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

# Form 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File No. 814-00735

# KCAP Financial, Inc.

(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of<br>Incorporation or organization) | 20-5951150<br>(I.R.S. Employer<br>Identification Number) |

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

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

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

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

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

| | | | | |
|---|---|---|---|---|
| Large accelerated filer | ☐ | | Accelerated filer | ☒ |
| Non-accelerated filer | ☐ | (Do not check if a smaller reporting company) | Smaller reporting company | ☐ |
| Emerging growth company | ☐ | | | |

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

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

The number of outstanding shares of common stock of the registrant as of November 1, 2017 was 37,339,224.

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

| | As of September 30, 2017 (unaudited) | As of December 31, 2016 |
|---|---|---|
| **ASSETS** | | |
| Investments at fair value: | | |
| Short-term investments (cost: 2017 - $57,024,828; 2016 - $28,699,269) | $ 57,024,828 | $ 28,699,269 |
| Debt securities (cost: 2017 - $134,031,011; 2016 - $249,520,234) | 127,026,829 | 238,343,330 |
| CLO Fund securities managed by affiliates (cost: 2017 - $73,495,563; 2016 - $71,734,809) | 49,973,662 | 51,908,784 |
| CLO Fund securities managed by non-affiliates (cost: 2017 - $5,049,176; 2016 - $5,116,508) | 1,869,682 | 2,265,566 |
| Equity securities (cost: 2017 - $10,389,008; 2016 - $10,389,007) | 4,450,177 | 5,056,355 |
| Asset Manager Affiliates (cost: 2017 - $53,341,230; 2016 - $55,341,230) | 39,679,000 | 40,198,000 |
| Joint Venture (cost: 2017 - $36,738,873; 2016 - $0) | 36,591,122 | — |
| Total Investments at Fair Value (cost: 2017 - $370,069,689; 2016 - $420,801,057) | 316,615,300 | 366,471,304 |
| Cash | 1,936,300 | 1,307,257 |
| Restricted cash | — | 8,528,298 |
| Interest receivable | 923,344 | 1,033,917 |
| Receivable for open trades | — | 2,950,658 |
| Accounts receivable | 2,000,021 | — |
| Due from affiliates | 1,159,759 | 612,854 |
| Other assets | 173,185 | 467,695 |
| Total Assets | $ 322,807,909 | $ 381,371,983 |
| **LIABILITIES** | | |
| Notes issued by KCAP Senior Funding I, LLC (net of discount and offering costs of: 2016 - $2,286,425 and $2,459,156, respectively) | $ — | $ 142,604,419 |
| 7.375% Notes due 2019 (net of offering costs of: 2017 - $306,073; 2016 - $550,774) | 26,693,927 | 32,980,151 |
| 6.125% Notes due 2022 (net of offering costs of: 2017 - $2,757,357) | 74,649,843 | — |
| Payable for open trades | 34,950,728 | 7,884,943 |
| Accounts payable and accrued expenses | 1,649,529 | 2,047,405 |
| Accrued interest payable | — | 930,086 |
| Due to affiliates | 78,438 | 54 |
| Total Liabilities | 138,022,465 | 186,447,058 |
| **COMMITMENTS AND CONTINGENCIES (Note 8)** | | |
| **STOCKHOLDERS' EQUITY** | | |
| Common stock, par value $0.01 per share, 100,000,000 common shares authorized; 37,485,993 issued, and 37,317,815 outstanding at September 30, 2017, and 37,282,296 issued, and 37,178,294 outstanding at December 31, 2016 | 373,178 | 371,783 |
| Capital in excess of par value | 354,341,009 | 353,404,155 |
| Excess distribution of net investment income | (19,589,473) | (14,630,319) |
| Accumulated net realized losses | (95,485,836) | (88,491,896) |
| Net unrealized depreciation on investments | (54,853,434) | (55,728,798) |
| Total Stockholders' Equity | 184,785,444 | 194,924,925 |
| Total Liabilities and Stockholders' Equity | $ 322,807,909 | $ 381,371,983 |
| NET ASSET VALUE PER COMMON SHARE | $ 4.95 | $ 5.24 |

See accompanying notes to consolidated financial statements.

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

| | Three Months Ended September 30, 2017 | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2017 | Nine Months Ended September 30, 2016 |
|---|---|---|---|---|
| **Investment Income:** | | | | |
| Interest from investments in debt securities | $ 2,439,671 | $ 5,186,745 | $ 11,764,702 | $ 16,106,654 |
| Interest from cash and short-term investments | 21,043 | 7,168 | 51,250 | 21,521 |
| Investment income on CLO Fund Securities managed by affiliates | 2,693,547 | 3,307,950 | 8,378,785 | 9,595,522 |
| Investment income on CLO Fund Securities managed by non-affiliates | 99,578 | 195,182 | 329,108 | 503,358 |
| Dividends from Asset Manager Affiliates | 180,000 | — | 180,000 | 1,400,000 |
| Investment income - Joint Venture | 685,000 | — | 685,000 | — |
| Capital structuring service fees | 134,504 | 321,744 | 298,629 | 481,456 |
| Total investment income | 6,253,343 | 9,018,789 | 21,687,474 | 28,108,510 |
| **Expenses:** | | | | |
| Interest and amortization of debt issuance costs | 1,371,953 | 2,122,325 | 5,790,242 | 6,960,355 |
| Compensation | 1,072,812 | 1,199,412 | 3,473,841 | 3,212,886 |
| Professional fees | 802,507 | 699,607 | 2,545,195 | 1,913,722 |
| Insurance | 80,794 | 102,254 | 256,473 | 315,307 |
| Administrative and other | 395,783 | 372,164 | 1,265,317 | 1,310,424 |
| Total expenses | 3,723,849 | 4,495,762 | 13,331,068 | 13,712,694 |
| **Net Investment Income** | **2,529,495** | **4,523,027** | **8,356,404** | **14,395,816** |
| **Realized And Unrealized Gains (Losses) On Investments:** | | | | |
| Net realized (losses) gains from investment transactions | (1,906,537) | 4,647,841 | (2,871,941) | (6,046,199) |
| Net change in unrealized appreciation (depreciation) on: | | | | |
| Debt securities | 1,759,152 | 456,530 | 4,172,723 | 2,539,345 |
| Equity securities | (186,368) | (4,579,566) | (606,179) | (4,896,852) |
| CLO Fund securities managed by affiliates | (1,590,062) | (993,011) | (3,695,876) | 5,890,984 |
| CLO Fund securities managed by non-affiliates | (34,655) | (137,193) | (328,552) | (136,490) |
| Asset Manager Affiliates investments | 2,922,000 | (1,113,000) | 1,481,000 | (12,706,000) |
| Joint Venture investment | (147,751) | — | (147,751) | — |
| Total net change in unrealized appreciation (depreciation) | 2,722,316 | (6,366,240) | 875,365 | (9,309,013) |
| Net realized and unrealized appreciation (depreciation) on investments | 815,779 | (1,718,399) | (1,996,576) | (15,355,212) |
| **Realized losses on extinguishments of debt** | (4,014,723) | (88,015) | (4,121,998) | (159,206) |
| **Net Increase (Decrease) In Stockholders' Equity Resulting From Operations** | $ (669,449) | $ 2,716,613 | $ 2,237,830 | $ (1,118,601) |
| Net Increase (Decrease) In Stockholders' Equity Resulting from Operations per Common Share: | | | | |
| Basic: | $ (0.02) | $ 0.07 | $ 0.06 | $ (0.03) |
| Diluted: | $ (0.02) | $ 0.07 | $ 0.06 | $ (0.03) |
| Net Investment Income Per Common Share: | | | | |
| Basic: | $ 0.07 | $ 0.12 | $ 0.23 | $ 0.39 |
| Diluted: | $ 0.07 | $ 0.12 | $ 0.23 | $ 0.39 |
| Weighted Average Shares of Common Stock Outstanding—Basic | 37,196,621 | 37,152,622 | 37,202,011 | 37,142,002 |
| Weighted Average Shares of Common Stock Outstanding—Diluted | 37,196,621 | 37,152,622 | 37,202,011 | 37,142,002 |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2017** | **2016** |
| **Operations:** | | |
| Net investment income | $ 8,356,404 | $ 14,395,816 |
| Net realized losses from investment transactions | (2,871,941) | (6,046,199) |
| Realized losses from extinguishments of debt | (4,121,998) | (159,206) |
| Net change in unrealized appreciation (depreciation) on investments | 875,365 | (9,309,013) |
| Net increase (decrease) in net assets resulting from operations | 2,237,830 | (1,118,602) |
| | | |
| **Stockholder distributions:** | (13,315,561) | (16,534,320) |
| | | |
| **Capital share transactions:** | | |
| (Repurchase) issuance of common stock for: | | |
| Common stock withheld for payroll taxes upon vesting of restricted stock | (224,944) | (247,926) |
| Dividend reinvestment plan | 288,192 | 549,627 |
| Stock based compensation | 875,002 | 1,154,123 |
| | | |
| Net increase in net assets resulting from capital transactions | 938,250 | 1,455,824 |
| | | |
| Net assets at beginning of period | 194,924,925 | 216,100,470 |
| | | |
| Net assets at end of period (including undistributed net investment income of $0 in 2017 and $0 in 2016) | $ 184,785,444 | $ 199,903,372 |
| | | |
| Net asset value per common share | $ 4.95 | $ 5.38 |
| Common shares outstanding at end of period | 37,317,815 | 37,160,770 |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended September 30, 2017 | Nine Months Ended September 30, 2016 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net increase (decrease) in stockholder's equity resulting from operations | $ 2,237,829 | $ (1,118,601) |
| Adjustments to reconcile net increase (decrease) in stockholder’s equity resulting from operations to net cash provided by in operating activities: | | |
| Net realized losses on investment transactions | 2,871,941 | 6,046,199 |
| Net change in unrealized depreciation on investments | (875,365) | 9,309,013 |
| Purchases of investments | (202,774,324) | (54,437,487) |
| Proceeds from sales and redemptions of investments | 252,169,877 | 75,555,567 |
| Net accretion of amortization on investments | (707,654) | 1,859,301 |
| Amortization of original issue discount on indebtedness | 352,340 | 464,320 |
| Amortization of debt issuance costs | 557,527 | 651,298 |
| Realized losses on extinguishments of debt | 4,121,998 | 159,206 |
| Payment-in-kind interest income | (829,774) | (975,661) |
| Stock-based compensation | 875,002 | 1,154,376 |
| Changes in operating assets and liabilities: | | |
| Decrease in receivable for open trades | 2,950,658 | — |
| Increase in payable for open trades | 27,065,785 | 9,652,500 |
| Decrease in interest receivable | 110,574 | 654,614 |
| (Increase) in accounts receivable | (2,000,021) | — |
| Decrease in other assets | 294,509 | 286,607 |
| (Increase) decrease in due from affiliates | (546,905) | 373,558 |
| Increase (decrease) in due to affiliates | 78,384 | (554,243) |
| (Decrease) in accounts payable | (397,876) | (219,587) |
| (Decrease) in accrued interest payable | (930,086) | (353,444) |
| Net cash provided by operating activities | 84,624,419 | 48,507,536 |
| FINANCING ACTIVITIES: | | |
| Issuance of 6.125% Notes Due 2022 | 77,407,200 | — |
| Debt issuance costs | (2,798,940) | — |
| Issuance (forfeitures) of restricted shares | 1,303 | (254) |
| Distributions to stockholders | (13,027,367) | (15,984,693) |
| Repayment/repurchase of Senior Funding Notes | (147,350,000) | (19,299,000) |
| Repurchase of 7.375% Notes Due 2019 | (6,530,925) | (7,399,650) |
| Common stock withheld for payroll taxes upon vesting of restricted stock | (224,944) | (247,926) |
| Decrease (increase) in restricted cash | — | (3,771,347) |
| Net cash used in financing activities | (92,523,674) | (46,702,870) |
| CHANGE IN CASH AND RESTRICTED CASH | (7,899,255) | 1,804,666 |
| CASH AND RESTRICTED CASH, BEGINNING OF PERIOD | 9,835,555 | — |
| CASH AND RESTRICTED CASH, END OF PERIOD | $ 1,936,300 | $ 1,804,666 |
| Supplemental Information: | | |
| Interest paid during the period | $ 5,810,461 | $ 6,173,626 |
| Dividends paid during the period under the dividend reinvestment plan | $ 289,478 | $ 549,627 |

See accompanying notes to consolidated financial statements.

**KCAP FINANCIAL, INC.**
**CONSOLIDATED SCHEDULE OF INVESTMENS**
**As of September 30, 2017**
**(unaudited)**

**Debt Securities Portfolio**

| Portfolio Company / Principal Business | Investment Interest Rate[1] / Maturity | Principal | Amortized Cost | Fair Value[2] |
|---|---|---|---|---|
| Advanced Lighting Technologies, Inc,(8)(14)(15) Consumer goods: Durable | First Lien Bond — 12.500% - 6/2019 - 00753CAG7 5.3% Cash, 7.3% PIK, Due 6/19 | $ 3,157,500 | $ 3,054,337 | $ 1,063,761 |
| Advantage Sales & Marketing Inc.(8)(14) Services: Business | Junior Secured Loan — Term Loan (Second Lien) 7.7% Cash, 1 month LIBOR(1.24%) + 6.50%; LIBOR Floor 1.00% , Due 7/22 | 1,000,000 | 1,001,518 | 962,300 |
| Anaren, Inc.(8) Aerospace and Defense | Senior Secured Loan — Term Loan (First Lien) 5.8% Cash, 3 month LIBOR(1.33%) + 4.50%; LIBOR Floor 1.00% , Due 2/21 | 1,513,396 | 1,529,286 | 1,529,286 |
| Asurion, LLC (fka Asurion Corporation)(8) Banking, Finance, Insurance & Real Estate | Senior Secured Loan — Replacement B-5 Term Loan 4.2% Cash, 3 month LIBOR(1.24%) + 3.00%; LIBOR Floor 0.00% , Due 11/23 | 1,994,987 | 2,007,456 | 2,007,556 |
| Avalign Technologies, Inc.(8)(14) Healthcare & Pharmaceuticals | Senior Secured Loan — Initial Term Loan (First Lien) 5.7% Cash, 1 month LIBOR(1.24%) + 4.50%; LIBOR Floor 1.00% , Due 7/21 | 1,078,170 | 1,075,612 | 1,078,170 |
| Avalign Technologies, Inc.(8)(14) Healthcare & Pharmaceuticals | Junior Secured Loan — Initial Term Loan (Second Lien) 9.7% Cash, 6 month LIBOR(1.46%) + 8.25%; LIBOR Floor 1.00% , Due 7/22 | 1,500,000 | 1,488,351 | 1,479,000 |
| Carolina Beverage Group LLC(8)(14) Beverage, Food and Tobacco | Senior Secured Bond — 10.625% - 08/2018 - 143818AA0 144A 10.6% Cash, Due 8/18 | 1,500,000 | 1,503,404 | 1,494,600 |
| CSM Bakery Solutions Limited (fka CSM Bakery Supplies Limited)(8)(14) Beverage, Food and Tobacco | Junior Secured Loan — Term Loan (Second Lien) 9.1% Cash, 3 month LIBOR(1.30%) + 7.75%; LIBOR Floor 1.00% , Due 7/21 | 3,000,000 | 3,009,449 | 2,851,800 |
| CT Technologies Intermediate Holdings, Inc. (Smart Holdings Corp.) (aka HealthPort)(8) Healthcare & Pharmaceuticals | Senior Secured Loan — New Term Loan Facility 5.5% Cash, 3 month LIBOR(1.24%) + 4.25%; LIBOR Floor 1.00% , Due 12/21 | 1,994,898 | 2,004,872 | 2,004,872 |
| DigiCert Holdings, Inc. (8) High Tech Industries | Junior Secured Loan — Term Loan (Second Lien) 9.0% Cash, 3 month LIBOR(1.24%) + 7.76%; LIBOR Floor 1.00% , Due 9/25 | 1,000,000 | 995,000 | 995,000 |
| Drew Marine Group Inc.(8)(14) Transportation: Cargo | Junior Secured Loan — Term Loan (Second Lien) 8.2% Cash, 1 month LIBOR(1.24%) + 7.00%; LIBOR Floor 1.00% , Due 5/21 | 2,500,000 | 2,496,958 | 2,500,000 |

See accompanying notes to consolidated financial statements.

| Portfolio Company / Principal Business | Investment Interest Rate[1] / Maturity | Principal | Amortized Cost | Fair Value |
|---|---|---|---|---|
| EagleTree-Carbide Acquisition Corp. (aka Corsair Components, Inc.)(8) High Tech Industries | Senior Secured Loan — First Lien Term Loan 5.7% Cash, 3 month LIBOR(1.23%) + 4.50%; LIBOR Floor 0.00% , Due 9/24 | 5,000,000 | 4,950,000 | 4,950,000 |
| EagleTree-Carbide Acquisition Corp. (aka Corsair Components, Inc.)(8) High Tech Industries | Junior Secured Loan — Term Loan (Second Lien) 9.8% Cash, 3 month LIBOR(1.33%) + 8.50%; LIBOR Floor 1.00% , Due 8/25 | 5,000,000 | 4,925,000 | 4,925,000 |
| Eastern Power, LLC (Eastern Covert Midco, LLC) (aka TPF II LC, LLC)(8) Utilities: Electric | Senior Secured Loan — Term Loan 5.0% Cash, 1 month LIBOR(1.24%) + 3.75%; LIBOR Floor 1.00% , Due 10/23 | 1,981,386 | 1,979,983 | 1,991,015 |
| EWT Holdings III Corp. (fka WTG Holdings III Corp.)(8) Environmental Industries | Senior Secured Loan — Term Loan (First Lien) 5.1% Cash, 3 month LIBOR(1.33%) + 3.75%; LIBOR Floor 1.00% , Due 1/21 | 2,992,385 | 3,037,271 | 3,037,271 |
| Exela Technologies, Inc.(8) Services: Business | Senior Secured Loan — Term Loan B 8.8% Cash, 3 month LIBOR(1.30%) + 7.50%; LIBOR Floor 1.00% , Due 6/23 | 2,000,000 | 1,961,345 | 1,986,200 |
| First American Payment Systems, L.P.(8)(14) Banking, Finance, Insurance & Real Estate | Junior Secured Loan — Term Loan (Second Lien) 11.7% Cash, 1 month LIBOR(1.23%) + 10.50%; LIBOR Floor 1.00% , Due 7/24 | 1,500,000 | 1,459,320 | 1,435,950 |
| Flexera Software LLC (fka Flexera Software, Inc.)(8) High Tech Industries | Senior Secured Loan — Term Loan (First Lien) 4.8% Cash, 3 month LIBOR(1.33%) + 3.50%; LIBOR Floor 1.00% , Due 4/20 | 2,000,000 | 1,995,000 | 1,995,000 |
| GI Advo Opco, LLC(8)(14) Healthcare & Pharmaceuticals | Senior Secured Loan — Term Loan 5.8% Cash, 3 month LIBOR(1.33%) + 4.50%; LIBOR Floor 1.00% , Due 11/21 | 236,732 | 235,090 | 236,684 |
| GK Holdings, Inc. (aka Global Knowledge)(8)(14) Services: Business | Junior Secured Loan — Initial Term Loan (Second Lien) 11.6% Cash, 3 month LIBOR(1.33%) + 10.25%; LIBOR Floor 1.00% , Due 1/22 | 1,500,000 | 1,481,433 | 1,476,600 |
| Global Tel*Link Corporation(8)(14) Telecommunications | Junior Secured Loan — Term Loan (Second Lien) 9.1% Cash, 3 month LIBOR(1.33%) + 7.75%; LIBOR Floor 1.25% , Due 11/20 | 4,000,000 | 3,965,663 | 3,939,200 |
| Grupo HIMA San Pablo, Inc.(8)(14) Healthcare & Pharmaceuticals | Senior Secured Loan — Term B Loan (First Lien) 8.5% Cash, 3 month LIBOR(1.50%) + 7.00%; LIBOR Floor 1.50% , Due 1/18 | 2,860,000 | 2,856,176 | 2,745,600 |

See accompanying notes to consolidated financial statements.

| Portfolio Company / Principal Business | Investment Interest Rate[1] / Maturity | Principal | Amortized Cost | Fair Value |
|---|---|---|---|---|
| Grupo HIMA San Pablo, Inc.(8)(14) Healthcare & Pharmaceuticals | Junior Secured Loan — Term Loan (Second Lien) 13.8% Cash, 3 month LIBOR(0.00%) + 13.75%; LIBOR Floor 0.00% , Due 7/18 | 7,191,667 | 7,167,268 | 6,544,417 |
| Harland Clarke Holdings Corp. (fka Clarke American Corp.)(8) Media: Advertising, Printing & Publishing | Senior Secured Loan — Tranche B-6 Term Loan 6.8% Cash, 3 month LIBOR(1.33%) + 5.50%; LIBOR Floor 1.00% , Due 2/22 | 3,477,848 | 3,510,198 | 3,512,627 |
| Hoffmaster Group, Inc.(8)(14) Forest Products & Paper | Junior Secured Loan — Initial Term Loan (Second Lien) 10.8% Cash, 3 month LIBOR(1.33%) + 9.50%; LIBOR Floor 1.00% , Due 11/24 | 1,600,000 | 1,557,040 | 1,600,960 |
| Industrial Services Acquisition, LLC (aka Evergreen / NAIC)(8)(14) Environmental Industries | Senior Secured Loan — Term Loan 6.3% Cash, 1 month LIBOR(1.25%) + 5.00%; LIBOR Floor 1.00% , Due 6/22 | 1,183,955 | 1,189,840 | 1,183,955 |
| Ivanti Software, Inc. (fka LANDesk Group, Inc.)(8)(14) High Tech Industries | Junior Secured Loan — Loan (Second Lien) 10.2% Cash, 1 month LIBOR(1.24%) + 9.00%; LIBOR Floor 1.00% , Due 1/25 | 3,228,619 | 3,228,619 | 3,186,970 |
| MB Aerospace ACP Holdings II Corp.(8) Aerospace and Defense | Senior Secured Loan — Initial Term Loan 6.8% Cash, 1 month LIBOR(1.25%) + 5.50%; LIBOR Floor 1.00% , Due 12/22 | 982,500 | 983,720 | 993,602 |
| National Home Health Care Corp.(8)(14) Healthcare & Pharmaceuticals | Junior Secured Loan — Term Loan (Second Lien) 10.2% Cash, 1 month LIBOR(1.23%) + 9.00%; LIBOR Floor 1.00% , Due 12/22 | 1,500,728 | 1,481,090 | 1,469,813 |
| Onex Carestream Finance LP(8)(14) Healthcare & Pharmaceuticals | Junior Secured Loan — Term Loan (Second Lien) 9.8% Cash, 3 month LIBOR(1.33%) + 8.50%; LIBOR Floor 1.00% , Due 12/19 | 1,704,810 | 1,704,810 | 1,685,205 |
| Playpower, Inc.(8) Construction & Building | Senior Secured Loan — Initial Term Loan (First Lien) 6.1% Cash, 3 month LIBOR(1.33%) + 4.75%; LIBOR Floor 1.00% , Due 6/21 | 997,449 | 1,007,336 | 1,007,423 |
| Roscoe Medical, Inc.(8)(14) Healthcare & Pharmaceuticals | Junior Secured Loan — Term Loan (Second Lien) 11.3% Cash, 3 month LIBOR(0.00%) + 11.25%; LIBOR Floor 0.00% , Due 9/19 | 6,700,000 | 6,675,833 | 6,492,300 |
| SCSG EA Acquisition Company, Inc.(8) Healthcare & Pharmaceuticals | Senior Secured Loan — Initial Term Loan (First Lien) 5.5% Cash, 3 month LIBOR(1.24%) + 4.25%; LIBOR Floor 1.00% , Due 9/23 | 4,000,000 | 3,980,220 | 3,980,000 |

See accompanying notes to consolidated financial statements.

| Portfolio Company / Principal Business | Investment Interest Rate[1] / Maturity | Principal | Amortized Cost | Fair Value |
|---|---|---|---|---|
| SCSG EA Acquisition Company, Inc.[(8)] Healthcare & Pharmaceuticals | Junior Secured Loan — Initial Term Loan (Second Lien) 9.5% Cash, 3 month LIBOR(1.24%) + 8.25%; LIBOR Floor 1.00% , Due 9/24 | 5,000,000 | 4,950,470 | 4,950,000 |
| Stafford Logistics, Inc. (dba Custom Ecology, Inc.)[(8)(14)(15)] Environmental Industries | Senior Secured Loan — Term Loan 9.8% Cash, 3 month LIBOR(4.25%) + 5.50%; LIBOR Floor 1.00% , Due 8/21 | 2,709,639 | 2,695,841 | 1,935,225 |
| Tank Partners Holdings, LLC[(8)(13)(14)] Energy: Oil & Gas | Senior Secured Loan — Loan 14.3% Cash, 4.0% Cash, 10.25% PIK, 1 month Prime Rate 4.0% | 11,640,915 | 11,255,256 | 8,220,814 |
| Tex-Tech Industries, Inc.[(8)] Textiles and Leather | Junior Secured Loan — Term Loan (Second Lien) 10.2% Cash, 1 month LIBOR(1.24%) + 9.00%; LIBOR Floor 1.00% , Due 8/24 | 8,008,000 | 7,948,833 | 7,847,840 |
| Time Manufacturing Acquisition, LLC[(8)] Capital Equipment | Senior Secured Loan — Term Loan 6.4% Cash, 3 month LIBOR(1.38%) + 5.00%; LIBOR Floor 1.00% , Due 2/23 | 997,494 | 995,017 | 995,000 |
| Trimaran Advisors, L.L.C.[(8)(9)] Related Party Loan | Senior Unsecured Loan — Revolving Credit Facility 9.0% Cash, 3 month LIBOR(0.00%) + 7.89%; LIBOR Floor 0.00% , Due 11/17 | 20,000,000 | 20,000,000 | 20,000,000 |
| TRSO I, Inc.[(8)(14)] Energy: Oil & Gas | Junior Secured Loan — Term Loan (Second Lien) 14.0% Cash, 3 month LIBOR(1.00%) + 13.00%; LIBOR Floor 1.00% , Due 12/19 | 1,000,000 | 993,631 | 1,000,000 |
| Weiman Products, LLC[(8)(14)] Consumer goods: Non-durable | Senior Secured Loan — Term Loan (2013) 5.8% Cash, 3 month LIBOR(1.33%) + 4.50%; LIBOR Floor 1.00% , Due 11/18 | 734,613 | 732,896 | 734,613 |
| WireCo WorldGroup Inc. [(8)(14)] Capital Equipment | Junior Secured Loan — Initial Term Loan (Second Lien) 10.3% Cash, 3 month LIBOR(1.32%) + 9.00%; LIBOR Floor 1.00% , Due 9/24 | 3,000,000 | 2,960,569 | 3,001,200 |
| **Total Investment in Debt Securities (69% of net asset value at fair value)** | | **$ 134,967,691** | **$ 134,031,011** | **$ 127,026,829** |

See accompanying notes to consolidated financial statements.

**Equity Securities Portfolio**

| Portfolio Company / Principal Business | Investment | Percentage Ownership/Shares | Amortized Cost | Fair Value[2] |
|---|---|---|---|---|
| Advanced Lighting Technologies, Inc,[(5)(8)(14)] Consumer goods: Durable | Preferred Stock Series C | 1.8% | $ 1 | $ 1,000 |
| Aerostructures Holdings L.P.[(5)(8)(14)] Aerospace and Defense | Partnership Interests | 1.2% | 1,000,000 | 1,000 |
| Aerostructures Holdings L.P.[(5)(8)(14)] Aerospace and Defense | Series A Preferred Interests | 1.2% | 250,961 | 742,902 |
| Caribe Media Inc. (fka Caribe Information Investments Incorporated)[(5)(8)(14)] Media: Advertising, Printing & Publishing | Common | 1.3% | 359,765 | 362,411 |
| DBI Holding LLC[(5)(8)(14)] Services: Business | Class A Warrants | 3.2% | 1 | 1,000 |
| eInstruction Acquisition, LLC[(5)(8)(14)] Services: Business | Membership Units | 1.1% | 1,079,617 | 1,000 |
| FP WRCA Coinvestment Fund VII, Ltd.[(3)(5)(14)] Capital Equipment | Class A Shares | 1,500 | 1,500,000 | 747,940 |
| Perseus Holding Corp.[(5)(8)(14)] Hotel, Gaming & Leisure | Common | 0.2% | 400,000 | 1,000 |
| Roscoe Investors, LLC[(5)(8)(14)] Healthcare & Pharmaceuticals | Class A Units | 1.6% | 1,000,000 | 1,234,000 |
| Tank Partners Holdings, LLC[(5)(8)(10)(14)] Aerospace and Defense | Class B Units | 5.8% | 980,000 | 1,000 |
| Tank Partners Holdings, LLC[(5)(8)(14)] Aerospace and Defense | Warrants | 1.3% | 185,205 | 1,000 |
| TRSO II, Inc.[(5)(8)(14)] Energy: Oil & Gas | Common Stock | 5.4% | 1,680,158 | 1,354,924 |
| New Millennium Holdco, Inc. (Millennium Health, LLC)[(5)(8)(14)] Healthcare & Pharmaceuticals | Common | 0.2% | 1,953,299 | 1,000 |
| **Total Investment in Equity Securities (2% of net asset value at fair value)** | | | **$ 10,389,007** | **$ 4,450,177** |

See accompanying notes to consolidated financial statements.

**CLO Fund Securities**

**CLO Subordinated Investments**

| Portfolio Company | Investment[11] | Percentage Ownership | Amortized Cost | Fair Value |
|---|---|---|---|---|
| Grant Grove CLO, Ltd.[3][12][14] | Subordinated Securities, effective interest N/M, 1/21 maturity | 22.2% | $ 2,485,886 | $ 1,000 |
| Katonah III, Ltd.[3][12][14] | Subordinated Securities, effective interest N/M, 5/15 maturity | 23.1% | 1,287,155 | 369,000 |
| Katonah 2007-I CLO Ltd.[3][6][14] | Subordinated Securities, effective interest 20.8%, 4/22 maturity | 100.0% | 31,123,451 | 21,447,386 |
| Trimaran CLO VII, Ltd.[3][6][13][14] | Subordinated Securities, effective interest N/M, 6/21 maturity | 10.5% | 379,830 | 10,000 |
| Catamaran CLO 2012-1 Ltd.[3][6][14] | Subordinated Securities, effective interest 17.1%, 12/23 maturity | 24.9% | 5,759,981 | 2,239,810 |
| Catamaran CLO 2013- 1 Ltd.[3][6][14] | Subordinated Securities, effective interest 14.1%, 1/25 maturity | 23.5% | 4,786,050 | 3,806,100 |
| Catamaran CLO 2014-1 Ltd.[3][6][14] | Subordinated Securities, effective interest 10.2%, 4/26 maturity | 32.4% | 8,681,740 | 4,847,620 |
| Dryden 30 Senior Loan Fund[3][14] | Subordinated Securities, effective interest 31.0%, 11/25 maturity | 7.5% | 1,276,135 | 1,499,682 |
| Catamaran CLO 2014-2 Ltd.[3][6][14] | Subordinated Securities, effective interest 12.8%, 10/26 maturity | 24.9% | 6,699,877 | 4,484,009 |
| Catamaran CLO 2015-1 Ltd.[3][6][14] | Subordinated Securities, effective interest 9.2%, 4/27 maturity | 9.9% | 4,416,694 | 3,033,719 |
| Catamaran CLO 2016-1 Ltd.[3][6][14] | Subordinated Securities, effective interest 6.8%, 1/29 maturity | 24.9% | 10,196,554 | 8,585,018 |
| **Total Investment in CLO Subordinated Securities** | | | **$ 77,093,353** | **$ 50,323,344** |

**CLO Rated-Note Investment**

| Portfolio Company | Investment | Percentage Ownership | Amortized Cost | Fair Value |
|---|---|---|---|---|
| Catamaran CLO 2014-1 Ltd.[3][6][14] | Float - 04/2026 - E - 14889FAC7, Par Value of $1,525,000, 7.1% cash, 4/26 maturity | 15.1% | 1,451,386 | 1,520,000 |
| Total Investment in CLO Rated-Note | | | $ 1,451,386 | $ 1,520,000 |
| **Total Investment in CLO Fund Securities (28% of net asset value at fair value)** | | | **$ 78,544,739** | **$ 51,843,344** |

See accompanying notes to consolidated financial statements.

**Asset Manager Affiliates**

| Portfolio Company / Principal Business | Investment | Percentage Ownership | Cost | Fair Value[2] |
|---|---|---|---|---|
| Asset Manager Affiliates[(8)(9)(14)] | Asset Management Company | 100% | $ 53,341,230 | $ 39,679,000 |
| **Total Investment in Asset Manager Affiliates (21% of net asset value at fair value)** | | | **$ 53,341,230** | **$ 39,679,000** |

**Joint Ventures**

| Portfolio Company / Principal Business | Investment | Percentage Ownership | Cost | Fair Value |
|---|---|---|---|---|
| KCAP Freedom 3 LLC[(14)] | Joint Venture | 60% | $ 36,738,873 | $ 36,591,122 |
| **Total Investment in Joint Ventures (20% of net asset value at fair value)** | | | **$ 36,738,873** | **$ 36,591,122** |

**Short-term Investments**

| Short-term Investments | Investment | Yield | Par /Amortized Cost | Fair Value[2] |
|---|---|---|---|---|
| JP Morgan Business Money Market Account[(7)(8)] | Money Market Account | 0.10% | $ 14,269 | $ 14,269 |
| US Bank Money Market Account[(7)(8)] | Money Market Account | 0.10% | 32,001,559 | 32,001,559 |
| U.S Treasury Bills[(8)] | U.S Treasury Bills, 912796LY3,10/19/17 maturity | 0.883% | 15,007,000 | 15,007,000 |
| U.S Treasury Bills[(8)] | U.S Treasury Bills, 912796KR9, 10/12/17 maturity | 0.801% | 10,002,000 | 10,002,000 |
| **Total Short-term Investments (31% of net asset value at fair value)** | | | **$ 57,024,828** | **$ 57,024,828** |
| **Total Investments[4]** | | | **$ 370,069,689** | **$ 316,615,300** |

1 A majority of the variable rate loans in the Company's investment portfolio bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly at the borrower's option. The Borrower may also elect to have multiple interest reset periods for each loan. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at September 30, 2017. As noted in the table above, 83% (based on par) of debt securities contain LIBOR floors which range between 1.00% and 3.0%.

2 Reflects the fair market value of all investments as of September 30, 2017, as determined by the Company's Board of Directors.

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

4 The aggregate cost of investments for federal income tax purposes is approximately $377 million. The aggregate gross unrealized appreciation is approximately $0.9 million, the aggregate gross unrealized depreciation is approximately $61.2 million, and the net unrealized depreciation is approximately $60.3 million.

5 Non-income producing.

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

7 Money market account holding cash.

See accompanying notes to consolidated financial statements.

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

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

10 Non-voting.

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

12 Notice of redemption has been received for this security.

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

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

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

See accompanying notes to consolidated financial statements.

## KCAP FINANCIAL, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS
## As of December 31, 2016

**Debt Securities Portfolio**

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

See accompanying notes to financial statements.

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

See accompanying notes to financial statements.

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

See accompanying notes to financial statements.

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

See accompanying notes to financial statements.

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

See accompanying notes to financial statements.

**Equity Securities Portfolio**

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

See accompanying notes to financial statements.

**CLO Fund Securities**

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

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

**CLO Rated-Note Investments**

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

**Asset Manager Affiliates**

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

See accompanying notes to financial statements.

**Time Deposits and Money Market Account**

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

(1) A majority of the variable rate loans in the Company's investment portfolio bear interest at a rate that may be determined by reference to either LIBOR or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), which typically resets semi-annually, quarterly, or monthly at the borrower's option. The Borrower may also elect to have multiple interest reset periods for each loan. For each such loan, the Company has provided the weighted average annual stated interest rate in effect at December 31, 2016. As noted in the table above, 93% (based on par) of debt securities contain LIBOR floors which range between 0.75% and 3.0%.

(2) Reflects the fair market value of all investments as of December 31, 2016, as determined by the Company's Board of Directors.

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

(4) The aggregate cost of investments for federal income tax purposes is approximately $429 million. The aggregate gross unrealized appreciation is approximately $2.1 million, the aggregate gross unrealized depreciation is approximately $65.0 million, and the net unrealized depreciation is approximately $62.9 million.

(5) Non-income producing.

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

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

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

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

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

(11) Non-voting.

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

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

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

See accompanying notes to financial statements.

**KCAP FINANCIAL, INC.**
**CONSOLIDATED FINANCIAL HIGHLIGHTS**
**(unaudited)**

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2017** | **2016** |
| **Per Share Data:** | | |
| Net asset value, at beginning of period | $ 5.24 | $ 5.82 |
| Net investment income[1] | 0.23 | 0.39 |
| Net realized losses from investments[1] | (0.08) | (0.17) |
| Realized losses from extinguishment of debt[1] | (0.11) | - |
| Net change in unrealized depreciation on investments[1] | 0.02 | (0.25) |
| Net decrease in net assets resulting from operations | 0.06 | (0.03) |
| Stockholder Distributions | (0.36) | (0.45) |
| Net increase (decrease) in net assets relating to stock-based transactions: | | |
| Common stock withheld for payroll taxes upon vesting of restricted stock | (0.01) | (0.01) |
| Dividend reinvestment plan | 0.01 | 0.01 |
| Stock based compensation | - | 0.04 |
| Net increase (decrease) in net assets relating to stock-based transactions[6] | - | 0.04 |
| Net asset value, end of period | $ 4.95 | $ 5.38 |
| Total net asset value return[2] | 1.3% | 0.2% |
| **Ratio/Supplemental Data:** | | |
| Per share market value at beginning of period | $ 3.98 | $ 4.07 |
| Per share market value at end of period | $ 3.65 | $ 4.63 |
| Total market return[3] | 0.7% | 24.8% |
| Shares outstanding at end of period | 37,317,815 | 37,160,770 |
| Net assets at end of period | $ 184,785,444 | $ 199,903,373 |
| Portfolio turnover rate[4] | 73.8% | 19.3% |
| Average par debt outstanding | $ 144,298,499 | $ 192,692,951 |
| Asset coverage ratio | 274% | 207% |
| Ratio of net investment income to average net assets[5] | 5.9% | 9.2% |
| Ratio of total expenses to average net assets[5] | 9.4% | 8.8% |
| Ratio of interest expense to average net assets[5] | 4.1% | 4.5% |
| Ratio of non-interest expenses to average net assets[5] | 5.3% | 4.3% |

1 Based on weighted average number of common shares outstanding-basic for the period.
2 Total net asset value return (not annualized) equals the change in the ending of period net asset value per share over the beginning of period net asset value per share plus distributions (including any return of capital), divided by the beginning of period net asset value per share.
3 Total market return equals the change in the ending of period market price per share over the beginning of period price per share plus distributions (including any return of capital), divided by the beginning of period market price per share.
4 Not annualized. Portfolio turnover rate equals the year-to-date sales and paydowns over the average of the invested assets at fair value.
5 Annualized
6 Totals may not sum due to rounding.

See accompanying notes to consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

## 1. ORGANIZATION

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

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

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

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

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

As of September 30, 2017, Katonah Debt Advisors and Trimaran Advisors, as well as affiliated management companies Katonah 2007-1 Management, L.L.C., Trimaran Advisors Management, L.L.C. and KCAP Management L.L.C., (collectively the “Asset Manager Affiliates”), had approximately $2.8 billion of par value assets under management. The Asset Manager Affiliates are each managed independently from KCAP by a separate management team (however, certain of the Company’s executive officers also act in similar capacities for one or both of the Asset Manager Affiliates). The Asset Manager Affiliates provide investment management services to CLO Funds, making day-to-day investment decisions concerning the assets of the CLO Funds. The Asset Manager Affiliates do not have any investments in the CLO Funds they manage; however, KCAP holds investments in a portion of the securities issued by the CLO Funds managed by the Asset Manager Affiliates.

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

The Company has three principal areas of investment:

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

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

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

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

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

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information. Accordingly, they do not include all of the information and footnotes required for annual consolidated financial statements. The unaudited interim consolidated financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto in the Company’s Form 10-K for the year ended December 31, 2016, as filed with the U.S. Securities and Exchange Commission (the “Commission” or the “SEC”).

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

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

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

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

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

In addition, in accordance with Regulation S-X promulgated by the SEC, additional financial information with respect to one of the CLO Funds in which the Company has an investment, Katonah 2007-I CLO Ltd. ("Katonah 2007-I CLO"), is required to be included in the Company's SEC filings. The additional financial information regarding the Asset Manager Affiliates and Katonah 2007-I CLO is set forth in Note 5 to these consolidated financial statements.

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

It is the Company's primary investment objective to generate current income and capital appreciation by lending directly to privately-held middle market companies. During the nine months ended September 30, 2017, the Company provided approximately $17 million to portfolio companies to support their growth objectives, none of which was contractually obligated. See also Note 8 – Commitments and Contingencies. As of September 30, 2017, the Company held loans it made to 38 investee companies with aggregate principal amounts of $135 million. The details of such loans have been disclosed on the consolidated schedule of investments as well as in Note 4 – Investments. In addition to providing loans to investee companies, from time to time the Company assists investee companies in securing financing from other sources by introducing such investee companies to sponsors or by, among other things, leading a syndicate of lenders to provide the investee companies with financing. During the nine months ended September 30, 2017, the Company did not engage in any such or similar activities.

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

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

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

**Consolidated Statements of Cash Flows**

| | | Nine Months Ended September 30, 2016 |
|---|---|---|
| Net cash (used in) financing activities as reported | $ | (46,702,870) |
| Impact of Adoption | | 3,771,347 |
| | | |
| Net cash (used in) financing activities after adoption | $ | (42,931,523) |

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

***Investments***

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

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

The FASB issued guidance that clarified and required disclosures about fair value measurements. These include requirements to disclose the amounts and reasons for significant transfers between Level I and Level II, as well as significant transfers in and out of Level III of the fair value hierarchy (see Note 4 – "Investments – Fair Value Measurements" for further information relating to Level I, Level II and Level III). The guidance also required that purchases, sales, issuances and settlements be presented gross in the Level III reconciliation.

ASC 820: Fair Value requires the disclosure in interim and annual periods of the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

*Interest Income*. Interest income, including the amortization of premium and accretion of discount, is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company generally places a loan or security on non-accrual status and ceases recognizing cash interest income on such loan or security when a loan or security becomes 90 days or more past due or if the Company otherwise does not expect the debtor to be able to service its debt obligations. Non-accrual loans remain in such status until the borrower has demonstrated the ability and intent to pay contractual amounts due or such loans become current. As of September 30, 2017, two issuers representing 1% of the Company's total investments at fair value were on a non-accrual status, and one of our investments, representing 2% of the Company's investments at fair value, was on partial non-accrual status, whereby we have recognized income on a portion of contractual payment-in-kind (PIK) amounts due.

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

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

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

For non-junior class CLO Fund securities, such as the Company's investment in the Class E Notes of the Catamaran CLO 2014-1, interest is earned at a fixed spread relative to the LIBOR index.

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

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

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

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

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

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

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

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

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

The following information sets forth the computation of basic and diluted net increase (decrease) in stockholders' equity per share for the three and nine months ended September 30, 2017 and 2016 (unaudited):

| | (unaudited) Three Months Ended September 30, | | (unaudited) Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** |
| Net increase (decrease) in net assets resulting from operations | $ (669,449) | $ 2,716,613 | $ 2,237,830 | $ (1,118,600) |
| Net (increase) decrease in net assets allocated to unvested share awards | 3,260 | (30,313) | (18,094) | 16,701 |
| Net increase (decrease) in net assets available to common stockholders | $ (666,189) | $ 2,686,300 | $ 2,219,736 | $ (1,101,900) |
| Weighted average number of common shares outstanding for basic shares computation | 37,196,621 | 37,152,622 | 37,202,011 | 37,142,002 |
| Weighted average number of common and common stock equivalent shares outstanding for diluted shares computation | 37,196,621 | 37,152,622 | 37,202,011 | 37,142,002 |
| Net increase (decrease) in net assets per basic common shares: | | | | |
| Net increase (decrease) in net assets from operations | $ (0.02) | $ 0.07 | $ 0.06 | $ (0.03) |
| Net increase (decrease) in net assets per diluted shares: | | | | |
| Net increase (decrease) in net assets from operations | $ (0.02) | $ 0.07 | $ 0.06 | $ (0.03) |

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

There were 50,000 options to purchase shares of common stock considered for the computation of the diluted per share information for the three months and nine months ended September 30, 2017 and 2016. Since the effects are anti-dilutive for both periods, the options were not considered in the computation. For the three months ended September 30, 2017 and 2016, the Company purchased 349 and 309 shares of common stock, respectively. For the nine months ended September 30, 2017 and 2016 the Company purchased 64,176 and 67,654 shares of common stock, respectively, in connection with the vesting of employee restricted stock, such shares are treated as treasury shares and reduce the weighted average shares outstanding in the computation of earnings per share.

The Company's Convertible Notes were included in the computation of the diluted net increase or decrease in net assets resulting from operations per share by application of the "if-converted method" for periods when the Convertible Notes were outstanding. Under the if-converted method, interest charges applicable to the convertible notes for the period are added to reported net increase or decrease in net assets resulting from operations and the full amount of shares (pro-rata if not outstanding for the full period) that would be issued are added to weighted average basic shares. Convertible notes are considered anti-dilutive only when its interest per share upon conversion exceeds the basic net increase or decrease in net assets resulting from operations per share. For the nine month period ended September 30, 2016, the effects of the convertible notes were anti-dilutive. The Convertible Notes matured and were repaid in March 2016.

**4. INVESTMENTS**

The following table shows the Company's portfolio by security type at September 30, 2017 and December 31, 2016:

| | September 30, 2017 (unaudited) | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| **Security Type** | **Cost/ Amortized Cost** | **Fair Value** | **%[1]** | **Cost/ Amortized Cost** | **Fair Value** | **%[1]** |
| Short-term Investments[2] | 57,024,828 | $ 57,024,828 | 18 | 28,699,269 | $ 28,699,269 | 8 |
| Senior Secured Loan | 49,982,415 | 46,124,914 | 15 | 207,701,078 | 200,322,152 | 55 |
| Junior Secured Loan | 59,490,855 | 58,343,554 | 18 | 37,251,776 | 35,444,440 | 10 |
| Senior Unsecured Loan | 20,000,000 | 20,000,000 | 6 | - | - | - |
| First Lien Bond | 3,054,337 | 1,063,762 | - | 3,060,919 | 1,089,338 | - |
| Senior Secured Bond | 1,503,404 | 1,494,600 | - | 1,506,461 | 1,487,400 | - |
| CLO Fund Securities | 78,544,739 | 51,843,344 | 16 | 76,851,317 | 54,174,350 | 15 |
| Equity Securities | 10,389,007 | 4,450,177 | 1 | 10,389,007 | 5,056,355 | 1 |
| Asset Manager Affiliates[3] | 53,341,230 | 39,679,000 | 13 | 55,341,230 | 40,198,000 | 11 |
| Joint Venture | 36,738,873 | 36,591,122 | 13 | - | - | - |
| Total | $ 370,069,689 | $ 316,615,300 | 100% | $ 420,801,057 | $ 366,471,304 | 100% |

1 Represents percentage of total portfolio at fair value.

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

3 Represents the equity investment in the Asset Manager Affiliates.

The industry-related information, based on the fair value of the Company's investment portfolio as of September 30, 2017 and December 31, 2016, for the Company's investment portfolio was as follows:

| | September 30, 2017 (unaudited) | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| **Industry Classification** | **Cost/ Amortized Cost** | **Fair Value** | **%[1]** | **Cost/ Amortized Cost** | **Fair Value** | **%** |
| Aerospace and Defense | $ 4,929,171 | $ 3,268,788 | 1% | $ 8,394,633 | $ 8,450,106 | 2% |
| Asset Management Company[2] | 53,341,230 | 39,679,000 | 13 | 55,341,230 | 40,198,000 | 11 |
| Automotive | - | - | - | 6,322,551 | 6,196,154 | 2 |
| Banking, Finance, Insurance & Real Estate | 3,466,776 | 3,443,506 | 1 | 6,805,514 | 6,782,010 | 2 |
| Beverage, Food and Tobacco | 4,512,854 | 4,346,400 | 1 | 15,198,830 | 14,703,372 | 4 |
| Capital Equipment | 5,455,586 | 4,744,140 | 1 | 6,185,129 | 5,575,048 | 2 |
| Chemicals, Plastics and Rubber | - | - | - | 6,421,909 | 6,444,073 | 2 |
| CLO Fund Securities | 78,544,739 | 51,843,344 | 16 | 76,851,317 | 54,174,350 | 15 |
| Construction & Building | 1,007,336 | 1,007,423 | - | 5,919,158 | 5,929,606 | 2 |
| Consumer goods: Durable | 3,054,338 | 1,064,762 | - | 12,319,905 | 10,118,736 | 3 |
| Consumer goods: Non-durable | 732,896 | 734,613 | - | 14,766,390 | 14,452,096 | 4 |
| Ecological | - | - | - | 1,741,292 | 1,760,783 | - |
| Energy: Electricity | - | - | - | 3,904,453 | 3,937,247 | 1 |
| Energy: Oil & Gas | 13,929,048 | 10,575,738 | 3 | 14,493,835 | 8,805,761 | 2 |
| Environmental Industries | 6,922,952 | 6,156,451 | 2 | 12,279,924 | 12,185,239 | 3 |
| Forest Products & Paper | 1,557,040 | 1,600,960 | 1 | 4,192,889 | 4,192,907 | 1 |
| Healthcare & Pharmaceuticals | 36,573,091 | 33,901,061 | 11 | 58,769,668 | 53,594,534 | 15 |
| High Tech Industries | 16,093,619 | 16,051,970 | 5 | 9,854,093 | 9,936,109 | 3 |
| Hotel, Gaming & Leisure | 400,000 | 1,000 | - | 400,000 | 1,000 | - |
| Joint Venture | 36,738,873 | 36,591,122 | 12 | - | - | - |
| Media: Advertising, Printing & Publishing | 3,869,962 | 3,875,038 | 1 | 11,712,682 | 11,453,447 | 3 |
| Media: Broadcasting & Subscription | - | - | - | 8,273,174 | 8,372,984 | 2 |
| Related Party Loan | 20,000,000 | 20,000,000 | 6 | - | - | - |
| Retail | - | - | - | 1,415,457 | 759,581 | - |
| Services: Business | 5,523,913 | 4,427,100 | 1 | 16,125,481 | 16,230,486 | 4 |
| Services: Consumer | - | - | - | 6,212,108 | 6,204,889 | 2 |
| Telecommunications | 3,965,663 | 3,939,200 | 1 | 12,809,799 | 12,767,823 | 3 |
| Textiles and Leather | 7,948,833 | 7,847,841 | 3 | - | - | - |
| Money Market Accounts | 32,015,828 | 32,015,828 | 11 | 28,699,269 | 28,699,269 | 8 |
| Transportation: Cargo | 2,496,958 | 2,500,000 | 1 | 7,557,315 | 7,190,135 | 2 |
| Transportation: Consumer | - | - | - | 2,412,614 | 2,324,516 | 1 |
| U.S. Government Obligation | 25,009,000 | 25,009,000 | 8 | - | - | |
| Utilities: Electric | 1,979,983 | 1,991,015 | 1 | 5,420,438 | 5,031,043 | 1 |
| Total | $ 370,069,689 | $ 316,615,300 | 100% | $ 420,801,057 | $ 366,471,304 | 100% |

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

2 Represents the equity investment in the Asset Manager Affiliates.

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

At September 30, 2017 and December 31, 2016, the total amount of non-qualifying assets was approximately 28% and 17% of the total investment portfolio, respectively. The majority of non-qualifying assets were foreign investments which were approximately 17% and 14% of the total investment portfolio, respectively (including the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 16% and 15% of total assets on such dates, respectively).

The following tables detail the ten largest portfolio investments (at fair value) as of September 30, 2017 and December 31, 2016:

| Investment | September 30, 2017 (unaudited) Cost/Amortized Cost | Fair Value | % of FMV |
|---|---|---|---|
| Asset Manager Affiliates | $ 53,341,230 | $ 39,679,000 | 13% |
| KCAP Freedom 3 LLC | 36,738,873 | 36,591,122 | 12 |
| US Bank Money Market Account | 32,001,559 | 32,001,559 | 10 |
| Katonah 2007-I CLO Ltd. | 31,123,451 | 21,447,386 | 7 |
| Trimaran Advisors, L.L.C. | 20,000,000 | 20,000,000 | 6 |
| U.S Treasury Bills - CUSIP: 912796LY3 | 15,007,000 | 15,007,000 | 5 |
| U.S Treasury Bills - CUSIP: 912796KR9 | 10,002,000 | 10,002,000 | 3 |
| Tank Partners Holdings, LLC | 12,420,461 | 8,222,814 | 3 |
| Catamaran CLO 2016-1 Ltd. | 10,196,554 | 8,585,018 | 3 |
| Grupo HIMA San Pablo, Inc. | 10,023,444 | 9,290,017 | 3 |
| Total | $ 230,854,572 | $ 200,825,916 | 65% |

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

Excluding the Asset Manager Affiliates and CLO Fund securities, the Company's ten largest portfolio companies represented approximately 49% and 13% of the total fair value of the Company's investments at September 30, 2017 and December 31, 2016, respectively.

**Investments in CLO Fund Securities**

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

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

In the third quarter of 2017, the Company purchased $3.8 million notional value of the Subordinated Notes of Catamaran 2014-1 CLO managed by Trimaran Advisors.

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

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

**Affiliate Investments**

The following table details investments in affiliates:

| | Fair Value at December 31, 2016 | Purchases/(Sales) of or Advances/(Distributions) | Net Accretion | Unrealized Gain/(Loss) | Fair Value at of September 30, 2017 (unaudited) | Interest Income | Dividend Income |
|---|---|---|---|---|---|---|---|
| Asset Manager Affiliates | $ 40,198,000 | $ (2,000,000) | $ - | $ 1,481,000 | $ 39,679,000 | $ - | $ 180,000 |
| Trimaran Advisors, LLC Related Party Loan | - | 20,000,000 | - | - | 20,000,000 | 506,306 | - |
| Katonah 2007-I CLO, Ltd. | 20,453,099 | (1,841,861) | 4,942,665 | (2,106,519) | 21,447,386 | 4,942,665 | - |
| Trimaran CLO VII, Ltd. | 1,195,152 | (1,264,090) | - | 78,938 | 10,000 | - | - |
| Catamaran CLO 2012-1, Ltd. | 2,819,412 | (636,377) | 476,425 | (419,650) | 2,239,810 | 476,425 | - |
| Catamaran CLO 2013-1, Ltd. | 4,918,807 | (985,219) | 534,047 | (661,535) | 3,806,101 | 534,047 | - |
| Catamaran CLO 2014-1, Ltd. | 4,546,682 | 303,037 | 560,220 | (562,318) | 4,847,621 | 560,220 | - |
| Catamaran CLO 2014-2, Ltd. | 5,092,087 | (880,468) | 612,786 | (340,395) | 4,484,010 | 612,786 | - |
| Catamaran CLO 2015-1, Ltd. | 3,223,255 | (442,803) | 316,181 | (62,913) | 3,033,719 | 316,181 | - |
| Catamaran CLO 2016-1, Ltd. | 8,350,290 | (791,935) | 848,489 | 178,174 | 8,585,018 | 848,489 | - |
| CRMN 2014-1A | 1,310,000 | - | 9,659 | 200,341 | 1,520,000 | 87,974 | - |
| KCAP Freedom 3, LLC | - | 36,738,873 | - | (147,751) | 36,591,122 | - | 685,000 |
| Total Affiliated Investments | $ 92,106,784 | $ 48,199,157 | $ 8,300,472 | $ (2,362,628) | $ 146,243,787 | $ 8,885,093 | $ 865,000 |

**Investment in Joint Venture:**

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

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

The Company has determined that the Joint Venture is an investment company under ASC 946, however, in accordance with such guidance; the Company will generally not consolidate its investment in a company other than a wholly owned investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. Accordingly, the Company does not consolidate its non-controlling interest in the Joint Venture.

**KCAP Freedom 3 LLC**
Summarized Balance Sheet (unaudited)

| | As of September 30, 2017 |
|---|---|
| Investment at fair value | $ 62,591,610 |
| Total Assets | $ 62,591,610 |
| | |
| Total Liabilities | $ 1,026,962 |
| Total Equity | 61,564,648 |
| Total Liabilities and Equity | $ 62,591,610 |

**KCAP Freedom 3 LLC**
Summarized Statements of Operations Information (unaudited)

| | For the period from July 20, 2017 (date of inception) to September 30, 2017 |
|---|---|
| Investment income | $ 1,026,962 |
| Operating Expenses | 10,000 |
| Net Investment Income | 1,016,962 |
| Unrealized appreciation on Investments | 79,258 |
| Net Income | $ 1,096,220 |

During the three months ended September 30, 2017, KCAP Management LLC recognized approximately $185 thousand of management fees from the Fund, which is a wholly-owned subsidiary of the Joint Venture. In turn, the Company has recognized dividend income of approximately $180 thousand during the three months ended September 30, 2017 (included in Dividends from Asset Manager Affiliates) related to distributions from KCAP Management, LLC.

**Fair Value Measurements**

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

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

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

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

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

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

The following table summarizes the fair value of investments by the above ASC 820: Fair Value hierarchy levels as of September 30, 2017 (unaudited) and December 31, 2016, respectively:

| | As of September 30, 2017 (unaudited) | | | |
|---|---|---|---|---|
| | Level I | Level II | Level III | Total |
| Money market accounts | $ — | $ 32,015,828 | $ — | $ 32,015,828 |
| U.S. Treasury Bills | 25,009,000 | — | — | 25,009,000 |
| Debt securities | — | 68,707,692 | 58,319,137 | 127,026,829 |
| CLO Fund securities | — | — | 51,843,344 | 51,843,344 |
| Equity securities | — | — | 4,450,177 | 4,450,177 |
| Asset Manager Affiliates | — | — | 39,679,000 | 39,679,000 |
| Joint Venture | — | — | 36,591,122 | 36,591,122 |
| Total | $ 25,009,000 | $ 100,723,520 | $ 190,882,780 | $ 316,615,300 |

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

As a BDC, the Company is required to invest primarily in the debt and equity of non-public companies for which there is little, if any, market-observable information. As a result, a significant portion of the Company's investments at any given time will likely be deemed Level III investments.

Investment values derived by a third party pricing service are generally deemed to be Level III values. For those that have observable trades, the Company considers them to be Level II.

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

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

The Company's policy for determining transfers between levels is based solely on the previously defined three-level hierarchy for fair value measurement. Transfers between the levels of the fair value hierarchy are separately noted in the tables below and the reason for such transfer described in each table's respective footnotes. Certain information relating to investments measured at fair value for which the Company has used unobservable inputs to determine fair value is as follows:

| | Nine Months Ended September 30, 2017 (unaudited) | | | | | |
|---|---|---|---|---|---|---|
| | Debt Securities | CLO Fund Securities | Equity Securities | Asset Manager Affiliate | Joint Venture | Total |
| Balance, December 31, 2016 | $ 153,741,745 | $ 54,174,350 | $ 5,056,355 | $ 40,198,000 | $ — | $ 253,170,450 |
| Transfers out of Level III(1) | — | — | — | — | — | — |
| Transfers into Level III(2) | 6,372,000 | — | — | — | — | 6,372,000 |
| Net accretion (amortization) | 206,241 | 443,434 | — | — | — | 649,675 |
| Purchases | 20,048,575 | 1,249,988 | 1 | — | 36,738,873 | 58,037,437 |
| Sales/Paydowns/Return of Capital | (126,670,826) | — | — | (2,000,000) | — | (128,670,826) |
| Total realized gain (loss) included in earnings | (995,630) | — | — | — | — | (995,630) |
| Total unrealized gain (loss) included in earnings | 5,617,032 | (4,024,428) | (606,179) | 1,481,000 | (147,751) | 2,319,674 |
| Balance, September 30, 2017 | $ 58,319,137 | $ 51,843,344 | $ 4,450,177 | $ 39,679,000 | $ 36,591,122 | 190,882,780 |
| Changes in unrealized gains (losses) included in earnings related to investments still held at reporting date | $ 1,174,559 | $ (4,024,428) | $ (1) | $ 1,481,000 | $ (147,751) | $ (1,368,870) |

[1]Transfers out of Level III represent a transfer of $0 relating to debt and equity securities for which pricing inputs, other than their quoted prices in active markets were observable as of September 30, 2017.

[2]Transfers into Level III represent a transfer of $6,372,000 relating to debt and equity securities for which pricing inputs, other than their quoted prices in active markets were unobservable as of September 30, 2017.

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

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

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

As of September 30, 2017, the Company's Level II portfolio investments were valued by a third party pricing services for which the prices are not adjusted and for which inputs are observable or can be corroborated by observable market data for substantially the full character of the financial instrument, or by inputs that are derived principally from, or corroborated by, observable market information. The fair value of the Company's Level II portfolio investments was $100,723,520 as of September 30, 2017.

As of September 30, 2017, the Company's Level III portfolio investments had the following valuation techniques and significant inputs:

| Type | Fair Value | Primary Valuation Methodology | Unobservable Inputs | Range of Inputs (Weighted Average) |
|---|---|---|---|---|
| **Debt Securities** | $ 11,219,800 | Enterprise Value | Average EBITDA Multiple / WACC | 5.2x - 6.7x (5.5x)<br>13.3% - 17.7% (16.8%) |
| | 47,099,337 | Income Approach | Implied Discount Rate | 6.0% - 26.4% (13.8%) |
| **Equity Securities** | 4,442,177 | Enterprise Value | Average EBITDA Multiple / WACC | 4.6x – 16.1x (10.4x)<br>10.6% - 14.6% (12.2%) |
| | 8,000 | Options Value | Qualitative Inputs(1) | |
| **CLO Fund Securities** | 30,395,957 | Discounted Cash Flow | Discount Rate | 12.0% |
| | | | Probability of Default | 2.0% |
| | | | Loss Severity | 25.9% |
| | | | Recovery Rate | 74.1% |
| | | | Prepayment Rate | 25.0% |
| | 21,447,386 | Liquidation Value | Qualitative Inputs(2) | |
| **Asset Manager Affiliate** | 39,679,000 | Discounted Cash Flow | Discount Rate | 2.5% - 12.0% (6.5%) |
| **Joint Venture** | 36,591,122 | Enterprise Value | Qualitative Inputs(2) | |
| **Total Level III Investments** | $ 190,882,780 | | | |

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

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

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

| Type | Fair Value | Primary Valuation Methodology | Unobservable Inputs | Range of Inputs (Weighted Average) |
|---|---|---|---|---|
| **Debt Securities** | $ 7,639,648 | Enterprise Value | Average EBITDA Multiple | 5.3x |
| | 146,102,097 | Income Approach | Implied Discount Rate | 5.6% - 21.5% (9.15%) |
| **Equity Securities** | 5,050,355 | Enterprise Value | Average EBITDA Multiple/WACC | 4.8x/7.4% - 14.1x/13.9% (9.3x/12.0%) |
| | 6,000 | Options Value | Qualitative Inputs(1) | |
| **CLO Fund Securities** | 45,824,060 | Discounted Cash Flow | Discount Rate | 11.3% - 13.0% (13.0%) |
| | | | Probability of Default | 2.0% - 2.5% (2.0%) |
| | | | Loss Severity | 25.0% - 25.9% (25.9%) |
| | | | Recovery Rate | 74.1% - 75.% (74.2%) |
| | | | Prepayment Rate | 25.0% - 29.1% (25.1%) |
| | 8,350,290 | Market Approach | 3rd Party Quote | 82.35% (82.35%) |
| **Asset Manager Affiliate** | 40,198,000 | Discounted Cash Flow | Discount Rate | 2.5% - 13.0% (7.6%) |
| **Total Level III Investments** | $ 253,170,450 | | | |

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

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

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

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

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

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

## 5. ASSET MANAGER AFFILIATES

*Wholly-Owned Asset Managers*

The Asset Manager Affiliates are wholly-owned portfolio companies. The Asset Manager Affiliates manage CLO Funds primarily for third party investors that invest in broadly syndicated loans, high yield bonds and other credit instruments issued by corporations. At September 30, 2017 and December 31, 2016, the Asset Manager Affiliates had approximately $2.8 billion and $3.0 billion of par value of assets under management, respectively, and the Company’s 100% equity interest in the Asset Manager Affiliates had a fair value of approximately $39.7 million and $40.2 million, respectively.

As a manager of the CLO Funds, the Asset Manager Affiliates receive contractual and recurring management fees from the CLO Funds for their management and advisory services. The annual fees which the Asset Manager Affiliates receive are generally based on a fixed percentage of assets under management (at par value and not subject to changes in market value), and the Asset Manager Affiliates generate net income equal to the amount by which their fee income exceeds their operating expenses, including compensation of their employees and income taxes. The management fees the Asset Manager Affiliates receive have three components - a senior management fee, a subordinated management fee and an incentive fee. Currently, all CLO Funds managed by the Asset Manager Affiliates are paying both their senior and subordinated management fees on a current basis.

For the three months ended September 30, 2017 and 2016, the Asset Manager Affiliates declared cash distributions of $880,000 and $750,000 to the Company, respectively. For the nine months ended September 30, 2017 and 2016, the Asset Manager Affiliates declared cash distributions of approximately $2.2 million and $2.7 million to the Company, respectively. Any distributions from the Asset Manager Affiliates out of their estimated tax-basis earnings and profits are recorded as “Dividends from Asset Manager Affiliates” on the Company’s statement of operations. The Company recognized $180,000 of Dividends from Asset Manager Affiliates in the Statement of Operations for the three months ended September 30, 2017.For the nine months ended September 30, 2017 and 2016, the Company recognized $180,000 and $1.4 million, respectively of Dividends from Asset Manager Affiliates in the Statement of Operations. The difference between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e., tax-basis return of capital). Distributions receivable, if any, are reflected in the Due from Affiliates account on the consolidated balance sheets.

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

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

On February 18, 2015, the FASB issued Accounting Standards Update 2015-2 (“ASU 2015-2”), which updated consolidation standards under ASC Topic 810, “Consolidation”. Under this update, a new consolidation analysis is required for VIEs and will limit the circumstances in which investment managers and similar entities are required to consolidate the entities that they manage. The FASB decided to eliminate some of the criteria under which their management fees are considered a variable interest and limit the circumstances in which variable interests in a VIE held by related parties of a reporting enterprise require the reporting enterprise to consolidate the VIE. The guidance is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2015, early adoption is permitted. The Asset Manager Affiliates adopted ASU 2015-2 in 2016 which resulted in the deconsolidation of the CLO Funds. Prior year amounts have been restated to reflect the retrospective adoption of ASU 2015-2. In addition, in accordance with Regulation S-X, additional financial information with respect to the Asset Manager Affiliates and one of the CLO Funds in which the Company has an investment, Katonah 2007-I CLO, is required to be included in the Company’s SEC Filings. This additional financial information regarding the Asset Manager Affiliates and Katonah 2007-1 CLO does not directly impact the financial position, results of operations, or cash flows of the Company.

**Asset Manager Affiliates**

Summarized Balance Sheet (unaudited)

| | As of September 30, 2017 | As of December 31, 2016 |
|---|---|---|
| Cash | $ 14,532,648 | $ 3,425,709 |
| Investments | 10,000,000 | - |
| Intangible Assets | 22,830,000 | 23,157,541 |
| Other Assets | 3,762,880 | 5,024,174 |
| Total Assets | $ 51,125,528 | $ 31,607,424 |
| | | |
| Total Liabilities | $ 25,970,228 | $ 6,619,619 |
| Total Equity | 25,155,300 | 24,987,805 |
| Total Liabilities and Equity | $ 51,125,528 | $ 31,607,424 |

**Asset Manager Affiliates**

Summarized Statements of Operations Information (unaudited)

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Fee Revenue | $ 3,027,460 | $ 3,148,353 | $ 12,000,010 | $ 9,707,075 |
| Interest Income | 25,298 | 570,865 | 31,208 | 1,138,483 |
| Total Income | 3,052,758 | 3,719,218 | 12,031,218 | 10,845,558 |
| Operating Expenses | 2,547,545 | 2,789,654 | 7,852,377 | 8,618,839 |
| Amortization of Intangibles | - | 327,541 | 327,541 | 982,623 |
| Interest Expense | 121,468 | 485,355 | 525,034 | 1,353,135 |
| Total Expenses | 2,669,013 | 3,602,550 | 8,704,952 | 10,954,597 |
| Pre-Tax Income (Loss) | 383,745 | 116,668 | 3,326,266 | (109,039) |
| Income Tax (Benefit) Expense | (79,791) | (100,862) | 978,769 | (346,447) |
| Net Income | $ 463,536 | $ 217,530 | $ 2,347,497 | $ 237,408 |

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

| | As of September 30, 2017 | As of December 31, 2016 |
|---|---|---|
| Total investments at fair value | $ 80,158,889 | $ 176,684,976 |
| Cash | 24,632,168 | 34,982,770 |
| Total Assets | 105,370,828 | 212,160,163 |
| CLO Debt at fair value | 104,216,372 | 208,812,164 |
| Total liabilities | 105,374,980 | 210,463,954 |
| Total Net Assets (deficit) | (4,151) | 1,696,209 |

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

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Interest income from investments | $ 1,185,765 | $ 2,330,108 | $ 4,336,891 | $ 7,338,815 |
| Total income | 1,203,940 | 2,373,500 | 4,392,101 | 7,683,808 |
| Interest expense | 1,275,068 | 2,184,144 | 4,289,994 | 6,724,410 |
| Total expenses | 1,401,622 | 2,400,770 | 4,885,278 | 7,497,100 |
| Net realized and unrealized gains (losses) | (48,669) | 1,397,748 | (1,207,183) | 3,783,015 |
| Increase in net assets resulting from operations | (246,351) | 1,370,478 | (1,700,360) | 3,969,723 |

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

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

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

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

*Related Party Transactions*

On February 26, 2013, the Company entered into a senior credit agreement (the "Trimaran Credit Facility") with Trimaran Advisors, pursuant to which Trimaran Advisors may borrow from time to time up to $20 million from the Company in order to provide capital necessary to support one or more of Trimaran Advisors' warehouse lines of credit and/or working capital in connection with Trimaran Advisors' warehouse activities. The Trimaran Credit Facility expires on November 20, 2017 and bears interest at an annual rate of 9.0%. Outstanding borrowings on the Trimaran Credit Facility are callable by the Company at any time. On April 15, 2013, the Trimaran Credit Facility was amended and upsized from $20 million to $23 million. At September 30, 2017 and December 31, 2016, there was $20 million and $0 million, respectively, outstanding under the Trimaran Credit Facility. For the three months ended September 30, 2017 and 2016, the Company recognized interest income of approximately $126,000 and $485,000, respectively, related to the Trimaran Credit Facility. For the nine months ended September 30, 2017 and 2016, the Company recognized interest income of approximately $529,000 and $1.3 million, respectively, related to the Trimaran Credit Facility.

## 6. BORROWINGS

The Company's debt obligations consist of the following:

| | As of September 30, 2017 (unaudited) | As of December 31, 2016 |
|---|---|---|
| Notes issued by KCAP Senior Funding I, LLC (net of discount and offering costs of: 2016 - $2,286,425 and $2,459,156, respectively) | $ - | $ 142,604,419 |
| 7.375 Notes (net of offering costs of: 2017 - $306,073; 2016 - $550,774) | 26,693,927 | 32,980,151 |
| 6.125 Notes (net of offering costs of: 2017 - $2,757,357) | 74,649,843 | - |
| Total | $ 101,343,770 | $ 175,584,570 |

The weighted average stated interest rate and weighted average maturity on all our debt outstanding as of September 30, 2017 were 6.4% and 4.2 years, respectively, and as of December 31, 2016 were 3.9% and 6.7 years, respectively.

*KCAP Senior Funding I, LLC (Debt Securitization)*

On June 18, 2013, the Company completed the sale of notes in a $140,000,000 debt securitization financing transaction. The notes offered in this transaction (the "KCAP Senior Funding I Notes") were issued by KCAP Senior Funding I, LLC, a newly formed special purpose vehicle (the "Issuer"), in which KCAP Senior Funding I Holdings, LLC, a wholly-owned subsidiary of the Company (the "Depositor"), owns all of the KCAP Senior Funding I Subordinated Notes (as defined below), and are backed by a diversified portfolio of bank loans. The indenture governing the KCAP Senior Funding I Notes contains an event of default that is triggered in the event that certain coverage tests are not met.

The secured notes (the "KCAP Senior Funding I Secured Notes") were issued as Class A senior secured floating rate notes which have an initial face amount of $77,250,000, are rated AAA (sf)/Aaa (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at the three-month LIBOR plus 1.50%, Class B senior secured floating rate notes which have an initial face amount of $9,000,000, are rated AA (sf)/Aa2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus the 3.25%, Class C secured deferrable floating rate notes which have an initial face amount of $10,000,000, are rated A (sf)/A2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 4.25%, and Class D secured deferrable floating rate notes which have an initial face amount of $9,000,000, are rated BBB (sf)/Baa2 (sf) by Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, and bear interest at three-month LIBOR plus 5.25%. The Depositor retained all of the subordinated notes of the Issuer (the "KCAP Senior Funding I Subordinated Notes"), which have an initial face amount of $34,750,000. The KCAP Senior Funding I Subordinated Notes do not bear interest and are not rated. Both the KCAP Senior Funding I Secured Notes and the KCAP Senior Funding I Subordinated Notes have a stated maturity on the payment date occurring in July, 2024, and are subject to a two year non-call period. The Issuer has a four year reinvestment period. The stated interest rate re-sets on a quarterly basis based upon the then-current level of the benchmark three-month LIBOR.

On December 8, 2014, the Company completed the sale of additional notes ("Additional Issuance Securities") in a $56,000,000 increase to the collateralized loan obligation transaction that originally closed on June 18, 2013 (the "Original Closing Date"). The issuance of additional notes was proportional across all existing classes of notes issued on the Original Closing Date.

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

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

As part of this transaction, the Company entered into a master loan sale agreement with the Depositor and the Issuer under which the Company sold or contributed certain bank loans to the Depositor, and the Depositor sold such loans to the Issuer in exchange for a combination of cash and the issuance of the KCAP Senior Funding I Subordinated Notes to the Depositor.

In connection with the issuance and sale of the KCAP Senior Funding I Notes, the Company has made customary representations, warranties and covenants in the purchase agreement by and between the Company, the Depositor, the Issuer and Guggenheim Securities, LLC, which served as the initial purchaser of the KCAP Senior Funding I Secured Notes. The KCAP Senior Funding I Secured Notes are the secured obligations of the Issuer, and an indenture governing the KCAP Senior Funding I Notes includes customary covenants and events of default. The KCAP Senior Funding I Notes were sold in a private placement transaction and have not been, and will not be, registered under the Securities Act of 1933, as amended, or any state "blue sky" laws and may not be offered or sold in the United States absent registration with the Securities and Exchange Commission or an applicable exemption from registration.

The Company serves as collateral manager to the Issuer under a collateral management agreement, which contains customary representations, warranties and covenants. Under the collateral management agreement, the Company will perform certain investment management functions, including supervising and directing the investment and reinvestment of the Issuer's assets, as well as perform certain administrative and advisory functions.

In addition, because each of the Issuer and the Depositor are consolidated subsidiaries, the Company did not recognize any gain or loss on the transfer of any of our portfolio assets to such vehicles in connection with the issuance and sale of the KCAP Senior Funding I Notes.

All of the Class A,B,C and D notes were repaid in the third quarter of 2017. In connection there with, the Company recorded a realized loss from the extinguishment of debt of $4.0 million in the third quarter of 2017.

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

*Fair Value of KCAP Senior Funding I.* The Company carried the KCAP Senior Funding I Notes at cost, net of unamortized discount and offering costs. The fair value of the KCAP Senior Funding I Notes was approximately $146.3 million at December 31, 2016. The fair value was determined based on third party indicative values. The KCAP Senior Funding I L.L.C. Notes were categorized as Level III under ASC 820: Fair Value.

*7.375% Notes Due 2019*

On October 10, 2012, the Company issued $41.4 million in aggregate principal amount of unsecured 7.375% Notes Due 2019 (the “7.375% Notes due 2019”). The net proceeds for these Notes, after the payment of underwriting expenses, were approximately $39.9 million. Interest on the 7.375% Notes Due 2019 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 7.375%, commencing December 30, 2012. The 7.375% Notes Due 2019 mature on September, 30, 2019 and are unsecured obligations of the Company. The 7.375% Notes Due 2019 are subject to redemption in whole or in part at any time or from time to time, at the option of the Company, on or after September 30, 2015, at a redemption price per security equal to 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to the date fixed for redemption. In addition, due to the asset coverage test applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 7.375% Notes Due 2019, the Company is limited in its ability to make distributions in certain circumstances. The indenture governing the 7.375% Notes Due 2019 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. At September 30, 2017, the Company was in compliance with all of its debt covenants.

For the three months ended September 30, 2017 and 2016, interest expense related to the 7.375% Notes Due 2019 was approximately $498,000 and $712,000, respectively. For the nine months ended September 30, 2017 and 2016, interest expense related to the 7.375% Notes Due 2019 was approximately $1.7 million and $2.2 million, respectively.

In connection with the issuance of the 7.375% Notes Due 2019, the Company incurred approximately $1.5 million of debt offering costs which are being amortized over the expected term of the facility on an effective yield method, of which approximately $306,000 remains to be amortized, and is included on the consolidated balance sheets as a reduction in the related debt liability.

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

During the third quarter of 2016, $5.0 million par value of the 7.375% Notes Due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of $88,015. KCAP subsequently surrendered these notes to the Trustee for cancellation.

During the fourth quarter of 2016, approximately $469,000 par value of the 7.375% Notes Due 2019 was redeemed by the Company, resulting in a realized loss on extinguishment of $15,006. KCAP subsequently surrendered these notes to the Trustee for cancellation.

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

*Fair Value of 7.375% Notes Due 2019.* The 7.375% Notes Due 2019 were issued in a public offering on October 10, 2012 and are carried at cost. The fair value of the Company’s outstanding 7.375% Notes Due 2019 was approximately $27.1 million at September 30, 2017. The fair value was determined based on the closing price on September 30, 2017 for the 7.375% Notes Due 2019. The 7.375% Notes Due 2019 are categorized as Level I under the ASC 820 Fair Value.

*6.125% Notes Due 2022*

During the third quarter of 2017, the Company issued $77.4 million in aggregate principal amount of unsecured 6.125% Notes due 2022 ("the 6.125 Notes Due 2022"). The net proceeds for these Notes, after the payment of underwriting expenses, were approximately $74.6 million. Interest on the 6.125% Notes Due 2022 is paid quarterly in arrears on March 30, June 30, September 30 and December 30, at a rate of 6.125%, commencing September 30, 2017. The 6.125% Notes Due 2022 mature on September, 30, 2022 and are unsecured obligations of the Company. The 6.125% Notes Due 2022 are subject to redemption in whole or in part at any time or from time to time, at the option of the Company, on or after September 30, 2019, at a redemption price per security equal to 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to the date fixed for redemption. In addition, Due to the asset coverage test applicable to the Company as a BDC and a covenant that the Company agreed to in connection with the issuance of the 6.125% Notes Due 2022, the Company is limited in its ability to make distributions in certain circumstances. The indenture governing the 6.125% Notes Due 2022 contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act relating to borrowing and dividends. At September 30, 2017, the Company was in compliance with all of its debt covenants.

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

In connection with the issuance of the 6.125% Notes Due 2022, the Company incurred approximately $2.8 million of debt offering costs which are being amortized over the expected term of the facility on an effective yield method, of which approximately $2.8 million remains to be amortized as of September 30, 2017, and is included on the consolidated balance sheets as a reduction in the related debt liability.

*Fair Value of 6.125% Notes Due 2022.* The 6.125% Notes Due 2022 were issued via public offering during the third quarter of 2017 and are carried at cost. The fair value of the Company's outstanding 6.125% Notes Due 2022 was approximately $77.3 million at September 30, 2017.The fair value was determined based on the closing price on September 30, 2017 for the 6.125% Notes Due 2022. The 6.125% Notes Due 2022 are categorized as Level I under the ASC 820 Fair Value.

*Convertible Notes*

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

In connection with the issuance of the Convertible Notes, the Company incurred approximately $2.4 million of debt offering costs, which were amortized over the term of the Convertible Notes on an effective yield method. On April 4, 2013, approximately $9 million of the Company's 8.75% Convertible Notes were converted at a price per share of $8.159 into 1,102,093 shares of KCAP common stock. On September 4, 2013, the Company purchased $2.0 million face value of its own Convertible Notes at a price of $114.50 plus accrued interest. KCAP subsequently surrendered these notes to the Trustee for cancellation effective September 13, 2013. During 2015, the Company repurchased approximately $19.3 million face value of its own Convertible Notes at a price ranging from $101.500 to $102.375. KCAP subsequently surrendered these notes to the Trustee for cancellation. Due to the cash conversion option embedded in the Convertible Notes, the Company applied the guidance in ASC 470-20-40, *Debt with Conversion and Other Options* and realized a loss on the extinguishment of this debt. The indenture governing the Convertible Notes contains certain restrictive covenants, including compliance with certain provisions of the 1940 Act and conditions governing the undertaking of new debt.

The Convertible Notes matured and were fully repaid on March 15, 2016.

For the nine months ended September 30, 2016, interest expense related to the Convertible Notes was approximately $378,000.

**7. DISTRIBUTABLE TAXABLE INCOME**

Effective December 11, 2006, the Company elected to be treated as a RIC under the Code and adopted a December 31 tax-calendar year end. As a RIC, the Company is not subject to federal income tax on the portion of its taxable income and gains distributed currently to its stockholders as a dividend. The Company's quarterly distributions, if any, are determined by the Board of Directors. The Company anticipates distributing substantially all of its taxable income and gains, within the Subchapter M rules, and thus the Company anticipates that it will not incur any federal or state income tax at the RIC level. As a RIC, the Company is also subject to a federal excise tax based on distributive requirements of its taxable income on a calendar year basis (e.g., calendar year 2017). Depending on the level of taxable income earned in a tax year, the Company may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4% excise tax on such income, to the extent required.

The following reconciles net increase (decrease) in net assets resulting from operations to taxable income for the nine months ended September 30, 2017 and 2016:

| | Nine Months Ended September 30, 2017 (unaudited) | 2016 (unaudited) |
|---|---|---|
| Net increase (decrease) in net assets resulting from operations | $ 2,237,830 | $ (1,118,601) |
| Net change in unrealized depreciation from investments | (875,365) | 9,309,013 |
| Excess capital gains over capital losses | 6,993,940 | 6,205,405 |
| Book/tax differences on CLO equity investments | (1,697,865) | 1,050,658 |
| Other book/tax differences | 224,785 | (673,454) |
| Taxable income before deductions for distributions | $ 6,883,325 | $ 14,773,021 |
| Taxable income before deductions for distributions per weighted average basic shares for the period | $ 0.19 | $ 0.40 |
| Taxable income before deductions for distributions per weighted average diluted shares for the period | $ 0.19 | $ 0.40 |

Dividends from Asset Manager Affiliates are recorded based upon a quarterly estimate of tax-basis earnings and profits of each Asset Manager Affiliate. Distributions in excess of the estimated tax-basis quarterly earnings and profits of each distributing Asset Manager Affiliate are recognized as tax-basis return of capital. The actual tax-basis earnings and profits and resulting dividend and/or return of capital for the year will be determined at the end of the tax year for each distributing Asset Manager Affiliate. For the nine months ended September 30, 2017 and 2016, the Asset Manager Affiliates declared cash distributions of $2.2 million and $2.7 million to the Company, respectively. The Company recognized $1.4 million, respectively, of dividends from Asset Manager Affiliates in the Statement of Operations for the nine months ended September 30, 2016. The difference of $2.0 million and $1.3 million, respectively, between cash distributions received and the tax-basis earnings and profits of the distributing affiliate, are recorded as an adjustment to the cost basis in the Asset Manager Affiliate (i.e. tax-basis return of capital), for the nine months ended September 30, 2017 and 2016, respectively.

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

At September 30, 2017, the Company had a net capital loss carryforward of approximately $98.0 million to offset net capital gains, to the extent provided by federal tax law. Of the net capital loss carryforward, $66.7 million is not subject to expiration under the RIC Modernization Act of 2010.

On September 22, 2017 the Company's Board of Directors declared a distribution to shareholders of $0.12 per share for a total of approximately $4.4 million. The record date was October 10, 2017 and the distribution was paid on October 26, 2017.

The Company adopted Financial Accounting Standards Board ASC Topic 740 Accounting for Uncertainty in Income Taxes ("ASC 740") as of January 1, 2007. ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the consolidated financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. The Company recognizes the tax benefits of uncertain tax positions only where the position is "more likely than not" to be sustained assuming examination by tax authorities. Management has analyzed the Company's tax positions, and has concluded that no liability for unrecognized tax benefits should be recorded related to uncertain tax positions taken on returns filed for open tax years (the last three fiscal years) or expected to be taken in the Company's current year tax return. The Company identifies its major tax jurisdictions as U.S. Federal and New York State, and the Company is not aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will change materially in the next 12 months. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an ongoing analysis of tax laws, regulations and interpretations thereof.

## 8. COMMITMENTS AND CONTINGENCIES

From time-to-time the Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the needs of the Company's investment in portfolio companies. Such instruments include commitments to extend credit and may involve, in varying degrees, elements of credit risk in excess of amounts recognized on the Company's balance sheet. Prior to extending such credit, the Company attempts to limit its credit risk by conducting extensive due diligence, obtaining collateral where necessary and negotiating appropriate financial covenants. As of September 30, 2017 and December 31, 2016, the Company had approximately $3 million and $565,000 of outstanding commitments to fund investments, respectively.

## 9. STOCKHOLDERS' EQUITY

During the nine months ended September 30, 2017 and 2016, the Company issued 75,059 and 153,792 shares, respectively, of common stock under its dividend reinvestment plan. For the nine months ended September 30, 2017, there were 139,620 grants, 10,982 forfeitures, and 242,918 shares vested plan with respect to restricted stock.. On February 14, 2013, the Company completed a public offering of 5,232,500 shares of common stock, which included the underwriters' full exercise of their option to purchase up to 682,500 shares of common stock, at a price of $9.75 per share. In conjunction with this offering, the Company also sold 200,000 shares of common stock to a member of its Board of Directors, at a price of $9.31125 per share, raising approximately $1.9 million in gross proceeds. On April 4, 2013, approximately $9 million of the Company's 8.75% Convertible Notes were converted at a price basis per share of $8.159 into 1,102,093 shares of KCAP common stock. On October 6, 2014, the Company priced a follow-on public offering of 3.0 million shares of its common stock at a price of $8.02 per share. The offering raised net proceeds were approximately $23.8 million, after deducting underwriting discounts and offering expenses. The total number of shares of the Company's common stock outstanding as of September 30, 2017 and December 31, 2016 was 37,317,815 and 37,178,294, respectively. During the nine months ended September 30, 2017 and 2016, the Company repurchased 64,176 and 67,654 shares, respectively, at an aggregate cost of approximately $225,000 and $248,000, respectively, in connection with the vesting of restricted stock awards.

## 10. EQUITY INCENTIVE PLAN

The Company has an equity incentive plan, established in 2006 and as amended in 2008, 2014, 2015 and most recently in May 2017 (the "Equity Incentive Plan"). The Company reserved 2,000,000 shares of common stock for issuance under the Equity Incentive Plan. The purpose of the Equity Incentive Plan is to provide officers and employees of the Company with additional incentives and align the interests of its employees with those of its shareholders. Options granted under the Equity Incentive Plan are exercisable at a price equal to the fair market value (market closing price) of the shares on the day the option is granted. Restricted stock granted under the Equity Incentive Plan is granted at a price equal to the fair market value (market closing price) of the shares on the day such restricted stock is granted. Vesting of restricted stock awarded under the 2008 amendment of the Equity Incentive Plan will occur in two equal installments of 50%, on each of the third and fourth anniversaries of the grant date; vesting of restricted stock subsequent to the 2014 amendment of the Equity Incentive Plan will vest in four equal installments of 25%, on each of the first four anniversaries of the grant date, except for the grant in September of 2017, which will occur in two equal installments of 50%, on each of the third and fourth anniversaries of the grant date.

*Stock Options*

On June 20, 2014, the Company's Board of Directors approved the amended and restated the 2011 Non-Employee Director Plan, which was approved by shareholders on June 10, 2011. Accordingly, the annual grant of options to non-employee directors has been discontinued and replaced with an annual grant of shares of restricted stock as partial annual compensation for the services of the non-employee directors.

On March 21, 2017, the Company's Board of Directors approved the 2017 Non-Employee Director Plan, which extended the term of the 2011 Non-Employee Director Plan (together, the "Non-Employee Director Plan"). The Company's shareholders approved the Non-Employee Director Plan on May 4, 2017.

Information with respect to options granted, exercised and forfeited under the Equity Incentive Plan for the period January 1, 2016 through September 30, 2017 is as follows:

| | Shares | Weighted Average Exercise Price per Share | Weighted Average Contractual Remaining Term (years) | Aggregate Intrinsic Value[1] |
|---|---|---|---|---|
| Options outstanding at January 1, 2016 | 50,000 | $ 7.72 | 3.4 | |
| Granted | — | — | | |
| Exercised | — | — | | |
| Forfeited | — | — | | |
| Options outstanding at December 31, 2016 | 50,000 | $ 7.72 | 2.4 | $ — |
| Granted | — | — | | |
| Exercised | — | — | | |
| Forfeited | — | — | | |
| Outstanding at September 30, 2017 | 50,000 | $ 7.72 | 1.6 | $ — |
| Total vested at September 30, 2017 | 50,000 | $ 7.72 | 1.6 | |

1 Represents the difference between the market value of shares of the Company and the exercise price of the options.

The Company uses a Binary Option Pricing Model (American, call option) to establish the expected value of all stock option grants. For the nine months ended September 30, 2017 and 2016, the Company did not recognize any non-cash compensation expense related to stock options. At September 30, 2017, the Company had no remaining compensation costs related to unvested stock option awards.

*Restricted Stock*

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

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

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

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

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

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

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

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

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

On June 16, 2015, the Company received exemptive relief to repurchase shares of its common stock from its employees in connection with certain equity compensation plan arrangements. During the nine months ended September 30, 2017 and 2016, the Company repurchased 64,176 and 67,654 shares, respectively, of common stock at an aggregate cost of approximately $225,000 and $248,000, respectively, in connection with the vesting of employee's restricted stock, which is reflected as Treasury Stock at cost on the Consolidated Balance Sheet. These shares are not available to be reissued under the Company's Equity Incentive Plan.

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

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

On September 19, 2017, the Company's Board of Directors approved the grant of 133,620 shares of restricted stock to the employees of the Company as partial compensation for their services. 50% of such awards will vest on the third anniversary of the grant date and the remaining 50% of the shares will vest on the fourth anniversary of the grant date.

During the nine months ended September 30, 2017, 242,918 shares of restricted stock vested and 10,982 shares of restricted stock were forfeited. As of September 30, 2017, after giving effect to these restricted stock awards, there were 297,199 shares of restricted stock outstanding. Information with respect to restricted stock granted, exercised and forfeited under the Plan for the period January 1, 2016 through September 30, 2017 is as follows:

| | **Non-vested Restricted Shares** |
|---|---|
| Non-vested shares outstanding at January 1, 2016 | 700,539 |
| Granted | 6,000 |
| Vested | (260,607) |
| Forfeited | (34,453) |
| Non-vested shares outstanding at December 31, 2016 | 411,479 |
| Granted | 139,620 |
| Vested | (242,918) |
| Forfeited | (10,982) |
| Non-Vested Outstanding at September 30, 2017 | 297,199 |

For the three months ended September 30, 2017, non-cash compensation expense related to restricted stock was approximately $226,000 of this amount approximately $83,000 was expensed at the Company, and approximately $143,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the three months ended September 30, 2016, non-cash compensation expense related to restricted stock was approximately $394,000 of this amount approximately $161,000 was expensed at the Company, and approximately $233,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the nine months ended September 30, 2017, non-cash compensation expense related to restricted stock was approximately $878,000 of this amount approximately $330,000 was expensed at the Company, and approximately $548,000 was a reimbursable expense allocated to the Asset Manager Affiliates. For the nine months ended September 30, 2016, non-cash compensation expense related to restricted stock was approximately $1.2 million; of this amount approximately $472,000 was expensed at the Company and approximately $682,000 was a reimbursable expense allocated to the Asset Manager Affiliates.

Distributions are paid on all outstanding shares of restricted stock, whether or not vested. In general, shares of unvested restricted stock are forfeited upon the recipient's termination of employment. As of September 30, 2017, the Company had approximately $1.4 million of total unrecognized compensation cost related to non-vested restricted share awards. That cost is expected to be recognized over the remaining weighted average period of 1.6 years.

## 11. OTHER EMPLOYEE COMPENSATION

The Company adopted a 401(k) plan ("401K Plan") effective January 1, 2007. The 401K Plan is open to all full time employees. The 401K Plan permits an employee to defer a portion of their total annual compensation up to the Internal Revenue Service annual maximum based on age and eligibility. The Company makes contributions to the 401K Plan of up to 2% of the Internal Revenue Service's annual maximum eligible compensation, which fully vests at the time of contribution. Approximately $1,000 and $1,000 was expensed during the three months ended September 30, 2017 and 2016, respectively, related to the 401K Plan. During the nine months ended September 30, 2017 and 2016, approximately $35,000 and $19,000 was expensed related to the 401K Plan.

The Company has also adopted a deferred compensation plan ("Profit-Sharing Plan") effective January 1, 2007. Employees are eligible for the Profit-Sharing Plan provided that they are employed and working with the Company to participate in at least 100 days during the year and remain employed as of the last day of the year. Employees do not make contributions to the Profit-Sharing Plan. On behalf of the employee, the Company may contribute to the Profit-Sharing Plan 1) up to 8.0% of all compensation up to the Internal Revenue Service annual maximum and 2) up to 5.7% excess contributions on any incremental amounts above the social security wage base limitation and up to the Internal Revenue Service annual maximum. Employees vest 100% in the Profit-Sharing Plan after five years of service. Approximately $46,000 and $46,000 was expensed during the three months ended September 30, 2017 and 2016, respectively, related to the Profit-Sharing Plan. During the nine months ended September 30, 2017 and 2016, approximately $139,000 and $138,000, respectively, was expensed related to the Profit-Sharing Plan.

## 12. SUBSEQUENT EVENTS

On October 31, 2017, the Joint Venture made a cash distribution to the Company of approximately $12.6 million. The Company expects that approximately $11.8 million of this distribution will be return of capital, reducing the cost basis of its investment in the JV by that amount. The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at the end of the year, therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

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

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

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

The Company has evaluated events and transactions occurring subsequent to September 30, 2017 for items that should potentially be recognized or disclosed in these financial statements. Other than as noted above, management has determined that there are no material subsequent events that would require adjustment to, or disclosure in, these consolidated financial statements.

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

In this Quarterly Report on Form 10-Q, "KCAP Financial," "Company," "we," "us," and "our" refer to KCAP Financial, Inc., and its wholly-owned subsidiaries.

The information contained in this section should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report and in conjunction with the financial statements and notes thereto in the Company's Form 10-K for the year ended December 31, 2016, as filed with the U.S. Securities and Exchange Commission (the "Commission" or the "SEC"). In addition, some of the statements in this report constitute forward-looking statements. The matters discussed in this Quarterly Report, as well as in future oral and written statements by management of KCAP Financial, that are forward-looking statements are based on current management expectations that involve substantial risks and uncertainties which could cause actual results to differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar words. Important assumptions include our ability to originate new investments, achieve certain margins and levels of profitability, the availability of additional capital, and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Quarterly Report should not be regarded as a representation by us that our plans or objectives will be achieved. The forward-looking statements contained in this Quarterly Report include statements as to:

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

There are a number of important risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward-looking statements. For a discussion of factors that could cause our actual results to differ from forward-looking statements contained in this Quarterly Report, please see the discussion in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. You should not place undue reliance on these forward-looking statements. The forward-looking statements made in this Quarterly Report relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances occurring after the date this Quarterly Report is filed with the SEC.

## GENERAL

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

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

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

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

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

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

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

From our Asset Manager Affiliates investment, we expect to receive recurring cash distributions and to generate capital appreciation through the addition of new CLO Funds managed by our Asset Manager Affiliates. We may also seek to monetize our investment in the Asset Manager Affiliates if and when business conditions warrant. The Asset Manager Affiliates manage CLO Funds that invest in broadly syndicated loans, high-yield bonds and other credit instruments. Collectively, the Asset Manager Affiliates have approximately $2.8 billion of par value assets under management as of September 30, 2017. The Asset Manager Affiliates are registered under the Investment Advisers Act of 1940, and are each managed independently from KCAP by a separate management team (however, certain of the Company's executive officers also act in similar capacities for one or both of the Asset Manager Affiliates).

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

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

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

**PORTFOLIO AND INVESTMENT ACTIVITY**

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

Total portfolio investment activity (excluding activity in time deposit and money market investments) for the nine months ended September 30, 2017 (unaudited) and for the year ended December 31, 2016 was as follows:

| | Debt Securities | CLO Fund Securities | Equity Securities | Asset Manager Affiliates | Joint Venture | Total Portfolio |
|---|---|---|---|---|---|---|
| Fair Value at December 31, 2015 | $ 284,639,244 | $ 55,872,382 | $ 9,548,488 | $ 57,381,000 | $ — | $ 407,441,114 |
| 2016 Activity: | | | | | | |
| Purchases / originations /draws | 74,584,952 | 10,140,000 | — | — | — | 84,724,952 |
| Sales / Pay-downs / Return of Capital | (123,240,416) | (4,200,000) | (4,563,521) | (1,250,000) | — | (133,253,937) |
| Net accretion (amortization) | 407,492 | (2,192,071) | — | — | — | (1,784,579) |
| Net realized (losses) gains | (540,649) | (10,111,560) | 4,484,742 | — | — | (6,167,467) |
| Net increase (decrease) in fair value | 2,492,707 | 4,665,599 | (4,413,354) | (15,933,000) | — | (13,188,048) |
| Fair Value at December 31, 2016 | 238,343,330 | 54,174,350 | 5,056,355 | 40,198,000 | — | 337,772,035 |
| Year to Date 2017 Activity: | | | | | | |
| Purchases / originations /draws | 137,288,374 | 1,249,988 | 1 | — | 36,738,873 | 175,277,236 |
| Sales / Pay-downs / Return of Capital | (250,169,877) | — | — | (2,000,000) | — | (252,169,877) |
| Net accretion (amortization) | 264,220 | 443,434 | — | — | — | 707,654 |
| Net realized gains (losses) | (2,871,941) | — | — | — | — | (2,871,941) |
| Net increase (decrease) in fair value | 4,172,723 | (4,024,428) | (606,179) | 1,481,000 | (147,751) | 875,365 |
| Fair Value at September 30, 2017 | $ 127,026,829 | $ 51,843,344 | $ 4,450,177 | $ 39,679,000 | $ 36,591,122 | $ 259,590,472 |

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

The following table shows the Company's portfolio by security type at September 30, 2017 and December 31, 2016:

| | September 30, 2017 (unaudited) | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| Security Type | Cost/ Amortized Cost | Fair Value | %[1] | Cost/ Amortized Cost | Fair Value | %[1] |
| Short-term Investments[2] | 57,024,828 | $ 57,024,828 | 18 | 28,699,269 | $ 28,699,269 | 8 |
| Senior Secured Loan | 49,982,415 | 46,124,914 | 15 | 207,701,078 | 200,322,152 | 55 |
| Junior Secured Loan | 59,490,855 | 58,343,554 | 18 | 37,251,776 | 35,444,440 | 10 |
| Senior Unsecured Loan | 20,000,000 | 20,000,000 | 6 | - | - | - |
| First Lien Bond | 3,054,337 | 1,063,762 | - | 3,060,919 | 1,089,338 | - |
| Senior Secured Bond | 1,503,404 | 1,494,600 | - | 1,506,461 | 1,487,400 | - |
| CLO Fund Securities | 78,544,739 | 51,843,344 | 16 | 76,851,317 | 54,174,350 | 15 |
| Equity Securities | 10,389,007 | 4,450,177 | 1 | 10,389,007 | 5,056,355 | 1 |
| Asset Manager Affiliates[3] | 53,341,230 | 39,679,000 | 13 | 55,341,230 | 40,198,000 | 11 |
| Joint Venture | 36,738,873 | 36,591,122 | 13 | - | - | - |
| Total | $ 370,069,689 | $316,615,300 | 100% | $ 420,801,057 | $366,471,304 | 100% |

1 Represents percentage of total portfolio at fair value.

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

3 Represents the equity investment in the Asset Manager Affiliates.

The industry-related information, based on the fair value of the Company's investment portfolio as of September 30, 2017 and December 31, 2016, for our investment portfolio were as follows:

| | September 30, 2017 (unaudited) | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| Industry Classification | Cost/ Amortized Cost | Fair Value | %[1] | Cost/ Amortized Cost | Fair Value | % |
| Aerospace and Defense | $ 4,929,171 | $ 3,268,788 | 1% | $ 8,394,633 | $ 8,450,106 | 2% |
| Asset Management Company[2] | 53,341,230 | 39,679,000 | 13 | 55,341,230 | 40,198,000 | 11 |
| Automotive | - | - | - | 6,322,551 | 6,196,154 | 2 |
| Banking, Finance, Insurance & Real Estate | 3,466,776 | 3,443,506 | 1 | 6,805,514 | 6,782,010 | 2 |
| Beverage, Food and Tobacco | 4,512,854 | 4,346,400 | 1 | 15,198,830 | 14,703,372 | 4 |
| Capital Equipment | 5,455,586 | 4,744,140 | 1 | 6,185,129 | 5,575,048 | 2 |
| Chemicals, Plastics and Rubber | - | - | - | 6,421,909 | 6,444,073 | 2 |
| CLO Fund Securities | 78,544,739 | 51,843,344 | 16 | 76,851,317 | 54,174,350 | 15 |
| Construction & Building | 1,007,336 | 1,007,423 | - | 5,919,158 | 5,929,606 | 2 |
| Consumer goods: Durable | 3,054,338 | 1,064,762 | - | 12,319,905 | 10,118,736 | 3 |
| Consumer goods: Non-durable | 732,896 | 734,613 | - | 14,766,390 | 14,452,096 | 4 |
| Ecological | - | - | - | 1,741,292 | 1,760,783 | - |
| Energy: Electricity | - | - | - | 3,904,453 | 3,937,247 | 1 |
| Energy: Oil & Gas | 13,929,048 | 10,575,738 | 3 | 14,493,835 | 8,805,761 | 2 |
| Environmental Industries | 6,922,952 | 6,156,451 | 2 | 12,279,924 | 12,185,239 | 3 |
| Forest Products & Paper | 1,557,040 | 1,600,960 | 1 | 4,192,889 | 4,192,907 | 1 |
| Healthcare & Pharmaceuticals | 36,573,091 | 33,901,061 | 11 | 58,769,668 | 53,594,534 | 15 |
| High Tech Industries | 16,093,619 | 16,051,970 | 5 | 9,854,093 | 9,936,109 | 3 |
| Hotel, Gaming & Leisure | 400,000 | 1,000 | - | 400,000 | 1,000 | - |
| Joint Venture | 36,738,873 | 36,591,122 | 12 | - | - | - |
| Media: Advertising, Printing & Publishing | 3,869,962 | 3,875,038 | 1 | 11,712,682 | 11,453,447 | 3 |
| Media: Broadcasting & Subscription | - | - | - | 8,273,174 | 8,372,984 | 2 |
| Related Party Loans | 20,000,000 | 20,000,000 | 6 | - | - | - |
| Retail | - | - | - | 1,415,457 | 759,581 | - |
| Services: Business | 5,523,913 | 4,427,100 | 1 | 16,125,481 | 16,230,486 | 4 |
| Services: Consumer | - | - | - | 6,212,108 | 6,204,889 | 2 |
| Telecommunications | 3,965,663 | 3,939,200 | 1 | 12,809,799 | 12,767,823 | 3 |
| Textiles and Leather | 7,948,833 | 7,847,841 | 3 | - | - | - |
| Money Market Accounts | 32,015,828 | 32,015,828 | 11 | 28,699,269 | 28,699,269 | 8 |
| Transportation: Cargo | 2,496,958 | 2,500,000 | 1 | 7,557,315 | 7,190,135 | 2 |
| Transportation: Consumer | - | - | - | 2,412,614 | 2,324,516 | 1 |
| U.S. Government Obligation | 25,009,000 | 25,009,000 | 8 | - | - | |
| Utilities: Electric | 1,979,983 | 1,991,015 | 1 | 5,420,438 | 5,031,043 | 1 |
| Total | $ 370,069,689 | $ 316,615,300 | 100% | $ 420,801,057 | $ 366,471,304 | 100% |

1 Calculated as a percentage of total portfolio at fair value.
2 Represents the equity investment in the Asset Manager Affiliates.

**Debt Securities Portfolio**

At September 30, 2017 and December 31, 2016, our investments in income producing debt securities portfolio, excluding CLO Fund securities, had a weighted average interest rate of approximately 9.2% and 7.0%, respectively. For the nine months ended September 30, 2017, our total net asset value return per share was 1.3% and our total market return based on our stock price was 0.7%. For the year ended December 31, 2016, our total net asset value return per share was 0.2% and our total market return based on stock price was 12.3%. Total net asset value return per share and total market return based on stock price do not reflect the sales load paid by stockholders.

The investment portfolio (excluding the Company's investment in Asset Manager Affiliates, CLO Fund Securities, the Joint Venture, and Short-term investments) at September 30, 2017 was spread across 19 different industries and 19 different entities with an average balance per entity of approximately $5.3 million. As of September 30, 2017, all but two of our portfolio companies were current on their debt service obligations.

We may invest up to 30% of our total assets in "Non-qualifying" opportunistic investments such as high-yield bonds, debt and equity securities of CLO Funds, foreign investments, and distressed debt or equity securities of large cap public companies. At September 30, 2017 and December 31, 2016, the total amount of non-qualifying assets were approximately 28% and 17% of the total investment portfolio, respectively. The majority of non-qualifying assets were foreign investments which were approximately 16% and 14% of the Company's total investment portfolio, respectively (including the Company's investments in CLO Funds, which are typically domiciled outside the U.S. and represented approximately 16% and 14% of its total assets on such dates, respectively). The investments in our Debt Securities Portfolio are all or predominantly below investment grade, and therefore have speculative characteristics with respect to the issuer's capacity to pay interest and repay principal.

**Asset Manager Affiliates**

The Asset Manager Affiliates are our wholly-owned asset management companies that manage CLO Funds that invest in broadly syndicated loans, high yield bonds and other credit instruments. The CLO Funds managed by our Asset Manager Affiliates consist primarily of credit instruments issued by corporations. As of September 30, 2017 and December 31, 2016, our Asset Manager Affiliates had approximately $2.8 billion and $3.0 billion of par value respectively, of assets under management on which they earn management fees, and were valued at approximately $39.7 million and $40.2 million, respectively.

All CLO Funds managed by the Asset Manager Affiliates are currently paying all senior and subordinate management fees. In addition, in the nine months ended September 30, 2017 our Asset Manager Affiliates recognized $3.0 million of incentive fees from one fund.

**CLO Fund Securities**

We typically make a minority investment in the subordinated securities or preferred stock of CLO Funds raised and managed by our Asset Manager Affiliates and may selectively invest in securities issued by CLO Funds managed by other asset management companies. As of September 30, 2017, we had approximately $52 million invested in CLO Fund Securities, issued primarily by funds managed by our Asset Manager Affiliates.

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

Our CLO Fund Securities as of September 30, 2017 and December 31, 2016 are as follows:

| CLO Fund Securities | Investment | %[1] | September 30, 2017 Cost/Amortized Cost | September 30, 2017 Fair Value | December 31, 2016 Cost/Amortized Cost | December 31, 2016 Fair Value |
|---|---|---|---|---|---|---|
| Grant Grove CLO, Ltd.[3] | Subordinated Securities | 22.2% | $ 2,485,886 | $ 1,000 | $ 2,485,886 | $ 1,000 |
| Katonah III, Ltd.[3] | Preferred Shares | 23.1 | 1,287,155 | 369,000 | 1,287,155 | 369,000 |
| Katonah 2007-I CLO Ltd.[2] | Preferred Shares | 100.0 | 31,123,451 | 21,447,386 | 28,022,646 | 20,453,099 |
| Trimaran CLO VII, Ltd.[2] | Income Notes | 10.5 | 379,830 | 10,000 | 1,643,920 | 1,195,152 |
| Catamaran CLO 2012-1 Ltd.[2] | Subordinated Notes | 24.9 | 5,759,981 | 2,239,810 | 5,919,933 | 2,819,412 |
| Catamaran CLO 2013-1 Ltd.[2] | Subordinated Notes | 23.5 | 4,786,050 | 3,806,100 | 5,237,222 | 4,918,807 |
| Catamaran CLO 2014-1 Ltd.[2] | Subordinated Notes | 32.4 | 8,681,740 | 4,847,620 | 7,818,484 | 4,546,682 |
| Catamaran CLO 2014-1 Ltd.[2] | Class E Notes | 15.1 | 1,451,386 | 1,520,000 | 1,441,727 | 1,310,000 |
| Dryden 30 Senior Loan Fund | Subordinated Notes | 7.5 | 1,276,135 | 1,499,682 | 1,343,467 | 1,895,566 |
| Catamaran CLO 2014-2 Ltd.[2] | Subordinated Notes | 24.9 | 6,699,877 | 4,484,009 | 6,967,560 | 5,092,087 |
| Catamaran CLO 2015-1 Ltd.[2] | Subordinated Notes | 9.9 | 4,416,694 | 3,033,719 | 4,543,317 | 3,223,255 |
| Catamaran CLO 2016-1 Ltd.[2] | Subordinated Notes | 24.9 | 10,196,554 | 8,585,018 | 10,140,000 | 8,350,290 |
| Total | | | $ 78,544,739 | $ 51,843,344 | $ 76,851,317 | $ 54,174,350 |

¹ Represents percentage of class held as of September 30, 2017.
² A CLO Fund managed by an Asset Manager Affiliate.
³ As of September 30, 2017, this CLO Fund security was not providing a distribution.

**Investment in Joint Venture:**

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

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

The Company has determined that the Joint Venture is an investment company under ASC 946, however, in accordance with such guidance, the Company will generally not consolidate its investment in a company other than a wholly owned investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. Accordingly, the Company does not consolidate its non-controlling interest in the Joint Venture.

The following tables detail the ten largest portfolio companies (at fair value) as of September 30, 2017 and December 31, 2016:

| | September 30, 2017 (unaudited) | | |
|---|---|---|---|
| **Investment** | **Cost/Amortized Cost** | **Fair Value** | **% of FMV** |
| Asset Manager Affiliates | $ 53,341,230 | $ 39,679,000 | 13% |
| KCAP Freedom 3 LLC | 36,738,873 | 36,591,122 | 12 |
| US Bank Money Market Account | 32,001,559 | 32,001,559 | 10 |
| Katonah 2007-I CLO Ltd. | 31,123,451 | 21,447,386 | 7 |
| Trimaran Advisors, L.L.C. | 20,000,000 | 20,000,000 | 6 |
| U.S Treasury Bills - CUSIP: 912796LY3 | 15,007,000 | 15,007,000 | 5 |
| U.S Treasury Bills - CUSIP: 912796KR9 | 10,002,000 | 10,002,000 | 3 |
| Tank Partners Holdings, LLC | 12,420,461 | 8,222,814 | 3 |
| Catamaran CLO 2016-1 Ltd. | 10,196,554 | 8,585,018 | 3 |
| Grupo HIMA San Pablo, Inc. | 10,023,444 | 9,290,017 | 3 |
| Total | $ 230,854,572 | $ 200,825,916 | 65% |

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

Excluding the Asset Manager Affiliates and CLO Fund Securities, the Company's ten largest portfolio companies represented approximately 49% and 13% of the total fair value of the Company's investments at September 30, 2017 and December 31, 2016, respectively.

**RESULTS OF OPERATIONS**

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

Set forth below is a discussion of our results of operations for the three and nine months ended September 30, 2017 and 2016.

*Revenue*

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

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

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

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

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

*Distributions from Asset Manager Affiliates.* We receive cash distributions from our investment in our Asset Manager Affiliates, which are wholly-owned and manage CLO Funds that invest primarily in broadly syndicated non-investment grade loans, high yield bonds and other credit instruments issued by corporations. As managers of CLO Funds, our Asset Manager Affiliates receive contractual and recurring management fees from the CLO Funds for their management and advisory services. In addition, our Asset Manager Affiliates may also earn income related to net interest on assets accumulated for future CLO issuances on which they have taken a first loss position in connection with loan warehouse arrangements for their CLO Funds. The annual management fees that our Asset Manager Affiliates receive are generally based on a fixed percentage of the par value of assets under management and are recurring in nature for the term of the CLO Fund so long as the Asset Manager Affiliates manage the fund. As a result, the annual management fees earned by our Asset Manager Affiliates generally are not subject to market value fluctuations in the underlying collateral. Our Asset Manager Affiliates may receive incentive fees provided such CLO Funds have achieved a minimum investment return to holders of their subordinated securities or preferred shares as per the terms of each CLO Fund management agreement. During the three and nine months ended September 30, 2017, the Asset Manager Affiliates received incentive fees from one fund.

The Asset Manager Affiliates are expected to pay future distributions to the Company based upon their after-tax free cash flow, which generally will be dependent upon the maintenance and growth in their assets under management and incentive fees. As a result of tax-basis goodwill amortization and certain other tax-related adjustments, portions of distributions received may be deemed return of capital. As amortizing funds which are paying incentive fees are redeemed, we expect incentive fees available for distribution to diminish. The fair value of our investment in our Asset Manager Affiliates was approximately $39.7 million at September 30, 2017, with an unrealized gain during the nine months ended September 30, 2017 of approximately $1.5 million. For the three months ended September 30, 2017 and 2016, we recognized dividend income of approximately $180,000 and $0 from the Asset Manager Affiliates, respectively, while cash distributions received were $880,000 and $750,000 for the three months ended September 30, 2017 and 2016, respectively. For the nine months ended September 30, 2017 and 2016, we recognized dividend income of approximately $180,000 and $1.4 million from the Asset Manager Affiliates, respectively, while cash distributions received were approximately $2.2 million and $2.7 million for the three months ended September 30, 2017 and 2016, respectively. The difference between cash distributions received and the tax-basis earnings and profits is recorded as an adjustment to the cost basis of the Asset Manager Affiliates investments. For interim periods, the Company estimates the tax attributes of any distributions as being either tax-basis earnings and profits (i.e., dividend income) or return of capital (i.e., adjustment to the Company’s cost basis in the Asset Manager Affiliates). The final determination of the tax attributes of distributions from our Asset Manager Affiliates is made on an annual (full calendar year) basis at the end of the year based upon taxable income and distributions for the full-year. Therefore, any estimate of tax attributes of distributions made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year. CLO Funds typically have automatic orderly wind-down features following an initial period of reinvestment. Thus, with all else being equal, as managed CLO Fund portfolios age, projected future assets under management (and associated management fees) will naturally decline, resulting in a reduction in fair value of our Asset Manager Affiliates. On the other hand, mandates to manage new CLO Fund portfolios will generally result in an increase in the fair value of our investment in our Asset Manager Affiliates. The aggregate of par value of assets under management by our Asset Manager Affiliates was $2.8 billion and $3.0 billion as of September 30, 2017 and December 31, 2016, respectively.

*Investment in Joint Venture.* For the three months ended September 30, 2017, the Company recognized $685,000 in investment income from its investment in the Joint Venture. As of September 30, 2017, the fair value of the Company’s investment in Joint venture was $36.6 million.

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

*Investment Income*

Investment income for the three months ended September 30, 2017 and 2016 was approximately $6.3 million and $9.0 million, respectively. Of these amounts, approximately $2.4 million and $5.2 million was attributable to interest income on our Debt Securities Portfolio.

Investment income for the nine months ended September 30, 2017 and 2016 was approximately $21.7 million and $28.1 million, respectively. Of these amounts, approximately $11.8 million and $16.1 million was attributable to interest income on our Debt Securities Portfolio.

The weighted average interest rate on our income producing Debt Securities Portfolio was 9.2% and 7.0% as of September 30, 2017 and December 31, 2016, respectively. For the nine months ended September 30, 2017, our total net asset value return per share was 1.3% and our total market return based on stock price was 0.7%. For the nine months ended September 30, 2016, our total net asset value return per share was 0.2% and our total market return based on stock price was 24.8%. Total net asset value return per share and total market return based on stock price do not reflect the sales load paid by stockholders.

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

For the three months ended September 30, 2017 and 2016, approximately $2.8 million and $3.5 million, respectively, of investment income was attributable to investments in CLO Fund Securities. For the nine months ended September 30, 2017 and 2016, approximately $8.7 million and $10.1 million, respectively, of investment income was attributable to investments in CLO Fund Securities. On a tax-basis, the Company recognized $2.3 million and $7.0 million of taxable distributable income on distributions from our CLO Fund Securities during the three and nine months ended September 30, 2017, respectively. Distributions from CLO Fund Securities are dependent on the performance of the underlying assets in each CLO Fund; interest payments, principal amortization and prepayments of the underlying loans in each CLO Fund are primary factors which determine the level of distributions on our CLO Fund Securities. The level of excess spread from CLO Fund Securities can be impacted by the timing and level of the resetting of the benchmark interest rate for the underlying assets (which reset at various times throughout the quarter) in the CLO Fund and the related CLO Fund bond liabilities (which reset at each quarterly distribution date); in periods of short-term and volatile changes in the benchmark interest rate, the levels of excess spread and distributions to us can vary significantly.

**Expenses**

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

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

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

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

Total expenses for the three months ended September 30, 2017 and 2016 were approximately $3.7 million and $4.5 million, respectively. Interest expense and amortization on debt issuance costs for the periods, were approximately $1.4 million and $2.1 million, respectively, on average debt outstanding of $34 million and $186 million, respectively.

For the three months ended September 30, 2017 and 2016, approximately $1.1 million and $1.2 million, respectively, of expenses were attributable to employee compensation, including salaries, bonuses, employee benefits, payroll taxes and stock-based compensation expense. For the three months ended September 30, 2017 and 2016, respectively, professional fees and insurance expenses totaled approximately $883,000 and $802,000. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately $396,000 and $372,000 for the three months ended September 30, 2017 and 2016, respectively.

Total expenses for the nine months ended September 30, 2017 and 2016 were approximately $13.3 million and $13.7 million, respectively. Interest expense and amortization on debt issuance costs for the periods, were approximately $5.8 million and $7.0 million, respectively, on average debt outstanding of $131 million and $193 million, respectively.

For the nine months ended September 30, 2017 and 2016, approximately $3.5 million and $3.2 million, respectively, of expenses were attributable to employee compensation, including salaries, bonuses, employee benefits, payroll taxes and stock-based compensation expense. For the nine months ended September 30, 2017 and 2016, respectively, professional fees and insurance expenses totaled approximately $2.8 million and $2.2 million. Administrative costs, which include occupancy expense, technology and other office expenses, totaled approximately $1.3 million and $1.3 million for the nine months ended September 30, 2017 and 2016, respectively.

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

Net investment income and net realized gains (losses) represents the net change in stockholder's equity before net unrealized appreciation or depreciation on investments. For the three months ended September 30, 2017, net investment income and net realized losses were approximately $623,000, or $0.02 per share. For the three months ended September 30, 2016, net investment income and net realized gains were approximately $9.2 million or $0.25 per share. For the nine months ended September 30, 2017, net investment income and net realized losses were approximately $5.5 million, or $0.15 per share. For the nine months ended September 30, 2016, net investment income and net realized losses were approximately $8.3 million or $0.22 per share. Net investment income represents the income earned on our investments less operating and interest expense before net realized gains or losses and unrealized appreciation or depreciation on investments. On February 29, 2016, Katonah X CLO Ltd. was fully liquidated and all of its outstanding obligations were satisfied. The Company received approximately $1.0 million in connection therewith related to its investment in the subordinated securities issued by Katonah X CLO Ltd. Accordingly, the Company recorded a realized loss during the first quarter of 2016 of approximately $6.6 million on its investment in Katonah X CLO Ltd. and a corresponding unrealized gain of the same amount in order to reverse the approximately $6.6 million of previously recorded unrealized depreciation with respect to the investment. For the three months ended September 30, 2017 and 2016, GAAP-basis net investment income was approximately $2.5 million or $0.07 per share, and $4.5 million or $0.12 per share, respectively, while tax-basis distributable income was approximately $2.3 million or $0.07 per share and $4.6 million or $0.12 per share, respectively. For the nine months ended September 30, 2017 and 2016, GAAP-basis net investment income was approximately $8.4 million or $0.23 per share, and $14.4 million or $0.39 per share, respectively, while tax-basis distributable income was approximately $6.9 million or $0.19 per share and $14.9 million or $0.40 per share, respectively.

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

During the three months ended September 30, 2017, our total investments had net unrealized appreciation of approximately $2.7 million. During the three months ended September 30, 2016, our total investments had net unrealized depreciation of approximately $6.4 million. For the three months ended September 30, 2017, our Asset Manager Affiliates had net unrealized appreciation of approximately $2.9 million. For the three months ended September 30, 2016, our Asset Manager Affiliates had net unrealized depreciation of approximately $1.1 million. For the three months ended September 30, 2017, our portfolio of debt securities and equity securities had net unrealized appreciation of approximately $1.6 million, compared with net unrealized depreciation of $4.1 million during the third quarter of 2016. For the three months ended September 30, 2017, our CLO Fund Securities had net unrealized depreciation of approximately $1.6 million compared with net unrealized depreciation of $1.1 million during the third quarter of 2016. For the three months ended September 30, 2017, our investment in the Joint Venture had net unrealized depreciation of $147,000.

During the nine months ended September 30, 2017, our total investments had net unrealized appreciation of approximately $875,000. During the nine months ended September 30, 2016, our total investments had net unrealized depreciation of approximately $9.3 million. For the nine months ended September 30, 2017, our Asset Manager Affiliates had net unrealized appreciation of approximately $1.5 million. For the nine months ended September 30, 2016, our Asset Manager Affiliates had net unrealized depreciation of approximately $12.7 million. For the nine months ended September 30, 2017, our portfolio of debt securities and equity securities had net unrealized appreciation of approximately $3.6 million, compared with net unrealized depreciation of $2.4 million during the nine months ended September 30, 2016. For the nine months ended September 30, 2017, our CLO Fund Securities had net unrealized depreciation of approximately $4.0 million compared with net unrealized appreciation of $5.8 million during the nine months ended September 30, 2016. For the nine months ended September 30, 2017, our investment in the Joint Venture had net unrealized depreciation of $147,000.

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

The net decrease in stockholders' equity resulting from operations for the three months ended September 30, 2017 was $669,000, or $0.02 per share. Net decrease in stockholders' equity resulting from operations for the three months ended September 30, 2016 was $2.7 million, or $0.07 per share.

The net increase in stockholders' equity resulting from operations for the nine months ended September 30, 2017 was $2.2 million, or $0.08 per share. Net decrease in stockholders' equity resulting from operations for the nine months ended September 30, 2016 was $1.1 million, or $0.03) per share.

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

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

As of September 30, 2017 and December 31, 2016 the fair value of investments and cash were as follows:

| Security Type | Investments at Fair Value September 30, 2017 | Investments at Fair Value December 31, 2016 |
|---|---|---|
| Cash | $ 1,186,838 | $ 1,307,257 |
| Restricted Cash | — | 8,528,298 |
| Short-term Investments | 57,024,828 | 28,699,269 |
| Senior Secured Loan | 46,124,913 | 200,322,152 |
| Junior Secured Loan | 58,343,554 | 35,444,440 |
| Senior Unsecured Loan | 20,000,000 | — |
| First Lien Bond | 1,063,762 | 1,089,338 |
| Senior Secured Bond | 1,494,600 | 1,487,400 |
| CLO Fund Securities | 51,843,344 | 54,174,350 |
| Equity Securities | 4,450,177 | 5,056,355 |
| Asset Manager Affiliates | 39,679,000 | 40,198,000 |
| Joint Venture | 36,591,122 | — |
| Total | $ 317,802,138 | $ 376,306,859 |

We use borrowed funds, known as “leverage,” to make investments and to attempt to increase returns to our shareholders by reducing our overall cost of capital. As a BDC, we are limited in the amount of leverage we can incur under the 1940 Act. We are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. As of September 30, 2017, we had approximately $104.4 million of par value of outstanding borrowings and our asset coverage ratio of total assets to total borrowings was 274%, compliant with the minimum asset coverage level of 200% generally required for a BDC by the 1940 Act. We may also borrow amounts of up to 5% of the value of our total assets for temporary purposes.

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

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

On July 20, 2017 $147.4 million par value of notes issued by KCAP Senior Funding were repaid in full, resulting in a realized loss on extinguishment of debt of $4 million.

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

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

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

**Stockholder Distributions**

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

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

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

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

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

The following table sets forth the quarterly distributions declared by us since for the two most recently completed fiscal years and the current fiscal year to date.

| | Distribution | Declaration Date | Record Date | Pay Date |
|---|---|---|---|---|
| 2017: | | | | |
| Third quarter | $ 0.12 | 9/22/2017 | 10/10/2017 | 10/26/2017 |
| Second quarter | 0.12 | 6/20/2017 | 7/7/2017 | 7/27/2017 |
| First quarter | 0.12 | 3/21/2017 | 4/7/2017 | 4/28/2017 |
| Total declared in 2017 | $ 0.36 | | | |
| 2016: | | | | |
| Fourth quarter | $ 0.12 | 12/14/2016 | 1/6/2017[1] | 1/27/2017 |
| Third quarter | 0.15 | 9/20/2016 | 10/14/2016 | 10/27/2016 |
| Second quarter | 0.15 | 6/21/2016 | 7/7/2016 | 7/28/2016 |
| First quarter | 0.15 | 3/18/2016 | 4/7/2016 | 4/28/2016 |
| Total declared in 2016 | $ 0.57 | | | |
| 2015: | | | | |
| Fourth quarter | $ 0.15 | 12/16/2015 | 1/6/2016[1] | 1/28/2016 |
| Third quarter | 0.21 | 9/22/2015 | 10/14/2015 | 10/27/2015 |
| Second quarter | 0.21 | 6/23/2015 | 7/6/2015 | 7/27/2015 |
| First quarter | 0.21 | 3/24/2015 | 4/6/2015 | 4/27/2015 |
| Total declared in 2015 | $ 0.78 | | | |

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

**OFF-BALANCE SHEET ARRANGEMENTS**

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 objectives. 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 September 30, 2017 and December 31, 2016, the Company had approximately $3 million and $565,000 of commitments to make such investments, respectively.

**CONTRACTUAL OBLIGATIONS**

The following table summarizes our contractual cash obligations and other commercial commitments as of September 30, 2017:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| **Contractual Obligations** | **Total** | **Less than one year** | **1 - 3 years** | **3 - 5 years** | **More than 5 years** |
| Long-term debt obligations | $ 104,407,200 | $ — | $ 27,000,000 | $ 77,407,200 | $ — |

**CRITICAL ACCOUNTING POLICIES**

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

***Valuation of Portfolio Investments***

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

***Interest Income***

Interest income, including amortization of premium and accretion of discount, 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 September 30, 2017, two issuers representing 1% of the Company's total investments at fair value were on a non-accrual status, and one of our investments, representing 2% of the Company's investments at fair value, was on partial non-accrual status, whereby we have recognized income on a portion of contractual payment-in-kind (PIK) amounts due.

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

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

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

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

***Distributions from Asset Manager Affiliates***

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

***Distributions from Joint Venture***

We recognize investment income from our joint venture based on the Company's share of thr tax-basis earnings and profits on the joint venture entity. For interim periods, the Company estimates the tax attributes of any distributions as being either tax-basis earnings and profits (i.e. dividend income) or return of capital (i.e. adjustment to the Company's cost basis in the Joint Venture). The final determination of the tax attributes of distributions from our Joint Venture is made on an annual (full calendar year) basis at the end of the year based upon taxable income and distributions for the full-year. Therefore, any estimate of tax attributes of distributions made on a quarterly basis may not be representative of the actual tax attributes of distributions for a full year.

***Payment in Kind Interest***

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

***Fee Income***

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

***Management Compensation***

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

***United States Federal Income Taxes***

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

***Distributions to Shareholders***

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

The following table sets forth the quarterly distributions declared by us since the most recent completed calendar year.

| | Distribution | Declaration Date | Record Date | Pay Date |
|---|---|---|---|---|
| 2017 (1) : | | | | |
| Third quarter | $ 0.12 | 9/22/2017 | 10/10/2017 | 10/26/2017 |
| Second quarter | 0.12 | 6/20/2017 | 7/7/2017 | 7/27/2017 |
| First quarter | 0.12 | 3/21/2017 | 4/7/2017 | 4/28/2017 |
| Total declared in 2017 | $ 0.36 | | | |
| 2016 (2) : | | | | |
| Fourth quarter | $ 0.12 | 12/14/2016 | 1/6/2017[1] | 1/27/2017 |
| Third quarter | 0.15 | 9/20/2016 | 10/14/2016 | 10/27/2016 |
| Second quarter | 0.15 | 6/21/2016 | 7/7/2016 | 7/28/2016 |
| First quarter | 0.15 | 3/18/2016 | 4/7/2016 | 4/28/2016 |
| Total declared in 2016 | $ 0.57 | | | |
| 2015 (3) : | | | | |
| Fourth quarter | $ 0.15 | 12/16/2015 | 1/6/2016[1] | 1/28/2016 |
| Third quarter | 0.21 | 9/22/2015 | 10/14/2015 | 10/27/2015 |
| Second quarter | 0.21 | 6/23/2015 | 7/6/2015 | 7/27/2015 |
| First quarter | 0.21 | 3/24/2015 | 4/6/2015 | 4/27/2015 |
| Total declared in 2015 | $ 0.78 | | | |

1 Percentage of distributions representing a return of capital will be determined on a full-year basis for 2017 in early 2018
2 Approximately 33.7% of 2016 distributions represented a return of capital.
3 Approximately 0.0% of 2015 distributions represented a return of capital.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2017[1] | 2016[1] | 2017[1] | 2016[1] |
| Net investment income | $ 0.07 | $ 0.12 | $ 0.23 | $ 0.39 |
| Tax Accounting Difference on CLO Equity Investments | (0.01) | - | (0.05) | 0.03 |
| Other tax accounting differences | 0.01 | - | 0.01 | (0.02) |
| Taxable distributable income | 0.06 | 0.12 | 0.19 | 0.40 |
| Cash distributed to the Company by Asset Manager Affiliates in excess of their taxable earnings | 0.02 | 0.02 | 0.05 | 0.03 |
| Cash received from CLO Equity Investments in excess of their taxable earnings | - | - | 0.03 | - |
| Available for distribution[2] | 0.08 | 0.14 | 0.27 | 0.43 |
| Distributed | 0.12 | 0.15 | 0.36 | 0.45 |
| Difference | $ (0.04) | $ (0.01) | $ (0.09) | $ (0.02) |

1 Table may not foot due to rounding.

2 The "Available for distribution" financial measure is a non-GAAP financial measure that is calculated by including the cash distributed to the Company by the Asset Manager Affiliates in excess of their taxable earnings to the Company's taxable distributable income, which is the most directly comparable GAAP financial measure. In order to reconcile the "Available for distribution" financial measure to taxable distributable income per share in accordance with GAAP, the $0.02 and $0.05 per share of cash distributed to the Company by the Asset Manager Affiliates in excess of their taxable earnings is subtracted from the "Available for distribution" financial measure for the three and nine months ended September, 30, 2017, respectively. The Company's management believes that the presentation of the non-GAAP "Available for distribution" financial measure provides useful information to investors.

**Recent Developments**

On October 31, 2017, the Joint Venture made a cash distribution to the Company of approximately $12.6 million. The Company expects that approximately $11.8 million of this distribution will be return of capital, reducing the cost basis of its investment in the Joint Venture by that amount. The final determination of the tax attributes of distributions from the Joint Venture is made on an annual (full calendar year) basis at the end of the year, therefore, any estimate of tax attributes of distributions made on an interim basis may not be representative of the actual tax attributes of distributions for the full year.

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

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

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

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

***Interest Rate Risk***

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

Our investment income is affected by fluctuations in various interest rates, including LIBOR and prime rates. As of September 30, 2017, approximately 98.1% of our debt securities portfolio were either fixed rate or floating rate with a spread to an interest rate index such as LIBOR or the prime rate. Most of these floating rate loans contain LIBOR floors ranging between 1.00% and 3.00%. We generally expect that future portfolio investments will predominately be floating rate investments. As of September 30, 2017, we had $104.4 million of borrowings outstanding at a current weighted average rate of 6.4%.

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

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

We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that our balance sheet at September 30, 2017 was to remain constant and no actions were taken to alter the existing interest rate sensitivity, the table below illustrates the impact on net investment income on our Debt Securities Portfolio for various hypothetical increases in interest rates:

| | Impact on net investment income from a change in interest rates at: | | |
|---|---|---|---|
| | 1% | 2% | 3% |
| Increase in interest rate | $ 864,592 | $ 1,700,553 | $ 2,536,515 |
| Decrease in interest rate | $ (220,059) | $ (220,059) | $ (220,059) |

As shown above, net investment income assuming a 1% increase in interest rates would increase by approximately $865,000 on an annualized basis, reflecting the impact to investments in our portfolio that are either fixed rate or which have embedded floors that would be unaffected by a 1% change in the underlying interest rate while our interest expense would be increasing. However, if the increase in rates was more significant, such as 2% or 3%, the net effect on net investment income would be an increase of approximately $1.7 million and $2.5 million, respectively. Since LIBOR underlying certain investments, as well as certain of our borrowings, is currently low, it is unlikely that the underlying rate will decrease by 1% or 2% or even 3%. If the underlying rate decreased to 0%, it would result in approximately a $220,000 decrease in net investment income.

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

We did not hold any derivative financial instruments for hedging purposes as of September 30, 2017.

*Portfolio Valuation*

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

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

## Item 4. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## Item 5. Controls and Procedures

*Evaluation of Disclosure Controls and Procedures*

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

*Changes in Internal Control Over Financial Reporting*

There have been no changes in our internal control over financial reporting during the three months ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. Other Information

**Item 1.** ***Legal Proceedings***

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

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

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

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

While we did not engage in any sales of unregistered securities during the three months ended September 30, 2017, we issued a total of 18,141 shares of common stock under our dividend reinvestment plan ("DRIP"). This issuance was not subject to the registration requirements of the Securities Act of 1933. For the three months ended September 30, 2017, the aggregate value of the shares of our common stock issued under our DRIP was approximately $64,000.

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

None.

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

Not Applicable.

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

None.

**Item 6.** ***Exhibits***

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

## SIGNATURES

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

| | | |
|---|---|---|
| | | KCAP FINANCIAL, INC. |
| Date: November 7, 2017 | By | /s/ Dayl W. Pearson |
| | | Dayl W. Pearson<br>*President and Chief Executive Officer*<br>*(Principal Executive Officer)* |
| Date: November 7, 2017 | By | /s/ Edward U. Gilpin |
| | | Edward U. Gilpin<br>*Chief Financial Officer*<br>*(Principal Financial and Accounting Officer)* |

* * * * *

## Exhibit Index

| Exhibit Number | Description of Document |
|---|---|
| 2.1 | Purchase and Sale Agreement, dated February 29, 2012, by and among Kohlberg Capital Corporation (the "Company"), Commodore Holdings, L.L.C., Trimaran Advisors, L.L.C., HBK Caravelle, L.L.C., Trimaran Fund Management, L.L.C., Jay R. Bloom, and Dean C. Kehler.(1) |
| 3.1 | Form of Certificate of Incorporation of the Company.(2) |
| 3.2 | Form of Bylaws of the Company, as amended and restated effective February 29, 2012.(3) |
| 4.1 | Form of Dividend Reinvestment Plan.(4) |
| 4.2 | Form of Base Indenture between the Company, as Issuer, and U.S. Bank National Association, as Trustee(5) |
| 4.3 | Form of First Supplemental Indenture between the Company and U.S. Bank National Association relating to the 7.375% Senior Notes Due 2019(5) |
| 4.4 | Form of Note relating to the 7.375% Senior Notes Due 2019 (included as part of Exhibit 4.3)(5) |
| 4.5 | Second Supplemental Indenture between the Company and U.S. Bank National Association relating to the 6.125% Notes Due 2022(6) |
| 4.6 | Form of 6.125% Notes Due 2022 (included as part of Exhibit 4.5).(6) |
| 11.1 | Computation of Per Share Earnings (included in the notes to the unaudited financial statements contained in this report). |
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.** |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.** |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U. S. C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ** |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U. S. C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.** |

** Submitted herewith

(1) Incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).

(2) Incorporated by reference to the exhibit included in Pre-Effective Amendment No. 1 on Form N-2, as filed on October 6, 2006 (File No. 333-136714).

(3) Incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K, as filed on March 1, 2012 (File No. 814-00735).

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

(5) Incorporated by reference to exhibit included in the Registration Statement in Form N-2, as filed on October 3, 2012 (File No. 333-183032).

(6) Incorporated by reference to the exhibit included in Post-Effective Amendment No. 1 on Form N-2, as filed on August 14, 2017 (File No. 333-218596).

**Exhibit 31.1**

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

I, Dayl W. Pearson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 30, 2017 of KCAP Financial, Inc. (the "registrant");

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

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

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

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

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

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

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

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

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

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

Date: November 7, 2017

By: / S / DAYL W. PEARSON

**Dayl W. Pearson**
**President and Chief Executive Officer**
**(Principal Executive Officer)**

**Exhibit 31.2**

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

I, Edward U. Gilpin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 30, 2017 of KCAP Financial, Inc. (the “registrant”);

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

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

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

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

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

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

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

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

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

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

Date: November 7, 2017

By: / S / EDWARD U. GILPIN

**Edward U. Gilpin**
**Chief Financial Officer**
**(Principal Financial Officer)**

**Exhibit 32.1**

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

In connection with the accompanying Quarterly Report of KCAP Financial, Inc. (the “Company”) on Form 10-Q for the quarter ended September 30, 2017 (the “Report”), I, Dayl W. Pearson, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

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

| | | |
|---|---|---|
| Date: November 7, 2017 | By: | / S / DAYL W. PEARSON |
| | | **Dayl W. Pearson** |
| | | **President and Chief Executive Officer** |
| | | **(Principal Executive Officer)** |

**Exhibit 32.2**

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

In connection with the accompanying Quarterly Report of KCAP Financial, Inc. (the “Company”) on Form 10-Q for the quarter ended September 30, 2017 (the “Report”), I, Edward U. Gilpin, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

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

| | | |
|---|---|---|
| Date: November 7, 2017 | By: | / S / EDWARD U. GILPIN |
| | | **Edward U. Gilpin** |
| | | **Chief Financial Officer** |
| | | **(Principal Financial Officer)** |