

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

FORM 10-Q

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

For the quarterly period ended March 31, 2020

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 State of Incorporation: Maryland Telephone: (704) 376-5502	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

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	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

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

Yes No

The number of shares of Capitala Finance Corp.'s common stock, \$0.01 par value, outstanding as of April 30, 2020 was 16,266,484.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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

	As of	
	March 31, 2020	December 31, 2019
	(unaudited)	
ASSETS		
Investments at fair value:		
Non-control/non-affiliate investments (amortized cost of \$252,701 and \$250,433, respectively)	\$ 214,789	\$ 241,046
Affiliate investments (amortized cost of \$80,578 and \$80,756, respectively)	84,857	98,763
Control investments (amortized cost of \$22,692 and \$22,692, respectively)	21,581	22,723
Total investments at fair value (amortized cost of \$355,971 and \$353,881, respectively)	321,227	362,532
Cash and cash equivalents	56,431	62,321
Interest and dividend receivable	1,515	1,745
Prepaid expenses	814	624
Deferred tax asset, net	-	-
Other assets	94	115
Total assets	\$ 380,081	\$ 427,337
LIABILITIES		
SBA Debentures (net of deferred financing costs of \$883 and \$1,006, respectively)	\$ 149,117	\$ 148,994
2022 Notes (net of deferred financing costs of \$1,307 and \$1,447, respectively)	73,693	73,553
2022 Convertible Notes (net of deferred financing costs of \$827 and \$916, respectively)	51,261	51,172
Credit Facility (net of deferred financing costs of \$1,165 and \$1,165, respectively)	(1,165)	(1,165)
Management and incentive fees payable	3,621	3,713
Interest and financing fees payable	1,224	2,439
Accounts payable and accrued expenses	375	518
Total liabilities	\$ 278,126	\$ 279,224
Commitments and contingencies (Note 2)		
NET ASSETS		
Common stock, par value \$0.01, 100,000,000 common shares authorized, 16,266,484 and 16,203,769 common shares issued and outstanding, respectively	\$ 163	\$ 162
Additional paid in capital	238,220	237,886
Total distributable loss	(136,428)	(89,935)
Total net assets	\$ 101,955	\$ 148,113
Total liabilities and net assets	\$ 380,081	\$ 427,337
Net asset value per share	\$ 6.27	\$ 9.14

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2020	2019
INVESTMENT INCOME		
Interest and fee income:		
Non-control/non-affiliate investments	\$ 4,707	\$ 7,285
Affiliate investments	1,679	2,399
Control investments	103	724
Total interest and fee income	<u>6,489</u>	<u>10,408</u>
Payment-in-kind interest and dividend income:		
Non-control/non-affiliate investments	336	442
Affiliate investments	180	149
Control investments	-	328
Total payment-in-kind interest and dividend income	<u>516</u>	<u>919</u>
Dividend income:		
Non-control/non-affiliate investments	-	1,281
Affiliate investments	25	-
Control investments	-	25
Total dividend income	<u>25</u>	<u>1,306</u>
Interest income from cash and cash equivalents	44	51
Total investment income	<u>7,074</u>	<u>12,684</u>
EXPENSES		
Interest and financing expenses	3,826	4,413
Base management fee	1,757	2,118
Incentive fees	-	1,034
General and administrative expenses	1,504	984
Total expenses	<u>7,087</u>	<u>8,549</u>
NET INVESTMENT INCOME (LOSS)	<u>(13)</u>	<u>4,135</u>
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS		
Net realized gain (loss) on investments:		
Non-control/non-affiliate investments	968	(3,909)
Affiliate investments	-	(111)
Control investments	-	(1,827)
Net realized gain (loss) on investments	<u>968</u>	<u>(5,847)</u>
Net unrealized appreciation (depreciation) on investments:		
Non-control/non-affiliate investments	(28,525)	6,039
Affiliate investments	(13,728)	(268)
Control investments	(1,142)	(4,276)
Net unrealized appreciation (depreciation) on investments	<u>(43,395)</u>	<u>1,495</u>
Net realized and unrealized loss on investments	<u>(42,427)</u>	<u>(4,352)</u>
Tax benefit	-	66
Total net realized and unrealized loss on investments, net of taxes	<u>(42,427)</u>	<u>(4,286)</u>
NET DECREASE IN NET ASSETS RESULTING FROM OPERATIONS	<u>\$ (42,440)</u>	<u>\$ (151)</u>
NET DECREASE IN NET ASSETS PER SHARE RESULTING FROM OPERATIONS – BASIC AND DILUTED	<u>\$ (2.62)</u>	<u>\$ (0.01)</u>
WEIGHTED AVERAGE COMMON STOCK OUTSTANDING – BASIC AND DILUTED	16,220,591	16,062,906
DISTRIBUTIONS PAID PER SHARE	\$ 0.25	\$ 0.25

See accompanying notes to consolidated financial statements.

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

For the Three Months Ended March 31, 2020 and 2019	Common Stock		Additional Paid in Capital	Total Distributable Loss	Total
	Number of Shares	Par Value			
BALANCE, December 31, 2019	16,203,769	\$ 162	\$ 237,886	\$ (89,935)	\$ 148,113
Net investment loss	-	-	-	(13)	(13)
Net realized gain on investments	-	-	-	968	968
Net unrealized depreciation on investments	-	-	-	(43,395)	(43,395)
Distributions to Shareholders:					
Stock issued under dividend reinvestment plan	62,715	1	334	-	335
Distributions declared	-	-	-	(4,053)	(4,053)
BALANCE, March 31, 2020	<u>16,266,484</u>	<u>\$ 163</u>	<u>\$ 238,220</u>	<u>\$ (136,428)</u>	<u>\$ 101,955</u>
BALANCE, December 31, 2018	16,051,547	\$ 161	\$ 241,757	\$ (51,274)	\$ 190,644
Net investment income	-	-	-	4,135	4,135
Net realized loss on investments	-	-	-	(5,847)	(5,847)
Net unrealized appreciation on investments	-	-	-	1,495	1,495
Tax benefit	-	-	-	66	66
Distributions to Shareholders:					
Stock issued under dividend reinvestment plan	32,596	-	255	-	255
Distributions declared	-	-	-	(4,014)	(4,014)
BALANCE, March 31, 2019	<u>16,084,143</u>	<u>\$ 161</u>	<u>\$ 242,012</u>	<u>\$ (55,439)</u>	<u>\$ 186,734</u>

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Net decrease in net assets resulting from operations	\$ (42,440)	\$ (151)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:		
Purchase of investments	(8,267)	(21,128)
Repayments and sales of investments	7,768	11,492
Net realized (gain) loss on investments	(968)	5,847
Net unrealized (appreciation) depreciation on investments	43,395	(1,495)
Payment-in-kind interest and dividends	(516)	(919)
Accretion of original issue discount on investments	(107)	(260)
Amortization of deferred financing fees	506	616
Tax benefit	-	(66)
Changes in assets and liabilities:		
Interest and dividend receivable	230	320
Prepaid expenses	(190)	78
Other assets	21	(7)
Management and incentive fees payable	(92)	1,001
Interest and financing fees payable	(1,215)	(1,640)
Accounts payable and accrued expenses	(143)	28
NET CASH USED IN OPERATING ACTIVITIES	(2,018)	(6,284)
CASH FLOWS FROM FINANCING ACTIVITIES		
Paydowns on SBA debentures	-	(15,700)
Proceeds from Credit Facility	-	15,000
Distributions paid to shareholders	(3,718)	(3,759)
Deferred financing fees paid	(154)	(82)
NET CASH USED IN FINANCING ACTIVITIES	(3,872)	(4,541)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(5,890)	(10,825)
CASH AND CASH EQUIVALENTS, beginning of period	62,321	39,295
CASH AND CASH EQUIVALENTS, end of period	\$ 56,431	\$ 28,470
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	\$ 4,535	\$ 5,059
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING TRANSACTIONS		
Distributions paid through dividend reinvestment plan share issuances	\$ 335	\$ 255

See accompanying notes to consolidated financial statements.

Capitala Finance Corp.
Consolidated Schedule of Investments
(in thousands, except for units/shares)
March 31, 2020
(unaudited)

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 - 210.7%						
Non-control/non-affiliated investments - United States						
3 Bridge Solutions, LLC	IT Consulting	First Lien Debt (13.0% Cash, Due 12/4/22)	\$ 13,274	\$ 13,274	\$ 13,274	13.0%
3 Bridge Solutions, LLC	IT Consulting	Preferred Units (965 units)		1,090	279	0.3%
3 Bridge Solutions, LLC	IT Consulting	Membership Units (39,000 units)		10	-	0.0%
				<u>14,374</u>	<u>13,553</u>	<u>13.3%</u>
Alternative Biomedical Solutions, LLC	Healthcare	First Lien Debt (8.0% Cash, 3.8% PIK, Due 12/18/22)	5,543	5,397	5,273	5.2%
Alternative Biomedical Solutions, LLC	Healthcare	First Lien Debt (8.0% Cash, 3.8% PIK, Due 12/18/22) ⁽⁶⁾ ⁽⁷⁾	13,250	12,860	5,323	5.2%
Alternative Biomedical Solutions, LLC	Healthcare	Membership Units (20,092 units)		800	-	0.0%
				<u>19,057</u>	<u>10,596</u>	<u>10.4%</u>
American Clinical Solutions, LLC	Healthcare	First Lien Debt (7.0% Cash, Due 12/31/22) ⁽⁷⁾	3,500	3,500	3,500	3.4%
American Clinical Solutions, LLC	Healthcare	First Lien Debt (2.0% PIK, Due 12/31/22) ⁽⁷⁾⁽⁸⁾	6,030	3,485	1,972	2.0%
				<u>6,985</u>	<u>5,472</u>	<u>5.4%</u>
AmeriMark Direct, LLC	Consumer Products	First Lien Debt (14.3% Cash, Due 9/8/21)	15,748	15,624	15,169	14.9%
				<u>15,624</u>	<u>15,169</u>	<u>14.9%</u>
BigMouth, Inc.	Consumer Products	First Lien Debt (10.1% Cash (1 month LIBOR + 8.5%, 0.5% Floor), Due 11/14/21) ⁽⁹⁾	1,714	1,714	1,692	1.7%
BigMouth, Inc.	Consumer Products	First Lien Debt (10.1% Cash (1 month LIBOR + 8.5%, 0.5% Floor), Due 11/14/21) ⁽⁷⁾	8,784	8,557	2,501	2.4%
				<u>10,271</u>	<u>4,193</u>	<u>4.1%</u>
Bluestem Brands, Inc.	Online Merchandise Retailer	First Lien Debt (7.0% Cash (1 month LIBOR + 6.0%, 1.0% Floor), Due 9/8/20) ⁽¹⁰⁾	2,869	2,869	2,869	2.8%
Bluestem Brands, Inc.	Online Merchandise Retailer	First Lien Debt (7.0% Cash (1 month LIBOR + 6.0%, 1.0% Floor), Due 9/8/20)	1,803	1,803	1,803	1.8%
Bluestem Brands, Inc.	Online Merchandise Retailer	First Lien Debt (11.3% Cash (Prime + 6.5%), Due 11/7/20) ⁽⁷⁾	3,529	3,529	2,416	2.4%
				<u>8,201</u>	<u>7,088</u>	<u>7.0%</u>
Burke America Parts Group, LLC	Home Repair Parts Manufacturer	Membership Units (14 units)		5	1,956	1.9%
				<u>5</u>	<u>1,956</u>	<u>1.9%</u>

Capitala Finance Corp.
Consolidated Schedule of Investments
(in thousands, except for units/shares)
March 31, 2020
(unaudited)

Portfolio Company, Country ^{(1), (2), (3), (4), (5)}	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
CableOrganizer Acquisition, LLC	Computer Supply Retail	First Lien Debt ⁽¹¹⁾		\$ 1,532	\$ 1,540	1.5%
				<u>1,532</u>	<u>1,540</u>	<u>1.5%</u>
California Pizza Kitchen, Inc.	Restaurant	Second Lien Debt (11.6% Cash (3 month LIBOR + 10.0%, 1.0% Floor), Due 8/23/23) ⁽⁷⁾	\$ 5,000	4,933	2,700	2.6%
				<u>4,933</u>	<u>2,700</u>	<u>2.6%</u>
Chicken Soup for the Soul, LLC	Multi-platform Media and Consumer Products	First Lien Debt (10.1% Cash (1 month LIBOR + 8.5%, 1.5% Floor), Due 12/13/20)	13,000	13,000	13,000	12.8%
				<u>13,000</u>	<u>13,000</u>	<u>12.8%</u>
Chief Fire Intermediate, Inc.	Security System Services	First Lien Debt (8.6% Cash (1 month LIBOR + 7.0%, 1.6% Floor), Due 11/8/24) ⁽⁷⁾	8,100	8,100	7,103	7.0%
Chief Fire Intermediate, Inc.	Security System Services	Class A Preferred Units (34,740 units)		913	-	0.0%
Chief Fire Intermediate, Inc.	Security System Services	Class B Common Units (3,510 units)		-	-	0.0%
				<u>9,013</u>	<u>7,103</u>	<u>7.0%</u>
CIS Secure Computing, Inc.	Government Services	First Lien Debt (10.1% Cash (1 month LIBOR + 8.5%, 1.0% Floor), 1.0% PIK, Due 9/14/22)	9,289	9,289	9,289	9.1%
CIS Secure Computing, Inc.	Government Services	Common Stock (46,163 shares)		1,000	2,487	2.5%
				<u>10,289</u>	<u>11,776</u>	<u>11.6%</u>
Corporate Visions, Inc.	Sales & Marketing Services	Second Lien Debt (9.0% Cash, 2.0% PIK, Due 11/29/21)	19,425	19,425	18,816	18.5%
Corporate Visions, Inc.	Sales & Marketing Services	Common Stock (15,750 shares)		1,575	-	0.0%
				<u>21,000</u>	<u>18,816</u>	<u>18.5%</u>
Currency Capital, LLC	Financial Services	First Lien Debt (13.4% Cash (1 month LIBOR + 12.0%, 0.5% Floor), 4.0% PIK, Due 4/20/20) ⁽¹²⁾⁽¹³⁾	16,219	16,219	15,963	15.7%
Currency Capital, LLC	Financial Services	Class A Preferred Units (2,000,000 units) ⁽¹²⁾		2,000	1,525	1.5%
				<u>18,219</u>	<u>17,488</u>	<u>17.2%</u>
Flavors Holdings, Inc.	Food Product Manufacturer	First Lien Debt (7.2% Cash (3 month LIBOR + 5.8%, 1.0% Floor), Due 6/30/20) ⁽¹³⁾	5,789	5,778	5,778	5.6%
Flavors Holdings, Inc.	Food Product Manufacturer	Second Lien Debt (11.5% Cash (3 month LIBOR + 10.0%, 1.0% Floor), Due 10/3/21)	12,000	11,896	11,896	11.7%
				<u>17,674</u>	<u>17,674</u>	<u>17.3%</u>

Capitala Finance Corp.
Consolidated Schedule of Investments
(in thousands, except for units/shares)
March 31, 2020
(unaudited)

Portfolio Company, Country ^{(1), (2), (3), (4), (5)}	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Freedom Electronics, LLC	Electronic Machine Repair	First Lien Debt (8.7% Cash, Due 12/20/23) ⁽⁶⁾⁽¹⁴⁾	\$ 6,425	\$ 6,425	\$ 6,265	6.2%
Freedom Electronics, LLC	Electronic Machine Repair	Membership Units (181,818 units)		182	129	0.1%
				<u>6,607</u>	<u>6,394</u>	<u>6.3%</u>
HUMC Opco, LLC	Healthcare	First Lien Debt (9.0% Cash, Due 8/16/20)	5,000	5,000	5,000	4.9%
				<u>5,000</u>	<u>5,000</u>	<u>4.9%</u>
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) ⁽¹⁵⁾	2,000	2,000	1,961	1.9%
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	6,864	6.8%
				<u>9,000</u>	<u>8,825</u>	<u>8.7%</u>
Jurassic Quest Holdings, LLC	Entertainment	First Lien Debt (9.5% Cash (1 month LIBOR + 7.5%, 2.0% Floor), Due 5/1/24)	9,665	9,665	8,763	8.6%
Jurassic Quest Holdings, LLC	Entertainment	Preferred Units (467,784 units)		480	-	0.0%
				<u>10,145</u>	<u>8,763</u>	<u>8.6%</u>
MicroHoldco, LLC	General Industrial	Preferred Units (838,042 units) ⁽¹¹⁾		838	670	0.7%
				<u>838</u>	<u>670</u>	<u>0.7%</u>
Rapid Fire Protection, Inc.	Security System Services	First Lien Debt (9.5% Cash, Due 11/22/24) ⁽⁶⁾⁽¹⁶⁾	6,427	6,427	6,229	6.1%
Rapid Fire Protection, Inc.	Security System Services	Common Stock (363 shares)		500	438	0.4%
				<u>6,927</u>	<u>6,667</u>	<u>6.5%</u>
Seitel, Inc.	Data Services	First Lien Debt (9.3% Cash (3 month LIBOR + 8.3%, 1.0% Floor), Due 3/15/23)	4,686	4,686	4,319	4.2%
				<u>4,686</u>	<u>4,319</u>	<u>4.2%</u>
Sequoia Healthcare Management, LLC	Healthcare Management	First Lien Debt (12.8% Cash, Due 6/26/20) ⁽⁷⁾	12,535	12,535	11,250	11.0%
				<u>12,535</u>	<u>11,250</u>	<u>11.0%</u>
Sur La Table, Inc.	Retail	First Lien Debt (10.0% Cash (3 month LIBOR + 9.0%, 1.0% Floor), Due 7/31/22) ⁽⁷⁾⁽¹³⁾	10,568	10,502	6,161	6.0%
				<u>10,502</u>	<u>6,161</u>	<u>6.0%</u>

Capitala Finance Corp.
Consolidated Schedule of Investments
(in thousands, except for units/shares)
March 31, 2020
(unaudited)

Portfolio Company, Country ^{(1), (2), (3), (4), (5)}	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Taylor Precision Products, Inc.	Household Product Manufacturer	Series C Preferred Stock (379 shares)		\$ 758	\$ 758	0.7%
				<u>758</u>	<u>758</u>	<u>0.7%</u>
U.S. BioTek Laboratories, LLC	Testing laboratories	First Lien Debt (9.3% Cash, Due 12/14/23) ⁽⁶⁾⁽¹⁷⁾	\$ 6,913	6,913	6,665	6.5%
U.S. BioTek Laboratories, LLC	Testing laboratories	Class A Preferred Units (500 Units)		540	174	0.2%
U.S. BioTek Laboratories, LLC	Testing laboratories	Class C Units (500 Units)		1	-	0.0%
				<u>7,454</u>	<u>6,839</u>	<u>6.7%</u>
U.S. Well Services, Inc.	Oil & Gas Services	Class A Common Stock (77,073 shares) ⁽¹⁸⁾		771	23	0.0%
U.S. Well Services, Inc.	Oil & Gas Services	Class B Common Stock (1,125,426 shares) ⁽¹⁸⁾		6,701	338	0.3%
				<u>7,472</u>	<u>361</u>	<u>0.3%</u>
Xirgo Technologies, LLC	Information Technology	Membership Units (600,000 units)		600	658	0.6%
				<u>600</u>	<u>658</u>	<u>0.6%</u>
Sub Total Non-control/non-affiliated investments - United States				<u>\$ 252,701</u>	<u>\$ 214,789</u>	<u>210.7%</u>
Affiliate Investments - 83.2%						
Affiliate investments - United States						
Burgaflex Holdings, LLC	Automobile Part Manufacturer	First Lien Debt (12.0% Cash, 3.0% PIK, Due 3/23/21)	\$ 14,278	\$ 14,278	\$ 14,035	13.8%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock Class B (1,085,073 shares)		362	-	0.0%
Burgaflex Holdings, LLC	Automobile Part Manufacturer	Common Stock Class A (1,253,198 shares)		1,504	-	0.0%
				<u>16,144</u>	<u>14,035</u>	<u>13.8%</u>
City Gear, LLC	Footwear Retail	Membership Unit Warrants ⁽¹¹⁾		-	2,477	2.4%
				<u>-</u>	<u>2,477</u>	<u>2.4%</u>
Eastport Holdings, LLC	Business Services	Second Lien Debt (14.3% Cash (3 month LIBOR + 13.0%, 0.5% Floor), Due 12/29/21) ⁽¹³⁾	16,500	16,199	16,211	15.9%
Eastport Holdings, LLC	Business Services	Membership Units (22.9% ownership)		3,263	15,522	15.2%
				<u>19,462</u>	<u>31,733</u>	<u>31.1%</u>

Capitala Finance Corp.
Consolidated Schedule of Investments
(in thousands, except for units/shares)
March 31, 2020
(unaudited)

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)		\$ 3,477	\$ 3,696	3.6%
GA Communications, Inc.	Advertising & Marketing Services	Series B-1 Common Stock (200,000 shares)		2	-	0.0%
				<u>3,479</u>	<u>3,696</u>	<u>3.6%</u>
LJS Partners, LLC	QSR Franchisor	Preferred Units (169,888 units)		437	722	0.7%
LJS Partners, LLC	QSR Franchisor	Common Membership Units (2,593,234 units)		1,224	792	0.8%
				<u>1,661</u>	<u>1,514</u>	<u>1.5%</u>
MMI Holdings, LLC	Medical Device Distributor	First Lien Debt (12.0% Cash, Due 1/31/21) ⁽¹³⁾	\$ 2,600	2,600	2,600	2.6%
MMI Holdings, LLC	Medical Device Distributor	Second Lien Debt (6.0% Cash, Due 1/31/21) ⁽¹³⁾	400	388	400	0.4%
MMI Holdings, LLC	Medical Device Distributor	Preferred Units (1,000 units, 6.0% PIK Dividend) ⁽¹⁹⁾		1,598	1,736	1.7%
MMI Holdings, LLC	Medical Device Distributor	Common Membership Units (45 units)		-	196	0.2%
				<u>4,586</u>	<u>4,932</u>	<u>4.9%</u>
Navis Holdings, Inc.	Textile Equipment Manufacturer	First Lien Debt (11.0% Cash, Due 6/30/23) ⁽¹³⁾	9,921	9,921	9,630	9.4%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Class A Preferred Stock (1,000 shares, 10.0% Cash Dividend) ⁽¹⁹⁾		1,000	1,000	1.0%
Navis Holdings, Inc.	Textile Equipment Manufacturer	Common Stock (60,000 shares)		-	99	0.1%
				<u>10,921</u>	<u>10,729</u>	<u>10.5%</u>
Nth Degree Investment Group, LLC	Business Services	Membership Units (6,088,000 Units)		6,088	1,271	1.2%
				<u>6,088</u>	<u>1,271</u>	<u>1.2%</u>
RAM Payment, LLC	Financial Services	First Lien Debt (9.9% Cash, Due 1/4/24) ⁽⁶⁾	8,900	8,900	8,900	8.7%
RAM Payment, LLC	Financial Services	Preferred Units (86,000 units, 8.0% PIK Dividend) ⁽¹⁹⁾		945	2,004	2.0%
				<u>9,845</u>	<u>10,904</u>	<u>10.7%</u>
Sierra Hamilton Holdings Corporation	Oil & Gas Engineering and Consulting Services	Second Lien Debt (15.0% PIK, Due 9/12/23)	811	779	778	0.8%
Sierra Hamilton Holdings Corporation	Oil & Gas Engineering and Consulting Services	Common Stock (15,068,000 shares)		6,958	2,080	2.0%
				<u>7,737</u>	<u>2,858</u>	<u>2.8%</u>

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March 31, 2020
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Portfolio Company, Country ^{(1), (2), (3), (4), (5)}	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
V12 Holdings, Inc.	Data Processing & Digital Marketing	Second Lien Debt ⁽¹¹⁾		\$ 655	\$ 708	0.7%
				<u>655</u>	<u>708</u>	<u>0.7%</u>
Sub Total Affiliate investments - United States				<u>\$ 80,578</u>	<u>\$ 84,857</u>	<u>83.2%</u>
Control Investments - 21.2%						
Control investments - United States						
Capitala Senior Loan Fund II, LLC	Investment Funds	Second Lien Debt (6.6% Cash (1 month LIBOR + 5.0%), Due 9/3/24) ⁽¹²⁾⁽²⁰⁾	-	-	-	0.0%
Capitala Senior Loan Fund II, LLC	Investment Funds	Membership Units (80.0% ownership) ⁽¹²⁾⁽²¹⁾⁽²²⁾		\$ 13,600	\$ 13,786	13.5%
				<u>13,600</u>	<u>13,786</u>	<u>13.5%</u>
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	3.8%
Vology, Inc.	Information Technology	Class A Preferred Units (9,041,810 Units)		5,215	3,918	3.9%
Vology, Inc.	Information Technology	Membership Units (5,363,982 Units)		-	-	0.0%
				<u>9,092</u>	<u>7,795</u>	<u>7.7%</u>
Sub Total Control investments - United States				<u>\$ 22,692</u>	<u>\$ 21,581</u>	<u>21.2%</u>
TOTAL INVESTMENTS - 315.1%				<u>\$ 355,971</u>	<u>\$ 321,227</u>	<u>315.1%</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 \$101,955 as of March 31, 2020.
- (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"). Unless otherwise noted, all of the Company's investments are deemed to be restricted securities under the Securities Act.
- (6) The cash rate equals the approximate current yield on our last-out portion of the unitranche facility.
- (7) Non-accrual investment.
- (8) The investment is convertible to preferred equity.
- (9) The investment has a \$1.7 million unfunded commitment.
- (10) The investment has a \$5.3 million unfunded commitment.
- (11) The investment has been exited or sold. The residual value reflects estimated earnout, escrow, or other proceeds expected post-closing.
- (12) 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 March 31, 2020, 8.2% of the Company's total assets were non-qualifying assets.
- (13) The maturity date of the original investment has been extended.
- (14) The investment has a \$0.5 million unfunded commitment.
- (15) The investment has a \$1.5 million unfunded commitment.
- (16) The investment has a \$4.5 million unfunded commitment.
- (17) The investment has a \$1.0 million unfunded commitment.
- (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 equity investment is income producing, based on rate disclosed.
- (20) The investment has a \$5.0 million unfunded commitment.
- (21) The investment has a \$6.4 million unfunded commitment.
- (22) The investment is valued based on the net asset value of the company.

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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>

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Portfolio Company, Country ^{(1), (2), (3), (4), (5)}	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
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%
Chief Fire Intermediate, Inc.	Security System Services	Class B Common Units (3,510 units)		-	-	0.0%
				<u>9,013</u>	<u>9,013</u>	<u>6.1%</u>
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%
				<u>10,389</u>	<u>11,279</u>	<u>7.6%</u>
Corporate Visions, Inc.	Sales & Marketing Services	Second Lien 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%
				<u>20,902</u>	<u>19,291</u>	<u>13.0%</u>
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%
				<u>18,269</u>	<u>18,773</u>	<u>12.7%</u>
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%
				<u>17,656</u>	<u>17,609</u>	<u>11.9%</u>
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%
				<u>6,122</u>	<u>6,100</u>	<u>4.1%</u>
HUMC Opco, LLC	Healthcare	First Lien Debt (9.0% Cash, Due 8/16/20)	5,000	5,000	5,000	3.4%
				<u>5,000</u>	<u>5,000</u>	<u>3.4%</u>
Installs, LLC	Logistics	First Lien Debt (9.3% Cash, Due 6/20/23) ⁽⁶⁾	2,924	2,924	2,924	2.0%
				<u>2,924</u>	<u>2,924</u>	<u>2.0%</u>

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Portfolio Company, Country ^{(1), (2), (3), (4), (5)}	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
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%
				<u>7,000</u>	<u>7,000</u>	<u>4.7%</u>
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%
				<u>11,215</u>	<u>10,912</u>	<u>7.4%</u>
MicroHoldco, LLC	General Industrial	Preferred Units ⁽⁹⁾		838	838	0.6%
				<u>838</u>	<u>838</u>	<u>0.6%</u>
Portrait Studio, LLC	Professional and Personal Digital Imaging	First Lien Debt ⁽⁹⁾		510	510	0.3%
				<u>510</u>	<u>510</u>	<u>0.3%</u>
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%
				<u>7,050</u>	<u>7,050</u>	<u>4.8%</u>
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%
				<u>4,749</u>	<u>4,749</u>	<u>3.2%</u>
Sequoia Healthcare Management, LLC	Healthcare Management	First Lien Debt (12.8% Cash, Due 6/26/20)	12,744	12,744	12,607	8.5%
				<u>12,744</u>	<u>12,607</u>	<u>8.5%</u>
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%
				<u>10,528</u>	<u>10,045</u>	<u>6.8%</u>
Taylor Precision Products, Inc.	Household Product Manufacturer	Series C Preferred Stock (379 shares)		758	758	0.5%
				<u>758</u>	<u>758</u>	<u>0.5%</u>
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%
				<u>7,471</u>	<u>7,026</u>	<u>4.7%</u>

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Portfolio Company, Country ^{(1), (2), (3), (4), (5)}	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
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%
				<u>7,472</u>	<u>2,273</u>	<u>1.5%</u>
Xirgo Technologies, LLC	Information Technology	Membership Units (600,000 units)		600	917	0.6%
				<u>600</u>	<u>917</u>	<u>0.6%</u>
Sub Total Non-control/non-affiliated investments - United States				<u>\$ 250,433</u>	<u>\$ 241,046</u>	<u>162.8%</u>
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%
				<u>16,287</u>	<u>15,056</u>	<u>10.1%</u>
City Gear, LLC	Footwear Retail	Membership Unit Warrants ⁽⁹⁾		-	3,326	2.2%
				<u>-</u>	<u>3,326</u>	<u>2.2%</u>
Eastport Holdings, LLC	Business Services	Second Lien 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%
				<u>19,418</u>	<u>34,322</u>	<u>23.2%</u>
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%
				<u>3,478</u>	<u>4,262</u>	<u>2.9%</u>
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%
				<u>1,517</u>	<u>1,881</u>	<u>1.3%</u>
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	Second Lien 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%
				<u>4,560</u>	<u>4,904</u>	<u>3.3%</u>

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Portfolio Company, Country ^{(1), (2), (3), (4), (5)}	Industry	Type of Investment	Principal Amount	Cost	Fair Value	% of Net Assets
Navis Holdings, Inc.	Textile Equipment Manufacturer	First Lien Debt (11.0% Cash, Due 6/30/23) ⁽¹⁶⁾	\$ 10,100	\$ 10,100	\$Z 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%
				<u>11,100</u>	<u>11,564</u>	<u>7.8%</u>
Nth Degree Investment Group, LLC	Business Services	Membership Units (6,088,000 Units)		6,088	6,088	4.1%
				<u>6,088</u>	<u>6,088</u>	<u>4.1%</u>
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%
				<u>9,947</u>	<u>10,744</u>	<u>7.3%</u>
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%
				<u>7,706</u>	<u>5,908</u>	<u>4.0%</u>
V12 Holdings, Inc.	Data Processing & Digital Marketing	Second Lien Debt ⁽⁹⁾		655	708	0.5%
				<u>655</u>	<u>708</u>	<u>0.5%</u>
Sub Total Affiliate investments - United States				<u>\$ 80,756</u>	<u>\$ 98,763</u>	<u>66.7%</u>
Control Investments - 15.3%						
Control investments - United States						
Capitala Senior Loan Fund II, LLC	Investment Funds	Second Lien 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%
				<u>13,600</u>	<u>13,631</u>	<u>9.2%</u>
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%
				<u>9,092</u>	<u>9,092</u>	<u>6.1%</u>
Sub Total Control investments - United States				<u>\$ 22,692</u>	<u>\$ 22,723</u>	<u>15.3%</u>
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"). Unless otherwise noted, all of the Company's investments are deemed to be restricted securities under the Securities 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.

CAPITALA FINANCE CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2020
(Unaudited)

Note 1. Organization

Capitala Finance Corp. (the “Company”, “we”, “us”, and “our”) is an externally managed non-diversified closed-end management investment company incorporated in Maryland that has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). The Company 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, 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 unaudited consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying our annual consolidated financial statements prepared in accordance with U.S. GAAP have been omitted. The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries, including Fund II, Fund III, and the Taxable Subsidiaries.

The Company’s financial statements as of March 31, 2020 and December 31, 2019 and for the periods ended March 31, 2020 and 2019 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.

The current period’s results of operations are not necessarily indicative of results that ultimately may be achieved for the year. Additionally, the unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto appearing in the Company’s Annual Report on Form 10-K for the year ended December 31, 2019, filed with the U.S. Securities and Exchange Commission (“SEC”) on March 2, 2020.

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 “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 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 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 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 March 31, 2020, the Company had outstanding unfunded commitments related to debt and equity investments in existing portfolio companies of \$11.4 million (CSLF II), \$5.3 million (Bluestem Brands, Inc.), \$4.5 million (Rapid Fire Protection, Inc), \$1.7 million (BigMouth, Inc.), \$1.5 million (J5 Infrastructure Partners, LLC), \$1.0 million (U.S. BioTek Laboratories, LLC), and \$0.5 million (Freedom Electronics, LLC). 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).

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 March 31, 2020, 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 March 31, 2020 and December 31, 2019, was \$10.2 million and \$10.3 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.

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 March 31, 2020 and December 31, 2019. 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 three months ended March 31, 2020 and 2019. 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.

For U.S. federal income tax purposes, as of March 31, 2020, the aggregate net unrealized depreciation for all securities was \$(51.9) million. As of March 31, 2020, gross unrealized appreciation was \$3.3 million and gross unrealized depreciation was \$(55.2) million. The aggregate cost of securities for U.S. federal income tax purposes was \$373.1 million as of March 31, 2020. 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.

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 March 31, 2020 and December 31, 2019, the Company recorded a net deferred tax asset of \$0.0. For the three months ended March 31, 2020 and 2019, the Company recorded a tax benefit of \$0.0 and \$66 thousand, respectively. As of March 31, 2020 and December 31, 2019, the valuation allowance on the Company's deferred tax asset was \$4.0 million and \$3.2 million, respectively. During the three months ended March 31, 2020 and 2019, the Company recognized an increase in the valuation allowance of \$0.8 million and \$0.0, respectively.

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.

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 March 31, 2020 and December 31, 2019, 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 Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) was enacted on March 27, 2020 and made significant prospective and retroactive changes to the U.S. federal income tax laws (and certain corresponding state and local conformity measures) including: 1) 5-year net operating loss (“NOL”) carrybacks with no taxable income limitation, 2) relaxation of the limitations on interest expense deductions, 3) qualified improvement property eligible for bonus depreciation, 4) acceleration of alternative minimum tax credits and related quick tax refunds, and 6) indirect tax measures, including workplace tax credits and deferral of social security payroll tax. Management has considered the impact of the CARES Act on the Company, its Taxable Subsidiaries, and the underlying portfolio companies, and the Company has reflected these potential impacts in the financial statements, related tax disclosures, and the value of the investments.

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 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, Liquidity Risk, and COVID-19 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. The value of the Company’s investments may also be detrimentally affected to the extent observable primary or secondary market yields for similar instruments issued by comparable companies increase materially or risk premiums 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.

The Company's operating results and portfolio companies may be negatively impacted by the recent outbreak of COVID-19. On March 11, 2020, the World Health Organization declared COVID-19 a pandemic, and on March 13, 2020, a national emergency was declared in the U.S. The ongoing spread of COVID-19 has had, and will continue to have, a material adverse impact on the U.S. and global economy as commercial activity and public perception have been negatively impacted by the outbreak. The ultimate extent to which the COVID-19 crisis will impact the Company's financial condition and results of operations will depend on future developments affecting not only the Company, but also the entire U.S. and global economy, which are inherently uncertain, including, among others, new information that may emerge concerning the severity and rate of spread of the disease.

Note 3. Recent Accounting Pronouncements

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 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 March 2020, the FASB issued ASU 2020-04, Reference Rate Reform. The amendments in ASU 2020-04 provide optional expedients and exceptions for applying U.S. GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met. The standard is effective as of March 12, 2020 through December 31, 2022. Management is currently evaluating the impact of the optional guidance on the Company's consolidated financial statements and disclosures. The Company did not utilize the optional expedients and exceptions provided by ASU 2020-04 during the quarter ended March 31, 2020.

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, and, to a lesser extent, equity securities issued by lower middle-market companies and traditional middle-market companies. As of March 31, 2020, our portfolio consisted of investments in 41 portfolio companies with a fair value of approximately \$321.2 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 March 31, 2020, 15.6% of the fair value of our first lien loans consisted of last-out loans. As of December 31, 2019, 18.1% 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 in some cases, may be subject to the interruption of cash interest payments upon certain events of default, at the discretion of the first lien lender.

During the three months ended March 31, 2020, the Company made approximately \$8.3 million of investments and had approximately \$7.8 million in repayments and sales, resulting in net investments of approximately \$0.5 million for the period. During the three months ended March 31, 2019, the Company made approximately \$21.1 million of investments and had approximately \$11.5 million in repayments and sales, resulting in net investments of approximately \$9.6 million for the period.

During the three months ended March 31, 2020, the Company funded \$3.4 million of previously committed capital to existing portfolio companies. During the three months ended March 31, 2020, the Company funded \$4.9 million of investments in portfolio companies for which it was not previously committed to fund. During the three months ended March 31, 2019, the Company funded \$2.1 million of previously committed capital to existing portfolio companies. During the three months ended March 31, 2019, the Company funded \$19.0 million of investments in portfolio companies for which it was not previously committed to fund. During the three months ended March 31, 2020 and 2019, the Company did not lead any syndicates and did not assist any portfolio companies in obtaining indirect financing.

As of March 31, 2020, the Company's Board of Directors approved the fair value of the Company's investment portfolio of approximately \$321.2 million in good faith in accordance with the Company's valuation procedures. The Company's Board of Directors approved the fair value of the Company's investment portfolio as of March 31, 2020 with input from a third-party valuation firm and the Investment Advisor based on information known or knowable as of the valuation date, including trailing and forward looking data. The COVID-19 pandemic is an unprecedented circumstance that materially impacts the fair value of the Company's investments. As a result, the fair value of the Company's portfolio investments may be further negatively impacted after March 31, 2020 by circumstances and events that are not yet known.

COVID-19 may also impact the Company's portfolio companies' ability to pay their respective contractual obligations, including principal and interest due to the Company, and some portfolio companies may require interest or principal deferrals in order to fulfill short-term liquidity needs in response to COVID-19. The Company is working with each of its portfolio companies to help them access short-term liquidity through interest deferrals, funding on unused lines of credit, and other sources of liquidity.

The composition of our investments as of March 31, 2020, 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	\$ 237,260	66.7%	\$ 210,984	65.7%
Second Lien Debt	54,275	15.2	51,509	16.0
Equity and Warrants	50,836	14.3	44,948	14.0
Capitala Senior Loan Fund II, LLC	13,600	3.8	13,786	4.3
Total	\$ 355,971	100.0%	\$ 321,227	100.0%

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	54,079	15.3	53,857	14.8
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	\$ 353,881	100.0%	\$ 362,532	100.0%

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

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

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

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

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

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

The following table presents the fair value measurements of investments, by major class, as of March 31, 2020, according to the fair value hierarchy (dollars in thousands):

	Fair Value Measurements ⁽¹⁾			Total
	Level 1	Level 2	Level 3	
First Lien Debt	\$ —	\$ —	\$ 210,984	\$ 210,984
Second Lien Debt	—	—	51,509	51,509
Equity and Warrants	361	—	44,587	44,948
Total	\$ 361	\$ —	\$ 307,080	\$ 307,441

(1) Excludes the Company's \$13.8 million investment in CSLF II, measured at NAV.

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

	Fair Value Measurements ⁽¹⁾			Total
	Level 1	Level 2	Level 3	
First Lien Debt	\$ —	\$ —	\$ 231,203	\$ 231,203
Second Lien Debt	—	—	53,857	53,857
Equity and Warrants	2,273	—	61,568	63,841
Total	\$ 2,273	\$ —	\$ 346,628	\$ 348,901

(1) Excludes the Company's \$13.6 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 three months ended March 31, 2020 (dollars in thousands):

	First Lien Debt	Second Lien Debt	Equity and Warrants	Total ⁽¹⁾
Balance as of January 1, 2020	\$ 231,203	\$ 53,857	\$ 61,568	\$ 346,628
Repayments/sales	(6,850)	—	(918)	(7,768)
Purchases	8,030	—	237	8,267
Payment in-kind interest and dividends accrued	346	127	43	516
Accretion of original issue discount	39	68	—	107
Realized gain on investments	50	—	918	968
Net unrealized depreciation on investments	(21,834)	(2,543)	(17,261)	(41,638)
Balance as of March 31, 2020	<u>\$ 210,984</u>	<u>\$ 51,509</u>	<u>\$ 44,587</u>	<u>\$ 307,080</u>

(1) Excludes the Company's \$13.8 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 three months ended March 31, 2019 (dollars in thousands):

	First Lien Debt	Second Lien Debt	Equity and Warrants	Total ⁽¹⁾
Balance as of January 1, 2019	\$ 237,570	\$ 105,608	\$ 92,054	\$ 435,232
Reclassifications	(5,374)	—	5,374	—
Repayments/sales	(5,592)	—	(5,900)	(11,492)
Purchases	16,277	3,800	1,051	21,128
Payment in-kind interest and dividends accrued	183	511	225	919
Accretion of original issue discount	51	209	—	260
Realized gain (loss) on investments	(10,678)	—	4,831	(5,847)
Net unrealized appreciation (depreciation) on investments	9,021	(3,259)	(4,237)	1,525
Transfers out of Level 3 ⁽²⁾	—	—	(9,861)	(9,861)
Balance as of March 31, 2019	<u>\$ 241,458</u>	<u>\$ 106,869</u>	<u>\$ 83,537</u>	<u>\$ 431,864</u>

(1) Excludes the Company's \$13.9 million investment in CSLF II, measured at NAV.

(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 three months ended March 31, 2019 was \$(0.3) million.

The net change in unrealized depreciation on investments held was (\$43.4) million and (\$2.5) million as of March 31, 2020 and 2019 and for the three months then ended, respectively, and is included in net unrealized appreciation (depreciation) on investments in the consolidated statements of operations.

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements of assets as of March 31, 2020 were as follows:

	Fair Value⁽²⁾ (in millions)	Valuation Approach	Unobservable Input	Range (Weighted Average)
First lien debt	\$ 141.4	Income	Required Rate of Return Leverage Ratio Adjusted EBITDA	7.0% – 22.0% (12.8%) 1.7x – 7.2x (3.6x) (\$0.8) million – \$114.0 million (\$15.4 million)
First lien debt	\$ 69.6	Enterprise Value Waterfall and Asset ⁽¹⁾	EBITDA Multiple Adjusted EBITDA Revenue Multiple Revenue	2.8x – 6.8x (4.1x) \$2.0 million – \$114.0 million (\$16.6 million) 0.2x – 0.9x (0.5x) \$13.4 million – \$761.3 million (\$451.9 million)
Second lien debt	\$ 47.7	Income	Required Rate of Return Leverage Ratio Adjusted EBITDA	11.5% – 22.3% (14.2%) 4.1x – 11.1x (5.2x) \$1.2 million – \$74.5 million (\$30.6 million)
Second lien debt	\$ 3.8	Enterprise Value Waterfall and Asset ⁽¹⁾	EBITDA Multiple Adjusted EBITDA	5.0x – 6.0x (5.1x) \$1.9 million – \$63.0 million (\$55.1 million)
Equity and warrants	\$ 44.6	Enterprise Value Waterfall and Asset ⁽¹⁾	EBITDA Multiple Adjusted EBITDA Revenue Multiple Revenue	4.5x – 9.0x (6.8x) \$1.9 million – \$19.6 million (\$9.3 million) 0.2x – 3.7x (0.6x) \$19.1 million – \$574.5 million (\$458.5 million)

(1) \$21.5 million in first lien debt, \$0.7 million in second lien debt, and \$3.9 million in equity and warrants were valued using the asset approach.

(2) Excludes the Company's \$13.8 million investment in CSLF II, measured at NAV.

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⁽²⁾ (in millions)	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	\$ 53.9	Income and Asset ⁽¹⁾	Required Rate of Return	6.0% – 15.0% (13.5%)
			Leverage Ratio	3.0x – 7.0x (5.3x)
			Adjusted EBITDA	\$1.8 million – \$74.5 million (\$32.7 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 second lien debt, and \$4.9 million in equity and warrants were valued using the asset approach.

(2) Excludes the Company's \$13.6 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 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 March 31, 2020 and December 31, 2019, \$13.6 million and \$3.4 million in equity capital had been contributed by Capitala and Trinity, respectively. As of March 31, 2020 and December 31, 2019, 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.

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 June 30, 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 March 31, 2020 and December 31, 2019, \$14.2 million and \$12.7 million was outstanding under the CSLF II Credit Facility, respectively. For the three months ended March 31, 2020, CSLF II incurred interest and financing expenses of \$0.2 million. For the three months ended March 31, 2019, CSLF II did not incur 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 March 31, 2020, and December 31, 2019, \$0.0 was outstanding on the Subordinated Notes. As of March 31, 2020 and 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 three months ended March 31, 2020 and 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 March 31, 2020 and December 31, 2019 (dollars in thousands):

	March 31, 2020	December 31, 2019
First lien loans ⁽¹⁾	\$ 22,358	\$ 28,396
Weighted average current interest rate on first lien loans	6.5%	6.4%
Number of portfolio companies	4	5
Largest portfolio company investment ⁽¹⁾	\$ 6,566	\$ 7,443
Total of five largest portfolio company investments ^{(1) (2)}	\$ 22,358	\$ 28,396

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

(2) Only four investments held as of March 31, 2020.

Below is CSLF II’s unaudited schedule of investments as of March 31, 2020 (dollars in thousands):

Portfolio Company	Industry	Type of Investment	Principal Amount	Cost	Fair Value
Investments at Fair Value					
Freedom Electronics, LLC	Electronic Machine Repair	First Lien Debt (7.0% Cash (1 month LIBOR + 5.0%, 2.0% Floor), Due 12/20/23)	\$ 5,431	\$ 5,431	\$ 5,431
RAM Payment, LLC	Financial Services	First Lien Debt (6.6% Cash (1 month LIBOR + 5.0%, 1.5% Floor), Due 1/4/24)	6,566	6,566	6,566
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)	5,917	5,917	5,917
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)	4,444	4,444	4,444
TOTAL INVESTMENTS			<u>\$ 22,358</u>	<u>\$ 22,358</u>	<u>\$ 22,358</u>

(1) The investment has a \$1.4 million unfunded commitment.

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	Electronic Machine Repair	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			<u>\$ 28,396</u>	<u>\$ 28,396</u>	<u>\$ 28,396</u>

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

Below are the statements of assets and liabilities for CSLF II (dollars in thousands):

	As of	
	March 31, 2020 (unaudited)	December 31, 2019
ASSETS		
Investments at fair value (amortized cost of \$22,358 and \$28,396, respectively)	\$ 22,358	\$ 28,396
Cash and cash equivalents	8,517	704
Interest receivable	117	151
Other assets	3	7
Total assets	<u>\$ 30,995</u>	<u>\$ 29,258</u>
LIABILITIES		
Credit facility (net of deferred financing costs of \$588 and \$621, respectively)	\$ 13,612	\$ 12,079
Interest and financing fees payable	127	113
Accounts payable	24	27
Total liabilities	<u>\$ 13,763</u>	<u>\$ 12,219</u>
NET ASSETS		
Members' capital	\$ 17,232	\$ 17,039
Total net assets	<u>\$ 17,232</u>	<u>\$ 17,039</u>

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

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
INVESTMENT INCOME		
Interest income	\$ 421	\$ 312
Fee income	3	68
Total investment income	<u>\$ 424</u>	<u>\$ 380</u>
EXPENSES		
Interest and financing expenses	\$ 160	\$ —
General and administrative expenses	71	87
Total expenses	<u>\$ 231</u>	<u>\$ 87</u>
NET INVESTMENT INCOME	<u>\$ 193</u>	<u>\$ 293</u>
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	<u>\$ 193</u>	<u>\$ 293</u>

	5.0%), Due 9/3/24)								
Capitala Senior Loan Fund II, LLC	Membership Units (80.0% ownership)	-	13,631	-	-	-	155	13,786	
		<u>-</u>	<u>13,631</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>155</u>	<u>13,786</u>	
Vology, Inc.	First Lien Debt (10.5% Cash (1 month LIBOR + 8.5%, 2.0% Floor), Due 12/31/21)	3,877	103	3,877	-	-	-	-	3,877
Vology, Inc.	Class A Preferred Units (9,041,810 Units)	-	5,215	-	-	-	(1,297)	3,918	
Vology, Inc.	Membership Units (5,363,982 Units)	-	-	-	-	-	-	-	-
		<u>103</u>	<u>9,092</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,297)</u>	<u>7,795</u>	
Total Control investments		<u>\$ 103</u>	<u>\$ 22,723</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,142)</u>	<u>\$ 21,581</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.

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
<u>Affiliate investments</u>									
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)	-	-	-	-	-	-	-	-
			1,837	14,384	432	(750)	-	990	15,056
City Gear, LLC	Membership Unit Warrants	-	-	3,184	111	-	(111)	142	3,326
			-	3,184	111	-	(111)	142	3,326
Eastport Holdings, LLC	Second Lien 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
			3,230	34,110	659	-	-	(447)	34,322
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
			-	4,807	299	-	-	(844)	4,262
J&J Produce Holdings, Inc.	Second Lien 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)	-	-	-	-	-	-	-	-
			485	6,210	-	(5,788)	(1,436)	1,014	-
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
			-	3,018	620	(293)	-	(1,464)	1,881
MMI Holdings, LLC	First Lien Debt (12.0% Cash, Due 1/31/21)	2,600	316	2,600	-	-	-	-	2,600
MMI Holdings, LLC	Second Lien 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
			340	4,797	98	-	-	9	4,904
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.	Second Lien 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)	-	-
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)		-	-	-	-	-	-	-
			220	10,597	7,215	(6,974)	(14,586)	3,748	-
Capitala Senior Loan Fund II, LLC	Second Lien 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
			1,040	13,695	-	-	-	(64)	13,631
Micro Precision, LLC	Second Lien Debt (10.0% Cash, Due 3/31/20)		-	106	1,862	-	(1,862)	-	-
Micro Precision, LLC	Second Lien 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)	-
			1,270	9,004	88	(7,904)	-	(1,188)	-
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)	-
			616	12,848	-	(11,100)	2,599	(4,347)	-
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)		-	-	-	-	-	-	-
			205	6,674	3,540	(4,332)	(6,158)	276	-
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
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
Total Control investments			\$ 3,470	\$ 69,145	\$ 24,019	\$ (30,310)	\$ (38,573)	\$ (1,558)	\$ 22,723

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

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 March 31, 2020 and December 31, 2019, the Company had incentive fees payable to the Investment Advisor of \$3.7 million.

For the three months ended March 31, 2020 and 2019, the Company incurred \$1.8 million and \$2.1 million in base management fees, respectively. The Company incurred \$0.0 and \$1.0 million in incentive fees related to pre-incentive fee net investment income for the three months ended March 31, 2020 and 2019, respectively. For the three months ended March 31, 2020 and 2019, our Investment Advisor waived \$0.0 in incentive fees.

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 associated with such functions on a direct basis without any incremental profit to our Administrator. Stockholder approval is not required to amend the Administration Agreement.

For the three months ended March 31, 2020 and 2019, the Company paid the Administrator \$0.4 million for the Company's allocable portion of the Administrator's overhead.

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

Note 7. Related Party Transactions

At March 31, 2020 and December 31, 2019, the Company had \$3.6 million and \$3.7 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 March 31, 2020, 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 March 31, 2020 and December 31, 2019 was \$10.2 million and \$10.3 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 March 31, 2020 and December 31, 2019, the Company had \$150.0 million of SBA-guaranteed debentures outstanding. The Company has issued all SBA-guaranteed debentures that were permitted under each of the Legacy Funds' respective SBIC licenses (as applicable), and there are no unused SBA debenture commitments remaining. 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 March 31, 2020, Fund III had total assets of \$229.5 million. As of December 31, 2019, Fund III had total assets of \$266.3 million. On June 10, 2014, the Company received an exemptive order from the SEC exempting the Company, Fund II, and Fund III from certain provisions of the 1940 Act (including an exemptive order granting relief from the asset coverage requirements for certain indebtedness issued by Fund II and Fund III as SBICs) and from certain reporting requirements mandated by the Securities Exchange Act of 1934, as amended, with respect to Fund II and Fund III. The Company intends to comply with the conditions of the order.

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 three months ended March 31, 2020 and 2019 (dollars in thousands):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Interest expense and annual charges	\$ 1,331	\$ 1,433
Deferred financing costs	124	285
Total interest and financing expenses	\$ 1,455	\$ 1,718
Average outstanding balance	\$ 150,000	\$ 160,292
Average stated interest and annual charge rate	3.56%	3.62%

As of March 31, 2020 and December 31, 2019, the Company's issued and outstanding SBA-guaranteed debentures mature as follows (dollars in thousands):

Fixed Maturity Date	Interest Rate	SBA Annual Charge	March 31, 2020	December 31, 2019
September 1, 2020	3.215%	0.285%	\$ 19,000	\$ 19,000
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
			\$ 150,000	\$ 150,000

2022 Notes

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

The following table summarizes the interest expense, deferred financing costs, average outstanding balance, and average stated interest rate on the 2022 Notes for the three months ended March 31, 2020 and 2019 (dollars in thousands):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Interest expense and annual charges	\$ 1,125	\$ 1,125
Deferred financing costs	140	132
Total interest and financing expenses	\$ 1,265	\$ 1,257
Average outstanding balance	\$ 75,000	\$ 75,000
Average stated interest rate	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’ overallotment 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 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 three months ended March 31, 2020 and 2019 (dollars in thousands):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Interest expense	\$ 749	\$ 749
Deferred financing costs	89	84
Total interest and financing expenses	\$ 838	\$ 833
Average outstanding balance	\$ 52,088	\$ 52,088
Average stated interest rate	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 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 three months ended March 31, 2020 and 2019 (dollars in thousands):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Interest expense	\$ —	\$ 216
Deferred financing costs	153	115
Unused commitment fees	115	274
Total interest and financing expenses	<u>\$ 268</u>	<u>\$ 605</u>
Average outstanding balance	<u>\$ —</u>	<u>\$ 15,666</u>
Average stated interest rate	—%	5.53%

As of March 31, 2020 and December 31, 2019, the Company had \$0.0 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 \$149.3 million and \$159.8 million, respectively, at March 31, 2020 and December 31, 2019. 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.

As of March 31, 2020, the Company was not in compliance with certain debt covenants in the Credit Facility, including its minimum net asset value covenant and its minimum interest coverage covenant. The Company's non-compliance with these covenants was largely driven by the increase in non-accrual loans and an increase in unrealized depreciation as the result of the impacts of COVID-19. The Company will not be able to borrow under the Credit Facility until a waiver or amendment can be obtained from ING Capital, LLC and the lender group or until such time that it can comply with the existing debt covenants in the Credit Facility.

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 March 31, 2020, 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	\$ 151,238	\$ —	\$ —	\$ 151,238
2022 Notes	75,000	55,500	55,500	—	—
2022 Convertible Notes	52,088	36,232	36,232	—	—
Credit Facility	—	—	—	—	—
Total	<u>\$ 277,088</u>	<u>\$ 242,970</u>	<u>\$ 91,732</u>	<u>\$ —</u>	<u>\$ 151,238</u>

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

The following table presents the carrying value and fair value of the Company's financial liabilities disclosed, but not carried, at fair value as of December 31, 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	\$ 277,088	\$ 277,635	\$ 126,468	\$ —	\$ 151,167

(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. Directors' Fees

Our independent directors receive an annual fee of \$50,000. They also receive \$5,000 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attending each board meeting and \$5,000 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attending each committee meeting. In addition, the chairman of the audit committee receives an annual fee of \$10,000 and each chairman of any other committee receives an annual fee of \$5,000 for their additional services, if any, in these capacities. For the three months ended March 31, 2020 and 2019, the Company recognized directors' fees expense of \$0.1 million and \$0.1 million, respectively. No compensation is expected to be paid to directors who are "interested persons" of the Company, as such term is defined in Section 2(a)(19) of the 1940 Act. Effective April 1, 2020, the Company's independent directors have agreed to waive 20% of the fees due to them for the remainder of the fiscal year ending December 31, 2020 due to the impact of COVID-19.

Note 10. 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 diluted earnings per share. For the three months ended March 31, 2020 and 2019, 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 increase (decrease) in net assets per share resulting from operations for the three months ended March 31, 2020 and 2019 (dollars in thousands, except share and per share data):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Net decrease in net assets resulting from operations	\$ (42,440)	\$ (151)
Weighted average common stock outstanding – basic and diluted	16,220,591	16,062,906
Net decrease in net assets per share resulting from operations – basic and diluted	\$ (2.62)	\$ (0.01)

Note 11. 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 three months ended March 31, 2020, we estimate that total distributions of \$4.1 million were classified as a return of capital. Distributions may be subject to reclassification based on future dividends and operating results and will not be determined until the end of the year.

The following table summarizes the Company's distribution declarations for the three months ended March 31, 2020 (dollars in thousands, except share and per share data):

Date Declared	Record Date	Payment Date	Amount Per Share	Cash Distribution	DRIP Shares Issued	DRIP Share Value
January 2, 2020	January 24, 2020	January 30, 2020	\$ 0.0833	\$ 1,231	14,593	\$ 119
January 2, 2020	February 20, 2020	February 27, 2020	0.0833	1,228	16,556	122
January 2, 2020	March 23, 2020	March 30, 2020	0.0833	1,259	31,566	94
Total Distributions Declared and Distributed			\$ 0.25	\$ 3,718	62,715	\$ 335

The following table summarizes the Company's distribution declarations for the three months ended March 31, 2019 (dollars in thousands, except share and per share data):

Date Declared	Record Date	Payment Date	Amount Per Share	Cash Distribution	DRIP Shares Issued	DRIP Share Value
January 2, 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
Total Distributions Declared and Distributed			\$ 0.25	\$ 3,759	32,596	\$ 255

Note 12. Financial Highlights

The following is a schedule of financial highlights for the three months ended March 31, 2020 and 2019 (dollars in thousands, except share and per share data):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Per share data:		
Net asset value at beginning of period	\$ 9.14	\$ 11.88
Net investment income ⁽¹⁾	—	0.26
Net realized gain (loss) on investments ⁽¹⁾	0.06	(0.36)
Net unrealized appreciation (depreciation) on investments ⁽¹⁾	(2.68)	0.09
Distributions – return of capital ⁽²⁾	(0.25)	—
Distributions – net investment income ⁽²⁾	—	(0.25)
Other ⁽³⁾	—	(0.01)
Net asset value at end of period	\$ 6.27	\$ 11.61
Net assets at end of period	\$ 101,955	\$ 186,734
Shares outstanding at end of period	16,266,484	16,084,143
Per share market value at end of period	\$ 3.13	\$ 7.96
Total return based on market value ⁽⁴⁾	(62.34)%	14.60%
Ratio/Supplemental data:		
Ratio of net investment income (loss) to average net assets ⁽⁵⁾	(0.04)%	10.56%
Ratio of incentive fees, to average net assets ⁽⁶⁾⁽⁷⁾	—%	0.55%
Ratio of interest and financing expenses to average net assets ⁽⁸⁾	12.31%	9.48%
Ratio of tax benefit to average net assets ⁽⁸⁾	—%	(0.14)%
Ratio of other operating expenses to average net assets ⁽⁸⁾	10.49%	6.67%
Ratio of total expenses including tax benefit, to average net assets ⁽⁵⁾⁽⁶⁾	22.80%	16.56%
Portfolio turnover rate ⁽⁹⁾	2.27%	2.54%
Average debt outstanding ⁽¹⁰⁾	\$ 277,088	\$ 303,046
Average debt outstanding per common share	\$ 17.03	\$ 18.84
Asset coverage ratio per unit ⁽¹¹⁾	\$ 1,802	\$ 2,228

(1) Based on daily weighted average balance of shares outstanding during the period.

(2) Distributions may be subject to reclassification based on future dividends and operating results and will not be determined until the end of the year.

(3) 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.

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

(5) Ratios are annualized. Incentive fees, included within the ratio are not annualized.

(6) The ratio of waived incentive fees to average net assets was 0.00% for the three months ended March 31, 2020 and 2019.

(7) Ratio is not annualized.

(8) Ratios are annualized.

(9) Portfolio turnover rate is calculated using the lesser of year-to-date sales or year-to-date purchases over the average of the invested assets at fair value. Portfolio turnover rates that cover less than a full period are not annualized.

(10) Based on the daily weighted average balance of debt outstanding during the period.

(11) 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 March 31, 2020 and 2019 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 150% asset coverage ratio we are required to maintain under the 1940 Act. Asset coverage per unit is expressed in terms of dollar amounts per \$1,000 of indebtedness.

Note 14. Subsequent Events

Management has evaluated subsequent events through the date of issuance of the consolidated financial statements included herein. There have been no subsequent events that occurred during such period that would be required to be recognized in the consolidated financial statements as of March 31, 2020.

Portfolio Activity

On April 24, 2020, the Company received \$1.7 million for its first lien revolver in BigMouth, Inc., repaid at par.

Distributions

On April 30, 2020, the Company's Board of Directors determined not to declare a distribution for the second quarter of 2020 due to the impact of COVID-19 on the Company's expected net investment income.

Other

On May 1, 2020, the Small Business Administration issued a "green light" letter inviting the Company to continue its application process for Capitala SBIC Fund VII, LP, as a wholly owned small business investment company subsidiary of Capitala Finance Corp. If approved, the additional SBIC license would provide the Company with an incremental source of attractive long-term capital. Receipt of a green light letter from the SBA does not assure an applicant that the SBA will ultimately issue an SBIC license and the Company has received no assurance or indication from the SBA that it will receive an additional SBIC license, or of the timeframe in which it would receive an additional license, should one ultimately be granted.

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

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

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

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

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

- our future operating results and the impact of the COVID-19 pandemic thereon;
- our business prospects and the prospects of our portfolio companies, including our and their ability to achieve our respective objectives as a result of the current COVID-19 pandemic;
- 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 and the impact of the COVID-19 pandemic thereon;
- 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 and the impact of the COVID-19 pandemic thereon.

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, due to the COVID-19 pandemic or otherwise, 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 and the impact of the COVID-19 pandemic thereon;
- interest rate volatility could adversely affect our results, particularly if we use leverage as part of our investment strategy; and
- the risks, uncertainties, and other factors we identify in “Risk Factors” and elsewhere in our Annual Report on Form 10-K and in this quarterly report on Form 10-Q.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. Important assumptions include our ability to originate new loans and investments, certain margins and levels of profitability, and the availability of additional capital. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Quarterly Report on Form 10-Q should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in “Risk Factors” and elsewhere in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019 and in this quarterly report on Form 10-Q. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events, or otherwise, unless required by law or U.S. Securities and Exchange Commission (“SEC”) rule or regulation.

Overview

We are a Maryland corporation that has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). 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, 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. The Small Business Credit Availability Act (the “SBCA”) allows 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 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 and as a result, our asset coverage requirements for senior securities was changed from 200% to 150%, effective November 1, 2019. As of March 31, 2020, our asset coverage ratio was 180.2%. 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 a 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 unaudited consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying our annual consolidated financial statements prepared in accordance with U.S. GAAP have been omitted. The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries.

The Company’s financial statements as of March 31, 2020 and December 31, 2019 and for the periods ended March 31, 2020 and 2019 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 consolidated financial statements and the reported amounts of revenues and expenses for the periods covered by such consolidated 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 dividends provision. PIK dividends, which represent contractually deferred dividends added to the equity balance, are recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company will typically cease accrual of PIK dividends when the fair value of the equity investment is less than the cost basis of the investment or when it is otherwise determined by management that PIK dividends are unlikely to be collected. If management determines that a decline in fair value is temporary in nature and the PIK dividends are more likely than not to be collected, management may elect to continue accruing PIK dividends.

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

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

Income Taxes

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

The Company has elected to be treated for U.S. federal income tax purposes and intends to comply with the requirement to qualify annually as a RIC under subchapter M of the Code and, among other things, intends to make the requisite distributions to its stockholders which will relieve the Company from U.S. federal income taxes.

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

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

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 periods ended March 31, 2020 and 2019. 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 March 31, 2020 and December 31, 2019, the Company recorded a net deferred tax asset of \$0.0. For the three months ended March 31, 2020 and 2019, the Company recorded a tax benefit of \$0.0 and \$66 thousand, respectively. As of March 31, 2020 and December 31, 2019, the valuation allowance on the Company's deferred tax asset was \$4.0 million and \$3.2 million, respectively. During the three months ended March 31, 2020 and 2019, the Company recognized an increase in the valuation allowance of \$0.8 million and \$0.0, 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 March 31, 2020 and December 31, 2019, 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 March 31, 2020 and December 31, 2019. 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, to a lesser extent, equity securities issued by lower middle-market companies and traditional middle-market companies. As of March 31, 2020, our portfolio consisted of investments in 41 portfolio companies with a fair value of approximately \$321.2 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 March 31, 2020, 15.6% of the fair value of our first lien loans consisted of last-out loans. As of December 31, 2019, 18.1% 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 in some cases, may be subject to the interruption of cash interest payments upon certain events of default, at the discretion of the first lien lender.

During the three months ended March 31, 2020, we made approximately \$8.3 million of investments and had approximately \$7.8 million in repayments and sales of investments, resulting in net investments of approximately \$0.5 million for the period. During the three months ended March 31, 2019, we made approximately \$21.1 million of investments and had approximately \$11.5 million in repayments and sales, resulting in net investments of approximately \$9.6 million for the period.

As of March 31, 2020, our debt investment portfolio, which represented 81.7% of the fair value of our total portfolio, had a weighted average annualized yield of approximately 9.9%. As of March 31, 2020, 41.6% of the fair value of our debt investment portfolio was bearing a fixed rate of interest. 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.

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.

As of March 31, 2020, the Board of Directors approved the fair value of our investment portfolio of approximately \$321.2 million in good faith in accordance with our valuation procedures. The Board of Directors approved the fair value of our investment portfolio as of March 31, 2020 with input from a third-party valuation firm and the Investment Advisor based on information known or knowable as of the valuation date, including trailing and forward looking data. The COVID-19 pandemic is an unprecedented circumstance that materially impacts the fair value of our investments. As a result, the fair value of our portfolio investments may be further negatively impacted after March 31, 2020 by circumstances and events that are not yet known.

COVID-19 may also impact our portfolio companies' ability to pay their respective contractual obligations, including principal and interest due to us, and some portfolio companies may require interest or amortization deferrals in order to fulfill short-term liquidity needs in response to COVID-19. We are working with each of our portfolio companies to help them access short-term liquidity through interest deferrals, funding on unused lines of credit, and access other sources of liquidity.

As of March 31, 2020, we had debt investments in eight portfolio companies on non-accrual status with an aggregate amortized cost of \$68.0 million and an aggregate fair value of \$42.9 million, which represented 19.1% and 13.4% of the investment portfolio, respectively. As of December 31, 2019, we had no investments on non-accrual status.

The increase in non-accrual investments from December 31, 2019 to March 31, 2020 was largely driven by the economic impact of COVID-19. For the three months ended March 31, 2020, the impact of non-accrual loans on our net investment income was an approximate decrease of \$1.6 million.

The following table summarizes the amortized cost and the fair value of investments as of March 31, 2020 (dollars in thousands):

	Investments at Amortized Cost	Percentage of Total	Investments at Fair Value	Percentage of Total
First Lien Debt	\$ 237,260	66.7%	\$ 210,984	65.7%
Second Lien Debt	54,275	15.2	51,509	16.0
Equity and Warrants	50,836	14.3	44,948	14.0
Capitala Senior Loan Fund II, LLC	13,600	3.8	13,786	4.3
Total	\$ 355,971	100.0%	\$ 321,227	100.0%

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	54,079	15.3	53,857	14.8
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	\$ 353,881	100.0%	\$ 362,532	100.0%

The following table shows the portfolio composition by industry grouping at fair value as of March 31, 2020 and December 31, 2019 (dollars in thousands):

	March 31, 2020		December 31, 2019	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
Business Services	\$ 33,004	10.3%	\$ 40,410	11.2%
Financial Services	28,392	8.8	29,517	8.1
Healthcare	21,068	6.6	27,928	7.7
Consumer Products	19,362	6.0	25,118	6.9
Sales & Marketing Services	18,816	5.9	19,291	5.3
Food Product Manufacturer	17,674	5.5	17,609	4.9
Automobile Part Manufacturer	14,035	4.4	15,056	4.2
Investment Funds	13,786	4.3	13,631	3.8
Security System Services	13,770	4.3	16,063	4.4
IT Consulting	13,553	4.2	13,773	3.8
Multi-Platform Media and Consumer Products	13,000	4.1	13,000	3.6
Government Services	11,776	3.7	11,279	3.1
Healthcare Management	11,250	3.5	12,607	3.5
Textile Equipment Manufacturer	10,729	3.3	11,564	3.2
Wireless Deployment Services	8,825	2.8	7,000	1.9
Entertainment	8,763	2.7	10,912	3.0
Information Technology	8,453	2.6	10,009	2.8
Online Merchandise Retailer	7,088	2.2	2,877	0.8
Testing Laboratories	6,839	2.1	7,026	1.9
Electronic Machine Repair	6,394	2.0	6,100	1.7
Retail	6,161	1.9	10,045	2.8
Medical Device Distributor	4,932	1.5	4,904	1.4
Data Services	4,319	1.3	4,749	1.3
Advertising & Marketing Services	3,696	1.2	4,262	1.2
Oil & Gas Engineering and Consulting Services	2,858	0.9	5,908	1.6
Restaurant	2,700	0.8	4,697	1.3
Footwear Retail	2,477	0.8	3,326	0.9
Home Repair Parts Manufacturer	1,956	0.6	2,489	0.7
Computer Supply Retail	1,540	0.5	1,490	0.4
QSR Franchisor	1,514	0.5	1,881	0.5
Household Product Manufacturer	758	0.2	758	0.2
Data Processing & Digital Marketing	708	0.2	708	0.2
General Industrial	670	0.2	838	0.2
Oil & Gas Services	361	0.1	2,273	0.6
Logistics	—	—	2,924	0.8
Professional and Personal Digital Imaging	—	—	510	0.1
Total	\$ 321,227	100.0%	\$ 362,532	100.0%

All investments made by the Company as of March 31, 2020 and December 31, 2019 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 March 31, 2020 and December 31, 2019 (dollars in thousands):

	March 31, 2020		December 31, 2019	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
South	\$ 140,916	43.9%	\$ 165,963	45.8%
West	65,454	20.4	70,102	19.3
Northeast	59,598	18.5	71,184	19.6
Midwest	55,259	17.2	55,283	15.3
Total	\$ 321,227	100.0%	\$ 362,532	100.0%

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

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

Our internal investment rating system incorporates the following five categories:

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

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

The following table shows the distribution of our investments on the 1 to 5 investment rating scale at fair value as of March 31, 2020 and December 31, 2019 (dollars in thousands):

Investment Rating	As of March 31, 2020		As of December 31, 2019	
	Investments at Fair Value	Percentage of Total Investments	Investments at Fair Value	Percentage of Total Investments
1	\$ 75,165	23.4%	\$ 85,688	23.6%
2	155,635	48.5	219,855	60.7
3	39,265	12.2	56,989	15.7
4	51,162	15.9	—	—
Total	\$ 321,227	100.0%	\$ 362,532	100.0%

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 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 March 31, 2020 and December 31, 2019, \$13.6 million and \$3.4 million in equity capital had been contributed by Capitala and Trinity, respectively. As of March 31, 2020 and December 31, 2019, 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.

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 June 30, 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 March 31, 2020 and December 31, 2019, \$14.2 million and \$12.7 million was outstanding under the CSLF II Credit Facility, respectively. For the three months ended March 31, 2020, CSLF II incurred interest and financing expenses of \$0.2 million. For the three months ended March 31, 2019, CSLF II did not incur 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 March 31, 2020, and December 31, 2019, \$0.0 was outstanding on the Subordinated Notes. As of March 31, 2020 and 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 three months ended March 31, 2020 and 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 March 31, 2020 and December 31, 2019 (dollars in thousands):

	March 31, 2020	December 31, 2019
First lien loans ⁽¹⁾	\$ 22,358	\$ 28,396
Weighted average current interest rate on first lien loans	6.5%	6.4%
Number of portfolio companies	4	5
Largest portfolio company investment ⁽¹⁾	\$ 6,566	\$ 7,443
Total of five largest portfolio company investments ^{(1) (2)}	\$ 22,358	\$ 28,396

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

(2) Only four investments held as of March 31, 2020.

Below is CSLF II's unaudited schedule of investments as of March 31, 2020 (dollars in thousands):

Portfolio Company	Industry	Type of Investment	Principal Amount	Cost	Fair Value
Investments at Fair Value					
Freedom Electronics, LLC	Electronic Machine Repair	First Lien Debt (7.0% Cash (1 month LIBOR + 5.0%, 2.0% Floor), Due 12/20/23)	\$ 5,431	\$ 5,431	\$ 5,431
RAM Payment, LLC	Financial Services	First Lien Debt (6.6% Cash (1 month LIBOR + 5.0%, 1.5% Floor), Due 1/4/24)	6,566	6,566	6,566
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)	5,917	5,917	5,917
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)	4,444	4,444	4,444
TOTAL INVESTMENTS			<u>\$ 22,358</u>	<u>\$ 22,358</u>	<u>\$ 22,358</u>

(1) The investment has a \$1.4 million unfunded commitment.

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	Electronic Machine Repair	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			<u>\$ 28,396</u>	<u>\$ 28,396</u>	<u>\$ 28,396</u>

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

Below are the statements of assets and liabilities for CSLF II (dollars in thousands):

	As of	
	March 31, 2020 (unaudited)	December 31, 2019
ASSETS		
Investments at fair value (amortized cost of \$22,358 and \$28,396, respectively)	\$ 22,358	\$ 28,396
Cash and cash equivalents	8,517	704
Interest receivable	117	151
Other assets	3	7
Total assets	<u>\$ 30,995</u>	<u>\$ 29,258</u>
LIABILITIES		
Credit facility (net of deferred financing costs of \$588 and \$621, respectively)	\$ 13,612	\$ 12,079
Interest and financing fees payable	127	113
Accounts payable	24	27
Total liabilities	<u>\$ 13,763</u>	<u>\$ 12,219</u>
NET ASSETS		
Members' capital	\$ 17,232	\$ 17,039
Total net assets	<u>\$ 17,232</u>	<u>\$ 17,039</u>

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

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
INVESTMENT INCOME		
Interest income	\$ 421	\$ 312
Fee income	3	68
Total investment income	<u>\$ 424</u>	<u>\$ 380</u>
EXPENSES		
Interest and financing expenses	\$ 160	\$ —
General and administrative expenses	71	87
Total expenses	<u>\$ 231</u>	<u>\$ 87</u>
NET INVESTMENT INCOME	<u>\$ 193</u>	<u>\$ 293</u>
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	<u>\$ 193</u>	<u>\$ 293</u>

Results of Operations

Operating results for the three months ended March 31, 2020 and 2019 were as follows (dollars in thousands):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Total investment income	\$ 7,074	\$ 12,684
Total expenses	7,087	8,549
Net investment income (loss)	(13)	4,135
Net realized gain (loss) on investments	968	(5,847)
Net unrealized appreciation (depreciation) on investments	(43,395)	1,495
Tax benefit	—	66
Net decrease in net assets resulting from operations	<u>\$ (42,440)</u>	<u>\$ (151)</u>

Investment income

The composition of our investment income for the three months ended March 31, 2020 and 2019 was as follows (dollars in thousands):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Interest income	\$ 6,170	\$ 10,021
Fee income	319	387
Payment-in-kind interest and dividend income	516	919
Dividend income	25	1,306
Interest from cash and cash equivalents	44	51
Total investment income	<u>\$ 7,074</u>	<u>\$ 12,684</u>

The income reported as interest income, 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 receive, and have received, more substantial one-time dividends from our equity investments.

For the three months ended March 31, 2020, total investment income decreased by \$5.6 million, or 44.2%, compared to the three months ended March 31, 2019. Interest income decreased from \$10.0 million for the three months ended March 31, 2019 to \$6.2 million for the three months ended March 31, 2020. The decrease from the prior period is due to lower average outstanding debt investments and the impact of non-accrual additions during the three months ended March 31, 2020 compared to the three months ended March 31, 2019. The increase in non-accrual investments was largely driven by the economic impact of COVID-19. For the three months ended March 31, 2020, the impact of non-accrual loans on our net investment income was an approximate decrease of \$1.6 million. PIK income declined from \$0.9 million for the three months ended March 31, 2019 to \$0.5 million for the three months ended March 31, 2020, due to a decrease in investments with a contractual PIK rate and the impact of non-accrual additions during the three months ended March 31, 2020. Fee income decreased from \$0.4 million for the three months ended March 31, 2019 to \$0.3 million for the three months ended March 31, 2020. For the three months ended March 31, 2020, we generated \$0.2 million in origination fees from new deployments and \$0.1 million in other fees. Comparatively, for the three months ended March 31, 2019, we generated \$0.4 million in origination fees from new deployments and \$0.0 million in other fees. Dividend income decreased from \$1.3 million for the three months ended March 31, 2019 to \$25 thousand for the three months ended March 31, 2020, primarily due to a \$1.3 million non-recurring dividend from a portfolio company received during the three months ended March 31, 2019.

Operating expenses

The composition of our expenses for the three months ended March 31, 2020 and 2019 was as follows (dollars in thousands):

	For the Three Months Ended	
	March 31, 2020	March 31, 2019
Interest and financing expenses	\$ 3,826	\$ 4,413
Base management fee	1,757	2,118
Incentive fees	—	1,034
General and administrative expenses	1,504	984
Total expenses	<u>\$ 7,087</u>	<u>\$ 8,549</u>

For the three months ended March 31, 2020, operating expenses decreased \$1.5 million, or 17.1%, compared to the three months ended March 31, 2019. Interest and financing expense decreased from \$4.4 million for the three months ended March 31, 2019 to \$3.8 million for the three months ended March 31, 2020. The decrease from the prior period is primarily related to lower average outstanding SBA debentures and lower utilization of our Credit Facility during the three months ended March 31, 2020 compared to the three months ended March 31, 2019. Base management fees declined from \$2.1 million for the three months ended March 31, 2019 to \$1.8 million for the three months ended March 31, 2020, due to lower average assets under management. Incentive fees declined from \$1.0 million for the three months ended March 31, 2019 to \$0.0 for the three months ended March 31, 2020 due to better net investment income returns in relation to our net asset value during the three months ended March 31, 2019. General and administrative expenses increased from \$1.0 million for the three months ended March 31, 2019 to \$1.5 million for the three months ended March 31, 2020, primarily due to an increase in legal and professional fees.

Net realized gain (loss) on investments

During the three months ended March 31, 2020 and 2019 we recognized \$1.0 million and \$(5.8) million, respectively, of net realized gain (loss) on our portfolio investments.

Net unrealized appreciation (depreciation) on investments

Net change in unrealized appreciation (depreciation) on investments reflects the net change in the fair value of our investment portfolio. For the three months ended March 31, 2020 and 2019, we had net unrealized appreciation (depreciation) of \$(43.4) million and \$1.5 million, respectively. The increase in net unrealized depreciation was due primarily to the negative economic impact and the increased uncertainty caused by COVID-19.

Tax benefit

For the three months ended March 31, 2020 and 2019, we recorded a tax benefit of \$0.0 and \$66 thousand, respectively.

Changes in net assets resulting from operations

For the three months ended March 31, 2020 and 2019, we recorded a net decrease in net assets resulting from operations of \$(42.4) million and \$(0.2) million, respectively. Based on the weighted average shares of common stock outstanding for the three months ended March 31, 2020 and 2019, our per share net decrease in net assets resulting from operations was \$(2.62) and \$(0.01), 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 March 31, 2020.

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 March 31, 2020, we had \$0.0 outstanding and \$60.0 million available under the Credit Facility.

As of March 31, 2020, the Company was not in compliance with certain debt covenants in the Credit Facility, including its minimum net asset value covenant and its minimum interest coverage covenant. The Company’s non-compliance with these covenants was largely driven by the increase in non-accrual loans and an increase in unrealized depreciation as the result of the impacts of COVID-19. The Company will not be able to borrow under the Credit Facility until a waiver or amendment can be obtained from ING Capital, LLC and the lender group or until such time that it can comply with the existing debt covenants in 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’ over-allotment 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 March 31, 2020, 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 \$50.0 million 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. There were no sales of our common stock under the ATM Program during the quarter ended March 31, 2020.

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. The SBCA allows 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 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 and as a result, our asset coverage requirements for senior securities was changed from 200% to 150%, effective November 1, 2019. As of March 31, 2020, our asset coverage ratio was 180.2%. If our asset coverage ratio falls below 150% due a decline in the fair market of our portfolio, including as the result of the economic impact caused by COVID-19, we may be limited in our ability to raise additional debt.

As of March 31, 2020, we had \$56.4 million in cash and cash equivalents, and our net assets totaled \$102.0 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 March 31, 2020 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	\$ 65,000	\$ 85,000	\$ —	\$ —	\$ 150,000
2022 Notes	—	75,000	—	—	75,000
2022 Convertible Notes	—	52,088	—	—	52,088
Credit Facility	—	—	—	—	—
Total Contractual Obligations	\$ 65,000	\$ 212,088	\$ —	\$ —	\$ 277,088

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 monthly distributions until March 31, 2020. As announced on April 1, 2020, distributions, if any, will be made on a quarterly basis effective for the second quarter of 2020. Our 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, 2018 through March 31, 2020:

Date Declared	Record Date	Payment Date	Amount 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
Total Distributions Declared and Distributed for 2020			<u>\$ 0.25</u>

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			\$ 1.00

Tax characteristics of all distributions paid are reported to stockholders on Form 1099 after the end of the calendar year. For the year ended December 31, 2018, total distributions of \$16.0 million were comprised 100% of ordinary income. For the year ended December 31, 2019, total distributions of \$16.1 million were comprised of approximately \$13.4 million from ordinary income and \$2.7 million from return of capital. For the three months ended March 31, 2020, we estimate that total distributions of \$4.1 million were classified as a return of capital. Distributions may be subject to reclassification based on future dividends and operating results and will not be determined until the end of the year.

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 March 31, 2020, 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 March 31, 2020 and December 31, 2019, was \$10.2 million and \$10.3 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 March 31, 2020, the Company had outstanding unfunded commitments related to debt and equity investments in existing portfolio companies of \$11.4 million (CSLF II), \$5.3 million (Bluestem Brands, Inc.), \$4.5 million (Rapid Fire Protection, Inc), \$1.7 million (BigMouth, Inc.), \$1.5 million (J5 Infrastructure Partners, LLC), \$1.0 million (U.S. BioTek Laboratories, LLC), and \$0.5 million (Freedom Electronics, LLC). 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).

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

Portfolio Activity

On April 24, 2020, the Company received \$1.7 million for its first lien revolver in BigMouth, Inc., repaid at par.

Distributions

On April 30, 2020, the Company's Board of Directors determined not to declare a distribution for the second quarter of 2020 due to the impact of COVID-19 on the Company's expected net investment income.

Other

On May 1, 2020, the Small Business Administration issued a "green light" letter inviting the Company to continue its application process for Capitala SBIC Fund VII, LP, as a wholly owned small business investment company subsidiary of Capitala Finance Corp. If approved, the additional SBIC license would provide the Company with an incremental source of attractive long-term capital. Receipt of a green light letter from the SBA does not assure an applicant that the SBA will ultimately issue an SBIC license and the Company has received no assurance or indication from the SBA that it will receive an additional SBIC license, or of the timeframe in which it would receive an additional license, should one ultimately be granted.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to financial market risks, including changes in interest rates. Changes in interest rates may affect both our cost of funding and our interest income from portfolio investments and cash and cash equivalents. We may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options, and forward contracts subject to the requirements of the 1940 Act. For the three months ended March 31, 2020, we did not engage in hedging activities.

As of March 31, 2020, we held 24 securities bearing a variable rate of interest. Our variable rate investments represent approximately 58.4% of the fair value of total debt investments. As of March 31, 2020, 41.0% of variable rate securities were yielding interest at a rate equal to the established interest rate floor, and 59.0% 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 March 31, 2020, we had \$0.0 outstanding on our Credit Facility, which has a variable rate of interest at one-month LIBOR + 3.5%. As of March 31, 2020, 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. In addition, in a prolonged low interest rate environment, including a reduction of LIBOR to zero, the difference between the total interest income earned on interest earning assets and the total interest expense incurred on interest bearing liabilities may be compressed, reducing our net interest income and potentially adversely affecting our operating results.

Based on our March 31, 2020 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	\$ 3,634	\$ —	\$ 3,634
Up 200 basis points	\$ 2,265	\$ —	\$ 2,265
Up 100 basis points	\$ 897	\$ —	\$ 897
Down 100 basis points	\$ (351)	\$ —	\$ (351)
Down 200 basis points	\$ (351)	\$ —	\$ (351)
Down 300 basis points	\$ (351)	\$ —	\$ (351)

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As of March 31, 2020 (the end of the period covered by this report), we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective and provided reasonable assurance that information required to be disclosed in our periodic SEC filings is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of such possible controls and procedures.

(b) Changes in Internal Controls Over Financial Reporting

Management has not identified any change in the Company's internal control over financial reporting that occurred during the first quarter of 2020 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019 (the “Annual Report on Form 10-K”), which could materially affect our business, financial condition and/or operating results, including the Risk Factor titled “Recent legislation may allow us to incur additional leverage”. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties that are not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. Other than the risk factors below, during the three months ended March 31, 2020, there have been no material changes from the risk factors set forth in our Annual Report on Form 10-K.

Events outside of our control, including public health crises, could negatively affect our portfolio companies and our results of our operations.

Periods of market volatility have occurred and could continue to occur in response to pandemics or other events outside of our control. These types of events have adversely affected and could continue to adversely affect operating results for us and for our portfolio companies. For example, in December 2019, a novel strain of coronavirus (“COVID-19”) surfaced in China and has since spread to other countries, including the United States, which has resulted in restrictions on travel and the temporary closure of many corporate offices, retail stores, and manufacturing facilities and factories in the affected jurisdictions, including the United States. In addition to these developments having adverse consequences for us and our portfolio companies have been, and could continue to be, adversely impacted, including through quarantine measures and travel restrictions imposed on its personnel or service providers based or temporarily located in affected countries, or any related health issues of such personnel or service providers. As the potential impact of COVID-19 is difficult to predict, the extent to which COVID-19 could negatively affect our and our portfolio companies’ operating results or the duration of any potential business or supply-chain disruption, is uncertain. Any potential impact to our results of operations will depend to a large extent on future developments and new information that could emerge regarding the duration and severity of COVID-19 and the actions taken by authorities and other entities to contain COVID-19 or treat its impact, all of which are beyond our control. These potential impacts, while uncertain, could adversely affect our and our portfolio companies’ operating results.

We are currently operating in a period of capital markets disruption and economic uncertainty.

The U.S. capital markets have experienced extreme volatility and disruption following the global outbreak of COVID-19 that began in December 2019. Some economists and major investment banks have expressed concern that the continued spread of the virus globally could lead to a world-wide economic downturn. Disruptions in the capital markets have increased the spread between the yields realized on risk-free and higher risk securities, resulting in illiquidity in parts of the capital markets. These and future market disruptions and/or illiquidity could be expected to have an adverse effect on our business, financial condition, results of operations and cash flows. Unfavorable economic conditions also could be expected to 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 have limited and could continue to limit our investment originations, limit our ability to grow and have a material negative impact on our operating results and the fair values of our debt and equity investments.

If the current period of capital market disruption and instability continues for an extended period of time, there is a risk that investors in our equity securities may not receive distributions consistent with historical levels or at all or that our distributions may not grow over time and a portion of our distributions may be a return of capital.

We intend to make distributions on a quarterly 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. Our ability to pay distributions might be adversely affected by the impact of one or more of the risk factors described in our Annual Report on Form 10-K including the COVID-19 pandemic described above. For example, if the temporary closure of many corporate offices, retail stores, and manufacturing facilities and factories in the jurisdictions, including the United States, affected by the COVID-19 pandemic were to continue for an extended period of time it could result in reduced cash flows to us from our existing portfolio companies, which could reduce cash available for distribution to our stockholders. If we violate certain covenants under our existing or future credit facilities or other leverage, we may be limited in our ability to make distributions. If we declare a distribution and if more stockholders opt to receive cash distributions rather than participate in our dividend reinvestment plan, we may be forced to sell some of our investments in order to make cash distribution payments. To the extent we make distributions to stockholders that include a return of capital, such portion of the distribution essentially constitutes a return of the stockholder's investment. Although such return of capital may not be taxable, such distributions would generally decrease a stockholder's basis in our common stock and may therefore increase such stockholder's tax liability for capital gains upon the future sale of such stock. A return of capital distribution may cause a stockholder to recognize a capital gain from the sale of our common stock even if the stockholder sells its shares for less than the original purchase price.

Due to the COVID-19 pandemic or other disruptions in the economy, we may not be able to increase our dividends and may reduce or defer our dividends and choose to incur US federal excise tax in order to preserve cash and maintain flexibility.

As a BDC, we are not required to make any distributions to shareholders other than in connection with our election to be taxed as a RIC under subchapter M of the Code. In order to maintain our tax treatment as a RIC, we must distribute to shareholders for each taxable year at least 90.0% of our investment company taxable income (i.e., net ordinary income plus realized net short-term capital gains in excess of realized net long-term capital losses). If we qualify for taxation as a RIC, we generally will not be subject to corporate-level U.S. federal income tax on our investment company taxable income and net capital gains (i.e., realized net long-term capital gains in excess of realized net short-term capital losses) that we timely distribute to shareholders. We will be subject to a 4.0% US federal excise tax on undistributed earnings of a RIC unless we distribute each calendar year at least the sum of (i) 98.0% of our ordinary income for the calendar year, (ii) 98.2% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year, and (iii) any ordinary income and net capital gains for preceding years that were not distributed during such years and on which we paid no federal income tax.

Under the Code, we may satisfy certain of our RIC distributions with dividends paid after the end of the current year. In particular, if we pay a distribution in January of the following year that was declared in October, November, or December of the current year and is payable to shareholders of record in the current year, the dividend will be treated for all US federal tax purposes as if it were paid on December 31 of the current year. In addition, under the Code, we may pay dividends, referred to as "spillover dividends," that are paid during the following taxable year that will allow us to maintain our qualification for taxation as a RIC and eliminate our liability for corporate-level U.S. federal income tax. Under these spillover dividend procedures, we may defer distribution of income earned during the current year until December of the following year. For example, we may defer distributions of income earned during 2020 until as late as December 31, 2021. If we choose to pay a spillover dividend, we will incur the 4% U.S. federal excise tax on some or all of the distribution.

Due to the COVID-19 pandemic or other disruptions in the economy, we anticipate that we may take certain actions with respect to the timing and amounts of our distributions in order to preserve cash and maintain flexibility. For example, we anticipate that we will not be able to increase our dividends. In addition, we may reduce our dividends and/or defer our dividends to the following taxable year. If we defer our dividends, we may choose to utilize the spillover dividend rules discussed above and incur the 4.0% U.S. federal excise tax on such amounts. To further preserve cash, we may combine these reductions or deferrals of dividends with one or more distributions that are payable partially in our common stock as discussed in the Annual Report on Form 10-K under "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."

Due to the recent COVID-19 pandemic, shares of BDCs have traded below their respective NAVs. If our shares of common stock trade at a discount from NAV, it could limit our ability to raise equity capital.

As a result of the COVID-19 pandemic, the stocks of BDCs as an industry, including shares of our common stock, have traded below NAV, at or near historic lows as a result of concerns over liquidity, leverage restrictions and distribution requirements. If our common stock trades below its NAV, 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 NAV could decrease and our level of distributions could be impacted.

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

During the quarter ended March 31, 2020, pursuant to our DRIP, we issued 62,715 shares of common stock to stockholders of record that did not opt out of our DRIP. The issuances were not subject to the registration requirements under the Securities Act of 1933, as amended. The cash paid for shares of common stock issued under our DRIP during the quarter ended March 31, 2020 was approximately \$0.3 million. Other than the shares issued under our DRIP during the quarter ended March 31, 2020, we did not sell any unregistered equity securities.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Item 6. Exhibits

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

Exhibit Number	Description of Document
3.1	Articles of Amendment and Restatement ⁽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⁾
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 pursuant to 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 pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
(1)	Previously filed in connection with the Pre-Effective Amendment No. 1 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-188956) filed on September 9, 2013.
(2)	Previously filed in connection with Pre-Effective Amendment No. 2 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-188956) filed on September 17, 2013.
(3)	Previously filed in connection with Pre-Effective Amendment No. 5 to Capitala Finance Corp.'s registration statement on Form N-2 (File No. 333-188956) filed on September 24, 2013.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 4, 2020

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

Date: May 4, 2020

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

Date: May 4, 2020

By /s/ Kevin A. Koonts
Kevin A. Koonts
Chief Accounting Officer
(Principal Accounting Officer)
Capitala Finance Corp.

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

I, Joseph B. Alala III, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Capitala Finance Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 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 Quarterly Report on Form 10-Q of Capitala Finance Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 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**

I, Joseph B. Alala III, Chief Executive Officer, in connection with the Quarterly Report of Capitala Finance Corp. (the "Company") on Form 10-Q for the quarterly period ended March 31, 2020, as filed with the U.S. Securities and Exchange Commission on the date hereof (the "Quarterly Report"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: May 4, 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**

I, Stephen A. Arnall, Chief Financial Officer, in connection with the Quarterly Report of Capitala Finance Corp. (the "Company") on Form 10-Q for the quarterly period ended March 31, 2020, as filed with the U.S. Securities and Exchange Commission on the date hereof (the "Quarterly Report"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: May 4, 2020

/s/ Stephen A. Arnall

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