

Solar Capital Ltd.
Form 10-Q
October 30, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarter Ended September 30, 2013

.. **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 814-00754

SOLAR CAPITAL LTD.

(Exact name of registrant as specified in its charter)

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Maryland
(State of Incorporation)

26-1381340
(I.R.S. Employer

500 Park Avenue

Identification No.)

New York, N.Y.
(Address of principal executive offices)

10022
(Zip Code)

(212) 993-1670

(Registrant's telephone number, including area code)

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 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 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller Reporting company

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

The number of shares of the registrant's Common Stock, \$.01 par value, outstanding as of October 29, 2013 was 44,272,918.

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SOLAR CAPITAL LTD.

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2013

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Table of Contents**PART I. FINANCIAL INFORMATION**

In this Quarterly Report, Solar Capital, Company, Fund, we, us, and our refer to Solar Capital Ltd. unless the context states otherwise.

Item 1. Financial Statements**SOLAR CAPITAL LTD.****CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES**

(in thousands, except share amounts)

	September 30, 2013 (unaudited)	December 31, 2012
Assets		
Investments at fair value:		
Companies less than 5% owned (cost: \$729,479 and \$856,134, respectively)	\$ 689,547	\$ 831,306
Companies 5% to 25% owned (cost: \$8,403 and \$167,564, respectively)	8,403	165,406
Companies more than 25% owned (cost: \$435,814 and \$408,373, respectively)	435,406	398,810
Total investments (cost: \$1,173,696 and \$1,432,071, respectively)	1,133,356	1,395,522
Cash	83,341	14,133
Foreign currency (cost: \$689 and \$899, respectively)	703	906
Interest and dividends receivable	18,411	15,147
Deferred financing costs	3,309	4,228
Derivatives		17
Receivable for investments sold	15,969	
Prepaid expenses and other assets	699	450
Total assets	\$ 1,255,788	\$ 1,430,403
Liabilities		
Revolving credit facilities (see note 6 and 8)	\$	\$ 264,452
Unsecured senior notes (see note 8)	100,000	100,000
Senior secured notes (see note 6 and 8)	75,000	75,000
Term loan (see note 6 and 8)	50,000	50,000
Dividends payable	17,762	23,217
Payable for investments purchased	9,775	21,756
Management fee payable (see note 3)	6,613	6,612
Performance-based incentive fee payable (see note 3)	5,407	6,050
Interest payable (see note 7)	2,590	2,406
Administrative services expense payable (see note 3)	1,450	1,058
Payable for common shares repurchased	277	
Other liabilities and accrued expenses	783	1,579
Total liabilities	\$ 269,657	\$ 552,130
Net Assets		
Common stock, par value \$0.01 per share, 200,000,000 and 200,000,000 common shares authorized, respectively, and 44,323,582 and 38,694,060 shares issued and outstanding, respectively	\$ 443	\$ 387
Paid-in capital in excess of par	1,111,468	978,279

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Distributions in excess of net investment income	(10,009)	(4,662)
Accumulated net realized loss	(72,507)	(55,631)
Net unrealized depreciation	(43,264)	(40,100)
Total net assets	\$ 986,131	\$ 878,273
Net Asset Value Per Share	\$ 22.25	\$ 22.70

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)**

(in thousands, except share amounts)

	Three months ended		Nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
INVESTMENT INCOME:				
Interest and dividends:				
Companies more than 25% owned	\$ 11,669	\$ 804	\$ 33,497	\$ 3,248
Companies 5% to 25% owned	3,189	13,460	11,650	19,112
Companies less than 5% owned	28,128	26,382	83,081	89,428
Total investment income	42,986	40,646	128,228	111,788
EXPENSES:				
Management fees (see note 3)	\$ 6,613	\$ 6,083	\$ 21,014	\$ 17,034
Performance-based incentive fees (see note 3)	5,407	5,565	16,601	14,431
Interest and other credit facility expenses	6,755	3,475	16,397	15,221
Administrative services expense (see note 3)	1,196	1,194	3,452	3,018
Other general and administrative expenses	1,387	2,011	4,361	4,015
Total operating expenses	21,358	18,328	61,825	53,719
Income tax expense		60		343
Total expenses	21,358	18,388	61,825	54,062
Net investment income	\$ 21,628	\$ 22,258	\$ 66,403	\$ 57,726
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, FOREIGN CURRENCIES AND DERIVATIVES:				
Net realized gain (loss) on investments:				
Companies more than 25% owned	\$	\$ 687	\$ 472	\$ 11,002
Companies 5% to 25% owned	(17,728)		(17,728)	
Companies less than 5% owned	2,185	(256)	794	(20,616)
Net realized gain (loss) on investments	(15,543)	431	(16,462)	(9,614)
Net realized loss on foreign currencies and derivatives:	(110)	(860)	(414)	(19)
Total net realized loss before income taxes	(15,653)	(429)	(16,876)	(9,633)
Income tax expense		(785)		
Net realized gain (loss)	(15,653)	356	(16,876)	(9,633)
Net change in unrealized gain (loss) on investments	5,904	6,869	(3,791)	44,989
Net change in unrealized gain (loss) on foreign currencies and derivatives	(1,309)	760	627	(619)
Net change in unrealized gain (loss)	4,595	7,629	(3,164)	44,370

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Net realized and unrealized gain (loss) on investments, foreign currencies and derivatives	(11,058)	7,985	(20,040)	34,737
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	\$ 10,570	\$ 30,243	\$ 46,363	\$ 92,463
EARNINGS PER SHARE (see note 5)	\$ 0.24	\$ 0.82	\$ 1.04	\$ 2.52

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**

(in thousands, except shares)

	Nine months ended September 30, 2013 (unaudited)	Year ended December 31, 2012
Increase in net assets resulting from operations:		
Net investment income	\$ 66,403	\$ 81,927
Net realized loss	(16,876)	(32,537)
Net change in unrealized gain (loss)	(3,164)	66,371
Net increase in net assets resulting from operations	46,363	115,761
Dividends and distributions to stockholders	(71,750)	(90,366)
Capital share transactions:		
Net proceeds from shares sold	146,857	45,020
Repurchase of common stock	(15,766)	
Less offering costs	(60)	(24)
Reinvestment of dividends	2,214	1,941
Net increase in net assets from capital transactions	133,245	46,937
Total increase in net assets	107,858	72,332
Net assets at beginning of period	878,273	805,941
Net assets at end of period	\$ 986,131	\$ 878,273
Capital share activity:		
Shares sold	6,253,226	2,000,000
Shares repurchased	(717,031)	
Shares issued from reinvestment of dividends	93,327	86,022
Net increase from capital share activity	5,629,522	2,086,022

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

(in thousands)

	Nine months ended	
	September 30, 2013	September 30, 2012
Cash Flows from Operating Activities:		
Net increase in net assets resulting from operations	\$ 46,363	\$ 92,463
Adjustments to reconcile net increase in net assets resulting from operations:		
Net realized loss on investments	16,462	9,614
Net realized loss on foreign currencies and derivatives	414	19
Net change in unrealized (gain) loss on investments	3,791	(44,989)
Net change in unrealized (gain) loss on foreign currencies and derivatives	(627)	619
(Increase) decrease in operating assets:		
Purchase of investments	(227,497)	(395,695)
Proceeds from disposition of investments	446,542	323,877
Capitalization of payment-in-kind interest	(10,427)	(25,569)
Collections of payment-in-kind interest	33,508	7,159
Fee revenue receivable		4,379
Deferred offering cost		(109)
Derivatives	17	
Receivable for investments sold	(15,969)	3,225
Interest and dividends receivable	(3,264)	(4,653)
Prepaid expenses and other assets	(249)	107
Increase (decrease) in operating liabilities:		
Payable for investments purchased	(11,981)	9,759
Management fee payable	1	806
Performance-based incentive fees payable	(643)	362
Deferred fee revenue		(318)
Administrative services expense payable	392	213
Interest payable	184	2,102
Other liabilities and accrued expenses	(796)	936
Net Cash Provided by (Used in) Operating Activities	276,221	(15,693)
Cash Flows from Financing Activities:		
Cash dividends paid	(74,991)	(42,621)
Common stock offering costs	(60)	
Deferred financing costs	919	2,548
Proceeds from shares sold	146,857	45,020
Repurchase of common stock	(15,489)	
Proceeds from borrowings	513,592	550,023
Repayments of borrowings	(778,044)	(538,016)
Net Cash Provided by (Used in) Financing Activities	(207,216)	16,954
NET INCREASE IN CASH AND CASH EQUIVALENTS	69,005	1,261
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	15,039	11,787
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 84,044	\$ 13,048

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Supplemental disclosure of cash flow information:

Cash paid for interest	\$ 16,213	\$ 5,398
Cash paid for income taxes	\$ 690	\$ 727

Non-cash financing activities consist of the reinvestment of dividends of \$2,214 and \$1,328 for the nine months ended September 30, 2013 and 2012, respectively.

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (unaudited)**

September 30, 2013

(in thousands)

Description ⁽¹⁾	Industry	Interest ⁽²⁾	Maturity	Par Amount*	Cost	Fair Value
Bank Debt/Senior Secured Loans						
48.9%						
Active Media Services, Inc	Media	9.75%	2/1/2018	\$ 10,000	\$ 9,729	\$ 9,725
AREP Embassy Row LLC ⁽⁴⁾	Diversified Real Estate Activities	9.50%	12/6/2013	37,820	37,682	37,820
AREP Fifty Seventh LLC ⁽³⁾⁽⁴⁾	Diversified Real Estate Activities	16.33%	1/30/2014	24,709	24,709	24,956
ARK Real Estate Partners II LP ⁽³⁾⁽⁴⁾	Diversified Real Estate Activities	14.70%	1/30/2014	8,026	8,026	8,107
AviatorCap SII, LLC I ⁽⁴⁾	Aerospace & Defense	12.00%	12/31/2014	2,474	2,460	2,474
AviatorCap SII, LLC II ⁽⁴⁾	Aerospace & Defense	11.00%	12/31/2014	3,320	3,298	3,320
AviatorCap SII, LLC III ⁽⁴⁾	Aerospace & Defense	13.00%	12/31/2014	696	690	696
Blue Coat Systems, Inc.	Internet Software & Services	9.50%	6/28/2020	20,500	20,299	20,654
Direct Buy Inc. ⁽⁵⁾	Multiline Retail	12.00% PIK	10/31/2019	8,403	8,403	8,403
Easy Financial Services, Inc. ⁽⁷⁾⁽⁸⁾	Consumer Finance	9.98%	10/4/2017	C\$ 10,000	9,737	9,710
Genex Services, Inc	Insurance	9.25%	1/26/2019	\$ 15,000	14,855	14,850
Global Tel*Link Corporation	Communications Equipment	9.00%	11/23/2020	13,500	13,239	13,202
Good Sam Enterprise, LLC	Insurance	11.50%	12/1/2016	7,000	6,668	7,525
Grakon, LLC ⁽³⁾	Machinery	12.00%	12/31/2015	9,524	8,179	9,524
Interactive Health Solutions, Inc.	Health Care Services	11.50%	10/4/2016	18,050	17,757	18,050
Isotoner Corporation	Specialty Retail	10.75%	1/8/2018	45,000	44,084	44,437
K2 Pure Solutions NoCal, L.P	Chemicals	10.00%	8/19/2019	11,500	11,273	11,270
MYI Acquiror Corporation ⁽⁸⁾⁽⁹⁾	Insurance	13% (12% Cash & 1% PIK) ⁽⁶⁾	3/13/2017	25,969	25,614	26,229
Quantum Foods, LLC	Food Products	10.77%	2/6/2018	37,500	37,500	37,500
SMG	Commercial Services & Supplies	10.75%	12/7/2018	25,000	24,599	25,000
Southern Auto Finance Company ⁽⁸⁾⁽¹⁰⁾	Consumer Finance	13.50%	10/19/2017	35,000	34,372	35,000
SOINT, LLC ⁽⁴⁾	Aerospace & Defense	15.00%	6/30/2016	11,592	11,416	11,592
Spencer Spirit Holdings, Inc.	Specialty Retail	11.00%	5/1/2017	10,000	10,000	10,750
The Endurance International Group, Inc.	Internet Software & Services	10.25%	5/9/2020	25,000	24,771	25,172
The Robbins Company TLA	Construction & Engineering	11.77%	5/31/2017	15,998	15,618	15,678
The Robbins Company TLB	Construction & Engineering	11.77%	4/25/2015	4,561	4,407	4,470
TravelClick, Inc.	Hotels, Restaurants & Leisure	9.75%	3/26/2018	20,000	19,821	20,000
Trinet HR Corporation	Professional Services	8.75%	2/20/2021	25,000	24,503	24,500
USAW 767 ⁽⁴⁾	Aerospace & Defense	14.50%	6/30/2014	1,602	1,598	1,602
Total Bank Debt/Senior Secured Loans					\$ 475,307	\$ 482,216
Subordinated Debt/Corporate Notes						
29.6%						
Adams Outdoor Advertising	Media	17.00%	12/8/2015	\$ 42,500	\$ 42,116	\$ 44,625
Alegeus Technologies Holdings Corp.	Health Care Technology	12.00%	2/15/2019	28,200	27,644	28,200
Asurion Holdco	Insurance	11.00%	3/2/2019	12,000	11,703	12,570
Crosman Corporation	Leisure Equipment & Products	13.00%	10/15/2016	15,219	14,931	15,219
Earthbound Farm	Food Products	14.25%	6/21/2017	58,947	58,091	58,947
Grakon Holdings LLC Sr ⁽³⁾	Machinery	14.00% PIK	12/31/2015	2,020	2,020	2,020
Grakon Holdings LLC Jr ⁽³⁾	Machinery	12.00% PIK	12/31/2015	13,294	12,010	11,300

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Granite Global Solutions Corp. ⁽⁷⁾⁽⁸⁾	Insurance	13.50%	11/30/2016	C\$	25,714	25,792	24,717
Richelieu Foods, Inc.	Food Products	13.75% (12% Cash & 1.75%PIK) ⁽⁶⁾	5/18/2016	\$	23,365	23,016	23,132
Rug Doctor Inc. ^{(11)***}	Diversified Consumer Services	17.59% ⁽⁶⁾	10/31/2014		56,411	52,200	23,693
WireCo. Worldgroup Inc.	Building Products	11.75%	5/15/2017		48,000	47,618	48,000

**Total Subordinated Debt/Corporate
Notes**

\$ 317,141 \$ 292,423

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (unaudited) (continued)**

September 30, 2013

(in thousands except shares/units)

Description ⁽¹⁾	Industry	Interest ⁽²⁾	Maturity	Shares/ Units	Cost	Fair Value
Preferred Equity 2.7%						
SOCAY Limited ⁽⁴⁾⁽⁸⁾⁽¹²⁾	Aerospace & Defense	8.55% ⁽⁶⁾	6/30/2018	14,327	\$ 14,327	\$ 14,490
SODO Corp. ⁽⁴⁾⁽¹²⁾	Aerospace & Defense	8.40% ⁽⁶⁾	6/30/2018	2,208	2,208	2,371
SOINT, LLC ⁽⁴⁾⁽⁸⁾⁽¹²⁾	Aerospace & Defense	15.00%	6/30/2018	86,667	8,667	9,533
Wyle Laboratories**	Aerospace & Defense	8.00%	7/17/2015	387	39	53
Total Preferred Equity					\$ 25,241	\$ 26,447
Common Equity / Partnership Interests / Warrants 33.7%						
Ark Real Estate Partners LP ^{(3)(4)**}	Diversified Real Estate Activities			45,905,653	\$ 45,235	\$ 23,630
Ark Real Estate Partners II LP ^{(3)(4)**}	Diversified Real Estate Activities			1,070,679	498	551
Crystal Capital Financial Holdings LLC ⁽⁴⁾⁽⁸⁾	Diversified Financial Services			275,000	275,000	294,264
Direct Buy Inc. ^{(5)**}	Multiline Retail			76,999		
Grakon, LLC ^{(3)**}	Machinery			1,714,286	1,714	
Grakon, LLC Warrants ^{(3)**}	Machinery			3,518,001		
Great American Group Inc. ^{(8)**}	Research & Consulting Services			572,800	2,681	172
Great American Group Inc. ^{(8)(13)**}	Research & Consulting Services			187,500	3	56
Nuveen Investments, Inc.**	Asset Management & Custody Banks			3,486,444	30,876	13,597
Total Common Equity/Partnerships Interests / Warrants					\$ 356,007	\$ 332,270
Total Investments 114.9%					\$ 1,173,696	\$ 1,133,356
Liabilities in Excess of Other Assets (14.9%)						(147,225)
Net Assets 100.0%						\$ 986,131

- (1) We generally acquire our investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the Securities Act). Our investments are therefore generally subject to certain limitations on resale, and may be deemed to be restricted securities under the Securities Act.
- (2) A majority of the variable rate debt investments bear interest at a rate that may be determined by reference to the London Interbank Offered Rate (LIBOR), and which may reset daily, quarterly or semi-annually. For each debt investment we have provided the current interest rate in effect as of September 30, 2013.
- (3) Investments are held in taxable subsidiaries. Ark Real Estate Partners LP is held through SLRC ADI Corp and our equity investment in Grakon LLC is held through Grakon TL Holding, Inc.
- (4) Denotes investments in which we are deemed to exercise a controlling influence over the management or policies of a company, as defined in the Investment Company Act of 1940 (1940 Act), due to beneficially owning, either directly or through one or more controlled companies, more than 25% of the outstanding voting securities of the investment. Transactions during the nine months ended September 30, 2013 in these controlled investments are as follows:

Name of Issuer	Fair Value at December 31, 2012	Gross Additions	Gross Reductions	Interest/Dividend Income	Fair Value at September 30, 2013
AREP Embassy Row LLC	\$	\$ 37,442	\$	\$ 1,407	\$ 37,820
AREP Fifty-Seventh LLC	24,215			2,553	24,956
ARK Real Estate Partners II LP	7,866			859	8,107

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ARK Real Estate Partners LP	35,095				23,630
ARK Real Estate Partners II LP	824				551
AviatorCap SII, LLC I	3,044		570	260	2,474
AviatorCap SII, LLC II	4,390		1,071	339	3,320
AviatorCap SII, LLC III	4,006		3,310	278	696
Crystal Capital Financial Holdings LLC	275,000			23,750	294,264
SOCAY Limited	14,490	412		902	14,490
SODO Corp.	2,371	58		137	2,371
SOINT, LLC	15,766		4,496	1,776	11,592
SOINT, LLC (preferred equity)	8,667			972	9,533
USAW 767	3,076		1,474	264	1,602
	\$ 398,810	\$ 37,912	\$ 10,921	\$ 33,497	\$ 435,406

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (unaudited) (continued)****September 30, 2013****(in thousands)**

- (5) Denotes investments in which we are an Affiliated Person but not exercising a controlling influence, as defined in the 1940 Act, due to beneficially owning, either directly or through one or more controlled companies, more than 5% but less than 25% of the outstanding voting securities of the investment. Transactions during the nine months ended September 30, 2013 in these affiliated investments are as follows:

Name of Issuer	Fair Value at December 31, 2012	Gross Additions	Gross Reductions	Interest/Dividend/ Other Income	Fair Value at September 30, 2013
Direct Buy Inc. (common equity)	\$	\$	\$	\$	\$
Direct Buy Inc.	7,700	703		727	8,403
DS Waters of America, Inc.	32,095	737	33,016	5,358	
Participating Preferred Units of DSW Group Holdings LLC					
Senior Preferred 15% Units of DSW Group Holdings LLC	125,611	5,628	117,694	5,565	
	\$ 165,406	\$ 7,068	\$ 150,710	\$ 11,650	\$ 8,403

- (6) A portion of the coupon may be payable in kind (PIK).
- (7) The following entities are domiciled outside the United States and the investments are denominated in Canadian Dollars: Granite Global Solutions Corp. and Easy Financials Services, Inc. in Canada.
- (8) Indicates assets that the Company believes may not represent qualifying assets under Section 55(a) of the Investment Company Act of 1940, as amended. Qualifying assets must represent at least 70% of the Company's total assets at the time of acquisition of any additional non-qualifying assets.
- (9) Solar Capital Ltd.'s foreign domiciled portion of MYI Aquiror Corporation is held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
- (10) Includes an unfunded commitment of \$9,775.
- (11) Includes PIK on \$13,478 of par at 4.50% PIK, \$15,784 of par at 5.25% PIK, \$17,041 of par at 8.00% PIK, and \$10,108 of par at 3.50% PIK.
- (12) Solar Capital Ltd.'s investments in SODO Corp., SOCAV Corp. and SOINT, LLC each include a one dollar investment in common shares.
- (13) Founders' Shares.
- * Denominated in USD unless otherwise noted.
- ** Non-income producing security.
- *** Investment is on non-accrual status.

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (unaudited) (continued)****September 30, 2013**

Industry Classification	Percentage of Total Investments (at fair value) as of September 30, 2013
Diversified Financial Services	26.0%
Food Products	10.5%
Diversified Real Estate Activities	8.4%
Insurance	7.6%
Specialty Retail	4.9%
Media	4.8%
Building Products	4.2%
Aerospace & Defense	4.1%
Internet Software & Services	4.0%
Consumer Finance	3.9%
Health Care Technology	2.5%
Commercial Services & Supplies	2.2%
Professional Services	2.2%
Diversified Consumer Services	2.1%
Machinery	2.0%
Construction & Engineering	1.8%
Hotels, Restaurants & Leisure	1.8%
Health Care Services	1.6%
Leisure Equipment & Products	1.3%
Asset Management & Custody Banks	1.2%
Communications Equipment	1.2%
Chemicals	1.0%
Multiline Retail	0.7%
Research & Consulting Services	0.0%
Total Investments	100.0%

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS**

December 31, 2012

(in thousands)

Description ⁽¹⁾	Industry	Interest ⁽²⁾	Maturity	Par Amount*/ Shares	Cost	Fair Value
Bank Debt/Senior Secured Loans 53.6%						
Asurion Corporation ⁽¹⁴⁾	Insurance	9.00%	5/24/2019	\$ 17,834	\$ 17,760	\$ 18,409
AREP Fifty Seventh LLC ⁽⁸⁾⁽¹⁰⁾⁽¹⁹⁾⁽²²⁾	Building & Real Estate	14.00%	8/1/2013	24,709	24,709	24,215
ARK Real Estate Partners II LP ⁽⁸⁾⁽¹⁰⁾⁽²⁰⁾⁽²²⁾	Building & Real Estate	14.00%	8/1/2013	8,026	8,026	7,866
AviatorCap SII, LLC I ⁽⁸⁾⁽²²⁾	Aerospace & Defense	12.00%	12/31/2014	3,044	3,018	3,044
AviatorCap SII, LLC II ⁽⁸⁾⁽²²⁾	Aerospace & Defense	11.00%	12/31/2014	4,390	4,347	4,390
AviatorCap SII, LLC III ⁽⁸⁾⁽²²⁾	Aerospace & Defense	13.00%	12/31/2014	4,006	3,952	4,006
Direct Buy Inc. ⁽⁹⁾⁽²³⁾	Home, Office Furnishing & Durable Consumer Products	12.00% ⁽⁶⁾	10/31/2019	7,700	7,700	7,700
DS Waters of America, Inc. ⁽⁹⁾⁽¹⁸⁾⁽²³⁾	Beverage, Foods & Tobacco	15% (11% Cash & 4% PIK) ⁽⁶⁾	2/28/2018	31,010	30,070	32,095
Fulton Holding Corp ⁽¹⁴⁾	Retail Stores	13.37%	5/28/2016	35,000	34,337	35,000
Easy Financial Services, Inc. ⁽³⁾⁽¹⁵⁾	Consumer Finance	11.80%	10/4/2017	C\$ 10,000	9,933	9,956
Grakon, LLC ⁽¹⁰⁾	Machinery	12.00%	12/31/2015	\$ 9,524	7,842	9,429
Good Sam Enterprise, LLC	Insurance	11.50%	12/1/2016	7,000	6,607	7,490
Isotoner Corporation	Personal & Nondurable Consumer Products	10.75%	1/8/2018	39,000	38,045	38,610
Interactive Health Solutions, Inc. ⁽¹³⁾	Healthcare, Education & Childcare	11.50%	10/4/2016	18,406	18,048	18,590
MYI Acquiror Corporation ⁽⁴⁾⁽⁷⁾⁽¹⁵⁾	Insurance	13% (12% Cash & 1% PIK) ⁽⁶⁾	3/13/2017	31,773	31,258	32,409
SMG	Healthcare, Education & Childcare	10.75%	12/7/2018	25,000	24,536	24,875
Southern Auto Finance Company ⁽¹⁵⁾⁽²¹⁾	Banking	13.50%	10/19/2017	35,000	34,301	35,000
SOINT, LLC ⁽⁸⁾⁽²²⁾	Aerospace & Defense	15.00%	6/30/2016	16,088	15,793	15,766
Spencer Spirit Holdings, Inc.	Retail Stores	11.00%	5/1/2017	10,000	10,000	10,850
The Endurance International Group, Inc.	Internet Software & Services	10.25%	5/9/2020	25,000	24,753	25,000
Transplace Texas, LP ⁽¹³⁾	Cargo Transport	11.00%	4/12/2017	20,000	19,615	19,700
Trident USA Health Services, LLC	Healthcare, Education & Childcare	11.75%	10/30/2017	43,000	42,214	42,140
USAW 767 ⁽⁸⁾⁽²²⁾	Aerospace & Defense	14.50%	6/30/2014	3,076	3,062	3,076
ViaWest Inc. ⁽¹⁴⁾	Personal, Food & Misc. Services	13.5% (12% Cash & 1.5% PIK) ⁽⁶⁾	5/20/2018	40,851	39,880	40,851
Total Bank Debt/Senior Secured Loans					\$ 459,806	\$ 470,467
Subordinated Debt/Corporate Notes 50.9%						
Adams Outdoor Advertising	Diversified/Conglomerate Service	18.00%	12/8/2015	\$ 42,500	\$ 42,014	\$ 43,350
Alegeus Technologies Holdings Corp.	Healthcare Technology	12.00%	2/15/2019	28,200	27,591	28,200
Asurion Holdco ⁽¹⁷⁾	Insurance	11.00%	3/2/2019	12,000	11,675	12,800
CIBT Solutions	Leisure, Amusement, Entertainment	13.50%	6/15/2018	36,200	35,483	36,200
Crosman Corporation	Leisure, Amusement, Entertainment	13.00%	10/15/2016	15,219	14,876	14,914
Earthbound Farm ⁽¹⁴⁾	Farming & Agriculture	14.25%	6/21/2017	58,947	57,966	56,000
Grakon Holdings LLC Sr ⁽¹⁰⁾	Machinery	14.00% ⁽⁶⁾	12/31/2015	1,822	1,822	1,804
Grakon Holdings LLC Jr ⁽¹⁰⁾	Machinery	12.00% ⁽⁶⁾	12/31/2015	12,166	10,489	8,516
Granite Global Solutions Corp. ⁽³⁾⁽¹⁵⁾	Insurance	13.50%	11/30/2016	C\$ 25,714	25,668	24,954
	Banking	13.00%	7/9/2015	\$ 85,000	83,878	85,000

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Midcap Financial Intermediate Holdings, LLC (14)(15)							
ProSieben Sat.1 Media AG ⁽³⁾⁽⁵⁾⁽¹⁵⁾	Broadcasting & Entertainment	7.70%(4.2% Cash & 3.5%PIK) ⁽⁶⁾	3/6/2017	16,911	21,022	20,375	
Richelieu Foods, Inc. ⁽¹³⁾	Beverage, Food & Tobacco	13.75%(12% Cash & 1.75%PIK) ⁽⁶⁾	5/8/2016	\$ 23,057	22,628	22,596	
Rug Doctor Inc. ⁽¹⁴⁾⁽¹⁶⁾	Personal, Food & Misc. Services	15.50% to 20.00%					
		(wtd. avg. 17.55%) ⁽⁶⁾	10/31/2014	54,072	51,941	43,258	
WireCo. Worldgroup Inc.	Building Products	11.75%	5/15/2017	48,000	47,556	48,960	
Total Subordinated Debt/Corporate Notes					\$ 454,609	\$ 446,927	

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)****December 31, 2012****(in thousands, except shares)**

Description ⁽¹⁾	Industry	Interest ⁽²⁾	Maturity	Par Amount*/ Shares/Units	Cost	Fair Value
Preferred Equity 17.2%						
Senior Preferred 15% Units of DSW Group Holdings LLC ⁽⁹⁾⁽²³⁾	Beverage, Food & Tobacco	15.00% PIK ⁽⁶⁾		1,500,725	\$ 129,794	\$ 125,611
SODO Corp. ⁽⁸⁾⁽¹¹⁾⁽²²⁾	Aerospace & Defense	8.41% ⁽⁶⁾	6/30/2018	2,151	2,151	2,371
SOCAY Limited ⁽⁸⁾⁽¹¹⁾⁽¹⁵⁾⁽²²⁾	Aerospace & Defense	8.57% ⁽⁶⁾	6/30/2018	13,915	13,915	14,490
SOINT, LLC ⁽⁸⁾⁽¹⁵⁾⁽²²⁾	Aerospace & Defense	15.00%	6/30/2018	86,667	8,667	8,667
Wyle Laboratories**	Aerospace & Defense	8.00%	7/17/2015	387	39	51
Total Preferred Equity					\$ 154,566	\$ 151,190
Common Equity / Partnership Interests / Warrants 37.2%						
Ark Real Estate Partners LP ^{(8)(10)(11)(22)**}	Buildings & Real Estate			45,905,653	\$ 45,235	\$ 35,095
Ark Real Estate Partners II LP ^{(8)(9)(10)(22)**}	Buildings & Real Estate			1,069,592	498	824
Crystal Capital Financial Holdings LLC ⁽⁸⁾⁽¹⁵⁾⁽²²⁾	Diversified Financial Services			275,000	275,000	275,000
Direct Buy Inc. ^{**} ⁽⁹⁾⁽²³⁾	Home, Office Furnishing & Durable Consumer Products			76,999		
Participating Preferred Units of DSW						
Group Holdings LLC ^{(9)(23)**}	Beverage, Food & Tobacco			1,292,964		
Grakon, LLC ^{(10)**}	Machinery			1,714,286	1,714	
Grakon, LLC Warrants ^{(10)**}	Machinery			3,518,001		
Great American Group Inc. ^{(15)**}	Personal, Food & Misc. Services			572,800	2,681	177
Great American Group Inc. ^{(12)(15)**}	Personal, Food & Misc. Services			187,500	3	58
Nuveen Investments, Inc. ^{**}	Finance			3,486,444	30,876	10,459
NXP Semiconductors Netherlands B.V. ^{(3)(15)**}	Electronics			159,827	4,357	4,207
Seven West Media Limited ⁽³⁾⁽¹⁵⁾	Broadcasting & Entertainment			656,530	2,726	1,118
Total Common Equity/Partnerships Interests / Warrants					\$ 363,090	\$ 326,938
Total Investments 158.9%					\$ 1,432,071	\$ 1,395,522
Liabilities in Excess of Other Assets ^(58.9%)						(517,249)
Net Assets 100.0%						\$ 878,273

(1) We generally acquire our investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"). Our investments are therefore generally subject to certain limitations on resale, and may be deemed to be "restricted securities" under the Securities Act.

(2) A majority of the variable rate debt investments bear interest at a rate that may be determined by reference to LIBOR or EURIBOR, and which reset daily, quarterly or semi-annually. For each debt investment we have provided the current interest rate in effect as of December 31, 2012.

(3) The following entities are domiciled outside the United States and the investments are denominated in either Euro, Canadian Dollars or Australian Dollars; ProSieben Sat.1 Media AG in Germany; Granite Global Solutions Corp., Easy Financials Services, Inc. in Canada; and Seven Media Group Limited in Australia. NXP Semiconductors Netherlands B.V. is domiciled in the Netherlands and is denominated in U.S. dollars. All other investments are domiciled in the United States.

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- (4) Solar Capital Ltd.'s foreign domiciled portion of MYI Aquiror Corporation is held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
- (5) Solar Capital Ltd.'s investment in ProSieben Sat. 1 Media AG is held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
- (6) A portion of the coupon may be payable in kind (PIK).
- (7) Includes an unfunded commitment of \$5,880.
- (8) Denotes a Control Investment. Control Investments are defined in the 1940 Act as investments in those companies that the Company is deemed to Control. Generally, under the 1940 Act, the Company is deemed to Control a company in which it has invested if it owns 25% or more of the voting securities of such company or has greater than 50% representation on its board.
- (9) Denotes an Affiliate Investment. Affiliate Investments are investments in those companies that are Affiliated Companies of the Company, as defined in the 1940 Act, which are not Control Investments. The Company is deemed to be an Affiliate of a company in which it has invested if it owns 5% or more but less than 25% of the voting securities of such company.
- (10) Investments are held in taxable subsidiaries. Ark Real Estate Partners LP is held through SLRC ADI Corp and our equity investment in Grakon LLC is held through Grakon TL Holding, Inc.
- (11) Solar Capital Ltd.'s investments in SODO Corp. and SOCA Y Corp. each include a one dollar investment in common shares.
- (12) Founders Shares.
- (13) Indicates an investment held by Solar Capital Ltd. through its wholly-owned financing subsidiary Solar Capital Funding II LLC (SC Funding). Such investments are pledged as collateral under the Senior Secured Loan Facility (see Note 8 to the consolidated financial statements) and are not generally available to the creditors of Solar Capital Ltd. Unless otherwise noted, as of December 31, 2012, all other investments were pledged as collateral for the Senior Secured Credit Facility, Term Loan and Senior Secured Notes (see Note 8 to the consolidated financial statements).
- (14) Indicates an investment partially held by Solar Capital Ltd. through its wholly-owned financing subsidiary SC Funding. (See footnote 13 above for further explanation.) Par amounts held through SC Funding include: Asurion Corp \$9,017; Earthbound Farm \$23,500; Fulton Holding Corp. \$18,000; Midcap Financial Intermediate Holdings, LLC \$23,500; Rug Doctor L.P. \$9,842; and ViaWest Inc. \$15,473. Remaining par balances are held directly by Solar Capital Ltd.

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)****December 31, 2012****(in thousands)**

- (15) Indicates assets that the Company believes may not represent qualifying assets under Section 55(a) of the Investment Company Act of 1940, as amended. Qualifying assets must represent at least 70% of the Company's total assets at the time of acquisition of any additional non-qualifying assets.
- (16) Includes PIK on \$13,026 of par at 4.50% PIK, \$15,167 of par at 5.25% PIK, \$16,037 of par at 8.00% PIK, and \$9,842 of par at 3.50% PIK.
- (17) Asurion Holdco has the option to pay interest in kind at L+10.25% if certain specified conditions are met.
- (18) In March 2012, Solar Capital Ltd. purchased \$36,991 par amount and sold \$7,000 par amount to a third party through a participation with no recourse to the Company.
- (19) Includes an unfunded commitment of \$5,695.
- (20) Includes an unfunded commitment of \$406.
- (21) Includes an unfunded commitment of \$9,775.
- (22) Denotes investments in which we are deemed to exercise a controlling influence over the management or policies of a company, as defined in the 1940 Act, due to beneficially owning, either directly or through one or more controlled companies, more than 25% of the outstanding voting securities of the investment. Transactions during the fiscal year ended December 31, 2012 in these controlled investments are as follows:

Name of Issuer	Fair Value at December 31, 2011	Gross Additions	Gross Reductions	Interest/ Dividend/ Income	Fair Value at December 31, 2012
AviatorCap SII, LLC I	\$ 3,671		684	\$ 434	\$ 3,044
AviatorCap SII, LLC II	5,611		1,306	596	4,390
AviatorCap SII, LLC III	8,724		4,850	944	4,006
AREP Fifty-Seventh LLC		24,709		520	24,215
ARK Real Estate Partners II LP		8,026		157	7,866
ARK Real Estate Partners LP		45,235			35,095
ARK Real Estate Partners II LP		498			824
USAW 767	4,831		1,828	619	3,076
SODO Corp.	1,949			175	2,371
SOCAY Limited	12,668			1,158	14,490
National Specialty Alloys LLC	16,000		21,299		
SOINT, LLC		16,335	579	1,044	15,766
SOINT, LLC		8,675		527	8,667
Crystal Capital Financial Holdings LLC		275,000			275,000
	\$ 53,454	378,478	30,546	\$ 6,174	\$ 398,810

- (23) Denotes investments in which we are an Affiliated Person but not exercising a controlling influence, as defined in the 1940 Act, due to beneficially owning, either directly or through one or more controlled companies, more than 5% but less than 25% of the outstanding voting securities of the investment. Transactions during the fiscal year ended December 31, 2012 in these affiliated investments are as follows:

Name of Issuer	Fair Value at December 31, 2011	Gross Additions	Gross Reductions	Interest/ Dividend/ Other Income	Fair Value at December 31, 2012
AREP Fifty-Seventh LLC	\$	19,768	19,768	\$ 1,019	\$
ARK Real Estate Partners II LP		8,026	8,026	122	
ARK Real Estate Partners LP	35,820	2,879	44,650		
Direct Buy Inc. (common equity)					
Direct Buy Inc.		7,700		143	7,700

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DS Waters of America, Inc.	35,696	6,755	3,944	32,095	
Senior Preferred 15% Units of DSW Group Holdings LLC	115,187	278	14,948	125,611	
	\$ 35,820	189,256	79,477	\$ 20,176	\$ 165,406

* Denominated in USD unless otherwise noted.

** Non-income producing security

See notes to consolidated financial statements.

Table of Contents**SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)****December 31, 2012**

Industry Classification	Percentage of Total Investments (at fair value) as of December 31, 2012
Diversified Financial Services	19.7%
Beverage, Food & Tobacco	12.9%
Banking	8.6%
Personal, Food & Misc. Services	7.8%
Insurance	6.9%
Buildings & Real Estate	4.9%
Healthcare, Education & Childcare	4.4%
Farming & Agriculture	4.0%
Aerospace & Defense	4.0%
Leisure, Amusement, Entertainment	3.7%
Building Products	3.5%
Retail Stores	3.3%
Diversified/Conglomerate Service	3.1%
Personal & Nondurable Consumer Products	2.8%
Healthcare Technology	2.0%
Internet Software & Services	1.8%
Broadcasting & Entertainment	1.5%
Machinery	1.4%
Cargo Transport	1.4%
Finance	0.7%
Consumer Finance	0.7%
Home, Office Furnishing & Durable Consumer Products	0.6%
Electronics	0.3%
 Total Investments	 100.0%

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

September 30, 2013

(in thousands, except shares)

Note 1. Organization

Solar Capital LLC, a Maryland limited liability company, was formed in February 2007 and commenced operations on March 13, 2007 with initial capital of \$1,200,000 of which 47.04% was funded by affiliated parties.

Immediately prior to our initial public offering, through a series of transactions, Solar Capital Ltd. merged with Solar Capital LLC, leaving Solar Capital Ltd. as the surviving entity (the Merger). Solar Capital Ltd. issued an aggregate of approximately 26.65 million shares of common stock and \$125,000 in senior unsecured notes to the existing Solar Capital LLC unit holders in connection with the Merger. Solar Capital Ltd. had no assets or operations prior to completion of the Merger and as a result, the historical books and records of Solar Capital LLC have become the books and records of the surviving entity. The number of shares used to calculate weighted average shares for use in computations on a per share basis have been decreased retroactively by a factor of approximately 0.4022 for all periods prior to February 9, 2010. This factor represents the effective impact of the reduction in shares resulting from the Merger.

Solar Capital Ltd. (Solar Capital , the Company or we), a Maryland corporation formed in November 2007, is a closed-end, externally managed, non-diversified management investment company that has elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). In addition, for tax purposes the Company has elected to be treated as a regulated investment company (RIC) under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code).

On February 9, 2010, Solar Capital priced its initial public offering, selling 5.68 million shares, including the underwriters over-allotment, at a price of \$18.50 per share. Concurrent with this offering, management purchased an additional 600,000 shares through a private placement, also at \$18.50 per share.

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 mezzanine and senior secured loans, each of which may include an equity component, and, to a lesser extent, by making direct equity investments in such companies.

Note 2. Significant Accounting Policies

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (GAAP), and include the accounts of the Company and its wholly-owned subsidiary, Solar Capital Luxembourg I S.a.r.l., which was incorporated under the laws of the Grand Duchy of Luxembourg on April 26, 2007. The consolidated financial statements reflect all adjustments and reclassifications which, in the opinion of management, are necessary for the fair presentation of the results of the operations and financial condition for the periods presented. All significant intercompany balances and transactions have been eliminated. Certain prior period amounts may have been reclassified to conform to the current period presentation.

Interim financial statements are prepared in accordance with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Regulation S-X, as appropriate. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. GAAP also requires management to make estimates and assumptions that affect the reported amount of assets and liabilities

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

September 30, 2013

(in thousands, except shares)

at the date of the financial statements and the reported amounts of income and expenses during the reported periods. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ materially. The current period's results of operations will not necessarily be indicative of results that ultimately may be achieved for the fiscal year ending on December 31, 2013.

In the opinion of management, all adjustments which are of a normal recurring nature considered necessary for the fair presentation of financial statements, have been included.

The significant accounting policies consistently followed by the Company are:

- (a) Investment transactions are accounted for on the trade date;
- (b) Under procedures established by our board of directors (the Board), we value investments, including certain senior secured debt, subordinated debt and other debt securities, for which market quotations are readily available, at such market quotations (unless they are deemed not to represent fair value). We attempt to obtain market quotations from at least two brokers or dealers (if available, otherwise from a principal market maker or a primary market dealer or other independent pricing service). We utilize mid-market pricing as a practical expedient for fair value unless a different point within the range is more representative. If and when market quotations are deemed not to represent fair value, we typically utilize independent third party valuation firms to assist us in determining fair value. Accordingly, such investments go through our multi-step valuation process as described below. In each case, our independent valuation firms consider observable market inputs together with significant unobservable inputs in arriving at their valuation recommendations. Debt investments with remaining maturities of 60 days or less shall each be valued at cost with interest accrued or discount amortized to the date of maturity, unless such valuation, in the judgment of Solar Capital Partners, LLC (the Investment Adviser), does not represent fair value, in which case such investments shall be valued at fair value as determined in good faith by or under the direction of our Board. Investments that are not publicly traded or whose market quotations are not readily available are valued at fair value as determined in good faith by or under the direction of our Board. Such determination of fair values involves subjective judgments and estimates.

With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board has approved a multi-step valuation process each quarter, as described below:

- (1) our quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals of the Investment Adviser responsible for the portfolio investment;
- (2) preliminary valuation conclusions are then documented and discussed with senior management of the Investment Adviser;
- (3) independent valuation firms engaged by our Board conduct independent appraisals and review the Investment Adviser's preliminary valuations and make their own independent assessment;

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- (4) the audit committee of the Board reviews the preliminary valuation of the Investment Adviser and that of the independent valuation firm and responds to the valuation recommendation of the independent valuation firm to reflect any comments; and

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

September 30, 2013

(in thousands, except shares)

- (5) the Board discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the input of the Investment Adviser, the respective independent valuation firm and the audit committee.

Investments in all asset classes are valued utilizing a market approach, an income approach, or both approaches, as appropriate. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. In following these approaches, the types of factors that we may take into account in fair value pricing our investments include, as relevant: available current market data, including relevant and applicable market trading and transaction comparables, applicable market yields and multiples, security covenants, call protection provisions, the nature and realizable value of any collateral, the portfolio company's ability to make payments, its earnings and discounted cash flows, the markets in which the portfolio company does business, comparisons of financial ratios of peer companies that are public, M&A comparables, our principal market (as the reporting entity) and enterprise values, among other factors. When available, broker quotations and/or quotations provided by pricing services are considered as an input in the valuation process. For the nine months ended September 30, 2013, there has been no change to the Company's valuation techniques and the nature of the related inputs considered in the valuation process.

Accounting Standards Codification (ASC) 820 classifies the inputs used to measure these fair values into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities, accessible by the Company at the measurement date.

Level 2: Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or other observable inputs other than quoted prices.

Level 3: Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment.

- (c) Gains or losses on investments are calculated by using the specific identification method.
- (d) The Company records interest, adjusted for amortization of premium and accretion of discount, on an accrual basis. Loan origination fees, original issue discount, and market discounts are capitalized and we amortize such amounts into income using the interest method or on a straight-line basis, as applicable. Upon the prepayment of a loan, any unamortized loan origination fees are recorded as interest income. We record prepayment premiums on loans and other investments as interest income when we receive such amounts. Capital structuring and other fees for services rendered are recorded as income when earned.
- (e) The Company intends to comply with the applicable provisions of the Internal Revenue Code pertaining to regulated investment companies to make distributions of taxable income sufficient to relieve it of substantially all Federal income taxes. The Company, at its discretion, may carry forward taxable income in excess of calendar year distributions and pay a 4% excise tax on this income. The Company will accrue excise tax on such estimated excess taxable income as appropriate.

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

September 30, 2013

(in thousands, except shares)

- (f) Book and tax basis differences relating to stockholder dividends and distributions and other permanent book and tax differences are typically reclassified among the Company's capital accounts annually. In addition, the character of income and gains to be distributed is determined in accordance with income tax regulations that may differ from GAAP.
- (g) Dividends and distributions to common stockholders are recorded as of the record date. The amount to be paid out as a dividend is determined by the Board. Net realized capital gains, if any, are generally distributed or deemed distributed at least annually.
- (h) In accordance with Regulation S-X Article 6.03 and ASC 810 *Consolidation*, the Company generally will not consolidate its interest in any operating company other than in investment company subsidiaries, certain financing subsidiaries, and controlled operating companies substantially all of whose business consists of providing services to the Company.
- (i) The accounting records of the Company are maintained in U.S. dollars. Any assets and liabilities denominated in foreign currencies are translated into U.S. dollars based on the rate of exchange of such currencies against U.S. dollars on the date of valuation. The Company will 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 market prices of securities held. Such fluctuations would be included with the net realized and unrealized gain or loss from investments. The Company's investments in foreign securities, if any, may involve certain risks, including without limitation: foreign exchange restrictions, expropriation, taxation or other political, social or economic risks, all of which could affect the market and/or credit risk of the investment. In addition, changes in the relationship of foreign currencies to the U.S. dollar can significantly affect the value of these investments in terms of US dollars and therefore the earnings of the Company.
- (j) The Company has made an irrevocable election to apply the fair value option of accounting to its senior secured credit facility (the Credit Facility) and its senior secured notes (the Senior Secured Notes), in accordance with ASC 825-10. The Company uses an independent third-party valuation firm to measure their fair value. (see Note 8)
- (k) The Company records origination and other expenses related to its other debt issuances as prepaid assets. These expenses are deferred and amortized using either the effective interest method or the straight-line method over the stated life. The straight-line method may be used on revolving facilities and when it approximates the effective yield method.
- (l) The Company may enter into forward exchange contracts in order to hedge against foreign currency risk. 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.
- (m) The Company records expenses related to shelf filings and applicable equity offering costs as prepaid assets. These expenses are charged as a reduction of capital upon utilization, in accordance with ASC 946-20-25.

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- (n) Investments that are expected to pay regularly scheduled interest in cash are generally placed on non-accrual status when principal or interest cash payments are past due 30 days or more and/or when it is no longer probable that principal or interest cash payments will be collected. Such non-accrual investments are restored to accrual status if past due principal and interest are paid in cash, and in management's judgment, are likely to continue timely payment of their remaining principal and interest obligations. Cash interest payments received on non-accrual designated investments may be recognized as income or applied to principal depending on management's judgment.

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- (o) The Company defines cash equivalents as securities that are readily convertible into known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only securities with a maturity of three months or less from the date of issue would qualify, with limited exceptions. The Company deems that certain U.S. Treasury bills, repurchase agreements and other high-quality, short-term debt securities would qualify as cash equivalents.

Note 3. Agreements

Solar Capital has an Investment Advisory and Management Agreement with the Investment Adviser, under which the Investment Adviser will manage the day-to-day operations of, and provide investment advisory services to, Solar Capital. For providing these services, the Investment Adviser receives a fee from Solar Capital, consisting of two components – a base management fee and an incentive fee. The base management fee is determined by taking the average value of Solar Capital’s gross assets at the end of the two most recently completed calendar quarters calculated at an annual rate of 2.00%. The incentive fee has two parts, as follows: one part is calculated and payable quarterly in arrears based on Solar Capital’s pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees or other fees that we receive from portfolio companies) accrued during the calendar quarter, minus Solar Capital’s operating expenses for the quarter (including the base management fee, any expenses payable under the Administration Agreement, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income does not include any realized capital gains computed net of all realized capital losses and unrealized capital depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of Solar Capital’s net assets at the end of the immediately preceding calendar quarter, is compared to the hurdle rate of 1.75% per quarter (7% annualized). Our net investment income used to calculate this part of the incentive fee is also included in the amount of our gross assets used to calculate the 2% base management fee. Solar Capital pays the Investment Adviser an incentive fee with respect to Solar Capital’s pre-incentive fee net investment income in each calendar quarter as follows: (1) no incentive fee in any calendar quarter in which Solar Capital’s pre-incentive fee net investment income does not exceed the hurdle rate; (2) 100% of Solar Capital’s pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter; and (3) 20% of the amount of Solar Capital’s pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter. These calculations are appropriately pro-rated for any period of less than three months.

The second part of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory and Management Agreement, as of the termination date), and will equal 20% of Solar Capital’s cumulative realized capital gains less cumulative realized capital losses, unrealized capital depreciation (unrealized depreciation on a gross investment-by-investment basis at the end of each calendar year) and all net capital gains upon which prior performance-based capital gains incentive fee payments were previously made to the Investment Adviser. For financial statement purposes, the second part of the incentive fee is accrued based upon 20% of cumulative net realized gains and net unrealized capital appreciation. No accrual was required for the three and nine months ended September 30, 2013 and 2012.

For the three and nine months ended September 30, 2013, the Company recognized \$6,613 and \$21,014, respectively, in base management fees and \$5,407 and \$16,601, respectively, in performance-based incentive

Table of Contents**SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2013****(in thousands, except shares)**

fees. For the three and nine months ended September 30, 2012, the Company recognized \$6,083 and \$17,034, respectively, in base management fees and \$5,565 and \$14,431, respectively, in performance-based incentive fees.

Solar Capital has also entered into an Administration Agreement with Solar Capital Management, LLC (the Administrator) under which the Administrator provides administrative services to Solar Capital. For providing these services, facilities and personnel, Solar Capital reimburses the Administrator for Solar Capital's allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations under the Administration Agreement, including rent. The Administrator will also provide, on Solar Capital's behalf, managerial assistance to those portfolio companies to which Solar Capital is required to provide such assistance.

For the three and nine months ended September 30, 2013, the Company recognized expenses under the Administration Agreement of \$1,196, and \$3,452, respectively. For the three and nine months ended September 30, 2012, the Company recognized expenses under the Administration Agreement of \$1,194, and \$3,018, respectively. No managerial assistance fees were accrued or collected for the three and nine months ended September 30, 2013 and 2012.

Note 4. Net Asset Value Per Share

At September 30, 2013, the Company's total net assets and net asset value per share were \$986,131 and \$22.25, respectively. This compares to total net assets and net asset value per share at December 31, 2012 of \$878,273 and \$22.70, respectively.

Note 5. Earnings Per Share

The following table sets forth the computation of basic and diluted net increase in net assets resulting from operations, pursuant to ASC 260-10, for the three and nine months ended September 30, 2013 and September 30, 2012:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
<u>Earnings per share (basic & diluted)</u>				
Numerator net increase in net assets resulting from operations:	\$ 10,570	\$ 30,243	\$ 46,363	\$ 92,463
Denominator weighted average shares:	44,741,537	36,948,921	44,676,970	36,732,790
Earnings per share:	\$ 0.24	\$ 0.82	\$ 1.04	\$ 2.52

Note 6. Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1. Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access.

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Level 2. Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:

- a) Quoted prices for similar assets or liabilities in active markets;
- b) Quoted prices for identical or similar assets or liabilities in non-active markets;
- c) Pricing models whose inputs are observable for substantially the full term of the asset or liability; and
- d) Pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability.

Level 3. Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset or liability.

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. For example, a Level 3 fair value measurement may include inputs that are observable (Levels 1 and 2) and unobservable (Level 3).

Therefore gains and losses for such assets and liabilities categorized within the Level 3 table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3).

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities. Reclassifications impacting Level 3 of the fair value hierarchy are reported as transfers in/out of the Level 3 category as of the beginning of the quarter in which the reclassifications occur.

The following tables present the balances of assets and liabilities measured at fair value on a recurring basis, as of September 30, 2013 and December 31, 2012:

Fair Value Measurements**As of September 30, 2013**

	Level 1	Level 2	Level 3	Total
Assets:				
Bank Debt/Senior Secured Loans	\$	\$ 65,881	\$ 416,335	\$ 482,216

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Subordinated Debt / Corporate Notes	12,570	279,853	292,423
Preferred Equity		26,447	26,447
Common Equity / Partnership Interests / Warrants	228	332,042	332,270
Derivative assets interest rate caps and foreign exchange contracts			
Liabilities:			
Credit Facility and Senior Secured Notes		125,000	125,000

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September 30, 2013

(in thousands, except shares)

Fair Value MeasurementsAs of December 31, 2012

	Level 1	Level 2	Level 3	Total
Assets:				
Bank Debt/Senior Secured Loans	\$	\$ 25,899	\$ 444,568	\$ 470,467
Subordinated Debt / Corporate Notes		33,175	413,752	446,927
Preferred Equity			151,190	151,190
Common Equity / Partnership Interests / Warrants	5,560		321,378	326,938
Derivative assets interest rate caps and foreign exchange contracts		17		17
Liabilities:				
Credit Facility and Senior Secured Notes			389,452	389,452

The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the nine months ended September 30, 2013 and the year ended December 31, 2012 as well as the portion of gains or losses included in income attributable to unrealized gains or losses related to those assets and liabilities still held at September 30, 2013 and December 31, 2012:

Fair Value Measurements Using Level 3 InputsAs of September 30, 2013

	Bank Debt/ Senior Secured Loans	Subordinated Debt/ Corporate Notes	Preferred Equity	Common Equity/ Partnership Interests/ Warrants
Fair value, December 31, 2012	\$ 444,568	\$ 413,752	\$ 151,190	\$ 321,378
Total gains or losses included in earnings:				
Net realized gain (loss)	7,327	4,549	(17,728)	
Net change in unrealized gain (loss)	(3,393)	(17,425)	4,583	10,664
Purchase of investment securities	170,703	3,209	6,096	
Proceeds from dispositions of investment securities	(202,870)	(124,232)	(117,694)	
Transfers in/out of Level 3				
Fair value, September 30, 2013	\$ 416,335	\$ 279,853	\$ 26,447	\$ 332,042
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period:				
Net change in unrealized gain (loss):	\$ 1,021	\$ (14,977)	\$ 602	\$ 6,751

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During the nine months ended September 30, 2013, there were no transfers in and out of Levels 1 and 2.

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The following table shows a reconciliation of the beginning and ending balances for fair valued liabilities measured using significant unobservable inputs (Level 3) for the nine months ended September 30, 2013:

	For the nine months ended September 30, 2013
Credit Facility and Senior Secured Notes	
Beginning fair value	\$ 389,452
Net realized (gain) loss	(517)
Net change in unrealized (gain) loss	517
Borrowings	513,592
Repayments	(778,044)
Transfers in/out of Level 3	
Ending fair value	\$ 125,000

The Company has made an irrevocable election to apply the fair value option of accounting to the Credit Facility and the Senior Secured Notes, in accordance with ASC 825-10. On September 30, 2013, there were borrowings of \$50,000 and \$75,000, respectively, on the Credit Facility and the Senior Secured Notes. The Company used an independent third-party valuation firm to measure the fair value of the Credit Facility and Senior Secured Notes.

Fair Value Measurements Using Level 3 Inputs**As of December 31, 2012**

	Bank Debt/ Senior Secured Loans	Subordinated Debt/ Corporate Notes	Preferred Equity	Common Equity/ Partnership Interests/ Warrants
Fair value, December 31, 2011	\$ 366,019	\$ 536,351	\$ 14,664	\$ 59,664
Total gains or losses included in earnings:				
Net realized gain (loss)		(36,049)		11,299
Net change in unrealized gain (loss)	22,976	39,384	(2,932)	(7,201)
Purchase of investment securities	223,710	101,858	139,736	278,962
Proceeds from dispositions of investment securities	(168,137)	(227,792)	(278)	(21,346)
Transfers in/out of Level 3				
Fair value, December 31, 2012	\$ 444,568	\$ 413,752	\$ 151,190	\$ 321,378

Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period:

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Net change in unrealized gain (loss):	\$	9,129	\$	(8,161)	\$	(3,376)	\$	(31,945)
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During the fiscal year December 31, 2012, there were no transfers in and out of Levels 1 and 2.

Table of Contents**SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2013****(in thousands, except shares)**

The following table shows a reconciliation of the beginning and ending balances for fair valued liabilities measured using significant unobservable inputs (Level 3) for the year ended December 31, 2012:

	For the year ended December 31, 2012
Credit Facility and Senior Secured Notes	
Beginning fair value	\$
Total unrealized appreciation	
Borrowings	489,957
Repayments	(100,505)
Transfers in/out of Level 3	
Ending fair value	\$ 389,452

The Company has made an irrevocable election to apply the fair value option of accounting to the Credit Facility and the Senior Secured Notes, in accordance with ASC 825-10. On December 31, 2012, there were borrowings of \$314,452 and \$75,000, respectively, on the Credit Facility and the Senior Secured Notes. The Company used an independent third-party valuation firm to measure the fair value of the Credit Facility and Senior Secured Notes.

Quantitative Information about Level 3 Fair Value Measurements

The Company typically determines the fair value of its performing debt investments utilizing a yield analysis. In a yield analysis, a price is ascribed for each investment based upon an assessment of current and expected market yields for similar investments and risk profiles. Additional consideration is given to current contractual interest rates, relative maturities and other key terms and risks associated with an investment. Among other factors, a significant determinant of risk is the amount of leverage used by the portfolio company relative to the total enterprise value of the company, and the rights and remedies of our investment within each portfolio company.

Significant unobservable quantitative inputs typically used in the fair value measurement of the Company's Level 3 assets and liabilities primarily reflect current market yields, including indices, and readily available quotes from brokers, dealers, and pricing services as indicated by comparable assets and liabilities, as well as enterprise values and earnings before income taxes, depreciation and amortization (EBITDA) multiples of similar companies, and comparable market transactions for equity securities.

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

September 30, 2013

(in thousands, except shares)

Quantitative information about the Company's Level 3 asset and liability fair value measurements as of September 30, 2013 is summarized in the table below:

	Asset or Liability	Fair Value at September 30, 2013	Valuation Techniques/ Methodology	Unobservable Input	Range (Weighted Average)
Senior Secured / Bank Debt	Asset	\$ 416,335	Yield Analysis/Market Approach/Broker quoted		