

GLADSTONE CAPITAL CORP
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

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Check the appropriate box:

- Preliminary Proxy Statement
 Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
 Definitive Proxy Statement
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 Soliciting Material Pursuant to §240.14a-12

GLADSTONE CAPITAL CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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GLADSTONE CAPITAL CORPORATION

1616 Anderson Road, Suite 208, McLean, Virginia 22102

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD ON FEBRUARY 9, 2005

To The Stockholders Of Gladstone Capital Corporation:

Notice Is Hereby Given that the Annual Meeting of Stockholders of Gladstone Capital Corporation, a Maryland corporation (the Company), will be held on Wednesday, February 9, 2005 at 11:00 a.m. local time at the Hilton McLean at 7920 Jones Branch Drive, McLean, VA 22102 for the following purposes:

- (1) To elect three Class I directors to hold office until the 2008 Annual Meeting of Stockholders.
- (2) To approve an amendment to the Company's Amended and Restated 2001 Equity Incentive Plan to increase the aggregate number of shares of capital stock authorized for issuance under such plan by 250,000 shares and to grant the board of directors the authority to reduce the exercise price for each outstanding option by an amount equal to the per share amount of any cash dividend paid to all holders of outstanding common stock.
- (3) To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

The board of directors has fixed the close of business on December 15, 2004 as the record date for the determination of stockholders entitled to notice of and to vote at this Annual Meeting and at any adjournment or postponement thereof.

By Order of the Board of Directors
/s/ TERRY BRUBAKER
Terry Brubaker
Secretary

McLean, Virginia
December 30, 2004

All stockholders are cordially invited to attend the meeting in person. Whether or not you expect to attend the meeting, please complete, date, sign and return the enclosed proxy as promptly as possible in order to ensure your representation at the meeting. A return envelope (which is postage prepaid if mailed in the United States) is enclosed for that purpose. Even if you have given your proxy, you may still vote in person if you attend the meeting. Please note, however, that if your shares are held of record by a broker, bank or other nominee and you wish to vote at the meeting, you must obtain from the record holder a proxy issued in your name.

GLADSTONE CAPITAL CORPORATION

1616 Anderson Road, Suite 208, McLean, Virginia 22102

**PROXY STATEMENT
FOR ANNUAL MEETING OF STOCKHOLDERS**

February 9, 2005

INFORMATION CONCERNING SOLICITATION AND VOTING

General

The enclosed proxy is solicited on behalf of the board of directors of Gladstone Capital Corporation, a Maryland corporation (the Company), for use at the Annual Meeting of Stockholders to be held on February 9, 2005, at 11:00 a.m. local time (the Annual Meeting), or at any adjournment or postponement thereof, for the purposes set forth herein and in the accompanying Notice of Annual Meeting. The Annual Meeting will be held at the Hilton McLean at 7920 Jones Branch Drive, McLean, VA 22102. The Company intends to mail this proxy statement and accompanying proxy card on or about January 5, 2005 to all stockholders entitled to vote at the Annual Meeting.

The Company is a closed-end, non-diversified, management investment company that has elected to be treated as a business development company under the Investment Company Act. The Company is externally managed by Gladstone Management Corporation, a registered investment adviser (Gladstone Management). Gladstone Management's address is 1616 Anderson Road, Suite 208, McLean, Virginia 22102.

Solicitation

The Company will bear the cost of solicitation of proxies, including preparation, assembly, printing and mailing of this proxy statement, the proxy card and any additional information furnished to stockholders. Copies of solicitation materials will be furnished to banks, brokerage houses, fiduciaries and custodians holding in their names shares of the Company's common stock beneficially owned by others to forward to such beneficial owners. The Company may reimburse persons representing beneficial owners of the Company's common stock for their costs of forwarding solicitation materials to such beneficial owners. Original solicitation of proxies by mail may be supplemented by telephone, telegram or personal solicitation by directors, officers or other regular employees of the Company and Gladstone Management. No additional compensation will be paid to directors, officers or other regular employees for such services. The Company has engaged Georgeson Shareholder Communications Company (Georgeson) to solicit proxies for the Annual Meeting. Georgeson will be paid a fee of \$6,500 for its basic solicitation services, which includes review of proxy materials, dissemination of broker search cards, distribution of proxy materials, solicitation of ADP, brokers, banks and institutional holders, and delivery of executed proxies. The term of the agreement with Georgeson will last for the period of the solicitation, and the agreement provides that the Company indemnify and hold harmless Georgeson against any third party claims, except in the case of Georgeson's gross negligence or intentional misconduct.

Voting Rights and Outstanding Shares

Only holders of record of the Company's common stock at the close of business on December 15, 2004 will be entitled to notice of and to vote at the Annual Meeting. At the close of business on December 15, 2004 the Company had outstanding and entitled to vote 11,278,510 shares of common stock.

Each holder of record of the Company's common stock on such date will be entitled to one vote for each share held on all matters to be voted upon at the Annual Meeting.

All votes will be tabulated by the inspector of election appointed for the meeting, who will separately tabulate affirmative and negative votes, abstentions and broker non-votes. Abstentions and broker non-votes are counted towards a quorum but are not counted for any purpose in determining whether a matter is approved. Therefore, with respect to the election of directors (Proposal 1) and the amendment to the Company's Amended and Restated 2001 Equity Incentive Plan (Proposal 2), abstentions and broker non-votes do not count either for or against such proposals.

Revocability of Proxies

Any person giving a proxy pursuant to this solicitation has the power to revoke it at any time before it is voted. It may be revoked by filing with the Secretary of the Company at the Company's principal executive office, 1616 Anderson Road, Suite 208, McLean, Virginia 22102, a written notice of revocation or a duly executed proxy bearing a later date, or it may be revoked by attending the meeting and voting in person.

Attendance at the meeting will not, by itself, revoke a proxy. However, no proxy is valid after eleven months from its date, unless otherwise provided in the proxy.

Stockholder Proposals and Stockholder Communications with the Board of Directors

The deadline for submitting a stockholder proposal for inclusion in the Company's proxy statement and form of proxy for the Company's 2006 annual meeting of stockholders pursuant to Rule 14a-8 of the Securities and Exchange Commission (the "SEC") is September 7, 2005. Stockholders wishing to submit proposals or director nominations that are not to be included in such proxy statement and proxy must deliver notice to the Secretary at the principal executive offices of the Company not later than the close of business on December 7, 2005 nor earlier than the close of business on November 7, 2005. Stockholders are also advised to review the Company's Bylaws, which contain additional requirements with respect to advance notice of stockholder proposals and director nominations.

The Company's Board has adopted a formal process by which stockholders may communicate with the Board. Stockholders who wish to communicate with the Board may do so by sending written communications addressed to the Board of Directors of Gladstone Capital Corporation, at 1616 Anderson Road, Suite 208, McLean, Virginia 22102. This information is also contained on the Company's website at www.gladstonecapital.com.

PROPOSAL 1

ELECTION OF THREE CLASS I DIRECTORS

The Company's board of directors (the "Board") is divided into three classes, Class I, Class II and Class III, of three directors each, with each class having a three-year term. In general, vacancies on the Board may be filled only by persons elected by a majority of the remaining directors. A director elected by the Board to fill a vacancy shall hold office for the remainder of the full term of the class of directors in which the vacancy occurred, and until his or her successor is elected and qualifies.

The Board presently has nine members. The term of office for the Class I directors is expiring in 2005. Each of the nominees for election to Class I are incumbent directors. If elected at the Annual Meeting, each nominee would serve until the 2008 annual meeting, and until his successor is elected and qualifies, or his earlier death, resignation or removal. No nominee has been proposed for election pursuant to any agreement or understanding between him and the Company.

Directors are elected by a majority of the votes present in person or represented by proxy and entitled to vote at the meeting. Shares represented by executed proxies will be voted, if authority to do so is not withheld, for the election of the nominees named below. In the event that any of the nominees should be unavailable for election as a result of an unexpected occurrence, such shares will be voted for the election of such substitute nominees as management may propose. The nominees have agreed to serve if elected, and management has no reason to believe that any of them will be unable to serve.

Set forth below is biographical information for each person nominated, each person whose term of office as a director will continue after the Annual Meeting, and each executive officer who is not a director.

Nominees for Election as Class I Directors for a Three-year Term Expiring at the 2008 Annual Meeting

Name, Address, Age	Position(s) Held With Company	Term of Office and Length of Term Served	Principal Occupation(s) During the Past Five Years	Other Directorships Held by Director
Disinterested Director				
Michela A. English (55)* Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Director	Term expires at 2005 Annual Meeting. Director of the Company since June 2002.	Private investor since 2004. President of Discovery Consumer Products, the retail, publishing and licensing arm of Discovery Communications, Inc., the leading global real-world media and entertainment company, from 1996 to 2004.	Gladstone Commercial Corporation
Interested Directors				
Anthony W. Parker (59)** Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Director	Term expires at 2005 Annual Meeting. Director of the Company since August 2001.	Founder and Chairman of the Board of Medical Funding Corporation, the owner of Snelling Metro Personnel, a staffing agency, since 1977.	Gladstone Commercial Corporation
George Stelljes III (43)** Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Director, President and Chief Investment Officer	Term expires at 2005 Annual Meeting. Director of the Company since July 2003.	President and Chief Investment Officer of the Company since April 2004. Executive Vice President and Chief Investment Officer of the Company from September 2002 to April 2004. Co-founder and Managing Member of Camden Partners, a private equity firm from 1999 to 2002.	None

Class II Directors Continuing in Office Until the 2006 Annual Meeting

Name, Address, Age	Position(s) Held With Company	Term of Office and Length of Term Served	Principal Occupation(s) During the Past Five Years	Other Directorships Held by Director
Disinterested Directors				
David A.R. Dullum (56) Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Director	Term expires at 2006 Annual Meeting. Director of the Company since August 2001.	Partner of New England Partners, a venture capital firm since 1995.	Gladstone Commercial Corporation
Maurice W. Coulon (63) Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Director	Term expires at 2006 Annual Meeting. Director of the Company since August 2003.	Private investor in real estate since 2000. Director of Portfolio Management of Morgan Stanley Real Estate Company from 1991 to 2000.	Gladstone Commercial Corporation
Interested Director				
Terry Lee Brubaker (61)** Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Director, Vice Chairman and Chief Operating Officer	Term expires at 2006 Annual Meeting. Director of the Company since May 2001.	Vice Chairman and Chief Operating Officer of the Company since April 2004. President and Chief Operating Officer of the Company from May 2001 to April 2004. Founder and chairman of the board of Heads Up Systems, a process consulting firm from 1999 to 2003.	Gladstone Commercial Corporation

Class III Directors Continuing in Office Until the 2007 Annual Meeting

Name, Address, Age	Position(s) Held With Company	Term of Office and Length of Term Served	Principal Occupation(s) During the Past Five Years	Other Directorships Held by Director
Disinterested Directors				
Paul Adलगren (62) Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Director	Term expires at 2007 Annual Meeting. Director of the Company since January 2003.	Pastor of Missionary Alliance Church since 1997.	Gladstone Commercial Corporation

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John H. Outland (59) Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Director	Term expires at 2007 Annual Meeting. Director of the Company since December 2003.	Vice President of Genworth Financial, Inc. since 2004. Managing Director of 1789 Capital Advisers, a financial consulting company, from 2002 to 2004. Vice President of Mortgage Backed Securities at Financial Guaranty Insurance Company from 1999 to 2001.	Gladstone Commercial Corporation
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Interested Director

David Gladstone (62)** Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Chairman of the Board and Chief Executive Officer	Term expires at 2007 Annual Meeting. Director of the Company since 2001.	Founder, Chief Executive Officer and Chairman of the Board of the Company since its inception in May 2001. From April 1997 to August 2001 Mr. Gladstone was chairman or vice chairman of the board of directors of American Capital Strategies, a publicly traded leveraged buyout company and mezzanine debt finance company.	Gladstone Commercial Corporation
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Executive Officer Who is Not a Director

Name, Address, Age	Position(s) Held With Company	Term of Office and Length of Term Served	Principal Occupation(s) During the Past Five Years	Directorships Held by Officer
Harry Brill (57) Gladstone Capital Corporation 1616 Anderson Road, Suite 208 McLean, Virginia 22102	Treasurer and Chief Financial Officer	Executive Officer since May 2001.	Treasurer and Chief Financial Officer since May 2001. Personal financial advisor from 1995 to 2001.	None

* Ms. English was recommended to the ethics, nominating and corporate governance committee to fill a vacancy on the Board in June 2002 by the Company's chief executive officer and is standing for election by stockholders for the first time.

** Messrs. Gladstone, Brubaker, and Stelljes are interested persons of the Company, within the meaning of the Investment Company Act of 1940, due to their positions as officers of the Company. Mr. Parker is an interested person of the Company as a result of a business relationship with the Company. For more information on Mr. Parker's business relationship with the Company see Certain Transactions on page 21.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE IN FAVOR OF EACH NOMINEE FOR CLASS I DIRECTOR.

Board Committees and Meetings

During the fiscal year ended September 30, 2004 the Board held 8 meetings. The Board has an audit committee, a compensation committee, an ethics, nominating and corporate governance committee, and an executive committee.

Audit Committee. The Company's Board has established an audit committee in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934. The audit committee operates pursuant to a written charter. The membership of the audit committee of the Board is comprised of Mr. Dullum, Ms. English and Mr. Outland. Each member of the audit committee is an independent director as defined by Nasdaq rules and the Company's own standards. The Board has unanimously determined that all members of the audit committee qualify as audit committee financial experts within the meaning of SEC rules. In addition, the Board has unanimously determined that all audit committee members are financially literate under current Nasdaq rules and that at least one member has financial management expertise. The audit committee is primarily responsible for oversight of the Company's financial statements and controls, assessing and ensuring the independence, qualifications and performance of the independent auditor, approving the independent auditor services and fees and reviewing and approving the annual audited financial statements for the Company before issuance, subject to Board approval. No members of the audit committee received any compensation from the Company during the last fiscal year other than directors' fees. Mr. Dullum serves as the audit committee chairman. The audit committee met 8 times during the last fiscal year. The Audit Committee has adopted a written Audit Committee Charter that is attached as Appendix A to these proxy materials.

Compensation Committee. The compensation committee determines compensation for the Company's executive officers and administers the Company's Amended and Restated 2001 Equity Incentive Plan (the 2001 Plan), as amended. The committee determines compensation policies, evaluates performance, and sets compensation levels. Membership of the compensation committee is comprised of Messrs. Coulon and Outland, each of whom is an independent director as defined by Nasdaq rules, and neither of whom is considered an interested person of the Company, as such term is defined in the Investment Company Act. Mr. Coulon serves as the compensation committee chairman. The compensation committee met 8 times during the last fiscal year.

Ethics, Nominating and Corporate Governance Committee. The ethics, nominating and corporate governance committee operates pursuant to a written charter and has the exclusive right to recommend candidates for election as directors to the Board. A copy of the committee's charter is available on the Company's website at www.gladstonecapital.com. The ethics, nominating and corporate governance committee believes that candidates for director should have certain minimum qualifications, including being able to read and understand basic financial statements, being over 21 years of age, having business experience, and having high moral character, however the committee retains the right to modify these minimum qualifications from time to time. The committee's process for identifying and evaluating nominees is as follows: In the case of incumbent directors whose terms of office are set to expire, the ethics, nominating and corporate governance committee reviews such directors' overall service to the Company during their term, including the number of meetings attended, level of participation, quality of performance, and any transactions of such directors with the Company during their term. In the case of new director candidates, the committee first determines whether the nominee must be independent for Nasdaq purposes or whether the candidate must not be considered an interested person under the Investment Company Act, which determination is based upon the Company's charter and bylaws, applicable securities laws, the rules and regulations of the SEC, Nasdaq rules, and the advice of counsel, if necessary. The committee then uses its network of contacts to compile a list of potential candidates, but may also engage, if it deems appropriate, a professional search firm. The committee then meets to discuss and consider such candidates' qualifications and then chooses a candidate by majority vote.

The ethics, nominating and corporate governance committee will consider director candidates recommended by stockholders provided the procedures set forth below are followed by stockholders in submitting recommendations. The committee does not intend to alter the manner in which it evaluates candidates, including the minimum criteria set forth above, based on whether the candidate was recommended by a stockholder or not.

Stockholders who wish to recommend individuals for consideration by the ethics, nominating and corporate governance committee to become nominees for election to the Board may do so by submitting a written recommendation to the Secretary of the Company at 1616 Anderson Road, Suite 208, McLean, Virginia 22102. Submissions must include sufficient biographical information concerning the recommended individual, including age, five year employment history with employer names and a description of the employer's business, whether such individual can read and understand basic financial statements and board memberships (if any), for the committee to consider. The submission must be accompanied by a written consent of the individual to stand for election if nominated by the Board and to serve if elected by the stockholders. Recommendations received by September 30, 2005, will be considered for nomination at the 2006 Annual Meeting of Stockholders. Recommendations received after September 30, 2005, will be considered for nomination at the 2007 Annual Meeting of Stockholders.

The Board may appoint not fewer than two members to the ethics, nominating and corporate governance committee. Currently, the membership is comprised of Messrs. Adalgren and Coulon, each of whom is considered an independent director under Nasdaq rules, and neither of whom is considered an interested person (as such term is defined in the Investment Company Act) of the Company. Mr. Adalgren serves as the chairman of the ethics, nominating and corporate governance committee. The ethics, nominating and corporate governance committee met 9 times during the last fiscal year.

Executive Committee. The executive committee has the authority to exercise all powers of the Board except for actions that must be taken by the full Board under the Maryland General Corporation Law, including electing the Chairman of the Board and the President. The Board may appoint not fewer than three members to the executive committee. Currently, the membership is comprised of Messrs. Gladstone, Brubaker, and Parker. The executive committee did not meet during the last fiscal year.

During the fiscal year ended September 30, 2004, each Board member attended 75% or more of the aggregate of the meetings of the Board and of the committees on which he or she served. The Company does not have a formal policy regarding attendance by directors at annual meetings of stockholders but encourages such attendance. Two members of the nine member Board attended the Company's 2004 Annual Meeting of stockholders.

Code of Ethics

The Company has adopted a code of business conduct and ethics that applies to its principal executive officer, principal financial officer, principal accounting officer, and all employees, officers and directors. The Company has posted a copy of its code of ethics on its website at www.gladstonecapital.com.

PROPOSAL 2

APPROVAL OF AN AMENDMENT TO THE COMPANY'S AMENDED AND RESTATED 2001 EQUITY INCENTIVE PLAN TO INCREASE THE AGGREGATE NUMBER OF SHARES OF CAPITAL STOCK AUTHORIZED FOR ISSUANCE UNDER SUCH PLAN BY 250,000 SHARES AND TO GRANT THE BOARD OF DIRECTORS THE AUTHORITY TO REDUCE THE OPTION PRICE FOR EACH OUTSTANDING OPTION BY AN AMOUNT EQUAL TO THE PER SHARE AMOUNT OF ANY CASH DIVIDEND PAID TO ALL HOLDERS OF OUTSTANDING COMMON STOCK

Effective July 23, 2001, we adopted the Amended and Restated 2001 Equity Incentive Plan (the 2001 Plan) for the purpose of attracting and retaining the services of executive officers, directors and other key

employees. We have authorized the issuance of 2,000,000 shares of capital stock to our officers, directors, employees and consultants, including the employees and directors of our Adviser under the 2001 Plan. As of December 15, 2004, we had issued options to purchase an aggregate of 1,920,500 shares of common stock. Of this total, options to purchase 1,265,498 shares remained outstanding and options to purchase 655,002 shares had already been exercised. Only 79,500 shares (plus any shares that might in the future be returned to the 2001 Plan as a result of cancellations or expiration of awards) remained available for future grant under the 2001 Plan as of December 15, 2004.

Our board of directors has approved an amendment to the 2001 Plan, subject to stockholder approval, to increase the number of shares of capital stock authorized for issuance under the 2001 Plan from a total of 2,000,000 shares to a total of 2,250,000 shares. Our board of directors adopted this amendment in order to ensure that we can continue to grant stock options at levels determined appropriate by our compensation committee.

In addition, the board of directors reviewed its policy regarding equity compensation and, in particular, its policy of granting stock options to executive officers. The Company has historically permitted its option holders to exercise their stock options by delivering to the Company a promissory note for the purchase price of the shares. This permits these option holders to receive dividends on the shares that they acquire while they are required to make periodic interest payments on the notes. Under the Sarbanes Oxley Act of 2002, executive officers of the Company are no longer permitted to borrow funds from the Company and this prohibits them from delivering a promissory note to the Company for the purpose of exercising their stock options. Because the executive officers must now come up with the exercise price without the benefit of a promissory note, we believe that the Company's executive officers are now unlikely to exercise their options and hold the shares. We believe that they will now be more likely to exercise their options and simultaneously sell the shares on the market, which does not provide them with the benefit of the dividends. Because our executive officers are less likely to exercise their options and hold their shares, we believe that our options may not be as significant of an incentive for our executive officers as would be the case if promissory notes were still available as a means for them to exercise options.

In response, the proposed amendment to the 2001 Plan would give the Board or, in its capacity as administrator of the 2001 Plan, the compensation committee the authority to elect to have the exercise price of options be reduced by the amount of any cash dividends paid on the Company's capital stock after the options are granted but before they are exercised. However, the exercise price of the options would never be reduced below zero. This authority would permit the Board (or compensation committee) to make such an election with respect to any option designated by the Board in its sole discretion, including new option grants, outstanding options or both.

Under the Company's current accounting policies, the Company generally does not expense options granted under the 2001 Plan although it expects to begin doing so during 2005 as a result of new rules for accounting for options. If the Board (or compensation committee) elects to have the exercise price of options reduced by the amount of cash dividends on the Company's outstanding stock, this would result in variable accounting for the Company's stock options. Variable accounting would require the Company to record a non-cash compensation expense with respect to options as the value of the options increases (including as a result of an increase in the Company's stock price). The expensing of stock options in such a manner would not affect the Company's taxable income. However when the individual exercised the option, the Company may be entitled to a deduction for tax purposes. Since the Company pays its dividends based on taxable income as opposed to reported income on its financial reports, a stock option may reduce dividends payable to stockholders several years after the option is granted.

If the proposal is adopted, options granted with the declining exercise price feature, as well as outstanding options that are amended to include this feature, would be treated as non-statutory stock options, and, under recently adopted federal tax laws, would potentially result in deferred compensation, and subject the option holders to federal income tax at the time that each portion of the options vests and is no longer subject to a risk of forfeiture. According to guidance recently issued by the Internal Revenue Service, we believe that the difference between the exercise price and the fair market value on each vesting date multiplied by the number of shares vesting on the particular vesting date may be considered ordinary income to the option holder. Additionally, we believe that, in such an event, the option holder would potentially be subject to a 20% penalty tax and interest payments.

Neither the Board nor the compensation committee have determined whether or when, if ever, to implement the declining exercise price feature with respect to future grants and/or outstanding options. The decision to do so, if at all, will be based on the Board or the compensation committee's determination that such a feature would be in the best interests of the Company's stockholders by further incentivizing the Company's personnel.

Because the options granted to the Company's non-employee directors are permitted only pursuant to the terms of an order granted by the Securities and Exchange Commission, the Company will not grant any options to non-employee directors containing this declining exercise feature, nor amend outstanding options held by non-employee directors to add this declining exercise feature, without confirmation from the staff of the Securities and Exchange Commission that inclusion of this feature is permissible under the terms of the Company's order (or until the Company has received a new order from the Securities and Exchange Commission explicitly permitting the inclusion of such a feature in the Company's non-employee director options).

Stockholders are requested to approve the amendment to the 2001 Plan. The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and voting at the meeting will be required to approve the amendment to the 2001 Plan. Abstentions and broker non-votes will be considered present and entitled to vote for the purpose of determining whether a quorum exists, although they will not be counted for any purpose in determining whether this matter has been approved.

**THE BOARD OF DIRECTORS RECOMMENDS
A VOTE IN FAVOR OF PROPOSAL 2.**

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The 2001 Plan, as amended, is attached as Appendix B to this proxy statement. The essential features of the 2001 Plan are outlined below:

Amended and Restated 2001 Equity Incentive Plan

Effective July 23, 2001, we adopted the 2001 Plan, for the purpose of attracting and retaining the services of executive officers, directors and other key employees. Under the 2001 Plan, our board of

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directors or our compensation committee may award incentive stock options within the meaning of Section 422 of the Code, or ISOs, to employees, and nonstatutory stock options to employees, and non-employee directors. In addition, the 2001 Plan permits the granting of rights to purchase restricted stock. Our personnel remain eligible to receive awards under the 2001 Plan following our October 1, 2004 engagement of Gladstone Management as our external advisor.

We have authorized for issuance 2,000,000 shares of capital stock under the 2001 Plan to our employees and directors. The share reserve consists of our common stock and preferred stock. Accordingly, participants in the 2001 Plan may receive options to purchase preferred or common stock, as determined by our board of directors or our compensation committee. Options granted under the 2001 Plan may be exercised for a period of no more than 10 years from the date of grant. Unless sooner terminated by our board of directors, the 2001 Plan will terminate on June 1, 2011, and no additional awards may be made under the 2001 Plan after that date.

Stock Options

Options granted under the 2001 Plan entitle the optionee, upon exercise, to purchase shares of capital stock from us at a specified exercise price per share. ISOs must have a per share exercise price of no less than the fair market value of a share of stock on the date of the grant or, if the optionee owns or is treated as owning, under Section 424(d) of the Code, more than 10% of the total combined voting power of all classes of our stock, 110% of the fair market value of a share of stock on the date of the grant. Nonstatutory stock options granted under the 2001 Plan must have a per share exercise price of no less than the fair market value of a share of stock on the date of the grant. Options are not transferable other than by laws of descent and distribution and will generally be exercisable during an optionee's lifetime only by the optionee.

Our compensation committee administers the 2001 Plan and has the authority, subject to the provisions of the 2001 Plan, to determine who will receive awards under the 2001 Plan and the terms of such awards. Our compensation committee will have the authority to adjust the number of shares available for options, the number of shares subject to outstanding options and the exercise price for options following the occurrence of events such as stock splits, dividends, distributions and recapitalizations. Our compensation committee may lower the exercise price for any outstanding stock options, or may issue replacement options for options previously granted at a higher exercise price.

If authorized by our compensation committee, the exercise price of an option may be paid in the form of shares of stock that are already owned by a participant. Our compensation committee also may provide that if an employee delivers shares of stock in full or partial payment of the exercise price of his or her stock option, the employee will be granted a reload stock option to purchase that number of shares of stock delivered by the employee. A reload stock option is the grant of a new stock option to the employee covering the same number of shares that such employee tendered in payment of the exercise price with respect to his or her original stock option. Under the terms of the 2001 Plan, this reload option shall have the same expiration date as the original stock option, an exercise price that is equal to the fair market value of our stock on the date of the original stock option exercise, and shall be designated as either an incentive stock option or nonstatutory stock option on the date of grant of the original stock option.

In addition, our compensation committee may permit a cashless exercise arrangement whereby an optionee may exercise a portion of his or her option by surrendering a portion of his or her option having a fair value equal to the aggregate exercise price of the portion of the option being exercised. If an option holder elects to make a cashless exercise of a portion of his or her option, he or she will receive upon exercise shares having an aggregate fair market value equal to the product of (1) the excess of the fair market value of a share on the exercise date over the exercise price and (2) the number of shares covered by the option.

Our compensation committee also may provide that certain optionees may pay the exercise price of their options with a promissory note. If an option holder elects to pay the exercise price of his or her option with a promissory note, interest on the note will accrue at a commercially reasonable market rate and the note will be subject to such other repayment terms and conditions as established by our compensation committee. We have from time to time permitted our employees, including our executive officers, to exercise options by promissory note in the past. However, the Sarbanes-Oxley Act of 2002 effectively prohibits us from making loans to our executive officers for exercising options in the future, although loans outstanding prior to July 30, 2002 including the promissory notes we have received from certain of our executive officers were explicitly exempted from this prohibition. Furthermore, prior to permitting non-employee directors to exercise their options with a promissory note, we would be required to receive an order from the SEC permitting such a loan on the basis that the terms of the loan are fair and reasonable and not overreaching. We currently do not intend to apply for such an order from the SEC.

Restricted Stock

Participants in the 2001 Plan may be provided with an opportunity to purchase restricted stock. These shares may be subject to a time-based vesting schedule, or the attainment of performance goals established by our compensation committee. The purchase price for restricted stock will not be less than the fair market value of our stock on the date of purchase. Upon a participant's termination of service with us, we may have the option to repurchase the unvested shares of stock at the original purchase price paid by a participant for such shares, if any. The specific terms and conditions of restricted stock purchases shall be governed by individual agreements in a form approved by our compensation committee. Restricted stock purchased under the 2001 Plan is transferable if so determined by our compensation committee in its discretion.

Corporate Transactions and Change in Control Provisions

Upon specified corporate transactions, as defined in the 2001 Plan, all outstanding awards under the 2001 Plan may either be assumed or substituted for by the surviving entity. If the surviving entity does not assume or substitute similar awards, the vesting of awards held by the participants whose continuous service has not terminated prior to the corporate transaction will be accelerated in full and then terminated to the extent not exercised prior to the closing date of the corporate transaction. With respect to any other awards which are not assumed or substituted and are held by participants whose continuous service has terminated on or prior to the closing date of the corporate transaction, such awards will not be accelerated unless otherwise provided in a written agreement between us, or any of our affiliates, and the participant.

Upon a change in control, as defined in the 2001 Plan, awards held by participants whose continuous service has not terminated prior to the change in control shall be subject to additional acceleration of vesting even if the surviving entity assumes the awards or substitutes similar awards, but only to the extent as provided in any written agreement between us, or any of our affiliates, and the participant.

Federal Tax Consequences

The following is a brief summary of the federal income tax aspects of stock options and restricted stock purchase rights available for grant under the 2001 Plan based upon the federal income tax laws in effect on the date hereof. This summary is not intended to be exhaustive and does not describe state or local tax consequences.

ISOs. No taxable ordinary income is realized by the participant upon the grant or exercise of an ISO. If shares of stock are issued to a participant pursuant to the exercise of an ISO, and if no disqualifying disposition of the shares is made by the participant within two years of the date of grant or within one year after the transfer of the shares to the participant, then: (i) upon the sale of the shares, any amount realized

in excess of the exercise price will be taxed to the participant as a long-term capital gain, and any loss sustained will be a capital loss, and (ii) no deduction will be allowed to us for federal income tax purposes. The exercise of an ISO will give rise to an item of tax preference that may result in an alternative minimum tax liability for the participant unless the participant makes a disqualifying disposition of the shares received upon exercise.

If stock acquired upon the exercise of an ISO is disposed of prior to the expiration of the holding periods described above, then generally: (1) the participant will realize ordinary income in the year of disposition in an amount equal to the excess, if any, of the fair market value of the shares at exercise (or, if less, the amount realized on the disposition of the shares) over the exercise price paid for such shares, and (2) we will be entitled to deduct any such recognized amount. Any further gain or loss realized by the participant will be taxed as short-term or long-term capital gain or loss, as the case may be, and will not result in any deduction by us. Subject to certain exceptions for disability or death, if an ISO is exercised more than three months following the termination of the participant's employment, the option will generally be taxed as a nonstatutory stock option.

Nonstatutory Stock Options. With respect to nonstatutory stock options: (1) no income is realized by the participant at the time the option is granted; (2) generally upon exercise of the option, the participant realizes ordinary income in an amount equal to the difference between the exercise price paid for the shares and the fair market value of the shares on the date of exercise and we will be entitled to a tax deduction in the same amount; and (3) at disposition, any appreciation (or depreciation) after the date of exercise is treated either as short-term or long-term capital gain (or loss), depending upon the length of time that the participant has held the shares.

Restricted Stock Awards. To the extent a participant's restricted stock award is fully vested and is not subject to our repurchase option, the participant will recognize taxable ordinary income equal to any excess of the stock's fair market value on the purchase date over the purchase price. In contrast, to the extent all of a participant's restricted stock award is subject to a vesting schedule and is subject to our repurchase option, no income tax with respect to such stock will be recognized at the time of purchase unless the participant files a Section 83(b) election. Instead, as and when the shares vest, ordinary income equal to the excess, if any, of the then fair market value of the stock over the participant's purchase price, will be recognized. Generally, we will be entitled to a tax deduction equal to the amount of ordinary income recognized by the participant.

Report Of The Audit Committee Of The Board Of Directors¹

The following is the report of the audit committee with respect to the Company's audited financial statements for the fiscal year ended September 30, 2004.

The audit committee has reviewed and discussed the Company's audited financial statements with management and PricewaterhouseCoopers LLP, the Company's independent auditor, with and without management present. The audit committee included in its review results of the auditor's examinations, the Company's internal controls, and the quality of the Company's financial reporting. The audit committee also reviewed the Company's procedures and internal control processes designed to ensure full, fair and adequate financial reporting and disclosures, including procedures for certifications by the Company's chief executive officer and chief financial officer that are required in periodic reports filed by the Company with the SEC. The audit committee is satisfied that the Company's internal control system is adequate and that the Company employs appropriate accounting and auditing procedures.

The audit committee also has discussed with PricewaterhouseCoopers LLP matters relating to the auditor's judgments about the quality, as well as the acceptability, of the Company's accounting principles as applied in its financial reporting as required by Statement of Auditing Standards No. 61 (Communications with audit committees). In addition, the audit committee has discussed with PricewaterhouseCoopers their independence from management and the Company, as well as the matters in the written disclosures received from PricewaterhouseCoopers and required by Independence Standards Board Standard No. 1 (Independence Discussions with audit committees). The audit committee received a letter from PricewaterhouseCoopers confirming their independence and discussed it with them. The audit committee discussed and reviewed with PricewaterhouseCoopers the Company's critical accounting policies and practices, internal controls, other material written communications to management, and the scope of PricewaterhouseCoopers' audits and all fees paid to PricewaterhouseCoopers during the fiscal year. The audit committee adopted guidelines requiring review and pre-approval by the audit committee of audit and non-audit services performed by PricewaterhouseCoopers for the Company. The audit committee has reviewed and considered the compatibility of PricewaterhouseCoopers' performance of non-audit services with the maintenance of PricewaterhouseCoopers' independence as the Company's independent auditor.

Based on the audit committee's review and discussions referred to above, the audit committee recommended to the board of directors that the Company's audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2004 for filing with the SEC. In addition, the audit committee has engaged PricewaterhouseCoopers LLP to serve as the Company's independent auditor for the fiscal year ending September 30, 2005.

The Audit Committee

David A.R. Dullum, *Chairman*

Michela A. English

John H. Outland

(1) The material in this report is not soliciting material, is not deemed filed with the SEC, and is not to be incorporated by reference into any filing of the Company under the Securities Act or the Exchange Act, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

Compensation of Directors and Executive Officers**Summary of Compensation**

The following table shows, for the fiscal year ended September 30, 2004, compensation awarded or paid to, or earned by, the Company's three highest paid executive officers and all directors (the "Compensated Persons") for all services rendered to the Company during this period. During the fiscal year ended September 30, 2004, the Compensated Persons were employees of Gladstone Capital Advisers, the Company's wholly-owned subsidiary. Under an expense sharing arrangement with Gladstone Capital Advisers, during this period Gladstone Management reimbursed Gladstone Capital Advisers for its pro rata share of Gladstone Capital Advisers' payroll and benefits expenses on an employee-by-employee basis, based on the percentage of time that its personnel spent on matters related to entities advised by Gladstone Management (e.g., Gladstone Commercial Corporation). The salary amounts set forth in the table below represent the total salary earned by the Compensated Persons during the period (including amounts paid to the Compensated Persons for services rendered to Gladstone Commercial Corporation, etc.). The compensation amounts for the non-employee directors represent solely the compensation received by these individuals with respect to Gladstone Capital Corporation (and does not include compensation received from Gladstone Commercial Corporation):

Name of Person, Position(1)	Aggregate Compensation From the Company	Pension or Retirement Benefits Accrued as Part of Company Expenses	Securities Underlying Options	Total Compensation From Company Paid to Directors
David Gladstone <i>Chief Executive Officer and Chairman of the Board of Directors</i>	\$ 200,000	\$ 6,000	0	206,000
Terry Lee Brubaker <i>Vice Chairman, Chief Operating Officer and Director</i>	\$ 218,335	\$ 6,000	45,000	224,335
George Stelljes III <i>President Chief Investment Officer and Director</i>	\$268,335	\$ 6,000	45,000	274,335
Paul Adelgren <i>Director</i>	\$ 18,500	\$	10,000	18,500
Maurice W. Coulon <i>Director</i>	\$ 18,500	\$	10,000	18,500
David A.R. Dullum <i>Director</i>	\$ 18,000	\$	10,000	18,000
Michela A. English <i>Director</i>	\$ 21,333	\$	10,000	21,333
John H. Outland(2) <i>Director</i>	\$ 15,333	\$	20,000	15,333
Anthony W. Parker <i>Director</i>	\$ 18,000	\$	10,000	18,000

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(1) The compensation received by Messrs. Gladstone, Brubaker and Stelljes was in their capacity as officers and not as directors of the Company. As noted above, the amounts in the table represent the aggregate compensation received by the Compensated Persons for their service to the Company and to Gladstone Commercial

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Corporation. The following table provides detail as to aggregate compensation paid for 2004 to the three highest paid executive officers of the Company solely in respect of services provided to Gladstone Capital Corporation:

Executive Officer	Salary	Bonus	Other Annual Compensation
Mr. Gladstone	\$ 119,167	\$ 0	\$ 0
Mr. Brubaker	\$ 196,775	\$ 0	\$ 0
Mr. Stelljes	\$ 162,757	\$ 50,000	\$ 0

(2) Mr. Outland joined the Board of Directors on December 9, 2003, after the end of fiscal 2003.

Stock Option Grants And Exercises

The following tables show for the fiscal year ended September 30, 2004, certain information regarding options granted to, exercised by, and held at year end by the Company's Compensated Persons:

Option Grants in Last Fiscal Year

	Individual Grants Number of Securities Underlying Options Granted (#)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Share)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(1)	
					5% (\$)	10% (\$)
David Gladstone	0	0 %	\$		\$	\$
Terry Lee Brubaker	45,000	14 %	\$ 22.55	4/6/2014	\$ 638,171	\$ 1,617,250
George Stelljes III	45,000	14 %	\$ 22.55	4/6/2004	\$ 638,171	\$ 1,617,250

(1) The potential realizable value is based on the term of the option at the time of its grant (10 years). It is calculated by assuming that the stock price on the date of the grant appreciates at the indicated annual rate, compounded annually for the entire term of the option and that the option is exercised and the underlying shares sold on the last day of its term for the appreciated stock price. The amounts represent certain assumed rates of appreciation only, in accordance with the rules of the SEC, and do not reflect the Company's estimate or projection of future stock price performance. Actual gains, if any, are dependent on the actual future performance of the Company's common stock and no gain to the optionee is possible unless the stock price increases over the option term, which will benefit all stockholders.

**Aggregated Option Exercises in Fiscal 2004
and Value of Options at End of Fiscal 2004**

Name	Shares Acquired on Exercise (#)	Value Realized \$(1)	Number of Securities Underlying Unexercised Options at FY-End (#) Vested	Value of Unexercised In-the Money Options FY-End \$(2)
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