

Solar Capital Ltd.  
Form 10-Q  
November 01, 2012  
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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, 2012

.. **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 or 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 31, 2012 was 38,694,058.

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**SOLAR CAPITAL LTD.**

**FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2012**

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

(in thousands, except shares)

|   | September 30,    | December 31,     |
|---|------------------|------------------|
|   | 2012             | 2011             |
|   | (unaudited)      |                  |
| <b>Assets</b>   |                  |                  |
| Investments at value:   |                  |                  |
| Companies less than 5% owned (cost: \$1,128,982 and \$1,062,844 respectively)   | \$ 1,078,553     | \$ 955,769       |
| Companies 5% to 25% owned (cost: \$72,492 and \$41,819, respectively)   | 62,103           | 35,820           |
| Companies more than 25% owned (cost: \$28,785 and \$47,910, respectively)   | 29,971           | 53,454           |
| <b>Total investments (cost: \$1,230,259 and \$1,152,573, respectively)</b>  | <b>1,170,627</b> | <b>1,045,043</b> |
| Cash and cash equivalents   | 13,048           | 11,787           |
| Interest and dividends receivable   | 14,416           | 9,763            |
| Deferred credit facility costs  | 1,087            | 3,635            |
| Deferred offering costs   | 578              | 469              |
| Receivable for investments sold   |                  | 3,225            |
| Fee revenue receivable  |                  | 4,379            |
| Unrealized appreciation on foreign exchange contracts and fair value of interest rate caps  | 30               | 649              |
| Prepaid expenses and other receivables  | 374              | 481              |
| <b>Total Assets</b>   | <b>1,200,160</b> | <b>1,079,431</b> |
| <b>Liabilities</b>  |                  |                  |
| Revolving credit facilities   | 123,362          | 201,355          |
| Senior secured notes  | 75,000           |                  |
| Term Loan   | 50,000           | 35,000           |
| Payable for investments purchased   | 32,202           | 22,443           |
| Dividend payable  | 23,200           |                  |
| Investment advisory and management fee payable  | 6,083            | 5,277            |
| Performance-based incentive fee payable   | 5,565            | 5,203            |
| Interest payable  | 3,165            | 1,063            |
| Administrative services fee payable   | 1,282            | 1,069            |
| Deferred fee revenue  |                  | 318              |
| Other accrued expenses and payables   | 2,698            | 1,762            |
| <b>Total Liabilities</b>  | <b>322,557</b>   | <b>273,490</b>   |
| <b>Net Assets</b>   |                  |                  |
| Common stock, par value \$0.01 per share, 38,667,196 and 36,608,038 shares issued and outstanding, respectively, 200,000,000 authorized | 387              | 366              |
| Paid-in capital in excess of par  | 974,507          | 928,180          |
| Undistributed net investment income   |                  | 2,245            |
| Distributions in excess of net investment income  | (7,178)          |                  |
| Accumulated net realized losses   | (28,012)         | (18,379)         |
| Net unrealized depreciation   | (62,101)         | (106,471)        |

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|                                  |            |            |
|----------------------------------|------------|------------|
| <b>Total Net Assets</b>          | \$ 877,603 | \$ 805,941 |
| Number of shares outstanding     | 38,667,196 | 36,608,038 |
| <b>Net Asset Value Per Share</b> | \$ 22.70   | \$ 22.02   |

See notes to consolidated financial statements.

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

(in thousands, except shares)

|  | Three months<br>ended<br>September 30,<br>2012 | Three months<br>ended<br>September 30,<br>2011 | Nine months<br>ended<br>September 30,<br>2012 | Nine months<br>ended<br>September 30,<br>2011 |
|--|--|--|---|---|
| <b>INVESTMENT INCOME:</b>  |  |  |   |   |
| Interest and dividends:  |  |  |   |   |
| Other interest and dividend income   | \$ 26,382                                      | \$ 30,988                                      | \$ 89,428                                     | \$ 97,117                                     |
| Companies 5% to 25% owned  | 13,460   |  | 19,112  |   |
| Companies more than 25% owned  | 804  | 4,341  | 3,248   | 5,789   |
| <b>Total investment income</b>   | <b>40,646</b>                                  | <b>35,329</b>                                  | <b>111,788</b>                                | <b>102,906</b>                                |
| <b>EXPENSES:</b>   |  |  |   |   |
| Investment advisory and management fees  | 6,083  | 5,236  | 17,034  | 15,319  |
| Performance-based incentive fees   | 5,565  | 5,216  | 14,431  | 15,273  |
| Interest and other credit facility expenses  | 3,475  | 2,242  | 15,221  | 6,174   |
| Administrative services fees   | 1,194  | 357  | 3,018   | 1,074   |
| Other general and administrative expenses  | 2,011  | 1,223  | 4,015   | 3,039   |
| <b>Total operating expenses</b>  | <b>18,328</b>                                  | <b>14,274</b>                                  | <b>53,719</b>                                 | <b>40,879</b>                                 |
| <b>Net investment income before income tax expense</b>   | <b>22,318</b>                                  | <b>21,055</b>                                  | <b>58,069</b>                                 | <b>62,027</b>                                 |
| Income tax expense   | 60   | 344  | 343   | 798   |
| <b>Net investment income</b>   | <b>22,258</b>                                  | <b>20,711</b>                                  | <b>57,726</b>                                 | <b>61,229</b>                                 |
| <b>REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, DERIVATIVES AND FOREIGN CURRENCIES:</b> |  |  |   |   |
| Net realized gain (loss):  |  |  |   |   |
| Investments:   |  |  |   |   |
| Companies more than 25% owned  | 687  |  | 11,002  |   |
| Companies 5% to 25% owned  |  | 784  |   | 784   |
| Companies less than 5% owned   | (256)  |  | (20,616)                                      | 5,106   |
| Net realized gain (loss) on investments  | 431  | 784  | (9,614)                                       | 5,890   |
| Foreign currencies & derivatives   | (860)  | 1,453  | (19)  | (8,096)                                       |
| Net realized gain (loss) before income taxes   | (429)  | 2,237  | (9,633)                                       | (2,206)                                       |
| Income tax expense   | (785)  | 137  |   | 137   |
| <b>Net realized gain (loss)</b>  | <b>356</b>                                     | <b>2,100</b>                                   | <b>(9,633)</b>                                | <b>(2,343)</b>                                |
| Net change in unrealized gain (loss):  |  |  |   |   |
| Investments  | 6,869  | (78,604)                                       | 44,989  | (53,802)                                      |
| Foreign currencies & derivatives   | 760  | 3,849  | (619)   | 4,374   |

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|   |           |             |           |          |
|---|-----------|-------------|-----------|----------|
| Net change in unrealized gain (loss)  | 7,629     | (74,755)    | 44,370    | (49,428) |
| <b>Net realized and unrealized gain (loss) on investments, derivatives and foreign currencies</b> | 7,985     | (72,655)    | 34,737    | (51,771) |
| <b>Net Increase (Decrease) in Net Assets Resulting From Operations</b>                            | \$ 30,243 | \$ (51,944) | \$ 92,463 | \$ 9,458 |
| Earnings (Loss) per share   | \$ 0.82   | \$ (1.42)   | \$ 2.52   | \$ 0.26  |

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<br>September 30, 2012<br>(unaudited) | Year ended<br>December 31, 2011 |
|---|--|---------------------------------|
| <b>Increase in net assets resulting from operations:</b>    |  |                                 |
| Net investment income                                       | \$ 57,726  | \$ 81,904                       |
| Net realized loss   | (9,633)  | (2,393)                         |
| Net change in unrealized gain (loss)                        | 44,370   | (18,196)                        |
| <b>Net increase in net assets resulting from operations</b> | <b>92,463</b>  | <b>61,315</b>                   |
| <b>Dividends and distributions to shareholders:</b>         | <b>(67,149)</b>  | <b>(87,532)</b>                 |
| <b>Capital share transactions:</b>                          |  |                                 |
| Common equity offering                                      | 45,020   |                                 |
| Reinvestment of dividends                                   | 1,328  | 5,164                           |
| <b>Total capital share transactions</b>                     | <b>46,348</b>  | <b>5,164</b>                    |
| <b>Net increase (decrease) in net assets</b>                | <b>71,662</b>  | <b>(21,053)</b>                 |
| Net assets at beginning of period                           | 805,941  | 826,994                         |
| <b>Net assets at end of period</b>                          | <b>\$ 877,603</b>                                      | <b>\$ 805,941</b>               |

See notes to consolidated financial statements.



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

(in thousands except shares)

|   | Nine months<br>ended<br>September 30, 2012 | Nine months<br>ended<br>September 30, 2011 |
|---|--|--|
| <b>Cash Flows from Operating Activities:</b>  |  |  |
| <b>Net increase in net assets from operations</b>   | \$ 92,463                                  | \$ 9,458                                   |
| <b>Adjustments to reconcile net increase in net assets from operations to net cash (used) provided by operating activities:</b> |  |  |
| Net realized (gain) loss from investments   | 9,614                                      | (5,890)                                    |
| Net realized (gain) loss from foreign currency exchange   | 19   | 348  |
| Net change in unrealized (gain) loss on investments   | (44,989)                                   | 53,802                                     |
| Net change in (gain) loss on derivatives  | 619  | (2,209)                                    |
| <b>(Increase) decrease in operating assets:</b>   |  |  |
| Purchase of investment securities   | (395,695)                                  | (324,541)                                  |
| Proceeds from disposition of investment securities  | 323,877                                    | 238,365                                    |
| Capitalization of payment-in-kind interest  | (25,569)                                   | (13,710)                                   |
| Collections of payment-in-kind interest   | 7,159                                      | 3,602                                      |
| Interest and dividends receivable   | (4,653)                                    | (5,267)                                    |
| Purchase of interest rate cap   |  | (2,938)                                    |
| Fee revenue receivable  | 4,379                                      | (282)                                      |
| Deferred offering costs   | (109)                                      | (376)                                      |
| Receivable for investments sold   | 3,225                                      | 7,335                                      |
| Prepaid expenses and other receivables  | 107  | (211)                                      |
| <b>Increase (decrease) in operating liabilities:</b>  |  |  |
| Payable for investments purchased   | 9,759                                      | 71,857                                     |
| Investment advisory and management fee payable  | 806  | 344  |
| Performance-based incentive fee payable   | 362  | 869  |
| Interest payable  | 2,102                                      | 672  |
| Administrative services fees  | 213  | 22   |
| Deferred fee revenue  | (318)                                      | (705)                                      |
| Other accrued expenses and payables   | 936  | 329  |
| <b>Net Cash (Used) Provided by Operating Activities</b>   | <b>(15,693)</b>                            | <b>30,874</b>                              |
| <b>Cash Flows from Financing Activities:</b>  |  |  |
| Cash dividends paid   | (42,621)                                   | (40,804)                                   |
| Common equity offering  | 45,020                                     |  |
| Deferred credit facility costs  | 2,548                                      | 1,712                                      |
| Proceeds from borrowings on senior secured notes  | 75,000                                     |  |
| Proceeds from borrowings on revolving/term credit facilities  | 475,023                                    | 1,103,669                                  |
| Repayments of borrowings on revolving/term credit facilities  | (538,016)                                  | (1,150,341)                                |
| <b>Net Cash Provided (Used) in Financing Activities</b>   | <b>16,954</b>                              | <b>(85,764)</b>                            |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>  | <b>1,261</b>                               | <b>(54,890)</b>                            |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>   | <b>11,787</b>                              | <b>288,732</b>                             |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>   | <b>\$ 13,048</b>                           | <b>\$ 233,842</b>                          |

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**Supplemental disclosure of cash flow information:**

|                                     |    |       |    |       |
|-------------------------------------|----|-------|----|-------|
| Cash paid for interest              | \$ | 5,398 | \$ | 3,390 |
| Cash paid for income taxes          | \$ | 727   | \$ | 477   |
| <b>Non-cash financing activity:</b> |    |       |    |       |
| Dividends reinvestment              | \$ | 1,328 | \$ | 2,895 |

See notes to consolidated financial statements.

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

September 30, 2012

(in thousands, except shares)

| Description(1)                                     | Industry   | Interest(2)                       | Maturity   | Par Amount/<br>Shares | Cost              | Fair<br>Value     |
|--|--|-----------------------------------|------------|-----------------------|-------------------|-------------------|
| <b>Bank Debt/Senior Secured<br/>Loans-54.3%</b>    |  |                                   |            |                       |                   |                   |
| Asurion Corporation(16)                            | Insurance  | 9.00%                             | 5/24/2019  | \$ 17,834             | \$ 17,757         | \$ 18,500         |
| AREP Fifty-Seventh LLC(10)(23)                     | Buildings & Real Estate                                | 14.00%                            | 8/1/2013   | 19,769                | 19,769            | 19,373            |
| ARK Real Estate Partners II<br>LP(10)(23)          | Buildings & Real Estate                                | 14.00%                            | 8/1/2013   | 8,027                 | 8,027             | 7,866             |
| AviatorCap SII, LLC I(9)                           | Aerospace & Defense                                    | 12.00%                            | 12/31/2014 | 3,225                 | 3,194             | 3,225             |
| AviatorCap SII, LLC II(9)                          | Aerospace & Defense                                    | 11.00%                            | 12/31/2014 | 4,733                 | 4,681             | 4,733             |
| AviatorCap SII, LLC III(9)                         | Aerospace & Defense                                    | 13.00%                            | 12/31/2014 | 5,151                 | 5,074             | 5,152             |
| Direct Buy Inc.(18)                                | Home, Office Furnishing &<br>Durable Consumer Products | 12.00%                            | 2/1/2017   | 25,000                | 24,347            | 5,000             |
| DS Waters of America, Inc.(10)(22)                 | Beverage, Food & Tobacco                               | 15% (11% Cash &<br>4% PIK)(7)     | 2/28/2018  | 30,689                | 29,682            | 31,763            |
| Fulton Holding Corp.                               | Retail Stores  | 13.37%                            | 5/28/2016  | 35,000                | 34,298            | 35,000            |
| Easy Financial Services,<br>Inc.(19)(24)           | Consumer Finance                                       | 10.50%                            | 10/5/2017  | 10,000                | 9,921             | 9,921             |
| Grakon, LLC(11)                                    | Machinery  | 12.00%                            | 12/31/2015 | 9,524                 | 7,738             | 9,429             |
| Good Sam Enterprise, LLC                           | Insurance  | 11.50%                            | 12/1/2016  | 7,000                 | 6,588             | 7,420             |
| Grocery Outlet Inc.(16)                            | Grocery  | 10.50%                            | 12/15/2017 | 33,096                | 32,208            | 33,261            |
| Isotoner Corporation                               | Personal & Nondurable Consumer<br>Products             | 10.75%                            | 1/8/2018   | 39,000                | 38,009            | 38,610            |
| Interactive Health Solutions,<br>Inc.(16)(17)      | Healthcare, Education &<br>Childcare                   | 11.50%                            | 10/4/2016  | 19,775                | 19,395            | 19,894            |
| MYI Acquiror<br>Corporation(4)(8)(19)              | Insurance  | 13% (12% Cash &<br>1% PIK)(7)     | 3/13/2017  | 31,707                | 31,168            | 32,024            |
| SMG  | Personal, Food & Misc. Services                        | 10.75%                            | 12/7/2018  | 25,000                | 24,522            | 24,875            |
| Southern Auto Finance<br>Company(19)               | Banking  | 13.50%                            | 10/19/2017 | 25,000                | 24,509            | 25,000            |
| SOINT, LLC(9)                                      | Aerospace & Defense                                    | 15.00%                            | 6/30/2016  | 16,667                | 16,344            | 16,333            |
| Spencer Spirit Holdings, Inc.                      | Retail Stores  | 11.00%                            | 5/1/2017   | 10,000                | 10,000            | 10,775            |
| T&D Solutions holdings                             | Utilities  | 13.00%                            | 1/29/2015  | 17,003                | 17,003            | 17,003            |
| Transplace Texas, LP(16)                           | Cargo Transport  | 11.00%                            | 4/12/2017  | 20,000                | 19,598            | 19,700            |
| Trident USA Health Services, LLC                   | Healthcare, Education &<br>Childcare                   | 11.75%                            | 10/30/2017 | 38,000                | 37,287            | 37,430            |
| USAW 767(9)  | Aerospace & Defense                                    | 14.50%                            | 6/30/2014  | 3,539                 | 3,519             | 3,539             |
| ViaWest Inc(16)                                    | Personal, Food & Misc. Services                        | 13.5% (12% Cash &<br>1.5% PIK)(7) | 5/20/2018  | 40,691                | 39,712            | 40,691            |
| <b>Total Bank Debt/Senior Secured<br/>Loans</b>    |  |                                   |            | <b>\$ 495,430</b>     | <b>\$ 484,350</b> | <b>\$ 476,517</b> |
| <b>Subordinated Debt/Corporate<br/>Notes 56.4%</b> |  |                                   |            |                       |                   |                   |
| Adams Outdoor Advertising                          | Diversified/Conglomerate Service                       | 18.00%                            | 12/8/2015  | \$ 42,500             | \$ 41,875         | \$ 42,500         |

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|   |                                   |  |            |                   |                   |                   |
|---|-----------------------------------|--|------------|-------------------|-------------------|-------------------|
| Asurion Holdco(21)                                  | Insurance                         | 11.00%(7)                              | 3/2/2019   | 12,000            | 11,655            | 12,800            |
| CIBT Solutions                                      | Leisure, Amusement, Entertainment | 13.50%                                 | 6/15/2018  | 36,200            | 35,473            | 36,200            |
| Crosman Corporation                                 | Leisure, Amusement, Entertainment | 13% (11% Cash & 2% PIK)(7)             | 10/15/2016 | 15,219            | 14,861            | 14,914            |
| Earthbound Farm(16)                                 | Farming & Agriculture             | 14.25%                                 | 6/21/2017  | 58,947            | 57,927            | 57,474            |
| Alegeus Technologies Holdings Corp.                 | Healthcare Technology             | 12.00%                                 | 2/15/2019  | 28,200            | 27,574            | 27,566            |
| Grakon Holdings LLC Sr(11)                          | Machinery                         | 14% PIK(7)                             | 12/31/2015 | 1,761             | 1,761             | 1,743             |
| Grakon Holdings LLC Jr(11)                          | Machinery                         | 12% PIK(7)                             | 12/31/2015 | 11,812            | 10,008            | 8,268             |
| Granite Global Solutions Corp.(3)(18)(19)           | Insurance                         | 13.50%                                 | 5/31/2016  | 18,182            | 18,029            | 15,725            |
| Midcap Financial Intermediate Holdings, LLC(16)(19) | Banking                           | 13.00%                                 | 7/9/2015   | 85,000            | 83,785            | 85,000            |
| ProSieben Sat.1 Media AG(3)(6)(19)                  | Broadcasting & Entertainment      | 8.43% (4.93% Cash & 3.5% PIK)(7)       | 3/6/2017   | 16,911            | 21,022            | 17,276            |
| Richelieu Foods, Inc.(15)                           | Beverage, Food & Tobacco          | 13.75% (12% Cash & 1.75% PIK)(7)       | 5/18/2016  | 22,952            | 22,498            | 22,493            |
| Rug Doctor L.P.(20)(16)                             | Personal, Food & Misc. Services   | 15.50% to 20.00% (wtd. avg. 17.54%)(7) | 10/31/2014 | 53,320            | 50,901            | 47,987            |
| Weetabix Group(3)(5)(19)                            | Beverage, Food & Tobacco          | 9.13% PIK(7)                           | 9/14/2016  | 23,216            | 43,485            | 37,485            |
| Weetabix Group(3)(5)(19)                            | Beverage, Food & Tobacco          | 10.29% PIK(7)                          | 5/3/2017   | 11,274            | 20,168            | 18,203            |
| WireCo. Worldgroup Inc.                             | Building Products                 | 11.75%                                 | 5/15/2017  | 48,000            | 47,536            | 48,960            |
| <b>Total Subordinated Debt/Corporate Notes</b>      |                                   |  |            | <b>\$ 485,494</b> | <b>\$ 508,558</b> | <b>\$ 494,594</b> |

See notes to consolidated financial statements.

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

September 30, 2012

(in thousands, except shares)

| Description(1)   | Industry                        | Interest(2)   | Maturity  | Par Amount/<br>Shares | Cost                | Fair<br>Value       |
|--|---------------------------------|---------------|-----------|-----------------------|---------------------|---------------------|
| <b>Preferred Equity 16.8%</b>  |                                 |               |           |                       |                     |                     |
| Senior Preferred 15% Units of DSW Group  |                                 |               |           |                       |                     |                     |
| Holdings LLC(10)   | Beverage, Food & Tobacco        | 15.00% PIK(7) |           | 1,445,321             | \$ 124,379          | \$ 122,274          |
| SODO Corp.(9)(12)  | Aerospace & Defense             | 8.43% PIK(7)  | 6/30/2018 | 2,117                 | 2,117               | 2,371               |
| SOCAY Limited(9)(12)(19)   | Aerospace & Defense             | 8.59% PIK(7)  | 6/30/2018 | 13,719                | 13,719              | 14,490              |
| SOINT, LLC(9)  | Aerospace & Defense             | 15.00% PIK(7) | 6/30/2018 | 86,667                | 8,667               | 8,667               |
| Wyle Laboratories  | Aerospace & Defense             | 8.00%         | 7/17/2015 | 387                   | 39                  | 50                  |
| <b>Total Preferred Equity</b>  |                                 |               |           |                       | <b>\$ 148,921</b>   | <b>\$ 147,852</b>   |
| <b>Common Equity / Partnership Interests / Warrants 5.9%</b>                   |                                 |               |           |                       |                     |                     |
| Ark Real Estate Partners LP(10)(11) Participating Preferred Units of DSW Group |                                 |               |           |                       |                     |                     |
| Holdings LLC(10)   | Beverage, Food & Tobacco        |               |           | 1,296,078             |                     |                     |
| Grakon, LLC(11)  | Machinery                       |               |           | 1,714,286             | 1,714               |                     |
| Grakon, LLC Warrants(11)   | Machinery                       |               |           | 3,518,001             |                     |                     |
| Great American Group Inc.(13)(19)  | Personal, Food & Misc. Services |               |           | 572,800               | 2,681               | 235                 |
| Great American Group Inc.(13)(19)  | Personal, Food & Misc. Services |               |           | 125,000               |                     |                     |
| Great American Group Inc.(14)(19)  | Personal, Food & Misc. Services |               |           | 187,500               | 3                   | 77                  |
| Nuveen Investments, Inc.   | Finance                         |               |           | 3,486,444             | 30,876              | 10,460              |
| NXP Semiconductors Netherlands B.V.(3)(19)                                     | Electronics                     |               |           | 210,271               | 5,732               | 5,259               |
| Seven West Media Limited(3)(19)  | Broadcasting & Entertainment    |               |           | 656,530               | 2,726               | 769                 |
| <b>Total Common Equity/Partnerships Interests / Warrants</b>                   |                                 |               |           |                       | <b>\$ 88,430</b>    | <b>\$ 51,664</b>    |
| <b>Total Investments 133.4%</b>  |                                 |               |           |                       | <b>\$ 1,230,259</b> | <b>\$ 1,170,627</b> |
| <b>Liabilities in Excess of Other Assets (33.4%)</b>                           |                                 |               |           |                       |                     | <b>(293,024)</b>    |
| <b>Net Assets 100.0%</b>   |                                 |               |           |                       |                     | <b>\$ 877,603</b>   |

- (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 September 30, 2012.
- (3) The following entities are domiciled outside the United States and the investments are denominated in either Euro, British Pounds, Canadian Dollars or Australian Dollars: Weetabix Group in the United Kingdom; ProSieben Sat.1 Media AG in Germany; Granite Global Solutions Corp. 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.
- (4) Solar Capital Ltd.'s foreign domiciled portion of MYI Aquiror Corporation is held through its wholly-owned subsidiary Solar Capital Luxembourg I S.ar.l.

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- (5) Solar Capital Ltd.'s investments in Weetabix Group are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
- (6) 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.
- (7) Coupon is payable in cash and/or in kind (PIK).
- (8) Includes an unfunded commitment of \$5,880.
- (9) 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 Investment Company Act of 1940, as amended (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.
- (10) 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.
- (11) 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.
- (12) Solar Capital Ltd.'s investments in SODO Corp. and SOCA Y Corp. each include a one dollar investment in common shares.
- (13) Founders Shares.
- (14) Contingent Founders Shares.
- (15) Indicates an investment held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC ( SC Funding ). Such investments are pledged as collateral under the Senior Secured Loan Facility (see Note 6 to the consolidated financial statements) and are not generally available to the creditors of Solar Capital Ltd. Unless otherwise noted, as of September 30, 2012, all other investments were pledged as collateral for the Senior Secured Credit Facility, Term Loan and Senior Secured Notes (see Note 6 to the consolidated financial statements).
- (16) Indicates an investment partially held by Solar Capital Ltd. through its wholly-owned subsidiary SC Funding. (See footnote 15 above for further explanation.) Par amounts held through SC Funding include: Asurion Corp \$9,017; Earthbound Farm \$23,500; Fulton Holding Corp. \$18,000; Grocery Outlet Inc. \$19,700; Interactive Health Solutions, Inc. \$14,476; Midcap Financial Intermediate Holdings, LLC \$23,500; Rug Doctor L.P. \$9,756; Transplace Texas, LP \$18,800 and ViaWest Inc. \$15,413. Remaining par balances are held directly by Solar Capital Ltd.

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**SOLAR CAPITAL LTD.**

**CONSOLIDATED SCHEDULE OF INVESTMENTS (unaudited) (continued)**

**September 30, 2012**

**(in thousands, except shares)**

(17) Includes an unfunded commitment of \$1,250.

(18) Investments on non-accrual status.

(19) Indicates assets that the Company believes do 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.

(20) Includes PIK payable on \$12,898 of par at 4.50% PIK, \$14,769 of par at 5.25% PIK, \$15,400 of par at 8.00% PIK, and \$9,669 of par at 3.50% PIK.

(21) Asurion Holdco has the option to pay interest in kind at L+10.25% if certain specified conditions are met.

(22) In March 2012, Solar Capital Ltd. purchased \$36,991 and participated \$7,000 to a third party with no recourse to the Company.

(23) Includes an unfunded commitment of \$15,151

(24) Includes an unfunded commitment of CAD 10,000

See notes to consolidated financial statements.

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

September 30, 2012

(in thousands, except shares)

| Industry Classification                             | Percentage of Total<br>Investments (at fair value) as<br>of September 30, 2012 |
|---|--|
| Beverage, Food & Tobacco                            | 19.8%  |
| Personal, Food & Misc. Services                     | 9.7%   |
| Banking   | 9.4%   |
| Insurance   | 7.4%   |
| Healthcare, Education & Childcare                   | 5.3%   |
| Buildings & Real Estate                             | 5.0%   |
| Farming & Agriculture                               | 4.9%   |
| Aerospace & Defense                                 | 4.9%   |
| Building Products                                   | 4.4%   |
| Leisure, Amusement, Entertainment                   | 4.2%   |
| Retail Stores                                       | 3.9%   |
| Diversified/Conglomerate Service                    | 3.6%   |
| Personal & Nondurable Consumer Products             | 3.3%   |
| Grocery   | 2.8%   |
| Healthcare Technology                               | 2.4%   |
| Machinery   | 1.7%   |
| Cargo Transport                                     | 1.7%   |
| Broadcasting & Entertainment                        | 1.5%   |
| Utilities   | 1.5%   |
| Consumer Finance                                    | 0.9%   |
| Finance   | 0.8%   |
| Electronics   | 0.5%   |
| Home, Office Furnishing & Durable Consumer Products | 0.4%   |
|   | 100%   |

See notes to consolidated financial statements.



**Table of Contents****SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS****December 31, 2011****(in thousands, except shares)**

| Description(1)                              | Industry   | Interest(2)                       | Maturity   | Par Amount/<br>Shares | Cost              | Fair<br>Value     |
|---|--|-----------------------------------|------------|-----------------------|-------------------|-------------------|
| <b>Bank Debt/Senior Secured Loans</b>       |  | <b>51.2%</b>                      |            |                       |                   |                   |
| Asurion Corporation(18)                     | Insurance  | 9.00%                             | 5/24/2019  | \$ 40,000             | \$ 39,811         | \$ 39,517         |
| Airvana Network Solutions Inc.              | Telecommunications                                     | 10.00%                            | 3/25/2015  | 8,324                 | 8,186             | 8,324             |
| AviatorCap SII, LLC I(10)                   | Aerospace & Defense                                    | 12.00%                            | 12/31/2014 | 3,728                 | 3,678             | 3,671             |
| AviatorCap SII, LLC II(10)                  | Aerospace & Defense                                    | 11.00%                            | 12/31/2014 | 5,697                 | 5,618             | 5,611             |
| AviatorCap SII, LLC III(10)                 | Aerospace & Defense                                    | 13.00%                            | 12/31/2014 | 8,856                 | 8,696             | 8,724             |
| Direct Buy Inc.(20)                         | Home, Office Furnishing &<br>Durable Consumer Products | 12.00%                            | 2/1/2017   | 25,000                | 24,332            | 5,875             |
| Fulton Holding Corp(18)                     | Retail Stores  | 13.74%                            | 5/28/2016  | 35,000                | 34,155            | 35,000            |
| Grakon, LLC                                 | Machinery  | 12.00%                            | 12/31/2015 | 9,524                 | 7,610             | 9,286             |
| Good Sam Enterprise, LLC                    | Insurance  | 11.50%                            | 12/1/2016  | 7,000                 | 6,523             | 6,860             |
| Grocery Outlet Inc.                         | Grocery  | 10.50%                            | 12/15/2017 | 33,600                | 32,599            | 32,592            |
| Isotoner Corporation                        | Personal & Nondurable<br>Consumer Products             | 10.75%                            | 1/8/2018   | 39,000                | 37,895            | 37,830            |
| Interactive Health Solutions, Inc.(18)(19)  | Healthcare, Education &<br>Childcare                   | 11.50%                            | 10/4/2016  | 20,131                | 19,691            | 19,930            |
| MYI Acquiror Corporation(3)(4)(8)(21)       |  | 13% (12% Cash &<br>1% PIK)(7)     | 3/13/2017  | 31,500                | 30,899            | 31,500            |
| Roundy's Supermarkets, Inc. 2nd Lien(18)    | Grocery  | 10.00%                            | 4/16/2016  | 22,000                | 21,685            | 22,069            |
| Southern Auto Finance Company(21)           | Banking  | 13.50%                            | 10/19/2017 | 25,000                | 24,453            | 24,437            |
| Spencer Spirit Holdings, Inc.               | Retail Stores  | 11.00%                            | 5/1/2017   | 10,000                | 10,000            | 10,000            |
| Transplace Texas, LP(18)                    | Cargo Transport  | 11.00%                            | 4/12/2017  | 20,000                | 19,533            | 19,500            |
| USAW 767(10)                                | Aerospace & Defense                                    | 14.50%                            | 12/31/2012 | 4,904                 | 4,850             | 4,831             |
| ViaWest Inc(18)                             | Personal, Food & Misc.<br>Services                     | 13.5% (12% Cash<br>& 1.5% PIK)(7) | 5/20/2016  | 33,255                | 32,520            | 32,756            |
| Vision Holding Corp.(18)                    | Healthcare, Education &<br>Childcare                   | 12.00%                            | 11/23/2016 | 37,500                | 36,869            | 37,125            |
| VPSI, Inc.(17)                              | Personal Transportation                                | 12.00%                            | 12/23/2015 | 16,958                | 16,598            | 16,958            |
| <b>Total Bank Debt/Senior Secured Loans</b> |  |                                   |            | <b>\$ 436,977</b>     | <b>\$ 426,201</b> | <b>\$ 412,396</b> |
| <b>Subordinated Debt/Corporate Notes</b>    |  | <b>67.9%</b>                      |            |                       |                   |                   |
| Adams Outdoor Advertising                   | Diversified/Conglomerate<br>Service                    | 18.00%                            | 12/8/2015  | \$ 42,500             | \$ 41,878         | \$ 42,075         |
| AMC Entertainment Holdings, Inc.            | Leisure, Amusement,<br>Entertainment                   | 5.55%PIK                          | 6/13/2012  | 27,141                | 27,086            | 26,462            |
| CIBT Solutions                              | Leisure, Amusement,<br>Entertainment                   | 13.50%                            | 6/15/2018  | 36,200                | 35,389            | 35,386            |
| Crosman Corporation                         |  | 13% (11% Cash &<br>2% PIK)(7)     | 10/15/2016 | 15,219                | 14,808            | 14,762            |
| DSW Group, Inc.                             | Beverage, Food & Tobacco                               | 15% PIK                           | 4/24/2012  | 125,106               | 124,972           | 106,340           |
| Earthbound Farm(18)                         | Farming & Agriculture                                  | 14.25%                            | 6/21/2017  | 58,947                | 57,739            | 56,590            |
| Grakon Holdings LLC Sr                      | Machinery  | 14% PIK                           | 12/31/2015 | 1,588                 | 1,588             | 1,469             |
| Grakon Holdings LLC Jr                      | Machinery  | 12% PIK                           | 12/31/2015 | 15,118                | 12,344            | 7,710             |
| Granite Global Solutions Corp.(3)(16)(21)   | Insurance  | 13.50%                            | 5/31/2016  | 29,983                | 30,234            | 29,121            |
| Magnolia River, LLC                         | Hotels, Motels, Inns and<br>Gaming                     | 14.00%                            | 4/28/2014  | 19,064                | 18,664            | 19,064            |
|   | Banking  | 14.25%                            | 7/9/2015   | 75,000                | 73,542            | 75,000            |

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|   |                                 |                                |            |                   |                   |                   |
|---|---------------------------------|--------------------------------|------------|-------------------|-------------------|-------------------|
| Midcap Financial Intermediate Holdings, LLC(18) |                                 |                                |            |                   |                   |                   |
| ProSieben Sat.1 Media AG(3)(6)(21)              | Broadcasting & Entertainment    | 8.83%(5.3% Cash & 3.5% PIK)(7) | 3/6/2017   | 21,125            | 20,261            | 10,508            |
| Richelieu Foods, Inc.(17)                       | Beverage, Food & Tobacco        | 13.75%                         | 5/18/2016  | 22,500            | 21,972            | 21,150            |
|   |                                 | 15.50% to 20.00%(7)            |            |                   |                   |                   |
| Rug Doctor L.P.(18)(22)                         | Personal, Food & Misc. Services | (wtd. avg. 17.54%)             | 10/31/2014 | 51,225            | 48,034            | 47,383            |
| Shoes For Crews, LLC (17)                       | Textiles & Leather              | 13.75%(7)                      | 7/23/2016  | 15,650            | 15,318            | 15,650            |
| Weetabix Group(3)(5)(21)                        | Beverage, Food & Tobacco        | 9.22% PIK                      | 9/14/2016  | 15,986            | 18,589            | 12,469            |
| Weetabix Group(3)(5)(21)                        | Beverage, Food & Tobacco        | 10.03%PIK                      | 5/3/2017   | 34,294            | 41,739            | 25,720            |
| <b>Total Subordinated Debt/Corporate Notes</b>  |                                 |                                |            | <b>\$ 606,646</b> | <b>\$ 604,157</b> | <b>\$ 546,859</b> |
| <b>Preferred Equity 1.8%</b>                    |                                 |                                |            |                   |                   |                   |
| SODO Corp.(10)(13)                              | Aerospace & Defense             | 8.43% PIK                      |            | 1,912             | \$ 2,009          | \$ 1,949          |
| SOCAY Limited(10)(13)                           | Aerospace & Defense             | 8.59% PIK                      |            | 12,357            | 13,059            | 12,668            |
| Wyle Laboratories                               | Aerospace & Defense             | 8.00%                          | 7/17/2015  | 387               | 39                | 47                |
| <b>Total Preferred Equity</b>                   |                                 |                                |            |                   | <b>\$ 15,107</b>  | <b>\$ 14,664</b>  |

**Table of Contents****SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)****December 31, 2011****(in thousands, except shares)**

| Description(1)   | Industry                                    | Interest(2) | Maturity | Par Amount/<br>Shares | Cost                | Fair<br>Value       |
|--|---|-------------|----------|-----------------------|---------------------|---------------------|
| <b>Common Equity / Partnership Interests / Warrants 8.8%</b> |   |             |          |                       |                     |                     |
| Ark Real Estate Partners LP(9)(11)(12)                       | Buildings & Real Estate                     |             |          | 41,818,834            | \$ 41,819           | \$ 35,820           |
| Grakon, LLC  | Machinery                                   |             |          | 1,714,286             | 1,714               |                     |
| Grakon, LLC Warrants   | Machinery                                   |             |          | 3,518,001             |                     |                     |
| Great American Group Inc.(14)                                | Personal, Food & Misc.<br>Services          |             |          | 572,800               | 2,681               | 69                  |
| Great American Group Inc.(15)                                | Personal, Food & Misc.<br>Services          |             |          | 187,500               | 3                   | 23                  |
| National Specialty Alloys, LLC(10)                           | Mining, Steel, Iron &<br>Nonprecious Metals |             |          | 1,000,000             | 10,000              | 16,000              |
| Nuveen Investments, Inc.                                     | Finance                                     |             |          | 3,486,444             | 30,875              | 7,844               |
| NXP Semiconductors Netherlands B.V.(3)                       | Electronics                                 |             |          | 645,292               | 17,592              | 9,918               |
| Seven West Media Limited                                     | Broadcasting &<br>Entertainment             |             |          | 437,687               | 2,424               | 1,450               |
| <b>Total Common Equity/Partnerships Interests / Warrants</b> |   |             |          |                       | <b>107,108</b>      | <b>71,124</b>       |
| <b>Total Investments 129.7%</b>                              |   |             |          |                       | <b>\$ 1,152,573</b> | <b>\$ 1,045,043</b> |
| <b>Liabilities in Excess of Other Assets (29.7%)</b>         |   |             |          |                       |                     | <b>(239,102)</b>    |
| <b>Net Assets 100.0%</b>                                     |   |             |          |                       |                     | <b>\$ 805,941</b>   |

- (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) For each debt investment we have provided the current interest rate in effect as of December 31, 2011. Variable rate debt investments generally bear interest at a rate that may be determined by reference to LIBOR or EURIBOR, and which may reset daily, quarterly or semi-annually.
- (3) The following entities are domiciled outside the United States and the investments are denominated in British Pounds, Euro, Canadian Dollars or Australian Dollars: Weetabix Group in the United Kingdom; ProSieben Sat.1 Media AG in Germany; Granite Global Solutions Corp. in Canada; and Seven West Media Group Pty Limited in Australia. NXP Semiconductors Netherlands B.V. is domiciled in the Netherlands and \$14,750 of MYI Aquiror Corporation is domiciled in the United Kingdom, but these assets are denominated in US Dollars. All other investments are domiciled in the United States.
- (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 investments in Weetabix Group are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
- (6) Solar Capital Ltd.'s investments in ProSieben Sat. 1 Media AG are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
- (7) Coupon is payable in cash and/or in kind (PIK).
- (8) Includes an unfunded commitment of \$6,000.
- (9) Solar Capital Ltd. has an unfunded commitment of \$2,879.
- (10) 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 Investment Company Act of 1940, as amended (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.
- (11) 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.
- (12) Solar Capital Ltd.'s investment in Ark Real Estate Partners LP is held through its taxable subsidiary SLRC ADI Corp.
- (13)

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SODO Corp. and SOCAPY Corp. own equity interests that represent a majority of the equity ownership in Aviator Cap SII, LLC and USAW 767. Solar Capital Ltd. s investments in SODO Corp. and SOCAPY Corp. each include a one dollar investment in common shares.

(14) Founders Shares.

(15) Contingent Founders Shares.

(16) Includes an unfunded commitment of \$15,600 Canadian Dollars or \$15,313 U.S Dollars as of December 31, 2011.

(17) Indicates an investment held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. Such investments are pledged as collateral under the Senior Secured Loan Facility (see Note 6 to the consolidated financial statements) and are not generally available to the creditors of Solar Capital Ltd. Unless otherwise noted, as of December 31, 2011, all other investments were pledged as collateral for the Senior Secured Revolving Credit Facility and the Term Loan (see Note 6 to the consolidated financial statements).

(18) Indicates an investment partially held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. (See note 17 above for further explanation.) Par amounts held through Solar Capital Funding II LLC include: Asurion \$14,224; Fulton Holding Corp. \$18,000; Interactive Health Solutions, Inc. \$10,236; Roundy s Supermarkets Inc. \$10,000; Transplace Texas, LP \$18,800; ViaWest Inc. \$15,239; Vision Holding Corp \$13,883; Earthbound \$23,500; Midcap Financial Intermediate Holdings, LLC \$23,500; and Rug Doctor L.P. \$9,515. Remaining par balances are held directly by Solar Capital Ltd.

(19) Includes an unfunded commitment of \$1,250.

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**SOLAR CAPITAL LTD.**

**CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)**

**December 31, 2011**

**(in thousands, except shares)**

(20) Investment is on non-accrual status.

(21) Indicates assets that the Company believes do 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.

(22) Includes PIK payable on \$12,466 of par at 4.50% PIK, \$14,405 of par at 5.25% PIK, \$14,839 of par at 8.00% PIK, and \$9,515 of par at 3.50% PIK. See notes to consolidated financial statements.

**Table of Contents****SOLAR CAPITAL LTD.****CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)****December 31, 2011****(in thousands, except shares)**

| <b>Industry Classification</b>                      | <b>Percentage of Total<br/>Investments (at fair value) as<br/>of December 31, 2011</b> |
|---|--|
| Beverage, Food & Tobacco                            | 16%  |
| Insurance   | 10%  |
| Banking   | 10%  |
| Personal, Food & Misc. Services                     | 8%   |
| Leisure, Amusement, Entertainment                   | 7%   |
| Healthcare, Education & Childcare                   | 5%   |
| Farming & Agriculture                               | 5%   |
| Grocery   | 5%   |
| Retail Stores                                       | 4%   |
| Diversified/Conglomerate Service                    | 4%   |
| Personal & Nondurable Consumer Products             | 4%   |
| Aerospace & Defense                                 | 4%   |
| Buildings & Real Estate                             | 3%   |
| Cargo Transport                                     | 2%   |
| Hotels, Motels, Inns and Gaming                     | 2%   |
| Machinery   | 2%   |
| Personal Transportation                             | 2%   |
| Mining, Steel, Iron & Nonprecious Metals            | 1%   |
| Textiles & Leather                                  | 1%   |
| Broadcasting & Entertainment                        | 1%   |
| Electronics   | 1%   |
| Telecommunications                                  | 1%   |
| Finance   | 1%   |
| Home, Office Furnishing & Durable Consumer Products | 1%   |
|   | <b>100%</b>  |

See notes to consolidated financial statements.

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**SOLAR CAPITAL LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)**

**September 30, 2012**

**(in thousands, except shares)**

**Note 1. Organization**

Solar Capital Ltd. ( Solar Capital , we , or the Company ), 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 ). In February 2010, Solar Capital Ltd. completed its initial public offering.

The Company s investment objective is to generate both current income and capital appreciation through debt and equity investments. We invest primarily in leveraged middle-market companies in the form of senior secured loans, mezzanine loans and equity securities. From time to time, we may also invest in public companies. Our business model is focused primarily on the direct origination of investments through portfolio companies or their financial sponsors. Our investments generally range between \$20 million and \$100 million each, although we expect that this investment size will vary, including proportionately with the size of our capital base.

**Note 2. Significant Accounting Policies**

**Basis of Presentation** 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 subsidiaries, Solar Capital Luxembourg I S.a.r.l., which was incorporated under the laws of the Grand Duchy of Luxembourg on April 26, 2007, and Solar Capital Funding II LLC ( SC Funding ), a Delaware limited liability company formed on December 8, 2010. 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 have been reclassified to conform to current year 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 Articles 6 or 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of management, all adjustments, consisting solely of normal recurring accruals considered necessary for the fair presentation of financial statements for the interim period, have been included. The current period s results of operations will not necessarily be indicative of results that ultimately may be achieved for the fiscal year ending December 31, 2012.

**Investments** The Company applies fair value accounting in accordance with GAAP. Securities transactions are accounted for on trade date. Securities for which market quotations are readily available on an exchange are valued at such price as of the closing price on the valuation date. The Company may also obtain quotes with respect to certain of its investments from pricing services or brokers or dealers in order to value assets. When doing so, the Company determines whether the quote obtained is sufficient according to GAAP to determine the fair value of the security. If determined adequate, the Company uses the quote obtained.

Securities for which reliable market quotations are not readily available or for which the pricing source does not provide a valuation or methodology or provides a valuation or methodology that, in the judgment of the Company s Investment Adviser or Board of Directors (the Board ), does not represent fair value, shall each be valued as follows:

- 1) The quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals responsible for the portfolio investment;

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**SOLAR CAPITAL LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)**

**September 30, 2012**

**(in thousands, except shares)**

- 2) Preliminary valuation conclusions are then documented and discussed with senior management;
- 3) Third-party valuation firms are engaged by, or on behalf of, the Board to conduct independent appraisals and review management's preliminary valuations and make their own independent assessment, for all material assets; and
- 4) The Board discusses valuations and determines the fair value of each investment in the portfolio in good faith based on the input of our Investment Adviser (Note 4) and, where appropriate, the respective independent valuation firms.

Valuation methods, among other measures and as applicable, may include comparisons of financial ratios of the portfolio companies that issued such securities to peer companies that are public, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings and discounted cash flows, the markets in which the portfolio company does business, and other relevant factors.

When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, the Company will consider the pricing indicated by the external event to corroborate the valuation. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of the investments may differ significantly from the values that would have been used had a readily available market value existed for such investments, and the differences could be material.

Investments of sufficient credit quality purchased within 60 days of maturity are valued at cost plus accreted discount, or minus amortized premium, which approximates fair value.

**Credit Facilities** The Company has made an irrevocable election to apply the fair value option of accounting to the certain credit facilities and senior secured notes (see Note 6), in accordance with Accounting Standards Codification (ASC) 825-10. The Company uses an independent third-party valuation firm to measure their fair values.

**Cash and Cash Equivalents** Cash and cash equivalents include investments in money market accounts or investments with original maturities of three months or less.

**Revenue Recognition** The Company's revenue recognition policies are as follows:

*Sales:* Gains or losses on the sale of investments are calculated by using the specific identification method.

*Interest Income:* Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as part of interest income. The Company has loans in its portfolio that contain a payment-in-kind (PIK) provision. PIK interest is accrued at the contractual rates and added to the loan principal on the reset dates.

*Dividend Income:* Dividend income on preferred equity securities is recorded as dividend income on an accrual basis to the extent that such amounts are payable by the portfolio company and are expected to be collected. Dividend income on common equity securities is recorded on the record date for private portfolio companies or on the ex-dividend date for publicly traded portfolio companies.

*Non-accrual:* Loans are placed on non-accrual status 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 is





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**SOLAR CAPITAL LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)**

**September 30, 2012**

**(in thousands, except shares)**

generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest are paid and, in management's judgment, are likely to remain current.

**Fee Revenue Receivable** Fee revenue receivable consists of premium payments owed to the Company at the maturity of certain loans. The premium payments are recorded as a receivable at the inception of the loan and are accreted into interest income over the respective terms of the applicable loans.

**Deferred Fee Revenue** Deferred fee revenue represents the unearned portion of premium payments owed to the Company at the maturity of certain loans.

**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 as a RIC, among other things, the Company is required to timely distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code, for each year. Depending on the level of taxable income earned in a given tax year, we may choose to carry forward taxable income in excess of current year dividend distributions into the next tax year and pay a 4% excise tax on such income, as required. To the extent that the Company estimates that its current year annual taxable income may be in excess of estimated current year dividend distributions, the Company may accrue an excise tax on estimated excess taxable income as it is earned. For the nine months ended September 30, 2012, \$343 was accrued for estimated U.S. Federal excise tax.

Although the Company files federal and state tax returns, its major tax jurisdiction is federal. The Company's inception-to-date federal tax years remain subject to examination by the Internal Revenue Service. The Company is also subject to taxes in Luxembourg, through Solar Capital Luxembourg I S.a.r.l., a wholly-owned subsidiary. Under the laws of Luxembourg, the Company pays a corporate income tax and a municipal business tax on its subsidiary's taxable income.

The Company has formed and used certain taxable subsidiaries to be taxed as a corporation for federal income tax purposes. These taxable subsidiaries allow the Company to hold portfolio companies organized as pass-through entities and still satisfy certain RIC income requirements. The Company does not consolidate the taxable subsidiaries for income tax purposes but recognizes the results of these subsidiaries for financial reporting purposes.

The Company evaluates tax positions taken or expected to be taken in the course of preparing its financial statements to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are reversed and recorded as a tax benefit or expense in the current year. All penalties and interest associated with income taxes are included in income tax expense. Conclusions regarding tax positions are subject to review and may be adjusted at a later date based on factors including, but not limited to, on-going analyses of tax laws, regulations and interpretations thereof. The Company did not have any uncertain tax positions that met the recognition or measurement criteria of ASC 740-10-25 nor did it have any unrecognized tax benefits as of the periods presented herein.

**Capital Accounts** Certain capital accounts including under (over) distributed net investment income, accumulated net realized gain or loss, net unrealized depreciation, and paid-in capital in excess of par, are adjusted, at least annually, for permanent differences between book and tax. In addition, the character of income and gains to be distributed is determined in accordance with income tax regulations that may differ from GAAP.

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**SOLAR CAPITAL LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)**

**September 30, 2012**

**(in thousands, except shares)**

At December 31, 2011, as a result of permanent book-to-tax differences, the Company decreased under (over) distributed net investment income by \$4,582, decreased accumulated net realized loss by \$8,555, and decreased paid-in capital in excess of par value by \$3,973. Aggregate stockholders' equity was not affected by this reclassification.

**Dividends** Dividends and distributions to common stockholders are recorded on the ex-dividend date. Quarterly dividend payments are determined by the Board and are generally based upon taxable earnings estimated by management. Net realized capital gains, if any, are typically distributed at least annually, although we may decide to retain such capital gains for investment. We have adopted a dividend reinvestment plan that provides for reinvestment of any distributions we declare in cash on behalf of our stockholders, unless a stockholder elects to receive cash. As a result, if our Board authorizes, and we declare, a cash dividend, then our stockholders who have not opted out of our dividend reinvestment plan will have their cash dividends automatically reinvested in additional shares of our common stock, rather than receiving the cash dividend. While we generally use newly issued shares to implement the plan, we may purchase shares in the open market in connection with our obligations under the plan. In particular, if our shares are trading at a significant discount to net asset value and we are otherwise permitted under applicable law to purchase such shares, we intend to purchase shares in the open market in connection with our obligations under our dividend reinvestment plan.

**Foreign Currency Translation** The accounting records of the Company are maintained in U.S. dollars. Foreign currency amounts are translated into U.S. dollars on the following basis:

- (i) Market value of investment securities, other assets and liabilities at the current rates of exchange.
- (ii) Purchase and sales of investment securities, income and expenses at the rates of exchange prevailing on the respective date of such transactions.

The Company does not isolate that portion of realized and unrealized gains or losses on investments that result from changes in market prices of investments from those that result from fluctuations in foreign exchange rates. Net realized foreign currency gains or losses arise from sales or repayments of foreign denominated investments (recorded in realized gain/loss on investments), maturities or terminations of foreign currency derivatives (recorded in realized gain/loss on derivatives), repayments of foreign denominated liabilities and other transactional gain or loss resulting from fluctuations in foreign exchange rates on amounts received or paid (recorded in realized gain/loss on foreign exchange). Net unrealized foreign exchange gains and losses arise from valuation changes in foreign denominated assets and liabilities, resulting from changes in exchange rates, including unrealized foreign exchange gains and losses on investments (recorded in unrealized gain/loss on investments), foreign currency derivatives (recorded in unrealized gain/loss on derivatives), and all other assets and liabilities (recorded in unrealized gain/loss on foreign exchange).

The Company's investments in foreign securities may involve certain risks such as 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 and therefore the earnings of the Company.

**Derivative Instruments and Hedging Activity** The Company recognizes derivatives as either assets or liabilities at fair value on its Consolidated Statements of Assets and Liabilities with valuation changes recorded as realized or unrealized gains and losses. The Company currently does not have any formally documented hedges that qualify for hedge accounting treatment.

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The Company generally uses foreign exchange forward contracts and/or borrowings on its multicurrency revolving credit facility to minimize foreign currency exchange risks. Changes in the values of the Company's

**Table of Contents****SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2012****(in thousands, except shares)**

foreign denominated assets are recorded in current earnings as realized and unrealized gains and losses; likewise, realized and unrealized gains and losses from derivatives and foreign denominated debt are also recorded in current earnings. The fair value of foreign exchange forward contracts is determined by recognizing the difference between the contract exchange rate and the current market exchange rate. Fluctuations in market values of assets and liabilities denominated in the same foreign currency offset in earnings, providing a natural foreign currency hedge.

The Company may use interest rate caps to create a synthetic ceiling on its borrowing rates. An interest rate cap is a derivative in which the buyer receives payments at the end of each period in which the interest rate exceeds an agreed cap rate. Interest payments on the Company's credit facilities are primarily LIBOR based. By purchasing caps on LIBOR, if LIBOR exceeds the cap rate, the Company will pay a higher interest rate on its credit facilities but receive an offsetting payment from the cap counterparty on the notional amount above the cap rate. Caps have an initial cost. The fair value of interest rate caps is determined using option pricing models that use readily available market inputs.

**Deferred Offering Costs** The Company records expenses related to shelf registration statement filings and other applicable offering costs as prepaid assets. These expenses are charged to capital upon utilization, in accordance with ASC 946-20-25.

**Receivable for Investments Sold** Receivable for investments sold represents a receivable for investments that have been sold but the proceeds have not been received.

**Payable for Investments Purchased** Payable for investments purchased represents a liability for investments that have been purchased but the proceeds have not been paid and any unfunded loan commitments.

**Deferred Credit Facility Costs** Deferred credit facility costs are amortized over the life of the related credit facility unless the fair value option was elected in accordance with ASC 825-10.

**Use of Estimates in the Preparation of Financial Statements** The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reported period. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ materially.

**Subsequent Events Evaluation** The Company evaluates the need for disclosures and/or adjustments resulting from subsequent events through the date the financial statements were issued.

**Note 3. Investments**

Investments consisted of the following as of September 30, 2012 and December 31, 2011:

|  | September 30, 2012  |                     | December 31, 2011   |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | Cost                | Fair Value          | Cost                | Fair Value          |
| Bank Debt/Senior Secured Loans               | \$ 484,350          | \$ 476,517          | \$ 426,201          | \$ 412,396          |
| Subordinated Debt/Corporate Notes            | 508,558             | 494,594             | 604,157             | 546,859             |
| Preferred Equity                             | 148,921             | 147,852             | 15,107              | 14,664              |
| Common Equity/Partnership Interests/Warrants | 88,430              | 51,664              | 107,108             | 71,124              |
| <b>Total</b>                                 | <b>\$ 1,230,259</b> | <b>\$ 1,170,627</b> | <b>\$ 1,152,573</b> | <b>\$ 1,045,043</b> |



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**SOLAR CAPITAL LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)**

**September 30, 2012**

**(in thousands, except shares)**

As of September 30, 2012, the Company had two non-accrual assets with a total market value of \$20,725. As of December 31, 2011, there was one non-accrual asset with a market value of \$5,875.

**Note 4. Agreements**

Solar Capital has an Investment Advisory and Management Agreement with Solar Capital Partners, LLC (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), commencing on February 12, 2007, and equals 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 capital gains upon which prior performance-based capital gains incentive fee payments were previously made to the adviser. For financial statement presentation purposes, a fee is accrued to include unrealized capital appreciation. No accrual was required for the capital gains based incentive fee for the nine months ended September 30, 2012 or for the year ended December 31, 2011.

Solar Capital has also entered into an Administration Agreement with Solar Capital Management, LLC (the "Administrator") under which the Administrator provides administrative services for 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.

**Table of Contents****SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2012****(in thousands, except shares)****Note 5. Derivatives**

The Company is exposed to interest rate risk both as a lender and a borrower. The Company's borrowing facilities and term loan bear interest at a floating rate, which means that rising interest rates would increase our cost of borrowing. To partially mitigate this risk, in 2011, the Company purchased two interest rate cap contracts, which effectively limit the interest rate payable on \$150 million of LIBOR based borrowings. The following table highlights the outstanding interest rate caps:

| Index Rate    | Cap Rate | Notional Amount | Expiration | Cost     | September 30, 2012 |                         | December 31, 2011 |                         | Counterparty |
|---------------|----------|-----------------|------------|----------|--------------------|-------------------------|-------------------|-------------------------|--------------|
|               |          |                 |            |          | Fair Value         | Unrealized Depreciation | Fair Value        | Unrealized Depreciation |              |
| 3 Month Libor | 1.0%     | \$ 100,000      | 1/13/2014  | \$ 1,950 | \$ 14              | \$ (1,936)              | \$ 279            | \$ (1,671)              | Wells Fargo  |
| 3 Month Libor | 1.0%     | 50,000          | 5/4/2014   | 988      | 16                 | (972)                   | 190               | (798)                   | Wells Fargo  |
|               |          | \$ 150,000      |            | \$ 2,938 | \$ 30              | \$ (2,908)              | \$ 469            | \$ (2,469)              |              |

The Company is also exposed to foreign exchange risk through its investments denominated in foreign currencies. The Company attempts to mitigate this risk through the use of foreign currency forward contracts and/or borrowing in local currencies. As an investment company, all changes in the fair value of assets, including changes caused by foreign currency fluctuation, flow through current earnings.

As of September 30, 2012, there were no open forward foreign currency contracts outstanding. As of December 31, 2011, there were two open forward foreign currency contracts entered into with SunTrust, one selling 966 Euro and the other selling 12,989 GBP, for USD values of \$1,295 and \$20,308 at December 31, 2011, respectively. Unrealized appreciation as of December 31, 2011 totaled \$180, or \$44 and \$136, respectively, for the Euro and GBP foreign currency forward contracts.

The Company had no derivatives designated as hedging instruments at September 30, 2012 and December 31, 2011.

**Note 6. Borrowing Facilities and Senior Secured Notes**

*Senior Secured Credit Facility* In June 2012, Solar Capital Ltd. entered into a \$485 million Senior Secured Credit Facility comprised of \$450 million of multi-currency revolving credit and a \$35 million term loan. In August 2012, the Company added \$40 million under the Facility's accordion feature split \$25 million in USD revolving credit commitments and \$15 million in a term loan. Borrowings bear interest at a rate per annum equal to LIBOR plus 2.50% or the alternate base rate plus 1.50%. The Facility has no LIBOR floor requirement. Citibank N.A. acted as Administrative Agent, JPMorgan Chase Bank, N.A. acted as Syndication Agent, and SunTrust Bank acted as Documentation Agent for the Facility. The Facility matures in July 2016 and includes a ratable amortization in the fourth year. At September 30, 2012, total outstanding USD equivalent borrowings under the Facility were \$135,907.

The Facility may be increased up to \$800 million with new or existing lenders. The Facility also contains certain customary affirmative and negative covenants and events of default. In addition, the Facility contains certain financial covenants that among other things, requires the Company to maintain a minimum shareholder's equity and a minimum asset coverage ratio. The Company will pay the issuers of the term loans quarterly in arrears a commitment fee at the rate of 0.25% per annum on the average daily outstanding balance.

In conjunction with the establishment of the Facility, the predecessor facility and a term loan was retired, resulting in \$2,295 of non-recurring charges to expense unamortized costs.





**Table of Contents****SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2012****(in thousands, except shares)**

At September 30, 2012, the Company had outstanding non-USD borrowings on the revolving portion of the Facility. Unrealized appreciation (depreciation) on these outstanding borrowings is indicated in the table below:

| <b>Foreign Currency</b> | <b>Local<br/>Currency<br/>Amount</b> | <b>US\$ Basis<br/>of<br/>Borrowing</b> | <b>Current<br/>Value</b> | <b>Unrealized<br/>Appreciation<br/>(Depreciation)</b> |
|-------------------------|--------------------------------------|--|--------------------------|---|
| British Pound           | 22,000                               | \$ 34,617                              | \$ 35,521                | (\$ 904)  |
| British Pound           | 3,000                                | \$ 4,659                               | \$ 4,844                 | (\$ 185)  |
| British Pound           | 10,000                               | \$ 15,530                              | \$ 16,146                | (\$ 616)  |
| Euro                    | 11,000                               | \$ 13,589                              | \$ 14,134                | (\$ 545)  |
| Canadian Dollar         | 15,000                               | \$ 15,205                              | \$ 15,262                | (\$ 57)   |
|                         |                                      | \$ 83,600                              | \$ 85,907                | (\$ 2,307)  |

*Senior Secured Notes* On May 10, 2012, the Company closed a private offering of \$75,000 of Senior Secured Notes ( Private Notes ) with a fixed interest rate of 5.875% and a maturity date of May 10, 2017. Interest on the Private Notes is due semi-annually on May 10<sup>th</sup> and November 10<sup>th</sup>. The Private Notes were issued in a private placement only to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended.

*Senior Secured Loan Facility* On December 17, 2010, Solar Capital Ltd. entered into a \$100 million senior secured credit facility (the \$100 Million Facility ) with Wells Fargo Securities LLC, as administrative agent. Solar Capital entered into (i) a Purchase and Sale Agreement (the Purchase and Sale Agreement ) with SC Funding, pursuant to which Solar Capital will sell to SC Funding certain loans that it has originated or acquired, or will originate or acquire (the Loans ) from time to time; (ii) a Loan and Servicing Agreement (the Loan and Servicing Agreement and, together with the Purchase and Sale Agreement, the Agreements ) with SC Funding as borrower; and (iii) various supporting documentation. The \$100 Million Facility is secured by all of the assets held by SC Funding. The \$100 Million Facility, among other things, matures on December 17, 2015 and bears interest based on LIBOR plus 2.75%. Under the Agreements, Solar Capital and SC Funding, as applicable, are required to comply with various covenants, reporting requirements and other customary requirements for similar credit facilities. The Purchase and Sale Agreement includes usual and customary events of default for credit facilities of this nature.

The Company has made an irrevocable election to apply the fair value option of accounting to the Facility and the Private Notes in accordance with ASC 825-10. Accounting for the Facility and the Private Notes at fair value will better align the measurement methodologies of assets and liabilities, which may mitigate certain earnings volatility. As a result of this election, \$3,881 and \$1,128 of costs related to the establishment of the Facility and the Private Notes, respectively, were expensed as incurred, rather than being deferred and amortized over the life of the obligation. ASC 825-10 requires entities to record the fair value of the selected assets and liabilities on the face of the Consolidated Statements of Assets and Liabilities and changes in fair value of the Facility and the Private Notes are reported in the Consolidated Statements of Operations. For the three and nine months ended September 30, 2012, the Facility and the Private Notes had no net change in price as a percentage of par but recognizes unrealized (appreciation) depreciation on non-USD borrowings due to changes in foreign exchange rates as noted in the table above.

The weighted average annualized interest cost for all borrowings for the nine months ended September 30, 2012 and 2011 was 4.74% and 3.53%, respectively. These costs are exclusive of commitment fees and for other prepaid expenses, if any, related to establishing the Facility, the Private Notes, and the \$100 Million Credit Facility (collectively the Credit Facilities. ) This weighted average annualized interest cost reflects the average



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**SOLAR CAPITAL LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)**

**September 30, 2012**

**(in thousands, except shares)**

interest cost for all outstanding borrowings. For the nine months ended September 30, 2012 and 2011, average debt outstanding was \$184,061 and \$117,092, respectively. The maximum amounts borrowed on the Credit Facilities during the nine months ended September 30, 2012 and 2011 was \$279,327 and \$435,356, respectively. There was \$248,362 drawn on the Credit Facilities as of September 30, 2012 and \$236,355 as of December 31, 2011. At September 30, 2012 and December 31, 2011, the Company was in compliance with all financial and operational covenants required by the Credit Facilities.

**Note 7. 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 (examples include active exchange-traded equity securities, exchange-traded derivatives, and most U.S. Government and agency securities).

**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 (examples include corporate and municipal bonds, which trade infrequently);
- c) Pricing models whose inputs are observable for substantially the full term of the asset or liability (examples include most over-the-counter derivatives, including foreign exchange forward contracts); 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 (examples include certain of our private debt and equity investments) and long-dated or complex derivatives (including certain equity and currency derivatives).

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

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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). Further, it should be noted that the following tables do not take into consideration the effect of offsetting Levels 1 and 2 financial instruments entered into by the Company that economically hedge certain exposures to the Level 3 positions.

**Table of Contents****SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2012****(in thousands, except shares)**

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, 2012 and December 31, 2011:

**Fair Value Measurements****As of September 30, 2012**

|  | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|--|----------------|----------------|----------------|--------------|
| <b>Assets:</b>                                   |                |                |                |              |
| Bank Debt/Senior Secured Loans                   |                | 25,920         | 450,597        | 476,517      |
| Subordinated Debt / Corporate Notes              |                | 30,076         | 464,518        | 494,594      |
| Preferred Equity                                 |                |                | 147,852        | 147,852      |
| Common Equity / Partnership Interests / Warrants | 6,340          |                | 45,324         | 51,664       |
| Derivative assets interest rate caps contracts   |                | 30             |                | 30           |
| <b>Liabilities:</b>                              |                |                |                |              |
| The Facility and Private Notes                   |                |                | 210,907        | 210,907      |

**Fair Value Measurements****As of December 31, 2011**

|  | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|--|----------------|----------------|----------------|--------------|
| <b>Assets:</b>                                   |                |                |                |              |
| Bank Debt/Senior Secured Loans                   | \$             | \$ 46,377      | \$ 366,019     | \$ 412,396   |
| Subordinated Debt / Corporate Notes              |                | 10,508         | 536,351        | 546,859      |
| Preferred Equity                                 |                |                | 14,664         | 14,664       |
| Common Equity / Partnership Interests / Warrants | 11,460         |                | 59,664         | 71,124       |
| Derivative assets interest rate cap              |                | 469            |                | 469          |
| Derivative assets forward contracts              |                | 180            |                | 180          |

**Table of Contents****SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2012****(in thousands, except shares)**

The tables below provide a summary of the changes in fair value of Level 3 assets and liabilities for the nine months ended September 30, 2012 and the year ended December 31, 2011, 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, 2012 and December 31, 2011:

**Fair Value Measurements Using Level 3 Inputs****As of September 30, 2012**

|   | <b>Bank Debt/<br/>Senior<br/>Secured<br/>Loans</b> | <b>Subordinated Debt/<br/>Corporate Notes</b> | <b>Preferred Equity</b> | <b>Common<br/>Equity/<br/>Partnership<br/>Interests/<br/>Warrants</b> |
|---|--|---|-------------------------|---|
| <b>Fair value, December 31, 2011</b>  | \$ 366,019   | \$ 536,351                                    | \$ 14,664               | \$ 59,664   |
| Total gains or losses included in earnings:   |  |   |                         |   |
| Net realized gain (loss)  |  | (20,322)                                      |                         | 11,002  |
| Net change in unrealized gain (loss)  | 4,439  | 36,181  | (624)                   | (7,220)   |
| Purchase of investment securities   | 170,748  | 92,174  | 134,090                 | 2,879   |
| Proceeds from dispositions of investment securities   | (90,609)   | (179,866)                                     | (278)                   | (21,001)  |
| Transfers in/out of Level 3   |  |   |                         |   |
| <b>Fair value, September 30, 2012</b>   | \$ 450,597   | \$ 464,518                                    | \$ 147,852              | \$ 45,324   |
| 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):   | \$ (9,408)   | \$ (11,363)                                   | \$ (1,068)              | \$ (31,964)   |

During the nine months ended September 30, 2012, there were no transfers in and out of Levels 1 and 2.

**Fair Value Measurements Using Level 3 Inputs****As of December 31, 2011**

|  | <b>Bank Debt/<br/>Senior<br/>Secured<br/>Loans</b> | <b>Subordinated Debt/<br/>Corporate Notes</b> | <b>Preferred Equity</b> | <b>Common<br/>Equity/<br/>Partnership<br/>Interests/<br/>Warrants</b> |
|--|--|---|-------------------------|---|
|--|--|---|-------------------------|---|

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|   |             |             |           |           |
|---|-------------|-------------|-----------|-----------|
| <b>Fair value, December 31, 2010</b>  | \$ 200,532  | \$ 566,308  | \$ 3,934  | \$ 53,092 |
| Total gains or losses included in earnings:   |             |             |           |           |
| Net realized gain (loss)  | (87)        | 6,218       |           | (4,500)   |
| Net change in unrealized gain (loss)  | (13,392)    | (6,991)     | (448)     | 6,931     |
| Purchase of investment securities   | 247,421     | 115,852     | 11,178    | 7,942     |
| Proceeds from dispositions of investment securities   | (68,455)    | (103,971)   |           | (3,801)   |
| Transfers in/out of Level 3   |             | (41,065)    |           |           |
| <b>Fair value, December 31, 2011</b>  | \$ 366,019  | \$ 536,351  | \$ 14,664 | \$ 59,664 |
| 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):   | \$ (15,535) | \$ (17,844) | \$ (448)  | \$ 4,988  |



**Table of Contents****SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2012****(in thousands, except shares)**

During 2011, one investment with a fair value of \$41,065 was transferred from Level 3 to Level 2 as a result of an increase in the availability and reliability of third party market quotes for this investment. During 2011, one asset with a fair value of \$9,900 was transferred from Level 2 to Level 1 when trading restrictions expired on a publicly traded equity investment.

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, 2012:

|  | <b>For the nine<br/>months ended<br/>September 30, 2012</b> |
|--|---|
| <b><u>The Facility and Private Notes</u></b> |   |
| Beginning fair value                         | \$  |
| Total unrealized appreciation                |   |
| Borrowings                                   | 314,907   |
| Repayments                                   | (104,000)   |
| Transfers in/out of Level 3                  |   |
| Ending fair value                            | \$ 210,907  |

The Company has made an irrevocable election to apply the fair value option of accounting to the Facility and the Private Notes, in accordance with ASC 825-10. On September 30, 2012, there were borrowings of \$135,907 and \$75,000, respectively, on the Facility and the Private Notes. For the three and nine months ended September 30, 2012, the Facility and the Private Notes had no net change in unrealized (appreciation) depreciation. The Company used an independent third-party valuation firm to measure the fair value of the Facility and Private Notes.

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 EBITDA multiples of similar companies, and comparable market transactions for equity securities.

**Table of Contents****SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2012****(in thousands, except shares)**

Quantitative information about the Company's Level 3 asset and liability fair value measurements as of September 30, 2012 is summarized in the table below:

## Quantitative Information about Level 3 Fair Value Measurements

|                                    | Asset or Liability | Fair Value at September 30, 2012 | Valuation Techniques/Methodology             | Unobservable Input              | Range (Weighted Average) |
|------------------------------------|--------------------|----------------------------------|--|---------------------------------|--------------------------|
| Senior Secured / Bank Debt         | Asset              | \$ 450,597                       | Yield Analysis/Market Approach/Broker quoted | Market Yields / Bid-Ask Spreads | 10.5% - 17.0% (12.9%)    |
| Subordinated Debt / Corporate Note | Asset              | \$ 464,518                       | Yield Analysis/Market Approach/Broker quoted | Market Yields / Bid-Ask Spreads | 12.00% - 18.0% (14.7%)   |
| Preferred Equity                   | Asset              | \$ 147,852                       | Yield Analysis                               | Market Yields                   | 8.0% - 15.00% (14.3%)    |
| Common Equity                      | Asset              | \$ 45,324                        | Market Approach                              | Enterprise Value                | 6.8x - 10.0x             |
| The Facility                       | Liability          | \$ 135,907                       | Yield Analysis/Market Approach               | Market Yields                   | L+0.5% - L+5.5% (L+2.7%) |
| Private Notes                      | Liability          | \$ 75,000                        | Yield Analysis/Market Approach               | Market Yields                   | 4.5% - 7.3% (6.7%)       |

Significant increases or decreases in any of the above unobservable inputs in isolation, including unobservable inputs used in deriving bid-ask spreads, if applicable, would result in a significantly lower or higher fair value measurement for such assets and liabilities.

**Note 8. Earnings Per Share**

The following information sets forth the computation of basic and diluted earnings (loss) per share, pursuant to ASC 260-10, for the three and nine months ended September 30, 2012 and 2011, respectively:

|   | Three months ended September 30, 2012 | Three months ended September 30, 2011 | Nine months ended September 30, 2012 | Nine months ended September 30, 2011 |
|---|---------------------------------------|---------------------------------------|--------------------------------------|--------------------------------------|
| Numerator for basic and diluted increase in net assets per share: | \$ 30,243                             | \$ (51,944)                           | \$ 92,463                            | \$ 9,458                             |
| Denominator for basic and diluted weighted average share:         | 36,948,921                            | 36,498,451                            | 36,732,790                           | 36,442,550                           |
| Basic and diluted earnings (loss) per share:                      | \$ 0.82                               | \$ (1.42)                             | \$ 2.52                              | \$ 0.26                              |

**Note 9. Taxation**

We did not have any uncertain tax positions that met the recognition or measurement criteria of ASC 740-10-25, *Income Taxes*, nor did we have any unrecognized tax benefits as of the periods presented herein. Although we file federal and state tax returns, our major tax jurisdiction is

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federal. Our inception-to-date federal tax years remain subject to examination by the Internal Revenue Service.

**Table of Contents****SOLAR CAPITAL LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****September 30, 2012****(in thousands, except shares)****Note 10. Financial Highlights**

The following is a schedule of financial highlights for the nine months ended September 30, 2012 and for the year ended December 31, 2011:

|   | <b>Nine months<br/>ended<br/>September 30, 2012</b> | <b>Year ended<br/>December 31, 2011</b> |
|---|---|---|
| <b>Per Share Data:(a)</b>                                   |   |   |
| Net asset value, beginning of year                          | \$ 22.02  | \$ 22.73                                |
| Net investment income                                       | 1.57  | 2.25                                    |
| Net realized and unrealized gain (loss)                     | 0.95  | (0.57)                                  |
| <b>Net increase in net assets resulting from operations</b> | <b>2.52</b>   | <b>1.68</b>                             |
| Dividends to shareholders                                   | (1.83)  | (2.40)                                  |
| Effect of dilution  | (0.01)  | 0.01                                    |
| Net asset value, end of period                              | \$ 22.70  | \$ 22.02                                |
| <b>Total return(b)</b>                                      | <b>12.23%</b>                                       | <b>(1.07)%</b>                          |
| Net assets, end of period                                   | \$ 877,603  | \$ 805,941                              |
| Per share market value at end of period                     | \$ 22.92  | \$ 22.09                                |
| Shares outstanding end of period                            | 38,667,196  | 36,608,038                              |
| <b>Ratio to average net assets:(c)</b>                      |   |   |
| Expenses without incentive fees                             | 4.76%   | 4.45%                                   |
| Incentive fees  | 1.75%   | 2.49%                                   |
| Total expenses  | 6.51%   | 6.94%                                   |
| Net investment income                                       | 6.99%   | 9.97%                                   |
| Portfolio turnover ratio                                    | 39.21%  | 34.54%                                  |

(a) Calculated using the average shares outstanding method

(b)

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Total return is based on the change in market price per share during the period and takes into account dividends reinvested with the dividend reinvestment plan. Not annualized for periods less than one year.

(c) Not annualized for nine months ended September 30, 2012

**Table of Contents****SOLAR CAPITAL LTD.****SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES (unaudited)**

(in thousands, except shares)

**Schedule 12-14**

| Portfolio Company  | Investment                  | As of<br>September 30, 2012<br>Number of<br>Shares/Principal<br>Amount | Nine months ended<br>September 30, 2012<br>Amount of<br>dividends and<br>interest included<br>in<br>income | Amount of<br>equity<br>in<br>net<br>profit<br>and loss | As of<br>September 30, 2012<br>Fair Value |
|--|-----------------------------|--|--|--|---|
| <b>Investments Owned Greater than 25%</b>                        |                             |  |  |  |   |
| AviatorCap SII, LLC I  | Senior Secured Debt         | 3,225  | \$ 345   | \$   | \$ 3,225                                  |
| AviatorCap SII, LLC II   | Senior Secured Debt         | 4,733  | 479  |  | 4,733                                     |
| AviatorCap SII, LLC III  | Senior Secured Debt         | 5,151  | 824  |  | 5,152                                     |
| USAW 767   | Senior Secured Debt         | 3,539  | 173  |  | 3,539                                     |
| SODO Corp.   | Preferred Equity/<br>Common | 2,117  | 130  |  | 2,371                                     |
| SOCAY Corp.  | Preferred Equity/<br>Common | 13,719   | 858  |  | 14,490                                    |
| SOINT, LLC   | Senior Secured Debt         | 16,667   | 387  |  | 16,333                                    |
| SOINT, LLC   | Preferred Equity/<br>Common | 86,667   | 196  |  | 8,667                                     |
| <b>Total Investments Owned Greater than 25%</b>                  |                             |  | \$ 3,392   | \$   | \$ 58,510                                 |
| <b>Investments Owned Greater than 5% and Less than 25%</b>       |                             |  |  |  |   |
| Ark Real Estate Partners LP                                      | Equity                      | 44,697,684   | \$   | \$   | \$ 34,864                                 |
| AREP Fifty-Seventh LLC   | Senior Debt                 | 19,769   | 430  |  | 19,373                                    |
| ARK Real Estate Partners II LP                                   | Senior Debt                 | 8,027  | 38   |  | 7,866                                     |
| DS Waters of America, Inc.                                       | Senior Debt                 | 30,689   | 1,207  |  | 31,763                                    |
| Senior Preferred 15% Units of DSW Group Holdings LLC             | Preferred Equity            | 1,445,321  | 9,471  |  | 122,274                                   |
| Participating Preferred Units of DSW Group Holdings LLC          | Common Equity               | 1,296,078  |  |  |   |
| <b>Total Investments Owned Greater than 5% and Less than 25%</b> |                             |  | \$ 11,146  | \$   | \$ 216,140                                |

**Table of Contents****SOLAR CAPITAL LTD.****SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES (unaudited) (continued)**

(in thousands, except shares)

The table below represents the balance at the beginning of the year, December 31, 2011 and any gross additions and reductions and net unrealized gain (loss) made to such investments as well as the ending fair value as of September 30, 2012.

Gross additions represent increases in the investment from additional investments, payments in kind of interest or dividends.

Gross reductions represent decreases in the investment from sales of investments or repayments.

|   | Beginning<br>Fair Value<br>December 31,<br>2011 | Gross<br>additions | Gross<br>reductions | Change in<br>Unrealized<br>Gain<br>(Loss) | Fair Value<br>as of<br>September 30,<br>2012 |
|---|---|--------------------|---------------------|---|--|
| AviatorCap SII, LLC I                                   | \$ 3,671  | \$ 19              | \$ 503              | \$ 38                                     | \$ 3,225                                     |
| AviatorCap SII, LLC II                                  | 5,611   | 27                 | 964                 | 58  | 4,732  |
| AviatorCap SII, LLC III                                 | 8,724   | 83                 | 3,704               | 49  | 5,152  |
| USAW 767  | 4,831   | 34                 | 1,365               | 39  | 3,539  |
| SODO Corp.  | 1,949   | 107                |                     | 315                                       | 2,371  |
| SOCAY Corp.   | 12,668  | 660                |                     | 1,162                                     | 14,490                                       |
| SOINT, LLC  |   | 16,343             |                     | (10)                                      | 16,333                                       |
| SOINT, LLC  |   | 8,667              |                     |   | 8,667  |
| Ark Real Estate Partners LP                             | 35,820  | 2,879              |                     | (3,835)                                   | 34,864                                       |
| AREP Fifty-Seventh LLC                                  |   | 19,769             |                     | (396)                                     | 19,373                                       |
| ARK Real Estate Partners II LP                          |   | 8,027              |                     | (161)                                     | 7,866  |
| DS Waters of America, Inc.                              |   | 36,437             | 6,755               | 2,081                                     | 31,763                                       |
| Senior Preferred 15% Units of DSW Group<br>Holdings LLC |   | 124,532            | 276                 | (1,982)                                   | 122,274                                      |

**Schedule 12-14**

| Portfolio Company                               | Investment              | Year ended December 31, 2011  |  |   | As of<br>December 31,<br>2011<br>Fair Value |
|---|-------------------------|---|--|---|---|
|   |                         | As of<br>December 31, 2011<br>Number of<br>Shares/Principal<br>Amount | Amount of<br>dividends and<br>interest included<br>in income | Amount of<br>equity in<br>net<br>profit<br>and loss |   |
| <b>Investments Owned Greater than 25%</b>       |                         |   |  |   |   |
| AviatorCap SII, LLC I                           | Senior Debt             | 3,678   | \$ 288   | \$  | \$ 3,671                                    |
| AviatorCap SII, LLC II                          | Senior Debt             | 5,618   | 243  |   | 5,611                                       |
| AviatorCap SII, LLC III                         | Senior Debt             | 8,696   | 628  |   | 8,724                                       |
| USAW 767  | Senior Debt             | 4,850   | 920  |   | 4,831                                       |
| SODO Corp.                                      | Preferred Equity/Common | 2,009   | 96   |   | 1,949                                       |
| SOCAY Corp.                                     | Preferred Equity/Common | 13,059  | 686  |   | 12,668                                      |
| National Specialty Alloys, LLC                  | Equity                  | 10,000  | 4,102  |   | 16,000                                      |
| <b>Total Investments Owned Greater than 25%</b> |                         |   | \$ 6,963   | \$  | \$ 53,454                                   |

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**Investments Owned Greater than 5% and Less than 25%**

|                             |        |            |        |
|-----------------------------|--------|------------|--------|
| Ark Real Estate Partners LP | Equity | 41,818,834 | 35,820 |
|-----------------------------|--------|------------|--------|

**Total Investments Owned Greater than 5% and Less than 25%**

\$ \$ \$ 35,820



**Table of Contents****SOLAR CAPITAL LTD.****SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES (unaudited) (continued)**

(in thousands, except shares)

The table below represents the balance at the beginning of the year, December 31, 2010 and any gross additions and reductions and net unrealized gain (loss) made to such investments as well as the ending fair value as of December 31, 2011.

Gross additions represent increases in the investment from additional investments, amortization and payments in kind of interest or dividends.

Gross reductions represent decreases in the investment from sales of investments or repayments.

|                                | <b>Beginning<br/>Fair Value<br/>December 31,<br/>2010</b> | <b>Gross<br/>additions</b> | <b>Gross<br/>reductions</b> | <b>Change<br/>in<br/>Unrealized<br/>Gain<br/>(Loss)</b> | <b>Fair Value<br/>as of<br/>December 31,<br/>2011</b> |
|--------------------------------|---|----------------------------|-----------------------------|---|---|
| AviatorCap SII, LLC I          | \$  | \$ 4,047                   | \$ 369                      | (7)   | \$ 3,671  |
| AviatorCap SII, LLC II         |   | 6,094                      | 476                         | (7)   | 5,611   |
| AviatorCap SII, LLC III        |   | 10,062                     | 1,366                       | 28  | 8,724   |
| USAW 767                       | 6,618   | 76                         | 1,848                       | (15)  | 4,831   |
| SODO Corp.                     | 390   | 1,619                      |                             | (60)  | 1,949   |
| SOCAY Corp.                    | 3,500   | 9,559                      |                             | (391)   | 12,668  |
| National Specialty Alloys, LLC | 10,000  |                            |                             | 6,000   | 16,000  |
| Ark Real Estate Partners LP    | 29,235  | 7,066                      | 53                          | (428)   | 35,820  |

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Solar Capital Ltd.:

We have reviewed the accompanying consolidated statement of assets and liabilities, including the consolidated schedule of investments, of Solar Capital Ltd. (the Company) as of September 30, 2012, and the consolidated statements of operations for the three and nine-month periods ended September 30, 2012 and 2011, the consolidated statement of changes in net assets for the nine-month period ended September 30, 2012 and consolidated statements of cash flows for the nine-month periods ended September 30, 2012 and 2011. These consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial accounting and reporting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated statement of assets and liabilities, including the consolidated schedule of investments, of Solar Capital Ltd. as of December 31, 2011, and the related consolidated statement of changes in net assets for the year ended December 31, 2011 and we expressed an unqualified opinion on them in our report dated February 22, 2012.

/s/ KPMG LLP

New York, New York

November 1, 2012

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

The following analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the notes thereto contained elsewhere in this report.

#### **Overview**

Solar Capital Ltd. ( "Solar", 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 we have elected to be treated as a regulated investment company ( "RIC" ) under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code" ). In February 2010, we completed our initial public offering and a concurrent private offering of shares to management.

We invest primarily in U.S. middle market companies, where we believe the supply of primary capital is limited and the investment opportunities are most attractive. Our investment objective is to generate both current income and capital appreciation through debt and equity investments. We invest primarily in leveraged middle market companies in the form of senior secured loans, mezzanine loans and equity securities. From time to time, we may also invest in public companies that are thinly traded. Our business model is focused primarily on the direct origination of investments through portfolio companies or their financial sponsors. Our investments generally range between \$20 million and \$100 million each, although we expect that this investment size will vary proportionately with the size of our capital base. We are managed by Solar Capital Partners, LLC. Solar Capital Management, LLC provides the administrative services necessary for us to operate.

In addition, we may invest a portion of our portfolio in other types of investments, which we refer to as opportunistic investments, which are not our primary focus but are intended to enhance our overall returns. These investments may include, but are not limited to, direct investments in public companies that are not thinly traded and securities of leveraged companies located in select countries outside of the United States.

As of September 30, 2012, our investments totaled \$1.17 billion and our net asset value was \$877.6 million. Our portfolio was comprised of debt and equity investments in 41 portfolio companies and our income producing assets, which represented 93.8% of our total portfolio at fair value, had a weighted average annualized yield on a fair value basis of approximately 13.9%.

#### ***Recent Developments***

##### *Dividend*

On November 1, 2012, our board of directors declared a quarterly dividend of \$0.60 per share payable on January 3, 2013 to holders of record as of December 20, 2012. We expect the dividend to be paid from taxable earnings with specific tax characteristics reported to stockholders after the end of the calendar year.

#### **Critical Accounting Policies**

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the periods reported. Actual results could materially differ from those estimates. We have identified the following items as critical accounting policies.

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### ***Valuation of Portfolio Investments***

We conduct the valuation of our assets, pursuant to which our net asset value is determined, at all times consistent with GAAP, and the 1940 Act. Our valuation procedures are set forth in more detail below:

Securities for which market quotations are readily available on an exchange are valued at the closing price on the day of valuation. We may also obtain quotes with respect to certain of our investments from pricing services or brokers or dealers in order to value assets. When doing so, we determine whether the quote obtained is sufficient according to GAAP to determine the fair value of the security. If determined reliable, we use the quote obtained.

Securities for which reliable market quotations are not readily available or for which the pricing source does not provide a valuation or methodology or provides a valuation or methodology that, in the judgment of our investment adviser or board of directors, does not represent fair value, shall be valued as follows: (i) each portfolio company or investment is initially valued by the investment professionals responsible for the portfolio investment; (ii) preliminary valuation conclusions are documented and discussed with our senior management; (iii) independent third-party valuation firms engaged by, or on behalf of, the board of directors will conduct independent appraisals and review management's preliminary valuations and make their own assessment for all material assets; (iv) the board of directors will discuss valuations and determine the fair value of each investment in our portfolio in good faith based on the input of the investment adviser and, where appropriate, the respective third-party valuation firms.

The recommendation of fair value will generally be based on the following factors, as relevant:

the nature and realizable value of any collateral including credit risk;

the portfolio company's ability to make payments;

the portfolio company's earnings and discounted cash flow;

the markets in which the issuer does business and; and

comparisons to publicly traded securities.

Securities for which market quotations are not readily available or for which a pricing source is not sufficient may include, but are not limited to, the following:

private placements and restricted securities that do not have an active trading market;

securities whose trading has been suspended or for which market quotes are no longer available;

debt securities that have recently gone into default and for which there is no current market;

securities whose prices are stale;

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securities affected by significant events; and

securities that the investment adviser believes were priced incorrectly.

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

GAAP fair value measurement guidance classifies the inputs used to measure these fair values into the following hierarchy:

**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 (examples include active exchange-traded equity securities, exchange-traded derivatives, and most U.S. Government and agency securities).

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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 (examples include corporate and municipal bonds, which trade infrequently);
- c) Pricing models whose inputs are observable for substantially the full term of the asset or liability (examples include most over-the-counter derivatives, including foreign exchange forward contracts); 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 (examples include certain of our private debt and equity investments) and long-dated or complex derivatives (including certain equity and currency derivatives).

**Fair Value Measurements****As of September 30, 2012**

|  | Level 1 | Level 2 | Level 3 | Total   |
|--|---------|---------|---------|---------|
| <b>Assets:</b>                                   |         |         |         |         |
| Bank Debt/Senior Secured Loans                   |         | 25,920  | 450,597 | 476,517 |
| Subordinated Debt / Corporate Notes              |         | 30,076  | 464,518 | 494,594 |
| Preferred Equity                                 |         |         | 147,852 | 147,852 |
| Common Equity / Partnership Interests / Warrants | 6,340   |         | 45,324  | 51,664  |
| Derivative assets – interest rate caps           |         | 30      |         | 30      |
| <b>Liabilities:</b>                              |         |         |         |         |
| The Facility and Private Notes                   |         |         | 210,907 | 210,907 |

At September 30, 2012, the fair value of investments classified as Level 3 was approximately \$1,108 million or 92.3% of total assets. There were no investments transferred in or out of Level 3 during the 3rd quarter of 2012.

**Revenue Recognition**

Our revenue recognition policies are as follows:

*Sales:* Gains or losses on the sale of investments are calculated by using the specific identification method.

*Interest Income:* Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as part of interest income. We have loans in our portfolio that contain a PIK provision. PIK interest is accrued at the contractual rates and added to the loan principal on the reset dates.

*Non-accrual:* Loans are placed on non-accrual status 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 is

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generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment about ultimate collectability of principal. Non-accrual loans are restored to accrual status when past due principal and interest is paid and, in management's judgment, are likely to remain current.

### ***Payment-in-Kind Interest***

We have investments in our portfolio which contain a PIK interest provision. Over time, PIK interest increases the principal balance of the investment, but is recorded as interest income. For us to maintain our status as a RIC, substantially all of this income must be paid out to stockholders in the form of dividends, even though we have not currently collected cash with respect to the PIK interest.

### ***New Accounting Pronouncements and Accounting Standards Updates***

In May 2011, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 was issued concurrently with International Financial Reporting Standards No. 13 (IFRS 13), Fair Value Measurements, to provide largely identical guidance about fair value measurement and disclosure requirements as is currently required under ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820). The new standards did not extend the use of fair value but, rather, provided guidance about how fair value should be applied where it already is required or permitted under IFRS or GAAP. For GAAP, most of the changes were clarifications of existing guidance or wording changes to align with IFRS 13. ASU 2011-04 eliminated the concepts of in-use and in-exchange when measuring fair value of all financial instruments. For Level 3 fair value measurements, the ASU requires that our disclosure include quantitative information about significant unobservable inputs, a qualitative discussion about the sensitivity of the fair value measurement to changes in the unobservable inputs and the interrelationship between inputs, and a description of our valuation process. Public companies were required to apply ASU 2011-04 prospectively for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a significant impact on the Company's financial statements or its disclosures.

### ***Portfolio Investments***

The total value of our investments was approximately \$1.17 billion and \$1.05 billion at September 30, 2012 and December 31, 2011, respectively. During the three months ended September 30, 2012, we invested approximately \$27.2 million in two new portfolio companies and \$0.2 million in one existing portfolio company. During the nine months ended September 30, 2012, we originated approximately \$191.8 million of investments in seven new portfolio companies and approximately \$89.9 million was invested in six existing portfolio companies.

In certain instances, we receive payments on our debt investments based on scheduled amortization of the outstanding balances. In addition, we may receive repayments of certain debt investments prior to their scheduled maturity date. The frequency or volume of these repayments may fluctuate significantly from period to period. Our portfolio activity may also reflect sales of securities. For the three months ended September 30, 2012, we had approximately \$64.5 million in debt investments repaid as well as \$7.0 million of investments sold. For the nine months ended September 30, 2012, we had approximately \$176.7 million in debt investments repaid and sales of securities of approximately \$36.4 million.

At September 30, 2012, we had investments in 41 portfolio companies that include debt and preferred securities in 37 portfolio companies, totaling approximately \$1.12 billion, and equity investments in seven portfolio companies totaling approximately \$51.7 million. At December 31, 2011, we had investments in 42 portfolio companies that include debt and preferred securities of 36 portfolio companies, totaling approximately \$973.9 million, and equity investments in seven portfolio companies totaling approximately \$71.1 million.

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The following table shows the fair value of our portfolio of investments by asset class as of September 30, 2012 and December 31, 2011 (in thousands):

|  | September 30, 2012  |                     | December 31, 2011   |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | Cost                | Fair Value          | Cost                | Fair Value          |
| Bank Debt/Senior Secured Loans               | \$ 484,350          | \$ 476,517          | \$ 426,201          | \$ 412,396          |
| Subordinated Debt/Corporate Notes            | 508,558             | 494,594             | 604,157             | 546,859             |
| Preferred Equity                             | 148,921             | 147,852             | 15,107              | 14,664              |
| Common Equity/Partnership Interests/Warrants | 88,430              | 51,664              | 107,108             | 71,124              |
| <b>Total</b>                                 | <b>\$ 1,230,259</b> | <b>\$ 1,170,627</b> | <b>\$ 1,152,573</b> | <b>\$ 1,045,043</b> |

As of September 30, 2012, the Company had two non-accrual assets with a total market value of \$20,725. As of December 31, 2011, there was one non-accrual asset with a market value of \$5,875.

As of September 30, 2012 and December 31, 2011, the weighted average yield on income producing investments in our portfolio based on fair market value was approximately 13.9% and 14.2%, respectively. The weighted average yield on income producing investments in our portfolio based on cost was approximately 13.9% and 13.2%, respectively.

***Results of Operations for the Three and Nine Months Ended September 30, 2012 compared to the Three and Nine Months Ended September 30, 2011***

*Investment Income*

For the three and nine months ended September 30, 2012, gross investment income totaled \$40.6 million and \$111.8 million, respectively. For the three and nine months ended September 30, 2011, gross investment income totaled \$35.3 million and \$102.9 million, respectively. The increase in gross investment income for the three and nine months ended September 30, 2012 as compared to the three and nine months ended September 30, 2011 was primarily due to a larger average earning asset base partially offset by a slightly lower weighted average yield on the comparative portfolios.

*Expenses*

Total expenses, including income taxes, totaled \$18.4 million and \$54.0 million, respectively, for the three and nine months ended September 30, 2012, of which \$11.6 million and \$31.5 million, respectively, were base management fees and performance-based incentive fees and \$3.5 million and \$15.2 million, respectively, were interest and other debt expenses. Administrative services and other general and administrative expenses totaled \$3.2 million and \$7.0 million, respectively, for the three and nine months ended September 30, 2012. Total expenses, including income taxes, totaled \$14.6 million and \$41.7 million, respectively, for the three and nine months ended September 30, 2011, of which \$10.5 million and \$30.6 million, respectively, were base management fees and performance-based incentive fees and \$2.2 million and \$6.2 million, respectively, were interest and other debt expenses. Administrative services and other general and administrative expenses totaled \$1.6 million and \$4.1 million, respectively, for the three and nine months ended September 30, 2011. Expenses consist of base investment advisory and management fees, insurance expenses, administrative services fees, legal fees, directors' fees, audit and tax services expenses, and other general and administrative expenses. The increase in expenses from the September 2012 periods to the September 2011 periods was primarily due to an increase in interest and related expenses associated with the establishment of a new credit facility and the issuance of private notes, together with a larger average outstanding debt balance relative to comparative periods. In addition, higher administrative services and other general and administrative expenses were primarily related to higher legal, insurance and tax services expense.



**Table of Contents***Net Investment Income*

The Company's net investment income totaled \$22.3 million and \$57.7 million, or \$0.60 and \$1.57, on a per average share basis, respectively, for the three and nine months ended September 30, 2012. The Company's net investment income totaled \$20.7 million and \$61.2 million, or \$0.57 and \$1.68 on a per average share basis, respectively, for the three and nine months ended September 30, 2011.

*Net Realized Gains (Losses)*

Net realized gains (losses) for the three and nine months ended September 30, 2012 were \$0.4 million and (\$9.6) million, respectively. For the three and nine months ended September 30, 2011, net realized gains (losses) totaled \$2.1 million and (\$2.3) million, respectively. Net realized gains were not significant for the three months ended September 30, 2012 but net realized losses for the nine month period ended September 30, 2012 were primarily derived from the recapitalization of our investment in DSW Group. Realized losses incurred upon the exit of this investment reversed out previously reported unrealized losses. Net realized gains and net realized losses for the three and nine months ended September 30, 2011, respectively, were primarily derived from selected exits of outperforming and underperforming investments.

*Net Unrealized Appreciation (Depreciation) on Investments, Foreign Currencies and Derivatives*

For the three and nine months ended September 30, 2012, the net change in unrealized appreciation (depreciation) on the Company's investments, cash equivalents, foreign currencies and other assets and liabilities totaled \$7.6 million and \$44.4 million, respectively. For the three and nine months ended September 30, 2011, the net change in unrealized appreciation (depreciation) on the Company's investments, cash equivalents, foreign currencies and other assets and liabilities totaled (\$74.8) million and (\$49.4) million, respectively. For the three and nine months ended September 30, 2012, unrealized appreciation was derived from a general tightening of credit spreads and modestly improved overall health of the investment portfolio. For the three and nine months ended September 30, 2011, unrealized depreciation was derived from a temporary spike in credit spreads and generally weaker market conditions during the period.

*Net Increase (Decrease) in Net Assets Resulting From Operations*

For the three and nine months ended September 30, 2012, the Company had a net increase in net assets resulting from operations of \$30.2 million and \$92.5 million, respectively. For the three months ended September 30, 2011, the Company had a net decrease in net assets resulting from operations of \$51.9 million. For the nine months ended September 30, 2011, the Company had a net increase in net assets resulting from operations of \$9.5 million. For the three and nine months ended September 30, 2012 earnings per average share were \$0.82 and \$2.52, respectively. Losses per average share were \$1.42 for the three months ended September 30, 2011. For the nine months ended September 30, 2011, earnings per average share totaled \$0.26.

**Liquidity and Capital Resources**

The Company's liquidity and capital resources are generated and generally available through its \$525 million credit facility maturing in July 2016 (the Facility) and a \$100 million credit facility maturing in December 2015, through cash flows from operations, investment sales, repayments of senior and subordinated loans, income earned on investments and cash equivalents, and we expect periodic follow-on equity and/or debt offerings. We may from time to time issue such securities in either public or private offerings. The issuance of debt or equity securities will depend on future market conditions, funding needs and other factors and there can be no assurance that any such issuance will occur or be successful. The primary use of existing funds and any funds raised in the future is expected to be for investments in portfolio companies, repayment of indebtedness, cash distributions to our shareholders, or for other general corporate purposes.

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On August 23, 2012, the Company entered into its most recent follow-on public equity offering of 2.0 million shares of common stock at \$22.51 per share raising approximately \$45.0 million in proceeds. In the future, the Company may raise additional equity or debt capital, among other considerations.

At September 30, 2012 and December 31, 2011, we had cash and cash equivalents of approximately \$13.0 million and \$11.8 million, respectively. Cash (used) and provided by operating activities for the nine months ended September 30, 2012 and 2011 was approximately (\$15.7) million and \$30.9 million, respectively. We expect that all current liquidity needs will be met with cash flows from operations and other activities.

**Credit Facilities and Senior Secured Notes** In June 2012, Solar Capital Ltd. entered into a \$485 million Senior Secured Credit Facility comprised of \$450 million of multi-currency revolving credit and a \$35 million term loan. In August 2012, the Company added \$40 million under the Facility's accordion feature split \$25 million in revolving credit commitments and \$15 million in a term loan. Borrowings bear interest at a rate per annum equal to the base rate plus 2.50% or the alternate base rate plus 1.50% and has no LIBOR floor requirement. The increased \$525 Million Facility matures in July 2016 and includes a ratable amortization in the fourth year. With additional new lenders or the increase in commitments of current lenders, the Facility may be increased up to \$800 million. The Facility contains certain customary affirmative and negative covenants and events of default. In addition, the Facility contains certain financial covenants that among other things, requires the Company to maintain a minimum shareholder's equity and a minimum asset coverage ratio. The Company will also pay issuers of term loans quarterly in arrears a commitment fee at the rate of 0.25% per annum on the average daily outstanding balance. In conjunction with the establishment of the Facility, a predecessor facility and term loan were retired.

On May 10, 2012, the Company closed a private offering of \$75,000 of Senior Secured Notes ( Private Notes ) with a fixed interest rate of 5.875% and a maturity date of May 10, 2017. Interest on the Private Notes is due semi-annually on May 10<sup>th</sup> and November 10<sup>th</sup>. The Private Notes were issued in a private placement only to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended.

On December 17, 2010, we established the \$100 Million Facility with Wells Fargo Securities, LLC acting as administrative agent. In connection with the \$100 Million Facility, our wholly-owned financing subsidiary, Solar Capital Funding II, LLC ( SC Funding ), as borrower, entered into a Loan and Servicing Agreement whereby we transferred certain loans we have originated or acquired or will originate or acquire from time to time to SC Funding via a Purchase and Sale Agreement. The \$100 Million Facility, as amended, among other things, matures on December 17, 2015 and generally bears interest based on LIBOR plus 2.75%. The \$100 Million Facility is secured by all of the assets held by SC Funding. Under the \$100 Million Facility, Solar and SC Funding, as applicable, have made certain customary representations and warranties, and are required to comply with various covenants, reporting requirements and other customary requirements for similar credit facilities. The \$100 Million Facility includes usual and customary events of default for credit facilities of this nature.

Certain covenants may restrict our business activities, including limitations that could hinder our ability to finance additional loans and investments or to make the distributions required to maintain our status as a RIC under Subchapter M of the Code.

**Contractual Obligations**

A summary of our significant contractual payment obligations is as follows as of September 30, 2012:

| (in millions)                                 | Total    | Payments Due by Period |           |           |                      |
|---|----------|------------------------|-----------|-----------|----------------------|
|   |          | Less than<br>1 Year    | 1-3 Years | 3-5 Years | More Than<br>5 Years |
| Senior secured revolving credit facilities(1) | \$ 123.4 | \$                     | \$        | \$ 123.4  | \$                   |
| Senior Secured Notes                          | \$ 75.0  | \$                     | \$        | \$ 75.0   | \$                   |
| Term Loan                                     | \$ 50.0  | \$                     | \$        | \$ 50.0   | \$                   |

(1) As of September 30, 2012, we had approximately \$452 million of unused borrowing capacity under our credit facilities.

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We have certain commitments pursuant to our Investment Advisory and Management Agreement entered into with Solar Capital Partners, LLC. We have agreed to pay a fee for investment advisory and management services consisting of two components – a base management fee and an incentive fee. Payments under the Investment Advisory and Management Agreement are equal to (1) a percentage of the value of our average gross assets and (2) a two-part incentive fee. We have also entered into a contract with Solar Capital Management, LLC to serve as our administrator. Payments under the Administration Agreement are equal to an amount based upon our allocable portion of Solar Capital Management, LLC's overhead in performing its obligation under the agreement, including rent, fees, and other expenses inclusive of our allocable portion of the compensation of our chief financial officer and any administrative staff.

**Off-Balance Sheet Arrangements**

In the normal course of its business, we trade various financial instruments and may enter into various investment activities with off-balance sheet risk, which include forward foreign currency contracts. Generally, these financial instruments represent future commitments to purchase or sell other financial instruments at specific terms at future dates. These financial instruments contain varying degrees of off-balance sheet risk whereby changes in the market value or our satisfaction of the obligations may exceed the amount recognized in our Consolidated Statement of Assets and Liabilities.

**Distributions and Dividends**

The following table reflects the cash distributions, including dividends and returns of capital, if any, per share that we have declared on our common stock since our initial public offering:

| <b>Date Declared</b> | <b>Record Date</b> | <b>Payment Date</b> | <b>Amount</b> |
|----------------------|--------------------|---------------------|---------------|
| <b>Fiscal 2012</b>   |                    |                     |               |
| November 1, 2012     | December 20, 2012  | January 3, 2013     | \$ 0.60       |
| July 31, 2012        | September 20, 2012 | October 2, 2012     | \$ 0.60       |
| May 1, 2012          | June 19, 2012      | July 3, 2012        | 0.60          |
| February 22, 2012    | March 20, 2012     | April 3, 2012       | 0.60          |
| <i>Total 2012</i>    |                    |                     | \$ 2.40       |
| <b>Fiscal 2011</b>   |                    |                     |               |
| November 1, 2011     | December 15, 2011  | December 29, 2011   | \$ 0.60       |
| August 2, 2011       | September 20, 2011 | October 4, 2011     | 0.60          |
| May 2, 2011          | June 17, 2011      | July 5, 2011        | 0.60          |
| March 1, 2011        | March 17, 2011     | April 4, 2011       | 0.60          |
| <i>Total 2011</i>    |                    |                     | \$ 2.40       |
| <b>Fiscal 2010</b>   |                    |                     |               |
| November 2, 2010     | December 17, 2010  | December 30, 2010   | \$ 0.60       |
| August 3, 2010       | September 17, 2010 | October 4, 2010     | 0.60          |
| May 4, 2010          | June 17, 2010      | July 2, 2010        | 0.60          |
| January 26, 2010     | March 18, 2010     | April 1, 2010       | 0.34*         |
| <i>Total 2010</i>    |                    |                     | \$ 2.14       |

\* Partial period dividend of \$0.60 per share prorated for the number of days that remained in the quarter after our initial public offering. Tax characteristics of all dividends will be reported to shareholders on Form 1099 after the end of each calendar year. Future quarterly dividends, if any, will be determined by our board of directors.



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We have elected to be taxed as a RIC under Subchapter M of the Code. To maintain our RIC status, we must distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of the assets legally available for distribution. In addition, although we currently intend to distribute net realized capital gains (net long-term capital gains in excess of short-term capital losses), if any, at least annually, out of the assets legally available for such distributions, we may in the future decide to retain such capital gains for investment.

We maintain an opt out dividend reinvestment plan for our common stockholders. As a result, if we declare a dividend, then stockholders cash dividends will be automatically reinvested in additional shares of our common stock, unless they specifically opt out of the dividend reinvestment plan so as to receive cash dividends.

## **Related Parties**

We have entered into a number of business relationships with affiliated or related parties, including the following:

We have entered into an Investment Advisory and Management Agreement with Solar Capital Partners, LLC. Mr. Gross, our chairman and chief executive officer, is the managing member and a senior investment professional of, and has financial and controlling interests in, Solar Capital Partners, LLC. In addition, Mr. Spohler, our chief operating officer is a partner and a senior investment professional of, and has financial interests in, Solar Capital Partners, LLC.

Solar Capital Management, LLC provides us with the office facilities and administrative services necessary to conduct day-to-day operations pursuant to our Administration Agreement. We reimburse Solar Capital Management, LLC for the allocable portion of overhead and other expenses incurred by it in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions, and the compensation of our chief compliance officer, our chief financial officer and any administrative support staff. Solar Capital Partners, LLC, our Investment Adviser, is the sole member of and controls Solar Capital Management, LLC.

We have entered into a license agreement with Solar Capital Partners, LLC, pursuant to which Solar Capital Partners, LLC has granted us a non-exclusive, royalty-free license to use the name Solar Capital.

Solar Capital Partners, LLC and its affiliates may also manage other funds in the future that may have investment mandates that are similar, in whole and in part, with ours. For example, Solar Capital Partners, LLC presently serves as investment adviser to Solar Senior Capital Ltd., a publicly traded BDC, which focuses on investing primarily in senior secured loans, including first lien, unitranche and second lien debt instruments. In addition, Michael S. Gross, our chairman and chief executive officer, Bruce Spohler, our chief operating officer, and Richard Peteka, our chief financial officer, serve in similar capacities for Solar Senior Capital Ltd.

Solar Capital Partners, LLC and its affiliates may determine that an investment is appropriate for us and for one or more of those other funds. In such event, depending on the availability of such investment and other appropriate factors, Solar Capital Partners, LLC or its affiliates may determine that we should invest side-by-side with one or more other funds. Any such investments will be made only to the extent permitted by applicable law and interpretive positions of the SEC and its staff, and consistent with Solar Capital Partners, LLC's allocation procedures.

In addition, we have adopted a formal code of ethics that governs the conduct of our officers and directors. Our officers and directors also remain subject to the duties imposed by both the 1940 Act and the Maryland General Corporation Law.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosure about Market Risk**

We are subject to financial market risks, including changes in interest rates. During the nine months ended September 30, 2012, certain of the loans in our portfolio had floating interest rates and our credit facilities also incur floating rate interest. Interest rates on these loans are typically based on floating LIBOR and reset to current market rates every one to six months. A moderate change in interest rates would not have a material effect on our net investment income. However, we may hedge against interest rate fluctuations from time-to-time by using standard hedging instruments such as futures, options, swaps, caps and forward contracts subject to the requirements of the 1940 Act. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of higher interest rates with respect to our portfolio of investments. During 2011, we purchased two 1.00% LIBOR caps on a total of \$150 million of notional for 3 years. If during the three year contract period LIBOR exceeds 1.00%, we will receive payments from the counterparty equal to the difference between LIBOR and 1.00% on \$150 million. The cost of the caps was approximately \$2.9 million.

The following table quantifies the potential changes in interest income net of interest expense should interest rates increase by 100 or 200 basis points or decrease by 25 basis points. Investment income is calculated as revenue from loans and other lending investments held at September 30, 2012. Interest expense is calculated separately for each of our borrowings. For our credit facilities, we use the balance and interest rate as of September 30, 2012 and adjust the interest rate based on the hypothetical changes below. The base interest rate case assumes the rates on our portfolio investments remain as they were on September 30, 2012. All of the hypothetical calculations are based on a model of our portfolio for the twelve months subsequent to September 30, 2012 and assume no change to any input other than the underlying base interest rates. Actual results could differ significantly from those estimated in the table.

| Change in Interest Rates | Estimated Percentage<br>Change in<br>Interest<br>Income Net of Interest<br>Expense<br>(Unaudited) |
|--------------------------|---|
| -25 Basis Points         | 0.27%   |
| Base Interest Rate       | 0.00%   |
| +100 Basis Points        | (0.73%)   |
| +200 Basis Points        | (0.82%)   |

**Item 4. Controls and Procedures****(a) Evaluation of Disclosure Controls and Procedures**

As of September 30, 2012 (the end of the period covered by this report), we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Act of 1934, as amended). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective and provided reasonable assurance that information required to be disclosed in our periodic Securities and Exchange Commission (SEC) filings is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of such possible controls and procedures.

**(b) Changes in Internal Controls Over Financial Reporting**

Management has not identified any change in the Company's internal control over financing reporting that occurred during the third quarter of 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We, Solar Capital Management, LLC and Solar Capital Partners, LLC are not currently subject to any material pending legal proceedings threatened against us. From time to time, we 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 the outcome of these legal proceedings cannot be predicted with certainty, we do not expect that these proceedings will have a material effect upon our business, financial condition or results of operations.

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which could materially affect our business, financial condition and/or operating results. The risks described in our Annual Report on Form 10-K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and/or operating results. There have been no material changes to the risk factors during the nine months ended September 30, 2012 discussed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011.

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

We did not engage in unregistered sales of equity securities during the quarter ended September 30, 2012.

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosure**

Not applicable.

**Item 5. Other Information**

None

**Table of Contents****Item 6. Exhibits**

## (a) Exhibits

The following exhibits are filed as part of this report or hereby incorporated by reference to exhibits previously filed with the SEC:

| Exhibit |   |
|---------|---|
| Number  | Description   |
| 3.1     | Articles of Amendment and Restatement(2)  |
| 3.2     | Amended and Restated Bylaws(2)  |
| 4.1     | Form of Common Stock Certificate(3)   |
| 4.2     | Form of Indenture(7)  |
| 10.1    | Dividend Reinvestment Plan(2)   |
| 10.2    | Form of Senior Secured Credit Agreement by and between the Registrant, Citibank, N.A., as administrative agent, the lenders party thereto, JPMorgan Chase Bank, N.A., as syndication agent, and SunTrust Bank, as documentation agent(8)  |
| 10.3    | Form of Loan and Servicing Agreement by and among the Registrant, Solar Capital Funding II LLC, Wells Fargo Securities, LLC, as administrative agent, Wells Fargo Delaware Trust Company, as collateral agent and Wells Fargo Bank, N.A., as account bank and collateral custodian(5)             |
| 10.4    | Investment Advisory and Management Agreement by and between Registrant and Solar Capital Partners, LLC(1)   |
| 10.5    | Form of Custodian Agreement(3)  |
| 10.6    | Administration Agreement by and between Registrant and Solar Capital Management, LLC(1)   |
| 10.7    | Form of Indemnification Agreement by and between Registrant and each of its directors(2)  |
| 10.8    | First Amendment to the Registration Rights Agreement by and between Registrant, Solar Cayman Limited, Solar Offshore Limited, Citigroup Global Markets Inc., J.P. Morgan Securities Inc. and purchasers in the initial private placement(1)   |
| 10.9    | Registration Rights Agreement by and between Registrant, Magnetar Capital Fund, LP and Solar Offshore Limited(2)  |
| 10.10   | Trademark License Agreement by and between Registrant and Solar Capital Partners, LLC(2)  |
| 10.11   | Form of Registration Rights Agreement(4)  |
| 10.12   | Form of Purchase and Sale Agreement by and between the Registrant and Solar Capital Funding II LLC(5)   |
| 10.13   | Amendment No. 2 to the Loan and Servicing Agreement by and among Registrant, Solar Capital Funding II LLC, Wells Fargo Securities, LLC, as administrative agent, Wells Fargo Delaware Trust Company, as collateral agent, and Wells Fargo Bank, N.A., as account bank and collateral custodian(6) |
| 11      | Computation of Per Share Earnings (included in the notes to the financial statements contained in this report).   |
| 31.1    | Certification of Chief Executive Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended.  |
| 31.2    | Certification of Chief Financial Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended.  |
| 32.1    | Certification of Chief Executive Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.   |
| 32.2    | Certification of Chief Financial Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.   |



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- (1) Previously filed in connection with Solar Capital Ltd. s registration statement on Form N-2 (File No. 333-148734) filed on January 18, 2008.
- (2) Previously filed in connection with Solar Capital Ltd. s registration statement on Form N-2 Pre-Effective Amendment No. 7 (File No. 333-148734) filed on January 7, 2010.
- (3) Previously filed in connection with Solar Capital Ltd. s registration statement on Form N-2 (File No. 333-148734) filed on February 9, 2010.
- (4) Previously filed in connection with Solar Capital Ltd. s report on Form 8-K filed on November 29, 2010.
- (5) Previously filed in connection with Solar Capital Ltd. s report on Form 8-K filed on December 22, 2010.
- (6) Previously filed in connection with Solar Capital Ltd. s report on Form 8-K filed on February 8, 2012.
- (7) Previously filed in connection with Solar Capital Ltd. s registration statement on Form N-2 Pre-Effective Amendment No. 1 (File No. 333-172968) filed on July 6, 2011.
- (8) Previously filed in connection with Solar Capital Ltd. s report on Form 8-K filed on July 6, 2012.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on November 1, 2012.

SOLAR CAPITAL LTD.

By: /s/ MICHAEL S. GROSS  
**Michael S. Gross**  
**Chief Executive Officer**  
**(Principal Executive Officer)**

By: /s/ RICHARD L. PETEKA  
**Richard L. Peteka**  
**Chief Financial Officer**  
**(Principal Financial and Accounting Officer)**