

**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 March 31, 2014

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 814-00712

**BLACKROCK KELSO CAPITAL CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**20-2725151**

(I.R.S. Employer  
Identification No.)

**40 East 52<sup>nd</sup> Street, New York, NY**

(Address of Principal Executive Offices)

**10022**

(Zip Code)

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

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

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

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

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

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

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

The number of shares of the Registrant's common stock, \$.001 par value per share, outstanding at April 29, 2014 was 74,657,940

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**BLACKROCK KELSO CAPITAL CORPORATION**  
**FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2014**

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

**Item 1. Consolidated Financial Statements**

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

	<b>March 31,</b>	<b>December 31,</b>
	<b>2014</b>	<b>2013</b>
<b>Assets</b>		
Investments at fair value:		
Non-controlled, non-affiliated investments (cost of \$756,704,422 and \$854,947,802)	\$ 758,232,782	\$ 881,305,181
Non-controlled, affiliated investments (cost of \$81,232,939 and \$75,514,208)	142,490,171	134,096,291
Controlled investments (cost of \$155,879,666 and \$154,038,211)	205,378,098	202,570,992
Total investments at fair value (cost of \$993,817,027 and \$1,084,500,221)	1,106,101,051	1,217,972,464
Cash and cash equivalents	34,066,687	18,474,784
Receivable for investments sold	67,859,864	22,756,286
Interest receivable	17,319,380	11,033,061
Prepaid expenses and other assets	11,367,121	11,410,320
<b>Total Assets</b>	<b>\$ 1,236,714,103</b>	<b>\$ 1,281,646,915</b>
<b>Liabilities</b>		
Payable for investments purchased	\$ —	\$ 21,000,000
Debt	459,042,200	477,981,494
Interest payable	3,159,576	7,896,016
Distributions payable	19,375,252	19,344,682
Base management fees payable	6,160,619	5,803,497
Incentive management fees payable	29,213,949	34,725,204
Accrued administrative services	187,026	270,000
Other accrued expenses and payables	5,285,235	4,921,681
<b>Total Liabilities</b>	<b>522,423,857</b>	<b>571,942,574</b>
<b>Net Assets</b>		
Common stock, par value \$.001 per share, 200,000,000 common shares authorized, 75,945,676 and 75,827,692 issued and 74,520,169 and 74,402,185 outstanding	75,946	75,828
Paid-in capital in excess of par	895,694,512	894,649,992
Distributions in excess of taxable net investment income	(27,654,805)	(19,373,748)
Accumulated net realized loss	(252,866,118)	(286,693,363)
Net unrealized appreciation (depreciation)	108,517,387	130,522,308
Treasury stock at cost, 1,425,507 and 1,425,507 shares held	(9,476,676)	(9,476,676)
<b>Total Net Assets</b>	<b>714,290,246</b>	<b>709,704,341</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 1,236,714,103</b>	<b>\$ 1,281,646,915</b>
<b>Net Asset Value Per Share</b>	<b>\$ 9.59</b>	<b>\$ 9.54</b>

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

	Three months ended	
	March 31, 2014	March 31, 2013
<b>Investment Income:</b>		
Interest income:		
Non-controlled, non-affiliated investments	\$ 24,088,064	\$ 24,832,109
Non-controlled, affiliated investments	1,102,012	948,005
Controlled investments	2,907,216	2,543,547
Total interest income	28,097,292	28,323,661
Fee income:		
Non-controlled, non-affiliated investments	807,500	2,741,659
Non-controlled, affiliated investments	—	—
Controlled investments	100,000	20,747
Total fee income	907,500	2,762,406
Dividend income:		
Non-controlled, non-affiliated investments	34,675	43,435
Non-controlled, affiliated investments	527,411	—
Controlled investments	—	—
Total dividend income	562,086	43,435
Total investment income	29,566,878	31,129,502
<b>Expenses:</b>		
Base management fees	6,160,619	5,349,956
Interest and credit facility fees	6,001,208	4,758,016
Incentive management fees	3,459,865	5,264,110
Professional fees	727,601	630,197
Amortization of debt issuance costs	544,599	366,006
Investment advisor expenses	532,806	558,098
Director fees	173,500	118,000
Administrative services	155,460	251,316
Other	717,025	869,725
Total expenses	18,472,683	18,165,424
<b>Net Investment Income</b>	<b>11,094,195</b>	<b>12,964,078</b>
<b>Realized and Unrealized Gain (Loss):</b>		
Net realized gain (loss):		
Non-controlled, non-affiliated investments	33,827,245	52,505
Non-controlled, affiliated investments	—	21
Controlled investments	—	(343)
Foreign currency	—	161,159
Net realized gain (loss)	33,827,245	213,342
Net change in unrealized appreciation or depreciation on:		
Non-controlled, non-affiliated investments	(25,340,019)	5,732,957
Non-controlled, affiliated investments	2,675,149	14,414,397
Controlled investments	965,651	(3,777,665)
Foreign currency translation	(305,702)	250,030
Net change in unrealized appreciation or depreciation	(22,004,921)	16,619,719
Net realized and unrealized gain (loss)	11,822,324	16,833,061
<b>Net Increase in Net Assets Resulting from Operations</b>	<b>\$ 22,916,519</b>	<b>\$ 29,797,139</b>
Net Investment Income Per Share - basic	\$ 0.15	\$ 0.18
Earnings Per Share - basic	\$ 0.31	\$ 0.40
Average Shares Outstanding - basic	74,517,547	73,957,696
Net Investment Income Per Share - diluted	\$ 0.15	\$ 0.17
Earnings Per Share - diluted	\$ 0.29	\$ 0.39
Average Shares Outstanding - diluted	84,414,275	78,356,242
Distributions Declared Per Share	\$ 0.26	\$ 0.26

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

	Three months ended	
	March 31, 2014	March 31, 2013
<b>Net Increase in Net Assets Resulting from Operations:</b>		
Net investment income	\$ 11,094,195	\$ 12,964,078
Net realized gain (loss)	33,827,245	213,342
Net change in unrealized appreciation or depreciation	(22,004,921)	16,619,719
Net increase in net assets resulting from operations	<u>22,916,519</u>	<u>29,797,139</u>
<b>Distributions to Stockholders from:</b>		
Net investment income	<u>(19,375,252)</u>	<u>(19,229,740)</u>
<b>Capital Share Transactions:</b>		
Equity component of convertible debt	—	1,231,650
Reinvestment of distributions	1,044,638	1,255,294
Net increase in net assets resulting from capital share transactions	<u>1,044,638</u>	<u>2,486,944</u>
<b>Total Increase in Net Assets</b>	4,585,905	13,054,343
Net assets at beginning of period	709,704,341	687,379,692
Net assets at end of period	<u>\$ 714,290,246</u>	<u>\$ 700,434,035</u>
<b>Capital Share Activity:</b>		
Shares issued from reinvestment of distributions	117,984	128,163
Net increase in shares outstanding	<u>117,984</u>	<u>128,163</u>

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

	<u>Three months ended</u>	
	<u>March 31, 2014</u>	<u>March 31, 2013</u>
<b>Operating Activities:</b>		
Net increase in net assets resulting from operations	\$ 22,916,519	\$ 29,797,139
<i>Adjustments to reconcile net increase in net assets resulting from operations:</i>		
PIK interest and dividends	(1,227,416)	(2,097,546)
Net amortization on investments	(872,206)	(3,090,310)
Amortization of debt issuance costs	544,600	366,006
Net change in unrealized on investments	21,699,219	(16,369,689)
Net change in unrealized on foreign currency translation	305,702	(250,030)
Net realized (gain) loss on investments	(33,827,245)	(52,183)
Net realized (gain) loss on foreign currency	—	(161,159)
<i>Changes in operating assets:</i>		
Purchase of investments	(61,727,731)	(43,929,002)
Purchase of foreign currency contracts—net	—	163,075
Proceeds from disposition of investments	188,032,090	104,212,921
Change in receivable for investments sold	(45,103,578)	(9,282,092)
Change in interest receivable	(6,286,319)	(7,231,167)
Change in prepaid expenses and other assets	(501,400)	(5,815,980)
<i>Changes in operating liabilities:</i>		
Change in payable for investments purchased	(21,000,000)	14,284,265
Change in interest payable	(4,736,440)	(2,238,803)
Change in management fees payable	357,122	(276,937)
Change in incentive management fees payable	(5,511,255)	(9,519,085)
Change in accrued administrative services	(82,974)	(67,732)
Change in other accrued expenses and payables	(147,446)	1,165,498
Net cash provided by (used in) operating activities	<u>52,831,242</u>	<u>49,607,189</u>
<b>Financing Activities:</b>		
Distributions paid in cash	(18,300,044)	(17,941,124)
Proceeds from debt	217,060,705	151,759,305
Repayments of debt	(236,000,000)	(191,581,650)
Net cash provided by (used in) financing activities	<u>(37,239,339)</u>	<u>(57,763,469)</u>
<b>Net increase (decrease) in cash</b>	<b>15,591,903</b>	<b>(8,156,280)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>18,474,784</b>	<b>9,122,141</b>
<b>Cash and cash equivalents, end of period</b>	<b><u>\$ 34,066,687</u></b>	<b><u>\$ 965,861</u></b>
<b>Supplemental disclosure of cash flow information and non-cash financing activities:</b>		
Cash paid during period for:		
Interest	\$ 10,504,775	\$ 6,682,226
Taxes	\$ 81,868	\$ 340,372
Distributions reinvested	\$ 1,044,638	\$ 1,255,294

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments**  
**March 31, 2014**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
<b>Senior Secured Notes—23.7%</b>						
Advanced Lighting Technologies, Inc., First Lien(i)	<i>Lighting</i>	10.50%	6/1/19	\$ 20,000,000	\$ 19,602,204	\$ 14,600,000
AGY Holding Corp., Second Lien(d)(i)	<i>Glass</i>					
	<i>Yarns/Fibers</i>	11.00%	12/15/16	21,762,500	19,659,665	19,368,625
American Piping Products, Inc., Second Lien(i)	<i>Distribution</i>	12.88%	11/15/17	15,000,000	14,768,507	14,850,000
American Residential Services L.L.C. et al., Second Lien(i)	<i>HVAC/ Plumbing</i>					
	<i>Services</i>	12.00%	4/15/15	46,000,000	45,841,732	46,000,000
BPA Laboratories Inc., First Lien(i)	<i>Healthcare</i>					
	<i>Services</i>	12.25%	4/1/17	35,078,000	34,308,518	35,078,000
Sizzling Platter LLC et al., First Lien(i)	<i>Restaurants</i>	12.25%	4/15/16	30,000,000	29,563,624	30,000,000
U.S. Well Services, LLC, Second Lien(i)	<i>Energy</i>	14.50%	2/15/17	9,000,000	8,924,213	9,000,000
<b>Total Senior Secured Notes</b>					<u>172,668,463</u>	<u>168,896,625</u>
<b>Unsecured Debt—16.7%</b>						
Higginbotham Insurance Holdings, Inc.	<i>Insurance</i>	11.00%	12/14/18	36,750,000	36,750,000	36,750,000
QHB Holdings LLC(o)	<i>Materials</i>	16.00%	12/17/19	20,000,000	20,000,000	20,000,000
Red Apple Stores Inc.(f)(g)(o)(p)	<i>Discount Stores</i>					
		18.00%	7/11/17	5,705,354	5,705,354	5,705,354
SVP Worldwide Ltd.(g)(o)(p)	<i>Consumer Products</i>					
		14.00%	6/27/18	44,280,477	44,280,477	44,280,477
Townsquare Media, LLC(o)	<i>Media &amp; Entertainment</i>					
		10.00%	9/30/19	12,460,584	12,460,584	12,460,584
<b>Total Unsecured Debt</b>					<u>119,196,415</u>	<u>119,196,415</u>
<b>Subordinated Debt—10.9%</b>						
A & A Manufacturing Co., Inc.(o)	<i>Protective Enclosures</i>					
		14.00%	5/16/16	32,995,314	32,995,314	32,995,314
Automobile Protection Corporation —APCO(n)	<i>Insurance</i>	9.73%	6/17/19	25,000,000	25,000,000	25,000,000
The Pay-O-Matic Corp.(o)	<i>Financial Services</i>					
		14.00%	9/30/16	20,400,000	20,400,000	19,992,000
<b>Total Subordinated Debt</b>					<u>78,395,314</u>	<u>77,987,314</u>

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments—(Continued)**  
**March 31, 2014**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
<b>Senior Secured Loans—70.5%(e)</b>						
Accriva Diagnostics, Inc., First Lien	<i>Healthcare</i>	12.25%	1/17/19	\$ 21,000,000	\$ 21,000,000	\$ 21,000,000
AGY Holding Corp., Second Lien(d)	<i>Glass</i>					
	<i>Yarns/Fibers</i>	12.00%	9/15/16	7,964,650	7,964,650	7,964,650
AL Solutions, Inc., Term Loan B, Second Lien(o)	<i>Metals</i>	5.00%	12/31/19	71,920	—	—
AmQuip Crane Rental LLC, Second Lien	<i>Construction Equipment</i>	12.00%	12/19/17	41,068,361	41,068,361	41,068,361
Bankruptcy Management Solutions, Inc., Term Loan A, First Lien(f)(n)	<i>Financial Services</i>	4.50%	6/27/17	1,635,417	1,542,938	1,586,354
Bankruptcy Management Solutions, Inc., Term Loan B, First Lien(f)(n)	<i>Financial Services</i>	7.00%	6/27/18	12,084,256	10,142,584	10,392,460
Citrus Energy Appalachia, LLC, Second Lien(n)	<i>Energy</i>	9.75%	7/26/18	27,717,857	26,968,925	26,886,319
Crimson Energy Partners III, L.L.C., Second Lien	<i>Energy</i>	10.75%	2/4/19	29,812,500	29,812,500	29,812,500
Expert Global Solutions, Inc., First Lien(n)	<i>Business Services</i>	8.50%	4/3/18	1,984,812	1,977,409	1,942,635
K2 Pure Solutions Nocal, L.P. First Lien(n)	<i>Chemicals</i>	10.00%	8/19/19	20,000,000	19,641,313	20,000,000
MediMedia USA, Inc., First Lien(n)	<i>Information Services</i>	8.00%	11/20/18	9,925,000	9,672,426	9,627,250
MediMedia USA, Inc., Second Lien(n)	<i>Information Services</i>	12.25%	11/20/19	60,000,000	58,430,518	58,200,000
Pre-Paid Legal Services, Inc., Second Lien(n)	<i>Legal Services</i>	9.75%	7/1/20	25,000,000	24,663,240	25,000,000
Quality Home Brands Holdings LLC, Second Lien(n)	<i>Materials</i>	11.75%	6/17/19	40,000,000	40,000,000	40,000,000
Red Apple Stores Inc., Second Lien(f)(g)(p)	<i>Discount Stores</i>	16.00%	1/11/17	21,800,000	21,800,000	21,800,000
Royal Adhesives and Sealants, LLC, Second Lien(n)	<i>Chemicals</i>	9.75%	1/31/19	6,000,000	5,894,338	6,165,000
Shoreline Energy LLC, Second Lien(n)	<i>Energy</i>	10.25%	3/30/19	30,000,000	29,181,054	30,000,000
Sur La Table, Inc., First Lien	<i>Consumer Products</i>	12.00%	7/28/17	50,000,000	50,000,000	51,000,000
TriMark USA, LLC., Second Lien(n)	<i>Food Service Equipment</i>	10.00%	8/11/19	15,000,000	14,705,934	14,700,000



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**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments—(Continued)**  
**March 31, 2014**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
United Subcontractors, Inc., First Lien(d)(n)(o)	<i>Building and Construction</i>	4.24%	6/30/15	\$ 5,015,119	\$ 4,948,095	\$ 5,015,119
Water Pik, Inc., Second Lien(n)	<i>Consumer Products</i>	9.75%	1/8/21	22,500,000	21,585,842	22,275,000
WBS Group LLC, First Lien(f)(n)	<i>Software</i>	9.50%	6/30/15	27,284,255	27,284,255	27,284,255
WBS Group LLC, Second Lien(f)(n)	<i>Software</i>	10.50%	12/31/15	24,999,000	24,696,856	24,999,000
Westward Dough Operating Company, LLC, First Lien(f)	<i>Restaurants</i>	9.00%	3/2/17	6,590,896	6,590,896	6,656,805
<b>Total Senior Secured Loans</b>					<u>499,572,134</u>	<u>503,375,708</u>
<b>Preferred Stock—4.2%</b>						
Advantage Insurance Holdings, Ltd.(d)(g)(i)(p)	<i>Insurance</i>	8.00%		500,000	5,201,442	5,201,442
BKC CLO 2014-1, Ltd.(c)(d)(g)(p)	<i>Financial Services</i>			498,000	4,980,000	4,980,000
KAGY Holding Company, Inc. (AGY Holding Corp.)(d)	<i>Glass Yarns/Fibers</i>	20.00%		22,960	5,247,890	4,601,292
Progress Financial Corporation, Series F-1(c)	<i>Financial Services</i>			963,710	740,313	1,272,097
Progress Financial Corporation, Series G(c)	<i>Financial Services</i>			1,758,256	2,013,112	2,320,898
USI Senior Holdings, Inc. (United Subcontractors)(c)(d)	<i>Building and Construction</i>			208,742	3,812,635	6,262,254
VSS-AHC Consolidated Holdings Corp. (Advanstar Global LLC)(d)	<i>Printing/Publishing</i>	15.00%		4,809	5,403,634	5,403,634
<b>Total Preferred Stock</b>					<u>27,399,026</u>	<u>30,041,617</u>
<b>Common Stock—18.1%(c)</b>						
Bankruptcy Management Solutions, Inc.(f)	<i>Financial Services</i>			368,124	16,654,505	17,817,202
DynaVox Inc.(k)	<i>Augmentative Communication Products</i>			272,369	758,069	24,513
ECI Holdco, Inc., Class A-1(f)	<i>Electronics</i>			20,540,133	23,077,697	69,836,451
M & M Tradition Holdings Corp.(d)	<i>Sheet Metal Fabrication</i>			500,000	5,000,000	10,750,000
Red Apple Stores Inc.(f)(g)(h)(p)	<i>Discount Stores</i>			8,756,859	7,937,119	7,649,565
Tygem Holdings, Inc., Class A	<i>Metals</i>			30,000	—	—

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments—(Continued)**  
**March 31, 2014**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
USI Senior Holdings, Inc. (United Subcontractors)(d)	<i>Building and Construction</i>			208,742	\$ 3,814,281	\$ 23,001,259
<b>Total Common Stock</b>					<u>57,241,671</u>	<u>129,078,990</u>
<b>Limited Partnership/Limited Liability Company Interests—9.7%</b>						
ARS Investment Holdings, LLC(c)(j)	<i>HVAC/Plumbing Services</i>			128,358	21,658	1,190,000
Higginbotham Investment Holdings, LLC(c)	<i>Insurance</i>			1,163	1,139,535	1,748,838
Marquette Transportation Company Holdings, LLC(c)(l)	<i>Transportation</i>			25,000	5,000,000	4,312,000
Marsico Holdings, LLC(c)(i)	<i>Financial Services</i>			91,445	1,848,077	18,732
Penton Business Media Holdings, LLC(c)(d)	<i>Information Services</i>			226	9,050,000	36,441,130
PG Holdco, LLC	<i>Healthcare Services</i>	15.00%		333	445,436	495,504
PG Holdco, LLC, Class A(c)	<i>Healthcare Services</i>			16,667	166,667	445,437
Sentry Security Systems Holdings, LLC(c)	<i>Security Services</i>			147,271	147,271	15,100
Sentry Security Systems Holdings, LLC	<i>Security Services</i>	8.00%		602,769	1,044,695	1,044,695
VSS-AHC Holdings LLC (Advanstar Global LLC)(c)(d)	<i>Printing/Publishing</i>			884,716	6,150,647	13,500,766
WBS Group LLC(c)(f)(m)	<i>Software</i>			—	1,000	6,056,783
Westward Dough Holdings, LLC, Class A(c)(f)	<i>Restaurants</i>			350,000	9,260,324	4,368,000
<b>Total Limited Partnership/Limited Liability Company Interests</b>					<u>34,275,310</u>	<u>69,636,985</u>
<b>Equity Warrants/Options—1.1%(c)</b>						
Bankruptcy Management Solutions, Inc., Tranche A(f)	<i>Financial Services</i>		expire 6/27/18	28,464	375,040	390,240
Bankruptcy Management Solutions, Inc., Tranche B(f)	<i>Financial Services</i>		expire 6/27/19	30,654	342,295	352,828
Bankruptcy Management Solutions, Inc., Tranche C(f)	<i>Financial Services</i>		expire 6/27/20	45,981	468,803	482,801
facet Investment, Inc.	<i>Medical Devices</i>		expire 1/18/21	1,978	250,000	80,415

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments—(Continued)**  
**March 31, 2014**  
(Unaudited)

Portfolio Company	Industry	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(a)	Fair Value(b)
Marsico Parent Superholdco, LLC(i)	<i>Financial Services</i>		expire 12/14/19	455	\$ 444,450	\$ —
Progress Financial Corporation	<i>Financial Services</i>		expire various	6,959,220	3,183,106	5,731,113
Twin River Worldwide Holdings, Inc., Contingent Value Rights	<i>Gaming</i>		expire 11/5/17	1,000	5,000	850,000
<b>Total Equity Warrants/Options</b>					<u>5,068,694</u>	<u>7,887,397</u>
<b>TOTAL INVESTMENTS—154.9%</b>					<u>\$ 993,817,027</u>	<u>1,106,101,051</u>
<b>OTHER ASSETS &amp; LIABILITIES (NET)—(54.9)%</b>						<u>(391,810,805)</u>
<b>NET ASSETS—100.0%</b>						<u>\$ 714,290,246</u>

- (a) Represents amortized cost for fixed income securities and cost for preferred and common stock, limited partnership/limited liability company interests and equity warrants/options.
- (b) Fair value is determined by or under the direction of the Company's Board of Directors. See Note 2 for further details.
- (c) Non-income producing equity securities at March 31, 2014.
- (d) Transaction and other information for "non-controlled, affiliated" investments under the Investment Company Act of 1940, whereby the Company owns 5% or more (but not more than 25%) of the portfolio company's outstanding voting securities.
- (e) Approximately 64% of the senior secured loans of the Company's portfolio companies bear interest at a floating rate that may be determined by reference to the London Interbank Offered Rate (LIBOR) or other base rate (commonly the Federal Funds Rate or the Prime Rate), at the borrower's option. In addition, approximately 63% of such senior secured loans have floors of 1.00% to 1.75%. The borrower under a senior secured loan generally has the option to select from interest reset periods of one, two, three or six months and may alter that selection at the end of any reset period. The stated interest rate represents the weighted average interest rate at March 31, 2014 of all contracts within the specified loan facility.

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Non-controlled, Affiliated Investments	Fair Value at December 31, 2013	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at March 31, 2014	Three Months Ended March 31, 2014			
						Net Realized Gain (Loss)	Interest Income	Fee Income	Dividend Income
Advantage Insurance Holdings, Ltd.									
Preferred Stock	\$ 5,100,822	\$ 100,620	\$ —	\$ —	\$ 5,201,442	\$ —	\$ —	\$ —	\$ 100,619
AGY Holding Corp.:									
Senior Secured Note	19,151,000	197,155	—	20,470	19,368,625	—	795,624	—	—
Senior Secured Loan	7,964,650	—	—	—	7,964,650	—	238,939	—	—
BKC CLO 2014-1, Ltd.									
Preferred Stock	—	4,980,000	—	—	4,980,000	—	—	—	—
KAGY Holding Company, Inc. (AGY Holding Corp.)									
Preferred Stock	4,732,950	231,371	—	(363,029)	4,601,292	—	—	—	231,370
M&M Tradition Holdings Corp.									
Common Stock	9,250,000	—	—	1,500,000	10,750,000	—	—	—	—
Penton Business Media Holdings, LLC									
Limited Liability Co. Interest	36,441,130	—	—	—	36,441,130	—	—	—	—
United Subcontractors, Inc.									
Senior Secured Loan	5,015,119	14,164	—	(14,164)	5,015,119	—	67,449	—	—
USI Senior Holdings, Inc.:									
Common Stock	21,575,553	—	—	1,425,706	23,001,259	—	—	—	—
Preferred Stock	6,262,254	—	—	—	6,262,254	—	—	—	—
VSS-AHC Consolidated Holdings Corp. (Advanstar Global LLC)									
Preferred Stock	5,208,213	195,421	—	—	5,403,634	—	—	—	195,422
VSS-AHC Holdings LLC. (Advanstar Global LLC)									
Limited Liability Co. Interest	13,394,600	—	—	106,166	13,500,766	—	—	—	—
<b>Totals</b>	<b>\$134,096,291</b>	<b>\$5,718,731</b>	<b>\$ —</b>	<b>\$2,675,149</b>	<b>\$142,490,171</b>	<b>\$ —</b>	<b>\$1,102,012</b>	<b>\$ —</b>	<b>\$ 527,411</b>

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

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

The aggregate fair value of non-controlled, affiliated investments at March 31, 2014 represents 19.9% of the Company’s net assets.

- (f) Transaction and other information for “controlled” investments under the Investment Company Act of 1940, whereby the Company owns more than 25% of the portfolio company’s outstanding voting securities.
- (g) Non-U.S. company or principal place of business outside the U.S.
- (h) Original purchase denominated in Canadian dollars.
- (i) Security is exempt from registration under Rule 144A of the Securities Act of 1933. Such securities may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. In the aggregate, these securities represent 26% of the Company’s net assets at March 31, 2014.
- (j) The Company is the sole stockholder of BKC ARS Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of American Residential Services L.L.C. and thus a non-controlled, non-affiliated investment.
- (k) During the period DynaVox completed an exchange of the outstanding L.L.C. units into an equivalent number of common shares.
- (l) The Company is the sole stockholder of BKC MTCH Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of Marquette Transportation Company Holdings, LLC and thus a non-controlled, non-affiliated investment.
- (m) The Company is the sole stockholder of BKC-WBS, LLC, a consolidated subsidiary, which is the beneficiary of more than 25% of the voting securities of WBS Group LLC and thus a controlled investment.

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Controlled Investments	Fair Value at December 31, 2013	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at March 31, 2014	Three Months Ended March 31, 2014		
						Net Realized Gain (Loss)	Interest Income	Fee Income
<b>Bankruptcy Management Solutions, Inc.:</b>								
Senior Secured Loan, First Lien, A	\$ 1,596,458	\$ 7,904	\$ (10,416)	\$ (7,592)	\$ 1,586,354	\$ —	\$ 26,420	\$ 100,000
Senior Secured Loan, First Lien, B	10,458,655	131,065	(76,971)	(120,289)	10,392,460	—	343,871	—
Common Stock	17,242,928	—	—	574,274	17,817,202	—	—	—
Warrants	1,193,880	—	—	31,989	1,225,869	—	—	—
<b>ECI Holdco, Inc.</b>								
Common Stock	68,604,042	—	—	1,232,409	69,836,451	—	—	—
<b>Red Apple Stores, Inc.:</b>								
Unsecured Debt	5,454,365	250,989	—	—	5,705,354	—	250,989	—
Senior Secured Loan	20,000,000	1,800,000	—	—	21,800,000	—	800,000	—
Common Stock	8,242,821	—	(305,702)	(287,554)	7,649,565	—	—	—
<b>WBS Group LLC:</b>								
Senior Secured Loan, First Lien	27,284,255	—	—	—	27,284,255	—	648,001	—
Senior Secured Loan, Second Lien	24,999,000	44,586	—	(44,586)	24,999,000	—	700,808	—
Limited Liability Co. Interest	6,056,783	—	—	—	6,056,783	—	—	—
<b>Westward Dough Operating Company, LLC</b>								
Senior Secured Loan	6,656,805	—	—	—	6,656,805	—	137,127	—
<b>Westward Dough Holdings, LLC</b>								
Limited Liability Co. Interest	4,781,000	—	—	(413,000)	4,368,000	—	—	—
<b>Totals</b>	<b>\$202,570,992</b>	<b>\$2,234,544</b>	<b>\$(393,089)</b>	<b>\$ 965,651</b>	<b>\$205,378,098</b>	<b>\$ —</b>	<b>\$2,907,216</b>	<b>\$ 100,000</b>

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

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

The aggregate fair value of controlled investments at March 31, 2014 represents 28.8% of the Company's net assets.

- (n) Security bears interest at a floating rate that may or may not include an interest rate floor.
- (o) Interest may be paid in cash or PIK, or a combination thereof which is generally at the option of the borrower. PIK earned is included in the cost basis of the security. PIK represented approximately 2.8% of interest income earned for the year ended March 31, 2014. In accordance with the Company's policy, PIK may be recorded on an effective yield basis.
- (p) BDCs are required to invest at least 70% of their total assets primarily in securities of private or thinly traded U.S. public companies, cash, cash equivalents, U.S. Government securities and other high quality debt investments that mature in one year or less. The securities referenced represent either fully or partially non-qualified assets for purposes of this requirement.

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments**  
**December 31, 2013**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
<b>Senior Secured Notes—31.9%</b>						
Advanced Lighting Technologies, Inc., First Lien(i)	<i>Lighting</i>	10.50%	6/1/19	\$ 20,000,000	\$ 19,582,933	\$ 15,000,000
AGY Holding Corp., Second Lien(d)(i)	<i>Glass</i>					
	<i>Yarns/Fibers</i>	11.00%	12/15/16	21,762,500	19,462,510	19,151,000
American Piping Products, Inc., Second Lien(i)	<i>Distribution</i>	12.88%	11/15/17	20,000,000	19,669,891	19,800,000
American Residential Services L.L.C. et al., Second Lien(i)	<i>HVAC/ Plumbing Services</i>	12.00%	4/15/15	46,000,000	45,801,024	46,000,000
BPA Laboratories Inc., First Lien(i)	<i>Healthcare Services</i>	12.25%	4/1/17	35,078,000	34,243,609	35,078,000
Sizzling Platter LLC et al., First Lien(i)	<i>Restaurants</i>	12.25%	4/15/16	30,000,000	29,508,767	30,600,000
TriMark USA, LLC., Second Lien(n)(o)	<i>Food Service Equipment</i>	13.00%	6/29/16	52,138,638	52,138,638	52,138,638
U.S. Well Services, LLC, Second Lien(i)	<i>Energy</i>	14.50%	2/15/17	9,000,000	8,917,538	8,917,538
<b>Total Senior Secured Notes</b>					<b>229,324,910</b>	<b>226,685,176</b>
<b>Unsecured Debt—16.7%</b>						
Higginbotham Insurance Holdings, Inc.	<i>Insurance</i>	11.00%	12/14/18	36,750,000	36,750,000	36,750,000
QHB Holdings LLC(o)	<i>Materials</i>	16.00%	12/17/19	20,000,000	20,000,000	20,000,000
Red Apple Stores Inc.(f)(g)(o)(q)	<i>Discount Stores</i>	18.00%	7/11/17	5,454,365	5,454,365	5,454,365
SVP Worldwide Ltd.(g)(o)(q)	<i>Consumer Products</i>	14.00%	6/27/18	44,170,052	44,170,052	44,170,052
Townsquare Media, LLC(o)	<i>Media &amp; Entertainment</i>	10.00%	9/30/19	12,156,667	12,156,667	12,156,667
<b>Total Unsecured Debt</b>					<b>118,531,084</b>	<b>118,531,084</b>
<b>Subordinated Debt—11.1%</b>						
A & A Manufacturing Co., Inc.(o)	<i>Protective Enclosures</i>	14.00%	5/16/16	32,995,314	32,995,314	32,995,314
Automobile Protection Corporation—APCO(n)	<i>Insurance</i>	9.74%	6/17/19	25,000,000	25,000,000	25,000,000
The Pay-O-Matic Corp.(o)	<i>Financial Services</i>	14.00%	9/30/16	20,400,000	20,400,000	20,400,000
<b>Total Subordinated Debt</b>					<b>78,395,314</b>	<b>78,395,314</b>

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments—(Continued)**  
**December 31, 2013**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
<b>Senior Secured Loans—74.3%(e)</b>						
Accriva Diagnostics, Inc., First Lien	<i>Healthcare</i>	12.25%	1/17/19	\$ 21,000,000	\$ 21,000,000	\$ 21,000,000
AGY Holding Corp., Second Lien(d)	<i>Glass Yarns/Fibers</i>	12.00%	9/15/16	7,964,650	7,964,650	7,964,650
AL Solutions, Inc., Term Loan B, Second Lien(o)	<i>Metals</i>	5.00%	12/31/19	71,032	—	—
Alpha Media Group Inc., First Lien(o)	<i>Publishing</i>	12.00%	7/15/16	6,280,313	4,338,433	538,000
AmQuip Crane Rental LLC, Second Lien	<i>Construction Equipment</i>	12.00%	12/19/17	41,068,361	41,068,361	39,014,942
Arclin US Holdings Inc., Second Lien(g)(n)(q)	<i>Chemicals</i>	7.75%	1/15/15	3,451,615	3,271,711	3,451,615
Ascend Learning, LLC, Second Lien(n)	<i>Education</i>	11.50%	12/6/17	20,000,000	20,000,000	20,000,000
Attachmate Corporation et al., Second Lien(n)	<i>Software</i>	11.00%	11/22/18	24,191,324	23,849,327	24,191,324
Bankruptcy Management Solutions, Inc., Term Loan A, First Lien(f)(n)	<i>Financial Services</i>	4.50%	6/27/17	1,645,833	1,545,450	1,596,458
Bankruptcy Management Solutions, Inc., Term Loan B, First Lien(f)(n)	<i>Financial Services</i>	7.00%	6/27/18	12,161,227	10,088,490	10,458,655
Citrus Energy Appalachia, LLC, Second Lien(n)	<i>Energy</i>	9.75%	7/26/18	27,787,500	26,993,013	26,953,875
Isola USA Corp., First Lien(n)	<i>Laminate Products</i>	9.25%	11/29/18	5,000,000	4,925,500	5,050,000
K2 Pure Solutions Nocal, L.P. First Lien(n)	<i>Chemicals</i>	10.00%	8/19/19	20,000,000	19,624,645	20,000,000
MediMedia USA, Inc., First Lien(n)	<i>Information Services</i>	8.00%	11/20/18	9,950,000	9,683,071	9,651,500
MediMedia USA, Inc., Second Lien(n)	<i>Information Services</i>	12.25%	11/20/19	60,000,000	58,360,932	58,200,000
Omnitracs, Inc., Second Lien(n)	<i>Trucking Fleet Management Systems</i>	8.75%	5/25/21	3,000,000	2,970,195	3,020,625
Pre-Paid Legal Services, Inc., Second Lien(n)	<i>Legal Services</i>	9.75%	7/1/20	25,000,000	24,649,793	25,000,000
Quality Home Brands Holdings LLC, Second Lien(n)	<i>Materials</i>	11.75%	6/17/19	40,000,000	40,000,000	40,000,000
Red Apple Stores Inc., Second Lien(f)(g)(q)	<i>Discount Stores</i>	16.00%	1/11/17	20,000,000	20,000,000	20,000,000

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments—(Continued)**  
**December 31, 2013**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
Renaissance Learning, Inc., Second Lien(n)	<i>Education</i>					
	<i>Software</i>	8.75%	5/14/21	\$ 3,000,000	\$ 2,955,733	\$ 3,031,875
Road Infrastructure Investment, LLC, Second Lien(n)	<i>Manufacturing</i>	10.25%	9/30/18	15,000,000	14,831,430	15,000,000
Royal Adhesives and Sealants, LLC, Second Lien(n)	<i>Chemicals</i>	9.75%	1/31/19	6,000,000	5,888,863	6,075,000
Shoreline Energy LLC, Second Lien(n)	<i>Energy</i>	10.25%	3/30/19	30,000,000	29,139,991	30,000,000
Sur La Table, Inc., First Lien	<i>Consumer</i>					
	<i>Products</i>	12.00%	7/28/17	50,000,000	50,000,000	51,000,000
United Subcontractors, Inc., First Lien(d)(n)(o)	<i>Building and</i>					
	<i>Construction</i>	4.25%	6/30/15	5,015,119	4,933,931	5,015,119
Water Pik, Inc., Second Lien(n)	<i>Consumer</i>					
	<i>Products</i>	9.75%	1/8/21	22,500,000	21,552,192	22,050,000
WBS Group LLC, First Lien(f)(n)	<i>Software</i>	9.50%	6/30/15	27,284,255	27,284,255	27,284,255
WBS Group LLC, Second Lien(f)(n)	<i>Software</i>	10.50%	12/31/15	24,999,000	24,652,270	24,999,000
Westward Dough Operating Company, LLC, First Lien(f)	<i>Restaurants</i>	8.00%	3/2/17	6,590,896	6,590,896	6,656,805
<b>Total Senior Secured Loans</b>					<u>528,163,132</u>	<u>527,203,698</u>
<b>Preferred Stock—3.5%</b>						
Advantage Insurance Holdings, Ltd.(d)(g)(i)(q)	<i>Insurance</i>	8.00%		500,000	5,100,822	5,100,822
Alpha Media Group Holdings Inc., Series A-2(p)	<i>Publishing</i>			5,000	—	—
KAGY Holding Company, Inc. (AGY Holding Corp.)(d)	<i>Glass</i>					
	<i>Yarns/Fibers</i>	20.00%		22,960	5,016,519	4,732,950
Progress Financial Corporation, Series F-1(p)	<i>Financial Services</i>			963,710	740,313	1,263,255
Progress Financial Corporation, Series G(p)	<i>Financial Services</i>			1,758,256	2,013,112	2,304,765
USI Senior Holdings, Inc. (United Subcontractors)(d)(p)	<i>Building and</i>					
	<i>Construction</i>			208,742	3,812,635	6,262,254
VSS-AHC Consolidated Holdings Corp. (Advanstar Global LLC)(d)	<i>Printing/</i>	15.00%		4,809	5,208,213	5,208,213
	<i>Publishing</i>					
<b>Total Preferred Stock</b>					<u>21,891,614</u>	<u>24,872,259</u>
<b>Common Stock—20.2%(p)</b>						
Alpha Media Group Holdings Inc., Class B	<i>Publishing</i>			12,500	—	—
Arclin Cayman Holdings Ltd.(g)(q)	<i>Chemicals</i>			450,532	9,722,203	18,440,000
Bankruptcy Management Solutions, Inc.(f)	<i>Financial</i>					
	<i>Services</i>			368,124	16,654,505	17,242,928



**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments—(Continued)**  
**December 31, 2013**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
ECI Holdco, Inc., Class A-1(f)	<i>Electronics</i>			20,540,133	\$ 23,077,697	\$ 68,604,042
M & M Tradition Holdings Corp.(d)	<i>Sheet Metal Fabrication</i>			500,000	5,000,000	9,250,000
Red Apple Stores Inc.(f)(g)(h)(q)	<i>Discount Stores</i>			8,756,859	8,242,821	8,242,821
Tygem Holdings, Inc., Class A	<i>Metals</i>			30,000	—	—
USI Senior Holdings, Inc. (United Subcontractors)(d)	<i>Building and Construction</i>			208,742	3,814,281	21,575,553
<b>Total Common Stock</b>					<b>66,511,507</b>	<b>143,355,344</b>
<b>Limited Partnership/Limited Liability Company</b>						
<b>Interests—9.6%</b>						
ARS Investment Holdings, LLC(j)(p)	<i>HVAC/ Plumbing Services</i>			128,358	21,658	1,130,000
DynaVox Systems Holdings, LLC(k)(p)	<i>Augmentative Communication Products</i>			272,369	758,069	32,684
Higginbotham Investment Holdings, LLC(p)	<i>Insurance</i>			1,163	1,139,535	1,715,117
Marquette Transportation Company Holdings, LLC(l)(p)	<i>Transportation</i>			25,000	5,000,000	2,912,000
Marsico Holdings, LLC(i)(p)	<i>Financial Services</i>			91,445	1,848,077	18,732
Penton Business Media Holdings, LLC(d)(p)	<i>Information Services</i>			226	9,050,000	36,441,130
PG Holdco, LLC	<i>Healthcare Services</i>	15.00%		333	430,772	430,772
PG Holdco, LLC, Class A(p)	<i>Healthcare Services</i>			16,667	166,667	410,569
Sentry Security Systems Holdings, LLC(p)	<i>Security Services</i>			147,271	147,271	15,943
Sentry Security Systems Holdings, LLC	<i>Security Services</i>	8.00%		602,729	1,024,686	1,024,686
VSS-AHC Holdings LLC (Advanstar Global LLC)(d)(p)	<i>Printing/ Publishing</i>			884,716	6,150,647	13,394,600
WBS Group LLC(f)(m)(p)	<i>Software</i>			—	1,000	6,056,783
Westward Dough Holdings, LLC, Class A(f)(p)	<i>Restaurants</i>			350,000	9,260,324	4,781,000
<b>Total Limited Partnership/Limited Liability Company Interests</b>					<b>34,998,706</b>	<b>68,364,016</b>

**BlackRock Kelso Capital Corporation**  
**Consolidated Schedules of Investments—(Continued)**  
**December 31, 2013**

Portfolio Company	Industry(a)	Interest Rate	Maturity	Principal Amount or Number of Shares/Units	Cost(b)	Fair Value(c)
<b>Equity Warrants/Options—4.3%(p)</b>						
Arclin Cayman Holdings Ltd., Tranche 1(g)(q)	<i>Chemicals</i>		expire 1/15/14	230,159	\$ 403,815	\$ 6,082,021
Arclin Cayman Holdings Ltd., Tranche 2(g)(q)	<i>Chemicals</i>		expire 1/15/15	230,159	323,052	6,088,754
Arclin Cayman Holdings Ltd., Tranche 3(g)(q)	<i>Chemicals</i>		expire 1/15/14	230,159	484,578	5,391,543
Arclin Cayman Holdings Ltd., Tranche 4(g)(q)	<i>Chemicals</i>		expire 1/15/15	230,159	403,815	5,399,833
Bankruptcy Management Solutions, Inc., Tranche A(f)	<i>Financial Services</i>		expire 6/27/18	28,464	375,040	375,725
Bankruptcy Management Solutions, Inc., Tranche B(f)	<i>Financial Services</i>		expire 6/27/19	30,654	342,295	343,631
Bankruptcy Management Solutions, Inc., Tranche C(f)	<i>Financial Services</i>		expire 6/27/20	45,981	468,803	474,524
facet Investment, Inc.	<i>Medical Devices</i>		expire 1/18/21	1,978	250,000	80,415
Marsico Parent Superholdco, LLC(i)	<i>Financial Services</i>		expire 12/14/19	455	444,450	—
Progress Financial Corporation	<i>Financial Services</i>		expire various	6,959,220	3,183,106	5,729,127
Twin River Worldwide Holdings, Inc., Contingent Value Rights	<i>Gaming</i>		expire 11/5/17	1,000	5,000	600,000
<b>Total Equity Warrants/Options</b>					<u>6,683,954</u>	<u>30,565,573</u>
<b>TOTAL INVESTMENTS—171.6%</b>					<u>\$1,084,500,221</u>	<u>1,217,972,464</u>
<b>OTHER ASSETS &amp; LIABILITIES (NET)—(71.6)%</b>						<u>(508,268,123)</u>
<b>NET ASSETS—100.0%</b>						<u>\$ 709,704,341</u>

- (a) Unaudited
- (b) Represents amortized cost for fixed income securities and cost for preferred and common stock, limited partnership/limited liability company interests and equity warrants/options.
- (c) Fair value is determined by or under the direction of the Company's Board of Directors. See Note 2 for further details.
- (d) Transaction and other information for "non-controlled, affiliated" investments under the Investment Company Act of 1940, whereby the Company owns 5% or more (but not more than 25%) of the portfolio company's outstanding voting securities.
- (e) Approximately 72% of the senior secured loans of the Company's portfolio companies bear interest at a floating rate that may be determined by reference to the London Interbank Offered Rate (LIBOR) or other base rate (commonly the Federal Funds Rate or the Prime Rate), at the borrower's option. In addition, approximately 71% of such senior secured loans have floors of 1.00% to 1.75%. The borrower under a senior secured loan generally has the option to select from interest reset periods of one, two, three or six months and may alter that selection at the end of any reset period. The stated interest rate represents the weighted average interest rate at December 31, 2013 of all contracts within the specified loan facility.

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Non-controlled, Affiliated Investments	Fair Value at December 31, 2012	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at December 31, 2013	For the Year Ended December 31, 2013				
						Net Realized Gain (Loss)	Interest Income	Fee Income	Dividend Income	
Advantage Insurance Holdings, Ltd.										
Preferred Stock	\$ —	\$ 5,100,822	\$ —	\$ —	\$ 5,100,822	\$ —	\$ —	\$ —	\$ —	\$ 100,823
AGY Holding Corp.:										
Senior Secured Note	—	19,462,510	—	(311,510)	19,151,000†	—	1,528,400	—	—	—
Senior Secured Loan	—	7,964,650	—	—	7,964,650†	—	496,462	—	—	—
KAGY Holding Company, Inc. (AGY Holding Corp.)										
Preferred Stock	—	5,016,519	—	(283,569)	4,732,950†	—	—	—	—	501,229
M&M Tradition Holdings Corp.										
Common Stock	6,250,000	—	—	3,000,000	9,250,000	—	—	—	—	—
Penton Business Media Holdings, LLC										
Limited Liability Co. Interest	22,111,124	—	—	14,330,006	36,441,130	—	—	—	—	—
Penton Media, Inc. et al.										
Senior Secured Loan	20,822,342	3,834,740	(23,687,192)	(969,890)	—	—	4,599,171	—	—	—
United Subcontractors, Inc.										
Senior Secured Loan	3,242,631	1,454,257	—	318,231	5,015,119	21	406,643	—	—	—
USI Senior Holdings, Inc.:										
Common Stock	3,485,140	88,832	(344)	18,001,925	21,575,553	—	—	—	—	—
Preferred Stock	4,934,133	87,527	—	1,240,594	6,262,254	—	—	—	—	—
VSS-AHC Consolidated Holdings Corp. (Advanstar Global LLC)										
Preferred Stock	—	5,208,213	—	—	5,208,213	—	—	—	—	399,212
VSS-AHC Holdings LLC. (Advanstar Global LLC)										
Limited Liability Co. Interest	6,904,802	—	—	6,489,798	13,394,600	—	—	—	—	—
<b>Totals</b>	<b>\$ 67,750,172</b>	<b>\$ 48,218,070</b>	<b>\$ (23,687,536)</b>	<b>\$ 41,815,585</b>	<b>\$ 134,096,291</b>	<b>\$ 21</b>	<b>\$ 7,030,676</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 1,001,264</b>

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

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

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

The aggregate fair value of non-controlled, affiliated investments at December 31, 2013 represents 18.9% of the Company’s net assets.

- (f) Transaction and other information for “controlled” investments under the Investment Company Act of 1940, whereby the Company owns more than 25% of the portfolio company’s outstanding voting securities.
- (g) Non-U.S. company or principal place of business outside the U.S.
- (h) Original purchase denominated in Canadian dollars.
- (i) Security is exempt from registration under Rule 144A of the Securities Act of 1933. Such securities may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. In the aggregate, these securities represent 27% of the Company’s net assets at December 31, 2013.
- (j) The Company is the sole stockholder of BKC ARS Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of American Residential Services L.L.C. and thus a non-controlled, non-affiliated investment.
- (k) The Company is the sole stockholder of BKC DVSH Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of DynaVox Systems LLC and thus a non-controlled, non-affiliated investment.
- (l) The Company is the sole stockholder of BKC MTCH Blocker, Inc., a consolidated subsidiary, which is the beneficiary of less than 5% of the voting securities of Marquette Transportation Company Holdings, LLC and thus a non-controlled, non-affiliated investment.
- (m) The Company is the sole stockholder of BKC-WBS, LLC, a consolidated subsidiary, which is the beneficiary of more than 25% of the voting securities of WBS Group LLC and thus a controlled investment.

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Controlled Investments	For the Year Ended December 31, 2013							
	Fair Value at December 31, 2012	Gross Additions (Cost)*	Gross Reductions (Cost)**	Net Unrealized Gain (Loss)	Fair Value at December 31, 2013	Net Realized Gain (Loss)	Interest Income	Fee Income
<b>Bankruptcy Management Solutions, Inc.:</b>								
Senior Secured Loan, First Lien, A	\$ 1,960,000	\$ 2,156,660	\$ (2,354,167)	\$ (166,035)	\$ 1,596,458	\$ 218,374	\$ 129,497	\$ 358,705
Senior Secured Loan, First Lien, B	17,148,766	32,131,115	(35,752,294)	(3,068,932)	10,458,655	2,269,456	2,779,506	100,000
Senior Secured Loan, Second Lien	7,703,412	406,328	(25,556,717)	17,446,977	— †	(24,547,868)	494,976	—
Common Stock	—	16,658,378	(3,873)	588,423	17,242,928	(9,600,072)	—	—
Warrants	—	1,216,827	(30,689)	7,742	1,193,880	(396,273)	—	—
<b>BKC CSP Blocker, Inc.</b>								
Common Stock	—	167,401	(167,401)	—	—	167,401	—	—
<b>ECI Holdco, Inc.</b>								
Common Stock	47,981,132	4,050,000	—	16,572,910	68,604,042	—	—	—
<b>Red Apple Stores, Inc.:</b>								
Unsecured Debt	—	5,454,365	—	—	5,454,365 ††	—	454,544	—
Senior Secured Loan	—	20,000,000	—	—	20,000,000 ††	—	1,546,669	1,250,000
Common Stock	—	8,512,095	(269,274)	—	8,242,821 ††	—	—	—
<b>WBS Group LLC:</b>								
Senior Secured Loan, First Lien	27,284,255	—	—	—	27,284,255	—	2,055,137	1,000,000
Senior Secured Loan, Second Lien	24,999,000	188,354	(140,633)	(47,721)	24,999,000	134	2,635,733	29,975
Limited Liability Co. Interest	6,056,783	—	—	—	6,056,783	—	—	—
<b>Westward Dough Operating Company, LLC</b>								
Senior Secured Loan	6,590,896	—	—	65,909	6,656,805	—	523,243	—
<b>Westward Dough Holdings, LLC</b>								
Limited Liability Co. Interest	3,612,000	—	—	1,169,000	4,781,000	—	—	—
<b>Totals</b>	<b>\$ 143,336,244</b>	<b>\$ 90,941,523</b>	<b>\$ (64,275,048)</b>	<b>\$ 32,568,273</b>	<b>\$ 202,570,992</b>	<b>\$ (31,888,848)</b>	<b>\$ 10,619,305</b>	<b>\$ 2,738,680</b>

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

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

† Investment no longer held at December 31, 2013.

†† Investment moved into controlled category during the period.

The aggregate fair value of controlled investments at December 31, 2013 represents 28.5% of the Company's net assets.

- (n) Security bears interest at a floating rate that may or may not include an interest rate floor.
- (o) Interest may be paid in cash or PIK, or a combination thereof which is generally at the option of the borrower. PIK earned is included in the cost basis of the security. PIK represented approximately 6.1% of interest income earned for the year ended December 31, 2013. In accordance with the Company's policy, PIK may be recorded on an effective yield basis.
- (p) Non-income producing equity securities at December 31, 2013.
- (q) BDCs are required to invest at least 70% of their total assets primarily in securities of private or thinly traded U.S. public companies, cash, cash equivalents, U.S. Government securities and other high quality debt investments that mature in one year or less. The securities referenced represent either fully or partially non-qualified assets for purposes of this requirement.

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

**1. Organization**

BlackRock Kelso Capital Corporation and subsidiaries (the “Company”) was organized as a Delaware corporation on April 13, 2005 and was initially funded on July 25, 2005. The Company has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940 (the “1940 Act”). In addition, for tax purposes the Company has qualified and has elected to be treated as a regulated investment company (“RIC”) under the Internal Revenue Code of 1986 (the “Code”). The Company is registered as an investment advisor under the Investment Advisers Act of 1940 (the “Advisers Act”).

The Company’s investment objective is to generate both current income and capital appreciation through debt and equity investments. The Company invests primarily in middle-market companies in the form of senior and junior secured and unsecured debt securities and loans, each of which may include an equity component, and by making direct preferred, common and other equity investments in such companies.

**2. Significant accounting policies**

***Unaudited Interim Consolidated Financial Statements***

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

Certain financial information that is normally included in annual financial statements, including certain financial statement footnotes, prepared in accordance with GAAP, is not required for interim reporting purposes and has been condensed or omitted herein. These consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements and notes related thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013, which was filed with the Securities and Exchange Commission (“SEC”) on March 6, 2014.

***Basis of Presentation***

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

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

***Investments***

Security transactions are accounted for on the trade date unless there are substantial conditions to the purchase. Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the amortized cost basis of the investment. Unrealized gains or losses primarily reflect the change in

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investment values, including the reversal of previously recorded unrealized gains or losses when gains or losses are realized. Realized gains or losses on the disposition of investments are calculated using the specific identification method.

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

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

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

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

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

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

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

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

Those investments for which market quotations are not readily available or for which market quotations are deemed not to represent fair value are valued utilizing a market approach, an income approach, or both approaches, as appropriate. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). The income approach

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uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. In following these approaches, the types of factors that the Company may take into account in determining the fair value of its investments include, as relevant and among other factors: available current market data, including relevant and applicable market trading and transaction comparables, applicable market yields and multiples, security covenants, call protection provisions, information rights, the nature and realizable value of any collateral, the portfolio company's ability to make payments, (e.g. non-performance risk), its earnings and discounted cash flows, the markets in which the portfolio company does business, comparisons of financial ratios of peer companies that are public, M&A comparables, the Company's principal market (as the reporting entity) and enterprise values.

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

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

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

Cash equivalents include short-term liquid overnight investments.

### ***Revenue recognition***

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

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

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

### ***U.S. Federal income taxes***

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

In order to qualify for favorable tax treatment as a RIC, the Company is required to distribute annually to its stockholders at least 90% of its investment company taxable income, as defined by the Code. To avoid federal excise taxes, we must distribute annually at least 98% of our ordinary income and 98.2% of net capital gains

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from the current year and any undistributed ordinary income and net capital gains from the preceding years. The Company, at its discretion, may carry forward taxable income in excess of calendar year distributions and pay a 4% excise tax on this income. If the Company chooses to do so, all other things being equal, this would increase expenses and reduce the amount available to be distributed to stockholders. The Company will accrue excise tax on estimated undistributed taxable income as required.

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

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

The Company may pay distributions in excess of its taxable net investment income. This excess would be a tax-free return of capital in the period and reduce the shareholder's tax basis in its shares. The cumulative amount is disclosed on the Consolidated Statements of Assets and Liabilities as distributions in excess of taxable net investment income. Cumulative distributions in excess of taxable net investment income are \$27,654,805 and \$19,373,748 as of March 31, 2014 and December 31, 2013, respectively.

### ***Distributions to Common Stockholders***

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

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

### ***Foreign Currency***

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

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

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

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



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***Debt Issuance Costs***

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

***Equity Offering Expenses***

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

***Non-Accrual Loans***

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

***Recently Issued Accounting Pronouncements***

In January 2013, the FASB issued ASU 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities* ("ASU 2013-01"). This update clarifies that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with Topic 815. This update is effective for the Company for the year ending December 31, 2013, and did not have a material effect on the Company's consolidated financial statements.

In June 2013, the FASB issued ASU No. 2013-08, *Financial Services-Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements* ("ASU 2013-08"). ASU 2013-08 changes the approach to the assessment of whether a company is an investment company, clarifies the characteristics of an investment company, provides comprehensive guidance for the investment company assessment and contains certain disclosure requirements. ASU 2013-08 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2013. Earlier application is prohibited. This update is effective for the Company for the year ending December 31, 2013, and did not have a material effect on the Company's consolidated financial statements.

**3. Agreements and related party transactions**

***Base Management Fee***

The Company has entered into an Investment Management Agreement (the "Management Agreement") with the Advisor, under which the Advisor, subject to the overall supervision of the Company's Board of Directors, manages the day-to-day operations of, and provides investment advisory services to, the Company. For providing these services, the Advisor receives a base management fee (the "Management Fee") from the Company quarterly in arrears at an annual rate of 2.0% of the Company's total assets, including any assets acquired with the proceeds of leverage.

For the three months ended March 31, 2014 and 2013, the Advisor earned \$6,160,619 and \$5,349,956, respectively, in in base management fees under the Management Agreement.

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

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

The Advisor will be entitled to receive the Incentive Fee if the Company's performance exceeds a "hurdle rate" during different measurement periods: trailing four quarters' periods (which applies only to the portion of the Incentive Fee based on income) and annual periods (which applies only to the portion of the Incentive Fee based on capital gains). The "trailing four quarters' periods" for purposes of determining the income portion of the Incentive Fee payable for the three months ended March 31, 2014 and 2013 was determined by reference to the four quarter periods ended on March 31, 2014 and 2013, respectively. The term "annual period" means the period beginning on July 1 of each calendar year and ending on June 30 of the next calendar year.

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

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

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

For the three months ended March 31, 2014 and 2013, the Advisor earned zero and \$1,543,384 respectively, in Incentive Fees based on income from the Company.

***Annual Incentive Fee Based on Capital Gains.*** The portion of the Incentive Fee based on capital gains is calculated and paid on an annual basis beginning on July 1, 2007, the first day of the calendar quarter in which the Public Market Event occurred and each annual period thereafter, ending on June 30 of the next calendar year. For each annual period, the Company pays the Advisor an Incentive Fee based on the amount by which (A) net realized capital gains, if any, to the extent they exceed gross unrealized capital depreciation, if any, occurring during the period exceeds (B) the amount, if any, by which the period's hurdle rate exceeds the amount of income used in the determination of the Incentive Fee based on income for the period. The amount of the excess of (A) over (B) described in this paragraph is referred to as the excess gain amount.

The portion of the Incentive Fee based on capital gains for each period will equal 50% of the period's excess gain amount, until such payments equal 20% of the period's capital gain amount distributed or distributable to stockholders. Thereafter, the portion of the Incentive Fee based on capital gains for the period equals an amount such that the portion of the Incentive Fee payments to the Advisor based on capital gains for

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the period equals 20% of the period's remaining excess gain amount. The result of this formula is that, if the portion of the Incentive Fee based on income for the period exceeds the period's hurdle, then the portion of the Incentive Fee based on capital gains will be capped at 20% of the capital gain amount.

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

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

The capital gains fee due the Advisor as calculated under the Management Agreement as described above, for the three months ended March 31, 2014 and 2013 were zero. In accordance with GAAP the hypothetical incentive fee for the three months ended March 31, 2014 and 2013, resulted in a capital gains incentive fee of \$3,459,865 and \$3,720,726, respectively. The total cumulative balance at March 31, 2014 and 2013 was \$29,213,949 and \$9,215,461, respectively.

#### ***Advisor Reimbursements***

The Management Agreement provides that the Company will reimburse the Advisor for costs and expenses incurred by the Advisor for office space rental, office equipment and utilities allocable to the Advisor under the Management Agreement, as well as any costs and expenses incurred by the Advisor relating to any non-investment advisory, administrative or operating services provided by the Advisor to the Company. For the three months ended March 31, 2014 and 2013, the Company incurred \$532,806 and \$558,098, respectively, for such investment advisor expenses under the Management Agreement.

From time to time, the Advisor may pay amounts owed by the Company to third party providers of goods or services. The Company will subsequently reimburse the Advisor for such amounts paid on its behalf. Reimbursements to the Advisor for the three months ended March 31, 2014 and 2013 were \$786,457 and \$1,004,665, respectively.

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

#### ***Administration***

The Company also has entered into an administration agreement with BlackRock Financial Management, Inc. (the "Administrator") under which the Administrator provides certain administrative services to the Company. For providing these services, facilities and personnel, the Company reimburses the Administrator for

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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 months ended March 31, 2014 and 2013, the Company incurred \$154,421 and \$201,283, respectively, for administrative services expenses payable to the Administrator under the administration agreement.

#### ***Advisor Stock Transactions***

In 2007, the Company's Board of Directors authorized the purchase by the Advisor from time to time in the open market of an indeterminate number of shares of the Company's common stock, in the Advisor's discretion, subject to compliance with the Company's and the Advisor's applicable policies and requirements of law. There were no such purchases during the three months ended March 31, 2014 and 2013.

In March 2011, the Company's Board of Directors authorized the purchase in a private placement of up to 1,000,000 shares of the Company's common stock, by the Advisor in its discretion, subject to compliance with the Company's and the Advisor's applicable policies and requirements of law. Pursuant to this authorization, on March 16, 2011, the Company issued and sold to the Advisor in a private placement 200,000 shares of common stock for \$2,000,000 or \$10.00 per share, which was the closing price of the Company's common stock price on The NASDAQ Global Select Market on that date. There were no private placement purchases for the three months ended March 31, 2014 and 2013.

At March 31, 2014 and December 31, 2013, the Advisor owned and had the right to vote approximately 107,000 and 46,000 shares, respectively, of the Company's common stock, representing less than 1.0% of the total shares outstanding. On such dates, under compensation arrangements for its officers and employees the Advisor owned of record but did not have the right to vote an additional 61,000 and 125,000 shares, respectively, of the Company's common stock. At March 31, 2014 and December 31, 2013, other entities affiliated with the Administrator beneficially owned approximately 4,808,000 shares, of the Company's common stock, representing approximately 6.5% of the total shares outstanding. An entity affiliated with the Administrator has ownership and financial interests in the Advisor.

#### **4. Earnings per share**

The following information sets forth the computation of basic and diluted net increase in net assets from operations per share (earnings per share) for the three months ended March 31, 2014 and 2013.

	<b>Three months ended March 31, 2014</b>	<b>Three months ended March 31, 2013</b>
<b>Earnings per share – basic:</b>		
Net increase in net assets resulting from operations	\$22,916,519	\$ 29,797,139
Weighted average shares outstanding – basic	74,517,547	73,957,696
<b>Earnings per share – basic:</b>	\$ 0.31	\$ 0.40
<b>Earnings per share – diluted:</b>		
Net increase in net assets resulting from operations, before adjustments	\$22,916,519	\$ 29,797,139
Adjustments for interest on unsecured convertible senior notes	1,641,956	720,347
Net increase in net assets resulting from operations, as adjusted	\$ 24,558,475	\$ 30,517,486
Weighted average shares outstanding – diluted	84,414,275	78,356,242
<b>Earnings per share – diluted:</b>	\$ 0.29	\$ 0.39

#### **5. Investments**

Purchases of investments, including PIK, for the three months ended March 31, 2014 and 2013 totaled \$62,955,147 and \$46,026,548, respectively. Sales, repayments and other exits of investments for the three months ended March 31, 2014 and 2013 totaled \$188,032,090 and \$104,212,921, respectively.

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At March 31, 2014, investments consisted of the following:

	<u>Cost</u>	<u>Fair Value</u>
Senior secured notes	\$ 172,668,463	\$ 168,896,625
Unsecured debt	119,196,415	119,196,415
Subordinated debt	78,395,314	77,987,314
Senior secured loans:		
First lien	152,799,916	154,504,878
Second/other priority lien	346,772,218	348,870,830
Total senior secured loans	<u>499,572,134</u>	<u>503,375,708</u>
Preferred stock	27,399,026	30,041,617
Common stock	57,241,671	129,078,990
Limited partnership/limited liability company interests	34,275,310	69,636,985
Equity warrants/options	5,068,694	7,887,397
Total investments	<u>\$ 993,817,027</u>	<u>\$ 1,106,101,051</u>

At December 31, 2013, investments consisted of the following:

	<u>Cost</u>	<u>Fair Value</u>
Senior secured notes	\$ 229,324,910	\$ 226,685,176
Unsecured debt	118,531,084	118,531,084
Subordinated debt	78,395,314	78,395,314
Senior secured loans:		
First lien	160,014,671	158,250,792
Second/other priority lien	368,148,461	368,952,906
Total senior secured loans	<u>528,163,132</u>	<u>527,203,698</u>
Preferred stock	21,891,614	24,872,259
Common stock	66,511,507	143,355,344
Limited partnership/limited liability company interests	34,998,706	68,364,016
Equity warrants/options	6,683,954	30,565,573
Total investments	<u>\$ 1,084,500,221</u>	<u>\$ 1,217,972,464</u>

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### *Industry Composition*

The industry composition of the portfolio at fair value at March 31, 2014 and December 31, 2013 was as follows:

<b>Industry</b>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Consumer Products	16.1%	14.6%
Personal and Other Services	15.5	17.1
Healthcare	11.3	12.1
Energy	8.7	5.4
Manufacturing	7.7	8.3
Electronics	6.3	5.6
Printing, Publishing and Media	6.0	5.6
Financial Services	5.9	4.9
Business Services	5.5	7.1
Chemicals	5.3	8.5
Beverage, Food and Tobacco	3.7	3.5
Retail	3.2	2.8
Building and Real Estate	3.1	2.7
Distribution	1.3	1.6
Containers and Packaging	0.4	0.2
Total	<u>100.0%</u>	<u>100.0%</u>

The geographic composition of the portfolio at fair value at March 31, 2014 was United States 95.9%, Canada 3.2% and the Cayman Islands 0.9%, and at December 31, 2013 was United States 93.1%, Canada 6.5% and the Cayman Islands 0.4%. The geographic composition is determined by the location of the corporate headquarters of the portfolio company.

### *Market and Credit Risk*

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

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

## 6. Derivatives

### *Foreign Currency*

The Company may enter into forward foreign currency contracts from time to time to facilitate settlement of purchases and sales of investments denominated in foreign currencies or to help mitigate the impact that an adverse change in foreign exchange rates would have on the value of the Company's investments denominated in foreign currencies. A forward foreign currency contract is a commitment to purchase or sell a foreign currency at a future date (usually the security transaction settlement date) at a negotiated forward rate. These contracts are marked-to-market by recognizing the difference between the contract exchange rate and the current market rate as unrealized appreciation or depreciation. Realized gains or losses are recognized when contracts are settled. The Company's forward foreign currency contracts generally have terms of approximately three months. The volume of open contracts at the end of each reporting period is reflective of the typical volume of transactions during each calendar quarter. Risks may arise as a result of the potential inability of the counterparties to meet the terms of their contracts. The Company attempts to limit this risk by dealing with only creditworthy counterparties. There were no open forward foreign currency contracts at March 31, 2014 or December 31, 2013.

### *Warrants*

The Company holds warrants and options in certain portfolio companies in an effort to achieve additional investment return. In purchasing warrants and options, the Company bears the risk of an unfavorable change in the value of the underlying equity interest. The aggregate fair value of warrants and options as of March 31, 2014 and December 31, 2013 represents 1.1% and 4.3%, respectively, of the Company's net assets.

The Company may enter into other derivative instruments and incur other exposures with other counterparties in the future. The derivative instruments held as of March 31, 2014 and December 31, 2013 reflect the volume of derivative activity throughout the periods presented.

## 7. Debt

In accordance with the 1940 Act, with certain limited exceptions, the Company is only allowed to borrow amounts such that its asset coverage, calculated pursuant to the 1940 Act, is at least 200% after such borrowing. As of March 31, 2014, the Company's asset coverage was 255%.

On March 27, 2014, the Company entered into an Amended and Restated Senior Secured Revolving Credit Facility ("Credit Facility") which has an initial aggregate principal amount of up to \$405,000,000 and canceled the prior credit facility that was outstanding at December 31, 2013. The Credit Facility has a stated maturity date of March 27, 2019. The interest rate applicable to borrowings thereunder is generally LIBOR plus an applicable margin of 2.25%. The Credit Facility's commitment may increase in size, under certain circumstances, up to a total of \$750,000,000.

On March 27, 2014, the Company entered into an Amended and Restated Senior Secured Term Loan Credit Agreement (the "Term Loan") which has a principal amount of \$15,000,000. The Term Loan has a stated maturity date of March 27, 2019. The interest rate applicable to borrowings thereunder is generally LIBOR plus an applicable margin of 3.25%.

On February 19, 2013, the Company closed a private offering of \$100,000,000 in aggregate principal amount of 5.50% unsecured convertible senior notes due 2018 (the "Convertible Notes"). The initial purchasers of the Convertible Notes fully exercised their overallotment option and purchased an additional \$15,000,000 in aggregate principal amount of the Convertible Notes. The closing of the overallotment option took place on March 4, 2013. With the exercise of the overallotment option, a total of \$115,000,000 in aggregate principal amount of the Convertible Notes was sold. Net proceeds to the Company from the offering, including the

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exercise of the overallotment option, were approximately \$111,300,000. The Convertible Notes were only offered to qualified institutional buyers as defined in the Securities Act of 1933, as amended (the “Securities Act”) pursuant to Rule 144A under the Securities Act.

The Convertible Notes are unsecured and bear interest at a rate of 5.50% per year, payable semi-annually in arrears. In certain circumstances and during certain periods, the Convertible Notes are convertible into cash, shares of BlackRock Kelso Capital’s common stock or a combination of cash and shares of the Company’s common stock, at the Company’s election, at an initial conversion rate of 86.0585 shares of common stock per \$1,000 principal amount of the Convertible Notes, which is equivalent to an initial conversion price of approximately \$11.62 per share of the Company’s common stock, subject to defined anti-dilution adjustments. The Company does not have the right to redeem the Convertible Notes prior to maturity. The Convertible Notes mature on February 15, 2018, unless repurchased or converted in accordance with their terms prior to such date.

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

The Company’s outstanding debt as of March 31, 2014 and December 31, 2013 was as follows:

	As of					
	March 31, 2014			December 31, 2013		
	Total Aggregate Principal Amount Available(1)	Principal Amount Outstanding	Carrying Value	Total Aggregate Principal Amount Available(1)	Principal Amount Outstanding	Carrying Value
Credit Facility	\$405,000,000(2)	\$155,000,000	\$155,000,000	\$350,000,000(2)	\$179,000,000	\$179,000,000
Senior Secured Notes	175,000,000	175,000,000	175,000,000	175,000,000	175,000,000	175,000,000
Convertible Notes	115,000,000	115,000,000	114,042,200(3)	115,000,000	115,000,000	113,981,494(4)
Term Loan	15,000,000	15,000,000	15,000,000	10,000,000	10,000,000	10,000,000
	<u>\$710,000,000</u>	<u>\$460,000,000</u>	<u>\$459,042,200</u>	<u>\$650,000,000</u>	<u>\$479,000,000</u>	<u>\$477,981,494</u>

- (1) Subject to borrowing base and leverage restrictions.
- (2) Provides for a feature that allows the Company, under certain circumstances, up to a total of \$750,000,000.
- (3) Represents the aggregate principal amount outstanding of the Convertible Notes less the unaccreted discount initially recorded upon issuance of the Convertible Notes. The total unaccreted discount for the 2018 Convertible Notes, was \$957,800 as of March 31, 2014.
- (4) Represents the aggregate principal amount outstanding of the Convertible Notes less the unaccreted discount initially recorded upon issuance of the Convertible Notes. The total unaccreted discount for the 2018 Convertible Notes, was \$1,018,506 as of December 31, 2013.

At March 31, 2014, the Company had \$155,000,000 drawn on the Credit Facility versus \$179,000,000 at December 31, 2013. Subject to compliance with applicable covenants and borrowing base limitations, the remaining amount available under the Credit Facility was \$250,000,000 at March 31, 2014 and \$171,000,000 at December 31, 2013.

The Company’s average outstanding debt balance during the three months ended March 31, 2014 and 2013 was \$482,367,741 and \$329,905,368, respectively. The maximum amounts borrowed during the three months ended March 31, 2014 and 2013 were \$517,042,201 and \$475,646,005, respectively.



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The weighted average annual interest cost for the three months ended March 31, 2014 and 2013 was 4.91% and 5.45%, respectively, exclusive of commitment fees and of other prepaid expenses related to establishing the Credit Facility, the Senior Secured Notes, the Convertible Notes and the Term Loan. With respect to any unused portion of the commitments under the Credit Facility, the Company incurs an annual commitment fee of 0.375% on the Credit Facility outstanding at March 31, 2014. Commitment fees incurred for the three months ended March 31, 2014 and 2013 were \$162,321 and \$306,015, respectively.

At March 31, 2014, the Company was in compliance with all covenants required under the Credit Facility, the Convertible Notes and the Senior Secured Notes.

## **8. Capital stock**

In 2008, the Company's Board of Directors approved a share repurchase plan under which the Company may repurchase up to 2.5 percent of its outstanding shares of common stock from time to time in open market or privately negotiated transactions. In 2009, the Board of Directors approved an extension and increase to the plan which authorized the Company to repurchase up to an additional 2.5 percent of its outstanding shares of common stock.

In May 2013, the repurchase plan was further extended through the earlier of June 30, 2014 or until the approved number of shares has been repurchased. During the three months ended March 31, 2014 and 2013 the Company purchased zero shares of its common stock on the open market. Since inception of the repurchase plan through March 31, 2014, the Company has purchased 1,425,507 shares of its common stock on the open market for \$9,476,676, including brokerage commissions. At March 31, 2014, the total number of remaining shares authorized for repurchase was 1,331,143. The Company currently holds the shares it repurchased in treasury.

## **9. Guarantees and commitments**

In the normal course of business, the Company may enter into guarantees on behalf of portfolio companies. Under these arrangements, the Company would be required to make payments to third parties if the portfolio companies were to default on their related payment obligations. The Company has no such guarantees outstanding at March 31, 2014 and 2013.

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

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

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

### *Fair Value Measurements and Disclosure*

ASC 820-10 defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements. ASC 820-10 defines fair value as the price that the Company would receive upon selling an investment or pay to transfer a liability in an orderly transaction to a market participant in the principal or most advantageous market for the investment. ASC 820-10 emphasizes that valuation techniques maximize the use of observable market inputs and minimize the use of unobservable inputs. Inputs refer broadly to the assumptions that market participants would use in pricing an asset or liability, including assumptions about risk.

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Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing an asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing an asset or liability developed based on the best information available in the circumstances.

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

Level 2 – Valuations based on unadjusted quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The inputs into the determination of fair value may require significant management judgment or estimation.

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

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

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

The carrying values of the Company's financial instruments approximate fair value. The carrying values of receivables, other assets, accounts payable and accrued expenses approximate fair value due to their short maturities. The fair value of the Company's Credit Facility, Convertible Notes and Senior Secured Notes is derived by taking the average of the high and low quotes as obtained from a broker. The fair value of the Credit Facility and Senior Secured Notes would be classified as Level 2 with respect to the fair value hierarchy.

The carrying and fair values of the Company's Credit Facility payable were \$155,000,000 and \$152,675,000 at March 31, 2014 and \$179,000,000 and \$176,315,000 at December 31, 2013. The carrying and fair values of the Company's Term Loan were \$15,000,000 and \$14,925,000 at March 31, 2014 and \$10,000,000 and \$9,950,000 at December 31, 2013. The carrying and fair values of the Company's Senior Secured Notes were \$175,000,000 and \$186,195,480 at March 31, 2014 and \$175,000,000 and \$187,375,280 at December 31, 2013. The carrying and fair values of the Company's Convertible Notes were \$114,042,200 and \$118,603,888 at March 31, 2014 and \$113,981,494 and \$116,546,078 at December 31, 2013. The carrying and fair values of the Company's total debt outstanding were therefore \$459,042,200 and \$472,399,368 at March 31, 2014 and \$477,981,494 and \$490,186,358 at December 31, 2013.

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The following tables summarize the fair values of the Company's investments, forward foreign currency contracts and cash and cash equivalents based on the inputs used at March 31, 2014 and December 31, 2013 in determining such fair values:

	Fair Value at March 31, 2014	Fair Value Inputs at March 31, 2014		
		Price Quotations (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Senior secured notes	\$ 168,896,625	\$ —	\$ —	\$ 168,896,625
Unsecured debt	119,196,415	—	—	119,196,415
Subordinated debt	77,987,314	—	—	77,987,314
Senior secured loans	503,375,708	—	—	503,375,708
Preferred stock	30,041,617	—	—	30,041,617
Common stock	129,078,990	—	—	129,078,990
Limited partnership/limited liability company interests	69,636,985	—	—	69,636,985
Equity warrants/options	7,887,397	—	—	7,887,397
Total investments	1,106,101,051	—	—	1,106,101,051
Cash and cash equivalents	34,066,687	34,066,687	—	—
Total	\$ 1,140,167,738	\$ 34,066,687	\$ —	\$ 1,106,101,051

	Fair Value at December 31, 2013	Fair Value Inputs at December 31, 2013		
		Price Quotations (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Senior secured notes	\$ 226,685,176	\$ —	\$ —	\$ 226,685,176
Unsecured debt	118,531,084	—	—	118,531,084
Subordinated debt	78,395,314	—	—	78,395,314
Senior secured loans	527,203,698	—	—	527,203,698
Preferred stock	24,872,259	—	—	24,872,259
Common stock	143,355,344	—	—	143,355,344
Limited partnership/limited liability company interests	68,364,016	—	—	68,364,016
Equity warrants/options	30,565,573	—	—	30,565,573
Total investments	1,217,972,464	—	—	1,217,972,464
Cash and cash equivalents	18,474,784	18,474,784	—	—
Total	\$ 1,236,447,248	\$ 18,474,784	\$ —	\$ 1,217,972,464

The valuation techniques used at March 31, 2014 and December 31, 2013 in determining the fair values of the Company's investments for which significant unobservable inputs were used were the market approach, income approach or both using third party valuation firms or broker quotes for identical or similar assets. The total fair market value using the market or income approach or using third party valuation firms was \$1,097,118,903 and \$1,200,162,280 as of March 31, 2014 and December 31, 2013, respectively. The remaining balance was determined using broker quotes for identical or similar assets.

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The following is a reconciliation for the three months ended March 31, 2014 of investments for which Level 3 inputs were used in determining fair value:

	Fair Value at December 31, 2013	Amortization of Premium/ Discount - Net	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation or Depreciation	Purchases	Sales or Repayments	Net Transfers in and/or out of Level 3	Fair Value at March 31, 2014
Senior secured notes	\$ 226,685,176	\$ 402,286	\$ 354,905	\$ (1,132,104)	\$ —	\$ (57,413,638)	\$ —	\$ 168,896,625
Unsecured debt	118,531,084	—	—	—	665,331	—	—	119,196,415
Subordinated debt	78,395,314	—	—	(408,000)	—	—	—	77,987,314
Senior secured loans	527,203,698	469,920	(3,531,997)	4,763,008	48,492,500	(74,021,421)	—	503,375,708
Preferred stock	24,872,259	—	—	(338,054)	5,507,412	—	—	30,041,617
Common stock	143,355,344	—	23,923,415	(5,006,518)	8,253,481	(41,446,732)	—	129,078,990
Limited partnership/LLC Interest	68,364,016	—	(1,750)	1,996,365	36,423	(758,069)	—	69,636,985
Equity warrants/options	30,565,573	—	13,082,672	(21,062,916)	—	(14,697,932)	—	7,887,397
<b>Total investments</b>	<b>\$ 1,217,972,464</b>	<b>\$ 872,206</b>	<b>\$ 33,827,245</b>	<b>\$ (21,188,219)</b>	<b>\$ 62,955,147</b>	<b>\$ (188,337,792)</b>	<b>\$ —</b>	<b>\$ 1,106,101,051</b>

The following is a reconciliation for the three months ended March 31, 2013 of investments for which Level 3 inputs were used in determining fair value:

	Fair Value at December 31, 2012	Amortization of Premium/ Discount - Net	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation or Depreciation	Purchases	Sales or Repayments	Net Transfers in and/or out of Level 3	Fair Value at March 31, 2013
Senior secured notes	\$ 193,934,286	\$ 680,521	\$ —	\$ (1,383,279)	\$ 25,537,030	\$ —	\$ —	\$ 218,768,558
Unsecured debt	69,725,040	7,707	—	(7,707)	110,527	—	—	69,835,567
Subordinated debt	97,910,598	486,363	—	710,637	—	(25,762,284)	—	73,345,314
Senior secured loans	556,456,919	1,915,719	59,422	(229,381)	19,622,666	(78,457,532)	—	499,367,813
Preferred stock	5,848,306	—	—	946,469	68,132	—	—	6,862,907
Common stock	72,341,231	—	16,178	6,327,826	67,789	(16,522)	—	78,736,502
Limited partnership/LLC Interest	49,037,167	—	(23,417)	8,908,948	31,280	23,417	—	57,977,395
Equity warrants/options	16,343,994	—	—	943,926	589,124	—	—	17,877,044
<b>Total investments</b>	<b>\$ 1,061,597,541</b>	<b>\$ 3,090,310</b>	<b>\$ 52,183</b>	<b>\$ 16,217,439</b>	<b>\$ 46,026,548</b>	<b>\$ (104,212,921)</b>	<b>\$ —</b>	<b>\$ 1,022,771,100</b>

There were no transfers between Levels during the three months ended March 31, 2014 and 2013. All realized and unrealized gains and losses are included in earnings (changes in net assets) and are reported as separate line items within the Company's consolidated statements of operations.

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

The significant unobservable input used in the income approach of fair value measurement of the Company's investments is the discount rate or market yield used to discount the estimated future cash flows expected to be received from the underlying investment, which include both future principal and interest

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payments. Significant increases or decreases in the discount rate would result in an decrease or increase in the fair value measurement. Included in the consideration and selection of discount rates are the following factors: risk of default, rating of the investment and comparable company investments, and call provisions.

The ranges of significant unobservable inputs used in the fair value measurement of the Company's Level 3 investments as of March 31, 2014 were as follows:

**EBITDA Multiples:**

	<u>Cost</u>	<u>Fair Value</u>	<u>Low to High</u>	<u>Weighted Average</u>
Unsecured debt	\$ 5,705,354	\$ 5,705,354	5.0x to 5.7x	5.3x
Senior secured loans	73,781,111	74,083,255	6.8 to 7.7x	7.3x
Preferred stock	22,419,026	25,061,617	5.5x to 6.1x	5.8x
Common stock	56,483,602	129,054,477	6.5x to 7.2x	6.9x
Limited partnerships/LLC interest	32,427,233	69,618,253	9.1x to 9.9x	9.5x
Equity warrants/options	4,369,244	6,956,982	6.1x to 7.0x	6.6x

**Market Yields:**

Senior secured notes	134,180,626	129,896,625	13.90% to 15.30%	14.60%
Unsecured debt	113,491,061	113,491,061	12.56% to 13.56%	13.06%
Subordinated debt	78,395,314	77,987,314	11.92% to 13.42%	12.67%
Senior secured loans	388,106,776	391,372,318	10.56% to 11.79%	11.18%

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## 11. Financial highlights

The following per share data and ratios have been derived from information provided in the consolidated financial statements. The following is a schedule of financial highlights for a common share outstanding during the three months ended March 31, 2014 and 2013.

	Three months ended March 31, 2014	Three months ended March 31, 2013
Per Share Data:		
Net asset value, beginning of period	\$ 9.54	\$ 9.31
Net investment income	0.15	0.18
Net realized and unrealized gain	0.16	0.22
Total from investment operations	0.31	0.40
Distributions to stockholders from net investment income	(0.26)	(0.26)
Equity component of warrant	—	0.01
Issuance (reinvestment) of stock at prices (below) above net asset value	—	0.01
Net increase (decrease) in net assets	0.05	0.16
Net asset value, end of period	\$ 9.59	\$ 9.47
Market price, end of period	\$ 9.17	\$ 10.00
Total return(1)(2)	1.17%	2.04%
Ratios / Supplemental Data:		
Ratio of operating expenses to average net assets(3)(4)	6.89%	7.66%
Ratio of interest and other debt related expenses to average net assets(3)	3.78%	3.01%
Ratio of total expenses to average net assets(3)(5)	10.67%	10.67%
Ratio of net investment income to average net assets(3)	6.41%	7.61%
Net assets, end of period	\$ 714,290,246	\$ 700,434,035
Average debt outstanding	\$ 482,367,741	\$ 329,905,368
Weighted average shares outstanding	74,517,547	73,957,696
Average debt per share(6)	\$ 6.47	\$ 4.46
Portfolio turnover	16%	10%

- (1) Total return is based on the change in market price per share during the respective periods. Total return calculations take into account distributions, if any, reinvested in accordance with the Company's dividend reinvestment plan and do not reflect brokerage commissions.
- (2) Not annualized.
- (3) Annualized.
- (4) Ratio excluding capital gains incentive fee for the three months ended March 31, 2014 and 2013 is 4.89% and 5.47%, respectively.
- (5) Ratio excluding capital gains incentive fee for the three months ended March 31, 2014 and 2013 is 8.67% and 8.48%, respectively.
- (6) Average debt per share is calculated as average debt outstanding divided by the weighted average shares outstanding during the applicable period.

## 12. Subsequent events

On April 29, 2014, the Company's Board of Directors declared a distribution of \$0.21 per share, payable on July 2, 2014 to stockholders of record at the close of business on June 18, 2014.

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

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

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

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

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

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

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

### **Overview**

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

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We are externally managed and have elected to be regulated as a BDC under the 1940 Act. As a BDC, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least 70% of our total assets in “qualifying assets,” including securities of private or thinly traded public U.S. companies, cash, cash equivalents, U.S. Government securities and high-quality debt investments that mature in one year or less.

### ***Investments***

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

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

### ***Revenues***

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

### ***Expenses***

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

### **Critical accounting policies**

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



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Management considers the critical accounting policies important to understanding the consolidated financial statements. In addition to the discussion below, our critical accounting policies are further described in the notes to the consolidated financial statements. See Note 2 to the consolidated financial statements for a description of significant accounting policies and of recently issued accounting pronouncements.

**Financial and operating highlights**

At March 31, 2014:

Investment Portfolio: \$1,140.2 million  
Net Assets: \$714.3 million  
Indebtedness (borrowings under Credit Facility, Convertible Notes, Term Loan and Senior Secured Notes): \$459.0 million  
Net Asset Value per share: \$9.59

Portfolio Activity for the Three Months Ended March 31, 2014:

Cost of investments during period, including PIK: \$63.0 million  
Sales, repayments and other exits during period: \$188.0 million  
Number of portfolio companies at end of period: 46

Operating Results for the Three Months Ended March 31, 2014:

Net investment income per share: \$0.15  
Distributions declared per share: \$0.26  
Earnings per share: \$0.31  
Net investment income: \$11.1 million  
Net realized and unrealized gains: \$11.8 million  
Net increase in net assets from operations: \$22.9 million

Net investment income per share, as adjusted<sup>1</sup>: \$0.19  
Earnings per share, as adjusted<sup>1</sup>: \$0.35  
Net investment income, as adjusted<sup>1</sup>: \$14.3 million

**As Adjusted<sup>1</sup>:** Amounts are adjusted to remove the incentive management fee expense based on Gains, as required by GAAP, and to include only the incremental incentive management fee expense based on Income. The incremental incentive management fee is based on each trailing four-fiscal quarter period, applied to the current quarter's incremental earnings, and without any reduction for incentive management fees paid during the prior three quarters. Amounts reflect the Company's ongoing operating results and reflect the Company's financial performance over time.

**Portfolio and investment activity**

We invested \$63.0 million during the three months ended March 31, 2014. The investments consisted primarily of senior secured loans secured by first liens (\$2.0 million, or 3.2%), or second liens (\$46.5 million, or 73.9%), unsecured or subordinated debt securities and equity securities (\$14.5 million, or 22.9%). Additionally, we received proceeds from sales/repayments and other exits of approximately \$188.0 million during the three months ended March 31, 2014.

At March 31, 2014, our portfolio of \$1,140.2 million (at fair value) consisted of 46 portfolio companies and was invested 44% in senior secured loans, 21% in equity investments, 17% in unsecured or subordinated debt securities, 15% in senior secured notes, and 3% in cash and cash equivalents. Our average investment by portfolio company at amortized cost, excluding investments below \$5.0 million, was approximately \$25.8 million at March 31, 2014. Our largest portfolio company investment by value was approximately \$69.8 million and our five largest portfolio company investments by value comprised approximately 24% of our portfolio at

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March 31, 2014. At December 31, 2013, our portfolio consisted of 51 portfolio companies and was invested 43% in senior secured loans, 22% in equity investments, 18% in senior secured notes, 16% in unsecured or subordinated debt securities and 1% in cash and cash equivalents. Our average investment by portfolio company at amortized cost, excluding investments below \$5.0 million, was approximately \$26.0 million at December 31, 2013.

The weighted average yield of the debt and income producing equity securities in our portfolio at fair value was 12.0% at March 31, 2014 and 12.1% at December 31, 2013. The weighted average yields on our senior secured loans and other debt securities at fair value were 11.3% and 13.1%, respectively, at March 31, 2014, versus 11.4% and 13.1%, at December 31, 2013. The weighted average yield of the debt and income producing equity securities in our portfolio at their current cost basis was 12.0% at March 31, 2014 and 12.0% at December 31, 2013. The weighted average yields on our senior secured loans and other debt securities at their current cost basis were 11.4% and 12.9%, respectively, at March 31, 2014, versus 11.4% and 13.0%, at December 31, 2013. Yields exclude common equity investments, preferred equity investments with no stated dividend rate, short-term investments, and cash and cash equivalents.

At March 31, 2014, 40% of our debt investments bore interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime Rate, and 60% bore interest at fixed rates. The percentage of our total debt investments that bore floating rate interest based on an interest rate floor was 37% at March 31, 2014. At December 31, 2013, 48% of our debt investments bore interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime Rate, and 52% bore interest at fixed rates. The percentage of our total debt investments that bore floating rate interest subject to an interest rate floor was 45% at December 31, 2013.

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

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

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

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

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

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The Advisor monitors and, when appropriate, changes the investment ratings assigned to each investment in our portfolio. In connection with our valuation process, the Advisor and Board of Directors review these investment ratings on a quarterly basis. Our average investment rating was 1.15 at March 31, 2014 and 1.14 at December 31, 2013. The following is a distribution of the investment ratings of our portfolio companies at March 31, 2014 and December 31, 2013:

	<u>March 31, 2014</u>	<u>December 31, 2013</u>
Grade 1	\$ 934,029,525	\$1,054,695,245
Grade 2	161,815,279	159,112,129
Grade 3	4,312,000	2,912,000
Grade 4	33,832	572,675
Not Rated	5,910,415	680,415
Total investments	<u>\$1,106,101,051</u>	<u>\$ 1,217,972,464</u>

## Results of operations

*Results comparisons for the three months ended March 31, 2014 and 2013.*

### *Investment income*

Investment income totaled \$29,566,878 and \$31,129,502, respectively, for the three months ended March 31, 2014 and 2013, of which \$16,084,881 and \$17,304,768 were attributable to interest and fees on senior secured loans, \$12,919,049 and \$13,779,002 to interest and fees earned on other debt securities, \$562,086 and \$43,435 to dividends from preferred equity securities and \$862 and \$2,297 to interest earned on cash equivalents, respectively. For the three months ended March 31, 2014 and 2013 investment income included fees of \$907,500 and \$2,762,406, respectively. For the three months ended March 31, 2014 fee income included \$600,000 from fees earned on capital structuring fees. Interest income earned is comprised of cash interest of approximately 97% as well as PIK interest of approximately 3% for the three months ended March 31, 2014. The decrease in investment income the current period is primarily attributed to a decrease in fee income.

### *Expenses*

Expenses for the three months ended March 31, 2014 and 2013 were \$18,472,683 and \$18,165,424, respectively, which consisted of \$6,160,619 and \$5,349,956 in base management fees, \$6,001,208 and \$4,758,016 in interest expense and fees, \$3,459,865 and \$5,264,110 in incentive management fees, \$727,601 and \$630,197 in professional fees, \$544,599 and \$366,006 in amortization of debt issuance costs, \$532,806 and \$558,098 in investment advisor expenses, \$173,500 and \$118,000 in director fees, \$155,460 and \$251,316 in administrative services, and \$717,025 and \$869,725 in other expenses, respectively. The increase in expenses for the three months ended March 31, 2014 was due to the increase interest expense and fees offset by a decrease in incentive fees for the period.

### *Net investment income*

Net investment income was \$11,094,195 and \$12,964,078 for the three months ended March 31, 2014 and 2013, respectively. The decrease is primarily a result of a decrease fee income earned during the period.

### *Net realized gain or loss*

Net realized gain of \$33,827,245 for the three months ended March 31, 2014 was mainly the result of realized gains on the sale of Arclin Cayman Holdings, Ltd. ("Arclin"). Net realized gain of \$213,342 for the three months ended March 31, 2013 was mainly the result of net gains on foreign currency transactions.

***Net unrealized appreciation or depreciation***

For the three months ended March 31, 2014 and 2013, the change in net unrealized appreciation or depreciation was a decrease in net unrealized appreciation of \$22,004,921 and increase in net unrealized appreciation of \$16,619,719, respectively. The decrease in net unrealized appreciation for the three months ended March 31, 2014 was due to the reversal of unrealized appreciation previously reported on Arclin. The increase in net unrealized appreciation for the three months ended March 31, 2013 was comprised of an increase in net unrealized appreciation on investments of \$16,369,689 and a net unrealized foreign currency translation gain of \$250,030.

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

The net increase in net assets resulting from operations for the three months ended March 31, 2014 and 2013 was \$22,916,519 and \$29,797,139, respectively. The decrease in the current period is primarily attributed to the reversal of unrealized appreciation offset by realized gains associated with the sale of our investment in Arclin.

***Supplemental Non-GAAP information***

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

We record our liability for Incentive Fees as we become legally obligated to pay them, based on a hypothetical liquidation at the end of each reporting period. Our obligation to pay Incentive Fees with respect to any fiscal quarter is based on a formula that reflects our results over a trailing four-fiscal quarter period ending with the current fiscal quarter. We are legally obligated to pay the amount resulting from the formula less any cash payments of Incentive Fees during the prior three quarters. The formula's requirement to reduce the Incentive Fees by amounts paid with respect to Incentive Fees in the prior three quarters has caused our Incentive Fees expense to become, generally concentrated in the fourth quarter of each year. Management believes that reflecting Incentive Fees throughout the year, as the related investment income is earned on a quarterly basis, is an effective measure of our profitability and financial performance that facilitates comparison of current results with historical results and with those of our peers. Our "as adjusted" results reflect Incentive Fees based on the formula we utilize for each trailing four-fiscal quarter period, with the formula applied to the current quarter's incremental earnings and without any reduction for Incentive Fees paid during the prior three quarters. The resulting amount represents an upper limit of each quarter's incremental Incentive Fees that we may become legally obligated to pay at the end of the year. Prior year amounts are estimated in the same manner. These estimates represent upper limits because, in any calendar year, subsequent quarters' investment underperformance could reduce the Incentive Fees payable with respect to prior quarters' operating results. Changes in the economic environment, financial markets and other parameters used in determining such estimates could cause actual results to differ and such differences could be material. See Note 3 to the consolidated financial statements in this Quarterly Report for a more detailed description of the Company's incentive management fee.

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

	Three months ended March 31, 2014	Three months ended March 31, 2013
<b>GAAP Basis:</b>		
Net Investment Income	\$ 11,094,195	\$ 12,964,078
Net Investment Income per share	0.15	0.18
Addback: GAAP incentive management fee expense based on Gains	3,459,865	3,720,726
Addback: GAAP incentive management fee expense based on Income	—	1,543,384
<b>Pre-Incentive Fee<sup>1</sup>:</b>		
Net Investment Income	\$ 14,554,060	\$ 18,228,188
Net Investment Income per share	0.20	0.25
Less: Incremental incentive management fee expense based on Income	277,207	2,098,240
<b>As Adjusted<sup>2</sup>:</b>		
Net Investment Income	\$ 14,276,853	\$ 16,129,948
Net Investment Income per share	0.19	0.22

**Pre-Incentive Fee<sup>1</sup>:** Amounts are adjusted to remove all incentive management fees. Such fees are calculated but not necessarily due and payable at this time.

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

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

During the three months ended March 31, 2014, we generated operating cash flows primarily from loan repayments, interest earned and fees received on senior secured loans and other debt securities

Net cash provided by operating activities during the three months ended March 31, 2014 was \$52,831,242. Our primary sources of cash from operating activities during the period consisted of a net increase in net assets from operations of \$22,916,519, and net proceeds from repayments (net of purchases, including PIK of \$62,955,147) of \$125,076,943 which was partially offset by the change in receivables for investments sold.

Net cash used in financing activities during the three months ended March 31, 2014 was \$37,239,339. Our primary use of cash for financing activities was \$18,939,295 in repayments net of borrowings under the Credit Facility. An additional use of cash for financing activities was \$18,300,044 of distributions.

[Table of Contents](#)**Contractual obligations**

A summary of our significant contractual payment obligations for the repayment of outstanding borrowings at March 31, 2014 is as follows:

	Payments Due By Period (dollars in millions)				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Credit Facility(1)	\$155.0	\$ —	\$ —	\$155.0	\$ —
Term Loan	15.0	—	—	15.0	—
Senior Secured Notes	175.0	—	158.0	17.0	—
Convertible Notes	114.0	—	—	114.0	—
Interest and Credit Facility Fees Payable	3.2	3.2	—	—	—

(1) At March 31, 2014, \$250.0 million remained unused under our Credit Facility.

**Off-balance sheet arrangements**

In the normal course of business, the Company may enter into guarantees on behalf of portfolio companies. Under these arrangements, the Company would be required to make payments to third parties if the portfolio companies were to default on their related payment obligations. The Company has no such guarantees outstanding at March 31, 2014.

**Distributions**

Our quarterly distributions, if any, are determined by our Board of Directors. Distributions are declared considering our estimate of annual taxable income available for distribution to stockholders and the amount of taxable income carried over from the prior year for distribution in the current year. We cannot assure stockholders that they will receive any distributions at all or distributions at a particular level. The following table lists the quarterly distributions per share from our common stock since March 2012.

Distributions Amount Per Share Outstanding	Record Date	Payment Date
\$0.26	March 20, 2012	April 3, 2012
\$0.26	June 19, 2012	July 3, 2012
\$0.26	September 19, 2012	October 3, 2012
\$0.26	December 20, 2012	January 3, 2013
\$0.26	March 19, 2013	April 2, 2013
\$0.26	June 18, 2013	July 2, 2013
\$0.26	September 19, 2013	October 3, 2013
\$0.26	December 20, 2013	January 3, 2014
\$0.26	March 20, 2014	April 3, 2014
\$0.21	June 18, 2014	July 2, 2014

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

We have elected to be taxed as a RIC under Subchapter M of the Code. In order to maintain favorable RIC tax treatment, we must distribute annually to our stockholders at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of the assets legally

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available for distribution. Under the Regulated Investment Company Modernization Act of 2010, capital losses incurred by the Company after December 31, 2010 will not be subject to expiration. In addition, such losses must be utilized prior to the losses incurred in the years preceding enactment. In order to avoid certain excise taxes imposed on RICs, we must distribute during each calendar year an amount at least equal to the sum of:

- 98% of our ordinary income for the calendar year;
- 98.2% of our capital gains in excess of capital losses for the one-year period ending on October 31st; and
- any ordinary income and net capital gains for preceding years that were not distributed during such years.

We maintain an “opt out” dividend reinvestment plan for our common stockholders. As a result, except as discussed below, if we declare a distribution, stockholders’ cash distributions 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 distributions. With respect to our distributions paid to stockholders during the three months ended March 31, 2014 and 2013, distributions reinvested pursuant to our dividend reinvestment plan totaled \$1,044,638 and \$1,255,294, respectively.

Under the terms of an amendment to our dividend reinvestment plan adopted on March 4, 2009, distributions may be paid in newly issued or treasury shares of our common stock at a price equal to 95% of the market price on the payment date. This feature of the plan means that, under certain circumstances, we may issue shares of our common stock at a price below net asset value per share, which could cause our stockholders to experience dilution. We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of these distributions from time to time. Also, we may be limited in our ability to make distributions due to the asset coverage test applicable to us as a BDC under the 1940 Act and due to provisions in our existing and future debt arrangements.

If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including possible loss of favorable RIC tax treatment. In addition, in accordance with U.S. generally accepted accounting principles and tax regulations, we include in income certain amounts that we have not yet received in cash, such as payment-in-kind interest, which represents contractual interest added to the loan balance that becomes due at the end of the loan term, or the accrual of original issue or market discount. Since we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute at least 90% of our investment company taxable income to obtain tax benefits as a RIC and may be subject to an excise tax. In order to satisfy the annual distribution requirement applicable to RICs, we have the ability to declare a large portion of a dividend in shares of our common stock instead of in cash. As long as a portion of such dividend is paid in cash (which portion can be as low as 10% for our taxable years ending prior to 2012) and certain requirements are met, the entire distribution would be treated as a dividend for U.S. federal income tax purposes.

#### **Recent developments**

On April 29, 2014, the Company’s Board of Directors declared a distribution of \$0.21 per share, payable on July 2, 2014 to stockholders of record at the close of business on June 18, 2014.

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

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

We are subject to financial market risks, including changes in interest rates. At March 31, 2014, 40% of our debt investments bore interest based on floating rates, such as LIBOR, the Federal Funds Rate or the Prime Rate. The interest rates on such investments generally reset by reference to the current market index after one to

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six months. At March 31, 2014, the percentage of our total debt investments that bore floating rate interest based on an interest rate floor was 37%. Floating rate investments subject to a floor generally reset by reference to the current market index after one to six months only if the index exceeds the floor.

While hedging activities may help to insulate us against adverse changes in interest rates, they also may limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments. During the three months ended March 31, 2014 and 2013, we did not engage in any interest rate hedging activity.

**Item 4. Controls and Procedures**

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

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



## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

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

### Item 1A. Risk Factors

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

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

#### Sales of unregistered securities

None.

#### Issuer purchases of equity securities

None.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not Applicable

### Item 5. Other Information

None.

### Item 6. Exhibits.

#### (a) Exhibits.

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

**SIGNATURES**

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

**BLACKROCK KELSO CAPITAL CORPORATION**

Date: May 1, 2014

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

Date: May 1, 2014

By: /s/ Corinne Pankovcin  
**Corinne Pankovcin**  
**Chief Financial Officer**

CEO CERTIFICATION

I, James R. Maher, certify that:

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

Date: May 1, 2014

By: /s/ James R. Maher  
James R. Maher  
Chairman of the Board and Chief Executive Officer

CFO CERTIFICATION

I, Corinne Pankovcin, certify that:

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

Date: May 1, 2014

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

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

In connection with the Quarterly Report on Form 10-Q of BlackRock Kelso Capital Corporation (the "Company") for the quarter ended March 31, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), James R. Maher, as Chief Executive Officer of the Company, and Corinne Pankovcin, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

/s/ James R. Maher

Name: James R. Maher  
Title: Chief Executive Officer  
Date: May 1, 2014

/s/ Corinne Pankovcin

Name: Corinne Pankovcin  
Title: Chief Financial Officer  
Date: May 1, 2014