revolver Commitments pursuant to **Section 2.1.4**; or (c) the date on which the Revolver Commitments are terminated pursuant to **Section 10.2**.

“Mezzanine Investments” means (i) debt Securities (including convertible debt Securities (other than the “in-the-money” equity component thereof)) (a) issued by public or private Portfolio Companies, (b) issued without registration under the Securities Act, (c) not issued pursuant to Rule 144A under the Securities Act (or any successor provision thereunder), (d) that are not Cash Equivalents and (e) contractually or structurally subordinated in right of payment to other debt of the same Portfolio Company and (ii) a Bank Loan that is not a First Lien Bank Loan, a Second Lien Bank Loan, High Yield Security, or a Last Out Loan.

“Moody’s” means Moody’s Investors Service, Inc. or any successor thereto.

“Multiemployer Plan” means any employee benefit plan of the type described in Section 4001(a)(3) of ERISA, to which Borrower or ERISA Affiliate makes or is obligated to make contributions, or during the preceding five plan years, has made or been obligated to make contributions.

“Notice of Borrowing” means a Notice of Borrowing to be provided by Borrower to request a Borrowing of Revolver Loans, in form satisfactory to Agent.

“Notice of Conversion/Continuation” means a Notice of Conversion/Continuation to be provided by Borrower to request conversion of Loans into or from LIBOR Index Loans or Base Rate Loans, in form satisfactory to Agent.

“Noteless Assigned Loan” means a Bank Loan with respect to which: (a) the underlying documentation either (i) does not require the Portfolio Company to execute and deliver a promissory note to evidence the indebtedness created under such Bank Loan or (ii) requires execution and delivery of such a promissory note only upon the request of any holder of the indebtedness created under such Bank Loan, and as to which the Borrower and Parent have not requested a promissory note from the related Portfolio Company; and (b) neither Borrower nor any of its Affiliates was an agent with respect to such Bank Loan at the time of origination.

“Obligations” means all (a) principal of and premium, if any, on the Loans, (b) interest, expenses, fees, indemnification obligations, reimbursement obligations, Extraordinary Expenses and other amounts payable by Borrower under the Transaction Documents, (c) Secured Bank Product Obligations, and (d) all other Debts, covenants, duties, obligations and liabilities of any kind (including Contingent Obligations) owing by Borrower pursuant to the Transaction Documents, whether now existing or hereafter arising, whether evidenced by a note or other writing, whether allowed in any Insolvency Proceeding, whether arising from an extension of credit, issuance of a letter of credit, acceptance, loan, guaranty, indemnification or otherwise, and whether direct or indirect, absolute or contingent, due or to become due, primary or secondary, or joint or several.

“OFAC” means the U.S. Department of the Treasury’s Office of Foreign Assets Control.

“Ordinary Course of Business” means, with respect to any transaction involving any Person, the ordinary course of such Person’s business, as conducted by such Person in accordance with past practices and undertaken by such Person in good faith and not for the purpose of evading any covenant or restriction in any Transaction Document.

“Organic Documents” means with respect to any Person, its charter, certificate or articles of incorporation, bylaws, articles of organization, limited liability agreement, operating agreement, members agreement, shareholders agreement, partnership agreement, certificate of partnership, certificate of formation, voting trust agreement, or similar agreement or instrument governing the formation or operation of such Person.

“Other Connection Taxes” means, with respect to any Lender, Taxes imposed as a result of a present or former connection between such Lender and the jurisdiction imposing such Tax (other than connections arising from such Lender having executed, delivered, become a party to, performed its obligations under, received payments under, received or perfected a security interest under, engaged in any other transaction pursuant to or enforced any Transaction Document, or sold or assigned an interest in any Loan or Transaction Document).

“Other Taxes” means all present or future stamp, court or documentary, intangible, recording, filing or similar Taxes that arise from any payment made under, from the execution, delivery, performance, enforcement or registration of, from the receipt or perfection of a security interest under, or otherwise with respect to, any Transaction Document, except any such Taxes that are Other Connection Taxes imposed with respect to an assignment (other than an assignment made pursuant to Section 12.4 of this Agreement).

“Overadvance” is as defined in **Section 2.1.5**.

“Overadvance Loan” means a LIBOR Index Revolver Loan made when an Overadvance exists or is caused by the funding thereof.

“Parent” means KCAP Financial, Inc., a Delaware corporation.

“Participant” is as defined in **Section 12.2**.

“Participation Interest” means a participation interest in a loan that would, at the time of acquisition or Borrower’s commitment to acquire the same, satisfy each of the following criteria: (i) such participation would constitute an Eligible Portfolio Investment were the underlying loan acquired directly, (ii) the seller of the participation is the lender on the subject loan, (iii) the aggregate participation in the loan does not exceed the principal amount or commitment of such loan, (iv) such participation does not grant, in the aggregate, to the participant in such participation a greater interest than the seller holds in the loan or commitment that is the subject of the participation, (v) the entire purchase price for such participation is paid in full at the time of its acquisition, and (vi) the participation provides the participant all of the economic benefit and risk of the whole or part of the loan or commitment that is the subject of the loan participation.

“PATRIOT Act” means the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).

“Payment Item” means each check, draft or other item of payment payable to Borrower, including those constituting proceeds of any Collateral.

“Performing” means with respect to any Eligible Portfolio Investment, such Eligible Portfolio Investment is not a Defaulted Obligation.

“Performing Last Out Loans” means funded Last Out Loans that (a) are not Second Lien Bank Loans and (b) are Performing.

“Permitted Discretion” means a determination made in the exercise of reasonable credit judgment, from the perspective of a secured asset-based lender.

“Permitted Liens” is as defined in **Section 9.2.2**.

“Person” means any individual, corporation, limited liability company, partnership, limited liability partnership, joint stock company, joint venture, association, trust, unincorporated organization, governmental authority or other entity.



“Plan” means any employee benefit plan (as defined in Section 3(3) of ERISA) established by Borrower or, with respect to any such plan that is subject to Section 412 of the Code or Title IV of ERISA, an ERISA Affiliate.

“Pledge Agreement” means that certain Pledge Agreement dated the Closing Date by and between Agent and Parent.

“Portfolio Company” means the issuer or obligor under any Portfolio Investment held by Borrower or any of its Subsidiaries.

“Portfolio Investment” means any Investment held by Borrower in its asset portfolio.

“Pro Rata” means with respect to any Lender, a percentage (rounded to the ninth decimal place) determined while (a) Revolver Commitments are outstanding, by dividing the amount of such Lender’s Revolver Commitment by the aggregate amount of all Revolver Commitments; and (b) at any other time, by dividing the amount of such Lender’s Loans by the aggregate amount of all outstanding Loans.

“Properly Contested” means with respect to any obligation of any Person, (a) the obligation is subject to a bona fide dispute regarding amount or such Person’s liability to pay; (b) the obligation is being properly contested in good faith by appropriate proceedings promptly instituted and diligently pursued; (c) appropriate reserves have been established in accordance with GAAP; (d) non-payment could not have a Material Adverse Effect, nor result in forfeiture or sale of any assets of such Person; (e) no Lien is imposed on assets of such Person, unless bonded and stayed to the satisfaction of Agent; and (f) if the obligation results from entry of a judgment or other order, such judgment or order is stayed pending appeal or other judicial review; and (g) if such contest is abandoned, settled, or determined adversely (in whole or in part) to such Person, such Person forthwith pays such amounts and all penalties, interest, and other amounts due in connection therewith. Only that portion of a Debt or Tax which is in dispute may be deemed Properly Contested.

“Property” means any interest in any kind of property or asset, whether real, personal or mixed, or tangible or intangible.

“Protective Advances” is as defined in **Section 2.1.6**.

“Quoted Investments” means an Eligible Portfolio Investment (including Cash Equivalents) which is traded in an active and orderly market for which market quotations are readily available.

“Report” is as defined in **Section II(c) on Exhibit D**.

“Required Lenders” means Lenders (subject to **Section 4.2**) having (a) Revolver Commitments in excess of 50% of the aggregate Revolver Commitments; and (b) if the Revolver Commitments have terminated, Loans in excess of 50% of all outstanding Loans; provided, however, that the Commitments and Loans of any Defaulting Lender shall be excluded from such calculation and at any time there is one Lender only, such Lender shall constitute the Required Lenders.

“Restrictive Agreement” means an agreement (other than a Transaction Document) that conditions or restricts the right of Borrower to incur or repay Borrowed Money, to grant Liens on any assets, to declare or make Distributions, to modify, extend or renew any agreement evidencing Borrowed Money, or to repay any intercompany Debt.

“Revolver Commitment” means, for any Lender, its obligation to make Revolver Loans up to the maximum principal amount shown on **Schedule 1**, as hereafter modified pursuant to an Assignment and Acceptance to which it is a party. “Revolver Commitments” means the aggregate amount of such commitments of all Lenders.

“Revolver Loan” means a loan made pursuant to **Section 2.1**, and any Swingline Loan, Overadvance Loan or Protective Advance.

“Revolving Loan” means any Bank Loan (other than a Delayed Draw Loan) that is a senior secured obligation (including funded and unfunded portions of revolving credit lines, unfunded commitments under specific facilities and other similar loans and investments) that under the underlying loan documents for such Bank Loan relating thereto may require one or more future advances to be made to the Portfolio Company by Borrower; provided that any such Bank Loan will be a Revolving Loan only until all commitments by Borrower to make advances to the Portfolio Company thereof expire, or are terminated, or are irrevocably reduced to zero.

“Royalties” means all royalties, fees, expense reimbursement and other amounts payable by Borrower under a license.

“S&P” means S&P Global Ratings, a division of S&P Global Inc., a New York corporation, or any successor thereto.

“Sale Agreement” means the Sale, Contribution and Master Participation Agreement, dated as of the Closing Date, between the Parent and Borrower, as amended, modified, waived, supplemented, restated or replaced from time to time.

“Sanctioned Country” means, at any time, a country, region or territory that is, or whose government is, the subject or target of any Sanctions.

“Sanctioned Person” means, at any time, (a) any Person listed in any Sanctions-related list of designated Persons maintained by OFAC, the U.S. Department of State, the United Nations Security Council, the European Union or any EU member state, (b) any Person located, organized, incorporated or resident in a Sanctioned Country or (c) any Person controlled by any such Person.

“Sanctions” means economic or financial sanctions or trade embargoes administered or enforced from time to time by (a) the U.S. government, including those administered by OFAC or the U.S. Department of State or (b) the United Nations Security Council, the European Union or Her Majesty’s Treasury of the United Kingdom.

“Scheduled Revolving Period End Date” means the date that is three (3) years from the Closing Date.

“SEC” means the Securities and Exchange Commission, and any successor agency thereto.

“Second Lien Bank Loan” means a Bank Loan (other than a First Lien Bank Loan and a Last Out Loan) that is entitled to the benefit of a second priority perfected security interest on all or substantially all of the Portfolio Company’s assets, and where the value of such assets is adequate (in the commercially reasonable judgment of the Servicer) to repay such Bank Loan in accordance with its terms and to repay all other loans of equal or higher seniority secured by a security interest in the same collateral); provided that if such Bank Loan is also secured by a first priority perfected security interest on other specified collateral securing the Portfolio Company obligations under such Bank Loan and otherwise satisfies the requirements of the definition of First Lien Bank Loan, then such Bank Loan shall be deemed to be a First Lien Bank Loan for the purposes of this Agreement.

“Secured Bank Product Obligations” means Debt, obligations and other liabilities with respect to Bank Products owing by Borrower to a Secured Bank Product Provider.

“Secured Bank Product Provider” means (a) AloStar or any of its Affiliates; and (b) any other Lender or Affiliate of a Lender that is providing a Bank Product, provided such provider delivers written notice to Agent, in form and substance satisfactory to Agent, within 10 days following the later of the Closing Date creation of the Bank Product, (i) describing the Bank Product and setting forth the maximum amount to be secured by the Collateral and the methodology to be used in calculating such amount, and (ii) agreeing to be bound by **Section XII of Exhibit D**.

“Secured Parties” means Agent, Lenders and Secured Bank Product Providers.

“Securities” means common and preferred stock, units and participations, member interests in limited liability companies, partnership interests in partnerships, notes, bonds, debentures, trust receipts and other obligations, instruments or evidences of indebtedness, including debt instruments of public and private issuers and tax-exempt securities (including warrants, rights, put and call options and other options relating thereto, representing rights, or any combination thereof) and other property or interests commonly regarded as securities or any form of interest or participation therein, but not including Bank Loans.

“Securities Act” means the United States Securities Act of 1933, as amended.

“Security Documents” means the deposit account control agreements, the Pledge Agreement, securities account control agreements, commodity account control agreements (or, without limitation, other agreements providing Agent “control” (as contemplated by Section 9-104 of the UCC) of a deposit account, securities account, commodity account or similar account), and all other documents, instruments and agreements now or hereafter securing or perfecting (or given with the intent to secure or perfect) any Obligations.

“Senior Officer” means a manager of Borrower or, if the context requires, a manager or the president, chief executive officer, chief financial officer, vice president or treasurer of the Servicer.

“Servicer” means Parent, in its capacity as servicer pursuant to the terms of the Servicing Agreement.

“Servicer Termination Event” means the occurrence of any one of the following:

(a) any failure by the Servicer to make any payment, transfer or deposit into the Dominion Account as required by this Agreement, which failure continues unremedied for a period of two (2) Business Days;

(b) any failure on the part of the Servicer to observe or perform in any material respect any covenants or agreements of the Servicer set forth in any Transaction Document to which the Servicer is a party (including, without limitation, any material delegation of the Servicer’s duties) and the same continues unremedied for a period of thirty (30) days after the earlier to occur of (i) the date on which written notice of such failure shall have been given to the Servicer by the Agent and (ii) the date on which a Senior Officer of the Servicer acquires knowledge thereof;

(c) the failure of the Servicer to make any payment when due (after giving effect to any related grace period) with respect to any Indebtedness, which Indebtedness is in excess of \$1,000,000 in the aggregate, or the occurrence of any event or condition that has resulted in the acceleration of such Indebtedness, whether or not waived;

(d) an Insolvency Proceeding is commenced by or against the Servicer (subject to the grace period in the definition thereof in the case of any involuntary proceeding commenced against the Servicer);

(e) the occurrence of an Event of Default;

(f) the occurrence of any Change of Control;

(g) any failure by the Servicer to deliver any reports required to be delivered by the Servicer pursuant to the Servicing Agreement on or before the date occurring two (2) Business Days after the date such report is required to be made or given, as the case may be;

(h) any representation, warranty or certification made by the Servicer in any Transaction Document or in any certificate delivered pursuant to any Transaction Document shall prove to have been incorrect when made, which has a Material Adverse Effect and which continues to be unremedied for a period of thirty (30) days after the earlier to occur of (i) the date on which written notice of such incorrectness shall have been given to the Servicer by the Agent and (ii) the date on which a Senior Officer of the Servicer acquires knowledge thereof;

(i) the rendering against the Servicer of one or more final judgments, decrees or orders for the payment of money in excess of \$1,000,000 in aggregate, and the continuance of such judgment, decree or order unsatisfied and in effect for any period of more than 60 consecutive days without a stay of execution;

(j) a finding by any court or governmental body of competent jurisdiction in a final, non-appealable judgment, or an admission by Servicer in a settlement of any lawsuit, that Servicer has committed fraud, willful misconduct, or a material violation of applicable securities laws, in each case which has a material adverse effect on the performance of its obligations under any of the Transaction Documents to which it is a party; or

(j) any Senior Officer of the Servicer is indicted for a criminal offense related to the business of the Servicer and is not terminated within ten (10) days after such indictment.

“Servicing Agreement” means the Servicing Agreement, dated as of the Closing Date, between the Servicer and Borrower, as may be amended, modified, waived, supplemented, restated or replaced from time to time, and of which the Agent shall be an express third-party beneficiary.

“Settlement-Date Basis” means that any Investment that has been purchased will not be treated as an Eligible Portfolio Investment until such purchase has settled, and any Eligible Portfolio Investment which has been sold will not be excluded as an Eligible Portfolio Investment until such sale has settled.

“Settlement Report” means a report summarizing Revolver Loans outstanding as of a given settlement date, allocated to Lenders on a Pro Rata basis in accordance with their Revolver Commitments.

“Short-Term U.S. Government Securities” means U.S. Government Securities maturing within three months of the applicable date of determination.

“Single Covenant Loan” means a Bank Loan that requires the Portfolio Company thereunder to comply with only one financial covenant (excluding any covenant relating to a borrowing base, asset valuation or similar asset-based requirement), in each case, regardless of whether compliance with one or more incurrence covenants is otherwise required by such Bank Loan.

“Solvent” means, as to any Person, such Person (a) owns Property whose fair salable value is greater than the amount required to pay all of its debts (including contingent, subordinated, unmatured and unliquidated liabilities); (b) owns Property whose present fair salable value (as defined below) is greater than the probable total liabilities (including contingent, subordinated, unmatured and unliquidated liabilities) of such Person as they become absolute and matured; (c) is able to pay all of its debts as they mature; (d) has capital that is not unreasonably small for its business and is sufficient to carry on its business and transactions and all business and transactions in which it is about to engage; (e) is not “insolvent” within the meaning of Section 101(32) of the Bankruptcy Code; and (f) has not incurred (by way of assumption or otherwise) any obligations or liabilities (contingent or otherwise) under any Transaction Documents, or made any conveyance in connection therewith, with actual intent to hinder, delay or defraud either present or future creditors of such Person or any of its Affiliates. “Fair salable value” means the amount that could be obtained for assets within a reasonable time, either through collection or through sale under ordinary selling conditions by a capable and diligent seller to an interested buyer who is willing (but under no compulsion) to purchase.

“Subsidiary” means, with respect to any Person, a corporation, partnership, limited liability company or other entity in which that Person directly or indirectly owns or controls more than 50% of the Equity Interests or more than 50% of the voting power of such corporation, partnership, limited liability company or other entity. Unless otherwise specified, each reference to Subsidiary in this Agreement means a Subsidiary of the Borrower.

“Structured Finance Obligation” means any obligation issued by a special purpose vehicle and secured directly by, referenced to, or representing ownership of or investment in, a pool of receivables or other financial assets of any obligor, including collateralized loan obligations, collateralized debt obligations and mortgaged-backed securities. For the avoidance of doubt, if an obligation satisfies the definition of “Structured Finance Obligation”, such obligation shall not (a) qualify as any other category of Portfolio Investment and (b) be included in the Borrowing Base.

“Swap Obligations” means, with respect to any Person, its obligations under a Hedging Agreement that constitutes a “swap” within the meaning of Section 1a(47) of the Commodity Exchange Act.

“Swingline Loan” means any Borrowing of Base Rate Revolver Loans funded with Agent’s funds, until such Borrowing is settled among Lenders or repaid by Borrower.

“Tangible Net Worth” means, as of any date, the total assets of Parent, calculated in accordance with GAAP, minus the total Debt of Parent, calculated on a consolidated basis in accordance with GAAP, minus the amount of all intangible items reflected therein, including all unamortized debt discount and expense, unamortized research and development expense, unamortized deferred charges, goodwill, patents, trademarks, service marks, trade names, copyrights, and all similar items that should properly be treated as intangibles in accordance with GAAP, minus all amounts due from Parent’s Affiliates.

“Taxes” means all present or future taxes, levies, imposts, duties, deductions, withholdings (including backup withholding), assessments, fees or other charges imposed by any governmental authority, including any interest, additions to tax or penalties applicable thereto.

“Third Party Finance Company” means a Person that is (i) an operating company with employees, officers and directors, (ii) in the primary business of originating loans or factoring or financing receivables, inventory or other current assets and (iii) an unaffiliated third party business organized under the laws of any State of the United States of America, domiciled in the United States of America, and with its principal operations and property located in the United States of America.

“Transaction Documents” means this Agreement, the Sale Agreement, the Servicing Agreement, the Custodian Agreement, each Guaranty, the Security Documents, any fee letter to which Agent is a party (including the Fee Letter), each Borrowing Base Certificate, each Compliance Certificate, any flow of funds agreement or disbursement letter delivered in connection with this Agreement or the transactions contemplated hereby, promissory note or other note (including, without limitation, any notes issued pursuant to **Section 2.1.2** of this Agreement), each document, instrument, certificate (including any information certificate, solvency certificate, incumbency certificate, closing certificate, or certificate with respect to Material Contracts)) or agreement now or hereafter delivered by Borrower, Parent or the Servicer to Agent or a Lender in connection with any transactions relating hereto, all Borrowing Base information, reports, financial statements and other materials delivered by Borrower hereunder, as well as other Reports and information provided by Agent to Lenders.

“Transferee” means any actual or potential Eligible Assignee, Participant or other Person acquiring an interest in any Obligations.

“Type” means any type of a Loan (i.e., Base Rate Loan or LIBOR Index Loan) that has the same interest option.

“UCC” means the Uniform Commercial Code as in effect in the State of Georgia or, when the laws of any other jurisdiction govern the perfection or enforcement of any Lien, the Uniform Commercial Code of such jurisdiction.

“Underlying Instruments” means the loan agreement, credit agreement, indenture or other agreement pursuant to which a Bank Loan or Portfolio Investment has been issued or created and each other agreement that governs the terms of or secures the obligations represented by such Bank Loan or Portfolio Investment or of which the holders of such Bank Loan or Portfolio Investment are the beneficiaries.

“Unitranche Loan” means each Bank Loan determined by Borrower in accordance with the Investment and Valuation Policies to be a “unitranche” loan or otherwise underwritten as such.

“Unquoted Investment” means an Eligible Portfolio Investment which is not a Quoted Investment.

“Unquoted Reported Value” has the meaning assigned to such term in **Section 9.1.11(b)(ii)(B)**.

“U.S. Government Securities” means securities that are direct obligations of, and obligations the timely payment of principal and interest on which is fully guaranteed by, the United States or any agency or instrumentality of the United States the obligations of which are backed by the full faith and credit of the United States and in the form of conventional bills, bonds, and notes.

“U.S. Person” means any Person that is a “United States Person” as defined in Section 7701(a)(30) of the Code.

“Value” means, with respect to any Eligible Portfolio Investment, the value thereof determined for purposes of this Agreement in accordance with **Section 9.1.11(b)(ii)**.

**1.2 Accounting Terms.** Under the Transaction Documents (except as otherwise specified herein), all accounting terms shall be interpreted, all accounting determinations shall be made, and all financial statements shall be prepared, in accordance with GAAP applied on a basis consistent with the most recent audited financial statements of Borrower delivered to Agent before the Closing Date and using the same asset valuation method as used in such financial statements, except for any change required or permitted by GAAP if Borrower’s certified public accountants concur in such change, the change is disclosed to Agent, and **Section 9.3** is amended in a manner satisfactory to Required Lenders to take into account the effects of the change.

**1.3 Uniform Commercial Code.** All other terms contained in this Agreement shall have, when the context so indicates, the meanings provided for by the UCC to the extent the same are used or defined therein. Without limiting the generality of the foregoing, the following terms shall have the meaning ascribed to them in the UCC: Account, Chattel Paper, Commercial Tort Claim, Commodity Account, Deposit Account, Document, Electronic Chattel Paper, Equipment, Fixtures, Goods, General Intangible, Instrument, Inventory, Investment Property, Letter-of-Credit Right, Payment Intangible, Proceeds, Securities Account, Software and Supporting Obligations.

**1.4 Certain Matters of Construction.** The terms “herein,” “hereof,” “hereunder” and other words of similar import refer to this Agreement as a whole and not to any particular section, paragraph or subdivision. Any pronoun used shall be deemed to cover all genders. In the computation of periods of time from a specified date to a later specified date, “from” means “from and including,” and “to” and “until” each mean “to but excluding.” The terms “including” and “include” shall mean “including, without limitation” and, for purposes of each Transaction Document, the parties agree that the rule of *ejusdem generis* shall not be applicable to limit any provision. Section titles appear as a matter of convenience only and shall not affect the interpretation of any Transaction Document. All references to (a) laws or statutes include all related rules, regulations, interpretations, amendments and successor provisions; (b) any document, instrument or agreement include any amendments, waivers and other modifications, extensions or renewals (to the extent permitted by the Transaction Documents); (c) any section mean, unless the context otherwise requires, a section of this Agreement; (d) any exhibits or schedules mean, unless the context otherwise requires, exhibits and schedules attached hereto, which are hereby incorporated by reference; (e) any Person include successors and assigns; (f) time of day means time of day at Agent’s notice address under **Section 13.3.1**; or (g) discretion of Agent or any Lender mean the sole and absolute discretion of such Person. The recitals and preamble hereto are incorporated by reference and shall be deemed an integral part of this Agreement. All calculations of Value, fundings of Loans, and payments of Obligations shall be in Dollars and, unless the context otherwise requires, all determinations (including calculations of Borrowing Base and financial covenants) made from time to time under the Transaction Documents shall be made in light of the circumstances existing at such time. Borrowing Base calculations shall be consistent with historical methods of valuation and calculation, and otherwise satisfactory to Agent (and not necessarily calculated in accordance with GAAP). Borrower shall have the burden of establishing any alleged negligence, misconduct or lack of good faith by Agent or any Lender under any Transaction Documents. No provision of any Transaction Documents shall be construed against any party by reason of such party having, or being deemed to have, drafted the provision. Whenever the phrase “to the best of Borrower’s knowledge” or words of similar import are used in any Transaction Documents, it means actual knowledge of a Senior Officer, or knowledge that a Senior Officer would have obtained if he or she had engaged in good faith and diligent performance of his or her duties, including reasonably specific inquiries of employees or agents and a good faith attempt to ascertain the matter to which such phrase relates.

## SECTION 2. CREDIT FACILITIES

### 2.1 Revolver Commitment

2.1.1 Revolver Loans. Each Lender agrees, severally on a Pro Rata basis up to its Revolver Commitment, on the terms set forth herein, to make Revolver Loans to Borrower from time to time through the Commitment Termination Date. The Revolver Loans may be repaid and reborrowed as provided herein. In no event shall Lenders have any obligation to honor a request for a Revolver Loan if the unpaid balance of Revolver Loans outstanding at such time (including the requested Loan) would exceed the Borrowing Base.

2.1.2 Revolver Notes. The Revolver Loans made by each Lender and interest accruing thereon shall be evidenced by the records of Agent and such Lender. At the request of any Lender, Borrower shall deliver a promissory note to such Lender evidencing Borrower's obligations in respect of the Revolver Commitments of such Lender.

2.1.3 Use of Proceeds. The proceeds of Revolver Loans shall be used by Borrower solely (a) to pay fees and transaction expenses associated with the closing of this credit facility; (b) to pay Obligations (including interest when due) in accordance with this Agreement; (c) for working capital and other lawful corporate purposes of Borrower; (d) to acquire Eligible Portfolio Investments pursuant to the Sale Agreement; (e) to make Eligible Portfolio Investments; (f) to pay cash Distributions to Parent in accordance with **Section 9.2.3**; (g) to pay Administrative Expenses (to the extent that funds on deposit in the Dominion Account are insufficient to pay such expenses when due), and (h) to pay Borrower Expenses (to the extent that funds on deposit in the Dominion Account are insufficient to pay such expenses when due). Borrower will not request any Loan, and Borrower and its Subsidiaries will not use, and its directors, officers, employees and agents will not use, the proceeds of any Loan (a) in the furtherance of an offer, payment, promise to pay, or authorization of the payment or giving of money, or anything else of value, to any Person in violation of any Anti-Corruption Laws, (b) for the purpose of funding, financing or facilitating any activities, business or transaction of or with any Sanctioned Person, or in any Sanctioned Country, to the extent such activities, businesses or transaction would be prohibited by Sanctions if conducted by a corporation incorporated in the United States or in an European Union member state or (c) in any manner that would result in the violation of any Sanctions applicable to any party hereto.

#### 2.1.4 Termination of Revolver Commitments.

(a) The Revolver Commitments shall terminate on the Commitment Termination Date, unless sooner terminated in accordance with this Agreement. Upon at least 30 days prior written notice to Agent, Borrower may, at its option, terminate the Revolver Commitments and this credit facility prior to the Scheduled Revolving Period End Date. Any notice of termination given by Borrower shall be irrevocable and on the effective date of such termination, Borrower shall make Full Payment of all Obligations.



(b) Concurrently with any termination of the Revolver Commitments and this credit facility during the first Loan Year, for whatever reason (including an Event of Default), Borrower shall pay to Agent, for the Pro Rata benefit of Lenders and as liquidated damages for loss of bargain (and not as a penalty), an amount equal to 1% of the Revolver Commitments. No termination charge shall be payable after the end of the first Loan Year.

2.1.5 Overadvances. If the aggregate Revolver Loans exceed the Borrowing Base (“Overadvance”) at any time, the excess amount shall be payable by Borrower **on demand** by Agent, but all such Revolver Loans shall nevertheless constitute Obligations secured by the Collateral and entitled to all benefits of the Transaction Documents. Agent may require Lenders to honor requests for Overadvance Loans and to forbear from requiring Borrower to cure an Overadvance, (a) when no other Event of Default is known to Agent, as long as the Overadvance does not continue for more than 30 consecutive days (and no Overadvance may exist for at least five consecutive days thereafter before further Overadvance Loans are required); and (b) regardless of whether an Event of Default exists, if Agent discovers an Overadvance not previously known by it to exist, as long as from the date of such discovery the Overadvance does not continue for more than 30 consecutive days. In no event shall Overadvance Loans (x) be required that would cause the outstanding Revolver Loans to exceed the aggregate Revolver Commitments and (y) exceed ten percent (10%) of the Borrowing Base. Any funding of an Overadvance Loan or sufferance of an Overadvance shall not constitute a waiver by Agent or Lenders of the Event of Default caused thereby. In no event shall Borrower be deemed a beneficiary of this Section nor authorized to enforce any of its terms.

2.1.6 Protective Advances. Agent shall be authorized, in its discretion, at any time that any conditions in **Section 6** are not satisfied, and without regard to the aggregate Commitments, to make Base Rate Revolver Loans (“Protective Advances”) (a) if Agent deems such Loans necessary or desirable to preserve or protect Collateral, or to enhance the collectibility or repayment of Obligations; or (b) to pay any other amounts chargeable to Borrower under any Transaction Documents, including costs, fees and expenses. Each Lender shall participate in each Protective Advance on a Pro Rata basis. Required Lenders may at any time revoke Agent’s authority to make further Protective Advances under clause (a) by written notice to Agent. Absent such revocation, Agent’s determination that funding of a Protective Advance is appropriate shall be conclusive.

### **SECTION 3. INTEREST, FEES AND CHARGES**

#### **3.1 Interest**

##### **3.1.1 Rates and Payment of Interest**

(a) The Obligations shall bear interest (i) if a Base Rate Loan, at the Base Rate in effect from time to time, plus the Applicable Margin; (ii) if a LIBOR Index Loan, at the Daily LIBOR Rate in effect from time to time, plus the Applicable Margin; and (iii) if any other Obligation (including, to the extent permitted by law, interest not paid when due), at the Base Rate in effect from time to time, plus the Applicable Margin for Base Rate Revolver Loans. Interest shall accrue from the date the Loan is advanced or the Obligation is incurred or payable, until paid by Borrower. If a Loan is repaid on the same day made, one day’s interest shall accrue. The Base Rate on the date hereof is 4.5% per annum and, therefore, the rate of interest in effect on the date hereof, expressed in simple interest terms, is 7.8576% per annum for Base Rate Revolver Loans. The Daily LIBOR Rate on the date hereof is 1.67007% per annum and, therefore, the rate of interest in effect on the date hereof, expressed in simple interest terms, is 4.98840% per annum for LIBOR Index Revolver Loans. All Loans shall bear interest at the Daily LIBOR Rate except as otherwise provided in **Section 3.6** of this Agreement.

(b) During an Insolvency Proceeding with respect to Borrower, or during any other Event of Default if Agent or Required Lenders in their discretion so elect, Obligations shall bear interest at the Default Rate (whether before or after any judgment). Borrower acknowledges that the cost and expense to Agent and Lenders due to an Event of Default are difficult to ascertain and that the Default Rate is a fair and reasonable estimate to compensate Agent and Lenders for this.

(c) Interest accrued on the Loans shall be due and payable in arrears, (i) on the first day of each calendar month; (ii) on any date of prepayment, with respect to the principal amount of Loans being prepaid; and (iii) on the Maturity Date or the date the Obligations are accelerated pursuant to the terms of this Agreement. Interest accrued on any other Obligations shall be due and payable as provided in the Transaction Documents and, if no payment date is specified, shall be due and payable **on demand**. Notwithstanding the foregoing, interest accrued at the Default Rate shall be due and payable **on demand**.

3.1.2 Application of LIBOR to Outstanding Loans. Borrower may on any Business Day, subject to delivery of a Notice of Conversion/Continuation, elect to convert any portion of the Base Rate Loans to LIBOR Index Loans or LIBOR Index Loans to Base Rate Loans.

3.1.3 Types of Loans. Except as otherwise provided in this Agreement, including pursuant to **Sections 3.1.2, 3.5 or 3.6**, all Loans shall be made as LIBOR Index Revolver Loans.

### 3.2 Fees

3.2.1 Unused Line Fee. Borrower shall pay to Agent, for the Pro Rata benefit of Lenders, a fee equal to (a) 0.375% per annum times the amount by which the Revolver Commitments exceed the average daily balance of Revolver Loans during any month if the daily unused amount as of the close of business on such day is less than 50% of the Commitments, and (b) 0.50% per annum times the amount by which the Revolver Commitments exceed the average daily balance of Revolver Loans during any month if the daily unused amount as of the close of business on such day is greater than or equal to 50% of the Commitments. Such fee shall be payable in arrears, on the first day of each month and on the Commitment Termination Date.

3.2.2 Reserved.

3.2.3 Closing Fee. On the Closing Date, Borrower shall pay to Agent, for the Pro Rata benefit of Lenders, a closing fee equal to 1% of the amount of the Commitments.

3.2.4 Agent Fees. Borrower shall pay to Agent, for its own account, the fees described in the Fee Letter. Borrower shall also pay to Agent its standard wire fee for each outgoing wire made by Agent at the request of Borrower.

**3.3 Computation of Interest, Fees, Yield Protection.** All interest, as well as fees and other charges calculated on a per annum basis, shall be computed for the actual days elapsed, based on a year of 360 days. Each determination by Agent of any interest, fees or interest rate hereunder shall be final, conclusive and binding for all purposes, absent manifest error. All fees shall be fully earned when due and shall not be subject to rebate, refund or proration. All fees payable under **Section 3.2** are compensation for services and are not, and shall not be deemed to be, interest or any other charge for the use, forbearance or detention of money. A certificate as to amounts payable by Borrower under **Section 3.4, 3.6, 3.7, or 5.10**, submitted to Borrower by Agent or the affected Lender, as applicable, shall be final, conclusive and binding for all purposes, absent manifest error, and Borrower shall pay such amounts to the appropriate party within 10 days following receipt of the certificate.

**3.4 Reimbursement Obligations.** Borrower shall reimburse Agent and Lenders for all Extraordinary Expenses. Borrower shall also reimburse Agent and, as applicable, Lenders, solely to the extent that such amounts do not constitute Extraordinary Expenses, for all (i) legal fees and expenses of one outside counsel for Agent and Lenders, taken as a whole (and, in the case of an actual conflict of interest, one additional counsel to the applicable Persons, taken as a whole, and to the extent reasonably necessary one local counsel in each relevant jurisdiction to Agent and Lenders, taken as a whole), in each case prior to an Event of Default, provided that after the occurrence and during the continuation of an Event of Default, Borrower shall reimburse Agent and Lenders for all legal fees and expenses of outside counsel incurred after the occurrence of such Event of Default, (ii) accounting, appraisal, consulting, and other fees, costs and expenses incurred by Agent, in connection with (a) negotiation and preparation of any Transaction Documents, including any amendment or other modification thereof; (b) administration of and actions relating to any Collateral, Transaction Documents and transactions contemplated thereby, including any actions taken to perfect or maintain priority of Agent's Liens on any Collateral, to maintain any insurance required hereunder or to verify Collateral; and (c) subject to the limits of **Section 9.1.2(b)**, each inspection, audit or appraisal with respect to Borrower, Servicer or Collateral, whether prepared by Agent's personnel or a third party. All legal, accounting and consulting fees shall be charged to Borrower by Agent's and Lenders' respective professionals at their full hourly rates, regardless of any reduced or alternative fee billing arrangements that Agent, any Lender, or any of their Affiliates may have with such professionals with respect to this or any other transaction; provided, that the foregoing shall in no way limit Borrower's obligations to reimburse Agent, or Lenders as provided for elsewhere in the Transaction Documents, including, without limitation, reimbursement of Extraordinary Expenses pursuant to this **Section 3.4** and reimbursements contemplated pursuant to **Section 9.1.2**. All amounts payable by Borrower under this Section shall be due **on demand**.

**3.5 Illegality.** If any Lender determines that any Applicable Law has made it unlawful, or that any governmental authority has asserted that it is unlawful, for any Lender or its applicable Lending Office to determine or charge interest rates based upon the Daily LIBOR Rate, or any governmental authority has imposed material restrictions on the authority of such Lender to purchase or sell, or to take deposits of, Dollars in the London interbank market, then, on notice thereof by such Lender to Agent, any obligation of such Lender to make LIBOR Index Loans or to convert Base Rate Loans to LIBOR Index Loans shall be suspended until such Lender notifies Agent that the circumstances giving rise to such determination no longer exist. Upon delivery of such notice, Borrower shall prepay or, if applicable, convert all LIBOR Index Loans of such Lender to Base Rate Loans immediately if such Lender may not lawfully continue to maintain such LIBOR Index Loans. Upon any such prepayment or conversion, Borrower shall also pay accrued interest on the amount so prepaid or converted.

**3.6 Inability to Determine Rates.** If Required Lenders notify Agent for any reason in connection with a request for a Borrowing of, or conversion to or continuation of, a LIBOR Index Loan that (a) Dollar deposits are not being offered to banks in the London interbank Eurodollar market for the Daily LIBOR Rate, (b) adequate and reasonable means do not exist for determining the Daily LIBOR Rate, or (c) the Daily LIBOR Rate does not adequately and fairly reflect the cost to such Lenders of funding such Loan, then Agent will promptly so notify Borrower and each Lender. Thereafter, the obligation of Lenders to make or maintain LIBOR Index Loans shall be suspended until Agent (upon instruction by Required Lenders) revokes such notice. Upon receipt of such notice, Borrower may revoke any pending request for a Borrowing of, conversion to or continuation of a LIBOR Index Loan or, failing that, will be deemed to have submitted a request for a Base Rate Loan.

**3.7 Increased Costs; Capital Adequacy.**

**3.7.1 Change in Law.** If any Change in Law shall:

(a) impose, modify or deem applicable any reserve, special deposit, compulsory loan, insurance charge or similar requirement against assets of, deposits with or for the account of, or credit extended or participated in by, any Lender (including any reserve requirement);

(b) subject any Lender to any Taxes (other than (A) Indemnified Taxes, (B) Taxes described in clauses (b) through (d) of the definition of Excluded Taxes and (C) Connection Income Taxes) on its loans, loan principal, letters of credit, commitments, or other obligations, or its deposits, reserves, other liabilities or capital attributable thereto; or

(c) impose on any Lender or interbank market any other condition, cost or expense (other than Taxes) affecting any Loan, Transaction Document, or Commitment;

and the result thereof shall be to increase the cost to such Lender of making or maintaining any Loan or Commitment, or to reduce the amount of any sum received or receivable by such Lender hereunder (whether of principal, interest or any other amount) then, upon request of such Lender, Borrower will pay to such Lender such additional amount or amounts as will compensate such Lender for such additional costs incurred or reduction suffered.

**3.7.2 Capital Adequacy.** If any Lender determines that any Change in Law affecting such Lender or any Lending Office of such Lender or such Lender's holding company, if any, regarding capital or liquidity requirements has or would have the effect of reducing the rate of return on such Lender's or holding company's capital as a consequence of this Agreement, or such Lender's Commitments or Loans to a level below that which such Lender or holding company could have achieved but for such Change in Law (taking into consideration such Lender's and holding company's policies with respect to capital adequacy and liquidity), then from time to time Borrower will pay to such Lender such additional amount or amounts as will compensate it or its holding company for any such reduction suffered.

**3.7.3 Compensation.** Failure or delay on the part of any Lender to demand compensation pursuant to this Section shall not constitute a waiver of its right to demand such compensation, but Borrower shall not be required to compensate a Lender for any increased costs incurred or reductions suffered more than nine months prior to the date that the Lender notifies Borrower of the Change in Law giving rise to such increased costs or reductions and of such Lender's intention to claim compensation therefor (except that, if the Change in Law giving rise to such increased costs or reductions is retroactive, then the nine-month period referred to above shall be extended to include the period of retroactive effect thereof).

**3.8 Mitigation.** If any Lender gives a notice under **Section 3.5** or requests compensation under **Section 3.7**, or if Borrower is required to pay additional amounts with respect to a Lender under **Section 5.10**, then, at the request of Borrower, such Lender shall use reasonable efforts to designate a different Lending Office or to assign its rights and obligations hereunder to another of its offices, branches or Affiliates, if, in the judgment of such Lender, such designation or assignment (a) would eliminate the need for such notice or reduce amounts payable or to be withheld in the future, as applicable; and (b) would not subject the Lender to any unreimbursed cost or expense and would not otherwise be disadvantageous to it or unlawful. Borrower shall pay all reasonable costs and expenses incurred by any Lender in connection with any such designation or assignment.

**3.9 Reserved.**

**3.10 Maximum Interest.** Notwithstanding anything to the contrary contained in any Transaction Document, the interest paid or agreed to be paid under the Transaction Documents shall not exceed the maximum rate of non-usurious interest permitted by Applicable Law ("maximum rate"). If Agent or any Lender shall receive interest in an amount that exceeds the maximum rate, the excess interest shall be applied to the principal of the Obligations or, if it exceeds such unpaid principal, refunded to Borrower. In determining whether the interest contracted for, charged or received by Agent or a Lender exceeds the maximum rate, such Person may, to the extent permitted by Applicable Law, (a) characterize any payment that is not principal as an expense, fee or premium rather than interest; (b) exclude voluntary prepayments and the effects thereof; and (c) amortize, prorate, allocate and spread in equal or unequal parts the total amount of interest throughout the contemplated term of the Obligations hereunder.

**SECTION 4. LOAN ADMINISTRATION**

**4.1 Manner of Borrowing and Funding Revolver Loans**

**4.1.1 Notice of Borrowing.**

(a) Whenever Borrower desires funding of a Borrowing of Revolver Loans, Borrower shall give Agent a Notice of Borrowing signed by a Senior Officer, which shall be in such form as may be required by Agent (and which notice may be given electronically subject to the limitations set forth in **Section 13.3.2**) and which shall specify the account of Borrower into which the proceeds of such Revolver Loans should be disbursed. Such notice must be received by Agent no later than 11:00 a.m. on the Business Day of the requested funding date, in the case of Base Rate Loans or LIBOR Index Loans. Notices received after 11:00 a.m. shall be deemed received on the next Business Day. Each Notice of Borrowing shall be irrevocable and shall specify (A) the amount of the Borrowing, and (B) the requested funding date (which must be a Business Day).

(b) Unless payment is otherwise timely made by Borrower, the becoming due of any Obligations (whether principal, interest, fees or other charges, including Extraordinary Expenses, Cash Collateral and Secured Bank Product Obligations) shall be deemed to be a request for Base Rate Revolver Loans on the due date, in the amount of such Obligations. The proceeds of such Revolver Loans shall be disbursed as direct payment of the relevant Obligation. In addition, Agent may, at its option, charge such Obligations against any operating, investment or other account of Borrower maintained with Agent or any of its Affiliates.

(c) If Borrower establishes a controlled disbursement account with Agent or any Affiliate of Agent, then the presentation for payment of any check, ACH or electronic debit, or other payment item at a time when there are insufficient funds to cover it shall be deemed to be a request for Base Rate Revolver Loans on the date of such presentation, in the amount of such payment item. The proceeds of such Revolver Loans may be disbursed directly to the controlled disbursement account or other appropriate account.

4.1.2 Fundings by Lenders. Each Lender shall timely honor its Revolver Commitment by funding its Pro Rata share of each Borrowing of Revolver Loans that is properly requested hereunder. Except for Borrowings to be made as Swingline Loans, Agent shall endeavor to notify Lenders of each Notice of Borrowing (or deemed request for a Borrowing) by 12:00 noon on the proposed funding date for Base Rate Loans or LIBOR Index Loans. Each Lender shall fund to Agent such Lender's Pro Rata share of the Borrowing to the account specified by Agent in immediately available funds not later than 2:00 p.m. on the requested funding date, unless Agent's notice is received after the times provided above, in which case Lender shall fund its Pro Rata share by 11:00 a.m. on the next Business Day. Subject to its receipt of such amounts from Lenders, Agent shall disburse the proceeds of the Revolver Loans as directed by Borrower. Unless Agent shall have received (in sufficient time to act) written notice from a Lender that it does not intend to fund its Pro Rata share of a Borrowing, Agent may assume that such Lender has deposited or promptly will deposit its share with Agent, and Agent may disburse a corresponding amount to Borrower. If a Lender's share of any Borrowing or of any settlement pursuant to **Section 4.1.3(b)** is not received by Agent, then Borrower agrees to repay to Agent **on demand** the amount of such share, together with interest thereon from the date disbursed until repaid, at the rate applicable to the Borrowing.

4.1.3 Swingline Loans; Settlement.

(a) Agent may, but shall not be obligated to, advance Swingline Loans to Borrower, up to an aggregate outstanding amount of \$5,000,000. Each Swingline Loan shall constitute a Revolver Loan for all purposes, except that payments thereon shall be made to Agent for its own account. The obligation of Borrower to repay Swingline Loans shall be evidenced by the records of Agent and need not be evidenced by any promissory note.

(b) Settlement of Swingline Loans and other Revolver Loans among Lenders and Agent shall take place on a date determined from time to time by Agent (but at least weekly), in accordance with the Settlement Report delivered by Agent to Lenders. Between settlement dates, Agent may in its discretion apply payments on Revolver Loans to Swingline Loans, regardless of any designation by Borrower or any provision herein to the contrary. Each Lender's obligation to make settlements with Agent is absolute and unconditional, without offset, counterclaim or other defense, and whether or not the Commitments have terminated, an Overadvance exists or the conditions in **Section 6** are satisfied. If, due to an Insolvency Proceeding with respect to Borrower or for any other reason, any Swingline Loan may not be settled among Lenders hereunder, then each Lender shall be deemed to have purchased from Agent a Pro Rata participation in such Loan and shall transfer the amount of such participation to Agent, in immediately available funds, within one Business Day after Agent's request therefor.

4.1.4 Notices. Borrower may request, convert or continue Loans, select interest rates and transfer funds based on telephonic or e-mailed instructions to Agent (subject to the limitations set forth in **Section 13.3.2**). Borrower shall confirm each such request by prompt delivery to Agent of a Notice of Borrowing or Notice of Conversion/Continuation, if applicable, but if it differs materially from the action taken by Agent or Lenders, the records of Agent and Lenders shall govern. Neither Agent nor any Lender shall have any liability for any loss suffered by Borrower as a result of Agent or any Lender acting upon its understanding of telephonic or e-mailed instructions (subject to the limitations set forth in **Section 13.3.2**) from a person believed in good faith by Agent or any Lender to be a person authorized to give such instructions on Borrower's behalf.

## 4.2 **Defaulting Lender**

4.2.1 **Reallocation of Pro Rata Share; Amendments.** For purposes of determining Lenders' obligations to fund or participate in Loans, to share in fees or for any other determination permitted hereunder, Agent may exclude the Commitments and Loans of any Defaulting Lender(s) from the calculation of Pro Rata shares. A Defaulting Lender shall have no right to vote on any amendment, waiver or other modification of a Transaction Document, except as provided in **Section 13.1.1(c)**.

4.2.2 **Payments; Fees.** Agent may, in its discretion, receive and retain any amounts payable to a Defaulting Lender under the Transaction Documents, and a Defaulting Lender shall be deemed to have assigned to Agent such amounts until all Obligations owing to Agent, non-Defaulting Lenders and other Secured Parties have been paid in full. Agent may apply such amounts to the Defaulting Lender's defaulted obligations or readvance the amounts to Borrower hereunder. A Lender shall not be entitled to receive any fees accruing hereunder during the period in which it is a Defaulting Lender, and the unfunded portion of its Commitment shall be disregarded for purposes of calculating the unused line fee under **Section 3.2.1**.

4.2.3 **Cure.** Agent may determine in its reasonable discretion that a Lender constitutes a Defaulting Lender and the effective date of such status shall be conclusive and binding on all parties, absent manifest error. Borrower and Agent may agree in writing that a Lender is no longer a Defaulting Lender. At such time, Pro Rata shares shall be reallocated without exclusion of such Lender's Commitments and Loans, and all outstanding Revolver Loans and other exposures under the Revolver Commitments shall be reallocated among Lenders and settled by Agent (with appropriate payments by the reinstated Lender) in accordance with the readjusted Pro Rata shares. Unless expressly agreed by Borrower and Agent, no reinstatement of a Defaulting Lender shall constitute a waiver or release of claims against such Lender. The failure of any Lender to fund a Loan or otherwise to perform its obligations hereunder shall not relieve any other Lender of its obligations, and no Lender shall be responsible for default by another Lender.

4.3 **One Obligation.** The Loans and other Obligations constitute one general obligation of Borrower and are secured by Agent's Lien (for the benefit of the Secured Parties) on all Collateral; provided, however, that Agent and each Lender shall be deemed to be a creditor of, and the holder of a separate claim against, Borrower to the extent of any Obligations jointly or severally owed by Borrower.

4.4 **Effect of Termination.** On the Maturity Date, all Obligations shall be immediately due and payable, and any Lender may terminate its and its Affiliates' Bank Products (including, only with the consent of Agent, any Cash Management Services). All undertakings of Borrower contained in the Transaction Documents shall survive any termination, and Agent shall retain its Liens in the Collateral for the benefit of the Secured Parties and all of its rights and remedies under the Transaction Documents until Full Payment of the Obligations. Notwithstanding Full Payment of the Obligations, Agent shall not be required to terminate its Liens in any Collateral unless, with respect to any damages Agent may incur as a result of the dishonor or return of Payment Items applied to Obligations, Agent receives (a) a written agreement satisfactory to Agent, executed by Borrower and any Person whose advances are used in whole or in part to satisfy the Obligations, indemnifying Agent and Lenders from such damages; and (b) such Cash Collateral as Agent, in its discretion, deems appropriate to protect against such damages. **Sections 3.4, 3.6, 3.7, 5.6, 5.10, 5.11, 11, 13.2** and this **Section 4.4**, and the obligation of Borrower and Lender with respect to each indemnity given by it in any Transaction Document, shall survive Full Payment of the Obligations and any release relating to this credit facility.

## SECTION 5. PAYMENTS

5.1 **General Payment Provisions.** All payments of Obligations shall be made in Dollars, without offset, counterclaim or defense of any kind, free of (and without deduction for) any Taxes (except as required by Applicable Law), and in immediately available funds, not later than 12:00 noon on the due date. Any payment after such time shall be deemed made on the next Business Day. Any prepayment of Loans shall be applied first to Base Rate Loans, then to LIBOR Index Loans.

5.2 **Repayment of Revolver Loans.** Revolver Loans shall be due and payable in full on the Maturity Date, unless payment is sooner required hereunder. Subject to Section 2.1.4(b), Revolver Loans may be prepaid from time to time, without penalty or premium in accordance with the terms of Section 5.7 of this Agreement. If any asset disposition includes the disposition of Bank Loans or other Property outside of, in the case of such other Property, the Ordinary Course, then the net proceeds thereof shall be applied to the Revolver Loans in an amount equal to not less than the value allocated to such Bank Loans in the Borrowing Base. Notwithstanding anything herein to the contrary, if an Overadvance exists, Borrower shall, on the sooner of Agent's demand or the first Business Day after Borrower has knowledge thereof, repay the outstanding Revolver Loans in an amount sufficient to reduce the principal balance of Revolver Loans to the Borrowing Base.

### 5.3 **Reserved.**

5.4 **Payment of Other Obligations.** Obligations other than Loans, including Extraordinary Expenses, shall be paid by Borrower as provided in the Transaction Documents or, if no payment date is specified, **on demand**.

5.5 **Dominion Account.** Borrower shall maintain Dominion Accounts pursuant to lockbox or other arrangements with Custodian. Borrower shall obtain an agreement (in form and substance satisfactory to Agent) from Custodian, establishing Agent's control over and Lien in (for the benefit of the Secured Parties) the lockbox or a Dominion Account, requiring immediate deposit of all remittances received in the lockbox to a Dominion Account, and waiving offset rights of Custodian, except for customary administrative charges. Agent and Lenders assume no responsibility to Borrower for any lockbox arrangement or a Dominion Account, including any claim of accord and satisfaction or release with respect to any Payment Items accepted by Custodian. Agent shall have the right at any time after the occurrence and during the continuation of an Event of Default to contact directly any or all administrative agents with respect to Portfolio Investments (or if there is no administrative agent for such Portfolio Investment, any Portfolio Company) to ensure that payments on the Bank Loans are directed to a Dominion Account. Borrower shall request in writing and otherwise take all necessary steps to ensure that all payments on Bank Loans or otherwise relating to Collateral are made directly to a Dominion Account (or a lockbox relating to a Dominion Account). If Borrower or Servicer receives cash or Payment Items with respect to any Collateral, it shall hold the same in trust and as agent for Agent (and shall not be commingled with Borrower's or Servicer's other funds) and promptly (not later than the next Business Day) deposit same into a Dominion Account. All such cash and Payment Items shall be subject to the Lien of Agent upon the earlier of the receipt thereof by Agent, Borrower or Servicer. Borrower hereby grants to Agent (for the benefit of the Secured Parties) a Lien upon all items and balances held in any lockbox and the Dominion Account as security for the payment of the Obligations, in addition to and cumulative with the general security interest in all other assets of Borrower (including all Deposit Accounts) as provided elsewhere in this Agreement or any other Transaction Document. Agent shall be entitled to apply immediately to the Obligations any wire transfer, check or other item of payment received by Agent. Interest shall continue accruing on the amount of any wire transfer, check or other Payment Item for one Business Day after the date that the proceeds of such wire transfer, check or other payment item become good, collected funds received by Agent and are applied to the Obligations. Borrower irrevocably waives the right to direct the application of any and all payments and collections at any time or times hereafter received by Agent from or on behalf of Borrower, and Borrower does hereby irrevocably agree that Agent shall have the continuing exclusive right to apply and reapply any and all such payments and collections received at any time or times hereafter by Agent or its agent against the Obligations in such manner as set forth herein.



**5.6 Marshaling; Payments Set Aside.** None of Agent or Lenders shall be under any obligation to marshal any assets in favor of Borrower or any of its Affiliates or against any Obligations. If any payment by or on behalf of Borrower is made to Agent or any Lender, or Agent or any Lender exercises a right of setoff, and such payment or the proceeds of such setoff or any part thereof is subsequently invalidated, declared to be fraudulent or preferential, set aside or required (including pursuant to any settlement entered into by Agent or such Lender in its discretion) to be repaid to a trustee, receiver or any other Person, then to the extent of such recovery, the Obligation originally intended to be satisfied, and all Liens, rights and remedies relating thereto, shall be revived and continued in full force and effect as if such payment had not been made or such setoff had not occurred.

**5.7 Allocation of Payments**

5.7.1 Allocation.

(a) Except as provided in clause (b) below, monies to be applied to the Obligations, whether arising from payments by Portfolio Companies, realization on Collateral, setoff or otherwise, shall be allocated as follows:

1. first, to all Administrative Expenses then due and payable;
2. second, to all costs and expenses, including Extraordinary Expenses, owing to Agent;
3. third, to all Obligations constituting fees then due and payable (other than Secured Bank Product Obligations);
4. fourth, to all Obligations constituting interest fees then due and payable (other than Secured Bank Product Obligations);
5. fifth, to all amounts owing to Agent on Swingline Loans;
6. sixth, to the principal amount of the Loans; and
7. last, to all other Obligations, including all Borrower Expenses then due and payable.

(b) Notwithstanding anything to the contrary contained in this Agreement, upon the occurrence and during the continuation of an Event of Default, all payments when due hereunder shall be applied by the Agent as follows:

1. first, to all Administrative Expenses then due and payable (other than Administrative Expenses arising pursuant to clause (b) of the definition thereof);
2. second, to all costs and expenses, including Extraordinary Expenses, owing to Agent;
3. third, to all amounts owing to Agent on Swingline Loans;
4. fourth, to all Obligations constituting fees (other than Secured Bank Product Obligations);
5. fifth, to all Obligations constituting interest (other than Secured Bank Product Obligations);
6. sixth, to all Loans and Secured Bank Product Obligations, including Cash Collateralization of Secured Bank Product Obligations; and
7. last, to all other Obligations, including all Borrower Expenses and costs and expenses owing to Servicer.

Amounts shall be applied to each category of Obligations set forth above until Full Payment thereof and then to the next category. If amounts are insufficient to satisfy a category, they shall be applied on a pro rata basis among the Obligations in the category. Amounts distributed with respect to any Secured Bank Product Obligations shall be the lesser of the maximum Secured Bank Product Obligations last reported to Agent or the actual Secured Bank Product Obligations as calculated by the methodology reported to Agent for determining the amount due. Agent shall have no obligation to calculate the amount to be distributed with respect to any Secured Bank Product Obligations, and may request a reasonably detailed calculation of such amount from the applicable Secured Party. If a Secured Party fails to deliver such calculation within five days following request by Agent, Agent may assume the amount to be distributed is zero. The allocations set forth in this Section are solely to determine the rights and priorities of Agent and Secured Parties as among themselves, and may be changed by agreement among them without the consent of Borrower. This Section is not for the benefit of or enforceable by Borrower.

5.7.2 Erroneous Application. Agent shall not be liable for any application of amounts made by it in good faith and, if any such application is subsequently determined to have been made in error, the sole recourse of any Lender or other Person to which such amount should have been made shall be to recover the amount from the Person that actually received it (and, if such amount was received by any Lender, such Lender hereby agrees to return it).

## 5.8 Application of Payments

5.8.1 Dominion Account. On any Business Day on which the entire ledger balance in the Dominion Account exceeds \$150,000, an amount equal to the lesser of (a) the entire balance in the Dominion Account, or (b) the outstanding amount of the Obligations shall be directed to Agent and applied by Agent to the Obligations on such Business Day. If, as a result of such application, a credit balance exists, the balance shall not accrue interest in favor of Borrower and shall be made available to Borrower as long as no Default or Event of Default exists. Borrower irrevocably waives the right to direct the application of any payments or Collateral proceeds, and agrees that Agent shall have the continuing, exclusive right to apply and reapply same against the Obligations in such manner as set forth herein.

5.8.2 Insurance and Condemnation Proceeds. Any proceeds of insurance (other than proceeds from workers' compensation or D&O insurance) and any awards arising from condemnation of any Collateral shall be paid to Agent. Any such proceeds or awards shall be applied to payment of the Revolver Loans, and then to any other Obligations outstanding.

5.8.3 Reinvestment. If requested by Borrower in writing within 15 days after Agent's receipt of any insurance proceeds or condemnation awards relating to any loss or destruction of Equipment or real estate, Borrower may use such proceeds or awards to repair or replace such Equipment or real estate (and until so used, the proceeds shall be held by Agent as Cash Collateral or applied to the Revolver Loans) as long as (i) no Default or Event of Default exists; (ii) such repair or replacement is promptly undertaken and concluded, in accordance with plans satisfactory to Agent (but in any event concluded within 180 days after the date of such loss); (iii) replacement buildings are constructed on the sites of the original casualties and are of comparable size, quality and utility to the destroyed buildings; (iv) the repaired or replaced Property is free of Liens (except in favor of Agent); (v) Borrower comply with disbursement procedures for such repair or replacement as Agent may reasonably require; and (vi) the aggregate amount of such proceeds or awards from any single casualty or condemnation does not exceed \$50,000.

## 5.9 Loan Account; Account Stated

5.9.1 Loan Account. Agent shall maintain in accordance with its usual and customary practices an account or accounts ("Loan Account") evidencing the Debt of Borrower resulting from each Loan from time to time. Any failure of Agent to record anything in the Loan Account, or any error in doing so, shall not limit or otherwise affect the obligation of Borrower to pay any amount owing hereunder. Agent may maintain a single Loan Account in the name of Borrower, and Borrower confirms that such arrangement shall have no effect on its liability for the Obligations.

5.9.2 Entries Binding. Entries made in the Loan Account shall constitute presumptive evidence of the information contained therein. If any information contained in the Loan Account is provided to or inspected by any Person, then such information shall be conclusive and binding on such Person for all purposes absent manifest error, except to the extent such Person notifies Agent in writing within 30 days after receipt or inspection that specific information is subject to dispute.

## 5.10 Taxes

5.10.1 Payments Free of Taxes. All payments by Borrower of Obligations shall be free and clear of and without reduction for any Taxes, except as required by Applicable Law. If Applicable Law requires Borrower or Agent to withhold or deduct any Tax (as determined in the good faith discretion of Borrower or Agent, as applicable), the withholding or deduction shall be based on information provided pursuant to **Section 5.11** and Agent shall pay the amount withheld or deducted to the relevant governmental authority. If the withholding or deduction is made on account of Indemnified Taxes or Other Taxes, the sum payable by Borrower shall be increased so that Agent or Lender, as applicable, receives an amount equal to the sum it would have received if no such withholding or deduction (including deductions applicable to additional sums payable under this Section) had been made. Without limiting the foregoing, Borrower shall timely pay all Other Taxes to the relevant governmental authorities.

5.10.2 Payment. Borrower shall indemnify, hold harmless and reimburse (within 10 days after demand therefor) Agent and Lenders for any Indemnified Taxes or Other Taxes (including those attributable to amounts payable under this Section) withheld or deducted by Borrower or Agent, or paid by Agent or any Lender with respect to any Obligations or Transaction Documents, whether or not such Taxes were properly asserted by the relevant governmental authority, and including all penalties, interest and reasonable expenses relating thereto. A certificate as to the amount of any such payment or liability delivered to Borrower by Agent, or by a Lender (with a copy to Agent), shall be conclusive, absent manifest error. As soon as practicable after any payment of Taxes by Borrower, Borrower shall deliver to Agent a receipt from the governmental authority or other evidence of payment satisfactory to Agent.

5.10.3 Treatment of Certain Refunds. If any party determines, in its sole discretion exercised in good faith, that it has received a refund of any Taxes as to which it has been indemnified pursuant to this Section (including by the payment of additional amounts pursuant to this Section), it shall pay to the indemnifying party an amount equal to such refund (but only to the extent of indemnity payments made under this Section with respect to the Taxes giving rise to such refund), net of all out-of-pocket expenses (including Taxes) of such indemnified party and without interest (other than any interest paid by the relevant governmental authority with respect to such refund). Such indemnifying party, upon the request of such indemnified party, shall repay to such indemnified party the amount paid over pursuant to this Section 5.10.3 (plus any penalties, interest or other charges imposed by the relevant governmental authority) in the event that such indemnified party is required to repay such refund to such governmental authority. Notwithstanding anything to the contrary in this Section 5.10.3, in no event will the indemnified party be required to pay any amount to an indemnifying party pursuant to this Section 5.10.3, the payment of which would place the indemnified party in a less favorable net after-Tax position than the indemnified party would have been in if the Tax subject to indemnification and giving rise to such refund had not been deducted, withheld or otherwise imposed and the indemnification payments or additional amounts with respect to such Tax had never been paid. This paragraph shall not be construed to require any indemnified party to make available its Tax returns (or any other information relating to its Taxes that it deems confidential) to the indemnifying party or any other Person.

## **5.11 Lender Tax Information**

5.11.1 Status of Lenders. Each Lender shall deliver documentation and information to Agent and Borrower, at the times and in form required by Applicable Law or reasonably requested by Agent or Borrower, sufficient to permit Agent or Borrower to determine (a) whether or not payments made with respect to Obligations are subject to Taxes, (b) if applicable, the required rate of withholding or deduction, and (c) such Lender's entitlement to any available exemption from, or reduction of, applicable Taxes for such payments or otherwise to establish such Lender's status for withholding tax purposes in the applicable jurisdiction.

5.11.2 Documentation. If Borrower is U.S. Person:

(a) any Lender that is a U.S. Person shall deliver to Agent and Borrower on or prior to the date on which such Lender becomes a Lender under this Agreement (and from time to time thereafter upon the reasonable request of Agent and Borrower) executed copies of IRS Form W-9 certifying that such Lender is exempt from U.S. federal backup withholding Tax to backup withholding or information reporting requirements.;

(b) any Foreign Lender shall, to the extent it is legally entitled to do so, deliver to Agent and Borrower on or prior to the date on which such Lender becomes a Lender under this Agreement (and from time to time thereafter upon the reasonable request of Agent and Borrower), whichever of the following is applicable

(i) in the case of a Foreign Lender that is claiming eligibility for benefits of an income tax treaty to which the United States is a party, executed copies of IRS Form W-8BEN or IRS Form W-8BEN-E as applicable, establishing an exemption from, or reduction of, U.S. federal withholding Tax pursuant to the "interest" article of such tax treaty and (y) with respect to any other applicable payments under any Transaction Document, IRS Form W-8BEN or IRS Form W-8BEN-E, as applicable, establishing an exemption from, or reduction of, U.S. federal withholding Tax pursuant to the "business profits" or "other income" article of such tax treaty;

(ii) executed copies of IRS Form W-8ECI;

(iii) executed copies of IRS Form W-8IMY and all required supporting documentation; or

(iv) in the case of a Foreign Lender claiming the benefits of the exemption for portfolio interest under Section 881(c) of the Code, IRS Form W-8BEN or IRS Form W-8BEN-E, as applicable and a certificate showing such Foreign Lender is not (i) a "bank" within the meaning of Section 881(c)(3)(A) of the Code, (ii) a "10 percent shareholder" of Borrower within the meaning of Section 881(c)(3)(B) of the Code, or (iii) a "controlled foreign corporation" described in Section 881(c)(3)(C) of the Code; or (e) any other form prescribed by Applicable Law as a basis for claiming exemption from or a reduction in withholding tax, together with such supplementary documentation necessary to allow Agent and Borrower to determine the withholding or deduction required to be made; and

(c) any Foreign Lender shall, to the extent it is legally entitled to do so, deliver to Agent and Borrower on or prior to the date on which such Foreign Lender becomes a Lender under this Agreement (and from time to time thereafter upon the reasonable request of Agent or Borrower), executed copies of any other form prescribed by applicable law as a basis for claiming exemption from or a reduction in U.S. federal withholding Tax, duly completed, together with such supplementary documentation as may be prescribed by applicable law to permit Agent or Borrower to determine the withholding or deduction required to be made.

5.11.3 Lender Obligations. Each Lender agrees that if any form or certification it previously delivered expires or becomes obsolete or inaccurate in any respect, it shall update such form or certification and promptly notify Borrower and Agent of any change in circumstances that would change any claimed Tax exemption or reduction. Each Lender shall indemnify, hold harmless and reimburse (within 10 days after demand therefor) Borrower and Agent for any Taxes, losses, claims, liabilities, penalties, interest and expenses (including reasonable attorneys' fees) incurred by or asserted against Borrower or Agent by any governmental authority due to such Lender's failure to deliver, or inaccuracy or deficiency in, any documentation required to be delivered by it pursuant to this Section. Each Lender authorizes Agent to set off any amounts due to Agent under this Section against any amounts payable to such Lender under any Transaction Document.

5.11.4 FATCA. If a payment made to a Lender under this Agreement would be subject to U.S. Federal withholding Tax imposed by FATCA, such Lender shall deliver to Agent, at the time or times prescribed by law and at such time or times reasonably requested by Agent, such documentation prescribed by Applicable Law (including as prescribed by Section 1471(b)(3)(C)(i) of the Code) and such additional documentation reasonably requested by Agent as may be necessary for Agent to comply with its obligations under FATCA, to determine that such Lender has complied with such Lender's obligations under FATCA, applicable reporting requirements of FATCA (including those contained in Section 1471(b) or 1472(b) of the Code, as applicable) or to determine the amount to deduct and withhold from such payment. Solely for purposes of this paragraph, "FATCA" shall include any amendments made to FATCA after the Closing Date.

## **SECTION 6. CONDITIONS PRECEDENT**

**6.1 Conditions Precedent to Initial Loans.** In addition to the conditions set forth in **Section 6.2**, Lenders shall not be required to fund any requested Loan, or otherwise extend credit to Borrower hereunder, until the date ("Closing Date") that each of the conditions set forth on Exhibit C attached hereto have been satisfied or waived in writing by Agent.

**6.2 Conditions Precedent to All Credit Extensions.** Agent and Lenders shall not be required to fund any Loans or grant any other accommodation to or for the benefit of Borrower, unless the following conditions are satisfied:

(a) No Default or Event of Default shall exist at the time of, or result from, such funding, issuance or grant;

(b) The representations and warranties of Borrower in the Transaction Documents shall be true and correct in all material respects on the date of, and upon giving effect to, such funding, issuance or grant (except for representations and warranties that expressly relate to an earlier date, and that any representation or warranty which is subject to any materiality qualifier shall be required to be true and correct in all respects);

(c) All conditions precedent in any other Transaction Document that are applicable to the funding of any credit extension shall be satisfied; and

(d) No event shall have occurred or circumstance exist that has or could reasonably be expected to have a Material Adverse Effect and no action, proceeding, investigation, regulation or legislation shall have been instituted, threatened or proposed before any court, governmental authority or legislative body to enjoin, restrain or prohibit, or to obtain damages in respect of, or which is related to or arises out of, this Agreement or any of the other Transaction Documents or the consummation of the transactions contemplated hereby or thereby.

Each request (or deemed request) by Borrower for funding of a Loan or grant of an accommodation shall constitute a representation by Borrower that the foregoing conditions are satisfied on the date of such request and on the date of such funding, issuance or grant. As an additional condition to any funding, issuance or grant, Agent shall have received such other information, documents, instruments and agreements as it deems appropriate in connection therewith including, but not limited to, an updated Borrowing Base Certificate. Each representation and warranty contained in this Agreement and the other Transaction Documents shall be deemed to be reaffirmed by Borrower as being true and correct in all material respects (except for representations and warranties that are subject to any materiality qualifiers shall be required to be true and correct in all respects) on each day that Borrower requests or is deemed to have requested an extension of credit hereunder, except for changes in the nature of Borrower's or, if applicable, any Subsidiary's business or operations that may occur after the date hereof in the Ordinary Course of Business so long as Agent has consented to such changes or such changes are not violative of any provision of this Agreement.

## **SECTION 7. COLLATERAL**

**7.1 Grant of Security Interest.** To secure the prompt payment and performance of all Obligations, Borrower hereby grants to Agent, for the benefit of Secured Parties, a continuing security interest in and Lien upon the following Property, whether now owned or hereafter acquired, and wherever located: (a) all Accounts; (b) all Chattel Paper, including electronic chattel paper; (c) all Commercial Tort Claims, including those shown on **Schedule 7**; (d) all Deposit Accounts; (e) all Documents; (f) all General Intangibles, including Intellectual Property; (g) all Goods, including Inventory, Equipment and fixtures; (h) all Instruments; (i) all Investment Property; (j) all Letter-of-Credit Rights; (k) all Supporting Obligations; (l) all monies, whether or not in the possession or under the control of Agent, a Lender, or a bailee or Affiliate of Agent or a Lender, including any Cash Collateral; (m) all accessions to, substitutions for, and all replacements, products, and cash and non-cash proceeds of the foregoing, including proceeds of and unearned premiums with respect to insurance policies, and claims against any Person for loss, damage or destruction of any Collateral; (n) all books and records (including customer lists, files, correspondence, tapes, computer programs, print-outs and computer records) pertaining to the foregoing; and (o) all other personal Property of Borrower.

### **7.2 Lien on Other Collateral**

**7.2.1 Deposit and other Accounts.** To further secure the prompt payment and performance of all Obligations, Borrower hereby grants to Agent, for the benefit of Secured Parties, a continuing security interest in and Lien upon all amounts credited to any Deposit Account, Securities Account and Commodity Account of Borrower, including any sums in any blocked or lockbox accounts or in any accounts into which such sums are swept. Borrower hereby authorizes and directs each bank or other depository to deliver to Agent, upon request, all balances in any Deposit Account, Securities Account and Commodity Account maintained by Borrower, without inquiry into the authority or right of Agent to make such request. Borrower shall take all actions (including, without limitation, the delivery of one or more control agreements) necessary to establish Agent's control (including through the execution of a deposit account control agreement as required by Agent) of each such Deposit Account, Securities Account and Commodity Account (other than a Deposit Account exclusively used for payroll, payroll taxes or employee benefits, or an account containing not more than \$10,000 at any time). Borrower shall be the sole account holder of each Deposit Account and shall not allow any other Person (other than Agent) to have control over a Deposit Account or any Property deposited therein (other than a Deposit Account exclusively used for payroll, payroll taxes or employee benefits). Borrower shall promptly notify Agent of any opening or closing of a Deposit Account and, with the consent of Agent, will amend **Schedule 2** to reflect same. At all times on and after the Closing Date, all Deposit Accounts, Securities Accounts and Commodity Accounts shall be primarily maintained with the Custodian.

7.2.2 Cash Collateral. Any Cash Collateral may be invested, at Agent's discretion (and with the consent of Borrower, as long as no Event of Default exists), but Agent shall have no duty to do so, regardless of any agreement or course of dealing with Borrower, and shall have no responsibility for any investment or loss. Borrower hereby grants to Agent, for the benefit of Secured Parties and as security for the Obligations, a security interest in all Cash Collateral held from time to time and all proceeds thereof, whether held in a Cash Collateral Account or otherwise. Agent may apply Cash Collateral to the payment of Obligations as they become due, in such order as Agent may elect. Each Cash Collateral Account and all Cash Collateral shall be under the sole dominion and control of Agent, and neither Borrower nor other Person shall have any right to any Cash Collateral, until Full Payment of all Obligations.

7.3 Reserved.

7.4 Other Collateral

7.4.1 Commercial Tort Claims. Borrower shall promptly notify Agent in writing if Borrower has a Commercial Tort Claim (other than, as long as no Default or Event of Default exists, a Commercial Tort Claim for less than \$500,000), shall promptly amend **Schedule 7** to include such claim, and shall take such actions as Agent deems appropriate to subject such claim to a duly perfected, first priority Lien in favor of Agent (for the benefit of Secured Parties).

7.4.2 Certain After-Acquired Collateral. Borrower shall promptly notify Agent in writing if, after the Closing Date, Borrower obtains any interest in any Collateral consisting of Deposit Accounts, Securities Accounts, Commodity Accounts, Chattel Paper (including, without limitation, tangible Chattel Paper and Electronic Chattel Paper), Documents, Instruments, Intellectual Property, Investment Property or Letter-of-Credit Rights and, upon Agent's request, shall promptly take such actions as Agent deems appropriate to effect Agent's duly perfected, first priority Lien upon such Collateral, including obtaining any appropriate possession, or control agreement and delivery of any applicable Collateral to the Custodian for the benefit of Agent, provided that prior to an Event of Default, Agent shall not require Borrower to deliver any such Collateral to Agent or any Person other than the Custodian. If any Collateral is in the possession of a third party, at Agent's request, Borrower shall obtain an acknowledgment that such third party holds the Collateral for the benefit of Agent.

7.5 No Assumption of Liability. The Lien on Collateral granted hereunder is given as security only and shall not subject Agent or any Lender to, or in any way modify, any obligation or liability of Borrower relating to any Collateral.

7.6 Further Assurances. Promptly upon request, Borrower shall deliver such instruments, assignments, title certificates, or other documents or agreements, and shall take such actions, as Agent deems appropriate under Applicable Law to evidence or perfect its Lien on any Collateral, or otherwise to give effect to the intent of this Agreement. Borrower authorizes Agent to file any financing statement that indicates the Collateral as "all assets" or "all personal property" of Borrower, or words to similar effect, and ratifies any action taken by Agent before the Closing Date to effect or perfect its Lien on any Collateral.

7.7 Continuation of Security Interest. Notwithstanding termination of this Agreement or of Lenders' commitments to extend Loans hereunder, until Full Payment of all Obligations, Agent shall retain its security interest in all presently owned and hereafter arising or acquired Collateral.



## SECTION 8. REPRESENTATIONS AND WARRANTIES

**8.1 General Representations and Warranties.** To induce Agent and Lenders to enter into this Agreement and to make available the Commitments and Loans, Borrower represents and warrants that:

8.1.1 Organization and Qualification. Borrower is duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization. Borrower is duly qualified, authorized to do business and in good standing as a foreign corporation in each jurisdiction where failure to be so qualified could reasonably be expected to have a Material Adverse Effect. Borrower has not changed its legal status or the jurisdiction in which it is organized or moved its chief executive office within the five (5) years preceding the Closing Date.

8.1.2 Power and Authority. Borrower is duly authorized to execute, deliver and perform its obligations under Transaction Documents to which it is a party. The execution, delivery and performance of the Transaction Documents have been duly authorized by all necessary action, and do not (a) require any consent or approval of any holders of Equity Interests of Parent or Borrower, other than those already obtained; (b) contravene the Organic Documents of Borrower; (c) violate or cause a default under any Applicable Law or Material Contract; or (d) result in or require the imposition of any Lien (other than Permitted Liens) on any Property of Borrower.

8.1.3 Enforceability. Each Transaction Document to which it is a party is a legal, valid and binding obligation of Borrower, enforceable in accordance with its terms, except as enforceability may be limited by bankruptcy, insolvency or similar laws affecting the enforcement of creditors' rights generally.

8.1.4 Capital Structure. **Schedule 4** shows, for Borrower, its name, its jurisdiction of organization, its authorized and issued Equity Interests, the holders of its Equity Interests, and all agreements binding on such holders with respect to their Equity Interests. Except as disclosed on **Schedule 4**, in the five years preceding the Closing Date, Borrower has not acquired any substantial assets from any other Person nor been the surviving entity in a merger or combination. Borrower has no Subsidiaries and does not own any Equity Interest in any other Person, other than Equity Interest acquired in connection with a Portfolio Investment. There are no outstanding purchase options, warrants, agreements to buy, subscription rights, agreements to issue or sell, convertible interests, phantom rights or powers of attorney relating to Equity Interests of Borrower.

8.1.5 Title to Properties; Priority of Liens. Borrower has good and marketable title to (or valid leasehold interests in) all of its real estate, and good title to all of its personal Property, including all Property reflected in any financial statements delivered to Agent or Lenders, in each case free of Liens except Permitted Liens. Borrower has paid and discharged all lawful claims that, if unpaid, could become a Lien on its Properties, other than Permitted Liens. All Liens of Agent in the Collateral are duly perfected, first priority Liens, subject only to Permitted Liens that are expressly allowed to have priority over Agent's Liens.

8.1.6 Reserved.

8.1.7 Financial Statements. The consolidated balance sheets, and related statements of income, cash flow and shareholder's equity, of Parent, Borrower, and their respective Subsidiaries that have been and are hereafter delivered to Agent and Lenders, are prepared in accordance with GAAP, and fairly present the financial positions and results of operations of Parent, Borrower, and their respective Subsidiaries at the dates and for the periods indicated. All projections delivered from time to time to Agent and Lenders have been prepared in good faith, based on reasonable assumptions in light of the circumstances at such time. Since December 31, 2016, there has been no change in the condition, financial or otherwise, of Parent, Borrower or Subsidiary that could reasonably be expected to have a Material Adverse Effect. No financial statement delivered to Agent or Lenders at any time contains any untrue statement of a material fact, nor fails to disclose any material fact necessary to make such statement not materially misleading. Borrower is Solvent. No transfer of property has been or will be made by Borrower or any of its Affiliates and no obligation has been or will be incurred by Borrower or any of its Affiliates in connection with the transactions contemplated by this Agreement or the other Transaction Documents with the intent to hinder, delay, or defraud either present or future creditors of Borrower or any of its Affiliates.

8.1.8 Surety Obligations. Borrower is not obligated as surety or indemnitor under any bond or other contract that assures payment or performance of any obligation of any Person, except as permitted hereunder.

8.1.9 Taxes. Each of Borrower and Parent has filed all federal, state and local tax returns and other reports that it is required by law to file, and has paid, or made provision for the payment of, all Taxes upon it, its income and its Properties that are due and payable, except to the extent being Properly Contested (and, in the case of matters being Properly Contested as of the Closing Date, fully disclosed to Agent and Lenders on or before the Closing Date). The provision for Taxes on the books of each of Borrower and Parent is adequate for all years not closed by applicable statutes, and for its current Fiscal Year.

8.1.10 Brokers. There are no brokerage commissions, finder's fees or investment banking fees payable in connection with any transactions contemplated by the Transaction Documents.

8.1.11 Intellectual Property. Borrower owns or has the lawful right to use all Intellectual Property necessary for the conduct of its business, without conflict with any rights of others. There is no pending or, to Borrower's knowledge, threatened Intellectual Property claim with respect to Borrower or any of its Property (including any Intellectual Property). Except as disclosed on **Schedule 5**, Borrower does not pay or owe any Royalty or other compensation to any Person with respect to any Intellectual Property. All Intellectual Property owned, used or licensed by, or otherwise subject to any interests of, Borrower is shown on **Schedule 5**.

8.1.12 Governmental Approvals. Borrower has, is in compliance with, and is in good standing with respect to, all approvals from all governmental authorities necessary to conduct its business and to own, lease and operate its Properties. All necessary import, export or other licenses, permits or certificates for the import or handling of any goods or other Collateral have been procured and are in effect, and Borrower has complied with all foreign and domestic laws with respect to the shipment and importation of any goods or Collateral.

8.1.13 Compliance with Laws. Borrower has duly complied, and its Properties and business operations are in compliance, in all material respects with all Applicable Law, except where noncompliance could not reasonably be expected to have a Material Adverse Effect. There have been no citations, notices or orders of material noncompliance issued to Borrower under any Applicable Law.

8.1.14 Burdensome Contracts. Borrower is not a party or subject to any contract, agreement or charter restriction that could reasonably be expected to have a Material Adverse Effect. Borrower is not party or subject to any Restrictive Agreement, except as shown on **Schedule 6**. No such Restrictive Agreement prohibits the execution, delivery or performance of any Transaction Document by Borrower.

8.1.15 Litigation. Except as shown on **Schedule 7**, there are no proceedings or investigations pending or, to Borrower's knowledge, threatened against Borrower or Parent, or any of their businesses, operations, Properties, prospects or conditions, that (a) relate to any Transaction Documents or transactions contemplated thereby; or (b) could reasonably be expected to have a Material Adverse Effect if determined adversely to Borrower or Parent. Except as shown on such Schedule, Borrower does not have a Commercial Tort Claim (other than, as long as no Default or Event of Default exists, a Commercial Tort Claim for less than \$50,000). Borrower is not in default with respect to any order, injunction or judgment of any governmental authority.

8.1.16 No Defaults. No event or circumstance has occurred or exists that constitutes a Default or Event of Default. Borrower is not in default, and no event or circumstance has occurred or exists that with the passage of time or giving of notice would constitute a default, under any Material Contract or in the payment of any Borrowed Money. There is no basis upon which any party (other than Borrower) could terminate a Material Contract prior to its scheduled termination date.

8.1.17 ERISA. Except as disclosed on **Schedule 8**, neither Borrower nor any of its Affiliates has any Plan on the date hereof. Borrower and each of its Affiliates is in full compliance with the requirements of ERISA and the regulations promulgated thereunder with respect to each Plan. No fact or situation that is reasonably likely to result in a Material Adverse Effect exists in connection with any Plan. Neither Borrower nor any of its Affiliates has any withdrawal liability in connection with a Multiemployer Plan.

8.1.18 [Reserved].

8.1.19 Labor Relations. Borrower is not party to or bound by any collective bargaining agreement, management agreement or consulting agreement. There are no material grievances, disputes or controversies with any union or other organization of Borrower's employees, or, to Borrower's knowledge, any asserted or threatened strikes, work stoppages or demands for collective bargaining. No goods or services have been or will be produced by Borrower in violation of any applicable labor laws or regulations or any collective bargaining agreement or other labor agreements or in violation of any minimum wage, wage-and-hour or other similar laws or regulations.

8.1.20 [Reserved].

8.1.21 Not a Regulated Entity. (a) Borrower is not an "investment company" and is not required to register as an "investment company" under the Investment Company Act; and (b) Borrower is not subject to regulation under the Federal Power Act, the Interstate Commerce Act, any public utilities code or any other Applicable Law regarding its authority to incur Debt.

8.1.22 Margin Stock. Borrower is not engaged, principally or as one of its important activities, in the business of extending credit for the purpose of purchasing or carrying any Margin Stock. No Loan proceeds will be used by Borrower to purchase or carry, or to reduce or refinance any Debt incurred to purchase or carry, any Margin Stock or for any related purpose governed by Regulations T, U or X of the Board of Governors.

8.1.23 Deposit and Other Accounts. **Schedule 2** sets forth all Deposit Accounts, Securities Accounts and Commodity Accounts maintained by Borrower, including all Dominion Accounts.

8.1.24 Anti-Terrorism Laws, Anti-Corruption Laws and Sanctions.

(a) Neither Borrower nor any of its Affiliates is in violation of any Anti-Terrorism Law; engages in or conspires to engage in any transaction that evades or avoids, or has the purpose of evading or avoiding, or attempts to violate, any of the prohibitions set forth in any Anti-Terrorism Law; or is a Sanctioned Person. Neither Borrower nor any of its Affiliates conducts any business or engages in making or receiving any contribution of funds, goods or services to or for the benefit of any Sanctioned Person or deals in, or otherwise engages in any transaction relating to, any property or interests in property blocked pursuant to Executive Order No. 13224.

(b) Borrower and its Affiliates have implemented and maintain in effect policies and procedures designed to ensure compliance by Borrower and such Affiliates and their respective directors, officers, employees and agents with Anti-Corruption Laws and applicable Sanctions, and Borrower and its Affiliates, their respective Subsidiaries and their respective directors, officers and employees and, to the knowledge of Borrower, its agents, are in compliance with Anti-Corruption Laws and applicable Sanctions. None of (i) Borrower, its Affiliates or any of their respective directors, officers or employees, or (ii) to the knowledge of Borrower, any agent of Borrower or its Affiliates or any of their respective Subsidiaries that will act in any capacity in connection with or benefit from the credit facilities established hereby, is a Sanctioned Person. No borrowing, use of proceeds or other transactions contemplated herein will violate Anti-Corruption Laws or applicable Sanctions.

8.1.25 Additional Collateral Matters.

(a) As of the date hereof: (i) no amount payable under or in connection with any of the Collateral is evidenced by any Instrument or tangible Chattel Paper (other than promissory notes delivered to the Custodian on the Closing Date); (ii) (1) Borrower does not hold, own or have any interest in any certificated securities or uncertificated securities other than those constituting Collateral with respect to which Agent has a perfected security interest in such Collateral, and (2) it has entered into a duly authorized, executed and delivered control agreement in form and substance satisfactory to Agent with respect to each Deposit Account, Securities Account and Commodity Account listed in **Schedule 2** with respect to which Agent has a perfected security interest in such accounts by "control" (as contemplated by Section 9-104 of the UCC); (iii) no amount payable under or in connection with any of the Collateral is evidenced by any Electronic Chattel Paper or any "transferable record" (as that term is defined in Section 201 of the Federal Electronic Signatures in Global and National Commerce Act, or in Section 16 of the Uniform Electronic Transactions Act as in effect in any relevant jurisdiction; and (iv) no amount payable under or in connection with any of the Collateral is evidenced by any Letter-of-Credit Rights.

(b) This Agreement and the other Security Documents create in favor of Agent, for the benefit of the Secured Parties referred to therein, a legal, valid, continuing and enforceable security interest and Lien in the Collateral, the enforceability of which is subject to applicable bankruptcy, insolvency, reorganization, moratorium or other laws affecting creditors' rights generally and subject to general principles of equity, regardless of whether considered in a proceeding in equity or at law. The financing statements, releases and other filings are in appropriate form and have been or will be filed in appropriate filing offices. Upon such filings and/or the obtaining of "control" (as contemplated by Section 9-104 of the UCC), Agent will have a perfected Lien on, and security interest in, to and under all right, title and interest of the grantors thereunder in all Collateral that may be perfected under the UCC (in effect on the date this representation is made) by filing, recording or registering a financing statement or analogous document (including without limitation the proceeds of such Collateral subject to the limitations relating to such proceeds in the UCC) or by obtaining control. The Pledged Collateral (as defined in the Pledge Agreement) has been delivered to Agent (together with stock powers or other appropriate instruments of transfer executed in blank form).

(c) If applicable, when a trademark security agreement or patent security agreement (or a short form thereof) is filed in the United States Patent and Trademark Office and when financing statements, releases and other filings in appropriate form are filed in the applicable filing offices, Agent shall have a fully perfected Lien on, and security interest in, all right, title and interest of Borrower in trademarks, patents and related assets constituting trademark and patent Collateral (as set forth in the applicable trademark security agreement or patent security agreement) in which a security interest may be perfected by filing, recording or registering a security agreement, financing statement or analogous document in the United States Patent and Trademark Office, as applicable. If applicable, when a copyright security agreement or patent security agreement is filed in the United States Copyright Office and when financing statements, releases and other filings in appropriate form are filed in the applicable filing offices, Agent shall have a fully perfected Lien on, and security interest in, all right, title and interest of Borrower in copyrights and assets constituting copyright Collateral (as set forth in the applicable trademark security agreement or patent security agreement) in which a security interest may be perfected by filing, recording or registering a security agreement, financing statement or analogous document in the United States Copyright Office, as applicable.

(d) Neither the businesses nor the properties of Borrower are affected by any fire, explosion, accident, strike, lockout or other labor dispute, drought, storm, hail, earthquake, embargo, act of God or of the public enemy or other casualty (whether or not covered by insurance).

(e) Neither Borrower nor any property of Borrower has (i) failed to comply with any Environmental Law or to obtain, maintain or comply with any permit, license or other approval required under any Environmental Law, (ii) has become subject to any liability under any Environmental Law, (iii) has received notice of any claim or investigation with respect to any material liability or non-compliance under any Environmental Law or (iv) knows of any basis for any liability under any Environmental Law, except, in each case, as could not, individually or in the aggregate, reasonably be expected to result in any material liability under Environmental Laws or have a Material Adverse Effect. Borrower is not undertaking, and Borrower has not completed, either individually or together with other potentially responsible parties, any investigation or assessment or remedial or response action relating to any actual or threatened release, discharge or disposal of hazardous materials at any site, location or operation, either voluntarily or pursuant to the order of any governmental authority or the requirements of any Environmental Law; and all hazardous materials generated, used, treated, handled or stored at, or transported to or from, any property currently or formerly owned or operated by Borrower have been disposed of in a manner not reasonably expected to result in material liability to Borrower.

8.1.26 Special Purpose Entity. Borrower has not and shall not:

(a) engage in any business or activity other than the purchase, receipt and management of Collateral, the transfer and pledge of Collateral pursuant to the terms of the Transaction Documents, the entry into and the performance under the Transaction Documents and such other activities as are incidental thereto;

(b) acquire or own any assets other than (a) the Collateral or (b) incidental property as may be necessary for the operation of Borrower and the performance of its obligations under the Transaction Documents;

(c) merge into or consolidate with any Person or dissolve, terminate or liquidate in whole or in part, transfer or otherwise dispose of all or substantially all of its assets (other than in accordance with the provisions hereof), without in each case first obtaining the prior written consent of the Agent, or except as permitted by this Agreement, change its legal structure, or jurisdiction of formation;

(d) fail to preserve its existence as an entity duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization or formation, or without the prior written consent of the Agent, amend, modify, terminate or fail to comply with the provisions of its operating agreement, or fail to observe limited liability company formalities;

(e) form, acquire or own any Subsidiary, own any equity interest in any other entity, or make any Investment in any Person (other than Portfolio Investments, Cash and Cash Equivalents) without the prior written consent of the Agent;

(f) commingle its assets with the assets of any of its Affiliates, or of any other Person;

(g) incur any Indebtedness, secured or unsecured, direct or contingent (including guaranteeing any obligation), other than Indebtedness to the Lenders hereunder or in conjunction with a repayment of all Loans owed to the Lenders and a termination of all the Commitments;

(h) fail to pay its debts and liabilities from its assets as the same shall become due;

(i) fail to maintain its records, books of account and bank accounts separate and apart from those of any other Person;

(j) enter into any contract or agreement with any Person, except (i) the Transaction Documents and (ii) other contracts or agreements that are upon terms and conditions that are commercially reasonable and that would be available on an arms-length basis with third parties other than such Affiliate;

(k) seek its dissolution or winding up in whole or in part;

(l) fail to correct any known misunderstandings regarding the separate identity of Borrower and the Parent or any other Person;

(m) except as provided in this Agreement, guarantee, become obligated for, or hold itself out to be responsible for the debt of another Person;

(n) fail either to hold itself out to the public as a legal entity separate and distinct from any other Person or to conduct its business solely in its own name in order not (i) to mislead others as to the identity of the Person with which such other party is transacting business, or (ii) to suggest that it is responsible for the debts of any third party (including any of its principals or Affiliates);

(o) fail to maintain adequate capital for the normal obligations reasonably foreseeable in a business of its size and character and in light of its contemplated business operations;

(p) file or consent to the filing of any petition, either voluntary or involuntary, to take advantage of any applicable insolvency, bankruptcy, liquidation or reorganization statute, or make an assignment for the benefit of creditors;

(q) except as may be required or permitted by the Code and regulations or other applicable state or local tax law, hold itself out as or be considered as a department or division of (i) any of its principals or Affiliates, (ii) any Affiliate of a principal or (iii) any other Person;

(r) fail to maintain separate financial statements, showing its assets and liabilities separate and apart from those of any other Person and not have its assets listed on any financial statement of any other Person; provided, however, that Borrower's assets may be included in a consolidated financial statement of its Affiliate provided that (a) appropriate notation shall be made on such consolidated financial statements to indicate the separateness of Borrower from such Affiliate and to indicate that Borrower's assets and credit are not available to satisfy the debts and other obligations of such Affiliate or any other Person and (b) such assets shall also be listed on Borrower's own separate balance sheet;

(s) fail to pay its own liabilities and expenses only out of its own funds;

(t) acquire the obligations or securities of its Affiliates or members;

(u) guarantee any obligation of any person, including an Affiliate;

(v) fail to allocate fairly and reasonably any overhead expenses that are shared with an Affiliate, including paying for office space and services performed by any employee of an Affiliate;

(w) fail to use separate invoices and checks bearing its own name;

(x) pledge its assets for the benefit of any other Person, other than with respect to payment of the indebtedness to the Secured

Parties hereunder;

(y) (i) fail at any time to have at least one (1) independent manager (the “Independent Manager”) which manager must, in each such instance, be a natural person who has prior experience as an independent director, independent manager or independent member with at least three years of employment experience, and who is provided by CT Corporation, Corporation Service Company, Global Securitization Services, National Registered Agents, Inc., Wilmington Trust Company, Stewart Management Company, Lord Securities Corporation or, if none of those companies is then providing professional Independent Managers, another nationally recognized company reasonably approved by the Lenders, in each case that is not an Affiliate of Borrower and that provides professional Independent Managers and other corporate services in the ordinary course of its business, and which individual is duly appointed as an Independent Manager and is not, and has never been, and will not while serving as Independent Manager be, any of the following: (v) a member, partner, equityholder, manager, director, officer or employee of Borrower or any of its respective equityholders or Affiliates (other than as an Independent Manager of Borrower or an Affiliate of Borrower that is not in the direct chain of ownership of Borrower and that is required by a creditor to be a single purpose bankruptcy remote entity); (x) a creditor, supplier or service provider (including provider of professional services) to Borrower or any of its equityholders or Affiliates (other than a nationally recognized company that routinely provides professional Independent Managers and other corporate services to Borrower or any of its equityholders or Affiliates in the ordinary course of business); (y) a family member of any such member, partner, equityholder, manager, director, officer, employee, creditor, supplier or service provider; or (z) a Person that controls (whether directly, indirectly or otherwise) any of (v), (x) or (y) above; or (ii) fail to ensure that all limited liability company action relating to the selection, maintenance or replacement of the Independent Manager shall require the written consent of the Agent. A natural person who otherwise satisfies the foregoing definition and satisfies subparagraph (v) by reason of being the Independent Manager of a “special purpose entity” affiliated with Borrower shall be qualified to serve as an Independent Manager of Borrower, provided that the fees that such individual earns from serving as Independent Manager of affiliates of Borrower in any given year constitute in the aggregate less than five percent (5%) of such individual’s annual income for that year;

(z) fail to provide that the unanimous consent of all managers (including the consent of Borrower’s Independent Manager) is required for Borrower to (a) institute proceedings to be adjudicated bankrupt or insolvent, (b) institute or consent to the institution of bankruptcy or insolvency proceedings against it, (c) file a petition seeking or consenting to reorganization or relief under any applicable federal or state law relating to bankruptcy or insolvency, (d) seek or consent to the appointment of a receiver, liquidator, assignee, trustee, sequestrator, custodian or any similar official for Borrower, (e) make any assignment for the benefit of Borrower’s creditors, (f) admit in writing its inability to pay its debts generally as they become due, or (g) take any action in furtherance of any of the foregoing;

(aa) fail to file its own tax returns separate from those of any other Person, except to the extent that Borrower is treated as a “disregarded entity” for tax purposes and is not required to file tax returns under applicable law, and pay any taxes required to be paid under applicable law; or

(bb) fail to comply with the special purpose entity requirements set forth in this **Section 8.1.26** such that Eversheds Sutherland (US) LLP or another law firm reasonably acceptable to the Agent could no longer render a substantive nonconsolidation opinion with respect to Borrower.

**8.2 Complete Disclosure.** No Transaction Document, nor any other agreement, document, certificate, or statement, delivered by or on behalf of Borrower or any of its Affiliates to Agent or any Lender contains any untrue statement of a material fact, nor fails to disclose any material fact necessary to make the statements contained therein not misleading. There is no fact or circumstance that Borrower or any of its Affiliates has failed to disclose to Agent in writing that could reasonably be expected to have a Material Adverse Effect.

**8.3 Updated Representations and Warranties.** Each representation and warranty contained in this Agreement and the other Transaction Documents shall be deemed to be reaffirmed by Borrower on each day that Borrower delivers or is required to deliver a Borrowing Base Certificate hereunder and on each day a Loan is made hereunder, except for changes in the nature of Borrower business or operations that may occur after the date hereof in the Ordinary Course of Business so long as Agent has provided its prior written consent (in its sole discretion) to such changes or such changes are not violative of any provision of this Agreement.



## SECTION 9. COVENANTS AND CONTINUING AGREEMENTS

**9.1 Affirmative Covenants.** As long as any Commitments or Obligations are outstanding, Borrower and/or Servicer, as applicable, shall do the following:

### 9.1.1 Collateral Reporting and Records.

(a) **Borrowing Base.** Borrower shall (or shall cause Servicer to) deliver to Agent, by the 15th day of each month, a Borrowing Base Certificate prepared as of the close of business of the previous month, and at such other times as Agent may request; provided that, while all calculations of Availability in any Borrowing Base Certificate shall originally be made by Borrower and certified by a Senior Officer, Agent may from time to time review and adjust any such calculation in its Permitted Discretion (i) to reflect its reasonable estimate of declines in value of any Collateral, due to collections received in the Dominion Account or otherwise; (ii) to adjust advance rates to reflect changes in dilution, quality, mix and other factors affecting Collateral; and (iii) to the extent the calculation is not made in accordance with this Agreement, Borrower, Agent and Lenders agree that the Borrowing Base Certificate and other information required to be delivered to Agent pursuant to this **Section 9.1.1** may be delivered electronically utilizing Agent's "Stucky Netlink" system or any other electronic transmission system approved by Agent, and any such information delivered electronically shall be deemed to be delivered with the following certification: "As of the date of this Certificate, no Event of Default exists or has occurred and is continuing. Borrower acknowledges that the Loans made by Agent and Lenders to, or for the benefit of, Borrower are based upon Agent's and Lenders' reliance on the information contained herein and all representations and warranties with respect to Collateral in the Loan Agreement are applicable to the Collateral included in this Certificate. The reliance by Agent and Lenders on this Certificate should not be deemed to limit the right of Agent to establish or revise criteria of eligibility or other reserves (including, but not limited to, rent reserves) or otherwise limit, impair, or affect in any manner the rights of Agent and Lenders under the Loan Agreement, in each case in its Permitted Discretion. In the event of any conflict between the determination of Agent of the amount of the Loans to Borrower in accordance with the terms of the Loan Agreement and the determination by Borrower of such amounts, the determination of Agent shall govern. All capitalized terms used in this Certificate shall have the meaning assigned to them in the Loan Agreement."

(b) **Servicing Reports.** Borrower shall cause Servicer to deliver to Agent all reports provided to Borrower pursuant to the terms of the Servicing Agreement.

### 9.1.2 Inspections; Appraisals

(a) Borrower and Servicer shall permit Agent from time to time, subject (except when a Default or Event of Default exists) to reasonable notice and normal business hours, to (i) visit and inspect Borrower's or, to the extent relating to the Transaction Documents and the Collateral, Servicer's Properties, (ii) inspect, audit and make extracts from Borrower's or, to the extent relating to the Transaction Documents and the Collateral, Servicer's books and records, and (iii) discuss with its officers, employees, agents, advisors and independent accountants of Borrower's or, to the extent relating to the Transaction Documents and the Collateral, Servicer's business, financial condition, assets, prospects and results of operations. Lenders may participate in any such visit or inspection, at their own expense. Neither Agent nor any Lender shall have any duty to Borrower or Servicer to make any inspection, nor to share any results of any inspection, appraisal or report with Borrower or Servicer. Borrower and Servicer acknowledge that all inspections, appraisals and reports are prepared by Agent and Lenders for their purposes, and Borrower and Servicer shall not be entitled to rely upon them.

(b) Reimburse Agent for all charges, costs and expenses of Agent in connection with (i) examinations of Servicer or Borrower's books and records or any other financial or Collateral matters as Agent deems appropriate for each day that an employee or agent of Agent shall be engaged in an examination or review of any of Servicer's or Borrower's properties), plus reasonable expenses, (ii) valuations of Portfolio Investments; (iii) the establishment of electronic collateral reporting systems performed by employees or agents of Agent; and (iv) the actual charges paid or incurred by Agent if it elects to employ the services of one or more third parties to perform financial audits of Borrower, establish electronic collateral reporting of Servicer or Borrower, appraise the Collateral or to assess Borrower's business valuation; provided that so long as no Event of Default has occurred and is continuing, the Borrower shall be responsible for all costs and expenses for only two (2) such visits per fiscal year by the Agent or its designees. Borrower agrees to pay Agent's then standard charges for examination activities, including the standard charges of Agent's internal examination and appraisal groups (\$1,000 per person per day as of the Closing Date), as well as the charges of any third party used for such purpose.

9.1.3 Financial and Other Information. Borrower and Parent shall keep adequate records and books of account with respect to its business activities, in which proper entries are made in accordance with GAAP reflecting all financial transactions, and shall furnish to Agent and Lenders:

(a) as soon as available, and in any event within 90 days after the close of each Fiscal Year, balance sheets as of the end of such Fiscal Year and the related statements of income, cash flow and shareholders' equity for such Fiscal Year, on a consolidated basis for Parent and its Subsidiaries, together with all supporting schedules and footnotes, which consolidated statements shall be audited and certified (without qualification) by Ernst & Young or any other firm of independent certified public accountants of recognized national standing selected by Parent, and shall set forth in comparative form corresponding figures for the preceding Fiscal Year and other information acceptable to Agent;

(b) as soon as available, and in any event within 45 days after the end of each of the first three Fiscal Quarters of each Fiscal Year, unaudited balance sheets as of the end of such Fiscal Quarter and the related statements of income and cash flow for such month and for the portion of the Fiscal Year then elapsed, on a consolidated basis for Parent and its Subsidiaries, setting forth in comparative form corresponding figures for the preceding Fiscal Year and certified by a manager of Borrower;

(c) as soon as available, and in any event within 45 days after the end of each Fiscal Quarter (but within 75 days after the last Fiscal Quarter in a Fiscal Year), unaudited balance sheets as of the end of such Fiscal Quarter and the related statements of income and cash flow for such month and for the portion of the Fiscal Year then elapsed, on a consolidated basis for Borrower and Borrower's Subsidiaries, setting forth in comparative form corresponding figures for the preceding Fiscal Year and certified by a manager of Borrower as prepared in accordance with GAAP and fairly presenting the financial position and results of operations for such quarter and period, subject to normal year-end adjustments and the absence of footnotes;

(d) concurrently with delivery of financial statements under clause (c) above, or more frequently if requested by Agent while a Default or Event of Default exists, a Compliance Certificate executed by a manager of Borrower;

(e) concurrently with delivery of financial statements under clause (a) above, copies of all management letters submitted to Parent and Borrower by their accountants in connection with such financial statements, and promptly upon receipt thereof, any final comment letter submitted by such accountants to management in connection with an annual audit;

(f) not later than 30 days prior to the end of each Fiscal Year, projections of Borrower's consolidated balance sheets, results of operations, cash flow and Availability for the next Fiscal Year, month by month;

(g) at any time upon Agent's request, all internal and external valuation reports and reviews relating to the Eligible Portfolio Investments (including all valuation reports delivered by the Approved Third-Party Appraiser in connection with the quarterly appraisals of Unquoted Investments), and any other information relating to the Eligible Portfolio Investments as requested by the Agent or any Lender;

(h) as soon as available, and in any event within 45 days after the end of each Fiscal Quarter, a copy of Borrower's loan data tape in a format reasonably acceptable to Agent, which shall include but not be limited to the following information: (i) for each Portfolio Investment, the name and number of the related Portfolio Company, the collection status, the loan status, an indication of whether or not such Portfolio Investment is an Eligible Portfolio Investment, the date of each scheduled payment and the outstanding balance, (y) the Borrowing Base for each Eligible Portfolio Investment, and such other information as may be reasonably required for the Backup Servicer to perform its duties under the Servicing Agreement;

(i) promptly after the sending or filing thereof, copies of any proxy statements, financial statements or reports that Borrower or Parent has made generally available to its shareholders; copies of any regular, periodic and special reports or registration statements or prospectuses that Borrower or Parent files with the SEC or any other governmental authority, or any securities exchange; and copies of any press releases or other statements made available by Borrower or Parent to the public concerning material changes to or developments in the business of Borrower or Parent;

(j) promptly after the sending or filing thereof, copies of any annual report to be filed in connection with each Plan or any employee benefit plan or similar employee benefit arrangement maintained or contributed to by Parent or Borrower that is not subject to the laws of the United States or is mandated by a government other than the United States for employees of Parent or Borrower; and

(k) such other reports and information (financial or otherwise) as Agent may request from time to time in connection with any Collateral or Borrower's or Servicer's financial condition or business.

Notwithstanding the foregoing, the requirement to deliver financial statements and other information set forth in **clauses (a), (b) and (i)** of this **Section 9.1.3** may be satisfied with respect to Parent by furnishing (A) the applicable financial statements of Parent, (B) the Parent's Form 10-K or 10-Q, or (C) such other instruments, documents or agreements filed with the SEC, as applicable, filed with the SEC, or by delivering notice to Agent (which notice may be sent via automated email through Parent's website) that such financial statements have been filed with the SEC, in each case, within the time periods specified in such paragraphs.

9.1.4 Notices. Borrower shall notify Agent and Lenders in writing, promptly after an Borrower's obtaining knowledge thereof, of any of the following that affects Borrower: (a) the threat or commencement of any proceeding or investigation, whether or not covered by insurance, if an adverse determination could have a Material Adverse Effect; (b) any pending or threatened labor dispute, strike or walkout, or the expiration of any material labor contract; (c) any default under or termination of a Material Contract; (d) the existence of any Default or Event of Default (together with what action, if any, Borrower is taking to correct the same); (e) any litigation involving an amount at issue in excess of \$50,000 or changes in existing litigation or any judgment against it or its assets with an amount at issue or assets involved exceeding \$50,000; (f) the assertion of any Intellectual Property claim, if an adverse resolution could have a Material Adverse Effect; (g) any violation or asserted violation of any Applicable Law by Borrower or with respect to the Collateral; (i) the occurrence of any event or occurrence which could possibly, as a result of the passage of time or otherwise, result in any of the events described in **Section 10.1(k)**; (j) the discharge of or any withdrawal or resignation by Parent's or Borrower's independent accountants; (k) any proposed opening of a new office or place of business, at least 30 days prior to such opening; (l) any failure of Borrower to pay rent at any of its business locations; (m) the filing of any Lien against Borrower (other than the Lien of Agent), notice from any taxing authorities as to claimed deficiencies or any tax lien or any notice relating to alleged ERISA violations, the occurrence of any Reportable Event or the occurrence of any Termination Event; (n) any damage or loss to property in excess of \$50,000; (o) any rejection, return, offset, dispute, loss or other circumstance in an amount equal to or greater than \$50,000 or otherwise having a Material Adverse Effect on any Collateral; and (p) any acceleration of the maturity of any Debt or the occurrence or existence of any event or circumstance which gives the holder of such Debt the right to accelerate.

9.1.5 Reserved.

9.1.6 Compliance with Laws; Taxes. Borrower and Servicer shall comply with all Applicable Laws, including laws regarding collection and payment of Taxes, and pay and discharge all Taxes prior to the date on which they become delinquent or penalties attach (unless such Taxes are being Properly Contested) and maintain all approvals from all governmental authorities necessary to the ownership of its Properties or conduct of its business, except where the failure to do so would not reasonably be expected to result in a Material Adverse Effect, and, without limiting the generality of the foregoing, act promptly and diligently to make appropriate remedial actions with respect to any Environmental Laws, whether or not directed to do so by any governmental authority. If an Account includes a charge for any Taxes, Agent is authorized, in its discretion, to pay the amount thereof to the proper taxing authority for the account of Borrower and to charge Borrower therefor; provided, however, that neither Agent nor Lenders shall be liable for any Taxes that may be due from Borrower or with respect to any Collateral.

9.1.7 Insurance. Parent shall maintain a fidelity bond with respect to Parent and all Subsidiaries of Parent covering certain (a) loss resulting from dishonest or fraudulent acts committed by an employee, (b) loss of property on premises or in transit, (c) loss resulting from forgery or alteration of instruments and other documents, (e) loss related to securities and (f) loss resulting from counterfeit currency, each as more specifically described in the fidelity bond filing previously provided to Agent. Parent shall also maintain insurance on the Collateral, with Borrower as a named insured, with financially sound and reputable insurance companies, in at least such amounts and against at least such risks as are usually insured against in the same general area by companies of established repute engaged in the same or similar business. Upon request, the Borrower shall promptly furnish the Agent copies of all such insurance policies or certificates evidencing such insurance and such other documents and evidence of insurance as the Agent shall request.

9.1.8 Licenses and Other Rights. Borrower and Servicer shall keep each license affecting any Collateral or any other material Property of Borrower and Servicer each in full force and effect; promptly notify Agent of any proposed modification to any such license, or entry into any new license, in each case at least 30 days prior to its effective date; pay all Royalties when due; notify Agent of any default or breach asserted by any Person to have occurred under any license; preserve and maintain its legal existence, authorities to transact business, rights and franchises, trade names, patents, trademarks, and permit necessary to the proper conduct of its business; and, except as could not reasonably be expected to have a Material Adverse Effect, remain in good standing and qualified to transact business as a foreign entity in any state or other jurisdiction in which it is required to be qualified to transact business as a foreign entity.

9.1.9 Other Affirmative Covenants. (a) If any amount payable under or in connection with any of the Collateral shall be evidenced by any Instrument or tangible Chattel Paper, Borrower shall forthwith endorse, assign and deliver the same to Custodian, accompanied by such instruments of transfer or assignment duly executed in blank as Agent may reasonably request from time to time; and (b) Borrower shall at all times defend its title to Collateral and Agent's Liens therein against all Persons, claims and demands whatsoever, except Permitted Liens.

9.1.10 Calculation of Borrowing Base. For purposes of this Agreement, the "Borrowing Base" shall be determined, as at any date of determination, as the sum of the products obtained by multiplying (x) the Value of each Eligible Portfolio Investment by (y) the applicable Advance Rate; provided that:

(a) the Advance Rate applicable to the aggregate Value of all Eligible Portfolio Investments in their entirety shall be 0% at any time when the Borrowing Base is composed entirely of Eligible Portfolio Investments issued by fewer than 8 different issuers;

(b) not more than \$5,000,000 of the Borrowing Base may consist of Portfolio Investments of the same Portfolio Company;

(c) not more than 15% of the Borrowing Base may consist of Portfolio Investments having a maturity date of greater than eight (8) years from the origination or closing date of such Portfolio Investment;

(d) Eligible Portfolio Investments that are not Cash, Cash Equivalents, Performing First Lien Bank Loans or Performing Last Out Loans shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 35% of the Borrowing Base;

(e) Eligible Portfolio Investments that are Revolving Loans and Delayed Draw Loans shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 15% of the Borrowing Base;

(f) Eligible Portfolio Investments that are Single Covenant Loans shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 40% of the Borrowing Base;

(g) Eligible Portfolio Investments that are Covenant Lite Loans (including, but not limited to, Covenant Lite Loans subject to clause (h) below) shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 40% of the Borrowing Base;

(h) Eligible Portfolio Investments that (i) are Covenant Lite Loans and (ii) for which the applicable Portfolio Company had EBITDA of less than \$50,000,000 for the 12 month period most recently ended shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 10% of the Borrowing Base;

(i) Eligible Portfolio Investments that are Unitranche Loans shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 15% of the Borrowing Base; and

(j) Eligible Portfolio Investments which are in the same Industry Classification Group shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 25% of the Borrowing Base.

For all purposes of this **Section 9.1.10**, all issuers of Eligible Portfolio Investments that are Affiliates of one another shall be treated as a single issuer (unless such issuers are Affiliates of one another solely because they are under the common Control of the same private equity sponsor or similar sponsor). For the avoidance of doubt, no Portfolio Investment shall be an Eligible Portfolio Investment unless, among the other requirements set forth in this Agreement, (i) such Investment is subject only to Permitted Liens and (ii) such Investment is Transferable.

9.1.11 Portfolio Value and Diversification.

(a) Industry Classification Groups. For purposes of this Agreement, Borrower shall assign each Eligible Portfolio Investment to an Industry Classification Group as reasonably determined by Borrower. To the extent that Borrower reasonably determines that any Eligible Portfolio Investment is not adequately correlated with the risks of other Eligible Portfolio Investments in an Industry Classification Group, such Eligible Portfolio Investment may be assigned by Borrower to an Industry Classification Group that is more closely correlated to such Eligible Portfolio Investment.

(b) Portfolio Valuation Etc.

(i) Settlement Date Basis. For purposes of this Agreement, all determinations of whether a Portfolio Investment is an Eligible Portfolio Investment shall be determined on a Settlement-Date Basis, provided that no such investment shall be included as an Eligible Portfolio Investment to the extent it has not been paid for in full.

(ii) Determination of Values. Borrower will conduct reviews of the value to be assigned to each of its Eligible Portfolio Investments as follows:

(A) Quoted Investments External Review. With respect to Quoted Investments, Borrower shall, on the date of any Notice of Borrowing and otherwise not less frequently than once each calendar month, determine the market value of such Quoted Investments which shall, in each case, be determined in accordance with one of the following methodologies as selected by Borrower (each such value, an “External Quoted Value”):

(w) in the case of public and 144A securities, the average of the recent bid prices as determined by two Approved Dealers selected by Borrower,

(x) in the case of Bank Loans, the average of the recent bid prices as determined by two Approved Dealers selected by Borrower or an Approved Pricing Service which makes reference to at least two Approved Dealers with respect to such Bank Loans,

(y) in the case of any Quoted Investment traded on an exchange, the closing price for such Eligible Portfolio Investment most recently posted on such exchange, and

(z) in the case of any other Quoted Investment, the fair market value thereof as determined by an Approved Pricing Service.

(B) Unquoted Investments. The value of each Unquoted Investment (the “Unquoted Reported Value”) shall be the “fair value” of such Unquoted Investment as reported in the most recent 10-Q or 10-K filed by Parent with the SEC (which valuations are (i) produced by Parent consistent with its Investment and Valuation Policies and (ii) are reviewed by Parent’s external auditors); *provided* that, (i) for each Unquoted Investment acquired by Borrower prior to the “fair value” thereof having been reported in the most recent 10-Q or 10-K filed by Parent with the SEC, the value thereof shall be the par value of such Unquoted Investment multiplied by the purchase price (expressed as a percentage of par) paid by Parent to acquire such Unquoted Investment, until such time as the “fair value” thereof is reported as described above in this **clause (B)**, (ii) if Agent so requests as a result of its reasonable determination that intervening events may have resulted in a change in the most recently determined (pursuant to this definition) “fair value” of such Unquoted Investment, Borrower shall cause Parent to recalculate (as of the date of determination of the value of such Unquoted Investment) its “fair value” calculation of such Unquoted Investment using the same methodology as described above in this **clause (B)**, and (iii) at the request of Agent, the Borrower shall cause Parent to deliver to Agent Parent’s internal valuation memorandum pursuant to which the “fair value” of any Unquoted Investment is established, and Agent shall maintain the confidentiality of any such internal valuation memorandum.

(C) Value of Quoted Investments. Subject to **Section 9.1.11(b)(ii)(F)**, the “Value” of each Quoted Investment for all purposes of this Agreement shall be the lower of (1) the External Quoted Value of such Quoted Investment as most recently determined pursuant to **Section 9.1.11(b)(ii)(A)** and (2) if such Quoted Investment is a debt investment, the par or face value of such Quoted Investment.

(D) Value of Unquoted Investments. Subject to **Section 9.1.11(b)(ii)(F)**, the “Value” of each Unquoted Investment for all purposes of this Agreement shall be the lower of (1) the Unquoted Reported Value of such Unquoted Investment as most recently determined pursuant to **Section 9.1.11(b)(ii)(B)** and (2) if such Unquoted Investment is a debt investment, the par or face value of such Unquoted Investment.

(E) Actions Upon an Overadvance. If Borrower determines that an Overadvance exists or that the Borrowing Base has declined by more than 15% from the Borrowing Base stated in the Borrowing Base Certificate last delivered by Borrower to the Agent, then Borrower shall, promptly and in any event within two Business Days as provided in **Section 9.1.3(a)**, deliver a Borrowing Base Certificate reflecting the new amount of the Borrowing Base and shall take the actions, and make the payments and prepayments (if any), all as more specifically set forth in **Section 2.1.5**.

(F) Failure to Determine Values. If Borrower shall fail to determine the value of any Eligible Portfolio Investment as at any date pursuant to the requirements of the foregoing subclauses (A), (B), (C) or (D), then the "Value" of such Eligible Portfolio Investment as at such date shall be deemed to be zero; provided that any such failure shall not constitute a Default or Event of Default hereunder solely due to such failure to determine value so as long as all Eligible Portfolio Investments with respect to which such failure has occurred are assigned a "Value" of zero in the Borrowing Base and all Borrowing Base Certificates for so long as such failure continues.

(iii) Generally Applicable Valuation Provisions.

(A) The value of any Portfolio Investments determined in accordance with any provision of this **Section 9.1.11** shall be the Value of such Portfolio Investment for purposes of this Agreement until a new Value for such Portfolio Investment is subsequently determined in good faith in accordance with this **Section 9.1.11**.

(B) The foregoing valuation procedures shall only be required to be used for purposes of calculating the Borrowing Base and shall not be required to be utilized by Borrower for any other purpose, including the delivery of financial statements or valuations required under ASC 820 or the Investment Company Act.

9.1.12 Special Purpose Entity. Borrower shall be in compliance with the special purpose entity requirements set forth in **Section**

**8.1.26.**

9.1.13 Investment and Valuation Policies. Borrower will (a) comply in all material respects with the Investment and Valuation Policies in regard to each Portfolio Investment, and in regard to compliance with Transaction Documents, including determinations with respect to the enforcement of its rights thereunder, and (b) furnish to the Agent, at least 20 days prior to its proposed effective date, prompt notice of any material changes in the Investment and Valuation Policies. Borrower shall not make any changes to its Investment and Valuation Policies except with the approval of its Valuation Committee, Audit Committee and Board of Directors.

9.1.14 Post-Closing Covenants. Borrower shall either (i) within forty-five (45) days after the Closing Date (or such later date as Borrower and Agent may agree) cause the Servicing Agreement to be amended or amended and restated in form and substance satisfactory to Agent to add the Backup Servicer as a party, or (ii) within sixty (60) days after the Closing Date, enter into an agreement in form and substance satisfactory to Agent with another backup servicer acceptable to Agent.



**9.2 Negative Covenants.** As long as any Commitments or Obligations are outstanding:

9.2.1 **Permitted Debt.** Borrower shall not create, incur, guarantee or suffer to exist any Debt, except the Obligations.

9.2.2 **Permitted Liens.** Borrower shall not create or suffer to exist any Lien upon any of its Property, except the following (collectively, "**Permitted Liens**"):

- (a) Liens in favor of Agent;
- (b) Liens for Taxes (excluding any Lien imposed pursuant to any of the provisions of ERISA) not yet due or being Properly Contested; and
- (c) statutory Liens (other than Liens for Taxes or imposed under ERISA) arising in the Ordinary Course of Business, but only if (i) payment of the obligations secured thereby is not yet due or is being Properly Contested, and (ii) such Liens do not materially impair the value or use of the Property or materially impair operation of the business of Borrower or Subsidiary.

9.2.3 **Distributions.** Declare or make any Distributions provided that Borrower may make Distributions to Parent so long as prior to and after giving pro forma effect to such Distribution (a) Availability is greater than or equal to \$500,000, and (b) no Event of Default has occurred and is continuing, or would result from such Distribution.

9.2.4 **Restricted Investments.** Borrower shall not create make any investment, other than (a) Portfolio Investments in the Ordinary Course of Business; and (b) to the extent subject to Agent's Lien and control, pursuant to documentation in form and substance satisfactory to Agent, and no other Liens, Cash and Cash Equivalents.

9.2.5 **Disposition of Assets.** (a) Borrower shall not make any disposition of assets (including a sale, lease, license, consignment or other transfer or disposition of assets (real or personal, tangible or intangible) or a disposition of property in connection with a sale-leaseback transaction or synthetic lease and including any sale or disposition of Equity Interests by any Subsidiary), except as expressly permitted by this **Section 9.2.5** or any other provision of this Agreement.

(b) Borrower may sell, transfer or otherwise dispose of Portfolio Investments that are not Eligible Portfolio Investments so long as (i) prior to and after giving effect to such sale, transfer or other disposition (and any concurrent acquisitions of Portfolio Investments) no Event of Default exists and the Borrower delivers to the Agent a certificate of a Senior Officer to such effect, (ii) such sale, transfer or disposition is for fair market value (as reasonably determined by Servicer), and (iii) the proceeds of such sale, transfer or disposition, if Cash, are deposited in the Dominion Account.

(c) Borrower may sell, transfer or otherwise dispose of Portfolio Investments that are Eligible Portfolio Investments so long as (i) prior to and after giving effect to such sale, transfer or other disposition (and any concurrent acquisitions of Portfolio Investments) no Default or Event of Default exists (unless, in the case of such a Default, such Default will be cured upon giving effect to such sale, transfer or disposition and the application of the proceeds thereof) and the Borrower delivers to the Agent a certificate of a Senior Officer to such effect, (ii) such sale, transfer or disposition is for either the greater of (A) fair market value, or (B) the amount allocable to such Portfolio Investment in the Borrowing Base, (iii) such sale, transfer or disposition is made for Cash, all of which is deposited in the Dominion Account, and (iv) upon giving effect to such sale, transfer or disposition and the application of the proceeds thereof, no Overadvance exists.

(d) Notwithstanding anything above that would otherwise prohibit the sale of a Portfolio Investment after the occurrence or during the continuance of a Default or an Event of Default, if the Borrower entered into a binding agreement to sell any such Portfolio Investment prior to the occurrence of such Default or an Event of Default, but such sale did not settle prior to the occurrence of such Default or an Event of Default, then the Borrower shall be permitted to consummate such sale notwithstanding the occurrence of such Default or an Event of Default; provided that the settlement for such sale occurs within the customary settlement period for similar trades.

(e) Agent's Lien on any Collateral that is sold or transferred pursuant to a disposition permitted under this **Section 9.2.5** shall be automatically released except as to Agent's Lien on the proceeds of such Collateral, which shall continue to attach to such proceeds.

(f) Any sale of a Portfolio Investment by Borrower to any of its Affiliates (other than a sale to Parent in connection with Parent's repurchase obligation for Warranty Portfolio Investments (as defined in the Sale Agreement)) shall require the prior written consent of Agent.

9.2.6 Fundamental Changes. Borrower shall not merge, combine, reorganize, or consolidate with any Person, or liquidate, wind up its affairs or dissolve itself, in each case whether in a single transaction or in a series of related transactions, except for mergers or consolidations of a wholly-owned Subsidiary with another wholly-owned Subsidiary or into Borrower; change its name or conduct business under any fictitious name; change its tax, charter or other organizational identification number or federal employer identification number (or equivalent); or change its form or state of organization.

9.2.7 Restrictive Agreements. Borrower shall not become a party to any Restrictive Agreement.

9.2.8 Conduct of Business. Borrower shall not engage in any business, other than its business as conducted on the Closing Date and any activities incidental thereto, and in each case only such businesses and other activities which are insured by the policies of insurance required by this Agreement; make any loans or other advances of money to any Person; form or acquire any Subsidiary after the Closing Date or permit any existing Subsidiary to issue any additional Equity Interests except to its parent; acquire any business, line of business, division, license rights or brand of another Person, or all or substantially all of another Person's assets; amend, modify or otherwise change any of its Organic Documents as in effect on the Closing Date, unless consented to in writing by Agent; file or consent to the filing of any consolidated income tax return with any Person other than Parent; make any change in accounting methods or treatment or reporting practices; change its Fiscal Year; enter into any Hedging Agreement, except to hedge risks arising in the Ordinary Course of Business and not for speculative purposes; or become a party to a Multiemployer Plan or any employee benefit plan or arrangement maintained or contributed to by Parent.

9.2.9 Affiliate Transactions. Borrower shall not enter into or be party to any transaction with an Affiliate, except (a) transactions contemplated by the Transaction Documents; (b) payment of reasonable compensation to officers, managers and employees for services actually rendered; (c) payment of customary directors' and managers' fees and indemnities; (d) transactions with Affiliates that were consummated prior to the Closing Date, as shown on **Schedule 10**; and (e) transactions with Affiliates in the Ordinary Course of Business, upon fair and reasonable terms fully disclosed to Agent and no less favorable than would be obtained in a comparable arm's-length transaction with a non-Affiliate.

9.2.10 Other Collateral Negative Covenants. Borrower shall not (a) keep, store or otherwise maintain any Collateral at any location other than with the Custodian; (b) change its chief executive office or principal place of business, or other office where books and records are kept; or (c) amend, restate, supplement, or otherwise modify any Material Contract without Agent's prior written consent.

**9.3 Financial Covenants.** As long as any Commitments or Obligations are outstanding:

9.3.1 Asset Coverage Ratio. Borrower shall maintain at all times an Asset Coverage Ratio of not less than 2.25 to 1.00.

9.3.2 Interest Coverage Ratio. Borrower shall maintain, as of the last date of each Fiscal Quarter, commencing with the fiscal quarter ending June 30, 2018, an Interest Coverage Ratio of not less than 2.15 to 1.00.

## **SECTION 10. EVENTS OF DEFAULT; REMEDIES ON DEFAULT**

**10.1 Events of Default.** Each of the following shall be an "Event of Default" hereunder, if the same shall occur for any reason whatsoever, whether voluntary or involuntary, by operation of law or otherwise:

(a) Borrower fails to pay any Obligations when due (whether at stated maturity, on demand, upon acceleration or otherwise);

(b) Any representation, warranty or other written statement of Borrower or Parent made in connection with any Transaction Documents or transactions contemplated thereby is incorrect or misleading in any material respect (or, if any such representation, warranty or other written statement is qualified by "materiality", "Material Adverse Effect" or similar language, in any respect) when given or deemed given;

(c) Borrower or Servicer breaches or fail to perform any covenant contained in Section 5.5, 7.2, 7.4, 9.1.1, 9.1.2, 9.1.3, 9.1.4, 9.1.6, 9.1.7, 9.1.10, 9.1.11, 9.1.12, 9.1.14, 9.2 or 9.3;

(d) Borrower or Parent breaches or fails to perform any other covenant contained in any Transaction Documents, and such breach or failure is not cured within 30 days after a Senior Officer of Parent or Borrower has knowledge thereof or receives notice thereof from Agent, whichever is sooner;

(e) A Guarantor repudiates, revokes or attempts to revoke its Guaranty; Parent or Borrower denies or contests the validity or enforceability of any Transaction Documents or Obligations, or the perfection or priority of any Lien granted to Agent; or any Transaction Document ceases to be in full force or effect for any reason (other than a waiver or release by Agent and Lenders);

(f) Any breach or default of an Borrower occurs under any Hedging Agreement, or any document, instrument or agreement to which it is a party or by which it or any of its Properties is bound, relating to any Debt (other than the Obligations) in excess of \$500,000, if the maturity of or any payment with respect to such Debt may be accelerated or demanded due to such breach (including, without limitation, pursuant to a required mandatory prepayment or "put" of such Debt to any person);

(g) (i) Any judgment or order for the payment of money is entered against Borrower or its assets in an amount that exceeds, individually or cumulatively with all unsatisfied judgments or orders against Borrower, \$500,000 or (ii) any one or more non-monetary judgments that have, or could reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect and, in either case, (A) enforcement proceedings are commenced by any creditor upon such judgment or order, or (B) there is a period of 30 consecutive days during which a stay of enforcement of such judgment or order, by reason of a pending appeal or otherwise, is not in effect;

(h) (i) a loss, theft, damage or destruction occurs with respect to any Collateral if the amount not covered by insurance exceeds \$500,000 or if a material portion of the Collateral is effected, or (ii) there shall occur any levy upon, or attachment, garnishment, or other seizure of, any portion of the Collateral or other assets of Borrower in excess of \$500,000;

(i) Borrower is enjoined, restrained or in any way prevented by any governmental authority from conducting any material part of its business; Borrower suffers the loss, revocation or termination of any material license, permit, lease or agreement necessary to its business; there is a cessation of any material part of Borrower's business for a material period of time; Borrower shall take any action, or shall make a determination, whether or not formally approved by Borrower's managers, to suspend the operation of its business in the ordinary course, liquidate all or a material portion of its assets, or employ an agent or other third party to conduct sales of any material portion of its business; any material Collateral or Property of Borrower is taken or impaired through condemnation; there occurs any uninsured loss to any material Collateral or Property of Borrower; Borrower agrees to or commences any liquidation, dissolution or winding up of its affairs; or Borrower is not Solvent;

(j) An Insolvency Proceeding is commenced by Borrower; Borrower makes an offer of settlement, extension or composition to its unsecured creditors generally; a trustee, receiver or similar official is appointed to take possession of any substantial Property of or to operate any of the business of Borrower; or an Insolvency Proceeding is commenced against Borrower and Borrower consents to institution of the proceeding, the petition commencing the proceeding is not timely contested by Borrower, the petition is not dismissed within 60 days after filing, or an order for relief is entered in the proceeding;

(k) A reportable event (consisting of any of the events set forth in Section 4043(b) of ERISA) shall occur which Agent, in its reasonable discretion, shall determine constitutes grounds for the termination by the Pension Benefit Guaranty Corporation of any Plan or the appointment by the appropriate United States district court of a trustee for any Plan, or if any Plan shall be terminated or any such trustee shall be requested or appointed, or if Borrower is in "default" (as defined in Section 4219(c)(5) of ERISA) with respect to payments to a Multiemployer Plan resulting from Borrower's complete or partial withdrawal from such Multiemployer Plan, or any similar event as any of the foregoing occurs in respect of any employee benefit plan or arrangement maintained or contributed to by Borrower that is not subject to the laws of the United States or is mandated by a government other than the United States for employees of Borrower.

(l) Borrower, Servicer or any of their Senior Officers is criminally indicted or convicted for (i) a felony committed in the conduct of such Person's business, or (ii) violating any state or federal law (including the Controlled Substances Act, Money Laundering Control Act of 1986 and Illegal Exportation of War Materials Act) that could lead to forfeiture of any material Property or any Collateral;

(m) A Change of Control occurs; or any event occurs or condition exists that has a Material Adverse Effect;

(n) Borrower shall become required to register as an "investment company" within the meaning of the Investment Company Act or the arrangements contemplated by the Transaction Documents shall require registration as an "investment company" within the meaning of the Investment Company Act;

(o) A Servicer Termination Event occurs;

(p) Any Transaction Document, or any Lien granted thereunder, shall (except in accordance with its terms), in whole or in part, terminate, cease to be effective or cease to be the legally valid, binding and enforceable obligation of Borrower; or

(q) Borrower fails to make any payment when due (whether by scheduled maturity, required prepayment, acceleration, demand, or otherwise) in respect of any Material Contract or fails to observe or perform any other agreement or condition relating to any such Material Contract or contained in any instrument or agreement evidencing, securing or relating thereto, or any other event occurs, the effect of which default or other event is to cause the termination of such Material Contract or to permit the counterparty to such Material Contract to terminate such Material Contract; or

(r) Parent fails to maintain, as of the end of each fiscal quarter, commencing with the fiscal quarter ending March 31, 2018, a Tangible Net Worth greater than or equal to \$100,000,000.

**10.2 Remedies upon Default.** If an Event of Default described in **Section 10.1(j)** occurs, then to the extent permitted by Applicable Law, all Obligations (other than Secured Bank Product Obligations) shall become automatically due and payable and all Commitments shall terminate, without any action by Agent or notice of any kind. In addition, or if any Event of Default exists, Agent may in its discretion (and shall upon written direction of Required Lenders) do any one or more of the following from time to time:

(a) declare any Obligations (other than Secured Bank Product Obligations) immediately due and payable and the Maturity Date to have occurred, whereupon the Obligations shall be due and payable without diligence, presentment, demand, protest or notice of any kind, all of which are hereby waived by Borrower to the fullest extent permitted by law;

(b) terminate, reduce or condition any Commitment, or make any adjustment to the Borrowing Base;

(c) solely with respect to the Event of Default described in **Section 10.1(o)**, terminate the Servicing Agreement with Servicer;

(d) require Borrower to Cash Collateralize Secured Bank Product Obligations and other Obligations that are contingent or not yet due and payable, and, if Borrower fails promptly to deposit such Cash Collateral, Agent may (and shall upon the direction of Required Lenders) advance the required Cash Collateral as Revolver Loans (whether or not an Overadvance exists or is created thereby, or the conditions in **Section 6** are satisfied); and

(e) exercise any other rights or remedies afforded under any agreement, by law, at equity or otherwise, including the rights and remedies of a secured party under the UCC. Such rights and remedies include the rights to (i) take possession of any Collateral; (ii) exercise all rights and obligations of Servicer under the Transaction Documents; (iii) require Borrower and Servicer to assemble Collateral, at Borrower's expense, and make it available to Agent at a place designated by Agent; (iv) enter any premises where Collateral is located and store Collateral on such premises until sold (and if the premises are owned or leased by Borrower or Servicer, Borrower and Servicer agree not to charge for such storage); (v) demand, sue for, collect or receive any money or property at any time payable or receivable in respect of the Collateral including, without limitation, instructing the obligor or obligors on any agreement, instrument or other obligation constituting part of the Collateral to make any payment required by the terms of such agreement, instrument or other obligation directly to Agent, and in connection with any of the foregoing, compromise, settle, extend the time for payment and make other modifications with respect thereto; provided, however, that in the event that any such payments are made directly to Borrower or Servicer, prior to receipt by any such obligor of such instruction, Borrower and/or Servicer shall segregate all amounts received pursuant thereto in trust for the benefit of Agent and shall promptly pay such amounts to Agent; (vi) direct Servicer to sell, assign, grant a license to use or otherwise liquidate, any and all investments made in whole or in part with the Collateral or any part thereof, and take possession of the proceeds of any such sale, assignment, license or liquidation; (vii) withdraw all moneys, instruments, securities and other property with Custodian or any other bank, financial securities, deposit or other account of Borrower constituting Collateral for application to the Obligations as provided herein; (viii) exercise any and all rights as beneficial and legal owner of the Collateral, including, without limitation, perfecting assignment of and exercising any and all voting, consensual and other rights and powers with respect to any Collateral; (ix) exercise all the rights and remedies of a secured party under the UCC; and (x) direct the sale or disposition and otherwise dispose of any Collateral in its then condition at public or private sale, with such notice as may be required by Applicable Law, in lots or in bulk, at such locations, all as Agent, in its discretion, deems advisable. Borrower agrees that (a) 10 days' notice (unless the Collateral is perishable or threatens to decline speedily in value, or is of a type customarily sold on a recognized market (in which event, such advance notice as may be practicable under the circumstances)) of any proposed sale or other disposition of Collateral by Agent shall be reasonable and (b) Quoted Investments constitute Collateral of a type customarily sold on a recognized market. Agent shall have the right to conduct such sales on Borrower's or Servicer's premises, without charge, and such sales may be adjourned from time to time in accordance with Applicable Law. Agent shall have the right to direct the sale or other disposition of any Collateral for cash, credit or any combination thereof, and Agent may purchase any Collateral at public or, if permitted by law, private sale and, in lieu of actual payment of the purchase price, may credit bid and set off the amount of such price against the Obligations. Each purchaser, assignee, licensee or recipient at any such sale shall acquire the property sold, assigned or licensed absolutely free from any claim or right on the part of Borrower, and Borrower hereby waives, to the fullest extent permitted by Applicable Law, all rights of redemption, stay and/or appraisal which it now has or may at any time in the future have under any rule of law or statute now existing or hereafter enacted. Agent shall not be obligated to make any sale of Collateral regardless of notice of sale having been given. To the fullest extent permitted by Applicable Law, Borrower hereby waives any claims against Agent arising by reason of the fact that the price at which any Collateral may have been sold, assigned or licensed at such a private sale was less than the price which might have been obtained at a public sale, even if Agent accepts the first offer received and does not offer such Collateral to more than one offeree.

**10.3 License.** Agent is hereby granted an irrevocable, non-exclusive license or other right to use, license or sub-license (without payment of royalty or other compensation to any Person) any or all Intellectual Property of Borrower or Servicer, computer hardware and software, trade secrets, brochures, customer lists, promotional and advertising materials, labels, packaging materials and other Property, in advertising for sale, marketing, selling, collecting, completing manufacture of, or otherwise exercising any rights or remedies with respect to, any Collateral. Borrower's rights and interests under Intellectual Property shall inure to Agent's benefit.

**10.4 Setoff.** At any time during an Event of Default, Agent, Lenders, and any of their Affiliates are authorized, to the fullest extent permitted by Applicable Law, to set off and apply any and all deposits (general or special, time or demand, provisional or final, in whatever currency) at any time held and other obligations (in whatever currency) at any time owing by Agent, such Lender or such Affiliate to or for the credit or the account of Borrower against any Obligations, regardless of the adequacy of any other Collateral and regardless of whether or not Agent, such Lender or such Affiliate shall have made any demand under this Agreement or any other Transaction Document and although such Obligations may be contingent or unmatured or are owed to a branch or office of Agent, such Lender or such Affiliate different from the branch or office holding such deposit or obligated on such indebtedness. The rights of Agent, each Lender and each such Affiliate under this Section are in addition to other rights and remedies (including other rights of setoff) that such Person may have.

**10.5 Remedies Cumulative; No Waiver.**

10.5.1 **Cumulative Rights.** All agreements, warranties, guaranties, indemnities and other undertakings of Borrower and Servicer under the Transaction Documents are cumulative and not in derogation of each other. The rights and remedies of Agent and Lenders are cumulative, may be exercised at any time and from time to time, concurrently or in any order, and are not exclusive of any other rights or remedies available by agreement, by law, at equity or otherwise. All such rights and remedies shall continue in full force and effect until Full Payment of all Obligations.

10.5.2 **Waivers.** No waiver or course of dealing shall be established by (a) the failure or delay of Agent or any Lender to require strict performance by Borrower and Servicer with any terms of the Transaction Documents, or to exercise any rights or remedies with respect to Collateral or otherwise; (b) the making of any Loan during a Default, Event of Default or other failure to satisfy any conditions precedent, or Agent's or any Lender's permitting to remain outstanding any Loan during a Default or Event of Default; or (c) acceptance by Agent or any Lender of any payment or performance by Borrower under any Transaction Documents in a manner other than that specified therein. It is expressly acknowledged by Borrower that any failure to satisfy a financial covenant on a measurement date shall not be cured or remedied by satisfaction of such covenant on a subsequent date.

**SECTION 11. AGENT**

This **Section 11** and the provisions contained in **Exhibit D** attached hereto (which are hereby incorporated by reference) are an agreement solely among Secured Parties and Agent, and shall survive Full Payment of the Obligations. Neither **Exhibit D**, nor this **Section 11**, confer any rights or benefits upon Borrower or any other Person. As between Borrower, Servicer and Agent, any action that Agent may take under any Transaction Documents or with respect to any Obligations shall be conclusively presumed to have been authorized and directed by Secured Parties.

## SECTION 12. BENEFIT OF AGREEMENT; ASSIGNMENTS

**12.1 Successors and Assigns.** This Agreement shall be binding upon and inure to the benefit of Borrower, Servicer, Agent, Lenders, Secured Parties, and their respective successors and assigns, except that (a) neither Servicer nor Borrower shall have the right to assign its rights or delegate its obligations under any Transaction Documents; and (b) any assignment by a Lender must be made in compliance with **Section 12.3**. Agent may treat the Person which made any Loan as the owner thereof for all purposes until such Person makes an assignment in accordance with **Section 12.3**. Any authorization or consent of a Lender shall be conclusive and binding on any subsequent transferee or assignee of such Lender.

### **12.2 Participations**

**12.2.1 Permitted Participants; Effect.** Any Lender may, subject to **Section 12.3.3** and with the prior written consent of Agent, in the ordinary course of its business and in accordance with Applicable Law, at any time sell to a financial institution ("Participant") a participating interest in the rights and obligations of such Lender under any Transaction Documents. Despite any sale by a Lender of participating interests to a Participant, such Lender's obligations under the Transaction Documents shall remain unchanged, such Lender shall remain solely responsible to the other parties hereto for performance of such obligations, such Lender shall remain the holder of its Loans and Commitments for all purposes, all amounts payable by Borrower shall be determined as if such Lender had not sold such participating interests, and Borrower and Agent shall continue to deal solely and directly with such Lender in connection with the Transaction Documents. Each Lender shall be solely responsible for notifying its Participants of any matters under the Transaction Documents, and Agent and the other Lenders shall not have any obligation or liability to any such Participant. A Participant that would be a Foreign Lender if it were a Lender shall not be entitled to the benefits of **Section 5.10** unless Borrower agrees otherwise in writing.

**12.2.2 Voting Rights.** Each Lender shall retain the sole right to approve, without the consent of any Participant, any amendment, waiver or other modification of any Transaction Documents other than that which forgives principal, interest or fees, reduces the stated interest rate or fees payable with respect to any Loan or Commitment in which such Participant has an interest, postpones the Commitment Termination Date, Maturity Date, or any date fixed for any regularly scheduled payment of principal, interest or fees on such Loan or Commitment, or releases Borrower, Guarantor or substantial portion of the Collateral.

**12.2.3 Benefit of Set-Off.** Borrower agrees that each Participant, if consented to in writing by Agent, shall have a right of set-off in respect of its participating interest to the same extent as if such interest were owing directly to a Lender, and each Lender shall also retain the right of set-off with respect to any participating interests sold by it. By exercising any right of set-off, a Participant agrees to share with Lenders all amounts received through its set-off, in accordance with **Section V** of **Exhibit D** as if such Participant were a Lender.

### **12.3 Assignments.**

**12.3.1 Permitted Assignments.** A Lender may assign to an Eligible Assignee any of its Loans, rights and obligations under the Transaction Documents, as long as (a) each assignment is of a constant, and not a varying, percentage of the transferor Lender's rights and obligations under the Transaction Documents and, in the case of a partial assignment, is in a minimum principal amount of \$10,000,000 (unless otherwise agreed by Agent in its discretion); (b) Agent shall have consented to such assignment (except to the extent such assignment is to a Lender, an Affiliate of a Lender or an Approved Fund with respect to such Lender) and (c) the parties to each such assignment shall execute and deliver to Agent, for its acceptance and recording, an Assignment and Acceptance. Nothing herein shall limit the right of a Lender to pledge or assign any rights under the Transaction Documents to secure obligations of such Lender, including a pledge or assignment to a Federal Reserve Bank; provided, however, that no such pledge or assignment shall release the Lender from its obligations hereunder nor substitute the pledge or assignee for such Lender as a party hereto.



12.3.2 Effect; Effective Date. Upon delivery to Agent of an assignment notice in form and substance satisfactory to Agent and a processing fee of \$3,500 (unless otherwise agreed by Agent in its discretion), the assignment shall become effective as specified in the notice, if it complies with this **Section 12.3**. From such effective date, the Eligible Assignee shall for all purposes be a Lender under the Transaction Documents, and shall have all rights and obligations of a Lender thereunder. Upon consummation of an assignment, the transferor Lender, Agent and Borrower shall make appropriate arrangements for issuance of replacement and/or new promissory notes, as applicable, in favor of such assignee Lender. The transferee Lender shall comply with **Section 5.11** and deliver, upon request, an administrative questionnaire satisfactory to Agent.

12.3.3 Certain Assignees. No assignment or participation may be made to Borrower, Affiliate of Borrower, Defaulting Lender or natural person. In connection with any assignment by a Defaulting Lender, such assignment shall be effective only upon payment by the Eligible Assignee or Defaulting Lender to Agent of an aggregate amount sufficient, upon distribution (through direct payment, purchases of participations or other compensating actions as Agent deems appropriate), (a) to satisfy all funding and payment liabilities then owing by the Defaulting Lender hereunder, and (b) to acquire its Pro Rata share of all Loans. If an assignment by a Defaulting Lender shall become effective under Applicable Law for any reason without compliance with the foregoing sentence, then the assignee shall be deemed a Defaulting Lender for all purposes until such compliance occurs.

12.3.4 Certain Pledges. Any Lender may, at any time and without consent of Borrower or Agent, pledge or assign a security interest in all or any portion of its rights under this Agreement (including under any notes issued for its benefit) to secure obligations of such Lender, including any pledge or assignment to secure obligations to a Federal Reserve Bank or any funding source of such Lender; provided that no such pledge or assignment shall release such Lender from any of its obligations hereunder or substitute any such pledgee or assignee for such Lender as a party hereto.

**12.4** Replacement of Certain Lenders. If a Lender (a) requests compensation under **Section 3.7.1** or requires Borrower to pay any Indemnified Taxes or additional amounts to any Lender or any governmental authority for the account of any Lender pursuant to **Section 5.10** and, in each case, such Lender has declined or is unable to designate a different lending office in accordance with **Section 3.8**, (b) fails to give its consent to any amendment, waiver or action for which consent of all Lenders was required and Required Lenders consented, or (c) is a Defaulting Lender, then, in addition to any other rights and remedies that any Person may have, Agent or Borrower may, by notice to such Lender within 120 days after such event, require such Lender to assign all of its rights and obligations under the Transaction Documents to Eligible Assignee(s), pursuant to appropriate Assignment and Acceptance(s), within 20 days after the notice; provided, that in the case of any such assignment resulting from a claim for compensation under **Section 3.7.1** or payments required to be made pursuant to **Section 5.10**, such assignment will result in a reduction in such compensation or payments thereafter. Agent is irrevocably appointed as attorney-in-fact to execute any such Assignment and Acceptance if the Lender fails to execute it. Such Lender shall be entitled to receive, in cash from such Eligible Assignee, concurrently with such assignment, all amounts owed to it under the Transaction Documents, including all principal, interest and fees through the date of assignment (but excluding any prepayment charge).

**SECTION 13. MISCELLANEOUS**

**13.1 Consents, Amendments and Waivers.**

13.1.1 Amendment. No modification of any Transaction Document, including any extension or amendment of a Transaction Document or any waiver of a Default or Event of Default, shall be effective without the prior written agreement of Agent (with the consent of Required Lenders) and Borrower party to such Transaction Document; provided, however, that (a) without the prior written consent of Agent, no modification shall be effective with respect to any provision in a Transaction Document that relates to any rights, duties or discretion of Agent; (b) without the prior written consent of each affected Lender, including a Defaulting Lender, no modification shall be effective that would (i) increase the Commitment of such Lender; (ii) reduce the amount of, or waive or delay payment of, any principal, interest or fees payable to such Lender (except as provided in **Section 4.2**); (iii) extend the Commitment Termination Date or the Maturity Date applicable to such Lender's Obligations; or (iv) amend this clause (b); (c) without the prior written consent of all Lenders (except any Defaulting Lender), no modification shall be effective that would (i) alter **Section 5.7, 7.1** (except to add Collateral) or **13.1.1**; (ii) amend the definition of Required Lenders; (iii) release all or substantially all of the Collateral, except as currently contemplated by the Transaction Documents; or (iv) release Borrower from liability for any Obligations; (e) without the prior written consent of all Lenders (i) increase any advance rate with respect to the Borrowing Base or (ii) amend the definition of Borrowing Base (or any defined term used in such definition), in each case, if the effect if as a result thereof the amounts available to be borrowed by Borrower would be immediately increased; and (f) without the prior written consent of a Secured Bank Product Provider, no modification shall be effective that affects its relative payment priority under **Section 5.7**.

13.1.2 Limitations. The agreement of Borrower or Servicer shall not be necessary to the effectiveness of any modification of a Transaction Document that deals solely with the rights and duties of Lenders, and/or Agent as among themselves. Only the consent of the parties to the Fee Letter or any agreement relating to a Bank Product shall be required for any modification of such agreement, and any non-Lender that is party to a Bank Product agreement shall have no right to participate in any manner in modification of any other Transaction Document. Any waiver or consent granted by Agent or Lenders hereunder shall be effective only if in writing and only for the matter specified.

13.1.3 Payment for Consents. Borrower will not, directly or indirectly, pay any remuneration or other thing of value, whether by way of additional interest, fee or otherwise, to any Lender (in its capacity as a Lender hereunder) as consideration for agreement by such Lender with any modification of any Transaction Documents, unless such remuneration or value is concurrently paid, on the same terms, on a Pro Rata basis to all Lenders providing their consent.

**13.2 Indemnity.** BORROWER SHALL INDEMNIFY AND HOLD HARMLESS THE INDEMNITEES AGAINST ANY CLAIMS, LIABILITIES, COSTS, EXPENSES AND OTHER AMOUNTS OF ANY KIND THAT MAY BE INCURRED BY OR ASSERTED AGAINST ANY INDEMNITEE IN ANY WAY RELATED TO THE TRANSACTION DOCUMENTS, THE COLLATERAL, ANY BREACH OF APPLICABLE LAW, OR OTHERWISE, INCLUDING CLAIMS ASSERTED BY BORROWER OTHER PERSON OR ARISING FROM THE NEGLIGENCE OF AN INDEMNITEE; provided, however, in no event shall Borrower have any obligation to indemnify or hold harmless an Indemnitee with respect to (a) any claims, liabilities, costs, expenses and other amounts of any kind in any way related to the Transaction Documents or Collateral that are determined in a final, non-appealable judgment by a court of competent jurisdiction to result from the gross negligence or willful misconduct of any Indemnitee, or (b) any claims, liabilities, costs, expenses and other amounts of any kind arising from disputes brought by an Indemnitee against another Indemnitee (other than any claim, litigation, investigation or proceeding that is brought by or against Agent or arranger, acting in its capacity as the Agent or arranger) that does not arise out of any act or omission of Borrower, Servicer or any of their respective subsidiaries.

**13.3 Notices and Communications.**

13.3.1 Notice Address. Subject to **Section 4.1.4**, all notices and other communications by or to a party hereto shall be in writing and shall be given to Borrower, at Borrower's address shown on the signature pages hereof, and to any other Person at its address shown on the signature pages hereof (or, in the case of a Person who becomes a Lender after the Closing Date, at the address shown on its Assignment and Acceptance), or at such other address as a party may hereafter specify by notice in accordance with this **Section 13.3**. Each such notice or other communication shall be effective only (a) if given by facsimile transmission, when transmitted to the applicable facsimile number, if confirmation of receipt is received; (b) if given by mail, three Business Days after deposit in the U.S. mail, with first-class postage pre-paid, addressed to the applicable address; (c) if given by personal delivery, when duly delivered to the notice address with receipt acknowledged; or (d) if given by electronic means, only at the time and to the extent provided in **Section 13.3.2**. In no event shall a voicemail message be effective as a notice, communication or confirmation under any of the Transaction Documents. Notwithstanding the foregoing, no notice to Agent pursuant to **Section 2.1.4, 3.1.2, or 4.1.1** shall be effective until actually received by the individual to whose attention at Agent such notice is required to be sent. Any written notice or other communication that is not sent in conformity with the foregoing provisions shall nevertheless be effective on the date actually received by the noticed party.

13.3.2 Electronic Communications. (i) Borrower authorizes Agent and Lenders to extend Loans, effect selections of interest rates, and transfer funds to or on behalf of Borrower based on instructions sent by electronic mail. Borrower shall confirm each such request by prompt delivery to Agent of a Notice of Borrowing, if applicable, but if the foregoing differs in any material respect from the action taken by Agent, the records of Agent shall govern.

(ii) Electronic mail and internet websites may be used for delivery of financial statements, Borrowing Base Certificates and other information required by **Section 9.1.3** (other than notices), administrative matters and distribution of Transaction Documents for execution, pursuant to procedures approved by Agent or as otherwise determined by Agent. Anything herein to the contrary notwithstanding, except as expressly provided **Section 13.2.2(i)**, notices delivered by electronic mail may not be used as effective notice under the Transaction Documents.

(iii) Unless Agent otherwise requires, communications sent to an electronic mail address of Agent shall be deemed received upon the sender's receipt of an acknowledgement from the intended recipient (such as by the "return receipt requested" function, as available, return e-mail, or other written acknowledgement); provided that if such communication is not sent during the normal business hours of the recipient, such communication shall be deemed to have been sent at the opening of business on the next Business Day for the recipient.

(iv) Agent shall not have any liability for any loss suffered by Borrower as a result of Agent's acting upon its understanding of electronic mail requests or instructions from a Person believed in good faith by Agent to be a Person authorized to give such requests or instructions on Borrower's behalf. Borrower shall indemnify, defend and hold harmless each Indemnitee from any claims arising from any electronic communication purportedly given by or on behalf of Borrower.

(v) Agent may, in its discretion and upon notice to Borrower (A) cease or suspend any actual or implied obligation it may have to act based on such electronic communications and (B) thereafter, disregard any such electronic communications.

13.3.3 **Non-Conforming Communications.** Agent and Lenders may rely upon any notices purportedly given by or on behalf of Borrower even if such notices were not made in a manner specified herein, were incomplete or were not confirmed, or if the terms thereof, as understood by the recipient, varied from a later confirmation. Borrower shall indemnify and hold harmless each Indemnitee from any liabilities, losses, costs and expenses arising from any telephonic communication purportedly given by or on behalf of Borrower.

**13.4 Performance of Borrower's Obligations.** Agent may, in its discretion at any time and from time to time, at Borrower's expense, pay any amount or do any act required of Borrower under any Transaction Documents or otherwise lawfully requested by Agent to (a) enforce any Transaction Documents or collect any Obligations; (b) protect, insure, maintain or realize upon any Collateral; or (c) defend or maintain the validity or priority of Agent's Liens in any Collateral, including any payment of a judgment, insurance premium, or landlord claim, or any discharge of a Lien. All payments, costs and expenses (including Extraordinary Expenses) of Agent under this Section shall be reimbursed to Agent by Borrower, **on demand**, with interest from the date incurred to the date of payment thereof at the Default Rate applicable to Base Rate Revolver Loans. Any payment made or action taken by Agent under this Section shall be without prejudice to any right to assert an Event of Default or to exercise any other rights or remedies under the Transaction Documents.

**13.5 Credit Inquiries.** Borrower hereby authorizes Agent and Lenders (but they shall have no obligation) to respond to usual and customary credit inquiries from third parties concerning Borrower.

**13.6 Severability.** Wherever possible, each provision of the Transaction Documents shall be interpreted in such manner as to be valid under Applicable Law. If any provision is found to be invalid under Applicable Law, it shall be ineffective only to the extent of such invalidity and the remaining provisions of the Transaction Documents shall remain in full force and effect.

**13.7 Cumulative Effect; Conflict of Terms.** The provisions of the Transaction Documents are cumulative. The parties acknowledge that the Transaction Documents may use several limitations, tests or measurements to regulate similar matters, and they agree that these are cumulative and that each must be performed as provided. Except as otherwise provided in another Transaction Document (by specific reference to the applicable provision of this Agreement), if any provision contained herein is in direct conflict with any provision in another Transaction Document, the provision herein shall govern and control.

**13.8 Counterparts.** Any Transaction Document may be executed in counterparts, each of which shall constitute an original, but all of which when taken together shall constitute a single contract. This Agreement shall become effective when Agent has received counterparts bearing the signatures of all parties hereto. Delivery of a signature page of any Transaction Document by telecopy or other electronic means shall be effective as delivery of a manually executed counterpart of such agreement.

**13.9 Entire Agreement.** Time is of the essence of the Transaction Documents. The Transaction Documents constitute the entire contract among the parties relating to the subject matter hereof, and supersede any and all previous agreements and understandings, oral or written, relating to the subject matter hereof.

**13.10 Relationship with Lenders.** The obligations of each Lender hereunder are several, and no Lender shall be responsible for the obligations or Commitments of any other Lender. Amounts payable hereunder to each Lender shall be a separate and independent debt. It shall not be necessary for Agent or any other Lender to be joined as an additional party in any proceeding for such purposes. Nothing in this Agreement and no action of Agent, Lenders or any other Secured Party pursuant to the Transaction Documents or otherwise shall be deemed to constitute Agent and any Secured Party to be a partnership, association, joint venture or any other kind of entity, nor to constitute control of Borrower.

**13.11 No Advisory or Fiduciary Responsibility.** In connection with all aspects of each transaction contemplated by any Transaction Document, Borrower and Servicer acknowledge and agree that (a)(i) this credit facility and any related arranging or other services by Agent, any Lender, any of their Affiliates or any arranger are arm's-length commercial transactions between Borrower, Servicer and such Person; (ii) Borrower and Servicer have consulted their own legal, accounting, regulatory and tax advisors to the extent they have deemed appropriate; and (iii) Borrower and Servicer are capable of evaluating, and understand and accept, the terms, risks and conditions of the transactions contemplated by the Transaction Documents; (b) each of Agent, Lenders, their Affiliates and any arranger is and has been acting solely as a principal and, except as expressly agreed in writing by the relevant parties, has not been, is not, and will not be acting as an advisor, agent or fiduciary for Borrower or Servicer, any of their Affiliates or any other Person, and has no obligation with respect to the transactions contemplated by the Transaction Documents except as expressly set forth therein; and (c) Agent, Lenders, their Affiliates and any arranger may be engaged in a broad range of transactions that involve interests that differ from those of Borrower and Servicer and their Affiliates, and have no obligation to disclose any of such interests to Borrower and Servicer or their Affiliates. To the fullest extent permitted by Applicable Law, Borrower and Servicer hereby waives and releases any claims that it may have against Agent, Lenders, their Affiliates and any arranger with respect to any breach of agency or fiduciary duty in connection with any transaction contemplated by a Transaction Document.

**13.12 Confidentiality.** Each of Agent and Lenders shall maintain the confidentiality of all Information (as defined below), except that Information may be disclosed (a) to its Affiliates and funding or financing sources, and to its and their partners, directors, officers, employees, agents, advisors and representatives (provided such Persons are informed of the confidential nature of the Information and instructed to keep it confidential); (b) to the extent requested by any governmental, regulatory or self-regulatory authority purporting to have jurisdiction over it or its Affiliates; (c) to the extent required by Applicable Law or by any subpoena or other legal process (provided that such Agent or Lender shall, to the extent permitted by law, endeavor to promptly notify the Borrower in advance of such pending disclosure); (d) to any other party hereto; (e) in connection with any action or proceeding, or other exercise of rights or remedies, relating to any Transaction Documents or Obligations; (f) subject to an agreement containing provisions substantially the same as this Section, to any Transferee or any actual or prospective party (or its advisors) to any Bank Product; (g) with the consent of Borrower; or (h) to the extent such Information (i) becomes publicly available other than as a result of a breach of this Section or (ii) is available to Agent, any Lender, or any of their Affiliates on a nonconfidential basis from a source other than Borrower. Notwithstanding the foregoing, Agent and Lenders may publish or disseminate general information describing this credit facility, including the names and addresses of Borrower and a general description of Borrower's and Parent's businesses, and may use Borrower's and Parent's logos, trademarks or product photographs in advertising materials, including, without limitation, "tombstones", league tables and press releases. As used herein, "Information" means all information received from Borrower or Parent relating to it or its business that is identified as confidential when delivered. Any Person required to maintain the confidentiality of Information pursuant to this Section shall be deemed to have complied if it exercises the same degree of care that it accords its own confidential information. Each of Agent and Lenders acknowledges that (i) Information may include material non-public information concerning Parent or Borrower; (ii) it has developed compliance procedures regarding the use of material non-public information; and (iii) it will handle such material non-public information in accordance with Applicable Law, including federal and state securities laws. Borrower and Parent consent to the publication by Agent or any Lender of advertising material relating to the financing transactions contemplated by this Agreement using Borrower's or Parent's name, product photographs, logo or trademark. Agent reserves the right to provide to industry trade organizations information necessary and customary for inclusion in league table measurements.

**13.13 GOVERNING LAW. THIS AGREEMENT AND THE OTHER TRANSACTION DOCUMENTS, UNLESS OTHERWISE SPECIFIED, SHALL BE GOVERNED BY THE LAWS OF THE STATE OF GEORGIA, WITHOUT GIVING EFFECT TO ANY CONFLICT OF LAW PRINCIPLES (BUT GIVING EFFECT TO FEDERAL LAWS RELATING TO NATIONAL BANKS).**

**13.14 Consent to Forum. BORROWER AND SERVICER EACH HEREBY CONSENTS TO THE NON-EXCLUSIVE JURISDICTION OF ANY FEDERAL OR STATE COURT SITTING IN OR WITH JURISDICTION OVER ATLANTA, GEORGIA, IN ANY PROCEEDING OR DISPUTE RELATING IN ANY WAY TO ANY TRANSACTION DOCUMENTS, AND AGREES THAT ANY SUCH PROCEEDING SHALL BE BROUGHT BY IT SOLELY IN ANY SUCH COURT. BORROWER AND SERVICER EACH IRREVOCABLY WAIVES ALL CLAIMS, OBJECTIONS AND DEFENSES THAT IT MAY HAVE REGARDING SUCH COURT'S PERSONAL OR SUBJECT MATTER JURISDICTION, VENUE OR INCONVENIENT FORUM. EACH PARTY HERETO IRREVOCABLY CONSENTS TO SERVICE OF PROCESS IN THE MANNER PROVIDED FOR NOTICES IN SECTION 13.3.1. Nothing herein shall limit the right of Agent or any Lender to bring proceedings against Borrower or Servicer in any other court, nor limit the right of any party to serve process in any other manner permitted by Applicable Law. Nothing in this Agreement shall be deemed to preclude enforcement by Agent of any judgment or order obtained in any forum or jurisdiction.**

**13.15** WAIVERS BY BORROWER AND SERVICER. TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, BORROWER AND SERVICER EACH HEREBY KNOWINGLY, INTENTIONALLY AND INTELLIGENTLY WAIVES (WITH THE BENEFIT OF ADVICE OF LEGAL COUNSEL OF ITS OWN CHOOSING), (A) THE RIGHT TO TRIAL BY JURY (WHICH AGENT AND EACH LENDER HEREBY ALSO WAIVES) IN ANY PROCEEDING OR DISPUTE OF ANY KIND RELATING IN ANY WAY TO ANY TRANSACTION DOCUMENTS, OBLIGATIONS OR COLLATERAL; (B) PRESENTMENT, DEMAND, PROTEST, NOTICE OF PRESENTMENT, DEFAULT, NON-PAYMENT, MATURITY, RELEASE, COMPROMISE, SETTLEMENT, EXTENSION OR RENEWAL OF ANY COMMERCIAL PAPER, ACCOUNTS, DOCUMENTS, INSTRUMENTS, CHATTEL PAPER AND GUARANTIES AT ANY TIME HELD BY AGENT ON WHICH BORROWER MAY IN ANY WAY BE LIABLE, AND HEREBY RATIFIES ANYTHING AGENT MAY DO IN THIS REGARD; (C) NOTICE PRIOR TO TAKING POSSESSION OR CONTROL OF ANY COLLATERAL; (D) ANY BOND OR SECURITY THAT MIGHT BE REQUIRED BY A COURT PRIOR TO ALLOWING AGENT TO EXERCISE ANY RIGHTS OR REMEDIES; (E) THE BENEFIT OF ALL VALUATION, APPRAISEMENT AND EXEMPTION LAWS; (F) ANY CLAIM AGAINST AGENT OR ANY LENDER, ON ANY THEORY OF LIABILITY, FOR SPECIAL, INDIRECT, CONSEQUENTIAL, EXEMPLARY OR PUNITIVE DAMAGES (AS OPPOSED TO DIRECT OR ACTUAL DAMAGES) IN ANY WAY RELATING TO ANY ENFORCEMENT ACTION OR EXERCISE OF RIGHTS OR REMEDIES, OF ANY KIND, THE OBLIGATIONS, TRANSACTION DOCUMENTS OR TRANSACTIONS RELATING THERETO; (G) NOTICE OF ACCEPTANCE HEREOF; AND (H) THE RIGHT TO ASSERT ANY CONFIDENTIAL RELATIONSHIP THAT IT MAY HAVE UNDER APPLICABLE LAW WITH ANY ACCOUNTING FIRM AND/OR SERVICE BUREAU IN CONNECTION WITH ANY INFORMATION REQUESTED BY AGENT PURSUANT TO OR IN ACCORDANCE WITH THIS AGREEMENT (AND BORROWER AND SERVICER EACH AGREE THAT AGENT MAY CONTACT DIRECTLY AND SUCH ACCOUNTING FIRM AND/OR SERVICE BUREAU IN ORDER TO OBTAIN ANY SUCH INFORMATION). BORROWER AND SERVICER EACH ACKNOWLEDGES THAT THE FOREGOING WAIVERS ARE A MATERIAL INDUCEMENT TO AGENT AND LENDERS ENTERING INTO THIS AGREEMENT AND THAT THEY ARE RELYING UPON THE FOREGOING IN THEIR DEALINGS WITH BORROWER. BORROWER AND SERVICER EACH HAS REVIEWED THE FOREGOING WAIVERS WITH ITS LEGAL COUNSEL AND HAS KNOWINGLY AND VOLUNTARILY WAIVED ITS JURY TRIAL AND OTHER RIGHTS FOLLOWING CONSULTATION WITH LEGAL COUNSEL. IN THE EVENT OF LITIGATION, THIS AGREEMENT MAY BE FILED AS A WRITTEN CONSENT TO A TRIAL BY THE COURT.

**13.16** Power of Attorney. Borrower and Servicer hereby irrevocably constitutes and appoints Agent (and all Persons designated by Agent) as Borrower or Servicer's true and lawful attorney (and agent-in-fact) for the purposes provided in this Section. Agent, or Agent's designee, may, without notice and in either its or Borrower's name, but at the cost and expense of Borrower: (a) endorse an Borrower's 's name on any Payment Item or other proceeds of Collateral (including proceeds of insurance) that come into Agent's possession or control; and (b) during an Event of Default, (i) collect, liquidate and receive balances in Deposit Accounts or investment accounts, and take control, in any manner, of proceeds of Collateral; (ii) prepare, file and sign Borrower's name to a proof of claim or other document in a bankruptcy of a Portfolio Company, or to any notice, assignment or satisfaction of Lien or similar document; (iii) receive, open and dispose of mail addressed to Borrower, and notify postal authorities to deliver any such mail to an address designated by Agent; (iv) endorse any Chattel Paper, Document, Instrument, bill of lading, or other document or agreement relating to any Collateral; (v) use Borrower's stationery and sign its name to verifications of Bank Loans; (vi) use information contained in any data processing, electronic or information systems relating to Collateral; (vii) make and adjust claims under insurance policies; (viii) take any action as may be necessary or appropriate to obtain payment under any letter of credit, banker's acceptance or other instrument for which Borrower is a beneficiary; and (ix) take all other actions as Agent deems appropriate to fulfill Borrower's obligations under the Transaction Documents.

**13.17** PATRIOT Act Notice. Agent and Lenders hereby notify Borrower and Servicer that pursuant to the requirements of the PATRIOT Act, Agent and Lenders are required to obtain, verify and record information that identifies Borrower and Servicer, including its legal name, address, tax ID number and other information that will allow Agent and Lenders to identify it in accordance with the PATRIOT Act. Agent and Lenders will also require information regarding each personal guarantor, if any, and may require information regarding Borrower's and Servicer's management and owners, such as legal name, address, social security number and date of birth.

**SECTION 14. CUSTODIAN AND BACKUP SERVICER**

**14.1 Designation of Custodian.** The role of Custodian with respect to the Underlying Instruments relating to the Portfolio Investments shall be conducted by the Person designated as Custodian hereunder until the resignation or removal of Custodian pursuant to the terms of the Custodian Agreement.

**14.2 Duties of Custodian.** The duties of the Custodian shall be set forth in the Custodian Agreement.

**14.3 Custodian Removal.** The Custodian may be removed pursuant to the terms of the Custodian Agreement; provided, however, the Custodian shall continue to act in such capacity until a successor Custodian has been appointed and has received all Underlying Instruments held by the previous Custodian.

**14.4 Access to Certain Documentation and Information Regarding the Collateral; Audits.** The Servicer, Borrower and the Custodian shall provide to the Agent access to the Underlying Instruments and all other documentation regarding the Collateral including in such cases where the Agent is required in connection with the enforcement of the rights or interests of the Lenders, or by applicable statutes or regulations, to review such documentation, such access being afforded without charge and upon reasonable prior written notice from the Agent. From time to time at the discretion of the Agent, the Agent may review the Servicer's collection and administration of the Collateral and may conduct an audit of the Collateral and Underlying Instruments in conjunction with such a review.

**14.5 Designation of Backup Servicer.** The role of Backup Servicer with respect to the Underlying Instruments shall be conducted by the Person designated as Backup Servicer hereunder from until the Agent shall give such Backup Servicer a Backup Servicer Termination Notice.

**14.6 Duties of Backup Servicer.** The duties of the Backup Servicer shall be set forth in the Servicing Agreement.

**14.7 Backup Servicer Removal.** The Backup Servicer may be removed, with or without cause, by the Agent (or Borrower with the Agent's consent in its sole discretion) by notice given in writing to the Backup Servicer (the "Backup Servicer Termination Notice"); provided that notwithstanding its receipt of a Backup Servicer Termination Notice, the Backup Servicer shall continue to act in such capacity until a successor Backup Servicer has been appointed and has agreed to act as Backup Servicer hereunder.

[Remainder of page intentionally left blank; signatures begin on following page]



**IN WITNESS WHEREOF**, this Agreement has been executed under seal and delivered as of the date set forth above.

ATTEST:

\_\_\_\_\_  
Secretary  
[SEAL]

**BORROWER:**

**KCAP FUNDING I, LLC**

By: \_\_\_\_\_

Name: Dayl Pearson

Title: Manager

Address:

295 Madison Avenue, 6<sup>th</sup> Floor  
New York, NY 10017  
Attn: Daniel Gilligan  
Facsimile: (212) 983-7654  
Email: gilligan@kcapinc.com

ATTEST:

\_\_\_\_\_  
Secretary  
[SEAL]

**SERVICER:**

**KCAP FINANCIAL, INC.**

By: \_\_\_\_\_

Name: Daniel Gilligan

Title: Vice President

Address:

295 Madison Avenue, 6<sup>th</sup> Floor  
New York, NY 10017  
Attn: Daniel Gilligan  
Facsimile: (212) 983-7654  
Email: gilligan@kcapinc.com

Signature Page – Loan and Security Agreement

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**AGENT AND LENDERS:**

**STATE BANK AND TRUST COMPANY,**  
as Agent and a Lender

By: \_\_\_\_\_

Name: Megan Enlow

Title: Director

Address:

State Bank and Trust Company  
3399 Peachtree Road, N.E., Suite 1900  
Atlanta, GA 30326  
Attn: KCAP Loan Administration Officer  
Telecopy: (404) 365-7112

with courtesy copies to (which shall not be deemed notice):

Troutman Sanders LLP  
600 Peachtree Street, NE Suite 5200  
Atlanta, Georgia 30308  
Attention: Hazen Dempster, Esq.  
Facsimile: (404) 885-3900

Signature Page – Loan and Security Agreement

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**CIBC BANK USA,**  
as a Lender and as Documentation Agent

By: \_\_\_\_\_  
Name: Steven Cohen  
Title: Managing Director  
Address: 120 S. LaSalle Street  
Chicago, Illinois 60603  
Attn: Michael Free  
Telecopy: (312) 564-6897

Signature Page – Loan and Security Agreement

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**WOODFOREST NATIONAL BANK,**  
as a Lender

By:

Name: Jeffrey A. Mitchell

Title: Senior Vice President, Corporate Banking

Address:

Woodforest National Bank - Loan Operations

25231 Grogan's Mill Rd.

Suite 450

The Woodlands, TX 77380

Telecopy: (832) 375-3004

Email: [CMBloanservicing@woodforest.com](mailto:CMBloanservicing@woodforest.com)

Signature Page – Loan and Security Agreement

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EXHIBIT A  
to  
Loan and Security Agreement

**ASSIGNMENT AND ACCEPTANCE**

Reference is made to the Loan and Security Agreement dated as of March 1, 2018, as amended ("Loan Agreement"), among **KCAP FUNDING I, LLC** ("Borrower"), **KCAP FINANCIAL, INC.**, as servicer, **STATE BANK AND TRUST COMPANY**, as agent ("Agent") for the financial institutions from time to time party to the Loan Agreement ("Lenders"), and such Lenders. Terms are used herein as defined in the Loan Agreement.

\_\_\_\_\_ ("Assignor") and \_\_\_\_\_ ("Assignee") agree as follows:

1. Assignor hereby assigns to Assignee and Assignee hereby purchases and assumes from Assignor (a) a principal amount of \$\_\_\_\_\_ of Assignor's outstanding Revolver Loans, and (b) the amount of \$\_\_\_\_\_ of Assignor's Revolver Commitment (which represents \_\_\_\_% of the total Revolver Commitments) (the foregoing items being, collectively, the "Assigned Interest"), together with an interest in the Transaction Documents corresponding to the Assigned Interest. This Agreement shall be effective as of the date ("Effective Date") indicated in the corresponding assignment notice delivered to Agent, provided such assignment notice is executed by Assignor, Assignee, Agent and Borrower, if applicable. From and after the Effective Date, Assignee hereby expressly assumes, and undertakes to perform, all of Assignor's obligations in respect of the Assigned Interest, and all principal, interest, fees and other amounts which would otherwise be payable to or for Assignor's account in respect of the Assigned Interest shall be payable to or for Assignee's account, to the extent such amounts accrue on or after the Effective Date.

2. Assignor (a) represents that as of the date hereof, prior to giving effect to this assignment, its Revolver Commitment is \$\_\_\_\_\_, the outstanding balance of its Revolver Loans is \$\_\_\_\_\_; (b) makes no representation or warranty and assumes no responsibility with respect to any statements, warranties or representations made in or in connection with the Loan Agreement or the execution, legality, validity, enforceability, genuineness, sufficiency or value of the Loan Agreement or any other instrument or document furnished pursuant thereto, other than that (i) Assignor is the legal and beneficial owner of the interest being assigned by it hereunder, (ii) the Assigned Interest is free and clear of any lien, encumbrance or other adverse claim, and (iii) it has full power and authority, and has taken all action necessary, to execute and deliver this Assignment and Assumption and to consummate the transactions contemplated hereby; and (c) makes no representation or warranty and assumes no responsibility with respect to the financial condition of Borrower or the performance by Borrower of its obligations under the Transaction Documents. *[Assignor is attaching the note[s] evidencing the Assigned Interests held by it and requests that Agent exchange such note[s] for new notes payable to Assignee [and Assignor].]*

3. Assignee (a) represents and warrants that it is legally authorized to enter into this Assignment and Acceptance; (b) confirms that it has received copies of the Loan Agreement and such other Transaction Documents and information as it has deemed appropriate to make its own credit analysis and decision to enter into this Assignment and Acceptance; (c) agrees that it shall, independently and without reliance upon Assignor and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under the Transaction Documents; (d) confirms that it is an Eligible Assignee; (e) appoints and authorizes Agent to take such action as agent on its behalf and to exercise such powers under the Loan Agreement as are delegated to Agent by the terms thereof, together with such powers as are incidental thereto; (f) agrees that it will observe and perform all obligations that are required to be performed by it as a "Lender" under the Transaction Documents; (g) represents and warrants that the assignment evidenced hereby will not result in a non-exempt "prohibited transaction" under Section 406 of ERISA and (h) agrees that it will keep confidential all information with respect to Borrower furnished to it by Borrower or the Assignor to the extent provided in the Loan Agreement. Assignee acknowledges and agrees that it will not sell or otherwise dispose of the Assigned Interest or any portion thereof, or grant any participation therein, in a manner which, or take any action in connection therewith which, would violate the terms of any of the Transaction Documents.

4. This Agreement shall be governed by the laws of the State of Georgia. If any provision is found to be invalid under Applicable Law, it shall be ineffective only to the extent of such invalidity and the remaining provisions of this Agreement shall remain in full force and effect.

5. Each notice or other communication hereunder shall be in writing, shall be sent by messenger, by telecopy or facsimile transmission, or by first-class mail, shall be deemed given when sent and shall be sent as follows:

(a) If to Assignee, to the following address (or to such other address as Assignee may designate from time to time):

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

(b) If to Assignor, to the following address (or to such other address as Assignor may designate from time to time):

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Payments hereunder shall be made by wire transfer of immediately available Dollars as follows:

If to Assignee, to the following account (or to such other account as Assignee may designate from time to time):

\_\_\_\_\_  
\_\_\_\_\_  
ABA No. \_\_\_\_\_  
\_\_\_\_\_  
Account No. \_\_\_\_\_  
Reference: \_\_\_\_\_

If to Assignor, to the following account (or to such other account as Assignor may designate from time to time):

\_\_\_\_\_  
\_\_\_\_\_  
ABA No. \_\_\_\_\_  
\_\_\_\_\_  
Account No. \_\_\_\_\_  
Reference: \_\_\_\_\_

IN WITNESS WHEREOF, this Assignment and Acceptance is executed as of \_\_\_\_\_.

\_\_\_\_\_  
("Assignee")

By \_\_\_\_\_  
Title:

\_\_\_\_\_  
("Assignor")

By \_\_\_\_\_  
Title:

CONSENTED TO, ACCEPTED AND AGREED,  
AS OF THE DATE SET FORTH ABOVE:

**AGENT:**

**STATE BANK AND TRUST COMPANY**, as Agent

By \_\_\_\_\_  
Name:  
Title:

ACKNOWLEDGED AND AGREED,  
AS OF THE DATE SET FORTH ABOVE:

**BORROWER:**

**KCAP FUNDING I, LLC**

By \_\_\_\_\_  
Name:  
Title:

EXHIBIT B  
to  
Loan and Security Agreement

**COMPLIANCE CERTIFICATE**

[Letterhead of Borrower]

\_\_\_\_\_, 20\_\_

State Bank and Trust Company, as Agent  
3399 Peachtree Road, N.E.  
Suite 1900  
Atlanta, Georgia 30326  
Attn: KCAP Loan Administration Officer

The undersigned, a manager of KCAP Funding I, LLC, a Delaware limited liability company ("**Borrower**"), gives this certificate to State Bank and Trust Company, in its capacity as agent for the hereinafter defined Lenders ("**Agent**"), in accordance with the requirements of Section 9.1.3 of that certain Loan and Security Agreement, dated March 1, 2018, by and among Borrower, Agent and the financial institutions party from time to time thereto as lenders (the "**Lenders**") (as at any time amended, the "Loan Agreement"). Capitalized terms used in this Certificate, unless otherwise defined herein, shall have the meanings ascribed to them in the Loan Agreement.

1. Attached hereto are copies of the [**unaudited**][**audited**] balance sheets and statements of income and cash flow of [**Parent**] [**Borrower**] for the Fiscal Quarter ending [\_\_\_\_\_, 20\_\_], accompanied by such material as are required to be delivered pursuant to Section 9.1.3, which have been prepared in accordance with GAAP and fairly present the financial position and results of operations of Borrower for such Fiscal Quarter, **subject to normal year-end adjustments and the absence of footnotes.**

2. (a) I hereby certify based upon my review of the balance sheets and statements of income of Borrower for the four Fiscal Quarter period ending [\_\_\_\_\_, 20\_\_], that the Asset Coverage Ratio for the relevant measurement period is [\_\_\_\_\_], which [**is**] [**is not**] in compliance with requirements of Section 9.3.1 to the Loan Agreement.

(b) I hereby certify based upon my review of the balance sheets and statements of income of Borrower for the four Fiscal Quarter Period ending [\_\_\_\_\_, 20\_\_], that the Interest Coverage Ratio for the relevant measurement period is [\_\_\_\_\_], which [**is**] [**is not**] in compliance with requirements of Section 9.3.2 to the Loan Agreement.

(c) I hereby certify based upon my review of the balance sheets and statements of income of Parent for the Fiscal Quarter ending [\_\_\_\_\_, 20\_\_], that Parent's Tangible Net Worth is \$\_\_\_\_\_, which [**is**] [**is not**] an Event of Default under Section 10.1(r) to the Loan Agreement.

3. No Default or Event of Default exists on the date hereof, other than: \_\_\_\_\_  
\_\_\_\_\_  
**[if none, so state];** and



4. **Attached** hereto is a schedule showing the calculations that support Borrower's compliance [*non-compliance*] with the financial covenants, as shown above.

5. The financial statements furnished to Agent for the Fiscal Quarter ending [\_\_\_\_\_, 20\_\_] were prepared in accordance with GAAP consistently applied and present fairly in all material respects the financial condition of Borrower at the close of, and the results of the Borrower's operations and cash flows for, the period(s) covered, subject to normal year end audit adjustments and the absence of footnotes. There has been no change in GAAP or the application thereof since the date of the audited financial statements furnished to Agent for the year ending [\_\_\_\_\_], other than the material accounting changes as disclosed on **Appendix III** hereto.

6. Except as set forth in **Appendix IV**, there has been no change in generally accepted accounting principles used in the preparation of the financial statements delivered to Agent herewith. If any such change has occurred, a statement of reconciliation conforming such financial statements to GAAP is attached hereto in **Appendix IV**.

Very truly yours,

---

Name:  
Title: Manager

*(Attachments)*

EXHIBIT C  
to  
Loan and Security Agreement

**CONDITIONS PRECEDENT**

(a) Each Lender requesting a note pursuant to **Section 2.1.2** shall have received such note(s), duly executed by Borrower. Each other Transaction Document shall have been duly executed and delivered to Agent by each of the signatories thereto, and Borrower shall be in compliance with all terms thereof.

(b) Agent shall have received acknowledgments of all filings or recordings necessary to perfect its Liens in the Collateral, as well as UCC and Lien searches and other evidence satisfactory to Agent that such Liens are the only Liens upon the Collateral, except Permitted Liens. Agent shall in its possession any original documents necessary to perfect and preserve its Lien, including stock certificates with corresponding powers executed in blank.

(c) Agent shall have received duly executed agreements establishing each Dominion Account and related lockbox (including all applicable deposit account control agreements), in form and substance, and with Custodian, satisfactory to Agent.

(d) Agent shall have received a telephone instruction letter duly executed by Borrower and in form and substance satisfactory to Agent.

(e) Agent shall have received certificates, in form and substance satisfactory to it, from a knowledgeable Senior Officer of Borrower certifying that, after giving effect to the initial Loans and transactions hereunder, (i) Borrower is Solvent; (ii) no Default or Event of Default exists; (iii) the representations and warranties set forth in **Section 8** are true and correct; and (iv) Borrower has complied with all agreements and conditions to be satisfied by it under the Transaction Documents.

(f) Agent shall have received a certificate of a duly authorized officer of Borrower and Servicer, certifying (i) that attached copies of such Person's Organic Documents are true and complete, and in full force and effect, without amendment except as shown, and that such Person is in good standing in the applicable jurisdictions, with good standing certificates attached; (ii) that an attached copy of resolutions authorizing execution and delivery of the Transaction Documents is true and complete, and that such resolutions are in full force and effect, were duly adopted, have not been amended, modified or revoked, and constitute all resolutions adopted with respect to this credit facility; (iii) to the title, name and signature of each Person authorized to sign the Transaction Documents; and (iv) that attached copies of Borrower's Material Contracts are true and complete, and in full force and effect, without amendment except as shown. Agent may conclusively rely on this certificate until it is otherwise notified by Borrower or Servicer in writing.

(g) Agent shall have received a written opinion of counsel to Borrower and Servicer in form and substance satisfactory to Agent covering, among other matters, (i) the enforceability of the Transaction Documents, (ii) the grant and perfection of security interests in the Collateral, (iii) the true sale or contribution (as applicable) of the Loans from Parent to Borrower, (iv) non-consolidation of Borrower with the Parent, and (v) such other matters as Agent may require in Agent's sole discretion.

(h) Agent shall have received copies of the Organic Documents of Borrower and Servicer, certified by the Secretary of State or other appropriate official of such Person's jurisdiction of organization. Agent shall have received good standing certificates for Borrower and Servicer, issued by the Secretary of State or other appropriate official of such Person's jurisdiction of organization and each jurisdiction where such Person's conduct of business or ownership of Property necessitates qualification.

(i) Agent shall have received copies of policies or certificates of insurance for the insurance policies (and applicable endorsements) carried by Parent, all in compliance with the Transaction Documents.

(j) Agent shall have completed its business, financial and legal due diligence of Borrower and Servicer, with results satisfactory to Agent. No material adverse change in the financial condition of Borrower or Servicer or in the quality, quantity or value of any Collateral shall have occurred since December 12, 2017.

(k) No Default or Event of Default shall exist at the time of, or result from, the making of the initial Loans and the consummation of the other transactions contemplated to occur on the Closing Date. There shall not have occurred any default of any Material Contract of Borrower.

(l) All conditions precedent in any other Transaction Document shall be satisfied.

(m) The representations and warranties of Borrower and Servicer in the Transaction Documents shall be true and correct on the date of, and upon giving effect to, the making of the initial Loans and the consummation of the other transactions contemplated to occur on the Closing Date (except for representations and warranties that expressly relate to an earlier date, in which case such representations and warranties shall be true and correct as of such earlier date).

(n) Either (i) the business plan previously provided to Agent shall continue to be, in all material respects, an accurate projection of Borrower's performance for the first twelve months following the Closing Date or (ii) Agent shall have received an updated business plan which will include an update of the same items contained in the business plan previously provided to Agent and shall be reasonably satisfactory to Agent in both form and substance.

(o) Agent shall have received all other agreements, documents, certificates and instruments requested by it (including one or more information certificates) and Agent shall have completed all business, financial and legal due diligence with respect to Borrower and Servicer (including, but not limited to, a review of any purchase and sale or contribution agreement and transition services agreement), the results of which shall be satisfactory to Agent.

(p) No material adverse changes in governmental regulations or policies affecting Borrower, Servicer or any Secured Party shall have occurred prior to the Closing Date.

(q) Borrower's tax assumptions, capital, organization, ownership and legal structure must be satisfactory to Agent.

(r) Agent shall have received customary background checks on Borrower and Servicer and senior management thereof, the results of which shall be satisfactory to Agent.

(s) Agent shall have received a duly executed and satisfactory disbursement letter and flow of funds memo for the Closing Date. Borrower shall have paid all fees and expenses (including, without limitation, audit fees, attorneys' fees of one outside counsel for Agent and Lenders, taken as a whole, UCC search fees, appraisal fees, documentation costs and expenses, and filing fees and expenses, as well as all fees owing to Agent and Lenders pursuant to the Fee Letter to the extent due on the Closing Date) to be paid to Agent and Lenders on the Closing Date.

(t) Agent shall have received a Borrowing Base Certificate dated as of the Closing Date and prepared as of the Closing Date or a recent date prior thereto that is acceptable to Agent. Upon giving effect to the initial funding of the Loans, and the payment by Borrower of all fees and expenses incurred in connection herewith, the repayment of any Debt contemplated to occur on the Closing Date, Availability shall be at least \$20,000,000.

(u) Agent shall have received evidence that Parent has sold or contributed Eligible Portfolio Investments (including Cash for the purpose of calculating Value thereof for this clause (u) and evidence satisfactory to Agent that such Cash has been deposited with Custodian) with a Value of not less than \$60,000,000 to Borrower, which Eligible Portfolio Investments shall be free and clear of all Liens, and the terms of such Eligible Portfolio Investments contribution or sale shall be acceptable to Agent.

(v) Agent shall have received, in each case in form and substance satisfactory to Agent, all necessary authorizations and consents for the closing of the transactions contemplated by this Agreement.

(w) Agent and Lenders shall have received their final credit approvals.

(x) Agent shall have received Commitments from at least one other Lender in an amount not less than \$20,000,000 in the aggregate.

(y) The Agent's receipt, at least one Business Day prior to the Closing Date, of all documentation and other information required by regulatory authorities under applicable "know your customer" and anti-money laundering rules and regulations, including, without limitation, the PATRIOT Act, in each case to the extent requested by the Agent in writing at least two Business Days prior to the Closing Date.

EXHIBIT D  
to  
Loan and Security Agreement

**AGENCY PROVISIONS**

**1. Appointment, Authority and Duties of Agent**

a. Appointment and Authority. Each Secured Party appoints and designates AloStar as Agent under all Transaction Documents. Agent may, and each Secured Party authorizes Agent to, enter into all Transaction Documents to which Agent is intended to be a party and accept all Security Documents, for the benefit of Secured Parties. Each Secured Party agrees that any action taken by Agent or Required Lenders in accordance with the provisions of the Transaction Documents, and the exercise by Agent or Required Lenders of any rights or remedies set forth therein, together with all other powers reasonably incidental thereto, shall be authorized by and binding upon all Secured Parties. Without limiting the generality of the foregoing, Agent shall have the sole and exclusive authority to (a) act as the disbursing and collecting agent for Lenders with respect to all payments and collections arising in connection with the Transaction Documents; (b) negotiate the terms of, execute and deliver as Agent each Transaction Document, including any intercreditor or subordination agreement, and any amendments thereto, and accept delivery of each Transaction Document from Borrower or other Person; (c) act as collateral agent for Secured Parties for purposes of perfecting and administering Liens under the Transaction Documents, and for all other purposes stated therein; (d) manage, supervise or otherwise deal with Collateral; and (e) take any enforcement action or exercise of rights or remedies, of any kind, in connection with the Obligations, the Collateral or the Transaction Documents, pursuant to the Transaction Documents, Applicable Law or otherwise. The duties of Agent shall be ministerial and administrative in nature, and Agent shall not have a fiduciary relationship with any Secured Party, Participant or other Person, by reason of any Transaction Document or any transaction relating thereto. Agent alone shall be authorized to determine whether any Portfolio Investments constitute Eligible Portfolio Investments, whether to impose or release any reserve, or whether any conditions to funding have been satisfied, which determinations and judgments, if exercised in good faith, shall exonerate Agent from liability to any Lender or other Person for any error in judgment. Agent may perform its duties through agents and employees. Agent may consult with and employ attorneys, accountants, appraisers, auditors, business valuation experts, environmental engineers or consultants, turnaround consultants, and other professionals and experts, and shall be entitled to act upon, and shall be fully protected in any action taken in good faith reliance upon, any advice given by any of Agent's attorneys, accountants, appraisers, auditors, business valuation experts, environmental engineers or consultants, turnaround consultants, or other professionals or experts. Agent shall not be responsible for the negligence or misconduct of any agents, employees or other Persons selected by it with reasonable care.

b. Duties and Lender Instructions. Agent shall not have any duties except those expressly set forth in the Transaction Documents. The conferral upon Agent of any right shall not imply a duty to exercise such right, unless instructed to do so by Lenders in accordance with this Agreement. The rights and remedies conferred upon Agent under the Transaction Documents may be exercised without the necessity of joinder of any other party, unless required by Applicable Law. Agent may request instructions from Required Lenders or other Secured Parties with respect to any act (including the failure to act) in connection with any Transaction Documents, and may seek assurances to its satisfaction from Secured Parties of their indemnification obligations against all claims, liabilities, costs, expenses and other amounts of any kind in any way related to the Transaction Documents or Collateral at any time that could be incurred by Agent in connection with any act. Agent shall be entitled to refrain from any act until it has received such instructions or assurances, and Agent shall not incur liability to any Person by reason of so refraining. Instructions of Required Lenders shall be binding upon all Secured Parties, and no Secured Party shall have any right of action whatsoever against Agent as a result of Agent acting or refraining from acting in accordance with the instructions of Required Lenders. Notwithstanding the foregoing, instructions by and consent of specific parties shall be required to the extent provided in **Section 13.1.1**. In no event shall Agent be required to take any action that, in its opinion, is contrary to Applicable Law or any Transaction Documents or could subject any Agent Indemnitee to personal liability.

## II. Agreements Regarding Collateral and Field Examination Reports

a. Lien Releases; Care of Collateral. Secured Parties authorize Agent to release any Lien with respect to any Collateral (a) upon Full Payment of the Obligations; (b) that is the subject of a disposition permitted under this Agreement; (c) that does not constitute a material part of the Collateral; or (e) with the written consent of all Lenders. Secured Parties authorize Agent to subordinate its Liens to any Lien permitted under **Section 9.2.2(b)**. Agent shall have no obligation to assure that any Collateral exists or is owned by Borrower, or is cared for, protected or insured, nor to assure that Agent's Liens have been properly created, perfected or enforced, or are entitled to any particular priority, nor to exercise any duty of care with respect to any Collateral.

b. Possession of Collateral. Agent and Secured Parties appoint each Lender as agent (for the benefit of Secured Parties) for the purpose of perfecting Liens in any Collateral held or controlled by such Lender, to the extent such Liens are perfected by possession or control. If any Lender obtains possession or control of any Collateral, it shall notify Agent thereof and, promptly upon Agent's request, deliver such Collateral to Agent or otherwise deal with it in accordance with Agent's instructions.

c. Reports. Agent shall promptly forward to each Lender, when complete, copies of any field audit or examination prepared by or for Agent with respect to Borrower or Collateral ("Report"). Each Lender agrees (a) that neither AloStar nor Agent makes any representation or warranty as to the accuracy or completeness of any Report, and shall not be liable for any information contained in or omitted from any Report; (b) that the Reports are not intended to be comprehensive audits or examinations, and that Agent or any other Person performing any audit or examination will inspect only specific information regarding Obligations or the Collateral and will rely significantly upon Borrower's books and records as well as upon representations of Borrower's officers and employees; and (c) to keep all Reports confidential and strictly for such Lender's internal use, and not to distribute any Report (or the contents thereof) to any Person (except to such Lender's Participants, attorneys and accountants) or use any Report in any manner other than administration of the Loans and other Obligations. Each Lender shall indemnify and hold harmless Agent and any other Person preparing a Report from any action such Lender may take as a result of or any conclusion it may draw from any Report, as well as from all claims, liabilities, costs, expenses and other amounts of any kind arising as a direct or indirect result of Agent furnishing a Report to such Lender at any time.

**III. Reliance By Agent.** Agent shall be entitled to rely, and shall be fully protected in relying, upon any certification, notice or other communication (including those by telephone, telex, telegram, telecopy or e-mail) believed by it to be genuine and correct and to have been signed, sent or made by the proper Person, and upon the advice and statements of Agent's attorneys, accountants, appraisers, auditors, business valuation experts, environmental engineers or consultants, turnaround consultants, or other professionals or experts. Agent shall have a reasonable and practicable amount of time to act upon any instruction, notice or other communication under any Transaction Document, and shall not be liable for any delay in acting.

**IV. Action Upon Default.** Agent shall not be deemed to have knowledge of any Default or Event of Default, or of any failure to satisfy any conditions in **Section 6**, unless it has received written notice from Borrower or Required Lenders specifying the occurrence and nature thereof. If any Lender acquires knowledge of a Default, Event of Default or failure of such conditions, it shall promptly notify Agent and the other Lenders thereof in writing. Each Secured Party agrees that, except as otherwise provided in any Transaction Documents or with the written consent of Agent and Required Lenders, it will not take any enforcement action or exercise of rights or remedies, of any kind, in connection with the Obligations, the Collateral or the Transaction Documents, accelerate Obligations (other than Secured Bank Product Obligations), or exercise any right that it might otherwise have under Applicable Law to credit bid at foreclosure sales, UCC sales or other similar dispositions of Collateral or to assert any rights relating to any Collateral.

**V. Ratable Sharing.** If any Lender shall obtain any payment or reduction of any Obligation, whether through set-off or otherwise, in excess of its share of such Obligation, determined on a Pro Rata basis or in accordance with **Section 5.7.1**, as applicable, such Lender shall forthwith purchase from Agent and the other Lenders such participations in the affected Obligation as are necessary to cause the purchasing Lender to share the excess payment or reduction on a Pro Rata basis or in accordance with **Section 5.7.1**, as applicable. If any of such payment or reduction is thereafter recovered from the purchasing Lender, the purchase shall be rescinded and the purchase price restored to the extent of such recovery, but without interest. Notwithstanding the foregoing, if a Defaulting Lender obtains a payment or reduction of any Obligation, it shall immediately turn over the amount thereof to Agent for application under **Section 4.2.2** and it shall provide a written statement to Agent describing the Obligation affected by such payment or reduction. No Lender shall set off against any Dominion Account without the prior consent of Agent.

**VI. Indemnification.** EACH LENDER SHALL INDEMNIFY AND HOLD HARMLESS AGENT INDEMNITEES AND ITS OFFICERS, DIRECTORS, EMPLOYEES, AFFILIATES, AGENTS AND ATTORNEYS, TO THE EXTENT NOT REIMBURSED BY BORROWER, ON A PRO RATA BASIS, AGAINST ALL CLAIMS THAT MAY BE INCURRED BY OR ASSERTED AGAINST ANY SUCH INDEMNITEE, PROVIDED THAT ANY CLAIM AGAINST AN AGENT INDEMNITEE RELATES TO OR ARISES FROM ITS ACTING AS OR FOR AGENT (IN THE CAPACITY OF AGENT), OTHER THAN CLAIMS DIRECTLY CAUSED BY THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF THE AGENT, DETERMINED BY A COURT OF COMPETENT JURISDICTION IN A FINAL AND NON-APPEALABLE ORDER. Agent, in its discretion, may reserve for any all claims, liabilities, costs, expenses and other amounts of any kind in any way related to the Transaction Documents or Collateral made at any time against an Agent Indemnatee or its officers, directors, employees, Affiliates, agents and attorneys, and may satisfy any judgment, order or settlement relating thereto, from proceeds of Collateral prior to making any distribution of Collateral proceeds to Secured Parties. If Agent is sued by any receiver, bankruptcy trustee, debtor-in-possession or other Person for any alleged preference or fraudulent transfer, then any monies paid by Agent in settlement or satisfaction of such proceeding, together with all interest, costs and expenses (including attorneys' fees) incurred in the defense of same, shall be promptly reimbursed to Agent by each Lender to the extent of its Pro Rata share.

**VII. Limitation on Responsibilities of Agent.** Agent shall not be liable to any Secured Party for any action taken or omitted to be taken under the Transaction Documents, except for losses directly and solely caused by Agent's gross negligence or willful misconduct. Agent does not assume any responsibility for any failure or delay in performance or any breach by Borrower, Servicer, Lender or other Secured Party of any obligations under the Transaction Documents. Agent does not make any express or implied representation, warranty or guarantee to Secured Parties with respect to any Obligations, Collateral, Transaction Documents or Borrower. No Agent Indemnitee shall be responsible to Secured Parties for any recitals, statements, information, representations or warranties contained in any Transaction Documents; the execution, validity, genuineness, effectiveness or enforceability of any Transaction Documents; the genuineness, enforceability, collectibility, value, sufficiency, location or existence of any Collateral, or the validity, extent, perfection or priority of any Lien therein; the validity, enforceability or collectibility of any Obligations; or the assets, liabilities, financial condition, results of operations, business, creditworthiness or legal status of Borrower, Servicer or Portfolio Company. No Agent Indemnitee shall have any obligation to any Secured Party to ascertain or inquire into the existence of any Default or Event of Default, the observance by any Person of any terms of the Transaction Documents, or the satisfaction of any conditions precedent contained in any Transaction Documents.

**VIII. Successor Agent and Co-Agents**

a. Resignation; Successor Agent. Subject to the appointment and acceptance of a successor Agent as provided below, Agent may resign at any time by giving at least 30 days written notice thereof to Lenders and Borrower. Upon receipt of such notice, Required Lenders shall have the right to appoint a successor Agent which shall be (a) a Lender or an Affiliate of a Lender; or (b) another financial institution approved by the Required Lenders and (provided no Default or Event of Default exists) is reasonably acceptable to Borrower. If no successor agent is appointed prior to the effective date of the resignation of Agent, then Agent may appoint a successor agent from among Lenders or, if no Lender accepts such role, Agent may appoint Required Lenders as successor Agent. Upon acceptance by a successor Agent of an appointment to serve as Agent hereunder, or upon appointment of Required Lenders as successor Agent, such successor Agent shall thereupon succeed to and become vested with all the powers and duties of the retiring Agent without further act, and the retiring Agent shall be discharged from its duties and obligations hereunder but shall continue to have the benefits of the indemnification set forth in **Sections 11.6** and **13.2**. Notwithstanding any Agent's resignation, the provisions of this **Exhibit D** shall continue in effect for its benefit with respect to any actions taken or omitted to be taken by it while Agent. Any successor to AloStar by merger or acquisition of stock or otherwise shall continue to be Agent hereunder without further act on the part of the parties hereto, unless such successor resigns as provided above.

b. Separate Collateral Agent. It is the intent of the parties that there shall be no violation of any Applicable Law denying or restricting the right of financial institutions to transact business in any jurisdiction. If Agent believes that it may be limited in the exercise of any rights or remedies under the Transaction Documents due to any Applicable Law, Agent may appoint an additional Person who is not so limited, as a separate collateral agent or co-collateral agent. If Agent so appoints a collateral agent or co-collateral agent, each right and remedy intended to be available to Agent under the Transaction Documents shall also be vested in such separate agent. Secured Parties shall execute and deliver such documents as Agent deems appropriate to vest any rights or remedies in such agent. If any collateral agent or co-collateral agent shall die or dissolve, become incapable of acting, resign or be removed, then all the rights and remedies of such agent, to the extent permitted by Applicable Law, shall vest in and be exercised by Agent until appointment of a new agent.



**IX. Due Diligence and Non-Reliance.** Each Lender acknowledges and agrees that it has, independently and without reliance upon Agent or any other Lenders, and based upon such documents, information and analyses as it has deemed appropriate, made its own credit analysis of Borrower and its own decision to enter into this Agreement and to fund Loans hereunder. Each Secured Party has made such inquiries as it feels necessary concerning the Transaction Documents, Collateral, Borrower and Servicer. Each Secured Party acknowledges and agrees that the other Secured Parties have made no representations or warranties concerning Borrower, Servicer, any Collateral or the legality, validity, sufficiency or enforceability of any Transaction Documents or Obligations. Each Secured Party will, independently and without reliance upon any other Secured Party, and based upon such financial statements, documents and information as it deems appropriate at the time, continue to make and rely upon its own credit decisions in making Loans, and in taking or refraining from any action under any Transaction Documents. Except for notices, reports and other information expressly requested by a Lender, Agent shall have no duty or responsibility to provide any Secured Party with any notices, reports or certificates furnished to Agent by Borrower or Servicer or any credit or other information concerning the affairs, financial condition, business or Properties of Borrower (or any of its Affiliates) which may come into possession of Agent or its Affiliates.

**X. Remittance of Payments and Collections**

a. Remittances Generally. All payments by any Lender to Agent shall be made by the time and on the day set forth in this Agreement, in immediately available funds. If no time for payment is specified or if payment is due on demand by Agent and request for payment is made by Agent by 11:00 a.m. on a Business Day, payment shall be made by Lender not later than 2:00 p.m. on such day, and if request is made after 11:00 a.m., then payment shall be made by 11:00 a.m. on the next Business Day. Payment by Agent to any Secured Party shall be made by wire transfer, in the type of funds received by Agent. Any such payment shall be subject to Agent's right of offset for any amounts due from such payee under the Transaction Documents.

b. Failure to Pay. If any Secured Party fails to pay any amount when due by it to Agent pursuant to the terms hereof, such amount shall bear interest from the due date until paid at the rate determined by Agent as customary in the banking industry for interbank compensation. In no event shall Borrower be entitled to receive credit for any interest paid by a Secured Party to Agent, nor shall any Defaulting Lender be entitled to interest on any amounts held by Agent pursuant to **Section 4.2**.

c. Recovery of Payments. If Agent pays any amount to a Secured Party in the expectation that a related payment will be received by Agent from Borrower and such related payment is not received, then Agent may recover such amount from each Secured Party that received it. If Agent determines at any time that an amount received under any Transaction Document must be returned to Borrower or paid to any other Person pursuant to Applicable Law or otherwise, then, notwithstanding any other term of any Transaction Document, Agent shall not be required to distribute such amount to any Lender. If any amounts received and applied by Agent to any Obligations are later required to be returned by Agent pursuant to Applicable Law, each Lender shall pay to Agent, **on demand**, such Lender's Pro Rata share of the amounts required to be returned.

**XI. Agent in its Individual Capacity.** As a Lender, AloStar shall have the same rights and remedies under the other Transaction Documents as any other Lender, and the terms "Lenders," "Required Lenders" or any similar term shall include AloStar in its capacity as a Lender. AloStar and its Affiliates may accept deposits from, lend money to, provide Bank Products to, act as financial or other advisor to, and generally engage in any kind of business with, Borrower and its Affiliates, as if AloStar were not Agent hereunder, without any duty to account therefor to Lenders. In their individual capacities, AloStar and its Affiliates may receive information regarding Borrower, its Affiliates and their Portfolio Companies (including information subject to confidentiality obligations), and each Secured Party agrees that AloStar and its Affiliates shall be under no obligation to provide such information to any Secured Party, if acquired in such individual capacity.

**XII. Bank Product Providers.** Each Secured Bank Product Provider, by delivery of a notice to Agent of a Bank Product, agrees to be bound by **Section 5.7** and this **Exhibit D**. Each Secured Bank Product Provider shall indemnify and hold harmless Agent Indemnitees, to the extent not reimbursed by Borrower, against all claims, liabilities, costs, expenses and other amounts of any kind in any way related to the Transaction Documents or Collateral that may be incurred by or asserted against any Agent Indemnitee in connection with such provider's Secured Bank Product Obligations at any time.

**XIII. Integration; References.** This **Exhibit D** is made an integral part of, and each reference to this Agreement refers to, the Loan and Security Agreement to which this **Exhibit D** is attached. Each reference to any section means, unless the context otherwise requires, a section of this Agreement.

EXHIBIT E  
to  
Loan and Security Agreement

Form of Borrowing Base Certificate

**KCAP Funding I, LLC**  
**Borrowing Base Certificate**  
**Date as of:**

**Gross Collateral**

Market Value Adjustment

**Contributed Assets @ FMV**

\$0.00

**Less: ineligible**

a The Advance Rate applicable to the aggregate Value of all Eligible Portfolio Investments in their entirety shall be 0% at any time when the Borrowing Base is composed entirely of Eligible Portfolio Investments issued by fewer than 8 different issuers;

b Not more than \$5,000,000 of the Borrowing Base may consist of Portfolio Investments of the same Portfolio Company;

c Not more than 15% of the Borrowing Base may consist of Portfolio Investments having a maturity date of greater than eight (8) years from the origination or closing date of such Portfolio Investment;

d Eligible Portfolio Investments that are not Cash, Cash Equivalents, Performing First Lien Bank Loans or Performing Last Out Loans shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 35% of the Borrowing Base;

e Eligible Portfolio Investments that are Revolving Loans and Delayed Draw Loans shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 15% of the Borrowing Base;

f Eligible Portfolio Investments that are Single Covenant Loans shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 40% of the Borrowing Base;

g Eligible Portfolio Investments that are Covenant Lite Loans (including, but not limited to, Covenant Lite Loans subject to clause (h) below) shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 40% of the Borrowing Base;

h Eligible Portfolio Investments that (i) are Covenant Lite Loans and (ii) for which the applicable Portfolio Company had EBITDA of less than \$50,000,000 for the 12 month period most recently ended shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 10% of the Borrowing Base;

i Eligible Portfolio Investments that are Unitranche Loans shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 15% of the Borrowing Base;

j Eligible Portfolio Investments which are in the same Industry Classification Group shall be excluded from the Borrowing Base to the extent such Eligible Portfolio Investments would exceed, in the aggregate, 25% of the Borrowing Base; and

k. Other ineligible.

**Total Ineligibles**

\$ -

**Total Eligible**

\$ -

**Blended Advance Rate**

**Borrowing Base**

\$ -

**Loan Roll Forward:**

**Beginning Loan Balance (as of previous Borrowing Base Report)**

**Collections since prior report (input as negative)**

**Advances since prior report**

**New Loan Balance**

\$-

**Maximum Facility Amount**

\$ 50,000,000.00

As of the date of this Certificate, no Event of Default exists or has occurred and is continuing. Borrower acknowledges that the Loans by Lender to Borrower are based upon Lender's reliance on the information contained herein and all representations and warranties with respect to US Collateral in the Loan Agreement are applicable to the US Collateral included in this Certificate. The reliance by Lender on this Certificate should not be deemed to limit the right of Lender to establish or revise criteria of eligibility or Availability Reserves or other Reserves or otherwise limit, impair, or affect in any manner the rights of Lender under the Loan Agreement. In the event of any conflict between the determination of Lender of the amount of the Loans to Borrower in accordance with the terms of the Loan Agreement and the determination by Borrower of such amounts, the determination of Lender shall govern. All capitalized terms used in this Certificate shall have the meaning assigned to them in the Loan Agreement.

SCHEDULE 1  
to  
Loan and Security Agreement

**COMMITMENTS OF LENDERS**

<b>Lender</b>	<b>Revolver Commitment</b>	<b>Total Commitments</b>
State Bank and Trust Company	\$ 20,000,000	\$ 20,000,000
CIBC Bank USA	\$ 15,000,000	\$ 15,000,000
Woodforest National Bank	\$ 15,000,000	\$ 15,000,000
TOTAL	\$ 50,000,000	\$ 50,000,000

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SCHEDULE 2  
to  
Loan and Security Agreement

**DEPOSIT AND OTHER ACCOUNTS**

<b>Depository Bank</b>	<b>Type of Account</b>	<b>Account Number</b>
U.S. Bank National Association	Collection Account ("Dominion Account")	190785-200
U.S. Bank National Association	Custodial Account ("Securities Account")	190785-700
U.S. Bank National Association	Distribution Account	190785-300
State Bank and Trust Company	Collection Account	1000203776

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SCHEDULE 3  
to  
Loan and Security Agreement

**BUSINESS LOCATIONS**

1. Borrower currently has the following business locations, and no others:  
  
Chief Executive Office: 295 Madison Avenue, 6<sup>th</sup> Floor, New York, New York 10017  
  
Other Locations: None
  2. In the five years preceding the Closing Date, Borrower has had no office or place of business located in any county other than as set forth above, except: None
  3. Each Subsidiary currently has the following business locations, and no others: N/A
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SCHEDULE 4  
to  
Loan and Security Agreement

**NAMES AND CAPITAL STRUCTURE**

1. The corporate names, jurisdictions of incorporation, and authorized and issued Equity Interests of Borrower and each Subsidiary are as follows:

<b>Name</b>	<b>Jurisdiction/Type of Entity</b>	<b>Number and Class of Authorized Shares</b>	<b>Number and Class of Issued Shares</b>
KCAP Funding I, LLC	Delaware limited liability company	N/A	N/A

2. The record holders of Equity Interests of Borrower and each Subsidiary are as follows:

<b>Name</b>	<b>Jurisdiction/Type of Entity</b>	<b>Class of Stock</b>	<b>Number of Shares</b>	<b>Record Owner</b>
KCAP Funding I, LLC	Delaware limited liability company	Membership interest	100%	KCAP Financial, Inc.

3. All agreements binding on holders of Equity Interests of Borrower and Subsidiaries with respect to such interests are as follows:

Amended and Restated Limited Liability Company Agreement of KCAP Funding I, LLC dated as of March 1, 2018

4. In the five years preceding the Closing Date, Borrower has not acquired any substantial assets from any other Person nor been the surviving entity in a merger or combination, except:

None

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SCHEDULE 5  
to  
Loan and Security Agreement

**PATENTS, TRADEMARKS, COPYRIGHTS AND LICENSES**

1. Borrower's patents:

<b>Patent</b>	<b>Owner</b>	<b>Status in Patent Office</b>	<b>Federal Registration No.</b>	<b>Registration Date</b>
None				

2. Borrower's trademarks:

<b>Trademark</b>	<b>Owner</b>	<b>Status in Trademark Office</b>	<b>Federal Registration No.</b>	<b>Registration Date</b>
None				

3. Borrower's copyrights:

<b>Copyright</b>	<b>Owner</b>	<b>Status in Copyright Office</b>	<b>Federal Registration No.</b>	<b>Registration Date</b>
None				

4. Borrower's licenses (other than routine business licenses, authorizing them to transact business in local jurisdictions):

<b>Licensor</b>	<b>Description of License</b>	<b>Term of License</b>	<b>Royalties Payable</b>
None			

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SCHEDULE 6  
to  
Loan and Security Agreement

**RESTRICTIVE AGREEMENTS**

None

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SCHEDULE 7  
to  
Loan and Security Agreement

**LITIGATION**

1. Proceedings and investigations pending against Borrower:  
None
  2. Threatened proceedings or investigations of which Borrower is aware:  
None
  3. Pending Commercial Tort Claim of Borrower:  
None
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SCHEDULE 8  
to  
Loan and Security Agreement

**PLANS**

None

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SCHEDULE 9  
to  
Loan and Security Agreement

**Intentionally Omitted**

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SCHEDULE 10  
to  
Loan and Security Agreement

**EXISTING AFFILIATE TRANSACTIONS**

None

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SCHEDULE 11  
to  
Loan and Security Agreement

**APPROVED DEALERS and APPROVED PRICING SERVICES**

**APPROVED DEALERS**

Antares Capital  
Ares Management  
BNP Paribas SA  
Bank of America Merrill Lynch  
Barclays Bank PLC  
BMO Capital Markets  
Bank of NY Mellon (BNYM Capital Markets)  
BTIG LLC  
Cantor Fitzgerald & Co.  
Citigroup Global Markets Inc.  
Citicorp Securities Services, Inc.  
Credit Agricole  
Credit Suisse Securities (USA) LLC  
Daiwa Capital Markets America Inc.  
Deutsche Bank Securities Inc.  
FBR Capital Markets & Co.  
Fidelity Brokerage Services LLC  
Fifth Third Bank  
Goldman, Sachs & Co.  
Golub Capital  
Guggenheim Securities LLC  
HSBC Securities (USA) Inc.  
Imperial Capital LLC  
ING Financial Markets LLC  
Jefferies & Company, Inc.  
J.P. Morgan Securities Inc.  
Lazard Ltd.  
Macquarie Capital USA Inc.  
Mitsubishi UFJ Securities USA Inc.  
Mizuho Securities USA Inc.  
Morgan Stanley & Co. Incorporated  
Morgan Stanley Smith Barney  
Nomura Securities International, Inc.  
RBC Capital Markets  
RBS Securities Inc.  
RW Baird  
Scotia Bank

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Societe Generale  
SunTrust Bank  
UBS Financial Services Inc.  
UBS Securities LLC  
Wells Fargo Advisors, LLC  
Wells Fargo Securities, LLC  
Wells Fargo Investments, LLC

**APPROVED PRICING SERVICES**

Bloomberg  
Interactive Data Corporation  
International Data Corporation  
Reuters Loan Pricing Corporation  
Markit Group Limited

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SCHEDULE 12  
to  
Loan and Security Agreement

**ELIGIBLE PORTFOLIO INVESTMENT CRITERIA**

A Portfolio Investment shall not be an Eligible Portfolio Investment on any date of determination unless it meets all of the following criteria:

- 1) (a) If an Investment in Indebtedness other than a Noteless Assigned Loan (and other than a High Yield Security that is held through DTC and has been credited to the Dominion Account), such Portfolio Investment is evidenced by an original promissory note registered in the name of Borrower, delivered to the Custodian and credited to the Dominion Account; provided, however, that solely in the case of Portfolio Investments (other than Noteless Assigned Loans) in which the Agent has a first priority perfected security interest pursuant to a valid Uniform Commercial Code filing, (x) if such Portfolio Investment is owned by Borrower on the Closing Date, Borrower shall have up to 45 Business Days following the Closing Date to deliver such original promissory note with respect to such Portfolio Investment to the Custodian, and (y) (1) if such Portfolio Investment is acquired by Borrower after the Closing Date, Borrower shall have up to 10 Business Days following the acquisition of such Portfolio Investment to deliver an original promissory note with respect to such Portfolio Investment to the Custodian and (2) as a result of the syndication, sale, transfer, assignment or exchange of a portion of a Portfolio Investment Borrower shall have up to 20 Business Days to return, transfer, assign or exchange any promissory note with respect to such Portfolio Investment and deliver new or additional promissory notes to the Custodian as required above (each note referred to in clause (x) or (y) during the time when it is not in the possession of the Custodian, an "Undelivered Note") (it being understood that during the time periods in clauses (x) and (y) above only the portion of such Portfolio Investment that has not been syndicated, sold, transferred, assigned or exchanged shall satisfy the criteria specified in this paragraph 1(a)); provided, further that (i) any portion of the Borrowing Base that consists of an Eligible Portfolio Investment that is an Undelivered Note shall be identified as such in any Borrowing Base Certificate and (ii) with respect to Undelivered Notes under clause (y) above, at no time may the aggregate amount of Undelivered Notes included in the Borrowing Base constitute more than 10% of the Portfolio Investments included in the Borrowing Base;
  - (b) If a debt investment is a Noteless Assigned Loan, the Custodian shall have received and credited to the Dominion Account an original of each transfer document or instrument relating to such Noteless Assigned Loan evidencing the assignment of such Noteless Assigned Loan from any prior third party owner thereof directly to Borrower (together with the consent of each party required under the applicable loan documentation);
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- (c) If any Investment in Indebtedness, (x) the Custodian shall have received originals or copies of each of the following, to the extent applicable, any related loan agreement, credit agreement, note purchase agreement, security agreement (if separate from any mortgage), sale and servicing agreement, acquisition agreement pursuant to which such Investment was acquired, subordination agreement, intercreditor agreement or similar instruments, guarantee, assumption or substitution agreement or similar material operative document, in each case together with any amendment or modification thereto; and (y) all documentation evidencing or otherwise relating to such Portfolio Investment has been duly authorized and executed, is in full force and effect and is the legal, binding and enforceable obligation of the parties thereto and has been delivered to the Custodian; and
- 2) Such Portfolio Investment, whether originated directly or purchased, was underwritten and closed in all material respects in accordance with the Investment and Valuation Policies;
  - 3) Such Portfolio Investment is Transferable (as defined below);
  - 4) Such Portfolio Investment is not a Defaulted Obligation;
  - 5) Such Portfolio Company of such Portfolio Investment has a trailing 12-month EBITDA of at least \$1,000,000, as calculated by Borrower in a commercially reasonable manner;
  - 6) Such Portfolio Investment does not represent an investment in any investment fund, Subsidiary, Structured Finance Obligation, Third Party Finance Companies, or similar off balance sheet financing vehicle, or any joint venture or other Person that is in the principal business of making debt or equity investments primarily in other unaffiliated Persons;
  - 7) (x) Such Portfolio Investment is owned by Borrower, free and clear of any liens and Agent holds a first priority, perfected security interest in the Portfolio Investment (subject to no other Lien other than Permitted Liens), (y) the Custodian is holding all documents evidencing or otherwise relating to such Portfolio Investment (which may be copies, except as required in paragraph (1)(a) above) and (z) the other steps to ensure that the Agent has “control” or other customary protection of the relevant Portfolio Investment have been taken;
  - 8) Such Portfolio Investment and related documents are in compliance, in all material respects, with applicable laws rules and regulations (including relating to usury, truth in lending, fair credit billing, fair credit reporting, equal credit opportunity, fair debt collection practices and privacy, OFAC and PATRIOT Act);
  - 9) Such Portfolio Investment is denominated and payable only in Dollars and the primary obligor or issuer of such Portfolio Investment is organized under the laws of the United States of America or Canada or any state, province or Commonwealth thereof (or, if approved by the Agent and the Lenders in their sole discretion, a member country of the European Union), is domiciled in the United States of America or Canada (or, if approved by the Agent in the Agent’s sole discretion, a member country of the European Union), and its principal operations and any property or other assets of the issuer thereunder pledged as collateral are primarily located in the United States of America and the only place of payment of such loans is the United States of America (or, if approved by the Agent in the Agent’s sole discretion, a member country of the European Union);
  - 10) Such Portfolio Investment, if a debt investment, bears interest which is due and payable no less frequently than semi-annually and provides for a fixed amount of principal payable on a scheduled payment date and or at maturity, and does not have a final maturity greater than 10 years;
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- 11) Such Portfolio Investment includes a contractual provision requiring all payments to be made without set off, defense or counterclaim, and does not include a contractual provision granting rights of rescission, set off, counterclaim or defense in favor of the obligor in respect of such Portfolio Investment;
- 12) Such Portfolio Investment is not (x) secured primarily by a mortgage, deed of trust or similar lien on real estate, or (y) issued by a Person whose primary asset is real estate, or whose value is otherwise primarily derived from real estate;
- 13) Such Portfolio Investment does not represent a consumer obligation (including a mortgage loan, auto loan, credit card loan or personal loan);
- 14) No payment in respect of such Portfolio Investment, if a debt investment, is subject to withholding in respect to taxes of any nature, unless the issuer is required to make customary and market-based gross-up payments on an after tax basis for the full amount of such tax;
- 15) Such Portfolio Investment is not a derivative instrument;
- 16) The issuer of such Portfolio Investment (or an agent on its behalf) is required to make payments directly into an account of Borrower over which the Agent has "control" and no other Person's assets are commingled in such account;
- 17) If such Portfolio Investment is a Participation Interest (other than a KCAP Participation Interest), the seller thereof has (x) long-term unsecured ratings of at least "Baa1" by Moody's and "BBB+" by S&P and (y) short-term unsecured ratings of at least "A-1" by S&P and "P-1" by Moody's;
- 18) If such Portfolio Investment is a KCAP Participation Interest, such Portfolio Investment has been a KCAP Participation Interest for not more than sixty (60) days after the date of the sale or contribution of such KCAP Participation Interest to Borrower; and
- 19) No Person acting as Agent, collateral agent or in a similar capacity shall be an Affiliate of Borrower.

For purposes of paragraph (3) above, "Transferable" means, in the case of any Portfolio Investment, both that:

(i) Borrower may create a security interest in or pledge all of its rights under and interest in such Portfolio Investment to secure its obligations under this Agreement or any other Transaction Document, and that such pledge or security interest may be enforced in any manner permitted under applicable law; and

(ii) such Portfolio Investment (and all documents related thereto) contains no provision that directly or indirectly restricts the assignment of Borrower's, or any assignee of Borrower's, rights under such Portfolio Investment (including any requirement that Borrower maintain a minimum ownership percentage of such Portfolio Investment); provided that, such Portfolio Investment may contain the following restrictions on customary and market based terms: (a) restrictions pursuant to which assignments may be subject to the consent of the obligor or Portfolio Company or agent under the Portfolio Investment so long as the applicable provision also provides that such consent may not be unreasonably withheld, (b) restrictions on transfer to parties that are not 'eligible assignees' within the customary and market based meaning of the term, and (c) restrictions on transfer to the applicable obligor or issuer under the Portfolio Investment or its equity holders or financial sponsor entities.

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SCHEDULE 13  
to  
Loan and Security Agreement

INDUSTRY CLASSIFICATION GROUPS

Industry Code	Description	Industry Code	Description
1020000	Energy Equipment & Services	5220000	Personal Products
1030000	Oil, Gas & Consumable Fuels	6020000	Health Care Equipment & Supplies
2020000	Chemicals	6030000	Health Care Providers & Services
2030000	Construction Materials	9551729	Health Care Technology
2040000	Containers & Packaging	6110000	Biotechnology
2050000	Metals & Mining	6120000	Pharmaceuticals
2060000	Paper & Forest Products	9551727	Life Sciences Tools & Services
3020000	Aerospace & Defense	7011000	Banks
3030000	Building Products	7020000	Thriffs & Mortgage Finance
3040000	Construction & Engineering	7110000	Diversified Financial Services
3050000	Electrical Equipment	7120000	Consumer Finance
3060000	Industrial Conglomerates	7130000	Capital Markets
3070000	Machinery	7210000	Insurance
3080000	Trading Companies & Distributors	7311000	Real Estate Investment Trusts (REITs)
3110000	Commercial Services & Supplies	7310000	Real Estate Management & Development
9612010	Professional Services	8020000	Internet Software & Services
3210000	Air Freight & Logistics	8030000	IT Services
3220000	Airlines	8040000	Software
3230000	Marine	8110000	Communications Equipment
3240000	Road & Rail	8120000	Technology Hardware, Storage & Peripherals
3250000	Transportation Infrastructure	8130000	Electronic Equipment, Instruments & Components
4011000	Auto Components	8210000	Semiconductors & Semiconductor Equipment
4020000	Automobiles	9020000	Diversified Telecommunication Services
4110000	Household Durables	9030000	Wireless Telecommunication Services
4120000	Leisure Products	9520000	Electric Utilities
4130000	Textiles, Apparel & Luxury Goods	9530000	Gas Utilities
4210000	Hotels, Restaurants & Leisure	9540000	Multi-Utilities
9551701	Diversified Consumer Services	9550000	Water Utilities
4310000	Media	9551702	Independent Power and Renewable Electricity Producers
4410000	Distributors	9551727	Life Sciences Tools and Services
4420000	Internet and Catalog Retail	9551729	Health Care Technology
4430000	Multiline Retail	9612010	Professional Services

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<b>Industry Code</b>	<b>Description</b>	<b>Industry Code</b>	<b>Description</b>
4440000	Specialty Retail	PF1	Project Finance: Industrial Equipment
5020000	Food & Staples Retailing	PF2	Projection Finance: Leisure and Gaming
5110000	Beverages	PF3	Project Finance: Natural Resources and Mining
5120000	Food Products	PF4	Project Finance: Oil and Gas
5130000	Tobacco	PF5	Project Finance: Power
5210000	Household Products	PF6	Project Finance: Public Finance and Real Estate
		PF7	Project Finance: Telecommunications
		PF8	Project Finance: Transport
		IPF	International Public Finance

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<u>List of Subsidiaries</u>	<u>Jurisdiction</u>
Katonah Debt Advisors, L.L.C. <sup>(1)(3)</sup>	Delaware
Kohlberg Capital Funding LLC I	Delaware
KCAP Senior Funding I Holdings, LLC	Delaware
KCAP Senior Funding I, LLC <sup>(4)</sup>	Delaware
KCAP Management, LLC	Delaware
Katonah Management Holdings LLC <sup>(1)</sup>	Delaware
Katonah X Management LLC <sup>(1)(2)</sup>	Delaware
Katonah 2007-I Management LLC <sup>(1)(2)</sup>	Delaware
Katonah 2007-I CLO Ltd	Delaware
Commodore Holdings, L.L.C. <sup>(1)</sup>	Delaware
Trimaran Advisors, L.L.C. <sup>(1)(3)</sup>	Delaware
Trimaran Advisors Management LLC <sup>(1)(3)</sup>	Delaware
Trimaran Risk Retention Holdings, LLC <sup>(1)(3)</sup>	Delaware
Trimaran RR I, LLC <sup>(1)(3)</sup>	Delaware
Trimaran RR II, LLC <sup>(1)(3)</sup>	Delaware
KCAP Funding I, LLC	Delaware

(1) Represents a wholly-owned portfolio company that is not consolidated for financial reporting purposes.

(2) A wholly-owned subsidiary of Katonah Management Holdings LLC.

(3) A wholly-owned subsidiary of Commodore Holdings, L.L.C.

(4) A wholly-owned subsidiary of KCAP Senior Funding I Holdings, LLC.

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the Registration Statement (Form S-8 333-218594) pertaining to the 2017 Equity Incentive and 2017 Non-Employee Director Plans of KCAP Financial, Inc. of our reports dated March 7, 2018, with respect to the consolidated financial statements of KCAP Financial, Inc., and the effectiveness of internal control over financial reporting of KCAP Financial, Inc., included in its Annual Report (Form 10-K) for the year ended December 31, 2017, filed with the Securities and Exchange Commission.

/s/ Ernst & Young LLP

New York, New York  
March 7, 2018

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**Consent of Independent Auditors**

We consent to the incorporation by reference in the Registration Statement (Form S-8 333-218594) pertaining to the 2017 Equity Incentive and 2017 Non-Employee Director Plans of KCAP Financial, Inc. of our report dated March 7, 2018, with respect to the combined financial statements of the Asset Manager Affiliates, included in KCAP Financial Inc.'s Annual Report (Form 10-K) for the year ended December 31, 2017, filed with the Securities and Exchange Commission.

/s/ Ernst & Young LLP

New York, New York  
March 7, 2018

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**Consent of Independent Auditors**

We consent to the incorporation by reference in the Registration Statement (Form S-8 333-218594) pertaining to the 2017 Equity Incentive and 2017 Non-Employee Director Plans of KCAP Financial, Inc. of our report dated March 9, 2017, with respect to the financial statements of Katonah 2007-I CLO Ltd., included in KCAP Financial Inc.'s Annual Report (Form 10-K) for the year ended December 31, 2016, filed with the Securities and Exchange Commission.

/s/ Ernst & Young LLP

New York, New York  
March 7, 2018

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

I, Dayl W. Pearson, certify that:

1. I have reviewed this annual report on Form 10-K of KCAP Financial, Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated 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 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: March 7, 2018

By: /s/ DAYL W. PEARSON

**Dayl W. Pearson**  
**President and Chief Executive Officer**  
**(Principal Executive Officer)**

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

I, Edward U. Gilpin, certify that:

1. I have reviewed this annual report on Form 10-K of KCAP Financial, Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated 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 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 March 7, 2018

By: /s/ EDWARD U. GILPIN

**Edward U. Gilpin**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

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

In connection with the accompanying Annual Report of KCAP Financial, Inc.(the "Company") on Form 10-K for the year ended December 31, 2017 (the "Report"), I, Dayl W. Pearson, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: March 7, 2018

By: /s/ DAYL W. PEARSON

**Dayl W. Pearson**  
**President and Chief Executive Officer**  
**(Principal Executive Officer)**

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

In connection with the accompanying Annual Report of KCAP Financial, Inc.(the "Company") on Form 10-K for the year ended December 31, 2017 (the "Report"), I, Edward U. Gilpin, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: March 7, 2018

By: /s/ EDWARD U. GILPIN

**Edward U. Gilpin**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

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