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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

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**FORM 10-Q**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended September 30, 2012

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-33559

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**BLACKROCK KELSO CAPITAL CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**20-2725151**  
(I.R.S. Employer  
Identification No.)

**40 East 52<sup>nd</sup> Street, New York, NY**  
(Address of Principal Executive Offices)

**10022**  
(Zip Code)

**Registrant's Telephone Number, Including Area Code: 212-810-5800**

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**Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report.**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer  Non-Accelerated filer  (Do not check if a smaller reporting company)  
Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes  No

The number of shares of the Registrant's common stock, \$.001 par value per share, outstanding at November 7, 2012 was 73,832,381

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**BLACKROCK KELSO CAPITAL CORPORATION**  
**FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2012**

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In this Quarterly Report, “Company”, “we”, “us” and “our” refer to BlackRock Kelso Capital Corporation unless the context states otherwise.

**Item 1. Consolidated Financial Statements**

**BlackRock Kelso Capital Corporation**  
**Consolidated Statements of Assets and Liabilities**  
(Unaudited)

	September 30, 2012	December 31, 2011
<b>Assets</b>		
Investments at fair value:		
Non-controlled, non-affiliated investments (cost of \$884,155,194 and \$959,635,127)	\$ 887,470,029	\$ 890,691,404
Non-controlled, affiliated investments (cost of \$44,239,954 and \$59,633,913)	58,121,346	71,035,799
Controlled investments (cost of \$151,419,698 and \$78,601,629)	148,386,742	87,225,239
Total investments at fair value (cost of \$1,079,814,846 and \$1,097,870,669)	1,093,978,117	1,048,952,442
Cash and cash equivalents	2,975,810	7,478,904
Cash denominated in foreign currencies (cost of \$834 and \$300,380)	936	300,089
Receivable for investments sold	204,595	2,734,705
Interest receivable	22,872,721	16,474,871
Dividends receivable	—	8,493,799
Prepaid expenses and other assets	4,942,631	6,740,517
Total Assets	<u>\$ 1,124,974,810</u>	<u>\$ 1,091,175,327</u>
<b>Liabilities</b>		
Payable for investments purchased	\$ 1,541,222	\$ 421,597
Unrealized depreciation on forward foreign currency contracts	771,405	1,106,241
Debt	384,600,000	343,000,000
Interest payable	2,557,731	5,592,184
Dividend distributions payable	19,160,728	19,040,586
Base management fees payable	5,964,904	5,293,755
Incentive management fees payable	2,963,803	11,878,159
Accrued administrative services	165,049	144,625
Other accrued expenses and payables	3,715,740	3,689,331
Total Liabilities	<u>421,440,582</u>	<u>390,166,478</u>
<b>Net Assets</b>		
Common stock, par value \$.001 per share, 200,000,000 common shares authorized, 75,120,620 and 74,636,091 issued and 73,695,113 and 73,210,584 outstanding	75,121	74,636
Paid-in capital in excess of par	987,373,660	983,082,373
Distributions in excess of taxable net investment income	(18,195,866)	(26,165,703)
Accumulated net realized loss	(267,939,687)	(194,505,823)
Net unrealized appreciation (depreciation)	11,697,676	(51,999,958)
Treasury stock at cost, 1,425,507 and 1,425,507 shares held	(9,476,676)	(9,476,676)
Total Net Assets	703,534,228	701,008,849
Total Liabilities and Net Assets	<u>\$ 1,124,974,810</u>	<u>\$ 1,091,175,327</u>
Net Asset Value Per Share	\$ 9.55	\$ 9.58

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Statements of Operations**  
(Unaudited)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
<b>Investment Income:</b>				
Interest income:				
Non-controlled, non-affiliated investments	\$ 27,543,637	\$ 24,001,231	\$ 81,802,597	\$ 67,222,334
Non-controlled, affiliated investments	1,037,387	835,283	4,053,330	3,509,261
Controlled investments	3,071,070	2,288,318	6,501,767	4,951,516
Total interest income	31,652,094	27,124,832	92,357,694	75,683,111
Fee income:				
Non-controlled, non-affiliated investments	8,369,140	4,701,489	15,457,315	15,781,903
Non-controlled, affiliated investments	602,344	387,558	735,708	546,114
Controlled investments	57,679	39,677	136,170	117,738
Total fee income	9,029,163	5,128,724	16,329,193	16,445,755
Dividend income:				
Non-controlled, non-affiliated investments	38,845	610,173	706,157	2,278,768
Non-controlled, affiliated investments	—	383,516	—	1,106,309
Controlled investments	—	—	—	—
Total dividend income	38,845	993,689	706,157	3,385,077
Total investment income	40,720,102	33,247,245	109,393,044	95,513,943
<b>Expenses:</b>				
Base management fees	5,964,904	5,124,033	16,877,541	14,547,503
Interest and credit facility fees	5,180,706	4,208,359	14,917,849	11,902,630
Incentive management fees	2,963,803	—	5,177,662	—
Amortization of debt issuance costs	634,677	634,678	1,890,236	1,871,184
Professional fees	577,051	683,095	1,080,582	1,345,608
Investment advisor expenses	511,774	315,435	1,364,420	1,176,450
Administrative services	164,074	319,500	416,608	866,121
Director fees	113,500	97,000	347,063	309,269
Other	671,341	900,532	1,975,362	1,914,697
Total expenses	16,781,830	12,282,632	44,047,323	33,933,462
<b>Net Investment Income</b>	<b>23,938,272</b>	<b>20,964,613</b>	<b>65,345,721</b>	<b>61,580,481</b>
<b>Realized and Unrealized Gain (Loss):</b>				
Net realized gain (loss):				
Non-controlled, non-affiliated investments	(4,417)	258,039	(75,340,007)	(37,073,408)
Non-controlled, affiliated investments	2,441,751	176,800	2,123,846	(4,892,398)
Controlled investments	—	18,929	—	22,372
Foreign currency	362,009	682,083	(217,703)	(496,180)
Net realized gain (loss)	2,799,343	1,135,851	(73,433,864)	(42,439,614)
Net change in unrealized appreciation or depreciation on:				
Non-controlled, non-affiliated investments	(1,814,151)	(4,598,697)	77,069,859	44,282,872
Non-controlled, affiliated investments	5,287,500	(190,180)	6,300,604	10,447,300
Controlled investments	(14,735,396)	(5,630,890)	(20,004,775)	(5,548,533)
Foreign currency translation	(1,146,461)	1,256,787	331,946	1,548,246
Net change in unrealized appreciation or depreciation	(12,408,508)	(9,162,980)	63,697,634	50,729,885
Net realized and unrealized gain (loss)	(9,609,165)	(8,027,129)	(9,736,230)	8,290,271
<b>Net Increase in Net Assets Resulting from Operations</b>	<b>\$ 14,329,107</b>	<b>\$ 12,937,484</b>	<b>\$ 55,609,491</b>	<b>\$ 69,870,752</b>
Net Investment Income Per Share	\$ 0.32	\$ 0.29	\$ 0.89	\$ 0.84
Earnings Per Share	\$ 0.19	\$ 0.18	\$ 0.76	\$ 0.96
Basic and Diluted Weighted-Average Shares Outstanding	73,692,104	73,101,398	73,555,011	72,966,076
Dividends Declared Per Share	\$ 0.26	\$ 0.26	\$ 0.78	\$ 0.84

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Statements of Changes in Net Assets**  
(Unaudited)

	Nine months ended	
	September 30, 2012	September 30, 2011
<b>Net Increase in Net Assets Resulting from Operations:</b>		
Net investment income	\$ 65,345,721	\$ 61,580,481
Net realized loss	(73,433,864)	(42,439,614)
Net change in unrealized appreciation or depreciation	63,697,634	50,729,885
Net increase in net assets resulting from operations	<u>55,609,491</u>	<u>69,870,752</u>
<b>Dividend Distributions to Stockholders from:</b>		
Net investment income	(57,375,884)	(61,321,309)
<b>Capital Share Transactions:</b>		
Proceeds from shares sold	—	2,000,000
Reinvestment of dividends	4,291,772	6,294,969
Purchases of treasury stock	—	(3,540,397)
Net increase in net assets resulting from capital share transactions	<u>4,291,772</u>	<u>4,754,572</u>
<b>Total Increase in Net Assets</b>	<u>2,525,379</u>	<u>13,304,015</u>
Net assets at beginning of period	701,008,849	698,479,924
Net assets at end of period	<u>\$ 703,534,228</u>	<u>\$ 711,783,939</u>
<b>Capital Share Activity:</b>		
Shares issued from subscriptions	—	200,000
Shares issued from reinvestment of dividends	484,529	646,298
Purchases of treasury stock	—	(400,000)
Net increase in shares outstanding	<u>484,529</u>	<u>446,298</u>

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Statements of Cash Flows**  
(Unaudited)

	<u>Nine months ended</u>	
	<u>September 30, 2012</u>	<u>September 30, 2011</u>
<b>Operating Activities:</b>		
Net increase in net assets resulting from operations	\$ 55,609,491	\$ 69,870,752
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by (used in) operating activities:		
Purchases of investments	(238,476,949)	(260,528,598)
Sales (purchases) of foreign currency contracts—net	(220,986)	(526,385)
Proceeds from sales/repayments of investments	203,491,979	163,013,170
Net change in unrealized appreciation or depreciation on investments	(63,365,688)	(49,181,639)
Net change in unrealized appreciation or depreciation on foreign currency translation	(331,946)	(1,548,246)
Net realized loss (gain) on investments	73,216,161	41,943,434
Net realized loss (gain) on foreign currency	217,703	496,180
Amortization of premium/discount—net	(11,364,420)	(7,411,408)
Amortization of debt issuance costs	1,890,236	1,871,184
Changes in operating assets and liabilities:		
Receivable for investments sold	2,530,110	4,853,918
Interest receivable	(6,397,850)	(5,241,224)
Dividends receivable	(317,146)	(2,871,143)
Prepaid expenses and other assets	(92,350)	(159,416)
Payable for investments purchased	1,119,625	209,039
Interest payable	(3,034,453)	2,058,726
Base management fees payable	671,149	769,012
Incentive management fees payable	(8,914,356)	(14,614,098)
Accrued administrative services	20,424	173,837
Other accrued expenses and payables	310,598	(47,113)
Net cash provided by (used in) operating activities	<u>6,561,332</u>	<u>(56,870,018)</u>
<b>Financing Activities:</b>		
Net proceeds from issuance of common stock	—	2,000,000
Dividend distributions paid	(52,963,972)	(59,264,457)
Proceeds from debt	225,900,000	278,250,000
Repayments of debt	(184,300,000)	(130,800,000)
Deferred debt issuance costs	—	(1,690,580)
Purchases of treasury stock	—	(3,540,397)
Net cash provided by (used in) financing activities	<u>(11,363,972)</u>	<u>84,954,566</u>
Effect of exchange rate changes on cash and cash equivalents	393	(18,407)
<b>Net increase (decrease) in cash</b>	<b>(4,802,247)</b>	<b>28,066,141</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>7,778,993</b>	<b>2,160,871</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 2,976,746</b>	<b>\$ 30,227,012</b>
<b>Supplemental disclosure of cash flow information and non-cash financing activities:</b>		
Cash paid during period for:		
Interest	\$ 17,289,778	\$ 8,800,205
Taxes	\$ 1,503,347	\$ 914,847
Dividend distributions reinvested	\$ 4,291,772	\$ 6,294,969

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments**  
**September 30, 2012**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
<b>Senior Secured Notes—24.8%</b>						
Advanced Lighting Technologies, Inc., First Lien(c)	<i>Lighting</i>	10.50%	6/1/19	\$ 20,000,000	\$ 19,516,414	\$ 20,000,000
AGY Holding Corp., Second Lien(p)	<i>Glass Yarns/Fibers</i>	11.00%	11/15/14	28,475,000	22,102,345	20,729,800
American Residential Services L.L.C. et al., Second Lien(c)	<i>HVAC Plumbing Services</i>	12.00%	4/15/15	40,000,000	39,886,426	40,000,000
BPA Laboratories Inc., First Lien(c)	<i>Healthcare Services</i>	12.25%	4/1/17	33,250,000	32,202,093	32,851,000
Sizzling Platter LLC et al., First Lien(c)	<i>Restaurants</i>	12.25%	4/15/16	30,000,000	29,239,911	30,000,000
TriMark USA, Inc., Second Lien(p)(q)(r)	<i>Food Service Equipment</i>	11.50%	11/30/13	33,109,988	33,109,988	31,123,390
<b>Total Senior Secured Notes</b>					<u>176,057,177</u>	<u>174,704,190</u>
<b>Unsecured Debt—6.9%</b>						
Maple Hill Acquisition LLC(q)	<i>Rigid Packaging</i>	13.50%	10/1/15	5,000,000	4,906,249	5,000,000
SVP Worldwide Ltd.(q)	<i>Consumer Products</i>	14.00%	6/27/18	43,613,583	43,613,583	43,613,583
<b>Total Unsecured Debt</b>					<u>48,519,832</u>	<u>48,613,583</u>
<b>Subordinated Debt—13.9%</b>						
A & A Manufacturing Co., Inc.(q)	<i>Protective Enclosures</i>	14.00%	5/16/16	32,995,314	32,995,314	32,995,314
MediMedia USA, Inc.(c)(p)	<i>Information Services</i>	11.38%	11/15/14	19,950,000	19,135,185	18,693,150
The Pay-O-Matic Corp.(q)	<i>Financial Services</i>	14.00%	9/30/16	20,400,000	20,400,000	20,400,000
Sarnova HC, LLC et al.(q)	<i>Healthcare Products</i>	14.00%	4/6/16	25,762,284	25,330,842	25,762,284
<b>Total Subordinated Debt</b>					<u>97,861,341</u>	<u>97,850,748</u>

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**September 30, 2012**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
<b>Senior Secured Loans—91.6%(e)</b>						
Advantage Sales & Marketing Inc., Second Lien(r)	<i>Marketing Services</i>	9.25%	6/17/18	\$ 10,000,000	\$ 9,885,565	\$ 10,000,000
Airvana Network Solutions Inc., First Lien(r)	<i>Software</i>	10.00%	3/25/15	3,642,857	3,597,539	3,642,857
Al Solutions, Inc., Term Loan B, Second Lien(q)	<i>Metals</i>	5.00%	12/31/19	66,690	—	—
Alpha Media Group Inc., First Lien(q)	<i>Publishing</i>	12.00%	7/15/13	5,401,712	4,165,336	583,385
American SportWorks LLC, Second Lien(f)(i)	<i>Utility Vehicles</i>	13.00%	6/16/15	8,000,000	8,000,000	1,360,000
AmQuip Crane Rental LLC, Second Lien	<i>Construction Equipment</i>	12.00%	12/19/17	43,600,000	43,600,000	38,716,800
Arclin US Holdings Inc., Second Lien(g)(p)(r)	<i>Chemicals</i>	7.75%	1/15/15	3,496,442	3,091,478	3,496,442
Ascend Learning, LLC, Second Lien(r)	<i>Education</i>	11.50%	12/6/17	20,000,000	19,553,073	20,000,000
Ashton Woods USA L.L.C., Second Lien	<i>Homebuilding</i>	11.75%	7/6/15	52,500,000	52,500,000	52,500,000
Attachmate Corporation et al., Second Lien(r)	<i>Software</i>	11.00%	11/22/18	20,000,000	19,433,108	19,580,000
Bankruptcy Management Solutions, Inc., Term Loan A, First Lien(f)(r)	<i>Financial Services</i>	7.50%	8/20/14	2,000,000	1,703,281	1,946,000
Bankruptcy Management Solutions, Inc., Term Loan B, First Lien(f)(p)(q)(r)	<i>Financial Services</i>	7.50%	8/20/14	21,411,840	13,104,268	17,707,591
Bankruptcy Management Solutions, Inc., Term Loan A, Second Lien(f)(p)(q)(r)	<i>Financial Services</i>	8.23%	8/20/15	33,477,584	24,680,089	12,888,869
The Bargain! Shop Holdings Inc., First Lien(g)(h)(p)	<i>Discount Stores</i>	16.00%	7/1/14	24,082,000	24,095,252	24,474,821
Berlin Packaging L.L.C., Second Lien(r)	<i>Rigid Packaging</i>	6.72%	8/17/15	24,000,000	23,740,741	23,544,000
Dial Global, Inc. et. al., Second Lien(r)	<i>Media &amp; Entertainment</i>	13.00%	7/21/17	42,500,000	41,995,735	41,225,000

The accompanying notes are an integral part of these consolidated financial statements.



**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**September 30, 2012**  
(Unaudited)

<b>Portfolio Company</b>	<b>Industry</b>	<b>Interest Rate</b>	<b>Maturity</b>	<b>Principal Amount or Number of Shares/Units</b>	<b>Cost(a)</b>	<b>Fair Value(b)</b>
Fitness Together Franchise Corporation, First Lien(q)	<i>Personal Fitness</i>	11.50%	11/10/13	\$ 6,209,518	\$ 6,209,518	\$ 5,824,530
Grocery Outlet Inc., First Lien(r)	<i>Grocery Retail</i>	10.52%	12/15/17	24,625,000	24,625,000	25,068,250
InterMedia Outdoors, Inc., Second Lien(r)	<i>Printing/Publishing</i>	7.11%	1/31/14	10,000,000	10,000,000	9,210,000
MCCI Group Holdings, LLC, Second Lien(r)	<i>Healthcare Services</i>	10.75%	1/29/18	40,000,000	40,000,000	40,000,000
Penton Media, Inc. et al., First Lien(d)(p)(q)(r)	<i>Information Services</i>	5.00%	8/1/14	23,396,461	19,279,367	18,717,170
Potters Holdings II, L.P., Second Lien(r)	<i>Engineered Glass Beads</i>	10.25%	11/6/17	15,000,000	14,823,227	15,000,000
Pre-Paid Legal Services, Inc., First Lien(r)	<i>Legal Services</i>	11.00%	12/31/16	15,000,000	14,652,710	15,000,000
Progress Financial Corporation, Second Lien(r)	<i>Financial Services</i>	13.00%	6/18/15	34,375,000	33,742,263	34,375,000
Renaissance Learning, Inc., Second Lien(r)	<i>Education Software</i>	12.00%	10/19/18	20,000,000	19,307,253	20,000,000
Road Infrastructure Investment, LLC, Second Lien(r)	<i>Manufacturing</i>	10.25%	9/30/18	10,000,000	9,814,014	10,000,000
SOURCEHOV LLC, Second Lien(r)	<i>Process Outsourcing</i>	10.50%	4/29/18	25,000,000	22,451,465	23,175,000
Sur La Table, Inc., First Lien	<i>Consumer Products</i>	12.00%	7/28/17	50,000,000	50,000,000	50,000,000
United Subcontractors, Inc., First Lien(d)(p)(q)(r)	<i>Building and Construction</i>	4.37%	6/30/15	3,562,863	3,434,766	3,113,944
Volume Services America, Inc. et al., Term Loan B, First Lien(r)	<i>Concession Services</i>	10.50%	9/16/16	44,212,500	43,041,599	44,212,500
WBS Group LLC, First Lien(f)(r)	<i>Software</i>	6.50%	12/31/12	27,284,255	27,284,255	27,284,255
WBS Group LLC, Second Lien(f)(r)	<i>Software</i>	10.50%	6/7/13	24,999,000	24,373,405	24,999,000

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**September 30, 2012**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
Westward Dough Operating Company, LLC, First Lien(f)	<i>Restaurants</i>	7.00%	3/2/17	\$ 6,590,896	\$ 6,590,896	\$ 6,590,896
<b>Total Senior Secured Loans</b>					<u>662,775,203</u>	<u>644,236,310</u>
<b>Preferred Stock—0.2%(s)</b>						
Alpha Media Group Holdings Inc., Series A-2	<i>Publishing</i>			5,000	—	—
Progress Financial Corporation, Series F-1	<i>Financial Services</i>			963,710	740,313	1,101,698
<b>Total Preferred Stock</b>					<u>740,313</u>	<u>1,101,698</u>
<b>Common Stock—10.3%(s)</b>						
Alpha Media Group Holdings Inc., Class B	<i>Publishing</i>			12,500	—	—
Arclin Cayman Holdings Ltd.(g)(p)	<i>Chemicals</i>			450,532	9,722,203	11,420,000
Bankruptcy Management Solutions, Inc.(f)(p)	<i>Financial Services</i>			326,873	9,600,072	—
BKC CSP Blocker, Inc.(j)	<i>Financial Services</i>			100	—	—
ECI Holdco, Inc., Class A-1 (Electrical Components)(f)	<i>Electronics</i>			19,040,132	19,027,697	45,315,512
M & M Tradition Holdings Corp.(d)	<i>Sheet Metal Fabrication</i>			500,000	5,000,000	8,250,000
Tygem Holdings, Inc., Class A	<i>Metals</i>			30,000	—	—
USI Senior Holdings, Inc. (United Subcontractors)(d)(p)	<i>Building and Construction</i>			164,851	7,475,821	7,391,920
<b>Total Common Stock</b>					<u>50,825,793</u>	<u>72,377,432</u>
<b>Limited Partnership/Limited Liability Company</b>						
<b>Interests—6.2%</b>						
ARS Investment Holdings, LLC(k)(s)	<i>HVAC/Plumbing Services</i>			102,601	—	840,000
ASW International LLC(f)(l)(s)	<i>Utility Vehicles</i>			12,800	7,428,827	—

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**September 30, 2012**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/ Units	Cost(a)	Fair Value(b)
DynaVox Systems Holdings, LLC(m)(s)	Augmentative Communication Products			272,369	\$ 758,069	\$ 144,408
Marquette Transportation Company Holdings, LLC(n)(s)	Transportation			25,000	5,000,000	6,132,000
Marsico Holdings, LLC (c)(s)	Financial Services			91,445	1,848,077	228,613
Penton Business Media Holdings LLC(d)(s)	Information Services			—	9,050,000	20,648,312
PG Holdco, LLC (Press Ganey)	Healthcare Services	15.00%		12,832	361,949	361,949
PG Holdco, LLC (Press Ganey), Class A(s)	Healthcare Services			16,667	166,667	299,133
Sentry Security Systems Holdings, LLC(s)	Security Services			147,271	147,271	7,660
Sentry Security Systems Holdings, LLC	Security Services	8.00%		602,729	931,076	931,076
VSS-AHC Holdings LLC (Advanstar)(s)	Printing/Publishing			352,941	4,199,161	3,903,702
WBS Group LLC (f)(o)(s)	Software			—	1,000	5,954,619
Westward Dough Holdings, LLC, Class A(f)(s)	Restaurants			350,000	9,260,324	4,340,000
<b>Total Limited Partnership/Limited Liability Company Interests</b>					<u>39,152,421</u>	<u>43,791,472</u>
<b>Equity Warrants/Options—1.6%(s)</b>						
Arclin Cayman Holdings Ltd., Tranche 1(g)(p)	Chemicals		expire 1/15/14	230,159	403,815	2,367,963
Arclin Cayman Holdings Ltd., Tranche 2(g)(p)	Chemicals		expire 1/15/15	230,159	323,052	2,478,068
Arclin Cayman Holdings Ltd., Tranche 3(g)(p)	Chemicals		expire 1/15/14	230,159	484,578	1,889,485
Arclin Cayman Holdings Ltd., Tranche 4(g)(p)	Chemicals		expire 1/15/15	230,159	403,815	2,061,340
Bankruptcy Management Solutions, Inc(f)(p)	Financial Services		expire 10/1/17	23,046	365,584	—

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**September 30, 2012**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/ Units	Cost(a)	Fair Value(b)
Facet Investment, Inc.	<i>Medical Devices</i>		expire 1/18/21	1,978	\$ 250,000	\$ 80,415
Marsico Superholdco SPV, LLC (c)	<i>Financial Services</i>		expire 12/14/19	455	444,450	—
Progress Financial Corporation	<i>Financial Services</i>		expire various	3,447,098	1,202,472	2,420,413
Twin River Worldwide Holdings, Inc., Contingent Value Rights	<i>Gaming</i>		expire 11/5/17	1,000	5,000	5,000
<b>Total Equity Warrants/Options</b>					<u>3,882,766</u>	<u>11,302,684</u>
<b>TOTAL INVESTMENTS— 155.5%</b>					<u>\$ 1,079,814,846</u>	<u>1,093,978,117</u>
<b>OTHER ASSETS &amp; LIABILITIES (NET)—(55.5)%</b>						<u>(390,443,889)</u>
<b>NET ASSETS—100.0%</b>						<u>\$ 703,534,228</u>

- (a) Represents amortized cost for fixed income securities and cost for preferred and common stock, limited partnership/limited liability company interests and equity warrants/options.
- (b) Fair value is determined by or under the direction of the Company's Board of Directors. See Note 2 for further details.
- (c) Security is exempt from registration under Rule 144A of the Securities Act of 1933. Such securities may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. In the aggregate, these securities represent 20.2% of the Company's net assets at September 30, 2012.
- (d) Transaction and other information for "non-controlled, affiliated" investments under the Investment Company Act of 1940, whereby the Company owns 5% or more (but not more than 25%) of the portfolio company's outstanding voting securities.
- (e) Approximately 72% of the senior secured loans of the Company's portfolio companies bear interest at a floating rate that may be determined by reference to the London Interbank Offered Rate (LIBOR) or other base rate (commonly the Federal Funds Rate or the Prime Rate), at the borrower's option. In addition, approximately 64% of such senior secured loans have floors of 1.00% to 2.00%. The borrower under a senior secured loan generally has the option to select from interest reset periods of one, two, three or six months and may alter that selection at the end of any reset period. The stated interest rate represents the weighted average interest rate at September 30, 2012 of all contracts within the specified loan facility.
- (f) Transaction and other information for "controlled" investments under the Investment Company Act of 1940, whereby the Company owns more than 25% of the portfolio company's outstanding voting securities.
- (g) Non-U.S. company or principal place of business outside the U.S.
- (h) Principal amount is denominated in Canadian dollars.
- (i) Non-accrual status (in default) at September 30, 2012 and therefore non-income producing. At September 30, 2012, the aggregate fair value and amortized cost of the Company's debt investments on non-accrual status represents 0.1% and 0.8% of total debt investments at fair value and amortized cost, respectively.

The accompanying notes are an integral part of these consolidated financial statements.

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Non-controlled, Affiliated Investments	Fair Value at December 31, 2011	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at September 30, 2012	Net Realized Gain (Loss)***	Interest Income***	Fee Income***
Conney Safety Products, LLC								
Subordinated Debt	\$ 25,582,734	\$ 735,708	\$(25,582,733)	\$ (735,709)	\$ — †	\$ —	\$ 2,137,580	\$ 735,708
Conney Prime Holdings LLC								
Limited Liability Co. Interest	1,785,488	—	(4,705,015)	2,919,527	— †	2,377,756	—	—
M&M Tradition Holdings Corp.								
Common Stock	7,250,000	—	—	1,000,000	8,250,000	—	—	—
MGHC Holding Corporation:								
Common Stock	224,200	—	(1,161,702)	937,502	— †	(113,266)	—	—
Warrants	—	—	(136,297)	136,297	— †	(136,297)	—	—
Penton Business Media Holdings LLC								
Limited Liability Co. Interest	20,321,858	—	—	326,454	20,648,312	—	—	—
Penton Media, Inc. et al.								
Senior Secured Loan	8,067,187	10,296,164	(119,698)	473,517	18,717,170	3	1,699,489	—
United Subcontractors, Inc.								
Senior Secured Loan	1,809,875	1,549,395	(178,130)	(67,196)	3,113,944	(4,006)	216,261	—
USI Senior Holdings, Inc.								
Common Stock	5,994,457	99,635	(12,384)	1,310,212	7,391,920	(344)	—	—
Totals	\$ 71,035,799	\$12,680,902	\$(31,895,959)	\$ 6,300,604	\$ 58,121,346	\$2,123,846	\$ 4,053,330	\$ 735,708

\* Gross additions include increases in the cost basis of investments resulting from new portfolio investments, payment-in-kind interest or dividends, the amortization of unearned income, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company into this category from a different category.

\*\* Gross reductions include decreases in the cost basis of investments resulting from principal collections related to investment repayments or sales, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company out of this category into a different category.

\*\*\* For the nine months ended September 30, 2012.

† Investment no longer held at September 30, 2012.

The aggregate fair value of non-controlled, affiliated investments at September 30, 2012 represents 8.3% of the Company's net assets.

- (j) The Company is sole stockholder of BKC CSP Blocker, Inc., a consolidated subsidiary and thus a controlled investment.
- (k) The Company is the sole stockholder of BKC ARS Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of American Residential Services L.L.C. and thus a non-controlled, non-affiliated investment.
- (l) The Company is the sole stockholder of BKC ASW Blocker, Inc., a consolidated subsidiary, which is the beneficiary of more than 25% of the voting securities of American SportWorks LLC and thus a controlled investment.
- (m) The Company is the sole stockholder of BKC DVSH Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of DynaVox Systems LLC and thus a non-controlled, non-affiliated investment.
- (n) The Company is the sole stockholder of BKC MTCH Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of Marquette Transportation Company Holdings, LLC and thus a non-controlled, non-affiliated investment.
- (o) The Company is the sole stockholder of BKC-WBS, LLC, a consolidated subsidiary, which is the beneficiary of more than 25% of the voting securities of WBS Group LLC and thus a controlled investment.

The accompanying notes are an integral part of these consolidated financial statements.

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Controlled Investments	Fair Value at December 31, 2011	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at September 30, 2012	Net Realized Gain (Loss)***	Interest Income***	Fee Income***
American SportWorks LLC								
Senior Secured Loan	\$ 3,550,900	\$ —	\$ —	\$ (2,190,900)	\$ 1,360,000	\$ —	\$ —	\$ —
ASW International LLC								
Limited Liability Co. Interest	—	—	—	—	—	—	—	—
Bankruptcy Management Solutions, Inc.:								
Senior Secured Loan, First Lien, A	1,948,000	118,166	—	(120,166)	1,946,000	—	129,922	118,167
Senior Secured Loan, First Lien, B	15,512,497	2,756,093	(146,668)	(414,331)	17,707,591	—	2,337,566	—
Senior Secured Loan, Second Lien	21,992,702	2,401,737	—	(11,505,570)	12,888,869	—	2,455,907	—
Common Stock	1,772,470	—	—	(1,772,470)	—	—	—	—
Warrants	4,190	—	—	(4,190)	—	—	—	—
BKC CSP Blocker, Inc.:								
Common Stock	—	—	—	—	—†	—	—	—
ECI Holdco, Inc.								
Common Stock	42,444,480	178,861	—	2,692,171	45,315,512	—	—	—
WBS Group LLC:								
Senior Secured Loan, First Lien	—	27,284,255	—	—	27,284,255	—	416,813	—
Senior Secured Loan, Second Lien	—	25,230,310	—	(231,310)	24,999,000	—	882,051	18,003
WBS Group LLC								
Limited Liability Co. Interest	—	7,492,304	—	(1,537,685)	5,954,619	—	—	—
Westward Dough Operating Company, LLC								
Senior Secured Loan	—	6,790,896	(200,000)	—	6,590,896	—	279,508	—
Westward Dough Holdings, LLC								
Limited Liability Co. Interest	—	9,260,324	—	(4,920,324)	4,340,000	—	—	—
Totals	<u>\$ 87,225,239</u>	<u>\$ 81,512,946</u>	<u>\$ (346,668)</u>	<u>\$ (20,004,775)</u>	<u>\$ 148,386,742</u>	<u>\$ —</u>	<u>\$ 6,501,767</u>	<u>\$ 136,170</u>

\* Gross additions include increases in the cost basis of investments resulting from new portfolio investments, payment-in-kind interest or dividends, the amortization of unearned income, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company into this category from a different category.

\*\* Gross reductions include decreases in the cost basis of investments resulting from principal collections related to investment repayments or sales, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company out of this category into a different category.

\*\*\* For the nine months ended September 30, 2012.

† Investment moved into the controlled category from the non-controlled, non-affiliated category.

The aggregate fair value of controlled investments at September 30, 2012 represents 21.1% of the Company's net assets.

- (p) BDCs are required to invest at least 70% of their total assets primarily in securities of private or thinly traded U.S. public companies, cash, cash equivalents, U.S. Government securities and other high quality debt investments that mature in one year or less. The securities referenced represent either fully or partially non-qualified assets for purposes of this requirement.
- (q) Interest may be paid in cash or paid-in-kind ("PIK") which is generally at the option of the borrower. PIK earned is included in the cost basis of the security. PIK represented approximately 3% of interest income earned for the nine months ended September 30, 2012. In accordance with the Company's policy, PIK may be recorded on an effective yield basis. For the nine months ended September 30, 2012, the following securities' PIK was recorded at the prior quarter's fair value: A1 Solutions, Inc. and Alpha Media Group Inc.
- (r) Security bears interest at a floating rate that may or may not include an interest rate floor.
- (s) Non-income producing equity securities at September 30, 2012.

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments**  
**December 31, 2011**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
<b>Senior Secured Notes—16.2%</b>						
AGY Holding Corp. Second Lien(q)	<i>Glass Yarns/Fibers</i>	11.00%	11/15/14	\$ 16,200,000	\$ 15,958,040	\$ 13,737,600
American Residential Services L.L.C. et al., Second Lien(d)	<i>HVAC Plumbing Services</i>	12.00%	4/15/15	40,000,000	39,865,081	40,400,000
Sizzling Platter LLC et al., First Lien(d)	<i>Restaurants</i>	12.25%	4/15/16	30,000,000	29,078,717	30,000,000
TriMark USA, Inc., Second Lien(f)(q)(r)	<i>Food Service Equipment</i>	11.50%	11/30/13	32,782,166	32,782,166	29,733,425
<b>Total Senior Secured Notes</b>					<u>117,684,004</u>	<u>113,871,025</u>
<b>Unsecured Debt—0.7%</b>						
Big Dumpster Acquisition, Inc.(r)	<i>Waste Management Equipment</i>	13.50%	7/5/15	56,177,438	45,226,690	—
Maple Hill Acquisition LLC	<i>Rigid Packaging</i>	13.50%	10/1/15	5,000,000	4,882,791	5,000,000
<b>Total Unsecured Debt</b>					<u>50,109,481</u>	<u>5,000,000</u>
<b>Subordinated Debt—23.3%</b>						
A & A Manufacturing Co., Inc.	<i>Protective Enclosures</i>	14.00%	5/16/16	27,403,430	27,147,191	27,403,430
Conney Safety Products, LLC(e)	<i>Safety Products</i>	16.00%	10/1/14	25,582,734	24,847,025	25,582,734
MediMedia USA, Inc.(d)(q)	<i>Information Services</i>	11.38%	11/15/14	19,950,000	18,903,945	19,171,950
MedQuist Inc. et al.(q)	<i>Medical Transcription</i>	13.00%	10/15/16	43,000,000	41,971,176	43,559,000
The Pay-O-Matic Corp.(r)	<i>Financial Services</i>	14.00%	1/15/15	15,366,867	15,269,195	15,366,867
PGA Holdings, Inc.	<i>Healthcare Services</i>	12.50%	3/12/16	5,000,000	4,947,850	5,000,000
Sarnova HC, LLC et al.(r)	<i>Healthcare Products</i>	14.00%	4/6/16	25,762,284	25,238,707	25,762,284
Wastequip, Inc.(r)	<i>Waste Management Equipment</i>	14.50%	2/5/15	10,194,216	8,611,497	1,192,724
<b>Total Subordinated Debt</b>					<u>166,936,586</u>	<u>163,038,989</u>

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**December 31, 2011**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
<b>Senior Secured Loans—93.5%(f)</b>						
Advantage Sales & Marketing Inc., Second Lien	<i>Marketing Services</i>	9.25%	6/17/18	\$ 10,000,000	\$ 9,870,527	\$ 9,790,000
Airvana Network Solutions Inc., First Lien	<i>Software</i>	10.00%	3/25/15	14,895,238	14,653,843	14,895,238
Alpha Media Group Inc., First Lien(r)	<i>Publishing</i>	12.00%	7/15/13	4,938,535	3,812,217	908,691
American SportWorks LLC, Second Lien(g)	<i>Utility Vehicles</i>	13.00%	6/16/15	8,000,000	8,000,000	3,550,900
AmQuip Crane Rental LLC, Second Lien	<i>Construction Equipment</i>	12.00%	12/19/17	43,600,000	43,600,000	43,600,000
Arclin US Holdings Inc., Second Lien(e)(h)(q)	<i>Chemicals</i>	7.75%	1/15/15	3,523,337	2,982,481	3,523,337
Ascend Learning, LLC, Second Lien	<i>Education</i>	11.50%	12/6/17	20,000,000	19,488,347	20,000,000
Ashton Woods USA L.L.C., Second Lien	<i>Homebuilding</i>	11.75%	7/6/15	37,500,000	37,236,720	37,500,000
Attachmate Corporation et al., Second Lien	<i>Software</i>	9.50%	10/27/17	5,000,000	4,933,770	4,775,000
Bankruptcy Management Solutions, Inc., Term Loan A, First Lien(g)	<i>Financial Services</i>	7.50%	8/20/14	2,000,000	1,585,115	1,948,000
Bankruptcy Management Solutions, Inc., Term Loan B, First Lien(g)(q)(r)	<i>Financial Services</i>	7.50%	8/20/14	18,689,755	10,494,843	15,512,497
Bankruptcy Management Solutions, Inc., Term Loan A, Second Lien(g)(q)(r)	<i>Financial Services</i>	8.37%	8/20/15	30,418,676	22,278,353	21,992,701
The Bargain! Shop Holdings Inc., Term Loan A, First Lien(h)(i)(q)	<i>Discount Stores</i>	15.00%	6/29/12	10,425,886	10,228,949	10,255,642
The Bargain! Shop Holdings Inc., Term Loan B, First Lien(h)(i)(q)	<i>Discount Stores</i>	15.00%	7/1/12	14,331,114	13,478,415	14,097,102
Berlin Packaging L.L.C., Second Lien	<i>Rigid Packaging</i>	6.81%	8/17/15	24,000,000	23,673,086	23,184,000
Dial Global, Inc. et. al., Second Lien	<i>Media &amp; Entertainment</i>	13.00%	7/21/17	42,500,000	41,916,962	41,916,962
Fitness Together Franchise Corporation, First Lien(r)	<i>Personal Fitness</i>	11.50%	11/10/13	7,275,283	7,275,283	6,693,260

The accompanying notes are an integral part of these consolidated financial statements.



**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**December 31, 2011**

<b>Portfolio Company</b>	<b>Industry(a)</b>	<b>Interest Rate</b>	<b>Maturity</b>	<b>Principal Amount or Number of Shares/Units</b>	<b>Cost(b)</b>	<b>Fair Value(c)</b>
Grocery Outlet Inc., First Lien	<i>Grocery Retail</i>	10.50%	12/15/17	\$ 25,000,000	\$ 25,000,000	\$ 25,000,000
Heartland Automotive Services II, Inc. et al., Term Loan A, First Lien	<i>Automobile Repair</i>	7.25%	1/30/14	3,170,391	3,169,702	2,986,508
Heartland Automotive Services II, Inc. et al., Term Loan B, First Lien(r)	<i>Automobile Repair</i>	9.25%	1/30/14	2,352,269	2,352,179	2,145,270
Henniges Automotive Holdings, Inc., First Lien	<i>Automotive</i>	12.00%	11/30/16	37,777,778	36,849,706	37,777,778
InterMedia Outdoors, Inc., Second Lien	<i>Printing/Publishing</i>	7.33%	1/31/14	10,000,000	10,000,000	8,750,000
MCCI Group Holdings, LLC, Second Lien	<i>Healthcare Services</i>	10.75%	1/29/18	40,000,000	40,000,000	40,000,000
Navilyst Medical, Inc., Second Lien	<i>Healthcare Services</i>	13.00%	8/14/15	15,000,000	14,873,074	14,490,000
Penton Media, Inc. et al., First Lien(e)(q)(r)	<i>Information Services</i>	5.00%	8/1/14	11,426,611	9,102,901	8,067,187
Physiotherapy Associates, Inc. et al., Second Lien	<i>Rehabilitation Centers</i>	12.00%	12/31/13	17,000,000	17,000,000	17,000,000
Potters Holdings II, L.P., Term Loan B, Second Lien	<i>Engineered Glass Beads</i>	10.25%	11/6/17	15,000,000	14,797,215	15,000,000
Pre-Paid Legal Services, Inc., Term Loan B, First Lien	<i>Legal Services</i>	11.00%	12/31/16	15,000,000	14,591,397	15,000,000
Progress Financial Corporation, Second Lien(r)	<i>Financial Services</i>	12.00%	7/26/16	30,000,000	29,541,114	30,000,000
Renaissance Learning, Inc., Second Lien	<i>Education Software</i>	12.00%	10/19/18	20,000,000	19,221,325	19,221,325
SOURCEHOV LLC, Second Lien	<i>Process Outsourcing</i>	10.50%	4/29/18	25,000,000	22,108,488	22,700,000
Sur La Table, Inc., Second Lien	<i>Consumer Products</i>	12.00%	7/28/17	50,000,000	50,000,000	50,000,000
United Subcontractors, Inc., First Lien(e)(q)(r)	<i>Building and Construction</i>	4.58%	6/30/15	2,172,719	2,063,501	1,809,875
Volume Services America, Inc. et al., Term Loan B, First Lien	<i>Concession Services</i>	10.50%	9/16/16	44,550,000	43,146,593	44,550,000
WBS Group LLC et al., Second Lien	<i>Software</i>	10.50%	6/7/13	20,000,000	19,898,550	18,700,000

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**December 31, 2011**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
Westward Dough Operating Company, LLC, Term Loan A, First Lien	<i>Restaurants</i>	4.30%	3/31/12	\$ 6,850,000	\$ 6,846,261	\$ 3,347,907
Westward Dough Operating Company, LLC, Term Loan B, First Lien(j)	<i>Restaurants</i>	7.30%	3/31/12	8,334,656	8,330,290	4,905,633
<b>Total Senior Secured Loans</b>					<u>664,401,207</u>	<u>655,594,813</u>
<b>Preferred Stock—0.0%</b>						
Alpha Media Group Holdings Inc., Series A-2(k)	<i>Publishing</i>			5,000	—	—
<b>Total Preferred Stock</b>					<u>—</u>	<u>—</u>
<b>Common Stock—9.4%(k)</b>						
Alpha Media Group Holdings Inc., Class B	<i>Publishing</i>			12,500	—	—
Arclin Cayman Holdings Ltd.(e)(h)(q)	<i>Chemicals</i>			450,532	9,722,203	8,299,998
Bankruptcy Management Solutions, Inc.(g)(q)	<i>Financial Services</i>			325,415	9,600,072	1,772,470
ECI Holdco, Inc., Class A-1 (Electrical Components)(g)	<i>Electronics</i>			18,848,836	18,848,836	42,444,480
M & M Tradition Holdings Corp.(e)	<i>Sheet Metal Fabrication</i>			500,000	5,000,000	7,250,000
MGHC Holding Corporation (Mattress Giant)(e)	<i>Bedding—Retail</i>			109,336	1,093,360	224,200
USI Senior Holdings, Inc. (United Subcontractors)(e)(q)	<i>Building and Construction</i>			109,750	7,388,570	5,994,457
<b>Total Common Stock</b>					<u>51,653,041</u>	<u>65,985,605</u>
<b>Limited Partnership/Limited Liability Company Interests—5.6%</b>						
ARS Investment Holdings, LLC(k)(l)	<i>HVAC/Plumbing Services</i>			102,601	—	1,110,000
ASW International LLC(g)(k)(m)	<i>Utility Vehicles</i>			12,800	7,428,827	—

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**December 31, 2011**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
Big Dumpster Coinvestment, LLC(k)	Waste Management Equipment			—	\$ 5,333,333	\$ —
Conney Prime Holdings LLC(e)(k)(n)	Safety Products			95,226	952,259	1,785,488
DynaVox Systems Holdings, LLC(k)(o)	Augmentative Communication Products			272,369	758,069	991,784
Marquette Transportation Company Holdings, LLC(k)(p)	Transportation			25,000	5,000,000	5,286,000
Marsico Holdings, LLC (d)(k)	Financial Services			91,445	1,848,077	248,730
Penton Business Media Holdings LLC(e)(k)	Information Services			—	9,050,000	20,321,858
PG Holdco, LLC (Press Ganey)(r)	Healthcare Services	15.00%		333	280,739	280,740
PG Holdco, LLC (Press Ganey), Class A(k)	Healthcare Services			16,667	166,667	345,833
Sentry Security Systems Holdings, LLC(k)	Security Services			147,271	147,271	4,127
Sentry Security Systems Holdings, LLC(r)	Security Services	8.00%		602,729	602,729	602,729
VSS-AHC Holdings LLC (Advanstar)(k)	Printing/Publishing			352,941	4,199,161	4,479,337
WBS Group Holdings, LLC, Class B-1(r)	Software	16.00%		8,000	<u>8,000,000</u>	<u>3,714,116</u>
<b>Total Limited Partnership/Limited Liability Company Interests</b>					<u>43,767,132</u>	<u>39,170,742</u>
<b>Equity Warrants/Options—0.9%(k)</b>						
Arclin Cayman Holdings Ltd., Tranche 1(e)(h)(q)	Chemicals		expire 1/15/14	230,159	403,815	1,433,846
Arclin Cayman Holdings Ltd., Tranche 2(e)(h)(q)	Chemicals		expire 1/15/15	230,159	323,052	1,618,076

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments - (Continued)**  
**December 31, 2011**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
Arclin Cayman Holdings Ltd., Tranche 3(e)(h)(q)	<i>Chemicals</i>		expire 1/15/14	230,159	\$ 484,578	\$ 1,167,002
Arclin Cayman Holdings Ltd., Tranche 4(e)(h)(q)	<i>Chemicals</i>		expire 1/15/15	230,159	403,815	1,379,772
Bankruptcy Management Solutions, Inc(g)(q)	<i>Financial Services</i>		expire 10/1/17	23,046	365,584	4,190
Facet Investment, Inc.	<i>Medical Devices</i>		expire 1/18/21	1,978	250,000	88,213
Marsico Superholdco SPV, LLC, (d)	<i>Financial Services</i>		expire 12/14/19	455	444,450	—
MGHC Holding Corporation(e)	<i>Bedding — Retail</i>		expire 1/31/12	75,928	136,297	—
Progress Financial Corporation	<i>Financial Services</i>		expire 7/26/18	429,596	502,627	596,169
Twin River Worldwide Holdings, Inc., Contingent Value Rights	<i>Gaming</i>		expire 11/5/17	1,000	5,000	4,000
<b>Total Equity Warrants/Options</b>					<u>3,319,218</u>	<u>6,291,268</u>
<b>TOTAL INVESTMENTS—149.6%</b>					<u>\$1,097,870,669</u>	<u>1,048,952,442</u>
<b>OTHER ASSETS &amp; LIABILITIES (NET)—(49.6)%</b>						<u>(347,943,593)</u>
<b>NET ASSETS—100.0%</b>						<u>\$ 701,008,849</u>

- (a) Unaudited
- (b) Represents amortized cost for fixed income securities and cost for preferred and common stock, limited partnership/limited liability company interests and equity warrants/options.
- (c) Fair value is determined by or under the direction of the Company's Board of Directors. See Note 2 for further details.
- (d) Security is exempt from registration under Rule 144A of the Securities Act of 1933. Such securities may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. In the aggregate, these securities represent 12.8% of the Company's net assets at December 31, 2011.
- (e) Transaction and other information for "non-controlled, affiliated" investments under the Investment Company Act of 1940, whereby the Company owns 5% or more (but not more than 25%) of the portfolio company's outstanding voting securities.
- (f) Approximately 68% of the senior secured loans to the Company's portfolio companies bear interest at a floating rate that may be determined by reference to the London Interbank Offered Rate (LIBOR) or other base rate (commonly the Federal Funds Rate or the Prime Rate), at the borrower's option. In addition, approximately 58% of such senior secured loans have floors of 1.00% to 3.25%. The borrower under a senior secured loan generally has the option to select from interest reset periods of one, two, three or nine months and may alter that selection at the end of any reset period. The stated interest rate represents the weighted average interest rate at December 31, 2011 of all contracts within the specified loan facility.

The accompanying notes are an integral part of these consolidated financial statements.

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Non-controlled, Affiliated Investments	Fair Value at December 31, 2010	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at December 31, 2011	Net Realized Gain (Loss)***	Interest Income***	Dividend Income***
Arclin Cayman Holdings Ltd.:								
Common Stock	\$ 8,370,000	\$ —	\$ (8,507,789)	\$ 137,789	\$ — †	\$ —	\$ —	\$ —
Warrants	5,453,023	—	(4,419,495)	(1,033,528)	— †	—	—	—
Arclin US Holdings Inc.								
Senior Secured Loan	3,459,541	44,416	(3,547,259)	43,302	— †	1,288	113,406	—
Conney Safety Products LLC								
Subordinated Debt	29,665,252	293,386	(4,829,858)	453,954	25,582,734	170,143	4,954,546	—
Conney Prime Holdings LLC								
Limited Liability Co. Interest	1,062,247	63,359	—	659,882	1,785,488	—	—	—
M&M Tradition Holdings Corp.:								
Preferred Stock	5,117,040	—	(4,968,000)	(149,040)	— ††	—	—	1,128,207
Common Stock	5,000,000	—	—	2,250,000	7,250,000	—	—	—
Mattress Giant Corporation								
Subordinated Debt	1,229,657	102,434	(4,014,328)	2,682,237	— ††	(2,784,672)	94,327	—
MGHC Holding Corporation:								
Common Stock	—	—	(2,285,815)	2,285,815	— ††	(2,285,815)	—	—
Common Stock	—	1,093,360	—	(869,160)	224,200	—	—	—
Warrants	—	136,297	—	(136,297)	—	—	—	—
Penton Business Media Holdings LLC								
Limited Liability Co. Interest	9,050,000	—	—	11,271,858	20,321,858	—	110,624	—
Penton Media, Inc. et al.								
Senior Secured Loan	—	9,126,321	(23,420)	(1,035,714)	8,067,187	12,709	394,918	—
United Subcontractors, Inc.								
Senior Secured Loan	1,589,952	282,513	—	(62,590)	1,809,875	—	67,861	—
USI Senior Holdings, Inc.								
Common Stock	7,379,489	79,504	—	(1,464,536)	5,994,457	—	—	—
<b>Totals</b>	<b>\$ 77,376,201</b>	<b>\$ 11,221,590</b>	<b>\$ (32,595,964)</b>	<b>\$ 15,033,972</b>	<b>\$ 71,035,799</b>	<b>\$ (4,886,347)</b>	<b>\$ 5,735,682</b>	<b>\$ 1,128,207</b>

\* Gross additions include increases in the cost basis of investments resulting from new portfolio investments, payment-in-kind interest or dividends, the amortization of unearned income, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company into this category from a different category.

\*\* Gross reductions include decreases in the cost basis of investments resulting from principal collections related to investment repayments or sales, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company out of this category into a different category.

\*\*\* For the twelve months ended December 31, 2011.

† Investment moved out of non-controlled, affiliated category at December 31, 2011.

†† Investment no longer held at December 31, 2011.

The aggregate fair value of non-controlled, affiliated investments at December 31, 2011 represents 10.1% of the Company's net assets.

- (g) Transaction and other information for "controlled" investments under the Investment Company Act of 1940, whereby the Company owns more than 25% of the portfolio company's outstanding voting securities.
- (h) Non-U.S. company or principal place of business outside the U.S.
- (i) Principal amount is denominated in Canadian dollars.
- (j) Non-accrual status (in default) at December 31, 2011 and therefore non-income producing. At December 31, 2011, the aggregate fair value and amortized cost of the Company's debt investments on non-accrual status represents 0.5% and 0.8% of total debt investments at fair value and amortized cost, respectively.
- (k) Non-income producing equity securities at December 31, 2011.
- (l) The Company is the sole stockholder of BKC ARS Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of American Residential Services L.L.C. and thus a non-controlled, non-affiliated investment.
- (m) The Company is the sole stockholder of BKC ASW Blocker, Inc., a consolidated subsidiary, which is the beneficiary of more than 25% of the voting securities of American SportWorks LLC and thus a controlled investment.

The accompanying notes are an integral part of these consolidated financial statements.

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Controlled Investments	Fair Value at December 31, 2010	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at December 31, 2011	Net Realized Gain (Loss)***	Interest/ Other Income***
AI Solutions, Inc.							
Senior Secured Loan	\$ 115,000	\$ —	\$ (115,000)	\$ —	\$ — †	\$ —	\$ 6,738
American SportWorks LLC							
Senior Secured Loan	7,200,000	—	—	(3,649,100)	3,550,900	—	1,104,445
ASW Investment Holdings, LLC							
Limited Liability Co. Interest	—	—	—	—	—	—	—
Bankruptcy Management Solutions, Inc.:							
Senior Secured Loan, First Lien, A	1,427,700	157,414	—	362,886	1,948,000	—	309,498
Senior Secured Loan, First Lien, B	—	10,524,207	(29,363)	5,017,653	15,512,497	39,727	1,685,875
Senior Secured Loan, Second Lien	21,342,029	3,762,586	—	(3,111,913)	21,992,702	—	4,405,452
Common Stock	4,516,560	60,832	—	(2,804,922)	1,772,470	—	—
Warrants	125,880	—	—	(121,690)	4,190	—	—
ECI Holdco, Inc.							
Common Stock	51,480,000	—	—	(9,035,520)	42,444,480	—	—
Electrical Components International, Inc.							
Senior Secured Loan	1,641,718	—	(1,641,718)	—	— †	—	14,730
Fitness Together Franchise Corporation							
Senior Secured Loan	6,119,804	628,104	(7,212,128)	464,220	— †	—	841,951
Fitness Together Holdings, Inc.:							
Preferred Stock Series A	—	—	(173,326)	173,326	— †	(156,062)	—
Preferred Stock Series A-1	—	—	(49,056)	49,056	— †	(44,539)	—
Preferred Stock Series B Convertible	1,478,000	—	(9,100,000)	7,622,000	— †	(7,637,759)	—
Common Stock	—	—	(118,500)	118,500	— †	(102,521)	—
<b>Totals</b>	<b>\$ 95,446,691</b>	<b>\$15,133,143</b>	<b>\$(18,439,091)</b>	<b>\$(4,915,504)</b>	<b>\$87,225,239</b>	<b>\$(7,901,154)</b>	<b>\$8,368,689</b>

\* Gross additions include increases in the cost basis of investments resulting from new portfolio investments, payment-in-kind interest or dividends, the amortization of unearned income, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company into this category from a different category.

\*\* Gross reductions include decreases in the cost basis of investments resulting from principal collections related to investment repayments or sales, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company out of this category into a different category.

\*\*\* For the year ended December 31, 2011. There was no dividend income from these securities during the period.

† Investment moved out of controlled category at December 31, 2011.

†† Investment no longer held at December 31, 2011.

The aggregate fair value of controlled investments at December 31, 2011 represents 12.4% of the Company's net assets.

- (n) The Company is the sole stockholder of BKC CSP Blocker, Inc., a consolidated subsidiary, which is the beneficiary of more than 5% (but less than 25%) of the voting securities of Conney Prime Holdings, LLC and thus a non-controlled, affiliated investment.
- (o) The Company is the sole stockholder of BKC DVSH Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of DynaVox Systems LLC and thus a non-controlled, non-affiliated investment.
- (p) The Company is the sole stockholder of BKC MTCH Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of Marquette Transportation Company Holdings, LLC and thus a non-controlled, non-affiliated investment.
- (q) BDCs are required to invest at least 70% of their total assets primarily in securities of private or thinly traded U.S. public companies, cash, cash equivalents, U.S. Government securities and other high quality debt investments that mature in one year or less. The securities referenced represent either fully or partially non-qualified assets for purposes of this requirement.
- (r) Interest may be paid in cash or paid-in-kind ("PIK") which may be at the option of the borrower. PIK earned is included in the cost basis of the security. In accordance with the Company's policy, PIK may be recorded on an effective yield basis.

The accompanying notes are an integral part of these consolidated financial statements.

**BlackRock Kelso Capital Corporation**  
**Notes to Consolidated Financial Statements (Unaudited)**

**1. Organization**

BlackRock Kelso Capital Corporation and subsidiaries (the “Company”) was organized as a Delaware corporation on April 13, 2005 and was initially funded on July 25, 2005. The Company has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940 (the “1940 Act”). In addition, for tax purposes the Company has qualified and has elected to be treated as a regulated investment company (“RIC”) under the Internal Revenue Code of 1986 (the “Code”). The Company’s investment objective is to generate both current income and capital appreciation through debt and equity investments. The Company invests primarily in middle-market companies in the form of senior and junior secured and unsecured debt securities and loans, each of which may include an equity component, and by making direct preferred, common and other equity investments in such companies.

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Certain financial information that is normally included in annual financial statements, including certain financial statement footnotes, prepared in accordance with GAAP, is not required for interim reporting purposes and has been condensed or omitted herein. These consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements and notes related thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, which was filed with the Securities and Exchange Commission (“SEC”) on March 1, 2012.

**2. Significant accounting policies**

***Basis of Presentation***

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated financial statements and the reported amounts of income and expenses during the reported period. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ and such differences could be material.

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries, which were established to hold certain investments of the Company. The Company owns 100% of each subsidiary and, as such, the subsidiaries are consolidated into the Company’s consolidated financial statements. The subsidiaries hold investments which are treated as pass through entities for tax purposes. By investing through these 100% owned subsidiaries, the Company is able to benefit from corporate tax treatment for these entities and thereby create a tax structure that is more advantageous with respect to the RIC status of the Company. Transactions between subsidiaries, to the extent they occur, are eliminated in consolidation.

Expenses are recorded on an accrual basis.

***Investments***

Security transactions are accounted for on the trade date unless there are substantial conditions to the purchase. Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the amortized cost basis of the investment. Unrealized gains or losses primarily reflect the change in investment values, including the reversal of previously recorded unrealized gains or losses when gains or losses are realized. Realized gains or losses on the disposition of investments are calculated using the specific identification method.

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Investments for which market quotations are readily available are valued at such market quotations unless they are deemed not to represent fair value. The Company obtains market quotations, when available, from an independent pricing service or one or more broker-dealers or market makers and utilizes the average of the range of bid and ask quotations. Debt and equity securities for which market quotations are not readily available or for which market quotations are deemed not to represent fair value are valued at fair value as determined in good faith by or under the direction of the Company's Board of Directors.

Because the Company expects that there will not be a readily available market for substantially all of the investments in its portfolio, the Company expects to value substantially all of its portfolio investments at fair value as determined in good faith by or under the direction of the Board of Directors using a consistently applied valuation process in accordance with a documented valuation policy that has been reviewed and approved by the Board of Directors. Due to the inherent uncertainty and subjectivity of determining the fair value of investments that do not have a readily available market value, the fair value of the Company's investments may differ significantly from the values that would have been used had a readily available market value existed for such investments and may differ materially from the values that the Company may ultimately realize.

In addition, changes in the market environment and other events may have differing impacts on the market quotations used to value some of the Company's investments than on the fair values of the Company's investments for which market quotations are not readily available. Market quotations may be deemed not to represent fair value in certain circumstances where BlackRock Kelso Capital Advisors LLC, the Company's investment advisor (the "Advisor"), believes that facts and circumstances applicable to an issuer, a seller or purchaser or the market for a particular security cause current market quotations to not reflect the fair value of the security. Examples of these events could include cases where a security trades infrequently causing a quoted purchase or sale price to become stale, where there is a "forced" sale by a distressed seller, where market quotations vary substantially among market makers, or where there is a wide bid-ask spread or significant increase in the bid-ask spread.

With respect to the Company's investments for which market quotations are not readily available or for which market quotations are deemed not to represent fair value, the Board of Directors has approved a multi-step valuation process applied each quarter, as described below:

(i) The quarterly valuation process begins with each portfolio company or investment being initially evaluated and rated by the investment professionals of the Advisor responsible for the portfolio investment;

(ii) The investment professionals provide recent portfolio company financial statements and other reporting materials to independent valuation firms engaged by the Board of Directors, such firms conduct independent appraisals each quarter and their preliminary valuation conclusions are documented and discussed with senior management of the Advisor;

(iii) The audit committee of the Board of Directors reviews the preliminary valuations prepared by the independent valuation firms; and

(iv) The Board of Directors discusses valuations and determines the fair value of each investment in the portfolio in good faith based on the input of the Advisor, the respective independent valuation firms and the audit committee.

Those investments for which market quotations are not readily available or for which market quotations are deemed not to represent fair value are valued utilizing a market approach, an income approach, or both approaches, as appropriate. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. In following these approaches, the types of factors that the Company may take into account in determining the fair value of its investments include, as relevant and among other factors: available current



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market data, including relevant and applicable market trading and transaction comparables, applicable market yields and multiples, security covenants, call protection provisions, information rights, the nature and realizable value of any collateral, the portfolio company's ability to make payments, (e.g. non-performance risk), its earnings and discounted cash flows, the markets in which the portfolio company does business, comparisons of financial ratios of peer companies that are public, M&A comparables, the Company's principal market (as the reporting entity) and enterprise values.

Until the end of the second calendar quarter following its acquisition, each unquoted investment in a new portfolio company generally is valued at amortized cost, which the Advisor believes approximates fair value under the circumstances. As of that date, an independent valuation firm conducts an initial independent appraisal of the investment.

Accounting Standards Codification ("ASC") 820-10, *Fair Value Measurements and Disclosures* ("ASC 820-10"), issued by the Financial Accounting Standards Board ("FASB"), defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements. See note 10 for further details.

### ***Cash and Cash Equivalents***

Cash equivalents include short-term liquid overnight investments.

### ***Revenue Recognition***

Interest income is recorded on an accrual basis and includes amortization of premiums and accretion of discounts. Discounts and premiums to par value on securities purchased are accreted/amortized into interest income over the life of the respective security. Premiums and discounts are determined based on the cash flows expected to be received for a particular investment upon maturity.

Dividend income is recorded on the ex-dividend date and is adjusted to the extent that the Company expects to collect such amounts. For loans and securities with payment-in-kind ("PIK") income, which represents contractual interest or dividends accrued and added to the principal balance and generally due at maturity, such income is accrued only to the extent that the Advisor believes that the PIK income is likely to be collected. To maintain the Company's status as a RIC, this non-cash source of income must be paid out to stockholders in the form of dividends, even though the Company has not yet collected the cash.

Fee income, such as structuring fees, origination, closing, commitment and other upfront fees are generally non-recurring and are recognized as revenue when earned. In instances where the Company does not perform significant services in connection with the related investment, fees paid to the Company in these situations may be deferred and amortized over the estimated life of the investment. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, structuring, closing, commitment and other upfront fees are recorded as income.

### ***U.S. Federal Income Taxes***

The Company has elected to be treated as a RIC under Subchapter M of the Code and operates in a manner so as to qualify for the tax treatment applicable to RICs.

In order to qualify for favorable tax treatment as a RIC, the Company is required to distribute annually to its stockholders at least 90% of its investment company taxable income, as defined by the Code. To avoid federal excise taxes, we must distribute annually at least 98% of our ordinary income and 98.2% of net capital gains from the current year and any undistributed ordinary income and net capital gains from the preceding years. The Company, at its discretion, may carry forward taxable income in excess of calendar year distributions and pay a 4% excise tax on this income. If the Company chooses to do so, all other things being equal, this would increase expenses and reduce the amount available to be distributed to stockholders. The Company will accrue excise tax on estimated undistributed taxable income as required.

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Dividends from net investment income and distributions from net realized capital gains are determined in accordance with U.S. federal income tax regulations, which may differ from those amounts determined in accordance with GAAP. These book/tax differences are either temporary or permanent in nature. To the extent these differences are permanent, they are charged or credited to paid-in-capital or accumulated net realized gain (loss), as appropriate, in the period that the differences arise. Temporary and permanent differences are primarily attributable to differences in the tax treatment of certain loans and the tax characterization of income and non-deductible expenses. These differences are generally determined in conjunction with the preparation of the Company's annual RIC tax return.

Book and tax basis differences relating to stockholder dividends and distributions and other permanent book and tax differences are reclassified among the Company's capital accounts. In addition, the character of income and gains to be distributed is determined in accordance with income tax regulations that may differ from GAAP.

The Company may pay distributions in excess of its taxable net investment income. This excess would be a tax-free return of capital in the period and reduce the shareholder's tax basis in its shares. The cumulative amount is disclosed on the Consolidated Statements of Assets and Liabilities as distributions in excess of taxable net investment income. Cumulative distributions in excess of taxable net investment income are \$18,195,866 and \$26,165,703 as of September 30, 2012 and December 31, 2011, respectively.

### ***Dividends to Common Stockholders***

Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount to be paid out as a dividend is determined by the Board of Directors. Net realized capital gains, if any, generally are distributed at least annually, although the Company may decide to retain such capital gains for investment.

The Company has adopted a dividend reinvestment plan that provides for reinvestment of distributions on behalf of stockholders, unless a stockholder elects to receive cash. As a result, if the Board of Directors authorizes, and the Company declares, a cash dividend, then stockholders who have not "opted out" of the dividend reinvestment plan will have their cash dividends automatically reinvested in additional shares of Common Stock, rather than receiving the cash dividends.

### ***Foreign Currency***

Foreign currency amounts are translated into United States dollars on the following basis:

- (i) market value of investment securities, other assets and liabilities—at the spot exchange rate on the last business day of the period; and
- (ii) purchases and sales of investment securities, income and expenses—at the rates of exchange prevailing on the respective dates of such transactions, income or expenses.

Although net assets and fair values are presented based on the applicable foreign exchange rates described above, the Company does not isolate that portion of the results of operations resulting from changes in foreign exchange rates on investments from the fluctuations arising from changes in fair values of investments held. Such fluctuations are included with the net realized and unrealized gain or loss from investments.

Investments denominated in foreign currencies and foreign currency transactions may involve certain considerations and risks not typically associated with those of domestic origin, including unanticipated movements in the value of the foreign currency relative to the U.S. dollar.

### ***Debt Issuance Costs***

Debt issuance costs are amortized over the term of the related debt using the straight line method.

### ***Equity Offering Expenses***

The Company records registration expenses related to its shelf registration statement and related SEC filings as prepaid assets. These expenses are charged as a reduction of capital upon utilization, in accordance with ASC 946, *Financial Services—Investment Companies*.

### ***Non-Accrual Loans***

Loans or debt securities are placed on non-accrual status, as a general matter, when principal or interest payments are past due 30 days or more or when there is reasonable doubt that principal or interest will be collected. Accrued interest generally is reversed when a loan or debt security is placed on non-accrual status. Interest payments received on non-accrual loans or debt securities may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans and debt securities are restored to accrual status when past due principal and interest is paid and, in management's judgment, are likely to remain current. The Company may make exceptions to this treatment if the loan has sufficient collateral value and is in the process of collection.

### ***Recently Issued Accounting Pronouncements***

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU 2011-04"), which amends the existing fair value guidance within ASC 820-10. The amendments include: (1) application of the concepts of highest and best use and valuation premise only to measuring the fair value of nonfinancial assets (that is, it does not apply to financial assets or any liabilities), (2) an exception to fair value measurement principles for financial assets and financial liabilities (and derivatives) with offsetting positions in market risks or counterparty credit risk, which allows an entity to measure the fair value of the net risk position, when several criteria are met, (3) extension of the prohibition of a blockage factor application to all fair value measurements, (4) a model for the fair value measurement of instruments classified within an entity's shareholders' equity which is consistent with the guidance of measuring the fair value for liabilities, (5) additional disclosures for fair value measurements categorized in Level 3 of the fair value hierarchy: (i) quantitative information about unobservable inputs used, (ii) a description of the valuation processes used by the entity and (iii) a qualitative discussion about the sensitivity of the measurements, (6) disclosure of the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed and (7) disclosure of any transfers between Levels 1 and 2 of the fair value hierarchy, not just significant transfers. The provisions of ASU 2011-04 were effective for the Company on January 1, 2012. Management has adopted the provisions of ASU 2011-04 on January 1, 2012. The adoption of ASU 2011-04 did not have an impact on the measurement of fair value of the Company's investments, but did impact the Company's disclosures related to fair value, which have been reflected in the notes to these consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet: Disclosures about Offsetting Assets and Liabilities* ASU 2011-11. These disclosure requirements are intended to help investors and other financial statement users to better assess the effect or potential effect of offsetting arrangements on an entity's financial position. They also improve transparency in the reporting of how companies mitigate credit risk, including disclosure of related collateral pledged or received. In addition, ASU 2011-11 facilitates comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of IFRS. ASU 2011-11 requires entities to disclose both gross and net information about both instruments and transactions eligible for offset in the financial position; and to disclose instruments and transactions subject to an agreement similar to a master netting agreement. ASU 2011-11 is effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. Management is currently evaluating the implications of ASU 2011-11 and its impact on financial statement disclosures.

## **3. Agreements and related party transactions**

### ***Base Management Fee***

The Company has entered into an Investment Management Agreement (the "Management Agreement") with the Advisor, under which the Advisor, subject to the overall supervision of the Company's Board of Directors, manages the day-to-day operations of, and provides investment advisory services to, the Company. For

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providing these services, the Advisor receives a base management fee (the “Management Fee”) from the Company quarterly in arrears at an annual rate of 2.0% of the Company’s total assets, including any assets acquired with the proceeds of leverage.

For the three and nine months ended September 30, 2012, the Advisor earned \$5,964,904 and \$16,877,541, respectively, in Management Fees under the Management Agreement. For the three and nine months ended September 30, 2011, the Advisor earned \$5,124,033 and \$14,547,503, respectively, in such fees from the Company.

### ***Incentive Management Fee***

The Management Agreement provides that the Advisor or its affiliates may be entitled to an incentive management fee (the “Incentive Fee”) under certain circumstances. The determination of the Incentive Fee, as described in more detail below, will result in the Advisor or its affiliates receiving no Incentive Fee payments if returns to Company stockholders do not meet an 8.0% annualized rate of return during the applicable fee measurement period, and will result in the Advisor or its affiliates receiving less than the full amount of the Incentive Fee percentage until returns to stockholders exceed an approximate 13.3% annualized rate of return during such period. Annualized rate of return in this context is computed by reference to the Company’s net asset value and does not take into account changes in the market price of the Company’s common stock.

The Advisor will be entitled to receive the Incentive Fee if the Company’s performance exceeds a “hurdle rate” during different measurement periods: trailing four quarters’ periods (which applies only to the portion of the Incentive Fee based on income) and annual periods (which applies only to the portion of the Incentive Fee based on capital gains). The “trailing four quarters’ periods” for purposes of determining the income portion of the Incentive Fee payable for the three months ended September 30, 2012 and 2011 was determined by reference to the four quarter periods ended on September 30, 2012 and 2011, respectively. The term “annual period” means the period beginning on July 1 of each calendar year and ending on June 30 of the next calendar year.

The hurdle rate for each measurement period is 2.0% multiplied by the Company’s net asset values at the beginning of each calendar quarter during the measurement period, calculated after giving effect to any distributions that occurred during the measurement period. A portion of the Incentive Fee is based on the Company’s income and a portion is based on capital gains. Each portion of the Incentive Fee is described below.

***Quarterly Incentive Fee Based on Income.*** For each trailing four quarters’ period, the Company pays the Advisor an Incentive Fee based on the amount by which (A) aggregate distributions and amounts distributable out of taxable net income (excluding any capital gain and loss) during the period less the sum of, if negative, net unrealized capital appreciation/(depreciation) and net realized capital gains/(losses) during the period, in excess of (B) the hurdle rate for the period. The amount of the excess of (A) over (B) described in this paragraph for each period is referred to as the excess income amount.

The portion of the Incentive Fee based on income for each period will equal 50% of the period’s excess income amount, until the cumulative Incentive Fee payments for the period equal 20% of the period’s income amount distributed or distributable to stockholders as described in clause (A) of the preceding paragraph. Thereafter, the portion of the Incentive Fee based on income for the period will equal 20% of the period’s remaining excess income amount.

For the three and nine months ended September 30, 2012, the Advisor earned zero and \$2,213,859, respectively, in Incentive Fees based on Income from the Company. For the three and nine months ended September 30, 2011, the Advisor earned no such fees.

***Annual Incentive Fee Based on Capital Gains.*** The portion of the Incentive Fee based on capital gains is calculated and paid on an annual basis beginning on July 1, 2007, the first day of the calendar quarter in which the Public Market Event occurred and each annual period thereafter, ending on June 30 of the next calendar year. For each annual period, the Company pays the Advisor an Incentive Fee based on the amount by which (A) net

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realized capital gains, if any, to the extent they exceed gross unrealized capital depreciation, if any, occurring during the period exceeds (B) the amount, if any, by which the period's hurdle rate exceeds the amount of income used in the determination of the Incentive Fee based on income for the period. The amount of the excess of (A) over (B) described in this paragraph is referred to as the excess gain amount.

The portion of the Incentive Fee based on capital gains for each period will equal 50% of the period's excess gain amount, until such payments equal 20% of the period's capital gain amount distributed or distributable to stockholders. Thereafter, the portion of the Incentive Fee based on capital gains for the period equals an amount such that the portion of the Incentive Fee payments to the Advisor based on capital gains for the period equals 20% of the period's remaining excess gain amount. The result of this formula is that, if the portion of the Incentive Fee based on income for the period exceeds the period's hurdle, then the portion of the Incentive Fee based on capital gains will be capped at 20% of the capital gain amount.

In calculating whether the portion of the Incentive Fee based on capital gains is payable with respect to any period, the Company accounts for its assets on a security-by-security basis. In addition, the Company uses the "period-to-period" method pursuant to which the portion of the Incentive Fee based on capital gains for any period is based on realized capital gains for the period reduced by realized capital losses and gross unrealized capital depreciation for the period. Based on current interpretations of Section 205(b)(3) of the Investment Advisers Act of 1940 by the SEC and its staff, the calculation of unrealized depreciation for each portfolio security over a period is based on the fair value of the security at the end of the period compared to the fair value at the beginning of the period. Incentive Fees earned in any of the periods described above are not subject to modification or repayment based upon performance in a subsequent period.

We are required under GAAP to accrue a hypothetical capital gains Incentive Fee based upon net realized capital gains and unrealized capital appreciation and depreciation on investments held at the end of each period. The accrual of this hypothetical capital gains incentive fee assumes all unrealized capital appreciation and depreciation is realized in order to reflect a hypothetical capital gains incentive fee that would be payable at each measurement date. If such amount is positive at the end of the period, then we record a capital gains incentive fee equal to 20% of such amount, less the amount of capital gains related incentive fees already accrued in prior periods. If the resulting amount is negative, the accrual for GAAP in a given period may result in an additional expense. There can be no assurance that such unrealized capital appreciation will be realized in the future. However, it should be noted that a fee so calculated and accrued would not be payable under the Investment Advisers Act of 1940 or the Management Agreement. Amounts actually paid will be consistent with the Advisers Act which specifically excludes consideration of unrealized capital appreciation.

The capital gains fee due to our investment advisor as calculated under the investment advisory and Management Agreement as described above, for the three months ended September 30, 2012 was zero. In accordance with GAAP the hypothetical incentive fee for the three and nine months ended September 30, 2012, resulted in a capital gains incentive fee of \$2,963,803, bringing the total GAAP accrual related to the capital gains Incentive Fee to \$2,963,803 as of September 30, 2012.

### ***Advisor Reimbursements***

The Management Agreement provides that the Company will reimburse the Advisor for costs and expenses incurred by the Advisor for office space rental, office equipment and utilities allocable to the Advisor under the Management Agreement, as well as any costs and expenses incurred by the Advisor relating to any non-investment advisory, administrative or operating services provided by the Advisor to the Company. For the three and nine months ended September 30, 2012, the Company incurred \$511,774 and \$1,364,420, respectively, and for the three and nine months ended September 30, 2011, the Company incurred \$315,435 and \$1,176,450, respectively, for such investment advisor expenses under the Management Agreement.

From time to time, the Advisor may pay amounts owed by the Company to third party providers of goods or services. The Company will subsequently reimburse the Advisor for such amounts paid on its behalf.

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Reimbursements to the Advisor for such purposes during the three and nine months ended September 30, 2012 were \$832,640 and \$2,295,143 respectively, and during the three and nine months ended September 30, 2011 were \$816,130 and \$1,583,453, respectively.

No person who is an officer, director or employee of the Advisor and who serves as a director of the Company receives any compensation from the Company for such services. Directors who are not affiliated with the Advisor receive compensation for their services and reimbursement of expenses incurred to attend meetings.

### **Administration**

The Company also has entered into an administration agreement with BlackRock Financial Management, Inc. (the "Administrator") under which the Administrator provides administrative services to the Company. For providing these services, facilities and personnel, the Company reimburses the Administrator for the Company's allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations under the administration agreement, including rent and the Company's allocable portion of the cost of certain of the Company's officers and their respective staffs. For the three and nine months ended September 30, 2012, the Company incurred \$112,976 and \$261,160, respectively, for administrative services expenses payable to the Administrator under the administration agreement. For the three and nine months ended September 30, 2011, the Company incurred \$268,303 and \$713,528, respectively, in such expenses.

### **Advisor Stock Transactions**

In March 2011, the Company's Board of Directors authorized the purchase in a private placement of up to 1,000,000 shares of the Company's common stock, by the Advisor in its discretion, subject to compliance with the Company's and the Advisor's applicable policies and requirements of law. There were no such purchases during the nine months ended September 30, 2012.

At September 30, 2012 and December 31, 2011, the Advisor owned and had the right to vote approximately 97,000 and 259,000 shares, respectively, of the Company's common stock, representing less than 1.0% of the total shares outstanding. On such dates, under compensation arrangements for its officers and employees the Advisor owned of record but did not have the right to vote an additional 258,000 and 275,000 shares, respectively, of the Company's common stock. At September 30, 2012 and December 31, 2011, other entities affiliated with the Administrator beneficially owned and had the right to vote approximately 6,019,000 shares of the Company's common stock, representing approximately 8.2% of the total shares outstanding.

## **4. Earnings per share**

The following information sets forth the computation of basic and diluted net increase in net assets from operations per share (earnings per share) for the three and nine months ended September 30, 2012 and 2011.

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Numerator for basic and diluted net increase in net assets per share	\$ 14,329,107	\$ 12,937,484	\$ 55,609,491	\$ 69,870,752
Denominator for basic and diluted net increase in net assets per share	73,692,104	73,101,398	73,555,011	72,966,076
Basic/diluted net increase in net assets per share from operations	\$ 0.19	\$ 0.18	\$ 0.76	\$ 0.96

Diluted net increase in net assets per share from operations equals basic net increase in net assets per share from operations for each period because there were no common stock equivalents outstanding during the above periods.

## 5. Investments

Purchases of investments for the three months ended September 30, 2012 and 2011 totaled \$16,788,620 and \$139,401,945, respectively, and for the nine months ended September 30, 2012 and 2011 totaled \$238,476,949 and \$260,528,598, respectively. Sales/repayments of investments for the three months ended September 30, 2012 and 2011 totaled \$82,255,990 and \$87,591,684, respectively, and for nine months ended September 30, 2012 and 2011 totaled \$203,491,979 and \$163,013,170, respectively.

At September 30, 2012, investments consisted of the following:

	<u>Cost</u>	<u>Fair Value</u>
Senior secured notes	\$ 176,057,177	\$ 174,704,190
Unsecured debt	48,519,832	48,613,583
Subordinated debt	97,861,341	97,850,748
Senior secured loans:		
First lien	241,783,787	244,166,199
Second/other priority lien	420,991,416	400,070,111
Total senior secured loans	662,775,203	644,236,310
Preferred stock	740,313	1,101,698
Common stock	50,825,793	72,377,432
Limited partnership/limited liability company interests	39,152,421	43,791,472
Equity warrants/options	3,882,766	11,302,684
Total investments	<u>\$ 1,079,814,846</u>	<u>\$ 1,093,978,117</u>

At December 31, 2011, investments consisted of the following:

	<u>Cost</u>	<u>Fair Value</u>
Senior secured notes	\$ 117,684,004	\$ 113,871,025
Unsecured debt	50,109,481	5,000,000
Subordinated debt	166,936,586	163,038,989
Senior secured loans:		
First lien	212,981,195	209,900,588
Second/other priority lien	451,420,012	445,694,225
Total senior secured loans	664,401,207	655,594,813
Common stock/preferred stock	51,653,041	65,985,605
Limited partnership/limited liability company interests	43,767,132	39,170,742
Equity warrants/options	3,319,218	6,291,268
Total investments	<u>\$ 1,097,870,669</u>	<u>\$ 1,048,952,442</u>

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### **Industry Composition**

The industry composition of the portfolio at fair value at September 30, 2012 and December 31, 2011 was as follows:

<b>Industry</b>	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Personal and Other Services	12.5%	13.1%
Healthcare	12.1	12.9
Business Services	10.2	9.9
Manufacturing	10.1	7.6
Printing, Publishing and Media	8.6	8.1
Consumer Products	8.6	4.8
Financial Services	8.3	8.3
Building and Real Estate	5.8	4.3
Chemicals	5.4	4.4
Retail	4.5	5.2
Electronics	4.2	4.1
Beverage, Food and Tobacco	3.7	3.6
Containers and Packaging	2.6	2.7
Distribution	2.4	5.1
Transportation	0.6	0.5
Telecommunications	0.3	1.4
Entertainment and Leisure	0.1	0.4
Automotive	—	3.6
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>

The geographic composition of the portfolio at fair value at September 30, 2012 was United States 95.6% and Canada 4.4%, and at December 31, 2011 was United States 96.0% and Canada 4.0%. The geographic composition is determined by the location of the corporate headquarters of the portfolio company.

### **Market, Credit and Industry Risk**

In the normal course of business, the Company invests in securities and enters into transactions where risks exist due to fluctuations in the market (market risk) or failure of the issuer of a security to meet all its obligations (issuer credit risk). The value of securities held by the Company may decline in response to certain events, including those directly involving the issuers whose securities are owned by the Company; conditions affecting the general economy; overall market changes; local, regional or global political, social or economic instability; and currency and interest rate and price fluctuations. Similar to issuer credit risk, the Company may be exposed to counterparty credit risk, or the risk that an entity with which the Company has unsettled or open transactions may fail to or be unable to perform on its commitments. The Company manages counterparty risk by entering into transactions only with counterparties that they believe have the financial resources to honor their obligations and by monitoring the financial stability of those counterparties. Financial assets, which potentially expose the Company to market, issuer and counterparty credit risks, consist principally of investments in portfolio companies. The extent of the Company's exposure to market, issuer and counterparty credit risks with respect to these financial assets is generally approximated by their value recorded in the consolidated statements of assets and liabilities. The Company is also exposed to credit risk related to maintaining all of its cash at a major financial institution.



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The Company has investments in lower rated and comparable quality unrated senior and junior secured, unsecured and subordinated debt securities and loans, which are subject to a greater degree of credit risk than more highly rated investments. The risk of loss due to default by the issuer is significantly greater for holders of such securities and loans, particularly in cases where the investment is unsecured or subordinated to other creditors of the issuer.

### 6. Derivatives

#### *Foreign Currency*

The Company may enter into forward foreign currency contracts from time to time to facilitate settlement of purchases and sales of investments denominated in foreign currencies or to help mitigate the impact that an adverse change in foreign exchange rates would have on the value of the Company's investments denominated in foreign currencies. A forward foreign currency contract is a commitment to purchase or sell a foreign currency at a future date (usually the security transaction settlement date) at a negotiated forward rate. These contracts are marked-to-market by recognizing the difference between the contract exchange rate and the current market rate as unrealized appreciation or depreciation. Realized gains or losses are recognized when contracts are settled. The Company's forward foreign currency contracts generally have terms of approximately three months. The volume of open contracts at the end of each reporting period is reflective of the typical volume of transactions during each calendar quarter. Risks may arise as a result of the potential inability of the counterparties to meet the terms of their contracts. The Company attempts to limit this risk by dealing with only creditworthy counterparties.

At September 30, 2012, details of open forward foreign currency contracts were as follows:

<u>Foreign Currency</u>	<u>Settlement Date</u>	<u>Amount and Transaction</u>	<u>US\$ Value at Settlement Date</u>	<u>US\$ Value at September 30, 2012</u>	<u>Unrealized Appreciation (Depreciation)</u>
Canadian dollar	October 17, 2012	23,098,161 Sold	\$ 22,690,971	\$ 23,464,260	\$ (773,289)
Canadian dollar	October 17, 2012	349,418 Purchased	(352,672)	(354,956)	2,284
Canadian dollar	October 17, 2012	358,000 Purchased	(364,074)	(363,674)	(400)
Total			\$ 21,974,225	\$ 22,745,630	\$ (771,405)

At December 31, 2011, details of open forward foreign currency contracts were as follows:

<u>Foreign Currency</u>	<u>Settlement Date</u>	<u>Amount and Transaction</u>	<u>US\$ Value at Settlement Date</u>	<u>US\$ Value at December 31, 2011</u>	<u>Unrealized Appreciation (Depreciation)</u>
Canadian dollar	January 18, 2012	295,000 Purchased	\$ (289,385)	\$ (290,124)	\$ 739
Canadian dollar	January 18, 2012	593,819 Purchased	(587,012)	(584,004)	(3,008)
Canadian dollar	January 18, 2012	24,982,000 Sold	23,465,055	24,569,027	(1,103,972)
Total			\$ 22,588,658	\$ 23,694,899	\$ (1,106,241)

All realized and unrealized gains and losses on forward foreign currency contracts are included in earnings (changes in net assets) and are reported as separate line items within the Company's consolidated statements of operations. Unrealized gains and losses on forward foreign currency contracts are also reported as separate line items within the Company's consolidated statements of assets and liabilities.

The Company may enter into other derivative instruments and incur other exposures with other counterparties in the future. The derivative instruments held as of September 30, 2012 and December 31, 2011 reflect the volume of derivative activity throughout the periods presented.

## **Warrants**

The Company holds warrants and options in certain portfolio companies in an effort to achieve additional investment return. In purchasing warrants and options, the Company bears the risk of an unfavorable change in the value of the underlying equity interest. The aggregate fair value of warrants and options as of September 30, 2012 and December 31, 2011 represents 1.6% and 0.9%, respectively, of the Company's net assets.

## **7. Debt**

Under the terms of the Company's amended and restated Senior Secured, Multi-Currency Credit Agreement (the "Credit Facility"), as amended on April 20, 2010, certain lenders agreed to extend credit to the Company in an aggregate principal amount not to exceed \$375,000,000 outstanding, at any one time, consisting of \$275,000,000 of revolving loan commitments and \$100,000,000 of term loan commitments. The Credit Facility is secured by substantially all of the assets in the Company's portfolio, including cash and cash equivalents. Subject to certain exceptions, pricing for outstanding borrowings is at LIBOR plus an applicable spread of either 3.00% or 3.25% for revolving loans, based on a pricing grid using the Company's credit rating, and LIBOR plus 3.00% for term loans. The Credit Facility does not contain a LIBOR floor requirement. At September 30, 2012, the effective LIBOR spread under the Credit Facility was 3.13%. Term loan commitments under the Credit Facility have been fully drawn and, once repaid, may not be reborrowed. The Credit Facility also includes an "accordion" feature that allows the Company, under certain circumstances, to increase the size of the Credit Facility by up to an additional \$275,000,000 of revolving loan commitments and \$250,000,000 of term loan commitments. The Credit Facility is used to supplement the Company's equity capital to make additional portfolio investments and for other general corporate purposes.

At September 30, 2012, the Company had \$209,600,000 drawn on the Credit Facility versus \$168,000,000 at December 31, 2011. Subject to compliance with applicable covenants and borrowing base limitations, the remaining amount available under the Credit Facility was \$165,400,000 at September 30, 2012.

On January 18, 2011, the Company closed a private placement issuance of \$158,000,000 in aggregate principal amount of five-year, senior secured notes with a fixed interest rate of 6.50% and a maturity date of January 18, 2016 and \$17,000,000 million in aggregate principal amount of seven-year, senior secured notes with a fixed interest rate of 6.60% and a maturity date of January 18, 2018 (collectively, the "Senior Secured Notes"). The Senior Secured Notes were sold to certain institutional accredited investors pursuant to an exemption from registration under the Securities Act of 1933, as amended. Interest on the Senior Secured Notes is due semi-annually on January 18 and July 18, commencing on July 18, 2011.

The Company's average outstanding debt balance during the three and nine months ended September 30, 2012 was \$420,729,348 and \$390,714,051, respectively. The maximum amounts borrowed during the three and nine months ended September 30, 2012 were \$469,900,000 and \$469,900,000, respectively, and during the three and nine months ended September 30, 2011 were \$320,000,000 and \$363,000,000.

The weighted average annual interest cost for the three and nine months ended September 30, 2012 was 4.73% and 4.87%, respectively, and for the three and nine months ended September 30, 2011 was 5.21% and 5.25%, exclusive of commitment fees and of other prepaid expenses related to establishing the Credit Facility and the Senior Secured Notes. With respect to any unused portion of the commitments under the Credit Facility, the Company incurs an annual commitment fee of 0.50%. Commitment fees incurred for the three and nine months ended September 30, 2012 were \$164,923 and \$611,922, respectively, and for the three and nine months ended September 30, 2011 were \$329,677 and \$995,649.

At September 30, 2012, the Company was in compliance with all covenants required under the Credit Facility and the Senior Secured Notes.

## **8. Capital stock**

In 2008, the Company's Board of Directors approved a share repurchase plan under which the Company may repurchase up to 2.5 percent of its outstanding shares of common stock from time to time in open market or privately negotiated transactions. In 2009, the Board of Directors approved an extension and increase to the plan which authorized the Company to repurchase up to an additional 2.5 percent of its outstanding shares of common stock. In May 2012, the repurchase plan was further extended through the earlier of June 30, 2013 or until the approved number of shares has been repurchased. During the nine months ended September 30, 2012, the Company purchased zero shares of its common stock on the open market. During the nine months ended September 30, 2011, the Company purchased a total of 400,000 shares of its common stock on the open market for \$3,540,397, including brokerage commissions. Since inception of the repurchase plan through September 30, 2012, the Company has purchased 1,425,507 shares of its common stock on the open market for \$9,476,676, including brokerage commissions. At September 30, 2012, the total number of remaining shares authorized for repurchase was 1,331,143. The Company currently holds the shares it repurchased in treasury.

## **9. Guarantees and commitments**

In the normal course of business, the Company may enter into guarantees on behalf of portfolio companies. Under these arrangements, the Company would be required to make payments to third parties if the portfolio companies were to default on their related payment obligations. The Company has no such guarantees outstanding at September 30, 2012 and December 31, 2011.

In the normal course of business, the Company enters into contractual agreements that provide general indemnifications against losses, costs, claims and liabilities arising from the performance of individual obligations under such agreements. The Company has had no prior claims or payments pursuant to such agreements. The Company's individual maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against the Company that have not yet occurred. However, based on management's experience, the Company expects the risk of loss to be remote.

From time to time, the Company may be a party to certain legal proceedings incidental to the normal course of its business, including the enforcement of the Company's rights under contracts with its portfolio companies. While the Company cannot predict the outcome of these legal proceedings with certainty, it does not expect that these proceedings will have a material effect on its consolidated financial statements.

## **10. Fair value of financial instruments**

### ***Fair Value Measurements and Disclosure***

ASC 820-10 defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements. ASC 820-10 defines fair value as the price that the Company would receive upon selling an investment or pay to transfer a liability in an orderly transaction to a market participant in the principal or most advantageous market for the investment. ASC 820-10 emphasizes that valuation techniques maximize the use of observable market inputs and minimize the use of unobservable inputs. Inputs refer broadly to the assumptions that market participants would use in pricing an asset or liability, including assumptions about risk. Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing an asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing an asset or liability developed based on the best information available in the circumstances.

Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

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Level 2 – Valuations based on unadjusted 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 inputs into the determination of fair value may require significant management judgment or estimation.

Transfers between levels, if any, represent the value as of the beginning of the period of any investment where a change in the pricing level occurred from the beginning to the end of the period.

The Company's valuation policy and fair value disclosures are consistent with ASC 820-10. The Company evaluates the source of inputs, including any markets in which its investments are trading, in determining fair value and categorizes each investment within the fair value hierarchy pursuant to ASC 820-10.

Under the 1940 Act, the Company is required to separately identify non-controlled investments where it owns 5% or more of a portfolio company's outstanding voting securities as investments in "affiliated" companies. In addition, under the 1940 Act, the Company is required to separately identify investments where it owns more than 25% of a portfolio company's outstanding voting securities as investments in "controlled" companies. Detailed information with respect to the Company's non-controlled non-affiliated, non-controlled affiliated and controlled investments is contained in the accompanying consolidated schedules of investments and other consolidated financial statements. The information in the tables below is presented on an aggregate portfolio basis, without segregating the non-controlled non-affiliated, non-controlled affiliated and controlled investment categories.

The carrying values of the Company's financial instruments approximate fair value. The carrying values of receivables, other assets, accounts payable and accrued expenses approximate fair value due to their short maturities. The fair value of the Company's Credit Facility and Senior Secured Notes is derived by taking the average of the high and low quotes as obtained from a broker. The fair value of the Credit Facility and Senior Secured Notes would be classified as Level 2 with respect to the fair value hierarchy. The carrying and fair values of the Company's Credit Facility payable were \$209,600,000 and \$204,360,000 at September 30, 2012 and \$168,000,000 and \$157,080,000 at December 31, 2011, respectively. The carrying and fair values of the Company's Secured Senior Notes were \$175,000,000 and \$188,302,790 at September 30, 2012 and \$175,000,000 and \$180,815,000 at December 31, 2011, respectively. The carrying and fair values of the Company's total debt outstanding were therefore \$384,600,000 and \$392,662,790 at September 30, 2012 and \$343,000,000 and \$337,895,000 at December 31, 2011, respectively.

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The following tables summarize the fair values of the Company's investments, forward foreign currency contracts and cash and cash equivalents based on the inputs used at September 30, 2012 and December 31, 2011 in determining such fair values:

	Fair Value at September 30, 2012	Fair Value Inputs at September 30, 2012		
		Price Quotations (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Senior secured notes	\$ 174,704,190	\$ —	\$ —	\$ 174,704,190
Unsecured debt	48,613,583	—	—	48,613,583
Subordinated debt	97,850,748	—	—	97,850,748
Senior secured loans	644,236,310	—	—	644,236,310
Preferred stock	1,101,698	—	—	1,101,698
Common stock	72,377,432	—	—	72,377,432
Limited partnership/limited liability company interests	43,791,472	—	—	43,791,472
Equity warrants/options	11,302,684	—	—	11,302,684
Total investments	1,093,978,117	—	—	1,093,978,117
Forward foreign currency contracts	(771,405)	—	(771,405)	—
Cash and cash equivalents	2,976,746	2,976,746	—	—
Total	\$ 1,096,183,458	\$ 2,976,746	\$ (771,405)	\$ 1,093,978,117

	Fair Value at December 31, 2011	Fair Value Inputs at December 31, 2011		
		Price Quotations (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Senior secured notes	\$ 113,871,025	\$ —	\$ —	\$ 113,871,025
Unsecured debt	5,000,000	—	—	5,000,000
Subordinated debt	163,038,989	—	—	163,038,989
Senior secured loans	655,594,813	—	—	655,594,813
Common stock	65,985,605	—	—	65,985,605
Limited partnership/limited liability company interests	39,170,742	—	—	39,170,742
Equity warrants/options	6,291,268	—	—	6,291,268
Total investments	1,048,952,442	—	—	1,048,952,442
Forward foreign currency contracts	(1,106,241)	—	(1,106,241)	—
Cash and cash equivalents	7,778,993	7,778,993	—	—
Total	\$ 1,055,625,194	\$ 7,778,993	\$ (1,106,241)	\$ 1,048,952,442

In determining the fair values of the Company's forward foreign currency contracts at September 30, 2012 and at December 31, 2011, the Company used unadjusted indicative price quotations for similar assets (Level 2).

The valuation techniques used at September 30, 2012 and December 31, 2011 in determining the fair values of the Company's investments for which significant unobservable inputs were used were the market approach, income approach or both using third party valuation firms or broker quotes for identical or similar assets. The total fair market value using the market or income approach or using third party valuation firms was \$1,093,828,709 and \$1,043,181,658 as of September 30, 2012 and December 31, 2011, respectively. The remaining balance was determined using broker quotes for identical or similar assets.

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The following is a reconciliation for the three months ended September 30, 2012 of investments for which Level 3 inputs were used in determining fair value:

	Fair Value at June 30, 2012	Amortization of Premium/ Discount - Net	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation or Depreciation	Purchases	Sales or Repayments	Net Transfers in and/or out of Level 3	Fair Value at September 30, 2012
Senior secured notes	\$ 174,802,676	\$ 550,364	\$ —	\$ (648,850)	\$ —	\$ —	\$ —	\$ 174,704,190
Unsecured debt	48,500,000	7,876	—	(7,876)	113,583	—	—	48,613,583
Subordinated debt	167,868,954	1,635,138	—	(3,070,611)	—	(68,582,733)	—	97,850,748
Senior secured loans	649,352,587	2,212,065	(8,420)	(12,390,513)	15,333,451	(10,262,860)	—	644,236,310
Preferred stock	—	—	—	361,385	740,313	—	—	1,101,698
Common stock	70,923,064	—	67,998	1,595,669	(128,917)	(80,382)	—	72,377,432
Limited partnership / LLC Interest	44,431,152	—	2,377,756	282,234	30,345	(3,330,015)	—	43,791,472
Equity warrants / options	9,664,681	—	—	938,158	699,845	—	—	11,302,684
<b>Total investments</b>	<b>\$ 1,165,543,114</b>	<b>\$ 4,405,443</b>	<b>\$ 2,437,334</b>	<b>\$ (12,940,404)</b>	<b>\$ 16,788,620</b>	<b>\$ (82,255,990)</b>	<b>\$ —</b>	<b>\$ 1,093,978,117</b>

The following is a reconciliation for the nine months ended September 30, 2012 of investments for which Level 3 inputs were used in determining fair value:

	Fair Value at December 31, 2011	Amortization of Premium/ Discount - Net	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation or Depreciation	Purchases	Sales or Repayments	Net Transfers in and/or out of Level 3	Fair Value at September 30, 2012
Senior secured notes	\$ 113,871,025	\$ 1,380,576	\$ —	\$ 2,459,992	\$ 56,992,597	\$ —	\$ —	\$ 174,704,190
Unsecured debt	5,000,000	221,009	(45,124,241)	45,203,232	43,613,583	(300,000)	—	48,613,583
Subordinated debt	163,038,989	2,493,968	(8,185,353)	3,887,004	10,661,605	(74,045,465)	—	97,850,748
Senior secured loans	655,594,813	7,268,867	42,290	(9,732,498)	115,887,205	(124,824,367)	—	644,236,310
Preferred stock	—	—	—	361,385	740,313	—	—	1,101,698
Common stock	65,985,605	—	(113,608)	7,219,077	278,489	(992,131)	—	72,377,432
Limited partnership /LLC Interest	39,170,742	—	(19,698,952)	9,235,441	18,414,257	(3,330,016)	—	43,791,472
Equity warrants /options	6,291,268	—	(136,297)	4,447,868	699,845	—	—	11,302,684
<b>Total investments</b>	<b>\$ 1,048,952,442</b>	<b>\$ 11,364,420</b>	<b>\$ (73,216,161)</b>	<b>\$ 63,081,501</b>	<b>\$ 247,287,894</b>	<b>\$ (203,491,979)</b>	<b>\$ —</b>	<b>\$ 1,093,978,117</b>

The following is a reconciliation for the three months ended September 30, 2011 of investments for which Level 3 inputs were used in determining fair value:

	Fair Value at June 30, 2011	Amortization of Premium/ Discount - Net	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation or Depreciation	Purchases	Sales or Repayments	Net Transfers in and/ or out of Level 3	Fair Value at September 30, 2011
Senior secured notes	\$ 112,640,527	\$ 78,217	\$ —	\$ 1,910,257	\$ —	\$ —	\$ —	\$ 114,629,001
Unsecured debt	7,046,484	533,581	—	(2,005,889)	76,999	—	—	5,651,175
Subordinated debt	177,102,396	233,729	206,435	126,823	10,900,878	(23,167,510)	—	165,402,751
Senior secured loans	532,635,156	1,916,575	242,333	(6,228,848)	127,921,440	(64,419,174)	—	592,067,482
Preferred stock	6,060,073	—	—	1,652,611	—	—	—	7,712,684
Common stock	78,192,892	—	—	(6,643,982)	—	—	—	71,548,910
Limited partnership / LLC Interest	29,523,080	—	—	689,134	—	—	—	30,212,214
Equity warrants /options	4,454,931	—	5,000	80,127	502,628	(5,000)	—	5,037,686
<b>Total investments</b>	<b>\$ 947,655,539</b>	<b>\$ 2,762,102</b>	<b>\$ 453,768</b>	<b>\$ (10,419,767)</b>	<b>\$ 139,401,945</b>	<b>\$ (87,591,684)</b>	<b>\$ —</b>	<b>\$ 992,261,903</b>

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The following is a reconciliation for the nine months ended September 30, 2011 of investments for which Level 3 inputs were used in determining fair value:

	Fair Value at December 31, 2010	Amortization of Premium/Discount - Net	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation or Depreciation	Purchases	Sales or Repayments	Net Transfers in and/or out of Level 3	Fair Value at September 30, 2011
Senior secured notes	\$ 88,265,252	\$ 166,358	\$ (237,750)	\$ 4,247,329	\$ 29,250,062	\$ (7,062,250)	\$ —	\$ 114,629,001
Unsecured debt	6,898,385	1,276,828	—	(2,754,412)	230,374	—	—	5,651,175
Subordinated debt	221,369,811	1,949,924	(2,578,239)	7,669,476	11,388,943	(74,397,164)	—	165,402,751
Senior secured loans	444,823,276	4,018,298	(35,710,100)	41,358,760	220,710,197	(83,132,949)	—	592,067,482
Preferred stock	6,595,040	—	(899,995)	2,017,644	—	(5)	—	7,712,684
Common stock	83,162,072	—	(2,385,754)	(8,746,303)	(460,246)	(20,859)	—	71,548,910
Limited partnership /LLC Interest	23,387,927	—	—	6,824,287	—	—	—	30,212,214
Equity warrants/options	5,583,903	—	5,000	(1,435,142)	888,925	(5,000)	—	5,037,686
<b>Total investments</b>	<b>\$ 880,085,666</b>	<b>\$ 7,411,408</b>	<b>\$ (41,806,838)</b>	<b>\$ 49,181,639</b>	<b>\$262,008,255</b>	<b>\$ (164,618,227)</b>	<b>\$ —</b>	<b>\$ 992,261,903</b>

There were no transfers between levels during three and the nine months ended September 30, 2012 and 2011. All realized and unrealized gains and losses are included in earnings (changes in net assets) and are reported as separate line items within the Company's consolidated statements of operations.

The ranges of unobservable inputs used in the fair value measurement of the Company's Level 3 investments as of September 30, 2012 were as follows:

EBITDA Multiples	2.5x to 10.75x
Market Yields	7.5% to 25.0%

The significant unobservable inputs used in the market approach of fair value measurement of the Company's investments are the market multiples of earnings before income tax, depreciation and amortization ("EBITDA") of the comparable guideline public companies. The independent valuation firms select a population of public companies for each investment with similar operations and attributes of the subject company. Using these guideline public companies' data, a range of multiples of enterprise value to EBITDA is calculated. The independent valuation firms select percentages from the range of multiples for purposes of determining the subject company's estimated enterprise value based on said multiple and generally the latest twelve months EBITDA of the subject company (or other meaningful measure). Significant increases or decreases in the multiple will result in an increase or decrease in enterprise value, resulting in an increase or decrease in the fair value estimate of the investment.

The significant unobservable input used in the income approach of fair value measurement of the Company's investments is the discount rate used to discount the estimated future cash flows expected to be received from the underlying investment, which include both future principal and interest payments. Significant increases or decreases in the discount rate would result in a decrease or increase in the fair value measurement. Included in the consideration and selection of discount rates are the following factors: risk of default, rating of the investment and comparable company investments, and call provisions.

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### 11. Financial highlights

The following per share data and ratios have been derived from information provided in the consolidated financial statements. The following is a schedule of financial highlights for a common share outstanding during the nine months ended September 30, 2012 and 2011.

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
<b>Per Share Data:</b>		
Net asset value, beginning of period	\$ 9.58	\$ 9.62
Net investment income	0.89	0.84
Net realized and unrealized gain	(0.13)	0.12
Total from investment operations	0.76	0.96
Dividend distributions to stockholders from net investment income	(0.78)	(0.84)
Issuance (reinvestment) of stock at prices (below) above net asset value	(0.01)	0.01
Net increase / (decrease) in net assets	(0.03)	0.13
Net asset value, end of period	\$ 9.55	\$ 9.75
Market price, end of period	\$ 9.72	\$ 7.30
Total return(1)(2)	29.79%	(27.69)%
<b>Ratios / Supplemental Data:</b>		
Ratio of operating expenses to average net assets(3)	5.12%	3.78%
Ratio of interest and other debt related expenses to average net assets(3)	3.16%	2.59%
Ratio of total expenses to average net assets(3)	8.28%	6.37%
Ratio of net investment income to average net assets(3)	12.29%	11.56%
Net assets, end of period	\$ 703,534,228	\$ 711,783,939
Average debt outstanding	\$ 390,714,051	\$ 276,577,106
Weighted average shares outstanding	73,555,011	72,966,076
Average debt per share(4)	\$ 5.31	\$ 3.79
Portfolio turnover(2)	19%	17%

(1) Total return is based on the change in market price per share during the respective periods. Total return calculations take into account dividends and distributions, if any, reinvested in accordance with the Company's dividend reinvestment plan and do not reflect brokerage commissions.

(2) Not annualized.

(3) Annualized.

(4) Average debt per share is calculated as average debt outstanding divided by the weighted average shares outstanding during the applicable period.

### 12. Subsequent events

On November 7, 2012, the Company's Board of Directors declared a dividend of \$0.26 per share, payable on January 3, 2013 to stockholders of record at the close of business on December 20, 2012.

In addition to the subsequent events included in these notes to the consolidated financial statements, the Company conducted a review for additional subsequent events and determined that no additional subsequent events had occurred that would require accrual or additional disclosures.



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

*The information contained in this section should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report.*

This report, and other statements that we may make, may contain forward-looking statements with respect to future financial or business performance, strategies or expectations. Forward-looking statements are typically identified by words or phrases such as “trend,” “opportunity,” “pipeline,” “believe,” “comfortable,” “expect,” “anticipate,” “current,” “intention,” “estimate,” “position,” “assume,” “potential,” “outlook,” “continue,” “remain,” “maintain,” “sustain,” “seek,” “achieve” and similar expressions, or future or conditional verbs such as “will,” “would,” “should,” “could,” “may” or similar expressions.

Forward-looking statements are subject to numerous assumptions, risks and uncertainties, which change over time. Forward-looking statements speak only as of the date they are made, and we assume no duty to and do not undertake to update forward-looking statements. Actual results could differ materially from those anticipated in forward-looking statements and future results could differ materially from historical performance.

In addition to factors previously identified elsewhere in the reports BlackRock Kelso Capital Corporation has filed with the Securities and Exchange Commission (the “SEC”), the following factors, among others, could cause actual results to differ materially from forward-looking statements or historical performance:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the impact of investments that we expect to make;
- our contractual arrangements and relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- our expected financings and investments;
- the adequacy of our cash resources and working capital, including our ability to obtain continued financing on favorable terms;
- the timing of cash flows, if any, from the operations of our portfolio companies;
- the impact of increased competition;
- the ability of the Advisor to locate suitable investments for us and to monitor and administer our investments;
- potential conflicts of interest in the allocation of opportunities between us and other investment funds managed by the Advisor or its affiliates;
- the ability of the Advisor to attract and retain highly talented professionals;
- fluctuations in foreign currency exchange rates; and
- the impact of changes to tax legislation and, generally, our tax position.

### Overview

We were incorporated in Delaware on April 13, 2005 and were initially funded on July 25, 2005. Our investment objective is to provide a combination of current income and capital appreciation. We intend to invest primarily in debt and equity securities of private and certain public U.S. middle-market companies.

We are externally managed and have elected to be regulated as a BDC under the 1940 Act. As a BDC, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least

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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.

### ***Investments***

Our level of investment activity can and does vary substantially from period to period depending on many factors, including the amount of debt and equity capital available to middle-market companies, the level of merger and acquisition activity, the general economic environment and the competitive environment for the types of investments we make.

As a BDC, we generally do not acquire any assets other than “qualifying assets” specified in the 1940 Act unless, at the time the acquisition is made, at least 70% of our total assets are qualifying assets (with certain limited exceptions). Qualifying assets include investments in “eligible portfolio companies.” Under the relevant SEC rules, the term “eligible portfolio company” includes most private companies, companies whose securities are not listed on a national securities exchange, and certain public companies that have listed their securities on a national securities exchange and have a market capitalization of less than \$250 million. These rules also permit us to include as qualifying assets certain follow-on investments in companies that were eligible portfolio companies at the time of initial investment but that no longer meet the definition.

### ***Revenues***

We generate revenues primarily in the form of interest on the debt we hold, dividends on our equity interests and capital gains on the sale of warrants and other debt or equity interests that we acquire in portfolio companies. Our investments in fixed income instruments generally have an expected maturity of three to ten years, although we have no lower or upper constraint on maturity, and typically bear interest at a fixed or floating rate. Interest on our debt securities is generally payable quarterly or semi-annually. In some cases, our debt instruments and preferred stock investments may defer payments of cash interest or dividends or pay interest or dividends in-kind. Any outstanding principal amount of our debt securities and any accrued but unpaid interest will generally become due at the maturity date. In addition, we may generate revenue in the form of prepayment fees, commitment, origination, capital structuring or due diligence fees, fees for providing significant managerial assistance.

### ***Expenses***

Our primary operating expenses include the payment of a base management fee and, depending on our operating results, an incentive management fee, interest and credit facility fees, expenses reimbursable under the Management Agreement, administration fees and the allocable portion of overhead under the administration agreement. The base management fee and incentive management fee compensate the Advisor for work in identifying, evaluating, negotiating, closing and monitoring our investments. Our management agreement with the Advisor provides that we will reimburse the Advisor for costs and expenses incurred by the Advisor for office space rental, office equipment and utilities allocable to the Advisor under the management agreement, as well as any costs and expenses incurred by the Advisor relating to any non-investment advisory, administrative or operating services provided by the Advisor to us. We bear all other costs and expenses of our operations and transactions.

### **Critical accounting policies**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Changes in the economic environment, financial

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markets and any other parameters used in determining such estimates could cause actual results to differ from these estimates. Management considers the following critical accounting policies important to understanding the consolidated financial statements. Our critical accounting policies are described in the notes to the consolidated financial statements. See Note 2 to the consolidated financial statements for a description of significant accounting policies and of recently issued accounting pronouncements.

### **Financial and operating highlights**

At September 30, 2012:

Investment Portfolio: \$1,097.0 million  
Net Assets: \$703.5 million  
Indebtedness (borrowings under Credit Facility and Senior Secured Notes): \$384.6 million  
Net Asset Value per share: \$9.55

Portfolio Activity for the Three Months Ended September 30, 2012:

Cost of investments during period: \$16.8 million  
Sales, repayments and other exits during period: \$82.3 million  
Number of portfolio companies at end of period: 50

Operating Results for the Three Months Ended September 30, 2012:

Net investment income per share: \$0.32  
Net investment income per share, pre-incentive fee: \$0.37  
Net investment income per share, as adjusted: \$0.30  
Dividends declared per share: \$0.26  
Earnings per share: \$0.19  
Earnings per share, as adjusted: \$0.17  
Net investment income: \$23.9 million  
Net investment income, pre-incentive fee: \$26.9 million  
Net investment income, as adjusted: \$21.9 million  
Net realized and unrealized losses: \$9.6 million  
Net increase in net assets from operations: \$14.3 million

See discussion on Supplemental Non-GAAP information beginning on page 48.

### **Portfolio and investment activity**

During the three months ended September 30, 2012, we invested approximately \$16.8 million across several existing portfolio companies. The investments consisted primarily of senior secured loans secured by second liens (\$10.7 million, or 63.7%), or first liens (\$4.6 million, or 27.6%) and unsecured or subordinated debt securities and equity securities (\$1.5 million, or 8.7%). Additionally, we received proceeds from sales/repayments and other exits of approximately \$82.3 million during the three months ended September 30, 2012.

At September 30, 2012, our portfolio of \$1,097.0 million (at fair value) consisted of 50 portfolio companies and was invested 59% in senior secured loans, 16% in senior secured notes, 13% in unsecured or subordinated debt securities, 12% in equity investments and less than 1% in cash and cash equivalents. At September 30, 2012 our average portfolio company at amortized cost was approximately \$21.6 million. Our average portfolio company investment at amortized cost, excluding investments below \$5.0 million was \$25.9 million at September 30, 2012. Our largest portfolio company investment by value was approximately \$52.5 million and our five largest portfolio company investments by value comprised approximately 21% of our portfolio at September 30, 2012. At December 31, 2011, our portfolio of \$1,056.7 million (at fair value) consisted of 54 portfolio companies and was invested 62% in senior secured loans, 11% in senior secured notes, 16% in unsecured or subordinated debt securities, 11% in equity investments and less than

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1% in cash and cash equivalents. At December 31, 2011 our average portfolio company at amortized cost was approximately \$20.3 million. Our average portfolio company investment at amortized cost, excluding investments below \$5.0 million was \$24.0 million at December 31, 2011. Our largest portfolio company investment by value was approximately \$50.0 million and our five largest portfolio company investments by value comprised approximately 21% of our portfolio at December 31, 2011.

The weighted average yield of the debt and income producing equity securities in our portfolio at fair value was 12.5% at September 30, 2012 and 12.7% at December 31, 2011. The weighted average yields on our senior secured loans and other debt securities at fair value were 12.0% and 13.6%, respectively, at September 30, 2012, versus 12.2% and 13.5% at December 31, 2011. The weighted average yield of the debt and income producing equity securities in our portfolio at their current cost basis was 12.2% at September 30, 2012 and 11.9% at December 31, 2011. The weighted average yields on our senior secured loans and other debt securities at their current cost basis were 11.6% and 13.5%, respectively, at September 30, 2012, versus 12.0% and 11.4% at December 31, 2011. Yields are computed using interest rates and dividend yields as of the balance sheet date and include amortization of loan origination fees, original issue discount and market premium or discount based on the expected cash flows of the respective portfolio investment. Yields exclude common equity investments, preferred equity investments with no stated dividend rate, short-term investments and cash and cash equivalents.

At September 30, 2012, 51% of our debt investments bore interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime Rate, and 49% bore interest at fixed rates. The percentage of our total debt investments that bore floating rate interest based on an interest rate floor was 46% at September 30, 2012. At December 31, 2011, 51% of our debt investments bore interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime Rate, and 49% bore interest at fixed rates. The percentage of our total debt investments that bore floating rate interest subject to an interest rate floor was 44% at December 31, 2011.

The Advisor employs a grading system for our entire portfolio. The Advisor grades all loans on a scale of 1 to 4. This system is intended to reflect the performance of the borrower's business, the collateral coverage of the loans and other factors considered relevant. Generally, the Advisor assigns only one loan grade to each portfolio company for all loan investments in that portfolio company; however, the Advisor will assign multiple ratings when appropriate for different investments in one portfolio company. The following is a description of the conditions associated with each investment rating:

**Grade 1:** Investments in portfolio companies whose performance is substantially within the Advisor's expectations and whose risk factors are neutral to favorable to those at the time of the original investment.

**Grade 2:** Investments in portfolio companies whose performance is below the Advisor's expectations and that require closer monitoring; however, no loss of investment return (interest and/or dividends) or principal is expected.

**Grade 3:** Investments in portfolio companies whose performance is below the Advisor's expectations and for which risk has increased materially since origination. Some loss of investment return is expected, but no loss of principal is expected. Companies graded 3 generally will be out of compliance with debt covenants and will be unlikely to make debt repayments on their original schedule.

**Grade 4:** Investments in portfolio companies whose performance is materially below the Advisor's expectations where business trends have deteriorated and risk factors have increased substantially since the original investment. Investments graded 4 are those for which some loss of principal is expected.

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The Advisor monitors and, when appropriate, changes the investment ratings assigned to each investment in our portfolio. In connection with our valuation process, the Advisor and Board of Directors review these investment ratings on a quarterly basis. Our average investment rating was 1.17 at September 30, 2012 versus 1.20 at December 31, 2011. The following is a distribution of the investment ratings of our portfolio companies at September 30, 2012 and December 31, 2011:

	September 30, 2012	December 31, 2011
Grade 1	\$ 912,980,838	\$ 872,465,840
Grade 2	172,600,205	156,359,268
Grade 3	6,132,000	9,000,116
Grade 4	2,179,659	11,035,005
Not Rated	85,415	92,213
Total investments	<u>\$ 1,093,978,117</u>	<u>\$ 1,048,952,442</u>

## Results of operations

*Results comparisons for the three months ended September 30, 2012 and 2011.*

### *Investment income*

Investment income totaled \$40,720,102 and \$33,247,245, respectively, for the three months ended September 30, 2012 and 2011, of which \$21,403,022 and \$20,969,719 were attributable to interest and fees on senior secured loans, \$19,274,373 and \$11,282,828 to interest earned on other debt securities, \$38,845 and \$993,689 to dividends from equity securities, and \$3,862 and \$1,009 to interest earned on cash equivalents, respectively. The increase in investment income for the three months ended September 30, 2012 is primarily attributable to one-time fees collected from the early repayment of one of our portfolio companies during the three months ended September 30, 2012.

For the three months ended September 30, 2012 fee income included \$8,733,840 from fees earned on early repayments of loans, \$248,953 from amortization of fees and \$46,370 from commitment and administration fees. For the three months ended September 30, 2011 fee income included \$477,931 from fees earned on early repayments of loans, \$513,293 from amortization of fees as well as \$4,137,500 from capital structuring and amendment fees. Interest income earned is comprised of cash interest of approximately 97% as well as PIK interest of approximately 3% for the three months ended September 30, 2012. The increase in fee income for the three months ended September 30, 2012 is primarily attributable to one-time fees collected from the early repayment of one of portfolio companies during the three months ended September 30, 2012.

### *Expenses*

Expenses for the three months ended September 30, 2012 and 2011 were \$16,781,830 and \$12,282,632, respectively, which consisted of \$5,964,904 and \$5,124,033 in base management fees, \$5,180,706 and \$4,208,359 in interest expense and fees related to the Credit Facility, \$2,963,803 and zero in incentive management fees, \$634,677 and \$634,678 in amortization of debt issuance costs, \$577,051 and \$683,095 in professional fees, \$511,774 and \$315,435 in Advisor expenses, \$164,074 and \$319,500 in administrative services, \$113,500 and \$97,000 in director fees and \$671,341 and \$900,532 in other expenses, respectively. The increase in base management fees in the current period reflects the overall growth and appreciation in value of our portfolio. The increase in interest and credit facility related expenses during the 2012 period is mainly a result of increased borrowing levels. Total borrowings were \$384,600,000 at September 30, 2012, compared to \$317,450,000 at September 30, 2011.

***Net investment income***

Net investment income was \$23,938,272 and \$20,964,613 for the three months ended September 30, 2012 and 2011, respectively. The increase is primarily attributable to interest and one-time fees collected from the early repayment of one of our portfolio companies during the three months ended September 30, 2012. The increase is offset by an increase in base management fees, incentive management fees and interest expense and fees related to the Credit Facility.

***Net realized gain or loss***

Net realized gain of \$2,799,343 for the three months ended September 30, 2012 was the result of \$2,437,334 in net gains realized from the disposition of our investments and \$362,009 in net gain realized on foreign currency transactions. Net realized gain of \$1,135,851 for the three months ended September 30, 2011 was the result of \$453,768 in net gains realized from the disposition of our investments and \$682,083 in net gains realized on foreign currency transactions. Foreign currency gains mainly represent net gains on forward currency contracts used to mitigate the impact that changes in foreign exchange rates would have on our investments denominated in foreign currencies. Net realized gain on investments for the three months ended September 30, 2012 resulted primarily from the disposition of our investment in Conney Prime Holdings LLC. Nearly the entire net realized gain on investments represents amounts that had been reflected in unrealized appreciation on investments in prior periods.

***Net unrealized appreciation or depreciation***

For the three months ended September 30, 2012, the change in net unrealized appreciation or depreciation on investments and foreign currency translation was a decrease in net unrealized appreciation of \$12,408,508. For the three months ended September 30, 2011, the change in net unrealized appreciation or depreciation was an increase in net unrealized depreciation of \$9,162,980. The decrease in net unrealized appreciation for the three months ended September 30, 2012 was comprised of a decrease in net unrealized appreciation on investments of \$11,262,047 and a net unrealized foreign currency translation loss of \$1,146,461. The increase in net unrealized depreciation for the three months ended September 30, 2011 was comprised of an increase in net unrealized depreciation on investments of \$10,419,767 and a net unrealized foreign currency translation gain of \$1,256,787. The decrease in net unrealized appreciation on investments for the three months ended September 30, 2012 includes reversals of prior periods' net unrealized appreciation as a result of investment dispositions. For the three months ended September 30, 2012, certain of our portfolio companies had strong performance while there was underperformance in certain others.

***Net increase in net assets resulting from operations***

The net increase in net assets resulting from operations for the three months ended September 30, 2012 and 2011 was an increase of \$14,329,107 and \$12,937,484, respectively. As compared to the prior period, the increase primarily reflects an increase in investment income, slightly offset by an increase in total expenses and net realized and unrealized losses for the three months ended September 30, 2012.

*Results comparisons for the nine months ended September 30, 2012 and 2011.*

***Investment income***

Investment income totaled \$109,393,044 and \$95,513,943, respectively, for the nine months ended September 30, 2012 and 2011, of which \$66,980,456 and \$47,411,616 were attributable to interest and fees on senior secured loans, \$41,697,592 and \$44,655,342 to interest earned on other debt securities, \$706,157 and \$3,385,077 to dividends from equity securities, \$8,839 and \$24,408 to interest earned on cash equivalents and zero and \$37,500 to other income, respectively.

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The increase in investment income for the nine months ended September 30, 2012 reflects a larger overall portfolio as a result of the deployment of debt capital under our credit facility. Although there was a slight decline in total investments at their current cost basis over the nine month period ended September 30, 2012, the average of our total investments at amortized cost for the nine month period ended September 30, 2012 was \$1,114,769,882, compared to \$1,002,121,455 for the nine month period ended September 30, 2011, also contributing to our increase in investment income.

### ***Expenses***

Expenses for the nine months ended September 30, 2012 and 2011 were \$44,047,323 and \$33,933,462, respectively, which consisted of \$16,877,541 and \$14,547,503 in base management fees, \$14,917,849 and \$11,902,630 in interest expense and fees related to the Credit Facility, \$5,177,662 and zero in incentive management fees, \$1,890,236 and \$1,871,184 in amortization of debt issuance costs, \$1,080,582, and \$1,345,608 in professional fees and \$1,364,420 and \$1,176,450 in Advisor expenses, \$416,608 and \$866,121 in administrative services, \$347,063 and \$309,269 in director fees and \$1,975,362 and \$1,914,697 in other expenses, respectively. The increase in base management fees reflects the overall growth of our portfolio. The increase in interest and credit facility related expenses were due to increased borrowings under our Credit Facility.

### ***Net investment income***

Net investment income was \$65,345,721 and \$61,580,481 for the nine months ended September 30, 2012 and 2011, respectively. The increase is primarily a result of an increase in investment income, partially offset by an increase in base management and incentive management fees, as well as interest and credit facility related expenses.

### ***Net realized gain or loss***

Net realized loss of \$73,433,864 for the nine months ended September 30, 2012 was the result of \$73,216,161 in net losses realized from the disposition of our investments and \$217,703 in net loss realized on foreign currency transactions. Net realized loss on investments for the nine months ended September 30, 2012 resulted primarily from the disposition of our debt and equity investments in Big Dumpster Acquisition, Inc. et al. as well as the restructuring of our equity investment in WBS Group Holdings, LLC. Nearly the entire net realized loss on investments represents amounts that had been reflected in unrealized depreciation on investments in prior periods. Foreign currency gains and losses are attributable to forward currency contracts used to mitigate the impact that changes in foreign exchange rates would have on our investments denominated in foreign currencies. Net realized loss of \$42,439,614 for the nine months ended September 30, 2011 was the result of \$41,943,434 in net losses realized from the disposition of our investments and \$496,180 in net losses realized on foreign currency transactions.

### ***Net unrealized appreciation or depreciation***

For the nine months ended September 30, 2012, the change in net unrealized appreciation or depreciation was a decrease in net unrealized depreciation of \$63,697,634. For the nine months ended September 30, 2011, the change in net unrealized appreciation or depreciation was a decrease in net unrealized depreciation of \$50,729,885. The decrease in net unrealized depreciation for the nine months ended September 30, 2012 was comprised of a decrease in net unrealized depreciation on investments of \$63,365,688 and a net unrealized foreign currency translation gain of \$331,946. The decrease was mainly attributable to the reversal of unrealized losses realized during the nine months ended September 30, 2012. The decrease in net unrealized depreciation for the nine months ended September 30, 2011 was comprised of a decrease in net unrealized depreciation on investments of \$49,181,639 and a net unrealized foreign currency translation gain of \$1,548,246.

***Net increase or decrease in net assets resulting from operations***

The net increase in net assets resulting from operations for the nine months ended September 30, 2012 and 2011 was an increase of \$55,609,491 and \$69,870,752, respectively. As compared to the prior period, the decrease primarily reflects an increase in net investment income offset by a net increase in realized and unrealized losses for the nine months ended September 30, 2012.

***Supplemental Non-GAAP information***

We report our financial results on a GAAP basis; however, management believes that evaluating our ongoing operating results may be enhanced if investors have additional non-GAAP basis financial measures. Management reviews non-GAAP financial measures to assess ongoing operations and, for the reasons described below, considers them to be effective indicators, for both management and investors, of our financial performance over time. Management does not advocate that investors consider such non-GAAP financial measures in isolation from, or as a substitute for, financial information prepared in accordance with GAAP.

We record our liability for Incentive Fees as we become legally obligated to pay them, based on a hypothetical liquidation at the end of each reporting period. Our obligation to pay Incentive Fees with respect to any fiscal quarter is based on a formula that reflects our results over a trailing four-fiscal quarter period ending with the current fiscal quarter. We are legally obligated to pay the amount resulting from the formula less any cash payments of Incentive Fees during the prior three quarters. The formula's requirement to reduce the Incentive Fees by amounts paid with respect to Incentive Fees in the prior three quarters has caused our Incentive Fees expense to become, generally concentrated in the fourth quarter of each year. Management believes that reflecting Incentive Fees throughout the year, as the related investment income is earned on a quarterly basis, is an effective measure of our profitability and financial performance that facilitates comparison of current results with historical results and with those of our peers. Our "as adjusted" results reflect Incentive Fees based on the formula we utilize for each trailing four-fiscal quarter period, with the formula applied to the current quarter's incremental earnings and without any reduction for Incentive Fees paid during the prior three quarters. The resulting amount represents an upper limit of each quarter's incremental Incentive Fees that we may become legally obligated to pay at the end of the year. Prior year amounts are estimated in the same manner. These estimates represent upper limits because, in any calendar year, subsequent quarters' investment underperformance could reduce the Incentive Fees payable with respect to prior quarters' operating results. Similarly, we record our liability for Incentive Fees based on capital gains by performing a hypothetical liquidation at the end of each reporting period. The accrual of this hypothetical capital gains incentive fee is required by GAAP, but it should be noted that a fee so calculated and accrued is not due and payable until the end of the measurement period, or every June 30. The incremental Incentive Fees disclosed for a given period are not necessarily indicative of actual full year results. Changes in the economic environment, financial markets and other parameters used in determining such estimates could cause actual results to differ and such differences could be material. See Note 3 to the consolidated financial statements in this Quarterly Report for a more detailed description of the Company's incentive management fee.



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Computations for all periods are derived from our consolidated financial statements as follows:

	Three months ended <u>September 30, 2012</u>	Three months ended <u>September 30, 2011</u>	Nine months ended <u>September 30, 2012</u>	Nine months ended <u>September 30, 2011</u>
GAAP incentive management fee expense based on Income	\$ —	\$ —	\$ 2,213,859	\$ —
GAAP incentive management fee expense based on Gains	2,963,803	—	2,963,803	—
Incremental incentive management fee expense based on Income	5,013,423	2,956,399	11,425,802	8,070,524
<b>GAAP Basis:</b>				
Net Investment Income	\$ 23,938,272	\$ 20,964,613	\$ 65,345,721	\$ 61,580,481
Net Increase in Net Assets from Operations	14,329,107	12,937,484	55,609,491	69,870,752
Net Investment Income per share	0.32	0.29	0.89	0.84
Net Increase in Net Assets from Operations per share	0.19	0.18	0.76	0.96
<b>Pre-Incentive Fee<sup>1</sup>:</b>				
Net Investment Income	\$ 26,902,075	\$ 20,964,613	\$ 68,309,524	\$ 61,580,481
Net Increase in Net Assets from Operations	17,292,910	12,937,484	58,573,294	69,870,752
Net Investment Income per share	0.37	0.29	0.93	0.84
Net Increase in Net Assets from Operations per share	0.23	0.18	0.80	0.96
<b>As Adjusted<sup>2</sup>:</b>				
Net Investment Income	\$ 21,888,652	\$ 18,008,214	\$ 59,097,581	\$ 53,509,957
Net Increase in Net Assets from Operations	12,279,487	9,981,085	49,361,351	61,800,228
Net Investment Income per share	0.30	0.25	0.80	0.73
Net Increase in Net Assets from Operations per share	0.17	0.14	0.67	0.85

**Pre-Incentive Fee<sup>1</sup>:** Amounts reflect our ongoing operating results and are the most effective indicator of our financial performance over time. Amounts are adjusted to remove the incentive management fee expense based on Gains, as required by GAAP.

**As Adjusted<sup>2</sup>:** Amounts are adjusted to remove the incentive management fee expense based on Gains, as required by GAAP, and to include the incremental incentive management fee expense based on Income. The incremental incentive fee is based on the formula utilized for each trailing four-fiscal quarter period, with the formula applied to the current quarter's incremental earnings, and without any reduction for incentive management fees paid during the prior three quarters.

### **Financial condition, liquidity and capital resources**

During the nine months ended September 30, 2012, we generated operating cash flows primarily from interest earned and fees received on senior secured loans and other debt securities, as well as from sales of selected portfolio company investments or repayments of principal.

Net cash provided by operating activities during the nine months ended September 30, 2012 was \$6,561,332. Our primary sources of cash from operating activities during the period consisted of a net increase in

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net assets from operations of \$55,609,491, which was offset by purchases of investments in portfolio companies (net of sales and repayments) of \$34,984,970.

Net cash used in financing activities during the nine months ended September 30, 2012 was \$11,363,972. Our primary source of cash for financing activities was \$41,600,000 in proceeds from borrowings, net of repayments under the Credit Facility. This source was more than offset by the use of cash for dividend distributions of \$52,963,972.

Our senior secured, multi-currency Credit Facility provides us with \$375,000,000 in total availability, consisting of \$275,000,000 of revolving loan commitments and \$100,000,000 of term loan commitments. The Credit Facility is secured by substantially all of the assets in the Company's portfolio, including cash and cash equivalents. The Credit Facility has a stated maturity date of December 6, 2013 and the interest rate applicable to borrowings thereunder is generally LIBOR plus an applicable spread of either 3.00% or 3.25% for revolving loans, based on a pricing grid depending on the Company's credit rating, and LIBOR plus 3.00% for term loans. The Credit Facility does not contain a LIBOR floor requirement. At September 30, 2012, the effective LIBOR spread under the Credit Facility was 3.13%. Term loan commitments under the Credit Facility have been fully drawn and, once repaid, may not be reborrowed. The Credit Facility also includes an "accordion" feature that allows the Company, under certain circumstances, to increase the size of the Credit Facility by up to an additional \$275,000,000 of revolving loan commitments and \$250,000,000 of term loan commitments. The Credit Facility is used to supplement the Company's equity capital to make additional portfolio investments and for other general corporate purposes. At September 30, 2012, we had \$209,600,000 drawn and outstanding under the Credit Facility, with \$165,400,000 available to us, subject to compliance with customary affirmative and negative covenants, including the maintenance of a minimum stockholders' equity, the maintenance of a ratio of not less than 200% of total assets (less total liabilities other than indebtedness) to total indebtedness, and restrictions on certain payments and issuance of debt. At September 30, 2012, the Company was in compliance with regulatory coverage requirements with an asset coverage ratio of approximately 282% and was in compliance with all financial covenants under our debt agreements. In addition, borrowings under the Credit Facility (and the incurrence of certain other permitted debt) are subject to compliance with a borrowing base that applies different advance rates to different types of assets in the Company's portfolio.

In January 2011, the Company closed a private placement issuance of \$158,000,000 in aggregate principal amount of Senior Secured Notes with a fixed interest rate of 6.50% and a maturity date of January 18, 2016 and \$17,000,000 million in aggregate principal amount of Senior Secured Notes with a fixed interest rate of 6.60% and a maturity date of January 18, 2018. Interest on the Senior Secured Notes is due semi-annually on January 18 and July 18, commencing on July 18, 2011. The proceeds from the issuance of the Senior Secured Notes were used to fund new portfolio investments, reduce outstanding borrowings under the Credit Facility and for general corporate purposes. The Senior Secured Notes contain customary affirmative and negative covenants substantially similar to those in our Credit Facility. At September 30, 2012, we were in compliance with all financial and operational covenants required by the Credit Facility and Senior Secured Notes.

At September 30, 2012, we had \$2,976,746 in cash and cash equivalents.

The primary use of existing funds is expected to be purchases of investments in portfolio companies, cash distributions to our stockholders, repayment of indebtedness and other general corporate purposes.

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### **Contractual obligations**

A summary of our significant contractual payment obligations for the repayment of outstanding borrowings at September 30, 2012 is as follows:

	Payments Due By Period (dollars in millions)				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Credit Facility(1)	\$209.6	\$ —	\$ 209.6	\$ —	\$ —
Senior Secured Notes	175.0	—	—	158.0	17.0
Interest and Credit Facility Fees Payable	2.8	2.8	—	—	—

(1) At September 30, 2012, \$165.4 million remained unused under our Credit Facility.

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

In the normal course of business, the Company may enter into guarantees on behalf of portfolio companies. Under these arrangements, the Company would be required to make payments to third parties if the portfolio companies were to default on their related payment obligations. The Company has no such guarantees outstanding at September 30, 2012.

### **Dividends**

Our quarterly dividends, if any, are determined by our Board of Directors. Dividends are declared considering our estimate of annual taxable income available for distribution to stockholders and the amount of taxable income carried over from the prior year for distribution in the current year. We cannot assure stockholders that they will receive any dividends and distributions at all or dividends and distributions at a particular level. The following table lists the quarterly dividend per share from our common stock since September 2010.

Dividend Amount Per Share Outstanding	Record Date	Payment Date
\$0.32	September 17, 2010	October 1, 2010
\$0.32	December 20, 2010	January 3, 2011
\$0.32	March 18, 2011	April 1, 2011
\$0.26	June 17, 2011	July 1, 2011
\$0.26	September 19, 2011	October 3, 2011
\$0.26	December 21, 2011	January 4, 2012
\$0.26	March 20, 2012	April 3, 2012
\$0.26	June 19, 2012	July 3, 2012
\$0.26	September 19, 2012	October 3, 2012
\$0.26	December 20, 2012	January 3, 2013

Tax characteristics of all dividends are reported to stockholders on Form 1099 after the end of the calendar year.

We have elected to be treated as a RIC under Subchapter M of the Code. In order to maintain favorable RIC tax treatment, we must distribute annually to our stockholders at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of the assets legally available for distribution. Under the Regulated Investment Company Modernization Act of 2010, capital losses incurred by the Company after December 31, 2010 will not be subject to expiration. In addition, such losses must be utilized prior to the losses incurred in the years preceding enactment. In order to avoid certain excise taxes imposed on RICs, we must distribute during each calendar year an amount at least equal to the sum of:

- 98% of our ordinary income for the calendar year;

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- 98.2% of our capital gains in excess of capital losses for the one-year period ending on October 31st; and
- any ordinary income and net capital gains for preceding years that were not distributed during such years.

We maintain an “opt out” dividend reinvestment plan for our common stockholders. As a result, except as discussed below, if we declare a dividend, stockholders’ cash dividends will be automatically reinvested in additional shares of our common stock, unless they specifically “opt out” of the dividend reinvestment plan so as to receive cash dividends. With respect to our dividends and distributions paid to stockholders during the nine months ended September 30, 2012 and 2011, dividends reinvested pursuant to our dividend reinvestment plan totaled \$4,291,772 and \$6,294,969, respectively.

Under the terms of an amendment to our dividend reinvestment plan adopted on March 4, 2009, dividends may be paid in newly issued or treasury shares of our common stock at a price equal to 95% of the market price on the dividend payment date. This feature of the plan means that, under certain circumstances, we may issue shares of our common stock at a price below net asset value per share, which could cause our stockholders to experience dilution. We may not be able to achieve operating results that will allow us to make dividends and distributions at a specific level or to increase the amount of these dividends and distributions from time to time. Also, we may be limited in our ability to make dividends and distributions due to the asset coverage test applicable to us as a BDC under the 1940 Act and due to provisions in our existing and future debt arrangements. If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including possible loss of favorable RIC tax treatment. In addition, in accordance with U.S. generally accepted accounting principles and tax regulations, we include in income certain amounts that we have not yet received in cash, such as payment-in-kind interest, which represents contractual interest added to the loan balance that becomes due at the end of the loan term, or the accrual of original issue or market discount. Since we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute at least 90% of our investment company taxable income to obtain tax benefits as a RIC and may be subject to an excise tax. In order to satisfy the annual distribution requirement applicable to RICs, we have the ability to declare a large portion of a dividend in shares of our common stock instead of in cash. As long as a portion of such dividend is paid in cash (which portion can be as low as 10% for our taxable years ending prior to 2012) and certain requirements are met, the entire distribution would be treated as a dividend for U.S. federal income tax purposes.

With respect to dividends paid to stockholders, certain income we receive from origination, structuring, closing, commitment and other upfront fees associated with investments in portfolio companies may cause our taxable income to exceed our GAAP income although the differences are expected to be temporary in nature.

### **Recent developments**

On May 2, 2012, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to \$1,500,000,000 of our common stock, preferred stock, debt securities, warrants representing rights to purchase shares of our common stock, preferred stock or debt securities and subscription rights, or units in the public market.

On November 7, 2012, the Company’s Board of Directors declared a dividend of \$0.26 per share, payable on January 3, 2013 to stockholders of record at the close of business on December 20, 2012.

Notice is hereby given in accordance with Section 23(c) of the 1940 Act that from time to time the Company may purchase shares of its common stock in the open market at prevailing market prices.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are subject to financial market risks, including changes in interest rates. At September 30, 2012, 51% of our debt investments bore interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime

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Rate. The interest rates on such investments generally reset by reference to the current market index after one to six months. At September 30, 2012, the percentage of our total debt investments that bore floating rate interest based on an interest rate floor was 46%. Floating rate investments subject to a floor generally reset by reference to the current market index after one to six months only if the index exceeds the floor.

To illustrate the potential impact of changes in interest rates, the Administrator provided the following analysis based on our September 30, 2012 balance sheet and assuming no changes in our investment structure. Net asset value is analyzed using the assumptions that interest rates, as defined by the LIBOR and U.S. Treasury yield curves, increase or decrease and that the yield curves of the rate shocks will be parallel to each other. Under this analysis, an instantaneous 100 basis point increase in LIBOR and U.S. Treasury yields would cause an increase of approximately \$1,000,000, or \$0.01 per share, in the value of our net assets at September 30, 2012 and a corresponding 100 basis point decrease in LIBOR and U.S. Treasury yields would cause a decrease of approximately \$1,200,000, or \$0.02 per share, in the value of our net assets on that date.

While hedging activities may help to insulate us against adverse changes in interest rates, they also may limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments. During the three and nine months ended September 30, 2012 and 2011, we did not engage in any interest rate hedging activity.

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

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our current disclosure controls and procedures are effective in timely alerting them to material information relating to us that is required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934.

There have been no changes in our internal control over financial reporting that occurred during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

From time to time, we and the Advisor may be a party to certain legal proceedings incidental to the normal course of our business, including the enforcement of our rights under contracts with our portfolio companies. While we cannot predict the outcome of these legal proceedings with certainty, we do not expect that these proceedings will have a material effect on our consolidated financial statements.

### **Item 1A. Risk Factors**

There have been no material changes from the risk factors previously disclosed in our most recent Form 10-K filing.

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

#### **Sales of unregistered securities**

None.

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**Issuer purchases of equity securities**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. [Reserved]**

**Item 5. Other Information**

None.

**Item 6. Exhibits.**

(a) Exhibits.

- 31.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

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

BLACKROCK KELSO CAPITAL CORPORATION

Date: November 8, 2012

By: /s/ James R. Maher

**James R. Maher**  
Chief Executive Officer

Date: November 8, 2012

By: /s/ Corinne Pankovcin

**Corinne Pankovcin**  
Chief Financial Officer

CEO CERTIFICATION

I, James R. Maher, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of BlackRock Kelso Capital Corporation;

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 consolidated financial condition, consolidated results of operations and consolidated cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer 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, including its consolidated subsidiaries, 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 consolidated 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; and

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 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 and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2012

By: /s/ James R. Maher

James R. Maher

Chairman of the Board and Chief Executive Officer



CFO CERTIFICATION

I, Corinne Pankovcin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of BlackRock Kelso Capital Corporation;

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 consolidated financial condition, consolidated results of operations and consolidated cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer 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, including its consolidated subsidiaries, 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 consolidated 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; and

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 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 and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2012

By: /s/ Corinne Pankovcin  
Corinne Pankovcin  
Chief Financial Officer and Treasurer

**Certification of CEO and CFO Pursuant to  
18 U.S.C. Section 1350,  
as Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report on Form 10-Q of BlackRock Kelso Capital Corporation (the "Company") for the quarter ended September 30, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), James R. Maher, as Chief Executive Officer of the Company, and Corinne Pankovcin, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the consolidated financial condition and consolidated results of operations of the Company.

/s/ James R. Maher

Name: James R. Maher  
Title: Chief Executive Officer  
Date: November 8, 2012

/s/ Corinne Pankovcin

Name: Corinne Pankovcin  
Title: Chief Financial Officer  
Date: November 8, 2012