

# Annual Report

December 31, 2017





# STONECASTLE FINANCIAL CORP.

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# Letter To Shareholders

Dear Shareholders,

In 2017, StoneCastle Financial Corp. ("StoneCastle Financial" or the "Company") achieved significant milestones. During the year the Company was assigned an A+ issuer rating from Kroll Bond Rating Agency, who also elected to assign a BBB+ rating for preferred shares, if and when any are issued. In the third quarter, the Company increased its dividend rate by 2.7% to \$0.38 per share. The Company continued to gain broader recognition in the marketplace for the quality and consistency of the investment portfolio, and for the diligence and discipline with which our advisor, StoneCastle Asset Management ("SAM"), originates investments. The management continues to focus on creating value for our shareholders, and we are proud of our achievements as a public company.

At year-end, the share price of StoneCastle Financial closed at \$20.13, up 16.21% for the year including dividend reinvestment, reflecting a market capitalization of \$131.7 million. The Company had a dividend yield of approximately 7.6% and total cumulative distributions of \$6.75 per share since inception. Total assets at year-end were \$170.4 million, with only 2% of total assets held in cash, and an estimated annualized portfolio yield of 9.05%.

As with all investments, timing is an important factor. We believe the current regulatory and economic environment continues to benefit community banks and our shareholders. For example, banks are poised to see regulatory relief from both amendments and rollbacks of regulations. We believe U.S. banks could experience increased profits through reduced regulatory compliance costs, flexibility to expand into new lines of business and an increase in the pace of mergers (which also brings significant cost savings), and most banks will see increased profits derived from the 40% reduction in their federal corporate tax rate, now at 21%.

New developments in accounting standards, known as CECL (current expected credit loss models), will be effective in 2020. This accounting measurement requires banks to increase their reserves for loan losses to cover the life of each loan they make. This will likely precipitate an increased need for capital to maintain their capital ratios, of which Tier 2 sub debt is the most cost-efficient form of capital to satisfy this need. StoneCastle Financial is in a great position to aid the potentially hundreds of banks that we believe will seek additional capital, solely to comply with these new accounting standards.

Turning to interest rates, most community banks benefit from a steepening of the interest rate curve as lending rates (the interest earned on loans) increase faster than bank deposit costs. The difference between the loan rates and deposit rates is called "net-interest margins" or "NIM" and is comparable to gross profits for a bank. NIM tends to increase in higher interest rate environments, and the interest earned increases even more when the interest rate curve steepens, likely benefitting community banks.

We believe our expertise in this sector, along with the potential for legislative relief in the regulatory environment, increasing steepness in the interest rate curve, and continued improving macro trends, offer current and prospective shareholders a unique and timely

# Letter To Shareholders

opportunity to invest broadly into the community banking industry. We also believe a stronger economy, continued bank mergers and changes to accounting standards will ensure a strong anticipated pipeline of activity for StoneCastle Financial as banks seek capital.

Finally, community banks are not given enough credit for the tremendous impact they have on their communities and local economic development. It is not widely known that community banks are the exclusive financial institutions serving nearly 900 U.S. counties, representing 28%<sup>1</sup> of all U.S. counties. They serve a geographically and socio-economic diverse client base and make a contribution to two important societal themes: financial access and financial inclusion. Community banks have a strong reputation for community service in support of the health and well-being of communities in which they operate.

Given these factors, we believe that StoneCastle Financial will continue to offer investors an attractive and differentiated opportunity, unparalleled in the public markets, one that also provides a societal good. We believe the combination of our long-term investment strategy, consistent and stable income stream and rigorous credit standards, positions StoneCastle to deliver sustainable income and capital appreciation.

On the following pages, we provide additional details on our 2017 financial and operational results.

We appreciate your continued support and interest in StoneCastle Financial and its mission. We look forward to updating you on our progress throughout the year.

Sincerely,

Joshua S. Siegel  
Chairman & CEO  
StoneCastle Financial Corp.

<sup>1</sup> Source: FDIC Quarterly, "Community Bank Developments in 2012", 2013, Volume 7, No.4, [www.fdic.gov](http://www.fdic.gov).

# About StoneCastle Financial Corp.

## MANAGEMENT DISCUSSION AND SUMMARY

This report provides information on the financial performance for StoneCastle Financial Corp. ("StoneCastle Financial" or the "Company") for the year ended December 31, 2017. StoneCastle Financial (BANX) is a closed-end management investment company listed on the NASDAQ Global Select Market.

As of year-end, the Company had total assets of \$170.4 million, consisting of total portfolio investments of \$166.9 million and cash and other assets of \$3.5 million. The total portfolio investments consisted of 29.4% term loans, 5.0% debt securities, 14.9% trust preferred securities, 27.1% credit securitizations, 20.4% preferred stock, 0.8% common stock, and 0.5% in a limited partnership interest and 1.9% in short term investments.

For the full year, StoneCastle Financial had gross investment income of \$17.4 million and operating expenses of \$7.0 million. This resulted in net investment income of \$10.4 million or \$1.58 per share based on average shares outstanding during the year. The Company had realized and unrealized gains of \$1.7 million or \$0.26 per share. During the year, StoneCastle Financial declared distributions of \$1.50 per share. Net Asset Value at year end was \$21.56 per share, reflecting an increase of \$0.34 from the prior year end.

Based on the fourth quarter 2017 dividend rate of \$0.38 per share and the closing price of \$20.13 per share on December 31, 2017, the year-end distribution yield was 7.6%. For the full year, an investment in StoneCastle Financial resulted in a total annual return of 16.21%, including the reinvestment of distributions based on the closing market prices of StoneCastle Financial's stock.

## PORTFOLIO DISCUSSION

### *THE PORTFOLIO*

StoneCastle Financial makes long-term, non-control investments in community banks seeking capital for organic growth, acquisitions, and share repurchases along with other investment opportunities. The Company primarily invests in senior debt and term loans, subordinated debt, credit securitizations, preferred securities and to a lesser extent, common stock.

Over the course of 2017, StoneCastle Financial purchased securities totaling \$29.5 million, which consisted of six transactions. During the same period, the Company executed sales of \$1.9 million in 1 transaction. In addition, the Company received call (redemption) notices for 16 transactions totaling \$61.1 million for the year and paydowns of approximately \$63,000.

# About StoneCastle Financial Corp.

As of December 31, 2017, the Company had a total investment portfolio of \$166.9 million representing 98% of total assets and consisting of:

<u>Investment Type</u>	<u>Amount</u>
Term Loans	29.4%
Debt Securities	5.0%
Trust Preferred Securities	14.9%
Credit Securitizations	27.1%
Preferred Securities	20.4%
Common Stock	0.8%
Limited Partnership Interest	0.5%
Short Term Investment	1.9%
Total Investments in Securities	<u>100.0%</u>

## *TERM LOANS*

StoneCastle Financial purchased \$20.5 million of term loans in two transactions in 2017. At year-end, the Company held seven investments in term loans totaling \$49.0 million or 29.4% of total investments. The Company's largest holding in a term loan is \$13.1 million of Baraboo Bancorporation, Inc. in Wisconsin (Senior Secured Term Loan, 10.50%, 12/28/2026).

## *DEBT SECURITIES*

StoneCastle Financial purchased \$1.4 million of debt securities in one transaction in 2017. At year-end, the Company held two debt security investments valued at \$8.2 million or 5.0% of total assets. The largest debt investment is \$4.5 million in Preferred Term Securities, Ltd. (Fixed Rate Mezzanine Notes, 9.74%, 9/15/2030).

## *TRUST PREFERRED SECURITIES*

At year-end, the Company held seven trust preferred investments totaling \$24.9 million, or 14.9% of the total investments. Trust preferred securities are debt securities that may qualify as capital for a bank or bank holding company.

While trust preferred securities may have been issued by both public and private banks, the securities held by the Company are typically more liquid securities, offered by large public banking institutions. The largest trust preferred investment is \$6.5 million in First Alliance Capital Trust I (Junior Subordinated Debt, 10.25%, 7/25/2031).

## *CREDIT SECURITIZATIONS*

During the year, the Company had no changes to credit securitizations. At year-end the Company held two positions in credit securitizations totaling \$45.3 million or 27.1% of total investments. The Community Funding CLO, Ltd. is the largest holding in this category valued at \$44.1 million. Community Funding CLO contains direct capital investments in 35 community

# About StoneCastle Financial Corp.

and regional banks from 24 states. The estimated effective yield for Community Funding in 2017 was 10.49%.

## *PREFERRED SECURITIES*

During 2017, StoneCastle Financial purchased \$7.5 million of preferred securities in two transactions. At year-end, the Company held ten distinct investments in preferred securities totaling \$34.1 million, or 20.4% of total investments. The Company's largest holding in preferred securities were \$12.6 million in Reliance Bancshares, Inc. in Missouri (Fixed Rate Cumulative Perpetual Preferred Stock, Series A, 9%). A majority of these investments qualify for dividend received deduction (DRD) or qualified dividend income (QDI) tax treatment. For more details, please see the 2017 Tax Information posted on the StoneCastle Financial website ([www.Stonecastle-Financial.com](http://www.Stonecastle-Financial.com)).

Please note that StoneCastle Financial is not a tax advisor and advises that shareholders consult a tax advisor regarding their personal tax status.

## *COMMON STOCK*

At the end of 2017, the Company had one equity investments totaling \$1.3 million, or 0.8% of the total investments. Equity securities are typically held for capital appreciation, however, some positions may be held for both dividend income and capital appreciation. In addition, the Company may utilize certain exchange traded funds as short-term positions expected to be redeployed into higher yielding, long-term investments.

## *LIMITED PARTNERSHIP INTEREST & MONEY MARKET FUND*

At year-end, StoneCastle Financial held an interest in Priam Capital Fund I, L.P, a holding company organized for the sole purpose of investing in First Mariner Bank in Baltimore, Maryland. This position was valued at \$846,000, or 0.5% of total investments. In addition, the Company utilizes The Morgan Stanley Institutional Liquidity Fund-Treasury Portfolio as a short-term position for cash to be redeployed into higher yielding, long-term investments which, at year end, was 1.9% of total investments.

## *PORTFOLIO CONSIDERATIONS*

StoneCastle Financial is steadfast in its pursuit of constructing a portfolio able to generate long-term, consistent and stable returns, primarily for income distribution and to a lesser extent, capital appreciation. The Company seeks to achieve this goal while maintaining high credit quality standards. At year end, the Company reported zero credit losses, zero impaired assets and no material deterioration of credit quality within the underlying portfolio. In 2017, the Company was assigned an issuer rating of A+ from Kroll Bond Rating Agency and a BBB+ rating for Preferred Shares<sup>1</sup>. The Company also maintains an A3 rating from Moody's Investor Services on its revolving credit facility.

# About StoneCastle Financial Corp.

Among the factors that affect the timing of capital deployment are: (i) a bank's timeframe to obtain internal approvals to issue, (ii) the protracted nature of mergers and acquisitions, and (iii) an approval process from government regulators which must provide final regulatory approvals for a bank merger, capital issuances and capital redemptions (refinancing).

In the first quarter of 2016, the Company received notification that Chicago Shore Corporation, Fixed Rate Cumulative Perpetual Preferred Stock, Series A, 9% and Chicago Shore Corporation, Fixed Rate Cumulative Perpetual Preferred Stock, Series B, 9% elected to defer dividend payments as permitted by terms of their security. At year-end 2017, StoneCastle had a fair value investment of \$5.7 million in these positions. Under GAAP, income from an investment in a preferred stock deferring payments on a cumulative basis cannot be accrued. StoneCastle monitors the positions for accrued and compounded payments. At the time the bank resumes dividend payments, the bank will be required to pay all deferred payments and the compounded rate of return on the missed payments, along with the current dividend due.

## *INVESTMENT PROCESS*

The Company conducts due diligence on pending investments in several phases, beginning with a preliminary screening and ending, in most cases, with an on-site management visit. The investment process includes both quantitative and qualitative reviews with investment decisions made by an investment committee with nearly 120 years of combined investment experience in the bank sector. The Company's disciplined approach to due diligence and commitment to credit quality reflects its long-term view. The Company believes shareholders have high regard for this dedicated and disciplined approach to portfolio construction, as we expect it will serve to provide predictable cash flows over an extended period of time.

## *INVESTMENT FOCUS*

The following graphic helps to illustrate the range of investments StoneCastle typically pursues at a bank relative to a traditional bank's capital structure. A bank's capital structure includes subordinated debt, preferred stock and common equity. Bank holding company senior debt can also be absorbed at the bank level and become part of the bank's capital structure. As a lender, a bank makes senior and mezzanine loans to borrowers. A bank's common equity and loan loss reserves offer a capital buffer to absorb credit losses from bank loans. StoneCastle typically invests in securities that rank senior to the common equity of a bank. As investors in senior and subordinated debt, StoneCastle would only incur a credit loss if the bank's common equity plus loan loss reserves were exhausted.

# About StoneCastle Financial Corp.

## **Conclusion**

We believe that StoneCastle Financial offers investors a unique opportunity to participate in the community banking industry.

The Company will continue to work diligently for our shareholders by prudently constructing an investment portfolio with the capital entrusted to us. As we work to deploy capital with a long-term view, credit quality and a rigorous investment approach are of paramount focus to our shareholders.

While StoneCastle Financial continued its solid progress in 2017, we believe 2018 holds a bright future and we look forward to our work ahead in pursuit of our goals.

We appreciate the feedback we receive from our shareholders. Thank you for your support of StoneCastle Financial Corp.

# StoneCastle Financial Corp.

## Schedule of Investments

As of December 31, 2017

Company <sup>(1)</sup>	Investment	# of Shares/Par Amount (\$) <sup>(2)</sup>	Fair Value <sup>(3)</sup>
<b>Term Loans – 34.7%</b>			
<b>Banking – 34.7%</b>			
Baraboo Bancorporation, Inc.	Senior Secured Term Loan, 10.50%, 12/28/2026	\$ 13,000,000	\$ 13,130,000
Fidelity Federal Bancorp	Subordinated Term Loan, 8.25%, 1/1/2028	\$ 8,000,000	8,020,000
First Community Holdings, Inc.	Subordinated Term Loan, 7.50%, 7/1/2027	\$ 12,500,000	12,375,000
Halbur Bancshares, Inc.	Subordinated Term Loan, 8.75%, 10/1/2026	\$ 3,000,000	3,007,500
Lincoln Park Bancorp	Subordinated Term Loan, 8.25%, 1/1/2026	\$ 5,000,000	5,012,500
MidWest Community Financial Corporation	Subordinated Term Loan, 7.25%, 1/1/2026	\$ 2,500,000	2,475,000
Midwest Regional Bank	Subordinated Term Loan, 8.625%, 1/1/2027	\$ 5,000,000	5,012,500
<b>Total Term Loans (Cost \$49,000,000)</b>			<b>49,032,500</b>
<b>Debt Securities – 5.8%</b>			
<b>Banking – 5.8%</b>			
MMCapS Funding I, Ltd. / MMCapS Funding I, Inc.	Fixed Rate Senior Notes, 8.04%, 6/8/2031, 144A <sup>(4)</sup>	\$ 4,446,824	3,668,630
Preferred Term Securities, Ltd. / Preferred Term Securities, Inc.	Fixed Rate Mezzanine Notes, 9.74%, 9/15/2030, 144A <sup>(1)</sup>	\$ 4,442,673	4,487,100
<b>Total Debt Securities (Cost \$8,054,313)</b>			<b>8,155,730</b>
<b>Trust Preferred Securities – 17.7%</b>			
<b>Banking – 17.7%</b>			
Capital City TPS LLC	Trust Preferred Security, Series 2015-1 9.74%, Note, 9/30/2030, 144A <sup>(4)</sup>	\$ 1,907,065	1,911,833
Central Trust Company Capital Trust I	Junior Subordinated Debt (Trust Preferred Security), 10.25%, 7/25/2031	\$ 2,500,000	2,531,250
First Alliance Capital Trust I	Junior Subordinated Debt (Trust Preferred Security), 10.25%, 7/25/2031	\$ 6,500,000	6,548,750
First Citizens TPS LLC	Trust Preferred Security, Series 2015-1 9.74%, Note, 9/30/2030, 144A <sup>(4)</sup>	\$ 2,224,910	2,236,034
M&T TPS LLC	Trust Preferred Security, Series 2015-1 9.74%, Note, 9/30/2030, 144A <sup>(4)</sup>	\$ 2,542,753	2,568,180
Mercantil TPS LLC	Trust Preferred Security Series 2015-1 9.74%, Note, 9/30/2030, 144A <sup>(4)</sup>	\$ 4,767,662	4,815,339
National Bank of Indianapolis TPS LLC	Trust Preferred Security, Series 2015-1 9.74%, Note, 9/30/2030, 144A <sup>(4)</sup>	\$ 4,290,896	4,323,078
<b>Total Trust Preferred Securities (Cost \$25,271,095)</b>			<b>24,934,464</b>

Company <sup>(1)</sup>	Investment	# of Shares/Par Amount (\$) <sup>(2)</sup>	Fair Value <sup>(3)</sup>
<b>Credit Securitizations – 32.1%</b>			
<b>Banking – 32.1%</b>			
Community Funding CLO, Ltd.	Preferred Shares <sup>(5)</sup> (Estimated effective yield 10.49%), 144A <sup>(4)</sup>	\$ 45,500,000	\$ 44,055,375
U.S. Capital Funding I, Ltd. / U.S. Capital Funding I, Corp.	Subordinate Income Note, Due 5/1/2034, 144A <sup>(4)(6)</sup>	\$ 4,700,000	1,219,650
<b>Total Credit Securitizations (Cost \$46,682,622)</b>			<b>45,275,025</b>
<b>Preferred Stocks – 24.2%</b>			
<b>Banking – 24.2%</b>			
Chicago Shore Corporation	Fixed Rate Cumulative Perpetual Preferred Stock, Series A, 9% <sup>(6)*</sup>	\$ 6,400,000	5,616,000
Chicago Shore Corporation	Fixed Rate Cumulative Perpetual Preferred Stock, Series B, 9% <sup>(6)**</sup>	\$ 150,000	131,625
First Priority Financial Corporation	Fixed Rate Cumulative Perpetual Preferred Stock, Series C, 9%	\$ 428,000	423,720
First Western Financial, Inc.	Fixed Rate Cumulative Perpetual Preferred Stock, Series A, 9%	\$ 3,890,000	3,851,100
First Western Financial, Inc.	Fixed Rate Cumulative Perpetual Preferred Stock, Series C, 9%	\$ 219,000	216,810
Katahdin Bankshares Corporation	Floating Rate Non-Cumulative Preferred Stock, Series D, 8.75%	\$ 10,000,000	9,900,000
Reliance Bancshares, Inc.	Fixed Rate Cumulative Perpetual Preferred Stock, Series A, 9%	\$ 12,750,000	12,622,500
Tennessee Valley Financial Holdings, Inc.	Fixed Rate Cumulative Perpetual Preferred Stock, Series A, 9%	\$ 100,000	97,500
Tennessee Valley Financial Holdings, Inc.	Fixed Rate Cumulative Perpetual Preferred Stock, Series B, 9%	\$ 49,000	47,775
The Queensborough Company	Fixed Rate Cumulative Perpetual Preferred Stock, Series A, 9%	\$ 1,218,000	1,205,820
<b>Total Preferred Stocks (Cost \$35,330,580)</b>			<b>34,112,850</b>
<b>Common Stocks – 0.9%</b>			
<b>Banking – 0.9%</b>			
Happy Bancshares, Inc.	Equity Security - Private Placement, 144A <sup>(4)(6)(7)</sup>	44,000	1,326,160
<b>Total Common Stocks (Cost \$1,001,000)</b>			<b>1,326,160</b>
<b>Limited Partnership Interest – 0.6%</b>			
<b>Banking – 0.6%</b>			
Priam Capital Fund I, L.P.	Private Placement of Limited Partnership Interest <sup>(6)(7)*</sup>	\$ 1,000,000	846,000
<b>Total Limited Partnership Interest (Cost \$1,003,317)</b>			<b>846,000</b>
<b>Total Long Term Investments (Cost \$166,342,927)</b>			<b>163,682,729</b>

Company <sup>(1)</sup>	Investment	# of Shares/Par Amount (\$) <sup>(2)</sup>	Fair Value <sup>(3)</sup>
<b>Short-Term Investment – 2.3%</b>			
Morgan Stanley Institutional Liquidity Funds – Treasury Portfolio	Institutional Share Class	3,228,817	\$ 3,228,817
<b>Total Short-Term Investment (Cost \$3,228,817)</b>			<b>3,228,817</b>
<b>Total Investments (Cost \$169,571,744)<sup>(8)(9)†</sup> - 118.3%</b>			<b>166,911,546</b>
<b>Other assets and liabilities, net - (18.3)%<sup>(10)</sup></b>			<b>(25,862,048)</b>
<b>Total Net Assets - 100.0%</b>			<b>\$ 141,049,498</b>

<sup>(1)</sup> We do not "control" and are not an "affiliate" of any of our investments, each as defined in the Investment Company Act (the "1940 Act").

<sup>(2)</sup> \$ represents security position traded in par amount.

<sup>(3)</sup> Fair Value is determined in good faith in accordance with the Company's valuation policy and is reviewed and accepted by the Company's Board of Directors.

<sup>(4)</sup> Security is exempt from registration under Rule 144A of the Securities Act of 1933.

<sup>(5)</sup> The preferred shares are considered an equity position in the credit securitization. Equity investments are entitled to recurring distributions which are generally equal to the remaining cash flow of the payments made by the underlying company's securities less contractual payments to debt holders and company expenses. The estimated effective yield indicated is based upon a current projection of the amount and timing of these recurring distributions and the estimated amount of repayment of principal upon termination. Such projections are periodically reviewed and adjusted as needed. The estimated effective yield may ultimately not be realized.

<sup>(6)</sup> Currently non-income producing security.

<sup>(7)</sup> Investments determined using significant unobservable inputs (Level 3). (see Note 2). The value of such securities is \$2,172,160 or 1.5% of net assets.

<sup>(8)</sup> Investments are income producing assets unless otherwise noted by footnote (6).

<sup>(9)</sup> Cost values reflect accretion of original issue discount or market discount, and amortization of premium.

<sup>(10)</sup> Includes \$25,750,000 in bank loans from Texas Capital Bank.

+ The Limited Partnership is an entity organized solely for the purpose of investing in First Mariner Bank.

\* As of December 31, 2017, this investment has deferred, undeclared and compounding dividends of \$1,334,381 that will be recognized by StoneCastle Financial Corp. once they are declared by Chicago Shore Corporation.

\*\* As of December 31, 2017, this investment has deferred, undeclared and compounding dividends of \$31,275 that will be recognized by StoneCastle Financial Corp. once they are declared by Chicago Shore Corporation.

† As of December 31, 2017, the cost basis of investment securities owned was substantially identical for both book and tax purposes. Gross unrealized appreciation of investments was \$891,423 and gross unrealized depreciation was \$3,549,467, resulting in net unrealized depreciation of \$2,658,044.

\* The following is a listing of the underlying unsecured loans, subordinated debentures and notes that were made by Community Funding CLO, Ltd. See Notes to Financial Statements for additional information on StoneCastle Financial Corp's. investment in Community Funding CLO, Ltd.

<b>Bank Name</b>	<b>Principal Amount</b>	<b>State</b>	<b>Bank Name</b>	<b>Principal Amount</b>	<b>State</b>
Progress Financial Corporation	\$ 5,500,000	Alabama	InterMountain Bancorp, Inc.	\$ 7,500,000	Montana
Cornerstone Community Bancorp	5,000,000	California	First State Holding Co.	9,350,000	Nebraska
Bankwell Financial Group	7,500,000	Connecticut	Highlands Bancorp, Inc.	7,500,000	New Jersey
SBT Bancorp, Inc.	7,500,000	Connecticut	Country Bank Holding Co., Inc.	7,500,000	New York
Biscayne Bancshares, Inc.	7,500,000	Florida	Pathfinder Bancorp, Inc.	10,000,000	New York
Idaho Trust Bancorp	5,000,000	Idaho	Quontic Bank Holdings Corporation	3,000,000	New York
Bancorp Financial, Inc.	12,500,000	Illinois	MidWest Community Financial Corp.	7,500,000	Oklahoma
Freeport Bancshares, Inc.	3,150,000	Illinois	Myers Bancshares, Inc.	10,000,000	Oklahoma
Market Street Bancshares, Inc.	7,500,000	Illinois	First Resource Bank	2,000,000	Pennsylvania
First Internet Bancorp	10,000,000	Indiana	Victory Bancorp, Inc.	5,000,000	Pennsylvania
Treynor Bancshares, Inc.	12,500,000	Iowa	Sandhills Holding Company, Inc.	8,500,000	South Carolina
Freedom Bancshares, Inc.	2,000,000	Kansas	First Citizens Bancshares, Inc.	10,000,000	Texas
Williams Holding Company, Inc.	1,000,000	Kansas	Happy Bancshares, Inc.	7,500,000	Texas
CB&T Holding Corp.	12,500,000	Louisiana	Linden Bancshares, Inc.	4,000,000	Texas
Delmar Bancorp	2,000,000	Maryland	First National Corporation	5,000,000	Virginia
Citizens Bancshares	12,500,000	Missouri	FS Bancorp, Inc.	10,000,000	Washington
First Bancshares, Inc.	2,500,000	Missouri	Partnership Community Bancshares	7,000,000	Wisconsin
Security State Bancshares, Inc.	12,500,000	Missouri			
			<b>Total</b>	<b>\$ 250,000,000</b>	

# StoneCastle Financial Corp.

As of December 31, 2017

## Geographic Distribution of Bank Issuers<sup>(1)</sup> (unaudited)

State	% of Total Investments <sup>(2)</sup>	State	% of Total Investments <sup>(2)</sup>
Alabama	0.60%	Missouri	13.73%
Arkansas	0.02%	Montana	0.81%
California	8.17%	Nebraska	1.04%
Colorado	2.49%	New Jersey	3.90%
Connecticut	1.61%	New York	5.03%
Florida	9.60%	North Carolina	0.39%
Georgia	0.74%	North Dakota	0.02%
Illinois	6.03%	Ohio	0.01%
Indiana	9.19%	Oklahoma	3.43%
Iowa	3.18%	Pennsylvania	0.78%
Kansas	2.21%	South Carolina	0.92%
Kentucky	0.01%	Tennessee	0.09%
Louisiana	1.38%	Texas	4.65%
Maine	6.05%	Virginia	0.58%
Maryland	0.96%	Washington	1.10%
Massachusetts	0.01%	West Virginia	0.16%
Michigan	1.57%	Wisconsin	8.79%
Minnesota	0.72%		
Mississippi	0.03%		
			<u>100.0%</u>



<sup>(1)</sup> The term "Bank Issuers" as used herein refers to banks or holding companies thereof and includes issuers in which we have direct and indirect investments. Includes Community Funding CLO, Ltd.

<sup>(2)</sup> For purposes of this table the calculation of the percentage of total Long-Term Investments are based on the Bank Issuers in which SCFC directly and indirectly holds investments. With respect to direct investments that are secured by obligations issued by Bank Issuers (each a "Secured Bond"), the percentage was calculated by prorating the market value of the Secured Bond among the obligations issued by the underlying Bank Issuers that collateralize such Secured Bond and dividing each such amount by total Long-Term Investments.

# Financial Statements

## Statement of Assets and Liabilities As of December 31, 2017

<b>Assets</b>	
Investments in securities, at fair value (Cost \$169,571,744)	\$ 166,911,546
Cash (see Note 7)	30,142
Interest and dividends receivable	2,435,308
Prepaid assets	1,053,360
<b>Total assets</b>	<b>170,430,356</b>
<b>Liabilities</b>	
Loan payable (see Note 7)	25,750,000
Dividends payable	2,486,070
Investment advisory fees payable	751,761
Loan interest payable	51,901
Directors' fees payable	13,326
Accrued expenses payable	327,800
<b>Total liabilities</b>	<b>29,380,858</b>
<b>Net Assets</b>	<b>\$ 141,049,498</b>
<b>Net assets consist of:</b>	
Common stock, at par (\$0.001 per share)	\$ 6,542
Paid-in capital	144,858,951
Accumulated net investment loss	(1,078,833)
Accumulated net realized loss on investments	(76,964)
Net unrealized depreciation on investments	(2,660,198)
<b>Net Assets</b>	<b>\$ 141,049,498</b>
<b>Net asset value per share</b>	
Common Stock Shares Outstanding	6,542,289
Net asset value per common share	\$ 21.56
Market price per share	\$ 20.13
Market price discount to net asset value per share	-6.63%

## Statement of Operations For the Year Ended December 31, 2017

This Statement of Operations summarizes the Company's investment income earned and expenses incurred in operating the Company. It also shows net gains (losses) for the period stated.

<b>Investment Income</b>	
Interest	\$ 13,121,426
Dividends	3,831,208
Origination fee income	170,054
Other income (Note 2)	250,000
<b>Total investment income</b>	<b>17,372,688</b>
<b>Expenses</b>	
Investment advisory fee	3,207,923
Interest expense	1,765,157
Professional fees	418,623
Transfer agent, custodian fees and administrator fees	259,205
Bank Fees	241,139
ABA marketing and licensing fees	216,667
Directors' fees	205,500
Investor relations fees	123,800
Delaware franchise tax	90,000
Insurance expense	72,400
Valuation service fees	60,000
Printing fees	55,000
Miscellaneous fees (proxy, printing, rating agency, etc.)	187,274
<b>Total expenses</b>	<b>6,902,688</b>
Plus: Advisory fee recaptured (Note 3)	115,000
<b>Total expenses after recapture</b>	<b>7,017,688</b>
<b>Net investment income</b>	<b>10,355,000</b>
<b>Realized and Unrealized Gain on Investments</b>	
Net realized gain on investments	600,956
Net change in net unrealized depreciation on investments	1,073,783
<b>Net realized and unrealized gain on investments</b>	<b>1,674,739</b>
<b>Net Increase in Net Assets Resulting From Operations</b>	<b>\$ 12,029,739</b>

## Statements of Changes In Net Assets

These statements of changes in net assets show how the value of the Company's net assets has changed during the last two periods. The difference reflects earnings less expenses, any investment gains and losses, distributions, if any, paid to shareholders and the net of Company share transactions.

	For the Year Ended December 31, 2017	For the Year Ended December 31, 2016
<b>Increase (Decrease) in Net Assets</b>		
<b>From Operations</b>		
Net investment income	\$ 10,355,000	\$ 10,175,245
Net realized gain on investments	600,956	327,807
Net change in unrealized appreciation/(depreciation) on investments	<u>1,073,783</u>	<u>(3,489,006)</u>
<b>Net increase in net assets resulting from operations</b>	<b>12,029,739</b>	<b>7,014,046</b>
<b>Distributions to shareholders</b>		
From net investment income	<u>(9,806,183)</u>	<u>(9,521,907)</u>
<b>Total distributions</b>	<b>(9,806,183)</b>	<b>(9,521,907)</b>
<b>From Company share transactions</b>		
Reinvestment of distributions	<u>270,736</u>	<u>293,147</u>
<b>Increase in net assets resulting from Company share transactions</b>	<b>270,736</b>	<b>293,147</b>
<b>Total increase/(decrease)</b>	<b>2,494,292</b>	<b>(2,214,714)</b>
<b>Net assets</b>		
<b>Beginning of year</b>	<u>138,555,206</u>	<u>140,769,920</u>
<b>End of year<sup>1</sup></b>	<b>\$ 141,049,498</b>	<b>\$ 138,555,206</b>
<b>Shares outstanding</b>		
Beginning of year	6,528,105	6,510,953
Reinvestment of distributions	<u>14,184</u>	<u>17,152</u>
<b>End of year</b>	<b>6,542,289</b>	<b>6,528,105</b>

<sup>1</sup> Includes accumulated net investment loss of (\$1,078,833) and (\$1,625,496), respectively.

## Statement of Cash Flow

This Statement of Cash Flows shows cash flow from operating and financing activities for the period stated.

	For the Year Ended December 31, 2017
<b>Cash flows from operating activities</b>	
Net increase in net assets from operations	\$ 12,029,739
<b>Adjustments to reconcile net increase in net assets from operations to net cash provided by operating activities:</b>	
Purchase of investment securities	(29,515,406)
Proceeds from sales and redemption of investment securities	62,327,500
Net purchase of short-term investments	(570,469)
Net realized gain on investments	(600,956)
Net change in unrealized depreciation on investments	(1,073,783)
Net accretion of premium	3,220
Increase in prepaid expenses	(251,957)
Decrease in interest receivable and dividends receivable	1,455,172
Decrease in payable for securities purchased	(2,252,539)
Decrease in advisory fees payable	(39,146)
Decrease in loan interest payable	(18,424)
Decrease in accrued fees payable	(13,496)
<b>Net cash provided by operating activities</b>	<b>41,479,455</b>
<b>Cash flows from financing activities</b>	
Decrease in loan payable	(35,750,000)
Cash distributions to shareholders	(9,464,776)
<b>Net cash used by financing activities</b>	<b>\$ (45,214,776)</b>
Net decrease in cash	(3,735,321)
<b>Cash:</b>	
Beginning of year	3,765,463
End of year	<b>\$ 30,142</b>
<b>Supplemental disclosure of cash flow information</b>	
<b>Cash paid for interest</b>	<b>\$ 1,783,581</b>
<b>Distributions reinvested</b>	<b>\$ 270,736</b>

# Financial Highlights

The financial highlights show how the Company's net asset value for a common stock share has changed during the period.

	For the Year Ended December 31, 2017	For the Year Ended December 31, 2016	For the Year Ended December 31, 2015	For the Year Ended December 31, 2014	For the Period Ended December 31, 2013†
<b>Per share operating performance</b>					
Net Asset value, beginning of year	\$ 21.22	\$ 21.62	\$ 21.86	\$ 23.07	\$ 23.49 <sup>1</sup>
Net investment income/(loss) <sup>2</sup>	1.58	1.56	1.44	0.84	(0.09)
Net realized and unrealized gain (loss) on investments <sup>2</sup>	0.26	(0.50)	(0.17)	0.01	(0.05)
Offering costs <sup>2</sup>	—	—	—	(0.06)	—
<b>Total from investment operations</b>	<b>1.84</b>	<b>1.06</b>	<b>1.27</b>	<b>0.79</b>	<b>(0.14)</b>
<b>Less distributions to shareholders</b>					
From net investment income	(1.50)	(1.46)	(1.29)	(1.22)	(0.28)
Return of capital	—	—	(0.22)	(0.78)	—
<b>Total distributions</b>	<b>(1.50)</b>	<b>(1.46)</b>	<b>(1.51)</b>	<b>(2.00)</b>	<b>(0.28)</b>
<b>Net asset value, end of year</b>	<b>\$ 21.56</b>	<b>\$ 21.22</b>	<b>\$ 21.62</b>	<b>\$ 21.86</b>	<b>\$ 23.07</b>
<b>Per share market value, end of year</b>	<b>\$ 20.13</b>	<b>\$ 18.69</b>	<b>\$ 16.30</b>	<b>\$ 19.47</b>	<b>\$ 24.56</b>
<b>Total investment return based on market value<sup>3</sup></b>	<b>16.21%</b>	<b>24.45%</b>	<b>(8.68)%</b>	<b>(13.59)%</b>	<b>(0.62)%*</b>
<b>Total investment return based on net asset value<sup>3</sup></b>	<b>9.62%</b>	<b>6.53%</b>	<b>7.88%</b>	<b>3.28%</b>	<b>(0.65)%*</b>
<b>Ratios and supplemental data</b>					
Net assets end of period (in millions)	\$ 141.0	\$ 138.6	\$ 140.8	\$ 142.1	\$ 108.3
Ratios (as a percentage of average net assets):					
Expenses before waivers and/or recoupment, if any <sup>4</sup>	4.93%	5.02%	4.87%	3.73%	3.04%**
Expenses after waivers and/or recoupment, if any <sup>5,6</sup>	5.01%	4.94%	4.50%	3.73%	3.04%**
Net investment income/(loss) <sup>7</sup>	7.39%	7.33%	6.56%	3.41%	(3.00)**
Portfolio turnover rate	16%	34%	101%	30%	81%*
<b>Revolving credit agreement</b>					
Total revolving credit agreement outstanding (000s)	\$ 25,750	\$ 61,500	\$ 25,000	\$ 22,500	\$ —
Asset Coverage per \$1,000 for revolving credit agreement <sup>8</sup>	6,478	3,253	6,631	7,317	—

<sup>1</sup> Net asset value at beginning of period reflects a deduction of \$1.51 per share of sales load and offering expense from the initial public offering price of \$25 per share.

<sup>2</sup> The net investment income, unrealized gain/(loss) on investments and offering costs per share was calculated using the average shares outstanding method.

<sup>3</sup> Based on share market price and reinvestment of distributions at the price obtained under the Dividend Reinvestment Plan. Total return does not include sales load and offering expenses.

<sup>4</sup> Ratio of expenses before waivers or recapture, if any to managed assets equals 3.67%, 3.58% and 3.62% for the years ended December 31, 2017, 2016 and 2015, respectively.

<sup>5</sup> Ratio of expenses after waivers or recapture, if any to managed assets equals 3.73%, 3.52% and 3.35% for the years ended December 31, 2017, 2016 and 2015, respectively.

<sup>6</sup> Excluding interest expense, net operating expenses would have been 3.75%, 3.74% and 3.54% for the years ended December 31, 2017, 2016 and 2015, respectively.

<sup>7</sup> Ratio of net investment income to managed assets equals 5.51%, 5.23% and 4.88% for the years ended December 31, 2017, 2016 and 2015, respectively.

<sup>8</sup> Calculated by subtracting the Company's total liabilities (excluding the loan) from the Company's total assets and dividing that amount by the loan outstanding in 000's.

\* Not-annualized.

\*\* Annualized.

† The Company commenced operations on November 13, 2013.

# Notes to Financial Statements

## **Note 1 — Organization**

StoneCastle Financial Corp. ("SCFC" or the "Company") is a Delaware corporation registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended, (the "Investment Company Act") which commenced investment operations on November 13, 2013. In addition, SCFC has elected to be treated for tax purposes as a regulated investment company, or "RIC" under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"). As an investment company, the Company follows the accounting and reporting guidance of the Financial Accounting Standards Board and the Accounting Standards Codification Topic 946 "Financial Services — Investment Companies."

SCFC's primary investment objective is to provide stockholders with current income, and to a lesser extent capital appreciation. We attempt to achieve our investment objectives through investments in preferred equity, subordinated debt, convertible securities and, to a lesser extent, common equity primarily in the U.S. community bank sector. We may also invest in similar securities of larger U.S. domiciled banks and companies that provide goods and/or services to banking companies. Together with banks, we refer to these types of companies as banking-related and intend, under normal circumstances, to invest at least 80% of the value of our net assets plus the amount of any borrowings for investment purposes in such businesses. There is no guarantee that we will achieve our investment objective.

## **Note 2 — Significant accounting policies**

The following is a summary of significant accounting policies consistently followed by SCFC in the preparation of its financial statements. The preparation of the financial statements is in conformity with U.S. generally accepted accounting principles ("U.S.GAAP") and requires the Board of Directors, inclusive of the sub-committees, and the Advisor to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents** — SCFC considers all highly liquid debt instruments with a maturity of three months or less at the time of purchase to be cash equivalents.

**Investment Valuation** — The most significant estimates made in the preparation of the Company's financial statements are the valuation of equity and debt investments and the effective yield calculation with respect to certain debt securities, as well as the related amounts of unrealized appreciation and depreciation of investments recorded. The Company believes that there is no single definitive method for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments that SCFC makes. The Company is required to specifically fair value each individual investment on a quarterly basis.

The Company complies with ASC 820-10, Fair Value Measurements and Disclosure, which establishes a three-level valuation hierarchy for disclosure of fair value measurements. ASC 820-10 clarified the definition of fair value and requires companies to expand their disclosure about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. ASC 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e. the "exit price") in an orderly transaction between market participants at the measurement date. ASC 820-10 also establishes the following three-tier fair value hierarchy:

- Level 1 — Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access;
- Level 2 — Observable inputs other than quoted prices included in level 1 that are observable for the asset or liability either directly or indirectly. These inputs may include quoted prices for the identical instrument on an active market, prices for similar instruments, interest rates, prepayment speeds, credit risk, yield curves, default rates, and similar data; and
- Level 3 — Unobservable inputs for the asset or liability to the extent that relevant observable inputs are not available, representing the Company's own assumptions about the assumptions that a market participant would use in valuing the asset or liability, and that would be based on the best information available.

To the extent securities owned by the Company are actively traded and valuation adjustments are not applied, they are categorized in Level 1 of the fair value hierarchy. Securities traded on inactive markets or valued by reference to similar instruments are generally categorized in Level 2 of the fair value hierarchy.

The availability of valuation techniques and observable inputs can vary from security to security and is affected by a wide variety of factors including the type of security, whether the security is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Those estimated values do not necessarily represent the amounts that may be ultimately realized due to the occurrence of future circumstances that cannot be reasonably determined. Because of the inherent uncertainty of valuation, those estimated values may be materially higher or lower than the values that would have been used had a ready market for the securities existed. Accordingly, the degree of judgment exercised by SCFC in determining fair value is greatest for securities categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement. The valuation levels are not necessarily an indication of the risk associated with investing in those securities.

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, SCFC's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. SCFC uses prices and

inputs that are current as of the measurement date, including periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many securities. This condition could cause a security to be reclassified to a lower level within the fair value hierarchy.

SCFC will determine fair value of its assets and liabilities in accordance with valuation procedures adopted by its Board of Directors. The Company may utilize the services of one or more regionally or nationally recognized independent valuation firms to help it determine the value of each investment for which a market price is not available. SCFC's Board will also review valuations of such investments provided by the Advisor. Securities for which market quotations are readily available shall be valued at "market value." If a market value cannot be obtained or if SCFC's Advisor determines that the value of a security as so obtained does not represent a fair value as of the measurement date (due to a significant development subsequent to the time its price is determined or otherwise), fair value shall be determined pursuant to the methodologies established by our Board of Directors. In making these determinations, the Company may engage an independent valuation firm from time to time to assist in determining the fair value of our investments. The methods for valuing these investments may include fundamental analysis, discounts from market prices of similar securities, purchase price of securities, subsequent private transactions in the security or related securities, or discounts applied to the nature and duration of restrictions on the disposition of the securities, as well as a combination of these and other factors.

**Investment in Credit Securitization.** On October 15, 2015, SCFC made an investment in Community Funding CLO, Ltd. ("Community Funding") a credit securitization. SCFC purchased \$45.5 million of Preferred Shares issued by Community Funding.

Community Funding was structured in two tranches: \$205.0 million of senior secured Class A Notes rated A3 by Moody's Investors Service and \$45.5 million of unrated Preferred Shares, for a total issuance of \$250.5 million. The collateral has an average yield of 7.00% and the Class A Notes initially pay a fixed rate coupon of 5.75%. The net proceeds were primarily used to fund direct capital investments into 35 community and regional banks from 24 different states. The capital issued to the banks was predominantly in the form of subordinated loans that rank senior in priority to Trust Preferred Securities, TARP, SBLF, Preferred Shares and Common Shares.

SCFC was the sole purchaser of the \$45.5 million Preferred Shares, funding their purchase with portfolio securities and cash. Income received by SCFC from its investments in the Preferred Shares is characterized as ordinary income. Income from the investment in Community Funding is recorded based upon an estimate of effective yield to maturity utilizing assumed cash flows. SCFC monitors the expected cash flows from its investment in Community Funding and the effective yield is determined and updated as needed. The Preferred Shares receive the remaining cash flows generated from the pooled transaction after expenses are paid. Expenses consist of administrative expenses and interest expense on the Class A notes, as well as, a service fee paid to StoneCastle Investment Management, LLC, an affiliate of StoneCastle Asset Management, StoneCastle Financial Corp.'s advisor. StoneCastle Asset Management, LLC ("The Servicer") rebates the entire service fee to SCFC quarterly. For the year ended December 31, 2017 this amounted to \$250,000.

The fair value of the credit securitization is determined using market price quotations (where observable) and other observable market inputs. When using market price quotations from brokers, fair value is calculated using the average of two or more indicative broker quotes obtained as of the valuation date. When quotations are unobservable, internal valuation models (typically including discounted cash flow analysis and comparable analysis) are employed. Credit securitizations are generally categorized as Level 2 or 3 in the fair value hierarchy, depending on the availability of broker quotes and observable inputs. At December 31, 2017, SCFC's investment in Community Funding was valued on the basis of the average of two broker quotes.

**Preferred and Trust Preferred Securities.** The fair value of preferred securities and trust preferred securities is generally determined using market price quotations (where observable) and other observable market inputs (including recently executed transactions). When using market price quotations from brokers, fair value is calculated using the average of two or more indicative broker quotes obtained as of the valuation date. When quotations are unobservable, internal valuation models (typically including discounted cash flow analysis and comparable analysis) are employed. Perpetual preferred securities are generally categorized as Level 2 or 3 in the fair value hierarchy, depending on the availability of observable inputs.

**Debt Securities.** Under procedures established by our Board of Directors, we value secured debt, unsecured debt, senior term loans, subordinated term loans and other debt securities, for which market quotations are readily available, at such market quotations (unless they are deemed not to represent fair value). We attempt to obtain market quotations from at least two brokers if available. If not available or when market quotations are deemed not to represent fair value, we typically utilize independent third party valuation firms to assist us in determining fair value. Our independent valuation firms consider observable market inputs together with significant unobservable inputs in arriving at their valuation recommendations for such Level 2 and Level 3 categorized assets. Investments that are not publicly traded or whose market quotations are not readily available are valued at fair value as determined in good faith by or under the direction of our Board of Directors. Such determination of fair values may involve subjective judgments and estimates.

**Equity Securities.** SCFC may invest in equity securities (including exchange traded funds) for which bid and ask prices can be observed in the marketplace. Bid prices reflect the highest price that the marketplace participants are willing to pay for an asset. Ask prices represent the lowest price that the marketplace participants are willing to accept for an asset. The Company's policy for listed securities for which no sale was reported on that date is generally to value the security using the last reported "bid" price if held long, and last reported "ask" price if sold short. Equity securities are generally categorized as Level 1 or 2 in the fair value hierarchy, depending on trading volume levels.

The Company's assets measured at fair value at December 31, 2017, were as follows:

	TOTAL FAIR VALUE AT 12-31-17	LEVEL 1 QUOTED PRICE	LEVEL 2 SIGNIFICANT OBSERVABLE INPUTS	LEVEL 3 SIGNIFICANT UNOBSERVABLE INPUTS
<b>Term Loans</b>	\$ 49,032,500	\$ —	\$ 49,032,500	\$ —
<b>Debt Securities</b>	8,155,730	—	8,155,730	—
<b>Trust Preferred Securities</b>	24,934,464	—	24,934,464	—
<b>Credit Securitizations</b>	45,275,025	—	45,275,025	—
<b>Preferred Stock</b>	34,112,850	—	34,112,850	—
<b>Common Stocks</b>	1,326,160	—	—	1,326,160
<b>Limited Partnership Interest</b>	846,000	—	—	846,000
<b>Short-Term Investments</b>	3,228,817	3,228,817	—	—
<b>Total Investments in Securities</b>	\$ 166,911,546	\$ 3,228,817	\$ 161,510,569	\$ 2,172,160

The Level 3 categorized assets listed above have been valued via the use of a) independent third party valuation firms, or, b) fair valued as determined in good faith by the Board of Directors, in accordance with procedures established by the Board of Directors.

For fair valuations using significant unobservable inputs, U.S. GAAP requires SCFC to present reconciliation of the beginning to ending balances for reported market values that presents changes attributable to total realized and unrealized gains or losses, purchase and sales, and transfers in and out of Level 3 during the period. Transfers in and out between levels are based on values at the end of a period. U.S. GAAP also requires SCFC to disclose amounts and reasons for all transfers in and out of Level 1 and Level 2 fair value measurements. A reconciliation of Level 3 investments is presented below:

	COMMON STOCK	LIMITED PARTNERSHIP INTEREST	TOTAL
<b>Balance at December 31, 2016</b>	\$ 3,310,256	\$ 896,500	\$ 4,206,756
Realized gains including earnings	442,657	—	442,657
Unrealized appreciation/ (depreciation) on investments	(482,896)	(50,500)	(533,396)
Purchases	—	—	—
Sales	(1,943,857)	—	(1,943,857)
Transfers in	—	—	—
Transfers out	—	—	—
<b>Balance at December 31, 2017</b>	\$ 1,326,160 <sup>(1)</sup>	\$ 846,000 <sup>(1)</sup>	\$ 2,172,160

<sup>(1)</sup> Value based on price to book valuation analysis.

The change in unrealized appreciation on Level 3 securities still held as of December 31, 2017 was \$(533,396).

	FAIR VALUE AT 12-31-17	VALUATION TECHNIQUES	UNOBSERVABLE INPUTS	ASSUMPTIONS	IMPACT TO VALUATION FROM AN INCREASE TO INPUT
Common Stock	\$ 1,326,160	Prior transaction analysis	Price to book ratio	1.45	Increase in observable input will increase the value
			Discount for transaction costs	3%	Increase in observable input will decrease the value
Limited Partnership Interest	\$ 846,000	Prior transaction analysis	Price to book ratio	0.96	Increase in observable input will increase the value
			Discount for transaction costs	3%	Increase in observable input will decrease the value
	<u>\$ 2,172,160</u>				

**Securities Transactions, Investment Income and Expenses** — Securities transactions are recorded on trade date for accounting and financial statement preparation purposes. Realized gains and losses on investments sold are recorded on the identified cost basis. Interest income is recorded on the accrual basis. Accretion of discounts and amortization of premiums are recorded on a daily basis using the effective yield method except for short term securities, which records discounts and premiums on a straight-line basis. Dividends are recorded on the ex-dividend date.

**Dividends and Distributions to Shareholders** — Dividends from net investment income, if any, are declared and paid quarterly. Distributions, if any, of net short-term capital gain and net capital gain (the excess of net long-term capital gain over the short-term capital loss) realized by SCFC, after deducting any available capital loss carryovers are declared and paid to shareholders at least annually. Income dividends and capital gain distributions are determined in accordance with U.S. federal income tax regulations, which may differ from U.S. GAAP. These differences include the treatment of non-taxable dividends, losses deferred due to wash sales and excise tax regulations. Permanent book and tax basis differences relating to shareholder distributions will result in reclassifications within the components of net assets.

**Note 3 — Investment Advisory Fee and Other Fee Arrangements**

StoneCastle Asset Management, LLC ("Advisor"), a subsidiary of StoneCastle Partners, LLC ("StoneCastle Partners"), serves as investment advisor to SCFC pursuant to a management agreement with SCFC (the "Management Agreement"). For its services as the investment advisor, SCFC pays the Advisor a fee at the annual rate of 1.75% of total assets. SCFC will pay the management fee quarterly in arrears, and it will be equal to 0.4375% (1.75% annualized) of our assets at the end of such quarter, including cash and cash equivalents and assets purchased with borrowings.

Pursuant to an agreement between SCFC and the Advisor, the Advisor agreed to waive \$115,000 representing a portion of the management fee that would otherwise be payable to the Advisor for the quarter ended December 31, 2016. As per the agreement, this fee may be recaptured by the Adviser for a period of one year ending December 31, 2017 to the extent net income earned by SCFC exceeds \$0.39 per share in any quarter. This fee was recaptured in the quarter ended March 31, 2017.

SCFC currently pays each Director who is not an officer or employee of the Advisor a fee of \$55,000 per annum, plus \$1,500 for each in-person meeting of the Board of Directors or committee meeting. The chairman of SCFC's audit committee and the Lead Independent Director are each to be paid an additional amount not expected to exceed \$10,000 per year. Directors do not receive any pension or retirement plan benefits and are not part of any profit sharing plan. Interested Directors do not receive any compensation from SCFC. SCFC has incurred \$205,500 of Directors fees for the year ended December 31, 2017.

**Note 4 — Purchases and Sales and Redemptions of Securities**

For the year ended December 31, 2017, (i) the cost of purchases was \$29,515,406, (ii) the sales and redemptions of securities was \$62,327,500. At December 31, 2017, the aggregate cost basis of securities for federal income tax purposes was \$169,569,590 and the aggregate net unrealized depreciation for all securities in which there is an excess of tax cost over value was \$2,658,044 (gross unrealized appreciation \$891,423; gross unrealized depreciation \$3,549,467).

**Note 5 — Federal Tax Information**

The Company intends to operate so as to qualify to be taxed as a RIC under Subchapter M of the Internal Revenue Code and, as such, to not be subject to federal income tax on the portion of its taxable income and gains distributed to stockholders. To qualify for RIC tax treatment, SCFC is required to distribute at least 90% of its investment company taxable income, as defined by the Code.

Because federal income tax regulations differ from accounting principles generally accepted in the United States, distributions in accordance with tax regulations may differ from net investment income and realized gains recognized for financial reporting purposes. Differences may be permanent or temporary. Permanent differences are reclassified among capital accounts in the financial statement to reflect their tax character. Temporary differences arise when certain items of income, expense, gain or loss are recognized at some time in the future. Differences in classification may also result from the treatment of short-term gains as ordinary income for tax purposes.

SCFC has followed the authoritative guidance on accounting for and disclosure of uncertainty in tax positions, which requires SCFC to determine whether a tax position is more likely than not to be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. SCFC has determined that there was no effect on the financial statements from following this authoritative guidance. In the normal course of business, SCFC is subject to examination by federal, state and local jurisdictions, where applicable, for tax years for which applicable statutes of limitations have not expired.

In order to present net asset components on the Statement of Assets and Liabilities that more closely represent their tax character, certain reclassifications are made to the net asset components. Net assets, net investment income and net realized gains were not affected by

these adjustments. For the year ended December 31, 2017, these adjustments increased accumulated net investment loss by \$2,154 and decreased accumulated net realized loss by \$2,154. The primary reason for this reclassification relates to a prior year audit partnership income/loss reclass.

As of December 31, 2017, the components of distributable earnings on a tax basis were as follows:

<b>Capital Loss Carryforwards</b>	(\$ 79,118)
<b>Unrealized Depreciation</b>	(2,658,044)
<b>Other Temporary Differences</b>	(1,078,833)
<b>Total</b>	<u>(\$ 3,815,995)</u>

The Company utilized \$600,956 of short-term capital loss carry forwards and the other temporary differences consists of distributions payable.

For the year ended December 31, 2017, the tax character of distributions paid by the Company was \$9,735,512 of ordinary income dividends. For the year ended December 31, 2016, the tax character of distributions paid by the Company was \$9,385,342 of ordinary income dividends. Distributions from net investment income and short-term capital gains are treated as ordinary income for federal tax purposes.

The Company declared a \$0.37 per share dividend on March 10, 2017 and June 2, 2017 and \$0.38 per share dividend on September 8, 2017 and December 7, 2017, which was paid on March 29, 2017, June 29, 2017, September 28, 2017 and January 3, 2018, respectively.

At December 31, 2017, the federal tax cost, aggregate gross unrealized appreciation and depreciation of securities held by SCFC were as follows:

<b>Federal tax cost</b>	\$ 169,569,590
<b>Gross unrealized appreciation</b>	<u>891,423</u>
<b>Gross unrealized depreciation</b>	(3,549,467)
<b>Net unrealized depreciation</b>	<u>(\$ 2,658,044)</u>

Pursuant to federal income tax rules applicable to regulated investment companies, SCFC may elect to treat certain capital losses up to and including December 31 as occurring on the first day of the following tax year. For the period after October 31, 2017 and ending December 31, 2017, any amount of losses elected within the tax year will not be recognized for federal income tax purposes until 2018. For the year ended December 31, 2017, SCFC had no ordinary income or long-term capital loss deferrals.

Accumulated capital losses represent net capital loss carry forwards as of December 31, 2017 that may be available to offset future realized capital gains and thereby reduce future capital gains distributions. SCFC is permitted to carry forward capital losses incurred for an unlimited period. Additionally, capital losses that are carried forward will retain their character as either short-term or long-term capital losses. For the year ended December 31, 2017, SCFC had capital loss carryforwards of \$79,118 all of which are short-term capital losses.

#### **Note 6 — Risk Considerations**

Risks are inherent in all investing. The following summarizes some, but not all, of the risks that should be considered for the Company. For additional information about the risks associated with investing in the Company, please see the Company's prospectus as well as other Company regulatory filings.

**Investment and Market Risk** — An investment in the Company's common shares ("Common Shares") is subject to investment risk, including the possible loss of the entire principal invested. Common Shares at any point in time may be worth less than the original investment, even after taking into account the reinvestment of Company dividends and distributions. The Company expects to utilize leverage, which will magnify investment risk.

**Preferred and Debt Securities Risk** — Preferred and debt securities in which the Company invests are subject to various risks, including credit risk, interest rate risk, call/prepayment risk and reinvestment risk. In addition, preferred securities are subject to certain other risks, including deferral and omission risk, subordination risk, limited voting rights risk and special redemption rights risk.

**Credit Risk** — The Company is subject to credit risk, which is the risk that an issuer of a security may be unable or unwilling to make dividend, interest and principal payments when due and the related risk that the value of a security may decline because of concerns about the issuer's ability or willingness to make such payments.

**Leverage Risk** — The use of leverage by the Company can magnify the effect of any losses. If the income and gains from the securities and investments purchased with leverage proceeds do not cover the cost of leverage, the return on the Common Shares will be less than if leverage had not been used. Moreover, leverage involves risks and special considerations for holders of Common Shares including the likelihood of greater volatility of net asset value and market price of the Common Shares than a comparable portfolio without leverage, and the risk that fluctuations in interest rates on reverse repurchase agreements, borrowings and short-term debt or in the dividend rates on any preferred shares issued by the Company will reduce the return to the holders of Common Shares or will result in fluctuations in the dividends paid on the Common Shares. There is no assurance that a leveraging strategy will be successful. See Note 7 for additional information on leverage.

**Call/Prepayment and Reinvestment Risk** — If an issuer of a security exercises an option to redeem its issue at par or prepay principal earlier than scheduled, the Company may be forced to reinvest in lower yielding securities. A decline in income could affect the Common Shares' market price or the overall return of the Company.

**Risks of Concentration in the Banking industry/Financial Sector** — Because the Company concentrates in the banking industry and may invest up to 100% of its managed assets in the banking industry and financials sector, it will be more susceptible to adverse economic or regulatory occurrences affecting the banking industry and financials sector, such as changes in interest rates, loan concentration and competition.

**Regulatory Risk** — Financial institutions, including community banks, are subject to various state and federal banking regulations that impact how they conduct business, including but not limited to how they obtain funding. Changes to these regulations could have an adverse effect on their operations and operating results and our investments. We expect to make long-

term investments in financial institutions that are subject to various state and federal regulations and oversight. Congress, state legislatures and the various bank regulatory agencies frequently introduce proposals to change the laws and regulations governing the banking industry in response to the Dodd-Frank Act, Consumer Financial Protection Bureau (the "CFPB") rulemaking or otherwise. The likelihood and timing of any proposals or legislation and the impact they might have on our investments in financial institutions affected by such changes cannot be determined and any such changes may be adverse to our investments. Federal banking regulators recently proposed amended regulatory capital regulations in response to The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and Basel III protocols which would impose even more stringent capital requirements. In the event that a regulated bank falls below certain capital adequacy standards, it may become subject to regulatory intervention including, but not limited to, being placed into a FDIC-administered receivership or conservatorship. The effect of inadequate capital can have a potentially adverse consequence on the institution's financial condition, its ability to operate as a going concern and its ability to operate as a regulated financial institution and may have a material adverse impact on our investments.

**Interest Rate Risk** — The Company is subject to interest rate risk, which is the risk that the preferred and debt securities in which the Company invests will decline in value because of rising market interest rates.

**Convertible Securities/Contingent Convertible Securities Risk** — The market value of convertible securities tends to decline as interest rates increase and, conversely, tends to increase as interest rates decline. In addition, because of the conversion feature, the market value of convertible securities tends to vary with fluctuations in the market value of the underlying common stock. Contingent convertible securities provide for mandatory conversion into common stock of the issuer under certain circumstances. Since the common stock of the issuer may not pay a dividend, investors in these instruments could experience a reduced income rate, potentially to zero; and conversion would deepen the subordination of the investor, hence worsening standing in a bankruptcy. In addition, some such instruments have a set stock conversion rate that would cause a reduction in value of the security if the price of the stock is below the conversion price on the conversion date.

**Illiquid and Restricted Securities Risk** — Investment of the Company's assets in illiquid and restricted securities may restrict the Company's ability to take advantage of market opportunities. Illiquid and restricted securities may be difficult to dispose of at a fair price at the times when the Company believes it is desirable to do so. The market price of illiquid and restricted securities generally is more volatile than that of more liquid securities, which may adversely affect the price that the Company pays for or recovers upon the sale of such securities. Illiquid and restricted securities are also more difficult to value, especially in challenging markets. The risks associated with illiquid and restricted securities may be particularly acute in situations in which the Company's operations require cash and could result in the Company borrowing to meet its short-term needs or incurring losses on the sale of illiquid or restricted securities.

#### **Note 7 — Revolving Credit Agreement**

On June 9, 2014, the Company entered into a revolving credit agreement (the "Credit Agreement") with a syndicate of financial institutions led by Texas Capital Bank, N.A. (collectively, the "Syndicates") to borrow up to \$45,000,000. On January 16th, 2015 the Company closed an additional \$25 million on the Credit Agreement, which increased the maximum borrowing amount to \$70 million.

On May 25, 2017, the Company amended its Credit Agreement to the following terms:

- The Facility is now solely funded by Texas Capital Bank, located in Dallas, Texas.
- The cost of the Facility has decreased to a significantly lower credit spread of LIBOR+2.35%, down from Libor +2.85%.
- The maturity date of the facility has been extended for five years to May 16, 2022.
- The size of the Facility has been adjusted from \$70 million to \$62 million, reflecting the maximum amount the Company can borrow based on current assets and internal guidelines.
- In the prior facility, the Company was required to maintain a deposit account of \$3.5 million of cash with the lead lender. The \$3.5 million account is no longer required.

The Facility is rated "A3" by Moody's Investor Services. The Facility remains secured by substantially all of the assets of the Company.

As of December 31, 2017, \$25,750,000 has been committed and drawn and is at fair value. Such borrowings constitute financial leverage. The Agreement has a five year term and a stated maturity of May 2022 and was priced at LIBOR +2.35%. The Company is charged a fee of 0.50% on any undrawn commitment balance. The Credit Agreement contains customary covenants, negative covenants and default provisions, including covenants that limit the Company's ability to incur additional debt or consolidate or merge into or with any person, other than as permitted, or sell, lease or otherwise transfer, directly or indirectly, all or substantially all of its assets. The covenants also impose on the Company asset coverage requirements, which are more stringent than those imposed on the Company by the Investment Company Act, as well as the Company's policies. For the year ended December 31, 2017, the average daily loan balance was \$45,250,000 at a weighted average interest rate of 3.62%. With respect to these borrowings, interest of \$1,765,157 is included in the Statement of Operations.

#### **Note 8 — Indemnification**

In the normal course of business, SCFC may enter into contracts that provide general indemnifications. SCFC's maximum exposure under these arrangements is dependent on claims that may be made against SCFC in the future, and therefore, cannot be estimated; however, based on experience, the risk of material loss from such claims is considered remote.

Under the SCFC's organizational documents, its officers and directors are indemnified against certain liabilities arising out of the performance of their duties to SCFC.

#### **Note 9 — Origination Fees and Other Income**

Includes closing fees (or origination fees or structuring fees) associated with investments in portfolio companies. Such fees are normally paid at closing of the Company's investments, are fully earned and non-refundable, and are generally non-recurring. Other Income includes service fees earned from the Community Funding CLO, Ltd. credit securitization and due diligence fees. SCFC had closing fee income of \$170,054 and other income of \$250,000 for the year ended December 31, 2017.

**Note 10 — Capital Share Transactions**

As of December 31, 2017, 50,000,000 shares of \$0.001 par value capital stock were authorized. Of the authorized shares, SCFC is authorized to issue 40,000,000 shares of common stock and 10,000,000 shares of preferred stock. Prior to commencement of operations on November 13, 2013, SCFC issued 4,001 shares of common stock. On November 13, 2013, SCFC sold 4,400,000 shares of our common stock via an initial public offering at a price of \$25.00 per share. On December 3, 2013 and December 11, 2013 SCFC sold an additional 125,000 shares and 167,047 shares, respectively, of our common stock at a public offering price of \$25.00 per share pursuant to the underwriters' exercise of the over-allotment option. On November 7, 2014, SCFC sold an additional 1,600,000 shares via an initial public offering at a price of \$23.00 per share. On December 2, 2014, SCFC sold an additional 202,000 shares of our common stock at a public offering price of \$23.00 per share pursuant to the underwriters' exercise of the over-allotment option. Total shares issued and outstanding at December 31, 2017 were 6,542,289.

**Note 11 — Subsequent Events**

Management has evaluated the impact of all subsequent events on the company and has determined that there were no subsequent events requiring recognition or disclosure in the financial statements.

# Auditor's Report

## Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of  
StoneCastle Financial Corp.

### Opinion on the Financial Statements

We have audited the accompanying statement of assets and liabilities of StoneCastle Financial Corp. (the "Company"), including the schedule of investments, as of December 31, 2017, the related statement of operations for the year then ended, the statement of cash flows for the year then ended, the statements of changes in net assets for each of the two years in the period then ended, and the financial highlights for each of the three years in the period then ended, and the related notes (collectively referred to as the "financial statements"). The financial highlights for the year ended December 31, 2014 and for the period November 13, 2013 (commencement) to December 31, 2013 were each audited by other auditors, and in their opinions dated February 27, 2015 and February 24, 2014 (respectively), they each expressed unqualified opinions on said financial highlights. In our opinion, the financial statements present fairly, in all material respects, the financial position of StoneCastle Financial Corp. as of December 31, 2017, the results of its operations for the year then ended, its cash flows for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the financial highlights for each of the three years in the period then ended, in conformity with accounting principles generally accepted in the United States of America.

### Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We have served as the Company's auditor since 2015.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management,

as well as evaluating the overall presentation of the financial statements. Our procedures included confirmation of securities owned as of December 31, 2017 by correspondence with the custodian and brokers; when replies were not received from brokers, we performed other auditing procedures. We believe that our audits provide a reasonable basis for our opinion.

TAIT, WELLER & BAKER LLP  
Philadelphia, Pennsylvania  
February 26, 2018

# Dividends and Distributions

## Dividends and Distributions

Dividends from net investment income are declared and paid on a quarterly basis. Distributions of net realized capital gains, if any, will be made at least annually. It is the Company's policy to comply with the requirements of the Internal Revenue Code of 1986, as amended, applicable to "regulated investment companies" or "RICs" and to distribute substantially all of its taxable income to its shareholders. In order to provide shareholders with a more stable level of dividend distributions, the Company may at times pay out more or less than distributable income earned in any particular quarter. The Company's current accumulated but undistributed net investment income, if any, is disclosed in the Statement of Assets and Liabilities, which comprises part of the financial information included in this report. The character and timing of dividends and distributions are determined in accordance with federal income tax regulations, which may differ from U.S. GAAP.

## Summary of Dividends Declared in 2017

Period	Amount Declared
1st Quarter 2017	\$ 0.37
2nd Quarter 2017	\$ 0.37
3rd Quarter 2017	\$ 0.38
4th Quarter 2017	\$ 0.38
	<u>\$ 1.50</u>

## Dividend Reinvestment Plan

We have a common stock dividend reinvestment plan for our stockholders. Our plan is implemented as an "opt out" dividend reinvestment plan. As a result, if a stockholder participates in our Automatic Dividend Reinvestment Plan ("Plan") all distributions will automatically be reinvested in additional common stock (unless a stockholder is ineligible or elects otherwise). If a stockholder opts out of the Plan, such stockholder will receive distributions in cash. If a stockholder holds shares with a brokerage firm that does not participate in the Plan, the stockholder may not be able to participate in the Plan and any dividend reinvestment may be effected on different terms than those of the Plan.

In the case that newly issued shares of our common stock are used to implement the Plan, the number of shares of common stock to be delivered to a participating stockholder shall be determined by (i) dividing the total dollar amount of the dividends payable to such stockholder by (ii) 97% of the average market prices per share of common stock at the close of regular trading on the NASDAQ Global Select Market for the five trading days immediately prior to the valuation date to be fixed by our Board of Directors.

In the case that shares repurchased on the open market are used to implement the Plan, the number of shares of common stock to be delivered to a participating stockholder shall be determined by dividing (i) the total dollar amount of the dividends payable to such stockholder by (ii) the weighted average purchase price of such shares.

We intend to use primarily newly issued shares to implement the dividend reinvestment plan (so long as we are trading at a premium to net asset value). If our shares are trading at a significant enough discount to net asset value and we are otherwise permitted under applicable law to purchase such shares, we intend to purchase shares in the open market in connection with our obligations under our dividend reinvestment plan. However, we reserve the right to issue new shares of our common stock in connection with our obligations under the dividend reinvestment plan even if our shares are trading below net asset value. Automatically reinvesting dividends and distributions does not mean that a stockholder does not have to pay income taxes due upon receiving dividends and distributions. Capital gains and income are realized although cash is not received by the stockholder.

For further information or to opt-out of or withdraw from the Plan, contact the Plan Agent, Computershare Trust Company, N.A. by writing to 250 Royall Street, Canton, Massachusetts 02021.

# Tax Information

For federal income tax purposes, the following information is furnished with respect to the distributions of the Company, if any, paid during its taxable year ended December 31, 2017.

37.00% of ordinary income dividends paid qualify for the corporate dividends-received deduction.

Under the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "Act"), 37.00% of ordinary dividends paid during the fiscal year ended December 31, 2017 are designated as "qualified dividend income," as defined in the Act, and are subject to reduced tax rates.

Eligible shareholders were mailed a 2017 Form 1099-DIV in early 2018. This reflected the tax character of all distributions paid in calendar year 2017.

## Additional Information

### **Availability of Quarterly Schedule of Investments**

The Company files their complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The Company's Form N-Q is available on the SEC's website at <http://www.sec.gov> and may also be reviewed and copied at the SEC's Public Reference Room in Washington, DC. Information on how to access documents on the SEC's website without charge may be obtained by calling (800) SEC-0330. The Company's Form N-Q may also be obtained upon request and without charge by calling Investor Relations (212) 354-6500 or on the Company's website at [www.StoneCastle-Financial.com](http://www.StoneCastle-Financial.com).

### **Availability of Proxy Voting Policies and Procedures**

A description of the policies and procedures that the Company uses to determine how to vote proxies relating to portfolio securities is available (1) without charge, upon request, by calling Investor Relations (212) 354-6500; (2) at [www.StoneCastle-Financial.com](http://www.StoneCastle-Financial.com); and (3) on the SEC's website at <http://www.sec.gov>.

### **Availability of Proxy Voting Record**

Information about how the Company voted proxies relating to securities held in the Company's portfolio during the Annual period ended June 30 is available upon request and without charge (1) at [www.StoneCastle-Financial.com](http://www.StoneCastle-Financial.com) or by calling Investor Relations (212) 354-6500 and (2) on the SEC's website at <http://www.sec.gov>.

# Results of Stockholders Meeting

The Annual Meeting of Stockholders of StoneCastle Financial Corp (the “Company”) was held on July 5, 2017. A description of the proposal and number of shares voted at the Meeting are as follows:

**Proposal 1:**

To elect two Class I Directors of the Company, each to serve for a term ending at the 2020 Annual Meeting of Stockholders of the Company and when his or her successor is duly elected and qualified.

	Voted For	Withheld
Clara Miller	4,684,906	70,789
George Shilowitz	4,220,949	534,746

**Proposal 2:**

The Board to approve an Agreement and Plan of Reorganization pursuant to which the Company would be reorganized into a newly formed Delaware statutory trust.

For	Against	Abstain	Non Votes
2,349,937	37,183	35,573	2,333,002

# Board Approval of the Management Agreement

At a meeting held on September 7, 2017, the Company's Board of Directors, including those Directors who are not "interested persons" as such term is defined in the Investment Company Act of 1940 ("Independent Directors"), reviewed and unanimously approved the continuance of the management agreement (the "Management Agreement") between the Company and StoneCastle Asset Management, LLC (the "Advisor").

Prior to approval of the continuance of the Management Agreement, the Directors had requested from the Advisor, and received and evaluated, extensive materials. They reviewed the proposed continuance of the Management Agreement with experienced counsel who is independent of the Advisor, who advised on the relevant legal standards.

The Directors considered the services provided by the Advisor to the Company. The Directors considered the Advisor's personnel and the depth of the Advisor's personnel who possess the experience to provide investment management services to the Company. Based on the information provided by the Advisor, the Directors concluded that (i) the nature, extent and quality of the services provided by the Advisor are appropriate and consistent with the terms of the Management Agreement, (ii) the quality of those services has been consistent with industry norms, (iii) the Company is likely to benefit from the continued provision of those services by the Advisor, (iv) the Advisor has sufficient personnel, with the appropriate education and experience, to serve the Company effectively and has demonstrated its continuing ability to attract and retain qualified personnel, and (v) the satisfactory nature, extent, and quality of services currently provided to the Company and its stockholders is likely to continue. In addition, the Board noted the Advisor's expertise in, and numerous relationships with investment professionals within, the banking industry in which the Company concentrates.

The Directors considered the overall investment performance of the Advisor and the Company since the Advisor was appointed the Company's investment adviser in November 2013. The Directors reviewed and considered the Company's performance relative to a peer group of 32 registered closed-end investment companies ("CEIC") and business development companies ("BDCs") selected by the Advisor that operate in a similar manner as the Company (the "Peer Group") noting, however, the limited usefulness of such information in light of the Company's unique investment strategy and industry focus. The Directors also reviewed and considered the Company's performance based on market price and net asset value versus the performance of the Bloomberg Barclays Aggregate Bond Index (the "Aggregate Bond Index") and the Bloomberg Barclays US Corporate High Yield 2% Issuer Capped Index (the "High Yield Index") for the 12 months ended December 31, 2016, for the six months ended June 30, 2017 and since inception (November 13, 2013) through June 30, 2017. The Directors noted that the indices were selected by the Advisor for comparison purposes because the indices' constituents had similar characteristics to those securities in which the Company may invest but acknowledged that no index was likely to correspond to the Company's holdings in light of the Company's unique investment strategy. The Directors noted that: (a) based on net asset value, the Company outperformed both indices for the six months ended June 30, 2017

and since inception (November 13, 2013 through June 30, 2017), and underperformed the High Yield Index and outperformed the Aggregate Bond Index for the 12 months ended December 31, 2016; and (b) based on market price, the Company outperformed both indices for the 12 months ended December 31, 2016 and underperformed both indices since inception (November 13, 2013 through June 30, 2017) and outperformed both indices for the six months ended June 30, 2017. The Directors also noted their review and evaluation of the Company's investment performance on an on-going basis throughout the year. The Directors considered the consistency of performance results and the short-term and long-term performance of the Company and recognized that such performance was impacted by, among other things, the limited operating history of the Company, issuer prepayment and calls and the time lag required for the initial deployment and subsequent redeployments of assets. They concluded that the performance of the Company and the Advisor represented satisfactory performance in light of the Company's investment objective and strategy.

The Directors considered the costs of the services provided by the Advisor, the compensation and benefits received by the Advisor in providing services to the Company, as well as the Advisor's profitability. The Directors were provided with and had reviewed the Advisor's unaudited balance sheet and income statement for the six months ended June 30, 2017 and the year ended December 31, 2016. The Directors noted that the Advisor appeared to be a viable concern generally and as investment adviser of the Company specifically, notwithstanding that the Advisor's profitability analysis indicated that the Advisor was not currently earning a profit in its capacity as investment adviser to the Company. The Directors concluded that the Advisor's fees and profits (if any) derived from its relationship with the Company in light of the Company's expenses were reasonable in relation to the nature and quality of the services provided, taking into account the fees charged by other investment advisers of CEICs and BDCs in the Peer Group. The Directors noted that the Company's management fee was in line with the average and median management fee of the Peer Group and, specifically, with two registered CEICs in the Peer Group. The Directors also concluded that the overall expense ratio of the Company (lower than the peer group median and average) was reasonable, taking into account the size of the Company, the quality of services provided by the Advisor, and the investment performance of the Company. On the basis of these considerations, together, with the other information it considered, the Board determined that the advisory fee to be received by the Advisor is reasonable in light of the services provided.

The Directors considered the extent to which economies of scale would be realized relative to fee levels as the Company grows, and whether the advisory fee levels reflect these economies of scale for the benefit of stockholders. The Directors determined that economies of scale would be achieved at higher asset levels for the Company to the benefit of Company stockholders as fixed expenses are spread over a larger asset base, however, the Directors noted that the opportunity for asset growth was limited because the Company is a closed-end investment company currently trading at a discount to its NAV.

At this time the Board noted its deliberations regarding the Advisor's services and performance from the Board meetings held throughout the year and the executive sessions, highlighting the Board's discussion of the Company's investment objective, long-term performance, investment style and process and review of the written materials provided by the Advisor. The Board also noted the high level of diligence the Board exercised throughout the year in evaluating the Advisor, and the extensive information provided with respect to the Advisor's performance and the Company's expenses on a quarterly basis. The Directors considered

whether any events have occurred that would constitute a reason for the Directors not to renew the Management Agreement and determined that there were none.

The Board concluded that the investment advisory fee rate under the Management Agreement is reasonable in relation to the services provided and that continuation of the Management Agreement is in the best interests of the stockholders of the Company. The Directors also concluded that the investment advisory fees are at acceptable levels in light of the quality of services provided to the Company. On these bases, the Directors concluded that the investment advisory fees for the Company under the Management Agreement are reasonable. In arriving at their decision, the Directors did not identify any single matter as controlling, but made their determination in light of all the circumstances.

# Management

## Board of Directors and Executive Officers

Our business and affairs are managed under the direction of our board of directors. Accordingly, our board of directors provides broad supervision over our affairs, including supervision of the duties performed by our Advisor. Our Advisor is responsible for our day-to-day operations. The names, ages and addresses of our directors and officers and specified employees of our Advisor, together with their principal occupations and other affiliations during the past five years, are set forth below. Each director and officer will hold office for the term to which he is elected and until his successor is duly elected and qualifies, or until he resigns or is removed in the manner provided by law. Unless otherwise indicated, the address of each director is c/o StoneCastle Partners, 152 West 57th Street, 35th Floor, New York, New York 10019. Our board of directors will initially consist of three directors who are not “interested persons” (as defined in the Investment Company Act of 1940 (the “Investment Company Act”)) of our Advisor or its affiliates and two directors who are “interested persons.” Our directors who are not interested persons are also independent pursuant to the NASDAQ stock exchange listing standards, and we refer to them as “independent directors.” We refer to the directors who are “interested persons” (as defined in the Investment Company Act) are referred to below as “interested directors.” Under our certificate of incorporation, the board is divided into three classes. Each class of directors will hold office for a three-year term. However, the initial members of the three classes have initial terms of one, two and three years, respectively. At each annual meeting of our stockholders, the successors to the class of directors whose terms expire at such meeting will be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election and until their successors are duly elected and qualified.

## Interested Directors

Name	Age	Position(s) Held with Company	Term End	Principal Occupation(s) Last 5 Years	Other Directorships Last 5 Years
Joshua Siegel	46	Chairman of the Board & Chief Executive Officer	2018	Managing Partner and CEO of StoneCastle Partners, LLC	StoneCastle Partners, LLC; StoneCastle Cash Management, LLC
George Shilowitz	52	Director & President	2019	Managing Partner and Co-CEO of StoneCastle Partners, LLC; Senior Portfolio Manager of StoneCastle Partners, LLC	StoneCastle Partners, LLC

## Independent Directors

Name	Age	Position(s) Held with Company	Term End	Principal Occupation(s) Last 5 Years	Other Directorships Last 5 Years
Alan Ginsberg	56	Director, Chairman of Audit Committee	2019	Managing Director, Bank America Securities until 5/08; Partner, Change Investments 5/08 to 8/09; Senior Advisor, StoneCastle Partners 5/10 to 5/13; Managing Director Barclays Bank 8/2017 — Present	External Advisory Board of Peabody Museum at Yale University

<u>Name</u>	<u>Age</u>	<u>Position(s) Held with Company</u>	<u>Term End</u>	<u>Principal Occupation(s) Last 5 Years</u>	<u>Other Directorships Last 5 Years</u>
Emil Henry	57	Director, Member of Audit Committee and Lead Independent Director	2018	CEO and Founder of Tiger Infrastructure Partners	Chairman, Board of Director of Tiger Cool Express, Hudson Fiber Network, Easterly Government Properties, American National
Clara Miller	68	Director, Member of Audit Committee	2019	Non-Profit Finance Fund 10/84 to 3/11; The F.B. Heron Foundation 3/11 to 12/17	GuideStar, The Robert Sterling Clark Foundation, and Family Independence Initiative

#### Executive Officers Who are not Directors

<u>Name</u>	<u>Age</u>	<u>Position(s) Held with Company</u>	<u>Term Served</u>	<u>Principal Occupation(s) Last 5 Years</u>
Patrick J. Farrell	58	Chief Financial Officer	Since April 1, 2014	Chief Financial Officer of StoneCastle Partners, LLC from April 2014 to date; Chief Financial Officer of Emerging Managers Group, LP
Rachel Schatten	47	General Counsel, Chief Compliance Officer and Secretary	Since July 2013	General Counsel and Chief Compliance Officer of Hardt Group, General Counsel and Chief Compliance Officer of StoneCastle Partners, LLC

#### Biographical Information

##### *Interested Directors*

The following sets forth certain biographical information for our Interested Directors. An Interested Director is an “interested person” as defined in Section 2(a)(19) of the 1940 Act:

**Joshua S. Siegel.** Chief Executive Officer & Chairman of the Board. Mr. Siegel is the founder and Managing Partner of StoneCastle Partners and serves as its Chief Executive Officer. With over two decades of experience in financial services, 19 of which have been spent advising clients and investing in financial institutions or assets, he is widely regarded as a leading expert and investor in the banking industry and is often quoted in financial media, including The Wall Street Journal, The New York Times, American Banker, and CNNMoney. In addition, he speaks frequently at industry events, including those hosted by the American Bankers Association, Conference of State Bank Supervisors, FDIC, Federal Reserve Bank and SNL Financial. A creative instructor with a passion for teaching, Mr. Siegel has regularly been invited to educate government regulators about the specialized community banking sector. He also serves as Adjunct Professor at the Columbia Business School in New York City. Immediately prior to co-founding StoneCastle, Mr. Siegel was a co-founder and Vice President of the Global Portfolio Solutions Group at Citigroup, a group organized to finance portfolios of financial assets for corporations and to invest in the sector as a principal and market maker. He later assumed responsibility for developing new products, including pooled investment strategies for the community banking sector. Mr. Siegel originally joined Salomon Brothers in 1996 (which was merged into Travelers in 1998 and into Citigroup in 1999) in the tax and lease division, providing financing and advisory services to government-sponsored enterprises

and Fortune 500 corporations. Prior to his tenure at Citigroup, Mr. Siegel worked at Sumitomo Bank where he served as a corporate lending officer, as a banker managing equipment lease and credit derivative transactions, and as a member of the New York Credit Committee and at Charterhouse, carrying out merchant banking and private equity transactions. Mr. Siegel has provided strategic advice to the Global Food Banking Network. He also provides annual economic support to Prep for Prep to make sure academic brilliance is recognized and nurtured without regard to a student's economic, demographic or sociological impediments. He holds a B.S. in Management and Accounting from Tulane University.

**George Shilowitz.** President and Director. Mr. Shilowitz is a Managing Partner and Co-CEO of StoneCastle Partners and serves as the Senior Portfolio Manager of StoneCastle Partners. Mr. Shilowitz has two decades of fixed income and principal investment experience. Mr. Shilowitz worked with StoneCastle since its founding in 2003 and became a partner in 2007. Prior to joining StoneCastle, Mr. Shilowitz was a senior executive at Shinsei Bank and participated in its highly successful turnaround, sponsored by J.C. Flowers & Co. and Ripplewood Partners. At Shinsei, Mr. Shilowitz managed various business units, including Merchant Banking and Principal Finance and was the President of its wholly-owned subsidiary, Shinsei Capital (USA) Limited. Prior to Shinsei, Mr. Shilowitz was a senior member of the Principal Transactions Group at Lehman Brothers in Asia from 1997-2000, focusing on proprietary investments and debt portfolio acquisitions from distressed financial institutions. From 1995-1997, he was a member of Salomon Brothers' asset finance group where he met and first collaborated with Mr. Siegel. Mr. Shilowitz began his career in 1991 at First Boston Corporation (now Credit Suisse) as a member of the fixed income mortgage arbitrage group and also held positions in the financial engineering group and in asset finance investment banking where he focused on banks and specialty finance companies. He holds a B.S. in Economics from Cornell University.

#### ***Independent Directors***

The following sets forth certain biographical information for our Independent Directors. Independent Directors are not "interested persons" of StoneCastle Financial Corp., as defined by the 1940 Act:

**Alan Ginsberg.** Mr. Ginsberg has more than 30 years of experience in providing financial advisory services to financial institutions. Mr. Ginsberg began his investment banking career at Salomon Brothers Inc. in 1983, followed by being a key member of a group that moved to UBS Financial Services Inc. in 1995 and to Donaldson, Lufkin & Jenrette in 1998. He remained at DLJ through the merger with Credit Suisse First Boston until 2004, when he was recruited to Head HSBC Bank USA's Financial Institutions Group Americas, remaining there until mid-2006. Following HSBC, Mr. Ginsberg was a senior member of the Banc of America Securities Financial Institutions Group. Currently, Mr. Ginsberg is a Managing Director of Barclay's and has advised on more than 70 strategic transactions and advisory assignments during his tenure as an investment banker. Mr. Ginsberg received his B.A. in Economics from Yale University. He currently serves on Yale's Peabody Museum Advisory Board, and he served as a Senior Advisor to StoneCastle Partners from 2010 until May 2013.

**Emil W. Henry, Jr.** Mr. Henry is the CEO and Founder of Tiger Infrastructure Partners, a private equity firm focused on infrastructure investment opportunities. Prior to founding Tiger Infrastructure Partners, he was Global Head of the Lehman Brothers Private Equity Infrastructure businesses, where he oversaw global infrastructure investments. In 2005,

Mr. Henry was appointed Assistant Secretary of the Treasury for Financial Institutions by the President of the United States. Until his departure in 2007, he was a key advisor to two Treasury Secretaries on economic, legislative and regulatory matters affecting U.S. financial institutions and markets. Before joining the Treasury, Mr. Henry was a partner of Gleacher Partners LLC, an investment banking and investment management firm, where he served as Chairman of Asset Management, and Managing Director, and where he oversaw the firm's investment activities. Mr. Henry began the formative part of his career at Morgan Stanley in the mid-1980s in that firm's merchant banking arm where he executed management buyouts for Morgan Stanley's flagship private equity fund. He holds an M.B.A. from Harvard Business School and a B.A. in Economics from Yale University.

**Clara Miller.** Clara Miller is President Emerita of the Heron Foundation, which helps people and communities help themselves out of poverty. She was President of Heron from 2011 through 2017. Prior to assuming Heron's presidency, Miller was President and CEO of Nonprofit Finance Fund which she founded and ran from 1984 through 2010. Miller serves on the boards of the Sustainability Accounting Standards Board (SASB), Family Independence Initiative, and StoneCastle Financial Corp. She is a board member of the U.S. Impact Investing Alliance and is a Bridgespan Fellow. In 2017 she was named Social Innovator of the Year by the University of New Hampshire. In 1996, Miller was appointed by President Clinton to the U.S. Treasury's first Community Development Advisory Board for the then-newly-created Community Development Financial Institutions Fund. She later became its Chair. She chaired the Opportunity Finance Network board for six years and was a member of the Community Advisory Committee of the Federal Reserve Bank of New York for eight years. Ms. Miller speaks and writes extensively and has been published in The Financial Times, Medium, The Atlantic Blog, Stanford Social Innovation Review, The Nonprofit Quarterly and The Chronicle of Philanthropy. She has spoken recently at Aspen Ideas Festival, Sciences Po, Oxford Saïd Business School, Bloomberg L.P., SOCAP, and Mission Investors Exchange.

#### ***Executive Officers Who Are Not Directors***

**Patrick J. Farrell.** Chief Financial Officer. Mr. Farrell has over 30 years of hands-on management experience in finance and accounting, specifically focused on domestic and offshore mutual funds, bank deposit account programs, investment advisory and broker dealer businesses. Prior to joining StoneCastle Partners as Chief Financial Officer in February 2014, Mr. Farrell was CFO/COO of the Emerging Managers Group, L.P., a specialty asset management firm focused on offshore mutual funds. Prior to that, Mr. Farrell was CFO at Reserve Management, where he oversaw all financial activities for the company. Earlier in his career, he held financial positions at Lexington Management, Drexel Burnham, Alliance Capital and New York Life Investment Management, all focused on investment advisory and mutual fund activities. He began his career at Peat Marwick Mitchell & Co. Mr. Farrell holds a B.S. in Business Administration-Accounting from Manhattan College. Mr. Farrell is a Certified Public Accountant in New York State and a member of the American Institute of Certified Public Accountants.

**Rachel Schatten.** General Counsel, Chief Compliance Officer and Secretary. Ms. Schatten had over 12 years of investment adviser experience prior to joining StoneCastle Partners as General Counsel and Chief Compliance Officer in 2013. From 2004 to 2013, she served as the U.S. General Counsel and Chief Compliance Officer of a subsidiary of Hardt Group Investments AG, an international fund of funds, and the General Securities Principal of its affiliated broker-dealer since its inception through its subsequent sale. Prior to her tenure at

the Hardt Group, Ms. Schatten was an Associate in the investment management group of Schulte Roth & Zabel LLP, where she counseled investment advisers on developing and structuring new hedge funds, including domestic and offshore entities, master feeder funds, and funds of funds. She holds Series 7, 63 and 24 licenses and is admitted to practice law in New York. She graduated Cum Laude from Albany Law School of Union University, where she was an associate editor of the Albany Law Review and a member of the Justinian Society.

Additional information regarding the Directors of StoneCastle Financial Corp. can be found in the Statement of Additional Information, which is available, without charge, upon request, by calling 1-877-373-6374 and is also available on the Company's website at <http://www.stonecastle-financial.com>

# Privacy Notice

StoneCastle Financial Corp. (“we” or “us”) is committed to maintaining your right to privacy. Protecting the information we receive as part of our relationship with you is of primary importance to us. Please take the time to read and understand the privacy policies and procedures that we have implemented to safeguard your nonpublic personal information.

## ***Information We Collect***

We must collect certain personally identifiable financial information about our customers to provide financial services and products. Nonpublic personal information means personally identifiable financial information and any list, description or other grouping of consumers that is derived using any personally identifiable financial information that is not publicly available. The personally identifiable financial information that we gather during the normal course of doing business with you may include:

1. information we receive from you on applications or other forms;
2. information about your transactions with us, our affiliates, or others;
3. information collected through the Internet; and
4. information we receive from a consumer reporting agency.

## ***Information We Use***

The information that we collect and store relating to you is primarily used to enable us to provide our services to you in the best possible manner. In addition, we may use the information for the following purposes:

1. To provide you with information relating to us;
2. To provide third parties with statistical information about the users of our website;
3. To monitor and conduct an analysis of our Website traffic and usage patterns; and
4. To analyze trends.

## ***Information We Disclose***

We do not disclose any nonpublic personal information about our customers or former customers to anyone, except as permitted or required by law, or as necessary to provide services to you. We may disclose all of the information we collect, as described above, to certain nonaffiliated third parties such as attorneys, accountants, auditors, regulators and persons or entities that are assessing our compliance with industry standards. We enter into contractual agreements with all nonaffiliated third parties that prohibit such third parties from disclosing or using the information other than to carry out the purposes for which we disclose the information.

If you have questions or comments about our privacy practices, please call us at (212) 354 6500.

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# StoneCastle Financial Corp.

## **BOARD OF DIRECTORS**

### *Interested Directors<sup>(1)</sup>*

Joshua S. Siegel, Chairman of the Board of Directors  
George Shilowitz

### *Independent Directors*

Alan Ginsberg  
Emil Henry, Jr.  
Clara Miller

## **OFFICERS**

Joshua S. Siegel, Chief Executive Officer  
George Shilowitz, President  
Patrick J. Farrell, Chief Financial Officer  
Rachel Schatten, General Counsel, Chief Compliance Officer and Secretary

## **INVESTMENT ADVISOR**

StoneCastle Asset Management LLC  
152 West 57th St, 35th Floor  
New York, NY 10019

## **INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Tait, Weller & Baker LLP  
1818 Market Street, Suite 2400  
Philadelphia, PA 19103

## **TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR**

Computershare Trust Company, N.A.  
250 Royall Street  
Canton, MA 02021

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*(1) As defined under the Investment Company Act of 1940, as amended.*