

Solar Capital Ltd.
Form 10-Q
November 01, 2012
[Table of Contents](#)

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.

Table of Contents

SOLAR CAPITAL LTD.

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

TABLE OF CONTENTS

	PAGE
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
<u>Consolidated Statements of Assets and Liabilities as of September 30, 2012 (unaudited) and December 31, 2011</u>	1
<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2012 (unaudited) and September 30, 2011 (unaudited)</u>	2
<u>Consolidated Statements of Changes in Net Assets for the nine months ended September 30, 2012 (unaudited) and the year ended December 31, 2011</u>	3
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 (unaudited) and September 30, 2011 (unaudited)</u>	4
<u>Consolidated Schedule of Investments as of September 30, 2012 (unaudited)</u>	5
<u>Consolidated Schedule of Investments as of December 31, 2011</u>	9
<u>Notes to Consolidated Financial Statements (unaudited)</u>	13
<u>Report of Independent Registered Public Accounting Firm</u>	30
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	31
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	40
Item 4. <u>Controls and Procedures</u>	40
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	41
Item 1A. <u>Risk Factors</u>	41
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
Item 3. <u>Defaults upon Senior Securities</u>	41
Item 4. <u>Mine Safety Disclosures</u>	41
Item 5. <u>Other Information</u>	41
Item 6. <u>Exhibits</u>	42
<u>Signatures</u>	44

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

(in thousands, except shares)

	September 30,	
	2012	December 31,
	(unaudited)	2011
Assets		
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
Total investments (cost: \$1,230,259 and \$1,152,573, respectively)	1,170,627	1,045,043
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
Total Assets	1,200,160	1,079,431
Liabilities		
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
Total Liabilities	322,557	273,490
Net Assets		
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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Total Net Assets	\$ 877,603	\$ 805,941
Number of shares outstanding	38,667,196	36,608,038
Net Asset Value Per Share	\$ 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 ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
INVESTMENT INCOME:				
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
Total investment income	40,646	35,329	111,788	102,906
EXPENSES:				
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
Total operating expenses	18,328	14,274	53,719	40,879
Net investment income before income tax expense	22,318	21,055	58,069	62,027
Income tax expense	60	344	343	798
Net investment income	22,258	20,711	57,726	61,229
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, DERIVATIVES AND FOREIGN CURRENCIES:				
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
Net realized gain (loss)	356	2,100	(9,633)	(2,343)
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)
Net realized and unrealized gain (loss) on investments, derivatives and foreign currencies	7,985	(72,655)	34,737	(51,771)
Net Increase (Decrease) in Net Assets Resulting From Operations	\$ 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 September 30, 2012 (unaudited)	Year ended December 31, 2011
Increase in net assets resulting from operations:		
Net investment income	\$ 57,726	\$ 81,904
Net realized loss	(9,633)	(2,393)
Net change in unrealized gain (loss)	44,370	(18,196)
Net increase in net assets resulting from operations	92,463	61,315
Dividends and distributions to shareholders:	(67,149)	(87,532)
Capital share transactions:		
Common equity offering	45,020	
Reinvestment of dividends	1,328	5,164
Total capital share transactions	46,348	5,164
Net increase (decrease) in net assets	71,662	(21,053)
Net assets at beginning of period	805,941	826,994
Net assets at end of period	\$ 877,603	\$ 805,941

See notes to consolidated financial statements.

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

(in thousands except shares)

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Cash Flows from Operating Activities:		
Net increase in net assets from operations	\$ 92,463	\$ 9,458
Adjustments to reconcile net increase in net assets from operations to net cash (used) provided by operating activities:		
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)
(Increase) decrease in operating assets:		
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)
Increase (decrease) in operating liabilities:		
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
Net Cash (Used) Provided by Operating Activities	(15,693)	30,874
Cash Flows from Financing Activities:		
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)
Net Cash Provided (Used) in Financing Activities	16,954	(85,764)
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,261	(54,890)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	11,787	288,732
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 13,048	\$ 233,842

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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
Non-cash financing activity:				
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/ Shares	Cost	Fair Value
Bank Debt/Senior Secured Loans-54.3%						
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 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 & 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 & 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, 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 Products	10.75%	1/8/2018	39,000	38,009	38,610
Interactive Health Solutions, Inc.(16)(17)	Healthcare, Education & Childcare	11.50%	10/4/2016	19,775	19,395	19,894
MYI Acquiror Corporation(4)(8)(19)	Insurance	13% (12% Cash & 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 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 & 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 & 1.5% PIK)(7)	5/20/2018	40,691	39,712	40,691
Total Bank Debt/Senior Secured Loans				\$ 495,430	\$ 484,350	\$ 476,517
Subordinated Debt/Corporate Notes 56.4%						
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
Total Subordinated Debt/Corporate Notes				\$ 485,494	\$ 508,558	\$ 494,594

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/ Shares	Cost	Fair Value
Preferred Equity 16.8%						
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
Total Preferred Equity					\$ 148,921	\$ 147,852
Common Equity / Partnership Interests / Warrants 5.9%						
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
Total Common Equity/Partnerships Interests / Warrants					\$ 88,430	\$ 51,664
Total Investments 133.4%					\$ 1,230,259	\$ 1,170,627
Liabilities in Excess of Other Assets (33.4%)						(293,024)
Net Assets 100.0%						\$ 877,603

- (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 SOCAPY 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.

Table of Contents

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 Investments (at fair value) as 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/ Shares	Cost	Fair Value
Bank Debt/Senior Secured Loans		51.2%				
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 & 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 Consumer Products	10.75%	1/8/2018	39,000	37,895	37,830
Interactive Health Solutions, Inc.(18)(19)	Healthcare, Education & Childcare	11.50%	10/4/2016	20,131	19,691	19,930
MYI Acquiror Corporation(3)(4)(8)(21)		13% (12% Cash & 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. Services	13.5% (12% Cash & 1.5% PIK)(7)	5/20/2016	33,255	32,520	32,756
Vision Holding Corp.(18)	Healthcare, Education & 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
Total Bank Debt/Senior Secured Loans				\$ 436,977	\$ 426,201	\$ 412,396
Subordinated Debt/Corporate Notes		67.9%				
Adams Outdoor Advertising	Diversified/Conglomerate Service	18.00%	12/8/2015	\$ 42,500	\$ 41,878	\$ 42,075
AMC Entertainment Holdings, Inc.	Leisure, Amusement, Entertainment	5.55%PIK	6/13/2012	27,141	27,086	26,462
CIBT Solutions	Leisure, Amusement, Entertainment	13.50%	6/15/2018	36,200	35,389	35,386
Crosman Corporation		13% (11% Cash & 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 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
Total Subordinated Debt/Corporate Notes				\$ 606,646	\$ 604,157	\$ 546,859
Preferred Equity 1.8%						
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
Total Preferred Equity					\$ 15,107	\$ 14,664

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/ Shares	Cost	Fair Value
Common Equity / Partnership Interests / Warrants 8.8%						
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. Services			572,800	2,681	69
Great American Group Inc.(15)	Personal, Food & Misc. Services			187,500	3	23
National Specialty Alloys, LLC(10)	Mining, Steel, Iron & 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 & Entertainment			437,687	2,424	1,450
Total Common Equity/Partnerships Interests / Warrants					107,108	71,124
Total Investments 129.7%					\$ 1,152,573	\$ 1,045,043
Liabilities in Excess of Other Assets (29.7%)						(239,102)
Net Assets 100.0%						\$ 805,941

- (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.

Table of Contents

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)**

Industry Classification	Percentage of Total Investments (at fair value) as of December 31, 2011
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%
	100%

See notes to consolidated financial statements.

Table of Contents

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;

Table of Contents

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

Table of Contents

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.

Table of Contents

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
Total	\$ 1,230,259	\$ 1,170,627	\$ 1,152,573	\$ 1,045,043

Table of Contents

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:

Foreign Currency	Local Currency Amount	US\$ Basis of Borrowing	Current Value	Unrealized Appreciation (Depreciation)
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 10th and November 10th. 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

Table of Contents

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**

	Level 1	Level 2	Level 3	Total
Assets:				
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
Liabilities:				
The Facility and Private Notes			210,907	210,907

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

	Level 1	Level 2	Level 3	Total
Assets:				
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**

	Bank Debt/ Senior Secured Loans	Subordinated Debt/ Corporate Notes	Preferred Equity	Common Equity/ Partnership Interests/ Warrants
Fair value, December 31, 2011	\$ 366,019	\$ 536,351	\$ 14,664	\$ 59,664
Total gains or losses included in earnings:				
Net realized gain (loss)		(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				
Fair value, September 30, 2012	\$ 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**

	Bank Debt/ Senior Secured Loans	Subordinated Debt/ Corporate Notes	Preferred Equity	Common Equity/ Partnership Interests/ Warrants
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Fair value, December 31, 2010	\$ 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)		
Fair value, December 31, 2011	\$ 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:

	For the nine months ended September 30, 2012
<u>The Facility and Private Notes</u>	
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:

	Nine months ended September 30, 2012	Year ended December 31, 2011
Per Share Data:(a)		
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)
Net increase in net assets resulting from operations	2.52	1.68
Dividends to shareholders	(1.83)	(2.40)
Effect of dilution	(0.01)	0.01
Net asset value, end of period	\$ 22.70	\$ 22.02
Total return(b)	12.23%	(1.07)%
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
Ratio to average net assets:(c)		
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 September 30, 2012 Number of Shares/Principal Amount	Nine months ended September 30, 2012 Amount of dividends and interest included in income	Amount of equity in net profit and loss	As of September 30, 2012 Fair Value
Investments Owned Greater than 25%					
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/ Common	2,117	130		2,371
SOCAY Corp.	Preferred Equity/ Common	13,719	858		14,490
SOINT, LLC	Senior Secured Debt	16,667	387		16,333
SOINT, LLC	Preferred Equity/ Common	86,667	196		8,667
Total Investments Owned Greater than 25%			\$ 3,392	\$	\$ 58,510
Investments Owned Greater than 5% and Less than 25%					
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			
Total Investments Owned Greater than 5% and Less than 25%			\$ 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 Fair Value December 31, 2011	Gross additions	Gross reductions	Change in Unrealized Gain (Loss)	Fair Value as of September 30, 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 Holdings LLC		124,532	276	(1,982)	122,274

Schedule 12-14

Portfolio Company	Investment	Year ended December 31, 2011			As of December 31, 2011 Fair Value
		As of December 31, 2011 Number of Shares/Principal Amount	Amount of dividends and interest included in income	Amount of equity in net profit and loss	
Investments Owned Greater than 25%					
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
Total Investments Owned Greater than 25%			\$ 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
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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.

	Beginning Fair Value December 31, 2010	Gross additions	Gross reductions	Change in Unrealized Gain (Loss)	Fair Value as of December 31, 2011
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

Table of Contents

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

Table of Contents

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.

Table of Contents

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).

Table of Contents

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
Assets:				
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
Liabilities:				
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

Table of Contents

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.

Table of Contents

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
Total	\$ 1,230,259	\$ 1,170,627	\$ 1,152,573	\$ 1,045,043