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

FORM 10-Q

(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, 2009

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

BLACKROCK KELSO CAPITAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

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

40 East 52nd Street, New York, NY
(Address of Principal Executive Offices)

10022
(Zip Code)

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

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 5, 2009 was 56,475,196.

[Table of Contents](#)

BLACKROCK KELSO CAPITAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2009

Table of Contents

	<u>INDEX</u>	<u>PAGE NO.</u>
PART I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements	
	Statements of Assets and Liabilities as of September 30, 2009 and December 31, 2008 (unaudited)	4
	Statements of Operations for the three and nine months ended September 30, 2009 and 2008 (unaudited)	5
	Statements of Changes in Net Assets for the nine months ended September 30, 2009 and 2008 (unaudited)	6
	Statements of Cash Flows for the nine months ended September 30, 2009 and 2008 (unaudited)	7
	Schedules of Investments as of September 30, 2009 and December 31, 2008 (unaudited)	8
	Notes to Financial Statements (unaudited)	22
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	33
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	40
Item 4.	Controls and Procedures	40
PART II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	40
Item 1A.	Risk Factors	40
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	41
Item 3.	Defaults Upon Senior Securities	41
Item 4.	Submission of Matters to a Vote of Security Holders	41
Item 5.	Other Information	41
Item 6.	Exhibits	42
	SIGNATURES	43

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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 ability of BlackRock Kelso Capital Advisors LLC, our investment advisor (the “Advisor”), to locate suitable investments for us and to monitor and administer our investments;
- 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.

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.

[Table of Contents](#)**PART 1. FINANCIAL INFORMATION**

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

Item 1. Financial Statements

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

	September 30, 2009	December 31, 2008
Assets:		
Investments at fair value:		
Non-controlled, non-affiliated investments (amortized cost of \$1,011,492,301 and \$1,115,354,825)	\$ 843,297,117	\$ 875,633,291
Non-controlled, affiliated investments (amortized cost of \$63,497,562 and \$64,268,941)	26,884,202	40,015,080
Controlled investments (amortized cost of \$69,902,772 and \$56,207,945)	10,495,706	11,196,555
Total investments at fair value (amortized cost of \$1,144,892,635 and \$1,235,831,711)	880,677,025	926,844,926
Cash equivalents	162,880	15,024,972
Cash denominated in foreign currencies (cost of \$342,871 and \$764,413)	349,803	761,299
Unrealized appreciation on forward foreign currency contracts	—	717,972
Interest receivable	16,496,729	16,300,537
Dividends receivable	6,174,061	4,161,246
Prepaid expenses and other assets	1,961,554	2,380,988
Total Assets	<u>\$ 905,822,052</u>	<u>\$ 966,191,940</u>
Liabilities:		
Payable for investments purchased	\$ 1,850,238	\$ 1,005,101
Unrealized depreciation on forward foreign currency contracts	408,512	1,054,165
Credit facility payable	347,500,000	426,000,000
Interest payable on credit facility	273,677	835,491
Dividend distributions payable	9,015,440	19,463,166
Base management fees payable	4,555,811	5,725,029
Accrued administrative services	189,957	170,445
Other accrued expenses and payables	1,652,122	1,643,042
Total Liabilities	<u>365,445,757</u>	<u>455,896,439</u>
Net Assets:		
Common stock, par value \$.001 per share, 100,000,000 common shares authorized, 57,308,179 and 55,670,594 issued and 56,346,500 and 55,292,487 outstanding	57,308	55,671
Paid-in capital in excess of par	826,790,721	818,627,914
Undistributed net investment income	48,174,028	3,855,016
Accumulated net realized gain (loss)	(64,606,945)	243,475
Net unrealized depreciation	(264,612,917)	(309,295,567)
Treasury stock at cost, 961,679 and 378,107 shares held	(5,425,900)	(3,191,008)
Total Net Assets	540,376,295	510,295,501
Total Liabilities and Net Assets	<u>\$ 905,822,052</u>	<u>\$ 966,191,940</u>
Net Asset Value Per Share	\$ 9.59	\$ 9.23

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

BlackRock Kelso Capital Corporation
Statements of Operations (Unaudited)

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Investment Income:				
From non-controlled, non-affiliated investments:				
Interest	\$ 27,636,401	\$ 35,516,763	\$ 90,126,212	\$ 101,133,085
Dividends	451,908	472,562	1,322,664	1,257,265
Other income	—	16,142	—	18,438
From non-controlled, affiliated investments:				
Interest	753,690	1,170,717	1,668,208	3,525,042
Dividends	279,079	257,618	820,493	994,668
From controlled investments:				
Interest	238,408	11,910	672,837	1,085,667
Total investment income	<u>29,359,486</u>	<u>37,445,712</u>	<u>94,610,414</u>	<u>108,014,165</u>
Expenses:				
Base management fees	4,555,811	5,841,124	13,951,061	16,991,573
Interest and credit facility fees	1,456,369	4,311,893	5,004,980	13,818,524
Investment advisor expenses	341,872	283,301	1,028,939	822,150
Professional fees	342,878	622,532	949,444	1,461,003
Administrative services	174,490	261,744	605,525	867,177
Amortization of debt issuance costs	172,031	149,068	511,520	482,493
Insurance	152,181	119,781	413,406	396,217
Director fees	84,083	82,450	268,238	275,185
Other	298,190	191,941	808,935	840,365
Total expenses	<u>7,577,905</u>	<u>11,863,834</u>	<u>23,542,048</u>	<u>35,954,687</u>
Net Investment Income	<u>21,781,581</u>	<u>25,581,878</u>	<u>71,068,366</u>	<u>72,059,478</u>
Realized and Unrealized Gain (Loss):				
Net realized gain (loss):				
Non-controlled, non-affiliated investments	(55,331,272)	187,711	(62,394,229)	314,350
Non-controlled, affiliated investments	—	—	12,240	112,783
Foreign currency	(981,390)	(158,501)	(2,468,431)	(1,710,861)
Net realized gain (loss)	<u>(56,312,662)</u>	<u>29,210</u>	<u>(64,850,420)</u>	<u>(1,283,728)</u>
Net change in unrealized appreciation or depreciation on:				
Non-controlled, non-affiliated investments	82,569,638	(36,330,023)	71,526,349	(94,515,860)
Non-controlled, affiliated investments	(13,462,326)	(1,700,589)	(22,434,442)	(7,966,047)
Controlled investments	(1,969,822)	(9,392,438)	(4,320,733)	(18,419,671)
Foreign currency translation	(1,460,443)	3,018,444	(88,524)	3,718,130
Net change in unrealized appreciation or depreciation	<u>65,677,047</u>	<u>(44,404,606)</u>	<u>44,682,650</u>	<u>(117,183,448)</u>
Net realized and unrealized gain (loss)	<u>9,364,385</u>	<u>(44,375,396)</u>	<u>(20,167,770)</u>	<u>(118,467,176)</u>
Net Increase (Decrease) in Net Assets Resulting from Operations	<u>\$ 31,145,966</u>	<u>\$ (18,793,518)</u>	<u>\$ 50,900,596</u>	<u>\$ (46,407,698)</u>
Net Investment Income Per Share	<u>\$ 0.39</u>	<u>\$ 0.47</u>	<u>\$ 1.28</u>	<u>\$ 1.34</u>
Earnings (Loss) Per Share	<u>\$ 0.55</u>	<u>\$ (0.34)</u>	<u>\$ 0.91</u>	<u>\$ (0.87)</u>
Basic and Diluted Weighted-Average Shares Outstanding	56,338,835	54,632,752	55,738,396	53,588,041

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

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

	<u>Nine months ended September 30, 2009</u>	<u>Nine months ended September 30, 2008</u>
Net Increase (Decrease) in Net Assets Resulting from Operations:		
Net investment income	\$ 71,068,366	\$ 72,059,478
Net realized gain (loss)	(64,850,420)	(1,283,728)
Net change in unrealized appreciation or depreciation	44,682,650	(117,183,448)
Net increase (decrease) in net assets resulting from operations	<u>50,900,596</u>	<u>(46,407,698)</u>
Dividend Distributions to Stockholders from:		
Net investment income	<u>(26,749,354)</u>	<u>(69,111,601)</u>
Capital Share Transactions:		
Reinvestment of dividends	8,164,444	28,689,398
Purchases of treasury stock	(2,234,892)	(193,078)
Net increase in net assets resulting from capital share transactions	<u>5,929,552</u>	<u>28,496,320</u>
Total Increase (Decrease) in Net Assets	<u>30,080,794</u>	<u>(87,022,979)</u>
Net assets at beginning of period	510,295,501	728,191,869
Net assets at end of period	<u>\$ 540,376,295</u>	<u>\$ 641,168,890</u>
Capital Share Activity:		
Shares issued from reinvestment of dividends	1,637,585	2,845,485
Purchases of treasury stock	(583,572)	(20,348)
Total increase in shares	<u>1,054,013</u>	<u>2,825,137</u>
Undistributed (distributions in excess of) net investment income	<u>\$ 48,174,028</u>	<u>\$ (2,463,476)</u>

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

BlackRock Kelso Capital Corporation
Statements of Cash Flows (Unaudited)

	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Operating Activities:		
Net increase (decrease) in net assets resulting from operations	\$ 50,900,596	\$ (46,407,698)
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided by (used in) operating activities:		
Purchases of long-term investments	(38,173,072)	(183,326,767)
Purchases of foreign currency—net	(3,989,829)	(1,544,873)
Proceeds from sales/repayments of long-term investments	72,248,410	112,069,141
Net change in unrealized appreciation or depreciation on investments	(44,771,174)	120,901,578
Net change in unrealized appreciation or depreciation on foreign currency translation	88,524	(3,718,130)
Net realized loss (gain) on investments	62,381,989	(427,133)
Net realized loss on foreign currency	2,468,431	1,710,861
Amortization of premium/discount—net	(4,023,105)	(2,280,622)
Amortization of debt issuance costs	511,520	482,493
Increase in interest receivable	(196,192)	(4,864,981)
Increase in dividends receivable	(2,012,815)	(1,628,586)
Increase in prepaid expenses and other assets	(92,086)	(1,151,632)
Increase in payable for investments purchased	845,137	1,060,000
Decrease in interest payable on credit facility	(561,814)	(282,273)
Increase (decrease) in base management fees payable	(1,169,218)	234,911
Increase (decrease) in accrued administrative services	19,512	(98,377)
Increase in other accrued expenses and payables	9,080	462,939
Net cash provided by (used in) operating activities	<u>94,483,894</u>	<u>(8,809,149)</u>
Financing Activities:		
Dividend distributions paid	(29,032,636)	(43,732,809)
Borrowings under credit facility	42,200,000	202,700,000
Repayments under credit facility	(120,700,000)	(93,000,000)
Decrease in deferred debt issuance costs	—	20,000
Purchases of treasury stock	(2,234,892)	(193,078)
Net cash provided by (used in) financing activities	<u>(109,767,528)</u>	<u>65,794,113</u>
Effect of exchange rate changes on cash and cash equivalents	10,046	(10,162)
Net increase (decrease) in cash	(15,273,588)	56,974,802
Cash and cash equivalents, beginning of period	15,786,271	5,088,559
Cash and cash equivalents, end of period	<u>\$ 512,683</u>	<u>\$ 62,063,361</u>
Supplemental disclosure of cash flow information and non-cash financing activities:		
Cash paid during period for:		
Interest	\$ 5,340,869	\$ 13,893,802
Franchise, excise and income taxes	\$ 500,051	\$ 93,449
Dividend distributions reinvested	\$ 8,164,444	\$ 28,689,398

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

BlackRock Kelso Capital Corporation
Schedules of Investments (Unaudited)
September 30, 2009

Portfolio Company	Industry	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
Senior Secured Notes—9.6%				
AGY Holding Corp., Second Lien, 11.00%, 11/15/14	Glass Yarns/ Fibers	\$ 23,500,000	\$ 23,118,044	\$ 21,690,500
TriMark Acquisition Corp., Second Lien, 11.50% (9.50% cash, 2.00% PIK), 11/30/13	Food Service Equipment	31,191,106	31,191,106	30,037,035
Total Senior Secured Notes			<u>54,309,150</u>	<u>51,727,535</u>
Unsecured Debt—27.0%				
ASM Intermediate Holdings Corp. II, 12.00% PIK, 12/27/13	Marketing Services	55,693,806	55,693,806	53,521,748
BE Foods, Inc., 6.00% (LIBOR + 5.00% cash or 5.75% PIK), 7/11/12	Food	26,175,516	25,683,844	24,212,352
Big Dumpster Acquisition, Inc., 13.50% PIK, 7/5/15	Waste Management Equipment	41,459,008	41,459,008	14,386,276
Marquette Transportation Company Holdings, LLC, 14.75% PIK, 3/21/14	Transportation	52,253,576	52,253,576	50,476,954
Marsico Parent Holdco, LLC et al., 12.50% PIK, 7/15/16, acquired 11/28/07(c)	Financial Services	10,937,947	10,937,947	2,220,403
Marsico Parent Superholdco, LLC et al., 14.50% PIK, 1/15/18, acquired 11/28/07(c)	Financial Services	7,518,656	7,206,363	1,150,354
Total Unsecured Debt			<u>193,234,544</u>	<u>145,968,087</u>
Subordinated Debt—24.0%				
A & A Manufacturing Co., Inc., 16.00% (12.00% cash, 4.00% PIK), 4/2/14	Protective Enclosures	19,445,017	19,445,017	16,042,139
Al Solutions, Inc., 16.00% PIK, 12/29/13(d)(e)	Metals	13,680,233	13,377,144	—
Conney Safety Products, LLC, 18.00% (16.00% cash, 2.00% PIK), 10/1/14	Safety Products	30,150,000	30,150,000	24,723,000
DynaVox Systems LLC, 15.00%, 6/23/15	Augmentative Communication Products	25,000,000	25,000,000	25,000,000
Mattress Giant Corporation, 11.00% PIK, 12/31/12(f)	Bedding —Retail	5,590,410	2,096,679	3,555,501
MediMedia USA, Inc., 11.38%, 11/15/14, acquired multiple dates(c)	Information Services	8,000,000	8,060,448	6,400,000
The Pay-O-Matic Corp., 14.00% (12.00% cash, 2.00% PIK), 1/15/15	Financial Services	15,366,867	15,366,867	15,366,867
PGA Holdings, Inc., 12.50%, 3/12/16	Healthcare Services	5,000,000	4,919,869	5,000,000
Sentry Security Systems, LLC, 16.00% (14.00% cash, 2.00% PIK), 8/7/12	Security Services	10,779,578	10,779,578	10,294,497
Tri-anim Health Services, Inc. et al., 14.00% (12.00% cash, 2.00% PIK), 6/4/15	Healthcare Products	15,021,667	15,021,667	15,021,667
U.S. Security Holdings, Inc., 13.00% (11.00% cash, 2.00% PIK), 5/8/14, acquired 5/10/06(c)	Security Services	7,000,000	7,000,000	5,250,000
Wastequip, Inc., 12.50% (10.00% cash, 2.50% PIK), 2/5/15	Waste Management Equipment	7,947,596	7,947,596	3,035,982
Total Subordinated Debt			<u>159,164,865</u>	<u>129,689,653</u>

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

BlackRock Kelso Capital Corporation
Schedules of Investments (Unaudited)—(Continued)
September 30, 2009

Portfolio Company	Industry	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
Senior Secured Loans—96.2%(g)				
Alpha Media Group Inc., First Lien, 12.00% PIK, 7/15/13	Publishing	\$ 3,846,250	\$ 2,459,606	\$ 2,202,128
Al Solutions, Inc., First Lien, 10.00%, 6/28/13(d)	Metals	150,000	147,231	150,000
American Residential Services L.L.C., Second Lien, 12.00% (10.00% cash, 2.00% PIK), 4/17/15	HVAC/ Plumbing Services	41,010,050	41,010,050	39,000,558
American Safety Razor Company, LLC, Second Lien, 6.54% (LIBOR + 6.25%), 1/30/14	Consumer Products	10,000,000	10,000,000	8,880,000
American SportWorks LLC, Second Lien, 20.00%, 6/27/14(d)(e)	Utility Vehicles	13,403,274	13,403,274	2,662,589
AmQuip Crane Rental LLC, Second Lien, 6.03% (LIBOR + 5.75%), 6/29/14	Construction Equipment	25,660,446	23,736,156	23,992,517
Applied Tech Products Corp. et al., Tranche A, First Lien, 7.75% (Base Rate + 4.50%), 10/24/10(e)	Plastic Packaging	731,669	730,460	282,329
Arclin US Holdings Inc., First Lien, 7.00% (Base Rate + 3.75%), 7/10/14(e)	Chemicals	6,423,655	3,186,548	5,877,900
Arclin US Holdings Inc., Second Lien, 10.75% (Base Rate + 7.50%), 7/10/15(e)	Chemicals	14,500,000	14,500,000	3,792,536
Bankruptcy Management Solutions, Inc., Second Lien, 6.50% (LIBOR + 6.25%), 7/31/13	Financial Services	24,250,000	24,250,000	18,163,250
The Bargain! Shop Holdings Inc., Term Loan A, First Lien, 14.50% (13.50% cash, 1.00% PIK), 6/29/12(h)	Discount Stores	13,697,214(i)	13,287,006	12,634,158
The Bargain! Shop Holdings Inc., Term Loan B, First Lien, 14.50% (13.50% cash, 1.00% PIK), 7/1/12(h)	Discount Stores	18,827,786(i)	17,624,090	17,366,541
Berlin Packaging L.L.C., Second Lien, 6.87% (LIBOR + 6.50%), 8/17/15	Rigid Packaging	24,000,000	23,470,124	22,056,000
Champion Energy Corporation et al., First Lien, 14.50%, 5/22/11	Heating and Oil Services	30,000,000	30,000,000	30,000,000
Custom Direct, Inc. et al., Second Lien, 6.28% (LIBOR + 6.00%), 12/31/14	Printing	10,000,000	10,000,000	7,690,000
Deluxe Entertainment Services Group Inc., Second Lien, 6.28% (LIBOR + 6.00%), 11/11/13	Entertainment	12,000,000	12,000,000	10,032,000
Electrical Components International, Inc., Second Lien, 11.50% (Base Rate + 8.25%), 5/1/14	Electronics	26,000,000	22,710,194	8,490,000
Event Rentals, Inc., Acquisition Loan, First Lien, 8.12% (LIBOR + 4.25% cash, 2.00% PIK), 12/19/13	Party Rentals	3,201,654	3,201,654	2,609,348
Facet Technologies, LLC, Second Lien, 17.50% PIK, 7/26/12	Medical Devices	32,852,264	32,852,264	12,812,383
Facet Technologies, LLC, Guaranty(j)	Medical Devices	—	—	(290,000)
Fairway Group Holdings Corp. et al., Term B Loan, First Lien, 11.25% (LIBOR + 7.75%), 1/18/13	Retail Grocery	1,470,000	1,467,980	1,470,000
Fairway Group Holdings Corp. et al., Term C Loan, Second Lien, 17.00%, 1/18/14	Retail Grocery	11,757,987	11,722,682	11,757,987

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

BlackRock Kelso Capital Corporation
Schedules of Investments (Unaudited)—(Continued)
September 30, 2009

Portfolio Company	Industry	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
Fitness Together Franchise Corporation, First Lien, 11.50% (9.50% cash, 2.00% PIK), 11/10/13(d)	Personal Fitness	\$ 6,986,848	\$ 6,986,848	\$ 6,008,690
Heartland Automotive Services II, Inc. et al., Term Loan A, First Lien, 7.25% (Base Rate + 4.00%), 1/30/14	Automobile Repair	3,325,862	3,324,358	3,016,557
Heartland Automotive Services II, Inc. et al., Term Loan B, First Lien, 9.25% (Base Rate + 4.00% cash, 2.00% PIK), 1/30/14	Automobile Repair	2,247,352	2,247,163	1,932,722
HIT Entertainment, Inc., Second Lien, 5.98% (LIBOR + 5.50%), 2/26/13	Entertainment	1,000,000	1,000,000	517,500
InterMedia Outdoor, Inc., Second Lien, 7.03% (LIBOR + 6.75%), 1/31/14	Printing/Publishing	10,000,000	10,000,000	8,320,000
Isola USA Corp., First Lien, 13.00% (Base Rate + 9.75%), 12/18/12	Electronics	10,901,316	9,929,700	9,495,046
Isola USA Corp., Second Lien, 17.75% (Base Rate + 14.50%), 12/18/13	Electronics	25,000,000	25,000,000	16,175,000
Kaz, Inc. et al., First Lien, 16.00% (12.00% cash, 4.00% PIK), 12/8/11	Consumer Products	13,364,224	13,276,643	13,364,224
LJVH Holdings Inc., Second Lien, 5.78% (LIBOR + 5.50%), 1/19/15(h)	Specialty Coffee	25,000,000	25,000,000	22,375,000
MCCI Group Holdings, LLC, Second Lien, 7.60% (LIBOR + 7.25%), 6/21/13	Healthcare Services	29,000,000	28,958,497	28,855,000
Navilyst Medical, Inc., Second Lien, 12.25%, 8/14/15	Healthcare Services	15,000,000	14,794,093	14,685,000
New Enterprise Stone & Lime Co., Inc., Second Lien, 12.50%, 7/11/14	Mining/Construction	35,000,000	34,738,922	35,000,000
Oriental Trading Company, Inc., Second Lien, 6.25% (LIBOR + 6.00%), 1/31/14	Party Supplies and Novelties	3,000,000	3,000,000	787,500
Penton Media, Inc. et al., Second Lien, 5.49% (LIBOR + 5.00%), 2/1/14(f)	Information Services	26,000,000	25,660,585	4,290,000
Physiotherapy Associates, Inc. et al., Second Lien, 12.00% (Base Rate + 8.75%), 12/31/13	Rehabilitation Centers	17,000,000	17,000,000	15,385,000
PQ Corporation, Second Lien, 6.75% (LIBOR + 6.50%), 7/30/15	Specialty Chemicals	10,000,000	8,923,998	8,190,000
Precision Parts International Services Corp. et al., First Lien, 8.00% (Base Rate + 4.75%), 9/30/11(e)	Automotive Parts	2,847,627	2,847,627	640,716
Premier Yachts, Inc. et al., Term A, First Lien, 4.00% (LIBOR + 3.75%), 8/22/12	Entertainment Cruises	6,300,327	6,285,151	6,300,327
Premier Yachts, Inc. et al., Term B, First Lien, 7.25% (LIBOR + 7.00%), 8/22/13	Entertainment Cruises	1,469,730	1,465,977	1,469,730
Sunrise Medical LTC LLC et al., Second Lien, 6.75% (LIBOR + 6.50%), 12/28/13	Healthcare Equipment	14,400,000	14,400,000	13,593,600
Total Safety U.S., Inc., Second Lien, 6.75% (LIBOR + 6.50%), 12/8/13	Industrial Safety Equipment	9,000,000	9,000,000	8,397,000
United Subcontractors, Inc., First Lien, 1.79% (LIBOR + 1.50%), 6/30/15(f)	Building and Construction	1,626,814	1,617,274	1,455,999
Water Pik, Inc., Second Lien, 5.75% (LIBOR + 5.50%), 6/15/14	Consumer Products	30,000,000	30,000,000	29,400,000

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

BlackRock Kelso Capital Corporation
Schedules of Investments (Unaudited)—(Continued)
September 30, 2009

<u>Portfolio Company</u>	<u>Industry</u>	<u>Principal Amount or Number of Shares/Units</u>	<u>Cost(a)</u>	<u>Fair Value(b)</u>
WBS Group LLC et al., Second Lien, 6.52% (LIBOR + 6.25%), 6/7/13	Software	\$ 20,000,000	\$ 20,000,000	\$ 17,000,000
Wembley, Inc., Second Lien, 8.50% (Base Rate + 5.25%), 8/23/12(e)	Gaming	1,000,000	1,000,000	67,500
Westward Dough Operating Company, LLC, Term Loan A, First Lien, 4.60% (LIBOR + 4.00%), 3/30/11	Restaurants	6,850,000	6,850,000	4,863,500
Westward Dough Operating Company, LLC, Term Loan B, First Lien, 7.60% (LIBOR + 7.00%), 3/30/11(e)	Restaurants	8,334,656	8,334,656	6,862,516
Total Senior Secured Loans			<u>643,400,811</u>	<u>520,080,351</u>
Preferred Stock—1.3%				
Alpha Media Group Holdings Inc., Series A-2(k)	Publishing	5,000	—	—
Facet Holdings Corp., Class A, 12.00% PIK(e)	Medical Devices	900	900,000	—
Fitness Together Holdings, Inc., Series A(d)(k)	Personal Fitness	187,500	173,326	—
Fitness Together Holdings, Inc., Series A-1(d)(k)	Personal Fitness	49,056	49,056	—
Fitness Together Holdings, Inc., Series B Convertible(d)(k)	Personal Fitness	11,343,804	6,500,000	1,691,000
M & M Tradition Holdings Corp., Series A Convertible, 16.00% PIK(f)	Sheet Metal Fabrication	4,968	4,968,000	5,117,040
Tygem Holdings, Inc., 8.00% PIK(d)(e)	Metals	10,789,367	10,826,867	—
Tygem Holdings, Inc., Series B Convertible(d)(k)	Metals	54,574,501	14,725,535	—
Total Preferred Stock			<u>38,142,784</u>	<u>6,808,040</u>
Common Stock—3.3%(k)				
Alpha Media Group Holdings Inc., Class B	Publishing	12,500	—	—
BKC ARS Blocker, Inc. (American Residential)(l)	HVAC/Plumbing Services	1,000	192,418	1,120,000
BKC ASW Blocker, Inc. (American SportWorks)(d)(m)	Utility Vehicles	1,000	250,001	247,394
BKC DVSH Blocker, Inc. (DynaVox Systems)(n)	Augmentative Communication Products	100	1,000,000	1,705,900
BKC MTCH Blocker, Inc. (Marquette Transportation)(o)	Transportation	1,000	5,000,000	2,498,000
Facet Holdings Corp.	Medical Devices	10,000	100,000	—
Fitness Together Holdings, Inc.(d)	Personal Fitness	173,547	118,500	—
M & M Tradition Holdings Corp.(f)	Sheet Metal Fabrication	500,000	5,000,000	5,240,000
MGHC Holding Corporation (Mattress Giant)(f)	Bedding—Retail	2,285,815	2,285,815	—
Tygem Holdings, Inc.(d)	Metals	3,596,456	3,608,956	—
USI Senior Holdings, Inc.(f)	Building and Construction	79,237	6,926,008	7,225,663
Total Common Stock			<u>24,481,698</u>	<u>18,036,957</u>

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

BlackRock Kelso Capital Corporation
Schedules of Investments (Unaudited)—(Continued)
September 30, 2009

Portfolio Company	Industry	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
Limited Partnership/Limited Liability Company Interests—2.3%				
Big Dumpster Coinvestment, LLC(k)	Waste Management			
	Equipment	—	\$ 5,333,333	\$ —
Marsico Parent Superholdco, LLC, 16.75% PIK, acquired 11/28/07(c)(e)	Financial			
	Services	1,750	1,650,005	—
PG Holdco, LLC (Press Ganey), 15.00% PIK	Healthcare Services	333	333,333	346,206
PG Holdco, LLC (Press Ganey), Class A(k)	Healthcare Services	16,667	166,667	233,333
Prism Business Media Holdings LLC (Penton Media)(f)(k)	Information			
	Services	68	14,943,201	—
Sentry Security Systems Holdings, LLC(k)	Security Services	147,271	147,271	—
Sentry Security Systems Holdings, LLC, 8.00% PIK	Security Services	602,729	602,729	327,075
VSS-AHC Holdings LLC (Advanstar)(k)	Printing/ Publishing	352,941	4,199,161	4,198,939
WBS Group Holdings, LLC, Class B, 16.00% PIK	Software	8,000	8,000,000	7,314,168
Total Limited Partnership/Limited Liability Company Interests			<u>35,375,700</u>	<u>12,419,721</u>
Equity Warrants/Options—0.0%(k)				
Kaz, Inc., expire 12/8/16	Consumer Products	49	512,000	174,533
Kaz, Inc., expire 12/8/16	Consumer Products	16	64,000	24,593
Kaz, Inc., expire 12/8/16	Consumer Products	16	24,000	11,787
Kaz, Inc., expire 12/8/16	Consumer Products	16	9,000	6,135
Marsico Superholdco SPV, LLC, expire 12/14/19, acquired 11/28/07(c)	Financial			
	Services	455	444,450	—
Total Equity Warrants/Options			<u>1,053,450</u>	<u>217,048</u>
TOTAL INVESTMENTS INCLUDING UNEARNED INCOME			<u>1,149,163,002</u>	<u>884,947,392</u>
UNEARNED INCOME—(0.8)%			<u>(4,270,367)</u>	<u>(4,270,367)</u>
TOTAL INVESTMENTS—163.0%			<u>\$1,144,892,635</u>	<u>880,677,025</u>
OTHER ASSETS & LIABILITIES (NET)—(63.0)%				<u>(340,300,730)</u>
NET ASSETS—100.0%				<u>\$ 540,376,295</u>

- (a) Represents amortized cost for fixed income securities and unearned income, 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).
- (c) These securities are exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. In the aggregate, these securities represent 2.8% of net assets at September 30, 2009.

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

[Table of Contents](#)

- (d) “Controlled” investments under the Investment Company Act of 1940, whereby the Company owns more than 25% of the portfolio company’s outstanding voting securities, are as follows:

<u>Controlled Investments</u>	<u>Fair Value at December 31, 2008</u>	<u>Gross Additions (Cost)*</u>	<u>Net Unrealized Gain (Loss)</u>	<u>Fair Value at September 30, 2009</u>	<u>Interest Income**</u>
Al Solutions, Inc.:					
Senior Secured Loan	\$ —	\$ 147,231	\$ 2,769	\$ 150,000	\$ 2,181
Subordinated Debt	—	53,383	(53,383)	—	53,383
American SportWorks LLC					
Senior Secured Loan	—	3,572,448	(909,859)	2,662,589	14,038
BKC ASW Blocker, Inc.					
Common Stock	—	5,884	241,510	247,394	—
Fitness Together Franchise Corporation					
Senior Secured Loan	6,496,555	104,905	(592,770)	6,008,690	603,235
Fitness Together Holdings, Inc.:					
Preferred Stock Series A	—	—	—	—	—
Preferred Stock Series A-1	—	—	—	—	—
Preferred Stock Series B Convertible	4,700,000	—	(3,009,000)	1,691,000	—
Common Stock	—	—	—	—	—
Tygem Holdings, Inc.:					
Preferred Stock	—	—	—	—	—
Preferred Stock Series B Convertible	—	—	—	—	—
Common Stock	—	—	—	—	—
Less: Unearned Income	—	(263,967)	—	(263,967)	—
Totals	<u>\$ 11,196,555</u>	<u>\$ 3,619,884</u>	<u>\$ (4,320,733)</u>	<u>\$ 10,495,706</u>	<u>\$ 672,837</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.

** For the nine months ended September 30, 2009. There were no realized gains (losses) or dividend income from these securities during the period.

The aggregate fair value of controlled investments (net of unearned income) at September 30, 2009 represents 1.9% of net assets.

- (e) Non-accrual status (in default) at September 30, 2009 and therefore non-income producing. At September 30, 2009, the aggregate fair value and amortized cost of debt investments on non-accrual status represents 2.4% and 5.5% of total debt investments at fair value and amortized cost, respectively.
- (f) “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, are as follows:

<u>Non-controlled, Affiliated Investments</u>	<u>Fair Value at December 31, 2008</u>	<u>Gross Additions (Cost)*</u>	<u>Gross Reductions (Cost)**</u>	<u>Net Unrealized Gain (Loss)</u>	<u>Fair Value at September 30, 2009</u>	<u>Net Realized Gain (Loss)***</u>	<u>Interest Income***</u>	<u>Dividend Income***</u>
American SportWorks LLC								
Senior Secured Loan	\$ 5,716,023	\$ —	\$(3,572,448)	\$ (2,143,575)	\$ — †	\$ —	\$ 27,617	\$ —
BKC ASW Blocker, Inc.								
Common Stock	16,399	—	(5,883)	(10,516)	— †	—	—	—
M&M Tradition Holdings Corp.:								
Preferred Stock	5,537,280	—	(408,000)	(12,240)	5,117,040	12,240	—	820,493
Common Stock	6,095,000	—	—	(855,000)	5,240,000	—	—	—
Mattress Giant Corporation								
Subordinated Debt	—	2,096,679	—	1,458,822	3,555,501	—	349,012	—
MGHC Holding Corporation								
Subordinated Debt	—	—	—	—	—	—	—	—
Common Stock	—	2,285,815	—	(2,285,815)	—	—	—	—
Penton Media, Inc.								
Senior Secured Loan	18,226,000	58,498	—	(13,994,498)	4,290,000	—	1,283,186	—

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

Table of Contents

Non-controlled, Affiliated Investments	Fair Value at December 31, 2008	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at September 30, 2009	Net Realized Gain (Loss)***	Interest Income***	Dividend Income***
Prism Business Media Holdings LLC Limited Liability Co. Interest	\$ 4,730,000	\$ —	\$ —	\$ (4,730,000)	\$ —	\$ —	\$ —	\$ —
United Subcontractors, Inc. Senior Secured Loan	—	1,617,273	—	(161,274)	1,455,999	—	8,393	—
USI Senior Holdings, Inc. Common Stock	—	6,926,008	—	299,654	7,225,662	—	—	—
Less: Unearned Income	(305,622)	305,622	—	—	—	—	—	—
Totals	<u>\$40,015,080</u>	<u>\$13,289,895</u>	<u>\$(3,986,331)</u>	<u>\$(22,434,442)</u>	<u>\$26,884,202</u>	<u>\$ 12,240</u>	<u>\$1,668,208</u>	<u>\$820,493</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, 2009.

† Investment moved out of the non-controlled, affiliated category into the controlled category during the period.

The aggregate fair value of non-controlled, affiliated investments (net of unearned income) at September 30, 2009 represents 5.0% of net assets.

(g) Approximately 62% 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 6% of such senior secured loans have floors of 1.50% to 3.50% on the LIBOR base rate. 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, 2009 of all contracts within the specified loan facility.

(h) Non-U.S. company or principal place of business outside the U.S.

(i) Principal amount is denominated in Canadian dollars.

(j) Guaranty by the Company on behalf of portfolio company Facet Technologies, LLC. The maximum amount of potential future payments under this guaranty is \$6,000,000 at September 30, 2009 with an expiration of July 2011.

(k) Non-income producing equity securities at September 30, 2009.

(l) The Company is the sole stockholder of BKC ARS Blocker, Inc., which is the beneficiary of less than 5% of the voting securities of American Residential Services L.L.C.

(m) The Company is the sole stockholder of BKC ASW Blocker, Inc., which is the beneficiary of more than 25% of the voting securities of American SportWorks LLC.

(n) The Company is the sole stockholder of BKC DVSH Blocker, Inc., which is the beneficiary of less than 5% of the voting securities of DynaVox Systems LLC.

(o) The Company is the sole stockholder of BKC MTCH Blocker, Inc., which is the beneficiary of less than 5% of the voting securities of Marquette Transportation Company Holdings, LLC.

PIK Payment-in-kind.

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

BlackRock Kelso Capital Corporation

Schedules of Investments

December 31, 2008

<u>Portfolio Company</u>	<u>Industry(a)</u>	<u>Principal Amount or Number of Shares/Units</u>	<u>Cost(b)</u>	<u>Fair Value(c)</u>
Senior Secured Notes—10.3%				
AGY Holding Corp., Second Lien, 11.00%, 11/15/14	Glass Yarns/ Fibers	\$23,500,000	\$ 23,079,223	\$ 22,818,500
TriMark Acquisition Corp., Second Lien, 11.50% (9.50% cash, 2.00% PIK), 11/30/13	Food Service Equipment	30,882,283	30,882,283	29,523,463
Total Senior Secured Notes			53,961,506	52,341,963
Unsecured Debt—27.4%				
AMC Entertainment Holdings, Inc., 7.00% PIK (LIBOR + 5.00%), 6/13/12	Entertainment	13,764,638	13,557,906	9,291,131
ASM Intermediate Holdings Corp. II, 12.00% PIK, 12/27/13	Marketing Services	50,918,276	50,918,276	39,716,255
BE Foods Investments, Inc., 7.39% (LIBOR + 5.00% cash or 5.75% PIK), 7/11/12	Food	24,950,709	24,326,664	19,561,356
Big Dumpster Acquisition, Inc., 13.50% PIK, 7/5/15	Waste Management Equipment	37,488,669	37,488,669	13,870,808
Lucite International Luxembourg Finance S.à.r.l., 13.97% PIK (EURIBOR + 9.00%), 7/14/14(d)	Chemicals	12,589,294(e)	16,066,347	15,784,742
Marquette Transportation Company Holdings, LLC, 14.75% PIK, 3/21/14	Transportation	45,423,354	45,423,354	39,245,778
Marsico Parent Holdco, LLC et al., 12.50% PIK, 7/15/16, acquired 11/28/07(f)	Financial Services	9,973,416	9,973,416	1,585,773
Marsico Parent Superholdco, LLC et al., 14.50% PIK, 1/15/18, acquired 11/28/07(f)	Financial Services	6,756,886	6,431,358	891,909
Total Unsecured Debt			204,185,990	139,947,752
Subordinated Debt—25.8%				
A & A Manufacturing Co., Inc., 14.00% (12.00% cash, 2.00% PIK), 4/2/14	Protective Enclosures	19,156,235	19,156,235	17,757,830
Advanstar, Inc., 8.46% PIK (LIBOR + 7.00%), 11/30/15	Printing/Publishing	7,164,027	7,164,027	2,752,688
Al Solutions, Inc., 16.00% PIK, 12/29/13(g)(h)	Metals	13,680,233	13,323,761	—
Conney Safety Products, LLC, 16.00%, 10/1/14	Safety Products	30,000,000	30,000,000	28,500,000
DynaVox Systems LLC, 15.00%, 6/23/15	Augmentative Communication Products	25,000,000	25,000,000	25,000,000
Mattress Giant Corporation, 16.25% PIK, 8/1/12(h)	Bedding—Retail	15,185,673	15,104,082	—
MediMedia USA, Inc., 11.38%, 11/15/14, acquired multiple dates(f)	Information Services	8,000,000	8,066,847	4,800,000
The Pay-O-Matic Corp., 14.00% (12.00% cash, 2.00% PIK), 1/15/15	Financial Services	15,290,415	15,290,415	14,663,508
PGA Holdings, Inc., 12.50%, 3/12/16	Healthcare Services	5,000,000	4,910,576	4,750,000
Sentry Security Systems, LLC, 15.00% (12.00% cash, 3.00% PIK), 8/7/12	Security Services	10,591,381	10,591,381	9,998,264
Tri-anim Health Services, Inc. et al., 14.00% (12.00% cash, 2.00% PIK), 6/4/15	Healthcare Products	15,021,667	15,021,667	14,100,000

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

BlackRock Kelso Capital Corporation
Schedules of Investments—(Continued)
December 31, 2008

<u>Portfolio Company</u>	<u>Industry(a)</u>	<u>Principal Amount or Number of Shares/Units</u>	<u>Cost(b)</u>	<u>Fair Value(c)</u>
U.S. Security Holdings, Inc., 13.00% (11.00% cash, 2.00% PIK), 5/8/14, acquired 5/10/06(f)	Security Services	\$ 7,000,000	\$ 7,000,000	\$ 5,250,000
Wastequip, Inc., 12.00% (10.00% cash, 2.00% PIK), 2/5/15	Waste Management Equipment	7,715,353	7,715,353	4,158,575
Total Subordinated Debt			178,344,344	131,730,865
Senior Secured Loans—112.9%(i)				
Advanstar Communications Inc., Second Lien, 6.46% (LIBOR + 5.00%), 11/30/14	Printing/Publishing	14,000,000	14,000,000	5,379,325
Alpha Media Group Inc., Second Lien, 8.97% (LIBOR + 7.50%), 2/11/15(h)	Publishing	20,000,000	19,344,012	2,000,000
American Residential Services L.L.C., Second Lien, 12.00% (10.00% cash, 2.00% PIK), 4/17/15	HVAC/Plumbing Services	40,401,000	40,401,000	35,027,667
American Safety Razor Company, LLC, Second Lien, 6.72% (LIBOR + 6.25%), 1/30/14	Consumer Products	10,000,000	10,000,000	7,510,000
American SportWorks LLC, Second Lien, 20.00%, 6/27/14(h)(j)	Utility Vehicles	13,403,274	13,403,274	5,716,023
AmQuip Crane Rental LLC, Second Lien, 6.25% (LIBOR + 5.75%), 6/29/14	Construction Equipment	25,660,446	23,432,847	23,171,383
Applied Tech Products Corp. et al., Tranche A, First Lien, 7.75% (Base Rate + 4.50%), 10/24/10	Plastic Packaging	1,230,907	1,227,441	847,900
Applied Tech Products Corp. et al., Tranche B, Second Lien, 11.75% (Base Rate + 8.50%), 4/24/11(h)	Plastic Packaging	2,308,004	2,299,537	—
Applied Tech Products Corp. et al., Tranche C, Third Lien, 15.25% PIK (Base Rate + 12.00%), 10/24/11(h)	Plastic Packaging	916,240	868,547	—
Arclin US Holdings Inc., Second Lien, 8.79% (LIBOR + 6.50%), 7/10/15	Chemicals	14,500,000	14,500,000	8,569,500
Bankruptcy Management Solutions, Inc., Second Lien, 8.13% (LIBOR + 6.25%), 7/31/13	Financial Services	24,437,500	24,437,500	18,059,313
The Bargain! Shop Holdings Inc., Term Loan A, First Lien, 14.50% (13.50% cash, 1.00% PIK), 6/29/12(d)	Discount Stores	13,981,476(k)	13,518,079	11,167,060
The Bargain! Shop Holdings Inc., Term Loan B, First Lien, 14.50% (13.50% cash, 1.00% PIK), 7/1/12(d)	Discount Stores	19,218,524(k)	17,965,225	15,349,911
Berlin Packaging L.L.C., Second Lien, 8.55% (LIBOR + 6.50%), 8/17/15	Rigid Packaging	24,000,000	23,402,716	19,968,000
Champion Energy Corporation et al., First Lien, 14.50%, 5/22/11	Heating and Oil Services	34,000,000	34,000,000	33,082,000
Custom Direct, Inc. et al., Second Lien, 7.46% (LIBOR + 6.00%), 12/31/14	Printing	10,000,000	10,000,000	6,590,000
Deluxe Entertainment Services Group Inc., Second Lien, 7.46% (LIBOR + 6.00%), 11/11/13	Entertainment	12,000,000	12,000,000	8,976,000
Electrical Components International, Inc., Second Lien, 11.50% (Base Rate + 8.25%), 5/1/14	Electronics	22,000,000	21,098,897	13,530,000

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

BlackRock Kelso Capital Corporation
Schedules of Investments—(Continued)
December 31, 2008

Portfolio Company	Industry(a)	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
Event Rentals, Inc., Acquisition Loan, First Lien, 6.99% (LIBOR + 4.00%), 12/19/13	Party Rentals	\$ 15,000,000	\$ 15,000,000	\$ 13,050,000
Facet Technologies, LLC, Second Lien, 16.00% (LIBOR + 2.00% cash, 10.00% PIK), 1/26/12	Medical Devices	28,547,347	28,547,347	26,263,559
Fairway Group Holdings Corp. et al., Term B Loan, First Lien, 9.50% (Base Rate + 4.25%), 1/18/13	Retail Grocery	1,470,000	1,467,522	1,470,000
Fairway Group Holdings Corp. et al., Term C Loan, Second Lien, 14.00% (13.00% cash, 1.00% PIK), 1/18/14	Retail Grocery	11,720,175	11,678,730	11,720,175
Fitness Together Franchise Corporation, First Lien, 11.50% (9.50% cash, 2.00% PIK), 11/10/13(g)	Personal Fitness	6,881,944	6,881,944	6,496,555
Heartland Automotive Services II, Inc. et al., Term Loan A, First Lien, 7.75% (LIBOR + 3.75%), 2/27/12	Automobile Repair	3,678,231	3,676,226	3,034,540
Heartland Automotive Services II, Inc. et al., Acquisition Loan, First Lien, 8.00% (LIBOR + 4.00%), 2/27/12	Automobile Repair	1,799,837	1,799,837	1,497,464
HIT Entertainment, Inc., Second Lien, 8.21% (LIBOR + 5.50%), 2/26/13	Entertainment	1,000,000	1,000,000	350,000
InterMedia Outdoor, Inc., Second Lien, 8.21% (LIBOR + 6.75%), 1/31/14	Printing/Publishing	10,000,000	10,000,000	7,240,000
Isola USA Corp., First Lien, 9.21% (LIBOR + 7.75%), 12/18/12	Electronics	8,901,316	8,812,731	7,726,342
Isola USA Corp., Second Lien, 15.67% (LIBOR + 12.25%), 12/18/13	Electronics	25,000,000	25,000,000	21,600,000
Kaz, Inc. et al., First Lien, 16.00% (12.00% cash, 4.00% PIK), 12/8/11	Consumer Products	33,022,141	32,730,352	32,526,809
LJVH Holdings Inc., Second Lien, 6.96% (LIBOR + 5.50%), 1/19/15(d)	Specialty Coffee	25,000,000	25,000,000	20,225,000
MCCI Group Holdings, LLC, Second Lien, 9.43% (LIBOR + 7.25%), 6/21/13	Healthcare Services	29,000,000	28,950,160	26,651,000
NAMIC/VA, Inc., Second Lien, 12.25%, 8/14/15	Healthcare Services	15,000,000	14,767,862	14,430,000
New Enterprise Stone & Lime Co., Inc., Second Lien, 12.50%, 7/11/14	Mining/Construction	35,000,000	34,698,054	32,410,000
Oriental Trading Company, Inc., Second Lien, 6.47% (LIBOR + 6.00%), 1/31/14	Party Supplies and Novelties	3,000,000	3,000,000	772,500
Penton Media, Inc. et al., Second Lien, 8.42% (LIBOR + 5.00%), 2/1/14(j)	Information Services	26,000,000	25,602,087	18,226,000
Physiotherapy Associates, Inc. et al., Second Lien, 12.00% (Base Rate + 8.75%), 12/31/13	Rehabilitation Centers	17,000,000	17,000,000	12,206,000
PQ Corporation, Second Lien, 9.97% (LIBOR + 6.50%), 7/30/15	Specialty Chemicals	10,000,000	8,785,959	7,860,000
Precision Parts International Services Corp. et al., First Lien, 8.00% (Base Rate + 4.75%), 9/30/11(h)	Automotive Parts	2,847,627	2,847,627	1,922,148

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

BlackRock Kelso Capital Corporation
Schedules of Investments—(Continued)
December 31, 2008

Portfolio Company	Industry(a)	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
Premier Yachts, Inc. et al., Term A, First Lien, 5.63% (LIBOR + 3.75%), 8/22/12	Entertainment Cruises	\$ 7,088,755	\$ 7,067,266	\$ 6,734,317
Premier Yachts, Inc. et al., Term B, First Lien, 8.88% (LIBOR + 7.00%), 8/22/13	Entertainment Cruises	1,758,235	1,752,951	1,658,016
Sunrise Medical LTC LLC et al., Second Lien, 6.97% (LIBOR + 6.50%), 12/28/13	Healthcare Equipment	14,400,000	14,400,000	11,750,400
Texas Competitive Electric Holdings Company LLC, Tranche B-2, First Lien, 5.58% (LIBOR + 3.50%), 10/10/14	Utilities	4,987,374	3,949,074	3,480,770
Total Safety U.S., Inc., Second Lien, 6.96% (LIBOR + 6.50%), 12/8/13	Industrial Safety Equipment	9,000,000	9,000,000	4,950,000
United Subcontractors, Inc., Tranche B, First Lien, 6.92% (LIBOR + 3.00% cash, 2.00% PIK), 12/27/12	Building and Construction	6,484,524	1,005,101	4,312,208
United Subcontractors, Inc., Second Lien, 11.69% (LIBOR + 7.25% cash, 2.00% PIK), 6/27/13	Building and Construction	10,109,782	10,109,782	6,743,225
Water Pik, Inc., Second Lien, 6.46% (LIBOR + 5.50%), 6/15/14	Consumer Products	30,000,000	30,000,000	26,400,000
WBS Group LLC et al., Second Lien, 8.81% (LIBOR + 6.25%), 6/7/13	Software	20,000,000	20,000,000	15,600,000
Wembley, Inc., Second Lien, 4.70% (LIBOR + 4.25%), 8/23/12(h)	Gaming	1,000,000	1,000,000	108,333
Westward Dough Operating Company, LLC, Term Loan A, First Lien, 5.46% (LIBOR + 4.00%), 3/30/11	Restaurants	6,850,000	6,850,000	5,199,150
Westward Dough Operating Company, LLC, Term Loan B, First Lien, 8.46% (LIBOR + 7.00%), 3/30/11(h)	Restaurants	8,334,656	8,334,656	6,446,407
Total Senior Secured Loans			<u>716,614,343</u>	<u>576,005,000</u>
Preferred Stock—2.0%				
Facet Holdings Corp., Class A, 12.00% PIK(h)	Medical Devices	900	900,000	—
Fitness Together Holdings, Inc., Series A(g)(l)	Personal Fitness	187,500	173,326	—
Fitness Together Holdings, Inc., Series A-1(g)(l)	Personal Fitness	49,056	49,056	—
Fitness Together Holdings, Inc., Series B Convertible(g)(l)	Personal Fitness	11,343,804	6,500,000	4,700,000
M & M Tradition Holdings Corp., Series A Convertible, 16.00% PIK(j)	Sheet Metal Fabrication	5,376	5,376,000	5,537,280
Tygem Holdings, Inc., 8.00% PIK(g)(h)	Metals	10,789,367	10,826,867	—
Tygem Holdings, Inc., Series B Convertible(g)(l)	Metals	54,574,501	14,725,535	—
Total Preferred Stock			<u>38,550,784</u>	<u>10,237,280</u>
Common Stock—1.8%(l)				
BKC ASW Blocker, Inc. (American SportWorks)(j)(m)	Utility Vehicles	1,000	250,000	16,399

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

BlackRock Kelso Capital Corporation
Schedules of Investments—(Continued)
December 31, 2008

Portfolio Company	Industry(a)	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
BKC DVSH Blocker, Inc. (DynaVox Systems)(n)	Augmentative Communication Products	100	\$ 1,000,000	\$ 1,000,000
BKC MTCH Blocker, Inc. (Marquette Transportation)(o)	Transportation	1,000	5,000,000	2,200,000
Facet Holdings Corp.	Medical Devices	10,000	100,000	—
Fitness Together Holdings, Inc.(g)	Personal Fitness	173,547	118,500	—
M & M Tradition Holdings Corp.(j)	Sheet Metal Fabrication	500,000	5,000,000	6,095,000
MGHC Holding Corporation (Mattress Giant)	Bedding—Retail	205,000	2,050,000	—
Tygem Holdings, Inc.(g)	Metals	3,596,456	3,608,956	—
Total Common Stock			<u>17,127,456</u>	<u>9,311,399</u>
Limited Partnership/Limited Liability Company Interests—2.5%				
ARS Investment Holdings, LLC (American Residential)(l)	HVAC/Plumbing Services	66,902	—	360,000
Big Dumpster Coinvestment, LLC(l)	Waste Management Equipment	—	5,333,333	—
Marsico Parent Superholdco, LLC, 16.75% PIK, acquired 11/28/07(f)	Financial Services	1,750	1,650,005	—
PG Holdco, LLC (Press Ganey), 15.00% PIK	Healthcare Services	333	333,333	282,169
PG Holdco, LLC (Press Ganey), Class A(l)	Healthcare Services	16,667	166,667	166,667
Prism Business Media Holdings LLC (Penton Media)(j)(l)	Information Services	68	14,943,200	4,730,000
Sentry Common Investors, LLC(l)	Security Services	147,271	147,271	—
Sentry Security Systems Holdings, LLC, 8.00% PIK	Security Services	602,729	602,729	117,546
WBS Group Holdings, LLC, Class B, 16.00% PIK	Software	8,000	8,000,000	6,878,899
Total Limited Partnership/Limited Liability Company Interests			<u>31,176,538</u>	<u>12,535,281</u>
Equity Warrants/Options—0.0%(l)				
ATEP Holdings, Inc. (Applied Tech), expire 10/24/15	Plastic Packaging	470	—	—
ATH Holdings, Inc. (Applied Tech), expire 10/24/15	Plastic Packaging	470	—	—
ATPP Holdings, Inc. (Applied Tech), expire 10/24/15	Plastic Packaging	470	90,112	—
ATPR Holdings, Inc. (Applied Tech), expire 10/24/15	Plastic Packaging	470	—	—
Kaz, Inc., expire 12/8/16	Consumer Products	49	512,000	7,417
Kaz, Inc., expire 12/8/16	Consumer Products	16	64,000	560
Kaz, Inc., expire 12/8/16	Consumer Products	16	24,000	164
Kaz, Inc., expire 12/8/16	Consumer Products	16	9,000	57
Marsico Superholdco SPV, LLC, expire 12/14/19, acquired 11/28/07(f)	Financial Services	455	444,450	—
Total Equity Warrants/Options			<u>1,143,562</u>	<u>8,198</u>

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

BlackRock Kelso Capital Corporation
Schedules of Investments—(Continued)
December 31, 2008

Portfolio Company	Industry(a)	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
TOTAL INVESTMENTS INCLUDING UNEARNED INCOME				
UNEARNED INCOME—(1.0)%			\$1,241,104,523	\$ 932,117,738
TOTAL INVESTMENTS—181.6%			(5,272,812)	(5,272,812)
OTHER ASSETS & LIABILITIES (NET)—(81.6)%			<u>\$1,235,831,711</u>	926,844,926
NET ASSETS—100.0%				<u>(416,549,425)</u>
				<u>\$ 510,295,501</u>

- (a) Unaudited.
- (b) Represents amortized cost for fixed income securities and unearned income, 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).
- (d) Non-U.S. company or principal place of business outside the U.S.
- (e) Principal amount is denominated in Euros.
- (f) These securities are exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. In the aggregate, these securities represent 2.5% of net assets at December 31, 2008.
- (g) "Controlled" investments under the Investment Company Act of 1940, whereby the Company owns more than 25% of the portfolio company's outstanding voting securities, are as follows:

Controlled Investments	Fair Value at December 31, 2007	Gross Additions (Cost)*	Net Unrealized Gain (Loss)	Fair Value at December 31, 2008	Interest Income**
Al Solutions, Inc.					
Subordinated Debt	\$12,648,145	\$ 675,616	\$(13,323,761)	\$ —	\$1,103,658
Fitness Together Franchise Corporation					
Senior Secured Loan	—	6,881,944	(385,389)	6,496,555	114,000
Fitness Together Holdings, Inc.:					
Preferred Stock Series A	—	173,326	(173,326)	—	—
Preferred Stock Series A-1	—	49,056	(49,056)	—	—
Preferred Stock Series B Convertible	—	6,500,000	(1,800,000)	4,700,000	—
Common Stock	—	118,500	(118,500)	—	—
Tygem Holdings, Inc.:					
Preferred Stock	—	—	—	—	—
Preferred Stock Series B Convertible	2,613,900	2,500,000	(5,113,900)	—	—
Common Stock	—	—	—	—	—
Less: Unearned Income	(427,650)	427,650	—	—	—
Totals	<u>\$14,834,395</u>	<u>\$17,326,092</u>	<u>\$(20,963,932)</u>	<u>\$11,196,555</u>	<u>\$1,217,658</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.

** For the year ended December 31, 2008. There were no realized gains (losses) or dividend income from these securities during the year.

The aggregate fair value of controlled investments (net of unearned income) at December 31, 2008 represents 2.2% of net assets.

- (h) Non-accrual status (in default) at December 31, 2008 and therefore non-income producing. At December 31, 2008, the aggregate fair value and amortized cost of debt investments on non-accrual status represents 1.8% and 6.6% of total debt investments at fair value and amortized cost, respectively.

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

Table of Contents

- (i) Approximately 66% 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), Euro Interbank Offered Rate (EURIBOR), or other base rate (commonly the Federal Funds Rate or the Prime Rate), at the borrower's option. In addition, approximately 12% of such senior secured loans have floors of 3.00% to 4.00% on the LIBOR base rate. 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 December 31, 2008 of all contracts within the specified loan facility.
- (j) "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, are as follows:

Non-controlled, Affiliated Investments	Fair Value at December 31, 2007	Gross Additions (Cost)*	Gross Reductions (Cost)**	'Net Unrealized Gain (Loss)	Fair Value at December 31, 2008	Net Realized Gain (Loss)***	Interest/ Other Income***	Dividend Income***
American SportWorks LLC								
Senior Secured Loan	\$13,202,280	\$ 200,994	\$ —	\$ (7,687,251)	\$ 5,716,023	\$ —	\$2,070,263	\$ —
BKC ASW Blocker, Inc.								
Common Stock	406,689	—	—	(390,290)	16,399	—	—	—
M&M Tradition Holdings Corp.:								
Preferred Stock	9,415,180	—	(3,832,000)	(45,900)	5,537,280	112,783	—	1,262,730
Common Stock	5,000,000	—	—	1,095,000	6,095,000	—	—	—
Penton Media, Inc.								
Senior Secured Loan	21,250,000	936,445	—	(3,960,445)	18,226,000	—	2,226,284	—
Prism Business Media Holdings LLC								
Limited Liability Co. Interest	16,500,000	—	—	(11,770,000)	4,730,000	—	—	—
Less: Unearned Income	(361,467)	55,845	—	—	(305,622)	—	—	—
Totals	\$65,412,682	\$1,193,284	\$(3,832,000)	\$(22,758,886)	\$40,015,080	\$ 112,783	\$4,296,547	\$1,262,730

* 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, 2008.

The aggregate fair value of non-controlled, affiliated investments (net of unearned income) at December 31, 2008 represents 7.8% of net assets.

(k) Principal amount is denominated in Canadian dollars.

(l) Non-income producing equity securities at December 31, 2008.

(m) The Company is the sole stockholder of BKC ASW Blocker, Inc., which is the beneficiary of 5% or more (but not more than 25%) of the voting securities of American SportWorks LLC.

(n) The Company is the sole stockholder of BKC DVSH Blocker, Inc., which is the beneficiary of less than 5% of the voting securities of DynaVox Systems LLC.

(o) The Company is the sole stockholder of BKC MTCH Blocker, Inc., which is the beneficiary of less than 5% of the voting securities of Marquette Transportation Company Holdings, LLC.

PIK Payment-in-kind.

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

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)

1. Organization

BlackRock Kelso Capital Corporation (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.

On July 25, 2005, the Company completed a private placement of 35,366,589 shares of its common stock at a price of \$15.00 per share receiving net proceeds of approximately \$529 million. On July 2, 2007, the Company completed an initial public offering through which it sold an additional 10,000,000 shares of its common stock at a price of \$16.00 per share and listed its shares on The NASDAQ Global Select Market. The Company received net proceeds of approximately \$150 million from this offering.

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In the opinion of management, all adjustments, consisting solely of normal recurring accruals, considered necessary for the fair presentation of financial statements for the interim periods, have been included. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year. Certain prior year amounts have been reclassified to conform to the current year presentation. The statement of cash flows for the nine months ended September 30, 2008 has been revised to include activity related to foreign currency balances and to present reinvested dividends as a supplemental non-cash disclosure. Reinvested dividends were previously presented within financing activities, with a corresponding amount presented within financing activities as dividends paid.

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 financial statements should be read in conjunction with the Company’s financial statements and notes related thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008, which was filed with the Securities and Exchange Commission (“SEC”) on March 16, 2009.

2. Significant accounting policies

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the 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 Company has reviewed subsequent events occurring through November 5, 2009, the date that these financial statements were issued, and determined that no subsequent events occurred requiring accrual or disclosure.

The significant accounting policies consistently followed by the Company are:

- (a) 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 generally obtains market quotations from an independent pricing service or one or more broker-dealers or market makers and utilizes mid-market pricing as a practical expedient for fair value. However, debt investments with remaining maturities within 60 days are valued at amortized cost, which approximates fair value. 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 value 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

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

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 undertakes a multi-step valuation process 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 of 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 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, 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 cost, which approximates fair value. As of that date, an independent valuation firm conducts an initial independent appraisal of the investment.

Effective January 1, 2008, the Company adopted changes issued by the Financial Accounting Standards Board (“FASB”) to Accounting Standards Codification (“ASC”) 820-10, *Fair Value Measurements and Disclosures* (“ASC 820-10”) (Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements*), which defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. The adoption of these changes did not have a material impact on the Company’s financial statements. See Note 10.

- (b) Security transactions are accounted for on the trade date unless there are substantial conditions to the purchase.
- (c) Gains or losses on the sale of investments are calculated using the specific identification method.
- (d) Interest income, adjusted for amortization of premium and accretion of discount, and dividend income is recorded on an accrual basis 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, PIK income may not be accrued if the portfolio company valuation indicates that the PIK income is not collectible. Origination, structuring, closing, commitment and other upfront fees and discounts and premiums on investments purchased are accreted/amortized over the life of the respective investment. Unamortized origination, structuring, closing, commitment and other upfront fees are recorded as unearned income. 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 interest income. Expenses are recorded on an accrual basis.
- (e) The Company has elected to be taxed as a RIC under Subchapter M of the Code and currently qualifies, and intends to continue to qualify each year, as a RIC under the Code.

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 investment company taxable income, as defined by the Code. To avoid federal excise

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

taxes, the Company must distribute annually at least 98% of its income (both ordinary income and net capital gains). 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.

- (f) 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.
- (g) Loans 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 is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans 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.
- (h) Recently Issued Accounting Pronouncements:

In September 2009, the FASB issued ASC 105-10, *Generally Accepted Accounting Principles* (Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*), which provides that on the effective date of this new accounting standard, the ASC will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the ASC will become non-authoritative. The adoption of this new standard on September 30, 2009 did not have a material impact on the Company's financial statements.

3. Agreements and related party transactions

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 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, 2009, the Advisor earned \$4,555,811 and \$13,951,061, respectively, in base management fees from the Company. For the three and nine months ended September 30, 2008, the Advisor earned \$5,841,124 and \$16,991,573, respectively, in such fees from the Company.

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

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: the transition period; 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 “transition period” began on July 1, 2007 and ended on June 30, 2008.
- The initial “trailing four quarters’ periods” ended on September 30, 2008. In other words, the income portion of the Incentive Fee payable for the quarterly period ended on September 30, 2008 was determined by reference to the four quarter period ended on September 30, 2008.
- The term “annual period” means the period beginning on July 1 of each calendar year beginning in 2007 and ending on June 30 of the next calendar year.

The hurdle rate for each measurement period is 2.0% multiplied by the net asset values of the Company’s common stock 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 of the first two measurement periods referred to above (the transition period and each rolling 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 amount, if any, by which net unrealized capital depreciation exceeds net realized capital gains during the period exceeds (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.

Periodic Incentive Fee Based on Capital Gains. The portion of the Incentive Fee based on capital gains is calculated on an annual basis. For each annual period, the Company paid or will pay the Advisor an Incentive Fee based on the amount by which (A) net 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 excess 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 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 excess 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.

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

For the three and nine months ended September 30, 2009 and 2008, the Advisor earned no Incentive Fee from the Company as the hurdle rate was not achieved. Although the Company did not incur any Incentive Fee during the three and nine months ended September 30, 2009, it may incur such fees in the future relating to investment performance since December 31, 2008 measured on a trailing four quarters' basis at December 31, 2009 and thereafter.

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, 2009, the Company incurred \$341,872 and \$1,028,939, respectively, for costs and expenses reimbursable to the Advisor under the Management Agreement. For the three and nine months ended September 30, 2008, the Company incurred \$283,301 and \$822,150, respectively, in such costs and expenses.

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. Reimbursements to the Advisor for the three and nine months ended September 30, 2009 were \$322,201 and \$996,768, respectively. Reimbursements to the Advisor for the three and nine months ended September 30, 2008 were \$354,192 and \$1,161,023, 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.

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, 2009, the Company incurred \$148,941 and \$482,916, respectively, for administrative services expenses payable to the Administrator under the administration agreement. For the three and nine months ended September 30, 2008, the Company incurred \$212,977 and \$725,538, respectively, in such expenses.

The PNC Financial Services Group, Inc. ("PNC") is a significant stockholder of the ultimate parent of the Administrator. PNC Global Investment Servicing Inc. ("PGIS"), a subsidiary of PNC, provides administrative and accounting services to the Company pursuant to a Sub-Administration and Accounting Services Agreement. PFPC Trust Company, another subsidiary of PNC, provides custodian services to the Company pursuant to a Custodian Services Agreement. Also, PGIS provides transfer agency and compliance support services to the Company pursuant to a Transfer Agency Agreement and a Compliance Support Services Agreement, respectively. For the services provided to the Company by PGIS and its affiliates, PGIS is entitled to an annual fee of 0.02% of the Company's average net assets plus reimbursement of reasonable expenses, and a base fee, payable monthly. PFPC Trust Company may charge the Company additional fees for cash overdraft balances or for sweeping excess cash balances.

For the three and nine months ended September 30, 2009, the Company incurred \$35,749 and \$146,178, respectively, for administrative, accounting, custodian and transfer agency services fees payable to PGIS and its affiliates under the related agreements. For the three and nine months ended September 30, 2008, the Company incurred \$55,232 and \$177,566, respectively, for such fees payable to PGIS and its affiliates.

In November 2007, the Company's Board of Directors authorized the purchase by the Advisor from time to time in the open market of an indeterminate number of shares of the Company's common stock, in the Advisor's discretion, subject to compliance with the Company's and the Advisor's applicable policies and requirements of law. Pursuant to this authorization, during the nine months ended September 30, 2009 and 2008, the Advisor purchased 80,867 and 103,735 shares of the Company's common stock in the open market for \$312,322 and \$1,232,599, respectively, including brokerage commissions.

At September 30, 2009 and December 31, 2008, the Advisor owned directly approximately 555,000 and 504,000 shares, respectively, of the Company's common stock, representing approximately 1.0% and 0.9% of the total shares outstanding. At September 30, 2009 and December 31, 2008, other entities affiliated with the Administrator and PGIS beneficially owned indirectly approximately 2,892,000 and 3,195,000 shares, respectively, of the Company's common stock, representing approximately 5.1% and 5.8% of the total shares outstanding. At September 30, 2009 and December 31, 2008, an entity affiliated with the Administrator and PGIS owned approximately 32.0% of the members' interests of the Advisor.

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

4. Earnings (loss) per share

The following information sets forth the computation of basic and diluted net increase (decrease) in net assets per share (earnings (loss) per share) resulting from operations for the three and nine months ended September 30, 2009 and 2008.

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Numerator for basic and diluted net increase (decrease) in net assets per share	\$ 31,145,966	\$ (18,793,518)	\$ 50,900,596	\$ (46,407,698)
Denominator for basic and diluted weighted average shares	56,338,835	54,632,752	55,738,396	53,588,041
Basic/diluted net increase (decrease) in net assets per share resulting from operations	\$ 0.55	\$ (0.34)	\$ 0.91	\$ (0.87)

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

5. Investments

Purchases of long-term investments for the three months ended September 30, 2009 and 2008 totaled \$10,983,186 and \$8,725,720, respectively, and for the nine months ended September 30, 2009 and 2008 totaled \$38,173,072 and \$183,326,767, respectively. Sales/repayments of long-term investments for the three months ended September 30, 2009 and 2008 totaled \$28,339,844 and \$60,585,583, respectively, and for nine months ended September 30, 2009 and 2008 totaled \$72,248,410 and \$112,069,141, respectively.

At September 30, 2009 investments consisted of the following:

	Cost	Fair Value
Senior secured notes	\$ 54,309,150	\$ 51,727,535
Unsecured debt	193,234,544	145,968,087
Subordinated debt	159,164,865	129,689,653
Senior secured loans:		
First lien	135,269,972	128,002,431
Second/other priority lien	508,130,839	392,077,920
Total senior secured loans	643,400,811	520,080,351
Preferred stock	38,142,784	6,808,040
Common stock	24,481,698	18,036,957
Limited partnership/limited liability company interests	35,375,700	12,419,721
Equity warrants/options	1,053,450	217,048
Total investments including unearned income	1,149,163,002	884,947,392
Unearned income	(4,270,367)	(4,270,367)
Total investments	<u>\$1,144,892,635</u>	<u>\$880,677,025</u>

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

At December 31, 2008, investments consisted of the following:

	<u>Cost</u>	<u>Fair Value</u>
Senior secured notes	\$ 53,961,506	\$ 52,341,963
Unsecured debt	204,185,990	139,947,752
Subordinated debt	178,344,344	131,730,865
Senior secured loans:		
First lien	168,886,032	156,001,597
Second/other priority lien	547,728,311	420,003,403
Total senior secured loans	<u>716,614,343</u>	<u>576,005,000</u>
Preferred stock	38,550,784	10,237,280
Common stock	17,127,456	9,311,399
Limited partnership/limited liability company interests	31,176,538	12,535,281
Equity warrants/options	1,143,562	8,198
Total investments including unearned income	1,241,104,523	932,117,738
Unearned income	(5,272,812)	(5,272,812)
Total investments	<u>\$1,235,831,711</u>	<u>\$926,844,926</u>

The industry composition of the portfolio at fair value at September 30, 2009 and December 31, 2008 was as follows, excluding unearned income:

<u>Industry</u>	<u>September 30,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>
Business Services	11.5%	8.9%
Healthcare	9.5	8.1
Other Services	9.1	9.6
Manufacturing	7.7	7.8
Consumer Products	7.4	10.0
Electronics	6.9	7.4
Beverage, Food and Tobacco	6.6	5.5
Transportation	6.0	4.4
Retail	5.8	4.7
Distribution	4.5	4.6
Chemicals	4.5	5.9
Financial Services	4.2	3.8
Metals	4.0	3.5
Utilities	3.4	3.9
Printing, Publishing and Media	3.0	5.0
Containers and Packaging	2.5	2.2
Entertainment and Leisure	2.4	3.5
Building and Real Estate	1.0	1.2
Total	<u>100.0%</u>	<u>100.0%</u>

The geographic composition of the portfolio at fair value at September 30, 2009 was United States 94.0%, Canada 5.9% and United Kingdom and other 0.1%, and at December 31, 2008 was United States 93.3%, Canada 5.0% and United Kingdom and other 1.7%. The geographic composition is determined by the location of the corporate headquarters of the portfolio company.

In the ordinary course of its business, the Company manages a variety of risks relating to its investments, including market risk and credit risk. Market risk is the risk of potential adverse changes to the values of investments because of changes in market conditions such as interest rate movements and volatility in investment prices. Credit risk is the risk of default or non-performance by portfolio companies equivalent to the investment's carrying amount. The Company is also exposed to credit risk related to maintaining all of its cash and cash equivalents at a major financial institution.

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.

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

6. Foreign currency transactions

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 the period. 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 creditworthy counterparties.

At September 30, 2009, 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, 2009</u>	<u>Unrealized Depreciation</u>
Canadian dollar	October 28, 2009	32,500,000 Sold	\$ 30,000,785	\$ 30,409,297	\$ (408,512)

At December 31, 2008, 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, 2008</u>	<u>Unrealized Appreciation/Depreciation</u>
Euro	January 21, 2009	8,500,000 Sold	\$ 10,795,085	\$ 11,849,250	\$(1,054,165)
Canadian dollar	January 21, 2009	33,200,000 Sold	28,034,621	27,316,649	717,972
Total			<u>\$ 38,829,706</u>	<u>\$ 39,165,899</u>	<u>\$ (336,193)</u>

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 statements of operations. Unrealized gains and losses on forward foreign currency contracts are also reported as separate line items within the Company's statements of assets and liabilities.

7. Credit agreement and borrowings

In accordance with the 1940 Act, with certain limited exceptions, the Company is only permitted to borrow such that its asset coverage, as defined in the 1940 Act, is at least 200% after such borrowing. At September 30, 2009, the Company's asset coverage for borrowed amounts was 255%. On December 28, 2007, the Company amended and restated its Senior Secured, Multi-Currency Credit Agreement (the "Credit Agreement"). Under the amended Credit Agreement, the lenders agreed to extend credit to the Company in an aggregate principal amount not to exceed \$600,000,000 outstanding, at any one time, consisting of \$455,000,000 in revolving loan commitments and \$145,000,000 in term loan commitments. Total availability and revolving loan commitments reverted to \$545,000,000 and \$400,000,000, respectively, on April 14, 2008. The Credit Agreement has a stated maturity date of December 6, 2010 and is secured by substantially all of the assets in the Company's portfolio, including cash and cash equivalents. The term loans under the facility mature on the termination date of the Credit Agreement, have been fully drawn and, once repaid, may not be reborrowed. Subject to certain exceptions, the interest rate payable under the facility is LIBOR plus 87.5 basis points with respect to revolving loans and LIBOR plus 150 basis points with respect to term loans. The Credit Agreement also includes an "accordion" feature that allows the Company to increase the size of the credit facility under certain circumstances to a maximum of \$1,000,000,000 with respect to the revolving loans and \$395 million with respect to the term loans. The Credit Agreement is used to supplement the Company's equity capital to make additional portfolio investments and for other general corporate purposes.

At September 30, 2009, the Company had \$347,500,000 drawn on the credit facility versus \$426,000,000 at December 31, 2008. The weighted average annual interest cost for the three and nine months ended September 30, 2009 was 1.44% and 1.56%, respectively, exclusive of 0.175% in commitment fees and of other prepaid expenses related to establishing the credit facility.

The average debt outstanding on the credit facility during the three and nine months ended September 30, 2009 was \$375,751,661 and \$410,515,697, respectively. The maximum amounts borrowed during the three and nine months ended September 30, 2009 was \$383,000,000 and \$434,000,000, respectively, and during the three and nine months ended September 30, 2008 was \$491,000,000. The remaining amount available under the facility was \$197,500,000 at September 30, 2009.

At September 30, 2009, the Company was in compliance with all financial and operational covenants required by the Credit Agreement.

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

8. Capital stock

As a closed-end investment company regulated as a BDC under the 1940 Act, the Company is prohibited from selling shares of its common stock at a price below the current net asset value of the stock, or NAV, unless its stockholders approve such a sale and its Board of Directors makes certain determinations. On May 18, 2009, the Company's stockholders approved a proposal to provide the Company with the flexibility, with approval of its Board of Directors and subject to certain other conditions, to sell shares of its common stock at a price below, but no more than 5 percent below, the then current NAV per share. The approval expires on the earlier of May 18, 2010 or on the date of the Company's 2010 Annual Meeting of Stockholders. Any sale of the Company's common stock at a price below NAV would have a dilutive effect on the NAV.

In August 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 May 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. The repurchase plan is expected to be in effect through the earlier of June 30, 2010 or until the approved number of shares has been repurchased. During the three months ended September 30, 2009, the Company did not make any purchases of its outstanding shares. During the nine months ended September 30, 2009, the Company purchased a total of 583,572 shares of its common stock on the open market for \$2,234,892, including brokerage commissions. Since inception of the repurchase plan through September 30, 2009, the Company has purchased 961,679 shares of its common stock on the open market for \$5,425,900, including brokerage commissions. At September 30, 2009, the total number of remaining shares authorized for repurchase was 1,794,971. The Company currently holds the shares it repurchased in treasury.

Under the terms of the Company's amended and restated dividend reinvestment plan adopted on March 4, 2009, dividends may be paid in newly issued or treasury shares of the Company's common stock at a price equal to 95 percent of the market price on the dividend payment date. This feature of the plan means that, under certain circumstances, the Company may issue shares of its common stock at a price below NAV per share, which could cause the Company's stockholders to experience dilution. With respect to the Company's April 3, 2009 and July 2, 2009 dividends, reinvestment at such prices resulted in dilution of the Company's NAV of approximately \$0.12 per share. Giving effect to the reinvestment at such price of the dividend to be paid by the Company on October 2, 2009 would result in additional dilution of approximately \$0.01 per share.

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 maximum amount of potential future payments under such guarantees was \$6,000,000 at September 30, 2009 with an expiration of July 2011. There were no guarantees outstanding at December 31, 2008. Guarantees made on behalf of portfolio companies are considered in determining the fair value of the Company's investments. The potential liability under such guarantees is reflected at fair value in the Company's schedules of investments.

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 financial statements.

10. Fair value of financial instruments

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 carrying and fair values of the Company's credit facility payable were \$347,500,000 and \$313,000,000 at September 30, 2009 and \$426,000,000 and \$234,000,000 at December 31, 2008, respectively.

Effective January 1, 2008, the Company adopted changes issued by the FASB to ASC 820-10. 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

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

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.

ASC 820-10 establishes a hierarchy that classifies these inputs into the three broad levels listed below:

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

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. Even if observable market data is available, such information may be the result of consensus pricing information or broker quotes which include a disclaimer that the broker would not be held to such a price in an actual transaction. The non-binding nature of consensus pricing and/or quotes accompanied by disclaimer would result in classification as Level 3 information, assuming no additional corroborating evidence.

In addition to using the above inputs in investment valuations, the Company continues to employ the valuation policy approved by its Board of Directors that is consistent with ASC 820-10 (see Note 2). Consistent with this valuation policy, the Company evaluates the source of inputs, including any markets in which its investments are trading, in determining fair value.

The following table summarizes the fair values of the Company's cash and cash equivalents, debt and equity investments and forward foreign currency contracts based on the inputs used as of September 30, 2009 in determining such fair values:

<u>Valuation Inputs</u>	<u>Cash and Cash Equivalents</u>	<u>Debt Investments</u>	<u>Equity Investments</u>	<u>Forward Foreign Currency Contracts</u>
Level 1 - Price quotations	\$ 512,683	\$ —	\$ —	\$ —
Level 2 - Significant other observable inputs	—	—	—	(408,512)
Level 3 - Significant unobservable inputs	—	843,195,259	37,481,766	—
Total fair value	<u>\$ 512,683</u>	<u>\$843,195,259</u>	<u>\$37,481,766</u>	<u>\$ (408,512)</u>

Debt investments include the Company's investments in senior secured notes, unsecured debt, subordinated debt and senior secured loans. Equity investments include the Company's investments in preferred stock, common stock, limited partnership/limited liability company interests and equity warrants/options.

The following table summarizes the valuation techniques used as of September 30, 2009 and December 31, 2008 in determining the fair values of the Company's investments for which significant unobservable inputs (Level 3) were used in determining fair value:

	<u>Debt Investments</u>	<u>Equity Investments</u>	<u>Total Investments</u>
Market approach, income approach or both, utilizing one or more third-party valuation firms	\$833,322,695	\$37,481,766	\$870,804,461
Broker quote(s)	9,872,564	—	9,872,564
Fair value at September 30, 2009	<u>\$843,195,259</u>	<u>\$37,481,766</u>	<u>\$880,677,025</u>
	<u>Debt Investments</u>	<u>Equity Investments</u>	<u>Total Investments</u>
Market approach, income approach or both, utilizing one or more third-party valuation firms	\$873,119,017	\$32,092,158	\$905,211,175
Broker quote(s)	21,633,751	—	21,633,751
Fair value at December 31, 2008	<u>\$894,752,768</u>	<u>\$32,092,158</u>	<u>\$926,844,926</u>

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

The following are reconciliations for the three and nine months ended September 30, 2009 of investments for which Level 3 inputs were used in determining fair value:

	Debt Investments	Equity Investments	Total Investments
Fair value at June 30, 2009	\$852,436,849	\$32,418,749	\$884,855,598
Amortization of premium/discount - net	1,359,922	—	1,359,922
Net realized loss	(53,195,865)	(2,135,407)	(55,331,272)
Net change in unrealized appreciation or depreciation	66,711,615	425,875	67,137,490
Net purchases, sales or redemptions	(24,117,262)	6,772,549	(17,344,713)
Net transfers in or out of Level 3	—	—	—
Fair value at September 30, 2009	<u>\$843,195,259</u>	<u>\$37,481,766</u>	<u>\$880,677,025</u>
	Debt Investments	Equity Investments	Total Investments
Fair value at December 31, 2008	\$894,752,768	\$32,092,158	\$926,844,926
Amortization of premium/discount - net	4,023,105	—	4,023,105
Net realized loss	(60,258,822)	(2,123,167)	(62,381,989)
Net change in unrealized appreciation or depreciation	50,436,857	(5,665,683)	44,771,174
Net purchases, sales or redemptions	(45,758,649)	13,178,458	(32,580,191)
Net transfers in or out of Level 3	—	—	—
Fair value at September 30, 2009	<u>\$843,195,259</u>	<u>\$37,481,766</u>	<u>\$880,677,025</u>

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 statements of operations. Transfers in or out of Level 3 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 following table contains information with respect to net unrealized appreciation or depreciation on investments for which Level 3 inputs were used in determining fair value that are still held by the Company at September 30, 2009.

	Debt Investments	Equity Investments	Total
Net change in unrealized appreciation or depreciation on investments held at end of period:			
Three months ended September 30, 2009	\$ 8,323,848	\$ (1,714,237)	\$ 6,609,611
Nine months ended September 30, 2009	\$ (8,299,797)	\$ (7,793,553)	\$ (16,093,350)
Net unrealized depreciation at September 30, 2009	\$(202,643,742)	\$(61,571,868)	\$(264,215,610)

11. Financial highlights

The following per share data and ratios have been derived from information provided in the financial statements. The following is a schedule of financial highlights for a common share outstanding during the nine months ended September 30, 2009 and 2008.

	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Per Share Data:		
Net asset value, beginning of period	\$ 9.23	\$ 13.78
Net investment income	1.28	1.34
Net realized and unrealized gain (loss)	(0.37)	(2.21)
Total from investment operations	0.91	(0.87)
Dividend distributions to stockholders from net investment income	(0.48)	(1.29)
Issuance of stock under dividend reinvestment plan at prices below net asset value	(0.12)	(0.10)
Purchases of treasury stock at prices below net asset value	0.05	—
Net increase (decrease) in net assets	0.36	(2.26)
Net asset value, end of period	<u>\$ 9.59</u>	<u>\$ 11.52</u>

BlackRock Kelso Capital Corporation
Notes to Financial Statements (Unaudited)—(Continued)

	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Market price, end of period	\$ 7.42	\$ 11.53
Total return(1)(2)	(19.81)%	(14.71)%
Ratios / Supplemental Data:		
Ratio of operating expenses to average net assets(3)	4.65%	4.24%
Ratio of credit facility related expenses to average net assets(3)	1.42%	2.80%
Ratio of total expenses to average net assets(3)	6.07%	7.04%
Ratio of net investment income to average net assets(3)	18.31%	14.12%
Net assets, end of period	\$ 540,376,295	\$ 641,168,890
Average debt outstanding	\$ 410,515,697	\$ 440,610,128
Weighted average shares outstanding	55,738,396	53,588,041
Average debt per share(4)	\$ 7.37	\$ 8.22
Portfolio turnover(2)	8%	10%

- (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.

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 financial statements and notes thereto appearing elsewhere in this report.

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 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 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.

On July 25, 2005, we completed a private placement of 35,366,589 shares of our common stock at a price of \$15.00 per share that raised approximately \$529 million in net proceeds. On July 2, 2007, we completed an initial public offering of 10,000,000 shares of our common stock at a price of \$16.00 per share that raised approximately \$150 million in net proceeds.

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 must 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 all 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.

[Table of Contents](#)

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. Payments of principal of our debt investments may be amortized over the stated term of the investment, deferred for several years or due entirely at maturity. 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, structuring or due diligence fees, fees for providing significant managerial assistance and consulting fees.

Expenses

Our primary operating expenses include the payment of a base management fee and, depending on our operating results, an incentive management fee, 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 financial statements, which have been prepared in accordance with GAAP. The preparation of these 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 markets and any other parameters used in determining such estimates could cause actual results to differ. Our critical accounting policies are further described in the notes to the financial statements and in Note 2 to the financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. See Note 2 to the financial statements in this Quarterly Report for a description of recently issued accounting pronouncements.

Portfolio and investment activity

During the three months ended September 30, 2009, we invested approximately \$11.0 million across five existing portfolio companies. The new investments consisted primarily of senior loans secured by first liens (\$1.5 million, or 14% of the total) or second liens (\$2.2 million, or 20%), unsecured or subordinated debt securities (\$4.6 million, or 42%) and equity securities (\$2.7 million, or 24%). Additionally, we received proceeds from sales/repayments of investment principal of approximately \$28.3 million during the three months ended September 30, 2009.

At September 30, 2009, our net portfolio of \$881 million (at fair value) consisted of 60 portfolio companies and was invested 59% in senior secured loans, 31% in unsecured or subordinated debt securities, 6% in senior secured notes, 4% in equity investments and less than 1% in cash and cash equivalents. Our average portfolio company investment at amortized cost was approximately \$19.1 million. Our largest portfolio company investment by value was approximately \$53.5 million and our five largest portfolio company investments by value comprised approximately 24% of our portfolio at September 30, 2009. At December 31, 2008, our net portfolio of \$943 million (at fair value) consisted of 63 portfolio companies and was invested 61% in senior secured loans, 28% in unsecured or subordinated debt securities, 6% in senior secured notes, 3% in equity investments and approximately 2% in cash and cash equivalents. Our average portfolio company investment at amortized cost was approximately \$19.6 million at December 31, 2008. Our largest portfolio company investment by value was approximately \$41.4 million and our five largest portfolio company investments by value comprised approximately 19% of our portfolio at December 31, 2008.

The weighted average yield of the debt and income producing equity securities in our portfolio at their current cost basis was 10.9% at September 30, 2009 and 11.0% at December 31, 2008. The weighted average yields on our senior secured loans and other debt securities at their current cost basis were 10.0% and 13.2%, respectively, at September 30, 2009, versus 10.2% and 12.2% at December 31, 2008. Yields are computed using interest rates and dividend yields as of the balance sheet date and include amortization of loan origination and commitment fees, original issue discount and market premium or discount. Yields exclude common equity investments, preferred equity investments with no stated dividend rate, short-term investments, cash and cash equivalents.

[Table of Contents](#)

At September 30, 2009, 41% of our debt investments bore interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime Rate, and 59% bore interest at fixed rates. The percentage of our total debt investments that bore floating rate interest based on an interest rate floor was 4% at September 30, 2009. At December 31, 2008, 47% of our debt investments bore interest based on floating rates and 53% bore interest at fixed rates. The percentage of our total debt investments that bore floating rate interest based on an interest rate floor was 8% at December 31, 2008.

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.

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 1.40 at September 30, 2009 versus 1.45 at December 31, 2008. The following is a distribution of the investment ratings of our portfolio companies at September 30, 2009 and December 31, 2008:

	September 30, 2009	December 31, 2008
Grade 1	\$638,423,610	\$626,372,188
Grade 2	178,053,158	245,441,091
Grade 3	33,846,916	11,051,924
Grade 4	34,623,708	49,252,535
Total investments including unearned income	884,947,392	932,117,738
Unearned income	(4,270,367)	(5,272,812)
Total investments	<u>\$880,677,025</u>	<u>\$926,844,926</u>

Results of operations

Results comparisons for the three months ended September 30, 2009 and 2008.

Investment income

Investment income totaled \$29,359,486 and \$37,445,712, respectively, for the three months ended September 30, 2009 and 2008, of which \$15,097,494 and \$22,696,445 were attributable to interest and fees on senior secured loans, \$13,529,859 and \$13,946,741 to interest earned on other debt securities, \$730,988 and \$730,180 to dividends from preferred equity securities, \$1,145 and \$56,204 to interest earned on short-term investments and cash equivalents, and zero and \$16,142 to other income, respectively. The decrease in investment income for the three months ended September 30, 2009 primarily reflects the impact of lower levels of LIBOR on interest income from our floating rate debt investments, which generally bear interest based on LIBOR. Three-month LIBOR averaged 0.41% during the three months ended September 30, 2009, compared to 2.91% during the three months ended September 30, 2008.

Expenses

Expenses for the three months ended September 30, 2009 and 2008 were \$7,577,905 and \$11,863,834, respectively, which consisted of \$4,555,811 and \$5,841,124 in base management fees, \$1,456,369 and \$4,311,893 in

[Table of Contents](#)

interest expense and fees related to the Credit Facility, \$341,872 and \$283,301 in Advisor expenses, \$342,878 and \$622,532 in professional fees, \$174,490 and \$261,744 in administrative services, \$172,031 and \$149,068 in amortization of debt issuance costs, \$152,181 and \$119,781 in insurance expenses, \$84,083 and \$82,450 in director fees and \$298,190 and \$191,941 in other expenses, respectively. The decrease in base management fees for the three months ended September 30, 2009 reflects a decline in the quarterly portfolio values on which the fees are paid (in arrears). The decrease in interest expense and fees related to the Credit Facility is mainly a result of reduced borrowing costs from lower prevailing levels of LIBOR. Other general and administrative expenses were generally lower due to the reduced level of new investment originations.

Net investment income

Net investment income was \$21,781,581 and \$25,581,878 for the three months ended September 30, 2009 and 2008, respectively. The decrease is primarily a result of a decline in interest income, which was partially offset by a decrease in interest and other expenses.

Net realized gain or loss

Net realized loss of \$(56,312,662) for the three months ended September 30, 2009 was the result of \$(55,331,272) in net realized loss from the disposition of investments and \$(981,390) in net realized loss on foreign currency transactions during the period. Net realized loss from the disposition of investments for the three months ended September 30, 2009 resulted primarily from the restructuring of our investments in Advanstar Inc., Alpha Media Group Inc. and Mattress Giant Corporation. The entire net realized loss represents amounts that had been reflected in unrealized depreciation on investments in prior periods. Foreign currency losses mainly represent losses on forward currency contracts used to hedge our investments denominated in foreign currencies. For the three months ended September 30, 2008, the net realized gain was \$29,210.

Net unrealized appreciation or depreciation

For the three months ended September 30, 2009 and 2008, the net change in unrealized appreciation or depreciation on our investments and foreign currency translation was appreciation of \$65,677,047 and depreciation of \$(44,404,606), respectively. The net unrealized appreciation for the three months ended September 30, 2009 was comprised of net unrealized appreciation on investments of \$67,137,490 and net unrealized depreciation on foreign currency translation of \$(1,460,443). The net unrealized appreciation on investments for the three months ended September 30, 2009 includes \$60,622,457 relating to the reversal of prior period net unrealized depreciation as a result of investment restructurings and dispositions. The net unrealized appreciation during the third quarter of 2009 was primarily a result of the reversals described above and improved capital market conditions. The valuations of our investments were favorably impacted by market-wide decreases in interest yields, as well as increases in multiples used to estimate the fair value of some of our investments. Market-wide movements and trading multiples are not necessarily indicative of any fundamental change in the condition or prospects of our portfolio companies. The net unrealized depreciation for the three months ended September 30, 2008 was comprised of net unrealized depreciation on investments of \$(47,423,050) and net unrealized appreciation on foreign currency translation of \$3,018,444.

Net increase or decrease in net assets resulting from operations

The net increase or decrease in net assets resulting from operations for the three months ended September 30, 2009 and 2008 was an increase of \$31,145,966 and a decrease of \$(18,793,518), respectively. As compared to the prior period, the increase primarily reflects the net unrealized appreciation on investments for the three months ended September 30, 2009.

Results comparisons for the nine months ended September 30, 2009 and 2008.

Investment income

Investment income totaled \$94,610,414 and \$108,014,165, respectively, for the nine months ended September 30, 2009 and 2008, of which \$52,118,041 and \$66,658,468 were attributable to interest and fees on senior secured loans, \$40,338,190 and \$39,012,023 to interest earned on other debt securities, \$2,143,158 and \$2,251,933 to dividends from preferred equity securities, \$11,025 and \$73,303 to interest earned on short-term investments and cash equivalents, and zero and \$18,438 to other income, respectively. The decrease in investment income primarily reflects the impact of lower levels of LIBOR on interest income from our floating rate debt investments, which generally bear interest based on LIBOR. Three-month LIBOR averaged 0.83% during the nine months ended September 30, 2009, compared to 2.98% during the nine months ended September 30, 2008.

Expenses

Expenses for the nine months ended September 30, 2009 and 2008 were \$23,542,048 and \$35,954,687, respectively, which consisted of \$13,951,061 and \$16,991,573 in base management fees, \$5,004,980 and \$13,818,524 in interest expense and fees related to the Credit Facility, \$1,028,939 and \$822,150 in Advisor expenses, \$949,444 and \$1,461,003 in professional fees, \$605,525 and \$867,177 in administrative services, \$511,520 and \$482,493 in amortization of debt issuance costs, \$413,406 and \$396,217 in insurance expenses, \$268,238 and \$275,185 in director fees and \$808,935 and \$840,365 in other expenses, respectively. The decrease in base management fees for the nine months ended September 30, 2009 reflects a decline in the quarterly portfolio values on which the fees are paid (in arrears). The decrease in interest expense and fees related to the Credit Facility is mainly a result of reduced borrowing costs from lower prevailing levels of LIBOR. Other general and administrative expenses were generally lower due to the reduced level of new investment originations.

Net investment income

Net investment income was \$71,068,366 and \$72,059,478 for the nine months ended September 30, 2009 and 2008, respectively. The decrease is primarily a result of a decline in interest income, which was partially offset by a decrease in interest and other expenses.

Net realized gain or loss

Net realized loss of \$(64,850,420) for the nine months ended September 30, 2009 was the result of \$(62,381,989) in net realized loss from the disposition of investments and \$(2,468,431) in net realized loss on foreign currency transactions during the period. Net realized loss from the disposition of investments for the nine months ended September 30, 2009 resulted primarily from the restructuring of our investments in Advanstar Inc., Alpha Media Group Inc., Mattress Giant Corporation and United Subcontractors Inc. Over 80 percent of the net realized loss represents amounts that had been reflected as unrealized depreciation on investments in prior periods. Foreign currency losses mainly represent losses on forward currency contracts used to hedge our investments denominated in foreign currencies. For the nine months ended September 30, 2008, the net realized loss was \$(1,283,728).

Net unrealized appreciation or depreciation

For the nine months ended September 30, 2009 and 2008, the change in net unrealized appreciation or depreciation was an increase in net unrealized appreciation of \$44,682,650 and \$(117,183,448), respectively. The increase in net unrealized appreciation for the nine months ended September 30, 2009 was comprised of net unrealized appreciation on investments of \$44,771,174 and net unrealized depreciation on foreign currency translation of \$(88,524). The net unrealized appreciation on investments for the nine months ended September 30, 2009 includes \$57,668,438 relating to the reversal of prior period net unrealized depreciation as a result of investment restructurings and dispositions. The net unrealized appreciation for the nine months ended September 30, 2009 was primarily a result of the reversals described above and improved capital market conditions. The valuations of our investments were favorably impacted by market-wide decreases in interest yields, as well as increases in multiples used to estimate the fair value of some of our investments. Market-wide movements and trading multiples are not necessarily indicative of any fundamental change in the condition or prospects of our portfolio companies. The increase in net unrealized depreciation for the nine months ended September 30, 2008 was comprised of net unrealized depreciation on investments of \$(120,901,578) and net unrealized appreciation on foreign currency translation of \$3,718,130.

Net increase or decrease in net assets resulting from operations

The net increase or decrease in net assets resulting from operations for the nine months ended September 30, 2009 and 2008 was an increase of \$50,900,596 and a decrease of \$(46,407,698), respectively. As compared to the prior period, the increase primarily reflects the net unrealized appreciation on investments for the nine months ended September 30, 2009.

Financial condition, liquidity and capital resources

During the nine months ended September 30, 2009, we generated operating cash flows primarily from interest earned and fees received on senior secured loans and other debt securities.

Net cash provided by operating activities during the nine months ended September 30, 2009 was \$94,483,894. Our primary sources of cash from operating activities during the period consisted of a net increase in net assets from operations of \$50,900,596 and sales of investments (net of purchases) of \$34,075,338.

[Table of Contents](#)

We used \$109,767,528 for financing activities during the nine months ended September 30, 2009, consisting primarily of \$29,032,636 of dividend distributions, \$78,500,000 of net repayments under our Credit Facility and \$2,234,892 of treasury stock purchases.

On December 28, 2007, we amended and restated our senior secured, multi-currency Credit Facility to provide us with \$600,000,000 in total availability, consisting of \$455,000,000 in revolving loan commitments and \$145,000,000 in term loan commitments. Total availability and revolving commitments reverted to \$545,000,000 and \$400,000,000, respectively, on April 14, 2008. Subject to certain conditions, we have the ability in the future to seek additional commitments from new and existing lenders up to an aggregate amount not to exceed \$1,000,000,000 with respect to revolving loans and \$395,000,000 with respect to term loans. The interest rate applicable to borrowings under the Credit Facility is generally LIBOR plus 87.5 basis points with respect to revolving loans and LIBOR plus 150 basis points with respect to term loans. The term loans have been fully drawn and mature on December 6, 2010, the termination date of the Credit Facility, and term loans, once repaid, may not be reborrowed. The Credit Facility is secured by substantially all of the assets in our portfolio, including cash and cash equivalents. At September 30, 2009, we had \$347,500,000 drawn and outstanding under the Credit Facility, with \$197,500,000 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, 2009, we had \$512,683 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.

On October 23, 2008, our Form N-2 shelf registration statement was declared effective by the SEC. The shelf registration permits us to offer, from time to time, up to \$1 billion 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.

As a closed-end investment company regulated as a BDC under the 1940 Act, we are prohibited from selling shares of our common stock at a price below the current net asset value of the stock, or NAV, unless our stockholders approve such a sale and our Board of Directors makes certain determinations. On May 18, 2009, our stockholders approved a proposal to provide us with the flexibility, with approval of our Board of Directors and subject to certain other conditions, to sell shares of our common stock at a price below, but no more than 5 percent below, our then current NAV per share. The approval expires on the earlier of May 18, 2010 or on the date of our 2010 Annual Meeting of Stockholders. Any sale of our common stock at a price below NAV would have a dilutive effect on our NAV.

The economic downturn generally and the disruptions in the capital markets in particular have decreased liquidity and increased the cost of raising capital, where available. In the near term, we expect to meet our liquidity needs through use of the remaining availability under our Credit Facility, continued cash flows from operations and investment sales. In the future, we may raise additional equity or debt capital off our shelf registration or may securitize a portion of our investments, among other options. However, under current market conditions equity capital may be difficult to raise because our ability to issue and sell our common stock at a price below NAV per share is limited in certain respects. In addition, the debt capital that will be available, if at all, may be at a higher cost, and on less favorable terms and conditions in the future. Continued inability to raise capital would have a negative effect on our operations.

Contractual obligations

A summary of our significant contractual payment obligations for the repayment of outstanding borrowings under our Credit Facility at September 30, 2009 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 Payable(1)	\$347.5	\$ —	\$ 347.5	\$ —	\$ —

(1) At September 30, 2009, \$197.5 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 maximum amount of potential future payments under such guarantees

[Table of Contents](#)

was \$6,000,000 at September 30, 2009 with an expiration of July 2011. There were no guarantees outstanding at December 31, 2008. Guarantees made on behalf of portfolio companies are considered in determining the fair value of the Company's investments.

Dividends

We intend to distribute quarterly dividends to our stockholders. Our quarterly dividends are determined by our Board of Directors. Dividends declared by the Company since July 25, 2005 (inception of operations) have been as follows:

<u>Dividend Amount Per Share Outstanding</u>	<u>Record Date</u>	<u>Pay Date</u>
\$0.20	December 31, 2005	January 31, 2006
\$0.20	March 15, 2006	March 31, 2006
\$0.23	June 15, 2006	June 30, 2006
\$0.30	September 15, 2006	September 29, 2006
\$0.42	December 31, 2006	January 31, 2007
\$0.42	March 15, 2007	March 30, 2007
\$0.42	May 15, 2007	May 31, 2007
\$0.42	September 14, 2007	September 28, 2007
\$0.43	December 14, 2007	December 31, 2007
\$0.43	March 17, 2008	March 31, 2008
\$0.43	June 16, 2008	June 30, 2008
\$0.43	September 15, 2008	September 30, 2008
\$0.43	December 15, 2008	December 31, 2008
\$0.16	March 20, 2009	April 3, 2009
\$0.16	June 19, 2009	July 2, 2009
\$0.16	September 18, 2009	October 2, 2009
\$0.32	December 21, 2009	January 4, 2010

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

The Company has qualified and elected and intends to continue to qualify for the tax treatment applicable to regulated investment companies under Subchapter M of the Code, and, among other things, has made and intends to continue to make the requisite distributions to its stockholders which will relieve the Company from federal income taxes. Therefore, no provision has been recorded for federal income taxes. 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. The Company will accrue excise tax on estimated undistributed taxable income as required.

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 investment company taxable income, as defined by the Code. To avoid federal excise taxes, the Company must distribute annually at least 98% of its income (both ordinary income and net capital gains).

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 distributions declared to stockholders for the nine months ended September 30, 2009, a total of \$9,084,002 was reinvested pursuant to our dividend reinvestment plan. With respect to our distributions declared to stockholders for the nine months ended September 30, 2008, a total of \$28,689,391 was reinvested pursuant to our dividend reinvestment plan.

Under the terms of our amended and restated 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. With respect to our distributions declared to stockholders for the nine months ended September 30, 2009, reinvestment at such prices resulted in cumulative dilution of our net asset value of approximately \$0.13 per share.

Income we receive from origination, structuring, closing, commitment and other upfront fees associated with investments in portfolio companies is treated as taxable income when received and accordingly, distributed to stockholders. For financial reporting purposes, such fees are recorded as unearned income and accreted/amortized over the life of the respective investment. For the three and nine months ended September 30, 2009, there were no such fees.

[Table of Contents](#)

For the three and nine months ended September 30, 2008, these fees totaled zero and \$2,571,938, respectively. We anticipate earning additional upfront fees in the future and such fees may cause our taxable income to exceed our GAAP income, although the differences are expected to be temporary in nature.

Temporary guidance issued by the Internal Revenue Service earlier this year permits publicly-traded RICs to distribute stock to satisfy their distribution requirements if stated conditions are met. Our Board of Directors has not yet made a determination whether to utilize the new guidance.

Recent developments

On November 4, 2009, our Board of Directors declared a dividend of \$0.32 per share, payable on January 4, 2010 to stockholders of record at the close of business on December 21, 2009.

Notice is hereby given in accordance with Section 23 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, 2009, 41% of our debt investments bore interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime Rate. The interest rates on such investments generally reset by reference to the current market index after one to six months. At September 30, 2009, the percentage of our total debt investments that bore floating rate interest based on an interest rate floor was 4%. 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, we have performed the following analysis based on our September 30, 2009 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 a decline of approximately \$11,300,000, or \$0.20 per share, in the value of our net assets at September 30, 2009 and a corresponding 100 basis point decrease in LIBOR and U.S. Treasury yields would cause an increase of approximately \$10,800,000, or \$0.19 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, 2009 and 2008, 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 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.

[Table of Contents](#)

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

Sales of unregistered securities

None.

Issuer purchases of equity securities

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

[Table of Contents](#)

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 5, 2009

By: _____ /s/ JAMES R. MAHER
James R. Maher
Chief Executive Officer

Date: November 5, 2009

By: _____ /s/ FRANK D. GORDON
Frank D. Gordon
Chief Financial Officer

CEO CERTIFICATION

I, James R. Maher, Chairman of the Board and Chief Executive Officer of BlackRock Kelso Capital Corporation, 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 financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer 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)) 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; and

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and

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 5, 2009

By: /s/ James R. Maher

James R. Maher
Chairman of the Board and
Chief Executive Officer

CFO CERTIFICATION

I, Frank D. Gordon, Chief Financial Officer and Treasurer of BlackRock Kelso Capital Corporation, 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 financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer 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)) 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; and

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and

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 5, 2009

By: /s/ Frank D. Gordon

Frank D. Gordon

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, 2009 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 Frank D. Gordon, 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 financial condition and results of operations of the Company.

/s/ James R. Maher

Name: James R. Maher
Title: Chief Executive Officer
Date: November 5, 2009

/s/ Frank D. Gordon

Name: Frank D. Gordon
Title: Chief Financial Officer
Date: November 5, 2009