

**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, 2019

**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 | Trading symbol(s) | Name of Each Exchange on Which Registered |
|---|-------------------|---|
| Common Stock, par value \$0.01 per share | CPTA | NASDAQ Global Select Market |
| 5.75% Convertible Notes due 2022 | CPTAG | NASDAQ Capital Market |
| 6.00% Notes due 2022 | CPTAL | 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.

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 Act.

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

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 Act).

Yes No

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$141.5 million based on the number of shares held by non-affiliates of the registrant as of June 28, 2019, 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 27, 2020 was 16,218,362.

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 2020 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 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 “Advisers 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. On March 1, 2019, Fund II repaid its outstanding SBA debentures and relinquished its SBIC license.

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 \$30.0 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, 2019, our Investment Advisor underwrote investments in approximately 160 lower middle-market and traditional middle-market companies totaling approximately \$1.8 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 approximately 160 portfolio companies totaling approximately \$1.8 billion of invested capital from 2000 through December 31, 2019. 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, and a private investment vehicle (referred to herein as “Capitala Specialty Lending Corp.” or “CSLC”), both of which provide 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 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 expect to make, and have made, co-investments with Fund IV, Fund V and/or CSLC to the extent their respective investment strategies align with ours.

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 chief operating officer, and John F. McGlinn, a senior managing director of our Investment Advisor. Messrs. Alala, Broyhill and McGlinn serve as our Investment Advisor’s investment committee. They are assisted by nineteen 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 15 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 \$30.0 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. 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, 2019, 81.1% 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, delayed draw facilities, or revolving credit 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, 2019, 18.1% of the fair value 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, 6.1% of our debt investments consisted of second lien loans as of December 31, 2019. 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, 12.8% of our debt investments consisted of subordinated loans as of December 31, 2019. Subordinated loans typically have a second lien on all or substantially all of the borrower's assets, but 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, 2019, our weighted average PIK yield was 0.8%. As of December 31, 2019, the weighted average annualized cash yield on our debt portfolio was 10.7%. 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.

The weighted annualized yield is calculated based on the effective interest rate as of period end, divided by the fair value of our 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.

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, a senior managing director of our Investment Advisor. They are assisted by a team of nineteen investment professionals. 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, McGlinn, and Broyhill meet on an as needed basis, frequently multiple times a week, 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 approximately 160 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, Los Angeles, New York, and Dallas 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 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 expanded upon into a full diligence memo and key findings 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 full diligence memo and key findings from due diligence to the investment committee on an ongoing 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.

PORTFOLIO COMPANIES

The following table sets forth certain information as of December 31, 2019 for each of our portfolio companies. The general terms of our debt and equity investments are described in “Investments.” Other than these investments, our only formal relationships with our portfolio companies will be the managerial assistance we may provide upon request and the board observer or participation rights we may receive in connection with our investment. Other than as indicated in the table below, we do not “control” and are not an “affiliate” of any of these portfolio companies, each as defined in the 1940 Act. In general, under the 1940 Act, we would “control” a portfolio company if we owned more than 25% of its voting securities and would be an “affiliate” of a portfolio company if we owned more than 5% of its voting securities.

| Name and Address of Portfolio Company | Nature of Business | Type of Investment and General Terms ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾ | % of Class Held | Cost (in thousands) | Fair Value (in thousands) |
|--|------------------------------|---|-----------------|---------------------|---------------------------|
| 3 Bridge Solutions, LLC 100 South Fifth Street Minneapolis, Minnesota 55402 | IT Consulting | First Lien Debt (10.7% Cash (1 month LIBOR + 9.0%, 1.0% Floor), Due 12/4/22) | | \$13,274 | \$13,274 |
| | | Preferred Units (965 units) | 3.2% | 1,090 | 499 |
| | | Membership Units (39,000 units) | 3.3% | 10 | — |
| Alternative Biomedical Solutions, LLC 1600 Wallace Drive Carrollton, Texas 75006 | Healthcare | First Lien Debt (8.0% Cash, 3.8% PIK, Due 12/18/22) | | 5,331 | 5,319 |
| | | First Lien Debt (8.0% Cash, 3.8% PIK, Due 12/18/22) ⁽⁶⁾ | | 13,125 | 10,624 |
| | | Membership Units (20,092 units) | 3.2% | 800 | — |
| American Clinical Solutions, LLC 2424 N. Federal Highway Boca Raton, Florida 33431 | Healthcare | First Lien Debt (7.0% Cash, Due 12/31/22) | | 3,500 | 3,500 |
| | | First Lien Debt (2.0% PIK, Due 12/31/22) ⁽⁷⁾ | | 3,485 | 3,485 |
| Amerimark Direct, LLC 100 Nixon Lane Edison, New Jersey 08837 | Consumer Products | First Lien Debt (14.3% Cash, Due 9/8/21) | | 15,974 | 15,633 |
| BigMouth, Inc 655 Winding Brook Drive Glastonbury, Connecticut 06033 | Consumer Products | First Lien Debt (10.3% Cash (1 month LIBOR + 8.5%, 0.5% Floor, Due 11/14/21) ⁽⁸⁾ | | 857 | 857 |
| | | First Lien Debt (10.2% Cash (1 month LIBOR + 8.5%, 0.5% Floor, Due 11/14/21) | | 8,784 | 8,628 |
| Bluestem Brands, Inc. 6509 Flying Cloud Drive Eden Prairie, Minnesota 55344 | Online Merchandise Retailer | First Lien Debt (9.3% Cash (1 month LIBOR + 7.5%, 1.0% Floor), Due 11/7/20) | | 3,529 | 2,877 |
| Burgaflex Holdings, LLC ⁽²¹⁾ 1101 Copper Avenue Fenton, Michigan 48430 | Automobile Part Manufacturer | First Lien Debt (12.0% Cash, 3.0% PIK, Due 3/23/21) | | 14,421 | 14,421 |
| | | Common Stock Class B (1,085,073 shares) | 11.5% | 362 | 635 |
| | | Common Stock Class A (1,253,198 shares) | 8.3% | 1,504 | — |

| Name and Address of Portfolio Company | Nature of Business | Type of Investment and General Terms ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾ | % of Class Held | Cost (in thousands) | Fair Value (in thousands) |
|--|--|--|-----------------|---------------------|---------------------------|
| Burke America Parts Group, LLC 5852 W. 51st Street Chicago, Illinois 60638 | Home Repair Parts Manufacturer | Membership Units (14 units) | 1.8% | \$ 5 | \$ 2,489 |
| CableOrganizer Acquisition, LLC 6250 NW 27th Way Ft. Lauderdale, Florida 33309 | Computer Supply Retail | First Lien Debt ⁽⁹⁾ | | 1,532 | 1,490 |
| California Pizza Kitchen, Inc. 12181 Bluff Creek Drive Playa Vista, California 90094 | Restaurant | Second Lien Debt (11.9% Cash (3 month LIBOR + 10.0%, 1.0% Floor), Due 8/23/23) | | 4,927 | 4,697 |
| Capitala Senior Loan Fund II, LLC ⁽²²⁾ 4201 Congress Street Charlotte, North Carolina 28209 | Investment Funds | Subordinated Debt (6.7% Cash (1 month LIBOR + 5.0%), Due 9/3/24) ⁽¹¹⁾⁽²⁰⁾ | | — | — |
| | | Membership Units (80.0% ownership) ⁽¹¹⁾⁽¹⁹⁾⁽²³⁾ | 80.0% | 13,600 | 13,631 |
| Chicken Soup for the Soul, LLC 132 East Putnam Avenue Cos Cob, Connecticut 06807 | Multi-platform Media and Consumer Products | First Lien Debt (10.2% Cash (1 month LIBOR + 8.5%, 1.5% Floor), Due 12/13/20) | | 13,000 | 13,000 |
| Chief Fire Intermediate, Inc. 10 West Broad Street Mount Vernon, New York 10552 | Security System Services | First Lien Debt (8.7% Cash (1 month LIBOR + 7.0%, 1.6% Floor), Due 11/8/24) | | 8,100 | 8,100 |
| | | Class A Preferred Units (34,740 units, 10.0% PIK Dividend) ⁽¹⁰⁾ | 6.2% | 913 | 913 |
| | | Class B Common Units (3,510 units) | 0.8% | — | — |
| City Gear, LLC ⁽²¹⁾ 4841 Summer Avenue Memphis, Tennessee 38122 | Footwear Retail | Membership Unit Warrants ⁽⁹⁾ | | — | 3,326 |
| CIS Secure Computing, Inc. 21050 Ashburn Crossing Dr. Ashburn, Virginia 20147 | Government Services | First Lien Debt (10.2% Cash (1 month LIBOR + 8.5%, 1.0% Floor), 1.0% PIK, Due 9/14/22) | | 9,389 | 9,389 |
| | | Common Stock (46,163 shares) | 4.0% | 1,000 | 1,890 |
| Corporate Visions, Inc. 5455 Kietzke Lane Reno, Nevada 89511 | Sales & Marketing Services | Subordinated Debt (9.0% Cash, 2.0% PIK, Due 11/29/21) | | 19,327 | 18,962 |
| | | Common Stock (15,750 shares) | 2.5% | 1,575 | 329 |
| Currency Capital, LLC 12100 Wilshire Boulevard Los Angeles, California 90025 | Financial Services | First Lien Debt (13.7% Cash (1 month LIBOR + 12.0%, 0.5% Floor), 2.0% PIK, Due 1/2/20) ⁽¹¹⁾ | | 16,269 | 16,269 |
| | | Class A Preferred Units (2,000,000 units) ⁽¹¹⁾ | 2.0% | 2,000 | 2,504 |
| Eastport Holdings, LLC ⁽²¹⁾ 813 Ridge Lake Blvd. Memphis, Tennessee 38120 | Business Services | Subordinated Debt (14.9% Cash (3 month LIBOR + 13.0%, 0.5% Floor), Due 12/29/21) ⁽¹⁶⁾ | | 16,155 | 16,500 |
| | | Membership Units (22.9% ownership) | 22.9% | 3,263 | 17,822 |
| Flavors Holdings, Inc. 300 Jefferson Street Camden, New Jersey 08104 | Food Product Manufacturer | First Lien Debt (7.7% Cash (3 month LIBOR + 5.8%, 1.0% Floor), Due 4/3/20) | | 5,778 | 5,767 |
| | | Second Lien Debt (11.9% Cash (3 month LIBOR + 10.0%, 1.0% Floor), Due 10/3/21) | | 11,878 | 11,842 |
| Freedom Electronics, LLC 2205 May Ct. NW Kennesaw, Georgia 30144 | Electronic Machine Repair | First Lien Debt (8.7% Cash, Due 12/20/23) ⁽⁶⁾⁽¹²⁾ | | 5,940 | 5,940 |
| | | Membership Units (181,818 units) | 0.6% | 182 | 160 |
| GA Communications, Inc. ⁽²¹⁾ 2196 West Part Court Stone Mountain, Georgia 30087 | Advertising & Marketing Services | Series A-1 Preferred Stock (1,998 shares, 8.0% PIK Dividend) ⁽¹⁰⁾ | 8.3% | 3,476 | 3,761 |
| | | Series B-1 Common Stock (200,000 shares) | 8.3% | 2 | 501 |

| Name and Address of Portfolio Company | Nature of Business | Type of Investment and General Terms ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾ | % of Class Held | Cost (in thousands) | Fair Value (in thousands) |
|--|---|--|-----------------|---------------------|---------------------------|
| HUMC Opco, LLC 308 Willow Avenue Hoboken, New Jersey 07030 | Healthcare | First Lien Debt (9.0% Cash, Due 8/16/20) | | \$ 5,000 | \$ 5,000 |
| Installs, LLC 241 Main Street Buffalo, New York 14203 | Logistics | First Lien Debt (9.3% Cash, Due 6/20/23) ⁽⁶⁾ | | 2,924 | 2,924 |
| J5 Infrastructure Partners, LLC 2030 Main Street Irvine, California 92614 | Wireless Deployment Services | First Lien Debt (8.3% Cash (1 month LIBOR + 6.5%, 1.8% Floor), Due 12/20/24) ⁽¹³⁾ | | — | — |
| | | First Lien Debt (8.3% Cash (1 month LIBOR + 6.5%, 1.8% Floor), Due 12/20/24) | | 7,000 | 7,000 |
| Jurassic Quest Holdings, LLC 200 River Point Conroe, Texas 77304 | Entertainment | First Lien Debt (9.5% Cash (1 month LIBOR + 7.5%, 2.0% Floor), Due 5/1/24) ⁽¹⁴⁾ | | 10,827 | 10,827 |
| | | Preferred Units (375,000 units) | 1.5% | 388 | 85 |
| LJS Partners, LLC ⁽²¹⁾ 10350 Ormsby Park Place Louisville, Kentucky 40223 | QSR Franchisor | Preferred Units (92,924 units) | 9.8% | 293 | 372 |
| | | Common Membership Units (2,593,234 units) | 8.5% | 1,224 | 1,509 |
| MicroHoldco, LLC 1102 Windam Road South Windam, Connecticut 06266 | General Industrial | Preferred Units ⁽⁹⁾ | | 838 | 838 |
| MMI Holdings, LLC ⁽²¹⁾ 325 McGill Avenue, Suite 195 Concord, North Carolina 28027 | Medical Device Distributor | First Lien Debt (12.0% Cash, Due 1/31/21) ⁽¹⁶⁾ | | 2,600 | 2,600 |
| | | Subordinated Debt (6.0% Cash, Due 1/31/21) ⁽¹⁶⁾ | | 388 | 400 |
| | | Preferred Units ⁽¹⁰⁾ (1,000 units, 6.0% PIK Dividend) | 100.0% | 1,572 | 1,710 |
| | | Common Membership Units (45 units) | 5.0% | — | 194 |
| Navis Holdings, Inc. ⁽²¹⁾ 113 Woodside Drive Lexington, North Carolina 27292 | Textile Equipment Manufacturer | First Lien Debt (11.0% Cash, Due 6/30/23) ⁽¹⁶⁾ | | 10,100 | 10,100 |
| | | Class A Preferred Stock (1,000 shares, 10% Cash Dividend) ⁽¹⁰⁾ | 100.0% | 1,000 | 1,000 |
| | | Common Stock (60,000 shares) | 13.8% | — | 464 |
| Nth Degree Investment Group, LLC ⁽²¹⁾ 3237 Satellite Blvd Duluth, Georgia 30096 | Business Services | Membership Units (6,088,000 Units) | 5.6% | 6,088 | 6,088 |
| Portrait Studio, LLC 2101 Cambridge Beltway Drive Charlotte, North Carolina 28273 | Professional and Personal Digital Imaging | First Lien Debt ⁽⁹⁾ | | 510 | 510 |
| RAM Payment, LLC ⁽²¹⁾ 412 North Cedar Bluff Road Knoxville, Tennessee 37923 | Financial Services | First Lien Debt (10.0% Cash, Due 1/4/24) ⁽⁶⁾ | | 9,019 | 9,019 |
| | | Preferred Units (86,000 units, 8.0% PIK Dividend) ⁽¹⁰⁾ | 6.1% | 928 | 1,725 |
| Rapid Fire Protection, Inc. 1530 Samco Road Rapid City, South Dakota 57702 | Security System Services | First Lien Debt (9.2% Cash, Due 11/22/24) ⁽⁶⁾⁽¹⁵⁾ | | 6,550 | 6,550 |
| | | Common Stock (363 shares) | 3.6% | 500 | 500 |
| Seitel, Inc. 10811 South Westview Circle Drive Houston, Texas 77043 | Data Services | First Lien Debt (10.0% Cash (1 month LIBOR + 8.3%, 1.0% Floor), Due 3/15/23) | | 4,749 | 4,749 |
| Sequoia Healthcare Management, LLC 10 Exchange Place Jersey City, New Jersey 07032 | Healthcare Management | First Lien Debt (12.8% Cash, Due 6/26/20) | | 12,744 | 12,607 |

| Name and Address of Portfolio Company | Nature of Business | Type of Investment and General Terms ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾ | % of Class Held | Cost (in thousands) | Fair Value (in thousands) |
|--|---|--|-----------------|---------------------|---------------------------|
| Sierra Hamilton Holdings Corporation ⁽²¹⁾ 900 Threadneedle Houston, Texas 77079 | Oil & Gas Engineering and Consulting Services | Second Lien Debt (15.0% PIK, Due 9/12/23) | | \$ 748 | \$ 748 |
| | | Common Stock (15,068,000 shares) | 13.7% | 6,958 | 5,160 |
| Sur La Table, Inc. 6100 4th Ave S Ste 500 Seattle, Washington 98108 | Retail | First Lien Debt (10.9% Cash (3 month LIBOR + 9.0%, 1.0% Floor), Due 7/31/22) ⁽¹⁶⁾⁽¹⁷⁾ | | 10,528 | 10,045 |
| Taylor Precision Products, Inc. 2311 W. 22nd Street Oak Brook, Illinois 60523 | Household Product Manufacturer | Series C Preferred Stock (379 shares) | 8.3% | 758 | 758 |
| U.S. BioTek Laboratories, LLC 16020 Linden Ave. N. Shoreline, Washington 98133 | Testing Laboratories | First Lien Debt (9.3% Cash, Due 12/14/23) ⁽⁶⁾⁽¹²⁾ | | 6,930 | 6,822 |
| | | Class A Preferred Units (500 Units) | 2.5% | 540 | 204 |
| | | Class C Units (500 Units) | 2.2% | 1 | — |
| U.S. Well Services, Inc. 1360 Post Oak Boulevard Houston, Texas 77056 | Oil & Gas Services | Class A Common Stock (77,073 shares) ⁽¹¹⁾⁽¹⁸⁾ | 0.1% | 771 | 146 |
| | | Class B Common Stock (1,125,426 shares) ⁽¹¹⁾⁽¹⁸⁾ | 1.6% | 6,701 | 2,127 |
| V12 Holdings, Inc. ⁽²¹⁾ 141 West Front Street, Suite 410 Red Bank, New Jersey 07701 | Data Processing & Digital Marketing | Subordinated Debt ⁽⁹⁾ | | 655 | 708 |
| Vology, Inc. ⁽²²⁾ 15950 Bay Vista Dr. Clearwater, Florida 33760 | Information Technology | First Lien Debt (10.5% Cash (1 month LIBOR + 8.5%, 2.0% Floor), Due 12/31/21) | | 3,877 | 3,877 |
| | | Class A Preferred Units (9,041,810 Units) | 51.6% | 5,215 | 5,215 |
| | | Membership Units (5,363,982 Units) | 32.6% | — | — |
| Xirgo Technologies, LLC 188 Camino Ruiz Camarillo, California 93012 | Information Technology | Membership Units (600,000 units) | 1.0% | 600 | 917 |
| | | | | <u>\$353,881</u> | <u>\$362,532</u> |

- (1) All investments valued using unobservable inputs (Level 3), unless otherwise noted.
- (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 \$148,113 as of December 31, 2019.
- (5) Capitala Finance Corp. generally acquires its investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the “Securities Act”). These investments are generally subject to certain limitations on resale, and may be deemed to be “restricted securities” under the Security Act.
- (6) The cash rate equals the approximate current yield on our last-out portion of the unitranche facility.
- (7) The investment is convertible to preferred equity.
- (8) The investment has a \$2.6 million unfunded commitment.
- (9) The investment has been exited or sold. The residual value reflects estimated earnout, escrow, or other proceeds expected post-closing.
- (10) The equity investment is income producing, based on rate disclosed.
- (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, 2019, 8.1% of the Company’s total assets were non-qualifying assets.

- (12) The investment has a \$1.0 million unfunded commitment.
- (13) The investment has a \$3.5 million unfunded commitment.
- (14) The investment has a \$0.5 million unfunded commitment.
- (15) The investment has a \$4.5 million unfunded commitment.
- (16) The maturity date of the original investment has been extended.
- (17) The company may elect to have 1.5% of its cash interest capitalized as paid-in-kind interest.
- (18) Investment is valued using observable inputs (Level 1). The stock of the company is traded on the NASDAQ Capital Market under the ticker "USWS."
- (19) The investment has a \$6.4 million unfunded commitment.
- (20) The investment has a \$5.0 million unfunded commitment.
- (21) "Affiliate Company" as defined under the 1940 Act.
- (22) "Control Company" as defined under the 1940 Act.
- (23) The investment is valued based on the net asset value of the company.

Set forth below is a brief description of each portfolio company representing greater than 5% of the fair value of our portfolio as of December 31, 2019.

Eastport Holdings, LLC is a holding company consisting of marketing and advertising companies located across the United States.

Corporate Visions, Inc. provides marketing and sales messaging, tools, and training services for global companies, concentrating on training solutions for sales and marketing professionals.

Currency Capital, LLC operates an equipment financing exchange that seeks to connect buyers, sellers, and lenders in order to simplify and enhance the buying and financing process for small businesses.

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, 2019 and 2018 (dollars in thousands):

| Investment Rating | As of December 31, 2019 | | As of December 31, 2018 | |
|-------------------|---------------------------------|---------------------------------------|---------------------------------|---------------------------------------|
| | Investments at Fair Value | Percentage of Total Investments | Investments at Fair Value | Percentage of Total Investments |
| 1 | \$ 85,688 | 23.6% | \$ 171,829 | 38.3% |
| 2 | 219,855 | 60.7 | 194,411 | 43.3 |
| 3 | 56,989 | 15.7 | 73,325 | 16.3 |
| 4 | — | — | 9,362 | 2.1 |
| 5 | — | — | — | — |
| Total | <u>\$ 362,532</u> | <u>100.0%</u> | <u>\$ 448,927</u> | <u>100.0%</u> |

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 is calculated 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.

Incentive Fee

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, 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:

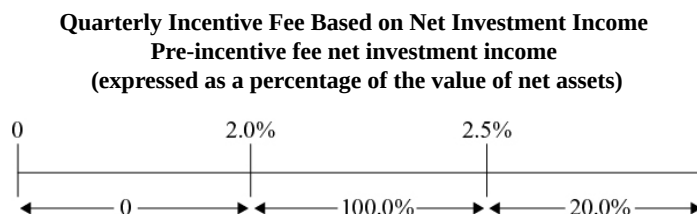
- no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle of 2.0%;
- 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle but is 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 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.

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:



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.

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

$$(\text{investment income} - (\text{management fee} + \text{other expenses})) = 0.55\%$$

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

$$(\text{investment income} - (\text{management fee} + \text{other expenses})) = 2.2\%$$

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

$$= 100\% \times (2.2\% - 2.0\%)$$

$$= 0.20\%$$

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

$$(\text{investment income} - (\text{management fee} + \text{other expenses})) = 2.80\%$$

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%))

$$\text{Catch-up} = 2.5\% - 2.0\%$$

$$= 0.5\%$$

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

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

$$= 0.5\% + 0.06\%$$

$$= 0.56\%$$

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%.

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

- (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.

-
- (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, 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 1, 2019. The Board’s consideration for re-approval of the Investment Advisory Agreement will be included in our definitive proxy statement filed for our 2020 meeting of stockholders. 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. Bank Global Fund Services to act on behalf of the Administrator in its performance of certain administrative services for us. The principal office of U.S. Bank Global Fund Services is 777 East Wisconsin Avenue, Milwaukee, Wisconsin 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 1, 2019, 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, McGlenn 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 other guidance issued by the Internal Revenue Service (“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 other applicable IRS guidance.

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%. 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.

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 150%, if certain conditions are met, after each issuance of senior securities. On March 23, 2018, the Small Business Credit Availability Act (the "SBCA") was signed into law, which included various changes to regulations under the federal securities laws that impact BDCs. The SBCA included changes to the 1940 Act to allow BDCs to decrease their asset coverage requirement from 200% to 150% (i.e. the amount of debt may not exceed 66.7% of the value of our total assets), if certain requirements are met. On November 1, 2018, the Board, including a "required majority" (as such term is defined in Section 57(o) of the 1940 Act) approved the application of the modified asset coverage. As a result, our asset coverage requirements for senior securities were changed from 200% to 150%, effective November 1, 2019.

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 150%, if certain requirements are met, 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. 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. Kevin A. Koonts 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, and is required to obtain an audit of the effectiveness of internal control over financial reporting performed by our independent registered public accounting firm; 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 III, which is our wholly owned subsidiary, is licensed to act as a SBIC and is regulated by the SBA. On March 1, 2019, Fund II repaid its outstanding SBA debentures and relinquished its SBIC license. As of December 31, 2019, investments in Fund III accounted for approximately 57.0% of the fair value of our portfolio. As of December 31, 2019, Fund III had \$150.0 million of SBA-guaranteed debentures outstanding under the SBIC program. Fund III is fully drawn and may not make borrowings in excess of their aggregate \$150.0 million of SBA-guaranteed debentures outstanding as of December 31, 2019.

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 industry size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on the number of employees or 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 prohibits an SBIC from providing funds to small businesses with certain characteristics, such as reeling or businesses with the majority of their employees located outside the U.S., business engaged in certain prohibited industries, such as project finance, real estate, farmland, financial intermediaries, or "passive" (i.e. non-operating) businesses. Without prior SBA approval, a SBIC may not invest an amount equal to more than approximately 30.0% of the SBIC's regulatory capital in any one company and its affiliates. Compliance with SBA requirements may cause 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 restricts the ability of an SBIC to provide financing to an "associate" as defined in the SBA regulations, without prior written exemption from the SBA. 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 Fund III fails to comply with applicable SBA regulations, the SBA could, depending on the severity of the violation, limit or prohibit Fund III's use of debentures, declare outstanding debentures immediately due and payable, and/or limit Fund III from making new investments. Such actions by the SBA would, in turn, negatively affect us because Fund III is our wholly owned subsidiary. Fund III was in compliance with the terms of the SBA's leverage as of December 31, 2019 as a result of having sufficient capital as defined under the SBA regulations.

The maximum leverage available to a "family" of affiliated SBIC funds is \$350.0 million, subject to SBA approval. SBA regulations currently limit the amount that a SBIC subsidiary may borrow to a maximum of \$150 million when it has at least \$75.0 million in regulatory capital. Affiliated SBICs are permitted to issue up to a combined maximum amount of \$350.0 million when they have at least \$175.0 million in regulatory capital. As of December 31, 2019, 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 150%, if certain conditions

are met, asset coverage test under the 1940 Act. This provides us with increased flexibility under the 150%, if certain conditions are met, asset coverage test by permitting us to borrow up to \$150.0 million more than we would otherwise be able to absent the receipt of this exemptive relief.

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

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. McGlenn, 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 McGlenn 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 IV and Fund V, which are private investment limited partnerships and CSLC, a private investment vehicle, all of which provide financing solutions to lower middle-market and traditional middle-market companies. 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 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.

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, and CSLC, both of which provide 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 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 expect to make, and have made, co-investments with Fund IV, Fund V, and/or CSLC to the extent their respective investment strategies align with ours.

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 June 1, 2016, the SEC issued the Order. Subject to satisfaction of certain conditions to the Order, we and certain of our affiliates are now permitted, together with any future BDCs, registered closed-end funds and certain private funds, each of whose investment adviser is our investment adviser or an investment adviser controlling, controlled by, or under common control with our investment adviser, to co-invest in negotiated investment opportunities where doing so would otherwise be prohibited under the 1940 Act, providing our stockholders with access to a broader array of investment opportunities. 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.

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 for other funds it currently manages or by its investment team while they were employed at prior positions.

The Investment Advisor manages other funds and may manage other entities in the future. The track record and achievements of these other entities are not necessarily indicative of future results that will be achieved by the Investment Advisor because these other entities may have investment objectives and strategies that differ from ours. Additionally, 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 150%, if certain conditions are met, 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, 2019, we had \$150.0 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 \$0.0 outstanding under the Credit Facility that provides for borrowings of up to \$60.0 million on a revolving basis and may be increased up to \$150.0 million pursuant to its “accordion” feature. The Order received from the SEC grants us 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 2020 Annual Stockholders Meeting, subject to certain determinations required to be made by our Board, we will ask our stockholders to approve 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 April 30, 2020 and

expiring on the earlier of the one year anniversary of the date of the 2020 Annual Stockholders Meeting and the date of our 2021 Annual Stockholders Meeting, which is expected to be held in April 2021.

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. Even though our Board has approved a resolution permitting the Company to be subject to a 150% asset coverage ratio, contractual leverage limitations under our existing Credit Facility or future borrowings may limit our ability to incur additional indebtedness.

The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below.

| Assumed Return on Our Portfolio ⁽¹⁾ (net of expenses) | (10.0)% | (5.0)% | 0.0% | 5.0% | 10.0% |
|--|---------|---------|--------|------|-------|
| Corresponding net return to common stockholder | (40.0)% | (24.7)% | (9.5)% | 5.8% | 21.1% |

(1) Assumes \$452.3 million in total assets, \$302.1 million in debt outstanding and \$148.1 million in net assets as of December 31, 2019, adjusted to reflect borrowings of \$25.0 million under the Credit Facility. Assumes an average cost of funds of 4.64% which includes the stated interest rate and the SBA annual charge. Actual interest payments may be different.

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 \$150.0 million of SBA-guaranteed debentures outstanding as of December 31, 2019. 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, 2019. In addition, as of December 31, 2019, we had approximately \$0.0 outstanding under the Credit Facility that provides for borrowings of up to \$60.0 million on a revolving basis and may be increased up to \$150.0 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 United States and around the world, may contribute to increased market volatility, may have long-term effects on the United States 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 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, subsequently, on March 29, 2017, the U.K. government began the formal process of leaving the European Union. 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. Under current Prime Minister Boris Johnson, the House of Commons passed the Brexit deal on December 20, 2019 and the U.K. formally left the European Union on January 31, 2020. The U.K. is currently in a transition period until December 31, 2020, where agreements surrounding trade and other aspects of the U.K.’s future relationship with the European Union will need to be finalized. Failure to come to terms on a free trade deal could result in checks and tariffs on U.K. goods traveling to the European Union and thus prolong the economic uncertainty. 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 policy of foreign nations, such as Russia and China, may have a severe impact on the worldwide and U.S. financial markets.

The Republican Party currently controls the executive branch and the Senate portion of the legislative branch 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. For example, in March 2018, the U.S. Senate passed a bill that eased financial regulations and reduced oversight for certain entities. The United States may also potentially withdraw from or renegotiate various trade agreements and take other actions that would change current trade policies of the United States. We cannot predict which, if any, of these actions will be taken or, if taken, their effect on the financial stability of the United States. 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. Any default by the U.S. government on its obligations or any prolonged U.S. government shutdown 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. In December 2017, the U.S. House of Representatives and U.S. Senate passed tax reform legislation, which the President signed into law. Such legislation made 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 tax treatment, 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 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). Any stockholder electing to receive cash will receive at least 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. Our independent registered public accounting firm is required to attest to the effectiveness of our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act.

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, we 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.

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.

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

Fund II and Fund III, became our wholly owned subsidiaries after the completion of the Formation Transactions. Fund II was licensed to act as an SBIC and was regulated by the SBA until March 1, 2019, when we prepaid all remaining SBIC debts related to Fund II and relinquished Fund II's license to act as an SBIC. Fund III is currently licensed to act as an SBIC and is regulated by the SBA. As of December 31, 2019, Fund III portfolio companies accounted for 57.0% of the fair value of our aggregate portfolio. An SBIC license allows an SBIC 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. Fund III was in compliance with the terms of the SBA's leverage requirements as of December 31, 2019 as a result of having sufficient capital as defined under the SBA regulations. If, in the future, Fund III fails to comply with applicable SBA regulations, Fund III could, depending on the severity of

the violation, limit or prohibit Fund III's use of debentures, declare outstanding debentures immediately due and payable, and/or limit Fund III from making new investments. Such actions by Fund III would, in turn, negatively affect us because Fund III is our wholly owned subsidiary.

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 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 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. If unauthorized parties gain access to such information and technology systems, they may be able to steal, publish, delete or modify private and sensitive information, including nonpublic personal information related to stockholders (and their beneficial owners) and material nonpublic information. The systems we have implemented to manage risks relating to these types of events could prove to be inadequate and, if compromised, could become inoperable for extended periods of time, cease to function properly or fail to adequately secure private information. Breaches such as those involving covertly introduced malware, impersonation of authorized users and industrial or other espionage may not be identified even with sophisticated prevention and detection systems, potentially resulting in further harm and preventing them from being addressed appropriately. The failure of these systems or of disaster recovery plans for any reason could cause significant interruptions in our and our Investment Advisor's operations and result in a failure to maintain the security, confidentiality or privacy of sensitive data, including personal information relating to stockholders, material nonpublic information and other sensitive information in our possession.

A disaster or a disruption in the infrastructure that supports our business, including a disruption involving electronic communications or other services used by us or third parties with whom we conduct business, or directly affecting our headquarters, could have a material adverse impact on our ability to continue to operate our business without interruption. Our disaster recovery programs may not be sufficient to mitigate the harm that may result from such a disaster or disruption. In addition, insurance and other safeguards might only partially reimburse us for our losses, if at all.

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.

In addition, cybersecurity has become a top priority for regulators around the world, and some jurisdictions have enacted laws requiring companies to notify individuals of data security breaches involving certain types of personal data. If we fail to comply with the relevant laws and regulations, we could suffer financial losses, a disruption of our businesses, liability to investors, regulatory intervention or reputational damage.

Economic sanction laws in the United States and other jurisdictions may prohibit us and our affiliates from transacting with certain countries, individuals and companies.

Economic sanction laws in the United States and other jurisdictions may prohibit us or our affiliates from transacting with certain countries, individuals and companies. In the United States, the U.S. Department of the Treasury's Office of Foreign Assets Control administers and enforces laws, executive orders and regulations establishing U.S. economic and trade sanctions, which prohibit, among other things, transactions with, and the provision of services to, certain non-U.S. countries, territories, entities and individuals. These types of sanctions may significantly restrict or completely prohibit investment activities in certain jurisdictions, and if we, our portfolio companies or other issuers in which we invest were to violate any such laws or regulations, we may face significant legal and monetary penalties.

The Foreign Corrupt Practices Act, or FCPA, and other anti-corruption laws and regulations, as well as anti-boycott regulations, may also apply to and restrict our activities, our portfolio companies and other issuers of our investments. If an issuer or we were to violate any such laws or regulations, such issuer or we may face significant legal and monetary penalties. The U.S. government has indicated that it is particularly focused on FCPA enforcement, which may increase the risk that an issuer or us becomes the subject of such actual or threatened enforcement. In addition, certain commentators have suggested that private investment firms and the funds that they manage may face increased scrutiny and/or liability with respect to the activities of their underlying portfolio companies. As such, a violation of the FCPA or other applicable regulations by us or an issuer of our portfolio investments could have a material adverse effect on us. We are committed to complying with the FCPA and other anti-corruption laws and regulations, as well as anti-boycott regulations, to which it is subject. As a result, we may be adversely affected because of our unwillingness to enter into transactions that violate any such laws or regulations.

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.

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. Our first lien loans may also include unitranche loans. Unitranche loans combine characteristics of traditional first lien senior secured loans as well as second lien and subordinated loans. Unitranche loans will expose us to the risks associated with second lien and subordinated loans to the extent we invest in the "last out" tranche. These first lien loans and bonds may include payment-in-kind ("PIK") interest, which represents contractual interest accrued and added to the principal that generally becomes due at maturity.

Second Lien Loans. Our second lien loans 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 loans 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, 2019, 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 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 the

Order. Subject to satisfaction of certain conditions to the Order, we and certain of our affiliates are now permitted, together with any future BDCs, registered closed-end funds and certain private funds, each of whose investment adviser is our investment adviser or an investment adviser controlling, controlled by, or under common control with our investment adviser, to co-invest in negotiated investment opportunities where doing so would otherwise be prohibited under the 1940 Act, providing our stockholders with access to a broader array of investment opportunities. 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.

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 two 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.

In November 2019, the SEC proposed a rule regarding the ability of a BDC (or a registered investment company) to use derivatives and other transactions that create future payment or delivery obligations (except reverse repurchase agreements and similar financing transactions). If adopted as proposed, BDCs that use derivatives would be subject to a value-at-risk (“VaR”) leverage limit, certain other derivatives risk management program and testing requirements and requirements related to board reporting. These new requirements would apply unless the BDC qualified as a “limited derivatives user,” as defined in the SEC’s proposal. A BDC that enters into reverse repurchase agreements or similar financing transactions would need to aggregate the amount of indebtedness associated with the reverse repurchase agreements or similar financing transactions with the aggregate amount of any other senior securities representing indebtedness when calculating the BDC’s asset coverage ratio. Under the proposed rule, a BDC may enter into an unfunded commitment agreement that is not a derivatives transaction, such as an agreement to provide financing to a portfolio company, if the BDC has a reasonable belief, at the time it enters into such an agreement, that it will have sufficient cash and cash equivalents to meet its obligations with respect to all of its unfunded commitment agreements, in each case as it becomes due. If the BDC cannot meet this test, it is required to treat unfunded commitments as a derivatives transaction subject to the requirements of the rule. Collectively, these proposed requirements, if adopted, may limit our ability to use derivatives and/or enter into certain other financial contracts.

Uncertainty relating to the LIBOR calculation process may adversely affect the value of our portfolio of the LIBOR-indexed, floating-rate debt securities.

In the recent past, concerns have been publicized that some of the member banks surveyed by the British Bankers’ Association (“BBA”) in connection with the calculation of LIBOR across a range of maturities and currencies may have been under-reporting or otherwise manipulating the inter-bank lending rate applicable to them in order to profit on their derivatives positions or to avoid an appearance of capital insufficiency or adverse reputational or other consequences that may have resulted from reporting inter-bank lending rates higher than those they actually submitted. A number of BBA member banks have entered into settlements

with their regulators and law enforcement agencies with respect to alleged manipulation of LIBOR, and investigations by regulators and governmental authorities in various jurisdictions are ongoing.

Actions by the BBA, regulators or law enforcement agencies may result in changes to the manner in which LIBOR is determined. Uncertainty as to the nature of such potential changes may adversely affect the market for LIBOR-based securities, including our portfolio of LIBOR-indexed, floating-rate debt securities. In addition, any further changes or reforms to the determination or supervision of LIBOR may result in a sudden or prolonged increase or decrease in reported LIBOR, which could have an adverse impact on the market for LIBOR-based securities or the value of our portfolio of LIBOR-indexed, floating-rate debt securities.

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 expected that a transition away from the widespread use of LIBOR to alternative rates will occur over the course of the next several years. As a result of this transition, interest rates on financial instruments tied to LIBOR rates, as well as the revenue and expenses associated with those financial instruments, may be adversely affected. Further, any uncertainty regarding the continued use and reliability of LIBOR as a benchmark interest rate could adversely affect the value of our financial instruments tied to LIBOR rates. The U.S. Federal Reserve, in conjunction with the Alternative Reference Rates Committee, a steering committee comprised of large U.S. financial institutions, is considering replacing U.S. dollar LIBOR with a new index calculated by short term repurchase agreements, backed by Treasury securities, called the Secured Overnight Financing Rate ("SOFR"). The first publication of SOFR was released in April 2018. Whether or not SOFR attains market traction as a LIBOR replacement remains a question and the future of LIBOR at this time is uncertain.

Additionally, on June 12, 2019 the Staff of the SEC's Division of Corporate Finance, Division of Investment Management, Division of Trading and Markets, and Office of the Chief Accountant issued a statement about the potentially significant effects on financial markets and market participants when LIBOR is discontinued in 2021 and is no longer available as a reference benchmark rate. The Staff encouraged all market participants to identify contracts that reference LIBOR and begin transitions to alternative rates. On December 30, 2019, the SEC's Chairman, Division of Corporate Finance and Office of the Chief Accountant issued a statement to encourage audit committees in particular to understand management's plans to identify and address the risks associated with the elimination of LIBOR, and, specifically, the impact on accounting and financial reporting and any related issues associated with financial products and contracts that reference LIBOR, as the risks associated with the discontinuation of LIBOR and transition to an alternative reference rate will be exacerbated if the work is not completed in a timely manner.

Our Credit Facility currently provides for borrowings up to \$60.0 million and may be increased up to \$150.0 million pursuant to its "accordion" feature. 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 3.50% 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 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 (e.g., borrowings for which the Company has elected the one month LIBOR will reset on the one month anniversary of the period based on the then selected LIBOR). For any given borrowing under the Credit Facility, the Company intends to elect what it believes to be an appropriate LIBOR taking into account the Company's needs at the time as well as the Company's view of future interest rate movements. The Credit Facility provides for the ability to step-down the pricing of the Credit Facility from LIBOR plus 3.50% to LIBOR plus 3.00% when certain conditions are met.

The Credit Facility provides for a Benchmark Replacement Rate (the "Benchmark Rate") to replace LIBOR when there is a public statement that LIBOR will cease to exist. The Credit Facility will transition to the new Benchmark Rate 90 days after the applicable public statement that LIBOR will cease to exist has been made, or earlier if agreed to by the Administrative Agent and the Company. The Benchmark Replacement Rate will be an alternate benchmark rate (which may include SOFR) that has been selected by the Administrative Agent and the Company. The applicable spread to the Benchmark Rate will be based on the

spread announced by the relevant governmental body governing the new Benchmark Rate or prevailing market convention for determining a spread to the new Benchmark Rate. The applicable spread or method for calculating the spread adjustment for the Benchmark Rate will be selected by the Administrative Agent and the Company.

Approximately 63% of the fair value of our debt investment portfolio is variable rate based on LIBOR. In the event LIBOR ceases to exist, our credit agreements typically either provide for use of an alternative rate based on Prime or allow the Company and other lenders in the facility to select a replacement index for LIBOR.

Other than our Credit Facility and variable rate loans, the Company has no other direct exposure to LIBOR based financial instruments.

The elimination of LIBOR or any other changes or reforms to the determination or supervision of LIBOR could have an adverse impact on the market for or value of any LIBOR-linked securities, loans, and other financial obligations or extensions of credit held by or due to us, or on our overall financial condition or results of operations. 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. In addition, the cessation of LIBOR could:

- Adversely impact the pricing, liquidity, value of, return on and trading for a broad array of financial products, including any LIBOR-linked securities, loans and derivatives that are included in our assets and liabilities;
- Require extensive changes to documentation that governs or references LIBOR or LIBOR-based products, including, for example, pursuant to time-consuming renegotiations of existing documentation to modify the terms of outstanding investments;
- Result in inquiries or other actions from regulators in respect of our preparation and readiness for the replacement of LIBOR with one or more alternative reference rates;
- Result in disputes, litigation or other actions with portfolio companies, or other counterparties, regarding the interpretation and enforceability of provisions in our LIBOR-based investments, such as fallback language or other related provisions, including, in the case of fallbacks to the alternative reference rates, any economic, legal, operational or other impact resulting from the fundamental differences between LIBOR and the various alternative reference rates;
- Require the transition and/or development of appropriate systems and analytics to effectively transition our risk management processes from LIBOR-based products to those based on one or more alternative reference rates, which may prove challenging given the limited history of the proposed alternative reference rates; and
- Cause us to incur additional costs in relation to any of the above factors.

There is no guarantee that a transition from LIBOR to an alternative will not result in financial market disruptions, significant increases in benchmark rates, or borrowing costs to borrowers, any of which could have a material adverse effect on our business, result of operations, financial condition, and unit price.

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 U.S. recession that began in mid-2007 and the 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.

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. The nature of litigation can make it difficult to predict the impact a particular lawsuit will have on the Company. There are many reasons that the Company cannot make these assessments, including, among others, one or more of the following: the proceeding is in its early stages; the damages sought are unspecified, unsupportable, unexplained or uncertain; discovery has not started or is not complete; there are significant facts in dispute; and there are other parties who may share in any ultimate liability.

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 2020 Annual Stockholders Meeting, subject to certain determinations required to be made by our Board, we will ask our stockholders to approve 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 April 30, 2020 and expiring on the earlier of the one year anniversary of the date of the 2020 Annual Stockholders Meeting and the date of our 2021 Annual Stockholders Meeting, which is expected to be held in April 2021. Although our Board is generally required to make certain determinations prior to any issuance of our common stock at a price below the then current net asset value ("NAV") per share, we may sell shares of our common stock at a price per share below the then current NAV in reliance on our stockholder approval obtained at the 2019 Annual Stockholders Meeting where the Board approved the Company's ability to sell below NAV in a \$50.0 million "at the market offering" (the "ATM Program"). However, if stockholders do not approve the ability to sell below NAV at the 2020 Annual Stockholders Meeting, then we will not be able to sell below NAV in the ATM Program after April 30, 2020.

If we were 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

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.

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

COMMON STOCK

Our common stock is traded on the NASDAQ Global Select Market under the symbol "CPTA."

HOLDERS

The last reported price for our common stock on February 27, 2020 was \$7.78 per share. As of February 27, 2020 there were 37 holders of record of our common stock.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

The following table sets forth, for each fiscal quarter within the two most recent fiscal years and the current fiscal quarter, 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 and the distributions declared by us for each fiscal quarter.

| Fiscal Year Ended | NAV Per Share ⁽¹⁾ | Sales Price | | Premium or (Discount) of High Sales Price to NAV ⁽²⁾ | Premium or (Discount) of Low Sales Price to NAV ⁽²⁾ | Declared Distributions Per Share ⁽³⁾ |
|---|---------------------------------|-------------|--------|---|--|---|
| | | High | Low | | | |
| December 31, 2020 | | | | | | |
| First Quarter (through February 27, 2020) | \$ * | \$9.20 | \$7.69 | * | * | \$0.25 |
| December 31, 2019 | | | | | | |
| Fourth Quarter | \$ 9.14 | \$9.12 | \$8.07 | (0.2)% | (11.7)% | \$0.25 |
| Third Quarter | \$ 9.40 | \$9.99 | \$7.34 | 6.3% | (21.9)% | \$0.25 |
| Second Quarter | \$ 9.55 | \$9.69 | \$7.97 | 1.5% | (16.5)% | \$0.25 |
| First Quarter | \$11.61 | \$8.74 | \$6.83 | (24.7)% | (41.2)% | \$0.25 |
| December 31, 2018 | | | | | | |
| Fourth Quarter | \$11.88 | \$8.80 | \$6.46 | (25.9)% | (45.6)% | \$0.25 |
| Third Quarter | \$12.71 | \$9.05 | \$8.29 | (28.8)% | (34.8)% | \$0.25 |
| Second Quarter | \$13.71 | \$8.60 | \$7.66 | (37.3)% | (44.1)% | \$0.25 |
| First Quarter | \$13.66 | \$8.15 | \$6.88 | (40.3)% | (49.6)% | \$0.25 |

(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) Unless otherwise noted, represents the distribution paid or to be paid in the specified quarter. See "Distributions" for detail related to tax characteristics of distributions paid.

* Not determinable at the time of filing

Shares of BDCs may trade at a market price that is less than the value of the net assets attributable to those shares. The possibility that our shares of common stock will trade at a discount from NAV or at premiums that are unsustainable over the long term are separate and distinct from the risk that our NAV will decrease. Since our initial public offering on September 25, 2013, our shares of common stock have traded at

times at both a discount and a premium to the net assets attributable to those shares. As of February 27, 2020, shares of our common stock traded at a discount of approximately (14.9%) of the NAV attributable to those shares as of December 31, 2019. It is not possible to predict whether the shares offered hereby will trade at, above, or below NAV.

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 1, 2017 through December 31, 2019:

| Date Declared | Record Date | Payment Date | Amount Per Share |
|--|--------------------|---------------------|-----------------------------|
| January 2, 2019 | January 24, 2019 | January 30, 2019 | \$0.0833 |
| January 2, 2019 | February 20, 2019 | February 27, 2019 | 0.0833 |
| January 2, 2019 | March 21, 2019 | March 28, 2019 | 0.0833 |
| April 1, 2019 | April 22, 2019 | April 29, 2019 | 0.0833 |
| April 1, 2019 | May 23, 2019 | May 30, 2019 | 0.0833 |
| April 1, 2019 | June 20, 2019 | June 27, 2019 | 0.0833 |
| July 1, 2019 | July 23, 2019 | July 30, 2019 | 0.0833 |
| July 1, 2019 | August 22, 2019 | August 29, 2019 | 0.0833 |
| July 1, 2019 | September 20, 2019 | September 27, 2019 | 0.0833 |
| October 1, 2019 | October 22, 2019 | October 29, 2019 | 0.0833 |
| October 1, 2019 | November 22, 2019 | November 29, 2019 | 0.0833 |
| October 1, 2019 | December 23, 2019 | December 30, 2019 | 0.0833 |
| Total Distributions Declared and Distributed for 2019 | | | <u>\$ 1.00</u> |

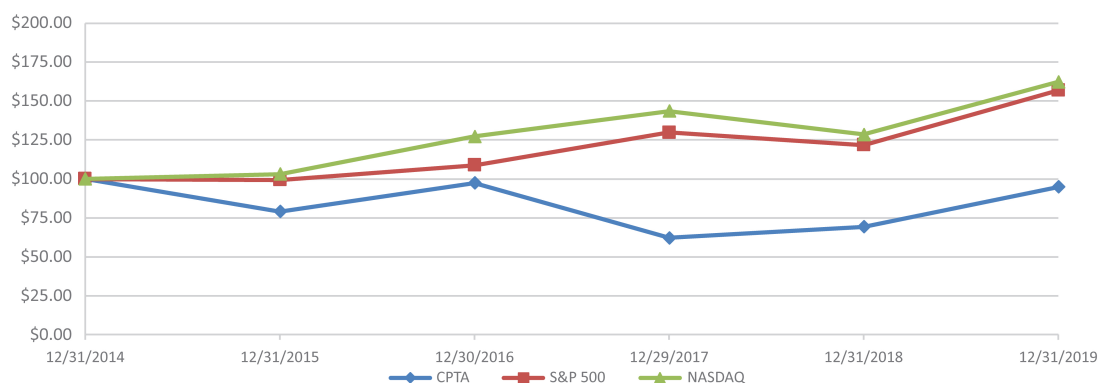
| Date Declared | Record Date | Payment Date | Amount Per Share |
|--|--------------------|---------------------|-----------------------------|
| January 2, 2018 | January 22, 2018 | January 30, 2018 | \$0.0833 |
| January 2, 2018 | February 20, 2018 | February 27, 2018 | 0.0833 |
| January 2, 2018 | March 23, 2018 | March 29, 2018 | 0.0833 |
| April 2, 2018 | April 19, 2018 | April 27, 2018 | 0.0833 |
| April 2, 2018 | May 22, 2018 | May 30, 2018 | 0.0833 |
| April 2, 2018 | June 20, 2018 | June 28, 2018 | 0.0833 |
| July 2, 2018 | July 23, 2018 | July 30, 2018 | 0.0833 |
| July 2, 2018 | August 23, 2018 | August 30, 2018 | 0.0833 |
| July 2, 2018 | September 20, 2018 | September 27, 2018 | 0.0833 |
| October 1, 2018 | October 23, 2018 | October 30, 2018 | 0.0833 |
| October 1, 2018 | November 21, 2018 | November 29, 2018 | 0.0833 |
| October 1, 2018 | December 20, 2018 | December 28, 2018 | 0.0833 |
| Total Distributions Declared and Distributed for 2018 | | | <u>\$ 1.00</u> |

| 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 and Distributed for 2017 | | | <u>\$ 1.42</u> |

Tax characteristics of all distributions paid are reported to stockholders on Form 1099 after the end of the calendar year. For the years ended December 31, 2018 and December 31, 2017 total distributions of \$16.0 million and \$22.6 million, respectively, were comprised 100% of ordinary income. For the year ended December 31, 2019, we estimate that total distributions of \$16.1 million were comprised of approximately \$13.4 million from ordinary income and \$2.7 million from return of capital.

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 December 31, 2014 through December 31, 2019. The graph assumes that on December 31, 2014, 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.

FEES AND EXPENSES

The following table is intended to assist you in understanding the costs and expenses that you will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates

and may vary. Except where the context suggests otherwise, whenever this report contains a reference to fees or expenses paid by “you”, “Capitala Finance”, or “us” or that “we” or “Capitala Finance” will pay fees or expenses, Capitala Finance will pay such fees and expenses out of our net assets and, consequently, you will indirectly bear such fees or expenses as an investor in Capitala Finance. However, you will not be required to deliver any money or otherwise bear personal liability or responsibility for such fees or expenses.

| | |
|--|-----------------------------|
| Stockholder transaction expenses: | |
| Sales load (as a percentage of offering price) | N/A ⁽¹⁾ |
| Offering expenses borne by us (as a percentage of offering price) | N/A ⁽²⁾ |
| Dividend reinvestment plan fees (per sales transaction fee) | \$15.00 ⁽³⁾ |
| Total stockholder transaction expenses (as a percentage of offering price) | —% |
| Annual expenses (as a percentage of net assets attributable to common stock): | |
| Base management fee | 4.79% ⁽⁴⁾ |
| Incentive fees payable from Net Investment Income | 0.90% ⁽⁵⁾ |
| Incentive fee payable from Capital Gains | —% ⁽⁵⁾ |
| Interest payments on borrowed funds | 8.43% ⁽⁶⁾ |
| Other expenses | 3.20% ⁽⁷⁾ |
| Acquired funds fees and expenses | 0.14% ⁽⁸⁾ |
| Total annual expenses | 17.46%⁽⁹⁾ |

-
- (1) In the event that any shares are sold to or through underwriters, a prospectus supplement will disclose the applicable sales load.
 - (2) The prospectus supplement corresponding to each offering will disclose the applicable estimated amount of offering expenses of the offering and the offering expenses borne by us as a percentage of the offering price.
 - (3) If a participant elects by written notice to the plan administrator to have the plan administrator sell part or all of the shares held by the plan administrator in the participant’s account and remit the proceeds to the participant, the plan administrator is authorized to deduct a transaction fee of \$15.00 plus a \$.10 per share brokerage commission from the proceeds. The expenses of the dividend reinvestment plan are included in “other expenses.” The plan administrator’s fees will be paid by us. There will be no brokerage charges or other charges to stockholders who participate in the plan.
 - (4) Reflects our gross base management fee as a percentage of net assets. Our base management fee under the Investment Advisory Agreement is calculated at an annual rate of 1.75% of our gross assets, which is our total assets as reflected on our balance sheet and includes any borrowings for investment purposes. The gross base management fee reflected in the table above is based on the fiscal year ended December 31, 2019. See “Investment Advisory Agreement.”
 - (5) Assumes that annual incentive fees earned by Capitala Investment Advisors remain consistent with the incentive fees earned by Capitala Investment Advisors during the fiscal year ended December 31, 2019 and includes accrued capital gains incentive fee. As of December 31, 2019, Capitala Investment Advisors has accrued no capital gains incentive fee. As we cannot predict whether we will meet the thresholds for incentive fees under the Investment Advisory Agreement, the incentive fees paid in subsequent periods, if any, may be substantially different than the fees incurred during the fiscal year ended December 31, 2019. On January 4, 2016, Capitala Investment Advisors voluntarily agreed to waive all or such portion of the quarterly incentive fees earned by Capitala Investment Advisors that would otherwise cause the Company’s quarterly net investment income to be less than the distribution payments declared by the Company’s Board of Directors. Quarterly incentive fees are earned by Capitala Investment Advisors 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. Capitala Investment Advisors will not be entitled to recoup any amount of incentive fees that it waives. This waiver was effective in the fourth quarter of 2015 and will continue unless otherwise publicly disclosed by the Company. However, because this is a voluntary waiver that is not guaranteed to last indefinitely, the

incentive fee reflected in the above table is presented on a gross basis and does not take into account the voluntary fee waiver. For more detailed information about the incentive fee calculations, see Part I, Item 1. Business, Agreements, Investment Advisory Agreement section of this Annual Report on Form 10-K.

- (6) In addition to our existing SBA-guaranteed debentures, 2022 Notes, and 2022 Convertible Notes, we may borrow funds from time to time to make investments to the extent we determine that additional capital would allow us to take advantage of additional investment opportunities or if the economic situation is otherwise conducive to doing so. The costs associated with any borrowings are indirectly borne by our stockholders. As of December 31, 2019, we had approximately \$75.0 million of 2022 Notes, and \$52.1 million of Convertible Notes outstanding. For purposes of this calculation, we have assumed that the December 31, 2019 amounts of 2022 Notes and 2022 Convertible Notes remain outstanding, and have computed interest expense using an assumed interest rate of 6.0% for the 2022 Notes, and 5.75% for the 2022 Convertible Notes which were the rates payable as of December 31, 2019. We have assumed \$150.0 million of SBA guaranteed debentures outstanding and have computed interest expense using an assumed interest rate of 3.56%. We have also assumed borrowings of \$25.0 million under the Credit Facility at an interest rate equal to 4.75% per annum.
- (7) “Other expenses” include our overhead expenses, including payments by us under the Administration Agreement based on the allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations to us under the Administration Agreement, and expenses relating to the Dividend Reinvestment Plan, for the fiscal year ended December 31, 2019.
- (8) The holders of shares of our common stock indirectly bear the expenses of our investment in CSLF II. No management fee is charged on our investment in CSLF II in connection with the administrative services provided to CSLF II. As CSLF II is structured as a private joint venture, no management fees are paid by CSLF II. Future expenses for CSLF II may be substantially higher or lower because certain expenses may fluctuate over time.
- (9) The holders of shares of our common stock indirectly bear the cost associated with our annual expenses.

Example

The following example demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in our common stock. In calculating the following expense amounts, we have assumed that our borrowings and annual operating expenses would remain at the levels set forth in the table above. In the event that shares are sold to or through underwriters, a prospectus supplement will restate this example to reflect the applicable sales load and offering expenses. See Note 6 above for additional information regarding certain assumptions regarding our level of leverage.

| | 1 Year | 3 Years | 5 Years | 10 Years |
|---|--------|---------|---------|----------|
| You would pay the following expenses on a \$1,000 investment, assuming a 5.0% annual return | \$166 | \$442 | \$658 | \$1,013 |

The example should not be considered a representation of future expenses, and actual expenses may be greater or less than those shown.

While the example assumes, as required by the applicable rules of the SEC, a 5.0% annual return, our performance will vary and may result in a return greater or less than 5.0%. The incentive fee under the Investment Advisory Agreement, which, assuming a 5.0% annual return, would either not be payable or would have an insignificant impact on the expense amounts shown above, is not included in the above example. The above illustration assumes that we will not realize any capital gains (computed net of all realized capital losses and unrealized capital depreciation) in any of the indicated time periods. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses and returns to our investors would be higher. For example, if we assumed that we received our 5.0% annual return completely in the form of net realized capital gains on our investments, computed net of all cumulative unrealized depreciation on our investments, the projected dollar amount of total cumulative expenses set forth in the above illustration would be as follows:

| | <u>1 Year</u> | <u>3 Years</u> | <u>5 Years</u> | <u>10 Years</u> |
|---|---------------|----------------|----------------|-----------------|
| You would pay the following expenses on a \$1,000 investment, assuming a 5.0% annual return | \$176 | \$464 | \$684 | \$1,033 |

The example assumes no sales load. However, in the event that securities are sold with a sales load, a prospectus supplement will provide a revised expense example that will include the effect of the sales load. In addition, while the examples assume reinvestment of all dividends and distributions at net asset value, participants in our dividend reinvestment plan will receive a number of shares of our common stock, generally determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the dividend payment date, which may be at, above or below net asset value.

SALES OF UNREGISTERED SECURITIES

During the year ended December 31, 2019, we issued 152,222 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, 2019 was approximately \$1.2 million. Other than the shares issued under our DRIP during the year ended December 31, 2019, 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, 2019, 2018, 2017, 2016, and 2015 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, | | | | |
|---|--|-------------|------------|-----------|-----------|
| | 2019 | 2018 | 2017 | 2016 | 2015 |
| Consolidated statements of operations data: | | | | | |
| Total investment income | \$ 44,035 | \$ 47,293 | \$ 51,089 | \$ 68,312 | \$ 63,976 |
| Total expenses, net of fee waivers | 30,992 | 31,271 | 35,565 | 39,272 | 38,649 |
| Net investment income | 13,043 | 16,022 | 15,524 | 29,040 | 25,327 |
| Net realized (loss) gain from investments | (19,756) | (34,804) | (24,189) | (22,766) | 5,436 |
| Net unrealized appreciation (depreciation) on investments and written call option | (20,306) | 840 | 2,970 | 2,878 | (16,913) |
| Tax (provision) benefit | (628) | 1,916 | (1,289) | — | — |
| Net (decrease) increase in net assets resulting from operations | \$ (27,647) | \$ (16,026) | \$ (6,984) | \$ 9,152 | \$ 13,850 |
| Per share data: | | | | | |
| Net investment income | \$ 0.81 | \$ 1.00 | \$ 0.98 | \$ 1.84 | \$ 1.67 |
| Net (decrease) increase in net assets resulting from operations | \$ (1.72) | \$ (1.00) | \$ (0.44) | \$ 0.58 | \$ 0.91 |
| Distributions declared | \$ 1.00 | \$ 1.00 | \$ 1.42 | \$ 1.80 | \$ 2.38 |
| Net asset value per share | \$ 9.14 | \$ 11.88 | \$ 13.91 | \$ 15.79 | \$ 17.04 |
| Consolidated statements of assets and liabilities data: | | | | | |
| Total assets | \$427,337 | \$493,165 | \$534,595 | \$584,415 | \$632,818 |
| Total net assets | \$148,113 | \$190,644 | \$221,887 | \$250,582 | \$268,802 |
| Other data: | | | | | |
| Total return ⁽¹⁾ | 37.75% | 12.14% | (35.68)% | 24.07% | (20.43)% |
| Number of portfolio company investments at year end | 43 | 44 | 47 | 53 | 57 |
| Total portfolio investments for the year | \$ 77,831 | \$107,802 | \$ 82,750 | \$120,844 | \$260,640 |
| Investment repayments for the year | \$128,122 | \$123,517 | \$115,810 | \$163,564 | \$142,713 |

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

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.

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

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”). 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 \$30.0 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, and, to a lesser extent, equity securities issued by lower middle-market companies and traditional middle-market companies.

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 150%, if certain requirements are met, after such borrowing, with certain limited exceptions. On March 23, 2018, the Small Business Credit Availability Act (the “SBCA”) was signed into law, which included various changes to regulations under the federal securities laws that impact BDCs. The SBCA included changes to the 1940 Act to allow BDCs to decrease their asset coverage requirement from 200% to 150% (i.e. the amount of debt may not exceed 66.7% of the value of our total assets), if certain requirements are met. On November 1, 2018, the Board, including a “required majority” (as such term is defined in Section 57(o) of the 1940 Act) approved the application of the modified asset coverage. As a result, our asset coverage requirements for senior securities changed from 200% to 150%, effective November 1, 2019. As of December 31, 2019, our asset coverage ratio was 216.5%. 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. During the fourth quarter of 2017, Florida Sidecar transferred all of its assets to the Company and was legally dissolved as a standalone partnership. On March 1, 2019, Fund II repaid its outstanding SBA debentures and relinquished its SBIC license.

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. Fund III, our subsidiary, is licensed under the Small Business Investment Company ("SBIC") Act and has elected to be regulated as BDC under the 1940 Act. Fund II, our subsidiary, was licensed under the SBIC Act until March 1, 2019 and has elected to be regulated as a BDC under the 1940 Act.

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. The 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.

The Company's financial statements as of December 31, 2019 and 2018, and for the years ended December 31, 2019, 2018, and 2017 are presented on a consolidated basis. The effects of all intercompany transactions between the Company and its subsidiaries (Fund II, Fund III, 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 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, and the Taxable Subsidiaries) in its consolidated financial statements. The Company does not consolidate its interest in Capitala Senior Loan Fund II, LLC ("CSLF II") because the investment is not considered a substantially wholly owned investment company subsidiary. Further, CSLF II is a joint venture for which shared power exists relating to the decisions that most significantly impact the economic performance of the entity. See Note 4 to the consolidated financial statements for a description of the Company's investment in CSLF II.

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, 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, 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 consolidated financial statements, certain accounting policies and estimates are considered

critical due to their impact on the reported amounts of assets and liabilities at the date of the 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 uses net asset value (“NAV”) as the fair value for its equity investment in CSLF II. CSLF II records its underlying investments at fair value on a quarterly basis in accordance with the 1940 Act and ASC 820.

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 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.

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.

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 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 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 PIK dividend 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.

In 2017, the Company elected to amend its tax year end from August 31 to December 31 and filed a tax return for the four months ended December 31, 2017.

The tax periods ended December 31, 2019, December 31, 2018, December 31, 2017, and August 31, 2017, 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, 2019 and 2018. 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.

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, 2019 and 2018, the Company recorded a net deferred tax asset of \$0.0 and \$0.6 million, respectively. For the years ended December 31, 2019 and 2018, the Company recorded a deferred tax benefit (provision) of \$(0.6) million and \$1.9 million, respectively. As of December 31, 2019 and 2018, the valuation allowance on the Company's deferred tax asset was \$3.2 million and \$0.4 million, respectively. During the years ended December 31, 2019 and December 31, 2018, the Company recognized an increase in the valuation allowance of \$2.8 million and \$0.0 million, respectively.

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, 2019 and 2018, 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, 2019 or 2018. 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.

Portfolio and Investment Activity

The Company's investment objective is to generate both current income and capital appreciation through debt and equity investments. 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, and subordinated loans and, to a lesser extent, equity securities issued by lower middle-market companies and traditional middle-market companies. As of December 31, 2019, our portfolio consisted of investments in 43 portfolio companies with a fair value of approximately \$362.5 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, delayed draw facilities, or revolving credit 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, 2019, 18.1% of the fair value of our first lien loans consisted of last-out loans. As of December 31, 2018, 13.7% of the fair value 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, but 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, 2019, we made approximately \$77.8 million of investments and had approximately \$128.1 million in repayments and sales of investments resulting in net repayments and sales of approximately \$50.3 million for the year. During the year ended December 31, 2018, we made approximately \$107.8 million of investments and had approximately \$123.5 million in repayments and sales resulting in net repayments and sales of approximately \$15.7 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. 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 had a strike price of \$1.5 million and a termination date of August 31, 2018. On August 27, 2018, FSC II exercised its option at a strike price of \$1.5 million.

As of December 31, 2019, our debt investment portfolio, which represented 78.6% of the fair value of our total portfolio, had a weighted average annualized yield of approximately 11.5%. As of December 31, 2019,

37.2% of the fair value of our debt investment portfolio was bearing a fixed rate of interest. As of December 31, 2018, our debt investment portfolio, which represented 76.4% of the fair value of our total portfolio, had a weighted average annualized yield of approximately 11.9%. As of December 31, 2018, 41.4% of the fair value of our debt investment portfolio was bearing a fixed rate of interest.

The weighted average annualized yield is calculated based on the effective interest rate as of period end, divided by the fair value of our 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 annualized yield will remain at its current level.

The following table summarizes the amortized cost and the fair value of investments as of December 31, 2019 (dollars in thousands):

| | Investments at Amortized Cost | Percentage of Total | Investments at Fair Value | Percentage of Total |
|-----------------------------------|-------------------------------------|------------------------|---------------------------------|------------------------|
| First Lien Debt | \$235,646 | 66.6% | \$ 231,203 | 63.8% |
| Second Lien Debt | 17,553 | 5.0 | 17,287 | 4.7 |
| Subordinated Debt | 36,526 | 10.3 | 36,570 | 10.1 |
| Equity and Warrants | 50,556 | 14.3 | 63,841 | 17.6 |
| Capitala Senior Loan Fund II, LLC | 13,600 | 3.8 | 13,631 | 3.8 |
| Total | <u>\$353,881</u> | <u>100.0%</u> | <u>\$ 362,532</u> | <u>100.0%</u> |

The following table summarizes the amortized cost and the fair value of investments as of December 31, 2018 (dollars in thousands):

| | Investments at Amortized Cost | Percentage of Total | Investments at Fair Value | Percentage of Total |
|-----------------------------------|-------------------------------------|------------------------|---------------------------------|------------------------|
| First Lien Debt | \$252,174 | 60.0% | \$ 237,570 | 52.9% |
| Second Lien Debt | 33,040 | 7.9 | 32,495 | 7.2 |
| Subordinated Debt | 72,562 | 17.3 | 73,113 | 16.3 |
| Equity and Warrants | 48,594 | 11.6 | 92,054 | 20.5 |
| Capitala Senior Loan Fund II, LLC | 13,600 | 3.2 | 13,695 | 3.1 |
| Total | <u>\$419,970</u> | <u>100.0%</u> | <u>\$ 448,927</u> | <u>100.0%</u> |

The following table shows the portfolio composition by industry grouping at fair value as of December 31, 2019 and 2018 (dollars in thousands):

| | December 31, 2019 | | December 31, 2018 | |
|---|---------------------------|-------------------------------|---------------------------|-------------------------------|
| | Investments at Fair Value | Percentage of Total Portfolio | Investments at Fair Value | Percentage of Total Portfolio |
| Business Services | \$ 40,410 | 11.2% | \$ 57,946 | 12.9% |
| Financial Services | 29,517 | 8.1 | 21,666 | 4.8 |
| Healthcare | 27,928 | 7.7 | 16,972 | 3.8 |
| Consumer Products | 25,118 | 6.9 | 27,746 | 6.2 |
| Sales & Marketing Services | 19,291 | 5.3 | 19,496 | 4.3 |
| Food Product Manufacturer | 17,609 | 4.9 | 17,335 | 3.9 |
| Security System Services | 16,063 | 4.4 | — | — |
| Automobile Part Manufacturer | 15,056 | 4.2 | 14,384 | 3.2 |
| IT Consulting | 13,773 | 3.8 | 15,233 | 3.4 |
| Investment Funds | 13,631 | 3.8 | 13,695 | 3.0 |
| Multi-platform media and consumer products | 13,000 | 3.6 | 13,000 | 2.9 |
| Healthcare Management | 12,607 | 3.5 | 13,792 | 3.1 |
| Textile Equipment Manufacturer | 11,564 | 3.2 | 12,848 | 2.8 |
| Government Services | 11,279 | 3.1 | 12,109 | 2.7 |
| Entertainment | 10,912 | 3.0 | — | — |
| Retail | 10,045 | 2.8 | 14,979 | 3.3 |
| Information Technology | 10,009 | 2.8 | 25,232 | 5.6 |
| Testing laboratories | 7,026 | 1.9 | 7,503 | 1.7 |
| Wireless Deployment Services | 7,000 | 1.9 | — | — |
| Electronic Machine Repair | 6,100 | 1.7 | 6,432 | 1.4 |
| Oil & Gas Engineering and Consulting Services | 5,908 | 1.6 | 6,854 | 1.5 |
| Medical Device Distributor | 4,904 | 1.4 | 4,797 | 1.1 |
| Data Services | 4,749 | 1.3 | — | — |
| Restaurant | 4,697 | 1.3 | 4,903 | 1.1 |
| Advertising & Marketing Services | 4,262 | 1.2 | 8,712 | 1.9 |
| Footwear Retail | 3,326 | 0.9 | 3,184 | 0.7 |
| Logistics | 2,924 | 0.8 | 2,984 | 0.7 |
| Online Merchandise Retailer | 2,877 | 0.8 | 3,499 | 0.8 |
| Home Repair Parts Manufacturer | 2,489 | 0.7 | 1,722 | 0.4 |
| Oil & Gas Services | 2,273 | 0.6 | 9,861 | 2.2 |
| QSR Franchisor | 1,881 | 0.5 | 3,018 | 0.7 |
| Computer Supply Retail | 1,490 | 0.4 | 10,597 | 2.4 |
| General Industrial | 838 | 0.2 | — | — |
| Household Product Manufacturer | 758 | 0.2 | 758 | 0.2 |
| Data Processing & Digital Marketing | 708 | 0.2 | 742 | 0.2 |
| Professional and Personal Digital Imaging | 510 | 0.1 | 6,674 | 1.5 |
| Telecommunications | — | — | 18,000 | 4.0 |
| Industrial Equipment Rental | — | — | 16,327 | 3.6 |
| Building Products | — | — | 14,833 | 3.3 |
| Conglomerate | — | — | 9,004 | 2.0 |
| Produce Distribution | — | — | 6,210 | 1.4 |
| Farming | — | — | 5,880 | 1.3 |
| Total | \$ 362,532 | 100.0% | \$ 448,927 | 100.0% |

With the exception of the international investment holdings noted below, all investments made by the Company as of December 31, 2019 and 2018 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, 2019 and 2018 (dollars in thousands):

| | December 31, 2019 | | December 31, 2018 | |
|---------------|---------------------------|-------------------------------|---------------------------|-------------------------------|
| | Investments at Fair Value | Percentage of Total Portfolio | Investments at Fair Value | Percentage of Total Portfolio |
| South | \$ 165,963 | 45.8% | \$ 224,856 | 50.1% |
| Northeast | 71,184 | 19.6 | 66,303 | 14.8 |
| West | 70,102 | 19.3 | 77,353 | 17.2 |
| Midwest | 55,283 | 15.3 | 77,537 | 17.3 |
| International | — | — | 2,878 | 0.6 |
| Total | <u>\$ 362,532</u> | <u>100.0%</u> | <u>\$ 448,927</u> | <u>100.0%</u> |

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, 2019 and 2018 (dollars in thousands):

| Investment Rating | As of December 31, 2019 | | As of December 31, 2018 | |
|-------------------|---------------------------|---------------------------------|---------------------------|---------------------------------|
| | Investments at Fair Value | Percentage of Total Investments | Investments at Fair Value | Percentage of Total Investments |
| 1 | \$ 85,688 | 23.6% | \$ 171,829 | 38.3% |
| 2 | 219,855 | 60.7 | 194,411 | 43.3 |
| 3 | 56,989 | 15.7 | 73,325 | 16.3 |
| 4 | — | — | 9,362 | 2.1 |
| 5 | — | — | — | — |
| Total | <u>\$ 362,532</u> | <u>100.0%</u> | <u>\$ 448,927</u> | <u>100.0%</u> |

As of December 31, 2019, we had no investments on non-accrual status. As of December 31, 2018, we had two debt investments on non-accrual status with an aggregate amortized cost of \$20.7 million and an aggregate fair value of \$9.4 million, which represented 4.9% and 2.1% of the investment portfolio, respectively.

Capitala Senior Loan Fund II, LLC

On December 20, 2018, Capitala and Trinity Universal Insurance Company (“Trinity”), a subsidiary of Kemper Corporation, entered into a limited liability company agreement (the “LLC Agreement”) to co-manage Capitala Senior Loan Fund II, LLC (“CSLF II”). The purpose and design of the joint venture is to invest primarily in senior secured first-out loans. Capitala and Trinity have committed to provide \$25.0 million of equity to CSLF II, with Capitala providing \$20.0 million and Trinity providing \$5.0 million. Capitala and Trinity each appointed two members to CSLF II’s four-person board of directors and investment committee. All material decisions with respect to CSLF II, including those involving its investment portfolio, require approval of a member on the board of directors and investment committee of at least one member representing Capitala and Trinity, respectively.

As of December 31, 2019 and 2018, \$13.6 million and \$3.4 million in equity capital had been contributed by Capitala and Trinity, respectively. As of December 31, 2019 and 2018, the Company and Trinity had \$6.4 million and \$1.6 million of unfunded equity capital commitments outstanding, respectively. The Company’s equity investment in CSLF II is not redeemable.

For the year ended December 31, 2019 and December 31, 2018, the Company received \$1.0 million and \$0.0, respectively, in dividend income from its equity interest in CSLF II.

On September 3, 2019, CSLF II entered into a senior secured revolving credit facility (the “CSLF II Credit Facility”) with KeyBank Specialty Finance Lending, an affiliate of KeyCorp. The CSLF II Credit Facility currently provides for borrowings up to \$60.0 million, subject to certain borrowing base restrictions. Borrowings under the CSLF II Credit Facility bear interest at a rate of 1-month LIBOR + 2.25%. Beginning the quarter ended March 31, 2020, CSLF II will incur unused fees of .35% when utilization of the CSLF II Credit Facility exceeds 50% and .65% when utilization of the CSLF II Credit Facility is less than 50%. The CSLF II Credit Facility matures on September 2, 2024.

As of December 31, 2019, \$12.7 million was outstanding under the CSLF II Credit Facility. For the year ended December 31, 2019, CSLF II incurred \$0.2 million of interest and financing expenses.

On September 3, 2019, Capitala and Trinity committed to provide \$25.0 million of subordinated debt (the “Subordinated Notes”) to CSLF II, with Capitala providing \$5.0 million and Trinity providing \$20.0 million. The Subordinated Notes currently bear interest at a rate of 1-month LIBOR + 5.00%. Beginning the quarter ended June 30, 2020, the Subordinated Notes will bear interest at a rate of 1-month LIBOR + 6.00%. The Subordinated Notes mature on September 3, 2024.

As of December 31, 2019, \$0.0 was outstanding on the Subordinated Notes. As of December 31, 2019, the Company and Trinity had \$5.0 million and \$20.0 million of unfunded commitments related to the

Subordinated Notes, respectively. For the year ended December 31, 2019, the Company did not incur any interest and financing expenses related to the Subordinated Notes.

Below is a summary of CSLF II's portfolio as of December 31, 2019 and 2018 (dollars in thousands):

| | December 31, 2019 | December 31, 2018 |
|---|-------------------|-------------------|
| First lien loans ⁽¹⁾ | \$28,396 | \$10,000 |
| Weighted average current interest rate on first lien loans | 6.4% | 7.6% |
| Number of portfolio companies | 5 | 2 |
| Largest portfolio company investment ⁽¹⁾ | \$ 7,443 | \$ 5,550 |
| Total of five largest portfolio company investments ⁽¹⁾⁽²⁾ | \$28,396 | \$10,000 |

(1) Based on principal amount outstanding at year end.

(2) Only two investments held as of December 31, 2018.

Below is CSLF II's schedule of investments as of December 31, 2019 (dollars in thousands):

| Portfolio Company | Industry | Type of Investment | Principal Amount | Cost | Fair Value |
|--|--------------------------|--|------------------|-----------------|-----------------|
| Investments at Fair Value | | | | | |
| Freedom Electronics, LLC | Electronics | First Lien Debt (7.0% Cash (1 month LIBOR + 5.0%, 2.0% Floor), Due 12/20/23) | \$ 5,445 | \$ 5,445 | \$ 5,445 |
| Installs, LLC | Logistics | First Lien Debt (5.8% Cash (1 month LIBOR + 4.0%, 1.8% Floor), Due 6/20/23) | 7,443 | 7,443 | 7,443 |
| RAM Payment, LLC | Financial Services | First Lien Debt (6.7% Cash (1 month LIBOR + 5.0%, 1.5% Floor), Due 1/4/24) | 6,653 | 6,653 | 6,653 |
| Rapid Fire Protection, Inc. ⁽¹⁾ | Security System Services | First Lien Debt (5.5% Cash (1 month LIBOR + 3.8%, 1.8% Floor), Due 11/22/24) | 4,400 | 4,400 | 4,400 |
| U.S. BioTek Laboratories, LLC | Testing Laboratories | First Lien Debt (7.0% Cash (3 month LIBOR + 5.0%, 2.0% Floor), Due 12/14/23) | 4,455 | 4,455 | 4,455 |
| TOTAL INVESTMENTS | | | \$28,396 | \$28,396 | \$28,396 |

(1) The investment has a \$3.0 million unfunded commitment.

Below is CSLF II's schedule of investments as of December 31, 2018 (dollars in thousands):

| Portfolio Company | Industry | Type of Investment | Principal Amount | Cost | Fair Value |
|----------------------------------|----------------------|--|------------------|-----------------|-----------------|
| Investments at Fair Value | | | | | |
| Freedom Electronics, LLC | Electronics | First Lien Debt (7.5% Cash (1 month LIBOR + 5.0%, 2.0% Floor), Due 12/20/23) | \$ 5,500 | \$ 5,500 | \$ 5,500 |
| U.S. BioTek Laboratories, LLC | Testing Laboratories | First Lien Debt (7.8% Cash (3 month LIBOR + 5.0%, 2.0% Floor), Due 12/14/23) | 4,500 | 4,500 | 4,500 |
| TOTAL INVESTMENTS | | | <u>\$10,000</u> | <u>\$10,000</u> | <u>\$10,000</u> |

Below are the statements of assets and liabilities for CSLF II as of December 31, 2019 and 2018 (dollars in thousands):

| | December 31, 2019 | December 31, 2018 |
|---|-------------------|-------------------|
| ASSETS | | |
| Investments at fair value (amortized cost of \$28,396 and \$10,000, respectively) | \$28,396 | \$10,000 |
| Cash and cash equivalents | 704 | 7,100 |
| Interest receivable | 151 | 31 |
| Other assets | 7 | — |
| Total assets | <u>\$29,258</u> | <u>\$17,131</u> |
| LIABILITIES | | |
| Credit facility (net of deferred financing costs of \$621 and \$0, respectively) | \$12,079 | \$ — |
| Interest and financing fees payable | 113 | — |
| Accounts payable | 27 | 12 |
| Total liabilities | <u>\$12,219</u> | <u>\$ 12</u> |
| NET ASSETS | | |
| Members' capital | <u>\$17,039</u> | <u>\$17,119</u> |
| Total net assets | <u>\$17,039</u> | <u>\$17,119</u> |

Below are the statements of operations for CSLF II (dollars in thousands):

| | <u>For the Year Ended December 31, 2019</u> | <u>For the period from December 20, 2018 (commencement of operations) to December 31, 2018</u> |
|---|---|--|
| INVESTMENT INCOME | | |
| Interest income | \$ 1,372 | \$ 31 |
| Fee income | 175 | 100 |
| Total investment income | <u>\$ 1,547</u> | <u>\$ 131</u> |
| EXPENSES | | |
| Interest and financing expenses | \$ 151 | \$ — |
| General and administrative expenses | 176 | 12 |
| Total expenses | <u>\$ 327</u> | <u>\$ 12</u> |
| NET INVESTMENT INCOME | <u>\$ 1,220</u> | <u>\$ 119</u> |
| NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS | <u>\$ 1,220</u> | <u>\$ 119</u> |

Results of Operations

Our operating results for the years ended December 31, 2019 and 2018 were as follows (dollars in thousands):

| | <u>For the Years Ended December 31,</u> | |
|--|---|-------------------|
| | <u>2019</u> | <u>2018</u> |
| Total investment income | \$ 44,035 | \$ 47,293 |
| Total expenses, net of incentive fee waiver | 30,992 | 31,271 |
| Net investment income | 13,043 | 16,022 |
| Net realized loss on investments | (19,756) | (34,804) |
| Net unrealized depreciation on investments | (20,306) | (5,955) |
| Net unrealized appreciation on Written Call Option | — | 6,795 |
| Tax benefit (provision) | (628) | 1,916 |
| Net decrease in net assets resulting from operations | <u>\$(27,647)</u> | <u>\$(16,026)</u> |

Investment income

The composition of our investment income for the years ended December 31, 2019 and 2018 was as follows (dollars in thousands):

| | <u>For the Years Ended December 31,</u> | |
|--|---|------------------|
| | <u>2019</u> | <u>2018</u> |
| Interest income | \$36,106 | \$ 40,357 |
| Fee income | 1,470 | 2,044 |
| Payment-in-kind interest and dividend income | 2,962 | 4,348 |
| Dividend income | 3,299 | 397 |
| Interest from cash and cash equivalents | 198 | 147 |
| Total investment income | <u>\$44,035</u> | <u>\$ 47,293</u> |

The income reported as interest income and PIK interest and PIK dividend income is generally based on the stated rates as disclosed in our consolidated schedules of investments. Accretion of discounts received for

purchased loans are included in interest income as an adjustment to yield. As a general rule, our interest income, 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 schedules 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, 2019, total investment income decreased by \$3.3 million, or 6.9%, compared to the year ended December 31, 2018. The decrease from the prior year was driven primarily by a decrease in interest income, from \$40.4 million for the year ended December 31, 2018 to \$36.1 million for the year ended December 31, 2019. The decline in interest income was due to a decline in the overall debt portfolio and a decline in the weighted average yield of the portfolio. PIK income declined from \$4.3 million for the year ended December 31, 2018, to \$3.0 million for the year ended December 31, 2019. The decrease in PIK income was due to a decline in investments with a contractual PIK rate. For the year ended December 31, 2019, we generated \$1.2 million in origination fees from new deployments and \$0.3 million in other fees. Comparatively, for the year ended December 31, 2018, we generated \$1.7 million in origination fees from new deployments and \$0.3 million in other fees. Dividend income increased from \$0.4 million for the year ended December 31, 2018 to \$3.3 million for the year ended December 31, 2019, due to \$1.0 million in dividends from CSLF II and several one-time dividends received from portfolio companies.

Operating expenses

The composition of our expenses for the years ended December 31, 2019 and 2018 was as follows (dollars in thousands):

| | For the Years Ended December 31, | |
|--|---|------------------|
| | 2019 | 2018 |
| Interest and financing expenses | \$17,121 | \$ 17,283 |
| Base management fee | 7,967 | 9,049 |
| Incentive fees, net of incentive fee waiver | 1,209 | 244 |
| General and administrative expenses | 4,695 | 4,695 |
| Total expenses, net of incentive fee waiver | \$30,992 | \$ 31,271 |

For the year ended December 31, 2019, operating expenses decreased by \$0.3 million, or 0.9%, compared to the year ended December 31, 2018. Interest and financing expenses declined from \$17.3 million for the year ended December 31, 2018 to \$17.1 million for the year ended December 31, 2019 due primarily to lower average debt outstanding during the period. Our base management fee declined from \$9.0 million for the year ended December 31, 2018 to \$8.0 million for the year ended December 31, 2019 due to lower average assets under management. Incentive fees, net of incentive fee waiver, increased from \$0.2 million to \$1.2 million primarily due to better net investment income returns in relation to our net asset value. General and administrative expenses were \$4.7 million for the year ended December 31, 2019 and December 31, 2018.

Net realized gains (losses) on sales of investments

During the years ended December 31, 2019 and 2018, we recognized \$(19.8) million and \$(34.8) million of net realized 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, 2019 and 2018, we had \$(20.3) million and \$(6.0) million of unrealized depreciation on investments, respectively.

Net unrealized appreciation on Written Call option

For the years ended December 31, 2019 and 2018, we had net unrealized appreciation on the Written Call Option of \$0.0 and \$6.8 million, respectively.

Tax benefit (provision)

For the years ended December 31, 2019 and 2018, we recorded a tax benefit (provision) of \$(0.6) million and \$1.9 million, respectively.

Changes in net assets resulting from operations

For the years ended December 31, 2019 and 2018, we recorded a net decrease in net assets resulting from operations of \$(27.6) million and \$(16.0) million, respectively. Based on the weighted average shares of common stock outstanding for the years ended December 31, 2019 and 2018, our per share net decrease in net assets resulting from operations was \$(1.72) and \$(1.00), respectively.

For the years ended December 31, 2018 and 2017

The comparison of our results of operations for the fiscal years ended December 31, 2018 and 2017 can be found in our annual report on Form 10-K for the fiscal year ended December 31, 2018 located within Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, which is incorporated by reference herein.

Summarized Financial Information of Our Unconsolidated Subsidiaries

During the year ended December 31, 2019, the Company sold or exited four portfolio companies that were considered significant subsidiaries under the guidance in Regulation S-X. During the year ended December 31, 2019, the Company wrote off its investment in AAE Acquisition, LLC and realized a loss of \$(20.4) million. During the year ended December 31, 2019, the Company sold its investments in Portrait Studio, LLC, CableOrganizer Acquisition, LLC, and Micro Precision, LLC and realized a gain/(loss) of \$(6.2) million, \$(14.6) million, and \$0.0, respectively.

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.

Since our IPO, we have raised approximately \$136.0 million in net proceeds from equity offerings through December 31, 2019.

On October 17, 2014, the Company entered into a senior secured revolving credit agreement (as amended the "Credit Facility") with ING Capital, LLC, as administrative agent, arranger, and bookrunner, and the lenders party thereto. The Credit Facility was amended on May 22, 2015, June 16, 2017, July 19, 2018, February 22, 2019, and December 23, 2019 (the "Amendments"). The Amendments were affected, among other things, in order to increase the total borrowings allowed under the Credit Facility, allow for stock repurchases, extend the maturity date, reduce the minimum required interest coverage ratio, reduce the minimum required net asset value, and reduce the minimum required asset coverage ratio. The Credit Facility currently provides for borrowings up to \$60.0 million and may be increased up to \$150.0 million pursuant to its "accordion" feature. The Credit Facility matures on April 30, 2022. As of December 31, 2019, we had \$0.0 outstanding and \$60.0 million available under the Credit Facility.

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

As of December 31, 2019, 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.

On December 31, 2019, we entered into an open market sale agreementSM with Jefferies LLC pursuant to which we may issue and sell up to \$50,000,000 in aggregate amount of shares of our common stock in amounts, and at times, to be determined by us (the “ATM Program”). Actual sales in this ATM Program will depend on a variety of factors to be determined by us including market conditions, the trading price of our common stock and determinations by us of the appropriate sources of funding. We may issue shares of our common stock at a price below the then current net asset value per share pursuant to the ATM Program.

We are only allowed to borrow money such that our asset coverage, as defined in the 1940 Act, equals at least 150% if certain requirements are met, after such borrowing, with certain limited exceptions. On March 23, 2018, the SBCA was signed into law, which included various changes to regulations under the federal securities laws that impact BDCs. The SBCA included changes to the 1940 Act to allow BDCs to decrease their asset coverage requirement from 200% to 150% (i.e. the amount of debt may not exceed 66.7% of the value of our total assets), if certain requirements are met. On November 1, 2018, the Board, including a “required majority” (as such term is defined in Section 57(o) of the 1940 Act) approved the application of the modified asset coverage. As a result, our asset coverage requirements for senior securities changed from 200% to 150%, effective November 1, 2019. As of December 31, 2019, our asset coverage ratio was 216.5%.

As of December 31, 2019, we had \$62.3 million in cash and cash equivalents, and our net assets totaled \$148.1 million.

Contractual Obligations

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

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

A summary of our significant contractual payment obligations as of December 31, 2019 are as follows (dollars in thousands):

| | Contractual Obligations Payments Due by Period | | | | Total |
|--------------------------------------|--|------------------|-----------------|----------------------|------------------|
| | Less Than 1 Year | 1 – 3 Years | 3 – 5 Years | More Than 5 Years | |
| SBA Debentures | \$19,000 | \$106,000 | \$25,000 | \$— | \$150,000 |
| 2022 Notes | — | 75,000 | — | — | 75,000 |
| 2022 Convertible Notes | — | 52,088 | — | — | 52,088 |
| Credit Facility | — | — | — | — | — |
| Total Contractual Obligations | \$19,000 | \$233,088 | \$25,000 | \$— | \$277,088 |

Senior Securities

Information about the Company's senior securities as of December 31, 2019, 2018, 2017, 2016, 2015, 2014 and 2013, and information about Fund II's and Fund III's senior securities as of December 31, 2012, 2011 and 2010 are shown in the following table.

| Class and Year | Total Amount Outstanding Exclusive of Treasury Securities ⁽¹⁾⁽⁶⁾ (in thousands) | Assets Coverage Per Unit ⁽²⁾⁽⁶⁾ | Involuntary Liquidation Preference per Unit ⁽³⁾ | Average Market Value per Unit ⁽⁴⁾ |
|--------------------------------------|---|---|--|---|
| Capitala Finance Corp. | | | | |
| Credit Facility⁽⁵⁾ | | | | |
| 2019 | \$ — | \$2,200 | — | N/A |
| 2018 | 10,000 | 2,400 | — | N/A |
| 2017 | 9,000 | 2,600 | — | N/A |
| 2016 | 44,000 | 2,600 | — | N/A |
| 2015 | 70,000 | 2,500 | — | N/A |
| 2014 | — | 1,800 | — | N/A |
| 2022 Notes | | | | |
| 2019 | \$ 75,000 | \$2,200 | — | \$1,000 |
| 2018 | 75,000 | 2,400 | — | 996 |
| 2017 | 75,000 | 2,600 | — | 1,014 |
| 2022 Convertible Notes | | | | |
| 2019 | \$ 52,088 | \$2,200 | — | \$ 994 |
| 2018 | 52,088 | 2,400 | — | 984 |
| 2017 | 52,088 | 2,600 | — | 1,001 |
| SBA-guaranteed debentures | | | | |
| 2019 | \$150,000 | N/A | — | N/A |
| 2018 | 165,700 | N/A | — | N/A |
| 2017 | 170,700 | N/A | — | N/A |
| 2016 | 170,700 | N/A | — | N/A |
| 2015 | 184,200 | N/A | — | N/A |
| 2014 | 192,200 | \$1,800 | — | N/A |
| 2013 | 202,200 | 2,300 | — | N/A |

| Class and Year | Total Amount Outstanding Exclusive of Treasury Securities ⁽¹⁾⁽⁶⁾ (in thousands) | Assets Coverage Per Unit ⁽²⁾⁽⁶⁾ | Involuntary Liquidation Preference per Unit ⁽³⁾ | Average Market Value per Unit ⁽⁴⁾ |
|---|---|---|--|---|
| 2021 Notes | | | | |
| 2016 | \$ 113,438 | \$2,600 | — | \$1,006 |
| 2015 | 113,438 | 2,500 | — | 1,020 |
| 2014 | 113,438 | 1,800 | — | 1,036 |
| Fund II SBA-guaranteed debentures | | | | |
| 2012 | \$ 52,200 | \$2,000 | — | N/A |
| 2011 | 52,200 | 1,600 | — | N/A |
| 2010 | 36,500 | 1,600 | — | N/A |
| Fund III SBA-guaranteed debentures | | | | |
| 2012 | \$125,000 | \$1,700 | — | N/A |
| 2011 | 90,000 | 1,700 | — | N/A |
| 2010 | 33,000 | 1,900 | — | N/A |

- (1) Total amount of each class of senior securities outstanding at the end of the period presented.
- (2) Asset coverage per unit is the ratio of the carrying value of our total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness. Asset coverage per unit is expressed in terms of dollar amounts per \$1,000 of indebtedness. Amounts are rounded to the nearest \$1,000.
- (3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it. The “—” indicates information that the SEC expressly does not require to be disclosed for certain types of senior securities.
- (4) Not applicable except for the 2021 Notes, the 2022 Notes and the 2022 Convertible Notes which are publicly traded. The Average Market Value Per Unit is calculated by taking the daily average closing price during the period and dividing it by twenty-five dollars per share and multiplying the result by one thousand to determine a unit price per thousand consistent with Asset Coverage Per Unit.
- (5) As of December 31, 2019, there was no outstanding balance on the Credit Facility. As of February 27, 2020 there was no outstanding balance on the Credit Facility.
- (6) We have excluded our SBA-guaranteed debentures from the asset coverage calculation as of December 31, 2019, 2018, 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 asset coverage ratio we are required to satisfy under the 1940 Act.

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 1, 2017 through December 31, 2019:

| Date Declared | Record Date | Payment Date | Amount Per Share |
|--|--------------------|---------------------|-------------------------|
| January 2, 2019 | January 24, 2019 | January 30, 2019 | \$0.0833 |
| January 2, 2019 | February 20, 2019 | February 27, 2019 | 0.0833 |
| January 2, 2019 | March 21, 2019 | March 28, 2019 | 0.0833 |
| April 1, 2019 | April 22, 2019 | April 29, 2019 | 0.0833 |
| April 1, 2019 | May 23, 2019 | May 30, 2019 | 0.0833 |
| April 1, 2019 | June 20, 2019 | June 27, 2019 | 0.0833 |
| July 1, 2019 | July 23, 2019 | July 30, 2019 | 0.0833 |
| July 1, 2019 | August 22, 2019 | August 29, 2019 | 0.0833 |
| July 1, 2019 | September 20, 2019 | September 27, 2019 | 0.0833 |
| October 1, 2019 | October 22, 2019 | October 29, 2019 | 0.0833 |
| October 1, 2019 | November 22, 2019 | November 29, 2019 | 0.0833 |
| October 1, 2019 | December 23, 2019 | December 30, 2019 | 0.0833 |
| Total Distributions Declared and Distributed for 2019 | | | \$ 1.00 |

| 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 |
| April 2, 2018 | April 19, 2018 | April 27, 2018 | 0.0833 |
| April 2, 2018 | May 22, 2018 | May 30, 2018 | 0.0833 |
| April 2, 2018 | June 20, 2018 | June 28, 2018 | 0.0833 |
| July 2, 2018 | July 23, 2018 | July 30, 2018 | 0.0833 |
| July 2, 2018 | August 23, 2018 | August 30, 2018 | 0.0833 |
| July 2, 2018 | September 20, 2018 | September 27, 2018 | 0.0833 |
| October 1, 2018 | October 23, 2018 | October 30, 2018 | 0.0833 |
| October 1, 2018 | November 21, 2018 | November 29, 2018 | 0.0833 |
| October 1, 2018 | December 20, 2018 | December 28, 2018 | 0.0833 |
| Total Distributions Declared and Distributed for 2018 | | | \$ 1.00 |

| <u>Date Declared</u> | <u>Record Date</u> | <u>Payment Date</u> | <u>Amount Per Share</u> |
|---|--------------------|---------------------|-------------------------|
| 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 and Distributed for 2017 | | | <u>\$ 1.42</u> |

Tax characteristics of all distributions paid are reported to stockholders on Form 1099 after the end of the calendar year. For the years ended December 31, 2018 and 2017 total distributions of \$16.0 million and \$22.6 million, respectively, were comprised 100% of ordinary income. For the year ended December 31, 2019, we estimate that total distributions of \$16.1 million were comprised of approximately \$13.4 million from ordinary income and \$2.7 million from return of capital.

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 which provides 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, and a private investment vehicle (referred to herein as "Capitala Specialty Lending Corp" or "CSLC"), both of which provide 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 expect to make, and have made, co-investments with Fund IV, Fund V, and/or CSLC to the extent their respective investment strategies align with ours.

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.

The Company may invest in the same unitranche facility as CSLF II, whereby CSLF II provides the first-out portion of the unitranche facility and the Company and other lenders provide the last-out portion of the unitranche facility. Under a guarantee agreement, the Company may be required to purchase its pro-rata portion of first-out loans from CSLF II upon certain triggering events, including acceleration upon payment default of the underlying borrower. As of December 31, 2019, the Company has evaluated the fair value of the guarantee under the guidance of ASC Topic 460 — Guarantees and determined that the fair value of the guarantee is immaterial as the risk of payment default for first-out loans in CSLF II is considered remote. The maximum exposure to credit risk as of December 31, 2019 and 2018, was \$10.3 million and \$4.3 million, respectively, and extends to the stated maturity of the underlying loans in CSLF 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, 2019, the Company had outstanding unfunded commitments related to debt and equity investments in existing portfolio companies of \$11.4 million (CSLF II), \$4.5 million (Rapid Fire Protection, Inc), \$3.5 million (J5 Infrastructure Partners, LLC), \$2.6 million (BigMouth, Inc.), \$1.0 million (Freedom Electronics, LLC), \$1.0 million (U.S. BioTek Laboratories, LLC), and \$0.5 million (Jurassic Quest Holdings, LLC). As of December 31, 2018, the Company had outstanding unfunded commitments related to debt and equity investments in existing portfolio companies of \$6.4 million (CSLF II), \$5.0 million (Portrait Studio, LLC), \$1.1 million (MC Sign Lessor, Corp), \$1.0 million (U.S. BioTek Laboratories, LLC), \$0.8 million (Freedom Electronics, LLC), and \$0.3 million (CableOrganizer Acquisition, LLC).

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, 2020 our Board declared the following distributions:

| Date Declared | Record Date | Payment Date | Distributions per Share |
|----------------------|--------------------|---------------------|--------------------------------|
| January 2, 2020 | January 24, 2020 | January 30, 2020 | \$0.0833 |
| January 2, 2020 | February 20, 2020 | February 27, 2020 | \$0.0833 |
| January 2, 2020 | March 23, 2020 | March 30, 2020 | \$0.0833 |

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, 2019, we did not engage in hedging activities.

As of December 31, 2019, we held 24 securities bearing a variable rate of interest. Our variable rate investments represent approximately 62.8% of the fair value of total debt investments. As of December 31, 2019, 20.6% of variable rate securities were yielding interest at a rate equal to the established interest rate floor and 79.4% of variable rate securities were yielding interest at a rate above its interest rate floor or were not subject to an interest rate floor. As of December 31, 2019, we had \$0.0 outstanding on our Credit Facility, which has a variable rate of interest at one-month LIBOR + 3.0%. As of December 31, 2019, all of our other interest paying liabilities, consisting of \$150.0 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, 2019 consolidated statement of assets and liabilities, the following table shows the annual impact on net income (excluding the potential related incentive fee impact) of base rate changes in interest rates (considering interest rate floors for variable rate securities) assuming no changes in our investment and borrowing structure (dollars in thousands):

| Basis Point Change | Increase (decrease) in interest income | (Increase) decrease in interest expense | Increase (decrease) in net income |
|---------------------------|---|--|--|
| Up 300 basis points | \$ 5,444 | \$— | \$ 5,444 |
| Up 200 basis points | \$ 3,611 | \$— | \$ 3,611 |
| Up 100 basis points | \$ 1,777 | \$— | \$ 1,777 |
| Down 100 basis points | \$(1,050) | \$— | \$(1,050) |
| Down 200 basis points | \$(1,187) | \$— | \$(1,187) |
| Down 300 basis points | \$(1,187) | \$— | \$(1,187) |

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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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, 2019 and 2018, 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, 2019, 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 the Company at December 31, 2019 and 2018, and 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, 2019, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission 2013 framework and our report dated March 2, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the 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. Our audits included performing procedures to assess the risks of material misstatement of the 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 financial statements. Our procedures included confirmation of investments owned as of December 31, 2019 and 2018, by correspondence with the custodians, agents and/or 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 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
March 2, 2020

Report of Independent Registered Public Accounting Firm

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

Opinion on Internal Control over Financial Reporting

We have audited Capitala Finance Corp.'s internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, Capitala Finance Corp. (the "Company") maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company, including the consolidated schedules of investments, as of December 31, 2019 and 2018, 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, 2019, and the related notes and our report dated March 2, 2020, expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the 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 audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's 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 generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) 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.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

Charlotte, North Carolina
March 2, 2020

Capitala Finance Corp.

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

| | As of | |
|--|----------------------|----------------------|
| | December 31, 2019 | December 31, 2018 |
| ASSETS | | |
| Investments at fair value | | |
| Non-control/non-affiliate investments (amortized cost of \$250,433 and \$280,114, respectively) | \$ 241,046 | \$ 286,843 |
| Affiliate investments (amortized cost of \$80,756 and \$72,300, respectively) | 98,763 | 92,939 |
| Control investments (amortized cost of \$22,692 and \$67,556, respectively) | <u>22,723</u> | <u>69,145</u> |
| Total investments at fair value (amortized cost of \$353,881 and \$419,970, respectively) | 362,532 | 448,927 |
| Cash and cash equivalents | 62,321 | 39,295 |
| Interest and dividend receivable | 1,745 | 3,778 |
| Prepaid expenses | 624 | 454 |
| Deferred tax asset, net | — | 628 |
| Other assets | <u>115</u> | <u>83</u> |
| Total assets | <u>\$ 427,337</u> | <u>\$ 493,165</u> |
| LIABILITIES | | |
| SBA Debentures (net of deferred financing costs of \$1,006 and \$1,688, respectively) | \$ 148,994 | \$ 164,012 |
| 2022 Notes (net of deferred financing costs of \$1,447 and \$1,987, respectively) | 73,553 | 73,013 |
| 2022 Convertible Notes (net of deferred financing costs of \$916 and \$1,259, respectively) | 51,172 | 50,829 |
| Credit Facility (net of deferred financing costs of \$1,165 and \$983, respectively) | (1,165) | 9,017 |
| Management and incentive fees payable | 3,713 | 2,487 |
| Interest and financing fees payable | 2,439 | 3,063 |
| Accounts payable and accrued expenses | 518 | 100 |
| Total liabilities | <u>\$ 279,224</u> | <u>\$ 302,521</u> |
| Commitments and contingencies (Note 2) | | |
| NET ASSETS | | |
| Common stock, par value \$0.01, 100,000,000 common shares authorized, 16,203,769 and 16,051,547 common shares issued and outstanding, respectively | \$ 162 | \$ 161 |
| Additional paid in capital | 237,886 | 241,757 |
| Total distributable loss | <u>(89,935)</u> | <u>(51,274)</u> |
| Total net assets | <u>\$ 148,113</u> | <u>\$ 190,644</u> |
| Total liabilities and net assets | <u>\$ 427,337</u> | <u>\$ 493,165</u> |
| Net asset value per share | \$ 9.14 | \$ 11.88 |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

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

| | For the Years Ended December 31, | | |
|---|----------------------------------|--------------------|-------------------|
| | 2019 | 2018 | 2017 |
| INVESTMENT INCOME | | | |
| Interest and fee income: | | | |
| Non-control/non-affiliate investments | \$ 27,659 | \$ 27,754 | \$ 31,084 |
| Affiliate investments | 8,351 | 7,945 | 4,509 |
| Control investments | 1,566 | 6,702 | 6,896 |
| Total interest and fee income | 37,576 | 42,401 | 42,489 |
| Payment-in-kind interest and dividend income: | | | |
| Non-control/non-affiliate investments | 1,721 | 2,248 | 4,503 |
| Affiliate investments | 869 | 1,251 | 1,898 |
| Control investments | 372 | 849 | 742 |
| Total payment-in-kind interest and dividend income | 2,962 | 4,348 | 7,143 |
| Dividend income: | | | |
| Non-control/non-affiliate investments | 1,345 | 59 | 225 |
| Affiliate investments | 50 | 238 | 641 |
| Control investments | 1,904 | 100 | 355 |
| Total dividend income | 3,299 | 397 | 1,221 |
| Other income | — | — | 125 |
| Interest income from cash and cash equivalents | 198 | 147 | 111 |
| Total investment income | 44,035 | 47,293 | 51,089 |
| EXPENSES | | | |
| Interest and financing expenses | 17,121 | 17,283 | 18,825 |
| Loss on extinguishment of debt | — | — | 2,732 |
| Base management fee | 7,967 | 9,049 | 9,780 |
| Incentive fees | 1,497 | 244 | 1,308 |
| General and administrative expenses | 4,695 | 4,695 | 3,878 |
| Expenses before incentive fee waiver | 31,280 | 31,271 | 36,523 |
| Incentive fee waiver (See Note 6) | (288) | — | (958) |
| Total expenses, net of incentive fee waiver | 30,992 | 31,271 | 35,565 |
| NET INVESTMENT INCOME | 13,043 | 16,022 | 15,524 |
| REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND WRITTEN CALL OPTION: | | | |
| Net realized gain (loss) on investments: | | | |
| Non-control/non-affiliate investments | 16,529 | (15,714) | (6,682) |
| Affiliate investments | 2,288 | 2,920 | 4,926 |
| Control investments | (38,573) | (22,010) | (22,433) |
| Net realized loss on investments | (19,756) | (34,804) | (24,189) |
| Net unrealized appreciation (depreciation) on investments: | | | |
| Non-control/non-affiliate investments | (16,116) | 16,487 | (11,577) |
| Affiliate investments | (2,632) | (5,982) | 4,436 |
| Control investments | (1,558) | (16,460) | 14,190 |
| Net unrealized appreciation (depreciation) on investments | (20,306) | (5,955) | 7,049 |
| Net unrealized appreciation (depreciation) on written call option | — | 6,795 | (4,079) |
| Net realized and unrealized loss on investments and written call option | (40,062) | (33,964) | (21,219) |
| Tax benefit (provision) | (628) | 1,916 | (1,289) |
| Total net realized and unrealized loss on investments and written call option, net of taxes | (40,690) | (32,048) | (22,508) |
| NET DECREASE IN NET ASSETS RESULTING FROM OPERATIONS | \$ (27,647) | \$ (16,026) | \$ (6,984) |
| NET DECREASE IN NET ASSETS PER SHARE RESULTING FROM OPERATIONS – BASIC AND DILUTED | \$ (1.72) | \$ (1.00) | \$ (0.44) |
| WEIGHTED AVERAGE COMMON STOCK OUTSTANDING – BASIC AND DILUTED | 16,117,719 | 15,993,436 | 15,903,167 |
| DISTRIBUTIONS PAID PER SHARE | \$ 1.00 | \$ 1.00 | \$ 1.42 |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

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

| For the Years Ended December 31, 2017, 2018, and 2019 | Common Stock | | Additional Paid in Capital | Total Distributable Loss | Total |
|--|---------------------|-----------|----------------------------------|--------------------------------|-----------|
| | Number of Shares | Par Value | | | |
| BALANCE, December 31, 2016 | 15,868,045 | \$159 | \$240,184 | \$ 10,239 | \$250,582 |
| Net investment income | — | — | — | 15,524 | 15,524 |
| Net realized loss on investments | — | — | — | (24,189) | (24,189) |
| Net unrealized appreciation on investments | — | — | — | 7,049 | 7,049 |
| Net 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) | 21 | — |
| BALANCE, December 31, 2017 | 15,951,231 | \$160 | \$241,027 | \$ (19,300) | \$221,887 |
| Net investment income | — | — | — | 16,022 | 16,022 |
| Net realized loss on investments | — | — | — | (34,804) | (34,804) |
| Net unrealized depreciation on investments | — | — | — | (5,955) | (5,955) |
| Net unrealized appreciation on written call option | — | — | — | 6,795 | 6,795 |
| Tax benefit | — | — | — | 1,916 | 1,916 |
| Distributions to Shareholders: | | | | | |
| Stock issued under dividend reinvestment plan | 100,316 | 1 | 768 | — | 769 |
| Distributions declared | — | — | — | (15,986) | (15,986) |
| Tax reclassification of stockholders' equity in accordance with generally accepted accounting principles | — | — | (38) | 38 | — |
| BALANCE, December 31, 2018 | 16,051,547 | \$161 | \$241,757 | \$ (51,274) | \$190,644 |
| Net investment income | — | — | — | 13,043 | 13,043 |
| Net realized loss on investments | — | — | — | (19,756) | (19,756) |
| Net unrealized depreciation on investments | — | — | — | (20,306) | (20,306) |
| Tax provision | — | — | — | (628) | (628) |
| Distributions to Shareholders: | | | | | |
| Stock issued under dividend reinvestment plan | 152,222 | 1 | 1,225 | — | 1,226 |
| Distributions declared | — | — | — | (16,110) | (16,110) |
| Return of capital | — | — | (2,659) | 2,659 | — |
| Tax reclassification of stockholders' equity in accordance with generally accepted accounting principles | — | — | (2,437) | 2,437 | — |
| BALANCE, December 31, 2019 | 16,203,769 | \$162 | \$237,886 | \$ (89,935) | \$148,113 |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Statements of Cash Flows
(in thousands)

| | For the Years Ended December 31, | | |
|---|---|------------------|------------------|
| | 2019 | 2018 | 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net decrease in net assets resulting from operations | \$ (27,647) | \$ (16,026) | \$ (6,984) |
| Adjustments to reconcile net decrease in net assets resulting from operations to net cash provided by operating activities: | | | |
| Purchase of investments | (77,831) | (107,802) | (82,750) |
| Repayments and sales of investments | 128,122 | 123,517 | 115,810 |
| Net realized loss on investments | 19,756 | 34,804 | 24,189 |
| Net unrealized (appreciation) depreciation on investments | 20,306 | 5,955 | (7,049) |
| Payment-in-kind interest and dividends | (2,962) | (4,348) | (7,143) |
| Accretion of original issue discount on investments | (996) | (1,114) | (1,357) |
| Payments from written call option | — | (20) | — |
| Net unrealized (appreciation) depreciation on written call option | — | (6,795) | 4,079 |
| Amortization of deferred financing fees | 2,370 | 1,885 | 2,100 |
| Loss on extinguishment of debt | — | — | 2,732 |
| Tax provision (benefit) | 628 | (1,916) | 1,289 |
| Changes in assets and liabilities: | | | |
| Interest and dividend receivable | 2,033 | (802) | 2,759 |
| Due from related parties | — | 95 | 87 |
| Prepaid expenses | (170) | (145) | 197 |
| Other assets | (32) | (28) | 17 |
| Due to related parties | — | — | (35) |
| Management and incentive fees payable | 1,226 | 315 | (4,254) |
| Interest and financing fees payable | (624) | (78) | 484 |
| Trade settlement payable | — | (175) | 175 |
| Accounts payable and accrued expenses | 418 | 100 | (536) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 64,597 | 27,422 | 43,810 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Paydowns on SBA debentures | (15,700) | (5,000) | — |
| Proceeds from Credit Facility | 16,500 | 31,000 | 9,000 |
| Repayments on Credit Facility | (26,500) | (30,000) | (44,000) |
| Issuance of 2022 Notes | — | — | 75,000 |
| Issuance of 2022 Convertible Notes | — | — | 52,088 |
| Repayment of 2021 Notes | — | — | (113,438) |
| Distributions paid to shareholders | (14,884) | (15,217) | (21,711) |
| Deferred financing fees paid | (987) | (131) | (5,809) |
| NET CASH USED IN FINANCING ACTIVITIES | (41,571) | (19,348) | (48,870) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 23,026 | 8,074 | (5,060) |
| CASH AND CASH EQUIVALENTS, beginning of year | 39,295 | 31,221 | 36,281 |
| CASH AND CASH EQUIVALENTS, end of year | \$ 62,321 | \$ 39,295 | \$ 31,221 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | |
| Cash paid for interest | \$ 13,784 | \$ 14,139 | \$ 15,503 |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING TRANSACTIONS | | | |
| Distributions paid through dividend reinvestment plan share issuances | \$ 1,226 | \$ 769 | \$ 865 |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments
(in thousands, except for units/shares)
December 31, 2019

| Portfolio Company, Country ^{(1),(2),(3),(4),(5)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|---|--|--|------------------|---------------|---------------|-----------------|
| Non-control/non-affiliated investments – 162.8% | | | | | | |
| Non-control/non-affiliated investments – United States | | | | | | |
| 3 Bridge Solutions, LLC | IT Consulting | First Lien Debt (10.7% Cash (1 month LIBOR + 9.0%, 1.0% Floor), Due 12/4/22) | \$ 13,274 | \$13,274 | \$13,274 | 9.0% |
| 3 Bridge Solutions, LLC | IT Consulting | Preferred Units (965 units) | | 1,090 | 499 | 0.3% |
| 3 Bridge Solutions, LLC | IT Consulting | Membership Units (39,000 units) | | 10 | — | 0.0% |
| | | | | <u>14,374</u> | <u>13,773</u> | <u>9.3%</u> |
| Alternative Biomedical Solutions, LLC | Healthcare | First Lien Debt (8.0% Cash, 3.8% PIK, Due 12/18/22) | 5,491 | 5,331 | 5,319 | 3.6% |
| Alternative Biomedical Solutions, LLC | Healthcare | First Lien Debt (8.0% Cash, 3.8% PIK, Due 12/18/22) ⁽⁶⁾ | 13,125 | 13,125 | 10,624 | 7.2% |
| Alternative Biomedical Solutions, LLC | Healthcare | Membership Units (20,092 units) | | 800 | — | 0.0% |
| | | | | <u>19,256</u> | <u>15,943</u> | <u>10.8%</u> |
| American Clinical Solutions, LLC | Healthcare | First Lien Debt (7.0% Cash, Due 12/31/22) | 3,500 | 3,500 | 3,500 | 2.3% |
| American Clinical Solutions, LLC | Healthcare | First Lien Debt (2.0% PIK, Due 12/31/22) ⁽⁷⁾ | 6,000 | 3,485 | 3,485 | 2.4% |
| | | | | <u>6,985</u> | <u>6,985</u> | <u>4.7%</u> |
| AmeriMark Direct, LLC | Consumer Products | First Lien Debt (14.3% Cash, Due 9/8/21) | 16,123 | 15,974 | 15,633 | 10.6% |
| | | | | <u>15,974</u> | <u>15,633</u> | <u>10.6%</u> |
| BigMouth, Inc. | Consumer Products | First Lien Debt (10.3% Cash (1 month LIBOR + 8.5%, 0.5% Floor), Due 11/14/21) ⁽⁸⁾ | 857 | 857 | 857 | 0.6% |
| BigMouth, Inc. | Consumer Products | First Lien Debt (10.2% Cash (1 month LIBOR + 8.5%, 0.5% Floor), Due 11/14/21) | 8,784 | 8,784 | 8,628 | 5.8% |
| | | | | <u>9,641</u> | <u>9,485</u> | <u>6.4%</u> |
| Bluestem Brands, Inc. | Online Merchandise Retailer | First Lien Debt (9.3% Cash (1 month LIBOR + 7.5%, 1.0% Floor), Due 11/7/20) | 3,529 | 3,529 | 2,877 | 1.9% |
| | | | | <u>3,529</u> | <u>2,877</u> | <u>1.9%</u> |
| Burke America Parts Group, LLC | Home Repair Parts Manufacturer | Membership Units (14 units) | | 5 | 2,489 | 1.7% |
| | | | | <u>5</u> | <u>2,489</u> | <u>1.7%</u> |
| CableOrganizer Acquisition, LLC | Computer Supply Retail | First Lien Debt ⁽⁹⁾ | | 1,532 | 1,490 | 1.0% |
| | | | | <u>1,532</u> | <u>1,490</u> | <u>1.0%</u> |
| California Pizza Kitchen, Inc. | Restaurant | Second Lien Debt (11.9% Cash (3 month LIBOR + 10.0%, 1.0% Floor), Due 8/23/23) | 5,000 | 4,927 | 4,697 | 3.2% |
| | | | | <u>4,927</u> | <u>4,697</u> | <u>3.2%</u> |
| Chicken Soup for the Soul, LLC | Multi-platform Media and Consumer Products | First Lien Debt (10.2% Cash (1 month LIBOR + 8.5%, 1.5% Floor), Due 12/13/20) | 13,000 | 13,000 | 13,000 | 8.8% |
| | | | | <u>13,000</u> | <u>13,000</u> | <u>8.8%</u> |
| Chief Fire Intermediate, Inc. | Security System Services | First Lien Debt (8.7% Cash (1 month LIBOR + 7.0%, 1.6% Floor), Due 11/8/24) | 8,100 | 8,100 | 8,100 | 5.5% |
| Chief Fire Intermediate, Inc. | Security System Services | Class A Preferred Units (34,740 units, 10.0% PIK Dividend) ⁽¹⁰⁾ | | 913 | 913 | 0.6% |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)

(in thousands, except for units/shares)

December 31, 2019

| Portfolio Company, Country ^{(1),(2),(3),(4),(5)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|---|------------------------------|--|------------------|--------|------------|-----------------|
| Chief Fire Intermediate, Inc. | Security System Services | Class B Common Units (3,510 units) | | \$ — | \$ — | 0.0% |
| | | | | 9,013 | 9,013 | 6.1% |
| CIS Secure Computing, Inc. | Government Services | First Lien Debt (10.2% Cash (1 month LIBOR + 8.5%, 1.0% Floor), 1.0% PIK, Due 9/14/22) | \$ 9,389 | 9,389 | 9,389 | 6.3% |
| CIS Secure Computing, Inc. | Government Services | Common Stock (46,163 shares) | | 1,000 | 1,890 | 1.3% |
| | | | | 10,389 | 11,279 | 7.6% |
| Corporate Visions, Inc. | Sales & Marketing Services | Subordinated Debt (9.0% Cash, 2.0% PIK, Due 11/29/21) | 19,327 | 19,327 | 18,962 | 12.8% |
| Corporate Visions, Inc. | Sales & Marketing Services | Common Stock (15,750 shares) | | 1,575 | 329 | 0.2% |
| | | | | 20,902 | 19,291 | 13.0% |
| Currency Capital, LLC | Financial Services | First Lien Debt (13.7% Cash (1 month LIBOR + 12.0%, 0.5% Floor), 2.0% PIK, Due 1/2/20) ⁽¹¹⁾ | 16,269 | 16,269 | 16,269 | 11.0% |
| Currency Capital, LLC | Financial Services | Class A Preferred Units (2,000,000 units) ⁽¹¹⁾ | | 2,000 | 2,504 | 1.7% |
| | | | | 18,269 | 18,773 | 12.7% |
| Flavors Holdings, Inc. | Food Product Manufacturer | First Lien Debt (7.7% Cash (3 month LIBOR + 5.8%, 1.0% Floor), Due 4/3/20) | 5,789 | 5,778 | 5,767 | 3.9% |
| Flavors Holdings, Inc. | Food Product Manufacturer | Second Lien Debt (11.9% Cash (3 month LIBOR + 10.0%, 1.0% Floor), Due 10/3/21) | 12,000 | 11,878 | 11,842 | 8.0% |
| | | | | 17,656 | 17,609 | 11.9% |
| Freedom Electronics, LLC | Electronic Machine Repair | First Lien Debt (8.7% Cash, Due 12/20/23) ⁽⁶⁾⁽¹²⁾ | 5,940 | 5,940 | 5,940 | 4.0% |
| Freedom Electronics, LLC | Electronic Machine Repair | Membership Units (181,818 units) | | 182 | 160 | 0.1% |
| | | | | 6,122 | 6,100 | 4.1% |
| HUMC Opco, LLC | Healthcare | First Lien Debt (9.0% Cash, Due 8/16/20) | 5,000 | 5,000 | 5,000 | 3.4% |
| | | | | 5,000 | 5,000 | 3.4% |
| Installs, LLC | Logistics | First Lien Debt (9.3% Cash, Due 6/20/23) ⁽⁶⁾ | 2,924 | 2,924 | 2,924 | 2.0% |
| | | | | 2,924 | 2,924 | 2.0% |
| J5 Infrastructure Partners, LLC | Wireless Deployment Services | First Lien Debt (8.3% Cash (1 month LIBOR + 6.5%, 1.8% Floor), Due 12/20/24) ⁽¹³⁾ | — | — | — | 0.0% |
| J5 Infrastructure Partners, LLC | Wireless Deployment Services | First Lien Debt (8.3% Cash (1 month LIBOR + 6.5%, 1.8% Floor), Due 12/20/24) | 7,000 | 7,000 | 7,000 | 4.7% |
| | | | | 7,000 | 7,000 | 4.7% |
| Jurassic Quest Holdings, LLC | Entertainment | First Lien Debt (9.5% Cash (1 month LIBOR + 7.5%, 2.0% Floor), Due 5/1/24) ⁽¹⁴⁾ | 10,827 | 10,827 | 10,827 | 7.3% |
| Jurassic Quest Holdings, LLC | Entertainment | Preferred Units (375,000 units) | | 388 | 85 | 0.1% |
| | | | | 11,215 | 10,912 | 7.4% |
| MicroHoldco, LLC | General Industrial | Preferred Units ⁽⁹⁾ | | 838 | 838 | 0.6% |
| | | | | 838 | 838 | 0.6% |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)
(in thousands, except for units/shares)
December 31, 2019

| Portfolio Company, Country ^{(1),(2),(3),(4),(5)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|---|---|--|------------------|------------------|------------------|-----------------|
| Portrait Studio, LLC | Professional and Personal Digital Imaging | First Lien Debt ⁽⁹⁾ | | \$ 510 | \$ 510 | 0.3% |
| | | | | 510 | 510 | 0.3% |
| Rapid Fire Protection, Inc. | Security System Services | First Lien Debt (9.2% Cash, Due 11/22/24) ⁽⁶⁾⁽¹⁵⁾ | \$ 6,550 | 6,550 | 6,550 | 4.4% |
| Rapid Fire Protection, Inc. | Security System Services | Common Stock (363 shares) | | 500 | 500 | 0.4% |
| | | | | 7,050 | 7,050 | 4.8% |
| Seitel, Inc. | Data Services | First Lien Debt (10.0% Cash (1 month LIBOR + 8.3%, 1.0% Floor), Due 3/15/23) | 4,749 | 4,749 | 4,749 | 3.2% |
| | | | | 4,749 | 4,749 | 3.2% |
| Sequoia Healthcare Management, LLC | Healthcare Management | First Lien Debt (12.8% Cash, Due 6/26/20) | 12,744 | 12,744 | 12,607 | 8.5% |
| | | | | 12,744 | 12,607 | 8.5% |
| Sur La Table, Inc. | Retail | First Lien Debt (10.9% Cash (3 month LIBOR + 9.0%, 1.0% Floor), Due 7/31/22) ⁽¹⁶⁾⁽¹⁷⁾ | 10,528 | 10,528 | 10,045 | 6.8% |
| | | | | 10,528 | 10,045 | 6.8% |
| Taylor Precision Products, Inc. | Household Product Manufacturer | Series C Preferred Stock (379 shares) | | 758 | 758 | 0.5% |
| | | | | 758 | 758 | 0.5% |
| U.S. BioTek Laboratories, LLC | Testing laboratories | First Lien Debt (9.3% Cash, Due 12/14/23) ⁽⁶⁾⁽¹²⁾ | 6,930 | 6,930 | 6,822 | 4.6% |
| U.S. BioTek Laboratories, LLC | Testing laboratories | Class A Preferred Units (500 Units) | | 540 | 204 | 0.1% |
| U.S. BioTek Laboratories, LLC | Testing laboratories | Class C Units (500 Units) | | 1 | — | 0.0% |
| | | | | 7,471 | 7,026 | 4.7% |
| U.S. Well Services, Inc. | Oil & Gas Services | Class A Common Stock (77,073 shares) ⁽¹¹⁾⁽¹⁸⁾ | | 771 | 146 | 0.1% |
| U.S. Well Services, Inc. | Oil & Gas Services | Class B Common Stock (1,125,426 shares) ⁽¹¹⁾⁽¹⁸⁾ | | 6,701 | 2,127 | 1.4% |
| | | | | 7,472 | 2,273 | 1.5% |
| Xirgo Technologies, LLC | Information Technology | Membership Units (600,000 units) | | 600 | 917 | 0.6% |
| | | | | 600 | 917 | 0.6% |
| Sub Total Non-control/non-affiliated investments – United States | | | | \$250,433 | \$241,046 | 162.8% |
| Affiliate Investments – 66.7% | | | | | | |
| Affiliate investments – United States | | | | | | |
| Burgaflex Holdings, LLC | Automobile Part Manufacturer | First Lien Debt (12.0% Cash, 3.0% PIK, Due 3/23/21) | \$ 14,421 | \$ 14,421 | \$ 14,421 | 9.7% |
| Burgaflex Holdings, LLC | Automobile Part Manufacturer | Common Stock Class B (1,085,073 shares) | | 362 | 635 | 0.4% |
| Burgaflex Holdings, LLC | Automobile Part Manufacturer | Common Stock Class A (1,253,198 shares) | | 1,504 | — | 0.0% |
| | | | | 16,287 | 15,056 | 10.1% |
| City Gear, LLC | Footwear Retail | Membership Unit Warrants ⁽⁹⁾ | | — | 3,326 | 2.2% |
| | | | | — | 3,326 | 2.2% |
| Eastport Holdings, LLC | Business Services | Subordinated Debt (14.9% Cash (3 month LIBOR + 13.0%, 0.5% Floor), Due 12/29/21) ⁽¹⁶⁾ | 16,500 | 16,155 | 16,500 | 11.2% |
| Eastport Holdings, LLC | Business Services | Membership Units (22.9% ownership) | | 3,263 | 17,822 | 12.0% |
| | | | | 19,418 | 34,322 | 23.2% |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)
(in thousands, except for units/shares)
December 31, 2019

| Portfolio Company, Country ^{(1),(2),(3),(4),(5)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|---|---|--|------------------|-----------------|-----------------|-----------------|
| GA Communications, Inc. | Advertising & Marketing Services | Series A-1 Preferred Stock (1,998 shares, 8.0% PIK Dividend) ⁽¹⁰⁾ | | \$ 3,476 | \$ 3,761 | 2.6% |
| GA Communications, Inc. | Advertising & Marketing Services | Series B-1 Common Stock (200,000 shares) | | 2 | 501 | 0.3% |
| | | | | 3,478 | 4,262 | 2.9% |
| LJS Partners, LLC | QSR Franchisor | Preferred Units (92,924 units) | | 293 | 372 | 0.3% |
| LJS Partners, LLC | QSR Franchisor | Common Membership Units (2,593,234 units) | | 1,224 | 1,509 | 1.0% |
| | | | | 1,517 | 1,881 | 1.3% |
| MMI Holdings, LLC | Medical Device Distributor | First Lien Debt (12.0% Cash, Due 1/31/21) ⁽¹⁶⁾ | \$ 2,600 | 2,600 | 2,600 | 1.8% |
| MMI Holdings, LLC | Medical Device Distributor | Subordinated Debt (6.0% Cash, Due 1/31/21) ⁽¹⁶⁾ | 400 | 388 | 400 | 0.3% |
| MMI Holdings, LLC | Medical Device Distributor | Preferred Units (1,000 units, 6.0% PIK Dividend) ⁽¹⁰⁾ | | 1,572 | 1,710 | 1.1% |
| MMI Holdings, LLC | Medical Device Distributor | Common Membership Units (45 units) | | — | 194 | 0.1% |
| | | | | 4,560 | 4,904 | 3.3% |
| Navis Holdings, Inc. | Textile Equipment Manufacturer | First Lien Debt (11.0% Cash, Due 6/30/23) ⁽¹⁶⁾ | 10,100 | 10,100 | 10,100 | 6.8% |
| Navis Holdings, Inc. | Textile Equipment Manufacturer | Class A Preferred Stock (1,000 shares, 10.0% Cash Dividend) ⁽¹⁰⁾ | | 1,000 | 1,000 | 0.7% |
| Navis Holdings, Inc. | Textile Equipment Manufacturer | Common Stock (60,000 shares) | | — | 464 | 0.3% |
| | | | | 11,100 | 11,564 | 7.8% |
| Nth Degree Investment Group, LLC | Business Services | Membership Units (6,088,000 Units) | | 6,088 | 6,088 | 4.1% |
| | | | | 6,088 | 6,088 | 4.1% |
| RAM Payment, LLC | Financial Services | First Lien Debt (10.0% Cash, Due 1/4/24) ⁽⁶⁾ | 9,019 | 9,019 | 9,019 | 6.1% |
| RAM Payment, LLC | Financial Services | Preferred Units (86,000 units, 8.0% PIK Dividend) ⁽¹⁰⁾ | | 928 | 1,725 | 1.2% |
| | | | | 9,947 | 10,744 | 7.3% |
| Sierra Hamilton Holdings Corporation | Oil & Gas Engineering and Consulting Services | Second Lien Debt (15.0% PIK, Due 9/12/23) | 782 | 748 | 748 | 0.5% |
| Sierra Hamilton Holdings Corporation | Oil & Gas Engineering and Consulting Services | Common Stock (15,068,000 shares) | | 6,958 | 5,160 | 3.5% |
| | | | | 7,706 | 5,908 | 4.0% |
| V12 Holdings, Inc. | Data Processing & Digital Marketing | Subordinated Debt ⁽⁹⁾ | | 655 | 708 | 0.5% |
| | | | | 655 | 708 | 0.5% |
| Sub Total Affiliate investments – United States | | | | \$80,756 | \$98,763 | 66.7% |
| Control Investments – 15.3% | | | | | | |
| Control investments – United States | | | | | | |
| Capitala Senior Loan Fund II, LLC | Investment Funds | Subordinated Debt (6.7% Cash (1 month LIBOR + 5.0%), Due 9/3/24) ⁽¹¹⁾⁽¹⁹⁾ | \$ — | \$ — | \$ — | 0.0% |
| Capitala Senior Loan Fund II, LLC | Investment Funds | Membership Units (80.0% ownership) ⁽¹¹⁾⁽²⁰⁾⁽²¹⁾ | | 13,600 | 13,631 | 9.2% |
| | | | | 13,600 | 13,631 | 9.2% |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)
(in thousands, except for units/shares)
December 31, 2019

| Portfolio Company, Country ^{(1),(2),(3),(4),(5)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|--|------------------------|---|-------------------------|-------------------------|-------------------------|------------------------|
| Vology, Inc. | Information Technology | First Lien Debt (10.5% Cash (1 month LIBOR + 8.5%, 2.0% Floor), Due 12/31/21) | \$ 3,877 | \$ 3,877 | \$ 3,877 | 2.6% |
| Vology, Inc. | Information Technology | Class A Preferred Units (9,041,810 Units) | | 5,215 | 5,215 | 3.5% |
| Vology, Inc. | Information Technology | Membership Units (5,363,982 Units) | | — | — | 0.0% |
| | | | | 9,092 | 9,092 | 6.1% |
| Sub Total Control investments – United States | | | | \$ 22,692 | \$ 22,723 | 15.3% |
| TOTAL INVESTMENTS – 244.8% | | | | <u>\$353,881</u> | <u>\$362,532</u> | <u>244.8%</u> |

- (1) All investments valued using unobservable inputs (Level 3), unless otherwise noted.
- (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 \$148,113 as of December 31, 2019.
- (5) Capitala Finance Corp. generally acquires its investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the “Securities Act”). These investments are generally subject to certain limitations on resale, and may be deemed to be “restricted securities” under the Security Act.
- (6) The cash rate equals the approximate current yield on our last-out portion of the unitranche facility.
- (7) The investment is convertible to preferred equity.
- (8) The investment has a \$2.6 million unfunded commitment.
- (9) The investment has been exited or sold. The residual value reflects estimated earnout, escrow, or other proceeds expected post-closing.
- (10) The equity investment is income producing, based on rate disclosed.
- (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, 2019, 8.1% of the Company’s total assets were non-qualifying assets.
- (12) The investment has a \$1.0 million unfunded commitment.
- (13) The investment has a \$3.5 million unfunded commitment.
- (14) The investment has a \$0.5 million unfunded commitment.
- (15) The investment has a \$4.5 million unfunded commitment.
- (16) The maturity date of the original investment has been extended.
- (17) The company may elect to have 1.5% of its cash interest capitalized as paid-in-kind interest.
- (18) Investment is valued using observable inputs (Level 1). The stock of the company is traded on the NASDAQ Capital Market under the ticker “USWS.”
- (19) The investment has a \$5.0 million unfunded commitment.
- (20) The investment has a \$6.4 million unfunded commitment.
- (21) The investment is valued based on the net asset value of the company.

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments
(in thousands, except for units/shares)
December 31, 2018

| Portfolio Company, Country ^{(1),(2),(3),(4),(19)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|---|--|--|------------------|---------------|---------------|-----------------|
| Non-control/non-affiliated investments – 150.4% | | | | | | |
| Non-control/non-affiliated investments – United States | | | | | | |
| 3 Bridge Solutions, LLC | IT Consulting | First Lien Debt (11.3% Cash (1 month LIBOR + 9.0%, 1.0% Floor), Due 12/4/22) | \$ 13,954 | \$13,954 | \$13,954 | 7.3% |
| 3 Bridge Solutions, LLC | IT Consulting | Preferred Units (965 units, 8.0% PIK) ⁽⁵⁾ | | 1,049 | 1,049 | 0.6% |
| 3 Bridge Solutions, LLC | IT Consulting | Membership Units (39,000 units) | | 10 | 230 | 0.1% |
| | | | | <u>15,013</u> | <u>15,233</u> | <u>8.0%</u> |
| Alternative Biomedical Solutions, LLC | Healthcare | First Lien Debt (9.5% Cash (1 month LIBOR + 7.0%, 1.0% Floor), Due 12/18/22) | 118 | 118 | 118 | 0.1% |
| Alternative Biomedical Solutions, LLC | Healthcare | First Lien Debt (12.4% Cash, Due 12/18/22) ⁽⁶⁾ | 13,000 | 13,000 | 10,370 | 5.4% |
| Alternative Biomedical Solutions, LLC | Healthcare | Membership Units (20,092 units) | | 800 | — | 0.0% |
| | | | | <u>13,918</u> | <u>10,488</u> | <u>5.5%</u> |
| American Clinical Solutions, LLC | Healthcare | First Lien Debt (10.5% Cash, 2.0% PIK, Due 6/11/20) ⁽⁷⁾ | 9,293 | 8,918 | 6,484 | 3.4% |
| | | | | <u>8,918</u> | <u>6,484</u> | <u>3.4%</u> |
| AmeriMark Direct, LLC | Consumer Products | First Lien Debt (12.8% Cash, Due 9/8/21) | 18,300 | 18,029 | 18,300 | 9.6% |
| | | | | <u>18,029</u> | <u>18,300</u> | <u>9.6%</u> |
| B&W Quality Growers, LLC | Farming | Membership Unit Warrants (91,739 Units) | | — | 5,880 | 3.1% |
| | | | | <u>—</u> | <u>5,880</u> | <u>3.1%</u> |
| BigMouth, Inc. | Consumer Products | First Lien Debt (14.3% Cash, Due 11/14/21) ⁽⁶⁾ | 9,094 | 9,094 | 9,094 | 4.8% |
| BigMouth, Inc. | Consumer Products | Series A Preferred Stock (350,000 shares, 8.0% PIK) ⁽⁵⁾ | | 411 | 352 | 0.2% |
| | | | | <u>9,505</u> | <u>9,446</u> | <u>5.0%</u> |
| Bluestem Brands, Inc. | Online Merchandise Retailer | First Lien Debt (10.0% Cash (1 month LIBOR + 7.5%, 1.0% Floor), Due 11/7/20) | 3,779 | 3,762 | 3,499 | 1.8% |
| | | | | <u>3,762</u> | <u>3,499</u> | <u>1.8%</u> |
| Burke America Parts Group, LLC | Home Repair Parts Manufacturer | Membership Units (14 units) | | 5 | 1,722 | 0.9% |
| | | | | <u>5</u> | <u>1,722</u> | <u>0.9%</u> |
| California Pizza Kitchen, Inc. | Restaurant | Second Lien Debt (12.5% Cash (1 month LIBOR + 10.0%, 1.0% Floor), Due 8/23/23) | 5,000 | 4,903 | 4,903 | 2.6% |
| | | | | <u>4,903</u> | <u>4,903</u> | <u>2.6%</u> |
| Cedar Ultimate Parent, LLC | Consumer Electronics | Series C Preferred Stock (4,759,250 units) | | 958 | — | 0.0% |
| Cedar Ultimate Parent, LLC | Consumer Electronics | Series D Preferred Stock (16,562,190 units) | | — | — | 0.0% |
| Cedar Ultimate Parent, LLC | Consumer Electronics | Series E Common Units (190,370 units) | | — | — | 0.0% |
| | | | | <u>958</u> | <u>—</u> | <u>0.0%</u> |
| Chicken Soup for the Soul, LLC | Multi-platform Media and Consumer Products | First Lien Debt (10.9% Cash (1 month LIBOR + 8.5%, 1.5% Floor), Due 12/13/20) | 13,000 | 13,000 | 13,000 | 6.8% |
| | | | | <u>13,000</u> | <u>13,000</u> | <u>6.8%</u> |
| CIS Secure Computing, Inc. | Government Services | First Lien Debt (10.8% Cash (1 month LIBOR + 8.5%, 1.0% Floor), 1.0% PIK, Due 9/14/22) | 10,428 | 10,428 | 10,428 | 5.5% |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)

(in thousands, except for units/shares)

December 31, 2018

| Portfolio Company, Country ^{(1),(2),(3),(4),(19)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|--|----------------------------------|---|------------------|----------|------------|-----------------|
| CIS Secure Computing, Inc. | Government Services | Common Stock (46,163 shares) | | \$ 1,000 | \$ 1,681 | 0.9% |
| | | | | 11,428 | 12,109 | 6.4% |
| Corporate Visions, Inc. | Sales & Marketing Services | Subordinated Debt (9.0% Cash, 2.0% PIK, Due 11/29/21) | \$ 18,940 | 18,940 | 18,679 | 9.8% |
| Corporate Visions, Inc. | Sales & Marketing Services | Common Stock (15,750 shares) | | 1,575 | 817 | 0.4% |
| | | | | 20,515 | 19,496 | 10.2% |
| Currency Capital, LLC | Financial Services | First Lien Debt (13.4% Cash (1 month LIBOR + 11.0%, 0.5% Floor), Due 1/2/20) ⁽⁸⁾ | 16,788 | 16,788 | 16,788 | 8.8% |
| Currency Capital, LLC | Financial Services | Class A Preferred Units (2,000,000 units) ⁽⁸⁾ | | 2,000 | 2,000 | 1.0% |
| | | | | 18,788 | 18,788 | 9.8% |
| Flavors Holdings, Inc. | Food Product Manufacturer | First Lien Debt (8.6% Cash (3 month LIBOR + 5.8%, 1.0% Floor), Due 4/3/20) | 6,300 | 6,241 | 6,070 | 3.2% |
| Flavors Holdings, Inc. | Food Product Manufacturer | Second Lien Debt (12.8% Cash (3 month LIBOR + 10.0%, 1.0% Floor), Due 10/3/21) | 12,000 | 11,809 | 11,265 | 5.9% |
| | | | | 18,050 | 17,335 | 9.1% |
| Freedom Electronics, LLC | Electronic Machine Repair | First Lien Debt (8.7% Cash (1 month LIBOR + 6.3%, 2.0% Floor), Due 12/20/23) ⁽⁹⁾ | 250 | 250 | 250 | 0.1% |
| Freedom Electronics, LLC | Electronic Machine Repair | First Lien Debt (9.1% Cash, Due 12/20/23) ⁽⁶⁾ | 6,000 | 6,000 | 6,000 | 3.1% |
| Freedom Electronics, LLC | Electronic Machine Repair | Membership Units (181,818 units) | | 182 | 182 | 0.1% |
| | | | | 6,432 | 6,432 | 3.3% |
| Installs, LLC | Logistics | First Lien Debt (9.3% Cash (1 month LIBOR + 7.0%, 1.8% Floor), Due 6/20/23) | 2,984 | 2,984 | 2,984 | 1.6% |
| | | | | 2,984 | 2,984 | 1.6% |
| MC Sign Lessor Corp. | Advertising & Marketing Services | First Lien Debt (9.3% Cash (1 month LIBOR + 7.0%, 1.0% Floor), Due 12/22/22) ⁽¹⁰⁾ | — | — | — | 0.0% |
| MC Sign Lessor Corp. | Advertising & Marketing Services | First Lien Debt (9.3% Cash (1 month LIBOR + 7.0%, 1.0% Floor), Due 12/22/22) ⁽¹¹⁾ | 3,905 | 3,905 | 3,905 | 2.0% |
| | | | | 3,905 | 3,905 | 2.0% |
| Nth Degree, Inc. | Business Services | First Lien Debt (13.9% Cash (1 month LIBOR + 11.5%, 1.0% Floor), 2.0% PIK, Due 3/29/23) ⁽¹²⁾ | 7,346 | 7,346 | 7,346 | 3.9% |
| Nth Degree, Inc. | Business Services | Preferred Stock (2,400 Units, 10.0% PIK dividend) ⁽⁵⁾ | | 3,244 | 16,490 | 8.6% |
| | | | | 10,590 | 23,836 | 12.5% |
| Sequoia Healthcare Management, LLC | Healthcare Management | First Lien Debt (10.8% Cash (1 month LIBOR + 8.5%, 1.8% Floor), Due 8/21/23) | 13,792 | 13,792 | 13,792 | 7.2% |
| | | | | 13,792 | 13,792 | 7.2% |
| Sunset Digital Holdings, LLC | Telecommunications | First Lien Debt (9.6% Cash (1 month LIBOR + 7.3%, 1.5% Floor), Due 8/2/19) | 18,000 | 18,000 | 18,000 | 9.4% |
| | | | | 18,000 | 18,000 | 9.4% |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)

(in thousands, except for units/shares)

December 31, 2018

| Portfolio Company, Country ^{(1),(2),(3),(4),(19)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|---|----------------------------------|--|------------------|------------------|------------------|-----------------|
| Sur La Table, Inc. | Retail | First Lien Debt (12.0% Cash, Due 7/28/20) | \$ 15,000 | \$ 15,000 | \$ 14,979 | 7.9% |
| | | | | 15,000 | 14,979 | 7.9% |
| Taylor Precision Products, Inc. | Household Product Manufacturer | Series C Preferred Stock (379 shares) | | 758 | 758 | 0.4% |
| | | | | 758 | 758 | 0.4% |
| U.S. BioTek Laboratories, LLC | Testing laboratories | First Lien Debt (10.1% Cash, Due 12/14/23) ⁽⁶⁾⁽¹³⁾ | 7,000 | 7,000 | 7,000 | 3.7% |
| U.S. BioTek Laboratories, LLC | Testing laboratories | Class A Preferred Units (500 Units, 10.0% PIK) ⁽⁵⁾ | | 502 | 502 | 0.3% |
| U.S. BioTek Laboratories, LLC | Testing laboratories | Class C Units (500 Units) | | 1 | 1 | 0.0% |
| | | | | 7,503 | 7,503 | 4.0% |
| U.S. Well Services, Inc. | Oil & Gas Services | Class A Common Stock (77,073 shares) ⁽⁸⁾ | | 771 | 632 | 0.3% |
| U.S. Well Services, Inc. | Oil & Gas Services | Class B Common Stock (1,125,426 shares) ⁽⁸⁾ | | 6,701 | 9,229 | 4.9% |
| | | | | 7,472 | 9,861 | 5.2% |
| Vology, Inc. | Information Technology | Subordinated Debt (15.0% Cash (1 month LIBOR + 14.0%, 1.0% Ceiling), 4.0% PIK Due 6/30/20) | 8,720 | 8,720 | 8,645 | 4.5% |
| | | | | 8,720 | 8,645 | 4.5% |
| Xirgo Technologies, LLC | Information Technology | Subordinated Debt (11.5% Cash, Due 3/1/22) | 15,750 | 15,750 | 15,750 | 8.3% |
| Xirgo Technologies, LLC | Information Technology | Membership Units (600,000 units) | | 600 | 837 | 0.4% |
| | | | | 16,350 | 16,587 | 8.7% |
| Sub Total Non-control/non-affiliated investments – United States | | | | 268,298 | 283,965 | 148.9% |
| Non-control/non-affiliated investments – Brazil | | | | | | |
| Velum Global Credit Management, LLC | Financial Services | First Lien Debt (15.0% PIK, Due 12/31/17) ⁽⁷⁾⁽⁸⁾⁽¹²⁾ | 14,277 | 11,816 | 2,878 | 1.5% |
| | | | | 11,816 | 2,878 | 1.5% |
| Sub Total Non-control/non-affiliated investments – Brazil | | | | 11,816 | 2,878 | 1.5% |
| Sub Total Non-control/non-affiliated investments | | | | \$280,114 | \$286,843 | 150.4% |
| Affiliate Investments – 48.8% | | | | | | |
| Affiliate investments – United States | | | | | | |
| Burgaflex Holdings, LLC | Automobile Part Manufacturer | First Lien Debt (12.0% Cash, 1.0% PIK, Due 3/23/21) | \$ 14,801 | \$ 14,801 | \$ 14,384 | 7.5% |
| Burgaflex Holdings, LLC | Automobile Part Manufacturer | Common Stock Class A (1,253,198 shares) | | 1,504 | — | 0.0% |
| Burgaflex Holdings, LLC | Automobile Part Manufacturer | Common Stock Class B (900,000 shares) | | 300 | — | 0.0% |
| | | | | 16,605 | 14,384 | 7.5% |
| City Gear, LLC | Footwear Retail | Membership Unit Warrants (11.4% fully diluted) ⁽¹⁴⁾ | | — | 3,184 | 1.7% |
| | | | | — | 3,184 | 1.7% |
| Eastport Holdings, LLC | Business Services | Subordinated Debt (15.8% Cash (3 month LIBOR + 13.0%, 0.5% Floor), Due 4/29/20) | 16,500 | 15,496 | 16,500 | 8.7% |
| Eastport Holdings, LLC | Business Services | Membership Units (22.9% ownership) | | 3,263 | 17,610 | 9.2% |
| | | | | 18,759 | 34,110 | 17.9% |
| GA Communications, Inc. | Advertising & Marketing Services | Series A-1 Preferred Stock (1,998 shares, 8.0% PIK Dividend) ⁽⁵⁾ | | 3,179 | 3,482 | 1.8% |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)
(in thousands, except for units/shares)
December 31, 2018

| Portfolio Company, Country ^{(1),(2),(3),(4),(19)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|---|---|---|-------------------------|-----------------|-------------------|------------------------|
| GA Communications, Inc. | Advertising & Marketing Services | Series B-1 Common Stock (200,000 shares) | | \$ 2 | \$ 1,325 | 0.7% |
| | | | | 3,181 | 4,807 | 2.5% |
| J&J Produce Holdings, Inc. | Produce Distribution | Subordinated Debt (13.0% Cash, Due 6/16/19) ⁽¹²⁾ | \$ 6,406 | 6,406 | 6,210 | 3.3% |
| 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% |
| | | | | 7,224 | 6,210 | 3.3% |
| LJS Partners, LLC | QSR Franchisor | Common Stock (1,587,848 shares) | | 1,188 | 3,018 | 1.6% |
| | | | | 1,188 | 3,018 | 1.6% |
| MMI Holdings, LLC | Medical Device Distributor | First Lien Debt (12.0% Cash, Due 1/31/20) ⁽¹²⁾ | 2,600 | 2,600 | 2,600 | 1.4% |
| MMI Holdings, LLC | Medical Device Distributor | Subordinated Debt (6.0% Cash, Due 1/31/20) ⁽¹²⁾ | 400 | 388 | 400 | 0.2% |
| MMI Holdings, LLC | Medical Device Distributor | Preferred Units (1,000 units, 6.0% PIK Dividend) ⁽⁵⁾ | | 1,474 | 1,612 | 0.8% |
| MMI Holdings, LLC | Medical Device Distributor | Common Membership Units (45 units) | | — | 185 | 0.1% |
| | | | | 4,462 | 4,797 | 2.5% |
| Sierra Hamilton Holdings Corporation | Oil & Gas Engineering and Consulting Services | Common Stock (15,068,000 shares) | | 6,958 | 6,854 | 3.6% |
| | | | | 6,958 | 6,854 | 3.6% |
| US Bath Group, LLC | Building Products | First Lien Debt (11.4% Cash (1 month LIBOR + 9.0%, 1.0% Floor), Due 1/2/23) | 12,750 | 12,750 | 12,750 | 6.7% |
| US Bath Group, LLC | Building Products | Membership Units (500,000 units) | | 500 | 2,083 | 1.1% |
| | | | | 13,250 | 14,833 | 7.8% |
| V12 Holdings, Inc. | Data Processing & Digital Marketing | Subordinated Debt ⁽¹⁵⁾ | — | 673 | 742 | 0.4% |
| | | | | 673 | 742 | 0.4% |
| Sub Total Affiliate investments – United States | | | | \$72,300 | \$92,939 | 48.8% |
| Control Investments – 36.3% | | | | | | |
| Control investments – United States | | | | | | |
| AAE Acquisition, LLC | Industrial Equipment Rental | Second Lien Debt (6.0% Cash, Due 8/24/19) ⁽¹²⁾ | \$ 16,327 | \$16,327 | \$16,327 | 8.6% |
| AAE Acquisition, LLC | Industrial Equipment Rental | Membership Units (2.2% fully diluted) | | 17 | — | 0.0% |
| AAE Acquisition, LLC | Industrial Equipment Rental | Warrants (37.8% fully diluted) | | — | — | 0.0% |
| | | | | 16,344 | 16,327 | 8.6% |
| CableOrganizer Acquisition, LLC | Computer Supply Retail | First Lien Debt (10.0% Cash, Due 5/24/19) ⁽¹⁶⁾ | 1,708 | 1,708 | 1,708 | 0.9% |
| CableOrganizer Acquisition, LLC | Computer Supply Retail | First Lien Debt (12.0% Cash, 4.0% PIK, Due 6/30/19) ⁽¹²⁾ | 8,889 | 8,889 | 8,889 | 4.6% |
| CableOrganizer Acquisition, LLC | Computer Supply Retail | Preferred Units (4,000,000 units) | | 2,354 | — | 0.0% |
| CableOrganizer Acquisition, LLC | Computer Supply Retail | Common Stock (21.3% fully diluted) | | 1,394 | — | 0.0% |
| CableOrganizer Acquisition, LLC | Computer Supply Retail | Common Stock Warrants (10.0% fully diluted) | | — | — | 0.0% |
| | | | | 14,345 | 10,597 | 5.5% |

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)
(in thousands, except for units/shares)
December 31, 2018

| Portfolio Company, Country ^{(1),(2),(3),(4),(19)} | Industry | Type of Investment | Principal Amount | Cost | Fair Value | % of Net Assets |
|---|---|--|-------------------------|------------------|-------------------|------------------------|
| Capitala Senior Loan Fund II, LLC | Investment Funds | Membership Units (80.0% ownership) ⁽⁸⁾⁽¹⁷⁾ | | \$ 13,600 | \$ 13,695 | 7.2% |
| | | | | 13,600 | 13,695 | 7.2% |
| Micro Precision, LLC | Conglomerate | Subordinated Debt (10.0% Cash, Due 1/1/19) ⁽¹²⁾ | \$ 1,862 | 1,862 | 1,862 | 1.0% |
| Micro Precision, LLC | Conglomerate | Subordinated Debt (14.0% Cash, 4.0% PIK, Due 1/1/19) ⁽¹²⁾ | 4,325 | 4,325 | 4,325 | 2.3% |
| Micro Precision, LLC | Conglomerate | Series A Preferred Units (47 units) | | 1,629 | 2,817 | 1.5% |
| | | | | 7,816 | 9,004 | 4.8% |
| Navis Holdings, Inc. | Textile Equipment Manufacturer | First Lien Debt (15.0% Cash, Due 10/30/20) ⁽¹²⁾ | 7,500 | 7,500 | 7,500 | 3.9% |
| Navis Holdings, Inc. | Textile Equipment Manufacturer | Class A Preferred Stock (1,000 shares, 10.0% Cash Dividend) ⁽⁵⁾ | | 1,000 | 1,000 | 0.5% |
| Navis Holdings, Inc. | Textile Equipment Manufacturer | Common Stock (300,000 shares) | | 1 | 4,348 | 2.3% |
| | | | | 8,501 | 12,848 | 6.7% |
| Portrait Studio, LLC | Professional and Personal Digital Imaging | First Lien Debt (9.0% Cash (1 month LIBOR + 7.0%, 1.0% Floor, 2.0% Ceiling), Due 12/31/22) ⁽¹⁸⁾ | — | — | — | 0.0% |
| Portrait Studio, LLC | Professional and Personal Digital Imaging | First Lien Debt (9.4% Cash (1 month LIBOR + 7.0%, 1.0% Floor, 5.0% Ceiling), Due 12/31/22) | 4,500 | 4,500 | 4,500 | 2.4% |
| Portrait Studio, LLC | Professional and Personal Digital Imaging | Preferred Units (4,350,000 Units) | | 2,450 | 2,174 | 1.1% |
| Portrait Studio, LLC | Professional and Personal Digital Imaging | Membership Units (150,000 Units) | | — | — | 0.0% |
| | | | | 6,950 | 6,674 | 3.5% |
| Sub Total Control investments – United States | | | | \$ 67,556 | \$ 69,145 | 36.3% |
| TOTAL INVESTMENTS – 235.5% | | | | \$419,970 | \$448,927 | 235.5% |

- (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 \$190,644 as of December 31, 2018.
- (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) 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, 2018, 9.2% of the Company’s total assets were non-qualifying assets.
- (9) The investment has a \$0.8 million unfunded commitment.
- (10) The investment has a \$0.5 million unfunded commitment.
- (11) The investment has a \$0.6 million unfunded commitment.
- (12) The maturity date of the original investment has been extended.

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.

Consolidated Schedule of Investments – (continued)

(in thousands, except for units/shares)

December 31, 2018

- (13) The investment has a \$1.0 million unfunded commitment.
- (14) The investment has been exited. The residual value reflects estimated earnout to be settled post-closing.
- (15) The investment has been exited. The residual value reflects estimated escrow and earnout to be settled post-closing.
- (16) The investment has a \$0.3 million unfunded commitment.
- (17) The investment has a \$6.4 million unfunded commitment.
- (18) The investment has a \$5.0 million unfunded commitment.
- (19) Capitala Finance Corp. generally acquires its investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the “Securities Act”). These investments are generally subject to certain limitations on resale, and may be deemed to be “restricted securities” under the Securities Act.

See accompanying notes to consolidated financial statements.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

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 commenced operations on May 24, 2013 and completed its initial public offering (“IPO”) on September 30, 2013. The Company is managed by Capitala Investment Advisors, LLC (the “Investment Advisor”), an investment adviser that is registered as an investment adviser under the Investment Advisers Act of 1940, as amended, and Capitala Advisors Corp. (the “Administrator”) provides the administrative services necessary for the Company to operate. For United States (“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 subsidiary that is 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 the Company and was legally dissolved as a standalone partnership. On March 1, 2019, Fund II repaid its outstanding SBA debentures and relinquished its SBIC license.

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. The 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

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

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

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, and the Taxable Subsidiaries.

The Company’s financial statements as of December 31, 2019 and 2018 and for the years ended December 31, 2019, 2018 and 2017 are presented on a consolidated basis. The effects of all intercompany transactions between the Company and its subsidiaries (Fund II, Fund III, 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 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, and the Taxable Subsidiaries) in its consolidated financial statements. The Company does not consolidate its interest in Capitala Senior Loan Fund II, LLC (“CSLF II”) because the investment is not considered a substantially wholly owned investment company subsidiary. Further, CSLF II is a joint venture for which shared power exists relating to the decisions that most significantly impact the economic performance of the entity. See Note 4 to the consolidated financial statements for a description of the Company’s investment in CSLF II.

Segments

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

Cash and Cash Equivalents

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

Investment Classification

In accordance with the provisions of the 1940 Act, the Company classifies its investments by level of control. As defined in the 1940 Act, “Control Investments” are investments in those companies that the Company is deemed to “Control.” “Affiliate Investments” are investments in those companies that are

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

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

“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.

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

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

transaction price is typically the best estimate of fair value at inception. When evidence supports a subsequent change to the carrying value from the original transaction price, adjustments are made to reflect the expected fair values.

As a practical expedient, the Company uses net asset value (“NAV”) as the fair value for its equity investment in CSLF II. CSLF II records its underlying investments at fair value on a quarterly basis in accordance with the 1940 Act and ASC 820.

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 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.

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.

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

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

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 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 PIK dividend 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.

Guarantees

The Company follows the guidance of ASC Topic 460—*Guarantees* ("ASC 460"). ASC 460 elaborates on the disclosure requirements of a guarantor in its interim and annual consolidated financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at

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

the inception of a guarantee, for those guarantees that are covered by ASC 460, the fair value of the obligation undertaken in issuing certain guarantees.

General and Administrative Expenses

General and administrative expenses are accrued as incurred. The Company's administrative expenses include personnel and overhead expenses allocable to the Company 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.

Earnings per share

The Company's earnings per share ("EPS") amounts have been computed based on the weighted-average number of shares of common stock outstanding for the period. Basic EPS is computed by dividing net increase (decrease) in net assets resulting from operations by the weighted average number of shares of common stock outstanding during the period of computation. Diluted EPS is computed by dividing net increase (decrease) in net assets resulting from operations, adjusted for the change in net assets resulting from the exercise of the dilutive shares, by the weighted average number of shares of common stock assuming all potentially dilutive shares had been issued. Diluted EPS reflects the potential dilution using the as-if-converted method for convertible debt, which could occur if all potentially dilutive securities were exercised.

Commitments and Contingencies

As of December 31, 2019, the Company had outstanding unfunded commitments related to debt and equity investments in existing portfolio companies of \$11.4 million (CSLF II), \$4.5 million (Rapid Fire Protection, Inc), \$3.5 million (J5 Infrastructure Partners, LLC), \$2.6 million (BigMouth, Inc.), \$1.0 million (Freedom Electronics, LLC), \$1.0 million (U.S. BioTek Laboratories, LLC), and \$0.5 million (Jurassic Quest Holdings, LLC). As of December 31, 2018, the Company had outstanding unfunded commitments related to debt and equity investments in existing portfolio companies of \$6.4 million (CSLF II), \$5.0 million (Portrait Studio, LLC), \$1.1 million (MC Sign Lessor, Corp), \$1.0 million (U.S. BioTek Laboratories, LLC), \$0.8 million (Freedom Electronics, LLC), and \$0.3 million (CableOrganizer Acquisition, LLC).

The Company may invest in the same unitranche facility as CSLF II whereby CSLF II provides the first-out portion of the unitranche facility and the Company and other lenders provide the last-out portion of the unitranche facility. Under a guarantee agreement, the Company may be required to purchase its pro-rata portion of first-out loans from CSLF II upon certain triggering events, including acceleration upon payment default of the underlying borrower. As of December 31, 2019, the Company has evaluated the fair value of the guarantee under the guidance of ASC Topic 460 — *Guarantees* and determined that the fair value of the guarantee is immaterial as the risk of payment default for first-out loans in CSLF II is considered remote. The maximum exposure to credit risk as of December 31, 2019 and 2018, was \$10.3 million and \$4.3 million, respectively, and extends to the stated maturity of the underlying loans in CSLF II.

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.

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

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. The nature of litigation can make it difficult to predict the impact a particular lawsuit will have on the Company. There are many reasons that the Company cannot make these assessments, including, among others, one or more of the following: the proceeding is in its early stages; the damages sought are unspecified, unsupported, unexplained or uncertain; discovery has not started or is not complete; there are significant facts in dispute; and there are other parties who may share in any ultimate liability.

In management's opinion, no direct losses with respect to litigation contingencies were probable as of December 31, 2019 and 2018. 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.

In 2017, the Company elected to amend its tax year end from August 31 to December 31 and filed a tax return for the four months ended December 31, 2017. The tax periods ended December 31, 2019, December 31, 2018, December 31, 2017, and August 31, 2017 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, 2019, 2018 and 2017. 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.

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, 2019 and 2018, the Company recorded a net deferred tax asset of \$0.0 and \$0.6 million, respectively. For the years ended December 31, 2019, 2018, and 2017, the Company recorded a deferred tax benefit (provision) of \$(0.6) million, \$1.9 million, and \$(1.3) million, respectively. As of December 31, 2019 and 2018, the valuation allowance on the Company's deferred tax asset was \$3.2 million and \$0.4 million, respectively. For the years ended December 31, 2019, 2018, and 2017, the Company recognized an increase in the valuation allowance of \$2.8 million, \$0.0 million, and \$0.4 million, respectively.

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

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 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 \$13.4 million, \$16.0 million, \$6.1 million, and \$25.2 million during the tax periods ended December 31, 2019, December 31, 2018, December 31, 2017, and August 31, 2017, respectively. For income tax purposes, the Company has paid distributions on its common stock that were accounted for as a return of capital in the amount of \$2.7 million for the tax year ended December 31, 2019. For the tax periods ended December 31, 2018, December 31, 2017, and August 31, 2017, there was no return of capital.

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, 2019 and 2018, 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.

Distributions

Distributions to common stockholders are recorded on the record 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

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

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 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 August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2018-13, Disclosure Framework—Changes to the Disclosure Requirement for Fair Value Measurement. The FASB issued the amendments as part of the disclosure framework project which is intended to improve the effectiveness of fair value disclosures in the notes to the financial statements by facilitating clear communication of the information required by U.S. GAAP that is most important to users of the financial statements. The standard is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2019. Management has evaluated the impact of adoption of ASU 2018-13 and determined that these changes will not have a significant impact on the Company's consolidated financial statements and disclosures.

In October 2018, the SEC adopted amendments (the "Amendments") to certain disclosure requirements that have become redundant, duplicative, overlapping, outdated, or superseded, in light of other SEC disclosure requirements, U.S. GAAP requirements, or changes in the information environment. In part, the Amendments require an investment company to present distributable earnings in total, rather than showing the three components of distributable earnings. The compliance date for the Amendments is for all filings on or after November 5, 2018. Management has adopted the Amendments and included the required disclosures in the Company's consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (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

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Note 3. Recent Accounting Pronouncements – (continued)

entitled in exchange for those goods or services. The new guidance significantly enhances 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 became effective for the annual reporting period beginning January 1, 2018, including interim periods within that reporting period. The Company completed its assessment in evaluating the potential impact on its consolidated financial statements and based on its 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 were no material changes to the recognition, timing, and classification of revenues and expenses; additionally, the Company's management determined that the adoption of ASU 2014-09 did not have a significant impact on its consolidated financial statement disclosures.

Note 4. Investments and Fair Value Measurements

The Company's investment objective is to generate both current income and capital appreciation through debt and equity investments. 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. As of December 31, 2019, our portfolio consisted of investments in 43 portfolio companies with a fair value of approximately \$362.5 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, delayed draw facilities, or revolving credit 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, 2019, 18.1% of the fair value of our first lien loans consisted of last-out loans. As of December 31, 2018, 13.7% of the fair value 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, but 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, 2019, the Company made approximately \$77.8 million of investments and had approximately \$128.1 million in repayments and sales resulting in net repayments and sales of approximately \$50.3 million for the year. During the year ended December 31, 2018, the Company made approximately \$107.8 million of investments and had approximately \$123.5 million in repayments and sales resulting in net repayments and sales of approximately \$15.7 million for the year. 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.

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

During the year ended December 31, 2019, the Company funded \$6.7 million of previously committed capital to existing portfolio companies. During the year ended December 31, 2019, the Company funded \$71.1 million of investments in portfolio companies for which it was not previously committed to fund. During the year ended December 31, 2018, the Company funded \$6.5 million of previously committed capital to existing portfolio companies. During the year ended December 31, 2018, the Company funded \$101.3 million of investments in portfolio companies for which it was not previously committed to fund. 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 years ended December 31, 2019 and 2018, the Company did not assist any portfolio companies in obtaining indirect 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 years ended December 31, 2019, 2018, and 2017, the Company did not lead any syndicates.

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. On August 27, 2018, FSC II exercised its option at the agreed upon strike price of \$1.5 million.

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 composition of our investments as of December 31, 2019, 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 | \$235,646 | 66.6% | \$231,203 | 63.8% |
| Second Lien Debt | 17,553 | 5.0 | 17,287 | 4.7 |
| Subordinated Debt | 36,526 | 10.3 | 36,570 | 10.1 |
| Equity and Warrants | 50,556 | 14.3 | 63,841 | 17.6 |
| Capitala Senior Loan Fund II, LLC | 13,600 | 3.8 | 13,631 | 3.8 |
| Total | <u>\$353,881</u> | <u>100.0%</u> | <u>\$362,532</u> | <u>100.0%</u> |

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

The composition of our investments as of December 31, 2018, 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 | \$252,174 | 60.0% | \$237,570 | 52.9% |
| Second Lien Debt | 33,040 | 7.9 | 32,495 | 7.2 |
| Subordinated Debt | 72,562 | 17.3 | 73,113 | 16.3 |
| Equity and Warrants | 48,594 | 11.6 | 92,054 | 20.5 |
| Capitala Senior Loan Fund II, LLC | 13,600 | 3.2 | 13,695 | 3.1 |
| Total | <u>\$419,970</u> | <u>100.0%</u> | <u>\$448,927</u> | <u>100.0%</u> |

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

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

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

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

In addition to using the above inputs in investment valuations, the Company continues to employ the valuation policy approved by the Board that is consistent with ASC 820 (see Note 2). Consistent with 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.

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

The following table presents the fair value measurements of investments, by major class, as of December 31, 2019 (dollars in thousands), according to the fair value hierarchy:

| | Fair Value Measurements ⁽¹⁾ | | | |
|---------------------|--|-------------|-------------------|-------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| First Lien Debt | \$ — | \$ — | \$ 231,203 | \$ 231,203 |
| Second Lien Debt | — | — | 17,287 | 17,287 |
| Subordinated Debt | — | — | 36,570 | 36,570 |
| Equity and Warrants | 2,273 | — | 61,568 | 63,841 |
| Total | \$ 2,273 | \$ — | \$ 346,628 | \$ 348,901 |

(1) Excludes our \$13.6 million investment in CSLF II, measured at NAV.

The following table presents the fair value measurements of investments, by major class, as of December 31, 2018 (dollars in thousands), according to the fair value hierarchy:

| | Fair Value Measurements ⁽¹⁾ | | | |
|---------------------|--|-------------|-------------------|-------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| First Lien Debt | \$ — | \$ — | \$ 237,570 | \$ 237,570 |
| Second Lien Debt | — | — | 32,495 | 32,495 |
| Subordinated Debt | — | — | 73,113 | 73,113 |
| Equity and Warrants | — | — | 92,054 | 92,054 |
| Total | \$ — | \$ — | \$ 435,232 | \$ 435,232 |

(1) Excludes our \$13.7 million investment in CSLF II, measured at NAV.

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, 2019 (dollars in thousands):

| | First Lien Debt | Second Lien Debt | Subordinated Debt | Equity and Warrants | Total |
|---|-------------------|------------------|-------------------|---------------------|-------------------|
| Balance as of January 1, 2019 | \$ 237,570 | \$ 32,495 | \$ 73,113 | \$ 92,054 | \$ 435,232 |
| Reclassifications | (2,773) | — | (5,215) | 7,988 | — |
| Repayments/sales | (65,495) | — | (27,843) | (34,784) | (128,122) |
| Purchases | 70,184 | 4,511 | — | 3,136 | 77,831 |
| Payment in-kind interest and dividends accrued | 1,173 | 317 | 652 | 820 | 2,962 |
| Accretion of original issue discount | 241 | 96 | 659 | — | 996 |
| Realized gain (loss) from investments | (19,859) | (20,411) | (4,288) | 24,802 | (19,756) |
| Net unrealized appreciation (depreciation) on investments | 10,162 | 279 | (508) | (22,587) | (12,654) |
| Transfers out of Level 3 | — | — | — | (9,861) | (9,861) |
| Balance as of December 31, 2019 | \$ 231,203 | \$ 17,287 | \$ 36,570 | \$ 61,568 | \$ 346,628 |

(1) Excludes our \$13.6 million investment in CSLF II, measured at NAV.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

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

- (2) The Company's investment in U.S. Well Services, Inc. is traded on the NASDAQ Capital Market under the ticker "USWS". Because the Company's investment is now traded in an active market, the Company has reclassified its investment in U.S. Well Services, Inc. from Level 3 to Level 1 of the fair value hierarchy. Transfers between levels, if any, are recognized at the beginning of the period in which transfers occur. The unrealized depreciation on the Company's investment in U.S. Well Services, Inc. for the year ended December 31, 2019 was \$(7.6) million.

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, 2018 (dollars in thousands):

| | First Lien Debt | Second Lien Debt | Subordinated Debt | Equity and Warrants | Total ⁽¹⁾ |
|--|--------------------|---------------------|----------------------|------------------------|----------------------|
| Balance as of January 1, 2018 | \$243,489 | \$30,794 | \$103,385 | \$122,271 | \$499,939 |
| Reclassifications | 16,723 | — | (20,806) | 4,083 | — |
| Repayments/sales | (95,294) | — | (8,463) | (19,760) | (123,517) |
| Purchases | 92,421 | — | — | 1,781 | 94,202 |
| Payment in-kind interest and dividends accrued | 1,712 | 482 | 1,337 | 817 | 4,348 |
| Accretion of original issue discount | 264 | 93 | 757 | — | 1,114 |
| Realized gain (loss) from investments | (20,799) | — | (20,499) | 6,494 | (34,804) |
| Net unrealized appreciation (depreciation) on investments | (946) | 1,126 | 17,402 | (23,632) | (6,050) |
| Balance as of December 31, 2018 | <u>\$237,570</u> | <u>\$32,495</u> | <u>\$73,113</u> | <u>\$92,054</u> | <u>\$435,232</u> |

- (1) Excludes our \$13.7 million investment in CSLF II, measured at NAV.

The following table provides a reconciliation of the beginning and ending balances for the Written Call Option that use Level 3 inputs for the year ended December 31, 2018 (dollars in thousands):

| | Written Call Option |
|--|------------------------|
| Balance as of January 1, 2018 | \$(6,815) |
| Payment from Written Call Option | 20 |
| Net unrealized appreciation on Written Call Option | 6,795 |
| Balance as of December 31, 2018 | <u>\$—</u> |

The net change in unrealized depreciation on investments held as of December 31, 2019 and 2018, was \$(13.5) million and \$(32.7) million, respectively, and is included in net unrealized depreciation on investments on the consolidated statements of operations.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

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 as of December 31, 2019 were as follows:

| | Fair Value (in millions) ⁽²⁾ | Valuation Approach | Unobservable Input | Range (Weighted Average) |
|---------------------|--|---|-------------------------|--|
| First lien debt | \$ 211.2 | Income | Required Rate of Return | 7.0% – 20.0% (12.0%) |
| | | | Leverage Ratio | 1.5x – 7.9x (3.8x) |
| | | | Adjusted EBITDA | \$0.8 million – \$114.0 million (\$13.6 million) |
| First lien debt | \$ 20.0 | Enterprise Value Waterfall and Asset ⁽¹⁾ | EBITDA Multiple | 6.0x – 6.0x (6.0x) |
| | | | Adjusted EBITDA | \$2.9 million – \$2.9 million (\$2.9 million) |
| | | | Revenue Multiple | 1.0x – 1.1x (1.1x) |
| | | | Revenue | \$13.3 million – \$21.6 million (\$19.5 million) |
| Second lien debt | \$ 17.3 | Income | Required Rate of Return | 13.5% – 15.0% (13.7%) |
| | | | Leverage Ratio | 4.6x – 5.5x (4.9x) |
| | | | Adjusted EBITDA | \$2.7 million – \$74.5 million (\$68.3 million) |
| Subordinated debt | \$ 36.6 | Income and Asset ⁽¹⁾ | Required Rate of Return | 6.0% – 14.9% (13.4%) |
| | | | Leverage Ratio | 3.0x – 7.0x (5.5x) |
| | | | Adjusted EBITDA | \$1.8 million – \$22.3 million (\$15.5 million) |
| Equity and warrants | \$ 61.6 | Enterprise Value Waterfall and Asset ⁽¹⁾ | Revenue Multiple | 0.4x – 4.7x (0.8x) |
| | | | Revenue | \$17.1 million – \$566.2 million (\$406.6 million) |
| | | | EBITDA Multiple | 3.9x – 10.0x (7.3x) |
| | | | Adjusted EBITDA | \$1.8 million – \$25.1 million (\$11.7 million) |

(1) \$2.0 million in first lien debt, \$0.7 million in subordinated debt, and \$4.9 million in equity and warrants were valued using the asset approach.

(2) Excludes our \$13.6 million investment in CSLF II, measured at NAV.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

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 as of December 31, 2018 were as follows:

| | Fair Value ⁽²⁾ (in millions) | Valuation Approach | Unobservable Input | Range (Weighted Average) |
|---------------------|--|---|---|--|
| First lien debt | \$195.1 | Income | Required Rate of Return Leverage Ratio Adjusted EBITDA | 9.2% – 16.0% (12.1%) 1.0x – 13.5x (4.3x) \$1.7 million – \$118.7 million (\$17.6 million) |
| First lien debt | \$ 42.5 | Enterprise Value Waterfall and Asset ⁽¹⁾ | EBITDA Multiple Adjusted EBITDA Revenue Multiple Revenue | 4.0x – 6.0x (5.3x) \$0.6 million – \$3.7 million (\$2.3 million) 0.9x – 0.9x (0.9x) \$13.0 million – \$13.0 million (\$13.0 million) |
| Second lien debt | \$ 16.2 | Income | Required Rate of Return Leverage Ratio Adjusted EBITDA | 12.5% – 15.5% (14.6%) 4.6x – 5.0x (4.8x) \$67.0 million – \$79.2 million (\$75.5 million) |
| Second lien debt | \$ 16.3 | Enterprise Value Waterfall and Asset | EBITDA Multiple Adjusted EBITDA | 5.6x – 5.6x (5.6x) \$9.2 million – \$9.2 million (\$9.2 million) |
| Subordinated debt | \$ 49.3 | Income | Required Rate of Return Leverage Ratio Adjusted EBITDA | 11.5% – 20.0% (14.1%) 3.1x – 9.1x (5.7x) \$1.7 million – \$15.8 million (\$10.5 million) |
| Subordinated debt | \$ 23.8 | Enterprise Value Waterfall and Asset ⁽¹⁾ | EBITDA Multiple Adjusted EBITDA Revenue Multiple Revenue | 6.0x – 8.0x (7.9x) \$1.7 million – \$3.1 million (\$3.0 million) 0.4x – 0.4x (0.4x) \$568.2 million – \$568.2 million (\$568.2 million) |
| Equity and warrants | \$ 92.1 | Enterprise Value Waterfall | EBITDA Multiple Adjusted EBITDA Revenue Multiple Revenue | 3.3x – 14.0x (6.5x) \$1.7 million – \$112.3 million (\$27.8 million) 0.4x – 0.4x (0.4x) \$164.6 million – \$568.2 million (\$455.1 million) |

(1) \$0.7 million in subordinated debt and \$2.9 million in first lien debt were valued using the asset approach.

(2) Excludes our \$13.7 million investment in CSLF II, measured at NAV.

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 Loan Fund II, LLC

On December 20, 2018, Capitala and Trinity Universal Insurance Company ("Trinity"), a subsidiary of Kemper Corporation, entered into a limited liability company agreement (the "LLC Agreement") to co-manage CSLF II. The purpose and design of the joint venture is to invest primarily in senior secured first-out loans. Capitala and Trinity have committed to provide \$25.0 million of equity to CSLF II, with

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 4. Investments and Fair Value Measurements – (continued)

Capitala providing \$20.0 million and Trinity providing \$5.0 million. Capitala and Trinity each appointed two members to CSLF II's four-person board of directors and investment committee. All material decisions with respect to CSLF II, including those involving its investment portfolio, require approval of a member on the board of directors and investment committee of at least one member representing Capitala and Trinity, respectively.

As of December 31, 2019 and 2018, \$13.6 million and \$3.4 million in equity capital had been contributed by Capitala and Trinity, respectively. As of December 31, 2019 and 2018, the Company and Trinity had \$6.4 million and \$1.6 million of unfunded equity capital commitments outstanding, respectively. The Company's equity investment in CSLF II is not redeemable.

For the years ended December 31, 2019 and 2018, the Company received \$1.0 million and \$0.0, respectively, in dividend income from its equity interest in CSLF II.

On September 3, 2019, CSLF II entered into a senior secured revolving credit facility (the "CSLF II Credit Facility") with KeyBank Specialty Finance Lending, an affiliate of KeyCorp. The CSLF II Credit Facility currently provides for borrowings up to \$60.0 million, subject to certain borrowing base restrictions. Borrowings under the CSLF II Credit Facility bear interest at a rate of 1-month LIBOR + 2.25%. Beginning the quarter ended March 31, 2020, CSLF II will incur unused fees of .35% when utilization of the CSLF II Credit Facility exceeds 50% and .65% when utilization of the CSLF II Credit Facility is less than 50%. The CSLF II Credit Facility matures on September 2, 2024.

As of December 31, 2019, \$12.7 million was outstanding under the CSLF II Credit Facility. For the year ended December 31, 2019, CSLF II incurred \$0.2 million of interest and financing expenses.

On September 3, 2019, Capitala and Trinity committed to provide \$25.0 million of subordinated debt (the "Subordinated Notes") to CSLF II, with Capitala providing \$5.0 million and Trinity providing \$20.0 million. The Subordinated Notes currently bear interest at a rate of 1-month LIBOR + 5.00%. Beginning the quarter ended June 30, 2020, the Subordinated Notes will bear interest at a rate of 1-month LIBOR + 6.00%. The Subordinated Notes mature on September 3, 2024.

As of December 31, 2019, \$0.0 was outstanding on the Subordinated Notes. As of December 31, 2019, the Company and Trinity had \$5.0 million and \$20.0 million of unfunded commitments related to the Subordinated Notes, respectively. For the year ended December 31, 2019, the Company did not incur any interest and financing expenses related to the Subordinated Notes.

Below is a summary of CSLF II's portfolio as of December 31, 2019 and 2018 (dollars in thousands):

| | December 31, 2019 | December 31, 2018 |
|---|-------------------|-------------------|
| First lien loans ⁽¹⁾ | \$28,396 | \$10,000 |
| Weighted average current interest rate on first lien loans | 6.4% | 7.6% |
| Number of portfolio companies | 5 | 2 |
| Largest portfolio company investment ⁽¹⁾ | \$ 7,443 | \$ 5,550 |
| Total of five largest portfolio company investments ⁽¹⁾⁽²⁾ | \$28,396 | \$10,000 |

(1) Based on principal amount outstanding at year end.

(2) Only two investments held as of December 31, 2018.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

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

Below is CSLF II's schedule of investments as of December 31, 2019 (dollars in thousands):

| Portfolio Company | Industry | Type of Investment | Principal Amount | Cost | Fair Value |
|--|--------------------------|--|-------------------------|-----------------|-------------------|
| Investments at Fair Value | | | | | |
| Freedom Electronics, LLC | Electronics | First Lien Debt (7.0% Cash (1 month LIBOR + 5.0%, 2.0% Floor), Due 12/20/23) | \$ 5,445 | \$ 5,445 | \$ 5,445 |
| Installs, LLC | Logistics | First Lien Debt (5.8% Cash (1 month LIBOR + 4.0%, 1.8% Floor), Due 6/20/23) | 7,443 | 7,443 | 7,443 |
| RAM Payment, LLC | Financial Services | First Lien Debt (6.7% Cash (1 month LIBOR + 5.0%, 1.5% Floor), Due 1/4/24) | 6,653 | 6,653 | 6,653 |
| Rapid Fire Protection, Inc. ⁽¹⁾ | Security System Services | First Lien Debt (5.5% Cash (1 month LIBOR + 3.8%, 1.8% Floor), Due 11/22/24) | 4,400 | 4,400 | 4,400 |
| U.S. BioTek Laboratories, LLC | Testing Laboratories | First Lien Debt (7.0% Cash (3 month LIBOR + 5.0%, 2.0% Floor), Due 12/14/23) | 4,455 | 4,455 | 4,455 |
| TOTAL INVESTMENTS | | | \$28,396 | \$28,396 | \$28,396 |

(1) The investment has a \$3.0 million unfunded commitment.

Below is CSLF II's schedule of investments as of December 31, 2018 (dollars in thousands):

| Portfolio Company | Industry | Type of Investment | Principal Amount | Cost | Fair Value |
|----------------------------------|----------------------|--|-------------------------|-----------------|-------------------|
| Investments at Fair Value | | | | | |
| Freedom Electronics, LLC | Electronics | First Lien Debt (7.5% Cash (1 month LIBOR + 5.0%, 2.0% Floor), Due 12/20/23) | \$ 5,500 | \$ 5,500 | \$ 5,500 |
| U.S. BioTek Laboratories, LLC | Testing Laboratories | First Lien Debt (7.8% Cash (3 month LIBOR + 5.0%, 2.0% Floor), Due 12/14/23) | 4,500 | 4,500 | 4,500 |
| TOTAL INVESTMENTS | | | \$10,000 | \$10,000 | \$10,000 |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

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

Below are the statements of assets and liabilities for CSLF II as of December 31, 2019 and 2018 (dollars in thousands):

| | <u>December 31, 2019</u> | <u>December 31, 2018</u> |
|---|--------------------------|--------------------------|
| ASSETS | | |
| Investments at fair value (amortized cost of \$28,396 and \$10,000, respectively) | \$28,396 | \$10,000 |
| Cash and cash equivalents | 704 | 7,100 |
| Interest receivable | 151 | 31 |
| Other assets | 7 | — |
| Total assets | <u>\$29,258</u> | <u>\$17,131</u> |
| LIABILITIES | | |
| Credit facility (net of deferred financing costs of \$621 and \$0, respectively) | \$12,079 | \$ — |
| Interest and financing fees payable | 113 | — |
| Accounts payable | 27 | 12 |
| Total liabilities | <u>\$12,219</u> | <u>\$ 12</u> |
| NET ASSETS | | |
| Members' capital | <u>\$17,039</u> | <u>\$17,119</u> |
| Total net assets | <u>\$17,039</u> | <u>\$17,119</u> |

Below are the statements of operations for CSLF II (dollars in thousands):

| | <u>For the Year Ended December 31, 2019</u> | <u>For the period from December 20, 2018 (commencement of operations) to December 31, 2018</u> |
|---|---|--|
| INVESTMENT INCOME | | |
| Interest income | \$1,372 | \$ 31 |
| Fee income | 175 | 100 |
| Total investment income | <u>\$1,547</u> | <u>\$131</u> |
| EXPENSES | | |
| Interest and financing expenses | \$ 151 | \$ — |
| General and administrative expenses | 176 | 12 |
| Total expenses | <u>\$ 327</u> | <u>\$ 12</u> |
| NET INVESTMENT INCOME | <u>\$1,220</u> | <u>\$119</u> |
| NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS | <u>\$1,220</u> | <u>\$119</u> |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 5. Transactions With Affiliated Companies

During the year ended December 31, 2019, the Company had investments in portfolio companies designated as affiliates under the 1940 Act. Transactions with affiliates were as follows (dollars in thousands):

| Company ⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income ⁽¹⁾ | December 31, 2018 Fair Value | Gross Additions ⁽²⁾ | Gross Reductions ⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2019 Fair Value |
|--|--|------------------|---|------------------------------|--------------------------------|---------------------------------|----------------------|--|------------------------------|
| <i>Affiliate investments</i> | | | | | | | | | |
| Burgaflex Holdings, LLC | First Lien Debt (12.0% Cash, 3.0% PIK, Due 3/23/21) | \$ 14,421 | \$ 1,837 | \$ 14,384 | \$ 370 | \$ (750) | \$ — | \$ 417 | \$ 14,421 |
| Burgaflex Holdings, LLC | Common Stock Class B (1,085,073 shares) | — | — | — | 62 | — | — | 573 | 635 |
| Burgaflex Holdings, LLC | Common Stock Class A (1,253,198 shares) | — | — | — | — | — | — | — | — |
| | | | <u>1,837</u> | <u>14,384</u> | <u>432</u> | <u>(750)</u> | <u>—</u> | <u>990</u> | <u>15,056</u> |
| City Gear, LLC | Membership Unit Warrants | — | — | 3,184 | 111 | — | (111) | 142 | 3,326 |
| | | | — | <u>3,184</u> | <u>111</u> | <u>—</u> | <u>(111)</u> | <u>142</u> | <u>3,326</u> |
| Eastport Holdings, LLC | Subordinated Debt (14.9% Cash (3 month LIBOR + 13.0%, 0.5% Floor), Due 12/29/21) | 16,500 | 3,230 | 16,500 | 659 | — | — | (659) | 16,500 |
| Eastport Holdings, LLC | Membership Units (22.9% ownership) | — | — | 17,610 | — | — | — | 212 | 17,822 |
| | | | <u>3,230</u> | <u>34,110</u> | <u>659</u> | <u>—</u> | <u>—</u> | <u>(447)</u> | <u>34,322</u> |
| GA Communications, Inc. ⁽⁵⁾ | Series A-1 Preferred Stock (1,998 shares, 8.0% PIK Dividend) | — | — | 3,482 | 299 | — | — | (20) | 3,761 |
| GA Communications, Inc. | Series B-1 Common Stock (200,000 shares) | — | — | 1,325 | — | — | — | (824) | 501 |
| | | | — | <u>4,807</u> | <u>299</u> | <u>—</u> | <u>—</u> | <u>(844)</u> | <u>4,262</u> |
| J&J Produce Holdings, Inc. | Subordinated Debt (13.0% Cash, Due 6/16/19) | — | 485 | 6,210 | — | (5,788) | (618) | 196 | — |
| J&J Produce Holdings, Inc. | Common Stock (8,182 shares) | — | — | — | — | — | (818) | 818 | — |
| J&J Produce Holdings, Inc. | Common Stock Warrants (6,369 shares) | — | — | — | — | — | — | — | — |
| | | | <u>485</u> | <u>6,210</u> | <u>—</u> | <u>(5,788)</u> | <u>(1,436)</u> | <u>1,014</u> | <u>—</u> |
| LJS Partners, LLC | Preferred Units (92,924 units) | — | — | — | 293 | — | — | 79 | 372 |
| LJS Partners, LLC | Common Membership Units (2,593,234 units) | — | — | 3,018 | 327 | (293) | — | (1,543) | 1,509 |
| | | | — | <u>3,018</u> | <u>620</u> | <u>(293)</u> | <u>—</u> | <u>(1,464)</u> | <u>1,881</u> |
| MMI Holdings, LLC | First Lien Debt (12.0% Cash, Due 1/31/21) | 2,600 | 316 | 2,600 | — | — | — | — | 2,600 |
| MMI Holdings, LLC | Subordinated Debt (6.0% Cash, Due 1/31/21) | 400 | 24 | 400 | — | — | — | — | 400 |
| MMI Holdings, LLC ⁽⁵⁾ | Preferred Units (1,000 units, 6.0% PIK Dividend) | — | — | 1,612 | 98 | — | — | — | 1,710 |
| MMI Holdings, LLC | Common Membership Units (45 units) | — | — | 185 | — | — | — | 9 | 194 |
| | | | <u>340</u> | <u>4,797</u> | <u>98</u> | <u>—</u> | <u>—</u> | <u>9</u> | <u>4,904</u> |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 5. Transactions With Affiliated Companies – (continued)

| Company ⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income ⁽¹⁾ | December 31, 2018 Fair Value | Gross Additions ⁽²⁾ | Gross Reductions ⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2019 Fair Value |
|--------------------------------------|---|------------------|---|------------------------------|--------------------------------|---------------------------------|----------------------|--|------------------------------|
| Navis Holdings, Inc. | First Lien Debt (11.0% Cash, Due 6/30/23) | \$ 10,100 | \$ 568 | \$ — | \$ 10,100 | \$ — | \$ — | \$ — | \$ 10,100 |
| Navis Holdings, Inc. ⁽⁵⁾ | Class A Preferred Stock (1,000 shares, 10.0% Cash Dividend) | | 50 | — | 1,000 | — | — | — | 1,000 |
| Navis Holdings, Inc. | Common Stock (60,000 shares) | | — | — | — | — | — | 464 | 464 |
| | | | 618 | — | 11,100 | — | — | 464 | 11,564 |
| Nth Degree Investment Group, LLC | Membership Units (6,088,000 Units) | | — | — | 6,088 | — | — | — | 6,088 |
| | | | — | — | 6,088 | — | — | — | 6,088 |
| RAM Payment, LLC | First Lien Debt (10.0% Cash, Due 1/4/24) | 9,019 | 1,212 | — | 9,489 | (470) | — | — | 9,019 |
| RAM Payment, LLC ⁽⁵⁾ | Preferred Units (86,000 Units, 8.0% PIK Dividend) | | — | — | 928 | — | — | 797 | 1,725 |
| | | | 1,212 | — | 10,417 | (470) | — | 797 | 10,744 |
| Sierra Hamilton Holdings Corporation | Second Lien Debt (15.0% PIK, Due 9/12/23) | 782 | 3 | — | 748 | — | — | — | 748 |
| Sierra Hamilton Holdings Corporation | Common Stock (15,068,000 shares) | | — | 6,854 | — | — | — | (1,694) | 5,160 |
| | | | 3 | 6,854 | 748 | — | — | (1,694) | 5,908 |
| US Bath Group, LLC | First Lien Debt (11.5% Cash (1 month LIBOR + 9.0%, 1.0% Floor), Due 1/2/23) | — | 676 | 12,750 | — | (12,750) | — | — | — |
| US Bath Group, LLC | Membership Units (500,000 units) | | — | 2,083 | — | (4,323) | 3,823 | (1,583) | — |
| | | | 676 | 14,833 | — | (17,073) | 3,823 | (1,583) | — |
| V12 Holdings, Inc. | Subordinated Debt | | — | 742 | — | (30) | 12 | (16) | 708 |
| | | | — | 742 | — | (30) | 12 | (16) | 708 |
| Total Affiliate investments | | | \$ 8,401 | \$ 92,939 | \$ 30,572 | \$ (24,404) | \$ 2,288 | \$ (2,632) | \$ 98,763 |
| Control investments | | | | | | | | | |
| AAE Acquisition, LLC | Second Lien Debt (6.0% PIK, Due 8/24/19) | \$ — | \$ — | \$ 16,327 | \$ 4,084 | \$ — | \$(20,411) | \$ — | \$ — |
| AAE Acquisition, LLC | Membership Units (2.2% fully diluted) | | — | — | — | — | (17) | 17 | — |
| AAE Acquisition, LLC | Warrants (58.9% fully diluted) | | — | — | — | — | — | — | — |
| | | | — | 16,327 | 4,084 | — | (20,428) | 17 | — |
| CableOrganizer Acquisition, LLC | First Lien Debt (8.0% Cash, Due 6/30/21) | — | 72 | 1,708 | 1,842 | (3,550) | — | — | — |
| CableOrganizer Acquisition, LLC | First Lien Debt (8.0% Cash, Due 6/30/21) | — | 148 | 8,889 | — | (3,424) | (5,465) | — | — |
| CableOrganizer Acquisition, LLC | Preferred Units – Series A1 (7,200,000 units) | | — | — | 5,373 | — | (5,373) | — | — |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 5. Transactions With Affiliated Companies – (continued)

| Company ⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income ⁽¹⁾ | December 31, 2018 Fair Value | Gross Additions ⁽²⁾ | Gross Reductions ⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2019 Fair Value |
|-------------------------------------|--|------------------|---|------------------------------|--------------------------------|---------------------------------|----------------------|--|------------------------------|
| CableOrganizer Acquisition, LLC | Preferred Units – Series A (4,000,000 units) | | \$ — | \$ — | \$ — | \$ — | \$ (2,354) | \$ 2,354 | \$ — |
| CableOrganizer Acquisition, LLC | Common Stock (14.9% fully diluted) | | — | — | — | — | (1,394) | 1,394 | — |
| CableOrganizer Acquisition, LLC | Common Stock Warrants (40.0% fully diluted) | | — | — | — | — | — | — | — |
| | | | <u>220</u> | <u>10,597</u> | <u>7,215</u> | <u>(6,974)</u> | <u>(14,586)</u> | <u>3,748</u> | <u>—</u> |
| Capitala Senior Loan Fund II, LLC | Subordinated Debt (6.7% Cash (1 month LIBOR + 5.0)% , Due 9/3/24) | \$ — | — | — | — | — | — | — | — |
| Capitala Senior Loan Fund II, LLC | Membership Units (80.0% ownership) | | 1,040 | 13,695 | — | — | — | (64) | 13,631 |
| | | | <u>1,040</u> | <u>13,695</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>(64)</u> | <u>13,631</u> |
| Micro Precision, LLC | Subordinated Debt (10.0% Cash, Due 3/31/20) | | 106 | 1,862 | — | (1,862) | — | — | — |
| Micro Precision, LLC | Subordinated Debt (14.0% Cash, 4.0% PIK, Due 3/31/20) | | 350 | 4,325 | 88 | (4,413) | — | — | — |
| Micro Precision, LLC | Series A Preferred Units (47 units) | | 814 | 2,817 | — | (1,629) | — | (1,188) | — |
| | | | <u>1,270</u> | <u>9,004</u> | <u>88</u> | <u>(7,904)</u> | <u>—</u> | <u>(1,188)</u> | <u>—</u> |
| Navis Holdings, Inc. | First Lien Debt (11.0% Cash, Due 6/30/23) | | 566 | 7,500 | — | (7,500) | — | — | — |
| Navis Holdings, Inc. ⁽⁵⁾ | Class A Preferred Stock (1,000 shares, 10.0% Cash Dividend) | | 50 | 1,000 | — | (1,000) | — | — | — |
| Navis Holdings, Inc. | Common Stock (60,000 shares) | | — | 4,348 | — | (2,600) | 2,599 | (4,347) | — |
| | | | <u>616</u> | <u>12,848</u> | <u>—</u> | <u>(11,100)</u> | <u>2,599</u> | <u>(4,347)</u> | <u>—</u> |
| Portrait Studio, LLC | First Lien Debt (9.0% Cash (1 month LIBOR + 7.0%, 1.0% Floor, 2.0% Ceiling), Due 12/31/22) | | 98 | — | 3,540 | (3,540) | — | — | — |
| Portrait Studio, LLC | First Lien Debt (9.1% Cash (1 month LIBOR + 7.0%, 1.0% Floor, 5.0% Ceiling), Due 12/31/22) | | 107 | 4,500 | — | (792) | (3,708) | — | — |
| Portrait Studio, LLC | Preferred Units (4,350,000 Units) | | — | 2,174 | — | — | (2,450) | 276 | — |
| Portrait Studio, LLC | Membership Units (150,000 Units) | | — | — | — | — | — | — | — |
| | | | <u>205</u> | <u>6,674</u> | <u>3,540</u> | <u>(4,332)</u> | <u>(6,158)</u> | <u>276</u> | <u>—</u> |
| Vology, Inc. | First Lien Debt (10.5% Cash (1 month LIBOR + 8.5%, 2.0% Floor), Due 12/31/21) | 3,877 | 119 | — | 3,877 | — | — | — | 3,877 |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 5. Transactions With Affiliated Companies – (continued)

| Company⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income⁽¹⁾ | December 31, 2018 Fair Value | Gross Additions⁽²⁾ | Gross Reductions⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2019 Fair Value |
|---|---|-------------------------|---|-------------------------------------|--------------------------------------|---------------------------------------|-----------------------------|---|-------------------------------------|
| Vology, Inc. | Class A Preferred Units (9,041,810 Units) | | \$ — | \$ — | \$ 5,215 | \$ — | \$ — | \$ — | \$ 5,215 |
| Vology, Inc. | Membership Units (5,363,982 Units) | | — | — | — | — | — | — | — |
| | | | 119 | — | 9,092 | — | — | — | 9,092 |
| <u>Total Control investments</u> | | | <u>\$ 3,470</u> | <u>\$ 69,145</u> | <u>\$24,019</u> | <u>\$(30,310)</u> | <u>\$(38,573)</u> | <u>\$(1,558)</u> | <u>\$ 22,723</u> |

- (1) Represents the total amount of interest, original issue discount, fees and dividends credited to income for the portion of the year an investment was included in Affiliate or Control categories, respectively.
- (2) Gross additions include increases in the cost basis of investments resulting from new portfolio investments, follow-on investments, accrued PIK and accretion of original issue discount. Gross additions also include transfers into Affiliate or Control classification.
- (3) Gross reductions include decreases in the cost basis of investments resulting from principal repayments and sales. Gross reductions also includes transfers out of Affiliate or Control classification.
- (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
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Note 5. Transactions With Affiliated Companies – (continued)

During the year ended December 31, 2018, the Company had investments in portfolio companies designated as affiliates under the 1940 Act. Transactions with affiliates were as follows (dollars in thousands):

| Company ⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income ⁽¹⁾ | December 31, 2017 Fair Value | Gross Additions ⁽²⁾ | Gross Reductions ⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2018 Fair Value |
|-------------------------------------|---|------------------|---|------------------------------|--------------------------------|---------------------------------|----------------------|--|------------------------------|
| <i>Affiliate investments</i> | | | | | | | | | |
| AAE Acquisition, LLC | Second Lien Debt (6.0% Cash, Due 8/24/19) | \$ — | \$ 479 | \$ 15,603 | \$ 320 | \$(16,165) | \$ — | \$ 242 | \$ — |
| AAE Acquisition, LLC | Membership Units (2.2% fully diluted) | — | — | — | — | (17) | — | 17 | — |
| AAE Acquisition, LLC | Warrants (37.8% fully diluted) | — | — | — | — | — | — | — | — |
| | | | 479 | 15,603 | 320 | (16,182) | — | 259 | — |
| Burgaflex Holdings, LLC | First Lien Debt (12.0% Cash, 1.0% PIK, Due 3/23/21) | 14,801 | 1,390 | — | 14,801 | — | — | (417) | 14,384 |
| Burgaflex Holdings, LLC | Subordinated Debt (14.0% Cash, Due 8/9/19) | — | 116 | 3,000 | — | (3,000) | — | — | — |
| Burgaflex Holdings, LLC | Subordinated Debt (12.0% Cash, Due 8/9/19) | — | 199 | 5,828 | — | (5,828) | — | — | — |
| Burgaflex Holdings, LLC | Common Stock Class A (1,253,198 shares) | — | — | 457 | — | — | — | (457) | — |
| Burgaflex Holdings, LLC | Common Stock Class B (900,000 shares) | — | — | — | 300 | — | — | (300) | — |
| | | | 1,705 | 9,285 | 15,101 | (8,828) | — | (1,174) | 14,384 |
| Chef'n Corporation | Series A Preferred Stock (1,000,000 shares) | — | — | — | — | (644) | 644 | — | — |
| | | | — | — | — | (644) | 644 | — | — |
| City Gear, LLC | Subordinated Debt (13.0% Cash, Due 10/20/19) | — | 918 | 8,231 | — | (8,231) | — | — | — |
| City Gear, LLC ⁽⁵⁾ | Preferred Membership Units (2.8% fully diluted, 9.0% Cash Dividend) | — | 117 | 1,269 | — | (1,269) | — | — | — |
| City Gear, LLC | Membership Unit Warrants (11.4% fully diluted) | — | — | 8,248 | — | (1,908) | 1,908 | (5,064) | 3,184 |
| | | | 1,035 | 17,748 | — | (11,408) | 1,908 | (5,064) | 3,184 |
| Eastport Holdings, LLC | Subordinated Debt (15.8% Cash (3 month LIBOR + 13.0%, 0.5% Floor), Due 4/29/20) | 16,500 | 1,168 | — | 15,496 | — | — | 1,004 | 16,500 |
| Eastport Holdings, LLC | Membership Units (22.9% ownership) | — | — | — | 4,733 | (1,470) | — | 14,347 | 17,610 |
| | | | 1,168 | — | 20,229 | (1,470) | — | 15,351 | 34,110 |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 5. Transactions With Affiliated Companies – (continued)

| Company ⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income ⁽¹⁾ | December 31, 2017 Fair Value | Gross Additions ⁽²⁾ | Gross Reductions ⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2018 Fair Value |
|--|---|------------------|---|------------------------------|--------------------------------|---------------------------------|----------------------|--|------------------------------|
| GA Communications, Inc. ⁽⁵⁾ | Series A-1 Preferred Stock (1,998 shares, 8.0% PIK Dividend) | | \$ — | \$ 3,225 | \$ 276 | \$ — | \$ — | \$ (19) | \$ 3,482 |
| GA Communications, Inc. | Series B-1 Common Stock (200,000 shares) | | — | 1,932 | — | — | — | (607) | 1,325 |
| | | | | 5,157 | 276 | — | — | (626) | 4,807 |
| J&J Produce Holdings, Inc. | Subordinated Debt (13.0% Cash, Due 6/16/19) | \$ 6,406 | 805 | 6,170 | 38 | — | — | 2 | 6,210 |
| J&J Produce Holdings, Inc. | Common Stock (8,182 shares) | | — | — | — | — | — | — | — |
| J&J Produce Holdings, Inc. | Common Stock Warrants (6,369 shares) | | — | — | — | — | — | — | — |
| | | | 805 | 6,170 | 38 | — | — | 2 | 6,210 |
| LJS Partners, LLC | Common Stock (1,587,848 shares) | | — | 7,650 | 293 | — | — | (4,925) | 3,018 |
| | | | — | 7,650 | 293 | — | — | (4,925) | 3,018 |
| MJC Holdings, LLC | Series A Preferred Units (2,000,000 units) | | — | — | — | (28) | 28 | — | — |
| | | | — | — | — | (28) | 28 | — | — |
| MMI Holdings, LLC | First Lien Debt (12.0% Cash, Due 1/31/20) | 2,600 | 317 | 2,600 | — | — | — | — | 2,600 |
| MMI Holdings, LLC | Subordinated Debt (6.0% Cash, Due 1/31/20) | 400 | 24 | 400 | — | — | — | — | 400 |
| MMI Holdings, LLC ⁽⁵⁾ | Preferred Units (1,000 units, 6.0% PIK Dividend) | | — | 1,520 | 92 | — | — | — | 1,612 |
| MMI Holdings, LLC | Common Membership Units (45 units) | | — | 193 | — | — | — | (8) | 185 |
| | | | 341 | 4,713 | 92 | — | — | (8) | 4,797 |
| MTI Holdings, LLC | Membership Units (2,000,000 units) | | — | 100 | — | (139) | 139 | (100) | — |
| | | | — | 100 | — | (139) | 139 | (100) | — |
| Sierra Hamilton Holdings Corporation | Common Stock (15,068,000 shares) | | — | 8,528 | — | — | — | (1,674) | 6,854 |
| | | | — | 8,528 | — | — | — | (1,674) | 6,854 |
| Source Capital Penray, LLC | Membership Units (11.3% ownership) | | 121 | 101 | — | — | — | (101) | — |
| | | | 121 | 101 | — | — | — | (101) | — |
| STX Healthcare Management Services, Inc. | Common Stock (1,200,000 shares) | | — | 93 | — | (108) | 108 | (93) | — |
| | | | — | 93 | — | (108) | 108 | (93) | — |
| US Bath Group, LLC | First Lien Debt (11.4% Cash (1 month LIBOR + 9.0%, 1.0% Floor), Due 1/2/23) | 12,750 | 1,806 | — | 15,000 | (2,250) | — | — | 12,750 |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 5. Transactions With Affiliated Companies – (continued)

| Company ⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income ⁽¹⁾ | December 31, 2017 Fair Value | Gross Additions ⁽²⁾ | Gross Reductions ⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2018 Fair Value |
|------------------------------------|---|------------------|---|------------------------------|--------------------------------|---------------------------------|----------------------|--|------------------------------|
| US Bath Group, LLC | Membership Units (500,000 units) | | \$ — | \$ — | \$ 500 | \$ — | \$ — | \$ 1,583 | \$ 2,083 |
| | | | 1,806 | — | 15,500 | (2,250) | — | 1,583 | 14,833 |
| U.S. Well Services, LLC | First Lien Debt (8.3% Cash (1 month LIBOR + 6.0%, 1.0% Floor), Due 2/2/22) | \$ — | 156 | 2,299 | — | (2,299) | — | — | — |
| U.S. Well Services, LLC | First Lien Debt (13.3% PIK (1 month LIBOR + 11.0%, 1.0% Floor), Due 2/2/22) | — | 567 | 9,516 | 409 | (9,925) | — | — | — |
| U.S. Well Services, LLC | Class A Units (5,680,688 Units) | | — | 15,004 | — | (6,260) | — | (8,744) | — |
| U.S. Well Services, LLC | Class B Units (2,076,298 Units) | | — | 955 | — | (441) | — | (514) | — |
| | | | 723 | 27,774 | 409 | (18,925) | — | (9,258) | — |
| V12 Holdings, Inc. | Subordinated Debt | — | — | 1,035 | — | (232) | 93 | (154) | 742 |
| | | | — | 1,035 | — | (232) | 93 | (154) | 742 |
| Total Affiliate investments | | | \$ 8,183 | \$ 103,957 | \$ 52,258 | \$ (60,214) | \$ 2,920 | \$ (5,982) | \$ 92,939 |
| Control investments | | | | | | | | | |
| AAE Acquisition, LLC | Second Lien Debt (6.0% Cash, Due 8/24/19) | \$ 16,327 | \$ 488 | \$ — | \$ 16,327 | \$ — | \$ — | \$ — | \$ 16,327 |
| AAE Acquisition, LLC | Membership Units (2.2% fully diluted) | | — | — | 17 | — | — | (17) | — |
| AAE Acquisition, LLC | Warrants (37.8% fully diluted) | | — | — | — | — | — | — | — |
| | | | 488 | — | 16,344 | — | — | (17) | 16,327 |
| CableOrganizer Acquisition, LLC | First Lien Debt (10.0% Cash, Due 5/24/19) | 1,708 | 121 | — | 1,708 | — | — | — | 1,708 |
| CableOrganizer Acquisition, LLC | First Lien Debt (12.0% Cash, 4.0% PIK, Due 6/30/19) | 8,889 | 1,173 | 12,373 | 515 | (2,354) | (1,646) | 1 | 8,889 |
| CableOrganizer Acquisition, LLC | Preferred Units (4,000,000 units) | | — | — | 2,354 | — | — | (2,354) | — |
| CableOrganizer Acquisition, LLC | Common Stock (21.3% fully diluted) | | — | 118 | — | — | — | (118) | — |
| CableOrganizer Acquisition, LLC | Common Stock Warrants (10.0% fully diluted) | | — | 60 | — | — | — | (60) | — |
| | | | 1,294 | 12,551 | 4,577 | (2,354) | (1,646) | (2,531) | 10,597 |
| Capitala Senior Loan Fund II, LLC | Membership Units (80.0% ownership) | | — | — | 13,600 | — | — | 95 | 13,695 |
| | | | — | — | 13,600 | — | — | 95 | 13,695 |
| Eastport Holdings, LLC | Subordinated Debt (15.8% Cash (3 month LIBOR + 13.0%, 0.5% Floor), Due 4/29/20) | — | 2,144 | 16,500 | 493 | (15,231) | — | (1,762) | — |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 5. Transactions With Affiliated Companies – (continued)

| Company ⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income ⁽¹⁾ | December 31, 2017 Fair Value | Gross Additions ⁽²⁾ | Gross Reductions ⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2018 Fair Value |
|-------------------------------------|--|------------------|---|------------------------------|--------------------------------|---------------------------------|----------------------|--|------------------------------|
| Eastport Holdings, LLC | Membership Units (22.9% ownership) | | \$ — | \$ 26,449 | \$ — | \$ (4,733) | \$ — | \$(21,716) | \$ — |
| | | | 2,144 | 42,949 | 493 | (19,964) | — | (23,478) | — |
| Kelle's Transport Service, LLC | First Lien Debt (4.0% Cash, Due 2/15/20) | \$ — | 82 | 2,000 | 1,300 | (3,300) | — | — | — |
| Kelle's Transport Service, LLC | First Lien Debt (2.2% Cash, Due 2/15/20) | — | 126 | 9,560 | — | (10,000) | (3,669) | 4,109 | — |
| Kelle's Transport Service, LLC | Membership Units (27.5% fully diluted) | | — | — | — | — | — | — | — |
| | | | 208 | 11,560 | 1,300 | (13,300) | (3,669) | 4,109 | — |
| Micro Precision, LLC | Subordinated Debt (10.0% Cash, Due 1/1/19) | 1,862 | 186 | 1,862 | — | — | — | — | 1,862 |
| Micro Precision, LLC | Subordinated Debt (14.0% Cash, 4.0% PIK, Due 1/1/19) | 4,325 | 601 | 4,154 | 171 | — | — | — | 4,325 |
| Micro Precision, LLC | Series A Preferred Units (47 units) | | — | 1,629 | — | — | — | 1,188 | 2,817 |
| | | | 787 | 7,645 | 171 | — | — | 1,188 | 9,004 |
| Navis Holdings, Inc. | First Lien Debt (15.0% Cash, Due 10/30/20) | 7,500 | 1,149 | 6,500 | 1,000 | — | — | — | 7,500 |
| Navis Holdings, Inc. ⁽⁵⁾ | Class A Preferred Stock (1,000 shares, 10.0% Cash Dividend) | | 100 | 1,000 | — | — | — | — | 1,000 |
| Navis Holdings, Inc. | Common Stock (300,000 shares) | | — | 5,005 | — | — | — | (657) | 4,348 |
| | | | 1,249 | 12,505 | 1,000 | — | — | (657) | 12,848 |
| On-Site Fuel Service, Inc. | First Lien Debt (18.0% Cash, Due 12/19/18) | — | 30 | — | 11,020 | — | (11,020) | — | — |
| On-Site Fuel Service, Inc. | Subordinated Debt (18.0% Cash, Due 12/19/18) | — | — | 11,588 | — | (11,020) | — | (568) | — |
| On-Site Fuel Service, Inc. | Series A Preferred Stock (32,782 shares) | | — | — | — | — | (3,278) | 3,278 | — |
| On-Site Fuel Service, Inc. | Series B Preferred Stock (23,648 shares) | | — | — | — | — | (2,364) | 2,364 | — |
| On-Site Fuel Service, Inc. | Common Stock (33,058 shares) | | — | — | — | — | (33) | 33 | — |
| | | | 30 | 11,588 | 11,020 | (11,020) | (16,695) | 5,107 | — |
| Portrait Studio, LLC | First Lien Debt (9.0% Cash (1 month LIBOR + 7.0%, 1.0% Floor, 2.0% Ceiling), Due 12/31/22) | — | 167 | 1,860 | 2,400 | (4,260) | — | — | — |
| Portrait Studio, LLC | First Lien Debt (9.4% Cash (1 month LIBOR + 7.0%, 1.0% Floor, 5.0% Ceiling), Due 12/31/22) | 4,500 | 435 | 4,500 | — | — | — | — | 4,500 |
| Portrait Studio, LLC | Preferred Units (4,350,000 Units) | | — | 2,450 | — | — | — | (276) | 2,174 |

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 5. Transactions With Affiliated Companies – (continued)

| Company ⁽⁴⁾ | Type of Investment | Principal Amount | Amount of Interest, Fees or Dividends Credited to Income ⁽¹⁾ | December 31, 2017 Fair Value | Gross Additions ⁽²⁾ | Gross Reductions ⁽³⁾ | Realized Gain/(Loss) | Unrealized Appreciation (Depreciation) | December 31, 2018 Fair Value |
|---|----------------------------------|------------------|---|------------------------------|--------------------------------|---------------------------------|--------------------------|--|------------------------------|
| Portrait Studio, LLC | Membership Units (150,000 Units) | | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |
| | | | 602 | 8,810 | 2,400 | (4,260) | — | (276) | 6,674 |
| <u>Total Control investments</u> | | | <u>\$ 6,802</u> | <u>\$107,608</u> | <u>\$50,905</u> | <u>\$(50,898)</u> | <u>\$(22,010)</u> | <u>\$(16,460)</u> | <u>\$ 69,145</u> |

- (1) Represents the total amount of interest, original issue discount, fees and dividends credited to income for the portion of the year an investment was included in Affiliate or Control categories, respectively.
- (2) Gross additions include increases in the cost basis of investments resulting from new portfolio investments, follow-on investments, accrued PIK and accretion of original issue discount. Gross additions also include transfers into Affiliate or Control classification.
- (3) Gross reductions include decreases in the cost basis of investments resulting from principal repayments and sales. Gross reductions also includes transfers out of Affiliate or Control classification.
- (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.

Note 6. 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 a majority of our non-interested directors, at an in-person meeting on August 1, 2019. 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,

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 6. Agreements – (continued)

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

- no incentive fee in any calendar quarter in which the pre-incentive fee net investment income does not exceed the hurdle of 2.0%;
- 100% of the pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle but is less than 2.5% in any calendar quarter (10.0% annualized). The Company refers to this portion of the pre-incentive fee net investment income (which exceeds the hurdle but is less than 2.5%) as the "catch-up." The "catch-up" is meant to provide the Investment Advisor with 20% of the pre-incentive fee net investment income as if a hurdle did not apply if this net investment income exceeds 2.5% in any calendar quarter; and
- 20% of the amount of the pre-incentive fee net investment income, if any, that exceeds 2.5% in any calendar quarter (10.0% annualized) is payable to the Investment Advisor (once the hurdle is reached and the catch-up is achieved, 20% of all pre-incentive fee investment income thereafter is allocated to the Investment Advisor).

CAPITALA FINANCE CORP.
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Note 6. Agreements – (continued)

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 December 31, 2019 and 2018, the Company had incentive fees payable to the Investment Advisor of \$3.7 million and \$2.5 million, respectively.

For the years ended December 31, 2019, 2018 and 2017, the Company incurred \$8.0 million, \$9.0 million and \$9.8 million in base management fees, respectively. The Company incurred \$1.5 million, \$0.2 million and \$1.3 million in incentive fees related to pre-incentive fee net investment income for the years ended December 31, 2019, 2018 and 2017, respectively. For the years ended December 31, 2019, 2018 and 2017, our Investment Advisor waived incentive fees of \$0.3 million, \$0.0 and \$1.0 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 net asset value, 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, 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 1, 2019. To the extent that the Administrator outsources any of its functions, the Company will pay the fees

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 6. Agreements – (continued)

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, 2019, 2018 and 2017 the Company paid the Administrator \$1.4 million, \$1.4 million and \$1.1 million, respectively, for the Company's allocable portion of the Administrator's overhead.

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

Note 7. Related Party Transactions

As of December 31, 2019 and 2018, the Company had \$3.7 million and \$2.5 million, respectively, of management and incentive fees payable to the Investment Advisor. These amounts are reflected in the accompanying consolidated statements of assets and liabilities under the caption "Management and incentive fees payable."

The Company may invest in the same unitranche facility as CSLF II whereby CSLF II provides the first-out portion of the unitranche facility and the Company and other lenders provide the last-out portion of the unitranche facility. Under a guarantee agreement, the Company may be required to purchase its pro-rata portion of first-out loans from CSLF II upon certain triggering events, including acceleration upon payment default of the underlying borrower. As of December 31, 2019, the Company has evaluated the fair value of the guarantee under the guidance of ASC Topic 460 — *Guarantees* and determined that the fair value of the guarantee is immaterial as the risk of payment default for first-out loans in CSLF II is considered remote. The maximum exposure to credit risk as of December 31, 2019 and 2018, was \$10.3 million and \$4.3 million, respectively, and extends to the stated maturity of the underlying loans in CSLF II.

Note 8. Borrowings

SBA Debentures

The Company, through its wholly owned subsidiary, uses debenture leverage provided through the SBA to fund a portion of its investment portfolio. As of December 31, 2019 and 2018, the Company had \$150.0 million and \$165.7 million, respectively, 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. On March 1, 2019, Fund II repaid its outstanding SBA debentures and relinquished its SBIC license. SBA-guaranteed debentures are secured by a lien on all assets of Fund III and were secured by a lien on all assets of Fund II prior to March 1, 2019. As of December 31, 2019, Fund III had total assets of \$266.3 million. As of December 31, 2018, Fund II and Fund III had total assets of \$332.7 million. On June 10, 2014, the Company received an exemptive order from the SEC exempting the Company, Fund II, and Fund III from certain provisions of the 1940 Act (including an exemptive order granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs) and from certain reporting requirements mandated by the Securities Exchange Act of 1934, as amended, with respect to Fund II and Fund III. The Company intends to comply with the conditions of the order.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 8. Borrowings – (continued)

The following table summarizes the interest expense and annual charges, deferred financing costs, average outstanding balance, and average stated interest and annual charge rate on the SBA-guaranteed debentures for the years ended December 31, 2019, 2018 and 2017 (dollars in thousands):

| | For the years ended | | |
|--|----------------------|----------------------|----------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Interest expense and annual charges | \$ 5,454 | \$ 6,244 | \$ 6,336 |
| Deferred financing costs | 682 | 612 | 611 |
| Total interest and financing expenses | <u>\$ 6,136</u> | <u>\$ 6,856</u> | <u>\$ 6,947</u> |
| Average outstanding balance | \$152,537 | \$169,028 | \$170,700 |
| Average stated interest and annual charge rate | 3.57% | 3.69% | 3.71% |

As of December 31, 2019 and 2018, 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, 2019 | December 31, 2018 |
|---------------------|------------------|----------------------|----------------------|----------------------|
| September 1, 2020 | 3.215% | 0.285% | \$ 19,000 | \$ 19,000 |
| March 1, 2021 | 4.084% | 0.515% | — | 15,700 |
| March 1, 2021 | 4.084% | 0.285% | 46,000 | 46,000 |
| March 1, 2022 | 2.766% | 0.285% | 10,000 | 10,000 |
| March 1, 2022 | 2.766% | 0.515% | 50,000 | 50,000 |
| March 1, 2023 | 2.351% | 0.515% | 25,000 | 25,000 |
| | | | <u>\$150,000</u> | <u>\$165,700</u> |

2021 Notes

On June 16, 2014, the Company issued \$113.4 million in aggregate principal amount of 7.125% fixed-rate notes due 2021 (the "2021 Notes"). On May 26, 2017, the Company caused notices to be issued to the holders of its 2021 Notes regarding the Company's exercise of its option to redeem all of the issued and outstanding 2021 Notes. 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.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 8. Borrowings – (continued)

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, 2019, 2018, and 2017 (dollars in thousands):

| | For the years ended | | |
|--|----------------------|----------------------|----------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Interest expense | \$ — | \$ — | \$ 3,908 |
| Deferred financing costs | — | — | 293 |
| Total interest and financing expenses | \$ — | \$ — | \$ 4,201 |
| Average outstanding balance | \$ — | \$ — | \$53,766 |
| Average stated interest rate | —% | —% | 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’ over-allotment option. The 2022 Notes will mature on May 31, 2022 and may be redeemed in whole or in part at any time or from time to time at 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.

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, 2019, 2018, and 2017 (dollars in thousands):

| | For the years ended | | |
|--|----------------------|----------------------|----------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Interest expense | \$ 4,500 | \$ 4,500 | \$ 2,812 |
| Deferred financing costs | 540 | 509 | 303 |
| Total interest and financing expenses | \$ 5,040 | \$ 5,009 | \$ 3,115 |
| Average outstanding balance | \$75,000 | \$75,000 | \$47,137 |
| Average stated interest rate | 6.0% | 6.0% | 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 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’ over-allotment option.

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

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 8. Borrowings – (continued)

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 U.S. 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, 2019, 2018, and 2017 (dollars in thousands):

| | For the years ended | | |
|---------------------------------------|----------------------|----------------------|----------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Interest expense | \$ 2,995 | \$ 2,995 | \$ 1,789 |
| Deferred financing costs | 342 | 324 | 180 |
| Total interest and financing expenses | <u>\$ 3,337</u> | <u>\$ 3,319</u> | <u>\$ 1,969</u> |
| Average outstanding balance | \$52,088 | \$52,088 | \$31,218 |
| Average stated interest rate | 5.75% | 5.75% | 5.75% |

Credit Facility

On October 17, 2014, the Company entered into a senior secured revolving credit agreement (as amended, the “Credit Facility”) with ING Capital, LLC, as administrative agent, arranger, and bookrunner, and the lenders party thereto. The Credit Facility was amended on May 22, 2015, June 16, 2017, July 19, 2018, February 22, 2019, and December 23, 2019 (the “Amendments”). The Amendments were affected, among other things, in order to increase the total borrowings allowed under the Credit Facility, allow for stock repurchases, extend the maturity date, reduce the minimum required interest coverage ratio, reduce the minimum required net asset value, and reduce the minimum required asset coverage ratio. The Credit Facility currently provides for borrowings up to \$60.0 million and may be increased up to \$150.0 million pursuant to its “accordion” feature. The Credit Facility matures on April 30, 2022.

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 3.50% 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 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 (e.g., borrowings for which the Company has elected the one month LIBOR will reset on the one month anniversary of the period based on the then selected LIBOR). For any given borrowing under the Credit Facility, the Company intends to elect what it believes to be an appropriate LIBOR taking into account the Company’s needs at the time as well as the Company’s view of future interest rate movements. The Credit Facility provides for the ability to step-down the pricing of the Credit Facility from LIBOR plus 3.50% to LIBOR plus 3.00% when certain conditions are met. The Company will also pay an unused commitment fee at a rate of 0.75% per

CAPITALA FINANCE CORP.
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Note 8. Borrowings – (continued)

annum on the unutilized portion of the aggregate commitments under the Credit Facility on each day when the utilized portion of the aggregate commitments is less than 35% for such day and 0.50% per annum on the unutilized portion of the aggregate commitments under the Credit Facility when the utilized portion is greater than 35% for such day.

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, 2019, 2018, and 2017 (dollars in thousands):

| | For the years ended | | |
|---------------------------------------|----------------------|----------------------|----------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Interest expense | \$ 580 | \$ 305 | \$ 908 |
| Deferred financing costs | 806 | 441 | 713 |
| Unused commitment fees | 1,222 | 1,353 | 972 |
| Total interest and financing expenses | <u>\$ 2,608</u> | <u>\$2,099</u> | <u>\$ 2,593</u> |
| Average outstanding balance | <u>\$10,448</u> | <u>\$6,304</u> | <u>\$22,493</u> |
| Average stated interest rate | 5.41% | 4.89% | 4.08% |

As of December 31, 2019 and 2018, the Company had \$0.0 and \$10.0 million, respectively, outstanding under the Credit Facility. The Credit Facility is secured by investments and cash held by the Company, exclusive of assets pledged as collateral for the Company's SBA debentures. Assets pledged to secure the Credit Facility had a carrying value of \$159.8 million and \$158.9 million, respectively, at December 31, 2019 and December 31, 2018. 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.

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, 2019, 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 | \$150,000 | \$151,167 | \$ — | \$ — | \$151,167 |
| 2022 Notes | 75,000 | 74,970 | 74,970 | — | — |
| 2022 Convertible Notes | 52,088 | 51,498 | 51,498 | — | — |
| Credit Facility | — | — | — | — | — |
| Total | <u>\$277,088</u> | <u>\$277,635</u> | <u>\$126,468</u> | <u>\$ —</u> | <u>\$151,167</u> |

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

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 8. Borrowings – (continued)

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, 2018, 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 | \$165,700 | \$165,436 | \$ — | \$ — | \$165,436 |
| 2022 Notes | 75,000 | 74,700 | 74,700 | — | — |
| 2022 Convertible Notes | 52,088 | 49,546 | 49,546 | — | — |
| Credit Facility | 10,000 | 10,030 | — | — | 10,030 |
| Total | \$302,788 | \$299,712 | \$124,246 | \$ — | \$175,466 |

(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 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 Credit Facility was based on future contractual cash payments discounted at estimated market interest rates for similar debt.

Note 9. 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. In 2017, the Company elected to amend its tax year end from August 31 to December 31 and has filed a tax return for the four months ended December 31, 2017.

Distributions from net investment income, distributions from net realized capital gains, and distributions classified as return of capital 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 periods ended December 31, 2019, December 31, 2018, December 31, 2017, and August 31, 2017, 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, deconsolidating book income from a wholly owned subsidiary, 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 the years ended December 31, 2019, 2018 and 2017, respectively.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 9. Income Taxes – (continued)

The following permanent differences due to adjustments for the realized gains (losses) upon disposition of partnership interests, deconsolidating book income from a wholly owned subsidiary, and for the transfer of distributions between accumulated capital gains, accumulated net investment income, and return of capital were reclassified for tax purposes for the tax periods ended December 31, 2019, December 31, 2018, December 31, 2017, and August 31, 2017 (dollars in thousands):

| | Tax year ended December 31, 2019 | Tax year ended December 31, 2018 | Tax period ended December 31, 2017 | Tax year ended August 31, 2017 |
|--|---|---|---|---|
| Increase (decrease) in accumulated net investment income | \$ (13) | \$ 38 | \$ — | \$ (67) |
| Increase (decrease) in accumulated net realized gains on investments | 2,450 | — | — | 88 |
| Increase (decrease) in capital in excess of par value | (2,437) | (38) | — | (21) |

For the tax periods ended December 31, 2019, December 31, 2018, December 31, 2017, and August 31, 2017, the tax basis components of distributable earnings were as follows (dollars in thousands):

| | Tax year ended December 31, 2019 | Tax year ended December 31, 2018 | Tax period ended December 31, 2017 | Tax year ended August 31, 2017 |
|--|---|---|---|---|
| Undistributed ordinary income | \$ — | \$ 1,016 | \$ 9,851 | \$ 8,999 |
| Accumulated capital losses | (95,186) | (79,063) | (44,078) | (43,618) |
| Unrealized appreciation (depreciation) | (9,190) | 6,519 | 34,065 | 25,994 |
| Other temporary differences | (6,423) | (610) | (9,426) | (8,276) |
| Total | <u><u>\$ (110,799)</u></u> | <u><u>\$ (72,138)</u></u> | <u><u>\$ (9,588)</u></u> | <u><u>\$ (16,901)</u></u> |

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 December 31, 2019, the Company has a short-term capital loss carry forward of \$15.1 million and a long-term capital loss carry forward of \$80.1 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 expenses and generally excludes unrealized appreciation (depreciation) on investments as investment gains and losses are not included in taxable income until they are realized.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 9. Income Taxes – (continued)

The following table reconciles net increase (decrease) in net assets resulting from operations to taxable income for the tax periods ended December 31, 2019, December 31, 2018, December 31, 2017, and August 31, 2017 (dollars in thousands):

| | Tax year ended December 31, 2019 | Tax year ended December 31, 2018 | Tax period ended December 31, 2017 | Tax year ended August 31, 2017 |
|---|---|---|---|---|
| Net increase (decrease) in net assets resulting from operations | \$(27,647) | \$(16,026) | \$(17,150) | \$ 1,647 |
| Net change in unrealized (appreciation) depreciation on investments | 20,306 | (840) | (1,698) | 18,518 |
| Capital loss carryforward (utilization) | 16,246 | 34,985 | 460 | (679) |
| Tax provision (benefit) | 628 | (1,916) | 1,289 | — |
| Other deductions for book in excess of deductions for tax | 2,903 | (9,051) | 24,981 | 9,053 |
| Total taxable income | <u>\$ 12,436</u> | <u>\$ 7,152</u> | <u>\$ 7,882</u> | <u>\$28,539</u> |

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 estimated tax character of distributions paid for the tax periods ended December 31, 2019, December 31, 2018, December 31, 2017, and August 31, 2017 were as follows (dollars in thousands):

| | Tax year ended December 31, 2019 | Tax year ended December 31, 2018 | Tax period ended December 31, 2017 | Tax year ended August 31, 2016 |
|-------------------|---|---|---|---|
| Ordinary income | \$13,451 | \$15,986 | \$6,052 | \$25,187 |
| Return of capital | 2,659 | — | — | — |
| Total | <u>\$16,110</u> | <u>\$15,986</u> | <u>\$6,052</u> | <u>\$25,187</u> |

For U.S. federal income tax purposes, as of December 31, 2019, the aggregate net unrealized depreciation for all securities was \$(9.2) million. As of December 31, 2019, gross unrealized appreciation was \$7.7 million and gross unrealized depreciation was \$(16.9) million. The aggregate cost of securities for U.S. federal income tax purposes was \$371.7 million as of December 31, 2019. For U.S. federal income tax purposes, as of December 31, 2018, the aggregate net unrealized appreciation for all securities was \$6.5 million. As of December 31, 2018, gross unrealized appreciation was \$31.9 million and gross unrealized depreciation was \$(25.4) million. The aggregate cost of securities for U.S. federal income tax purposes was \$442.4 million as of December 31, 2018.

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, 2019, the Taxable Subsidiaries had net operating losses for U.S. federal income tax purposes of approximately \$16.4 million. If not utilized, \$6.1 million of these net operating losses will expire in the year ended December 31, 2037, \$2.4 million of these net operating losses will expire in the year ended December 31, 2036, and \$7.9 million of these net

CAPITALA FINANCE CORP.
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December 31, 2019

Note 9. Income Taxes – (continued)

operating losses have no expiration. As of December 31, 2019, the Taxable Subsidiaries had net operating loss for state income tax purposes of approximately \$14.8 million. If not utilized, \$0.4 million of these net operating losses will expire in the year ended December 31, 2037, \$1.0 million of these net operating losses will expire in the year ended December 31, 2036, and \$13.4 million of these net operating losses have no expiration.

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 toward 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 24.62%, 24.86%, and 25.00% as of December 31, 2019, 2018 and 2017, respectively. The implementation of the Tax Act did not have a material impact on the Company's financial position and results of operations.

Deferred U.S. federal income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting and U.S. federal income tax purposes. Components of deferred tax assets (liabilities) as of December 31, 2019 and 2018 are as follows (dollars in thousands):

| | December 31, 2019 | December 31, 2018 |
|--|----------------------|----------------------|
| Deferred tax assets: | | |
| Net operating loss carryforwards | \$ 4,033 | \$ 2,963 |
| Capital loss carryforwards | 243 | — |
| Other deferred tax assets | 5 | 58 |
| Less valuation allowance | (3,166) | (364) |
| Total deferred tax assets | 1,115 | 2,657 |
| Deferred tax liabilities: | | |
| Net unrealized appreciation on investments | (1,115) | (2,029) |
| Total deferred tax liabilities | (1,115) | (2,029) |
| Net deferred tax asset (liability) | <u>\$ —</u> | <u>\$ 628</u> |

At December 31, 2019 and December 31, 2018, the valuation allowance on deferred tax assets was \$3.2 and \$0.4 million, respectively, which represents the tax effect of net operating losses that we do not believe we will realize through future taxable 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.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 9. Income Taxes – (continued)

Total income tax expense (benefit) differs from the amount computed by applying the federal statutory income tax rate of 21% to net investment loss and net realized and unrealized appreciation (depreciation) on investments for the years ended December 31, 2019, 2018, and 2017, are as follows (dollars in thousands):

| | For the years ended | | |
|--|----------------------|----------------------|----------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Tax expense (benefit) at statutory rates | \$(1,742) | \$(1,447) | \$1,998 |
| State income tax expense (benefit), net of federal benefit | (300) | (266) | 188 |
| Tax benefit on net operating losses | — | — | (908) |
| Adjustment to unrealized appreciation | (359) | (159) | — |
| Other adjustments | 218 | (40) | — |
| Tax expense on permanent items | — | — | 140 |
| Revaluation for federal rate change | — | — | (492) |
| Revaluation for state rate change | 10 | (5) | — |
| Change in valuation allowance | 2,801 | 1 | 363 |
| Total tax provision (benefit), net | <u>\$ 628</u> | <u>\$(1,916)</u> | <u>\$1,289</u> |

For the years ended December 31, 2019, 2018 and 2017, the components of the Company's tax provision include the following (dollars in thousands):

| | For the years ended | | |
|------------------------------------|----------------------|----------------------|----------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Deferred tax provision (benefit) | | | |
| Federal | \$(1,862) | \$(1,615) | \$ 778 |
| State | (311) | (302) | 148 |
| Less change in valuation allowance | 2,801 | 1 | 363 |
| Total tax provision (benefit), net | <u>\$ 628</u> | <u>\$(1,916)</u> | <u>\$1,289</u> |

Note 10. 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, 2019, 2018 and 2017, 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 11. 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.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 11. Stockholders' Equity – (continued)

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, 2019, the Company had 16,203,769 shares of common stock outstanding.

Note 12. Summarized Financial Information of Our Unconsolidated Subsidiaries

During the year ended December 31, 2019, the Company sold or exited four portfolio companies that were considered significant subsidiaries under the guidance in Regulation S-X. During the year ended December 31, 2019, the Company wrote off its investment in AAE Acquisition, LLC and realized a loss of \$(20.4) million. During the year ended December 31, 2019, the Company sold its investments in Portrait Studio, LLC, CableOrganizer Acquisition, LLC, and Micro Precision, LLC and realized a gain/(loss) of \$(6.2) million, \$(14.6) million, and \$0.0, respectively.

Note 13. 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. For the years ended December 31, 2019, 2018, and 2017, 3.3 million in convertible shares related to the 2022 Convertible Notes were considered anti-dilutive.

The following information sets forth the computation of the weighted average basic and diluted net decrease in net assets per share resulting from operations for the years ended December 31, 2019, 2018 and 2017 (dollars in thousands, except share and per share data):

| Basic and diluted | For the years ended | | |
|--|------------------------------|------------------------------|------------------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Net decrease in net assets resulting from operations | \$ (27,647) | \$ (16,026) | \$ (6,984) |
| Weighted average common stock outstanding – basic and diluted | 16,117,719 | 15,993,436 | 15,903,167 |
| Net decrease in net assets per share resulting from operations – basic and diluted | \$ (1.72) | \$ (1.00) | \$ (0.44) |

Note 14. Distributions

The Company's distributions are recorded on the record 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.

Tax characteristics of all distributions paid are reported to stockholders on Form 1099 after the end of the calendar year. For the years ended December 31, 2018 and 2017, total distributions of \$16.0 million and \$22.6 million, respectively, were comprised 100% of ordinary income. For the year ended December 31, 2019, we estimate that total distributions of \$16.1 million were comprised of approximately \$13.4 million from ordinary income and \$2.7 million from return of capital.

CAPITALA FINANCE CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 14. Distributions – (continued)

The following tables summarize the Company's distribution declarations for the years ended December 31, 2019, 2018 and 2017 (in thousands, except share and per share data):

| <u>Date Declared</u> | <u>Record Date</u> | <u>Payment Date</u> | <u>Amount Per Share</u> | <u>Cash Distribution</u> | <u>DRIP Shares Issued</u> | <u>DRIP Share Value</u> |
|---|--------------------|---------------------|-------------------------|--------------------------|---------------------------|-------------------------|
| January 2, 2019 | January 24, 2019 | January 30, 2019 | \$0.0833 | \$ 1,256 | 10,270 | \$ 81 |
| January 2, 2019 | February 20, 2019 | February 27, 2019 | 0.0833 | 1,253 | 10,570 | 85 |
| January 2, 2019 | March 21, 2019 | March 28, 2019 | 0.0833 | 1,250 | 11,756 | 89 |
| April 1, 2019 | April 22, 2019 | April 29, 2019 | 0.0833 | 1,246 | 11,479 | 94 |
| April 1, 2019 | May 23, 2019 | May 30, 2019 | 0.0833 | 1,243 | 11,579 | 97 |
| April 1, 2019 | June 20, 2019 | June 27, 2019 | 0.0833 | 1,238 | 11,747 | 104 |
| July 1, 2019 | July 23, 2019 | July 30, 2019 | 0.0833 | 1,237 | 11,721 | 106 |
| July 1, 2019 | August 22, 2019 | August 29, 2019 | 0.0833 | 1,231 | 16,079 | 113 |
| July 1, 2019 | September 20, 2019 | September 27, 2019 | 0.0833 | 1,231 | 14,327 | 114 |
| October 1, 2019 | October 22, 2019 | October 29, 2019 | 0.0833 | 1,231 | 14,482 | 115 |
| October 1, 2019 | November 22, 2019 | November 29, 2019 | 0.0833 | 1,234 | 14,079 | 113 |
| October 1, 2019 | December 23, 2019 | December 30, 2019 | 0.0833 | 1,234 | 14,133 | 115 |
| Total Distributions Declared and Distributed for 2019 | | | <u>\$ 1.00</u> | <u>\$14,884</u> | <u>152,222</u> | <u>\$1,226</u> |

| <u>Date Declared</u> | <u>Record Date</u> | <u>Payment Date</u> | <u>Amount Per Share</u> | <u>Cash Distribution</u> | <u>DRIP Shares Issued</u> | <u>DRIP Share Value</u> |
|---|--------------------|---------------------|-------------------------|--------------------------|---------------------------|-------------------------|
| January 2, 2018 | January 22, 2018 | January 30, 2018 | \$0.0833 | \$ 1,275 | 7,280 | \$ 54 |
| January 2, 2018 | February 20, 2018 | February 27, 2018 | 0.0833 | 1,275 | 8,076 | 54 |
| January 2, 2018 | March 23, 2018 | March 29, 2018 | 0.0833 | 1,274 | 7,631 | 56 |
| April 2, 2018 | April 19, 2018 | April 27, 2018 | 0.0833 | 1,278 | 7,006 | 53 |
| April 2, 2018 | May 22, 2018 | May 30, 2018 | 0.0833 | 1,277 | 6,875 | 54 |
| April 2, 2018 | June 20, 2018 | June 28, 2018 | 0.0833 | 1,280 | 6,591 | 52 |
| July 2, 2018 | July 23, 2018 | July 30, 2018 | 0.0833 | 1,279 | 6,515 | 53 |
| July 2, 2018 | August 23, 2018 | August 30, 2018 | 0.0833 | 1,277 | 6,699 | 56 |
| July 2, 2018 | September 20, 2018 | September 27, 2018 | 0.0833 | 1,249 | 10,066 | 84 |
| October 1, 2018 | October 23, 2018 | October 30, 2018 | 0.0833 | 1,249 | 10,918 | 85 |
| October 1, 2018 | November 21, 2018 | November 29, 2018 | 0.0833 | 1,249 | 11,342 | 86 |
| October 1, 2018 | December 20, 2018 | December 28, 2018 | 0.0833 | 1,255 | 11,317 | 82 |
| Total Distributions Declared and Distributed for 2018 | | | <u>\$ 1.00</u> | <u>\$15,217</u> | <u>100,316</u> | <u>\$769</u> |

CAPITALA FINANCE CORP.
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December 31, 2019

Note 14. Distributions – (continued)

| 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 2017 | | | <u>\$ 1.42</u> | <u>\$21,711</u> | <u>83,186</u> | <u>\$865</u> |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Note 15. Financial Highlights and Senior Securities

The following is a schedule of financial highlights and senior securities for the years ended December 31, 2019, 2018, 2017, 2016, and 2015 (dollars in thousands, except share and per share data):

| | For the years ended December 31, | | | | |
|---|----------------------------------|------------|------------|------------|------------|
| | 2019 | 2018 | 2017 | 2016 | 2015 |
| Per share data: | | | | | |
| Net asset value at beginning of year | \$ 11.88 | \$ 13.91 | \$ 15.79 | \$ 17.04 | \$ 18.56 |
| Net investment income ⁽¹⁾ | 0.81 | 1.00 | 0.98 | 1.84 | 1.67 |
| Net realized gain (loss) on investments ⁽¹⁾ | (1.23) | (2.18) | (1.52) | (1.44) | 0.35 |
| Net unrealized appreciation (depreciation) on investments ⁽¹⁾ | (1.26) | (0.37) | 0.44 | 0.35 | (1.11) |
| Net unrealized appreciation (depreciation) on Written Call Option ⁽¹⁾ | — | 0.43 | (0.26) | (0.17) | — |
| Tax benefit (provision) ⁽¹⁾ | (0.04) | 0.12 | (0.08) | — | — |
| Distributions – net investment income | (0.83) | (1.00) | (1.42) | (1.80) | (1.88) |
| Distributions – return of capital | (0.17) | — | — | — | — |
| Distributions – net realized gains | — | — | — | — | (0.50) |
| Issuance of common stock | — | — | — | — | (0.15) |
| Accretive impact of stock repurchase | — | — | — | — | 0.13 |
| Other ⁽⁶⁾ | (0.02) | (0.03) | (0.02) | (0.03) | (0.03) |
| Net asset value at end of year | \$ 9.14 | \$ 11.88 | \$ 13.91 | \$ 15.79 | \$ 17.04 |
| Net assets at end of year | \$ 148,113 | \$ 190,644 | \$ 221,887 | \$ 250,582 | \$ 268,802 |
| Shares outstanding at end of year | 16,203,769 | 16,051,547 | 15,951,231 | 15,868,045 | 15,777,345 |
| Per share market value at end of year | \$ 8.73 | \$ 7.17 | \$ 7.28 | \$ 12.93 | \$ 12.08 |
| Total return based on market value ⁽²⁾ | 37.75% | 12.14% | (35.68)% | 24.07% | (20.43)% |
| Ratio/Supplemental data: | | | | | |
| Ratio of net investment income to average net assets | 7.85% | 7.60% | 6.54% | 11.32% | 9.55% |
| Ratio of incentive fee, net of incentive fee waiver, to average net assets ⁽⁵⁾ | 0.73% | 0.12% | 0.15% | 2.01% | 1.88% |
| Ratio of interest and financing expenses to average net assets | 10.30% | 8.20% | 7.94% | 7.68% | 7.17% |
| Ratio of loss on extinguishment of debt to average net assets | —% | —% | 1.15% | —% | —% |
| Ratio of tax (benefit) provision to average net assets | 0.38% | (0.91)% | 0.54% | —% | —% |
| Ratio of other operating expenses to average net assets | 7.62% | 6.52% | 5.75% | 5.61% | 5.52% |
| Ratio of total expenses including tax provision, net of incentive fee waiver to average net assets ⁽⁵⁾ | 19.03% | 13.93% | 15.53% | 15.30% | 14.57% |
| Portfolio turnover rate ⁽³⁾ | 19.18% | 22.69% | 16.34% | 21.33% | 25.99% |
| Average debt outstanding ⁽⁴⁾ | \$ 290,073 | \$ 302,420 | \$ 325,314 | \$ 356,758 | \$ 324,824 |
| Average debt outstanding per common share | \$ 17.90 | \$ 18.84 | \$ 20.39 | \$ 22.48 | \$ 20.59 |
| Total Debt Outstanding Exclusive of Treasury Securities: | | | | | |
| Credit Facility | \$ — | \$ 10,000 | \$ 9,000 | \$ 44,000 | \$ 70,000 |
| SBA Debentures | \$ 150,000 | \$ 165,700 | \$ 170,700 | \$ 170,700 | \$ 184,200 |
| 2021 Notes | \$ — | \$ — | \$ — | \$ 113,438 | \$ 113,438 |
| 2022 Notes | \$ 75,000 | \$ 75,000 | \$ 75,000 | \$ — | \$ — |
| 2022 Convertible Notes | \$ 52,088 | \$ 52,088 | \$ 52,088 | \$ — | \$ — |

CAPITALA FINANCE CORP.
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Note 15. Financial Highlights and Senior Securities – (continued)

| | For the years ended December 31, | | | | |
|---|----------------------------------|----------|----------|----------|----------|
| | 2019 | 2018 | 2017 | 2016 | 2015 |
| Asset coverage per unit:⁽⁷⁾ | | | | | |
| Credit Facility | \$ 2,165 | \$ 2,391 | \$ 2,630 | \$ 2,592 | \$ 2,465 |
| SBA Debentures | N/A | N/A | N/A | N/A | N/A |
| 2021 Notes | N/A | N/A | N/A | \$ 2,592 | \$ 2,465 |
| 2022 Notes | \$ 2,165 | \$ 2,391 | \$ 2,630 | N/A | N/A |
| 2022 Convertible Notes | \$ 2,165 | \$ 2,391 | \$ 2,630 | N/A | N/A |
| Involuntary liquidation preference per unit:⁽⁸⁾ | | | | | |
| Credit Facility | — | — | — | — | — |
| SBA Debentures | — | — | — | — | — |
| 2021 Notes | — | — | — | — | — |
| 2022 Notes | — | — | — | — | — |
| 2022 Convertible Notes | — | — | — | — | — |
| Average market value per unit:⁽⁹⁾ | | | | | |
| Credit Facility | N/A | N/A | N/A | N/A | N/A |
| SBA Debentures | N/A | N/A | N/A | N/A | N/A |
| 2021 Notes | N/A | N/A | N/A | \$ 1,006 | \$ 1,020 |
| 2022 Notes | \$ 1,000 | \$ 996 | \$ 1,014 | N/A | N/A |
| 2022 Convertible Notes | \$ 994 | \$ 984 | \$ 1,001 | N/A | N/A |

- (1) Based on daily weighted average balance of shares outstanding during the period.
- (2) Total investment return is calculated assuming a purchase of common shares at the current market value on the first day and a sale at the current market value on the last day of the period reported. Dividends and distributions, if any, are assumed for purposes of this calculation to be reinvested at prices obtained under the Company's DRIP. Total investment return does not reflect brokerage commissions.
- (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) The ratio of waived incentive fees to average net assets was 0.17%, 0.00%, 0.40%, 0.65%, and 0.40% for the years ended December 31, 2019, 2018, 2017, 2016, and 2015, respectively.
- (6) 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.
- (7) Asset coverage per unit is the ratio of the carrying value of our total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness. We have excluded our SBA-guaranteed debentures from the asset coverage calculation as of December 31, 2019, 2018, 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 (150% after November 1, 2019) 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.
- (8) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it. The "—" indicates information that the SEC expressly does not require to be disclosed for certain types of senior securities.
- (9) Not applicable except for the 2021 Notes, the 2022 Notes and the 2022 Convertible Notes which are publicly traded. The Average Market Value Per Unit is calculated by taking the daily average closing price during the period and dividing it by \$25 per share and multiplying the result by \$1,000 to determine a unit price per thousand consistent with Asset Coverage Per Unit.

CAPITALA FINANCE CORP.
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Note 16. Selected Quarterly Financial Data (Unaudited)

| (Dollars in thousands, except per share data) | For the quarter ended | | | |
|--|-----------------------|-----------------------|------------------|-------------------|
| | December 31, 2019 | September 30, 2019 | June 30, 2019 | March 31, 2019 |
| Total investment income | \$9,634 | \$10,126 | \$ 11,590 | \$12,684 |
| Net investment income | \$1,902 | \$ 2,984 | \$ 4,022 | \$ 4,135 |
| Net increase (decrease) in net assets resulting from operations | \$ (69) | \$ 1,717 | \$(29,144) | \$ (151) |
| Net investment income per share ⁽¹⁾ | \$ 0.12 | \$ 0.18 | \$ 0.25 | \$ 0.26 |
| Net increase (decrease) in net assets resulting from operations per share ⁽¹⁾ | \$ (0.00) | \$ 0.11 | \$ (1.81) | \$ (0.01) |
| Net asset value per share at end of period | \$ 9.14 | \$ 9.40 | \$ 9.55 | \$ 11.61 |

| (Dollars in thousands, except per share data) | For the quarter ended | | | |
|--|-----------------------|-----------------------|------------------|-------------------|
| | December 31, 2018 | September 30, 2018 | June 30, 2018 | March 31, 2018 |
| Total investment income | \$11,308 | \$ 11,530 | \$11,882 | \$12,572 |
| Net investment income | \$ 3,501 | \$ 3,851 | \$ 4,231 | \$ 4,438 |
| Net increase (decrease) in net assets resulting from operations | \$ (9,201) | \$(11,916) | \$ 4,948 | \$ 141 |
| Net investment income per share ⁽¹⁾ | \$ 0.22 | \$ 0.24 | \$ 0.26 | \$ 0.28 |
| Net increase (decrease) in net assets resulting from operations per share ⁽¹⁾ | \$ (0.57) | \$ (0.74) | \$ 0.31 | \$ 0.01 |
| Net asset value per share at end of period | \$ 11.88 | \$ 12.71 | \$ 13.71 | \$ 13.66 |

(1) Calculated based on weighted average shares outstanding during the quarter.

Note 17. 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 December 31, 2019.

Distributions

On January 2, 2020, the Company's Board declared normal monthly distributions for January, February, and March of 2020 as set forth below:

| Date Declared | Record Date | Payment Date | Distributions per Share |
|-----------------|-------------------|-------------------|----------------------------|
| January 2, 2020 | January 24, 2020 | January 30, 2020 | \$0.0833 |
| January 2, 2020 | February 20, 2020 | February 27, 2020 | \$0.0833 |
| January 2, 2020 | March 23, 2020 | March 30, 2020 | \$0.0833 |

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, 2019 (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, 2019 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, 2019.

The Company's independent registered public accounting firm that audited the financial statements has issued an audit report on the effectiveness of our internal control over financial reporting as of December 31, 2019. This report appears on page [F-2](#) of this Annual Report on Form 10-K.

(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 2019 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 2020 Annual Meeting of Stockholders with the Securities and Exchange Commission, 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 2020 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 2020 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 2020 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 2020 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 2020 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:

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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⁾ |
| 4.5 | Description of Securities (filed herewith) |
| 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⁾ |
| 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⁾ |
| 10.13 | Form of Amendment No. 3, dated as of July 19, 2018, 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, and First National Bank of Pennsylvania, as documentation agent⁽¹²⁾ |

| Exhibit Number | Description of Document |
|-----------------------|--|
| 10.14 | Form of Amendment No. 4, dated as of February 22, 2019, 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, and First National Bank of Pennsylvania, as documentation agent⁽¹³⁾. |
| 10.15 | Form of Amendment No. 6, to Senior Secured Revolving Credit Agreement, dated as of December 23, 2019, among Capitala Finance Corp., as borrower, the lenders from time to time party thereto, and ING Capital LLC, as administrative agent⁽¹⁵⁾. |
| 10.16 | Second Amended and Restated Limited Liability Company Agreement of Capitala Senior Loan Fund II, LLC⁽¹⁴⁾. |
| 10.17 | Open Market Sale AgreementSM, dated as of December 31, 2019, by and among Capitala Finance Corp., Capitala Investment Advisors, LLC, Capitala Advisors Corp. and Jefferies LLC⁽¹⁶⁾. |
| 14.1 | Code of Business Conduct⁽¹⁾. |
| 14.2 | Code of Ethics⁽¹¹⁾. |
| 21.1 | List of Subsidiaries (filed herewith) |
| 23.1 | Consent of Independent Registered Public Accounting Firm (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) |

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- (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.
- (11) Previously filed in connection with Capitala Finance Corp.'s report on Form 10-K filed on February 27, 2018.
- (12) Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on July 20, 2018.
- (13) Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on February 28, 2019.
- (14) Previously filed in connection with Capitala Finance Corp.'s report on Form 10-K filed on March 4, 2019.

- (15) Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on December 23, 2019.
- (16) Previously filed in connection with Capitala Finance Corp.'s report on Form 8-K filed on December 31, 2019.

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.

| | |
|---------------------|--|
| Date: March 2, 2020 | Capitala Finance Corp. By <u>/s/ Joseph B. Alala III</u> Joseph B. Alala III Chief Executive Officer (Principal Executive Officer) Capitala Finance Corp. |
| Date: March 2, 2020 | By <u>/s/ Stephen A. Arnall</u> Stephen A. Arnall Chief Financial Officer (Principal Financial Officer) Capitala Finance Corp. |
| Date: March 2, 2020 | By <u>/s/ Kevin A. Koonts</u> Kevin A. Koonts Chief Accounting Officer (Principal 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.

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|--|---------------|
| <u>/s/ Joseph B. Alala III</u> Joseph B. Alala III | Chief Executive Officer, President and Chairman of the Board of Directors (Principal Executive Officer) | March 2, 2020 |
| <u>/s/ M. Hunt Broyhill</u> M. Hunt Broyhill | Director | March 2, 2020 |
| <u>/s/ R. Charles Moyer</u> R. Charles Moyer | Director | March 2, 2020 |
| <u>/s/ Larry W. Carroll</u> Larry W. Carroll | Director | March 2, 2020 |
| <u>/s/ H. Paul Chapman</u> H. Paul Chapman | Director | March 2, 2020 |

DESCRIPTION OF SECURITIES**A. Common Stock, \$0.01 par value per share**

As of December 31, 2019, the authorized common stock of Capitala Finance Corp. (the “Company,” “we,” “our” or “us”) consisted of 100,000,000 shares of stock, par value \$0.01 per share. Our common stock is quoted on The Nasdaq Global Select Market under the ticker symbol “CPTA.” There are no outstanding options or warrants to purchase our stock. No stock has been authorized for issuance under any equity compensation plans. Under Maryland law, our stockholders generally are not personally liable for our debts or obligations.

Under our charter, our board of directors is authorized to classify and reclassify any unissued shares of stock into other classes or series of stock without obtaining stockholder approval. As permitted by the Maryland General Corporation Law, our charter provides that the board of directors, without any action by our stockholders, may amend the charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have authority to issue.

All shares of our common stock have equal rights as to earnings, assets, voting and distributions and, when they are issued, will be duly authorized, validly issued, fully paid and nonassessable. Distributions may be paid to the holders of our common stock if, as and when authorized by our board of directors and declared by us out of assets legally available therefor. Shares of our common stock have no preemptive, conversion or redemption rights and are freely transferable, except where their transfer is restricted by federal and state securities laws or by contract. In the event of our liquidation, dissolution or winding up, each share of our common stock would be entitled to share ratably in all of our assets that are legally available for distribution after we pay all debts and other liabilities and subject to any preferential rights of holders of our preferred stock, if any preferred stock is outstanding at such time. Each share of our common stock is entitled to one vote on all matters submitted to a vote of stockholders, including the election of directors. Except as provided with respect to any other class or series of stock, the holders of our common stock will possess exclusive voting power. There is no cumulative voting in the election of directors, which means that holders of a majority of the outstanding shares of common stock can elect all of our directors, and holders of less than a majority of such shares will be unable to elect any director.

Certain Provisions of the Maryland General Corporation Law and Our Charter and Bylaws

The Maryland General Corporation Law and our charter and bylaws contain provisions that could make it more difficult for a potential acquirer to acquire us by means of a tender offer, proxy contest or otherwise. These 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 of directors. 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.

Classified Board of Directors

Our board of directors is divided into three classes of directors serving staggered three-year terms. The terms of the first, second and third classes will expire at the annual meeting of stockholders held in 2020, 2021 and 2022, respectively, and in each case, those directors will serve until their successors are duly elected and qualify. Upon expiration of their current terms, directors of each class will be elected to serve for three-year terms until their successors are duly elected and qualify and each year one class of directors will be elected by the stockholders. A classified board may render a change in control of us or removal of our incumbent management more difficult. We believe, however, that the longer time required to elect a majority of a classified board of directors will help to ensure the continuity and stability of our management and policies.

Election of Directors

Our bylaws provide that the affirmative vote of the holders of a plurality of the outstanding shares of stock, entitled to vote in the election of directors cast at a meeting of stockholders duly called and at which a quorum is present, will be required to elect a director. Pursuant to our charter, our board of directors may amend the bylaws to alter the vote required to elect directors.

Number of Directors; Vacancies; Removal

Our charter provides that the number of directors will be set only by the board of directors in accordance with our bylaws. Our bylaws provide that a majority of our entire board of directors may at any time increase or decrease the number of directors. However, unless our bylaws are amended, the number of directors may never be less than one nor more than nine. Our charter provides that, at such time as we have at least three independent directors and our common stock is registered under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), we elect to be subject to the provision of Subtitle 8 of Title 3 of the Maryland General Corporation Law regarding the filling of vacancies on the board of directors. Accordingly, at such time, except as may be provided by the board of directors in setting the terms of any class or series of preferred stock, any and all vacancies on the board of directors may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term of the directorship in which the vacancy occurred and until a successor is elected and qualifies, subject to any applicable requirements of the Investment Company Act of 1940, as amended (the “1940 Act”).

Our charter provides that a director may be removed only for cause, as defined in our charter, and then only by the affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors.

Action by Stockholders

Under the Maryland General Corporation Law, stockholder action can be taken only at an annual or special meeting of stockholders or by unanimous written consent in lieu of a meeting (unless the charter provides for stockholder action by less than unanimous written consent, which our charter does not). These provisions, combined with the requirements of our bylaws regarding the calling of a stockholder-requested special meeting of stockholders discussed below, may have the effect of delaying consideration of a stockholder proposal until the next annual meeting.

Advance Notice Provisions for Stockholder Nominations and Stockholder Proposals

Our bylaws provide that with respect to an annual meeting of stockholders, nominations of persons for election to the board of directors and the proposal of business to be considered by stockholders may be made only (1) pursuant to our notice of the meeting, (2) by the board of directors or (3) by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice procedures of our bylaws. With respect to special meetings of stockholders, only the business specified in our notice of the meeting may be brought before the meeting. Nominations of persons for election to the board of directors at a special meeting may be made only (1) pursuant to our notice of the meeting, (2) by the board of directors or (3) provided that the board of directors has determined that directors will be elected at the meeting, by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice provisions of the bylaws.

The purpose of requiring stockholders to give us advance notice of nominations and other business is to afford our board of directors a meaningful opportunity to consider the qualifications of the proposed nominees and the advisability of any other proposed business and, to the extent deemed necessary or desirable by our board of directors, to inform stockholders and make recommendations about such qualifications or business, as well as to provide a more orderly procedure for conducting meetings of stockholders. Although our bylaws do not give our board of directors any power to disapprove stockholder nominations for the election of directors or proposals recommending certain action, they may have the effect of precluding a contest for the election of directors or the consideration of stockholder proposals if proper procedures are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its own proposal without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our stockholders.

Calling of Special Meetings of Stockholders

Our bylaws provide that special meetings of stockholders may be called by our board of directors and certain of our officers. Additionally, our bylaws provide that, subject to the satisfaction of certain procedural and informational requirements by the stockholders requesting the meeting, a special meeting of stockholders will be called by the secretary of the corporation upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast at such meeting.

Approval of Extraordinary Corporate Action; Amendment of Charter and Bylaws

Under Maryland law, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business, unless approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter. However, a Maryland corporation may provide in its charter for approval of these matters by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. Our charter generally provides for approval of charter amendments and extraordinary transactions by the stockholders entitled to cast at least a majority of the votes entitled to be cast on the matter. Our charter also provides that certain charter amendments, any proposal for our conversion, whether by charter amendment, merger or otherwise, from a closed-end company to an open-end company or any proposal for our liquidation or dissolution requires the approval of the stockholders entitled to cast at least 80% of the votes entitled to be cast on such matter. However, if such amendment or proposal is approved by a majority of our continuing directors (in addition to approval by our board of directors), such amendment or proposal may be approved by a majority of the votes entitled to be cast on such a matter. The “continuing directors” are defined in our charter as (1) our current directors, (2) those directors whose nomination for election by the stockholders or whose election by the directors to fill vacancies is approved by a majority of our current directors then on the board of directors or (3) any successor directors whose nomination for election by the stockholders or whose election by the directors to fill vacancies is approved by a majority of continuing directors or the successor continuing directors then in office. In any event, in accordance with the requirements of the 1940 Act, any amendment or proposal that would have the effect of changing the nature of our business so as to cause us to cease to be, or to withdraw our election as, a business development company would be required to be approved by a majority of our outstanding voting securities, as defined under the 1940 Act.

Our charter and bylaws provide that the board of directors will have the exclusive power to adopt, alter, amend or repeal any provision of our bylaws.

No Appraisal Rights

Except with respect to appraisal rights arising in connection with the Control Share Act discussed below, as permitted by the Maryland General Corporation Law, our charter provides that stockholders will not be entitled to exercise appraisal rights unless a majority of the board of directors shall determine such rights apply.

Control Share Acquisitions

The Maryland General Corporation Law provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter (the “Control Share Act”). Shares owned by the acquirer, by officers or by directors who are employees of the corporation are excluded from shares entitled to vote on the matter. Control shares are voting shares of stock which, if aggregated with all other shares of stock owned by the acquirer or in respect of which the acquirer is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquirer to exercise voting power in electing directors within one of the following ranges of voting power:

- one-tenth or more but less than one-third;
- one-third or more but less than a majority; or
- a majority or more of all voting power.

The requisite stockholder approval must be obtained each time an acquirer crosses one of the thresholds of voting power set forth above. Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval or shares acquired directly from the corporation. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel the board of directors of the corporation to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction of certain conditions, including an undertaking to pay the expenses of the meeting. If no request for a meeting is made, the corporation may itself present the question at any stockholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then the corporation may redeem for fair value any or all of the control shares, except those for which voting rights have previously been approved. The right of the corporation to redeem control shares is subject to certain conditions and limitations, including compliance with the 1940 Act. Fair value is determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquirer or of any meeting of stockholders at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquirer becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of appraisal rights may not be less than the highest price per share paid by the acquirer in the control share acquisition.

The Control Share Act does not apply (a) to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction or (b) to acquisitions approved or exempted by the charter or bylaws of the corporation. Our bylaws contain a provision exempting from the Control Share Act any and all acquisitions by any person of our shares of stock. There can be no assurance that such provision will not be amended or eliminated at any time in the future. However, the SEC staff has taken the position that, under the 1940 Act, an investment company may not avail itself of the Control Share Act. As a result, we will amend our bylaws to be subject to the Control Share Act only if the Board of Directors determines that it would be in our best interests and if the SEC staff does not object to our determination that our being subject to the Control Share Act does not conflict with the 1940 Act.

Business Combinations

Under Maryland law, “business combinations” between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder (the “Business Combination Act”). These business combinations include a merger, consolidation, share exchange or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested stockholder is defined as:

- any person who beneficially owns 10% or more of the voting power of the corporation’s outstanding voting stock; or
- an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then outstanding voting stock of the corporation.

A person is not an interested stockholder under this statute if the board of directors approved in advance the transaction by which the stockholder otherwise would have become an interested stockholder. However, in approving a transaction, the board of directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the board.

After the five-year prohibition, any business combination between the Maryland corporation and an interested stockholder generally must be recommended by the board of directors of the corporation and approved by the affirmative vote of at least:

- 80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation; and
- two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder.

These super-majority vote requirements do not apply if the corporation's common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares. The statute permits various exemptions from its provisions, including business combinations that are exempted by the board of directors before the time that the interested stockholder becomes an interested stockholder. Our board of directors has adopted a resolution that any business combination between us and any other person is exempted from the provisions of the Business Combination Act, provided that the business combination is first approved by the board of directors, including a majority of the directors who are not interested persons as defined in the 1940 Act. This resolution may be altered or repealed in whole or in part at any time; however, our board of directors will adopt resolutions so as to make us subject to the provisions of the Business Combination Act only if the board of directors determines that it would be in our best interests and if the SEC staff does not object to our determination that our being subject to the Business Combination Act does not conflict with the 1940 Act. If this resolution is repealed, or the board of directors does not otherwise approve a business combination, the statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Conflict with 1940 Act

Our bylaws provide that, if and to the extent that any provision of the Maryland General Corporation Law, including the Control Share Act (if we amend our bylaws to be subject to such Act) and the Business Combination Act, or any provision of our charter or bylaws conflicts with any provision of the 1940 Act, the applicable provision of the 1940 Act will control.

B. Debt Securities –6.00% Notes due 2022

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. The 2022 Notes are listed on the NASDAQ Global Select Market under the trading symbol "CPTAL" with a par value \$25.00 per share.

The 2022 Notes were issued under that certain indenture, dated June 16, 2014 (the "Base Indenture"), by and between the Company and U.S. Bank National Association (the "Trustee"), as supplemented by the second supplemental indenture dated as of May 16, 2017 (the "Second Supplemental Indenture" and, together with the Base Indenture, the "2022 Notes Indenture"), between the Company and the Trustee.

The 2022 Notes Indenture provides that debt securities may be issued thereunder from time to time in one or more series. The 2022 Notes Indenture and the 2022 Notes are governed by, and construed in accordance with, the laws of the State of New York. The 2022 Notes Indenture does not limit the amount of debt securities that we may issue under the 2022 Notes Indenture. We may, without the consent of the holders of the debt securities of any series, issue additional debt securities ranking equally with, and otherwise similar in all respects to, the debt securities of the series so that those additional debt securities will be consolidated and form a single series with the debt securities of the series previously offered and sold.

The 2022 Notes are the Company's direct unsecured obligations and rank:

- *pari passu* in right of payment with the Company's future unsecured unsubordinated indebtedness, including the 2022 Convertible Notes (as defined below);
- senior to any of the Company's future indebtedness that expressly states it is subordinated in right of payment to the 2022 Notes,
- effectively subordinated in right of payment to all of the Company's existing and future secured indebtedness (including indebtedness that is initially unsecured, but to which the Company subsequently grant security) to the extent of the value of the assets securing such indebtedness; and
- structurally subordinated to all existing and future indebtedness and other obligations of any of the Company's subsidiaries, financing vehicles, or similar facilities.

The 2022 Notes 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, upon not less than 30 days' nor more than 60 days' written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to but not including the date fixed for redemption. A holder may be prevented from exchanging or transferring the 2022 Notes when they are subject to redemption. In case any 2022 Notes are to be redeemed in part only, the redemption notice will provide that, upon surrender of such 2022 Note, a holder will receive, without a charge, a new 2022 Note or 2022 Notes of authorized denominations representing the principal amount of such holders remaining unredeemed Notes. Any exercise of our option to redeem the 2022 Notes will be done in compliance with the 1940 Act and the related rules, regulations and interpretations, to the extent applicable. If we redeem only some of the 2022 Notes, the Trustee or the Depositary Trust Company ("DTC"), as applicable, will determine the method for selection of the particular Notes to be redeemed, in accordance with the indenture and the 1940 Act and in accordance with the rules of any national securities exchange or quotation system on which the Notes are listed. Unless we default in payment of the redemption price, on and after the date of redemption, interest will cease to accrue on the 2022 Notes called for redemption.

As required by federal law for all bonds and notes of companies that are publicly offered in the United States, the debt securities are governed by a document called an "indenture." An indenture is a contract between us and a financial institution acting as trustee on a holders behalf, and is subject to and governed by the Trust Indenture Act of 1939, as amended. The Trustee with respect to the 2022 Notes has two main roles. First, the Trustee can enforce a holder's rights against us if we default under the applicable Notes. There are some limitations on the extent to which the Trustee acts on a holder's behalf, see "Events of Default" for more information. Second, the Trustee performs certain administrative duties for us, such as sending interest and principal payments to holders of the 2022 Notes.

General

For purposes of this description, any reference to the payment of principal of, or premium or interest, if any, on, the 2022 Notes will include additional amounts if required by the terms of the 2022 Notes.

The 2022 Notes Indenture does not limit the amount of debt securities that may be issued thereunder from time to time. Debt securities issued under the 2022 Notes Indenture, when a single trustee is acting for all debt securities issued thereunder, are called the "indenture securities." The 2022 Notes Indenture also provides that there may be more than one trustee thereunder, each with respect to one or more different series of indenture securities. See "Resignation of Trustee" below. At a time when two or more trustees are acting under the 2022 Notes Indenture, each with respect to only certain series, the term "indenture securities" means the one or more series of debt securities with respect to which each respective trustee is acting. In the event that there is more than one trustee under the 2022 Notes Indenture, the powers and trust obligations of each trustee described in this description will extend only to the one or more series of indenture securities for which it is trustee. If two or more trustees are acting under the 2022 Notes Indenture, then the indenture securities for which each trustee is acting would be treated as if issued under separate indentures.

The 2022 Notes Indenture does not contain any provisions that give a holder protection in the event we issue a large amount of debt or we are acquired by another entity.

Global Securities

The 2022 Notes were issued as registered securities in book-entry form only. A global security represents one or any other number of individual debt securities. Generally, all debt securities represented by the same global securities will have the same terms.

Each debt security issued in book-entry form is represented by a global security that we deposit with and register in the name of a financial institution or its nominee that we select. The financial institution that we select for this purpose is called the depository. DTC is the depository for all debt securities issued in book-entry form.

A global security may not be transferred to or registered in the name of anyone other than the depository or its nominee, unless special termination situations arise. We describe those situations below under “Special Situations when a Global Security Will Be Terminated.” As a result of these arrangements, the depository, or its nominee, will be the sole registered owner and holder of all debt securities represented by a global security, and investors will be permitted to own only beneficial interests in a global security. Beneficial interests must be held by means of an account with a broker, bank or other financial institution that in turn has an account with the depository or with another institution that has an account with the depository. Thus, an investor whose security is represented by a global security will not be a holder of the debt security, but only an indirect holder of a beneficial interest in the global security.

Special Considerations for Global Securities

As an indirect holder, an investor’s rights relating to a global security will be governed by the account rules of the investor’s financial institution and of the depository, as well as general laws relating to securities transfers. The depository that holds the global security will be considered the holder of the debt securities represented by the global security.

If debt securities are issued only in the form of a global security, an investor should be aware of the following:

- an investor cannot cause the debt securities to be registered in its name and cannot obtain certificates for its interest in the debt securities, except in the special situations we describe below;
- an investor will be an indirect holder and must look to its own bank or broker for payments on the debt securities and protection of its legal rights relating to the debt securities, as we describe under “Issuance of Securities in Registered Form” above;
- an investor may not be able to sell interests in the debt securities to some insurance companies and other institutions that are required by law to own their securities in non-book-entry form;
- an investor may not be able to pledge its interest in a global security in circumstances where certificates representing the debt securities must be delivered to the lender or other beneficiary of the pledge in order for the pledge to be effective;
- the depository’s policies, which may change from time to time, will govern payments, transfers, exchanges and other matters relating to an investor’s interest in a global security. We and the Trustee have no responsibility for any aspect of the depository’s actions or for its records of ownership interests in a global security. We and the Trustee also do not supervise the depository in any way;
- if we redeem less than all the debt securities of a particular series being redeemed, DTC’s practice is to determine by lot the amount to be redeemed from each of its participants holding that series;

- an investor is required to give notice of exercise of any option to elect repayment of its debt securities, through its participant, to the applicable trustee and to deliver the related debt securities by causing its participant to transfer its interest in those debt securities, on DTC's records, to the applicable trustee;
- DTC requires that those who purchase and sell interests in a global security deposited in its book-entry system use immediately available funds. A holder's broker or bank may also require a holder to use immediately available funds when purchasing or selling interests in a global security; and
- financial institutions that participate in the depository's book-entry system, and through which an investor holds its interest in a global security, may also have their own policies affecting payments, notices and other matters relating to the debt securities. There may be more than one financial intermediary in the chain of ownership for an investor. We do not monitor and are not responsible for the actions of any of those intermediaries.

Special Situations when a Global Security Will Be Terminated

In a few special situations, a global security will be terminated and interests in it will be exchanged for certificates in non-book-entry form (certificated securities). After that exchange, the choice of whether to hold the certificated debt securities directly or in street name will be up to the investor. Investors must consult their own banks or brokers to find out how to have their interests in a global security transferred on termination to their own names, so that they will be holders.

If a global security is terminated, only the depository, and not we or the applicable trustee, is responsible for deciding the names of the institutions in whose names the debt securities represented by the global security will be registered and, therefore, who will be the holders of those debt securities.

Payment and Paying Agents

We will pay interest to the person listed in the applicable trustee's records as the owner of the debt security at the close of business on a particular day in advance of each due date for interest, even if that person no longer owns the debt security on the interest due date. That day, usually about two weeks in advance of the interest due date, is called the "record date." Because we will pay all the interest for an interest period to the holders on the record date, holders buying and selling debt securities must work out between themselves the appropriate purchase price. The most common manner is to adjust the sales price of the debt securities to prorate interest fairly between buyer and seller based on their respective ownership periods within the particular interest period. This prorated interest amount is called "accrued interest."

Payments on Global Securities

We will make payments on the 2022 Notes so long as they are represented by a global security in accordance with the applicable policies of the depository as in effect from time to time. Under those policies, we will make payments directly to the depository, or its nominee, and not to any indirect holders who own beneficial interests in the global security. An indirect holder's right to those payments will be governed by the rules and practices of the depository and its participants, as described under "Global Securities."

Payment When Offices Are Closed

If any payment is due on the 2022 Notes on a day that is not a business day, we will make the payment on the next day that is a business day. Payments made on the next business day in this situation will be treated under the 2022 Notes Indenture as if they were made on the original due date, except as otherwise indicated in this description. Such payment will not result in a default under the 2022 Notes or the 2022 Notes Indenture, and no interest will accrue on the payment amount from the original due date to the next day that is a business day.

Events of Default under the 2022 Notes

A holder will have rights if an Event of Default occurs in respect of the 2022 Notes and is not cured, as described later in this subsection.

The term “Event of Default” in respect of the 2022 Notes means any of the following:

- we do not pay the principal of, or any premium on, any 2022 Notes when due and payable;
- we do not pay interest on any 2022 Notes when due and such default is not cured within 30 days;
- we remain in breach of any other covenant with respect to the 2022 Notes for 60 days after we receive a written notice of default stating we are in breach. The notice must be sent by either the Trustee or holders of at least 25% of the principal amount of the 2022 Notes;
- we file for bankruptcy or certain other events of bankruptcy, insolvency or reorganization occur and in the case of certain orders or decrees entered against us under bankruptcy law, such order or decree remains undischarged or unstayed for a period of 60 days; and
- on the last business day of each of twenty-four consecutive calendar months, the 2022 Notes have the asset coverage, as defined in the 1940 Act, of less than 100% after giving effect to any exemptive relief granted to us by the SEC;

An Event of Default for the 2022 Notes does not necessarily constitute an Event of Default for any other series of debt securities issued under the same or any other indenture. The Trustee may withhold notice to the holders of the 2022 Notes of any default, except in the payment of principal or interest, if it in good faith considers the withholding of notice to be in the best interests of the holders.

Remedies if an Event of Default Occurs

If an Event of Default has occurred and is continuing, the Trustee or the holders of not less than 25% in principal amount of the 2022 Notes may declare the entire principal amount of all the 2022 Notes to be due and immediately payable. This is called a declaration of acceleration of maturity. In certain circumstances, a declaration of acceleration of maturity may be canceled by the holders of a majority in principal amount of the 2022 Notes if (1) we have deposited with the Trustee all amounts due and owing with respect to the 2022 Notes (other than principal that has become due solely by reason of such acceleration) and certain other amounts, and (2) any other Events of Default have been cured or waived.

The Trustee is not required to take any action under the 2022 Notes Indenture at the request of any holders unless the holders offer the Trustee protection from expenses and liability reasonably satisfactory to it (called an “indemnity”). If indemnity reasonably satisfactory to the Trustee is provided, the holders of a majority in principal amount of the 2022 Notes may direct the time, method and place of conducting any lawsuit or other formal legal action seeking any remedy available to the Trustee. The Trustee may refuse to follow those directions in certain circumstances. No delay or omission in exercising any right or remedy will be treated as a waiver of that right, remedy or Event of Default.

Before a holder is allowed to bypass the Trustee and bring its own lawsuit or other formal legal action or take other steps to enforce its rights or protect its interests relating to the 2022 Notes, the following must occur:

- it must give the Trustee written notice that an Event of Default has occurred and remains uncured;
- the holders of at least 25% in principal amount of all the 2022 Notes must make a written request that the Trustee take action because of the default and must offer the Trustee indemnity, security, or both reasonably satisfactory to it the Trustee against the cost, expenses, and other liabilities of taking that action;

- the Trustee must not have taken action for 60 days after receipt of the above notice and offer of indemnity and/or security; and
- the holders of a majority in principal amount of the 2022 Notes must not have given the Trustee a direction inconsistent with the above notice during that 60-day period.

However, a holder is entitled at any time to bring a lawsuit for the payment of money due on its 2022 Notes on or after the due date.

Book-entry and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the Trustee and how to declare or cancel an acceleration of maturity.

Each year, we will furnish to the Trustee a written statement of certain of our officers certifying that to their knowledge we are in compliance with the 2022 Notes Indenture and the 2022 Notes, or else specifying any default.

Waiver of Default

The holders of a majority in principal amount of the 2022 Notes may waive any past defaults other than a default than:

- in the payment of principal or interest; or
- in respect of a covenant that cannot be modified or amended without the consent of each holder.

Merger or Consolidation

Under the terms of the 2022 Notes Indenture, we are generally permitted to consolidate or merge with another entity. We are also permitted to sell all or substantially all of our assets to another entity. However, we may not take any of these actions unless all the following conditions are met:

- where we merge out of existence or convey or transfer our assets substantially as an entirety, the resulting entity must agree to be legally responsible for our obligations under the 2022 Notes;
- the merger or sale of assets must not cause a default on the 2022 Notes and we must not already be in default (unless the merger or sale would cure the default). For purposes of this no-default test, a default would include an Event of Default that has occurred and has not been cured, as described under “Events of Default” above. A default for this purpose would also include any event that would be an Event of Default if the requirements for giving us a notice of default or our default having to exist for a specific period of time were disregarded;
- we must deliver certain certificates and documents to the Trustee; and

Modification or Waiver

There are three types of changes we can make to the 2022 Notes Indenture and the 2022 Notes issued thereunder.

Changes Requiring Approval

First, there are changes that we cannot make to the 2022 Notes without specific approval. The following is a list of those types of changes:

- change the stated maturity of the principal of or interest on the 2022 Notes;
- reduce any amounts due on the 2022 Notes;

- reduce the amount of principal payable upon acceleration of the maturity of a 2022 Note following a default;
- change the place or currency of payment on a Note;
- impair the right to sue for payment;
- reduce the percentage of holders of 2022 Notes whose consent is needed to modify or amend the 2022 Notes Indenture; and
- reduce the percentage of holders of 2022 Notes whose consent is needed to waive compliance with certain provisions of the 2022 Notes Indenture or to waive certain defaults.

Changes Not Requiring Approval

The second type of change does not require any vote by the holders of the 2022 Notes. This type is limited to clarifications and certain other changes that would not adversely affect holders of the 2022 Notes in any material respect.

Changes Requiring Majority Approval

Any other change to the 2022 Notes Indenture and the 2022 Notes would require the following approval:

- if the change affects only the 2022 Notes, it must be approved by the holders of a majority in principal amount of the 2022 Notes; and
- if the change affects more than one series of debt securities issued under the same 2022 Notes Indenture, it must be approved by the holders of a majority in principal amount of all of the series affected by the change, with all affected series voting together as one class for this purpose.

In each case, the required approval must be given by written consent.

The holders of a majority in principal amount of all of the series of debt securities issued under the 2022 Notes Indenture, voting together as one class for this purpose, may waive our compliance with some of our covenants in the 2022 Notes Indenture. However, we cannot obtain a waiver of a payment default or of any of the matters covered by the bullet points included above under “— Changes Requiring Approval.”

Further Details Concerning Voting

When taking a vote, we will use the following rules to decide how much principal to attribute to the 2022 Notes:

The 2022 Notes will not be considered outstanding, and therefore not eligible to vote, if we have deposited or set aside in trust money for their payment or redemption. The 2022 Notes will also not be eligible to vote if they have been fully defeased as described later under “— Defeasance — Full Defeasance.”

We will generally be entitled to set any day as a record date for the purpose of determining the holders of the 2022 Notes that are entitled to vote or take other action under the 2022 Notes Indenture. However, the record date may not be more than 30 days before the date of the first solicitation of holders to vote on or take such action. If we set a record date for a vote or other action to be taken by holders of the 2022 Notes, that vote or action may be taken only by persons who are holders of the 2022 Notes on the record date and must be taken within eleven months following the record date.

Book-entry and other indirect holders should consult their banks or brokers for information on how approval may be granted or denied if we seek to change the 2022 Notes Indenture or the 2022 Notes or request a waiver.

Defeasance

The following defeasance provisions will be applicable to the 2022 Notes. “Defeasance” means that, by depositing with a trustee an amount of cash and/or government securities sufficient to pay all principal and interest, if any, on the 2022 Notes when due and satisfying any additional conditions noted below, we will be deemed to have been discharged from our obligations under the 2022 Notes. In the event of a “covenant defeasance,” upon depositing such funds and satisfying similar conditions discussed below we would be released from certain of the restrictive covenants under the 2022 Notes Indenture relating to the 2022 Notes. The consequences to the holders of the 2022 Notes is that, while they no longer benefit from those restrictive covenants under the 2022 Notes Indenture, and while the 2022 Notes may not be accelerated for any reason, the holders of 2022 Notes nonetheless are guaranteed to receive the principal and interest owed to them.

Covenant Defeasance

Under current U.S. federal tax law and the 2022 Notes Indenture, we can make the deposit described below and be released from some of the restrictive covenants in the 2022 Notes Indenture under which the 2022 Notes were issued. This is called “covenant defeasance.” In that event, a holder would lose the protection of those restrictive covenants but would gain the protection of having money and government securities set aside in trust to repay the 2022 Notes. In order to achieve covenant defeasance, we must do the following:

- Since the 2022 Notes are denominated in U.S. dollars, we must deposit in trust for the benefit of all holders of the 2022 Notes a combination of cash and U.S. government or U.S. government agency notes or bonds that will generate enough cash to make interest, principal and any other payments on the 2022 Notes on their various due dates;
- we must deliver to the trustee a legal opinion of our counsel confirming that, under current U.S. federal income tax law, we may make the above deposit without causing a holder to be taxed on the 2022 Notes any differently than if we did not make the deposit;
- we must deliver to the trustee a legal opinion of our counsel stating that the above deposit does not require registration by us under the 1940 Act, and a legal opinion and officers’ certificate stating that all conditions precedent to covenant defeasance have been complied with;
- defeasance must not result in a breach or violation of, or result in a default under, the 2022 Notes Indenture or any of our other material agreements or instruments; and
- no default or event of default with respect to the 2022 Notes shall have occurred and be continuing and no defaults or events of default related to bankruptcy, insolvency or reorganization shall occur during the next 90 days.

If we accomplish covenant defeasance, a holder can still look to us for repayment of the 2022 Notes if there were a shortfall in the trust deposit or the trustee is prevented from making payment. In fact, if one of the remaining Events of Default occurred (such as our bankruptcy) and the 2022 Notes became immediately due and payable, there might be a shortfall. Depending on the event causing the default, a holder may not be able to obtain payment of the shortfall.

Full Defeasance

If there is a change in U.S. federal tax law, as described below, we can legally release ourselves from all payment and other obligations on the 2022 Notes (called “full defeasance”) if we put in place the following other arrangements for a holder to be repaid:

- Since the 2022 Notes are denominated in U.S. dollars, we must deposit in trust for the benefit of all holders of the 2022 Notes a combination of money and U.S. government or U.S. government agency notes or bonds that will generate enough cash to make interest, principal and any other payments on the 2022 Notes on their various due dates;

- we must deliver to the trustee a legal opinion confirming that there has been a change in current U.S. federal tax law or a U.S. Internal Revenue Service ruling that allows us to make the above deposit without causing a holder to be taxed on the 2022 Notes any differently than if we did not make the deposit. Under current U.S. federal tax law the deposit and our legal release from the 2022 Notes would be treated as though we paid the appropriate share of the cash and notes or bonds at the time the cash and notes or bonds were deposited in trust in exchange for the 2022 Notes and a holder would recognize gain or loss on the 2022 Notes at the time of the deposit;
- we must deliver to the trustee a legal opinion of our counsel stating that the above deposit does not require registration by us under the 1940 Act, and a legal opinion and officers' certificate stating that all conditions precedent to defeasance have been complied with;
- defeasance must not result in a breach or violation of, or constitute a default under, of the 2022 Notes Indenture or any of our other material agreements or instruments; and
- no default or event of default with respect to the 2022 Notes shall have occurred and be continuing and no defaults or events of default related to bankruptcy, insolvency or reorganization shall occur during the next 90 days.

If we ever did accomplish full defeasance, as described above, a holder would have to rely solely on the trust deposit for repayment of the 2022 Notes. A holder could not look to us for repayment in the unlikely event of any shortfall. Conversely, the trust deposit would most likely be protected from claims of our lenders and other creditors if we ever became bankrupt or insolvent.

Form, Exchange and Transfer of Certificated Registered Securities

If registered 2022 Notes cease to be issued in book-entry form, they will be issued:

- only in fully registered certificated form;
- without interest coupons; and
- unless we indicate otherwise, in denominations of \$25 and amounts that are multiples of \$25.

Holders may exchange their certificated securities for 2022 Notes of smaller denominations or combined into fewer 2022 Notes of larger denominations, as long as the total principal amount is not changed and as long as the denomination is equal to or greater than \$25.

Holders may exchange or transfer their certificated securities at the office of the trustee. We have appointed the trustee to act as our agent for registering 2022 Notes in the names of holders transferring 2022 Notes. We may appoint another entity to perform these functions or perform them ourselves.

Holders will not be required to pay a service charge to transfer or exchange their certificated securities, but they may be required to pay any tax or other governmental charge associated with the transfer or exchange. The transfer or exchange will be made only if our transfer agent is satisfied with the holder's proof of legal ownership.

We may appoint additional transfer agents or cancel the appointment of any particular transfer agent. We may also approve a change in the office through which any transfer agent acts.

If we redeem any of the 2022 Notes, we may block the transfer or exchange of those 2022 Notes selected for redemption during the period beginning 15 days before the day we mail the notice of redemption and ending on the day of that mailing, in order to freeze the list of holders to prepare the mailing. We may also refuse to register transfers or exchanges of any certificated 2022 Notes selected for redemption, except that we will continue to permit transfers and exchanges of the unredeemed portion of any 2022 Notes that will be partially redeemed.

If a registered Note is issued in book-entry form, only the depositary will be entitled to transfer and exchange the Note as described in this subsection, since it will be the sole holder of the Note.

Resignation of Trustee

The trustee may resign or be removed with respect to the 2022 Notes provided that a successor trustee is appointed to act with respect to the 2022 Notes. In the event that two or more persons are acting as trustee with respect to different series of indenture securities under the 2022 Notes Indenture, each of the trustees will be a trustee of a trust separate and apart from the trust administered by any other trustee.

Indenture Provisions — Subordination

Upon any distribution of our assets upon our dissolution, winding up, liquidation or reorganization, the payment of the principal of (and premium, if any) and interest, if any, on any indenture securities denominated as subordinated debt securities is to be subordinated to the extent provided in the indenture in right of payment to the prior payment in full of all Senior Indebtedness (as defined below), but our obligation to a holder to make payment of the principal of (and premium, if any) and interest, if any, on such subordinated debt securities will not otherwise be affected. In addition, no payment on account of principal (or premium, if any), sinking fund or interest, if any, may be made on such subordinated debt securities at any time unless full payment of all amounts due in respect of the principal (and premium, if any), sinking fund and interest on Senior Indebtedness has been made or duly provided for in money or money's worth.

In the event that, notwithstanding the foregoing, any payment by us is received by the trustee in respect of subordinated debt securities or by the holders of any of such subordinated debt securities, upon our dissolution, winding up, liquidation or reorganization before all Senior Indebtedness is paid in full, the payment or distribution received by the trustee in respect of such subordinated debt securities or by the holders of any of such subordinated debt securities must be paid over to the holders of the Senior Indebtedness or on their behalf for application to the payment of all the Senior Indebtedness remaining unpaid until all the Senior Indebtedness has been paid in full, after giving effect to any concurrent payment or distribution to the holders of the Senior Indebtedness. Subject to the payment in full of all Senior Indebtedness upon this distribution by us, the holders of such subordinated debt securities will be subrogated to the rights of the holders of the Senior Indebtedness to the extent of payments made to the holders of the Senior Indebtedness out of the distributive share of such subordinated debt securities.

By reason of this subordination, in the event of a distribution of our assets upon our insolvency, certain of our senior creditors may recover more, ratably, than holders of any subordinated debt securities or the holders of any indenture securities that are not Senior Indebtedness. The indenture provides that these subordination provisions will not apply to money and securities held in trust under the defeasance provisions of the indenture.

Senior Indebtedness is defined in the indenture as the principal of (and premium, if any) and unpaid interest on:

- our indebtedness (including indebtedness of others guaranteed by us), whenever created, incurred, assumed or guaranteed, for money borrowed, that we have designated as "Senior Indebtedness" for purposes of the indenture and in accordance with the terms of the indenture (including any indenture securities designated as Senior Indebtedness), and
- renewals, extensions, modifications and refinancings of any of this indebtedness.

If this prospectus is being delivered in connection with the offering of a series of indenture securities denominated as subordinated debt securities, the accompanying prospectus supplement will set forth the approximate amount of our Senior Indebtedness and of our other Indebtedness outstanding as of a recent date.

C. Debt Securities –5.75% Convertible Notes due 2022

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. The 2022 Convertible Notes are listed on the NASDAQ Capital Market under the trading symbol “CPTAG” with a par value \$25.00 per share.

The 2022 Convertible Notes were issued under the Base Indenture, as supplemented by the third supplemental indenture dated as of May 26, 2017 (the “Third Supplemental Indenture” and, together the Base Indenture, the “2022 Convertible Notes Indenture”), between the Company and the Trustee.

The 2022 Convertible Notes Indenture provides that the 2022 Convertible Notes may be issued thereunder from time to time in one or more series. The 2022 Convertible Notes Indenture and the 2022 Convertible Notes are governed by, and construed in accordance with, the laws of the State of New York. The 2022 Convertible Notes Indenture does not limit the amount of 2022 Convertible Notes that we may issue under the 2022 Convertible Notes Indenture. We may, without the consent of the holders of the debt securities of any series, issue additional debt securities ranking equally with, and otherwise similar in all respects to, the debt securities of the series so that those additional debt securities will be consolidated and form a single series with the debt securities of the series previously offered and sold.

The Convertible 2022 Notes are the Company’s direct unsecured obligations and rank:

- *pari passu* in right of payment with the Company’s future unsecured unsubordinated indebtedness, including the 2022 Notes;
- senior to any of the Company’s future indebtedness that expressly states it is subordinated in right of payment to the 2022 Notes,
- effectively subordinated in right of payment to all of the Company’s existing and future secured indebtedness (including indebtedness that is initially unsecured, but to which the Company subsequently grant security) to the extent of the value of the assets securing such indebtedness; and
- structurally subordinated to all existing and future indebtedness and other obligations of any of the Company’s subsidiaries, financing vehicles, or similar facilities.

As required by federal law for all bonds and notes of companies that are publicly offered in the United States, the debt securities are governed by a document called an “indenture.” An indenture is a contract between us and a financial institution acting as trustee on a holder’s behalf, and is subject to and governed by the Trust Indenture Act of 1939, as amended. The Trustee with respect to the 2022 Convertible Notes has two main roles. First, the Trustee can enforce a holder’s rights against us if we default under the 2022 Convertible Notes. There are some limitations on the extent to which the Trustee acts on a holder’s behalf, see “Events of Default” for more information. Second, the Trustee performs certain administrative duties for us, such as sending interest and principal payments to holders of the 2022 Convertible Notes.

General

For purposes of this description, any reference to the payment of principal of, or premium or interest, if any, on, the 2022 Convertible Notes will include additional amounts if required by the terms of the 2022 Convertible Notes.

The 2022 Convertible Notes Indenture does not limit the amount of debt securities that may be issued thereunder from time to time. Debt securities issued under the 2022 Convertible Notes Indenture, when a single trustee is acting for all debt securities issued thereunder, are called the “indenture securities.” The 2022 Convertible Notes also provides that there may be more than one trustee thereunder, each with respect to one or more different series of indenture securities. At a time when two or more trustees are acting under the 2022 Convertible Notes Indenture, each with respect to only certain series, the term “indenture securities” means the one or more series of debt securities with respect to which each respective trustee is acting. In the event that there is more than one trustee under the 2022 Convertible Notes Indenture, the powers and trust obligations of each trustee described in this description will extend only to the one or more series of indenture securities for which it is trustee. If two or more trustees are acting under the 2022 Convertible Notes Indenture, then the indenture securities for which each trustee is acting would be treated as if issued under separate indentures.

The 2022 Convertible Notes Indenture does not contain any provisions that give a holder protection in the event we issue a large amount of debt or we are acquired by another entity.

Cancellation and Repurchase

We will cause all 2022 Convertible Notes surrendered for payment, registration of transfer or exchange or conversion, if surrendered to any person other than the Trustee (including any of our agents, subsidiaries or affiliates), to be delivered to the Trustee for cancellation. All 2022 Convertible Notes delivered to the Trustee will be cancelled by the Trustee in accordance with its customary procedures. No 2022 Convertible Notes will be authenticated in exchange for any 2022 Convertible Notes cancelled as provided in the indenture. Any 2022 Convertible Notes surrendered for cancellation may not be reissued or resold and will be promptly cancelled.

We may, to the extent permitted by law, and directly or indirectly (regardless of whether such 2022 Convertible Notes are surrendered to us), repurchase the 2022 Convertible Notes in the open market or otherwise, whether by us or our subsidiaries or through a private or public tender or exchange offer or through counterparties to private agreements, including by cash-settled swaps or other derivatives. Any 2022 Convertible Notes repurchased by us may, at our option, be surrendered to the Trustee for cancellation.

Payments on the 2022 Convertible Notes; Paying Agent and Registrar; Transfer and Exchange

We will pay the principal of, and interest on, the 2022 Convertible Notes in global form registered in the name of or held by DTC or its nominee in immediately available funds to DTC or its nominee, as the case may be, as the registered holder of such global note.

We will pay the principal of any certificated 2022 Convertible Notes at the office or agency designated by us for that purpose. We have initially designated the Trustee as our paying agent and registrar and its agency in New York, New York as a place where 2022 Convertible Notes may be presented for payment or for registration of transfer. We may, however, change the paying agent or registrar without prior notice to the holders of the 2022 Convertible Notes, and we may act as paying agent or registrar. Interest on certificated 2022 Convertible Notes will be payable (i) to holders having an aggregate principal amount of \$5,000,000 or less, by check mailed to the holders of these 2022 Convertible Notes and (ii) to holders having an aggregate principal amount of more than \$5,000,000, either by check mailed to each holder or, upon application by a holder to the registrar not later than the relevant regular record date (as defined below), by wire transfer in immediately available funds to that holder’s account within the United States, which application will remain in effect until the holder notifies, in writing, the registrar to the contrary.

A holder of 2022 Convertible Notes may transfer or exchange 2022 Convertible Notes at the office of the registrar in accordance with the 2022 Convertible Notes Indenture and the applicable procedures of DTC. The registrar and the Trustee may require a holder, among other things, to furnish appropriate endorsements and transfer documents. No service charge will be imposed by us, the Trustee or the registrar for any registration of transfer or exchange of 2022 Convertible Notes, but we may require a holder to pay a sum sufficient to cover any transfer tax or other similar governmental charge required by law or permitted by the indenture. We are not required to transfer or exchange any Note surrendered for conversion or required repurchase.

The registered holder of a Note will be treated as its owner for all purposes.

Conversion Rights

General

Holders may convert their 2022 Convertible Notes at the conversion rate at any time prior to the close of business on the scheduled trading day immediately preceding the maturity date. The conversion rate is initially 1.5913 shares of our common stock per \$25.00 principal amount of 2022 Convertible Notes (equivalent to an initial conversion price of approximately \$15.71 per share of our common stock). The conversion rate is subject to adjustment as described below. The Trustee will initially act as the conversion agent, but any shares of our common stock issuable upon conversion will be issued by us directly to the relevant converting holder in accordance with the indenture.

A holder may convert fewer than all of such holder's 2022 Convertible Notes so long as the 2022 Convertible Notes converted are a multiple of \$25.00 principal amount.

If a holder of 2022 Convertible Notes has submitted 2022 Convertible Notes for repurchase upon a fundamental change, the holder may convert those 2022 Convertible Notes only if that holder first withdraws its repurchase notice.

Upon conversion, a holder will not receive any cash payment for accrued and unpaid interest, if any, except as described below. We will not issue fractional shares of our common stock upon conversion of 2022 Convertible Notes. Instead we will pay cash in lieu of any fractional share based on the last reported sale price of our common stock on the conversion date. Our payment and delivery to a holder of shares of our common stock (and any cash in lieu of fractional shares) into which a 2022 Convertible Note is convertible will be deemed to satisfy in full our obligation to pay:

- the principal amount of the note; and
- accrued and unpaid interest, if any, to, but not including, the conversion date.

As a result, accrued and unpaid interest, if any, to, but not including, the conversion date will be deemed to be paid in full rather than cancelled, extinguished or forfeited.

Notwithstanding the immediately preceding paragraph, if 2022 Convertible Notes are converted after the close of business on a regular record date for the payment of interest, holders of such 2022 Convertible Notes at the close of business on such regular record date will receive the full amount of interest payable on such 2022 Convertible Notes on the corresponding interest payment date notwithstanding the conversion. 2022 Convertible Notes surrendered for conversion during the period from the close of business on any regular record date to 9:00 a.m. New York City time (the "open of business") on the immediately following interest payment date must be accompanied by funds equal to the amount of interest payable on the 2022 Convertible Notes so converted; provided that no such payment need be made:

- for conversions following the regular record date immediately preceding the maturity date;
- if we have specified a fundamental change repurchase date that is after a regular record date and on or prior to the corresponding interest payment date; or
- to the extent of any overdue interest, if any overdue interest exists at the time of conversion with respect to such note.

If a holder converts 2022 Convertible Notes, we will pay any documentary, stamp or similar issue or transfer tax due on the issue of shares of our common stock upon the conversion, unless the tax is due because the holder requests any shares to be issued in a name other than the holder's name, in which case the holder will pay that tax.

Conversion Procedures

If a holder holds a beneficial interest in a global note, to convert, it must comply with DTC's procedures for converting a beneficial interest in a global note and, if required, pay funds equal to interest payable on the next interest payment date to which such holder is not entitled and, if required, pay all taxes or duties, if any.

If a holder hold a certificated note, to convert it must:

- complete and manually sign the conversion notice on the back of the note, or a facsimile of the conversion notice;
- deliver the conversion notice, which is irrevocable, and the note to the conversion agent;
- if required, furnish appropriate endorsements and transfer documents and, if required, pay all taxes or duties, if any; and
- if required, pay funds equal to interest payable on the next interest payment date.

We refer to the date a holder complies with the relevant procedures for conversion described above as the "conversion date."

If a holder has already delivered a repurchase notice as described under "— Fundamental Change Permits Holders to Require Us to Repurchase 2022 Convertible Notes" with respect to a 2022 Convertible Note, the holder may not surrender that 2022 Convertible Note for conversion until the holder has withdrawn the repurchase notice in accordance with the relevant provisions of the 2022 Convertible Note Indenture. If a holder submits its 2022 Convertible Notes for required repurchase, the holder's right to withdraw the repurchase notice and convert the 2022 Convertible Notes that are subject to repurchase will terminate at the close of business on the business day immediately preceding the relevant fundamental change repurchase date.

Limitation on Beneficial Ownership

Notwithstanding the foregoing, no holder of 2022 Convertible Notes is entitled to receive shares of our common stock upon conversion to the extent (but only to the extent) that such receipt would cause such converting holder to become, directly or indirectly, a "beneficial owner" (within the meaning of Section 13(d) of the Exchange Act and the rules and regulations promulgated thereunder) of more than 5.0% of the shares of our common stock outstanding at such time (the "limitation"). Any purported delivery of shares of our common stock upon conversion of 2022 Convertible Notes will be void and have no effect to the extent (but only to the extent) that such delivery would result in the converting holder becoming the beneficial owner of more than the limitation. If any delivery of shares of our common stock owed to a holder upon conversion of 2022 Convertible Notes is not made, in whole or in part, as a result of the limitation, our obligation to make such delivery will not be extinguished and we will deliver such shares as promptly as practicable after any such converting holder gives notice to us that such delivery would not result in it being the beneficial owner of more than 5.0% of the shares of common stock outstanding at such time. The limitation will no longer apply following the effective date of any fundamental change, as defined in "— Fundamental Change Permits Holders to Require Us to Repurchase 2022 Convertible Notes."

Settlement Upon Conversion

We will deliver to the converting holder in respect of each \$25.00 principal amount of 2022 Convertible Notes being converted a number of shares of common stock equal to the conversion rate (plus cash in lieu of fractional shares).

Except as described under "— Adjustment to Shares Delivered Upon Conversion Upon a Make-Whole Fundamental Change" and "— Recapitalizations, Reclassifications and Changes of Our Common Stock," we will deliver the consideration due in respect of conversion on the third business day immediately following the relevant conversion date.

Each conversion will be deemed to have been effected as to any 2022 Convertible Notes surrendered for conversion on the conversion date. The person in whose name any shares of our common stock will be issuable upon such conversion will become the holder of record of such shares as of the close of business on the conversion date solely for the purpose of receiving or participating in any dividend, distribution, issuance, share split or combination, tender or exchange offer or any other event that would lead to a conversion rate adjustment as described under “— Conversion Rate Adjustments” below.

Conversion Rate Adjustments

The conversion rate will be adjusted as described below, except that we will not make any adjustments to the conversion rate if holders of the 2022 Convertible Notes participate (other than in the case of a share split or share combination), at the same time and upon the same terms as holders of our common stock and solely as a result of holding the 2022 Convertible Notes, in any of the transactions described below without having to convert their 2022 Convertible Notes as if they held a number of shares of common stock equal to the conversion rate, multiplied by the principal amount of 2022 Convertible Notes held by such holder.

- (1) If we exclusively issue shares of our common stock as a dividend or distribution on shares of our common stock, or if we effect a share split or share combination, the conversion rate will be adjusted based on the following formula:

$$CR_1 = CR_0 \times \frac{OS_1}{OS_0}$$

where,

CR₀ = the conversion rate in effect immediately prior to the open of business on the ex-dividend date of such dividend or distribution, or immediately prior to the effectiveness of such share split or combination, as applicable;

CR₁ = the conversion rate in effect immediately after the open of business on such ex-dividend date or immediately after such effectiveness;

OS₀ = the number of shares of our common stock outstanding immediately prior to the open of business on such ex-dividend date or immediately prior to such effectiveness; and

OS₁ = the number of shares of our common stock outstanding immediately after giving effect to such dividend, distribution, share split or share combination.

Any adjustment made under this clause (1) will become effective immediately after the open of business on the ex-dividend date for such dividend or distribution, or immediately after the effectiveness of such share split or share combination, as applicable. If any dividend or distribution of the type described in this clause (1) is declared but not so paid or made, the conversion rate will be immediately readjusted, effective as of the date our board of directors or a committee thereof determines not to pay such dividend or distribution, to the conversion rate that would then be in effect if such dividend or distribution had not been declared.

- (2) If we issue to all or substantially all holders of our common stock any rights, options or warrants entitling them, for a period of not more than 45 calendar days after the issuance date for such distribution, to subscribe for or purchase shares of our common stock at a price per share that is less than the average of the last reported sale prices of our common stock for the 10 consecutive trading day period ending on, and including, the trading day immediately preceding the date of announcement of such issuance, the conversion rate will be adjusted based on the following formula:

$$CR_1 = CR_0 \times \frac{OS_0 + X}{OS_0 + Y}$$

where,

CR₀ = the conversion rate in effect immediately prior to the open of business on the ex-dividend date for such issuance;

CR₁ = the conversion rate in effect immediately after the open of business on such ex-dividend date;

OS₀ = the number of shares of our common stock outstanding immediately prior to the open of business on such ex-dividend date;

X = the total number of shares of our common stock issuable pursuant to such rights, options or warrants; and

Y = the number of shares of our common stock equal to the aggregate price payable to exercise such rights, options or warrants, divided by the average of the last reported sale prices of our common stock over the 10 consecutive trading day period ending on, and including, the trading day immediately preceding the date of announcement of the issuance of such rights, options or warrants.

Any increase made under this clause (2) will be made successively whenever any such rights, options or warrants are issued and will become effective immediately after the open of business on the ex-dividend date for such issuance. To the extent that shares of common stock are not delivered after the expiration of such rights, options or warrants, the conversion rate will be decreased to the conversion rate that would then be in effect had the increase with respect to the issuance of such rights, options or warrants been made on the basis of delivery of only the number of shares of common stock actually delivered. If such rights, options or warrants are not so issued, the conversion rate will be decreased to the conversion rate that would then be in effect if such ex-dividend date for such issuance had not occurred.

For the purpose of this clause (2), in determining whether any rights, options or warrants entitle the holders to subscribe for or purchase shares of the common stock at less than such average of the last reported sale prices for the 10 consecutive trading day period ending on, and including, the trading day immediately preceding the date of announcement of such issuance, and in determining the aggregate offering price of such shares of common stock, there will be taken into account any consideration received by us for such rights, options or warrants and any amount payable on exercise or conversion thereof, the value of such consideration, if other than cash, to be determined by our board of directors or a committee thereof.

(3) If we distribute shares of our capital stock, evidences of our indebtedness, other assets or property of ours or rights, options or warrants to acquire our capital stock or other securities, to all or substantially all holders of our common stock, excluding:

- dividends, distributions or issuances as to which an adjustment was effected pursuant to clause (1) or (2) above;
- dividends or distributions paid exclusively in cash; and
- spin-offs to which the provisions set forth below in this clause (3) will apply;

then the conversion rate will be adjusted based on the following formula:

$$CR_1 = CR_0 \times \frac{SP_0}{SP_0 - FMV}$$

where,

CR_0 = the conversion rate in effect immediately prior to the open of business on the ex-dividend date for such distribution;

CR_1 = the conversion rate in effect immediately after the open of business on such ex-dividend date;

SP_0 = the average of the last reported sale prices of our common stock over the 10 consecutive trading day period ending on, and including, the trading day immediately preceding the ex-dividend date for such distribution; and

FMV = the fair market value (as determined by our board of directors or a committee thereof) of the shares of capital stock, evidences of indebtedness, assets, property, rights, options or warrants distributed with respect to each outstanding share of our common stock on the ex-dividend date for such distribution.

Any increase made under this clause (3) above will become effective immediately after the open of business on the ex-dividend date for such distribution. If such distribution is not so paid or made, the conversion rate will be decreased to be the conversion rate that would then be in effect if such dividend or distribution had not been declared. Notwithstanding the foregoing, if “ FMV ” (as defined above) is equal to or greater than “ SP_0 ” (as defined above), in lieu of the foregoing increase, each holder of a Note will receive, in respect of each \$25.00 principal amount thereof, at the same time and upon the same terms as holders of our common stock, the amount and kind of our capital stock, evidences of our indebtedness, other assets or property of ours or rights, options or warrants to acquire our capital stock or other securities that such holder would have received if such holder owned a number of shares of common stock equal to the conversion rate in effect on the ex-dividend date for the distribution.

With respect to an adjustment pursuant to this clause (3) where there has been a payment of a dividend or other distribution on our common stock of shares of capital stock of any class or series, or similar equity interest, of or relating to a subsidiary or other business unit, that are, or, when issued, will be, listed or admitted for trading on a U.S. national securities exchange, which we refer to as a “spin-off,” the conversion rate will be adjusted based on the following formula:

$$CR_1 = CR_0 \times \frac{FMV + MP_0}{MP_0}$$

where,

CR_0 = the conversion rate in effect immediately prior to the open of business on the ex-dividend date for the spin-off;

CR_1 = the conversion rate in effect immediately after the open of business on the ex-dividend date for the spin-off;

FMV = the average of the last reported sale prices of the capital stock or similar equity interest distributed to holders of our common stock applicable to one share of our common stock (determined by reference to the definition of “last reported sale price” set forth below as if references therein to our common stock were to such capital stock or similar equity interest) over the first 10 consecutive trading day period after, and including, the ex-dividend date of the spin-off (the “valuation period”); and

MP_0 = the average of the last reported sale prices of our common stock over the valuation period.

The adjustment to the conversion rate under the preceding paragraph will occur on the last trading day of the valuation period but will be given effect as of the open of business on the ex-dividend date for the spin-off; provided that in respect of any conversion during the valuation period, references in the preceding paragraph with respect to 10 trading days shall be deemed to be replaced with such lesser number of trading days as have elapsed between the ex-dividend date of such spin-off and the conversion date in determining the conversion rate.

- (4) If any cash dividend or distribution is made by us to all or substantially all holders of our common stock, other than a regular, monthly cash dividend that does not exceed the DTA, the conversion rate will be adjusted based on the following formula:

$$CR_1 = CR_0 \times \frac{SP_0 - DTA}{SP_0 - C}$$

where,

CR_0 = the conversion rate in effect immediately prior to the open of business on the ex-dividend date for such dividend or distribution;

CR_1 = the conversion rate in effect immediately after the open of business on the ex-dividend date for such dividend or distribution;

SP_0 = the last reported sale price of our common stock on the trading day immediately preceding the ex-dividend date for such dividend or distribution;

DTA = the dividend threshold amount, which will initially be equal to \$0.13 per month; provided that if there is not an ex-dividend date for a dividend in any month, the dividend threshold amount may be carried forward by the Company to the next subsequent month and to the extent the aggregate amount of any dividends with an ex-dividend date in such subsequent month is less than \$0.26 such difference may be carried forward to the second subsequent month, subject to a maximum dividend threshold amount at any time of \$0.39; and

C = the amount in cash per share we distribute to holders of our common stock.

The initial dividend threshold amount (DTA) is subject to adjustment in a manner inversely proportional to adjustments to the conversion rate; provided that no adjustment will be made to the dividend threshold amount (DTA) for any adjustment to the conversion rate under this clause (4). If an adjustment is required to be made as set forth in this clause (4) as a result of a distribution that is not a regular monthly dividend, the dividend threshold amount (DTA) will be deemed to be zero. Notwithstanding the foregoing, if at any time regular dividends are distributed other than on a monthly basis, the dividend threshold amount (DTA) shall be appropriately adjusted as set forth in an Officers' Certificate delivered to the Trustee and shall apply to such regular dividends.

Any increase made under this clause (4) will become effective immediately after the open of business on the ex-dividend date for such dividend or distribution. If such dividend or distribution is not so paid, the conversion rate will be decreased, effective as of the date our board of directors or a committee thereof determines not to make or pay such dividend or distribution, to be the conversion rate that would then be in effect if such dividend or distribution had not been declared. Notwithstanding the foregoing, if "C" (as defined above) is equal to or greater than "SP0" (as defined above), in lieu of the foregoing increase, each holder of a Note will receive, for each \$25.00 principal amount of 2022 Convertible Notes, at the same time and upon the same terms as holders of shares of our common stock, the amount of cash that such holder would have received if such holder owned a number of shares of our common stock equal to the conversion rate on the ex-dividend date for such cash dividend or distribution.

- (5) If we or any of our subsidiaries make a payment in respect of a tender or exchange offer for our common stock, to the extent that the cash and value of any other consideration included in the payment per share of common stock exceeds the last reported sale price of our common stock on the trading day next succeeding the last date on which tenders or exchanges may be made pursuant to such tender or exchange offer, the conversion rate will be adjusted based on the following formula:

$$CR_1 = CR_0 \times \frac{AC + (SP_1 \times OS_1)}{OS_0 \times SP_1}$$

where,

CR_0 = the conversion rate in effect immediately prior to the open of business on the trading day immediately following the date such tender or exchange offer expires;

CR_1 = the conversion rate in effect immediately after the open of business on the trading day immediately following the date such tender or exchange offer expires;

AC = the aggregate value of all cash and any other consideration (as determined by our board of directors or a committee thereof) paid or payable for shares purchased in such tender or exchange offer;

OS_0 = the number of shares of our common stock outstanding immediately prior to the date such tender or exchange offer expires (prior to giving effect to the purchase of all shares accepted for purchase or exchange in such tender or exchange offer);

OS_1 = the number of shares of our common stock outstanding immediately after the date such tender or exchange offer expires (after giving effect to the purchase of all shares accepted for purchase or exchange in such tender or exchange offer); and

SP_1 = the average of the last reported sale prices of our common stock over the 10 consecutive trading day period commencing on, and including, the trading day next succeeding the date such tender or exchange offer expires.

The adjustment to the conversion rate under the preceding paragraph will occur at the close of business on the 10th trading day immediately following, and including, the trading day next succeeding the date such tender or exchange offer expires but will be given effect as of the open of business on the trading day next succeeding the date such tender or exchange offer expires; provided that in respect of any conversion within the 10 trading days immediately following, and including, the expiration date of any tender or exchange offer, references with respect to 10 trading days shall be deemed replaced with such lesser number of trading days as have elapsed between the expiration date of such tender or exchange offer and the conversion date in determining the conversion rate.

Notwithstanding the foregoing, if a conversion rate adjustment becomes effective on any ex-dividend date as described above, and a holder that has converted its 2022 Convertible Notes on or after such ex-dividend date and on or prior to the related record date would be treated as the record holder of shares of our common stock as of the related conversion date as described under “— Settlement Upon Conversion” based on an adjusted conversion rate for such ex-dividend date, then, notwithstanding the foregoing conversion rate adjustment provisions, the conversion rate adjustment relating to such ex-dividend date will not be made for such converting holder. Instead, such holder will be treated as if such holder were the record owner of the shares of our common stock on an unadjusted basis and participate in the related dividend, distribution or other event giving rise to such adjustment.

Except as stated herein, we will not adjust the conversion rate for the issuance of shares of our common stock or any securities convertible into or exchangeable for shares of our common stock or the right to purchase shares of our common stock or such convertible or exchangeable securities.

As used in this section, “ex-dividend date” means the first date on which the shares of our common stock trade on the applicable exchange or in the applicable market, regular way, without the right to receive the issuance, dividend or distribution in question, from us or, if applicable, from the seller of our common stock on such exchange or market (in the form of due bills or otherwise) as determined by such exchange or market.

We are permitted to increase the conversion rate of the 2022 Convertible Notes by any amount for a period of at least 20 business days if our board of directors or a committee thereof determines that such increase would be in our best interest. We may also (but are not required to) increase the conversion rate to avoid or diminish income tax to holders of our common stock or rights to purchase shares of our common stock in connection with a dividend or distribution of shares (or rights to acquire shares) or similar event. We will not take any action that would result in an adjustment of the conversion rate, pursuant to the provisions described above, in such a manner as to result in the reduction of the conversion price to less than the par value per share of our common stock.

A holder may, in some circumstances, including a distribution of cash dividends to holders of our shares of common stock, be deemed to have received a distribution subject to U.S. federal income tax as a result of an adjustment or the nonoccurrence of an adjustment to the conversion rate.

To the extent that we have a rights plan in effect upon conversion of the 2022 Convertible Notes, a holder will receive, in addition to the shares of common stock received in connection with such conversion, the rights under the rights plan, unless prior to any conversion, the rights have separated from the common stock, in which case, and only in such case, the conversion rate will be adjusted at the time of separation as if we distributed to all holders of our common stock, shares of our capital stock, evidences of indebtedness, assets, property, rights, options or warrants as described in clause (3) above, subject to readjustment in the event of the expiration, termination or redemption of such rights.

Notwithstanding any of the foregoing, the conversion rate will not be adjusted:

- upon the issuance of any shares of our common stock pursuant to any present or future plan providing for the reinvestment of dividends or interest payable on our securities and the investment of additional optional amounts in shares of our common stock under any plan;
- upon the issuance of any shares of our common stock or options or rights to purchase those shares pursuant to any present or future employee, director or consultant benefit plan or program of or assumed by us or any of our subsidiaries;
- upon the issuance of any shares of our common stock pursuant to any option, warrant, right or exercisable, exchangeable or convertible security not described in the preceding bullet and outstanding as of the date the 2022 Convertible Notes were first issued;
- solely for a change in the par value of the common stock or a change in our jurisdiction of incorporation; or
- for accrued and unpaid interest, if any.

Adjustments to the conversion rate will be calculated to the nearest 1/10,000th of a share. We are not required to make an adjustment in the conversion rate unless the adjustment would require a change of at least 1% in the conversion rate. However, we will carry forward any adjustments that are less than 1% of the conversion rate and make such carried forward adjustment, regardless of whether the aggregate adjustment is less than 1%, on the conversion date for any 2022 Convertible Notes.

The “last reported sale price” of our common stock on any date means the closing sale price per share (or if no closing sale price is reported, the average of the bid and ask prices or, if more than one in either case, the average of the average bid and the average ask prices) on that date as reported in composite transactions for the principal U.S. national or regional securities exchange on which our common stock is traded. The last reported sale price will be determined without reference to after-hours trading or extended market trading. If our common stock is not listed for trading on a U.S. national or regional securities exchange on the relevant date, the “last reported sale price” will be the last quoted bid price for our common stock in the over-the-counter market on the relevant date as reported by OTC Markets Group Inc. or a similar organization. If our common stock is not so quoted, the “last reported sale price” will be the average of the mid-point of the last bid and ask prices for our common stock on the relevant date from each of at least three nationally recognized independent investment banking firms selected by us for this purpose.

“Scheduled trading day” means a day that is scheduled to be a trading day on the principal U.S. national or regional securities exchange or market on which our common stock is listed or admitted for trading. If our common stock is not so listed or admitted for trading, “scheduled trading day” means a “business day.”

“Trading day” means a day on which (i) trading in our common stock generally occurs on The NASDAQ Global Select Market or, if our common stock is not then listed on The NASDAQ Global Select Market, on the principal other U.S. national or regional securities exchange on which our common stock is then listed or, if our common stock is not then listed on a U.S. national or regional securities exchange, on the principal other market on which our common stock is then traded, and (ii) a last reported sale price for our common stock is available on such securities exchange or market. If our common stock is not so listed or traded, “trading day” means a “business day.”

Recapitalizations, Reclassifications and Changes of Our Common Stock

In the case of:

- any recapitalization, reclassification or change of our common stock (other than changes resulting from a subdivision or combination or a change solely in par value),
- any consolidation, merger or combination involving us,
- any sale, lease or other transfer to a third party of all or substantially all of our and our subsidiaries’ consolidated assets, or
- any statutory share exchange,

in each case, as a result of which our common stock would be converted into, or exchanged for, stock, other securities, other property or assets (including cash or any combination thereof), then, at and after the effective time of the transaction, the right to convert each \$25.00 principal amount of 2022 Convertible Notes will be changed into a right to convert such principal amount of 2022 Convertible Notes into the kind and amount of shares of stock, other securities or other property or assets (including cash or any combination thereof) that a holder of a number of shares of common stock equal to the conversion rate immediately prior to such transaction would have owned or been entitled to receive (the “reference property”) upon such transaction. However, at and after the effective time of the transaction, any shares of our common stock that we would have been required to deliver upon conversion of the 2022 Convertible Notes will instead be deliverable in the amount and type of reference property that a holder of that number of shares of our common stock would have received in such transaction. If the transaction causes our common stock to be converted into the right to receive more than a single type of consideration (determined based in part upon any form of stockholder election), the reference property into which the 2022 Convertible Notes will become convertible will be deemed to be the kind and amount of consideration elected to be received by a majority of our common stock voted for such an election (if electing between two types of consideration) or a plurality of our common stock voted for such an election (if electing between more than two types of consideration), as the case may be. If the holders receive only cash in such transaction, then for all conversions that occur after the effective date of such transaction (i) the consideration due upon conversion of each \$25.00 principal amount of 2022 Convertible Notes shall be solely cash in an amount equal to the conversion rate in effect on the conversion date (as may be increased by any additional shares as described under “— Adjustment to Shares Due Upon Conversion Upon a Make-Whole Fundamental Change”), multiplied by the price paid per share of common stock in such transaction and (ii) we will satisfy our conversion obligation by paying cash to converting holders on the third business day immediately following the relevant conversion date. We are not permitted to become a party to any such transaction unless its terms are consistent with the foregoing in all material respects.

In connection with any adjustment to the conversion rate described above, we will also adjust the initial dividend threshold (as defined under “— Conversion Rate Adjustments”) based on the relative value of shares of common stock comprising the reference property as compared to the value of any non-stock consideration comprising the reference property. If the reference property is composed solely of non-stock consideration, the initial dividend threshold will be zero.

Adjustments of Prices

Whenever any provision of the 2022 Convertible Notes Indenture requires us to calculate the last reported sale prices over a span of multiple days (including the “stock price” (as defined below) for purposes of a make-whole fundamental change), our board of directors or a committee thereof will make appropriate adjustments to each to account for any adjustment to the conversion rate that becomes effective, or any event requiring an adjustment to the conversion rate where the ex-dividend date of the event occurs, at any time during the period when the last reported sale prices are to be calculated.

Adjustment to Shares Delivered Upon Conversion Upon a Make-Whole Fundamental Change

If a “fundamental change” as defined in clauses (1), (2) or (4) below and determined after giving effect to any exceptions to or exclusions from such definition, but without regard to the proviso in clause (2) of the definition thereof (a “make-whole fundamental change”) occurs and a holder elects to convert its 2022 Convertible Notes in connection with such make-whole fundamental change, we will, under certain circumstances, increase the conversion rate for the 2022 Convertible Notes so surrendered for conversion by a number of additional shares of common stock (the “additional shares”), as described below. A conversion of 2022 Convertible Notes will be deemed for these purposes to be “in connection with” such make-whole fundamental change if the notice of conversion of the 2022 Convertible Notes is received by the conversion agent from, and including, the effective date of the make-whole fundamental change up to, and including, the business day immediately prior to the related fundamental change repurchase date (or, in the case of a make-whole fundamental change that would have been a fundamental change but for the proviso in clause (2) of the definition thereof, the 35th calendar day immediately following the effective date of such make-whole fundamental change).

We will notify holders of the effective date of any make-whole fundamental change and issue a press release announcing such effective date no later than five business days after such effective date.

The number of additional shares, if any, by which the conversion rate will be increased will be determined by reference to the table below, based on the date on which the make-whole fundamental change occurs or becomes effective (the “effective date”) and the price (the “stock price”) paid (or deemed to be paid) per share of our common stock in the make-whole fundamental change. If the holders of our common stock receive only cash in a make-whole fundamental change described in clause (2) of the definition of fundamental change, the stock price will be the cash amount paid per share. Otherwise, the stock price will be the average of the last reported sale prices of our common stock over the five trading day period ending on, and including, the trading day immediately preceding the effective date of the make-whole fundamental change.

The stock prices set forth in the column headings of the table below will be adjusted as of any date on which the conversion rate of the 2022 Convertible Notes is otherwise adjusted. The adjusted stock prices will equal the stock prices immediately prior to such adjustment, multiplied by a fraction, the numerator of which is the conversion rate immediately prior to the adjustment giving rise to the stock price adjustment and the denominator of which is the conversion rate as so adjusted. The number of additional shares will be adjusted in the same manner and at the same time as the conversion rate as set forth under “— Conversion Rate Adjustments.”

The following table sets forth the number of additional shares to be received per \$25.00 principal amount of 2022 Convertible Notes for each stock price and effective date set forth below:

Effective Stock Price

| Effective Date | \$13.78 | \$14.00 | \$14.50 | \$15.00 | \$15.50 | \$15.71 | \$16.00 | \$16.50 | \$17.00 | \$17.50 | \$18.00 | \$18.50 |
|----------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| May 26, 2017 | 0.2228 | 0.2040 | 0.1647 | 0.1303 | 0.1003 | 0.0890 | 0.0747 | 0.0532 | 0.0355 | 0.0216 | 0.0113 | 0.0046 |
| May 31, 2018 | 0.2228 | 0.2040 | 0.1647 | 0.1303 | 0.1003 | 0.0890 | 0.0747 | 0.0532 | 0.0355 | 0.0216 | 0.0113 | 0.0046 |
| May 31, 2019 | 0.2228 | 0.2040 | 0.1647 | 0.1303 | 0.1003 | 0.0890 | 0.0747 | 0.0526 | 0.0347 | 0.0210 | 0.0111 | 0.0046 |
| May 31, 2020 | 0.2228 | 0.2040 | 0.1647 | 0.1303 | 0.0981 | 0.0859 | 0.0706 | 0.0483 | 0.0308 | 0.0177 | 0.0088 | 0.0035 |
| May 31, 2021 | 0.2228 | 0.2040 | 0.1605 | 0.1194 | 0.0852 | 0.0729 | 0.0577 | 0.363 | 0.0207 | 0.0101 | 0.0040 | 0.0013 |
| May 31, 2022 | 0.2228 | 0.1934 | 0.1327 | 0.0753 | 0.0215 | 0.0000 | 0.0000 | 0.0000 | 0.0000 | 0.0000 | 0.0000 | 0.0000 |

The exact stock prices and effective dates may not be set forth in the table above, in which case

- If the stock price is between two stock prices in the table or the effective date is between two effective dates in the table, the number of additional shares will be determined by a straight-line interpolation between the number of additional shares set forth for the higher and lower stock prices and the earlier and later effective dates, as applicable, based on a 365-day year.
- If the stock price is greater than \$18.50 per share (subject to adjustment in the same manner as the stock prices set forth in the column headings of the table above), no additional shares will be added to the conversion rate.
- If the stock price is less than \$13.78 per share (subject to adjustment in the same manner as the stock prices set forth in the column headings of the table above), no additional shares will be added to the conversion rate.

Notwithstanding the foregoing, in no event will the conversion rate per \$25.00 principal amount of 2022 Convertible Notes exceed 1.8142, subject to adjustment in the same manner as the conversion rate as set forth under “— Conversion Rate Adjustments.”

Our obligation to satisfy the additional shares requirement could be considered a penalty, in which case the enforceability thereof would be subject to general principles of reasonableness and equitable remedies.

Fundamental Change Permits Holders to Require Us to Repurchase 2022 Convertible Notes

If a “fundamental change” (as defined below in this section) occurs at any time, holders have the right, at their option, to require us to repurchase for cash any or all of their 2022 Convertible Notes, or any portion of the principal amount thereof that is equal to \$25.00 or a multiple of \$25.00. The price we are required to pay is equal to 100% of the principal amount of the 2022 Convertible Notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date (unless the fundamental change repurchase date falls after a regular record date but on or prior to the interest payment date to which such regular record date relates, in which case we will instead pay the full amount of accrued and unpaid interest to the holder of record on such regular record date, and the fundamental change repurchase price will be equal to 100% of the principal amount of the 2022 Convertible Notes to be repurchased). The fundamental change repurchase date will be a date specified by us that is not less than 20 or more than 35 business days following the date of our fundamental change notice as described below (and will be subject to postponement by a number of days by which our notice of the fundamental change is delivered to holders beyond the deadline set forth in the fourth immediately succeeding paragraph).

A “fundamental change” will be deemed to have occurred at the time after the 2022 Convertible Notes are originally issued if any of the following occurs:

- (1) a “person or group” within the meaning of Section 13(d) of the Exchange Act, other than us, our subsidiaries and our and their employee benefit plans, has become the direct or indirect beneficial owner of our common equity representing more than 50% of the voting power of our common equity and files a Schedule 13D or Schedule TO or any other schedule, form or report under the Exchange Act disclosing such beneficial ownership;

- (2) the consummation of (A) any recapitalization, reclassification or change of our common stock (other than changes resulting from a subdivision or combination or a change solely in par value) as a result of which our common stock would be converted into, or exchanged for, stock, other securities, other property or assets; (B) any share exchange, consolidation or merger of us pursuant to which our common stock will be converted into cash, securities or other property; or (C) any sale, lease or other transfer in one transaction or a series of transactions of all or substantially all of the consolidated assets of us and our subsidiaries, taken as a whole, to any person other than one of our subsidiaries; provided, however, that a transaction described in clause (A) or (B) in which the holders of all classes of our common equity immediately prior to such transaction own, directly or indirectly, more than 50% of all classes of common equity of the continuing or surviving corporation or transferee or the parent thereof immediately after such transaction in substantially the same proportions as such ownership immediately prior to such transaction will not be a fundamental change pursuant to this clause (2);
- (3) our stockholders approve any plan or proposal for the liquidation or dissolution of us; or
- (4) our common stock (or other common stock underlying the 2022 Convertible Notes) ceases to be listed or quoted on any of The New York Stock Exchange, The NASDAQ Global Select Market or The NASDAQ Global Market (or any of their respective successors).

A transaction or transactions described in clause (2) above will not constitute a fundamental change (even if that transaction is, or those transactions are, also described under another clause above) if at least 90% of the consideration received or to be received by our common stockholders, excluding cash payments for fractional shares, in connection with such transaction or transactions consists of shares of common stock that are listed or quoted on any of The New York Stock Exchange, The NASDAQ Global Select Market or The NASDAQ Global Market (or any of their respective successors) or will be so listed or quoted when issued or exchanged in connection with such transaction or transactions and as a result of such transaction or transactions the 2022 Convertible Notes become convertible into such consideration, excluding cash payments for fractional shares.

After any transaction in which our common stock is replaced by the securities of another entity, should one occur, following completion of any related make-whole fundamental change period and any related fundamental change purchase date, references to us in the definition of “fundamental change” above will apply to such other entity instead. In addition, a filing that would otherwise constitute a fundamental change under clause (1) above will not constitute a fundamental change if (x) the filing occurs in connection with a transaction in which we become a wholly-owned subsidiary of an SEC-reporting entity, and for purposes of the conversion provisions herein, our common stock is replaced by the publicly-traded and listed securities of such SEC-reporting company, and (y) no such filing is made or is in effect with respect to common equity representing more than 50% of the voting power of such other company.

On or before the 20th day after the date the fundamental change occurred, we will provide to all holders of the 2022 Convertible Notes and the Trustee and paying agent a written notice of the occurrence of the fundamental change and of the resulting repurchase right. Such notice will state, among other things:

- the events causing a fundamental change;
- the date of the fundamental change;
- the last date on which a holder may exercise the repurchase right;
- the fundamental change repurchase price;
- the fundamental change repurchase date;
- the name and address of the paying agent and the conversion agent, if applicable;
- if applicable, the conversion rate and any adjustments to the conversion rate;
- if applicable, that the 2022 Convertible Notes with respect to which a fundamental change repurchase notice has been delivered by a holder may be converted only if the holder withdraws the fundamental change repurchase notice in accordance with the terms of the indenture; and
- the procedures that holders must follow to require us to repurchase their 2022 Convertible Notes.

Simultaneously with providing such notice, we will publish a notice containing this information in a newspaper of general circulation in The City of New York or publish the information on our website or through such other public medium as we may use at that time.

To exercise the fundamental change repurchase right, a holder must deliver, on or before the business day immediately preceding the fundamental change repurchase date, the 2022 Convertible Notes to be repurchased, duly endorsed for transfer, together with a written repurchase notice and the form entitled "Form of Fundamental Change Repurchase Notice" on the reverse side of the 2022 Convertible Notes duly completed, to the paying agent. Each repurchase notice must state:

- if certificated, the certificate numbers of a holder's 2022 Convertible Notes to be delivered for repurchase or if not certificated, the notice must comply with appropriate DTC procedures;
- the portion of the principal amount of 2022 Convertible Notes to be repurchased, which must be \$25.00 or an integral multiple thereof; and
- that the 2022 Convertible Notes are to be repurchased by us pursuant to the applicable provisions of the 2022 Convertible Notes and the indenture.

If the 2022 Convertible Notes are not in certificated form, the notice given by each holder must comply with appropriate DTC procedures.

Holders may withdraw any repurchase notice (in whole or in part) by a written notice of withdrawal delivered to the paying agent prior to the close of business on the business day immediately preceding the fundamental change repurchase date. The notice of withdrawal will state:

- the principal amount of the withdrawn 2022 Convertible Notes;
- if certificated 2022 Convertible Notes have been issued, the certificate numbers of the withdrawn 2022 Convertible Notes or, if not certificated, the notice must comply with appropriate DTC procedures; and
- the principal amount, if any, which remains subject to the repurchase notice, which must be \$25.00 or an integral multiple thereof.

If the 2022 Convertible Notes are not in certificated form, the notice given by each holder must comply with appropriate DTC procedures.

We are required to repurchase the 2022 Convertible Notes surrendered for repurchase in accordance with the 2022 Convertible Notes Indenture on the fundamental change repurchase date, subject to extension if necessary to comply with the provisions of the 1940 Act. Holders will receive payment of the fundamental change repurchase price on the later of (i) the fundamental change repurchase date and (ii) the time of book-entry transfer or the delivery of the 2022 Convertible Notes to the paying agent. If on the fundamental change repurchase date the paying agent holds money sufficient to pay the fundamental change repurchase price of the 2022 Convertible Notes for which holders have surrendered and not withdrawn repurchase notices on the fundamental change repurchase date, then:

- the 2022 Convertible Notes will cease to be outstanding and interest will cease to accrue (whether or not book-entry transfer of the 2022 Convertible Notes is made or whether or not the 2022 Convertible Notes are delivered to the paying agent); and
- all other rights of the holder will terminate (other than the right to receive the fundamental change repurchase price upon delivery or transfer of the 2022 Convertible Notes).

In connection with any repurchase offer pursuant to a fundamental change repurchase notice, we will, if required:

- comply with the provisions of Rule 13e-4, Rule 14e-1 and any other tender offer rules under the Exchange Act that may then be applicable;
- file a Schedule TO or any other required schedule under the Exchange Act; and
- otherwise comply with all federal and state securities laws in connection with any offer by us to repurchase the 2022 Convertible Notes;

in each case, so as to permit the rights and obligations under this “— Fundamental Change Permits Holders to Require Us to Repurchase 2022 Convertible Notes” to be exercised in the time and in the manner specified in the indenture.

No 2022 Convertible Notes may be repurchased on any date at the option of holders upon a fundamental change if the principal amount of the 2022 Convertible Notes has been accelerated, and such acceleration has not been rescinded, on or prior to such date (except in the case of an acceleration resulting from a default by us in the payment of the fundamental change repurchase price with respect to such 2022 Convertible Notes).

The repurchase rights of the holders could discourage a potential acquirer of us. The fundamental change repurchase feature, however, is not the result of management’s knowledge of any specific effort to obtain control of us by any means or part of a plan by management to adopt a series of anti-takeover provisions.

The term fundamental change is limited to specified transactions and may not include other events that might adversely affect our financial condition. In addition, the requirement that we offer to repurchase the 2022 Convertible Notes upon a fundamental change may not protect holders in the event of a highly leveraged transaction, reorganization, merger or similar transaction involving us.

The definition of fundamental change includes a phrase relating to the conveyance, transfer, sale, lease or disposition of “all or substantially all” of our consolidated assets. There is no precise, established definition of the phrase “substantially all” under applicable law. Accordingly, the ability of a holder of the 2022 Convertible Notes to require us to repurchase its 2022 Convertible Notes as a result of the conveyance, transfer, sale, lease or other disposition of less than all of our assets may be uncertain.

If a fundamental change were to occur, we may not have enough funds to pay the fundamental change repurchase price. Our ability to repurchase the 2022 Convertible Notes for cash may be limited by restrictions on our ability to obtain funds for such repurchase through dividends from our subsidiaries, the terms of our then existing borrowing arrangements or otherwise. Under our existing credit facility, we would be prohibited from making any such repurchase without consent from the lenders thereunder or a waiver or modification of such requirements. If we fail to repurchase the 2022 Convertible Notes when required following a fundamental change, we will be in default under the 2022 Convertible Notes Indenture. In addition, we have, and may in the future incur, other indebtedness with similar change in control provisions permitting our holders to accelerate or to require us to repurchase our indebtedness upon the occurrence of similar events or on some specific dates.

Events of Default under the 2022 Convertible Notes

A holder has rights if an Event of Default occurs in respect of the 2022 Convertible Notes and is not cured, as described later in this subsection.

- (1) default in any payment of interest on any 2022 Convertible Note when due and payable and the default continues for a period of 30 days;

- (2) default in the payment of principal of any 2022 Convertible Note when due and payable at its stated maturity, upon any required repurchase, upon declaration of acceleration or otherwise;
- (3) our failure to comply with our obligation to convert the 2022 Convertible Notes in accordance with the 2022 Convertible Notes Indenture upon exercise of a holder's conversion right;
- (4) our failure to give a fundamental change notice as described under “— Fundamental Change Permits Holders to Require Us to Repurchase 2022 Convertible Notes”;
- (5) we remain in breach of a covenant in respect of the 2022 Convertible Notes for 60 days after we receive a written notice of default stating we are in breach (the notice must be sent by either the Trustee or holders of at least 25% of the principal amount of the 2022 Convertible Notes);
- (6) our failure to comply with the obligation set forth under “Investment Company Act — Section 18(a)(1)(A) as Modified by Section 61(a)(1)”;
- (7) default by us or any of our significant subsidiaries, as defined in Article 1, Rule 1-02 of Regulation S-X under the Exchange Act, with respect to any mortgage, agreement or other instrument under which there may be outstanding, or by which there may be secured or evidenced, any indebtedness for money borrowed in excess of \$25 million in the aggregate of us and/or any such subsidiary, whether such indebtedness now exists or will hereafter be created (i) resulting in such indebtedness becoming or being declared due and payable or (ii) constituting a failure to pay the principal or interest of any such debt when due and payable at its stated maturity, upon required repurchase, upon declaration of acceleration or otherwise unless such indebtedness is discharged, or such acceleration is rescinded, stayed or annulled, within a period of 30 calendar days after written notice of such failure is given to us by the Trustee or to us and the Trustee by the holders of at least 25.0% in aggregate principal amount of the 2022 Convertible Notes then outstanding;
- (8) (a) we or any of our significant subsidiaries, as defined in Article 1, Rule 1-02 of Regulation S-X under the Exchange Act, file for bankruptcy or (b) certain events of bankruptcy, insolvency, or reorganization of us or any of our significant subsidiaries, as defined in Article 1, Rule 1-02 of Regulation S-X under the Exchange Act occur and remain undischarged or unstayed for a period of 60 days; or
- (9) a final judgment for the payment of \$25 million or more (excluding any amounts covered by insurance) rendered against us or any of our significant subsidiaries, as defined in Article 1, Rule 1-02 of Regulation S-X under the Exchange Act, which judgment is not discharged or stayed within 60 days after (i) the date on which the right to appeal thereof has expired if no such appeal has commenced, or (ii) the date on which all rights to appeal have been extinguished.

Remedies if an Event of Default Occurs

If an Event of Default occurs and is continuing, the Trustee by notice to the Company, or the holders of at least 25% in principal amount of the outstanding 2022 Convertible Notes by notice to the Company and the Trustee, may, and the Trustee at the request of such holders will, declare 100% of the principal of and accrued and unpaid interest, if any, on all the 2022 Convertible Notes to be due and payable. In case of certain events of bankruptcy, insolvency or reorganization involving the Company, but not any of its subsidiaries, 100% of the principal of and accrued and unpaid interest on the 2022 Convertible Notes will automatically become due and payable. Upon such a declaration of acceleration, such principal and accrued and unpaid interest, if any, will be due and payable immediately.

If an event of default occurs and is continuing, the Trustee by notice to us, or the holders of at least 25% in principal amount of the outstanding 2022 Convertible Notes by notice to us and the Trustee, may, and the Trustee at the request of such holders will, declare 100% of the principal of and accrued and unpaid interest, if any, on all the 2022 Convertible Notes to be due and payable. In case of certain events of bankruptcy, insolvency or reorganization involving us, but not any of our subsidiaries, 100% of the principal of and accrued and unpaid interest on the 2022 Convertible Notes will automatically become due and payable. Upon such a declaration of acceleration, such principal and accrued and unpaid interest, if any, will be due and payable immediately.

The provisions described in the paragraph above, however, are subject to the condition that if, at any time after the principal of the 2022 Convertible Notes will have been so declared due and payable, and before any judgment or decree for the payment of the moneys due will have been obtained as provided in the 2022 Convertible Note Indenture, we will pay or deliver, as the case may be, or will deposit with the Trustee an amount of cash and/or shares of common stock sufficient to pay all matured installments of interest upon all the 2022 Convertible Notes, all amounts of consideration due upon the conversion of any and all converted 2022 Convertible Notes, and the principal of any and all 2022 Convertible Notes which will have become due otherwise than by acceleration (with interest upon such principal and, to the extent that payment of such interest is enforceable under applicable law, on overdue installments of interest, at the rate or rates, if any, specified in the 2022 Convertible Notes to the date of such payment or deposit) and such amount as will be sufficient to cover all amounts owing to the Trustee and its agents and counsel, and if any and all events of default under the 2022 Convertible Note Indenture, other than the non-payment of the principal of 2022 Convertible Notes which will have become due by acceleration, will have been cured, waived or otherwise remedied as provided in the 2022 Convertible Note Indenture, then and in every such case the holders of a majority in aggregate principal amount of all the 2022 Convertible Notes then outstanding, by written notice to us and to the Trustee, may rescind and annul such declaration and its consequences, but no such rescission and annulment will extend to or will affect any subsequent default or will impair any right consequent on such default.

Notwithstanding the foregoing, the 2022 Convertible Notes Indenture provides that, to the extent we elect, the sole remedy for an event of default relating to our failure to comply with our obligations as set forth under “— Reports” below and for any failure to comply with the requirements of Section 314(a)(1) of the Trust Indenture Act (which also relate to the provision of reports) will, after the occurrence of such an event of default, consist exclusively of the right to receive additional interest on the 2022 Convertible Notes at a rate equal to:

- 0.25% per annum of the principal amount of the 2022 Convertible Notes outstanding for each day during the 90-day period beginning on, and including, the date on which such an event of default first occurs; and
- 0.50% per annum of the principal amount of the 2022 Convertible Notes outstanding for each day during the 90-day period beginning on, and including, the 91st day following, and including, the occurrence of such an event of default during which such event of default is continuing.

If we so elect, such additional interest will be payable in the same manner and on the same dates as the stated interest payable on the 2022 Convertible Notes. On the 181st day after such event of default (if the event of default relating to the reporting obligations is not cured or waived prior to such 181st day), the 2022 Convertible Notes will be subject to acceleration as provided above. The provisions of the 2022 Convertible Notes Indenture described in this paragraph will not affect the rights of holders of 2022 Convertible Notes in the event of the occurrence of any other event of default. In the event we do not elect to pay the additional interest following an event of default in accordance with this paragraph or we elected to make such payment but do not pay the additional interest when due, the 2022 Convertible Notes will be immediately subject to acceleration as provided above.

In order to elect to pay the additional interest as the sole remedy during the first 180 days after the occurrence of an event of default relating to the failure to comply with the reporting obligations in accordance with the immediately preceding paragraph, we must notify in writing all holders of record of 2022 Convertible Notes, the Trustee and the paying agent of such election prior to the fifth business day of such 180-day period. Upon our failure to timely give such notice, the 2022 Convertible Notes will be immediately subject to acceleration as provided above.

If any portion of the amount payable on the 2022 Convertible Notes upon acceleration is considered by a court to be unearned interest (through the allocation of the value of the instrument to the embedded warrant or otherwise), the court could disallow recovery of any such portion.

The holders of a majority in principal amount of the outstanding 2022 Convertible Notes may waive all past defaults, except with respect to nonpayment of principal or interest, with respect to the failure to deliver the consideration due upon conversion or with respect to a covenant that cannot be modified or amended without the consent of each holder.

Each holder will have the right to receive payment or delivery, as the case may be, of:

- the principal (including the fundamental change repurchase price, if applicable) of;
- accrued and unpaid interest, if any, on; and
- the consideration due upon conversion of,

its 2022 Convertible Notes, on or after the respective due dates expressed or provided for in the indenture, or to institute suit for the enforcement of any such payment or delivery, as the case may be, and such right to receive such payment or delivery, as the case may be, on or after such respective dates will not be impaired or affected without the consent of such holder.

Subject to the provisions of the 2022 Convertible Notes Indenture relating to the duties of the Trustee, if an event of default occurs and is continuing, the Trustee will be under no obligation to exercise any of the rights or powers under the 2022 Convertible Notes Indenture at the request or direction of any of the holders unless such holders have offered to the Trustee indemnity or security satisfactory to it against any loss, liability or expense (including fees and expenses of its counsel). Except to enforce the right to receive payment of principal or interest when due, or the right to receive payment or delivery of the consideration due upon conversion, no holder may pursue any remedy with respect to the 2022 Convertible Notes Indenture or the 2022 Convertible Notes unless:

- (1) such holder has previously given the Trustee written notice that an event of default is continuing;
- (2) holders of at least 25% in principal amount of the outstanding 2022 Convertible Notes have requested the Trustee in writing to institute proceedings to remedy such event of default;
- (3) such holders have offered to the Trustee indemnity, security, or both, reasonably satisfactory to the Trustee, against the costs, expenses and liabilities to be incurred in compliance with such request;
- (4) the Trustee for 60 days after its receipt of such notice, request and offer of indemnity and/or security has failed to institute any such proceeding; and
- (5) the holders of a majority in principal amount of the outstanding 2022 Convertible Notes have not given the Trustee a direction that, in the opinion of the Trustee, is inconsistent with such request during that 60-day period.

Subject to certain restrictions and the Trustee's right to demand security or indemnity satisfactory to it in accordance with the indenture, the holders of a majority in principal amount of the outstanding 2022 Convertible Notes are given the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or of exercising any trust or power conferred on the Trustee.

The 2022 Convertible Notes Indenture provides that in the event an event of default has occurred and is continuing, the Trustee will be required in the exercise of its powers to use the degree of care that a prudent person would use in the conduct of its own affairs under the circumstances. The Trustee, however, may refuse to follow any direction that conflicts with law or the 2022 Convertible Notes Indenture or that the Trustee determines is unduly prejudicial to the rights of any other holder or that would involve the Trustee in personal liability. Prior to taking any action under the indenture, the Trustee will be entitled to indemnification satisfactory to it in its sole discretion against all losses and expenses caused by taking or not taking such action.

The 2022 Convertible Notes Indenture provides that if a default occurs and is continuing and is known to the Trustee, the Trustee must deliver to each holder notice of the default within 90 days after it occurs. Except in the case of a default in the payment of principal of or interest on any 2022 Convertible Note or a default in the payment or delivery of the consideration due upon conversion, the Trustee may withhold notice if and so long as the Trustee in good faith determines that withholding notice is in the interests of the holders.

The Trustee shall not be charged with knowledge of any fact, notice of default or event of default with respect to the 2022 Convertible Notes unless either (i) a responsible officer of the Trustee shall have actual knowledge of such default or event of default or (ii) written notice of such fact, default or event of default shall have been given by us or by the holders of at least 25% of the aggregate principal amount of the 2022 Convertible Notes and received by a responsible officer of the Trustee and references the 2022 Convertible Notes Indenture and the 2022 Convertible Notes.

Merger or Consolidation

The 2022 Convertible Notes Indenture provides that we will not consolidate with or merge with or into, or sell, convey, or transfer all or substantially all of our properties and assets to, another person, unless all the following conditions are met:

- where we merge out of existence or convey or transfer our assets substantially as an entirety, the resulting entity must agree to be legally responsible for our obligations under the 2022 Convertible Notes;
- immediately after giving effect to such transaction, no default or event of default has occurred and is continuing under the indenture. For purposes of this no-default test, a default would include an event of default that has occurred and has not been cured, as described under “Events of Default” below. A default for this purpose would also include any event that would be an event of default if the requirements for giving us a notice of default or our default having to exist for a specific period of time were disregarded; and
- we must deliver certain certificates and documents to the Trustee.

Upon any such consolidation, merger or sale, conveyance, or transfer, the resulting, surviving or transferee person (if not us) will succeed to us, and may exercise every right and power of, ours under the 2022 Convertible Note Indenture, and we will be discharged from our obligations under the 2022 Convertible Notes and the 2022 Convertible Note Indenture.

Although these types of transactions are permitted under the 2022 Convertible Note Indenture, certain of the foregoing transactions could constitute a fundamental change permitting each holder to require us to repurchase the 2022 Convertible Notes of such holder as described above.

An assumption by any person of obligations under the 2022 Convertible Notes and the 2022 Convertible Notes Indenture might be deemed for U.S. federal income tax purposes to be an exchange of the 2022 Convertible Notes for new 2022 Convertible Notes by the holders thereof, resulting in recognition of gain or loss for such purposes and possibly other adverse tax consequences to the holders. Holders should consult their own tax advisors regarding the tax consequences of such an assumption.

Modification and Amendment

Subject to certain exceptions, the 2022 Convertible Notes Indenture or the 2022 Convertible Notes may be amended with the consent of the holders of at least a majority in principal amount of the 2022 Convertible Notes then outstanding (including without limitation, consents obtained in connection with a repurchase of, or tender or exchange offer for, 2022 Convertible Notes) and, subject to certain exceptions, any past default or compliance with any provisions may be waived with the consent of the holders of a majority in principal amount of the 2022 Convertible Notes then outstanding (including, without limitation, consents obtained in connection with a repurchase of, or tender or exchange offer for, 2022 Convertible Notes). However, without the consent of each holder of an outstanding 2022 Convertible Note affected, no amendment may, among other things:

- (1) reduce the amount of 2022 Convertible Notes whose holders must consent to an amendment;
- (2) reduce the rate of or extend the stated time for payment of interest on any note;

- (3) reduce the principal of or extend the stated maturity of any note;
- (4) make any change that adversely affects the conversion rights of any 2022 Convertible Notes;
- (5) reduce the fundamental change repurchase price of any 2022 Convertible Note or amend or modify in any manner adverse to the holders of 2022 Convertible Notes our obligation to make such payments, whether through an amendment or waiver of provisions in the covenants, definitions or otherwise;
- (6) make any 2022 Convertible Note payable in money other than that stated in the note;
- (7) impair the right of any holder to receive payment of principal and interest on such holder's 2022 Convertible Notes on or after the due dates therefor or to institute suit for the enforcement of any payment on or with respect to such holder's 2022 Convertible Notes; or
- (8) make any change in the amendment provisions that require each holder's consent or in the waiver provisions, except to increase any such percentage or to provide that other provisions of the 2022 Convertible Notes Indenture cannot be modified or waived without the consent of the holder of each outstanding 2022 Convertible Note affected thereby.

Without the consent of any holder, we and the Trustee may amend the 2022 Convertible Notes Indenture without notice to:

- (1) cure or supplement any ambiguity, omission, defect or inconsistency in a manner that does not adversely affect the interests of any holder of the 2022 Convertible Notes in any material respect;
- (2) provide for the assumption by a successor entity of our obligations under the 2022 Convertible Note Indenture;
- (3) secure the 2022 Convertible Notes;
- (4) add to our covenants or events of default for the benefit of the holders or surrender any right or power conferred upon us;
- (5) make any change that does not adversely affect the interests of any holder of 2022 Convertible Notes in any material respect;
- (6) conform the provisions of the 2022 Convertible Notes Indenture to the "Description of 2022 Convertible Notes" section in the prospectus supplement related thereto as determined in good faith by us;
- (7) comply with any requirement of the SEC in connection with the qualification of the 2022 Convertible Notes Indenture under the Trust Indenture Act;
- (8) reflect the replacement of our common stock by reference property as described under "— Recapitalizations, Reclassifications and Changes of Our Common Stock"; or
- (9) evidence and provide for the appointment under the 2022 Convertible Notes Indenture of a successor Trustee.

Holders do not need to approve the particular form of any proposed amendment. It will be sufficient if such holders approve the substance of the proposed amendment. After an amendment under the 2022 Convertible Notes Indenture becomes effective, we are required to mail to the holders a notice briefly describing such amendment. However, the failure to give such notice to all the holders, or any defect in the notice, will not impair or affect the validity of the amendment.

Discharge

We may satisfy and discharge our obligations under the 2022 Convertible Notes Indenture by delivering to the securities registrar for cancellation all outstanding 2022 Convertible Notes or by depositing with the Trustee or delivering to the holders, as applicable, after the 2022 Convertible Notes have become due and payable, whether at maturity, any fundamental change repurchase date, upon conversion or otherwise, shares of common stock (and cash in lieu of fractional shares) solely to satisfy outstanding conversions, as applicable, and cash sufficient to pay all of the outstanding 2022 Convertible Notes and all other sums payable under the 2022 Convertible Notes Indenture by us. Such discharge is subject to terms contained in the indenture.

Calculations in Respect of 2022 Convertible Notes

We are responsible for making all calculations called for under the 2022 Convertible Notes. These calculations include, but are not limited to, determinations of the last reported sale prices of our common stock, accrued interest payable on the 2022 Convertible Notes and the conversion rate of the 2022 Convertible Notes. We will make all these calculations in good faith and, absent manifest error, our calculations will be final and binding on holders of 2022 Convertible Notes. We will provide a schedule of our calculations to each of the Trustee and the conversion agent, and each of the Trustee and conversion agent is entitled to rely conclusively upon the accuracy of our calculations without independent verification. The Trustee will forward our calculations to any holder of 2022 Convertible Notes upon the request of that holder.

Reports

The 2022 Convertible Notes Indenture provides that any documents or reports that we are required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act must be filed by us with the Trustee within 15 days after the same are required to be filed with the SEC (giving effect to any grace period provided by Rule 12b-25 under the Exchange Act). Documents filed by us with the SEC via the EDGAR system will be deemed to be filed with the Trustee as of the time such documents are filed via EDGAR.

Delivery of such reports, information and documents to the Trustee is for informational purposes only and the Trustee's receipt of such shall not constitute constructive notice of any information contained therein or determinable from information contained therein, including our compliance with any of its covenants under the 2022 Convertible Notes Indenture (as to which the Trustee is entitled to rely exclusively on officers' certificates). The Trustee shall not be obligated to monitor or confirm, on a continuing basis or otherwise, our compliance with the covenants or with respect to any reports or other documents filed with the SEC or website under the indenture, or participate in any conference calls. Delivery of reports to the Trustee shall not constitute knowledge of, or notice to, the Trustee of the information contained therein.

1940 Act — Section 18(a)(1)(A) as Modified by Section 61(a)(1)

We agree that for the period of time during which 2022 Convertible Notes are outstanding, we will not violate Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act or any successor provisions thereto of the 1940 Act, whether or not we continue to be subject to such provisions of the 1940 Act, but giving effect to any exemptive relief that may be granted to us by the SEC.

Trustee

U.S. Bank National Association is the Trustee, security registrar, paying agent and conversion agent. U.S. Bank National Association, in each of its capacities, including without limitation as Trustee, security registrar, paying agent and conversion agent, assumes no responsibility for the accuracy or completeness of the information concerning us or our affiliates or any other party contained in this document or the related documents or for any failure by us or any other party to disclose events that may have occurred and may affect the significance or accuracy of such information, or for any information provided to it by us, including but not limited to last reported sale prices of our stock, settlement amounts and any other information.

We may maintain banking relationships in the ordinary course of business with the Trustee and its affiliates.

Governing Law

The 2022 Convertible Notes Indenture provides that it and the 2022 Convertible Notes will be governed by and construed in accordance with the laws of the State of New York.

Book-Entry, Settlement and Clearance

Global Notes

The 2022 Convertible Notes were initially issued in the form of one or more registered notes in global form, without interest coupons (the “global notes”). Upon issuance, each of the global notes was deposited with the Trustee as custodian for DTC and registered in the name of Cede & Co., as nominee of DTC.

Ownership of beneficial interests in a global note are limited to persons who have accounts with DTC (“DTC participants”) or persons who hold interests through DTC participants. Under procedures established by DTC:

- upon deposit of a global note with DTC’s custodian, DTC credited portions of the principal amount of the global note to the accounts of the DTC participants designated by the underwriters; and
- ownership of beneficial interests in a global note are shown on, and transfer of ownership of those interests will be effected only through, records maintained by DTC (with respect to interests of DTC participants) and the records of DTC participants (with respect to other owners of beneficial interests in the global note).

Beneficial interests in global notes may not be exchanged for 2022 Convertible Notes in physical, certificated form except in the limited circumstances described below.

Book-Entry Procedures for Global Notes

All interests in the global notes will be subject to the operations and procedures of DTC. We provide the following summary of those operations and procedures solely for the convenience of investors. The operations and procedures of DTC are controlled by that settlement system and may be changed at any time. Neither we nor the underwriters are responsible for those operations or procedures.

So long as DTC’s nominee is the registered owner of a global note, that nominee will be considered the sole owner or holder of the 2022 Convertible Notes represented by that global note for all purposes under the indenture. Except as provided below, owners of beneficial interests in a global note:

- will not be entitled to have 2022 Convertible Notes represented by the global note registered in their names;
- will not receive or be entitled to receive physical, certificated 2022 Convertible Notes; and
- will not be considered the owners or holders of the 2022 Convertible Notes under the 2022 Convertible Notes Indenture for any purpose, including with respect to the giving of any direction, instruction or approval to the Trustee under the 2022 Convertible Note Indenture.

As a result, each investor who owns a beneficial interest in a global note must rely on the procedures of DTC to exercise any rights of a holder of 2022 Convertible Notes under the 2022 Convertible Notes Indenture (and, if the investor is not a participant or an indirect participant in DTC, on the procedures of the DTC participant through which the investor owns its interest).

Payments of principal and interest and of amounts due upon conversion with respect to the 2022 Convertible Notes represented by a global note will be made by the Trustee to DTC's nominee as the registered holder of the global note. Neither we nor the Trustee will have any responsibility or liability for the payment of amounts to owners of beneficial interests in a global note, for any aspect of the records relating to or payments made on account of those interests by DTC, or for maintaining, supervising or reviewing any records of DTC relating to those interests.

Payments by participants and indirect participants in DTC to the owners of beneficial interests in a global note will be governed by standing instructions and customary industry practice and will be the responsibility of those participants or indirect participants and DTC.

Transfers between participants in DTC will be effected under DTC's procedures and will be settled in same-day funds.

Certificated Notes

2022 Convertible Notes in physical, certificated form will be issued and delivered to each person that DTC identifies as a beneficial owner of the related 2022 Convertible Notes only if:

- DTC notifies us at any time that it is unwilling or unable to continue as depositary for the global notes and a successor depositary is not appointed within 90 days;
- DTC ceases to be registered as a clearing agency under the Exchange Act and a successor depositary is not appointed within 90 days; or
- an event of default with respect to the 2022 Convertible Notes has occurred and is continuing and such beneficial owner requests that its 2022 Convertible Notes be issued in physical, certificated form.

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)

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement (Form N-2 No. 333-230336) of Capitala Finance Corp. and in the related Prospectus of our reports dated March 2, 2020, with respect to the consolidated financial statements of Capitala Finance Corp. and the effectiveness of internal control over financial reporting of Capitala Finance Corp. included in this Annual Report (Form 10-K) for the year ended December 31, 2019.

/s/ Ernst & Young LLP

Charlotte, North Carolina
March 2, 2020

**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: March 2, 2020

/s/ Joseph B. Alala III

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

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

I, Stephen A. 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: March 2, 2020

/s/ Stephen A. Arnall

Stephen A. Arnall
Chief Financial Officer
(Principal Financial Officer)
Capitala Finance Corp.

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

In connection with the Annual Report on Form 10-K of Capitala Finance Corp. (the “Company”) for the annual period ended December 31, 2019, as filed with the Securities and 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: March 2, 2020

/s/ Joseph B. Alala III

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

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

In connection with the Annual Report on Form 10-K of Capitala Finance Corp. (the "Company") for the annual period ended December 31, 2019, as filed with the Securities and 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: March 2, 2020

/s/ Stephen A. Arnall

Stephen A. Arnall
Chief Financial Officer
(Principal Financial Officer)
Capitala Finance Corp.