GLADSTONE INVESTMENT CORPORATION\DE
Form 10-K
June 02, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended March 31, 2009

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 814-00704

GLADSTONE INVESTMENT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**83-0423116** (I.R.S. Employer Identification No.)
1521 Westbranch Drive, Suite 200 **McLean, Virginia** (Address of principal executive offices)	**22102** (Zip Code)

(703) 287-5800
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $0.001 par value per share		**NASDAQ Global Select Market**
(Title of each class)		(Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES o NO x

Indicate by check if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. YES o NO x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES o NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12 b-2 of the Exchange Act). YES o NO x

The aggregate market value of the voting stock held by non-affiliates of the Registrant on September 30, 2008, based on the closing price on that date of $6.88 on the NASDAQ Global Select Market, was $210,637,992. For the purposes of calculating this amount only, all directors and executive officers of the Registrant have been treated as affiliates. There were 22,080,133 shares of the Registrant s Common Stock, $0.001 par value, outstanding as of May 29, 2009.

Documents Incorporated by Reference. Portions of the Registrant s Proxy Statement relating to the Registrant s 2009 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K as indicated herein.

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GLADSTONE INVESTMENT CORPORATION

FORM 10-K FOR THE FISCAL YEAR ENDED

MARCH 31, 2009

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FORWARD-LOOKING STATEMENTS

All statements contained herein, other than historical facts, may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933(the Securities Act), as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements may relate to, among other things, future events or our future performance or financial condition. In some cases, you can identify forward-looking statements by terminology such as may, might, believe, will, provided, anticipate, future, could, growth, plan, intend, expect, should, would, if, seek, possible, potential, likely or the negative of such terms or comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) further adverse changes in the economy and the capital markets; (2) risks associated with negotiation and consummation of pending and future transactions; (3) the loss of one or more of our executive officers, in particular David Gladstone, Terry Lee Brubaker, George Stelljes III or David Dullum; (4) changes in our business strategy; (5) availability, terms and deployment of capital; (6) changes in our industry, interest rates, exchange rates or the general economy; (7) the degree and nature of our competition; and (8) those factors described in the Risk Factors section of this Form 10-K. We caution readers not to place undue reliance on any such forward-looking statement. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Form 10-K.

PART I

In this Annual Report on Form 10-K, or Annual Report, the Company, we, us, and our refer to Gladstone Investment Corporation and its wholly-owned subsidiaries unless the context otherwise indicates.

Item 1. Business

Overview

We were incorporated under the General Corporation Laws of the State of Delaware on February 18, 2005. On June 22, 2005 we completed an initial public offering and commenced operations. We were primarily established for the purpose of investing in subordinated loans, mezzanine debt, preferred stock and warrants to purchase common stock of small and medium-sized companies in connection with buyouts and other recapitalizations. We also invest in senior secured loans, common stock and, to a much lesser extent, senior and subordinated syndicated loans. Our investment objective is to generate both current income and capital gains through these debt and equity instruments. We operate as a closed-end, non-diversified management investment company and have elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act).

Our Investment Strategy

We seek to achieve returns from current income from senior, subordinated and mezzanine debt, and capital gains from preferred stock and warrants to purchase common stock that we purchase in connection with buyouts and recapitalizations of small and mid-sized companies with established management teams. We seek to make investments that generally range between $10 million and $40 million each, although this investment size may vary proportionately as the size of our capital base changes. Typically, our investments mature in no more than seven years and accrue interest at fixed or variable rates. We invest either by ourselves or jointly with other buyout funds and/or management of the portfolio company, depending on the opportunity. If we are participating in an investment with one or more co-investors, then our investment is likely to be smaller than if we were to be investing alone.

We expect that our target portfolio over time will include mostly subordinated loans, mezzanine debt, preferred stock, and warrants to buy common stock. Structurally, subordinated loans and mezzanine loans usually rank lower in priority of payment to senior debt, such as senior bank debt, and may be unsecured. However, subordinated debt and mezzanine loans rank senior to common and preferred equity in a borrower s capital structure. Typically, subordinated debt and mezzanine loans have elements of both debt and equity instruments, offering returns in the form of interest payments associated with senior debt, while providing lenders an opportunity to participate in the capital appreciation of a borrower, if any, through an equity position. Due to its higher risk profile and often less restrictive covenants as compared to senior debt, mezzanine debt generally earns a higher return than senior secured debt. Any warrants associated with mezzanine loans are typically detachable, which allows lenders to receive repayment of their principal on an agreed amortization schedule while retaining

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their equity interest in the borrower. Mezzanine debt also may include a put feature, which permits the holder to sell its equity interest back to the borrower at a price determined through a pre-determined formula.

Our Investments

Control and Affiliate Investments

At March 31, 2009 and 2008, we had investments in Control and Affiliate investments, at fair value, of approximately $157.0 million and $142.2 million, respectively, in revolving credit facilities, senior debt and subordinated debt. In addition, at March 31, 2009 and 2008, we held, at fair value, approximately $62.2 million and $50.7 million, respectively, in preferred and common equity of those companies.

At March 31, 2009 and 2008, our investments in Control investments, at fair value, represented approximately 77% and 70%, respectively, of our net assets. Also, at March 31, 2009 and 2008, our investments in Affiliate investments, at fair value, represented approximately 25% and 23%, respectively, of our net assets.

Investment Activity

On May 19, 2008, we invested approximately $5.75 million in Tread Corporation (Tread) and its subsidiaries. The investment was comprised of approximately $750,000 in preferred stock, $5.0 million of senior second lien debt notes and a nominal amount in convertible common stock warrants. Tread, based in Roanoke, VA, was founded in 1957 and manufactures products that store, transport and mix the primary ingredients for liquid explosives, which are ammonium nitrate and fuel oil.

On August 22, 2008, we invested approximately $21.4 million in Galaxy Tool Holding Corporation (Galaxy) and its subsidiaries. The investment was comprised of approximately $4.1 million and $48,000 in preferred stock and common stock, respectively, and $17.25 million in a senior second lien debt note. Galaxy, based in Winfield, KS, was founded in 1985 and is a manufacturer of specialized tooling for the aerospace industry, as well as blow and injection molds for the plastics industry.

On August 29, 2008, we restructured our investment with Quench USA, LLC (Quench), reaching a settlement on the revolving credit facility and the term A senior subordinated debt and increased the term B senior subordinated debt to $8.0 million. In the restructuring, approximately $617,000 of distributions were received, $567,000 of which were recorded as ordinary income. The remaining $50,000 reduced our basis in Quench. Furthermore, due to a decrease in our ownership percentage in the investment, Quench was reclassified in these financial statements as an Affiliate investment, along with all unrealized gains and losses and interest income associated with the investment since the date of the restructuring.

On September 11, 2008, we invested approximately $3.1 million in A. Stucki Holding Corp. (Stucki) in the form of additional debt to the existing senior subordinated term debt for Stucki s acquisition of the assets of Alco Spring Industries, Inc. (Alco). Alco, located in Chicago, IL, is one of the last independent manufacturers of hot wound springs for the transportation and heavy equipment industries. This investment carries the same terms as the original senior subordinated term debt facility. Our equity securities and ownership position did not change as a result of this transaction.

In October 2008, we executed a guaranty of a vehicle finance facility agreement between Ford Motor Credit Company (FMC) and Auto Safety House, LLC (ASH), one of our Control investments (the Finance Facility). The Finance Facility provides ASH with a line of credit of up to $500,000 for component Ford parts used by ASH to build truck bodies under a separate contract. Title and ownership of the parts is retained by Ford. The guaranty of the Finance Facility will expire upon termination of the separate parts supply contract with Ford or upon our replacement as guarantor. The Finance Facility is secured by all the assets of Business Investment. As of March 31, 2009, we have not been required to make any payments on the guaranty of the Finance Facility.

On November 10, 2008, we invested approximately $10.7 million in Country Club Enterprises, LLC (CCE), comprised of approximately $3.7 million in preferred stock and $7.0 million in subordinated term debt. CCE, headquartered in Wareham, MA, was founded in 1975 and is one of the largest distributors of golf carts in the United States.

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In April 2009, we entered into agreements with certain of our Control and Affiliate investments that included repayments and reductions of portions of certain senior term debt and revolving lines of credit. See Note 13, Subsequent Events in our Notes to the Consolidated Financial Statements.

Near-term Investment Strategy and Compliance with the Regulated Investment Company Asset Diversification Test

As of the date of this report, we have limited capital resources available to make additional investments. Moreover, because of recent changes in our asset portfolio and their effect on our ability to satisfy certain elements of the Internal Revenue Code s rules for maintenance of our regulated investment company, or RIC, status, we are currently unable to make new investments, including additional investments in our portfolio companies (such as advances under outstanding lines of credit), without jeopardizing our continued status as a RIC. Under the rules applicable to RICs, we are required to be in compliance with the asset diversification test at each quarter end, with June 30, 2009 being the next quarterly measurement date. As of the date of this report, however, due to sales of Non-Control/Non-Affiliate investments subsequent to the quarter ended March 31, 2009, there is a significant possibility that at June 30, 2009, we will be below the 50% threshold of the asset diversification test. However, failure to meet the asset diversification test alone will not result in our loss of RIC status. In circumstances where the failure to meet the quarterly 50% threshold is the result of fluctuations in the value of assets, including as a result of the sale of assets, we are still deemed under the rules to satisfy the asset diversification test and, therefore, maintain our RIC status, as long as we have not made any new investments since the time that we fell below the 50% threshold.

Although we currently qualify as a RIC, if we make any additional investments before regaining compliance with the asset diversification test, our RIC status will be threatened. In this situation, if we did not regain compliance with the 50% threshold prior to the next quarterly measurement date following the additional investment, we would be in non-compliance with the RIC rules and would have thirty days to cure our failure of the asset diversification test to avoid our loss of RIC status. Potential cures for failure of the asset diversification test include raising additional equity or debt capital, or changing the composition of our assets, which could include full or partial divestitures of investments, such that we would once again exceed the 50% threshold. We are currently seeking to obtain a short-term credit facility under which we would be able to borrow funds at each quarter end that would allow us to satisfy the asset diversification test for the foreseeable future, thereby allowing us to make additional investments prior to June 30, 2009, or thereafter, and be in compliance with this test. There can be no assurance, however, that we will be able to enter into such a credit facility on reasonable terms, if at all, or that any other cures will be available to us such that our investment activity could resume.

Non-Control/Non-Affiliate Investments

At March 31, 2009 and 2008, we held investments in Non-Control/Non-Affiliate investments of approximately $94.7 million and $142.7 million, at fair value, respectively. These investments were comprised primarily of syndicated loan participations of senior notes of both public and private companies and also non-syndicated loan investments where we did not have a significant ownership interest in the portfolio company. Also included in Non-Control/Non-Affiliate investments, at both March 31, 2009 and 2008, were common stock warrants of one Non-Control/Non-Affiliate company, which carried fair values of $0 and $265, respectively. Our investments, at fair value, in Non-Control/Non-Affiliate investments represented approximately 44% and 69% of our net assets at March 31, 2009 and 2008, respectively. Subsequent to March 31, 2009, we sold 29 of the remaining 32 senior syndicated loans (collectively, the Subsequent Syndicated Loan Sales) included in the Non-Control/Non-Affiliate investments for an aggregate of approximately $69.2 million in cash proceeds and recorded a realized loss of approximately $34.6 million in connection with these sales. These loans were sold to pay down all unpaid principal and interest owing to Deutsche Bank, A.G. under our prior credit agreement. Given foreseeable market conditions, we do not intend to significantly continue to invest in senior syndicated loans in the near term. See Note 13, Subsequent Events in our Notes to the Consolidated Financial Statements.

Investment Concentrations

Approximately 59.0% of the aggregate fair value of our investment portfolio at March 31, 2009 consisted of senior term debt, approximately 21.2% was senior subordinated term debt and approximately 19.8% was preferred and common equity securities. At March 31, 2009, we had an aggregate of approximately $348.9 million, at cost, invested in 46 portfolio companies. The following table outlines our investments by type at March 31, 2009 and 2008:

	March 31, 2009		March 31, 2008	
	Cost	Fair Value	Cost	Fair Value
Senior Term Debt	$ 230,861	$ 185,161	$ 269,270	$ 244,878
Senior Subordinated Term Debt	72,762	66,576	43,894	38,644
Subordinated Term Debt			1,089	1,089
Preferred & Common Equity Securities	45,322	62,193	36,552	50,993
Total Investments	**$ 348,945**	**$ 313,930**	**$ 350,805**	**$ 335,604**

As a result of the Subsequent Syndicated Loan Sales, as of May 29, 2009, 46.3% of the aggregate fair value of our investment portfolio consisted of senior term debt, approximately 27.7% was senior subordinated term debt and 26.0% was preferred and common equity securities. As of May 29, 2009, we had an aggregate of approximately $239.7 million, at cost, invested in 17 portfolio companies.

Investments at fair value consisted of the following industry classifications at March 31, 2009 and 2008:

	March 31, 2009			March 31, 2008		
		Percentage of			Percentage of	
	Fair Value	Total Investments	Net Assets	Fair Value	Total Investments	Net Assets
Aerospace and Defense	$ 22,436	7.2%	10.4%	$	0.0%	0.0%
Automobile	14,436	4.6%	6.7%	2,074	0.6%	1.0%
Beverage, Food and Tobacco	1,570	0.5%	0.7%	3,454	1.0%	1.7%
Broadcasting and Entertainment	1,934	0.6%	0.9%	3,499	1.1%	1.7%
Buildings and Real Estate	10,709	3.4%	5.0%	11,734	3.5%	5.7%
Cargo Transport	13,324					