

**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, 2014**

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

Commission File Number	Exact name of registrants as specified in their charters, addresses of principal executive offices, telephone numbers and states or other jurisdictions of incorporation or organization	I.R.S. Employer Identification Number
814-01022	<b>Capitala Finance Corp.</b> 4201 Congress St., Suite 360 Charlotte, North Carolina Telephone: (704) 376-5502 State of Incorporation: Maryland	90-0945675

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 or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

Capitala Finance Corp.	Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
	Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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 10, 2014 was 12,974,420.

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**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Capitala Finance Corp.**

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

	<b>As of</b>	
	<b>September 30, 2014</b>	<b>December 31, 2013</b>
	<b>(unaudited)</b>	
<b>ASSETS</b>		
Investments at fair value		
Non-control/non-affiliate investments (amortized cost of \$158,338 and \$84,138, respectively)	\$ 181,245	\$ 99,140
Affiliate investments (amortized cost of \$161,730 and \$159,104, respectively)	185,051	189,098
Control investments (amortized cost of \$67,422 and \$58,057, respectively)	78,830	76,481
Total investments at fair value (amortized cost of \$387,490 and \$301,299, respectively)	445,126	364,719
Cash and cash equivalents	107,576	101,622
Interest and dividend receivable	3,541	2,917
Due from related parties	541	1,645
Deferred financing fees (net of accumulated amortization of \$2,873 and \$2,216, respectively)	8,581	4,871
Prepaid expenses	47	654
Total assets	\$ 565,412	\$ 476,428
<b>LIABILITIES</b>		
SBA debentures payable	\$ 192,200	\$ 202,200
Notes payable	113,438	-
Due to related parties	469	1,153
Incentive fee payable	-	1,525
Interest payable	968	2,723
Accounts payable and accrued expenses	221	157
Total liabilities	\$ 307,296	\$ 207,758
<b>Commitments and contingencies (Note 2)</b>		
<b>NET ASSETS</b>		
Common stock, par value \$.01, 100,000,000 common shares authorized, 12,974,420 common shares issued and outstanding	\$ 130	\$ 130
Additional paid in capital	188,408	188,408
Accumulated undistributed net investment income	13,363	16,760
Accumulated undistributed net realized loss from investments	(1,421)	(48)
Net unrealized appreciation on investments	57,636	63,420
Total net assets	258,116	268,670
Total liabilities and net assets	\$ 565,412	\$ 476,428
Net asset value per share	\$ 19.89	\$ 20.71

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,	
	2014	2013 (combined)	2014	2013 (combined)
<b>INVESTMENT INCOME</b>				
Interest and fee income:				
Non-control/Non-affiliate investments	\$ 4,104	\$ 2,061	\$ 10,170	\$ 6,110
Affiliate investments	4,790	2,796	12,415	8,981
Control investments	1,422	1,088	4,259	2,719
Total interest and fee income	10,316	5,945	26,844	17,810
Payment-in-kind interest and dividend income:				
Non-control/Non-affiliate investments	202	45	626	132
Affiliate investments	334	114	956	268
Control investments	192	263	479	692
Total payment-in-kind interest and dividend income	728	422	2,061	1,092
Dividend income:				
Non-control/Non-affiliate investments	152	2	1,666	2
Affiliate investments	29	29	745	86
Control investments	(61)	2,127	4,734	2,586
Total dividend income	120	2,158	7,145	2,674
Other income	-	210	-	1,571
Interest income from cash and cash equivalents	3	66	17	141
Total investment income	11,167	8,801	36,067	23,288
<b>EXPENSES</b>				
Interest expense and amortization of deferred financing fees	4,268	2,237	8,870	6,527
Management fees	2,536	980	6,830	2,994
Incentive fees	-	-	2,838	-
General and administrative expenses	857	147	2,870	382
Expenses before management fee waiver	7,661	3,364	21,408	9,903
Management fee waiver (See Note 5)	(38)	-	(238)	-
Total expenses net of management fee waiver	7,623	3,364	21,170	9,903
<b>NET INVESTMENT INCOME</b>	<b>3,544</b>	<b>5,437</b>	<b>14,897</b>	<b>13,385</b>
<b>REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS:</b>				
Net realized gain (loss) from investments:				
Non-control/Non-affiliate investments	-	6,011	1,158	6,011
Affiliate investments	(3,055)	(4,140)	(2,704)	(4,140)
Control investments	-	-	173	364
Total realized gain (loss) from investments	(3,055)	1,871	(1,373)	2,235
Net unrealized appreciation (depreciation) on investments	(178)	601	(5,784)	6,442
Net gain/(loss) on investments	(3,233)	2,472	(7,157)	8,677
<b>NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS</b>	<b>\$ 311</b>	<b>\$ 7,909</b>	<b>\$ 7,740</b>	<b>\$ 22,062</b>
<b>NET INCREASE IN NET ASSETS PER SHARE RESULTING FROM OPERATIONS</b>				
- BASIC AND DILUTED	\$ 0.02	\$ 0.61	\$ 0.60	\$ 1.70
<b>WEIGHTED AVERAGE COMMON STOCK OUTSTANDING - BASIC AND DILUTED</b>				
	12,974,420	12,974,420	12,974,420	12,974,420

N/A – Not Applicable

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

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

	General Partner	Limited Partners	Common Stock		Additional Paid in Capital	Accumulated Undistributed Net Investment Income	Accumulated Undistributed Net Realized Gains (Losses)	Net Unrealized Appreciation (Depreciation) on Investments	Total
			Number of Shares	Par Value					
BALANCE, December 31, 2012	\$ 282	\$ 77,358	-	\$ -	\$ -	\$ 8,560	\$ -	\$ 56,233	\$ 142,433
Partners' capital contributions	-	24,852	-	-	-	-	-	-	24,852
Distribution to partners	-	-	-	-	-	(5,186)	(2,235)	-	(7,421)
Formation Transactions	(282)	(102,210)	8,974,420	90	114,198	-	-	-	11,796
Public offering of common stock	-	-	4,000,000	40	74,210	-	-	-	74,250
Net investment income	-	-	-	-	-	13,385	-	-	13,385
Net realized gain on portfolio investments	-	-	-	-	-	-	2,235	-	2,235
Net change in unrealized appreciation on portfolio investments	-	-	-	-	-	-	-	6,442	6,442
BALANCE, September 30, 2013	\$ -	\$ -	12,974,420	\$ 130	\$ 188,408	\$ 16,759	\$ -	\$ 62,675	\$ 267,972
BALANCE, December 31, 2013	\$ -	\$ -	12,974,420	\$ 130	\$ 188,408	\$ 16,760	\$ (48)	\$ 63,420	\$ 268,670
Net investment income	-	-	-	-	-	14,897	-	-	14,897
Net realized loss on portfolio investments	-	-	-	-	-	-	(1,373)	-	(1,373)
Net change in unrealized appreciation on portfolio investments	-	-	-	-	-	-	-	(5,784)	(5,784)
Dividends declared and paid	-	-	-	-	-	(18,294)	-	-	(18,294)
BALANCE, September 30, 2014	\$ -	\$ -	12,974,420	\$ 130	\$ 188,408	\$ 13,363	\$ (1,421)	\$ 57,636	\$ 258,116

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,	
	2014	2013 (combined)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net increase in net assets resulting from operations	\$ 7,740	\$ 22,062
Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities:		
Purchase of portfolio investments	(150,304)	(75,817)
Repayments of portfolio investments	64,833	50,209
Net realized (gain)/loss on portfolio investments	1,373	(2,235)
(Increase) decrease in net unrealized appreciation on portfolio investments	5,784	(6,442)
Payment-in-kind interest accrued, net of payments received	(2,061)	(930)
Accretion of original issue discount on portfolio investments	(32)	(35)
Amortization of deferred financing fees	656	522
Changes in assets and liabilities:		
Interest and dividend receivable	(624)	(398)
Due from related parties	1,104	(288)
Prepaid expenses	607	-
Due to related parties	(684)	306
Incentive fee payable	(1,525)	-
Interest payable	(1,755)	(1,821)
Accounts payable and accrued expenses	64	1,852
Other assets	-	(2)
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(74,824)</b>	<b>(13,017)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from issuance of SBA-guaranteed debentures	-	25,000
Partners' capital contributions	-	24,852
Proceeds from IPO, net of underwriting expense	-	74,250
Paydowns on SBA-guaranteed debentures	(10,000)	-
Issuance of notes	113,438	-
Dividends declared and paid	(18,294)	(7,421)
Deferred financing fees paid	(4,366)	(606)
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>80,778</b>	<b>116,075</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>5,954</b>	<b>103,058</b>
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<b>101,622</b>	<b>30,467</b>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>\$ 107,576</b>	<b>\$ 133,525</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	\$ 9,964	\$ 7,828
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING TRANSACTIONS</b>		
In-kind contribution of assets	\$ -	\$ 11,796

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments  
(in thousands, except for units)  
September 30, 2014  
(unaudited)

Company <sup>(3,4)</sup>	Industry	Investment Interest Rate / Maturity	Principal Amount	Cost	Fair Value	% of Net Assets
<b>Non-control/Non-affiliated investments - 70.4%</b>						
AAE Acquisition, LLC	Industrial Equipment Rental	Senior Secured Term Debt (12% Cash, Due 5/6/15)	\$ 11,000	\$ 10,997	\$ 11,000	4.3%
AAE Acquisition, LLC	Industrial Equipment Rental	Membership Units (14% fully diluted)	-	17	2,212	0.9%
				11,014	13,212	5.2%
A Wireless Holding Company	Cellular Device Retailer	Subordinated Debt (12% Cash, Due 9/09/19)	12,000	12,000	12,000	4.6%
				12,000	12,000	4.6%
American Exteriors, LLC <sup>(1)</sup>	Replacement Window Manufacturer	Senior Secured Debt (17% Cash, Due 6/30/15)	4,404	3,204	4,404	1.7%
American Exteriors, LLC <sup>(1)</sup>	Replacement Window Manufacturer	Jr. Convertible Note (10% Cash, Due 6/30/16)	500	415	500	0.2%
American Exteriors, LLC <sup>(7)</sup>	Replacement Window Manufacturer	Common Stock Warrants (15% fully diluted)	-	-	-	0.0%
				3,619	4,904	1.9%
Boot Barn Holding Corporation	Western Wear Retail	Common Stock (2,400 shares)	-	2,400	9,202	3.6%
				2,400	9,202	3.6%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock (293,186 shares)	-	258	193	0.1%
Caregiver Services, Inc. <sup>(7)</sup>	In-Home Healthcare Services	Common Stock Warrants (655,908 units)	-	264	431	0.1%
				522	624	0.2%
Crowley Holdings, Inc. <sup>(5)</sup>	Transportation	Series A Income Preferred Shares (6,000 shares, 10% cash, 2% PIK dividend)	-	6,114	6,114	2.4%
				6,114	6,114	2.4%
CSM Bakery Solutions, LLC	Bakery Supplies Distributor	Subordinated Debt (L+7.75%, 1% Floor, Due 8/7/22)	17,000	16,628	17,000	6.6%
				16,628	17,000	6.6%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Senior Secured Term Debt (13% Cash, Due 10/6/16)	2,000	2,000	2,000	0.8%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Common Unit Warrants (12% fully diluted)	-	-	-	0.0%
				2,000	2,000	0.8%
Kelle's Transport Service, LLC	Transportation	Senior Secured Debt (14% Cash, Due 3/31/19)	15,603	15,586	15,603	6.0%
Kelle's Transport Service, LLC <sup>(5)</sup>	Transportation	Preferred Units (1,000 units, 10% PIK Dividend)	-	2,732	2,732	1.1%
Kelle's Transport Service, LLC	Transportation	Common Stock Warrants (15% fully diluted)	-	23	2,489	1.0%
				18,341	20,824	8.1%
Medical Depot, Inc. <sup>(1)</sup>	Medical Device Distributor	Subordinated Debt (14% Cash, Due 9/27/20)	4,667	4,667	4,667	1.8%

Medical Depot, Inc.	Medical Device Distributor	Series C Convertible Preferred Stock (740 shares)	-	1,333	5,408	2.1%
				<u>6,000</u>	<u>10,075</u>	<u>3.9%</u>
Meritas Schools Holdings, LLC	Education Services	Subordinated Debt (L+9%, 1% Floor, Due 1/23/2021)	3,000	2,985	3,000	1.2%
				<u>2,985</u>	<u>3,000</u>	<u>1.2%</u>
Naples Lumber & Supply Co <sup>(1)</sup>	Building Supplies	Subordinated Debt (7% cash, Due 6/30/15)	2,109	1,309	2,109	0.8%
Naples Lumber & Supply Co	Building Supplies	Common Stock Warrants (10% fully diluted)	-	-	700	0.3%
				<u>1,309</u>	<u>2,809</u>	<u>1.1%</u>
Nielsen & Bainbridge, LLC	Home Décor Manufacturer	Subordinated Debt (L+9.25%, 1% Floor, Due 8/15/21)	15,000	14,777	15,000	5.8%
				<u>14,777</u>	<u>15,000</u>	<u>5.8%</u>
Pickaway Plains Ambulance Services, Inc. <sup>(1)</sup> <sup>(2)</sup>	Medical Transportation Services	Senior Secured Term Debt (13% Cash, Due 12/31/15)	1,548	-	-	0.0%
Pickaway Plains Ambulance Services, Inc.	Medical Transportation Services	Common Stock Warrants (5% fully diluted)	-	-	-	0.0%
				<u>-</u>	<u>-</u>	<u>0.0%</u>
Precision Manufacturing, LLC <sup>(2)</sup>	Industrial Boiler Manufacturer	Subordinated Debt (14% PIK, Due 2/13/15)	219	200	128	0.0%
Precision Manufacturing, LLC <sup>(2)</sup>	Industrial Boiler Manufacturer	Subordinated Debt (14% Cash, Due 10/31/14)	300	300	192	0.1%
Precision Manufacturing, LLC <sup>(2)</sup>	Industrial Boiler Manufacturer	Subordinated Debt (6.5% Cash, 6.5% PIK, Due 2/10/17)	2,611	2,500	1,602	0.6%
Precision Manufacturing, LLC	Industrial Boiler Manufacturer	Membership Unit Warrants (6.65% fully diluted)	-	-	-	0.0%
				<u>3,000</u>	<u>1,922</u>	<u>0.7%</u>
Sequoia Healthcare Management, LLC	Healthcare Management	Senior Secured Debt (12% cash, 4% PIK, due 7/17/2019)	12,604	12,365	12,604	4.9%
				<u>12,365</u>	<u>12,604</u>	<u>4.9%</u>
Sierra Hamilton, LLC	Oil & Gas Engineering and Consulting Services	Senior Secured Debt (12.25% Cash, Due 12/15/18)	15,000	15,000	15,491	6.0%
				<u>15,000</u>	<u>15,491</u>	<u>6.0%</u>
Southern Pump & Tank Company, LLC <sup>(1)</sup>	Petroleum Equipment Supplier	Senior Secured Term Debt (13% Cash, 6% PIK, Due 1/15/15)	4,235	3,436	3,802	1.5%
Southern Pump & Tank Company, LLC	Petroleum Equipment Supplier	Common Stock Warrants (10% fully diluted)	-	-	-	0.0%
				<u>3,436</u>	<u>3,802</u>	<u>1.5%</u>
Stoddard Hill Media Holdings, LLC	IT Hosting Services	Class D Preferred Units (132,159 shares)	-	300	529	0.2%
				<u>300</u>	<u>529</u>	<u>0.2%</u>
Tenere, Inc.	Industrial Manufacturing	Senior Secured Term Debt (11% Cash, 2% PIK, Due 12/15/17)	3,487	3,487	3,487	1.4%
				<u>3,487</u>	<u>3,487</u>	<u>1.4%</u>
TGI Friday's, Inc.	Restaurant	Subordinated Debt (L+8.25%, 1% Floor, Due 7/15/21)	10,000	9,960	10,000	3.9%
				<u>9,960</u>	<u>10,000</u>	<u>3.9%</u>
U.S. Well Services, LLC	Oil & Gas Services	Senior Secured Debt (L+11.50%, 0.5% floor, Due 5/2/19)	4,883	4,781	4,883	1.9%
				<u>4,781</u>	<u>4,883</u>	<u>1.9%</u>





Velum Global Credit Management, LLC <sup>(8)</sup>	Financial Services	Senior Secured Debt (15% Cash, Due 12/31/15)	8,300	8,300	8,300	3.2%
				8,300	8,300	3.2%
Worklife America, Inc.	Professional Employer Organization	Common Unit Warrants (3.84% ownership)	-	-	2,964	1.1%
Worklife America, Inc.	Professional Employer Organization	Preferred Unit Warrants (3.84% ownership)	-	-	499	0.2%
				-	3,463	1.3%
<b>Sub Total Non-control/Non-affiliated investments</b>				<u>\$ 158,338</u>	<u>\$ 181,245</u>	<u>70.4%</u>
<b>Affiliate investments - 71.6%</b>						
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Senior Subordinated Debt (14% cash, due 8/14/2019)	\$ 5,000	\$ 5,000	\$ 5,000	1.9%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Junior Subordinated Debt (12% cash, due 8/14/2019)	7,225	7,225	7,225	2.8%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock (11.54% Ownership)	-	2,104	2,314	0.9%
				14,329	14,539	5.6%
ChefN Corporation	Culinary Products	Subordinated Debt (13%, 2% PIK at company's option, Due 5/16/18)	6,300	6,300	6,300	2.4%
ChefN Corporation	Culinary Products	Series A Preferred Stock (1,000,000 shares)	-	1,000	5,206	2.0%
				7,300	11,506	4.4%
City Gear, LLC	Footwear Retail	Subordinated Debt (13% Cash, Due 9/28/16)	8,231	8,231	8,231	3.2%
City Gear, LLC <sup>(5)</sup>	Footwear Retail	Preferred Membership Units (9% cash dividend)	-	1,269	1,269	0.5%
City Gear, LLC	Footwear Retail	Membership Unit Warrants (14.15% fully diluted)	-	-	6,213	2.4%
				9,500	15,713	6.1%
Corporate Visions, Inc.	Sales & Marketing Services	Subordinated Debt (14% Cash, 2% PIK, Due 3/22/18)	11,344	11,344	11,344	4.4%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (2,216,463 shares)	-	2,576	11,082	4.3%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock Warrant (403,257 shares)	-	-	2,016	0.8%
				13,920	24,442	9.5%
GA Communications, Inc. <sup>(5)</sup>	Advertising & Marketing Services	Series A-1 Preferred Stock (1,998 shares, 8% PIK dividend)	-	2,145	2,510	1.0%
GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)	-	2	1,930	0.7%
				2,147	4,440	1.7%
Impresa Aerospace Holdings, LLC	Aerospace Parts Manufacturer	Class A Membership Units (1,006,621 units)	-	900	-	0.0%
Impresa Aerospace Holdings, LLC	Aerospace Parts Manufacturer	Class C Membership Units (362,416 units)	-	362	-	0.0%
Impresa Aerospace Holdings, LLC	Aerospace Parts Manufacturer	Class F Membership Units (604,504 units)	-	605	-	0.0%
				1,867	-	0.0%
J&J Produce Holdings, Inc.	Produce Distribution	Subordinated Debt (13% Cash, Due 7/16/18)	5,182	5,182	5,182	2.0%

J&J Produce Holdings, Inc.	Produce Distribution	Common Stock (8,182 shares)	-	818	643	0.2%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock Warrants (4,506 shares)	-	-	354	0.1%
				6,000	6,179	2.3%
LJS Partners, LLC	QSR Franchisor	Common Stock (1,500,000 shares)	-	1,500	2,959	1.1%
				1,500	2,959	1.1%
MJC Holdings, LLC	Specialty Clothing	Series A Preferred Units (2,000,000 units)	-	2,000	4,941	1.9%
				2,000	4,941	1.9%
MMI Holdings, LLC	Medical Device Distributor	Senior Secured Debt (12% Cash, Due 10/17/14)	2,600	2,600	2,600	1.0%
MMI Holdings, LLC	Medical Device Distributor	Subordinated Debt (6% Cash, Due 8/15/15)	400	388	400	0.2%
MMI Holdings, LLC <sup>(5)</sup>	Medical Device Distributor	Preferred Units (1,000 units, 6% PIK dividend)	-	1,116	1,254	0.4%
MMI Holdings, LLC	Medical Device Distributor	Common Units (45 units)	-	-	152	0.1%
				4,104	4,406	1.7%
MTI Holdings, LLC	Retail Display & Security Services	Subordinated Debt (12% Cash, Due 11/1/18)	8,000	8,000	8,000	3.1%
MTI Holdings, LLC	Retail Display & Security Services	Capital Units (2,000,000 units)	-	2,000	4,392	1.7%
				10,000	12,392	4.8%
Source Capital ABUTEC, LLC	Environmental Services Products	Senior Secured Debt (12% Cash, 3% PIK, Due 12/28/17)	5,243	5,243	5,243	2.0%
Source Capital ABUTEC, LLC	Environmental Services Products	Preferred Membership Units (10.8% fully diluted)	-	1,240	181	0.1%
				6,483	5,424	2.1%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Subordinated Debt (13% Cash, Due 2/17/17)	2,500	2,500	2,500	1.0%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Common Stock Warrants (6.65% ownership)	-	-	512	0.2%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Membership Units (11.3% ownership)	-	750	727	0.3%
				3,250	3,739	1.5%
Source Capital SSCR, LLC	Personal Product Manufacturer	Senior Secured Term Debt (10% Cash, Due 6/12/17)	3,000	3,000	2,824	1.1%
Source Capital SSCR, LLC	Personal Product Manufacturer	Subordinated Debt (14% Cash, Due 9/15/17)	17,125	17,125	13,613	5.3%
Source Capital SSCR, LLC	Personal Product Manufacturer	Preferred Membership Units (15.8% ownership)	-	1,878	-	0.0%
Source Capital SSCR, LLC	Personal Product Manufacturer	Membership Unit Warrant (0.31% ownership)	-	10	-	0.0%
				22,013	16,437	6.4%
Source Recycling, LLC <sup>(2)</sup>	Metal Recycler	Subordinated Debt (13% Cash, Due 9/2/16)	5,000	5,000	4,150	1.6%
Source Recycling, LLC	Metal Recycler	Membership Units (68,656 units)	-	1,590	-	0.0%
Source Recycling, LLC	Metal Recycler	Membership Unit Warrants (1% fully diluted)	-	-	-	0.0%
				6,590	4,150	1.6%
Sparus Holdings, Inc. <sup>(1)</sup>	Energy Services	Senior Secured Debt (12% Cash, 2% PIK, Due 3/21/16)	12,078	12,078	11,715	4.5%
Sparus Holdings, Inc.	Energy Services	Series B Preferred Stock (5,703 shares)	-	1,173	-	0.0%

Sparus Holdings, Inc.	Energy Services	Common Stock Warrants (3,491 shares)	-	-	-	0.0%
				<u>13,251</u>	<u>11,715</u>	<u>4.5%</u>

STX Healthcare Management Services, Inc. (1)	Dental Practice Management	Subordinated Debt (14% Cash, Due 7/31/15)	7,425	7,425	7,425	2.9%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock (1,200,000 shares)	-	1,200	710	0.3%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock Warrants (1,154,254 shares)	-	218	683	0.3%
				8,843	8,818	3.5%
TCE Holdings, Inc.	Oil & Gas Services	Subordinated Debt (12% Cash, 2% PIK, Due 11/22/18)	12,273	12,273	12,273	4.8%
TCE Holdings, Inc.	Oil & Gas Services	Subordinated Debt (12% Cash, 2% PIK, Due 2/1/19)	9,779	9,779	9,779	3.8%
TCE Holdings, Inc.	Oil & Gas Services	Class A Common Stock (3,600 shares)	-	3,600	3,600	1.4%
				25,652	25,652	10.0%
V12 Holdings, Inc. (1)	Data Processing & Digital Marketing	Bridge Note (0% Cash, Due 12/31/14)	663	361	663	0.2%
V12 Holdings, Inc. (1)	Data Processing & Digital Marketing	Tier 2 Note (0% Cash, Due 12/31/14)	81	44	81	0.0%
V12 Holdings, Inc. (1)	Data Processing & Digital Marketing	Senior Subordinated Note (0% Cash, Due 12/31/14)	3,563	2,369	3,563	1.4%
V12 Holdings, Inc. (1)	Data Processing & Digital Marketing	Tier 3 Note (0% Cash, Due 12/31/14)	299	207	299	0.1%
V12 Holdings, Inc. (1)	Data Processing & Digital Marketing	Jr. Subordinated Note (0% Cash, Due 12/31/14)	2,750	-	2,750	1.1%
V12 Holdings, Inc. (1)	Data Processing & Digital Marketing	Tier 4 Note (0% Cash, Due 12/31/14)	243	-	243	0.1%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Series A-1 Preferred Stock (255,102 shares)	-	-	-	0.0%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Series A-3 Preferred Stock (88,194 shares)	-	-	-	0.0%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Series A-5 Preferred Stock (20,530 shares)	-	-	-	0.0%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Common Stock Warrants (2,063,629 warrants)	-	-	-	0.0%
				2,981	7,599	2.9%
<b>Sub Total Affiliate investments</b>				<u>\$ 161,730</u>	<u>\$ 185,051</u>	<u>71.6%</u>
<b>Control investments - 30.5%</b>						
CableOrganizer Acquisition, LLC	Computer Supply Retail	Senior Secured Term Debt (12% Cash, 4% PIK, Due 5/24/18)	\$ 10,715	\$ 10,715	\$ 10,715	4.2%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock (1,125,000 shares)	-	1,125	1,366	0.5%
				11,840	12,081	4.7%
KBP Investments, LLC (5)(6)	QSR Franchisee	Class A Preferred Stock (8,270 shares, 10% Cash Dividend)	-	8,269	8,269	3.2%
KBP Investments, LLC	QSR Franchisee	Class A Common Stock (380,413 shares)	-	-	11,735	4.5%
				8,269	20,004	7.7%
Market E's, LLC (1)	Online Travel Sales & Marketing	Senior Secured Debt (10% Cash, Due 5/31/15)	1,033	965	1,000	0.4%
Market E's, LLC (1)(2)	Online Travel Sales & Marketing	Subordinated Debt (14% Cash, 3% PIK, Due 12/31/14)	2,897	2,833	750	0.3%
Market E's, LLC	Online Travel Sales & Marketing	Class A Preferred Stock (600 shares)	-	240	-	0.0%

Market E's, LLC	Online Travel Sales & Marketing	Class B Preferred Stock (2,411 shares)	-	965	-	0.0%
Market E's, LLC	Online Travel Sales & Marketing	Class A Common Stock (600 shares)	-	-	-	0.0%
				5,003	1,750	0.7%
Micro Precision, LLC	Conglomerate	Subordinated Debt (10% Cash, Due 9/16/16)	1,862	1,862	1,862	0.7%
Micro Precision, LLC	Conglomerate	Subordinated Debt (14% Cash, 4% PIK, Due 9/16/16)	3,655	3,655	3,655	1.4%
Micro Precision, LLC	Conglomerate	Series A Preferred Units (47 units)	-	1,629	1,906	0.7%
				7,146	7,423	2.8%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Senior Secured Term Debt (17% Cash, 3% PIK at Company's option, Due 2/1/16)	6,500	6,500	6,500	2.6%
Navis Holdings, Inc. <sup>(5)</sup>	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares, 10% Cash Dividend)	-	1,000	1,000	0.3%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (300,000 shares)	-	1	2,441	1.0%
				7,501	9,941	3.9%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Subordinated Debt (14% Cash, 4% PIK, Due 12/19/16)	4,997	4,997	4,997	1.9%
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	2,300	0.9%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Common Stock (33,107 shares)	-	33	-	0.0%
				10,673	7,297	2.8%
Print Direction, Inc.	Printing Services	Senior Secured Term Debt (15% Cash, Due 2/24/19)	14,000	14,000	14,000	5.4%
Print Direction, Inc.	Printing Services	Common Stock (19,363 shares)	-	2,990	6,066	2.4%
Print Direction, Inc.	Printing Services	Common Stock Warrants (3% fully diluted)	-	-	268	0.1%
				16,990	20,334	7.9%
<b>Sub Total Control investments</b>				<b>\$ 67,422</b>	<b>\$ 78,830</b>	<b>30.5%</b>
<b>TOTAL INVESTMENTS - 172.5%</b>				<b>\$ 387,490</b>	<b>\$ 445,126</b>	<b>172.5%</b>

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

(2) Due to deterioration in credit quality, this investment is on non-accrual status.

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

(4) Percentages are based on net assets of \$258,116 as of September 30, 2014.

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

(6) During the fourth quarter of 2013, the Company accepted a consent fee that waives its right to dividends through September 30, 2014.

(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.

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments  
(in thousands, except for units)  
December 31, 2013

Company <sup>(4,5)</sup>	Industry	Investment Interest Rate / Maturity	Principal Amount	Cost	Fair Value	% of Net Assets
<b>Non-control/Non-affiliated investments - 36.9%</b>						
AAE Acquisition, LLC	Industrial Equipment Rental	Senior Secured Term Debt (12% Cash, Due 5/6/15)	\$ 19,000	\$ 18,992	\$ 19,000	7.1%
AAE Acquisition, LLC	Industrial Equipment Rental	Membership Units (21% fully diluted)	-	25	3,500	1.3%
				19,017	22,500	8.4%
American Exteriors, LLC <sup>(1)</sup>	Replacement Window Manufacturer	Senior Secured Debt (14.0% Cash, Due 6/30/14)	4,565	3,365	4,565	1.7%
American Exteriors, LLC <sup>(1)</sup>	Replacement Window Manufacturer	Jr. Convertible Note (10.0% Cash, Due 6/30/15)	500	416	612	0.2%
American Exteriors, LLC <sup>(8)</sup>	Replacement Window Manufacturer	Common Stock Warrants (15% fully diluted)	-	-	1,106	0.4%
				3,781	6,283	2.3%
Boot Barn Holding Corporation	Western Wear Retail	Common Stock (2,400 shares)	-	2,400	4,774	1.8%
				2,400	4,774	1.8%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock (293,186 shares)	-	258	231	0.1%
Caregiver Services, Inc. <sup>(8)</sup>	In-Home Healthcare Services	Common Stock Warrants (655,908 units)	-	264	517	0.2%
				522	748	0.3%
Crowley Holdings, Inc. <sup>(6)</sup>	Transportation	Series A Income Preferred Shares (6,000 shares, 10% cash, 2% PIK dividend)	-	6,000	6,000	2.2%
				6,000	6,000	2.2%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Senior Secured Term Debt (13% Cash, Due 10/6/16)	2,000	2,000	2,000	0.7%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Common Unit Warrants (12% fully diluted)	-	-	800	0.3%
				2,000	2,800	1.0%
Medical Depot, Inc.	Medical Device Distributor	Subordinated Debt (14% Cash, Due 10/11/16)	4,667	4,667	4,667	1.7%
Medical Depot, Inc.	Medical Device Distributor	Series C Convertible Preferred Stock (740 shares)	-	1,333	2,129	0.8%
				6,000	6,796	2.5%
Naples Lumber & Supply Co <sup>(1)</sup>	Building Supplies	Subordinated Debt (6% cash, Due 2/15/14)	2,109	1,309	2,109	0.8%
Naples Lumber & Supply Co	Building Supplies	Common Stock Warrants (10% fully diluted)	-	-	400	0.1%
				1,309	2,509	0.9%
Pickaway Plains Ambulance Services, Inc. <sup>(1,2)</sup>	Medical Transportation Services	Senior Secured Term Debt (13% Cash, Due 12/31/15)	1,548	-	-	0.0%
Pickaway Plains Ambulance Services, Inc.	Medical Transportation Services	Common Stock Warrants (5% fully diluted)	-	-	-	0.0%
				-	-	0.0%
Precision Manufacturing, LLC <sup>(2)</sup>	Industrial Boiler Manufacturer	Subordinated Debt (13% Cash, Due 2/10/17)	2,500	2,500	1,536	0.6%
Precision Manufacturing, LLC	Industrial Boiler Manufacturer	Membership Unit Warrants (70,000 units)	-	-	-	0.0%
				2,500	1,536	0.6%
Sierra Hamilton, LLC	Oil & Gas Engineering and Consulting Services	Senior Secured Debt (12.25% Cash, 12/15/18)	15,000	15,000	15,000	5.6%
				15,000	15,000	5.6%

Southern Pump & Tank Company, LLC <sup>(1)</sup>	Petroleum Equipment Supplier	Senior Secured Term Debt (13% Cash, 6% PIK, Due 6/15/14)	3,633	3,213	3,624	1.3%
Southern Pump & Tank Company, LLC	Petroleum Equipment Supplier	Common Stock Warrants (10% fully diluted)	-	-	-	0.0%
				<u>3,213</u>	<u>3,624</u>	<u>1.3%</u>
Stoddard Hill Media Holdings, LLC	IT Hosting Services	Class D Preferred Units (132,159 shares)	-	300	453	0.2%
				<u>300</u>	<u>453</u>	<u>0.2%</u>
Tenere, Inc.	Industrial Manufacturing	Senior Secured Term Debt (11% Cash, 2% PIK, Due 12/17/17)	3,440	3,440	3,440	1.3%
				<u>3,440</u>	<u>3,440</u>	<u>1.3%</u>
Worklife America, Inc.	Professional Employer Organization	Senior Secured Debt (12% Cash, Due 12/28/16)	18,656	18,656	18,656	7.0%
Worklife America, Inc.	Professional Employer Organization	Common Unit Warrants (3.84% ownership)	-	-	3,441	1.3%
Worklife America, Inc.	Professional Employer Organization	Preferred Unit Warrants (3.84% ownership)	-	-	580	0.2%
				<u>18,656</u>	<u>22,677</u>	<u>8.5%</u>
<b>Sub Total Non-control/Non-affiliated investments</b>				<u>\$ 84,138</u>	<u>\$ 99,140</u>	<u>36.9%</u>
<b>Affiliate investments - 70.4%</b>						
ChefN Corporation	Culinary Products	Subordinated Debt (15%, 3% PIK at company's option, Due 5/16/18)	\$ 6,300	\$ 6,300	\$ 6,300	2.3%
ChefN Corporation	Culinary Products	Series A Preferred Stock (1,000,000 shares)	-	1,000	4,002	1.5%
				<u>7,300</u>	<u>10,302</u>	<u>3.8%</u>
City Gear, LLC	Footwear Retail	Subordinated Debt (13% Cash, Due 9/28/16)	8,231	8,231	8,231	3.1%
City Gear, LLC <sup>(6)</sup>	Footwear Retail	Preferred Membership Units (2.78% fully diluted, 9% dividend)	-	1,269	1,269	0.5%
City Gear, LLC	Footwear Retail	Membership Unit Warrants (11.37% fully diluted)	-	-	5,307	2.0%
				<u>9,500</u>	<u>14,807</u>	<u>5.6%</u>
Corporate Visions, Inc.	Sales & Marketing Services	Subordinated Debt (14% Cash, 2% PIK, Due 3/22/18)	11,174	11,174	11,174	4.2%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (2,216,463 shares)	-	2,576	9,797	3.6%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock Warrant (403,257 shares)	-	-	1,782	0.7%
				<u>13,750</u>	<u>22,753</u>	<u>8.5%</u>
GA Communications, Inc.	Advertising & Marketing Services	Series A-1 Preferred Stock (1,998 shares)	-	1,998	2,370	0.9%
GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)	-	2	2,541	0.9%
				<u>2,000</u>	<u>4,911</u>	<u>1.8%</u>
Impresa Aerospace Holdings, LLC <sup>(3)</sup>	Aerospace Parts Manufacturer	Subordinated Debt (4.1% Cash, Due 4/28/16)	13,274	12,258	10,064	3.7%
Impresa Aerospace Holdings, LLC	Aerospace Parts Manufacturer	Class A Membership Units (1,006,621 units)	-	900	-	0.0%
Impresa Aerospace Holdings, LLC	Aerospace Parts Manufacturer	Class C Membership Units (362,416 units)	-	362	-	0.0%
Impresa Aerospace Holdings, LLC	Aerospace Parts Manufacturer	Class F Membership Units (604,504 units)	-	604	-	0.0%
				<u>14,124</u>	<u>10,064</u>	<u>3.7%</u>



Company (4,5)	Industry	Investment Interest Rate / Maturity	Principal Amount	Cost	Fair Value	% of Net Assets
J&J Produce Holdings, Inc.	Produce Distribution	Subordinated Debt (13% Cash, Due 7/16/18)	5,182	5,182	5,182	2.0%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock (8,182 Shares)	-	818	934	0.3%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock Warrants (4,506 shares)	-	-	515	0.2%
				6,000	6,631	2.5%
LJS Partners, LLC	QSR Franchisor	Common Stock (1,500,000 shares)	-	1,500	14,622	5.4%
				1,500	14,622	5.4%
MJC Holdings, LLC	Specialty Clothing	Subordinated Debt (14%, 2% PIK at company's option, Due 1/16/18)	7,500	7,500	7,500	2.8%
MJC Holdings, LLC	Specialty Clothing	Series A Preferred Units (2,000,000 units)	-	2,000	5,224	1.9%
				9,500	12,724	4.7%
MMI Holdings, LLC	Medical Device Distributor	Senior Secured Debt (12% Cash, Due 10/17/14)	2,600	2,600	2,600	1.1%
MMI Holdings, LLC	Medical Device Distributor	Subordinated Debt (6% Cash, Due 8/15/15)	400	388	400	0.1%
MMI Holdings, LLC	Medical Device Distributor	Preferred Units (1,000 units)	-	1,052	1,200	0.4%
MMI Holdings, LLC	Medical Device Distributor	Common Units (45 units)	-	-	125	0.0%
				4,040	4,325	1.6%
MTI Holdings, LLC	Retail Display & Security Services	Subordinated Debt (12% Cash, Due 11/1/18)	8,000	8,000	8,000	3.0%
MTI Holdings, LLC	Retail Display & Security Services	Capital Units (2,000,000 units)	-	2,000	2,823	1.1%
				10,000	10,823	4.1%
Source Capital ABUTEC, LLC	Environmental Services Products	Senior Secured Debt (12% Cash, 3% PIK, Due 12/28/17)	5,125	5,125	5,125	1.9%
Source Capital ABUTEC, LLC	Environmental Services Products	Preferred Membership Units (15.5% fully diluted)	-	1,240	60	0.0%
				6,365	5,185	1.9%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Subordinated Debt (13% Cash, Due 2/17/17)	2,500	2,500	2,500	0.9%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Membership Units (11.3% fully diluted)	-	750	810	0.3%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Common Stock Warrants (6.65% fully diluted)	-	-	576	0.2%
				3,250	3,886	1.4%
Source Capital SSCR, LLC	Personal Product Manufacturer	Senior Secured Term Debt (14% Cash, Due 7/6/17)	15,000	15,000	12,115	4.5%
Source Capital SSCR, LLC	Personal Product Manufacturer	Senior Secured Term Debt (14% Cash, 5% PIK, Due 3/28/14)	2,079	2,079	1,958	0.7%
Source Capital SSCR, LLC	Personal Product Manufacturer	Preferred Membership Units (14,718 units)	-	1,720	-	0.0%
Source Capital SSCR, LLC	Personal Product Manufacturer	Membership Unit Warrants (0.987% fully diluted)	-	-	-	0.0%
				18,799	14,073	5.2%
Source Recycling, LLC (2)	Metal Recycler	Subordinated Debt (13% Cash, Due 9/2/16)	5,000	5,000	3,950	1.5%
Source Recycling, LLC	Metal Recycler	Membership Units (68,658 units)	-	1,590	-	0.0%
Source Recycling, LLC	Metal Recycler	Membership Unit Warrants (1% fully diluted)	-	-	-	0.0%
				6,590	3,950	1.5%
Sparus Holdings, Inc.(1)	Energy Services	Subordinated Debt (12% Cash, Due 3/21/16)	7,000	7,000	7,000	2.6%

Sparus Holdings, Inc.	Energy Services	Series B Preferred Stock (5,703 shares)	-	1,173	1,479	0.6%
Sparus Holdings, Inc.	Energy Services	Common Stock Warrants (3,491 shares)	-	-	304	0.1%
				<u>8,173</u>	<u>8,783</u>	<u>3.3%</u>
STX Healthcare Management Services, Inc. <sup>(1)</sup>	Dental Practice Management	Subordinated Debt (14% Cash, Due 7/31/15)	7,425	7,425	7,425	2.8%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock (1,200,000 shares)	-	1,200	942	0.4%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock Warrants (1,154,254 shares)	-	218	906	0.3%
				<u>8,843</u>	<u>9,273</u>	<u>3.5%</u>
Take 5 Oil Change, Inc.	Quick Lube Services	Common Stock (10,692 shares)	-	1,069	1,604	0.6%
				<u>1,069</u>	<u>1,604</u>	<u>0.6%</u>
TCE Holdings, Inc.	Oil & Gas Services	Subordinated Debt (12% Cash, 2% PIK, Due 11/22/18)	12,088	12,088	12,088	4.5%
TCE Holdings, Inc.	Oil & Gas Services	Subordinated Debt (12% Cash, 2% PIK, Due 2/1/19)	9,633	9,633	9,633	3.6%
TCE Holdings, Inc.	Oil & Gas Services	Class A Common Stock (3,600 shares)	-	3,600	3,600	1.3%
				<u>25,321</u>	<u>25,321</u>	<u>9.4%</u>
V12 Holdings <sup>(1)</sup>	Data Processing & Digital Marketing	Bridge Note (0% Cash, Due 12/31/14)	663	361	663	0.3%
V12 Holdings <sup>(1)</sup>	Data Processing & Digital Marketing	Tier 2 Note (0% Cash, Due 12/31/14)	81	44	81	0.0%
V12 Holdings <sup>(1)</sup>	Data Processing & Digital Marketing	Senior Subordinated Note (0% Cash, Due 12/31/14)	3,563	2,369	3,598	1.3%
V12 Holdings <sup>(1)</sup>	Data Processing & Digital Marketing	Tier 3 Note (0% Cash, Due 12/31/14)	299	206	314	0.1%
V12 Holdings <sup>(1)</sup>	Data Processing & Digital Marketing	Jr. Subordinated Note (0% Cash, Due 12/31/14)	2,750	-	405	0.2%
V12 Holdings <sup>(1)</sup>	Data Processing & Digital Marketing	Tier 4 Note (0% Cash, Due 12/31/14)	243	-	-	0.0%
V12 Holdings	Data Processing & Digital Marketing	Series A-1 Preferred Stock (255,102 shares)	-	-	-	0.0%
V12 Holdings	Data Processing & Digital Marketing	Series A-3 Preferred Stock (88,194 shares)	-	-	-	0.0%
V12 Holdings	Data Processing & Digital Marketing	Series A-5 Preferred Stock (20,530 shares)	-	-	-	0.0%
V12 Holdings	Data Processing & Digital Marketing	Common Stock Warrants (2,063,629 warrants)	-	-	-	0.0%
				<u>2,980</u>	<u>5,061</u>	<u>1.9%</u>
<b>Sub Total Affiliate investments</b>				<u>\$ 159,104</u>	<u>\$ 189,098</u>	<u>70.4%</u>
<b>Control investments - 28.4%</b>						
CableOrganizer Acquisition, LLC	Computer Supply Retail	Senior Secured Debt (12% Cash, 4% PIK, Due 5/24/18)	\$ 6,585	\$ 6,585	\$ 6,585	2.5%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock (1,125,000 shares)	-	1,125	88	0.0%
				<u>7,710</u>	<u>6,673</u>	<u>2.5%</u>
KBP Investments, LLC <sup>(6)(7)</sup>	QSR Franchisee	Class A Preferred Stock (8,270 shares, 10% Dividend)	-	8,269	8,269	3.1%
KBP Investments, LLC	QSR Franchisee	Class A Common Stock (380,413 shares)	-	-	16,518	6.1%
				<u>8,269</u>	<u>24,787</u>	<u>9.2%</u>
Market E's, LLC	Online Travel Sales & Marketing	Senior Secured Debt (10% Cash, Due 12/31/14)	650	650	650	0.2%
Market E's, LLC <sup>(1)(2)</sup>	Online Travel Sales & Marketing	Senior Subordinated Debt (14% Cash, 3% PIK, Due 12/31/14)	3,014	2,832	988	0.4%
Market E's, LLC	Online Travel Sales & Marketing	Class A Preferred Stock (600 shares)	-	240	-	0.0%

Market E's, LLC	Online Travel Sales & Marketing	Class B Preferred Stock (2,411 shares)	-	965	-	0.0%
Market E's, LLC	Online Travel Sales & Marketing	Class A Common Stock (600 shares)	-	-	-	0.0%
				<u>4,687</u>	<u>1,638</u>	<u>0.6%</u>
Micro Precision, LLC	Conglomerate	Subordinated Debt (10% Cash, Due 9/16/16)	1,862	1,862	1,862	0.7%
Micro Precision, LLC	Conglomerate	Subordinated Debt (14% Cash, 4% PIK, Due 9/16/16)	3,557	3,557	3,557	1.3%
Micro Precision, LLC	Conglomerate	Common Stock (47 units)	-	1,629	2,210	0.8%
				<u>7,048</u>	<u>7,629</u>	<u>2.8%</u>
Navis Holdings, Inc.	Textile Equipment Manufacturer	Senior Secured Term Debt (17%, 3% PIK at company's option, Due 2/1/16)	6,753	6,753	6,753	2.5%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares)	-	1,000	1,200	0.5%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (300,000 shares)	-	1	1,079	0.4%
				<u>7,754</u>	<u>9,032</u>	<u>3.4%</u>
On-Site Fuel Services, Inc.	Fuel Transportation Services	Subordinated Debt (14% Cash, 4% PIK, Due 12/19/16)	4,848	4,848	4,848	1.8%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series A Preferred Stock (32,782 shares)	-	3,278	2,719	1.0%
On-Site Fuel Services, Inc. <sup>(6)</sup>	Fuel Transportation Services	Series B Preferred Stock (23,648 shares)	-	2,451	2,707	1.0%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Common Stock (33,107 shares)	-	33	-	0.0%
				<u>10,610</u>	<u>10,274</u>	<u>3.8%</u>
Print Direction, Inc. <sup>(1)</sup>	Printing Services	Subordinated Debt (12% Cash, 6% PIK, Due 7/25/2018)	4,424	4,389	4,424	1.6%
Print Direction, Inc. <sup>(1)</sup>	Printing Services	Subordinated Debt (14% Cash, Due 7/31/18)	4,600	4,600	4,600	1.7%
Print Direction, Inc.	Printing Services	Common Stock (19,363 shares)	-	2,990	7,110	2.7%
Print Direction, Inc.	Printing Services	Common Stock Warrants (3% fully diluted)	-	-	314	0.1%
				<u>11,979</u>	<u>16,448</u>	<u>6.1%</u>
<b>Sub Total Control investments</b>				<u>\$ 58,057</u>	<u>\$ 76,481</u>	<u>28.4%</u>
<b>TOTAL INVESTMENTS - 135.7%</b>				<u>\$ 301,299</u>	<u>\$ 364,719</u>	<u>135.7%</u>

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

(2) Due to deterioration in credit quality, this investment is on non-accrual status.

(3) The debt investment is accruing interest based on the terms of the forbearance agreement.

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

(5) Percentages are based on net assets of \$268,670 as of December 31, 2013.

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

(7) During the fourth quarter of 2013, the Company accepted a consent fee that waives its right to dividends through September 30, 2014.

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

See accompanying notes to consolidated financial statements.

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2014

(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”). We are an “emerging growth company” within the meaning of the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”), and as such, are subject to reduced public company reporting requirements. We commenced operations on May 24, 2013 and completed our 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 (the “Advisers Act”), and Capitala Advisors Corp. (the “Administrator”) provides the administrative services necessary for us to operate. In addition, for U.S. federal income tax purposes, the Company intends to elect to be treated as a regulated investment company (“RIC”), under Subchapter M of the Internal Revenue Code of 1986, as amended (the “Code”) commencing with our tax year ending August 31, 2014.

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 smaller and lower 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, we offer customized financing to business owners, management teams and financial sponsors for change of ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives. We invest primarily in traditional mezzanine, senior subordinated and unitranche debt, as well as senior and second-lien loans and, to a lesser extent, equity securities issued by smaller and lower 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 continue to hold their existing investments and continue 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. As of September 30, 2014, the Company had 12,974,420 shares of common stock outstanding.

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

### **Basis of Presentation**

The accompanying unaudited financial statements are presented in conformity with United States generally accepted accounting principles (“U.S. GAAP”) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual consolidated financial statements prepared in accordance with U.S. GAAP are omitted. In the opinion of management, all adjustments, consisting solely of normal recurring adjustments necessary for the fair presentation of financial statements for the interim period, have been reflected in the unaudited consolidated financial statements. 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 period ended December 31, 2013, filed with the U.S. Securities and Exchange Commission (“SEC”) on March 28, 2014. Financial statements prepared on a U.S. GAAP basis require management to make estimates and assumptions that affect the amounts and disclosures reported in the consolidated financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

The consolidated financial statements of the Company include the accounts of the Company and its wholly-owned subsidiaries as described in the Formation Transactions presented in Note 1. The transactions related to Fund II, Fund III, and the Florida Sidecar constitute an exchange of shares between entities under common control and will be accounted for in accordance with the Accounting Standards Codification (“ASC”), Topic 805, *Business Combinations* (“ASC 805”). As such, the results of the Company’s operations and cash flows for the three and nine months ended September 30, 2013 have been presented on a combined basis in order to provide comparative information with respect to prior periods. The Formation Transactions also included an asset acquisition of certain assets in Fund I and Fund III Parent. In accordance with ASC 805, the assets acquired were recorded at fair value at the date of acquisition, September 24, 2013.

The Company’s financial position as of September 30, 2014 is presented on a consolidated basis. The effects of all intercompany transactions between the Company and its subsidiaries (Fund II, Fund III, and the Florida Sidecar) 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.

### **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.

### **Segments**

In accordance with ASC Topic 280 - *Segment Reporting*, the Company has determined that it has a single reporting segment and operating unit structure.

### **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. Cash and cash equivalents include deposits in money market accounts. The Company deposits its cash in financial institutions and, at times, such balances may be in excess of the Federal Deposit Insurance Corporation (“FDIC”) insurance limits.

### **Investment Classification**

In accordance with the provisions of the 1940 Act, the Company classifies investment 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, our board of directors (the "Board") uses various valuation approaches, and engages a third-party valuation firm, which provides an independent review 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 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 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 (as defined below). 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.

### *Valuation Techniques*

#### *Senior and Subordinated Secured Loans*

The Company's portfolio primarily consists of private debt instruments ("Level 3 debt"). We consider our Level 3 debt to be performing loans if the borrower is not in default, the borrower is remitting payments in a timely manner, the loan is in covenant compliance or is otherwise not deemed to be impaired. In determining the fair value of the performing Level 3 debt, the Company's Board considers fluctuations in current interest rates, the trends in yields of debt instruments with similar credit ratings (if applicable), the financial condition of the borrower, economic conditions and other relevant factors, both qualitative and quantitative. In the event that a Level 3 debt instrument is not performing, as defined above, the Board will evaluate the value of the collateral utilizing the same framework described above for a performing loan to determine the value of the Level 3 debt instrument.

This evaluation will be updated no less than quarterly for Level 3 debt instruments that are not performing, and more frequently for time periods where there are significant changes in the collateral or significant changes in the perceived performance of the underlying portfolio company. The collateral value will be analyzed on an ongoing basis using internal metrics, appraisals, third-party valuation agents and other data as may be acquired and analyzed by our management and Board.

#### *Equity Investments in Private Companies*

Our Board determines the fair value of its investments in private companies by incorporating valuations that consider the evaluation of financing and sale transactions with third-parties, expected cash flows and market-based information, including comparable transactions, and performance multiples, among other factors, and may use third-party valuation agents. Such non-public investments are included in Level 3 of the fair value hierarchy.

#### *Warrants*

Our Board will ascribe value to warrants based on valuation techniques that can include discounted cash flow analyses, option pricing models, comparable analyses and other techniques as deemed appropriate. Such warrants are included in Level 3 of the fair value hierarchy to the extent issued by non-public companies.

### **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 ("PIK") provision. 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 income:* Generally, when interest and/or principal payments on a loan become materially past due, or if 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. Dividend income may be reversed in the event that a previously declared dividend is no longer expected to be paid by the portfolio company. 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 collection of 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.

*Other Income:* Origination, amendment, consent, closing and/or commitment 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 maturity date are recorded as income upon receipt.

#### **General and Administrative Expenses**

General and administrative expenses are accrued as incurred. The Company's general and administrative expenses include personnel expenses allocable to the Company under the Administration Agreement, legal and audit fees, director fees, director and officer insurance, and other expenses payable under the Administration Agreement.

#### **Deferred Financing Fees**

Costs incurred to issue the SBA-guaranteed debentures and notes payable are capitalized and are amortized over the term of the debt agreements under the effective interest method.

#### **Commitments and Contingencies**

As of September 30, 2014 and December 31, 2013, the Company had \$1.2 million and \$0 of outstanding unfunded commitments, respectively. The Company's unfunded commitments are all related to debt agreements with existing portfolio companies.

In the ordinary course of its business, the Company may enter into contracts or agreements that contain indemnifications or warranties. Future events could occur that lead to the execution of these provisions against the Company. Based on its history and experience, management feels 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. As of September 30, 2014, resolution of any outstanding claims is not expected to materially affect the Company's business, financial position, results of operation, or liquidity.

#### **Income Taxes**

The Company intends to elect to be treated for federal income tax purposes, and intends 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 federal income taxes. Therefore, no provision has been recorded for 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 a tax year, the Company may choose to carry forward taxable income in excess of current year dividend distributions into the next 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.

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 his or her 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 his or her 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.



For income tax purposes, the Company has paid distributions on its common stock from ordinary income in the amount of \$18.3 million during the tax year ended August 31, 2014. The tax character of the distributions is based on estimated taxable income for the tax year ended August 31, 2014. The tax character of the distributions based on actual taxable income for the tax year ended August 31, 2014 will be disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

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, 2014 and December 31, 2013, 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 have 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, 2014 and December 31, 2013. 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 for the three and nine month periods ended September 30, 2014 and September 30, 2013. 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 statement of operations.

#### **Dividends**

Dividends to common stockholders are recorded on the ex-dividend date. The amount to be paid out as a dividend is approved 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.

We have adopted an "opt out" dividend reinvestment plan for our common stockholders. As a result, if we declare a cash dividend or other distribution, each stockholder that has not "opted out" of our dividend reinvestment plan will have his/her dividends automatically reinvested in additional shares of our 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 in loans 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 loan-to-liquidation values with each loan and the collateral underlying the loan.

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 June 2013, the FASB issued ASU No. 2013-08, "*Financial Services – Investment Companies (Topic 946), Amendments to the Scope, Measurement, and Disclosure Requirements.*" The amendments in this accounting standards update affect the scope, measurement, and disclosure requirements for investment companies under U.S. GAAP, and clarify the characteristics of an investment company, provide comprehensive guidance for assessing whether an entity is an investment company, require that an investment company measure non-controlling ownership interests in other investment companies at fair value rather than using the equity method of accounting, and require additional disclosures. This standard is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2013. The Company has adopted this standard and the required disclosures are presented in the consolidated financial statements.

### **Note 4. Investments**

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 SBA under the SBIC Act, we offer customized financing to business owners, management teams and financial sponsors for change of ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives. We invest primarily in traditional mezzanine, senior subordinated and unitranche debt, as well as senior and second-lien loans and, to a lesser extent, equity securities issued by smaller and lower middle-market companies. As of September 30, 2014, our portfolio consisted of investments in 50 portfolio companies with a fair value of approximately \$445.1 million.

During the three months ended September 30, 2014, the Company made approximately \$86.7 million of investments in new or existing portfolio companies and had approximately \$44.7 million in exits and repayments resulting in net investments of approximately \$42.0 million for the period. During the three months ended September 30, 2013, the Company made approximately \$34.2 million of investments in new or existing portfolio companies and had approximately \$23.1 million in exits and repayments resulting in net investments of approximately \$11.1 million for the period.

During the nine months ended September 30, 2014, the Company made approximately \$150.3 million of investments in new or existing portfolio companies and had approximately \$64.8 million in exits and repayments resulting in net investments of approximately \$85.5 million for the period. During the nine months ended September 30, 2013, the Company made approximately \$75.8 million of investments in new or existing portfolio companies and had approximately \$50.2 million in exits and repayments resulting in net investments of approximately \$25.6 million for the period.

During the three and nine month periods ended September 30, 2014, all new investments were made to portfolio companies in which the Company was not previously contractually obligated to provide financial support. 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 nine month period ended September 30, 2014, the Company did not lead any syndicates. During the three months ended September 30, 2014 the Company did not assist any portfolio companies in obtaining indirect financing. During the nine month period ended September 30, 2014, the Company helped Print Direction, Inc. obtain a \$3.5 million senior revolving credit facility.

The composition of our investments as of September 30, 2014, at amortized cost and fair value were 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>
Senior Secured Debt	\$ 134,258	34.6%	\$ 136,171	30.6%
Subordinated Debt	187,842	48.5	186,483	41.9
Equity and Warrants	65,390	16.9	122,472	27.5
Total	<u>\$ 387,490</u>	<u>100.0%</u>	<u>\$ 445,126</u>	<u>100.0%</u>

The composition of our investments as of December 31, 2013, at amortized cost and fair value were 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>
Senior Secured Debt	\$ 103,457	34.3%	\$ 102,071	28.0%
Subordinated Debt	136,638	45.4	133,710	36.7
Equity and Warrants	61,204	20.3	128,938	35.3
Total	<u>\$ 301,299</u>	<u>100.0%</u>	<u>\$ 364,719</u>	<u>100.0%</u>

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 our Company's valuation policy, we evaluate the source of inputs, including any markets in which our 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 interest and dividends, 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 valuation methodologies are utilized by the company in estimating fair value and are summarized as follows:

*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 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. 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. 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.

*Income Approach*

The income approach utilizes a discounted cash flow methodology in which the Company estimates fair value based on the present value of a stream 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.

*Asset Approach*

The asset approach values an investment based on the greater of the enterprise value or the underlying collateral securing the investment. See discussion of determining enterprise value above. This approach is used when the debt is not performing in accordance with its contractual terms or 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.

The following table presents fair value measurements of investments, by major class, as of September 30, 2014 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Senior Secured Debt	\$ —	\$ —	\$ 136,171	\$ 136,171
Subordinated Debt	—	—	186,483	186,483
Equity and Warrants	—	—	122,472	122,472
Total	\$ —	\$ —	\$ 445,126	\$ 445,126

The following table presents fair value measurements of investments, by major class, as of December 31, 2013 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Senior Secured Debt	\$ —	\$ —	\$ 102,071	\$ 102,071
Subordinated Debt	—	—	133,710	133,710
Equity and Warrants	—	—	128,938	128,938
Total	\$ —	\$ —	\$ 364,719	\$ 364,719

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, 2014 (dollars in thousands):

	Senior Secured Debt	Subordinated Debt	Equity and Warrants	Total
Balance as of January 1, 2014	\$ 102,071	\$ 133,710	\$ 128,938	\$ 364,719
Change in classification due to restructure	(7,073)	7,073	—	—
Repayments	(36,300)	(23,683)	(4,850)	(64,833)
Purchases	76,345	69,069	4,890	150,304
Payment in-kind interest and dividends, net of payments received	809	792	460	2,061
Accretion of original issue discount	25	7	—	32
Realized gain/(loss) from investments	—	(5,059)	3,686	(1,373)
Increase/(decrease) in net unrealized appreciation	294	4,574	(10,652)	(5,784)
Balance as of September 30, 2014	\$ 136,171	\$ 186,483	\$ 122,472	\$ 445,126

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, 2013 (dollars in thousands):

	Senior Secured Debt	Subordinated Debt	Equity and Warrants	Total
Balance as of January 1, 2013	\$ 73,638	\$ 101,659	\$ 108,634	\$ 283,931
Change in classification due to restructure	6,735	(6,735)	—	—
Repayments	(22,958)	(20,004)	(7,247)	(50,209)
Purchases	24,775	44,459	6,583	75,817
Purchase related to asset acquisition	5,601	2,353	3,842	11,796
Payment in-kind interest and dividends, net of payments received	362	568	—	930
Accretion of original issue discount	4	31	—	35
Realized gain/(loss) from investments	—	(2,597)	4,832	2,235
Increase in net unrealized appreciation	75	3,899	2,468	6,442
Balance as of September 30, 2013	\$ 88,232	\$ 123,633	\$ 119,112	\$ 330,977

The net change in unrealized appreciation on investments held as of September 30, 2014 was a decrease of \$7.4 million and is included in net unrealized depreciation on investments in the consolidated statements of operations for the nine months ended September 30, 2014. The net change in unrealized appreciation on investments held as of September 30, 2013 was \$4.2 million and is included in net unrealized appreciation on investments in the consolidated statements of operations for the nine months ended September 30, 2014.

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements of assets as of September 30, 2014 were as follows (dollars in thousands, except EBITDA amounts):

	<u>Fair Value</u>	<u>Valuation Approach</u>	<u>Level 3 Input</u>	<u>Range of Inputs</u>	<u>Weighted Average</u>
Subordinated debt and second lien notes			Required Rate of Return	8.8% - 20.0%	
			Leverage Ratio	1.4x - 9.9x	13.1%
	\$ 169,053	Income	Adjusted EBITDA	\$2.3 million-\$200.0 million	4.4x
					\$41.3 million
Subordinated debt and second lien notes		Enterprise Value	Adjusted EBITDA Multiple	5.0x - 5.0x	5.4x
	\$ 17,430	Waterfall and Asset (1)	Adjusted EBITDA	\$0.7 million - \$2.8 million	\$2.3 million
Senior debt and first lien notes			Required Rate of Return	10.0% - 18.0%	14.3%
			Leverage Ratio	1.0x - 9.9x	4.3x
	\$ 136,171	Income and Asset (1)	Adjusted EBITDA	\$0.6 million- \$44.4 million	\$10.2 million
Equity shares and warrants		Enterprise Value	Adjusted EBITDA Multiple	4.5x - 11.0x	7.3x
	\$ 122,472	Waterfall	Adjusted EBITDA	\$1.6 million - \$205.9 million	\$25.2 million

(1) \$14.4 million in subordinated notes and \$9.3 million senior notes were valued using the asset approach.

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements of assets as of December 31, 2013 were as follows (dollars in thousands, except EBITDA amounts):

	<u>Fair Value</u>	<u>Valuation Approach</u>	<u>Level 3 Input</u>	<u>Range of Inputs</u>	<u>Weighted Average</u>
Subordinated debt and second lien notes			Required Rate of Return	7.0% - 18.0%	14.1%
			Leverage Ratio	1.2x - 4.6x	3.1x
	\$ 111,711	Income	Adjusted EBITDA	\$2.3 million-\$25.8 million	\$11.2 million
Subordinated debt and second lien notes		Enterprise Value	Adjusted EBITDA Multiple	4.3x - 11.5x	9.5x
	21,999	Waterfall and Asset (1)	Adjusted EBITDA	\$1.3 million - \$2.2 million	\$2.0 million
Senior debt and first lien notes			Required Rate of Return	10.0% - 24.5%	15.2%
			Leverage Ratio	1.2x - 9.9x	3.8x
	102,071	Income and Asset (1)	Adjusted EBITDA	\$0.6 million-\$29.7 million	\$11.2 million
Equity shares and warrants		Enterprise Value	Adjusted EBITDA Multiple	1.6x - 9.5x	7.1x
	128,938	Waterfall	Adjusted EBITDA	\$1.4 million - \$229.0 million	\$23.8 million
			Transaction Price	n/a	n/a

(1) \$15.0 million in subordinated notes and \$3.6 million in senior notes were valued using the asset approach.

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

## Note 5. Agreements

On September 24, 2013, the Company entered into an investment advisory agreement (the “Investment Advisory Agreement”) with the Investment Advisor, which was approved by the Board of Directors of the Company on June 10, 2013. The initial term of the Investment Advisory Agreement is two years, with automatic, one-year renewals at the end of each year subject to certain approvals by our Board of Directors. The Investment Advisory Agreement may be terminated by either party without penalty upon 60 days’ written notice to the other party. Subject to the overall supervision of our Board of Directors, the Investment Advisor manages our day-to-day operations, and provides investment advisory and management services to us. Under the terms of our 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, our 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, we have 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 our gross assets, which is our total assets as reflected on our Consolidated Statements of Assets and Liabilities and includes any borrowings for investment purposes. Although we do 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 our 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 our gross assets at the end of the first calendar quarter subsequent to our IPO, and thereafter based on the average value of our 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. For the first twelve months following our IPO, the Investment Advisor waived the portion of the base management fee payable on cash and cash equivalents held at the Company level, excluding cash and cash equivalents held by the Legacy Funds that were acquired by the Company in connection with the Formation Transactions.

Prior to the Formation Transactions, the management fee charged by each Legacy Fund for each fiscal quarter was the lesser of (a) an amount equal to an annual rate of .625% of the sum of (i) the Legacy Funds' regulatory capital and (ii) the amount of an assumed two tiers of outstanding leverage based on such regulatory capital, or (b) an amount negotiated between the general partner and the management company. The management fee was reduced by certain fees ultimately received by the investment adviser to the Legacy Funds from the portfolio companies. Payments of the management fee were made quarterly in advance. Certain direct expenses such as legal, audit, tax, and limited partner expense were the responsibility of the Legacy Funds.

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 our 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). Our net investment income used to calculate this part of the incentive fee is also included in the amount of our gross assets used to calculate the 1.75% base management fee. We pay the Investment Advisor an incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle of 2.0%;
- 100% of our 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). We refer to this portion of our pre-incentive fee net investment income (which exceeds the hurdle but is less than 2.5%) as the "catch-up." The "catchup" is meant to provide our Investment Advisor with 20% of our 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 our pre-incentive fee net investment income, if any, that exceeds 2.5% in any calendar quarter (10.0% annualized) is payable to our 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).

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.

We will defer cash payment of the portion of any incentive fee otherwise earned by our Investment Advisor that would, when taken together with all other incentive fees paid to our 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) our pre-incentive fee net investment income during such period, (b) our net unrealized appreciation or depreciation during such period and (c) our 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. Such deferred amounts will be calculated using a period of shorter than 12 full calendar months until 12 full calendar months have passed since completion of our IPO.

For the three months ended September 30, 2014 and 2013, we incurred \$2.5 million and \$1.0 million in base management fees, respectively. For the three months ended September 30, 2014 and 2013, our Investment Advisor waived \$38 thousand and \$0, respectively. For the three months ended September 30, 2014 and 2013, we incurred \$0 million and \$0, respectively, in incentive fees related to pre-incentive fee net investment income.

For the nine months ended September 30, 2014 and 2013, we incurred \$6.8 million and \$3.0 million in base management fees, respectively. For the nine months ended September 30, 2014 and 2013, our Investment Advisor waived \$238 thousand and \$0, respectively. For the nine months ended September 30, 2014 and 2013, we incurred \$2.8 million and \$0, respectively, in incentive fees related to pre-incentive fee net investment income.

On September 24, 2013, the Company entered into a separate administration agreement (the "Administration Agreement") with Capitala Advisors Corp., our Administrator, pursuant to which our Administrator has agreed to furnish us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Our Administrator also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders. In addition, our Administrator assists us in determining and publishing our net asset value, oversees the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others.

Payments under the Administration Agreement are equal to an amount based upon our allocable portion of our Administrator's overhead in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions and our allocable portion of the compensation of our chief financial officer, chief compliance officer and our allocable portion of the compensation of any administrative support staff. Under the Administration Agreement, our Administrator will also provide on our behalf managerial assistance to those portfolio companies that request such assistance. The Administration Agreement has an initial term of two years and may be renewed annually with the approval of our Board of Directors. The Administration Agreement may be terminated by either party without penalty upon 60 days' written notice to the other party. To the extent that our Administrator outsources any of its functions, we 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.

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, 2014 and December 31, 2013, the Company had the following receivables from (payables to) related parties relating to management fees, incentive fees, and reimbursable expenses (dollars in thousands):

	September 30, 2014	December 31, 2013
CapitalSouth Corporation	\$ 252	\$ 252
Shareholders/Limited Partners	270	267
CapitalSouth Fund III, L.P.	—	1,118
Capitala Investment Advisors, LLC	(450)	(2,670)
Total	<u>\$ 72</u>	<u>\$ (1,033)</u>

These amounts are reflected in the accompanying statements of financial position under the captions, “Due from related parties”, “Incentive fee payable” and “Due to related parties.”

At times, the Company maintains deposit accounts and certificates of deposit with financial institutions that are shareholders of the Company. Total deposits with these financial institutions were approximately \$34 thousand and \$2.8 million at September 30, 2014 and December 31, 2013, respectively.

## 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, 2014, the Company has issued \$192.2 million of SBA-guaranteed debentures. 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, 2014, Fund II and Fund III had total assets of approximately \$374.3 million. 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.

For the three months ended September 30, 2014 and September 30, 2013, we recorded \$2.1 million and \$2.2 million, respectively, of interest, annual charges, and financing expenses related to the SBA guaranteed debentures, of which \$1.9 million and \$2.0 million, respectively, was attributable to interest expense and annual charges, and \$0.2 million and \$0.2 million, respectively, was attributable to amortization of commitment and upfront fees. For the nine months ended September 30, 2014 and September 30, 2013, we recorded \$6.4 million and \$6.5 million, respectively, of interest, annual charges, and financing expenses related to the SBA guaranteed debentures, of which \$5.9 million and \$6.0 million, respectively, was attributable to interest expense and annual charges, and \$0.5 million and \$0.5 million, respectively, was attributable to amortization of commitment and upfront fees. The weighted average interest rate for all SBA-guaranteed debentures as of September 30, 2014 and December 31, 2013 was 3.51% and 3.57%, respectively. 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, 2014 and December 31, 2013 was 0.48% and 0.50%, respectively.

As of September 30, 2014 and December 31, 2013, the Company's issued and outstanding SBA-guaranteed debentures mature as follows (dollars in thousands):

<u>Date of Pooling</u>	<u>Fixed Maturity Date</u>	<u>Interest Rate</u>	<u>SBA Annual Charge</u>	<u>September 30, 2014</u>	<u>December 31, 2013</u>
March 1, 2004	March 1, 2014	4.120%	0.855%	\$ —	\$ 2,000
September 1, 2004	September 1, 2014	4.684%	0.855%	—	8,000
September 1, 2005	September 1, 2015	4.941%	0.871%	8,000	8,000
March 1, 2006	March 1, 2016	5.524%	0.871%	2,000	2,000
September 1, 2006	September 1, 2016	5.535%	0.941%	11,500	11,500
March 1, 2009	March 1, 2019	4.620%	0.941%	5,000	5,000
September 1, 2010	September 1, 2020	3.215%	0.285%	19,000	19,000
March 1, 2011	March 1, 2021	4.084%	0.515%	15,700	15,700
March 1, 2011	March 1, 2021	4.084%	0.285%	46,000	46,000
March 1, 2012	March 1, 2022	2.766%	0.285%	10,000	10,000
March 1, 2012	March 1, 2022	2.766%	0.515%	50,000	50,000
March 1, 2013	March 1, 2023	2.351%	0.515%	25,000	25,000
				<u>\$ 192,200</u>	<u>\$ 202,200</u>

ASC Topic 820 requires disclosure of the fair value of financial instruments for which it is practical to estimate such value. The Company estimates that the fair value of its SBA-guaranteed debentures is approximately \$192.0 million and \$200.7 million as of September 30, 2014 and December 31, 2013, respectively. The fair value estimate was based on future contractual cash payments discounted at market interest rates to borrow from the SBA as of the measurement date. Because the market interest rate is considered an unobservable input, SBA-guaranteed debentures are considered a level 3 financial instrument in the fair value hierarchy.

#### Notes

In June 2014, the Company issued \$113.4 million in aggregate principal amount of 7.125% fixed-rate notes due 2021 (the "Notes"). The Notes will mature on June 16, 2021, 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 June 16, 2017 at a redemption price equal to 100% of the outstanding principal, plus accrued and unpaid interest. Interest will be payable quarterly beginning September 16, 2014.

As of September 30, 2014, the carrying amount and fair value of the Notes was \$113.4 million and \$115.0 million, respectively. The fair value of the Notes, which are publicly traded, is based upon closing market quotes as of the measurement date. Because the fair value is determined by quoted prices for the Notes, the Notes are considered a level 1 financial instrument in the fair value hierarchy. As of September 30, 2014, \$4.4 million of financing costs related to the Notes have been capitalized and are being amortized over the term of the Notes. For the three months ended September 30, 2014, the Company has recorded \$2.0 million of interest expense and \$0.1 million of amortization of deferred financing costs related to the Notes. For the nine months ended September 30, 2014, the Company has recorded \$2.4 million of interest expense and \$0.1 million of amortization of deferred financing costs related to the Notes.

#### Note 8. 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 also receive \$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, 2014, the Company recognized director fee expense of \$90,000 and \$278,250, respectively. For the three and nine months ended September 30, 2013, the Company recognized director fee expense of \$0 and \$0, 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 9. Stockholders' Equity**

On September 24, 2013, we issued 8,974,420 shares of common stock to the limited partners of the Legacy Funds, in exchange for 100% of their membership interests or certain investment assets of such Legacy Fund, as the case may be. On September 30, 2013, we issued 4,000,000 shares of common stock in connection with the closing of our IPO. The shares issued in the IPO were priced at \$20.00 per share. We received proceeds of \$74.25 million in the IPO, net of underwriters' discounts and commissions totaling \$4.0 million and offering expenses totaling \$1.75 million. The Legacy Funds bore the other expenses associated with the offering. As of September 30, 2014, the Company had 12,974,420 shares of common stock outstanding.

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

The Company holds a control interest, as defined by the 1940 Act, in four majority owned portfolio companies that are not consolidated in the Company's consolidated financial statements. Below is a brief description of each portfolio company, along with summarized financial information as of September 30, 2014 and December 31, 2013, and for the nine month period ended September 30, 2014 and September 30, 2013.

### ***Print Direction, Inc.***

Print Direction, Inc., incorporated in Georgia on May 11, 2006, is a professional printing services firm serving customers, particular fast food, retail, and other similar chains, throughout the United States. Print Direction, Inc. also provides warehousing and distribution services for these customers. The income the Company generated from Print Direction, Inc., which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation/depreciation, was \$3.9 million and \$3.2 million for the nine months ended September 30, 2014 and September 30, 2013, 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, was \$3.3 million and \$1.6 million for the nine months ended September 30, 2014 and September 30, 2013, respectively.

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

On-Site Fuel Service, Inc. is a 100% owned subsidiary of On-Site Fuel Holdings, Inc., which was incorporated in Delaware on December 19, 2011. On-Site Fuel Service, Inc. provides fueling services for commercial and government vehicle fleets throughout the southeast United States. The loss the Company generated from On-Site Fuel Service, Inc., which includes all interest, dividends, PIK interest and dividends, fees, and unrealized depreciation, was \$2.5 million for the nine months ended September 30, 2014. The income the Company generated from On-Site Fuel Service, Inc. which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation was \$1.8 million for the nine months ended September 30, 2013.

### ***CableOrganizer Holdings, LLC***

CableOrganizer Holdings, 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 Holdings, LLC, which includes all interest, dividends, PIK interest and dividends, fees, and unrealized appreciation, was \$2.4 million and \$0.3 million for the nine months ended September 30, 2014 and September 30, 2013, respectively.

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

	As of	
	September 30, 2014	December 31, 2013
<b>Balance Sheet - Print Direction, Inc.</b>		
Current assets	\$ 4,889	\$ 5,738
Noncurrent assets	5,481	5,955
Total assets	<u>\$ 10,370</u>	<u>\$ 11,693</u>
Current liabilities	\$ 3,146	\$ 3,828
Noncurrent liabilities	14,510	10,496
Total liabilities	<u>\$ 17,656</u>	<u>\$ 14,324</u>
Total equity	<u>\$ (7,286)</u>	<u>\$ (2,631)</u>
<b>Statements of Operations - Print Direction, Inc.</b>		
	Nine Months Ended	
	September 30, 2014	September 30, 2013
Net sales	\$ 16,763	\$ 18,919
Cost of goods sold	6,629	8,174
Gross profit	<u>\$ 10,134</u>	<u>\$ 10,745</u>
Other expenses	\$ 9,997	\$ 9,493
Income before income taxes	137	1,252
Income tax provision	58	551
Net income	<u>\$ 79</u>	<u>\$ 701</u>
<b>Balance Sheet - Navis Holdings, Inc.</b>		
	As of	
	September 30, 2014	December 31, 2013
Current assets	\$ 4,574	\$ 5,216
Noncurrent assets	5,399	5,333
Total assets	<u>\$ 9,973</u>	<u>\$ 10,549</u>
Current liabilities	\$ 3,441	\$ 1,761
Noncurrent liabilities	6,897	7,053
Total liabilities	<u>\$ 10,338</u>	<u>\$ 8,814</u>
Total equity	<u>\$ (365)</u>	<u>\$ 1,735</u>
<b>Statements of Operations - Navis Holdings, Inc.</b>		
	Nine Months Ended	
	September 30, 2014	September 30, 2013
Net sales	\$ 10,642	\$ 10,895
Cost of goods sold	6,630	7,442
Gross profit	<u>\$ 4,012</u>	<u>\$ 3,453</u>
Other expenses	\$ 3,713	\$ 3,469
Income (loss) before income taxes	299	(16)
Income tax provision (benefit)	124	(4)
Net income	<u>\$ 175</u>	<u>\$ (12)</u>

	As of	
	September 30, 2014	December 31, 2013
<b>Balance Sheet – On-Site Fuel Service, Inc.</b>		
Current assets	\$ 16,695	\$ 15,578
Noncurrent assets	17,375	18,124
Total assets	<u>\$ 34,070</u>	<u>\$ 33,702</u>
Current liabilities	\$ 14,572	\$ 12,666
Noncurrent liabilities	11,284	11,442
Total liabilities	<u>\$ 25,856</u>	<u>\$ 24,108</u>
Total equity	<u>\$ 8,214</u>	<u>\$ 9,594</u>

	Nine Months Ended	
	September 30, 2014	September 30, 2013
<b>Statements of Operations - On-Site Fuel Service, Inc.</b>		
Net sales	\$ 158,709	\$ 179,465
Cost of goods sold	150,540	170,904
Gross profit	<u>\$ 8,169</u>	<u>\$ 8,561</u>
Other expenses	\$ 9,548	\$ 8,818
Loss before income taxes	(1,379)	(257)
Income tax provision	—	—
Net loss	<u>\$ (1,379)</u>	<u>\$ (257)</u>

	As of	
	September 30, 2014	December 31, 2013
<b>Balance Sheet – CableOrganizer Holdings, LLC</b>		
Current assets	\$ 3,641	\$ 2,441
Noncurrent assets	12,659	8,469
Total assets	<u>\$ 16,300</u>	<u>\$ 10,910</u>
Current liabilities	\$ 1,804	\$ 1,299
Noncurrent liabilities	10,925	6,585
Total liabilities	<u>\$ 12,729</u>	<u>\$ 7,884</u>
Total equity	<u>\$ 3,571</u>	<u>\$ 3,026</u>

	Nine Months Ended	
	September 30, 2014	September 30, 2013
<b>Statements of Operations - CableOrganizer Holdings, LLC</b>		
Net sales	\$ 18,191	\$ 12,178
Cost of goods sold	11,585	7,295
Gross profit	<u>\$ 6,606</u>	<u>\$ 4,883</u>
Other expenses	\$ 5,893	\$ 3,863
Income before income taxes	713	1,020
Income tax provision	—	—
Net loss	<u>\$ 713</u>	<u>\$ 1,020</u>

**Note 11. Earnings Per Share**

In accordance with the provisions of ASC 260, *Earnings per Share*, 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, 2014, there were no dilutive shares.

The following information sets forth the computation of the weighted average basic and diluted net increase in net assets per share from operations for the three and nine months ended September 30, 2014 and September 30, 2013 (dollars in thousands except share and per share data):

<b>Basic and diluted</b>	<b>For the three months ended</b>		<b>For the nine months ended</b>	
	<b>September 30, 2014</b>	<b>September 30, 2013</b>	<b>September 30, 2014</b>	<b>September 30, 2013</b>
Net increase in net assets from operations	\$ 311	\$ 7,909	\$ 7,740	\$ 22,062
Weighted average common shares outstanding	12,974,420	12,974,420	12,974,420	12,974,420
Net increase in net assets per share from operations- basic and diluted	\$ 0.02	\$ 0.61	\$ 0.60	\$ 1.70

**Note 12. Dividend**

The Company's dividends and distributions are recorded on the record date. Shareholders have the option to receive payment of the dividend in cash, shares of common stock, or a combination of cash and common stock.

The following table summarizes the Company's dividend declarations and distributions for the nine months ended September 30, 2014:

<b>Date Declared</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Amount Per Share</b>
February 27, 2014	March 14, 2014	March 26, 2014	\$ 0.47
May 8, 2014	June 9, 2014	June 26, 2014	0.47
August 7, 2014	September 12, 2014	September 26, 2014	0.47
		Total Dividends Declared	\$ 1.41



### Note 13. Financial Highlights

The following is a schedule of financial highlights for the nine months ended September 30, 2014 and 2013 (dollars in thousands, except share and per share data):

	September 30, 2014	September 30, 2013
<b>Per share data:</b>		
Net asset value at beginning of period(1)	\$ 20.71	\$ 17.74
Net investment income(2)	1.15	1.03
Net realized gain (loss) on investments	(0.10)	0.17
Net increase (decrease) in unrealized appreciation on investments	<u>(0.45)</u>	<u>0.50</u>
Net increase in stockholders' equity	<u>0.60</u>	<u>1.70</u>
Capital contributions from partners	—	1.92
Dividends declared and paid from accumulated net investment income	(1.41)	—
Capital distributions to partners	—	(0.57)
Net asset value at end of period	\$ 19.89	\$ 20.79
Net assets at end of period	\$ 258,116	\$ 269,722
Shares outstanding at end of period	12,974,420	12,974,420
Per share market value at end of period	\$ 17.72	\$ 19.20
Total return based on market value(3)	(4.12)%	(4.00)%
<b>Ratio/Supplemental data:</b>		
Ratio of net investment income to average net assets(1)(5)	7.55%	7.14%
Ratio of incentive fee to average net assets(1)(5)	1.44%	—%
Ratio of debt related expenses to average net assets(1)(5)	4.50%	3.48%
Ratio of other operating expenses, net of management fee waiver to average net assets(1)(5)(8)	4.80%	1.80%
Ratio of total expenses to average net assets(1)(5)	10.74%	5.29%
Portfolio turnover rate(4)	16.14%	2.27%
Average Debt Outstanding(6)	\$ 238,293	\$ 186,797
Average Debt Outstanding per common share	\$ 18.37	\$ 14.40
Asset Coverage ratio per unit(7)	\$ 1,845	\$ 2,268

- (1) Net asset value as of January 1, 2013 and average net assets for the nine months ended September 30, 2013 are presented as if the IPO and Formation Transactions had occurred on January 1, 2013. See Note 2 for a further description of the basis of presentation of the Company's financial statements.
- (2) Net investment income per share is calculated using the weighted average shares outstanding during the period.
- (3) 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 dividend reinvestment plan. Total investment return does not reflect brokerage commissions. Total investment returns covering less than a full period are not annualized. Portfolio turnover rates that cover less than a full period are not annualized.
- (4) 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.
- (5) Ratios are annualized.
- (6) Based on daily weighted average balance of debt outstanding during the period.
- (7) 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. Asset coverage per unit is expressed in terms of dollar amounts per \$1,000 of indebtedness.
- (8) The ratio of waived management fees to average net assets was .09% for the nine months ended September 30, 2014. For the period ended September 30, 2013, there was no management fee waiver.

### 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 and for the nine month period ended September 30, 2014.

#### **Distributions**

On October 3, 2014, the Company announced that it has declared distributions for the months of October, November, and December of 2014. The Company converted to monthly distributions, effective October 2014. Accordingly, on October 2, 2014, the Company's Board of Directors declared the following distributions:

Record Date	Payment Date	Amount Per Share	
10/22/14	10/30/14	\$	0.1567
11/21/14	11/28/14	\$	0.1567
12/19/14	12/30/14	\$	0.1567

### ***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. The Credit Facility initially provides for borrowings up to \$50,000,000 and may be increased up to \$150,000,000 pursuant to its “accordion” feature. The Credit Facility matures on October 17, 2018.

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 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.

### ***Portfolio Activity***

On October 23, 2014, the Company invested \$5.0 million in the first lien senior debt (LIBOR plus 5.75%, 1.00% floor) of Flavors Holdings, Inc. On November 4, 2014, the Company invested an additional \$3.0 million in the first lien senior debt (LIBOR plus 5.75%, 1.00% floor) of Flavors Holdings, Inc. On October 27, 2014, the Company invested \$12.0 million in the subordinated debt (LIBOR plus 10.00%/1.00% floor) of Flavors Holdings, Inc.

On October 30, 2014, Boot Barn Inc. completed an initial public offering (“IPO”) and began trading on the NYSE under the ticker symbol BOOT. Based on a 25:1 stock conversion at IPO, the Company now owns 600,000 shares of common stock in Boot Barn, which priced at \$16 per share in an all primary offering.

On October 31, 2014, the Company received \$2.8 million from Naples Lumber & Supply Co., representing full repayment of the investment, generating a gain of \$1.4 million.

## **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.

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 this Quarterly Report on Form 10-Q.

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" in our Annual Report on Form 10-K. 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 (the "1940 Act"). We are an emerging growth company within the meaning of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), 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 smaller and lower middle-market companies in the United States, 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, product or service with competitive advantages and industry-appropriate margins. We primarily invest in companies with between \$5 million and \$30 million in trailing twelve month earnings before interest, tax, depreciation and amortization ("EBITDA").

We invest in mezzanine and senior subordinated debt investments that are secured by subordinated liens on all of our borrowers' assets and, to a lesser extent, in senior, cash flow-based "unitranche" securities. 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 have to 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 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 smaller and lower 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 Fund's wholly-owned subsidiaries. Fund II and Fund III retained their SBIC licenses and continue to hold their existing investments and continue 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. As of September 30, 2014, the Company had 12,974,420 shares of common stock outstanding.

At the time of the Formation Transactions, our portfolio consisted of: (i) approximately \$326.3 million in investments; (ii) an aggregate of approximately \$67.1 million in cash, interest receivable and other assets; and (iii) 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. We may also seek other forms of leverage and borrow funds to make investments, including before we have fully invested the proceeds of this offering.

## **Basis of Presentation**

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles ("U.S. GAAP"). The consolidated financial statements of the Company include the accounts of the Company and its wholly-owned subsidiaries as described in the Formation Transactions presented in Note 1 to our Consolidated Financial Statements. The transactions related to Fund II, Fund III, and the Florida Sidecar constitute an exchange of shares between entities under common control and will be accounted for in accordance with the Accounting Standards Codification ("ASC"), Topic 805, *Business Combinations* ("ASC 805"). As such, the results of the Company's operations and cash flows for the three and nine months ended September 30, 2013 have been presented on a combined basis in order to provide comparative information with respect to prior periods. The Formation Transactions also included an asset acquisition of certain assets in Fund I and Fund III Parent. In accordance with ASC 805, the assets acquired were recorded at fair value at the date of acquisition, September 24, 2013.

The Company's financial position as of September 30, 2014 is presented on a consolidated basis. The effects of all intercompany transactions between the Company and its subsidiaries (Fund II, Fund III, and the Florida Sidecar) have been eliminated in consolidation. All financial data and information included in these financial statements have been presented on the basis described above. In the opinion of management, the financial statements reflect all adjustments that are necessary for the fair presentation of financial results as of and for the periods presented.

### **Revenues**

We generate revenue primarily from the periodic cash interest we will 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, 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 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, 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 (the "Exchange Act"), 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 any 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 our Consolidated Financial Statements. While all of these policies are important to understanding our consolidated 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 consolidated 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 judgment 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 they review. 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.

#### *Valuation Techniques*

##### *Senior and Subordinated Secured Loans*

The Company's portfolio primarily consists of private debt instruments ("Level 3 debt"). We consider our Level 3 debt to be performing loans if the borrower is not in default, the borrower is remitting payments in a timely manner, the loan is in covenant compliance or is otherwise not deemed to be impaired. In determining the fair value of the performing Level 3 debt, the Company's Board considers fluctuations in current interest rates, the trends in yields of debt instruments with similar credit ratings (if applicable), the financial condition of the borrower, economic conditions and other relevant factors, both qualitative and quantitative. In the event that a Level 3 debt instrument is not performing, as defined above, the Board will evaluate the value of the collateral utilizing the same framework described above for a performing loan to determine the value of the Level 3 debt instrument.

This evaluation will be updated no less than quarterly for Level 3 debt instruments that are not performing, and more frequently for time periods where there are significant changes in the collateral or significant changes in the perceived performance of the underlying portfolio company. The collateral value will be analyzed on an ongoing basis using internal metrics, appraisals, third-party valuation agents and other data as may be acquired and analyzed by our management and Board.

##### *Equity Investments in Private Companies*

Our Board determines the fair value of its investments in private companies by incorporating valuations that consider the evaluation of financing and sale transactions with third-parties, expected cash flows and market-based information, including comparable transactions, and performance multiples, among other factors, and may use third-party valuation agents. Such non-public investments are included in Level 3 of the fair value hierarchy.

## *Warrants*

Our Board will ascribe value to warrants based on valuation techniques that can include discounted cash flow analyses, option pricing models, comparable analyses and other techniques as deemed appropriate. Such warrants are included in Level 3 of the fair value hierarchy to the extent issued by non-public companies.

## **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 ("PIK") provision. 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 income:* Generally, when interest and/or principal payments on a loan become materially past due, or if 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 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 and continue accruing interest income in cases where a loan is currently paying 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. Dividend income may be reversed in the event that a previously declared dividend is no longer expected to be paid by the portfolio company. 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 collection of 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.

*Other Income:* Origination, amendment, consent, closing and/or commitment 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 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-1s 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 intends to elect to be treated for federal income tax purposes, and intends 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 federal income taxes. Therefore, no provision has been recorded for 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 a tax year, the Company may choose to carry forward taxable income in excess of current year dividend distributions into the next 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.

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 his or her 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 his or her 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.

For income tax purposes, we have paid distributions on our common stock from ordinary income in the amount of \$18.3 million during the tax year ended August 31, 2014. The tax character of the distributions is based on estimated taxable income for the tax year ended August 31, 2014. The tax character of the distributions based on actual taxable income for the tax year ended August 31, 2014 will be disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

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, 2014 and December 31, 2013, 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 have a negative 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, 2014 and December 31, 2013. 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 for the three and nine month periods ended September 30, 2014 and September 30, 2013. 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 statement of operations.

## Portfolio and Investment Activity

As of September 30, 2014, our portfolio consisted of investments in 50 portfolio companies with a fair value of approximately \$445.1 million.

During the three months ended September 30, 2014, we made approximately \$86.7 million of investments in new or existing portfolio companies and had approximately \$44.7 million in exits and repayments resulting in net investments of approximately \$42.0 million for the period. During the three months ended September 30, 2013, we made approximately \$34.2 million of investments in new or existing portfolio companies and had approximately \$23.1 million in exits and repayments resulting in net investments of approximately \$11.1 million for the period.

During the nine months ended September 30, 2014, we made approximately \$150.3 million of investments in new or existing portfolio companies and had approximately \$64.8 million in exits and repayments resulting in net investments of approximately \$85.5 million for the period. During the nine months ended September 30, 2013, we made approximately \$75.8 million of investments in new or existing portfolio companies and had approximately \$50.2 million in exits and repayments resulting in net investments of approximately \$25.6 million for the period.

As of September 30, 2014, our average portfolio company investment and our largest portfolio company investment at amortized cost and fair value was approximately \$7.7 million and \$8.9 million, and \$25.7 million and \$25.7 million, respectively. As of September 30, 2014, the Company had approximately \$107.6 million of cash and cash equivalents. As of December 31, 2013, our average portfolio company investment and our largest portfolio company investment at amortized cost and fair value was approximately \$7.3 million and \$8.9 million, and \$25.3 million and \$25.3 million, respectively. As of December 31, 2013, the Company had \$101.6 million of cash and cash equivalents.

The following table summarizes the amortized cost and the fair value of investments and cash and cash equivalents as of September 30, 2014 (dollars in thousands):

	Investments at Amortized Cost	Amortized Cost Percentage of Total Portfolio	Investments at Fair Value	Fair Value Percentage of Total Portfolio
Senior Secured Debt	\$ 134,258	27.1%	\$ 136,171	24.6%
Subordinated Debt	187,842	38.0	186,483	33.7
Equity and Warrants	65,390	13.2	122,472	22.2
Cash and Cash Equivalents	107,576	21.7	107,576	19.5
<b>Total</b>	<b>\$ 495,066</b>	<b>100.0%</b>	<b>\$ 552,702</b>	<b>100.0%</b>

The following table summarizes the amortized cost and the fair value of investments and cash and cash equivalents as of December 31, 2013 (dollars in thousands):

	Investments at Amortized Cost	Amortized Cost Percentage of Total Portfolio	Investments at Fair Value	Fair Value Percentage of Total Portfolio
Senior Secured Debt	\$ 103,457	25.7%	\$ 102,071	21.9%
Subordinated Debt	136,638	33.9	133,710	28.7
Equity and Warrants	61,204	15.2	128,938	27.6
Cash and Cash Equivalents	101,622	25.2	101,622	21.8
<b>Total</b>	<b>\$ 402,921</b>	<b>100.0%</b>	<b>\$ 466,341</b>	<b>100.0%</b>

As of September 30, 2014, our income-bearing investment portfolio, which represented nearly 73% of our total portfolio, had a weighted average yield of approximately 12.8%. As of September 30, 2014, 85% of our income-bearing investment portfolio was bearing a fixed rate of interest. As of December 31, 2013, our income-bearing investment portfolio, which represented nearly 65% of our total portfolio, had a weighted average yield of approximately 13.7% all bearing a fixed rate of interest.

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

	September 30, 2014		December 31, 2013	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
Oil & Gas Services	\$ 30,535	6.8%	\$ 25,321	7.0%
Transportation	26,938	6.1	6,000	1.6
Sales & Marketing Services	24,442	5.5	22,753	6.3
Printing Services	20,334	4.6	16,448	4.5
QSR Franchisee	20,004	4.5	24,787	6.8
Bakery Supplies Distributor	17,000	3.8	—	—
Personal Product Manufacturer	16,437	3.7	14,073	3.9
Footwear Retail	15,713	3.5	14,807	4.1
Oil & Gas Engineering and Consulting Services	15,491	3.5	15,000	4.1
Home Décor Manufacturer	15,000	3.4	—	—
Automobile Part Manufacturer	14,539	3.3	—	—
Medical Device Distributor	14,481	3.3	11,121	3.0
Industrial Equipment Rental	13,212	3.0	22,500	6.2
Healthcare Management	12,604	2.8	—	—
Retail Display & Security Services	12,392	2.8	10,823	3.0
Computer Supply Retail	12,081	2.7	6,673	1.8
Wireless Communication Retailer	12,000	2.7	—	—
Energy Services	11,715	2.6	8,783	2.4
Culinary Products	11,506	2.6	10,302	2.8
Restaurant	10,000	2.2	—	—
Textile Equipment Manufacturer	9,941	2.2	9,031	2.5
Western Wear Retail	9,202	2.1	4,774	1.3
Dental Practice Management	8,818	2.0	9,273	2.6
Financial Services	8,300	1.9	—	—
Data Processing & Digital Marketing	7,599	1.7	5,061	1.4
Conglomerate	7,423	1.7	7,630	2.1
Fuel Transportation Services	7,297	1.6	10,274	2.8
Produce Distribution	6,179	1.4	6,631	1.8
Environmental Services Products	5,424	1.2	5,185	1.4
Specialty Clothing	4,941	1.1	12,724	3.5
Replacement Window Manufacturer	4,904	1.1	6,284	1.7
Advertising & Marketing Services	4,440	1.0	4,911	1.3
Metal Recycler	4,150	0.9	3,950	1.1
Petroleum Equipment Supplier	3,802	0.9	3,624	1.0
Automotive Chemicals & Lubricants	3,739	0.8	3,886	1.1
Industrial Manufacturing	3,487	0.8	3,440	0.9
Professional Employer Organization	3,463	0.8	22,677	6.2
Education Services	3,000	0.7	—	—
QSR Franchisor	2,959	0.7	14,622	4.0
Building Supplies	2,809	0.6	2,509	0.7
Specialty Defense Contractor	2,000	0.4	2,799	0.8
Industrial Boiler Manufacturer	1,922	0.4	1,536	0.4
Online Travel Sales & Marketing	1,750	0.4	1,638	0.4
In-Home Healthcare Services	624	0.1	748	0.2
IT Hosting Services	529	0.1	453	0.1
Aerospace Parts Manufacturer	—	—	10,064	2.8
Quick Lube Services	—	—	1,604	0.4
Medical Transportation Services	—	—	—	—
<b>Total</b>	<b>\$ 445,126</b>	<b>100.0%</b>	<b>\$ 364,719</b>	<b>100.0%</b>

With the exception of an \$8.3 million investment in an internationally headquartered company, all investments made by the Company as of September 30, 2014 and December 31, 2013 were made in portfolio companies located in the United States. 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, 2014 and December 31, 2013 (dollars in thousands):

	September 30, 2014		December 31, 2013	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
South	\$ 279,720	62.8%	\$ 254,143	69.7%
West	85,020	19.1	66,637	18.3
Northeast	41,851	9.4	23,436	6.4
Midwest	30,235	6.8	20,503	5.6
International	8,300	1.9	—	—
Total	\$ 445,126	100.0%	\$ 364,719	100.0%

In addition to various risk management tools, our investment adviser 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 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 senior or senior subordinated debt 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 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 adviser will review these investment ratings on a quarterly basis, and our Board of Directors will affirm such ratings. 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 performance rating scale at fair value as of September 30, 2014 (dollars in thousands):

<b>Investment Performance Rating</b>	<b>Investments at Fair Value</b>	<b>Percentage of Total Investments</b>
1	\$ 160,818	36.1%
2	219,308	49.3
3	57,178	12.8
4	7,822	1.8
5	—	—
Total	<u>\$ 445,126</u>	<u>100.0%</u>

The following table shows the distribution of our investments on the 1 to 5 investment performance rating scale at fair value as of December 31, 2013 (dollars in thousands):

<b>Investment Performance Rating</b>	<b>Investments at Fair Value</b>	<b>Percentage of Total Investments</b>
1	\$ 183,194	50.2%
2	129,721	35.5
3	44,680	12.3
4	7,124	2.0
5	—	—
Total	<u>\$ 364,719</u>	<u>100.0%</u>

As of September 30, 2014, the Company had debt investments in four portfolio companies on non-accrual status with a total principal amount of \$13.5 million, amortized cost of \$11.8 million and a fair value of \$7.8 million, which represented 3.7%, 3.0%, and 1.8% of the investment portfolio, respectively. As of December 31, 2013, the Company had debt investments in four portfolio companies on non-accrual status with a total principal amount of \$12.1 million, amortized cost of \$10.3 million and a fair value of \$6.5 million representing 3.3%, 2.8% and 1.8% of the investment portfolio, respectively.

## Results of Operations

Operating results for the three and nine months ended September 30, 2014 and September 30, 2013 are as follows (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Total investment income	\$ 11,167	\$ 8,801	\$ 36,067	\$ 23,288
Total expenses, net	7,623	3,364	21,170	9,903
Net investment income	3,544	5,437	14,897	13,385
Net realized gain (loss) from investments	(3,055)	1,871	(1,373)	2,235
Net increase (decrease) in unrealized appreciation	(178)	601	(5,784)	6,442
Net increase in net assets resulting from operations	\$ 311	\$ 7,909	\$ 7,740	\$ 22,062

### Investment income

The composition of our investment income for the three and nine months ended September 30, 2014 and September 30, 2013 was as follows (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Interest and fee income	\$ 10,316	\$ 5,945	\$ 26,844	\$ 17,810
Payment-in-kind interest and dividend income	728	422	2,061	1,092
Dividend income	120	2,158	7,145	2,674
Other income	—	210	—	1,571
Interest from cash and cash equivalents	3	66	17	141
Total Investment Income	\$ 11,167	\$ 8,801	\$ 36,067	\$ 23,288

For the three months ended September 30, 2014, total investment income increased \$2.4 million, or 26.9%, compared to the three months ended September 30, 2013. The increase from the prior period related primarily to higher interest and PIK income as the result of an increasing investment portfolio, partially offset by lower dividend income for the current period. For the nine months ended September 30, 2014, total investment income increased \$12.8 million, or 54.9%, compared to the nine months ended September 30, 2013. The increase from the prior period relates to higher dividend income mostly from recapitalizations of control investments, and higher loan interest and fee income resulting from an increasing investment portfolio.

### Operating expenses

The composition of our expenses for the three and nine months ended September 30, 2014 and September 30, 2013 was as follows (dollars in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Interest expense and amortization of deferred financing fees	\$ 4,268	\$ 2,237	\$ 8,870	\$ 6,527
Management fees, net of management fee waiver	2,498	980	6,592	2,994
Incentive fees	—	—	2,838	—
General and administrative expenses	857	147	2,870	382
Total expenses	\$ 7,623	\$ 3,364	\$ 21,170	\$ 9,903

For the three months ended September 30, 2014, operating expenses increased \$4.3 million, or 126.6%, compared to the three months ended September 30, 2013. For the nine months ended September 30, 2014, operating expenses increased \$11.3 million, or 113.8%, compared to the nine months ended September 30, 2013. The increase from the prior period is attributable to incentive and management fees under the Advisory Agreement along with increased general and administrative expenses due to regulatory and reporting costs subsequent to our IPO on September 30, 2013, and an increase in interest expense as a result of our June 2014 \$113.4 million offering of 7.125% fixed rate notes due 2021 (“the Notes”). It should be noted that the three months ended September 30, 2013 was the first quarter of operations for the Company following the IPO, but did not include a full allocation of operating expenses and management fees since the IPO was completed on the last day of the reporting period.

#### *Net realized gains/losses on sales of investments*

During the three and nine months ended September 30, 2014, we recognized \$3.1 million and \$1.4 million, respectively, of net realized losses on our portfolio investments. Gross losses for the third quarter of 2014 totaling \$5.2 million related to the exit of Impresa Aerospace Holdings, LLC debt were partially offset by a \$2.1 million gain on the exit of Take 5 Oil Change, Inc. During the three and nine months ended September 30, 2013, we recognized \$1.9 million and \$2.2 million, respectively, of net realized gains on portfolio investments.

#### *Net unrealized appreciation/depreciation on investments*

Net change in unrealized appreciation on investments reflects the net change in the fair value of our investment portfolio. For the three months ended September 30, 2014, we had a \$0.2 million decrease in unrealized appreciation on portfolio investments. For the nine months ended September 30, 2014, we had a \$5.8 million decrease in unrealized appreciation on portfolio investments. For the three and nine months ended September 30, 2013, we had a \$0.6 million and \$6.4 million, respectively, increase in unrealized appreciation on portfolio investments.

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

For the three and nine months ended September 30, 2014, we recorded a net increase in net assets resulting from operations of \$0.3 million and \$7.7 million, respectively. Based on the weighted average shares of common stock outstanding for the three and nine months ended September 30, 2014, our per share net increase in net assets resulting from operations was \$0.02 and \$0.60, respectively. For the three and nine months ended September 30, 2013, we recorded a net increase in net assets resulting from operations of \$7.9 million and \$22.1 million, respectively. Based on the weighted average shares of common stock outstanding for the three and nine months ended September 30, 2013 our per share net increase in net assets resulting from operations was \$0.61 and \$1.70, respectively.

#### **Financial Condition, Liquidity and Capital Resources**

In addition to cash flows generated from operations, including earnings on investments in our portfolio and future investments, as well as interest earned from the temporary investment of cash in U.S. government securities and other high-quality debt investments that mature in one year or less, we intend to continue to seek capital through future equity and debt capital raises. In addition to the \$74.25 million in net proceeds received from our IPO on September 30, 2014, the Company issued \$113.4 million in aggregate principal amount of 7.125% fixed-rate notes in June of 2014. The Notes will mature on June 16, 2021, 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 June 17, 2017 at a redemption price equal to 100% of the outstanding principal, plus accrued and unpaid interest. The notes will bear interest at a rate of 7.125% per year payable quarterly on March 16, June 16, September 16, and December 16 of each year, beginning September 16, 2014. The Notes are listed on the New York Stock Exchange under the trading symbol “CLA” with a par value \$25.00 per share.

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, 2014, we had \$107.6 million in cash and cash equivalents, and our net assets totaled \$258.1 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 the Company's significant contractual payment obligations as of September 30, 2014 is as follows (dollars in thousands):

	<b>Contractual Obligations Payments Due by Period</b>				<b>Total</b>
	<b>Less Than 1 Year</b>	<b>1 - 3 Years</b>	<b>3 - 5 Years</b>	<b>More Than 5 Years</b>	
SBA-Guaranteed Debentures	\$ 8,000	\$ 13,500	\$ 5,000	\$ 165,700	\$ 192,200
Note Obligations	—	—	—	113,438	113,438
<b>Total Contractual Obligations</b>	<b>\$ 8,000</b>	<b>\$ 13,500</b>	<b>\$ 5,000</b>	<b>\$ 279,138</b>	<b>\$ 305,638</b>

### Distributions

In order to qualify as a RIC and to avoid U.S. federal corporate level 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. To the extent that we have income available, we intend to make quarterly distributions to our stockholders for the first four full quarters subsequent to our IPO and then 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. 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 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 dividend reinvestment plan. 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 dividend reinvestment plan will not receive any corresponding cash distributions with which to pay any such applicable taxes.

#### **Related Parties**

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

In addition, the Investment Advisor’s investment team also manages 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. 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. 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.

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, president and chairman of our Board, is the chief executive officer, president and a director of our Administrator, and Mr. Broyhill, a member of our Board, is the trustee of a trust that has a controlling interest in our Administrator.

#### **Off-balance sheet arrangements**

We have no 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 3, 2014, we announced that we have declared distributions for the months of October, November, and December of 2014. The Company converted to monthly distributions, effective October 2014. Accordingly, on October 2, 2014, the Company’s Board of Directors declared the following distributions:

Record Date	Payment Date	Amount Per Share
10/22/14	10/30/14	\$ 0.1567
11/21/14	11/28/14	\$ 0.1567
12/19/14	12/30/14	\$ 0.1567

### ***Credit Facility***

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. The Credit Facility initially provides for borrowings of up to \$50,000,000 and may be increased up to \$150,000,000 pursuant to its “accordion” feature. The Credit Facility matures on October 17, 2018.

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 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.

### ***Portfolio Activity***

On October 23, 2014, we invested \$5.0 million in the first lien senior debt (LIBOR plus 5.75%, 1.00% floor) of Flavors Holdings, Inc. On November 4, 2014, we invested an additional \$3.0 million in the first lien senior debt (LIBOR plus 5.75%, 1.00% floor) of Flavors Holdings, Inc. On October 27, 2014, we invested \$12.0 million in the subordinated debt (LIBOR plus 10.00%/1.00% floor) of Flavors Holdings, Inc.

On October 30, 2014, Boot Barn Inc. completed an initial public offering (“IPO”) and began trading on the NYSE under the ticker symbol BOOT. Based on a 25:1 stock conversion at IPO, we now own 600,000 shares of common stock in Boot Barn, which priced at \$16 per share in an all primary offering.

On October 31, 2014, we received \$2.8 million from Naples Lumber & Supply Co., representing full repayment of the investment, generating a gain of \$1.5 million.

### **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 three and nine months ended September 30, 2014, we did not engage in hedging activities.

As of September 30, 2014, the Company held 5 securities at a cost of \$49.1 million bearing a variable rate of interest. The Company’s variable rate investments represent approximately 15% of the fair market value of total interest earning investments. All variable rate securities are London Interbank Offered Rate-based (“LIBOR”) and are subject to interest rate floors. As of and for the three and nine month periods ended September 30, 2014, all variable rate securities are yielding interest at a rate equal to the established interest rate floor. As of September 30, 2014, all of our interest paying liabilities, consisting of \$192.2 million in SBA-guaranteed debentures and \$113.4 million in notes payable, bear interest at a fixed rate.

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

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

As of September 30, 2014 (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 Controls Over Financial Reporting**

Management has not identified any change in the Company's internal control over financing reporting that occurred during the third quarter of 2014 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, is 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. 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 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, 2013, 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 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. 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, 2013.

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

During the quarter ended September 30, 2014, we issued 5,995 shares of common stock under our dividend reinvestment plan. 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 dividend reinvestment plan during the quarter ended September 30, 2014 was approximately \$110 thousand. Other than the shares issued under our dividend reinvestment plan during the quarter ended September 30, 2014, we did not sell any unregistered equity securities and we did not repurchase any of our equity securities.

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

None.

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

None.

#### **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>
3.1	Articles of Amendment and Restatement(1)
3.4	Bylaws(1)
4.1	Form of Common Stock Certificate(1)
4.2	Form of Base Indenture(2)
4.3	Form of First Supplemental Indenture(2)
4.4	Form of Global Note (included as Exhibit A to the Form of First Supplemental Indenture)(2)
10.1	Form of Dividend Reinvestment Plan(1)
10.2	Form of Investment Advisory Agreement by and between Registrant and Capitala Investment Advisors, LLC(1)
10.3	Form of Custodian Agreement(1)
10.4	Form of Administration Agreement by and between Registrant and Capitala Advisors Corp.(1)
10.5	Form of Indemnification Agreement by and between Registrant and each of its directors(1)
10.6	Form of Trademark License Agreement by and between Registrant and Capitala Investment Advisors, LLC(1)
10.7	Form of Senior Secured Revolving Credit Agreement dated October 17, 2014, among Capitala Finance Corp., as Borrower, the lenders party thereto, and ING Capital LLC, as Administrative Agent, Arranger and Bookrunner(3)
10.8	Form of Guarantee, Pledge and Security Agreement dated October 17, 2014, among Capitala Finance Corp., as Borrower, the subsidiary guarantors party thereto, ING Capital LLC, as Revolving Administrative Agent for the Revolving Lenders and as Collateral Agent, and each Financing Agent and Designated Indebtedness Holder party thereto(3)
11.1	Computation of Per Share Earnings (included in the notes to the consolidated financial statements contained in this report)
31.1	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)
31.2	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)
32.1	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)
32.2	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)
(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. 333-193374) filed on May 21, 2014.
(3)	Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on October 21, 2014.

**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 10, 2014

By /s/ Joseph B. Alala III

Joseph B. Alala III

Chief Executive Officer

*(Principal Executive Officer)*

Capitala Finance Corp.

Date: November 10, 2014

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 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 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)) 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) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) 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 10, 2014

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

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**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
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 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)) 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) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) 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 10, 2014

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

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**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, 2014, 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 10, 2014

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

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**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, 2014, 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 10, 2014

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

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