

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarter Ended September 30, 2017

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Exact name of registrant as specified in its  
charter, address of principal executive  
office, telephone number and state or other jurisdiction of incorporation  
or organization

Commission  
File Number  
814-01022

I.R.S. Employer  
Identification Number  
90-0945675

**Capitala Finance Corp.**  
4201 Congress St., Suite 360  
Charlotte, North Carolina  
Telephone: (704) 376-5502  
State of Incorporation: Maryland

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.

Capitala Finance Corp. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Capitala Finance Corp. 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 the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Capitala Finance Corp. Large accelerated filer  Accelerated filer   
Non-accelerated filer  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 Exchange Act).

Capitala Finance Corp. Yes  No

The number of shares of Capitala Finance Corp.'s common stock, \$0.01 par value, outstanding as of November 3, 2017 was 15,936,507.

## TABLE OF CONTENTS

	<u>Page</u>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	<b><u>3</u></b>
<u>Item 1. Consolidated Financial Statements</u>	<u>3</u>
<u>Consolidated Statements of Assets and Liabilities as of September 30, 2017 (unaudited) and December 31, 2016</u>	<u>3</u>
<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2017 and 2016 (unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Changes in Net Assets for the nine months ended September 30, 2017 and 2016 (unaudited)</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016 (unaudited)</u>	<u>6</u>
<u>Consolidated Schedules of Investments as of September 30, 2017 (unaudited) and December 31, 2016</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements as of September 30, 2017 (unaudited)</u>	<u>17</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>42</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>63</u>
<u>Item 4. Controls and Procedures</u>	<u>64</u>
<b><u>PART II. OTHER INFORMATION</u></b>	<b><u>64</u></b>
<u>Item 1. Legal Proceedings</u>	<u>64</u>
<u>Item 1A. Risk Factors</u>	<u>64</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>64</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>64</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>64</u>
<u>Item 5. Other Information</u>	<u>64</u>
<u>Item 6. Exhibits</u>	<u>65</u>
<u>Signatures</u>	<u>66</u>

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Capitala Finance Corp.

Consolidated Statements of Assets and Liabilities  
(in thousands, except share and per share data)

	As of	
	September 30, 2017 (unaudited)	December 31, 2016
<b>ASSETS</b>		
Investments at fair value		
Non-control/non-affiliate investments (amortized cost of \$276,221 and \$391,706, respectively)	\$ 274,795	\$ 393,525
Affiliate investments (amortized cost of \$76,414 and \$39,279, respectively)	98,101	61,464
Control investments (amortized cost of \$102,079 and \$82,791, respectively)	98,210	86,650
Total investments at fair value (amortized cost of \$454,714 and \$513,776, respectively)	471,106	541,639
Cash and cash equivalents	52,307	36,281
Interest and dividend receivable	4,246	5,735
Due from related parties	74	182
Prepaid expenses	409	506
Other assets	82	72
Total assets	<u>\$ 528,224</u>	<u>\$ 584,415</u>
<b>LIABILITIES</b>		
SBA debentures (net of deferred financing costs of \$2,454 and \$2,911, respectively)	\$ 168,246	\$ 167,789
2021 Notes (net of deferred financing costs of \$0 and \$3,025, respectively)	-	110,413
2022 Notes (net of deferred financing costs of \$2,618 and \$0, respectively)	72,382	-
2022 Convertible Notes (net of deferred financing costs of \$1,658 and \$0, respectively)	50,430	-
Credit Facility (net of deferred financing costs of \$1,096 and \$759, respectively)	(1,096)	43,241
Due to related parties	-	35
Management and incentive fee payable	2,228	6,426
Interest and financing fees payable	1,512	2,657
Accounts payable and accrued expenses	-	536
Deferred tax liability	2,660	-
Written call option at fair value (proceeds of \$20 and \$20, respectively)	5,555	2,736
Total liabilities	<u>\$ 301,917</u>	<u>\$ 333,833</u>
Commitments and contingencies (Note 2)		
<b>NET ASSETS</b>		
Common stock, par value \$.01, 100,000,000 common shares authorized, 15,930,631 and 15,868,045 common shares issued and outstanding, respectively	\$ 159	\$ 159
Additional paid in capital	240,897	240,184
Undistributed net investment income	15,684	22,973
Accumulated net realized losses from investments	(38,630)	(37,881)
Net unrealized appreciation on investments, net of deferred taxes	13,732	27,863
Net unrealized depreciation on written call option	(5,535)	(2,716)
Total net assets	<u>\$ 226,307</u>	<u>\$ 250,582</u>
Total liabilities and net assets	<u>\$ 528,224</u>	<u>\$ 584,415</u>
Net asset value per share	\$ 14.21	\$ 15.79

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Statements of Operations  
(in thousands, except share and per share data)  
(unaudited)

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2017	2016	2017	2016
<b>INVESTMENT INCOME</b>				
Interest and fee income:				
Non-control/non-affiliate investments	\$ 6,935	\$ 10,520	\$ 23,978	\$ 31,870
Affiliate investments	1,187	1,150	3,344	4,754
Control investments	1,639	3,545	5,209	8,681
Total interest and fee income	9,761	15,215	32,531	45,305
Payment-in-kind interest and dividend income:				
Non-control/non-affiliate investments	1,103	1,176	3,810	2,966
Affiliate investments	611	101	1,254	293
Control investments	166	241	574	707
Total payment-in-kind interest and dividend income	1,880	1,518	5,638	3,966
Dividend income:				
Non-control/non-affiliate investments	-	-	168	206
Affiliate investments	555	29	612	86
Control investments	25	545	330	2,135
Total dividend income	580	574	1,110	2,427
Other Income	48	42	125	85
Interest income from cash and cash equivalents	43	8	85	15
Total investment income	12,312	17,357	39,489	51,798
<b>EXPENSES</b>				
Interest and financing expenses	4,585	4,938	14,726	14,990
Loss on extinguishment of debt	-	-	2,732	-
Base management fee	2,417	2,619	7,436	8,049
Incentive fees	-	1,782	1,308	5,155
General and administrative expenses	900	889	2,941	2,984
Expenses before incentive fee waiver	7,902	10,228	29,143	31,178
Incentive fee waiver (See Note 5)	-	(312)	(958)	(1,673)
Total expenses, net of fee waivers	7,902	9,916	28,185	29,505
<b>NET INVESTMENT INCOME</b>	<b>4,410</b>	<b>7,441</b>	<b>11,304</b>	<b>22,293</b>
<b>REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND WRITTEN CALL OPTION:</b>				
Net realized gain (loss) from investments:				
Non-control/non-affiliate investments	(10,381)	1,192	(5,336)	1,261
Affiliate investments	98	(18,222)	4,587	(26,303)
Control investments	-	-	-	145
Total realized loss from investments	(10,283)	(17,030)	(749)	(24,897)
Net unrealized appreciation (depreciation) on investments:				
Non-control/non-affiliate investments	9,605	(8,217)	(3,245)	(6,915)
Affiliate investments	(1,472)	15,230	(498)	3,060
Control investments	(4,946)	1,461	(7,728)	8,412
Total unrealized appreciation (depreciation) from investments	3,187	8,474	(11,471)	4,557
Net unrealized depreciation on written call option	(407)	(898)	(2,819)	(898)
Change in provision for deferred taxes on unrealized appreciation on investments	(2,660)	-	(2,660)	-
Net loss on investments and written call option	(10,163)	(9,454)	(17,699)	(21,238)
<b>NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS</b>	<b>\$ (5,753)</b>	<b>\$ (2,013)</b>	<b>\$ (6,395)</b>	<b>\$ 1,055</b>
<b>NET INCREASE (DECREASE) IN NET ASSETS PER SHARE RESULTING FROM OPERATIONS – BASIC AND DILUTED</b>	<b>\$ (0.36)</b>	<b>\$ (0.13)</b>	<b>\$ (0.40)</b>	<b>\$ 0.07</b>
<b>WEIGHTED AVERAGE COMMON STOCK OUTSTANDING – BASIC AND DILUTED</b>	<b>15,911,160</b>	<b>15,829,878</b>	<b>15,891,636</b>	<b>15,807,801</b>
<b>DISTRIBUTIONS PAID PER SHARE</b>	<b>\$ 0.39</b>	<b>\$ 0.47</b>	<b>\$ 1.17</b>	<b>\$ 1.41</b>

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Statements of Changes in Net Assets  
(in thousands, except share data)  
(unaudited)

	<u>Common Stock</u>		<u>Additional Paid in Capital</u>	<u>Undistributed Net Investment Income</u>	<u>Accumulated Net Realized Losses</u>	<u>Net Unrealized Appreciation on Investments, net of Deferred Taxes</u>	<u>Net Unrealized Depreciation on Written Call Option</u>	<u>Total</u>
	<u>Number of Shares</u>	<u>Par Value</u>						
BALANCE, December 31, 2015	15,777,345	\$ 158	\$ 239,104	\$ 8,570	\$ (1,299)	\$ 22,269	\$ -	\$ 268,802
Net investment income	-	-	-	22,293	-	-	-	22,293
Net realized loss from investments	-	-	-	-	(24,897)	-	-	(24,897)
Net change in unrealized appreciation on investments	-	-	-	-	-	4,557	-	4,557
Net change in unrealized depreciation on written call option	-	-	-	-	-	(898)	-	(898)
Distributions to Shareholders:								
Stock issued under dividend reinvestment plan	66,814	-	813	-	-	-	-	813
Distributions declared	-	-	-	(22,293)	-	-	-	(22,293)
BALANCE, September 30, 2016	<u>15,844,159</u>	<u>\$ 158</u>	<u>\$ 239,917</u>	<u>\$ 8,570</u>	<u>\$ (26,196)</u>	<u>\$ 25,928</u>	<u>\$ -</u>	<u>\$ 248,377</u>
BALANCE, December 31, 2016	15,868,045	\$ 159	\$ 240,184	\$ 22,973	\$ (37,881)	\$ 27,863	\$ (2,716)	\$ 250,582
Net investment income	-	-	-	11,304	-	-	-	11,304
Net realized loss from investments	-	-	-	-	(749)	-	-	(749)
Net change in unrealized depreciation on investments	-	-	-	-	-	(11,471)	-	(11,471)
Net change in unrealized depreciation on written call option	-	-	-	-	-	-	(2,819)	(2,819)
Change in provision for deferred taxes on unrealized appreciation on investments	-	-	-	-	-	(2,660)	-	(2,660)
Distributions to Shareholders:								
Stock issued under dividend reinvestment plan	62,586	-	713	-	-	-	-	713
Distributions declared	-	-	-	(18,593)	-	-	-	(18,593)
BALANCE, September 30, 2017	<u>15,930,631</u>	<u>\$ 159</u>	<u>\$ 240,897</u>	<u>\$ 15,684</u>	<u>\$ (38,630)</u>	<u>\$ 13,732</u>	<u>\$ (5,535)</u>	<u>\$ 226,307</u>

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Statements of Cash Flows  
(in thousands)  
(unaudited)

	For the Nine Months Ended September 30	
	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net increase (decrease) in net assets resulting from operations	\$ (6,395)	\$ 1,055
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided by operating activities:		
Purchase of investments	(39,690)	(53,949)
Repayments and sales of investments	104,709	128,586
Net realized loss on investments	749	24,897
Net unrealized (appreciation) depreciation on investments	11,471	(4,557)
Payment-in-kind interest and dividends	(5,638)	(3,966)
Accretion of original issue discount on investments	(1,068)	(2,335)
Proceeds from written call option	-	20
Net unrealized depreciation on written call option	2,819	898
Amortization of deferred financing fees	1,868	1,614
Loss on extinguishment of debt	2,732	-
Change in provision for deferred taxes on unrealized appreciation on investments	2,660	-
Changes in assets and liabilities:		
Interest and dividend receivable	1,489	251
Due from related parties	108	56
Prepaid expenses	97	322
Other assets	(10)	(8)
Due to related parties	(35)	(6)
Management and incentive fee payable	(4,198)	3,031
Interest and financing fees payable	(1,145)	(2,063)
Accounts payable and accrued expenses	(536)	(387)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>69,987</b>	<b>93,459</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Paydowns on SBA debentures	-	(13,500)
Proceeds from Credit Facility	-	4,000
Payments to Credit Facility	(44,000)	(36,000)
Issuance of 2022 Notes	75,000	-
Issuance of 2022 Convertible Notes	52,088	-
Repayment of 2021 Notes	(113,438)	-
Distributions paid to shareholders	(17,880)	(21,480)
Deferred financing fees paid	(5,731)	-
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(53,961)</b>	<b>(66,980)</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>16,026</b>	<b>26,479</b>
CASH AND CASH EQUIVALENTS, beginning of period	36,281	34,105
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 52,307</u>	<u>\$ 60,584</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	\$ 13,611	\$ 15,139
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING TRANSACTIONS</b>		
Distributions paid through dividend reinvestment plan share issuances	\$ 713	\$ 813

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments  
(in thousands, except for units/shares)  
September 30, 2017  
(unaudited)

Company (1),(2),(3),(4)	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
<b>Non-control/non-affiliated investments - 121.5%</b>						
American Clinical Solutions, LLC	Healthcare	First Lien Debt (10.5% Cash, 1% PIK, Due 6/11/20)	\$ 9,045	\$ 9,045	\$ 7,571	3.3%
				9,045	7,571	3.3%
American Exteriors, LLC	Replacement Window Manufacturer	First Lien Debt (10% PIK, Due 1/1/19) (5)(6)	7,847	5,429	2,706	1.2%
American Exteriors, LLC	Replacement Window Manufacturer	Common Stock Warrants (10% fully diluted)		-	-	0.0%
				5,429	2,706	1.2%
AmeriMark Direct, LLC	Consumer Products	First Lien Debt (12.75% Cash, Due 9/8/21)	19,400	18,980	19,400	8.6%
				18,980	19,400	8.6%
B&W Quality Growers, LLC	Farming	Membership Unit Warrants (91,739 Units)		-	5,724	2.5%
				-	5,724	2.5%
BigMouth, Inc.	Consumer Products	First Lien Debt (13.2% Cash, Due 11/14/21) (7)	9,964	9,964	9,964	4.4%
BigMouth, Inc.	Consumer Products	Series A Preferred Stock (350,000 shares, 8% PIK) (8)		375	771	0.3%
				10,339	10,735	4.7%
Bluestem Brands, Inc.	Online Merchandise Retailer	First Lien Debt (8.74% Cash (1 month LIBOR + 7.5%, 1% Floor), Due 11/7/20)	4,092	4,015	3,840	1.7%
				4,015	3,840	1.7%
Brunswick Bowling Products, Inc.	Bowling Products	First Lien Debt (8% Cash (1 month LIBOR + 6%, 2% Floor), Due 5/22/20)	1,600	1,600	1,600	0.7%
Brunswick Bowling Products, Inc.	Bowling Products	First Lien Debt (16.25% Cash (1 month LIBOR + 14.25%, 2% Floor), Due 5/22/20)	5,586	5,586	5,586	2.5%
Brunswick Bowling Products, Inc.	Bowling Products	Preferred Shares (2,966 shares, 8% PIK) (8)		3,597	6,144	2.7%
				10,783	13,330	5.9%
Burke America Parts Group, LLC	Home Repair Parts Manufacturer	Membership Units (14 units)		5	3,213	1.4%
				5	3,213	1.4%
California Pizza Kitchen, Inc.	Restaurant	Second Lien Debt (11.24% Cash (1 month LIBOR + 10%, 1% Floor), Due 8/23/23)	5,000	4,874	4,874	2.2%
				4,874	4,874	2.2%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock (293,186 shares)		258	44	0.0%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock Warrants (655,908 units) (9)		264	98	0.0%
				522	142	0.0%
Cedar Electronics Holding Corp.	Consumer Electronics	Subordinated Debt (12% Cash, Due 12/26/20) (6)	21,550	21,550	8,477	3.7%
				21,550	8,477	3.7%
CIS Secure Computing, Inc.	Government Services	First Lien Debt (9.73% Cash (1 month LIBOR + 8.5%, 1% Floor), 1% PIK, Due 9/14/22) (10)	7,070	7,070	7,070	3.1%



CIS Secure Computing, Inc.

Government Services

Common Stock (46,163 shares)

1,000

1,000

0.4%

Company <sup>(1),(2),(3),(4)</sup>	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
				8,070	8,070	3.5%
Corporate Visions, Inc.	Sales & Marketing Services	Subordinated Debt (9% Cash, 2% PIK, Due 11/29/21)	16,515	16,515	15,252	6.7%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (15,750 shares)		1,575	921	0.4%
				18,090	16,173	7.1%
Currency Capital, LLC	Financial Services	First Lien Debt (12.23% Cash (1 month LIBOR + 11%, 0.50% Floor) Due 1/20/22) <sup>(11)</sup>	16,000	16,000	16,000	7.1%
Currency Capital, LLC	Financial Services	Class A Preferred Units (2,000,000 units) <sup>(11)</sup>		2,000	2,000	0.9%
				18,000	18,000	8.0%
Flavors Holdings, Inc.	Food Product Manufacturer	First Lien Debt (7.08% Cash (3 month LIBOR + 5.75%, 1% Floor), Due 4/3/20)	6,800	6,674	6,249	2.8%
Flavors Holdings, Inc.	Food Product Manufacturer	Second Lien Debt (11.33% Cash (3 month LIBOR + 10%, 1% Floor), Due 10/3/21)	12,000	11,723	10,525	4.7%
				18,397	16,774	7.5%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Subordinated Debt (Due 12/9/19) <sup>(12)</sup>	2,000	2,000	-	0.0%
				2,000	-	0.0%
Nth Degree, Inc.	Business Services	First Lien Debt (8.23% Cash (1 month LIBOR + 7%, 1% Floor), 1% PIK, Due 12/14/20)	9,006	9,006	9,006	4.0%
Nth Degree, Inc.	Business Services	First Lien Debt (12.73% Cash (1 month LIBOR + 11.5%, 1% Floor), 2% PIK, Due 12/14/20)	7,460	7,460	7,460	3.3%
Nth Degree, Inc.	Business Services	Preferred Stock (2,400 Units, 10% PIK dividend) <sup>(8)</sup>		2,866	8,932	4.0%
				19,332	25,398	11.3%
Portrait Innovations, Inc.	Professional and Personal Digital Imaging	First Lien Debt (9% Cash, Due 12/27/17) <sup>(13)</sup>	960	960	960	0.4%
Portrait Innovations, Inc.	Professional and Personal Digital Imaging	First Lien Debt (9.6% Cash, Due 2/26/20)	9,000	9,000	8,455	3.7%
				9,960	9,415	4.1%
Sequoia Healthcare Management, LLC	Healthcare Management	First Lien Debt (13% Cash, 4% PIK, Due 7/17/19)	9,892	9,829	9,892	4.4%
				9,829	9,892	4.4%
Sur La Table, Inc.	Retail	First Lien Debt (12% Cash, Due 7/28/20)	15,000	15,000	14,915	6.6%
				15,000	14,915	6.6%
Taylor Precision Products, Inc.	Household Product Manufacturer	Series C Preferred Stock (379 shares)		758	1,184	0.5%
				758	1,184	0.5%
Velum Global Credit Management, LLC	Financial Services	First Lien Debt (15% PIK, Due 12/31/17) <sup>(5)(11)(14)</sup>	11,816	11,816	11,232	5.0%
				11,816	11,232	5.0%
Vintage Stock, Inc.	Specialty Retail	First Lien Debt (13.74% Cash (1 month LIBOR + 12.5%, 0.5% floor), 3% PIK, Due 11/3/21)	21,288	21,288	21,288	9.4%
				21,288	21,288	9.4%

Company (1),(2),(3),(4)	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Vology, Inc.	Information Technology	Subordinated Debt (15% Cash (3 month LIBOR + 14%, 1% Ceiling), 4% PIK Due 1/24/21)	8,289	8,289	8,085	3.6%
				8,289	8,085	3.6%
Western Windows Systems, LLC	Building Products	First Lien Debt (11.7% Cash, Due 7/31/20) (7)	10,500	10,500	10,500	4.7%
Western Windows Systems, LLC	Building Products	Membership Units (39,860 units)		3,000	7,452	3.3%
				13,500	17,952	8.0%
Xirgo Technologies, LLC	Information Technology	Subordinated Debt (11.5% Cash, Due 3/1/22)	15,750	15,750	15,750	7.0%
Xirgo Technologies, LLC	Information Technology	Membership Units (600,000 units)		600	655	0.3%
				16,350	16,405	7.3%
<b>Sub Total Non-control/non-affiliated investments</b>				<b>\$ 276,221</b>	<b>\$ 274,795</b>	<b>121.5%</b>
<b>Affiliate investments - 43.3%</b>						
AAE Acquisition, LLC	Industrial Equipment Rental	Second Lien Debt (8% Cash, 4% PIK, Due 8/24/19) (5)	\$ 15,688	\$ 15,688	\$ 15,374	6.8%
AAE Acquisition, LLC	Industrial Equipment Rental	Membership Units (2.19% fully diluted)		17	-	0.0%
AAE Acquisition, LLC	Industrial Equipment Rental	Warrants (37.78% fully diluted)		-	-	0.0%
				15,705	15,374	6.8%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Subordinated Debt (14% Cash, Due 8/9/19) (15)	3,000	3,000	3,000	1.3%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Subordinated Debt (12% Cash, Due 8/9/19) (15)	5,828	5,828	5,693	2.5%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock (1,253,198 shares)		1,504	627	0.3%
				10,332	9,320	4.1%
City Gear, LLC	Footwear Retail	Subordinated Debt (13% Cash, Due 10/20/19) (5)	8,231	8,231	8,231	3.6%
City Gear, LLC	Footwear Retail	Preferred Membership Units (2.78% fully diluted, 9% Cash Dividend) (8)		1,269	1,269	0.6%
City Gear, LLC	Footwear Retail	Membership Unit Warrants (11.38% fully diluted)		-	8,056	3.5%
				9,500	17,556	7.7%
GA Communications, Inc.	Advertising & Marketing Services	Series A-1 Preferred Stock (1,998 shares, 8% PIK Dividend) (8)		2,836	3,163	1.4%
GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)		2	1,906	0.8%
				2,838	5,069	2.2%
J&J Produce Holdings, Inc.	Produce Distribution	Subordinated Debt (6% Cash, 7% PIK, Due 6/16/19) (5)	6,255	6,255	6,035	2.7%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock (8,182 shares)		818	-	0.0%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock Warrants (6,369 shares)		-	-	0.0%
				7,073	6,035	2.7%

<u>Company</u> <sup>(1),(2),(3),(4)</sup>	<u>Industry</u>	<u>Type of Investment</u>	<u>Principal Amount</u>	<u>Cost</u>	<u>Fair Value</u>	<u>% of Net Assets</u>
LJS Partners, LLC	QSR Franchisor	Common Stock (1,500,000 shares)		896	8,404	3.7%
				896	8,404	3.7%
MMI Holdings, LLC	Medical Device Distributor	First Lien Debt (12% Cash, Due 1/31/18) <sup>(5)</sup>	2,600	2,600	2,600	1.1%
MMI Holdings, LLC	Medical Device Distributor	Subordinated Debt (6% Cash, Due 1/31/18) <sup>(5)</sup>	400	388	400	0.2%
MMI Holdings, LLC	Medical Device Distributor	Preferred Units (1,000 units, 6% PIK dividend) <sup>(8)</sup>		1,359	1,497	0.7%
MMI Holdings, LLC	Medical Device Distributor	Common Membership Units (45 units)		-	187	0.1%
				4,347	4,684	2.1%
MTI Holdings, LLC	Retail Display & Security Services	Membership Units (2,000,000 units) <sup>(16)</sup>		-	439	0.2%
				-	439	0.2%
Sierra Hamilton Holdings Corporation	Oil & Gas Engineering and Consulting Services	Common Stock (15,068,000 shares)		6,958	6,958	3.1%
				6,958	6,958	3.1%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Membership Units (11.3% ownership) <sup>(16)</sup>		-	101	0.0%
				-	101	0.0%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock (1,200,000 shares) <sup>(16)</sup>		-	93	0.0%
				-	93	0.0%
U.S. Well Services, LLC	Oil & Gas Services	First Lien Debt (7.24% Cash (1 month LIBOR + 6%, 1% floor), Due 2/2/22) <sup>(17)</sup>	2,022	2,022	2,022	0.9%
U.S. Well Services, LLC	Oil & Gas Services	First Lien Debt (12.24% PIK (1 month LIBOR + 11%, 1% floor), Due 2/2/22)	9,230	9,230	9,230	4.1%
U.S. Well Services, LLC	Oil & Gas Services	Class A Units (5,680,688 Units)		6,259	11,014	4.9%
U.S. Well Services, LLC	Oil & Gas Services	Class B Units (2,076,298 Units)		441	767	0.3%
				17,952	23,033	10.2%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Subordinated Debt <sup>(16)</sup>		813	1,035	0.5%
				813	1,035	0.5%
<b>Sub Total Affiliate investments</b>				<u>\$ 76,414</u>	<u>\$ 98,101</u>	<u>43.3%</u>
<b>Control investments- 43.4%</b>						
CableOrganizer Acquisition, LLC	Computer Supply Retail	First Lien Debt (12% Cash, 4% PIK, Due 5/24/18)	\$ 12,247	\$ 12,247	\$ 12,247	5.4%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock (19.7% fully diluted)		1,394	109	0.0%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock Warrants (10% fully diluted )		-	55	0.0%
				13,641	12,411	5.4%
Eastport Holdings, LLC	Business Services	Subordinated Debt (14.32% Cash (3 month LIBOR + 13%, 0.5% Floor), Due 4/29/20)	16,500	14,549	16,500	7.3%

<u>Company</u> <sup>(1),(2),(3),(4)</sup>	<u>Industry</u>	<u>Type of Investment</u>	<u>Principal Amount</u>	<u>Cost</u>	<u>Fair Value</u>	<u>% of Net Assets</u>
Eastport Holdings, LLC	Business Services	Membership Units (33.3% ownership) <sup>(18)</sup>		4,733	22,366	9.9%
				<u>19,282</u>	<u>38,866</u>	<u>17.2%</u>
Kelle's Transport Service, LLC	Transportation	First Lien Debt (4% Cash, Due 2/15/20) <sup>(19)</sup>	1,545	1,545	1,545	0.7%
Kelle's Transport Service, LLC	Transportation	First Lien Debt (1.46% Cash, Due 2/15/20) <sup>(5)</sup>	13,674	13,668	9,368	4.2%
Kelle's Transport Service, LLC	Transportation	Membership Units (27.5% fully diluted)		-	-	0.0%
				<u>15,213</u>	<u>10,913</u>	<u>4.9%</u>
Micro Precision, LLC	Conglomerate	Subordinated Debt (10% Cash, Due 9/15/18) <sup>(5)</sup>	1,862	1,862	1,862	0.8%
Micro Precision, LLC	Conglomerate	Subordinated Debt (14% Cash, 4% PIK, Due 9/15/18) <sup>(5)</sup>	4,112	4,112	4,112	1.8%
Micro Precision, LLC	Conglomerate	Series A Preferred Units (47 units)		1,629	1,629	0.7%
				<u>7,603</u>	<u>7,603</u>	<u>3.3%</u>
Navis Holdings, Inc.	Textile Equipment Manufacturer	First Lien Debt (15% Cash, Due 10/30/20) <sup>(5)</sup>	6,500	6,500	6,500	2.9%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares, 10% Cash Dividend) <sup>(8)</sup>		1,000	1,000	0.4%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (300,000 shares)		1	5,330	2.4%
				<u>7,501</u>	<u>12,830</u>	<u>5.7%</u>
On-Site Fuel Services, Inc.	Fuel Transportation Services	Subordinated Debt (14% Cash, 4% PIK, Due 12/19/18) <sup>(5)(6)</sup>	11,834	11,020	11,588	5.1%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series A Preferred Stock (32,782 shares)		3,278	-	0.0%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series B Preferred Stock (23,648 shares)		2,365	-	0.0%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Common Stock (33,107 shares)		33	-	0.0%
				<u>16,696</u>	<u>11,588</u>	<u>5.1%</u>
Print Direction, Inc.	Printing Services	First Lien Debt (10% Cash, 2% PIK, Due 2/24/19) <sup>(6)</sup>	19,153	19,153	3,999	1.8%
Print Direction, Inc.	Printing Services	Common Stock (18,543 shares)		2,990	-	0.0%
Print Direction, Inc.	Printing Services	Common Stock Warrants (820 shares)		-	-	0.0%
				<u>22,143</u>	<u>3,999</u>	<u>1.8%</u>
<b>Sub Total Control investments</b>				<u>\$ 102,079</u>	<u>\$ 98,210</u>	<u>43.4%</u>
<b>TOTAL INVESTMENTS - 208.2%</b>				<u>\$ 454,714</u>	<u>\$ 471,106</u>	<u>208.2%</u>
<b>Derivatives - (2.5)%</b>						
Eastport Holdings, LLC	Business Services	Written Call Option <sup>(18)</sup>		\$ (20)	\$ (5,555)	(2.5)%
<b>TOTAL DERIVATIVES- (2.5)%</b>				<u>\$ (20)</u>	<u>\$ (5,555)</u>	<u>(2.5)%</u>

- (1) All investments valued using significant unobservable inputs (Level 3).
- (2) All debt investments are income producing, unless otherwise noted. Equity and warrant investments are non-income producing, unless otherwise noted.
- (3) Percentages are based on net assets of \$226,307 as of September 30, 2017.
- (4) All companies are headquartered in the United States, unless otherwise noted
- (5) The maturity date of the original investment has been extended.
- (6) Non-accrual investment.
- (7) The cash rate equals the approximate current yield on our last-out portion of the unitranche facility.
- (8) The equity investment is income producing, based on rate disclosed.
- (9) The equity investment has an exercisable put option
- (10) The investment has a \$4.0 million unfunded commitment.
- (11) Indicates assets that the Company believes do not represent "qualifying assets" under Section 55(a) of the Investment Company Act of 1940, as amended. Qualifying assets must represent at least 70% of the Company's total assets at the time of acquisition of any additional non-qualifying assets. As of September 30, 2017, 5.5% of the Company's total assets were non-qualifying assets.
- (12) Interest rate was amended to zero. The Company is entitled to receive earn-out payments of up to \$2.4 million in satisfaction of the debt.
- (13) The investment has a \$2.0 million unfunded commitment.
- (14) The company is headquartered in Brazil.
- (15) In addition to the stated rate, the investment is paying 3% default interest.
- (16) The investment has been exited. The residual value reflects estimated escrow to be settled post-closing.
- (17) The investment has a \$1.0 million unfunded commitment.
- (18) The Company has written a call option that enables CapitalSouth Partners Florida Sidecar Fund II, L.P. to purchase up to 31.25% of the Company's interest at a strike price of \$1.5 million. As of September 30, 2017, the fair value of the written call option is approximately \$5.6 million. See Note 4 to the consolidated financial statements for further detail on the written call option transaction.
- (19) The investment has a \$1.5 million unfunded commitment.

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments  
(in thousands, except for units/shares)  
December 31, 2016

Company <sup>(4), (5)</sup>	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
<b>Non-control/non-affiliated investments - 157.1%</b>						
AAE Acquisition, LLC	Industrial Equipment Rental	Second Lien Debt (12% Cash, Due 3/31/18)	\$ 11,000	\$ 11,000	\$ 10,755	4.3%
AAE Acquisition, LLC	Industrial Equipment Rental	Membership Units (14% fully diluted)		17	-	0.0%
				11,017	10,755	4.3%
American Clinical Solutions, LLC	Healthcare	First Lien Debt (10.5% Cash (3 month LIBOR + 9.5%, 1% Floor), Due 6/11/20) <sup>(13)</sup>	9,034	9,034	8,582	3.4%
				9,034	8,582	3.4%
American Exteriors, LLC	Replacement Window Manufacturer	First Lien Debt (10% PIK, Due 1/1/17) <sup>(1)(2)</sup>	6,456	4,679	2,571	1.0%
American Exteriors, LLC	Replacement Window Manufacturer	Common Stock Warrants (10% fully diluted)		-	-	0.0%
				4,679	2,571	1.0%
AmeriMark Direct, LLC	Consumer Products	First Lien Debt (12.75% Cash, Due 9/8/21)	19,700	19,192	19,542	7.8%
				19,192	19,542	7.8%
B&W Quality Growers, LLC	Farming	Subordinated Debt (14% Cash, Due 7/23/20)	6,000	5,996	6,000	2.4%
B&W Quality Growers, LLC	Farming	Membership Unit Warrants (91,739 Units)		20	5,779	2.3%
				6,016	11,779	4.7%
BigMouth, Inc.	Consumer Products	First Lien Debt (12.6% Cash, Due 11/14/21) <sup>(3)</sup>	10,313	10,313	10,313	4.1%
BigMouth, Inc.	Consumer Products	Series A Preferred Stock (350,000 shares, 8% PIK) <sup>(6)</sup>		354	354	0.1%
				10,667	10,667	4.2%
Bluestem Brands, Inc.	Online Merchandise Retailer	First Lien Debt (8.5% Cash (1 month LIBOR + 7.5%, 1% Floor), Due 11/7/20)	4,279	4,169	4,169	1.7%
				4,169	4,169	1.7%
Brock Holdings III, Inc.	Industrial Specialty Services	Second Lien Debt (10% Cash (1 month LIBOR + 8.25%, 1.75% Floor), Due 3/16/18)	5,000	4,935	4,750	1.9%
				4,935	4,750	1.9%
Brunswick Bowling Products, Inc.	Bowling Products	First Lien Debt (8% Cash (1 month LIBOR + 6.0%, 2% Floor), Due 5/22/20)	1,600	1,600	1,600	0.6%
Brunswick Bowling Products, Inc.	Bowling Products	First Lien Debt (16.25% Cash (1 month LIBOR + 14.25%, 2% Floor), Due 5/22/20)	5,586	5,586	5,586	2.2%
Brunswick Bowling Products, Inc.	Bowling Products	Preferred Shares (2,966 shares, 8% PIK) <sup>(6)</sup>		3,384	5,317	2.1%
				10,570	12,503	4.9%
Burke America Parts Group, LLC	Home Repair Parts Manufacturer	Membership Units (14 units)		5	1,408	0.6%
				5	1,408	0.6%
California Pizza Kitchen, Inc.	Restaurant	Second Lien Debt (11% Cash (1 month LIBOR + 10%, 1% Floor), Due 8/23/23)	5,000	4,857	4,857	1.9%
				4,857	4,857	1.9%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock (293,186 shares)		258	137	0.1%

Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock Warrants (655,908 units) <sup>(7)</sup>		<u>264</u>	<u>309</u>	<u>0.1%</u>
				<u>522</u>	<u>446</u>	<u>0.2%</u>
Cedar Electronics Holding Corp.	Consumer Electronics	Subordinated Debt (12% Cash, Due 12/26/20)	21,550	<u>21,550</u>	<u>20,818</u>	<u>8.3%</u>
				<u>21,550</u>	<u>20,818</u>	<u>8.3%</u>
Community Choice Financial, Inc.	Financial Services	First Lien Debt (18% Cash (1 month LIBOR + 17%, 1% Floor), Due 3/30/18) <sup>(1)(8)</sup>	15,000	<u>15,000</u>	<u>15,000</u>	<u>6.0%</u>
				<u>15,000</u>	<u>15,000</u>	<u>6.0%</u>
Construction Partners, Inc.	Construction Services	Second Lien Debt (11.5% Cash, Due 6/12/20)	9,500	<u>9,500</u>	<u>9,500</u>	<u>3.8%</u>
				<u>9,500</u>	<u>9,500</u>	<u>3.8%</u>
Corporate Visions, Inc.	Sales & Marketing Services	Subordinated Debt (9% Cash, 2% PIK, Due 11/29/21)	16,267	16,267	15,648	6.2%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (15,750 shares)		<u>1,575</u>	<u>728</u>	<u>0.3%</u>
				<u>17,842</u>	<u>16,376</u>	<u>6.5%</u>
CSM Bakery Solutions, LLC	Bakery Supplies Distributor	Second Lien Debt (8.75% Cash (1 month LIBOR + 7.75%, 1% Floor), Due 8/7/22)	12,000	<u>11,813</u>	<u>10,776</u>	<u>4.3%</u>
				<u>11,813</u>	<u>10,776</u>	<u>4.3%</u>
Emerging Markets Communications, LLC	Satellite Communications	Second Lien Debt (10.625% Cash (1 month LIBOR + 9.625%, 1% Floor), Due 7/1/22)	5,000	<u>4,946</u>	<u>5,000</u>	<u>2.0%</u>
				<u>4,946</u>	<u>5,000</u>	<u>2.0%</u>
Flavors Holdings, Inc.	Food Product Manufacturer	First Lien Debt (6.75% Cash (1 month LIBOR + 5.75%, 1% Floor), Due 4/3/20)	7,100	6,930	6,411	2.6%



Company <sup>(4),(5)</sup>	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Flavors Holdings, Inc.	Food Product Manufacturer	Second Lien Debt (11% Cash (1 month LIBOR + 10%, 1% Floor), Due 10/3/21)	12,000	11,671	10,188	4.1%
				18,601	16,599	6.7%
Group Cirque du Soleil, Inc.	Entertainment	Second Lien Debt (9.25% Cash (3 month LIBOR + 8.25%, 1% Floor), Due 7/8/23) <sup>(8)</sup>	1,000	988	987	0.4%
				988	987	0.4%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Subordinated Debt (Due 12/9/19) <sup>(9)</sup>	2,000	2,000	1,532	0.6%
				2,000	1,532	0.6%
Kelle's Transport Service, LLC	Transportation	First Lien Debt (14% Cash, Due 3/31/19)	13,674	13,668	13,252	5.3%
Kelle's Transport Service, LLC	Transportation	Preferred Units (1,000 units, 10% PIK Dividend) <sup>(6)</sup>		3,433	3,433	1.4%
Kelle's Transport Service, LLC	Transportation	Common Stock Warrants (15% fully diluted)		22	171	0.1%
				17,123	16,856	6.8%
Medical Depot, Inc.	Medical Device Distributor	Subordinated Debt (14% Cash, Due 9/27/20) <sup>(1)</sup>	14,667	14,667	14,667	5.9%
Medical Depot, Inc.	Medical Device Distributor	Series C Convertible Preferred Stock (740 shares)		1,333	6,440	2.6%
				16,000	21,107	8.5%
Nielsen & Bainbridge, LLC	Home Décor Manufacturer	Second Lien Debt (10.5% Cash (6 month LIBOR + 9.25%, 1% Floor), Due 8/15/21)	15,000	14,849	14,670	5.9%
				14,849	14,670	5.9%
Nth Degree, Inc.	Business Services	First Lien Debt (8.0% Cash (1 month LIBOR + 7%, 1% Floor), 1% PIK, Due 12/14/20)	9,904	9,904	9,904	4.0%
Nth Degree, Inc.	Business Services	First Lien Debt (12.5% Cash (1 month LIBOR + 11.5%, 1% Floor), 2% PIK, Due 12/14/20)	7,351	7,351	7,351	2.9%
Nth Degree, Inc.	Business Services	Preferred Stock (10% PIK dividend) <sup>(6)</sup>		2,662	4,581	1.8%
				19,917	21,836	8.7%
Portrait Innovations, Inc.	Professional and Personal Digital Imaging	Subordinated Debt (12% Cash, Due 2/26/20)	9,000	9,000	9,000	3.6%
				9,000	9,000	3.6%
Sequoia Healthcare Management, LLC	Healthcare Management	First Lien Debt (12% Cash, 4% PIK, Due 7/17/19)	10,851	10,750	10,851	4.3%
				10,750	10,851	4.3%
Sierra Hamilton, LLC	Oil & Gas Engineering and Consulting Services	First Lien Debt (12.25% Cash, Due 12/15/18) <sup>(2)</sup>	15,000	15,000	4,500	1.8%
				15,000	4,500	1.8%
Sur La Table, Inc.	Retail	First Lien Debt (12% Cash, Due 7/28/20)	15,000	15,000	15,000	6.0%
				15,000	15,000	6.0%
Taylor Precision Products, Inc.	Household Product Manufacturer	Series C Preferred Stock (379 shares)		758	1,001	0.4%
				758	1,001	0.4%
U.S. Well Services, LLC	Oil & Gas Services	First Lien Debt (14.1% PIK (1 month LIBOR + 13.5%, 0.5% floor), Due 5/2/19)	15,083	15,054	15,083	6.0%
				15,054	15,083	6.0%
Velum Global Credit Management, LLC	Financial Services	First Lien Debt (15% PIK, Due 12/31/17) <sup>(1)(8)</sup>	10,553	10,553	10,553	4.2%

			10,553	10,553	4.2%
Vintage Stock, Inc.	Specialty Retail	First Lien Debt (13.1% Cash (1 month LIBOR + 12.5%, 0.5% floor), 3% PIK, Due 11/3/21)	22,067	22,067	8.8%
			<u>22,067</u>	<u>22,067</u>	<u>8.8%</u>
Vology, Inc.	Information Technology	Subordinated Debt (15% Cash (3 month LIBOR + 14%, 1% Floor, 2% PIK), Due 1/24/21)	8,082	8,082	3.2%
			<u>8,082</u>	<u>8,082</u>	<u>3.2%</u>
Western Windows Systems, LLC	Building Products	First Lien Debt (11.7% Cash, Due 7/31/20) <sup>(3)</sup>	10,500	10,500	4.2%
Western Windows Systems, LLC	Building Products	Membership Units (39,860 units)	3,000	7,652	3.0%
			<u>13,500</u>	<u>18,152</u>	<u>7.2%</u>
Xirgo Technologies, LLC	Information Technology	Subordinated Debt (11.5% Cash, Due 3/1/22)	15,750	15,750	6.3%
Xirgo Technologies, LLC	Information Technology	Membership Units (400,000 units)	400	400	0.2%
			<u>16,150</u>	<u>16,150</u>	<u>6.5%</u>
<b>Sub Total Non-control/non-affiliated investments</b>			<u>\$ 391,706</u>	<u>\$ 393,525</u>	<u>157.1%</u>
<b>Affiliate investments - 24.5%</b>					
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Subordinated Debt (14% Cash, Due 8/9/19) <sup>(10)</sup>	\$ 3,000	\$ 3,000	\$ 3,000 1.2%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Subordinated Debt (12% Cash, Due 8/9/19) <sup>(10)</sup>	5,828	5,828	5,828 2.3%

Company <sup>(4),(5)</sup>	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock (1,253,198 shares)		1,504	1,248	0.5%
				10,332	10,076	4.0%
City Gear, LLC	Footwear Retail	Subordinated Debt (13% Cash, Due 9/28/17) <sup>(1)</sup>	8,231	8,231	8,231	3.3%
City Gear, LLC	Footwear Retail	Preferred Membership Units (2.78% fully diluted, 9% Cash Dividend) <sup>(6)</sup>		1,269	1,269	0.5%
City Gear, LLC	Footwear Retail	Membership Unit Warrants (11.38% fully diluted)		-	9,736	3.9%
				9,500	19,236	7.7%
GA Communications, Inc.	Advertising & Marketing Services	Series A-1 Preferred Stock (1,998 shares, 8% PIK dividend) <sup>(6)</sup>		2,648	2,864	1.1%
GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)		2	1,046	0.4%
				2,650	3,910	1.5%
J&J Produce Holdings, Inc.	Produce Distribution	Subordinated Debt (13% Cash, Due 7/16/18)	6,182	6,182	6,182	2.5%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock (8,182 shares)		818	-	0.0%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock Warrants (6,369 shares)		-	-	0.0%
				7,000	6,182	2.5%
LJS Partners, LLC	QSR Franchisor	Common Stock (1,500,000 shares)		1,525	8,497	3.4%
				1,525	8,497	3.4%
MJC Holdings, LLC	Specialty Clothing	Series A Preferred Units (2,000,000 units)		1,000	5,011	2.0%
				1,000	5,011	2.0%
MMI Holdings, LLC	Medical Device Distributor	First Lien Debt (12% Cash, Due 1/31/18) <sup>(1)</sup>	2,600	2,600	2,600	1.0%
MMI Holdings, LLC	Medical Device Distributor	Subordinated Debt (6% Cash, Due 1/31/18) <sup>(1)</sup>	400	388	400	0.2%
MMI Holdings, LLC	Medical Device Distributor	Preferred Units (1,000 units, 6% PIK dividend) <sup>(6)</sup>		1,296	1,433	0.6%
MMI Holdings, LLC	Medical Device Distributor	Common Membership Units (45 units)		-	228	0.1%
				4,284	4,661	1.9%
MTI Holdings, LLC	Retail Display & Security Services	Membership Units (2,000,000 units) <sup>(12)</sup>		-	537	0.2%
				-	537	0.2%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Subordinated Debt (13% Cash, Due 4/8/19) <sup>(1)</sup>	1,425	1,425	1,425	0.6%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Membership Units (11.3% ownership)		750	805	0.3%
				2,175	2,230	0.9%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock (1,200,000 shares) <sup>(12)</sup>		-	109	0.0%
				-	109	0.0%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Subordinated Debt <sup>(12)</sup>		813	1,015	0.4%
				813	1,015	0.4%
<b>Sub Total Affiliate investments</b>				<b>\$ 39,279</b>	<b>\$ 61,464</b>	<b>24.5%</b>

**Control investments- 34.6%**

CableOrganizer Acquisition, LLC	Computer Supply Retail	First Lien Debt (12% Cash, 4% PIK, Due 5/24/18)	\$ 11,882	\$ 11,882	\$ 11,882	4.8%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock (19.7% fully diluted ownership)		1,394	200	0.1%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock Warrants (10% fully diluted ownership)		-	101	0.0%
				<u>13,276</u>	<u>12,183</u>	<u>4.9%</u>
Eastport Holdings, LLC	Business Services	Subordinated Debt (13.9% Cash (3 month LIBOR + 13%, 0.5% Floor), Due 4/29/20)	16,500	13,982	16,500	6.6%
Eastport Holdings, LLC	Business Services	Membership Units (30.1% fully diluted) <sup>(11)</sup>		4,733	13,395	5.3%
				<u>18,715</u>	<u>29,895</u>	<u>11.9%</u>
Micro Precision, LLC	Conglomerate	Subordinated Debt (10% Cash, Due 9/15/18) <sup>(1)</sup>	1,862	1,862	1,862	0.8%
Micro Precision, LLC	Conglomerate	Subordinated Debt (14% Cash, 4% PIK, Due 9/15/18) <sup>(1)</sup>	3,989	3,989	3,989	1.6%
Micro Precision, LLC	Conglomerate	Series A Preferred Units (47 units)		1,629	2,523	1.0%
				<u>7,480</u>	<u>8,374</u>	<u>3.4%</u>
Navis Holdings, Inc.	Textile Equipment Manufacturer	First Lien Debt (15% Cash, Due 10/30/20) <sup>(1)</sup>	6,500	6,500	6,500	2.6%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares, 10% Cash Dividend)		1,000	1,000	0.4%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (300,000 shares)		1	5,634	2.2%
				<u>7,501</u>	<u>13,134</u>	<u>5.2%</u>
On-Site Fuel Services, Inc.	Fuel Transportation Services	Subordinated Debt (14% Cash, 4% PIK, Due 12/19/17) <sup>(1)(2)</sup>	10,303	9,837	10,303	4.1%

<u>Company</u> <sup>(4), (5)</sup>	<u>Industry</u>	<u>Type of Investment</u>	<u>Principal Amount</u>	<u>Cost</u>	<u>Fair Value</u>	<u>% of Net Assets</u>
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series A Preferred Stock (32,782 shares)		3,278	-	0.0%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series B Preferred Stock (23,648 shares)		2,365	-	0.0%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Common Stock (33,107 shares)		33	-	0.0%
				<u>15,513</u>	<u>10,303</u>	<u>4.1%</u>
Print Direction, Inc.	Printing Services	First Lien Debt (10% Cash, 2% PIK, Due 2/24/19)	17,316	17,316	12,761	5.1%
Print Direction, Inc.	Printing Services	Common Stock (18,543 shares)		2,990	-	0.0%
Print Direction, Inc.	Printing Services	Common Stock Warrants (820 shares)		-	-	0.0%
				<u>20,306</u>	<u>12,761</u>	<u>5.1%</u>
<b>Sub Total Control investments</b>				<u>\$ 82,791</u>	<u>\$ 86,650</u>	<u>34.6%</u>
<b>TOTAL INVESTMENTS - 216.2%</b>				<u>\$ 513,776</u>	<u>\$ 541,639</u>	<u>216.2%</u>
<b>Derivatives - (1.1)%</b>						
Eastport Holdings, LLC	Business Services	Written Call Option <sup>(11)</sup>		\$ (20)	\$ (2,736)	(1.1)%
				<u>\$ (20)</u>	<u>\$ (2,736)</u>	<u>(1.1)%</u>
<b>TOTAL DERIVATIVES- (1.1)%</b>				<u>\$ (20)</u>	<u>\$ (2,736)</u>	<u>(1.1)%</u>

(1) The maturity date of the original investment has been extended.

(2) Non-accrual investment.

(3) The cash rate equals the approximate current yield on our last-out portion of the unitranche facility.

(4) All debt investments are income producing, unless otherwise noted. Equity and warrant investments are non-income producing, unless otherwise noted.

(5) Percentages are based on net assets of \$250,582 as of December 31, 2016.

(6) The equity investment is income producing, based on rate disclosed.

(7) The equity investment has an exercisable put option.

(8) Indicates assets that the Company believes do not represent "qualifying assets" under Section 55(a) of the Investment Company Act of 1940, as amended. Qualifying assets must represent at least 70% of the Company's total assets at the time of acquisition of any additional non-qualifying assets. As of December 31, 2016, 4.5% of the Company's total assets were non-qualifying assets.

(9) Interest rate was amended to zero. The Company is entitled to receive earn-out payments of up to \$2.4 million in satisfaction of the debt.

(10) In addition to the stated rate, the investment is paying 3% default interest.

(11) The Company has written a call option that enables CapitalSouth Partners Florida Sidecar Fund II, L.P. to purchase up to 31.25% of the Company's interest at a strike price of \$1.5 million. As of December 31, 2016, the fair value of the written call option is approximately \$2.7 million. See Note 4 to the consolidated financial statements for further detail on the written call option transaction.

(12) The investment has been exited. The residual value reflects estimated escrow to be settled post-closing.

(13) The portfolio company is currently being charged default interest rate of prime plus 10.5%.

See accompanying notes to consolidated financial statements.

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

**Note 1. Organization**

Capitala Finance Corp. (the “Company”, “we”, “us”, and “our”) is an externally managed non-diversified closed-end management investment company incorporated in Maryland that has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). The Company is an “emerging growth company” within the meaning of the Jumpstart Our Business Startups Act of 2012, and as such, is subject to reduced public company reporting requirements. The Company commenced operations on May 24, 2013 and completed its initial public offering (“IPO”) on September 30, 2013. The Company is managed by Capitala Investment Advisors, LLC (the “Investment Advisor”), an investment adviser that is registered as an investment adviser under the Investment Advisers Act of 1940, as amended, and Capitala Advisors Corp. (the “Administrator”) provides the administrative services necessary for the Company to operate. For U.S. federal income tax purposes, the Company has elected to be treated, and intends to comply with the requirements to continue to qualify annually, as a regulated investment company (“RIC”) under Subchapter M of the Internal Revenue Code of 1986, as amended (the “Code”).

The Company was formed for the purpose of: (i) acquiring, through a series of transactions, an investment portfolio from the following entities: CapitalSouth Partners Fund I Limited Partnership (“Fund I”); CapitalSouth Partners Fund II Limited Partnership (“Fund II”); CapitalSouth Partners Fund III, L.P. (“Fund III Parent”); CapitalSouth Partners SBIC Fund III, L.P. (“Fund III”) and CapitalSouth Partners Florida Sidecar Fund I, L.P. (“Florida Sidecar” and, collectively with Fund I, Fund II, Fund III and Fund III Parent, the “Legacy Funds”); (ii) raising capital in the IPO and (iii) continuing and expanding the business of the Legacy Funds by making additional debt and equity investments in lower middle-market and traditional middle-market companies.

The Company’s investment objective is to generate both current income and capital appreciation through debt and equity investments. Both directly and through our subsidiaries that are licensed by the U.S. Small Business Administration (“SBA”) under the Small Business Investment Company (“SBIC”) Act, the Company offers customized financing to business owners, management teams and financial sponsors for change of ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives. The Company invests in first lien, second lien, subordinated loans, and, to a lesser extent, equity securities issued by lower middle-market companies and traditional middle-market companies.

On September 24, 2013, the Company acquired 100% of the limited partnership interests in Fund II, Fund III and Florida Sidecar and each of their respective general partners, as well as certain assets from Fund I and Fund III Parent, in exchange for an aggregate of 8,974,420 shares of the Company’s common stock (the “Formation Transactions”). Fund II, Fund III and Florida Sidecar became the Company’s wholly owned subsidiaries. Fund II and Fund III retained their SBIC licenses, continued to hold their existing investments at the time of the IPO and have continued to make new investments. The IPO consisted of the sale of 4,000,000 shares of the Company’s common stock at a price of \$20.00 per share resulting in net proceeds to the Company of \$74.25 million, after deducting underwriting fees and commissions totaling \$4.0 million and offering expenses totaling \$1.75 million. The other costs of the IPO were borne by the limited partners of the Legacy Funds.

The Company has formed and expects to continue to form certain taxable subsidiaries (the “Taxable Subsidiaries”), which are taxed as corporations for income tax purposes. These Taxable Subsidiaries allow the Company to make equity investments in companies organized as pass-through entities while continuing to satisfy the requirements of a RIC under the Code.

**Note 2. Summary of Significant Accounting Policies**

**Basis of Presentation**

The Company is considered an investment company as defined in Accounting Standards Codification (“ASC”) Topic 946 – *Financial Services – Investment Companies* (“ASC 946”). The accompanying unaudited consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying our annual consolidated financial statements prepared in accordance with U.S. GAAP have been omitted. The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries, including Fund II, Fund III, Florida Sidecar, and the Taxable Subsidiaries.

The Company's financial statements as of September 30, 2017 are presented on a consolidated basis. The effects of all intercompany transactions between the Company and its subsidiaries (Fund II, Fund III, Florida Sidecar, and the Taxable Subsidiaries) have been eliminated in consolidation. All financial data and information included in these consolidated financial statements have been presented on the basis described above. In the opinion of management, the consolidated financial statements reflect all adjustments that are necessary for the fair presentation of financial results as of and for the periods presented.

The current period's results of operations are not necessarily indicative of results that ultimately may be achieved for the year. Additionally, the unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the U.S. Securities and Exchange Commission ("SEC") on March 7, 2017.

#### **Use of Estimates in the Preparation of Financial Statements**

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates under different assumptions and conditions. The most significant estimates in the preparation of the consolidated financial statements are investment valuation, revenue recognition, and income taxes.

#### **Consolidation**

As provided under Regulation S-X and ASC 946, the Company will generally not consolidate its investment in a company other than a substantially wholly owned investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. Accordingly, the Company consolidated the results of the Company's wholly owned investment company subsidiaries in its consolidated financial statements. The Company did not consolidate its interest in Capitala Senior Liquid Loan Fund I, LLC ("CSLLF") during the periods it was in existence because the investment was not considered a substantially wholly owned investment company subsidiary. Further, CSLLF was a joint venture for which shared power existed relating to the decisions that most significantly impacted the economic performance of the entity. See Note 4 to the consolidated financial statements for a description of the Company's investment in CSLLF.

#### **Segments**

In accordance with ASC Topic 280 — *Segment Reporting* ("ASC 280"), the Company has determined that it has a single reporting segment and operating unit structure. While the Company invests in several industries and geographic locations, all investments share similar business and economic risks. As such, all investment activities have been aggregated into a single segment.

#### **Cash and Cash Equivalents**

The Company considers cash equivalents to be highly liquid investments with original maturities of three months or less at the date of purchase. The Company deposits its cash in financial institutions and, at times, such balances may be in excess of the Federal Deposit Insurance Corporation insurance limits.

#### **Investment Classification**

In accordance with the provisions of the 1940 Act, the Company classifies its investments by level of control. As defined in the 1940 Act, "Control Investments" are investments in those companies that the Company is deemed to "Control." "Affiliate Investments" are investments in those companies that are "Affiliated Companies" of the Company, as defined in the 1940 Act, other than Control Investments. "Non-Control/Non-Affiliate Investments" are those investments that are neither Control Investments nor Affiliate Investments. Generally under the 1940 Act, the Company is deemed to control a company in which it has invested if the Company owns more than 25% of the voting securities of such company and/or has greater than 50% representation on its board or has the power to exercise control over management or policies of such portfolio company. The Company is deemed to be an affiliate of a company in which the Company has invested if it owns between 5% and 25% of the voting securities of such company.

#### **Valuation of Investments**

The Company applies fair value accounting to all of its financial instruments in accordance with the 1940 Act and ASC Topic 820 — *Fair Value Measurements and Disclosures* ("ASC 820"). ASC 820 defines fair value, establishes a framework used to measure fair value and requires disclosures for fair value measurements. In accordance with ASC 820, the Company has categorized its financial instruments carried at fair value, based on the priority of the valuation technique, into a three-level fair value hierarchy, as discussed in Note 4.

In determining fair value, the Company's board of directors (the "Board") uses various valuation approaches, and engages a third-party valuation firm, which provides an independent valuation of certain investments. In accordance with U.S. GAAP, a fair value hierarchy for inputs is used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available.

Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Board. Unobservable inputs reflect the Board's assumptions about the inputs market participants would use in pricing the asset or liability developed based upon the best information available in the circumstances.

The availability of valuation techniques and observable inputs can vary from security to security and is affected by a wide variety of factors including the type of security, whether the security is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Those estimated values do not necessarily represent the amounts that may be ultimately realized due to the occurrence of future circumstances that cannot be reasonably determined. Because of the inherent uncertainty of valuation, those estimated values may be materially higher or lower than the values that would have been used had a market for the securities existed. Accordingly, the degree of judgment exercised by the Board in determining fair value is greatest for securities categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement.

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. The Company uses prices and inputs that are current as of the measurement date, including periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many securities. This condition could cause a security to be reclassified to a lower level within the fair value hierarchy.

In estimating the fair value of portfolio investments, the Company starts with the cost basis of the investment, which includes original issue discount or premium and payment-in-kind ("PIK") income, if any. The transaction price is typically the best estimate of fair value at inception. When evidence supports a subsequent change to the carrying value from the original transaction price, adjustments are made to reflect the expected fair values.

As a practical expedient, the Company used the net asset value ("NAV") as the basis for the fair value of its investment in CSLLF for the periods held. CSLLF recorded its underlying investments at fair value on a daily basis utilizing pricing information from third-party sources.

The valuation methodologies summarized below are utilized by the Company in estimating fair value.

#### *Enterprise Value Waterfall Approach*

The enterprise value waterfall approach determines an enterprise value based on earnings before interest, tax, depreciation and amortization ("EBITDA") multiples of publicly traded companies that are considered similar to the subject portfolio company. The Company considers a variety of items in determining a reasonable pricing multiple, including, but not limited to, operating results, budgeted projections, growth, size, risk, profitability, leverage, management depth, diversification, market position, supplier or customer dependence, asset utilization, liquidity metrics, and access to capital markets. EBITDA of the portfolio company is adjusted for non-recurring items in order to reflect a normalized level of earnings that is representative of future earnings. In certain instances, the Company may also utilize revenue multiples to determine enterprise value. When available, the Company may assign a pricing multiple or value its equity investments based on the value of recent investment transactions in the subject portfolio company or offers to purchase the portfolio company. The enterprise value is adjusted for financial instruments with seniority to the Company's ownership and for the effect of any instrument which may dilute the Company's investment in the portfolio company. The adjusted enterprise value is then apportioned based on the seniority and privileges of the Company's investments within the portfolio company.

The enterprise value waterfall approach is primarily utilized to value the Company's equity securities, including warrants. However, the Company may utilize the enterprise value waterfall approach to value certain debt securities.

#### *Income Approach*

The income approach utilizes a discounted cash flow methodology in which the Company estimates fair value based on the present value of expected cash flows discounted at a market rate of interest. The determination of a discount rate, or required rate of return, takes into account the portfolio company's fundamentals and perceived credit risk. Because the majority of the Company's portfolio companies do not have a public credit rating, determining a discount rate often involves assigning an implied credit rating based on the portfolio company's operating metrics compared to average metrics of similar publicly rated debt. Operating metrics include, but are not limited to, EBITDA interest coverage, leverage ratios, return on capital, and debt to equity ratios. The implied credit rating is used to assign a base discount rate range based on publicly available yields on similarly rated debt securities. The Company may apply a premium to the discount rate utilized in determining fair value when performance metrics and other qualitative information indicate that there is an additional level of uncertainty about collectability of cash flows.



### *Asset Approach*

The asset approach values an investment based on the value of the underlying collateral securing the investment. This approach is used when the Company has reason to believe that it will not collect all principal and interest in accordance with the contractual terms of the debt agreement.

### **Revenue Recognition**

The Company's revenue recognition policies are as follows:

*Interest income and paid-in-kind interest income:* Interest income is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company has loans in the portfolio that contain a payment-in-kind interest ("PIK interest") provision. The PIK interest, which represents contractually deferred interest added to the loan balance that is generally due at maturity, is recorded on an accrual basis to the extent that such amounts are expected to be collected. PIK interest is not accrued if the Company does not expect the issuer to be able to pay all principal and interest when due.

*Non-accrual investments:* Generally, when interest and/or principal payments on a loan become 90 days or more past due, or when the Company otherwise does not expect the borrower to be able to service its debt and other obligations, the Company will place the loan on non-accrual status, and will generally cease recognizing interest income and PIK interest on that loan for financial reporting purposes. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. The Company writes off any previously accrued and uncollected interest when it is determined that interest is no longer considered collectible. The Company may elect to cease accruing PIK interest and continue accruing interest income in cases where a loan is currently paying its interest income but, in management's judgment, there is a reasonable likelihood of principal loss on the loan. Non-accrual loans are returned to accrual status when the borrower's financial condition improves such that management believes current interest and principal payments are expected to be collected.

*Gains and losses on investment sales and paydowns:* Realized gains and losses on investments are recognized using the specific identification method.

*Dividend income and paid-in-kind dividends:* Dividend income is recognized on the date dividends are declared. The Company holds preferred equity investments in the portfolio that contain a payment-in-kind dividend ("PIK dividends") provision. PIK dividends, which represent contractually deferred dividends added to the equity balance, are recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company will typically cease accrual of PIK dividends when the fair value of the equity investment is less than the cost basis of the investment or when it is otherwise determined by management that PIK dividends are unlikely to be collected. If management determines that a decline in fair value is temporary in nature and the PIK dividends are more likely than not to be collected, management may elect to continue accruing PIK dividends.

*Original issue discount:* Discounts received to par on loans purchased are capitalized and accreted into income over the life of the loan. Any remaining discount is accreted into income upon prepayment of the loan.

*Other income:* Origination fees, amendment fees, consent fees, and other fees associated with investments in portfolio companies are recognized as income when the investment transaction closes (to the extent services are performed to earn such income). Prepayment penalties received by the Company for debt instruments repaid prior to maturity date are recorded as income upon receipt.

### **Loan Sales**

The Company follows the guidance in ASC Topic 860 — *Transfers and Servicing* ("ASC 860") when accounting for loan participations and partial loan sales as it relates to concluding on sales accounting treatment for such transactions. Based on the Company's analysis of all loan participations and partial sales completed, the Company believes that all such transactions meet the criterion required by ASC 860 to qualify for sales accounting treatment.

### **General and Administrative Expenses**

General and administrative expenses are paid as incurred. The Company's administrative expenses include personnel and overhead expenses allocable to the Company paid by and reimbursed to the Administrator under an administration agreement between the Company and the Administrator (the "Administration Agreement"). Other operating expenses such as legal and audit fees, director fees, and director and officer insurance are generally paid directly by the Company.

## Deferred Financing Fees

Costs incurred to issue the Company's debt obligations are capitalized and are amortized over the term of the debt agreements under the effective interest method.

## Commitments and Contingencies

As of September 30, 2017, the Company had outstanding unfunded commitments related to debt investments in existing portfolio companies of \$4.0 million (CIS Secure Computing, Inc.), \$2.0 million (Portrait Innovations, Inc.), \$1.5 million (Kelle's Transport Service, LLC), and \$1.0 million (US Well Services, LLC). As of December 31, 2016, the Company had outstanding unfunded commitments related to debt investments in an existing portfolio company of \$1.2 million (On-Site Fuel Services, Inc.).

In addition to unfunded commitments related to debt investments, the Company also has extended a guaranty on behalf of one of our portfolio companies, whereby we have guaranteed \$1.5 million of obligations of Kelle's Transport Service, LLC. As of September 30, 2017 we have not been required to make payments on this or any previous guaranties, and we consider the credit risks to be remote and the fair value of this guaranty to be immaterial.

In the ordinary course of business, the Company may enter into contracts or agreements that contain indemnifications or warranties. Future events could occur that could lead to the execution of these provisions against the Company. Based on its history and experience, management believes that the likelihood of such an event is remote.

In the ordinary course of business, the Company may directly or indirectly be a defendant or plaintiff in legal actions with respect to bankruptcy, insolvency or other types of proceedings. Such lawsuits may involve claims that could adversely affect the value of certain financial instruments owned by the Company or result in direct losses to the Company. In management's opinion, no direct losses with respect to litigation contingencies were probable as of September 30, 2017 and December 31, 2016. Management is of the opinion that the ultimate resolution of such claims, if any, will not materially affect the Company's business, financial position, results of operations or liquidity. Furthermore, in management's opinion, it is not possible to estimate a range of reasonably possible losses with respect to other litigation contingencies.

## Income Taxes

The Company has elected to be treated for U.S. federal income tax purposes, and intends to comply with the requirements to qualify annually thereafter, as a RIC under Subchapter M of the Code and, among other things, intends to make the requisite distributions to its stockholders which will relieve the Company from U.S. federal income taxes. Therefore, no provision has been recorded for U.S. federal income taxes.

In order to qualify as a RIC, among other requirements, the Company is required to timely distribute to its stockholders at least 90.0% of its investment company taxable income, as defined by the Code, for each fiscal tax year. The Company will be subject to a nondeductible U.S. federal excise tax of 4.0% on undistributed income if it does not distribute at least 98.0% of its ordinary income in any calendar year and 98.2% of its capital gain net income for each one-year period ending on October 31.

Depending on the level of taxable income earned in an excise tax year, the Company may choose to carry forward taxable income in excess of current year dividend distributions into the next excise tax year and pay a 4.0% excise tax on such income, as required. To the extent that the Company determines that its estimated current year annual taxable income will be in excess of estimated current year dividend distributions for excise tax purposes, the Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned. Since the Company's IPO, the Company has not accrued or paid excise tax.

The Company's Taxable Subsidiaries accrue income taxes payable based on the applicable statutory rates on the unrealized appreciation of the underlying investments held by the Taxable Subsidiaries. As of September 30, 2017, and December 31, 2016, the Company recorded a deferred tax liability of \$2.7 million and \$0.0 million, respectively. For the three and nine months ended September 30, 2017, the Company recorded a change in provision for deferred taxes on unrealized appreciation on investments of \$2.7 million. For the three and nine months ended September 30, 2016, no change in provision for deferred taxes on unrealized appreciation on investments was recorded.

In accordance with certain applicable U.S. Treasury regulations and private letter rulings issued by the Internal Revenue Service, a RIC may treat a distribution of its own stock as fulfilling its RIC distribution requirements if each stockholder may elect to receive its entire distribution in either cash or stock of the RIC, subject to a limitation on the aggregate amount of cash to be distributed to all stockholders, which limitation must be at least 20.0% of the aggregate declared distribution. If too many stockholders elect to receive cash, each stockholder electing to receive cash will receive a pro rata amount of cash (with the balance of the distribution paid in stock). In no event will any stockholder, electing to receive cash, receive less than 20.0% of its entire distribution in cash. If these and certain other requirements are met, for U.S. federal income tax purposes, the amount of the dividend paid in stock will be equal to the amount of cash that could have been received instead of stock.

ASC Topic 740 — *Income Taxes* (“ASC 740”), provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company’s tax returns to determine whether the tax positions are “more-likely-than-not” to be sustained by the applicable tax authority. Tax positions deemed to meet a “more-likely-than-not” threshold would be recorded as a tax benefit or expense in the current period. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits as income tax expense in the consolidated statements of operations. As of September 30, 2017 and December 31, 2016, there were no uncertain tax positions.

The Company is required to determine whether a tax position of the Company is more likely-than-not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. De-recognition of a tax benefit previously recognized could result in the Company recording a tax liability that could negatively impact the Company’s net assets.

U.S. GAAP provides guidance on thresholds, measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition that is intended to provide better financial statement comparability among different entities.

The Company’s activities since commencement of operations remain subject to examination by U.S. federal, state, and local tax authorities. No interest expense or penalties have been assessed for the three and nine months ended September 30, 2017 and September 30, 2016. If the Company was required to recognize interest and penalties, if any, related to unrecognized tax benefits this would be recognized as income tax expense in the consolidated statements of operations.

### **Distributions**

Distributions to common stockholders are recorded as payable on the declaration date. The amount to be paid out as a dividend is determined by the Board. Net capital gains, if any, are generally distributed at least annually, although we may decide to retain such capital gains for reinvestment.

The Company has adopted an “opt out” dividend reinvestment plan (“DRIP”) for common stockholders. As a result, if the Company declares a cash dividend or other distribution, each stockholder that has not “opted out” of the DRIP will have its dividends automatically reinvested in additional shares of the Company’s common stock rather than receiving cash dividends. Stockholders who receive distributions in the form of shares of common stock will be subject to the same federal, state and local tax consequences as if they received cash distributions.

### **Company Investment Risk, Concentration of Credit Risk, and Liquidity Risk**

The Investment Advisor has broad discretion in making investments for the Company. Investments will generally consist of debt and equity instruments that may be affected by business, financial market or legal uncertainties. Prices of investments may be volatile, and a variety of factors that are inherently difficult to predict, such as domestic or international economic and political developments, may significantly affect the results of the Company’s activities and the value of its investments. In addition, the value of the Company’s portfolio may fluctuate as the general level of interest rates fluctuate.

The value of the Company’s investments may be detrimentally affected to the extent, among other things, that a borrower defaults on its obligations, there is insufficient collateral and/or there are extensive legal and other costs incurred in collecting on a defaulted loan, observable secondary or primary market yields for similar instruments issued by comparable companies increase materially or risk premiums required in the market between smaller companies, such as our borrowers, and those for which market yields are observable, increase materially.

The Investment Advisor may attempt to minimize this risk by maintaining low debt-to-liquidation values with each debt investment and the collateral underlying the debt investment.

The Company’s assets may, at any time, include securities and other financial instruments or obligations that are illiquid or thinly traded, making purchase or sale of such securities and financial instruments at desired prices or in desired quantities difficult. Furthermore, the sale of any such investments may be possible only at substantial discounts, and it may be extremely difficult to value any such investments accurately.

### Note 3. Recent Accounting Pronouncements

In January 2016, FASB issued ASU 2016-01, *Financial Instruments — Overall* (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). ASU 2016-01 retains many current requirements for the classification and measurement of financial instruments; however, it significantly revises an entity’s accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. ASU 2016-01 also amends certain disclosure requirements associated with the fair value of financial instruments. This guidance is effective for annual and interim periods beginning after December 15, 2017, and early adoption is not permitted for public business entities. Management is currently evaluating the impact these changes will have on the Company’s consolidated financial position or results of operations.

In October 2016, the SEC adopted new rules and amended existing rules (together, “final rules”) intended to modernize the reporting and disclosure of information by registered investment companies. In part, the final rules amend Regulation S-X and require standardized, enhanced disclosures about derivatives in investment company financial statements, as well as other amendments. The compliance date for the amendments to Regulation S-X is August 1, 2017. Management has adopted the amendments to Regulation S-X and included required disclosures in the Company’s consolidated financial statements and related disclosures.

### Note 4. Investments and Fair Value Measurements

The Company’s investment objective is to generate both current income and capital appreciation through debt and equity investments. Both directly and through the Company’s subsidiaries that are licensed by the SBA under the SBIC Act, the Company offers customized financing to business owners, management teams and financial sponsors for change of ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives. The Company invests in first lien, second lien, and subordinated loans. Most of the Company’s debt investments are coupled with equity interests, whether in the form of detachable “penny” warrants or equity co-investments made pari-passu with our borrowers’ financial sponsors. As of September 30, 2017, our portfolio consisted of investments in 46 portfolio companies with a fair value of approximately \$471.1 million.

Most of the Company’s debt investments are structured as first lien loans. First lien loans may contain some minimum amount of principal amortization, excess cash flow sweep feature, prepayment penalties, or any combination of the foregoing. First lien loans are secured by a first priority lien in existing and future assets of the borrower and may take the form of term loans or delayed draw facilities. In some cases, first lien loans may be subordinated, solely with respect to the payment of cash interest, to an asset based revolving credit facility.

The Company also invests in debt instruments structured as second lien loans. Second lien loans are loans which have a second priority security interest in all or substantially all of the borrower’s assets, and which are not subject to the blockage of cash interest payments to the Company at the first lien lender’s discretion.

In addition to first and second lien loans, the Company may also invest in subordinated loans. Subordinated loans typically have a second lien on all or substantially all of the borrower’s assets, and unlike second lien loans, may be subject to the interruption of cash interest payments upon certain events of default, at the discretion of the first lien lender.

During the three months ended September 30, 2017, the Company made approximately \$11.4 million of investments and had approximately \$22.4 million in repayments and sales resulting in net repayments and sales of approximately \$11.0 million for the period. During the three months ended September 30, 2016, the Company made approximately \$26.0 million of investments and had approximately \$111.9 million in repayments and sales of investments resulting in net repayments and sales of approximately \$85.9 million for the period.

During the nine months ended September 30, 2017, the Company made approximately \$39.7 million of investments and had approximately \$104.7 million in repayments and sales resulting in net repayments and sales of approximately \$65.0 million for the period. During the nine months ended September 30, 2016, the Company made approximately \$53.9 million of investments and had approximately \$128.6 million in repayments and sales of investments resulting in net repayments and sales of approximately \$74.7 million for the period.

During the three and nine months ended September 30, 2017, the Company funded \$0.4 million and \$0.7 million, respectively, of previously committed capital to existing portfolio companies. During the three and nine months ended September 30, 2017, the Company funded \$11.0 million and \$21.7 million, respectively, of investments in portfolio companies for which it was not previously committed to fund. During the three and nine months ended September 30, 2016, the Company funded \$0.0 million and \$2.8 million, respectively, of previously committed capital to existing portfolio companies. During the three and nine months ended September 30, 2016, the Company funded \$26.0 million and \$51.1 million, respectively, of investments in portfolio companies for which it was not previously committed to fund. In addition to investing directly in portfolio companies, the Company may assist portfolio companies in securing financing from other sources by introducing portfolio companies to sponsors or by leading a syndicate of investors to provide the portfolio companies with financing. During the three and nine months ended September 30, 2017 and September 30, 2016, the Company did not lead any syndicates and did not assist any portfolio companies in obtaining indirect financing.

On August 31, 2016, the Company sold a portion of 14 securities across 10 portfolio companies to CapitalSouth Partners Florida Sidecar Fund II, L.P. (“FSC II”), including granting an option to acquire a portion of the Company’s equity investment in Eastport Holdings, LLC (the “Written Call Option”), in exchange for 100% of the partnership interests in FSC II. Concurrent with the sale of these assets to FSC II, the Company received cash consideration of \$47.6 million from an affiliated third-party purchaser in exchange for 100% of the partnership interests of FSC II. These assets were sold to FSC II at their June 30, 2016 fair market values, resulting in a net realized gain of \$0.1 million. The Company’s Board pre-approved this transaction pursuant to Section 57(f) of the 1940 Act.

The Company collected and will periodically collect principal and interest payments related to certain of the securities purchased by FSC II. Such principal and interest payments will be remitted timely to FSC II based on its proportionate share of the security. FSC II does not have any recourse to the Company related to the non-payment of principal or interest by the underlying issuers of the securities.

The Written Call Option granted FSC II the right to purchase up to 31.25% of the Company’s equity investment in Eastport Holdings, LLC. The Written Call Option has a strike price of \$1.5 million and a termination date of August 31, 2018. The fair value of the Written Call Option, which has been treated as a derivative liability and is recorded in the financial statement line item Written Call Option at fair value in the Company’s consolidated statements of assets and liabilities, was approximately \$5.6 million as of September 30, 2017. For purposes of determining the fair value of the Written Call Option, the Company calculated the difference in the fair value of the underlying equity investment in Eastport Holdings, LLC and the strike price of the Written Call Option, or intrinsic value. The time value of the Written Call Option as of September 30, 2017 was determined to be insignificant. The Written Call Option is classified as a Level 3 financial instrument.

The composition of our investments as of September 30, 2017, at amortized cost and fair value was as follows (dollars in thousands):

	<b>Investments at Amortized Cost</b>	<b>Amortized Cost Percentage of Total Portfolio</b>	<b>Investments at Fair Value</b>	<b>Fair Value Percentage of Total Portfolio</b>
First Lien Debt	\$ 246,188	54.2%	\$ 221,205	47.0%
Second Lien Debt	32,284	7.1	30,774	6.5
Subordinated Debt	120,161	26.4	106,019	22.5
Equity and Warrants	56,081	12.3	113,108	24.0
<b>Total</b>	<b>\$ 454,714</b>	<b>100.0%</b>	<b>\$ 471,106</b>	<b>100.0%</b>

The composition of our investments as of December 31, 2016, at amortized cost and fair value was as follows (dollars in thousands):

	<b>Investments at Amortized Cost</b>	<b>Amortized Cost Percentage of Total Portfolio</b>	<b>Investments at Fair Value</b>	<b>Fair Value Percentage of Total Portfolio</b>
First Lien Debt	\$ 244,647	47.6%	\$ 226,578	41.8%
Second Lien Debt	74,559	14.5	71,483	13.2
Subordinated Debt	148,849	29.0	150,232	27.8
Equity and Warrants	45,721	8.9	93,346	17.2
<b>Total</b>	<b>\$ 513,776</b>	<b>100.0%</b>	<b>\$ 541,639</b>	<b>100.0%</b>

As noted above, the Company values all investments in accordance with ASC 820. ASC 820 requires enhanced disclosures about assets and liabilities that are measured and reported at fair value. As defined in ASC 820, fair value is 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.

ASC 820 establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability of inputs used in measuring investments at fair value. Market price observability is affected by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Based on the observability of the inputs used in the valuation techniques, the Company is required to provide disclosures on fair value measurements according to the fair value hierarchy. The fair value hierarchy ranks the observability of the inputs used to determine fair values. Investments carried at fair value are classified and disclosed in one of the following three categories:

- Level 1 — Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.
- Level 2 — Valuations based on inputs other than quoted prices in active markets, which are either directly or indirectly observable.
- Level 3 — Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

In addition to using the above inputs in investment valuations, the Company continues to employ the valuation policy approved by the Board that is consistent with ASC 820 (see Note 2). Consistent with the Company's valuation policy, the Company evaluates the source of inputs, including any markets in which its investments are trading, in determining fair value.

In estimating fair value of portfolio investments, the Company starts with the cost basis of the investment, which includes amortized original issue discount and PIK income, if any. The transaction price is typically the best estimate of fair value at inception. When evidence supports a subsequent change to the carrying value from the original transaction price, adjustments are made to reflect the expected fair values.

The following table presents the fair value measurements of investments, by major class, as of September 30, 2017 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
First Lien Debt	\$ —	\$ —	\$ 221,205	\$ 221,205
Second Lien Debt	—	—	30,774	30,774
Subordinated Debt	—	—	106,019	106,019
Equity and Warrants	—	—	113,108	113,108
Total	\$ —	\$ —	\$ 471,106	\$ 471,106

The following table presents fair value measurements of the Written Call Option as of September 30, 2017 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Written Call Option	\$ —	\$ —	\$ (5,555)	\$ (5,555)
Total	\$ —	\$ —	\$ (5,555)	\$ (5,555)

The following table presents fair value measurements of investments, by major class, as of December 31, 2016 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
First Lien Debt	\$ —	\$ —	\$ 226,578	\$ 226,578
Second Lien Debt	—	—	71,483	71,483
Subordinated Debt	—	—	150,232	150,232
Equity and Warrants	—	—	93,346	93,346
Total	\$ —	\$ —	\$ 541,639	\$ 541,639

The following table presents fair value measurements of the Written Call Option as of December 31, 2016 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Written Call Option	\$ —	\$ —	\$ (2,736)	\$ (2,736)
Total	\$ —	\$ —	\$ (2,736)	\$ (2,736)

The following table provides a reconciliation of the beginning and ending balances for investments that use Level 3 inputs for the nine months ended September 30, 2017 (dollars in thousands):

	<b>First Lien Debt</b>	<b>Second Lien Debt</b>	<b>Subordinated Debt</b>	<b>Equity and Warrants</b>	<b>Total</b>
Balance as of January 1, 2017	\$ 226,578	\$ 71,483	\$ 150,232	\$ 93,346	\$ 541,639
Reclassifications	(4,659)	—	(9,000)	13,659	—
Repayments/sales	(21,798)	(45,804)	(22,092)	(15,015)	(104,709)
Purchases	31,308	4,000	1,182	3,200	39,690
Payment in-kind interest and dividends accrued	3,609	688	651	690	5,638
Accretion of original issue discount	199	299	570	—	1,068
Realized gain (loss) from investments	(7,119)	(1,456)	—	7,826	(749)
Net unrealized appreciation (depreciation) on investments	(6,913)	1,564	(15,524)	9,402	(11,471)
Balance as of September 30, 2017	<u>\$ 221,205</u>	<u>\$ 30,774</u>	<u>\$ 106,019</u>	<u>\$ 113,108</u>	<u>\$ 471,106</u>

The following table provides a reconciliation of the beginning and ending balances for the Written Call Option that use Level 3 inputs for the nine months ended September 30, 2017 (dollars in thousands):

	<b>Written Call Option</b>
Balance as of January 1, 2017	\$ (2,736)
Net unrealized depreciation on Written Call Option	(2,819)
Balance as of September 30, 2017	<u>\$ (5,555)</u>

The following table provides a reconciliation of the beginning and ending balances for investments that use Level 3 inputs for the nine months ended September 30, 2016 (dollars in thousands):

	<b>First Lien Debt</b>	<b>Second Lien Debt</b>	<b>Subordinated Debt</b>	<b>Equity and Warrants</b>	<b>Total <sup>(1)</sup></b>
Balance as of January 1, 2016	\$ 199,843	\$ 80,610	\$ 194,485	\$ 98,480	\$ 573,418
Repayments/sales	(25,149)	(12,750)	(67,899)	(21,734)	(127,532)
Purchases	24,489	4,850	19,474	5,136	53,949
Payment in-kind interest and dividends accrued	2,608	—	429	929	3,966
Accretion of original issue discount	170	134	2,031	—	2,335
Realized gain (loss) from investments	(5,024)	(168)	(26,783)	6,404	(25,571)
Net unrealized appreciation (depreciation) on investments	(3,709)	(560)	13,808	(6,679)	2,860
Balance as of September 30, 2016	<u>\$ 193,228</u>	<u>\$ 72,116</u>	<u>\$ 135,545</u>	<u>\$ 82,536</u>	<u>\$ 483,425</u>

(1) Excludes our \$20.4 million investment in CSLLF, measured at NAV.

The following table provides a reconciliation of the beginning and ending balances for the Written Call Option that use Level 3 inputs for the nine months ended September 30, 2016 (dollars in thousands):

	<b>Written Call Option</b>
Balance as of January 1, 2016	\$ —
Net unrealized depreciation on Written Call Option	(898)
Proceeds from Written Call Option	(20)
Balance as of September 30, 2016	<u>\$ (918)</u>

The net change in unrealized depreciation on investments held as of September 30, 2017 and September 30, 2016, was \$(14.0) million and \$(1.7) million, respectively, and is included in net unrealized appreciation (depreciation) on investments in the consolidated statements of operations.

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements of assets and (liabilities) as of September 30, 2017 were as follows:

	<b>Fair Value (in millions)</b>	<b>Valuation Approach</b>	<b>Unobservable Input</b>	<b>Range (Weighted Average)</b>
First lien debt	\$ 184.8	Income	Required Rate of Return Leverage Ratio Adjusted EBITDA	10.7% - 23.0% (13.8%) 1.3x - 7.0x (3.4x) \$1.7 million - \$128.1 million (\$23.2 million)
First lien debt	\$ 36.4	Enterprise Value Waterfall and Asset <sup>(1)</sup>	EBITDA Multiple Adjusted EBITDA Revenue Multiple Revenue	5.8x - 5.8x (5.8x) \$2.5 million - \$4.0 million (\$3.0 million) 0.2x - 0.2x (0.2x) \$56.2 million - \$56.2 million (\$56.2 million)
Second lien debt	\$ 15.4	Income	Required Rate of Return Leverage Ratio Adjusted EBITDA	11.3% - 17.5% (15.5%) 4.8x - 4.9x (4.9x) \$72.0 million - \$79.5 million (\$77.1 million)
Second lien debt	\$ 15.4	Enterprise Value Waterfall	EBITDA Multiple Adjusted EBITDA	6.5x - 6.5x (6.5x) \$7.7 million - \$7.7 million (\$7.7 million)
Subordinated debt	\$ 62.0	Income	Required Rate of Return Leverage Ratio Adjusted EBITDA	11.5% - 20.3% (14.4%) 3.2x - 7.1x (5.1x) 3.2 million - \$15.1 million (\$10.1 million)
Subordinated debt	\$ 44.0	Enterprise Value Waterfall and Asset <sup>(1)</sup>	EBITDA Multiple Adjusted EBITDA Revenue Multiple Revenue	6.0x - 7.3x (6.7x) \$1.7 million - \$26.1 million (\$17.7 million) 0.2x - 0.2x (0.2x) \$140.5 million - \$140.5 million (\$140.5 million)
Equity and warrants	\$ 113.1	Enterprise Value Waterfall	EBITDA Multiple Adjusted EBITDA	5.0x - 14.2x (7.8x) \$0.9 million - \$78.7 million (\$21.8 million)
Written Call Option	\$ (5.6)	Enterprise Value Waterfall	EBITDA Multiple Adjusted EBITDA	7.3x - 7.3x (7.3x) \$26.1 million - \$26.1 million (\$26.1 million)

(1) \$1.0 million in subordinated debt and \$6.7 million in first lien debt were valued using the asset approach.

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements of assets and (liabilities) as of December 31, 2016 were as follows:

	<b>Fair Value (in millions)</b>	<b>Valuation Approach</b>	<b>Unobservable Input</b>	<b>Range (Weighted Average)</b>
First lien debt	\$ 173.3	Income	Required Rate of Return Leverage Ratio Adjusted EBITDA	9.5% - 18.0% (14.2%) 2.0x - 6.4x (4.1x) \$1.8 million - \$166.0 million (\$24.1 million)
First lien debt	\$ 53.3	Enterprise Value Waterfall and Asset <sup>(1)</sup>	EBITDA Multiple Adjusted EBITDA Revenue Multiple Revenue	4.5x - 9.0x (6.3x) \$2.5 million - \$34.3 million (\$13.1 million) 0.3x - 0.3x (0.3x) \$88.1 million - \$88.1 million (\$88.1 million)
Second lien debt	\$ 71.5	Income	Required Rate of Return Leverage Ratio Adjusted EBITDA	10.0% - 17.3% (13.3%) 0.0x - 7.5x (5.0x) \$8.1 million - \$166.0 million (\$76.5 million)
Subordinated debt	\$ 114.6	Income	Required Rate of Return Leverage Ratio Adjusted EBITDA	11.5% - 20.0% (13.6%) 1.5x - 6.7x (4.1x) 2.0 million - \$63.7 million (\$21.4 million)
Subordinated debt	\$ 35.6	Enterprise Value Waterfall and Asset <sup>(1)</sup>	EBITDA Multiple Adjusted EBITDA	5.0x - 8.7x (6.3x) \$1.8 million - \$27.6 million (\$15.7 million)
Equity and warrants	\$ 93.3	Enterprise Value Waterfall	EBITDA Multiple Adjusted EBITDA	4.5x - 12.2x (7.6%) \$1.8 million - \$63.7 million (\$17.5 million)
Written Call Option	\$ (2.7)	Enterprise Value Waterfall	EBITDA Multiple Adjusted EBITDA	6.25x - 6.25x (6.25x) \$27.6 million - \$27.6 million (\$27.6 million)

(1) \$2.5 million in subordinated debt and \$2.6 million in first lien debt were valued using the asset approach



The significant unobservable inputs used in the valuation of the Company's investments are required rate of return, adjusted EBITDA, EBITDA multiples, revenue multiples, and leverage ratios. Changes in any of these unobservable inputs could have a significant impact on the Company's estimate of fair value. An increase (decrease) in the required rate of return or leverage will result in a lower (higher) estimate of fair value while an increase (decrease) in adjusted EBITDA, EBITDA multiples, revenue, or revenue multiples will result in a higher (lower) estimate of fair value.

#### *Capitala Senior Liquid Loan Fund I, LLC*

On March 24, 2015, the Company and Trinity Universal Insurance Company ("Trinity"), a subsidiary of Kemper Corporation, entered into a limited liability company agreement to co-manage CSLLF. The purpose and design of the joint venture was to invest primarily in broadly syndicated senior secured loans to middle-market companies, which were purchased on the secondary market. Capitala and Trinity committed to provide \$25.0 million of equity to CSLLF, with Capitala providing \$20.0 million and Trinity providing \$5.0 million, resulting in an 80%/20% economic ownership between the two parties. The board of directors and investment committee of CSLLF were split 50/50 between Trinity and Capitala, resulting in equal voting power between the two entities. In September 2016, the Company and Trinity elected to wind-down operations of CSLLF. During the fourth quarter of 2016, CSLLF sold all referenced assets underlying the total return swap ("TRS") and declared final distributions, inclusive of dividends and return of capital.

Because the TRS was wound down in a prior period, only comparative period disclosures are included herein. For the three and nine months ended September 30, 2016, the Company received \$0.5 million and \$1.6 million, respectively, in dividend income from its equity interest in CSLLF.

On March 27, 2015, CSLLF entered into a TRS with Bank of America, N.A. ("Bank of America") that was indexed to a basket of senior secured loans purchased by CSLLF. CSLLF obtained the economic benefit of the loans underlying the TRS, including the net interest spread between the interest income generated by the underlying loans and the interest expense type payment under the TRS, the realized gain (loss) on liquidated loans, and the unrealized appreciation (depreciation) on the underlying loans.

The terms of the TRS were governed by an ISDA 2002 Master Agreement, the Schedule thereto, and Credit Support Annex to such Schedule, and the confirmation exchanged thereunder, between CSLLF and Bank of America, which collectively established the TRS, and are collectively referred to herein as the "TRS Agreement." Pursuant to the terms of the TRS Agreement, CSLLF selected a portfolio of loans with a maximum market value (determined at the time each such loan becomes subject to the TRS) of \$100.0 million, which was also referred to as the maximum notional amount of the TRS. Each individual loan, and the portfolio of loans taken as a whole, had to meet criteria described in the TRS Agreement. CSLLF received from Bank of America a periodic payment on set dates that was based upon any coupons, both earned and accrued, generated by the loans underlying the TRS, subject to limitations described in the TRS Agreement as well as any fees associated with the loans included in the portfolio. CSLLF paid to Bank of America interest at a rate equal to the London Interbank Offered Rate ("LIBOR") plus 1.25% per annum; the LIBOR option paid by CSLLF was determined on an asset by asset basis such that the tenor of the LIBOR option (1 month, 3 month, etc.) matched the tenor of the underlying reference asset. In addition, upon the termination of any loan subject to the TRS or any repayment of the underlying reference asset, CSLLF either received from Bank of America the appreciation in the value of such loan, or paid to Bank of America any depreciation in the value of such loan.

CSLLF was required to pay an unused facility fee of 1.25% on any amount of unused facility under the minimum facility amount of \$70.0 million as outlined in the TRS Agreement. Such unused facility fees were not applied during the first 4 months and last 60 days of the term of the TRS. CSLLF also agreed to pay Bank of America customary fees and expenses in connection with the establishment and maintenance of the TRS.

CSLLF was required to initially cash collateralize a specified percentage of each loan (generally 20% to 35% of the market value of senior secured loans) included under the TRS in accordance with margin requirements described in the TRS Agreement. As of December 31, 2016, CSLLF had posted \$0.0 million in collateral to Bank of America in relation to the TRS, which was recorded on CSLLF's statements of assets and liabilities as cash held as collateral on total return swap. The cash collateral represented CSLLF's maximum credit exposure as of December 31, 2016.

In connection with the TRS, CSLLF made customary representations and warranties and was required to comply with various covenants, reporting requirements and other customary requirements for similar transactions governed by an ISDA 2002 Master Agreement.

CSLLF's receivable due on the TRS represents realized amounts from payments on underlying loans in the total return swap portfolio. At December 31, 2016, the receivable due on TRS was \$0.1 million and is recorded on CSLLF's statement of assets and liabilities below. CSLLF does not offset collateral posted in relation to the TRS with any unrealized appreciation or depreciation outstanding in the statement of assets and liabilities as of December 31, 2016.

Transactions in TRS contracts during the three and nine months ended September 30, 2016 resulted in \$1.4 million and \$2.8 million, respectively, in realized gains and \$0.8 million and \$2.4 million, respectively, in unrealized appreciation, which was recorded on CSLLF's statements of operations below.

The following represents the volume of the CSLLF's derivative transactions during the three and nine months ended September 30, 2016 (dollars in thousands):

	<b>For the Three Months Ended September 30, 2016</b>	<b>For the Nine Months Ended September 30, 2016</b>
Average notional par amount of contract	\$ 68,935	\$ 74,674

Below is certain summarized financial information for CSLLF as of December 31, 2016 and for the three and nine months ended September 30, 2016 (dollars in thousands):

**Selected Statements of Assets and Liabilities:**

	<b>As of December 31, 2016</b>
<b>ASSETS</b>	
Receivable due on Total Return Swap	\$ 82
Total assets	<u>\$ 82</u>
<b>LIABILITIES</b>	
Distribution payable	\$ 82
Total liabilities	<u>\$ 82</u>
<b>NET ASSETS</b>	
Total net assets	\$ —
Total liabilities and net assets	<u>\$ 82</u>

**Selected Statements of Operations (unaudited):**

	<b>For the Three Months Ended September 30, 2016</b>	<b>For the Nine Months Ended September 30, 2016</b>
Administrative and legal expenses	\$ (15)	\$ (131)
Net operating loss	<u>\$ (15)</u>	<u>\$ (131)</u>
Net realized gain on Total Return Swap	\$ 1,374	\$ 2,810
Net unrealized appreciation on Total Return Swap	775	2,380
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	<u>\$ 2,134</u>	<u>\$ 5,059</u>

## Note 5. Agreements

On September 24, 2013, the Company entered into an investment advisory agreement (the “Investment Advisory Agreement”) with our Investment Advisor, which was initially approved by the Board on June 10, 2013. Unless earlier terminated in accordance with its terms, the Investment Advisory Agreement will remain in effect if approved annually by the Board or by a majority of our outstanding voting securities, including, in either case, by a majority of our non-interested directors. The Investment Advisory Agreement was most recently re-approved by the Board, including by a majority of our non-interested directors, at an in-person meeting on August 3, 2017. Subject to the overall supervision of the Board, the Investment Advisor manages our day-to-day operations, and provides investment advisory and management services to us. Under the terms of the Investment Advisory Agreement, the Investment Advisor:

- determines the composition of our portfolio, the nature and timing of the changes to our portfolio and the manner of implementing such changes;
- identifies, evaluates and negotiates the structure of the investments we make (including performing due diligence on our prospective portfolio companies);
- closes and monitors the investments we make; and
- provides us with other investment advisory, research and related services as we may from time to time require.

The Investment Advisor’s services under the Investment Advisory Agreement are not exclusive, and it is free to furnish similar services to other entities so long as its services to us are not impaired.

The Investment Advisory Agreement provides that, absent willful misfeasance, bad faith or negligence in the performance of its duties or by reason of the reckless disregard of its duties and obligations, the Investment Advisor and its officers, managers, partners, agents, employees, controlling persons, members and any other person or entity affiliated with it are entitled to indemnification from the Company, for any damages, liabilities, costs and expenses (including reasonable attorneys’ fees and amounts reasonably paid in settlement) arising from the rendering of our Investment Advisor’s services under the Investment Advisory Agreement or otherwise as Investment Advisor for the Company.

Pursuant to the Investment Advisory Agreement, the Company has agreed to pay the Investment Advisor a fee for investment advisory and management services consisting of two components — a base management fee and an incentive fee.

The base management fee is calculated at an annual rate of 1.75% of the gross assets, which are the total assets reflected on the consolidated statements of assets and liabilities and includes any borrowings for investment purposes. Although the Company does not anticipate making significant investments in derivative financial instruments, the fair value of any such investments, which will not necessarily equal their notional value, will be included in the calculation of gross assets. For services rendered under the Investment Advisory Agreement, the base management fee is payable quarterly in arrears. The base management fee was initially calculated based on the value of the gross assets at the end of the first calendar quarter subsequent to the IPO, and thereafter based on the average value of the gross assets at the end of the two most recently completed calendar quarters, and appropriately adjusted for any share issuances or repurchases during the current calendar quarter.

The incentive fee consists of the following two parts:

The first part of the incentive fee is calculated and payable quarterly in arrears based on the pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees or other fees that we receive from portfolio companies) accrued during the calendar quarter, minus our operating expenses for the quarter (including the base management fee, expenses payable under the Administration Agreement to our Administrator, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with PIK interest and zero coupon securities), accrued income that we have not yet received in cash. Pre-incentive fee net investment income does not include any realized capital gains, computed net of all realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a hurdle of 2.0% per quarter (8.0% annualized). The net investment income used to calculate this part of the incentive fee is also included in the amount of the gross assets used to calculate the 1.75% base management fee. The Company pays the Investment Advisor an incentive fee with respect to the pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which the pre-incentive fee net investment income does not exceed the hurdle of 2.0%;

- 100% of the pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle but is less than 2.5% in any calendar quarter (10.0% annualized). The Company refers to this portion of the pre-incentive fee net investment income (which exceeds the hurdle but is less than 2.5%) as the “catch-up.” The “catch-up” is meant to provide the Investment Advisor with 20% of the pre-incentive fee net investment income as if a hurdle did not apply if this net investment income exceeds 2.5% in any calendar quarter; and
- 20% of the amount of the pre-incentive fee net investment income, if any, that exceeds 2.5% in any calendar quarter (10.0% annualized) is payable to the Investment Advisor (once the hurdle is reached and the catch-up is achieved, 20% of all pre-incentive fee investment income thereafter is allocated to the Investment Advisor).

As announced on January 4, 2016, the Investment Advisor has voluntarily agreed to waive all or such portion of the quarterly incentive fees earned by the Investment Advisor that would otherwise cause the Company’s quarterly net investment income to be less than the distribution payments declared by the Board. Quarterly incentive fees are earned by the Investment Advisor pursuant to the Investment Advisory Agreement. Incentive fees subject to the waiver cannot exceed the amount of incentive fees earned during the period, as calculated on a quarterly basis. The Investment Advisor will not be entitled to recoup any amount of incentive fees that it waives. The waiver was effective in the fourth quarter of 2015 and will continue unless otherwise publicly disclosed by the Company.

The second part of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory Agreement, as of the termination date), and will equal 20% of our realized capital gains, if any, on a cumulative basis from inception through the end of each calendar year, computed net of all realized capital losses and unrealized capital depreciation on a cumulative basis, less the aggregate amount of any previously paid capital gain incentive fees with respect to each of the investments in our portfolio.

The Company will defer cash payment of the portion of any incentive fee otherwise earned by the Investment Advisor that would, when taken together with all other incentive fees paid to the Investment Advisor during the most recent 12 full calendar month period ending on or prior to the date such payment is to be made, exceed 20% of the sum of (a) the pre-incentive fee net investment income during such period, (b) the net unrealized appreciation or depreciation during such period and (c) the net realized capital gains or losses during such period. Any deferred incentive fees will be carried over for payment in subsequent calculation periods to the extent such payment is payable under the Investment Advisory Agreement. As of September 30, 2017 and December 31, 2016, the Company had incentive fees payable to the Investment Advisor of \$2.2 million and \$6.4 million, respectively.

For the three months ended September 30, 2017 and 2016, the Company incurred \$2.4 million and \$2.6 million in base management fees, respectively. The Company incurred \$0.0 million and \$1.8 million in incentive fees related to pre-incentive fee net investment income for the three months ended September 30, 2017 and 2016, respectively. For the three months ended September 30, 2017 and 2016, the Investment Advisor waived incentive fees of \$0.0 million and \$0.3 million, respectively.

For the nine months ended September 30, 2017 and 2016, the Company incurred \$7.4 million and \$8.0 million in base management fees, respectively. The Company incurred \$1.3 million and \$5.2 million in incentive fees related to pre-incentive fee net investment income for the nine months ended September 30, 2017 and 2016, respectively. For the nine months ended September 30, 2017 and 2016, the Investment Advisor waived incentive fees of \$1.0 million and \$1.7 million, respectively.

On September 24, 2013, the Company entered into the Administration Agreement pursuant to which the Administrator has agreed to furnish the Company with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. The Administrator also performs, or oversees the performance of the required administrative services, which include, among other things, being responsible for the financial records that the Company is required to maintain and preparing reports to our stockholders. In addition, the Administrator assists in determining and publishing the NAV, oversees the preparation and filing of the tax returns and the printing and dissemination of reports to the stockholders, and generally oversees the payment of the expenses and the performance of administrative and professional services rendered to the Company by others.

Payments under the Administration Agreement are equal to an amount based upon the allocable portion of the Administrator’s overhead in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions and the allocable portion of the compensation of the chief financial officer and the chief compliance officer, and their respective administrative support staff. Under the Administration Agreement, the Administrator will also provide, on the Company’s behalf, managerial assistance to those portfolio companies that request such assistance. Unless terminated earlier in accordance with its terms, the Administration Agreement will remain in effect if approved annually by the Board. The Board most recently approved the renewal of the Administration Agreement on August 3, 2017. To the extent that the Administrator outsources any of its functions, the Company will pay the fees associated with such functions on a direct basis without any incremental profit to our Administrator. Stockholder approval is not required to amend the Administration Agreement.

For the three and nine months ended September 30, 2017, the Company paid the Administrator \$0.3 million and \$0.8 million, respectively, for the Company's allocable portion of the Administrator's overhead. For the three and nine months ended September 30, 2016, the Company paid the Administrator \$0.3 million and \$0.8 million, respectively, for the Company's allocable portion of the Administrator's overhead.

The Administration Agreement provides that, absent willful misfeasance, bad faith or negligence in the performance of its duties or by reason of the reckless disregard of its duties and obligations, our Administrator and its officers, managers, partners, agents, employees, controlling persons, members and any other person or entity affiliated with it are entitled to indemnification from the Company for any damages, liabilities, costs and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) arising from the rendering of our Administrator's services under the Administration Agreement or otherwise as Administrator for the Company.

#### Note 6. Related Party Transactions

At September 30, 2017 and December 31, 2016, the Company had the following receivables from (payables to) related parties relating to certain management fees, incentive fees, reimbursable expenses, and other payments owed to related parties (dollars in thousands):

	September 30, 2017	December 31, 2016
CapitalSouth Corporation	\$ 74	\$ 182
CapitalSouth Partners Florida Sidecar Fund II, L.P.	—	(35)
Capitala Investment Advisors, LLC	(2,228)	(6,426)
Total	<u>\$ (2,154)</u>	<u>\$ (6,279)</u>

These amounts are reflected in the accompanying consolidated statements of assets and liabilities under the captions, "Due from related parties", "Management and incentive fee payable" and "Due to related parties."

On August 31, 2016, the Company sold assets to FSC II in exchange for 100% of the partnership interests in FSC II. Concurrent with the sale of these assets to FSC II, the Company received cash consideration of \$47.6 million from an affiliated third-party purchaser in exchange for 100% of the partnership interests of FSC II. The Company's Board pre-approved this transaction pursuant to Section 57(f) of the 1940 Act. Capitala Advisors Corp., the Company's administrator, also serves as the administrator to FSC II. See Note 4 for a further description of this transaction.

#### Note 7. Borrowings

##### SBA Debentures

The Company, through its two wholly owned subsidiaries, uses debenture leverage provided through the SBA to fund a portion of its investment portfolio. As of September 30, 2017 and December 31, 2016, the Company has \$170.7 million of SBA-guaranteed debentures outstanding. The Company has issued all SBA-guaranteed debentures that were permitted under each of the Legacy Funds' respective SBIC licenses (as applicable), and there are no unused SBA debenture commitments remaining. SBA-guaranteed debentures are secured by a lien on all assets of Fund II and Fund III. As of September 30, 2017 and December 31, 2016, Fund II and Fund III had total assets of approximately \$344.0 million and \$349.4 million, respectively. On June 10, 2014, the Company received an exemptive order from the SEC exempting the Company, Fund II, and Fund III from certain provisions of the 1940 Act (including an exemptive order granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs) and from certain reporting requirements mandated by the Securities Exchange Act of 1934, as amended, with respect to Fund II and Fund III. The Company intends to comply with the conditions of the order.

The weighted average interest rate for all SBA-guaranteed debentures as of September 30, 2017 and December 31, 2016 was 3.29%. In addition to the stated interest rate, the SBA also charges an annual fee on all SBA-guaranteed debentures issued, which is included in the Company's interest expense. The weighted average annual fee for all SBA-guaranteed debentures as of September 30, 2017 and December 31, 2016 was 0.43%.

The following table summarizes the interest expense and annual charges, and deferred financing costs on the SBA-guaranteed debentures for the three and nine months ended September 30, 2017 and 2016 (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Interest expense and annual charges	\$ 1,597	\$ 1,724	\$ 4,739	\$ 5,276
Deferred financing costs	153	157	456	477
Total interest and financing expenses	<u>\$ 1,750</u>	<u>\$ 1,881</u>	<u>\$ 5,195</u>	<u>\$ 5,753</u>

As of September 30, 2017 and December 31, 2016, the Company's issued and outstanding SBA-guaranteed debentures mature as follows (dollars in thousands):

Fixed Maturity Date	Interest Rate	SBA Annual Charge		September 30, 2017	December 31, 2016
March 1, 2019	4.620%	0.941%		5,000	5,000
September 1, 2020	3.215%	0.285%		19,000	19,000
March 1, 2021	4.084%	0.515%		15,700	15,700
March 1, 2021	4.084%	0.285%		46,000	46,000
March 1, 2022	2.766%	0.285%		10,000	10,000
March 1, 2022	2.766%	0.515%		50,000	50,000
March 1, 2023	2.351%	0.515%		25,000	25,000
				<u>\$ 170,700</u>	<u>\$ 170,700</u>

#### 2021 Notes

On June 16, 2014, the Company issued \$113.4 million in aggregate principal amount of 7.125% fixed-rate notes due 2021 (the "2021 Notes"). On May 26, 2017, the Company caused notices to be issued to the holders of its 2021 Notes regarding the Company's exercise of its option to redeem all of the issued and outstanding 2021 Notes, pursuant to Section 1104 of the Indenture dated as of June 16, 2014, between the Company and U.S. Bank National Association, as trustee, and Section 1.01(h) of the First Supplemental Indenture dated as of June 16, 2014. The Company redeemed all \$113.4 million in aggregate principal amount of the 2021 Notes on June 25, 2017. The Notes were redeemed at 100% of their principal amount (\$25 per Note), plus the accrued and unpaid interest thereon from June 16, 2017, through, but excluding, June 25, 2017. As a result of the redemption, the Company recognized a loss on the extinguishment of debt of \$0.0 million and \$2.7 million, respectively, for the three and nine months ended September 30, 2017, due to the amortization of the deferred financing costs remaining on the 2021 Notes.

The following table summarizes the interest expense and deferred financing costs, excluding debt extinguishment costs, on the 2021 Notes for the three and nine months ended September 30, 2017 and 2016 (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Interest expense	\$ —	\$ 2,021	\$ 3,908	\$ 6,062
Deferred financing costs	—	141	293	414
Total interest and financing expenses	<u>\$ —</u>	<u>\$ 2,162</u>	<u>\$ 4,201</u>	<u>\$ 6,476</u>

#### 2022 Notes

On May 16, 2017, the Company issued \$70.0 million in aggregate principal amount of 6.0% fixed-rate notes due May 31, 2022 (the "2022 Notes"). On May 25, 2017, the Company issued an additional \$5.0 million in aggregate principal amount of the 2022 Notes pursuant to a partial exercise of the underwriters' overallocation option. The 2022 Notes will mature on May 31, 2022, and may be redeemed in whole or in part at any time or from time to time at the Company's option on or after May 31, 2019 at a redemption price equal to 100% of the outstanding principal, plus accrued and unpaid interest. Interest is payable quarterly beginning August 31, 2017.

The following table summarizes the interest expense and deferred financing costs on the 2022 Notes for the three and nine months ended September 30, 2017 and 2016 (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Interest expense	\$ 1,132	\$ —	\$ 1,687	\$ —
Deferred financing costs	121	—	181	—
Total interest and financing expenses	<u>\$ 1,253</u>	<u>\$ —</u>	<u>\$ 1,868</u>	<u>\$ —</u>

#### 2022 Convertible Notes

On May 26, 2017, the Company issued \$50.0 million in aggregate principal amount of 5.75% fixed-rate convertible notes due on May 31, 2022 (the "2022 Convertible Notes"). On June 26, 2017, the Company issued an additional \$2.1 million in aggregate principal amount of the 2022 Convertible Notes pursuant to a partial exercise of the underwriters' overallocation option. Interest is payable quarterly beginning August 31, 2017.

The 2022 Convertible Notes are convertible, at the holder's option, into shares of the Company's common stock at any time on or prior to the close of business on the business day immediately preceding the maturity date. The conversion rate for the 2022 Convertible Notes is initially 1.5913 shares per \$25.00 principal amount of 2022 Convertible Notes (equivalent to an initial conversion price of approximately \$15.71 per share of common stock). The initial conversion premium is approximately 14.0%. Upon conversion, the Company will deliver shares of its common stock (and cash in lieu of fractional shares). The conversion rate is subject to adjustment if certain events occur as outlined in the supplemental indenture relating to the 2022 Convertible Notes. The Company has determined that the embedded conversion option in the 2022 Convertible Notes is not required to be separately accounted for as a derivative under GAAP.

In addition, pursuant to a "fundamental change" as defined in the supplemental indenture relating to the 2022 Convertible Notes, holders of the 2022 Convertible Notes may require the Company to repurchase for cash all or part of their 2022 Convertible Notes at a repurchase price equal to 100.0% of the principal amount of the 2022 Convertible Notes to be repurchased, plus accrued and unpaid interest through, but excluding, the repurchase date. The 2022 Convertible Notes are not redeemable prior to maturity and no "sinking fund" is provided for the 2022 Convertible Notes.

The following table summarizes the interest expense and deferred financing costs on the 2022 Convertible Notes for the three and nine months ended September 30, 2017 and 2016 (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Interest expense	\$ 759	\$ —	\$ 1,040	\$ —
Deferred financing costs	77	—	102	—
Total interest and financing expenses	<u>\$ 836</u>	<u>\$ —</u>	<u>\$ 1,142</u>	<u>\$ —</u>

#### Credit Facility

On October 17, 2014, the Company entered into a senior secured revolving credit agreement (the "Credit Facility") with ING Capital, LLC, as administrative agent, arranger, and bookrunner, and the lenders party thereto. On June 16, 2017, the Company entered into an amendment to its Credit Facility with ING Capital, LLC (the "Amendment"). Pursuant to the Amendment, the Credit Facility currently provides for borrowings up to \$114.5 million and may be increased up to \$200.0 million pursuant to its "accordion" feature. The Credit Facility matures on June 16, 2021.

Borrowings under the Credit Facility bear interest, at the Company's election, at a rate per annum equal to (i) the one, two, three or six month LIBOR, as applicable, plus 3.00% or (ii) 2.00% plus the highest of (A) a prime rate, (B) the Federal Funds rate plus 0.5% and (C) three month LIBOR plus 1.0%. The Company's ability to elect LIBOR indices with various tenors (e.g., one, two, three or six month LIBOR) on which the interest rates for borrowings under the Credit Facility are based, provides the company with increased flexibility to manage interest rate risks as compared to a borrowing arrangement that does not provide for such optionality. Once a particular LIBOR rate has been selected, the interest rate on the applicable amount borrowed will reset after the applicable tenor period and be based on the then applicable selected LIBOR rate (e.g., borrowings for which the Company has elected the one month LIBOR rate will reset on the one month anniversary of the period based on the then selected LIBOR rate). For any given borrowing under the Credit Facility, the Company intends to elect what it believes to be an appropriate LIBOR rate taking into account the Company's needs at the time as well as the Company's view of future interest rate movements. The Amendment provides for the ability to step-down the pricing of the Credit Facility from LIBOR plus 3.00% to LIBOR plus 2.75% when certain conditions are met. The Company will also pay an unused commitment fee at a rate of 2.50% per annum on the amount (if positive) by which 40% of the aggregate commitments under the Credit Facility exceeds the outstanding amount of loans under the Credit Facility and 0.50% per annum on any remaining unused portion of the Credit Facility.

The following table summarizes the interest expense, deferred financing costs, and unused commitment fees on the Credit Facility for the three and nine months ended September 30, 2017 and 2016 (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Interest expense	\$ 59	\$ 581	\$ 874	\$ 1,845
Deferred financing costs	341	242	834	723
Unused commitment fees	346	72	612	193
Total interest and financing expenses	<u>\$ 746</u>	<u>\$ 895</u>	<u>\$ 2,320</u>	<u>\$ 2,761</u>

As of September 30, 2017 and December 31, 2016, the Company had \$0.0 million and \$44.0 million, respectively, outstanding under the Credit Facility. The Credit Facility is secured by investments and cash held by Capitala Finance Corp., exclusive of assets held at our two SBIC subsidiaries. Assets pledged to secure the Credit Facility had a fair value of \$185.4 million at September 30, 2017. As part of the terms of the Credit Facility, the Company may not make cash distributions with respect to any taxable year that exceed 110% (125% if the Company is not in default and its covered debt does not exceed 85% of the borrowing base) of the amounts required to be distributed to maintain eligibility as a RIC and to reduce our tax liability to zero for taxes imposed on our investment company taxable income and net capital gains.

## Note 8. Fair Value of Financial Instruments

### Financial Instruments Disclosed, But Not Carried, At Fair Value

The following table presents the carrying value and fair value of the Company's financial liabilities disclosed, but not carried, at fair value as of September 30, 2017, and the level of each financial liability within the fair value hierarchy (dollars in thousands):

	Carrying Value (1)	Fair Value	Level 1	Level 2	Level 3
SBA debentures	\$ 170,700	\$ 173,577	\$ —	\$ —	\$ 173,577
2022 Notes	75,000	75,900	75,900	—	—
2022 Convertible Notes	52,088	51,983	51,983	—	—
Credit Facility	—	—	—	—	—
<b>Total</b>	<b>\$ 297,788</b>	<b>\$ 301,460</b>	<b>\$ 127,883</b>	<b>\$ —</b>	<b>\$ 173,577</b>

(1) Carrying value equals the gross principal outstanding at period end.

The following table presents the carrying value and fair value of the Company's financial liabilities disclosed, but not carried, at fair value as of December 31, 2016, and the level of each financial liability within the fair value hierarchy (dollars in thousands):

	Carrying Value (1)	Fair Value	Level 1	Level 2	Level 3
SBA debentures	\$ 170,700	\$ 175,581	\$ —	\$ —	\$ 175,581
2021 Notes	113,438	115,888	115,888	—	—
Credit Facility	44,000	43,927	—	—	43,927
<b>Total</b>	<b>\$ 328,138</b>	<b>\$ 335,396</b>	<b>\$ 115,888</b>	<b>\$ —</b>	<b>\$ 219,508</b>

(1) Carrying value equals the gross principal outstanding at period end.

The estimated fair value of the Company's SBA debentures was based on future contractual cash payments discounted at market interest rates to borrow from the SBA as of the measurement date.

The estimated fair value of the 2021 Notes was based on the closing price as of the measurement date as the 2021 Notes were traded on the New York Stock Exchange under the ticker "CLA."

The estimated fair value of the 2022 Notes and 2022 Convertible Notes was based on their respective closing prices as of the measurement date as they are traded on the NASDAQ Global Select Market under the ticker "CPTAL" (2022 Notes) and on the NASDAQ Capital Market under the ticker "CPTAG" (2022 Convertible Notes).

The estimated fair value of the Company's Credit Facility was based on future contractual cash payments discounted at estimated market interest rates for similar debt.

## Note 9. Directors Fees

Our independent directors receive an annual fee of \$50,000. They also receive \$5,000 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attending each board meeting and \$5,000 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attending each committee meeting. In addition, the chairman of the audit committee receives an annual fee of \$10,000 and each chairman of any other committee receives an annual fee of \$5,000 for their additional services, if any, in these capacities. For the three and nine months ended September 30, 2017, the Company recognized directors fees expense of \$0.1 million and \$0.3 million, respectively. For the three and nine months ended September 30, 2016, the Company recognized directors fees expense of \$0.1 million and \$0.3 million, respectively. No compensation is expected to be paid to directors who are "interested persons" of the Company, as such term is defined in Section 2(a)(19) of the 1940 Act

## Note 10. Summarized Financial Information of Our Unconsolidated Subsidiaries

The Company holds a control interest, as defined by the 1940 Act, in six portfolio companies that are considered significant subsidiaries under the guidance in Regulation S-X, but are not consolidated in the Company's consolidated financial statements. Below is a brief description of each such portfolio company, along with summarized financial information as of September 30, 2017 and December 31, 2016, and for the nine months ended September 30, 2017 and September 30, 2016, respectively.



### ***CableOrganizer Acquisition, LLC***

CableOrganizer Acquisition, LLC, a Delaware limited liability company that began operations on April 23, 2013, is a leading online provider of cable and wire management products. The income the Company generated from CableOrganizer Acquisition, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$1.3 million and \$1.4 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

### ***Eastport Holdings, LLC***

Eastport Holdings, LLC, an Ohio limited liability company organized on November 1, 2011, is a holding company consisting of marketing and advertising companies located across the U.S. The income the Company generated from Eastport Holdings, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$7.9 million and \$11.0 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

### ***Kelle's Transport Service, LLC***

Kelle's Transport Service, LLC, a Delaware limited liability company organized on March 28, 2014, provides temperature sensitive transportation services throughout North America. The loss the Company generated from Kelle's Transport Service, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$(3.7) million and \$(1.2) million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

### ***Navis Holdings, Inc.***

Navis Holdings, Inc., incorporated in Delaware on December 21, 2010, designs and manufactures leading machinery for the global knit and woven finishing textile industries. The income the Company generated from Navis Holdings, Inc., which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation) was \$0.8 million and \$2.1 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

### ***On-Site Fuel Services, Inc.***

On-Site Fuel Services, Inc. is a 100% owned subsidiary of On-Site Fuel Holdings, Inc., which was incorporated in Delaware on December 19, 2011. On-Site Fuel Services, Inc. provides fueling services for commercial and government vehicle fleets throughout the southeast U.S. The income the Company generated from On-Site Fuel Service, Inc., which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$0.1 million and \$1.9 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

### ***Micro Precision, LLC***

Micro Precision, LLC, formed on August 5, 2011 as a Delaware limited liability company, is a prime contractor supplying critical parts and mechanical assemblies to the United States Department of Defense as well as designer and manufacturer of locomotive air horns. The income (loss) the Company generated from Micro Precision, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$(0.2) million and \$0.7 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

The summarized unaudited financial information of our unconsolidated subsidiaries was as follows (dollars in thousands):

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheet – CableOrganizer Acquisition, LLC</b>		
Current assets	\$ 8,859	\$ 5,589
Noncurrent assets	9,714	9,872
Total assets	<u>\$ 18,573</u>	<u>\$ 15,461</u>
Current liabilities	\$ 8,365	\$ 4,219
Noncurrent liabilities	12,247	11,882
Total liabilities	<u>\$ 20,612</u>	<u>\$ 16,101</u>
Total deficit	<u>\$ (2,039)</u>	<u>\$ (640)</u>
<b>Statements of Operations – CableOrganizer Acquisition, LLC</b>		
	September 30, 2017	September 30, 2016
Net sales	\$ 21,926	\$ 17,440
Cost of goods sold	15,558	11,703
Gross profit	<u>\$ 6,368</u>	<u>\$ 5,737</u>
Other expenses	\$ 7,767	\$ 6,877
Loss before income taxes	(1,399)	(1,140)
Income tax benefit	—	—
Net loss	<u>\$ (1,399)</u>	<u>\$ (1,140)</u>
<b>Balance Sheet – Eastport Holdings, LLC</b>		
	September 30, 2017	December 31, 2016
Current assets	\$ 93,749	\$ 96,175
Noncurrent assets	150,772	145,802
Total assets	<u>\$ 244,521</u>	<u>\$ 241,977</u>
Current liabilities	\$ 153,294	\$ 157,622
Noncurrent liabilities	44,558	41,355
Total liabilities	<u>\$ 197,852</u>	<u>\$ 198,977</u>
Total equity	<u>\$ 46,669</u>	<u>\$ 43,000</u>
<b>Statements of Operations – Eastport Holdings, LLC</b>		
	September 30, 2017	September 30, 2016
Net sales	\$ 415,289	\$ 388,036
Cost of goods sold	308,434	305,926
Gross profit	<u>\$ 106,855</u>	<u>\$ 82,110</u>
Other expenses	\$ 102,116	\$ 76,195
Income before income taxes	4,739	5,915
Income tax provision	650	1,596
Net income	<u>\$ 4,089</u>	<u>\$ 4,319</u>

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheet – Kelle’s Transport Services, LLC</b>		
Current assets	\$ 8,863	\$ 8,415
Noncurrent assets	12,379	13,374
Total assets	\$ 21,242	\$ 21,789
Current liabilities	\$ 12,073	\$ 4,664
Noncurrent liabilities	17,487	14,962
Total liabilities	\$ 29,560	\$ 19,626
Total equity(deficit)	\$ (8,318)	\$ 2,163

	For the nine months ended	
	September 30, 2017	September 30, 2016
<b>Statements of Operations – Kelle’s Transport Services, LLC</b>		
Net sales	\$ 38,594	\$ 49,095
Cost of goods sold	37,879	41,198
Gross profit	\$ 715	\$ 7,897
Other expenses	\$ 10,906	\$ 9,219
Loss before income taxes	(10,191)	(1,322)
Income tax provision	—	43
Net loss	\$ (10,191)	\$ (1,365)

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheets - Navis Holdings, Inc.</b>		
Current assets	\$ 4,967	\$ 4,655
Noncurrent assets	3,131	3,446
Total assets	\$ 8,098	\$ 8,101
Current liabilities	\$ 2,473	\$ 2,448
Noncurrent liabilities	7,006	6,719
Total liabilities	\$ 9,479	\$ 9,167
Total deficit	\$ (1,381)	\$ (1,066)

	For the nine months ended	
	September 30, 2017	September 30, 2016
<b>Statement of Operations - Navis Holdings, Inc.</b>		
Net sales	\$ 9,990	\$ 13,866
Cost of goods sold	6,251	8,585
Gross profit	\$ 3,739	\$ 5,281
Other expenses	\$ 3,389	\$ 3,666
Income before income taxes	350	1,615
Income tax provision	140	633
Net income	\$ 210	\$ 982

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheets - On-Site Fuel Services, Inc.</b>		
Current assets	\$ 22,400	\$ 13,079
Noncurrent assets	22,930	16,283
Total assets	<u>\$ 45,330</u>	<u>\$ 29,362</u>
Current liabilities	\$ 21,157	\$ 35,244
Noncurrent liabilities	34,215	1,127
Total liabilities	<u>\$ 55,372</u>	<u>\$ 36,371</u>
Total deficit	<u>\$ (10,042)</u>	<u>\$ (7,009)</u>

	For the nine months ended	
	September 30, 2017	September 30, 2016
<b>Statement of Operations - On-Site Fuel Services, Inc.</b>		
Net sales	\$ 113,822	\$ 78,408
Cost of goods sold	93,013	62,522
Gross profit	<u>\$ 20,809</u>	<u>\$ 15,886</u>
Other expenses	\$ 23,843	\$ 18,785
Loss before income taxes	(3,034)	(2,899)
Income tax provision	-	-
Net loss	<u>\$ (3,034)</u>	<u>\$ (2,899)</u>

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheets - Micro Precision, LLC</b>		
Current assets	\$ 6,312	\$ 10,580
Noncurrent assets	19,808	15,562
Total assets	<u>\$ 26,120</u>	<u>\$ 26,142</u>
Current liabilities	\$ 7,253	\$ 8,680
Noncurrent liabilities	13,951	16,137
Total liabilities	<u>\$ 21,204</u>	<u>\$ 24,817</u>
Total equity	<u>\$ 4,916</u>	<u>\$ 1,325</u>

	For the nine months ended	
	September 30, 2017	September 30, 2016
<b>Statement of Operations - Micro Precision, LLC</b>		
Net sales	\$ 12,289	\$ 13,294
Cost of goods sold	7,522	8,659
Gross profit	<u>\$ 4,767</u>	<u>\$ 4,635</u>
Other expenses	\$ 4,509	\$ 5,101
Income/(loss) before income taxes	258	(466)
Income tax provision	-	-
Net income/(loss)	<u>\$ 258</u>	<u>\$ (466)</u>

#### Note 11. Earnings Per Share

In accordance with the provisions of ASC Topic 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. As of September 30, 2017, all convertible shares related to the 2022 Convertible Notes were considered anti-dilutive. As of September 30, 2016, there were no dilutive shares.

The following information sets forth the computation of the weighted average basic and diluted net increase (decrease) in net assets per share from operations for the three and nine months ended September 30, 2017 and September 30, 2016 (dollars in thousands, except share and per share data):

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
<b>Basic and diluted</b>				
Net increase (decrease) in net assets from operations – basic and diluted	\$ (5,753)	\$ (2,013)	\$ (6,395)	\$ 1,055
Weighted average common shares outstanding – basic and diluted	15,911,160	15,829,878	15,891,636	15,807,801
Net increase (decrease) in net assets per share from operations – basic and diluted	<u>\$ (0.36)</u>	<u>\$ (0.13)</u>	<u>\$ (0.40)</u>	<u>\$ 0.07</u>



## Note 12. Distributions

The Company's distributions are recorded as payable on the declaration date. Shareholders have the option to receive payment of their distribution in cash, shares of common stock, or a combination of cash and common stock.

The following table summarizes the Company's distribution declarations for the nine months ended September 30, 2017 (dollars in thousands, except share and per share data):

<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Amount Per Share</u>	<u>Cash Distribution</u>	<u>DRIP Shares Issued</u>	<u>DRIP Share Value</u>
January 3, 2017	January 20, 2017	January 30, 2017	\$ 0.13	\$ 1,993	5,304	\$ 70
January 3, 2017	February 20, 2017	February 27, 2017	0.13	1,993	5,195	70
January 3, 2017	March 23, 2017	March 30, 2017	0.13	1,998	4,948	67
April 3, 2017	April 19, 2017	April 27, 2017	0.13	1,996	5,164	69
April 3, 2017	May 23, 2017	May 29, 2017	0.13	1,990	5,880	76
April 3, 2017	June 21, 2017	June 29, 2017	0.13	1,969	7,959	97
July 3, 2017	July 21, 2017	July 28, 2017	0.13	1,995	5,889	73
July 3, 2017	August 23, 2017	August 30, 2017	0.13	1,957	13,162	111
July 3, 2017	September 20, 2017	September 28, 2017	0.13	1,989	9,085	80
Total Distributions Declared and Distributed			<u>\$ 1.17</u>	<u>\$ 17,880</u>	<u>62,586</u>	<u>\$ 713</u>

The following table summarizes the Company's distribution declarations for the nine months ended September 30, 2016 (dollars in thousands, except share and per share data):

<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Amount Per Share</u>	<u>Cash Distribution</u>	<u>DRIP Shares Issued</u>	<u>DRIP Share Value</u>
January 4, 2016	January 22, 2016	January 28, 2016	\$ 0.1567	\$ 2,392	8,135	\$ 80
January 4, 2016	February 19, 2016	February 26, 2016	0.1567	2,405	7,076	70
January 4, 2016	March 22, 2016	March 30, 2016	0.1567	2,397	7,079	77
April 1, 2016	April 22, 2016	April 28, 2016	0.1567	2,392	6,625	85
April 1, 2016	May 23, 2016	May 30, 2016	0.1567	2,372	8,147	104
April 1, 2016	June 21, 2016	June 29, 2016	0.1567	2,369	8,229	108
July 1, 2016	July 22, 2016	July 29, 2016	0.1567	2,382	7,025	98
July 1, 2016	August 22, 2016	August 30, 2016	0.1567	2,391	6,256	90
July 1, 2016	September 22, 2016	September 29, 2016	0.1567	2,380	8,242	101
Total Distributions Declared and Distributed			<u>\$ 1.41</u>	<u>\$ 21,480</u>	<u>66,814</u>	<u>\$ 813</u>

### Note 13. Financial Highlights

The following is a schedule of financial highlights for the nine months ended September 30, 2017 and 2016 (dollars in thousands, except share and per share data):

	<u>September 30, 2017</u>	<u>September 30, 2016</u>
<b>Per share data:</b>		
Net asset value at beginning of period	\$ 15.79	\$ 17.04
Net investment income <sup>(1)</sup>	0.71	1.41
Net realized loss on investments <sup>(1)</sup>	(0.05)	(1.57)
Net unrealized appreciation (depreciation) on investments <sup>(1)</sup>	(0.72)	0.29
Net unrealized depreciation on Written Call Option <sup>(1)</sup>	(0.18)	(0.06)
Change in provision for deferred taxes on unrealized appreciation on investments <sup>(1)</sup>	(0.17)	—
Distributions declared from net investment income	(1.17)	(1.41)
Other <sup>(7)</sup>	—	(0.02)
Net asset value at end of period	<u>\$ 14.21</u>	<u>\$ 15.68</u>
Net assets at end of period	\$ 226,307	\$ 248,377
Shares outstanding at end of period	15,930,631	15,844,159
Per share market value at end of period	\$ 9.54	\$ 13.11
Total return based on market value <sup>(2)</sup>	(18.50)%	21.84%
<b>Ratio/Supplemental data:</b>		
Ratio of net investment income to average net assets <sup>(9)</sup>	6.70%	11.99%
Ratio of incentive fee, net of incentive fee waiver, to average net assets <sup>(6)(10)</sup>	0.15%	1.35%
Ratio of interest and financing expenses to average net assets <sup>(8)</sup>	8.17%	7.76%
Ratio of loss on extinguishment of debt to average net assets <sup>(10)</sup>	1.13%	—
Ratio of other operating expenses, to average net assets <sup>(8)</sup>	5.75%	5.71%
Ratio of total expenses, net of fee waivers to average net assets <sup>(6)(9)</sup>	15.20%	14.82%
Portfolio turnover rate <sup>(3)</sup>	7.81%	9.42%
Average debt outstanding <sup>(4)</sup>	\$ 333,572	\$ 364,430
Average debt outstanding per common share	\$ 20.94	\$ 23.00
Asset coverage ratio per unit <sup>(5)</sup>	\$ 2,781	\$ 2,640

- (1) Based on daily weighted average balance of shares outstanding during the period.
- (2) Total investment return is calculated assuming a purchase of common shares at the current market value on the first day and a sale at the current market value on the last day of the period reported. Dividends and distributions, if any, are assumed for purposes of this calculation to be reinvested at prices obtained under the Company's DRIP. Total investment return does not reflect brokerage commissions. Total investment returns covering less than a full period are not annualized.
- (3) Portfolio turnover rate is calculated using the lesser of year-to-date sales or year-to-date purchases over the average of the invested assets at fair value. Portfolio turnover rates that cover less than a full period are not annualized.
- (4) Based on daily weighted average balance of debt outstanding during the period.
- (5) Asset coverage per unit is the ratio of the carrying value of our total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness. We have excluded our SBA-guaranteed debentures from the asset coverage calculation as of September 30, 2017 and September 30, 2016 pursuant to the exemptive relief granted by the SEC in June 2014 that permits us to exclude such debentures from the definition of senior securities in the 200% asset coverage ratio we are required to maintain under the 1940 Act. Asset coverage per unit is expressed in terms of dollar amounts per \$1,000 of indebtedness.
- (6) The ratio of waived incentive fees to average net assets was 0.40% and 0.65% for the nine months ended September 30, 2017 and September 30, 2016.
- (7) Includes the impact of different share amounts used in calculating per share data as a result of calculating certain per share data based on weighted average shares outstanding during the period and certain per share data based on shares outstanding as of a period end or transaction date.
- (8) Ratios are annualized.
- (9) Ratios are annualized. Incentive fees, net of incentive fee waiver, and loss on extinguishment of debt included within the ratio are not annualized.
- (10) Ratios are not annualized.

### Note 14. Subsequent Events

Management has evaluated subsequent events through the date of issuance of the consolidated financial statements included herein. There have been no subsequent events that occurred during such period that would be required to be recognized in the consolidated financial statements as of September 30, 2017.

#### Distributions

On October 2, 2017, the Company's Board declared normal monthly distributions for October, November, and December of 2017 as set forth below:

<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Distributions per Share</u>
October 2, 2017	October 23, 2017	October 30, 2017	\$ 0.0833
October 2, 2017	November 21, 2017	November 29, 2017	\$ 0.0833
October 2, 2017	December 20, 2017	December 28, 2017	\$ 0.0833

#### Portfolio Activity

On October 31, 2017, the Company funded \$2.0 million of its unfunded commitment to CIS Secure Computing, Inc.



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

The following discussion and analysis should be read in conjunction with our consolidated financial statements and related notes and other financial information appearing elsewhere in this Quarterly Report on Form 10-Q.

Except as otherwise specified, references to "we," "us," "our" or the "Company", refer to Capitala Finance Corp.

This Quarterly Report, including Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements that involve substantial risks and uncertainties. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about the Company, our current and prospective portfolio investments, our industry, our beliefs, and our assumptions. Words such as "anticipates," "expects," "intends," "plans," "will," "may," "continue," "believes," "seeks," "estimates," "would," "could," "should," "targets," "projects," and variations of these words and similar expressions are intended to identify forward-looking statements.

Some of the statements in the Quarterly Report on Form 10-Q constitute forward-looking statements, which relate to future events or our performance or financial condition. The forward-looking statements contained in this Quarterly Report on Form 10-Q involve risks and uncertainties, including statements as to:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the impact of investments that we expect to make;
- our contractual arrangements and relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- our expected financings and investments;
- the adequacy of our cash resources and working capital; and
- the timing of cash flows, if any, from the operations of our portfolio companies.

These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements, including without limitation:

- an economic downturn could impair our portfolio companies' ability to continue to operate or repay their borrowings, which could lead to the loss of some or all of our investments in such portfolio companies;
- a contraction of available credit and/or an inability to access the equity markets could impair our lending and investment activities;
- interest rate volatility could adversely affect our results, particularly if we use leverage as part of our investment strategy; and
- the risks, uncertainties and other factors we identify in "Risk Factors" and elsewhere in our Annual Report on Form 10-K.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. Important assumptions include our ability to originate new loans and investments, certain margins and levels of profitability and the availability of additional capital. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Quarterly Report on Form 10-Q should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in "Risk Factors" and elsewhere 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, which apply only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law or U.S. Securities and Exchange Commission ("SEC") rule or regulation.

## OVERVIEW

We are a Maryland corporation that has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940 as amended (the “1940 Act”). We are an “emerging growth company” within the meaning of the Jumpstart Our Business Startups Act of 2012, and as such, are subject to reduced public company reporting requirements. Our investment objective is to generate both current income and capital appreciation through debt and equity investments. We are managed by Capitala Investment Advisors, LLC (the “Investment Advisor”), and Capitala Advisors Corp. (the “Administrator”) provides the administrative services necessary for us to operate.

We provide capital to lower and traditional middle-market companies in the United States (“U.S.”), with a non-exclusive emphasis on the Southeast, Southwest and Mid-Atlantic regions. We invest primarily in companies with a history of earnings growth and positive cash flow, proven management teams, products or services with competitive advantages and industry-appropriate margins. We primarily invest in companies with between \$4.5 million and \$30 million in trailing twelve month earnings before interest, tax, depreciation, and amortization (“EBITDA”).

We invest in first lien, second lien, and subordinated loans. Most of our debt investments are coupled with equity interests, whether in the form of detachable “penny” warrants or equity co-investments made *pari-passu* with our borrowers’ financial sponsors.

As a BDC, we are required to comply with certain regulatory requirements. For instance, we generally must invest at least 70% of our total assets in “qualifying assets,” including securities of private or thinly traded public U.S. companies, cash, cash equivalents, U.S. government securities and high-quality debt investments that mature in one year or less. In addition, we are only allowed to borrow money such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing, with certain limited exceptions. To maintain our regulated investment company (“RIC”) status, we must meet specified source-of-income and asset diversification requirements. To maintain our RIC tax treatment under subchapter M of the Internal Revenue Code of 1986, as amended (the “Code”) for U.S. federal income tax purposes, we must distribute at least 90% of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, for the taxable year.

## Corporate History

We commenced operations on May 24, 2013 and completed our initial public offering (“IPO”) on September 30, 2013. The Company was formed for the purpose of (i) acquiring, through a series of transactions, an investment portfolio from the following entities: CapitalSouth Partners Fund I Limited Partnership (“Fund I”); CapitalSouth Partners Fund II Limited Partnership (“Fund II”); CapitalSouth Partners Fund III, L.P. (“Fund III Parent”); CapitalSouth Partners SBIC Fund III, L.P. (“Fund III”) and CapitalSouth Partners Florida Sidecar Fund I, L.P. (“Florida Sidecar”) and, collectively with Fund I, Fund II, Fund III and Fund III Parent, the “Legacy Funds”); (ii) raising capital in the IPO and (iii) continuing and expanding the business of the Legacy Funds by making additional debt and equity investments in lower middle-market and traditional middle-market companies.

On September 24, 2013, the Company acquired 100% of the limited partnership interests in Fund II, Fund III and Florida Sidecar and each of their respective general partners, as well as certain assets from Fund I and Fund III Parent, in exchange for an aggregate of 8,974,420 shares of the Company’s common stock (the “Formation Transactions”). Fund II, Fund III and Florida Sidecar became the Company’s wholly owned subsidiaries. Fund II and Fund III retained their SBIC licenses, and continued to hold their existing investments at the time of IPO and have continued to make new investments after the IPO. The IPO consisted of the sale of 4,000,000 shares of the Company’s common stock at a price of \$20.00 per share resulting in net proceeds to the Company of \$74.25 million, after deducting underwriting fees and commissions totaling \$4.0 million and offering expenses totaling \$1.75 million. The other costs of the IPO were borne by the limited partners of the Legacy Funds.

At the time of the Formation Transactions, our portfolio consisted of: (1) approximately \$326.3 million in investments; (2) an aggregate of approximately \$67.1 million in cash, interest receivable and other assets; and (3) liabilities of approximately \$202.2 million of SBA-guaranteed debt payable. We have two SBIC-licensed subsidiaries that have elected to be regulated as BDCs under the 1940 Act.

## Basis of Presentation

The Company is considered an investment company as defined in Accounting Standards Codification (“ASC”) Topic 946 – *Financial Services – Investment Companies* (“ASC 946”).

The Company has formed and expects to continue to form certain taxable subsidiaries (the “Taxable Subsidiaries”), which are taxed as corporations for income tax purposes. These Taxable Subsidiaries allow the Company to make equity investments in companies organized as pass-through entities while continuing to satisfy the requirements of a RIC under the Code.

The accompanying unaudited consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying our annual consolidated financial statements prepared in accordance with U.S. GAAP have been omitted. The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries, including Fund II, Fund III, Florida Sidecar, and the Taxable Subsidiaries.

The Company’s financial statements as of September 30, 2017 are presented on a consolidated basis. The effects of all intercompany transactions between the Company and its subsidiaries (Fund II, Fund III, Florida Sidecar, and Taxable Subsidiaries) have been eliminated in consolidation. All financial data and information included in these consolidated financial statements have been presented on the basis described above. In the opinion of management, the consolidated financial statements reflect all adjustments that are necessary for the fair presentation of financial results as of and for the periods presented.

The current period’s results of operations are not necessarily indicative of results that ultimately may be achieved for the year. Additionally, the unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto appearing in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on March 7, 2017.

### **Consolidation**

As provided under Regulation S-X and ASC 946, the Company will generally not consolidate its investment in a company other than an investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. Accordingly, the Company consolidated the results of the Company’s wholly owned investment company subsidiaries in its consolidated financial statements. The Company did not consolidate its interest in Capitala Senior Liquid Loan Fund I, LLC (“CSLLF”) during the periods it was in existence because the investment was not considered a substantially wholly owned investment company subsidiary. Further, CSLLF was a joint venture for which shared power existed relating to the decisions that most significantly impacted the economic performance of the entity. See Note 4 to the consolidated financial statements for description of the Company’s investment in CSLLF.

### **Revenues**

We generate revenue primarily from the periodic cash interest we collect on our debt investments. In addition, most of our debt investments offer the opportunity to participate in a borrower’s equity performance through warrant participation, direct equity ownership or otherwise, which we expect to result in revenue in the form of dividends and/or capital gains. Further, we may generate revenue in the form of commitment, origination, amendment, structuring or diligence fees, monitoring fees, fees for providing managerial assistance and possibly consulting fees and performance-based fees. These fees will be recognized as they are earned.

### **Expenses**

Our primary operating expenses include the payment of investment advisory fees to our Investment Advisor, our allocable portion of overhead and other expenses incurred by our Administrator in performing its obligations under an administration agreement between us and the Administrator (the “Administration Agreement”) and other operating expenses as detailed below. Our investment advisory fee will compensate our Investment Advisor for its work in identifying, evaluating, negotiating, closing, monitoring and servicing our investments. We will bear all other expenses of our operations and transactions, including (without limitation):

- the cost of our organization;
- the cost of calculating our net asset value, including the cost of any third-party valuation services;
- the cost of effecting sales and repurchases of our shares and other securities;
- interest payable on debt, if any, to finance our investments;
- fees payable to third parties relating to, or associated with, making investments (such as legal, accounting, and travel expenses incurred in connection with making investments), including fees and expenses associated with performing due diligence reviews of prospective investments and advisory fees;
- transfer agent and custodial fees;

- fees and expenses associated with marketing efforts;
- costs associated with our reporting and compliance obligations under the 1940 Act, the Securities Exchange Act of 1934, as amended, other applicable federal and state securities laws and ongoing stock exchange listing fees;
- federal, state and local taxes;
- independent directors' fees and expenses;
- brokerage commissions;
- costs of proxy statements, stockholders' reports and other communications with stockholders;
- fidelity bond, directors' and officers' liability insurance, errors and omissions liability insurance and other insurance premiums;
- direct costs and expenses of administration, including printing, mailing, telephone and staff;
- fees and expenses associated with independent audits and outside legal costs; and
- all other expenses incurred by either our Administrator or us in connection with administering our business, including payments under the Administration Agreement that will be based upon our allocable portion of overhead and other expenses incurred by our Administrator in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions, and our allocable portion of any costs of compensation and related expenses of our chief compliance officer and our chief financial officer and their respective administrative support staff.

### **Critical Accounting Policies and Use of Estimates**

In the preparation of our consolidated financial statements and related disclosures, we have adopted various accounting policies that govern the application of U.S. GAAP. Our significant accounting policies are described in Note 2 to the consolidated financial statements. While all of these policies are important to understanding our financial statements, certain accounting policies and estimates are considered critical due to their impact on the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the periods covered by such financial statements. We have identified investment valuation, revenue recognition, and income taxes as our most critical accounting estimates. We continuously evaluate our estimates, including those related to the matters described below. Because of the nature of the judgments and assumptions we make, actual results could materially differ from those estimates under different assumptions or conditions. A discussion of our critical accounting policies follows.

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

The Company applies fair value accounting to all of its financial instruments in accordance with the 1940 Act and ASC Topic 820 — *Fair Value Measurements and Disclosures* ("ASC 820"). ASC 820 defines fair value, establishes a framework used to measure fair value and requires disclosures for fair value measurements. In accordance with ASC 820, the Company has categorized its financial instruments carried at fair value, based on the priority of the valuation technique, into a three-level fair value hierarchy as discussed in Note 4 to our consolidated financial statements.

In determining fair value, our board of directors (the "Board") uses various valuation approaches, and engages a third-party independent valuation firm, which provides positive assurance on the investments it reviews. In accordance with U.S. GAAP, a fair value hierarchy for inputs is used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available.

Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Board. Unobservable inputs reflect the Boards' assumptions about the inputs market participants would use in pricing the asset or liability developed based upon the best information available in the circumstances. The fair value hierarchy is categorized into three levels based on the inputs as follows:

**Level 1** — Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 securities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.

**Level 2** — Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

**Level 3** — Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The availability of valuation techniques and observable inputs can vary from security to security and is affected by a wide variety of factors including the type of security, whether the security is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Those estimated values do not necessarily represent the amounts that may be ultimately realized due to the occurrence of future circumstances that cannot be reasonably determined. Because of the inherent uncertainty of valuation, those estimated values may be materially higher or lower than the values that would have been used had a market for the securities existed. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for securities categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement.

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. We use prices and inputs that are current as of the measurement date, including periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many securities. This condition could cause a security to be reclassified to a lower level within the fair value hierarchy.

As a practical expedient, the Company used net asset value ("NAV") as the basis for the fair value of its investment in CSLLF for the periods held. CSLLF recorded its underlying investments at fair value on a daily basis utilizing pricing information from third-party sources.

### ***Valuation Techniques***

#### ***Enterprise Value Waterfall Approach***

The enterprise value waterfall approach determines an enterprise value based on EBITDA multiples of publicly traded companies that are considered similar to the subject portfolio company. The Company considers a variety of items in determining a reasonable pricing multiple, including, but not limited to, operating results, budgeted projections, growth, size, risk, profitability, leverage, management depth, diversification, market position, supplier or customer dependence, asset utilization, liquidity metrics, and access to capital markets. EBITDA of the portfolio company is adjusted for non-recurring items in order to reflect a normalized level of earnings that is representative of future earnings. In certain instances, the Company may also utilize revenue multiples to determine enterprise value. When available, the Company may assign a pricing multiple or value its equity investments based on the value of recent investment transactions in the subject portfolio company or offers to purchase the portfolio company. The enterprise value is adjusted for financial instruments with seniority to the Company's ownership and for the effect of any instrument which may dilute the Company's investment in the portfolio company. The adjusted enterprise value is then apportioned based on the seniority and privileges of the Company's investments within the portfolio company.

The enterprise value waterfall approach is primarily utilized to value the Company's equity securities, including warrants. However, the Company may utilize the enterprise value waterfall approach to value certain debt securities.

#### ***Income Approach***

The income approach utilizes a discounted cash flow methodology in which the Company estimates fair value based on the present value of expected cash flows discounted at a market rate of interest. The determination of a discount rate, or required rate of return, takes into account the portfolio company's fundamentals and perceived credit risk. Because the majority of the Company's portfolio companies do not have a public credit rating, determining a discount rate often involves assigning an implied credit rating based on the portfolio company's operating metrics compared to average metrics of similar publicly rated debt. Operating metrics include, but are not limited to, EBITDA, interest coverage, leverage ratio, return on capital, and debt to equity ratios. The implied credit rating is used to assign a base discount rate range based on publicly available yields on similarly rated debt securities. The Company may apply a premium to the discount rate utilized in determining fair value when performance metrics and other qualitative information indicate that there is an additional level of uncertainty about collectability of cash flows.

### *Asset Approach*

The asset approach values an investment based on value or the underlying collateral securing the investment. This approach is used when the Company has reason to believe that it will not collect all principal and interest in accordance with the contractual terms of the debt agreement.

### **Revenue Recognition**

The Company's revenue recognition policies are as follows:

*Interest income and paid-in-kind interest income:* Interest income is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company has loans in the portfolio that contain a payment-in-kind interest ("PIK interest") provision. The PIK interest, which represents contractually deferred interest added to the loan balance that is generally due at maturity, is recorded on the accrual basis to the extent that such amounts are expected to be collected. PIK interest is not accrued if the Company does not expect the issuer to be able to pay all principal and interest when due.

*Non-accrual investments:* Generally, when interest and/or principal payments on a loan become 90 days or more past due, or when the Company otherwise does not expect the borrower to be able to service its debt and other obligations, the Company will place the loan on non-accrual status, and will generally cease recognizing interest income and PIK interest on that loan for financial reporting purposes. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. The Company writes off any previously accrued and uncollected cash interest when it is determined that interest is no longer considered collectible. The Company may elect to cease accruing PIK interest and continue accruing interest income in cases where a loan is currently paying its interest income but, in management's judgment, there is a reasonable likelihood of principal loss on the loan. Non-accrual loans are returned to accrual status when the borrower's financial condition improves such that management believes current interest and principal payments are expected to be collected.

*Gains and losses on investment sales and paydowns:* Realized gains and losses on investments are recognized using the specific identification method.

*Dividend income and paid-in-kind dividends:* Dividend income is recognized on the date dividends are declared. The Company holds preferred equity investments in the portfolio that contain a payment-in-kind dividend ("PIK dividends") provision. PIK dividends, which represent contractually deferred dividends added to the equity balance, are recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company will typically cease accrual of PIK dividends when the fair value of the equity investment is less than the cost basis of the investment or when it is otherwise determined by management that PIK dividends are unlikely to be collected. If management determines that a decline in fair value is temporary in nature and the PIK dividends are more likely than not to be collected, management may elect to continue accruing PIK dividends.

*Original issue discount:* Discounts received to par on loans purchased are capitalized and accreted into income over the life of the loan. Any remaining discount is accreted into income upon prepayment of the loan.

*Other income:* Origination fees (to the extent services are performed to earn such income), amendment fees, consent fees, and other fees associated with investments in portfolio companies are recognized as income when the investment transaction closes. Prepayment penalties received by the Company for debt instruments repaid prior to the maturity date are recorded as income upon receipt.

### **Income Taxes**

Prior to the Formation Transactions, the Legacy Funds were treated as partnerships for U.S. federal, state and local income tax purposes and, therefore, no provision has been made in the accompanying consolidated financial statements for federal, state or local income taxes. In accordance with the partnership tax law requirements, each partner would include their respective components of the Legacy Funds' taxable profits or losses, as shown on their Schedule K-1 in their respective tax or information returns. The Legacy Funds are disregarded entities for tax purposes prior to and post the Formation Transactions.

The Company has elected to be treated for U.S. federal income tax purposes, and intends to comply with the requirement to qualify annually thereafter, as a RIC under Subchapter M of the Code and, among other things, intends to make the requisite distributions to its stockholders which will relieve the Company from U.S. federal income taxes. Therefore, no provision has been recorded for U.S. federal income taxes.

In order to qualify as a RIC, among other requirements, the Company is required to timely distribute to its stockholders at least 90.0% of its investment company taxable income, as defined by the Code, for each fiscal tax year. The Company will be subject to a nondeductible U.S. federal excise tax of 4.0% on undistributed income if it does not distribute at least 98.0% of its ordinary income in any calendar year and 98.2% of its capital gain net income for each one-year period ending on October 31.

Depending on the level of taxable income earned in an excise tax year, the Company may choose to carry forward taxable income in excess of current year dividend distributions into the next excise tax year and pay a 4.0% excise tax on such income, as required. To the extent that the Company determines that its estimated current year annual taxable income will be in excess of estimated current year dividend distributions for excise tax purposes, the Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned. Since the Company's IPO, the Company has not accrued or paid excise tax.

The Company's Taxable Subsidiaries accrue income taxes payable based on the applicable statutory rates on the unrealized appreciation of the underlying investments held by the Taxable Subsidiaries. As of September 30, 2017, and December 31, 2016, the Company recorded a deferred tax liability of \$2.7 million and \$0.0 million, respectively. For the three and nine months ended September 30, 2017, the Company recorded a change in provision for deferred taxes on unrealized appreciation on investments of \$2.7 million. For the three and nine months ended September 30, 2016, no change in provision for deferred taxes on unrealized appreciation on investments was recorded.

In accordance with certain applicable treasury regulations and private letter rulings issued by the Internal Revenue Service, a RIC may treat a distribution of its own stock as fulfilling its RIC distribution requirements if each stockholder may elect to receive its entire distribution in either cash or stock of the RIC, subject to a limitation on the aggregate amount of cash to be distributed to all stockholders, which limitation must be at least 20.0% of the aggregate declared distribution. If too many stockholders elect to receive cash, each stockholder electing to receive cash will receive a pro rata amount of cash (with the balance of the distribution paid in stock). In no event will any stockholder, electing to receive cash, receive less than 20.0% of its entire distribution in cash. If these and certain other requirements are met, for U.S. federal income tax purposes, the amount of the dividend paid in stock will be equal to the amount of cash that could have been received instead of stock.

ASC Topic 740 — *Income Taxes* ("ASC 740"), provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the consolidated financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax positions deemed to meet a "more-likely-than-not" threshold would be recorded as a tax benefit or expense in the current period. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits as income tax expense in the consolidated statements of operations. As of September 30, 2017 and December 31, 2016, there were no uncertain tax positions.

The Company is required to determine whether a tax position of the Company is more likely-than-not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. De-recognition of a tax benefit previously recognized could result in the Company recording a tax liability that could negatively impact the Company's net assets.

U.S. GAAP provides guidance on thresholds, measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition that is intended to provide better financial statement comparability among different entities.

The Company has concluded that it was not necessary to record a liability for any such tax positions as of September 30, 2017 and December 31, 2016. However, the Company's conclusions regarding this policy may be subject to review and adjustment at a later date based on factors including, but not limited to, ongoing analyses of, and changes to, tax laws, regulations and interpretations thereof.

The Company's activities from commencement of operations remain subject to examination by U.S. federal, state, and local tax authorities. No interest expense or penalties have been assessed as of September 30, 2017 and December 31, 2016. If the Company were required to recognize interest and penalties, if any, related to unrecognized tax benefits this would be recognized as income tax expense in the consolidated statements of operations.

#### **Portfolio and Investment Activity**

As of September 30, 2017, our portfolio consisted of investments in 46 portfolio companies with a fair value of approximately \$471.1 million.

During the three months ended September 30, 2017, we made approximately \$11.4 million of investments and had approximately \$22.4 million in repayments and sales resulting in net repayments and sales of approximately \$11.0 million for the period. During the three months ended September 30, 2016, we made approximately \$26.0 million of investments and had approximately \$111.9 million in repayments and sales resulting in net investments of approximately \$85.9 million for the period.

During the nine months ended September 30, 2017, we made approximately \$39.7 million of investments and had approximately \$104.7 million in repayments and sales of investments resulting in net repayments and sales of approximately \$65.0 million for the period. During the nine months ended September 30, 2016, we made approximately \$53.9 million of investments and had approximately \$128.6 million in repayments and sales resulting in net repayments and sales of approximately \$74.7 million for the period.

On August 31, 2016, we sold a portion of 14 securities across 10 portfolio companies to CapitalSouth Partners Florida Sidecar Fund II, L.P. ("FSC II"), including granting an option to acquire a portion of our equity investment in Eastport Holdings, LLC (the "Written Call Option"), in exchange for 100% of the partnership interests in FSC II. Concurrent with the sale of these assets to FSC II, we received cash consideration of \$47.6 million from an affiliated third-party purchaser in exchange for 100% of the partnership interests of FSC II. These assets were sold to FSC II at their June 30, 2016 fair market values, resulting in a net realized gain of \$0.1 million. Our Board pre-approved this transaction pursuant to Section 57(f) of the 1940 Act.

The Company collected and will periodically collect principal and interest payments related to certain of the securities purchased by FSC II. Such principal and interest payments will be remitted timely to FSC II based on its proportionate share of the security. FSC II does not have any recourse to the Company related to the non-payment of principal or interest by the underlying issuers of the securities.

The Written Call Option granted FSC II the right to purchase up to 31.25% of our equity investment in Eastport Holdings, LLC. The Written Call Option has a strike price of \$1.5 million and a termination date of August 31, 2018. The fair value of the Written Call Option, which has been treated as a derivative liability and is recorded in the financial statement line item Written Call Option at fair value in our consolidated statements of assets and liabilities, was approximately \$5.6 million as of September 30, 2017. For purposes of determining the fair value of the Written Call Option, we calculated the difference in the fair value of the underlying equity investment in Eastport Holdings, LLC and the strike price of the Written Call Option, or intrinsic value. The time value of the Written Call Option as of September 30, 2017 was determined to be insignificant. The Written Call Option is classified as a Level 3 financial instrument.

As of September 30, 2017, our average portfolio company investment and our largest portfolio company investment at amortized cost and fair value was approximately \$9.9 million and \$22.1 million, and \$10.2 million and \$38.9 million, respectively. As of September 30, 2017, the Company had approximately \$52.3 million of cash and cash equivalents. As of December 31, 2016, our average portfolio company investment and our largest portfolio company investment at amortized cost and fair value was approximately \$9.7 million and \$10.2 million, and \$22.1 million and \$29.9 million, respectively. As of December 31, 2016, the Company had approximately \$36.3 million of cash and cash equivalents.

As of September 30, 2017, our debt investment portfolio, which represented 76.0% of our total portfolio, had a weighted average annualized yield of approximately 12.9%, exclusive of the impact of our non-accrual debt investments. As of September 30, 2017, 58.2% of our debt investment portfolio was bearing a fixed rate of interest. As of December 31, 2016, our debt investment portfolio, which represented 82.8% of our total portfolio, had a weighted average annualized yield of approximately 13.2%, exclusive of the impact of our non-accrual debt investments. As of December 31, 2016, 57.1% of our debt investment portfolio was bearing a fixed rate of interest.

The following table summarizes the amortized cost and the fair value of investments and cash and cash equivalents as of September 30, 2017 (dollars in thousands):

	Investments at Amortized Cost	Percentage of Total	Investments at Fair Value	Percentage of Total
First Lien Debt	\$ 246,188	48.5%	\$ 221,205	42.2%
Second Lien Debt	32,284	6.4	30,774	5.9
Subordinated Debt	120,161	23.7	106,019	20.3
Equity and Warrants	56,081	11.1	113,108	21.6
Cash and Cash Equivalents	52,307	10.3	52,307	10.0
Total	<u>\$ 507,021</u>	<u>100.0%</u>	<u>\$ 523,413</u>	<u>100.0%</u>

The following table summarizes the amortized cost and the fair value of investments and cash and cash equivalents as of December 31, 2016 (dollars in thousands):

	Investments at Amortized Cost	Percentage of Total	Investments at Fair Value	Percentage of Total
First Lien Debt	\$ 244,647	44.5%	\$ 226,578	39.2%
Second Lien Debt	74,559	13.5	71,483	12.3
Subordinated Debt	148,849	27.1	150,232	26.0
Equity and Warrants	45,721	8.3	93,346	16.2
Cash and Cash Equivalents	36,281	6.6	36,281	6.3
Total	<u>\$ 550,057</u>	<u>100.0%</u>	<u>\$ 577,920</u>	<u>100.0%</u>



The following table shows the portfolio composition by industry grouping at fair value (dollars in thousands):

	September 30, 2017		December 31, 2016	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
Business Services	\$ 64,264	13.6%	\$ 51,731	9.5%
Consumer Products	30,135	6.4	30,209	5.6
Financial Services	29,232	6.2	25,553	4.7
Information Technology	24,490	5.2	24,232	4.5
Oil & Gas Services	23,033	4.9	15,083	2.8
Specialty Retail	21,288	4.5	22,067	4.1
Building Products	17,952	3.8	18,152	3.3
Footwear Retail	17,556	3.7	19,236	3.5
Food Product Manufacturer	16,774	3.6	16,599	3.1
Sales & Marketing Services	16,173	3.4	16,376	3.0
Industrial Equipment Rental	15,374	3.3	10,755	2.0
Retail	14,915	3.2	15,000	2.8
Bowling Products	13,330	2.8	12,503	2.3
Textile Equipment Manufacturer	12,830	2.7	13,134	2.4
Computer Supply Retail	12,411	2.6	12,183	2.2
Fuel Transportation Services	11,588	2.5	10,303	1.9
Transportation	10,913	2.3	16,856	3.1
Healthcare Management	9,892	2.1	10,851	2.0
Professional and Personal Digital Imaging	9,415	2.0	9,000	1.7
Automobile Part Manufacturer	9,320	2.0	10,076	1.9
Consumer Electronics	8,477	1.8	20,818	3.8
QSR Franchisor	8,404	1.8	8,497	1.6
Government Services	8,070	1.7	—	—
Conglomerate	7,603	1.6	8,374	1.5
Healthcare	7,571	1.6	8,582	1.6
Oil & Gas Engineering and Consulting Services	6,958	1.5	4,500	0.8
Produce Distribution	6,035	1.3	6,182	1.1
Farming	5,724	1.2	11,779	2.2
Advertising & Marketing Services	5,069	1.1	3,910	0.7
Restaurant	4,874	1.0	4,857	0.9
Medical Device Distributor	4,684	1.0	25,768	4.8
Printing Services	3,999	0.8	12,761	2.4
Online Merchandise Retailer	3,840	0.8	4,169	0.8
Home Repair Parts Manufacturer	3,213	0.7	1,408	0.3
Replacement Window Manufacturer	2,706	0.6	2,571	0.5
Household Product Manufacturer	1,184	0.3	1,001	0.2
Data Processing & Digital Marketing	1,035	0.2	1,015	0.2
Retail Display & Security Services	439	0.2	537	0.1
In-Home Healthcare Services	142	0.0	446	0.1
Automotive Chemicals & Lubricants	101	0.0	2,230	0.4
Dental Practice Management	93	0.0	109	0.0
Home Décor Manufacturer	—	—	14,670	2.7
Bakery Supplies Distributor	—	—	10,776	2.0
Construction Services	—	—	9,500	1.7
Specialty Clothing	—	—	5,011	0.9
Satellite Communications	—	—	5,000	0.9
Industrial Specialty Services	—	—	4,750	0.9
Specialty Defense Contractor	—	—	1,532	0.3
Entertainment	—	—	987	0.2
Total	\$ 471,106	100.0%	\$ 541,639	100.0

With the exception of the international investment holdings noted below, all investments made by the Company as of September 30, 2017 and December 31, 2016 were made in portfolio companies located in the U.S. The geographic composition is determined by the location of the corporate headquarters of the portfolio company, which may not be indicative of the primary source of the portfolio company's business. The following table shows the portfolio composition by geographic region at fair value as of September 30, 2017 and December 31, 2016 (dollars in thousands):

	September 30, 2017		December 31, 2016	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
South	\$ 231,305	49.1%	\$ 257,162	47.5%
West	97,503	20.7	85,642	15.8
Midwest	85,027	18.0	118,682	21.9
Northeast	46,039	9.8	68,613	12.7
International	11,232	2.4	11,540	2.1
Total	\$ 471,106	100.0%	\$ 541,639	100.0%

In addition to various risk management tools, our Investment Advisor also uses an investment rating system to characterize and monitor our expected level of return on each investment in our portfolio.

As part of our valuation procedures, we risk rate all of our investments. In general, our investment rating system uses a scale of 1 to 5, with 1 being the lowest probability of default and principal loss. Our internal rating is not an exact system, but it is used internally to estimate the probability of: (i) default on our debt securities and (ii) loss of our debt principal, in the event of a default. In general, our internal rating system may also assist our valuation team in its determination of the estimated fair value of equity securities or equity-like securities. Our internal risk rating system generally encompasses both qualitative and quantitative aspects of our portfolio companies.

Our internal investment rating system incorporates the following five categories:

Investment Rating	Definition
1	In general, the investment may be performing above our internal expectations. Full return of principal and interest is expected. Capital gain is expected.
2	In general, the investment may be performing within our internal expectations, and potential risks to the applicable investment are considered to be neutral or favorable compared to any potential risks at the time of the original investment. All new investments are initially given this rating.
3	In general, the investment may be performing below our internal expectations and therefore, investments in this category may require closer internal monitoring; however, the valuation team believes that no loss of investment return (interest and/or dividends) or principal is expected. The investment also may be out of compliance with certain financial covenants.
4	In general, the investment may be performing below internal expectations and quantitative or qualitative risks may have increased substantially since the original investment. Loss of some or all principal is expected.
5	In general, the investment may be performing substantially below our internal expectations and a number of quantitative or qualitative risks may have increased substantially since the original investment. Loss of some or all principal is expected.

Our Investment Advisor will monitor and, when appropriate, change the investment ratings assigned to each investment in our portfolio. In connection with our valuation process, our Investment Advisor will review these investment ratings on a quarterly basis. The investment rating of a particular investment should not, however, be deemed to be a guarantee of the investment's future performance.

The following table shows the distribution of our investments on the 1 to 5 investment rating scale at fair value as of September 30, 2017 and December 31, 2016 (dollars in thousands):

Investment Performance Rating	As of September 30, 2017		As of December 31, 2016	
	Investments at Fair Value	Percentage of Total Investments	Investments at Fair Value	Percentage of Total Investments
1	\$ 188,611	40.0%	\$ 183,826	33.9%
2	149,196	31.7	215,058	39.7
3	106,529	22.6	125,381	23.2
4	26,770	5.7	17,374	3.2
5	—	—	—	—
Total	\$ 471,106	100.0%	\$ 541,639	100.0%

As of September 30, 2017, we had debt investments in 4 portfolio companies on non-accrual status with an amortized cost of \$57.2 million and a fair value of \$26.8 million, which represented 12.6% and 5.7% of the investment portfolio, respectively. As of December 31, 2016, we had debt investments in 3 portfolio companies on non-accrual status with amortized cost of \$29.5 million and a fair value of \$17.4 million, which represented 5.7% and 3.2% of the investment portfolio, respectively.

#### **Capitala Senior Liquid Loan Fund I, LLC**

On March 24, 2015, the Company and Trinity Universal Insurance Company (“Trinity”), a subsidiary of Kemper Corporation, entered into a limited liability company agreement to co-manage CSLLF. The purpose and design of the joint venture was to invest primarily in broadly syndicated senior secured loans to middle-market companies, which were purchased on the secondary market. Capitala and Trinity committed to provide \$25.0 million of equity to CSLLF, with Capitala providing \$20.0 million and Trinity providing \$5.0 million, resulting in an 80%/20% economic ownership between the two parties. The board of directors and investment committee of CSLLF were split 50/50 between Trinity and Capitala, resulting in equal voting power between the two entities. In September 2016, the Company and Trinity elected to wind-down operations of CSLLF. During the fourth quarter of 2016, CSLLF sold all referenced assets underlying the total return swap (“TRS”) and declared final distributions, inclusive of dividends and return of capital, in December 2016.

Because the TRS was wound down in a prior period, only comparative period disclosures are included herein. For the three and nine months ended September 30, 2016, the Company received \$0.5 million and \$1.6 million, respectively, in dividend income from its equity interest in CSLLF.

On March 27, 2015, CSLLF entered into a TRS with Bank of America, N.A. (“Bank of America”) that was indexed to a basket of senior secured loans purchased by CSLLF. CSLLF obtained the economic benefit of the loans underlying the TRS, including the net interest spread between the interest income generated by the underlying loans and the interest expense type payment under the TRS, the realized gain (loss) on liquidated loans, and the unrealized appreciation (depreciation) on the underlying loans.

The terms of the TRS were governed by an ISDA 2002 Master Agreement, the Schedule thereto, and Credit Support Annex to such Schedule, and the confirmation exchanged thereunder, between CSLLF and Bank of America, which collectively established the TRS, and are collectively referred to herein as the “TRS Agreement.” Pursuant to the terms of the TRS Agreement, CSLLF selected a portfolio of loans with a maximum market value (determined at the time each such loan becomes subject to the TRS) of \$100.0 million, which was also referred to as the maximum notional amount of the TRS. Each individual loan, and the portfolio of loans taken as a whole, had to meet criteria described in the TRS Agreement. CSLLF received from Bank of America a periodic payment on set dates that was based upon any coupons, both earned and accrued, generated by the loans underlying the TRS, subject to limitations described in the TRS Agreement as well as any fees associated with the loans included in the portfolio. CSLLF paid to Bank of America interest at a rate equal to the London Interbank Offered Rate (“LIBOR”) plus 1.25% per annum; the LIBOR option paid by CSLLF was determined on an asset by asset basis such that the tenor of the LIBOR option (1 month, 3 month, etc.) matched the tenor of the underlying reference asset. In addition, upon the termination of any loan subject to the TRS or any repayment of the underlying reference asset, CSLLF either received from Bank of America the appreciation in the value of such loan, or paid to Bank of America any depreciation in the value of such loan.

CSLLF was required to pay an unused facility fee of 1.25% on any amount of unused facility under the minimum facility amount of \$70.0 million as outlined in the TRS Agreement. Such unused facility fees were not applied during the first 4 months and last 60 days of the term of the TRS. CSLLF also agreed to pay Bank of America customary fees and expenses in connection with the establishment and maintenance of the TRS.

CSLLF was required to initially cash collateralize a specified percentage of each loan (generally 20% to 35% of the market value of senior secured loans) included under the TRS in accordance with margin requirements described in the TRS Agreement. As of December 31, 2016, CSLLF had posted \$0.0 million in collateral to Bank of America in relation to the TRS which was recorded on CSLLF’s statements of assets and liabilities as cash held as collateral on total return swap. The cash collateral represented CSLLF’s maximum credit exposure as of December 31, 2016.

In connection with the TRS, CSLLF made customary representations and warranties and was required to comply with various covenants, reporting requirements and other customary requirements for similar transactions governed by an ISDA 2002 Master Agreement.

CSLLF's receivable due on the TRS represents realized amounts from payments on underlying loans in the total return swap portfolio. At December 31, 2016, the receivable due on TRS was \$0.1 million, respectively, and is recorded on CSLLF's statement of assets and liabilities below. CSLLF does not offset collateral posted in relation to the TRS with any unrealized appreciation or depreciation outstanding in the statement of assets and liabilities as of December 31, 2016.

Transactions in TRS contracts during the three and nine months ended September 30, 2016 resulted in \$1.4 million and \$2.8 million, respectively, in realized gains and \$0.8 million and \$2.4 million, respectively, in unrealized appreciation, which was recorded on CSLLF's statements of operations below.

The following represents the volume of the CSLLF's derivative transactions during the three and nine months ended September 30, 2016 (dollars in thousands):

	<b>For the Three Months Ended September 30, 2016</b>	<b>For the Nine Months Ended September 30, 2016</b>
Average notional par amount of contract	\$ 68,935	\$ 74,674

Below is certain summarized financial information for CSLLF as of December 31, 2016 and for the three and nine months ended September 30, 2016 (dollars in thousands):

**Selected Statements of Assets and Liabilities:**

	<b>As of December 31, 2016</b>
<b>ASSETS</b>	
Receivable due on Total Return Swap	\$ 82
Total assets	<u>\$ 82</u>
<b>LIABILITIES</b>	
Distribution payable	\$ 82
Total liabilities	<u>\$ 82</u>
<b>NET ASSETS</b>	
Total net assets	\$ —
Total liabilities and net assets	<u>\$ 82</u>

**Selected Statements of Operation (unaudited):**

	<b>For the Three Months Ended September 30, 2016</b>	<b>For the Nine Months Ended September 30, 2016</b>
Administrative and legal expenses	\$ (15)	\$ (131)
Net operating loss	<u>\$ (15)</u>	<u>\$ (131)</u>
Net realized gain on Total Return Swap	\$ 1,374	\$ 2,810
Net unrealized appreciation on Total Return Swap	775	2,380
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	<u>\$ 2,134</u>	<u>\$ 5,059</u>

## Results of Operations

Operating results for the three and nine months ended September 30, 2017 and 2016 were as follows (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Total investment income	\$ 12,312	\$ 17,357	\$ 39,489	\$ 51,798
Total expenses, net of incentive fee waivers	7,902	9,916	28,185	29,505
Net investment income	4,410	7,441	11,304	22,293
Net realized gain (loss) from investments	(10,283)	(17,030)	(749)	(24,897)
Net unrealized appreciation (depreciation) on investments	3,187	8,474	(11,471)	4,557
Net unrealized depreciation on written call option	(407)	(898)	(2,819)	(898)
Change in provision for deferred taxes on unrealized appreciation on investments	(2,660)	—	(2,660)	—
Net increase (decrease) in net assets resulting from operations	\$ (5,753)	\$ (2,013)	\$ (6,395)	\$ 1,055

### Investment income

The composition of our investment income for the three and nine months ended September 30, 2017 and 2016 was as follows (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Interest income	\$ 9,514	\$ 14,654	\$ 31,288	\$ 43,002
Fee income	247	561	1,243	2,303
Payment-in-kind interest and dividend income	1,880	1,518	5,638	3,966
Dividend income	580	574	1,110	2,427
Other income	48	42	125	85
Interest from cash and cash equivalents	43	8	85	15
Total investment income	\$ 12,312	\$ 17,357	\$ 39,489	\$ 51,798

The income reported as interest income and PIK interest and dividend income is generally based on the stated rates as disclosed in our consolidated schedule of investments. Accretion of discounts paid for purchased loans are included in interest income as an adjustment to yield. As a general rule, our interest income and PIK interest and dividend income are recurring in nature.

We also generate fee income primarily through origination fees charged for new investments, and secondarily via amendment fees, consent fees, prepayment penalties, and other fees. While the fee income is typically non-recurring for each investment, most of our new investments include an origination fee; as such, fee income is dependent upon our volume of directly originated investments and the fee structure associated with those investments.

We earn dividends on certain equity investments within our investment portfolio. As noted in our consolidated schedule of investments, some investments are scheduled to pay a periodic dividend, though these recurring dividends do not make up a significant portion of our total investment income. We may and have received more substantial one-time dividends from our equity investments.

For the three months ended September 30, 2017, total investment income decreased by \$5.0 million, or 29.1%, compared to the three months ended September 30, 2016. The period over period decline was driven primarily by a \$5.1 million decline in interest income due to less average investments outstanding and an increase in non-accrual investments. For the three months ended September 30, 2017, PIK income increased by \$0.4 million compared to the three months ended September 30, 2016, primarily due to investment restructurings that provided for an increase in the PIK rate being charged. For the three months ended September 30, 2017, we generated \$0.2 million in origination fees from new deployments and \$45 thousand in non-origination fees. Comparatively, for the three months ended September 30, 2016, we generated no origination fees from new deployments and \$0.6 million in non-origination fees.

For the nine months ended September 30, 2017, total investment income decreased by \$12.3 million, or 23.8%, compared to the nine months ended September 30, 2016. The period over period decline was driven primarily by a \$11.7 million decline in interest income due to less average debt investments outstanding and an increase in non-accrual investments. For the nine months ended September 30, 2017, PIK income increased by \$1.7 million compared to the nine months ended September 30, 2016, primarily due to investment restructurings that provided for an increase to the PIK rate being charged. For the nine months ended September 30, 2017, we generated \$0.6 million in origination fees from new deployments and \$0.6 million in non-origination fees. Comparatively, for the nine months ended September 30, 2016, we generated \$0.7 million in origination fees from new deployments and \$1.6 million in non-origination fees. Dividend income decreased from \$2.4 million for the nine months ended September 30, 2016, to \$1.1 million for the nine months ended September 30, 2017. The decrease in dividend income was driven primarily by the wind-down of CSLLF, which did not pay a dividend for the nine months ended September 30, 2017, but paid a dividend of \$1.6 million for the nine months ended September 30, 2016.

### **Operating expenses**

The composition of our expenses for the three and nine months ended September 30, 2017 and September 30, 2016 was as follows (dollars in thousands):

	<b>For the three months ended</b>		<b>For the nine months ended</b>	
	<b>September 30, 2017</b>	<b>September 30, 2016</b>	<b>September 30, 2017</b>	<b>September 30, 2016</b>
Interest and financing expenses	\$ 4,585	\$ 4,938	\$ 14,726	\$ 14,990
Loss on extinguishment of debt	—	—	2,732	—
Base management fee	2,417	2,619	7,436	8,049
Incentive fees, net of incentive fee waiver	—	1,470	350	3,482
General and administrative expenses	900	889	2,941	2,984
Total expenses, net of incentive fee waiver	<u>\$ 7,902</u>	<u>\$ 9,916</u>	<u>\$ 28,185</u>	<u>\$ 29,505</u>

For the three months ended September 30, 2017, operating expenses decreased \$2.0 million, or 20.3%, compared to the three months ended September 30, 2016. For the three months ended September 30, 2017, interest and financing expenses decreased \$0.4 million compared to the three months ended September 30, 2016, due primarily to lower Credit Facility utilization during the period. Management fees declined by \$0.2 million, from \$2.6 million for the three months ended September 30, 2016 to \$2.4 million for the three months ended September 30, 2017, due to lower average assets under management. Incentive fees, net of incentive fee waiver, declined by \$1.5 million, from \$1.5 million for the three months ended September 30, 2016 to \$0.0 for the three months ended September 30, 2017, due to lower pre-incentive fee net investment income.

For the nine months ended September 30, 2017, operating expenses decreased \$1.3 million, or 4.5%, compared to the nine months ended September 30, 2016. For the nine months ended September 30, 2017, we recognized a \$2.7 million loss on extinguishment of debt related to repayment of the 2021 Notes. The increase in expenses related to the loss on extinguishment of debt was offset by (i) a decline in management fees, from \$8.0 million for the nine months ended September 30, 2016 to \$7.4 million for the nine months ended September 30, 2017, due to lower average assets under management and (ii) a decline in net incentive fees, net of incentive fee waiver from \$3.5 million for the nine months ended September 30, 2016 to \$0.4 million for the nine months ended September 30, 2017, due to lower pre-incentive fee net investment income, and (iii) a decline in interest and financing expense, from \$15.0 million for the nine months ended September 30, 2016 to \$14.7 million for the nine months ended September 30, 2017, due to a lower average debt balance outstanding during the period.

### **Net realized gains (losses) on sales of investments**

During the three and nine months ended September 30, 2017, we recognized \$(10.3) million and \$(0.7) million, respectively, of net realized losses on our portfolio investments. During the three and nine months ended September 30, 2016, we recognized \$(17.0) million and \$(24.9) million, respectively, of net realized losses on our portfolio investments.

### **Net unrealized appreciation (depreciation) on investments**

Net change in unrealized appreciation (depreciation) on investments reflects the net change in the fair value of our investment portfolio. For the three months ended September 30, 2017 we had \$3.2 million of net unrealized appreciation on investments. For the nine months ended September 30, 2017 we had \$(11.5) million of net unrealized depreciation on investments. For the three months ended September 30, 2016 we had \$8.5 million of net unrealized appreciation on investments. For the nine months ended September 30, 2016 we had \$4.6 million of net unrealized appreciation on investments.

### **Change in provision for deferred taxes on unrealized appreciation on investments**

Change in provision for deferred taxes on unrealized appreciation on investments reflects the deferred tax effect of the net change in unrealized appreciation of investments held in our Taxable Subsidiaries. For the three and nine months ended September 30, 2017, we had a change in provision for deferred taxes on unrealized appreciation on investments of \$(2.7) million. For the three and nine months ended September 30, 2016, we had no change in provision for deferred taxes on unrealized appreciation on investments.

### ***Net unrealized appreciation (depreciation) on Written Call Option***

For the three and nine months ended September 30, 2017, we had net unrealized depreciation on the Written Call Option of \$(0.4) million and \$(2.8) million, respectively. For the three and nine months ended September 30, 2016 we had net unrealized depreciation on the Written Call Option of \$(0.9) million. As previously noted, unrealized appreciation (depreciation) on the Written Call Option is based on the change in fair value of the underlying equity investment in Eastport Holdings, LLC, less the strike price of the Written Call Option.

### ***Changes in net assets resulting from operations***

For the three and nine months ended September 30, 2017, we recorded a net decrease in net assets resulting from operations of \$(5.8) million and \$(6.4) million, respectively. Based on the weighted average shares of common stock outstanding for the three and nine months ended September 30, 2017, our per share net decrease in net assets resulting from operations was \$(0.36) and \$(0.40), respectively. For the three and nine months ended September 30, 2016, we recorded a net increase (decrease) in net assets resulting from operations of \$(2.0) million and \$1.1 million, respectively. Based on the weighted average shares of common stock outstanding for the three and nine months ended September 30, 2016, our per share net increase in net assets resulting from operations was \$(0.13) and \$0.07, respectively.

### **Summarized Financial Information of Our Unconsolidated Subsidiaries**

The Company holds a control interest, as defined by the 1940 Act, in six portfolio companies that are considered significant subsidiaries under the guidance in Regulation S-X, but are not consolidated in the Company's consolidated financial statements. Below is a brief description of each such portfolio company, along with summarized financial information as of September 30, 2017 and December 31, 2016, and for the nine months ended September 30, 2017 and September 30, 2016, respectively.

#### ***CableOrganizer Acquisition, LLC***

CableOrganizer Acquisition, LLC, a Delaware limited liability company that began operations on April 23, 2013, is a leading online provider of cable and wire management products. The income the Company generated from CableOrganizer Acquisition, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$1.3 million and \$1.4 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

#### ***Eastport Holdings, LLC***

Eastport Holdings, LLC, an Ohio limited liability company organized on November 1, 2011, is a holding company consisting of marketing and advertising companies located across the U.S. The income the Company generated from Eastport Holdings, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$7.9 million and \$11.0 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

#### ***Kelle's Transport Service, LLC***

Kelle's Transport Service, LLC, a Delaware limited liability company organized on March 28, 2014, provides temperature sensitive transportation services throughout North America. The loss the Company generated from Kelle's Transport Service, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$(3.7) million and \$(1.2) million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

#### ***Navis Holdings, Inc.***

Navis Holdings, Inc., incorporated in Delaware on December 21, 2010, designs and manufactures leading machinery for the global knit and woven finishing textile industries. The income the Company generated from Navis Holdings, Inc., which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation) was \$0.8 million and \$2.1 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

#### ***On-Site Fuel Services, Inc.***

On-Site Fuel Services, Inc. is a 100% owned subsidiary of On-Site Fuel Holdings, Inc., which was incorporated in Delaware on December 19, 2011. On-Site Fuel Services, Inc. provides fueling services for commercial and government vehicle fleets throughout the southeast U.S. The income the Company generated from On-Site Fuel Service, Inc., which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$0.1 million and \$1.9 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

#### ***Micro Precision, LLC***

Micro Precision, LLC, formed on August 5, 2011 as a Delaware limited liability company, is a prime contractor supplying critical parts and mechanical assemblies to the United States Department of Defense as well as designer and manufacturer of locomotive air horns. The income (loss) the Company generated from Micro Precision, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation (depreciation), was \$(0.2) million and \$0.7 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

The summarized unaudited financial information of our unconsolidated subsidiaries was as follows (dollars in thousands):

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheet – CableOrganizer Acquisition, LLC</b>		
Current assets	\$ 8,859	\$ 5,589
Noncurrent assets	9,714	9,872
Total assets	<u>\$ 18,573</u>	<u>\$ 15,461</u>
Current liabilities	\$ 8,365	\$ 4,219
Noncurrent liabilities	12,247	11,882
Total liabilities	<u>\$ 20,612</u>	<u>\$ 16,101</u>
Total deficit	<u>\$ (2,039)</u>	<u>\$ (640)</u>
<b>Statements of Operations – CableOrganizer Acquisition, LLC</b>		
	September 30, 2017	September 30, 2016
Net sales	\$ 21,926	\$ 17,440
Cost of goods sold	15,558	11,703
Gross profit	<u>\$ 6,368</u>	<u>\$ 5,737</u>
Other expenses	\$ 7,767	\$ 6,877
Loss before income taxes	(1,399)	(1,140)
Income tax benefit	—	—
Net loss	<u>\$ (1,399)</u>	<u>\$ (1,140)</u>
<b>Balance Sheet – Eastport Holdings, LLC</b>		
	September 30, 2017	December 31, 2016
Current assets	\$ 93,749	\$ 96,175
Noncurrent assets	150,772	145,802
Total assets	<u>\$ 244,521</u>	<u>\$ 241,977</u>
Current liabilities	\$ 153,294	\$ 157,622
Noncurrent liabilities	44,558	41,355
Total liabilities	<u>\$ 197,852</u>	<u>\$ 198,977</u>
Total equity	<u>\$ 46,669</u>	<u>\$ 43,000</u>
<b>Statements of Operations – Eastport Holdings, LLC</b>		
	September 30, 2017	September 30, 2016
Net sales	\$ 415,289	\$ 388,036
Cost of goods sold	308,434	305,926
Gross profit	<u>\$ 106,855</u>	<u>\$ 82,110</u>
Other expenses	\$ 102,116	\$ 76,195
Income before income taxes	4,739	5,915
Income tax provision	650	1,596
Net income	<u>\$ 4,089</u>	<u>\$ 4,319</u>



	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheet – Kelle’s Transport Services, LLC</b>		
Current assets	\$ 8,863	\$ 8,415
Noncurrent assets	12,379	13,374
Total assets	<u>\$ 21,242</u>	<u>\$ 21,789</u>
Current liabilities	\$ 12,073	\$ 4,664
Noncurrent liabilities	17,487	14,962
Total liabilities	<u>\$ 29,560</u>	<u>\$ 19,626</u>
Total equity(deficit)	<u>\$ (8,318)</u>	<u>\$ 2,163</u>

	For the nine months ended	
	September 30, 2017	September 30, 2016
<b>Statements of Operations – Kelle’s Transport Services, LLC</b>		
Net sales	\$ 38,594	\$ 49,095
Cost of goods sold	37,879	41,198
Gross profit	<u>\$ 715</u>	<u>\$ 7,897</u>
Other expenses	\$ 10,906	\$ 9,219
Loss before income taxes	(10,191)	(1,322)
Income tax provision	—	43
Net loss	<u>\$ (10,191)</u>	<u>\$ (1,365)</u>

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheets - Navis Holdings, Inc.</b>		
Current assets	\$ 4,967	\$ 4,655
Noncurrent assets	3,131	3,446
Total assets	<u>\$ 8,098</u>	<u>\$ 8,101</u>
Current liabilities	\$ 2,473	\$ 2,448
Noncurrent liabilities	7,006	6,719
Total liabilities	<u>\$ 9,479</u>	<u>\$ 9,167</u>
Total deficit	<u>\$ (1,381)</u>	<u>\$ (1,066)</u>

	For the nine months ended	
	September 30, 2017	September 30, 2016
<b>Statement of Operations - Navis Holdings, Inc.</b>		
Net sales	\$ 9,990	\$ 13,866
Cost of goods sold	6,251	8,585
Gross profit	<u>\$ 3,739</u>	<u>\$ 5,281</u>
Other expenses	\$ 3,389	\$ 3,666
Income before income taxes	350	1,615
Income tax provision	140	633
Net income	<u>\$ 210</u>	<u>\$ 982</u>

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheets - On-Site Fuel Services, Inc.</b>		
Current assets	\$ 22,400	\$ 13,079
Noncurrent assets	22,930	16,283
Total assets	<u>\$ 45,330</u>	<u>\$ 29,362</u>
Current liabilities	\$ 21,157	\$ 35,244
Noncurrent liabilities	34,215	1,127
Total liabilities	<u>\$ 55,372</u>	<u>\$ 36,371</u>
Total deficit	<u>\$ (10,042)</u>	<u>\$ (7,009)</u>

	For the nine months ended	
	September 30, 2017	September 30, 2016
<b>Statement of Operations - On-Site Fuel Services, Inc.</b>		
Net sales	\$ 113,822	\$ 78,408
Cost of goods sold	93,013	62,522

Gross profit	\$ 20,809	\$ 15,886
Other expenses	\$ 23,843	\$ 18,785
Loss before income taxes	(3,034)	(2,899)
Income tax provision	-	-
Net loss	\$ (3,034)	\$ (2,899)

	As of	
	September 30, 2017	December 31, 2016
<b>Balance Sheets - Micro Precision, LLC</b>		
Current assets	\$ 6,312	\$ 10,580
Noncurrent assets	19,808	15,562
Total assets	<u>\$ 26,120</u>	<u>\$ 26,142</u>
Current liabilities	\$ 7,253	\$ 8,680
Noncurrent liabilities	13,951	16,137
Total liabilities	<u>\$ 21,204</u>	<u>\$ 24,817</u>
Total equity	<u>\$ 4,916</u>	<u>\$ 1,325</u>
<b>Statement of Operations - Micro Precision, LLC</b>		
	For the nine months ended	
	September 30, 2017	September 30, 2016
Net sales	\$ 12,289	\$ 13,294
Cost of goods sold	7,522	8,659
Gross profit	<u>\$ 4,767</u>	<u>\$ 4,635</u>
Other expenses	\$ 4,509	\$ 5,101
Income/(loss) before income taxes	258	(466)
Income tax provision	-	-
Net income/(loss)	<u>\$ 258</u>	<u>\$ (466)</u>

#### Financial Condition, Liquidity and Capital Resources

We use and intend to use existing cash primarily to originate investments in new and existing portfolio companies, pay distributions to our shareholders, and repay indebtedness.

On September 30, 2013, we issued 4,000,000 shares at \$20.00 per share in our IPO, yielding net proceeds of \$74.25 million.

On October 17, 2014, we entered into a senior secured revolving credit agreement (the "Credit Facility") with ING Capital, LLC, as administrative agent, arranger, and bookrunner, and the lenders party thereto. On June 16, 2017, we entered into an amendment to our Credit Facility with ING Capital, LLC (the "Amendment"). Pursuant to the Amendment, the Credit Facility currently provides for borrowings up to \$114.5 million and may be increased up to \$200.0 million pursuant to its "accordion" feature. The Credit Facility matures on June 16, 2021. As of September 30, 2017, we had \$0.0 outstanding and \$114.5 million available under the Credit Facility.

On April 13, 2015, we completed an underwritten offering of 3,500,000 shares of our common stock at a public offering price of \$18.32 per share. The total proceeds received in the offering net of underwriting discounts and offering costs were approximately \$61.7 million.

On May 16, 2017, we issued \$70.0 million in aggregate principal amount of 6.0% fixed-rate notes due May 31, 2022 (the "2022 Notes"). On May 25, 2017, we issued an additional \$5.0 million in aggregate principal amount of the 2022 Notes pursuant to a partial exercise of the underwriters' over-allotment option. The 2022 Notes will mature on May 31, 2022, and may be redeemed in whole or in part at any time or from time to time at our option on or after May 31, 2019 at a redemption price equal to 100% of the outstanding principal, plus accrued and unpaid interest. Interest is payable quarterly beginning August 31, 2017. The 2022 Notes are listed on the NASDAQ Global Select Market under the trading symbol "CPTAL" with a par value \$25.00 per share.

On May 26, 2017, we issued \$50.0 million in aggregate principal amount of 5.75% fixed-rate convertible notes due on May 31, 2022 (the "2022 Convertible Notes"). On June 26, 2017, we issued an additional \$2.1 million in aggregate principal amount of the 2022 Convertible Notes pursuant to a partial exercise of the underwriters' over-allotment option. Interest is payable quarterly beginning August 31, 2017. The 2022 Convertible Notes are listed on the NASDAQ Capital Market under the trading symbol "CPTAG" with a par value \$25.00 per share.

As of September 30, 2017, Fund II had \$26.2 million in regulatory capital and \$20.7 million in SBA-guaranteed debentures outstanding and Fund III had \$75.0 million in regulatory capital and \$150.0 million in SBA-guaranteed debentures outstanding. In addition to our existing SBA-guaranteed debentures, we may, if permitted by regulation, seek to issue additional SBA-guaranteed debentures as well as other forms of leverage and borrow funds to make investments. On June 10, 2014, we received an exemptive order from the SEC exempting us, Fund II and Fund III from certain provisions of the 1940 Act (including an exemptive order granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs) and from certain reporting requirements mandated by the Securities Exchange Act of 1934, as amended, with respect to Fund II and Fund III. We intend to comply with the conditions of the order.

As of September 30, 2017, we had \$52.3 million in cash and cash equivalents, and our net assets totaled \$226.3 million.

### Contractual Obligations

We have entered into two contracts under which we have material future commitments: the Investment Advisory Agreement, pursuant to which the Investment Advisor serves as our investment adviser, and the Administration Agreement, pursuant to which our Administrator agrees to furnish us with certain administrative services necessary to conduct our day-to-day operations. Payments under the Investment Advisory Agreement in future periods will be equal to: (1) a percentage of the value of our gross assets; and (2) an incentive fee based on our performance. Payments under the Administration Agreement will occur on an ongoing basis as expenses are incurred on our behalf by our Administrator.

The Investment Advisory Agreement and the Administration Agreement are each terminable by either party without penalty upon 60 days' written notice to the other. If either of these agreements is terminated, the costs we incur under new agreements may increase. In addition, we will likely incur significant time and expense in locating alternative parties to provide the services we expect to receive under both our Investment Advisory Agreement and our Administration Agreement. Any new investment advisory agreement would also be subject to approval by our stockholders.

A summary of our significant contractual payment obligations as of September 30, 2017 are as follows (dollars in thousands):

	Contractual Obligations Payments Due by Period				Total
	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years	
SBA Debentures	\$ —	\$ 24,000	\$ 121,700	\$ 25,000	\$ 170,700
2022 Notes	—	—	75,000	—	75,000
2022 Convertible Notes	—	—	52,088	—	52,088
Credit Facility	—	—	—	—	—
<b>Total Contractual Obligations</b>	<b>\$ —</b>	<b>\$ 24,000</b>	<b>\$ 248,788</b>	<b>\$ 25,000</b>	<b>\$ 297,788</b>

### Distributions

In order to qualify as a RIC and to avoid corporate-level U.S. federal income tax on the income we distribute to our stockholders, we are required to distribute at least 90% of our net ordinary income and our net short-term capital gains in excess of net long-term capital losses, if any, to our stockholders on an annual basis. Additionally, we must distribute an amount at least equal to the sum of 98% of our net ordinary income (during the calendar year) plus 98.2% of our net capital gain income (during each 12-month period ending on October 31) plus any net ordinary income and capital gain net income for preceding years that were not distributed during such years and on which we paid no U.S. federal income tax to avoid a U.S. federal excise tax. We made quarterly distributions to our stockholders for the first four full quarters subsequent to our IPO. To the extent we have income available, we have made and intend to make monthly distributions thereafter. Our monthly stockholder distributions, if any, will be determined by our Board on a quarterly basis. Any distribution to our stockholders will be declared out of assets legally available for distribution.

We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of our distributions from time to time, and from time to time we may decrease the amount of our distributions. In addition, we may be limited in our ability to make distributions due to the asset coverage requirements applicable to us as a BDC under the 1940 Act. If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including the possible loss of our qualification as a RIC. We cannot assure stockholders that they will receive any distributions.

To the extent our taxable earnings fall below the total amount of our distributions for that fiscal year, a portion of those distributions may be deemed a return of capital to our stockholders for U.S. federal income tax purposes. Thus, the source of a distribution to our stockholders may be the original capital invested by the stockholder rather than our income or gains. Stockholders should read any written disclosure accompanying any stockholder distribution carefully and should not assume that the source of any distribution is our ordinary income or capital gains.

We have adopted an "opt out" dividend reinvestment plan ("DRIP") for our common stockholders. As a result, if we declare a distribution, then stockholders' cash distributions will be automatically reinvested in additional shares of our common stock unless a stockholder specifically "opts out" of our DRIP. If a stockholder opts out, that stockholder will receive cash distributions. Although distributions paid in the form of additional shares of our common stock will generally be subject to U.S. federal, state and local taxes in the same manner as cash distributions, stockholders participating in our DRIP will not receive any corresponding cash distributions with which to pay any such applicable taxes.

The following tables summarize our distributions declared from January 2, 2015 to September 30, 2017:

<b>Date Declared</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Amount Per Share</b>
January 3, 2017	January 20, 2017	January 30, 2017	\$ 0.13
January 3, 2017	February 20, 2017	February 27, 2017	0.13
January 3, 2017	March 23, 2017	March 30, 2017	0.13
April 3, 2017	April 19, 2017	April 27, 2017	0.13
April 3, 2017	May 23, 2017	May 29, 2017	0.13
April 3, 2017	June 24, 2017	June 29, 2017	0.13
July 3, 2017	July 21, 2017	July 28, 2017	0.13
July 3, 2017	August 23, 2017	August 30, 2017	0.13
July 3, 2017	September 20, 2017	September 28, 2017	0.13
Total Distributions Declared and Distributed			<u>\$ 1.17</u>

<b>Date Declared</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Amount Per Share</b>
January 4, 2016	January 22, 2016	January 28, 2016	\$ 0.1567
January 4, 2016	February 19, 2016	February 26, 2016	0.1567
January 4, 2016	March 22, 2016	March 30, 2016	0.1567
April 1, 2016	April 22, 2016	April 28, 2016	0.1567
April 1, 2016	May 23, 2016	May 30, 2016	0.1567
April 1, 2016	June 21, 2016	June 29, 2016	0.1567
July 1, 2016	July 22, 2016	July 29, 2016	0.1567
July 1, 2016	August 22, 2016	August 30, 2016	0.1567
July 1, 2016	September 22, 2016	September 29, 2016	0.1567
September 22, 2016	October 21, 2016	October 28, 2016	0.1300
September 22, 2016	November 21, 2016	November 29, 2016	0.1300
September 22, 2016	December 21, 2016	December 29, 2016	0.1300
Total Distributions Declared and Distributed			<u>\$ 1.80</u>

<b>Date Declared</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Amount Per Share</b>
January 2, 2015	January 22, 2015	January 29, 2015	\$ 0.1567
January 2, 2015	February 20, 2015	February 26, 2015	0.1567
January 2, 2015	March 23, 2015	March 30, 2015	0.1567
February 26, 2015	March 23, 2015 <sup>(1)</sup>	March 30, 2015	0.0500
February 26, 2015	April 23, 2015 <sup>(1)</sup>	April 29, 2015	0.0500
February 26, 2015	May 21, 2015 <sup>(1)</sup>	May 28, 2015	0.0500
February 26, 2015	June 22, 2015 <sup>(1)</sup>	June 29, 2015	0.0500
February 26, 2015	July 23, 2015 <sup>(1)</sup>	July 30, 2015	0.0500
February 26, 2015	August 21, 2015 <sup>(1)</sup>	August 28, 2015	0.0500
February 26, 2015	September 23, 2015 <sup>(1)</sup>	September 29, 2015	0.0500
February 26, 2015	October 23, 2015 <sup>(1)</sup>	October 29, 2015	0.0500
February 26, 2015	November 20, 2015 <sup>(1)</sup>	November 27, 2015	0.0500
February 26, 2015	December 22, 2015 <sup>(1)</sup>	December 30, 2015	0.0500
April 1, 2015	April 23, 2015	April 29, 2015	0.1567
April 1, 2015	May 21, 2015	May 28, 2015	0.1567
April 1, 2015	June 22, 2015	June 29, 2015	0.1567
July 1, 2015	July 23, 2015	July 30, 2015	0.1567
July 1, 2015	August 21, 2015	August 28, 2015	0.1567
July 1, 2015	September 23, 2015	September 29, 2015	0.1567
October 1, 2015	October 23, 2015	October 29, 2015	0.1567
October 1, 2015	November 20, 2015	November 27, 2015	0.1567
October 1, 2015	December 22, 2015	December 30, 2015	0.1567
Total Distributions Declared and Distributed			<u>\$ 2.38</u>

(1) On February 26, 2015, the Company's Board declared a special distribution of \$0.50 per share of the Company's common stock, which was paid monthly over the remainder of 2015.

## Related Parties

We have entered into the Investment Advisory Agreement with the Investment Advisor. Joseph B. Alala, our chief executive officer and chairman of our Board, is the managing partner and chief investment officer of the Investment Advisor, and M. Hunt Broyhill, a member of our Board, has an indirect controlling interest in the Investment Advisor.

In addition, an affiliate of the Investment Advisor also manages CapitalSouth Partners SBIC Fund IV, L.P. (“Fund IV”), a private investment limited partnership providing financing solutions to smaller and lower middle-market companies that had its first closing in March 2013 and obtained SBA approval for its SBIC license in April 2013. In addition to Fund IV, affiliates of the Investment Advisor may manage several affiliated funds whereby institutional limited partners in Fund IV have the opportunity to co-invest with Fund IV in portfolio investments. An affiliate of the Investment Advisor also manages Capitala Private Credit Fund V, L.P. (“Fund V”); a private investment limited partnership providing financing solutions to lower middle-market and traditional middle-market companies. The Investment Advisor and its affiliates may also manage other funds in the future that may have investment mandates that are similar, in whole and in part, with ours. To the extent permitted by the 1940 Act and interpretation of the SEC staff, the Investment Advisor and its affiliates may determine that an investment is appropriate for us and for one or more of those other funds. In such event, depending on the availability of such investment and other appropriate factors, the Investment Advisor or its affiliates may determine that we should invest side-by-side with one or more other funds. Any such investments will be made only to the extent permitted by applicable law and interpretive positions of the SEC and its staff, and consistent with the Investment Advisor’s allocation procedures. We do not expect to make co-investments, or otherwise compete for investment opportunities, with Fund IV because its focus and investment strategy differ from our own. However, we do expect to make co-investments with Fund V given its similar investment strategy.

On September 10, 2015, we, Fund II, Fund III, Fund V, and the Investment Advisor filed an application for exemptive relief with the SEC to permit an investment fund and one or more other affiliated investment funds, including future affiliated investment funds, to participate in the same investment opportunities through a proposed co-investment program where such participation would otherwise be prohibited under the 1940 Act. On June 1, 2016, the SEC issued an order (the “Order”) permitting this relief. Pursuant to the Order, we are permitted to co-invest in such investment opportunities with our affiliates if a “required majority” (as defined in Section 57(o) of the 1940 Act) of our independent directors make certain conclusions in connection with a co-investment transaction, including, but not limited to, that (1) the terms of the potential co-investment transaction, including the consideration to be paid, are reasonable and fair to us and our stockholders and do not involve overreaching in respect of us or our stockholders on the part of any person concerned, and (2) the potential co-investment transaction is consistent with the interests of our stockholders and is consistent with our then-current investment objective and strategies.

On August 31, 2016, the Company sold assets to FSC II in exchange for 100% of the partnership interests in FSC II. Concurrent with the sale of these assets to FSC II, the Company received cash consideration of \$47.6 million from an affiliated third-party purchaser in exchange for 100% of the partnership interests of FSC II. The Company’s Board pre-approved this transaction pursuant to Section 57(f) of the 1940 Act. Capitala Advisors Corp., the Company’s administrator, also serves as the administrator to FSC II.

We have entered into a license agreement with the Investment Advisor, pursuant to which the Investment Advisor has agreed to grant us a non-exclusive, royalty-free license to use the name “Capitala.”

We have entered into the Administration Agreement with our Administrator. Pursuant to the terms of the Administration Agreement, our Administrator provides us with the office facilities and administrative services necessary to conduct our day-to-day operations. Mr. Alala, our chief executive officer and chairman of our Board, is the chief executive officer, president and a director of our Administrator.

## Off-balance sheet arrangements

As of September 30, 2017, the Company had outstanding unfunded commitments related to debt investments in existing portfolio companies of \$4.0 million (CIS Secure Computing, Inc.), \$2.0 million (Portrait Innovations, Inc.), \$1.5 million (Kelle’s Transport Service, LLC), and \$1.0 million (US Well Services, LLC). As of December 31, 2016, the Company had outstanding unfunded commitments related to debt investments in an existing portfolio company of \$1.2 million (On-Site Fuel Services, Inc.).

In addition to unfunded commitments related to debt investments, the Company also has extended a guaranty on behalf of one of our portfolio companies, whereby we have guaranteed \$1.5 million of obligations of Kelle’s Transport Service, LLC. As of September 30, 2017 we have not been required to make payments on this or any previous guaranties, and we consider the credit risks to be remote and the fair value of this guaranty to be immaterial.

We have no other off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## Recent Developments

### Distributions

On October 2, 2017 our Board declared the following distributions:

Date Declared	Record Date	Payment Date	Distributions per Share	
October 2, 2017	October 23, 2017	October 30, 2017	\$	0.0833
October 2, 2017	November 21, 2017	November 29, 2017	\$	0.0833
October 2, 2017	December 20, 2017	December 28, 2017	\$	0.0833

### Portfolio Activity

On October 31, 2017, the Company funded \$2.0 million of its unfunded commitment to CIS Secure Computing, Inc.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to financial market risks, including changes in interest rates. Changes in interest rates may affect both our cost of funding and our interest income from portfolio investments and cash and cash equivalents. We may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts subject to the requirements of the 1940 Act. For the nine months ended September 30, 2017, we did not engage in hedging activities.

As of September 30, 2017, we held 17 securities bearing a variable rate of interest. Our variable rate investments represent approximately 41.8% of the fair value of total debt investments. As of September 30, 2017, 10.2% of variable rate securities were yielding interest at a rate equal to the established interest rate floor or interest rate ceiling and 89.8% of variable rate securities were yielding interest at a rate above its existing floor or were not subject to an interest rate floor. As of September 30, 2017, we had \$0.0 million outstanding on our Credit Facility, which has a variable rate of interest at one month LIBOR + 3.0%. As of September 30, 2017, all of our other interest paying liabilities, consisting of \$170.7 million in SBA-guaranteed debentures, \$75.0 million in 2022 Notes, and \$52.1 million in 2022 Convertible Notes, were bearing interest at a fixed rate.

Interest rate sensitivity refers to the change in earnings that may result from changes in the level of interest rates. Because we fund a portion of our investments with borrowings, our net investment income is affected by the difference between the rate at which we invest and the rate at which we borrow. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income.

Based on our September 30, 2017 consolidated statements of assets and liabilities, the following table shows the annual impact on net income (excluding the potential related incentive fee impact) of base rate changes in interest rates (considering interest rate floors for variable rate securities) assuming no changes in our investment and borrowing structure (dollars in thousands):

Basis Point Change	Increase (decrease) in interest income	(Increase) decrease in interest expense	Increase (decrease) in net income
Up 300 basis points	\$ 4,314	\$ —	\$ 4,314
Up 200 basis points	\$ 2,858	\$ —	\$ 2,858
Up 100 basis points	\$ 1,401	\$ —	\$ 1,401
Down 100 basis points	\$ (651)	\$ —	\$ (651)
Down 200 basis points	\$ (651)	\$ —	\$ (651)
Down 300 basis points	\$ (651)	\$ —	\$ (651)

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

##### ***(a) Evaluation of Disclosure Controls and Procedures***

As of September 30, 2017 (the end of the period covered by this report), we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective and provided reasonable assurance that information required to be disclosed in our periodic SEC filings is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of such possible controls and procedures.

##### ***(b) Changes in Internal Control Over Financial Reporting***

Management has not identified any change in the Company's internal control over financial reporting that occurred during the third quarter of 2017 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### **PART II. OTHER INFORMATION**

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

None of us, our Investment Advisor or Administrator or any of the Legacy Funds, are currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us, or against our Investment Advisor or Administrator or any of the Legacy Funds. From time to time, we, our Investment Advisor or Administrator, or any of the Legacy Funds may be a party to certain legal proceedings in the ordinary course of business, including proceedings relating to the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings, if any, cannot be predicted with certainty, we do not expect that these proceedings will have a material effect upon our financial condition or results of operations.

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

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, which could materially affect our business, financial condition and/or operating results. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties that are not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. During the nine months ended September 30, 2017, there have been no material changes from the risk factors set forth 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**

During the quarter ended September 30, 2017, we issued 28,136 shares of common stock under our DRIP. The issuances were not subject to the registration requirements under the Securities Act of 1933, as amended. The cash paid for shares of common stock issued under our DRIP during the quarter ended September 30, 2017 was approximately \$0.3 million. Other than the shares issued under our DRIP during the quarter ended September 30, 2017, we did not sell any unregistered equity securities.

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

None.

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

Not applicable.

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

None.



## Item 6. Exhibits

The following exhibits are filed as part of this report or hereby incorporated by reference to exhibits previously filed with the SEC:

<b>Exhibit Number</b>	<b>Description of Document</b>
<a href="#"><u>3.1</u></a>	<a href="#"><u>Articles of Amendment and Restatement</u></a> <sup>(1)</sup>
<a href="#"><u>3.2</u></a>	<a href="#"><u>Certificate of Limited Partnership of CapitalSouth Partners Fund II Limited Partnership</u></a> <sup>(2)</sup>
<a href="#"><u>3.3</u></a>	<a href="#"><u>Certificate of Limited Partnership of CapitalSouth Partners SBIC Fund III, L.P.</u></a> <sup>(2)</sup>
<a href="#"><u>3.4</u></a>	<a href="#"><u>Bylaws</u></a> <sup>(1)</sup>
<a href="#"><u>3.5</u></a>	<a href="#"><u>Form of Amended and Restated Limited Partnership Agreement of CapitalSouth Partners Fund II Limited Partnership</u></a> <sup>(3)</sup>
<a href="#"><u>3.6</u></a>	<a href="#"><u>Form of Amended and Restated Agreement of Limited Partnership of CapitalSouth Partners SBIC Fund III, L.P.</u></a> <sup>(3)</sup>
<a href="#"><u>4.1</u></a>	<a href="#"><u>Form of Common Stock Certificate</u></a> <sup>(1)</sup>
<a href="#"><u>11.1</u></a>	<a href="#"><u>Computation of Per Share Earnings (included in the notes to the consolidated financial statements contained in this report)</u></a>
<a href="#"><u>31.1</u></a>	<a href="#"><u>Certification of Chief Executive Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u></a>
<a href="#"><u>31.2</u></a>	<a href="#"><u>Certification of Chief Financial Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u></a>
<a href="#"><u>32.1</u></a>	<a href="#"><u>Certification of Chief Executive Officer 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u></a>
<a href="#"><u>32.2</u></a>	<a href="#"><u>Certification of Chief Financial Officer 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u></a>
(1)	Previously filed in connection with the Pre-Effective Amendment No. 1 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-188956) filed on September 9, 2013.
(2)	Previously filed in connection with Pre-Effective Amendment No. 2 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-188956) filed on September 16, 2013.
(3)	Previously filed in connection with Pre-Effective Amendment No. 5 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-188956) filed on September 24, 2013.

**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.

Date: November 6, 2017

By /s/ Joseph B. Alala III  
Joseph B. Alala III  
Chief Executive Officer  
*(Principal Executive Officer)*  
Capitala Finance Corp.

Date: November 6, 2017

By /s/ Stephen A. Arnall  
Stephen A. Arnall  
Chief Financial Officer  
*(Principal Financial and Accounting Officer)*  
Capitala Finance Corp.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO RULE 13A-14 OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Joseph B. Alala III, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Capitala Finance Corp.;
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, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2017

/s/ Joseph B. Alala III  
\_\_\_\_\_  
Joseph B. Alala III  
Chief Executive Officer  
(Principal Executive Officer)  
Capitala Finance Corp.

---

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO RULE 13A-14 OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Stephen A. Amall, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Capitala Finance Corp.;
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, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2017

/s/ Stephen A. Amall  
\_\_\_\_\_  
Stephen A. Amall  
Chief Financial Officer  
(Principal Financial and Accounting Officer)  
Capitala Finance Corp.

---

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Joseph B. Alala III, Chief Executive Officer, in connection with the Quarterly Report of Capitala Finance Corp. (the "Company") on Form 10-Q for the quarterly period ended September 30, 2017, as filed with the U.S. Securities and Exchange Commission on the date hereof (the "Quarterly Report"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: November 6, 2017

/s/ Joseph B. Alala III  
\_\_\_\_\_  
Joseph B. Alala III  
Chief Executive Officer  
(Principal Executive Officer)  
Capitala Finance Corp.

---

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Stephen A. Arnall, Chief Financial Officer, in connection with the Quarterly Report of Capitala Finance Corp. (the "Company") on Form 10-Q for the quarterly period ended September 30, 2017, as filed with the U.S. Securities and Exchange Commission on the date hereof (the "Quarterly Report"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: November 6, 2017

/s/ Stephen A. Arnall  
\_\_\_\_\_  
Stephen A. Arnall  
Chief Financial Officer  
*(Principal Financial and Accounting Officer)*  
Capitala Finance Corp.

---