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

FORM 10-K

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

For the Fiscal Year Ended December 31, 2017

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

Commission File Number	Exact name of registrant as specified in its charter, address of principal executive office, telephone number and state or other jurisdiction of incorporation or organization	I.R.S. Employer Identification Number
814-01022	**Capitala Finance Corp.** 4201 Congress St., Suite 360 Charlotte, North Carolina, 28209 Telephone: (704) 376-5502 State of Incorporation: Maryland	90-0945675

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	The NASDAQ Global Select Market
5.75% Convertible Notes due 2022	The NASDAQ Global Select Market
6.00% Notes due 2022	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934.

Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark 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).

Yes ☐ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

☐

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

Large accelerated filer ☐	Accelerated filer ☒
Non-accelerated filer ☐	Smaller reporting company ☐
	Emerging growth company ☒

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $189.6 million based on the number of shares held by non-affiliates of the registrant as of June 30, 2017, which was the last business day of the registrant's most recently completed second fiscal quarter. For the purposes of calculating this amount only, all directors and executive officers of the registrant have been treated as affiliates.

The number of shares of Capitala Finance Corp.'s common stock, $0.01 par value, outstanding as of February 26, 2018 was 15,958,511

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A relating to the registrant's 2018 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days following the end of the Company's fiscal year, are incorporated by reference in Part III of this Annual Report on Form 10-K as indicated herein.

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PART I

In this Annual Report on Form 10-K, except as otherwise indicated, the terms:

- *"we," "us," "our," "Capitala Finance" and the "Company" refer to Capitala Finance Corp., together with its consolidated subsidiaries;*
- *The "Investment Advisor" and "Capitala Investment Advisors" refer to Capitala Investment Advisors, LLC, our investment adviser; and*
- *The "Administrator" refers to Capitala Advisors Corp., our administrator.*

ITEM 1. BUSINESS

FORMATION OF OUR COMPANY

We are 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. We are 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 "Advisors Act"), and Capitala Advisors Corp. (the "Administrator") provides the administrative services necessary for us to operate. For U.S. federal income tax purposes, we have elected to be treated, and intend 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").

Our 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 in first lien loans, second lien loans and subordinated loans, and, to a lesser extent, equity securities issued by lower middle-market companies and traditional middle-market companies.

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

On September 24, 2013, we 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 our common stock (the "Formation Transactions"). Fund II, Fund III and Florida Sidecar became our wholly owned subsidiaries. Fund II and Fund III retained their SBIC licenses, continued to hold their existing investments at the time of the IPO and have continued to make new investments. The IPO consisted of the sale of 4,000,000 shares of our common stock at a price of $20.00 per share resulting in net proceeds to us 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.

During the fourth quarter of 2017, Florida Sidecar transferred all of its assets to Capitala Finance Corp. and was legally dissolved as a standalone partnership.

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

OUR INVESTMENT STRATEGY

Our investment objective is to generate both current income and capital appreciation through debt and equity investments. We expect the companies in which we invest will generally have between $4.5 million and $30 million in trailing twelve month earnings before interest, tax, depreciation and amortization ("EBITDA"). We believe our focus on direct lending to private companies enables us to receive higher interest rates and more substantial equity participation. As part of that strategy, we may invest in first lien loans, which have a first priority security interest in all or some of the borrower's assets. In addition, our first lien loans may include positions in "stretch" senior secured loans, also referred to as "unitranche" loans, which combine characteristics of traditional first lien senior secured loans and second lien loans, providing us with greater influence and security in the primary collateral of a borrower and potentially mitigating loss of principal should a borrower default. We also may invest in second lien loans, which have a second priority security interest in all or substantially all of the borrower's assets. In addition to first and second lien loans, we invest in subordinated loans, which may include mezzanine and other types of junior debt investments. Like second lien loans, our subordinated loans typically have a second lien on all or substantially all of the borrower's assets; however, the principal difference between subordinated loans and second lien loans is that in a subordinated loan, we may be subject to the interruption of cash interest payments, at the discretion of the first lien lender, upon certain events of default. In addition to debt securities, we may acquire equity or detachable equity-related interests (including warrants) from a borrower. Typically, the debt in which we invest is not initially rated by any rating agency; however, we believe that if such investments were rated, they would be rated below investment grade. Below investment grade securities, which are often referred to as "high yield" or "junk," have predominantly speculative characteristics with respect to the issuer's capacity to pay interest and repay principal. We intend to target investments that mature in four to six years from our investment.

We typically will not limit the size of our loan commitments to a specific percentage of a borrower's assets that serve as collateral for our loan, although we attempt to protect against risk of loss on our debt investments by structuring, underwriting and pricing loans based on anticipated cash flows of our borrowers. As of December 31, 2017, our Investment Advisor underwrote investments in 126 lower middle-market and traditional middle-market companies totaling more than $1.2 billion of invested capital since 2000, and we believe that a continuation of this strategy allows us to make structured investments with more attractive pricing and greater opportunities for meaningful equity participation than traditional asset-based, senior secured loans. Further, we believe that we benefit from our Investment Advisor's long-standing relationships with many private equity fund sponsors, whose participation in portfolio companies, we believe, makes repayment from refinancing, asset sales and/or sales of the borrowers themselves more likely than a strategy whereby we consider investments only in founder-owned or non-sponsored borrowers.

OUR INVESTMENT ADVISOR

We are managed by the Investment Advisor, whose investment team members have significant and diverse experience financing, advising, operating and investing in lower middle-market and middle-market companies. Moreover, our Investment Advisor's investment team has refined its investment strategy by sourcing, reviewing, acquiring and monitoring 126 portfolio companies totaling more than $1.2 billion of invested capital from 2000 through December 31, 2017. The Investment Advisor's investment team also manages CapitalSouth Partners SBIC Fund IV, L.P. ("Fund IV"), a private investment limited partnership providing financing solutions to smaller and lower middle-market companies. Fund IV had its first closing in March 2013 and obtained SBA approval for its SBIC license in April 2013. In addition to Fund IV, affiliates of the Investment Advisor may manage several affiliated funds whereby institutional limited partners in Fund IV have the opportunity to co-invest with Fund IV in portfolio investments. An affiliate of the Investment Advisor also manages Capitala Private Credit Fund V, L.P. ("Fund V"), a private investment limited partnership providing financing solutions to the lower middle-market and traditional middle-market. The Investment Advisor and its affiliates may also manage other funds in the future that may have investment mandates that are similar, in whole and in part, with ours. To the extent permitted by the 1940 Act and interpretation of the staff of the U.S. Securities and Exchange Commission (the "SEC"), the Investment Advisor and its affiliates may determine that an investment is appropriate for us and for one or more of those other funds. In such event, depending on the availability of such investment and other appropriate factors, the Investment Advisor or its affiliates may determine that we should invest side-by-side with one or more other funds. Any such investments will be made only to the extent permitted by applicable law and interpretive positions of the SEC and its staff, and consistent with the Investment Advisor's allocation procedures. We do not expect to make co-investments, or otherwise compete for investment opportunities, with Fund IV because its focus and investment strategy differs from our own. However, we do expect to make, and have made, co-investments with Fund V given its similar investment strategy.

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

Our Investment Advisor is led by Joseph B. Alala, III, our chief executive officer, chairman of our Board of Directors (the "Board"), and the managing partner and chief investment officer of our Investment Advisor, M. Hunt Broyhill, a member of the Board and a partner of our Investment Advisor, Stephen A. Arnall, our chief financial officer, and John F. McGlinn, our chief operating officer, secretary and treasurer, and a director of our Investment Advisor. Messrs. Alala, Broyhill and McGlinn serve as our Investment Advisor's investment committee. They are assisted by Christopher B. Norton, Peter Sherman, Michael S. Marr, Richard Wheelahan, Adam Richeson, Randall Fontes, Eric Althofer, and Davis Hutchens, who each serve as directors of our Investment Advisor, as well as eleven other investment professionals.

Our Investment Advisor's investment committee, as well as certain key investment team members that are involved in screening and underwriting portfolio transactions, have worked together for more than ten years. These investment professionals have an average of over 20 years of experience in various finance-related fields, including operations, corporate finance, investment banking, business law and merchant banking, and have collectively developed a broad network of contacts that can offer us investment opportunities. Much of our Investment Advisor's investment team has worked together screening opportunities, underwriting new investments and managing a portfolio of investments in lower middle-market and traditional middle-market companies through two recessions, a credit crunch, the dot-com boom and bust and a historic, leverage-fueled asset valuation bubble.

INVESTMENTS

We will engage in various investment strategies from time to time in order to achieve our overall lending and investment objectives. Our strategies will generally require current cash yields and sensible leverage and fixed charge coverage ratios and either a first or second lien position (subject to limited instances in which we will not obtain security) in the collateral of the portfolio company. The strategy we select will depend upon, among other things, market opportunities, the skills and experience of our Investment Advisor's investment team, the result of our financial, operational and strategic evaluation of the opportunity, and our overall portfolio composition. Most of our existing debt investments offer, and we expect most of our future debt investments will offer, the opportunity to participate in a borrower's equity performance through warrant participation, direct equity ownership or otherwise, and many notes that we purchase will require the borrower to pay an early termination fee. Collectively, these attributes have been, and are expected to be, important contributors to the returns generated by our Investment Advisor's investment team.

The Investment Advisor's investment team uses a disciplined investment portfolio monitoring and risk management process that emphasizes strict underwriting standards and guidelines, strong due diligence investigation, regular portfolio review, analysis and performance-guided responses, and proper investment diversification. We allocate capital among different industries, geographies and private equity sponsors on the basis of relative risk/reward profiles as a function of their associated downside risk, volatility, perceived fundamental risk and our ability to obtain favorable investment protection terms.

Types of Investments

We will target debt investments that yield meaningful current income and, in many cases, provide the opportunity for capital appreciation through equity securities. In each case, the following criteria and guidelines are applied to the review of a potential investment; however, not all criteria are met in every single investment in our portfolio, nor do we guarantee that all criteria will be met in the investments we will make in the future.

- ***Established Companies With Positive Cash Flow.*** We seek to invest in established companies with a history of generating revenues and positive cash flows. We intend to focus on companies with a history of profitability and minimum trailing twelve month EBITDA of between \$4.5 million and \$30 million. We do not intend to invest in start-up companies, distressed or "turn-around" situations or companies with business plans that we do not understand.
- ***Experienced Management Teams with Meaningful Investment.*** We seek to invest in companies in which senior or key managers have significant company or industry-level experience and have significant equity ownership. It has been our experience that these management teams are more committed to the company's success and more likely to manage the company in a manner that protects our debt and equity investments.
- ***Significant Invested Capital.*** We believe that the existence of an appropriate amount of equity beneath our debt capital provides valuable support for our investment. In addition, the degree to which the particular investment is a meaningful one for the portfolio company's financial sponsor, and the financial sponsor's ability and willingness to invest additional equity capital as and to the extent necessary, are also important considerations.
- ***Appropriate Capital Structures.*** We seek to invest in companies that are appropriately capitalized. First, we examine the amount of equity that is being invested by the company's private equity sponsor to determine whether there is a sufficient capital cushion beneath our invested capital. We also analyze the amount of leverage and the characteristics of senior debt with lien priority over our investment.
- ***Strong Competitive Position.*** We intend to invest in companies that have developed strong, defensible product or service offerings within their respective market segments. These companies should be well positioned to capitalize on organic and strategic growth opportunities, and should compete in industries with strong fundamentals and meaningful barriers to entry. We further analyze prospective portfolio investments in order to identify competitive advantages within their respective industries, which may result in superior operating margins or industry-leading growth.
- ***Customer and Supplier Diversification.*** We expect to invest in companies with sufficiently diverse customer and supplier bases. We believe these companies will be better able to endure industry consolidation, economic contraction and increased competition than those that are not sufficiently diversified. However, we also recognize that from time to time, an attractive investment opportunity with some concentration among its customer base or supply chain will present itself. We believe that concentration issues can be evaluated and, in some instances (whether due to supplier or customer product or platform diversification, the existence and quality of long-term agreements with such customers or suppliers or other select factors), mitigated, thus presenting a superior risk-adjusted pricing scenario.

Debt Investments

The Investment Advisor's investment team tailors the terms of each debt investment to the facts and circumstances of the transaction, the needs of the prospective portfolio company and, as applicable, its financial sponsor, negotiating a structure that seeks to protect our rights and manage our risk while creating incentives for the portfolio company to achieve its business plan. As of December 31, 2017, 64.5% of our debt investments were secured by a first lien on the assets of the portfolio company, and 35.5% of our debt investments were secured by a second lien on the assets of the portfolio company. We expect our primary source of return to be the monthly cash interest we will collect on our debt investments. We also typically seek board observation rights with each portfolio company and we offer (and have historically provided) managerial and strategic assistance to these companies. We seek to further protect invested principal by negotiating appropriate affirmative, negative and financial covenants in our debt documents that are conservative enough to represent a prudent cushion at closing or to budgeted projections, but that are flexible enough to afford our portfolio companies and their financial sponsors sufficient latitude to allow them to grow their businesses. Typical covenants include default triggers and remedies (including penalties), lien protection, leverage and fixed charge coverage ratios, change of control provisions and put rights. Most of our loans feature call protection to enhance our total return on debt investments that are repaid prior to maturity.

Most of our debt investments are structured as first lien loans, and as of December 31, 2017, 64.5% of the fair value of our debt investments consisted of such investments. First lien loans may contain some minimum amount of principal amortization, excess cash flow sweep feature, prepayment penalties, or any combination of the foregoing. First lien loans are secured by a first priority lien in existing and future assets of the borrower and may take the form of term loans or delayed draw facilities. In some cases, first lien loans may be subordinated, solely with respect to the payment of cash interest, to an asset based revolving credit facility. Unitranche debt, a form of first lien loan, typically involves issuing one debt security that blends the risk and return profiles of both senior secured and subordinated debt in one debt security, bifurcating the loan into a first-out tranche and last-out tranche. As of December 31, 2017, 13.7% of our first lien loans consisted of last-out loans. We believe that unitranche debt can be attractive for many lower middle-market and traditional middle-market businesses, given the reduced structural complexity, single lender interface and elimination of intercreditor or potential agency conflicts among lenders.

We may also invest in debt instruments structured as second lien loans. On a fair market value basis, 8.2% of our debt investments consisted of second lien loans as of December 31, 2017. Second lien loans are loans which have a second priority security interest in all or substantially all of the borrower's assets, and which are not subject to the blockage of cash interest payments to us at the first lien lender's discretion.

In addition to first and second lien loans, we may also invest in subordinated loans. On a fair market value basis, 27.3% of our debt investments consisted of subordinated loans as of December 31, 2017. Subordinated loans typically have a second lien on all or substantially all of the borrower's assets, and unlike second lien loans, may be subject to the interruption of cash interest payments upon certain events of default, at the discretion of the first lien lender. Our subordinated loans are typically issued with five year terms.

Some of our debt investments have payment-in-kind ("PIK") interest, which is a form of interest that is not paid currently in cash, but is accrued and added to the loan balance until paid at the end of the term. While we generally seek to minimize the percentage of our fixed return that is in the form of PIK interest, we sometimes receive PIK interest due to prevailing market conditions that do not support the overall blended interest yield on our debt investments being paid in all-cash interest. As of December 31, 2017, our weighted average PIK yield, exclusive of the impact on non-accrual debt investments, is 1.5%. As of December 31, 2017, the weighted average annualized cash yield on our debt portfolio was 11.3%, exclusive of the impact of non-accrual debt investments. In addition to yield in the form of current cash and PIK interest, some of our debt investments include an equity component, such as a warrant to purchase a common equity interest in the borrower for a nominal price.

Equity Investments

When we make a debt investment, we may be granted equity participation in the form of detachable warrants to purchase common equity in the company in the same class of security that the owners or equity sponsors receive upon funding. In addition, we may make non-control equity co-investments in conjunction with a loan transaction with a borrower. The Investment Advisor's investment team generally seeks to structure our equity investments, such as direct equity co-investments, to provide us with minority rights provisions and, to the extent available, event-driven put rights. They also seek to obtain limited registration rights in connection with these investments, which may include "piggyback" registration rights. In addition to warrants and equity co-investments, our debt investments in the future may contain a synthetic equity position.

INVESTMENT PROCESS

Our Investment Advisor's investment team is led by its investment committee and is responsible for all aspects of our investment process. The current members of the investment committee are Joseph B. Alala, III, our chief executive officer, chairman of our Board and the managing partner and chief investment officer of our Investment Advisor, M. Hunt Broyhill, a partner of our Investment Advisor, and John F. McGlinn, our chief operating officer, secretary and treasurer, and a director of our Investment Advisor. Peter Sherman serves as chief risk officer and a director of our Investment Advisor. Richard Wheelahan, our chief compliance officer and general counsel, Christopher B. Norton, Michael S. Marr, Randall Fontes, Adam Richeson, Eric Althofer, and Davis Hutchens, serve as directors of our Investment Advisor, and Casey Swercheck, Danny Speake, Christian MacCarron, and Jack Vander Leeuw each serve as vice presidents of our Investment Advisor. While the investment strategy involves a team approach, whereby potential transactions are screened by various members of the investment team, Mr. Alala and one other member of the investment committee of the Investment Advisor must approve investments in order for them to proceed. Messrs. Alala and McGlinn meet weekly and, together with Mr. Broyhill, on an as needed basis, depending on the nature and volume of investment opportunities. The Investment Advisor's investment committee has worked together for over fifteen years. The stages of our investment selection process are as follows:

Deal Generation/Origination

Deal generation and origination is maximized through long-standing and extensive relationships with industry contacts, brokers, commercial and investment bankers, entrepreneurs, service providers (such as lawyers and accountants), as well as current and former clients, portfolio companies and investors. Our Investment Advisor's investment team supplements these lead generators by also utilizing broader marketing efforts, such as attendance at prospective borrower industry conventions, an active calling effort to investment banking boutiques, private equity firms and independent sponsors that are also investing in high quality lower middle-market and traditional middle-market companies, and, most importantly, based on our Investment Advisor's track record as a responsive, flexible, value-add lender and co-investor, as demonstrated by 126 investments in lower middle-market and traditional middle-market businesses and equity co-investments with reputed private equity firms since 2000. We believe we have developed a reputation as a knowledgeable and reliable source of capital, providing value-added industry advice and financing assistance to borrowers' businesses and in executing financial sponsors' growth strategies. Furthermore, with offices throughout the United States, we have the ability to cover a large geographical area and to market to unique groups from each office. Specifically, our Charlotte, Raleigh, Fort Lauderdale, Atlanta, and Los Angeles offices cover significant territory that is traditionally underserved, allowing us to source a high volume of direct deal flow.

Screening

All potential investments that are received are screened for suitability and consistency with our investment criteria (see "— Due Diligence and Underwriting," below). In screening potential investments, our Investment Advisor's investment team utilizes the same value-oriented investment philosophy they employed in their work with the Legacy Funds and commits resources to managing downside exposure. If a potential investment meets our basic investment criteria, a deal team is assigned to perform preliminary due diligence. In doing so, we consider some or all of the following factors:

- A comprehensive financial model that we prepare based on quantitative analysis of historical financial performance, financial projections made by management or the financial sponsor, and pro forma financial ratios assuming an investment consistent with possible structures. In analyzing our model, we test various investment structures, pricing options, downside scenarios and other sensitivities in order to better understand potential risks and possible financial covenant ratios;

- The competitive landscape and industry dynamics impacting the potential portfolio company;
- Strengths and weaknesses of the potential investment's business strategy and industry outlook; and
- Results of a broad qualitative analysis of the company's products or services, market position and outlook, customers, suppliers and quality of management.

If the results of this preliminary due diligence are satisfactory, the deal team prepares an executive summary that is presented to our Investment Advisor's investment committee in a meeting that includes all members of the portfolio and investment teams. This executive summary includes the following areas:

- Company history and summary of product(s) and/or service(s);
- An overview of investors, anticipated capital sources and transaction timing;
- Investment structure and expected returns, including initial projected financial ratios;
- Analysis of historical financial results and key assumptions;
- Analysis of the company's business strategy;
- Analysis of the financial sponsor's relevant experience or expected strategy;
- Investment strengths, weaknesses and priority issues to be addressed in due diligence; and
- Pro forma capitalization and ownership.

If our investment committee recommends moving forward, we will issue a non-binding term sheet or indication of interest to the potential portfolio company and, when applicable, its financial sponsor. If a term sheet is successfully negotiated, we will begin more formal due diligence and underwriting as we progress towards the ultimate investment approval and closing.

Due Diligence and Underwriting

The completion of due diligence deliverables is led by at least two investment professionals. However, all investment and portfolio team members are regularly updated with due diligence progress, especially any issues that emerge. The two investment professionals leading the due diligence efforts are typically assigned to the original deal team that worked on the executive summary. However, post-term sheet deal teams sometimes contain one or more additional investment professionals and may include other professionals from business development, portfolio or other areas if a particular skill or experience set would be especially valuable in the due diligence process. The members of the underwriting team complete due diligence and analyze the relationships among the prospective portfolio company's business plan, operations and expected financial performance. Due diligence consists of some or all of the following:

- On-site visits with management and relevant key employees;
- In-depth review of historical and projected financial statements, including covenant calculation work sheets;
- Interviews with customers and suppliers;
- Management background checks;
- Review of reports by third-party accountants, outside counsel and other industry, operational or financial experts, whether retained by us or the financial sponsor;
- Review of material contracts; and
- Review of financial sponsor's due diligence package and internal executive summaries.

Typically, we utilize outside experts to analyze the legal affairs, accounting systems and financial results and, where appropriate, we engage specialists to investigate certain issues. During the underwriting process, significant, ongoing attention is devoted to sensitivity analyses regarding whether a company might bear a significant "downside" case and remain profitable and in compliance with assumed financial covenants. These "downside" scenarios typically involve assumptions regarding the loss of key customers and/or suppliers, an economic downturn, adverse regulatory changes and other relevant stressors that we attempt to simulate in our quantitative and qualitative analyses. Further, we continually examine the effect of these scenarios on financial ratios and other metrics.

During the underwriting process, the executive summary that was completed for the initial investment committee presentation is updated and changes are presented at subsequent, weekly meetings of the investment committee for continued discussion and, to the extent applicable, the investment committee issues new instructions to the underwriting team from the investment committee.

Approval, Documentation and Closing

The underwriting team for the proposed investment presents the updated executive summary and key findings from due diligence to the investment committee on an ongoing, weekly basis. Prior to the commencement of documentation, approval from the investment committee is sought and, if approved, the underwriting professionals heretofore involved proceed to documentation.

At all times during the documentation process, the underwriting professionals who conducted the due diligence remain involved; likewise, all extensively negotiated documentation decisions are made by the lead underwriting team member, in accordance with input from at least one investment committee member and guidance from outside counsel. As and to the extent necessary, key documentation challenges are brought before the investment committee for prompt discussion and resolution. Upon the completion of satisfactory documentation and the satisfaction of closing conditions, final approval is sought from the investment committee before closing and funding.

ONGOING RELATIONSHIPS WITH PORTFOLIO COMPANIES

Monitoring

Our Investment Advisor monitors our portfolio companies on an ongoing basis. It monitors the financial trends of each portfolio company to determine if it is meeting its business plan and to assess the appropriate course of action for each company. We generally require our portfolio companies to provide annual audited financial statements and quarterly unaudited financial statements, in each case, with management discussion and analysis and covenant compliance certificates, and monthly unaudited financial statements. Using the monthly financial statements, we calculate and evaluate all financial covenants and additional financial coverage ratios that might not be part of our covenant package in the loan documents. For purposes of analyzing a portfolio company's financial performance, we may adjust their financial statements to reflect pro forma results in the event of a recent change of control, sale, acquisition or anticipated cost savings.

Our Investment Advisor has several methods of evaluating and monitoring the performance and fair value of our investments, including the following:

- Assessment of success in adhering to each portfolio company's business plan and compliance with covenants;
- Periodic and regular contact with portfolio company management and, if appropriate, the financial or strategic sponsor, to discuss financial position, requirements and accomplishments;
- Comparisons to our other portfolio companies in the industry, if any;
- Attendance at and participation in the board meetings; and
- Review of monthly and quarterly financial statements and financial projections for portfolio companies.

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

As part of our valuation procedures, we risk rate all of our investments. In general, our investment rating system uses a scale of 1 to 5, with 1 being the lowest probability of default and principal loss. Our internal rating is not an exact system, but 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	Summary Description
1	In general, the investment may be performing above our internal expectations. Full return of principal and interest is expected. Capital gain is expected.
2	In general, the investment may be performing within our internal expectations, and potential risks to the applicable investment are considered to be neutral or favorable compared to any potential risks at the time of the original investment. All new investments are initially given this rating.
3	In general, the investment may be performing below our internal expectations and therefore, investments in this category may require closer internal monitoring; however, the valuation team believes that no loss of investment return (interest and/or dividends) or principal is expected. The investment also may be out of compliance with certain financial covenants.
4	In general, the investment may be performing below internal expectations and quantitative or qualitative risks may have increased substantially since the original investment. Loss of some or all principal is expected.
5	In general, the investment may be performing substantially below our internal expectations and a number of quantitative or qualitative risks may have increased substantially since the original investment. Loss of some or all principal is expected.

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

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

	As of December 31, 2017		As of December 31, 2016	
Investment Rating	Investments at Fair Value	Percentage of Total Investments	Investments at Fair Value	Percentage of Total Investments
1	$ 191,204	38.2%	$ 183,826	33.9%
2	186,445	37.3	215,058	39.7
3	97,309	19.5	125,381	23.2
4	24,981	5.0	17,374	3.2
5	—	—	—	—
Total	$ 499,939	100.0%	$ 541,639	100.0%

AGREEMENTS

Investment Advisory Agreement

Our Investment Advisor is registered as an investment adviser under the Advisers Act. 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.

Management Fee

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 Capitala Finance level, excluding cash and cash equivalents held by the Legacy Funds that were acquired by Capitala Finance in connection with the Formation Transactions.

The incentive fee consists of the following two parts:

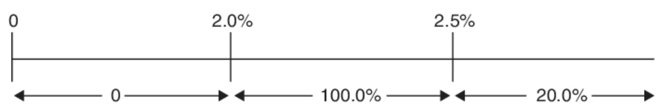
The first part of the incentive fee is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (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 an administration agreement between us and the administrator (the "Administration Agreement"), and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with PIK interest and zero coupon securities), accrued income that we have not yet received in cash. Pre-incentive fee net investment income does not include any realized capital gains, computed net of all realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a hurdle of 2.0% per quarter (8.0% annualized). Our net investment income used to calculate this part of the incentive fee is also included in the amount of our gross assets used to calculate the 1.75% base management fee. We pay the Investment Advisor an incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle of 2.0%;
- 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle but is less than 2.5% in any calendar quarter (10.0% annualized). We refer to this portion of our pre-incentive fee net investment income (which exceeds the hurdle but is less than 2.5%) as the “catch-up.” The “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 Investment Advisor has voluntarily agreed to waive all or such portion of the quarterly incentive fees earned by the Investment Advisor that would otherwise cause our quarterly net investment income to be less than the distribution payments declared by our Board. Quarterly incentive fees are earned by the Investment Advisor pursuant to the Investment Advisory Agreement. Incentive fees subject to the waiver cannot exceed the amount of incentive fees earned during the period, as calculated on a quarterly basis. The Investment Advisor will not be entitled to recoup any amount of incentive fees that it waives. The waiver was effective in the fourth quarter of 2015 and will continue unless otherwise publicly disclosed by the Company.

The following is a graphical representation of the calculation of the income-related portion of the incentive fee:

Quarterly Incentive Fee Based on Net Investment Income
Pre-incentive fee net investment income
(expressed as a percentage of the value of net assets)



Percentage of pre-incentive fee net investment income allocated to the Capitala Investment Advisors

These calculations are appropriately pro-rated for any period of less than three months and adjusted for any share issuances or repurchases during the relevant quarter. You should be aware that a rise in the general level of interest rates can be expected to lead to higher interest rates applicable to our debt investments. Accordingly, an increase in interest rates would make it easier for us to meet or exceed the incentive fee hurdle rate and may result in a substantial increase of the amount of incentive fees payable to our Investment Advisor with respect to pre-incentive fee net investment income.

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

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

Examples of Quarterly Incentive Fee Calculation

Example 1: Income Related Portion of Incentive Fee*

Alternative 1:

Assumptions

Investment income (including interest, dividends, fees, etc.) = 1.25%

Hurdle rate(1) = 2.0%

Management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%
Pre-incentive fee net investment income

(investment income – (management fee + other expenses)) = 0.55%

Pre-incentive net investment income does not exceed hurdle rate, therefore there is no incentive fee.

Alternative 2:

Assumptions

Investment income (including interest, dividends, fees, etc.) = 2.9%

Hurdle rate(1) = 2.0%

Management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%
Pre-incentive fee net investment income

(investment income – (management fee + other expenses)) = 2.2%

Incentive fee = 100% × pre-incentive fee net investment income, subject to the "catch-up"(4)

= 100% × (2.2% – 2.0%)

= 0.20%

Pre-incentive fee net investment income exceeds the hurdle rate, but does not fully satisfy the "catch-up" provision, therefore the income related portion of the incentive fee is 0.20%.

Alternative 3:

Assumptions

Investment income (including interest, dividends, fees, etc.) = 3.50%

Hurdle rate(1) = 2.0%

Management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%
Pre-incentive fee net investment income

(investment income – (management fee + other expenses)) = 2.80%

Incentive fee = 20% × pre-incentive fee net investment income, subject to "catch-up"(4)
Incentive fee = 100% × "catch-up" + (20% × (pre-incentive fee net investment income – 2.5%))

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* The hypothetical amount of pre-incentive fee net investment income shown is based on a percentage of total net assets.

Catch-up $= 2.5\% - 2.0\%$
$= 0.5\%$

Incentive fee $= (100\% \times 0.5\%) + (20\% \times (2.80\% - 2.5\%))$

$= 0.5\% + (20\% \times 0.3\%)$

$= 0.5\% + 0.06\%$

$= 0.56\%$

Pre-incentive fee net investment income exceeds the hurdle rate, and fully satisfies the "catch-up" provision, therefore the income related portion of the incentive fee is 0.56%.

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(1) Represents 8.0% annualized hurdle rate.

(2) Represents 2.00% annualized management fee.

(3) Excludes organizational and offering expenses.

(4) The "catch-up" provision is intended to provide the Investment Advisor with an incentive fee of 20% on all of Capitala Finance's pre-incentive fee net investment income as if a hurdle rate did not apply when its net investment income exceeds 2.5% in any calendar quarter.

Example 2: Capital Gains Portion of Incentive Fee

Alternative 1:

Assumptions

- Year 1: $20 million investment made in Company A ("Investment A"), and $30 million investment made in Company B ("Investment B")
- Year 2: Investment A sold for $50 million and fair market value ("FMV") of Investment B determined to be $32 million
- Year 3: FMV of Investment B determined to be $25 million
- Year 4: Investment B sold for $31 million

The capital gains portion of the incentive fee would be:

- Year 1: None
- Year 2: Capital gains incentive fee of $6 million ($30 million realized capital gains on sale of Investment A multiplied by 20%)
- Year 3: None

$5 million (20% multiplied by ($30 million cumulative capital gains less $5 million cumulative capital depreciation)) less $6 million (previous capital gains fee paid in Year 2).

- Year 4: Capital gains incentive fee of $200,000

$6.2 million ($31 million cumulative realized capital gains multiplied by 20%) less $6 million (capital gains fee taken in Year 2).

Alternative 2:

Assumptions

- Year 1: $20 million investment made in Company A ("Investment A"), $30 million investment made in Company B ("Investment B") and $25 million investment made in Company C ("Investment C")
- Year 2: Investment A sold for $50 million, FMV of Investment B determined to be $25 million and FMV of Investment C determined to be $25 million
- Year 3: FMV of Investment B determined to be $27 million and Investment C sold for $30 million

- Year 4: FMV of Investment B determined to be $24 million
- Year 5: Investment B sold for $20 million

The capital gains incentive fee, if any, would be:

- Year 1: None
- Year 2: $5 million capital gains incentive fee

20% multiplied by $25 million ($30 million realized capital gains on Investment A less unrealized capital depreciation on Investment B).

- Year 3: $1.4 million capital gains incentive fee(1)

$6.4 million (20% multiplied by $32 million ($35 million cumulative realized capital gains less $3 million unrealized capital depreciation)) less $5 million capital gains fee received in Year 2.

- Year 4: None
- Year 5: None

$5 million (20% multiplied by $25 million (cumulative realized capital gains of $35 million less realized capital losses of $10 million)) less $6.4 million cumulative capital gains fee paid in Year 2 and Year 3.

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(1) As illustrated in Year 3 of Alternative 2 above, if the Company were to be wound up on a date other than December 31 of any year, the Company may have paid aggregate capital gain incentive fees that are more than the amount of such fees that would be payable if the Company had been wound up on December 31 of such year.

Example 3: Application of the Incentive Fee Deferral Mechanism

Assumptions

- In each of Years 1 through 4 in this example pre-incentive fee net investment income equals $40.0 million per year, which we recognized evenly in each quarter of each year and paid quarterly. This amount exceeds the hurdle rate and the requirement of the “catch-up” provision in each quarter of such year. As a result, the annual income related portion of the incentive fee, before the application of the deferral mechanism in any year is $8.0 million ($40.0 million multiplied by 20%). All income-related incentive fees were paid quarterly in arrears.
- In each year preceding Year 1, we did not generate realized or unrealized capital gains or losses, no capital gain-related incentive fee was paid and there was no deferral of incentive fees.
- Year 1: We did not generate realized or unrealized capital gains or losses.
- Year 2: We realized a $30.0 million capital gain and did not otherwise generate realized or unrealized capital gains or losses.
- Year 3: We recognized $5.0 million of unrealized capital depreciation and did not otherwise generate realized or unrealized capital gains or losses.
- Year 4: We realized a $6.0 million capital gain and did not otherwise generate realized or unrealized capital gains or losses.

	Income Related Incentive Fee Accrued Before Application of Deferral Mechanism	Capital Gains Related Incentive Fee Accrued Before Application of Deferral Mechanism	Incentive Fee Calculations	Incentive Fees Paid and Deferred
Year 1	$8.0 million ($40.0 million multiplied by 20%)	None	$8.0 million	Incentive fees of $8.0 million paid; no incentive fees deferred
Year 2	$8.0 million ($40.0 million multiplied by 20%)	$6.0 million (20% of $30.0 million)	$14.0 million	Incentive fees of $14.0 million paid; no incentive fees deferred
Year 3	$8.0 million ($40.0 million multiplied by 20%)	None (20% of cumulative net capital gains of $25.0 million ($30.0 million in cumulative realized gains less $5.0 million in cumulative unrealized capital depreciation) less $6.0 million of capital gains fee paid in Year 2)	$7.0 million (20% of the sum of (a) our pre-incentive fee net investment income, (b) our net unrealized appreciation or depreciation during such period and (c) our net realized capital gains or losses during Year 3)	Incentive fees of $7.0 million paid; $8.0 million of incentive fees accrued but payment restricted to $7.0 million; $1.0 million of incentive fees deferred
Year 4	$8.0 million ($40.0 million multiplied by 20%)	$0.2 million (20% of cumulative net capital gains of $31.0 million ($36.0 million cumulative realized capital gains less $5.0 million cumulative unrealized capital depreciation) less $6.0 million of capital gains fee paid in Year 2)	$8.2 million	Incentive fees of $9.2 million paid ($8.2 million of incentive fees accrued in Year 4 plus $1.0 million of deferred incentive fees); no incentive fees deferred

Payment of Our Expenses

The investment team of our Investment Advisor and their respective staffs, when and to the extent engaged in providing investment advisory and management services, and the compensation and routine overhead expenses of such personnel allocable to such services, are provided and paid for by the Investment Advisor. We bear all other costs and expenses of our operations and transactions, including (without limitation):

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

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

Duration and Termination

The Investment Advisory Agreement was initially approved by the Board on June 10, 2013 and signed on September 24, 2013. The Investment Advisory Agreement was most recently re-approved by the Board, including by a majority of our non-interested directors, at an in-person meeting on August 3, 2017. Unless earlier terminated as described below, the Investment Advisory Agreement will remain in effect from year to year if approved annually by our Board or by the affirmative vote of the holders of a majority of our outstanding voting securities, including, in either case, approval by a majority of our directors who are not parties to such agreement or who are not "interested persons" of any such party, as such term is defined in Section 2(a)(19) of the 1940 Act. The Investment Advisory Agreement will automatically terminate in the event of its assignment. The Investment Advisory Agreement may also be terminated by either party without penalty upon not less than 60 days' written notice to the other party. See "Risk Factors — Risks Relating to Our Business and Structure — Capitala Investment Advisors has the right to resign on 60 days' notice and we may not be able to find a suitable replacement within such time, resulting in a disruption in our operations that could adversely affect our financial condition, business and results of operations."

Indemnification

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, the Investment Advisor and its officers, managers, partners, agents, employees, controlling persons, members and any other person or entity affiliated with it are entitled to indemnification from Capitala Finance for any damages, liabilities, costs and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) arising from the rendering of the Investment Advisor's services under the Investment Advisory Agreement or otherwise as an investment adviser of Capitala Finance.

Organization of the Investment Advisor

The Investment Advisor is a Delaware limited liability company. The principal executive offices of the Investment Advisor are located at 4201 Congress Street, Suite 360, Charlotte, North Carolina 28209.

Administration Agreement

Capitala Advisors Corp., a North Carolina corporation, serves as our administrator. The principal executive offices of our Administrator are located at 4201 Congress Street, Suite 360, Charlotte, North Carolina 28209. The Administrator, pursuant to a sub-administration agreement, has engaged U.S. Bancorp Fund Services, LLC to act on behalf of the Administrator in its performance of certain administrative services for us. The principal office of U.S. Bancorp Fund Services, LLC is 777 East Wisconsin Avenue, Milwaukee, WI 53202. Pursuant to the Administration Agreement, our administrator furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Under the Administration Agreement, 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 their respective 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. Unless terminated earlier in accordance with its terms, the Administration Agreement will remain in effect if approved annually by our Board. On August 3, 2017, 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.

Our Administrator also provides administrative services to our Investment Advisor. As a result, the Investment Advisor will also reimburse our Administrator for its allocable portion of our Administrator's overhead, including rent, the fees and expenses associated with performing compliance functions for the Investment Advisor, and its allocable portion of the compensation of any administrative support staff.

The Administration Agreement provides that, absent willful misfeasance, bad faith or negligence in the performance of its duties or by reason of the reckless disregard of its duties and obligations, our Administrator and its officers, managers, partners, agents, employees, controlling persons, members and any other person or entity affiliated with it are entitled to indemnification from Capitala Finance 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 Capitala Finance.

License Agreement

We have entered into a license agreement with the Investment Advisor pursuant to which the Investment Advisor has agreed to grant us a non-exclusive, royalty-free license to use the name "Capitala." Under this agreement, we have a right to use the Capitala name for so long as the Investment Advisory Agreement with the Investment Advisor is in effect. Other than with respect to this limited license, we will have no legal right to the "Capitala" name.

Staffing

Capitala Finance has no employees. Mr. Alala, through his financial interests in the Investment Advisor, will be entitled to a portion of any investment advisory fees paid by Capitala Finance to the Investment Advisor. Our other executive officers are employees of our Administrator and perform their functions under the terms of our Administration Agreement.

Our day-to-day investment operations are managed by the Investment Advisor. The Investment Advisor's investment team currently consists of the members of its investment committee, Messrs. Alala, McGlinn and

Broyhill, and a team of nineteen additional investment professionals. The Investment Advisor may hire additional investment professionals, based upon its needs, in the future. See "— Investment Advisory Agreement."

In addition, we reimburse our Administrator for our allocable portion of overhead and other expenses incurred by it in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions, and the compensation of our chief financial officer, chief compliance officer, and their respective administrative support staff. See "— Administration Agreement."

VALUATION PROCESS AND DETERMINATION OF NET ASSET VALUE

We determine the net asset value of our investment portfolio each quarter by subtracting our total liabilities from the fair value of our gross assets.

We conduct the valuation of our assets, pursuant to which our net asset value shall be determined, at all times consistent with U.S. generally accepted accounting principles ("U.S. GAAP") and the 1940 Act. Our valuation procedures are set forth in more detail below:

Securities for which market quotations are readily available on an exchange shall be valued at such price as of the closing price on the day of valuation. We may also obtain quotes with respect to certain of our investments from pricing services or brokers or dealers in order to value assets. When doing so, we determine whether the quote obtained is sufficient according to U.S. GAAP to determine the fair value of the security. If determined adequate, we use the quote obtained.

Securities for which reliable market quotations are not readily available or for which the pricing source does not provide a valuation or methodology or provides a valuation or methodology that, in the judgment of our Investment Advisor or the Board, does not represent fair value, which we expect will represent a substantial majority of the investments in our portfolio, shall be valued as follows: (i) each portfolio company or investment is initially valued by the investment professionals responsible for the portfolio investment; (ii) preliminary valuation conclusions are documented and discussed with our senior management; (iii) independent third-party valuation firms engaged by, or on behalf of, the Board will conduct independent appraisals, review management's preliminary valuations and prepare separate preliminary valuation conclusions on a selected basis such that each portfolio investment shall be independently reviewed at least annually (investments will not be selected for such review, however, if they (a) have a value as of the previous quarter of less than 1.0% of our gross assets as of the previous quarter, or (b) have a value as of the current quarter of less than 1.0% of our gross assets as of the previous quarter, after taking into account any repayment of principal during the current quarter); and (iv) the Board will discuss valuations and determine the fair value of each investment in our portfolio in good faith based on the input of the Investment Advisor and, where appropriate, the respective third-party valuation firms.

The recommendation of fair value will generally be based on the following factors, as relevant:

- the nature and realizable value of any collateral;
- the portfolio company's ability to make payments;
- the portfolio company's earnings and discounted cash flow;
- the markets in which the issuer does business; and
- comparisons to publicly traded securities.

Securities for which market quotations are not readily available or for which a pricing source is not sufficient may include, but are not limited to, the following:

- private placements and restricted securities that do not have an active trading market;
- securities whose trading has been suspended or for which market quotes are no longer available;
- debt securities that have recently gone into default and for which there is no current market;
- securities whose prices are stale;

- securities affected by significant events; and
- securities that the Investment Advisor believes were priced incorrectly.

Determination of fair value involves subjective judgments and estimates not susceptible to substantiation by auditing procedures. Accordingly, under current auditing standards, the notes to our financial statements will refer to the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on our financial statements. In addition, the SBA has established certain valuation guidelines for SBICs to follow when valuing portfolio investments.

In making the good faith determination of the value of these securities, we start with the cost basis of the security, which includes the amortized original issue discount and PIK interest or dividends, if any. We prepare the valuations of our investments in portfolio companies using the most recent portfolio company financial statements and forecasts. We also consult updates that we receive from senior management members at portfolio companies, whether solicited for valuation purposes, or received in the ordinary course of our portfolio monitoring or due diligence process. These updates include information such as industry trends, new product development or service offerings and other operational or strategic issues.

For debt securities that are not publicly traded or for which there is no market, we begin with our investment rating of the security as described above. Using this investment rating, we seek to determine the value of the security as if we intended to sell the security in a current sale. The factors that may be taken into account in arriving at fair value include the following, as applicable: the portfolio company's ability to service its interest and principal payment obligations, its estimated earnings and projected discounted cash flows, the nature and realizable value of any collateral, the financial environment in which the portfolio company operates, comparisons to securities of similar publicly traded companies, statistical ratios compared to lending standards and to other similarly situated securities, and other relevant factors.

As part of the valuation process, the audit committee reviews the preliminary evaluations prepared by the independent valuation firm engaged by the Board, as well as management's valuation recommendations. Management and the independent valuation firm respond to the preliminary evaluation to reflect comments provided by the audit committee. The audit committee reviews the final valuation report and management's valuation recommendations and makes a recommendation to the Board based on its analysis of the methodologies employed and the various weights that should be accorded to each portion of the valuation as well as factors that the independent valuation firm and management may not have considered in their evaluation process. The Board then evaluates the audit committee recommendations and undertakes a similar analysis to determine the fair value of each investment in the portfolio in good faith.

Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for such investments, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to differ from the valuations assigned at any time. For a discussion of the risks inherent in determining the fair value of securities for which readily available market values do not exist, see "Risk Factors."

Determinations in Connection with Offerings

In connection with certain future offerings of shares of our common stock, our Board, or an authorized committee thereof, will be required to make the determination that we are not selling shares of our common stock at a price below the then current net asset value of our common stock at the time at which the sale is made. Our Board, or an authorized committee thereof, will consider the following factors, among others, in making such a determination:

- the net asset value of our common stock disclosed in the most recent periodic report that we filed with the SEC;

- our management's assessment of whether any material change in the net asset value of our common stock has occurred (including through the realization of gains on the sale of our portfolio securities) during the period beginning on the date of the most recently disclosed net asset value of our common stock and ending as of a time within 48 hours (excluding Sundays and holidays) of the sale of our common stock; and
- the magnitude of the difference between (i) a value that our Board, or an authorized committee thereof, has determined reflects the current (as of a time within 48 hours, excluding Sundays and holidays) net asset value of our common stock, which is based upon the net asset value of our common stock disclosed in the most recent periodic report that we filed with the SEC, as adjusted to reflect our management's assessment of any material change in the net asset value of our common stock since the date of the most recently disclosed net asset value of our common stock, and (ii) the offering price of the shares of our common stock in the proposed offering.

Moreover, to the extent that there is even a remote possibility that we may (i) issue shares of our common stock at a price per share below the then current net asset value per share of our common stock at the time at which the sale is made or (ii) trigger the undertaking (which we provide in certain registration statements we file with the SEC) to suspend the offering of shares of our common stock if the net asset value per share of our common stock fluctuates by certain amounts in certain circumstances until the prospectus is amended, our Board will elect, in the case of clause (i) above, either to postpone the offering until such time that there is no longer the possibility of the occurrence of such event or to undertake to determine the net asset value per share of our common stock within two days prior to any such sale to ensure that such sale will not be below our then current net asset value per share and, in the case of clause (ii) above, to comply with such undertaking or to undertake to determine the net asset value per share of our common stock to ensure that such undertaking has not been triggered.

These processes and procedures are part of our compliance policies and procedures. Records will be made contemporaneously with all determinations described in this section and these records will be maintained with other records that we are required to maintain under the 1940 Act.

COMPETITION

We compete for investments with other BDCs and investment funds (including private equity funds, private credit funds, mezzanine funds and other SBICs), as well as traditional financial services companies such as commercial banks and other sources of funding. Additionally, competition for investment opportunities has emerged among alternative investment vehicles, such as collateralized loan obligations ("CLOs") and other BDCs, some of which are sponsored by other alternative asset investors, as these entities have begun to focus on making investments in lower middle-market and traditional middle-market companies. As a result of these new entrants, competition for our investment opportunities may intensify. Many of these entities have greater financial and managerial resources than we do. We believe we will be able to compete with these entities primarily on the basis of our experience and reputation, our willingness to make smaller investments than other specialty finance companies, the contacts and relationships of our Investment Advisor, our responsive and efficient investment analysis and decision-making processes, and the investment terms we offer.

We believe that certain of our competitors may make first lien and second lien loans with interest rates and returns that will be comparable to or lower than the rates and returns that we will target. Therefore, we will not seek to compete solely on the interest rates and returns that we offer to potential portfolio companies. For additional information concerning the competitive risks we face, see "Risk Factors — Risks Relating to Our Business and Structure — We operate in a highly competitive market for investment opportunities, which could reduce returns and result in losses."

ELECTION TO BE TAXED AS A RIC

As a BDC, the Company has elected to be treated, and intends to comply with the requirements to continue to qualify annually, as a RIC under subchapter M of the Code. As a RIC, we generally will not have to pay corporate-level U.S. federal income taxes on any income that we distribute to our stockholders as dividends. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, to qualify for RIC tax treatment we must distribute to our stockholders, for each taxable year, at least 90% of our "investment company taxable income," which generally is our ordinary income plus the excess of our realized net short-term capital gains over our realized net long-term capital losses (the "Annual Distribution Requirement").

TAXATION AS A RIC

For any taxable year in which we:

- qualify as a RIC; and
- satisfy the Annual Distribution Requirement,

we generally will not be subject to U.S. federal income tax on the portion of our income we distribute to stockholders. We will be subject to U.S. federal income tax at the regular corporate rates on any income or capital gains not distributed to our stockholders.

We will be subject to a 4% nondeductible U.S. federal excise tax on certain undistributed income unless we distribute in a timely manner an amount at least equal to the sum of (1) 98% of our net ordinary income for each calendar year, (2) 98.2% of our capital gain net income for the one-year period ending October 31 in that calendar year and (3) any income recognized, but not distributed, in preceding years and on which we paid no corporate-level U.S. federal income tax (the "Excise Tax Distribution Requirement").

In order to qualify as a RIC for U.S. federal income tax purposes, we must, among other things:

- continue to qualify as a BDC under the 1940 Act at all times during each taxable year;
- derive in each taxable year at least 90% of our gross income from dividends, interest, payments with respect to loans of certain securities, gains from the sale or other disposition of stock, securities or foreign currencies, net income from certain "qualified publicly traded partnerships," or other income derived with respect to our business of investing in such stock or securities (the "90% Income Test"); and
- diversify our holdings so that at the end of each quarter of the taxable year:
  - at least 50% of the value of our assets consists of cash, cash equivalents, U.S. Government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer; and
  - no more than 25% of the value of our assets is invested in the securities, other than U.S. government securities or securities of other RICs, of one issuer, of two or more issuers that are controlled, as determined under applicable Code rules, by us and that are engaged in the same or similar or related trades or businesses or of certain "qualified publicly traded partnerships" (the "Diversification Tests").

Qualified earnings may exclude such income as management fees received in connection with our SBIC subsidiaries or other potential outside managed funds and certain other fees.

In accordance with certain applicable Treasury regulations and private letter rulings issued by the IRS, 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 that the aggregate amount of cash to be distributed to all stockholders must be at least 20% of the aggregate declared distribution. If too many stockholders elect to receive cash, each stockholder electing to receive cash must 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% 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. We have no current intention of paying dividends in shares of our stock in accordance with these Treasury regulations or private letter rulings.

We may be required to recognize taxable income in circumstances in which we do not receive cash. For example, if we hold debt obligations that are treated under applicable tax rules as having original issue discount (such as debt instruments with PIK interest or, in certain cases, increasing interest rates or issued with warrants), we must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by us in the same taxable year. We may also have to include in income other amounts that we have not yet received in cash, such as PIK interest, deferred loan origination fees that are paid after origination of the loan or are paid in non-cash compensation such as warrants or stock, or certain income with respect to equity investments in foreign corporations. Because any original issue discount or other amounts accrued will be included in our investment company taxable income for the year of accrual, we may be required to make a distribution to our stockholders in order to satisfy the Annual Distribution Requirement, even though we will not have received any corresponding cash amount.

Gain or loss realized by us from the sale or exchange of warrants acquired by us as well as any loss attributable to the lapse of such warrants generally will be treated as capital gain or loss. Such gain or loss generally will be long-term or short-term, depending on how long we held a particular warrant.

Although we do not presently expect to do so, we are authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, we are not permitted to make distributions to our stockholders while our debt obligations and other senior securities are outstanding unless certain “asset coverage” tests are met. Moreover, our ability to dispose of assets to meet our distribution requirements may be limited by (1) the illiquid nature of our portfolio and/or (2) other requirements relating to our status as a RIC, including the Diversification Tests. If we dispose of assets in order to meet the Annual Distribution Requirement or the Excise Tax Distribution Requirement, we may make such dispositions at times that, from an investment standpoint, are not advantageous. If we are prohibited from making distributions or are unable to obtain cash from other sources to make the distributions, we may fail to qualify as a RIC, which would result in us becoming subject to corporate-level U.S. federal income tax.

In addition, we will be partially dependent on our SBIC subsidiaries for cash distributions to enable us to meet the RIC distribution requirements. Our SBIC subsidiaries may be limited by the Small Business Investment Act of 1958, and SBA regulations governing SBICs, from making certain distributions to us that may be necessary to maintain our tax treatment as a RIC. We may have to request a waiver of the SBA’s restrictions for our SBIC subsidiaries to make certain distributions to maintain our RIC tax treatment. We cannot assure you that the SBA will grant such waiver. If our SBIC subsidiaries are unable to obtain a waiver, compliance with the SBA regulations may cause us to fail to qualify for tax treatment as a RIC, which would result in us becoming subject to corporate-level U.S. federal income tax.

The remainder of this discussion assumes that we will qualify as a RIC and have satisfied the Annual Distribution Requirement.

Any transactions in options, futures contracts, constructive sales, hedging, straddle, conversion or similar transactions, and forward contracts will be subject to special tax rules, the effect of which may be to accelerate income to us, defer losses, cause adjustments to the holding periods of our investments, convert long-term capital gains into short-term capital gains, convert short-term capital losses into long-term capital losses or have other tax consequences. These rules could affect the amount, timing and character of distributions to stockholders. We do not currently intend to engage in these types of transactions.

A RIC is limited in its ability to deduct expenses in excess of its “investment company taxable income” (which is, generally, ordinary income plus net realized short-term capital gains in excess of net realized long-term capital losses). If our expenses in a given year exceed gross taxable income (e.g., as the result of large amounts of equity-based compensation), we would experience a net operating loss for that year. However, a RIC is not permitted to carry forward net operating losses to subsequent years. In addition, expenses can be used only to offset investment company taxable income, not net capital gain. Due to these limits on the deductibility of expenses, we may for tax purposes have aggregate taxable income for several years that we are required to distribute and that is taxable to our stockholders even if such income is greater than the aggregate net income we actually earned during those years. Such required distributions may be made from our cash assets or by liquidation of investments, if necessary. We may realize gains or losses from such liquidations. In the event we realize net capital gains from such transactions, you may receive a larger capital gain distribution than you would have received in the absence of such transactions.

Investment income received from sources within foreign countries, or capital gains earned by investing in securities of foreign issuers, may be subject to foreign income taxes withheld at the source. In this regard, withholding tax rates in countries with which the United States does not have a tax treaty are often as high as 35% or more. The United States has entered into tax treaties with many foreign countries that may entitle us to a reduced rate of tax or exemption from tax on this related income and gains. The effective rate of foreign tax cannot be determined at this time since the amount of our assets to be invested within various countries is not now known. We do not anticipate being eligible for the special election that allows a RIC to treat foreign income taxes paid by such RIC as paid by its stockholders.

If we acquire stock in certain foreign corporations that receive at least 75% of their annual gross income from passive sources (such as interest, dividends, rents, royalties or capital gain) or hold at least 50% of their total assets in investments producing such passive income ("passive foreign investment companies"), we could be subject to U.S. federal income tax and additional interest charges on "excess distributions" received from such companies or gain from the sale of stock in such companies, even if all income or gain actually received by us is timely distributed to our stockholders. We would not be able to pass through to our stockholders any credit or deduction for such a tax. Certain elections may, if available, ameliorate these adverse tax consequences, but any such election requires us to recognize taxable income or gain without the concurrent receipt of cash. We intend to limit and/or manage our holdings in passive foreign investment companies to minimize our tax liability. In addition, under recently proposed regulations, income required to be included as a result of such an election would not be qualifying income for purposes of the 90% Income Test unless we receive a distribution of such income from the passive foreign investment company in the same taxable year to which the inclusion relates.

Foreign exchange gains and losses realized by us in connection with certain transactions involving non-dollar debt securities, certain foreign currency futures contracts, foreign currency option contracts, foreign currency forward contracts, foreign currencies, or payables or receivables denominated in a foreign currency are subject to Code provisions that generally treat such gains and losses as ordinary income and losses and may affect the amount, timing and character of distributions to our stockholders. Any such transactions that are not directly related to our investment in securities (possibly including speculative currency positions or currency derivatives not used for hedging purposes) could, under future Treasury regulations, produce income not among the types of "qualifying income" from which a RIC must derive at least 90% of its annual gross income.

ACQUISITION OF PORTFOLIO ASSETS OF THE LEGACY FUNDS

We believe that our acquisition of the Legacy Funds' portfolio assets in exchange for shares of our common stock generally was tax free to us and the Legacy Funds. As a result, our initial adjusted basis in the Legacy Funds' portfolio assets was equal to the Legacy Funds' adjusted basis in such assets immediately prior to our acquisition of such assets increased by any gain recognized by the Legacy Funds as a result of such transaction. Such adjusted basis will be used in determining the amount of our taxable gain or loss upon a sale or other disposition of such assets. To the extent that such assets had built-in gain (i.e., assets whose fair market value exceeds our tax basis at the time we acquired them) on the date of acquisition, when such gain is recognized by us upon a sale or other disposition such assets, we will be required to distribute such gain to our stockholders in order to eliminate our liability for corporate-level U.S. federal income tax on such gain and possibly to maintain our qualification as a RIC under the Code. Investors will be subject to tax on the distribution even though such gain accrued prior to our acquisition of such assets and even though the distribution effectively represents a return of their investment.

In addition, to the extent that any beneficial owner of interests in the Legacy Funds on the date of our acquisition of the Legacy Funds' portfolio assets was a C corporation (a "corporate partner"), we will be required to pay a corporate-level U.S. federal income tax on the net amount of any such built-in gains attributable to the corporate partners that we recognize during the ten-year period (or shorter applicable period) beginning on the date of acquisition. Alternatively, we may make a special election to cause the gain to be recognized at the time of the acquisition. In that event, the Legacy Funds would be required to recognize such built-in gain as if a proportionate share of such Funds' assets were sold at the time of the acquisition. We do not anticipate making this election at this time. Any corporate-level built-in gain tax is payable at the time the built-in gains are recognized (which generally will be the years in which the built-in gain assets are sold in a taxable transaction). The amount of this tax will vary depending on the assets that are actually sold by us in this 10-year period (or shorter applicable period), the actual amount of net built-in gain or loss present in those assets as of the acquisition date and effective tax rates. The payment of any such corporate-level U.S. federal income tax on built-in gains will be a company expense that will be borne by all stockholders (not just any former corporate partners) and will reduce the amount available for distribution to stockholders.

FAILURE TO QUALIFY AS A RIC

If we fail to satisfy the 90% Income Test or the Diversification Tests for any taxable year, we may nevertheless continue to qualify as a RIC for such year if certain relief provisions are applicable (which may, among other things, require us to pay certain corporate-level U.S. federal income taxes or to dispose of certain assets).

If we were unable to qualify for treatment as a RIC and the foregoing relief provisions are not applicable, we would be subject to tax on all of our taxable income at regular corporate rates, regardless of whether we make any distributions to our stockholders. Distributions would not be required, and any distributions would be taxable to our stockholders as ordinary dividend income to the extent of our current and accumulated earnings and profits and, subject to certain limitations, may be eligible for the 20% maximum rate for noncorporate taxpayers provided certain holding period and other requirements were met. Subject to certain limitations under the Code, corporate distributees would be eligible for the dividends-received deduction. Distributions in excess of our current and accumulated earnings and profits would be treated first as a return of capital to the extent of the stockholder's tax basis, and any remaining distributions would be treated as a capital gain. To requalify as a RIC in a subsequent taxable year, we would be required to satisfy the RIC qualification requirements for that year and dispose of any earnings and profits from any year in which we failed to qualify as a RIC. Subject to a limited exception applicable to RICs that qualified as such under the Code for at least one year prior to disqualification and that requalify as a RIC no later than the second year following the nonqualifying year, we could be subject to tax on any unrealized net built-in gains in the assets held by us during the period in which we failed to qualify as a RIC that are recognized within the subsequent five years, unless we made a special election to pay corporate-level U.S. federal income tax on such built-in gain at the time of our requalification as a RIC.

REGULATION

A BDC is regulated under the 1940 Act. A BDC must be organized in the U.S. for the purpose of investing in or lending to primarily private companies and making significant managerial assistance available to them. A BDC may use capital provided by public stockholders and from other sources to make long-term, private investments in businesses. A BDC provides stockholders the ability to retain the liquidity of a publicly traded stock while sharing in the possible benefits, if any, of investing in primarily privately owned companies.

We may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC unless authorized by vote of a majority of the outstanding voting securities, as required by the 1940 Act. A majority of the outstanding voting securities of a company is defined under the 1940 Act as the lesser of: (a) 67% or more of such company's voting securities present at a meeting if more than 50% of the outstanding voting securities of such company are present or represented by proxy, or (b) more than 50% of the outstanding voting securities of such company. We do not anticipate any substantial change in the nature of our business.

As with other companies regulated by the 1940 Act, a BDC must adhere to certain substantive regulatory requirements. A majority of our directors must be persons who are not interested persons, as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect the BDC. Furthermore, as a BDC, we are prohibited from protecting any director or officer against any liability to us or our stockholders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office.

As a BDC, we are generally required to meet an asset coverage ratio, defined under the 1940 Act as the ratio of our gross assets (less all liabilities and indebtedness not represented by senior securities) to our outstanding senior securities, of at least 200% after each issuance of senior securities. We may also be prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of our directors who are not interested persons and, in some cases, prior approval by the SEC. On June 1, 2016, the SEC issued the Order, which permits us and certain of our affiliates to co-invest with one or more other affiliated investment funds, including future affiliated investment funds, where co-investing would otherwise be prohibited under the 1940 Act. Pursuant to the Order, the Company is permitted to co-invest with its affiliates if a "required majority" (as defined in Section 57(o) of the 1940 Act) of the Company's independent directors make certain conclusions in connection with a co-investment transaction, including, but not limited to, that (1) the terms of the potential co-investment transaction, including the consideration to be paid, are reasonable and fair to the Company and its stockholders and do not involve overreaching in respect of the Company or its stockholders on the part of any person concerned, and (2) the potential co-investment transaction is consistent with the interests of the Company's stockholders and is consistent with its then-current investment objectives and strategies.

We are generally not permitted to issue and sell our common stock at a price below net asset value per share. See "Risk Factors — Risks Relating to Our Business and Structure — Regulations governing our operation as a BDC affect our ability to raise additional capital and the way in which we do so. As a BDC, the necessity of raising additional capital may expose us to risks, including the typical risks associated with leverage." We may, however, sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the then-current net asset value of our common stock if our Board determines that such sale is in our best interests and the best interests of our stockholders, and our stockholders approve our policy and practice of making such sales. In any such case, under such circumstances, the price at which our common stock is to be issued and sold may not be less than a price which, in the determination of our Board, closely approximates the market value of such common stock. In addition, we may generally issue new shares of our common stock at a price below net asset value in rights offerings to existing stockholders, in payment of dividends and in certain other limited circumstances.

We will be periodically examined by the SEC for compliance with the 1940 Act.

As a BDC, we are subject to certain risks and uncertainties. See "Risk Factors — Risks Relating to Our Business and Structure."

QUALIFYING ASSETS

Under the 1940 Act, a BDC may not acquire any asset other than assets of the type listed in Section 55(a) of the 1940 Act, which are referred to as qualifying assets, unless, immediately after such acquisition is made, qualifying assets represent at least 70% of the BDC's gross assets. The principal categories of qualifying assets relevant to our proposed business are the following:

- Securities purchased in transactions not involving any public offering, the issuer of which is an eligible portfolio company;
- Securities received in exchange for or distributed with respect to securities described in the bullet above or pursuant to the exercise of options, warrants or rights relating to such securities; and
- Cash, cash items, government securities or high quality debt securities (within the meaning of the 1940 Act), maturing in one year or less from the time of investment.

An eligible portfolio company is generally a domestic company that is not an investment company (other than a SBIC wholly owned by a BDC) and that:

- does not have a class of securities with respect to which a broker may extend margin credit at the time the acquisition is made;
- is controlled by the BDC and has an affiliate of the BDC on its board;
- does not have any class of securities listed on a national securities exchange;
- is a public company that lists its securities on a national securities exchange with a market capitalization of less than $250 million; or

- meets such other criteria as may be established by the SEC.

Control, as defined by the 1940 Act, is presumed to exist where a BDC beneficially owns more than 25% of the outstanding voting securities of the portfolio company.

In addition, a BDC must have been organized and have its principal place of business in the U.S. and must be operated for the purpose of making investments in eligible portfolio companies, or in other securities that are consistent with its purpose as a BDC.

SIGNIFICANT MANAGERIAL ASSISTANCE TO PORTFOLIO COMPANIES

BDCs generally must offer to make available to the issuer of the securities significant managerial assistance, except in circumstances where either (i) the BDC controls such issuer of securities or (ii) the BDC purchases such securities in conjunction with one or more other persons acting together and one of the other persons in the group makes available such managerial assistance. Making available significant managerial assistance means, among other things, any arrangement whereby the BDC, through its directors, officers or employees, offers to provide, and, if accepted, does so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company.

TEMPORARY INVESTMENTS

Pending investment in other types of "qualifying assets," as described above, our investments may consist of cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment, which we refer to, collectively, as temporary investments, so that 70% of our assets are qualifying assets. Typically, we will invest in U.S. Treasury bills or in repurchase agreements, provided that such agreements are fully collateralized by cash or securities issued by the U.S. government or its agencies. A repurchase agreement involves the purchase by an investor, such as us, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed-upon future date and at a price which is greater than the purchase price by an amount that reflects an agreed-upon interest rate. There is no percentage restriction on the proportion of our assets that may be invested in such repurchase agreements. However, if more than 25% of our gross assets constitute repurchase agreements from a single counterparty, we would not meet the diversification tests in order to qualify as a RIC under the Code. Thus, we do not intend to enter into repurchase agreements with a single counterparty in excess of this limit. Our Investment Advisor will monitor the creditworthiness of the counterparties with which we enter into repurchase agreement transactions.

SENIOR SECURITIES

We are permitted, under specified conditions, to issue multiple classes of indebtedness and one class of stock senior to our common stock if our asset coverage, as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance. On June 10, 2014, we received an exemptive order from the SEC granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs. In addition, while any senior securities remain outstanding, we must make provisions to prohibit any distribution to our stockholders or the repurchase of such securities or shares unless we meet the applicable asset coverage ratios at the time of the distribution or repurchase. We may also borrow amounts up to 5% of the value of our gross assets for temporary or emergency purposes without regard to asset coverage. For a discussion of the risks associated with leverage, see "Risk Factors — Risks Relating to Our Business and Structure."

CODE OF ETHICS

We and our Investment Advisor have adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act and Rule 204A-1 under the Advisers Act that establishes procedures for personal investments and restricts certain transactions by our personnel. Our code of ethics generally does not permit investments by our employees in securities that may be purchased or held by us. You may read and copy our code of ethics at the SEC's Public Reference Room in Washington, D.C. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You may also obtain copies of the code of ethics, after paying a duplicating fee, by electronic request at the following email address: publicinfo@sec.gov, or by writing the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549. Our code of ethics is also available on our website at *www.Capitalagroup.com.*

COMPLIANCE POLICIES AND PROCEDURES

We and our Investment Advisor have adopted and implemented written policies and procedures reasonably designed to detect and prevent violation of the federal securities laws and are required to review these compliance policies and procedures annually for their adequacy and the effectiveness of their implementation and designate a chief compliance officer to be responsible for administering the policies and procedures. Richard G. Wheelahan, III currently serves as our chief compliance officer.

SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") imposes a wide variety of regulatory requirements on publicly-held companies and their insiders. Many of these requirements affect us. For example:

- pursuant to Rule 13a-14 of the 1934 Act, our chief executive officer and chief financial officer must certify the accuracy of the financial statements contained in our periodic reports;
- pursuant to Item 307 of Regulation S-K, our periodic reports must disclose our conclusions about the effectiveness of our disclosure controls and procedures;
- pursuant to Rule 13a-15 of the 1934 Act, our management is required to prepare an annual report regarding its assessment of our internal control over financial reporting. When we are no longer an emerging growth company under the JOBS Act, our independent registered public accounting firm will be required to audit our internal controls over financial reporting; and
- pursuant to Item 308 of Regulation S-K and Rule 13a-15 of the 1934 Act, our periodic reports must disclose whether there were significant changes in our internal controls over financial reporting or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

The Sarbanes-Oxley Act requires us to review our current policies and procedures to determine whether we comply with the Sarbanes-Oxley Act and the regulations promulgated thereunder. We will continue to monitor our compliance with all regulations that are adopted under the Sarbanes-Oxley Act and will take actions necessary to ensure that we are in compliance therewith.

PROXY VOTING POLICIES AND PROCEDURES

We have delegated our proxy voting responsibility to the Investment Advisor. The proxy voting policies and procedures of the Investment Advisor are set forth below. The guidelines will be reviewed periodically by the Investment Advisor and our non-interested directors, and, accordingly, are subject to change. For purposes of the proxy voting policies and procedures described below, "we," "our" and "us" refers to the Investment Advisor.

Introduction

An investment adviser registered under the Advisers Act has a fiduciary duty to act solely in the best interests of its clients. As part of this duty, we recognize that we must vote client securities in a timely manner free of conflicts of interest and in the best interests of our clients.

These policies and procedures for voting proxies for our investment advisory clients are intended to comply with Section 206 of, and Rule 206(4)-6 under, the Advisers Act.

Proxy Policies

We will vote proxies relating to our portfolio securities in what we perceive to be the best interest of our clients' stockholders. We will review on a case-by-case basis each proposal submitted to a stockholder vote to determine its impact on the portfolio securities held by our clients. Although we will generally vote against proposals that may have a negative impact on our clients' portfolio securities, we may vote for such a proposal if there exist compelling long-term reasons to do so.

Our proxy voting decisions will be made by the senior officers who are responsible for monitoring each of our clients' investments. To ensure that our vote is not the product of a conflict of interest, we will require that: (1) anyone involved in the decision making process disclose to our managing member any potential conflict that he or she is aware of and any contact that he or she has had with any interested party regarding a proxy vote; and (2) employees involved in the decision making process or vote administration are prohibited from revealing how we intend to vote on a proposal in order to reduce any attempted influence from interested parties.

Proxy Voting Records

You may obtain information about how we voted proxies by making a written request for proxy voting information to: Capitala Investment Advisors, LLC, 4201 Congress Street, Suite 360, Charlotte, North Carolina 28209.

PRIVACY PRINCIPLES

We are committed to maintaining the privacy of our stockholders and to safeguarding their non-public personal information. The following information is provided to help you understand what personal information we collect, how we protect that information and why, in certain cases, we may share information with select other parties.

Generally, we do not receive any non-public personal information relating to our stockholders, although certain non-public personal information of our stockholders may become available to us. We do not disclose any non-public personal information about our stockholders or former stockholders to anyone, except as permitted by law or as is necessary in order to service stockholder accounts (for example, to a transfer agent or third-party administrator).

We restrict access to non-public personal information about our stockholders to employees of our Investment Advisor and its affiliates with a legitimate business need for the information. We maintain physical, electronic and procedural safeguards designed to protect the non-public personal information of our stockholders.

SMALL BUSINESS INVESTMENT COMPANY REGULATIONS

Fund II and Fund III, which are our wholly owned subsidiaries, are licensed to act as SBICs and are regulated by the SBA. As of December 31, 2017, investments in Fund II and Fund III accounted for approximately 11.2% and 51.7%, respectively, of our total portfolio. As of December 31, 2017, Fund II and Fund III had $20.7 million and $150.0 million, respectively, of SBA-guaranteed debentures outstanding under the SBIC program. Fund II and Fund III are fully drawn and may not make borrowings in excess of their aggregate $170.7 million of SBA-guaranteed debentures outstanding as of December 31, 2017.

The SBIC licenses allow our SBIC subsidiaries to borrow funds by issuing SBA-guaranteed debentures, subject to the issuance of a capital commitment by the SBA and other customary procedures. The SBA regulations require, among other things, that a licensed SBIC be examined periodically and audited by an independent auditor to determine the SBIC's compliance with the relevant SBA regulations. SBA-guaranteed debentures are non-recourse, interest-only debentures with interest payable semi-annually and have a ten year maturity. The principal amount of SBA-guaranteed debentures is not required to be paid prior to maturity but may be prepaid at any time without penalty. The interest rate of SBA-guaranteed debentures is fixed at the time of issuance at a market-driven spread over U.S. Treasury Notes with 10-year maturities.

SBICs are designed to stimulate the flow of private equity capital to eligible small businesses. Under current SBA regulations, a licensed SBIC may provide capital to those entities that have a tangible net worth not exceeding $19.5 million and an average annual net income after U.S. federal income taxes not exceeding $6.5 million for the two most recent fiscal years. In addition, a licensed SBIC must devote 25.0% of its investment activity to those entities that have a tangible net worth not exceeding $6.0 million and an average annual net income after U.S. federal income taxes not exceeding $2.0 million for the two most recent fiscal years. The SBA regulations also provide alternative size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on factors such as the number of employees and gross sales. The SBA regulations permit licensed SBICs to make long-term loans to small businesses, invest in the equity securities of such businesses and provide them with consulting and advisory services. The SBA also places certain limitations on the financing terms of investments by SBICs in portfolio companies and prohibits SBICs from providing funds for certain purposes or to businesses in a few prohibited industries. Compliance with SBA requirements may cause Fund II and Fund III to forego attractive investment opportunities that are not permitted under SBA regulations.

Further, the SBA regulations require that a licensed SBIC be periodically examined and audited by the SBA to determine its compliance with the relevant SBA regulations. The SBA prohibits, without prior SBA approval, a “change of control” of an SBIC or transfers that would result in any person (or a group of persons acting in concert) owning 10.0% or more of a class of capital stock of a licensed SBIC. If either Fund II or Fund III fails to comply with applicable SBA regulations, the SBA could, depending on the severity of the violation, limit or prohibit Fund II’s and Fund III’s use of debentures, declare outstanding debentures immediately due and payable, and/or limit Fund II and Fund III from making new investments. Such actions by the SBA would, in turn, negatively affect us because Fund II and Fund III are our wholly owned subsidiaries. Fund II and Fund III were in compliance with the terms of the SBA’s leverage as of December 31, 2017 as a result of having sufficient capital as defined under the SBA regulations.

In December 2015, the 2016 omnibus spending bill approved by Congress and signed into law by the President increased the amount of SBA-guaranteed debentures that affiliated SBIC funds can have outstanding from $225.0 million to $350.0 million, subject to SBA approval. SBA regulations currently limit the amount that an SBIC subsidiary may borrow to a maximum of $150 million when it has at least $75 million in regulatory capital. Affiliated SBICs are permitted to issue up to a combined maximum amount of $350 million when they have at least $175 million in regulatory capital. As of December 31, 2017, Fund II had $26.2 million in regulatory capital and $20.7 million in SBA-guaranteed debentures outstanding and Fund III had $75.0 million in regulatory capital and $150.0 million in SBA-guaranteed debentures outstanding.

On June 10, 2014, we received exemptive relief from the SEC to permit us to exclude the debt of our SBIC subsidiaries guaranteed by the SBA from the definition of senior securities in the 200% asset coverage test under the 1940 Act. This provides us with increased flexibility under the 200% asset coverage test by permitting us to borrow up to $170.7 million more than we would otherwise be able to absent the receipt of this exemptive relief.

Our SBIC subsidiaries are subject to regulation and oversight by the SBA, including requirements with respect to maintaining certain minimum financial ratios and other covenants. Receipt of SBIC licenses does not assure that our SBIC subsidiaries will receive SBA-guaranteed debenture funding, which is dependent upon our SBIC subsidiaries continuing to be in compliance with SBA regulations and policies. The SBA, as a creditor, will have a superior claim to our SBIC subsidiaries’ assets over our stockholders in the event we liquidate our SBIC subsidiaries or the SBA exercises its remedies under the SBA-guaranteed debentures issued by our SBIC subsidiaries upon an event of default.

NASDAQ GLOBAL SELECT MARKET REQUIREMENTS

We have adopted certain policies and procedures intended to comply with the NASDAQ Global Select Market’s corporate governance rules. We will continue to monitor our compliance with all future listing standards that are approved by the SEC and will take actions necessary to ensure that we are in compliance therewith.

AVAILABLE INFORMATION

Our executive offices are located at 4201 Congress Street, Suite 360, Charlotte, NC 28209. We maintain a website located at *www.Capitalagroup.com* and our phone number is (704) 376-5502. We make available free of charge on our website our proxy statement, annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as reasonably practical after we file such material with, or furnish to, the SEC. Information contained on our website is not incorporated by reference into this Annual Report on Form 10-K and you should not consider information contained on our website to be part of this Annual Report on Form 10-K or any other report we file with the SEC.

The SEC also maintains a website that contains reports, proxy and information statements and other information we file with the SEC at *www.sec.gov*. Copies of these reports, proxy and information statements and other information may also be obtained, after paying a duplicating fee, by electronic request at publicinfo@sec.gov, or by writing to the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-0102. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

ITEM 1A. RISK FACTORS

Investing in our securities involves a number of significant risks. Before you invest in our securities, you should be aware of various risks, including those described below and elsewhere in this Annual Report on Form 10-K. You should carefully consider these risk factors, together with all of the other information included in this Annual Report on Form 10-K, before you decide whether to make an investment in our securities. The risks set out below are not the only risks we face. Additional risks and uncertainties not presently known to us or not presently deemed material by us may also impair our operations and performance. If any of the following events occur, our business, financial condition, results of operations and cash flows could be materially and adversely affected. In such case, our net asset value and the trading price of our securities could decline, and you may lose all or part of your investment. The risk factors described below are the principal risk factors associated with an investment in us as well as those factors generally associated with an investment company with investment objectives, investment policies, capital structure, or trading markets similar to ours.

Risks Relating to Our Business and Structure

We have a limited operating history as a BDC.

Capitala Finance was formed in February 2013 and has only operated as a BDC since September 2013. As a result, we are subject to many of the business risks and uncertainties associated with recently formed businesses, including the risk that we will not achieve our investment objective and that the value of your investment could decline substantially. As a BDC, we are subject to the regulatory requirements of the SEC, in addition to the specific regulatory requirements applicable to BDCs under the 1940 Act and RICs under the Code. Our management and that of the Investment Advisor did not have any prior experience operating under this regulatory framework, and we incur substantial costs, and expend significant time or other resources, to operate under this regulatory framework. From time to time, the Investment Advisor may pursue investment opportunities in which it has more limited experience. We may also be unable to replicate the historical performance of prior investment funds managed by our management team. In addition, we may be unable to generate sufficient revenue from our operations to make or sustain distributions to our stockholders.

Our investment portfolio is recorded at fair value, with our Board having final responsibility for overseeing, reviewing and approving, in good faith, its estimate of fair value and, as a result, there may be uncertainty as to the value of our portfolio investments.

Under the 1940 Act, we are required to carry our portfolio investments at market value or, if there is no readily available market value, at fair value as determined by us, with our Board having final responsibility for overseeing, reviewing and approving, in good faith, our estimate of fair value. Typically, there will not be a public market for the securities of the privately held companies in which we invest. As a result, we value these securities quarterly at fair value based on input from management, a third-party independent valuation firm and our audit committee, and with the oversight, review and approval of our Board.

The determination of fair value and, consequently, the amount of unrealized gains and losses in our portfolio, are to a certain degree, subjective and dependent on a valuation process approved by our Board. Certain factors that may be considered in determining the fair value of our investments include external events, such as private mergers, sales and acquisitions involving comparable companies. Because such valuations, and particularly valuations of private securities and private companies, are inherently uncertain, they may fluctuate over short periods of time and may be based on estimates. Our fair value determinations may differ materially from the values that would have been used if a ready market for these securities existed. Due to this uncertainty, our fair value determinations may cause our net asset value on a given date to materially understate or overstate the value that we may ultimately realize on one or more of our investments. As a result, investors purchasing our common stock based on an overstated net asset value would pay a higher price than the value of our investments might warrant. Conversely, investors selling shares during a period in which the net asset value understates the value of our investments would receive a lower price for their shares than the value of our investments might warrant. In addition, we may not be able to realize the values on our investments needed to pay interest on our borrowings.

Our financial condition and results of operations depend on our ability to effectively manage and deploy capital.

Our ability to achieve our investment objective depends on our ability to effectively manage and deploy capital, which depends, in turn, on our Investment Advisor's ability to identify, evaluate and monitor, and our ability to finance and invest in, companies that meet our investment criteria.

Accomplishing our investment objective on a cost-effective basis is largely a function of our Investment Advisor's handling of the investment process, its ability to provide competent, attentive and efficient services and our access to investments offering acceptable terms. In addition to monitoring the performance of our existing investments, our Investment Advisor's investment team may also be called upon, from time to time, to provide managerial assistance to some of our portfolio companies as well as other funds that they manage. These demands on their time may distract them or slow our rate of investment. See also "— There are significant potential conflicts of interest that could negatively affect our investment returns."

Even if we are able to grow and build upon our investment operations, any failure to manage our growth effectively could have a material adverse effect on our business, financial condition, results of operations and prospects. The results of our operations depend on many factors, including the availability of opportunities for investment, readily accessible short and long-term funding alternatives in the financial markets, and economic conditions. Furthermore, if we cannot successfully operate our business or implement our investment policies and strategies, it could negatively impact our ability to make distributions.

We depend upon Capitala Investment Advisors' key personnel for our future success.

We depend on the diligence, skill and network of business contacts of Joseph B. Alala, III, M. Hunt Broyhill and John F. McGlinn, who serve as the members of the investment committee of the Investment Advisor and lead the Investment Advisor's investment team. Our success depends on the continued service of these individuals and the other senior investment professionals available to the Investment Advisor. We cannot assure you that unforeseen business, medical, personal or other circumstances would not lead Messrs. Alala, Broyhill or McGlinn or any other such individual to terminate his relationship with us. Additionally, we cannot assure you that a reduction in revenue to the Investment Advisor, including as a result of fee waivers or a decrease in our assets, would not lead to a loss of investment professionals in the future. Such loss of members of the Investment Advisor's investment committee and other investment professionals could have a material adverse effect on our ability to achieve our investment objective as well as on our financial condition and results of operations. In addition, we can offer no assurance that the Investment Advisor will continue indefinitely as our investment adviser.

The members of the Investment Advisor's investment team are and may in the future become affiliated with entities engaged in business activities similar to those intended to be conducted by us, and may have conflicts of interest in allocating their time. For example, an affiliate of the Investment Advisor also manages Fund V, a private investment limited partnership providing financing solutions to the lower middle-market and traditional middle-market. Mr. Alala dedicates a significant portion of his time to the activities of Capitala Finance; however, he may become engaged in other business activities that could divert his time and attention in the future.

We operate in a highly competitive market for investment opportunities, which could reduce returns and result in losses.

We compete for investments with other BDCs with similar investment strategies, private equity funds with similar investment strategies, venture lending funds, finance companies with venture lending units and banks focused on venture lending. Many of our potential competitors are substantially larger and have considerably greater financial, technical and marketing resources than we have. For example, some competitors may have a lower cost of capital and access to funding sources that are not available to us. In addition, some of our competitors have higher risk tolerances or different risk assessments than we have. These characteristics might allow our competitors to consider a wider variety of investments, establish more relationships or offer better pricing and more flexible structuring than we are able to offer. We may lose investment opportunities if we do not match our competitors' pricing, terms or structure. If we are forced to match our competitors' pricing, terms or structure, we may not be able to achieve acceptable returns on our investments or may bear substantial risk of capital loss. We believe a significant part of our competitive advantage stems from the fact that the market for investments in lower and traditional middle-market companies is underserved by traditional commercial banks and other financing sources. A significant increase in the number and/or the size of our competitors in this target market could force us to accept less attractive investment terms. Furthermore, many of our potential competitors have greater experience operating under, or will not be subject to, the regulatory restrictions that the 1940 Act impose on us as a BDC.

Any inability of our Capitala Investment Advisors to maintain or develop strong referral relationships, or the failure of these relationships to generate investment opportunities, could adversely affect our business.

We depend upon our Investment Advisor to maintain its relationships with venture capital and private equity firms, placement agents, investment banks, management groups and other financial institutions, and we expect to rely to a significant extent upon these relationships to provide us with potential investment opportunities. If our Investment Advisor fails to maintain such relationships, or to develop new relationships with other sources of investment opportunities, we will not be able to grow our investment portfolio. In addition, individuals with whom our Investment Advisor has relationships are not obligated to provide us with investment opportunities, and we can offer no assurance that these relationships will generate investment opportunities for us in the future.

Our success depends on the ability of Capitala Investment Advisors to attract and retain qualified personnel in a competitive environment.

Our growth requires that the Investment Advisor retain and attract new investment and administrative personnel in a competitive market. Its ability to attract and retain personnel with the requisite credentials, experience and skills depends on several factors including, but not limited to, its ability to offer competitive wages, benefits and professional growth opportunities. Many of the entities with which the Investment Advisor competes for experienced personnel, including investment funds (such as private equity funds, credit funds and mezzanine funds) and traditional financial services companies, have greater resources than the Investment Advisor has. We cannot assure you that a reduction in revenue to the Investment Advisor, including as a result of fee waivers or a decrease in our assets, would not lead to a loss of investment professionals in the future.

There are significant potential conflicts of interest that could negatively affect our investment returns.

The members of the Investment Advisor's investment team also monitor and service other affiliated investment funds. In addition, our executive officers and directors, as well as the current and future members of our Investment Advisor's investment team may serve as officers, directors or principals of other entities that operate in the same or a related line of business as we do. Accordingly, they may have obligations to investors in those entities, the fulfillment of which obligations may not be in the best interests of us or our stockholders. However, the Investment Advisor's investment team does not intend to sponsor or manage another BDC with an investment strategy that is substantially similar to our investment strategy.

In the course of our investing activities, we pay management and incentive fees to the Investment Advisor and reimburse the Investment Advisor for certain expenses it incurs. As a result, investors in our common stock invest on a "gross" basis and receive distributions on a "net" basis after expenses, resulting in a lower rate of return than an investor might achieve through direct investments. Accordingly, there may be times when the management team of the Investment Advisor will have interests that differ from those of our stockholders, giving rise to a conflict. The Investment Advisor will not be reimbursed for any performance-related compensation for its employees. We have entered into a royalty-free license agreement with our Investment Advisor, pursuant to which the Investment Advisor grants us a non-exclusive royalty-free license to use the name "Capitala." Under the license agreement, we have the right to use the "Capitala" name for so long as the Investment Advisor or one of its affiliates remains our Investment Advisor. In addition, we pay our Administrator 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 the compensation of our chief financial officer, chief compliance officer and their respective administrative support staff. These arrangements create conflicts of interest that our Board must monitor.

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

As a BDC, we are substantially limited in our ability to co-invest in privately negotiated transactions with affiliated funds unless we obtain an exemptive order from the SEC. On September 10, 2015, we, Fund II, Fund III, Fund V, and the Investment Advisor filed an application for exemptive relief with the SEC to permit an investment fund and one or more other affiliated investment funds, including future affiliated investment funds, to participate in the same investment opportunities through a proposed co-investment program where such participation would otherwise be prohibited under the 1940 Act. On June 1, 2016, the SEC issued an order permitting this relief. This exemptive relief is subject to certain conditions designed to ensure that the participation by one investment fund in a co-investment transaction would not be on a basis different from or less advantageous than that of other affiliated investment funds.

In the ordinary course of business, we may enter into transactions with portfolio companies that may be considered related party transactions. In order to ensure that we do not engage in any prohibited transactions with any persons affiliated with us, we have implemented certain written policies and procedures whereby our executive officers screen each of our transactions for any possible affiliations between the proposed portfolio investment and us, companies controlled by us or our executive officers and directors. We will not enter into any agreements unless and until we are satisfied that doing so will not raise concerns under the 1940 Act or, if such concerns exist, we have taken appropriate actions to seek review and approval by our Board or exemptive relief for such transaction. Our Board will review these procedures on an annual basis.

The investment committee and other investment professionals of Capitala Investment Advisors may, from time to time, possess material non-public information about or related to our portfolio companies, limiting our investment discretion.

Members of our Investment Advisor's investment committee and other investment professionals of the Investment Advisor may serve as directors of, or in a similar capacity to, portfolio companies in which we invest. In the event that material nonpublic information is obtained with respect to such companies, or we become subject to trading restrictions under the internal trading policies of those companies or as a result of applicable law or regulations, we could be prohibited for a period of time from purchasing or selling the securities of such companies, and this prohibition may have an adverse effect on us.

The involvement of our interested directors in the valuation process may create conflicts of interest.

We make many of our portfolio investments in the form of loans and securities that are not publicly traded and for which no market-based price quotation is available. As a result, our Board determines the fair value of these loans and securities in good faith as described in the section titled "Valuation of Investments" in Note 2 to our Consolidated Financial Statements. In connection with that determination, investment professionals from the Investment Advisor may provide our Board with valuations based upon the most recent portfolio company financial statements available and projected financial results of each portfolio company. While the valuation for certain portfolio investments is reviewed by an independent valuation firm quarterly, the ultimate determination of fair value is made by our Board, including our interested directors, and not by such third-party valuation firm. The participation of the Investment Advisor's investment professionals in our valuation process could result in conflicts of interest as the Investment Advisor's management fee is based, in part, on the value of our gross assets, and its incentive fees will be based, in part, on realized and unrealized gains and depreciation.

The terms of the Investment Advisory Agreement with Capitala Investment Advisors and the Administration Agreement with our Administrator were not negotiated on an arm's length basis and may not be as favorable to us as if they had been negotiated with an unaffiliated third-party, including an incentive fee structure that may induce Capitala Investment Advisors to pursue speculative investments, and to use leverage when it may be unwise to do so.

The Investment Advisory Agreement and the Administration Agreement were negotiated between related parties. Consequently, their terms, including fees payable to the Investment Advisor and the Administrator, may not be as favorable to us as if they had been negotiated with an unaffiliated third-party.

The incentive fee payable by us to the Investment Advisor may create an incentive for the Investment Advisor to pursue investments on our behalf that are riskier or more speculative than would be the case in the absence of such compensation arrangement. The incentive fee payable to our Investment Advisor is calculated based on a percentage of our return on invested capital. This may encourage our Investment Advisor to use leverage to increase the return on our investments. Under certain circumstances, the use of leverage may increase the likelihood of default, which would impair the value of our common stock. In addition, our Investment Advisor receives the incentive fee based, in part, upon net capital gains realized on our investments. Unlike that portion of the incentive fee based on income, there is no hurdle rate applicable to the portion of the incentive fee based on net capital gains. As a result, the Investment Advisor may have a tendency to invest more capital in investments that are likely to result in capital gains as compared to income-producing securities. Such a practice could result in our investing in more speculative securities than would otherwise be the case, which could result in higher investment losses, particularly during economic downturns.

Although we currently do not anticipate doing so, we may invest, to the extent permitted by law, in the securities and instruments of other investment companies, including private funds, and, to the extent we so invest, will bear our ratable share of any such investment company's expenses, including management and performance fees. We also remain obligated to pay management and incentive fees to our Investment Advisor with respect to the assets invested in the securities and instruments of other investment companies. With respect to each of these investments, each of our stockholders will bear his or her share of the management and our Investment Advisor's incentive fee as well as indirectly bearing the management and performance fees and other expenses of any investment companies in which we invest.

Capitala Investment Advisors' liability is limited under the Investment Advisory Agreement, and we have agreed to indemnify Capitala Investment Advisors against certain liabilities, which may lead Capitala Investment Advisors to act in a riskier manner on our behalf than it would when acting for its own account.

Under the Investment Advisory Agreement, the Investment Advisor has not assumed any responsibility to us other than to render the services called for under that agreement. It is not responsible for any action of our Board in following or declining to follow the Investment Advisor's advice or recommendations. Under the Investment Advisory Agreement, the Investment Advisor, its officers, members and personnel, and any person controlling or controlled by the Investment Advisor are not liable to us, any subsidiary of ours, our directors, our stockholders or any subsidiary's stockholders or partners for acts or omissions performed in accordance with and pursuant to the Investment Advisory Agreement, except those resulting from acts constituting gross negligence, willful misfeasance, bad faith or reckless disregard of the duties that the Investment Advisor owes to us under the Investment Advisory Agreement. In addition, as part of the Investment Advisory Agreement, we have agreed to indemnify the Investment Advisor and each of its officers, directors, members, managers and employees from and against any claims or liabilities, including reasonable legal fees and other expenses reasonably incurred, arising out of or in connection with our business and operations or any action taken or omitted on our behalf pursuant to authority granted by the Investment Advisory Agreement, except where attributable to gross negligence, willful misfeasance, bad faith or reckless disregard of such person's duties under the Investment Advisory Agreement. These protections may lead the Investment Advisor to act in a riskier manner when acting on our behalf than it would when acting for its own account.

A general increase in interest rates will likely have the effect of making it easier for our Investment Advisor to receive incentive fees, without necessarily resulting in an increase in our net earnings.

Under the structure of our Investment Advisory Agreement with our Investment Advisor, any general increase in interest rates will likely have the effect of making it easier for our Investment Advisor to meet the quarterly hurdle rate for payment of income incentive fees under the Investment Advisory Agreement without any additional increase in relative performance on the part of our Investment Advisor. In addition, in view of the catch-up provision applicable to income incentive fees under the Investment Advisory Agreement, our Investment Advisor could potentially receive a significant portion of the increase in our investment income attributable to such a general increase in interest rates. If that were to occur, our increase in net earnings, if any, would likely be significantly smaller than the relative increase in our Investment Advisor's income incentive fee resulting from such a general increase in interest rates.

PIK interest payments we receive will increase our assets under management and, as a result, will increase the amount of base management fees and incentive fees payable by us to Capitala Investment Advisors.

Certain of our debt investments contain provisions providing for the payment of contractual PIK interest. Because PIK interest results in an increase in the size of the loan balance of the underlying loan, the receipt by us of PIK interest will have the effect of increasing our assets under management. As a result, because the base management fee that we pay to the Investment Advisor is based on the value of our gross assets, the receipt by us of PIK interest will result in an increase in the amount of the base management fee payable by us. In addition, any such increase in a loan balance due to the receipt of PIK interest will cause such loan to accrue interest on the higher loan balance, which will result in an increase in our pre-incentive fee net investment income and, as a result, an increase in incentive fees that are payable by us to the Investment Advisor.

Capitala Investment Advisors has the right to resign on 60 days' notice, and we may not be able to find a suitable replacement within such time, resulting in a disruption in our operations that could adversely affect our financial condition, business and results of operations.

Our Investment Advisor has the right, under the Investment Advisory Agreement, to resign at any time on 60 days' written notice, whether we have found a replacement or not. If our Investment Advisor resigns, we may not be able to find a new investment adviser or hire internal management with similar expertise and ability to provide the same or equivalent services on acceptable terms within 60 days, or at all. If we are unable to do so quickly, our operations are likely to experience a disruption, our financial condition, business and results of operations as well as our ability to pay distributions are likely to be adversely affected and the market price of our shares may decline. In addition, the coordination of our internal management and investment activities is likely to suffer if we are unable to identify and reach an agreement with a single institution or group of executives having the expertise possessed by our Investment Advisor and its affiliates. Even if we are able to retain comparable management, whether internal or external, the integration of such management and their lack of familiarity with our investment objective may result in additional costs and time delays that may adversely affect our financial condition, business and results of operations.

Capitala Investment Advisors may not be able to achieve the same or similar returns as those achieved by its investment team while they were employed at prior positions.

Although in the past Mr. Alala and other members of our Investment Advisor's investment team have held senior positions at a number of investment firms, including the Legacy Funds, their track record and achievements are not necessarily indicative of future results that will be achieved by our Investment Advisor. We cannot assure you that we will be able to achieve the results realized by prior vehicles managed by our Investment Advisor's investment team, including the Legacy Funds.

Any failure on our part to maintain our status as a BDC would reduce our operating flexibility.

We have elected to be regulated as a BDC under the 1940 Act. The 1940 Act imposes numerous constraints on the operations of BDCs. For example, BDCs are required to invest at least 70% of their gross assets in specified types of securities, primarily in private companies or thinly traded U.S. public companies, cash, cash equivalents, U.S. government securities and other high quality debt investments that mature in one year or less. Furthermore, any failure to comply with the requirements imposed on BDCs by the 1940 Act could cause the SEC to bring an enforcement action against us and/or expose us to claims of private litigants. In addition, upon approval of a majority of our stockholders, we may elect to withdraw our status as a BDC. If we decide to withdraw our election, or if we otherwise fail to qualify, or maintain our qualification, as a BDC, we may be subject to the substantially greater regulation under the 1940 Act as a closed-end investment company. Compliance with such regulations would significantly decrease our operating flexibility and could significantly increase our costs of doing business.

Regulations governing our operation as a BDC affect our ability to raise additional capital and the way in which we do so. As a BDC, the necessity of raising additional capital may expose us to risks, including the typical risks associated with leverage.

We may issue debt securities or preferred stock and/or borrow money from banks or other financial institutions, which we refer to collectively as “senior securities,” up to the maximum amount permitted by the 1940 Act. Under the provisions of the 1940 Act, we are permitted, as a BDC, to issue senior securities in amounts such that our asset coverage ratio, as defined in the 1940 Act, equals at least 200% of gross assets less all liabilities and indebtedness not represented by senior securities, after each issuance of senior securities. If the value of our assets declines, we may be unable to satisfy this test. If that happens, we may be required to sell a portion of our investments and, depending on the nature of our leverage, repay a portion of our indebtedness at a time when such sales may be disadvantageous. Also, any amounts that we use to service our indebtedness would not be available for distributions to our common stockholders. Furthermore, as a result of issuing senior securities, we would also be exposed to typical risks associated with leverage, including an increased risk of loss.

As of December 31, 2017, we had $170.7 million of outstanding SBA-guaranteed debentures, $75.0 million of 6.0% fixed rate notes due May 31, 2022 (the “2022 Notes”) outstanding, $52.1 million of 5.75% fixed rate convertible notes due May 31, 2022 (the “2022 Convertible Notes”) outstanding, and $9.0 million outstanding under the Credit Facility that provides for borrowings of up to $114.5 million on a revolving basis and may be increased up to $200.0 million pursuant to its “accordion” feature. We have received an exemptive order from the SEC granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs. If we issue preferred stock, the preferred stock would rank “senior” to common stock in our capital structure, preferred stockholders would have separate voting rights on certain matters and might have other rights, preferences, or privileges more favorable than those of our common stockholders, and the issuance of preferred stock could have the effect of delaying, deferring or preventing a transaction or a change of control that might involve a premium price for holders of our common stock or otherwise be in your best interest.

We generally may not issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the then-current net asset value per share of our common stock if our Board determines that such sale is in our best interests and in the best interests of our stockholders, and our stockholders approve such sale. In any such case, the price at which our securities are to be issued and sold may not be less than a price that, in the determination of our Board, closely approximates the market value of such securities (less any commission or discount). If we raise additional funds by issuing more common stock or senior securities convertible into, or exchangeable for, our common stock, then the percentage ownership of our stockholders at that time will decrease, and you may experience dilution.

At our 2017 Annual Stockholders Meeting, subject to certain determinations required to be made by our Board, our stockholders approved our ability to sell or otherwise issue shares of our common stock, not exceeding 25% of our then outstanding common stock immediately prior to each such offering, at a price below the then current net asset value per share during a period beginning on May 3, 2017 and expiring on the earlier of the one year anniversary of the date of the 2017 Annual Stockholders Meeting and the date of our 2018 Annual Stockholders Meeting, which is expected to be held in April 2018.

In certain limited circumstances, pursuant to an SEC staff interpretation, we may also issue shares at a price below net asset value in connection with a transferable rights offering so long as: (1) the offer does not discriminate among stockholders; (2) we use our best efforts to ensure an adequate trading market exists for the rights; and (3) the ratio of the offering does not exceed one new share for each three rights held. If we raise additional funds by issuing more common stock or senior securities convertible into, or exchangeable for, our common stock, the percentage ownership of our stockholders at that time would decrease and they may experience dilution. Moreover, we can offer no assurance that we will be able to issue and sell additional equity securities in the future, on favorable terms or at all.

We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us, and the calculation of our base management fee, which is based upon our gross assets, may have the effect of encouraging our Investment Advisor to utilize leverage when it may not be advisable to do so.

The use of leverage magnifies the potential for gain or loss on amounts invested and, therefore, increases the risks associated with investing in our securities. In addition to the existing SBA-guaranteed debentures, the 2022 Notes, the 2022 Convertible Notes and the Credit Facility, we may borrow from and issue senior debt securities to banks, insurance companies and other lenders in the future. Holders of these senior securities will have fixed dollar claims on our assets that are superior to the claims of our common stockholders, and we would expect such lenders to seek recovery against our assets in the event of a default. If the value of our assets decreases, leverage would cause net asset value to decline more sharply than it otherwise would have had we not been leveraged. Similarly, any decrease in our income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could also negatively affect our ability to make distributions on our common stock. Leverage is generally considered a speculative investment technique. Our ability to service any debt that we incur will depend largely on our financial performance and will be subject to prevailing economic conditions and competitive pressures. Moreover, as the management fee payable to our Investment Advisor will be payable based on our gross assets, including those assets acquired through the use of leverage, our Investment Advisor will have a financial incentive to incur leverage that may not be consistent with our stockholders' interests. In addition, our common stockholders will bear the burden of any increase in our expenses as a result of leverage, including any increase in the management fee payable to our Investment Advisor.

The Credit Facility, and any other credit facility into which we may enter, imposes financial and operating covenants that restrict our business activities, including limitations that could hinder our ability to finance additional loans and investments or to make the distributions required to maintain our tax treatment as a RIC under the Code.

To the extent we borrow money to finance our investments, changes in interest rates will affect our cost of capital and net investment income.

To the extent we borrow money to finance our investments; our net investment income will depend, in part, upon the difference between the rate at which we borrow funds and the rate at which we invest those funds. As a result, we can offer no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income in the event we borrow money to finance our investments. In periods of rising interest rates, our cost of funds would increase, which could reduce our net investment income. We expect that our long-term fixed-rate investments will be financed primarily with equity and long-term debt. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act. Our Investment Advisor does not have significant experience with utilizing these techniques and did not implement these techniques to any significant extent with our portfolio. If we do not implement these techniques properly, we could experience losses on our hedging positions, which could be material.

A disruption in the capital markets and the credit markets could impair our ability to raise capital and negatively affect our business.

As a BDC, we have to maintain our ability to raise additional capital for investment purposes. Without sufficient access to the capital markets or credit markets, we may be forced to curtail our business operations or we may not be able to pursue new business opportunities.

In the past, the capital markets and the credit markets have experienced periods of extreme volatility and disruption and, accordingly, there has been and may continue to be uncertainty in the financial markets in general. Continuing U.S. debt ceiling and budget deficit concerns, including automatic spending cuts stemming from sequestration, together with signs of deteriorating sovereign debt conditions in Europe, have increased the possibility of additional credit-rating downgrades and economic slowdowns, or a recession in the U.S. The impact of this or any further downgrades to the U.S. government's sovereign credit rating or its perceived creditworthiness could adversely affect the U.S. and global financial markets and economic conditions. These developments, along with the European sovereign debt crisis, could cause interest rates and borrowing costs to rise, which may negatively impact our ability to access the debt markets on favorable terms. Continued adverse economic conditions could have a material adverse effect on our business, financial condition and results of operations. Any further disruptive conditions in the financial industry and the impact of new legislation in response to those conditions could restrict our business operations and could adversely impact our results of operations and financial condition.

If the fair value of our assets declines substantially, we may fail to maintain the asset coverage ratios imposed upon us by the 1940 Act. Any such failure would affect our ability to issue senior securities, including borrowings, and pay dividends, which could materially impair our business operations. Our liquidity could be impaired further by an inability to access the capital markets or to consummate new borrowing facilities to provide capital for normal operations, including new originations. In recent years, reflecting concern about the stability of the financial markets, many lenders and institutional investors have reduced or ceased providing funding to borrowers.

We have fully drawn on our SBA-guaranteed debentures and, absent changes to legislation or regulation, may not make borrowings in excess of their aggregate $170.7 million of SBA-guaranteed debentures outstanding as of December 31, 2017. We also had approximately $75.0 million and $52.1 million, respectively, of the 2022 Notes and 2022 Convertible Notes outstanding as of December 31, 2017. In addition, as of December 31, 2017, we had approximately $9.0 million outstanding under the Credit Facility that provides for borrowings of up to $114.5 million on a revolving basis and may be increased up to $200.0 million pursuant to its "accordion" feature. If we are unable to secure additional debt financing on commercially reasonable terms, our liquidity could be reduced significantly. If we are unable to repay amounts outstanding under any debt facilities we may obtain and are declared in default or are unable to renew or refinance these facilities, we may not be able to operate our business in the normal course. These situations may arise due to circumstances that we may be unable to control, such as lack of access to the credit markets, a severe decline in the value of the U.S. dollar, another economic downturn or an operational problem that affects third parties or us, and could materially damage our business.

You should also be aware that a rise in the general level of interest rates can be expected to lead to higher interest rates applicable to our debt investments. Accordingly, an increase in interest rates would make it easier for us to meet or exceed the incentive fee hurdle rate and may result in a substantial increase of the amount of incentive fees payable to our Investment Advisor with respect to our pre-incentive fee net investment income.

Global economic, political and market conditions may adversely affect our business, results of operations and financial condition, including our revenue growth and profitability.

The current worldwide financial market situation, as well as various social and political tensions in the U.S. and around the world, may contribute to increased market volatility, may have long-term effects on the U.S. and worldwide financial markets, and may cause economic uncertainties or deterioration in the United States and worldwide. The U.S. and global capital markets experienced extreme volatility and disruption during the economic downturn that began in mid-2007, and the U.S. economy was in a recession for several consecutive calendar quarters during the same period. In 2010, a financial crisis emerged in

Europe, triggered by high budget deficits and rising direct and contingent sovereign debt, which created concerns about the ability of certain nations to continue to service their sovereign debt obligations. Risks resulting from such debt crisis, including any austerity measures taken in exchange for bailout of certain nations, and any future debt crisis in Europe or any similar crisis elsewhere could have a detrimental impact on the global economic recovery, sovereign and non-sovereign debt in certain countries and the financial condition of financial institutions generally. In June 2016, the United Kingdom held a referendum in which voters approved an exit from the European Union ("Brexit"), and, accordingly, on February 1, 2017, the U.K. Parliament voted in favor of allowing the U.K. government to begin the formal process of Brexit. The initial negotiations on Brexit commenced in June 2017. Brexit created political and economic uncertainty and instability in the global markets (including currency and credit markets), and especially in the United Kingdom and the European Union, and this uncertainty and instability may last indefinitely. Because of the election results in the U.K. in June 2017, there is increased uncertainty on the timing of Brexit. There is continued concern about national-level support for the Euro and the accompanying coordination of fiscal and wage policy among European Economic and Monetary Union member countries. In addition, the fiscal and monetary policies of foreign nations, such as Russia and China, may have a severe impact on the worldwide and U.S. financial markets.

As a result of the 2016 U.S. election, the Republican Party currently controls both the executive and legislative branches of government, which increases the likelihood that legislation may be adopted that could significantly affect the regulation of U.S. financial markets. Areas subject to potential change, amendment or repeal include the Dodd-Frank Act and the authority of the Federal Reserve and the Financial Stability Oversight Council. The U.S. may also potentially withdraw from or renegotiate various trade agreements and take other actions that would change current trade policies of the U.S. We cannot predict which, if any, of these actions will be taken or, if taken, their effect on the financial stability of the U.S. Such actions could have a significant adverse effect on our business, financial condition and results of operations. We cannot predict the effects of these or similar events in the future on the U.S. economy and securities markets or on our investments. We monitor developments and seek to manage our investments in a manner consistent with achieving our investment objective, but there can be no assurance that we will be successful in doing so.

Further downgrades of the U.S. credit rating, impending automatic spending cuts, another government shutdown or a failure to raise the statutory debt limit of the United States could negatively impact our liquidity, financial condition and earnings.

Recent U.S. debt ceiling and budget deficit concerns have increased the possibility of additional credit-rating downgrades and economic slowdowns, or a recession in the U.S. In the future, the U.S. government may not be able to meet its debt payments unless the federal debt ceiling is raised. If legislation increasing the debt ceiling is not enacted, as needed, and the debt ceiling is reached, the U.S. federal government may stop or delay making payments on its obligations, which could negatively impact the U.S. economy and our portfolio companies. In addition, disagreement over the federal budget has caused the U.S. federal government to shut down for periods of time. Continued adverse political and economic conditions could have a material adverse effect on our business, financial condition and results of operations.

We may experience fluctuations in our quarterly and annual results.

We may experience fluctuations in our quarterly and annual operating results due to a number of factors, including our ability or inability to make investments in companies that meet our investment criteria, any sales, dispositions or liquidity events of our portfolio companies, the interest rate payable on the debt securities we acquire, the level of portfolio dividend and fee income, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions. Given that the portfolio is concentrated, distributions, dispositions or liquidity events affecting a portfolio company in which we own a significant position may adversely affect our net asset value and results of operations. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

Our Board may change our investment objective, operating policies and strategies without prior notice or stockholder approval, the effects of which may be adverse.

Our Board has the authority to modify or waive our investment objective, operating policies, investment criteria and strategies without prior notice and without stockholder approval. We cannot predict the effect any changes to our current operating policies, investment criteria and strategies would have on our business, net asset value, operating results and value of our stock. However, the effects might be adverse, which could negatively impact our ability to make distributions and cause you to lose all or part of your investment.

We will be subject to corporate-level U.S. federal income tax if we are unable to qualify or maintain our RIC tax treatment under the Code.

Although we have elected to be treated as a RIC beginning with our taxable year ended August 31, 2014, no assurance can be given that we will be able to continue to qualify for and maintain our RIC tax treatment under the Code. To continue to maintain our RIC tax treatment under the Code, we must meet the following source-of-asset diversification, and distribution requirements.

The income source requirement will be satisfied if we obtain at least 90% of our income for each year from dividends, interest, gains from the sale or other disposition of stock or securities or similar sources. The asset diversification requirement will be satisfied if we meet certain asset diversification requirements at the end of each quarter of our taxable year. Failure to meet those requirements may result in our having to dispose of certain investments quickly in order to prevent the loss of our RIC tax treatment under the Code. Because most of our investments will be in private companies, and therefore will be relatively illiquid, any such dispositions could be made at disadvantageous prices and could result in substantial losses.

The annual distribution requirement for a RIC will be satisfied if we distribute to our stockholders on an annual basis at least 90% of our net ordinary income and net short-term capital gains in excess of our net long-term capital losses, if any. Because we may use debt financing, we are subject to certain asset coverage ratio requirements under the 1940 Act, as well as future financial covenants under loan and credit agreements that could, under certain circumstances, restrict us from making distributions necessary to satisfy the distribution requirement. If we are unable to obtain cash from other sources, we could fail to qualify for tax treatment as a RIC under the Code.

If we fail to qualify for tax treatment as a RIC under the Code for any reason and remain or become subject to corporate-level U.S. federal income tax on all of our income, the resulting corporate taxes could substantially reduce our net assets, the amount of income available for distribution or reinvestment and the amount of our distributions.

We cannot predict how tax reform legislation will affect us, our investments, or our stockholders, and any such legislation could adversely affect our business.

Legislative or other actions relating to taxes could have a negative effect on us. The rules dealing with U.S. federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Treasury Department. The U.S. House of Representatives and U.S. Senate recently passed tax reform legislation, which the President recently signed into law. Such legislation will make many changes to the Internal Revenue Code, including significant changes to the taxation of business entities, the deductibility of interest expense, and the tax treatment of capital investment. We cannot predict with certainty how any changes in the tax laws might affect us, our stockholders, or our portfolio investments. New legislation and any U.S. Treasury regulations, administrative interpretations or court decisions interpreting such legislation could significantly and negatively affect our ability to qualify for tax treatment as a RIC or the U.S. federal income tax consequences to us and our stockholders of such qualification, or could have other adverse consequences. Stockholders are urged to consult with their tax advisor regarding tax legislative, regulatory, or administrative developments and proposals and their potential effect on an investment in our securities.

We may not be able to pay our stockholders distributions, our distributions may not grow over time and a portion of our distributions may be a return of capital.

We intend to pay distributions to our stockholders out of assets legally available for distribution. We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. Our ability to pay distributions might be adversely affected by, among other things, the impact of one or more of the risk factors described herein. In addition, the inability to satisfy the asset coverage test applicable to us as a BDC can limit our ability to pay distributions. All distributions will be paid at the discretion of our Board and will depend on our earnings, our financial condition, maintenance of our RIC status, compliance with applicable BDC regulations and such other factors as our Board may deem relevant from time to time. We cannot assure you that we will pay distributions to our stockholders in the future. In the event we liquidate or dispose of a significant equity position in our portfolio, we may distribute a special dividend relating to the realized capital gains from such investment in order to minimize to the greatest extent possible our U.S. federal income or excise tax liability.

When we make distributions, we will be required to determine the extent to which such distributions are paid out of current or accumulated earnings and profits. Distributions in excess of current and accumulated earnings and profits will be treated as a non-taxable return of capital, which is a return of a portion of a stockholder's original investment in our common stock, to the extent of an investor's basis in our stock and, assuming that an investor holds our stock as a capital asset, thereafter as a capital gain. Generally, a non-taxable return of capital will reduce an investor's basis in our stock for U.S. federal income tax purposes, which will result in higher tax liability when the stock is sold.

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

For U.S. federal income tax purposes, we include in our taxable income certain amounts that we have not yet received in cash, such as PIK interest or original issue discount, which may arise if we receive warrants in connection with the origination of a loan or possibly in other circumstances. Such original issue discount or increases in loan balances as a result of contractual PIK arrangements are included in our taxable income before we receive any corresponding cash payments. We also may be required to include in our taxable income certain other amounts that we will not receive in cash.

Since, in certain cases, we may recognize taxable income before or without receiving corresponding cash payments, we may have difficulty meeting the annual distribution requirement necessary to maintain our RIC tax treatment under the Code. Accordingly, to satisfy our RIC distribution requirements, we may have to sell some of our investments at times and/or at prices we would not consider advantageous, raise additional debt or equity capital or forgo new investment opportunities. If we are not able to obtain cash from other sources, we may fail to qualify as a RIC for tax treatment under the Code and thus become subject to corporate-level U.S. federal income tax.

Capitala Investment Advisors is not obligated to reimburse us for any part of the incentive fee it receives that is based on accrued income that we never receive.

Part of the incentive fee payable by us to our Investment Advisor that relates to our net investment income is computed and paid on income that may include interest that has been accrued but not yet received in cash, such as market discount, debt instruments with PIK interest, preferred stock with PIK dividends and zero coupon securities. If a portfolio company defaults on a loan that is structured to provide accrued interest, it is possible that accrued interest previously used in the calculation of the incentive fee will become uncollectible. Our Investment Advisor will not be under any obligation to reimburse us for any part of the incentive fees it received that was based on accrued income that we never receive as a result of a default by an entity on the obligation that resulted in the accrual of such income.

We may in the future choose to pay dividends in our own stock, in which case you may be required to pay tax in excess of the cash you receive.

We may distribute taxable dividends that are payable in part in our stock. In accordance with certain applicable Treasury regulations and guidance issued by the Internal Revenue Service ("IRS"), a RIC may treat a distribution of its own stock as fulfilling the 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 that the aggregate amount of cash to be distributed to all stockholders must be at least 20% of the aggregate declared distribution. If too many stockholders elect to receive cash, the cash available for distribution must be allocated among the stockholders electing to receive cash (with the balance of the distribution paid in stock). In no event will any stockholder, electing to receive cash, receive the lesser of (a) the portion of the distribution such stockholder has elected to receive in cash or (b) an amount equal to his or her entire distribution times the percentage limitation on cash available for distribution. 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. Taxable stockholders receiving such dividends (whether received in cash, our stock, or a combination thereof) will be required to include the full amount of the dividend as ordinary income (or as long-term capital gain to the extent such distribution is properly reported as a capital gain dividend) to the extent of our current and accumulated earnings and profits for U.S. federal income tax purposes. As a result, a U.S. stockholder may be required to pay tax with respect to such dividends in excess of any cash received. If a U.S. stockholder sells the stock it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our stock.

If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud. As a result, stockholders and noteholders could lose confidence in our financial and other public reporting, which would harm our business.

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports and, together with adequate disclosure controls and procedures, are designed to prevent fraud. Any failure to implement required new or improved controls, or difficulties encountered in their implementation could cause us to fail to meet our reporting obligations. In addition, any testing by us conducted in connection with Section 404 of the Sarbanes-Oxley Act, or the subsequent testing by our independent registered public accounting firm (when undertaken, as noted below), may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses or that may require prospective or retroactive changes to our consolidated financial statements or identify other areas for further attention or improvement. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on our business.

We are required to disclose changes made in our internal controls and procedures over financial reporting on a quarterly basis and our management is required to assess the effectiveness of these controls annually. However, for as long as we are an “emerging growth company” under the JOBS Act, our independent registered public accounting firm will not be required to attest to the effectiveness of our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act. We could be an “emerging growth company” for up to five years from the date of our IPO.

An independent assessment of the effectiveness of our internal controls could detect problems that our management’s assessment might not. Undetected material weaknesses in our internal controls could lead to financial statement restatements and require us to incur the expense of remediation. As a public company, may incur significant additional expenses in the near term, which may negatively impact our financial performance and our ability to make distributions to our stockholders. This process also will result in a diversion of management’s time and attention. We cannot be certain as to the timing of completion of any evaluation, testing and remediation actions or the impact of the same on our operations, and we may not be able to ensure that the process is effective or that our internal controls over financial reporting are or will be effective in a timely manner. In the event that we are unable to maintain or achieve compliance with Section 404 of the Sarbanes-Oxley Act and related rules, the market price of our common stock may be adversely affected.

New and pending legislation may allow us to incur additional leverage.

As a BDC, under the 1940 Act generally we are not permitted to incur indebtedness unless immediately after such borrowing we have an asset coverage for total borrowings of at least 200% (i.e., the amount of debt may not exceed 50% of the value of our total assets or we may borrow an amount equal to 100% of net assets). The adoption of either the Financial CHOICE Act of 2017, which was passed by the U.S House of Representatives in June 2017, or the Small Business Credit Availability Act, which was passed by the Financial Services Committee of the U.S. House of Representatives in November 2017, would modify this section of the 1940 Act and increase the amount of debt that BDCs may incur by modifying the asset coverage percentage from 200% to 150%. As a result, we may be able to incur additional indebtedness in the future and therefore your risk of an investment in us may increase. In addition, in December 2015, the 2016 omnibus spending bill approved by Congress and signed into law by the President increased the amount of SBA-guaranteed debentures that affiliated SBIC funds can have outstanding from $225.0 million to $350.0 million, subject to SBA approval. This new legislation may allow us to issue additional SBIC debentures above the $225.0 million of SBA-guaranteed debentures previously permitted pending application for and receipt of additional SBIC licenses. If we incur this additional indebtedness in the future, your risk of an investment in our securities may increase.

Changes in laws or regulations governing our operations may adversely affect our business or cause us to alter our business strategy.

We and our portfolio companies will be subject to applicable local, state and federal laws and regulations. New legislation may be enacted or new interpretations, rulings or regulations could be adopted, including those governing the types of investments we are permitted to make, any of which could harm us and our stockholders, potentially with retroactive effect. Additionally, any changes to the laws and regulations governing our operations relating to permitted investments may cause us to alter our investment strategy in order to avail ourselves of new or different opportunities. Such changes could result in material differences to the strategies and plans set forth herein and may result in our investment focus shifting from the areas of expertise of our Investment Advisor’s investment team to other types of investments in which the investment team may have less expertise or little or no experience. Thus, any such changes, if they occur, could have a material adverse effect on our results of operations and the value of your investment. In addition, any change to the SBA’s current debenture SBIC program could have a significant impact on our ability to obtain lower-cost financing and, therefore, our competitive advantage over other finance companies.

Over the last several years, there has been an increase in regulatory attention to the extension of credit outside of the traditional banking sector, raising the possibility that some portion of the non-bank financial sector will be subject to new regulation. While it cannot be known at this time whether these regulations will be implemented or what form they will take, increased regulation of non-bank credit extension could negatively impact our operations, cash flows or financial condition, impose additional costs on us, intensify the regulatory supervision of us or otherwise adversely affect our business

Two of our wholly owned subsidiaries are licensed by the U.S. Small Business Administration, and as a result, we are subject to SBA regulations.

Fund II and Fund III, which became our wholly owned subsidiaries after the completion of the Formation Transactions, are licensed to act as SBICs and are regulated by the SBA. As of December 31, 2017, Fund II and Fund III portfolio companies accounted for 62.9% of our aggregate portfolio. The SBIC licenses allow our SBIC subsidiaries to borrow funds by issuing SBA-guaranteed debentures, subject to the issuance of a capital commitment by the SBA and other customary procedures. The SBA regulations require, among other things, that a licensed SBIC be examined periodically and audited by an independent auditor to determine the SBIC’s compliance with the relevant SBA regulations.

Under current SBA regulations, a licensed SBIC may provide capital to those entities that have a tangible net worth not exceeding $19.5 million and an average annual net income after U.S. federal income taxes not exceeding $6.5 million for the two most recent fiscal years. In addition, a licensed SBIC must devote 25.0% of its investment activity to those entities that have a tangible net worth not exceeding $6.0 million and an average annual net income after U.S. federal income taxes not exceeding $2.0 million for the two most recent fiscal years. The SBA regulations also provide alternative size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on factors such as the number of employees and gross sales. The SBA regulations permit licensed SBICs to make long term loans to small businesses, invest in the equity securities of such businesses and provide them with consulting and advisory services. The SBA also places certain limitations on the financing terms of investments by SBICs in portfolio companies and prohibits SBICs from providing funds for certain purposes or to businesses in a few prohibited industries. Compliance with SBA requirements may cause a Legacy Fund to forego attractive investment opportunities that are not permitted under SBA regulations.

The SBA also prohibits, without prior SBA approval, a “change of control” of an SBIC or transfers that would result in any person (or a group of persons acting in concert) owning 10.0% or more of a class of capital stock of a licensed SBIC. If Fund II or Fund III fails to comply with applicable SBA regulations, the SBA could, depending on the severity of the violation, limit or prohibit such Fund’s use of debentures, declare outstanding debentures immediately due and payable, and/or limit such Fund from making new investments. Such actions by the SBA would, in turn, negatively affect us because Fund II and Fund III are our wholly owned subsidiaries. Each of Fund II and Fund III was in compliance with the terms of the SBA’s leverage requirements as of December 31, 2017 as a result of having sufficient capital as defined under the SBA regulations.

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 1934 Act with respect to Fund II and Fund III. We intend to comply with the conditions of the order. As a result, we will generally be permitted to incur a greater amount of leverage relative to our total assets and net asset value, which may expose us to a greater degree of risk.

Our wholly owned SBIC subsidiaries may be unable to make distributions to us that will enable us to meet or maintain RIC tax treatment, which could result in the imposition of a corporate-level U.S. federal income tax.

In order for us to continue to qualify for RIC tax treatment under the Code and to minimize corporate-level U.S. federal income taxes, we will be required to distribute substantially all of our net ordinary income and net capital gain income, including income from certain of our subsidiaries, which includes the income from our SBIC subsidiaries. We will be partially dependent on our SBIC subsidiaries for cash distributions to enable us to meet the RIC distribution requirements. Our SBIC subsidiaries may be limited by the Small Business Investment Act of 1958, and SBA regulations governing SBICs, from making certain distributions to us that may be necessary to maintain our status as a RIC. We may have to request a waiver of the SBA’s restrictions for our SBIC subsidiaries to make certain distributions to maintain our RIC status. We cannot assure you that the SBA will grant such waiver and if our SBIC subsidiaries are unable to obtain a waiver, compliance with the SBA regulations may result in loss of RIC tax treatment and a consequent imposition of a corporate-level U.S. federal income tax on all of our income.

Our business is subject to increasingly complex corporate governance, public disclosure and accounting requirements that are costly and could adversely affect our business and financial results.

As a publicly traded company, we incur legal, accounting and other expenses, including costs associated with the periodic reporting requirements applicable to a company whose securities are registered under the 1934 Act, or the Exchange Act, as well as additional corporate governance requirements, including requirements under the Sarbanes Oxley Act, and other rules implemented by the SEC. Also, we are subject to changing rules and regulations of federal and state government as well as the stock exchange on which our common stock is listed. These entities, including the Public Company Accounting Oversight Board, the SEC and the NASDAQ Stock Market, have issued a significant number of new and increasingly complex requirements and regulations over the course of the last several years and continue to develop additional regulations and requirements in response to laws enacted by Congress. Our efforts to comply with these existing requirements, or any revised or amended requirements, have resulted in, and are likely to continue to result in, an increase in expenses and a diversion of management’s time from other business activities.

We are highly dependent on information systems and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to make distributions to our stockholders.

Our business is highly dependent on the communications and information systems of the Investment Advisor. Certain of these systems are provided to the Investment Advisor by third-party service providers. Any failure or interruption of such systems, including as a result of the termination of an agreement with any such third-party service provider, sudden electrical or telecommunications outages, natural disasters such as earthquakes, tornadoes, and hurricanes, events arising from local or larger scale political or social matters, including terrorist attacks, and cyber-attacks could cause delays or other problems in our activities. Any of the above, in turn, could have a material adverse effect on our operating results and negatively affect the market price of our common stock and our ability to make distributions to our stockholders.

Internal and external cyber threats, as well as other disasters, could impair our ability to conduct business effectively.

The occurrence of a disaster, such as a cyber-attack against us or against a third-party that has access to our data or networks, a natural catastrophe, an industrial accident, failure of our disaster recovery systems, or consequential employee error, could have an adverse effect on our ability to communicate or conduct business, negatively impacting our operations and financial condition. This adverse effect can become particularly acute if those events affect our electronic data processing, transmission, storage, and retrieval systems, or impact the availability, integrity, or confidentiality of our data.

We depend heavily upon computer systems to perform necessary business functions. Despite our implementation of a variety of security measures, our computer systems, networks, and data, like those of other companies, could be subject to cyber-attacks and unauthorized access, use, alteration, or destruction, such as from physical and electronic break-ins or unauthorized tampering. If one or more of these events occurs, it could potentially jeopardize the confidential, proprietary, and other information processed, stored in, and transmitted through our computer systems and networks. Such an attack could cause interruptions or malfunctions in our operations, which could result in financial losses, litigation, regulatory penalties, client dissatisfaction or loss, reputational damage, and increased costs associated with mitigation of damages and remediation.

Third parties with which we do business may also be sources of cybersecurity or other technological risk. We outsource certain functions and these relationships allow for the storage and processing of our information, as well as client, counterparty, employee, and borrower information. While we engage in actions to reduce our exposure resulting from outsourcing, ongoing threats may result in unauthorized access, loss, exposure, destruction, or other cybersecurity incident that affects our data, resulting in increased costs and other consequences as described above.

Terrorist attacks, acts of war or natural disasters may affect the market for our common stock, impact the businesses in which we invest and harm our business, operating results and financial condition.

Terrorist acts, acts of war or natural disasters may disrupt our operations, as well as the operations of the businesses in which we invest. Such acts have created, and continue to create, economic and political uncertainties and have contributed to global economic instability. Future terrorist activities, military or security operations, or natural disasters could further weaken the domestic/global economies and create additional uncertainties, which may negatively impact the businesses in which we invest directly or indirectly and, in turn, could have a material adverse impact on our business, operating results and financial condition. Losses from terrorist attacks and natural disasters are generally uninsurable.

To the extent original issue discount and PIK interest constitute a portion of our income, we will be exposed to typical risks associated with such income being required to be included in taxable and accounting income prior to receipt of cash representing such income.

Our investments may include original issue discount (“OID”) instruments and contractual PIK interest, which represents contractual interest added to a loan balance and due at the end of such loan’s term. To the extent OID or PIK interest constitute a portion of our income, we are exposed to typical risks associated with such income being required to be included in taxable and accounting income prior to receipt of cash, including the following:

- OID instruments may have higher yields, which reflect the payment deferral and credit risk associated with these instruments;
- OID accruals may create uncertainty about the source of our distributions to stockholders;
- OID and PIK instruments may have unreliable valuations because their continuing accruals require continuing judgments about the collectability of the deferred payments and the value of the collateral; and
- OID and PIK instruments may represent a higher credit risk than coupon loans.

If we cannot obtain additional capital because of either regulatory or market price constraints, we could be forced to curtail or cease our new lending and investment activities, our net asset value could decrease and our level of distributions and liquidity could be affected adversely.

Our ability to secure additional financing and satisfy our financial obligations under indebtedness outstanding from time to time will depend upon our future operating performance, which is subject to the prevailing general economic and credit market conditions, including interest rate levels and the availability of credit generally, and financial, business and other factors, many of which are beyond our control. The prolonged continuation or worsening of current economic and capital market conditions could have a material adverse effect on our ability to secure financing on favorable terms, if at all.

If we are unable to obtain additional debt capital, then our equity investors will not benefit from the potential for increased returns on equity resulting from leverage to the extent that our investment strategy is successful and we may be limited in our ability to make new commitments or fundings to our portfolio companies.

We are an "emerging growth company" under the JOBS Act, and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our securities less attractive to investors.

We are and we will remain an "emerging growth company" as defined in the JOBS Act until the earlier of (a) the last day of the fiscal year (i) following the fifth anniversary of the completion of our IPO, (ii) in which we have total annual gross revenue of at least $1.0 billion, or (iii) in which we are deemed to be a large accelerated filer, which means the market value of our common stock that is held by non-affiliates exceeds $700 million as of the end of the previous second fiscal quarter, and (b) the date on which we have issued more than $1.0 billion in non-convertible debt during the prior three-year period. For so long as we remain an "emerging growth company" we have chosen to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not "emerging growth companies" including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act.

In addition, Section 107 of the JOBS Act also provides that an "emerging growth company" may take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an "emerging growth company" can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have chosen to take advantage of the extended transition period for complying with new or revised accounting standards, which may make it more difficult for investors and securities analysts to evaluate us since our financial statements may not be comparable to companies that comply with public company effective dates and may result in less investor confidence.

Because of the exemptions from various reporting requirements provided to us as an "emerging growth company" under the JOBS Act and because we will have an extended transition period for complying with new or revised financial accounting standards, we may be less attractive to investors and it may be difficult for us to raise additional capital as and when we need it. Investors may be unable to compare our business with other companies in our industry if they believe that our financial accounting is not as transparent as other companies in our industry. If we are unable to raise additional capital as and when we need it, our financial condition and results of operations may be materially and adversely affected.

Our Board is authorized to reclassify any unissued shares of common stock into one or more classes of preferred stock, which could convey special rights and privileges to its owners.

Under Maryland General Corporation Law and our charter, our Board is authorized to classify and reclassify any authorized but unissued shares of stock into one or more classes of stock, including preferred stock. Prior to the issuance of shares of each class or series, our Board will be required by Maryland law and our charter to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Thus, our Board could authorize the issuance of shares of preferred stock with terms and conditions that could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or otherwise be in their best interest. The cost of any such reclassification would be borne by our common stockholders. Certain matters under the 1940 Act require the separate vote of the holders of any issued and outstanding preferred stock. For example, holders of preferred stock would vote separately from the holders of common stock on a proposal to cease operations as a BDC. In addition, the 1940 Act provides that holders of preferred stock are entitled to vote separately from holders of common stock to elect two preferred stock directors. We currently have no plans to issue preferred stock. The issuance of preferred shares convertible into shares of common stock may also reduce the net income and net asset value per share of our common stock upon conversion, provided, that we will only be permitted to issue such convertible preferred stock to the extent we comply with the requirements of Section 61 of the 1940 Act, including obtaining common stockholder approval. These effects, among others, could have an adverse effect on your investment in our common stock.

Provisions of the Maryland General Corporation Law and of our charter and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.

The Maryland General Corporation Law and our charter and bylaws contain provisions that may discourage, delay or make more difficult a change in control of Capitala Finance or the removal of our directors. We are subject to the Maryland Business Combination Act, subject to any applicable requirements of the 1940 Act. Our Board has adopted a resolution exempting from the Maryland Business Combination Act any business combination between us and any other person, subject to prior approval of such business combination by our Board, including approval by a majority of our independent directors. If the resolution exempting business combinations is repealed or our Board does not approve a business combination, the Maryland Business Combination Act may discourage third parties from trying to acquire control of us and increase the difficulty of consummating such an offer. Our bylaws exempt from the Maryland Control Share Acquisition Act acquisitions of our stock by any person. If we amend our bylaws to repeal the exemption from the Maryland Control Share Acquisition Act, the Maryland Control Share Acquisition Act also may make it more difficult for a third-party to obtain control of us and increase the difficulty of consummating such a transaction. It is the position of the staff of the SEC's Division of Investment Management that if a BDC fails to opt-out of the Maryland Control Share Acquisition Act, it acts in a manner inconsistent with Section 18(i) of the 1940 Act.

We have also adopted measures that may make it difficult for a third-party to obtain control of us, including provisions of our charter classifying our Board in three classes serving staggered three-year terms, and authorizing our Board to classify or reclassify shares of our stock in one or more classes or series, to cause the issuance of additional shares of our stock, to amend our charter without stockholder approval and to increase or decrease the number of shares of stock that we have authority to issue. These provisions, as well as other provisions of our charter and bylaws, may delay, defer or prevent a transaction or a change in control that might otherwise be in the best interests of our stockholders.

The foregoing provisions are expected to discourage certain coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us to negotiate first with our Board. However, these provisions may deprive a stockholder of the opportunity to sell such stockholder's shares at a premium to a potential acquirer. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging any such acquisition proposals because, among other things, the negotiation of such proposals may improve their terms. Our Board has considered both the positive and negative effects of the foregoing provisions and determined that they are in the best interest of our stockholders.

Risks Related to Our Investments

Our investments are very risky and highly speculative.

We invest primarily in first lien loans, second lien loans, subordinated debt investments and select equity investments issued by leveraged companies, each of which carries with it a significant degree of risk.

First Lien Loans. There is a risk that the collateral securing our loans may decrease in value over time, may be difficult to sell in a timely manner, may be difficult to appraise and may fluctuate in value based upon the success of the business and market conditions, including as a result of the inability of the portfolio company to raise additional capital, and, in some circumstances, our lien could be subordinated to claims of other creditors. In addition, deterioration in a portfolio company's financial condition and prospects, including its inability to raise additional capital, may be accompanied by deterioration in the value of the collateral for the loan. Consequently, the fact that a loan is secured does not guarantee that we will receive principal and interest payments according to the loan's terms, or at all, or that we will be able to collect on the loan should we be forced to enforce our remedies.

Second Lien Loans. Our second lien debt investments have a second priority security interest in all or substantially all of the assets of the borrower. As such, other creditors may rank senior to us in the event of an insolvency, which could likely in many cases result in a substantial or complete loss on such investment in the case of such insolvency. This may result in an above average amount of risk and loss of principal.

Subordinated Loans. Our subordinated debt investments are generally subordinated to first lien loans and may be unsecured. As such, other creditors may rank senior to us in the event of an insolvency, which could likely in many cases result in a substantial or complete loss on such investment in the case of such insolvency. This may result in an above average amount of risk and loss of principal.

Equity Investments. When we invest in loans, we may acquire equity securities as well. In addition, we may invest directly in the equity securities of portfolio companies.

The equity interests we receive may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience. The portfolio currently has several significant equity positions. Distributions, dispositions, or liquidity events of these investments may affect our results of operations and cause us to have to pay a special dividend relating to the realized gains from such investment in order to minimize to the greatest extent possible our U.S. federal income or excise tax liability.

In addition, investing in lower and traditional middle-market companies involves a number of significant risks, including:

- these companies may have limited financial resources and may be unable to meet their obligations under their debt securities that we hold, which may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of us realizing any guarantees we may have obtained in connection with our investment;
- they typically have shorter operating histories, narrower product lines and smaller market shares than larger businesses, which tend to render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns;
- they are more likely to depend on the management talents and efforts of a small group of persons; therefore, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on our portfolio company and, in turn, on us;

- they generally have less predictable operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, and may require substantial additional capital to support their operations, finance expansion or maintain their competitive position;
- they may have difficulty accessing the capital markets to meet future capital needs, which may limit their ability to grow or to repay their outstanding indebtedness upon maturity; and
- our executive officers, directors and our Investment Advisor may, in the ordinary course of business, be named as defendants in litigation arising from our investments in the portfolio companies.

An investment strategy focused primarily on smaller privately held companies involves a high degree of risk and presents certain challenges, including the lack of available information about these companies, a dependence on the talents and efforts of only a few key portfolio company personnel and a greater vulnerability to economic downturns.

Our portfolio consists primarily of debt and equity investments in smaller privately owned venture capital-backed companies. Investing in venture capital-backed companies involves a number of significant risks. Typically, the debt in which we will invest is not initially rated by any rating agency; however, we believe that if such investments were rated, they would be rated below investment grade. Below investment grade securities, which are often referred to as “high yield” or “junk,” have predominantly speculative characteristics with respect to the issuer’s capacity to pay interest and repay principal. Compared to larger publicly owned companies, these venture capital-backed companies may be in a weaker financial position and experience wider variations in their operating results, which may make them more vulnerable to economic downturns. Typically, these companies need more capital to compete; however, their access to capital is limited and their cost of capital is often higher than that of their competitors. Our portfolio companies often face intense competition from larger companies with greater financial, technical and marketing resources and their success typically depends on the managerial talents and efforts of an individual or a small group of persons. Therefore, any loss of its key employees could affect a portfolio company’s ability to compete effectively and harm its financial condition. Further, some of these companies conduct business in regulated industries that are susceptible to regulatory changes. These factors could impair the cash flow of our portfolio companies and result in other events, such as bankruptcy. These events could limit a portfolio company’s ability to repay its obligations to us, which may have an adverse effect on the return on, or the recovery of, our investment in these businesses. Deterioration in a borrower’s financial condition and prospects may be accompanied by deterioration in the value of the loan’s collateral.

Generally, little public information exists about these companies, and we are required to rely on the ability of our Investment Advisor’s investment team to obtain adequate information to evaluate the potential returns from investing in these companies. If we are unable to uncover all material information about these companies, we may not make a fully informed investment decision, and we may lose money on our investments. Also, privately held companies frequently have less diverse product lines and smaller market presence than larger competitors. These factors could adversely affect our investment returns as compared to companies investing primarily in the securities of public companies.

Many of our loans are not fully amortizing and if a borrower cannot repay or refinance such loans at maturity, our results will suffer.

Most of the loans in which we invest are not structured to fully amortize during their lifetime. Accordingly, a significant portion of the principal amount of such a loan may be due at maturity. As of December 31, 2017, all debt instruments in our portfolio, on a fair value basis, will not fully amortize prior to maturity. In order to create liquidity to pay the final principal payment, borrowers typically must raise additional capital. If they are unable to raise sufficient funds to repay us or we have not elected to enter into a new loan agreement providing for an extended maturity, the loan will go into default, which will require us to foreclose on the borrower’s assets, even if the loan was otherwise performing prior to maturity. This will deprive Capitala Finance from immediately obtaining full recovery on the loan and prevent or delay the reinvestment of the loan proceeds in other, more profitable investments.

Our investments in leveraged portfolio companies may be risky, and you could lose all or part of your investment.

Investment in leveraged companies involves a number of significant risks. Leveraged companies in which we invest may have limited financial resources and may be unable to meet their obligations under their loans and debt securities that we hold. Such developments may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of our realizing any guarantees that we may have obtained in connection with our investment. Smaller leveraged companies also may have less predictable operating results and may require substantial additional capital to support their operations, finance their expansion or maintain their competitive position.

Our portfolio companies may incur debt that ranks equally with, or senior to, our investments in such companies.

Our portfolio companies may have, or may be permitted to incur, other debt that ranks equally with, or in some cases senior to, the debt in which we invest. By their terms, such debt instruments may entitle the holders to receive payment of interest or principal on or before the dates on which we are entitled to receive payments with respect to the debt instruments in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of debt instruments ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution. After repaying such senior creditors, such portfolio company may not have sufficient remaining assets to repay its obligation to us. In the case of debt ranking equally with debt instruments in which we invest, we would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant portfolio company.

Second priority liens on collateral securing loans that we make to our portfolio companies may be subject to control by senior creditors with first priority liens. If there is a default, the value of the collateral may not be sufficient to repay in full both the first priority creditors and us.

Certain loans that we make are secured by a second priority security interest in the same collateral pledged by a portfolio company to secure senior debt owed by the portfolio company to commercial banks or other traditional lenders. Often the senior lender has procured covenants from the portfolio company prohibiting the incurrence of additional secured debt without the senior lender's consent. Prior to and as a condition of permitting the portfolio company to borrow money from us secured by the same collateral pledged to the senior lender, the senior lender may require assurances that it will control the disposition of any collateral in the event of bankruptcy or other default. In many such cases, the senior lender requires us to enter into an "intercreditor agreement" prior to permitting the portfolio company to borrow from us. Typically the intercreditor agreements we are requested to execute expressly subordinate our debt instruments to those held by the senior lender and further provide that the senior lender shall control: (i) the commencement of foreclosure or other proceedings to liquidate and collect on the collateral; (ii) the nature, timing and conduct of foreclosure or other collection proceedings; (iii) the amendment of any collateral document; (iv) the release of the security interests in respect of any collateral; and (v) the waiver of defaults under any security agreement. Because of the control we may cede to senior lenders under intercreditor agreements we may enter, we may be unable to realize the proceeds of any collateral securing some of our loans.

If we make subordinated investments, the obligors or the portfolio companies may not generate sufficient cash flow to service their debt obligations to us.

We have made, and may make, subordinated investments that rank below other obligations of the obligor in right of payment. Subordinated investments are subject to greater risk of default than senior obligations as a result of adverse changes in the financial condition of the obligor or economic conditions in general. If we make a subordinated investment in a portfolio company, the portfolio company may be highly leveraged, and its relatively high debt-to-equity ratio may create increased risks that its operations might not generate sufficient cash flow to service all of its debt obligations.

The disposition of our investments may result in contingent liabilities.

Substantially all of our investments involve loans and private securities. In connection with the disposition of an investment in loans and private securities, we may be required to make representations about the business and financial affairs of the portfolio company typical of those made in connection with the sale of a business. We may also be required to indemnify the purchasers of such investment to the extent that any such representations turn out to be inaccurate or with respect to potential liabilities. These arrangements may result in contingent liabilities that ultimately result in funding obligations that we must satisfy through our return of distributions previously made to us.

There may be circumstances where our debt investments could be subordinated to claims of other creditors or we could be subject to lender liability claims.

Even though we may have structured most of our investments as secured loans, if one of our portfolio companies were to go bankrupt, depending on the facts and circumstances, and based upon principles of equitable subordination as defined by existing case law, a bankruptcy court could subordinate all or a portion of our claim to that of other creditors and transfer any lien securing such subordinated claim to the bankruptcy estate. The principles of equitable subordination defined by case law have generally indicated that a claim may be subordinated only if its holder is guilty of misconduct or where the senior loan is re-characterized as an equity investment and the senior lender has actually provided significant managerial assistance to the bankrupt debtor. We may also be subject to lender liability claims for actions taken by us with respect to a borrower's business or instances where we exercise control over the borrower. It is possible that we could become subject to a lender's liability claim, including as a result of actions taken in rendering significant managerial assistance or actions to compel and collect payments from the borrower outside the ordinary course of business. Such risk of equitable subordination may be potentially heightened with respect to various portfolio investments that we may be deemed to control. See also "— Because we will not hold controlling equity interests in most of our portfolio companies, we may not be in a position to exercise control over our portfolio companies or to prevent decisions by management of our portfolio companies that could decrease the value of our investments."

Economic recessions could impair our portfolio companies and harm our operating results.

Certain of our portfolio companies may be susceptible to an economic downturn and may be unable to repay our loans during this period. Therefore, assets may become non-performing and the value of our portfolio may decrease during this period. The adverse economic conditions also may decrease the value of collateral securing some of our loans and the value of our equity investments. A recession could lead to financial losses in our portfolio and a decrease in our revenues, net income and the value of our assets.

Adverse economic conditions also may decrease the value of collateral securing some of our loans and the value of our equity investments at fair value. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could prevent us from increasing investments and harm our operating results.

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, acceleration of the time when the loans are due and foreclosure on its secured assets, which could trigger cross-defaults under other agreements and jeopardize the portfolio company's ability to meet its obligations under the debt that we hold. We may incur additional expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company. In addition, if one of our portfolio companies were to go bankrupt, depending on the facts and circumstances, including the extent to which we actually provided significant managerial assistance to that portfolio company, a bankruptcy court might re-characterize our debt holdings and subordinate all or a portion of our claim to that of other creditors.

These portfolio companies may face intense competition, including competition from companies with greater financial resources, more extensive research and development, manufacturing, marketing and service capabilities and greater number of qualified and experienced managerial and technical personnel. They may need additional financing which they are unable to secure and which we are unable or unwilling to provide, or they may be subject to adverse developments unrelated to the technologies they acquire.

The health and performance of our portfolio companies could be adversely affected by political and economic conditions in the countries in which they conduct business.

Some of the products of our portfolio companies are developed, manufactured, assembled, tested or marketed outside the U.S. Any conflict or uncertainty in these countries, including due to natural disasters, public health concerns, political unrest or safety concerns, could harm their business, financial condition and results of operations. In addition, if the government of any country in which their products are developed, manufactured or sold sets technical or regulatory standards for products developed or manufactured in or imported into their country that are not widely shared, it may lead some of their customers to suspend imports of their products into that country, require manufacturers or developers in that country to manufacture or develop products with different technical or regulatory standards and disrupt cross-border manufacturing, marketing or business relationships which, in each case, could harm their businesses.

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

We generally invest in companies whose securities are not publicly traded, and whose securities will be subject to legal and other restrictions on resale or will otherwise be less liquid than publicly traded securities. There is no established trading market for the securities in which we invest. The illiquidity of these investments may make it difficult for us to sell these investments when desired. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we had previously recorded these investments. As a result, we do not expect to achieve liquidity in our investments in the near-term. Further, we may face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we have material non-public information regarding such portfolio company.

Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio.

Following an initial investment in a portfolio company, we may make additional investments in that portfolio company as "follow-on" investments, in order to: (i) increase or maintain in whole or in part our equity ownership percentage; (ii) exercise warrants, options ***or*** convertible securities that were acquired in the original or a subsequent financing; or (iii) attempt to preserve or enhance the value of our investment. We may elect not to make follow-on investments or otherwise lack sufficient funds to make those investments. We will have the discretion to make any follow-on investments, subject to the availability of capital resources. The failure to make follow-on investments may, in some circumstances, jeopardize the continued viability of a portfolio company and our initial investment, or may result in a missed opportunity for us to increase our participation in a successful operation. Even if we have sufficient capital to make a desired follow-on investment, we may elect not to make a follow-on investment because we do not want to increase our concentration of risk, we prefer other opportunities, we are subject to BDC requirements that would prevent such follow-on investments, or the follow-on investment would affect our qualification as a RIC. For example, we may be prohibited under the 1940 Act from making follow-on investments in our portfolio companies that we may be deemed to "control" or in which affiliates of our Investment Advisor are also invested.

Our ability to enter into new transactions with our affiliates, and to restructure or exit our investments in portfolio companies that we are deemed to "control" under the 1940 Act, will be restricted by the 1940 Act, which may limit the scope of investment opportunities available to us.

We are prohibited under the 1940 Act from participating in certain transactions with our affiliates without the prior approval of our independent directors and, in some cases, the Securities Exchange Commission ("SEC"). Any person that owns, directly or indirectly, 5% or more of our outstanding voting securities will be our affiliate for purposes of the 1940 Act and we are generally prohibited from buying or selling any security from or to such affiliate without the prior approval of our independent directors. The 1940 Act also prohibits certain "joint" transactions with certain of our affiliates, which could include concurrent investments in the same company, without prior approval of our independent directors and, in some cases, the SEC. We are prohibited from buying or selling any security from or to any person that controls us or who owns more than 25% of our voting securities or certain of that person's affiliates, or entering into prohibited joint transactions with such persons, absent the prior approval of the SEC. As a result of these restrictions, we may be prohibited from buying or selling any security (other than any security of which we are the issuer) from or to any company that is advised or managed by our Investment Advisor or its affiliates without the prior approval of the SEC, which may limit the scope of investment opportunities that would otherwise be available to us.

In the future, we may co-invest with investment funds, accounts and vehicles managed by our Investment Advisor or its affiliates when doing so is consistent with our investment strategy as well as applicable law and SEC staff interpretations. We generally will only be permitted to co-invest with such investment funds, accounts and vehicles where the only term that is negotiated is price. On June 1, 2016, the SEC issued an exemptive order permitting us and certain of our affiliates, to co-invest together in portfolio companies subject to certain conditions included therein. We expect that this order will permit greater flexibility to negotiate the terms of co-investments with investment funds, accounts and investment vehicles managed by our Investment Advisor or its affiliates in a manner consistent with our investment objective, positions, policies, strategies and restrictions as well as regulatory requirements and other pertinent factors.

In addition, within our portfolio there are investments that may be deemed to be “controlled” investments under the 1940 Act. To the extent that our investments in such portfolio companies need to be restructured or that we choose to exit these investments in the future, our ability to do so may be limited if such restructuring or exit also involves the affiliates of our Investment Advisor because such a transaction could be considered a joint transaction prohibited by the 1940 Act in the absence of our receipt of relief from the SEC in connection with such transaction. For example, if an affiliate of our Investment Advisor were required to approve a restructuring of an investment in the portfolio and the affiliate of our Investment Advisor was deemed to be our affiliate, such a restructuring transaction may constitute a prohibited joint transaction under the 1940 Act.

Our portfolio may lack diversification among portfolio companies, which may subject us to a risk of significant loss if one or more of these companies defaults on its obligations under any of its debt instruments.

Our portfolio may be concentrated in a limited number of portfolio companies. Beyond the asset diversification requirements associated with our RIC tax treatment under the Code, we do not have fixed guidelines for diversification, and our investments may be concentrated in relatively few companies. As our portfolio is less diversified than the portfolios of some larger funds, we are more susceptible to failure if a single loan fails. The disposition or liquidity of a significant investment may also adversely impact our net asset value and our results of operations. Similarly, the aggregate returns we realize may be significantly adversely affected if a small number of investments perform poorly or if we need to write down the value of any one investment.

We are a non-diversified investment company within the meaning of the 1940 Act, and therefore we are not limited with respect to the proportion of our assets that may be invested in securities of a single issuer.

We are classified as a non-diversified investment company within the meaning of the 1940 Act, which means that we are not limited by the 1940 Act with respect to the proportion of our assets that we may invest in securities of a single issuer. Beyond the asset diversification requirements associated with our RIC tax treatment under the Code, we do not have fixed guidelines for diversification. To the extent that we assume large positions in the securities of a small number of issuers or our investments are concentrated in relatively few industries, our net asset value may fluctuate to a greater extent than that of a diversified investment company as a result of changes in the financial condition or the market’s assessment of the issuer. We may also be more susceptible to any single economic or regulatory occurrence than a diversified investment company.

Our portfolio may be concentrated in a limited number of industries, which may subject us to a risk of significant loss if there is a downturn in a particular industry in which a number of our investments are concentrated.

Our portfolio may be concentrated in a limited number of industries. A downturn in any particular industry in which we are invested could significantly impact the aggregate returns we realize. If an industry in which we have significant investments suffers from adverse business or economic conditions, as these industries have to varying degrees, a material portion of our investment portfolio could be affected adversely, which, in turn, could adversely affect our financial position and results of operations.

Because we will not hold controlling equity interests in most of our portfolio companies, we may not be in a position to exercise control over our portfolio companies or to prevent decisions by management of our portfolio companies that could decrease the value of our investments.

We currently hold controlling equity positions in seven portfolio companies. Although we may do so in the future, we expect that we will not hold controlling equity positions in most of our portfolio companies. If we do not hold a controlling equity position in a portfolio company, we are subject to the risk that the portfolio company may make business decisions with which we disagree, and that the management and/or stockholders of the portfolio company may take risks or otherwise act in ways that are adverse to our interests. Due to the lack of liquidity of the debt and equity investments that we typically hold in our portfolio companies, we may not be able to dispose of our investments in the event we disagree with the actions of a portfolio company and may therefore suffer a decrease in the value of our investments.

Our equity ownership in a portfolio company may represent a control investment. Our ability to exit a control investment in a timely manner could result in a realized loss on the investment.

We currently have, and may acquire in the future, control investments in portfolio companies. Our ability to divest ourselves from a debt or equity investment in a controlled portfolio company could be restricted due to illiquidity in a private stock, limited trading volume on a public company's stock, inside information on a company's performance, insider blackout periods, or other factors that could prohibit us from disposing of the investment as we would if it were not a control investment. Additionally, we may choose not to take certain actions to protect a debt investment in a control investment portfolio company. As a result, we could experience a decrease in the value of our portfolio company holdings and potentially incur a realized loss on the investment.

If the assets securing the loans that we make decrease in value, then we may lack sufficient collateral to cover losses.

To attempt to mitigate credit risks, we will typically take a security interest in the available assets of our portfolio companies. There is no assurance that we will obtain or properly perfect our liens.

There is a risk that the collateral securing our loans may decrease in value over time, may be difficult to sell in a timely manner, may be difficult to appraise and may fluctuate in value based upon the success of the business and market conditions, including as a result of the inability of a portfolio company to raise additional capital. In some circumstances, our lien could be subordinated to claims of other creditors. Consequently, the fact that a loan is secured does not guarantee that we will receive principal and interest payments according to the loan's terms, or that we will be able to collect on the loan should we be forced to enforce our remedies.

In addition, because we may invest in technology-related companies, a substantial portion of the assets securing our investment may be in the form of intellectual property, if any, inventory and equipment and, to a lesser extent, cash and accounts receivable. Intellectual property, if any, that is securing our loan could lose value if, among other things, the company's rights to the intellectual property are challenged or if the company's license to the intellectual property is revoked or expires, the technology fails to achieve its intended results or a new technology makes the intellectual property functionally obsolete. Inventory may not be adequate to secure our loan if our valuation of the inventory at the time that we made the loan was not accurate or if there is a reduction in the demand for the inventory.

Similarly, any equipment securing our loan may not provide us with the anticipated security if there are changes in technology or advances in new equipment that render the particular equipment obsolete or of limited value, or if the company fails to adequately maintain or repair the equipment. Any one or more of the preceding factors could materially impair our ability to recover principal in a foreclosure.

Defaults by our portfolio companies will harm our operating results.

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its secured assets, which could trigger cross-defaults under other agreements and jeopardize our portfolio company's ability to meet its obligations under the debt securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company. Any extension or restructuring of our loans could adversely affect our cash flows. In addition, if one of our portfolio companies were to go bankrupt, even though we may have structured our interest as senior debt, depending on the facts and circumstances, including the extent to which we actually provided managerial assistance to that portfolio company, a bankruptcy court might recharacterize our debt holding and subordinate all or a portion of our claim to that of other creditors. If any of these occur, it could materially and adversely affect our operating results and cash flows.

If our portfolio companies are unable to protect their proprietary, technological and other intellectual property rights, our business and prospects could be harmed, and if portfolio companies are required to devote significant resources to protecting their intellectual property rights, the value of our investment could be reduced.

Our future success and competitive position will depend in part upon the ability of our portfolio companies to obtain, maintain and protect proprietary technology used in their products and services. The intellectual property held by our portfolio companies often represents a substantial portion of the collateral securing our investments and/or constitutes a significant portion of the portfolio companies' value that may be available in a downside scenario to repay our loans. Our portfolio companies will rely, in part, on patent, trade secret and trademark law to protect that technology, but competitors may misappropriate their intellectual property, and disputes as to ownership of intellectual property may arise. Portfolio companies may, from time to time, be required to institute litigation to enforce their patents, copyrights or other intellectual property rights, protect their trade secrets, determine the validity and scope of the proprietary rights of others or defend against claims of infringement. Such litigation could result in substantial costs and diversion of resources. Similarly, if a portfolio company is found to infringe or misappropriate a third-party's patent or other proprietary rights, it could be required to pay damages to the third-party, alter its products or processes, obtain a license from the third-party and/or cease activities utilizing the proprietary rights, including making or selling products utilizing the proprietary rights. Any of the foregoing events could negatively affect both the portfolio company's ability to service our debt investment and the value of any related debt and equity securities that we own, as well as any collateral securing our investment.

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

As a BDC, we are required to carry our investments at market value or, if no market value is ascertainable, at the fair value as determined in good faith by our Board. Decreases in the market values or fair values of our investments will be recorded as unrealized depreciation. Any unrealized depreciation in our loan portfolio could be an indication of a portfolio company's inability to meet its repayment obligations to us with respect to the affected loans. This could result in realized losses in the future and ultimately in reductions of our income available for distribution in future periods.

Prepayments of our debt investments by our portfolio companies could adversely impact our results of operations and reduce our return on equity.

We are subject to the risk that the investments we make in our portfolio companies may be repaid prior to maturity. When this occurs, we will generally reinvest these proceeds in temporary investments or repay any revolving credit facility, depending on expected future investment in new portfolio companies. Temporary investments will typically have substantially lower yields than the debt being prepaid and we could experience significant delays in reinvesting these amounts. Any future investment in a new portfolio company may also be at lower yields than the debt that was repaid. As a result, our results of operations could be materially adversely affected if one or more of our portfolio companies elect to prepay amounts owed to us. Additionally, prepayments could negatively impact our return on equity, which could result in a decline in the market price of our common stock.

We may not realize gains from our equity investments.

Certain investments that we may make include warrants or other equity securities. Investments in equity securities involve a number of significant risks, including the risk of further dilution as a result of additional issuances, inability to access additional capital and failure to pay current distributions. Investments in preferred securities involve special risks, such as the risk of deferred distributions, credit risk, illiquidity and limited voting rights. In addition, we may from time to time make non-control, equity investments in portfolio companies. Our goal is ultimately to realize gains upon our disposition of such equity interests. However, the equity interests we receive may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience. We also may be unable to realize any value if a portfolio company does not have a liquidity event, such as a sale of the business, recapitalization or public offering, which would allow us to sell the underlying equity interests. We will often seek puts or similar rights to give us the right to sell our equity securities back to the portfolio company issuer. We may be unable to exercise these put rights for the consideration provided in our investment documents if the issuer is in financial distress.

We may expose ourselves to risks if we engage in hedging transactions.

If we engage in hedging transactions, we may expose ourselves to risks associated with such transactions. We may utilize instruments such as forward contracts, currency options and interest rate swaps, caps, collars and floors to seek to hedge against fluctuations in the relative values of our portfolio positions from changes in currency exchange rates and market interest rates. Hedging against a decline in the values of our portfolio positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline. However, such hedging can establish other positions designed to gain from those same developments, thereby offsetting the decline in the value of such portfolio positions. Such hedging transactions may also limit the opportunity for gain if the values of the underlying portfolio positions increase. It may not be possible to hedge against an exchange rate or interest rate fluctuation that is so generally anticipated that we are not able to enter into a hedging transaction at an acceptable price. Moreover, for a variety of reasons, we may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Any such imperfect correlation may prevent us from achieving the intended hedge and expose us to risk of loss. In addition, it may not be possible to hedge fully or perfectly against currency fluctuations affecting the value of securities denominated in non-U.S. currencies because the value of those securities is likely to fluctuate as a result of factors not related to currency fluctuations.

The SEC has proposed a new rule under the 1940 Act that would govern the use of derivatives (defined to include any swap, security-based swap, futures contract, forward contract, option or any similar instrument) as well as financial commitment transactions (defined to include reverse repurchase agreements, short sale borrowings and any firm or standby commitment agreement or similar agreement) by BDCs. Under the proposed rule, a BDC would be required to comply with one of two alternative portfolio limitations and manage the risks associated with derivatives transactions and financial commitment transactions by segregating certain assets. Furthermore, a BDC that engages in more than a limited amount of derivatives transactions or that uses complex derivatives would be required to establish a formalized derivatives risk management program. If the SEC adopts this rule in the form proposed, we may incur greater and indirect costs to engage in derivatives transactions or financial commitment transactions, and our ability to enter into transactions involving such instruments may be hindered, which could have an adverse effect on our business, financial condition and results of operations.

The interest rates of our term loans to our portfolio companies that extend beyond 2021 might be subject to change based on recent regulatory changes.

LIBOR, the London Interbank Offered Rate, is the basic rate of interest used in lending between banks on the London interbank market and is widely used as a reference for setting the interest rate on loans globally. We typically use LIBOR as a reference rate in term loans we extend to portfolio companies such that the interest due to us pursuant to a term loan extended to a portfolio company is calculated using LIBOR. Some of our term loan agreements with portfolio companies contain a stated minimum value for LIBOR.

On July 27, 2017, the United Kingdom's Financial Conduct Authority, which regulates LIBOR, announced that it intends to phase out LIBOR by the end of 2021. It is unclear if at that time whether or not LIBOR will cease to exist or if new methods of calculating LIBOR will be established such that it continues to exist after 2021. The U.S. Federal Reserve, in conjunction with the Alternative Reference Rates Committee, a steering committee comprised of large US financial institutions, is considering replacing U.S. dollar LIBOR with a new index calculated by short term repurchase agreements, backed by Treasury securities. The future of LIBOR at this time is uncertain. If LIBOR ceases to exist, we may need to renegotiate the credit agreements extending beyond 2021 with our portfolio companies that utilize LIBOR as a factor in determining the interest rate to replace LIBOR with the new standard that is established.

The effect of global climate change may impact the operations of our portfolio companies.

There may be evidence of global climate change. Climate change creates physical and financial risk and some of our portfolio companies may be adversely affected by climate change. For example, the needs of customers of energy companies vary with weather conditions, primarily temperature and humidity. To the extent weather conditions are affected by climate change, energy use could increase or decrease depending on the duration and magnitude of any changes. Increases in the cost of energy could adversely affect the cost of operations of our portfolio companies if the use of energy products or services is material to their business. A decrease in energy use due to weather changes may affect some of our portfolio companies' financial condition, through decreased revenues. Extreme weather conditions in general require more system backup, adding to costs, and can contribute to increased system stresses, including service interruptions. Energy companies could also be affected by the potential for lawsuits against or taxes or other regulatory costs imposed on greenhouse gas emitters, based on links drawn between greenhouse gas emissions and climate change.

In December 2015 the United Nations, of which the U.S. is a member, adopted a climate accord (the "Paris Agreement") with the long-term goal of limiting global warming and the short-term goal of significantly reducing greenhouse gas emissions. Although the U.S. ratified the Paris Agreement on November 4, 2016, the current administration announced the U.S. would cease participation. As a result, some of our portfolio companies may become subject to new or strengthened regulations or legislation, at least through November 4, 2020 (the earliest date the U.S. may withdraw from the Paris Agreement), which could increase their operating costs and/or decrease their revenues.

We may choose to waive or defer enforcement of covenants in the debt securities held in our portfolio, which may cause us to lose all or part of our investment in these companies.

We structure the debt investments in our portfolio companies to include business and financial covenants placing affirmative and negative obligations on the operation of the company's business and its financial condition. However, from time to time we may elect to waive breaches of these covenants, including our right to payment, or waive or defer enforcement of remedies, such as acceleration of obligations or foreclosure on collateral, depending upon the financial condition and prospects of the particular portfolio company. These actions may reduce the likelihood of our receiving the full amount of future payments of interest or principal and be accompanied by a deterioration in the value of the underlying collateral as many of these companies may have limited financial resources, may be unable to meet future obligations and may go bankrupt. This could negatively impact our ability to pay dividends, could adversely affect our results of operations and financial condition and cause the loss of all or part of your investment.

Our investments in securities rated below investment grade are speculative in nature and are subject to additional risk factors such as increased possibility of default, illiquidity of the security, and changes in value based on changes in interest rates.

The securities that we invest in are typically rated below investment grade. Securities rated below investment grade are often referred to as "leveraged loans," "high yield" or "junk" securities, and may be considered "high risk" compared to debt instruments that are rated investment grade. High yield securities are regarded as having predominantly speculative characteristics with respect to the issuer's capacity to pay interest and repay principal in accordance with the terms of the obligations and involve major risk exposure to adverse conditions. In addition, high yield securities generally offer a higher current yield than that available from higher grade issues, but typically involve greater risk. These securities are especially sensitive to adverse changes in general economic conditions, to changes in the financial condition of their issuers and to price fluctuation in response to changes in interest rates. During periods of economic downturn or rising interest rates, issuers of below investment grade instruments may experience financial stress that could adversely affect their ability to make payments of principal and interest and increase the possibility of default.

Our investments may be in portfolio companies which may have limited operating histories and financial resources.

We expect that our portfolio will continue to consist of investments that may have relatively limited operating histories. These companies may be particularly vulnerable to U.S. and foreign economic downturns such as the current recession and European financial crisis, may have more limited access to capital and higher funding costs, may have a weaker financial position and may need more capital to expand or compete. These businesses also may experience substantial variations in operating results. They may face intense competition, including from companies with greater financial, technical and marketing resources. Furthermore, some of these companies do business in regulated industries and could be affected by changes in government regulation. Accordingly, these factors could impair their cash flow or result in other events, such as bankruptcy, which could limit their ability to repay their obligations to us, and may adversely affect the return on, or the recovery of, our investment in these companies. We cannot assure you that any of our investments in our portfolio companies will be successful. Our portfolio companies compete with larger, more established companies with greater access to, and resources for, further development in these new technologies. We may lose our entire investment in any or all of our portfolio companies.

Risks Relating to our Securities

The market price of our common stock may fluctuate significantly.

The market price and liquidity of the expected market for shares of our common stock may be significantly affected by numerous factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include:

- price and volume fluctuations in the overall stock market from time to time;
- investor demand for our shares;
- significant volatility in the market price and trading volume of securities of BDCs or other companies in our sector, which are not necessarily related to the operating performance of these companies;
- changes in regulatory policies or tax guidelines with respect to RICs, BDCs or SBICs;
- failure to qualify as a RIC, or the loss of RIC tax treatment;
- any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;
- changes, or perceived changes, in the value of our portfolio investments;
- departures of the Investment Advisor’s key personnel;
- operating performance of companies comparable to us; or
- general economic conditions and trends and other external factors.

Our business and operation could be negatively affected if we become subject to any securities litigation or stockholder activism, which could cause us to incur significant expense, hinder execution of investment strategy and impact our stock price.

In the past, following periods of volatility in the market price of a company’s securities, securities class action litigation has often been brought against that company. Stockholder activism, which could take many forms or arise in a variety of situations, increased in the BDC space recently. Specifically, we are currently subject to class action litigation.

On December 28, 2017, an alleged stockholder filed a putative class action lawsuit complaint, *Paskowitz v. Capitala Finance Corp., et al.,* in the United States District Court for the Central District of California (case number 2:17-cv-09251-MWF-AS) (the "*Paskowitz* Action*"),* against the Company and certain of its current officers on behalf of all persons who purchased or otherwise acquired the Company's common stock between January 4, 2016 and August 7, 2017. On January 3, 2018, another alleged stockholder filed a putative class action complaint, *Sandifer v. Capitala Finance Corp., et al.,* in the United States District Court for the Central District of California (case number 2:18-cv-00052-MWF-AS) (the "*Sandifer* Action"), asserting substantially similar claims on behalf of the same putative class and against the same defendants. The complaints in the *Paskowitz* Action and the *Sandifer* Action allege certain violations of the securities laws, including, inter alia, that the defendants made certain materially false and misleading statements and omissions regarding the Company's business, operations, and prospects. On February 2, 2018, the *Sandifer* Action was transferred, on stipulation of the parties, to the United States District Court for the Western District of North Carolina on February 2, 2018, which remains pending. While the Company intends to vigorously defend itself in this litigation, the outcome of these legal proceedings cannot be predicted with certainty.

Estimating an amount or range of possible losses resulting from litigation proceedings is inherently difficult and requires an extensive degree of judgment, particularly where the matters involve indeterminate claims for monetary damages, are in the early stages of the proceedings, and are subject to appeal. In addition, because most legal proceedings are resolved over extended periods of time, potential losses are subject to change due to, among other things, new developments, changes in legal strategy, the outcome of intermediate procedural and substantive rulings and other parties' settlement posture and their evaluation of the strength or weakness of their case against us. For these reasons, we are currently unable to predict the ultimate timing or outcome of, or reasonably estimate the possible losses or a range of possible losses resulting from, the matters described above. Based on information currently available, the Company does not believe that any reasonably possible losses arising from the currently pending legal matters described above will be material to the Company's results of operations or financial condition. However, in light of the inherent uncertainties involved in such matters, an adverse outcome in this litigation could materially adversely affect the Company's financial condition, results of operations or cash flows in any particular reporting period.

Securities litigation and corresponding stockholder activism, if any, including potential proxy contests, could result in substantial costs and divert management's and our Board's attention and resources from our business. Additionally, such securities litigation and stockholder activism could give rise to perceived uncertainties as to our future, adversely affect our relationships with service providers and make it more difficult to attract and retain qualified personnel. Also, we may be required to incur significant legal fees and other expenses related to any securities litigation and activist stockholder matters. Further, our stock price could be subject to significant fluctuation or otherwise be adversely affected by the events, risks and uncertainties of any securities litigation and stockholder activism.

Investing in our common stock may involve an above average degree of risk.

The investments we make may result in a higher amount of risk, volatility, or loss of principal than alternative investment options. These investments in portfolio companies may be highly speculative and aggressive, and therefore, an investment in our common stock may not be suitable for investors with lower risk tolerance.

Our shares of common stock have a limited trading history and we cannot assure you that the market price of shares of our common stock will not decline.

Our shares of common stock have a limited trading history and we cannot assure you that a public trading market will be sustained for such shares. We cannot predict the prices at which our common stock will trade. We cannot assure you that the market price of shares of our common stock will not decline at any time. In addition, our common stock has from time to time traded below its net asset value since our inception and if our common stock continues to trade below its net asset value, we will generally not be able to sell additional shares of our common stock to the public at its market price without first obtaining the approval of our stockholders (including our unaffiliated stockholders) and our independent directors for such issuance.

Our common stockholders will bear the expenses associated with our borrowings, and the holders of our debt securities will have certain rights senior to our common stockholders.

All of the costs of offering and servicing our debt securities, including interest thereon, is borne by our common stockholders. The interests of the holders of any debt we may issue will not necessarily be aligned with the interests of our common stockholders. In particular, the rights of holders of our debt to receive interest or principal repayment will be senior to those of our common stockholders. In addition, we may grant a lender a security interest in a significant portion or all of our assets, even if the total amount we may borrow from such lender is less than the amount of such lender's security interest in our assets.

Sales of substantial amounts of our common stock in the public market may have an adverse effect on the market price of our common stock.

Sales of substantial amounts of our common stock, or the availability of such common stock for sale, could adversely affect the prevailing market prices for our common stock. If this occurs and continues for a sustained period of time, it could impair our ability to raise additional capital through the sale of securities should we desire to do so.

Shares of our common stock have traded at a discount from net asset value and may do so in the future.

Shares of closed-end investment companies have frequently traded at a market price that is less than the net asset value that is attributable to those shares. In part as a result of adverse economic conditions and increasing pressure within the financial sector of which we are a part, our common stock has at times traded below its net asset value per share since our IPO on September 30, 2013. Our shares could continue trade at a discount to net asset value. The possibility that our shares of common stock may trade at a discount from net asset value over the long term is separate and distinct from the risk that our net asset value will decrease. We cannot predict whether shares of our common stock will trade above, at or below its net asset value. If our common stock trades below its net asset value, we will generally not be able to issue additional shares of our common stock at its market price without first obtaining the approval for such issuance from our stockholders and our independent directors. If additional funds are not available to us, we could be forced to curtail or cease our new lending and investment activities, and our net asset value could decrease and our level of distributions could be impacted.

You may not receive distributions or our distributions may decline or may not grow over time, and you will experience dilution in your ownership percentage if you opt out of our dividend reinvestment plan.

We intend to make distributions on a monthly basis to our stockholders out of assets legally available for distribution. We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. Our ability to pay distributions might be materially and adversely affected by the impact of one or more of the risks described herein. Due to the asset coverage test applicable to us under the 1940 Act as a BDC, we may be limited in our ability to make distributions. All distributions will be made at the discretion of our Board and will depend on our earnings, financial condition, maintenance of RIC tax treatment, compliance with applicable BDC, SBA regulations and such other factors as our Board may deem relevant from time to time. We cannot assure you that we will make distributions to our stockholders in the future.

All dividends declared in cash payable to stockholders that are participants in our dividend reinvestment plan are automatically reinvested in shares of our common stock. As a result, our stockholders that opt out of our dividend reinvestment plan will experience dilution in their ownership percentage of our common stock over time.

We will have broad discretion over the use of proceeds of any successful offering of securities.

We will have significant flexibility in applying the proceeds of any successful offering of our securities. We will also pay operating expenses, and may pay other expenses such as due diligence expenses of potential new investments, from net proceeds. Our ability to achieve our investment objective may be limited to the extent that the net proceeds of any offering, pending full investment, are used to pay operating expenses. In addition, we can provide you no assurance that the any offering will be successful, or that by increasing the size of our available equity capital, our aggregate expenses, and correspondingly, our expense ratio, will be lowered.

The net asset value per share of our common stock may be diluted if we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock.

At our 2017 Annual Stockholders Meeting, subject to certain determinations required to be made by our Board, our stockholders approved our ability to sell or otherwise issue shares of our common stock, not exceeding 25% of our then outstanding common stock immediately prior to each such offering, at a price below the then current net asset value per share during a period beginning on May 3, 2017 and expiring on the earlier of the one-year anniversary of the date of the 2017 Annual Stockholders Meeting and the date of our 2018 Annual Stockholders Meeting, which is expected to be held in April 2018.

Any decision to sell shares of our common stock below its then current net asset value per share would be subject to the determination by our Board that such issuance is in our and our stockholders' best interests. If we were to sell shares of our common stock below its then current net asset value per share; such sales would result in an immediate dilution to the net asset value per share of our common stock. This dilution would occur as a result of the sale of shares at a price below the then current net asset value per share of our common stock and a proportionately greater decrease in the stockholders' interest in our earnings and assets and their voting interest in us than the increase in our assets resulting from such issuance. Because the number of shares of common stock that could be so issued and the timing of any issuance is not currently known, the actual dilutive effect cannot be predicted.

Further, if our current stockholders do not purchase any shares to maintain their percentage interest, regardless of whether such offering is above or below the then current net asset value per share, their voting power will be diluted. For example, if we sell an additional 10% of our common shares at a 10% discount from net asset value, a stockholder who does not participate in that offering for its proportionate interest will suffer net asset value dilution of up to 1.0% or $10 per $1,000 of net asset value.

Your interest in Capitala Finance may be diluted if you do not fully exercise your subscription rights in any rights offering.

In the event we issue subscription rights to purchase shares of our common stock, stockholders who do not fully exercise their rights should expect that they will, at the completion of the offer, own a smaller proportional interest in Capitala Finance than would otherwise be the case if they fully exercised their rights.

We cannot state precisely the amount of any such dilution in share ownership because we do not know at this time what proportion of the shares would be purchased as a result of a rights offering.

In addition, if the subscription price in a rights offering is less than our net asset value per share, then our stockholders would experience an immediate dilution of the aggregate net asset value of their shares as a result of the rights offering. The amount of any decrease in net asset value is not predictable because it is not known at this time what the subscription price and net asset value per share will be on the expiration date of any rights offering or what proportion of the shares will be purchased as a result of such rights offering. Such dilution could be substantial.

If we issue preferred stock, the net asset value and market value of our common stock will likely become more volatile.

We cannot assure you that the issuance of preferred stock would result in a higher yield or return to the holders of our common stock. The issuance of preferred stock would likely cause the net asset value and market value of the common stock to become more volatile. If the dividend rate on the preferred stock were to approach the net rate of return on our investment portfolio, the benefit of leverage to the holders of the common stock would be reduced. If the dividend rate on the preferred stock were to exceed the net rate of return on our portfolio, the leverage would result in a lower rate of return to the holders of common stock than if we had not issued preferred stock. Any decline in the net asset value of our investments would be borne entirely by the holders of common stock. Therefore, if the market value of our portfolio were to decline, the leverage would result in a greater decrease in net asset value to the holders of common stock than if we were not leveraged through the issuance of preferred stock. This greater net asset value decrease would also tend to cause a greater decline in the market price for the common stock. We might be in danger of failing to maintain the required asset coverage of the preferred stock or of losing our ratings, if any, on the preferred stock or, in an extreme case, our current investment income might not be sufficient to meet the dividend requirements on the preferred stock. In order to counteract such an event, we might need to liquidate investments in order to fund a redemption of some or all of the preferred stock. In addition, we would pay (and the holders of common stock would bear) all costs and expenses relating to the issuance and ongoing maintenance of the preferred stock, including higher advisory fees if our total return exceeds the dividend rate on the preferred stock. Holders of preferred stock may have different interests than holders of common stock and may at times have disproportionate influence over our affairs.

Holders of any preferred stock we might issue would have the right to elect members of our Board and class voting rights on certain matters.

Holders of any preferred stock we might issue, voting separately as a single class, would have the right to elect two members of our Board at all times and in the event dividends become two full years in arrears would have the right to elect a majority of the directors until such arrearage is completely eliminated. In addition, preferred stockholders have class voting rights on certain matters, including changes in fundamental investment restrictions and conversion to open-end status, and accordingly can veto any such changes. Restrictions imposed on the declarations and payment of dividends or other distributions to the holders of our common stock and preferred stock, both by the 1940 Act and by requirements imposed by rating agencies, if any, or the terms of our credit facilities, if any, might impair our ability to maintain our RIC tax treatment under the Code for U.S. federal income tax purposes. While we would intend to redeem our preferred stock to the extent necessary to enable us to distribute our income as required to maintain our qualification as a RIC, there can be no assurance that such actions could be effected in time to meet the tax requirements.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our executive offices are located at 4201 Congress Street, Suite 360, Charlotte, North Carolina 28209, and are provided by our Administrator in accordance with the terms of the Administration Agreement. We believe that our office facilities are suitable and adequate for our business as it is contemplated to be conducted.

ITEM 3. LEGAL PROCEEDINGS

Other than as described below, we and our subsidiaries are not currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us or our subsidiaries. From time to time, we, or our subsidiaries may be a party to certain legal proceedings in the ordinary course of business, including proceedings relating to the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings, if any, cannot be predicted with certainty, we do not expect that these proceedings will have a material effect upon our financial condition or results of operations.

On December 28, 2017, an alleged stockholder filed a putative class action lawsuit complaint, *Paskowitz v. Capitala Finance Corp., et al.,* in the United States District Court for the Central District of California (case number 2:17-cv-09251-MWF-AS) (the "*Paskowitz* Action*"),* against the Company and certain of its current officers on behalf of all persons who purchased or otherwise acquired the Company's common stock between January 4, 2016 and August 7, 2017. On January 3, 2018, another alleged stockholder filed a putative class action complaint, *Sandifer v. Capitala Finance Corp., et al.,* in the United States District Court for the Central District of California (case number 2:18-cv-00052-MWF-AS) (the "*Sandifer* Action"), asserting substantially similar claims on behalf of the same putative class and against the same defendants. The complaints in the *Paskowitz* Action and the *Sandifer* Action allege certain violations of the securities laws, including, inter alia, that the defendants made certain materially false and misleading statements and omissions regarding the Company's business, operations, and prospects. On February 2, 2018, the *Sandifer* Action was transferred, on stipulation of the parties, to the United States District Court for the Western District of North Carolina on February 2, 2018, which remains pending. While the Company intends to vigorously defend itself in this litigation, the outcome of these legal proceedings cannot be predicted with certainty.

Estimating an amount or range of possible losses resulting from litigation proceedings is inherently difficult and requires an extensive degree of judgment, particularly where the matters involve indeterminate claims for monetary damages, are in the early stages of the proceedings, and are subject to appeal. In addition, because most legal proceedings are resolved over extended periods of time, potential losses are subject to change due to, among other things, new developments, changes in legal strategy, the outcome of intermediate procedural and substantive rulings and other parties' settlement posture and their evaluation of the strength or weakness of their case against us. For these reasons, we are currently unable to predict the ultimate timing or outcome of, or reasonably estimate the possible losses or a range of possible losses resulting from, the matters described above. Based on information currently available, the Company does not believe that any reasonably possible losses arising from the currently pending legal matters described above will be material to the Company's results of operations or financial condition. However, in light of the inherent uncertainties involved in such matters, an adverse outcome in this litigation could materially adversely affect the Company's financial condition, results of operations or cash flows in any particular reporting period.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

PRICE RANGE OF COMMON STOCK

Our common stock is traded on the NASDAQ Global Select Market under the symbol "CPTA." The following table sets forth, for each fiscal quarter within the two most recent fiscal years, the range of high and low intraday sales prices of our common stock as reported on the NASDAQ Global Select Market, the premium (discount) of sales price to our net asset value (NAV) and the distributions declared by us for each fiscal quarter.

Fiscal 2017	NAV(1)	High	Low	Premium or (Discount) of High Sales Price to NAV(2)	Premium or (Discount) of Low Sales Price to NAV(2)	Declared Distributions(3)
Fourth Quarter	$ 13.91	$ 10.00	$ 7.12	(28.1)%	(48.8)%	$ 0.25
Third Quarter	$ 14.21	$ 13.57	$ 8.67	(4.5)%	(39.0)%	$ 0.39
Second Quarter	$ 14.97	$ 14.43	$ 12.85	(3.6)%	(14.2)%	$ 0.39
First Quarter	$ 15.71	$ 14.65	$ 13.00	(6.7)%	(17.3)%	$ 0.39

Fiscal 2016	NAV(1)	High	Low	Premium or (Discount) of High Sales Price to NAV(2)	Premium or (Discount) of Low Sales Price to NAV(2)	Declared Distributions(3)
Fourth Quarter	$ 15.79	$ 13.95	$ 11.51	(11.7)%	(27.1)%	$ 0.39
Third Quarter	$ 15.68	$ 15.80	$ 12.75	0.8%	(18.7)%	$ 0.47
Second Quarter	$ 16.28	$ 14.20	$ 11.72	(12.8)%	(28.0)%	$ 0.47
First Quarter	$ 16.29	$ 13.18	$ 9.54	(19.1)%	(41.4)%	$ 0.47

(1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low sales prices. The net asset values shown are based on outstanding shares at the end of each period.

(2) Calculated as of the respective high or low intraday sales price divided by the quarter end NAV and subtracting 1.

(3) Represents the distributions paid or to be paid in the specified quarter.

HOLDERS

The last reported price for our common stock on February 26, 2018 was $7.18 per share. As of February 26, 2018 there were 44 holders of record of our common stock.

DISTRIBUTIONS

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

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

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

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

The following table summarizes our distributions declared during fiscal years ended 2018, 2017, and 2016:

Date Declared	Record Date	Payment Date	Amount Per Share
January 2, 2018	January 22, 2018	January 30, 2018	$ 0.0833
January 2, 2018	February 20, 2018	February 27, 2018	0.0833
January 2, 2018	March 23, 2018	March 29, 2018	0.0833
Total Distributions Declared for Fiscal 2018			$ 0.25

Date Declared	Record Date	Payment Date	Amount Per Share
January 3, 2017	January 20, 2017	January 30, 2017	$ 0.1300
January 3, 2017	February 20, 2017	February 27, 2017	0.1300
January 3, 2017	March 23, 2017	March 30, 2017	0.1300
April 3, 2017	April 19, 2017	April 27, 2017	0.1300
April 3, 2017	May 23, 2017	May 29, 2017	0.1300
April 3, 2017	June 21, 2017	June 29, 2017	0.1300
July 3, 2017	July 21, 2017	July 28, 2017	0.1300
July 3, 2017	August 23, 2017	August 30, 2017	0.1300
July 3, 2017	September 20, 2017	September 28, 2017	0.1300
October 2, 2017	October 23, 2017	October 30, 2017	0.0833
October 2, 2017	November 21, 2017	November 29, 2017	0.0833
October 2, 2017	December 20, 2017	December 28, 2017	0.0833
Total Distributions Declared for Fiscal 2017			$ 1.42

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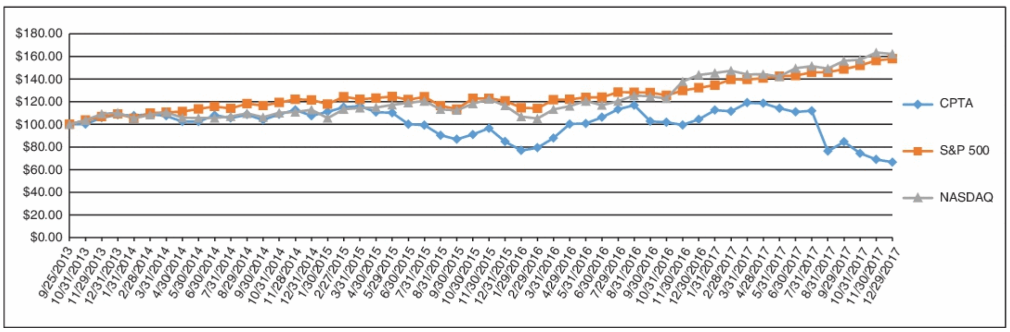
Date Declared	Record Date	Payment Date	Amount Per Share
January 4, 2016	January 22, 2016	January 28, 2016	$ 0.1567
January 4, 2016	February 19, 2016	February 26, 2016	0.1567
January 4, 2016	March 22, 2016	March 30, 2016	0.1567
April 1, 2016	April 22, 2016	April 28, 2016	0.1567
April 1, 2016	May 23, 2016	May 30, 2016	0.1567
April 1, 2016	June 21, 2016	June 29, 2016	0.1567
July 1, 2016	July 22, 2016	July 29, 2016	0.1567
July 1, 2016	August 22, 2016	August 30, 2016	0.1567
July 1, 2016	September 22, 2016	September 29, 2016	0.1567
September 22, 2016	October 21, 2016	October 28, 2016	0.1300
September 22, 2016	November 21, 2016	November 29, 2016	0.1300
September 22, 2016	December 21, 2016	December 29, 2016	0.1300
Total Distributions Declared for Fiscal 2016			$ 1.80

PERFORMANCE GRAPH

The following graph compares the cumulative return on our common stock with that of the Standard & Poor's 500 Stock Index and the NASDAQ Financial 100 index, as we do not believe there is an appropriate index of companies with an investment strategy similar to our own with which to compare the return on our common stock, for the period from September 25, 2013, the date our common stock began trading, through December 31, 2017. The graph assumes that on September 25, 2013, a person invested $100 in each of our common stock, the Standard & Poor's 500 Stock Index and the NASDAQ Financial 100 index. The graph measures total stockholder return, which takes into account both changes in stock price and dividends. The graph also assumes that dividends paid are reinvested in the same class of equity securities at the frequency with which dividends are paid on such securities during the applicable fiscal year.



The graph and other information furnished under this Part II Item 5 of this annual report on Form 10-K shall not be deemed to be "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C under, or to the liabilities of Section 18 of, the 1934 Act. The stock price performance included in the above graph is not necessarily indicative of future stock price performance.

SALES OF UNREGISTERED SECURITIES

During the year ended December 31, 2017, we issued 83,186 shares of common stock under our DRIP. The issuances were not subject to the registration requirements under the Securities Act of 1933, as amended. The cash paid for shares of common stock issued under our DRIP during the year ended December 31, 2017 was approximately $0.9 million. Other than the shares issued under our DRIP during the year ended December 31, 2017, we did not sell any unregistered equity securities.

ISSUER PURCHASES OF EQUITY SECURITIES

None.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data of the Company as of and for the years ended December 31, 2017, 2016, 2015, 2014 and 2013 are derived from our consolidated financial statements that have been audited by Ernst & Young LLP, our independent registered public accounting firm. This consolidated financial data should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this Form 10-K and with Management's Discussion and Analysis of Financial Condition and Results of Operations which follows (dollars in thousands except share and per share data):

	As of and for the years ended December 31,				
	2017	2016	2015	2014	2013
Consolidated statements of operations data:					
Total investment income	$ 51,089	$ 68,312	$ 63,976	$ 49,528	$ 35,433
Total expenses, net of fee waivers	35,565	39,272	38,649	29,562	15,949
Net investment income	15,524	29,040	25,327	19,966	19,484
Net realized gain (loss) from investments	(24,189)	(22,766)	5,436	832	2,187
Net unrealized appreciation (depreciation) on investments and written call option	2,970	2,878	(16,913)	(24,238)	7,187
Tax provision	(1,289)	—	—	—	—
Net increase (decrease) in net assets resulting from operations	$ (6,984)	$ 9,152	$ 13,850	$ (3,440)	$ 28,858
Per share data:					
Net investment income	$ 0.98	$ 1.84	$ 1.67	$ 1.54	$ 1.50
Net increase (decrease) in net assets resulting from operations	$ (0.44)	$ 0.58	$ 0.91	$ (0.27)	$ 2.22
Distributions declared	$ 1.42	$ 1.80	$ 2.38	$ 1.88	$ 0.47
Net asset value per share	$ 13.91	$ 15.79	$ 17.04	$ 18.56	$ 20.71
Consolidated statements of assets and liabilities data:					
Total assets	$534,595	$584,415	$632,818	$539,864	$476,428
Total net assets	$221,887	$250,582	$268,802	$240,837	$268,670
Other data:					
Total Return(1)(2)	(35.68)%	24.07%	(20.43)%	(0.85)%	1.88%
Number of portfolio company investments at year end	47	53	57	52	41
Total portfolio investment deployments for the year	$ 82,750	$120,844	$260,640	$216,276	$110,929
Investment repayments for the year	$115,810	$163,564	$142,713	$ 80,197	$ 52,755

(1) Total investment return for the years ended December 31, 2017, 2016, 2015 and 2014 is calculated assuming a purchase of common shares at the current market value on the first day and a sale at the current market value on the last day of the period reported. Dividends and distributions, if any, are assumed for purposes of this calculation to be reinvested at prices obtained under the Company's dividend reinvestment plan. Total investment return does not reflect brokerage commissions.

(2) Total investment return for the year ended December 31, 2013 is calculated assuming a purchase of common shares at the IPO offering price per share at September 25, 2013 of $20.00 and a sale at the current market value on the last day of the period reported. Dividends and distributions, if any, are assumed for purposes of this calculation to be reinvested at prices obtained under the Company's dividend reinvestment plan. Total investment return does not reflect brokerage commissions. Total investment returns covering less than a full period are not annualized.

ITEM 7. 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 Annual Report on Form 10-K.

Forward-Looking Statements

This Annual Report on Form 10-K, including Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements that involve substantial risks and uncertainties. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about the Company, our current and prospective portfolio investments, our industry, our beliefs, and our assumptions. Words such as "anticipates," "expects," "intends," "plans," "will," "may," "continue," "believes," "seeks," "estimates," "would," "could," "should," "targets," "projects," and variations of these words and similar expressions are intended to identify forward-looking statements.

Some of the statements in this Annual Report on Form 10-K constitute forward-looking statements, which relate to future events or our performance or financial condition. The forward-looking statements contained in our Annual Report on Form 10-K 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 Annual Report on Form 10-K.

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

Overview

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

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

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

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

Corporate History

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

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

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

During the fourth quarter of 2017, Florida Sidecar transferred all of its assets to Capitala Finance Corp. and was legally dissolved as a standalone partnership.

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

Basis of Presentation

The Company is considered an investment company as defined in Accounting Standards Codification ("ASC") Topic 946 — *Financial Services — Investment Companies* ("ASC 946"). The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles ("U.S. GAAP") and pursuant to the requirements for reporting on Form 10-K and Article 6 of Regulation S-X. The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries as described in the Formation Transactions above. The transactions related to Fund II, Fund III, and Florida Sidecar constituted an exchange of shares between entities under common control and have been accounted for in accordance with ASC Topic 805, *Business Combinations ("ASC 805").*

The Company's financial statements as of December 31, 2017 and 2016 are presented on a consolidated basis. The effects of all intercompany transactions between the Company and its subsidiaries (Fund II, Fund III, Florida Sidecar, and the Taxable Subsidiaries) have been eliminated in consolidation. All financial data and information included in these consolidated financial statements have been presented on the basis described above. In the opinion of management, the consolidated financial statements reflect all adjustments that are necessary for the fair presentation of financial results as of and for the periods presented.

Consolidation

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

Revenues

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

Expenses

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

- the cost of our organization;
- the cost of calculating our net asset value, including the cost of any third-party valuation services;
- the cost of effecting sales and repurchases of our shares and other securities;
- interest payable on debt, if any, to finance our investments;
- fees payable to third parties relating to, or associated with, making investments (such as legal, accounting and travel expenses incurred in connection with making investments), including fees and expenses associated with performing due diligence reviews of prospective investments and advisory fees;
- transfer agent and custodial fees;
- fees and expenses associated with marketing efforts;
- costs associated with our reporting and compliance obligations under the 1940 Act, the Securities Exchange Act of 1934, as amended (the "1934 Act") other applicable federal and state securities laws and ongoing stock exchange listing fees;
- federal, state and local taxes;
- independent directors' fees and expenses;
- brokerage commissions;
- costs of proxy statements, stockholders' reports and other communications with stockholders;
- fidelity bond, directors' and officers' liability insurance, errors and omissions liability insurance and other insurance premiums;
- direct costs and expenses of administration, including printing, mailing, telephone and staff;
- fees and expenses associated with independent audits and outside legal costs; and
- all other expenses incurred by either our Administrator or us in connection with administering our business, including payments under the Administration Agreement that will be based upon our allocable portion of overhead and other expenses incurred by our Administrator in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions, and our allocable portion of any costs of compensation and related expenses of our chief compliance officer and our chief financial officer and their respective administrative support staff.

Critical Accounting Policies and Use of Estimates

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

Because of the nature of the judgments and assumptions we make, actual results could materially differ from those estimates under different assumptions or conditions. A discussion of our critical accounting policies follows.

Valuation of Investments

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

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

Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Board. Unobservable inputs reflect the 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 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.

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

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

Valuation Techniques

Enterprise Value Waterfall Approach

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

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

Income Approach

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

Asset Approach

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

Revenue Recognition

The Company's revenue recognition policies are as follows:

Interest income and paid-in-kind interest income: Interest income is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company has loans in the portfolio that contain a payment-in-kind interest ("PIK interest") provision. The PIK interest, which represents contractually deferred interest added to the loan balance that is generally due at maturity, is recorded on 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: Management reviews all loans that become 90 days or more past due, or when there is reasonable doubt that principal or interest will be collected, for possible placement on non-accrual status. When the Company otherwise does not expect the borrower to be able to service its debt and other obligations, the Company will place the loan on non-accrual status, and will generally cease recognizing interest income and PIK interest on that loan for financial reporting purposes. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. The Company writes off any previously accrued and uncollected cash interest when it is determined that interest is no longer considered collectible. The Company may elect to cease accruing PIK interest and continue accruing interest income in cases where a loan is currently paying its interest income but, in management's judgment, there is a reasonable likelihood of principal loss on the loan. Non-accrual loans are returned to accrual status when the borrower's financial condition improves such that management believes current interest and principal payments are expected to be collected.

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

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

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

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

Income Taxes

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

The Company has elected to be treated for U.S. federal income tax purposes, and intends to comply with the requirement to qualify annually 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.

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

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

The Company's Taxable Subsidiaries record deferred tax assets or liabilities related to temporary book versus tax differences on the income or loss generated by the underlying equity investments held by the Taxable Subsidiaries. As of December 31, 2017, and December 31, 2016, the Company recorded a net deferred tax liability of $1.3 million and $0.0 million, respectively. For the year ended December 31, 2017, the Company recorded a tax provision of $1.3 million. For the years ended December 31, 2016 and 2015, no tax provision was recorded.

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

ASC Topic 740 — *Income Taxes* ("ASC 740"), provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the 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 December 31, 2017 and December 31, 2016, there were no uncertain tax positions.

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

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

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

The tax years ended August 31, 2017, 2016 and 2015 remain subject to examination by U.S. federal, state, and local tax authorities. No interest expense or penalties have been assessed for the years ended December 31, 2017, 2016 and 2015. If the Company was required to recognize interest and penalties, if any, related to unrecognized tax benefits this would be recognized as income tax expense in the consolidated statements of operations.

Portfolio and Investment Activity

As of December 31, 2017, our portfolio consisted of investments in 47 portfolio companies with a fair value of approximately $499.9 million.

During the year ended December 31, 2017, we made approximately $82.8 million of investments and had approximately $115.8 million in repayments and sales of investments resulting in net repayments and sales of approximately $33.0 million for the year. During the year ended December 31, 2016, we made approximately $120.8 million of investments and had approximately $163.6 million in repayments and sales resulting in net repayments and sales of approximately $42.8 million for the year. During the year ended December 31, 2015, we made approximately $260.6 million of investments and had approximately $142.7 million in repayments and sales resulting in net investments of approximately $117.9 million for the year.

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

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

The Written Call Option granted FSC II the right to purchase up to 31.25% of our equity investment in Eastport Holdings, LLC. The Written Call Option has a strike price of $1.5 million and a termination date of August 31, 2018. The fair value of the Written Call Option, which has been treated as a derivative liability and is recorded in the financial statement line item Written Call Option at fair value in our consolidated statements of assets and liabilities, was approximately $6.8 million and $2.7 million as of December 31, 2017 and 2016, respectively. For purposes of determining the fair value of the Written Call Option, we calculated the difference in the fair value of the underlying equity investment in Eastport Holdings, LLC and the strike price of the Written Call Option, or intrinsic value. The time value of the Written Call Option as of December 31, 2017 and 2016 was determined to be insignificant. The Written Call Option is classified as a Level 3 financial instrument. The Written Call Option was the only option contract granted by us during the year ended December 31, 2016, and the Written Call Option remained outstanding as of December 31, 2017.

As of December 31, 2017, our average portfolio company investment and our largest portfolio company investment at amortized cost and fair value was approximately $9.9 million and $10.6 million, and $21.6 million and $42.9 million, respectively. As of December 31, 2017, the Company had approximately $31.2 million of cash and cash equivalents. As of December 31, 2016, our average portfolio company investment and our largest portfolio company investment at amortized cost and fair value was approximately $9.7 million and $10.2 million, and $22.1 million and $29.9 million, respectively. As of December 31, 2016, the Company had approximately $36.3 million of cash and cash equivalents.

As of December 31, 2017, our debt investment portfolio, which represented 75.5% of our total portfolio, had a weighted average annualized yield of approximately 12.8%, exclusive of the impact of our non-accrual debt investments. As of December 31, 2017, 51.7% of our debt investment portfolio was bearing a fixed rate of interest. As of December 31, 2016, our debt investment portfolio, which represented 82.8% of our total portfolio, had a weighted average annualized yield of approximately 13.2%, exclusive of the impact of our non-accrual debt investments. As of December 31, 2016, 57.1% of our debt investment portfolio was bearing a fixed rate of interest.

The weighted annualized yield is calculated based on the effective interest rate as of period end, divided by the fair value of our accruing debt investments. The weighted average annualized yield of our debt investments is not the same as a return on investment for our stockholders but, rather, relates to a portion of our investment portfolio and is calculated before the payment of all of our fees and expenses. There can be no assurance that the weighted average yield will remain at its current level.

The following table summarizes the amortized cost and the fair value of investments and cash and cash equivalents as of December 31, 2017 (dollars in thousands):

	Investments at Amortized Cost	Percentage of Total	Investments at Fair Value	Percentage of Total
First Lien Debt	$ 257,147	51.8%	$ 243,489	45.8%
Second Lien Debt	32,465	6.6	30,794	5.8
Subordinated Debt	120,235	24.2	103,385	19.5
Equity and Warrants	55,180	11.1	122,271	23.0
Cash and Cash Equivalents	31,221	6.3	31,221	5.9
Total	$ 496,248	100.0%	$ 531,160	100.0%

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

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

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

	December 31, 2017		December 31, 2016	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
Business Services	$ 70,122	14.0%	$ 51,731	9.5%
Consumer Products	29,612	5.9	30,209	5.6
Oil & Gas Services	27,774	5.6	15,083	2.8
Financial Services	26,920	5.4	25,553	4.7
Information Technology	24,761	5.0	24,232	4.5
Healthcare	21,368	4.3	8,582	1.6
Specialty Retail	20,713	4.1	22,067	4.1
Building Products	17,879	3.6	18,152	3.3
Footwear Retail	17,748	3.6	19,236	3.5
Sales & Marketing Services	17,388	3.5	16,376	3.0
Food Product Manufacturer	16,222	3.2	16,599	3.1
Industrial Equipment Rental	15,603	3.1	10,755	2.0
Retail	15,000	3.0	15,000	2.8
Computer Supply Retail	12,551	2.5	12,183	2.2
Textile Equipment Manufacturer	12,505	2.5	13,134	2.4
IT Consulting	12,231	2.4	—	—
Fuel Transportation Services	11,588	2.3	10,303	1.9
Transportation	11,560	2.3	16,856	3.1
Government Services	10,320	2.1	—	—
Automobile Part Manufacturer	9,285	1.9	10,076	1.9
Healthcare Management	9,014	1.8	10,851	2.0
Professional and Personal Digital Imaging	8,810	1.8	9,000	1.7
Refrigeration/HVAC Services	8,736	1.7	—	—

	December 31, 2017		December 31, 2016	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
Oil & Gas Engineering and Consulting Services	$ 8,528	1.7%	$ 4,500	0.8%
QSR Franchisor	7,650	1.5	8,497	1.6
Conglomerate	7,645	1.5	8,374	1.5
Bowling Products	7,186	1.4	12,503	2.3
Produce Distribution	6,170	1.2	6,182	1.1
Farming	5,581	1.1	11,779	2.2
Advertising & Marketing Services	5,157	1.0	3,910	0.7
Restaurant	4,880	1.0	4,857	0.9
Medical Device Distributor	4,713	0.9	25,768	4.8
Online Merchandise Retailer	3,755	0.8	4,169	0.8
Consumer Electronics	3,498	0.7	20,818	3.8
Home Repair Parts Manufacturer	2,767	0.6	1,408	0.3
Replacement Window Manufacturer	1,880	0.4	2,571	0.5
Household Product Manufacturer	1,316	0.3	1,001	0.2
Data Processing & Digital Marketing	1,035	0.2	1,015	0.2
In-Home Healthcare Services	174	0.1	446	0.1
Automotive Chemicals & Lubricants	101	0.0	2,230	0.4
Retail Display & Security Services	100	0.0	537	0.1
Dental Practice Management	93	0.0	109	0.0
Home Décor Manufacturer	—	—	14,670	2.7
Printing Services	—	—	12,761	2.4
Bakery Supplies Distributor	—	—	10,776	2.0
Construction Services	—	—	9,500	1.7
Specialty Clothing	—	—	5,011	0.9
Satellite Communications	—	—	5,000	0.9
Industrial Specialty Services	—	—	4,750	0.9
Specialty Defense Contractor	—	—	1,532	0.3
Entertainment	—	—	987	0.2
Total	$ 499,939	100.0%	$ 541,639	100.0%

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

	At December 31, 2017		At December 31, 2016	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
South	$ 254,829	51.0%	$ 257,162	47.5%
West	107,835	21.5	85,642	15.8
Midwest	84,832	17.0	118,682	21.9
Northeast	44,428	8.9	68,613	12.7
International	8,015	1.6	11,540	2.1
Total	$ 499,939	100.0%	$ 541,639	100.0%

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

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

Our internal investment rating system incorporates the following five categories:

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

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

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

	As of December 31, 2017		As of December 31, 2016	
Investment Rating	Investments at Fair Value	Percentage of Total Investments	Investments at Fair Value	Percentage of Total Investments
1	$ 191,204	38.2%	$ 183,826	33.9%
2	186,445	37.3	215,058	39.7
3	97,309	19.5	125,381	23.2
4	24,981	5.0	17,374	3.2
5	—	—	—	—
Total	$ 499,939	100.0%	$ 541,639	100.0%

As of December 31, 2017, we had debt investments in four portfolio companies on non-accrual status with an amortized cost of $50.1 million and a fair value of $25.0 million, which represented 10.8% and 5.0% of the investment portfolio, respectively. As of December 31, 2016, we had debt investments in three portfolio companies on non-accrual status with amortized cost of $29.5 million and a fair value of $17.4 million, which represented 5.7% and 3.2% of the investment portfolio, respectively.

Capitala Senior Liquid Loan Fund I, LLC

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

Because the TRS was wound down in a prior period, only comparative period disclosures are included herein. For the years ended December 31, 2016 and December 31, 2015, the Company received $1.8 million and $0.9 million, respectively, in dividend income from its equity interest in CSLLF. For the year ended December 31, 2016, CSLLF declared a return of capital distribution to the Company in the amount of $20.0 million, which included $19.9 million in cash received in December 2016, and $0.1 million paid in the first quarter of 2017.

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

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

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

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

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

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

Transactions in TRS contracts during the year ended December 31, 2016 resulted in $2.3 million in realized gains and $2.8 million in unrealized appreciation. Transactions in TRS contracts during the year ended December 31, 2015 resulted in $1.4 million in realized gains and $(2.8) million in unrealized depreciation, which is recorded on CSLLF's statements of operations below.

The following represents the volume of the CSLLF's derivative transactions during the years ended December 31, 2016 and 2015 (dollars in thousands):

	For the year ended December 31, 2016	For the year ended December 31, 2015(1)
Average notional par amount of contract	$ 56,681	$ 61,306

(1) Average calculated from period of TRS inception, March 27, 2015 to December 31, 2015.

Below is certain summarized financial information for CSLLF as of December 31, 2016 and for the years ended December 31, 2016, and December 31, 2015 (dollars in thousands):

Selected Statements of Assets and Liabilities:

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

Selected Statements of Operations Information:

	For the Year Ended December 31, 2016	For the period from March 27, 2015 to December 31, 2015
Administrative and legal expenses	$ (193)	$ (104)
Net operating loss	$ (193)	$ (104)
Net realized gain on Total Return Swap	$ 2,306	$ 1,366
Net change in unrealized appreciation (depreciation) on Total Return Swap	2,828	(2,828)
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	$ 4,941	$ (1,566)

Results of Operations

Our operating results for the years ended December 31, 2017, 2016 and 2015 are as follows (dollars in thousands):

	For the Year Ended December 31,		
	2017	2016	2015
Total investment income	$ 51,089	$ 68,312	$ 63,976
Total expenses, net of fee waivers	35,565	39,272	38,649
Net investment income	15,524	29,040	25,327
Total realized gain (loss) from investments	(24,189)	(22,766)	5,436
Net unrealized appreciation (depreciation) on investments	7,049	5,594	(16,913)
Net unrealized depreciation on written call option	(4,079)	(2,716)	—
Tax provision	(1,289)	—	—
Net increase (decrease) in net assets resulting from operations	$ (6,984)	$ 9,152	$ 13,850

Investment income

The composition of our investment income for the years ended December 31, 2017, 2016 and 2015 was as follows (dollars in thousands):

	For the Year Ended December 31,		
	2017	2016	2015
Interest income	$ 40,462	$ 54,990	$ 50,586
Fee income	2,027	4,118	5,944
Payment-in-kind interest and dividend income	7,143	6,300	5,084
Dividend income	1,221	2,792	2,101
Interest from cash and cash equivalents	111	27	5
Other income	125	85	256
Total investment income	$ 51,089	$ 68,312	$ 63,976

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

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

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

For the year ended December 31, 2017, total investment income decreased by $17.2 million, or 25.2%, compared to the year ended December 31, 2016. The decrease from the prior year was driven primarily by a $14.5 million decline in interest income, from $55.0 million for the year ended December 31, 2016, to $40.5 million for the year ended December 31, 2017. The decline in interest income was caused by a decline in average outstanding debt investments, and an increase in average non-accrual debt investments. Fee income declined by $2.1 million compared to the prior year, from $4.1 million for the year ended December 31, 2016 to $2.0 million for the year ended December 31, 2017. For the year ended December 31, 2017, we generated $1.2 million in origination fees from new deployments and $0.8 million in other fees. Comparatively, for the year ended December 31, 2016, we generated $2.1 million in origination fees from new deployments and $2.0 million in other fees. Dividend income decreased from $2.8 million for the year ended December 31, 2016 to $1.2 million for the year ended December 31, 2017, mostly driven by a $1.8 million decrease in dividends paid by CSLLF. PIK income increased $0.8 million compared to the prior year, from $6.3 million for the year ended December 31, 2016 to $7.1 million for the year ended December 31, 2017. The increase in PIK income was primarily due to investments restructured during the year ended December 31, 2017 that provided for an increase in the PIK rate being charged.

For the year ended December 31, 2016, total investment income increased by $4.3 million, or 6.8%, compared to the year ended December 31, 2015. The increase from the prior period relates primarily to higher interest and PIK income from a larger average investment portfolio. For the year ended December 31, 2016, we generated $2.1 million in origination fees from new deployments and $2.0 million in other fees. Comparatively, for the year ended December 31, 2015, we generated $3.5 million in origination fees from new deployments and $2.4 million in other fees. The year over year decline in origination fee income was due to a decline in investment originations. Dividend income increased from $2.1 million for the year ended December 31, 2015 to $2.8 million for the year ended December 31, 2016, mostly driven by a $0.9 million increase in dividends paid by CSLLF.

Operating expenses

The composition of our expenses for the years ended December 31, 2017, 2016 and 2015 was as follows (dollars in thousands):

	For the Year Ended December 31,		
	2017	2016	2015
Interest and financing expenses	$ 18,825	$ 19,711	$ 19,022
Loss on extinguishment of debt	2,732	—	—
Base management fee	9,780	10,588	10,590
Incentive fees, net of incentive fee waiver	350	5,169	4,985
General and administrative expenses	3,878	3,804	4,052
Total expenses, net of fee waivers	$ 35,565	$ 39,272	$ 38,649

For the year ended December 31, 2017, operating expenses decreased by $3.7 million, or 9.4%, compared to the year ended December 31, 2016. For the year ended December 31, 2017, we recognized a $2.7 million loss on extinguishment of debt related to repayment of the 7.125% fixed-rate notes due 2021. The increase in expenses related to the loss on extinguishment of debt was offset by (i) a decline in base management fees, from $10.6 million for the year ended December 31, 2016, to $9.8 million for the year ended December 31, 2017 due to lower average assets under management, (ii) a decline in incentive fees, net of incentive fee waiver, from $5.2 million for the year ended December 31, 2016 to $0.4 million for the year ended December 31, 2017, due to lower pre-incentive fee net investment income, and (iii) a decline in interest and financing expenses, from $19.7 million for the year ended December 31, 2016 to $18.8 million for the year ended December 31, 2017, primarily due to a lower average debt balance outstanding during the period.

For the year ended December 31, 2016, operating expenses increased by $0.6 million, or 1.6%, compared to the year ended December 31, 2015. The increase from the prior period was primarily due to an increase in interest and financing expenses due to a larger average outstanding balance on the senior secured revolving credit agreement (the “Credit Facility”) with ING Capital, LLC, as administrative agent, arranger, and bookrunner, and the lender party thereto for the year ended December 31, 2016 compared to the year ended December 31, 2015. Other expenses remained relatively unchanged year over year.

Net realized gains (losses) on sales of investments

During the years ended December 31, 2017, 2016, and 2015, we recognized $(24.2) million, $(22.8) million and $5.4 million of net realized gains (losses) on our portfolio investments, respectively.

Net unrealized appreciation (depreciation) on investments

Net change in unrealized appreciation (depreciation) on investments reflects the net change in the fair value of our investment portfolio. For the years ended December 31, 2017, 2016, and 2015, we had $7.0 million, $5.6 million and $(16.9) million of unrealized appreciation (depreciation) on investments, respectively.

Net unrealized depreciation on Written Call option

For the years ended December 31, 2017, 2016 and 2015 we had net unrealized depreciation on the Written Call Option of $4.1 million, $2.7 million, and $0.0 million, respectively.

Tax provision

For the year ended December 31, 2017, we recorded a tax provision of $1.3 million. For the years ended December 31, 2016 and 2015, we recorded a tax provision of $0.0 million.

Changes in net assets resulting from operations

For the years ended December 31, 2017, 2016, and 2015 we recorded a net increase (decrease) in net assets resulting from operations of $(7.0) million, $9.2 million, and $13.9 million, respectively. Based on the weighted average shares of common stock outstanding for the years ended December 31, 2017, 2016, and 2015 our per share net increase (decrease) in net assets resulting from operations was $(0.44), $0.58 and $0.91, respectively.

Summarized Financial Information of Our Unconsolidated Subsidiaries

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

CableOrganizer Acquisition, LLC

CableOrganizer Acquisition, LLC, a Delaware limited liability company that began operations on April 23, 2013, is a leading online provider of cable and wire management products. The income the Company generated from CableOrganizer Acquisition, LLC, which includes all interest, dividends, PIK interest and PIK dividends, fees, and unrealized appreciation (depreciation), was $1.8 million, $1.9 million, and $0.4 million for the years ended December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

Eastport Holdings, LLC

Eastport Holdings, LLC, an Ohio limited liability company organized on November 1, 2011, is a holding company consisting of marketing and advertising companies located across the U.S. The income the Company generated from Eastport Holdings, LLC, which includes all interest, dividends, PIK interest and PIK dividends, fees, and unrealized appreciation (depreciation), was $11.4 million and $14.3 million for the years ended December 31, 2017 and December 31, 2016, respectively. The Company invested in the portfolio company in January 2016. As such, comparative financial information for the year ended December 31, 2015 is not presented.

Kelle’s Transport Service, LLC

Kelle’s Transport Service, LLC, a Delaware limited liability company organized on March 28, 2014, provides temperature sensitive transportation services throughout North America. The income (loss) the Company generated from Kelle’s Transport Service, LLC, which includes all interest, dividends, PIK interest and PIK dividends, fees, realized losses, and unrealized appreciation (depreciation), was $(6.9) million, $(1.2) million, and $3.0 million for the years ended December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

Navis Holdings, Inc.

Navis Holdings, Inc., incorporated in Delaware on December 21, 2010, designs and manufactures leading machinery for the global knit and woven finishing textile industries. The income the Company generated from Navis Holdings, Inc., which includes all interest, dividends, PIK interest and PIK dividends, fees, and unrealized appreciation (depreciation) was $0.7 million, $1.9 million, and $4.2 million for the years ended December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

On-Site Fuel Services, Inc.

On-Site Fuel Services, Inc. is a 100% owned subsidiary of On-Site Fuel Holdings, Inc., which was incorporated in Delaware on December 19, 2011. On-Site Fuel Services, Inc. provides fueling services for commercial and government vehicle fleets throughout the southeast U.S. The income (loss) the Company generated from On-Site Fuel Service, Inc., which includes all interest, dividends, PIK interest and PIK dividends, fees, and unrealized appreciation (depreciation), was $0.1 million, $4.5 million, and $(3.2) million for the years ended December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

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

	As of	
Balance Sheet – CableOrganizer Acquisition, LLC	**December 31, 2017**	**December 31, 2016**
Current assets	$ 5,286	$ 5,589
Noncurrent assets	9,664	9,872
Total assets	$ 14,950	$ 15,461
Current liabilities	$ 5,207	$ 4,219
Noncurrent liabilities	12,373	11,882
Total liabilities	$ 17,580	$ 16,101
Total deficit	$ (2,630)	$ (640)

	For the year ended		
Statements of Operations – CableOrganizer Acquisition, LLC	**December 31, 2017**	**December 31, 2016**	**December 31, 2015**
Net sales	$ 27,134	$ 23,277	$ 25,315
Cost of goods sold	19,778	15,715	16,878
Gross profit	$ 7,356	$ 7,562	$ 8,437
Other expenses	$ 9,345	$ 10,344	$ 10,008
Loss before income taxes	(1,989)	(2,782)	(1,571)
Net loss	$ (1,989)	$ (2,782)	$ (1,571)

	As of	
Balance Sheet – Eastport Holdings, LLC	**December 31, 2017**	**December 31, 2016**
Current assets	$ 94,186	$ 96,175
Noncurrent assets	185,087	145,802
Total assets	$ 279,273	$ 241,977
Current liabilities	$ 142,250	$ 157,622
Noncurrent liabilities	70,765	41,355
Total liabilities	$ 213,015	$ 198,977
Total equity	$ 66,258	$ 43,000

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Statement of Operations – Eastport Holdings, LLC	For the year ended December 31, 2017	December 31, 2016
Net sales	$ 556,895	$ 499,986
Cost of goods sold	411,167	377,036
Gross profit	$ 145,728	$ 122,950
Other expenses	$ 134,231	$ 111,677
Income before income taxes	11,497	11,273
Income tax provision	628	—
Net income	$ 10,869	$ 11,273

Balance Sheet – Kelle's Transport Service, LLC	As of December 31, 2017	December 31, 2016
Current assets	$ 6,734	$ 8,554
Noncurrent assets	11,801	13,237
Total assets	$ 18,535	$ 21,791
Current liabilities	$ 11,092	$ 4,655
Noncurrent liabilities	17,693	14,962
Total liabilities	$ 28,785	$ 19,617
Total equity (deficit)	$ (10,250)	$ 2,174

Statements of Operations – Kelle's Transport Service, LLC	For the year ended December 31, 2017	December 31, 2016	December 31, 2015
Net sales	$ 51,405	$ 65,471	$ 66,942
Cost of goods sold	49,343	55,859	54,027
Gross profit	$ 2,062	$ 9,612	$ 12,915
Other expenses	$ 14,077	$ 12,804	$ 12,071
Income (loss) before income taxes	(12,015)	(3,192)	844
Income tax provision	5	44	50
Net income (loss)	$ (12,020)	$ (3,236)	$ 794

Balance Sheet – Navis Holdings, Inc.	As of December 31, 2017	December 31, 2016
Current assets	$ 4,721	$ 4,655
Noncurrent assets	2,950	3,446
Total assets	$ 7,671	$ 8,101
Current liabilities	$ 1,941	$ 2,448
Noncurrent liabilities	6,973	6,719
Total liabilities	$ 8,914	$ 9,167
Total deficit	$ (1,243)	$ (1,066)

Statements of Operations – Navis Holdings, Inc.	For the year ended December 31, 2017	December 31, 2016	December 31, 2015
Net sales	$ 13,948	$ 17,803	$ 17,076
Cost of goods sold	8,724	10,933	11,087
Gross profit	$ 5,224	$ 6,870	$ 5,989
Other expenses	$ 4,647	$ 5,070	$ 5,414
Income before income taxes	577	1,800	575
Income tax provision	229	701	343
Net income	$ 348	$ 1,099	$ 232

Balance Sheet – On-Site Fuel Services, Inc.	As of December 31, 2017	December 31, 2016
Current assets	$ 28,064	$ 13,079
Noncurrent assets	26,807	16,314
Total assets	$ 54,871	$ 29,393
Current liabilities	$ 32,626	$ 16,498
Noncurrent liabilities	34,515	19,903
Total liabilities	$ 67,141	$ 36,401
Total deficit	$ (12,270)	$ (7,008)

Statements of Operations – On-Site Fuel Service, Inc.	For the year ended December 31, 2017	December 31, 2016	December 31, 2015
Net sales	$ 157,774	$ 110,412	$ 114,137
Cost of goods sold	149,436	101,714	106,668
Gross profit	$ 8,338	$ 8,698	$ 7,469
Other expenses	$ 13,600	$ 13,682	$ 13,592
Loss before income taxes	(5,262)	(4,984)	(6,123)
Income tax provision	—	14	1,967
Net loss	$ (5,262)	$ (4,998)	$ (8,090)

Financial Condition, Liquidity and Capital Resources

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

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

On October 17, 2014, we entered into the Credit Facility. On June 16, 2017, we entered into an amendment to our Credit Facility with ING Capital, LLC (the “Amendment”). Pursuant to the Amendment, the Credit Facility currently provides for borrowings up to $114.5 million and may be increased up to $200.0 million pursuant to its “accordion” feature. The Credit Facility matures on June 16, 2021. As of December 31, 2017, we had $9.0 million outstanding and $105.5 million available under the Credit Facility.

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

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

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

As of December 31, 2017, Fund II had $26.2 million in regulatory capital and $20.7 million in SBA-guaranteed debentures outstanding and Fund III had $75.0 million in regulatory capital and $150.0 million in SBA-guaranteed debentures outstanding. In addition to our existing SBA-guaranteed debentures, we may, if permitted by regulation, seek to issue additional SBA-guaranteed debentures as well as other forms of leverage and borrow funds to make investments. On June 10, 2014, we received an exemptive order from the SEC exempting us, Fund II and Fund III from certain provisions of the 1940 Act (including an exemptive order granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs) and from certain reporting requirements mandated by the 1934 Act, with respect to Fund II and Fund III. We intend to comply with the conditions of the order.

As of December 31, 2017, we had $31.2 million in cash and cash equivalents, and our net assets totaled $221.9 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 incur under new agreements may increase. In addition, we will likely incur significant time and expense in locating alternative parties to provide the services we expect to receive under both our Investment Advisory Agreement and our Administration Agreement. Any new investment advisory agreement would also be subject to approval by our stockholders.

A summary of our significant contractual payment obligations as of December 31, 2017 are as follows (dollars in thousands):

	Contractual Obligations Payments Due by Period				
	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years	Total
SBA Debentures	$ —	$ 24,000	$121,700	$ 25,000	$ 170,700
2022 Notes	—	—	75,000	—	75,000
2022 Convertible Notes	—	—	52,088	—	52,088
Credit Facility	—	—	9,000	—	9,000
Total Contractual Obligations	$ —	$ 24,000	$257,788	$ 25,000	$ 306,788

Distributions

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

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

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

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

The following tables summarize our distributions declared from January 2, 2015 through December 31, 2017:

Date Declared	Record Date	Payment Date	Amount Per Share
January 3, 2017	January 20, 2017	January 30, 2017	$ 0.1300
January 3, 2017	February 20, 2017	February 27, 2017	0.1300
January 3, 2017	March 23, 2017	March 30, 2017	0.1300
April 3, 2017	April 19, 2017	April 27, 2017	0.1300
April 3, 2017	May 23, 2017	May 29, 2017	0.1300
April 3, 2017	June 24, 2017	June 29, 2017	0.1300
July 3, 2017	July 21, 2017	July 28, 2017	0.1300
July 3, 2017	August 23, 2017	August 30, 2017	0.1300
July 3, 2017	September 20, 2017	September 28, 2017	0.1300
October 2, 2017	October 23, 2017	October 30, 2017	0.0833
October 2, 2017	November 21, 2017	November 29, 2017	0.0833
October 2, 2017	December 20, 2017	December 28, 2017	0.0833
Total Distributions Declared and Distributed for 2017			$ 1.42

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

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

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

Related Parties

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

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

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

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

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

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

Off-balance Sheet Arrangements

As of December 31, 2017, the Company had outstanding unfunded commitments related to debt investments in existing portfolio companies of $3.1 million (Portrait Studio, LLC), $2.0 million (CIS Secure Computing, Inc.), $1.0 million (Kelle's Transport Service, LLC), and $0.7 million (U.S. Well Services, LLC). As of December 31, 2016, the Company had outstanding unfunded commitments related to debt investments in an existing portfolio company of $1.2 million (On-Site Fuel Services, Inc.).

In addition to unfunded commitments related to debt investments, the Company also has extended a guaranty on behalf of one of our portfolio companies, whereby we have guaranteed $1.9 million of obligations of Kelle's Transport Service, LLC. As of December 31, 2017 we have not been required to make payments on this or any previous guaranties, and we consider the credit risks to be remote and the fair value of this guaranty to be immaterial.

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

Recent Developments

Distributions

On January 2, 2018, our Board declared the following distributions:

Date Declared	Record Date	Payment Date	Amount Per Share
January 2, 2018	January 22, 2018	January 30, 2018	$ 0.0833
January 2, 2018	February 20, 2018	February 27, 2018	0.0833
January 2, 2018	March 23, 2018	March 29, 2018	0.0833
Total Distributions Declared for Fiscal 2018			$ 0.25

Portfolio Activity

On January 2, 2018, the Company invested $15.0 million in first lien debt and $0.5 million in membership units of US Bath Group, LLC. The debt investment has a yield of LIBOR + 9.0% with a 1.0% floor.

On January 19, 2018, the Company received $7.2 million in cash repayment for its first lien debt investment in Brunswick Bowling Products, Inc., repaid at par.

ITEM 7A. 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 year ended December 31, 2017, we did not engage in hedging activities.

As of December 31, 2017, we held 21 securities bearing a variable rate of interest. Our variable rate investments represent approximately 48.3% of the fair value of total debt investments. As of December 31, 2017, 8.5% of variable rate securities were yielding interest at a rate equal to the established interest rate floor or interest rate ceiling and 91.5% of variable rate securities were yielding interest at a rate above its interest rate floor, below its interest rate ceiling, or were not subject to an interest rate floor. As of December 31, 2017, we had $9.0 million outstanding on our Credit Facility, which has a variable rate of interest at one-month LIBOR + 3.0%. As of December 31, 2017, all of our other interest paying liabilities, consisting of $170.7 million in SBA-guaranteed debentures, $75.0 million in 2022 Notes, and $52.1 million in 2022 Convertible Notes, were bearing interest at a fixed rate.

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

Based on our December 31, 2017 consolidated statements of assets and liabilities, the following table shows the annual impact on net income (excluding the potential related incentive fee impact) of base rate changes in interest rates (considering interest rate floors for variable rate securities) assuming no changes in our investment and borrowing structure (dollars in thousands):

Basis Point Change	Increase (decrease) in interest income	(Increase) decrease in interest expense	Increase (decrease) in net income
Up 300 basis points	$ 5,240	$ (270)	$ 4,970
Up 200 basis points	$ 3,486	$ (180)	$ 3,306
Up 100 basis points	$ 1,731	$ (90)	$ 1,641
Down 100 basis points	$ (1,282)	$ 91	$ (1,191)
Down 200 basis points	$ (1,361)	$ 143	$ (1,218)
Down 300 basis points	$ (1,361)	$ 143	$ (1,218)

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ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Capitala Finance Corp.

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of assets and liabilities of Capitala Finance Corp. (the "Company"), including the consolidated schedules of investments, as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in net assets and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Capitala Finance Corp. at December 31, 2017 and 2016, the results of its operations, changes in its net assets, and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of the Company's internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our procedures included confirmation of securities owned as of December 31, 2017 and 2016 by correspondence with the custodian and directly with management or designees of the portfolio companies, as applicable. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 2013.

Charlotte, North Carolina
February 27, 2018

Capitala Finance Corp.

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

	As of December 31, 2017	As of December 31, 2016
ASSETS		
Investments at fair value		
Non-control/non-affiliate investments (amortized cost of $298,132 and $391,706, respectively)	$ 288,374	$ 393,525
Affiliate investments (amortized cost of $77,336 and $39,279, respectively)	103,957	61,464
Control investments (amortized cost of $89,559 and $82,791, respectively)	107,608	86,650
Total investments at fair value (amortized cost of $465,027 and $513,776, respectively)	499,939	541,639
Cash and cash equivalents	31,221	36,281
Interest and dividend receivable	2,976	5,735
Due from related parties	95	182
Prepaid expenses	309	506
Other assets	55	72
Total assets	$ 534,595	$ 584,415
LIABILITIES		
SBA debentures (net of deferred financing costs of $2,300 and $2,911, respectively)	$ 168,400	$ 167,789
2021 Notes (net of deferred financing costs of $0 and $3,025, respectively)	—	110,413
2022 Notes (net of deferred financing costs of $2,496 and $0, respectively)	72,504	—
2022 Convertible Notes (net of deferred financing costs of $1,583 and $0, respectively)	50,505	—
Credit Facility (net of deferred financing costs of $1,293 and $759, respectively)	7,707	43,241
Due to related parties	—	35
Management and incentive fee payable	2,172	6,426
Interest and financing fees payable	3,141	2,657
Accounts payable and accrued expenses	—	536
Trade settlement payable	175	—
Deferred tax liability, net	1,289	—
Written call option at fair value (proceeds of $20 and $20, respectively)	6,815	2,736
Total liabilities	$ 312,708	$ 333,833
Commitments and contingencies (Note 2)		
NET ASSETS		
Common stock, par value $.01, 100,000,000 common shares authorized, 15,951,231 and 15,868,045 common shares issued and outstanding, respectively	$ 160	$ 159
Additional paid in capital	241,027	240,184
Undistributed net investment income	15,854	22,973
Accumulated net realized losses from investments	(61,982)	(37,881)
Net unrealized appreciation on investments, net of deferred taxes	33,623	27,863
Net unrealized depreciation on written call option	(6,795)	(2,716)
Total net assets	$ 221,887	$ 250,582
Total liabilities and net assets	$ 534,595	$ 584,415
Net asset value per share	$ 13.91	$ 15.79

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

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

	For the Year Ended December 31		
	2017	2016	2015
INVESTMENT INCOME			
Interest and fee income:			
Non-control/non-affiliate investments	$ 31,084	$ 42,667	$ 39,535
Affiliate investments	4,509	5,723	11,589
Control investments	6,896	10,718	5,406
Total interest and fee income	42,489	59,108	56,530
Payment-in-kind interest and dividend income:			
Non-control/non-affiliate investments	4,503	4,965	2,644
Affiliate investments	1,898	383	1,363
Control investments	742	952	1,077
Total payment-in-kind interest and dividend income	7,143	6,300	5,084
Dividend income:			
Non-control/non-affiliate investments	225	263	617
Affiliate investments	641	115	115
Control investments	355	2,414	1,369
Total dividend income	1,221	2,792	2,101
Other Income	125	85	256
Interest income from cash and cash equivalents	111	27	5
Total investment income	51,089	68,312	63,976
EXPENSES			
Interest and financing expenses	18,825	19,711	19,022
Loss on extinguishment of debt	2,732	—	—
Base management fee	9,780	10,588	10,590
Incentive fees	1,308	6,842	6,043
General and administrative expenses	3,878	3,804	4,052
Expenses before incentive fee waiver	36,523	40,945	39,707
Incentive fee waiver (See Note 7)	(958)	(1,673)	(1,058)
Total expenses, net of fee waivers	35,565	39,272	38,649
NET INVESTMENT INCOME	15,524	29,040	25,327
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND WRITTEN CALL OPTION:			
Net realized gain (loss) from investments:			
Non-control/non-affiliate investments	(6,682)	1,261	8,758
Affiliate investments	4,926	(24,172)	(9,109)
Control investments	(22,433)	145	5,787
Net realized gain (loss) from investments	(24,189)	(22,766)	5,436
Net unrealized appreciation (depreciation) on investments:			
Non-control/non-affiliate investments	(11,577)	(11,661)	(4,161)
Affiliate investments	4,436	4,124	1,142
Control investments	14,190	13,131	(13,894)
Net unrealized appreciation (depreciation) from investments	7,049	5,594	(16,913)
Net unrealized depreciation on written call option	(4,079)	(2,716)	—
Net loss on investments and written call option	(21,219)	(19,888)	(11,477)
Tax provision	(1,289)	—	—
Total net realized and unrealized gain (loss) on investments and written call option, net of taxes	(22,508)	(19,888)	(11,477)
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	$ (6,984)	$ 9,152	$ 13,850
NET INCREASE (DECREASE) IN NET ASSETS PER SHARE RESULTING FROM OPERATIONS – BASIC AND DILUTED	$ (0.44)	$ 0.58	$ 0.91
WEIGHTED AVERAGE COMMON STOCK OUTSTANDING – BASIC AND DILUTED	15,903,167	15,819,175	15,210,577
DISTRIBUTIONS PAID PER SHARE	$ 1.42	$ 1.80	$ 2.38

See accompanying notes to consolidated financial statements.

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Capitala Finance Corp.

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

	Common Stock							
	Number of Shares	Par Value	Additional Paid in Capital	Undistributed Net Investment Income	Accumulated Net Realized Gains (Losses)	Net Unrealized Appreciation (Depreciation) on Investments, net of Deferred Taxes	Net Unrealized Depreciation on Written Call Option	Total
BALANCE, December 31, 2014	12,974,420	$130	$188,408	$ 12,314	$ 803	$ 39,182	$ —	$240,837
Net investment income	—	—	—	25,327	—	—	—	25,327
Net realized gain from investments	—	—	—	—	5,436	—	—	5,436
Net change in unrealized depreciation on investments	—	—	—	—	—	(16,913)	—	(16,913)
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	(774,858)	(8)	(11,992)	—	—	—	—	(12,000)
Distributions to Shareholders:								
Stock issued under dividend reinvestment plan	77,783	1	1,023	—	—	—	—	1,024
Distributions declared	—	—	—	(25,673)	(10,936)	—	—	(36,609)
Tax reclassification of stockholders' equity in accordance with generally accepted accounting principles	—	—	—	(3,398)	3,398	—	—	—
BALANCE, December 31, 2015	15,777,345	$158	$239,104	$ 8,570	$ (1,299)	$ 22,269	$ —	$268,802
Net investment income	—	—	—	29,040	—	—	—	29,040
Net realized loss from investments	—	—	—	—	(22,766)	—	—	(22,766)
Net change in unrealized appreciation on investments	—	—	—	—	—	5,594	—	5,594
Net change in unrealized depreciation on written call option	—	—	—	—	—	—	(2,716)	(2,716)
Distributions to Shareholders:								
Stock issued under dividend reinvestment plan	90,700	1	1,102	—	—	—	—	1,103
Distributions declared	—	—	—	(28,475)	—	—	—	(28,475)
Tax reclassification of stockholders' equity in accordance with generally accepted accounting principles	—	—	(22)	13,838	(13,816)	—	—	—
BALANCE, December 31, 2016	15,868,045	$159	$240,184	$ 22,973	$ (37,881)	$ 27,863	$ (2,716)	$250,582
Net investment income	—	—	—	15,524	—	—	—	15,524
Net realized loss from investments	—	—	—	—	(24,189)	—	—	(24,189)
Net change in unrealized appreciation on investments	—	—	—	—	—	7,049	—	7,049
Net change in unrealized depreciation on written call option	—	—	—	—	—	—	(4,079)	(4,079)
Tax provision	—	—	—	—	—	(1,289)	—	(1,289)
Distributions to Shareholders:								
Stock issued under dividend reinvestment plan	83,186	1	864	—	—	—	—	865
Distributions declared	—	—	—	(22,576)	—	—	—	(22,576)
Tax reclassification of stockholders' equity in accordance with generally accepted accounting principles	—	—	(21)	(67)	88	—	—	—
BALANCE, December 31, 2017	15,951,231	$160	$241,027	$ 15,854	$ (61,982)	$ 33,623	$ (6,795)	$221,887

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Statements of Cash Flows
(in thousands)

	For the Year Ended December 31		
	2017	**2016**	**2015**
CASH FLOWS FROM OPERATING ACTIVITIES			
Net increase (decrease) in net assets resulting from operations	$ (6,984)	$ 9,152	$ 13,850
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided by (used in) operating activities:			
Purchase of investments	(82,750)	(120,844)	(260,640)
Repayments and sales of investments	115,810	163,564	142,713
Net realized (gain) loss on investments	24,189	22,766	(5,436)
Net unrealized (appreciation) depreciation on investments	(7,049)	(5,594)	16,913
Payment-in-kind interest and dividends	(7,143)	(6,300)	(5,084)
Accretion of original issue discount on investments	(1,357)	(2,775)	(585)
Proceeds from written call option	—	20	—
Net unrealized depreciation on written call option	4,079	2,716	—
Amortization of deferred financing fees	2,100	2,149	1,966
Loss on extinguishment of debt	2,732	—	—
Tax provision	1,289	—	—
Changes in assets and liabilities:			
Interest and dividend receivable	2,759	(345)	(2,277)
Due from related parties	87	74	262
Prepaid expenses	197	(3)	12
Other assets	17	36	166
Due to related parties	(35)	29	(2)
Management and incentive fee payable	(4,254)	4,739	1,528
Interest and financing fees payable	484	(330)	85
Accounts payable and accrued expenses	(536)	69	145
Trade settlement payable	175	—	—
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	43,810	69,123	(96,384)
CASH FLOWS FROM FINANCING ACTIVITIES			
Paydowns on SBA debentures	—	(13,500)	(8,000)
Proceeds from Credit Facility	9,000	29,000	105,000
Payments to Credit Facility	(44,000)	(55,000)	(35,000)
Issuance of 2022 Notes	75,000	—	—
Issuance of 2022 Convertible Notes	52,088	—	—
Repayment of 2021 Notes	(113,438)	—	—
Issuance of common stock, net of offering and underwriting costs	—	—	61,700
Distributions paid to shareholders	(21,711)	(27,372)	(35,585)
Repurchases of common stock under stock repurchase program	—	—	(12,000)
Deferred financing fees paid	(5,809)	(75)	(733)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(48,870)	(66,947)	75,382
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(5,060)	2,176	(21,002)
CASH AND CASH EQUIVALENTS, beginning of year	36,281	34,105	55,107
CASH AND CASH EQUIVALENTS, end of year	$ 31,221	$ 36,281	$ 34,105
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid for interest	$ 15,503	$ 17,591	$ 16,349
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING TRANSACTIONS			
Distributions paid through dividend reinvestment plan share issuances	$ 865	$ 1,103	$ 1,024

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments
(in thousands, except for units/shares)
December 31, 2017

Portfolio Company, Country(1),(2),(3),(4)	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Non-control/non-affiliated investments – 130.0%						
Non-control/non-affiliated investments – United States						
3 Bridge Solutions, LLC	IT Consulting	First Lien Debt (10.38% Cash (1 month LIBOR + 9.0%, 1% Floor), Due 12/4/22)	$ 11,250	$ 11,250	$ 11,250	5.1%
3 Bridge Solutions, LLC	IT Consulting	Preferred Units (965,250 units, 8% PIK)(5)		971	971	0.4%
3 Bridge Solutions, LLC	IT Consulting	Membership Units (39,000 units)		10	10	0.0%
				12,231	12,231	5.5%
Alternative Biomedical Solutions, LLC	Healthcare	First Lien Debt (11.74% Cash, Due 12/18/22)(6)	13,000	13,000	13,000	5.9%
Alternative Biomedical Solutions, LLC	Healthcare	Membership Units (20,092 units)		800	800	0.4%
				13,800	13,800	6.3%
American Clinical Solutions, LLC	Healthcare	First Lien Debt (10.5% Cash, 1% PIK, Due 6/11/20)	9,068	9,068	7,568	3.4%
				9,068	7,568	3.4%
American Exteriors, LLC	Replacement Window Manufacturer	First Lien Debt (10% PIK, Due 1/1/19)(7)(8)	8,287	5,679	1,880	0.8%
American Exteriors, LLC	Replacement Window Manufacturer	Common Stock Warrants (10% fully diluted)		—	—	0.0%
				5,679	1,880	0.8%
AmeriMark Direct, LLC	Consumer Products	First Lien Debt (12.75% Cash, Due 9/8/21)	19,100	18,713	19,100	8.6%
				18,713	19,100	8.6%
B&W Quality Growers, LLC	Farming	Membership Unit Warrants (91,739 Units)		—	5,581	2.5%
				—	5,581	2.5%
BigMouth, Inc.	Consumer Products	First Lien Debt (13.3% Cash, Due 11/14/21)(6)	9,790	9,790	9,790	4.4%
BigMouth, Inc.	Consumer Products	Series A Preferred Stock (350,000 shares, 8% PIK)(5)		382	722	0.3%
				10,172	10,512	4.7%
Bluestem Brands, Inc.	Online Merchandise Retailer	First Lien Debt (9.07% Cash (1 month LIBOR + 7.5%, 1% Floor), Due 11/7/20)	4,029	3,965	3,755	1.7%
				3,965	3,755	1.7%
Brunswick Bowling Products, Inc.	Bowling Products	First Lien Debt (8% Cash (1 month LIBOR + 6%, 2% Floor), Due 5/22/20)	1,600	1,600	1,600	0.7%
Brunswick Bowling Products, Inc.	Bowling Products	First Lien Debt (16.25% Cash (1 month LIBOR + 14.25%, 2% Floor), Due 5/22/20)	5,586	5,586	5,586	2.5%
				7,186	7,186	3.2%
Burke America Parts Group, LLC	Home Repair Parts Manufacturer	Membership Units (14 units)		5	2,767	1.2%
				5	2,767	1.2%
California Pizza Kitchen, Inc.	Restaurant	Second Lien Debt (11.57% Cash (1 month LIBOR + 10%, 1% Floor), Due 8/23/23)	5,000	4,880	4,880	2.2%
				4,880	4,880	2.2%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock (293,186 shares)		258	54	0.0%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock Warrants (655,908 units)(9)		264	120	0.1%
				522	174	0.1%

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)
(in thousands, except for units/shares)
December 31, 2017

Portfolio Company, Country(1),(2),(3),(4)	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Cedar Electronics Holding Corp.	Consumer Electronics	Subordinated Debt (12% Cash, Due 12/26/20)(7)	$ 21,550	$ 21,550	$ 3,498	1.6%
				21,550	3,498	1.6%
CIS Secure Computing, Inc.	Government Services	First Lien Debt (9.88% Cash (1 month LIBOR + 8.5%, 1% Floor), 1% PIK, Due 9/14/22)(10)	9,116	9,116	9,116	4.1%
CIS Secure Computing, Inc.	Government Services	Common Stock (46,163 shares)		1,000	1,204	0.5%
				10,116	10,320	4.6%
Corporate Visions, Inc.	Sales & Marketing Services	Subordinated Debt (9% Cash, 2% PIK, Due 11/29/21)	18,159	18,159	16,995	7.7%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (15,750 shares)		1,575	393	0.2%
				19,734	17,388	7.9%
Currency Capital, LLC	Financial Services	First Lien Debt (12.38% Cash (1 month LIBOR + 11%, 0.50% Floor) Due 1/20/22)(11)	17,000	17,000	17,000	7.7%
Currency Capital, LLC	Financial Services	Class A Preferred Units (2,000,000 units)(11)		2,000	1,905	0.9%
				19,000	18,905	8.6%
Flavors Holdings, Inc.	Food Product Manufacturer	First Lien Debt (7.44% Cash (3 month LIBOR + 5.75%, 1% Floor), Due 4/3/20)	6,700	6,589	5,911	2.7%
Flavors Holdings, Inc.	Food Product Manufacturer	Second Lien Debt (11.69% Cash (3 month LIBOR + 10%, 1% Floor), Due 10/3/21)	12,000	11,740	10,311	4.6%
				18,329	16,222	7.3%
Nth Degree, Inc.	Business Services	First Lien Debt (8.38% Cash (1 month LIBOR + 7%, 1% Floor), 1% PIK, Due 12/14/20)	8,833	8,833	8,833	4.0%
Nth Degree, Inc.	Business Services	First Lien Debt (12.88% Cash (1 month LIBOR + 11.5%, 1% Floor), 2% PIK, Due 12/14/20)	7,200	7,200	7,200	3.2%
Nth Degree, Inc.	Business Services	Preferred Stock (2,400 Units, 10% PIK dividend)(5)		2,938	11,140	5.0%
				18,971	27,173	12.2%
Sequoia Healthcare Management, LLC	Healthcare Management	First Lien Debt (12% Cash, 4% PIK, Due 7/17/19)	9,014	8,964	9,014	4.1%
				8,964	9,014	4.1%
Spectra Services Holdings, LLC	Refrigeration/HVAC services	First Lien Debt (10% Cash, 4% PIK, Due 12/27/22)	7,450	7,450	7,450	3.4%
Spectra Services Holdings, LLC	Refrigeration/HVAC services	Class A Units (1,283,823 units, 4% Cash dividend, 11% PIK dividend)(5)		1,286	1,286	0.6%
Spectra Services Holdings, LLC	Refrigeration/HVAC services	Class B Units (257 units)		—	—	0.0%
				8,736	8,736	4.0%
Sur La Table, Inc.	Retail	First Lien Debt (12% Cash, Due 7/28/20)	15,000	15,000	15,000	6.8%
				15,000	15,000	6.8%
Taylor Precision Products, Inc.	Household Product Manufacturer	Series C Preferred Stock (379 shares)		758	1,316	0.6%
				758	1,316	0.6%
Vintage Stock, Inc.	Specialty Retail	First Lien Debt (13.86% Cash (1 month LIBOR + 12.5%, 0.5% floor), 3% PIK, Due 11/3/21)	20,713	20,713	20,713	9.3%
				20,713	20,713	9.3%
Vology, Inc.	Information Technology	Subordinated Debt (15% Cash (3 month LIBOR + 14%, 1% Ceiling), 4% PIK Due 6/30/20)	8,374	8,374	8,374	3.8%
				8,374	8,374	3.8%

See accompanying notes to consolidated financial statements.

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Portfolio Company, Country(1),(2),(3),(4)	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Western Windows Systems, LLC	Building Products	First Lien Debt (11.9% Cash, Due 7/31/20)(6)	$ 10,500	$ 10,500	$ 10,500	4.7%
Western Windows Systems, LLC	Building Products	Membership Units (39,860 units)		3,000	7,379	3.3%
				13,500	17,879	8.0%
Xirgo Technologies, LLC	Information Technology	Subordinated Debt (11.5% Cash, Due 3/1/22)	15,750	15,750	15,750	7.1%
Xirgo Technologies, LLC	Information Technology	Membership Units (600,000 units)		600	637	0.3%
				16,350	16,387	7.4%
Sub Total Non-control/non-affiliated investments – United States				286,316	280,359	126.4%
Non-control/non-affiliated investments – Brazil						
Velum Global Credit Management, LLC	Financial Services	First Lien Debt (15% PIK, Due 12/31/17)(7)(8)(11)(12)	12,275	11,816	8,015	3.6%
				11,816	8,015	3.6%
Sub Total Non-control/non-affiliated investments – Brazil				11,816	8,015	3.6%
Sub Total Non-control/non-affiliated investments				$298,132	$288,374	130.0%
Affiliate investments – 46.8%						
Affiliate investments – United States						
AAE Acquisition, LLC	Industrial Equipment Rental	Second Lien Debt (8% Cash, 4% PIK, Due 8/24/19)(8)	$ 15,846	$ 15,846	$ 15,603	7.0%
AAE Acquisition, LLC	Industrial Equipment Rental	Membership Units (2.19% fully diluted)		17	—	0.0%
AAE Acquisition, LLC	Industrial Equipment Rental	Warrants (37.78% fully diluted)		—	—	0.0%
				15,863	15,603	7.0%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Subordinated Debt (14% Cash, Due 8/9/19)(13)	3,000	3,000	3,000	1.4%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Subordinated Debt (12% Cash, Due 8/9/19)(13)	5,828	5,828	5,828	2.6%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock (1,253,198 shares)		1,504	457	0.2%
				10,332	9,285	4.2%
City Gear, LLC	Footwear Retail	Subordinated Debt (13% Cash, Due 10/20/19)(8)	8,231	8,231	8,231	3.7%
City Gear, LLC	Footwear Retail	Preferred Membership Units (2.78% fully diluted, 9% Cash Dividend)(5)		1,269	1,269	0.6%
City Gear, LLC	Footwear Retail	Membership Unit Warrants (11.38% fully diluted)		—	8,248	3.7%
				9,500	17,748	8.0%
GA Communications, Inc.	Advertising & Marketing Services	Series A-1 Preferred Stock (1,998 shares, 8% PIK Dividend)(5)		2,902	3,225	1.5%
GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)		2	1,932	0.9%
				2,904	5,157	2.4%
J&J Produce Holdings, Inc.	Produce Distribution	Subordinated Debt (6% Cash, 7% PIK, Due 6/16/19)(8)	6,368	6,368	6,170	2.8%
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 (6,369 shares)		—	—	0.0%
				7,186	6,170	2.8%
LJS Partners, LLC	QSR Franchisor	Common Stock (1,500,000 shares)		896	7,650	3.4%
				896	7,650	3.4%
MMI Holdings, LLC	Medical Device Distributor	First Lien Debt (12% Cash, Due 1/31/19)(8)	2,600	2,600	2,600	1.2%
MMI Holdings, LLC	Medical Device Distributor	Subordinated Debt (6% Cash, Due 1/31/19)(8)	400	388	400	0.2%
MMI Holdings, LLC	Medical Device Distributor	Preferred Units (1,000 units, 6% PIK dividend)(5)		1,381	1,520	0.7%

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Portfolio Company, Country[(1),(2),(3),(4)]	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
MMI Holdings, LLC	Medical Device Distributor	Common Membership Units (45 units)		$ —	$ 193	0.1%
				4,369	4,713	2.2%
MTI Holdings, LLC	Retail Display & Security Services	Membership Units (2,000,000 units)[(14)]		—	100	0.0%
				—	100	0.0%
Sierra Hamilton Holdings Corporation	Oil & Gas Engineering and Consulting Services	Common Stock (15,068,000 shares)		6,958	8,528	3.8%
				6,958	8,528	3.8%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Membership Units (11.3% ownership)[(14)]		—	101	0.0%
				—	101	0.0%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock (1,200,000 shares)[(14)]		—	93	0.0%
				—	93	0.0%
U.S. Well Services, LLC	Oil & Gas Services	First Lien Debt (7.35% Cash (1 month LIBOR + 6%, 1% floor), Due 2/2/22)[(15)]	$ 2,299	2,299	2,299	1.0%
U.S. Well Services, LLC	Oil & Gas Services	First Lien Debt (12.35% PIK (1 month LIBOR + 11%, 1% floor), Due 2/2/22)	9,516	9,516	9,516	4.3%
U.S. Well Services, LLC	Oil & Gas Services	Class A Units (5,680,688 Units)		6,259	15,004	6.8%
U.S. Well Services, LLC	Oil & Gas Services	Class B Units (2,076,298 Units)		441	955	0.4%
				18,515	27,774	12.5%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Subordinated Debt[(19)]		813	1,035	0.5%
				813	1,035	0.5%
Sub Total Affiliate investments – United States				$ 77,336	$ 103,957	46.8%
Control investments – 48.5%						
Control investments – United States						
CableOrganizer Acquisition, LLC	Computer Supply Retail	First Lien Debt (12% Cash, 4% PIK, Due 5/24/18)	$ 12,373	$ 12,373	$ 12,373	5.6%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock (21.3% fully diluted)		1,394	118	0.1%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock Warrants (10% fully diluted)		—	60	0.0%
				13,767	12,551	5.7%
Eastport Holdings, LLC	Business Services	Subordinated Debt (14.49% Cash (3 month LIBOR + 13%, 0.5% Floor), Due 4/29/20)	16,500	14,738	16,500	7.4%
Eastport Holdings, LLC	Business Services	Membership Units (33.3% ownership)[(16)]		4,733	26,449	11.9%
				19,471	42,949	19.3%
Kelle's Transport Service, LLC	Transportation	First Lien Debt (4% Cash, Due 2/15/20)[(17)]	2,000	2,000	2,000	0.9%
Kelle's Transport Service, LLC	Transportation	First Lien Debt (1.46% Cash, Due 2/15/20)[(8)]	13,674	13,669	9,560	4.3%
Kelle's Transport Service, LLC	Transportation	Membership Units (27.5% fully diluted)		—	—	0.0%
				15,669	11,560	5.2%
Micro Precision, LLC	Conglomerate	Subordinated Debt (10% Cash, Due 9/15/18)[(8)]	1,862	1,862	1,862	0.8%
Micro Precision, LLC	Conglomerate	Subordinated Debt (14% Cash, 4% PIK, Due 9/15/18)[(8)]	4,154	4,154	4,154	1.9%
Micro Precision, LLC	Conglomerate	Series A Preferred Units (47 units)		1,629	1,629	0.7%
				7,645	7,645	3.4%

See accompanying notes to consolidated financial statements.

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Consolidated Schedule of Investments – (continued)
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Portfolio Company, Country(1),(2),(3),(4)	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Navis Holdings, Inc.	Textile Equipment Manufacturer	First Lien Debt (15% Cash, Due 10/30/20)(8)	$ 6,500	$ 6,500	$ 6,500	2.9%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares, 10% Cash Dividend)(5)		1,000	1,000	0.5%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (300,000 shares)		1	5,005	2.3%
				7,501	12,505	5.7%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Subordinated Debt (18% Cash, Due 12/19/18)(7)(8)	14,072	11,020	11,588	5.2%
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 (33,058 shares)		33	—	0.0%
				16,696	11,588	5.2%
Portrait Studio, LLC	Professional and Personal Digital Imaging	First Lien Debt (8.56% Cash (1 month LIBOR + 7%, 2% ceiling), Due 12/31/22)(18)		1,860	1,860	0.9%
Portrait Studio, LLC	Professional and Personal Digital Imaging	First Lien Debt (8.56% Cash (1 month LIBOR + 7%, 5% ceiling), Due 12/31/22)		4,500	4,500	2.0%
Portrait Studio, LLC	Professional and Personal Digital Imaging	Preferred Units (4,350,000 Units)		2,450	2,450	1.1%
Portrait Studio, LLC	Professional and Personal Digital Imaging	Membership Units (150,000 Units)		—	—	0.0%
				8,810	8,810	4.0%
Sub Total Control investments – United States				$ 89,559	$107,608	48.5%
TOTAL INVESTMENTS – 225.3%				**$465,027**	**$499,939**	**225.3%**
Derivatives – (3.1)%						
Derivatives – United States						
Eastport Holdings, LLC	Business Services	Written Call Option(16)		$ (20)	$ (6,815)	(3.1)%
Sub Total Derivatives – United States				$ (20)	$ (6,815)	(3.1)%
TOTAL DERIVATIVES – (3.1)%				**$ (20)**	**$ (6,815)**	**(3.1)%**

(1) All investments valued using unobservable inputs (Level 3).

(2) All investments valued by the Board of Directors.

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

(4) Percentages are based on net assets of $221,887 as of December 31, 2017.

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

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

(7) Non-accrual investment.

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

(9) The equity investment has an excercisable put option.

(10) The investment has a $2.0 million unfunded commitment.

(11) Indicates assets that the Company believes do not represent “qualifying assets” under Section 55(a) of the Investment Company Act of 1940, as amended. Qualifying assets must represent at least 70% of the Company’s total assets at the time of acquisition of any additional non-qualifying assets. As of December 31, 2017, 5.0% of the Company’s total assets were non-qualifying assets.

(12) The company is headquartered in Brazil.

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

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(13) In addition to the stated rate, the Company is charging 3% default interest on the investment.

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

(15) The investment has a $0.7 million unfunded commitment.

(16) The Company has written a call option that enables CapitalSouth Partners Florida Sidecar Fund II, L.P. to purchase up to 31.25% of the Company's interest at a strike price of $1.5 million. As of December 31, 2017, the fair value of the written call option is approximately $6.8 million. See Note 4 to the consolidated financial statements for further detail on the written call option transaction.

(17) The investment has a $1.0 million unfunded commitment.

(18) The investment has a $3.1 million unfunded commitment.

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

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments
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Portfolio Company, Country(4),(5),(14),(15)	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Non-control/non-affiliated investments – 157.1%						
Non-control/non-affiliated investments – United States						
AAE Acquisition, LLC	Industrial Equipment Rental	Second Lien Debt (12% Cash, Due 3/31/18)	$ 11,000	$ 11,000	$ 10,755	4.3%
AAE Acquisition, LLC	Industrial Equipment Rental	Membership Units (14% fully diluted)		17	—	0.0%
				11,017	10,755	4.3%
American Clinical Solutions, LLC	Healthcare	First Lien Debt (10.5% Cash (3 month LIBOR + 9.5%, 1% Floor), Due 6/11/20)(13)	9,034	9,034	8,582	3.4%
				9,034	8,582	3.4%
American Exteriors, LLC	Replacement Window Manufacturer	First Lien Debt (10% PIK, Due 1/1/17)(1)(2)	6,456	4,679	2,571	1.0%
American Exteriors, LLC	Replacement Window Manufacturer	Common Stock Warrants (10% fully diluted)		—	—	0.0%
				4,679	2,571	1.0%
AmeriMark Direct, LLC	Consumer Products	First Lien Debt (12.75% Cash, Due 9/8/21)	19,700	19,192	19,542	7.8%
				19,192	19,542	7.8%
B&W Quality Growers, LLC	Farming	Subordinated Debt (14% Cash, Due 7/23/20)	6,000	5,996	6,000	2.4%
B&W Quality Growers, LLC	Farming	Membership Unit Warrants (91,739 Units)		20	5,779	2.3%
				6,016	11,779	4.7%
BigMouth, Inc.	Consumer Products	First Lien Debt (12.6% Cash, Due 11/14/21)(3)	10,313	10,313	10,313	4.1%
BigMouth, Inc.	Consumer Products	Series A Preferred Stock (350,000 shares, 8% PIK)(6)		354	354	0.1%
				10,667	10,667	4.2%
Bluestem Brands, Inc.	Online Merchandise Retailer	First Lien Debt (8.5% Cash (1 month LIBOR + 7.5%, 1% Floor), Due 11/7/20)	4,279	4,169	4,169	1.7%
				4,169	4,169	1.7%
Brock Holdings III, Inc.	Industrial Specialty Services	Second Lien Debt (10% Cash (1 month LIBOR + 8.25%, 1.75% Floor), Due 3/16/18)	5,000	4,935	4,750	1.9%
				4,935	4,750	1.9%
Brunswick Bowling Products, Inc.	Bowling Products	First Lien Debt (8% Cash (1 month LIBOR + 6.0%, 2% Floor), Due 5/22/20)	1,600	1,600	1,600	0.6%
Brunswick Bowling Products, Inc.	Bowling Products	First Lien Debt (16.25% Cash (1 month LIBOR + 14.25%, 2% Floor), Due 5/22/20)	5,586	5,586	5,586	2.2%
Brunswick Bowling Products, Inc.	Bowling Products	Preferred Shares (2,966 shares, 8% PIK)(6)		3,384	5,317	2.1%
				10,570	12,503	4.9%
Burke America Parts Group, LLC	Home Repair Parts Manufacturer	Membership Units (14 units)		5	1,408	0.6%
				5	1,408	0.6%
California Pizza Kitchen, Inc.	Restaurant	Second Lien Debt (11% Cash (1 month LIBOR + 10%, 1% Floor), Due 8/23/23)	5,000	4,857	4,857	1.9%
				4,857	4,857	1.9%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock (293,186 shares)		258	137	0.1%
Caregiver Services, Inc.	In-Home Healthcare Services	Common Stock Warrants (655,908 units)(7)		264	309	0.1%
				522	446	0.2%

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Capitala Finance Corp.

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Portfolio Company, Country(4),(5),(14),(15)	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Cedar Electronics Holding Corp.	Consumer Electronics	Subordinated Debt (12% Cash, Due 12/26/20)	$ 21,550	$ 21,550	$ 20,818	8.3%
				21,550	20,818	8.3%
Community Choice Financial, Inc.	Financial Services	First Lien Debt (18% Cash (1 month LIBOR + 17%, 1% Floor), Due 3/30/18)(1)(8)	15,000	15,000	15,000	6.0%
				15,000	15,000	6.0%
Construction Partners, Inc.	Construction Services	Second Lien Debt (11.5% Cash, Due 6/12/20)	9,500	9,500	9,500	3.8%
				9,500	9,500	3.8%
Corporate Visions, Inc.	Sales & Marketing Services	Subordinated Debt (9% Cash, 2% PIK, Due 11/29/21)	16,267	16,267	15,648	6.2%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (15,750 shares)		1,575	728	0.3%
				17,842	16,376	6.5%
CSM Bakery Solutions, LLC	Bakery Supplies Distributor	Second Lien Debt (8.75% Cash (1 month LIBOR + 7.75%, 1% Floor), Due 8/7/22)	12,000	11,813	10,776	4.3%
				11,813	10,776	4.3%
Emerging Markets Communications, LLC	Satellite Communications	Second Lien Debt (10.625% Cash (1 month LIBOR + 9.625%, 1% Floor), Due 7/1/22)	5,000	4,946	5,000	2.0%
				4,946	5,000	2.0%
Flavors Holdings, Inc.	Food Product Manufacturer	First Lien Debt (6.75% Cash (1 month LIBOR + 5.75%, 1% Floor), Due 4/3/20)	7,100	6,930	6,411	2.6%
Flavors Holdings, Inc.	Food Product Manufacturer	Second Lien Debt (11% Cash (1 month LIBOR + 10%, 1% Floor), Due 10/3/21)	12,000	11,671	10,188	4.1%
				18,601	16,599	6.7%
Immersive Media Tactical Solutions, LLC	Specialty Defense Contractor	Subordinated Debt (Due 12/9/19)(9)	2,000	2,000	1,532	0.6%
				2,000	1,532	0.6%
Kelle's Transport Service, LLC	Transportation	First Lien Debt (14% Cash, Due 3/31/19)	13,674	13,668	13,252	5.3%
Kelle's Transport Service, LLC	Transportation	Preferred Units (1,000 units, 10% PIK Dividend)(6)		3,433	3,433	1.4%
Kelle's Transport Service, LLC	Transportation	Common Stock Warrants (15% fully diluted)		22	171	0.1%
				17,123	16,856	6.8%
Medical Depot, Inc.	Medical Device Distributor	Subordinated Debt (14% Cash, Due 9/27/20)(1)	14,667	14,667	14,667	5.9%
Medical Depot, Inc.	Medical Device Distributor	Series C Convertible Preferred Stock (740 shares)		1,333	6,440	2.6%
				16,000	21,107	8.5%
Nielsen & Bainbridge, LLC	Home Décor Manufacturer	Second Lien Debt (10.5% Cash (6 month LIBOR + 9.25%, 1% Floor), Due 8/15/21)	15,000	14,849	14,670	5.9%
				14,849	14,670	5.9%
Nth Degree, Inc.	Business Services	First Lien Debt (8.0% Cash (1 month LIBOR + 7%, 1% Floor), 1% PIK, Due 12/14/20)	9,904	9,904	9,904	4.0%
Nth Degree, Inc.	Business Services	First Lien Debt (12.5% Cash (1 month LIBOR + 11.5%, 1% Floor), 2% PIK, Due 12/14/20)	7,351	7,351	7,351	2.9%
Nth Degree, Inc.	Business Services	Preferred Stock (10% PIK dividend)(6)		2,662	4,581	1.8%
				19,917	21,836	8.7%

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

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Portfolio Company, Country[(4),(5),(14),(15)]	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Portrait Innovations, Inc.	Professional and Personal Digital Imaging	Subordinated Debt (12% Cash, Due 2/26/20)	$ 9,000	$ 9,000	$ 9,000	3.6%
				9,000	9,000	3.6%
Sequoia Healthcare Management, LLC	Healthcare Management	First Lien Debt (12% Cash, 4% PIK, Due 7/17/19)	10,851	10,750	10,851	4.3%
				10,750	10,851	4.3%
Sierra Hamilton, LLC	Oil & Gas Engineering and Consulting Services	First Lien Debt (12.25% Cash, Due 12/15/18)(2)	15,000	15,000	4,500	1.8%
				15,000	4,500	1.8%
Sur La Table, Inc.	Retail	First Lien Debt (12% Cash, Due 7/28/20)	15,000	15,000	15,000	6.0%
				15,000	15,000	6.0%
Taylor Precision Products, Inc.	Household Product Manufacturer	Series C Preferred Stock (379 shares)		758	1,001	0.4%
				758	1,001	0.4%
U.S. Well Services, LLC	Oil & Gas Services	First Lien Debt (14.1% PIK (1 month LIBOR + 13.5%, 0.5% floor), Due 5/2/19)	15,083	15,054	15,083	6.0%
				15,054	15,083	6.0%
Vintage Stock, Inc.	Specialty Retail	First Lien Debt (13.1% Cash (1 month LIBOR + 12.5%, 0.5% floor), 3% PIK, Due 11/3/21)	22,067	22,067	22,067	8.8%
				22,067	22,067	8.8%
Vology, Inc.	Information Technology	Subordinated Debt (15% Cash (3 month LIBOR + 14%, 1% Floor, 2% PIK), Due 1/24/21)	8,082	8,082	8,082	3.2%
				8,082	8,082	3.2%
Western Windows Systems, LLC	Building Products	First Lien Debt (11.7% Cash, Due 7/31/20)(3)	10,500	10,500	10,500	4.2%
Western Windows Systems, LLC	Building Products	Membership Units (39,860 units)		3,000	7,652	3.0%
				13,500	18,152	7.2%
Xirgo Technologies, LLC	Information Technology	Subordinated Debt (11.5% Cash, Due 3/1/22)	15,750	15,750	15,750	6.3%
Xirgo Technologies, LLC	Information Technology	Membership Units (400,000 units)		400	400	0.2%
				16,150	16,150	6.5%
Sub Total Non-control/non-affiliated investments – United States				380,165	381,985	152.5%
Non-control/non-affiliated investments – Brazil						
Velum Global Credit Management, LLC	Financial Services	First Lien Debt (15% PIK, Due 12/31/17)(1)(8)	10,553	10,553	10,553	4.2%
				10,553	10,553	4.2%
Sub Total Non-Control/non-affiliated investments – Brazil				10,553	10,553	4.2%
Non-control/non-affiliated investments – Canada						
Group Cirque du Soleil, Inc.	Entertainment	Second Lien Debt (9.25% Cash (3 month LIBOR + 8.25%, 1% Floor), Due 7/8/23)(8)	1,000	988	987	0.4%
				988	987	0.4%
Sub Total Non-Control/non-affiliated investments – Canada				988	987	0.4%
Sub Total Non-control/non – affiliated investments				$391,706	$393,525	157.1%
Affiliate investments – 24.5%						
Affiliate investments – United States						
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Subordinated Debt (14% Cash, Due 8/9/19)(10)	$ 3,000	$ 3,000	$ 3,000	1.2%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Subordinated Debt (12% Cash, Due 8/9/19)(10)	5,828	5,828	5,828	2.3%

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

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

Portfolio Company, Country[4],[5],[14],[15]	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock (1,253,198 shares)		$ 1,504	$ 1,248	0.5%
				10,332	10,076	4.0%
City Gear, LLC	Footwear Retail	Subordinated Debt (13% Cash, Due 9/28/17)[1]	$ 8,231	8,231	8,231	3.3%
City Gear, LLC	Footwear Retail	Preferred Membership Units (2.78% fully diluted, 9% Cash Dividend)[6]		1,269	1,269	0.5%
City Gear, LLC	Footwear Retail	Membership Unit Warrants (11.38% fully diluted)		—	9,736	3.9%
				9,500	19,236	7.7%
GA Communications, Inc.	Advertising & Marketing Services	Series A-1 Preferred Stock (1,998 shares, 8% PIK dividend)[6]		2,648	2,864	1.1%
GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)		2	1,046	0.4%
				2,650	3,910	1.5%
J&J Produce Holdings, Inc.	Produce Distribution	Subordinated Debt (13% Cash, Due 7/16/18)	6,182	6,182	6,182	2.5%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock (8,182 shares)		818	—	0.0%
J&J Produce Holdings, Inc.	Produce Distribution	Common Stock Warrants (6,369 shares)		—	—	0.0%
				7,000	6,182	2.5%
LJS Partners, LLC	QSR Franchisor	Common Stock (1,500,000 shares)		1,525	8,497	3.4%
				1,525	8,497	3.4%
MJC Holdings, LLC	Specialty Clothing	Series A Preferred Units (2,000,000 units)		1,000	5,011	2.0%
				1,000	5,011	2.0%
MMI Holdings, LLC	Medical Device Distributor	First Lien Debt (12% Cash, Due 1/31/18)[1]	2,600	2,600	2,600	1.0%
MMI Holdings, LLC	Medical Device Distributor	Subordinated Debt (6% Cash, Due 1/31/18)[1]	400	388	400	0.2%
MMI Holdings, LLC	Medical Device Distributor	Preferred Units (1,000 units, 6% PIK dividend)[6]		1,296	1,433	0.6%
MMI Holdings, LLC	Medical Device Distributor	Common Membership Units (45 units)		—	228	0.1%
				4,284	4,661	1.9%
MTI Holdings, LLC	Retail Display & Security Services	Membership Units (2,000,000 units)[12]		—	537	0.2%
				—	537	0.2%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Subordinated Debt (13% Cash, Due 4/8/19)[1]	1,425	1,425	1,425	0.6%
Source Capital Penray, LLC	Automotive Chemicals & Lubricants	Membership Units (11.3% ownership)		750	805	0.3%
				2,175	2,230	0.9%
STX Healthcare Management Services, Inc.	Dental Practice Management	Common Stock (1,200,000 shares)[12]		—	109	0.0%
				—	109	0.0%
V12 Holdings, Inc.	Data Processing & Digital Marketing	Subordinated Debt[12]		$ 813	$ 1,015	0.4%
				813	1,015	0.4%
Sub Total Affiliate investments – United States				$ 39,279	$ 61,464	24.5%
Control investments – 34.6%						
Control investments – United States						
CableOrganizer Acquisition, LLC	Computer Supply Retail	First Lien Debt (12% Cash, 4% PIK, Due 5/24/18)	$ 11,882	$ 11,882	$ 11,882	4.8%
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock (19.7% fully diluted ownership)		1,394	200	0.1%

See accompanying notes to consolidated financial statements.

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Capitala Finance Corp.

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

Portfolio Company, Country[(4),(5),(14),(15)]	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
CableOrganizer Acquisition, LLC	Computer Supply Retail	Common Stock Warrants (10% fully diluted ownership)		$ —	$ 101	0.0%
				13,276	12,183	4.9%
Eastport Holdings, LLC	Business Services	Subordinated Debt (13.9% Cash (3 month LIBOR + 13%, 0.5% Floor), Due 4/29/20)	$ 16,500	13,982	16,500	6.6%
Eastport Holdings, LLC	Business Services	Membership Units (30.1% fully diluted)[(11)]		4,733	13,395	5.3%
				18,715	29,895	11.9%
Micro Precision, LLC	Conglomerate	Subordinated Debt (10% Cash, Due 9/15/18)[(1)]	1,862	1,862	1,862	0.8%
Micro Precision, LLC	Conglomerate	Subordinated Debt (14% Cash, 4% PIK, Due 9/15/18)[(1)]	3,989	3,989	3,989	1.6%
Micro Precision, LLC	Conglomerate	Series A Preferred Units (47 units)		1,629	2,523	1.0%
				7,480	8,374	3.4%
Navis Holdings, Inc.	Textile Equipment Manufacturer	First Lien Debt (15% Cash, Due 10/30/20)[(1)]	6,500	6,500	6,500	2.6%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares, 10% Cash Dividend)		1,000	1,000	0.4%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (300,000 shares)		1	5,634	2.2%
				7,501	13,134	5.2%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Subordinated Debt (14% Cash, 4% PIK, Due 12/19/17)[(1)(2)]	10,303	9,837	10,303	4.1%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series A Preferred Stock (32,782 shares)		3,278	—	0.0%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Series B Preferred Stock (23,648 shares)		2,365	—	0.0%
On-Site Fuel Services, Inc.	Fuel Transportation Services	Common Stock (33,058 shares)		33	—	0.0%
				15,513	10,303	4.1%
Print Direction, Inc.	Printing Services	First Lien Debt (10% Cash, 2% PIK, Due 2/24/19)	17,316	17,316	12,761	5.1%
Print Direction, Inc.	Printing Services	Common Stock (18,543 shares)		2,990	—	0.0%
Print Direction, Inc.	Printing Services	Common Stock Warrants (820 shares)		—	—	0.0%
				20,306	12,761	5.1%
Sub Total Control investments – United States				$ 82,791	$ 86,650	34.6%
TOTAL INVESTMENTS – 216.2%				**$513,776**	**$541,639**	**216.2%**
Derivatives – (1.1)%						
Derivatives – United States						
Eastport Holdings, LLC	Business Services	Written Call Option[(11)]		$ (20)	$ (2,736)	(1.1)%
Sub Total Derivatives – United States				$ (20)	$ (2,736)	(1.1)%
TOTAL DERIVATIVES – (1.1)%				**$ (20)**	**$ (2,736)**	**(1.1)%**

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

(2) Non-accrual investment.

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

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

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

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

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

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

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

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

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

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

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

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

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

(14) All investments valued using unobservable inputs (Level 3).

(15) All investments valued by the Board of Directors.

See accompanying notes to consolidated financial statements.

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 1. Organization

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

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

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

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

During the fourth quarter of 2017, Florida Sidecar transferred all of its assets to Capitala Finance Corp. and was legally dissolved as a standalone partnership.

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

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

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

The Company's financial statements as of December 31, 2017 and 2016 are presented on a consolidated basis. The effects of all intercompany transactions between the Company and its subsidiaries (Fund II, Fund III, Florida Sidecar, and the Taxable Subsidiaries) have been eliminated in consolidation. All financial data and information included in these consolidated financial statements have been presented on the basis described above. In the opinion of management, the consolidated financial statements reflect all adjustments that are necessary for the fair presentation of financial results as of and for the periods presented.

Use of Estimates in the Preparation of Financial Statements

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

Consolidation

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

Segments

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

Cash and Cash Equivalents

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

Investment Classification

In accordance with the provisions of the 1940 Act, the Company classifies its investments by level of control. As defined in the 1940 Act, "Control Investments" are investments in those companies that the

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 2. Summary of Significant Accounting Policies – (continued)

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

Valuation of Investments

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

In determining fair value, the Company's board of directors (the "Board") uses various valuation approaches, and engages a third-party valuation firm, which provides an independent valuation of certain investments 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 Board's assumptions about the inputs market participants would use in pricing the asset or liability developed based upon the best information available in the circumstances.

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

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

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 2. Summary of Significant Accounting Policies – (continued)

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

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

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

Enterprise Value Waterfall Approach

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

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

Income Approach

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

Asset Approach

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

Note 2. Summary of Significant Accounting Policies – (continued)

Revenue Recognition

The Company's revenue recognition policies are as follows:

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

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

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

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

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

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

Loan Sales

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

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 2. Summary of Significant Accounting Policies – (continued)

General and Administrative Expenses

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

Deferred Financing Fees

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

Commitments and Contingencies

As of December 31, 2017, the Company had outstanding unfunded commitments related to debt investments in existing portfolio companies of $3.1 million (Portrait Studio, LLC), $2.0 million (CIS Secure Computing, Inc.), $1.0 million (Kelle's Transport Service, LLC), and $0.7 million (U.S. Well Services, LLC). As of December 31, 2016, the Company had outstanding unfunded commitments related to debt investments in an existing portfolio company of $1.2 million (On-Site Fuel Services, Inc.).

In addition to unfunded commitments related to debt investments, the Company also has extended a guaranty on behalf of one of our portfolio companies, whereby we have guaranteed $1.9 million of obligations of Kelle's Transport Service, LLC. As of December 31, 2017 we have not been required to make payments on this or any previous guaranties, and we consider the credit risks to be remote and the fair value of this guaranty to be immaterial.

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

On December 28, 2017, an alleged shareholder filed a putative class action complaint, *Paskowitz v. Capitala Finance Corp., et al.*, in the United States District Court for the Central District of California (case number 2:17-cv-09251-MWF-AS) (the "*Paskowitz* Action"), against the Company and certain of its current officers on behalf of all persons who purchased or otherwise acquired the Company's common stock between January 4, 2016 and August 7, 2017. On January 3, 2018, another alleged shareholder filed a putative class action complaint, *Sandifer v. Capitala Finance Corp., et al.*, in the United States District Court for the Central District of California (case number 2:18-cv-00052-MWF-AS) (the "*Sandifer* Action"), asserting substantially similar claims on behalf of the same putative class and against the same defendants. The complaints in the *Paskowitz* Action and the *Sandifer* Action allege certain violations of the securities laws, including, inter alia, that the defendants made certain materially false and misleading statements and omissions regarding the Company's business, operations, and prospects. On February 2, 2018, the *Sandifer* Action was transferred, on stipulation of the parties, to the United States District Court for the Western District of North Carolina (case number 3:18-cv-00063-MOC-DCK). The defendants filed a motion to transfer the *Paskowitz* Action to the United States District Court for the Western District of North Carolina on February 2, 2018, which remains pending. While the Company intends to vigorously defend itself in this litigation, the outcome of these legal proceedings cannot be predicted with certainty.

Estimating an amount or range of possible losses resulting from litigation proceedings is inherently difficult and requires an extensive degree of judgment, particularly where the matters involve indeterminate claims for monetary damages, are in the early stages of the proceedings, and are subject to appeal. In addition, because most legal proceedings are resolved over extended periods of time, potential losses are subject to

Note 2. Summary of Significant Accounting Policies – (continued)

change due to, among other things, new developments, changes in legal strategy, the outcome of intermediate procedural and substantive rulings and other parties' settlement posture and their evaluation of the strength or weakness of their case against us. For these reasons, we are currently unable to predict the ultimate timing or outcome of, or reasonably estimate the possible losses or a range of possible losses resulting from, the matters described above. Based on information currently available, the Company does not believe that any reasonably possible losses arising from the currently pending legal matters described above will be material to the Company's results of operations or financial condition. However, in light of the inherent uncertainties involved in such matters, an adverse outcome in this litigation could materially and adversely affect the Company's financial condition, results of operations or cash flows in any particular reporting period.

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

Income Taxes

The Company has elected to be treated for U.S. federal income tax purposes, and intends to comply with the requirements to qualify annually 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.

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

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

The Company's Taxable Subsidiaries record deferred tax assets or liabilities related to temporary book versus tax differences on the income or loss generated by the underlying equity investments held by the Taxable Subsidiaries. As of December 31, 2017, and December 31, 2016, the Company recorded a net deferred tax liability of $1.3 million and $0.0 million, respectively. For the year ended December 31, 2017, the Company recorded a tax provision of $1.3 million. For the years ended December 31, 2016 and 2015, no tax provision was recorded.

In accordance with certain applicable U.S. Treasury regulations and guidance issued by the Internal Revenue Service, a RIC may treat a distribution of its own stock as fulfilling its RIC distribution requirements if each stockholder may elect to receive its entire distribution in either cash or stock of the RIC, subject to a limitation on the aggregate amount of cash to be distributed to all stockholders, which limitation must be at least 20.0% of the aggregate declared distribution. If too many stockholders elect to receive cash, the cash available for distribution must be allocated among the stockholders electing to receive cash (with the balance

CAPITALA FINANCE CORP.

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Note 2. Summary of Significant Accounting Policies – (continued)

of the distribution paid in stock). In no event will any stockholder, electing to receive cash, receive the lesser of (a) the portion of the distribution such stockholder has elected to receive in cash or (b) an amount equal to his or her entire distribution times the percentage limitation on cash available for distribution. If these and certain other requirements are met, for U.S federal income tax purposes, the amount of the dividend paid in stock will be equal to the amount of cash that could have been received instead of stock. For income tax purposes, the Company has paid distributions on its common stock from ordinary income in the amount of $25.2 million, $24.5 million, and $25.1 million during the tax years ended August 31, 2017, 2016 and 2015, respectively.

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

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

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

The tax years ended August 31, 2017, 2016 and 2015, and 2014 remain subject to examination by U.S. federal, state, and local tax authorities. No interest expense or penalties have been assessed as of December 31, 2017 and 2016. If the Company was required to recognize interest and penalties, if any, related to unrecognized tax benefits this would be recognized as income tax expense in the consolidated statements of operations.

Distributions

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

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

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

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 2. Summary of Significant Accounting Policies – (continued)

uncertainties. Prices of investments may be volatile, and a variety of factors that are inherently difficult to predict, such as domestic or international economic and political developments, may significantly affect the results of the Company’s activities and the value of its investments. In addition, the value of the Company’s portfolio may fluctuate as the general level of interest rates fluctuate.

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

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

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

Note 3. Recent Accounting Pronouncements

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

In May 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Accounting Standards Codification (“ASC”) Topic 606) (“ASU 2014-09”). ASU 2014-09 supersedes the revenue recognition requirements under ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the ASC. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The new guidance will significantly enhance comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. Additionally, the guidance requires improved disclosures as to the nature, amount, timing and uncertainty of revenue that is recognized. The new guidance will be effective for the annual reporting period beginning after December 15, 2017, including interim periods within that reporting period. The Company completed its initial assessment in evaluating the potential impact on its consolidated financial statements and based on its initial assessment, determined that its financial contracts are excluded from the scope of ASU 2014-09. As a result of the scope exception for financial contracts, the Company's management has determined that there will be no material changes to the recognition timing and classification of revenues and expenses; additionally, the Company's management does not expect the adoption of ASU 2014-09 to have a significant impact on its consolidated financial statement disclosures upon adoption.

Note 4. Investments and Fair Value Measurements

The Company’s investment objective is to generate both current income and capital appreciation through debt and equity investments. Both directly and through the Company’s subsidiaries that are licensed by the SBA under the SBIC Act, the Company offers customized financing to business owners, management teams

Note 4. Investments and Fair Value Measurements – (continued)

and financial sponsors for change of ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives. The Company invests in first lien loans, second lien loans, and subordinated loans. Most of the Company's debt investments are coupled with equity interests, whether in the form of detachable "penny" warrants or equity co-investments made pari-passu with our borrowers' financial sponsors. As of December 31, 2017, our portfolio consisted of investments in 47 portfolio companies with a fair value of approximately $499.9 million.

Most of the Company's debt investments are structured as first lien loans. First lien loans may contain some minimum amount of principal amortization, excess cash flow sweep feature, prepayment penalties, or any combination of the foregoing. First lien loans are secured by a first priority lien in existing and future assets of the borrower and may take the form of term loans or delayed draw facilities. Unitranche debt, a form of first lien loan, typically involves issuing one debt security that blends the risk and return profiles of both senior secured and subordinated debt in one debt security, bifurcating the loan into a first-out tranche and last-out tranche. As of December 31, 2017, 13.7% of our first lien loans consisted of last-out loans. In some cases, first lien loans may be subordinated, solely with respect to the payment of cash interest, to an asset based revolving credit facility.

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

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

During the year ended December 31, 2017, the Company made approximately $82.8 million of investments and had approximately $115.8 million in repayments and sales resulting in net repayments and sales of approximately $33.0 million for the year. During the year ended December 31, 2016, the Company made approximately $120.8 million of investments and had approximately $163.6 million in repayments and sales resulting in net repayments and sales of approximately $42.8 million for the year. During the year ended December 31, 2015, the Company made approximately $260.6 million of investments and had approximately $142.7 million in repayments and sales resulting in net investments of approximately $117.9 million for the year.

During the year ended December 31, 2017, the Company funded $5.9 million of previously committed capital to existing portfolio companies. During the year ended December 31, 2017, the Company funded $76.9 million of investments in portfolio companies for which it was not previously committed to fund. During the year ended December 31, 2016, the Company funded $2.8 million of previously committed capital to existing portfolio companies. During the year ended December 31, 2016, the Company funded $118.0 million of investments in portfolio companies for which it was not previously committed to fund. During the year ended December 31, 2015, the Company funded $52.4 million of previously committed capital to existing portfolio companies. During the year ended December 31, 2015, the Company funded $208.2 million of investments in portfolio companies for which it was not previously committed to fund. In addition to investing directly in portfolio companies, the Company may assist portfolio companies in securing financing from other sources by introducing portfolio companies to sponsors or by leading a syndicate of investors to provide the portfolio companies with financing. During the year ended December 31, 2017, the Company assisted one portfolio company in obtaining indirect financing by providing a limited guarantee. During the year ended December 31, 2016, the Company did not lead any syndicates and did not assist any

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 4. Investments and Fair Value Measurements – (continued)

portfolio companies in obtaining indirect financing. During the year ended December 31, 2015, the Company assisted one company in securing financing from other sources as part of a loan syndication.

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

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

The Written Call Option granted FSC II the right to purchase up to 31.25% of the Company's equity investment in Eastport Holdings, LLC. The Written Call Option has a strike price of $1.5 million and a termination date of August 31, 2018. The fair value of the Written Call Option, which has been treated as a derivative liability and is recorded in the financial statement line item Written Call Option at fair value in the Company's consolidated statements of assets and liabilities, was approximately $6.8 million and $2.7 million as of December 31, 2017 and 2016, respectively. For purposes of determining the fair value of the Written Call Option, the Company calculated the difference in the fair value of the underlying equity investment in Eastport Holdings, LLC and the strike price of the Written Call Option, or intrinsic value. The time value of the Written Call Option as of December 31, 2017 and 2016 was determined to be insignificant. The Written Call Option is classified as a Level 3 financial instrument.

The composition of our investments as of December 31, 2017, at amortized cost and fair value was as follows (dollars in thousands):

	Investments at Amortized Cost	Amortized Cost Percentage of Total Portfolio	Investments at Fair Value	Fair Value Percentage of Total Portfolio
First Lien Debt	$ 257,147	55.3%	$ 243,489	48.7%
Second Lien Debt	32,465	7.0	30,794	6.1
Subordinated Debt	120,235	25.8	103,385	20.7
Equity and Warrants	55,180	11.9	122,271	24.5
Total	$ 465,027	100.0%	$ 499,939	100.0%

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

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

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 4. Investments and Fair Value Measurements – (continued)

As noted above, the Company values all investments in accordance with ASC 820. ASC 820 requires enhanced disclosures about assets and liabilities that are measured and reported at fair value. As defined in ASC 820, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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

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

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

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

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

The following table presents the fair value measurements of investments, by major class, as of December 31, 2017 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
First Lien Debt	$ —	$ —	$ 243,489	$ 243,489
Second Lien Debt	—	—	30,794	30,794
Subordinated Debt	—	—	103,385	103,385
Equity and Warrants	—	—	122,271	122,271
Total	$ —	$ —	$ 499,939	$ 499,939

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 4. Investments and Fair Value Measurements – (continued)

The following table presents fair value measurements of the Written Call Option as of December 31, 2017 (dollars in thousands), according to the fair value hierarchy:

	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Written Call Option	$ —	$ —	$ (6,815)	$ (6,815)
Total	$ —	$ —	$ (6,815)	$ (6,815)

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

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

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

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

The following table provides a reconciliation of the beginning and ending balances for investments that use Level 3 inputs for the year ended December 31, 2017 (dollars in thousands):

	First Lien Debt	Second Lien Debt	Subordinated Debt	Equity and Warrants	Total
Balance as of January 1, 2017	$ 226,578	$ 71,483	$ 150,232	$ 93,346	$ 541,639
Reclassifications	(7,109)	—	(9,000)	16,109	—
Repayments/sales	(26,409)	(45,804)	(22,092)	(21,505)	(115,810)
Purchases	69,722	4,000	2,730	6,298	82,750
Payment in-kind interest and dividends accrued	4,378	846	987	932	7,143
Accretion of original issue discount	274	322	761	—	1,357
Realized gain (loss) from investments	(28,356)	(1,456)	(2,000)	7,623	(24,189)
Net unrealized appreciation (depreciation) on investments	4,411	1,403	(18,233)	19,468	7,049
Balance as of December 31, 2017	$ 243,489	$ 30,794	$ 103,385	$122,271	$ 499,939

CAPITALA FINANCE CORP.

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Note 4. Investments and Fair Value Measurements – (continued)

The following table provides a reconciliation of the beginning and ending balances for the Written Call Option that use Level 3 inputs for the year ended December 31, 2017 (dollars in thousands):

	Written Call Option
Balance as of January 1, 2017	$ (2,736)
Net unrealized depreciation on Written Call Option	(4,079)
Balance as of December 31, 2017	$ (6,815)

The following table provides a reconciliation of the beginning and ending balances for investments that use Level 3 inputs for the year ended December 31, 2016 (dollars in thousands):

	First Lien Debt	Second Lien Debt	Subordinated Debt	Equity and Warrants	Total
Balance as of January 1, 2016	$ 199,843	$ 80,610	$ 194,485	$ 98,480	$ 573,418
Repayments/sales	(35,823)	(12,750)	(71,527)	(22,410)	(142,510)
Purchases	72,702	4,850	37,406	5,886	120,844
Payment in-kind interest and dividends accrued	4,471	—	596	1,233	6,300
Accretion of original issue discount	364	191	2,219	1	2,775
Realized gain (loss) from investments	(5,024)	(168)	(25,325)	7,078	(23,439)
Net unrealized appreciation (depreciation) on investments	(9,955)	(1,250)	12,378	3,078	4,251
Balance as of December 31, 2016	$ 226,578	$ 71,483	$ 150,232	$ 93,346	$ 541,639

The following table provides a reconciliation of the beginning and ending balances for the Written Call Option that use Level 3 inputs for the year ended December 31, 2016 (dollars in thousands):

	Written Call Option
Balance as of January 1, 2016	$ —
Net unrealized depreciation on Written Call Option	(2,716)
Proceeds from Written Call Option	(20)
Balance as of December 31, 2016	$ (2,736)

The net change in unrealized appreciation (depreciation) on investments held as of December 31, 2017 and 2016 was $(1.6) million and $3.9 million, respectively, and is included in net unrealized appreciation (depreciation) on investments in the consolidated statements of operations.

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December 31, 2017

Note 4. Investments and Fair Value Measurements – (continued)

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements of assets (liabilities) as of December 31, 2017 were as follows:

	Fair Value (in millions)	Valuation Approach	Unobservable Input	Range (Weighted Average)
First lien debt			Required Rate of Return	8.6% – 21.2% (13.5%)
			Leverage Ratio	1.7x – 7.0x (3.6x)
	$211.2	Income	Adjusted EBITDA	$1.8 million – $131.2 million ($21.1 million)
First lien debt		Enterprise Value Waterfall and	EBITDA Multiple	4.0x – 7.0x (5.5x)
	$32.3	Asset[1]	Adjusted EBITDA	$2.1 million – $3.1 million ($2.6 million)
Second lien debt			Required Rate of Return	11.6% – 17.6% (14.4%)
			Leverage Ratio	4.9x – 7.0x (6.0x)
	$30.8	Income	Adjusted EBITDA	$7.3 million – $78.5 million ($41.1 million)
Subordinated debt			Required Rate of Return	11.5% – 19.0% (14.2%)
			Leverage Ratio	3.2x – 8.1x (5.6x)
	$64.4	Income	Adjusted EBITDA	$3.2 million – $15.1 million ($9.7 million)
Subordinated debt			EBITDA Multiple	6.0x – 7.5x (7.2x)
		Enterprise Value	Adjusted EBITDA	$1.8 million – $30.1 million ($21.2 million)
		Waterfall and	Revenue Multiple	0.2x – 0.2x (0.2x)
	$39.0	Asset[1]	Revenue	$150.7 million – $150.7 million ($150.7 million)
Equity and warrants		Enterprise Value	EBITDA Multiple	3.5x – 14.5x (7.9x)
	$122.3	Waterfall	Adjusted EBITDA	$1.8 million – $77.6 million ($24.3 million)
Written Call Option		Enterprise Value	EBITDA Multiple	7.25x – 7.25x (7.25x)
	$(6.8)	Waterfall	Adjusted EBITDA	$30.1 million – $30.1 million ($30.1 million)

(1) $1.0 million in subordinated debt and $1.9 million in first lien debt were valued using the asset approach.

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 4. Investments and Fair Value Measurements – (continued)

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

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

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

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

Capitala Senior Liquid Loan Fund I, LLC

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

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 4. Investments and Fair Value Measurements – (continued)

Because the TRS was wound down in a prior period, only comparative period disclosures are included herein. For the years ended December 31, 2016 and December 31, 2015, the Company received $1.8 million and $0.9 million, respectively, in dividend income from its equity interest in CSLLF. For the year ended December 31, 2016, CSLLF declared a return of capital distribution to the Company in the amount of $20.0 million, which included $19.9 million in cash received in December 2016 and $0.1 million paid in the first quarter of 2017.

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

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

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

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

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

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

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 4. Investments and Fair Value Measurements – (continued)

Transactions in TRS contracts during the year ended December 31, 2016 resulted in $2.3 million in realized gains and $2.8 million in unrealized appreciation. Transactions in TRS contracts during the year ended December 31, 2015 resulted in $1.4 million in realized gains and $(2.8) million in unrealized depreciation, which is recorded on CSLLF's statements of operations below.

The following represents the volume of the CSLLF's derivative transactions during the year December 31, 2016 and 2015 (dollars in thousands):

	For the year ended December 31, 2016	For the year ended December 31, 2015[1]
Average notional par amount of contract	$ 56,681	$ 61,306

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(1) Average calculated from period of TRS inception, March 27, 2015 to December 31, 2015.

Below is certain summarized financial information for CSLLF as of December 31, 2016 and for the years ended December 31, 2016, and December 31, 2015 (dollars in thousands):

Selected Statements of Assets and Liabilities:

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

Selected Statements of Operations Information:

	For the Year Ended December 31, 2016	For the period from March 27, 2015 to December 31, 2015
Administrative and legal expenses	$ (193)	$ (104)
Net operating loss	$ (193)	$ (104)
Net realized gain on Total Return Swap	$ 2,306	$ 1,366
Net change in unrealized appreciation (depreciation) on Total Return Swap	2,828	(2,828)
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	$ 4,941	$ (1,566)

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 5. Fair Value of Financial Instruments

Financial Instruments Disclosed, But Not Carried, At Fair Value

The following table presents the carrying value and fair value of the Company's financial liabilities disclosed, but not carried, at fair value as of December 31, 2017, and the level of each financial liability within the fair value hierarchy (dollars in thousands):

	Carrying Value(1)	Fair Value	Level 1	Level 2	Level 3
SBA debentures	$ 170,700	$ 173,373	$ —	$ —	$ 173,373
2022 Notes	75,000	75,600	75,600	—	—
2022 Convertible Notes	52,088	51,775	51,775	—	—
Credit Facility	9,000	9,038	—	—	9,038
Total	$ 306,788	$ 309,786	$ 127,375	$ —	$ 182,411

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

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

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

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

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

The estimated fair value of the Company's 7.125% fixed rate notes due 2021 (the "2021 Notes") was based on the closing price as of the measurement date as the 2021 Notes were traded on the New York Stock Exchange under the ticker "CLA."

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

The estimated fair value of the senior secured revolving credit agreement (the "Credit Facility") with ING Capital, LLC, as administrative agent, arranger, and bookrunner, and the lender party thereto was based on future contractual cash payments discounted at estimated market interest rates for similar debt.

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 6. Transactions With Affiliated Companies

During the year ended December 31, 2017, the Company had investments in portfolio companies designated as affiliates under the 1940 Act. Transactions with affiliates were as follows:

Company[4]	Type of Investment	Principal Amount	Amount of Interest, Fees or Dividends Credited to Income[1]	December 31, 2016 Fair Value	Gross Additions[2]	Gross Reductions[3]	Realized Gain/(Loss)	Unrealized Gain/(Loss)	December 31, 2017 Fair Value
Affiliate investments									
AAE Acquisition, LLC	Second Lien Debt (8% Cash, 4% PIK, Due 8/24/19)	$ 15,846	$ 757	$ —	$ 15,846	$ —	$ —	$ (243)	$ 15,603
AAE Acquisition, LLC	Membership Units (2.19% fully diluted)	—	—	—	16	—	—	(16)	—
AAE Acquisition, LLC	Warrants (37.78% fully diluted)	—	—	—	—	—	—	—	—
			757	—	15,862	—	—	(259)	15,603
Burgaflex Holdings, LLC	Subordinated Debt (14% Cash, Due 8/9/19)	3,000	515	3,000	—	—	—	—	3,000
Burgaflex Holdings, LLC	Subordinated Debt (12% Cash, Due 8/9/19)	5,828	886	5,828	—	—	—	—	5,828
Burgaflex Holdings, LLC	Common Stock (1,253,198 shares)	—	—	1,248	—	—	—	(791)	457
			1,401	10,076	—	—	—	(791)	9,285
City Gear, LLC	Subordinated Debt (13% Cash, Due 10/20/19)	8,231	1,085	8,231	—	—	—	—	8,231
City Gear, LLC[5]	Preferred Membership Units (2.78% fully diluted, 9% Cash Dividend)	—	115	1,269	—	—	—	—	1,269
City Gear, LLC	Membership Unit Warrants (11.38% fully diluted)	—	—	9,736	—	—	—	(1,488)	8,248
			1,200	19,236	—	—	—	(1,488)	17,748
GA Communications, Inc.[5]	Series A-1 Preferred Stock (1,998 shares, 8% PIK Dividend)	—	—	2,864	255	—	—	106	3,225
GA Communications, Inc.	Series B-1 Common Stock (200,000 shares)	—	—	1,046	—	—	—	886	1,932
			—	3,910	255	—	—	992	5,157
J&J Produce Holdings, Inc.	Subordinated Debt (6% Cash, 7% PIK, Due 6/16/19)	6,368	632	6,182	186	—	—	(198)	6,170
J&J Produce Holdings, Inc.	Common Stock (8,182 shares)	—	—	—	—	—	—	—	—
J&J Produce Holdings, Inc.	Common Stock Warrants (6,369 shares)	—	—	—	—	—	—	—	—
			632	6,182	186	—	—	(198)	6,170
LJS Partners, LLC	Common Stock (1,500,000 shares)	—	—	8,497	—	(630)	—	(217)	7,650
			—	8,497	—	(630)	—	(217)	7,650
MJC Holdings, LLC	Series A Preferred Units (2,000,000 units)	—	—	5,011	—	(5,473)	4,473	(4,011)	—
			—	5,011	—	(5,473)	4,473	(4,011)	—
MMI Holdings, LLC	First Lien Debt (12% Cash, Due 1/31/19)	2,600	317	2,600	—	—	—	—	2,600
MMI Holdings, LLC	Subordinated Debt (6% Cash, Due 1/31/19)	400	24	400	—	—	—	—	400
MMI Holdings, LLC[5]	Preferred Units (1,000 units, 6% PIK Dividend)	—	—	1,433	85	—	—	2	1,520
MMI Holdings, LLC	Common Membership Units (45 units)	—	—	228	—	—	—	(35)	193
			341	4,661	85	—	—	(33)	4,713
MTI Holdings, LLC	Membership Units (2,000,000 units)	—	—	537	—	(437)	437	(437)	100
			—	537	—	(437)	437	(437)	100

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 6. Transactions With Affiliated Companies – (continued)

Company[4]	Type of Investment	Principal Amount	Amount of Interest, Fees or Dividends Credited to Income[1]	December 31, 2016 Fair Value	Gross Additions[2]	Gross Reductions[3]	Realized Gain/(Loss)	Unrealized Gain/(Loss)	December 31, 2017 Fair Value
Sierra Hamilton Holdings Corporation	Common Stock (15,068,000 shares)	$ —	$ —	$ —	$ 6,958	$ —	$ —	$ 1,570	$ 8,528
			—	—	6,958	—	—	1,570	8,528
Source Capital Penray, LLC	Subordinated Debt (13% Cash, Due 4/8/19)	—	78	1,425	—	(1,425)	—	—	—
Source Capital Penray, LLC	Membership Units (11.3% ownership)	—	526	805	—	(750)	—	46	101
			604	2,230	—	(2,175)	—	46	101
STX Healthcare Management Services, Inc.	Common Stock (1,200,000 shares)	—	—	109	—	(16)	16	(16)	93
			—	109	—	(16)	16	(16)	93
U.S. Well Services, LLC	First Lien Debt (7.35% Cash (1 month LIBOR + 6%, 1% floor), Due 2/2/22)	2,299	132	—	2,299	—	—	—	2,299
U.S. Well Services, LLC	First Lien Debt (12.35% PIK (1 month LIBOR + 11%, 1% floor), Due 2/2/22)	9,516	83	—	9,516	—	—	—	9,516
U.S. Well Services, LLC	Class A Units (5,680,688 Units)	—	—	—	6,260	—	—	8,744	15,004
U.S. Well Services, LLC	Class B Units (2,076,298 Units)	—	—	—	441	—	—	514	955
			215	—	18,516	—	—	9,258	27,774
V12 Holdings, Inc.	Subordinated Debt	—	—	1,015	—	—	—	20	1,035
			—	1,015	—	—	—	20	1,035
Sub Total Affiliate investments			$ 5,150	$ 61,464	$ 41,862	$ (8,731)	$ 4,926	$ 4,436	$ 103,957
Control investments									
CableOrganizer Acquisition, LLC	First Lien Debt (12% Cash, 4% PIK, Due 5/24/18)	$ 12,373	$ 1,473	$ 11,882	$ 491	$ —	$ —	$ —	$ 12,373
CableOrganizer Acquisition, LLC	Common Stock (21.3% fully diluted)	—	—	200	—	—	—	(82)	118
CableOrganizer Acquisition, LLC	Common Stock Warrants (10% fully diluted)	—	—	101	—	—	—	(41)	60
			1,473	12,183	491	—	—	(123)	12,551
Capitala Senior Liquid Loan Fund I, LLC	Common Stock (80% Ownership)	—	5	—	—	—	—	—	—
			5	—	—	—	—	—	—
Eastport Holdings, LLC	Subordinated Debt (14.49% Cash (3 month LIBOR + 13%, 0.5% Floor), Due 4/29/20)	16,500	3,138	16,500	757	—	—	(757)	16,500
Eastport Holdings, LLC	Membership Units (33.3% ownership)	—	—	13,395	—	—	—	13,054	26,449
			3,138	29,895	757	—	—	12,297	42,949
Kelle's Transport Service, LLC	First Lien Debt (4% Cash, Due 2/15/20)	2,000	22	—	2,000	—	—	—	2,000
Kelle's Transport Service, LLC	First Lien Debt (1.46% Cash, Due 2/15/20)	13,674	77	—	13,669	—	—	(4,109)	9,560
Kelle's Transport Service, LLC	Membership Units (27.5% fully diluted)	—	—	—	—	—	—	—	—
			99	—	15,669	—	—	(4,109)	11,560
Micro Precision, LLC	Subordinated Debt (10% Cash, Due 9/15/18)	1,862	186	1,862	—	—	—	—	1,862
Micro Precision, LLC	Subordinated Debt (14% Cash, 4% PIK, Due 9/15/18)	4,154	577	3,989	165	—	—	—	4,154

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 6. Transactions With Affiliated Companies – (continued)

Company[4]	Type of Investment	Principal Amount	Amount of Interest, Fees or Dividends Credited to Income[1]	December 31, 2016 Fair Value	Gross Additions[2]	Gross Reductions[3]	Realized Gain/(Loss)	Unrealized Gain/(Loss)	December 31, 2017 Fair Value
Micro Precision, LLC	Series A Preferred Units (47 units)	$ —	$ —	$ 2,523	$ —	$ —	$ —	$ (894)	$ 1,629
			763	8,374	165	—	—	(894)	7,645
Navis Holdings, Inc.	First Lien Debt (15% Cash, Due 10/30/20)	6,500	989	6,500	—	—	—	—	6,500
Navis Holdings, Inc.[5]	Class A Preferred Stock (1,000 shares, 10% Cash Dividend)	—	100	1,000	—	—	—	—	1,000
Navis Holdings, Inc.	Common Stock (300,000 shares)	—	250	5,634	—	—	—	(629)	5,005
			1,339	13,134	—	—	—	(629)	12,505
On-Site Fuel Services, Inc.	Subordinated Debt (18% Cash, Due 12/19/18)	14,072	—	10,303	1,182	—	—	103	11,588
On-Site Fuel Services, Inc.	Series A Preferred Stock (32,782 shares)	—	—	—	—	—	—	—	—
On-Site Fuel Services, Inc.	Series B Preferred Stock (23,648 shares)	—	—	—	—	—	—	—	—
On-Site Fuel Services, Inc.	Common Stock (33,058 shares)	—	—	—	—	—	—	—	—
			—	10,303	1,182	—	—	103	11,588
Portrait Studio, LLC	First Lien Debt (8.56% Cash (1 month LIBOR + 7%, 2% ceiling), Due 12/31/22)	1,860	—	—	1,860	—	—	—	1,860
Portrait Studio, LLC	First Lien Debt (8.56% Cash (1 month LIBOR + 7%, 5% ceiling), Due 12/31/22)	4,500	—	—	4,500	—	—	—	4,500
Portrait Studio, LLC	Preferred Units (4,350,000 Units)	—	—	—	2,450	—	—	—	2,450
Portrait Studio, LLC	Membership Units (150,000 Units)	—	—	—	—	—	—	—	—
			—	—	8,810	—	—	—	8,810
Print Direction, Inc.	First Lien Debt (10% cash 2% PIK, due 2/24/19)	—	434	12,761	2,087	—	(19,403)	4,555	—
Print Direction, Inc.	Common Stock (18,543 shares)	—	—	—	40	—	(3,030)	2,990	—
Print Direction, Inc.	Common Stock Warrants (820 shares)	—	—	—	—	—	—	—	—
			434	12,761	2,127	—	(22,433)	7,545	—
Sub Total Control investments			$ 7,251	$ 86,650	$ 29,201	$ —	$ (22,433)	$ 14,190	$ 107,608

(1) Represents the total amount of interest, fees or dividends credited to income for the portion of the year an investment was included in Control or Affiliate categories, respectively.

(2) Gross additions include increases in the cost basis of investments resulting from new portfolio investments, follow-on investments and accrued PIK interest. Gross additions also include transfers into an affiliate or control classification.

(3) Gross reductions include decreases in the total cost basis of investments resulting from principal or PIK repayments and sales.

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

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

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 7. Agreements

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

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

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

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

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

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

The incentive fee consists of the following two parts:

The first part of the incentive fee is calculated and payable quarterly in arrears based on the pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees or other fees that we receive from portfolio companies) accrued during the

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 7. Agreements – (continued)

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

- no incentive fee in any calendar quarter in which the pre-incentive fee net investment income does not exceed the hurdle of 2.0%;
- 100% of the pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle but is less than 2.5% in any calendar quarter (10.0% annualized). The Company refers to this portion of the pre-incentive fee net investment income (which exceeds the hurdle but is less than 2.5%) as the "catch-up." The "catch-up" is meant to provide the Investment Advisor with 20% of the pre-incentive fee net investment income as if a hurdle did not apply if this net investment income exceeds 2.5% in any calendar quarter; and
- 20% of the amount of the pre-incentive fee net investment income, if any, that exceeds 2.5% in any calendar quarter (10.0% annualized) is payable to the Investment Advisor (once the hurdle is reached and the catch-up is achieved, 20% of all pre-incentive fee investment income thereafter is allocated to the Investment Advisor).

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

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

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

Note 7. Agreements – (continued)

December 31, 2017 and December 31, 2016, the Company had incentive fees payable to the Investment Advisor of $2.2 million and $6.4 million, respectively.

For the years ended December 31, 2017, 2016 and 2015, the Company incurred $9.8 million, $10.6 million and $10.6 million in base management fees, respectively. The Company incurred $1.3 million, $6.8 million, and $6.0 million in incentive fees related to pre-incentive fee net investment income for the years ended December 31, 2017, 2016, and 2015, respectively. For the years ended December 31, 2017, 2016 and 2015, our Investment Advisor waived incentive fees of $1.0 million, $1.7 million and $1.1 million, respectively.

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

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

For the years ended December 31, 2017, 2016, and 2015, the Company paid the Administrator $1.1 million for the Company's allocable portion of the Administrator's overhead.

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

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Note 8. Related Party Transactions

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

	December 31, 2017	December 31, 2016
CapitalSouth Corporation	$ 74	$ 182
CapitalSouth Partners Florida Sidecar Fund II, L.P.	21	(35)
Capitala Investment Advisors, LLC	(2,172)	(6,426)
Total	$ (2,077)	$ (6,279)

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

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

Note 9. 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 December 31, 2017 and December 31, 2016 the Company has $170.7 million of SBA-guaranteed debentures outstanding. The Company has issued all SBA-guaranteed debentures that were permitted under each of the Legacy Funds' respective SBIC licenses (as applicable), and there are no unused SBA debenture commitments remaining. SBA-guaranteed debentures are secured by a lien on all assets of Fund II and Fund III. As of December 31, 2017 and December 31, 2016, Fund II and Fund III had total assets of approximately $341.5 million and $349.4 million, respectively. On June 10, 2014, the Company received an exemptive order from the SEC exempting the Company, Fund II, and Fund III from certain provisions of the 1940 Act (including an exemptive order granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs) and from certain reporting requirements mandated by the Securities Exchange Act of 1934, as amended (the "1934 Act"), with respect to Fund II and Fund III. The Company intends to comply with the conditions of the order.

The following table summarizes the interest expense and annual charges, deferred financing costs, average balance outstanding, and average stated interest and annual charge rate on the SBA-guaranteed debentures for the years ended December 31, 2017, December 31, 2016 and December 31, 2015 (dollars in thousands):

	For the year ended		
	December 31, 2017	December 31, 2016	December 31, 2015
Interest expense and annual charges	$ 6,336	$ 6,873	$ 7,519
Deferred financing costs	611	627	655
Total interest and financing expenses	$ 6,947	$ 7,500	$ 8,174
Average outstanding balance	$170,700	$178,695	$ 189,526
Average stated interest and annual charge rate	3.71%	3.83%	3.96%

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 9. Borrowings – (continued)

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

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

2021 Notes

On June 16, 2014, the Company issued $113.4 million in aggregate principal amount of the 2021 Notes. On May 26, 2017, the Company caused notices to be issued to the holders of its 2021 Notes regarding the Company's exercise of its option to redeem all of the issued and outstanding 2021 Notes. The Company redeemed all $113.4 million in aggregate principal amount of the 2021 Notes on June 25, 2017. The Notes were redeemed at 100% of their principal amount ($25 per Note), plus the accrued and unpaid interest thereon from June 16, 2017, through, but excluding, June 25, 2017. As a result of the redemption, the Company recognized a loss on the extinguishment of debt of $2.7 million for the year ended December 31, 2017 due to the amortization of the deferred financing costs remaining on the 2021 Notes.

The following table summarizes the interest expense, deferred financing costs, average outstanding balance and average stated interest rate on the 2021 Notes for the years ended December 31, 2017, 2016, and 2015 (dollars in thousands):

	For the year ended		
	December 31, 2017	December 31, 2016	December 31, 2015
Interest expense	$ 3,908	$ 8,082	$ 8,082
Deferred financing costs	293	557	519
Total interest and financing expenses	$ 4,201	$ 8,639	$ 8,601
Average outstanding balance	$ 53,766	$113,438	$ 113,438
Average stated interest rate	7.13%	7.13%	7.13%

2022 Notes

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

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 9. Borrowings – (continued)

The following table summarizes the interest expense, deferred financing costs, average outstanding balance, and average stated interest rate on the 2022 Notes for the years ended December 31, 2017, 2016, and 2015 (dollars in thousands):

	For the year ended		
	December 31, 2017	December 31, 2016	December 31, 2015
Interest expense	$ 2,812	$ —	$ —
Deferred financing costs	303	—	—
Total interest and financing expenses	$ 3,115	$ —	$ —
Average outstanding balance	$ 47,137	$ —	$ —
Average stated interest rate	6.0%	—	—

2022 Convertible Notes

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

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

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

The following table summarizes the interest expense, deferred financing costs, average outstanding balance, and average stated interest rate on the 2022 Convertible Notes for the years ended December 31, 2017, 2016, and 2015 (dollars in thousands):

	For the year ended		
	December 31, 2017	December 31, 2016	December 31, 2015
Interest expense	$ 1,789	$ —	$ —
Deferred financing costs	180	—	—
Total interest and financing expenses	$ 1,969	$ —	$ —
Average outstanding balance	$ 31,218	$ —	$ —
Average stated interest rate	5.75%	—	—

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 9. Borrowings – (continued)

Credit Facility

On October 17, 2014, the Company entered into the Credit Facility. On June 16, 2017, the Company entered into an amendment to its Credit Facility with ING Capital, LLC (the "Amendment"). Pursuant to the Amendment, the Credit Facility currently provides for borrowings up to $114.5 million and may be increased up to $200.0 million pursuant to its "accordion" feature. The Credit Facility matures on June 16, 2021.

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

The following table summarizes the interest expense, deferred financing costs, unused commitment fees, average outstanding balance, and average stated interest rate on the Credit Facility for the years ended December 31, 2017, 2016, and 2015 (dollars in thousands):

	For the year ended		
	December 31, 2017	December 31, 2016	December 31, 2015
Interest expense	$ 908	$ 2,303	$ 724
Deferred financing costs	713	965	794
Unused commitment fees	972	304	729
Total interest and financing expenses	$ 2,593	$ 3,572	$ 2,247
Average outstanding balance	$ 22,493	$ 64,625	$ 21,860
Average stated interest rate	4.08%	3.51%	3.25%

As of December 31, 2017 and 2016, the Company had $9.0 million and $44.0 million, respectively, outstanding under the Credit Facility. The Credit Facility is secured by investments and cash held by Capitala Finance Corp., exclusive of assets held at our two SBIC subsidiaries. Assets pledged to secure the Credit Facility had a carrying value of $192.4 million at December 31, 2017. As part of the terms of the Credit Facility, the Company may not make cash distributions with respect to any taxable year that exceed 110% (125% if the Company is not in default and our covered debt does not exceed 85% of the borrowing base) of the amounts required to be distributed to maintain eligibility as a RIC and to reduce our tax liability to zero for taxes imposed on our investment company taxable income and net capital gains.

CAPITALA FINANCE CORP.

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Note 10. Income Taxes

The Company has elected to be treated as a RIC under subchapter M of the Code. As a RIC, the Company is not taxed on any investment company taxable income or capital gains which it distributes to stockholders. The Company intends to make the requisite distributions to its stockholders which will relieve the Company from U.S. federal income taxes. The Company's tax year-end is August 31.

Dividends from net investment income and distributions from net realized capital gains are determined in accordance with U.S. federal tax regulations, which may differ from amounts in accordance with U.S. GAAP and those differences could be material.

Permanent differences between taxable income and net investment income for financial reporting purposes are reclassified among the capital accounts in the financial statements to reflect their tax character. During the years ended December 31, 2017, 2016, and 2015, the Company reclassified for book purposes amounts arising from permanent differences in the book and tax basis of partnership investments sold, sales relating to defaulted bond accruals, and book and tax character of distributions paid. Such reclassifications are reported in "Tax reclassifications of stockholders' equity in accordance with generally accepted accounting principles" in the statements of changes in net assets for years ended December 31, 2017, 2016, and 2015, respectively.

The following permanent differences due to adjustments for the realized gains (losses) upon disposition of partnership interests and for the transfer of distributions between accumulated capital gains and accumulated net investment income were reclassified for tax purposes for the tax years ended August 31, 2017, 2016, and 2015 (dollars in thousands):

	Tax year ended August 31, 2017	Tax year ended August 31, 2016	Tax year ended August 31, 2015
Increase (decrease) in accumulated net investment income	$ (67)	$ 13,838	$ (3,398)
Increase (decrease) in accumulated net realized gains on investments	88	(13,816)	3,398
Increase (decrease) in capital in excess of par value	(21)	(22)	—

For the tax years ended August 31, 2017, 2016, and 2015, the tax basis components of distributable earnings were as follows (dollars in thousands):

	Tax year ended August 31, 2017	Tax year ended August 31, 2016	Tax year ended August 31, 2015
Undistributed ordinary income	$ 8,999	$ 5,646	$ —
Accumulated capital gains (losses)	(43,618)	(44,296)	8,378
Unrealized appreciation	25,994	47,837	25,269
Other temporary differences	(8,276)	(2,570)	(8,196)
Total	$(16,901)	$ 6,617	$ 25,451

Capital losses in excess of capital gains earned in a tax year may generally be carried forward and used to offset capital gains, subject to certain limitations. Under the Regulated Investment Company Modernization Act of 2010, capital losses incurred after September 30, 2011 will not be subject to expiration. As of August 31, 2017, the Company has a short-term capital loss carry forward of $3.2 million and a long-term capital loss carry forward of $40.4 million.

Taxable income generally differs from net increase (decrease) in net assets resulting from operations for financial reporting purposes due to temporary and permanent differences in the recognition of income and

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 10. Income Taxes – (continued)

expenses and generally excludes unrealized appreciation (depreciation) on investments as investment gains and losses are not included in taxable income until they are realized.

The following table reconciles net increase in net assets resulting from operations to taxable income for the tax years ended August 31, 2017, 2016 and 2015 (dollars in thousands):

	Tax year ended August 31, 2017	Tax year ended August 31, 2016	Tax year ended August 31, 2015
Net increase in net assets resulting from operations	$ 1,647	$ 10,291	$ 10,983
Net change in unrealized (appreciation) depreciation on investments and written call option	18,518	(20,809)	35,557
Capital loss carryforward (utilization)	(679)	44,296	(7,565)
Other deductions for book in excess of deductions for tax	9,053	(3,654)	4,488
Total taxable income	$28,539	$ 30,124	$ 43,463

For income tax purposes, distributions paid to stockholders are reported as ordinary income, return of capital, long term capital gains or a combination thereof. The tax character of distributions paid for the tax years ended August 31, 2017, 2016, and 2015 (dollars in thousands):

	Tax year ended August 31, 2017	Tax year ended August 31, 2016	Tax year ended August 31, 2015
Ordinary income	$ 25,187	$ 24,478	$ 25,063
Long-term capital gains	—	8,378	10,705
Return of capital	—	—	—
Total	$ 25,187	$ 32,856	$ 35,768

For U.S. federal income tax purposes, as of August 31, 2017, the aggregate net unrealized appreciation for all securities was $26.0 million. As of August 31, 2017, gross unrealized appreciation was $72.6 million and gross unrealized depreciation was $46.6 million. The aggregate cost of securities for U.S. federal income tax purposes was $450.1 million.

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

The Company acquired the non-controlling interest in Print Direction, Inc. on December 1, 2017 and converted the entity to CPTA Master Blocker, Inc. (Georgia), retaining its net operating losses in the transaction pursuant to Section 382 of the Code. As of December 31, 2017, the Taxable Subsidiaries had net operating losses for federal income tax purposes of approximately $8.9 million. If not utilized, $6.5 million of these net operating losses will expire in the year ended December 31, 2037 and $2.4 million of these net operating losses will expire in the year ended December 31, 2036.

On December 22, 2017, the United States enacted tax reform legislation through the Tax Cuts and Jobs Act, which significantly changes the existing U.S. tax laws, including a reduction in the corporate tax rate from 35% to 21%, a move from a worldwide tax system to a territorial system, as well as other changes. The Taxable Subsidiaries' provisional tax is based on the new lower blended federal and state corporate tax rate of 25%. This estimate incorporates assumptions made based on the Taxable Subsidiaries' current interpretation of the Tax Act and may change, possibly materially, as we complete our analysis and receive additional clarification and implementation guidance.

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December 31, 2017

Note 10. Income Taxes – (continued)

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting and tax purposes. Components of deferred tax assets (liabilities) as of December 31, 2017 and 2016 are as follows (dollars in thousands):

	December 31, 2017	December 31, 2016
Deferred tax assets:		
Net operating loss carryforwards	$ 2,216	$ —
Less valuation allowance	(363)	—
	1,853	—
Deferred tax liabilities:		
Net unrealized appreciation on investments	(2,809)	—
Basis reduction in partnership investments	(333)	—
	(3,142)	—
Net deferred tax liability	$ (1,289)	$ —

At December 31, 2017, the valuation allowance on deferred tax assets was $0.4 million which represents the state tax effect of net operating losses that we do not believe we will realize through future taxable income. The Company believes it is more likely than not that there is an ability to realize its remaining deferred tax assets through future table income. Any adjustments to the Company's valuation allowance will depend on estimates of future taxable income and will be made in the period such determination is made.

Total income tax expense (benefit) differs from the amount computed by applying the federal statutory income tax rate of 35% to net investment loss and net realized and unrealized appreciation (depreciation) on investments for the year ended December 31, 2017, 2016, and 2015, as follows (dollars in thousands):

	December 31, 2017	December 31, 2016	December 31, 2015
Tax expense at statutory rates	$ 1,998	$ —	$ —
State income tax expense (net of federal benefit)	188	—	—
Tax benefit on net operating losses	(908)	—	—
Tax expense on permanent items	140	—	—
Revaluation for federal rate change	(492)		
Change in valuation allowance	363	—	—
Total tax provision, net	$ 1,289	$ —	$ —

Total income taxes are computed by applying the federal statutory rate of 35% plus an estimated blended state rate of 4%.

For the years ended December 31, 2017, 2016 and 2015, the components of the Company's tax provision include the following (dollars in thousands):

	December 31, 2017	December 31, 2016	December 31, 2015
Deferred tax expense			
Federal	$ 778	$ —	$ —
State	148	—	—
Less valuation allowance	363		
Total tax provision, net	$ 1,289	$ —	$ —

CAPITALA FINANCE CORP.

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Note 11. Directors Fees

Our independent directors receive an annual fee of $50,000. They also receive $5,000 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attending each board meeting and $5,000 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attending each committee meeting. In addition, the chairman of the audit committee receives an annual fee of $10,000 and each chairman of any other committee receives an annual fee of $5,000 for their additional services, if any, in these capacities. For the years ended December 31, 2017, 2016 and 2015, the Company recognized directors fees expense of $0.4 million. 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 12. Stockholders’ Equity

On September 24, 2013, we issued 8,974,420 shares of common stock to the limited partners of the Legacy Funds, in exchange for 100% of their membership interests or certain investment assets of such Legacy Funds, as the case may be. On September 30, 2013, we issued 4,000,000 shares of common stock in connection with the closing of our IPO. The shares issued in the IPO were priced at $20.00 per share. We received proceeds of $74.25 million in the IPO, net of underwriters’ discounts and commissions of $5.75 million.

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. As of December 31, 2017, the Company had 15,951,231 shares of common stock outstanding.

Note 13. Summarized Financial Information of Our Unconsolidated Subsidiaries

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

CableOrganizer Acquisition, LLC

CableOrganizer Acquisition, LLC, a Delaware limited liability company that began operations on April 23, 2013, is a leading online provider of cable and wire management products. The income the Company generated from CableOrganizer Acquisition, LLC, which includes all interest, dividends, PIK interest and PIK dividends, fees, and unrealized appreciation (depreciation), was $1.8 million, $1.9 million, and $0.4 million for the years ended December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

Eastport Holdings, LLC

Eastport Holdings, LLC, an Ohio limited liability company organized on November 1, 2011, is a holding company consisting of marketing and advertising companies located across the U.S. The income the Company generated from Eastport Holdings, LLC, which includes all interest, dividends, PIK interest and PIK dividends, fees, and unrealized appreciation (depreciation), was $11.4 million and $14.3 million for the years ended December 31, 2017 and December 31, 2016, respectively. The Company invested in the portfolio company in January 2016. As such, comparative financial information for the year ended December 31, 2015 is not presented.

CAPITALA FINANCE CORP.

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December 31, 2017

Note 13. Summarized Financial Information of Our Unconsolidated Subsidiaries – (continued)

Kelle's Transport Service, LLC

Kelle's Transport Service, LLC, a Delaware limited liability company organized on March 28, 2014, provides temperature sensitive transportation services throughout North America. The income (loss) the Company generated from Kelle's Transport Service, LLC, which includes all interest, dividends, PIK interest and PIK dividends, fees, realized losses, and unrealized appreciation (depreciation), was $(6.9) million, $(1.2) million, and $3.0 million for the years ended December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

Navis Holdings, Inc.

Navis Holdings, Inc., incorporated in Delaware on December 21, 2010, designs and manufactures leading machinery for the global knit and woven finishing textile industries. The income the Company generated from Navis Holdings, Inc., which includes all interest, dividends, PIK interest and PIK dividends, fees, and unrealized appreciation (depreciation) was $0.7 million, $1.9 million, and $4.2 million for the years ended December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

On-Site Fuel Services, Inc.

On-Site Fuel Services, Inc. is a 100% owned subsidiary of On-Site Fuel Holdings, Inc., which was incorporated in Delaware on December 19, 2011. On-Site Fuel Services, Inc. provides fueling services for commercial and government vehicle fleets throughout the southeast U.S. The income (loss) the Company generated from On-Site Fuel Service, Inc., which includes all interest, dividends, PIK interest and PIK dividends, fees, and unrealized appreciation (depreciation), was $0.1 million, $4.5 million, and $(3.2) million for the years ended December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

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

	As of	
Balance Sheet – CableOrganizer Acquisition, LLC	**December 31, 2017**	**December 31, 2016**
Current assets	$ 5,286	$ 5,589
Noncurrent assets	9,664	9,872
Total assets	$ 14,950	$ 15,461
Current liabilities	$ 5,207	$ 4,219
Noncurrent liabilities	12,373	11,882
Total liabilities	$ 17,580	$ 16,101
Total deficit	$ (2,630)	$ (640)

	For the year ended		
Statements of Operations – CableOrganizer Acquisition, LLC	**December 31, 2017**	**December 31, 2016**	**December 31, 2015**
Net sales	$ 27,134	$ 23,277	$ 25,315
Cost of goods sold	19,778	15,715	16,878
Gross profit	$ 7,356	$ 7,562	$ 8,437
Other expenses	$ 9,345	$ 10,344	$ 10,008
Loss before income taxes	(1,989)	(2,782)	(1,571)
Net loss	$ (1,989)	$ (2,782)	$ (1,571)

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 13. Summarized Financial Information of Our Unconsolidated Subsidiaries – (continued)

Balance Sheet – Eastport Holdings, LLC	As of December 31, 2017	As of December 31, 2016
Current assets	$ 94,186	$ 96,175
Noncurrent assets	185,087	145,802
Total assets	$ 279,273	$ 241,977
Current liabilities	$ 142,250	$ 157,622
Noncurrent liabilities	70,765	41,355
Total liabilities	$ 213,015	$ 198,977
Total equity	$ 66,258	$ 43,000

Statement of Operations – Eastport Holdings, LLC	For the year ended December 31, 2017	For the year ended December 31, 2016
Net sales	$ 556,895	$ 499,986
Cost of goods sold	411,167	377,036
Gross profit	$ 145,728	$ 122,950
Other expenses	$ 134,231	$ 111,677
Income before income taxes	11,497	11,273
Income tax provision	628	—
Net income	$ 10,869	$ 11,273

Balance Sheet – Kelle's Transport Service, LLC	As of December 31, 2017	As of December 31, 2016
Current assets	$ 6,734	$ 8,554
Noncurrent assets	11,801	13,237
Total assets	$ 18,535	$ 21,791
Current liabilities	$ 11,092	$ 4,655
Noncurrent liabilities	17,693	14,962
Total liabilities	$ 28,785	$ 19,617
Total equity (deficit)	$ (10,250)	$ 2,174

Statements of Operations – Kelle's Transport Service, LLC	For the year ended December 31, 2017	December 31, 2016	December 31, 2015
Net sales	$ 51,405	$ 65,471	$ 66,942
Cost of goods sold	49,343	55,859	54,027
Gross profit	$ 2,062	$ 9,612	$ 12,915
Other expenses	$ 14,077	$ 12,804	$ 12,071
Income (loss) before income taxes	(12,015)	(3,192)	844
Income tax provision	5	44	50
Net income (loss)	$ (12,020)	$ (3,236)	$ 794

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 13. Summarized Financial Information of Our Unconsolidated Subsidiaries – (continued)

Balance Sheet – Navis Holdings, Inc.	As of December 31, 2017	As of December 31, 2016
Current assets	$ 4,721	$ 4,655
Noncurrent assets	2,950	3,446
Total assets	$ 7,671	$ 8,101
Current liabilities	$ 1,941	$ 2,448
Noncurrent liabilities	6,973	6,719
Total liabilities	$ 8,914	$ 9,167
Total deficit	$ (1,243)	$ (1,066)

Statements of Operations – Navis Holdings, Inc.	For the year ended December 31, 2017	December 31, 2016	December 31, 2015
Net sales	$ 13,948	$ 17,803	$ 17,076
Cost of goods sold	8,724	10,933	11,087
Gross profit	$ 5,224	$ 6,870	$ 5,989
Other expenses	$ 4,647	$ 5,070	$ 5,414
Income before income taxes	577	1,800	575
Income tax provision	229	701	343
Net income	$ 348	$ 1,099	$ 232

Balance Sheet – On-Site Fuel Services, Inc.	As of December 31, 2017	As of December 31, 2016
Current assets	$ 28,064	$ 13,079
Noncurrent assets	26,807	16,314
Total assets	$ 54,871	$ 29,393
Current liabilities	$ 32,626	$ 16,498
Noncurrent liabilities	34,515	19,903
Total liabilities	$ 67,141	$ 36,401
Total deficit	$ (12,270)	$ (7,008)

Statements of Operations – On-Site Fuel Service, Inc.	For the year ended December 31, 2017	December 31, 2016	December 31, 2015
Net sales	$ 157,774	$ 110,412	$ 114,137
Cost of goods sold	149,436	101,714	106,668
Gross profit	$ 8,338	$ 8,698	$ 7,469
Other expenses	$ 13,600	$ 13,682	$ 13,592
Loss before income taxes	(5,262)	(4,984)	(6,123)
Income tax provision	—	14	1,967
Net loss	$ (5,262)	$ (4,998)	$ (8,090)

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 14. Earnings Per Share

In accordance with the provisions of ASC Topic 260, Earnings per Share ("ASC 260"), basic earnings per share is computed by dividing earnings available to common stockholders 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 December 31, 2017, all convertible shares related to the 2022 Convertible Notes, which would be approximately 3.3 million shares if converted, were considered anti-dilutive. As of December 31, 2017, 2016, and 2015, there were no dilutive shares.

The following information sets forth the computation of the weighted average basic and diluted net increase (decrease) in net assets per share resulting from operations for the years ended December 31, 2017, 2016 and 2015 (dollars in thousands, except share and per share data):

	For the year ended		
Basic and diluted	**December 31, 2017**	**December 31, 2016**	**December 31, 2015**
Net increase (decrease) in net assets resulting from operations	$ (6,984)	$ 9,152	$ 13,850
Weighted average common stock outstanding – basic and diluted	15,903,167	15,819,175	15,210,577
Net increase (decrease) in net assets per share resulting from operations – basic and diluted	$ (0.44)	$ 0.58	$ 0.91

Note 15. Distributions

The Company's distributions are recorded as payable on the declaration date. Stockholders 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 tables summarize the Company's distribution declarations during the years ended December 31, 2017, 2016 and 2015 (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 3, 2017	January 20, 2017	January 30, 2017	$ 0.1300	$ 1,993	5,304	$ 70
January 3, 2017	February 20, 2017	February 27, 2017	0.1300	1,993	5,195	70
January 3, 2017	March 23, 2017	March 30, 2017	0.1300	1,998	4,948	67
April 3, 2017	April 19, 2017	April 27, 2017	0.1300	1,996	5,164	69
April 3, 2017	May 23, 2017	May 29, 2017	0.1300	1,990	5,880	76
April 3, 2017	June 21, 2017	June 29, 2017	0.1300	1,969	7,959	97
July 3, 2017	July 21, 2017	July 28, 2017	0.1300	1,995	5,889	73
July 3, 2017	August 23, 2017	August 30, 2017	0.1300	1,957	13,162	111
July 3, 2017	September 20, 2017	September 28, 2017	0.1300	1,989	9,085	80
October 2, 2017	October 23, 2017	October 30, 2017	0.0833	1,280	5,876	48
October 2, 2017	November 21, 2017	November 29, 2017	0.0833	1,278	6,856	49
October 2, 2017	December 20, 2017	December 28, 2017	0.0833	1,273	7,868	55
Total Distributions Declared and Distributed for Fiscal 2017			$ 1.42	$ 21,711	83,186	$ 865

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 15. Distributions – (continued)

Date Declared	Record Date	Payment Date	Amount Per Share	Cash Distribution	DRIP Shares Issued	DRIP Share Value
January 4, 2016	January 22, 2016	January 28, 2016	$ 0.1567	$ 2,392	8,135	$ 80
January 4, 2016	February 19, 2016	February 26, 2016	0.1567	2,405	7,076	70
January 4, 2016	March 22, 2016	March 30, 2016	0.1567	2,397	7,079	77
April 1, 2016	April 22, 2016	April 28, 2016	0.1567	2,392	6,625	85
April 1, 2016	May 23, 2016	May 30, 2016	0.1567	2,372	8,147	104
April 1, 2016	June 21, 2016	June 29, 2016	0.1567	2,369	8,229	108
July 1, 2016	July 22, 2016	July 29, 2016	0.1567	2,382	7,025	98
July 1, 2016	August 22, 2016	August 30, 2016	0.1567	2,391	6,256	90
July 1, 2016	September 22, 2016	September 29, 2016	0.1567	2,380	8,242	101
September 22, 2016	October 21, 2016	October 28, 2016	0.1300	1,977	6,619	82
September 22, 2016	November 21, 2016	November 29, 2016	0.1300	1,926	11,384	136
September 22, 2016	December 21, 2016	December 29, 2016	0.1300	1,989	5,883	72
Total Distributions Declared and Distributed for Fiscal 2016			$ 1.80	$ 27,372	90,700	$ 1,103

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(1)	March 30, 2015	0.0500	635	683	12
February 26, 2015	April 23, 2015(1)	April 29, 2015	0.0500	824	—	—
February 26, 2015	May 21, 2015(1)	May 28, 2015	0.0500	808	998	16
February 26, 2015	June 22, 2015(1)	June 29, 2015	0.0500	793	1,361	20
February 26, 2015	July 23, 2015(1)	July 30, 2015	0.0500	783	1,600	23
February 26, 2015	August 21, 2015(1)	August 28, 2015	0.0500	776	1,819	24
February 26, 2015	September 23, 2015(1)	September 29, 2015	0.0500	739	4,475	53
February 26, 2015	October 23, 2015(1)	October 29, 2015	0.0500	750	2,974	38
February 26, 2015	November 20, 2015(1)	November 27, 2015	0.0500	753	2,694	35
February 26, 2015	December 22, 2015(1)	December 30, 2015	0.0500	764	2,216	25
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
July 1, 2015	July 23, 2015	July 30, 2015	0.1567	2,454	5,016	74
July 1, 2015	August 21, 2015	August, 28, 2015	0.1567	2,434	5,701	74
July 1, 2015	September 23, 2015	September 29, 2015	0.1567	2,320	14,026	168
October 1, 2015	October 23, 2015	October 29, 2015	0.1567	2,349	9,317	119
October 1, 2015	November 20, 2015	November 27, 2015	0.1567	2,358	8,443	111
October 1, 2015	December 22, 2015	December 30, 2015	0.1567	2,392	6,929	79
Total Distributions Declared and Distributed for Fiscal 2015			$ 2.38	$ 35,585	77,783	$ 1,024

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

Note 16. Share Repurchase Program

On February 26, 2015, the Company's Board authorized a program for the purpose of repurchasing up to $12.0 million worth of its common stock. Under the repurchase program, the Company could have, but was not obligated to, repurchase its outstanding common stock in the open market from time to time provided that the Company complied with the prohibitions under its Insider Trading Policies and Procedures and the guidelines specified in Rule 10b-18 of the 1934 Act, as amended, including certain price, market volume and timing constraints. The repurchase program was in place until the earlier of March 31, 2016 or until $12.0 million of the Company's outstanding shares of common stock had been repurchased. As of December 31, 2017, the repurchase program has expired and has not been extended by the Board.

The Company repurchased 774,858 shares of common stock in open market transactions for an aggregate cost (including transaction costs) of $12.0 million, utilizing the maximum amount available under the repurchase program. The Company is incorporated in Maryland and under the laws 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.

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December 31, 2017

Note 17. Financial Highlights

The following is a schedule of financial highlights for the years ended December 31, 2017, 2016, 2015, 2014 and 2013 (dollars in thousands, except share and per share data):

	For the years ended December 31,				
	2017	2016	2015	2014	2013
Per share data:					
Net asset value at beginning of period	$ 15.79	$ 17.04	$ 18.56	$ 20.71	$ 17.61
Net investment income(1)	0.98	1.84	1.67	1.54	1.50
Net realized gain (loss) on investments(1)	(1.52)	(1.44)	0.35	0.06	0.17
Net unrealized appreciation (depreciation) on investments(1)	0.44	0.35	(1.11)	(1.87)	0.55
Net unrealized depreciation on Written Call Option(1)	(0.26)	(0.17)	—	—	—
Tax provision(1)	(0.08)	—	—	—	—
Distributions declared from net investment income	(1.42)	(1.80)	(1.88)	(1.88)	(0.47)
Distributions declared from net realized gains	—	—	(0.50)	—	—
Partners' capital distribution	—	—	—	—	1.92
Distribution to partners	—	—	—	—	(0.57)
Issuance of common stock	—	—	(0.15)	—	—
Accretive impact of stock repurchase	—	—	0.13	—	—
Other(7)	(0.02)	(0.03)	(0.03)	—	—
Net asset value at end of period	$ 13.91	$ 15.79	$ 17.04	$ 18.56	$ 20.71
Net assets at end of period	$ 221,887	$ 250,582	$ 268,802	$ 240,837	$ 268,670
Shares outstanding at end of period	15,951,231	15,868,045	15,777,345	12,974,420	12,974,420
Per share market value at end of period	$ 7.28	$ 12.93	$ 12.08	$ 17.87	$ 19.90
Total return based on market value(2)	(35.68)%	24.07%	(20.43)%	(0.85)%	1.88%
Ratio/Supplemental data:					
Ratio of net investment income to average net assets	6.54%	11.32%	9.55%	7.78%	7.68%
Ratio of incentive fee, net of incentive fee waiver, to average net assets(6)	0.15%	2.01%	1.88%	1.11%	0.60%
Ratio of interest and financing expenses to average net assets	7.94%	7.68%	7.17%	5.21%	3.30%
Ratio of loss on extinguishment of debt to average net assets	1.15%	—%	—%	—%	—%
Ratio of tax provision to average net assets	0.54%	—%	—%	—%	—%
Ratio of other operating expenses net of management fee waiver to average net assets(8)	5.75%	5.61%	5.52%	5.20%	2.38%
Ratio of total expenses including tax provision, net of fee waivers to average net assets(6)(8)	15.53%	15.30%	14.57%	11.52%	6.28%
Portfolio turnover rate(3)	16.34%	21.33%	25.99%	18.62%	16.77%
Average debt outstanding(4)	$ 325,314	$ 356,758	$ 324,824	$ 255,268	$ 198,159
Average debt outstanding per common share	$ 20.39	$ 22.48	$ 20.59	$ 19.67	$ 15.27
Asset coverage ratio per unit(5)	$ 2,630	$ 2,592	$ 2,465	$ 1,788	$ 2,376

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Note 17. Financial Highlights – (continued)

(1) Based on daily weighted average balance of shares outstanding during the period.

(2) Total investment return for the years ended December 31, 2017, 2016, 2015, and 2014 is calculated assuming a purchase of common shares at the current market value on the first day and a sale at the current market value on the last day of the period reported. Dividends and distributions, if any, are assumed for purposes of this calculation to be reinvested at prices obtained under the Company's DRIP. Total investment return does not reflect brokerage commissions. Total investment return for the year ended December 31, 2013 is calculated assuming a purchase of common shares at the IPO offering price per share at September 25, 2013, of $20.00 and a sale at the current market value on the last day of the period reported. Dividends and distributions, if any, are assumed for purposes of this calculation to be reinvested at prices obtained under the Company's dividend reinvestment plan. Total investment return does not reflect brokerage commissions. Total investment returns covering less than a full period are not annualized.

(3) Portfolio turnover rate is calculated using the lesser of year-to-date sales or year-to-date purchases over the average of the invested assets at fair value.

(4) Based on daily weighted average balance of debt outstanding during the period.

(5) Asset coverage per unit is the ratio of the carrying value of our total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness. We have excluded our SBA-guaranteed debentures from the asset coverage calculation as of December 31, 2017, 2016, and 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.

(6) The ratio of waived incentive fees to average net assets was 0.40% and 0.65%, and 0.40% for the years ended December 31, 2017, 2016 and 2015, respectively. There were no waived incentive fees for the years ended December 31, 2014 and 2013.

(7) Includes the impact of different share amounts used in calculating per share data as a result of calculating certain per share data based on weighted average shares outstanding during the period and certain per share data based on shares outstanding as of a period end or transaction date.

(8) The ratio of waived management fees to average net assets was 0.09% and 0.13% for the years ended December 31, 2014 and 2013, respectively. There were no waived management fees for the years ended December 31, 2017, 2016 and 2015.

Note 18. Selected Quarterly Financial Data (Unaudited)

	For the quarter ended			
(Dollars in thousands, except per share data)	**December 31, 2017**	**September 30, 2017**	**June 30, 2017**	**March 31, 2017**
Total investment income	$ 11,600	$ 12,312	$ 12,362	$ 14,815
Net investment income	$ 4,220	$ 4,410	$ 703	$ 6,191
Net increase (decrease) in net assets resulting from operations	$ (587)	$ (5,753)	$ (5,525)	$ 4,881
Net investment income per share[(1)]	$ 0.26	$ 0.28	$ 0.04	$ 0.39
Net increase (decrease) in net assets resulting from operations per share[(1)]	$ (0.04)	$ (0.36)	$ (0.35)	$ 0.31
Net asset value per share at end of period	$ 13.91	$ 14.21	$ 14.97	$ 15.71

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 18. Selected Quarterly Financial Data (Unaudited) – (continued)

	For the quarter ended			
(Dollars in thousands, except per share data)	**December 31, 2016**	**September 30, 2016**	**June 30, 2016**	**March 31, 2016**
Total investment income	$ 16,515	$ 17,357	$ 16,991	$ 17,449
Net investment income	$ 6,747	$ 7,441	$ 7,431	$ 7,421
Net increase (decrease) in net assets resulting from operations	$ 8,097	$ (2,013)	$ 7,257	$ (4,189)
Net investment income per share[1]	$ 0.43	$ 0.47	$ 0.47	$ 0.47
Net increase (decrease) in net assets resulting from operations per share[1]	$ 0.51	$ (0.13)	$ 0.46	$ (0.27)
Net asset value per share at end of period	$ 15.79	$ 15.68	$ 16.28	$ 16.29

(1) Calculated based on weighted average shares outstanding during the quarter.

Note 19. Subsequent Events

Management has evaluated subsequent events through the date of issuance of the consolidated financial statements included herein. There have been no subsequent events that occurred during such period that would be required to be recognized in the consolidated financial statements as of and for the year ended December 31, 2017.

Distributions

On January 2, 2018, the Company's Board declared normal monthly distributions for January, February and March of 2018 as set forth below:

Date Declared	**Record Date**	**Payment Date**	**Distributions Per Share**
January 2, 2018	January 22, 2018	January 30, 2018	$ 0.0833
January 2, 2018	February 20, 2018	February 27, 2018	0.0833
January 2, 2018	March 23, 2018	March 29, 2018	0.0833
Total Distributions Declared for Fiscal 2018			$ 0.25

Portfolio Activity

On January 2, 2018, the Company invested $15.0 million in first lien debt and $0.5 million in membership units of US Bath Group, LLC. The debt investment has a yield of LIBOR + 9.0% with a 1.0% floor.

On January 19, 2018, the Company received $7.2 million in cash repayment for its first lien debt investment in Brunswick Bowling Products, Inc., repaid at par.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

As of December 31, 2017 (the end of the period covered by this report), we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective and provided reasonable assurance that information required to be disclosed in our periodic SEC filings is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of such possible controls and procedures.

(b) Report of Management on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP. The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2017 based upon the criteria in the 2013 Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on management's assessment, management determined that the Company's internal control over financial reporting was effective as of December 31, 2017.

Due to the Company's status as an "emerging growth company" under the Jumpstart Our Business Startups Act of 2012, the Company was not required to obtain an attestation report from the Company's independent registered public accounting firm on the Company's internal control over financial reporting as of December 31, 2017.

(c) 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 fourth quarter of 2017 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

We will file a definitive Proxy Statement for our 2018 Annual Meeting of Stockholders with the Securities and Exchange Commission (the "SEC"), pursuant to Regulation 14A, not later than 120 days after the end of our fiscal year. Accordingly, certain information required by Part III has been omitted under General Instruction G(3) to Form 10-K. Only those sections of our definitive Proxy Statement that specifically address the items set forth herein are incorporated by reference.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2018 Annual Meeting of Stockholders, to be filed with the SEC within 120 days following the end of our fiscal year.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2018 Annual Meeting of Stockholders, to be filed with the SEC within 120 days following the end of our fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2018 Annual Meeting of Stockholders, to be filed with the SEC within 120 days following the end of our fiscal year.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2018 Annual Meeting of Stockholders, to be filed with the SEC within 120 days following the end of our fiscal year.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2018 Annual Meeting of Stockholders, to be filed with the SEC within 120 days following the end of our fiscal year.

PART IV

ITEM 15. EXHIBITS AND CONSOLIDATED FINANCIAL STATEMENT SCHEDULES

a. The following documents are filed as part of this Annual Report:

The following consolidated financial statements are set forth in Item 8:

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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b. Exhibits

Exhibit Number	Description of Document
3.1	Articles of Amendment and Restatement[(1)]
3.2	Certificate of Limited Partnership of CapitalSouth Partners Fund II Limited Partnership[(2)]
3.3	Certificate of Limited Partnership of CapitalSouth Partners SBIC Fund III, L.P.[(2)]
3.4	Bylaws[(1)]
3.5	Form of Amended and Restated Limited Partnership Agreement of CapitalSouth Partners Fund II Limited Partnership[(3)]
3.6	Form of Amended and Restated Agreement of Limited Partnership of CapitalSouth Partners SBIC Fund III, L.P.[(3)]
4.1	Form of Common Stock Certificate[(1)]
4.2	Form of Base Indenture[(4)]
4.3	Form of Second Supplemental Indenture relating to the 6.00% notes due 2022, by and between the Registrant and U.S. Bank National Association, as trustee, including the form of Global Note[(8)]
4.4	Form of the Third Supplemental Indenture relating to the 5.75% convertible notes due 2022, by and between the Registrant and U.S. Bank National Association, as trustee, including the form of Global Note[(9)]
10.1	Form of Dividend Reinvestment Plan[(1)]
10.2	Form of Investment Advisory Agreement by and between Registrant and Capitala Investment Advisors, LLC[(1)]
10.3	Form of Custodian Agreement[(1)]
10.4	Form of Administration Agreement by and between Registrant and Capitala Advisors Corp.[(1)]
10.5	Form of Indemnification Agreement by and between Registrant and each of its directors[(1)]
10.6	Form of Trademark License Agreement by and between Registrant and Capitala Investment Advisors, LLC[(1)]
10.7	Form of Senior Secured Revolving Credit Agreement dated October 17, 2014, among Capitala Finance Corp., as Borrower, the lenders party thereto, and ING Capital LLC, as Administrative Agent, Arranger and Bookrunner[(5)]
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[(5)]
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[(6)]
10.10	Form of Incremental Assumption Agreement, dated August 19, 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[(8)]
10.11	Form of Amendment No. 2 to Senior Secured Revolving Credit Agreement dated June 16, 2017, among Capitala Finance Corp., as Borrower, the lenders party thereto, and ING Capital LLC, as administrative agent, arranger, and bookrunner[(10)]

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Exhibit Number	Description of Document
10.12	Form of Amendment No. 1 to Guarantee, Pledge and Security Agreement dated June 16, 2017, 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(10)
11.1	Computation of Per Share Earnings (included in the notes to the consolidated financial statements contained in this report)
14.1	Code of Business Conduct(1)
14.2	Code of Ethics(*)
21.1	List of Subsidiaries (filed herewith)
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)

(*) 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 August 25, 2015.

(8) Previously filed in connection with Post-Effective Amendment No. 5 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-204582) filed on May 16, 2017.

(9) Previously filed in connection with Post-Effective Amendment No. 6 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-204582) filed on May 26, 2017.

(10) Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on June 21, 2017.

c. Consolidated Financial Statement Schedules

No consolidated financial statement schedules are filed herewith because (1) such schedules are not required or (2) the information has been presented in the aforementioned consolidated financial statements.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

	Capitala Finance Corp.
Date: February 27, 2018	By /s/ Joseph B. Alala III
	Joseph B. Alala III Chief Executive Officer *(Principal Executive Officer)* Capitala Finance Corp.
Date: February 27, 2018	By /s/ Stephen A. Arnall
	Stephen A. Arnall Chief Financial Officer *(Principal Financial and Accounting Officer)* Capitala Finance Corp.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Joseph B. Alala III Joseph B. Alala III	Chief Executive Officer, President and Chairman of the Board of Directors *(Principal Executive Officer)*	February 27, 2018
/s/ Stephen A. Arnall Stephen A. Arnall	Chief Financial Officer *(Principal Financial and Accounting Officer)*	February 27, 2018
/s/ M. Hunt Broyhill M. Hunt Broyhill	Director	February 27, 2018
/s/ R. Charles Moyer R. Charles Moyer	Director	February 27, 2018
/s/ Larry W. Carroll Larry W. Carroll	Director	February 27, 2018
/s/ H. Paul Chapman H. Paul Chapman	Director	February 27, 2018

Exhibit 14.2

Capitala Finance Corp.
Capitala Investment Advisors, LLC
Capitala Private Advisors, LLC
CODE OF ETHICS

1.1 **Purpose**

This Code of Ethics applies to: (i) Capitala Investment Advisors, LLC ("***CIA***" or "***Capitala***"), which serves as the investment adviser to Capitala Finan Corp. (the "***BDC***") and CapitalSouth Partners SBIC Fund IV, L.P. ("***Fund IV***"), (ii) Capitala Private Advisors, LLC, a wholly-owned subsidiary of CI ("***CPA***", and together with CIA, the "***Firm***"), which serves as investment adviser to Capitala Private Credit Fund V, L.P. ("***Fund V***"), and the (iii) the BDC. Additionally, the Firm may, from time to time, also serve as investment adviser to other client accounts such as non-registered pooled investment ve and separately managed accounts, including those not yet formed (collectively with Fund IV and Fund V, excluding the BDC, the "***Private Funds***" or "***Non-BDC Clients***"). References to "***Clients***" and ***"Funds"*** in this Code of Ethics include the BDC and Non-BDC Clients.

The Firm and the BDC have and will continue to uphold a high level of business ethics and personal integrity in all types of transactions and intera Accordingly, the Firm and the BDC have adopted this Code of Ethics pursuant to Rule 204A-1 under the Investment Advisers Act of 1940, as amended "***Advisers Act***") and Rule 17j-1 under the Investment Company Act of 1940, as amended (the "***Investment Company Act***"). This Code of Ethics is intended to (i) set forth standards of ethical and legal behavior required of the Employees (as defined below); (ii) emphasize the Firm's commitment to ethics compliance with the law, including Federal Securities Laws[1] and the Small Business Investment Act of 1958, as amended (the "***SBIC Act***"); (iii) provide reporting mechanisms for known or suspected ethical or legal violations; and (iv) assist in preventing and detecting wrongdoing.

Additionally, it is the policy of the Firm and of the BDC that no Employee shall, in connection with the purchase or sale, directly or indirectly, by person of any security held or to be acquired by a Client account managed by the Firm:

(1) Employ any device, scheme or artifice to defraud the BDC;

(2) Make to the BDC any untrue statement of a material fact or omit to state to the BDC a material fact necessary in order to make the s made, in light of the circumstances under which it is made, not misleading;

(3) Engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon the BDC; or

(4) Engage in any manipulative practice with respect to the BDC.

This Code of Ethics also specifically addresses insider trading and the reporting by Employees of certain personal securities holdings and transactions. the potential liability to which the Firm and its directors and officers may be subject to under the federal securities laws, it is critical that all E thoroughly familiarize themselves with the Code of Ethics.

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[1] The term "***Federal Securities Laws***" includes for purposes of this Code of Ethics: the Securities Act of 1933 (the "***1933 Act***"), the Securities Exchange Ac of 1934 (the "***1934 Act***"), the Sarbanes-Oxley Act of 2002 ("***Sarbanes-Oxley***"), the Investment Company Act, the Advisers Act, Title V of the Gramm-Leac Bliley Act (relating to privacy regulation), any Securities and Exchange Commission ("***SEC***") rules adopted thereunder, the Bank Secrecy Act of 1970 a applies to the operations of both the BDC and the Firm (anti-money laundering regulation), and any rules adopted thereunder by the SEC or the Depa of Treasury.

For purposes of this Code of Ethics, the term "Employee" shall mean the Firm's (i) Access Persons, as defined in Investment Advisers Act Rule 204A-1, Access Persons, as defined in Investment Company Act 17j-1, (iii) supervised persons, as defined in Advisers Act Section 202(a)(25), and (iv) all othe employees of the Firm not otherwise covered by (i)-(iii) herein.

Notwithstanding the foregoing, the term "Employee" shall not include any director of the BDC who is not an "interested person" of the BDC wit meaning of Section 2(a)(19) of the Investment Company Act, for purposes of **Sections 2.6** and **2.7** of this Code of Ethics, unless such person otherwise is supervised person of the Firm. Furthermore, **Section 2.4** of this Code of Ethics shall not apply to each director of a BDC who is not an "interested perso the BDC within the meaning of Section 2(a)(19) of the Investment Company Act, and who would be required to make a personal securities transaction r solely by reason of being a BDC director, except that such director shall be required to make a quarterly transaction report pursuant to **Section 2.4.1** if the director knew or, in the ordinary course of fulfilling his or her official duties as a BDC director should have known that during the 15-day period imme before or after the director's transaction in a Reportable Security, the BDC purchased or sold the Reportable Security, or the BDC or the Firm co purchasing or selling the Reportable Security.

1.2 Standards of Business Conduct

The Firm is committed to adhering to the highest ethical and professional standards and to acting with integrity and in the best interests Clients. As such, the Firm's and the BDC's Joint Compliance Manual and this Code of Ethics, in particular, are based on the principle that the Employe the Firm will:

- place the interests of the Firm's Clients before personal interests;
- conduct their affairs consistently with the standards and requirements set forth herein and in such a manner as to avoid any actual or p conflict of interest or any abuse of an employee's position of trust and responsibility; and
- adhere to the fundamental standard that the Firm's personnel should not take advantage of their positions of trust and responsibility personal benefit.

The following standards of business conduct are not exclusive, but are illustrative of the standards to which the Firm strives to attain.

(1) No Access Person shall engage, directly or indirectly, in any business transaction or arrangement for personal profit inconsistent with the best interests of the Company or its shareholders or clients, as applicable; nor shall he or she make use confidential information gained by reason of his or her employment by or affiliation with the Company or affiliates therec order to derive a personal profit for himself or herself or for any Beneficial Interest, in violation of the fiduciary duty owe Company or its shareholders or clients, as applicable.

(2) Any Access Person recommending or authorizing the purchase or sale of a Covered Security by the Company or its advis clients shall, at the time of such recommendation or authorization, disclose any Beneficial Interest in, or Beneficial Ownersi such Covered Security or the issuer thereof.

(3) No Access Person shall dispense any information concerning securities holdings or securities transactions of the Company o advisory clients to anyone outside the Company, without obtaining prior written approval from the Designated Officer, or person or persons as these individuals may designate to act on their behalf. Notwithstanding the preceding sentence, such Ac Person may dispense such information without obtaining prior written approval:

(a) when there is a public report containing the same information;

(b) when such information is dispensed in accordance with compliance procedures established to prevent conflicts of inter between the Company and its affiliates;

(c) when such information is reported to directors of the Company; or

(d) in the ordinary course of his or her duties on behalf of the Company.

(4) All personal securities transactions should be conducted consistent with this Code and in such a manner as to avoid act potential conflicts of interest, the appearance of a conflict of interest, or any abuse of an individual's position of tru responsibility within the Company.

1.2.1 Fair Dealing

Employees shall behave honestly and ethically at all times and with all people. They shall act in good faith, with due care, and shall engage only in open competition, by treating ethically colleagues, competitors and third-parties. Stealing proprietary information, possessing trade secret informatio was obtained without the owner's consent, or inducing such disclosures by past or present employees of other companies is prohibited. No Employee shou take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or other practices.

1.2.2 Conflicts of Interest

1.2.2.1 Generally

A conflict of interest exists when a person's private interests interferes in any way with the interests of the Firm. A conflict can arise when an Employe actions or has interests that may make it difficult to perform his or her work for the Firm objectively and effectively. Conflicts of interest may also ar an Employee, or a member of his or her family, receives improper personal benefits as a result of his or her position at the Firm. Loans to, or guarante obligations of, Employees and their family members may create conflicts of interest. It is almost always a conflict of interest for an Employee to simultaneously for the Firm and for a competitor, a Portfolio Company or one of the Firm's sources of financing.

All Employees shall disclose any material transactions or relationships that reasonably could be expected to give rise to a conflict to the Chief Co Offier ("***CCO***") promptly upon becoming aware of such conflict. Such relationships include, among others serving on the board of a charity or non-pr organization or being a member of an investment committee. No action may be taken with respect to such transaction or party unless and until such a has been approved by the CCO. Additionally, the CCO must approve activities that involve teaching assignments, lectures or business-related spea engagements, consulting engagements, publication of articles or radio or television appearances.

Conflicts of interest may not always be clear-cut, so if you have a question, you should immediately consult with the CCO.

1.2.2.2 Personal Conflicts of Interest

Each Employee should strive to avoid all situations that present or could reasonably be expected to present a conflict between his or her personal i and those of the Firm (including the Clients). Conflicts of interest may arise when:

- An Employee's position or responsibilities with the Firm give that person the opportunity to obtain financial gain beyond his or her norm compensation;
- An Employee's personal or family loyalties or interests are inconsistent with, or appear to be inconsistent with, the best interests of the Fi its investors or clients;
- An Employee takes actions or has interests, either within or outside the scope of such person's employment or service with the Firm, that mal difficult to perform his or her responsibilities and duties to the Firm and the Clients and their investors objectively and effectively; or
- An Employee has an opportunity and an incentive to favor the interests of one investor or Client over another.

The following is a non-exhaustive list of situations where a conflict of interest may arise and which are therefore prohibited unless specifically appro the CCO and the Chief Executive Officer ("***CEO***"):

- Working for any competitor of the Firm or providing business services to any third party that are substantially similar to the services pro by the Employee to the Firm and the Clients;
- Serving as a director, trustee, officer or employee of, or consultant for, or in any other similar capacity with, any client of the Firm, any i in a Client, or any Portfolio Company, regardless of whether such service is compensated, unless such service is within the scope of employme or service with the Firm;
- Acting as a broker, finder or other intermediary for the benefit of a third party in transactions involving the Firm, any Client or its inves any Portfolio Company, unless such service is within the scope of employment or service with the Firm;
- Using confidential or proprietary information about the Firm or any of its investors, the Clients, or any Portfolio Company, or any other business partner for the personal gain of a third party, the Employee's personal gain, or the gain of a member of such Employee's relatives or affiliates;
- Having, or a member of the Employee's family having, an interest in a transaction in which the Firm, one of the Clients or one of its investo involved; and

- Holding, or a member of the Employee's family holding, any ownership interest in any entity that is a competitor of the Firm, or in any Clien any of its investors, or in any Portfolio Company, except that an Employee and his or her family members may hold common shares in an publicly traded entity.

1.2.2.3 Conflicts Among Client Interests

In addition to the conflicts of interest directly involving Employees set forth above, actual or potential conflicts of interest also may arise in the f situations, among others, in connection with the formation and management of the Clients:

- When allocating investments, time and resources among Clients;
- When providing services to the Clients or to Portfolio Companies for which the Firm will be compensated when such fees are not offset aga management fees;
- When offering or allocating co-investment opportunities to investors in the Client;
- When selecting investors to sit on the advisory committee of a Client; and
- When valuing assets held by Clients and calculating carried interest payable by a Client.

When conflicts arise between Clients, the Firm will seek to mitigate the conflict, and in doing so, it may consider many factors, including the interests o Client with respect to the immediate issue and/or with respect to the longer term course of dealing among the Clients. Except as may be specified in relevant Client Agreements, the Firm's determinations as to which factors are relevant to the resolution of all conflict of interest, and the resolut conflicts, will be made in the Firm's discretion.

The following policies are designed to assuage conflicts of interest among Clients:

- A Client will not make any investment, or take any material action with respect to any investment, unless the Firm believes that such investment or action is an appropriate investment or action considered solely from the viewpoint of such entity.
- Capitala and the other entities comprising the Firm will abide by the provisions of the relevant Client Agreements, which include procedures, restrictions or other provisions addressing many important conflicts of interest.
- As required by the relevant Client Agreements, but also in additional situations where the Firm in its discretion determines it would be u the Firm will consult with the advisory committee for the relevant entity on conflicts of interest. The members of the Client advisory comi are not affiliated with the Firm other than by being investors or representatives of investors in the Clients and play an important r resolving conflicts of interest by approving or disapproving decisions that involve certain conflicts of interest referred to it by the G Partner in accordance with the relevant Client Agreements or as to which the General Partner may consult with the advisory committe own volition.
- When the Firm deems it appropriate in its sole discretion, unaffiliated third-parties may be used to help resolve conflicts.
- The Firm may determine that a third party unaffiliated with the Firm making an investment on the same or similar terms as a Client demonst the fairness of the transaction to such Client.

1.2.2.4 Allocating Investment Opportunities

The Firm and its related entities engage in a broad range of activities, including investment activities for their own account and for the account of investment funds and the provision of investment advisory and other services to funds and operating companies. In connection with its investment activit the Firm may encounter situations in which it must determine how to allocate investment opportunities among various funds and other persons, including primary Clients the Firm manages, other Clients that have been formed to invest side-by-side with one or more of the Clients in particular transactions entered into by such Clients, and investors and other third parties acting as "co-sponsors" or co-investors with the Firm with respect to a particular transac strategic or other reasons.

In allocating investment opportunities, the Firm may be faced with a variety of potential conflicts of interest. For example, in allocating an inves opportunity among Clients with different fee, expense and compensation structures, the Firm may have an incentive to allocate investment opportunitie the Clients or other vehicles from which the Firm or its related persons may derive, directly or indirectly, a higher fee, compensation or other benefit.

Subject to its fiduciary duties and applicable law, as well as any relevant restrictions or other limitations contained in the relevant Client Agreem Firm will determine how to allocate investment opportunities using its best judgment, considering such factors as it deems relevant.

The Firm will typically cause Clients to co-invest in transactions according to the Firm's Allocation Policy. Unless nothing is negotiated other than pr Clients may not invest alongside the BDC without complying with the conditions of the exemptive relief granted by the SEC to the BDC, which per certain co-investments between the BDC and the Clients advised by the Firm.

1.2.2.5 Conflicts Under the SBIC Act

In general, subject to receiving prior written exemptions from the Small Business Administration ("***SBA***"), the Firm may not engage in a plethora of financin transactions which may constitute conflicts of interest. See Section 107.730 of the SBIC Act – Financings which constitute conflicts of interest, the t which are incorporated herein. Moreover, under the SBIC Act, without prior authorization or written consent by the SBA, the Firm may not engage i dealing that prejudices (i) a Small Business (as defined under the SBIC Act), (ii) an SBIC, (iii) the partners of an SBIC, or (iv) the SBA. The Firm is prohibit under the SBIC Act from, among other things:

- Providing financing to any "Associate" of any SBIC of the Firm, with "Associate" being a very broadly defined term which includes investment adviser to an SBIC, as well as Control Persons of the SBIC and certain Close and Secondary Relatives of certain Control Pe such terms are defined in the SBIC Act); or
- Providing financings to an "Associate" of another SBIC if any Associate of any SBIC of the Firm has received or will receive any dire indirect financings or commitment from that SBIC or another SBIC in connection therewith.

See Section 107.730 of the SBIC Act for other financings which may constitute conflicts of interest.

In general, financings with Associates require the SBA's prior written approval.

1.2.3 Corporate Opportunities

Employees are prohibited from taking for themselves or for third parties opportunities that are discovered through the use of corporate property, inform or position without the consent of the CCO and the CEO. No Employee may use company property, information or position for improper personal gain, an no employee may compete with the Firm directly or indirectly. Employees owe a duty to the Firm to advance its legitimate business interests whene possible.

1.2.4 Outside Business Activities

A conflict of interest may arise when outside business activities require the time and attention of an Employee that could be applied to the Firm an business. Thus, an Employee may not engage in an outside business activity, other than the performance of services to the Firm, for material compensatio any kind, direct or indirect, unless (a) the CCO (in consultation with the CEO) expressly authorizes such activity after full disclosure of such pr activity by the Employee or (b) solely in the case of interns, part-time employees and others who for similar reasons are expected to engage in ou business activities, such outside activity is fully disclosed and clearly known to the CCO prior to the Employee joining the Firm and the CCO is informe any material additions or changes to such outside activity. The CCO and the CEO may subject any such outside business activity to such restrictio limitations as they deem appropriate.

1.2.5 Confidentiality

Maintaining the confidentiality of Clients' business information, confidential personal and business information that is provided to the Firm by other t parties with whom the Firm does business (including investors in the Clients), and the Firm's own proprietary information is fundamental to the success of Firm. It is the responsibility of every Employee to protect confidential information and to limit disclosure to those persons who have a business need to k that information.

Employees should consider all information they come in contact with in the course of their employment to be confidential unless the information is known to be public and the Employee knows that the source of the information does not expect it to be treated confidentially.

Examples of information that is confidential include:

- all personal, financial, business or other information provided to the Firm by any investor or prospective investor in any Client;
- information about Portfolio Companies not generally known to the public, and information about the Clients' investments in Portf Companies;
- due diligence information obtained by the Firm;
- to the extent not already described above, information relating to other third parties with whom the Firm does business, such as fina counterparties, administrators, placement or referral agents, and information about the services provided, relationship with such partie their business, financial or other information;
- all information contained in proprietary databases; and

- the Firm's own business, financial and technological information, and information about the Firm's products or services, to the exten clearly made public by authorized officers of the Firm.

Some practical steps Employees should consider in carrying out their confidentiality obligations include:

- maintaining work spaces so that unauthorized persons are not likely to intentionally or unintentionally have access to confidential information;
- being aware of the potential for conversations to be overheard, whether in the office or in public places, and holding conversations with t mind;
- if an Employee is not certain whether a person requesting information is authorized to request it or have it provided to them, consulting wit CCO or another supervisory person;
- where appropriate, marking information as "confidential" or "for internal use only" before providing it to another person; and
- not reading, working on computers or discussing the Firm's business in public places if it is possible that third parties could read the documen or overhear the conversation.

The obligation to preserve confidential information continues even after employment ends.

Section 1.5 of this Code of Ethics specifically addresses the confidentiality of "inside information" and should be read together with this Section 1.2.5.

1.2.6 Protection and Proper Use of Firm Assets

All Employees should endeavor to protect the Firm's assets and ensure their efficient use. Theft, carelessness, and waste have a direct impact on the profitability. Any suspected incident of fraud or theft should be immediately reported for investigation. The Firm's equipment should not be used for n Firm business, though incidental personal use is permitted.

The obligation of Employees to protect the Firm's assets includes its proprietary information. Proprietary information includes intellectual property, business, marketing and service plans, investment proposals and strategies, databases, records, salary information and unpublished financial data and re Unauthorized use or distribution of this information would violate Firm policy. It could also be illegal and result in civil or criminal penalties.

1.2.7 Timely and Truthful Public Disclosure

In reports and documents filed with or submitted to the SEC and other regulators by the Firm, and in other public communications made by the Firm, Employees involved in the preparation of such reports and documents (including those who are involved in the preparation of financial or other reports the information included in such reports and documents) shall make disclosures that are full, fair, accurate, timely and understandable. Where app Employees shall provide thorough and accurate financial and accounting data for inclusion in such disclosures. They shall not knowingly conceal or information, misrepresent material facts or omit material facts necessary to avoid misleading the Firm's independent public auditors, investors or the Employees must cooperate with the CCO when the CCO is compiling information for SEC filings, required internal recordkeeping and reports, inte investigations, and other compliance matters.

1.2.8 Accounting

All Employees (and not just the Firm's accounting staff) are responsible for reporting complete and accurate information about the business, earnin financial condition of the Firm and its Clients, as applicable. The financial statements of the Firm and each Client, as applicable, must fairly and compl reflect its operations and financial condition.

Each Employee is responsible for ensuring that all transactions in which he or she is involved are reported completely, accurately and in sufficient This information is of critical importance for preparing such financial statements and reports to its members and Client investors. Every Employee sh always cooperate fully with the Firm's finance team and its independent auditors.

Firm financial records must be prepared and maintained in accordance with all applicable laws and regulations. Each Employee involved in prepar financial statements will follow generally accepted accounting principles and other applicable accounting standards and rules, including those of t each as applicable.

The Firm's records belong to the Firm. Employees may not remove any such records or copies thereof from Firm property unless they have a legiti business reason for doing so. Any documents or records that are removed for a legitimate business purpose must be returned as soon as reasonably possible.

No Employee may engage in, allow, or conceal any irregularity in the Firm's bookkeeping or accounting. Each Employee must promptly bring to attention of the CCO and for the BDC, the BDC's Audit Committee, any information he or she may have concerning (i) significant deficiencies in the des or operation or internal control over financial reporting that could adversely affect the Firm's ability to record, process, summarize and report finan (ii) any fraud, whether or not material, that involves management or other Employees who have a significant role in the Firm's financial reporting, discl or internal control over financial reporting, and (iii) any other actual or suspected irregularity or concealment thereof.

1.3 Compliance With Laws

Obeying the law is one of the foundations on which the Firm's ethical standards are built. In conducting the business of the Firm, Employees must com with applicable governmental laws, rules and regulations at all levels of government in the United States and in any non-U.S. jurisdiction in which t does business.

Specifically, Employees may not take any of the following actions in connection with any securities transaction to be undertaken by the Firm for itself behalf of any Client or any other party, all of which are prohibited by law:

- Employ any device, scheme or artifice to defraud the person or entity making the purchase or sale;
- Make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statement, in ligh circumstances under which it was made, not misleading;

- Engage in an act, practice, or course of conduct that operates or would operate as a fraud or deceit;

- Engage in any manipulative practice with respect to any person or entity that is a party to the transaction or with respect to any security o interest held or to be acquired by the Firm or a Client (including price manipulation); or

- Consummate a purchase or sale of a security or other interest while in possession of material non-public information regarding such securi interest, or communicate such information to any person, in violation of any applicable securities law or other applicable laws and regulations.

Although not all Employees are expected to know the details of all laws, it is important for each Employee to know enough about the applicable loca and national laws implicated by their business activities to know when to seek advice from the CCO or other appropriate personnel, including the Fi legal counsel. The Code of Ethics does not attempt to identify or explain all laws to which the Firm and its operations are subject, but brief summai certain laws applicable to the Firm's business are as follows:

1.3.1 Investment Advisers Act of 1940

The Investment Advisers Act requires the registration of and imposes various other substantive regulatory requirements on investment advisers, whic generally defined as persons in the business of providing advice to others with respect to investments in securities. Capitala is an investment adviser bec it provides such advice to the Clients, which are its Clients under the Investment Advisers Act. Accordingly, Capitala has registered with the SEC investment adviser under the Investment Advisers Act. This Code of Ethics is designed to satisfy certain requirements under, and otherwise help en compliance with, the Investment Advisers Act and other federal securities laws.

1.3.2 Investment Company Act of 1940

The Investment Company Act requires the registration of and imposes various other substantive regulatory requirements on investment companies, which generally defined as issuers primarily engaged in the business of investing in securities. The Firm, with the assistance of its legal counsel, ensures that the Private Funds managed by the Firm are exempt from registration under the Investment Company Act by ensuring that the Clients can avail themselv certain exceptions from the definition of "investment company" set forth in Section 3(c) of the Investment Company Act. BDCs, for which the Firm serves the investment adviser, are registered under the Investment Company Act.

1.3.3 Securities Act of 1933

The Securities Act requires that any offer or sale of securities using the means and instrumentalities of interstate commerce be registered with t pursuant to the Securities Act, unless an exemption from registration exists. Its primary purpose is to ensure that buyers of securities receive complet accurate information before they invest. The Firm, with the assistance of its legal counsel, ensures that all offerings of interests in Private Funds ar from registration under the Securities Act, typically pursuant to Regulation D thereunder.

1.3.4 Securities Exchange Act of 1934

The Exchange Act provides for, among other things, the registration and regulation of securities exchanges, the registration of securities listed c exchanges, financial and other reporting requirements for companies whose securities are so registered, and the registration and regulation of n securities associations and of brokers and dealers in securities. The Private Funds do not have securities registered on any exchange. The BDCs managi the Firm are expected to have securities traded on the NASDAQ Stock Market, the New York Stock Exchange or similar national securities exchan Firm conducts its business so as to avoid any requirement that it register as a broker or dealer.

1.3.5 State Securities Laws

The various states where the Firm conducts business have laws concerning the offer and sale of securities that are applicable to the Firm's business with respective states. Federal securities laws preempt these state securities laws in many, but not all, respects.

1.3.6 Anti-Money Laundering Regulations

Congress has enacted a number of statutes to combat money laundering including the Bank Secrecy Act, which provides for the Department of Treasu monitor domestic and international money flows; the Money Laundering Control Act; the Money Laundering Suppression Act; and the USA PATRIOT . Several agencies of the Department of Treasury assist in preventing and detecting money laundering, most notably the Financial Crimes Enforc Network ("***FinCEN***") and the Treasury's Office of Foreign Assets Control ("***OFAC***"). A number of foreign countries also have money laundering laws an regulation. See Section 6 of the Firm's Joint Compliance Manual for additional information.

1.4 **Personal Trading**

All Firm employees must be familiar with and abide by these personal trading policies and procedures. In addition, Rule 204A-1 under the Investm Advisers Act requires an investment adviser's Access Persons (i) to submit reports of their personal securities transactions and holdings periodically investment advisor for review, and (ii) to obtain pre-approval from the adviser for certain types of securities transactions. Rule 17j-1 of the Inves Company Act imposes similar securities reporting requirements.

These personal trading policies and procedures shall apply to (and references to an "Employee" in these personal trading policies and procedures sh deemed to include, as applicable) all Employees (whether or not they are Access Persons, as defined in the Investment Advisers Act), their spouses/par (unless separated) and any other family members residing in the same household with them. The only exception to the foregoing is if the CCO affirmative determines (and documents its determination) that an Employee is not an Access Person and does not need to be subjected to these personal trading pol and procedures, it being expected that the CCO would rarely, if ever, make such a determination.

1.4.1 Securities Holdings and Transaction Reports

Each Employee must provide to the CCO a current securities holdings report ("Holdings Report") in the form attached hereto as **Appendix E-1**:

- in the case of existing Employees, within ten days after the effectiveness of this Code of Ethics (unless previously provided with respect to most recently ended calendar year);
- in the case of new Employees, no later than ten days after initial employment with the Firm; and

- in the case of all Employees, annually not later than 45 days after the end of the fiscal year.

Each Holdings Report must set forth:

- for each Reportable Security (as defined below) in which the Employee has any direct or indirect beneficial ownership, (i) the title and ty security, (ii) the exchange ticker symbol or CUSIP number (if applicable), and (iii) the number of shares and principal amount of such security;

- for each account in which any securities (including securities that are not Reportable Securities) are held for the Employee's direct or indire benefit, the name of any broker, dealer or bank with which the employee maintains such account; and

- the date the Employee submits the statement.

Information in a Holdings Report must be current as of a date no more than 45 days prior to the date the report is submitted. If the Employee (includin Employee's family members, as applicable) has no holdings to report, then he/she must nevertheless submit a Holdings Report in the form attached hereto **Appendix E-1** indicating that they have no reportable holdings.

An Employee may satisfy the requirement that he or she provide certain of the information on a Holdings Report by providing one or more broker statements, provided that such brokerage statements set forth all the information that is required to be set forth in the Employee's Holdings Employees exercising this option must nevertheless submit a Holdings Report each year as provided above. See the form of Holdings Report attached her as **Appendix E-1** for more detail.

Each Employee must provide to the CCO a quarterly transaction report ("Transaction Report") in the form attached hereto as **Appendix E-2** within thirty days after the end of each calendar quarter. Each Transaction Report must set forth the following information about each transaction during such calend involving any Reportable Security in which the Employee had, or as a result of the transaction acquired, any direct or indirect beneficial ownership:

- the date of the transaction, the title and ticker symbol or CUSIP number, interest rate and maturity date, number of shares and the p amount of each reportable security;

- the nature of the transaction (i.e., purchase, sale or any other type of acquisition or disposition);

- the price of the security at which the transaction was effected;

- the name of the broker, dealer or bank with or through which the transaction was effected; and

- the date the Employee submits the report.

If the Employee (including the Employee's family members, as applicable) has no transactions to report, then he/she must nevertheless submit a Transac Report in the form attached hereto as **Appendix E-2** indicating that they have no reportable transactions.

An Employee may satisfy the requirement that he or she provide certain of the information on a Transaction Report by providing one or more broke statements or by providing trade confirmations, provided that such brokerage statements or trade confirmations set forth all the information that is req be set forth in the Employee's Transaction Report. Employees exercising this option must nevertheless submit a Transaction Report each quarter as prov above. See the form of Transaction Report attached hereto as **Appendix E-2** for more detail.

The CCO shall review all Holdings and Transaction Reports to ensure compliance with these personal trading policies and procedures.

The Firm requests that all Employees have the brokers or other custodians of their securities accounts provide periodic statements and tran confirmations directly to the CCO. Attached as **Appendix E-3** is a form of letter to the Firm in which an Employee confirms that it has instructed the brok other custodian of an account to do so. While not required, the Firm encourages Employees to provide such instructions to their brokers or other cus and, after doing so with respect to an account, to provide the Firm a letter regarding such account in the form attached as **Appendix E-3**.

No less frequently than annually, the BDC's CCO must furnish to its Board, and the Board must consider, a written report that:

- describes any issues arising under the Code of Ethics or procedures since the last report to the Board, including but not limited to, information material violations of the Code of Ethics or procedures and sanctions imposed in response to the material violations; and
- certifies that the BDC has adopted procedures reasonably necessary to prevent Employees from violating the Code of Ethics.

"Reportable Security" means any and all securities, except for the following exempted securities and transactions:

- direct obligations of the government of the United States;
- bankers' acceptances, bank certificates of deposit, commercial paper and high quality short-term debt instruments, including repurch agreements;
- shares issued by money market funds;
- shares issued by open-end funds to which none of the Firm or any of its affiliates provide investment advice;
- shares issued by unit investment trusts that are invested exclusively in one or more open-end funds, none of which are funds to which the or any of its affiliates provides investment advice; and
- for purposes of Transaction Reports only, securities held in investment accounts over which an employee has no direct or indirect influen control or pursuant to an automatic investment plan.

1.4.2 Pre-Approval of Certain Transactions

Rule 204A-1 under the Investment Advisers Act and Rule 17j-1 under the Investment Company Act requires that Access Persons of an investment ad obtain pre-approval of the adviser before participating in an initial public offering or a limited securities offering. In furtherance of the foregoing, a furtherance of the Firm's policies regarding insider trading, it is the policy of the Firm that all Employees obtain the prior approval from the CCO before:

- purchasing or selling the securities of any company set forth on the Restricted List (as defined below);
- acquiring any securities in an initial public offering; or
- purchasing securities in a Limited Offering (as defined below, and generally including any private placement).

"Limited Offering" means any offering that is exempt from registration under Section 4(2) or 4(6) of the Securities Act or Regulation D thereunde includes, but is not limited to, offerings of interests in hedge, venture capital and other types of funds, start-up and other privately held companies, an estate investment partnerships.

Prior approval shall be sought by submitting to the CCO an approval request setting forth the details of the proposed transaction, in the form attache as **Appendix E-4** or in such other form as to which the CCO may prescribe or agree. Employees shall provide such additional detail as may be requeste the CCO or else not participate in the proposed transaction. Purchases will be approved by the CCO only when the CCO believes such purchases and sales are not in conflict with the holdings and best interests of the Firm or any Client of the Firm. In considering such pre-clearance, the CCO or his or her d will consider whether the opportunity is being offered to the Employee by virtue of his or her position with the Firm. Employees who have acquired securities in a Limited Offering are required to disclose such investment to the Firm when they participate in any Client's subsequent consideration of an investmen the issuer.

No Employee should purchase a security held or being considered for investment by a Client.

1.4.3 Prohibited Transactions

General Prohibition. No Access Person shall purchase or sell, directly or indirectly, any Covered Security in which he or she has, or by reason o transaction acquires, any direct or indirect Beneficial Ownership and which such Access Person knows or should have known at the time of such purcha sale is being considered for purchase or sale by the Company or its advisory clients, or is held in the portfolio of the Company unless such Access Pe shall have obtained prior written approval for such purpose from the Designated Officer.

An Access Person who becomes aware that the Company is considering the purchase or sale of, or the recommendation to an advisory client of the purc or sale of, any Covered Security by any person must immediately notify the Designated Officer of any interest that such Access Person may have in outstanding Covered Securities of the issuer thereof. An Access Person shall similarly notify the Designated Officer of any other interest or connect such Access Person might have in or with such issuer. Once an Access Person becomes aware that the Company is considering or recommending the purchas or sale of a Covered Security or that the Company or an advisory client holds a Covered Security in its portfolio, such Access Person may not engage, without prior approval of the Designated Officer, in any transaction in any Covered Securities of that issuer. The foregoing notifications or permission ma provided verbally, but should be confirmed in writing as soon and with as much detail as possible.

Initial Public Offerings and Limited Offerings. Investment Personnel of the Company must obtain approval from the Company before directly or indirec acquiring Beneficial Ownership in any securities in an Initial Public Offering or in a Limited Offering.

Blackout Periods. No Investment Personnel shall execute a securities transaction in any security that the Company or an advisory client own considering or recommending for purchase or sale.

Company Acquisition of Shares in Companies that Investment Personnel Hold Through Limited Offerings. Investment Personnel who have been authorize to acquire securities in a Limited Offering must disclose that investment to the Designated Officer when they are involved in the Company's subsequ consideration of an investment in the issuer, and the Company's decision to purchase such securities must be independently reviewed by Investmen Personnel with no personal interest in that issuer.

Gifts. Generally, no Access Person may accept, directly or indirectly, any gift, favor, or service of more than *de minimis* value (*e.g.*, $500) from any person with whom he or she transacts business on behalf of the Company or any advisory client. Please refer to our Code of Business Conduct and Ethics.

Service as Director. No Access Person shall serve on the board of directors of a portfolio company of the Company without prior written authorization Designated Officer based upon a determination that the board service would be consistent with the interests of the Company and its shareholders an advisory clients.

1.4.4 Restricted List

The Firm will maintain a list (the "Restricted List") identifying companies about which the Firm has material non-public information or as to which the Fir otherwise desires that employees (and in some cases, the Client) not engage in, or obtain prior approval for, securities transactions. Employees shall c prior approval as specified above, using the form attached hereto as **Appendix E-4**, prior to engaging in any transaction involving the securities of a company set forth on the Restricted List.

Maintenance of the Restricted List shall primarily be the responsibility of the CCO, but all employees share responsibility for ensuring that the Res List includes companies about which the Firm has material non-public information and companies falling within such other categories as the CCO ma determine need to be set forth on the Restricted List. Such categories may include, for example, companies with which the Firm has entered i confidentiality agreements protecting the other companies' confidential information, prospective portfolio companies under active consideration investment by the Firm for a Client, and companies considering enter material transactions with Portfolio Companies. Employees who receive, intend receive, or reasonably expect to receive material, non-public information about a company are required to promptly report this fact to the CCO so th company can be added to the Restricted List unless they know such company already to be on the Restricted List.

Companies included on the Restricted List must not be discussed with persons outside the Firm without the prior consent of the CCO. When a company placed on the Restricted List, no employee may trade in the securities or other instruments of the company absent authorization from the CCO (which e in rare cases will be denied) until that company is removed from the Restricted List. In addition, no employee of the Firm may recommend trading in su company, or otherwise disclose material nonpublic information, to <u>anyone</u>. The Restricted List is a <u>highly confidential</u> list of companies that is maintained in the possession of the CCO, and its contents must not be communicated directly or indirectly to anyone outside the Firm.

The Restricted List will be periodically reviewed by the CCO, with such Employee assistance as the CCO deems necessary, to ensure the appropriatenes companies on the list and whether or not any companies need to be added or deleted.

1.5 **Insider Trading**

1.5.1 <u>Legal Background</u>

Employees of the Firm, in the conduct of their investment responsibilities, may occasionally obtain material non-public information about securities financial instruments or the issuers thereof. Such information may not be acted upon by an employee for his or her benefit or for the benefit of the F others. The Firm strictly prohibits an employee from buying, selling, recommending or otherwise transacting in or leading or causing others to transact security where such employee possesses or is deemed to possess material non-public information relevant to such security. Prohibited actions include, but not limited to, actual trading, tipping, front running and scalping. The Firm's Insider Trading Policy and Procedures are attached to its Joint Compl Manual as **Appendix T**.

1.5.2 <u>Firm Procedures for Preventing the Misuse of Material, Nonpublic Information</u>

The Firm's policy requires stringent avoidance of the misuse of inside information. Accordingly, the following procedures, which are designed to prev such misuse, are to be followed by all Employees:

- Those in possession of material, nonpublic information must preserve the confidentiality of such information and abstain from trading until inside information is disclosed and made public.

- Given the potentially severe consequences to the Firm and its personnel of a wrong decision, any Employee who is uncertain as to whether information he or she possesses is material "inside" information must contact the CCO for advice rather than relying on his or her own judg or interpretation.

- The CCO must make a determination that material "inside" information has become public, and only then will trading in the affected secur be authorized.

- No Employee, while in possession of material inside information relevant to a security of a company, shall purchase or sell, or recommen direct the purchase or sale of any securities issued by that company.

- No Employee shall use material inside information to purchase or sell securities for his or her own account, or for any account in which he has a beneficial interest.

- The CCO or his designee will periodically review Employee trades for evidence of insider trading and will investigate suspected inside trades.

- Inside information shall only be discussed within the Firm and then only on a need-to-know basis. No employee of the Firm shall disclose inside information concerning any company to any person outside the Firm, except in the ordinary course of his or her duties for the Firm o affiliates or otherwise with the authorization of the CCO.

- If an Employee obtains information that the Employee believes may be material, nonpublic information, the Employee must immediately notif the CCO of the information. If the CCO determines that the information constitutes material, nonpublic information that might expose the or any of its affiliates to liability for "insider trading," the company to which the information relates will be placed on the Restricted List.

If inside information is later disclosed to the general public, any employee in possession of inside information must allow sufficient time (as determined the CCO) to elapse for the investing public to assimilate and evaluate the information before taking any action for his or her personal account on the the disclosed facts. These prohibitions apply not only to the securities of the issuers to which the inside information is directly related but also to any securities (for example, securities of companies in the same industry) that may reasonably be expected to be affected by the public disclosure of the in information.

1.6 Gifts and Entertainment

The purpose of business entertainment and gifts in a commercial setting is to create goodwill and sound working relationships to better serve the Firm a Clients and investors, not for personal gain or to gain an unfair business advantage. In providing or accepting gifts or entertainment, Employees of th must abide by the following principles:

- Employees should not provide or accept any gift or participate in any entertainment activity that would reflect poorly on the Firm.

- Gifts and entertainment must comply with all applicable laws, including laws regarding interactions with representatives of governm entities.

- Gifts and entertainment should be reasonable and not overly frequent, lavish or extravagant in nature, as compared to similar activities the industry.
- Gifts and entertainment should be for a valid business purpose, provide an opportunity for a meaningful business conversation, or be conside usual or customary for the industry and circumstances at hand.
- No gift or entertainment should ever be offered or accepted by an Employee or any family member of an Employee unless it is consistent customary business practices and cannot be construed as a bribe or payoff.

The offer or acceptance of cash gifts by any Employee is prohibited. Employees should discuss with the CCO any gifts or proposed gifts that they think be inappropriate.

Gifts and entertainment provided by employees in connection with the business of the Firm with a value in excess of $500.00 must, if reasonably practical, be approved in advance by the CCO, and must in any event be reported in writing to the CCO after the fact. Gifts and entertainment accepted by employe connection with the business of the Firm with a value in excess of $500.00 must be reported in writing to the CCO. Employees should use common sense estimating the value of gifts and entertainment they receive and in determining whether and when gifts should be aggregated for purposes of the fore erring on the side of aggregation. For example, the entire cost of attending a sporting event (tickets, parking, concessions, etc.) would typically be consi a single item. All gifts shall be reflected in a gift log, containing a basic description of the gift, a good faith estimate of the value of the gift and a des of its disposition (i.e. given, accepted, rejected, returned to sender, etc.). Attached **Appendix E-5** to this Code of Ethics is a form for requesting approv for, and for reporting, gifts and entertainment with a value in excess of $500.00.

1.7 **General Provisions**

1.7.1 Violations of this Code of Ethics

All Employees shall promptly report any known or suspected violations of this Code of Ethics, or any known or suspected illegal or unethical behav the CCO. All reports will be treated confidentially to the extent permitted by law and investigated promptly. No retaliatory action of any kind permitted against anyone making such a report in good faith, and the CCO will strictly enforce this prohibition.

In the event of failure by any employee to comply with the provisions of this Code of Ethics or applicable Securities Laws, the Firm may impose disciplinar action as deemed appropriate by the CCO in consultation with the CEO. If the CCO determines that this Code of Ethics has been violated, includin failure to report a violation or the withholding of information related to a violation, the offending Employee may be disciplined for non-compliance penalties up to and including removal from office or dismissal. Such penalties may include written notices to the individual involved and suspension with without pay or benefits. Violations of this Code of Ethics may also constitute violations of law and may result in criminal penalties and civil liabilities for the offending Employee and the Firm. All Employees must cooperate in internal investigations of misconduct.

1.7.2 Educating Employees about the Code of Ethics

The CCO shall:

- Provide each Employee a copy of this Code of Ethics, including any amendments hereto, and inform them of their duties and obligatic thereunder.
- Supervise, along with the CCO, the implementation of this Code of Ethics; and
- Administer and maintain annual Code of Ethics acknowledgements as specified below.

1.7.3 Acknowledgement of Receipt of this Code of Ethics

Each employee of the Firm will be required, initially upon his or her employment or the applicability of this Code of Ethics and annually thereafte promptly upon any amendment to this Code of Ethics, to acknowledge receipt of this Code of Ethics and to certify that he or she has read and unders and agrees to comply, and has complied, with this Code of Ethics. Such acknowledgements may be contained within other acknowledgements pertaining this Code of Ethics, it being intended that the Initial and Annual Forms of Certification of Receipt and Compliance attached to the Firm's Joint Compli Manual as**Appendix A** and covering other areas of the Firm's Joint Compliance Manual of which this Code of Ethics is a part will serve this purpose. S certifications shall be delivered to the CCO or his or her designee. If an Employee is unable to make any representation or other statement contained such certification, the Employee shall report to the CCO in writing the reasons why and the CCO will document such reasons and determine the appro course of action, which may include remedying the situation, agreeing to an alternate appropriate form of certification, or such other course of action be determined by the CCO.

1.7.4 Recordkeeping

Rule 204-2(a)(12) and (13) of the Investment Advisers Act requires advisors to keep copies of certain records relating to its Code of Ethics. In accor therewith, the CCO shall maintain or cause to be maintained in an easily accessible place, the following records:

- A copy of all Codes of Ethics and relevant Firm policies and procedures in effect within the 5 years preceding the then-current date;
- A record of any violation of the Code of Ethics and of any action taken as a result of such violation;
- A list of all persons who are, or within the 5 years preceding the then-current date have been, required to make reports pursuant to this Ethics, or who were responsible for reviewing these reports;
- A copy of all written acknowledgements certifying receipt of this Code of Ethics for all employees who currently are, or within the preceding the then-current date were, employees;
- A record of all personal trading by Employees of the Firm, consisting a copy of all Holdings and Transactions Reports submitted within years preceding the then-current date and any decisions approving the acquisition of securities in initial public offerings or Limited Offer and any other securities transactions requiring approval hereunder; and

- Record of approval in connection with any pre-clearance process under this Code of Ethics.

No less frequently than annually, the Corporation must furnish to the Board, and the Board must consider, a corporation written report that (a) desc issues arising under the Code or procedures since the last report to the Board, including but not limited to, information about material violations of th or procedures and sanctions imposed in response to the material violations; and (b) certifies that the Corporation has adopted procedures reaso necessary to prevent Access Persons from violating the Code.

<u>Disclaimer of Beneficial Ownership</u>. Any report required under this **Section 1.7** may contain a statement that the report shall not be construed as an admis by the person submitting such duplicate confirmation or account statement or making such report that he or she has any direct or indirect bene ownership in the Covered Security to which the report relates.

The reports required to be submitted under this Section IV shall be delivered to the Designated Officer. The Designated Officer shall review such rep determine whether any transactions recorded therein constitute a violation of the Code. Before making any determination that a violation h committed by any Access Person, such Access Person shall be given an opportunity to supply additional explanatory material. The Designated Officer of Corporation shall maintain copies of its Access Persons' reports as required by Rule 17j-1(f) of the 1940 Act.

1.7.5 <u>Obligation to Report a Violation</u>

Every Access Person who becomes aware of a violation of this Code by any person must report it to the Designated Officer, who shall report it to appro management personnel. The management personnel will take such disciplinary action that they consider appropriate under the circumstances. In the ca officers or other employees of the Company, such action may include removal from office. If the management personnel consider disciplinary action aga any person, they will cause notice thereof to be given to that person and provide to that person the opportunity to be heard. The Board will be notifie timely manner, of remedial action taken with respect to violations of the Code.

APPENDIX E-1
Securities Holdings Report

CAPITALA GROUP

SECURITIES HOLDINGS REPORT

Name: ________________________________ Date of Submission: __________________

Title: ________________________________

Information must be current as of no more than 45 days prior to date of submission.

Reporting Period: _________________________

☐ Initial Holdings Report
☐ Annual Holdings Report (must be submitted by February 14)
(check one)

Accounts: List here all securities accounts maintained by you, your spouse/partner, and any other individuals residing in your household, regardless of wha type of securities are held in the account. Attach additional pages if necessary.

Name of Broker, Dealer, Bank or other Custodian	Legal Owner	Your Relationship With Legal Owner	Account Number	Account Statements Provided to Capitala/Phoenix (Yes or No)

Reportable Securities: Provide the following information for all Reportable Securities* beneficially owned by you, your spouse/partner, and any o individuals residing in your household (including those in the accounts named above). Attach additional pages if necessary. With respect to any Report Security held in a brokerage or similar account, in lieu of listing that security below and providing the following information, you may attach as an exh this report your current statement from the relevant brokerage firm or other account custodian, provided that it includes all of the information lis and is current as of a date no more than 45 days prior to the date of this report.

Name of Issuer and Type of Security (including Ticker Symbol or CUSIP Number, if applicable)	Legal Owner and Your Relationship With Legal Owner	Amount Invested (e.g., Principal Amount) and Number of Shares Owned (if applicable)	Interest Rate and Maturity Date (if applicable)	Current Value of the Investment	Name of Broker, Dealer, Bank or other Custodian (if applicable)

* "Reportable Security" means any and all securities, except for (i) direct obligations of the government of the United States; (ii) bankers' acceptances, certificates of deposit, commercial paper and high quality short-term debt instruments, including repurchase agreements; (iii) shares issued by money mar funds; (iv) shares issued by open-end funds to which none of the Firm or any of its affiliates provide investment advice; (v) shares issued by unit investme trusts that are invested exclusively in one or more open-end funds, none of which are funds to which the Firm or any of its affiliates provides inves advice; and (vi) securities held in investment accounts over which the holder has no direct or indirect influence or control or pursuant to an au investment plan.***Reportable Securities include most non-publicly traded securities, including without limitation investments in hedge and other private investment funds, privately held businesses, and real estate and other investment partnerships.*** Direct interests in real estate (i.e., real estate as to which hold the deed in your name) are not securities and do not need to be listed.

CERTIFICATION

I hereby certify that the foregoing report (including brokerage or similar statements provided therewith) discloses all accounts and securities h required to be set forth therein.

____

Name: ___________________________

Position: ___________________________

Date: _________________, 20__

APPENDIX E-2
Securities Transaction Report

CAPITALA GROUP

SECURITIES TRANSACTION REPORT

Name: ________________________________ Date of Submission: __________________

Title: ________________________________

Must be submitted within 30 days after the end of each calendar quarter.

Reporting Period: ________________________ (indicate calendar quarter)

Transactions involving Reportable Securities: PROVIDE THE FOLLOWING INFORMATION FOR ALL TRANSACTIONS INVOLVING REPORTABLE SECURITIES* BY YOU, SPOUSE/PARTNER, AND ANY OTHER INDIVIDUALS RESIDING IN YOUR HOUSEHOLD DURING THE REPORTING PERIOD IDENTIFIED ABOVE. WITH RESPECT TO ANY TRANSACTION CONDU THROUGH A BROKERAGE OR SIMILAR ACCOUNT, IN LIEU OF LISTING THAT TRANSACTION BELOW AND PROVIDING THE FOLLOWING INFORMATION, YOU MAY ATTACH AS EXHIBITS REPORT THE RELEVANT TRADE CONFIRMATION AND/OR ACCOUNT STATEMENT, PROVIDED THAT IT INCLUDES ALL OF THE INFORMATION REQUIRED BELOW. ATTACH ADDITIONAL necessary.

Purchases of Reportable Securities

Date of Transaction	Name of Issuer and Type of Security (including Ticker Symbol or CUSIP Number, if applicable)	Legal Owner and Your Relationship to Legal Owner	Amount Invested or Sold (e.g., Principal Amount) and Number of Shares Involved (if applicable)	Price at which Transaction was Effected	Interest Rate and Maturity Date (if applicable)	Name of Person with or through which Transaction was Effected

Sales of Reportable Securities

Date of Transaction	Name of Issuer and Type of Security (including Ticker Symbol or CUSIP Number, if applicable)	Legal Owner and Your Relationship to Legal Owner	Amount Invested or Sold (e.g., Principal Amount) and Number of Shares Involved (if applicable)	Price at which Transaction was Effected	Interest Rate and Maturity Date (if applicable)	Name of Person with or through which Transaction was Effected

* "Reportable Security" means any and all securities, except for (i) direct obligations of the government of the United States; (ii) bankers' acceptances, certificates of deposit, commercial paper and high quality short-term debt instruments, including repurchase agreements; (iii) shares issued by money mar funds; (iv) shares issued by open-end funds to which none of the Firm or any of its affiliates provide investment advice; (v) shares issued by unit investme trusts that are invested exclusively in one or more open-end funds, none of which are funds to which the Firm or any of its affiliates provides inves advice; and (vi) securities held in investment accounts over which the holder has no direct or indirect influence or control or pursuant to an au investment plan.***Reportable Securities include most non-publicly traded securities, including without limitation investments in hedge and other private investment funds, privately held businesses, and real estate and other investment partnerships.*** Direct interests in real estate (i.e., real estate as to which hold the deed in your name) are not securities and do not need to be listed.

CERTIFICATION

I hereby certify that the foregoing report (including brokerage or similar statements or trade confirmations provided therewith) discloses all se transactions required to be set forth therein.

____

Name: __________________________

Position: __________________________

Date: ________________, 20__

APPENDIX E-3

Form of Letter Regarding Brokerage Statements

FORM OF LETTER REGARDING BROKERAGE STATEMENTS

____________________, 20__

Capitala Group
4201 Congress Street, Suite 360
Charlotte, NC 28209
Attention: Richard G. Wheelahan, Chief Compliance Officer

Re: Personal Securities Account

Dear Richard:

This letter is to notify you that I, my spouse/partner, or a member of my family residing with me has a beneficial interest in a securities account as follows:

Name of owner of the account: ___________________________________

My relation to the owner (if not me): ___________________________________

Account Number: ______________________

Name of broker: ______________________

Address of broker: ______________________
____
____

Broker contact: ______________________ (name)
______________________ (telephone number)

I have notified the broker that I am employed by a firm required by the Investment Advisers Act to collect certain information from me about my pers securities holdings and transactions on a quarterly and annual basis, and I have requested that duplicate copies of all account statements and tra confirmations for this account be mailed directly to your attention. I hereby consent to your contacting the broker as indicated above with any inquiri may have about this account.

Sincerely,

____

Name: ___________________________

APPENDIX E-4
Securities Transaction Approval Request Form

SECURITIES TRANSACTION APPROVAL REQUEST FORM

____________________, 20__

Capitala Group
4201 Congress Street, Suite 360
Charlotte, NC 28209
Attention: Richard G. Wheelahan, Chief Compliance Officer

Re: Personal Securities Transaction Approval

Dear Richard:

This letter is to notify you that I, my spouse/partner, or a member of my family residing with me desires to participate in the following transaction involv
securities for which prior approval is required pursuant to the Code of Ethics (the "Code of Ethics") of Capitala Group (the "Group").

Name of person to participate in the transaction: ______________________________

My relation to such person (if not me): ______________________________

Description of transaction (including name of issuer, type of transaction, and any other details that may be relevant to your consider
____
____
____

Reason approval is required (check one):

Purchase or sale of securities of a company on the Group's restricted securities list.

Acquisition of securities in an initial public offering.

Purchase of securities in a Limited Offering (as defined in the Code of Ethics).

Date on or about which transaction is expected to be consummated: _______________________

I hereby agree to provide you such information as you may request about the transaction described above and represent that any and all information
provided you or may provide you about this transaction is or will be (and does not and will not omit any information necessary to make such informa
truthful, accurate and not misleading.

Sincerely,

____
Name: ______________________________

Approval granted
Approval denied

____
Richard G. Wheelahan, Chief Compliance Officer

APPENDIX E-5

Gift/Entertainment Approval Request and Reporting Form

GIFT/ENTERTAINMENT APPROVAL REQUEST AND REPORTING FORM

____________________, 20__

Capitala Group
4201 Congress Street, Suite 360
Charlotte, NC 28209
Attention: Richard G. Wheelahan, Chief Compliance Officer

Re: Gift/Entertainment Approval Request or Report

Dear Richard:

This letter is to notify you (and, if applicable as indicated below, request your approval) of the gift(s) and/or entertainment described below and recei given by me, as required pursuant to the Code of Ethics (the "Code of Ethics") of Capitala Group.

Reason this letter is submitted (check one):

1. Request approval to provide gifts and/or entertainment with a value in excess of $500.00.

2. Report after the fact (e.g., because prior approval was not reasonably practical) the provision of gifts and/or entertainment with a in excess of $500.00.

3. Report receipt of gifts and/or entertainment with a value in excess of $500.00.

Name and employer of recipient of gifts/entertainment (for items 1 and 2 above):

____

Name and employer of party providing gifts/entertainment (for item 3 above):

____

Description of gifts/entertainment: ____

____

____

Estimated value: $__________________

Date on or about which gifts/entertainment were or are expected to be provided:

________________, 20__

I HEREBY AGREE TO PROVIDE YOU SUCH INFORMATION AS YOU MAY REQUEST ABOUT THE GIFTS/ENTERTAINMENT DESCRIBED ABOVE AND REPRESENT THAT ANY AND ALL INFORM HAVE PROVIDED YOU OR MAY PROVIDE YOU ABOUT THIS TRANSACTION IS OR WILL BE (AND DOES NOT AND WILL NOT OMIT ANY INFORMATION NECESSARY TO MAKE information) truthful, accurate and not misleading.

Sincerely,

____
Name: ______________________________

For requests for approval only:

Approval granted
Approval denied

____
Richard G. Wheelahan, Chief Compliance Officer

Exhibit 21.1

List of Subsidiaries

CapitalSouth Partners Fund II Limited Partnership (North Carolina)
CapitalSouth Partners F-II, LLC (North Carolina)
CapitalSouth Partners SBIC Fund III, L.P. (Delaware)
CapitalSouth Partners SBIC F-III, LLC (North Carolina)
CPTA Master Blocker, Inc. (Georgia)

Exhibit 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

I, Joseph B. Alala III, certify that:

1. I have reviewed this Annual Report on Form 10-K of Capitala Finance Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2018

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

Exhibit 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

I, Stephen A. Arnall, certify that:

1. I have reviewed this Annual Report on Form 10-K of Capitala Finance Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

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

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

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

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

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

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

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

Date: February 27, 2018

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

Exhibit 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

In connection with the Annual Report on Form 10-K of Capitala Finance Corp. (the “Company”) for the annual period ended December 31, 2017, as filed with the Securities Exchange Commission on the date hereof (the “Report”), I, Joseph B. Alala III, Chief Executive Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: February 27, 2018

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

Exhibit 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

In connection with the Annual Report on Form 10-K of Capitala Finance Corp. (the "Company") for the annual period ended December 31, 2017, as filed with the Securities Exchange Commission on the date hereof (the "Report"), I, Stephen A. Arnall, Chief Financial Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: February 27, 2018

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