FIDUS INVESTMENT Corp
Form POS 8C
April 29, 2019
Table of Contents

Securities Act File No. 333-223350

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM N-2

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933
Pre-Effective Amendment No.
Post-Effective Amendment No. 3

FIDUS INVESTMENT CORPORATION

(Exact Name of Registrant as Specified in Charter)

1603 Orrington Avenue, Suite 1005

Evanston, Illinois 60201

(Address of Principal Executive Offices)

(847) 859-3940

(Registrant s Telephone Number, including Area Code)

Edward H. Ross

Chief Executive Officer

1603 Orrington Avenue, Suite 1005

Evanston, Illinois 60201

(Name and Address of Agent for Service)

COPIES TO:

Steven B. Boehm

Payam Siadatpour

Eversheds Sutherland (US) LLP

700 Sixth Street, NW, Suite 700

Washington, D.C. 20001-3980

(202) 383-0100

Approximate date of proposed public offering: From time to time after the effective date of the Registration Statement.

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box.

It is proposed that this filing will become effective (check appropriate box):

when declared effective pursuant to section 8(c).

Table of Contents

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject To Completion, Dated April 29, 2019

PROSPECTUS

$300,000,000

Common Stock

Preferred Stock

Subscription Rights

Debt Securities

Warrants

We may offer, from time to time, in one or more offerings or series, together or separately, up to $300,000,000 of our common stock, preferred stock, subscription rights, debt securities, or warrants representing rights to purchase shares of our common stock, preferred stock, or debt securities, which we refer to collectively as the securities. There are $231,000,000 of securities available for issuance under this prospectus as a result of our issuance of our 6.000% notes due 2024 (the 2024 Notes) in February 2019 for an aggregate principal amount of $69,000,000. We may sell our common stock through underwriters or dealers, at-the-market to or through a market maker into an existing trading market or otherwise directly to one or more purchasers or through agents or through a combination of methods of sale. The identities of such underwriters, dealers, market makers or agents, as the case may be, will be described in one or more supplements to this prospectus. The securities may be offered at prices and on terms to be described in one or more supplements to this prospectus.

We may offer shares of common stock at a discount to net asset value per share in certain circumstances. On June 7, 2018, our common stockholders voted to allow us to sell or otherwise issue common stock at a price below net asset value per share for a period of one year ending on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders. We expect to present to our stockholders a similar proposal at our 2019 Annual Meeting of Stockholders. Sales of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share. In addition, continuous sales of common stock below net asset value may have a negative impact on total returns and could have a negative impact on the market price of our shares of common stock. See Risk Factors on page 12 and Sales of Common Stock Below Net Asset Value on page 101 of this prospectus for more information.

Our stockholders specified that the cumulative number of shares sold in each offering during the one-year period ending on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders may not exceed 25.0% of our outstanding common stock immediately prior to such sale. In addition, we cannot issue shares of our common stock below net asset value unless our board of directors determines that it would be in our and our stockholders best interests to do so. Shares of closed-end investment companies such as us frequently trade at a discount to their net asset value. This risk is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our common stock will trade above, at or below net asset value. You should read this prospectus and the applicable prospectus supplement carefully before you invest in our common stock.

Table of Contents

We provide customized debt and equity financing solutions to lower middle-market companies located throughout the United States. We are an externally managed, closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended. Our investment objective is to provide attractive risk-adjusted returns by generating both current income from our debt investments and capital appreciation from our equity related investments. Our strategy includes partnering with business owners, management teams and financial sponsors by providing customized financing for ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives.

We generally invest in securities that would be rated below investment grade if they were rated. Below investment grade securities, which are often referred to as high yield or junk, have speculative characteristics with respect to our capacity to pay interest and repay principal.

Our common stock is listed on the Nasdaq Global Select Market under the symbol FDUS. On April 24, 2019, the last reported sale price of our common stock on the Nasdaq Global Select Market was $15.46 per share and our net asset value on December 31, 2018 was $16.47 per share.

Fidus Investment Advisors, LLC serves as our investment advisor and as our administrator.

Investing in our securities is speculative and involves numerous risks, and you could lose your entire investment if any of the risks occur. Among these risks is the risk associated with leverage and dilution. For more information regarding these risks, please see Risk Factors beginning on page 12.

Please read this prospectus and the accompanying prospectus supplement, if any, before investing, and keep it for future reference. It concisely sets forth important information about us that a prospective investor ought to know before investing in our securities. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission. This information is available free of charge by contacting us at 1603 Orrington Avenue, Suite 1005, Evanston, Illinois 60201, Attention: Investor Relations, by accessing our website at *http://www.fdus.com* or by calling us collect at (847) 859-3940. Information contained on our website is not incorporated by reference into, and you should not consider that information to be part of, this prospectus or any prospectus supplement. The Securities and Exchange Commission also maintains a website at *http://www.sec.gov* that contains such information.

The Securities and Exchange Commission has not approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is , 2019

TABLE OF CONTENTS

Table of Contents

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission, or the SEC, using the shelf registration process. Under the shelf registration process, we may offer, from time to time, up to $300,000,000 worth of our common stock, preferred stock, subscription rights, debt securities, or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities on terms to be determined at the time of the offering. There are $231,000,000 of securities available for issuance under this prospectus as a result of our issuance of our 6.000% notes due 2024 (the 2024 Notes) in February 2019 for an aggregate principal amount of $69,000,000. This prospectus provides you with a general description of the securities that we may offer. Each time we use this prospectus to offer securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. To the extent required by law and the rules and regulations of the SEC, we will amend or supplement the information contained in this prospectus and any accompanying prospectus supplement to reflect any material changes to such information subsequent to the date of the prospectus and any accompanying prospectus supplement and prior to the completion of any offering pursuant to the prospectus and any accompanying prospectus supplement. Please carefully read this prospectus and any accompanying prospectus supplement together with the additional information described under Available Information and Risk Factors before you make an investment decision. During an offering, we will disclose material amendments to this prospectus through a post-effective amendment or prospectus supplement.

No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus or any accompanying supplement to this prospectus. You must not rely on any unauthorized information or representations not contained in this prospectus or any accompanying prospectus supplement as if we had authorized it. This prospectus and any accompanying prospectus supplement do not constitute an offer to sell or a solicitation of any offer to buy any security other than the registered securities to which they relate, nor do they constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The information contained in this prospectus and any accompanying prospectus supplement is accurate as of the dates on their covers.

Table of Contents

PROSPECTUS SUMMARY

This summary highlights some of the information in this prospectus. It is not complete and may not contain all of the information that you may want to consider. You should read the entire prospectus and any prospectus supplement carefully, including Risk Factors, Selected Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations, Available Information, and Incorporation by Reference and the financial statements contained elsewhere in this prospectus.

Fidus Investment Corporation (FIC), a Maryland Corporation, operates as an externally managed BDC under the 1940 Act. FIC completed its initial public offering, or IPO, in June 2011. In addition, FIC 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). As of December 31, 2018, our shares were listed on the NASDAQ Global Select Market under the symbol FDUS.

FIC may make investments directly or through its three wholly-owned investment company subsidiaries, Fidus Mezzanine Capital, L.P. (Fund I), Fidus Mezzanine Capital II, L.P. (Fund II) and Fidus Mezzanine Capital III, L.P. (Fund III) (collectively Fund I, Fund II and Fund III are referred to as the Funds). Fidus Investment GP, LLC, the general partner of the Funds, is also a wholly owned subsidiary of FIC. The Funds are licensed by the U.S. Small Business Administration (the SBA) as small business investment companies (SBICs). The Funds utilize the proceeds of the issuance of SBA-guaranteed debentures to enhance returns to our stockholders. We believe that utilizing both FIC and the Funds as investment vehicles provides us with access to a broader array of investment opportunities. Given our access to lower cost capital through the SBA s SBIC debenture program, we expect that the majority of our investments will continue to be made through the Funds until the Funds reach their borrowing limit under the program. For three or more SBICs under common control, the maximum amount of outstanding SBA debentures cannot exceed $350.0 million.

Unless otherwise noted in this prospectus, the terms we, us, our, the Company, Fidus and FIC refer to Fidus Investment Corporation and its consolidated subsidiaries.

As used in this prospectus, the term our investment advisor refers to Fidus Investment Advisors, LLC.

Fidus Investment Corporation

We provide customized debt and equity financing solutions to lower middle-market companies, which we define as U.S. based companies having revenues between $10.0 million and $150.0 million. Our investment objective is to provide attractive risk-adjusted returns by generating both current income from our debt investments and capital appreciation from our equity related investments. Our investment strategy includes partnering with business owners, management teams and financial sponsors by providing customized financing for ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives. We seek to maintain a diversified portfolio of investments in order to help mitigate the potential effects of adverse economic events related to particular companies, regions or industries.

We invest in companies that possess some or all of the following attributes: predictable revenues; positive cash flows; defensible and/or leading market positions; diversified customer and supplier bases; and proven management teams with strong operating discipline. We target companies in the lower middle-market with annual earnings, before interest, taxes, depreciation and amortization, or EBITDA, between $5.0 million and $30.0 million; however, we may from time to time opportunistically make investments in larger or smaller companies. Our investments typically range between $5.0 million and $30.0 million per portfolio company.

As of December 31, 2018, we had debt and equity investments in 63 portfolio companies with an aggregate fair value of $643.0 million. The weighted average yield on our debt investments as of December 31, 2018 was 12.6%. The weighted average yield of our debt investments is not the same as a return on investment for our stockholders but, rather, relates to a portion of our investment portfolio and is calculated before the payment of all of our fees and expenses. The weighted average yield on our debt investments is higher than the return our stockholders will realize because it does not reflect expenses of the Company or the sales load paid by our stockholders. The weighted average yield was computed using the effective interest rates and investments at cost as of December 31, 2018, including accretion of original issue discount (OID) and loan origination fees, but excluding investments on non-accrual status, if any. There can be no assurance that the weighted average yield will remain at its current level. For the year ended December 31, 2018, our total return based on net asset value (NAV) per share was 12.6% and our total return based on market value was (15.8%). For the year ended December 31, 2017, our total return based on NAV was 11.9% and our total return based on market value was 3.2%. Total return based on net asset value per share equals the change in net asset value per share during the period, plus dividends paid per share during the period, less other non-operating changes during the period, and divided by beginning net asset value per share for the period. Non-operating changes include any items that affect net asset value per share other than increase from investment operations, such as the effects of share issuances and repurchases and other miscellaneous items. Total return based on market value equals the change in the market value of our common stock per share during the period divided by the market value per share at the beginning of the period, and assumes reinvestment of dividends at prices obtained by our dividend reinvestment plan during the period. While these two figures reflect fund expenses, they do not reflect any sales load that may be paid by investors.

Table of Contents

Market Opportunity

We believe that the limited amount of capital available to lower middle-market companies, coupled with the desire of these companies for flexible and partnership-oriented sources of capital, creates an attractive investment environment for us. From our perspective, lower middle-market companies have faced difficulty raising debt capital in both the capital markets and private markets. Given limited sources of capital for lower middle-market companies, we see opportunities for attractive risk-adjusted returns. Furthermore, we believe that, with a large pool of uninvested private equity capital seeking debt capital to complete buy-out transactions and a substantial supply of refinancing opportunities, there is an opportunity to attain appealing risk-adjusted returns on debt and equity investments in our target markets. See The Company in the accompanying prospectus for more information.

Business Strategy

We intend to accomplish our goal of becoming one of the premier providers of capital to and value-added partner of lower middle-market companies by:

- leveraging the experience of our investment advisor;
- capitalizing on our strong transaction sourcing network;
- serving as a value-added partner with customized financing solutions;
- employing rigorous due diligence and underwriting processes focused on capital preservation;
- actively managing our portfolio;
- benefiting from lower cost of capital through our SBIC subsidiaries.

Investment Criteria/Guidelines

We use the following criteria and guidelines in evaluating investment opportunities and constructing our portfolio. However, not all of these criteria and guidelines have been, or will be, met in connection with each of our investments.

Value Orientation / Positive Cash Flow. Our investment advisor places a premium on analysis of business fundamentals from an investor s perspective and has a distinct value orientation. We focus on companies with proven business models in which we can invest at relatively low multiples of operating cash flow. We also typically invest in portfolio companies with a history of profitability and minimum trailing twelve month EBITDA of $5.0 million. We do not invest in start-up companies, turn-around situations or companies that we believe have unproven business plans.

Experienced Management Teams with Meaningful Equity Ownership. We target portfolio companies that have management teams with significant experience and/or relevant industry experience coupled with meaningful equity ownership. We believe management teams with these attributes are more likely to manage the companies in a manner that protects our debt investment and enhances the value of our equity investment.

Niche Market Leaders with Defensible Market Positions. We seek to invest in portfolio companies that have developed defensible and/or leading positions within their respective markets or market niches and are well positioned to capitalize on growth opportunities. We favor companies that demonstrate significant competitive advantages, which we believe helps to protect their market position and profitability.

Table of Contents

Diversified Customer and Supplier Base. We prefer to invest in portfolio companies that have a diversified customer and supplier base. Companies with a diversified customer and supplier base are generally better able to endure economic downturns, industry consolidation and shifting customer preferences.

Significant Equity Value. We believe the existence of significant underlying equity value provides important support to our debt investments. With respect to our debt investments, we look for portfolio companies where management/sponsors have provided significant equity funding and where we believe aggregate enterprise value significantly exceeds aggregate indebtedness, after consideration of our investment.

Viable Exit Strategy. We invest in portfolio companies that we believe will provide steady cash flows to service our debt, ultimately repay our loans and provide working capital for their respective businesses. In addition, we seek to invest in portfolio companies whose business models and expected future cash flows offer attractive exit possibilities for our equity investments. We expect to exit our investments typically through one of three scenarios: (a) the sale of the portfolio company resulting in repayment of all outstanding debt and monetization of equity; (b) the recapitalization of the portfolio company through which our investments are replaced with debt or equity from a third party or parties; or (c) the repayment of the initial or remaining principal amount of our debt investment from cash flow generated by the portfolio company. In some investments, there may be scheduled amortization of some portion of our debt investment that would result in a partial exit of our investment prior to the maturity of the debt investment.

About Our Advisor

Our investment activities are managed by Fidus Investment Advisors, LLC, our investment advisor, and supervised by our board of directors, a majority of whom are not interested persons of Fidus as defined in Section 2(a)(19) of the 1940 Act, and who we refer to hereafter as the Independent Directors. Pursuant to the terms of the investment advisory and management agreement, which we refer to as the Investment Advisory Agreement, between us and our investment advisor, our investment advisor is responsible for determining the composition of our portfolio, including sourcing potential investments, conducting research and diligence on potential investments and equity sponsors, analyzing investment opportunities, structuring our investments and monitoring our investments and portfolio companies on an ongoing basis. Our investment advisor s investment professionals seek to capitalize on their significant deal origination and sourcing, underwriting, due diligence, investment structuring, execution, portfolio management and monitoring experience. These professionals have developed a broad network of contacts within the investment community, have gained extensive experience investing in assets that constitute our primary focus and have expertise in investing across all levels of the capital structure of lower middle-market companies. For information regarding the people who control our investment advisor and their affiliations with the Company, see Certain Relationships and Related Transactions Investment Advisory Agreement in the accompanying prospectus.

Our relationship with our investment advisor is governed by and dependent on the Investment Advisory Agreement and may be subject to conflicts of interest. We pay our investment advisor a fee for its services under the Investment Advisory Agreement consisting of two components a base management fee and an incentive fee. The base management fee is calculated at an annual rate of 1.75% of the average value of our total assets (other than cash or cash equivalents but including assets purchased with borrowed amounts). The incentive fee consists of two parts. The first part is calculated and payable quarterly in arrears and equals 20.0% of our pre-incentive fee net investment income for the immediately preceding quarter, subject to a 2.0% preferred return, or hurdle, and a catch up feature. The second part is determined and payable in arrears as of the end of each fiscal year in an amount equal to 20.0% of our realized capital gains, if any, on a cumulative basis from inception through the end of each fiscal year, computed net of all realized capital losses and unrealized capital depreciation on a cumulative basis, less the aggregate amount of any capital gain incentive fees paid in prior years. We accrue, but do not pay, a capital gains incentive fee in connection with any unrealized capital appreciation, as appropriate. For more information about how we compensate our investment advisor and the related conflicts of interest, see Management and Other Agreements Investment Advisory Agreement and Certain Relationships and Related Transactions Conflicts of Interest in the accompanying prospectus.

Among other things, our board of directors is charged with protecting our interests by monitoring how our investment advisor addresses conflicts of interest associated with its management services and compensation. Our board of directors is not expected to review or approve each borrowing or incurrence of leverage. However, our board of directors periodically reviews our investment advisor s portfolio management decisions and portfolio performance. In addition, our board of directors at least annually reviews the services provided by and fees paid to our investment advisor. In connection with these reviews, our board of directors, including a majority of our Independent Directors, considers whether the fees and expenses (including those related to leverage) that we pay to our investment advisor are fair and reasonable in relation to the services provided. Renewal of our Investment Advisory Agreement must be approved each year by our board of directors, including a majority of our Independent Directors.

With respect to the administrative agreement with our investment advisor, our board of directors reviews the methodology employed in determining how the expenses are allocated to us. Our board of directors assesses the reasonableness of such reimbursements for expenses allocated to us based on the breadth, depth and quality of such services as compared to the estimated cost to us of obtaining similar services from third-party service providers known to be available. In addition, our board of directors considers whether any third-party service provider would be capable of providing all such services at comparable cost and quality.

Fidus Investment Advisors, LLC is a Delaware limited liability company that is registered as an investment advisor under the Investment Advisers Act of 1940, as amended, or the Advisers Act. In addition, Fidus Investment Advisors, LLC serves as our administrator and provides us with office space, equipment and clerical, book-keeping and record-keeping services pursuant to an administration agreement, which we refer to as the Administration Agreement.

Operating and Regulatory Structure

Our investment activities are managed by our investment advisor and supervised by our board of directors, a majority of whom are not interested persons of us, our investment advisor or its affiliates.

As a BDC, we are required to comply with certain regulatory requirements. For example, while we are permitted to finance investments using leverage, which may include the issuance of shares of preferred stock, or notes and other borrowings, our ability to use leverage is limited in significant respects. See Regulation. Any decision on our part to use leverage will depend upon our assessment of the attractiveness of available investment opportunities in relation to the costs and perceived risks of such leverage. The use of leverage to finance investments creates certain risks and potential conflicts of interest. See Risk Factors Risks Relating to Our Business and Structure Regulations governing our operations as a BDC affect our ability to raise, and the way in which we raise, additional capital which may have a negative effect on our growth and Risk Factors Risks Relating to Our Business and Structure Because we borrow money and may in the future issue additional senior securities including preferred stock and debt securities, the potential for gain or loss on amounts invested in us is magnified and may increase the risk of investing in us.

We have elected to be treated for U.S. federal income tax purposes as a regulated investment company, or RIC, under Subchapter M of the Internal Revenue Code of 1986, as amended, or the Code. In order to maintain our tax treatment as a RIC, we must satisfy certain source of income, asset diversification and distribution requirements. See Material U.S. Federal Income Tax Considerations.

Risk Factors

The value of our assets, as well as the market price of our shares, will fluctuate. Our investments may be risky, and you may lose part of or all of your investment in us. Investing in our securities involves other risks, including the following:

our dependence on key personnel of our investment advisor and our executive officers;

our ability to maintain or develop referral relationships;

our use of leverage;

legislation that took effect in 2018 would allow us to incur additional leverage;

the availability of additional capital on attractive terms or at all;

uncertain valuations of our portfolio investments;

competition for investment opportunities;

actual and potential conflicts of interests with our investment advisor;

other potential conflicts of interest;

SBA regulations affecting our wholly-owned SBIC subsidiaries;

changes in interest rates;

the impact of a protracted decline in liquidity of credit markets on our business and portfolio of investments;

our ability to maintain our status as a RIC and as a BDC;

the timing, form and amount of any distributions from our portfolio companies;

changes in laws or regulations applicable to us;

dilutions risks related to our ability to issue shares below our current net asset value;

possible resignation of our investment advisor;

the general economy and its impact on the industries in which we invest;

risks associated with investing in lower middle-market companies;

the ability of our investment advisor to identify, invest in and monitor companies that meet our investment criteria; and our ability to invest in qualifying assets.

See Risk Factors beginning on page 12 and the other information included in this prospectus, and any prospectus supplement, for additional discussion of factors you should carefully consider before deciding to invest in our securities.

Corporate Information

Our principal executive offices are located at 1603 Orrington Avenue, Suite 1005, Evanston, Illinois 60201, and our telephone number is (847) 859-3940. Our corporate website is located at *http://www.fdus.com*. Information on our website is not incorporated into this prospectus or any supplements to this prospectus, and you should not consider information contained on our website to be part of this prospectus or any supplements to this prospectus.

The Offering

We may offer, from time to time, up to $300,000,000 worth of our securities, on terms to be determined at the time of the offering. There are $231,000,000 of securities available for issuance under this prospectus as a result of our issuance of our 6.000% notes due 2024 (the 2024 Notes) in February 2019 for an aggregate principal amount of $69,000,000. Our securities may be offered at prices and on terms to be disclosed in one or more prospectus supplements.

We may sell or otherwise issue shares of common stock at a discount to net asset value per share at prices approximating market value less selling expenses upon approval, in certain circumstances, of our board of directors, including a majority of our directors that are not interested persons of the Company, as defined in the 1940 Act. On June 7, 2018, our stockholders voted to allow us to issue common stock at a price below net asset value per share for a period of one year ended on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders. We expect to present to our stockholders a similar proposal at our 2019 Annual Meeting of Stockholders. See Sales of Common Stock Below Net Asset Value in this prospectus and in any accompanying prospectus supplement, if applicable. Sales or other issuances of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share.

Table of Contents

Our stockholders did not specify a maximum discount below net asset value at which we are able to sell or otherwise issue our common stock; however, we do not intend to sell or otherwise issue shares of our common stock below net asset value unless our board of directors determines that it would be in our stockholders best interest to do so. The level of net asset value dilution that could result from such an offering is not limited.

Our securities may be offered directly to one or more purchasers by us or through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to the offering will disclose the terms of the offering, including the name or names of any agents or underwriters involved in the sale of our securities by us, the purchase price, and any fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See Plan of Distribution. We may not sell any of our securities through agents, underwriters or dealers without delivery of a prospectus supplement describing the method and terms of the offering of our securities.

The Nasdaq Global Select Market Symbol	FDUS
Use of proceeds	We intend to use the net proceeds from selling our securities to make investments in lower middle-market companies in accordance with our investment objective and strategies and for working capital and general corporate purposes. See Use of Proceeds.
Dividends and distributions	We pay quarterly distributions to our stockholders out of assets legally available for distribution. Our distributions, if any, will be determined by our board of directors. Our ability to declare distributions depends on our earnings, our overall financial condition (including our liquidity position), qualification for or maintenance of our RIC status and such other factors as our board of directors may deem relevant from time to time. When we make distributions, we will be required to determine the extent to which such distributions are paid out of current or accumulated earnings, recognized capital gains or capital. To the extent there is a return of capital, investors will be required to reduce their basis in our stock for U.S. federal income tax purposes. In the future, our distributions may include a return of capital.
Dividend reinvestment plan	We have adopted a dividend reinvestment plan for our common stockholders, which is an opt out dividend reinvestment plan. Under this plan, if we declare a cash distribution, our stockholders who have not opted out of our dividend reinvestment plan will have their cash distribution automatically reinvested in additional

shares of our common stock, rather than receiving the cash distribution. If a stockholder opts out, that stockholder will receive cash distributions. Stockholders who receive distributions in the form of shares of common stock generally are subject to the same U.S. federal income

	tax consequences as stockholders who elect to receive their distributions in cash; however, since their cash distributions will be reinvested, such stockholders will not receive cash with which to pay any applicable taxes on reinvested distributions. See Dividend Reinvestment Plan.
Taxation	We have elected to be treated as a RIC for U.S. federal income tax purposes. Accordingly, we generally will not pay corporate-level U.S. federal income taxes on any net ordinary income or capital gains that we distribute to our stockholders. To maintain our tax treatment as a RIC and the associated tax benefits, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of our realized net ordinary income and realized net short-term capital gains, if any, in excess of our net long-term capital losses. See Distributions and Material U.S. Federal Income Tax Considerations.
Effective trading at a discount	Shares of closed-end investment companies, including business development companies, frequently trade at a discount to their net asset value. The risk that our shares may trade at a discount to our net asset value is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our shares will trade above, at or below net asset value. See Risk Factors.
Sales of common stock below net asset value	Generally, the offering price per share of our common stock, exclusive of any underwriting commissions or discounts, may not be less than the net asset value per share of our common stock at the time we make the offering except (1) in connection with a rights offering to our existing stockholders, (2) with the consent of the majority of our common stockholders and approval of our board of directors, or (3) under such circumstances as the SEC may permit. On June 7, 2018, our common stockholders voted to allow us to sell or otherwise issue common stock at a price below net asset value per share for a period of one year ending on the earlier of June 7, 2019 or our 2019 Annual Meeting of Stockholders. We expect to present to our stockholders a similar proposal at our 2019 Annual Meeting of Stockholders. Sales or other issuances by us of our common stock at a discount from our net asset value pose potential risks for our existing stockholders whether or not they participate in the offering, as well as for new investors who participate in the offering.

See Sales of Common Stock Below Net Asset Value in this prospectus and in the prospectus supplement, if applicable.

Table of Contents

Leverage	We borrow funds to make additional investments. We use this practice, which is known as leverage, to attempt to increase returns to our stockholders, but it involves significant risks. See Risk Factors, Senior Securities and Regulation Senior Securities. With certain limited exceptions, we are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% (or 150% if we satisfy certain requirements in the future) after such borrowing. The amount of leverage that we employ at any particular time will depend on our Investment Advisor s investment committee s and our board of directors assessment of market and other factors at the time of any proposed borrowing. In addition, the maximum amount of leverage that three or more SBICs under common control can have outstanding is $350.0 million.
Available Information	We are required to file periodic reports, current reports, proxy statements and other information with the SEC. This information is available on the SEC s Internet website at *www.sec.gov*. We intend to provide much of the same information on our website at *www.fdus.com*. Information contained on our website is not part of this prospectus or any prospectus supplement and should not be relied upon as such.
Incorporation by Reference	This prospectus is part of a registration statement that we have filed with the SEC. In accordance with the Small Business Credit Availability Act, we are allowed to incorporate by reference the information that we file with the SEC, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to comprise a part of this prospectus from the date we file that document. Any reports filed by us with the SEC subsequent to the date of this filing and before the date that any offering of any securities by means of this prospectus and any accompanying prospectus supplement is terminated will automatically update and, where applicable, supersede any information contained in this prospectus or incorporated by reference in this prospectus. See Incorporation by Reference.

Table of Contents

FEES AND EXPENSES

The following table is intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by you, us, the Company or Fidus, or that we will pay fees or expenses, stockholders will indirect bear such fees or expenses as investors in us.

Stockholder transaction expenses:		
Sales load (as a percentage of offering price)		(1)
Offering expenses borne by us (as a percentage of offering price)		(2)
Dividend reinvestment plan expenses		(3)
Total stockholder transaction expenses paid by us (as a percentage of offering price)		(4)
Annual expenses (as a percentage of net assets attributable to common stock)[(5)]:		
Base management fee	2.85%	(6)
Incentive fees payable under Investment Advisory Agreement	2.36%	(7)
Interest payments on borrowed funds	2.96%	(8)
Other expenses	1.07%	(9)
Total annual expenses	9.24%	(10)

(1) In the event that securities to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will disclose the applicable sales load.

(2) In the event that we conduct an offering of any of our securities, a corresponding prospectus supplement will disclose the estimated offering expenses because they will be ultimately borne by the Company (and indirectly by our stockholders).

(3) The expenses of administering our dividend reinvestment plan are included in other expenses.

(4) Total stockholder transaction expenses may include a sales load and will be disclosed in a future prospectus supplement, if any.

(5) Net assets attributable to common stock equals average net assets, which is calculated as the average of the net assets balances as of each quarter end during the year ended December 31, 2018 and the prior year end.

(6) Our base management fee is 1.75% of the average value of our total assets (other than cash and cash equivalents but including assets purchased with borrowed amounts). This item represents actual base management fees incurred for the year ended December 31, 2018. We may from time to time decide it is appropriate to change the terms of the Investment Advisory Agreement. Under the 1940 Act, any material change to our Investment Advisory Agreement must be submitted to stockholders for approval. The 2.85% reflected in the table is calculated on our net assets (rather than our total assets). See Management and Other Agreements Investment Advisory Agreement.

(7) This item represents actual fees incurred on pre-incentive fee net investment income (income incentive fee) for the year ended December 31, 2018. As of December 31, 2018, there was no capital gains incentive fee payable (in cash), and accordingly no capital gains incentive fee amount has been included in the estimated expenses

figure reflected in the table above. For the year ended December 31, 2018, we accrued capital gains incentive fees of $2.9 million in accordance with U.S. GAAP, which equals 0.74% of net assets attributable to common stock ; such amount has not been included in the estimated expenses figure reflected in the table above.

The incentive fee consists of two parts:

The first, payable quarterly in arrears, equals 20.0% of our pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets, (including interest that is accrued but not yet received in cash), subject to a 2.0% quarterly (8.0% annualized) hurdle rate and a catch-up provision measured as of the end of each calendar quarter. Under this provision, in any calendar quarter, our investment advisor receives no incentive fee until our pre-incentive fee net investment income equals the hurdle rate of 2.0% but then receives, as a catch-up, 100.0% of our 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 2.5%. The effect of this provision is that, if pre-incentive fee net investment income exceeds 2.5% in any calendar quarter, our investment advisor will receive 20.0% of our pre-incentive fee net investment income as if a hurdle rate did not apply.

Table of Contents

The second part, payable annually in arrears, equals 20.0% of our realized capital gains net of realized capital losses and unrealized capital depreciation, if any, on a cumulative basis from inception through the end of the fiscal year (or upon the termination of the Investment Advisory Agreement, as of the termination date), less the aggregate amount of any previously paid capital gain incentive fees. In accordance with U.S. GAAP, we accrue the capital gains incentive fee in our consolidated financial statements considering the fair value of investments on that date (i.e., the amount of fee which would be payable under a hypothetical liquidation based on the fair value of investments as of that date), which differs from the calculation of the amount payable in cash by the inclusion of unrealized capital appreciation.

See Management and Other Agreements Investment Advisory Agreement.

(8) As of December 31, 2018, we had outstanding SBA debentures of $191.0 million; we had $50.0 million outstanding of our 5.875% notes due 2023 (the Public Notes); we had $36.5 million of outstanding borrowings under our senior secured revolving credit agreement with certain lenders party thereto and ING Capital, LLC, as administrative agent (the Credit Facility), which has total commitment of $90.0 million. Interest payments on borrowed funds is based on estimated annual interest and fee expenses on outstanding SBA debentures, Public Notes and borrowings under the Credit Facility as of December 31, 2018 with a weighted average stated interest rate of 4.149% as of that date. We also pay a commitment fee between 0.5% and 1.0% per annum based the unutilized commitment under our Credit Facility. We have estimated the annual interest expense on borrowed funds and caution you that our actual interest expense will depend on prevailing interest rates and our rate of borrowing, which may be substantially higher than the estimate provided in this table.

(9) Other expenses represent our estimated annual operating expenses, as a percentage of net assets attributable to common shares estimated for the current year, including professional fees, directors fees, insurance costs, expenses of our dividend reinvestment plan and payments under the Administration Agreement based on our allocable portion of overhead and other expenses incurred by our administrator. See Management and Other Agreements Administration Agreement. Other expenses exclude interest payments on borrowed funds, and if we issue debt securities or preferred stock, interest payments on debt securities and distributions with respect to preferred stock. We currently do not have any class of securities outstanding other than common stock. Other expenses are based on actual other expenses for the year ended December 31, 2018.

(10) Total annual expenses as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. We borrow money to leverage our net assets and increase our total assets. The SEC requires that the total annual expenses percentage be calculated as a percentage of net assets (defined as total assets less total liabilities), rather than the total assets, including assets that have been purchased with borrowed amounts. If the total annual expenses percentage were calculated instead as a percentage of average consolidated total assets, our total annual expenses would be 5.41% of average consolidated total assets.

Example

The following example demonstrates the projected dollar amount of total cumulative expenses over various periods with respect to a hypothetical investment in us. In calculating the following expense amounts, we have assumed we would have no additional leverage, that none of our assets are cash or cash equivalents and that our annual operating expenses would remain at the levels set forth in the table above. Transaction expenses are not included in the following example.

	1 year	3 years	5 years	10 years

You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$ 95	$ 272	$ 433	$ 778
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return resulting entirely from net realized capital gains (all of which is subject to our incentive fee on capital gains)	$ 102	$ 291	$ 461	$ 813

Table of Contents

The foregoing table is to assist you in understanding the various costs and expenses that an investor in our common stock will bear directly or indirectly. While the example assumes, as required by the SEC, a 5.0% annual return, our performance will vary and may result in a return greater or less than 5.0%. Assuming a 5.0% annual return, the incentive fee under the Investment Advisory Agreement would either not be payable or have an insignificant impact on the expense amounts shown above. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses, and returns to our investors, would be higher. In addition, while the example assumes reinvestment of all distributions at net asset value, if our board of directors authorizes and we declare a cash dividend, participants in our dividend reinvestment plan who have not otherwise elected to receive cash will receive a number of shares of our common stock, determined by dividing the total dollar amount of the distribution payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the distribution. See Dividend Reinvestment Plan for additional information regarding our dividend reinvestment plan.

This example and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses (including the cost of debt, if any, and other expenses) may be greater or less than those shown.

Table of Contents

RISK FACTORS

Investing in our securities involves a number of significant risks. You should carefully consider these risk factors, together with all of the other information included in this prospectus, or any prospectus supplement. The risks set out below are not the only risks we face. Additional risks and uncertainties not presently known to us or not presently deemed material by us may also impair our operations and performance. If any of the following events occur, our business, financial condition, results of operations and cash flows could be materially and adversely affected. In such case, our net asset value and the trading price of our common stock could decline, and you may lose all or part of your investment.

Risks Relating to Our Business and Structure

We are dependent upon our investment advisor s managing members and our executive officers for our future success. If our investment advisor was to lose any of its managing members or we lose any of our executive officers, our ability to achieve our investment objective could be significantly harmed.

We depend on the investment expertise, skill and network of business contacts of the managing members of our investment advisor, who evaluate, negotiate, structure, execute and monitor our investments. Our future success will depend to a significant extent on the continued service and coordination of the investment professionals of our investment advisor and executive officers. Certain investment professionals and executives may not devote all of their business time to our operations and may have other demands on their time as a result of other activities. The departure of any of these individuals could have a material adverse effect on our ability to achieve our investment objective.

Our business model depends, to a significant extent, upon strong referral relationships with financial institutions, sponsors and investment professionals. Any inability of our investment advisor to maintain or develop these relationships, or the failure of these relationships to generate investment opportunities, could adversely affect our business.

We depend upon the investment professionals of our investment advisor to maintain their relationships with financial institutions, sponsors and investment professionals, and we intend to rely to a significant extent upon these relationships to provide us with potential investment opportunities. If the investment professionals of our investment advisor fail to maintain such relationships, or to develop new relationships with other sources of investment opportunities, we will not be able to grow our investment portfolio. In addition, individuals with whom the investment professionals of our investment advisor have relationships are not obligated to provide us with investment opportunities, and, therefore, we can offer no assurance that these relationships will generate investment opportunities for us in the future.

Our financial condition and results of operation depends on our ability to manage our business effectively.

Our ability to achieve our investment objective and grow depends on our ability to manage our business and deploy our capital effectively. This depends, in turn, on our investment advisor s ability to identify, evaluate and monitor companies that meet our investment criteria. Accomplishing our investment objectives on a cost-effective basis depends upon our investment advisor s execution of our investment process, its ability to provide competent, attentive and efficient services to us and, to a lesser extent, our access to financing on acceptable terms. Our investment advisor has substantial responsibilities under the Investment Advisory Agreement. In addition, our investment advisor s investment professionals may be called upon to provide managerial assistance to our portfolio companies. These activities may distract them or slow our rate of investment. Any failure to manage our business and our future growth effectively could have a material adverse effect on our business, financial condition and results of operations.

We may suffer credit losses and our investments could be rated below investment grade.

Private debt in the form of second lien, subordinated, and first lien (senior secured or unitranche loans) to corporate and asset-based borrowers is highly speculative and involves a high degree of risk of credit loss, and therefore an investment in our shares of common stock may not be suitable for someone with a low tolerance for risk. These risks are likely to increase during an economic recession.

Table of Contents

In addition, investments in our portfolio are typically not rated by any rating agency. We believe that if such investments were rated, the vast majority would be rated below investment grade (which is sometimes referred to as junk) due to speculative characteristics of the issuer s capacity to pay interest and repay principal. Our investments may result in an amount of risk, volatility or potential loss of principal that is greater than that of alternative investments.

Because we borrow money and may in the future issue additional senior securities, including preferred stock and debt securities, the potential for gain or loss on amounts invested in us is magnified and may increase the risk of investing in us.

Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in us. The Funds borrow from and issue debt securities to the SBA, and we may borrow from banks and other lenders in the future. The SBA has fixed dollar claims on the Funds assets that are superior to the claims of our stockholders. We may also borrow from banks and other lenders or issue additional senior securities including preferred stock and debt securities in the future. If the value of our assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more sharply than it would have had we not used leverage. Conversely, if the value of our assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our income in excess of interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect our ability to make distributions to our stockholders. Leverage is generally considered a speculative investment technique.

Our ability to achieve our investment objectives may depend in part on our ability to achieve additional leverage on favorable terms by borrowing from the SBA, banks or other lenders, and there can be no assurance that such additional leverage can in fact be achieved.

As a BDC, we are generally required to meet a coverage ratio at least equal to 200.0% (or 150.0% if we satisfy certain requirements in the future) of total assets to total borrowings and other senior securities, which include all of our borrowings (other than the Funds SBA leverage under the terms of SEC exemptive relief) and any preferred stock we may issue in the future. If this ratio declines below 200.0% (or 150.0% if we satisfy certain requirements in the future), we may not be able to incur additional debt and may need to sell a portion of our investments to repay some debt when it is disadvantageous to do so, and we may not be able to make distributions to our stockholders.

The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing in the table below.

Assumed Return on Our Portfolio

(Net of Expenses)

	(10.0)%	**(5.0)%**	**0.0%**	**5.0%**	**10.0%**
Corresponding return to common stockholder [1]	(20.1)%	(11.5)%	(2.9)%	5.8%	14.4%

(1) Assumes $693.9 million in total assets, $191.0 million in outstanding SBA debentures, $36.5 million in borrowings under the Credit Facility, $50.0 million oustanding of our Public Notes, $403.0 million in net assets as of December 31, 2018, and an average cost of funds of 4.149%.

Funding a portion of our investments with preferred stock would magnify the potential for gain or loss and the risks of investing in us in the same way as our other borrowings.

Preferred stock, which is another form of leverage, has the same risks to our common stockholders as borrowings because the distributions with respect to any preferred stock must be cumulative. Payment of such distributions and repayment of the liquidation preference of such preferred stock must take preference over any distributions or other payments to our common stockholders, and preferred stockholders are not subject to any of our expenses or losses and are not entitled to participate in any income or appreciation in excess of their stated preference.

Table of Contents

Legislation that took effect in 2018 would allow us to incur additional leverage.

As a BDC, under the 1940 Act generally we are not permitted to incur indebtedness unless immediately after such borrowing we have an asset coverage for total borrowings of at least 200.0% (i.e., the amount of debt may not exceed 50.0% of the value of our assets). However, legislation that took effect in 2018 has modified the 1940 Act by allowing a BDC to increase the maximum amount of leverage it may incur from an asset coverage ratio of 200.0% to an asset coverage ratio of 150.0%, if certain requirements are met. Under the legislation, we are allowed to increase our leverage capacity if stockholders representing at least a majority of the votes cast, when quorum is met, approve a proposal to do so. If we receive stockholder approval, we would be allowed to increase our leverage capacity on the first day after such approval. Alternatively, the legislation allows the required majority of our independent directors, as defined in Section 57(o) of the 1940 Act, to approve an increase in our leverage capacity, and such approval would become effective after one year. In either case, we would be required to make certain disclosures on our website and in SEC filings regarding, among other things, the receipt of approval to increase our leverage, our leverage capacity and usage, and risks related to leverage.

Leverage magnifies the potential for loss on investments and on invested equity capital. As we use leverage to partially finance our investments, you will experience increased risks of investing in our securities. For example, as we increase our leverage and, as a result, our total interest expense and other required payments on such indebtedness, any decrease in our income would cause net investment income to decline more sharply than it would have had we not borrowed, and the decline could negatively affect our ability to make the required payments on such indebtedness or on our other securities. Increased leverage may also cause a downgrade of our credit rating. Leverage is generally considered a speculative investment technique.

All of our portfolio investments are recorded at fair value as determined in good faith by our board of directors, and, as a result, there is uncertainty as to the value of our portfolio investments and the valuation process for certain of our portfolio holdings creates a conflict of interest.

All of our portfolio investments take the form of debt and equity securities that are not publicly-traded. The debt and equity securities in which we invest for which market quotations are not readily available are valued at fair value as determined in good faith by our board of directors. As part of the valuation process, we may take into account the following types of factors, if relevant, in determining the fair value of our investments:

- a comparison of the portfolio company s securities to comparable publicly-traded securities;
- the enterprise value of a portfolio company;
- the nature and realizable value of any collateral;
- the portfolio company s ability to make payments and its earnings and discounted cash flow;
- the markets in which the portfolio company does business; and

changes in the interest rate environment and the credit markets generally that may affect the price at which similar investments may be made in the future and other relevant factors.

The fair value of each investment in our portfolio is determined quarterly by our board of directors. Any changes in fair value of portfolio securities from the prior period are recorded in our consolidated statement of operations as net change in unrealized appreciation or depreciation.

In connection with that determination, investment professionals from our investment advisor prepare portfolio company valuations based upon the most recent portfolio company financial statements available and projected financial results of each portfolio company. In addition, certain members of our board of directors have a pecuniary interest in our investment advisor. The participation of our investment advisor s investment professionals in our valuation process, and the pecuniary interest in our investment advisor by certain members of our board of directors, may result in a conflict of interest as the management fees that we pay our investment advisor are based on our total assets (other than cash and cash equivalents but including assets purchased with borrowed amounts).

Our board of directors engages one or more independent valuation firm(s) to conduct independent appraisals of a selection of our portfolio investments for which market quotations are not readily available. Each portfolio company investment is generally appraised by the valuation firm(s) at least once every calendar year and each new portfolio company investment is appraised at least once in the twelve-month period following the initial investment. In certain instances, we may determine that it is not cost-effective, and as a result it is not in our stockholders best interest, to request the independent appraisal of certain portfolio company investments. Such instances include, but are not limited to, situations where we determine that the fair value of the portfolio company investment is relatively insignificant to the fair value of the total portfolio. Our board of directors consulted with the independent valuation firm(s) in arriving at our determination of fair value for 16 and 18 of our portfolio company investments representing 36.0% and 32.0% of the total portfolio investments at fair value (exclusive of new portfolio company investments made during the three months ended December 31, 2018 and 2017, respectively) as of December 31, 2018 and 2017, respectively.

Table of Contents

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 our 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. Declines in prices and liquidity in the corporate debt markets may also result in significant net unrealized depreciation in our debt portfolio. Our net asset value could be adversely affected if our determinations regarding the fair value of our investments were materially higher than the values that we ultimately realize upon the disposal of such investments.

We operate in a highly competitive market for investment opportunities, which could reduce returns and result in losses.

A number of entities compete with us to make the types of investments that we make. We compete with public and private funds, other BDCs, commercial and investment banks, commercial financing companies and, to the extent they provide an alternative form of financing, private equity and hedge funds. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, we believe some of our competitors may have access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments. These characteristics could allow our competitors to consider a wider variety of investments, establish more relationships and offer better pricing and more flexible structuring than we offer. We may lose investment opportunities if we do not match our competitors pricing, terms and structure. If we match our competitors pricing, terms and structure, we may experience a decrease in net investment income or an increase in risk of capital loss. A significant part of our competitive advantage stems from the fact that the lower middle-market is underserved by traditional commercial and investment banks, and generally has less access to capital. A significant increase in the number and/or the size of our competitors in this target market could force us to accept less attractive investment terms.

Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC or the source of income, asset diversification and distribution requirements we must satisfy to maintain our RIC status. The competitive pressures we face may have a material adverse effect on our business, financial condition and results of operations. As a result of this existing and potentially increasing competition, we may not be able to take advantage of attractive investment opportunities from time to time, and we may not be able to identify and make investments that are consistent with our investment objective.

Our management and incentive fee structure may create incentives for our investment advisor that are not fully aligned with the interests of our stockholders and may encourage our investment advisor to make speculative investments.

The management and incentive fees paid to our investment advisor are based on our total assets (other than cash or cash equivalents but including assets purchased with borrowed amounts), and our investor advisor may therefore benefit when we incur debt or use leverage. This fee structure may encourage our investment advisor to cause us to borrow money to finance additional investments. Under certain circumstances, the use of borrowed money may increase the likelihood of default, which would disfavor our stockholders. Our board of directors is charged with protecting our interests by monitoring how our investment advisor addresses these and other conflicts of interests. Our board of directors is not expected to review or approve each borrowing or incurrence of leverage. However, our board of directors, periodically reviews our investment advisor s portfolio management decisions and portfolio performance. In addition, our board of directors at least annually reviews the services provided by and fees paid to our investment advisor. In connection with these reviews, our board of directors, including a majority of our Independent Directors, considers whether the fees and expenses (including those related to leverage) that we pay to our investment advisor are fair and reasonable in relation to the services provided and must approve renewal of our Advisory Agreement.

The part of the incentive fee payable to our investment advisor that relates to our net investment income is computed and paid on income that includes interest income that has been accrued but not yet received in cash. This fee structure may encourage our investment advisor to favor debt financings that provide for deferred interest, rather than current cash payments of interest. Our investment advisor may have an incentive to invest in deferred interest securities in circumstances where it would not have done so but for the opportunity to continue to earn the incentive fee even when the issuers of the deferred interest securities would not be able to make actual cash payments to us on such securities. This risk could be increased because our investment advisor is not obligated to reimburse us for any incentive fees received even if we subsequently incur losses or never receive in cash the deferred interest that was previously accrued.

Table of Contents

The incentive fee is based, in part, upon net capital gains realized on our investments. Unlike the portion of the incentive fee based on income, there is no hurdle rate applicable to the portion of the incentive fee based on net capital gains. As a result, our investment advisor may have a tendency to invest more capital in investments that are likely to result in capital gains as compared to income producing securities. Such a practice could result in our investing in more speculative securities than would otherwise be the case, which could result in higher investment losses, particularly during economic downturns.

We may be obligated to pay our investment advisor incentive compensation even if we incur a loss and may pay more than 20.0% of our net capital gains because we cannot recover payments made in previous years.

Our investment advisor will be entitled to incentive compensation for each fiscal quarter in an amount equal to a percentage of the excess of our pre-incentive fee net investment income for that quarter above a threshold return for that quarter. Our pre-incentive fee net investment income for incentive compensation purposes excludes realized and unrealized capital losses that we may incur in the fiscal quarter, even if such capital losses result in a net loss on our consolidated statement of operations for that quarter. Thus, we may be required to pay our investment advisor incentive compensation for a fiscal quarter even if there is a decline in the value of our portfolio or we incur a net loss for that quarter. Further, if we pay an incentive fee of 20.0% of our realized capital gains (net of all realized capital losses and unrealized capital depreciation on a cumulative basis) and thereafter experience additional realized capital losses or unrealized capital depreciation, we will not be able to recover any portion of the incentive fee previously paid.

A general increase in interest rates will likely have the effect of making it easier for the investment advisor to receive incentive fees, without necessarily resulting in an increase in our net earnings.

Given the structure of the Investment Advisory Agreement, any general increase in interest rates can be expected to lead to higher interest rates applicable to our debt investments and will likely have the effect of making it easier for the investment advisor to meet the quarterly hurdle rate for payment of income incentive fees under the Investment Advisory Agreement without any additional increase in relative performance on the part of the investment advisor. This may occur without a corresponding increase in distributions to our stockholders. In addition, in view of the catch-up provision applicable to income incentive fees under the Investment Advisory Agreement, the investment advisor could potentially receive a significant portion of the increase in our investment income attributable to such a general increase in interest rates. If that were to occur, our increase in net earnings, if any, would likely be significantly smaller than the relative increase in the Adviser s income incentive fee resulting from such a general increase in interest rates.

We may have potential conflicts of interest related to obligations that our investment advisor may have to other clients.

Currently, the Company, the Funds, Fidus Credit Opportunities, L.P. and Fidus Equity Opportunities Fund, L.P. are the only investment vehicles managed by our investment advisor. The Investment Advisory Agreement does not limit our investment advisor s ability to act as an investment advisor to other funds, including other BDCs, or other investment advisory clients. To the extent our investment advisor acts as an investment advisor to other funds or clients, including Fidus Credit Opportunities, L.P. and Fidus Equity Opportunities Fund, L.P., we may have conflicts of interest with our investment advisor or its other clients that elect to invest in similar types of securities as those in which we invest. Members of our investment advisor s investment committee serve or may serve as officers, directors or principals of entities that operate in the same or a related line of business as we do, or of investment funds or other investment vehicles managed by our investment advisor. In serving in these multiple capacities, they may have obligations to other clients or investors in those entities, the fulfillment of which may not be in the best interests of us or our stockholders. Our investment advisor will seek to allocate investment opportunities among eligible accounts in a manner that is fair and equitable over time and consistent with an allocation policy approved by our board of directors.

Table of Contents

To the extent our investment advisor forms affiliates, including Fidus Credit Opportunities, L.P. and Fidus Equity Opportunities Fund, L.P., we may co-invest on a concurrent basis with such affiliates, subject to compliance with applicable regulations and regulatory guidance and our allocation procedures. While we may co-invest with investment entities managed by our investment advisor or its affiliates, to the extent permitted by the 1940 Act and the rules and regulations thereunder, the 1940 Act imposes significant limits on co-investment. On January 4, 2017, the SEC granted us relief sought in an exemptive application that expands our ability to co-invest in portfolio companies with certain of our affiliates managed by our investment advisor in a manner consistent with our investment objective, positions, policies, strategies and restrictions as well as regulatory requirements and other pertinent factors, subject to compliance with certain conditions (the Order). Pursuant to the Order, we are permitted to co-invest with our affiliates if a required majority (as defined in Section 57(o) of the 1940 Act) of our independent directors make certain conclusions in connection with a co-investment transaction, including that (1) the terms of the transactions, including the consideration to be paid, are reasonable and fair to us and our stockholders and do not involve overreaching by us or our stockholders on the part of any person concerned, and (2) the transaction is consistent with the interests of our stockholders and is consistent with our investment objective and strategies. We intend to co-invest, subject to the conditions included in the Order.

Our investment advisor or its investment committee may, from time to time, possess material non-public information, limiting our investment discretion.

The investment professionals of our investment advisor may serve as directors of, or in a similar capacity with, companies in which we invest, the securities of which are purchased or sold on our behalf. In the event that material non-public information is obtained with respect to such companies, or we become subject to trading restrictions under the internal trading policies of those companies or as a result of applicable law or regulations, we could be prohibited for a period of time from purchasing or selling the securities of such companies, and this prohibition may have an adverse effect on us.

We may have conflicts related to other arrangements with our investment advisor.

We entered into a license agreement with Fidus Partners, LLC under which Fidus Partners, LLC granted us a non-exclusive (provided that there is not a change in control of Fidus Partners, LLC), royalty-free license to use the name Fidus. Some of the members of our investment advisor s investment committee and the senior origination professionals of our investment advisor are members of Fidus Partners, LLC. See Management and Other Agreements License Agreement. In addition, we rent office space from our investment advisor and pay to our investment advisor our allocable portion of overhead and other expenses incurred in performing its obligations under the Administration Agreement, such as our allocable portion of the cost of our chief financial officer and chief compliance officer. This creates conflicts of interest that our board of directors must monitor.

The Funds are licensed by the SBA, and, therefore, are subject to SBA regulations.

The Funds are licensed to operate as SBICs and are regulated by the SBA. Under current SBA regulations, a licensed SBIC can provide capital to those entities that have a tangible net worth not exceeding $19.5 million and an average annual net income after U.S. federal income taxes not exceeding $6.5 million for the two most recent fiscal years. In addition, a licensed SBIC must devote 25.0% of its investment activity to those entities that have a tangible net worth not exceeding $6.0 million and an average annual net income after U.S. federal income taxes not exceeding $2.0 million for the two most recent fiscal years. The SBA regulations also provide alternative size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on either the number of employees or the gross sales of the business. The SBA regulations permit licensed SBICs to make long term loans to small businesses, invest in the equity securities of such businesses and provide them with consulting and advisory services. The SBA also places certain limitations on the financing terms of investments by SBICs in portfolio companies and prohibits SBICs from providing funds for certain purposes or to businesses in certain prohibited industries. Further, the SBA regulations require that a licensed SBIC be periodically examined and audited by the SBA staff to determine its compliance with the relevant SBA regulations. Compliance with these SBA requirements may cause the Funds to forego attractive investment opportunities that are not permitted under the SBA regulations, and may cause the Funds to make investments they otherwise would not make in order to remain in compliance with these regulations.

Failure to comply with the SBA regulations could result in the loss of the SBIC licenses and the resulting inability to participate in the SBA debenture program. The SBA prohibits, without prior SBA approval, a change of control of an SBIC or transfers that would result in any person (or a group of persons acting in concert) owning 10.0% or more of a class of capital stock of a licensed SBIC. Current SBA regulations provide the SBA with certain rights and remedies if an SBIC violates their terms. A key regulatory metric for SBA is the extent of Capital Impairment, which is the extent of realized (and, in certain circumstances, net unrealized) losses compared with the SBIC s private capital commitments. Interest payments, management fees, organization and other expenses are included in determining realized losses. SBA regulations preclude the full amount of unrealized appreciation from portfolio companies from being considered when calculating Capital Impairment in certain circumstances. Remedies for regulatory violations are graduated in severity depending on the seriousness of Capital Impairment or other regulatory violations. For minor regulatory infractions, the SBA issues a warning. For more serious infractions, the use of SBA debentures may be limited or prohibited, outstanding debentures can be declared to be immediately due and payable, restrictions on distributions and making new investments may be imposed and management fees may be required to be reduced. In severe cases, the SBA may require the removal of a general partner of an SBIC or its officers, directors, managers or partners, or the SBA may obtain appointment of a receiver for the SBIC.

SBA regulations limit the amount of SBA-guaranteed debt that may be borrowed by an SBIC.

The SBA regulations currently limit the amount that is available to be borrowed by any SBIC and guaranteed by the SBA to 300.0% of an SBIC s regulatory capital or $175.0 million, whichever is less. For three or more SBICs under common control, the maximum amount of outstanding SBA debentures cannot exceed $350.0 million. If the Funds borrow the maximum amount from the SBA and thereafter require additional capital, our cost of capital may increase, and there is no assurance that we will be able to obtain additional financing on acceptable terms.

Moreover, the Funds current status as SBICs does not automatically assure that they will continue to receive funding through the SBA debenture program. Receipt of SBA debenture funding is dependent upon the Funds continuing compliance with SBA regulations and policies and there being funding available. The amount of SBA debenture funding available to SBICs is dependent upon annual Congressional authorizations and in the future may be subject to annual Congressional appropriations. There can be no assurance that there will be sufficient SBA debenture funding available at the times desired by the Funds.

The debentures issued by the Funds and guaranteed by the SBA have a maturity of ten years and bear interest semi-annually at fixed rates. Certain of the Funds SBA debentures begin to mature in 2021 and will require repayment on or before the respective maturity dates. The Funds will need to generate sufficient cash flow to make required debt payments on such debentures. If the Funds are unable to generate such cash flow, the SBA, as guarantor of the debentures, will have a superior claim to our assets over our stockholders in the event the Funds liquidate or the SBA exercises its remedies under such debentures as the result of a default by the Funds.

The Funds, as SBICs, are limited in their ability to make distributions to us, which could result in us being unable to meet the minimum distribution requirements to maintain our status as a RIC.

In order to maintain our tax treatment as a RIC, we are required to distribute to our stockholders on an annual basis 90.0% of our net ordinary income and net short-term capital gains in excess of net long-term capital losses. For this purpose, our taxable income will include the income of the Funds (and any other entities that are disregarded as separate from us for U.S. federal income tax purposes). The Funds ability to make distributions to us may be limited by the Small Business Investment Act of 1958. As a result, in order to maintain our tax treatment as a RIC, we may be required to make distributions attributable to the Funds income without receiving any corresponding cash distributions with respect to such income. We can make no assurances that the Funds will be able to make, or not be limited in making, distributions to us. If we are unable to satisfy the annual distribution requirements, we may fail to maintain our tax treatment as a RIC, which would result in the imposition of corporate-level U.S. federal income tax on our entire taxable income without regard to any distributions made by us. See We will be subject to corporate-level U.S. federal income tax if we are unable to maintain our tax treatment as a RIC under Subchapter M of the Code.

Changes in interest rates will affect our cost of capital and net investment income.

Most of our debt investments bear interest at fixed rates and the value of these investments could be negatively affected by increases in market interest rates. In addition, to the extent that we borrow additional funds to make investments, an increase in interest rates would make it more expensive for us to use debt to finance our investments. As a result, a significant increase in market interest rates could both reduce the value of our portfolio

Table of Contents

investments and increase our cost of capital, which would reduce our net investment income. Conversely, a decrease in interest rates may have an adverse impact on our returns by requiring us to seek lower yields on our debt investments and by increasing the risk that our portfolio companies will prepay the debt investments, resulting in the need to redeploy capital at potentially lower rates.

In July 2017, the head of the United Kingdom Financial Conduct Authority announced the desire to phase out the use of London Interbank Offered Rate (LIBOR) by the end of 2021. There is currently no definitive information regarding the future utilization of LIBOR or of any particular replacement rate. As such, the potential effect of any such event on our cost of capital and net investment income cannot yet be determined. In addition, any further changes or reforms to the determination or supervision of LIBOR may result in a sudden or prolonged increase or decrease in reported LIBOR, which could have an adverse impact on the market value for or value of any LIBOR-linked securities, loans, and other financial obligations or extensions of credit held by or due to us and could have a material adverse effect on our business, financial condition and results of operations.

You should also be aware that a rise in market interest rates typically leads to higher interest rates applicable to our debt investments. Accordingly, an increase in interest rates may result in an increase of the amount of incentive fees payable to our investment advisor.

Our ability to enter into transactions involving derivatives and financial commitment transactions may be limited.

The SEC has proposed a new rule under the 1940 Act that would govern the use of derivatives (defined to include any swap, security-based swap, futures contract, forward contract, option or any similar instrument) as well as financial commitment transactions (defined to include reverse repurchase agreements, short sale borrowings and any firm or standby commitment agreement or similar agreement) by BDCs. Under the proposed rule, a BDC would be required to comply with one of two alternative portfolio limitations and manage the risks associated with derivatives transactions and financial commitment transactions by segregating certain assets. Furthermore, a BDC that engages in more than a limited amount of derivatives transactions or that uses complex derivatives would be required to establish a formalized derivatives risk management program. If the SEC adopts this rule in the form proposed, our ability to enter into transactions involving such instruments may be hindered, which could have an adverse effect on our business, financial condition and results of operations.

Global economic, political and market conditions may adversely affect our business, results of operations and financial condition, including our revenue growth and profitability.

The current worldwide financial market situation, as well as various social and political tensions in the United States and around the world, may contribute to increased market volatility, may have long-term effects on the U.S. and worldwide financial markets, and may cause economic uncertainties or deterioration in the United States and worldwide. The U.S. and global capital markets experienced extreme volatility and disruption during the economic downturn that began in mid-2007, and the U.S. economy was in a recession for several consecutive calendar quarters during the same period. In 2010, a financial crisis emerged in Europe, triggered by high budget deficits and rising direct and contingent sovereign debt, which created concerns about the ability of certain nations to continue to service their sovereign debt obligations. Risks resulting from such debt crisis, including any austerity measures taken in exchange for bailout of certain nations, and any future debt crisis in Europe or any similar crisis elsewhere could have a detrimental impact on the global economic recovery, sovereign and non-sovereign debt in certain countries and the financial condition of financial institutions generally. In June 2016, the United Kingdom held a referendum in which voters approved an exit from the European Union (Brexit), and, subsequently, on March 29, 2017, the U.K. government began the formal process of leaving the European Union, which is currently set to occur on March 29, 2019. Because the U.K. Parliament rejected Prime Minister Theresa May s proposed Brexit deal with the European

Union in January 2019, there is increased uncertainty on the final outcome of Brexit. Brexit has created political and economic uncertainty and instability in the global markets (including currency and credit markets) and especially in the United Kingdom and European Union, and this uncertainty and instability may last indefinitely. The implications of the United Kingdom s pending withdrawal from the European Union are unclear at present. There is continued concern about national-level support for the Euro and the accompanying coordination of fiscal and wage policy among European Economic and Monetary Union member countries. In addition, the fiscal and monetary policies of foreign nations, such as Russia and China, may have a severe impact on the worldwide and U.S. financial markets.

Table of Contents

The current state of the economy and financial markets of the U.S., United Kingdom, China and other several countries in the European Union increases the likelihood of adverse effects on our financial position and results of operations.

Due to federal budget deficit concerns, S&P downgraded the federal government s credit rating from AAA to AA+ for the first time in history on August 5, 2011. Further downgrades or warnings by S&P or other rating agencies, and the U.S. government s credit and deficit concerns in general, could cause interest rates and borrowing costs to rise, which may negatively impact both the perception of credit risk associated with our debt portfolio and our ability to access the debt markets on favorable terms. In addition, a decreased U.S. government credit rating could create broader financial turmoil and uncertainty, which may weigh heavily on our financial performance and the value of our common stock.

In 2010, a financial crisis emerged in Europe, triggered by high budget deficits and rising direct and contingent sovereign debt, which created concerns about the ability of certain nations to continue to service their sovereign debt obligations. Risks resulting from such debt crisis and any future debt crisis in Europe or any similar crisis elsewhere could have a detrimental impact on the global economic recovery, sovereign and non-sovereign debt in certain countries and the financial condition of financial institutions generally.

In the second quarter of 2015, stock prices in China experienced a significant drop, resulting primarily from continued selloff of shares trading in Chinese markets. In addition, in August 2015, Chinese authorities sharply devalued China s currency. Since then, the Chinese capital markets have continued to experience periods of instability. In June 2016, British voters passed a referendum to exit the European Union leading to heightened volatility in global markets and foreign currencies. These market and economic disruptions have affected, and may in the future affect, the U.S. capital markets, which could adversely affect our business, financial condition or results of operations.

In October 2014, the Federal Reserve announced that it was concluding its bond-buying program, or quantitative easing, which was designed to stimulate the economy and expand the Federal Reserve s holdings of long-term securities, suggesting that key economic indicators, such as the unemployment rate, had showed signs of improvement since the inception of the program. It is unclear what effect, if any, the conclusion of the Federal Reserve s bond-buying program will have on the value of our investments. Additionally, since December 2015, the Federal Reserve has continued to raise the Federal Funds Rate and has announced its intention to continue to raise the federal funds rate over time. These developments, along with the U.S. government s credit and deficit concerns, the European sovereign debt crisis and the economic slowdown in China, could cause interest rates and borrowing costs to rise, which may negatively impact our ability to access the debt markets on favorable terms.

We may experience fluctuations in our quarterly operating results.

We could experience fluctuations in our quarterly operating results due to a number of factors, including our ability or inability to make investments in companies that meet our investment criteria, the interest rate payable on the debt securities we acquire, the default rate on such securities, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

We will be subject to corporate-level U.S. federal income tax if we are unable to maintain our tax treatment as a RIC under Subchapter M of the Code.

We have elected to be treated as a RIC under Subchapter M of the Code; however, no assurance can be given that we will be able to maintain our RIC tax treatment. To maintain our tax treatment as a RIC under Subchapter M of the

Code and to avoid the imposition of U.S. federal income taxes on income and gains distributed to our stockholders, we must meet certain requirements, including source-of-income, asset diversification and annual distribution requirements. The source-of-income requirement will be satisfied if we derive at least 90.0% of our gross income for each year from dividends, interest, gains from sale of securities or similar sources. To maintain our tax treatment as a RIC, we must also meet certain asset diversification requirements at the end of each calendar quarter. Failure to meet these requirements may result in our losing our RIC tax treatment or our having to dispose of certain investments quickly in order to prevent the loss of RIC tax treatment. Because most of our investments will be in private or thinly traded public companies, any such dispositions could be made at disadvantageous prices and may result in substantial losses. The annual distribution requirement applicable to RICs will be satisfied if we distribute at least 90.0% of our net ordinary income and net short-term capital gains in excess of net long-term capital losses, if any, to our stockholders on an annual basis. In addition, we will be subject to a 4.0% nondeductible federal excise tax to the extent that we do not satisfy certain additional minimum distribution requirements on a calendar-year basis. We will be subject, to the extent we use debt financing, to certain asset coverage ratio requirements under the 1940 Act and financial covenants under loan and credit agreements that could, under certain circumstances, restrict us from making annual distributions necessary to maintain our tax treatment as a RIC. If we are unable to obtain cash from other sources, we may fail to maintain our tax treatment as a RIC and, thus, may be subject to U.S. federal corporate income tax on our entire taxable income without regard to any distributions made by us. If we fail to maintain our tax treatment as a RIC for any reason and become subject to U.S. corporate income tax, the resulting tax liability could substantially reduce our net assets, the amount of income available for distributions to stockholders and the amount of our distributions and the amount of funds available for new investments. Such a failure could have a material adverse effect on us and our stockholders.

We may not be able to pay you distributions, our distributions may not grow over time, a portion of distributions paid to you may be a return of capital, and investors in our debt securities may not receive all of the interest income to which they are entitled.

We intend to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution. We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. Our ability to pay distributions might be adversely affected by the impact of one or more of the risk factors described in this annual report on Form 10-K. In addition, due to the asset coverage test applicable to us as a BDC, in the future, we may be limited in our ability to make distributions. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of RIC tax treatment, compliance with applicable BDC regulations, SBA regulations, state corporate laws affecting the distribution of corporate assets and such other factors as our board of directors may deem relevant from time to time. We cannot assure you that we will make distributions to our stockholders in the future.

If we issue debt securities in the future, the above-referenced restrictions on distributions may also inhibit our ability to make required interest payments to holders of any such debt securities, which may cause a default under the terms of our then-existing debt agreements. Such a default could materially increase our cost of raising capital, as well as cause us to incur penalties under the terms of our then-existing debt agreements.

When we make quarterly distributions, we will be required to determine the extent to which such distributions are paid out of current and accumulated earnings and profits, recognized capital gain or capital. To the extent there is a return of capital, an investor gets his or her own invested capital returned to him or her, but reduced by the amount of the Company s expenses and any sales load he or she may have paid. In addition, investors will be required to reduce their basis in our stock for U.S. federal income tax purposes.

We may have difficulty paying our required distributions if we recognize income before, or without, receiving cash representing such income.

For U.S. federal income tax purposes, we are required to include in our income certain amounts that we have not yet received in cash, such as OID, which may arise if we receive warrants in connection with the making of a loan or in other circumstances, and contractual PIK interest, which represents contractual interest added to the loan balance and due at the end of the loan term. Such OID, or increases in loan balances as a result of contracted PIK arrangements, will be included in our income before we receive any corresponding cash payments. We also may be required to include in our income certain other amounts that we will not receive in cash.

Since in certain cases we may be required to recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute on an annual basis at least 90.0% of our net ordinary income and net short-term capital gains in excess of net long-term capital losses, if any, to maintain our tax treatment as a RIC. In such a case, we may have to sell some of our investments at times and/or at prices we would not consider advantageous, raise additional debt or equity capital or forgo new investment opportunities to satisfy the annual distribution requirements. In such circumstances, if we are unable to obtain such cash from other sources, we may fail to maintain our tax treatment as a RIC and thus be subject to corporate-level U.S. federal income tax. See We will be subject to corporate-level U.S. federal income tax if we are unable to maintain our tax treatment as a RIC under Subchapter M of the Code.

Table of Contents

If a portfolio company defaults on a loan that is structured to provide accrued interest, it is possible that accrued interest previously used in the calculation of the incentive fee will become uncollectible. Our investment advisor will not be under any obligation to reimburse us for any part of the incentive fee it received that was based on accrued income that we never receive as a result of a default by an entity on the obligation that resulted in the accrual of such income. That part of the incentive fee payable by us that relates to our net investment income will be computed and paid on income that may include interest that has been accrued but not yet received in cash, such as market discount, debt instruments with PIK interest, preferred stock with PIK dividends and zero coupon securities.

To the extent the we invest in OID instruments, including PIK loans, zero coupon bonds, and debt securities with attached warrants, investors will be exposed to the risks associated with the inclusion of such non-cash income in taxable and accounting income prior to receipt of cash, including the following risks:

- the interest payments deferred on a PIK loan are subject to the risk that the borrower may default when the deferred payments are due in cash at the maturity of the loan;

- the interest rates on PIK loans are higher to reflect the time-value of money on deferred interest payments and the higher credit risk of borrowers who may need to defer interest payments;

- PIK instruments may have unreliable valuations because the accruals require judgments about ultimate collectability of the deferred payments and the value of the associated collateral;

- an election to defer PIK interest payments by adding them to principal increases our gross assets and, thus, increases future base management fees to the Adviser and, because interest payments will then be payable on a larger principal amount, the PIK election also increases the Adviser s future income incentive fees at a compounding rate;

- market prices of OID instruments are more volatile because they are affected to a greater extent by interest rate changes than instruments that pay interest periodically in cash;

- the deferral of interest on a PIK loan increases its loan-to-value ratio, which is a measure of the riskiness of a loan;

- OID creates the risk of non-refundable cash payments to the Adviser based on non-cash accruals that may never be realized;

- for U.S. federal income tax purposes, we will be required to make distributions of OID income to shareholders without receiving any cash and such distributions have to be paid from offering proceeds or the sale of assets without investors being given any notice of this fact; and the required recognition of OID, including PIK, interest for U.S. federal income tax purposes may have a negative impact on liquidity, because it represents a non-cash component of the our taxable income that must, nevertheless, be distributed in cash to investors to avoid it being subject to corporate level taxation.

You may have a current tax liability on distributions you elect to reinvest in our common stock but would not receive cash to pay such tax liability.

If you participate in our dividend reinvestment plan, you will be deemed to have received, and for U.S. federal income tax purposes will be taxed on, the amount reinvested in our common stock to the extent the amount reinvested was not a tax-free return of capital. As a result, unless you are a tax-exempt entity, you may have to use funds from other sources to pay your tax liability on the value of our common stock received as a result of the distribution.

Table of Contents

Because we expect to distribute substantially all of our net investment income and net realized capital gains to our stockholders, we will need additional capital to finance our growth, and such capital may not be available on favorable terms or at all.

We have elected to be taxed for U.S. federal income tax purposes as a RIC under Subchapter M of the Code. If we continue to meet certain requirements, including source-of-income, asset diversification and distribution requirements, and if we continue to be regulated as a BDC, we will continue to qualify to be taxed as a RIC and therefore will not have to pay U.S. federal corporate income tax on income that we timely distribute to our stockholders, allowing us to substantially reduce or eliminate our corporate-level income tax liability. As a BDC, we are generally required to meet a coverage ratio of total assets to total senior securities, which includes all of our borrowings (other than SBA leverage) and any preferred stock we may issue in the future, of at least 200.0% at the time we issue any debt or preferred stock. This requirement limits the amount of our leverage. Because we will continue to need capital to grow our investment portfolio, this limitation may prevent us from incurring debt or issuing preferred stock and require us to raise additional equity at a time when it may be disadvantageous to do so.

While we expect to be able to borrow and to issue additional debt and equity securities, we cannot assure you that debt and equity financing will be available to us on favorable terms, or at all. If additional funds are not available to us, we could be forced to curtail or cease new investment activities, and our net asset value could decline. In addition, as a BDC, we generally are not permitted to issue equity securities priced below net asset value without stockholder approval. At our Annual Stockholders Meeting on June 7, 2018, our stockholders voted to allow us to issue common stock at a price below net asset value per share for a period of one year ending on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders. We expect to present to our stockholders a similar proposal at our 2019 Annual Meeting of Stockholders. The maximum number of shares issuable below net asset value pursuant to the authority granted by our stockholders that could result in such dilution is limited to 25.0% of FIC s then outstanding common stock immediately prior to each such sale. We do not intend to issue shares of our common stock below net asset value unless our board of directors determines that it would be in our stockholders best interests to do so. The level of net asset value dilution that could result from such an offering is not limited.

Illustration: Examples of Dilutive Effect of the Issuance of Shares Below Net Asset Value. The following table illustrates the level of net asset value dilution that would be experienced by a nonparticipating stockholder in three different hypothetical offerings of different sizes and levels of discount from net asset value per share, although it is not possible to predict the level of market price decline that may occur. Actual sales prices and discounts may differ from the presentation below.

Assume that Company XYZ has 1,000,000 common shares outstanding, $15,000,000 in total assets and $5,000,000 in total liabilities. The current net asset value and net asset value per share are thus $10,000,000 and $10.00, respectively. The table illustrates the dilutive effect on nonparticipating Stockholder A of (1) an offering of 50,000 shares (5.0% of the outstanding shares) at $9.50 per share after offering expenses and commission (a 5.0% discount from net asset value), (2) an offering of 100,000 shares (10.0% of the outstanding shares) at $9.00 per share after offering expenses and commissions (a 10.0% discount from net asset value) and (3) an offering of 200,000 shares (20.0% of the outstanding shares) at $8.00 per share after offering expenses and commissions (a 20.0% discount from net asset value). The acronym NAV stands for net asset value.

In any offering of common stock, we will present the actual dilution to stockholders in tabular form in the prospectus supplement specific to that offering.

	Prior to Sale Below NAV	Example 1 5% Offering At 5% Discount Following Sale	% Change	Example 2 10% Offering At 10% Discount Following Sale	% Change	Example 3 20% Offering At 20% Discount Following Sale	% Change	Example 4 25% Offering At 25% Discount Following Sale	% Change	Exam 25% Of At 100% Following Sale
ce										
are to Public		$ 10.00		$ 9.47		$ 8.42		$ 7.89		$
s per Share		$ 9.50		$ 9.00		$ 8.00		$ 7.50		$
NAV										
Outstanding	1,000,000	1,050,000	5.00%	1,100,000	10.00%	1,200,000	20.00%	1,250,000	25.00%	1,250,00

-23-

Table of Contents

hare	$ 10.00	$ 9.98	(0.24)%	$ 9.91	(0.91)%	$ 9.67	(3.33)%	$ 9.50	(5.00)%	$ 8.00
Stockholder										
d by er A	10,000	10,000		10,000		10,000		10,000		10,000
Held by er A	1.0%	0.95%	(4.76)%	0.91%	(9.09)%	0.83%	(16.67)%	0.80%	(20.00)%	0.80%
t Values										
/ Held by er A	$ 100,000	$ 99,762	(0.24)%	$ 99,091	(0.91)%	$ 96,667	(3.33)%	$ 95,000	(5.00)%	$ 80,000
stment by er A to be $10.00	$ 100,000	$ 100,000		$ 100,000		$ 100,000		$ 100,000		$ 100,000
ion to er A (Total Total)		$ (238)		$ (909)		$ (3,333)		$ (5,000)		$ (20,000)
Amounts										
hare Held by er A		$ 9.98		$ 9.91		$ 9.67		$ 9.50		$ 8.00
per Share ockholder A to be $10.00 on Shares to Sale)	$ 10.00	$ 10.00		$ 10.00		$ 10.00		$ 10.00		$ 10.00
er Share Held lder A Share Less per Share)		$ (0.02)		$ (0.09)		$ (0.33)		$ (0.50)		$ (2.00)
Dilution to er A (Dilution Divided by per Share)			(0.24)%		(0.91)%		(3.33)%		(5.00)%	

Our board of directors may change our investment objective, operating policies and strategies without prior notice or stockholder approval, the effects of which may be adverse.

Our board of directors has the authority, except as otherwise provided by the 1940 Act, to modify or waive certain of our operating policies and strategies without prior notice and without stockholder approval. Under Maryland law, we also cannot be dissolved without prior stockholder approval except by judicial action. In addition, upon approval of a majority of our stockholders, we may elect to withdraw our status as a BDC. If we, or Fund I, decide to withdraw our election, or if we otherwise fail to maintain our qualification, as a BDC, we may be subject to the substantially greater regulation under the 1940 Act as a closed-end investment company. Compliance with such regulations would significantly decrease our operating flexibility, and could significantly increase our costs of doing business. We cannot predict the effect any changes to our current operating policies and strategies would have on our business, operating results or the value of our common stock. Nevertheless, any such changes could adversely affect our business and impair our ability to make distributions.

Regulations governing our operation as a BDC affect our ability to raise, and the way in which we raise, additional capital which may have a negative effect on our growth.

Our business will require capital to operate and grow. We may acquire such additional capital from the following sources:

Senior Securities. Currently we, through the Funds, issue debt securities guaranteed by the SBA and have access to funds under a revolving credit facility. In the future, we may issue debt securities or preferred stock and/or borrow money from banks or other financial institutions, which we refer to collectively as senior securities. As a result of issuing senior securities, we will be exposed to additional risks, including, but not limited to, the following:

Under the provisions of the 1940 Act, we are permitted, as a BDC, to issue senior securities only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200.0% after each issuance of senior securities (or 150.0%, if certain requirements are met). If the value of our assets declines, we may be unable to satisfy this test. If that happens, we may sell a portion of our investments and, depending on the nature of our leverage, repay a portion of our debt at a time when such sales and/or repayments may be disadvantageous. Further, we will not be permitted to declare or make any distribution to stockholders or repurchase shares until such time as we satisfy this test.

Any amounts that we use to service our debt or make payments on preferred stock will not be available for distributions to our common stockholders.

It is likely that any senior securities or other indebtedness we issue will be governed by an indenture or other instrument containing covenants restricting our operating flexibility. Additionally, some of these securities or other indebtedness may be rated by rating agencies, and in obtaining a rating for such securities and other indebtedness, we may be required to abide by operating and investment guidelines that further restrict operating and financial flexibility.

We and, indirectly, our stockholders will bear the cost of issuing and servicing such securities and other indebtedness.

Preferred stock or any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our common stock, including separate voting rights and could delay or prevent a transaction or a change in control to the detriment of the holders of our common stock.

Additional Common Stock. Under the provisions of the 1940 Act, we are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, warrants, options or rights to acquire our common stock, at a price below the current net asset value of the common stock if our board of directors determines that such sale is in the best interests of our stockholders, and our stockholders approve such sale. At our Annual Stockholders Meeting on June 7, 2018, our stockholders voted to allow us to issue common stock at a price below net asset value per share for a period of one year ending on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders. We expect to present to our stockholders a similar proposal at our 2019 Annual Meeting of Stockholders. The maximum number of shares issuable below net asset value pursuant to the authority granted by our stockholders that could result in such dilution is limited to 25.0% of FIC s then outstanding common stock immediately prior to each such sale. We do not intend to sell or otherwise issue shares of our common stock below net asset value unless our board of directors determines that it would be in our stockholders best interests to do so. The level of net asset value dilution that could result from such an offering is not limited. In any such case, however, the price at which our common stock is to be issued and sold may not be less than a price which, in the determination of our board of directors, closely approximates the market value of such securities (less any distributing commission or discount). We may also make rights offerings to our stockholders at prices per share less than the net asset value per share, subject to applicable requirements of the 1940 Act and the regulations and staff interpretations thereunder. If we raise additional funds by issuing more common stock or senior securities convertible into, or exchangeable for, our common stock, the percentage ownership of our stockholders at that time would decrease, and they may experience dilution. Moreover, we can offer no assurance that we will be able to issue and sell additional equity securities in the future, on favorable terms or at all.

The U.S. Presidential Administration may make substantial changes to financial regulation, as well as fiscal and tax policies that may adversely affect our business.

The Republican Party currently controls the executive branch and the senate portion of the legislative branch of government, which increases the likelihood that legislation may be adopted that could significantly affect the regulation of U.S. financial markets. Areas subject to potential change, amendment or repeal include the Wall Street Reform and Consumer protection Act of 2010 (Dodd-Frank Act) and the authority of the Federal Reserve and the Financial Stability Oversight Council. For example, in March 2018 the U.S. Senate passed a bill that eased financial regulations and reduced oversight for certain entities. The United States may also potentially withdraw from or renegotiate various trade agreements and take other actions that would change current trade policies of the United States. We cannot predict which, if any, of these actions will be taken or, if taken, their effect on the financial stability of the United States. Such actions could have a significant adverse effect on our business, financial condition and results of operations. We cannot predict the effects of these or similar events in the future on the U.S. economy and securities markets or on our investments. We monitor developments and seek to manage our investments in a manner consistent with achieving our investment objective, but there can be no assurance that we will be successful in doing so.

On May 24, 2018, the U.S. presidential administration signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act, which increased from $50 billion to $250 billion the asset threshold for designation of systemically important financial institutions or SIFIs subject to enhanced prudential standards set by the Federal Reserve Board, staggering application of this change based on the size and risk of the covered bank

Table of Contents

holding company. On May 30, 2018, the Federal Reserve Board voted to consider changes to the Volcker Rule that would loosen compliance requirements for all banks. The effect of this change and any further rules or regulations are and could be complex and far-reaching, and the change and any future laws or regulations or changes thereto could negatively impact our operations, cash flows or financial condition, impose additional costs on us, intensify the regulatory supervision of us or otherwise adversely affect our business, financial condition and results of operations.

Uncertainty about U.S. Presidential Administration initiatives could negatively impact our business, financial condition and results of operations.

The current administration has called for significant changes to U.S. trade, healthcare, immigration, foreign and government regulatory policy. In this regard, there is significant uncertainty with respect to legislation, regulation and government policy at the federal level, as well as the state and local levels. Recent events have created a climate of heightened uncertainty and introduced new and difficult-to-quantify macroeconomic and political risks with potentially far-reaching implications. There has been a corresponding meaningful increase in the uncertainty surrounding interest rates, inflation, foreign exchange rates, trade volumes and fiscal and monetary policy. To the extent the U.S. Congress or the current administration implements changes to U.S. policy, those changes may impact, among other things, the U.S. and global economy, international trade and relations, unemployment, immigration, corporate taxes, healthcare, the U.S. regulatory environment, inflation and other areas. Although we cannot predict the impact, if any, of these changes to our business, they could adversely affect our business, financial condition, operating results and cash flows. Until we know what policy changes are made and how those changes impact our business and the business of our competitors over the long term, we will not know if, overall, we will benefit from them or be negatively affected by them.

Recent tax legislation could have a negative effect on the Company.

On December 22, 2017, tax reform legislation commonly referred to as the Tax Cuts and Jobs Act was signed into law. This legislation makes significant changes to the U.S. federal income tax rules applicable to both individuals and entities, including permanently reducing the U.S. federal corporate income tax rate, reducing the maximum U.S. federal individual income tax rate (effective for taxable years 2018 through 2025), restricting the deductibility of interest expense, and changing the rules regarding the calculation of net operating loss deductions that may be used to offset taxable income. There is uncertainty as to the impact of this legislation on us, the entities in which we invest, or an investment in our securities. New legislation and any U.S. Treasury regulations, administrative interpretations or court decisions interpreting such legislation could significantly and negatively affect the Company s ability to qualify for tax treatment as a RIC or the U.S. federal income tax consequences to the Company and its investors of such qualification, or could have other adverse consequences. You are urged to consult with your tax advisor with respect to the impact of this legislation and the status of any other regulatory or administrative developments and proposals and their potential effect on your investment in our securities.

Changes in laws or regulations governing our operations may adversely affect our business or cause us to alter our business strategy.

We are subject to regulation at the local, state and federal level. New legislation may be enacted or new interpretations, rulings or regulations could be adopted, including those governing the types of investments we are permitted to make, any of which could harm us and our stockholders, potentially with retroactive effect. In addition, any change to the SBA s current debenture program could have a significant impact on our ability to obtain low-cost leverage and, therefore, our competitive advantage over other funds.

Legal, tax and regulatory changes could occur that may adversely affect us. For example, from time to time the market for private equity transactions has been (and is currently being) adversely affected by a decrease in the availability of senior and subordinated financings for transactions, in part in response to credit market disruptions and/or regulatory pressures on providers of financing to reduce or eliminate their exposure to the risks involved in such transactions.

Additionally, any changes to the laws and regulations governing our operations related to permitted investments may cause us to alter our investment strategy in order to meet our investment objectives. Such changes could result in material differences to the strategies and plans set forth in this Annual Report and may shift our investment focus from the areas of expertise of our investment advisor to other types of investments in which our investment advisor may have little or no expertise or experience. Any such changes, if they occur, could have a material adverse effect on our results of operations and the value of your investment.

Table of Contents

Changes to U.S. tariff and import/export regulations may have a negative effect on our portfolio companies and, in turn, harm us.

There has been ongoing discussion and commentary regarding potential significant changes to U.S. trade policies, treaties and tariffs. The current U.S. presidential administration, along with the U.S. Congress, has created significant uncertainty about the future relationship between the United States and other countries with respect to trade policies, treaties and tariffs. These developments, or the perception that any of them could occur, may have a material adverse effect on global economic conditions and the stability of global financial markets, and may significantly reduce global trade and, in particular, trade between the impacted nations and the United States. Any of these factors could depress economic activity and restrict our portfolio companies access to suppliers or customers and have a material adverse effect on their business, financial condition and results of operations, which in turn would negatively impact us.

Our ability to enter into and exit investment transactions with our affiliates will be restricted.

Except in those instances where we have received prior exemptive relief from the SEC, we will be prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of our Independent Directors. We, our investment advisor, the Funds, and Fidus Credit Opportunities, L.P. received exemptive relief from the SEC under the 1940 Act, which permits us to co-invest with other funds managed by our investment advisor or its affiliates in a manner consistent with our investment objective, positions, policies, strategies and restrictions as well as regulatory requirements and other pertinent factors. In addition, any person that owns, directly or indirectly, 5.0% or more of our outstanding voting securities is deemed our affiliate for purposes of the 1940 Act and we are generally prohibited from buying or selling any security from or to such affiliate, absent the prior approval of our Independent Directors. The 1940 Act also prohibits joint transactions with an affiliate, which could include investments in the same portfolio company (whether at the same or different times), without prior approval of our Independent Directors. If a person acquires more than 25.0% of our voting securities, we will be prohibited from buying or selling any security from or to such person, or entering into joint transactions with such person, absent the prior approval of the SEC. These restrictions could limit or prohibit us from making certain attractive investments that we might otherwise make absent such restrictions.

Our investment advisor can resign on 60 days notice, and we may not be able to find a suitable replacement within that time, resulting in a disruption in our operations that could adversely affect our financial condition, business and results of operations.

Our investment advisor has the right, under the Investment Advisory Agreement, to resign at any time upon not less than 60 days written notice, whether we have found a replacement or not. If our investment advisor resigns, we may not be able to find a new investment advisor and administrator or hire internal management with similar expertise and ability to provide the same or equivalent services on acceptable terms within 60 days, or at all. If we are unable to do so quickly, our operations are likely to experience a disruption, our financial condition, business and results of operations as well as our ability to pay distributions are likely to be adversely affected and the market price of our shares may decline. In addition, investment activities are likely to suffer if we are unable to identify and reach an agreement with a single institution or group of executives having the expertise possessed by our investment advisor and its affiliates. Even if we are able to retain comparable management, whether internal or external, the integration of such management and their lack of familiarity with our investment objective may result in additional costs and time delays that may adversely affect our financial condition, business and results of operations.

Table of Contents

Our investment advisor can resign from its role as our administrator under the Administration Agreement, and we may not be able to find a suitable replacement, resulting in a disruption in our operations that could adversely affect our financial condition, business and results of operations.

Our investment advisor also has the right to resign under the Administration Agreement, whether we have found a replacement or not. If our investment advisor resigns as our administrator, we may not be able to find a new administrator or hire internal management with similar expertise and ability to provide the same or equivalent services on acceptable terms, or at all. If we are unable to do so quickly, our operations are likely to experience a disruption, our financial condition, business and results of operations as well as our ability to pay distributions are likely to be adversely affected and the market price of our shares may decline. In addition, administrative activities are likely to suffer if we are unable to identify and reach an agreement with a service provider or individuals with the expertise possessed by our investment advisor. Even if we are able to retain a comparable service provider or individuals to perform such services, whether internal or external, their integration into our business and lack of familiarity with our investment objective may result in additional costs and time delays that may adversely affect our financial condition, business and results of operations.

Efforts to comply with the Sarbanes-Oxley Act will involve significant expenditures, and non-compliance with the Sarbanes-Oxley Act may adversely affect us and the market price of our common stock.

As a publicly-traded company, we incur legal, accounting and other expenses, including costs associated with the periodic reporting requirements applicable to a company whose securities are registered under the Exchange Act, as well as additional corporate governance requirements, including requirements under the Sarbanes-Oxley Act and other rules implemented by the SEC.

Section 404 of the Sarbanes-Oxley Act requires that public companies evaluate and report on their systems of internal control over financial reporting. In addition, our independent registered public accounting firm must report on management s evaluation of those controls. In future periods, we may identify deficiencies in our system of internal controls over financial reporting that may require remediation. There can be no assurances that any such future deficiencies identified may not be material weaknesses that would be required to be reported in future periods.

Internal and external cyber threats, as well as other disasters, could impair our ability to conduct business effectively.

The occurrence of a disaster, such as a cyber-attack against us or against a third-party that has access to our data or networks, a natural catastrophe, an industrial accident, failure of our disaster recovery systems, or consequential employee error, could have an adverse effect on our ability to communicate or conduct business, negatively impacting our operations and financial condition. This adverse effect can become particularly acute if those events affect our electronic data processing, transmission, storage, and retrieval systems, or impact the availability, integrity, or confidentiality of our data.

We depend heavily upon computer systems to perform necessary business functions. Despite our implementation of a variety of security measures, our computer systems, networks, and data, like those of other companies, could be subject to cyber-attacks and unauthorized access, use, alteration, or destruction, such as from physical and electronic break-ins or unauthorized tampering, malware and computer virus attacks, or system failures and disruptions. If one or more of these events occurs, it could potentially jeopardize the confidential, proprietary, and other information processed, stored in, and transmitted through our computer systems and networks. Such an attack could cause interruptions or malfunctions in our operations, which could result in financial losses, litigation, regulatory penalties, client dissatisfaction or loss, reputational damage, and increased costs associated with mitigation of damages and remediation.

Third parties with which we do business may also be sources of cybersecurity or other technological risk. We outsource certain functions and these relationships allow for the storage and processing of our information, as well as client, counterparty, employee, and borrower information. While we engage in actions to reduce our exposure resulting from outsourcing, ongoing threats may result in unauthorized access, loss, exposure, destruction, or other cybersecurity incident that affects our data, resulting in increased costs and other consequences as described above.

Table of Contents

Risks Relating to Our Investments

Economic recessions or downturns could impair our portfolio companies and harm our operating results.

Many of our portfolio companies are susceptible to economic slowdowns or recessions (including industry specific downturns) and may be unable to repay our debt investments during these periods. Therefore, our non-performing assets are likely to increase and the value of our portfolio is likely to decrease during these periods. Adverse economic conditions may decrease the value of collateral securing some of our debt investments and the value of our equity investments. Economic slowdowns or recessions could lead to financial losses in our portfolio and a decrease in revenues, net income and assets. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could prevent us from increasing our investments and harm our operating results.

A portfolio company s failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its assets, which could trigger cross-defaults under other agreements and jeopardize our portfolio company s ability to meet its obligations under the loans and debt securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company.

Terrorist attacks, acts of war, or natural disasters may affect any market for our common stock, impact the businesses in which we invest and harm our business, operating results and financial condition.

Portfolio investments may be affected by force majeure events *(i.e.,* events beyond the control of the party claiming that the event has occurred, including, without limitation, acts of God, fire, flood, earthquakes, war, terrorism and labor strikes). Some force majeure events may adversely affect the ability of a party (including a portfolio company or a counterparty to us or a portfolio company) to perform its obligations until it is able to remedy the force majeure event. In addition, the cost to a portfolio company of repairing or replacing damaged assets resulting from such force majeure event could be considerable. Additionally, a major governmental intervention into industry, including the nationalization of an industry or the assertion of control over one or more companies or its assets, could result in a loss to us, including if its investment in such issuer is cancelled, unwound or acquired (which could be without what we consider to be adequate compensation). To the extent we are exposed to investments in portfolio companies that as a group are exposed to such force majeure events, the risks and potential losses to us are enhanced.

Our investments in certain industry sectors, such as the energy sector, may be subject to significant political, economic and capacity risks that may increase the possibility that we lose all or a part of our investment.

The revenues and profitability of certain portfolio companies may be significantly affected by the future prices of and the demand for oil, natural gas liquids and natural gas, which are inherently uncertain. Investments in energy companies may have significant shortfalls in projected cash flow if prices decline from levels projected at the time the investment is made. Various factors beyond our control could affect energy prices, including worldwide supplies, political instability or armed conflicts in oil, natural gas liquids and natural gas producing regions, the price of foreign imports, the level of consumer demand, the price and availability of alternative fuels, capacity constraints and changes in existing government regulation, taxation and price controls. Energy prices have fluctuated greatly during the past, and energy markets continue to be volatile.

Changes in healthcare laws and other regulations applicable to some of our portfolio companies businesses may constrain their ability to offer their products and services.

Changes in healthcare or other laws and regulations applicable to the businesses of some of our portfolio companies may occur that could increase their compliance and other costs of doing business, require significant systems enhancements, or render their products or services less profitable or obsolete, any of which could have a material adverse effect on their results of operations. There has also been an increased political and regulatory focus on healthcare laws in recent years, and new legislation could have a material effect on the business and operations of some of our portfolio companies.

Table of Contents

If our portfolio companies are unable to protect their intellectual property rights, our business and prospects could be harmed, and if portfolio companies are required to devote significant resources to protecting their intellectual property rights, the value of our investment could be reduced.

Our future success and competitive position will depend in part upon the ability of our portfolio companies to obtain, maintain and protect proprietary technology used in their products and services. The intellectual property held by our portfolio companies often represents a substantial portion of the collateral securing our investments and/or constitutes a significant portion of the portfolio companies value and may be available in a downside scenario to repay our loans. Our portfolio companies will rely, in part, on patent, trade secret, and trademark law to protect that technology, but competitors may misappropriate their intellectual property, and disputes as to ownership of intellectual property may arise. Portfolio companies may, from time to time, be required to institute litigation to enforce their patents, copyrights, or other intellectual property rights; protect their trade secrets; determine the validity and scope of the proprietary rights of others; or defend against claims of infringement. Such litigation could result in substantial costs and diversion of resources. Similarly, if a portfolio company is found to infringe or misappropriate a third-party s patent or other proprietary rights, it could be required to pay damages to the third party, alter its products or processes, obtain a license from the third-party, and/or cease activities utilizing the proprietary rights, including making or selling products utilizing the proprietary rights. Any of the foregoing events could negatively affect both the portfolio company s ability to service our debt investment and the value of any related debt and equity securities that we own, as well as any collateral securing our investment.

Our investments in portfolio companies may be risky, and we could lose all or part of our investment.

Investing in lower middle-market companies involves a number of significant risks. Among other things, these companies:

- may have limited financial resources and may be unable to meet their obligations under their debt instruments that we hold, which may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of us realizing any guarantees from subsidiaries or affiliates of portfolio companies that we may have obtained in connection with our investment;

- may have shorter operating histories, narrower product lines and smaller market shares, which tend to render them more vulnerable to competitors actions and market conditions, as well as general economic downturns, than larger businesses;

- are more likely to depend on the management talents and efforts of a small group of persons; therefore, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on our portfolio company and, in turn, on us;

- generally have less predictable operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, and may require substantial additional capital to support their operations, finance expansion or maintain their competitive position; and generally have less publicly available information about their businesses, operations and financial condition. If we are unable to uncover all material information about these companies, we may not make a fully informed investment decision, and may lose all or part of our investment.

In addition, in the course of providing significant managerial assistance to certain portfolio companies, certain of our management and directors may serve as directors on the boards of such companies. To the extent that litigation arises out of investments in these portfolio companies, our management and directors may be named as defendants in such litigation, which could result in an expenditure of funds (through our indemnification of such officers and directors) and the diversion of management time and resources.

The lack of liquidity in our investments may adversely affect our business.

All of our assets may be invested in illiquid securities, and a substantial portion of our investments in leveraged companies will be subject to legal and other restrictions on resale or will otherwise be less liquid than more broadly traded public securities. The illiquidity of these investments may make it difficult for us to sell such investments when desired. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded these investments. As a result, we do not expect to achieve liquidity in our investments in the near-term. However, to maintain the elections to be regulated as a BDC and as a RIC, we may have to dispose of investments if they do not satisfy one or more of the applicable criteria under the respective regulatory frameworks. We may also face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we or our investment advisor have material nonpublic information regarding such portfolio company.

We may not have the funds to make additional investments in our portfolio companies which could impair the value of our portfolio.

After our initial investment in a portfolio company, we may be called upon from time to time to provide additional funds to such company or have the opportunity to increase our investment through the exercise of a warrant to purchase common stock. There is no assurance that we will make, or will have sufficient funds to make, follow-on investments. Any decisions not to make a follow-on investment or any inability on our part to make such an investment may have a negative impact on a portfolio company in need of such an investment, may result in a missed opportunity for us to increase our participation in a successful operation or may reduce the expected yield on the investment. Even if we have sufficient capital to make a desired follow-on investment, we may elect not to make a follow-on investment because we may not want to increase our level of risk, because we prefer other opportunities or because we are inhibited by compliance with BDC requirements, SBA regulations or the desire to maintain our RIC tax treatment. Our ability to make follow-on investments may also be limited by our investment advisor s allocation policy.

Portfolio companies may incur debt that ranks equally with, or senior to, our investments in such companies.

We will invest primarily in second lien and subordinated debt as well as equity issued by lower middle-market companies. The portfolio companies generally have, or may be permitted to incur, other debt that ranks equally with, or senior to, the debt in which we invest. By their terms, such senior debt instruments may entitle the holders to receive payment of interest or principal on or before the dates on which we are entitled to receive payments with respect to the debt instruments in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of debt instruments ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution. After repaying such senior creditors, such portfolio company may not have any remaining assets to use for repaying its obligation to us. In the case of debt ranking equally with debt instruments in which we invest, we would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant portfolio company.

There may be circumstances where our debt investments could be subordinated to claims of other creditors or could be subject to lender liability claims.

Even though we may have structured certain of our investments as senior loans, if one of our portfolio companies were to go bankrupt, depending on the facts and circumstances, including the extent to which we actually provided managerial assistance to that portfolio company, a bankruptcy court might recharacterize our debt investment and subordinate all or a portion of our claim to that of other creditors. We may also be subject to lender liability claims for actions taken by us with respect to a borrower s business or instances where we exercise control over the borrower. It is possible that we could become subject to a lender s liability claim, including as a result of actions taken in rendering significant managerial assistance.

Second priority liens on collateral securing loans that we make to our portfolio companies may be subject to control by senior creditors with first priority liens. If there is a default, the value of the collateral may not be sufficient to repay in full both the first priority creditors and us.

Certain loans we make to portfolio companies are and will be secured on a second priority basis by the same collateral securing senior secured debt of such companies. The first priority liens on the collateral secure the portfolio company s obligations under any outstanding senior debt and may secure certain other future debt that may be permitted to be incurred by the company under the agreements governing the loans. The holders of obligations secured by the first priority liens on the collateral will generally control the liquidation of and be entitled to receive proceeds from any realization of the collateral to repay their obligations in full before us. In addition, the value of the collateral in the event of liquidation will depend on market and economic conditions, the availability of buyers and other factors. There can be no assurance that the proceeds, if any, from the sale or sales of all of the collateral would be sufficient to satisfy the loan obligations secured by the second priority liens after payment in full of all obligations secured by the first priority liens on the collateral. If such proceeds are not sufficient to repay amounts outstanding under the loan obligations secured by the second priority liens, then we, to the extent not repaid from the proceeds of the sale of the collateral, will only have an unsecured claim against the company s remaining assets, if any.

Table of Contents

The rights we may have with respect to the collateral securing the loans we make to portfolio companies with senior debt outstanding may also be limited pursuant to the terms of one or more intercreditor agreements entered into with the holders of senior debt. Under an intercreditor agreement, at any time that obligations having the benefit of the first priority liens are outstanding, any of the following actions that may be taken in respect to the collateral will be at the direction of the holders of the obligations secured by the first priority liens:

- the ability to cause the commencement of enforcement proceedings against the collateral;
- the ability to control the conduct of such proceedings;
- the approval of amendments to collateral documents;
- releases of liens on the collateral; and
- waivers of past defaults under collateral documents.

We may not have the ability to control or direct such actions, even if our rights are adversely affected.

We may hold the debt securities of leveraged companies that may, due to the significant volatility of such companies, enter into bankruptcy proceedings.

Leveraged companies may experience bankruptcy or similar financial distress. The bankruptcy process has a number of significant inherent risks. Many events in a bankruptcy proceeding are the product of contested matters and adversary proceedings and are beyond the control of the creditors. A bankruptcy filing by an issuer may adversely and permanently affect the issuer. If the proceeding is converted to a liquidation, the value of the issuer may not equal the liquidation value that was believed to exist at the time of the investment. The duration of a bankruptcy proceeding is also difficult to predict, and a creditor s return on investment can be adversely affected by delays until the plan of reorganization or liquidation ultimately becomes effective. The administrative costs in connection with a bankruptcy proceeding are frequently high and would be paid out of the debtor s estate prior to any return to creditors. Because the standards for classification of claims under bankruptcy law are vague, our influence with respect to the class of securities or other obligations we own may be lost by increases in the number and amount of claims in the same class or by different classification and treatment. In the early stages of the bankruptcy process, it is often difficult to estimate the extent of, or even to identify, any contingent claims that might be made. In addition, certain claims that have priority by law (for example, claims for taxes) may be substantial.

Any unrealized depreciation we experience on our investment portfolio may be an indication of future realized losses, which could reduce our income available for distribution.

As a BDC, we are required to carry our investments at fair value as determined in good faith by our board of directors. Decreases in the fair values of our investments will be recorded as unrealized depreciation. Any unrealized depreciation in our investment portfolio could be an indication of a portfolio company s inability to meet its repayment obligations to us with respect to the affected investments. This could result in realized losses in the future and ultimately in reductions of our income available for distribution in future periods.

Defaults by our portfolio companies will harm our operating results.

A portfolio company s failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its assets. This could trigger cross-defaults under other agreements and jeopardize the portfolio company s ability to meet its obligations under the debt or equity securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms, which may include the waiver of certain financial covenants, reduced interest and/or loss of principal, with a defaulting portfolio company.

Table of Contents

To the extent OID and PIK-interest constitute a portion of our income, we will be exposed to typical risks associated with such income being required to be included in taxable and accounting income prior to receipt of cash representing such income.

Our investments may include original-issue-discount instruments and contractual PIK-interest arrangements. To the extent OID or PIK-interest constitutes a portion of our income, we are exposed to typical risks associated with such income being required to be included in taxable and accounting income prior to receipt of cash, including the following:

- The higher interest rates of OID and PIK instruments reflect the payment deferral, which results in a higher principal amount at the maturity of the instrument as compared to the original principal amount of the instrument, and increased credit risk associated with these instruments, and OID and PIK instruments generally represent a significantly higher credit risk than coupon loans.

- Even if the accounting conditions for income accrual are met, the borrower could still default when our actual collection is supposed to occur at the maturity of the obligation.

- OID and PIK instruments may have unreliable valuations because their continuing accruals require continuing judgments about the collectability of the deferred payments and the value of any associated collateral. OID and PIK-income may also create uncertainty about the source of our cash distributions.

- To the extent we provide loans with interest-only payments or moderate loan amortization, the majority of the principal payment or amortization of principal may be deferred until loan maturity. Because this debt generally allows the borrower to make a large lump-sum payment of principal at the end of the loan term, there is a risk of loss if the borrower is unable to pay the lump sum or refinance the amount owed at maturity.

- For accounting purposes, any cash distributions to stockholders representing OID and PIK-income are not treated as coming from paid-in capital, even though the cash to pay them comes from the offering proceeds. As a result, despite the fact that a distribution representing OID and PIK-income could be paid out of amounts invested by our stockholders, the 1940 Act does not require that stockholders be given notice of this fact by reporting it as a return of capital.

- In certain cases, we may recognize taxable income before or without receiving corresponding cash payments and, as a result, we may have difficulty meeting the annual distribution requirement necessary to maintain our qualification as a RIC.

We do not expect to control many of our portfolio companies.

We do not expect to control many of our portfolio companies, even though we may have board representation or board observation rights, and the debt agreements may contain certain restrictive covenants. As a result, we are subject to the risk that a portfolio company in which we invest may make business decisions with which we disagree and the management of such company, as representatives of the holders of the company s common equity, may take risks or otherwise act in ways that do not serve our interests as debt investors. Due to the lack of liquidity for our investments in private companies in the lower middle-market, we may not be able to dispose of our interests in our portfolio companies as readily as we would like or at an appropriate valuation. As a result, a portfolio company may make decisions that could decrease the value of our portfolio holdings.

We are a non-diversified investment company within the meaning of the 1940 Act; therefore we are not limited with respect to the proportion of our assets that may be invested in securities of a single issuer.

We are classified as a non-diversified investment company within the meaning of the 1940 Act, which means that we are not limited by the 1940 Act with respect to the proportion of our assets that we may invest in securities of a single issuer. To the extent that we assume large positions in the securities of a small number of issuers, our net asset value may fluctuate to a greater extent than that of a diversified investment company as a result of changes in the financial condition or the market s assessment of the issuer and the aggregate returns we realize may be significantly adversely affected if a small number of investments perform poorly or if we need to write down the value of any one investment. Additionally, while we are not targeting any specific industries, our investments may be concentrated in relatively few industries. As a result, a downturn in any particular industry in which we are invested could also significantly impact the aggregate returns we realize. We may also be more susceptible to any single economic or regulatory occurrence than a diversified investment company. Beyond the asset diversification requirements applicable to RICs, we do not have fixed guidelines for diversification, and our investments could be concentrated in relatively few portfolio companies.

Table of Contents

Prepayments of our debt investments by our portfolio companies could adversely impact our results of operations and reduce our return on equity.

We are subject to the risk that the investments we make in our portfolio companies may be repaid prior to maturity. When this occurs, we will generally reinvest these proceeds in temporary investments (cash equivalents), pending future investments in new portfolio companies. These temporary investments will typically have substantially lower yields than the debt being repaid, and we could experience significant delays in reinvesting these amounts. In addition, any future investment of such amounts in a new portfolio company may also be at lower yields than the investment that was repaid. As a result, our results of operations could be materially adversely affected if one or more of our portfolio companies elect to prepay amounts owed to us. Additionally, prepayments could negatively impact our return on equity, which could result in a decline in the market price of our common stock.

We may not realize gains from our equity investments.

Certain investments that we have made in the past and may make in the future include warrants or other equity or equity-related securities. Typically we make non-control, equity investments in portfolio companies. Our goal is to realize gains upon our disposition of such equity interests. However, the equity interests we receive may not appreciate in value and, in fact, may decline in value. We also may be unable to realize any value if a portfolio company does not have a liquidity event, such as a sale of the business, recapitalization or public offering, which would allow us to sell the underlying equity interests. We often seek puts or similar rights to give us the right to sell our equity securities back to the portfolio company issuer. We may be unable to exercise these put rights for the consideration provided in our investment documents if the issuer is in financial distress. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience.

If our primary investments are deemed not to be qualifying assets, we could be precluded from investing in our desired manner or deemed to be in violation of the 1940 Act.

In order to maintain our status as a BDC, we may not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70.0% of our total assets are qualifying assets. We believe that most of the investments that we may acquire in the future will constitute qualifying assets. However, we may be precluded from investing in what we believe are attractive investments if such investments are not qualifying assets for purposes of the 1940 Act. If we do not invest a sufficient portion of our assets in qualifying assets, we could violate the 1940 Act provisions applicable to BDCs and be precluded from making follow-on investments in existing portfolio companies (which could result in the dilution of our position) or required to dispose of investments at inappropriate times in order to come into compliance with the 1940 Act. If we need to dispose of such investments quickly, it could be difficult to dispose of such investments on favorable terms. We may not be able to find a buyer for such investments and, even if we do find a buyer, we may have to sell the investments at a substantial loss. Any such outcomes would have a material adverse effect on our business, financial condition, results of operations and cash flows. Furthermore, any failure to comply with the requirements imposed on BDCs by the 1940 Act could cause the SEC to bring an enforcement action against us and/or expose us to claims of private litigants. If we do not maintain our status as a BDC, we would be subject to regulation as a registered closed-end investment company under the 1940 Act. As a registered closed-end investment company, we would be subject to substantially more regulatory restrictions under the 1940 Act, which would significantly decrease our operating flexibility.

The disposition of our investments may result in contingent liabilities.

A significant portion of our investments involve private securities and we expect that a significant portion of our investments will continue to involve private securities. In connection with the disposition of an investment in private securities, we may be required to make representations about the business and financial affairs of the portfolio company typical of those made in connection with the sale of a business. Additionally, customary terms of such sales agreements generally provide adjustments to the initial purchase price determined on the closing date if the portfolio company s net working capital varies from preliminary amounts utilized in determining the initial purchase price; such adjustments could subsequently result in upward or downward revisions to the initial purchase price and impact our amount of realized gain or loss on sale. We may also be required to indemnify the purchasers of such investment to the extent that any such representations turn out to be inaccurate or with respect to potential liabilities. These arrangements may result in contingent liabilities that ultimately result in funding obligations that we must satisfy through its return of distributions previously made to it.

We may be unable to invest a significant portion of any net proceeds from an offering or from exiting an investment or other capital on acceptable terms, which could harm our financial condition and operating results.

We may be unable to invest the net proceeds of any offering or from exiting an investment or other sources of capital on acceptable terms within the time period that we anticipate or at all. Delays in investing such capital may cause our performance to be worse than that of fully invested BDCs or other lenders or investors pursuing comparable investment strategies.

Depending on market conditions and the amount of the capital involved, it may take us a substantial period of time to invest substantially all the capital in securities meeting our investment objective. During this period, we will invest such capital primarily in short-term securities consistent with our BDC election and our election to be taxed as a RIC, which may produce returns that are significantly lower than the returns which we expect to achieve when our portfolio is fully invested in longer-term investments in pursuit of our investment objective. Any distributions that we pay during such period may be substantially lower than the distributions that we may be able to pay when our portfolio is fully invested. In addition, until such time as the net proceeds of any offering or from exiting an investment or other sources capital are invested in new investments meeting our investment objective, the market price for our common stock may decline.

Our investment advisor s liability is limited under the Investment Advisory Agreement, and we have agreed to indemnify our investment advisor against certain liabilities, which may lead our investment advisor to act in a riskier manner on our behalf than it would when acting for its own account.

Under the Investment Advisory Agreement, our investment advisor does not assume any responsibility to us other than to render the services called for under that agreement, and it is not responsible for any action of our board of directors in following or declining to follow our investment advisor s advice or recommendations. Under the terms of the Investment Advisory Agreement, our investment advisor and its officers, directors, members, managers, partners, stockholders and employees are not liable to us, any subsidiary of ours, our directors, our stockholders or any subsidiary s stockholders or partners for acts or omissions performed in accordance with and pursuant to the Investment Advisory Agreement, except those resulting from acts constituting gross negligence, willful misconduct, bad faith or reckless disregard of our investment advisor s duties under the Investment Advisory Agreement. In addition, we have agreed to indemnify our investment advisor and its officers, directors, members, managers, partners, stockholders and employees from and against any claims or liabilities, including reasonable legal fees and other expenses reasonably incurred, arising out of or in connection with our business and operations or any action taken or omitted on our behalf pursuant to authority granted by the Investment Advisory Agreement, except where attributable to gross negligence, willful misconduct, bad faith or reckless disregard of such person s duties under the Investment Advisory Agreement. These protections may lead our investment advisor to act in a riskier manner when acting on our behalf than it would when acting for its own account.

Risks Relating to an Offering of Our Securities

Shares of closed-end investment companies, including business development companies, frequently trade at a discount to their net asset value.

Shares of closed-end investment companies, including BDCs, frequently trade at a discount from net asset value. This characteristic of closed-end investment companies and BDCs is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our common stock will trade at, above or below net asset value. In addition, if our common stock trades below net asset value, we will generally not be able to issue additional common stock at the market price without first obtaining the approval of our stockholders and our Independent

Directors. On June 7, 2018 our stockholders voted to allow us to sell or otherwise issue common stock at a price below net asset value per share for a period of one year ending on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders. We expect to present to our stockholders a similar proposal at our 2019 Annual Meeting of Stockholders. Selling or otherwise issuing shares of FIC s common stock below its then current net asset value per share would result in a dilution of FIC s existing common stockholders. The maximum number of shares issuable below net asset value pursuant to the authority granted by our stockholders that could result in such dilution is limited to 25.0% of FIC s then outstanding common stock immediately prior to each such sale. We do not intend to sell or otherwise issue shares of our common stock below net asset value unless our board of directors determines that it would be in our stockholders best interests to do so. The level of net asset value dilution that could result from such an offering is not limited.

Table of Contents

Market conditions may increase the risks associated with our business and an investment in us.

The current worldwide financial market situation may contribute to increased market volatility, may have long-term effects on the U.S. and worldwide financial markets and may cause economic uncertainties or deterioration in the U.S. and worldwide. These conditions raised the level of many of the risks described herein and, if repeated or continued, could have an adverse effect on our portfolio companies and on their results of operations, financial conditions, access to credit and capital. The stress in the credit market and upon banks has led other creditors to tighten credit and the terms of credit. In certain cases, senior lenders to our portfolio companies can block payments by our portfolio companies in respect of our loans to such portfolio companies. In turn, these could have adverse effects on our business, financial condition, results of operations, distributions to our stockholders, access to capital, valuation of our assets and our stock price. Notwithstanding any recent gains across either the equity or debt markets, these conditions may continue for a prolonged period of time or worsen in the future.

If, in the future, we sell common stock at a discount to our net asset value per share, stockholders who do not participate in such sale will experience immediate dilution in an amount that may be material.

On June 7, 2018, our stockholders approved our ability to sell or otherwise issue shares of our common stock at a discount from net asset value per share, as long as the cumulative number of shares sold pursuant to such authority does not exceed 25.0% of our then outstanding common stock immediately prior to each such sale, for a period of one year ending on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders. Our stockholders will be asked to vote on a similar proposal at our 2019 Annual Meeting of Stockholders. If we sell or otherwise issue shares of our common stock at a discount to net asset value, it will pose a risk of dilution to our stockholders. In particular, stockholders who do not purchase additional shares at or below the discounted price in proportion to their current ownership will experience an immediate decrease in net asset value per share (as well as in the aggregate net asset value of their shares if they do not participate at all). These stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we experience in our assets, potential earning power and voting interests from such issuances or sale. In addition, such issuances or sales may adversely affect the price at which our common stock trades. For additional information and hypothetical examples of these risks, see Sales of Common Stock Below Net Asset Value, and for actual dilution illustrations specific to an offering, see the prospectus supplement pursuant to which such sale is made.

Our net asset value may have changed significantly since our last valuation.

Our board of directors determines the fair value of our portfolio investments on a quarterly basis based on input from our investment advisor, our audit committee and, as to certain of our investments, a third party independent valuation firm. While the board of directors will review our net asset value per share in connection with any offering, it will not always have the benefit of input from the independent valuation firm when it does so. The fair value of various individual investments in our portfolio and/or the aggregate fair value of our investments may change significantly over time. If the fair value of our investment portfolio at December 31, 2018 is less than the fair value was at the time of an offering during 2018, then we may record an unrealized loss on our investment portfolio and may report a lower net asset value per share than was reflected in the Selected Consolidated Financial Data and the financial statements included in the prospectus supplement of that offering. If the fair value of our investment portfolio at December 31, 2018 is greater than the fair value at the time of an offering during 2018, we may record an unrealized gain on our investment portfolio and may report a greater net asset value per share than so reflected in the prospectus supplement of that offering. Upon publication of this information in connection with our announcement of operating results for our fiscal year ended December 31, 2018, the market price of our common stock may fluctuate materially, and may be substantially less than the price per share you pay for our common stock in an offering.

Table of Contents

The market price of our securities may fluctuate significantly.

The market price and liquidity of the market for shares of our common stock may be significantly affected by numerous factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include:

- significant volatility in the market price and trading volume of securities of BDCs or other companies in our sector, which is not necessarily related to the operating performance of these companies;
- exclusion of our common stock from certain market indices, such as the Russell 2000 Financial Services Index, could reduce the ability of certain institutional investors to own our common stock and could put short term pressure on our common stock;
- changes in regulatory policies or tax guidelines, particularly with respect to RICs, BDCs or SBICs;
- loss of RIC or BDC status;
- loss of status as an SBIC for the Funds, or any other SBIC subsidiary we may form;
- changes or perceived changes in earnings or variations in operating results;
- changes or perceived changes in the value of our portfolio of investments;
- changes in accounting guidelines governing valuation of our investments;
- any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;
- departure of our investment advisor s key personnel;
- operating performance of companies comparable to us;
- general economic trends and other external factors; and

loss of a major funding source.

Investing in our securities may involve an above average degree of risk.

The investments we make in accordance with our investment objective may result in a higher amount of risk than alternative investment options and a higher risk of volatility or loss of principal. Our investments in portfolio companies may be highly speculative; therefore, an investment in our securities may not be suitable for someone with lower risk tolerance.

Sales of substantial amounts of our common stock may have an adverse effect on the market price of our common stock.

As of April 24, 2019, we had 24,463,119 shares of common stock outstanding. Sales of substantial amounts of our common stock, or the availability of shares for sale, could adversely affect the prevailing market price of our common stock. If this occurs and continues, it could impair our ability to raise additional capital through the sale of equity securities should we desire to do so.

If we issue preferred stock and/or debt securities, the net asset value and market value of our common stock may become more volatile.

We cannot assure you that the issuance of preferred stock and/or debt securities would result in a higher yield or return to the holders of our common stock. The issuance of preferred stock and/or debt securities would likely cause the net asset value and market value of our common stock to become more volatile. If the distribution rate on the preferred stock, or the interest rate on the debt securities, were to approach the net rate of return on our investment portfolio, the benefit of leverage to the holders of our common stock would be reduced. If the distribution rate on the preferred stock, or the interest rate on the debt securities, were to exceed the net rate of return on our portfolio, the use of leverage would result in a lower rate of return to the holders of common stock than if we had not issued the preferred stock and/or debt securities. Any decline in the net asset value of our investment would be borne entirely by the holders of our common stock. Therefore, if the market value of our portfolio were to decline, the leverage would result in a greater decrease in net asset value to the holders of our common stock than if we were not leveraged through the issuance of preferred stock and/or debt securities. This decline in net asset value would also tend to cause a greater decline in the market price for our common stock.

There is also a risk that, in the event of a sharp decline in the value of our net assets, we would be in danger of failing to maintain required asset coverage ratios which may be required by the preferred stock and/or debt securities or of a downgrade in the ratings of the preferred stock and/or debt securities or our current investment income might not be sufficient to meet the distribution requirements on the preferred stock or the interest payments on the debt securities. In order to counteract such an event, we might need to liquidate investments in order to fund redemption of some or all of the preferred stock and/or debt securities. In addition, we would pay (and the holders of our common stock would bear) all costs and expenses relating to the issuance and ongoing maintenance of the preferred stock and/or debt securities. Holders of preferred stock and/or debt securities may have different interests than holders of common stock and may at times have disproportionate influence over our affairs.

Table of Contents

If we issue auction rate preferred stock and you purchase such auction rate preferred stock, you may not be able to sell your auction rate preferred stock at an auction if the auction fails.

If we issue auction rate preferred stock and you purchase such auction rate preferred stock, you may not be able to sell your auction rate preferred stock at an auction if the auction fails, i.e., if more shares of auction rate preferred stock are offered for sale than there are buyers for those shares. Also, if you place an order (a hold order) at an auction to retain auction rate preferred stock only at a specified rate that exceeds the rate set at the auction, you will not retain your auction rate preferred stock. Additionally, if you place a hold order without specifying a rate below which you would not wish to continue to hold your shares and the auction sets a below-market rate, you will receive a lower rate of return on your shares than any market rate of those securities. Finally, the distribution period of these securities may be changed, subject to certain conditions and with notice to the holders of the auction rate preferred stock, which could also affect the liquidity of your investment.

If you try to sell your auction rate preferred stock between auctions, you may not receive full value on your investment.

If you try to sell your auction rate preferred stock between auctions, you may not be able to sell them for their liquidation preference per share or such amount per share plus accumulated distributions. If we have designated a special distribution period of more than seven days, changes in interest rates could affect the price you would receive if you sold your shares in the secondary market. Broker-dealers that maintain a secondary trading market for the auction rate preferred stock are not required to maintain this market, and we will not be required to redeem auction rate preferred stock if either an auction or an attempted secondary market sale fails because of a lack of buyers. The auction rate preferred stock will likely not be registered on a stock exchange. If you sell your auction rate preferred stock to a broker-dealer between auctions, you may receive less than the price you paid for them, especially when market interest rates have risen since the last auction or during a special distribution period. Due to recent market disruption most auction-rate preferred stock have been unable to hold successful auctions and holders of such shares have suffered reduced liquidity, including the inability to sell such shares in a secondary market.

The trading market or market value of our debt securities or any convertible debt securities, if issued to the public, may be volatile.

Our debt securities or any convertible debt securities, if issued to the public, may or may not have an established trading market. We cannot assure investors that a trading market for our debt securities or any convertible debt securities, if issued to the public, would develop or be maintained if developed. In addition to our creditworthiness, many factors may materially adversely affect the trading market for, and market value of, our publicly issued debt securities or any convertible debt securities. These factors include, but are not limited to, the following:

- the time remaining to the maturity of these debt securities;
- the outstanding principal amount of debt securities with terms identical to these debt securities;
- the general economic environment;

- the supply of debt securities trading in the secondary market, if any;
- the redemption, repayment or convertible features, if any, of these debt securities;
- the level, direction and volatility of market interest rates generally; and
- market rates of interest higher or lower than rates borne by the debt securities.

There also may be a limited number of buyers for our debt securities. This too may materially adversely affect the market value of the debt securities or the trading market for the debt securities. Our debt securities may include convertible features that cause them to more closely bear risks associated with an investment in our common stock.

Table of Contents

Our credit ratings, if any, may not reflect all risks of an investment in our debt securities or any convertible debt securities.

Our credit ratings, if any, will be an assessment by third parties of our ability to pay our obligations. Consequently, real or anticipated changes in our credit ratings will generally affect the market value of any publicly issued debt securities. Our credit ratings, however, may not reflect the potential impact of risks related to market conditions generally or other factors discussed herein about the market value of, or trading market for, any publicly issued debt securities.

Terms relating to redemption may materially adversely affect the return on any debt securities.

If we issue any debt securities or any convertible debt securities that are redeemable at our option, we may choose to redeem the debt securities at times when prevailing interest rates are lower than the interest rate paid on the debt securities. In addition, if the debt securities are subject to mandatory redemption, we may be required to redeem the debt securities at times when prevailing interest rates are lower than the interest rate paid on the debt securities. In this circumstance, a holder of our debt securities may not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as the debt securities being redeemed.

The issuance of subscription rights, warrants or convertible debt that are exchangeable for our common stock, will cause your interest in us to be diluted as a result of any such rights, warrants or convertible debt offering.

Stockholders who do not fully exercise rights, warrants or convertible debt issued to them in any offering of subscription rights, warrants or convertible debt to purchase our common stock should expect that they will, at the completion of the offering, own a smaller proportional interest in us than would otherwise be the case if they fully exercised their rights, warrants or convertible debt. We cannot state precisely the amount of any such dilution in share ownership because we do not know what proportion of the common stock would be purchased as a result of any such offering.

In addition, if the subscription price, warrant price or convertible debt price is less than our net asset value per share of common stock at the time of such offering, then our stockholders would experience an immediate dilution of the aggregate net asset value of their shares as a result of the offering. The amount of any such decrease in net asset value is not predictable because it is not known at this time what the subscription price, warrant price, convertible debt price or net asset value per share will be on the expiration date of such offering or what proportion of our common stock will be purchased as a result of any such offering. The risk of dilution is greater if there are multiple rights offerings. However, our board of directors will make a good faith determination that any offering of subscription rights, warrants or convertible debt would result in a net benefit to existing stockholders.

Future offerings of debt securities, which would be senior to our common stock upon liquidation, or equity securities, which could dilute our existing stockholders and may be senior to our common stock for the purposes of distributions, may harm the value of our common stock.

In the future, we may attempt to increase our capital resources by making additional offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred stock or common stock, subject to the restrictions of the 1940 Act. Upon a liquidation of our company, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings would receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings by us may dilute the holdings of our existing stockholders or reduce the value of our common stock, or both. Any preferred stock we may issue would have a preference on distributions that could limit our ability to make distributions to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our stockholders bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in us. In addition, proceeds from a sale of common stock will likely be used to increase our total assets or to pay down our borrowings, among other uses. This would increase our asset coverage ratio and permit us to incur additional leverage under rules pertaining to BDCs by increasing our borrowings or issuing senior securities such as preferred stock or additional debt securities.

Table of Contents

Provisions of the Maryland General Corporation Law and our charter and bylaws could deter takeover attempts and have an adverse effect on the price of our common stock.

The Maryland General Corporation Law contains provisions that may discourage, delay or make more difficult a change in control of us or the removal of our directors. In addition, our board of directors may, without stockholder action, authorize the issuance of shares of stock in one or more classes or series, including preferred stock. Our charter and bylaws contain provisions that limit liability and provide for indemnification of our directors and officers. These provisions and others also may have the effect of deterring hostile takeovers or delaying changes in control or management. We are generally prohibited from engaging in mergers and other business combinations with stockholders that beneficially own 10.0% or more of the voting power of our outstanding voting stock, or with their affiliates, for five years after the most recent date on which such stockholders became the beneficial owners of 10.0% or more of the voting power of our outstanding voting stock and thereafter unless our directors and stockholders approve the business combination in the prescribed manner. See Description of Our Capital Stock Business Combinations. Maryland law may discourage third parties from trying to acquire control of us and increase the difficulty of consummating such an offer.

We have also adopted measures that may make it difficult for a third party to obtain control of us, including provisions of our charter authorizing our board of directors to classify or reclassify shares of our stock in one or more classes or series and to cause the issuance of additional shares of our stock, including preferred stock. In addition, we have adopted a classified board of directors. A classified board may render a change in control of us or removal of our incumbent management more difficult. These provisions, as well as other provisions of our charter and bylaws, may delay, defer or prevent a transaction or a change in control that might otherwise be in the best interests of our stockholders.

Our business and operation could be negatively affected if we become subject to any securities litigation or shareholder activism, which could cause us to incur significant expense, hinder execution of investment strategy and impact our stock price.

In the past, following periods of volatility in the market price of a company s securities, securities class action litigation has often been brought against that company. Shareholder activism, which could take many forms or arise in a variety of situations, has been increasing in the BDC space recently. While we are currently not subject to any securities litigation or shareholder activism, due to the potential volatility of our stock price and for a variety of other reasons, we may in the future become the target of securities litigation or shareholder activism. Securities litigation and shareholder activism, including potential proxy contests, could result in substantial costs and divert management s and our board of directors attention and resources from our business. Additionally, such securities litigation and shareholder activism could give rise to perceived uncertainties as to our future, adversely affect our relationships with service providers and make it more difficult to attract and retain qualified personnel. Also, we may be required to incur significant legal fees and other expenses related to any securities litigation and activist shareholder matters. Further, our stock price could be subject to significant fluctuation or otherwise be adversely affected by the events, risks and uncertainties of any securities litigation and shareholder activism.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements that involve substantial risks and uncertainties. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about us, our current and prospective portfolio investments, our industry, our beliefs, and our assumptions. Words such as anticipates, expects, intends, plans, will, may, continue, believes, seeks, estimates, targets, projects and variations of these words and similar expressions are intended to identify forward-looking statements. The forward-looking statements contained in this report involve risks and uncertainties, including statements as to:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the impact of investments that we expect to make;
- our contractual arrangements and relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- our expected financing and investments;
- the adequacy of our cash resources and working capital;

Table of Contents

- the timing of cash flows, if any, from the operations of our portfolio companies;
- the impact of increased competition;
- the ability of our investment advisor to identify suitable investments for us and to monitor and administer our investments;
- the ability of our investment advisor to attract and retain highly talented professionals;
- our regulatory structure and tax status;
- our ability to operate as a BDC, a SBIC and a RIC;
- the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;
- the timing, form and amount of any dividend distributions;
- the impact of fluctuations in interest rates on our business;
- the valuation of any investments in portfolio companies, particularly those having no liquid trading market; and
- our ability to recover unrealized losses.

These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements, including without limitation:

- an economic downturn could impair our portfolio companies ability to continue to operate, which could lead to the loss of value in of some or all of our investments in such portfolio companies;
- a contraction of available credit and/or an inability to access the equity markets could impair our lending and investment activities;

- interest rate volatility could adversely affect our results, particularly because we use leverage as part of our investment strategy;

- currency fluctuations could adversely affect the results of our investments in portfolio companies with foreign operations; and,

- the risks, uncertainties and other factors we identify in Risk Factors contained in this prospectus and in our other filings with the SEC.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. Important assumptions include our ability to originate new loans and investments, certain margins and levels of profitability and the availability of additional capital. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this prospectus should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in Risk Factors and elsewhere in this prospectus. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this prospectus. The forward-looking statements and projections contained in this prospectus are excluded from the safe harbor protection provided by Section 27A of the Securities Act of 1933, as amended, or the Securities Act.

Table of Contents

USE OF PROCEEDS

Unless otherwise specified in any prospectus supplement accompanying this prospectus, we intend to use the net proceeds from the sale of our securities to invest in lower middle-market companies in accordance with our investment objective and strategies, to repay the outstanding indebtedness under our Credit Facility, if any, and for working capital and general corporate purposes. We will also pay operating expenses, including management, incentive and administrative fees, and may pay other expenses, from the net proceeds of any offering. We plan to raise new equity when we have attractive investment opportunities available. Pending such use, we will invest the net proceeds of any offering primarily in short-term securities consistent with our BDC election and our election to be taxed as a RIC. See Regulation Temporary Investments for additional information about temporary investments we may make while waiting to make longer-term investments in pursuit of our investment objective.

Pending such use, we will invest the net proceeds of this offering primarily in cash, cash equivalents, U.S. Government securities and other high-quality debt instruments that mature in one year or less, or temporary investments, as appropriate. These securities may have lower yields than our other investments and accordingly result in lower distributions, if any, by us during such period. See Regulation Temporary Investments. Our ability to achieve our investment objective may be limited to the extent that the net proceeds from the offering, pending full investment, are held in interest bearing deposits or other short-term instruments that produce income at a rate less than our cost of capital.

Table of Contents

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock began trading on June 21, 2011 on the NASDAQ Global Market under the symbol FDUS. Effective January 3, 2012, our common stock was included in the Nasdaq Global Select Market. The following table lists the high and low closing sale price for our common stock, and the closing sale price as a percentage of net asset value, or NAV, and the cash distributions per share that we have declared on our common stock for each fiscal quarter during the last two most recently completed fiscal years and through April 24, 2019.

Period	NAV (1)	High Closing Sales Price	Low Closing Sales Price	Premium / (Discount) of High Sales Price to NAV (2)	Premium / (Discount) of Low Sales Price to NAV (2)	Dividends Declared Per Share (3)
Year Ending December 31, 2019:						
First Quarter	*	$ 15.68	$ 11.90	*	*	$ 0.39
Second Quarter (through April 24, 2019)	*	15.52	15.33	*	*	*
Year Ended December 31, 2018:						
First Quarter	$ 16.28	$ 15.55	$ 12.77	(4.5)%	(21.6)%	$ 0.39
Second Quarter	16.20	14.55	12.81	(10.2)	(20.9)	0.39
Third Quarter	16.41	15.42	14.31	(6.0)	(12.8)	0.39
Fourth Quarter	16.47	14.66	11.61	(11.0)	(29.5)	0.43
Year Ended December 31, 2017:						
First Quarter	15.80	17.57	15.88	11.2	0.5	0.39
Second Quarter	15.87	18.06	16.37	13.8	3.2	0.39
Third Quarter	15.97	17.04	15.80	6.7	(1.1)	0.39
Fourth Quarter	16.05	16.83	15.18	4.9	(5.4)	0.43

(1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low sales prices. The net asset values shown are based on outstanding shares at the end of each period.
(2) Calculated as the difference between the respective high or low closing sales price and the quarter end net asset value divided by the quarter end net asset value.
(3) Represents the regular and special, if applicable, distribution declared in the specified quarter. We have adopted an opt out dividend reinvestment plan for our common stockholders. As a result, if we declare a distribution, stockholders cash distributions will be automatically reinvested in additional shares of our common stock, unless they specifically opt out of the dividend reinvestment plan so as to receive cash distributions. See Dividend Reinvestment Plan.
* Not determinable at the time of filing.

Shares of BDCs may trade at a market price that is less than the net asset value of those shares. The possibilities that our shares of common stock will trade at a discount from net asset value or at premiums that are unsustainable over the long term are separate and distinct from the risk that our net asset value will decrease. It is not possible to predict whether any common stock offered pursuant to this prospectus supplement will trade at, above, or below net asset value.

We intend to continue to pay quarterly distributions to our stockholders. Our distributions may include returns of paid-in capital, as well as declared dividends from earnings and profits. Our quarterly distributions, if any, are determined by our board of directors. We have elected to be taxed as a RIC under Subchapter M of the Code. As long as we qualify for tax treatment as a RIC, we will not be taxed on our investment company taxable income or net capital gain, to the extent that such income or gain is distributed, or deemed to be distributed, to stockholders on a timely basis.

There were no deemed distributions during the years 2018, 2017 or 2016.

We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of these distributions from time to time. If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including possible loss of our tax treatment as a RIC. We cannot assure stockholders that they will receive any distributions at a particular level.

We have adopted a dividend reinvestment plan that provides for reinvestment of our distributions on behalf of our stockholders, unless a stockholder elects to receive cash. As a result, if our board of directors authorizes, and we declare, a cash distribution, then our stockholders who have not opted out of our dividend reinvestment plan will have their cash distribution automatically reinvested in additional shares of our common stock, rather than receiving the cash distribution. Under the terms of our dividend reinvestment plan, dividends will primarily be paid in newly issued shares of common stock. However, we reserve the right to purchase shares in the open market in connection with the implementation of the plan. This feature of the plan means that, under certain circumstances, we may issue shares of our common stock at a price below net asset value per share, which could cause our stockholders to experience dilution.

Table of Contents

To maintain our tax treatment as a RIC, we must, among other things, distribute at least 90.0% of our net ordinary income and our net short-term capital gains in excess of our net long-term capital losses, if any. In order to avoid certain excise taxes imposed on RICs, we currently intend to distribute during each calendar year an amount at least equal to the sum of (1) 98.0% of our net ordinary income for the calendar year, (2) 98.2% of our capital gain net income for the calendar year and (3) any net ordinary income and capital gain net income for the preceding calendar year that were not distributed during such year and on which we paid no U.S. federal income tax. We may retain for investment some or all of our net capital gain (i.e., net long-term capital gains in excess of net short-term capital losses) and treat such amounts as deemed distributions to our stockholders. If we do this, you will be treated as if you received an actual distribution of the capital gain we retain and then reinvested the net after-tax proceeds in our common stock. You also may be eligible to claim a tax credit (or, in certain circumstances, a tax refund) equal to your allocable share of the tax we paid on the capital gain deemed distributed to you. Please refer to Material U.S. Federal Income Tax Considerations for further information regarding the consequences of our retention of net capital gain. We can offer no assurance that we will achieve results that will permit the payment of any cash distributions and, if we issue senior securities, we will be prohibited from making distributions if doing so causes us to fail to maintain the asset coverage ratios stipulated by the 1940 Act or if distributions are limited by the terms of any of our borrowings. See Regulation and Material U.S. Federal Income Tax Considerations.

We may make distributions that are payable in cash or shares of our common stock at the election of each stockholder. In accordance with Treasury regulations and published guidance issued by the Internal Revenue Service, a publicly offered RIC may treat distributions of its own stock as counting towards its RIC distribution requirements if each stockholder may elect to receive his, her, or its entire distribution in either cash or stock of the RIC. This published guidance applies even if the aggregate amount of cash available to be distributed to all stockholders is no more than 20% of the aggregate declared distribution. Under the published guidance, if too many stockholders elect to receive their distributions in cash, the cash available for distribution must be allocated among the shareholders electing to receive cash (with the balance of the distribution paid in stock). If we decide to make any distributions that are payable in part in shares of our stock, U.S. stockholders receiving such distributions generally will be required to include the full amount of the distribution (whether received in cash, shares of our stock, or a combination thereof) as ordinary income (or as long-term capital gain to the extent such distribution is properly reported as a capital gain dividend) to the extent of our current and accumulated earnings and profits. As a result, a U.S. stockholder may be required to pay tax with respect to such distributions in excess of any cash received. If a U.S. stockholder sells the stock it receives in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the distribution, depending on the market price of our stock at the time of the sale. Furthermore, with respect to non-U.S. stockholders, we may be required to withhold U.S. federal tax with respect to such distributions, including in respect of all or a portion of such distributions that are payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our stock in order to pay taxes owed on such distributions, it may put downward pressure on the trading price of shares of our stock.

Distributions in excess of our current and accumulated profits and earnings would be treated first as a return of capital to the extent of the stockholder s tax basis, and any remaining distributions would be treated as a capital gain. The determination of the tax attributes of our distributions will be made annually as of the end of our fiscal year based upon our taxable income for the full year and distributions paid for the full year. Therefore, a determination made on a quarterly basis may not be representative of the actual tax attributes of our distributions for a full year. Each year, a statement on Form 1099-DIV identifying the source of the distribution will be sent to our U.S. stockholders of record. Our board of directors presently intends to declare and pay quarterly dividends. Our ability to pay dividends could be affected by future business performance, liquidity, capital needs, alternative investment opportunities and loan covenants.

Table of Contents

SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data of FIC and its subsidiaries, including the Funds, as of and for the years ended December 31, 2018, 2017, 2016, 2015 and 2014, is derived from the consolidated financial statements that have been audited by RSM US LLP, an independent registered public accounting firm. This financial data should be read in conjunction with our consolidated financial statements and the notes thereto included elsewhere in this prospectus and with Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in Thousands, Except Per Share Data)				
Statement of operations data:					
Total investment income	$ 76,425	$ 68,615	$ 60,229	$ 54,269	$ 46,116
Interest and financing expenses	12,956	9,893	10,594	9,428	7,507
Base management fee	11,365	9,788	8,254	7,545	5,899
Incentive fee	12,351	10,968	10,369	6,481	4,857
All other expenses	4,272	4,069	3,986	3,932	4,189
Net investment income before income taxes	35,481	33,897	27,026	26,883	23,664
Income tax provision (benefit)	720	220	425	390	383
Net investment income	34,761	33,677	26,601	26,493	23,281
Net realized gains (losses)	(10,269)	17,904	(13,835)	9,531	(17,029)
Net change in unrealized appreciation (depreciation)	25,718	(5,426)	29,009	(10,086)	13,250
Income tax (provision) benefit from realized gains on investments	(758)	(2,204)	(205)	39	(17)
Net increase in net assets resulting from operations	$ 49,452	$ 43,951	$ 41,570	$ 25,977	$ 19,485
Per share data:					
Net asset value (at end of period)	$ 16.47	$ 16.05	$ 15.76	$ 15.17	$ 15.16
Net investment income	$ 1.42	$ 1.43	$ 1.45	$ 1.64	$ 1.62
Net gain (loss) on investments	$ 0.60	$ 0.44	$ 0.82	$ (0.04)	$ (0.26)
Net increase in net assets resulting from operations	$ 2.02	$ 1.87	$ 2.27	$ 1.60	$ 1.36
Dividends	$ 1.60	$ 1.60	$ 1.60	$ 1.60	$ 1.72
Other data:					
Weighted average annual yield on debt investments (1)	12.6%	13.0%	13.1%	13.3%	13.4%
Number of portfolio companies at year end	63	63	57	53	42
Expense ratios (as percentage of average net assets (2)):					
Operating expenses	7.0%	6.6%	7.8%	7.3%	6.7%
Interest expense	3.3%	2.6%	3.7%	3.8%	3.4%

Total return based on market value (3)	(15.8%)	3.2%	23.8%	2.4%	(23.2%)
Total return based on net asset value (4)	12.6%	11.9%	15.0%	10.6%	8.9%

(1) Weighted average yields are computed using the effective interest rates for debt investments at cost as of the period end date, including accretion of original issue discount and loan origination fees, but excluding debt investments on non-accrual status, if any. The weighted average yield of our debt investments is not the same as a return on investment for our stockholders but, rather, relates to a portion of our investment portfolio and is calculated before the payment of all of our and our subsidiaries fees and expenses.

(2) Average net assets is calculated as the average of the net asset balances as of each quarter end during the fiscal year and the prior year end.

(3) Total return based on market value equals the change in the market value of our common stock per share during the period divided by the market value per share at the beginning of the period, and assumes reinvestment of dividends at prices obtained by our dividend reinvestment plan during the period. The return does not reflect any sales load that may be paid by an investor.

(4) Total return based on net asset value per share equals the change in net asset value per share during the period, plus dividends paid per share during the period, less other non-operating changes during the period, and divided by beginning net asset value per share for the period. Non-operating changes include any items that affect net asset value per share other than increase from investment operations, such as the effects of share issuances and repurchases and other miscellaneous items.

	As of December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
	(Dollars in Thousands)				
Statement of assets and liabilities data:					
Total investments, fair value	$ 642,982	$ 596,308	$ 524,454	$ 443,269	$ 396,355
Total assets (5)	693,876	646,263	586,742	480,668	431,020
Borrowings	277,500	242,800	224,000	229,000	183,500
Total net assets	402,985	393,273	353,785	247,362	243,263

(5) In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-03, *Interest Imputation of interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability rather than as an asset. We adopted ASU 2015-03 as of January 1, 2016. Prior to adoption, we recorded deferred financing costs as an asset on the consolidated statements of assets and liabilities. Upon adoption of ASU 2015-03, we reclassified these deferred costs to a direct offset of the related debt liability on the consolidated statements of assets and liabilities. In the table above, the new guidance has been applied retrospectively to fiscal years 2015 and 2014 to conform presentation.

Table of Contents

SELECTED QUARTERLY FINANCIAL DATA

The following tables set forth certain quarterly financial information for each of the eight quarters ending with the quarter ended December 31, 2018 (dollars in thousands, except per share data). This information was derived from our unaudited consolidated financial statements. Results for any quarter are not necessarily indicative of results for the past fiscal year or for any future quarter.

	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
Total investment income	$ 18,233	$ 18,112	$ 17,872	$ 22,208
Net investment income	7,377	8,958	7,481	10,945
Net increase in net assets from operations	15,025	7,644	14,801	11,982
Net investment income per share	$ 0.30	$ 0.37	$ 0.31	$ 0.45
Net increase in net assets from operations per share	$ 0.61	$ 0.31	$ 0.61	$ 0.49
Net asset value per share at end of period	$ 16.28	$ 16.20	$ 16.41	$ 16.47

	March 31, 2017	June 30, 2017	September 30, 2017	December 31, 2017
Total investment income	$ 16,228	$ 17,271	$ 18,048	$ 17,068
Net investment income	7,859	8,942	9,189	7,687
Net increase in net assets from operations	9,532	9,957	12,055	12,407
Net investment income per share	$ 0.35	$ 0.39	$ 0.38	$ 0.31
Net increase in net assets from operations per share	$ 0.42	$ 0.44	$ 0.49	$ 0.51
Net asset value per share at end of period	$ 15.80	$ 15.87	$ 15.97	$ 16.05

Table of Contents

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Selected Consolidated Financial Data, Fidus Investment Corporation s consolidated financial statements and related notes appearing elsewhere in this prospectus. The information contained in this section contains forward-looking statements that involve risks and uncertainties. Please see Risk Factors and Special Note Regarding Forward-Looking Statements for a discussion of the uncertainties, risks and assumptions associated with these statements.

General and Corporate Structure

We provide customized debt and equity financing solutions to lower middle-market companies, which we define as U.S. based companies having revenues between $10.0 million and $150.0 million. Our investment objective is to provide attractive risk-adjusted returns by generating both current income from our debt investments and capital appreciation from our equity related investments. Our investment strategy includes partnering with business owners, management teams and financial sponsors by providing customized financing for ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives. We seek to maintain a diversified portfolio of investments in order to help mitigate the potential effects of adverse economic events related to particular companies, regions or industries.

FIC was formed as a Maryland corporation on February 14, 2011. We completed our initial public offering, or IPO, in June 2011.

On June 20, 2011, FIC acquired all of the limited partnership interests of Fund I and membership interests of Fidus Mezzanine Capital GP, LLC, its general partner, resulting in Fund I becoming our wholly-owned SBIC subsidiary. Immediately following the acquisition, we and Fund I elected to be treated as business development companies, or BDCs, under the 1940 Act and our investment activities have been managed by Fidus Investment Advisors, LLC, our investment advisor, and supervised by our board of directors, a majority of whom are independent of us. On March 29, 2013, we commenced operations of a second wholly-owned subsidiary, Fund II. Fund I and Fund II are collectively referred to as the Funds.

Fund I received its SBIC license on October 22, 2007 and Fund II received its SBIC license on May 28, 2013. We plan to continue to operate the Funds as SBICs, subject to SBA approval, and to utilize the proceeds of the sale of SBA-guaranteed debentures to enhance returns to our stockholders. We have also made, and continue to make, investments directly through FIC. We believe that utilizing FIC and the Funds as investment vehicles provides us with access to a broader array of investment opportunities.

We have certain wholly-owned taxable subsidiaries (the Taxable Subsidiaries), each of which generally holds one or more of our portfolio investments listed on the consolidated schedules of investments. The Taxable Subsidiaries are consolidated for financial reporting purposes, such that the our consolidated financial statements reflect our investment in the portfolio company investments owned by the Taxable Subsidiaries. The purpose of the Taxable Subsidiaries is to permit us to hold equity investments in portfolio companies that are taxed as partnerships for U.S. federal income tax purposes (such as entities organized as limited liability companies (LLCs) or other forms of pass through entities) while complying with the source-of-income requirements contained in the RIC tax provisions. The Taxable Subsidiaries are not consolidated with us for U.S. federal corporate income tax purposes, and each Taxable Subsidiary will be subject to U.S. federal corporate income tax on its taxable income. Any such income or expense is reflected in the consolidated statements of operations.

Revenues: We generate revenue in the form of interest and fee income on debt investments and capital gains and distributions, if any, on equity investments. Our debt investments, whether in the form of second lien, subordinated or first lien loans, typically have terms of five to seven years and bear interest at a fixed rate but may bear interest at a floating rate. In some instances, we receive payments on our debt investments based on scheduled amortization of the outstanding balances. In addition, we receive repayments of some of our debt investments prior to their scheduled maturity dates, which may include prepayment penalties. The frequency or volume of these repayments fluctuates significantly from period to period. Our portfolio activity may reflect the proceeds of sales of securities. In some cases, our investments provide for deferred interest payments or PIK interest. The principal amount of loans and any accrued but unpaid interest generally become due at the maturity date. In addition, we may generate revenue in the form of commitment, origination, amendment, or structuring fees and fees for providing managerial assistance. Debt investment origination fees, OID and market discount or premium, if any, are capitalized, and we accrete or amortize such amounts into interest income. We record prepayment premiums on loans as fee income. Interest and dividend income is recorded on the accrual basis to the extent that we expect to collect such amounts. Debt investments or preferred equity securities are placed on non-accrual status when principal, interest or dividend payments become materially past due, or when there is reasonable doubt that principal, interest or dividends will be collected. See Critical Accounting Policies and Use of Estimates Revenue Recognition. Interest is accrued daily based on the outstanding principal amount and the contractual terms of the debt. Dividend income is recorded as dividends are declared or at the point an obligation exists for the portfolio company to make a distribution, and is generally recognized when received. Distributions of earnings from portfolio companies are evaluated to determine if the distribution is a distribution of earnings or a return of capital. Distributions of earnings are included in dividend income while a return of capital is recorded as a reduction in the cost basis of the investment. Estimates are adjusted as necessary after the relevant tax forms are received from the portfolio company.

We recognize realized gains or losses on investments based on the difference between the net proceeds from the disposition and the cost basis of the investment, without regard to unrealized gains or losses previously recognized. We record current period changes in fair value of investments that are measured at fair value as a component of the net change in unrealized appreciation (depreciation) on investments in the consolidated statements of operations.

Expenses: All investment professionals of our investment advisor and/or its affiliates, when and to the extent engaged in providing investment advisory and management services to us, and the compensation and routine overhead expenses allocable to personnel who provide these services to us, are provided and paid for by our investment advisor and not by us. We bear all other out-of-pocket costs and expenses of our operations and transactions, including, without limitation, those relating to:

- organization;
- calculating our net asset value (including the cost and expenses of any independent valuation firm);
- fees and expenses incurred by our investment advisor under the Investment Advisory Agreement or payable to third parties, including agents, consultants or other advisors, in monitoring financial and legal affairs for us and in monitoring our investments and performing due diligence on our prospective portfolio companies or otherwise relating to, or associated with, evaluating and making investments, including dead deal costs;
- interest payable on debt, if any, incurred to finance our investments;
- offerings of our common stock and other securities;
- investment advisory fees and management fees;

administration fees and expenses, if any, payable under the Administration Agreement (including payments under the Administration Agreement between us and our investment advisor based upon our allocable portion of our investment advisor s overhead in performing its obligations under the Administration Agreement, including rent and the allocable portion of the cost of our officers, including our chief compliance officer, our chief financial officer, and their respective staffs);

transfer agent, dividend agent and custodial fees and expenses;

federal and state registration fees;

all costs of registration and listing our shares on any securities exchange;

U.S. federal, state and local taxes;

Independent Directors fees and expenses;

costs of preparing and filing reports or other documents required by the SEC or other regulators including printing costs;

costs of any reports, proxy statements or other notices to stockholders, including printing and mailing costs;

our allocable portion of any fidelity bond, directors and officers/errors and omissions liability insurance, and any other insurance premiums;

direct costs and expenses of administration, including printing, mailing, long distance telephone, copying, secretarial and other staff, independent auditors and outside legal costs;

proxy voting expenses; and

all other expenses reasonably incurred by us or our investment advisor in connection with administering our business.

Table of Contents

Portfolio Composition, Investment Activity and Yield

During the years ended December 31, 2018 and 2017, we invested $212.3 million and $214.7 million in debt and equity investments, respectively, including 15 and 14 new portfolio companies, respectively. During the years ended December 31, 2018 and 2017, we received proceeds from sales or repayments, including principal, return of capital dividends and net realized gains (losses), of $188.3 million and $163.7 million, respectively, including exits of 15 and eight portfolio companies, respectively. The following table summarizes investment purchases and sales and repayments of investments by type for the years ended December 31, 2018 and 2017 (dollars in millions).

	Purchases of Investments				Sales and Repayments of Investments			
	2018		2017		2018		2017	
Second Lien Debt	$ 136.5	64.3%	$ 127.2	59.2%	$ 103.7	55.0%	$ 55.6	33.9%
Subordinated Debt	40.2	18.9	61.7	28.8	54.3	28.8	51.3	31.3
First Lien Debt	25.4	12.0	10.9	5.1	1.8	1.0	32.7	20.0
Equity	10.2	4.8	14.0	6.5	26.1	13.9	23.0	14.1
Warrants			0.9	0.4	2.4	1.3	1.1	0.7
Royalty Rights								
Total	$ 212.3	100.0%	$ 214.7	100.0%	$ 188.3	100.0%	$ 163.7	100.0%

As of December 31, 2018, the fair value of our investment portfolio totaled $643.0 million and consisted of 60 active portfolio companies and three portfolio companies that have sold their underlying operations. As of December 31, 2018, seven debt investments bore interest at a variable rate, which represented $75.9 million of our portfolio on a fair value basis, and the remainder of our debt portfolio was comprised of fixed rate investments. Overall, the portfolio had net unrealized appreciation of $44.2 million as of December 31, 2018. As of December 31, 2018, our average active portfolio company investment at amortized cost was $10.0 million, which excludes investments in the three portfolio companies that have sold their underlying operations.

As of December 31, 2017, the fair value of our investment portfolio totaled $596.3 million and consisted of 60 active portfolio companies and three portfolio companies that have sold their underlying operations. As of December 31, 2017, three debt investments bore interest at a variable rate, which represented $26.1 million of our portfolio on a fair value basis, and the remainder of our debt portfolio was comprised of fixed rate investments. Overall, the portfolio had net unrealized appreciation of $18.5 million as of December 31, 2017. As of December 31, 2017, our average active portfolio company investment at amortized cost was $9.6 million, which excludes investments in the three portfolio companies that have sold their underlying operations.

The weighted average yield on debt investments as of December 31, 2018 and 2017 was 12.6% and 13.0%, respectively. The weighted average yield of our debt investments is not the same as a return on investment for our stockholders but, rather, relates to a portion of our investment portfolio and is calculated before the payment of all of our and our subsidiaries fees and expenses. The weighted average yields were computed using the effective interest rates for debt investments at cost as of December 31, 2018 and 2017, including the accretion of OID and loan origination fees, but excluding investments on non-accrual status, if any. The following table shows the portfolio composition by investment type at fair value and cost and as a percentage of total investments (dollars in millions):

	Fair Value				Cost			
	December 31, 2018		December 31, 2017		December 31, 2018		December 31, 2017	
Second Lien Debt	$ 366.5	57.0%	$ 341.3	57.3%	$ 380.0	63.5%	$ 357.6	62.0%
Subordinated Debt	104.3	16.2	126.5	21.2	105.9	17.7	126.5	21.9
First Lien Debt	51.8	8.1	28.8	4.8	52.2	8.7	31.9	5.5
Equity	106.7	16.6	84.6	14.2	53.5	8.9	53.9	9.3
Warrants	13.7	2.1	15.1	2.5	7.0	1.2	7.7	1.3
Royalty Rights					0.2		0.2	
Total	$ 643.0	100.0%	$ 596.3	100.0%	$ 598.8	100.0%	$ 577.8	100.0%

Table of Contents

The following table shows portfolio composition by geographic region at fair value and cost and as a percentage of total investments (dollars in millions). The geographic composition is determined by the location of the corporate headquarters of the portfolio company, which may not be indicative of the primary source of the portfolio company s business.

	Fair Value				Cost			
	December 31, 2018		December 31, 2017		December 31, 2018		December 31, 2017	
Midwest	$ 161.1	25.1%	$ 168.0	28.2%	$ 152.6	25.5%	$ 161.8	28.1%
Southeast	176.8	27.5	130.2	21.8	155.3	25.9	130.7	22.6
Northeast	89.7	13.9	107.8	18.1	84.2	14.1	105.3	18.2
West	62.8	9.8	63.4	10.6	54.5	9.1	54.0	9.3
Southwest	152.6	23.7	126.9	21.3	152.2	25.4	126.0	21.8
Total	$ 643.0	100.0%	$ 596.3	100.0%	$ 598.8	100.0%	$ 577.8	100.0%

The following table shows the detailed industry composition of our portfolio at fair value and cost as a percentage of total investments:

	Fair Value		Cost	
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017
Specialty Distribution	13.4%	6.2%	14.1%	6.2%
Business Services	9.7	6.5	10.3	7.3
Information Technology Services	8.5	10.7	8.5	11.0
Component Manufacturing	7.9	6.6	8.9	7.0
Healthcare Services	7.8	10.8	7.7	9.9
Oil & Gas Services	6.4	4.7	1.7	2.7
Aerospace & Defense Manufacturing	5.8	4.4	6.0	4.3
Transportation Services	5.2	7.1	5.4	7.3
Healthcare Products	4.8	7.3	3.2	7.1
Vending Equipment Manufacturing	4.6	5.7	5.2	5.9
Industrial Cleaning & Coatings	4.1	4.3	4.7	4.6
Promotional Products	4.1	3.0	4.2	2.9
Building Products Manufacturing	3.8	5.1	5.1	5.4
Retail	2.4	2.8	2.7	2.9
Utility Equipment Manufacturing	2.4	2.6	2.5	2.8
Consumer Products	2.3	3.3	2.6	2.7
Packaging	2.2	0.1	2.4	0.1
Environmental Industries	1.9		2.0	
Utilities: Services	1.7	1.6	1.7	1.7
Oil & Gas Distribution	1.0	1.0	1.0	1.0
Capital Equipment Manufacturing	0.0	3.4	0.0	3.4
Restaurants	0.0	0.4	0.1	1.7

Specialty Chemicals	0.0	0.2	0.0	0.2
Apparel Distribution		0.9		1.0
Electronic Components Supplier		0.6		0.2
Laundry Services		0.7		0.7
Safety Products Manufacturing		0.0		0.0
Total	100.0%	100.0%	100.0%	100.0%

Table of Contents

Portfolio Asset Quality

In addition to various risk management and monitoring tools, our investment advisor uses an internally developed investment rating system to characterize and monitor the credit profile and our expected level of returns on each investment in our portfolio. We use a five-level numeric rating scale. The following is a description of the conditions associated with each investment rating:

Investment Rating 1 is used for investments that involve the least amount of risk in our portfolio. The portfolio company is performing above expectations, the debt investment is expected to be paid in the near term and the trends and risk factors are favorable, and may include an expected capital gain on the equity investment.

Investment Rating 2 is used for investments that involve a level of risk similar to the risk at the time of origination. The portfolio company is performing substantially within our expectations and the risk factors are neutral or favorable. Each new portfolio investment enters our portfolio with Investment Rating 2.

Investment Rating 3 is used for investments performing below expectations and indicates the investment s risk has increased somewhat since origination. The portfolio company requires closer monitoring, but we expect a full return of principal and collection of all interest and/or dividends.

Investment Rating 4 is used for investments performing materially below expectations and the risk has increased materially since origination. The investment has the potential for some loss of investment return, but we expect no loss of principal.

Investment Rating 5 is used for investments performing substantially below our expectations and the risks have increased substantially since origination. We expect some loss of principal.

The following table shows the distribution of our investments on the 1 to 5 investment rating scale at fair value and cost as of December 31, 2018 and 2017 (dollars in millions):

	Fair Value				Cost			
Investment Rating	**December 31, 2018**		**December 31, 2017**		**December 31, 2018**		**December 31, 2017**	
1	$ 123.8	19.2%	$ 125.7	21.1%	$ 63.7	10.7%	$ 83.2	14.4%
2	403.1	62.7	398.4	66.8	396.2	66.2	393.6	68.1
3	94.3	14.7	51.8	8.7	101.4	16.9	60.7	10.5
4	21.3	3.3	18.3	3.1	33.2	5.5	28.3	4.9
5	0.5	0.1	2.1	0.3	4.3	0.7	12.0	2.1
Total	$ 643.0	100.0%	$ 596.3	100.0%	$ 598.8	100.0%	$ 577.8	100.0%

Based on our investment rating system, the weighted average rating of our portfolio as of December 31, 2018 and 2017 was 2.0 and 1.9, respectively, on a fair value basis and 2.2 and 2.1, respectively, on a cost basis.

Non-Accrual

As of December 31, 2018 and December 31, 2017, we had debt investments in two portfolio companies on non-accrual status, respectively (dollars in millions):

	December 31, 2018		December 31, 2017	
Portfolio Company	**Fair Value**	**Cost**	**Fair Value**	**Cost**
K2 Industrial Services, Inc.	$ 13.2	$ 14.3	$ (2)	$ (2)
Restaurant Finance Co, LLC	(1)	(1)	2.1	9.3
Six Month Smiles Holdings, Inc.	(1)	(1)	5.0	9.4
US GreenFiber, LLC	7.6	15.3	(2)	(2)
Total	$ 20.8	$ 29.6	$ 7.1	$ 18.7

(1) Portfolio company was no longer held at period end.
(2) Portfolio company debt investments were not on non-accrual status at period end.

Table of Contents

Discussion and Analysis of Results of Operations

Comparison of fiscal years ended December 31, 2018, 2017, and 2016

Investment Income

Below is a summary of the changes in total investment income for the years ended December 31, 2018, 2017, and 2016, as well as a comparison of those periods year-over-year (dollars in millions, percent change calculated based on underlying dollar amounts in thousands):

	Years Ended December 31,			2018 vs. 2017		2017 vs. 2016	
	2018	**2017**	**2016**	**$ Change**	**% Change (1)**	**$ Change**	**% Change (1)**
Interest income	$ 60.9	$ 55.1	$ 47.5	$ 5.8	10.5%	$ 7.6	15.9%
Payment-in-kind interest income	6.6	7.0	5.2	(0.4)	(6.6%)	1.8	34.9%
Dividend income	4.0	1.9	3.7	2.1	115.4%	(1.8)	(49.1%)
Fee income	4.8	4.5	3.7	0.3	7.8%	0.8	20.9%
Interest on idle funds and other income	0.1	0.1	0.1		NM		NM
Total investment income	$ 76.4	$ 68.6	$ 60.2	$ 7.8	11.4%	$ 8.4	13.9%

(1) NM = Not meaningful

For the year ended December 31, 2018, total investment income was $76.4 million, an increase of $7.8 million or 11.4%, from the $68.6 million of total investment income for the year ended December 31, 2017. As reflected in the table above, the increase is primarily attributable to the following:

- $5.3 million increase in total interest income (including payment-in-kind interest income) resulting from higher average debt investment balances outstanding, partially offset by a decrease in weighted average debt yield, during 2018 as compared to 2017.

- $2.1 million increase in dividend income, during 2018 as compared to 2017, due to increased levels of distributions received from equity investments.

- $0.3 million increase in fee income resulting from an increase in prepayment fee income, and partially offset by a decrease in debt amendment fee income, during 2018 as compared to 2017.

For the year ended December 31, 2017, total investment income was $68.6 million, an increase of $8.4 million or 13.9%, from the $60.2 million of total investment income for the year ended December 31, 2016. As reflected in the table above, the increase is primarily attributable to the following:

$9.4 million increase in total interest income (including payment-in-kind interest income) resulting from higher average debt investment balances outstanding, partially offset by a small decrease in weighted average debt yield and two additional portfolio companies on non-accrual status, during 2017 as compared to 2016.

$0.8 million increase in fee income resulting from an increase in structuring fees due to a comparative increase in new investments and an increase in debt amendment fee income, during 2017 as compared to 2016.

$(1.8) million decrease in dividend income, during 2017 as compared to 2016, due to decreased levels of distributions received from equity investments and certain prior year dividend tax character true-ups recognized in 2017 upon receipt of the relevant tax forms from the underlying portfolio companies.

Expenses

Below is a summary of the changes in total expenses, including income tax provision, for the years ended December 31, 2018, 2017, and 2016, as well as a comparison of those periods year-over-year (dollars in millions, percent change calculated based on underlying dollar amounts in thousands):

	Years Ended December 31,			**2018 vs. 2017**		**2017 vs. 2016**	
	2018	**2017**	**2016**	**$ Change**	**% Change [1]**	**$ Change**	**% Change [1]**
Interest and financing expenses	$ 13.0	$ 9.9	$ 10.6	$ 3.1	31.0%	$ (0.7)	(6.6%)
Base management fee	11.4	9.8	8.3	1.6	16.1%	1.5	18.6%
Incentive fee income	9.4	8.9	7.4	0.5	5.6%	1.5	20.9%
Incentive fee capital gains	2.9	2.1	3.0	0.8	43.0%	(0.9)	(31.4%)
Administrative service expenses	1.5	1.4	1.4	0.1	2.4%		NM
Professional fees	1.3	1.4	1.3	(0.1)	(6.3%)	0.1	7.2%
Other general and administrative expenses	1.4	1.2	1.2	0.2	21.4%		NM
Total expenses, before income tax provision	40.9	34.7	33.2	6.2	17.9%	1.5	4.6%
Income tax provision	0.7	0.2	0.4	0.5	227.3%	(0.2)	(48.2%)
Total expenses, including income tax provision	$ 41.6	$ 34.9	$ 33.6	$ 6.7	19.3%	$ 1.3	3.9%

(1) NM = Not meaningful

For the year ended December 31, 2018, total expenses, including income tax provision, were $41.6 million, an increase of $6.7 million or 19.3%, from the $34.9 million of total expenses, including income tax provision, for the year ended December 31, 2017. As reflected in the table above, the increase is primarily attributable to the following:

- $3.1 million increase in interest and financing expenses due to an increase in average borrowings outstanding and an increase in weighted average interest rate on borrowings during 2018 as compared to 2017.

- $1.6 million increase in base management fee due to higher average total assets during 2018 as compared to 2017.

- $0.8 million increase in the capital gains incentive fee due to a $4.4 million increase in net gain on investments (net realized gains (losses) plus net change in unrealized appreciation (depreciation) on investments) during 2018, as compared to the same period in 2017.

- $0.5 million increase in the income incentive fee due to a $2.5 million increase in pre-incentive fee net investment income during 2018, as compared to the same period in 2017.

- $0.2 million increase in other general and administrative expenses during 2018 resulting from the write-off of deferred equity offering costs related to our previous Form N-2 registration statement.

For the year ended December 31, 2017, total expenses, including income tax provision, were $34.9 million, an increase of $1.3 million or 3.9%, from the $33.6 million of total expenses, including income tax provision, for the year ended December 31, 2016. As reflected in the table above, the increase is primarily attributable to the following:

- $1.5 million increase in base management fee due to higher average total assets during 2017 as compared to 2016.

- $1.5 million increase in the income incentive fee due to a $7.7 million increase in pre-incentive fee net investment income during 2017, as compared to the same period in 2016.

- $(0.7) million decrease in interest and financing expenses due to a decrease in average borrowings outstanding and a decrease in weighted average interest rate on borrowings during 2017 as compared to 2016.

- $(0.9) million decrease in the capital gains incentive fee due to a $(4.7) million decrease in net gain on investments (net realized gains (losses) plus net change in unrealized appreciation (depreciation) on investments) during 2017, as compared to the same period in 2016.

Net Investment Income

Net investment income was $34.8 million, $33.7 million, and $26.6 million for the years ended December 31, 2018, 2017, and 2016, respectively.

Net investment income increased by $1.1 million, or 3.2%, during fiscal 2018 as compared to fiscal 2017, as a result of the $7.8 million increase in total investment income compared to only a $6.7 million increase in total expenses, including income tax provision.

Net investment income increased by $7.1 million, or 26.6%, during fiscal 2017 as compared to fiscal 2016, as a result of the $8.4 million increase in total investment income compared to only a $1.3 million increase in total expenses, including income tax provision.

Table of Contents

Net Gain (Loss) on Investments

For the year ended December 31, 2018, the total net realized loss on investments, before income tax provision on realized gains, was $(10.3) million. Income tax (provision) benefit from realized gains on investments was $(0.8) million for the year ended December 31, 2018. Significant realized gains (losses) for the year ended December 31, 2018 are summarized below (dollars in millions):

Portfolio Company	Realization Event	Net Realized Gains (Losses)
World Wide Packaging, LLC	Exit of portfolio company	$ 7.0
Apex Microtechnology, Inc.	Exit of portfolio company	6.7
FAR Research Inc.	Sale of portfolio company	3.3
Caldwell & Gregory, LLC	Exit of portfolio company	1.0
Thermoforming Technology Group LLC (dba Brown Machine Group)	Sale of portfolio company	0.7
Malabar International	Escrow distribution	0.3
Worldwide Express Operations, LLC	Distributions tax character true-up	0.2
Ice House America, LLC	Exit of portfolio company	0.1
Other		0.1
IOS Acquisitions, Inc.	Exit of portfolio company	(0.1)
Inflexxion, Inc.	Exit of portfolio company	(6.5)
Restaurant Finance Co, LLC	Exit of portfolio company	(6.8)
Cavallo Bus Lines Holdings, LLC	Exit of portfolio company	(7.4)
Six Month Smiles Holdings, Inc.	Exit of portfolio company	(8.9)
Net realized gain (loss) on investments		(10.3)
Income tax provision from realized gains on investments		(0.8)
Net realized gain (loss), net of income tax provision, on investments		$ (11.1)

For the year ended December 31, 2017, the total net realized gain on investments, before income tax provision on realized gains, was $17.9 million. Income tax (provision) benefit from realized gains on investments was $(2.2) million for the year ended December 31, 2017. Significant realized gains (losses) for the year ended December 31, 2017 are summarized below (dollars in millions):

Portfolio Company	Realization Event	Net Realized Gains (Losses)
Malabar International	Exit of portfolio company	$ 6.8
Worldwide Express Operations, LLC	Sale of portfolio company	6.4
Lightning Diversion Systems, LLC	Exit of portfolio company	4.1
EBL, LLC (EbLens)	Sale of portfolio company	2.2
Brook & Whittle Limited	Exit of portfolio company	1.0
Anatrace Products, LLC	Sale of portfolio company	0.9
Other		0.1

Carlson Systems Holdings, Inc.	Escrow distribution		0.1
FTH Acquisition Corp. VII	Exit of portfolio company		(1.3)
FDS Avionics Corp. (dba Flight Display Systems)	Restructuring		(2.4)
Net realized gain (loss) on investments			17.9
Income tax provision from realized gains on investments			(2.2)
Net realized gain (loss), net of income tax provision, on investments		$	15.7

-54-

Table of Contents

For the year ended December 31, 2016, the total net realized loss on investments, before income tax provision on realized gains, was $(13.8) million. Income tax (provision) benefit from realized gains on investments was $(0.2) million for the year ended December 31, 2016. Significant realized gains (losses) for the year ended December 31, 2016 are summarized below (dollars in millions):

Portfolio Company	Realization Event	Net Realized Gains (Losses)
Carlson Systems Holdings, Inc.	Distribution related to sale of operations	$ 4.1
Lightning Diversion Systems, LLC	Distribution	1.1
Premium Franchise Brands, LLC	Exit of portfolio company	1.1
National Truck Protection Co., Inc.	Exit of portfolio company	1.0
Safety Products Group, LLC	Distribution related to sale of operations	0.5
Westminster Cracker Company, Inc.	Distribution related to sale of operations	0.2
Connect-Air International, Inc.	Escrow distribution	0.2
Other		0.1
Continental Anesthesia Management, LLC	Exit of portfolio company	(0.3)
Channel Technologies Group, LLC	Exit of portfolio company	(0.9)
Pinnergy, Ltd.	Restructuring	(8.9)
Paramount Building Solutions, LLC	Exit of portfolio company	(12.0)
Net realized gain (loss) on investments		(13.8)
Income tax provision from realized gains on investments		(0.2)
Net realized gain (loss), net of income tax provision, on investments		$ (14.0)

During the years ended December 31, 2018, 2017 and 2016, we recorded a net change in unrealized appreciation (depreciation) on investments attributable to the following (dollars in millions):

	Years Ended December 31,		
Unrealized Appreciation (Depreciation)	2018	2017	2016
Exit, sale or restructuring of investments	$ 11.2	$ (14.4)	$ 21.5
Fair value adjustments to debt investments	(18.0)	(14.1)	(10.3)
Fair value adjustments to equity investments	32.5	23.1	17.8
Net change in unrealized appreciation (depreciation)	$ 25.7	$ (5.4)	$ 29.0

Net Increase in Net Assets Resulting From Operations

Net increase in net assets resulting from operations was $49.5 million, $44.0 million, and $41.6 million for the years ended December 31, 2018, 2017, and 2016, respectively, as a result of the events described above.

Liquidity and Capital Resources

As of December 31, 2018, we had $42.0 million in cash and cash equivalents and our net assets totaled $403.0 million. We believe that our current cash and cash equivalents on hand, our Credit Facility and our anticipated cash flows from operations will provide adequate capital resources with which to operate and finance our investment business and make distributions to our stockholders for at least the next 12 months. We intend to generate additional cash primarily from the future offerings of securities (including the at-the-market program) and future borrowings, as well as cash flows from operations, including income earned from investments in our portfolio companies. On both a short-term and long-term basis, our primary use of funds will be investments in portfolio companies and cash distributions to our stockholders. During the year ended December 31, 2018, we repaid $67.3 million of SBA debentures which would have matured during the period March 1, 2019 through March 1, 2022. Our remaining outstanding SBA debentures continue to mature in 2021 and subsequent years through 2028, which will require repayment on or before the respective maturity dates.

Cash Flows

For the year ended December 31, 2018, we experienced a net increase in cash and cash equivalents in the amount of $0.4 million. During that period, we used $8.1 million of cash for operating activities, which included the funding of $212.3 million of investments, which were partially offset by proceeds received from sales and repayments of investments of $188.3 million. During the same period, we received proceeds from the issuances of SBA debentures of $27.0 million, net proceeds of $25.0 million from borrowings under our Credit Facility and proceeds from the issuance of our Public Notes of $50.0 million; which were partially offset by repayments of SBA debentures of $67.3 million, cash dividends paid to stockholders of $39.2 million, the payment of deferred financing costs related to our debt financings of $2.7 million and repurchases of common stock under the Stock Repurchase Program (as defined below) of $0.6 million.

For the year ended December 31, 2017, we experienced a net decrease in cash and cash equivalents of $15.5 million. During that period, we used $28.2 million of cash for operating activities, which included $214.7 million used for purchases of investments, which is partially offset by proceeds of $163.7 million from sales and repayments of investments. During the same period, we received net proceeds from secondary offerings of shares of our common stock off of our effective shelf registration statement of $32.3 million, proceeds from the issuances of SBA debentures of $49.0 million, and proceeds from net borrowings under the Credit Facility of $11.5 million, which were partially offset by repayment of SBA debentures of $41.7 million, cash dividends paid to stockholders of $36.8 million and the payment of deferred financing costs of $1.6 million.

For the year ended December 31, 2016, we experienced a net increase in cash and cash equivalents of $25.4 million. During that period, we used $33.6 million of cash for operating activities, which included $197.8 million used for purchases of investments, which is partially offset by proceeds of $137.5 million from sales and repayments of investments. During the same period, we received net proceeds from secondary offerings of shares of our common stock off of our effective shelf registration statement of $94.7 million and proceeds from the issuances of SBA debenture of $10.5 million, which were partially offset by net repayment of borrowings under the Credit Facility of $15.5 million, cash dividends paid to stockholders of $29.9 million and the payment of deferred financing costs of $0.8 million.

Capital Resources

We anticipate that we will continue to fund our investment activities on a long-term basis through a combination of additional debt and equity capital.

SBA debentures

The Funds are licensed SBICs, and have the ability to issue debentures guaranteed by the SBA at favorable interest rates. Under the Small Business Investment Act and the SBA rules applicable to SBICs, an SBIC can have outstanding at any time debentures guaranteed by the SBA in an amount up to twice its regulatory capital. The SBA regulations currently limit the amount that is available to be borrowed by any SBIC and guaranteed by the SBA to 300.0% of an SBIC s regulatory capital or $175.0 million, whichever is less. For three or more SBICs under common control, the maximum amount of outstanding SBA debentures cannot exceed $350.0 million. SBA debentures have fixed interest rates that approximate prevailing 10-year Treasury Note rates plus a spread and have a maturity of ten years with interest payable semi-annually. The principal amount of the SBA debentures is not required to be paid before maturity but may be pre-paid at any time. As of December 31, 2018, Fund I and Fund II had $41.0 million and $150.0 million of outstanding SBA debentures, respectively. Fund I has commenced a wind-down plan and can no longer issue additional SBA debentures. Subject to SBA regulatory requirements and approval of an additional SBIC licensed fund, we may access up to $159.0 million of additional SBA debentures under the SBIC debenture program.

Credit Facility

In June 2014, we entered into the Credit Facility to provide additional funding for our investment and operational activities. On December 29, 2017, we entered into an amendment to the Credit Facility to, among other things, extend the maturity date from June 16, 2018 to June 16, 2019. On June 5, 2018, we entered into an incremental commitment agreement, whereby the amount available for borrowing under the Credit Facility was increased from $50.0 million to $75.0 million. On October 19, 2018, we entered into an incremental commitment agreement, whereby the amount available for borrowing under the Credit Facility was increased from $75.0 million to $90.0 million, with allowance for future increases in the commitments up to $100.0 million. The Credit Facility is secured by substantially all of our assets, excluding the assets of the Funds.

Amounts available to borrow under the Credit Facility are subject to a minimum borrowing/collateral base that applies an advance rate to certain portfolio investments. We are subject to limitations with respect to the investments securing the Credit Facility, including, but not limited to, restrictions on sector concentrations, loan size, transferability, payment frequency and status and collateral interests, as well as restrictions on portfolio company leverage, which may also affect the borrowing base and therefore amounts available to borrow.

Borrowings under the Credit Facility bear interest, subject to our election, on a per annum basis equal to (i) the alternate base rate plus 2.5% or (ii) the applicable LIBOR, which varies depending on the period of the borrowing under the Credit Facility, plus 3.5%. The alternate base rate is equal to the greater of (i) prime rate, (ii) the federal funds rate plus 0.5% or (iii) the three-month LIBOR plus 1.0%. We pay a commitment fee ranging from 0.5% to 1.0% per annum based on the size of the unused portion of the Credit Facility.

We have made customary representations and warranties and are required to comply with various covenants, reporting requirements and other customary requirements for similar credit facilities. These covenants are subject to important limitations and exceptions that are described in the documents governing the Credit Facility. As of December 31, 2018, we were in compliance with all covenants of the Credit Facility and there were $36.5 million of borrowings outstanding under the Credit Facility.

Public Notes

On February 2, 2018, we closed the public offering of approximately $43.5 million in aggregate principal amount of our 5.875% notes due 2023, or the Public Notes. On February 22, 2018, the underwriters exercised their overallotment option to purchase an additional $6.5 million in aggregate principal of the Public Notes. The total net proceeds to us from the Public Notes, including the exercise of the underwriters overallotment option, after deducting underwriting discounts of approximately $1.5 million and estimated offering expenses of $0.4 million, were approximately $48.1 million.

The Public Notes will mature on February 1, 2023 and bear interest at a rate of 5.875%. The Public Notes are unsecured obligations and rank pari passu with our future unsecured indebtedness; effectively subordinated to all of our existing and future secured indebtedness; and structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries, financing vehicles, or similar facilities we may form in the future, with respect to claims on the assets of any such subsidiaries, financing vehicles, or similar facilities. The Public Notes may be redeemed in whole or in part at any time or from time to time at our option on or after February 1, 2020. Interest on the Public Notes is payable quarterly on February 1, May 1, August 1 and November 1 of each year. The Public Notes are listed on the NASDAQ Global Select Market under the trading symbol FDUSL. As of December 31, 2018, the outstanding principal balance of the Public Notes was $50.0 million.

As of December 31, 2018, the weighted average stated interest rates for our SBA debentures, the Public Notes and the Credit Facility were 3.344%, 5.875% and 6.000%, respectively. As of December 31, 2018, we had $53.5 million of unutilized commitment under our Credit Facility, and we were subject to a 0.500% fee on such amount. As of December 31, 2018, the weighted average stated interest rate on total debt outstanding was 4.149%.

As a BDC, we are generally required to meet a coverage ratio of total assets to total senior securities, which include borrowings and any preferred stock we may issue in the future, of at least 200.0%. This requirement limits the amount that we may borrow. We have received exemptive relief from the U.S. Securities and Exchange Commission (SEC), to allow us to exclude any indebtedness guaranteed by the SBA and issued by the Funds from the 200.0% asset coverage requirements, which, in turn, will enable us to fund more investments with debt capital. Recent legislation, however, modifies the required minimum asset coverage ratio from 200.0% to 150.0%, if certain requirements are met. Under the legislation, we are allowed to increase our leverage capacity if stockholders representing at least a majority of the votes cast, when a quorum is present, approve a proposal to do so. If we receive stockholder approval, we would be allowed to increase our leverage capacity on the first day after such approval. Alternatively, the legislation allows the majority of our independent directors to approve an increase in our leverage capacity, and such approval would become effective after the one-year anniversary of such approval.

As a BDC, we are generally not permitted to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the then-current net asset value per share of our common stock if our board of directors, including Independent Directors, determines that such sale is in the best interests of us and our stockholders, and if our stockholders approve such sale. On June 7, 2018, our stockholders voted to allow us to sell or otherwise issue common stock at a price below net asset value per share for a period of one year ending on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders. We expect to present to our stockholders a similar proposal at our 2019 Annual Meeting of Stockholders. Our stockholders specified that the cumulative number of shares sold in each offering during the one-year period ending on the earlier of June 7, 2019 or the date of our 2019 Annual Meeting of Stockholders may not exceed 25.0% of our outstanding common stock immediately prior to each such sale.

Stock repurchase plan

We have an open market stock repurchase program (the Stock Repurchase Program) under which we may acquire up to $5.0 million of our outstanding common stock. Under the Stock Repurchase Program, we may, but are not obligated to, repurchase outstanding common stock in the open market from time to time provided that we comply with the prohibitions under our insider trading policies and the requirements of Rule 10b-18 of the Securities Exchange Act of 1934, as amended, including certain price, market value and timing constraints. The timing, manner, price and amount of any share repurchases will be determined by our management, in its discretion, based upon the evaluation of economic and market conditions, stock price, capital availability, applicable legal and regulatory requirements and other corporate considerations. On October 30, 2018, the Board extended the Stock Repurchase Program through December 31, 2019, or until the approved dollar amount has been used to repurchase shares. The Stock Repurchase Program does not require us to repurchase any specific number of shares and the Company cannot assure that any shares will be repurchased under the Stock Repurchase Program. The Stock Repurchase Program may be suspended, extended, modified or discontinued at any time. During the year ended December 31, 2018, we repurchased 44,821 shares of common stock on the open market for $0.6 million. We did not make any repurchases of common stock during the years ended December 31, 2017 and 2016. Refer to Note 8 to our consolidated financial statements for additional information concerning stock repurchases.

Critical Accounting Policies and Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make certain estimates and assumptions affecting amounts reported in the financial statements. We have identified investment valuation and revenue recognition as our most critical accounting estimates. We continuously evaluate our estimates, including those related to the matters described below. These estimates are based on the information that is currently available to us and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ materially from those estimates under different assumptions or conditions. A discussion of our critical accounting policies follows.

Valuation of Portfolio Investments

As a BDC, we report our assets and liabilities at fair value at all times consistent with GAAP and the 1940 Act. Accordingly, we are required to periodically determine the fair value of all of our portfolio investments.

Our investments generally consist of illiquid securities including debt and equity investments in lower middle-market companies. Investments for which market quotations are readily available are valued at such market quotations. Because we expect that there will not be a readily available market for substantially all of the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by our board of directors using a documented valuation policy and consistently applied valuation process. 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 our investments may differ significantly from the values that would have been used had a readily available market value existed for such investments, and the difference could be material.

Table of Contents

With respect to investments for which market quotations are not readily available, our board of directors undertakes a multi-step valuation process each quarter, as described below:

- our quarterly valuation process begins with each portfolio company or investment being initially evaluated and rated by the investment professionals of our investment advisor responsible for the portfolio investment;

- preliminary valuation conclusions are then documented and discussed with the investment committee of our investment advisor;

- our board of directors engages one or more independent valuation firm(s) to conduct independent appraisals of a selection of our portfolio investments for which market quotations are not readily available. Each portfolio company investment is generally appraised by the valuation firm(s) at least once every calendar year and each new portfolio company investment is appraised at least once in the twelve-month period following the initial investment. In certain instances, we may determine that it is not cost-effective, and as a result it is not in our stockholders best interest, to request the independent appraisal of certain portfolio company investments. Such instances include, but are not limited to, situations where we determine that the fair value of the portfolio company investment is relatively insignificant to the fair value of the total portfolio. Our board of directors consulted with the independent valuation firm(s) in arriving at our determination of fair value for 16 and 18 of our portfolio company investments representing 36.0% and 32.0% of the total portfolio investments at fair value (exclusive of new portfolio company investments made during the three months ended December 31, 2018 and 2017, respectively) as of December 31, 2018 and 2017, respectively;

- the audit committee of our board of directors reviews the preliminary valuations of our investment advisor and of the independent valuation firm(s) and responds and supplements the valuation recommendations to reflect any comments; and

- our board of directors discusses the valuations and determines the fair value of each investment in our portfolio in good faith, based on the input of our investment advisor, the independent valuation firm(s) and the audit committee.

In making the good faith determination of the value of portfolio investments, we start with the cost basis of the security. The transaction price is typically the best estimate of fair value at inception. When evidence supports a subsequent change to the carrying value from the original transaction price, adjustments are made to reflect the expected exit values.

Consistent with the policies and methodologies adopted by our board of directors, we perform detailed valuations of our debt and equity investments, including an analysis on the Company s unfunded loan commitments, using both the market and income approaches as appropriate. Under the market approach, we typically use the enterprise value methodology to determine the fair value of an investment. There is no one methodology to estimate enterprise value and, in fact, for any one portfolio company, enterprise value is generally best expressed as a range of values, from which we derive a single estimate of enterprise value. Under the income approach, we typically prepare and analyze discounted cash flow models to estimate the present value of future cash flows of either an individual debt investment or of the underlying portfolio company itself.

We evaluate investments in portfolio companies using the most recent portfolio company financial statements and forecasts. We also consult with the portfolio company s senior management to obtain further updates on the portfolio company s performance, including information such as industry trends, new product development and other operational issues.

For our debt investments the primary valuation technique used to estimate the fair value is the discounted cash flow method. However, if there is deterioration in credit quality or a debt investment is in workout status, we may consider other methods in determining the fair value, including the value attributable to the debt investment from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis. Our discounted cash flow models estimate a range of fair values by applying an appropriate discount rate to the future cash flow streams of our debt investments, based on future interest and principal payments as set forth in the associated loan agreements. We prepare a weighted average cost of capital for use in the discounted cash flow model for each investment, based on factors including, but not limited to: current pricing and credit metrics for similar proposed or executed investment transactions of private companies; the portfolio company s historical financial results and outlook; and the portfolio company s current leverage and credit quality as compared to leverage and credit quality as of the date the investment was made. We may also consider the following factors when determining the fair value of debt investments: the portfolio company s ability to make future scheduled payments; prepayment penalties and other fees; estimated remaining life; the nature and realizable value of any collateral securing such debt investment; and changes in the interest rate environment and the credit markets that generally may affect the price at which similar investments may be made. We estimate the remaining life of our debt investments to generally be the legal maturity date of the instrument, as we generally intend to hold loans to maturity. However, if we have information available to us that the loan is expected to be repaid in the near term, we would use an estimated remaining life based on the expected repayment date.

For our equity investments, including equity securities and warrants, we generally use a market approach, including valuation methodologies consistent with industry practice, to estimate the enterprise value of portfolio companies. Typically, the enterprise value of a private company is based on multiples of EBITDA, net income, revenues, or in limited cases, book value. In estimating the enterprise value of a portfolio company, we analyze various factors consistent with industry practice, including but not limited to original transaction multiples, the portfolio company s historical and projected financial results, applicable market trading and transaction comparables, applicable market yields and leverage levels, the nature and realizable value of any collateral, the markets in which the portfolio company does business, and comparisons of financial ratios of peer companies that are public. Where applicable, we consider our ability to influence the capital structure of the portfolio company, as well as the timing of a potential exit.

We may also utilize an income approach when estimating the fair value of our equity securities, either as a primary methodology if consistent with industry practice or if the market approach is otherwise not applicable, or as a supporting methodology to corroborate the fair value ranges determined by the market approach. We typically prepare and analyze discounted cash flow models based on projections of the future free cash flows (or earnings) of the portfolio company. We consider various factors, including but not limited to the portfolio company s projected financial results, applicable market trading and transaction comparables, applicable market yields and leverage levels, the markets in which the portfolio company does business, and comparisons of financial ratios of peer companies that are public.

The fair value of our royalty rights are calculated based on projected future cash flows and the specific provisions contained in the pertinent royalty agreement. The determination of the fair value of such royalty rights is not a significant component of our valuation process.

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

Revenue Recognition

Investments and related investment income. Realized gains or losses on investments are recorded upon the sale or disposition of a portfolio investment and are calculated as the difference between the net proceeds from the sale or disposition and the cost basis of the investment, without regard to unrealized appreciation or depreciation previously recognized. Net change in unrealized appreciation or depreciation on the consolidated statements of operations includes changes in the fair value of investments from the prior period, as determined by our board of directors through the application of our valuation policy, as well as reclassifications of any prior period unrealized appreciation or depreciation on exited investments to realized gains or losses on investments.

Interest and dividend income. Interest and dividend income are recorded on the accrual basis to the extent that we expect to collect such amounts. Interest is accrued daily based on the outstanding principal amount and the contractual terms of the debt. Dividend income is recorded as dividends are declared or at the point an obligation exists for the portfolio company to make a distribution, and is generally recognized when received. Distributions from portfolio companies are evaluated to determine if the distribution is a distribution of earnings or a return of capital. Distributions of earnings are included in dividend income while a return of capital is recorded as a reduction in the cost basis of the investment. Estimates are adjusted as necessary after the relevant tax forms are received from the portfolio company.

PIK income. Certain of our investments contain a PIK income provision. The PIK income, computed at the contractual rate specified in the applicable investment agreement, is added to the principal balance of the investment, rather than being paid in cash, and recorded as interest or dividend income, as applicable, on the consolidated statements of operations. Generally, PIK can be paid-in-kind or all in cash. We stop accruing PIK income when there is reasonable doubt that PIK income will be collected. PIK income is included in our taxable income and, therefore, affects the amount we are required to pay to our stockholders in the form of dividends in order to maintain our tax treatment as a RIC and to avoid paying corporate-level U.S. federal income tax, even though we have not yet collected the cash.

Non-accrual. When there is reasonable doubt that principal, interest or dividends will be collected, loans or preferred equity investments are placed on non-accrual status and we will generally cease recognizing interest or dividend income. Interest and dividend payments received on non-accrual investments may be recognized as interest or dividend income or applied to the investment principal balance based on management s judgment. Non-accrual investments are restored to accrual status when past due principal, interest or dividends are paid and, in management s judgment, are likely to remain current.

Warrants. In connection with our debt investments, we will sometimes receive warrants or other equity-related securities (Warrants). We determine the cost basis of Warrants based upon their respective fair values on the date of receipt in proportion to the total fair value of the debt and Warrants received. Any resulting difference between the face amount of the debt and its recorded fair value resulting from the assignment of value to the Warrants is treated as OID, and accreted into interest income using the effective interest method over the term of the debt investment.

Fee income. All transaction fees earned in connection with our investments are recognized as fee income and are generally non-recurring. Such fees typically include fees for services, including structuring and advisory services, provided to portfolio companies. We recognize income from fees for providing such structuring and advisory services when the services are rendered or the transactions are completed. Upon the prepayment of a loan or debt security, any prepayment penalties are recorded as fee income when earned.

We also typically receive loan origination or closing fees in connection with investments. Such loan origination and closing fees are capitalized as unearned income and offset against investment cost basis on our consolidated statements of assets and liabilities and accreted into interest income over the term of the investment.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the revenue recognition requirements in *Revenue Recognition (Topic 605)*. Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for annual and interim reporting periods beginning after December 15, 2017. We adopted the ASU effective January 1, 2018. The majority of our income streams are specifically excluded from the scope of the ASU as they relate to financial instruments that are within the scope of other topics, and in general the impact of adopting the ASU is not material to our consolidated financial position or disclosures.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820) Changes to the Disclosure Requirements for Fair Value Measurement*, which modifies the disclosure requirements on fair value measurements. The guidance is effective for annual and interim reporting periods beginning after December 15, 2019. We are currently evaluating the impact this ASU will have on our consolidated financial position or disclosures.

In August 2018, the SEC issued Final Rule Release No. 33-10532, *Disclosure Update and Simplification*, which amends certain SEC disclosure requirements that have become redundant, duplicative, overlapping, outdated, or superseded, in light of other SEC disclosure requirements, U.S. GAAP requirements, or changes in the information environment. As it pertains to us, the amendments include certain presentation changes to the net assets section of the consolidated statements of assets and liabilities, and the consolidated statements of changes in net assets (among other changes). The amendments are effective for all filings submitted on or after November 5, 2018. We adopted the amendments effective November 5, 2018. The amendments do not have a material effect on our consolidated financial position or disclosures.

Table of Contents

Off-Balance Sheet Arrangements

We may be a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of our portfolio companies. We had off-balance sheet arrangements consisting of outstanding commitments to fund various undrawn revolving loans and other credit facilities totaling $10.9 million and $8.4 million as of December 31, 2018 and 2017, respectively. Such outstanding commitments are summarized in the following table (dollars in millions):

	December 31, 2018		December 31, 2017	
Portfolio Company Investment	Total Commitment	Unfunded Commitment	Total Commitment	Unfunded Commitment
American AllWaste LLC (dba Waste Water Transport Services) Delayed Draw Commitment Term Loan-B	$ 3.0	$ 2.3	$	$
B&B Roadway and Security Solutions, LLC Common Equity (Units)	0.1	0.1		
FDS Avionics Corp. (dba Flight Display Systems) Revolving Loan	0.2	0.1		
Mesa Line Services, LLC Delayed Draw Term Loan Commitment	4.0	3.1	4.0	4.0
Oaktree Medical Centre, P.C. (dba Pain Management Associates) Senior Secured Revolving Loan			2.5	
Rhino Assembly Company, LLC Delayed Draw Commitment	0.9	0.9	1.5	1.5
Safety Products Group, LLC Common Equity (Units)	2.9(1)	2.9(1)	2.9	2.9
UBEO, LLC Delayed Draw Term Loan Commitment	1.5	1.5		
Total	$ 12.6	$ 10.9	$ 10.9	$ 8.4

(1) Portfolio company was no longer held at period end. The commitment represents our maximum potential liability related to certain guaranteed obligations stemming from the prior sale of the portfolio company s underlying operations.

Additional detail for each of the commitments above is provided in our consolidated schedules of investments.

Contractual Obligations

As of December 31, 2018, our future fixed commitments (1) for cash payments are as follows:

Total

		Less Than 1 Year	**1 - 3 Years**	**3 - 5 Years**	**More Than 5 Years**
		(Dollars in millions)			
SBA debentures	$ 191.0	$	$ 2.0	$ 33.5	$ 155.5
Credit Facility borrowings	36.5	36.5			
Public Notes	50.0			50.0	
Total	$ 277.5	$ 36.5	$ 2.0	$ 83.5	$ 155.5

(1) Fixed commitments in the table above include the principal balance of the obligations as of December 31, 2018. While these obligations are outstanding, we will also incur related interest expense. The amount of interest expense that we ultimately incur will depend on the timing of repayments (which may occur on or before the stated maturity dates), and, as it relates to our Credit Facility, changes in the underlying variable reference interest rates. As of December 31, 2018, the weighted average stated interest rates for our SBA debentures, the Public Notes and the Credit Facility were 3.344%, 5.875% and 6.000%, respectively. As of December 31, 2018, we had $53.5 million of unutilized commitment under our Credit Facility, and we were subject to a 0.500% fee on such amount.

We have certain contracts under which we have material future commitments. We entered into the Investment Advisory Agreement with our investment advisor in accordance with the 1940 Act. Under the Investment Advisory Agreement, our investment advisor provides us with investment advisory and management services. We pay the following amounts for these services (a) a management fee equal to a percentage of the average of our total assets (excluding cash and cash equivalents) and (b) an incentive fee based on our performance. See Business Management and Other Agreements Investment Advisory Agreement Management Fee.

Under the Administration Agreement, our investment advisor furnishes us with office facilities and equipment, provides us clerical, bookkeeping and record keeping services at such facilities and provides us with other administrative services necessary to conduct our day-to-day operations. See Business Management and Other Agreements Administration Agreement.

If any of our contractual obligations discussed above are terminated, our costs under any new agreements that we enter into may increase. In addition, we would likely incur significant time and expense in locating alternative parties to provide the services we expect to receive under our Investment Advisory Agreement and our Administration Agreement. Any new investment advisory agreement would also be subject to approval by our Independent Directors and our stockholders.

Table of Contents

Related Party Transactions

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

- We have entered into the Investment Advisory Agreement with Fidus Investment Advisors, LLC, as our investment advisor. Pursuant to the agreement our investment advisor manages our day-to-day operating and investing activities. We pay our investment advisor a fee for its services under the Investment Advisory Agreement consisting of two components a base management fee and an incentive fee. See Note 5 to our consolidated financial statements.

- Edward H. Ross, our Chairman and Chief Executive Officer, and Thomas C. Lauer, our President, are managers of Fidus Investment Advisors, LLC. In May 2015, Fidus Investment Advisors, LLC entered into a combination with Fidus Partners, LLC (the Combination), by which members of Fidus Investment Advisors LLC and Fidus Partners, LLC (Partners) contributed all of their respective membership interest in Fidus Investment Advisors LLC and Partners to a newly formed limited liability company, Fidus Group Holdings, LLC (Holdings). As a result, Fidus Investment Advisors LLC is a wholly-owned subsidiary of Holdings, which is a limited liability company organized under the laws of Delaware.

- We entered into the Administration Agreement with Fidus Investment Advisors, LLC to provide us with the office facilities and administrative services necessary to conduct day-to-day operations. See Note 5 to our consolidated financial statements.

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

In connection with the IPO and our election to be regulated as a BDC, we applied for and received exemptive relief from the SEC on March 27, 2012 to allow us to take certain actions that would otherwise be prohibited by the 1940 Act, as applicable to BDCs. The relief permits FIC and Fund I, each of which has elected to be treated as a BDC, to operate effectively as one company, specifically allowing them to: (1) engage in certain transactions with each other; (2) invest in securities in which the other is or proposes to be an investor; (3) file consolidated reports with the SEC; and (4) be subject to modified consolidated asset coverage requirements for senior securities issued by a BDC and its SBIC subsidiary. Fund II has not elected to be treated as a BDC and is not party to this exemptive relief. The fourth exemption described above allows us to exclude any indebtedness guaranteed by the SBA and issued by Fund I from the asset coverage requirements applicable to us. Effective June 30, 2014, pursuant to separate exemptive relief from the SEC, any SBA debentures issued by Fund II are not considered senior securities for purposes of the asset coverage requirements.

While we may co-invest with investment entities managed by our investment advisor or its affiliates, to the extent permitted by the 1940 Act and the rules and regulations thereunder, the 1940 Act imposes significant limits on co-investment. The SEC staff has granted us relief sought in an exemptive application that expands our ability to co-invest in portfolio companies with other funds managed by our investment advisor or its affiliates (Affiliated Funds) in a manner consistent with our investment objective, positions, policies, strategies and restrictions as well as regulatory requirements and other pertinent factors, subject to compliance with certain conditions (the Order). Pursuant to the Order, we are permitted to co-invest with our affiliates if a required majority (as defined in

Section 57(o) of the 1940 Act) or our independent directors make certain conclusions in connection with a co-investment transaction, including that (1) the terms of the transactions, including the consideration to be paid, are reasonable and fair to us and our stockholders and do not involve overreaching by us or our stockholders on the part of any person concerned, and (2) the transaction is consistent with the interests of our stockholders and is consistent with our investment objective and strategies.

In addition, we, Fund I and our investment advisor have each adopted a joint code of ethics pursuant to Rule 17j-1 under the 1940 Act that governs the conduct of our and our investment advisor s officers, directors and employees. Additionally, our investment advisor has adopted a code of ethics pursuant to rule 204A-1 under the Advisers Act and in accordance with Rule 17j-1(c) under the 1940 Act. We, and Fund I, have also adopted a code of business conduct that is applicable to all officers, directors and employees of Fidus and our investment advisor. Our officers and directors also remain subject to the duties imposed by both the 1940 Act and the Maryland General Corporation Law.

Table of Contents

Recent Developments

On January 3, 2019, we invested $17.0 million in subordinated debt, common equity and preferred equity, and made a commitment for up to $11.0 million of additional subordinated debt, of BCM One Group Holdings, Inc., a provider of managed technology solutions and services.

On January 3, 2019, we exited our debt investments in Gurobi Optimization, LLC. We received payment in full of $20.4 million on our subordinated debt, which includes a prepayment penalty.

On January 28, 2019, we exited our existing debt and equity investments in K2 Industrial Services, Inc. We received payment in full on our Tranche A and A-1 notes, including prepayment penalties, and recognized a loss of approximately $1.3 million on our equity investment. We converted our remaining Tranche B note into a new debt security of K2 Merger Agreement Agent, LLC (the residual escrow entity).

On January 28, 2019, we invested $18.4 million in subordinated debt and common equity of BCC Group Holdings, Inc., a leading provider of software and data solutions designed to enhance direct mail processing.

On January 31, 2019, the board of directors declared a regular quarterly dividend of $0.39 per share payable on March 22, 2019 to stockholders of record as of March 8, 2019.

On February 1, 2019, we exited our debt investment in Fiber Materials, Inc. We received payment in full of $4.0 million on our second lien debt.

On February 1, 2019, we exited our debt investment in Tile Redi, LLC. We received payment in full of $10.2 million on our first lien debt.

On February 7, 2019, we invested $10.5 million in first lien debt and common equity of Diversified Search, LLC, a leading multi-practice retained executive search firm.

On February 8, 2019, we closed the public offering of approximately $60.0 million in aggregate principal amount of our 6.000% notes due 2024, or the 2024 Notes. On February 19, 2019, the underwriters exercised their option to purchase an additional $9.0 million in aggregate principal of the 2024 Notes. The total net proceeds to us from the 2024 Notes, including the exercise of the underwriters option, after deducting underwriting discounts of approximately $2.1 million and estimated offering expenses of $0.4 million, were approximately $66.5 million.

The 2024 Notes will mature on February 15, 2024 and bear interest at a rate of 6.000%. The 2024 Notes are unsecured obligations and rank pari passu with our future unsecured indebtedness, including our outstanding Public Notes; effectively subordinated to all of our existing and future secured indebtedness; and structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries, financing vehicles, or similar facilities we may form in the future, with respect to claims on the assets of any such subsidiaries, financing vehicles, or similar facilities. The 2024 Notes may be redeemed in whole or in part at any time or from time to time at our option on or after February 15, 2021. Interest on the 2024 Notes is payable quarterly on February 15, May 15, August 15 and November 15 of each year, beginning May 15, 2019. The 2024 Notes are listed on the NASDAQ Global Select Market under the trading symbol FDUSZ. We may from time to time repurchase the 2024 Notes in accordance with the 1940 Act and the rules promulgated thereunder. As of April 24, 2019, the outstanding principal balance of the 2024 Notes was approximately $69.0 million.

The indenture governing the 2024 Notes, or the Indenture, contains certain covenants, including covenants (i) requiring our compliance with the asset coverage requirements set forth in Section 18(a)(1)(A) as modified by such provisions of Section 61(a) of the 1940 Act as may be applicable to us from time to time, whether or not we continue to be subject to such provisions of the 1940 Act; (ii) requiring our compliance, under certain circumstances, with a modified version of the requirements set forth in Section 18(a)(1)(B) as modified by such provisions of Section 61(a) of the 1940 Act as may be applicable to us from time to time, whether or not we continue to be subject to such provisions of the 1940 Act, prohibiting the declaration of any cash dividend or distribution upon any class of our capital stock (except to the extent necessary for us to maintain its treatment as a RIC under Subchapter M of the Code), or purchasing any such capital stock, if our asset coverage, as defined in the 1940 Act, were below 200% at the time of the declaration of the dividend or distribution or the purchase and after deducting the amount of such dividend, distribution, or purchase; and (iii) requiring us to provide financial information to the holders of the 2024 Notes and the Trustee if we cease to be subject to the reporting requirements of the Securities Exchange Act of 1934. These covenants are subject to limitations and exceptions that are described in the Indenture.

On February 28, 2019, we repaid $19.8 million of SBA debentures with a weighted average interest rate of 3.1% which would have matured on dates ranging from September 1, 2021 to March 1, 2025.

On March 12, 2019, we invested $5.5 million in first lien debt and common equity of Bedford Precision Parts LLC, a leading distributor and assembler of replacement parts, accessories and kits for the spraying equipment industry (paint, foam, other).

On March 21, 2019, our wholly-owned subsidiary, Fidus Mezzanine Capital III, L.P. received a license from the SBA to operate as an SBIC.

On March 29, 2019, we exited our common equity investment in Consolidated Infrastructure Group Holdings, LP and realized a loss of $0.4 million.

On April 24, 2019, we executed an amendment and restatement of our Credit Facility, whereby, among other things, the total commitments under the Credit Facility increased from $90 million to $100 million, the final maturity date was extended from June 16, 2019 to April 24, 2023, and the pricing on the Credit Facility was reduced from LIBOR plus 3.50% to LIBOR plus 3.00%. The amendment also includes an expansion of the accordion feature to $250 million to accommodate further growth of the Company, and modifies certain covenants to the Credit Facility.

Table of Contents

SENIOR SECURITIES

Information about our senior securities is shown in the following table for the years indicated in the table, unless otherwise noted. RSM US LLP s report on the senior securities table as of December 31, 2018, is attached as an exhibit to the registration statement of which this prospectus is a part.

Class and Year(6)	Total Amount Outstanding Exclusive of Treasury Securities (1)	Asset Coverage per Unit (2)(5)	Involuntary Liquidation Preference per Unit (3)	Average Market Value per Unit (4)
	(Table Dollars in Thousands; Footnotes to Table Dollars in Whole Dollars)			
SBA debentures				
2007	$	$	$ *	N/A
2008	46,450	1,701	*	N/A
2009	79,450	1,610	*	N/A
2010	93,500	1,556	*	N/A
2011	104,000	2,351	*	N/A
2012	144,500		*	N/A
2013	144,500		*	N/A
2014	173,500		*	N/A
2015	213,500		*	N/A
2016	224,000		*	N/A
2017	231,300		*	N/A
2018	191,000		*	N/A
Credit Facility				
2007	$ 15,520	$ 2,285	$ *	N/A
2008			*	N/A
2009			*	N/A
2010			*	N/A
2011			*	N/A
2012			*	N/A
2013			*	N/A
2014	10,000	42,676	*	N/A
2015	15,500	30,733	*	N/A
2016			*	N/A
2017	11,500	55,311	*	N/A
2018	36,500	18,643	*	N/A
Public Notes				
2018	$ 50,000	$ 13,610	$ *	$ 1,287

(1) Total amount of each class of senior securities outstanding at the end of the period presented.
(2)

Asset coverage per unit is the ratio of the carrying value of our total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness. Asset coverage per unit is expressed in terms of dollar amounts per $1,000 of indebtedness.

(3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it. The * indicates information which the SEC expressly does not require to be disclosed for certain types of senior securities.

(4) Not applicable to SBA debentures and Credit Facility because these senior securities are not registered for public trading. The average market value per unit for the Public Notes is based on the average of the closing market price as of each quarter end during the fiscal year and the prior year end, as applicable, and is expressed per $1,000 of indebtedness. The Public Notes were issued in $25 increments.

(5) We have excluded our SBA-guaranteed debentures with respect to Fund I from the asset coverage calculation with respect to Fund I as of December 31, 2012 pursuant to the exemptive relief granted by the SEC in March 2012 that permits us to exclude such debentures from the definition of senior securities in the 200% asset coverage ratio we are required to maintain under the 1940 Act. We have excluded our SBA-guaranteed debentures with respect to Fund II from the asset coverage calculation as of December 31, 2014 pursuant to the exemptive relief granted by the SEC in June 2014 that permits us to exclude such debentures from the definition of senior securities in the 200% (or 150% if we satisfy certain requirements in the future) asset coverage ratio we are required to maintain under the 1940 Act.

(6) On February 8, 2019, we closed the public offering of $60.0 million in aggregate principal amount of our 2024 Notes. The ticker symbol for the 2024 Notes is FDUSZ. On February 19, 2019, the underwriters exercised their option to purchase an additional $9.0 million in aggregate principal of the 2024 Notes. As of April 24, 2019, the outstanding principal balance of the 2024 Notes was approximately $69.0 million.

Table of Contents

THE COMPANY

General

We provide customized debt and equity financing solutions to lower middle-market companies, which we define as U.S. based companies having revenues between $10.0 million and $150.0 million. Our investment objective is to provide attractive risk-adjusted returns by generating both current income from our debt investments and capital appreciation from our equity related investments. Our investment strategy includes partnering with business owners, management teams and financial sponsors by providing customized financing for ownership transactions, recapitalizations, strategic acquisitions, business expansion and other growth initiatives. We seek to maintain a diversified portfolio of investments in order to help mitigate the potential effects of adverse economic events related to particular companies, regions or industries.

We invest in companies that possess some or all of the following attributes: predictable revenues; positive cash flows; defensible and/or leading market positions; diversified customer and supplier bases; and proven management teams with strong operating discipline. We target companies in the lower middle-market with annual earnings, before interest, taxes, depreciation and amortization, or EBITDA, between $5.0 million and $30.0 million; however, we may from time to time opportunistically make investments in larger or smaller companies. Our investments typically range between $5.0 million and $30.0 million per portfolio company.

As of December 31, 2018, we had debt and equity investments in 63 portfolio companies with an aggregate fair value of $643.0 million. The weighted average yield on our debt investments as of December 31, 2018 was 12.6%. The weighted average yield of our debt investments is not the same as a return on investment for our stockholders but, rather, relates to a portion of our investment portfolio and is calculated before the payment of all of our fees and expenses. The weighted average yield was computed using the effective interest rates and investments at cost as of December 31, 2018, including accretion of OID and loan origination fees, but excluding investments on non-accrual status, if any. There can be no assurance that the weighted average yield will remain at its current level.

As of December 31, 2017, we had debt and equity investments in 63 portfolio companies with an aggregate fair value of $596.3 million. The weighted average yield on our debt investments as of December 31, 2017 was 13.0%. The weighted average yield of our debt investments is not the same as a return on investment for our stockholders but, rather, relates to a portion of our investment portfolio and is calculated before the payment of all of our fees and expenses. The weighted average yield was computed using the effective interest rates and investments at cost as of December 31, 2017, including accretion of OID and loan origination fees, but excluding investments on non-accrual status, if any. There can be no assurance that the weighted average yield will remain at its current level.

Market Opportunity

We believe that the limited amount of capital available to lower middle-market companies, coupled with the desire of these companies for flexible and partnership-oriented sources of capital, creates an attractive investment environment for us. We believe the following factors will continue to provide us with opportunities to grow and deliver attractive returns to stockholders.

The lower middle-market represents a large, underserved market. We believe that lower middle-market companies, most of which are privately-held, are relatively underserved by traditional capital providers such as commercial banks, finance companies, hedge funds and collateralized loan obligation funds. Further, we believe that companies of this size generally possess conservative capital structures with significant enterprise value cushions, as compared to larger companies with more financing options.

Current credit market dislocation for lower middle-market companies has created an opportunity for attractive risk-adjusted returns. In this market, we believe traditional capital sources, such as commercial banks, finance companies, hedge funds and collateralized loan obligation funds have reduced lending and investing in the lower middle-market, which has resulted in increased opportunities for alternative funding sources. In addition, we believe that there continues to be less competition in the lower middle-market and an increased opportunity for attractive risk-adjusted returns. The remaining lenders and investors in the current environment are requiring lower amounts of senior and total leverage, increased equity commitments and more comprehensive covenant packages than was customary in the years leading up to the credit crisis.

Table of Contents

Large pools of uninvested private equity capital should drive future transaction velocity. We believe there is a large pool of uninvested private equity capital, and we expect that private equity firms will remain active investors in lower middle-market companies. Private equity funds generally seek to leverage their investments by combining their equity capital with senior secured loans and/or mezzanine debt provided by other sources, and our relationships with private equity firms position us to partner with private equity investors.

Future refinancing activity is expected to create additional investment opportunities. A high volume of financings completed will mature in the coming years. Additionally, we believe that demand for debt financing from lower middle-market companies will remain strong because these companies will continue to require credit to refinance existing debt, to support growth initiatives and to finance acquisitions. We believe this supply of opportunities coupled with limited financing providers focused on lower middle-market companies will continue to offer investment opportunities with attractive risk-adjusted returns.

Our Advisor

Our investment activities are managed by Fidus Investment Advisors, LLC, our investment advisor, and supervised by our board of directors, a majority of whom are not interested persons of FIC as defined in section 2(a)(19) of the 1940 Act, and who we refer to hereafter as the Independent Directors. Pursuant to the terms of the investment advisory and management agreement, which we refer to as the Investment Advisory Agreement, between us and our investment advisor, our investment advisor is responsible for determining the composition of our portfolio, including sourcing potential investments, conducting research and diligence on potential investments and equity sponsors, analyzing investment opportunities, structuring our investments and monitoring our investments and portfolio companies on an ongoing basis. Our investment advisor s investment professionals seek to capitalize on their significant deal origination and sourcing, underwriting, due diligence, investment structuring, execution, portfolio management and monitoring experience. These professionals have developed a broad network of contacts within the investment community, have gained extensive experience investing in assets that constitute our primary focus and have expertise in investing across all levels of the capital structure of lower middle-market companies.

Our relationship with our investment advisor is governed by and dependent on the Investment Advisory Agreement and may be subject to conflicts of interest. We pay our investment advisor a fee for its services under the Investment Advisory Agreement consisting of two components a base management fee and an incentive fee. The base management fee is calculated at an annual rate of 1.75% of the average value of our total assets (other than cash or cash equivalents but including assets purchased with borrowed amounts). The incentive fee consists of two parts. The first part is calculated and payable quarterly in arrears and equals 20.0% of our pre-incentive fee net investment income for the immediately preceding quarter, subject to a 2.0% preferred return, or hurdle, and a catch up feature. The second part is determined and payable in arrears as of the end of each fiscal year in an amount equal to 20.0% of our realized capital gains, if any, on a cumulative basis from inception through the end of each fiscal year, computed net of all realized capital losses and unrealized capital depreciation on a cumulative basis, less the aggregate amount of any capital gain incentive fees paid in prior years. We accrue, but do not pay, a capital gains incentive fee in connection with any unrealized capital appreciation, as appropriate. For more information about how we compensate our investment advisor, see Management and Other Agreements Investment Advisory Agreement.

Among other things, our board of directors is charged with protecting our interests by monitoring how our investment advisor addresses conflicts of interest associated with its management services and compensation. Our board of directors is not expected to review or approve each borrowing or incurrence of leverage. However, our board of directors periodically reviews our investment advisor s portfolio management decisions and portfolio performance. In addition, our board of directors at least annually reviews the services provided by and fees paid to our investment advisor. In connection with these reviews, our board of directors, including a majority of our Independent Directors, considers whether the fees and expenses (including those related to leverage) that we pay to our investment advisor are fair and reasonable in relation to the services provided. Renewal of our Investment Advisory Agreement must be approved each year by our board of directors, including a majority of our Independent Directors.

Fidus Investment Advisors, LLC is a Delaware limited liability company that is registered as an investment advisor under the Investment Advisers Act of 1940, as amended, or the Advisers Act. In addition, Fidus Investment Advisors, LLC serves as our administrator and provides us with office space, equipment and clerical, book-keeping and record-keeping services pursuant to an administration agreement, which we refer to as the Administration Agreement.

Business Strategy

We intend to accomplish our goal of becoming one of the premier providers of capital to and value-added partner of lower middle-market companies by:

Leveraging the Experience of Our Investment Advisor. Our investment advisor s investment professionals have significant experience investing in, lending to and advising companies across multiple industries and changing market cycles. These professionals have diverse backgrounds with prior experience in senior management positions at investment banks, specialty finance companies, commercial banks and privately and publicly held companies and have extensive experience investing across all levels of the capital structure of lower middle-market companies. We believe these professionals possess an in-depth understanding of the strategic, financial and operational challenges and opportunities of lower middle-market companies, enabling our investment advisor to effectively identify, assess, structure and monitor our investments.

Capitalizing on Our Strong Transaction Sourcing Network. Our investment advisor s investment professionals possess an extensive network of long-standing relationships with private equity firms, middle-market senior lenders, junior capital partners, financial intermediaries and management teams of privately owned businesses. We believe that the combination of our investment advisor s relationships and our reputation as a reliable, responsive and value-added financing partner helps us generate a steady stream of new investment opportunities and proprietary deal flow.

Serving as a Value-Added Partner with Customized Financing Solutions. We follow a partnership-oriented investment approach and focus on opportunities where we believe we can add value to a portfolio company. We primarily concentrate on industries or market niches in which the investment professionals of our investment advisor have prior experience. These professionals also have expertise in structuring securities at all levels of the capital structure, which we believe positions us well to meet the unique financing needs of our portfolio companies. We invest primarily in second lien and subordinated debt securities, typically coupled with an equity interest; however, on a selective basis we may invest in first lien senior secured or unitranche loans. Further, as a publicly-traded BDC, we have a longer investment horizon without the capital return requirements of traditional private investment vehicles. We believe this flexibility enables us to generate attractive risk-adjusted returns on invested capital and enables us to be a better long-term partner for our portfolio companies. We believe that by leveraging the industry and structuring expertise of our investment advisor coupled with our long-term investment horizon, we are well positioned to be a value-added partner for our portfolio companies.

Employing Rigorous Due Diligence and Underwriting Processes Focused on Capital Preservation. Our investment advisor follows a disciplined and credit-oriented approach to evaluating and investing in companies. We focus on companies with proven business models, significant free cash flow, defensible market positions and significant enterprise value cushion for our debt investments. In making investment decisions, we seek to minimize the risk of capital loss without foregoing the opportunity for capital appreciation. Our investment advisor s investment professionals have developed extensive due diligence and underwriting processes designed to better assess a portfolio company s prospects and to determine the appropriate investment structure. Our investment advisor thoroughly analyzes each potential portfolio company s competitive position, financial performance, management team, growth potential and industry attractiveness. As part of this process, our investment advisor also participates in meetings with management, tours of facilities, discussions with industry professionals and third-party reviews. We believe this approach enables us to build and maintain an attractive investment portfolio that meets our return and value criteria over the long term.

Actively Managing our Portfolio. We believe that our investment advisor s initial and ongoing portfolio review process allows us to effectively monitor the performance and prospects of our portfolio companies. We seek to obtain board observation rights or board seats with respect to our portfolio companies, and we conduct monthly financial reviews and have regular discussions with portfolio company management. We structure our investments with a comprehensive set of financial maintenance, affirmative and negative covenants. We believe that active monitoring of our portfolio companies compliance with covenants provides us with an early warning of any financial difficulty and enhances our ability to protect our invested capital.

Maintaining Portfolio Diversification. We seek to maintain a portfolio of investments that is appropriately diversified among companies, industries, geographic regions and end markets. We have made investments in portfolio companies in the following industries: business services, industrial products and services, value-added distribution, healthcare products and services, consumer products and services (including retail, food and beverage), energy services, defense and aerospace, transportation and logistics, information technology services and niche manufacturing. We believe that investing across various industries helps mitigate the potential effects of negative economic events for particular companies, regions and industries.

Benefiting from Lower Cost of Capital. The Funds SBIC licenses allow us to issue SBA-guaranteed debentures. These SBA debentures carry long-term fixed rates that are generally lower than rates on comparable bank and public debt. Because lower-cost SBA leverage is, and will continue to be, a significant part of our funding strategy, our relative cost of debt capital should be lower than many of our competitors. For three or more SBICs under common control, the maximum amount of outstanding SBA debentures cannot exceed $350.0 million.

Investments

We seek to create a diversified investment portfolio that primarily includes loans and, to a lesser extent, equity securities. Our investments typically range between $5.0 million to $30.0 million per portfolio company, although this investment size may vary proportionately with the size of our capital base. Our investment objective is to provide attractive risk-adjusted returns by generating both current income from our debt investments and capital appreciation from our equity related investments. We may invest in the equity securities of our portfolio companies, such as preferred stock, common stock, warrants and other equity interests, either directly or in conjunction with our debt investments.

Second Lien Debt. The majority of our debt investments take the form of second lien debt, which includes senior subordinated notes. Second lien debt investments obtain security interests in the assets of the portfolio company as collateral in support of the repayment of such loans. Second lien debt typically is senior on a lien basis to other liabilities in the issuer s capital structure and has the benefit of a security interest over assets of the issuer, though ranking junior to first lien debt secured by those assets. First lien lenders and second lien lenders typically have separate liens on the collateral, and an intercreditor agreement provides the first lien lenders with priority over the second lien lenders liens on the collateral. These loans typically provide for no contractual loan amortization, with all amortization deferred until loan maturity, and may include payment-in-kind (PIK) interest, which increases the principal balance over the term and, coupled with the deferred principal payment provision, increases credit risk exposure over the life of the loan.

Subordinated Debt. These investments are typically structured as unsecured, subordinated notes. Structurally, subordinated debt usually ranks subordinate in priority of payment to first lien and second lien debt and may not have the benefit of financial covenants common in first lien and second lien debt. Subordinated debt may rank junior as it relates to proceeds in certain liquidations where it does not have the benefit of a lien in specific collateral held by creditors (typically first lien and/or second lien) who have a perfected security interest in such collateral. However, subordinated debt ranks senior to common and preferred equity in an issuer s capital structure. These loans typically have relatively higher fixed interest rates (often representing a combination of cash pay and PIK interest) and amortization of principal deferred to maturity. The PIK feature (meaning a feature allowing for the payment of interest in the form of additional principal amount of the loan instead of in cash), which effectively operates as negative amortization of loan principal, coupled with the deferred principal payment provision, increases credit risk exposure over the life of the loan.

First Lien Debt. To a lesser extent, we also structure some of our debt investments as senior secured or first lien debt investments. First lien debt investments are secured by a first priority lien on existing and future assets of the borrower and may take the form of term loans or revolving lines of credit. First lien debt is typically senior on a lien basis to other liabilities in the issuer s capital structure and has the benefit of a first-priority security interest in assets of the issuer. The security interest ranks above the security interest of any second lien lenders in those assets. Our first lien debt may include stand-alone first lien loans, last out first lien loans, or unitranche loans. Stand-alone first lien loans are traditional first lien loans. All lenders in the facility have equal rights to the collateral that is subject to the first-priority security interest. Last out first lien loans have a secondary priority behind super-senior first out first lien loans in the collateral securing the loans in certain circumstances. The arrangements for a last out first lien loan are set forth in an agreement among lenders, which provides lenders with first out and last out payment streams based on a single lien on the collateral. Since the first out lenders generally have priority over the last out lenders for receiving payment under certain specified events of default, or upon the occurrence of other triggering events under intercreditor agreements or agreements among lenders, the last out lenders bear a greater risk and, in exchange, receive a higher effective interest rate, through arrangements among the lenders, than the first out lenders or lenders in stand-alone first lien loans. Agreements among lenders also typically provide greater voting rights to the last out lenders than the intercreditor agreements to which second lien lenders often are subject.

Many of our debt investments also include excess cash flow sweep features, whereby principal repayment may be required before maturity if the portfolio company achieves certain defined operating targets. Additionally, our debt investments typically have principal prepayment penalties in the early years of the loan. Substantially all of our debt investments provide for a fixed interest rate.

Equity Securities. Our equity securities typically consist of either a direct minority equity investment in common or preferred stock or membership/partnership interests of a portfolio company, or we may receive warrants to buy a minority equity interest in a portfolio company in connection with a debt investment. Warrants we receive with our debt investments typically require only a nominal cost to exercise, and thus, as a portfolio company appreciates in value, we may achieve additional investment return from this equity interest. Our equity investments are typically not control-oriented investments, and in many cases, we acquire equity securities as part of a group of private equity investors in which we are not the lead investor. We may structure such equity investments to include provisions protecting our rights as a minority-interest holder, as well as a put, or right to sell such securities back to the issuer, upon the occurrence of specified events. In many cases, we may also seek to obtain registration rights in connection with these equity interests, which may include demand and piggyback registration rights. Our equity investments typically are made in connection with debt investments to the same portfolio companies.

Our Consolidated Portfolio

We generally seek to invest in companies from the broad range of industries in which our investment advisor has direct experience. The following is a representative list of the broad industry segments in which we have invested; however, we may invest in other industries if we are presented with attractive opportunities.

- aerospace & defense;
- business services;
- consumer products / multi-unit;
- energy services;
- healthcare products;
- infrastructure;
- logistics & transportation;
- niche manufacturing;
- software & tech-enabled services; and
- value-added distribution.

industrial;

As of December 31, 2018, we had investments in 63 portfolio companies with an aggregate fair value of $643.0 million. As of December 31, 2017, we had investments in 63 portfolio companies with an aggregate fair value of $596.3 million.

Table of Contents

The following table shows the portfolio composition by geographic region at fair value and cost and as a percentage of total investments (dollars in millions). The geographic composition is determined by the location of the corporate headquarters of the portfolio company, which may not be indicative of the primary source of the portfolio company s business.

	Fair Value				Cost			
	December 31, 2018		December 31, 2017		December 31, 2018		December 31, 2017	
Midwest	$ 161.1	25.1%	$ 168.0	28.2%	$ 152.6	25.5%	$ 161.8	28.1%
Southeast	176.8	27.5	130.2	21.8	155.3	25.9	130.7	22.6
Northeast	89.7	13.9	107.8	18.1	84.2	14.1	105.3	18.2
West	62.8	9.8	63.4	10.6	54.5	9.1	54.0	9.3
Southwest	152.6	23.7	126.9	21.3	152.2	25.4	126.0	21.8
Total	$ 643.0	100.0%	$ 596.3	100.0%	$ 598.8	100.0%	$ 577.8	100.0%

The following table shows the detailed industry segment composition of our portfolio at fair value and cost as a percentage of total investments.

	Fair Value		Cost	
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017
Specialty Distribution	13.4%	6.2%	14.1%	6.2%
Business Services	9.7	6.5	10.3	7.3
Information Technology Services	8.5	10.7	8.5	11.0
Component Manufacturing	7.9	6.6	8.9	7.0
Healthcare Services	7.8	10.8	7.7	9.9
Oil & Gas Services	6.4	4.7	1.7	2.7
Aerospace & Defense Manufacturing	5.8	4.4	6.0	4.3
Transportation Services	5.2	7.1	5.4	7.3
Healthcare Products	4.8	7.3	3.2	7.1
Vending Equipment Manufacturing	4.6	5.7	5.2	5.9
Industrial Cleaning & Coatings	4.1	4.3	4.7	4.6
Promotional Products	4.1	3.0	4.2	2.9
Building Products Manufacturing	3.8	5.1	5.1	5.4
Retail	2.4	2.8	2.7	2.9
Utility Equipment Manufacturing	2.4	2.6	2.5	2.8
Consumer Products	2.3	3.3	2.6	2.7
Packaging	2.2	0.1	2.4	0.1
Environmental Industries	1.9		2.0	
Utilities: Services	1.7	1.6	1.7	1.7
Oil & Gas Distribution	1.0	1.0	1.0	1.0
Capital Equipment Manufacturing	0.0	3.4	0.0	3.4
Restaurants	0.0	0.4	0.1	1.7

Specialty Chemicals	0.0	0.2	0.0	0.2
Apparel Distribution		0.9		1.0
Electronic Components Supplier		0.6		0.2
Laundry Services		0.7		0.7
Safety Products Manufacturing		0.0		0.0
Total	100.0%	100.0%	100.0%	100.0%

Investment Criteria/Guidelines

We use the following criteria and guidelines in evaluating investment opportunities and constructing our portfolio. However, not all of these criteria and guidelines have been, or will be, met in connection with each of our investments.

Table of Contents

Value Orientation / Positive Cash Flow. Our investment advisor places a premium on analysis of business fundamentals from an investor s perspective and has a distinct value orientation. We focus on companies with proven business models in which we can invest at relatively low multiples of operating cash flow. We also typically invest in portfolio companies with a history of profitability and minimum trailing twelve month EBITDA of $5.0 million. We do not invest in start-up companies, turn-around situations or companies that we believe have unproven business plans.

Experienced Management Teams with Meaningful Equity Ownership. We target portfolio companies that have management teams with significant experience and/or relevant industry experience coupled with meaningful equity ownership. We believe management teams with these attributes are more likely to manage the companies in a manner that protects our debt investment and enhances the value of our equity investment.

Niche Market Leaders with Defensible Market Positions. We seek to invest in portfolio companies that have developed defensible and/or leading positions within their respective markets or market niches and are well positioned to capitalize on growth opportunities. We favor companies that demonstrate significant competitive advantages, which we believe helps to protect their market position and profitability.

Diversified Customer and Supplier Base. We prefer to invest in portfolio companies that have a diversified customer and supplier base. Companies with a diversified customer and supplier base are generally better able to endure economic downturns, industry consolidation and shifting customer preferences.

Significant Equity Value. We believe the existence of significant underlying equity value provides important support to our debt investments. With respect to our debt investments, we look for portfolio companies where management/sponsors have provided significant equity funding and where we believe aggregate enterprise value significantly exceeds aggregate indebtedness, after consideration of our investment.

Viable Exit Strategy. We invest in portfolio companies that we believe will provide steady cash flows to service our debt, ultimately repay our loans and provide working capital for their respective businesses. In addition, we seek to invest in portfolio companies whose business models and expected future cash flows offer attractive exit possibilities for our portfolio equity investments. We expect to exit our investments typically through one of three scenarios: (a) the sale of the portfolio company resulting in repayment of all outstanding debt and monetization of equity; (b) the recapitalization of the portfolio company through which our investments are replaced with debt or equity from a third party or parties; or (c) the repayment of the initial or remaining principal amount of our debt investment from cash flow generated by the portfolio company. In some investments, there may be scheduled amortization of some portion of our debt investment that would result in a partial exit of our investment prior to the maturity of the debt investment.

Investment Committee

Our investment advisor has formed an investment committee to evaluate and approve all of our investments. The investment committee process is intended to bring the diverse experience and perspectives of the committee s members to the analysis and consideration of each investment. The investment committee also serves to provide investment consistency and adherence to our investment advisor s core investment philosophy and policies. The investment committee also determines appropriate investment sizing and suggests ongoing monitoring requirements.

The members of the investment committee that evaluate and approve all of our investments are Edward H. Ross, Thomas C. Lauer, John H. Grigg, Robert G. Lesley, Jr., John J. Ross, II, Thomas J. Steiglehner, and W. Andrew Worth.

Investment Process Overview

Our investment advisor has developed the following investment process based on the experience of its investment professionals to identify investment opportunities and to structure investments quickly and effectively. Furthermore, our investment advisor seeks to identify those companies exhibiting superior fundamental risk-reward profiles and strong defensible business franchises while focusing on the relative value of the security in the portfolio company s capital structure. The investment process consists of five distinct phases:

Investment Generation/Origination;

- Initial Evaluation;
- Due Diligence and Underwriting;
- Documentation and Closing; and
- Active Portfolio Management.

Each of the phases is described in more detail below.

Investment Generation/Origination. Our investment origination efforts are focused on leveraging our investment advisor s extensive network of long-standing relationships with private equity firms, middle-market senior lenders, junior-capital partners, financial intermediaries, service providers and management teams of privately owned businesses. We believe that our investment advisor s investment professionals have reputations as reliable, responsive and value-added partners for lower middle-market companies. Our investment advisor s focus and reputation as a valued-added partner generates a balanced mix of proprietary deal flow and a steady stream of new deal opportunities.

Initial Evaluation. After a potential transaction is received by our investment advisor, it will conduct an initial review of the transaction materials to determine whether it meets our investment criteria and complies with SBA and other regulatory compliance requirements.

If the potential transaction initially meets our investment criteria, at least two members of the investment committee, referred to as the deal team, will conduct a preliminary due diligence review, taking into consideration some or all of the following factors:

- A comprehensive financial model based on quantitative analysis of historical financial performance, projections and pro forma adjustments to determine a range of estimated internal rates of return.
- An initial call or meeting with the portfolio company management team, owner, private equity sponsor or other deal partner.
- A brief industry and market analysis, leveraging direct industry expertise from other investment professionals of our investment advisor.
- Preliminary qualitative analysis of the portfolio company management team s competencies and backgrounds.
- Potential investment structures and pricing terms.

Upon successful completion of the screening process, the deal team prepares a screening memorandum and makes a recommendation to the investment committee. At this time, the investment committee will also consider whether the investment would be made by FIC or through the Funds. If the investment committee supports the deal team s recommendation, the deal team issues a non-binding term sheet to the potential portfolio company. Such a term sheet will typically include the key economic terms based on our analysis conducted during the screening process. Upon agreement on a term sheet with the potential portfolio company, our investment advisor will begin a formal diligence and underwriting process.

Due Diligence and Underwriting. Our investment advisor has developed a rigorous and disciplined due diligence process that includes a comprehensive understanding of a borrower s industry, market, operational, financial, organizational and legal positions and prospects. The due diligence review will take into account information that the deal team deems necessary to make an informed decision about the creditworthiness of the borrower and the risks of the investment, which includes some or all of the following:

- Initial or additional site visits and facility tours with management and key personnel.
- Review of the business history, operations and strategy.
- In depth review of industry and competition.
- Analysis of key customers and suppliers, including review of any concentrations and key contracts.
- Detailed review of historical and projected financial statements, including a review of at least three years of performance (annual and monthly), key financial ratios, revenue, expense and profitability drivers and sensitivities to management s financial projections.
- Detailed evaluation of company management, including background checks.
- Third party reviews of accounting, environmental, legal, insurance, material contracts, competition, industry and market studies and interviews with customers and suppliers, (each as appropriate).
- Financial sponsor diligence, if applicable, including portfolio company and other reference checks.

Table of Contents

During the due diligence process, significant attention is given to sensitivity analyses and how the portfolio company might be expected to perform given various scenarios, including downside, base case and upside. Upon satisfactory completion of the due diligence review process, the deal team will present their findings and a recommendation to the investment committee. If the investment committee supports the deal team s recommendation, the deal team will proceed with negotiating and documenting the investment.

Documentation and Closing. Our investment advisor works with the management of a potential portfolio company and its other capital providers, including, as applicable, senior, junior and equity capital providers to structure an investment. Our investment advisor structures each investment with an acute focus on capital preservation and will tailor the terms of each investment to the facts and circumstances of the transaction and the prospective portfolio company. We seek to limit the downside of our investments by:

- Targeting an optimal total return on our investments (including a combination of current and deferred interest, prepayment penalties and equity participation) that compensates us for credit risk.

- Negotiating covenants in connection with our investments that afford our portfolio companies as much flexibility in managing their businesses as possible, yet consistent with preservation of our capital. Such restrictions may include affirmative and negative covenants, default penalties, lien protection, change of control provisions and board rights, including either board observation or rights to a seat on the board under some circumstances.

- Structuring financial covenants and terms in our debt investments that require a portfolio company to reduce leverage over time, thereby mitigating the risk of loss and increasing the likelihood of achieving targeted returns on investment. These methods may include, among others: leverage covenants requiring a decreasing ratio of debt to cash flow; cash flow covenants requiring an increasing ratio of cash flow to interest expense and possibly other cash expenses such as capital expenditures, cash taxes and mandatory principal payments; and debt incurrence prohibitions, or limiting a company s ability to relever its balance sheet. In addition, limitations on asset sales and capital expenditures prevent a company from changing the nature of its business or capitalization without our consent.

We expect to hold most of our investments to maturity or repayment, but may exit our investments earlier if a liquidity event takes place, such as a sale or recapitalization of a portfolio company, or if we determine that a sale of one or more of our investments is in our best interest.

Active Portfolio Management. Active portfolio monitoring is a vital part of our investment process and we continuously monitor the status and progress of the portfolio companies. The same deal team that was involved in the investment process will continue its involvement in the portfolio company post-investment. This provides for continuity of knowledge and allows the deal team to maintain a strong business relationship with key management of its portfolio companies for post-investment assistance and monitoring purposes.

As part of the monitoring process, the deal team conducts a comprehensive review of the financial and operating results of each portfolio company that includes a review of the monthly/quarterly financials relative to prior year and budget, a review of the financial projections including cash flow and liquidity needs, meeting with management, attending board meetings and reviewing compliance certificates and covenants. We maintain an ongoing dialogue with the management and any controlling equity holders of a portfolio company that will include discussions about the company s business plans and growth opportunities and any changes in industry and competitive dynamics. While we maintain limited involvement in the ordinary course operations of our portfolio companies, we may maintain a higher level of involvement in non-ordinary course financing or strategic activities and any non-performing scenarios. Our investment advisor s portfolio management will also include quarterly portfolio reviews with all investment professionals and investment committee members.

Investment Rating System

In addition to various risk management and monitoring tools, our investment advisor uses an internally developed investment rating system to characterize and monitor the credit profile and our expected level of returns on each investment in our portfolio. We use a five-level numeric rating scale. The following is a description of the conditions associated with each investment rating:

Investment Rating 1 is used for investments that involve the least amount of risk in our portfolio. The portfolio company is performing above expectations, the debt investment is expected to be paid in the near term and the trends and risk factors are favorable, and may include an expected capital gain.

Table of Contents

Investment Rating 2 is used for investments that involve a level of risk similar to the risk at the time of origination. The portfolio company is performing substantially within our expectations and the risks factors are neutral or favorable. Each new portfolio investment enters our portfolio with Investment Rating 2.

Investment Rating 3 is used for investments performing below expectations and indicates the investment s risk has increased somewhat since origination. The portfolio company requires closer monitoring, but we expect a full return of principal and collection of all interest and/or dividends.

Investment Rating 4 is used for investments performing materially below our expectations and the risk has increased materially since origination. The portfolio company has the potential for some loss of investment return, but we expect no loss of principal.

Investment Rating 5 is used for investments performing substantially below our expectations and the risks have increased substantially since origination. We expect some loss of principal.

The following table shows the distribution of our investments on the 1 to 5 investment rating scale at fair value and cost as of December 31, 2018 and 2017 (dollars in millions).

	Fair Value				**Cost**			
Investment Rating	**December 31, 2018**		**December 31, 2017**		**December 31, 2018**		**December 31, 2017**	
1	$ 123.8	19.2%	$ 125.7	21.1%	$ 63.7	10.7%	$ 83.2	14.4%
2	403.1	62.7	398.4	66.8	396.2	66.2	393.6	68.1
3	94.3	14.7	51.8	8.7	101.4	16.9	60.7	10.5
4	21.3	3.3	18.3	3.1	33.2	5.5	28.3	4.9
5	0.5	0.1	2.1	0.3	4.3	0.7	12.0	2.1
Total	$ 643.0	100.0%	$ 596.3	100.0%	$ 598.8	100.0%	$ 577.8	100.0%

Based on our investment rating system, the weighted average rating of our portfolio as of December 31, 2018 and 2017 was 2.0 and 1.9, respectively, on a fair value basis and 2.2 and 2.1, respectively, on a cost basis.

Determination of Net Asset Value and Valuation Process

We determine the net asset value per share of our common stock on at least a quarterly basis, and more frequently if we are required to do so in connection with the issuance of shares of our common stock or pursuant to applicable federal laws and regulations. The net asset value per share of common stock is equal to the carrying value of our total assets minus liabilities and any preferred stock outstanding divided by the total number of shares of common stock outstanding. Our business plan calls for us to invest primarily in illiquid securities issued by private companies. These portfolio investments may be subject to restrictions on resale and will generally have no established trading market. Because there is not a readily available market for substantially all of the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by our board of directors using a documented valuation policy and consistently applied valuation process in accordance with authoritative accounting guidelines. See Management s Discussion and Analysis of Financial Condition and Results of Operations Critical

Accounting Policies and Use of Estimates   Valuation of Portfolio Investments.

Competition

Our primary competitors in providing financing to lower middle-market companies include public and private funds, other BDCs, SBICs, commercial and investment banks, commercial financing companies and, to the extent they provide an alternative form of financing, private equity and hedge funds. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, we believe some competitors may have access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC or to the distribution and other requirements we must satisfy to maintain our RIC status.

Table of Contents

We use the expertise of the investment professionals of our investment advisor to assess investment risks and determine appropriate pricing for our investments in portfolio companies. In addition, the relationships of the investment professionals of our investment advisor enable us to learn about, and compete effectively for, financing opportunities with attractive lower middle-market companies in the industries in which we seek to invest. For additional information concerning the competitive risks we face, see Risk Factors Risks Relating to Our Business and Structure We operate in a highly competitive market for investment opportunities, which could reduce returns and result in losses.

Employees

We do not have any direct employees, and our day-to-day investment operations are managed by our investment advisor, which is also acting as our administrator. We have a chief executive officer, president, chief financial officer and chief compliance officer and, to the extent necessary, our board of directors may elect to hire additional personnel going forward. Our officers are employees of, and are compensated by, our investment advisor, and our allocable portion of the cost of our chief financial officer and chief compliance officer and their respective staffs are paid by us pursuant to the Administration Agreement. Some of our executive officers are also officers of our investment advisor. See Management and Other Agreements Administration Agreement.

Properties

We do not own any real estate or other physical properties materially important to our operation. Our headquarters are located at 1603 Orrington Avenue, Suite 1005, Evanston, Illinois 60201, and are provided by our investment advisor pursuant to the Administration Agreement. Our investment advisor also maintains additional office space at 227 West Trade Street, Suite 1910, Charlotte, North Carolina 28202, 1140 Avenue of the Americas, Suite 1500, New York, New York 10036, and 170 Meeting Street, Suite 226, Charleston, South Carolina 29401. We believe that our office facilities are suitable and adequate to our business as we contemplate conducting it.

Legal Proceedings

We may, from time to time, be involved in litigation arising out of our operations in the normal course of business or otherwise. Furthermore, third parties may try to seek to impose liability on us in connection with the activities of our portfolio companies. While the outcome of any current legal proceedings cannot at this time be predicted with certainty, we do not expect any current matters will materially affect our financial condition or results of operations; however, there can be no assurance whether any pending legal proceedings will have a material adverse effect on our financial condition or results of operations in any future reporting period.

Table of Contents

PORTFOLIO COMPANIES

The following table sets forth certain audited information as of December 31, 2018, for the portfolio companies in which we had a debt or equity investment (dollars in thousands). Other than these investments, our only formal relationships with our portfolio companies are the managerial assistance ancillary to our investments and the board observer or participation rights we may receive.

Company	Investment Type	Industry	Percentage of Class Held (a)	Rate Cash/PIK	Matu
tems)		Aerospace & Defense Manufacturing			
	Second Lien Debt			4.00%/11.00%	4/1/20
	Revolving Loan			4.00%/11.00%	4/1/20
	Common Equity (7,478 shares)		93.5%		
		Industrial Cleaning & Coatings			
	Second Lien Debt (d)			0.00%/15.00%	6/25/2
	Second Lien Debt (d)			0.00%/12.00%	6/25/2
	Second Lien Debt (d)			0.00%/19.00%	6/25/2
	Common Equity (1,673 shares)		3.0%		
		Specialty Chemicals			
	Common Equity (1,396 units)		13.9%		
		Aerospace & Defense Manufacturing			
	Second Lien Debt			12.00%/0.00%	5/30/2
	Common Equity (10 units)		9.8%		
		Healthcare Services			
	Second Lien Debt			13.00%/0.00%	6/30/2
	Preferred Equity (126,662 units)		3.4%		
	Warrant (505,176 units)		13.7%		
		Healthcare Services			
	Subordinated Debt			11.00%/1.50%	3/13/2
	Common Equity (1,625,731 units)		7.7%		

	Utility Equipment Manufacturing		
Second Lien Debt		13.85%/1.50%	11/25/2
Common Equity (2,500,000 shares)	21.4%		
	Healthcare Products		
Subordinated Debt		10.50%/0.00%	9/29/2
Common Equity (8,500 units)	15.6%		
	Oil & Gas Services		
Second Lien Debt		12.00%/0.00%	1/24/2
Common Equity Class A-2 (42,500 units)	41.7%		
Common Equity Class B (1,000 units)	0.0%		

ed

	Aerospace & Defense Manufacturing		
			By:
Second Lien Debt		12.00%/1.50">	

PETER FAMILY REVOCABLE TRUST

By: /s/ JAMES B. PETER

James B. Peter, M.D., Ph.D., as Trustee

and

By: /s/ JOAN C. PETER

Joan C. Peter, as Trustee

ESTES FAMILY TRUST

By: /s/ JAMES B. ESTES

	James B. Estes, as Trustee
and	
By:	/s/ DEBORAH A. ESTES
	Deborah A. Estes, as Trustee

JAMES B. PETER ROLLOVER IRA

By: /s/ JAMES B. PETER

James B. Peter, M.D., Ph.D.

D-12

APPENDIX E

[Execution Version]

SUBSCRIPTION, MERGER AND EXCHANGE AGREEMENT

Dated as of September 29, 2005,

Among

AMERIPATH HOLDINGS, INC.,

AMERIPATH GROUP HOLDINGS, INC.,

AQUA ACQUISITION CORP.,

THE STOCKHOLDERS OF AMERIPATH HOLDINGS, INC. SET FORTH ON THE SIGNATURE PAGES HEREOF,

And

THE STOCKHOLDERS OF SPECIALTY LABORATORIES, INC. SET FORTH ON THE SIGNATURE PAGES HEREOF

TABLE OF CONTENTS

SUBSCRIPTION, MERGER AND EXCHANGE AGREEMENT (this "*Agreement*"), dated as of September 29, 2005, among AMERIPATH HOLDINGS, INC., a Delaware corporation ("*Aqua*"), AMERIPATH GROUP HOLDINGS, INC., a Delaware corporation and a wholly owned subsidiary of Aqua ("*Holdings*"), AQUA ACQUISITION CORP., a Delaware corporation and a wholly owned subsidiary of Holdings ("*Merger Sub*"), the stockholders of Aqua set forth on *Schedule 1.01(a)* hereto (collectively, the "*Aqua Stockholders*"), and the stockholders of Specialty Laboratories, Inc., a California corporation ("*Silver*") set forth on *Schedule 1.01(b)* hereto (collectively, the "*Founder Parties*").

WHEREAS, Aqua has organized Holdings, and Holdings has organized Merger Sub, for the purpose of effecting the transactions contemplated hereby;

WHEREAS, Holdings shall issue 55,121,279 shares of the common stock, par value $0.01 per share, of Holdings ("*Holdings Common Stock*") and 55,121,279 shares of Series A participating preferred stock, par value $0.001 per share, of Holdings ("*Holdings Preferred Stock*") to Aqua Stockholders in exchange for an aggregate $45,900,000, and 47,471,279 shares of the common stock, par value $0.01, of Aqua ("*Aqua Common Stock*"), subject to adjustment in accordance with Sections 1.01(a) and 1.07 hereof and otherwise on the terms and subject to the conditions set forth in this Agreement;

WHEREAS, Holdings shall issue 19,930,208 shares of Holdings Common Stock and 19,930,208 shares of Holdings Preferred Stock to Founder Parties in exchange for 9,025,000 shares of the common stock, no par value, of Silver ("*Silver Common Stock*"), subject to adjustment in accordance with Sections 1.01(b) and 1.07 hereof and otherwise on the terms and subject to the conditions set forth in this Agreement;

WHEREAS, the parties intend, by executing this Agreement, that the foregoing exchanges of Aqua Common Stock and Silver Common Stock for Holdings Common Stock and Holdings Preferred Stock qualify as a tax-free exchange under Section 351 of the Internal Revenue Code of 1986, as amended (the "*Code*");

WHEREAS, the respective Boards of Directors of Merger Sub and Aqua have approved and declared advisable, and the Board of Directors of Holdings has approved, the merger of Merger Sub with and into Aqua on the terms and subject to the conditions set forth in this Agreement, and the stockholders of Merger Sub and Aqua have adopted this Agreement;

WHEREAS, simultaneously with the execution of this Agreement, Aqua, AmeriPath, Inc., a Delaware corporation ("*Opco*"), Silver and Silver Acquisition Corp., a California corporation and a wholly owned subsidiary of Opco ("*Silver Merger Sub*"), have entered into an Agreement and Plan of Merger (the "*Silver Merger Agreement*"), pursuant to which Silver Merger Sub shall be merged with and into Silver (the "*Silver Merger*") and as a result, Opco will acquire all of the outstanding stock of Silver immediately after the consummation of the transactions contemplated by this Agreement;

WHEREAS, in connection with the transactions contemplated by this Agreement, the Certificate of Incorporation of Holdings shall be amended and restated in the form of *Exhibit A* hereto (the "*Restated Holdings Charter*"); and

WHEREAS, the parties hereto desire to make certain representations, warranties, covenants and agreements in connection with the Transactions (as defined in Section 1.01) and also to prescribe various conditions to the Transactions.

NOW, THEREFORE, in consideration of the foregoing and the representations, warranties, covenants and agreements herein contained, the parties hereto, intending to be legally bound, hereby agree as follows:

ARTICLE I

The Subscription, Merger and Exchange

SECTION 1.01 *The Subscription, Merger and Exchange.* On the terms and subject to the conditions set forth in this Agreement, and in accordance with the Delaware General Corporation Law (the "*DGCL*"), the following transactions shall take place at the Closing (as defined in Section 1.02) (the transactions contemplated by this Section 1.01 are referred to in this Agreement collectively as the "*Transactions*"):

(a) Each Aqua Stockholder shall (i) subscribe and pay for and Holdings shall issue to such Aqua Stockholder the number of fully paid and nonassessable shares of Holdings Common Stock and Holdings Preferred Stock set forth opposite the name of such Aqua Stockholder on *Schedule 1.01(a)* of this Agreement under the headings "Holdings Common Shares From Cash" and "Holdings Preferred Shares From Cash," respectively, at a purchase price of $1.20 (the "*Holdings Common Stock Price*") per share of Holdings Common Stock in cash and $4.80 (the "*Holdings Preferred Stock Price*") per share of Holdings Preferred Stock in cash (collectively, the "*Holdings Subscription*"), or (ii) sell and transfer the number of shares of Aqua Common Stock set forth opposite such Aqua Stockholder's name on *Schedule 1.01(a)* of this Agreement under the heading "Contributed Shares" to Holdings, and, in exchange therefor, Holdings shall issue to such Aqua Stockholder the number of fully paid and nonassessable shares of Holdings Common Stock and Holdings Preferred Stock set forth opposite the name of such Aqua Stockholder on *Schedule 1.01(a)* of this Agreement under the headings "Holdings Common Shares From Contribution" and "Holdings Preferred Shares From Contribution," respectively (the "*Aqua Stockholder Exchange*"). In addition, prior to the Effective Time (as defined below), it is contemplated that, with the consent of Aqua, certain additional stockholders of Aqua ("*Additional Aqua Stockholders*") shall, by execution and delivery of a joinder in the form attached as *Exhibit B* hereto (a "*Joinder*"), agree to become parties to this Agreement and be bound by the terms and conditions hereof as if an Aqua Stockholder hereunder. The Additional Aqua Stockholders shall be entitled to contribute shares of Aqua Common Stock to Holdings, and in exchange for each such share, Holdings shall issue to such stockholders fully paid and nonassessable shares of Holdings Common Stock and fully paid and nonassessable shares of Holdings Preferred Stock, in each case, in the same proportion and at the same price as the shares of Holdings Common Stock and Holdings Preferred Stock to be issued in the Aqua Stockholder Exchange. Upon execution and delivery of a Joinder by any Additional Aqua Stockholder, *Schedule 1.01(a)* shall be amended, without any further action by any of the parties hereto, to reflect the contribution to be made by such Additional Aqua Stockholder.

(b) Each Founder Party shall sell and transfer the number of shares of Silver Common Stock set forth opposite the name of such Founder Party on *Schedule 1.01(b)* of this Agreement under the heading "Contributed Shares" to Holdings, and, in exchange therefor, Holdings shall issue to such Founder Party the number of fully paid and nonassessable shares of Holdings Common Stock and Holdings Preferred Stock set forth opposite the name of such Founder Party on *Schedule 1.01(b)* of this Agreement under the headings "Holdings Common Shares From Contribution" and "Holdings Preferred Shares From Contribution," respectively (collectively, the "*Founder Exchange*"). Notwithstanding the foregoing, if, at the Effective Time, the Founder Parties do not hold an aggregate 20% or more of the outstanding shares of Holdings Common Stock and an aggregate 20% or more of the outstanding shares of Holdings Preferred Stock, then the shares of Silver Common Stock to be contributed by the Specialty Family Limited Partnership pursuant to the Founder Exchange shall be increased such that at the Effective Time, the Founder Parties hold an aggregate 20% of the outstanding shares of Holdings Common Stock and an aggregate 20% of the outstanding shares of Holdings Preferred Stock. In any such event *Schedule 1.01(b)* shall be amended, without any further action by any of the parties hereto, to reflect the additional contribution to be made by the Specialty Family Limited Partnership.

(c) (i) Holdings and James B. Peter, M.D., Ph.D. ("*Founder*") shall execute and deliver the agreement relating to services to be provided by Founder in the form attached as *Exhibit C* (the "*Founder Agreement*"), and (ii) Holdings, Aqua Stockholders and Founder Parties shall execute and deliver the Holdings Stockholders' Agreement in the form attached as *Exhibit D* (the "*Holdings Stockholders' Agreement*") and the Registration Rights Agreement in the form attached as *Exhibit E* (the "*Registration Rights Agreement*"). The Founder Agreement, the Holdings Stockholders' Agreement and the Registration Rights Agreement are, collectively, the "*Holdings Agreements*."

(d) Merger Sub shall be merged with and into Aqua at the Effective Time (as defined in Section 1.03) (the "*Merger*"). At the Effective Time, the separate corporate existence of Merger Sub shall cease and Aqua shall continue as the surviving corporation (the "*Surviving Corporation*").

(e) At the Effective Time, Holdings and Aqua shall take all action necessary such that each outstanding option to purchase shares of Aqua Common Stock (an "*Aqua Option*"), whether or not then exercisable, shall be cancelled and shall entitle the holder thereof to receive, as soon as reasonably practicable after the surrender thereof, only an amount in cash equal to the product of (x) the total number of shares of Aqua Common Stock subject to the Aqua Option times (y) the excess, if any, of the value of the Merger Consideration over the exercise price per share of Aqua Common stock under such Aqua Option, less applicable Taxes required to be withheld with respect to such payment. The Aqua Option Plan (as defined in Section 3.03) shall be terminated immediately after the Effective Time, and the provisions in any agreement, arrangement or other benefit plan providing for the issuance, transfer or grant of any capital stock of Aqua or any interest in respect of any capital stock of Aqua shall be deleted immediately after the Effective Time, and Aqua shall take such actions to ensure that following the Effective Time no holder of an Aqua Option or any participant in or a party to the Aqua Option Plan or any similar plan or other agreement, arrangement or benefit plan shall have any right thereunder to acquire any capital stock or any interest in respect of any capital stock of the Surviving Corporation.

SECTION 1.02 *Closing.* The closing (the "*Closing*") of the Transactions shall take place at the offices of Ropes & Gray LLP, 45 Rockefeller Plaza, New York, New York, 10111 as promptly as practicable after all the conditions set forth in Article IX have been satisfied (or, to the extent permitted by Law (as defined in Section 3.05), waived by the parties entitled to the benefits thereof), in each case other than those conditions that by their nature are to be satisfied at the Closing, but subject to the fulfillment or waiver of those conditions (and in any event, not more than two business days following the satisfaction or waiver of all such conditions), or at such other place, time and date as shall be agreed in writing between Aqua and Founder. The date on which the Closing occurs is referred to in this Agreement as the "*Closing Date*". Notwithstanding anything to the contrary set forth herein, (i) the Holdings Subscription, the Aqua Stockholder Exchange and the Founder Exchange shall be deemed to occur simultaneously with each other, in each case, immediately prior to the Effective Time, and (ii) the Effective Time shall be deemed to occur immediately prior to the effective time of the Silver Merger. All amounts of cash contributed to Holdings by the applicable Aqua Stockholders in exchange for shares of Holdings Common Stock and Holdings Preferred Stock hereunder shall be delivered to Holdings at the Closing by wire transfer of immediately available funds to an account designated by Holdings to such Aqua Stockholders. All certificates (or affidavits of loss reasonably acceptable to Holdings), each accompanied by a stock power duly executed by the record holders thereof, representing the shares of Aqua Common Stock or Silver Common Stock contributed to Holdings in accordance with Section 1.01 shall be delivered to Holdings at the Closing. At the Closing, Aqua shall surrender to Holdings the certificate representing all of the issued and outstanding shares of Holdings Common Stock prior to the Effective Time and such shares shall be cancelled at Closing in consideration for $6.00 per share payable by Holdings.

SECTION 1.03 *Effective Time.* Prior to the Closing, Aqua shall prepare, and on the Closing Date Aqua shall cause to be filed with the Secretary of State of the State of Delaware a certificate of merger or other appropriate documents (in any such case, the "*Certificate of Merger*") executed in accordance with Section 251 of the DGCL and shall make all other filings or recordings required under the DGCL. The Merger shall become effective at such time as the Certificate of Merger is duly filed with the Secretary of State of the State of Delaware or at such other time as Aqua shall specify in the Certificate of Merger (the time the Merger becomes effective being the "*Effective Time*").

SECTION 1.04 *Effects.* The Merger shall have the effects set forth in the DGCL, including Section 259 of the DGCL.

SECTION 1.05 *Certificate of Incorporation and Bylaws.*

(a) *Certificate of Incorporation*. The Certificate of Incorporation of the Surviving Corporation shall be amended at the Effective Time to read in the form of *Exhibit F*, and, as so amended, such Certificate of Incorporation shall be the Certificate of Incorporation of the Surviving Corporation until thereafter changed or amended as provided therein or by applicable Law.

(b) *Bylaws*. The Bylaws of Aqua as in effect immediately prior to the Effective Time shall be the Bylaws of the Surviving Corporation until thereafter changed or amended as provided therein or by applicable Law.

SECTION 1.06 *Directors and Officers.*

(a) *Directors*. The directors of Aqua immediately prior to the Effective Time shall be the directors of the Surviving Corporation, until the earlier of their resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

(b) *Officers*. The officers of Aqua immediately prior to the Effective Time shall be the officers of the Surviving Corporation, until the earlier of their resignation or removal or until their respective successors are duly elected or appointed and qualified, as the case may be.

SECTION 1.07 *Adjustment to Purchase Price.* The parties acknowledge and agree that the Holdings Subscription, the Aqua Stockholder Exchange and the Founder Exchange each assume that (i) the per share value of a share of Aqua Common Stock contributed to Holdings prior to the Effective Time is $6.00, (ii) the per share value of a share of Silver Common Stock contributed to Holdings prior to the Effective Time is $13.25, (iii) 20% of the value of cash and contributed securities in such Transactions will be used to subscribe for, or will be exchanged for, Holdings Common Stock (the "*Holdings Common Allocation*"), (iv) 80% of the value of cash and contributed securities in such Transactions will be used to subscribe for, or will be exchanged for, Holdings Preferred Stock (the "*Holdings Preferred Allocation*"), and (v) the per share value of the shares of Holdings Common Stock and Holdings Preferred Stock issued in such transactions are the Holdings Common Stock Price and the Holdings Preferred Stock Price, respectively. Notwithstanding the foregoing, the parties agree that it may be in the best interest of Holdings to adjust the Holdings Common Allocation and the Holdings Preferred Allocation or sell shares of Holdings Common Stock and Holdings Preferred Stock at a price per share other than the Holdings Common Stock Price and the Holdings Preferred Stock Price, respectively. Accordingly, the parties agree that Holdings shall be entitled to amend this agreement to adjust one or more of the Holdings Common Allocation, the Holdings Preferred Allocation, the Holdings Common Stock Price and Holdings Preferred Stock Price, *provided* that pursuant to any such amendment (A) the per share value of a share of Aqua Common Stock contributed to Holdings shall remain $6.00, (B) the per share value of a share of Silver Common Stock contributed to Holdings shall remain at $13.25, (C) the sum of the amended Holdings Common Allocation and amended Holdings Preferred Allocation equals 100%, (D) the sum of the amended Holdings Common Stock Price and amended Holdings Preferred Stock equals $6.00, and (E) any such amended Holdings Common Allocation, amended Holdings Preferred Allocation, amended Holdings Common Stock Price and amended Holdings Preferred Stock Price shall apply to each of the Holdings Subscription, the Aqua Stockholder Exchange and the Founder Exchange. Upon any such amendment, *Schedules 1.01(a)* and *1.01(b)* shall be amended, without any further action by any of the parties hereto, to reflect the foregoing amendments to the Holdings Common Allocation, the Holdings Preferred Allocation, the Holdings Common Stock Price and the Holdings Preferred Stock Price, if any.

ARTICLE II

Effect on the Capital Stock of the Constituent Corporations; Exchange of Certificates

SECTION 2.01 *Effect of Merger on Capital Stock.* At the Effective Time, by virtue of the Merger and without any action on the part of the holder of any capital stock of Aqua or Merger Sub:

(a) *Capital Stock of Merger Sub.* Each issued and outstanding share of capital stock of Merger Sub shall be converted into and become one fully paid and nonassessable share of common stock, par value $0.01 per share, of the Surviving Corporation.

(b) *Cancellation of Certain Owned Shares.* Each share of the common stock, par value $0.01, of Aqua ("*Aqua Common Stock*"), that is held in the treasury of Aqua, or outstanding and held by Holdings or any direct or indirect wholly owned subsidiary of Aqua, shall no longer be outstanding and shall automatically be canceled and retired and shall cease to exist, and no Holdings Common Stock or other consideration shall be delivered or deliverable in exchange therefor.

(c) *Conversion of Aqua Common Stock.* Subject to Section 2.01(b), each share of Aqua Common Stock that is issued and outstanding prior to the Effective Time, other than Dissenting Shares (as defined in Section 2.01(d)), shall be converted into the right to receive $6.00 in cash (collectively, the "*Merger Consideration*"). As of the Effective Time, all such shares of Aqua Common Stock shall no longer be outstanding and shall automatically be canceled and retired and shall cease to exist, and each holder of a certificate representing any such shares of Aqua Common Stock shall cease to have any rights with respect thereto, except the right to receive Merger Consideration upon surrender of such certificate, without interest.

(d) *Dissenting Shares.* Notwithstanding anything in this Agreement to the contrary, shares of Aqua Common Stock that are issued and outstanding immediately prior to the Effective Time and that are held by a holder who was entitled to and has validly demanded appraisal rights in accordance with Section 262 of the DGCL ("*Dissenting Shares*") shall not be converted into the right to receive the Merger Consideration unless and until such holder shall have failed to perfect or shall have effectively withdrawn or lost such holder's appraisal rights under the DGCL but instead shall be converted into the right to receive payment from the Surviving Corporation with respect to such Dissenting Shares in accordance with the DGCL. If any such holder shall have failed to perfect or shall have effectively withdrawn or lost such right, each share of such holder shall be treated as a share of Aqua Common Stock that had been converted as of the Effective Time into the right to receive the Merger Consideration in accordance with Section 2.01(c).

ARTICLE III

Representations and Warranties of Aqua

Aqua represents and warrants to the Founder Parties that, except as set forth in the corresponding section of the letter, dated as of the date of this Agreement, from Aqua to the Founder Parties (the "*Aqua Disclosure Letter*"), or in any other section of Aqua Disclosure Letter if the relevance of such disclosure or matter is reasonably apparent (except that no matter shall be deemed to be disclosed for purposes of Section 3.05 or Section 3.20 of Aqua Disclosure Letter if it is not set forth or cross-referenced in such section of Aqua Disclosure Letter):

SECTION 3.01 *Organization, Standing and Power.* Each of Aqua and each of its subsidiaries (the "*Aqua Subsidiaries*") is a corporation, partnership or limited liability company duly organized, validly existing and in good standing under the laws of the jurisdiction in which it is organized and has full corporate, partnership or limited liability company power and authority to conduct its businesses as presently conducted. Aqua and each Aqua Subsidiary is duly qualified to do business as a foreign corporation, partnership or limited liability company and is in good standing in each jurisdiction where the nature of its business or the ownership or leasing of its properties make such qualification necessary, except where the failure to so qualify has not had and could not reasonably be expected to have an Aqua Material Adverse Effect (as defined in Section 11.03). Aqua has made available to the Founder Parties true and complete copies of the articles of incorporation of Aqua, as amended to the date of this Agreement (as so amended, the "*Aqua Charter*"), the Bylaws of Aqua, as amended to the date of this Agreement (as so amended, the "*Aqua Bylaws*") and the comparable charter and organizational documents of each Aqua Subsidiary.

SECTION 3.02 *Aqua Subsidiaries; Equity Interests.* (a) Section 3.02(a) of Aqua Disclosure Letter lists each Aqua Subsidiary, its jurisdiction of organization and each holder of outstanding capital stock or other ownership interests of such subsidiary. All the outstanding shares of capital stock or other ownership interests of each Aqua Subsidiary have been validly issued and are fully paid and nonassessable and, except as set forth in Aqua Disclosure Letter, are owned by Aqua, by another Aqua Subsidiary or by Aqua and another Aqua Subsidiary, free and clear of all pledges, liens, hypothecations, claims, charges, mortgages, encumbrances and security interests of any kind or nature whatsoever (collectively, "*Liens*"). No shares of capital stock of any Aqua Subsidiary have been issued in violation of any purchase option, call option, right of first refusal, preemptive right, subscription right or any similar right. No shares of capital stock of any Aqua Subsidiary are reserved for issuance.

(b) Except for its interests in the Aqua Subsidiaries, Aqua does not as of the date of this Agreement own, directly or indirectly, (i) any capital stock, membership interest, partnership interest or other equity interest in any person or securities convertible into or exchangeable for any equity interest of any person or (ii) any participating interest in the revenues or profits of any person, and neither Aqua nor any Aqua Subsidiary is subject to any obligation to make any investment (in the form of loan, capital contribution or otherwise) in any person.

SECTION 3.03 *Capital Structure.* The authorized capital stock of Aqua consists of 100,000,000 shares of Aqua Common Stock. At the close of business on September 28, 2005 (the "*Capitalization Date*"), (i) 57,904,067 shares of Aqua Common Stock were issued and outstanding, (ii) no shares of Aqua Common Stock were held by Aqua in its treasury and (iii) 8,191,202 shares of Aqua Common Stock were subject to outstanding Aqua Options, 1,108,798 additional shares of Aqua Common Stock were reserved for issuance pursuant to Aqua's 2003 Stock Option and Restricted Stock Plan (the "*Aqua Option Plan*"). Since the Capitalization Date, no other shares of capital stock or other voting securities of Aqua have been issued or reserved for issuance, other than the issuance of Aqua Common Stock upon the exercise of Aqua Options outstanding on the Capitalization Date and in accordance with their present terms and other than as permitted pursuant to Section 7.01(a). All outstanding shares of Aqua Common Stock are, and all such shares that may be issued prior to the Effective Time will be when issued, duly authorized, validly issued, fully paid and nonassessable and not subject to or issued in violation of any purchase option, call option, right of first refusal, preemptive right, subscription right or any similar right under any provision of the DGCL, the Aqua Charter, the Aqua Bylaws, any Contract (as defined in Section 3.05) to which Aqua is a party or otherwise. There are not any bonds, debentures, notes or other indebtedness of Aqua or any Aqua Subsidiary having the right to vote (or convertible into, or exchangeable for, securities having the right to vote) on any matters on which holders of Aqua Common Stock or holders of equity securities of any Aqua Subsidiary may vote ("*Voting Aqua Debt*"). Except as set forth above there are not any options, warrants, rights, convertible or exchangeable securities, "phantom" stock rights, stock appreciation rights, restricted stock awards, dividend equivalent awards, stock-based performance units, commitments, Contracts (as defined in Section 3.05), arrangements or undertakings of any kind to which Aqua or any Aqua Subsidiary is a party (i) obligating Aqua or any Aqua Subsidiary to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock or other equity interests in, or any security convertible into or exercisable or exchangeable for any capital stock of or other equity interest in, Aqua or of any Aqua Subsidiary or any Voting Aqua Debt or (ii) obligating Aqua or any Aqua Subsidiary to issue, grant, extend or enter into any such option, warrant, call, right, security, commitment, Contract, arrangement or undertaking. There are not any outstanding contractual obligations of Aqua or any Aqua Subsidiary to repurchase, redeem or otherwise acquire any shares of capital stock of Aqua or any Aqua Subsidiary.

SECTION 3.04 *Authority; Execution and Delivery, Enforceability.* Aqua has all requisite corporate power and authority to execute and deliver this Agreement and to consummate the Transactions contemplated by this Agreement. The execution and delivery by Aqua of this Agreement and the consummation by Aqua of the Transactions contemplated by this Agreement have been duly authorized by all necessary corporate action on the part of Aqua. The Aqua Stockholders who hold a majority of the issued and outstanding shares of Aqua Common Stock, have duly approved this Agreement. Aqua has duly executed and delivered this Agreement, and this Agreement constitutes its legal, valid and binding obligation, enforceable against it in accordance with its terms.

SECTION 3.05 *No Conflicts; Consents.* (a) The execution and delivery by Aqua of this Agreement do not, and the consummation of the Merger and the other Transactions contemplated by this Agreement and compliance with the terms hereof will not, conflict with, or result in any violation of or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation, modification or acceleration of any obligation or to loss of a material asset (including material intellectual property asset) or benefit under, or result in the creation of any Lien upon any of the properties or assets of Aqua or any Aqua Subsidiary under, any provision of (i) the Aqua Charter, the Aqua Bylaws or the comparable charter or organizational documents of any Aqua Subsidiary, (ii) any contract, lease, license, loan, credit agreement, indenture, note, bond, mortgage, deed of trust, agreement, Aqua Permit (as defined in Section 3.15), obligation, concession, franchise or other instrument (collectively, "*Contracts*") to which Aqua or any Aqua Subsidiary is a party or by which any of their respective properties or assets is bound or (iii) subject to the filings and other matters referred to in Section 3.05(b), any writ, judgment, order, award, consent decree, waiver, stipulation, subpoena, citation, notice, summons, restraining order, injunction, stay, ruling or decree (collectively, "*Judgments*"), or statute, law (including common law), ordinance, rule (including any New York Stock Exchange or other stock exchange rule or listing requirement) or regulation (collectively, "*Laws*") applicable to Aqua or any Aqua Subsidiary or their respective properties or assets, other than, in the case of clauses (ii) and (iii) above, any such items that, individually or in the aggregate, have not had and could not reasonably be expected to have an Aqua Material Adverse Effect.

(b) No consent, approval, license, permit, order or authorization ("*Consent*") of, or registration, declaration or filing with, or permit from, any government or any court of competent jurisdiction, tribunal, judicial body, arbitrator, stock exchange, administrative or regulatory agency, self-regulatory organization, commission or other governmental or quasi-governmental authority or instrumentality, in each case, whether local, state or Federal, domestic or foreign (a "*Governmental Entity*"), is required to be obtained or made by or with respect to Aqua or any Aqua Subsidiary in connection with the execution, delivery and performance of this Agreement or the consummation of the Transactions contemplated by this Agreement, other than (i) compliance with and filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "*HSR Act*"), (ii) relicensures that may be required following the Effective Time pursuant to applicable state or Federal Law, (iii) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware and appropriate documents with the relevant authorities of the other jurisdictions in which Aqua is qualified to do business, (iv) such filings as may be required in connection with the taxes described in Section 8.05, and (v) such other items (A) required solely by reason of the participation of the Founder Parties (as opposed to any third party) in the Transactions or (B) that, individually or in the aggregate, have not had and could not reasonably be expected to have an Aqua Material Adverse Effect.

SECTION 3.06 *SEC Documents; Undisclosed Liabilities.* (a) Opco has filed all reports, schedules, forms, statements and other documents required to be filed by Opco with the SEC since December 31, 2002 pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the "*Exchange Act*") (the "*Aqua SEC Documents*").

(b) As of its respective date, each Aqua SEC Document complied in all material respects with the requirements of the Exchange Act and the rules and regulations of the SEC promulgated thereunder applicable to such Aqua SEC Document, and did not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. Except to the extent that information contained in any Aqua SEC Document has been revised or superseded by a later filed Aqua SEC Document, none of the Aqua SEC Documents contains any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The consolidated financial statements of Aqua included in the Aqua SEC Documents comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with generally accepted accounting principles ("*GAAP*") (except, in the case of unaudited statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present the consolidated financial position of Opco and its consolidated subsidiaries as of the dates thereof and the consolidated results of their operations and cash flows for the periods shown (subject, in the case of unaudited statements, to normal year-end audit adjustments).

(c) Except as set forth in the financial statements filed with the 2004 10-K or incurred in the ordinary course since December 31, 2004, as of the date of this Agreement neither Aqua nor any Aqua Subsidiary has any liabilities or obligations of any nature (whether accrued, absolute, contingent or otherwise) that, individually or in the aggregate, could reasonably be expected to have an Aqua Material Adverse Effect.

(d) None of the Aqua Subsidiaries (other than Opco) is, or has at any time been, subject to the reporting requirements of Sections 13(a) and 15(d) of the Exchange Act.

SECTION 3.07 *Absence of Certain Changes or Events.* Since December 31, 2004, (i) Aqua and each Aqua Subsidiary has conducted its business only in the ordinary course and in a manner consistent with past practice (except in connection with the negotiation and execution and delivery of this Agreement and the Silver Merger Agreement), (ii) no event has occurred and no action has been taken that would have been prohibited by the terms of Section 7.01(a) if such Section had been in effect as of and at all times since December 31, 2004, and (iii) there has not been any change, event, condition, circumstance or state of facts (whether or not covered by insurance), individually or in the aggregate, that has had or could reasonably be expected to have an Aqua Material Adverse Effect.

SECTION 3.08 *Taxes.* (a) Each of Aqua and each Aqua Subsidiary has timely filed, or has caused to be timely filed on its behalf, all Tax Returns required to be filed by it with the appropriate Governmental Entity, and all such Tax Returns are true, complete and accurate in all material respects. All Taxes shown to be due on such Tax Returns, or other Taxes owed, have been timely paid. Aqua has afforded the Founder Parties the opportunity to examine true and correct copies of all material Tax Returns, examination reports, ruling requests and statements of deficiencies, filed, assessed against or agreed to by Aqua or any Aqua Subsidiary.

(b) Except as could not reasonably be expected to have an Aqua Material Adverse Effect, each of Aqua and each Aqua Subsidiary has timely paid any Taxes that are due and payable by it. The most recent financial statements contained in the Aqua SEC Documents filed with the SEC prior to the date of this Agreement (the "*Filed Aqua SEC Documents*") reflect an adequate reserve for all Taxes payable (or that may become payable) by Aqua or any Aqua Subsidiary (in addition to any reserve for deferred Taxes to reflect timing differences between book and Tax items) for all Taxable periods and portions thereof through the date of such financial statements. No deficiency with respect to any Taxes has been proposed, asserted or assessed against Aqua or any Aqua Subsidiary, and no requests for waivers of the time to assess any such Taxes are pending.

(c) The Federal income Tax Returns of Aqua and each Aqua Subsidiary consolidated in such Tax Returns have been examined by and settled with the United States Internal Revenue Service, or have closed by virtue of the expiration of the relevant statute of limitations, for all years ending on or before December 31, 2001. All material assessments for Taxes due with respect to such completed and settled examinations or any concluded litigation have been fully paid.

(d) There are no material Liens for Taxes (other than for current Taxes not yet due and payable) on the assets of Aqua or any Aqua Subsidiary. Neither Aqua nor any Aqua Subsidiary is a party to any Contract with respect to Taxes, including (i) a "closing agreement" as defined under Code Section 7121 (or any corresponding or similar provision of state, local or foreign Law), (ii) a waiver of any statute of limitations in respect of Taxes or the agreement to an extension of time with respect to a material assessment of deficiency, (iii) any Tax allocation, indemnity or sharing agreement or (iv) a power of attorney with respect to any Tax.

(e) Each of Aqua and each Aqua Subsidiary has complied in all material respects with all applicable Laws relating to the withholding of Taxes and has timely withheld and paid to the proper Governmental Entities all amounts required to have been withheld and paid in connection with amounts paid or owing to any employee, independent contractor, creditor or stockholder.

(f) There are no audits or other administrative or court proceedings presently pending with regard to any Taxes for which Aqua or any Aqua Subsidiary could be liable. No dispute or claim concerning any Taxes for which Aqua or any Aqua Subsidiary could be liable has been claimed or raised by any Governmental Entity in writing to Aqua, and no claim has been made in writing to Aqua by any Governmental Entity in a jurisdiction where Aqua or any Aqua Subsidiary does not file Tax Returns that Aqua or any such Aqua Subsidiary is, or may be, subject to taxation by that jurisdiction.

(g) Neither Aqua nor any Aqua Subsidiary (i) has been a member of an affiliated group filing a consolidated federal income Tax return (other than such a group of which Aqua is the common parent) or (ii) will be required to pay the Taxes of any other person under Treasury regulation Section 1.1502-6 (or similar Law), as a transferee or successor, by Contract or otherwise.

(h) Within the past five years, neither Aqua nor any Aqua Subsidiary (i) has constituted either a "distributing corporation" or a "controlled corporation" within the meaning of Section 355(a)(1)(A) of the Code in a distribution qualifying (or intended to qualify) under Section 355 of the Code (or so much of Section 356 as related to Section 355) or (ii) been a party to any transaction that was reported as a reorganization within the meaning of Section 368.

(i) Neither Aqua nor any Aqua Subsidiary is a party to any Contract that, individually or collectively, could give rise to the payment of any amount which would not be deductible by reason of Section 162(m).

(j) For purposes of this Agreement:

"*Taxes*" includes all forms of taxation, whenever created or imposed, and whether of the United States or elsewhere, and whether imposed by a local, municipal, governmental, state, foreign, Federal or other Governmental Entity, or in connection with any agreement with respect to Taxes, including all interest, penalties and additions imposed with respect to such amounts.

"*Tax Return*" means any Federal, state, local, provincial and foreign Tax return, declaration, statement, report, schedule, form or other information filed with respect to any Tax, including any claim for refunds of any Tax and any attachment to or any amendment or supplement of any of the foregoing, filed or required to be filed with any Governmental Entity in connection with the determination, assessment or collection of any Tax or the administration of any Laws relating to any Tax.

SECTION 3.09 *Absence of Changes in Benefit Plans.* Except as disclosed in the Filed Aqua SEC Documents, from the date of the most recent financial statements included in the Filed Aqua SEC Documents to the date of this Agreement, there has not been any adoption or amendment in any material respect by Aqua or any Aqua Subsidiary of any collective bargaining agreement or any bonus, pension, profit sharing, deferred compensation, incentive compensation, stock ownership, stock purchase, stock option, phantom stock, retirement, vacation, severance, change of control, indemnification, disability, death benefit, hospitalization, medical or other plan, agreement, arrangement or understanding providing benefits to any current or former employee, officer or director of Aqua or any Aqua Subsidiary (collectively, "*Aqua Benefit Plans*"). Except as disclosed in the Filed Aqua SEC Documents, as of the date of this Agreement there are not any employment, severance or termination agreements or arrangements between Aqua or any Aqua Subsidiary and any current or former executive officer or director of Aqua or any Aqua Subsidiary (collectively, the "*Aqua Benefit Agreements*").

SECTION 3.10 *ERISA Compliance; Excess Parachute Payments.* (a) The Aqua Disclosure Letter contains a list of any and all Aqua Benefit Plans, including any and all "employee pension benefit plans" (as defined in Section 3(2) of the Employee Retirement Income Security Act of 1974, as amended ("*ERISA*")) ("*Aqua Pension Plans*"), "employee welfare benefit plans" (as defined in Section 3(1) of ERISA) and all other fringe benefit plans or arrangements maintained, or contributed to, by Aqua or any Aqua Subsidiary for the benefit of any current or former employees, consultants, officers or directors of Aqua or any Aqua Subsidiary (or the dependents of the foregoing or with respect to which Aqua may have any material liability). Each Aqua Benefit Plan has been administered in compliance with its terms and applicable Law, other than instances of noncompliance that, individually and in the aggregate, have not had and could not reasonably be expected to have an Aqua Material Adverse Effect. All reports and disclosures relating to each Aqua Benefit Plan required to be filed with or furnished to any Governmental Entity or plan participants or beneficiaries have been filed or furnished in all material respects in accordance with applicable law in a timely manner. All contributions required to be made to each Aqua Benefit Plan pursuant to the terms of such plan have been timely made. Aqua has made available to the Founder Parties true, complete and correct copies of (i) each Aqua Benefit Plan (or, in the case of any unwritten Aqua Benefit Plan, a description thereof), (ii) the most recent annual report on Form 5500 filed with the Internal Revenue Service with respect to each Aqua Benefit Plan (if any such report was required), (iii) the most recent summary plan description for each Aqua Benefit Plan for which such summary plan description is required and (iv) each true agreement or group annuity contract relating to any Aqua Benefit Plan.

(b) Each Aqua Pension Plan intended to be a "qualified plan" within the meaning of Section 401(a) of the Code has been the subject of a determination letter from the Internal Revenue Service to the effect that such Aqua Pension Plan is qualified and exempt from Federal income taxes under Sections 401(a) and 501(a), respectively, of the Code, and no such determination letter has been revoked nor, to the knowledge of Aqua, has revocation been threatened, and nothing has occurred since the date of its most recent determination letter in any respect that would adversely affect its qualification or materially increase its costs.

(c) No Aqua Benefit Plan is a "multiemployer plan" within the meaning of Section 3(37) of ERISA (a "*Multiemployer Pension Plan*"), and no Aqua Benefit Plan is subject to Title IV or Section 302 of ERISA or Section 412 or 4971 of the Code.

(d) None of Aqua, any Aqua Subsidiary, any officer of Aqua or any of the Aqua Subsidiaries or any of the Aqua Benefit Plans that are subject to ERISA, including Aqua Pension Plans, any trusts created thereunder or any trustee or administrator thereof, has engaged in a "prohibited transaction" (as such term is defined in Section 406 of ERISA or Section 4975 of the Code) or any other breach of fiduciary responsibility that could subject Aqua, any Aqua Subsidiary or any officer of Aqua or any Aqua Subsidiary to the tax or penalty on prohibited transactions imposed by such Section 4975 or to any liability under Section 502(i) or 502(1) of ERISA, except as could not reasonably be expected to have an Aqua Material Adverse Effect.

(e) No Aqua Benefit Plan or trust has been terminated, nor has there been any "reportable event" (as that term is defined in Section 4043 of ERISA) with respect to any Aqua Benefit Plan during the last five years. Neither Aqua nor any Aqua Subsidiary has incurred a "complete withdrawal" or a "partial withdrawal" (as such terms are defined in Sections 4203 and 4205, respectively, of ERISA) since the effective date of such Sections 4203 and 4205 with respect to any Multiemployer Pension Plan.

(f) With respect to any Aqua Benefit Plan that is an employee welfare benefit plan, (i) no such Aqua Benefit Plan is unfunded or funded through a "welfare benefits fund" (as such term is defined in Section 419(e) of the Code), and (ii) no such Aqua Benefit Plan provides for life, health, medical, disability or other welfare benefits to former employees or beneficiaries or dependents thereof, except for health continuation coverage provided at no expense to Aqua or any Aqua Subsidiary as required by Section 4980B of the Code or Part 6 of Title I of ERISA.

(g) There are no material actions, claims, liens or investigations existing or pending (other than routine claims for benefits) or, to the knowledge of Aqua, threatened with respect to any Aqua Benefit Plan. No Aqua Benefit Plan is under audit or investigation by any Governmental Entity and no such completed audit, if any, has resulted in the imposition of any Tax during the last 12 months.

SECTION 3.11 *Litigation; Inspections and Investigations.* (a) As of the date of this Agreement, there is no claim, suit, action, audit or proceeding pending or, to the knowledge of Aqua, threatened against Aqua, any Aqua Subsidiary or, to the knowledge of Aqua, any person that Aqua or any Aqua Subsidiary has agreed to indemnify in respect thereof, nor, to the knowledge of Aqua, is there any investigation of Aqua (collectively, "*Aqua Litigation*") that if adversely decided could result (x) in a liability to Aqua and the Aqua Subsidiaries in excess of $5,000,000 or (y) in injunctive or other equitable remedy against such parties that would materially affect the operation of the business of Aqua, and Aqua is not aware of any basis for any such claim, suit, action, audit, proceeding or investigation. As of the date of this Agreement, there is no Aqua Litigation that, individually or in the aggregate, has had or could reasonably be expected to have an Aqua Material Adverse Effect. As of the date of this Agreement, there is not any Judgment outstanding against Aqua or any Aqua Subsidiary or affecting any of their respective properties or assets or business operations. There is no Judgment (whether outstanding as of the date of this Agreement or first outstanding after the date of this Agreement) the effect of which has had or could reasonably be expected to have an Aqua Material

Adverse Effect. Aqua and any Aqua Subsidiaries have in all material respects performed all of the obligations required to be performed to the date of this Agreement by any Judgment against Aqua or any Aqua Subsidiary, or by any Contract that settled any suit, action or proceeding against Aqua or any Aqua Subsidiary.

(b) None of Aqua or any Aqua Subsidiaries nor, to Aqua's knowledge, any of their respective officers, directors, employees or agents (or stockholders, representatives or other persons acting on the express, implied or apparent authority of such entities) is currently, or has been within the last two years, with respect to any state or Federal criminal enforcement agency or with respect to Medicare, Medicaid, or any other state or Federal health care payment or reimbursement program: (i) the subject of any audit or, to the knowledge of Aqua, any investigation; or (ii) party to any Contract or Judgment that (A) requires, or could reasonably be expected to require, the payment of a material amount of money by Aqua or any of the Aqua Subsidiaries to any state or Federal agency, program, or fiscal intermediary, or (B) requires or prohibits any activity by Aqua or any of the Aqua Subsidiaries; and which, in the case of either (A) or (B) of this sentence, is either punitive in nature, or serves as a civil penalty.

SECTION 3.12 *Compliance with Applicable Laws; Compliance Program.* (a) The business of Aqua and the Aqua Subsidiaries is currently being conducted and since January 1, 2004 has been conducted in compliance with all applicable Laws, including those relating to licensure, certification, and operation of clinical laboratories, individuals providing services in or to clinical laboratories, reimbursement for products or services provided by Aqua and the Aqua Subsidiaries, submission of claims to any payor, including Medicare, Medicaid or other third party payors, for items or services, and Environmental Laws (as defined in Section 3.16), except for instances of noncompliance that, individually and in the aggregate, have not had and could not reasonably be expected to have an Aqua Material Adverse Effect. Neither Aqua nor any Aqua Subsidiaries have received any written notice asserting a failure to comply with any Law, which failure has had or could reasonably be expected to have an Aqua Material Adverse Effect, and which notice has not prior to the date of this Agreement been fully and completely resolved. This Section 3.12 does not relate to matters with respect to Taxes, which are the subject of Section 3.08.

(b) Aqua and the Aqua Subsidiaries have timely filed all material filings and reports of every kind whatsoever required by Law or by written or oral Contract or otherwise to have been filed or made with respect to the provision of services by Aqua and the Aqua Subsidiaries to third-party purchasers, including, but not limited to, Medicare and Medicaid, insurance carriers and other fiscal intermediaries. No validation review or program integrity review related to Aqua and the Aqua Subsidiaries has been conducted by any commission, board or agency in connection with the Medicare or Medicaid program, and no such reviews are scheduled, pending or, to Aqua's knowledge, threatened against or affecting Aqua or the Aqua Subsidiaries or the consummation of the transactions contemplated hereby.

(c) Aqua and the Aqua Subsidiaries maintain an effective voluntary compliance program to promote compliance with Law that is consistent with model compliance guidance issued by the United States Department of Health and Human Services Office of Inspector General ("*OIG*") and applicable laws and regulations. To the knowledge of Aqua, no individual employed by, contracting independently with or otherwise providing services or supplies in connection with the conduct of business by Aqua or any Aqua Subsidiary is excluded from participation in the Medicare or Medicaid programs or is listed on the excluded individuals list published by the OIG.

SECTION 3.13 *Material Contracts.* (a) Section 3.13(a) of the Aqua Disclosure Letter sets forth a list of the following Contracts, whether written or oral (and if oral, a complete and accurate summary thereof) to which Aqua or any Aqua Subsidiary is a party, in each case to the extent in effect on this date of this Agreement (the "*Aqua Material Contracts*"):

(i) Aqua Benefit Plans or Aqua Benefit Agreements;

(ii) Contracts for the provision of laboratory services to the top 25 customers of Aqua, measured by revenue for the period January to June 2005;

(iii) Contracts providing for the licensing of material Intellectual Property Rights (as defined in Section 3.14);

(iv) Contracts which are reasonably likely to involve aggregate payments by or to Aqua or any Aqua Subsidiary of more than $2,500,000 annually or $5,000,000 over the remaining term of the Contract), other than the sale of services or products in the ordinary course of business;

(v) real property leases or subleases;

(vi) Contracts that (A) limit the ability of Aqua or any Aqua Subsidiary or affiliate of, or successor to, Aqua, or, to the knowledge of Aqua, any executive officer of Aqua, to compete in any line of business or with any person or in any geographic area or during any period of time, (B) require Aqua or any Aqua Subsidiary or affiliate of, or successor to, Aqua to use any supplier or third party for all or substantially all of any of its material requirements or need in any respect, (C) limit or purport to limit the ability of Aqua or any Aqua Subsidiary or affiliate of, or successor to, Aqua to solicit any customers or clients of the other parties thereto, (D) require Aqua or any Aqua Subsidiary or affiliate of, or successor to, Aqua to provide to the other parties thereto "most favored nations" pricing or (E) require Aqua or any Aqua Subsidiary or affiliate of, or successor to, Aqua to market or co-market any products or services of a third party (other than any customer of Aqua or any Aqua Subsidiary);

(vii) Contracts relating to (A) any indebtedness (which does not include accounts payable incurred in the ordinary course of business), notes payable (including notes payable in connection with acquisitions), accrued interest payable or other obligations for borrowed money, whether current, short-term, or long-term, secured or unsecured, of Aqua or any Aqua Subsidiary, (B) any purchase money indebtedness or earn-out or similar obligation in respect of purchases of property or assets by Aqua or any Aqua Subsidiary, (C) any lease obligations of Aqua or any Aqua Subsidiary under leases which are capital leases in accordance with GAAP, (D) any financing of Aqua or any Aqua Subsidiary effected through "special purpose entities" or synthetic leases or project financing, (E) any obligations of Aqua or any Aqua Subsidiary in respect of banker's acceptances or letters of credit (other than stand-by letters of credit in support of ordinary course trade payables), (F) any obligation or liability of Aqua or any Aqua Subsidiary with respect to interest rate swaps, collars, caps, currency derivatives and similar hedging obligations or (G) any guaranty of any of the foregoing (the liabilities and obligations referred to in (A) through (G) above, "*Indebtedness*");

(viii) Contracts entered into by Aqua or any of the Aqua Subsidiaries and any other person providing for the acquisition by Aqua or such Aqua Subsidiary (including by merger, consolidation, acquisition of stock or assets or any other business combination) of any corporation, partnership, other business organization or division or unit thereof or any material amount of assets of such other person, and information identifying the maximum amounts, if any, that are still payable or potentially payable to any other person under such Contracts pursuant to any post-closing adjustment to the purchase price (including under any "earnout" or other similar provision);

(ix) stockholder agreements, registration rights agreements, voting trusts or other Contracts to which Aqua is a party or by which it is bound relating to the voting of any shares of the capital stock of Aqua,

(x) joint venture contracts, partnership arrangements or other agreements outside the ordinary course of business involving a sharing of profits, losses, costs or liabilities of any person by Aqua or any Aqua Subsidiary with any third person;

(xi) all confidentiality, non-disclosure or standstill agreements entered into by Aqua or any of the Aqua Subsidiaries (other than in the ordinary course of business); and

(xii) other Contracts not covered by the foregoing, that are otherwise material to Aqua and the Aqua Subsidiaries, taken as a whole.

(b) Aqua has made available to Parent or publicly filed as exhibits to the Aqua SEC Documents true, complete and correct copies of all written Contracts required to be listed in Section 3.13(a) of the Aqua Disclosure Letter, together with all amendments, waivers or other changes thereto, and a complete and accurate written summary of each oral Contract required to be listed. All Aqua Material Contracts are in full force and effect, constitute legal, valid and binding obligations of the respective parties thereto, and are enforceable in accordance with their respective terms. Aqua or the Aqua Subsidiary that is a party to any Aqua Material Contract has in all material respects performed all of the obligations required to be performed by it to the date of this Agreement, and there exists no default, or any event which upon the giving of notice or the passage of time, or both, would give rise to a default, in the performance by Aqua or such applicable Aqua Subsidiaries or, to the knowledge of Aqua, any other party to any Aqua Material Contract of their respective obligations thereunder. Neither Aqua nor any Aqua Subsidiary has received any written notice of the intention of any party to terminate or cancel any Aqua Material Contract, whether as a termination or cancellation for convenience or for default of Aqua or any Aqua Subsidiary thereunder.

SECTION 3.14 *Intellectual Property.* Aqua and the Aqua Subsidiaries own, or are validly licensed or otherwise have the right to use, all patents, patent rights, patented inventions, proprietary rights, trade secrets, trademarks, trademark rights, trade names, trade name rights, service marks, service mark rights, copyrights and other proprietary intellectual property rights and computer programs (collectively, "*Intellectual Property Rights*") which are material to the conduct of the business of Aqua and the Aqua Subsidiaries, as conducted on the date of this Agreement, taken as a whole. No claims are pending or, to the knowledge of Aqua, threatened that Aqua or any of the Aqua Subsidiaries is infringing or has since January 1, 2002 infringed the rights of any person with regard to any Intellectual Property Right**.**To the knowledge of Aqua, no person is infringing or since January 1, 2002 has infringed the rights of Aqua or any of the Aqua Subsidiaries with respect to any Intellectual Property Right. To the knowledge of Aqua, there is no prior art that may render any patent held by or licensed to Aqua or any Aqua Subsidiary invalid or any patent application held by or licensed to Aqua or any Aqua Subsidiary unpatentable which has not been disclosed to the Office to which the patent application was made. To the knowledge of Aqua, there has been no inequitable conduct with respect to the prosecution of any patent or patent application held by or licensed to Aqua or any Aqua Subsidiary.

SECTION 3.15 *Aqua Permits.* (a) Each of Aqua and the Aqua Subsidiaries has obtained any and all material licenses, franchises, permits, easements, rights, consents, orders, approvals, variances, exemptions, accreditations and other authorizations of or issued by any Governmental Entity required by Law or otherwise necessary to enable Aqua or the Aqua Subsidiaries to (i) conduct the business of Aqua as heretofore conducted and (ii) obtain reimbursement related to services provided in connection with the Medicare or Medicaid programs, and all contracts, programs and other arrangements with third-party payers, insurers or fiscal intermediaries (collectively, the "*Aqua Permits*"). Aqua Permits are, and after giving effect to the consummation of the transactions contemplated hereby, will continue to be, valid and in full force and effect and no violations exist in respect thereof, except for violations that, individually and in the aggregate, have not had and could not reasonably be expected to have an Aqua Material Adverse Effect.

(b) To the knowledge of Aqua, all individuals employed by, or providing services as individual contractors to, Aqua or any Aqua Subsidiary in connection with the conduct of business by Aqua or any Aqua Subsidiary have obtained and currently maintain all necessary Aqua Permits required to perform such services or provide such supplies to Aqua or the Aqua Subsidiaries.

SECTION 3.16 *Environmental Matters.* Except as has not had and could not reasonably be expected to have an Aqua Material Adverse Effect, (i) to the knowledge of Aqua, no facts, circumstances or conditions exist with respect to any real property now or previously owned, leased and/or operated by Aqua or by any Aqua Subsidiary or affiliates ("*Aqua Real Property*") that have resulted or could reasonably be expected to result in a violation of any Environmental Law, (ii) there has been no Release (as defined herein) of any Hazardous Substance (as defined herein) on, at, from or, to the knowledge of Aqua, to any Aqua Real Property, (iii) to Aqua's knowledge, there has been no Release of any Hazardous Substance on, at, to or from any property adjacent to or in the immediate vicinity of the Aqua Real Property which, through soil, subsoil, bedrock, surface or ground water migration, has come or could reasonably be expected to come to be located on the Aqua Real Property, (iv) none of the Aqua Real Property has been used for the storage, treatment, generation, transportation, processing, handling, production or disposal of any Hazardous Substance or as a landfill or other waste disposal site, except in each case in this paragraph (iv) in material compliance with applicable Law, and (v) there are no underground storage tanks located on or beneath any of the Aqua Real Property. As used in this Agreement, (i) the term "*Environmental Law*" means any Law relating to the protection of the environment, health, safety and natural resources, including for the prevention of pollution or contamination, or the cleanup, regulation and protection of the air, water or soil in the indoor or outdoor environment, (ii) the term "*Release*" means the spill, emission, leaking, pumping, injecting, deposit, disposal, discharge, dispersal, leaching or migrating of any Hazardous Substance into the indoor or outdoor environment, in each case other than in material compliance with applicable Law, and (iii) the term "*Hazardous Substances*" means any pollutant, contaminant, effluent, emission, radioactive substance, toxic substance, hazardous waste, hazardous material, medical waste, radioactive waste, petroleum or petroleum derived substance or waste, asbestos (and any substance containing asbestos), polychlorinated biphenyls, flammable explosives, methane, chemicals known to cause cancer or reproductive toxicity, any material that, because of its quantity, concentration or physical, chemical or infectious characteristics, may cause or pose a present or potential threat to human health or the environment when improperly used, treated, stored, disposed of, generated, manufactured, transported, or otherwise handled, all other substances or related materials defined as hazardous or toxic in, or otherwise included within the scope of, any Environmental Law, and any hazardous or toxic constituent thereof.

SECTION 3.17 *Real Property.* Aqua does not own any real property. Aqua or one of the Aqua Subsidiaries has a good and valid leasehold interest in each parcel of real property leased by Aqua or any of the Aqua Subsidiaries (the "*Aqua Leased Property*"). To Aqua's knowledge, (i) Aqua or one of the Aqua Subsidiaries has the right to use and occupy the Aqua Leased Property for the full term of the lease or sublease relating thereto, and (ii) neither Aqua nor any of the Aqua Subsidiaries has assigned its interest under any such lease or sublease or sublet any part of the premises covered thereby or exercised any option or right thereunder except as has not had and as could not reasonably be expected to have, individually or in the aggregate, an Aqua Material Adverse Effect.

SECTION 3.18 *Insurance.* Aqua and the Aqua Subsidiaries, taken as a whole, are covered by valid and currently effective insurance policies issued in favor of Aqua and the Aqua Subsidiaries that are customary in all material respects for companies of similar size and financial condition in Aqua's industry. All such policies are in full force and effect, all premiums due and payable thereon have been paid and Aqua and the Aqua Subsidiaries have complied with the provisions of such policies, except where such failure to be in full force and effect, such nonpayment or such noncompliance has not had and could not reasonably be expected to have, individually or in the aggregate, an Aqua Material Adverse Effect. Section 3.18 of the Aqua Disclosure Letter contains a list of the policies issued to Aqua and the Aqua Subsidiaries that are in effect on the date of this Agreement. None of Aqua or any of the Aqua Subsidiaries has been advised of any defense to coverage or reservation of rights in connection with any material claim to coverage asserted or noticed by Aqua or any of the Aqua Subsidiaries under or in connection with any of their existing insurance policies. None of Aqua or any of the Aqua Subsidiaries has received any written notice from or on behalf of any insurance carrier issuing policies or binders relating to or covering Aqua or the Aqua Subsidiaries that Aqua reasonably believes will cause a cancellation or non-renewal of existing policies or binders or a material decrease in coverage or a material increase in deductible or self insurance retention.

SECTION 3.19 *Labor Matters.* None of Aqua or any of the Aqua Subsidiaries is a party to, or is bound by, any collective bargaining agreement, contract or other agreement or understanding with a labor union or labor organization. None of Aqua or any of the Aqua Subsidiaries is the subject of a proceeding asserting that Aqua or any of the Aqua Subsidiaries has committed an unfair labor practice (within the meaning of the National Labor Relations Act) or seeking to compel Aqua or any of the Aqua Subsidiaries to bargain with any labor organization as to wages and conditions of employment. There is (i) no strike or material labor dispute, slowdown or stoppage pending or, to the knowledge of Aqua, threatened against Aqua or any of the Aqua Subsidiaries and (ii) to the knowledge of Aqua, no union certification petition has been filed with respect to the employees of Aqua or the Aqua Subsidiaries. None of Aqua or any of the Aqua Subsidiaries has received written notice of the intent of any Governmental Entity responsible for the enforcement of labor or employment Laws to conduct an investigation with respect to or relating to employees of Aqua or any of the Aqua Subsidiaries and, to the knowledge of Aqua, no such investigation is in progress. Aqua and Aqua Subsidiaries have at all times complied with the provisions of the Workers Adjustment and Retraining Notification Act of 1988.

SECTION 3.20 *Affiliate Contracts and Affiliated Transactions.* No officer or director of Aqua or any Aqua Subsidiary (or, to Aqua's knowledge, any family member of any such person who is an individual or any entity in which any such person or any such family member owns a material beneficial interest) or any person owning 5% or more of Aqua Common Stock is a party to any material Contract with or binding upon Aqua or any of the Aqua Subsidiaries or any of their respective properties or assets or has any material interest in any material property owned by Aqua or any of the Aqua Subsidiaries or has engaged in any material transaction with any of the foregoing within the last twelve months.

SECTION 3.21 *Brokers.* No broker, investment banker, financial advisor or other person is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the Transactions based upon arrangements made by or on behalf of Aqua.

ARTICLE IV

Representations and Warranties with respect to Holdings and Merger Sub

Aqua, Holdings and Merger Sub, jointly and severally, represent and warrant to Founder Parties that:

SECTION 4.01 *Organization, Standing and Power.* Each of Holdings and Merger Sub is duly organized, validly existing and in good standing under the laws of Delaware and has full corporate power and authority to conduct its businesses as presently conducted.

SECTION 4.02 *Holdings.* (a) Since the date of its incorporation, Holdings has not carried on any business or conducted any operations other than the execution of this Agreement, the performance of its obligations hereunder and thereunder and matters ancillary thereto.

(b) On the date of this Agreement, the authorized capital stock of Holdings consists of 100 shares of Holdings Common Stock and Holdings is a wholly owned subsidiary of Aqua.

SECTION 4.03 *Merger Sub.* (a) Since the date of its incorporation, Merger Sub has not carried on any business or conducted any operations other than the execution of this Agreement, the performance of its obligations hereunder and matters ancillary thereto.

(b) The authorized capital stock of Merger Sub consists of 100 shares of common stock, par value $0.01 per share, all of which have been validly issued, are fully paid and nonassessable and are owned by Holdings free and clear of any Lien.

SECTION 4.04 *Authority; Execution and Delivery, Enforceability.* (a) Each of Holdings and Merger Sub has all requisite corporate power and authority to execute and deliver this Agreement and to consummate the Transactions. The execution and delivery by each of Holdings and Merger Sub of this Agreement and the consummation by it of the Transactions have been duly authorized by all necessary corporate action on the part of Holdings and Merger Sub. Holdings, as sole stockholder of Merger Sub, has adopted this Agreement. Each of Holdings and Merger Sub has duly executed and delivered this Agreement, and this Agreement constitutes its legal, valid and binding obligation, enforceable against it in accordance with its terms.

(b) Holdings has all requisite corporate power and authority to execute and deliver the Holdings Agreements and to consummate the transactions contemplated by the Holdings Agreements. The execution and delivery by Holdings of the Holdings Agreements and the consummation by it of the transactions contemplated thereby have been duly authorized by all necessary corporate action on the part of Holdings. The Holdings Agreements, when executed and delivered by Holdings and the other parties thereto, will constitute Holdings's legal, valid and binding obligation, enforceable against it in accordance with its terms.

SECTION 4.05 *No Conflicts.* The execution and delivery by Holdings and Merger Sub of this Agreement do not, and the execution and delivery by Holdings of the Holdings Agreements will not, and the consummation of the Transactions and the transactions contemplated by the Holdings Agreements and compliance with the terms hereof and thereof will not, conflict with, or result in any violation of or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to loss of a material benefit under, or result in the creation of any Lien upon any of the properties or assets of Holdings or Merger Sub under, any provision of (i) the charter or organizational documents of Holdings or Merger Sub, (ii) any Contract to which Holdings or Merger Sub is a party or (iii) any Judgment or Law applicable to Holdings or Merger Sub.

SECTION 4.06 *Brokers.* No broker, investment banker, financial advisor or other person is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the Transactions based upon arrangements made by or on behalf of Holdings or Merger Sub.

ARTICLE V

Representations and Warranties of Aqua Stockholders

Each Aqua Stockholder represents and warrants to Founder Parties, as to itself only, that:

SECTION 5.01 *Organization; Authority; Execution and Delivery, Enforceability.* Such Aqua Stockholder, if it is not an individual, is duly organized, validly existing and in good standing under the laws of the jurisdiction in which it is organized. Such Aqua Stockholder (a) if it is not an individual, has all requisite power and authority and (b) if he or she is an individual, has the legal capacity, in each case to execute and deliver this Agreement and the Holdings Agreements to which he, she, or it is a party and to consummate the Transactions and the transactions contemplated by the Holdings Agreements to which he, she, or it is a party. The execution and delivery by such Aqua Stockholder, if it is not an individual, of this Agreement and the Holdings Agreements to which it is a party and the consummation by it of the Transactions and the transactions contemplated by the Holdings Agreements to which it is a party have been duly authorized by all necessary action on the part of such Aqua Stockholder. Such Aqua Stockholder has duly executed and delivered this Agreement, and this Agreement constitutes, and the Holdings Agreements to which he, she, or it is a party, when executed by all the parties thereto, will constitute, his, her or its legal, valid and binding obligation, enforceable against him, her or it in accordance with its terms.

SECTION 5.02 *No Conflicts.* The execution and delivery by such Aqua Stockholder of this Agreement do not, and the execution and delivery by such Aqua Stockholder of the Holdings Agreements to which he, she, or it is a party will not, and the consummation of the Transactions and the transactions contemplated by the Holdings Agreements to which he, she, or it is a party and compliance with the terms hereof and thereof will not, conflict with, or result in any violation of or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to loss of a material benefit under, or result in the creation of any Lien upon any of the properties or assets of such Aqua Stockholder under, any provision of (i) the charter or organizational documents of such Aqua Stockholder, if it is not an individual, (ii) any Contract to which such Aqua Stockholder is a party or (iii) any Judgment or Law applicable to such Aqua Stockholder.

SECTION 5.03 *Aqua Common Stock.* Such Aqua Stockholder is the record and beneficial owner of, and has good title to, the shares of Aqua Common Stock to be contributed to Holdings pursuant to the Aqua Stockholder Exchange, free and clear of any Liens.

SECTION 5.04 *Brokers.* No broker, investment banker, financial advisor or other person is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the Transactions based upon arrangements made by or on behalf of such Aqua Stockholder.

ARTICLE VI

Representations and Warranties of Founder Parties

Each Founder Party represents and warrants to Aqua, Holdings, Merger Sub and the Aqua Stockholders as to itself only, that:

SECTION 6.01 *Organization; Authority; Execution and Delivery, Enforceability.* Such Founder Party, if it is not an individual, is duly organized, validly existing and in good standing under the laws of the jurisdiction in which it is organized. Such Founder Party (a) if it is not an individual, has all requisite power and authority, and (b) if he or she is an individual, has the legal capacity, in each case to execute and deliver this Agreement and the Holdings Agreements to which he, she or it is a party and to consummate the Transactions and the transactions contemplated by the Holdings Agreements to which he, she or it is a party. The execution and delivery by such Founder Party, if it is not an individual, of this Agreement and the Holdings Agreements to which he, she or it is a party and the consummation by such Founder Party of the Transactions and the transactions contemplated by the Holdings Agreements to which he, she or it is a party have been duly authorized by all necessary action on the part of such Founder Party. Such Founder Party has duly executed and delivered this Agreement, and this Agreement constitutes, and the Holdings Agreements to which he, she or it is a party, when executed by all the parties thereto, will constitute, such Founder Party's legal, valid and binding obligation, enforceable against him, her or it in accordance with its terms.

SECTION 6.02 *No Conflicts.* The execution and delivery by such Founder Party of this Agreement do not, and the execution and delivery by such Founder Party of the Holdings Agreements to which he, she or it is a party will not, and the consummation of the Transactions and the transactions contemplated by the Holdings Agreements to which he, she or it is a party, and compliance with the terms hereof and thereof will not, conflict with, or result in any violation of or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to loss of a material benefit under, or result in the creation of any Lien upon any of the properties or assets of such Founder Party under, any provision of (i) the charter or organizational documents of such Founder Stockholder, if it is not an individual,

(ii) any Contract to which such Founder Party is a party or (iii) any Judgment or Law applicable to such Founder Party.

SECTION 6.03 *Silver Common Stock.* Such Founder Party is the record and beneficial owner of, and has good title to, the shares of Silver Common Stock to be contributed to Holdings pursuant to the Founder Exchange, free and clear of any Liens.

SECTION 6.04 *Brokers.* No broker, investment banker, financial advisor or other person is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the Transactions based upon arrangements made by or on behalf of such Founder Party.

ARTICLE VII

Covenants Relating to Conduct of Business

SECTION 7.01 *Conduct of Business.* (a) *Conduct of Business*. Except for matters set forth in the Aqua Disclosure Letter or otherwise contemplated by this Agreement, from the date of this Agreement to the Effective Time, Aqua shall, and shall cause each Aqua Subsidiary to, (i) conduct its business in the usual, regular and ordinary course in substantially the same manner as previously conducted, (ii) use all reasonable efforts to preserve intact its current business organization, (iii) use all reasonable efforts to keep available the services of its current officers and employees and keep its relationships with customers, suppliers, licensors, licensees, distributors and others having business dealings with them, and (iv) comply, in all material respects, with all applicable Laws. Except for matters set forth in the Aqua Disclosure Letter or otherwise contemplated by this Agreement, from the date of this Agreement to the Effective Time, Aqua shall not, and shall not permit any Aqua Subsidiary to, do any of the following without the prior written consent of Founder Parties:

(A) (1) declare, set aside or pay any dividends on, or make any other distributions in respect of, any of its capital stock, other than dividends and distributions by a direct or indirect wholly owned subsidiary of Aqua to its parent, (2) split, combine or reclassify any of its capital stock or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for shares of its capital stock, other than any of the foregoing by a direct or indirect wholly owned subsidiary of Aqua, or (3) purchase, redeem or otherwise acquire any shares of capital stock of Aqua or any other securities thereof or any rights, warrants or options to acquire any such shares or other securities;

(B) issue, deliver, sell or grant (1) any shares of its capital stock, (2) any Voting Aqua Debt or other voting securities, (3) any securities convertible into or exchangeable for, or any options, warrants or rights to acquire, any such shares, Voting Aqua Debt, voting securities or convertible or exchangeable securities or (4) any "phantom" stock, "phantom" stock rights, stock appreciation rights or stock-based performance units, other than in the case of clauses (1), (2), (3) and (4) (x) any such issuance, delivery, sale or grant pursuant to an equity plan approved by the Board of Directors of Aqua, (y) issuances upon the exercise of any options for Aqua Common Stock and (z) issuances to Aqua or a wholly owned subsidiary of Aqua;

(C) amend or propose to amend the certificate of incorporation, bylaws or other comparable organizational documents of Aqua, Holdings or Opco (other than the filing of the Restated Holdings Charter contemplated by this Agreement);

(D) sell, lease (as lessor), license or otherwise dispose of any properties or assets that are material, individually or in the aggregate, to Aqua and the Aqua Subsidiaries, taken as a whole, except in the ordinary course of business consistent with past practice;

(E) authorize, recommend, propose or announce an intention to adopt a plan of complete or partial liquidation or dissolution;

(F) knowingly or intentionally take any action that results or is reasonably likely to result in any of the representations or warranties of Aqua hereunder being untrue in any material respect; or

(G) authorize any of, or commit or agree to take any of, the foregoing actions.

(b) Except for matters set forth in the Aqua Disclosure Letter or otherwise contemplated by this Agreement, from the date of this Agreement to the Effective Time, Aqua shall not, without the prior written consent of Founder Parties, (i) take, or omit to take, any action that could reasonably be expected to result in a breach of the fiduciary duties of Aqua or its board of directors to the Founder Parties under the DGCL, or (ii) take any action which Holdings would be prohibited from taking without the consent of, or notice to, the Founder Parties under the terms of the Holdings Stockholders Agreement or applicable Law without obtaining such consent or providing such notice (assuming, in each case, for such purposes that on the date of this Agreement each of the Aqua Stockholders and each of the Founder Parties hold shares of Aqua capital stock equivalent to the shares of Holdings Common Stock and Holdings Preferred Stock to be received by such parties upon consummation of the Transactions).

(c) *Advice of Changes*. Aqua shall promptly advise Founder Parties orally and in writing of any change or event that has or could reasonably be expected to have an Aqua Material Adverse Effect.

ARTICLE VIII

Additional Agreements

SECTION 8.01 *Access to Information; Confidentiality.* Aqua shall, and shall cause each of the Aqua Subsidiaries to, afford to Founder Parties and to the Founder Parties' officers, employees, accountants, counsel, financial advisors and other representatives, reasonable access during normal business hours during the period prior to the Effective Time to all Aqua properties, books, contracts, commitments, personnel and records and, during such period, Aqua shall, and shall cause each of its subsidiaries to, furnish promptly to Founder Parties (a) a copy of each report, schedule, registration statement and other document filed by Aqua during such period pursuant to the requirements of Federal or state securities laws and (b) all other information concerning Aqua business, properties and personnel as Founder Parties may reasonably request; *provided*, *however*, that Aqua may withhold (i) any document or information that is subject to the terms of a confidentiality agreement with a third party or (ii) such portions of documents or information relating to pricing or other matters that are highly competitively sensitive. If any material is withheld by Aqua pursuant to the proviso to the preceding sentence, Aqua shall inform Founder Parties as to the general nature of what is being withheld.

SECTION 8.02 *Best Efforts; Notification.* Upon the terms and subject to the conditions set forth in this Agreement, each of the parties shall use its best efforts to take, or cause to be taken, all actions, and to do, or cause to be done, and to assist and cooperate with the other parties in doing, all things necessary, proper or advisable to consummate and make effective, in the most expeditious manner practicable, the Transactions, including (i) the obtaining of all necessary Consents of Governmental Entities and the making of all necessary registrations, declarations and filings (including filings with Governmental Entities, if any) and the taking of all reasonable steps as may be necessary to obtain an approval or waiver from, or to avoid an action or proceeding by, any Governmental Entity, (ii) the obtaining of all necessary consents, approvals or waivers from third parties, (iii) the defending of any lawsuits or other legal proceedings, whether judicial or administrative, challenging this Agreement or the consummation of the Transactions, including seeking to have any stay or temporary restraining order entered by any court or other Governmental Entity vacated or reversed and (iv) the execution and delivery of any additional instruments necessary to consummate the Transactions and to fully carry out the purposes of this Agreement. Notwithstanding the foregoing, this Section 8.02 shall not require any party to provide any financing for any of the Transactions that has not otherwise been agreed to be provided by such party pursuant to the other provisions of this Agreement.

SECTION 8.03 *Fees and Expenses.* All fees and expenses incurred in connection with the Transactions shall be paid by the party incurring such fees or expenses, whether or not the Transactions are consummated.

SECTION 8.04 *Public Announcements.* The parties will consult with each other and will mutually agree upon any press release or other public announcement pertaining to the Transactions and shall not issue any such press release or make any such public statement prior to such consultation and agreement, except as may be required by applicable Law, in which case the party proposing to issue such press release or make such public announcement shall use its reasonable best efforts to consult in good faith with the other party before issuing any such press release or making any such public announcement.

SECTION 8.05 *Transfer Taxes.* All stock transfer, real estate transfer, documentary, stamp, recording and other similar Taxes (including interest, penalties and additions to any such Taxes) ("*Transfer Taxes*") incurred in connection with the Transactions shall be paid by Holdings, Merger Sub or the Surviving Corporation.

ARTICLE IX

Conditions Precedent

SECTION 9.01 *Conditions to Each Party's Obligation To Effect The Transactions.* The respective obligation of each party to effect the Transactions is subject to the satisfaction or waiver on or prior to the Closing Date of the following conditions:

(a) *Antitrust.* The waiting period (and any extension thereof) applicable to the Transactions under the HSR Act shall have been terminated or shall have expired and any Consents of, filings with and notices to, all Governmental Entities required of the parties hereto or any of their respective subsidiaries or other affiliates in connection with the Transactions, shall have been obtained, effected or made.

(b) *No Injunctions or Restraints.* No Judgment or Law preventing the consummation of the Transactions shall be in effect; *provided*, *however*, that prior to asserting this condition, each of the parties shall have used its reasonable best efforts to have such legal prohibition removed.

(c) *Silver Merger.* All conditions to the closing of the Silver Merger (other than the consummation of the Holdings Subscription, the Aqua Stockholder Exchange, the Founder Exchange or the Merger), shall have been satisfied or waived in accordance with the terms of the Silver Merger Agreement.

SECTION 9.02 *Conditions to Obligations of Aqua, Holdings, Merger Sub and the Aqua Stockholders.* The obligations of Aqua, Holdings, Merger Sub and the Aqua Stockholders to effect the Transactions are further subject to the following conditions:

(a) *Representations and Warranties.* The representations and warranties of Founder Parties in this Agreement shall be true and correct as of the Closing Date as though made on the Closing Date, other than for such failures to be true and correct that, individually and in the aggregate, have not had and could not have a material adverse effect on the ability of Founder Parties to consummate the Transactions. Aqua and Holdings shall have received a certificate signed on behalf of Founder Parties by Founder to such effect.

(b) *Performance of Obligations of Founder Parties.* Founder Parties shall have performed in all material respects all obligations required to be performed by them under this Agreement at or prior to the Closing Date, and Aqua and Holdings shall have received a certificate signed on behalf of Founder Parties by Founder to such effect.

SECTION 9.03 *Conditions to Obligations of Founder Parties.* The obligations of Founder Parties to effect the Transactions are further subject to the following conditions:

(a) *Representations and Warranties.* The representations and warranties of Aqua (i) set forth Sections 3.01, 3.03, 3.04, 3.05(a) and 3.21 in this Agreement (collectively, the "*Specified Sections*") shall be true and correct in all material respects as of the Closing Date, except to the extent such representations and warranties expressly relate to an earlier date (in which case such representations and warranties shall be true and correct as of such earlier date) and (ii) set forth in this Agreement (other than the Specified Sections), disregarding qualifications as to "materiality", "Aqua Material Adverse Effect" or words of similar import, shall be true and correct as of the Closing Date as though made on the Closing Date, except to the extent such representations and warranties expressly relate to an earlier date (in which case such representations and warranties, disregarding qualifications as to "materiality", "Aqua Material Adverse Effect" or words of similar import, shall be true and correct as of such earlier date), other than, in the case of clause (ii) only, for such failures to be true and correct that, individually and in the aggregate, have not had an Aqua Material Adverse Effect. The representations and warranties of Holdings, Merger Sub and Aqua Stockholders in this Agreement, disregarding qualifications as to "materiality", "Aqua Material Adverse Effect" or words of similar import, shall be true and correct as of the Closing Date as though made on the Closing Date, except to the extent such representations and warranties expressly relate to an earlier date (in which case such representations and warranties, disregarding qualifications as to "materiality", "Aqua Material Adverse Effect" or words of similar import, shall be true and correct on and as of such earlier date), other than for such failures to be true and correct that, individually and the aggregate, have not had and could not reasonably be expected to have an Aqua Material Adverse Effect. Founder shall have received a certificate signed on behalf of Aqua by the chief executive officer of Aqua to such effect with respect to the representations and warranties of Aqua, Holdings and Merger Sub.

(b) *Performance of Obligations of Aqua and Holdings.* Aqua and Holdings shall have performed in all material respects all obligations required to be performed by them under this Agreement at or prior to the Closing Date (other than pursuant to Section 7.01(b)), and Founder shall have received a certificate signed on behalf of Aqua by the chief executive officer of Aqua to such effect.

(c) *Restated Holdings Charter.* The Restated Holdings Charter shall have been filed with the Secretary of State of the State of Delaware, and such charter shall have been certified by such official as the Amended and Restated Certificate of Incorporation of Holdings.

(d) *Absence of Aqua Material Adverse Effect.* There shall not have occurred after the date of this Agreement any event, change, condition, circumstance or state of facts, or aggregation of events, changes, conditions, circumstances or state of facts, that has had or could reasonably be expected to have, individually or in the aggregate, an Aqua Material Adverse Effect.

ARTICLE X

Termination, Amendment and Waiver

SECTION 10.01 *Termination.* (a) This Agreement shall terminate automatically, without any action on the part of any party hereto, upon the termination of the Silver Merger Agreement in accordance with its terms.

(b) This Agreement may be terminated by either Aqua or Founder Parties:

(i) if any Governmental Entity issues an order, decree or ruling or takes any other action permanently enjoining, restraining or otherwise prohibiting the Transactions and such order, decree, ruling or other action shall have become final and nonappealable; or

(ii) if any condition to the obligation of such party to consummate the Transactions set forth in Section 9.02 (in the case of Aqua and Holdings) or 9.03 (in the case of Founder Parties) becomes incapable of satisfaction prior to the Outside Date (as such term is defined in the Silver Merger Agreement); provided, however, the failure of such condition is not the result of a material breach of this Agreement by the party seeking to terminate this Agreement.

SECTION 10.02 *Effect of Termination.* In the event of termination of this Agreement as provided in Section 10.01, this Agreement shall forthwith become void and have no effect, without any liability or obligation on the part of any party hereto or their respective affiliates, officers, directors or stockholders, other than Section 3.15, Section 4.06, Section 5.04, Section 6.04, Section 8.03, this Section 10.02 and Article XI, which provisions shall survive such termination, and except to the extent that such termination results from the willful and material breach by a party of any provision set forth in this Agreement.

SECTION 10.03 *Amendment; Extension; Waiver.* (a) Other than in accordance with Sections 1.01(a), 1.01(b) and 1.07, this Agreement may not be amended except by an instrument in writing signed on behalf of each of the parties.

(c) At any time, the parties may to the extent legally allowed (i) extend the time for the performance of any of the obligations or other acts of the other parties, (ii) waive any inaccuracies in the representations and warranties contained in this Agreement or in any document delivered pursuant to this Agreement or (ii) waive compliance with any of the agreements or conditions contained in this Agreement. Any agreement on the part of a party to any such extension or waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party. The failure of any party to this Agreement to assert any of its rights under this Agreement or otherwise shall not constitute a waiver of such rights. The rights and remedies provided herein shall be cumulative and not exclusive of any rights or remedies provided by Law.

(d) The prior written consent of Silver shall be required for any amendment, extension or waiver of any provision of this Agreement that, in any case, (i) increases the economic value of the aggregate consideration to be received by the Founder Parties for each share of Silver Common Stock to be contributed to Holdings by the Founder Parties in the Founder Exchange, or (ii) changes or otherwise has the effect of changing any other provision of this Agreement, which change could reasonably be expected to prevent or materially delay the consummation of the Transactions.

ARTICLE XI

General Provisions

SECTION 11.01 *Nonsurvival of Representations, Warranties, Covenants and Agreements.* None of the representations, warranties, covenants and agreements contained in this Agreement or in any instrument delivered pursuant to this Agreement shall survive the Effective Time, except the representations and warranties of Holdings, the Aqua Stockholders and the Founder Parties set forth in Articles IV, V and VI and the covenant set forth in Section 7.01(b) shall, in each case, survive the Effective Time. This Section 11.01 shall not limit any covenant or agreement of the parties which by its terms contemplates performance after the Effective Time (which covenant or agreement shall survive in accordance with its terms).

SECTION 11.02 *Notices.* All notices, requests, claims, demands and other communications under this Agreement shall be in writing and shall be delivered personally, delivered by nationally recognized overnight courier service, sent by certified or registered mail, postage prepaid, or sent by facsimile (subject to electronic confirmation of such facsimile transmission and the sending (on the date of such facsimile transmission) of a confirmation copy of such facsimile by nationally recognized overnight courier service or by certified or registered mail, postage prepaid). Any such notice or communication shall be deemed to have been given (i) when delivered, if personally delivered, (ii) one business day after it is deposited with a nationally recognized overnight courier service, if sent by nationally recognized overnight courier service, (iii) the day of sending, if sent by facsimile prior to 5:00 p.m. (EST) on any business day or the next succeeding business day if sent by facsimile after 5:00 p.m. (EST) on any business day or on any day other than a business day or (iv) five business days after the date of mailing, if mailed by certified or registered mail, postage prepaid, in each case, to the following address or facsimile number, or to such other address or addresses or facsimile number or numbers as such party may subsequently designate to the other parties by notice given hereunder:

(a)

if to Aqua, Holdings, Merger Sub or Aqua Stockholders, to:
c/o AmeriPath, Inc.
7111 Fairway Drive, Suite 400
Palm Beach Gardens, Florida 33418
Facsimile: (561) 841-8527
Attention: Jarod T. Moss, Esq.

with a copies to:

Welsh, Carson, Anderson & Stowe IX, L.P.
320 Park Avenue, Suite 2500
New York, New York 10022
Facsimile: (212) 893-9566
Attention: D. Scott Mackesy

and

Ropes & Gray LLP
45 Rockefeller Plaza
New York, New York 10111
Facsimile: 212-841-5725
Attention: Othon A. Prounis, Esq.

(b)

if to Founder Parties, to the addresses set forth on *Schedule 1.01(b)*, with copies to:

Guth Christopher LLP
10866 Wilshire Blvd., Suite 1250
Los Angeles, California 90024
Facsimile: 310-470-8354
Attention: Theodore E. Guth, Esq.

and

O'Melveny & Myers LLP
Times Square Tower
7 Times Square
New York, New York 10036
Facsimile: 212-326-2061
Attention: Spencer D. Klein, Esq.
Gregory D. Puff, Esq.

SECTION 11.03 *Definitions.* For purposes of this Agreement:

An "*affiliate*" of any person means another person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, such first person.

An "*Aqua Material Adverse Effect* means any change, effect, event, occurrence or circumstance that has a material adverse effect on (i) the business, financial condition or results of operations of Aqua and the Aqua Subsidiaries, taken as a whole, or (ii) the ability of Aqua to perform its obligations under this Agreement or to consummate the Merger and the other transactions contemplated by this Agreement, in the case of each of (i) and (ii) other than effects relating to (A) changes, effects, events, occurrences or circumstances that generally affect the United States economy or the industries in which Aqua operates (other than changes in Law that do not exist and have not been proposed prior to the date of this Agreement) and, in each case, that do not have a materially disproportionate impact on Aqua and the Aqua Subsidiaries, taken as a whole, (B) changes in Law (but only to the extent such changes exist or have been proposed prior to the date of this Agreement) or reimbursement policies or practices of customers, (C) the announcement of this Agreement or the Transactions, or (D) those matters described in Section 11.03 of the Aqua Disclosure Letter.

A "*person*" means any individual, firm, corporation, partnership, company, limited liability company, trust, joint venture, association, Governmental Entity or other entity.

A "*subsidiary*" of any person means another person, an amount of the voting securities, other voting ownership or voting partnership interests of which is sufficient to elect at least a majority of its Board of Directors or other governing body (or, if there are no such voting interests, 50% or more of the equity interests of which) is owned directly or indirectly by such first person.

SECTION 11.04 *Interpretation.* When a reference is made in this Agreement to a Section, such reference shall be to a Section of this Agreement unless otherwise indicated. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Each party hereto has participated in the drafting of this Agreement, which each party acknowledges and agrees is the result of extensive negotiations among the parties. Whenever the words "include", "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation". Unless otherwise provided herein, each accounting term used in this Agreement has the meaning given to it in accordance with GAAP. When used herein, the phrase "to the knowledge of" any person or any similar phrase means the actual knowledge of the officers and directors of such person and such person's subsidiaries and other individuals who have similar powers and duties as the officers of such persons, and the knowledge of facts that such individuals should have after reasonable due inquiry. The definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms and to the masculine as well as to the feminine and neuter genders of such terms. Any agreement or statute referred to herein means such agreement or statute as from time to time amended, qualified or supplemented, including, in the case of statutes, by succession of comparable successor statutes. References to the Exchange Act are also references to the rules and regulations of the SEC promulgated thereunder. References to a person are also to its successors and permitted assigns.

SECTION 11.05 *Severability.* If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any Law or public policy, all other terms, conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the Transactions is not affected in any manner materially adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible.

SECTION 11.06 *Counterparts.* This Agreement may be executed in one or more counterparts (and delivered by facsimile), all of which shall be considered one and the same original agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other parties.

SECTION 11.07 *Entire Agreement; Third-Party Beneficiaries.* This Agreement, taken together with the Silver Merger Agreement, the Confidentiality Agreement (as defined in the Silver Merger Agreement) and the Aqua Disclosure Letter and the other schedules to this Agreement, (a) constitute the entire agreement, and supersede all prior agreements and understandings, both written and oral, among the parties with respect to the Transactions and (b) except for the provisions of Section 10.03(c), are not intended to confer upon any person other than the parties any rights or remedies. Silver shall be an intended third party beneficiary with respect to Section 10.03(c), and shall be entitled to the rights and benefits of, with full power to enforce, the provisions thereof.

SECTION 11.08 *Governing Law.* This Agreement shall be governed by, and construed in accordance with, the laws of the State of New York applicable to agreements made and to be performed entirely within such state.

SECTION 11.09 *Assignment.* Neither this Agreement nor any of the rights, interests or obligations under this Agreement shall be assigned, in whole or in part, by operation of law or otherwise by any of the parties without the prior written consent of the other parties; *provided*, that any Aqua Stockholder shall have the right to assign all or any portion of its rights to subscribe and pay for shares of Holdings Common Stock and Holdings Preferred Stock, and receive such shares from Holdings, in each case, pursuant to Section 1.01(a)(i), to any other person approved by Holdings (it being understood that any such assignment shall not relieve such assigning Aqua Stockholder of its obligations under Section 1.01(a)(i) if and to the extent such assignee elects not to undertake such subscription or make such payment at the time the Holdings Subscription is consummated). Any purported assignment other than in accordance with this Section 11.09 shall be void. Subject to the preceding sentences, this Agreement will be binding upon, inure to the benefit of, and be enforceable by, the parties and their respective successors and assigns.

SECTION 11.10 *Enforcement; Jurisdiction; WAIVER OF JURY TRIAL.* The parties acknowledge and agree that irreparable damage (for which money damages would not be an adequate remedy) would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that, in addition to any other remedies, the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in any New York state court or any Federal court, in each case, located in New York County, this being in addition to any other remedy to which they are entitled at law or in equity. In addition, each of the parties hereto (a) consents to submit itself to the personal jurisdiction of any New York state court or any Federal court located in New York County in the event any dispute arises out of this Agreement or any Transaction, (b) agrees that it will not attempt to deny or defeat such personal jurisdiction by motion or other request for leave from any such court, (c) irrevocably and unconditionally waives, to the fullest extent it may legally and effectively do so, the defense of an inconvenient forum to the maintenance of any action arising out of this Agreement or any Transaction in any such court, (d) agrees that it will not bring any action relating to this Agreement or any Transaction in any court other than any New York state court or any Federal court, in each case, sitting in the New York County and (e) WAIVES ANY RIGHT TO TRIAL BY JURY WITH RESPECT TO ANY ACTION RELATED TO OR ARISING OUT OF THIS AGREEMENT OR ANY TRANSACTION.

IN WITNESS WHEREOF, Aqua, Holdings, Merger Sub, Aqua Stockholders, and Founder Parties have duly executed this Agreement, all as of the date first written above.

AMERIPATH HOLDINGS, INC.

By: /s/ DONALD E. STEEN

Name: Donald E. Steen
Title: Chief Executive Officer

AMERIPATH GROUP HOLDINGS, INC.

By: /s/ DONALD E. STEEN

Name: Donald E. Steen
Title: Chief Executive Officer

AQUA ACQUISITION CORP.

By: /s/ DONALD E. STEEN

Name: Donald E. Steen
Title: President

Aqua Stockholders:

WELSH, CARSON, ANDERSON & STOWE IX, L.P.

By: WCAS IX Associates, LLC,
its General Partner

By: /s/ D. SCOTT MACKESY

Name: D. Scott Mackesy
Title: Manager

WCAS CAPITAL PARTNERS III, L.P.

By: WCAS CP III Associates LLC,
its General Partner

By: /s/ D. SCOTT MACKESY

Name: D. Scott Mackesy
Title: Manager

Founder Parties:

SPECIALTY FAMILY LIMITED PARTNERSHIP

By: /s/ JAMES B. PETER

James B. Peter, M.D.
as Managing General Partner

By: The Peter Family Revocable Trust,
as a General Partner

By: /s/ JAMES B. PETER

James B. Peter, M.D.,
as Trustee

and

By: /s/ JOAN C. PETER

Joan C. Peter,
as Trustee

By: /s/ DEBORAH A. ESTES

Deborah A. Estes,
as a General Partner

JAMES B. PETER, JR. THIRD GENERATION TRUST

By: /s/ DEBORAH A ESTES

Deborah A Estes,
as a Trustee

JOAN C. NONEMAN THIRD GENERATION TRUST

By: /s/ CHRISTINE M. GARD

Christine M. Gard,
as a Trustee

DEBORAH A. ESTES THIRD GENERATION TRUST

By: /s/ ARTHUR L. PETER

Arthur L. Peter,
as a Trustee

and

By: /s/ KAREN M. CANE

Karen M. Cane,
as a Trustee

CHRISTINE M. GARD THIRD GENERATION TRUST

By: /s/ JOAN C. NONEMAN

Joan C. Noneman,
as a Trustee

KAREN M. CANE THIRD GENERATION TRUST

By: /s/ ARTHUR L. PETER

Arthur L. Peter,
as a Trustee

and

By: /s/ CHRISTINE M. GARD

Christine M. Gard, as a Trustee

ARTHUR L. PETER THIRD GENERATION TRUST

By: /s/ JAMES B. PETER, JR.

James B. Peter, Jr.,
as a Trustee

ARTHUR L. PETER AND MIA M. LINDSAY, AS JOINT TENANTS

By: /s/ ARTHUR L. PETER

Arthur L. Peter,
as a Co-Tenant

and

By: /s/ MIA M. LINDSAY

Mia M. Lindsay,
as a Co-Tenant

By: /s/ JAMES B. PETER, JR.

James B. Peter, Jr.,
in his individual capacity

ý **PLEASE MARK VOTES AS IN THIS EXAMPLE**

REVOCABLE PROXY
SPECIALTY LABORATORIES, INC.

SPECIAL MEETING OF STOCKHOLDERS
[ ]

This Proxy is Solicited on Behalf of the Board of Directors of Specialty Laboratories, Inc.

The undersigned revokes all previous proxies, acknowledges receipt of the Notice of the Special Meeting of Stockholders to be held [ ] and the Proxy Statement and appoints [ ], the proxyholders of the undersigned, with full power of substitution, to vote all shares of Common Stock of Specialty Laboratories, Inc. (the "Company") which the undersigned is entitled to vote, either on his or her own behalf or on behalf of any entity or entities, at the Special Meeting of Stockholders of the Company to be held at [ ], on [ ], [ ] at [ ] a.m. Pacific Time (the "Special Meeting"), and at any adjournment or postponement thereof, with the same force and effect as the undersigned might or could do if personally present thereat The shares represented by this Proxy shall be voted in the manner set forth on the adjacent column.

		For	Against	Abstain
1.	To approve the Agreement and Plan of Merger (the "Merger Agreement") dated as of September 29, 2005, among Specialty Laboratories, Inc., AmeriPath Holdings, Inc., AmeriPath, Inc. and Silver Acquisition Corp., and the merger contemplated by the Merger Agreement (the "Merger"), under which each share of Specialty Common Stock will be converted into the right to receive $13.25 in cash, except as set forth in the Merger Agreement.	o	o	o
2.	To approve the postponement or adjournment of the Special Meeting to a later date to solicit additional proxies in favor of the approval of the Merger Agreement and the Merger if there are not sufficient votes for approval of the Merger Agreement and the Merger at the Special Meeting.	o	o	o

3. In their discretion, the proxyholders are authorized to vote upon such other matters as may properly come before the Special Meeting or at any adjournment or postponement thereof.

PLEASE CHECK BOX IF YOU PLAN TO ATTEND THE MEETING o

Date

Please be sure to sign and date this Proxy in the box below

The Board of Directors recommends a vote FOR each of the Items 1 and 2 listed above. This Proxy, when properly executed, will be voted as specified above. If no specification is made, this Proxy will be voted FOR each of Items 1 and 2 above, and will grant discretionary authority pursuant to Item 3.

Stockholder sign above Co-holder (if any) sign above

Detach above card, sign, date and mail in postage paid envelope provided.

SPECIALTY LABORATORIES, INC.

Note: Please sign, date and return promptly in the accompanying envelope. Please sign exactly as your name appears on this proxy card. If shares are held jointly, each person should sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by authorized person.

WHETHER OR NOT YOU ATTEND THE SPECIAL MEETING IN PERSON, YOU ARE URGED TO SIGN AND PROMPTLY MAIL THIS PROXY IN THE RETURN ENVELOPE SO THAT YOUR STOCK MAY BE REPRESENTED AT THE SPECIAL MEETING.

PLEASE ACT PROMPTLY
SIGN, DATE & MAIL YOUR PROXY CARD TODAY

MARK HERE FOR CHANGE OF ADDRESS AND PROVIDE YOUR CURRENT ADDRESS ON THE LINES BELOW. RETURN IN POSTAGE PAID ENVELOPE PROVIDED TOGETHER WITH YOUR SIGNED PROXY.

QuickLinks