

**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, 2008

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

**Kohlberg Capital Corporation**

(Exact name of Registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

295 Madison Avenue, 6th Floor  
New York, New York 10017  
(Address of principal executive offices)  
(212) 455-8300

(Registrant's telephone number, including area code)

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

Title of  
each class

Name of exchange on which registered

Common Shares, par value \$0.01 per share

The NASDAQ Global Select Market

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 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, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

(Do not check if a  
smaller reporting company)

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, 2008 was approximately \$180 million based upon a closing price of \$10.00 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 16, 2009 was 21,570,869.

---

---

---

## DOCUMENTS INCORPORATED BY REFERENCE

**Documents incorporated by reference:** Portions of Kohlberg Capital Corporation's Proxy Statement for its 2009 Annual Meeting of Shareholders to be held on June 15, 2009 (the "Proxy Statement") are incorporated by reference in this Annual Report on Form 10-K in response to Part III, Items 10, 11, 12, 13 and 14.

## NOTE ABOUT REFERENCES TO KOHLBERG CAPITAL CORPORATION

In this Annual Report on Form 10-K (the "Annual Report"), the "Company", "we", "us" and "our" refer to Kohlberg Capital Corporation, its subsidiaries and its wholly-owned portfolio company, Katonah Debt Advisors, L.L.C. ("Katonah Debt Advisors" or "KDA") and related companies, unless the context otherwise requires.

## NOTE ABOUT TRADEMARKS

Kohlberg Capital Corporation, our logo and other trademarks of Kohlberg Capital Corporation are the property of Kohlberg Capital Corporation. 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 within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act. The matters discussed in this Annual Report, as well as in future oral and written statements by management of Kohlberg Capital Corporation, 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. 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 impact of investments that we expect to make;
- our informal relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- our expected financings and investments;
- our regulatory structure and tax treatment;
- our ability to operate as a BDC and a RIC;
- the adequacy of our cash resources and working capital; and
- the timing of cash flows, if any, from the operations of our portfolio companies, including Katonah Debt Advisors.

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.

---

## TABLE OF CONTENTS

	<b>Page</b>
<b>Part I</b>	
Item 1. Business	1
Item 1A. Risk Factors	32
Item 1B. Unresolved Staff Comments	42
Item 2. Properties	42
Item 3. Legal Proceedings	43
Item 4. Submission of Matters to a Vote of Security Holders	43
<b>Part II</b>	
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	44
Item 6. Selected Financial Data	48
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	49
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	58
Item 8. Financial Statements and Supplementary Data	60
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	60
Item 9A. Controls and Procedures	60
Item 9B. Other Information	61
<b>Part III</b>	
Item 10. Directors, Executive Officers and Corporate Governance	62
Item 11. Executive Compensation	62
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	62
Item 13. Certain Relationships and Related Transactions, and Director Independence	62
Item 14. Principle Accountant Fees and Services	62
<b>Part IV</b>	
Item 15. Exhibits and Financial Statement Schedules	63
Signatures	66
Financial Statements	F-1

---

## PART I

### Item 1. *Business*

#### KOHLBERG CAPITAL CORPORATION

We are an internally managed, non-diversified closed-end investment company that has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). We originate, structure and invest in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies. We define the middle market as comprising companies with earnings before interest, taxes, depreciation and amortization, which we refer to as “EBITDA,” of \$10 million to \$50 million and/or total debt of \$25 million to \$150 million. In addition to our middle market investment business, our wholly-owned portfolio company, Katonah Debt Advisors and its affiliates (collectively, “Katonah Debt Advisors”), manage collateralized loan obligation funds (“CLO Funds”) that invest in broadly syndicated loans, high-yield bonds and other corporate credit instruments. We acquired Katonah Debt Advisors and certain related assets prior to our initial public offering from affiliates of Kohlberg & Co., LLC (“Kohlberg & Co.”), a leading private equity firm focused on middle market investing. As of December 31, 2008, Katonah Debt Advisors had approximately \$2.1 billion of assets under management.

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

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

Our common stock is traded on The NASDAQ Global Select Market under the symbol “KCAP.” The net asset value per share of our common stock at December 31, 2008 was 11.68. On December 31, 2008, the last reported sale price of a share of our common stock on The NASDAQ Global Select Market was \$3.64.

#### CORPORATE HISTORY AND OFFICES

We were formed in August 2006 as a Delaware limited liability company. 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 to affiliates of Kohlberg & Company in exchange for the ownership interests of Katonah Debt Advisors and in securities issued by CLO Funds managed by Katonah Debt Advisors and two other asset managers. We are an internally managed, non-diversified, closed-end investment company that has elected to be regulated as a BDC under the 1940 Act.

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. Information about us may also be obtained from the Securities and Exchange Commission’s website (<http://www.sec.gov>). We maintain a website on the Internet at <http://www.kohlbergcapital.com>. Information contained in our website is not incorporated by reference into this Annual Report, and that information should not be considered as part of this Annual Report. We make available free of charge on our website our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (the “SEC”).

## KEY QUANTITATIVE AND QUALITATIVE FINANCIAL MEASURES AND INDICATORS

### Net Asset Value

Our net asset value (“NAV”) per share was \$11.68 and \$14.38 as of December 31, 2008 and December 31, 2007, respectively. As we must report our assets at fair value for each reporting period, NAV also represents the amount of stockholders’ equity per share for the reporting period. Our NAV is comprised mostly of investment assets less debt and other liabilities:

	December 31, 2008		December 31, 2007	
	Fair Value <sup>1</sup>	per Share <sup>1</sup>	Fair Value <sup>1</sup>	per Share <sup>1</sup>
Investments at fair value:				
Time deposits	\$ 12,185,997	\$ 0.57	\$ 15,674,489	\$ 0.87
Money market account	10	—	20,766	—
Debt securities	384,486,111	17.94	410,954,082	22.81
CLO Fund securities	56,635,236	2.64	31,020,000	1.72
Equity securities	4,389,831	0.21	4,752,250	0.27
Asset manager affiliates	56,528,088	2.64	58,585,360	3.25
Cash	251,412	0.01	2,088,770	0.12
Other assets	8,395,626	0.39	10,046,242	0.56
Total Assets	\$ 522,872,311	\$ 24.40	\$ 533,141,959	\$ 29.60
Borrowings	\$ 261,691,148	\$ 12.21	\$ 255,000,000	\$ 14.15
Other liabilities	10,899,063	0.51	19,073,795	1.06
Total Liabilities	\$ 272,590,211	\$ 12.72	\$ 274,073,795	\$ 15.21
NET ASSET VALUE	\$ 250,282,100	\$ 11.68	\$ 259,068,164	\$ 14.39

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

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

### Leverage

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. Our borrowings are through a secured financing facility (the “Facility”). As of December 31, 2008, we had approximately \$262 million of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 196%, slightly below the minimum asset coverage level generally required for a BDC by the 1940 Act primarily as a result of unrealized fair value losses on our investments. Until the minimum asset coverage level is met, we will be unable to incur additional debt or issue securities senior to our common stock. As a result, we will be severely limited in our ability to raise capital to make new investments until our asset coverage ratio exceeds 200%. However, because we have no public debt or preferred stock outstanding, failure to maintain asset coverage of at least 200% will not limit our ability, under the 1940 Act, to pay dividends from our net investment income. As of March 12, 2009, our Facility balance was approximately \$245 million and our asset coverage ratio was approximately 209%, above the minimum asset coverage level generally required for a BDC by the 1940 Act.

During September 2008, we were notified by the lenders that the liquidity banks providing the underlying funding for the Facility did not intend to renew their liquidity facility to the lenders unless we agreed to certain revised terms for the Facility. As a result, the lenders proposed new terms to us in order to extend additional fundings under the Facility. We viewed such proposed terms as unfavorable and have opted to forego the revolving credit feature of the Facility and to amortize existing borrowings under the Facility. In accordance with the terms of the Facility, all principal and excess interest collected from the assets by which the Facility is secured are used to amortize the Facility through a termination date of September 29, 2010 (the "amortization period"). During the amortization period the interest rate will continue to be based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. We believe we have sufficient cash and liquid assets to fund normal operations and dividend distributions. At the end of the amortization period, we may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings or we may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

Under our Facility, we must maintain a leverage ratio covenant of at least one to one based on the ratio of the Facility outstanding balance to our most recently reported Generally Accepted Accounting Principles ("GAAP") stockholders' equity balance (determined quarterly in conjunction with the Company's financial reporting filings with the Securities and Exchange Commission) as of the Facility outstanding balance determination date. At year-end, our leverage ratio covenant was met using the December 31, 2008 Facility balance and the latest filed quarterly stockholders' equity balance which, at that time, was as of September 30, 2008. We remain in compliance with the leverage covenant ratio based on the March 12, 2009 Facility balance and the GAAP stockholders' equity balance as of September 30, 2008.

Please refer to "Certain United States Federal Income Tax Considerations — Taxation as a Regulated Investment Company" for a summary of a special circumstance that would allow us to meet our annual RIC distribution requirement for 2009 (and perhaps subsequent years) by distributing shares of our stock in lieu of a significant portion of the cash (or other property other than our stock) that we would otherwise be required to distribute to satisfy such distribution requirement.

### **Investment Portfolio Summary Attributes as of and for the Year Ended December 31, 2008**

Our investment portfolio generates net investment income which is generally used to fund our dividend. Our investment portfolio consists of three primary components: debt securities, CLO Fund securities and our investment in our wholly owned asset manager, Katonah Debt Advisors. We also have investments in equity securities of approximately \$4 million, which comprises approximately 1% of our investment portfolio. Below are summary attributes for each of our primary investment portfolio components (see "Investment Portfolio" and "Investments and Operations" for a more detailed description) as of and for the year ended December 31, 2008:

#### *Debt Securities*

- represent approximately 75% of total investment portfolio;
- represent credit instruments issued by corporate borrowers;
- no asset-backed securities such as those secured by commercial mortgages or residential mortgages and no consumer borrowings;
- primarily senior secured and junior secured loans (42% and 25% respectively);
- spread across 26 different industries and 93 different entities;
- average balance per entity of approximately \$4 million;
- all but two issuers current on their debt service obligations;
- weighted average interest rate of 7.0%.

#### *CLO Fund Securities (as of the last monthly trustee report prior to December 31, 2008 unless otherwise specified)*

- represent approximately 11% of total investment portfolio at December 31, 2008;
- represent investments in subordinated securities or equity securities issued by CLO Funds;
- all CLO Funds invest primarily in credit instruments issued by corporate borrowers;
- no asset-backed securities such as those secured by commercial mortgages or residential mortgages and no consumer borrowings;

- all CLO Funds have made all required cash payments to all classes of investors;
- nine different CLO Fund securities; five of such CLO Funds are managed by Katonah Debt Advisors;
- seasoned CLOs (for which at least four quarterly distributions have been made) currently providing an annualized 29% cash return on investment during the year ended December 31, 2008.

#### *Katonah Debt Advisors*

- represents approximately 11% of total investment portfolio;
- represents our 100% ownership of the equity interest of a CLO Fund manager focused on corporate credit investing;
- Katonah Debt Advisors has approximately \$2.1 billion of assets under management;
- receives contractual and recurring asset management fees based on par value of managed investments;
- typically receives a one-time structuring fee upon completion of a new CLO Fund;
- may receive an incentive fee upon liquidation of a CLO Fund provided that the CLO Fund achieves a minimum designated return on investment;
- dividends declared by Katonah Debt Advisors are recognized as dividend income from affiliate asset manager on our statement of operations and are an additional source of income to pay our dividend;
- for the year ended December 31, 2008, Katonah Debt Advisors had an after-tax net loss of approximately \$765,000;
- for the year ended December 31, 2008, Katonah Debt Advisors made a distribution of over \$1 million in the form of a dividend which is recognized as current earnings to the Company.

#### *Time Deposits and Money Market Accounts*

- time deposits and money market accounts represent approximately 2% of our total investment portfolio;
- time deposits, represented by overnight Eurodollar deposits, are partially restricted under terms of the secured credit facility;
- the money market account contains restricted cash held for employee flexible spending accounts.

#### **Revenue**

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

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

*Dividends from Investments in CLO Fund Securities* . We generate dividend income primarily from our investments in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by Katonah Debt Advisors and also from our selective investments in securities issued by funds managed by other asset management companies. CLO Funds managed by Katonah Debt Advisors invest primarily in broadly syndicated non-investment grade loans, high-yield bonds and other credit instruments of corporate issuers. The Company distinguishes CLO Funds managed by Katonah Debt Advisors as “CLO fund securities managed by affiliate.” The underlying assets in each of the CLO Funds in which we have any investment are generally diversified secured or unsecured corporate debt and exclude mortgage pools or mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities), debt to companies providing mortgage lending and emerging markets investments. Our CLO Fund securities are subordinate to senior bond holders who typically receive a fixed spread over LIBOR on their investment. The CLO Funds are leveraged funds and any excess cash flow or “excess spread” (interest earned by the underlying securities in the fund less payments made to senior bond holders 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 bond liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and distributions to us can vary significantly.



*Dividends from Affiliate Asset Manager.* We generate dividend income from our investment in Katonah Debt Advisors, an asset management company, which is a wholly-owned portfolio company that primarily manages CLO Funds that invest mainly in broadly syndicated non-investment grade loans, high yield bonds and other credit instruments issued by corporations. As a manager of CLO Funds, Katonah Debt Advisors receives contractual and recurring management fees as well as an expected one-time structuring fee from the CLO Funds for its management and advisory services. In addition, Katonah Debt Advisors may also earn income related to net interest on assets accumulated for future CLO issuances on which it has provided a first loss guaranty in connection with loan warehouse arrangements for its CLO Funds. Katonah Debt Advisors generates annual operating income equal to the amount by which its fee income exceeds its operating expenses. The annual management fees which Katonah Debt Advisors receives are generally based on a fixed percentage of the par value of assets under management and are recurring in nature for the term of the CLO Fund so long as Katonah Debt Advisors manages the fund. As a result, the annual management fees earned by Katonah Debt Advisors generally are not subject to market value fluctuations in the underlying collateral. In future years, Katonah Debt Advisors may receive incentive fees upon the liquidation of CLO Funds it manages, provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares.

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

## **Expenses**

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

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

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

## **Net Unrealized Depreciation on Investments**

During the year ended December 31, 2008, the Company's investments had net depreciation of approximately \$40 million.

The net unrealized depreciation for the year ended December 31, 2008 is primarily due to i) an approximate \$27 million net decrease in the market value of certain broadly syndicated loans as a result of current market conditions; ii) an approximate \$5 million decrease in the net value of CLO equity investments (as of December 31, 2008, there are no CLO Funds in default and all CLO Fund debt tranches are providing a current cash return, however, two CLO Funds have each had one tranche of debt downgraded); and, iii) a \$28 million decrease in Katonah Debt Advisors' assets under management from December 31, 2007 to December 31, 2008 and a related settlement with JP Morgan regarding terminated warehouse facilities.

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

The net change in stockholders' equity resulting from operations for the year ended December 31, 2008 was an approximate decrease of \$10 million, or a decrease of \$0.47 per share.

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

Net investment income and net realized gains (losses) comprises the net increase or decrease in stockholders' equity before net unrealized appreciation or depreciation on investments. For the year ended December 31, 2008 net investment income and realized gains (losses) were approximately \$30 million, or \$1.49 per share. Generally, we seek to fund our dividend from net investment income and net realized gains. For the year ended December 31, 2008, dividend distributions totaled approximately \$30 million or \$1.44 per share.

## Dividends

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

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

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

	<u>Dividend</u>	<u>Declaration Date</u>	<u>Record Date</u>	<u>Pay Date</u>
2008:				
Fourth quarter	\$ 0.27	12/19/2008	12/31/2008	1/29/2009
Third quarter	0.35	9/19/2008	10/9/2008	10/28/2008
Second quarter	0.41	6/13/2008	7/9/2008	7/28/2008
First quarter	<u>0.41</u>	3/14/2008	4/8/2008	4/28/2008
Total declared for 2008	<u>\$ 1.44</u>			
2007:				
Fourth quarter	\$ 0.39	12/14/2007	12/24/2007	1/24/2008
Third quarter	0.37	9/24/2007	10/10/2007	10/26/2007
Second quarter	0.35	6/8/2007	7/9/2007	7/23/2007
First quarter	<u>0.29</u>	3/13/2007	4/6/2007	4/17/2007
Total declared for 2007	<u>\$ 1.40</u>			

Due to our ownership of Katonah Debt Advisors and certain timing, structural and tax considerations our dividend distributions may include a return of capital for tax purposes. For the year ended December 31, 2008, Katonah Debt Advisors had approximately \$765,000 of GAAP net losses and distributed approximately \$1 million in dividends to us, and for the year ended December 31, 2007, Katonah Debt Advisors earned approximately \$3 million of GAAP net income and distributed \$500,000 in dividends to us; dividends are recorded as declared by Katonah Debt Advisors as income on our statement of operations.

Please refer to “Distributions” and “Certain United States Federal Income Tax Considerations” for further information regarding our dividend distributions.

## INVESTMENT PORTFOLIO

### Investment Objective

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

Our middle market investment business targets companies that have strong historical cash flows, experienced management teams and identifiable and defensible market positions in industries with positive dynamics. We seek to manage risk through a rigorous credit and investment underwriting process and an active portfolio monitoring program.

We expect to continue to benefit from our ownership of Katonah Debt Advisors in four ways. First, by working with the investment professionals at Katonah Debt Advisors, we have multiple sources of investment opportunities. Second, the experienced team of credit analysts at Katonah Debt Advisors, the members of which also serve as officers of the Company, have specializations covering more than 20 industry groups and they assist us in reviewing potential investments and monitoring our portfolio. Third, we may continue to make investments in CLO Funds or other funds managed by Katonah Debt Advisors, which we believe will provide us with a current cash investment return. Fourth, we expect to continue to receive distributions of recurring fee income and the potential to generate capital appreciation from our investment in Katonah Debt Advisors as the platform grows.

The following table shows the Company's portfolio by security type at December 31, 2008 and December 31, 2007:

Security Type	December 31, 2008			December 31, 2007		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Time Deposits	\$ 12,185,997	\$ 12,185,997	2%	\$ 15,674,489	\$ 15,674,489	3%
Money Market Account	10	10	—	20,766	20,766	—
Senior Secured Loan	235,123,695	218,342,528	42	265,390,844	260,138,674	50
Junior Secured Loan	143,370,524	126,498,918	25	120,620,715	113,259,293	22
Mezzanine Investment	37,097,183	32,557,165	6	32,418,975	33,066,115	6
Senior Subordinated Bond	3,008,197	2,287,500	1	3,009,230	2,490,000	1
Senior Unsecured Bond	5,259,487	4,800,000	1	2,000,000	2,000,000	-
CLO Fund Securities	66,376,595	56,635,236	11	36,061,264	31,020,000	6
Equity Securities	5,256,660	4,389,831	1	5,043,950	4,752,250	1
Affiliate Asset Managers	38,948,271	56,528,088	11	33,469,995	58,585,360	11
Total	<u>\$ 546,626,619</u>	<u>\$ 514,225,273</u>	<u>100%</u>	<u>\$ 513,710,228</u>	<u>\$ 521,006,947</u>	<u>100%</u>

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

### Investment Securities

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

Kohlberg Capital's Board of Directors is ultimately and solely responsible for making a good faith determination of the fair value of portfolio investments on a quarterly basis. Duff & Phelps, LLC, an independent valuation firm, provided third party valuation consulting services to Kohlberg Capital's Board of Directors which consisted of certain limited procedures that the Company's Board of Directors identified and requested them to perform. Upon completion of these limited procedures, Duff & Phelps, LLC concluded that the fair value of those investments subjected to the limited procedures did not appear unreasonable. Kohlberg Capital's Board of Directors considers various commonly accepted methods of valuation to determine the fair value of investments as appropriate in conformity with GAAP. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for such investments, and the differences could be material.



Our portfolio investments at fair value decreased from \$521 million at December 31, 2007 to \$514 million as of December 31, 2008. The net decrease in portfolio size relates primarily to unrealized mark-to-market fair value declines in our investment portfolio, offset by approximately \$27 million of net investments (at cost) made with the proceeds of an equity issuance in May 2008. Such declines relate primarily to illiquidity in the broader debt markets and not to specific credit issues related to securities held in our portfolio. Although there can be no assurance that we will be able to do so, our intention is to hold such assets to maturity and thus mitigate such unrealized losses. First lien loan balances at fair value decreased to \$218 million at December 31, 2008 from \$260 million at December 31, 2007. Second lien, mezzanine loan and bond positions increased to \$166 million at December 31, 2008 from \$151 million at December 31, 2007. We had equity securities, other than CLO equity securities, totaling \$4 million and investments in CLO Fund securities of \$57 million at fair value as of December 31, 2008.

As of December 31, 2008, our investments in loans and debt securities had an annual weighted average interest rate of approximately 7.0%.

The characteristics of our investment securities at fair value, excluding CLO equity securities, are presented in the following table as of each quarter end from December 31, 2006 through December 31, 2008:

Security Type (\$ in millions)	4Q08		3Q08		2Q08		1Q08	
	\$	%	\$	%	\$	%	\$	%
First Lien	\$ 218.3	56%	\$ 228.8	57%	\$ 216.2	56%	\$ 216.1	59%
Second Lien/Mezzanine/Bond	166.1	43	166.9	42	164.5	43	147.1	40
Equity	4.4	1	4.5	1	3.6	1	3.6	1
Total	<u>\$ 388.9</u>	<u>100%</u>	<u>\$ 400.2</u>	<u>100%</u>	<u>\$ 384.3</u>	<u>100%</u>	<u>\$ 366.8</u>	<u>100%</u>

Security Type (\$ in millions)	4Q07		3Q07		2Q07		1Q07		4Q06	
	\$	%	\$	%	\$	%	\$	%	\$	%
First Lien	\$ 260.1	63%	\$ 190.2	55%	\$ 164.3	59%	\$ 150.4	69%	\$ 163.3	86%
Second Lien/Mezzanine/Bond	150.8	36	148.6	43	110.8	40	64.3	30	27.5	14
Equity	4.8	1	5.0	2	3.0	1	3.0	1	—	—
Total	<u>\$ 415.7</u>	<u>100%</u>	<u>\$ 343.8</u>	<u>100%</u>	<u>\$ 278.1</u>	<u>100%</u>	<u>\$ 217.7</u>	<u>100%</u>	<u>\$ 190.8</u>	<u>100%</u>

The industry concentrations, based on the fair value of the Company's investment portfolio as of December 31, 2008 and December 31, 2007, were as follows:

Industry Classification	December 31, 2008			December 31, 2007		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Aerospace and Defense	\$ 35,545,254	\$ 34,846,047	7%	\$ 32,583,716	\$ 32,481,819	6%
Asset Management Companies <sup>2</sup>	38,948,271	56,528,088	11	33,469,995	58,585,360	10
Automobile	8,811,625	7,750,003	2	5,286,731	5,147,010	1
Broadcasting and Entertainment	2,982,607	2,850,000	1	2,978,999	2,782,500	1
Buildings and Real Estate <sup>3</sup>	38,404,495	19,231,787	4	37,726,396	34,944,226	7
Cargo Transport	20,099,157	20,071,001	4	14,967,369	14,958,789	3
Chemicals, Plastics and Rubber	6,613,081	5,840,000	1	3,956,582	3,220,000	1
CLO Fund Securities	66,376,595	56,635,236	11	36,061,264	31,020,000	6
Containers, Packaging and Glass	7,347,292	7,316,295	1	8,895,059	8,895,059	2
Diversified/Conglomerate Manufacturing	6,282,124	6,095,170	1	8,931,343	8,718,855	2
Diversified/Conglomerate Service	15,868,152	15,139,713	3	17,962,721	17,303,969	3
Ecological	2,721,193	2,727,813	1	3,937,850	3,937,850	1
Electronics	15,172,568	13,686,879	3	15,830,382	15,158,502	3
Farming and Agriculture	4,298,336	1,538,550	-	4,800,651	4,058,835	1
Finance	14,979,849	13,830,557	3	11,590,697	11,209,824	2
Healthcare, Education and Childcare	49,379,475	49,581,920	10	46,715,870	46,637,705	9
Home and Office Furnishings, Housewares, and Durable Consumer Goods	21,331,162	20,273,496	4	24,091,185	23,265,816	3
Hotels, Motels, Inns and Gaming	6,322,276	6,073,739	1	9,364,165	9,091,041	2
Insurance	10,983,041	10,693,769	2	24,346,884	23,941,763	5
Leisure, Amusement, Motion Pictures, Entertainment	16,929,910	16,903,100	3	18,402,600	18,402,600	4
Machinery (Non-Agriculture, Non-Construction, Non-Electronic)	35,514,554	36,263,857	7	39,573,338	39,483,418	8
Mining, Steel, Iron and Non-Precious Metals	21,751,631	19,589,104	4	16,338,446	16,069,759	3
Oil and Gas	5,998,263	5,940,000	1	5,997,874	5,960,000	1
Personal and Non Durable Consumer Products (Mfg. Only)	15,208,764	12,264,708	2	17,315,776	14,750,095	3
Personal, Food and Miscellaneous Services	14,722,088	11,445,381	2	13,918,651	13,765,201	3
Printing and Publishing	29,914,605	28,130,061	5	21,622,999	21,236,473	4
Retail Stores	3,755,829	3,755,829	1	4,962,500	4,813,625	1
Time Deposits and Money Market Account	12,186,007	12,186,007	2	15,695,255	15,695,255	2
Utilities	18,178,415	17,037,163	3	16,384,930	15,471,598	3
<b>Total</b>	<b>\$ 546,626,619</b>	<b>\$ 514,225,273</b>	<b>100%</b>	<b>\$ 513,710,228</b>	<b>\$ 521,006,947</b>	<b>100%</b>

<sup>1</sup> Calculated as a percentage of total portfolio at fair value.

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

<sup>3</sup> Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators. As of December 31, 2008 and December 31, 2007, the Company had no exposure to mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset backed securities) or companies providing mortgage lending.

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

Our debt securities investment portfolio at December 31, 2008 was spread across 26 different industries and 93 different entities with an average balance per entity of approximately \$4 million. As of December 31, 2008, two issuers representing 0.2% of total investments at fair value was considered in default. Our portfolio, including the CLO Funds in which we invest, and the CLO Funds managed by Katonah Debt Advisors, consist exclusively of credit instruments issued by companies and do not include investments in asset-backed securities, such as those secured by commercial mortgages, residential mortgages or other consumer borrowings.

We may invest up to 30% of our investment portfolio in opportunistic investments in high-yield bonds, debt and equity securities in CLO Funds, distressed debt or equity securities of public companies. We expect that these public companies generally will have debt that is non-investment grade. We also may invest in debt of middle market companies located outside of the United States, of which investments are not anticipated to be in excess of 10% of our investment portfolio at the time such investments are made. At December 31, 2008, approximately 14% of our investments were foreign assets (including our investments in CLO Funds, which are typically domiciled outside the U.S. and represent approximately 11% of our portfolio). As a result of regulatory restrictions, we are not permitted to invest in any portfolio company in which Kohlberg & Co. or any fund that it manages has a pre-existing investment.

As of December 31, 2008, our ten largest portfolio companies represented approximately 31% of the total fair value of our investments. Our largest investment, Katonah Debt Advisors, which is our wholly-owned portfolio company, represented 11% of the total fair value of our investments. Excluding Katonah Debt Advisors and CLO Fund securities, our ten largest portfolio companies represent approximately 16% of the total fair value of our investments.

### **CLO Fund Securities**

We typically make a minority investment in the subordinated securities or preferred shares of CLO Funds raised and managed by Katonah Debt Advisors and may selectively invest in securities issued by CLO Funds managed by other asset management companies. The securities issued by CLO Funds managed by Katonah Debt Advisors are primarily held by third parties. As of December 31, 2008, we had approximately \$57 million invested in CLO Fund securities, including those issued by funds managed by Katonah Debt Advisors. In addition, in connection with the closing of Katonah 2007-I, Katonah Debt Advisors' most recent CLO Fund, on January 23, 2008, we invested approximately \$29 million to acquire all of the shares of the most junior class of securities of that CLO Fund. The CLO Funds managed by Katonah Debt Advisors invest primarily in broadly syndicated non-investment grade loans, high-yield bonds and other credit instruments of corporate issuers. The underlying assets in each of the CLO Funds in which we have any investment are generally diversified secured or unsecured corporate debt and exclude mortgage pools or mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities), debt to companies providing mortgage lending and emerging markets investments. Subject to the availability of any such investment opportunities and prevailing market conditions we may continue to make such investments. The CLO Funds are leveraged funds and any excess cash flow or "excess spread" (interest earned by the underlying securities in the fund less payments made to senior bond holders and less fund expenses and management fees) is paid to the holders of the CLO Fund's subordinated securities or preferred shares.

During the year ended December 31, 2008, our CLO Fund securities for which we had a full year's payments returned an average 29% cash-on-cash return. Our CLO Fund securities as of December 31, 2008 and December 31, 2007 are as follows:

CLO Fund Securities	Investment	% <sup>1</sup>	December 31, 2008		December 31, 2007	
			Cost	Fair Value	Cost	Fair Value
Grant Grove CLO, Ltd.	Subordinated Securities	22.2%	\$ 4,620,951	\$ 4,665,000	\$ 4,415,580	\$ 4,250,000
Katonah III, Ltd.	Preferred Shares	23.1	4,500,000	1,661,000	4,500,000	2,810,000
Katonah IV, Ltd.	Preferred Shares	17.1	3,150,000	1,601,000	3,150,000	2,420,000
Katonah V, Ltd.	Preferred Shares	26.7	3,320,000	1,172,000	3,320,000	420,000
Katonah VII CLO Ltd. <sup>2</sup>	Subordinated Securities	16.4	4,500,000	2,629,000	4,500,000	3,950,000
Katonah VIII CLO Ltd. <sup>2</sup>	Subordinated Securities	10.3	3,400,000	2,252,000	3,400,000	3,290,000
Katonah IX CLO Ltd. <sup>2</sup>	Preferred Shares	6.9	2,000,000	1,921,000	2,000,000	2,000,000
Katonah X CLO Ltd. <sup>2</sup>	Subordinated Securities	33.3	11,324,758	11,875,000	10,775,684	11,880,000
Katonah 2007-1 CLO Ltd. <sup>2</sup>	Preferred Shares					
		100	29,560,886	28,859,236	—	—
Total			\$ 66,376,595	\$ 56,635,236	\$ 36,061,264	\$ 31,020,000

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

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

Our investments in CLO Fund securities are carried at fair value, which is based on 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 bonds and preferred shares/income notes, when available. We recognize unrealized appreciation or depreciation on our investments in CLO Fund securities as either or both (i) comparable yields in the market change or (ii) based on changes in 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 investment. We determine the fair value of our investments in CLO Fund securities on an individual security-by-security basis.

The table below summarizes certain attributes of each CLO Fund as per their most recent trustee report as of December 31, 2008:

CLO Fund Securities <sup>1</sup>	Number of Securities	Number of Issuers	Number of Industries	Average Security Position Size	Average Issuer Position Size
Grant Grove CLO, Ltd.	233	172	32	\$ 1,227,114	\$ 1,662,311
Katonah III, Ltd.	288	199	31	1,284,316	1,858,708
Katonah IV, Ltd.	297	206	28	1,064,247	1,534,375
Katonah V, Ltd.	337	233	30	697,774	1,009,227
Katonah VII CLO Ltd.	263	210	33	1,350,514	1,691,358
Katonah VIII CLO Ltd	262	205	33	1,508,199	1,927,551
Katonah IX CLO Ltd	260	204	33	1,603,269	2,043,383
Katonah X CLO Ltd	257	200	33	1,855,771	2,384,665
Katonah 2007-1 CLO Ltd	202	164	31	1,563,595	1,925,891

<sup>1</sup> All data from most recent trustee reports as of December 31, 2008

## Katonah Debt Advisors

Katonah Debt Advisors is our wholly-owned asset management company that primarily manages CLO Funds that invest in broadly syndicated loans, high yield bonds and other credit instruments. The CLO Funds managed by Katonah Debt Advisors consist exclusively of credit instruments issued by corporations and do not invest in asset-backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings. As of December 31, 2008, Katonah Debt Advisors had approximately \$2.1 billion of assets under management, and was valued at approximately \$55 million.

As a manager of the CLO Funds, Katonah Debt Advisors receives contractual and recurring management fees as well as a one-time structuring fee from the CLO Funds for its management and advisory services. In addition, Katonah Debt Advisors may also earn income related to net interest on assets accumulated for future CLO issuances on which it has provided a first loss guaranty in connection with loan warehouse arrangements for its CLO Funds. The annual management fees which Katonah Debt Advisors receives are generally based on a fixed percentage of the par value of assets under management and are recurring in nature for the term of the CLO Fund so long as Katonah Debt Advisors manages the fund. As a result, the annual management fees earned by Katonah Debt Advisors are not subject to market value fluctuations in the underlying collateral. Katonah Debt Advisors generates annual operating income equal to the amount by which its fee income exceeds its operating expenses. In future years, Katonah Debt Advisors may receive accrued incentive fees upon the liquidation of CLO Funds it manages, provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares.

The revenue that Katonah Debt Advisors generates through the fees it receives for managing CLO Funds and after paying the expenses associated with its operations, including compensation of its employees, may be distributed to us. Cash distributions of Katonah Debt Advisors' net income are recorded as dividends from affiliate asset manager when declared. As with all other investments, Katonah Debt Advisors' fair value is periodically determined. The valuation is based primarily on a percentage of its assets under management and/or based on Katonah Debt Advisors' estimated operating income. Any change in value from period to period is recognized as unrealized gain or loss.

In October 2007, Katonah Debt Advisors entered into a letter agreement (the "Letter Agreement") with Bear Stearns & Co. Inc. relating to the formation of up to three CLO funds to be formed in 2008 ("2008 CLO Funds") for which Katonah Debt Advisors would serve as the collateral manager. Pursuant to the Letter Agreement, Katonah Debt Advisors agreed to reimburse JPMorgan Securities Inc. ("JPMorgan") (f/k/a Bear Stearns & Co. Inc.), including if the 2008 CLO Funds failed to close, for a portion of the losses (if any) on the resale of the warehoused assets in an amount up to \$22.5 million (which amount was reduced to \$18 million in connection with the closing of the first of the 2008 CLO Funds) (the "First Loss Commitment") plus any accumulated net interest income accrued on the warehoused assets to which Katonah Debt Advisors would otherwise have been entitled. Also in October 2007, warehouse facilities with Bear Stearns Investment Products Inc. were established providing for a warehouse credit line for each of the 2008 CLO Funds to fund the initial accumulation of assets for the 2008 CLO Funds.

On January 23, 2008, Katonah Debt Advisors and Bear Stearns closed the first of the 2008 CLO Funds, Katonah 2007-I CLO Ltd. None of the other CLO funds contemplated by the Letter Agreement were completed. As a result, pursuant to the Letter Agreement, both Katonah Debt Advisors and JPMorgan asserted claims against the other and defenses thereto. Without admitting any liability or wrongdoing, Katonah Debt Advisors and JPMorgan agreed to compromise and settle all of the disputes, issues and claims between them relating to the Letter Agreement in exchange for an agreement to terminate all obligations and liabilities of Katonah Debt Advisors and of JPMorgan under the existing Letter Agreement and ancillary warehouse facilities documentation relating to the 2008 CLO Funds (including Katonah Debt Advisors' First Loss Commitment and its obligation to serve as the collateral manager to the warehouse facilities), payment by Katonah Debt Advisors of an aggregate of \$6 million in installments over a period of one year and the forfeiture by Katonah Debt Advisors of the net interest income earned through the date of the settlement on the warehoused assets. In December 2008, Katonah Debt Advisors entered into a settlement and termination agreement with JP Morgan reflecting the settlement terms described above. As a result of this settlement, Katonah Debt Advisors recognized a \$6 million settlement cost and write-off of previously accrued net interest income on warehoused assets of approximately \$4 million for the year ended December 31, 2008. For the year ended December 31, 2008, Katonah Debt Advisors had an after-tax loss of approximately \$765,000.

Kohlberg Capital recognized the impact of this settlement and forfeiture of warehouse income as a non-cash reduction to the unrealized appreciation of the value of its investment in Katonah Debt Advisors. Consequently, this settlement is not expected to have a material impact on Kohlberg Capital's net investment income or quarterly dividend.

## Time Deposits and Money Market Accounts

Cash time deposits primarily represent overnight Eurodollar investments of cash held in non-demand deposit accounts. Such time deposits are partially restricted under terms of the secured revolving credit facility. The money market account is restricted cash held for employee flexible spending accounts.

## INVESTMENTS AND OPERATIONS

### Overview

We are an internally managed, non-diversified closed-end investment company that has elected to be regulated as a BDC under the 1940 Act. We originate, structure and invest in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies. We define the middle market as comprising companies with EBITDA of \$10 million to \$50 million and/or total debt of \$25 million to \$150 million. In addition to our middle market investment business, our wholly-owned portfolio company, Katonah Debt Advisors, manages CLO Funds that invest in broadly syndicated loans, high-yield bonds and other corporate credit instruments. We acquired Katonah Debt Advisors and certain related assets prior to our initial public offering from affiliates of Kohlberg & Co., a leading private equity firm focused on middle market investing. As of December 31, 2008, Katonah Debt Advisors had approximately \$2.1 billion of assets under management.

Our investment objective is to generate current income and capital appreciation from our investments. In the current economic environment, capital appreciation is difficult to achieve due to real or perceived credit concerns, illiquidity in the market and the resulting impact on fair values. However, we believe our longer-term investment horizon and quality of assets will allow us to generate current income and capital appreciation on discounted assets as they amortize and repay at par. We also expect to receive distributions of recurring fee income and, if debt markets stabilize and recover, to generate capital appreciation from our investment in the asset management business of Katonah Debt Advisors. Our investment portfolio as well as the investment portfolios of the CLO Funds in which we have invested and the investment portfolios of the CLO Funds managed by Katonah Debt Advisors consist exclusively of credit instruments and other securities issued by companies and do not include any asset backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings.

As of December 31, 2008, we had total secured term loan, mezzanine debt, bond and equity investments of approximately \$389 million, total investments in CLO Fund securities managed by our wholly-owned portfolio company Katonah Debt Advisors and three other asset managers of approximately \$57 million, and total investment in 100% of Katonah Debt Advisors' asset management company of approximately \$55 million.

As of December 31, 2008, we had a portfolio of investment securities that included first and second lien secured loans. Our investments generally averaged between \$1 million to \$10 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. We expect that the size of our investments and maturity dates will vary as follows:

- senior secured term loans from \$10 to \$20 million maturing in five to seven years;
- second lien term loans from \$5 to \$20 million maturing in six to eight years;
- senior unsecured loans \$5 to \$10 million maturing in six to eight years;
- mezzanine loans from \$5 to \$10 million maturing in seven to ten years; and
- equity investments from \$1 to \$5 million.

When we extend senior secured term loans, we will generally take a security interest in the available assets of the portfolio company, including the equity interests of their 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 repaid 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 their 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.

## Investment Objective

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

## Credit and Investment Process

We employ the same due diligence intensive investment strategy that our senior management team, Katonah Debt Advisors and Kohlberg & Co. have used over the past 22 years. Due to our ability to source transactions through multiple channels, we expect to maintain a substantial 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 top tier 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 source investment opportunities from:

- private equity sponsors;
- regional investment banks for non-sponsored companies;
- other middle market lenders with whom we can "club" loans;
- Katonah Debt Advisors with regard to high-yield bonds and syndicated loans; and
- Kohlberg & Co. with regard to selected private equity investment opportunities.

In our experience, good credit judgment is based on a thorough understanding of both the qualitative and quantitative factors which 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. Using our Maximum Reasonable Adversity model, we also look at a variety of 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 and experience of management;
- 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;
- Balance sheet analysis of working capital efficiency;
- 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 Maximum Reasonable Adversity credit modeling;
- 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.

### **Credit Monitoring**

Our management team has significant experience monitoring portfolios of middle market investments and this is enhanced by the credit monitoring procedures of Katonah Debt Advisors. 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 the management and private equity sponsor, if applicable, of the portfolio company to take any necessary remedial action quickly. In addition, most of our senior management team, including the credit team at Katonah Debt Advisors, have substantial workout and restructuring experience.

In order to assist us in detecting issues with portfolio companies as early as possible, we perform a monthly financial analysis of each portfolio company. This analysis typically includes:



- reviewing financial statements with comparisons to prior year financial statements, as well as the current budget including key financial ratios such as debt/EBITDA, margins and fixed charge coverage;
- independently computing and verifying compliance with financial covenants;
- reviewing and analyzing monthly borrowing base, if any;
- a monthly discussion of MD&A with company management and the private equity sponsor, if applicable;
- determining if current performance could cause future financial covenant default;
- discussing prospects with the private equity sponsor, if applicable;
- determining if a portfolio company should be added to our “watch list” (companies to be reviewed in more depth);
- if a company is not meeting expectations, reviewing original underwriting assumptions and determining if either enterprise value or asset value has deteriorated enough to warrant further action; and
- a monthly update to be reviewed by both the Chief Executive Officer (“CEO”) and Chief Investment Officer (“CIO”).

### **Investment Securities**

We invest in senior secured loans and mezzanine debt and, to a lesser extent equity capital, of middle market companies in a variety of industries. We generally target companies that generate positive cash flows because we look to cash flows as the primary source for servicing debt. As of December 31, 2008, together with our wholly-owned portfolio company Katonah Debt Advisors, we had a staff of 18 investment professionals who specialize in specific industries and generally seek to invest in companies about which we have direct expertise. However, we may invest in other industries if we are presented with attractive opportunities. For more information regarding our investment securities, see “INVESTMENT PORTFOLIO—Investment Securities.”

### **CLO Fund Securities**

As of December 31, 2008, we had \$57 million, invested in CLO Fund securities, including those issued by funds managed by Katonah Debt Advisors. CLO Funds managed by Katonah Debt Advisors invest primarily in broadly syndicated non-investment grade loans, high-yield bonds and other credit instruments of corporate issuers. The underlying assets in each of the CLO Funds in which we have any investment are generally diversified secured or unsecured corporate debt and exclude mortgage pools or mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities), debt to companies providing mortgage lending and emerging markets investments.

The CLO Funds are leveraged funds and any excess cash flow or “excess spread” (interest earned by the underlying securities in the fund less payments made to senior bond holders and less fund expenses and management fees) is paid to us and the other holders of the CLO Fund’s subordinated securities or preferred shares based on the proportionate share of such class. During the year ended December 31, 2008, our CLO Fund securities for which we had a full year’s quarterly payments returned an average 29% cash-on-cash return.

The securities issued by CLO Funds managed by Katonah Debt Advisors are primarily held by third parties. As of December 31, 2008, we had \$48 million invested at fair value in five Katonah Debt Advisors managed CLO Funds. We typically make a minority investment in the subordinated securities or preferred shares of CLO Funds raised and managed by Katonah Debt Advisors and may selectively invest in securities issued by CLO Funds managed by other asset management companies. For more information regarding our investment securities, see “INVESTMENT PORTFOLIO—Investment in CLO Fund Securities.”

### **Katonah Debt Advisors**

Katonah Debt Advisors is our wholly-owned asset management company that manages CLO Funds that invest in broadly syndicated loans, high yield bonds and other credit instruments. The CLO Funds managed by Katonah Debt Advisors consist exclusively of credit instruments issued by corporations and do not invest in asset-backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings. As of December 31, 2008, Katonah Debt Advisors had approximately \$2.1 billion of assets under management, and was valued at approximately \$55 million.

As a manager of the CLO Funds, Katonah Debt Advisors receives contractual and recurring management fees as well as a one-time structuring fee from the CLO Funds for its management and advisory services. In addition, Katonah Debt Advisors may also earn income related to net interest on assets accumulated for future CLO issuances on which it has provided a first loss guaranty in connection with loan warehouse arrangements for its CLO Funds. The annual management fees which Katonah Debt Advisors receives are generally based on a fixed percentage of the par value of assets under management and are recurring in nature for the term of the CLO Fund so long as Katonah Debt Advisors manages the fund. As a result, the annual management fees earned by Katonah Debt Advisors are not subject to market value fluctuations in the underlying collateral. Katonah Debt Advisors generates annual operating income equal to the amount by which its fee income exceeds its operating expenses. In future years, Katonah Debt Advisors may receive accrued incentive fees upon the liquidation of CLO Funds it manages, provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares.

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

The revenue that Katonah Debt Advisors generates through the fees it receives for managing CLO Funds and after paying the expenses associated with its operations, including compensation of its employees, may be distributed to Kohlberg Capital Corporation. Cash distributions of Katonah Debt Advisors' net income are recorded as dividends from affiliate asset manager when declared. As with all other investments, Katonah Debt Advisors' fair value is periodically determined. The valuation is based primarily on a percentage of its assets under management and/or based on Katonah Debt Advisors' estimated operating income. Any change in value from period to period is recognized as unrealized gain or loss.

As a separately taxable corporation, Katonah Debt Advisors is taxed at normal corporate rates. For tax purposes, any distributions of taxable net income earned by Katonah Debt Advisors to us would generally need to be distributed to our stockholders. Katonah Debt Advisors' taxable net income differs from GAAP net income for both deferred tax timing adjustments and permanent tax adjustments. Deferred tax timing adjustments may include differences between lease cash payments to GAAP straight line expense and adjustments for the recognition and timing of depreciation, bonuses to employees, stock option expense, and interest rate caps. Permanent differences may include adjustments, limitations or disallowances for meals and entertainment expenses, penalties and tax goodwill amortization.

Goodwill amortizable for tax was created upon the purchase of 100% of the equity interests in Katonah Debt Advisors prior to our initial public offering in exchange for shares of our 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, for tax purposes such exchange was considered a taxable asset purchase under the Internal Revenue Code of 1986, as amended ("Code"). At the time of the transfer, Katonah Debt Advisors had equity of approximately \$1 million resulting in tax goodwill of approximately \$32 million which will be amortized for tax purposes on a straight-line basis over 15 years, resulting in an annual difference between GAAP income and taxable income of approximately \$2 million per year over such period.

## **Revenues**

We generate revenue in the form of interest income on debt securities and capital gains, if any, on warrants or other equity-related securities that we acquire from our portfolio companies. In addition, we generate revenue in the form of commitment and facility fees and, to a lesser extent, due diligence fees. Any such fees will be generated in connection with our investments and recognized as earned or, in some cases, recognized over the life of the loan. We expect our investments generally to have a term of between five and eight years and bear interest at various rates ranging from 2% to 10% over the prevailing market rates for Treasury securities. Where applicable, we seek to collateralize our investments by obtaining security interests in our portfolio companies' assets. Interest on debt securities will generally be payable monthly or quarterly, with amortization of principal typically occurring over the term of the security. In those limited instances where we choose to defer amortization of the loan for a period of time from the date of the initial investment, the principal amount of the debt securities and any accrued but unpaid interest will generally become due at the maturity date.

We also generate dividend income from our investment in CLO equities. These subordinated securities are the most junior class of securities issued by the CLO Funds and are subordinated in priority of payment to each other class of securities issued by these CLO Funds. Dividends on CLO equities are generally paid quarterly.

## Expenses

Because we are an internally managed BDC, we pay the costs associated with employing investment management professionals and other employees as well as running our operations. Our primary non-interest expenses include employee salaries and benefits, the costs of identifying, evaluating, negotiating, closing, monitoring and servicing our investments and our related overhead charges and expenses, including rental expense and interest expense incurred in connection with borrowings. Because we are internally managed, we do not pay any management fees to any third party.

## Our Strategic Relationship with Kohlberg & Co.

We believe that we derive substantial benefits from our strategic relationship with Kohlberg & Co. The Co-managing partners of Kohlberg & Co., are members of our Board of Directors, and are also members of our Investment Committee. Through such participation, we have access to the expertise of these individuals in middle market and leveraged investing, which we believe enhances our capital raising, due diligence, investment selection and credit analysis activities. Affiliates of Kohlberg & Co., including those who serve and have served on our Board of Directors and on our Investment Committee, own, in the aggregate, approximately 15% of our outstanding common stock. Kohlberg & Co. is a leading U.S. private equity firm which manages investment funds that acquire middle market companies. Since its founding in 1987, Kohlberg & Co. has organized six private equity funds, through which it has raised approximately \$3.5 billion of committed capital and completed more than 80 platform and add-on acquisitions with an aggregate value of approximately \$8 billion.

Because we are an internally managed BDC, we do not pay any fees to Kohlberg & Co. or any of its affiliates. Under the 1940 Act, we are generally prohibited from buying or selling any security from or to any portfolio company of a private equity fund managed by Kohlberg & Co. without the prior approval of the Securities and Exchange Commission (the "SEC"). In addition, we may co-invest on a concurrent basis with Kohlberg & Co. or any of our affiliates, subject to compliance with existing regulatory guidance, applicable regulations and our allocation procedures. Certain types of negotiated co-investments may be made only if we receive an order from the SEC permitting us to do so. There can be no assurance that any such order will be obtained.

## LEVERAGE

In addition to funds available from the issuance of our common stock, 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. The amount of leverage that we employ at any time depends on our assessment of the market and other factors at the time of any proposed borrowing. As of December 31, 2008, we had \$262 million of outstanding borrowings and our asset coverage ratio was 196%, slightly below the minimum asset coverage level generally required for a BDC by the 1940 Act, primarily as a result of unrealized fair value losses on our investments. Until the minimum asset coverage level is met, we will be unable to incur additional debt or issue securities senior to our common stock. As a result, we will be severely limited in our ability to raise capital to make new investments until our asset coverage ratio exceeds 200%. However, because we have no public debt or preferred stock outstanding, failure to maintain asset coverage of at least 200% will not limit our ability, under the 1940 Act, to pay dividends from our net investment income. As of March 12, 2009, our Facility balance was approximately \$245 million and our asset coverage ratio was approximately 209%, above the minimum asset coverage level generally required for a BDC by the 1940 Act.

On February 14, 2007, we entered into a secured revolving credit facility (the "Facility") under which we had a right to obtain up to \$200 million in financing. On October 1, 2007, we amended the Facility to increase our borrowing capacity from \$200 million to \$275 million, extend the maturity date from February 12, 2012 to October 1, 2012 and increase the interest spread charged on outstanding borrowings by 15 basis points, to 0.85%. In addition, the amendment revised the method for determining the required equity contribution from Kohlberg Capital to Kohlberg Capital Funding LLC I ("KCAP Funding"). Subject to certain thresholds, the required equity contribution will be increased from \$45 million to \$60 million, depending on the amount of outstanding borrowings. Advances under the Facility are used primarily to make additional investments.

The Facility is secured by loans acquired by us with the advances under the Facility. We borrow under the Facility through our wholly-owned, special-purpose bankruptcy remote subsidiary, KCAP Funding, our wholly-owned, special-purpose bankruptcy remote subsidiary through which we borrow under the Facility. Under the Facility, funds are loaned by BMO Capital Markets Corp. (through its affiliate Fairway Finance Company, LLC) and Deutsche Bank AG, New York Branch (through its affiliate Riverside Funding LLC), the pro-rata lenders, based on prevailing commercial paper rates or, if the commercial paper market is at any time unavailable, at prevailing LIBOR rates, in each case plus an applicable spread.

Under the Facility, we are subject to limitations as to how borrowed funds may be used, including restrictions on geographic and industry concentrations, loan size, payment frequency and status, average life, collateral interests and investment ratings. We are also subject to regulatory restrictions on leverage which may affect the amount of funding that we can obtain under the Facility. The Facility also includes certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, a violation of which could result in the early amortization of the Facility, limit further advances and, in some cases, result in an event of default. The interest charged on borrowed funds is based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. The interest charged on borrowed funds is payable monthly. We paid a one-time, 0.50% structuring fee at the time we entered into the Facility, as well as a one-time, 1% structuring fee on the \$75 million increase in borrowing availability under the Facility at the time we entered into the Facility amendment. Additionally, we are also required to pay an annual commitment fee, payable monthly, equal to 0.225% for any unused portion of the Facility.

During September 2008, we were notified by the lenders that the liquidity banks providing the underlying funding for the Facility did not intend to renew their liquidity facility to the lenders unless we agreed to certain revised terms for the Facility. As a result, the lenders proposed new terms to us in order to extend additional fundings under the Facility. We viewed such proposed terms as unfavorable and have opted to forego the revolving credit feature of the Facility and to amortize existing borrowings under the Facility. In accordance with the terms of the Facility, all net interest and any principal collected from the assets by which the Facility is secured are used to amortize the Facility through a termination date of September 29, 2010 (the "amortization period"). During the amortization period, the interest rate will continue to be based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. We believe we have sufficient cash and liquid assets to fund normal operations and dividend distributions. At the end of the amortization period, we may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings or we may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

Under our Facility, we must maintain a leverage ratio covenant of at least one to one based on the ratio of the Facility outstanding balance to our most recently reported GAAP stockholders' equity balance (determined quarterly in conjunction with the Company's financial reporting filings with the Securities and Exchange Commission) as of the Facility outstanding balance determination date. At year-end, our leverage ratio covenant was met using the December 31, 2008 Facility balance and the latest filed quarterly stockholders' equity balance which, at that time, was as of September 30, 2008. We remain in compliance with the leverage covenant ratio based on the March 12, 2009 Facility balance and the GAAP stockholders' equity balance as of September 30, 2008.

The current economic environment and the availability of credit, which is severely limited, affected our ability to extend the Facility and we may not be able to enter into another facility as a result of such conditions should they continue.

We estimate that the portfolio of loans securing the Facility will be required to generate an annual rate of return of approximately 3% to cover annual interest payments on obligations incurred under the Facility. As of December 31, 2008, our investments in loans and debt securities had an annual weighted average interest rate of approximately 7.0%.

## **COMPETITION**

Our primary competitors provide financing to prospective portfolio companies and include commercial banks, specialty finance companies, hedge funds, structured investment funds and investment banks. Many of these entities have greater financial and 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 "Risk Factors—Risks Related to Our Business—We operate in a highly competitive market for investment opportunities."

We believe that we provide a unique combination of an experienced middle market origination and credit team, an existing credit platform at Katonah Debt Advisors that includes experienced lenders with broad industry expertise and an Investment Committee that includes co-managing partners of Kohlberg & Co., a leading experienced and successful middle market private equity firm. We believe that this combination of resources provides us with a thorough credit process and multiple sources of investment opportunities to enhance our asset selection process.

## COMPETITIVE ADVANTAGES

We believe that we can successfully compete with other providers of capital in the markets in which we compete for the following reasons:

- **Internally managed structure and significant management resources** . 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. As a result, we do not pay investment advisory fees and all of our income is available to pay our operating costs and to make distributions to our stockholders.
- **Multiple sourcing capabilities for assets** . We have multiple sources of loans, mezzanine investments and equity investments through our industry relationships, Katonah Debt Advisors and our strategic relationship with Kohlberg & Co.
- **Disciplined investment process** . We employ a rigorous credit review process and due diligence intensive investment strategy which our senior management has developed over more than 20 years of lending. For each analyzed company, we develop our own underwriting case and multiple stress case scenarios and an event-specific financial model reflecting company, industry and market variables. Generally, both we and the CLO Funds managed by Katonah Debt Advisors have decided not to invest in highly leveraged or “covenant light” credit facilities.
- **Katonah Debt Advisors’ credit platform** . Katonah Debt Advisors serves as a source of our direct investment opportunities and cash flow, and certain credit analysts employed by Katonah Debt Advisors who also serve as officers of the Company serve as a resource for credit analysis.
- **Investments in a wide variety of portfolio companies in a number of different industries with no direct exposure to mortgage-backed securities** . Our investment portfolio (excluding our investments in Katonah Debt Advisors and CLO Fund securities) is spread across 26 different industries and 93 different entities with an average balance per entity of approximately \$4 million. Our investment portfolio as well as the investment portfolios of the CLO Funds in which we have invested and the investment portfolios of the CLO Funds managed by Katonah Debt Advisors consist exclusively of credit instruments and other securities issued by companies and do not include any asset-backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings.
- **Strategic relationship with Kohlberg & Co** . We believe that Kohlberg & Co. is one of the oldest and most well-known private equity firms focused on the middle market, and we expect to continue to derive substantial benefits from our strategic relationship with Kohlberg & Co.
- **Significant equity ownership and alignment of incentives** . Our senior management team, the senior management team of Katonah Debt Advisors and affiliates of Kohlberg & Co. together have a significant equity interest in the Company, ensuring that their incentives are strongly aligned with those of our stockholders.

## EMPLOYEES

As of February 28, 2009, the Company had 28 employees.

## 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. As of December 31, 2008, we did not have any preferred stock outstanding.

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 quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals responsible for the portfolio investment. Preliminary valuation conclusions are then documented and discussed with our senior management. The Valuation Committee of our Board of Directors reviews these preliminary valuations and makes recommendations to our Board of Directors. Where appropriate, the Valuation Committee may utilize an independent valuation firm selected by our Board of Directors. The Valuation Committee has selected an independent valuation firm to assist with the periodic valuation of our illiquid securities. Our Board of Directors discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the recommendations of the Valuation Committee.

Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined under our procedures may differ significantly from the values that would have been used had a ready market existed for the investments or from the values that would have been placed on our assets by other market participants, and the differences could be material.

There is no single standard for determining fair value. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we must determine the fair value of each individual investment on a quarterly basis. We record unrealized depreciation on investments when we believe that an investment has decreased in value, including where collection of a loan or realization of an equity security is doubtful. Conversely, we record unrealized appreciation if we believe that our investment has appreciated in value, for example, because the underlying portfolio company has appreciated in value.

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 the underlying CLO Funds. Our investments are generally subject to restrictions on resale and generally have no established trading market. Because of the type of investments that we make and the nature of our business, our valuation process requires an analysis of various factors. Our valuation methodology includes the examination of, among other things, the underlying investment performance, financial condition and market changing events that impact valuation.

With respect to private debt and equity investments, each investment is valued using industry valuation benchmarks, and, where appropriate, such as valuing private warrants, the input value in our valuation model may be assigned a discount reflecting the illiquid nature of the investment and our minority, non-control position. When a qualifying external event such as a significant purchase transaction, public offering or subsequent loan or warrant sale occurs, the pricing indicated by the external event is considered in determining our private debt or equity valuation. Securities that are traded in the over-the-counter market or on a stock exchange generally are valued at the prevailing bid price on the valuation date. However, restricted or thinly traded public securities may be valued at discounts from the public market value due to limitations on our ability to sell the securities.

Our investments in CLO Fund securities are carried at fair value, which is based on 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 bonds and preferred shares/income notes, when available. 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 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 investment. We determine the fair value of our investments in CLO Fund securities on an individual security-by-security basis. If we were to sell a group of CLO Fund securities in a pool in one or more transactions, the total value received for that pool may be different than the sum of the fair values of the individual investments in CLO Fund securities.

## **ELECTION TO BE REGULATED AS A BUSINESS DEVELOPMENT COMPANY AND A REGULATED INVESTMENT COMPANY**

Our elections to be regulated as a BDC and to be treated as a RIC have a significant impact on our future operations:

***We report our investments at market value or fair value with changes in value reported through our statement of operations.***

We report all of our investments, including debt investments, at market value or, for investments that do not have a readily available market value, at their "fair value" as determined in good faith by our Board of Directors pursuant to procedures approved by our Board of Directors. Changes in these values are reported through our statement of operations under the caption of "net unrealized appreciation (depreciation) on investments." See "Determination of Net Asset Value."

***Our ability to use leverage as a means of financing our portfolio of investments is limited.***

As a BDC, we are required to meet a coverage ratio of total assets to total senior securities of at least 200%. For this purpose, senior securities generally include all borrowings, guarantees of borrowings and any preferred stock we may issue in the future. Our ability to utilize leverage as a means of financing our portfolio of investments is limited by this asset coverage test. Our asset coverage ratio was below 200% as of December 31, 2008. However, as of March 12, 2009, our Facility balance was approximately \$245 million and our asset coverage ratio was approximately 209%, above the minimum asset coverage level generally required for a BDC by the 1940 Act. See "LEVERAGE."

***We intend to distribute substantially all of our net taxable income to our stockholders. We generally will be required to pay U.S. federal income taxes only on the portion of our net taxable income and gains that we do not distribute to stockholders.***

We have elected to be treated as a RIC for U.S. federal income tax purposes, commencing with our taxable year ended December 31, 2006. As a RIC, we intend to distribute to our stockholders substantially all of our net investment company income. In addition, we may retain certain net long-term capital gains and elect to treat such net capital gains as distributed to our stockholders. If this happens, you will be treated as if you received an actual distribution of the capital gains and reinvested the net after-tax proceeds in us. You also may be eligible to claim a tax credit against your U.S. federal income tax liability (or, in certain circumstances, a tax refund) equal to your allocable share of the tax we pay on the deemed distribution. See “Certain United States Federal Income Tax Considerations.”

As a RIC, we generally are required to pay U.S. federal income taxes only on the portion of our net taxable income and gains that we do not distribute (actually or constructively). Katonah Debt Advisors, our wholly-owned taxable portfolio company, receives fee income earned with respect to its management services. We expect that Katonah Debt Advisors will form additional direct or indirect subsidiaries which will receive similar fee income. Some of these subsidiaries may be treated as corporations for U.S. federal income tax purposes, and as a result, such subsidiaries will be subject to income tax at regular corporate rates, for U.S. federal and state purposes, although, as a RIC, dividends and distributions of capital received by us from our taxable subsidiaries and distributed to our stockholders will not subject us to U.S. federal income taxes. As a result, the net return to us on such investments held by such subsidiaries will be reduced to the extent that the subsidiaries are subject to income taxes.

In addition, due to the asset coverage test applicable to us as a BDC, we may be limited in our ability to make distributions. See “Distributions.” Also, restrictions and provisions in our Facility may limit our ability to make distributions. See “Obligations and Indebtedness.”

***We are required to comply with the provisions of the 1940 Act applicable to BDCs.***

As a BDC, we are required to have a majority of directors who are not “interested” persons under the 1940 Act. In addition, we are required to comply with other applicable provisions of the 1940 Act, including those requiring the adoption of a code of ethics, fidelity bond and custody arrangements. See also “Regulation.”

## **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 companies and making managerial assistance available to them. A BDC provides stockholders with the ability to retain the liquidity of a publicly traded stock, while sharing in the possible benefits of investing in emerging-growth or expansion-stage privately-owned companies. The 1940 Act contains prohibitions and restrictions relating to transactions between BDCs and their directors and officers and principal underwriters 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. In the ordinary course of business, we may enter into transactions with portfolio companies that may be considered related party transactions. We have implemented certain procedures, both written and unwritten, to ensure that we do not engage in any prohibited transactions with any persons affiliated with us. If such affiliations are found to exist, we seek Board and/or committee review and approval or exemptive relief for such transactions, as appropriate.

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 outstanding any class of securities with respect to which a broker or dealer may extend margin credit;
    - (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 any class of securities listed on a national securities exchange.
- 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;
- Cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment; and
- Under certain circumstances, securities of companies that were eligible portfolio companies at the time of the initial investment but that are not eligible portfolio companies at the time of the follow-on investment.

In May 2008, the SEC adopted a rule under the 1940 Act that further expands the definition of an “eligible portfolio company” to include certain domestic operating companies that list their securities on a national securities exchange.

### **Significant Managerial Assistance**

A BDC must have been 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. However, to count portfolio securities as “qualifying assets” for the purpose of the 70% test, the BDC must either control the issuer of the securities or must offer to make available to the issuer of the securities (other than small and solvent companies described above) significant managerial assistance; except that, where the BDC purchases such securities in conjunction with one or more other persons acting together, one of the other persons in 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, significant 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.

## Senior Securities and 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. For a discussion of the risks associated with the resulting leverage, see “Risk Factors—Risks Related to Our Business—The debt we incur could increase the risk of investing in our Company.” Our asset coverage ratio was below 200% as of December 31, 2008. However, as of March 12, 2009, our Facility balance was approximately \$245 million and asset coverage ratio was approximately 209%, above the minimum asset coverage level generally required for a BDC by the 1940 Act. See “LEVERAGE.”

## 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. We may be prohibited under the 1940 Act from conducting certain transactions with our affiliates without the prior approval of our directors who are not interested persons and, in some cases, the prior approval of the SEC. You can obtain a copy of the code of ethics by any of the methods described under “Available Information.”

## 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 physical, electronic and procedural safeguards designed to protect the non-public personal information of our stockholders.

## Proxy Voting Policy and Procedures

Although most of the securities we hold are not voting securities, some of our investments may entitle us to vote proxies. We vote proxies relating to our portfolio securities in the best interest of our stockholders. We 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 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 believe there exists a compelling long-term reason to do so.

Our proxy voting decisions are made by our Investment Committee, which is responsible for monitoring each of our investments. To ensure that our vote is not the product of a conflict of interest, we require that (1) anyone involved in the decision making process disclose to our CCO 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 proxy 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 will be periodically examined by the SEC for compliance with the 1940 Act.

We will not “concentrate” our investments, that is, invest 25% or more of our assets in any particular industry (determined at the time of investment).

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 CCO who is responsible for administering these policies and procedures.

## **CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS**

The following discussion is a general summary of certain material U.S. federal income tax considerations applicable to us and to an investment in our shares. This summary does not purport to be a complete description of the income tax considerations applicable to such an investment. For example, we have not described tax consequences that we assume to be generally known by investors or certain considerations that may be relevant to certain types of holders subject to special treatment under U.S. federal income tax laws, including stockholders subject to the alternative minimum tax, tax-exempt organizations, insurance companies, regulated investment companies, dealers in securities, pension plans and trusts, and financial institutions. This summary assumes that investors hold our common stock as capital assets (within the meaning of the Code). The discussion is based upon the Code, Treasury regulations, and administrative and judicial interpretations, each as in effect as of the date of this filing and all of which are subject to change, possibly retroactively, which could affect the continuing validity of this discussion. This summary does not discuss any aspects of U.S. estate or gift tax or foreign, state or local tax. It does not discuss the special treatment under U.S. federal income tax laws that could result if we invested in tax-exempt securities or certain other investment assets in which we do not currently intend to invest.

A “U.S. stockholder” generally is a beneficial owner of shares of our common stock who is for U.S. federal income tax purposes:

- a citizen or individual resident of the United States including an alien individual who is a lawful permanent resident of the United States or meets the “substantial presence” test in Section 7701(b) of the Code;
- a corporation or other entity taxable as a corporation, for U.S. federal income tax purposes, created or organized in or under the laws of the United States or any political subdivision thereof;
- a trust over the administration of which a court in the U.S. has primary supervision or over which U.S. persons have control; or
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source.

A “Non-U.S. stockholder” is a beneficial owner of shares of our common stock that is neither a U.S. stockholder nor a partnership for U.S. federal income tax purposes. If a partnership (including an entity treated as a partnership for U.S. federal income tax purposes) holds shares of our common stock, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. A prospective stockholder who is a partner of a partnership holding shares of our common stock should consult his, her or its tax advisors with respect to the purchase, ownership and disposition of shares of our common stock.

Tax matters are very complicated and the tax consequences to an investor of an investment in our shares will depend on the facts of his, her or its particular situation. We encourage investors to consult their tax advisors regarding the specific consequences of such an investment, including tax reporting requirements, the applicability of U.S. federal, state, local and foreign tax laws, eligibility for the benefits of any applicable tax treaty and the effect of any possible changes in the tax laws.

### **Election to be Taxed as a Regulated Investment Company**

As a BDC, we have elected to be treated as a RIC under Subchapter M of the Code commencing with our taxable year ended December 31, 2006. As a RIC, we generally will not have to pay corporate-level taxes on any income or gains that we distribute to our stockholders as dividends. To qualify for treatment as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, to qualify for treatment as a RIC, we must distribute to our stockholders, for each taxable year, at least 90% of our “net investment company income,” which is generally the sum of our net investment income plus the excess, if any, of realized net short-term capital gains over realized net long-term capital losses (the “Annual Distribution Requirement”).

## Taxation as a Regulated Investment Company

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 ( *i.e.* , net realized long-term capital gains in excess of net realized short-term capital losses) we distribute to stockholders with respect to that year. We will be subject to U.S. federal income tax at the regular corporate rates on any net ordinary income or capital gain not distributed (or deemed distributed) to our stockholders. As a RIC, we will be subject to a 4% nondeductible U.S. federal excise tax on certain net taxable undistributed income unless we distribute in a timely manner an amount at least equal to the sum of (1) 98% of our net ordinary income for each calendar year, (2) 98% of our capital gain net income for the 1-year period ending October 31 in that calendar year and (3) any net income realized, but not distributed, in the preceding year. We will not be subject to excise taxes on amounts on which we are required to pay corporate income tax (such as retained net capital gains). We currently intend to make sufficient distributions each taxable year and/or pay sufficient corporate income tax to avoid any excise tax liability, although we reserve the right to pay an excise tax rather than make an additional distribution when circumstances warrant (e.g., the payment of an excise tax amount that we deem to be *de minimis*).

To qualify for tax treatment as a RIC for U.S. federal income tax purposes, in addition to satisfying the Annual Distribution Requirement, we must, among other things:

- have in effect at all times during each taxable year an election to be regulated as a BDC under the 1940 Act;
- in each taxable year, derive at least 90% of our gross income from (a) 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 (b) net income derived from an interest in a “qualified publicly traded partnership” (as defined by the Code) (all such income “Qualifying Income”); and
- diversify our holdings so that at the end of each quarter of the taxable year: (i) 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 such issuer; and (ii) 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 (a) one issuer, (b) 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 (c) one or more “qualified publicly traded partnerships” (the “Diversification Tests”).

We conduct the business of Katonah Debt Advisors through direct or indirect subsidiaries. Some of our subsidiaries are treated as corporations for U.S. federal income tax purposes. As a result, such subsidiaries will be subject to tax at regular corporate rates. We will recognize income from these subsidiaries to the extent that we receive dividends and distributions of capital from these subsidiaries. Some of the wholly-owned subsidiaries may be treated as disregarded entities for U.S. federal income tax purposes. As a result, we may directly recognize fee income earned by these subsidiaries. Fee income that we recognize directly through entities that are treated as disregarded entities for U.S. federal tax purposes will generally not constitute Qualifying Income. We intend to monitor our recognition of fee income to ensure that at least 90% of our gross income in each taxable year is Qualifying Income.

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 that are 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 to satisfy the Annual Distribution Requirement, even though we will not have received an amount of cash that corresponds with the income accrued.

However, pursuant to guidance issued in 2009 by the U.S. Internal Revenue Service, under certain circumstances it is possible for us to meet the Annual Distribution Requirement for 2009 even though we limit how much cash (and other property which is not our stock) that we distribute in the aggregate to our stockholders (which limit can be as low as 10%) when compared to how much cash (and other property which is not our stock) that we would need to distribute for us to meet the Annual Distribution Requirement without relying on such guidance (a "qualifying limited-cash distribution"). In the case of a qualifying limited-cash distribution, to the extent we do not distribute cash (and other property which is not our stock), we must distribute shares of our stock (based on a market-price valuation method determined pursuant to such guidance) to our stockholders as part of such distribution. While we have not made any qualifying limited-cash distributions to date, we reserve the right to make such distributions in the future, subject to compliance with applicable tax requirements.

We could also be subject to a U.S. federal income tax (including interest charges) on distributions received from investments in passive foreign investment companies "PFICs" (defined below) or on proceeds received from the disposition of shares in PFICs, which tax cannot be eliminated by making distributions to our stockholders. A PFIC is any foreign corporation in which (i) 75% or more of the gross income for the taxable year is passive income, or (ii) the average percentage of the assets (generally by value, but by adjusted tax basis in certain cases) that produce or are held for the production of passive income is at least 50%. Generally, passive income for this purpose means dividends, interest (including income equivalent to interest), royalties, rents, annuities, the excess of gains over losses from certain property transactions and commodities transactions, and foreign currency gains. Passive income for this purpose does not include rents and royalties received by the foreign corporation from active business and certain income received from related persons. If we are in a position to treat and so treat such a PFIC as a "qualified electing fund" ("QEF") we will be required to include our share of the company's income and net capital gain annually, regardless of whether we receive any distribution from the company. Alternately, we may make an election to mark the gains (and to a limited extent losses) in such holdings "to the market" as though we had sold and repurchased our holdings in those PFICs on the last day of our taxable year. Such gains and losses are treated as ordinary income and loss. The QEF and mark-to-market elections may have the effect of accelerating the recognition of income (without the receipt of cash) and increasing the amount required to be distributed for us to avoid taxation.

We may also invest in "controlled foreign corporations" ("CFCs"). A non-U.S. corporation will be a CFC if "U.S. Shareholders" ( *i.e.* , each U.S. investor that owns (directly or by attribution) 10% or more of the interests in the non-U.S. corporation (by vote)) own (directly or by attribution) more than 50% (by vote or value) of the outstanding interests of the non-U.S. corporation. If we are a U.S. Shareholder with respect to a non-U.S. corporation, we will be required each year to include in income our pro rata share of the corporation's "Subpart F income" (as defined in the Code). Therefore, investments in CFCs may have the effect of accelerating the recognition of income (without the receipt of cash) and increasing the amount required to be distributed for us to avoid taxation.

We are authorized to borrow funds and to sell assets to satisfy the Annual Distribution Requirement and to avoid any excise tax liability. However, depending on the types of debt and equity securities we have outstanding, we may be prohibited under the 1940 Act from making distributions to our stockholders while our debt obligations and other senior securities are outstanding unless certain "asset coverage" tests are met. See "Regulation—Senior Securities; Coverage Ratio." Moreover, our ability to dispose of assets to meet the Annual Distribution Requirement and to avoid any excise tax liability may be limited by (1) the illiquid nature of our portfolio, or (2) other requirements relating to our tax treatment as a RIC, including the Diversification Tests. If we dispose of assets to meet the Annual Distribution Requirements and to avoid any excise tax liability, we may make such dispositions at times that, from an investment standpoint, are not advantageous.

Gain or loss realized by us from the sale or exchange of 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 gain or loss generally will be long-term or short-term, depending on how long we held a particular warrant. Our transactions in options, futures contracts, hedging transactions and forward contracts will be subject to special tax rules, the effect of which may be to accelerate income to us, defer losses, cause adjustments to the holding periods of our investments, convert long-term capital gains into short-term capital gains, convert short-term capital losses into long-term capital losses or have other tax consequences. These rules could affect the amount, timing and character of distributions to stockholders. We do not currently intend to engage in these types of transactions.

A RIC is not permitted to deduct expenses in excess of its "investment company taxable income" (which is, generally, ordinary income plus net short-term capital gains in excess of net long-term capital losses). If our expenses in a given year exceed investment company taxable income ( *e.g.* , as the result of large amounts of equity-based compensation), we would experience a net operating loss for that year. However, a RIC is not permitted to carry forward net operating losses to subsequent years. In addition, expenses can be used only to offset investment company taxable income, not net capital gain (that is, the excess of net long-term capital gains over the net short-term capital losses). Due to these limits on the deductibility of expenses, we may for tax purposes have aggregate taxable income over a period of several years that we are required to distribute and that is taxable to our stockholders even if such income is greater than the net income we actually earned during those years in the aggregate. Such required distributions may be made from our cash assets or by liquidation of investments, if necessary. We may realize gains or losses from such liquidations. In the event we realize net capital gains from such transactions, you may receive a larger capital gain distribution than you would have received in the absence of such transactions. Assuming we qualify for tax treatment as a RIC, our corporate-level U.S. federal income tax should be substantially reduced or eliminated, and, as explained below in "—Taxation of U.S. Stockholders," a portion of our distributions or deemed distributions may be characterized as long-term capital gain in the hands of stockholders. Except as otherwise provided, the remainder of this discussion assumes that we qualify for tax treatment as a RIC and have satisfied the Annual Distribution Requirement.

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

If we were to fail to qualify for tax treatment as a RIC (including if our Board of Directors elected to temporarily or permanently revoke our RIC election), we would be subject to tax on all of our taxable income at regular corporate rates. We would not be able to deduct distributions to stockholders, nor would distributions be required to be made. Such distributions would be taxable to our stockholders as dividend income to the extent of our current and accumulated earnings and profits and (if made during a taxable year beginning before January 1, 2011) provided certain holding period and other requirements were met, could potentially qualify for treatment as “qualified dividend income” in the hands of stockholders taxed as individuals eligible for the 15% maximum rate. Subject to certain limitations under the Code, corporate distributees may be eligible for the dividends received deduction with respect to our dividend distributions. 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. To requalify as a RIC in a subsequent taxable year, we would be required to satisfy the RIC qualification requirements for that year and dispose of any earnings and profits from any year in which we failed to qualify for tax treatment as a RIC. Subject to a limited exception applicable to RICs that qualified as such under Subchapter M of the Code for at least one year prior to disqualification and that requalify as a RIC no later than the second year following the nonqualifying year, we could be subject to tax on any unrealized net built-in gains in the assets held by us during the period in which we failed to qualify for tax treatment as a RIC that are recognized within the subsequent 10 years, unless we made a special election to pay corporate-level tax on such built-in gain at the time of our requalification as a RIC.

## **Taxation of U.S. Stockholders**

For U.S. federal income tax purposes, distributions by us generally are taxable to U.S. stockholders as ordinary income or capital gains. Distributions of our “investment company taxable income” (which is, generally, our ordinary income plus net realized short-term capital gains in excess of net realized long-term capital losses) will be taxable as ordinary income to U.S. stockholders to the extent of our current or accumulated earnings and profits, whether paid in cash or reinvested in additional common stock through our dividend reinvestment plan. For taxable years beginning before January 1, 2011, to the extent such distributions paid by us are attributable to dividends from U.S. corporations and certain qualified foreign corporations, such distributions may be designated by us as “qualified dividend income” eligible to be taxed in the hands of non-corporate stockholders at the rates applicable to long-term capital gains, provided holding period and other requirements are met at both the stockholder and company levels. In this regard, it is anticipated that distributions paid by us generally will not be attributable to dividends and, therefore, generally will not be qualified dividend income. Distributions of our net capital gains (which is generally our realized net long-term capital gains in excess of realized net short-term capital losses) properly designated by us as “capital gain dividends” will be taxable to a U.S. stockholder as long-term capital gains (currently at a maximum rate of 15% in the case of individuals, trusts or estates), regardless of the U.S. stockholder’s holding period for his, her or its common stock and regardless of whether paid in cash or reinvested in additional common stock. Distributions in excess of our current and accumulated earnings and profits first will reduce a U.S. stockholder’s adjusted tax basis in such stockholder’s common stock and, after the adjusted basis is reduced to zero, will constitute capital gains to such U.S. stockholder.

We may retain some or all of our realized net long-term capital gains in excess of realized net short-term capital losses and designate the retained net capital gains as a “deemed distribution.” In that case, among other consequences, we will pay tax on the retained amount, each U.S. stockholder will be required to include his, her or its share of the deemed distribution in income as if it had been actually distributed to the U.S. stockholder, and the U.S. stockholder will be entitled to claim a credit equal to his, her or its allocable share of the tax paid thereon by us. The amount of the deemed distribution net of such tax will be added to the U.S. stockholder’s cost basis for his, her or its common stock. Since we expect to pay tax on any retained net capital gains at our regular corporate tax rate, and since that rate is in excess of the maximum rate currently payable by individuals on long-term capital gains, the amount of tax that individual stockholders will be treated as having paid and for which they will receive a credit will exceed the tax they owe on the retained net capital gain. Such excess generally may be claimed as a credit against the U.S. stockholder’s other federal income tax obligations or may be refunded to the extent it exceeds a stockholder’s liability for U.S. federal income tax. A stockholder that is not subject to U.S. federal income tax or otherwise required to file a U.S. federal income tax return would be required to file a U.S. federal income tax return on the appropriate form to claim a refund for the taxes we paid. For U.S. federal income tax purposes, the tax basis of shares owned by a stockholder generally will be increased by an amount equal to the difference between the amount of undistributed capital gains included in the stockholder’s gross income and the tax deemed paid by the stockholder as described in this paragraph. To utilize the deemed distribution approach, we must provide written notice to our stockholders prior to the expiration of 60 days after the close of the relevant taxable year. We cannot treat any of our investment company taxable income as a “deemed distribution.” We may also make actual distributions to our stockholders of some or all of realized net long-term capital gains in excess of realized net short-term capital losses.

For purposes of determining (1) whether the Annual Distribution Requirement is satisfied for any year and (2) the amount of capital gain dividends paid for that year, we may, under certain circumstances, elect to treat a dividend that is paid during the following taxable year as if it had been paid during the taxable year in question. If we make such an election, the U.S. stockholder will still be treated as receiving the dividend in the taxable year in which the distribution is made. However, any dividend declared by us in October, November or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of the following year, will be treated as if it had been received by our U.S. stockholders on December 31 of the year in which the dividend was declared. A U.S. stockholder generally will recognize taxable gain or loss if the U.S. stockholder sells or otherwise disposes of his, her or its shares of our common stock. Any gain arising from such sale or disposition generally will be treated as long-term capital gain or loss if the U.S. stockholder has held his, her or its shares for more than one year. Otherwise, it will be classified as short-term capital gain or loss. However, any capital loss arising from the sale or disposition of shares of our common stock held for six months or less will be treated as long-term capital loss to the extent of the amount of capital gain dividends received, or undistributed capital gain deemed received, with respect to such shares. In addition, all or a portion of any loss recognized upon a disposition of shares of our common stock may be disallowed if other shares of our common stock are purchased (whether through reinvestment of distributions or otherwise) within 30 days before or after the disposition. In such a case, the basis of the newly purchased shares will be adjusted to reflect the disallowed loss. For taxable years beginning before January 1, 2011, individual U.S. stockholders are subject to a maximum U.S. federal income tax rate of 15% on their net capital gain (*i.e.*, the excess of realized net long-term capital gain over realized net short-term capital loss for a taxable year) including any long-term capital gain derived from an investment in our shares. Such rate is lower than the maximum rate on ordinary income currently payable by individuals. Corporate U.S. stockholders currently are subject to U.S. federal income tax on net capital gain at the maximum 35% rate also applied to ordinary income. Non-corporate stockholders with net capital losses for a year (*i.e.*, capital losses in excess of capital gains) generally may deduct up to \$3,000 of such losses against their ordinary income each year (\$1,500 for married individuals filing separately); any net capital losses of a non-corporate stockholder in excess of \$3,000 (\$1,500 for married individuals filing separately) generally may be carried forward and used in subsequent years as provided in the Code. Corporate stockholders generally may not deduct any net capital losses for a year, but may carry back such losses for three years or carry forward such losses for five years.

Distributions are taxable to stockholders even if they are paid from income or gains earned by us before a stockholder's investment (and thus were included in the price the stockholder paid). If an investor purchases shares of our common stock shortly before the record date of a distribution, the price of the shares will include the value of the distribution and the investor will be subject to tax on the distribution even though economically, it may represent a return of his, her or its investment. Distributions are taxable whether stockholders receive them in cash or reinvest them in additional shares through the Dividend Reinvestment Plan. A stockholder whose distributions are reinvested in shares will be treated as having received a dividend equal to either (i) the fair market value of the shares issued to the stockholder (if we issue new shares), or (ii) the amount of cash allocated to the stockholder for the purchase of shares on its behalf (if we purchase shares on the open market). We will send to each of our U.S. stockholders, as promptly as possible after the end of each calendar year, a notice detailing, on a per share and per distribution basis, the amounts includible in such U.S. stockholder's taxable income for such year as ordinary income and as long-term capital gain. In addition, the U.S. federal tax status of each year's distributions generally will be reported to the IRS (including the amount of dividends, if any, eligible for the 15% "qualified dividend income" rate). Distributions may also be subject to additional state, local and foreign taxes depending on a U.S. stockholder's particular situation. Dividends distributed by us generally will not be eligible for the corporate dividends-received deduction or the preferential rate applicable to "qualified dividend income."

We may be required to withhold U.S. federal income tax ("backup withholding"), currently at a rate of 28%, from all distributions to any non-corporate U.S. stockholder (1) who fails to furnish us with a correct taxpayer identification number or a certificate that such stockholder is exempt from backup withholding, or (2) with respect to whom the IRS notifies us that such stockholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect. An individual's taxpayer identification number is his or her social security number. Any amount withheld under backup withholding is allowed as a credit against the U.S. stockholder's federal income tax liability, provided that proper information is provided to the IRS.

Under Treasury regulations, if a stockholder recognizes a loss with respect to our shares of \$2 million or more for an individual stockholder or \$10 million for a corporate stockholder, the stockholder must file with the IRS a disclosure statement on Form 8886. Direct stockholders of portfolio securities are in many cases excepted from this reporting requirement, but under current guidance, stockholders of a RIC are not excepted. Future guidance may extend the current exception from this reporting requirement to stockholders of most or all RICs. The fact that a loss is reportable under these regulations does not affect the legal determination of whether a taxpayer's treatment of the loss is proper. Stockholders should consult their tax advisors to determine the applicability of these regulations in light of their individual circumstances.

### **Taxation of Non-U.S. Stockholders**

Whether an investment in the shares is appropriate for a non-U.S. stockholder will depend upon that person's particular circumstances. Non-U.S. stockholders should consult their tax advisors before investing in our common stock. In general, dividend distributions (other than certain distributions derived from net long-term capital gains, certain interest income and short term capital gains, as described below) paid by us to a non-U.S. stockholder are subject to withholding of U.S. federal income tax at a rate of 30% (or lower applicable treaty rate) even if they are funded by income or gains that, if paid to a non-U.S. stockholder directly, would not be subject to withholding. If the distributions are effectively connected with a U.S. trade or business of the non-U.S. stockholder, (and, if an income tax treaty applies, attributable to a permanent establishment in the United States), we will not be required to withhold federal tax if the non-U.S. stockholder complies with applicable certification and disclosure requirements, although the distributions will be subject to U.S. federal income tax at the rates applicable to U.S. stockholders. (Special certification requirements apply to a non-U.S. stockholder that is a foreign partnership or a foreign trust and such entities are urged to consult their tax advisors.) For taxable years beginning prior to January 1, 2008, except as provided below, we generally will not be required to withhold any amounts with respect to certain distributions of (1) U.S.-source interest income that meets certain requirements, and (2) net short-term capital gains in excess of net long-term capital losses, in each case to the extent we properly designate such distributions. We intend to make such designations. In respect of distributions described in clause (1) above, however, we will be required to withhold amounts with respect to distributions to a non-U.S. stockholder:

- that has not provided a satisfactory statement that the beneficial owner is not a U.S. person;
- to the extent that the dividend is attributable to certain interest on an obligation if the non-U.S. stockholder is the issuer or is a 10% stockholder of the issuer;
- that is within certain foreign countries that have inadequate information exchange with the United States; or
- to the extent the dividend is attributable to interest paid by a person that is a related person of the non-U.S. stockholder and the non-U.S. stockholder is a "controlled foreign corporation" for U.S. federal income tax purposes.

Actual or deemed distributions of our net capital gain to a non-U.S. stockholder, and gains realized by a non-U.S. stockholder upon the sale of our common stock, will not be subject to U.S. federal withholding tax and generally will not be subject to U.S. federal income tax unless the distributions or gain, as the case may be, are effectively connected with a U.S. trade or business of the non-U.S. stockholder (and, if an income tax treaty applies, are attributable to a permanent establishment maintained by the non-U.S. stockholder in the U.S.), or in the case of an individual stockholder, the stockholder is present in the U.S. for a period or periods aggregating 183 days or more during the year of the sale or capital gain dividend and certain other conditions are met. If we distribute our net capital gain in the form of deemed rather than actual distributions, a non-U.S. stockholder will be entitled to a U.S. federal income tax credit or tax refund equal to the stockholder's allocable share of the tax we pay on the capital gains deemed to have been distributed. To obtain the refund, the non-U.S. stockholder must obtain a U.S. taxpayer identification number and file a U.S. federal income tax return even if the non-U.S. stockholder would not otherwise be required to obtain a U.S. taxpayer identification number or file a U.S. federal income tax return. For a corporate non-U.S. stockholder, distributions (both actual and deemed), and gains realized upon the sale of our common stock that are effectively connected to a U.S. trade or business may, under certain circumstances, be subject to an additional "branch profits tax" at a 30% rate (or at a lower rate if provided for by an applicable treaty).

A non-U.S. stockholder who is a non-resident alien individual, and who is otherwise subject to withholding of U.S. federal tax, may be subject to information reporting and backup withholding of U.S. federal income tax on dividends unless the non-U.S. stockholder provides us or the dividend paying agent with an IRS Form W-8BEN (or an acceptable substitute or successor form) or otherwise meets documentary evidence requirements for establishing that it is a non-U.S. stockholder or otherwise establishes an exemption from backup withholding. Investment in the shares may not be appropriate for a non-U.S. stockholder. Non-U.S. persons should consult their tax advisors with respect to the U.S. federal income tax and withholding tax, and state, local and foreign tax consequences of an investment in the shares.

## **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 dividend, then our stockholders who have not “opted out” of our dividend reinvestment plan will have their cash dividends 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 their cash dividend reinvested in shares of our common stock. A registered stockholder may elect to receive an entire dividend 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 dividends 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 dividends 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 dividends 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 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. The number of shares of our common stock to be outstanding after giving effect to payment of the dividend cannot be established until the value per share at which additional shares will be issued has been determined and elections of our stockholders have been tabulated.

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 dividends 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 dividends will not be affected by the form in which you receive them. See “Certain United States Federal Income Tax Considerations.”

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 common stock involves a high degree of risk. The risks set forth below are not the only risks we face. If any of the following risks occur, our business, financial condition and results of our operations could be materially adversely affected. In such case, the net asset value and the trading price of our common stock could decline, and you may lose all or part of your investment.*

### **Risks Related to Our Business**

#### ***We have a limited operating history.***

We were organized in August 2006 to continue the middle market investment business and asset management business of Katonah Debt Advisors, which was organized in 2005 by Kohlberg & Co. Katonah Debt Advisors commenced its asset management operations with the hiring of E.A. Kratzman, its President (who also serves as our Vice President and a member of our Investment Committee), in June 2005 and began its middle market lending operations in February 2006 with the hiring of Dayl W. Pearson, who serves as our President and CEO and as one of our directors, and R. Jon Corless, who serves as our CIO. In December 2006, we completed an initial public offering of our common stock and our common stock was listed on The Nasdaq Global Select Market. We have a limited operating history. As a result, we have limited operating results which demonstrate our ability to manage our business. We are subject to all of the business risks and uncertainties associated with any new business enterprise, including the risk that we will not achieve our investment objective and that the value of your investment in us could decline substantially.

#### ***We are dependent upon 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 objective 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 and our Board of Directors. The departure of any of the members of our senior management or a significant number of our senior personnel could have a material 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.

#### ***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 plan to make in prospective portfolio companies. We compete with other BDCs, as well as a large 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, technical, 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 comparable to or 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 and increased risk of credit losses. 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 have greater experience operating under, or 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. Although Kohlberg & Co. has agreed to notify us of equity investment opportunities that are presented to Kohlberg & Co. but do not fit the investment profile of Kohlberg & Co. or its affiliates, no such referral to date has resulted in an investment by us or Katonah Debt Advisors.

#### ***If we are unable to source investments effectively, we may be unable to achieve our investment objective.***

Our ability to achieve our investment objective depends on our senior management team's ability to identify, evaluate, finance 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 and our investment professionals may also be called upon to provide managerial assistance to our portfolio companies. 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 assure you that any such employees will contribute to the success of our business or that we will implement such systems effectively. Failure to manage our future growth effectively could have a material adverse effect on our business, financial condition and results of operations.

***There is a risk that we may not make distributions.***

We intend to continue to make distributions on a quarterly basis to our stockholders. We may not be able to achieve operating results that will allow us to make distributions at historical or any specific levels or to increase the amount of these distributions from time to time. In addition, due to the asset coverage test applicable to us as a BDC, depending on the types of debt and equity securities we have outstanding, we may be limited in our ability to make distributions. See “Distributions” and “LEVERAGE.” Also, restrictions and provisions in our Facility may limit our ability to make distributions. If we do not distribute a certain percentage of our income annually, we could fail to qualify for tax treatment as a RIC and we would be subject to corporate level U.S. federal income tax. Furthermore, in accordance with current IRS guidance, we may make distributions under special circumstances that would allow us to meet our annual RIC distribution requirement for 2009 (and perhaps subsequent years) by distributing shares of our stock in lieu of a significant portion of the cash (or other property other than our stock) that we would otherwise be required to distribute to satisfy such distribution requirement. See “Certain United States Federal Income Tax Considerations.” We cannot ensure that we will make distributions at historical or any other specified levels or at all.

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

In accordance with accounting principles generally accepted in the United States (“GAAP”) and the Code, we include in income certain amounts that we have not yet received in cash, such as contracted payment-in-kind (“PIK”) interest, which represents contractual interest added to the loan balance and due at the end of the loan term. In addition to the cash yields received on our loans, in some instances, certain loans may also include any of the following: end of term payments, exit fees, balloon payment fees or prepayment fees. The increases in loan balances as a result of contracted PIK arrangements are included in income for the period in which such 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 “original issue discount” for tax purposes, which we must recognize as ordinary income, increasing the amounts we are required to distribute to qualify as a RIC eligible for pass-through tax treatment. 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, resulting in a dividend distribution requirement in excess of current cash received. Since in certain cases we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute 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. If we are unable to meet these distribution requirements, we will not qualify for tax treatment as a RIC or, even if such distribution requirement is satisfied, we may be subject to tax on the amount that is undistributed. Accordingly, we may have to sell some of our assets, raise additional debt or equity securities or reduce new investment originations to meet these distribution requirements and avoid tax. See “Certain United States Federal Income Tax Considerations.”

***We may incur losses as a result of “first loss” agreements into which we or Katonah Debt Advisors may enter in connection with warehousing credit arrangements which we put in place prior to raising a CLO Fund and pursuant to which we agree to reimburse credit providers for a portion of losses (if any) on warehouse investments.***

We and Katonah Debt Advisors may, in the future, enter into “first loss” agreements in connection with warehouse credit lines to be established by Katonah Debt Advisors to fund the initial accumulation of loan investments for future CLO Funds that Katonah Debt Advisors will manage. Such agreements (referred to as “first loss agreements” or “first loss obligations”) frequently relate to (i) losses as a result of individual loan investments being ineligible for purchase by the CLO Fund (typically due to a payment default on such loan) 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. As a result, we 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. For example, as a result of an engagement letter with Bear Stearns & Co. Inc., we have agreed to make certain payments to JP Morgan, Inc. in connection with a settlement of claims. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – COMMITMENTS.”

***Any unrealized losses we experience on our loan portfolio may be an indication of future realized losses, which could reduce our income available for distribution.***

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 procedures approved by our Board of Directors. Decreases in the market values or fair values of our investments will be recorded as unrealized losses. Any unrealized losses in our loan portfolio could be an indication of a portfolio company's inability to meet its repayment obligations to us with respect to the affected loans. This could result in realized losses in the future and ultimately in reductions of our income available for distribution in future periods.

***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, the default rate on such securities, the level of our expenses, variations in and the 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. Also, an increase in interest rates available to investors could make investment in our common stock less attractive if we are not able to increase our dividend rate, which could reduce the value of our common stock.

***The debt we incur could increase the risk of investing in our Company.***

As of December 31, 2008, we had \$262 million of outstanding indebtedness, which accrues interest based on prevailing commercial paper rates plus 0.85% (or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread) and matures on September 29, 2010. Lenders have fixed dollar claims on our assets that are superior to the claims of our stockholders, and we may grant a security interest in our assets in connection with our borrowings. In the case of a liquidation event, those lenders would receive proceeds before our stockholders. In addition, borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. Leverage is generally considered a speculative investment technique. If the value of our assets increases, then leverage would cause the net asset value attributable to our common stock to increase more than it otherwise would have had we not leveraged. Conversely, if the value of our assets decreases, leverage would cause the net asset value attributable to our common stock to decline more than it otherwise would have had we not used leverage. Similarly, any increase in our revenue in excess of interest expense on our borrowed funds would cause our net income to increase more than it would without leverage. Any decrease in our revenue would cause our net income to decline more than it would have had we not borrowed funds and could negatively affect our ability to make distributions on our common stock. Our ability to service any debt that we incur will depend largely on our financial performance and will be subject to prevailing economic conditions and competitive pressures. The current economic environment and the availability of credit, which is severely limited, affected our ability to extend the Facility and we may not be able to enter into another facility as a result of such conditions should they continue.

As a BDC, we are generally required to meet a coverage ratio of total assets to total borrowings and other senior securities, which include all of our borrowings and other debt securities and any preferred stock we may issue in the future, of at least 200%. If this ratio declines below 200%, we may not be able to incur additional debt and may need to sell a portion of our investments to repay some debt when it is disadvantageous to do so, and we may not be able to make distributions. As of December 31, 2008, we had \$262 million of outstanding borrowings and our asset coverage ratio was 196%, primarily as a result of unrealized fair value losses on our investments. Until the minimum asset coverage level is met, we will be unable to incur additional debt or issue securities senior to our common stock. As a result, we will be severely limited in our ability to raise capital to make new investments until our asset coverage ratio exceeds 200%. However, because we have no public debt or preferred stock outstanding, failure to maintain asset coverage of at least 200% will not limit our ability, under the 1940 Act, to pay dividends from our net investment income.

As of March 12, 2009, our Facility balance was approximately \$245 million and our asset coverage ratio was approximately 209%, above the minimum asset coverage level generally required for a BDC by the 1940 Act. Under our Facility, we must maintain a leverage ratio covenant of at least one to one based on the ratio of the Facility outstanding balance to our most recently reported GAAP stockholders' equity balance (determined quarterly in conjunction with the Company's financial reporting filings with the Securities and Exchange Commission) as of the Facility outstanding balance determination date. At year-end, our leverage ratio covenant was met using the December 31, 2008 Facility balance and the latest filed quarterly stockholders' equity balance which, at that time, was as of September 30, 2008. We remain in compliance with the leverage covenant ratio based on the March 12, 2009 Facility balance and the GAAP stockholders' equity balance as of September 30, 2008.

***Because we have outstanding indebtedness, we are exposed to additional risks, including the typical risks associated with leverage.***

We borrow funds or may issue senior securities, pursuant to our existing Facility or other agreements, to make additional investments. 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% after such borrowing or issuance. The amount of leverage that we employ 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. Leverage involves risks and special considerations of stockholders, including:

- a likelihood of greater volatility of net asset value and market price of our common stock than a comparable portfolio without leverage;
- exposure to increased risk of loss if we incur debt or issue senior securities to finance investments because a decrease in the value of our investments would have a greater negative impact on our returns and therefore the value of our common stock than if we did not use leverage;
- that the covenants contained in the documents governing the Facility or other debt instruments could restrict our operating flexibility. Such covenants may impose asset coverage or investment portfolio composition requirements that are more stringent than those imposed by the 1940 Act and could require us to liquidate investments at an inopportune time; and
- that we, and indirectly our stockholders, will bear the cost of leverage, including issuance and servicing costs (*i.e.*, interest).

Any requirement that we sell assets at a loss to redeem or pay interest or dividends on any leverage, or for other reasons, would reduce our net asset value and also make it difficult for the net asset value to recover. Our Board of Directors, in their judgment, nevertheless may determine to use leverage if they expect that the benefits to our stockholders of maintaining the leveraged position will outweigh the risks.

***The agreements governing our Facility contain various covenants that limit our discretion in operating our business and also include certain financial covenants.***

We have entered into a credit facility that is backed by a revolving pool of loans. Under the Facility, we are subject to limitations as to how borrowed funds may be used, including restrictions on geographic and industry concentrations, loan size, payment frequency and status, average life, collateral interests and investment ratings, as well as regulatory restrictions on leverage which may affect the amount of funding that may be obtained. There are also certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, a violation of which could result in the early amortization of the Facility, limit further advances and, in some cases, result in an event of default. An event of default under the Facility would result, among other things, in the termination of the availability of further funds under the Facility and an accelerated maturity date for all amounts outstanding under the Facility, which would likely disrupt our business and, potentially, the portfolio companies whose loans we financed through the Facility. This could reduce our revenues and, by delaying any cash payment allowed to us under the Facility until the lender has been paid in full, reduce our liquidity and cash flow and impair our ability to grow our business and maintain our qualification as a RIC. If we default under certain provisions of the Facility, the remedies available to the lender may limit our ability to declare dividends.

During September 2008, we were notified by the lenders that the liquidity banks providing the underlying funding for the Facility did not intend to renew their liquidity facility to the lenders unless we agreed to certain revised terms for the Facility. As a result, the lenders proposed new terms to us in order to extend additional fundings under the Facility. We viewed such proposed terms as unfavorable and have opted to forego the revolving credit feature of the Facility and to amortize existing borrowings under the Facility. In accordance with the terms of the Facility, all principal and interest collected from the assets securing the Facility are used to amortize the Facility through a termination date of September 29, 2010 (the "amortization period"). During the amortization period, the interest rate will continue to be based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread.

We believe we have sufficient cash and liquid assets to fund normal operations and dividend distributions. However, because we are required to use interest income earned on the assets securing the Facility to amortize the Facility during the amortization period, we may need to sell other assets not pledged to secure the Facility, potentially at a loss, in order to generate sufficient cash to make the required dividend distributions necessary to maintain our RIC status. In addition, at the end of the amortization period, we may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings or we may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

Under our Facility, we must maintain a leverage ratio covenant of at least one to one based on the ratio of the Facility outstanding balance to our most recently reported GAAP stockholders' equity balance (determined quarterly in conjunction with the Company's financial reporting filings with the Securities and Exchange Commission) as of the Facility outstanding balance determination date. At year-end, our leverage ratio covenant was met using the December 31, 2008 Facility balance and the latest filed quarterly stockholders' equity balance which, at that time, was as of September 30, 2008. We remain in compliance with the leverage covenant ratio based on the March 12, 2009 Facility balance and the GAAP stockholders' equity balance as of September 30, 2008.

***Because we intend 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 qualify as a RIC, to avoid payment of excise taxes and to minimize or avoid payment of income taxes, we intend 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 income taxes with respect thereto, and elect to treat as deemed distributions to our stockholders). As a BDC, 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%. 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. While we expect to be able to borrow and to issue additional debt and equity securities, 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 any of our outstanding borrowings. In addition, as a BDC, we are generally not permitted to 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, and our net asset value could decline. On March 13, 2007, June 8, 2007, September 24, 2007, December 14, 2007, March 14, 2008, June 13, 2008, September 19, 2008 and December 19, 2008 we declared dividends in the amount of \$0.29 per share, \$0.35 per share, \$0.37 per share, \$0.39 per share, \$0.41 per share, \$0.41 per share, \$0.35 per share and \$0.27 per share, respectively. These dividends represented our estimated distributable income for the quarters ended March 31, 2007, June 30, 2007, September 30, 2007, December 31, 2007, March 31, 2008, June 30, 2008, September 30, 2008, and December 31, 2008, respectively, plus a portion of our undistributed 2006 distributable income.

***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 (except as required by the 1940 Act) 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, operating results and value of our stock. Nevertheless, the effects may adversely affect our business and impact our ability to make distributions.

## 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 and selected equity investments issued by middle market companies.

*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 addition, when we invest in senior secured loans or mezzanine debt, we may acquire warrants. 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;
- 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 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.

***Our portfolio investments for which there is no readily available market, including our investment in Katonah Debt Advisors, 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 procedures approved by our Board of Directors. These valuations are initially prepared by our management and reviewed by our Valuation Committee which utilizes its best judgment in arriving at the fair value of these securities. However, the Board of Directors retains ultimate authority as to the appropriate valuation of each investment. Where appropriate, our Board of Directors utilizes the services of an independent valuation firm to aid it in determining fair value, particularly in the case of our investments in CLO Funds and in Katonah Debt Advisors, which are valued quarterly, and investments in mezzanine and equity securities, which are valued regularly. The independent valuation firm provides third-party valuation consulting services, which consist of certain limited procedures that we identify and request the independent valuation firm to perform. 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. The value of our investment in Katonah Debt Advisors is determined based on a percentage of the assets under management and a multiple of its operating income, both of which are based, in part, on an analysis of the valuation of comparable asset management companies. 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 or from the valuations that would be placed on our assets by other market participants. Our net asset value could be adversely affected if our determinations regarding the fair value of our investments were materially higher than the values that we ultimately realize upon the disposal of such securities, particularly if we are forced to sell securities in a distressed market to fund operations.

***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, 2008, our largest investment, our 100% equity interest in Katonah Debt Advisors, equaled approximately 11% of the fair value of our investments. Beyond the asset diversification requirements associated with our qualification as a RIC (as described further in "Certain United States Federal Income Tax Considerations"), 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. In accordance with our current policy, we will not "concentrate" our investments, that is, invest 25% or more of our assets in any particular industry (determined at the time of investment). However, 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 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.

***Economic recessions or downturns could negatively impact our portfolio companies and harm our operating results.***

Many of our portfolio companies may be susceptible to economic slowdowns or recessions and may be unable to repay our loans during these periods. Therefore, our non-performing assets are likely to increase and the value of our portfolio is likely to decrease during these periods. Adverse economic conditions may also decrease the value of collateral securing some of our loans and the value of our equity investments. Economic slowdowns or recessions could lead to financial losses in our portfolio and a decrease in revenues, net income and assets. 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 prevent us from increasing investments and harm our operating results. For instance, the freezing up of the credit markets and lack of investments in general reduce our ability to make additional investments.

***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.

***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.

***Our portfolio companies may incur debt that ranks equally 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 equally 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 equally 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.

***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 if we actually render significant managerial assistance.

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

We may 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.

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

We 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. As a result, we do not expect to achieve liquidity in our investments in the near-term. 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.

***We may not receive all or a portion of the income we expect to continue to receive from Katonah Debt Advisors.***

We expect to receive distributions of recurring fee income, after the payment of its expenses, from the asset management activities of Katonah Debt Advisors. However, the existing asset management agreements pursuant to which Katonah Debt Advisors receives such fee income from the CLO Funds for which it serves as manager 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 Katonah Debt Advisors of the indenture governing the applicable CLO Fund, breaches by Katonah Debt Advisors of certain specified provisions of the indenture, material breaches of representations or warranties made by Katonah Debt Advisors, bankruptcy or insolvency of Katonah Debt Advisors, fraud or criminal activity on the part of Katonah Debt Advisors 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 Katonah Debt Advisors 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 to pay the subordinated management fees, we will not receive the fee income that we expect to continue to receive from Katonah Debt Advisors, which will reduce income available to make distributions to our stockholders.

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

As of December 31, 2008, we had \$57 million invested in the subordinated securities or preferred shares issued by CLO Funds managed by Katonah Debt Advisors and certain other third party asset managers. We expect to continue to acquire subordinated securities in the future in CLO Funds managed by Katonah Debt Advisors and/or third party managers. These subordinated securities are the most junior class of securities issued by the CLO Funds and are subordinated in priority of payment to each 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 default loans or individual fund assets, the value of the subordinated securities at their redemption could be reduced. Additionally, we may not be able to continue to complete new CLO Funds due to prevailing CLO market conditions or other factors.

#### **Risks Related to Our Operation as a BDC**

***Our management team has limited experience managing a BDC.***

The 1940 Act imposes numerous constraints on the operations of BDCs. For example, BDCs are required to invest at least 70% of their total assets in specified types of securities, primarily in private companies or thinly traded U.S. public companies, cash, cash equivalents, U.S. government securities and other high quality debt investments that mature in one year or less. See “Regulation.” Our management team’s limited experience in managing a portfolio of assets under such constraints may hinder our ability to take advantage of attractive investment opportunities and, as a result, achieve our investment objective. Furthermore, any failure to comply with the requirements imposed on BDCs by the 1940 Act could cause the SEC to bring an enforcement action against us and/or expose us to claims of private litigants. If we do not remain a BDC, we might be regulated as a closed-end investment management company under the 1940 Act, which would further decrease our operating flexibility and may prevent us from operating our business as described in this Annual Report. See “Election to be Regulated as a Business Development Company and a Regulated Investment Company.”

Furthermore, our management team’s limited experience in managing a BDC that qualifies as a RIC, which is subject to operating limitations under the Code, may hinder our ability to invest in certain assets that might otherwise be part of our investment strategy, thus reducing the return on your investment. For a description of the requirements to maintain RIC pass-through tax treatment, please see “Certain United States Federal Income Tax Considerations.”

***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 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 generally are prohibited from buying or selling any security 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 are prohibited from buying or selling any security from or to such person or certain of that person’s affiliates, or entering into prohibited joint transactions with such persons, absent the prior approval of the SEC. Similar restrictions limit our ability to transact business with our officers or directors or their affiliates. As a result of these restrictions, we may be prohibited from buying or selling any security from or to any portfolio company of a private equity fund managed by Kohlberg & Co. without the prior approval of the SEC. In addition, we may co-invest on a concurrent basis with Kohlberg & Co. or any of our affiliates, subject to compliance with existing regulatory guidance, applicable regulations and our allocation procedures. Certain types of negotiated co-investments may be made only if we receive an order from the SEC permitting us to do so. There can be no assurance that any such order will be obtained.

***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% after such issuance or incurrence. Depending on the type of debt or preferred stock we have outstanding, our ability to pay dividends or issue additional senior securities may be restricted if our asset coverage ratio were not at least 200%. If the value of our assets declines, we may be unable to satisfy this test. If that happens, we may be required to liquidate a portion of our investments and repay a portion of our indebtedness at a time when such sales may be disadvantageous.

- *Senior Securities.* As a result of issuing senior securities, we would also be exposed to typical risks associated with leverage, including an increased risk of loss. If we issue preferred securities they would rank “senior” to common stock in our capital structure. Preferred stockholders would have separate voting rights and may have rights, preferences or privileges more favorable than those of our common stock. Furthermore, the issuance of preferred securities could have the effect of delaying, deferring or preventing a transaction or a change of control that might involve a premium price for our common stockholders or otherwise be in your best interest.
- *Additional Common Stock.* Our Board of Directors may decide to issue common stock to finance our operations rather than issuing debt or other senior securities. As a BDC, we are generally not able to issue our common stock at a price below net asset value without first obtaining required approvals from our stockholders and our independent directors; we received the required stockholder approval at a special meeting on July 21, 2008 (this approval is valid for one year from the date of such approval). In any such case, the price at which our securities are to be issued and sold may not be less than a price, that in the determination of our Board of Directors, closely approximates the market value of such securities (less any 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 the 1940 Act. If we raise additional funds by issuing more common stock or senior securities convertible into, or exchangeable for, our common stock, the percentage ownership of our stockholders at that time would decrease, and you may experience dilution.
- *Securitization.* In addition to issuing securities to raise capital as described above, we securitize a portion of our loans to generate cash for funding new investments through our Facility. To securitize loans, we have created a wholly-owned subsidiary and contributed a pool of loans to the subsidiary. An inability to successfully securitize our loan portfolio could limit our ability to grow our business and fully execute our business strategy and adversely affect our earnings, if any. Moreover, the 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, or changes in the interpretations thereof, and any failure by us 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, 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 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. 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.

***If we do not invest a sufficient portion of our assets in “qualifying assets,” we could fail to qualify as a BDC or 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 “Regulation.”

We believe that most of the senior loans and mezzanine investments that we acquire constitute “qualifying assets.” However, investments in the equity securities of CLO Funds generally do not qualify as “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 or could lose our status as a BDC, 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 Katonah Debt Advisors’ 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) or could require us to dispose of investments at inappropriate times in order to come into compliance with the 1940 Act. If we need to dispose of such investments quickly, it would be difficult to dispose of such investments on favorable terms. For example, we may have difficulty in finding a buyer and, even if we do find a buyer, we may have to sell the investments at a substantial loss.

***If we are unable to qualify as a RIC under Subchapter M of the Code, we will be subject to corporate-level U.S. federal income tax, which will adversely affect our results of operations and financial condition.***

Provided we qualify as a RIC, we will generally not be subject to corporate-level U.S. federal income taxes on income distributed to our stockholders as dividends. We will not continue to qualify for pass-through tax treatment as a RIC, and thus will be subject to corporate-level U.S. federal income taxes, if we are unable to comply with the source-of-income, asset diversification and distribution requirements contained in the Code, or if we fail to maintain our election to be regulated as a BDC under the 1940 Act. Failure to meet the requirements for tax treatment as a RIC would subject us to taxes, which would reduce the return on your investment. As such, our failure to qualify for tax treatment as a RIC would have a material adverse effect on us, the net asset value of our common stock and the total return obtainable from your investment in our common stock. We may, from time to time, organize and conduct the business of our wholly-owned portfolio company, Katonah Debt Advisors, through additional direct or indirect wholly-owned subsidiaries which may, in some cases, be taxable as corporations. For additional information see “Regulation” and “Certain United States Federal Income Tax Considerations.”

**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, 6th 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***

We are not a party to any pending legal proceedings.

**Item 4.      *Submission of Matters to a Vote of Security Holders***

Not Applicable.

## PART II

### Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

#### PRICE RANGE OF COMMON STOCK

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 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. 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 2006-2008

	High	Low	Close	NAV <sup>1</sup>
<b>2008:</b>				
Fourth quarter	\$ 8.41	\$ 3.14	\$ 3.64	\$ 11.68
Third quarter	\$ 11.01	\$ 8.07	\$ 8.59	\$ 12.97
Second quarter	\$ 13.35	\$ 9.41	\$ 10.00	\$ 13.14
First quarter	\$ 12.99	\$ 9.56	\$ 10.38	\$ 13.98
<b>2007:</b>				
Fourth quarter	\$ 15.49	\$ 10.00	\$ 12.00	\$ 14.38
Third quarter	\$ 19.10	\$ 13.65	\$ 15.06	\$ 14.77
Second quarter	\$ 19.68	\$ 15.75	\$ 18.55	\$ 15.39
First quarter	\$ 18.00	\$ 15.05	\$ 16.00	\$ 14.78
<b>2006:</b>				
Fourth quarter December 11, 2006—December 31, 2006	\$ 17.45	\$ 15.79	\$ 17.30	\$ 14.29

---

<sup>1</sup> Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low closing sales prices.

We began paying quarterly dividends 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 7—"Distributable Tax Income" from our Notes to the Financial Statements included herein.

## Dividend Declarations

	<u>Dividend</u>	<u>Declaration Date</u>	<u>Record Date</u>	<u>Pay Date</u>
2008:				
Fourth quarter	\$ 0.27	12/19/2008	12/31/2008	1/29/2009
Third quarter	0.35	9/19/2008	10/9/2008	10/28/2008
Second quarter	0.41	6/13/2008	7/9/2008	7/28/2008
First quarter	0.41	3/14/2008	4/8/2007	4/28/2008
Total declared for 2008	<u>\$ 1.44</u>			
2007:				
Fourth quarter	\$ 0.39	12/14/2007	12/24/2007	1/24/2008
Third quarter	0.37	9/24/2007	10/10/2007	10/26/2007
Second quarter	0.35	6/8/2007	7/9/2007	7/23/2007
First quarter	0.29	3/13/2007	4/6/2007	4/17/2007
Total declared for 2007	<u>\$ 1.40</u>			

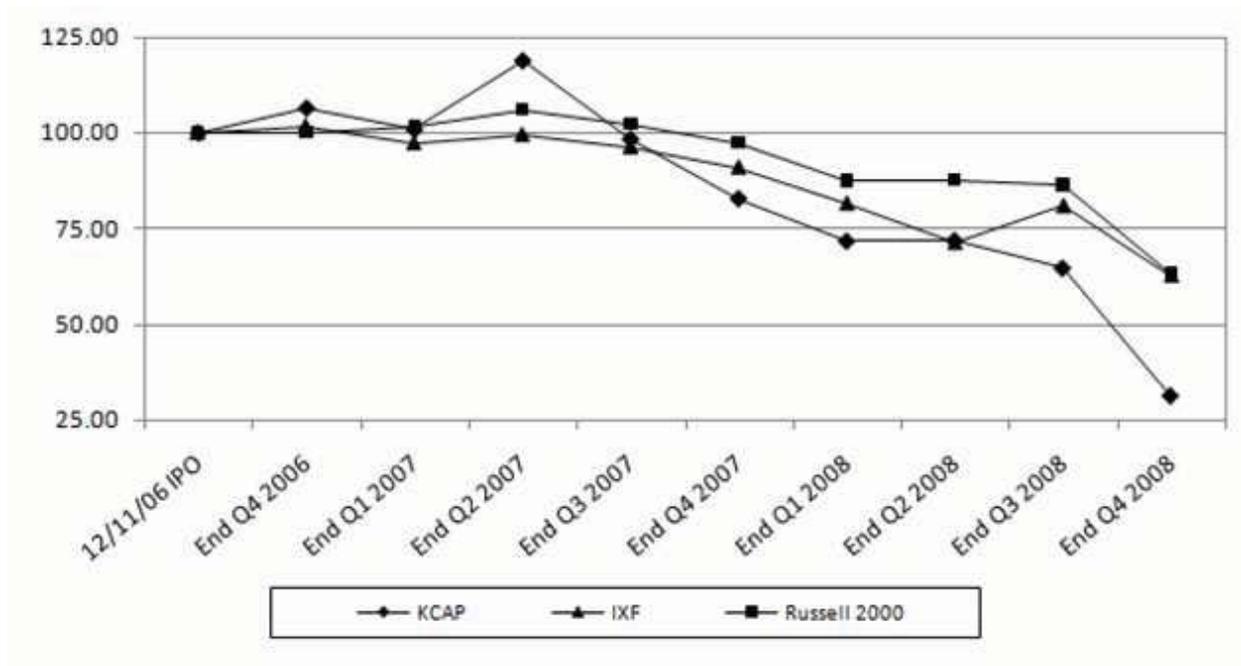
---

Note: No dividend was declared for the period from December 11, 2006 (inception) to December 31, 2006. The distributable income earned during this period was paid during 2007.

## 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, 2008. The graph assumes that, on December 11, 2006, a person invested \$100 in each of our common stock and the Russell 2000 Index. 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, 2008)**



<sup>1</sup> Total return includes reinvestment of dividends through December 31, 2008. 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 closer to Kohlberg Capital Corporation's than the companies represented by the S&P 500, which the Company used in previous disclosures.

**HOLDERS**

As of December 31, 2008, there were 19 shareholders of record of our common stock and approximately 7,900 beneficial shareholders of the Company.

**SALES OF UNREGISTERED SECURITIES**

We did not sell any securities during the period covered by this report that were not registered under the Securities Act. However, we issued 316,237 shares of common stock pursuant to a dividend reinvestment plan. See Note 9, "Stockholders' Equity," of our Notes to the Consolidated Financial Statements included herein.

**ISSUER PURCHASES OF EQUITY SECURITIES**

In November 2008, the Board of Directors approved a \$5 million share repurchase plan. Any share repurchases are subject to timing restrictions and other applicable regulations. We did not repurchase any shares of our common stock during the year ended December 31, 2008.

## **DIVIDEND POLICY**

We intend to continue to distribute quarterly dividends to our stockholders. Our quarterly dividends, 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 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% 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. If this requirement is not met, we will be required to pay a nondeductible excise tax equal to 4% of the amount by which 98% of the current year's taxable income exceeds the 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, if we incur public indebtedness or issue public senior securities, we may be prohibited from making distributions if doing so causes us to fail to maintain the asset coverage ratios stipulated by the 1940 Act or if distributions are limited by the terms of any of our borrowings.

We maintain an "opt out" dividend reinvestment plan for our common stockholders. As a result, if we declare a dividend, then stockholders' cash dividends 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 dividends.

**Item 6. Selected Financial Data**

The following selected financial and other data for the period from December 11, 2006, the date of our initial public offering and conversion to a corporation, through December 31, 2006 and for the years ended December 31, 2007 and 2008 is derived from our financial statements. The data should be read in conjunction with our financial statements and notes thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which are included in this Annual Report.

**KOHLBERG CAPITAL CORPORATION  
SELECTED FINANCIAL DATA**

	Year Ended December 31, 2008	Year Ended December 31, 2007 <sup>1</sup>	For the Period December 11, 2006 (inception) through December 31, 2006 <sup>1</sup>
<b>Income Statement Data:</b>			
Interest and related portfolio income:			
Interest and Dividends	\$ 46,208,978	\$ 37,219,713	\$ 1,110,109
Fees and other income	1,653,232	759,301	41,794
Dividends from affiliate asset manager	1,350,000	500,000	—
<b>Total interest and related portfolio income</b>	<b>49,212,210</b>	<b>38,479,014</b>	<b>1,151,903</b>
Expenses:			
Interest and amortization of debt issuance costs	10,925,624	7,229,597	—
Compensation	3,940,638	4,104,761	175,186
Other	3,640,031	4,385,707	487,254
<b>Total operating expenses</b>	<b>18,506,293</b>	<b>15,720,065</b>	<b>662,440</b>
<b>Net Investment Income</b>	<b>30,705,917</b>	<b>22,758,949</b>	<b>489,463</b>
Realized and unrealized gains (losses) on investments:			
Net realized gains (losses)	(575,179)	266,317	1,077
Net change in unrealized gains (losses)	(39,698,065)	3,116,719	4,180,000
<b>Total net gains (losses)</b>	<b>(40,273,244)</b>	<b>3,383,036</b>	<b>4,181,077</b>
<b>Net increase in net assets resulting from operations</b>	<b>\$ (9,567,327)</b>	<b>\$ 26,141,985</b>	<b>\$ 4,670,540</b>
<b>Per Share:</b>			
Earnings per common share—basic	\$ (0.47)	\$ 1.45	\$ 0.26
Net investment income plus net realized gains per share—basic	\$ 1.49	\$ 1.28	\$ 0.03
Net investment income plus net realized gains per share—diluted	\$ 1.47	\$ 1.28	\$ 0.03
Dividends declared per common share	\$ 1.44	\$ 1.40	\$ —
<b>Balance Sheet Data:</b>			
Investment assets at fair value	\$ 514,225,273	\$ 521,006,947	\$ 281,087,215
Total assets	\$ 522,872,311	\$ 533,141,959	\$ 282,375,847
Total debt outstanding	\$ 261,691,148	\$ 255,000,000	\$ —
Stockholders' equity	\$ 250,282,100	\$ 259,068,164	\$ 256,400,423
Net asset value per common share	\$ 11.68	\$ 14.38	\$ 14.29
Common shares outstanding at end of year	21,436,936	18,017,699	17,946,333
<b>Other Data:</b>			
Investments funded <sup>2</sup>	109,442,643	373,852,286	191,706,724
Principal collections related to investment repayments or sales <sup>2</sup>	72,345,600	104,037,559	533,315
Number of portfolio investments at year end <sup>2</sup>	149	145	86
Weighted average yield of income producing debt investments <sup>3</sup>	7.0%	9.5%	9.0%

<sup>1</sup> Certain prior year amounts have been reclassified to conform to current year presentation.

<sup>2</sup> Does not include investments in time deposits or money markets

<sup>3</sup> Weighted average yield of income producing debt investments is calculated as the average yield to par outstanding balances for investments in loans and mezzanine debt. The yields on CLO equities and investment in our wholly-owned portfolio manager, Katonah Debt Advisors, are excluded.



## **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 "Risk Factors" and "Note about Forward-Looking Statements" appearing elsewhere herein.*

### **OVERVIEW**

We are an internally managed, non-diversified closed-end investment company that has elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940, as amended (the "1940 Act"). We originate, structure and invest in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies. We define the middle market as comprising companies with earnings before interest, taxes, depreciation and amortization, which we refer to as "EBITDA," of \$10 million to \$50 million and/or total debt of \$25 million to \$150 million. In addition to our middle market investment business, our wholly-owned portfolio company, Katonah Debt Advisors and its affiliates (collectively, "Katonah Debt Advisors"), manage collateralized loan obligation funds ("CLO Funds") that invest in broadly syndicated loans, high-yield bonds and other corporate credit instruments. We acquired Katonah Debt Advisors and certain related assets prior to our initial public offering from affiliates of Kohlberg & Co., LLC ("Kohlberg & Co."), a leading private equity firm focused on middle market investing. As of December 31, 2008, Katonah Debt Advisors had approximately \$2.1 billion of assets under management.

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

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

Our common stock is traded on The NASDAQ Global Select Market under the symbol "KCAP." The net asset value per share of our common stock at December 31, 2008 was \$11.68. On December 31, 2008, the last reported sale price of a share of our common stock on The NASDAQ Global Select Market was \$3.64.

### **CRITICAL ACCOUNTING POLICIES**

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

#### **Basis of Presentation**

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States. The financial statements reflect all adjustments and reclassifications which, in the opinion of management, are necessary for the fair presentation of the Company's results of operations and financial condition for the periods presented.

#### **Valuation of Portfolio Investments**

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

Value, as defined in Section 2(a)(41) of 1940 Act, is (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.

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

Effective January 1, 2007 we adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements ("SFAS 157"), which among other things, requires enhanced disclosures about financial instruments carried at fair value. See Note 4, "Investments," of our Notes to the Consolidated Financial Statements included herein for additional information about the level of market observability associated with investments carried at fair value.

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

Our investments in CLO Fund securities are carried at fair value, which is based either on (i) the present value of the net expected cash inflows for interest income and principal repayments from underlying assets and the cash outflows for interest expense, debt paydown and other fund costs for the CLO Funds which are approaching or past the end of their reinvestment period and therefore begin to sell assets and/or use 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) the net asset value of the CLO Fund for CLO Funds which are approaching or past the end of their reinvestment period and therefore begin to sell assets and/or use principal repayments to pay-down CLO Fund debt, and for which there are negligible net cash distributions to the class of securities we own, or (iii) a discounted cash flow model for more recent CLO Funds that utilizes prepayment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar bonds or preferred shares to those in which the Company has invested. We recognize unrealized appreciation or depreciation on our investments in CLO Fund securities as comparable yields in the market change and/or based on changes in 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 Investment. We determine the fair value of our investments in CLO Fund securities on an individual security-by-security basis.

Our investment in Katonah Debt Advisors is carried at fair value and is based on multiple approaches to value which involve value drivers such as assets under management ("AUM"), cash flow, and earnings before income taxes, depreciation and amortization ("EBITDA"). These value drivers are analyzed in the context of both quantifiable historical experience and projected performance. AUM or earnings multiples from peer comparables are then applied to the value drivers to determine fair value. Our investments in Katonah Debt Advisors and CLO Fund securities are reviewed quarterly by Duff & Phelps, LLC, an independent valuation firm, who performs certain limited procedures that the Company's Board of Directors identified and requested, and whose conclusion is that the fair value of those investments subjected to the limited procedures did not appear to be unreasonable.

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 company. 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.

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

After our adoption of SFAS 157, investments measured and reported at fair value are classified and disclosed in one of the following categories:

- Level I – 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 SFAS 157, the Company does not adjust the quoted price for these investments, even in situations where we hold 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, and fair value is determined through the use of models or other valuation methodologies. Investments which are generally included in this category include illiquid corporate loans and bonds and less liquid, privately held or restricted equity securities for which some level of recent trading activity has been observed.
- Level III – Pricing inputs are unobservable for the investment and includes situations where there is little, if any, market activity for the investment. The inputs 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 process.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and it considers factors specific to the investment.

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, adjusted for amortization of premium and accretion of discount, is recorded on the accrual basis to the extent that such amounts are expected to be collected. We generally place a loan on non-accrual status and cease recognizing interest income on such loan or security when a loan or security becomes 90 days or more past due or if we otherwise do not expect the debtor to be able to service its debt obligations. Non-accrual loans remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due or such loans become current. As of December 31, 2008, two issuers representing 0.2% of our total investments at fair value were on non-accrual status. As of December 31, 2007, no loans or debt securities were greater than 90 days past due or on non-accrual status.

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

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

## **Dividends from Affiliate Asset Manager**

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

## **Payment in Kind Interest**

We may have loans in our portfolio that contain a payment-in-kind (“PIK”) provision. PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as interest income. To maintain our RIC status, this non-cash source of income must be paid out to stockholders in the form of dividends, even though the Company has not yet collected the 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 Kohlberg Capital Corporation 2006 Equity Incentive Plan as amended (our “Equity Incentive Plan”) to officers and employees for services rendered to us. We follow Statement of Financial Accounting Standards No. 123R (revised 2004), *Accounting for Stock-Based Compensation*, a method by which the fair value of options or restricted stock is determined and expensed. We use a Binary Option Pricing Model (American, call option) as its valuation model to establish the expected value of all stock option grants.

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

## **United States Federal Income Taxes**

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.

## **Dividends**

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

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

## PORTFOLIO AND INVESTMENT ACTIVITY

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

Total portfolio investment activity (excluding activity in time deposit and money market investments) for the years ended December 31, 2008 and December 31, 2007 was as follows:

	<u>Debt Securities</u>	<u>CLO Fund Securities</u>	<u>Equity Securities</u>	<u>Affiliate Asset Managers</u>	<u>Total Portfolio</u>
<b>2007 Activity:</b>					
Purchases / originations / draws	\$ 336,182,774	\$ 14,775,000	\$ 5,043,950	\$ 75,000	\$ 356,076,724
Pay-downs / pay-offs / sales	(104,037,559)	—	—	—	(104,037,559)
Net accretion of discount	260,848	416,264	—	—	677,112
Net realized gains	266,317	—	—	—	266,317
Increase (decrease) in fair value	<u>(12,485,682)</u>	<u>(5,041,264)</u>	<u>(291,700)</u>	<u>20,935,365</u>	<u>3,116,719</u>
Fair Value at December 31, 2007	\$ 410,954,082	\$ 31,020,000	\$ 4,752,250	\$ 58,585,360	\$ 505,311,692
<b>2008 Activity:</b>					
Purchases / originations / draws	\$ 71,949,153	\$ 28,859,236	\$ 212,710	\$ 5,478,276	\$ 106,499,376
Pay-downs / pay-offs / sales	(71,671,847)	—	—	—	(71,671,847)
Net accretion of discount	717,195	1,456,095	—	—	2,173,290
Net realized losses	(575,179)	—	—	—	(575,179)
Increase (decrease) in fair value	<u>(26,887,293)</u>	<u>(4,700,095)</u>	<u>(575,129)</u>	<u>(7,535,548)</u>	<u>(39,698,065)</u>
Fair Value at December 31, 2008	<u>\$ 384,486,111</u>	<u>\$ 56,635,236</u>	<u>\$ 4,389,831</u>	<u>\$ 56,528,088</u>	<u>\$ 502,039,266</u>

Following completion of our initial public offering, we used approximately \$185 million of the net proceeds of that offering to acquire a portfolio of approximately \$185 million in aggregate principal amount of senior secured loans that were originated during 2006 through a special purpose vehicle organized by Katonah Debt Advisors. These loans were acquired by us for cash at their fair value. Subsequent to our acquisition of these assets and consistent with our investment strategy, we began to reposition our investment portfolio toward a heavier weighting in second lien senior loans and mezzanine loans.

Prior to our initial public offering, we issued an aggregate of 1,258,000 common shares, having a value of approximately \$19 million, to affiliates of Kohlberg & Co. to acquire certain subordinated securities and preferred stock securities issued by CLO Funds (Katonah III, Ltd., Katonah IV, Ltd., Katonah V, Ltd., Katonah VII CLO, Ltd., and Katonah VIII CLO, Ltd.) managed by Katonah Debt Advisors and two other asset managers. Subsequent to our initial public offering, we purchased approximately \$13 million of CLO Fund securities issued by other CLOs managed by Katonah Debt Advisors and approximately \$4 million of CLO Fund securities managed by a third party asset manager. Our total investment in CLO Fund securities at fair value is approximately \$31 million as of December 31, 2007. In connection with the closing of Katonah Debt Advisor's most recent CLO Fund on January 23, 2008, we invested approximately \$29 million to acquire all of the shares of the most junior class of securities of the CLO Fund.

Prior to our initial public offering, we issued an aggregate of 2,226,333 common shares, having a value of approximately \$33 million, to affiliates of Kohlberg & Co. to acquire Katonah Debt Advisors. As a result, Katonah Debt Advisors is a wholly-owned portfolio company that manages CLO Funds which invest in broadly syndicated loans, high-yield bonds and other credit instruments. As of December 31, 2008, Katonah Debt Advisors had approximately \$2.1 billion of assets under management. Katonah Debt Advisors had after-tax net loss of approximately \$765,000 for the year ended December 31, 2008 and distributed approximately \$1 million to us in the form of dividends.

In December 2007, we committed to make an investment in a new distressed investment platform organized by Steven Panagos and Jonathan Katz and named Panagos and Katz Situational Investing (“PKSIL”). Mr. Panagos was most recently national practice leader of Kroll Zolfo Cooper’s Corporate Advisory and Restructuring Practice and Mr. Katz was the founding partner of Special Situations Investing, a distressed investing vehicle of JP Morgan. We expect that funds managed by PKSIL will invest in the debt and equity securities of companies that are restructuring due to financial or operational distress. We also expect that PKSIL may selectively originate new credit facilities with borrowers that are otherwise unable to access traditional credit markets. To this date PKSIL has not raised any investment funds and may not be able to successfully complete an investment fund in 2009. We committed to invest up to \$2.5 million directly in PKSIL through an investment in Class A shares. We have a 35% economic interest in PKSIL through our investment in Class B shares on which we will receive our pro rata share of its operating income and may make an investment of up to \$25 million in funds managed by PKSIL on which we will receive investment income. PKSIL may also source distressed debt opportunities in which we may make direct investments. As of December 31, 2008, we funded approximately \$1.8 million of our \$2.5 million total commitment to PKSIL which is an investment in the Class A shares of PKSIL.

Both Katonah Debt Advisors and PKSIL are considered affiliate investments. As of December 31, 2008, our affiliate asset manager investments at fair value are approximately \$57 million.

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

## **RESULTS OF OPERATIONS**

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

Set forth below is a discussion of our results of operations for the years ended December 31, 2008 and 2007.

### **Investment Income**

Investment income for the years ended December 31, 2008 and 2007, and for the period December 11, 2006 (inception) through December 31, 2006 was approximately \$49 million, \$38 million, and \$1 million, respectively. Of this amount, approximately \$33 million, \$30 million and \$572,000, respectively, was attributable to interest income on our loan and bond investments. A portion of such interest income is attributable to net interest earned on assets accumulated for future CLO issuance on which Katonah Debt Advisors entered into a first loss agreement in connection with loan warehouse arrangements for Katonah Debt Advisors CLO Funds. For the year ended December 31, 2008, approximately \$107,000 of such net interest related to the first loss arrangements previously accrued was written off. For the year ended December 31, 2007 and for the period December 11, 2006 (inception) through December 31, 2006, approximately \$2 million and \$0, respectively of such net interest related to the first loss arrangements was earned.

For the years ended December 31, 2008 and 2007, and for the period December 11, 2006 (inception) through December 31, 2006, approximately \$13 million, \$7 million and \$405,000, respectively, of investment income was attributable to investments in CLO fund securities.

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

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

## **Dividends from Affiliate Asset Manager**

As of December 31, 2008, our investment in Katonah Debt Advisors was approximately \$55 million. For the years ended December 31, 2008 and 2007, Katonah Debt Advisors had GAAP net loss of approximately \$765,000 and net income of approximately \$3 million, respectively. During the years ended December 31, 2008 and 2007 distributions from Katonah Debt Advisors totaled approximately \$1 million, and \$500,000, respectively. Distributions of Katonah Debt Advisors' net income are recorded on the statements of operations as dividends from affiliate asset manager.

## **Expenses**

Total expenses for the years ended December 31, 2008 and 2007, and for the period December 11, 2006 (inception) through December 31, 2006 were approximately \$19 million, \$16 million, and \$641,000, respectively. Interest expense and amortization on debt issuance costs for the period, which includes facility and program fees on the unused loan balance, was approximately \$11 million, and \$7 million, respectively, on average debt outstanding of \$248 million and \$106 million. There was no interest expense or debt outstanding for the period December 11, 2006 (inception) through December 31, 2006. Approximately \$4 million, \$4 million, and \$175,000 respectively, of expenses were attributable to employment compensation, including salaries, bonuses and stock option expense for the years ended December 31, 2008 and 2007, and for the period December 11, 2006 (inception) through December 31, 2006. For the year ended December 31, 2008, professional fees and insurance expenses totaled approximately \$2 million. For the year ended December 31, 2007 and for the period December 11, 2006 (inception) through December 31, 2006, professional fees and insurance expenses totaled approximately \$3 million, and \$384,000, respectively. For the year ended December 31, 2008, administrative and other costs totaled approximately \$1 million. For the year ended December 31, 2007 and for the period December 11, 2006 (inception) through December 31, 2006, administrative and other costs totaled approximately \$1 million, and \$82,000, respectively. These costs include occupancy expense, technology and other office expenses.

Interest and compensation expense are generally expected to be our largest expenses each period. Interest expense is dependent on the average outstanding principal balance on our credit facility and the base index rate for the period. Compensation expense includes base salaries, bonuses, stock compensation, employee benefits and employer related payroll costs. The largest components of total compensation costs are base salaries and bonuses; generally, base salaries are expensed as incurred and bonus expenses are estimated and accrued since bonuses are paid annually.

## **Net Unrealized Depreciation on Investments**

During the year ended December 31, 2008, our total investments had net unrealized depreciation of approximately \$40 million. During the year ended December 31, 2007 and for the period December 11, 2006 (inception) through December 31, 2006, our total investments had net unrealized appreciation of approximately \$3 million, and \$4 million, respectively.

The \$40 million of unrealized losses during the year ended December 31, 2008 are due to unrealized losses of \$32 million on debt securities, equity securities and CLO Fund securities in our investment portfolio, and a \$8 million decrease in the value of Katonah Debt Advisors. The decrease in the unrealized value of Katonah Debt Advisors is primarily the result of a \$28 million decrease in assets under management from December 31, 2007 to December 31, 2008 and a related settlement with JP Morgan regarding terminated warehouse facilities.

The \$3 million of unrealized gains during the year ended December 31, 2007 were due to unrealized losses of \$18 million on debt securities, equity securities and CLO Fund securities in our investment portfolio, offset by a \$21 million increase in the value of Katonah Debt Advisors. The increase in the unrealized value of Katonah Debt Advisors was primarily as a result of an increase in Katonah Debt Advisors' assets under management to \$2.1 billion as of December 31, 2007 from \$1.2 billion as of December 31, 2006.

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

The net decrease in stockholders' equity resulting from operations for the year ended December 31, 2008 was an approximately \$10 million, or \$0.47 per share. The net increase in stockholders' equity resulting from operations for the year ended December 31, 2007 and for the period December 11, 2006 (inception) through December 31, 2006 was approximately \$26 million, and \$5 million, respectively, or \$1.45 and \$0.26 per share.

## FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES

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

However, because we are required to use interest income earned on the assets securing the Facility to amortize the Facility during the amortization period, we may need to sell other assets not pledged to secure the Facility, potentially at a loss, in order to generate sufficient cash to make the required dividend distributions necessary to maintain our RIC status. In addition, at the end of the amortization period, we may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings or we may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

As a BDC, we are limited in the amount of leverage we can incur to finance our investment portfolio. We are required to meet a coverage ratio of total assets to total senior securities of at least 200%. For this purpose, senior securities include all borrowings and any preferred stock. As a result, our ability to utilize leverage as a means of financing our portfolio of investments is limited by this asset coverage test. Our asset coverage ratio was below 200% as of December 31, 2008. As of March 12, 2009, our Facility balance was approximately \$245 million and our asset coverage ratio was approximately 209%, above the minimum asset coverage level generally required for a BDC by the 1940 Act. See “LEVERAGE.”

As of December 31, 2008 and December 31, 2007 the fair value of investments and cash were as follows:

Security Type	Investments at Fair Value	
	December 31, 2008	December 31, 2007
Cash	\$ 251,412	\$ 2,088,770
Time Deposits	12,185,997	15,674,489
Money Market Account	10	20,766
Senior Secured Loan	218,342,528	260,138,674
Junior Secured Loan	126,498,918	113,259,293
Mezzanine Investment	32,557,165	33,066,115
Senior Subordinated Bond	2,287,500	2,490,000
Senior Unsecured Bond	4,800,000	2,000,000
CLO Fund Securities	56,635,236	31,020,000
Equity Securities	4,389,831	4,752,250
Affiliate Asset Managers	56,528,088	58,585,360
Total	\$ 514,476,685	\$ 523,095,717

On February 14, 2007, we entered into a secured revolving credit facility (the “Facility”) under which we had a right to obtain up to \$200 million in financing loaned by or through BMO Capital Markets Corp. On October 1, 2007, the Company amended the Facility to increase the Company’s borrowing capacity from \$200 million to \$275 million, extend the maturity date from February 12, 2012 to October 1, 2012 and increase the interest spread charged on outstanding borrowings by 15 basis points, to 0.85%. The interest rate is based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. Interest is payable monthly. Advances under the Facility are used by us primarily to make additional investments. The Facility is secured by loans acquired by us with the advances under the Facility. We have borrowed under the Facility through our wholly-owned, special-purpose bankruptcy remote subsidiary, Kohlberg Capital Funding LLC I.

As of December 31, 2008, the outstanding balance on the Facility was \$262 million. During September 2008, we were notified by the lenders that the liquidity banks providing the underlying funding for the Facility did not intend to renew their liquidity facility to the lenders unless we agreed to certain revised terms for the Facility. As a result, the lenders proposed new terms to us in order to extend additional fundings under the Facility. We viewed such proposed terms as unfavorable and have opted to forego the revolving credit feature of the Facility and to amortize existing borrowings under the Facility. In accordance with the terms of the Facility, all principal and interest collected from the assets by which the Facility is secured are used to amortize the Facility through a termination date of September 29, 2010 (the “amortization period”). During the amortization period the interest rate will continue to be based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. We believe we have sufficient cash and liquid assets to fund normal operations and dividend distributions. At the end of the amortization period, we may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings or we may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

Under our Facility, we must maintain a leverage ratio covenant of at least one to one based on the ratio of the Facility outstanding balance to our most recently reported GAAP stockholders' equity balance (determined quarterly in conjunction with the Company's financial reporting filings with the Securities and Exchange Commission) as of the Facility outstanding balance determination date. At year-end, our leverage ratio covenant was met using the December 31, 2008 Facility balance and the latest filed quarterly stockholders' equity balance which, at that time, was as of September 30, 2008. We remain in compliance with the leverage covenant ratio based on the March 12, 2009 Facility balance and the GAAP stockholders' equity balance as of September 30, 2008.

We expect our cash on hand, liquid investments, and cash generated from operations, including income earned from investments and any income distributions made by Katonah Debt Advisors, our wholly-owned portfolio company, will be adequate to meet our cash needs at our current level of operations. Our Facility contains collateral requirements, including, but not limited to, minimum diversity, rating and yield, and limitations on loan size.

## COMMITMENTS

We are a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the needs of 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 our balance sheet. Prior to extending such credit, we attempt to limit our credit risk by conducting extensive due diligence, obtaining collateral where necessary and negotiating appropriate financial covenants. As of December 31, 2008 and December 31, 2007, we had committed to make a total of approximately \$3 million and \$4 million, respectively, of investments in various revolving senior secured loans, of which approximately \$1 million was funded as of December 31, 2008 and \$866,000 was funded as of December 31, 2007. As of December 31, 2008 and December 31, 2007, we had committed to make a total of approximately \$0 and \$8 million, respectively, of investments in a delayed draw senior secured loans of which \$0 was funded as of December 31, 2008 and approximately \$5 million was funded as of December 31, 2007.

In October 2007 Katonah Debt Advisors entered into a letter agreement (the "Letter Agreement") with Bear Stearns & Co. Inc. ("Bear Stearns") in connection with a warehouse credit line established to fund the initial accumulation of assets for three CLO funds, pursuant to which agreement Katonah Debt Advisors undertook certain "first loss" commitments, as described in more detail below. In return for Katonah Debt Advisors' first loss commitment, Katonah Debt Advisors was entitled to receive net interest income from the underlying assets in the loan warehouse. In the future, Kohlberg Capital or Katonah Debt Advisors may enter into similar agreements in connection with funding the initial accumulation of senior secured corporate loans and certain other debt securities for future CLO Funds that Katonah Debt Advisors will manage. Such "first loss" commitments relate to (i) losses (if any) as a result of individual loan investments being ineligible for purchase by a new CLO Fund (typically due to a payment default on such loan) when such fund formation is completed or, (ii) if a new CLO Fund has not been completed before the expiration of the related warehouse credit line, the loss (if any, and net of any accumulated interest income) on the resale of loans and debt securities funded by such warehouse credit line. In return for Katonah Debt Advisors' first loss commitment, Katonah Debt Advisors was entitled to receive net interest income from the underlying assets in the loan warehouse.

Under the Letter Agreement with Bear Stearns, Katonah Debt Advisors engaged Bear Stearns to structure and raise three CLO funds, to be named Katonah 2007-I CLO Ltd. ("Katonah 2007"), Katonah 2008-I CLO Ltd. ("Katonah 2008-I") and Katonah 2008-II CLO Ltd. ("Katonah 2008-II" and, together with Katonah 2007 and Katonah 2008-I, the "2008 CLO Funds"), to be managed by Katonah Debt Advisors (directly or indirectly through a services contract with an affiliate of Katonah Debt Advisors). As part of this engagement, Bear Stearns provided certain credit lines to accumulate and fund into a loan warehouse the initial assets for the 2008 CLO Funds. As mentioned above, Katonah Debt Advisors undertook a first loss commitment, requiring Katonah Debt Advisors to reimburse Bear Stearns in certain circumstance for (i) certain losses (if any) incurred on the assets warehoused for the 2008 CLO Funds prior to their completion, or (ii) if one or all of the CLO Funds fail to close, a portion of the losses (if any) on the resale of the warehoused assets. On January 23, 2008, Katonah Debt Advisors and Bear Stearns closed Katonah 2007. Katonah Debt Advisors received a structuring fee upon closing and Katonah Debt Advisors expects to earn an ongoing asset management fee based on the par amount of the underlying investments in Katonah 2007. Approximately \$212 million of assets were transferred from the loan warehouse into Katonah 2007. While the securities issued by the CLO Funds managed by Katonah Debt Advisors are primarily held by third parties, Kohlberg Capital invested approximately \$29 million to acquire all of the shares of the most junior class of securities of Katonah 2007. In connection with the closing of Katonah 2007, Katonah Debt Advisors' maximum first loss obligation amount under its commitment letter with Bear Stearns was reduced from \$22.5 million to \$18 million.

None of the other 2008 CLO Funds were completed and, as a result, pursuant to the Letter Agreement, both Katonah Debt Advisors and JPMorgan asserted claims against the other and defenses thereto. Without admitting any liability or wrongdoing, Katonah Debt Advisors and JPMorgan agreed to compromise and settle all of the disputes, issues and claims between them relating to the agreements in exchange for an agreement to terminate all obligations and liabilities of Katonah Debt Advisors and of JPMorgan under the existing agreements relating to the 2008 CLO Funds, payment by Katonah Debt Advisors of an aggregate of \$6 million in installments over a period of one year and the forfeiture by Katonah Debt Advisors of the net interest income earned through the settlement date on the warehoused assets. In December 2008, Katonah Debt Advisors entered into a settlement and termination agreement with JPMorgan reflecting the settlement terms described above.

As a result of this settlement, Katonah Debt Advisors recognized a \$6 million settlement cost and write-off of previously accrued net interest income on warehoused assets of approximately \$4 million for the year ended December 31, 2008. For the year ended December 31, 2008, Katonah Debt Advisors had an after-tax loss of approximately \$765,000.

Kohlberg Capital Corporation recognized the impact of this settlement and forfeiture of warehouse income as a reduction to the unrealized appreciation of the value of its investment in Katonah Debt Advisors. Consequently, this settlement is not expected to have a material impact on Kohlberg Capital Corporation's net investment income or quarterly dividend.

As of December 31, 2008, the Company funded approximately \$1.8 million of our \$2.5 million total commitment to PKSIL which is an investment in the Class A shares of PKSIL.

## CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual cash obligations and other commercial commitments as of December 31, 2008:

Contractual Obligations	Payments Due by Period						
	Total	2009	2010	2011	2012	2013	More than 5 years
Operating lease obligations	\$ 1,244,357	\$ 309,691	\$ 304,649	\$ 311,504	\$ 318,513	\$ —	\$ —
Long-term debt obligations	261,691,148	—	261,691,148	—	—	—	—
Unused lending commitments <sup>1</sup>	1,640,000	1,640,000	—	—	—	—	—
<b>Total</b>	<b>\$ 264,575,505</b>	<b>\$ 1,949,691</b>	<b>\$ 261,995,797</b>	<b>\$ 311,504</b>	<b>\$ 318,513</b>	<b>\$ —</b>	<b>\$ —</b>

<sup>1</sup> Represents the unfunded lending commitment in connection with revolving lines of credit or delayed funding draws on loans made to portfolio companies.

## RECENT DEVELOPMENTS

None.

### 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, 2008, approximately 88% of our loans at fair value in our portfolio were at floating rates with a spread to an interest rate index such as LIBOR or the prime rate. We generally expect that future portfolio investments will predominately be floating rate investments. As of December 31, 2008, we had \$262 million of borrowings outstanding at a floating rate tied to prevailing commercial paper rates plus a margin of 0.85%.

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

We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that our balance sheet at December 31, 2008 were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical increase or decrease of a 1% change in interest rates would correspondingly affect net interest income proportionately by approximately \$1 million over a one-year period. Correspondingly, a hypothetical increase or decrease of a 1% change in interest rates would correspondingly affect net interest expense proportionately by approximately \$1 million over a one-year period. Because most of our investments at December 31, 2008 were floating rate with a spread to an index similar to our financing facility, we would not expect a significant impact on our net interest spread.

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

We did not hold any derivative financial instruments for hedging purposes as of December 31, 2008. In connection with the Facility established on February 14, 2007 and as amended on October 1, 2007, our special purpose subsidiary may be required under certain circumstances to enter into interest rate swap agreements or other interest rate hedging transactions.

## Portfolio Valuation

We carry our investments at fair value, as determined in good faith by our Board of Directors pursuant to procedures approved by our Board of Directors. Investments for which market quotations are readily available are valued at such market quotations. The Board of Directors has retained an independent valuation firm to provide third-party valuation consulting services, which consist of certain limited procedures that we identify and request the independent valuation firm to perform. During the preceding twelve months ended December 31, 2008, approximately 54% of our investments were investments that were marked to market or for which we utilized the valuation services provided by the independent valuation firm in connection with the determination of fair value by our Board of Directors. 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 a 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 significantly from the values that would have been used had a ready market existed for such investments or from the values that would have been placed on our assets by other market participants, and the differences could be material. In addition, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately 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.

Our Board of Directors is ultimately and solely responsible for determining the fair value of portfolio investments on a quarterly basis in good faith. Duff & Phelps, LLC, an independent valuation firm, provided, third party valuation consulting services to our Board of Directors, which consisted of certain limited procedures that our Board of Directors identified and requested them to perform. Each quarter, Duff & Phelps, LLC, performs such procedures on the Company's investment in Katonah Debt Advisors and all CLO Fund securities. In addition, Duff & Phelps, LLC performs its procedures on all illiquid junior and mezzanine securities such that they are reviewed at least once during a trailing 12 month period. Upon completion of the limited procedures, Duff & Phelps, LLC concluded that the fair value of those investments subjected to the limited procedures did not appear to be unreasonable. In the future, our Board of Directors may continue to utilize the services of Duff & Phelps, LLC or may use another third party valuation provider.

**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***

Not applicable.

**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 our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), has evaluated the effectiveness of the design and operation of our 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, our CEO and CFO have concluded that our current disclosure controls and procedures are effective as of the end of the period covered by this report.

***Management's Report on Internal Control Over Financial Reporting.*** Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Rules 13a-15(f). Kohlberg Capital Corporation'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.

Our 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 Kohlberg Capital Corporation;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of Kohlberg Capital Corporation's management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our 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.

Management assessed the effectiveness of Kohlberg Capital Corporation's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on management's assessment, management concluded that Kohlberg Capital Corporation maintained effective internal control over financial reporting as of December 31, 2008.

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

***Changes in Internal Control Over Financial Reporting*** . The Company's management, under the supervision and with the participation of various members of management, including our CEO and our CFO, has evaluated any change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act). Management has concluded that there have been no changes in the Company's internal control over financial reporting identified in connection with this evaluation that occurred during the year ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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

None.

### 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, 2009, and is incorporated herein by reference.

We have adopted a Code of Ethics that applies to directors and officers of the Company and a Sarbanes-Oxley Code of Ethics that applies to directors, officers and employees of the Company. Both of these codes of conduct are published on our website at [www.kohlbergcap.com](http://www.kohlbergcap.com). We intend to disclose any future amendments to, or waivers from, these codes of conduct 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, 2009, 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, 2009, 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, 2009, 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, 2009, and is incorporated herein by reference.

## PART IV

### Item 15. Exhibits and Financial Statement Schedules

#### 1. Financial Statements

The following financial statements of Kohlberg Capital Corporation (the “Company” or the “Registrant”) are filed herewith:

Balance Sheets as of December 31, 2008 and December 31, 2007	F-4
Statements of Operations for the years ended December 31, 2008, December 31, 2007 and for the period from December 11, 2006 (inception) through December 31, 2006	F-5
Statements of Changes in Net Assets for the years ended December 31, 2008, December 31, 2007 and for the period from December 11, 2006 (inception) through December 31, 2006	F-6
Statements of Cash Flows for the years ended December 31, 2008, December 31, 2007 and for the period from December 11, 2006 (inception) through December 31, 2006	F-7
Schedules of Investments as of December 31, 2008 and December 31, 2007	F-8
Financial Highlights for the years ended December 31, 2008, December 31, 2007 and for the period from December 11, 2006 (inception) through December 31, 2006	F-32
Notes to Financial Statements	F-33

#### 2. Exhibits

### EXHIBIT INDEX

<b>Exhibit Number</b>	<b>Description</b>
3.1	Form of Certificate of Incorporation of Kohlberg Capital Corporation (the “Company”). <sup>(1)</sup>
3.2	Form of Bylaws of the Company. <sup>(2)</sup>
4.1	Specimen Certificate of the Company’s common stock, par value \$0.01 per share. <sup>(1)</sup>
4.2	Form of Registration Rights Agreement. <sup>(3)</sup>
4.3	Form of Dividend Reinvestment Plan. <sup>(3)</sup>
10.1	Form of the Amended and Restated 2006 Equity Incentive Plan. <sup>(9)</sup>
10.2	Form of Company Non-Qualified Stock Option Certificate. <sup>(3)</sup>
10.3	Form of Custodian Agreement by and among Kohlberg Capital Corporation and U.S. Bank National Association. <sup>(3)</sup>
10.4	Form of License and Referral Agreement between the Company and Kohlberg & Company, LLC. <sup>(1)</sup>
10.5	Form of Overhead Allocation Agreement between the Company and Katonah Debt Advisors, LLC. <sup>(3)</sup>
10.6	Form of Employment Agreement between the Company and Dayl W. Pearson. <sup>(3)</sup>
10.7	Form of Employment Agreement between the Company and Michael I. Wirth. <sup>(3)</sup>
10.8	Form of Employment Agreement between the Company and R. Jon Corless. <sup>(3)</sup>
10.9	Form of Employment Agreement between the Company and E.A. Kratzman. <sup>(3)</sup>
10.10	Form of Employment Agreement between Katonah Debt Advisors and E.A. Kratzman. <sup>(3)</sup>
10.11	Form of Indemnification Agreement for Officers and Directors of the Company. <sup>(4)</sup>



<b>Exhibit Number</b>	<b>Description</b>
10.12	Execution Copy of Loan Funding and Servicing Agreement dated as of February 14, 2007, by and among Kohlberg Capital Funding LLC I, Kohlberg Capital Corporation, each of the conduit lenders and institutional lenders from time to time party thereto, each of the lender agents from time to time party thereto, BMO Capital Markets Corp., as the Agent, Lyon Financial Services, Inc. (d/b/a U.S. Bank Portfolio Services), as the Backup Services, and U.S. Bank National Association, as Trustee. <sup>(5)</sup>
10.13	Execution Copy of First Amendment to Loan Funding and Servicing Agreement, dated as of May 30, 2007, by and among Kohlberg Capital Funding LLC I, the Company, each of the conduit lenders and institutional lenders from time to time party thereto, each of the lender agents from time to time party thereto, BMO Capital Markets Corp., as the Agent, Lyon Financial Services, Inc. (d/b/a U.S. Bank Portfolio Services), as the Backup Servicer, and U.S. Bank National Association, as Trustee. <sup>(6)</sup>
10.14	Execution Copy of Second Amendment to Loan Funding and Servicing Agreement, dated as of October 1, 2007, by and among Kohlberg Capital Funding LLC I, the Company, each of the conduit lenders and institutional lenders from time to time party thereto, each of the lender agents from time to time party thereto, BMO Capital Markets Corp., as the Agent, Lyon Financial Services, Inc. (d/b/a U.S. Bank Portfolio Services), as the Backup Servicer, and U.S. Bank National Association, as Trustee. <sup>(6)</sup>
10.15	Execution Copy of Third Amendment to Loan Funding and Servicing Agreement, dated as of November 21, 2007, by and among Kohlberg Capital Funding LLC I, the Company, each of the conduit lenders and institutional lenders from time to time party thereto, each of the lender agents from time to time party thereto, BMO Capital Markets Corp., as the Agent, Lyon Financial Services, Inc. (d/b/a U.S. Bank Portfolio Services), as the Backup Servicer, and U.S. Bank National Association, as Trustee. <sup>(8)</sup>
10.16	Execution Copy of Purchase and Sale Agreement dated as of February 14, 2007, by and among Kohlberg Capital Funding LLC I and the Company. <sup>(7)</sup>
10.17	Form of 2008 Non-Employee Director Plan. <sup>(10)</sup>
21.1	List of Subsidiaries.
23.1	Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm.
31.1	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.
31.2	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.
32.1	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.
32.2	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.

<sup>(1)</sup> 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).

<sup>(2)</sup> Incorporated by reference to the exhibit included on Form N-2, as filed on March 16, 2007 (File No. 333-141382).

<sup>(3)</sup> Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 2 on Form N-2, as filed on November 20, 2006 (File No. 333-136714).

<sup>(4)</sup> Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 3 on Form N-2, as filed on November 24, 2006 (File No. 333-136714).

<sup>(5)</sup> Incorporated by reference to Exhibit 10.15 of the Annual Report on Form 10-K, as filed on March 29, 2007 (File No. 814-00735).

<sup>(6)</sup> Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 1 on Form N-2, as filed on October 18, 2007 (File No. 333-146190).

<sup>(7)</sup> Incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K, as filed on February 16, 2007 (File No. 814-00735).



- (8) Incorporated by reference to Exhibit 10.15 of the Annual Report on Form 10-K, as filed on March 14, 2008 (File No. 814-00735).
- (9) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, as filed on June 19, 2008 (File No. 814-00735).
- (10) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 1 on Form N-2, as filed on June 30, 2008 (File No. 333-151268).



## INDEX TO FINANCIAL STATEMENTS

Reports of Independent Registered Public Accounting Firm	F-2
Balance Sheets as of December 31, 2008 and December 31, 2007	F-4
Statements of Operations for the years ended December 31, 2008, December 31, 2007 and for the period from December 11, 2006 (inception) through December 31, 2006	F-5
Statements of Changes in Net Assets for the years ended December 31, 2008, December 31, 2007 and for the period from December 11, 2006 (inception) through December 31, 2006	F-6
Statements of Cash Flows for the years ended December 31, 2008, December 31, 2007 and for the period from December 11, 2006 (inception) through December 31, 2006	F-7
Schedules of Investments as of December 31, 2008 and December 31, 2007	F-8
Financial Highlights for the years ended December 31, 2008, December 31, 2007 and for the period from December 11, 2006 (inception) through December 31, 2006	F-32
Notes to Financial Statements	F-33

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Kohlberg Capital Corporation  
New York, New York

We have audited the accompanying balance sheets of Kohlberg Capital Corporation (the “Company”), including the schedules of investments, as of December 31, 2008 and 2007, and the related statements of operations, changes in net assets, and cash flows and the financial highlights for each of the years in the two-year period ended December 31, 2008 and for the period from December 11, 2006 (inception) through December 31, 2006. These financial statements and financial highlights are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our procedures included confirmation of securities owned as of December 31, 2008, by correspondence with the custodian and selling or agent banks; where replies were not received from selling or agent banks, we performed other auditing procedures. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Kohlberg Capital Corporation at December 31, 2008 and 2007, and the results of its operations, its changes in net assets, its cash flows and the financial highlights for each of the years in the two-year period ended December 31, 2008, and for the period from December 11, 2006 (inception) through December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, the financial statements include investments valued at \$502,039,266 (approximately 96% of total assets) and \$505,311,692 (approximately 95% of total assets) as of December 31, 2008 and 2007, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on the methods and information described in Note 2 to the financial statements.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 16, 2009 expressed an unqualified opinion on the Company's internal control over financial reporting.

DELOITTE & TOUCHE LLP

New York, New York  
March 16, 2009

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Kohlberg Capital Corporation  
New York, New York

We have audited the internal control over financial reporting of Kohlberg Capital Corporation (the "Company") as of December 31, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. 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 conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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 the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheet of the Company, including the schedule of investments, as of December 31, 2008, and the related statements of operations, changes in net assets, cash flows and the financial highlights for the year then ended and our report dated March 16, 2009 expressed an unqualified opinion on those financial statements and financial highlights and included an explanatory paragraph regarding investments whose fair values have been estimated by management in the absence of readily determinable fair values.

DELOITTE & TOUCHE LLP

New York, New York  
March 16, 2009

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

	<u>As of</u> <u>December 31, 2008</u>	<u>As of</u> <u>December 31, 2007</u>
<b>ASSETS</b>		
Investments at fair value:		
Time deposits (cost: 2008 - \$12,185,997; 2007 - \$15,674,489)	\$ 12,185,997	\$ 15,674,489
Money market account (cost: 2008 - \$10; 2007 - \$20,766)	10	20,766
Debt securities (cost: 2008 - \$423,859,086; 2007 - \$423,439,764)	384,486,111	410,954,082
CLO fund securities managed by non-affiliates (cost: 2008 - \$15,590,951; 2007 - \$15,385,580)	9,099,000	9,900,000
CLO fund securities managed by affiliate (cost: 2008 - \$50,785,644; 2007 - \$20,675,684)	47,536,236	21,120,000
Equity securities (cost: 2008 - \$5,256,660; 2007 - \$5,043,950)	4,389,831	4,752,250
Asset manager affiliates (cost: 2008 - \$38,948,271; 2007 - \$33,469,995)	56,528,088	58,585,360
Total Investments at fair value	514,225,273	521,006,947
Cash	251,412	2,088,770
Restricted cash	2,119,991	1,418,868
Interest and dividends receivable	4,168,599	5,592,637
Due from affiliates	390,590	540,773
Other assets	1,716,446	2,493,964
Total assets	<u>\$ 522,872,311</u>	<u>\$ 533,141,959</u>
<b>LIABILITIES</b>		
Borrowings	\$ 261,691,148	\$ 255,000,000
Payable for open trades	1,955,000	5,905,000
Accounts payable and accrued expenses	3,064,403	6,141,892
Dividend payable	5,879,660	7,026,903
Total liabilities	<u>\$ 272,590,211</u>	<u>\$ 274,073,795</u>
Commitments and contingencies (note 8)		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$.01 per share, 100,000,000 common shares authorized; 21,776,519 and 21,436,936 common shares issued and outstanding at December 31, 2008 and 18,017,699 issued and outstanding at December 31, 2007	\$ 214,369	\$ 180,177
Capital in excess of par value	282,171,860	252,771,715
Accumulated undistributed (distribution in excess of) net investment income	977,904	(1,180,447)
Accumulated net realized losses	(680,687)	-
Net unrealized appreciation (depreciation) on investments	(32,401,346)	7,296,719
Total stockholders' equity	<u>\$ 250,282,100</u>	<u>\$ 259,068,164</u>
Total liabilities and stockholders' equity	<u>\$ 522,872,311</u>	<u>\$ 533,141,959</u>
<b>NET ASSET VALUE PER SHARE</b>	<u>\$ 11.68</u>	<u>\$ 14.38</u>

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**  
**STATEMENTS OF OPERATIONS**

	<b>For the Year Ended</b>	<b>For the Year Ended</b>	<b>For the Period</b>
	<b>December 31, 2008</b>	<b>December 31, 2007</b>	<b>(inception) through</b>
			<b>December 31, 2006</b>
<b>Investment Income:</b>			
Interest from investments in debt securities	\$ 33,386,213	\$ 29,606,231	\$ 572,065
Interest from cash and time deposits	251,287	552,509	132,841
Dividends from investments in CLO fund securities managed by non-affiliates	5,946,736	4,528,021	377,503
Dividends from investments in CLO fund securities managed by affiliate	6,624,742	2,532,952	27,700
Dividends from affiliate asset manager	1,350,000	500,000	—
Capital structuring service fees	1,653,232	759,301	41,794
<b>Total investment income</b>	<b>49,212,210</b>	<b>38,479,014</b>	<b>1,151,903</b>
<b>Expenses:</b>			
Interest and amortization of debt issuance costs	10,925,624	7,229,597	—
Compensation	3,940,638	4,104,761	175,186
Professional fees	1,992,142	2,887,515	371,624
Insurance	286,456	174,647	12,821
Organizational Expenses	—	—	40,000
Administrative and other	1,361,433	1,323,545	41,647
<b>Total expenses</b>	<b>18,506,293</b>	<b>15,720,065</b>	<b>641,278</b>
<b>Net Investment Income before Income Tax Expense</b>	<b>30,705,917</b>	<b>22,758,949</b>	<b>510,625</b>
Excise taxes	—	—	(21,162)
<b>Net Investment Income</b>	<b>30,705,917</b>	<b>22,758,949</b>	<b>489,463</b>
<b>Realized And Unrealized Gains (Losses) On Investments:</b>			
Net realized gain (loss) from investment transactions	(575,179)	266,317	1,077
Net change in unrealized appreciation (depreciation) on:			
Debt securities	(26,887,293)	(12,485,682)	—
Equity securities	(575,129)	(291,700)	—
CLO fund securities managed by affiliate	(3,693,724)	444,316	—
CLO fund securities managed by non-affiliates	(1,006,371)	(5,485,580)	—
Affiliate asset manager investments	(7,535,548)	20,935,365	4,180,000
<b>Net realized and unrealized appreciation (depreciation) on investments</b>	<b>(40,273,244)</b>	<b>3,383,036</b>	<b>4,181,077</b>
<b>Net Increase (Decrease) In Stockholders' Equity Resulting From Operations</b>	<b>\$ (9,567,327)</b>	<b>\$ 26,141,985</b>	<b>\$ 4,670,540</b>
Net Increase (Decrease) in Stockholders' Equity Resulting from Operations per Common Share—Basic and Diluted	\$ (0.47)	\$ 1.45	\$ 0.26
Net Investment Income Per Common Share—Basic	\$ 1.51	\$ 1.27	\$ 0.03
Net Investment Income Per Common Share—Diluted	\$ 1.50	\$ 1.27	\$ 0.03
Net Investment Income and Net Realized Gains (Losses) Per Common Share—Basic	\$ 1.49	\$ 1.28	\$ 0.03
Net Investment Income and Net Realized Gains (Losses) Per Common Share—Diluted	\$ 1.47	\$ 1.28	\$ 0.03
Weighted Average Shares of Common Stock Outstanding—Basic	20,276,430	17,977,348	17,946,333
Weighted Average Shares of Common Stock Outstanding—Diluted	20,455,322	17,977,348	17,946,333

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**  
**STATEMENTS OF CHANGES IN NET ASSETS**

	<u>Year Ended</u> <u>December 31, 2008</u>	<u>Year Ended</u> <u>December 31, 2007</u>	<u>For the Period</u> <u>December 11, 2006</u> <u>(inception) through</u> <u>December 31, 2006</u>
<b>Operations:</b>			
Net investment income	\$ 30,705,917	\$ 22,758,949	\$ 489,463
Net realized gain (loss) from investment transactions	(575,179)	266,317	1,077
Net change in unrealized gain (loss) on investments	(39,698,065)	3,116,719	4,180,000
Net increase (decrease) in net assets resulting from operations	(9,567,327)	26,141,985	4,670,540
<b>Shareholder distributions:</b>			
Dividends from net investment income to common stockholders	(29,377,019)	(22,758,949)	—
Dividends from net investment income to restricted stockholders	(246,626)	—	—
Dividends in excess of net investment income to common stockholders	—	(1,669,909)	—
Distributions from paid-in capital to common stockholders	—	(481,437)	—
Distributions from realized gains to common stockholders	—	(267,394)	—
Net decrease in net assets resulting from stockholder distributions	(29,623,645)	(25,177,689)	—
<b>Capital share transactions:</b>			
Issuance of common stock for:			
Initial public offering	—	—	199,451,388
Interest in affiliate company	—	—	33,394,995
Interest in CLO securities managed by affiliate	—	—	18,870,000
Dividend reinvestment plan	2,591,296	1,103,245	—
Rights offering	26,925,214	—	—
Vesting of restricted stock	30	—	—
Stock based compensation	888,368	600,200	13,500
Net increase in net assets resulting from capital share transactions	30,404,908	1,703,445	251,729,883
Net assets at beginning of period	259,068,164	256,400,423	—
Net assets at end of period (including accumulated undistributed net investment income of \$977,904 in 2008, accumulated distribution in excess of net investment income of \$1,180,447 in 2007, and accumulated undistributed net investment income of \$489,463 in 2006)	\$ 250,282,100	\$ 259,068,164	\$ 256,400,423
Net asset value per common share	\$ 11.68	\$ 14.38	\$ 14.29
Common shares outstanding at end of period	21,436,936	18,017,699	17,946,333

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**  
**STATEMENTS OF CASH FLOWS**

	Year Ended December 31, 2008	Year Ended December 31, 2007	For the Period December 11, 2006 (inception) through December 31, 2006
<b>OPERATING ACTIVITIES:</b>			
Net increase (decrease) in stockholders' equity resulting from operations	\$ (9,567,327)	\$ 26,141,985	\$ 4,670,540
Adjustments to reconcile net increase (decrease) in stockholders' equity resulting from operations:			
Net realized loss (gain) on investment transactions	575,179	(266,317)	(1,077)
Net unrealized loss (gain) on investments	39,698,065	(3,116,719)	(4,180,000)
Net accretion of discount on securities	(2,173,289)	(677,112)	(3,819)
Amortization of debt issuance cost	522,015	319,093	—
Purchases of investments	(108,769,127)	(360,579,378)	(200,987,595)
Payment-in-kind interest	(1,680,247)	(502,482)	—
Proceeds from sale and redemption of investments	75,181,094	106,944,232	533,315
Stock based compensation expense	888,368	600,200	13,500
Changes in operating assets and liabilities:			
Decrease (increase) in interest and dividends receivable	1,424,038	(4,990,552)	(602,085)
Decrease (increase) in other assets	255,502	(371,842)	(156,890)
Decrease (increase) in due from affiliates	150,183	(540,773)	—
Increase (decrease) in due to affiliates	—	(87,832)	87,832
Increase (decrease) in accounts payable and accrued expenses	(3,077,489)	4,437,344	1,704,548
Net cash used in operating activities	<u>(6,573,035)</u>	<u>(232,690,153)</u>	<u>(198,921,731)</u>
<b>FINANCING ACTIVITIES:</b>			
Issuance of stock (net of offering costs)	26,925,244	—	199,451,388
Dividends paid in cash	(28,179,592)	(17,047,541)	—
Proceeds from issuance of debt (net of offering costs)	50,000,000	255,000,000	—
Cash paid on repayment of debt	(43,308,852)	—	—
Debt issuance costs	—	(2,284,325)	—
Increase in restricted cash	<u>(701,123)</u>	<u>(1,418,868)</u>	<u>—</u>
Net cash provided by financing activities	<u>4,735,677</u>	<u>234,249,266</u>	<u>199,451,388</u>
CHANGE IN CASH	(1,837,358)	1,559,113	529,657
CASH, BEGINNING OF PERIOD	<u>2,088,770</u>	<u>529,657</u>	<u>—</u>
CASH, END OF PERIOD	<u>\$ 251,412</u>	<u>\$ 2,088,770</u>	<u>\$ 529,657</u>
<b>Supplemental Information:</b>			
Interest paid during the period	\$ 10,984,993	\$ 5,474,198	\$ —
Non-cash dividends paid during the period under dividend reinvestment plan	\$ 2,591,296	\$ 1,103,245	\$ —
Issuance of common stock for affiliate investment	\$ —	\$ —	\$ 33,394,995
Issuance of common stock for CLO equity investments managed by affiliate	\$ —	\$ —	\$ 18,870,000
Non-cash settlement of warehoused loans	\$ —	\$ 13,293,674	\$ —

See accompanying notes to financial statements.

**KOHLBERG CAPITAL CORPORATION**

**SCHEDULE OF INVESTMENTS**

**As of December 31, 2008**

**Debt Securities Portfolio**

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Cost</b>	<b>Value<sup>2</sup></b>
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Deferred Draw Term Loan (First Lien) 6.6%, Due 6/13	\$ 356,819	\$ 356,819	\$ 356,819
Advanced Lighting Technologies, Inc. <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Revolving Loan 3.9%, Due 6/13	960,000	952,585	960,000
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Junior Secured Loan — Second Lien Term Loan Note 8.5%, Due 6/14	5,000,000	5,000,000	5,000,000
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan (First Lien) 4.6%, Due 6/13	1,834,277	1,834,277	1,834,277
Aero Products International, Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 7.0%, Due 4/12	3,118,560	3,118,560	3,118,560
Aerostructures Acquisition LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Delayed Draw Term Loan 7.5%, Due 3/13	429,397	429,397	429,397
Aerostructures Acquisition LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 7.5%, Due 3/13	5,436,949	5,436,949	5,436,949
AGA Medical Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Tranche B Term Loan 4.2%, Due 4/13	3,832,209	3,829,883	3,458,569
AGS LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Delayed Draw Term Loan 3.5%, Due 5/13	442,044	436,817	419,942
AGS LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Initial Term Loan 3.5%, Due 5/13	3,159,324	3,121,965	3,001,357
AmerCable Incorporated <sup>6</sup> <i>Machinery (Non-Agriculture, Non- Construction, Non-Electronic)</i>	Senior Secured Loan — Initial Term Loan 5.0%, Due 6/14	5,900,113	5,900,113	5,900,113
Astoria Generating Company Acquisitions, L.L.C. <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Term C 4.2%, Due 8/13	4,000,000	4,040,652	3,613,340

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Atlantic Marine Holding Company <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Term Loan 6.5%, Due 3/14	\$ 1,721,939	\$ 1,731,184	\$ 1,721,939
Aurora Diagnostics, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Tranche A Term Loan (First Lien) 6.7%, Due 12/12	4,265,636	4,231,984	4,265,636
Awesome Acquisition Company (CiCi's Pizza) <sup>6</sup> <i>Personal, Food and Miscellaneous Services</i>	Junior Secured Loan — Term Loan (Second Lien) 6.5%, Due 6/14	4,000,000	3,977,593	3,820,000
AZ Chem US Inc. <i>Chemicals, Plastics and Rubber</i>	Junior Secured Loan — Second Lien Term Loan 6.0%, Due 2/14	3,300,000	2,649,436	2,640,000
AZ Chem US Inc. <sup>6</sup> <i>Chemicals, Plastics and Rubber</i>	Junior Secured Loan — Second Lien Term Loan 6.0%, Due 2/14	4,000,000	3,963,645	3,200,000
Bankruptcy Management Solutions, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Junior Secured Loan — Loan (Second Lien) 8.1%, Due 7/13	2,443,750	2,473,717	1,906,125
Bankruptcy Management Solutions, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Senior Secured Loan — Term Loan (First Lien) 4.5%, Due 7/12	1,955,000	1,964,334	1,803,488
Bicent Power LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Advance (Second Lien) 5.5%, Due 12/14	4,000,000	4,000,000	3,730,000
BP Metals, LLC <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Term Loan 10.1%, Due 6/13	4,937,500	4,937,500	4,937,500
Broadlane, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan 8.5%, Due 8/13	4,987,500	4,918,231	4,987,500
Caribe Information Investments Incorporated <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan 3.4%, Due 3/13	1,694,554	1,688,542	1,364,116
Cast & Crew Payroll, LLC (Payroll Acquisition) <sup>6</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Secured Loan — Initial Term Loan 4.4%, Due 9/12	9,208,100	9,234,910	9,208,100
CEI Holdings, Inc. (Cosmetic Essence) <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 6.3%, Due 3/14	1,469,323	1,403,698	1,322,391
Centaur, LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Term Loan (First Lien) 9.3%, Due 10/12	2,792,043	2,763,495	2,652,440

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Charlie Acquisition Corp. <i>Personal, Food and Miscellaneous Services</i>	Mezzanine Investment — Senior Subordinated Notes 15.5%, Due 6/13	\$ 10,893,401	\$ 10,744,496	\$ 7,625,381
Clarke American Corp. <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Tranche B Term Loan 4.2%, Due 6/14	2,955,000	2,955,000	2,296,035
CoActive Technologies, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Senior Secured Loan — Term Loan (First Lien) 4.5%, Due 7/14	3,960,000	3,944,053	3,960,000
CoActive Technologies, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Term Loan (Second Lien) 8.2%, Due 1/15	2,000,000	1,966,739	2,000,000
Coastal Concrete Southeast, LLC <i>Buildings and Real Estate</i> <sup>4</sup>	Mezzanine Investment — Mezzanine Term Loan 10.0%, Due 3/13	8,886,903	8,557,108	6,931,785
Cooper-Standard Automotive Inc <sup>6</sup> <i>Automobile</i>	Senior Unsecured Bond — 8.4%, Due 12/14	4,000,000	3,259,487	2,800,000
DaimlerChrysler Financial Services Americas LLC <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Term Loan (First Lien) 6.0%, Due 8/12	3,959,925	3,723,431	2,771,947
Dealer Computer Services, Inc. (Reynolds & Reynolds) <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Term Loan (Second Lien) 6.0%, Due 10/13	1,000,000	1,007,900	990,000
Dealer Computer Services, Inc. (Reynolds & Reynolds) <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Term Loan (Third Lien) 8.0%, Due 4/14	7,700,000	7,501,237	6,747,125
Delta Educational Systems, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan 7.5%, Due 6/12	2,748,162	2,748,162	2,748,162
Dex Media West LLC <i>Printing and Publishing</i>	Senior Secured Loan — Tranche B Term Loan 7.1%, Due 10/14	7,000,000	6,309,065	6,289,990
Dresser, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Term Loan (Second Lien) 8.0%, Due 5/15	3,000,000	2,964,626	2,830,005
DRI Holdings, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — US Term Loan (Second Lien) 10.1%, Due 7/15	6,000,000	5,411,785	6,000,000
Edgestone CD Acquisition Corp. (Custom Direct) <sup>6</sup> <i>Printing and Publishing</i>	Junior Secured Loan — Loan (Second Lien) 7.5%, Due 12/14	5,000,000	5,000,000	4,850,000

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Cost</b>	<b>Value<sup>2</sup></b>
Edgestone CD Acquisition Corp. (Custom Direct) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan (First Lien) 4.2%, Due 12/13	\$ 4,455,857	\$ 4,460,205	\$ 3,965,713
eInstruction Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Initial Term Loan 5.8%, Due 7/13	4,781,365	4,781,365	4,781,365
eInstruction Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — Term Loan (Second Lien) 9.3%, Due 7/14	10,000,000	10,000,000	10,000,000
Emerson Reinsurance Ltd. <sup>3</sup> <i>Insurance</i>	Senior Secured Loan — Series C Loan 7.3%, Due 12/11	1,000,000	1,000,000	1,000,000
Endeavor Energy Resources, L.P. <sup>6</sup> <i>Oil and Gas</i>	Junior Secured Loan — Initial Loan (Second Lien) 6.3%, Due 4/12	4,000,000	4,000,000	4,000,000
Fasteners For Retail, Inc. <sup>6</sup> <i>Diversified/Conglomerate Manufacturing</i>	Senior Secured Loan — Term Loan 6.6%, Due 12/12	4,320,878	4,327,124	4,277,670
FD Alpha Acquisition LLC (Fort Dearborn) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — US Term Loan 6.3%, Due 11/12	1,740,026	1,624,251	1,713,926
First American Payment Systems, L.P. <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Term Loan 4.3%, Due 10/13	3,398,000	3,398,000	3,398,000
First Data Corporation <i>Finance</i>	Senior Secured Loan — Initial Tranche B-2 Term Loan 3.2%, Due 9/14	4,974,811	4,534,131	4,520,860
Flatiron Re Ltd. <sup>3,6</sup> <i>Insurance</i>	Senior Secured Loan — Closing Date Term Loan 5.7%, Due 12/10	96,855	97,333	96,855
Flatiron Re Ltd. <sup>3,6</sup> <i>Insurance</i>	Senior Secured Loan — Delayed Draw Term Loan 5.7%, Due 12/10	46,914	47,146	46,914
Ford Motor Company <sup>6</sup> <i>Automobile</i>	Senior Secured Loan — Term Loan 5.0%, Due 12/13	1,969,849	1,967,877	1,378,894
Freescale Semiconductor, Inc. <i>Electronics</i>	Senior Subordinated Bond — 10.3%, Due 12/16	3,000,000	3,008,197	2,287,500
Frontier Drilling USA, Inc. <sup>6</sup> <i>Oil and Gas</i>	Senior Secured Loan — Term B Advance 9.3%, Due 6/13	2,000,000	1,998,263	1,940,000

Portfolio Company / Principal Business	Investment		Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity				
Getty Images, Inc. <i>Printing and Publishing</i>	Senior Secured Loan — Initial Term Loan 8.1%, Due 7/15		\$ 2,981,250	\$ 2,981,250	\$ 2,712,938
Ginn LA Conduit Lender, Inc. <sup>10</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — First Lien Tranche A Credit-Linked Deposit 7.8%, Due 6/11		1,257,143	1,224,101	150,857
Ginn LA Conduit Lender, Inc. <sup>10</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — First Lien Tranche B Term Loan 7.8%, Due 6/11		2,694,857	2,624,028	323,383
Ginn LA Conduit Lender, Inc. <sup>10</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Junior Secured Loan — Loan (Second Lien) 11.8%, Due 6/12		3,000,000	2,715,997	90,000
Gleason Works, The <sup>6</sup> <i>Machinery (Non-Agriculture, Non- Construction, Non-Electronic)</i>	Senior Secured Loan — New US Term Loan 4.9%, Due 6/13		2,437,280	2,443,443	2,205,739
Hawkeye Renewables, LLC <sup>6</sup> <i>Farming and Agriculture</i>	Senior Secured Loan — Term Loan (First Lien) 7.3%, Due 6/12		2,908,544	2,856,515	1,250,674
HMSC Corporation (aka Swett and Crawford) <sup>6</sup> <i>Insurance</i>	Junior Secured Loan — Loan (Second Lien) 6.0%, Due 10/14		5,000,000	4,831,923	4,550,000
Huish Detergents Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Junior Secured Loan — Loan (Second Lien) 4.7%, Due 10/14		1,000,000	1,000,000	765,000
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Initial Term Loan (First Lien) 4.7%, Due 4/14		3,723,929	3,577,920	3,165,339
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Junior Secured Loan — Loan (Second Lien) 7.6%, Due 10/14		3,000,000	3,000,000	2,347,500
Infiltrator Systems, Inc. <sup>6</sup> <i>Ecological</i>	Senior Secured Loan — Term Loan 7.3%, Due 9/12		2,727,813	2,721,193	2,727,813
Inmar, Inc. <sup>6</sup> <i>Retail Stores</i>	Senior Secured Loan — Term Loan 2.7%, Due 4/13		3,755,829	3,755,829	3,755,829
International Aluminum Corporation (IAL Acquisition Co.) <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Term Loan 4.8%, Due 3/13		3,001,367	3,001,367	3,001,367
Intrapac Corporation/Corona Holdco <sup>6</sup> <i>Containers, Packaging and Glass</i>	Senior Secured Loan — First Lien Term Loan 6.9%, Due 5/12		4,316,295	4,329,467	4,316,295

Portfolio Company / Principal Business	Investment		Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity				
Intrapac Corporation/Corona Holdco <sup>6</sup> <i>Containers, Packaging and Glass</i>	Junior Secured Loan — Term Loans (Second Lien) 10.9%, Due 5/13		\$ 3,000,000	\$ 3,017,825	\$ 3,000,000
Jones Stephens Corp. <sup>6</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — Term Loan 5.2%, Due 9/12		10,090,295	10,068,492	10,090,295
JW Aluminum Company <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Junior Secured Loan — Term Loan (Second Lien) 7.2%, Due 12/13		5,371,429	5,387,168	3,222,857
Kepler Holdings Limited <sup>3,6</sup> <i>Insurance</i>	Senior Secured Loan — Loan 7.0%, Due 6/09		5,000,000	5,006,639	5,000,000
KIK Custom Products Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Junior Secured Loan — Loan (Second Lien) 8.5%, Due 12/14		5,000,000	5,000,000	3,400,000
La Paloma Generating Company, LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Loan (Second Lien) 5.0%, Due 8/13		2,000,000	2,014,136	2,000,000
LBREP/L-Suncal Master I LLC <sup>6,10</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — Term Loan (First Lien) 5.5%, Due 1/10		3,875,156	3,835,789	290,637
LBREP/L-Suncal Master I LLC <sup>6,10</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Junior Secured Loan — Term Loan (Second Lien) 9.5%, Due 1/11		2,000,000	1,920,211	7,500
LBREP/L-Suncal Master I LLC <sup>10</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Junior Secured Loan — Term Loan (Third Lien) 11.3%, Due 2/12		2,332,868	2,332,868	1,000
Lear Corporation <i>Automobile</i>	Senior Secured Loan — Term Loan 3.7%, Due 4/12		1,993,927	1,709,640	1,694,838
Legacy Cabinets, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan 5.8%, Due 8/12		2,269,824	2,269,824	2,269,824
Levlad, LLC & Arbonne International, LLC <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 4.5%, Due 3/14		2,731,786	2,731,786	1,693,708
LN Acquisition Corp. (Lincoln Industrial) <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 6.8%, Due 1/15		2,000,000	2,000,000	1,970,000
LPL Holdings, Inc. <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Tranche D Term Loan 2.8%, Due 6/13		3,305,000	3,324,288	3,139,750

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Manitowoc Company Inc., The <i>Diversified/Conglomerate Manufacturing</i>	Senior Secured Loan — Term B Loan 6.5%, Due 8/14	\$ 2,000,000	\$ 1,955,000	\$ 1,817,500
MCCI Group Holdings, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 6.6%, Due 12/12	5,899,925	5,884,108	5,899,925
MCCI Group Holdings, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — Term Loan (Second Lien) 9.4%, Due 6/13	1,000,000	1,000,000	1,000,000
Murray Energy Corporation <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Tranche B Term Loan (First Lien) 6.9%, Due 1/10	1,949,367	1,954,403	1,910,380
Mylan Inc. <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — U.S. Tranche B Term Loan 5.0%, Due 10/14	1,969,849	1,912,634	1,792,563
National Interest Security Company, L.L.C. <i>Aerospace and Defense</i>	Mezzanine Investment — Mezzanine Facility 15.0%, Due 6/13	3,000,000	3,000,000	3,000,000
National Interest Security Company, L.L.C. <i>Aerospace and Defense</i>	Junior Secured Loan — Second Lien Term Loan 15.0%, Due 6/13	1,000,000	1,000,000	1,000,000
National Interest Security Company, L.L.C. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan - First Lien 7.8%, Due 12/12	8,075,000	8,075,000	8,075,000
Northeast Biofuels, LP <sup>6</sup> <i>Farming and Agriculture</i>	Senior Secured Loan — Construction Term Loan 8.3%, Due 6/13	1,382,120	1,384,467	276,424
Northeast Biofuels, LP <sup>6</sup> <i>Farming and Agriculture</i>	Senior Secured Loan — Synthetic LC Term Loan 8.3%, Due 6/13	57,257	57,354	11,451
PAS Technologies Inc. <i>Aerospace and Defense</i>	Senior Secured Loan — Incremental Term Loan Add On 6.8%, Due 6/11	744,382	744,382	744,382
PAS Technologies Inc. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 6.8%, Due 6/11	3,680,556	3,665,393	3,680,556
Pegasus Solutions, Inc. <sup>6</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Secured Loan — Term Loan 7.8%, Due 4/13	5,695,000	5,695,000	5,695,000
Pegasus Solutions, Inc. <sup>13</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Unsecured Bond — 10.5%, Due 4/15	2,000,000	2,000,000	2,000,000

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Primus International Inc. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 4.3%, Due 6/12	\$ 1,246,565	\$ 1,248,519	\$ 1,215,401
QA Direct Holdings, LLC <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan 6.8%, Due 8/14	4,937,343	4,896,292	4,937,343
Resco Products, Inc. <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Junior Secured Loan — Term Loan (Second Lien) 10.2%, Due 6/14	6,650,000	6,471,193	6,517,000
Rhodes Companies, LLC, The <sup>6</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — First Lien Term Loan 5.0%, Due 11/10	1,685,674	1,629,483	842,837
Rhodes Companies, LLC, The <sup>6</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Junior Secured Loan — Second Lien Term Loan 9.2%, Due 11/11	2,013,977	2,022,278	503,494
San Juan Cable, LLC <sup>6</sup> <i>Broadcasting and Entertainment</i>	Junior Secured Loan — Loan (Second Lien) 7.7%, Due 10/13	3,000,000	2,982,607	2,850,000
Schneller LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 5.1%, Due 6/13	4,694,560	4,658,215	4,694,560
Seismic Micro-Technology, Inc. (SMT) <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan 5.8%, Due 6/12	1,430,000	1,427,248	1,430,000
Seismic Micro-Technology, Inc. (SMT) <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan 5.8%, Due 6/12	953,333	951,498	953,333
Specialized Technology Resources, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Junior Secured Loan — Loan (Second Lien) 7.5%, Due 12/14	7,500,000	7,500,000	7,500,000
Specialized Technology Resources, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Senior Secured Loan — Term Loan (First Lien) 3.0%, Due 6/14	3,930,101	3,930,101	3,930,101
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Delayed Draw Term Loan 3.0%, Due 7/12	766,973	771,034	766,973
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Initial Term Loan 4.0%, Due 7/12	3,805,590	3,825,741	3,805,590
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Loan (Second Lien) 7.5%, Due 7/13	1,750,000	1,758,373	1,750,000

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Texas Competitive Electric Holdings Company, LLC (TXU) <i>Utilities</i>	Senior Secured Loan — Initial Tranche B-2 Term Loan 5.6%, Due 10/14	\$ 1,989,924	\$ 1,814,330	\$ 1,810,831
TPF Generation Holdings, LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Loan (Second Lien) 5.7%, Due 12/14	2,000,000	2,028,327	1,900,000
TransAxle LLC <i>Automobile</i>	Senior Secured Loan — Revolving Loan 6.0%, Due 8/11	400,000	397,067	398,716
TransAxle LLC <i>Automobile</i>	Senior Secured Loan — Term Loan 5.8%, Due 9/12	1,477,554	1,477,554	1,477,554
TUI University, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 6.1%, Due 10/14	3,736,736	3,581,708	3,568,583
Twin-Star International, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan 7.9%, Due 4/13	4,339,736	4,339,736	4,339,736
United Maritime Group, LLC (fka Teco Transport Corporation) <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Term Loan (Second Lien) 9.0%, Due 12/13	6,500,000	6,486,324	6,500,000
Walker Group Holdings LLC <i>Cargo Transport</i>	Junior Secured Loan — Term Loan B 12.6%, Due 12/12	526,500	526,500	526,500
Walker Group Holdings LLC <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Term Loan B 12.5%, Due 12/12	5,000,000	5,000,000	5,000,000
Water PIK, Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Loan (First Lien) 4.2%, Due 6/13	1,965,050	1,954,720	1,965,050
Wesco Aircraft Hardware Corp. <i>Aerospace and Defense</i>	Junior Secured Loan — Loan (Second Lien) 6.2%, Due 3/14	2,000,000	1,923,443	1,845,000
Wesco Aircraft Hardware Corp. <sup>6</sup> <i>Aerospace and Defense</i>	Junior Secured Loan — Loan (Second Lien) 6.2%, Due 3/14	4,132,887	4,161,055	3,812,589
WireCo WorldGroup Inc. <sup>6, 13</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Mezzanine Investment — 11.0%, Due 2/15	10,000,000	10,000,000	10,000,000
WireCo WorldGroup Inc. <sup>13</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Mezzanine Investment — 11.0%, Due 2/15	5,000,000	4,795,580	5,000,000

Portfolio Company / Principal Business	Investment Interest Rate <sup>1</sup> / Maturity	Principal	Cost	Value <sup>2</sup>
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Acquisition Term Loan 3.7%, Due 6/12	\$ 775,624	\$ 767,066	\$ 729,087
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Synthetic Letter of Credit .4%, Due 6/12	668,413	661,032	628,304
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Synthetic Revolver Deposit 1.1%, Due 6/12	167,103	165,259	157,077
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Term Loan (Second Lien) 6.0%, Due 12/12	2,683,177	2,687,607	2,468,522
X-Rite, Incorporated <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Loan (Second Lien) 14.4%, Due 10/13	645,361	645,361	645,361
X-Rite, Incorporated <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan (First Lien) 7.3%, Due 10/12	633,560	631,128	633,560
<b>Total Investment in Debt Securities (154% of net asset value at fair value)</b>		<b>\$430,366,772</b>	<b>\$ 423,859,086</b>	<b>\$ 384,486,111</b>

#### Equity Portfolio

Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Cost	Value <sup>2</sup>
Aerostructures Holdings L.P. <sup>7</sup> <i>Aerospace and Defense</i>	Partnership Interests	1.2%	\$ 1,000,000	\$ 750,000
Aerostructures Holdings L.P. <sup>7</sup> <i>Aerospace and Defense</i>	Series A Preferred Interests	0.0%	160,361	160,361
Allen-Vanguard Corporation <sup>3,7</sup> <i>Aerospace and Defense</i>	Common Shares	10,253	42,542	1,853
Coastal Concrete Southeast, LLC <sup>7,8</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Warrants	580	474,140	—
eInstruction Acquisition, LLC <sup>7</sup> <i>Healthcare, Education and Childcare</i>	Membership Units	1.1%	1,079,617	1,079,617

<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Percentage Interest/Shares</b>	<b>Cost</b>	<b>Value <sup>2</sup></b>
FP WRCA Coinvestment Fund VII, Ltd. <sup>3,7</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Class A Shares	15,000	\$ 1,500,000	\$ 2,398,000
Park Avenue Coastal Holding, LLC <i>Buildings and Real Estate</i> <sup>4</sup>	Common Interests	2.0%	1,000,000	—
<b>Total Investment in Equity Securities (2% of net asset value at fair value)</b>			<b>\$ 5,256,660</b>	<b>\$ 4,389,831</b>

#### CLO Fund Securities

<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Percentage Interest</b>	<b>Cost</b>	<b>Value <sup>2</sup></b>
Grant Grove CLO, Ltd. <sup>3,13</sup>	Subordinated Securities	22.2%	\$ 4,620,951	\$ 4,665,000
Katonah III, Ltd. <sup>3,13</sup>	Preferred Shares	23.1%	4,500,000	1,661,000
Katonah IV, Ltd. <sup>3,13</sup>	Preferred Shares	17.1%	3,150,000	1,601,000
Katonah V, Ltd. <sup>3,13</sup>	Preferred Shares	26.7%	3,320,000	1,172,000
Katonah VII CLO Ltd. <sup>3,9,13</sup>	Subordinated Securities	16.4%	4,500,000	2,629,000
Katonah VIII CLO Ltd <sup>3,9,13</sup>	Subordinated Securities	10.3%	3,400,000	2,252,000
Katonah IX CLO Ltd <sup>3,9,13</sup>	Preferred Shares	6.9%	2,000,000	1,921,000
Katonah X CLO Ltd <sup>3,9,13</sup>	Subordinated Securities	33.3%	11,324,758	11,875,000
Katonah 2007-I CLO Ltd. <sup>3,9,13</sup>	Preferred Shares	100.0%	29,560,886	28,859,236
<b>Total Investment in CLO Fund Securities (23% of net asset value at fair value)</b>			<b>\$ 66,376,595</b>	<b>\$ 56,635,236</b>

#### Asset Manager Affiliates

<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Percentage Interest</b>	<b>Cost</b>	<b>Value <sup>2</sup></b>
Katonah Debt Advisors, LLC	Membership Interests	100%	\$ 37,151,495	\$ 54,731,312
PKSIL	Class A Shares	100%	1,793,276	1,793,276
PKSIL	Class B Shares	35%	3,500	3,500
<b>Total Investment in Asset Manager Affiliates (22% of net asset value at fair value)</b>			<b>\$ 38,948,271</b>	<b>\$ 56,528,088</b>

## Time Deposits and Money Market Account

<b>Time Deposits and Money Market Account</b>	<b>Investment</b>	<b>Yield</b>	<b>Cost</b>	<b>Value <sup>2</sup></b>
US Bank Eurodollar Sweep CL2	Time Deposit	0.10%	\$ 10,462,702	\$ 10,462,702
JP Morgan Asset Account	Time Deposit	0.20%	1,723,295	1,723,295
JP Morgan Business Money Market Account	Money Market Account	0.19%	<u>10</u>	<u>10</u>
<b>Total Investment in Time Deposit and Money Market Accounts (5% of net asset value at fair value)</b>			<u>\$ 12,186,007</u>	<u>\$ 12,186,007</u>
<b>Total Investments <sup>5</sup> (205% of net asset value at fair value)</b>			<u>\$ 546,626,619</u>	<u>\$ 514,225,273</u>

The accompanying notes are an integral part of these financial statements.

- <sup>1</sup> A majority of the variable rate loans to our portfolio companies bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly. For each such loan, we have provided the weighted average annual stated interest rate in effect at December 31, 2008.
- <sup>2</sup> Reflects the fair market value of all existing investments as of December 31, 2008, as determined by our Board of Directors.
- <sup>3</sup> Non-U.S. company or principal place of business outside the U.S.
- <sup>4</sup> Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators. As of December 31, 2008, we had no exposure to mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset backed securities), companies providing mortgage lending or emerging markets investments either directly or through our investments in CLO funds.
- <sup>5</sup> The aggregate cost of investments for federal income tax purposes is approximately \$547 million. The aggregate gross unrealized appreciation is approximately \$20 million and the aggregate gross unrealized depreciation is approximately \$53 million.
- <sup>6</sup> Pledged as collateral for the secured revolving credit facility (see Note 6 to the financial statements).
- <sup>7</sup> Non-income producing.
- <sup>8</sup> Warrants having a strike price of \$0.01 and expiration date of March 2017.
- <sup>9</sup> An affiliate CLO Fund managed by Katonah Debt Advisors or its affiliate.
- <sup>10</sup> Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- <sup>11</sup> Time deposit investment partially restricted under terms of the secured credit facility (see Note 6 to financial statements).
- <sup>12</sup> Money market account holding restricted cash for employee flexible spending accounts.
- <sup>13</sup> These securities are exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions that are exempt from registration, normally to qualified institutional buyers.

**KOHLBERG CAPITAL CORPORATION**

**SCHEDULE OF INVESTMENTS**

**As of December 31, 2007**

**Debt Securities Portfolio**

<b>Portfolio Company / Principal Business</b>	<b>Investment Interest Rate<sup>1</sup> / Maturity</b>	<b>Principal</b>	<b>Cost</b>	<b>Value<sup>2</sup></b>
Advanced Lighting Technologies, Inc. <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Revolving Loan 7.5%, Due 6/13	\$ —	\$ —	\$ —
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Junior Secured Loan — Second Lien Term Loan Note 11.1%, Due 6/14	5,000,000	4,990,905	5,000,000
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan (First Lien) 7.9%, Due 6/13	3,573,000	3,573,000	3,573,000
Advanced Lighting Technologies, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Deferred Draw Term Loan (First Lien) 7.5%, Due 6/13	650,268	650,268	650,268
Aero Products International, Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 8.8%, Due 4/12	3,700,000	3,700,000	3,681,500
Aerostructures Acquisition LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Delayed Draw Term Loan 7.9%, Due 3/13	500,000	500,000	497,500
Aerostructures Acquisition LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 7.8%, Due 3/13	6,378,125	6,378,125	6,378,125
AGA Medical Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Tranche B Term Loan 7.2%, Due 4/13	3,832,209	3,829,343	3,654,970
AGS LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Delayed Draw Term Loan 7.7%, Due 5/13	579,194	562,331	550,234
AGS LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Initial Term Loan 7.9%, Due 5/13	4,802,419	4,732,592	4,562,298
Allen-Vanguard Corporation <sup>3</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — US Term Loan 12.0%, Due 9/12	2,309,736	2,277,028	2,277,028
AmerCable Incorporated <sup>6</sup> <i>Machinery (Non-Agriculture, Non- Construction, Non-Electronic)</i>	Senior Secured Loan — Initial Term Loan 8.4%, Due 6/14	6,965,000	6,965,000	6,965,000

Portfolio Company / Principal Business	Investment		Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity				
Astoria Generating Company Acquisitions, LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Second Lien Term Loan C 8.7%, Due 8/13		\$ 4,000,000	\$ 4,049,430	\$ 3,900,000
Atlantic Marine Holding Company <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Term Loan 7.1%, Due 3/14		1,739,465	1,750,599	1,730,768
Aurora Diagnostics, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Tranche A Term Loan (First Lien) 9.0%, Due 12/12		4,060,000	4,010,521	4,019,823
Awesome Acquisition Company (CiCi's Pizza) <sup>6</sup> <i>Personal, Food and Miscellaneous Services</i>	Junior Secured Loan — Term Loan (Second Lien) 9.8%, Due 6/14		4,000,000	3,973,451	3,820,000
AZ Chem US Inc. <sup>6</sup> <i>Chemicals, Plastics and Rubber</i>	Junior Secured Loan — Second Lien Term Loan 10.6%, Due 2/14		4,000,000	3,956,582	3,220,000
Bankruptcy Management Solutions, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Senior Secured Loan — First Lien Term Loan 7.6%, Due 7/12		1,975,000	1,987,070	1,846,625
Bankruptcy Management Solutions, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Junior Secured Loan — Loan (Second Lien) 11.1%, Due 7/13		2,468,750	2,505,651	1,987,344
Bay Point Re Limited <sup>3,6</sup> <i>Insurance</i>	Senior Secured Loan — Loan 9.6%, Due 12/10		3,000,000	3,019,487	3,019,487
Bicent Power LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Advance (Second Lien) 8.8%, Due 12/14		4,000,000	4,000,000	3,730,000
Byram Healthcare Centers, Inc. <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan A 10.1%, Due 11/11		3,733,691	3,733,691	3,733,691
Byram Healthcare Centers, Inc. <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Revolving Loan 9.7%, Due 11/10		375,000	375,000	375,000
Caribe Information Investments Incorporated <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan 7.3%, Due 3/13		2,815,534	2,803,185	2,709,951
Cast & Crew Payroll, LLC (Payroll Acquisition) <sup>6</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Secured Loan — Initial Term Loan 7.8%, Due 9/12		10,608,400	10,647,600	10,647,600
CEI Holdings, Inc. (Cosmetic Essence) <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 7.5%, Due 3/14		1,850,051	1,751,546	1,665,046

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Centaur, LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Term Loan (First Lien) 8.8%, Due 10/12	\$ 4,122,807	\$ 4,069,243	\$ 3,978,509
Centaur, LLC <sup>6</sup> <i>Hotels, Motels, Inns, and Gaming</i>	Senior Secured Loan — Delayed Draw Term Loan 8.7%, Due 10/12	—	—	—
Charlie Acquisition Corp. <i>Personal, Food and Miscellaneous Services</i>	Mezzanine Investment — Senior Subordinated Notes 15.5%, Due 6/13	10,127,500	9,945,201	9,945,201
Clarke American Corp. <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Tranche B Term Loan 7.3%, Due 6/14	2,985,000	2,985,000	2,693,963
Clayton Holdings, Inc <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Term Loan 7.0%, Due 12/11	614,320	616,752	552,888
Coastal Concrete Southeast, LLC <i>Buildings and Real Estate</i> <sup>4</sup>	Mezzanine Investment — Mezzanine Term Loan 15.0%, Due 3/13	8,120,914	7,711,760	8,120,914
Concord Re Limited <sup>3</sup> <i>Insurance</i>	Senior Secured Loan — Term Loan 9.2%, Due 2/12	3,000,000	3,024,013	3,000,000
CST Industries, Inc. <sup>6</sup> <i>Diversified/Conglomerate Manufacturing</i>	Senior Secured Loan — Term Loan 7.9%, Due 8/13	987,500	990,623	990,623
DaimlerChrysler Financial Services Americas LLC <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Term Loan (First Lien) 9.0%, Due 8/12	1,995,000	1,903,193	1,923,519
Dealer Computer Services, Inc. (Reynolds & Reynolds) <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Term Loan (Third Lien) 12.3%, Due 4/14	3,500,000	3,537,846	3,491,250
Dealer Computer Services, Inc. (Reynolds & Reynolds) <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Term Loan (Second Lien) 10.3%, Due 10/13	1,000,000	1,009,544	990,000
Delta Educational Systems, Inc. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan 8.3%, Due 6/12	2,876,053	2,876,053	2,876,053
DeltaTech Controls, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Senior Secured Loan — Term Loan (First Lien) 8.0%, Due 7/14	4,000,000	3,980,991	3,980,991
DeltaTech Controls, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Term Loan (Second Lien) 11.7%, Due 1/15	2,000,000	1,961,246	1,961,246

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Dresser, Inc. <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Term Loan (Second Lien) 11.1%, Due 5/15	\$ 3,000,000	\$ 2,959,031	\$ 2,861,250
Edgestone CD Acquisition Corp. (Custom Direct) <sup>6</sup> <i>Printing and Publishing</i>	Junior Secured Loan — Loan (Second Lien) 10.8%, Due 12/14	5,000,000	5,000,000	5,000,000
Edgestone CD Acquisition Corp. (Custom Direct) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan (First Lien) 7.6%, Due 12/13	4,975,000	4,980,828	4,980,828
eInstruction Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — Second Lien Term Loan (Dec. 2007) 12.5%, Due 7/14	10,000,000	10,000,000	10,000,000
eInstruction Corporation <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Initial Term Loan (Dec. 2007) 9.0%, Due 7/13	4,970,013	4,970,013	4,970,013
Emerson Reinsurance Ltd. <sup>3</sup> <i>Insurance</i>	Senior Secured Loan — Series C Loan 10.2%, Due 12/11	3,000,000	3,000,000	2,985,000
Endeavor Energy Resources, L.P. <i>Oil and Gas</i>	Junior Secured Loan — Second Lien Term Loan 9.6%, Due 3/12	4,000,000	4,000,000	4,000,000
Fasteners For Retail, Inc. <sup>6</sup> <i>Diversified/Conglomerate Manufacturing</i>	Senior Secured Loan — Term Loan 7.9%, Due 12/12	7,926,391	7,940,720	7,728,231
FD Alpha Acquisition LLC (Fort Dearborn) <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — US Term Loan 8.3%, Due 11/12	915,400	915,400	901,669
First American Payment Systems, L.P. <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Term Loan 8.2%, Due 10/13	3,694,000	3,694,000	3,601,650
Flatiron Re Ltd. <sup>3</sup> <i>Insurance</i>	Senior Secured Loan — Closing Date Term Loan 9.1%, Due 12/10	3,664,488	3,691,697	3,646,165
Flatiron Re Ltd. <sup>3</sup> <i>Insurance</i>	Senior Secured Loan — Delayed Draw Term Loan 9.1%, Due 12/10	1,774,986	1,788,166	1,766,111
Ford Motor Company <sup>6</sup> <i>Automobile</i>	Senior Secured Loan — Term Loan 8.0%, Due 12/13	1,989,950	1,987,554	1,845,678
Freescale Semiconductor, Inc. <i>Electronics</i>	Senior Subordinated Bond — 10.1%, Due 12/16	3,000,000	3,009,230	2,490,000

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Frontier Drilling USA, Inc. <sup>6</sup> <i>Oil and Gas</i>	Senior Secured Loan — Term B Advance 8.7%, Due 6/13	\$ 2,000,000	\$ 1,997,874	\$ 1,960,000
Ginn LA Conduit Lender, Inc. <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — First Lien Tranche A Credit-Linked Deposit 8.2%, Due 6/11	1,257,143	1,218,578	1,026,143
Ginn LA Conduit Lender, Inc. <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — First Lien Tranche B Term Loan 8.3%, Due 6/11	2,701,714	2,618,835	2,205,274
Ginn LA Conduit Lender, Inc. <i>Buildings and Real Estate</i> <sup>4</sup>	Junior Secured Loan — Second Lien Term Loan 12.3%, Due 6/12	3,000,000	2,680,274	1,925,010
Gleason Works, The <sup>6</sup> <i>Machinery (Non-Agriculture, Non- Construction, Non-Electronic)</i>	Senior Secured Loan — New US Term Loan 6.8%, Due 6/13	2,437,280	2,444,818	2,324,556
Hawkeye Renewables, LLC <sup>6</sup> <i>Farming and Agriculture</i>	Senior Secured Loan — Term Loan (First Lien) 9.0%, Due 6/12	2,962,406	2,894,213	2,346,640
HealthSouth Corporation <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan 7.7%, Due 3/13	1,262,594	1,266,540	1,208,403
HMSC Corporation (aka Swett and Crawford) <sup>6</sup> <i>Insurance</i>	Junior Secured Loan — Loan (Second Lien) 10.7%, Due 10/14	5,000,000	4,803,383	4,550,000
Huish Detergents Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Junior Secured Loan — Loan (Second Lien) 9.1%, Due 10/14	1,000,000	1,000,000	811,660
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Initial Term Loan (First Lien) 7.4%, Due 4/14	4,161,071	3,947,013	3,682,548
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Junior Secured Loan — Loan (Second Lien) 11.6%, Due 10/14	3,000,000	3,000,000	2,430,000
Hunter Fan Company <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Delayed Draw Term Loan 7.2%, Due 4/14	—	—	—
IAL Acquisition Co. (International Aluminum Corporation) <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Term Loan 7.6%, Due 3/13	4,039,700	4,039,700	4,039,700
Infiltrator Systems, Inc. <sup>6</sup> <i>Ecological</i>	Senior Secured Loan — Term Loan 8.4%, Due 9/12	3,950,000	3,937,850	3,937,850

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Inmar, Inc. <sup>6</sup> <i>Retail Stores</i>	Senior Secured Loan — Term Loan 7.3%, Due 4/13	\$ 4,962,500	\$ 4,962,500	\$ 4,813,625
Intrapac Corporation/Corona Holdco <sup>6</sup> <i>Containers, Packaging and Glass</i>	Senior Secured Loan — First Lien Term Loan 8.5%, Due 5/12	5,850,000	5,873,152	5,873,152
Intrapac Corporation/Corona Holdco <sup>6</sup> <i>Containers, Packaging and Glass</i>	Junior Secured Loan — Term Loans (Second Lien) 12.5%, Due 5/13	3,000,000	3,021,907	3,021,907
Jones Stephens Corp. <sup>6</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — Term Loan 8.8%, Due 9/12	10,245,530	10,217,367	10,217,367
JW Aluminum Company <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Junior Secured Loan — Term Loan (Second Lien) 11.1%, Due 12/13	5,371,429	5,390,350	5,210,286
Kepler Holdings Limited <sup>3</sup> <i>Insurance</i>	Senior Secured Loan — Loan 10.3%, Due 6/09	3,000,000	3,000,000	2,985,000
Kepler Holdings Limited <sup>3,6</sup> <i>Insurance</i>	Senior Secured Loan — Loan 10.3%, Due 6/09	2,000,000	2,020,139	1,990,000
KIK Custom Products Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Junior Secured Loan — Loan (Second Lien) 9.8%, Due 12/14	5,000,000	5,000,000	3,400,000
La Paloma Generating Company, LLC <i>Utilities</i>	Junior Secured Loan — Loan (Second Lien) 8.3%, Due 8/13	2,000,000	2,017,210	1,890,000
LBREP/L-Suncal Master I LLC <i>Buildings and Real Estate</i> <sup>4</sup>	Junior Secured Loan — Term Loan (Third Lien) 13.8%, Due 2/12	2,254,068	2,254,068	2,006,120
LBREP/L-Suncal Master I LLC <sup>6</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Senior Secured Loan — Term Loan (First Lien) 8.2%, Due 1/10	3,920,000	3,842,022	3,567,200
LBREP/L-Suncal Master I LLC <sup>6</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Junior Secured Loan — Term Loan (Second Lien) 12.2%, Due 1/11	2,000,000	1,918,000	1,780,000
Legacy Cabinets, Inc. <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — First Lien Term Loan 8.6%, Due 8/12	2,955,000	2,955,000	2,955,000
Levlad, LLC & Arbonne International, LLC <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Term Loan 7.2%, Due 3/14	2,898,451	2,898,451	2,266,589

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
LN Acquisition Corp. (Lincoln Industrial) <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Initial Term Loan (Second Lien) 10.9%, Due 1/15	\$ 2,000,000	\$ 2,000,000	\$ 1,970,000
LPL Holdings, Inc. <sup>6</sup> <i>Finance</i>	Senior Secured Loan — Tranche D Term Loan 6.8%, Due 6/13	5,338,639	5,376,752	5,131,767
MCCI Group Holdings, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Junior Secured Loan — Term Loan (Second Lien) 12.7%, Due 6/13	1,000,000	1,000,000	1,000,000
MCCI Group Holdings, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 9.4%, Due 12/12	5,960,018	5,940,018	5,960,018
Murray Energy Corporation <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Senior Secured Loan — Tranche B Term Loan (First Lien) 7.9%, Due 1/10	1,969,620	1,979,459	1,890,835
National Interest Security Company, L.L.C. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 9.7%, Due 12/12	5,000,000	5,000,000	5,000,000
Northeast Biofuels, LP <sup>6</sup> <i>Farming and Agriculture</i>	Senior Secured Loan — Construction Term Loan 8.5%, Due 6/13	1,365,854	1,368,725	1,229,268
Northeast Biofuels, LP <sup>6</sup> <i>Farming and Agriculture</i>	Senior Secured Loan — Synthetic LC Term Loan 8.1%, Due 6/13	536,585	537,713	482,927
PAS Technologies Inc. <i>Aerospace and Defense</i>	Senior Secured Loan — Incremental Term Loan Add On 8.5%, Due 6/11	856,741	856,741	856,741
PAS Technologies Inc. <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 8.4%, Due 6/11	4,236,111	4,211,616	4,211,616
Pegasus Solutions, Inc. <sup>12</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Unsecured Bond — 10.5%, Due 4/15	2,000,000	2,000,000	2,000,000
Pegasus Solutions, Inc. <sup>6</sup> <i>Leisure, Amusement, Motion Pictures, Entertainment</i>	Senior Secured Loan — Term Loan 8.1%, Due 4/13	5,755,000	5,755,000	5,755,000
Primus International Inc. <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — Term Loan 7.7%, Due 6/12	3,259,279	3,265,878	3,177,797
QA Direct Holdings, LLC <sup>6</sup> <i>Printing and Publishing</i>	Senior Secured Loan — Term Loan 9.6%, Due 8/14	4,987,469	4,938,587	4,950,063

Portfolio Company / Principal Business	Investment	Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity			
Resco Products, Inc. <sup>6</sup> <i>Mining, Steel, Iron and Non-Precious Metals</i>	Junior Secured Loan — Second Lien Term Loan 13.1%, Due 6/14	\$ 5,000,000	\$ 4,928,938	\$ 4,928,938
Rhodes Companies, LLC, The <sup>6</sup> <i>Buildings and Real Estate</i>	Senior Secured Loan — First Lien Term Loan 8.3%, Due 11/10	1,878,788	1,780,166	1,647,077
Rhodes Companies, LLC, The <sup>6</sup> <i>Buildings and Real Estate</i>	Junior Secured Loan — Second Lien Term Loan 12.6%, Due 11/11	2,000,000	2,011,185	1,266,680
San Juan Cable, LLC <sup>6</sup> <i>Broadcasting and Entertainment</i>	Junior Secured Loan — Second Lien Term Loan 10.7%, Due 10/13	3,000,000	2,978,999	2,782,500
Schneller LLC <sup>6</sup> <i>Aerospace and Defense</i>	Senior Secured Loan — First Lien Term Loan 8.7%, Due 6/13	4,975,000	4,927,882	4,950,125
Seismic Micro-Technology, Inc. (SMT) <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan 7.6%, Due 6/12	995,000	992,532	992,532
Seismic Micro-Technology, Inc. (SMT) <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan 7.6%, Due 6/12	1,492,500	1,488,798	1,488,798
Sorenson Communications, Inc. <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Tranche C Term Loan 7.4%, Due 8/13	2,791,551	2,807,105	2,720,897
Specialized Technology Resources, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Senior Secured Loan — Term Loan (First Lien) 7.3%, Due 6/14	5,970,000	5,970,000	5,970,000
Specialized Technology Resources, Inc. <sup>6</sup> <i>Diversified/Conglomerate Service</i>	Junior Secured Loan — Loan (Second Lien) 11.8%, Due 12/14	7,500,000	7,500,000	7,500,000
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Delayed Draw Term Loan 7.4%, Due 7/12	825,699	831,324	831,324
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — Initial Term Loan 7.3%, Due 7/12	4,097,298	4,125,208	4,125,208
Standard Steel, LLC <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Loan (Second Lien) 10.8%, Due 7/13	1,750,000	1,760,240	1,760,240
Stolle Machinery Company <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Junior Secured Loan — Loan (Second Lien) 11.4%, Due 9/13	1,000,000	1,015,115	975,000

Portfolio Company / Principal Business	Investment		Principal	Cost	Value <sup>2</sup>
	Interest Rate <sup>1</sup> / Maturity				
Stolle Machinery Company <sup>6</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Senior Secured Loan — First Lien Term Loan 7.9%, Due 9/12		\$ 1,975,000	\$ 1,985,124	\$ 1,945,375
TLC Funding Corp. <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 9.9%, Due 5/12		3,930,000	3,850,590	3,959,475
TPF Generation Holdings, LLC <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Second Lien Term Loan 9.1%, Due 12/14		2,000,000	2,033,096	1,890,000
TransAxle LLC <i>Automobile</i>	Senior Secured Loan — Revolver 8.2%, Due 8/11		490,909	486,678	488,832
TransAxle LLC <sup>6</sup> <i>Automobile</i>	Senior Secured Loan — Term Loan 9.2%, Due 9/12		2,812,500	2,812,500	2,812,500
TUI University, LLC <sup>6</sup> <i>Healthcare, Education and Childcare</i>	Senior Secured Loan — Term Loan (First Lien) 8.1%, Due 10/14		3,990,000	3,794,292	3,810,450
Twin-Star International, Inc. <sup>6</sup> <i>Home and Office Furnishings, Housewares, and Durable Consumer Products</i>	Senior Secured Loan — Term Loan 7.8%, Due 4/13		4,975,000	4,975,000	4,975,000
United Maritime Group, LLC (fka Teco Transport Corporation) <sup>6</sup> <i>Cargo Transport</i>	Junior Secured Loan — Term Loan (Second Lien) 12.8%, Due 12/13		4,500,000	4,500,000	4,511,250
United Maritime Group, LLC (fka Teco Transport Corporation) <sup>6</sup> <i>Cargo Transport</i>	Senior Secured Loan — 1st Lien Term Loan 9.0%, Due 12/12		2,000,000	2,000,000	2,000,000
Water PIK, Inc. <sup>6</sup> <i>Personal and Non Durable Consumer Products (Mfg. Only)</i>	Senior Secured Loan — Loan (First Lien) 8.2%, Due 6/13		2,985,000	2,965,778	2,925,300
Wesco Aircraft Hardware Corp. <sup>6</sup> <i>Aerospace and Defense</i>	Junior Secured Loan — Second Lien Term Loan 10.6%, Due 3/14		4,132,887	4,166,447	4,132,887
WireCo WorldGroup Inc. <sup>12</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Mezzanine Investment — 11.0%, Due 2/15		5,000,000	4,762,014	5,000,000
WireCo WorldGroup Inc. <sup>12</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Mezzanine Investment — 11.0%, Due 2/15		10,000,000	10,000,000	10,000,000
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Junior Secured Loan — Term Loan (Second Lien) 9.3%, Due 12/12		2,683,177	2,688,724	2,555,726

Portfolio Company / Principal Business	Investment Interest Rate <sup>1</sup> / Maturity	Principal	Cost	Value <sup>2</sup>
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Acquisition Term Loan 7.1%, Due 6/12	\$ 783,980	\$ 772,832	\$ 733,021
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Synthetic Letter of Credit 7.1%, Due 6/12	668,412	658,900	618,280
Wolf Hollow I, LP <sup>6</sup> <i>Utilities</i>	Senior Secured Loan — Synthetic Revolver Deposits 7.1%, Due 6/12	167,103	164,727	154,570
X-Rite, Incorporated <sup>6</sup> <i>Electronics</i>	Senior Secured Loan — Term Loan (First Lien) 8.5%, Due 10/12	1,995,000	1,985,328	1,985,025
X-Rite, Incorporated <sup>6</sup> <i>Electronics</i>	Junior Secured Loan — Loan (Second Lien) 12.4%, Due 10/13	1,000,000	1,000,000	1,000,000
<b>Total Investment in Debt Securities</b> <b>(159% of net asset value at fair value)</b>		<b>\$ 426,014,170</b>	<b>\$ 423,439,764</b>	<b>\$ 410,954,082</b>

#### Equity Portfolio

Portfolio Company / Principal Business	Investment	Percentage Interest/Shares	Cost	Value <sup>2</sup>
Aerostructures Holdings L.P. <sup>7</sup> <i>Aerospace and Defense</i>	Partnership Interest	1.2%	\$ 1,000,000	\$ 1,000,000
eInstruction Acquisition, LLC <sup>7</sup> <i>Healthcare, Education and Childcare</i>	Membership Units	1.1%	1,069,810	1,069,810
FP WRCA Coinvestment Fund VII, Ltd. <sup>3,7</sup> <i>Machinery (Non-Agriculture, Non-Construction, Non-Electronic)</i>	Class A Shares	15,000	1,500,000	1,500,000
Park Avenue Coastal Holding, LLC <sup>7</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Common Interests	2.0%	1,000,000	803,000
Coastal Concrete Southeast, LLC <sup>7,8</sup> <i>Buildings and Real Estate</i> <sup>4</sup>	Warrants	580	474,140	379,440
<b>Total Investment in Equity Securities</b> <b>(2% of net asset value at fair value)</b>			<b>\$ 5,043,950</b>	<b>\$ 4,752,250</b>

## CLO Fund Securities

<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Percentage Interest</b>	<b>Cost</b>	<b>Value <sup>2</sup></b>
Grant Grove CLO, Ltd. <sup>3, 12</sup>	Subordinated Securities	22.2%	\$ 4,415,580	\$ 4,250,000
Katonah III, Ltd. <sup>3, 12</sup>	Preferred Shares	23.1%	4,500,000	2,810,000
Katonah IV, Ltd. <sup>3, 12</sup>	Preferred Shares	17.1%	3,150,000	2,420,000
Katonah V, Ltd. <sup>3, 12</sup>	Preferred Shares	26.7%	3,320,000	420,000
Katonah VII CLO Ltd. <sup>3, 9, 12</sup>	Subordinated Securities	16.4%	4,500,000	3,950,000
Katonah VIII CLO Ltd <sup>3, 9, 12</sup>	Subordinated Securities	10.3%	3,400,000	3,290,000
Katonah IX CLO Ltd <sup>3, 9, 12</sup>	Preferred Shares	6.9%	2,000,000	2,000,000
Katonah X CLO Ltd <sup>3, 9, 12</sup>	Subordinated Securities	33.3%	10,775,684	11,880,000
<b>Total Investment in CLO Fund Securities</b> (12% of net asset value at fair value)			<b>\$ 36,061,264</b>	<b>\$ 31,020,000</b>

## Asset Manager Affiliates

<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Percentage Interest</b>	<b>Cost</b>	<b>Value <sup>2</sup></b>
Katonah Debt Advisors, LLC	Membership Interests	100%	\$ 33,394,995	\$ 58,510,360
PKSIL	Class A Shares	100%	71,500	71,500
PKSIL	Class B Shares	35%	3,500	3,500
<b>Total Investment in Asset Manager Affiliates</b> (23% of net asset value at fair value)			<b>\$ 33,469,995</b>	<b>\$ 58,585,360</b>

## Time Deposits and Money Market Account

<b>Portfolio Company / Principal Business</b>	<b>Investment</b>	<b>Yield</b>	<b>Cost</b>	<b>Value <sup>2</sup></b>
US Bank Eurodollar Sweep CL2 <sup>3, 10</sup>	Time Deposit	3.50%	\$ 12,809,784	\$ 12,809,784
JP Morgan Asset Account	Time Deposit	3.49%	2,864,705	2,864,705
JP Morgan Business Money Market Account <sup>11</sup>	Money Market Account	0.43%	20,766	20,766
<b>Total Investment in Time Deposits and Money Market Account</b> (6% of net asset value at fair value)			<b>\$ 15,695,255</b>	<b>\$ 15,695,255</b>
<b>Total Investments <sup>5</sup></b> (201% of net asset value at fair value)			<b>\$ 513,710,228</b>	<b>\$ 521,006,947</b>

The accompanying notes are an integral part of these financial statements.

- <sup>1</sup> A majority of the variable rate loans to our portfolio companies bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly. For each such loan, we have provided the weighted average annual stated interest rate in effect at December 31, 2007.
- <sup>2</sup> Reflects the fair market value of all existing investments as of December 31, 2007, as determined by our Board of Directors.
- <sup>3</sup> Non-U.S. company or principal place of business outside the U.S.
- <sup>4</sup> Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators. As of December 31, 2007, we had no exposure to mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset backed securities), companies providing mortgage lending or emerging markets investments either directly or through our investments in CLO funds.
- <sup>5</sup> The aggregate cost of investments for federal income tax purposes is approximately \$500 million. The aggregate gross unrealized appreciation is approximately \$27 million and the aggregate gross unrealized depreciation is approximately \$20 million.
- <sup>6</sup> Pledged as collateral for the secured revolving credit facility (see Note 6 to the financial statements).
- <sup>7</sup> Non-income producing.
- <sup>8</sup> Warrants having a strike price of \$0.01 and expiration date of March 2017.
- <sup>9</sup> An affiliate CLO Fund managed by Katonah Debt Advisors or its affiliate.
- <sup>10</sup> Time deposit investment partially restricted under terms of the secured credit facility (see Note 6 to financial statements).
- <sup>11</sup> Money market account holding restricted cash for employee flexible spending accounts.
- <sup>12</sup> These securities are exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions that are exempt from registration, normally to qualified institutional buyers.

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

	For the Year Ended December 31, 2008	For the Year Ended December 31, 2007	For the Period December 11, 2006 (inception) through December 31, 2006
<b>Per Share Data:</b>			
Net asset value, at beginning of period	\$ 14.38	\$ 14.29	\$ 15.00
Underwriting Costs	—	—	(0.97)
Post-IPO net asset value	14.38	14.29	14.03
<b>Net income (loss)</b>			
Net investment income <sup>1</sup>	1.51	1.27	0.02
Net realized gains <sup>1</sup>	(0.03)	0.01	—
Net change in unrealized appreciation on investments <sup>1</sup>	(4.16)	0.12	0.24
Net income (loss)	(2.68)	1.40	0.26
<b>Net decrease in net assets resulting from distributions</b>			
From net investment income	(1.44)	(1.36)	—
From capital gains	—	(0.01)	—
From return of capital	—	(0.03)	—
Total distributions to shareholders	(1.44)	(1.40)	—
Effect of distributions on restricted stock <sup>1</sup>	(0.01)	—	—
Net decrease in net assets resulting from distributions	(1.45)	(1.40)	—
<b>Net increase in net assets relating to stock-based transactions</b>			
Issuance of common stock (not including DRIP)	1.27	—	—
Issuance of common stock under dividend reinvestment plan	0.12	0.06	—
Stock based compensation expense	0.04	0.03	—
Net increase in net assets relating to stock-based transactions	1.43	0.09	—
Net asset value, end of period	\$ 11.68	\$ 14.38	\$ 14.29
Total net asset value return <sup>2</sup>	(8.7) %	10.4%	1.9%
<b>Ratio/Supplemental Data:</b>			
Per share market value at beginning of period	\$ 12.00	\$ 17.30	\$ 15.00
Per share market value at end of period	\$ 3.64	\$ 12.00	\$ 17.30
Total market return <sup>3</sup>	(57.6) %	(22.5) %	15.3%
Shares outstanding at end of period	21,436,936	18,017,699	17,946,333
Net assets at end of period	\$ 250,282,100	\$ 259,068,164	\$ 256,000,423
Portfolio turnover rate	14.0%	24.5%	0.3% <sup>4</sup>
Asset coverage ratio	196%	202%	N/A
Ratio of net investment income to average net assets	11.6%	8.5%	4.4% <sup>5</sup>
Ratio of total expenses to average net assets	7.0%	5.9%	6.3% <sup>5</sup>
Ratio of interest expense to average net assets	4.1%	2.7%	—% <sup>5</sup>
Ratio of non-interest expenses to average net assets	2.9%	3.2%	6.3% <sup>5</sup>

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

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

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

<sup>4</sup> Not annualized

<sup>5</sup> Annualized

See accompanying notes to financial statements.

# KOHLBERG CAPITAL CORPORATION

## NOTES TO FINANCIAL STATEMENTS

### 1. ORGANIZATION

Kohlberg Capital Corporation (“Kohlberg Capital” or the “Company”) is an internally managed, non-diversified closed-end investment company that is regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended. The Company originates, structures and invests in senior secured term loans, mezzanine debt and selected equity securities primarily in privately-held middle market companies. The Company defines the middle market as comprising companies with earnings before interest, taxes, depreciation and amortization (“EBITDA”), of \$10 million to \$50 million and/or total debt of \$25 million to \$150 million. The Company was formed as a Delaware LLC on August 8, 2006 and, prior to the issuance of shares of the Company’s common stock in its initial public offering, converted to a corporation incorporated in Delaware on December 11, 2006. Prior to its initial public offering (“IPO”), the Company did not have material operations. The Company’s IPO of 14,462,000 shares of common stock raised net proceeds of approximately \$200 million. Prior to the IPO, the Company issued 3,484,333 shares to affiliates of Kohlberg & Co., LLC (“Kohlberg & Co.”), a leading middle market private equity firm, in exchange for the contribution of their ownership interests in Katonah Debt Advisors, LLC (“Katonah Debt Advisors”) securities issued by collateralized loan obligation funds (“CLO Funds”) managed by Katonah Debt Advisors and two other asset managers to the Company. As of December 31, 2008, Katonah Debt Advisors had approximately \$2.1 billion of assets under management. On April 28, 2008 the Company completed a rights offering which resulted in the issuance of 3.1 million common shares and net proceeds of approximately \$27 million.

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

The Company has elected to be treated as a Regulated Investment Company (“RIC”) under Subchapter M of the Internal Revenue Code of 1986, as amended (the “Code”). To qualify as a RIC, the Company must, among other things, meet certain source-of-income and asset diversification requirements. Pursuant to this election, the Company generally will not have to pay corporate-level taxes on any income that it distributes to its stockholders.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

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

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make significant estimates and assumptions that affect reported amounts and disclosure in the financial statements, including the fair value of investments that do not have a readily available market value valued at approximately \$502 million (approximately 96% of total assets) and \$505 million (approximately 95% of total assets) as of December 31, 2008 and 2007, respectively. Actual results could differ from those estimates and the differences could be material.

Certain reclassifications were made to prior year’s presentation to conform to the current year. Time deposits and money market accounts, which were previously classified as cash and cash equivalents, have been reclassified to short term investments and certain income distributions have been reclassified to distributions from paid-in-capital to conform with current presentation.

## Investments

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

*Valuation of Portfolio Investments* . Kohlberg Capital's Board of Directors is ultimately and solely responsible for making a good faith determination of the fair value of portfolio investments on a quarterly basis. Debt and equity securities for which market quotations are readily available are generally valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued by the Board of Directors based on inputs of management, the Valuation Committee of the Board of Directors, and an independent valuation firm that has been engaged at the direction of the Board to assist in the valuation of the portfolio under a consistently applied valuation policy and process. Valuations are conducted on 100% of the investment portfolio at the end of each fiscal quarter.

Duff & Phelps, LLC, an independent valuation firm, provided third party valuation consulting services to the Company's Board of Directors which consisted of certain limited procedures that the Company's Board of Directors identified and requested them to perform. Each quarter, Duff & Phelps, LLC, performs such procedures on the Company's investment in Katonah Debt Advisors and all CLO Fund securities. In addition, Duff & Phelps, LLC performs its procedures on all illiquid junior and mezzanine securities such that they are reviewed at least once during a trailing 12 month period. Upon completion of the limited procedures, Duff & Phelps, LLC concluded that the fair value of those investments subjected to the limited procedures did not appear to be unreasonable.

As part of the valuation process, the Company may take into account the following types of factors, as relevant, in the determination of fair value: the enterprise value of a portfolio company, the nature and realizable value of any collateral, the portfolio company's ability to make debt service payments, its earnings, net cash flows, changes in the interest rate environment and the credit markets that may generally affect the price at which similar investment may be made, the markets in which the portfolio company does business, evaluations to peer comparables, seasoning of the loan and other relevant factors. If possible, the Company will corroborate its valuation of an investment with an external event such as a recent purchase transaction, public offering or sale.

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

The Company's valuation process is described as follows at the end of each fiscal quarter:

- 1) Each portfolio company or investment is cross-referenced to an independent pricing service to determine if a current market quote is available;
  - a) The nature and quality of such quote is reviewed to determine reliability and relevance of the quote – factors considered include if the quote is from a transaction, a broker quote, the date and aging of such quote, if the transaction is arms-length, a liquidation or distressed sale and other factors.
- 2) If an investment does not have a market quotation on either a broad market exchange or from an independent pricing service, the investment is initially valued by the Company's investment professionals responsible for the portfolio investment in conjunction with the portfolio management team.
- 3) Preliminary valuation conclusions are discussed and documented by management.
- 4) With respect to the valuations of Katonah Debt Advisors, the CLO Fund securities and other illiquid junior and mezzanine securities selected on a rotating quarterly basis such that they are reviewed at least once during a trailing 12 month period, an independent valuation firm, engaged by our Board of Directors, conducts independent valuations and reviews management's preliminary valuations and makes their own independent valuation assessment.
- 5) The Valuation Committee of the Board of Directors reviews the portfolio valuations, as well as the input and report of the independent valuation firm.

- 6) Upon approval of the investment valuations by the Valuation Committee of the Board of Directors, the Audit Committee of the Board of Directors reviews the results for inclusion in the Company's quarterly and annual financial statements.
- 7) The Board of Directors discusses the valuations and determines in good faith that the fair values of each investment in the portfolio is reasonable based upon the independent pricing service, input of management, independent valuation firms and the recommendations of the Valuation Committee of the Board of Directors.

*Loans and Debt Securities.* For loans and debt securities for which market quotations are readily available, such as broadly syndicated term loans and bonds, fair value generally is equal to the market price for those loans and securities. For loans and debt securities for which a market quotation is not readily available, such as middle market term loans, second lien term loans and mezzanine debt investments, fair value is determined by evaluating the borrower's enterprise value and other market or income valuation approaches generally used to determine fair value. The analysis of enterprise value or overall financial condition or other factors or methodologies may lead to a determination of fair value at a different amount other than cost; as a general rule, such loans and debt securities will be subject to fair value write-downs or other adjustment based on other observable market data or analysis of the borrower and investment as well as when the asset is considered impaired.

*Equity and Equity-Related Securities .* The Company's equity and equity-related securities in portfolio companies for which there is no liquid public market are carried at fair value based on the enterprise value of the portfolio company, which is determined using various factors, including cash flow from operations of the portfolio company and other pertinent factors, such as recent offers to purchase a portfolio company's securities or other liquidation events. The determined fair values are generally discounted to account for restrictions on resale and minority ownership positions. The value of the Company's equity and equity-related securities in public companies for which market quotations are readily available are based upon the closing public market price on the balance sheet date. The Company's investment in its wholly-owned asset management company, Katonah Debt Advisors, is valued based on standard measures such as the percentage of assets under management and a multiple of operating income used to value other asset management companies.

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

The Company's investments in CLO Fund securities are carried at fair value, which is based either on (i) the present value of the net expected cash inflows for interest income and principal repayments from underlying assets and 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 begin to sell assets and/or use principal repayments to pay-down CLO Fund debt, and for which there continue to be net cash distributions to the class of securities owned by the Company, or (ii) the net asset value of the CLO Fund for CLO Funds which are approaching or past the end of their reinvestment period and therefore begin to sell assets and/or use principal repayments to pay-down CLO Fund debt, and for which there are negligible net cash distributions to the class of securities owned by the Company, or (iii) a discounted cash flow model for more recent CLO Funds that utilizes prepayment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar bonds or preferred shares to those in which the Company has invested. The Company recognizes 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 Investment. The Company determines the fair value of its investments in CLO Fund securities on an individual security-by-security basis.

*Cash .* The Company defines cash as demand deposits.

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

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

**Interest Income** . Interest income, including amortization of premium and accretion of discount, is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company generally places a loan or security on non-accrual status and ceases recognizing interest income on such loan or security when a loan or security becomes 90 days or more past due or if the Company otherwise does not expect the debtor to be able to service its debt obligations. Non-accrual loans remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due or such loans become current. As of December 31, 2008, two issuers representing approximately 0.2% of total investments at fair value were considered in default.

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

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

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

**Debt Issuance Costs** . Debt issuance costs represent fees and other direct costs incurred in connection with the Company's borrowings. These amounts are capitalized and amortized ratably over the contractual term of the borrowing as a component of interest expense. At December 31, 2008, there was an unamortized debt issuance cost of approximately \$2 million included in other assets in the accompanying balance sheet. Amortization expense for the years ended December 31, 2008 and 2007 was approximately \$522,000 and \$319,000, respectively. The Company had no borrowing facility in place or amortization of debt issuance costs at and for the period ended December 31, 2006.

**Expenses** . The Company is internally managed and expenses costs, as incurred, with regard to the running of its operations. Primary operating expenses include employee salaries and benefits, the costs of identifying, evaluating, negotiating, closing, monitoring and servicing the Company's investments and related overhead charges and expenses, including rental expense and any interest expense incurred in connection with borrowings. The Company and its asset manager affiliates share office space and certain other shared operating expenses. The Company has entered into an Overhead Allocation Agreement with its asset manager affiliates which provides for the sharing of such expenses based on an equal sharing of office lease costs and the ratable usage of other shared resources. The aggregate net payments of such expenses under the Overhead Allocation Agreement are not material.

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

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

### 3. EARNINGS (LOSSES) PER SHARE

The following information sets forth the computation of basic and diluted net increase (decrease) in stockholders' equity per share for the the years ended December 31, 2008 and 2007, and for the period December 11, 2006 (inception) through December 31, 2006:

	<u>For the Year Ended December 31, 2008</u>	<u>For the Year Ended December 31, 2007</u>	<u>For the Period December 11, 2006 (inception) through December 31, 2006</u>
Numerator for basic and diluted net increase (decrease) in stockholders' equity resulting from operations per share:	\$ (9,567,327)	\$ 26,141,985	\$ 4,670,540
Denominator for basic weighted average shares:	20,276,430	17,977,348	17,946,333
Dilutive effect of restricted stock:	178,892	—	—
Dilutive effect of stock options:	—	—	—
Denominator for diluted weighted average shares: <sup>1</sup>	<u>20,455,322</u>	<u>17,977,348</u>	<u>17,946,333</u>
Basic net increase (decrease) in stockholders' equity resulting from operations per share:	\$ (0.47)	\$ 1.45	\$ 0.26
Diluted net increase (decrease) in stockholders' equity resulting from operations per share:	\$ (0.47)	\$ 1.45	\$ 0.26

<sup>1</sup> All stock options outstanding are anti-dilutive.

### 4. INVESTMENTS

The Company invests in senior secured loans and mezzanine debt and, to a lesser extent, equity capital of middle market companies in a variety of industries. The Company generally targets companies that generate positive cash flows because the Company looks to cash flows as the primary source for servicing debt. However, the Company may invest in other industries if it is presented with attractive opportunities.

The following table shows the Company's portfolio by security type at December 31, 2008 and December 31, 2007:

Security Type	<u>December 31, 2008</u>			<u>December 31, 2007</u>		
	<u>Cost</u>	<u>Fair Value</u>	<u>%<sup>1</sup></u>	<u>Cost</u>	<u>Fair Value</u>	<u>%<sup>1</sup></u>
Time Deposits	\$ 12,185,997	\$ 12,185,997	5%	\$ 15,674,489	\$ 15,674,489	6%
Money Market Account	10	10	—	20,766	20,766	—
Senior Secured Loan	235,123,695	218,342,528	87	265,390,844	260,138,674	100
Junior Secured Loan	143,370,524	126,498,918	51	120,620,715	113,259,293	44
Mezzanine Investment	37,097,183	32,557,165	12	32,418,975	33,066,115	12
Senior Subordinated Bond	3,008,197	2,287,500	1	3,009,230	2,490,000	1
Senior Unsecured Bond	5,259,487	4,800,000	2	2,000,000	2,000,000	1
CLO Fund Securities	66,376,595	56,635,236	23	36,061,264	31,020,000	12
Equity Securities	5,256,660	4,389,831	2	5,043,950	4,752,250	2
Affiliate Asset Managers	38,948,271	56,528,088	22	33,469,995	58,585,360	23
Total	<u>\$ 546,626,619</u>	<u>\$ 514,225,273</u>	<u>205%</u>	<u>\$ 513,710,228</u>	<u>\$ 521,006,947</u>	<u>201%</u>

<sup>1</sup> Calculated as a percentage of net asset value

The unaudited industry concentrations, based on the fair value of the Company's investment portfolio as of December 31, 2008 and December 31, 2007, were as follows:

Industry Classification	December 31, 2008			December 31, 2007		
	Cost	Fair Value	% <sup>1</sup>	Cost	Fair Value	% <sup>1</sup>
Aerospace and Defense	\$ 35,545,254	\$ 34,846,047	14%	\$ 32,583,716	\$ 32,481,819	13%
Asset Management Companies <sup>2</sup>	38,948,271	56,528,088	23	33,469,995	58,585,360	23
Automobile	8,811,625	7,750,003	3	5,286,731	5,147,010	2
Broadcasting and Entertainment	2,982,607	2,850,000	1	2,978,999	2,782,500	1
Buildings and Real Estate <sup>3</sup>	38,404,495	19,231,787	8	37,726,396	34,944,226	13
Cargo Transport	20,099,157	20,071,001	8	14,967,369	14,958,789	6
Chemicals, Plastics and Rubber	6,613,081	5,840,000	2	3,956,582	3,220,000	1
CLO Fund Securities	66,376,595	56,635,236	23	36,061,264	31,020,000	12
Containers, Packaging and Glass	7,347,292	7,316,295	3	8,895,059	8,895,059	3
Diversified/Conglomerate						
Manufacturing	6,282,124	6,095,170	2	8,931,343	8,718,855	3
Diversified/Conglomerate Service	15,868,152	15,139,713	6	17,962,721	17,303,969	7
Ecological	2,721,193	2,727,813	1	3,937,850	3,937,850	2
Electronics	15,172,568	13,686,879	5	15,830,382	15,158,502	6
Farming and Agriculture	4,298,336	1,538,550	1	4,800,651	4,058,835	2
Finance	14,979,849	13,830,557	6	11,590,697	11,209,824	4
Healthcare, Education and Childcare	49,379,475	49,581,920	20	46,715,870	46,637,705	18
Home and Office Furnishings, Housewares, and Durable Consumer Goods	21,331,162	20,273,496	8	24,091,185	23,265,816	9
Hotels, Motels, Inns and Gaming	6,322,276	6,073,739	2	9,364,165	9,091,041	4
Insurance	10,983,041	10,693,769	4	24,346,884	23,941,763	9
Leisure, Amusement, Motion Pictures, Entertainment	16,929,910	16,903,100	6	18,402,600	18,402,600	7
Machinery (Non-Agriculture, Non- Construction, Non-Electronic)	35,514,554	36,263,857	14	39,573,338	39,483,418	15
Mining, Steel, Iron and Non-Precious Metals	21,751,631	19,589,104	8	16,338,446	16,069,759	6
Oil and Gas	5,998,263	5,940,000	2	5,997,874	5,960,000	2
Personal and Non Durable Consumer Products (Mfg. Only)	15,208,764	12,264,708	5	17,315,776	14,750,095	6
Personal, Food and Miscellaneous Services	14,722,088	11,445,381	5	13,918,651	13,765,201	5
Printing and Publishing	29,914,605	28,130,061	11	21,622,999	21,236,473	8
Retail Stores	3,755,829	3,755,829	2	4,962,500	4,813,625	2
Time Deposits and Money Market Account	12,186,007	12,186,007	5	15,695,255	15,695,255	6
Utilities	18,178,415	17,037,163	7	16,384,930	15,471,598	6
<b>Total</b>	<b>\$ 546,626,619</b>	<b>\$ 514,225,273</b>	<b>205%</b>	<b>\$ 513,710,228</b>	<b>\$ 521,006,947</b>	<b>201%</b>

<sup>1</sup> Calculated as a percentage of net asset value.

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

<sup>3</sup> Buildings and real estate relate to real estate ownership, builders, managers and developers and excludes mortgage debt investments and mortgage lenders or originators. As of December 31, 2008 and December 31, 2007, the Company had no exposure to mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset backed securities) or companies providing mortgage lending.

The Company may invest up to 30% of the investment portfolio in opportunistic investments in high-yield bonds, debt and equity securities in CLO Funds, distressed debt or equity securities of public companies. The Company expects that these public companies generally will have debt that is non-investment grade. The Company also may invest in debt of middle market companies located outside of the United States, which investments (excluding the Company's investments in CLO Funds) are generally not anticipated to be in excess of 10% of the investment portfolio at the time such investments are made. As a result of regulatory restrictions, the Company is not permitted to invest in any portfolio company in which Kohlberg & Co. or any fund that it manages has a pre-existing investment.

At December 31, 2008 and December 31, 2007, approximately 14% and 11%, respectively, of the Company's investments were foreign assets (including the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 11% and 6% of its portfolio on such dates).

At December 31, 2008 and December 31, 2007, the Company's ten largest portfolio companies represented approximately 31% and 29%, respectively, of the total fair value of its investments. The Company's largest investment, Katonah Debt Advisors which is its wholly-owned portfolio company, represented 11% and 12% of the total fair value of the Company's investments at December 31, 2008 and December 31, 2007, respectively. Excluding Katonah Debt Advisors and CLO Fund securities, our ten largest portfolio companies represented approximately 16% and 17% of the total fair value of our investments at December 31, 2008 and December 31, 2007, respectively.

### **Investment in CLO Fund Securities**

The Company typically makes a minority investment in the most junior class of securities of CLO Funds (typically preferred shares or subordinated securities) managed by Katonah Debt Advisors and may selectively invest in securities issued by funds managed by other asset management companies. It is the Company's intention that its aggregate CLO Investments generally not exceed 15% of the Company's total investment portfolio. Preferred shares or subordinated securities issued by CLO Funds are entitled to recurring dividend distributions which generally equal the net remaining cash flow of the payments made by the underlying CLO Fund's securities less contractual payments to senior bond holders and CLO Fund expenses. CLO Funds managed by Katonah Debt Advisors ("CLO fund securities managed by affiliate") invest primarily in broadly syndicated non-investment grade loans, high-yield bonds and other credit instruments of corporate issuers. The underlying assets in each of the CLO Funds in which we have any investment are generally diversified secured or unsecured corporate debt and exclude mortgage pools or mortgage securities (residential mortgage bonds, commercial mortgage backed securities, or related asset-backed securities), debt to companies providing mortgage lending and emerging markets investments. The CLO Funds are leveraged funds and any excess cash flow or "excess spread" (interest earned by the underlying securities in the fund less payments made to senior bond holders and less fund expenses and management fees) is paid to the holders of the CLO Fund's subordinated securities or preferred stock.

On January 23, 2008, the Company's wholly-owned asset management company, Katonah Debt Advisors, closed a new \$315 million CLO Fund. The Company received a structuring fee upon closing and Katonah Debt Advisors earns an ongoing asset management fee based on the par amount of the underlying investments in the CLO Fund. Securities issued by CLO Funds managed by Katonah Debt Advisors are primarily held by third parties. Kohlberg Capital invested approximately \$29 million to acquire all of the shares of the most junior class of securities of this latest CLO Fund.

As of December 31, 2008, all of the CLO Funds in which the Company holds investments continue to make cash payments to all classes of investors. As of December 31, 2008, the Company's seasoned CLO Fund securities (for which at least four quarterly distributions have been made) had an average annual cash yield of approximately 29%.

The subordinated securities and preferred stock securities are considered equity positions in the CLO Funds and, as of December 31, 2008 and December 31, 2007, the Company had approximately \$57 million and \$31 million, respectively, of such CLO equity investments at fair value. The cost basis of the Company's investment in CLO Fund equity securities as of December 31, 2008 was approximately \$66 million and aggregate unrealized losses on the CLO Fund securities totaled approximately \$9 million. The cost basis of the Company's investment in CLO Fund equity securities as of December 31, 2007, was approximately \$36 million and aggregate unrealized losses on the CLO Fund securities totaled approximately \$5 million.

### **Fair Value Measurements**

The Company adopted SFAS No. 157 as of January 1, 2008, which among other matters, requires enhanced disclosures about investments that are measured and reported at fair value. SFAS No. 157 establishes a hierarchical disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value. 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.

Investments measured and reported at fair value are classified and disclosed in one of the following categories.

Level I – 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 SFAS 157, the Company does not adjust the quoted price for these investments, even in situations where we hold 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, and fair value is determined through the use of models or other valuation methodologies. Investments which are generally included in this category include illiquid corporate loans and bonds and less liquid, privately held or restricted equity securities for which some level of recent trading activity has been observed.

Level III – Pricing inputs are unobservable for the investment and includes situations where there is little, if any, market activity for the investment. The inputs 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 process.

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 considers factors specific to the investment.

The following table summarizes the fair value of investments by the above SFAS No. 157 fair value hierarchy levels as of December 31, 2008:

	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
Time deposits and money market account	\$ -	\$ 12,186,007	\$ -	\$ 12,186,007
Debt securities	-	-	384,486,111	384,486,111
CLO fund securities	-	-	56,635,236	56,635,236
Equity securities	1,853	-	4,387,978	4,389,831
Asset manager affiliates	-	-	56,528,088	56,528,088

The following table summarizes the Level III investments by valuation methodology as of December 31, 2008:

<b>Fair Value Based on</b>	<u>Debt Securities</u>	<u>CLO Fund Securities</u>	<u>Equity Securities</u>	<u>Asset Manager Affiliates</u>	<u>Total</u>
Third party pricing service	—%	—%	—%	—%	—%
Public / private company comparables	77	—	—	11	88
Discounted cash flow	—	11	—	—	11
Residual enterprise value	—	—	1	—	1
<b>Total</b>	<u>77 %</u>	<u>11 %</u>	<u>1 %</u>	<u>11 %</u>	<u>100 %</u>

As a BDC, it is required that the Company invest primarily in the debt and equity of non-public companies for which there is little, if any, market-observable information. As a result, most, if not all, of the Company's investments at any given time will most likely be deemed Level III investments. The Company believes that investments classified as Level III for SFAS No. 157 have a further hierarchal framework which prioritizes and ranks such valuations based on the degree of independent and observable inputs, objectivity of data and models and the level of judgment required to adjust comparable data. The hierarchy of such methodologies are presented in the above table and discussed below in descending rank.

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

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

Values derived for asset manager affiliates using public/private company comparables generally utilize market-observable data from such comparables and specific, non-public and non-observable financial measures (such as assets under management, historical and prospective earnings) for the asset manager affiliate. The Company recognizes that comparable asset managers may not be fully comparable to its asset manager affiliates and typically identifies a range of performance measures and/or adjustments within the comparable population for 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.

Values derived through use of discounted cash flow models and residual enterprise value models typically have little, if any, market activity or market-observable data for such investments. Such investments are grouped as Level III assets.

The changes in investments measured at fair value for which the Company has used Level III inputs to determine fair value are as follows:

	<b>Years Ended December 31, 2008</b>				
	<b>Debt Securities</b>	<b>CLO Fund Securities</b>	<b>Equity Securities</b>	<b>Asset Manager Affiliates</b>	<b>Total</b>
Balance, December 31, 2007	\$ 410,954,082	\$ 31,020,000	\$ 4,752,250	\$ 58,585,360	\$505,311,692
Transfers in/out of Level 3	—	—	—	—	—
Net amortization/(accretion) of premium/(discount)	717,194	1,456,095	—	—	2,173,289
Purchases (sales), net	277,308	28,859,236	170,168	5,478,276	34,784,988
Total gain (loss) realized and unrealized included in earnings	(27,462,473)	(4,700,095)	(534,440)	(7,535,548)	(40,232,556)
Balance, December 31, 2008	<u>\$ 384,486,111</u>	<u>\$ 56,635,236</u>	<u>\$ 4,387,978</u>	<u>\$ 56,528,088</u>	<u>\$502,037,413</u>
Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date	<u>\$ (26,887,293)</u>	<u>\$ (4,700,095)</u>	<u>\$ (534,440)</u>	<u>\$ (7,535,548)</u>	<u>\$ (39,657,376)</u>

## 5. AFFILIATE ASSET MANAGERS

### *Wholly-Owned Asset Manager*

Prior to its IPO, the Company issued an aggregate of 2,226,333 common shares, having a value of approximately \$33 million, to affiliates of Kohlberg & Co. to acquire Katonah Debt Advisors. As a result, Katonah Debt Advisors is a wholly-owned portfolio company. As of December 31, 2008, Katonah Debt Advisors and its affiliates had approximately \$2.1 billion of assets under management.

Katonah Debt Advisors manages CLO Funds primarily for third party investors that invest in broadly syndicated loans, high yield bonds and other credit instruments issued by corporations. These CLO Funds do not invest in asset-backed securities secured by commercial mortgages, residential mortgages or other consumer borrowings. At December 31, 2008, Katonah Debt Advisors had approximately \$2.1 billion of assets under management and the Company's 100% equity interest in Katonah Debt Advisors was valued at approximately \$55 million. As a manager of the CLO Funds, Katonah Debt Advisors receives contractual and recurring management fees and may receive a one-time structuring fee from the CLO Funds for its management and advisory services. The annual fees which Katonah Debt Advisors receives are generally based on a fixed percentage of assets under management (at par value and not subject to changes in market value), and Katonah Debt Advisors generates annual operating income equal to the amount by which its fee income exceeds its operating expenses. In future years, Katonah Debt Advisors may receive accrued incentive fees upon the liquidation of CLO Funds it manages, provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred stock.

On January 2, 2008, the Katonah Debt Advisors platform acquired substantially all of the assets of Scott's Cove Capital Management LLC ("Scott's Cove"), an asset manager focused on an event-driven credit long short investment strategy. As a result of the acquisition, approximately \$60 million of fee paying assets under management integrated within the Katonah Debt Advisors asset management platform. In connection with the acquisition, Katonah Debt Advisors entered into employment agreements with three Scott's Cove investment professionals, and expects these individuals will assist in structuring, raising and investing new funds to be managed by Katonah Debt Advisors.

The Company expects to receive distributions of recurring fee income and to generate capital appreciation from its investment in the asset management business of Katonah Debt Advisors. By making investments in CLO Funds raised by Katonah Debt Advisors in the future, for which the Company expects to receive a current cash return, the Company can help Katonah Debt Advisors to raise these funds which in turn will increase its assets under management which will result in additional management fee income.

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

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

Tax goodwill amortization 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, for tax purposes such exchange was considered an asset purchase under Section 351(a) of the IRS 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 will be amortized for tax purposes on a straight-line basis over 15 years, resulting in an annual difference between GAAP income and taxable income by approximately \$2 million per year over such period.

At December 31, 2008 and at December 31, 2007 a net amount due from affiliates totaled approximately \$391,000 and approximately \$541,000, respectively.

Summarized financial information for Katonah Debt Advisors follows:

	<u>As of</u> <u>December 31, 2008</u> <u>(Unaudited)</u>	<u>As of</u> <u>December 31, 2007</u> <u>(Unaudited)</u>
<b>Assets:</b>		
Current assets	\$ 8,153,011	\$ 7,035,155
Noncurrent assets	318,106	396,111
<b>Total assets</b>	<u>\$ 8,471,117</u>	<u>\$ 7,431,266</u>
<b>Liabilities:</b>		
Current liabilities	3,652,380	4,254,202
<b>Total liabilities</b>	<u>\$ 3,652,380</u>	<u>\$ 4,254,202</u>
	<u>Years Ended</u> <u>December 31, 2008</u> <u>(Unaudited)</u>	<u>Years Ended</u> <u>December 31, 2007</u> <u>(Unaudited)</u>
Gross revenue	\$ 11,206,771	\$ 11,262,969
Total expenses	11,971,596	8,505,115
<b>Net income (loss)</b>	<u>\$ (764,825)</u>	<u>\$ 2,757,854</u>
Dividends declared	<u>\$ 1,350,000</u>	<u>\$ 500,000</u>
<b>Cumulative undistributed net income</b>	<u>\$ 70,319</u>	<u>\$ 2,185,144</u>

#### *Distressed Debt Platform*

In December 2007, the Company committed to make an investment in a new distressed investment platform organized by Steven Panagos and Jonathan Katz named Panagos and Katz Situational Investing (“PKSIL”). Mr. Panagos was most recently national practice leader of Kroll Zolfo Cooper’s Corporate Advisory and Restructuring Practice and Mr. Katz was the founding partner of Special Situations Investing, a distressed investing vehicle of JP Morgan. The Company expects that funds managed by PKSIL will invest in the debt and equity securities of companies that are restructuring due to financial or operational distress. The Company also expects that PKSIL may selectively originate new credit facilities with borrowers that are otherwise unable to access traditional credit markets. The Company has committed to invest up to \$2.5 million directly in PKSIL through an investment in Class A shares. The Company has a 35% economic interest in PKSIL through its investment in Class B shares on which it will receive its pro rata share of PKSIL’s operating income and may make an investment of up to \$25 million in the funds managed by PKSIL on which the Company will receive investment income. PKSIL may also source distressed debt opportunities in which we may make direct investments. As of December 31, 2008, the Company funded approximately \$1.8 million of its \$2.5 million total commitment to PKSIL which is an investment in the Class A shares of PKSIL. As of December 31, 2008, PKSIL had no significant operations.

## **6. BORROWINGS**

The Company’s debt obligations consist of the following:

	<u>As of</u> <u>December 31, 2008</u>	<u>As of</u> <u>December 31, 2007</u>
Secured credit facility, \$275 million commitment due September 29, 2010	\$ 261,691,148	\$ 255,000,000

On February 14, 2007, the Company entered into an arrangement under which the Company may obtain up to \$200 million in financing (the “Facility”). On October 1, 2007, the Company amended the Facility to increase the Company’s borrowing capacity from \$200 million to \$275 million, extend the maturity date from February 12, 2012 to October 1, 2012 and increase the interest spread charged on outstanding borrowings by 15 basis points, to 0.85%. The interest rate is based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. Interest is payable monthly.

Advances under the Facility are used by the Company primarily to make additional investments. The Facility is secured by loans that it currently owns and the loans acquired by the Company with the advances under the Facility. The Company borrows under the Facility through its wholly-owned, special-purpose bankruptcy remote subsidiary, Kohlberg Capital Funding LLC I.

During September 2008, the Company was notified by the lenders that the liquidity banks providing the underlying funding for the Facility did not intend to renew their liquidity facility to the lenders unless the Company agreed to certain revised terms for the Facility. As a result, the lenders proposed new terms to the Company in order to extend additional fundings under the Facility. The Company viewed such proposed terms as unfavorable and has opted to forego the revolving credit feature of the Facility and to amortize existing borrowings under the Facility. In accordance with the terms of the Facility, all principal and interest collected from the assets by which the Facility is secured are used to amortize the Facility through a termination date of September 29, 2010 (the "amortization period"). During the amortization period the interest rate will continue to be based on prevailing commercial paper rates plus 0.85% or, if the commercial paper market is at any time unavailable, prevailing LIBOR rates plus an applicable spread. The Company believes it has sufficient cash and liquid assets to fund normal operations and dividend distributions. At the end of the amortization period, the Company may be required to sell or transfer the remaining assets securing the Facility, potentially at a loss, to repay any remaining outstanding borrowings, or the Company may enter into a new agreement with the lenders providing for continued amortization of the Facility borrowings or into alternative financing arrangements with another lender.

Under our Facility, we must maintain a leverage ratio covenant of at least one to one based on the ratio of the Facility outstanding balance to our most recently reported GAAP stockholders' equity balance (determined quarterly in conjunction with the Company's financial reporting filings with the Securities and Exchange Commission) as of the Facility outstanding balance determination date. At year-end, our leverage ratio covenant was met using the December 31, 2008 Facility balance and the latest filed quarterly stockholders' equity balance which, at that time, was as of September 30, 2008. The Company remains in compliance with the leverage covenant ratio based on the March 12, 2009 Facility balance and the GAAP stockholders' equity balance as of September 30, 2008.

The weighted average daily debt balance for the year ended December 31, 2008 and 2007 was approximately \$248 million and \$106 million, respectively. For the year ended December 31, 2008 and 2007, the weighted average interest rate on weighted average outstanding borrowings was approximately 3% and 5% respectively, which excludes the amortization of deferred financing costs and facility and program fees on unfunded balances. The Company is in compliance with all its debt covenants. As of December 31, 2008, the Company had restricted cash balances of approximately \$2 million and time deposit balances of approximately \$6 million, which it maintained in accordance with the terms of the Facility.

## 7. DISTRIBUTABLE TAX INCOME

The Company intends to distribute quarterly dividends to its stockholders. The Company's quarterly dividends, if any, will be determined by the Board of Directors. To maintain its RIC status, the Company must timely distribute an amount equal to at least 90% of its taxable 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. 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. We have distributed, or intend to distribute, sufficient dividends to eliminate taxable income for our completed tax fiscal years. If we fail to satisfy the 90% distribution requirement or otherwise fail to qualify as a RIC in any tax year, we would be subject to income tax in such year on all of our taxable income, regardless of whether we made any distributions to our shareholders. We have a tax fiscal year that ends on December 31.

For the quarter ended December 31, 2008, the Company declared a dividend on December 19, 2008 of \$0.27 per share for a total of approximately \$6 million. The record date was December 31, 2008 and the dividend was distributed on January 29, 2009. For the year ended December 31, 2008, the Company paid dividends of approximately \$30 million or \$1.44 per share. For income tax purposes our distributions to shareholders for the fiscal year ended December 31, 2008 were composed of \$1.41 per share of non-qualified distributions and \$0.03 per share of qualified distributions. The tax character of distributions are the same as reported on the Statements of Changes in Net Assets.

The following reconciles net increase in stockholders' equity resulting from operations to taxable income for the year ended December 31, 2008:

	<b>Year Ended December 31, 2008</b>
Pre-tax net decrease in stockholders' equity resulting from operations	\$ (9,567,327)
Net unrealized losses on investments transactions not taxable	39,698,065
Income not currently taxable	(1,390,939)
Expenses not currently deductible	940,864
Taxable income before deductions for distributions	<u>\$ 29,680,663</u>
Taxable income before deductions for distributions per weighted average shares for the period	\$ 1.46



As of December 31, 2008, the tax-basis components of accumulated losses were as follows:

	<b>Year Ended December 31, 2008</b>
Undistributed ordinary income	\$ 977,904
Capital loss carryforward	(680,687)
Net unrealized depreciation	<u>(32,401,346)</u>
<b>Total tax-basis accumulated losses</b>	<b>\$ <u>(32,104,129)</u></b>

As of December 31, 2008, the Company had a net capital loss carryforward of \$680,687 to offset future capital gains to the extent provided by regulations, all of which will expire on December 31, 2016.

As of December 31, 2008, the Company had temporary book/tax differences primarily attributed to amortization of discount on CLO Fund Securities. Permanent differences, resulting primarily from non-deductible stock option expense, and other book to tax differences resulted in the following reclassifications among the Company's components of stockholders' equity at December 31, 2008:

	<b>Year Ended December 31, 2008</b>
Accumulated undistributed net investment income	\$ 1,076,078
Accumulated net realized loss	\$ (105,508)
Paid-in-capital	\$ (970,570)

## 8. COMMITMENTS AND CONTINGENCIES

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the needs of the Company's investment in portfolio companies. Such instruments include commitments to extend credit and may involve, in varying degrees, elements of credit risk in excess of amounts recognized on our balance sheet. Prior to extending such credit, we attempt to limit our credit risk by conducting extensive due diligence, obtaining collateral where necessary and negotiating appropriate financial covenants. As of December 31, 2008 and December 31, 2007, the Company had committed to make a total of approximately \$3 million and \$4 million, respectively, of investments in various revolving senior secured loans, of which approximately \$1 million was funded as of December 31, 2008 and \$866,000 was funded as of December 31, 2007. As of December 31, 2008 and December 31, 2007, the Company had committed to make a total of approximately \$0 and \$8 million, respectively, of investments in a delayed draw senior secured loans of which \$0 was funded as of December 31, 2008 and approximately \$5 million was funded as of December 31, 2007.

In October 2007 Katonah Debt Advisors entered into a letter agreement (the "Letter Agreement") with Bear Stearns & Co. Inc. ("Bear Stearns") in connection with a warehouse credit line established to fund the initial accumulation of assets for three CLO funds, pursuant to which agreement Katonah Debt Advisors undertook certain "first loss" commitments, as described in more detail below. In return for Katonah Debt Advisors' first loss commitment, Katonah Debt Advisors was entitled to receive net interest income from the underlying assets in the loan warehouse. In the future, Kohlberg Capital or Katonah Debt Advisors may enter into similar agreements in connection with funding the initial accumulation of senior secured corporate loans and certain other debt securities for future CLO Funds that Katonah Debt Advisors will manage. Such "first loss" commitments relate to (i) losses (if any) as a result of individual loan investments being ineligible for purchase by a new CLO Fund (typically due to a payment default on such loan) when such fund formation is completed or, (ii) if a new CLO Fund has not been completed before the expiration of the related warehouse credit line, the loss (if any, and net of any accumulated interest income) on the resale of loans and debt securities funded by such warehouse credit line. In return for Katonah Debt Advisors' first loss commitment, Katonah Debt Advisors was entitled to receive net interest income from the underlying assets in the loan warehouse.

Under the Letter Agreement with Bear Stearns, Katonah Debt Advisors engaged Bear Stearns to structure and raise three CLO funds, to be named Katonah 2007-I CLO Ltd. ("Katonah 2007"), Katonah 2008-I CLO Ltd. ("Katonah 2008-I") and Katonah 2008-II CLO Ltd. ("Katonah 2008-II") and, together with Katonah 2007 and Katonah 2008-I, the "2008 CLO Funds"), to be managed by Katonah Debt Advisors (directly or indirectly through a services contract with an affiliate of Katonah Debt Advisors). As part of this engagement, Bear Stearns provided certain credit lines to accumulate and fund into a loan warehouse the initial assets for the 2008 CLO Funds. As mentioned above, Katonah Debt Advisors undertook a first loss commitment, requiring Katonah Debt Advisors to reimburse Bear Stearns in certain circumstances for (i) certain losses (if any) incurred on the assets warehoused for the 2008 CLO Funds prior to their completion, or (ii) if one or all of the CLO Funds fail to close, a portion of the losses (if any) on the resale of the warehoused assets. On January 23, 2008, Katonah Debt Advisors and Bear Stearns closed Katonah 2007. Katonah Debt Advisors received a structuring fee upon closing and Katonah Debt Advisors expects to earn an ongoing asset management fee based on the par amount of the underlying investments in Katonah 2007. Approximately \$212 million of assets were transferred from the loan warehouse into Katonah 2007. While the securities issued by the CLO Funds managed by Katonah Debt Advisors are primarily held by third parties, Kohlberg Capital invested approximately \$29 million to acquire all of the shares of the most junior class of securities of Katonah 2007. In connection with the closing of Katonah 2007, Katonah Debt Advisors' maximum first loss obligation amount under its commitment letter with Bear Stearns was reduced from \$22.5 million to \$18 million.



None of the other 2008 CLO Funds were completed and, as a result, pursuant to the Letter Agreement, both Katonah Debt Advisors and J.P. Morgan Securities Inc. ("JPMorgan") (f/k/a Bear Stearns & Co. Inc.) asserted claims against the other and defenses thereto. Without admitting any liability or wrongdoing, Katonah Debt Advisors and JPMorgan agreed to compromise and settle all of the disputes, issues and claims between them relating to the agreements in exchange for an agreement to terminate all obligations and liabilities of Katonah Debt Advisors and of JPMorgan under the existing agreements relating to the 2008 CLO Funds, payment by Katonah Debt Advisors of an aggregate of \$6 million in installments over a period of one year and the forfeiture by Katonah Debt Advisors of the net interest income earned through the settlement date on the warehoused assets. In December 2008, Katonah Debt Advisors entered into a settlement and termination agreement with JPMorgan reflecting the settlement terms described above.

As a result of this settlement, Katonah Debt Advisors recognized a \$6 million settlement cost and write-off of previously accrued net interest income on warehoused assets of approximately \$4 million for the year ended December 31, 2008. For the year ended December 31, 2008, Katonah Debt Advisors had an after-tax loss of approximately \$765,000.

The Company recognized the impact of this settlement and forfeiture of warehouse income as a non-cash reduction to the unrealized appreciation of the value of its investment in Katonah Debt Advisors and contributed additional equity to Katonah Debt Advisors. Consequently, this settlement is not expected to have a material impact on Kohlberg Capital's net investment income or quarterly dividend.

As of December 31, 2008, the Company funded approximately \$1.8 million of our \$2.5 million total commitment to PKSIL which is an investment in the Class A shares of PKSIL.

## **9. STOCKHOLDERS' EQUITY**

On December 11, 2006, the Company completed its IPO of 14,462,000 shares of common stock at \$15.00 per share, less an underwriting discount and IPO expenses paid by the Company totaling \$1.22 per share for net proceeds of approximately \$200 million. Prior to its IPO, the Company issued to affiliates of Kohlberg & Co. a total of 3,484,333 shares of its common stock for the acquisition of certain subordinated securities issued by CLO Funds and for the acquisition of Katonah Debt Advisors. On April 28, 2008 the Company completed a rights offering which resulted in the issuance of 3.1 million common shares and net proceeds of approximately \$27 million. During the years ended December 31, 2008 and December 31, 2007, the Company issued 316,237 and 71,366 shares, respectively, of common stock under its dividend reinvestment plan. For the year ended December 31, 2008, the Company issued 359,250 shares of restricted stock for which 16,667 shares were forfeited and 3,000 shares were converted to common stock during the year due to vesting. The total number of shares issued and outstanding as of December 31, 2008 was 21,776,519 and 21,436,936, respectively and shares issued and outstanding as of December 31, 2007 was 18,017,699.

## **10. EQUITY INCENTIVE PLAN**

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

### *Stock Options*

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

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

During the year ended December 31, 2007, 90,000 options granted to employees were forfeited. During the year ended December 31, 2008, 1,265,000 options granted to employees were forfeited, inclusive of options forfeited in exchange for restricted stock as noted above. As of December 31, 2008, 20,000 total options were outstanding, 10,000 of which were exercisable. The options have an estimated remaining contractual life of 9 years and 5 months.

During the year ended December 31, 2008, the weighted average grant date fair value per share for options granted during the period was \$1.50. During the year ended December 31, 2007, the weighted average grant date fair value per share for options granted during the period was \$1.90. For the years ended December 31, 2008 and December 31, 2007, the weighted average grant date fair value per share for options forfeited during the period was \$1.58 and \$1.81, respectively. Information with respect to options granted, exercised and forfeited under the Plan for the year ended December 31, 2008 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, 2008	1,315,000	\$ 15.52		
Granted	20,000	\$ 11.97		
Exercised	—			
Forfeited	<u>(1,315,000)</u>	\$ 15.52		
Outstanding at December 31, 2008	<u>20,000</u>	\$ 11.97	9.5	\$ —
Total vested at December 31, 2008	10,000	\$ 11.97	8.8	

<sup>1</sup> Represents the difference between the market value of the options at December 31, 2008 and the cost for the option holders to exercise the options.

The Company uses a Binary Option Pricing Model (American, call option) as its valuation model to establish the expected value of all stock option grants. For the year ended December 31, 2008, total stock option expense of approximately \$329,000 was recognized and expensed at the Company; of this amount approximately \$260,000 was expensed at the Company and approximately \$69,000 was expensed at Katonah Debt Advisors. At December 31, 2008, the Company had approximately \$7,000 of compensation cost related to unvested stock-based awards, the cost for which is expected to be recognized by the Company over a weighted average period of 0.4 years.

#### *Restricted Stock*

On June 13, 2008, the Company's shareholders approved the Company's 2006 Equity Incentive Plan, as amended and the board of directors approved the grant of awards of 100,250 shares of restricted stock to certain executive officers of the Company. Such awards of restricted stock will vest as to 50% of the shares on the third anniversary of the grant date and the remaining 50% of the shares on the fourth anniversary of the grant date.

On June 13, 2008, the Company's Board of Directors authorized the Company to allow employees who agree to cancel options that they hold to receive shares of the Company's common stock to receive 1 share of restricted stock for every 5 options so cancelled. The shares of restricted stock received by employees through any such transaction will vest annually generally over the remaining vesting schedule as was applicable to the cancelled options. As of December 31, 2008, employees holding options to purchase 1,295,000 shares individually entered into agreements to cancel such options and to receive 259,000 shares of restricted stock.

During the year ended December 31, 2008, 3,000 shares of restricted stock were vested and converted into common shares. As of December 31, 2008, 334,250 restricted shares remain unvested and 5,333 shares are vested and are pending conversion to common shares upon the employee meeting certain contractual obligations.

As of December 31, 2008, after giving effect to these option cancellations and restricted stock awards, there were options to purchase 20,000 shares of common stock outstanding and there were 339,583 shares of restricted stock outstanding. Information with respect to restricted stock granted, exercised and forfeited under the Plan for the year ended December 31, 2008 is as follows:

	<b>Non-Vested Restricted Shares</b>	<b>Weighted Average Exercise Price per Share</b>	<b>Weighted Average Contractual Remaining Term (years)</b>
Non-vested shares outstanding at January 1, 2008	—	\$ —	
Granted	359,250	\$ 10.73	2.4
Exercised	(3,000)	\$ 9.21	
Forfeited	(16,667)	\$ 9.21	
Outstanding at December 31, 2008	<u>339,583</u>	\$ 10.83	2.4
Total non-vested shares at December 31, 2008	334,250	\$ 10.84	2.4
Total vested shares at December 31, 2008	5,333	\$ 10.39	

During the years ended December 31, 2008, the Company recognized non-cash compensation expense of approximately \$525,000 relating to restricted stock grants; of this amount approximately \$463,000 was expensed at the Company and approximately \$62,000 was expensed at Katonah Debt Advisors. Dividends are paid on all issued shares of restricted stock, whether or not vested. In general, shares of unvested restricted stock are forfeited upon the recipient's termination of employment.

## 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 Plan permits an employee to defer a portion of their total annual compensation up to the Internal Revenue Service annual maximum based on age and eligibility. The Company makes contributions to the 401K Plan of up to 2.67% of the employee's first 74.9% of maximum eligible compensation, which fully vest at the time of contribution. For the years ended December 31, 2008 and 2007, the Company made contributions to the 401K Plan of approximately \$33,000 and \$22,000, respectively.

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 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. 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. For the year ended December 31, 2008, the Company did not contribute to the Profit-Sharing Plan. For the year ended December 31, 2007, the Company increased its contributions to the Profit-Sharing Plan by approximately \$138,000.

## 12. IMPACT OF NEW ACCOUNTING STANDARDS

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ("SFAS 159"), which provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to more easily understand the effect of a company's choice to use fair value on its earnings. SFAS 159 also requires entities to display the fair value of the selected assets and liabilities on the face of the balance sheet. SFAS 159 does not eliminate disclosure requirements of other accounting standards, including fair value measurement disclosures in SFAS 157. This statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company has determined that adoption of SFAS 159 does not have an impact on the Company's financial position or results of operations.

### 13. SELECTED QUARTERLY DATA (Unaudited)

	<u>Q1 2008</u>	<u>Q2 2008</u>	<u>Q3 2008</u>	<u>Q4 2008</u>
Total interest and related portfolio income	\$ 14,332,842	\$ 12,265,524	\$ 11,328,553	\$ 11,285,291
Net investment income and realized gains	\$ 8,049,958	\$ 7,762,979	\$ 7,467,710	\$ 6,850,091
Net increase (decrease) in net assets resulting from operations	\$ 195,252	\$ 7,297,285	\$ 3,988,536	\$ (21,048,400)
Net increase (decrease) in net assets resulting from operations per share—basic	\$ 0.01	\$ 0.36	\$ 0.19	\$ (0.98)
Net increase (decrease) in net assets resulting from operations per share—diluted	\$ 0.01	\$ 0.36	\$ 0.18	\$ (0.97)
Net investment income and realized gains per share—basic	\$ 0.45	\$ 0.38	\$ 0.35	\$ 0.32
Net investment income and realized gains per share—diluted	\$ 0.45	\$ 0.38	\$ 0.34	\$ 0.31

	<u>Q1 2007<sup>1</sup></u>	<u>Q2 2007<sup>1</sup></u>	<u>Q3 2007<sup>1</sup></u>	<u>Q4 2007</u>
Total interest and related portfolio income	\$ 6,534,567	\$ 8,578,364	\$ 10,483,244	\$ 12,882,839
Net investment income and realized gains	\$ 4,892,907	\$ 5,425,858	\$ 6,018,176	\$ 6,688,325
Net increase (decrease) in net assets resulting from operations	\$ 13,949,008	\$ 16,940,501	\$ (4,683,689)	\$ (63,835)
Net increase (decrease) in net assets resulting from operations per share—basic and diluted	\$ 0.78	\$ 0.94	\$ (0.26)	\$ —
Net investment income and realized gains per share—basic and diluted	\$ 0.27	\$ 0.30	\$ 0.33	\$ 0.37

<sup>1</sup> Certain unaudited Quarterly Data has been reclassified to conform with current presentation

### 14. SUBSEQUENT EVENTS

None, other than those noted above.

## EXHIBIT INDEX

<b>Exhibit Number</b>	<b>Description</b>
3.1	Form of Certificate of Incorporation of Kohlberg Capital Corporation (the "Company"). <sup>(1)</sup>
3.2	Form of Bylaws of the Company. <sup>(2)</sup>
4.1	Specimen certificate of the Company's common stock, par value \$0.01 per share. <sup>(1)</sup>
4.2	Form of Registration Rights Agreement. <sup>(3)</sup>
4.3	Form of Dividend Reinvestment Plan. <sup>(3)</sup>
10.1	Form of the Amended and Restated 2006 Equity Incentive Plan. <sup>(9)</sup>
10.2	Form of Company Non-Qualified Stock Option Certificate. <sup>(3)</sup>
10.3	Form of Custodian Agreement by and among Kohlberg Capital Corporation and U.S. Bank National Association. <sup>(3)</sup>
10.4	Form of License and Referral Agreement between the Company and Kohlberg & Company, LLC. <sup>(1)</sup>
10.5	Form of Overhead Allocation Agreement between the Company and Katonah Debt Advisors, LLC. <sup>(3)</sup>
10.6	Form of Employment Agreement between the Company and Dayl W. Pearson. <sup>(3)</sup>
10.7	Form of Employment Agreement between the Company and Michael I. Wirth. <sup>(3)</sup>
10.8	Form of Employment Agreement between the Company and R. Jon Corless. <sup>(3)</sup>
10.9	Form of Employment Agreement between the Company and E.A. Kratzman. <sup>(3)</sup>
10.10	Form of Employment Agreement between Katonah Debt Advisors and E.A. Kratzman. <sup>(3)</sup>
10.11	Form of Indemnification Agreement for Officers and Directors of the Company. <sup>(4)</sup>
10.12	Execution Copy of Loan Funding and Servicing Agreement dated as of February 14, 2007, by and among Kohlberg Capital Funding LLC I, Kohlberg Capital Corporation, each of the conduit lenders and institutional lenders from time to time party thereto, each of the lender agents from time to time party thereto, BMO Capital Markets Corp., as the Agent, Lyon Financial Services, Inc. (d/b/a U.S. Bank Portfolio Services), as the Backup Services, and U.S. Bank National Association, as Trustee. <sup>(5)</sup>
10.13	Execution Copy of First Amendment to Loan Funding and Servicing Agreement, dated as of May 30, 2007, by and among Kohlberg Capital Funding LLC I, the Company, each of the conduit lenders and institutional lenders from time to time party thereto, each of the lender agents from time to time party thereto, BMO Capital Markets Corp., as the Agent, Lyon Financial Services, Inc. (d/b/a U.S. Bank Portfolio Services), as the Backup Servicer, and U.S. Bank National Association, as Trustee. <sup>(6)</sup>
10.14	Execution Copy of Second Amendment to Loan Funding and Servicing Agreement, dated as of October 1, 2007, by and among Kohlberg Capital Funding LLC I, the Company, each of the conduit lenders and institutional lenders from time to time party thereto, each of the lender agents from time to time party thereto, BMO Capital Markets Corp., as the Agent, Lyon Financial Services, Inc. (d/b/a U.S. Bank Portfolio Services), as the Backup Servicer, and U.S. Bank National Association, as Trustee. <sup>(6)</sup>

<b>Exhibit Number</b>	<b>Description</b>
10.15	Execution Copy of Third Amendment to Loan Funding and Servicing Agreement, dated as of November 21, 2007, by and among Kohlberg Capital Funding LLC I, the Company, each of the conduit lenders and institutional lenders from time to time party thereto, each of the lender agents from time to time party thereto, BMO Capital Markets Corp., as the Agent, Lyon Financial Services, Inc. (d/b/a U.S. Bank Portfolio Services), as the Backup Servicer, and U.S. Bank National Association, as Trustee. <sup>(8)</sup>
10.16	Execution Copy of Purchase and Sale Agreement dated as of February 14, 2007, by and among Kohlberg Capital Funding LLC I and the Company. <sup>(7)</sup>
10.17	Form of 2008 Non-Employee Director Plan. <sup>(10)</sup>
21.1	List of Subsidiaries.
23.1	Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm.
31.1	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.
31.2	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.
32.1	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.
32.2	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.

- (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).
- (2) Incorporated by reference to the exhibit included on Form N-2, as filed on March 16, 2007 (File No. 333-141382).
- (3) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 2 on Form N-2, as filed on November 20, 2006 (File No. 333-136714).
- (4) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 3 on Form N-2, as filed on November 24, 2006 (File No. 333-136714).
- (5) Incorporated by reference to Exhibit 10.15 of the Annual Report on Form 10-K, as filed on March 29, 2007 (File No. 814-00735).
- (6) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 1 on Form N-2, as filed on October 18, 2007 (File No. 333-146190).
- (7) Incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K, as filed on February 16, 2007 (File No. 814-00735).
- (8) Incorporated by reference to Exhibit 10.15 of the Annual Report on Form 10-K, as filed on March 14, 2008 (File No. 814-00735).
- (9) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, as filed on June 19, 2008 (File No. 814-00735).
- (10) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 1 on Form N-2, as filed on June 30, 2008 (File No. 333-151268).

**Exhibit 23.1**

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the Registration Statement on Form S-8 of our reports, dated March 16, 2009, relating to the financial statements and financial highlights of Kohlberg Capital Corporation (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the valuation of investments whose fair values have been estimated by management in the absence of readily determinable fair values), and the effectiveness of internal control over financial reporting, appearing in the Annual Report on Form 10-K of Kohlberg Capital Corporation for the year ended December 31, 2008.

DELOITTE & TOUCHE LLP

New York, New York  
March 16, 2009

---





**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 Kohlberg Capital Corporation (the "Company") on Form 10-K for the year ended December 31, 2008 (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 16, 2009

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

---

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

In connection with the accompanying Quarterly Report of Kohlberg Capital Corporation (the "Company") on Form 10-K for the year ended December 31, 2008 (the "Report"), I, Michael I. Wirth, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 16, 2009

By: \_\_\_\_\_ / S / MICHAEL I. WIRTH  
**Michael I. Wirth**  
**Chief Financial Officer and Chief Compliance Officer**  
**(Principal Financial Officer)**

---