

Capitala Finance Corp.  
Form 10-Q  
August 10, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the Quarter Ended June 30, 2015**

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

<b>Commission File Number</b>	<b>Exact name of registrant as specified in its charter, address of principal executive office, telephone number and state of incorporation</b> Capitala Finance Corp.  4201 Congress St., Suite 360  Charlotte, North Carolina  Telephone: (704) 376-5502  State of Incorporation: Maryland	<b>I.R.S. Employer Identification Number</b>       90-0945675
814-01022		

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 ☐

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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 ☐ Accelerated filer ☒  
Non-accelerated filer ☐ Smaller reporting company ☐

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 August 7, 2015 was 16,145,625.

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**PART I FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****Capitala Finance Corp.****Consolidated Statements of Assets and Liabilities****(in thousands, except share and per share data)**

	As of	
	June 30,	December 31,
	2015	2014
	(unaudited)	
ASSETS		
Investments at fair value		
Non-control/non-affiliate investments (amortized cost of \$325,856 and \$219,163, respectively)	\$345,881	\$ 236,804
Affiliate investments (amortized cost of \$142,628 and \$154,552, respectively)	147,951	171,471
Control investments (amortized cost of \$78,150 and \$67,440, respectively)	71,482	72,062
Total investments at fair value (amortized cost of \$546,634 and \$441,155, respectively)	565,314	480,337
Cash and cash equivalents	39,533	55,107
Interest and dividend receivable	4,063	3,113
Due from related parties	256	518
Deferred financing fees (net of accumulated amortization of \$4,231 and \$3,288, respectively)	9,368	10,002
Prepaid expenses	236	515
Other assets	90	274
Total assets	\$618,860	\$ 549,866
LIABILITIES		
SBA debentures	\$192,200	\$ 192,200
Notes	113,438	113,438
Revolving Credit Facility	-	-
Distribution payable	4,879	-
Trade settlement payable	10,772	-
Due to related parties	4	8
Management and incentive fee payable	2,544	159

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Interest and financing fees payable	3,145	2,902
Accounts payable and accrued expenses	13	322
Total liabilities	\$326,995	\$ 309,029

Commitments and contingencies (Note 2)

NET ASSETS

Common stock, par value \$.01, 100,000,000 common shares authorized, 16,262,391 and 12,974,420 common shares issued and outstanding, respectively	163	130
Additional paid in capital	246,386	188,408
Accumulated undistributed net investment income	8,640	12,314
Accumulated undistributed net realized gain from investments	17,996	803
Net unrealized appreciation on investments	18,680	39,182
Total net assets	291,865	240,837
Total liabilities and net assets	\$618,860	\$ 549,866
Net asset value per share	\$17.95	\$ 18.56

See accompanying notes to consolidated financial statements.

**Capitala Finance Corp.****Consolidated Statements of Operations****(in thousands, except share and per share data)****(unaudited)**

	<b>For the three months ended June 30</b>		<b>For the six months ended June 30</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
<b>INVESTMENT INCOME</b>				
Interest and fee income:				
Non-control/Non-affiliate investments	\$ 9,516	\$ 3,125	\$ 17,191	\$ 6,066
Affiliate investments	3,081	3,884	6,672	7,625
Control investments	1,086	1,504	2,725	2,837
Total interest and fee income	13,683	8,513	26,588	16,528
Payment-in-kind interest and dividend income:				
Non-control/Non-affiliate investments	375	251	689	424
Affiliate investments	394	330	650	623
Control investments	422	163	621	287
Total payment-in-kind interest and dividend income	1,191	744	1,960	1,334
Dividend income:				
Non-control/Non-affiliate investments	154	1,351	307	1,514
Affiliate investments	29	687	58	716
Control investments	25	1,225	209	4,795
Total dividend income	208	3,263	574	7,025
Interest income from cash and cash equivalents	2	6	3	14
Total investment income	15,084	12,526	29,125	24,901
<b>EXPENSES</b>				
Interest and financing expenses	4,681	2,401	9,317	4,601
Base management fee	2,587	2,276	4,997	4,294
Incentive fees	1,329	1,408	2,510	2,838
General and administrative expenses	1,170	883	2,167	2,013
Expenses before management fee waiver	9,767	6,968	18,991	13,746
Management fee waiver (See Note 5)	-	(76)	-	(200)
Total expenses net of management fee waiver	9,767	6,892	18,991	13,546
<b>NET INVESTMENT INCOME</b>	<b>5,317</b>	<b>5,634</b>	<b>10,134</b>	<b>11,355</b>

**REALIZED AND UNREALIZED GAIN  
(LOSS) ON INVESTMENTS:**
**Net realized gain from investments:**

Non-control/Non-affiliate investments	7,670	-	7,698	1,158
Affiliate investments	7,098	351	7,098	351
Control investments	1,069	111	10,381	173
Total realized gain from investments	15,837	462	25,177	1,682
Net unrealized appreciation/(depreciation) on investments	(16,212)	) 116	(20,502)	) (5,607)
Net gain (loss) on investments	(375)	) 578	4,675	(3,925)

**NET INCREASE IN NET ASSETS  
RESULTING FROM OPERATIONS**

\$ 4,942	\$ 6,212	\$ 14,809	\$ 7,430
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**NET INCREASE IN NET ASSETS PER  
SHARE RESULTING FROM  
OPERATIONS – BASIC AND DILUTED**

\$ 0.31	\$ 0.48	\$ 1.02	\$ 0.57
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**WEIGHTED AVERAGE COMMON  
STOCK OUTSTANDING - BASIC AND  
DILUTED**

15,957,926	12,974,420	14,474,446	12,974,420
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DISTRIBUTIONS PAID PER SHARE	\$ 0.62	\$ 0.47	\$ 1.14	\$ 0.47
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DISTRIBUTIONS PAYABLE PER SHARE	\$ 0.30	\$ -	\$ 0.30	\$ -
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See accompanying notes to consolidated financial statements.



**Capitala Finance Corp.****Consolidated Statements of Changes in Net Assets****(in thousands, except share data)****(unaudited)**

	<b>Common Stock</b>		<b>Additional</b>	<b>Accumulated</b>	<b>Accumulated</b>	<b>Net</b>	<b>Unrealized</b>	
	<b>Number of</b>	<b>Par</b>	<b>Paid in</b>	<b>Undistributed</b>	<b>Realized</b>	<b>Net</b>	<b>Appreciation</b>	
	<b>Shares</b>	<b>Value</b>	<b>Capital</b>	<b>Net</b>	<b>Gains</b>	<b>(Depreciation)</b>	<b>on</b>	
				<b>Investment</b>	<b>(Losses)</b>	<b>Investments</b>	<b>Total</b>	
				<b>Income</b>				
BALANCE, December 31, 2013	12,974,420	\$ 130	\$ 188,408	\$ 16,760	\$ (48 )	\$ 63,420	\$ 268,670	
Net investment income	-	-	-	11,355	-	-	11,355	
Net realized gain on portfolio investments	-	-	-	-	1,682	-	1,682	
Net change in unrealized appreciation/(depreciation) on portfolio investments	-	-	-	-	-	(5,607 )	(5,607 )	
Distributions declared	-	-	-	(12,196 )	-	-	(12,196 )	
BALANCE, June 30, 2014	12,974,420	\$ 130	\$ 188,408	\$ 15,919	\$ 1,634	\$ 57,813	\$ 263,904	
BALANCE, December 31, 2014	12,974,420	\$ 130	\$ 188,408	\$ 12,314	\$ 803	\$ 39,182	\$ 240,837	
Net investment income	-	-	-	10,134	-	-	10,134	
Net realized gain from investments	-	-	-	-	25,177	-	25,177	
Net change in unrealized appreciation/(depreciation) on portfolio investments	-	-	-	-	-	(20,502 )	(20,502 )	
Issuance of common stock, net of offering and underwriting costs	3,500,000	35	61,665				61,700	
Repurchase and retirement of common stock under stock repurchase program	(224,602 )	(2 )	(3,888 )				(3,890 )	
Distributions to shareholders:							-	
Stock issued under dividend reinvestment plan	12,573	-	201	-	-	-	201	

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Distributions declared	-	-	-	(13,808 )	(7,984 )	-	(21,792 )
BALANCE, June 30, 2015	16,262,391	\$ 163	\$ 246,386	\$ 8,640	\$ 17,996	\$ 18,680	\$ 291,865

See accompanying notes to consolidated financial statements.

**Capitala Finance Corp.****Consolidated Statements of Cash Flows****(in thousands)****(unaudited)**

	<b>For the six months ended June 30</b>	
	<b>2015</b>	<b>2014</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net increase in net assets resulting from operations	\$ 14,809	\$ 7,430
Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities:		
Purchase of portfolio investments	(170,008 )	(63,584 )
Repayments of portfolio investments	91,931	20,160
Net realized gain on portfolio investments	(25,177 )	(1,682 )
Net unrealized depreciation on portfolio investments	20,502	5,607
Payment-in-kind interest and dividends	(1,960 )	(1,334 )
Accretion of original issue discount on portfolio investments	(265 )	(7 )
Amortization of deferred financing fees	943	369
Changes in assets and liabilities:		
Interest and dividend receivable	(950 )	(17 )
Due from related parties	262	1,104
Prepaid expenses	279	425
Other assets	184	-
Trade settlement payable	10,772	9,959
Due to related parties	(4 )	(508 )
Management and incentive fee payable	2,385	(288 )
Interest payable	243	152
Accounts payable and accrued expenses	(309 )	54
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(56,363 )</b>	<b>(22,160 )</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Paydowns on SBA-guaranteed debentures	-	(10,000 )
Proceeds from credit facility	25,000	-
Payments to credit facility	(25,000 )	-
Issuance of notes	-	113,438
Issuance of common stock, net of offering and underwriting costs	61,700	-
Distributions paid to shareholders	(16,713 )	(12,196 )
Repurchases of common stock under stock repurchase program	(3,890 )	-
Deferred financing fees paid	(308 )	(4,201 )

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NET CASH PROVIDED BY FINANCING ACTIVITIES	\$ 40,789	\$ 87,041
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(15,574 )	64,881
CASH AND CASH EQUIVALENTS, beginning of period	\$ 55,107	\$ 101,622
CASH AND CASH EQUIVALENTS, end of period	\$ 39,533	\$ 166,503
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	\$ 7,883	\$ 4,075
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING TRANSACTIONS		
Distributions declared and payable	\$ 4,879	\$ -
Distribution paid through DRIP share issuances	\$ 201	\$ -

See accompanying notes to consolidated financial statements.

**Capitala Finance Corp.****Consolidated Schedule of Investments****(in thousands, except for units)****June 30, 2015****(unaudited)**

Company <sup>(4, 5)</sup>	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets	
Non-control/Non-affiliated investments - 118.6%							
AAE Acquisition, LLC	Industrial Equipment Rental	Senior Secured Term Debt (12% Cash, Due 3/31/18) <sup>(1)</sup>	\$ 11,000	\$ 10,999	\$ 11,000	3.8	%
AAE Acquisition, LLC	Industrial Equipment Rental	Membership Units (14% fully diluted)		17	2,449	0.8	%
				11,016	13,449	4.6	%
American Clinical Solutions, LLC	Healthcare	Senior Secured Debt (L+9.5% Cash, 1% Floor, Due 6/11/20)	10,000	10,000	10,000	3.4	%
				10,000	10,000	3.4	%
American Exteriors, LLC	Replacement Window Manufacturer	Senior Secured Debt (14% Cash, Due 1/15/16) <sup>(1)</sup>	4,879	3,679	4,868	1.6	%
American Exteriors, LLC	Replacement Window Manufacturer	Jr. Convertible Note (10% Cash, Due 12/31/16) <sup>(1)</sup>	500	416	500	0.2	%
American Exteriors, LLC	Replacement Window Manufacturer	Common Stock Warrants (15% fully diluted) <sup>(7)</sup>		-	-	0.0	%

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				4,095	5,368	1.8	%
B&W Quality Growers, LLC	Farming	Subordinated Debt (14% Cash, Due 7/23/20)	10,000	9,991	10,000	3.4	%
B&W Quality Growers, LLC	Farming	Membership Unit Warrants (91,739 Units)		20	1,068	0.4	%
				10,011	11,068	3.8	%
Bluestem Brands, Inc.	Online Merchandise Retailer	Senior Secured Term Debt (L+7.5% Cash, 1% Floor, Due 11/7/20)	4,654	4,487	4,487	1.5	%
				4,487	4,487	1.5	%
Boot Barn Holdings, Inc	Western Wear Retail	Common Stock (95,252 shares) <sup>(8)</sup>		381	3,048	1.0	%
				381	3,048	1.0	%
Brock Holdings III, Inc.	Industrial Specialty Services	Subordinated Debt (L+8.25% Cash, 1.75% Floor, Due 3/16/18)	5,000	4,863	4,863	1.7	%
				4,863	4,863	1.7	%
Brunswick Bowling Products, Inc.	Bowling Products	Senior Secured Term Debt (L+6.0% Cash, 2% Floor, Due 5/22/20)	2,000	2,000	2,000	0.7	%
Brunswick Bowling Products, Inc.	Bowling Products	Subordinated Debt (L+14.25% Cash, 2% Floor, Due 5/22/20)	6,983	6,983	6,983	2.4	%
Brunswick Bowling Products, Inc.	Bowling Products	Preferred Shares (2,966 shares, 8% PIK)		2,993	2,993	1.0	%
				11,976	11,976	4.1	%
Burke America Parts Group, LLC	Home Repair Parts Manufacturer	Senior Secured Term Debt (9.5% cash, due 4/30/20)	5,000	4,852	4,852	1.7	%
		Warrants (14 units)		5	5	0.0	%

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Burke America Parts Group, LLC	Home Repair Parts Manufacturer						
				4,857	4,857	1.7	%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock (293,186 shares)		258	281	0.1	%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock Warrants (655,908 units) <sup>(7)</sup>		264	629	0.2	%
				522	910	0.3	%
Cedar Electronics Holding Corp.	Consumer Electronics	Subordinated Debt (12% Cash, Matures 12/26/20)	28,300	28,300	28,300	9.7	%
				28,300	28,300	9.7	%
Community Choice Financial, Inc.	Financial Services	Senior Secured Revolving Debt (L+13.0% Cash, 1% Floor, Due 3/27/17) <sup>(8)</sup>	20,000	20,000	20,000	6.9	%
				20,000	20,000	6.9	%
Construction Partners, Inc.	Construction Services	Subordinated Debt (11.5% Cash, Due 6/12/20)	12,500	12,500	12,500	4.3	%
				12,500	12,500	4.3	%
Corporate Visions, Inc.	Sales & Marketing Services	Subordinated Debt (9% Cash, 2% PIK, Due 11/29/21)	15,779	15,779	15,779	5.4	%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (15,750 shares)		1,575	1,575	0.5	%
				17,354	17,354	5.9	%
Crowley Holdings, Inc.	Transportation	Series A Income Preferred Shares (6,000 shares, 10% Cash, 2% PIK dividend) <sup>(6)</sup>		6,207	6,207	2.1	%

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				6,207	6,207	2.1	%
CSM Bakery Solutions, LLC	Bakery Supplies Distributor	Subordinated Debt (L+7.75% Cash, 1% Floor, Due 8/7/22)	17,000	16,663	16,244	5.6	%
				16,663	16,244	5.6	%
Emerging Markets Communications, LLC	Satellite Communications	Subordinated Debt (L+9.625% Cash, 1% Floor, Due 7/16/23)	5,000	4,925	4,925	1.7	%
				4,925	4,925	1.7	%
Flavors Holdings, Inc.	Food Product Manufacturer	Senior Secured Term Debt (L+5.75% Cash, 1% Floor, Due 4/3/20)	7,700	7,430	7,430	2.5	%
Flavors Holdings, Inc.	Food Product Manufacturer	Subordinated Debt (L+10% Cash, 1% Floor, Due 10/3/21)	12,000	11,567	11,567	4.0	%
				18,997	18,997	6.5	%
Group Cirque du Soleil, Inc.	Entertainment	Subordinated Debt (L+8.25% Cash, 1% Floor, Due 7/8/23) <sup>(8)</sup>	1,000	985	985	0.3	%
				985	985	0.3	%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Senior Secured Term Debt (13% Cash, Due 10/6/16)	2,000	2,000	1,577	0.5	%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Common Unit Warrants (12% fully diluted)		-	-	0.0	%
				2,000	1,577	0.5	%
Kelle's Transport Service, LLC	Transportation	Senior Secured Debt (14% Cash, Due 3/31/19)	14,984	14,971	14,984	5.2	%
Kelle's Transport Service, LLC	Transportation	Preferred Units (1,000 units, 10% PIK Dividend) <sup>(6)</sup>		2,947	2,947	1.0	%
	Transportation			22	4,337	1.5	%



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Kelle's Transport Service, LLC		Common Stock Warrants (15% fully diluted)		17,940	22,268	7.7	%
Maxim Crane Works, L.P	Crane Rental and Sales	Subordinated Debt (L+9.25% Cash, 1% Floor, Due 11/26/18)	5,000	5,038	5,038	1.7	%
				5,038	5,038	1.8	%
Medical Depot, Inc.	Medical Device Distributor	Subordinated Debt (14% Cash, Due 9/27/20) <sup>(1)</sup>	4,667	4,667	4,667	1.6	%
Medical Depot, Inc.	Medical Device Distributor	Series C Convertible Preferred Stock (740 shares)		1,333	7,820	2.7	%
				6,000	12,487	4.3	%
Merlin International, Inc.	IT Government Contracting	Subordinated Debt (12.5% Cash, Due 12/16/19)	20,000	20,000	20,000	6.9	%
				20,000	20,000	6.9	%
Nielsen & Bainbridge, LLC	Home Décor Manufacturer	Subordinated Debt (L+9.25% Cash, 1% Floor, Due 8/15/21)	15,000	14,801	14,535	5.0	%
				14,801	14,535	5.0	%
Portrait Innovations, Inc.	Professional and Personal Digital Imaging	Senior Secured Term Debt (12% Cash, Due 2/26/20)	15,000	15,000	15,000	5.1	%
				15,000	15,000	5.1	%
Sequoia Healthcare Management, LLC	Healthcare Management	Senior Secured Term Debt (12% cash, 4% PIK, due 7/17/19)	12,357	12,162	12,357	4.2	%
				12,162	12,357	4.2	%
Sierra Hamilton, LLC	Oil & Gas Engineering and Consulting Services	Senior Secured Debt (12.25% Cash, Due 12/15/18)	15,000	15,000	14,196	4.9	%

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				15,000	14,196	4.9	%
Southern Pump & Tank Company, LLC	Petroleum Equipment Supplier	Senior Secured Term Debt (13% Cash, 6% PIK, Due 7/15/15) <sup>(1)</sup>	4,442	3,614	4,442	1.5	%
Southern Pump & Tank Company, LLC	Petroleum Equipment Supplier	Common Stock Warrants (10% fully diluted)	-	-	-	0.0	%
				3,614	4,442	1.5	%
Stoddard Hill Media Holdings, LLC	IT Hosting Services	Class D Preferred Units <sup>(12)</sup>	-	-	96	0.0	%
				-	96	0.0	%
Taylor Precision Products, Inc.	Household Product Manufacturer	Series C Preferred Stock (379 shares)		758	758	0.3	%
				758	758	0.3	%
Tenere, Inc.	Industrial Manufacturing	Senior Secured Term Debt (11% Cash, 2% PIK, Due 12/15/17) <sup>(9)</sup>	3,546	3,546	3,546	1.2	%
				3,546	3,546	1.2	%
US LBM Holdings, LLC	Building Products	Senior Secured Debt (L+7% Cash, 1% Floor, Due 5/2/20)	4,968	4,879	4,875	1.7	%
				4,879	4,875	1.7	%
U.S. Well Services, LLC	Oil & Gas Services	Senior Secured Debt (L+11.5% Cash, 0.5% floor, Due 5/2/19) <sup>(10)</sup>	8,758	8,679	8,671	3.0	%
				8,679	8,671	3.0	%
Velum Global Credit Management, LLC	Financial Services	Senior Secured Debt (15% Cash, Due 12/31/15) <sup>(8)</sup>	8,300	8,300	8,300	2.8	%
				8,300	8,300	2.8	%
Worklife America, Inc.	Professional Employer	Common Stock Warrants (3.84%)	-	-	1,808	0.7	%

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	Organization	ownership)						
Worklife America, Inc.	Professional Employer Organization	Preferred Stock Warrants (3.84% ownership)	-	389	0.1	%		
			-	2,197	0.8	%		
<b>Sub Total Non-control/Non-affiliated investments</b>			\$325,856	\$345,881	118.6	%		
<b>Affiliate investments - 50.7%</b>								
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Senior Subordinated Debt (14% Cash, due 8/9/2019)	\$5,000	\$5,000	\$5,000	1.7	%	
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Junior Subordinated Debt (12% Cash, due 8/9/2019)	7,200	7,200	7,200	2.5	%	
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock (1,253,198 shares)		1,504	3,734	1.3	%	
				13,704	15,934	5.5	%	
City Gear, LLC	Footwear Retail	Subordinated Debt (13% Cash, Due 9/28/16)	8,231	8,231	8,231	2.8	%	
City Gear, LLC	Footwear Retail	Preferred Membership Units (9% Cash dividend) (6)		1,269	1,269	0.4	%	
City Gear, LLC	Footwear Retail	Membership Unit Warrants (14.15% fully diluted)		-	7,839	2.7	%	
				9,500	17,339	5.9	%	
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (12)	-	588	0.2	%		
			-	588	0.2	%		
GA Communications, Inc.	Advertising & Marketing	Series A-1 Preferred Stock (1,998 shares,	2,302	2,659	0.9	%		

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	Services	8% PIK dividend) <sup>(6)</sup>					
GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)		2	1,161	0.4	%
				2,304	3,820	1.3	%
J&J Produce Holdings, Inc.	Produce Distribution	Subordinated Debt (13% Cash, Due 7/16/18)	5,182	5,182	5,158	1.8	%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock (8,182 shares)		818	-	0.0	%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock Warrants (4,506 shares)		-	-	0.0	%
				6,000	5,158	1.8	%
LJS Partners, LLC	QSR Franchisor	Common Stock (1,500,000 shares)		1,500	2,587	0.9	%
				1,500	2,587	0.9	%
MJC Holdings, LLC	Specialty Clothing	Series A Preferred Units (2,000,000 units)		2,000	6,250	2.1	%
				2,000	6,250	2.1	%
MMI Holdings, LLC	Medical Device Distributor	Senior Secured Debt (12% Cash, Due 1/31/17) <sup>(1)</sup>	2,600	2,600	2,600	0.9	%
MMI Holdings, LLC	Medical Device Distributor	Subordinated Debt (6% Cash, Due 1/31/17) <sup>(1)</sup>	400	388	400	0.1	%
MMI Holdings, LLC	Medical Device Distributor	Preferred Units (1,000 units, 6% PIK dividend) <sup>(6)</sup>		1,175	1,311	0.4	%
MMI Holdings, LLC	Medical Device Distributor	Common Membership Units (45 units)		-	208	0.1	%
				4,163	4,519	1.5	%
MTI Holdings, LLC			8,000	8,000	8,000	2.8	%

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	Retail Display & Security Services	Subordinated Debt (12% Cash, Due 11/1/18)						
MTI Holdings, LLC	Retail Display & Security Services	Membership Units (2,000,000 units)		2,000	5,095	1.7	%	
				10,000	13,095	4.5	%	
Source Capital ABUTEC, LLC	Oil & Gas Services	Senior Secured Term Debt (12% Cash, 3% PIK, Due 12/28/17) <sup>(13)</sup>	5,404	5,404	4,689	1.6	%	
Source Capital ABUTEC, LLC	Oil & Gas Services	Preferred Membership Units (10.8% fully diluted)		1,240	-	0.0	%	
				6,644	4,689	1.6	%	
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Subordinated Debt (13% Cash, Due 2/17/17)	2,500	2,500	2,500	0.8	%	
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Common Stock Warrants (6.65% ownership)		-	553	0.2	%	
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Membership Units (11.3% ownership)		750	781	0.3	%	
				3,250	3,834	1.3	%	
Source Capital SSCR, LLC	Personal Product Manufacturer	Senior Secured Term Debt (7% Cash, Due 6/12/17)	5,750	5,750	5,470	1.9	%	
Source Capital SSCR, LLC	Personal Product Manufacturer	Subordinated Debt (7% Cash, Due 9/15/17) <sup>(2)</sup>	17,875	17,875	10,530	3.6	%	
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	%	
				25,513	16,000	5.5	%	

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Source Recycling, LLC	Scrap Metal Recycler	Subordinated Debt (13% Cash, Due 9/2/16)	5,000	5,000	4,927	1.7	%
Source Recycling, LLC	Scrap Metal Recycler	Membership Units (68,656 units)		1,590	-	0.0	%
Source Recycling, LLC	Scrap Metal Recycler	Membership Unit Warrants (1% fully diluted)		-	-	0.0	%
				6,590	4,927	1.7	%
Sparus Holdings, Inc.	Energy Services	Senior Secured Term Debt (12% Cash, 2% PIK, Due 3/21/16)	5,085	5,085	5,085	1.7	%
Sparus Holdings, Inc.	Energy Services	Subordinated Debt (9% Cash, 5% PIK, Due 3/21/16) <sup>(3)</sup>	8,314	8,066	5,740	2.0	%
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	%
				14,324	10,825	3.7	%
STX Healthcare Management Services, Inc.	Dental Practice Management	Subordinated Debt (12.5% Cash, Due 7/31/18) <sup>(1)</sup>	6,425	6,425	6,425	2.2	%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock (1,200,000 shares)		1,200	915	0.3	%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock Warrants (1,154,254 shares)		218	881	0.3	%
				7,843	8,221	2.8	%
TCE Holdings, Inc.	Oil & Gas Services	Subordinated Debt (12% Cash, 2% PIK, Due 2/1/19)	12,397	12,397	11,914	4.1	%
TCE Holdings, Inc.	Oil & Gas Services	Subordinated Debt (12% Cash, 2% PIK, Due 2/1/19)	9,879	9,879	9,494	3.3	%

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TCE Holdings, Inc.	Oil & Gas Services	Class A Common Stock (3,600 shares)		3,600	721	0.2	%
				25,876	22,129	7.6	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Senior Secured Term Debt (15% PIK, Due 11/26/16)	437	437	437	0.1	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Bridge Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	663	361	663	0.2	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Tier 2 Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	81	44	81	0.0	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Senior Subordinated Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	3,563	2,369	3,563	1.3	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Tier 3 Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	299	206	299	0.1	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Jr. Subordinated Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	2,750	-	2,750	1.0	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Tier 4 Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	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	%
				3,417	8,036	2.8	%

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<b>Sub Total Affiliate investments</b>				\$ 142,628	\$ 147,951	50.7	%
<b>Control investments - 24.4%</b>							
CableOrganizer Acquisition, LLC	Computer Supply Retail	Senior Secured Term Debt (12% Cash, 4% PIK, Due 5/24/18)	\$ 10,802	\$ 10,802	\$ 10,802	3.7	%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock (1,125,000 shares)		1,125	575	0.2	%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock Warrants (570,000 shares)		-	292	0.1	%
				11,927	11,669	4.0	%
Capitala Senior Liquid Loan Fund I, LLC	Investment Fund	Common Stock (80% ownership) <sup>(8)</sup> <sup>(11)</sup>		15,200	15,256	5.2	%
				15,200	15,256	5.2	%
CION/Capitala Senior Liquid Loan Fund I, LLC	Investment Fund	Common Stock (20% ownership) <sup>(8)</sup> <sup>(15)</sup>		-	-	0.0	%
				-	-	0.0	%
Market E's, LLC	Online Travel Sales & Marketing	Senior Secured Debt (0% Cash, Due 12/31/16) <sup>(1)</sup>	985	985	1,000	0.3	%
Market E's, LLC	Online Travel Sales & Marketing	Subordinated Debt (0% Cash, Due 12/31/16) <sup>(1)</sup>	2,897	2,875	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	%
				5,065	1,750	0.6	%



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Micro Precision, LLC	Conglomerate	Subordinated Debt (10% Cash, Due 9/16/16)	1,862	1,862	1,862	0.6	%
Micro Precision, LLC	Conglomerate	Subordinated Debt (14% Cash, 4% PIK, Due 9/16/16)	3,753	3,753	3,753	1.3	%
Micro Precision, LLC	Conglomerate	Series A Preferred Units (47 units)		1,629	1,629	0.6	%
				7,244	7,244	2.5	%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Senior Secured Term Debt (17%, 3% PIK at Company's option, Due 2/1/16)	6,500	6,500	6,500	2.1	%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares, 10% Cash Dividend) (6)		1,000	1,000	0.3	%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (300,000 shares)		1	3,966	1.4	%
				7,501	11,466	3.8	%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Subordinated Debt (14% Cash, 4% PIK, Due 12/19/16) <sup>(14)</sup>	7,473	7,473	6,629	2.3	%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series A Preferred Stock (32,782 shares)		3,278	-	0.0	%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series B Preferred Stock (23,648 shares)		2,365	-	0.0	%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Common Stock (33,107 shares)		33	-	0.0	%
				13,149	6,629	2.3	%
Print Direction, Inc.	Printing Services	Senior Secured Term Debt (10% Cash, 2% PIK, Due 2/24/19)	15,074	15,074	15,074	5.2	%

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Print Direction, Inc.	Printing Services	Common Stock (19,363 shares)	2,990	2,294	0.8	%
Print Direction, Inc.	Printing Services	Common Stock Warrants (3% fully diluted)	-	100	0.0	%
			18,064	17,468	6.0	%
<b>Sub Total Control investments</b>			\$78,150	\$71,482	24.4	%
<b>TOTAL INVESTMENTS -193.7%</b>			<b>\$546,634</b>	<b>\$565,314</b>	<b>193.7</b>	<b>%</b>

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

(2) Non-accrual investment.

(3) PIK non-accrual investment.

(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 \$291,865 as of June 30, 2015.

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

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

(8) Indicates assets that the Company believes do not represent "qualifying assets" under Section 55(a) of the Investment Company Act of 1940, as amended. Qualifying assets must represent at least 70% of the Company's total assets at the time of acquisition of any additional non-qualifying assets. As of June 30, 2015, 7.7% of the Company's total assets were non-qualifying assets.

(9) The investment has a \$0.6 million unfunded commitment.

(10) The investment has a \$6.0 million unfunded commitment.

(11) The investment has a \$4.8 million unfunded commitment.

(12) Investment has been exited. The remaining fair value represents post transaction true-up that will result in additional cash payments made to the Company.

(13) Interest rate amended to 6% cash and 6% PIK through December 31, 2015.

(14) Interest rate amended to 8% cash through December 31, 2015.

(15) The investment has a \$10.0 million unfunded commitment.

See accompanying notes to consolidated financial statements.

**Capitala Finance Corp.****Consolidated Schedule of Investments****(in thousands, except for units)****December 31, 2014**

Company <sup>(4, 5)</sup>	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets	
Non-control/Non-affiliated investments - 98.3%							
AAE Acquisition, LLC	Industrial Equipment Rental	Senior Secured Term Debt (12% Cash, Due 3/31/18) <sup>(1)</sup>	\$ 11,000	\$ 10,998	\$ 11,000	4.6	%
AAE Acquisition, LLC	Industrial Equipment Rental	Membership Units (14% fully diluted)		17	2,212	0.9	%
				11,015	13,212	5.5	%
A Wireless Holding Company	Wireless Communication Retailer	Subordinated Debt (12% Cash, Due 9/09/19)	12,000	12,000	12,000	5.0	%
				12,000	12,000	5.0	%
American Exteriors, LLC	Replacement Window Manufacturer	Senior Secured Debt (14% Cash, Due 6/30/15) <sup>(1) (11)</sup>	4,357	3,157	4,357	1.8	%
American Exteriors, LLC	Replacement Window Manufacturer	Jr. Convertible Note (10% Cash, Due 6/30/16) <sup>(1)</sup>	500	415	500	0.2	%
American Exteriors, LLC	Replacement Window Manufacturer	Common Stock Warrants (15% fully diluted) <sup>(7)</sup>		-	-	0.0	%
				3,572	4,857	2.0	%

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Bluestem Brands, Inc.	Online Merchandise Retailer	Senior Secured Term Debt (L+7.5% Cash, 1% Floor, Due 11/7/2020)	5,000	4,804	4,804	2.0	%
				4,804	4,804	2.0	%
Boot Barn Holdings, Inc	Western Wear Retail	Common Stock (600,000 shares) <sup>(8)</sup>		2,400	10,920	4.5	%
				2,400	10,920	4.5	%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock (293,186 shares)		258	193	0.1	%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock Warrants (655,908 units) <sup>(7)</sup>		264	431	0.2	%
				522	624	0.3	%
Construction Partners, Inc.	Construction Services	Subordinated Debt (11.5% Cash, Due 6/12/2020)	12,500	12,500	12,500	5.2	%
				12,500	12,500	5.2	%
Crowley Holdings, Inc.	Transportation	Series A Income Preferred Shares (6,000 shares, 10% Cash, 2% PIK dividend) <sup>(6)</sup>		6,145	6,145	2.6	%
				6,145	6,145	2.6	%
CSM Bakery Solutions, LLC	Bakery Supplies Distributor	Subordinated Debt (L+7.75% Cash, 1% Floor, Due 8/7/22)	17,000	16,640	16,297	6.8	%
				16,640	16,297	6.8	%
Flavors Holdings, Inc.	Food Product Manufacturer	Senior Secured Term Debt (L+5.75% Cash, 1% Floor, Due 4/3/2020)	7,900	7,594	7,594	3.2	%
Flavors Holdings, Inc.	Food Product Manufacturer	Subordinated Debt (L+10%, 1% Floor, Due 10/3/2021)	12,000	11,532	11,532	4.7	%

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				19,126	19,126	7.9	%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Senior Secured Term Debt (13% Cash, Due 10/6/16)	2,000	2,000	1,850	0.8	%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Common Unit Warrants (12% fully diluted)		-	-	0.0	%
				2,000	1,850	0.8	%
Kelle's Transport Service, LLC	Transportation	Senior Secured Debt (14% Cash, Due 3/31/19)	15,366	15,351	15,366	6.3	%
Kelle's Transport Service, LLC	Transportation	Preferred Units (1,000 units, 10% PIK Dividend) <sup>(6)</sup>		2,802	2,802	1.2	%
Kelle's Transport Service, LLC	Transportation	Common Stock Warrants (15% fully diluted)		23	2,781	1.2	%
				18,176	20,949	8.7	%
Medical Depot, Inc.	Medical Device Distributor	Subordinated Debt (14% Cash, Due 9/27/20) <sup>(1)</sup>	4,667	4,667	4,667	1.9	%
Medical Depot, Inc.	Medical Device Distributor	Series C Convertible Preferred Stock (740 shares)		1,333	5,283	2.2	%
				6,000	9,950	4.1	%
Meritas Schools Holdings, LLC	Education Services	Subordinated Debt (L+9% Cash, 1% Floor, Due 1/23/2021)	3,000	2,986	3,000	1.2	%
				2,986	3,000	1.2	%
Merlin International, Inc.	IT Government Contracting	Subordinated Debt (12.5% Cash, Due 12/16/2019)	20,000	20,000	20,000	8.3	%
				20,000	20,000	8.3	%
Nielsen & Bainbridge, LLC			15,000	14,785	14,611	6.1	%

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	Home Décor Manufacturer	Subordinated Debt (L+9.25% Cash, 1% Floor, Due 8/15/21)		14,785	14,611	6.1	%
Precision Manufacturing, LLC	Industrial Boiler Manufacturer	Subordinated Debt (14% Cash, Due 2/13/15) <sup>(2)</sup>	200	200	-	0.0	%
Precision Manufacturing, LLC	Industrial Boiler Manufacturer	Subordinated Debt (14% Cash, Due 2/28/15) <sup>(2)</sup>	300	300	-	0.0	%
Precision Manufacturing, LLC	Industrial Boiler Manufacturer	Subordinated Debt (13% Cash, Due 2/10/17) <sup>(2)</sup>	2,850	2,850	-	0.0	%
Precision Manufacturing, LLC	Industrial Boiler Manufacturer	Membership Unit Warrants (6.65% fully diluted)		-	-	0.0	%
				3,350	-	0.0	%
Sequoia Healthcare Management, LLC	Healthcare Management	Senior Secured Term Debt (12% cash, 4% PIK, due 7/17/2019)	12,420	12,195	12,420	5.2	%
				12,195	12,420	5.2	%
Sierra Hamilton, LLC	Oil & Gas Engineering and Consulting Services	Senior Secured Debt (12.25% Cash, Due 12/15/18)	15,000	15,000	14,547	6.0	%
				15,000	14,547	6.0	%
Southern Pump & Tank Company, LLC	Petroleum Equipment Supplier	Senior Secured Term Debt (13% Cash, 6% PIK, Due 1/15/15) <sup>(1)</sup>	4,316	3,495	3,850	1.6	%
Southern Pump & Tank Company, LLC	Petroleum Equipment Supplier	Common Stock Warrants (10% fully diluted)		-	-	0.0	%
				3,495	3,850	1.6	%
Stoddard Hill Media Holdings, LLC	IT Hosting Services	Class D Preferred Units (132,159 shares)		300	480	0.2	%

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				300	480	0.2	%
Taylor Precision Products, Inc.	Household Product Manufacturer	Series C Preferred Stock (379 shares)		758	758	0.3	%
				758	758	0.3	%
Tenere, Inc.	Industrial Manufacturing	Senior Secured Term Debt (11% Cash, 2% PIK, Due 12/15/17) <sup>(9)</sup>	3,510	3,510	3,510	1.5	%
				3,510	3,510	1.5	%
TGI Friday's, Inc.	Restaurant Chain	Subordinated Debt (L+8.25% Cash, 1% Floor, Due 7/15/21)	10,000	9,962	9,738	4.0	%
				9,962	9,738	4.0	%
US LBM Holdings, LLC	Building Products	Senior Secured Debt (L+7.0% Cash, 1% Floor, Due 5/2/2020)	4,992	4,895	4,895	2.0	%
				4,895	4,895	2.0	%
U.S. Well Services, LLC	Oil & Gas Services	Senior Secured Debt (L+11.5% Cash, 0.5% floor, Due 5/2/19) <sup>(10)</sup>	4,822	4,727	4,761	2.0	%
				4,727	4,761	2.0	%
Velum Global Credit Management, LLC	Financial Services	Senior Secured Debt (15% Cash, Due 12/31/15) <sup>(8)</sup>	8,300	8,300	8,300	3.4	%
				8,300	8,300	3.4	%
Worklife America, Inc.	Professional Employer Organization	Common Stock Warrants (3.84% ownership)		-	2,311	0.9	%
Worklife America, Inc.	Professional Employer Organization	Preferred Stock Warrants (3.84% ownership)		-	389	0.2	%
				-	2,700	1.1	%
<b>Sub Total</b>				<b>\$219,163</b>	<b>\$236,804</b>	<b>98.3</b>	<b>%</b>
<b>Non-control/Non-affiliated</b>							

**investments****Affiliate investments -  
71.1%**

Burgaflex Holdings, LLC	Automobile Part Manufacturer	Senior Subordinated Debt (14% Cash, due 8/19/2019)	\$ 5,000	\$ 5,000	\$ 5,000	2.1	%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Junior Subordinated Debt (12% Cash, due 8/19/2019)	7,200	7,200	7,200	3.0	%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock (1,253,198 shares)		1,504	3,646	1.5	%
				13,704	15,846	6.6	%
City Gear, LLC	Footwear Retail	Subordinated Debt (13% Cash, Due 9/28/16)	8,231	8,231	8,213	3.4	%
City Gear, LLC	Footwear Retail	Preferred Membership Units (9% Cash dividend) <sup>(6)</sup>		1,269	1,269	0.5	%
City Gear, LLC	Footwear Retail	Membership Unit Warrants (14.15% fully diluted)		-	6,205	2.6	%
				9,500	15,687	6.5	%
Corporate Visions, Inc.	Sales & Marketing Services	Subordinated Debt (14% Cash, 2% PIK, Due 3/22/18)	11,402	11,402	11,402	4.7	%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (2,216,463 shares)		2,576	10,348	4.3	%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock Warrant (403,257 shares)		-	1,882	0.8	%
				13,978	23,632	9.8	%
GA Communications, Inc.	Advertising & Marketing Services	Series A-1 Preferred Stock (1,998 shares, 8% PIK dividend) <sup>(6)</sup>		2,197	2,559	1.1	%



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GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)	2	1,660	0.7	%
				2,199	1.8	%
J&J Produce Holdings, Inc.	Produce Distribution	Subordinated Debt (13% Cash, Due 7/16/18)	5,182	5,182	2.2	%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock (8,182 shares)	818	341	0.1	%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock Warrants (4,506 shares)	-	188	0.1	%
LJS Partners, LLC	QSR Franchisor	Common Stock (1,500,000 shares)	1,500	5,711	2.4	%
				2,506	1.0	%
MJC Holdings, LLC	Specialty Clothing	Series A Preferred Units (2,000,000 units)	2,000	5,723	2.4	%
				2,506	1.0	%
MMI Holdings, LLC	Medical Device Distributor	Senior Secured Debt (12% Cash, Due 1/31/17) <sup>(1)</sup>	2,600	2,600	1.0	%
MMI Holdings, LLC	Medical Device Distributor	Subordinated Debt (6% Cash, Due 1/31/17) <sup>(1)</sup>	400	388	0.2	%
MMI Holdings, LLC	Medical Device Distributor	Preferred Units (1,000 units, 6% PIK dividend) <sup>(6)</sup>	1,136	1,273	0.5	%
MMI Holdings, LLC	Medical Device Distributor	Common Membership Units (45 units)	-	126	0.1	%
				4,124	1.8	%
MTI Holdings, LLC	Retail Display & Security Services	Subordinated Debt (12% Cash, Due 11/1/18)	8,000	8,000	3.3	%

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MTI Holdings, LLC	Retail Display & Security Services	Membership Units (2,000,000 units)		2,000	4,958	2.1	%
				10,000	12,958	5.4	%
Source Capital ABUTEC, LLC	Oil & Gas Services	Senior Secured Term Debt (12% Cash, 3% PIK, Due 12/28/17)	5,283	5,283	5,166	2.1	%
Source Capital ABUTEC, LLC	Oil & Gas Services	Preferred Membership Units (10.8% fully diluted)		1,240	-	0.0	%
				6,523	5,166	2.1	%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Subordinated Debt (13% Cash, Due 2/17/17)	2,500	2,500	2,500	1.1	%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Common Stock Warrants (6.65% ownership)		-	578	0.2	%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Membership Units (11.3% ownership)		750	813	0.3	%
				3,250	3,891	1.6	%
Source Capital SSCR, LLC	Personal Product Manufacturer	Senior Secured Term Debt (7% Cash, Due 6/12/17)	5,000	5,000	4,751	2.0	%
Source Capital SSCR, LLC	Personal Product Manufacturer	Subordinated Debt (7% Cash, Due 9/15/17)	17,125	17,125	11,490	4.7	%
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	%
				24,013	16,241	6.7	%
Source Recycling, LLC	Scrap Metal Recycler	Subordinated Debt (13% Cash, Due 9/2/16)	5,000	5,000	4,927	2.0	%

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Source Recycling, LLC	Scrap Metal Recycler	Membership Units (68,656 units)		1,590	-	0.0	%
Source Recycling, LLC	Scrap Metal Recycler	Membership Unit Warrants (1% fully diluted)		-	-	0.0	%
				6,590	4,927	2.0	%
Sparus Holdings, Inc.	Energy Services	Senior Secured Term Debt (12% Cash, 2% PIK, Due 3/21/16) <sup>(3)</sup>	5,034	5,012	4,050	1.7	%
Sparus Holdings, Inc.	Energy Services	Subordinated Debt (9% Cash, 5% PIK, Due 3/21/16) <sup>(3)</sup>	8,108	8,066	6,523	2.7	%
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	%
				14,251	10,573	4.4	%
STX Healthcare Management Services, Inc.	Dental Practice Management	Subordinated Debt (12.5% Cash, Due 7/31/18) <sup>(1)</sup>	6,425	6,425	6,425	2.6	%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock (1,200,000 shares)		1,200	714	0.3	%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock Warrants (1,154,254 shares)		218	687	0.3	%
				7,843	7,826	3.2	%
TCE Holdings, Inc.	Oil & Gas Services	Subordinated Debt (12% Cash, 2% PIK, Due 11/22/18)	12,294	12,294	11,995	5.0	%
TCE Holdings, Inc.	Oil & Gas Services	Subordinated Debt (12% Cash, 2% PIK, Due 11/22/18)	9,796	9,796	9,516	4.0	%
TCE Holdings, Inc.	Oil & Gas Services	Class A Common Stock (3,600 shares)		3,600	2,650	1.1	%

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				25,690	24,161	10.1	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Senior Secured Term Debt (15% PIK, Due 11/26/16)	406	406	406	0.2	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Bridge Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	663	361	663	0.3	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Tier 2 Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	81	44	81	0.0	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Senior Subordinated Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	3,563	2,369	3,563	1.5	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Tier 3 Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	299	207	299	0.1	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Jr. Subordinated Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	2,750	-	2,750	1.1	%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Tier 4 Note (0% Cash, Due 6/30/15) <sup>(1)</sup>	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	%
				3,387	8,005	3.3	%
<b>Sub Total Affiliate investments</b>				\$ 154,552	\$ 171,471	71.1	%

**Control investments -  
30.0%**

CableOrganizer Acquisition, LLC	Computer Supply Retail	Senior Secured Term Debt (12% Cash, 4% PIK, Due 5/24/18)	\$ 10,587	\$ 10,587	\$ 10,587	4.4	%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock (1,125,000 shares)		1,125	927	0.4	%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock Warrants (570,000 shares)		-	470	0.2	%
				11,712	11,984	5.0	%
KBP Investments, LLC	QSR Franchisee	Class A Preferred Stock (8,270 shares, 10% Cash Dividend) <sup>(6)</sup>		8,269	8,269	3.4	%
KBP Investments, LLC	QSR Franchisee	Class A Common Stock (380,413 shares)		-	9,196	3.9	%
				8,269	17,465	7.3	%
Market E's, LLC	Online Travel Sales & Marketing	Senior Secured Debt (0% Cash, Due 12/31/16) <sup>(1)</sup>	985	985	1,000	0.4	%
Market E's, LLC	Online Travel Sales & Marketing	Subordinated Debt (0% Cash, Due 12/31/16) <sup>(1)</sup>	2,875	2,875	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	%
				5,065	1,750	0.7	%
Micro Precision, LLC	Conglomerate	Subordinated Debt (10% Cash, Due	1,862	1,862	1,862	0.8	%

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9/16/16)

Micro Precision, LLC	Conglomerate	Subordinated Debt (14% Cash, 4% PIK, Due 9/16/16)	3,688	3,688	3,688	1.5	%
Micro Precision, LLC	Conglomerate	Series A Preferred Units (47 units)		1,629	1,629	0.7	%
				7,179	7,179	3.0	%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Senior Secured Term Debt (17%, 3% PIK at Company's option, Due 2/1/16)	6,500	6,500	6,500	2.7	%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares, 10% Cash Dividend) (6)		1,000	1,000	0.4	%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (300,000 shares)		1	3,077	1.3	%
				7,501	10,577	4.4	%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Subordinated Debt (14% Cash, 4% PIK, Due 12/19/16)	5,048	5,048	4,783	2.0	%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series A Preferred Stock (32,782 shares)		3,278	-	0.0	%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series B Preferred Stock (23,648 shares)		2,365	-	0.0	%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Common Stock (33,107 shares)		33	-	0.0	%
				10,724	4,783	2.0	%
Print Direction, Inc.	Printing Services	Senior Secured Term Debt (15% Cash, Due 2/24/19)	14,000	14,000	14,000	5.8	%
Print Direction, Inc.	Printing Services			2,990	4,141	1.7	%

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Common Stock  
(19,363 shares)

Print Direction, Inc.	Printing Services	Common Stock Warrants (3% fully diluted)	-	183	0.1	%
			16,990	18,324	7.6	%
<b>Sub Total Control investments</b>			\$67,440	\$72,062	30.0	%
<b>TOTAL INVESTMENTS</b>			<b>\$441,155</b>	<b>\$480,337</b>	<b>199.4</b>	<b>%</b>
<b>-199.4%</b>						

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

(2) Non-Accrual Investment.

(3) PIK Non-Accrual Investment.

(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 \$240,837 as of December 31, 2014.

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

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

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.

(9) The investment has a \$0.6 million unfunded commitment.

(10) The investment has a \$10.0 million unfunded commitment.

(11) The Company is currently paying 17% cash rate due to covenant non-compliance.

**CAPITALA FINANCE CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2015**

**(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. For U.S. federal income tax purposes, the Company has elected to be treated, and intends to comply with the requirements to continue to qualify annually, as a regulated investment company (“RIC”), under Subchapter M of the Internal Revenue Code of 1986, as amended (the “Code”).

The Company was formed for the purpose of: (i) acquiring, through a series of transactions, an investment portfolio from the following entities: CapitalSouth Partners Fund I Limited Partnership (“Fund I”); CapitalSouth Partners Fund II Limited Partnership (“Fund II”); CapitalSouth Partners Fund III, L.P. (“Fund III Parent”); CapitalSouth Partners SBIC Fund III, L.P. (“Fund III”) and CapitalSouth Partners Florida Sidecar Fund I, L.P. (“Florida Sidecar” and, collectively with Fund I, Fund II, Fund III and Fund III Parent, the “Legacy Funds”); (ii) raising capital in the IPO; and (iii) continuing and expanding the business of the Legacy Funds by making additional debt and equity investments in 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 lower middle market and 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 June 30, 2015, the Company had 16,262,391 shares of common stock outstanding.

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

### **Basis of Presentation**

The accompanying unaudited financial statements have been prepared 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 and Article 6 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 periods, 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, 2014, filed with the U.S. Securities and Exchange Commission (“SEC”) on March 4, 2015. 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 Company is considered an investment company as defined in ASC Topic 946 – *Financial Services – Investment Companies*. Accordingly, the required disclosures as outlined in the Accounting Standards Update are included in the Company’s consolidated financial statements.

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

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

### **Consolidation**

As provided under Regulation S-X and ASC Topic 946 – *Financial Services – Investment Companies*, the Company will generally not consolidate its investment in a company other than a substantially wholly owned investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. Accordingly, the Company consolidated the results of the Company’s wholly owned subsidiaries in its consolidated financial statements. The Company does not consolidate its interests in Capitala Senior Liquid Loan Fund I, LLC (“CSLLF”) and CION/Capitala Senior Liquid Loan Fund I, LLC (“CCSLLF”) because the entities are not considered substantially wholly owned investment company subsidiaries. Further, CSLLF and CCSLLF are joint ventures for which shared power exists relating to the decisions that most significantly impact the economic performance of the entities. See Note 4 for further description of the Company’s investments in CSLLF and CCSLLF.

The Company’s financial position as of June 30, 2015 is presented on a consolidated basis. The effects of all intercompany transactions between the Company and its consolidated 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.

## **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. 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 valuation of certain investments. In accordance with U.S. GAAP, a fair value hierarchy for inputs is used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available.

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

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

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

As a practical expedient, the Company uses the net asset value (“NAV”) as the fair value of CSLLF and CCSLLF. CSLLF and CCSLLF record its underlying investments at fair value on a daily basis utilizing pricing information from third-party sources. Management may perform model-based analytical valuations in instances where an investment is considered illiquid or for which pricing is not available from third-party sources.

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

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

### *Income Approach*

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

### *Asset Approach*

The asset approach values an investment based on 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 investment 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.

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

*Non-accrual investments:* Generally, when interest and/or principal payments on a loan become 90 days or more past due, or 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 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.

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

*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 administrative expenses include personnel and overhead expenses allocable to the Company under the Administration Agreement paid by and reimbursable to the Administrator. Other operating expenses such as legal and audit fees, director fees, director and officer insurance, and other expenses are generally paid directly by the Company.





## **Deferred Financing Fees**

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

## **Commitments and Contingencies**

As of June 30, 2015 and December 31, 2014, the Company had outstanding unfunded commitments related to debt investments in existing portfolio companies of \$6.6 million and \$10.6 million, respectively. As of June 30, 2015 and December 31, 2014, the Company also had unfunded commitments related to its equity investment in Capitala Senior Liquid Loan Fund I, LLC of \$4.8 million and \$0.0 million, respectively. As of June 30, 2015 and December 31, 2014, the Company also had unfunded commitments related to its equity investment in CION/Capitala Senior Liquid Loan Fund I, LLC of \$10.0 million and \$0.0 million, respectively.

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 believes that the likelihood of such an event is remote.

In the ordinary course of business, the Company may directly or indirectly be a defendant or plaintiff in legal actions with respect to bankruptcy, insolvency or other types of proceedings. Such lawsuits may involve claims that could adversely affect the value of certain financial instruments owned by the Company or result in direct losses to the Company. In management's opinion, no direct losses with respect to litigation contingencies were probable of occurring as of June 30, 2015 and December 31, 2014. Management is of the opinion that the ultimate resolution of such claims will not materially affect the company's business, financial position, results of operations or liquidity. Furthermore, in management's opinion, it is not possible to estimate a range of reasonably possible losses with respect to other litigation contingencies.

## **Income Taxes**

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

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

Depending on the level of taxable income earned in 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.

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 June 30, 2015 and December 31, 2014, 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 on the Company’s net assets.

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

The Company's activities since commencement of operations remain subject to examination by U.S. federal, state, and local tax authorities. No interest expense or penalties have been assessed for the three and six months ended June 30, 2015 and June 30, 2014. 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 as payable on the declaration 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.

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

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

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

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

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

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

### **Note 3. Recent Accounting Pronouncements**

In 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.

In April 2015, the FASB has issued Accounting Standards Update "ASU" No. 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs* ("ASU 2015-03"). ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. ASU 2015-03 is effective for fiscal years that begin after December 15, 2015 and early adoption is permitted. Management is currently evaluating the impact these changes will have on the Company's consolidated financial statements and disclosures.

In May 2015, the FASB issued ASU No. 2015-07, *Fair Value Measurement (Topic 820) – Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share*. ASU 2015-07 permits a reporting entity, as a practical expedient, to measure the fair value of certain investments using the net asset value per share of the investment and provides guidance on required disclosures for such investments. The standard is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2015 and early adoption is permitted. Management is currently evaluating the impact these changes will have on the Company's consolidated financial statements and disclosures.

#### **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 June 30, 2015, our portfolio consisted of investments in 60 portfolio companies with a fair value of approximately \$565.3 million.

During the three months ended June 30, 2015, the Company made approximately \$102.8 million of investments and had approximately \$57.4 million in repayments resulting in net investments of approximately \$45.4 million for the period. During the three months ended June 30, 2014, the Company made approximately \$22.6 million of investments and had approximately \$9.4 million in repayments resulting in net investments of approximately \$13.2 million for the period.

During the six months ended June 30, 2015, the Company made approximately \$170.0 million of investments and had approximately \$91.9 million in repayments resulting in net investments of approximately \$78.1 million for the period. During the six months ended June 30, 2014, the Company made approximately \$63.6 million of investments and had approximately \$20.2 million in repayments resulting in net investments of approximately \$43.4 million for the period.

During the three and six months ended June 30, 2015, the Company funded \$5.2 million and \$19.4 million, respectively, of previous committed capital to existing portfolio companies. During the three and six months ended June 30, 2014, all investments were made to portfolio companies in which the Company was not previously obligated to provide financial support. During the six months ended June 30, 2015 and 2014, the Company funded \$150.6 million and \$63.6 million, respectively, of investments in new and existing portfolio companies for which it was not previously committed to provide the 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 six month periods ended June 30, 2015 and June 30, 2014, the Company did not lead any syndicates. During the six month period ended June 30, 2015 the Company did not assist any portfolio companies in obtaining indirect financing. During the six months ended June 30, 2014, the Company helped Print Direction, Inc. obtain a \$3.5 million senior revolving credit facility.

The composition of our investments as of June 30, 2015, 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	\$ 204,237	37.4	%	\$ 204,242	36.1	%
Subordinated Debt	272,563	49.8		262,998	46.5	
Equity and Warrants	54,634	10.0		82,818	14.7	
Capitala Senior Liquid Loan Fund I, LLC	15,200	2.8		15,256	2.7	
Total	\$ 546,634	100.0	%	\$ 565,314	100.0	%

The composition of our investments as of December 31, 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	\$ 146,399	33.2	%	\$ 146,314	30.5	%
Subordinated Debt	231,901	52.6		222,300	46.3	
Equity and Warrants	62,855	14.2		111,723	23.2	
Total	\$ 441,155	100.0	%	\$ 480,337	100.0	%

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.

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Level 2—Valuations based on inputs other than quoted prices in active markets, which are either directly or indirectly observable.

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

In addition to using the above inputs in investment valuations, the Company continues to employ the valuation policy approved by the Board that is consistent with ASC 820 (See Note 2). Consistent with the Company's valuation policy, the Company evaluates the source of inputs, including any markets in which 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 original issue discount or premium and payment-in-kind income, if any. The transaction price is typically the best estimate of fair value at inception. When evidence supports a subsequent change to the carrying value from the original transaction price, adjustments are made to reflect the expected fair values.

The following table presents fair value measurements of investments, by major class, as of June 30, 2015 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Senior Secured Debt	\$—	\$—	\$204,242	\$204,242
Subordinated Debt	—	—	262,998	262,998
Equity and Warrants <sup>(1)</sup>	3,048	—	79,770	82,818
Total	\$3,048	\$—	\$547,010	\$550,058

Excludes \$15.3 million fair value associated with our investment in CSLLF, measured using net asset (1) value. Because the Company's investment in CSLLF is not redeemable, CSLLF is considered a Level 3 measurement.

The following table presents fair value measurements of investments, by major class, as of December 31, 2014 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Senior Secured Debt	\$—	\$—	\$146,314	\$146,314
Subordinated Debt	—	—	222,300	222,300
Equity and Warrants	10,920	—	100,803	111,723
Total	\$10,920	\$—	\$469,417	\$480,337

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The following table provides a reconciliation of the beginning and ending balances for investments that use Level 3 inputs for the six months ended June 30, 2015 (dollars in thousands):

	<b>Senior Secured Debt</b>	<b>Subordinated Debt</b>	<b>Equity and Warrants <sup>(1)</sup></b>	<b>Total</b>
Balance as of January 1, 2015	\$ 146,314	\$ 222,300	\$ 100,803	\$ 469,417
Repayments	(3,743 )	(46,497 )	(28,708 )	(78,948 )
Purchases	60,511	89,731	4,566	154,808
Payment in-kind interest and dividends	941	641	378	1,960
Accretion of original issue discount	128	137	—	265
Realized gain/(loss) from investments	—	(3,350 )	17,563	14,213
Increase/(decrease) in net unrealized appreciation	91	36	(14,832 )	(14,705 )
Balance as of June 30, 2015	\$ 204,242	\$ 262,998	\$ 79,770	\$ 547,010

Excludes investment activity and fair value associated with our investment in CSLLF. During the six months ended (1) June 30, 2015, the Company invested \$15.2 million in CSLLF and had \$0.1 million in appreciation related to underlying earnings generated by CSLLF.

The following table provides a reconciliation of the beginning and ending balances for investments that use Level 3 inputs for the six months ended June 30, 2014 (dollars in thousands):

	<b>Senior Secured Debt</b>	<b>Subordinated Debt</b>	<b>Equity and Warrants</b>	<b>Total</b>
Balance as of January 1, 2014	\$ 102,071	\$ 133,710	\$ 128,938	\$ 364,719
Change in classification due to restructure	(14,073 )	14,073	—	—
Repayments	(9,401 )	(9,100 )	(1,659 )	(20,160 )
Purchases	49,657	11,159	2,768	63,584
Payment in-kind interest and dividends	404	642	288	1,334
Accretion of original issue discount	7	—	—	7
Realized gain from investments	—	55	1,627	1,682
Increase/(decrease) in net unrealized appreciation	248	1,144	(6,999 )	(5,607 )
Balance as of June 30, 2014	\$ 128,913	\$ 151,683	\$ 124,963	\$ 405,559

The net change in unrealized appreciation on investments held as of June 30, 2015 was \$2.0 million and is included in net unrealized appreciation/(depreciation) on investments in the consolidated statements of operations for the six months ended June 30, 2015. The net change in unrealized depreciation on investments held as of June 30, 2014 was \$(5.6) million and is included in net unrealized appreciation/(depreciation) on investments in the consolidated statements of operations for the six months ended June 30, 2014.

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements of assets as of June 30, 2015 were as follows:

	Fair Value	Valuation Approach	Level 3 Input	Range of Inputs	Weighted Average
Subordinated debt and second lien notes	\$232.6 million	Income	Required Rate of Return	9.3% - 30.0%	13.2%
			Leverage Ratio	1.7x - 12.9x	4.2x
			Adjusted EBITDA	\$1.6 million-\$218.8 million	\$43.9 million
Subordinated debt and second lien notes	\$30.4 million	Enterprise Value	Adjusted EBITDA Multiple	3.3x - 5.8x	4.4x
			Adjusted EBITDA Revenue Multiple	\$1.8 million - \$2.0 million	\$1.9 million
			Waterfall and Asset (1)	0.4x- 2.5x	1.6x
			Revenue Multiple	\$17.4 million - \$38.6 million	\$26.5 million
Senior debt and first lien notes	\$189.0 million	Income	Required Rate of Return	8.0% - 50.0%	13.7%
			Leverage Ratio	0.2x - 8.7x	3.7x
			Adjusted EBITDA	\$1.0 million- \$137.6 million	\$28.4 million
Senior debt and first lien notes	\$15.2 million	Enterprise Value Waterfall and Asset (1)	Revenue Multiple	2.5x - 2.5x \$18.9 million- \$18.9 million	2.5x \$18.9 million
Equity shares and warrants <sup>(2)</sup>	\$79.8 million	Enterprise Value Waterfall	Adjusted EBITDA Multiple	4.0x - 10.5x \$1.8 million -\$280.9 million	7.1x \$36.7 million
			Adjusted EBITDA		

(1) \$16.2 million in subordinated notes and \$14.8 million senior notes were valued using the asset approach.

(2) Excludes our \$15.3 million investment in CSLLF, measured at NAV.

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements of assets as of December 31, 2014 were as follows:

	<b>Fair Value</b>	<b>Valuation Approach</b>	<b>Level 3 Input</b>	<b>Range of Inputs</b>	<b>Weighted Average</b>
Subordinated debt and second lien notes	\$ 195.0 million	Income	Required Rate of Return	10.0% - 20.0%	12.9%
			Leverage Ratio	0.8x – 8.0x	3.8x
			Adjusted EBITDA	\$2.1 million-\$204.1 million	\$44.6 million
Subordinated debt and second lien notes	\$ 27.3 million	Enterprise Value Waterfall and Asset (1)			4.3x
			Adjusted EBITDA Multiple	3.3x – 5.5x	\$1.8 million
			Adjusted EBITDA	\$1.6 million - \$2.0 million	
			Revenue Multiple	0.4x- 2.5x	
Senior debt and first lien notes	\$ 127.8 million	Income	Revenue Multiple	\$17.2 million - \$39.7 million	1.5x
			Revenue		\$27.6 million
			Revenue		
Senior debt and first lien notes	\$ 127.8 million	Income	Required Rate of Return	6.8% - 33.3%	14.3%
			Leverage Ratio	1.1x – 6.2x	3.7x
			Adjusted EBITDA	\$1.0 million- \$95.4 million	\$22.0 million
Senior debt and first lien notes	\$ 18.5 million	Enterprise Value Waterfall and Asset (1)	Revenue Multiple	0.4x – 2.5x	0.5x
			Revenue	\$17.2 million- \$39.7 million	\$37.7 million
Equity shares and warrants	\$ 100.8 million	Enterprise Value Waterfall	Adjusted EBITDA Multiple	5.0x – 10.5x	7.0x
			Adjusted EBITDA	\$1.6 million -\$215.3 million	\$26.3 million
			Transaction Price	n/a	n/a

(1) \$12.2 million in subordinated notes and \$14.1 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, revenue, revenue 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, revenue, revenue multiples, or transaction prices will result in a higher (lower) estimate of fair value.

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

On March 24, 2015, Capitala and Trinity Universal Insurance Company ("Trinity"), a subsidiary of Kemper Corporation ("Kemper"), entered into a limited liability company agreement to co-manage Capitala Senior Liquid Loan Fund I, LLC ("CSLLF"). The purpose and design of the joint venture is to invest primarily in broadly syndicated senior secured loans to larger middle market companies, which will be purchased on the secondary market. Capitala and Trinity have committed to provide \$25.0 million of equity to CSLLF, with Capitala providing \$20.0 million and Trinity providing \$5.0 million, resulting in an 80/20% ownership between the two parties. As of June 30, 2015, \$15.2 million and \$3.8 million in capital had been contributed by Capitala and Trinity, respectively. The Company's investment in CSLLF is not redeemable; as such, the fair value of CSLLF is classified as a Level 3 measurement.

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

The terms of the TRS are governed by an ISDA 2002 Master Agreement, the Schedule thereto and Credit Support Annex to such Schedule, and the confirmation exchanged thereunder, between CSLLF and Bank of America., which collectively establish the TRS, and are collectively referred to herein as the “TRS Agreement”. Pursuant to the terms of the TRS Agreement, CSLLF may select a portfolio of loans with a maximum market value (determined at the time each such loan becomes subject to the TRS) of \$100,000,000, which is also referred to as the maximum notional amount of the TRS. Each individual loan, and the portfolio of loans taken as a whole, must meet criteria described in the TRS Agreement. CSLLF receives from Bank of America, a periodic payment on set dates that is based upon any coupons, both earned and accrued, generated by the loans underlying the TRS, subject to limitations described in the TRS Agreement as well as any fees associated with the loans included in the portfolio. CSLLF pays to Bank of America interest at a rate equal to LIBOR plus 1.25% per annum; the LIBOR option paid by CSLLF is determined on an asset by asset basis such that the tenor of the LIBOR option (1 month, 3 month, etc.) matches the tenor of the underlying reference asset. In addition, upon the termination of any loan subject to the TRS or any repayment of the underlying reference asset, CSLLF either receives from Bank of America, the appreciation in the value of such loan, or pays to Bank of America any depreciation in the value of such loan.

CSLLF is required to pay a unused facility fee of 1.25% on any amount of unused facility under the minimum facility amount of \$70,000,000 as outlined in the TRS agreement. Such unused facility fee will not apply during the first 4 months and last 60 days of the term of the TRS. CSLLF will also pay Bank of America customary fees and expenses in connection with the establishment and maintenance of the TRS.

CSLLF is required to initially cash collateralize a specified percentage of each loan (generally 20% to 35% of the market value of senior secured loans) included under the TRS in accordance with margin requirements described in the TRS Agreement. As of June 30, 2015, CSLLF has posted \$9.9 million in collateral to Bank of America in relation to the TRS which is recorded on CSLLF’s statements of assets and liabilities as cash held as collateral on total return swap. CSLLF may be required to post additional collateral as a result of a decline in the mark-to-market value of the portfolio of loans subject to the TRS. The \$9.9 million in cash collateral represents CSLLF’s maximum credit exposure as of June 30, 2015.

In connection with the TRS, CSLLF has made customary representations and warranties and is required to comply with various covenants, reporting requirements and other customary requirements for similar transactions governed by an ISDA 2002 Master Agreement. As of June 30, 2015, CSLLF is not in default with regards to any covenants or requirements of the TRS.

CSLLF’s receivable due on total return swap represents realized amounts from payments on underlying loans in the total return swap portfolio. At June 30, 2015, the receivable due on total return swap was \$0.04 million and is recorded on CSLLF’s statements of assets and liabilities below. CSLLF does not offset collateral posted in relation to the TRS with any unrealized appreciation or depreciation outstanding in the statements of assets and liabilities as of June 30, 2015.



Transactions in TRS contracts during the three months and six months ended June 30, 2015 resulted in \$0.1 million in realized gains and \$0.1 million in unrealized appreciation, which is recorded on CSLLF's statements of operations below.

CSLLF only held one derivative position as of the three and six months ended June 30, 2015 and the derivative held is subject to a netting arrangement. The following table represents CSLLF's gross and net amounts after offset under Master Agreements ("MA") of the derivative assets and liabilities presented by derivative type net of the related collateral pledged by the CSLLF as of June 30, 2015 (dollars in thousands):

	<b>Gross Derivative Assets/(Liabilities) Subject to MA</b>	<b>Derivative Amount Available for Offset</b>	<b>Net Amount Presented in the Consolidated Statements of Assets and Liabilities</b>	<b>Cash Collateral Received</b>	<b>Net Amount of Derivative Assets/(Liabilities)</b>
<b><u>June 30, 2015</u></b>					
Total Return Swap <sup>(1)</sup>	\$ 93	\$ —	\$ 93	\$ —	\$ 93

(1) Cash was posted for initial margin requirements for the total return swap as of June 30, 2015 and is reported on CSLLF's statements of assets and liabilities as cash collateral on total return swap.

The following represents the volume of the CSLLF's derivative transactions during the three and six months ended June 30, 2015 (dollars in thousands):

	<b>For the three months ended June 30, 2015</b>	<b>For the six months ended June 30, 2015 <sup>(1)</sup></b>
Average notional par amount of contract	\$ 22,516	\$ 21,568

(1) Average calculated from period of TRS inception, March 27 to June 30, 2015.

The following is a summary of the TRS reference assets as of June 30, 2015 (dollars in thousands):

**Capitala Senior Liquid Loan Fund I, LLC Loan Portfolio as of June 30, 2015**

<b>Portfolio Company</b>	<b>Business Description</b>	<b>Security Type</b>	<b>Maturity Date</b>	<b>Current Interest Rate <sup>(2)</sup></b>	<b>Principal</b>	<b>Initial Notional Cost <sup>(3)</sup></b>
21st Century Oncology, Inc.	Healthcare, Education and Childcare	Senior Loan	April, 2022	Libor + 5.5%, 1% floor	2,000	1,980
ABG Intermediate Holdings 2, LLC <sup>(4)</sup>	Textiles and Leather	Senior Loan	May, 2021	Libor + 4.5%, 1% floor	1,996	1,976
American Rock Salt Company, LLC	Mining, Steel, Iron and Non Precious Metals	Senior Loan	May, 2021	Libor + 3.75%, 1% floor	1,995	1,995
Anchor Glass Container Corp <sup>(4)</sup>	Containers, Packaging and Glass	Senior Loan	June, 2022	Libor + 3.75%, 1% floor	500	498
Aspen Dental Management, Inc.	Healthcare, Education and Childcare	Senior Loan	April, 2022	Libor + 4.5%, 1% floor	1,500	1,493
Bass Pro Group, LLC	Retail Stores	Senior Loan	June, 2020	Libor + 3.25%, .75% floor	998	995
Bioplan USA, Inc. <sup>(4)</sup>	Diversified/Conglomerate Service	Senior Loan	September, 2021	Libor + 4.75%, 1% floor	998	848
Blue Coat Systems, Inc.	Electronics	Senior Loan	May, 2022	Libor + 3.5%, 1% floor	2,000	2,000
Brock Holdings III, Inc. <sup>(4)</sup>	Buildings and Real Estate	Senior Loan	March, 2017	Libor + 4.5%, 1% floor	1,500	1,493
CDS U.S. Intermediate Holdings, Inc. <sup>(4)</sup>	Leisure, Amusement, Entertainment	Senior Loan	July, 2022	Libor + 4.25%, 1% floor	1,000	998
Communications Sales & Leasing, Inc.	Finance	Senior Loan	October, 2022	Libor + 4.0%, 1% floor	2,000	1,960
Concordia Healthcare Corp	Healthcare, Education and Childcare	Senior Loan	April, 2022	Libor + 3.75%, 1% floor	1,500	1,492
Convatec Healthcare E S.A.	Healthcare, Education and Childcare	Senior Loan	June, 2020	Libor + 3.25%, 1% floor	2,000	1,998
Emerging Markets Communications, LLC <sup>(4)</sup>	Telecommunications	Senior Loan	June, 2021	Libor + 4.25%, 1% floor	2,500	2,462
Eresearch Technology, Inc.	Healthcare, Education and Childcare	Senior Loan	May, 2022	Libor + 4.5%, 1% floor	2,500	2,487
Genoa Healthcare Group, LLC	Healthcare, Education and Childcare	Senior Loan	May, 2022	Libor + 3.5%, 1% floor	2,000	1,990
Infiltrator Systems, Inc. <sup>(4)</sup>	Containers, Packaging and Glass	Senior Loan	May, 2022	Libor + 4.25%, 1% floor	1,000	995
Informatica Corporation <sup>(4)</sup>	Electronics	Senior Loan	June, 2022	Libor + 3.5%, 1% floor	2,500	2,495

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Integra Telecom, Inc.	Telecommunications	Senior Loan	February, 2020	Libor + 4.25%, 1% floor	2,992	2,977
JILL Holdings, LLC	Retail Stores	Senior Loan	May, 2020	Libor + 5.0%, 1% floor	2,000	1,990
LS Deco, LLC <sup>(4)</sup>	Buildings and Real Estate	Senior Loan	May, 2022	Libor + 4.5%, 1% floor	2,000	1,980
LTF Merger Sub, Inc. <sup>(4)</sup>	Leisure, Amusement, Entertainment	Senior Loan	June, 2022	Libor + 3.25%, 1% floor	1,500	1,495
Minerals Technologies, Inc. <sup>(4)</sup>	Diversified Natural Resources, Precious Metals and Minerals	Senior Loan	May, 2021	Libor + 3.0%, .75% floor	1,500	1,500
Mitel Networks Corp	Telecommunications	Senior Loan	April, 2022	Libor + 4.0%, 1% floor	3,000	2,970
MJ Acquisition Corp <sup>(4)</sup>	Healthcare, Education and Childcare	Senior Loan	April, 2022	Libor + 3.0%, 1% floor	1,000	998
Mohegan Tribal Gaming Authority	Leisure, Amusement, Entertainment	Senior Loan	November, 2019	Libor + 4.5%, 1% floor	1,995	1,992
Navios Maritime Midstream Partners, LP <sup>(4)</sup>	Cargo Transport	Senior Loan	June, 2020	Libor + 4.5%, 1% floor	2,000	1,980
Novelis, Inc.	Mining, Steel, Iron and Non Precious Metals	Senior Loan	June, 2022	Libor + 3.25%, .75% floor	2,500	2,488
Penn Products Terminals, LLC	Cargo Transport	Senior Loan	April, 2022	Libor + 3.75%, 1% floor	748	744
Securus Technologies, Inc. <sup>(4)</sup>	Telecommunications	Senior Loan	April, 2020	Libor + 4.25%, 1% floor	2,000	1,980
Skillsoft Corporation <sup>(4)</sup>	Electronics	Senior Loan	April, 2021	Libor + 4.75%, 1% floor	2,000	1,980
Sterigenics-Nordion Holdings, LLC	Healthcare, Education and Childcare	Senior Loan	May, 2022	Libor + 4.5%, 1% floor	2,000	1,995
STG-Fairway Acquisitions, Inc <sup>(4)</sup>	Diversified/Conglomerate Service	Senior Loan	June, 2022	Libor + 5.25%, 1% floor	3,000	2,955
Tekni-Plex Incorporated <sup>(4)</sup>	Containers, Packaging and Glass	Senior Loan	April, 2022	Libor + 3.5%, 1% floor	2,500	2,487
Touchtunes Music Corp	Electronics	Senior Loan	May, 2022	Libor + 4.75%, 1% floor	1,500	1,492
TWCC Holding Corp <sup>(4)</sup>	Broadcasting & Entertainment	Senior Loan	February, 2020	Libor + 5.0%, .75% floor	1,995	1,975
Zep, Inc. <sup>(4)</sup>	Personal and Non Durable Consumer Products	Senior Loan	June, 2022	Libor + 4.75%, 1% floor	1,000	995
					67,717	67,128
Total Accrued Interest, net of expenses						
Total unrealized appreciation on TRS						

(1) Represents the fair value determined in accordance with ASC Topic 820.

(2) All interest is payable in cash

(3) Represents the initial amount of par on the investment in which the TRS is referenced

(4) The referenced asset is unsettled as of June 30, 2015

Below is certain summarized financial information for CSLLF as of June 30, 2015 and December 31, 2015 and for the three and six months ended June 30, 2015 (dollars in thousands):

**Selected  
Statements  
of Assets and  
Liabilities  
Information  
(unaudited):**

	<b>As of June 30, 2015</b>	<b>December 31, 2014</b>
Unrealized appreciation on Total Return Swap	\$93	\$ -
Cash held as collateral on Total Return Swap	9,884	-
Non-collateral cash and cash equivalents	9,062	-
Receivable due on Total Return Swap	42	-
Other assets	1	-
Total assets	\$19,082	\$ -
Accrued Expenses	\$12	\$ -
Total Liabilities	\$12	\$ -
Members Equity	\$19,070	\$ -
Total liabilities and net assets	\$19,082	\$ -

**Selected Statement of Operations Information (unaudited):**

	<b>For the three months ended June 30</b>		<b>For the six months ended June 30</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Administrative and Legal Expenses	80	-	80	-
Net Operating Loss	\$(80)	\$ -	\$(80)	\$ -
Net realized gain on Total Return Swap	57		57	
Net unrealized appreciation on Total Return Swap	93	-	93	-
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	\$70	\$ -	\$70	\$ -



***CION/Capitala Senior Liquid Loan Fund I, LLC***

On June 24, 2015, the Company formed a joint venture with CION Investment Corporation (“CION”), to create CION/Capitala Senior Liquid Loan Fund I, LLC (“CCSLLF”). The joint venture is expected to invest primarily in senior secured loans to broadly syndicated and larger middle-market companies.

The Company and CION have committed to provide an aggregate of \$50 million of equity to the joint venture, with the Company providing \$10 million and CION providing \$40 million. In addition, CCSLLF is in negotiations to obtain third party asset-level financing. As of June 30, 2015, neither the Company nor CION have made an initial capital call to CCSLLF. As such, CCSLLF generated no net income for the three and six month periods ended June 30, 2015 and holds no assets as of June 30, 2015. The Company and CION intend to begin funding the portfolio with new investments during the third quarter of 2015.

As a practical expedient, the Company will use NAV to value its investment in CCSLLF. Because our investment in CCSLLF is not redeemable without restriction, the fair value of CCSLLF will be classified as a level 3 measurement.

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

The following table presents the carrying value and fair value of the Company’s financial liabilities disclosed, but not carried, at fair value as of June 30, 2015, and the level of each financial liability within the fair value hierarchy (dollars in thousands):

	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
SBA debentures	\$ 192,200	\$ 194,441	\$ —	\$ —	\$ 194,441
Notes	113,438	116,660	116,660	—	—
Total	305,638	\$ 311,101	\$ 116,660	\$ —	\$ 194,441

The following table presents the carrying value and fair value of the Company’s financial liabilities disclosed, but not carried, at fair value as of December 31, 2014, and the level of each financial liability within the fair value hierarchy (dollars in thousands):

<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
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	<b>Carrying Value</b>				
SBA debentures	\$ 192,200	\$ 191,947	\$ —	\$	—\$191,947
Notes	113,438	115,479	115,479	—	—
Total	305,638	\$ 307,426	\$ 115,479	\$	—\$191,947

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

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

## Note 5. Agreements

On September 24, 2013, the Company entered into an initial investment advisory agreement (the "Investment Advisory Agreement") with our Investment Advisor, which was initially approved by the Board of Directors of the Company on June 10, 2013. The Investment Advisory Agreement was re- approved by the Board of Directors of the Company on August 6, 2015. 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 and/or our stockholders. Subject to the overall supervision of our Board, our 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 gross 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.

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% (8.0% annualized);

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 “catch-up” 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 the Investment Advisor (once the hurdle is reached and the catch-up is achieved, 20% of all pre-incentive fee investment income thereafter is allocated to the Investment Advisor).

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), commencing with the 2013 calendar year 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 June 30, 2015 and 2014, we incurred \$2.6 million and \$2.3 million in base management fees, respectively. For the three months ended June 30, 2015 and 2014, our Investment Advisor waived fees of zero and \$0.1 million, respectively. For the three months ended June 30, 2015 and 2014, we incurred \$1.3 million and \$1.4 million, respectively, in incentive fees related to pre-incentive fee net investment income.

For the six months ended June 30, 2015 and 2014, we incurred \$5.0 million and \$4.3 million in base management fees, respectively. For the six months ended June 30, 2015 and 2014, our Investment Advisor waived fees of zero and \$0.2 million, respectively. For the six months ended June 30, 2015 and 2014, we incurred \$2.5 million and \$2.8 million, respectively, in incentive fees related to pre-incentive fee net investment income.

On September 24, 2013, the Company entered into an 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. On August 6, 2015, the Board approved the renewal of the Administration Agreement. 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.

For the three and six months ended June 30, 2015, we paid our administrator \$0.3 million and \$0.6 million for our allocable portion of the Administrator’s overhead paid directly by and reimbursable to the Administrator. For the three and six months ended June 30, 2014, we paid our administrator \$0.2 million and \$0.5 million for our allocable portion of the Administrator’s overhead paid directly by and reimbursable to the Administrator.

The Administration Agreement provides that, absent willful misfeasance, bad faith or gross 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 June 30, 2015 and December 31, 2014, the Company had the following receivables from (payables to) related parties relating to management fees, incentive fees, and reimbursable expenses (dollars in thousands):

	<b>June 30, 2015</b>	<b>December 31, 2014</b>
CapitalSouth Corporation	\$252	\$ 252
Shareholders/Limited Partners	—	205
Capitala Investment Advisors, LLC	(2,544)	(106 )
Total	\$(2,292)	\$ 351

These amounts are reflected in the accompanying statements of financial position under the captions, "Due from related parties", "Management and 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 \$31 thousand at December 31, 2014. There were no related party deposits outstanding at June 30, 2015.

**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 June 30, 2015, 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 June 30, 2015, Fund II and Fund III had total assets of approximately \$373.4 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 June 30, 2015 and June 30, 2014, the Company recorded \$2.1 million and \$2.1 million, respectively, of interest, annual charges, and financing expenses related to the SBA guaranteed debentures, of which \$1.9 million and \$1.9 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 six months ended June 30, 2015 and June 30, 2014, the Company recorded \$4.1 million and \$4.3 million, respectively, of interest, annual charges, and financing expenses related to the SBA guaranteed debentures, of which \$3.8 million and \$3.9 million, respectively, was attributable to interest expense and annual charges, and \$0.3 million and \$0.4 million, respectively, was attributable to amortization of commitment and upfront fees. The weighted average interest rate for all SBA-guaranteed debentures as of June 30, 2015 and December 31, 2014 was 3.51% and 3.51%, 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 June 30, 2015 and December 31, 2014 was 0.48% and 0.48%, respectively.

As of June 30, 2015 and December 31, 2014, the Company's issued and outstanding SBA-guaranteed debentures mature as follows (dollars in thousands):

<b>Fixed Maturity Date</b>	<b>Interest Rate</b>	<b>SBA Annual Charge</b>	<b>June 30, 2015</b>	<b>December 31, 2014</b>
September 1, 2015	4.941	% 0.871	% \$ 8,000	\$ 8,000
March 1, 2016	5.524	% 0.871	% 2,000	2,000
September 1, 2016	5.535	% 0.941	% 11,500	11,500
March 1, 2019	4.620	% 0.941	% 5,000	5,000
September 1, 2020	3.215	% 0.285	% 19,000	19,000
March 1, 2021	4.084	% 0.515	% 15,700	15,700

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March 1, 2021	4.084	%	0.285	%	46,000	46,000
March 1, 2022	2.766	%	0.285	%	10,000	10,000
March 1, 2022	2.766	%	0.515	%	50,000	50,000
March 1, 2023	2.351	%	0.515	%	25,000	25,000
					\$ 192,200	\$ 192,200

### *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.

For the three and six months ended June 30, 2015, the Company has recorded \$2.0 million and \$4.0 million of interest expense and \$0.1 million and \$0.3 million of amortization of deferred financing costs related to the Notes, respectively.

For the three and six months ended June 30, 2014, the Company has recorded \$0.3 million of interest expense and \$0.02 million of amortization of deferred financing costs related to the Notes, respectively.

### *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 borrowing 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. On January 6, 2015, the Company entered into an Incremental Assumption Agreement, (the “Incremental Assumption Agreement”), relating to the Credit Facility. The Incremental Assumption Agreement increased the amount of borrowings available under the Credit Facility from \$50,000,000 to \$80,000,000. The \$30,000,000 increase in total commitments under the Credit Facility was executed under the “accordion” feature of the Credit Facility, which allows for an increase in total commitments under the Credit Facility up to \$150,000,000.

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.

On April 14, 2015, the Company repaid the full \$25.0 million balance outstanding on the Credit Facility, which included \$15.0 million drawn at March 31, 2015, \$10.0 million drawn on April 2, 2015, and accrued interest to date. There are no borrowings outstanding as of June 30, 2015.

For the three months ended June 30, 2015, the Company recorded \$28 thousand of interest expense, \$0.2 million of amortization of deferred financing costs and \$0.2 million of unused commitment fees related to the Credit Facility.

For the six months ended June 30, 2015, the Company recorded \$36 thousand of interest expense, \$0.4 million of amortization of deferred financing costs and \$0.5 million of unused commitment fees related to the Credit Facility.

The Credit Facility is secured by investments and cash held by Capitala Finance Corp., exclusive of assets held at our two SBIC subsidiaries. Assets pledged to secure the Credit Facility were \$237.9 million at June 30, 2015. As part of the terms of the Credit Facility, the Company may not make cash distributions with respect to any taxable year that exceed 110% (125% if the Company is not in default and its covered debt does not exceed 85% of the borrowing base) of the amounts required to be distributed to maintain eligibility as a RIC and to reduce the Company's tax liability to zero for taxes imposed on its investment company taxable income and net capital gains.

#### **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 six months ended June 30, 2015, the Company recognized director fee expense of \$0.1 million and \$0.2 million, respectively. For the three and six months ended June 30, 2014, the Company recognized director fee expense of \$0.1 million and \$0.2 million, respectively. No compensation is expected to be paid to directors who are “interested persons” of the Company, as such term is defined in Section 2(a)(19) of the 1940 Act.

#### **Note 9. Summarized Financial Information of Our Unconsolidated Subsidiaries**

The Company holds a control interest, as defined by the 1940 Act, in three majority owned portfolio companies that are considered significant subsidiaries under the guidance in Regulation S-X, but are not consolidated in the Company’s consolidated financial statements. Below is a brief description of each portfolio company, along with summarized financial information as of June 30, 2015 and December 31, 2014, and for the six month periods ended June 30, 2015 and June 30, 2014.

##### ***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 loss the Company generated from Print Direction, Inc., which includes all interest, dividends, PIK interest and dividends, fees, and unrealized depreciation, was \$(0.9) million for the six months ended June 30, 2015. The income the Company generated from Print Direction, Inc., which includes all interest, dividends, PIK interest and dividends, fees, and unrealized depreciation, was \$3.6 million for the six months ended June 30, 2014.

##### ***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 \$1.5 million and \$2.8 million for the six months ended June 30, 2015 and June 30, 2014, 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 \$(0.2) million for the six months ended June 30, 2015. 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 (\$2.2) million for the six months ended June 30, 2014.



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

<b>Balance Sheet - Print Direction, Inc.</b>	<b>As of</b>	
	<b>June 30, 2015</b>	<b>December 31, 2014</b>
Current assets	\$4,355	\$ 5,055
Noncurrent assets	5,439	5,346
Total assets	\$9,794	\$ 10,401
Current liabilities	\$2,915	\$ 3,193
Noncurrent liabilities	14,580	14,510
Total liabilities	\$17,495	\$ 17,703
Total deficit	\$(7,701 )	\$ (7,302 )

  

<b>Statements of Operations - Print Direction, Inc.</b>	<b>Six Months Ended</b>	
	<b>June 30, 2015</b>	<b>June 30, 2014</b>
Net sales	\$ 8,269	\$ 11,748
Cost of goods sold	3,215	4,611
Gross profit	\$ 5,054	\$ 7,137
Other expenses	\$ 5,752	\$ 6,977
Income (loss) before income taxes	(698 )	160
Income tax provision (benefit)	(293 )	67
Net income (loss)	\$ (405 )	\$ 93

<b>Balance Sheet - Navis Holdings, Inc.</b>	<b>As of</b>	
	<b>June 30, 2015</b>	<b>December 31, 2014</b>
Current assets	\$5,293	\$ 4,818
Noncurrent assets	4,351	5,002
Total assets	\$9,644	\$ 9,820
Current liabilities	\$2,842	\$ 3,179
Noncurrent liabilities	6,912	6,921
Total liabilities	\$9,754	\$ 10,100
Total deficit	\$(110 )	\$ (280 )

<b>Statements of Operations - Navis Holdings, Inc.</b>	<b>Six Months Ended</b>	
	<b>June 30, 2015</b>	<b>June 30, 2014</b>
Net sales	\$ 7,697	\$ 7,918
Cost of goods sold	4,839	4,691
Gross profit	\$ 2,858	\$ 3,227
Other expenses	\$ 2,714	\$ 2,427
Income before income taxes	144	800
Income tax provision	58	318
Net income	\$ 86	\$ 482

<b>Balance Sheet - On-Site Fuel Service, Inc.</b>	<b>As of June 30, 2015</b>	<b>December 31, 2014</b>
Current assets	\$ 11,056	\$ 13,021
Noncurrent assets	18,228	18,464
Total assets	\$ 29,284	\$ 31,485
Current liabilities	\$ 10,656	\$ 12,439
Noncurrent liabilities	14,160	12,174
Total liabilities	\$ 24,816	\$ 24,613
Total equity	\$ 4,468	\$ 6,872

<b>Statements of Operations - On-Site Fuel Service, Inc.</b>	<b>Six Months Ended June 30, 2015</b>	<b>June 30, 2014</b>
Net sales	\$ 59,692	\$ 110,211
Cost of goods sold	57,728	104,868
Gross profit	\$ 1,964	\$ 5,343
Other expenses	\$ 3,569	\$ 6,247
Income (loss) before income taxes	(1,605 )	(904 )
Income tax provision (benefit)	—	—
Net loss	\$ (1,605 )	\$ (904 )

#### **Note 10. Public Offering**

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

#### **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 June 30, 2015, 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 six months ended June 30, 2015 and June 30, 2014 (dollars in thousands except share and per share data):

<b>Basic and diluted</b>	<b>For the three months ended</b>		<b>For the six months ended</b>	
	<b>June 30, 2015</b>	<b>June 30, 2014</b>	<b>June 30, 2015</b>	<b>June 30, 2014</b>
Net increase in net assets from operations	\$4,942	\$ 6,212	\$14,809	\$ 7,430
Weighted average common shares outstanding	15,957,926	12,974,420	14,474,446	12,974,420
Net increase in net assets per share from operations-basic and diluted	\$0.31	\$ 0.48	\$1.02	\$ 0.57

## **Note 12. Distributions**

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

The following table summarizes the Company's distribution declarations for the six months ended June 30, 2015 (dollars in thousands, except share and per share data):

Date Declared	Record Date	Payment Date	Amount Per Share	Cash Distribution	DRIP Shares Issued	DRIP Share Value
January 2, 2015	January 22, 2015	January 29, 2015	\$ 0.1567	\$ 2,033	—	\$ —
January 2, 2015	February 20, 2015	February 26, 2015	0.1567	2,033	—	—
January 2, 2015	March 23, 2015	March 30, 2015	0.1567	1,994	2,139	38
February 26, 2015	March 23, 2015 <sup>(1)</sup>	March 30, 2015	0.05	635	683	12
February 26, 2015	April 23, 2015 <sup>(1)</sup>	April 29, 2015	0.05	824	—	—
February 26, 2015	May 21, 2015 <sup>(1)</sup>	May 28, 2015	0.05	808	998	16
February 26, 2015	June 22, 2015 <sup>(1)</sup>	June 29, 2015	0.05	793	1,361	20
February 26, 2015	July 23, 2015 <sup>(1)</sup>	July 30, 2015	0.05	—	—	—
February 26, 2015	August 21, 2015 <sup>(1)</sup>	August 28, 2015	0.05	—	—	—
February 26, 2015	September 23, 2015 <sup>(1)</sup>	September 29, 2015	0.05	—	—	—
February 26, 2015	October 23, 2015 <sup>(1)</sup>	October 29, 2015	0.05	—	—	—
February 26, 2015	November 20, 2015 <sup>(1)</sup>	November 27, 2015	0.05	—	—	—
February 26, 2015	December 22, 2015 <sup>(1)</sup>	December 30, 2015	0.05	—	—	—
April 1, 2015	April 23, 2015	April 29, 2015	0.1567	2,581	—	—
April 1, 2015	May 21, 2015	May 28, 2015	0.1567	2,529	3,126	52
April 1, 2015	June 22, 2015	June 29, 2015	0.1567	2,483	4,266	63
Total distributions declared			\$ 1.44	\$ 16,713	12,573	\$ 201

<sup>(1)</sup> On February 26, 2015, the Company's Board of Directors declared a special distribution of \$0.50 per share of the Company's common stock, to be paid monthly over the remainder of 2015.

The following table summarizes the Company's distribution declarations for the six months ended June 30, 2014:

Date Declared	Record Date	Payment Date	Amount Per Share
February 27, 2014	March 14, 2014	March 26, 2014	\$ 0.47
May 8, 2014	June 9, 2014	June 26, 2014	0.47
Total Distributions Declared			\$ 0.94

### Note 13. Share Repurchase Program

On February 26, 2015, the Company's board of directors authorized a program for the purpose of repurchasing up to \$12.0 million worth of its common stock. Under the repurchase program, the Company may, but is not obligated to,

repurchase its outstanding common stock in the open market from time to time provided that the Company complies with the prohibitions under its Insider Trading Policies and Procedures and the guidelines specified in Rule 10b-18 of the Securities Exchange Act of 1934, as amended, including certain price, market volume and timing constraints. Unless extended by the Company's board of directors, the Company expects the repurchase program to be in place until the earlier of March 31, 2016 or until \$12.0 million of the Company's outstanding shares of common stock have been repurchased.

During the six months ended June 30, 2015, the Company repurchased 224,602 shares of common stock in open market transactions for an aggregate cost (including transaction costs) of \$3.9 million. Since the approval of the Plan, the Company has repurchased 224,602 shares of common stock in open market transactions for an aggregate cost (including transaction costs) of \$3.9 million. As of June 30, 2015, none of these share repurchases were unsettled. The Company is incorporated in Maryland and under the law of the state, shares repurchased are considered retired (repurchased shares become authorized but unissued shares) rather than treasury stock. As a result, the cost of the stock repurchased is recorded as a reduction to capital in excess of par value on the consolidated statement of changes in net assets.

#### Note 14. Financial Highlights

The following is a schedule of financial highlights for the six months ended June 30, 2015 and 2014 (dollars in thousands, except share and per share data):

	June 30, 2015	June 30, 2014
Per share data:		
Net asset value at beginning of period	\$ 18.56	\$ 20.71
Net investment income(1)	0.70	0.87
Net realized gain on investments(1)	1.74	0.13
Net decrease in unrealized appreciation on investments(1)	(1.42)	(0.43)
Dividends declared from net investment income	(0.94)	(0.94)
Dividends declared from net realized gains	(0.50)	—
Issuance of common stock	(0.15)	—
Accretive impact of stock repurchase	0.02	—
Other(8)	(0.06)	—
Net asset value at end of period	\$ 17.95	\$ 20.34
Net assets at end of period	\$ 291,865	\$ 263,904
Shares outstanding at end of period	16,262,391	12,974,420
Per share market value at end of period	\$ 15.60	\$ 18.89
Total return based on market value(2)	(6.72)%	(0.32)%
<b>Ratio/Supplemental data:</b>		
Ratio of net investment income to average net assets(4)	7.95%	8.63%
Ratio of incentive fee to average net assets(4)	1.97%	2.16%
Ratio of debt related expenses to average net assets(4)	7.31%	3.49%
Ratio of other operating expenses, net of management fee waiver to average net assets(4)(7)	5.62%	4.64%

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Ratio of total expenses to average net assets(4)	14.90	%	10.29	%
Portfolio turnover rate(3)	17.63	%	5.21	%
Average debt outstanding(5)	\$ 307,876		\$ 204,063	
Average debt outstanding per common share	\$ 18.93		\$ 15.73	
Asset coverage ratio per unit(6)	\$ 3,573		\$ 1,863	

- (1) Based on daily weighted average balance of shares outstanding during the period.  
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, (2) 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 rate is calculated using the lesser of year-to-date sales or year-to-date purchases over the (3) average of the invested assets at fair value. Portfolio turnover rates that cover less than a full period are not annualized.
- (4) Ratios are annualized.
- (5) Based on daily weighted average balance of debt outstanding during the period.  
Asset coverage per unit is the ratio of the carrying value of our total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness. We have excluded our SBA-guaranteed debentures from the asset coverage calculation as of June 30, (6) 2015 pursuant to the exemptive relief granted by the SEC in June 2014 that permits us to exclude such debentures from the definition of senior securities in the 200% asset coverage ratio we are required to maintain under the 1940 Act. Asset coverage per unit is expressed in terms of dollar amounts per \$1,000 of indebtedness. Including our unfunded commitments of \$21.4 million as of June 30, 2015, our asset coverage ratio would be \$3,005.
- (7) The ratio of waived management fees to average net assets was 0.15% for the six months ended June 30, 2014.  
Includes the impact of different share amounts used in calculating per share data as a result of calculating certain (8) per share data based on weighted average shares outstanding during the period and certain per share data based on shares outstanding as of a period end or transaction date.

## Note 15. 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 June 30, 2015.

### *Distributions*

On July 1, 2015, the Company's Board of Directors declared normal monthly distributions for July, August, and September of 2015 as set forth below:

Date Declared	Record Date	Payment Date	Distributions per Share
July 1, 2015	July 23, 2015	July 30, 2015	\$ 0.1567
July 1, 2015	August 21, 2015	August 28, 2015	\$ 0.1567
July 1, 2015	September 23, 2015	September 29, 2015	\$ 0.1567





***Portfolio Activity***

On July 13, 2015, the Company received \$4.8 million in proceeds for liquidation of our investments in Southern Pump & Tank Company.

On July 24, 2015, the Company invested \$8.0 million in subordinated debt of Vology, Inc. yielding 15% cash interest.

On July 31, 2015, the Company invested \$27.0 million in senior secured term debt of Western Window Systems, LLC initially yielding 12.2% cash interest. The Company also invested \$3.0 million in the common stock of Western Window Systems, LLC. The Company led syndication of this investment, which included a \$5.0 million revolver and an \$18.0 million first-out term loan.

On July 31, 2015, the Company funded its \$6.0 million commitment to U.S. Well Services, LLC senior secured debt, yielding 12% interest.

## 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," "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 lower and traditional middle-market companies primarily 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 debt investments that are secured by subordinated liens on all or a portion of our borrowers’ assets and, to a lesser extent, in senior, cash flow-based “unitranche” securities. Many 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 of the Internal Revenue Code for 1986, as amended (the “Code”) for U.S. federal income tax purposes, we must distribute at least 90% of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, for the taxable year.

## Corporate History

We commenced operations on May 24, 2013 and completed our initial public offering (“IPO”) on September 30, 2013. The Company was formed for the purpose of (i) acquiring, through a series of transactions, an investment portfolio from the following entities: CapitalSouth Partners Fund I Limited Partnership (“Fund I”); CapitalSouth Partners Fund II Limited Partnership (“Fund II”); CapitalSouth Partners Fund III, L.P. (“Fund III Parent”); CapitalSouth Partners SBIC

Fund III, L.P. (“Fund III”) and CapitalSouth Partners Florida Sidecar Fund I, L.P. (“Florida Sidecar” and, collectively with Fund I, Fund II, Fund III and Fund III Parent, the “Legacy Funds”); (ii) raising capital in the IPO and (iii) continuing and expanding the business of the Legacy Funds by making additional debt and equity investments in lower middle market and 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, 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 June 30, 2015, the Company had 16,262,391 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.

## **Basis of Presentation**

The accompanying unaudited financial statements have been prepared 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 and Article 6 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 periods, 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, 2014, filed with the U.S. Securities and Exchange Commission (“SEC”) on March 4, 2015. 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.

## Consolidation

As provided under Regulation S-X and ASC Topic 946 – *Financial Services – Investment Companies*, the Company will generally not consolidate its investment in a company other than an investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. Accordingly, the Company consolidated the results of the Company's wholly owned subsidiaries in its consolidated financial statements. The Company does not consolidate its interests in Capitala Senior Liquid Loan Fund I, LLC ("CSLLF") and CION/Capitala Senior Liquid Loan Fund I, LLC ("CCSLLF") because the entities are not considered substantially wholly owned investment company subsidiaries. Further, CSLLF and CCSLLF are joint ventures for which shared power exists relating to the decisions that most significantly impact the economic performance of the entities. See Note 4 for description of the Company's investments in CSLLF and CCSLLF.

The Company's financial position as of June 30, 2015 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.

## 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, as amended, other applicable federal and state securities laws and ongoing stock exchange listing fees;
- federal, state and local taxes;
- independent directors' fees and expenses;
- brokerage commissions;
- costs of proxy statements, stockholders' reports and other communications with stockholders;



- fidelity bond, directors' and officers' liability insurance, errors and omissions liability insurance and other insurance premiums;

- direct costs and expenses of administration, including printing, mailing, telephone and staff;

- fees and expenses associated with independent audits and outside legal costs; and

- all other expenses incurred by either our Administrator or us in connection with administering our business, including payments under the Administration Agreement that will be based upon our allocable portion of overhead and other expenses incurred by our Administrator in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions, and our allocable portion of any costs of compensation and related expenses of our chief compliance officer and our chief financial officer and 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 defines fair value, establishes a framework used to measure fair value and requires disclosures for fair value measurements. In accordance with ASC 820, the Company has categorized its financial instruments carried at fair value, based on the priority of the valuation technique, into a three-level fair value hierarchy as discussed in Note 4 to our Consolidated Financial Statements.

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

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

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

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

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

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

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



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

As a practical expedient, the Company uses net asset value ("NAV") as the fair value for CSLLF and CCSLLF. CSLLF and CCSLLF record their underlying investments at fair value on a daily basis utilizing pricing information from third-party sources. In the event pricing is not available or an investment is considered illiquid, management may perform model-based analytical valuations in instances where an investment is considered illiquid or for which pricing is not available from third-party sources

### ***Valuation Techniques***

#### *Enterprise Value Waterfall Approach*

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

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

#### *Income Approach*

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

#### *Asset Approach*

The asset approach values an investment based on 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 investment 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.

#### *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. The PIK interest, which represents contractually deferred interest added to the loan balance that is generally due at maturity, is recorded on the accrual basis to the extent that such amounts are expected to be collected. PIK interest is not accrued if the Company does not expect the issuer to be able to pay all principal and interest when due.

*Non-accrual investments:* Generally, when interest and/or principal payments on a loan become 90 days or more past due, or 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 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.

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

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

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 June 30, 2015 and December 31, 2014, 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 June 30, 2015 and December 31, 2014. 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 six month periods ended June 30, 2015 and June 30, 2014. 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 June 30, 2015, our portfolio consisted of investments in 60 portfolio companies with a fair value of approximately \$565.3 million.

During the three months ended June 30, 2015, we made approximately \$102.8 million of investments and had approximately \$57.4 million in repayments resulting in net investments of approximately \$45.4 million for the period. During the three months ended June 30, 2014, we made approximately \$22.6 million of investments and had approximately \$9.4 million in repayments resulting in net investments of approximately \$13.2 million for the period.

During the six months ended June 30, 2015, we made approximately \$170.0 million of investments and had approximately \$91.9 million in repayments resulting in net investments of approximately \$78.1 million for the period. During the six months ended June 30, 2014, we made approximately \$63.6 million of investments and had

approximately \$20.2 million in repayments resulting in net investments of approximately \$43.4 million for the period.

As of June 30, 2015, our debt investment portfolio, which represented 82.7% of our total portfolio, had a weighted average yield of approximately 12.0%. As of June 30, 2015, 73.8% of our debt investment portfolio was bearing a fixed rate of interest. As of December 31, 2014, our debt investment portfolio, which represented 76.7% of our total portfolio, had a weighted average yield of approximately 12.5%. As of December 31, 2014, 79.0% of our debt investment portfolio was bearing a fixed rate of interest.

The following table summarizes the amortized cost and the fair value of investments and cash and cash equivalents as of June 30, 2015 (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	\$ 204,237	34.8	%	\$ 204,242	33.8	%
Subordinated Debt	272,563	46.5		262,998	43.5	
Equity and Warrants	54,634	9.3		82,818	13.7	
Capitala Senior Liquid Loan Fund I, LLC	15,200	2.6		15,256	2.5	
Cash and Cash Equivalents	39,533	6.8		39,533	6.5	
Total	\$ 586,167	100.0	%	\$ 604,847	100.0	%

The following table summarizes the amortized cost and the fair value of investments and cash and cash equivalents as of December 31, 2014 (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	\$ 146,399	29.5	%	\$ 146,314	27.3	%
Subordinated Debt	231,901	46.7		222,300	41.5	
Equity and Warrants	62,855	12.7		111,723	20.9	
Cash and Cash Equivalents	55,107	11.1		55,107	10.3	
Total	\$ 496,262	100.0	%	\$ 535,444	100.0	%

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

	<b>June 30, 2015</b>			<b>December 31, 2014</b>		
	<b>Investments at Fair Value</b>	<b>Percentage of Total Portfolio</b>		<b>Investments at Fair Value</b>	<b>Percentage of Total Portfolio</b>	
Oil & Gas Services	\$35,489	6.2	%	\$ 34,088	7.1	%
Transportation	28,475	4.9		27,094	5.6	
Financial Services	28,300	4.9		8,300	1.7	
Consumer Electronics	28,300	4.9		—	—	
IT Government Contracting	20,000	3.5		20,000	4.2	
Food Product Manufacturer	18,997	3.4		19,126	4.0	
Sales & Marketing Services	17,942	3.2		23,632	4.9	
Printing Services	17,468	3.1		18,324	3.8	
Footwear Retail	17,339	3.1		15,687	3.3	
Medical Device Distributor	17,006	3.0		14,349	3.0	
Bakery Supplies Distributor	16,244	2.9		16,297	3.4	
Personal Product Manufacturer	16,000	2.8		16,241	3.4	
Automobile Part Manufacturer	15,934	2.8		15,846	3.3	
Investment Fund	15,256	2.7		—	—	
Professional and Personal Digital Imaging	15,000	2.7		—	—	
Home Décor Manufacturer	14,535	2.6		14,611	3.0	
Oil & Gas Engineering and Consulting Services	14,196	2.5		14,547	3.0	
Industrial Equipment Rental	13,449	2.4		13,212	2.8	
Retail Display & Security Services	13,095	2.3		12,958	2.7	
Construction Services	12,500	2.2		12,500	2.6	
Healthcare Management	12,357	2.2		12,420	2.6	
Bowling Products	11,976	2.1		—	—	
Computer Supply Retail	11,669	2.1		11,984	2.5	
Textile Equipment Manufacturer	11,466	2.0		10,577	2.2	
Farming	11,068	2.0		—	—	
Energy Services	10,825	1.9		10,573	2.2	
Healthcare	10,000	1.8		—	—	
Dental Practice Management	8,221	1.5		7,826	1.6	
Data Processing & Digital Marketing	8,036	1.4		8,005	1.7	
Conglomerate	7,244	1.3		7,179	1.5	
Fuel Transportation Services	6,629	1.2		4,783	1.0	
Specialty Clothing	6,250	1.1		5,723	1.2	
Replacement Window Manufacturer	5,368	0.9		4,857	1.0	
Produce Distribution	5,158	0.9		5,711	1.2	
Crane Rental and Sales	5,038	0.9		—	—	
Scrap Metal Recycler	4,927	0.9		4,927	1.0	
Satellite Communications	4,925	0.9		—	—	
Building Products	4,875	0.9		4,895	1.0	
Industrial Specialty Services	4,863	0.9		—	—	

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Home Repair Parts Manufacturer	4,857	0.9	—	—
Retail	4,487	0.8	—	—
Petroleum Equipment Supplier	4,442	0.8	3,850	0.8
Automotive Chemicals & Lubricants	3,834	0.7	3,891	0.8
Advertising & Marketing Services	3,820	0.7	4,219	0.9
Industrial Manufacturing	3,546	0.6	3,510	0.7
Western Wear Retail	3,048	0.5	10,920	2.3
QSR Franchisor	2,587	0.5	2,506	0.5
Professional Employer Organization	2,197	0.4	2,700	0.6
Online Travel Sales & Marketing	1,750	0.3	1,750	0.4
Specialty Defense Contractor	1,577	0.3	1,850	0.4
Entertainment	985	0.2	—	—
In-Home Healthcare Services	910	0.2	624	0.1
Culinary Products	758	0.1	—	—
IT Hosting Services	96	0.0	480	0.1
QSR Franchisee	—	—	17,465	3.6
Wireless Communication Retailer	—	—	12,000	2.5
Restaurant Chain	—	—	9,738	2.0
Online Merchandise Retailer	—	—	4,804	1.0
Education Services	—	—	3,000	0.6
Home Product Manufacturer	—	—	758	0.2
Total	\$565,314	100.0	% \$480,337	100.0 %

As of June 30, 2015, we had 5 portfolio companies within the energy sector, representing approximately 10.7% of the total investment portfolio, based on fair values. The June 30, 2015 fair values were approximately 85.8% of cost, compared to 89.5% at December 31, 2014.

At June 30, 2015, all energy related investments were current on interest payments. Management continues to closely monitor each of these investments, maintaining frequent dialogue with company management and, where appropriate, sponsors.

With the exception of an \$8.3 million investment and a \$1.0 million investment in internationally headquartered companies, all investments made by us as of June 30, 2015 and December 31, 2014 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 June 30, 2015 and December 31, 2014 (dollars in thousands):

	<b>June 30, 2015</b>			<b>December 31, 2014</b>		
	<b>Investments at Fair Value</b>	<b>Percentage of Total Portfolio</b>		<b>Investments at Fair Value</b>	<b>Percentage of Total Portfolio</b>	
South	\$298,559	52.8	%	\$272,457	56.7	%
Midwest	100,426	17.8		38,103	7.9	
Northeast	93,573	16.6		86,411	18.0	
West	63,471	11.2		75,066	15.7	
International	9,285	1.6		8,300	1.7	
Total	\$565,314	100.0	%	\$480,337	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 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 all principal is expected.   |
| 5 | In general, the investment may be performing substantially below our internal expectations and a number of quantitative or qualitative risks may have increased substantially since the original investment. Loss of some or all principal is expected.   |

Our Investment Advisor will monitor and, when appropriate, change the investment ratings assigned to each investment in our portfolio. In connection with our valuation process, our Investment Advisor will review these investment ratings on a quarterly basis, and our Board 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 June 30, 2015 and December 31, 2014 (dollars in thousands):

Investment Performance Rating	As of June 30, 2015			As of December 31, 2014		
	Investments at Fair Value	Percentage of Total Investments		Investments at Fair Value	Percentage of Total Investments	
1	\$ 126,801	22.4	%	\$ 146,471	30.5	%
2	343,125	60.7		271,864	56.6	
3	83,108	14.7		55,325	11.5	
4	12,280	2.2		6,677	1.4	
5	—	—		—	—	
Total	\$ 565,314	100.0	%	\$ 480,337	100.0	%

As of June 30, 2015, the Company had one debt investment on cash non-accrual status with an amortized cost of \$17.9 million and a fair value of \$10.5 million representing 3.3% and 1.9% of the investment portfolio, respectively. As of December 31, 2014, the Company had debt investments in one portfolio company on cash non-accrual status with an amortized cost of \$3.4 million and a fair value of \$0.0 million representing 0.8% and 0.0% of the investment portfolio, respectively.

As of June 30, 2015, the Company had one debt investment on PIK non-accrual status with an amortized cost of \$8.1 million, and a fair value of \$5.7 million, representing 1.5%, and 1.0% of the investment portfolio, respectively. As of December 31, 2014, the Company had debt investments in one portfolio company on PIK non-accrual status with an amortized cost of \$13.1 million, and a fair value of \$10.6 million, representing 3.0%, and 2.2% of the investment portfolio, respectively.

## Results of Operations

Operating results for the three and six months ended June 30, 2015 and 2014 are as follows (dollars in thousands):

	For the three months ended		For the six months ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Total investment income	\$ 15,084	\$ 12,526	\$ 29,125	\$ 24,901
Total expenses, net	9,767	6,892	18,991	13,546
Net investment income	5,317	5,634	10,134	11,355
Net realized gain from investments	15,837	462	25,177	1,682
Net unrealized appreciation/(depreciation)	(16,212 )	116	(20,502 )	(5,607 )
Net increase in net assets resulting from operations	\$ 4,942	\$ 6,212	\$ 14,809	\$ 7,430

***Investment income***

The composition of our investment income for the three months ended June 30, 2015 and 2014 was as follows (dollars in thousands):

	For the three months ended		For the six months ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Interest income	\$ 11,821	\$ 8,196	\$ 23,497	\$ 15,762
Fee Income	1,862	317	3,091	766
Payment-in-kind interest and dividend income	1,191	744	1,960	1,334
Dividend income	208	3,263	574	7,025
Interest from cash and cash equivalents	2	6	3	14
Total investment income	\$ 15,084	\$ 12,526	\$ 29,125	\$ 24,901

The income reported as interest income and payment-in-kind interest and dividend income is generally based on the stated rates as disclosed in the Company's Schedule of Investments. Accretion/(Amortization) of discounts and premiums paid for purchased loans are included in interest income as an adjustment to yield. As a general rule, the Company's interest income and payment-in-kind interest and dividend income is recurring in nature.



The Company also generates fee income primarily through origination fees charged for new investments, and secondarily via amendment fees, consent fees, prepayment penalties, and other fees. While the fee income is typically non-recurring for each investment, most of the Company's new investments include an origination fee; as such, fee income is dependent upon the Company's volume of deployments and to the fee structure associated with those deployments.

The Company earns dividends on certain equity investments within its investment portfolio. As noted in the Company's Schedule of Investments, some investments are scheduled to pay a periodic dividend though these recurring dividends do not make up a significant portion of the Company's total investment income. The Company may and has received more substantial one-time dividends from its equity investment as part of dividend recapitalizations.

For the three months ended June 30, 2015, total investment income increased \$2.6 million, or 20.4% compared to the three months ended June 30, 2014. The increase from the prior period relates primarily to higher interest and PIK income from a growing investment portfolio and increase in fee income due to increase in deployments, offset by a decline in non-recurring dividend income.

For the six months ended June 30, 2015, total investment income increased \$4.2 million, or 17.0% compared to the six months ended June 30, 2014. The increase from the prior period relates primarily to higher interest and PIK income from a growing investment portfolio and increase in fee income due to increase in deployments, offset by a decline in non-recurring dividend income.

### *Operating expenses*

The composition of our expenses for the three months ended June 30, 2015 and June 30, 2014 was as follows (dollars in thousands):

	<b>For the three months ended</b>		<b>For the six months ended</b>	
	<b>June 30, 2015</b>	<b>June 30, 2014</b>	<b>June 30, 2015</b>	<b>June 30, 2014</b>
Interest and financing fees	\$ 4,681	\$ 2,401	\$ 9,317	\$ 4,601
Management fees, net of management fee waiver	2,587	2,200	4,997	4,094
Incentive fees	1,329	1,408	2,510	2,838
General and administrative expenses	1,170	883	2,167	2,013
Total expenses	\$ 9,767	\$ 6,892	\$ 18,991	\$ 13,546

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For the three months ended June 30, 2015, operating expenses increased \$2.9 million, or 41.7%, compared to the three months ended June 30, 2014. For the six months ended June 30, 2015, operating expenses increased \$5.4 million, or 40.2%, compared to the six months ended June 30, 2014. The increase for both the three and six month periods was primarily due to interest and financing expense. Interest and financing expenses increased period over period due to the issuance of Notes in June of 2014 and the Credit Facility in October of 2014. Management fees increased over prior period due to growth in assets under management.

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

During the three and six months ended June 30, 2015, we recognized \$15.8 million and \$25.2 million, respectively, of net realized gains on our portfolio investments. During the three and six months ended June 30, 2014, we recognized \$0.5 million and \$1.7 million, respectively, of net realized gains on our portfolio investments. The Company recognized \$14.8 million in realized gains on its two largest equity investments outstanding at March 31, 2015 (Corporate Visions, Inc. and Boot Barn Holdings, Inc.) during the second quarter and \$9.3 million in realized gains on its largest equity investment outstanding at December 31, 2015 (KBP Investments, LLC.) during the first quarter, continuing to execute its rotation strategy out of equity and into interest yielding debt 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 June 30, 2015, we had net unrealized depreciation of \$(16.2) million on portfolio investments. During the three months ended June 30, 2015, we had \$(15.7) million in net unrealized depreciation related to reversal of net unrealized appreciation on investments with net realized gains recognized during the period. For the six months ended June 30, 2015, we had net unrealized depreciation of \$(20.5) million on portfolio investments. During the six months ended June 30, 2015, we had \$(20.8) million in net unrealized depreciation related to reversal of net unrealized appreciation on investments with net realized gains recognized during the period.

For the three months ended June 30, 2014, we had a \$0.1 million increase in unrealized appreciation on portfolio investments. For the six months ended June 30, 2014, we had \$(5.6) million net unrealized depreciation on portfolio investments.

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

For the three and six months ended June 30, 2015, we recorded a net increase in net assets resulting from operations of \$4.9 million and \$14.8 million, respectively. Based on the weighted average shares of common stock outstanding for the three and six months ended June 30, 2015, our per share net increase in net assets resulting from operations was

\$0.31 and \$1.02, respectively. For the three and six months ended June 30, 2014, we recorded a net increase in net assets resulting from operations of \$6.2 million and \$7.4 million, respectively. Based on the weighted average shares of common stock outstanding for the three and six months ended June 30, 2014 our per share net increase in net assets resulting from operations was \$0.48 and \$0.57, respectively.

## Financial Condition, Liquidity and Capital Resources

The Company uses and intends to use existing cash primarily to originate investments in new and existing portfolio companies, pay dividends to our shareholders, and repay indebtedness.

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

Including the net proceeds from the Company's IPO on September 30, 2013, the Company has raised approximately \$329.4 million in net proceeds and credit availability in debt and equity offerings through June 30, 2015.

The Company issued \$113.4 million in aggregate principal amount of 7.125% fixed-rate notes in June of 2014, yielding net proceeds of \$109.1 million after underwriting costs. 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 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.

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.

On January 6, 2015, the Company entered into an Incremental Assumption Agreement, (the "Incremental Assumption Agreement"), relating to the Credit Facility. The Incremental Assumption Agreement increased the amount of borrowings available under the Credit Facility from \$50,000,000 to \$80,000,000. The \$30,000,000 increase in total commitments under the Credit Facility was executed under the "accordion" feature of the Credit Facility, which allows for an increase in total commitments under the Credit Facility up to \$150,000,000. As of June 30, 2015, the Company had no outstanding balance and \$80.0 million available on the Credit Facility.

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

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.

On February 26, 2015, the Company's board of directors authorized a program for the purpose of repurchasing up to \$12.0 million worth of its common stock. Under the repurchase program, the Company may, but it is not obligated to, repurchase its outstanding common stock in the open market from time to time provided that the Company complies with the prohibitions under its Insider Trading Policies and Procedures and the guidelines specified in Rule 10b-18 of the Securities Exchange Act of 1934, as amended, including certain price, market volume and timing constraints. Unless extended by the Company's board of directors, the Company expects the repurchase program to be in place until the earlier of March 31, 2016 or until \$12.0 million of the Company's outstanding shares of common stock have been repurchased.

During the three and six months ended June 30, 2015, the Company repurchased 224,602 shares of common stock in open market transactions for an aggregate cost (including transaction costs) of \$3.9 million. As of June 30, 2015, none of these share repurchases were unsettled. The Company is incorporated in Maryland and under the law of the state, shares repurchased are considered retired (repurchased shares become authorized but unissued shares) rather than treasury stock. As a result, the cost of the stock repurchased is recorded as a reduction to capital in excess of par value on the consolidated statement of changes in net assets.

As of June 30, 2015, Fund II had \$26.2 million in regulatory capital and \$42.2 million in SBA- guaranteed debentures outstanding and Fund III had \$75.0 million in regulatory capital and \$150.0 million in SBA-guaranteed debentures outstanding. In addition to our existing SBA-guaranteed debentures, we may, if permitted by regulation, seek to issue additional SBA-guaranteed debentures as well as other forms of leverage and borrow funds to make investments. On June 10, 2014, we received an exemptive order from the SEC exempting us, Fund II and Fund III from certain provisions of the 1940 Act (including an exemptive order granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs) and from certain reporting requirements mandated by the Securities Exchange Act of 1934, as amended, with respect to Fund II and Fund III. We intend to comply with the conditions of the order.



As of June 30, 2015, we had \$39.5 million in cash and cash equivalents, and our net assets totaled \$291.9 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 will 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 June 30, 2015 is as follows (dollars in thousands):

	<b>Contractual Obligations Payments Due by Period</b>				
	<b>Less Than 1 Year</b>	<b>1 - 3 Years</b>	<b>3 - 5 Years</b>	<b>More Than 5 Years</b>	<b>Total</b>
SBA-Guaranteed Debentures	\$ 10,000	\$ 11,500	\$ 5,000	\$ 165,700	\$ 192,200
Note Obligations	—	—	—	113,438	113,438
Total Contractual Obligations	\$ 10,000	\$ 11,500	\$ 5,000	\$ 279,138	\$ 305,638

### Distributions

In order to qualify as a RIC and to avoid corporate-level U.S. federal income tax on the income we distribute to our stockholders, we are required to distribute at least 90% of our net ordinary income and our net short-term capital gains in excess of net long-term capital losses, if any, to our stockholders on an annual basis. Additionally, we must distribute an amount at least equal to the sum of 98% of our net ordinary income (during the calendar year) plus

98.2% of our net capital gain income (during each 12-month period ending on October 31) plus any net ordinary income and capital gain net income for preceding years that were not distributed during such years and on which we paid no U.S. federal income tax to avoid a U.S. federal excise tax. To the extent that we have income available, we intend to make monthly distributions to our stockholders. 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.



The following table summarizes our distributions declared since the IPO through June 30, 2015:

<b>Date Declared</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Amount Per Share</b>
April 1, 2015	June 22, 2015	June 29, 2015	\$ 0.1567
April 1, 2015	May 21, 2015	May 28, 2015	0.1567
April 1, 2015	April 23, 2015	April 29, 2015	0.1567
February 26, 2015	December 22, 2015	December 30, 2015	0.05
February 26, 2015	November 20, 2015	November 27, 2015	0.05
February 26, 2015	October 23, 2015	October 29, 2015	0.05
February 26, 2015	September 23, 2015	September 29, 2015	0.05
February 26, 2015	August 21, 2015	August 28, 2015	0.05
February 26, 2015	July 23, 2015	July 30, 2015	0.05
February 26, 2015	June 22, 2015	June 29, 2015	0.05
February 26, 2015	May 21, 2015	May 28, 2015	0.05
February 26, 2015	April 23, 2015	April 29, 2015	0.05
February 26, 2015	March 23, 2015	March 30, 2015	0.05
January 2, 2015	March 23, 2015	March 30, 2015	0.1567
January 2, 2015	February 20, 2015	February 26, 2015	0.1567
January 2, 2015	January 22, 2015	January 29, 2015	0.1567
Total Distributions Declared			\$ 1.44

<b>Date Declared</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Amount Per Share</b>
October 2, 2014	December 19, 2014	December 30, 2014	\$ 0.1567
October 2, 2014	November 21, 2014	November 28, 2014	0.1567
October 2, 2014	October 22, 2014	October 30, 2014	0.1567
August 7, 2014	September 12, 2014	September 26, 2014	0.47
May 8, 2014	June 9, 2014	June 26, 2014	0.47
February 27, 2014	March 14, 2014	March 26, 2014	0.47
Total Distributions Declared			\$ 1.88

<b>Date Declared</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Amount Per Share</b>
November 11, 2013	December 10, 2013	December 30, 2013	\$ 0.47
Total Distributions Declared			\$ 0.47

## Related Parties

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

In addition, Capitala Investment Advisors' investment team manages CapitalSouth Partners SBIC Fund IV, L.P. ("Fund IV"), a private investment limited partnership providing financing solutions to companies that generate between \$5 million and \$50 million in annual revenues and have between \$1 million and \$5 million in annual earnings before interest, taxes, depreciation and amortization. Fund IV had its first closing in March 2013 and obtained approval for its Small Business Investment Company license from the U.S. Small Business Administration in April 2013. In addition to Fund IV, affiliates of Capitala Investment Advisors manage several other affiliated funds. Capitala Investment Advisors 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, Capitala Investment Advisors 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 Capitala Investment Advisors' allocation procedures. We will not co-invest in transactions with other entities affiliated with Capitala Investment Advisors unless we obtain an exemptive order from the SEC or do so in accordance with existing regulatory guidance. 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 Capitala Investment Advisors, pursuant to which Capitala Investment Advisors 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 of Directors, is the chief executive officer, president and a director of our Administrator, and Mr. Broyhill, a member of our Board of Directors, has an indirect controlling interest in Capitala Investment Advisors.

## 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 July 1, 2015, the Company's Board of Directors declared normal monthly distributions for July, August, and September of 2015 as set forth below:

Date Declared	Record Date	Payment Date	Distributions per Share
July 1, 2015	July 23, 2015	July 30, 2015	\$ 0.1567
July 1, 2015	August 21, 2015	August 28, 2015	\$ 0.1567
July 1, 2015	September 23, 2015	September 29, 2015	\$ 0.1567

### *Portfolio Activity*

On July 13, 2015, the Company received \$4.8 million in proceeds for liquidation of our investments in Southern Pump & Tank Company.

On July 24, 2015, the Company invested \$8.0 million in subordinated debt of Vology, Inc. yielding 15% cash interest.

On July 31, 2015, the Company invested \$27.0 million in senior secured term debt of Western Window Systems, LLC initially yielding 12.2% cash interest. The Company also invested \$3.0 million in the common stock of Western Window Systems, LLC. The Company led syndication of this investment, which included a \$5.0 million revolver and an \$18.0 million first-out term loan.

On July 31, 2015, the Company funded its \$6.0 million commitment to U.S. Well Services, LLC senior secured debt, yielding 12% interest.

**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 six months ended June 30, 2015, we did not engage in hedging activities.

As of June 30, 2015, the Company held 15 securities at a cost of \$123.3 million and a fair value of \$122.6 million, bearing a variable rate of interest. The Company's variable rate investments represent approximately 26.2% of the fair market value of total interest earning debt investments. All variable rate securities are London Interbank Offered Rate ("LIBOR") based and are subject to interest rate floors. As of June 30, 2015, all variable rate securities were yielding interest at a rate equal to the established interest rate floor. As of June 30, 2015, the Company had no outstanding balance on its revolving credit facility which has a variable rate of interest at LIBOR + 300. As of June 30, 2015, all of our other interest paying liabilities, consisting of \$192.2 million in SBA-guaranteed debentures and \$113.4 million in notes payable, were bearing interest at a fixed rate.

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

Based on our June 30, 2015 consolidated statement of assets and liabilities, the following table shows the annual impact on net income (excluding the potential related incentive fee impact) of base rate changes in interest rates (considering interest rate floors for variable rate securities) assuming no changes in our investment and borrowing structure (dollars in thousands):

Basis Point Change	Interest Income	Interest Expense	Net Income
Up 300 basis points	\$ 2,716	—	\$ 2,716
Up 200 basis points	\$ 1,446	—	\$ 1,446
Up 100 basis points	\$ 252	—	\$ 252
Down 100 basis points	—	—	—
Down 200 basis points	—	—	—
Down 300 basis points	—	—	—

**Item 4. Controls and Procedures**

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

As of June 30, 2015 (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 second quarter of 2015 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, against our Investment Advisor, Administrator or any of the Legacy Funds. From time to time, we, our Investment Advisor or Administrator, or any of the Legacy Funds may be a party to certain legal proceedings in the ordinary course of business, including proceedings relating to the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings 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, 2014, 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, 2014.

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

During the quarter ended June 30, 2015, we issued 9,751 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 June 30, 2015 was approximately \$151 thousand. Other than the shares issued under our dividend reinvestment plan during the quarter ended June 30, 2015, we did not sell any unregistered equity securities.

During the three and six months ended June 30, 2015, we repurchased 224,602 shares at a weighted average price of \$17.29 resulting in \$3.9 million paid during the three and six months ended June 30, 2015. The following table outlines repurchases of our common stock during the three and six months ended June 30, 2015:

<b>Period</b>	<b>(a) Total Number of Shares Purchased</b>	<b>(b) Average Price Paid per Share</b>	<b>(c) Total Number of Shares Purchased as Part of Publicly Announced Program</b>	<b>(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Program</b>
April 1, 2015 – June 30, 2015	224,602	\$ 17.29	224,602	\$ 8.1 million

**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:

### Exhibit

#### Number Description of Document

- |      |  |
|------|--|
| 3.1  | Articles of Amendment and Restatement <sup>(1)</sup>   |
| 3.2  | Certificate of Limited Partnership of CapitalSouth Partners Fund II Limited Partnership <sup>(2)</sup>                         |
| 3.3  | Certificate of Limited Partnership of CapitalSouth Partners SBIC Fund III, L.P. <sup>(2)</sup>                                 |
| 3.4  | Bylaws <sup>(1)</sup>  |
| 3.5  | Form of Amended and Restated Limited Partnership Agreement of CapitalSouth Partners Fund II Limited Partnership <sup>(3)</sup> |
| 3.6  | Form of Amended and Restated Agreement of Limited Partnership of CapitalSouth Partners SBIC Fund III, L.P. <sup>(3)</sup>      |
| 4.1  | Form of Common Stock Certificate <sup>(1)</sup>  |
| 4.2  | Form of Base Indenture <sup>(4)</sup>  |
| 4.3  | Form of First Supplemental Indenture <sup>(4)</sup>  |
| 4.4  | Form of Global Note (included as Exhibit A to the Form of First Supplemental Indenture) <sup>(4)</sup>                         |
| 10.1 | Form of Dividend Reinvestment Plan <sup>(1)</sup>  |
| 10.2 | Form of Investment Advisory Agreement by and between Registrant and Capitala Investment Advisors, LLC <sup>(1)</sup>           |
| 10.3 | Form of Custodian Agreement <sup>(1)</sup>   |
| 10.4 | Form of Administration Agreement by and between Registrant and Capitala Advisors Corp. <sup>(1)</sup>                          |
| 10.5 | Form of Indemnification Agreement by and between Registrant and each of its directors <sup>(1)</sup>                           |
| 10.6 | Form of Trademark License Agreement by and between Registrant and Capitala Investment Advisors, LLC <sup>(1)</sup>             |
| 10.7 |  |

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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 <sup>(5)</sup>

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 <sup>(5)</sup>

10.9 Form of Incremental Assumption Agreement, dated January 6, 2015, relating to the Senior Secured Revolving Credit Agreement, dated as of October 17, 2014, among Capitala Finance Corp., as borrower, the lenders from time to time party thereto, and ING Capital LLC, as administrative agent, arranger and bookrunner <sup>(6)</sup>

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- 10.10 First Amended and Restated Limited Liability Company Agreement of Capitala Senior Liquid Loan Fund I, LLC, dated March 24, 2015 <sup>(7)</sup>
- 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. 333-188956) filed on September 16, 2013.
- (3) Previously filed in connection with Pre-Effective Amendment No. 5 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-188956) filed on September 24, 2013.
- (4) 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.
- (5) Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on October 21, 2014.
- (6) Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on January 8, 2015.
- (7) Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on March 24, 2015.

## 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: August 10, 2015 By/s/ Joseph B. Alala III  
Joseph B. Alala III  
Chief Executive Officer  
(*Principal Executive Officer*)  
Capitala Finance Corp.

Date: August 10, 2015 By/s/ Stephen A. Arnall  
Stephen A. Arnall  
Chief Financial Officer  
(*Principal Financial and Accounting Officer*)  
Capitala Finance Corp.