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# KCAP

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## FINANCIAL, INC.

**Investor Presentation**

**February 5, 2013**

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## Forward Looking Information

This presentation includes forward-looking statements. The matters discussed in this presentation, as well as in future oral and written statements by management of KCAP Financial, Inc., that are forward-looking statements are based on current management expectations that involve substantial risks and uncertainties which could cause actual results to differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the negative of these terms or other similar words. Important assumptions include our ability to acquire or originate new investments, achieve certain margins and levels of profitability, the availability of additional capital, and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this presentation should not be regarded as a representation by us that our plans or objectives will be achieved.

There are a number of important risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward-looking statements. You should not place undue reliance on these forward-looking statements. The forward-looking statements relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances occurring after the date of this presentation.

# INVESTMENT HIGHLIGHTS

## Innovative Strategy and Platform

- ◆ Internally managed structure
- ◆ 100% ownership of CLO fund Asset Manager Affiliates (Katonah Debt Advisors and Trimaran Advisors)

## Highly Experienced Management Team

- ◆ Seasoned management team with average industry tenure of 25+ years
- ◆ Managed loan portfolios through numerous cycles

## Dynamic Business Model

- ◆ Compelling middle market opportunities; multi-channel origination capabilities
- ◆ Enhanced portfolio yield through high returns on investments in CLO funds
- ◆ Disciplined investment process with seasoned credit professionals

## Strong Portfolio

- ◆ First lien / second lien / mezz and equity
- ◆ CLO Fund investments
- ◆ Asset Manager Affiliates: synergies + stable cash flow and dividend

## Low Leverage

- ◆ \$88 million in borrowings as of September 30, 2012
- ◆ \$60 million is unsecured, convertible notes at 8.75% with a 2016 maturity
- ◆ \$28 million of borrowings through a secured facility at L+ 300
- ◆ Asset coverage is 335%, well above the minimum 200% (1:1) required for a BDC

## Alignment of Interests

- ◆ No external management fees
- ◆ Board members and management own in excess of 17% of shares

# OVERVIEW – BUSINESS MODEL

*Internally managed BDC with a diversified portfolio of corporate credit investments and an attractive asset management business*



KCAP Financial, Inc.  
NASDAQ: "KCAP"

## Principal Investing

### Corporate Loan Investments

- ◆ \$135 million in debt securities
- ◆ Average unlevered yield  $\approx$  8%
- ◆ Focus on secured investments (76%)

### CLO Fund Investments

- ◆ \$68 million investments in CLO Funds
- ◆ Average yield of  $\approx$  51% on fair value

## Managed Funds

### Asset Managers Affiliates (AMA)

- ◆ Asset management business
- ◆ \$3.3 billion in AUM
- ◆ \$74 million fair value
- ◆ Current net annual cash flow run rate:  $\approx$  \$6-8M
- ◆ Distributions contribute to KCAP's net investment income

# QUARTERLY DIVIDENDS

<b>2012</b>	<i>Dividend</i>	<i>Yield</i>
Fourth quarter	\$ 0.28	12%
Third quarter	\$ 0.24	10%
Second quarter	\$ 0.24	13%
First quarter	\$ 0.18	10%
	<b>\$ 0.94</b>	

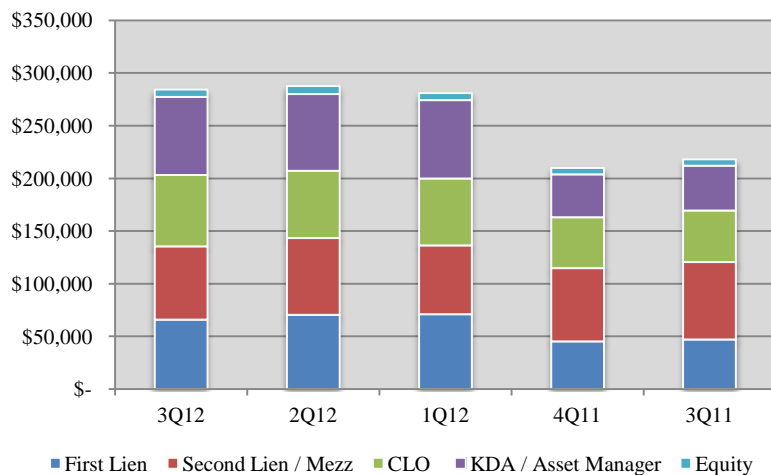
<b>2011</b>	<i>Dividend</i>	<i>Yield</i>
Fourth quarter	\$ 0.18	11%
Third quarter	\$ 0.18	12%
Second quarter	\$ 0.17	9%
First quarter	\$ 0.17	8%
	<b>\$ 0.70</b>	

<b>2010</b>		
Fourth quarter	\$ 0.17	10%
Third quarter	\$ 0.17	10%
Second quarter	\$ 0.17	14%
First quarter	\$ 0.17	12%
	<b>\$ 0.68</b>	

# PORTFOLIO HIGHLIGHTS

## ASSET MIX

**Investments at Fair Value (in thousands)**



	3Q12	2Q12	1Q12	4Q11	3Q11
First Lien	22%	23%	24%	18%	18%
Second Lien / Mezz	23%	24%	22%	28%	28%
CLO	22%	21%	21%	20%	19%
Asset Manager Affiliates	24%	24%	25%	16%	16%
Equity	2%	3%	2%	2%	2%

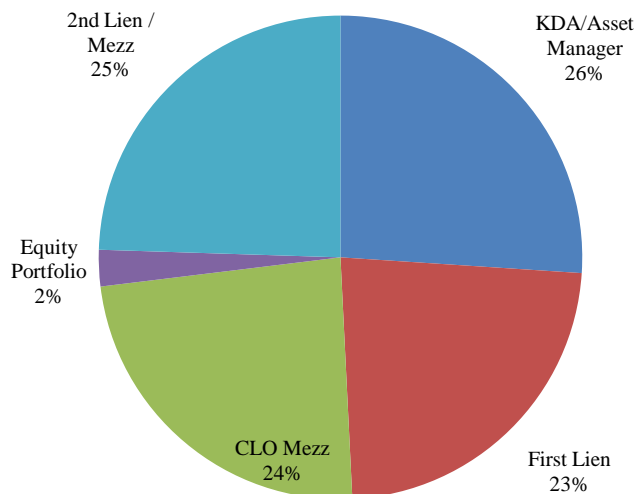
\*As a percent of Total Assets

	3Q12	2Q12	1Q12	4Q11	3Q11
First Lien	65,869	70,445	71,085	45,259	47,019
Second Lien / Mezz	69,609	72,819	65,272	69,414	73,588
CLO	67,784	63,884	63,404	48,438	48,761
Asset Manager Affiliates	73,989	72,896	74,594	40,814	42,629
Equity	6,912	7,719	6,722	6,041	6,010

# INVESTMENT PORTFOLIO

*A balanced investment risk / return profile*

3Q12



<u>Investment</u>	<u>Yield</u>
First lien <sup>1</sup>	5.5%
Second lien / Mezz <sup>1</sup>	10.9%
CLO Mezz <sup>2</sup>	51%
Asset Manager Affiliates <sup>3</sup>	8.1%
Equity Portfolio	--
<b>Approx. Weighted Average Yield</b>	<b>17.6%</b>

<sup>1</sup> Yield based on par

<sup>2</sup> Yield based on fv

<sup>3</sup> Asset Manager Affiliates estimated yield on cost; excludes incentive fees

## Portfolio Statistics

### Total Portfolio:

Fair value \$284 million

Book value \$338 million

### Portfolio (excluding AMA & CLO Securities):

Fair value \$142 million

Book value \$175 million

Number of issuers 53

Average deal/issuer size \$2.6 million

In default <1%

Fixed rate 30%

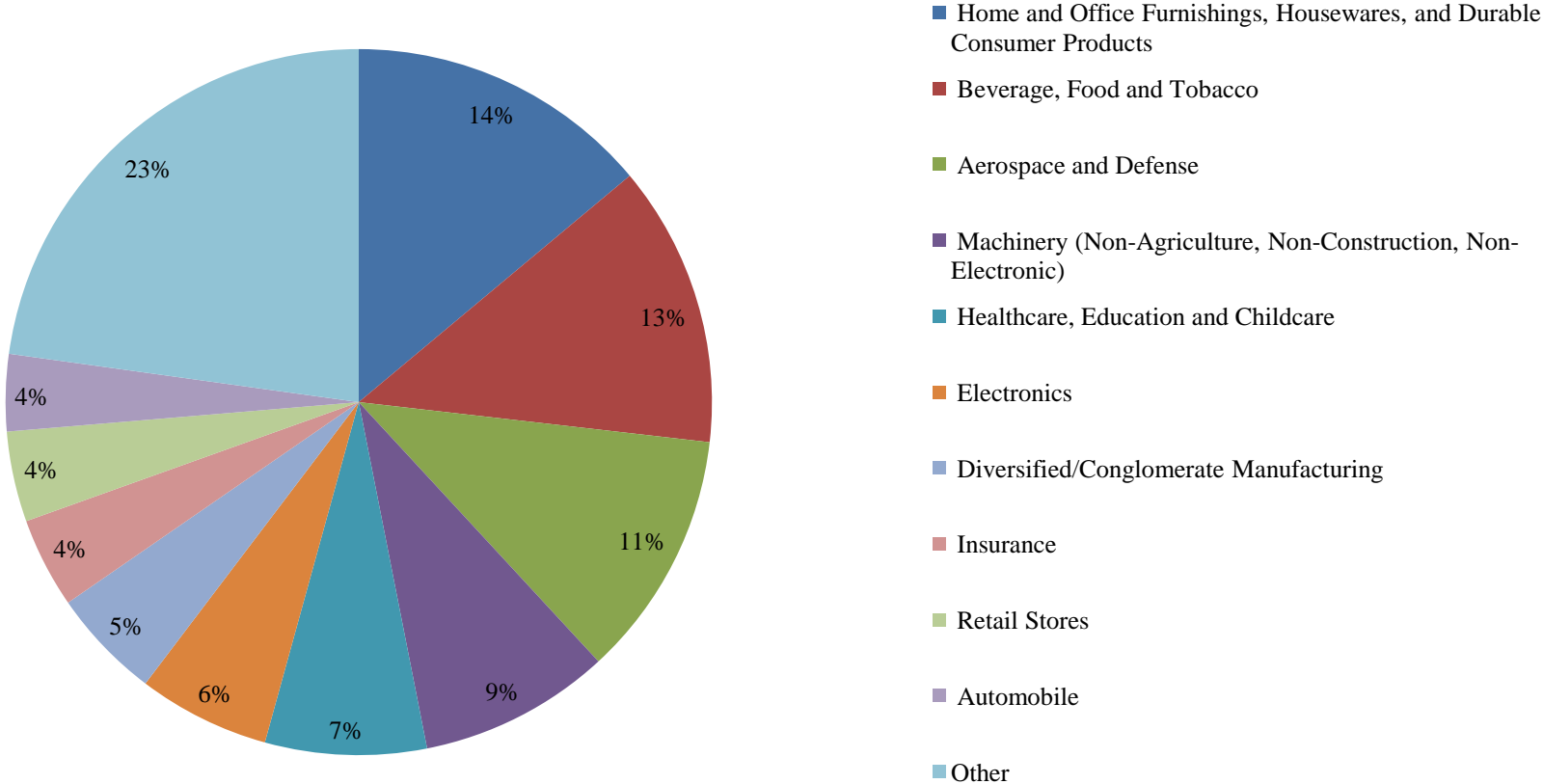
Floating rate 65%

Equity (neither fixed/floating) 5%

Note: Percentages to total fair value excluding KDA & CLO Securities

# PORTFOLIO HIGHLIGHTS

## PORTFOLIO LOAN SECURITIES - INDUSTRY DIVERSIFICATION





# STRONG CREDIT QUALITY

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*Experienced management team has led to strong credit performance in a challenging environment*

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- ◆ Only five portfolio companies on non-accrual status as of September 30, 2012
- ◆ Hard Watch List represents less than 1% of total assets (four issuers)
  - ◆ Three of the five watch list assets are senior secured loans
- ◆ Despite mark-to-market unrealized losses, portfolio assets continue to amortize or pay-off at par
- ◆ 76% of corporate loan portfolio is secured

# CLO FUND PORTFOLIO

## *Understanding risks and return*

### CLO Fund Structure

Remaining financing term	8 years
Current portfolio yield	L + 368 bps
W/A cost of debt capital	<u>L + 55 bps</u>
Net interest spread	<u>313 bps</u>
Fees and expenses	<u>55 bps</u>
Net spread to equity	<u>258bps</u>

#### Current Actual CLO Portfolio Performance:

-on current carrying value 51%

Data as of most recent trustee report for 3Q12 quarter-end

### CLO Fund Statistics

Fair value	\$64 million
Par	\$95 million
Cost	\$80 million
<i>Diversity:</i>	
Number of CLOs	13
Average number of issuers	140
Average number of industries	27
Average position size	\$2.1 million

# LEVERAGE

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## *Low Leverage and Room for Growth Relative to Peers*

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- ◆ \$60 million in convertible notes and \$28 million through a secured credit facility
- ◆ Debt-to-equity of 0.43x based on net asset value of \$207 million for the quarter ended September 30, 2012
- ◆ Asset coverage at 335% at September 30, 2012; BDC structure requires minimum asset coverage of 200%
- ◆ Convertible notes are fixed rate, five year (2016) maturity
- ◆ Initial conversion price of \$8.44 (10% premium over pricing date market close and above \$8.21 reported NAV prior to issuance)
- ◆ Secured credit facility is at a spread to LIBOR

# FINANCIAL HIGHLIGHTS

	3Q12	2Q12	1Q12	4Q11	3Q11	2Q11
Earnings per share	\$ 0.39	\$ 0.36	\$ 0.28	\$ 0.31	\$ 0.32	\$ 0.26
Net investment income per share	\$ 0.27	\$ 0.23	\$ 0.14	\$ 0.18	\$ 0.18	\$ 0.12
Net realized and unrealized gain (loss) per share	\$ 0.04	\$ (0.16)	\$ (0.12)	\$ (0.24)	\$ (0.24)	\$ (0.08)
Net asset value per share	\$ 7.82	\$ 7.66	\$ 7.78	\$ 7.85	\$ 8.29	\$ 8.52
Dividend distribution per share	\$ 0.24	\$ 0.24	\$ 0.18	\$ 0.18	\$ 0.18	\$ 0.17
Share Price						
High	\$ 9.36	\$ 7.47	\$ 7.46	\$ 6.88	\$ 8.34	\$ 8.32
Low	\$ 7.27	\$ 5.51	\$ 6.25	\$ 5.50	\$ 3.42	\$ 7.04
Close	\$ 9.26	\$ 7.26	\$ 6.91	\$ 6.31	\$ 5.85	\$ 7.95

# FINANCIAL HIGHLIGHTS

## NET ASSET VALUE

September 30, 2012	Fair Value	NAV per Share
<i>Investments at fair value:</i>		
Debt securities	\$ 135,477,765	\$ 5.12
CLO Fund securities	67,784,447	2.56
Equity securities	6,911,736	0.26
KDA / asset manager	<u>73,989,000</u>	<u>2.80</u>
Total Investments	284,162,948	10.74
Cash	2,413,104	0.09
Other assets	<u>16,365,200</u>	<u>0.62</u>
Total Assets	\$ <u>302,941,252</u>	\$ <u>11.45</u>
Borrowings	\$ 88,000,000	\$ 3.33
Other Liabilities	<u>8,043,003</u>	<u>0.30</u>
Total Liabilities	\$ <u>96,043,003</u>	\$ <u>3.63</u>
<b>NET ASSET VALUE</b>	\$ <b><u>206,898,249</u></b>	\$ <b><u>7.82</u></b>

## INVESTMENT PORTFOLIO

September 30, 2012	Cost	Fair Value
Senior secured loan	\$ 73,626,420	\$ 65,868,784
Junior secured loan	53,570,960	37,237,835
Mezzanine	8,518,913	9,401,536
Senior subordinated bond	21,846,118	22,577,830
Preferred	400,000	391,760
CLO Fund securities	85,506,168	67,784,447
Equity securities	17,012,236	6,911,735
KDA / asset manager	<u>83,203,884</u>	<u>73,989,000</u>
<b>Total Assets</b>	\$ <b><u>343,684,697</u></b>	\$ <b><u>284,162,927</u></b>

# SUBSEQUENT EVENTS

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- ✓ In October 2012, the Company sold \$41.4 million in aggregate principal amount of 7.375% senior unsecured notes, a portion of the proceeds were used to pay down our credit facility.
- ✓ On December 20, 2012, Trimaran Advisors, L.L.C. closed a \$415 million CLO fund of leveraged loans and high yield bonds. Trimaran Advisors is the collateral manager for this fund and we invested approximately \$12.7 million in tranches of junior notes (\$3.8 million in the single-B-rated tranche and \$8.9 million in the subordinated notes) issued by the CLO fund in connection with the transaction.

# SUMMARY OF KCAP ATTRIBUTES

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*Dynamic business model generates sustainable dividends*

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- ✓ Sustainable, recurring revenues not dependent on capital gains
    - ◆ Recurring interest income from secured loan and CLO portfolios
    - ◆ Stable asset management fee income from Asset Manager Affiliates
  - ✓ New investments in current market environment provide higher returns and enhance portfolio yield
  - ✓ Not reliant on high leverage to generate returns
  - ✓ Floating rate assets, many with minimum index rate floors, provide NAV protection and increased earnings in a rising rate environment
  - ✓ Experienced credit managers with long track records
  - ✓ Interest aligned with shareholders – significant insider ownership and internally managed
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# Q & A

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