

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 June 30, 2006

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 000-51327

BlackRock Kelso Capital Corporation  
-----

(Exact Name of Registrant as Specified in Its Charter)

Delaware 20-2725151  
-----

(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

40 East 52nd Street, New York, New York 10022  
-----

(Address of Principal Executive Offices) (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 is a large accelerated  
filer, an accelerated filer or a non-accelerated filer as defined in Rule 12b-2  
of the Exchange Act. Large accelerated filer  Accelerated filer   
Non-Accelerated filer

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 August 10, 2006, was 36,893,977.

BLACKROCK KELSO CAPITAL CORPORATION

FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2006

Table of Contents

| INDEX   | PAGE NO.  |    |
|---------|---|----|
| -----   | -----   |    |
| PART I. | FINANCIAL INFORMATION   |    |
| Item 1. | Financial Statements  |    |
|         | Statements of Assets and Liabilities as of<br>June 30, 2006 (unaudited) and December 31, 2005 | 4  |
|         | Statements of Operations (unaudited) for the<br>three and six months ended June 30, 2006      | 5  |
|         | Statement of Changes in Net Assets (unaudited)<br>for the six months ended June 30, 2006      | 6  |
|         | Statement of Cash Flows (unaudited) for<br>the six months ended June 30, 2006                 | 7  |
|         | Schedules of Investments as of June 30, 2006<br>(unaudited) and December 31, 2005             | 8  |
|         | Notes to Financial Statements (unaudited)   | 15 |
| Item 2. | Management's Discussion and Analysis of Financial<br>Condition and Results of Operations      | 21 |

|            |  |    |
|------------|--|----|
| Item 3.    | Quantitative and Qualitative Disclosures about<br>Market Risk  | 25 |
| Item 4.    | Controls and Procedures  | 25 |
| PART II.   | OTHER INFORMATION  |    |
| Item 1.    | Legal Proceedings  | 26 |
| Item 1A.   | Risk Factors   | 26 |
| Item 2.    | Unregistered Sales of Equity Securities and<br>Use of Proceeds | 26 |
| Item 3.    | Defaults Upon Senior Securities                                | 26 |
| Item 4.    | Submission of Matters to a Vote of Security Holders            | 26 |
| Item 5.    | Other Information  | 26 |
| Item 6.    | Exhibits   | 27 |
| SIGNATURES |  | 28 |

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 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. BlackRock Kelso Capital Corporation (the "Company") cautions that 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 the Company assumes no duty to and does not undertake to update forward-looking statements. Actual results could differ materially from those anticipated in forward-looking statements and future results could differ materially from historical performance.

In addition to factors previously disclosed in the Company's Securities and Exchange Commission (the "SEC") reports and those identified elsewhere in this report, the following factors, among others, could cause actual results to differ materially from forward-looking statements or historical performance:

- (1) the introduction, withdrawal, success and timing of business initiatives and strategies;
- (2) changes in political, economic or industry conditions, the interest rate environment or financial and capital markets, which could result in changes in the value of the Company's assets;
- (3) the relative and absolute investment performance and operations of the Company's investment adviser, BlackRock Kelso Capital Advisors LLC (the "Investment Advisor");
- (4) the impact of increased competition;
- (5) the impact of future acquisitions and divestitures;
- (6) the unfavorable resolution of legal proceedings;
- (7) the extent and timing of any share repurchases;
- (8) the impact, extent and timing of technological changes and the adequacy of intellectual property protection;
- (9) the impact of legislative and regulatory actions and reforms and regulatory, supervisory or enforcement actions of government agencies relating to the Company or the Investment Advisor;
- (10) terrorist activities, which may adversely affect the general economy, real estate, financial and capital markets, specific industries, and the Company and the Investment Advisor;
- (11) the ability of the Investment Advisor to attract and retain highly talented professionals;
- (12) fluctuations in foreign currency exchange rates; and
- (13) the impact of changes to tax legislation and, generally, the tax position of the Company.

Forward-looking statements speak only as of the date they are made. The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

## PART I. 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

|   | JUNE 30, 2006<br>(UNAUDITED) | DECEMBER 31, 2005 |
|---|------------------------------|-------------------|
|   | -----                        | -----             |
| <b>ASSETS:</b>  |                              |                   |
| Cash and cash equivalents (amortized cost of \$123,522,867 and \$288,984,387)   | \$ 123,522,867               | \$ 288,972,347    |
| Investments, at fair value (amortized cost of \$451,148,550 and \$250,184,074)  | 453,205,721                  | 250,436,350       |
| Receivable for investments sold   | -                            | 996,250           |
| Interest receivable   | 3,710,392                    | 1,656,131         |
| Dividends receivable  | 32,378                       | -                 |
| Other assets  | 143,583                      | 165,363           |
|   | -----                        | -----             |
| Total Assets  | \$ 580,614,941               | \$ 542,226,441    |
|   | =====                        | =====             |
| <b>LIABILITIES:</b>   |                              |                   |
| Payable to custodian  | \$ 17,348,239                | \$ -              |
| Payable for investments purchased   | 6,247,500                    | 4,198,296         |
| Dividend distribution payable   | 19,832                       | 7,073,318         |
| Legal fees (offering costs) payable   | 584,453                      | 587,080           |
| Management fees payable   | 453,573                      | 455,329           |
| Accrued administrative services expenses  | 967,726                      | 508,950           |
| Other accrued expenses and payables   | 612,673                      | 698,619           |
|   | -----                        | -----             |
| Total Liabilities   | 26,233,996                   | 13,521,592        |
|   | -----                        | -----             |
| <b>NET ASSETS:</b>  |                              |                   |
| Common stock, par value \$.001 per share, 40,000,000 common shares authorized, 36,893,977 and 35,366,589 issued and outstanding | 36,894                       | 35,367            |
| Paid-in capital in excess of par  | 552,207,075                  | 529,298,432       |
| Undistributed (distributions in excess of) net investment income  | 281,509                      | (870,327)         |
| Accumulated net realized (loss) gain  | (201,704)                    | 1,141             |
| Net unrealized appreciation   | 2,057,171                    | 240,236           |
|   | -----                        | -----             |
| Total Net Assets  | 554,380,945                  | 528,704,849       |
|   | -----                        | -----             |
| Total Liabilities and Net Assets  | \$ 580,614,941               | \$ 542,226,441    |
|   | =====                        | =====             |
| Net Asset Value Per Share   | \$ 15.03                     | \$ 14.95          |
|   | =====                        | =====             |

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

BLACKROCK KELSO CAPITAL CORPORATION  
STATEMENTS OF OPERATIONS (UNAUDITED)

|   | FOR THE THREE MONTHS<br>ENDED<br>JUNE 30, 2006 | FOR THE SIX MONTHS<br>ENDED<br>JUNE 30, 2006 |
|---|--|--|
|   | -----  | -----  |
| INVESTMENT INCOME:                                    |  |  |
| Interest income                                       | \$ 11,963,082                                  | \$ 20,442,574                                |
| Dividend income                                       | 161,419  | 313,337                                      |
| Other income  | 20,134   | 122,134                                      |
|   | -----  | -----  |
| Total investment income                               | 12,144,635                                     | 20,878,045                                   |
|   | -----  | -----  |
| EXPENSES:   |  |  |
| Management fees                                       | 2,734,456                                      | 5,399,334                                    |
| Administrative services                               | 291,762  | 580,107                                      |
| Professional fees                                     | 106,082  | 319,999                                      |
| Investment Advisor expenses                           | 203,179  | 281,136                                      |
| Director fees   | 86,873   | 157,061                                      |
| Insurance   | 46,566   | 83,105                                       |
| Other   | 45,651   | 79,687                                       |
|   | -----  | -----  |
| Expenses before management fee waiver                 | 3,514,569                                      | 6,900,429                                    |
| Management fee waiver                                 | (1,367,361)                                    | (2,699,800)                                  |
|   | -----  | -----  |
| Net expenses  | 2,147,208                                      | 4,200,629                                    |
|   | -----  | -----  |
| NET INVESTMENT INCOME                                 | 9,997,427                                      | 16,677,416                                   |
|   | -----  | -----  |
| REALIZED AND UNREALIZED GAIN (LOSS):                  |  |  |
| Net realized gain (loss) on investments               | 202,321  | (202,845)                                    |
|   | -----  | -----  |
| Net change in unrealized appreciation (depreciation): |  |  |
| Investments   | 970,702  | 1,804,895                                    |
| Cash equivalents                                      | -  | 12,040                                       |
|   | -----  | -----  |
| Net change in unrealized appreciation                 | 970,702  | 1,816,935                                    |
|   | -----  | -----  |
| Net realized and unrealized gain                      | 1,173,023                                      | 1,614,090                                    |
|   | -----  | -----  |
| NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS  | \$ 11,170,450                                  | \$ 18,291,506                                |
|   | =====  | =====  |
| Earnings Per Share                                    | \$ 0.31  | \$ 0.51                                      |
|   | =====  | =====  |
| Basic and Diluted Weighted-Average Shares Outstanding | 36,345,171                                     | 36,017,156                                   |

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

BLACKROCK KELSO CAPITAL CORPORATION  
STATEMENT OF CHANGES IN NET ASSETS (UNAUDITED)  
FOR THE SIX MONTHS ENDED JUNE 30, 2006

NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS:

|  |               |
|--|---------------|
| Net investment income                                | \$ 16,677,416 |
| Net change in unrealized appreciation                | 1,816,935     |
| Net realized loss on investments                     | (202,845)     |
|  | -----         |
| Net increase in net assets resulting from operations | 18,291,506    |
|  | -----         |

|  |              |
|--|--------------|
| DIVIDENDS TO SHAREHOLDERS FROM NET INVESTMENT INCOME | (15,525,485) |
|  | -----        |

|  |            |
|--|------------|
| CAPITAL SHARE TRANSACTIONS:  |            |
| Proceeds from shares sold  | 810,000    |
| Reinvestment of dividends  | 22,100,075 |
|  | -----      |
| Net increase in net assets resulting from capital share transactions | 22,910,075 |
|  | -----      |

|                                   |             |
|-----------------------------------|-------------|
| TOTAL INCREASE IN NET ASSETS      | 25,676,096  |
| Net assets at beginning of period | 528,704,849 |
|                                   | -----       |

|                             |                |
|-----------------------------|----------------|
| Net assets at end of period | \$ 554,380,945 |
|                             | =====          |

|  |              |
|--|--------------|
| CAPITAL SHARE ACTIVITY:                      |              |
| Shares issued from subscriptions             | 54,000       |
| Shares issued from reinvestment of dividends | 1,473,388    |
|  | -----        |
| Total increase in shares                     | \$ 1,527,388 |
|  | =====        |

|                                     |            |
|-------------------------------------|------------|
| ACCUMULATED DISTRIBUTIONS:          |            |
| Undistributed net investment income | \$ 281,509 |
|                                     | =====      |

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

BLACKROCK KELSO CAPITAL CORPORATION  
STATEMENT OF CASH FLOWS (UNAUDITED)  
FOR THE SIX MONTHS ENDED JUNE 30, 2006

OPERATING ACTIVITIES:

|   |    |               |
|---|----|---------------|
| Net increase in net assets resulting from operations  | \$ | 18,291,506    |
| Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities: |    |               |
| Proceeds from dispositions of short-term investments - net  |    | 24,990,928    |
| Purchases of long-term investments  |    | (260,908,244) |
| Proceeds from principal repayments/dispositions of long-term investments  |    | 35,363,676    |
| Net change in unrealized appreciation on investments  |    | (1,804,895)   |
| Net realized loss on investments  |    | 202,845       |
| Amortization of premium/discount - net  |    | (615,961)     |
| Decrease in receivable for investments sold   |    | 996,250       |
| Increase in interest receivable   |    | (2,054,261)   |
| Increase in dividends receivable  |    | (32,378)      |
| Decrease in other assets  |    | 21,780        |
| Increase in payable for investments purchased   |    | 2,049,204     |
| Decrease in legal fees (offering costs) payable   |    | (2,627)       |
| Decrease in management fees payable   |    | (1,756)       |
| Increase in accrued administrative services expenses  |    | 458,776       |
| Decrease in other accrued expenses and payables   |    | (85,946)      |
|   |    | -----         |
| Net cash used in operating activities   |    | (183,131,103) |
|   |    | -----         |

FINANCING ACTIVITIES:

|   |    |               |
|---|----|---------------|
| Increase in payable to custodian                          |    | 17,348,239    |
| Proceeds from capital subscriptions                       |    | 810,000       |
| Dividends paid - net of reinvestment                      |    | (476,616)     |
|   |    | -----         |
| Net cash provided by financing activities                 |    | 17,681,623    |
|   |    | -----         |
| Net decrease in cash and cash equivalents                 |    | (165,449,480) |
| Cash and cash equivalents, beginning of period            |    | 288,972,347   |
|   |    | -----         |
| Cash and cash equivalents, end of period                  | \$ | 123,522,867   |
|   |    | =====         |
| Supplemental disclosure of non-cash financing activities: |    |               |
| Dividend distributions reinvested                         | \$ | 22,100,075    |
|   |    | =====         |

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

BLACKROCK KELSO CAPITAL CORPORATION  
SCHEDULES OF INVESTMENTS (UNAUDITED)  
JUNE 30, 2006

| Portfolio Company (a)<br>-----  | Industry<br>-----            | Principal<br>Amount or<br>Number of<br>Shares/Units<br>----- | Cost (b)<br>----- | Fair<br>Value<br>----- |
|---|------------------------------|--|-------------------|------------------------|
| <b>SHORT-TERM INVESTMENTS - 14.8%</b><br>-----  |                              |  |                   |                        |
| Asset-Backed Security - 2.7%  |                              |  |                   |                        |
| RACERS Trust, Series 2005-17-0, 5.21%<br>(LIBOR + 0.02%/Q), 8/21/06, acquired 8/29/05 (c)                         | Asset-Backed Security        | \$ 15,000,000  | \$ 15,000,000     | \$ 15,000,000          |
| -----   |                              |  |                   |                        |
| Certificates of Deposit - 2.7%  |                              |  |                   |                        |
| DEPPA BANK plc, New York, 4.53%, 10/16/06   | Banking                      | 15,000,000   | 15,000,000        | 14,948,577             |
| -----   |                              |  |                   |                        |
| Commercial Paper - 8.3%   |                              |  |                   |                        |
| Morgan Stanley & Co. Incorporated, 5.39%, 8/4/06  | Securities Broker and Dealer | 26,000,000   | 26,000,000        | 26,000,000             |
| Natexis Banques Populaires US Finance Co. LLC,<br>4.56%, 7/31/06  | Banking                      | 20,000,000   | 19,924,083        | 19,924,083             |
| -----   |                              |  |                   |                        |
| Total Commercial Paper  |                              | 46,000,000   | 45,924,083        | 45,924,083             |
| -----   |                              |  |                   |                        |
| Master Notes - 1.1%   |                              |  |                   |                        |
| Citigroup Global Markets Inc., 4.63%, 8/25/06   | Financial Services           | 6,000,000  | 6,000,000         | 6,000,000              |
| -----   |                              |  |                   |                        |
| TOTAL SHORT-TERM INVESTMENTS  |                              | \$ 82,000,000  | \$ 81,924,083     | \$ 81,872,660          |
| =====   |                              |  |                   |                        |
| <b>LONG-TERM INVESTMENTS - 66.9%</b><br>-----   |                              |  |                   |                        |
| Subordinated Debt / Corporate Notes - 1.6%  |                              |  |                   |                        |
| First Mercury Holdings, Inc., 13.17%<br>(LIBOR + 8.00%/Q), 8/15/12, acquired 8/12/05 (c)                          | Insurance                    | \$ 1,800,000   | 1,784,239         | 1,854,000              |
| U.S. Security Holdings, Inc., 13.00%, 5/8/14,<br>acquired 5/10/06 (c)   | Security Services            | 7,000,000  | 7,000,000         | 7,026,250              |
| -----   |                              |  |                   |                        |
| Total Subordinated Debt / Corporate Notes   |                              | \$ 8,800,000   | 8,784,239         | 8,880,250              |
| -----   |                              |  |                   |                        |
| Senior Secured Loans (d) - 64.0%  |                              |  |                   |                        |
| AGY Holding Corp., Second Lien, 12.50%<br>(LIBOR + 7.00%), 4/7/13   | Glass Yarns/Fibers           | \$ 10,000,000  | 10,000,000        | 10,150,000             |
| ALM Media, Inc., Second Lien, 11.25%<br>(LIBOR + 5.75%), 3/7/11   | Publishing                   | 39,750,000   | 39,752,286        | 39,978,563             |
| Applied Tech Products Corp. et al., Tranche A,<br>First Lien, 9.32% (LIBOR + 4.50%), 10/24/10                     | Plastic Packaging            | 4,251,515  | 4,222,979         | 4,222,979 (e)          |
| Applied Tech Products Corp. et al., Tranche B,<br>Second Lien, 13.82% (LIBOR + 9.00%), 4/24/11                    | Plastic Packaging            | 1,951,515  | 1,933,858         | 1,933,858 (e)          |
| Applied Tech Products Corp. et al., Tranche C,<br>Third Lien, 17.32% (LIBOR + 6.30% cash,<br>6.20% PIK), 10/24/11 | Plastic Packaging            | 715,236  | 625,010           | 625,010 (e)            |

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



BLACKROCK KELSO CAPITAL CORPORATION  
SCHEDULES OF INVESTMENTS (UNAUDITED) (continued)  
JUNE 30, 2006

| Portfolio Company (a)   | Industry                               | Principal<br>Amount or<br>Number of<br>Shares/Units | Cost (b)     | Fair<br>Value  |
|---|--|---|--------------|----------------|
| Bare Escentuals Beauty, Inc., Second Lien, 12.43%<br>(LIBOR + 7.00%), 2/18/13                               | Cosmetics                              | \$ 4,000,000  | \$ 4,000,000 | \$ 4,040,000   |
| Benchmark Medical Holdings Inc., First Lien, 8.34%<br>(LIBOR + 3.00%), 12/27/12                             | Rehabilitation Centers                 | 1,990,000   | 1,990,000    | 1,990,000      |
| Benchmark Medical Holdings, Inc., Second Lien,<br>12.06% (LIBOR + 7.00%), 6/27/13                           | Rehabilitation Centers                 | 9,000,000   | 9,000,000    | 9,000,000      |
| Bushnell Performance Optics, First Lien, 8.32%<br>(LIBOR + 3.00%), 8/19/11                                  | Leisure Products                       | 995,122   | 995,122      | 1,000,512      |
| Cambridge International, Inc., Second Lien, 12.31%<br>(LIBOR + 6.50%), 11/11/13                             | Metal Conveyor Belts                   | 20,500,000  | 20,298,814   | 20,295,000     |
| Cannondale Bicycle Corporation, Second Lien, 12.35%<br>(LIBOR + 7.00%), 6/5/10                              | Bicycles/Apparel                       | 10,000,000  | 10,000,000   | 10,000,000 (e) |
| Champion Energy Corporation et al., First Lien, 10.50%<br>(LIBOR + 5.00%), 6/29/11                          | Heating and Oil Services               | 15,000,000  | 15,000,000   | 15,000,000 (e) |
| Champion Energy Corporation et al., Second Lien,<br>16.00% (12.00% cash, 4.00% PIK), 6/30/12                | Heating and Oil Services               | 20,000,000  | 19,700,000   | 19,700,000 (e) |
| Clean Earth Inc., Tranche B, First Lien, 7.98%<br>(LIBOR + 2.75%), 10/17/11                                 | Environmental Services                 | 1,462,521   | 1,462,521    | 1,466,177      |
| Data Transmission Network Corporation, Second Lien,<br>13.30% (LIBOR + 8.00%), 9/10/13                      | Information Services                   | 4,000,000   | 4,000,000    | 4,000,000      |
| Delta Air Lines, Inc., Term Loan B, First Lien, 10.02%<br>(LIBOR + 4.75%), 3/16/08                          | Airlines                               | 1,000,000   | 1,000,000    | 1,020,313      |
| Deluxe Entertainment Services Group Inc., Second Lien,<br>13.75% (LIBOR + 8.25%), 7/28/11                   | Entertainment                          | 16,000,000  | 16,000,000   | 16,480,000     |
| DynaVox Systems LLC, Term Loan B, First Lien,<br>9.00% (LIBOR + 3.50%), 6/30/11                             | Augmentative<br>Communication Products | 3,500,000   | 3,474,006    | 3,500,000      |
| DynaVox Systems LLC, Term Loan C, First Lien,<br>10.50% (LIBOR + 5.00%), 12/13/11                           | Augmentative<br>Communication Products | 1,750,000   | 1,736,993    | 1,750,000      |
| Eight O'Clock Coffee Company, First Lien, 8.13%<br>(LIBOR + 3.00%), 11/14/11                                | Coffee Distributor                     | 2,705,357   | 2,705,357    | 2,705,357      |
| Eight O'Clock Coffee Company, Second Lien, 12.13%<br>(LIBOR + 7.00%), 11/14/12                              | Coffee Distributor                     | 12,000,000  | 12,000,000   | 12,180,000     |
| Electrical Components International Holdings Company,<br>Second Lien, 11.78% (LIBOR + 6.50%), 5/1/14        | Electronics                            | 20,000,000  | 20,000,000   | 20,050,000     |
| Event Rentals, Inc., First Lien, 10.80% (LIBOR +<br>5.25%), 11/17/11  | Party Rentals                          | 14,228,693  | 14,228,693   | 14,228,693 (e) |
| Event Rentals, Inc., Acquisition Loan,<br>First Lien, 10.74% (LIBOR + 5.25%), 11/17/11                      | Party Rentals                          | 17,225,000  | 17,225,000   | 17,225,000 (e) |
| Haggar Clothing Co., Second Lien, 12.28%<br>(LIBOR + 7.00%), 11/1/11  | Apparel                                | 2,500,000   | 2,477,761    | 2,500,000      |
| Heartland Automotive Services II Inc. et al.,<br>Term Loan A, First Lien, 8.96% (LIBOR + 3.75%),<br>2/27/12 | Automobile Repair                      | 6,864,375   | 6,857,437    | 6,898,697      |

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

BLACKROCK KELSO CAPITAL CORPORATION  
SCHEDULES OF INVESTMENTS (UNAUDITED) (continued)  
JUNE 30, 2006

| Portfolio Company (a)  | Industry                          | Principal<br>Amount or<br>Number of<br>Shares/Units | Cost (b)           | Fair<br>Value      |
|--|-----------------------------------|---|--------------------|--------------------|
| Heartland Automotive Services II Inc. et al.,<br>Acquisition Loan (Funded), First Lien, 9.11%,<br>(LIBOR + 4.00%), 2/27/12 | Automobile Repair                 | \$ 1,740,000  | \$ 1,740,000       | \$ 1,740,000       |
| Heartland Automotive Services II Inc. et al.,<br>Acquisition Loan (Unfunded), First Lien, 0.75%,<br>2/27/08                | Automobile Repair                 | 1,260,000   | 1,260,000          | \$ 1,260,000       |
| HIT Entertainment, Inc., Second Lien, 10.58%<br>(LIBOR + 5.50%), 2/26/13   | Entertainment                     | 1,000,000   | 1,000,000          | 1,005,000          |
| Houghton International Inc., First Lien, 8.40%<br>(LIBOR + 3.00%), 12/15/11  | Specialty Chemicals               | 4,919,444   | 4,919,444          | 4,950,191          |
| International Radiology Group, L.L.C. et al., First<br>Lien,<br>10.00% (Base Rate + 1.75%), 6/30/11                        | Healthcare Management<br>Services | 5,000,000   | 4,950,039          | 5,000,000          |
| International Radiology Group, L.L.C. et al., Second<br>Lien, 13.75% (Base Rate + 5.50%), 6/30/12                          | Healthcare Management<br>Services | 10,000,000  | 9,900,046          | 10,000,000         |
| MacAndrews Deluxe Holdings LLC, First<br>Lien,<br>13.00%, 7/28/11  | Entertainment                     | 14,000,000  | 14,000,000         | 14,105,000         |
| Precision Parts International Services Corp. et al.,<br>First Lien, 8.81% (LIBOR + 3.75%), 9/30/11                         | Automotive Parts                  | 2,985,000   | 2,985,000          | 2,977,538          |
| Prism Business Media Holdings, Inc., Second Lien,<br>11.13% (LIBOR + 6.00%), 9/30/13                                       | Information Services              | 11,000,000  | 10,990,669         | 10,835,000         |
| Professional Paint, Inc., Second Lien, 11.38%<br>(LIBOR + 5.75%), 5/31/13  | Paint and Coatings                | 16,000,000  | 16,000,000         | 16,160,000         |
| QTC Acquisition Inc., Second Lien, 11.85%<br>(LIBOR + 6.50%), 5/10/13  | Disability Evaluations            | 10,000,000  | 10,000,000         | 10,000,000         |
| Robertson Aviation, L.L.C., First Lien, 9.04%<br>(LIBOR + 3.50%), 4/19/13  | Aviation Fuel Systems             | 5,000,000   | 4,987,500          | 5,025,000          |
| United Subcontractors, Inc., Second Lien, 11.95%<br>(LIBOR + 7.25%), 6/27/13   | Building and Construction         | 10,000,000  | 10,000,000         | 9,950,000          |
| US Investigations Services, Inc., Tranche B, First<br>Lien,<br>7.92% (LIBOR + 2.50%), 10/14/12                             | Investigative Services            | 1,973,197   | 1,973,197          | 1,968,264          |
| US Investigations Services, Inc., Tranche C, First<br>Lien,<br>7.92% (LIBOR + 2.50%), 10/14/12                             | Investigative Services            | 741,803   | 741,803            | 739,949            |
| Wastequip, Inc., Second Lien, 11.00%<br>(LIBOR + 5.50%), 7/15/12   | Waste Treatment                   | 500,000   | 500,000            | 500,000            |
| Wembley, Inc., Second Lien, 8.74%<br>(LIBOR + 3.75%), 8/23/12  | Gaming                            | 1,000,000   | 1,000,000          | 1,005,833          |
| Westward Dough Operating Company, LLC, Term<br>Loan A, First Lien, 9.51% (LIBOR + 4.00%),<br>3/30/11                       | Restaurants                       | 8,000,000   | 8,000,000          | 8,000,000 (e)      |
| Westward Dough Operating Company, LLC, Term<br>Loan B, First Lien, 12.51% (LIBOR + 7.00%),<br>3/30/11                      | Restaurants                       | 8,000,000   | 8,000,000          | 8,000,000 (e)      |
| <b>Total Senior Secured Loans</b>  |                                   | <b>\$ 354,508,778</b>                               | <b>353,633,535</b> | <b>355,161,934</b> |

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

BLACKROCK KELSO CAPITAL CORPORATION  
SCHEDULES OF INVESTMENTS (UNAUDITED) (continued)  
JUNE 30, 2006

| Portfolio Company (a)                                    | Industry                 | Principal<br>Amount or<br>Number of<br>Shares/Units | Cost (b)     | Fair<br>Value  |
|--|--------------------------|---|--------------|----------------|
| Closed-End Funds - 1.4%                                  |                          |   |              |                |
| Eaton Vance Floating-Rate Income Trust                   | Closed-End Fund          | 175,000   | \$ 2,988,407 | \$ 3,171,000   |
| Nuveen Floating Rate Income Fund                         | Closed-End Fund          | 94,400  | 1,159,147    | 1,232,864      |
| PIMCO Floating Rate Strategy Fund                        | Closed-End Fund          | 170,000   | 2,997,026    | 3,224,900      |
| Total Closed-End Funds                                   |                          |   | 7,144,580    | 7,628,764      |
| Equity Warrants - 0.0% (f)                               |                          |   |              |                |
| ATEP Holdings, Inc., expire 10/24/15                     | Plastic Packaging        | 470   | -            | -              |
| ATH Holdings, Inc., expire 10/24/15                      | Plastic Packaging        | 470   | -            | -              |
| ATPP Holdings, Inc., expire 10/24/15                     | Plastic Packaging        | 470   | 90,112       | 90,112         |
| ATPR Holdings, Inc., expire 10/24/15                     | Plastic Packaging        | 470   | -            | -              |
| Champion Energy Corporation, expire 6/29/16              | Heating and Oil Services | 15,900  | 300,000      | 300,000        |
| Total Equity Warrants                                    |                          |   | 390,112      | 390,112        |
| TOTAL LONG-TERM INVESTMENTS<br>INCLUDING UNEARNED INCOME |                          |   | 369,952,466  | 372,061,060    |
| UNEARNED INCOME - (0.1)%                                 |                          |   | (727,999)    | (727,999)      |
| TOTAL LONG-TERM INVESTMENTS                              |                          |   | 369,224,467  | 371,333,061    |
| TOTAL INVESTMENTS - 81.7%                                |                          |   | 451,148,550  | 453,205,721    |
| OTHER ASSETS & LIABILITIES (NET) - 18.3%                 |                          |   |              | 101,175,224    |
| NET ASSETS - 100.0%                                      |                          |   |              | \$ 554,380,945 |

- (a) None of our portfolio companies are "controlled" or "affiliated" as defined in the Investment Company Act of 1940.
- (b) Represents amortized cost for fixed income securities and unearned income, and cost for closed-end funds and equity warrants.
- (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 4.3% of net assets at June 30, 2006.
- (d) Approximately 90% of the senior secured loans to our 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. Additionally, the borrower under a senior secured loan generally has the option to select from interest rate reset periods of one, two, three or six months and may alter that selection at the end of any reset period. Current reset frequencies for floating rate instruments other than senior secured loans are indicated by Q (quarterly) or S (semiannually).
- (e) Fair value of this investment determined by or under the direction of our Board of Directors (see Note 2). The aggregate fair value of these investments (net of unearned income) is \$98,597,653, or 17.8% of net assets, at June 30, 2006.
- (f) Equity warrants are non-income producing securities.

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

BLACKROCK KELSO CAPITAL CORPORATION  
SCHEDULES OF INVESTMENTS  
DECEMBER 31, 2005

| Portfolio Company (a)  | Industry                        | Principal<br>Amount or<br>Number of<br>Shares/Units | Cost (b)           | Fair<br>Value      |
|--|---------------------------------|---|--------------------|--------------------|
| <b>SHORT-TERM INVESTMENTS - 20.1%</b>  |                                 |   |                    |                    |
| <b>Asset-Backed Security - 2.8%</b>  |                                 |   |                    |                    |
| RACERS Trust, Series 2005-17-O, 4.39%<br>(LIBOR + 0.02%/Q), 8/21/06,<br>acquired 8/29/05 (d)                         | Asset-Backed Security           | \$ 15,000,000                                       | \$ 15,000,000      | \$ 15,006,300      |
| <b>Certificates of Deposit - 5.7%</b>  |                                 |   |                    |                    |
| DEPPA BANK plc, New York, 4.53%, 10/16/06  | Banking                         | 15,000,000  | 15,000,000         | 14,961,713         |
| Washington Mutual Bank N.A., 4.46%, 3/28/06  | Banking                         | 15,000,000  | 15,000,000         | 14,999,820         |
| <b>Total Certificates of Deposit</b>   |                                 | <b>30,000,000</b>                                   | <b>30,000,000</b>  | <b>29,961,533</b>  |
| <b>Commercial Paper - 11.6%</b>  |                                 |   |                    |                    |
| Barclays US Funding Corp., 4.24%, 2/3/06   | Banking                         | 26,000,000  | 25,900,019         | 25,900,019         |
| BNP Paribas (Canada), 3.83%, 1/24/06   | Banking                         | 1,500,000   | 1,496,397          | 1,496,397          |
| Credit Suisse First Boston USA, Inc.,<br>3.83%, 1/27/06  | Securities Broker<br>and Dealer | 8,000,000   | 7,978,626          | 7,978,626          |
| Morgan Stanley & Co. Incorporated,<br>4.08%, 8/4/06  | Securities Broker<br>and Dealer | 26,000,000  | 26,000,000         | 26,003,120         |
| <b>Total Commercial Paper</b>  |                                 | <b>61,500,000</b>                                   | <b>61,375,042</b>  | <b>61,378,162</b>  |
| <b>TOTAL SHORT-TERM INVESTMENTS</b>  |                                 | <b>\$ 106,500,000</b>                               | <b>106,375,042</b> | <b>106,345,995</b> |
| <b>LONG-TERM INVESTMENTS - 27.3%</b>   |                                 |   |                    |                    |
| <b>Subordinated Debt / Corporate Notes - 1.3%</b>  |                                 |   |                    |                    |
| First Mercury Holdings, Inc., 12.33%<br>(LIBOR + 8.00%/Q), 8/15/12,<br>acquired 8/12/05 (d)                          | Insurance                       | \$ 1,800,000  | 1,782,965          | 1,831,500          |
| InSight Health Services Corp., 9.17%<br>(LIBOR + 5.25%/Q), 11/1/11,<br>acquired 9/16/05 (d)                          | Diagnostic Imaging              | 2,500,000   | 2,488,066          | 2,375,000          |
| Select Medical Holdings Corporation, 9.93%<br>(LIBOR + 5.75%/S), 9/15/15,<br>acquired 9/15/05 (d)                    | Specialty Hospitals             | 2,500,000   | 2,500,000          | 2,512,500          |
| <b>Total Subordinated Debt / Corporate Notes</b>   |                                 | <b>\$ 6,800,000</b>                                 | <b>6,771,031</b>   | <b>6,719,000</b>   |
| <b>Senior Secured Loans (e) - 24.8%</b>  |                                 |   |                    |                    |
| Applied Tech Products Corp. et al.,<br>Tranche A, First Lien, 8.91%<br>(LIBOR + 4.50%), 10/24/10                     | Plastic Packaging               | \$ 4,251,515  | 4,219,701          | 4,219,629 (f)      |
| Applied Tech Products Corp. et al.,<br>Tranche B, Second Lien, 13.41%<br>(LIBOR + 9.00%), 4/24/11                    | Plastic Packaging               | 1,951,515   | 1,932,040          | 1,932,000 (f)      |
| Applied Tech Products Corp. et al.,<br>Tranche C, Third Lien, 16.91%<br>(LIBOR + 6.30% cash,<br>6.20% PIK), 10/24/11 | Plastic Packaging               | 696,970   | 598,331            | 598,145 (f)        |
| Benchmark Medical Holdings Inc.,<br>First Lien, 9.00%<br>(Base Rate + 1.75%), 12/27/12                               | Rehabilitation Centers          | 2,000,000   | 2,000,000          | 2,015,000          |
| Benchmark Medical Holdings Inc.,<br>Second Lien, 13.00% (Base Rate<br>+ 5.75%), 6/27/13                              | Rehabilitation Centers          | 9,000,000   | 9,000,000          | 9,000,000          |
| Bushnell Performance Optics, First<br>Lien, 7.53% (LIBOR + 3.00%), 8/19/11   | Leisure Products                | 1,000,000   | 1,000,000          | 1,012,469          |

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

BLACKROCK KELSO CAPITAL CORPORATION  
SCHEDULES OF INVESTMENTS (continued)  
DECEMBER 31, 2005

| Portfolio Company (a)<br>-----  | Industry<br>-----               | Principal<br>Amount or<br>Number of<br>Shares/Units<br>----- | Cost (b)<br>-----  | Fair<br>Value<br>----- |
|---|---------------------------------|--|--------------------|------------------------|
| Cannondale Bicycle Corporation, Second Lien, 11.53% (LIBOR + 7.00%), 6/5/10                     | Bicycles/Apparel                | \$ 10,000,000  | \$ 10,000,000      | \$ 10,000,000 (f)      |
| Champion Energy Corporation et al., First Lien, 13.38% (LIBOR + 9.00%), 6/30/09                 | Heating and Oil Services        | 18,000,000   | 18,000,000         | 18,000,000 (f)         |
| Clean Earth Inc., Tranche B, First Lien, 7.39% (LIBOR + 3.00%), 10/17/11                        | Environmental Services          | 1,500,000  | 1,500,000          | 1,515,000              |
| Delta Air Lines, Inc., Term Loan B, First Lien, 11.01% (LIBOR + 6.50%), 3/16/08                 | Airlines                        | 1,000,000  | 1,000,000          | 1,036,750              |
| Eight O'Clock Coffee Company, First Lien, 7.44% (LIBOR + 3.00%), 11/14/11                       | Coffee Distributor              | 3,000,000  | 3,000,000          | 3,022,500              |
| Eight O'Clock Coffee Company, Second Lien, 11.44% (LIBOR + 7.00%), 11/14/12                     | Coffee Distributor              | 12,000,000   | 12,000,000         | 12,000,000             |
| Event Rentals, Inc., First Lien, 9.94% (LIBOR + 5.25%), 11/17/11                                | Party Rentals                   | 14,454,545   | 14,454,545         | 14,454,545 (f)         |
| Event Rentals, Inc., Acquisition Loan (Funded), First Lien, 9.92% (LIBOR + 5.25%), 11/17/11     | Party Rentals                   | 9,847,159  | 9,847,159          | 9,847,159 (f)          |
| Event Rentals, Inc., Acquisition Loan (Unfunded), First Lien, 0.50%, 11/18/07                   | Party Rentals                   | 2,198,295  | 2,198,295          | 2,198,295 (f)          |
| Haggar Clothing Co., Second Lien, 11.51% (LIBOR + 7.00%), 11/1/11                               | Apparel                         | 2,500,000  | 2,500,000          | 2,500,000              |
| The Hertz Corporation, Tranche B, First Lien, 8.50% (Base Rate + 1.25%), 12/21/12               | Automobile and Equipment Rental | 2,000,000  | 2,000,000          | 2,022,500              |
| HIT Entertainment, Inc., Second Lien, 9.71% (LIBOR + 5.50%), 2/26/13                            | Entertainment                   | 1,000,000  | 1,000,000          | 990,000                |
| Houghton International Inc., First Lien, 9.25% (Base Rate + 2.00%), 12/15/11                    | Specialty Chemicals             | 5,000,000  | 5,000,000          | 5,043,750              |
| MD Beauty, Inc., Second Lien, 11.25% (LIBOR + 7.00%), 2/18/13                                   | Cosmetics                       | 3,000,000  | 3,000,000          | 3,022,500              |
| Metaldyne Corporation et al., First Lien, 8.58% (LIBOR + 4.50%), 12/31/09                       | Automotive Parts                | 998,741  | 988,476            | 1,001,237              |
| NTELOS Inc., Second Lien, 9.39% (LIBOR + 5.00%), 2/24/12  | Telecommunications              | 2,000,000  | 1,984,276          | 2,020,000              |
| PBI Media, Inc., Second Lien, 10.24% (LIBOR + 6.00%), 9/30/13                                   | Information Services            | 6,000,000  | 5,990,032          | 5,940,000              |
| Precision Parts International Services Corp. et al., First Lien, 7.98% (LIBOR + 3.75%), 9/30/11 | Automotive Parts                | 3,000,000  | 3,000,000          | 3,022,501              |
| QTC Acquisition Inc., Second Lien, 10.84% (LIBOR + 6.50%), 5/10/13                              | Disability Evaluations          | 10,000,000   | 10,000,000         | 10,075,000             |
| US Investigations Services, Inc., Tranche B, First Lien, 7.00% (LIBOR + 2.50%), 10/14/12        | Investigative Services          | 1,995,000  | 1,995,000          | 1,999,988              |
| U.S. Security Holdings, Inc., First Lien, 7.27% (LIBOR + 3.25%), 2/29/12                        | Security Services               | 983,400  | 983,400            | 990,776                |
| Wastequip, Inc., Second Lien, 10.53% (LIBOR + 6.00%), 7/15/12                                   | Waste Treatment                 | 500,000  | 500,000            | 506,250                |
| Wembley, Inc., Second Lien, 7.83% (LIBOR + 3.75%), 8/23/12                                      | Gaming                          | 1,000,000  | 1,000,000          | 1,006,250              |
| <b>Total Senior Secured Loans</b>   |                                 | <b>\$ 130,877,140</b>  | <b>130,691,255</b> | <b>130,992,244</b>     |

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

BLACKROCK KELSO CAPITAL CORPORATION  
SCHEDULES OF INVESTMENTS (continued)  
DECEMBER 31, 2005

| Portfolio Company (a)                                    | Industry          | Principal<br>Amount or<br>Number of<br>Shares/Units | Cost (b)       | Fair<br>Value  |
|--|-------------------|---|----------------|----------------|
| Closed-End Funds - 1.4%                                  |                   |   |                |                |
| Eaton Vance Floating-Rate Income Trust                   | Closed-End Fund   | 175,000   | \$ 2,988,408   | \$ 2,952,250   |
| Nuveen Floating Rate Income Fund                         | Closed-End Fund   | 94,400  | 1,159,147      | 1,188,496      |
| PIMCO Floating Rate Strategy Fund                        | Closed-End Fund   | 170,000   | 2,997,026      | 3,036,200      |
| Total Closed-End Funds                                   |                   |   | 7,144,581      | 7,176,946      |
| Equity Warrants - 0.0% (g)                               |                   |   |                |                |
| ATEP Holdings, Inc., expire 10/24/15                     | Plastic Packaging | 470   | -              | - (f)          |
| ATH Holdings, Inc., expire 10/24/15                      | Plastic Packaging | 470   | -              | - (f)          |
| ATPP Holdings, Inc., expire 10/24/15                     | Plastic Packaging | 470   | 90,114         | 90,114 (f)     |
| ATPR Holdings, Inc., expire 10/24/15                     | Plastic Packaging | 470   | -              | - (f)          |
| Total Equity Warrants                                    |                   |   | 90,114         | 90,114         |
| TOTAL LONG-TERM INVESTMENTS<br>INCLUDING UNEARNED INCOME |                   |   | 144,696,981    | 144,978,304    |
| UNEARNED INCOME - (0.2)%                                 |                   |   | (887,949)      | (887,949)      |
| TOTAL LONG-TERM INVESTMENTS                              |                   |   | 143,809,032    | 144,090,355    |
| TOTAL INVESTMENTS - 47.4%                                |                   |   | \$ 250,184,074 | 250,436,350    |
| OTHER ASSETS & LIABILITIES (NET) - 52.6%                 |                   |   |                | 278,268,499    |
| NET ASSETS - 100.0%                                      |                   |   |                | \$ 528,704,849 |

- (a) None of our portfolio companies are "controlled" or "affiliated" as defined in the Investment Company Act of 1940.
- (b) Unaudited.
- (c) Represents amortized cost for fixed income securities and unearned income, and cost for closed-end funds and equity warrants.
- (d) 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 4.1% of net assets at December 31, 2005.
- (e) Approximately 98% of the senior secured loans to our 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. Additionally, the borrower under a senior secured loan generally has the option to select from interest rate reset periods of one, two, three or six months and may alter that selection at the end of any reset period. Current reset frequencies for floating rate instruments other than senior secured loans are indicated by Q (quarterly) or S (semiannually).
- (f) Fair value of this investment determined by or under the direction of our Board of Directors (see Note 2). The aggregate fair value of these investments (net of unearned income) is \$60,451,938, or 11.4% of net assets, at December 31, 2005.
- (g) Equity warrants are non-income producing securities.

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

## 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 filed an election to be treated 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, or 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 intends to invest 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 (the "Offering") of 35,366,589 shares of its common stock, par value \$.001 per share (the "Common Stock"), at a price of \$15.00 per share. Net proceeds from the Offering of \$529,333,799 reflect the payment of a placement fee of \$507,407 and legal fees and other offering costs of \$657,639.

The accompanying interim 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 period, have been included. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

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, 2005, which was filed with the Securities and Exchange Commission on March 29, 2006.

## 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 significant accounting policies consistently followed by the Company are:

- (a) Investments for which market quotations are readily available are valued at such market quotations, which are generally obtained from an independent pricing service or one or more broker-dealers or market makers. However, debt investments with remaining maturities within 60 days are valued at cost plus accreted discount, or minus amortized premium, which approximates fair value. Debt and equity securities for which market quotations are not readily available 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 many of the investments in its portfolio, the Company expects to value many 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 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 the differences could be material.

BLACKROCK KELSO CAPITAL CORPORATION  
NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

With respect to the Company's investments for which market quotations are not readily available, the Board of Directors undertakes a multi-step valuation process each quarter, as described below:

- (1) The quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals of BlackRock Kelso Capital Advisors LLC, the Company's investment adviser (the "Investment Advisor"), responsible for the portfolio investment;
- (2) Preliminary valuation conclusions are then documented and discussed with senior management;
- (3) To the extent determined by the Audit Committee of the Board of Directors, independent valuation firms engaged by the Board of Directors conduct independent appraisals and review management's preliminary valuations and their own independent assessment;
- (4) The Audit Committee of the Board of Directors reviews the preliminary valuations of the investment professionals, senior management and independent valuation firms; and
- (5) 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 Investment Advisor, the respective independent valuation firms and the Audit Committee.

The types of factors that the Company may take into account in fair value pricing its investments include, as relevant, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings and discounted cash flow, the markets in which the portfolio company does business, comparison to publicly traded securities and other relevant factors.

Determination of fair values involves subjective judgments and estimates. Accordingly, these notes to the financial statements express the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on the financial statements.

The carrying value of the Company's financial instruments approximate fair value. The carrying value of receivables, other assets, accounts payable and accrued expenses approximate fair value due to their short maturity.

None of the Company's portfolio companies are controlled by or affiliated with the Company as defined in the 1940 Act.

- (b) Cash equivalents include short-term investments in money market instruments with remaining maturities when purchased of three months or less.
- (c) Security transactions are accounted for on the trade date unless there are substantial conditions to the purchase.
- (d) Gains or losses on the sale of investments are calculated using the specific identification method.
- (e) Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Interest income is not accrued if collection is deemed doubtful or the related investment is in default. For loans and debt securities with contractual payment-in-kind ("PIK") interest, which represents contractual interest accrued and added to the loan balance and which generally becomes due at maturity, PIK interest is not accrued if the portfolio company valuation indicates that the PIK interest 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. Dividend income is recorded on the ex-dividend date. Expenses are recorded on an accrual basis.



BLACKROCK KELSO CAPITAL CORPORATION  
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) (Continued)

- (f) Organizational costs of the Company were expensed as incurred. Offering costs were charged against paid-in capital.
- (g) 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 shareholders which will relieve the Company from federal income and excise taxes. Therefore, no provision has been recorded for federal income or excise taxes.

In order to qualify as a RIC, the Company is required to distribute annually to its shareholders 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).

In accordance with GAAP, book and tax basis differences relating to distributions to shareholders and other permanent book and tax differences are reclassified to capital in excess of par. In addition, the character of income and gains to be distributed is determined in accordance with income tax regulations that may differ from GAAP.

- (h) Dividends and distributions to common shareholders are recorded on the ex-date. The amount to be paid out as a dividend is determined by the Board of Directors. Recent dividends declared by the Company were as follows:

| Dividend Amount<br>Per Share Outstanding<br>----- | Ex-Date<br>-----   | Record Date<br>----- | Pay Date<br>-----  |
|---|--------------------|----------------------|--------------------|
| \$0.20  | December 29, 2005  | December 31, 2005    | January 31, 2006   |
| \$0.20  | March 29, 2006     | March 15, 2006       | March 31, 2006     |
| \$0.23  | June 28, 2006      | June 15, 2006        | June 30, 2006      |
| \$0.30  | September 13, 2006 | September 15, 2006   | September 29, 2006 |

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

### 3. Agreements and Related Party Transaction

The Company has entered into an Investment Management Agreement (the "Management Agreement") with the Investment Advisor, under which the Investment 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 Investment Advisor receives a fee (the "Management Fee") from the Company at an annual rate of 2.0% of the Company's total assets, including any assets acquired with the proceeds of leverage. For services rendered under the Management Agreement during the period commencing from July 25, 2005, the closing of the Offering (the "Closing"), through and including the first twelve months of operations, the Management Fee will be payable monthly in arrears. For services rendered under the Management Agreement after that time, the Management Fee will be paid quarterly in arrears. The Investment Advisor has contractually agreed to waive its rights to receive one-half of the amount of the Management Fee the Investment Advisor would otherwise be entitled to receive from the Company until the first date on which 90% of the assets of the Company are invested in portfolio companies in accordance with the Company's investment objective, excluding investments in cash, cash equivalents, U.S. government securities and other high-quality debt investments that mature in one year or less from the date of investment, or the first anniversary of the Closing, whichever is sooner (the "Ramp-Up Date"). Thereafter, the Investment Advisor has agreed to waive, until such time as the Company has completed an initial public offering of its Common Stock and listed its Common Stock on a national securities exchange (collectively, the "Public Market Event"), one-quarter of the amount of the Management Fee the Investment Advisor would otherwise be entitled to receive from the Company. In addition, the Investment Advisor has agreed to (a) waive Management Fees for any calendar year in excess of approximately \$11.9 million until the earlier of (i) such time as the Company has completed the Public Market Event or (ii) the fourth anniversary of the Company's inception of operations and (b) waive Management Fees in excess of approximately \$5.6 million during the fifth year of the Company's operations unless the Company has completed the Public Market Event.

BLACKROCK KELSO CAPITAL CORPORATION  
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) (Continued)

For the three and six months ended June 30, 2006, the Investment Advisor earned \$1,367,095 and \$2,699,534 in management fees, net of the waiver provision, from the Company.

The Management Agreement provides that the Investment Advisor or its affiliates may be entitled to an incentive fee (the "Carried Interest") under certain circumstances. The determination of the Carried Interest, as described in more detail below, will result in the Investment Advisor or its affiliates receiving no Carried Interest payments if returns to Company shareholders, as described in more detail below, do not meet an 8.0% annualized rate of return and will result in the Investment Advisor or its affiliates receiving less than the full amount of the Carried Interest percentage until returns to shareholders exceed an approximate 13.3% annualized rate of return.

Commencing on the Ramp-Up Date, the Company will pay to the Investment Advisor or its affiliates at the same time as, and not in advance of, any distributions in respect of the Company's Common Stock, (i) 50% of the amount by which the cumulative distributions and amounts distributable to the holders of the Common Stock of the Company exceed an 8% annualized rate of return on net asset value on the Ramp-Up Date until the Investment Advisor or its affiliates have received from the Company an amount equal to 20% of the sum of the cumulative amounts distributed pursuant to this paragraph and the cumulative amounts of net income (including realized capital gains in excess of realized capital losses) in excess of net unrealized capital depreciation distributed to the holders of the Company's Common Stock, and (ii) thereafter an amount equal to 20% of the sum of the amount distributed pursuant to this paragraph and the cumulative amounts of net income (including realized capital gains in excess of realized capital losses) in excess of net unrealized capital depreciation distributed to the holders of the Company's Common Stock. After the Public Market Event, if any, the amounts above will be measured and paid quarterly on a rolling four-quarter basis and will take into account any decrease in net unrealized depreciation during the measurement period to the extent such decrease did not exceed the net amount of capital depreciation at the beginning of such period and does not exceed the excess of cumulative realized capital gains over cumulative realized capital losses.

During the three and six months ended June 30, 2006, no Carried Interest amounts were earned by the Investment Advisor.

The Management Agreement provides that the Company will reimburse the Investment Advisor for costs and expenses incurred by the Investment Advisor for office space rental, office equipment and utilities allocable to the performance by the Investment Advisor of its duties under the Management Agreement, as well as any costs and expenses incurred by the Investment Advisor relating to any non-investment advisory, administrative or operating services provided by the Investment Advisor to the Company. For the three and six months ended June 30, 2006, the Company incurred \$203,179 and \$281,136, respectively, for costs and expenses reimbursable to the Investment Advisor under the Management Agreement.

No person who is an officer, director or employee of the Investment 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 Investment Advisor receive compensation for their services and reimbursement of expenses incurred to attend meetings.

The Company has also entered into an Administration Agreement with BlackRock Financial Management, Inc. (the "Administrator"), a majority-owned subsidiary of The PNC Financial Services Group, Inc. ("PNC"), 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 six months ended June 30, 2006, the Company incurred \$249,316 and \$495,891, respectively, for administrative services expenses payable to the Administrator under the Administration Agreement.

From time to time, the Investment Advisor or the Administrator may pay amounts owed by the Company to third party providers of goods or services. The Company will subsequently reimburse the Investment Advisor or the Administrator, as the case may be, for such amounts paid on its behalf. Reimbursements to the Investment Advisor for the three and six months ended June 30, 2006 were \$282,261 and \$432,253, respectively, and reimbursements to the Administrator

BLACKROCK KELSO CAPITAL CORPORATION  
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) (Continued)

for the three and six months ended June 30, 2006 were \$2,594 and \$27,494, respectively. An additional \$1,009 in reimbursements remains payable to the Investment Advisor at June 30, 2006.

PFPC Inc. ("PFPC"), 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, PFPC 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 PFPC and its affiliates, PFPC 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 may charge the Company additional fees for cash overdraft balances or for sweeping excess cash balances.

For the three months and six months ended June 30, 2006, the Company incurred \$49,935 and \$105,344, respectively, for administrative, accounting, custodian and transfer agency services fees payable to PFPC and its affiliates under the related agreements.

On July 25, 2005, in connection with the closing of the Offering, the Company issued approximately 33,333,333 shares of its Common Stock to BlackRock Kelso Capital Holding LLC, an entity for which the Investment Advisor serves as manager, in exchange for total consideration of \$500,000,000 (\$15.00 per share), consisting of \$80,282,060 in cash and a portfolio of short-term investments and cash equivalents valued at \$419,717,940. The transaction was effected in accordance with the Company's valuation procedures governing securities transactions with affiliates and was ratified by the Board of Directors.

On March 8, 2006, the Company's Board of Directors authorized the issuance and sale from time to time of up to \$2,500,000 in aggregate net asset value of shares of the Company's Common Stock to certain existing and future employees of the Investment Advisor at a price per share equal to the greater of \$15.00 or the Company's most recently determined net asset value per share at the time of sale. Pursuant to this authorization, on April 1, 2006 the Company issued and sold in a private placement 54,000 shares of Common Stock for aggregate proceeds of \$810,000 to certain employees of the Investment Advisor. On August 10, 2006, the Company's Board of Directors authorized the issuance and sale from time to time of an unlimited number of shares of the Company's Common Stock to the Investment Advisor at a price per share equal to the Company's most recently determined net asset value per share at the time of sale, such shares to be used by the Advisor for employee compensation purposes. Sales under both of the foregoing authorizations are expected to be exempt from the registration requirements of the Securities Act of 1933.

At June 30, 2006, the Investment Advisor beneficially owned indirectly approximately 766,000 shares of the Company's Common Stock, representing approximately 2.1% of the total shares outstanding. At June 30, 2006, other entities affiliated with the Administrator and PFPC beneficially owned indirectly approximately 2,426,000 shares of the Company's Common Stock, representing approximately 6.6% of the total shares outstanding. These percentages of total shares outstanding did not change appreciably from December 31, 2005. At June 30, 2006 and December 31, 2005, an entity affiliated with the Administrator and PFPC owned 36.5% of the members' interests of the Investment Advisor.

#### 4. Earnings Per Share

The following information sets forth the computation of basic and diluted net increase in net assets per share resulting from operations for the three and six months ended June 30, 2006.

|  | Three Months Ended<br>June 30, 2006<br>----- | Six Months Ended<br>June 30, 2006<br>----- |
|--|--|--|
| Numerator for basic and diluted net increase in net assets per share         | \$11,170,450                                 | \$18,291,506                               |
| Denominator for basic and diluted weighted average shares                    | 36,345,171                                   | 36,017,156                                 |
| Basic/diluted net increase in net assets per share resulting from operations | \$0.31                                       | \$0.51                                     |

BLACKROCK KELSO CAPITAL CORPORATION  
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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

5. Purchases and Sales/Repayments of Investments

Excluding short-term investments, the Company's purchases and sales/repayments of investments for the three months ended June 30, 2006 totaled \$188,254,574 and \$29,107,373, respectively, and for the six months ended June 30, 2006 totaled \$260,908,244 and \$35,363,676, respectively.

6. Commitments and Contingencies

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.

7. 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 six months ended June 30, 2006:

Per Share Data:

|  |    |             |
|--|----|-------------|
| Net asset value, beginning of period                       | \$ | 14.95       |
|  |    | -----       |
| Net investment income                                      |    | 0.46        |
| Net realized and unrealized gain                           |    | 0.05        |
|  |    | -----       |
| Total from investment operations                           |    | 0.51        |
|  |    | -----       |
| Less: Dividends to shareholders from net investment income |    | (0.43)      |
|  |    | -----       |
| Net change in net assets                                   |    | 0.08        |
|  |    | -----       |
| Net asset value, end of period                             | \$ | 15.03       |
|  |    | =====       |
| <br>   |    |             |
| Total return (1) (2)                                       |    | 3.42%       |
| <br>   |    |             |
| Ratios / Supplemental Data:                                |    |             |
| Ratio of expenses to average net assets (3)                |    |             |
| Before management fee waiver                               |    | 2.57%       |
| After management fee waiver                                |    | 1.57%       |
| Ratio of net investment income to average net assets (3)   |    | 6.21%       |
| Net assets, end of period                                  | \$ | 554,380,945 |
| Portfolio turnover (2)                                     |    | 15%         |

-----  
(1) Total return is based on the change in net asset value per share during the period and takes into account dividends and distributions, if any, reinvested in accordance with the Company's dividend reinvestment plan.

(2) Not annualized.

(3) Annualized.

## 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 treated 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 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 the Offering of 35,366,589 shares of our Common Stock at a price of \$15.00 per share, less a placement fee of \$507,407 and legal fees and other offering costs of \$657,639. We received approximately \$529.3 million in net proceeds from the Offering.

We have qualified and elected to be treated as a regulated investment company, or a RIC, under Subchapter M of the Code. To continue to qualify as a RIC, we must, among other things, continue to meet certain source-of-income and asset diversification requirements. Pursuant to these elections, we generally have not had and will not have to pay corporate-level taxes on any income that we distribute to our shareholders.

### Portfolio and Investment Activity

The second quarter was active. We believe this level of activity is a result of our expansive transaction network and growing team of investment professionals, as well as current market conditions. During the quarter ended June 30, 2006, we invested approximately \$188.3 million across eight new and six existing portfolio companies. The new investments consisted primarily of senior loans secured by second liens (\$141.6 million) and first liens (\$39.3 million), and subordinated debt (\$7.0 million). For the year-to-date period through June 30, 2006, we invested \$260.9 million across 14 new and 7 existing portfolio companies.

During the quarter, we received proceeds from principal repayments/dispositions of approximately \$29.1 million. The majority of that total represents a refinancing we completed for an existing portfolio company in which we restructured the terms and increased the amount of our investment, enabling the issuer to repay higher cost debt. For the year-to-date period through June 30, 2006, we received proceeds from principal repayments/dispositions of approximately \$35.4 million.

At June 30, 2006, our net portfolio (investments plus cash and cash equivalents) of \$577 million consisted of 35 portfolio companies and was invested 61% in senior secured loans, 2% in subordinated debt/corporate notes, 1% in publicly traded, floating rate closed-end funds, less than 1% in common stock/warrants and 36% in short-term investments (including cash and cash equivalents). Our average portfolio company investment by market value was approximately \$10 million. Our largest portfolio company investment by market value was approximately \$40 million and our five largest portfolio company investments by market value comprised approximately 26% of our net assets at June 30, 2006. At December 31, 2005, our net portfolio of \$539 million consisted of 26 portfolio companies and was invested 25% in senior secured loans, 1% in subordinated debt/corporate notes, 1% in publicly traded, floating rate closed-end funds, less than 1% in common stock/warrants and 73% in short-term investments (including cash and cash equivalents).

Our weighted average yield on invested capital other than closed-end funds, short-term investments and cash equivalents was 11.4% at June 30, 2006 versus 10.9% at March 31, 2006 and 10.7% at December 31, 2005. The weighted average yield on our invested capital including closed-end funds, short-term investments and cash equivalents was 9.1% at June 30, 2006, versus 7.0% and 6.0% at March 31, 2006 and December 31, 2005, respectively. Net of expenses, such yields were 7.6% at June 30, 2006, 5.5% at March 31, 2006 and 4.4% at December 31, 2005. The weighted average yields on our subordinated debt/corporate notes and senior secured loans were 12.8% and 11.5%,

respectively, at June 30, 2006 versus 10.7% and 10.9%, respectively, at March 31, 2006, and 10.3% and 10.8%, respectively, at December 31, 2005. Yields are computed using interest rates and dividend yields as of the purchase date and include amortization of loan origination and commitment fees, original issue discount and market premium or discount, weighted by the value of the respective investment when averaged.

At June 30, 2006, 89% of our long-term investments bear interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime Rate, and 11% bear interest at fixed rates. At December 31, 2005, more than 98% of our long-term investments bore interest based on floating rates.

#### Results of Operations

We commenced operations on July 25, 2005 and, therefore, there is no comparable period from the prior year with which to compare the results of operations for the three and six months ended June 30, 2006.

#### Operating Results for the Three Months Ended June 30, 2006

##### Operating Income

Investment income totaled \$12,144,635 for the three months ended June 30, 2006, of which \$8,176,419 was attributable to interest and amortization of upfront fees on senior secured loans, \$3,580,213 to interest earned on short-term investments and cash equivalents, \$206,451 to interest earned on subordinated debt/corporate notes, \$161,418 to dividends received from closed-end funds and \$20,134 to other income. In connection with the successful completion of a refinancing for an existing portfolio company, during the three months ended June 30, 2006 we recognized \$1,125,114 of unamortized upfront loan fees and prepayment fees as interest income attributable to senior secured loans. As we continue to invest in longer-term investments, we expect that we will generate additional income at rates higher than those we received on our investments since our inception of operations, although there can be no assurance that we will achieve this objective.

##### Operating Expenses

Net operating expenses for the three months ended June 30, 2006 were \$2,147,208, consisting of \$1,367,095 in management fees (net of management fee waiver of \$1,367,361), \$291,762 in administrative services expenses, \$106,082 in professional fees, \$203,179 in Investment Advisor expenses, \$86,873 in director fees, \$46,566 in insurance expenses, and \$45,651 in other expenses. For the three months ended June 30, 2006, no incentive fee, or Carried Interest, amounts were paid or owed to the Investment Advisor.

##### Net Investment Income

Net investment income was \$9,997,427 for the three months ended June 30, 2006.

##### Net Realized Gain

Net realized gain on investments of \$202,321 for the three months ended June 30, 2006 resulted primarily from the disposition of one subordinated debt/corporate note position and one senior secured loan position.

##### Net Unrealized Appreciation

For the three months ended June 30, 2006, the change in net unrealized appreciation was \$970,702, which was comprised of an increase in net unrealized appreciation on investments.

##### Net Increase in Net Assets Resulting From Operations

The net increase in net assets resulting from operations for the three months ended June 30, 2006 was \$11,170,450.

## Operating Results for the Six Months Ended June 30, 2006

### Operating Income

Investment income totaled \$20,878,045 for the six months ended June 30, 2006, of which \$12,386,193 was attributable to interest and amortization of upfront fees on senior secured loans, \$7,706,119 to interest earned on short-term investments and cash equivalents, \$350,262 to interest earned on subordinated debt/corporate notes, \$313,337 to dividends received from closed-end funds and \$122,134 to other income. In connection with the successful completion of a refinancing for an existing portfolio company, during the six months ended June 30, 2006 we recognized \$1,125,114 of unamortized upfront loan fees and prepayment fees as interest income attributable to senior secured loans. As we continue to invest in longer-term investments, we expect that we will generate additional income at rates higher than those we received on our investments since our inception of operations, although there can be no assurance that we will achieve this objective.

### Operating Expenses

Net operating expenses for the six months ended June 30, 2006 were \$4,200,629, consisting of \$2,699,534 in management fees (net of management fee waiver of \$2,699,800), \$580,107 in administrative services expenses, \$319,999 in professional fees, \$281,136 in Investment Advisor expenses, \$157,061 in director fees, \$83,105 in insurance expenses, and \$79,687 in other expenses. For the six months ended June 30, 2006, no incentive fee, or Carried Interest, amounts were paid or owed to the Investment Advisor.

### Net Investment Income

Net investment income was \$16,677,416 for the six months ended June 30, 2006.

### Net Realized Loss

Net realized loss on investments of \$202,845 for the six months ended June 30, 2006 resulted primarily from realized losses on the disposition of two subordinated debt/corporate notes positions, which were partially offset by realized gains on the disposition of one subordinated debt/corporate note position and one senior secured loan position.

### Net Unrealized Appreciation

For the six months ended June 30, 2006, the change in net unrealized appreciation was \$1,816,935, which was comprised of an increase in net unrealized appreciation on investments of \$1,804,895 and a decrease in net unrealized depreciation on cash equivalents of \$12,040.

### Net Increase in Net Assets Resulting From Operations

The net increase in net assets resulting from operations for the six months ended June 30, 2006 was \$18,291,506.

### Financial Condition, Liquidity and Capital Resources

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. The net proceeds from the Offering of \$529,333,799 consisted of cash of \$109,615,859 and a contribution of short-term investments and cash equivalents of \$419,717,940.

On March 8, 2006, our Board of Directors authorized the issuance and sale from time to time of up to \$2,500,000 in aggregate net asset value of shares of our Common Stock to certain existing and future employees of the Investment Advisor at a price per share equal to the greater of \$15.00 or our most recently determined net asset value per share at the time of sale. Pursuant to this authorization, on April 1, 2006 we issued and sold in a private placement 54,000 shares of Common Stock for aggregate proceeds of \$810,000 to certain employees of the Investment Advisor.

During the six months ended June 30, 2006, we generated cash primarily from cash flows from operations, including interest earned on senior secured loans and subordinated debt/corporate notes, as well as from temporary investments in cash equivalents and other high-quality debt investments that mature in one year or less. In the future, we may also fund a portion of our investments through borrowings from banks and issuances of senior securities. As a business

development company, we are subject to regulations governing our operations that affect our ability to raise additional capital. In the future, we may also securitize a portion of our investments in senior secured loans or other assets.

At June 30, 2006, we had \$123,522,867 in cash and cash equivalents and \$81,872,660 in other short-term investments that we intend to use in our operations.

Our primary uses of funds are investments in portfolio companies, payment of fees and other operating expenses and cash distributions to shareholders.

Our operating activities resulted in a net use of cash of \$183,131,103 for the six months ended June 30, 2006, primarily due to net purchases of investments.

Our financing activities resulted in the inflow of cash of \$17,681,623 for the six months ended June 30, 2006, primarily due to temporary borrowings from our custodian. In addition, our non-cash financing activities consisted of \$22,100,075 of dividend distributions reinvested.

#### Off-Balance Sheet Financing

At June 30, 2006, we had no off-balance sheet contractual obligations or arrangements.

#### Dividends

We intend to distribute quarterly dividends to our shareholders. Our quarterly dividends, if any, will be determined by our Board of Directors. Recent dividends declared by the Company were as follows:

| Dividend Amount<br>Per Share Outstanding<br>----- | Ex-Date<br>-----   | Record Date<br>----- | Pay Date<br>-----  |
|---|--------------------|----------------------|--------------------|
| \$0.20  | December 29, 2005  | December 31, 2005    | January 31, 2006   |
| \$0.20  | March 29, 2006     | March 15, 2006       | March 31, 2006     |
| \$0.23  | June 28, 2006      | June 15, 2006        | June 30, 2006      |
| \$0.30  | September 13, 2006 | September 15, 2006   | September 29, 2006 |

We have qualified and elected to be taxed as a regulated investment company, or RIC, under Subchapter M of the Code. To maintain our RIC status, we must distribute annually at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of the assets legally available for distribution. In order to avoid certain excise taxes imposed on RICs, we currently intend to distribute during each calendar year an amount at least equal to the sum of (1) 98% of our ordinary income for the calendar year, (2) 98% of our capital gains in excess of capital losses for the one-year period ending on October 31st and (3) any ordinary income and net capital gains for preceding years that were not distributed during such years. In addition, although we currently intend to distribute realized net capital gains (i.e., net long-term capital gains in excess of short-term capital losses), if any, at least annually, out of the assets legally available for such distributions, we may in the future decide to retain such capital gains for investment.

We maintain an "opt out" dividend reinvestment plan for our common shareholders. As a result, if we declare a dividend, shareholders' 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.

We may not be able to achieve operating results that will allow us to make dividends and distributions at a specific level or to increase the amount of these dividends and distributions from time to time. In addition, we may be limited in our ability to make dividends and distributions due to the asset coverage test for borrowings when applicable to us as a business development company under the 1940 Act and due to provisions in future credit facilities. If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including possible loss of our status as a regulated investment company. We cannot assure shareholders that they will receive any dividends and distributions or dividends and distributions at a particular level.

With respect to the dividends paid to shareholders, income from origination, structuring, closing, commitment and other upfront fees associated with investments in portfolio companies is treated as taxable income and accordingly, distributed to shareholders. For the three and six months ended June 30, 2006, these fees totaled \$445,722 and \$773,222, respectively.



Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are subject to financial market risks, including changes in interest rates. At June 30, 2006, 89% of our long-term investments bear 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. In addition, at June 30, 2006, 36% of our net portfolio consists of high quality short-term investments and cash equivalents.

To illustrate the potential impact of changes in interest rates, we have performed the following analysis based on our June 30, 2006 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 \$1,800,000 in the value of our net assets at June 30, 2006.

While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments. During the three and six months ended June 30, 2006, we did not engage in any hedging activities.

Item 4. Controls and Procedures

As of the end of the period covered by this report, the Company 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 the Company 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

We are not a party in any material pending legal proceeding, and no such proceedings are known to be contemplated.

Item 1A. Risk Factors

Not required.

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

On April 1, 2006, we completed a private placement of 54,000 shares of our common stock, par value \$.001 per share, for aggregate proceeds of \$810,000, which were used for general corporate purposes. The placement was exempt from the registration requirements of the Securities Act of 1933 (the "Securities Act") pursuant to Section 4(2) of the Securities Act and Regulation D, Rule 506 promulgated thereunder for transactions not involving a public offering and based on the fact that the common stock was issued to accredited investors.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits.

(a) Exhibits.

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

(b) Reports on Form 8-K.

On August 10, 2006, we filed a current report on Form 8-K, pursuant to Item 7.01 reporting the issuance of a press release announcing a fiscal third quarter dividend of \$0.30 per share.

On May 9, 2006, we filed a current report on Form 8-K, pursuant to Item 7.01 reporting the issuance of a press release announcing a fiscal second quarter dividend of \$0.23 per share.

On March 8, 2006, we filed a current report on Form 8-K, pursuant to Item 7.01 reporting the issuance of a press release announcing a fiscal first quarter dividend of \$0.20 per share.

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: August 11, 2006

By: /s/ James R. Maher  
-----  
James R. Maher  
Chief Executive Officer

Date: August 11, 2006

By: /s/ Frank D. Gordon  
-----  
Frank D. Gordon  
Chief Financial Officer

## CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, James R. Maher, certify that:

1. I have reviewed this quarterly report on Form 10-Q of BlackRock Kelso Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the 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 period 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(c)) and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Not applicable (until the first fiscal year ending after July 15, 2007).
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosures 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: August 11, 2006

/s/James R. Maher

-----  
Name: James R. Maher  
Title: Chief Executive Officer

## CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Frank D. Gordon, 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 period 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(c)) and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Not applicable (until the first fiscal year ending after July 15, 2007).
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosures 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: August 11, 2006

/s/ Frank D. Gordon

-----

Name: Frank D. Gordon

Title: Chief Financial Officer

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 ending June 30, 2006 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 ss.18 U.S.C. ss.1350, as adopted pursuant to ss.906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (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: August 11, 2006

/s/ Frank D. Gordon

-----

Name: Frank D. Gordon  
Title: Chief Financial Officer  
Date: August 11, 2006

This certification accompanies the report pursuant to ss.906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of ss.18 of the Securities Exchange Act of 1934, as amended.

A signed original of this certification required by ss.906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.