

GLADSTONE CAPITAL CORP

Form 10-Q

May 04, 2010

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

- x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**FOR THE QUARTER ENDED MARCH 31, 2010**

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

**COMMISSION FILE NUMBER: 814-00237**

**GLADSTONE CAPITAL CORPORATION**

(Exact name of registrant as specified in its charter)

**MARYLAND**

(State or other jurisdiction of incorporation or organization)

**54-2040781**

(I.R.S. Employer Identification No.)

**1521 WESTBRANCH DRIVE, SUITE 200**

**MCLEAN, VIRGINIA 22102**

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(Address of principal executive office)

**(703) 287-5800**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (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  No .

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company .

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares of the issuer's Common Stock, \$0.001 par value, outstanding as of May 4, 2010 was 21,039,242.

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## GLADSTONE CAPITAL CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

	March 31, 2010	September 30, 2009
<b>ASSETS</b>		
Non-Control/Non-Affiliate investments (Cost 3/31/10: \$274,627; 9/30/09: \$312,043)	\$ 256,227	\$ 286,997
Control investments (Cost 3/31/10: \$55,467; 9/30/09: \$52,350)	35,524	33,972
Total investments at fair value (Cost 3/31/10: \$330,094; 9/30/09: \$364,393)	291,751	320,969
Cash	4,261	5,276
Interest receivable investments in debt securities	2,387	3,048
Interest receivable employees (Refer to Note 4)	91	85
Due from custodian	10,571	3,059
Due from Adviser (Refer to Note 4)		69
Deferred financing fees	1,610	1,230
Prepaid assets	288	341
Receivable from portfolio companies, less allowance for uncollectible receivables of \$177 and \$0 at March 31, 2010 and September 30, 2009, respectively	367	1,528
Other assets	312	305
<b>TOTAL ASSETS</b>	<b>\$ 311,638</b>	<b>\$ 335,910</b>
<b>LIABILITIES</b>		
Accounts payable	\$	\$ 67
Interest payable	244	378
Fee due to Administrator (Refer to Note 4)	176	216
Due to Adviser (Refer to Note 4)	2,365	834
Borrowings under line of credit at fair value (Cost 3/31/10: \$53,000; 9/30/09: \$83,000)	53,000	83,350
Accrued expenses and deferred liabilities	1,203	1,800
Funds held in escrow	101	189
<b>TOTAL LIABILITIES</b>	<b>57,089</b>	<b>86,834</b>
<b>NET ASSETS</b>	<b>\$ 254,549</b>	<b>\$ 249,076</b>
<b>ANALYSIS OF NET ASSETS</b>		
Common stock, \$0.001 par value, 50,000,000 shares authorized and 21,039,242 and 21,087,574 shares issued and outstanding at March 31, 2010 and September 30, 2009, respectively	\$ 21	\$ 21
Capital in excess of par value	327,709	328,203
Notes receivable employees (Refer to Note 4)	(8,503)	(9,019)
Net unrealized depreciation on investments	(38,343)	(43,425)
Net unrealized appreciation on borrowings under line of credit		(350)
Accumulated Net Realized Losses	(26,335)	(26,354)
<b>TOTAL NET ASSETS</b>	<b>\$ 254,549</b>	<b>\$ 249,076</b>
<b>NET ASSETS PER SHARE</b>	<b>\$ 12.10</b>	<b>\$ 11.81</b>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.



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**GLADSTONE CAPITAL CORPORATION**  
**CONDENSED CONSOLIDATED SCHEDULE OF INVESTMENTS**  
**AS OF MARCH 31, 2010**  
**(DOLLAR AMOUNTS IN THOUSANDS)**  
**(UNAUDITED)**

Company (1)	Industry	Investment (2)	Cost	Fair Value
<b>NON-CONTROL/NON-AFFILIATE INVESTMENTS</b>				
<i>Non-syndicated Loans:</i>				
Access Television Network, Inc.	Service-cable airtime (infomercials)	Senior Term Debt (14.5%, Due 12/2009) (5) (11)	\$ 963	\$ 794
Allison Publications, LLC	Service-publisher of consumer oriented magazines	Senior Term Debt (10.5%, Due 9/2012) (5) Senior Term Debt (13.0%, Due 12/2010) (5)	9,399 195	8,779 191
Anitox Acquisition Company	Manufacturing-preservatives for animal feed	Line of Credit, \$3,000 available (4.5%, Due 1/2011) (5) Senior Term Debt (8.5%, Due 1/2012) (5) Senior Term Debt (10.5%, Due 1/2012) (3) (5)	1,950 2,603 3,688	1,950 2,596 3,660
BAS Broadcasting	Service-radio station operator	Senior Term Debt (11.5%, Due 7/2013) (5)	7,435	6,766
Chinese Yellow Pages Company	Service-publisher of Chinese language directories	Line of Credit, \$700 available (7.3%, Due 9/2010) (5) Senior Term Debt (7.3%, Due 9/2010) (5)	450 425	432 407
CMI Acquisition, LLC	Service-recycling	Senior Subordinated Term Debt (10.3%, Due 11/2012) (5)	6,240	6,061
Doe & Ingalls Management LLC	Distributor-specialty chemicals	Senior Term Debt (8.0%, Due 11/2010) (5) Senior Term Debt (9.0%, Due 11/2010) (3) (5)	1,900 4,343	1,881 4,299
Finn Corporation	Manufacturing-landscape equipment	Common Stock Warrants (7) (8)	37	651
GFRC Holdings LLC	Manufacturing-glass-fiber reinforced concrete	Senior Term Debt (9.0%, Due 12/2012) (5) Senior Subordinated Term Debt (11.5%, Due 12/2012) (3) (5)	6,405 6,649	6,333 6,516
Global Materials Technologies, Inc.	Manufacturing-steel wool products and metal fibers	Senior Term Debt (14.0%, Due 6/2010) (3) (5)	4,310	3,232

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Heartland Communications Group	Service-radio station operator	Senior Term Debt (10.0%, Due 5/2011) (5)	4,559	2,272
Interfilm Holdings, Inc.	Service-slitter and distributor of plastic films	Senior Term Debt (12.3%, Due 10/2012) (5)	4,924	4,796
International Junior Golf Training Acquisition Company	Service-golf training	Line of Credit, \$1,500 available (9.0%, Due 5/2010) (5) (13)	1,500	1,487
		Senior Term Debt (8.5%, Due 5/2012) (5)	1,854	1,823
		Senior Term Debt (10.5%, Due 5/2012) (3) (5)	2,500	2,438
KMBQ Corporation	Service-AM/FM radio broadcaster	Line of Credit, \$200 available (11.0%, Due 7/2010) (5)	162	32
		Senior Term Debt (11.0%, Due 7/2010) (5)	1,921	384
Legend Communications of Wyoming LLC	Service-operator of radio stations	Line of Credit, \$500 available (12.0%, Due 6/2011) (5)	497	430
		Senior Term Debt (12.0%, Due 6/2013) (5)	9,373	8,107
Newhall Holdings, Inc.	Service-distributor of personal care products and supplements	Line of Credit, \$1,350 available (5.0%, Due 5/2010) (5)	1,000	934
		Senior Term Debt (5) (5.0%, Due 5/2012) (5)	3,870	3,614
		Senior Term Debt (5.0%, Due 5/2012) (3) (5)	4,648	4,294
		Preferred Equity (7) (8)		
		Common Stock (7) (8)		
Northern Contours, Inc.	Manufacturing-veneer and laminate components	Senior Subordinated Term Debt (13.0%, Due 9/2012) (5)	6,388	5,781

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## GLADSTONE CAPITAL CORPORATION

## CONDENSED CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

AS OF MARCH 31, 2010

(DOLLAR AMOUNTS IN THOUSANDS)

(UNAUDITED)

Company (1)	Industry	Investment (2)	Cost	Fair Value
Northstar Broadband, LLC	Service-cable TV franchise owner	Senior Term Debt (0.7%, Due 12/2012) (5)	\$ 143	\$ 120
Pinnacle Treatment Centers, Inc.	Service-Addiction treatment centers	Senior Term Debt (10.5%, Due 12/2011) (5)	2,350	2,332
		Senior Term Debt (10.5%, Due 12/2011) (3) (5)	7,500	7,359
Precision Acquisition Group Holdings, Inc.	Manufacturing-consumable components for the aluminum industry	Equipment Note (13.0%, Due 10/2010) (5)	1,000	975
		Senior Term Debt (13.0%, Due 10/2010) (5)	4,125	4,022
		Senior Term Debt (13.0%, Due 10/2010) (3) (5)	4,053	3,952
PROFITSystems Acquisition Co.	Service-design and develop ERP software	Line of Credit, \$350 available (4.5%, Due 7/2010)		
		Senior Term Debt (8.5%, Due 7/2011) (5)	1,300	1,216
		Senior Term Debt (10.5%, Due 7/2011) (3) (5)	2,900	2,686
RCS Management Holding Co.	Service-healthcare supplies	Senior Term Debt (8.5%, Due 1/2011) (3) (5)	2,187	2,179
		Senior Term Debt (10.5%, Due 1/2011) (4) (5)	3,060	3,037
Reliable Biopharmaceutical Holdings, Inc.	Manufacturing-pharmaceutical and biochemical intermediates	Line of Credit, \$5,000 available (9.0%, Due 10/2010) (5)	700	698
		Mortgage Note (9.5%, Due 10/2014) (5)	7,293	7,284
		Senior Term Debt (9.0%, Due 10/2012) (5)	1,305	1,302
		Senior Term Debt (11.0%, Due 10/2012) (3) (5)	11,753	11,635
		Senior Subordinated Term Debt (12.0%, Due 10/2013) (5) Common Stock Warrants (7) (8)	6,000 209	5,873
Saunders & Associates	Manufacturing-equipment provider for frequency control devices	Senior Term Debt (9.8%, Due 5/2013) (5)	9,558	9,534
SCI Cable, Inc.	Service-cable, internet, voice provider	Senior Term Debt (non-accrual, Due 10/2008) (5) (10) (13)	3,031	379
Sunburst Media - Louisiana, LLC	Service-radio station operator	Senior Term Debt (10.5%, Due 6/2011) (5)	6,401	5,961



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Sunshine Media Holdings	Service-publisher regional B2B trade magazines	Line of credit, \$2,000 available (9.0%, Due 2/2011) (5)	799	751
		Senior Term Debt (10.5%, Due 5/2012) (5)	16,948	15,931
		Senior Term Debt (13.3%, Due 5/2012) (3) (5)	10,700	9,898
Thibaut Acquisition Co.	Service-design and disribute wall covering	Line of Credit, \$1,000 available (9.0%, Due 1/2011) (5)	1,000	957
		Senior Term Debt (8.5%, Due 1/2011) (5)	1,413	1,352
		Senior Term Debt (12.0%, Due 1/2011) (3) (5)	3,000	2,839
VantaCore	Service-acquisition of aggregate quarries	Senior Subordinated Term Debt (12.0%, Due 8/2013) (14)	13,590	13,590
Viapack, Inc.	Manufacturing-polyethylene film	Senior Real Estate Term Debt (10.0%, Due 3/2011) (5)	725	719
		Senior Term Debt (13.0%, Due 3/2011) (3) (5)	4,058	4,022
Westlake Hardware, Inc.	Retail-hardware and variety	Senior Subordinated Term Debt (10.3%, Due 1/2011) (5)	15,000	14,700
		Senior Subordinated Term Debt (11.5%, Due 1/2011) (5)	10,000	9,700
Winchester Electronics	Manufacturing-high bandwidth connectors and cables	Senior Term Debt (5.2%, Due 12/2010) (5)	1,250	1,244
		Senior Term Debt (5.7%, Due 5/2013) (5)	1,686	1,648
		Senior Subordinated Term Debt (14.0%, Due 6/2013) (5)	9,900	9,529
<i>Subtotal Non-syndicated loans</i>			265,125	248,364

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**GLADSTONE CAPITAL CORPORATION**  
**CONDENSED CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)**  
**AS OF MARCH 31, 2010**  
**(DOLLAR AMOUNTS IN THOUSANDS)**  
**(UNAUDITED)**

Company (1)	Industry	Investment (2)	Cost	Fair Value
<b>Syndicated Loans:</b>				
Puerto Rico Cable Acquisition Company, Inc.	Service-telecommunications	Senior Subordinated Term Debt (7.8%, Due 1/2012) (6)	\$ 7,167	\$ 6,284
WP Evenflo Group Holdings Inc.	Manufacturing-infant and juvenile products	Senior Term Debt (8.0%, Due 2/2013) (6)	1,891	1,579
		Senior Preferred Equity (7) (8)	333	
		Junior Preferred Equity (7) (8)	111	
		Common Stock (7) (8)		
<i>Subtotal - Syndicated loans</i>			9,502	7,863
<b>Total Non-Control/Non-Affiliate Investments</b>			<b>\$ 274,627</b>	<b>\$ 256,227</b>
<b>CONTROL INVESTMENTS</b>				
BERTL, Inc.	Service-web-based evaluator of digital imaging products	Line of Credit, \$1,023 available (non-accrual, Due 10/2010) (7)(10)(12) Common Stock (7) (8)	\$ 996 423	\$ 232
Clinton Holdings, LLC	Distribution-aluminum sheets and stainless steel	Senior Subordinated Term Debt (12.0%, Due 1/2013) (5) Common Stock Warrants (7) (8)	17,140 109	12,855
Defiance Integrated Technologies, Inc.	Manufacturing-trucking parts	Senior Term Debt (11.0%, Due 4/2013) (3) (5) Common Stock (7) (8) Guaranty (\$250)	8,324 1	8,325
Lindmark Acquisition, LLC	Service-advertising	Senior Subordinated Term Debt (non-accrual, Due 10/2012) (5) (9) (10)	10,000	8,825
		Senior Subordinated Term Debt (non-accrual, Due 12/2010) (5) (9) (10)	2,000	1,765
		Senior Subordinated Term Debt (non-accrual, Due Upon Demand) (5)(9)(10)	1,788	1,274
		Common Stock (7) (8)	1	
LYP Holdings Corp.	Service-yellow pages publishing	Line of credit, \$1,850 available (10.0%, Due 12/2010) (7)	1,698	1,698
		Senior Term Debt (12.5%, Due 2/2012) (7)	325	325
		Line of Credit, \$3,000 available (non-accrual, Due 6/2010) (7) (10)	1,170 2,688	64

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		Senior Term Debt (non-accrual, Due 6/2011) (7) (10)		
		Senior Term Debt (non-accrual, Due 6/2011) (3) (7) (10)	2,750	
		Common Stock Warrants (7) (8)		
U.S. Healthcare Communications, Inc.	Service-magazine publisher/operator	Line of credit, \$400 available (non-accrual, Due 12/2010) (7) (10)	269	161
		Line of credit, \$450 available (non-accrual, Due 12/2010) (7) (10)	450	
		Common Stock (7) (8)	2,470	
Western Directories, Inc.	Service-directory publisher	Line of credit, \$1,280 available (non-accrual, Due 12/2010) (7) (10)	1,280	
		Preferred Stock (7) (8)	1,584	
		Common Stock (7) (8)	1	
<b>Total Control Investments</b>			<b>\$ 55,467</b>	<b>\$ 35,524</b>
<b>Total Investments</b>			<b>\$ 330,094</b>	<b>\$ 291,751</b>

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**GLADSTONE CAPITAL CORPORATION**

**CONDENSED CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)**

**AS OF MARCH 31, 2010**

**(DOLLAR AMOUNTS IN THOUSANDS)**

**(UNAUDITED)**

- 
- (1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.
  - (2) Percentage represents interest rates in effect at March 31, 2010 and due date represents the contractual maturity date.
  - (3) Last Out Tranche of senior debt, meaning if the portfolio company is liquidated, the holder of the Last Out Tranche is paid after the senior debt.
  - (4) Last Out Tranche of senior debt, meaning if the portfolio company is liquidated, the holder of the Last Out Tranche is paid after the senior debt, however, the debt is also junior to another Last Out Tranche.
  - (5) Fair value was based on opinions of value submitted by Standard & Poor's Securities Evaluations, Inc.
  - (6) Security valued based on the indicative bid price on or near March 31, 2010, offered by the respective syndication agent's trading desk or secondary desk.
  - (7) Fair value was based on the total enterprise value of the portfolio company using a liquidity waterfall approach. The Company also considered discounted cash flow methodologies.
  - (8) Security is non-income producing.
  - (9) Lindmark's loan agreement was amended in March 2009 such that any unpaid current interest accrues at a success fee rate. The success fee is to be paid upon certain conditions being met and is not recorded until paid. Please refer to Note 2, Summary of Significant Accounting Policies - Interest Income Recognition. For the three and six months ended March 31, 2010, the Company recorded \$0 of interest income.
  - (10) BERTL, Lindmark, SCI Cable, U.S. Healthcare, Western Directories and a portion of LYP Holdings are currently past due on interest payments and are on non-accrual.
  - (11) Access TV's loan matured in December 2009. The Company is actively working to recover amounts due under this loan, however, there is no assurance that there will be any recovery of amounts past due.
  - (12) ACE Expeditors' interest and BERTL's interest include paid in kind interest. Please refer to Note 2, Summary of Significant Accounting Policies.
  - (13) Subsequent to March 31, 2010, International Junior Golf's line of credit was extended to May 2011 and SCI Cable's senior term debt was amended with a maturity date of October 2012.
  - (14) VantaCore's fair value was based on the full repayment subsequent to March 31, 2010. Please refer to Note 10, Subsequent Events.

*THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.*

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**GLADSTONE CAPITAL CORPORATION**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS**  
**AS OF SEPTEMBER 30, 2009**  
**(DOLLAR AMOUNTS IN THOUSANDS)**

Company (1)	Industry	Investment (2)	Cost	Fair Value
<b>NON-CONTROL/NON-AFFILIATE INVESTMENTS</b>				
<i>Non-syndicated Loans:</i>				
Access Television Network, Inc.	Service-cable airtime (infomercials)	Senior Term Debt (14.5%, Due 12/2009) (5) (9)	\$ 963	\$ 868
ACE Expeditors, Inc	Service-over-the-ground logistics	Senior Term Debt (13.5%, Due 9/2014) (5) (13) Common Stock Warrants (8)	5,106 200	4,864 564
ActivStyle Acquisition Co.	Service-medical products distribution	Senior Term Debt (13.0%, Due 4/2014) (3) (5)	4,000	3,940
Allison Publications, LLC	Service-publisher of consumer oriented magazines	Senior Term Debt (10.0%, Due 9/2012) (5) Senior Term Debt (13.0%, Due 12/2010) (5)	9,709 260	8,746 246
Anitox Acquisition Company	Manufacturing-preservatives for animal feed	Line of Credit, \$3,000 available (4.5%, Due 1/2010) (5) Senior Term Debt (8.5%, Due 1/2012) (5) Senior Term Debt (10.5%, Due 1/2012) (3) (5)	1,700 2,877 3,688	1,681 2,823 3,582
BAS Broadcasting	Service-radio station operator	Senior Term Debt (11.5%, Due 7/2013) (5) Senior Term Debt (12.0%, Due 7/2009) (3) (5) (12)	7,300 950	5,840 475
CCS, LLC	Service-cable TV franchise owner	Senior Term Debt (non-accrual, Due 8/2008) (5) (10) (12)	631	126
Chinese Yellow Pages Company	Service-publisher of Chinese language directories	Line of Credit, \$700 available (7.3%, Due 9/2010) (5) Senior Term Debt (7.3%, Due 9/2010) (5)	450 518	427 488
CMI Acquisition, LLC	Service-recycling	Senior Subordinated Term Debt (10.3%, Due 11/2012) (5)	6,233	5,890
Doe & Ingalls Management LLC	Distributor-specialty chemicals	Senior Term Debt (6.8%, Due 11/2010) (5) Senior Term Debt (7.8%, Due 11/2010) (3) (5)	2,300 4,365	2,266 4,267
Finn Corporation	Manufacturing-landscape equipment	Common Stock Warrants (8)	37	1,223

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GFRC Holdings LLC	Manufacturing-glass-fiber reinforced concrete	Line of Credit, \$2,000 available (4.5%, Due 12/2010)		
		Senior Term Debt (9.0%, Due 12/2012) (5)	6,599	6,450
		Senior Subordinated Term Debt (11.5%, Due 12/2012) (3) (5)	6,665	6,432
Global Materials Technologies, Inc.	Manufacturing-steel wool products and metal fibers	Senior Term Debt (13.0%, Due 6/2010) (3) (5)	4,410	3,528
Heartland Communications Group	Service-radio station operator	Senior Term Debt (10.0%, Due 5/2011) (5)	4,567	2,726
Interfilm Holdings, Inc.	Service-slitter and distributor of plastic films	Senior Term Debt (12.3%, Due 10/2012) (5)	4,950	4,715
International Junior Golf Training Acquisition Company	Service-golf training	Line of Credit, \$1,500 available (9.0%, Due 5/2010) (5)	700	690
		Senior Term Debt (8.5%, Due 5/2012) (5)	2,120	2,036
		Senior Term Debt (10.5%, Due 5/2012) (3) (5)	2,500	2,366
KMBQ Corporation	Service-AM/FM radio broadcaster	Line of Credit, \$200 available (11.0%, Due 3/2010) (5)	153	69
		Senior Term Debt (11.0%, Due 3/2010) (5)	1,785	801
Legend Communications of Wyoming LLC	Service-operator of radio stations	Line of Credit, \$500 available (12.0%, Due 6/2011) (5)	497	450
		Senior Term Debt (12.0%, Due 6/2013) (5)	9,373	8,482
Newhall Holdings, Inc.	Service-distributor of personal care products and supplements	Line of Credit, \$3,000 available (11.3%, Due 5/2010) (5)	1,000	945
		Senior Term Debt (5) (11.3%, Due 5/2012) (5)	3,870	3,657
		Senior Term Debt (14.3%, Due 5/2012) (3) (5)	4,410	4,112

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## GLADSTONE CAPITAL CORPORATION

## CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

SEPTEMBER 30, 2009

(DOLLAR AMOUNTS IN THOUSANDS)

Company (1)	Industry	Investment (2)	Cost	Fair Value
Northern Contours, Inc.	Manufacturing-veneer and laminate components	Senior Subordinated Term Debt (10.0%, Due 5/2010) (5)	\$ 6,562	\$ 5,414
Pinnacle Treatment Centers, Inc.	Service-Addiction treatment centers	Line of Credit, \$500 available (4.5%, Due 12/2009) Senior Term Debt (10.5%, Due 12/2011) (5) Senior Term Debt (10.5%, Due 12/2011) (3) (5)	2,750 7,500	2,633 7,059
Precision Acquisition Group Holdings, Inc.	Manufacturing-consumable components for the aluminum industry	Equipment Note (8.5%, Due 10/2011) (5) Senior Term Debt (8.5%, Due 10/2010) (5) Senior Term Debt (11.5%, Due 10/2010) (3) (5)	1,000 4,250 4,074	988 4,192 4,023
PROFITSystems Acquisition Co.	Service-design and develop ERP software	Line of Credit, \$350 available (4.5%, Due 7/2010) Senior Term Debt (8.5%, Due 7/2011) (5) Senior Term Debt (10.5%, Due 7/2011) (3) (5)	1,600 2,900	1,468 2,632
RCS Management Holding Co.	Service-healthcare supplies	Senior Term Debt (8.5%, Due 1/2011) (3) (5) Senior Term Debt (10.5%, Due 1/2011) (4) (5)	2,437 3,060	2,383 2,949
Reliable Biopharmaceutical Holdings, Inc.	Manufacturing-pharmaceutical and biochemical intermediates	Line of Credit, \$5,000 available (9.0%, Due 10/2010) (5) Mortgage Note (9.5%, Due 10/2014) (5) Senior Term Debt (9.0%, Due 10/2012) (5) Senior Term Debt (11.0%, Due 10/2012) (3) (5) Senior Subordinated Term Debt (12.0%, Due 10/2013) (5) Common Stock Warrants (8)	800 7,335 1,530 11,813 6,000 209	788 7,261 1,507 11,518 5,640 282
Saunders & Associates	Manufacturing-equipment provider for frequency control devices	Senior Term Debt (9.8%, Due 5/2013) (5)	10,780	10,618
SCI Cable, Inc.	Service-cable, internet, voice provider	Senior Term Debt (9.3%, Due 10/2008) (5) (12)	2,881	576
Sunburst Media - Louisiana, LLC	Service-radio station operator	Senior Term Debt (10.5%, Due 6/2011) (5)	6,411	5,817
Sunshine Media Holdings			16,948	15,973

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	Service-publisher regional B2B trade magazines	Senior Term Debt (11.0%, Due 5/2012) (5) Senior Term Debt (13.5%, Due 5/2012) (3) (5)	10,700	9,978
Thibaut Acquisition Co.	Service-design and disribute wall covering	Line of Credit, \$1,000 available (9.0%, Due 1/2011) (5) Senior Term Debt (8.5%, Due 1/2011) (5) Senior Term Debt (12.0%, Due 1/2011) (3) (5)	1,000 1,487 3,000	933 1,387 2,745
Tulsa Welding School	Service-private welding school	Line of credit, \$750 available (9.5%, Due 9/2011) Senior Term Debt (9.5%, Due 9/2013) (5) Senior Term Debt (12.8%, Due 9/2013) (5)	4,144 7,960	4,144 7,950
VantaCore	Service-acquisition of aggregate quarries	Senior Subordinated Term Debt (12.0%, Due 8/2013) (5)	13,726	13,589
Viapack, Inc.	Manufacturing-polyethylene film	Senior Real Estate Term Debt (10.0%, Due 3/2011) (5) Senior Term Debt (13.0%, Due 3/2011) (3) (5)	775 4,061	743 3,893
Visual Edge Technology, Inc.	Service-office equipment distribution	Line of credit, \$3,000 available (10.8%, Due 9/2011) (5) Senior Subordinated Term Debt (15.5%, Due 8/2011) (5)	2,981 5,000	2,340 3,925
Westlake Hardware, Inc.	Retail-hardware and variety	Senior Subordinated Term Debt (9.0%, Due 1/2011) (5) Senior Subordinated Term Debt (10.3%, Due 1/2011) (5)	15,000 10,000	14,269 9,400
Winchester Electronics	Manufacturing-high bandwidth connectors and cables	Senior Term Debt (5.3%, Due 5/2013) (5) Senior Term Debt (5.7%, Due 5/2013) (5) Senior Subordinated Term Debt (14.0%, Due 6/2013) (5)	1,147 1,690 9,925	1,136 1,642 9,478
<i>Subtotal - Non-syndicated loans</i>			298,322	277,048



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## GLADSTONE CAPITAL CORPORATION

## CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

SEPTEMBER 30, 2009

(DOLLAR AMOUNTS IN THOUSANDS)

Company (1)	Industry	Investment (2)	Cost	Fair Value
<b>Syndicated Loans:</b>				
GTM Holdings, Inc.	Manufacturing-socks	Senior Subordinated Term Debt (11.8%, Due 4/2014) (6)	\$ 500	\$ 220
Kinetek Acquisition Corp.	Manufacturing-custom engineered motors & controls	Senior Term Debt (3.6%, Due 11/2013) (7)	1,438	925
Puerto Rico Cable Acquisition Company, Inc.	Service-telecommunications	Senior Subordinated Term Debt (7.8%, Due 1/2012) (6)	7,174	5,713
Wesco Holdings, Inc.	Service-aerospace parts and distribution	Senior Subordinated Term Debt (6.0%, Due 3/2014) (7)	2,264	1,856
WP Evenflo Group Holdings Inc.	Manufacturing-infant and juvenile products	Senior Term Debt (8.0%, Due 2/2013) (6) Senior Preferred Equity (8) Junior Preferred Equity (8) Common Stock (8)	1,901 333 111	1,235
<i>Subtotal - Syndicated loans</i>			13,721	9,949
<b>Total Non-Control/Non-Affiliate Investments</b>			<b>\$ 312,043</b>	<b>\$ 286,997</b>
<b>CONTROL INVESTMENTS</b>				
BERTL, Inc.	Service-web-based evaluator of digital imaging products	Line of Credit, \$842 available (non-accrual, Due 10/2009) (10)(13)(15) Common Stock (8) (15)	\$ 930 424	\$
Clinton Holdings, LLC	Distribution-aluminum sheets and stainless steel	Senior Subordinated Term Debt (12.0%, Due 1/2013) (5) (14) Escrow Funding Note (12.0%, Due 1/2013) (5) (14) Common Stock Warrants (8) (15)	15,500 640 109	12,013 496
Defiance Integrated Technologies, Inc.	Manufacturing-trucking parts	Senior Term Debt (11.0%, Due 4/2010) (3) (11) Senior Term Debt (11.0%, Due 4/2010) (3) (11) Common Stock (8) (15) Guaranty (\$250)	6,005 1,178 1	6,005 1,178 816
Lindmark Acquisition, LLC	Service-advertising	Senior Subordinated Term Debt (11.3%, Due 10/2012) (5) (16) Senior Subordinated Term Debt (13.0%, Due Upon Demand) (5) (16) Common Stock (8) (15)	12,000 1,553 1	10,410 1,049

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LYP Holdings Corp.	Service-yellow pages publishing	Line of credit, \$1,250 available (10.0%, Due 7/2010) (15)	1,168	1,168
		Senior Term Debt (12.5%, Due 2/2012) (15)	325	325
		Line of Credit, \$3,000 available (non-accrual, Due 6/2010) (10) (15)	1,170	421
		Senior Term Debt (non-accrual, Due 6/2011) (10) (15)	2,688	
		Senior Term Debt (non-accrual, Due 6/2011) (3) (10) (15)	2,750	
		Common Stock Warrants (8) (15)		
U.S. Healthcare Communications, Inc.	Service-magazine publisher/operator	Line of credit, \$200 available (non-accrual, Due 3/2010) (10) (15)	169	91
		Line of credit, \$450 available (non-accrual, Due 3/2010) (10) (15)	450	
		Common Stock (8) (15)	2,470	
Western Directories, Inc.	Service-directory publisher	Line of credit, \$1,250 available (non-accrual, Due 12/2009) (10) (15)	1,234	
		Preferred Stock (8) (15)	1,584	
		Common Stock (8) (15)	1	
<b>Total Control Investments</b>			<b>\$ 52,350</b>	<b>\$ 33,972</b>
<b>Total Investments</b>			<b>\$ 364,393</b>	<b>\$ 320,969</b>

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- (1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.
  - (2) Percentage represents interest rates in effect at September 30, 2009 and due date represents the contractual maturity date.
  - (3) Last Out Tranche of senior debt, meaning if the portfolio company is liquidated, the holder of the Last Out Tranche is paid after the senior debt.
  - (4) Last Out Tranche of senior debt, meaning if the portfolio company is liquidated, the holder of the Last Out Tranche is paid after the senior debt, however, the debt is also junior to another Last Out Tranche.
  - (5) Fair value was based on opinions of value submitted by Standard & Poor's Securities Evaluations, Inc.
  - (6) Security valued based on the indicative bid price on or near September 30, 2009, offered by the respective syndication agent's trading desk or secondary desk.
  - (7) Security valued based on the transaction sale price subsequent to September 30, 2009.
  - (8) Security is non-income producing.
  - (9) Access Television includes a success fee with a fair value of \$1.
  - (10) BERTL, CCS, U.S. Healthcare, Western Directories and a portion of LYP Holdings are currently past due on interest payments and are on non-accrual. BERTL's loan matured in October 2009 and the Company is actively working to recover amounts due under this loan. However, there is no assurance that there will be any recovery of amounts past due.
  - (11) Fair value of security estimated to be equal to cost due to recent recapitalization.
  - (12) BAS Broadcasting's loan matured in July 2009, CCS's loan matured in August 2008 and SCI Cable's loan matured in October 2008. The Company is actively working to recover amounts due under these loans, however, there is no assurance that there will be any recovery of amounts past due.
  - (13) ACE Expeditors' interest and BERTL's interest include paid in kind interest. Please refer to Note 2, Summary of Significant Accounting Policies.
  - (14) Subsequent to September 30, 2009, Clinton's senior subordinated term debt and escrow funding note were combined into one term note, with an interest rate of 12.0% and maturity date of January 2013. In addition, a term loan was entered into for \$320, with an interest rate of 12.0% and maturity date of January 2013.
  - (15) Fair value was based on the total enterprise value of the portfolio company using a liquidity waterfall approach. The Company also considered discounted cash flow methodologies.
  - (16) Lindmark's loan agreement was amended in March 2009 such that any unpaid current interest accrues at a success fee rate. The success fee is to be paid upon certain conditions being met and is not recorded until paid. Please refer to Note 2, Summary of Significant Accounting Policies - Interest Income Recognition. For the period from April 2009 through September 2009, the Company recorded \$0 of interest income.

*THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.*

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## GLADSTONE CAPITAL CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

	Three Months Ended March 31,		Six Months Ended March 31,		
	2010	2009	2010	2009	
<b>INVESTMENT INCOME</b>					
Interest income	Non-Control/Non-Affiliate investments	\$ 8,523	\$ 10,329	\$ 17,432	\$ 21,990
Interest income	Control investments	709	482	1,477	502
Interest income	Cash		1		11
Interest income	Notes receivable from employees (Refer to Note 4)	108	117	221	235
Prepayment fees and other income		474		488	
Total investment income		9,814	10,929	19,618	22,738
<b>EXPENSES</b>					
Interest expense		1,136	2,016	2,671	4,478
Loan servicing fee (Refer to Note 4)		852	1,526	1,781	3,149
Base management fee (Refer to Note 4)		739	484	1,459	917
Incentive fee (Refer to Note 4)		1,072	1,089	1,447	2,265
Administration fee (Refer to Note 4)		176	211	354	438
Professional fees		219	205	1,131	518
Amortization of deferred financing fees		449	726	943	1,446
Stockholder related costs		144	196	222	284
Directors fees		48	48	97	97
Insurance expense		79	65	147	122
Compensation expense (Refer to Note 4)		245		245	
Other expenses		187	74	254	140
Expenses before credit from Adviser		5,346	6,640	10,751	13,854
Credit to base management and incentive fees from Adviser (Refer to Note 4)		(6)	(1,266)	(35)	(2,553)
Total expenses net of credit to base management and incentive fees		5,340	5,374	10,716	11,301
NET INVESTMENT INCOME		4,474	5,555	8,902	11,437
<b>REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, DERIVATIVE AND BORROWINGS UNDER LINE OF CREDIT:</b>					
Net realized gain (loss) on investments		892	(2,000)	(28)	(3,731)
Realized loss on settlement of derivative			(304)		(304)
Unrealized appreciation on derivative			304		304
Net unrealized appreciation (depreciation) on investments		2,483	6,725	5,082	(6,528)
Net unrealized depreciation on borrowings under line of credit		131		350	
Net gain (loss) on investments, derivative and borrowings under line of credit		3,506	4,725	5,404	(10,259)

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NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	\$	7,980	\$	10,280	\$	14,306	\$	1,178
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:								
Basic and Diluted	\$	0.38	\$	0.48	\$	0.68	\$	0.05
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:								
Basic and Diluted		21,075,445		21,087,574		21,081,576		21,087,574

*THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.*

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**GLADSTONE CAPITAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**  
**(DOLLAR AMOUNTS IN THOUSANDS)**  
**(UNAUDITED)**

	<b>Six Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<i>Operations:</i>		
Net investment income	\$ 8,902	\$ 11,437
Net realized loss on investments	(28)	(3,731)
Realized loss on settlement of derivative		(304)
Unrealized appreciation on derivative		304
Net unrealized appreciation (depreciation) on investments	5,082	(6,528)
Net unrealized depreciation on borrowings under line of credit	350	
Net increase in net assets from operations	14,306	1,178
<i>Capital transactions:</i>		
Shelf offering costs	(74)	(3)
Distributions to stockholders	(8,853)	(17,714)
Repayment of principal on employee notes		4
Conversion of former employee stock option loans from recourse to non-recourse	(420)	
Reclassification of principal on employee note	514	
Net decrease in net assets from capital transactions	(8,833)	(17,713)
Total increase (decrease) in net assets	5,473	(16,535)
Net assets at beginning of year	249,076	271,748
Net assets at end of period	\$ 254,549	\$ 255,213

*THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.*

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## GLADSTONE CAPITAL CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(DOLLAR AMOUNTS IN THOUSANDS)

(UNAUDITED)

	Six Months Ended March 31,	
	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net increase in net assets resulting from operations	\$ 14,306	\$ 1,178
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by operating activities:		
Purchase of investments	(7,320)	(17,129)
Principal repayments on investments	38,418	27,980
Proceeds from sale of investments	3,119	2,212
Net amortization of premiums and discounts	63	(109)
Increase in investment balance due to paid in kind interest	(60)	(377)
Repayment of paid in kind interest	51	
Net realized loss on investments	28	3,731
Amortization of deferred financing fees	943	1,445
Realized loss on settlement of derivative		304
Unrealized appreciation on derivative		(304)
Change in net unrealized (depreciation) appreciation on investments	(5,082)	6,528
Change in net unrealized appreciation on borrowings under line of credit	(350)	
Change in compensation expense from non-recourse notes	245	
Decrease in interest receivable	655	89
Increase in funds due from custodian	(7,512)	(5,588)
Decrease in prepaid assets	53	57
Decrease in due from affiliate	69	
Decrease in receivables from portfolio companies	1,161	
Increase in other assets	(2)	(317)
Decrease in accounts payable	(67)	
Decrease in interest payable	(134)	(166)
Decrease in accrued expenses and deferred liabilities	(752)	(33)
Increase in fees due to affiliate (Refer to Note 4)	1,531	235
Decrease in administration fee due to Gladstone Administration (Refer to Note 4)	(39)	(37)
Decrease in funds held in escrow	(89)	(113)
Net cash provided by operating activities	39,235	19,586
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Shelf offering costs	(74)	(3)
Borrowings from the line of credit	5,500	39,300
Repayments on the line of credit	(35,500)	(36,960)
Distributions paid	(8,853)	(17,714)
Receipt of principal on notes receivable employees (Refer to Note 4)		4
Deferred financing fees	(1,323)	(177)
Net cash used in financing activities	(40,250)	(15,550)
<b>NET (DECREASE) INCREASE IN CASH</b>	(1,015)	4,036
<b>CASH, BEGINNING OF PERIOD</b>	5,276	6,493
<b>CASH, END OF PERIOD</b>	\$ 4,261	\$ 10,529

**NON-CASH FINANCING ACTIVITIES**

Portfolio company payoff proceeds held in escrow (included in other assets and other liabilities)	\$	155	\$
Reclassification of principal on employee note (Refer to Note 4)	\$	514	\$
Conversion of former employee stock option loans from recourse to non-recourse (Refer to Note 6)	\$	420	\$

*THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.*



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## GLADSTONE CAPITAL CORPORATION

## FINANCIAL HIGHLIGHTS

(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AND PER UNIT DATA)

(UNAUDITED)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2010	2009	2010	2009
<b>Per Share Data (1)</b>				
Net asset value at beginning of period	\$ 11.92	\$ 12.04	\$ 11.81	\$ 12.89
<i>Income from investment operations:</i>				
Net investment income (2)	0.21	0.26	0.42	0.54
Net realized gain (loss) on investments (2)	0.04	(0.09)		(0.18)
Realized loss on settlement of derivative (2)		(0.01)		(0.01)
Unrealized appreciation on derivative (2)		0.01		0.01
Net unrealized appreciation (depreciation) on investments (2)	0.12	0.31	0.24	(0.31)
Net unrealized depreciation on borrowings under line of credit (2)	0.01		0.02	
Total from investment operations	0.38	0.48	0.68	0.05
Distributions to stockholders (3)	(0.21)	(0.42)	(0.42)	(0.84)
Conversion of former employee stock option loans from recourse to non-recourse	(0.02)		(0.02)	
Reclassification of principal on employee note			0.02	
Anti-dilutive effect from retirement of employee loan shares	0.03		0.03	
Net asset value at end of period	\$ 12.10	\$ 12.10	\$ 12.10	\$ 12.10
Per share market value at beginning of period	\$ 7.69	\$ 8.09	\$ 8.93	\$ 15.24
Per share market value at end of period	\$ 11.80	\$ 6.26	\$ 11.80	\$ 6.26
Total return (4)(5)	56.94%	(17.93)%	38.77%	(54.11)%
Shares outstanding at end of period	21,039,242	21,087,574	21,039,242	21,087,574
<b>Statement of Assets and Liabilities Data:</b>				
Net assets at end of period	\$ 254,549	\$ 255,213	\$ 254,549	\$ 255,213
Average net assets (6)	\$ 251,111	\$ 249,526	\$ 251,111	\$ 255,763
<b>Senior Securities Data:</b>				
Borrowings under line of credit	\$ 53,000	\$ 153,370	\$ 53,000	\$ 153,370
Asset coverage ratio (7)(8)	575%	266%	575%	266%
Asset coverage per unit (8)	\$ 5,754	\$ 2,659	\$ 5,754	\$ 2,659
<b>Ratios/Supplemental Data:</b>				
Ratio of expenses to average net assets-annualized (9)	8.52%	10.64%	8.60%	10.83%
Ratio of net expenses to average net assets-annualized (10)	8.51%	8.61%	8.57%	8.84%
Ratio of net investment income to average net assets-annualized	7.13%	8.91%	7.12%	8.94%

(1) Based on actual shares outstanding at the end of the corresponding period.

(2) Based on weighted average basic per share data.

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- (3) Distributions are determined based on taxable income calculated in accordance with income tax regulations which may differ from amounts determined under accounting principles generally accepted in the United States of America.
- (4) Total return equals the change in the ending market value of the Company's common stock from the beginning of the period taking into account distributions reinvested in accordance with the terms of the Company's dividend reinvestment plan. Total return does not take into account distributions that may be characterized as a return of capital. For further information on the estimated character of the Company's distributions please refer to Note 8.
- (5) Amounts were not annualized.
- (6) Average net assets are computed using the average of the balance of net assets at the end of each month of the reporting period.
- (7) As a business development company, the Company is generally required to maintain a ratio of at least 200% of total assets, less all liabilities and indebtedness not represented by senior securities, to total borrowings.
- (8) Asset coverage ratio is the ratio of the carrying value of the Company's total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness (including interest payable and guarantees). Asset coverage per unit is the asset coverage ratio expressed in terms of dollar amounts per \$1 thousand of indebtedness.

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- (9) Ratio of expenses to average net assets is computed using expenses before credits from Adviser to the base management and incentive fees and including income tax expense.
- (10) Ratio of net expenses to average net assets is computed using total expenses net of credits from Adviser to the base management and incentive fees and including income tax expense.

*THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.*

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**GLADSTONE CAPITAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2010**

**(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA AND AS OTHERWISE INDICATED)**

**(UNAUDITED)**

**NOTE 1. ORGANIZATION**

Gladstone Capital Corporation (the Company) was incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. The Company is a closed-end, non-diversified management investment company that has elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). In addition, the Company has elected to be treated for tax purposes as a regulated investment company (RIC) under the Internal Revenue Code of 1986, as amended (the Code). The Company's investment objective is to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, senior subordinated notes and junior subordinated notes, of established private businesses that are substantially owned by leveraged buyout funds, individual investors or are family-owned businesses, with a particular focus on senior notes. In addition, the Company may acquire from others existing loans that meet this profile.

Gladstone Business Loan, LLC (Business Loan), a wholly-owned subsidiary of the Company, was established on February 3, 2003 for the purpose of holding the Company's portfolio of loan investments. Gladstone Capital Advisers, Inc. is also a wholly-owned subsidiary of the Company, which was established on December 30, 2003.

Gladstone SBIC, LP (Gladstone SBIC) and Gladstone SBIC GP, LLC, the general partner of Gladstone SBIC, were established on December 4, 2008 as wholly-owned subsidiaries of the Company for the purpose of applying for and holding a license to enable the Company, through Gladstone SBIC, to make investments in accordance with the United States Small Business Administration guidelines for small business investment companies.

Gladstone Financial Corporation (Gladstone Financial), a wholly-owned subsidiary of the Company, was established on November 21, 2006 for the purpose of holding a license to operate as a Specialized Small Business Investment Company. Gladstone Financial (previously known as Gladstone SSBIC Corporation) acquired this license in February 2007. This will enable the Company, through this subsidiary, to make investments in accordance with the United States Small Business Administration guidelines for specialized small business investment companies.

The financial statements of the subsidiaries are consolidated with those of the Company.

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The Company is externally managed by Gladstone Management Corporation (the Adviser ), an unconsolidated affiliate of the Company.

### **NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### *Unaudited Interim Financial Statements*

Interim financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. In the opinion of the Company s management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair statement of financial statements for the interim periods have been included. The current period s results of operations are not necessarily indicative of results that ultimately may be achieved for the year. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company s Form 10-K for the fiscal year ended September 30, 2009, as filed with the Securities and Exchange Commission (the SEC ) on November 23, 2009.

The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

#### *Reclassifications*

Certain amounts in the prior year s financial statements have been reclassified to conform to the current year presentation with no effect to net increase in net assets resulting from operations. The Company s asset coverage ratio calculation was revised so the indebtedness includes interest payable and guarantees.

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*Out-of-Period Adjustment*

During the three and six months ended March 31, 2010, the Company recorded adjustments to interest income, operating expenses and certain balance sheet accounts to reverse interest income and record additional expenses primarily related to professional fees that were not correctly recorded in prior periods. The net adjustments resulted in reductions of \$408 and \$551 in net investment income for the three and six months ended March 31, 2010, respectively. These adjustments reduced net investment income per share by \$0.02 and \$0.03 for the three and six months ended March 31, 2010, respectively. These adjustments both individually and in the aggregate were not material to any of the fiscal 2009 interim or full year consolidated financial statements nor are they expected to be material to full year fiscal 2010 results.

*Investment Valuation Policy*

The Company carries its investments at market value to the extent that market quotations are readily available and reliable, and otherwise at fair value, as determined in good faith by its Board of Directors. In determining the fair value of the Company's investments, the Adviser has established an investment valuation policy (the Policy). The Policy is approved by the Company's Board of Directors and each quarter the Board of Directors reviews whether the Adviser has applied the Policy consistently and votes whether or not to accept the recommended valuation of the Company's investment portfolio.

The Company uses generally accepted valuation techniques to value its portfolio unless the Company has specific information about the value of an investment to determine otherwise. From time to time the Company may accept an appraisal of a business in which the Company holds securities. These appraisals are expensive and occur infrequently but provide a third-party valuation opinion that may differ in results, techniques and scopes used to value the Company's investments. When these specific third-party appraisals are engaged or accepted, the Company uses estimates of value provided by such appraisals and its own assumptions including estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date to value the investment the Company has in that business.

The Policy, which is summarized below, applies to publicly-traded securities, securities for which a limited market exists and securities for which no market exists.

**Publicly-traded securities:** The Company determines the value of publicly-traded securities based on the closing price for the security on the exchange or securities market on which it is listed and primarily traded on the valuation date. To the extent that the Company owns restricted securities that are not freely tradable, but for which a public market otherwise exists, the Company will use the market value of that security adjusted for any decrease in value resulting from the restrictive feature.

**Securities for which a limited market exists:** The Company values securities that are not traded on an established secondary securities market, but for which a limited market for the security exists, such as certain participations in, or assignments of, syndicated loans, at the quoted bid price. In valuing these assets, the Company assesses trading activity in an asset class and evaluates variances in prices and other market insights to determine if any available quote prices are reliable. If the Company concludes that quotes based on active markets or trading activity may be relied upon, firm bid prices are requested; however, if a firm bid price is unavailable, the Company bases the value of the security upon the indicative bid price offered by the respective originating syndication agent's trading desk, or secondary desk, on or near the valuation date. To the extent that the Company uses the indicative bid price as a basis for valuing the security, the Adviser may take further steps to consider additional

information to validate that price in accordance with the Policy.

In the event these limited markets become illiquid such that market prices are no longer readily available, the Company will value its syndicated loans using estimated net present values of the future cash flows or discounted cash flows ( DCF ). The use of a DCF methodology follows that prescribed by the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 820, Fair Value Measurements and Disclosures, which provides guidance on the use of a reporting entity's own assumptions about future cash flows and risk-adjusted discount rates when relevant observable inputs, such as quotes in active markets, are not available. When relevant observable market data does not exist, the alternative outlined in ASC 820 is the use of valuing investments based on DCF. For the purposes of using DCF to provide fair value estimates, the Company considers multiple inputs such as a risk-adjusted discount rate that incorporates adjustments that market participants would make both for nonperformance and liquidity risks. As such, the Company develops a modified discount rate approach that incorporates risk premiums including, among others, increased probability of default, or higher loss given default, or increased liquidity risk. The DCF valuations applied to the syndicated loans provide an estimate of what the Company believes a market participant would pay to purchase a syndicated loan in an active market, thereby establishing a fair value. The Company will apply the DCF methodology in illiquid markets until quoted prices are available or are deemed reliable based on trading activity.

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As of March 31, 2010, the Company assessed trading activity in its syndicated loan assets and determined that there continued to be market liquidity and a functioning secondary market for these assets. Thus, firm bid prices or indicative bids were used to fair value the Company's remaining syndicated loans as of March 31, 2010.

**Securities for which no market exists:** The valuation methodology for securities for which no market exists falls into three categories: (1) portfolio investments comprised solely of debt securities; (2) portfolio investments in controlled companies comprised of a bundle of securities, which can include debt and equity securities; and (3) portfolio investments in non-controlled companies comprised of a bundle of investments, which can include debt and equity securities.

(1) **Portfolio investments comprised solely of debt securities:** Debt securities that are not publicly-traded on an established securities market, or for which a limited market does not exist ( Non-Public Debt Securities ), and that are issued by portfolio companies where the Company has no equity or equity-like securities, are fair valued in accordance with the terms of the Policy, which utilizes opinions of value submitted to the Company by Standard & Poor's Securities Evaluations, Inc. ( SPSE ). The Company may also submit paid in kind ( PIK ) interest to SPSE for their evaluation when it is determined the PIK interest is likely to be received.

(2) **Portfolio investments in controlled companies comprised of a bundle of investments, which can include debt and equity securities:** The fair value of these investments is determined based on the total enterprise value of the portfolio company, or issuer, utilizing a liquidity waterfall approach, for the Company's Non-Public Debt Securities and equity or equity-like securities (e.g. preferred equity, equity, or other equity-like securities) that are purchased together as part of a package, where the Company has control or could gain control through an option or warrant security; both the debt and equity securities of the portfolio investment would exit in the mergers and acquisition market as the principal market, generally through a sale or recapitalization of the portfolio company. In accordance with ASC 820-10, the Company applies the in-use premise of value which assumes the debt and equity securities are sold together. Under this liquidity waterfall approach, the Company first calculates the total enterprise value of the issuer by incorporating some or all of the following factors to determine the total enterprise value of the issuer:

- the issuer's ability to make payments;
- the earnings of the issuer;
- recent sales to third parties of similar securities;
- the comparison to publicly traded securities; and
- DCF or other pertinent factors.

In gathering the sales to third parties of similar securities, the Company may reference industry statistics and use outside experts. Once the Company has estimated the total enterprise value of the issuer, the Company will subtract the value of all the debt securities of the issuer, which are valued at the contractual principal balance. Fair values of these debt securities are discounted for any shortfall of total enterprise value over the total debt outstanding for the issuer. Once the values for all outstanding senior securities (which include the debt securities) have been subtracted from the total enterprise value of the issuer, the remaining amount, if any, is used to determine the value of the issuer's equity or equity like securities. If, in the Adviser's judgment, the liquidity waterfall approach does not accurately reflect the value of the debt component, the Adviser may recommend that the Company use a valuation by SPSE, or if that is unavailable, a DCF valuation technique.



**(3) Portfolio investments in non-controlled companies comprised of a bundle of investments, which can include debt and equity securities:** The Company values Non-Public Debt Securities that are purchased together with equity and equity-like securities from the same portfolio company, or issuer, for which the Company does not control or cannot gain control as of the measurement date, using a hypothetical secondary market as the Company's principal market. In accordance with ASC 820-10, the Company determines its fair value of these debt securities of non-control investments assuming the sale of an individual debt security using the in-exchange premise of value. As such, the Company estimates the fair value of the debt component using estimates of value provided by SPSE and its own assumptions in the absence of observable market data, including synthetic credit ratings, estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. For equity or equity-like securities of investments for which the Company does not control or cannot gain control as of the measurement date, the Company estimates the fair value of the equity using the in-exchange premise of value based on factors such as the overall value of the issuer, the relative fair value of other units of account including debt, or other relative value approaches. Consideration also is given to capital structure and other contractual obligations that may impact the fair value of the equity. Further, the Company may utilize comparable values of similar companies, recent investments and indices with similar structures and risk characteristics or its own assumptions in the absence of other observable market data and may also employ DCF valuation techniques.

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Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have been obtained had a ready market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned. There is no single standard for determining fair value in good faith, as fair value depends upon circumstances of each individual case. In general, fair value is the amount that the Company might reasonably expect to receive upon the current sale of the security in an arms-length transaction in the security's principal market.

Refer to Note 3 for additional information regarding fair value measurements under ASC 820-10.

*Interest Income Recognition*

Interest income, adjusted for amortization of premiums and acquisition costs and for the accretion of discounts, is recorded on the accrual basis to the extent that such amounts are expected to be collected. Generally, when a loan becomes 90 days or more past due or if the Company's qualitative assessment indicates that the debtor is unable to service its debt or other obligations, the Company will place the loan on non-accrual status and cease recognizing interest income on that loan until the borrower has demonstrated the ability and intent to pay contractual amounts due. However, the Company remains contractually entitled to this interest. Interest payments received on loans on non-accrual may be recognized as income or applied to principal depending upon management's judgment. Loans on non-accrual are restored to accrual status when past due principal and interest is paid or due to a restructuring such that the interest income is deemed to be collectible, and in management's judgment, are likely to remain current. At March 31, 2010, one Non-Control/Non-Affiliate investment and five Control investments were on non-accrual with an aggregate cost basis of approximately \$26,422, or 8.0% of the cost basis of all loans in the Company's portfolio. At September 30, 2009, one Non-Control/Non-Affiliate investment and four Control investments were on non-accrual with an aggregate cost basis of approximately \$10,022, or 2.8% of the cost basis of all loans in the Company's portfolio. Success fees are recorded upon receipt and are contractually due upon a change of control in a portfolio company.

*Paid in Kind Interest*

The Company has two loans in its portfolio which contain PIK provisions. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as income. To maintain the Company's status as a RIC, this non-cash source of income must be paid out to stockholders in the form of distributions, even though the Company has not yet collected the cash. The Company recorded PIK income of \$49 and \$100 for the three and six months ended March 31, 2010, respectively, as compared to \$13 and \$31 for the three and six months ended March 31 2009, respectively.

*Services Provided to Portfolio Companies*

As of March 31, 2010 and September 30, 2009, the Company had gross receivables from portfolio companies of \$544 and \$1,528, respectively, of reimbursements for non-recurring costs incurred on behalf of the portfolio companies. The allowance for uncollectible receivables was \$177 and \$0 as of March 31, 2010 and September 30, 2009, respectively.

*Recent Accounting Pronouncements*

In August 2009, FASB issued Accounting Standard Update ( ASU ) No. 2009-05, Fair Value Measurements and Disclosures: Measuring Liabilities at Fair Value. The update provides clarification to ASC 820 for the valuation techniques required to measure the fair value of liabilities. ASU No. 2009-05 also provides clarification around required inputs to the fair value measurement of a liability and definition of a Level 1 liability. ASU No. 2009-05 is effective for interim and annual periods beginning after August 28, 2009. The Company adopted ASU No. 2009-05 beginning with the quarter ended December 31, 2009. The adoption of this standard did not have a material effect on the Company's financial position and results of operations.

In September 2009, the FASB issued ASU No. 2009-12, Measuring Fair Value Measurements and Disclosures: Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), that provides additional guidance on how companies should estimate the fair value of certain alternative investments, such as hedge funds, private equity funds and venture capital funds. The fair value of such investments can now be determined using net asset value ( NAV ) as a practical expedient, unless it is probable that the investment will not be sold at a price equal to NAV. In those situations, the practical expedient cannot be used and disclosure of the remaining actions necessary to complete the sale will be required. New disclosures of the attributes of all investments within the scope of the new guidance is required, regardless of whether an entity used the practical expedient to measure the fair value of any of its investments. ASU No. 2009-12 is effective for the first annual or interim reporting period ending after December 15, 2009, with early application permitted. The Company determined that the adoption of this standard did not have a material effect on its financial position and results of operations as of and for the six months ended March 31, 2010.

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In December 2009, the FASB issued ASU No. 2009-17, Consolidations: Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities, that amends the FASB ASC for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this ASU replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact such entity's economic performance and (1) the obligation to absorb losses of such entity or (2) the right to receive benefits from such entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in ASU No. 2009-17 also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. ASU No. 2009-17 is effective for annual periods beginning after November 15, 2009. The Company does not believe the adoption of this standard will have a material effect on its financial position and results of operations.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures, that requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. The FASB also clarified existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. The new and revised disclosures are required to be implemented in interim or annual periods beginning after December 15, 2009, except for the gross presentation of the Level 3 rollforward, which is required for annual reporting periods beginning after December 15, 2010. The Company adopted ASU No. 2010-06 beginning with the quarter ended March 31, 2010. The adoption of this standard did not have a material effect on the Company's financial position and results of operations.

In February 2010, the FASB issued ASU No. 2010-09, Subsequent Events, that amended its guidance on subsequent events. SEC filers are not required to disclose the date through which an entity has evaluated subsequent events. The amended guidance was effective upon issuance for all entities.

In February 2010, the FASB issued ASU 2010-10, Consolidations to defer FAS 167, Amendments to FASB Interpretation No. 46(R), for certain investment entities that have the attributes of entities subject to ASC 946 (the investment company guide). In addition, the ASU (1) amends the requirements for evaluating whether a decision maker or service contract is a variable interest to clarify that a quantitative approach should not be the sole consideration in assessing the criteria and (2) clarifies that related parties should be considered in applying all of the decision maker and service contract criteria. The Company's adoption of this standard did not have a material effect on its financial position and results of operations.

**NOTE 3. INVESTMENTS**

The Company adopted guidance for fair value measurements on October 1, 2008. In part, this guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. The guidance provides a consistent definition of fair value that focuses on exit price in the principal, or most advantageous, market and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. The guidance also establishes the following three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;

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- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 2 inputs are in those markets for which there are few transactions, the prices are not current, little public information exists or instances where prices vary substantially over time or among brokered market makers; and
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement. Unobservable inputs are those inputs that reflect the Company's own assumptions that market participants would use to price the asset or liability based upon the best available information.

As of March 31, 2010, all of the Company's assets were valued using Level 3 inputs.

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The following table presents the financial instruments carried at fair value as of March 31, 2010 and September 30, 2009, by caption on the accompanying condensed consolidated statements of assets and liabilities for each of the three levels of hierarchy established by the guidance:

As of March 31, 2010				Total Fair Value Reported in Condensed Consolidated Statements of Assets and Liabilities
Level 1	Level 2	Level 3		
Senior Term Debt	\$	\$	\$ 188,348	\$ 188,348
Senior Subordinated Term Debt			102,752	102,752
Preferred Equity Securities				
Common Equity Securities			651	651
Total investments at fair value	\$	\$	\$ 291,751	\$ 291,751

As of September 30, 2009				Total Fair Value Reported in Condensed Consolidated Statements of Assets and Liabilities
Level 1	Level 2	Level 3		
Senior Term Debt	\$	\$	\$ 212,290	\$ 212,290
Senior Subordinated Term Debt			105,794	105,794
Preferred Equity Securities				
Common Equity Securities			2,885	2,885
Total investments at fair value	\$	\$	\$ 320,969	\$ 320,969

*Changes in Level 3 Fair Value Measurements*

The following table provides a roll-forward in the changes in fair value during the three-month period from December 31, 2009 to March 31, 2010, and for the six-month period from September 30, 2009 to March 31, 2010, for all investments for which the Company determines fair value using unobservable (Level 3) factors. When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated by external sources). Accordingly, the losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology.

**Fair value measurements using unobservable data inputs (Level 3)**

	Non-Control/ Non-Affiliate Investments	Control Investments	Total
<b>Three months ended March 31, 2010:</b>			
Fair value at December 31, 2009	\$ 272,380	\$ 34,258	\$ 306,638
Total gains or losses			
Realized losses (a)	892		892
Reversal of prior period depreciation on realization (b)	2,031		2,031

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Unrealized appreciation (depreciation) (b)	1,018	(566)	452
New investments, repayments and settlements (c)			
Issuances/New investments	3,308	1,832	5,140
Settlements/Repayments	(23,065)		(23,065)
Sales	(337)		(337)
Transfers into/out of Level 3			
Fair value as of March 31, 2010	\$ 256,227	\$ 35,524	\$ 291,751
<b>Six months ended March 31, 2010:</b>			
Fair value at September 30, 2009	\$ 286,997	\$ 33,972	\$ 320,969
Total gains or losses			
Realized losses (a)	(28)		(28)
Reversal of prior period depreciation on realization (b)	3,437		3,437
Unrealized depreciation (b)	3,211	(1,566)	1,645
New investments, repayments and settlements, net (c)			
Issuances/New investments	4,202	3,118	7,320
Settlements/Repayments	(38,473)		(38,473)
Sales	(3,119)		(3,119)
Transfers into/out of Level 3			
Fair value as of March 31, 2010	\$ 256,227	\$ 35,524	\$ 291,751

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	Senior Term Debt	Senior Subordinated Term Debt	Preferred Equity Securities	Common Equity Securities	Total
<b>Three months ended March 31, 2010:</b>					
Fair value at December 31, 2009	\$ 198,577	\$ 106,609	\$	\$ 1,452	\$ 306,638
Total gains or losses					
Realized losses (a)	(312)	(163)		1,367	892
Reversal of prior period depreciation on realization (b)	1,066	1,212		(247)	2,031
Unrealized appreciation (depreciation) (b)	414	392		(354)	452
New investments, repayments, and settlements, net (c)					
Issuances/New investments	4,901	239			5,140
Settlements/Repayments	(16,298)	(5,200)		(1,567)	(23,065)
Sales		(337)			(337)
Transfers into/out of Level 3					
Fair value as of March 31, 2010	\$ 188,348	\$ 102,752	\$	\$ 651	\$ 291,751
<b>Six months ended March 31, 2010:</b>					
Fair value at September 30, 2009	\$ 212,290	\$ 105,794	\$	\$ 2,885	\$ 320,969
Total gains or losses					
Realized losses (a)	(825)	(570)		1,367	(28)
Reversal of prior period depreciation on realization (b)	2,065	1,619		(247)	3,437
Unrealized depreciation (b)	1,210	2,222		(1,787)	1,645
New investments, repayments and settlements, net (c)					
Issuances/New investments	6,078	1,242			7,320
Settlements/Repayments	(31,545)	(5,361)		(1,567)	(38,473)
Sales	(925)	(2,194)			(3,119)
Transfers into/out of Level 3					
Fair value as of March 31, 2010	\$ 188,348	\$ 102,752	\$	\$ 651	\$ 291,751
<b>Three months ended March 31, 2009:</b>					
Fair value at December 31, 2008	\$ 384,012	\$ 566	\$	\$	\$ 384,578
Realized losses (a)	(2,000)			(304)	(2,304)
Reversal of prior period depreciation on realization (b)	1,960			304	2,264
Unrealized appreciation (b)	1,239	3,526			4,765
New investments, repayments, and settlements, net (c)	(15,616)	11,410			(4,206)
Transfers in (out) of Level 3					
Fair value as of March 31, 2009	\$ 369,595	\$ 15,502	\$	\$	\$ 385,097
<b>Six months ended March 31, 2009:</b>					
Fair value at September 30, 2008	\$ 407,153	\$ 780	\$	\$	\$ 407,933
Realized losses (a)	(3,731)			(304)	(4,035)
Reversal of prior period depreciation on realization (b)	3,145			304	3,449
Unrealized appreciation (depreciation) (b)	(12,387)	2,714			(9,673)
New investments, repayments, and settlements, net (c)	(24,585)	12,008			(12,577)
Transfers in (out) of Level 3					
Fair value as of March 31, 2009	\$ 369,595	\$ 15,502	\$	\$	\$ 385,097





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- (a) Included in net realized loss on investments on the accompanying condensed consolidated statements of operations for the three and six months ended March 31, 2010 and 2009.
- (b) Included in unrealized appreciation (depreciation) on investments on the accompanying condensed consolidated statements of operations for the three and six months ended March 31, 2010 and 2009.
- (c) Includes increases in the cost basis of investments resulting from new portfolio investments, the amortization of discounts, premiums and closing fees as well as decreases in the cost basis of investments resulting from principal repayments or sales.

*Non-Control/Non-Affiliate Investments*

As of March 31, 2010 and September 30, 2009, the Company held Non-Control/Non-Affiliate investments in the aggregate of approximately \$256,227 and \$286,997, at fair value, respectively.

*Control Investments*

As of March 31, 2010 and September 30, 2009, the Company held Control investments in the aggregate of approximately \$35,524 and \$33,972, at fair value, respectively. As of March 31, 2010, the Control investments were comprised of BERTL, Inc. ( BERTL ), Clinton Holdings, LLC ( Clinton ), Defiance Integrated Technologies, Inc. ( Defiance ), Lindmark Acquisition, LLC ( Lindmark ), LYP Holdings Corp. ( LYP Holdings ), U.S. Healthcare Communications, Inc. ( U.S. Healthcare ) and Western Directories, Inc. ( Western Directories ).

- *BERTL:* The Company originally purchased a past due debt instrument in MCA Communications, LLC and the Company accepted a deed in lieu of foreclosure in satisfaction of BERTL's obligations under the debt instrument in September 2007. BERTL is a web-based evaluator of digital imaging products.
- *Clinton:* In September 2009, the Company took control of certain Clinton entities by exercising contractual rights under the investment documents. Clinton is a distributor of aluminum sheets and stainless steel.
- *Defiance:* In July 2009, the Company acquired from the previous owner certain assets of Defiance Acquisition Corp., consisting of tangible and intangible personal property. The Company acquired these assets through a newly formed subsidiary, Defiance, and intends to continue the business under its control. Defiance is a manufacturer of trucking parts.
- *Lindmark:* In March 2009, the Company acquired from the previous owner certain assets of Lindmark Outdoor Advertising, LLC, consisting of all tangible and intangible personal property. The Company acquired these assets through a newly formed subsidiary, Lindmark, and intends to continue the business under its control. Lindmark is a billboard advertising company.

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- *LYP Holdings:* In July 2008, the Company acquired from the previous owner certain assets of LocalTel, Inc., consisting of all tangible and intangible personal property. The Company acquired these assets through a newly formed subsidiary, LYP Holdings, and intends to continue the business under its control. LYP Holdings is a publisher of community yellow page directories.

- *U.S. Healthcare:* The Company offered at public sale certain assets of U.S. Healthcare Communications, LLC in January 2008, consisting generally of all fixtures of tangible and intangible personal property. The Company acquired these assets in the sale through a newly formed subsidiary, U.S. Healthcare, and intends to continue the business under its control. U.S. Healthcare is a trade magazine operator.

- *Western Directories:* In August 2008, the Company acquired from the previous owner certain assets of West Coast Yellow Pages, Inc., consisting of all tangible and intangible personal property. The Company acquired these assets through a newly

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formed subsidiary, Western Directories, and intends to continue the business under its control. Western Directories is a publisher of community yellow page directories.

### *Investment Concentrations*

As of March 31, 2010, the Company had aggregate investments in 41 portfolio companies and approximately 64.6% of the aggregate fair value of such investments was senior term debt, approximately 35.2% was senior subordinated term debt, no investments were in junior subordinated debt and approximately 0.2% was in equity securities. The following table outlines the Company's investments by type at March 31, 2010 and September 30, 2009:

	March 31, 2010		September 30, 2009	
	Cost	Fair Value	Cost	Fair Value
Senior Term Debt	\$ 212,955	\$ 188,348	\$ 240,172	\$ 212,290
Senior Subordinated Term Debt	111,861	102,752	118,743	105,794
Preferred Equity Securities	2,028		2,028	
Common Equity Securities	3,250	651	3,450	2,885
<b>Total Investments</b>	<b>\$ 330,094</b>	<b>\$ 291,751</b>	<b>\$ 364,393</b>	<b>\$ 320,969</b>

Investments at fair value consisted of the following industry classifications as of March 31, 2010 and September 30, 2009:

Industry Classification	March 31, 2010			September 30, 2009		
	Fair Value	Total Percentage Investments	Net Assets	Fair Value	Total Percentage Investments	Net Assets
Aerospace & Defense	\$			\$ 1,857	0.6%	0.7%
Automobile	8,325	2.9%	3.3%	7,999	2.5%	3.2%
Broadcast (TV & Radio)	43,394	14.9%	17.0%	43,403	13.5%	17.4%
Buildings & Real Estate	12,848	4.4%	5.0%	12,882	4.0%	5.2%
Cargo Transport				5,427	1.7%	2.2%
Chemicals, Plastics & Rubber	15,717	5.4%	6.2%	15,884	4.9%	6.4%
Diversified/Conglomerate Manufacturing	1,579	0.5%	0.6%	1,236	0.4%	0.5%
Diversified Natural Resources, Precious Metals & Minerals	13,590	4.7%	5.3%	13,589	4.2%	5.5%
Electronics	25,856	8.9%	10.2%	27,899	8.7%	11.2%
Farming & Agriculture	8,857	3.0%	3.5%	9,309	2.9%	3.7%
Healthcare, Education & Childcare	41,700	14.3%	16.4%	58,054	18.1%	23.3%
Home & Office Furnishings	10,929	3.7%	4.3%	16,744	5.2%	6.7%
Leisure, Amusement, Movies & Entertainment	5,747	2.0%	2.3%	5,091	1.6%	2.0%
Machinery	8,949	3.1%	3.5%	9,202	2.9%	3.7%
Mining, Steel, Iron & Non-Precious Metals	22,149	7.5%	8.7%	21,926	6.8%	8.8%
Personal & Non-durable Consumer Products	8,841	3.0%	3.5%	8,714	2.7%	3.5%
Printing & Publishing	38,870	13.3%	15.3%	37,864	11.8%	15.2%

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Retail Stores	24,400	8.4%	9.6%	23,669	7.4%	9.5%
Textiles & Leather				220	0.1%	0.1%
<b>Total</b>	\$ 291,751	100.0%		\$ 320,969	100.0%	

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The investments at fair value were included in the following geographic regions of the United States at March 31, 2010 and September 30, 2009:

Geographic Region	March 31, 2010			September 30, 2009		
	Fair Value	Total Percentage Investments	Net Assets	Fair Value	Total Percentage Investments	Net Assets
Midwest	\$ 150,628	51.6%	59.2%	\$ 172,263	53.7%	69.2%
West	61,837	21.2%	24.3%	65,678	20.5%	26.4%
Southeast	29,670	10.2%	11.7%	34,708	10.8%	13.9%
Mid-Atlantic	28,824	9.9%	11.3%	28,437	8.8%	11.4%
Northeast	14,508	5.0%	5.7%	14,170	4.4%	5.7%
U.S. Territory	6,284	2.1%	2.5%	5,713	1.8%	2.3%
	\$ 291,751	100.0%		\$ 320,969	100.0%	

The geographic region indicates the location of the headquarters for the Company's portfolio companies. A portfolio company may have a number of other business locations in other geographic regions.

### *Investment Principal Repayments*

The following table summarizes the contractual principal repayment and maturity of the Company's investment portfolio by fiscal year, assuming no voluntary prepayments:

	Amount
For the remaining six months ending September 30:	
2010	\$ 20,904
For the fiscal year ending September 30:	
2011	92,686
2012	78,069
2013	119,763
2014	6,116
2015	6,851
<b>Total Contractual Repayments</b>	<b>324,389</b>
Investments in equity securities	5,278
Unamortized premiums, discounts and investment acquisition costs on debt securities	427
<b>Total</b>	<b>\$ 330,094</b>

### **NOTE 4. RELATED PARTY TRANSACTIONS**

#### *Loans to Employees*

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The Company provided loans to employees of the Adviser, who at the time of the loans were joint employees of the Company and either the Adviser or the Company's previous investment adviser, Gladstone Capital Advisers, Inc., for the exercise of options under the Amended and Restated 2001 Equity Incentive Plan, which has since been terminated and is no longer in operation. The loans require the quarterly payment of interest at the market rate in effect at the date of issue, have varying terms not exceeding ten years and have been recorded as a reduction of net assets. The loans are evidenced by full recourse notes that are due upon maturity or 60 days following termination of employment, and the shares of common stock purchased with the proceeds of the loan are posted as collateral. No new loans were issued during the six months ended March 31, 2010 or March 31, 2009. The Company received \$0 and \$4 of principal repayments during the six months ended March 31, 2010 and March 31, 2009, respectively. The Company recognized interest income from all employee stock option loans of \$108 and \$221 for the three and six months ended March 31, 2010, respectively, and \$117 and \$235 for the three and six months ended March 31, 2009, respectively.

During the six months ended March 31, 2010, \$514 of an employee stock option loan to a former employee of the Adviser was transferred from notes receivable employees to other assets in connection with the termination of her employment with the Adviser and the later amendment of the loan. The interest on the loan from the time the employee stopped working for the Adviser is included in other income on the condensed consolidated statement of operations.

Table of Contents*Compensation Expense*

During the three months ended March 31, 2010, the employee stock option loans of two former employees were converted from recourse to non-recourse loans. The conversions were non-cash transactions and were accounted for as repurchases of the shares previously received by the employees upon exercise of the stock option in exchange for the non-recourse notes. The repurchases were accounted for as treasury stock transactions at the fair value of the shares, totaling \$420. Since the value of the stock option loans totaled \$665, the Company recorded compensation expense of \$245.

*Investment Advisory and Management Agreement*

The Company is externally managed by the Adviser, which is controlled by its chairman and chief executive officer, under a contractual investment advisory agreement. On October 1, 2006, the Company entered into the investment advisory agreement (the *Advisory Agreement*). Under the *Advisory Agreement*, the Company pays the Adviser an annual base management fee of 2% of its average gross assets, which is defined as total assets less uninvested cash and cash equivalents resulting from borrowings calculated as of the end of the two most recently completed fiscal quarters. The *Advisory Agreement* also includes a two-part incentive fee.

The following tables summarize the management fees, incentive fees and associated credits reflected in the accompanying condensed consolidated statement of operations:

	Three months ended		Six months ended	
	March 31, 2010	March 31, 2009	March 31, 2010	March 31, 2009
Base management fee (1)	\$ 739	\$ 484	\$ 1,459	\$ 917
Credit for fees received by Adviser from the portfolio companies		(80)		(85)
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum (2)	(6)	(97)	(13)	(203)
Net base management fee	\$ 733	\$ 307	\$ 1,446	\$ 629
Incentive fee	\$ 1,072	\$ 1,089	\$ 1,447	\$ 2,265
Credit from voluntary, irrevocable waiver issued by Adviser's board of directors		(1,089)	(22)	(2,265)
Net incentive fee	\$ 1,072	\$	\$ 1,425	\$
Credit for fees received by Adviser from the portfolio companies	\$	\$ (80)	\$	\$ (85)
Fee reduction for the voluntary, irrevocable waiver of 2% fee on senior syndicated loans to 0.5% per annum	(6)	(97)	(13)	(203)
Incentive fee credit		(1,089)	(22)	(2,265)
Credit to base management and incentive fees from Adviser	\$ (6)	\$ (1,266)	\$ (35)	\$ (2,553)



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(1) Base management fee is net of loan servicing fees per the terms of the Advisory Agreement.

(2) The board of our Adviser voluntarily, irrevocably and unconditionally waived, for the three and six months ended March 31, 2010 and 2009, the annual 2.0% base management fee to 0.5% for senior syndicated loan participations. Fees waived cannot be recouped by the Adviser in the future.

Overall, the base management fee due to the Adviser cannot exceed 2% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year. Amounts included in Due to Adviser in the accompanying condensed consolidated statements of assets and liabilities were as follows:

	March 31, 2010		September 30, 2009	
Unpaid base management fee to Adviser	\$	733	\$	617
Unpaid incentive fee to Adviser		1,425		
Unpaid loan servicing fees to Adviser		207		217
Total Due to Adviser	\$	2,365	\$	834

As of March 31, 2010 and September 30, 2009, Due from Adviser totaled \$0 and \$69, respectively, which included reimbursements for non-recurring costs incurred on behalf of the portfolio companies.

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*Loan Servicing and Portfolio Company Fees*

The Adviser also services the loans held by Business Loan, in return for which it receives a 1.5% annual fee based on the monthly aggregate outstanding balance of the loans pledged under the Company's line of credit. Since the Company owns these loans, all loan servicing fees paid to the Adviser have been and continue to be treated as reductions directly against the 2% base management fee under the Advisory Agreement. For the three and six months ended March 31, 2010 and 2009, these loan servicing fees totaled \$852 and \$1,781, and \$1,526 and \$3,149, respectively, all of which were deducted against the 2% base management fee in order to derive the base management fee, which is presented as the line item Base management fee in the accompanying condensed consolidated statements of operations. As of March 31, 2010 and September 30, 2009, the Company owed \$207 and \$217, respectively, of unpaid loan servicing fees to the Adviser, which are recorded in Fees due to Adviser in the accompanying condensed consolidated statements of assets and liabilities.

*Administration Agreement*

On October 1, 2006, the Company entered into an administration agreement (the Administration Agreement) with Gladstone Administration, LLC (the Administrator), an affiliate of the Adviser. Under the Administration Agreement, the Company pays separately for administrative services. The Administration Agreement provides for payments equal to the Company's allocable portion of the Administrator's overhead expenses in performing its obligations under the Administration Agreement, including, but not limited to, rent for employees of the Administrator, and the allocable portion of salaries and benefits expenses of the Company's chief financial officer, chief compliance officer, internal counsel, treasurer and their respective staffs. For the three and six months ended March 31, 2010 and 2009, the Company recorded administration fees of \$176 and \$354, and \$211 and \$438, respectively. As of March 31, 2010 and September 30, 2009, the Company owed \$176 and \$216, respectively, of unpaid administration fees to the Adviser, which is recorded in the Fee due to Administrator in the accompanying condensed consolidated statements of assets and liabilities.

**NOTE 5. LINE OF CREDIT**

On March 15, 2010, the Company, through Business Loan, entered into a fourth amended and restated credit agreement which currently provides for a \$127,000 revolving line of credit arranged by Key Equipment Finance Inc. as administrative agent (the Credit Facility). Branch Banking and Trust Company (BB&T) and ING Capital LLC (ING) also joined the Credit Facility as committed lenders. Subject to certain terms and conditions, the Credit Facility may be expanded up to \$202,000 through the addition of other committed lenders to the facility. Advances under the Credit Facility will generally bear interest at the 30-day LIBOR (subject to a minimum rate of 2%), plus 4.5% per annum, with a commitment fee of 0.5% per annum on undrawn amounts. As of March 31, 2010, there was a cost basis of approximately \$53,000 of borrowings outstanding under the Credit Facility at an average interest rate of 6.5%. Available borrowings are subject to various constraints imposed under the Credit Facility, based on the aggregate loan balance pledged by Business Loan. Interest is payable monthly during the term of the Credit Facility. The Credit Facility matures on March 15, 2012, and, if the facility is not renewed or extended by this date, all principal and interest will be due and payable on March 15, 2013. In addition, if the Credit Facility is not renewed on or before March 15, 2012, the Company will be required to use all principal collections from its loans to pay outstanding principal on the Credit Facility.

The Credit Facility contains covenants that require Business Loan to maintain its status as a separate entity, prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions), and restrict material changes to the Company's credit and collection policies. The facility requires a minimum of 20 obligors in the borrowing base and also limits payments of distributions. As of March 31, 2010, Business Loan had 23 obligors and the Company was in compliance with all of the facility covenants.

The Company applied ASC 825, Financial Instruments, specifically for the Credit Facility, which was consistent with its application of ASC 820 to its investments. ASC 825 requires that the Company apply a fair value methodology to the Credit Facility. The Company estimated the fair value of the Credit Facility using estimates of value provided by an independent third party and its own assumptions in the absence of observable market data, including estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. The Company also considered its own credit risk. Since the Credit Facility was entered into during the three months ended March 31, 2010, the cost basis of the Credit Facility of \$53,000 was determined to be the best approximation of fair value as of March 31, 2010. The following table presents the Credit Facility carried at fair value as of March 31, 2010 and September 30, 2009, by caption on the accompanying consolidated statements of assets and liabilities for each of the three levels of hierarchy established by ASC 820-10:

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	As of March 31, 2010				Total Fair Value Reported in Condensed Consolidated Statement of Assets and Liabilities
	Level 1	Level 2	Level 3		
Borrowings under Line of Credit	\$	\$	\$ 53,000	\$	53,000
Total	\$	\$	\$ 53,000	\$	53,000

	As of September 30, 2009				Total Fair Value Reported in Condensed Consolidated Statement of Assets and Liabilities
	Level 1	Level 2	Level 3		
Borrowings under Line of Credit	\$	\$	\$ 83,350	\$	83,350
Total	\$	\$	\$ 83,350	\$	83,350

*Changes in Level 3 Fair Value Measurements*

The following table provides a roll-forward in the changes in fair value during the three-month period from December 31, 2009 to March 31, 2010 and the six month period from September 30, 2009 to March 31, 2010, for the Credit Facility for which the Company determines fair value using unobservable (Level 3) factors. When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated by external sources). Accordingly, the losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology.

**Fair value measurements using unobservable data inputs (Level 3)**

	Borrowings under line of credit	
<b>Three months ended March 31, 2010:</b>		
Fair value at December 31, 2009	\$	73,531
Unrealized depreciation (a)		(131)
Borrowings		2,600
Repayments		(23,000)
Transfers into/out of Level 3		
Fair value as of March 31, 2010	\$	53,000
<b>Six months ended March 31, 2010:</b>		
Fair value at September 30, 2009	\$	83,350
Unrealized depreciation (a)		(350)
Borrowings		5,500
Repayments		(35,500)
Transfers into/out of Level 3		
Fair value as of March 31, 2010	\$	53,000

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(a) Included in unrealized depreciation on borrowings under line of credit on the accompanying condensed consolidated statements of operations for the three and six months ended March 31, 2010.

**NOTE 6. COMMON STOCK TRANSACTIONS**

On October 20, 2009, the Company filed a registration statement on Form N-2 with the SEC that was amended on December 9, 2009. The SEC declared the registration statement effective on January 28, 2010 and such registration statement will permit the Company to issue, through one or more transactions, up to an aggregate of \$300,000 in securities, consisting of common stock, senior common

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stock, preferred stock, subscription rights, debt securities and warrants to purchase common stock, or a combination of these securities.

Transactions in common stock were as follows:

	Shares	Total Value
Balance at September 30, 2009	21,087,574	\$ 328,224
Conversion of recourse to non-recourse loans (1)		(420)
Retirement of employee loan shares (2)	(48,332)	
Shelf offering costs		(74)
Balance at March 31, 2010	21,039,242	\$ 327,730

(1) During the three months ended March 31, 2010, the employee stock option loans of two former employees of the Adviser were converted from recourse to non-recourse loans. The conversions were non-cash transactions and were accounted for as repurchases of the shares previously received by the employees of the Adviser upon exercise of the stock options in exchange for the non-recourse notes. The repurchases were accounted for as treasury stock transactions at the fair value of the shares, which totaled \$420.

(2) During the three months ended March 31, 2010, subsequent to the conversion of the stock option loans of two former employees of the Adviser from recourse to non-recourse, the loans came due when the underlying market value for the collateral reached the outstanding loan amount. As such, and consistent with the loan agreements, the shares pledged as collateral were retired in March 2010. Since these shares were already accounted for during the conversion to non-recourse above, these became non-cash events that did not require journal entries to the financial statements. However, they resulted in a reduction of the number of shares of common stock outstanding.

The following table is a summary of all outstanding notes issued to employees of the Adviser for the exercise of stock options:

Issue Date	Number of Options Exercised	Strike Price of Options Exercised	Amount of Promissory Note Issued to Employees	Outstanding Balance of Employee Loans at 3/31/10	Maturity Date	Interest Rate on Note
Aug-01	93,334	\$ 15.00	\$ 1,400	\$ 1,400	Aug-10	4.90%
Aug-01	18,334	15.00	275	255	Aug-10	4.90%
Sep-04	13,332	15.00	200	198	Sep-13	5.00%
Aug-01	393,334	15.00	5,900	5,900	Aug-10	4.90%
Aug-01	18,334	15.00	275	275	Aug-10	4.90%
Jul-06	13,332	15.00	200	200	Jul-15	8.26%
Jul-06	18,334	15.00	275	275	Jul-15	8.26%
	568,334		\$ 8,525	\$ 8,503		

In accordance with ASC 505-10-45-2, Equity, receivables from employees for the issuance of capital stock to employees prior to the receipt of cash payment should be reflected in the balance sheet as a reduction to stockholders' equity. Therefore, these recourse notes were recorded as loans to employees and are included in the equity section of the accompanying condensed consolidated statements of assets and liabilities. As of March 31, 2010, the Company determined that these notes were still recourse.

**NOTE 7. NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE**

The following table sets forth the computation of basic and diluted net increase in net assets resulting from operations per common share for the three and six months ended March 31, 2010 and 2009:

	Three months ended March 31,		Six months ended March 31,	
	2010	2009	2010	2009
Numerator for basic and diluted net increase in net assets resulting from operations per share	\$ 7,980	\$ 10,280	\$ 14,306	\$ 1,178
Denominator for basic and diluted shares	21,075,445	21,087,574	21,081,576	21,087,574
Basic and diluted net increase in net assets resulting from operations per common share	\$ 0.38	\$ 0.48	\$ 0.68	\$ 0.05

Table of Contents**NOTE 8. DISTRIBUTIONS**

The following table lists the per share distributions paid for the six months ended March 31, 2010 and 2009:

<b>Fiscal Year</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Distribution per Share</b>
2010	October 22, 2009	October 30, 2009	\$ 0.07
	November 19, 2009	November 30, 2009	\$ 0.07
	December 22, 2009	December 31, 2009	\$ 0.07
	January 21, 2010	January 29, 2010	\$ 0.07
	February 18, 2010	February 26, 2010	\$ 0.07
	March 23, 2010	March 31, 2010	\$ 0.07
	Total		\$ 0.42
2009	October 23, 2008	October 31, 2008	\$ 0.14
	November 19, 2008	November 28, 2008	\$ 0.14
	December 22, 2008	December 31, 2008	\$ 0.14
	January 22, 2009	January 31, 2009	\$ 0.14
	February 19, 2009	February 27, 2009	\$ 0.14
	March 23, 2009	March 30, 2009	\$ 0.14
	Total		\$ 0.84

Aggregate distributions declared and paid for the six months ended March 31, 2010 and 2009 were approximately \$8,853 and \$17,714, respectively. All distributions were declared based on estimates of net investment income for the respective fiscal years, and some of the distributions include a return of capital.

The timing and characterization of certain income and capital gains distributions are determined annually in accordance with federal tax regulations which may differ from GAAP. These differences primarily relate to items recognized as income for financial statement purposes and realized gains for tax purposes. As a result, net investment income and net realized gain (loss) on investment transactions for a reporting period may differ significantly from distributions during such period. Accordingly, the Company may periodically make reclassifications among certain of its capital accounts without impacting the net asset value of the Company.

**NOTE 9. COMMITMENTS AND CONTINGENCIES**

As of March 31, 2010, the Company was not party to any signed term sheets for potential investments.

In July 2009, the Company executed a guaranty of a line of credit agreement between Comerica Bank and Defiance Integrated Technologies, Inc., one of its Control investments. If Defiance has a payment default, the guaranty is callable once the bank has reduced its claim by using commercial reasonable efforts to collect through disposition of the Defiance collateral. The guaranty is limited to \$250 plus interest on that amount accrued from the date demand payment is made under the guaranty, and all costs incurred by the bank in its collection efforts. As of March 31, 2010, the Company has not been required to make any payments on the guaranty of the line of credit agreement and the Company considers the credit risk to be remote. The Company reports off-balance sheet guarantees on its condensed consolidated schedule of



investments, as required by the 1940 Act.

**NOTE 10. SUBSEQUENT EVENTS***Distributions*

In April 2010, the Company's Board of Directors declared the following monthly cash distributions:

<b>Record Date</b>	<b>Payment Date</b>	<b>Distribution per Share</b>
April 22, 2010	April 30, 2010	\$ 0.07
May 20, 2010	May 28, 2010	\$ 0.07
June 22, 2010	June 30, 2010	\$ 0.07

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*Investment Activity*

Subsequent to March 31, 2010, the Company extended approximately \$1,200 of revolver draws and additional investments to existing portfolio companies. In addition, the Company extended \$400 in a new investment, FedCap Partners, LLC, which is a fund that invests in government contractors. The Company's investment commitment in FedCap Partners is the lesser of \$2,000 or 10% of the fund's aggregate investor commitments. The Company also received approximately \$14,994 from scheduled and unscheduled loan repayments and a loan payoff. This included a \$13,590 payoff from VantaCore.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
(dollar amounts in thousands, except per share data or unless otherwise indicated)

All statements contained herein, other than historical facts, may constitute forward-looking statements. 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 estimate, may, might, believe, will, provided, anticipate, future, could, growth, plan, 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. We caution readers not to place undue reliance on any such forward-looking statements. 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-Q.

The following analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the notes thereto contained elsewhere in this report and our annual report on Form 10-K for the fiscal year ended September 30, 2009.

## OVERVIEW

### General

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objective is to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, senior subordinated notes and junior subordinated notes, of established private businesses that are substantially owned by leveraged buyout funds, individual investors or are family-owned businesses, with a particular focus on senior notes. In addition, we may acquire from others existing loans that meet this profile. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants or other equity instruments that we may receive when we make loans. We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the Investment Company Act of 1940, as amended (the "1940 Act"). In addition, for tax purposes we have elected to be treated as a regulated investment company ("RIC") under the Internal Revenue Code of 1986, as amended (the "Code").

We seek to invest in small and medium-sized private U.S. businesses that meet certain criteria, including some but not all of the following: the potential for growth in cash flow, adequate assets for loan collateral, experienced management teams with a significant ownership interest in the borrower, profitable operations based on the borrower's cash flow, reasonable capitalization of the borrower (usually by leveraged buyout funds or venture capital funds) and the potential to realize appreciation and gain liquidity in our equity position, if any. We anticipate that liquidity in our equity position will be achieved through a merger or acquisition of the borrower, a public offering of the borrower's stock or by exercising our right to require the borrower to repurchase our warrants, though there can be no assurance that we will always have these rights. We lend to borrowers that need funds to finance growth, restructure their balance sheets or effect a change of control.

**Business Environment**

While economic conditions generally appear to be improving somewhat, we remain cautious about a long-term economic recovery. The recent recession generally, and the disruptions in the capital markets in particular, have decreased liquidity and increased our cost of debt and equity capital, where available. The longer these conditions persist, the greater the probability that these factors could continue to increase our costs of, and significantly limit our access to, debt and equity capital and, thus, have an adverse effect on our operations and financial results. Many of the companies in which we have made or will make investments are still susceptible to the economic conditions, which may affect the ability of one or more of our portfolio companies to repay our loans or engage in a liquidity event, such as a sale, recapitalization or initial public offering. The economic conditions could also disproportionately impact some of the industries in which we invest, causing us to be more vulnerable to losses in our portfolio, which could cause the number of our non-performing assets to increase and the fair market value of our portfolio to decrease. We do not know when market conditions will stabilize, if adverse conditions will intensify or the full extent to which the disruptions will affect us. If market instability persists or intensifies, we may experience difficulty in raising capital.

Challenges in the current market are intensified for us by certain regulatory limitations under the Code and the 1940 Act, as well as contractual restrictions under the agreement governing our credit facility that further constrain our ability to access the capital markets. To maintain our qualification as a RIC, we must satisfy, among other requirements, an annual distribution requirement to pay out at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. Because we are required to

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distribute our income in this manner, and because the illiquidity of many of our investments makes it difficult for us to finance new investments through the sale of current investments, our ability to make new investments is highly dependent upon external financing. Our external financing sources include the issuance of equity securities, debt securities or other leverage such as borrowings under our line of credit. Our ability to seek external debt financing, to the extent that it is available under current market conditions, is further subject to the asset coverage limitations of the 1940 Act, which require us to have at least a 200% asset coverage ratio, meaning generally that for every dollar of debt, we must have two dollars of assets.

Market conditions have also affected the trading price of our common stock and thus our ability to finance new investments through the issuance of equity. When our stock is trading below net asset value ( NAV ), as it has consistently traded for most of the last 18 months, our ability to issue equity is constrained by provisions of the 1940 Act which generally prohibit the issuance and sale of our common stock below NAV per share without stockholder approval other than through sales to our then-existing stockholders pursuant to a rights offering. At our annual meeting of stockholders held on February 18, 2010, stockholders approved a proposal which authorizes us to sell shares of our common stock at a price below our then current NAV per share for a period of one year from the date of approval, provided that our Board of Directors makes certain determinations prior to any such sale. On May 3, 2010, the closing market price of our common stock was \$13.87, which price represented a 15% premium to our March 31, 2010 NAV per share.

Current economic conditions may also decrease the value of collateral securing some of our loans, as well as the value of our equity investments, which has impacted and may continue to impact our ability to borrow under our credit facility. For the six months ended March 31, 2010, we recorded net unrealized appreciation on our portfolio of investments of \$5,082. We may see decreases in the value of our portfolio, which will further limit our ability to borrow under our current credit facility. Additionally, our credit facility contains covenants regarding the maintenance of certain minimum net worth requirements which are affected by the decrease in value of our portfolio. Failure to meet these requirements would result in a default which, if we are unable to obtain a waiver from our lenders, would result in the acceleration of our repayment obligations under our credit facility. As of March 31, 2010, we were in compliance with all of the facility covenants.

We expect that, given these regulatory and contractual constraints in combination with current market conditions, debt and equity capital may be costly or difficult for us to access. However, we believe that our entry into a new \$127,000 credit facility with a two-year term (discussed in detail further below) increases our ability to make new investments consistent with our strategy of making conservative investments in businesses that we believe will weather the current economy and that are likely to produce attractive long-term returns for our stockholders.

**Syndicated Loan Valuations**

In monitoring the market activity during the quarter ended March 31, 2010, we noted markets conditions indicating continued liquidity and a better functioning secondary market for syndicated loans. Therefore, in accordance with Accounting Standards Codification ( ASC ) 820, and following our valuation procedures which specify the use of third-party indicative bid quotes for valuing syndicated loans where there is a liquid public market for those loans and market pricing quotes are readily available, third-party bid quotes were used to value the remaining syndicated loans not sold during the quarter ended March 31, 2010. As we noted some illiquidity in the public market, we don't believe that the third-party bid quotes are representative of Level 2 inputs.

**Investment Highlights**

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*Purchases:* During the six months ended March 31, 2010, we extended \$180 of investments to a new portfolio company and \$7,140 of investments to existing portfolio companies through revolver draws or the additions of new term notes, for total investments of \$7,320.

*Repayments:* During the six months ended March 31, 2010, five borrowers made unscheduled full payoffs of \$31,006, one borrower made an unscheduled partial payoff of \$950 and we experienced contractual amortization, revolver repayments and some principal payments received ahead of schedule for an aggregate of \$6,513, for total principal repayments of \$38,469.

*Sales:* During the six months ended March 31, 2010, we sold three syndicated loans (which resulted in our exit from three portfolio companies) for an aggregate of \$3,119 in net proceeds.

Since our initial public offering in August 2001, we have made 263 different loans to, or investments in, 127 companies for a total of approximately \$958,933, before giving effect to principal repayments on investments and divestitures.

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**Financing Highlights**

On March 15, 2010, through our wholly-owned subsidiary, Gladstone Business Loan, LLC ( *Business Loan* ), we entered into a fourth amended and restated credit agreement which provides for a \$127,000 revolving line of credit arranged by Key Equipment Finance Inc. as administrative agent (the *Credit Facility* ). Branch Banking and Trust Company ( *BB&T* ) and ING Capital LLC ( *ING* ) also joined the *Credit Facility* as committed lenders. Subject to certain terms and conditions, the *Credit Facility* may be expanded up to \$202 million through the addition of other committed lenders to the facility. The *Credit Facility* matures in two years on March 15, 2012, and, if the facility is not renewed or extended by this date, all principal and interest will be due and payable on March 15, 2013. Advances under the *Credit Facility* will generally bear interest at the 30-day LIBOR (subject to a minimum rate of 2%), plus 4.5% per annum, with a commitment fee of 0.5% per annum on undrawn amounts.

During the six months ended March 31, 2010, we applied Financial Accounting Standards Board ( *FASB* ) ASC 825, *Financial Instruments*, specifically to our *Credit Facility*, which requires us to apply a fair value methodology to the *Credit Facility* as of March 31, 2010. Since the *Credit Facility* was entered into during the three months ended March 31, 2010, the cost basis of the *Credit Facility* of \$53,000 was determined to be the best approximation of fair value as of March 31, 2010.

**Registration Statement**

On October 20, 2009, we filed a registration statement on Form N-2 with the Securities and Exchange Commission (the *SEC* ) that was amended on December 9, 2009. The *SEC* declared the registration statement effective on January 28, 2010 and such registration statement will permit us to issue, through one or more transactions, up to an aggregate of \$300,000 in securities, consisting of common stock, senior common stock, preferred stock, subscription rights, debt securities and warrants to purchase common stock, or a combination of these securities.

Table of Contents**RESULTS OF OPERATIONS***Comparison of the Three Months Ended March 31, 2010 to the Three Months Ended March 31, 2009*

A comparison of our operating results for the three months ended March 31, 2010 and March 31, 2009 is shown below:

	2010	For the three months ended March 31,		
		2009	\$ Change	% Change
<b>INVESTMENT INCOME</b>				
Interest income non control/non affiliate investments	\$ 8,523	\$ 10,329	\$ (1,806)	(17.5)%
Interest income control investments	709	482	227	47.1%
Interest income cash		1	(1)	(100.0)%
Interest income notes receivable from employees	108	117	(9)	(7.7)%
Prepayment fees and other income	474		474	
Total investment income	9,814	10,929	(1,115)	(10.2)%
<b>EXPENSES</b>				
Interest expense	1,136	2,016	(880)	(43.7)%
Loan servicing fee	852	1,526	(674)	(44.2)%
Base management fee	739	484	255	52.7%
Incentive fee	1,072	1,089	(17)	(1.6)%
Administration fee	176	211	(35)	(16.6)%
Professional fees	219	205	14	6.8%
Amortization of deferred financing fees	449	726	(277)	(38.2)%
Stockholder related costs	144	196	(52)	(26.5)%
Directors fees	48	48		0.0%
Insurance expense	79	65	14	21.5%
Compensation expense	245		245	
Other expenses	187	74	113	152.7%
Expenses before credit from Adviser	5,346	6,640	(1,294)	(19.5)%
Credit to base management and incentive fees from Adviser	(6)	(1,266)	1,260	(99.5)%
Total expenses net of credit to base management and incentive fees	5,340	5,374	(34)	(0.6)%
<b>NET INVESTMENT INCOME</b>	<b>4,474</b>	<b>5,555</b>	<b>(1,081)</b>	<b>(19.5)%</b>
<b>REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, DERIVATIVE AND BORROWINGS UNDER LINE OF CREDIT:</b>				
Net realized gain (loss) on investments	892	(2,000)	2,892	(144.6)%
Realized loss on settlement of derivative		(304)	304	(100.0)%
Net unrealized appreciation on derivative		304	(304)	(100.0)%
Net unrealized appreciation on investments	2,483	6,725	(4,242)	(63.1)%
Net unrealized depreciation on borrowings under line of credit	131		131	
Net gain on investments, derivative and borrowings under line of credit	3,506	4,725	(1,219)	(25.8)%



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NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	\$	7,980	\$	10,280	\$	(2,300)	(22.4)%
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### Investment Income

Investment income for the three months ended March 31, 2010 was \$9,814, as compared to \$10,929 for the three months ended March 31, 2009. Interest income from our aggregate investment portfolio decreased for the three months ended March 31, 2010, as compared to the prior year period. The level of interest income from investments is directly related to the balance, at cost, of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The weighted average yield varies from period to period based on the current stated interest rate on interest-bearing investments and the amounts of loans for which interest is not accruing. Interest income from our investments decreased primarily due to the overall reduction in the cost basis of our investments, resulting from the exit of loans subsequent to March 31, 2009, partially offset by an increase in the weighted average yield on our portfolio. The annualized weighted average yield on our portfolio, excluding cash and cash equivalents, was 10.9% for the three months ended March 31, 2010 as compared to 9.7% for the prior year period. During the three months ended March 31, 2010, six investments were on non-accrual, for an aggregate of approximately \$26,422 at cost, or 8.0% of the aggregate

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cost of our investment portfolio, and during the prior year period, three investments were on non-accrual, for an aggregate of approximately \$10,659 at cost, or 2.4% of the aggregate cost of our investment portfolio. The increase in investments on non-accrual was due primarily to the addition of one portfolio company (Lindmark). Although we did not historically report Lindmark as non-accrual, we have not recognized interest income on this investment since April 2009.

Interest income from Non-Control/Non-Affiliate investments decreased for the three months ended March 31, 2010, as compared to the prior year period. The decrease was primarily attributable to an overall decrease in the aggregate Non-Control/Non-Affiliate investments held at March 31, 2010 compared to the prior year period. The decrease was also attributable to the conversion of two Non-Control/Non-Affiliate investments held during the prior year period (Clinton and Defiance) to Control investments. In addition, we reversed previously recorded interest income of approximately \$90 during the three months ended March 31, 2010. The success fees earned during the three months ended March 31, 2010 and March 31, 2009 included in interest income were \$848 and \$21, respectively. Success fees earned during the three months ended March 31, 2010 resulted from payoffs from ActivStyle, Saunders and Visual Edge. Success fees earned during the three months ended March 31, 2009 resulted from a refinancing by It's Just Lunch.

Interest income from Control investments increased for the three months ended March 31, 2010, as compared to the prior year period. The increase was attributable to two additional Control investments held during the quarter ended March 31, 2010 (Clinton and Defiance), which were converted from Non-Control/Non-Affiliate investments, as compared to the prior year period.

The following table lists the interest income from investments for the five largest portfolio company investments during the respective periods:

**Three months ended March 31, 2010**

Company	Interest Income	% of Total
Visual Edge	\$ 967	10.5%
Reliable Biopharma	738	8.0%
Sunshine Media	693	7.5%
Westlake Hardware	672	7.3%
Clinton	514	5.5%
<b>Subtotal</b>	<b>\$ 3,584</b>	<b>38.8%</b>
Other companies	5,648	61.2%
<b>Total interest income</b>	<b>\$ 9,232</b>	<b>100.0%</b>

**Three months ended March 31, 2009**

Company	Interest Income	% of Total
Sunshine Media	\$ 824	7.6%
Reliable Biopharma	757	7.0%
Westlake Hardware	597	5.5%
Clinton	465	4.3%
VantaCore	416	3.9%
<b>Subtotal</b>	<b>\$ 3,059</b>	<b>28.3%</b>

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Other companies		7,752	71.7%
<b>Total interest income</b>	<b>\$</b>	<b>10,811</b>	<b>100.0%</b>

Interest income from invested cash for the three months ended March 31, 2010 and 2009 was nominal. Interest income is based on the amount of cash held in interest bearing accounts and the interest earned on our custodial account prior to disbursement.

Interest income from loans to our employees, in connection with the exercise of employee stock options, decreased slightly for the three months ended March 31, 2010 as compared to the prior year period due to the reduction of employee loans during the previous quarter ended December 31, 2009.

Prepayment fees and other income increased for the three months ended March 31, 2010 as compared to the prior year period. The income for the current period consisted of prepayment penalty fees received upon unscheduled principal repayments as well as interest from stock option loans of former employees.

### Operating Expenses

Operating expenses, net of credits from the Adviser for fees earned and voluntary and irrevocable waivers applied to the base management and incentive fees, decreased for the three months ended March 31, 2010, as compared to the prior year period. This reduction was primarily due to a decrease in interest expense and the amortization of deferred financing fees incurred in connection with the Credit Facility, as well as a decrease in incentive fees, which were offset by a reduction in the Adviser's voluntary credit to the incentive fee and compensation expense.

Interest expense decreased for the three months ended March 31, 2010 as compared to the prior year period due primarily to decreased borrowings under our line of credit during the three months ended March 31, 2010 as well as a lower weighted average annual interest cost, which is determined by using the annual stated interest rate plus commitment and other fees, plus the amortization of deferred financing fees divided by the weighted average debt outstanding.

Loan servicing fees decreased for the three months ended March 31, 2010 as compared to the prior year period. These fees are incurred in connection with a loan servicing agreement between Business Loan and our Adviser, which is based on the size of our

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investment portfolio. The decrease was primarily due to the reduction in the size of our investment portfolio, in particular the loans in our borrowing base. Due to voluntary, irrevocable and unconditional waivers applied during these periods, senior syndicated loans incurred a 0.5% annual fee, whereas proprietary loans incurred a 1.5% annual fee. All of these fees were offset against the amount of the base management fee due to our Adviser.

Base management fee (which is net of loan servicing fees) increased for the three months ended March 31, 2010 as compared to the prior year period. However, the gross management fee (consisting of the loan servicing fees plus the base management fee) decreased from the prior year period as shown below:

	Three months ended	
	March 31, 2010	March 31, 2009
Loan servicing fee	\$ 852	\$ 1,526
Base management fee	739	484
Gross management fee	\$ 1,591	\$ 2,010

Gross management fee decreased due to fewer total assets held during the three months ended March 31, 2010. The base management fee is computed quarterly as described under *Investment Advisory and Management Agreement* in Note 4 of the notes to the consolidated financial statements in our Annual Report on Form 10-K as filed with the SEC on November 23, 2009, and is summarized in the table below:

	Three months ended	
	March 31, 2010	March 31, 2009
Base management fee (1)	\$ 739	\$ 484
Credit for fees received by Adviser from the portfolio companies		(80)
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum (2)	(6)	(97)
Net base management fee	\$ 733	\$ 307

(1) Base management fee is net of loan servicing fees per the terms of the Advisory Agreement.

(2) The board of our Adviser voluntarily and irrevocably waived, for the three months ended March 31, 2010 and 2009, the annual 2.0% base management fee to 0.5% for senior syndicated loan participations. Fees waived cannot be recouped by the Adviser in the future.

Incentive fee decreased slightly for the three months ended March 31, 2010 as compared to the prior year period. The board of directors of our Adviser voluntarily, irrevocably and unconditionally waived the entire incentive fee for the three months ended March 31, 2009. No portion of the incentive fee was waived during the three months ended March 31, 2010. The incentive fee and associated credits are summarized in the table below:

	Three months ended	
	March 31, 2010	March 31, 2009
Incentive fee	\$ 1,072	\$ 1,089
Credit from voluntary, irrevocable waiver issued by Adviser's board of directors		(1,089)

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Net incentive fee	\$	1,072	\$
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Administration fee decreased for the three months ended March 31, 2010 as compared to the prior year period, due to a decrease of administration staff and related expenses, as well as a decrease in our total assets in comparison to the total assets of all companies managed by our Adviser under similar agreements. The calculation of the administration fee is described in detail above under *Investment Advisory and Management Agreement* in Note 4 of the notes to the consolidated financial statements in our Annual Report on Form 10-K as filed with the SEC on November 23, 2009.

Compensation expense increased for the three months ended March 31, 2010 as compared to the prior year period due to the conversion of stock option loans of two former employees of the Adviser from recourse to non-recourse loans. The conversions were non-cash transactions and were accounted for as repurchases of the shares previously received by the employees of the Adviser upon exercise of the stock options in exchange for the non-recourse notes. The repurchases were accounted for as treasury stock transactions at the fair value of the shares, totaling \$420. Since the value of the stock option loans totaled \$665, we recorded compensation expense of \$245.

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Other operating expenses (including professional fees, deferred financing fees, stockholder related costs, director's fees, insurance and other direct expenses) increased for the three months ended March 31, 2010 as compared to the prior year period, due primarily to legal fees incurred in connection with troubled loans during the three months ended March 31, 2010 and the provision for uncollectible receivables from portfolio companies.

**Net Realized Gain (Loss) on Investments**

Net realized gain on investments for the three months ended March 31, 2010 was \$892, which consisted of a gain from ACE Expeditors of \$1,366, partially offset by an aggregate of \$474 of losses from the CCS payoff and GoldToe syndicated loan sale. Net realized loss on investments for the three months ended March 31, 2009 was \$2,000, which resulted from writing off the remaining balance of the Greatwide senior subordinated term loan.

**Realized Loss on Settlement of Derivative**

During the three months ended March 31, 2009, we realized a loss of \$304 due to the expiration of the interest rate cap in February 2009.

**Net Unrealized Appreciation on Derivative**

Net unrealized appreciation (depreciation) on derivative is the net change in the fair value of our interest rate cap during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. For the three months ended March 31, 2009, we recorded unrealized appreciation on derivative of \$304, which resulted from the reversal of previously recorded unrealized depreciation when the loss was realized during the March 2009 quarter (see discussion above).

**Net Unrealized Appreciation on Investments**

Net unrealized appreciation (depreciation) on investments is the net change in the fair value of our investment portfolio during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. The net unrealized appreciation on investments for the three months ended March 31, 2010 consisted of the following:

• Control investments	\$	(566)
• Non-Control/Non-Affiliate investments		1,018
• Reversal of previously recorded unrealized depreciation upon realization of losses		2,031
Total	\$	2,483

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Although our investment portfolio appreciated during the three months ended March 31, 2010, our entire portfolio was fair valued at 88% of cost as of March 31, 2010. The cumulative unrealized depreciation of our investments does not have an impact on our current ability to pay distributions to stockholders; however, it may be an indication of future realized losses, which could ultimately reduce our income available for distribution.

### **Net Unrealized Depreciation on Borrowings under Line of Credit**

Net unrealized depreciation on borrowings under line of credit is the net change in the fair value of our line of credit borrowings during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. We elected to apply ASC 825, Financial Instruments, which requires that we apply a fair value methodology to the Credit Facility. We estimated the fair value of the Credit Facility using estimates of value provided by an independent third party and our own assumptions in the absence of observable market data, including estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. Since the Credit Facility was entered into during the three months ended March 31, 2010, the cost basis of the Credit Facility of \$53,000 was determined to be the best approximation of the fair value as of March 31, 2010.

### **Net Increase in Net Assets Resulting from Operations**

For the three months ended March 31, 2010, we realized a net increase in net assets resulting from operations of \$7,980 as a result of the factors discussed above. For the three months ended March 31, 2009, we realized a net increase in net assets resulting from operations of \$10,280. Our net increase in net assets resulting from operations per basic and diluted weighted average common share for the three months ended March 31, 2010 and March 31, 2009 were \$0.38 and \$0.48, respectively.

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*Comparison of the Six Months Ended March 31, 2010 to the Six Months Ended March 31, 2009*

A comparison of our operating results for the six months ended March 31, 2010 and March 31, 2009 is shown below:

	2010	For the six months ended March 31,		
		2009	\$ Change	% Change
<b>INVESTMENT INCOME</b>				
Interest income non control/non affiliate investments	\$ 17,432	\$ 21,990	\$ (4,558)	(20.7)%
Interest income control investments	1,477	502	975	194.2%
Interest income cash		11	(11)	(100.0)%
Interest income notes receivable from employees	221	235	(14)	(6.0)%
Prepayment fees and other income	488		488	
Total investment income	19,618	22,738	(3,120)	(13.7)%
<b>EXPENSES</b>				
Interest expense	2,671	4,478	(1,807)	(40.4)%
Loan servicing fee	1,781	3,149	(1,368)	(43.4)%
Base management fee	1,459	917	542	59.1%
Incentive fee	1,447	2,265	(818)	(36.1)%
Administration fee	354	438	(84)	(19.2)%
Professional fees	1,131	518	613	118.3%
Amortization of deferred financing fees	943	1,446	(503)	(34.8)%
Stockholder related costs	222	284	(62)	(21.8)%
Directors fees	97	97		0.0%
Insurance expense	147	122	25	20.5%
Compensation expense	245		245	
Other expenses	254	140	114	81.4%
Expenses before credit from Adviser	10,751	13,854	(3,103)	(22.4)%
Credit to base management and incentive fees from Adviser	(35)	(2,553)	2,518	(98.6)%
Total expenses net of credit to base management and incentive fees	10,716	11,301	(585)	(5.2)%
NET INVESTMENT INCOME	8,902	11,437	(2,535)	(22.2)%
<b>REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, DERIVATIVE AND BORROWINGS UNDER LINE OF CREDIT:</b>				
Net realized loss on investments	(28)	(3,731)	3,703	(99.2)%
Realized loss on settlement of derivative		(304)	304	(100.0)%
Net unrealized appreciation on derivative		304	(304)	(100.0)%
Net unrealized appreciation (depreciation) on investments	5,082	(6,528)	11,610	(177.8)%
Net unrealized appreciation on borrowings under line of credit	350		350	
Net gain (loss) on investments, derivative and borrowings under line of credit	5,404	(10,259)	15,663	(152.7)%
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	\$ 14,306	\$ 1,178	\$ 13,128	1,114.4%



**Investment Income**

Investment income for the six months ended March 31, 2010 was \$19,618, as compared to \$22,738 for the six months ended March 31, 2009. Interest income from our aggregate investment portfolio decreased for the six months ended March 31, 2010, as compared to the prior year period. The level of interest income from investments is directly related to the balance, at cost, of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The weighted average yield varies from period to period based on the current stated interest rate on interest-bearing investments and the amounts of loans for which interest is not accruing. Interest income from our investments decreased primarily due to the overall reduction in the cost basis of our investments, resulting from the exit of loans subsequent to March 31, 2009, partially offset by an increase in the weighted average yield on our portfolio. The annualized weighted average yield on our portfolio, excluding cash and cash equivalents, was 10.7% for the six months ended March 31, 2010 as compared to 10.0% for the prior year period. During the six months ended March 31, 2010, six investments were on non-accrual, for an aggregate of approximately \$26,422 at cost, or 8.0% of the aggregate cost of our investment portfolio, and during the prior year period, three investments were on non-accrual, for an aggregate of approximately \$10,659 at cost, or 2.4% of the aggregate cost of our investment portfolio. The increase in investments on non-accrual was due

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primarily to the addition of one portfolio company (Lindmark). Although we did not historically report Lindmark as non-accrual, we have not recognized interest income on this investment since April 2009.

Interest income from Non-Control/Non-Affiliate investments decreased for the six months ended March 31, 2010, as compared to the prior year period. The decrease was primarily attributable to an overall decrease in the aggregate Non-Control/Non-Affiliate investments held at March 31, 2010 compared to the prior year period. The decrease was also attributable to the conversion of two Non-Control/Non-Affiliate investments held during the prior year period (Clinton and Defiance) to Control investments. In addition, we reversed previously recorded interest of approximately \$598 during the six months ended March 31, 2010. The success fees earned during the six months ended March 31, 2010 and March 31, 2009, included in interest income, were \$1,387 and \$21, respectively. Success fees earned during the six months ended March 31, 2010 resulted from payoffs by ActivStyle, Saunders and Visual Edge, an amendment to senior term debt issued to Doe & Ingalls and a refinancing by Tulsa Welding. Success fees earned during the six months ended March 31, 2009 resulted from a refinancing by It's Just Lunch.

Interest income from Control investments increased for the six months ended March 31, 2010, as compared to the prior year period. The increase was attributable to two additional Control investments held during the six months ended March 31, 2010 (Clinton and Defiance), which were converted from Non-Control/Non-Affiliate investments, as compared to the prior year period. In addition, we reversed previously recorded interest of approximately \$75 during the six months ended March 31, 2010.

The following table lists the interest income from investments for the five largest portfolio company investments during the respective periods:

**Six months ended March 31, 2010**

Company	Interest Income	% of Total
Westlake Hardware	\$ 1,596	8.5%
Sunshine Media	1,539	8.1%
Reliable Biopharma	1,497	7.9%
Visual Edge	1,246	6.6%
Clinton	1,036	5.5%
<b>Subtotal</b>	<b>6,914</b>	<b>36.6%</b>
Other companies	11,995	63.4%
<b>Total interest income</b>	<b>\$ 18,909</b>	<b>100.0%</b>

**Six months ended March 31, 2009**

Company	Interest Income	% of Total
Sunshine Media	\$ 1,667	7.4%
Reliable Biopharma	1,530	6.8%
Westlake Hardware	1,213	5.4%
Clinton	940	4.2%
VantaCore	857	3.8%
<b>Subtotal</b>	<b>6,207</b>	<b>27.6%</b>
Other companies	16,285	72.4%
<b>Total interest income</b>	<b>22,492</b>	<b>100.0%</b>

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Interest income from invested cash for the six months ended March 31, 2010 and 2009 was nominal. Interest income is based on the amount of cash held in interest bearing accounts and the interest earned on our custodial account prior to disbursement.

Interest income from loans to our employees, in connection with the exercise of employee stock options, decreased slightly for the six months ended March 31, 2010 as compared to the prior year period due to the reduction of employee loans during the prior quarter ended December 31, 2009.

Prepayment fees and other income increased for the six months ended March 31, 2010 as compared to the prior year period. The income for the current period consisted of prepayment penalty fees received upon unscheduled principal repayments as well as interest from stock option loans of former employees.

### **Operating Expenses**

Operating expenses, net of credits from the Adviser for fees earned and voluntary and irrevocable waivers applied to the base management and incentive fees, decreased for the six months ended March 31, 2010, as compared to the prior year period. This reduction was primarily due to a decrease in interest expense and the amortization of deferred financing fees incurred in connection with the Credit Facility, as well as a decrease in incentive fees, which were offset by a reduction in the Adviser's voluntary credit to the incentive fee, compensation expense and an increase in professional fees.

Interest expense decreased for the six months ended March 31, 2010 as compared to the prior year period due primarily to decreased borrowings under our line of credit during the six months ended March 31, 2010 as well as a lower weighted average annual interest cost, which is determined by using the annual stated interest rate plus commitment and other fees, plus the amortization of deferred financing fees divided by the weighted average debt outstanding.

Loan servicing fees decreased for the six months ended March 31, 2010 as compared to the prior year period. These fees are incurred in connection with a loan servicing agreement between Business Loan and our Adviser, which is based on the size of our investment

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portfolio. The decrease was primarily due to the reduction in the size of our investment portfolio, in particular the loans in our borrowing base. Due to voluntary, irrevocable and unconditional waivers applied during these periods, senior syndicated loans incurred a 0.5% annual fee, whereas proprietary loans incurred a 1.5% annual fee. All of these fees were offset against the amount of the base management fee due to our Adviser.

Base management fee (which is net of loan servicing fees) increased for the six months ended March 31, 2010 as compared to the prior year period. However, the gross management fee (consisting of the loan servicing fees plus the base management fee) decreased from the prior year period as shown below:

	Six months ended	
	March 31, 2010	March 31, 2009
Loan servicing fee	\$ 1,781	\$ 3,149
Base management fee	1,459	917
Gross management fee	\$ 3,240	\$ 4,066

Gross management fee decreased due to fewer total assets held during the six months ended March 31, 2010. The base management fee is computed quarterly as described under Investment Advisory and Management Agreement in Note 4 of the notes to the consolidated financial statements in our Annual Report on Form 10-K as filed with the SEC on November 23, 2009, and is summarized in the table below:

	Six months ended	
	March 31, 2010	March 31, 2009
Base management fee (1)	\$ 1,459	\$ 917
Credit for fees received by Adviser from the portfolio companies		(85)
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum (2)	(13)	(203)
Net base management fee	\$ 1,446	\$ 629

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- (1) Base management fee is net of loan servicing fees per the terms of the Advisory Agreement.  
(2) The board of our Adviser voluntarily and irrevocably waived, for the six months ended March 31, 2010 and 2009, the annual 2.0% base management fee to 0.5% for senior syndicated loan participations. Fees waived cannot be recouped by the Adviser in the future.

Incentive fee decreased for the six months ended March 31, 2010 as compared to the prior year period. The board of directors of our Adviser voluntarily, irrevocably and unconditionally waived a portion of the incentive fee for the six months ended March 31, 2010 and the entire incentive fee for the six months ended March 31, 2009. The incentive fee and associated credits are summarized in the table below:

	Six months ended	
	March 31, 2010	March 31, 2009
Incentive fee	\$ 1,447	\$ 2,265
Credit from voluntary, irrevocable waiver issued by Adviser's board of directors	(22)	(2,265)
Net incentive fee	\$ 1,425	\$

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Administration fee decreased for the six months ended March 31, 2010 as compared to the prior year period, due to a decrease of administration staff and related expenses, as well as a decrease in our total assets in comparison to the total assets of all companies managed by our Adviser under similar agreements. The calculation of the administration fee is described in detail above under Investment Advisory and Management Agreement in Note 4 of the notes to the consolidated financial statements in our Annual Report on Form 10-K as filed with the SEC on November 23, 2009.

Compensation expense increased for the six months ended March 31, 2010 as compared to the prior year period due to the conversion of stock option loans of two former employees from recourse to non-recourse loans. The conversions were non-cash transactions and were accounted for as repurchases of the shares previously received by the employees upon exercise of the stock option in exchange for the non-recourse notes. The repurchases were accounted for as treasury stock transactions at the fair value of the shares, totaling \$420. Since the value of the stock option loans totaled \$665, we recorded compensation expense of \$245.

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Other operating expenses (including professional fees, deferred financing fees, stockholder related costs, director's fees, insurance and other direct expenses) increased for the six months ended March 31, 2010 as compared to the prior year period, due primarily to legal fees incurred in connection with troubled loans during the six months ended March 31, 2010 and the provision for uncollectible receivables from portfolio companies.

**Net Realized Loss on Investments**

Net realized loss on investments for the six months ended March 31, 2010 was \$28, which consisted of \$1,394 of losses from the Gold Toe, Kinetek and Wesco syndicated loan sales and CCS payoff, offset by a \$1,366 gain from ACE Expeditors payoff. Net realized loss on investments for the six months ended March 31, 2009 was \$3,731, which consisted of \$2,000 from writing off the remaining balance of the Greatwide senior subordinated term loan and a \$1,758 loss from the sale of the Greatwide senior subordinated term loan, offset by a \$27 gain from the Country Road payoff.

**Realized Loss on Settlement of Derivative**

During the six months ended March 31, 2009, we realized a loss of \$304 due to the expiration of the interest rate cap in February 2009.

**Net Unrealized Appreciation on Derivative**

Net unrealized appreciation (depreciation) on derivative is the net change in the fair value of our interest rate cap during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. For the six months ended March 31, 2009, we recorded unrealized appreciation on derivative of \$304, which resulted from the reversal of previously recorded unrealized depreciation when the loss was realized during the quarter ended March 31, 2009 (see discussion above).

**Net Unrealized Appreciation (Depreciation) on Investments**

Net unrealized appreciation (depreciation) on investments is the net change in the fair value of our investment portfolio during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. The net unrealized appreciation on investments for the six months ended March 31, 2010 consisted of the following:

• Control investments	\$	(1,566)
• Non-Control/Non-Affiliate investments		3,437
• Reversal of previously recorded unrealized depreciation upon realization of losses		3,211
Total	\$	5,082

Although our investment portfolio appreciated during the six months ended March 31, 2010, our entire portfolio was fair valued at 88% of cost as of March 31, 2010. The cumulative unrealized depreciation of our investments does not have an impact on our current ability to pay distributions to stockholders; however, it may be an indication of future realized losses, which could ultimately reduce our income available for distribution.

#### **Net Unrealized Depreciation on Borrowings under Line of Credit**

Net unrealized depreciation on borrowings under line of credit is the net change in the fair value of our line of credit borrowings during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. We elected to apply ASC 825, Financial Instruments, which requires that we apply a fair value methodology to the Credit Facility. We estimated the fair value of the Credit Facility using estimates of value provided by an independent third party and our own assumptions in the absence of observable market data, including estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. Since the Credit Facility was entered into during the six months ended March 31, 2010, the cost basis of the Credit Facility of \$53,000 was determined to be the best approximation of fair value as of March 31, 2010.

#### **Net Increase in Net Assets Resulting from Operations**

For the six months ended March 31, 2010, we realized a net increase in net assets resulting from operations of \$14,306 as a result of the factors discussed above. For the six months ended March 31, 2009, we realized a net increase in net assets resulting from operations of \$1,178. Our net increase in net assets resulting from operations per basic and diluted weighted average common share for the six months ended March 31, 2010 and March 31, 2009 were \$0.68 and \$0.05, respectively.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES (dollar amounts in thousands, unless otherwise indicated)****Operating Activities**

At March 31, 2010, we had investments in debt securities of, or loans to, 41 private companies with a cost basis totaling approximately \$330,094. During the six months ended March 31, 2010 and March 31, 2009, the following investment activity occurred:

Quarter Ended	New Investments (1)	Principal Repayments (2)	Proceeds from Sales/Exits (3)	Net Gain (Loss) on Sale/Exit
March 31, 2010	\$ 5,153	\$ 23,065	\$ 337	\$ 892
December 31, 2009	2,167	15,404	2,782	(920)
	\$ 7,320	\$ 38,469	\$ 3,119	\$ (28)
March 31, 2009	\$ 8,427	\$ 13,053	\$	\$ (2,000)
December 31, 2008	8,702	14,927	2,212	(1,731)
	\$ 17,129	\$ 27,980	\$ 2,212	\$ (3,731)

**(1) New Investments:**

Quarter Ended	Companies	New Investments Investments	Disbursements to Existing Portfolio Companies	Total Disbursements
March 31, 2010		\$	\$ 5,153	\$ 5,153
December 31, 2009	1(a)	180	1,987	2,167
	1	\$ 180	\$ 7,140	\$ 7,320
March 31, 2009		\$	\$ 8,427	\$ 8,427
December 31, 2008			8,702	8,702
		\$	\$ 17,129	\$ 17,129

(a) Northstar Broadband

**(2) Principal Repayments (including repayment of paid in kind interest previously applied to principal balance):**

Quarter Ended	Number of Companies Fully Exited	Unscheduled Principal Repayments (*)	Scheduled Principal Repayments	Total Principal Repayments	Net Gain on Sale/Exit (#)
March 31, 2010	4(a)	\$ 18,902	\$ 4,163	\$ 23,065	\$ 1,055
December 31, 2009	1(b)	13,054	2,350	15,404	



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	5	\$	31,956	\$	6,513	\$	38,469	\$	1,055
March 31, 2009	(c)	\$	7,813	\$	5,240	\$	13,053	\$	
December 31, 2008	2(d)		6,966		7,961		14,927		
	2	\$	14,779	\$	13,201	\$	27,980	\$	

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(\*) Includes principal repayments due to excess cash flows, covenant violations, exits, refinancings, etc.

(#) Net gain on principal repayments of \$1,055 plus the net loss on sales/exits of \$1,083 (per footnote 3 below) equals net loss of \$28, which is included on the condensed consolidated statement of operations for the six months ended March 31, 2010.

(a) Full payoff from ACE Expeditors (which resulted in a gain on the warrants), ActivStyle, CCS and Visual Edge.

(b) Full payoff from Tulsa Welding and partial payoff from BAS Broadcasting senior term debt (last out tranche).

(c) Refinancing from ACE Expeditors and Sunburst Media.

(d) Full payoff from Community Media and Country Road.

Table of Contents**(3) Proceeds from Sales/Exits:**

Quarter Ended	Number of Companies Fully Exited	Proceeds Received	Position (Principal) Exited	Unamortized Loan Costs (*)	Net Loss on Exit (#)
March 31, 2010	1(a)	\$ 337	\$ (500)	\$	\$ (163)
December 31, 2009	2(b)	2,782	(3,685)	(17)	(920)
	3	\$ 3,119	\$ (4,185)	\$ (17)	\$ (1,083)
March 31, 2009	1(c)	\$	(2,000)	\$	(2,000)
December 31, 2008	(d)	2,212	(3,950)	7	(1,731)
	1	\$ 2,212	\$ (5,950)	\$ 7	\$ (3,731)

(\*) Includes balance of premiums, discounts and acquisition cost at time of exit.

(#) Net gain on principal repayments of \$1,055 (per footnote 2 above) plus the net loss on sales/exits of \$1,083 equals net loss of \$28, which is included on the condensed consolidated statement of operations for the six months ended March 31, 2010.

- (a) Complete sale of Gold Toe senior subordinated syndicated loan.
- (b) Complete sale of Kinetek senior term syndicated loan and Wesco Holdings senior subordinated syndicated loan.
- (c) Write-off of Greatwide Logistics senior subordinated syndicated loan.
- (d) Partial sale of Greatwide Logistics senior term syndicated loan.

The following table summarizes the contractual principal repayments and maturity of our investment portfolio by fiscal year, assuming no voluntary prepayments:

	Amount
For the remaining six months ending September 30:	2010 \$ 20,904
For the fiscal year ending September 30:	2011 92,686
	2012 78,069
	2013 119,763
	2014 6,116
	2015 6,851
	<b>Total Contractual Repayments</b> 324,389
	Investments in equity securities 5,278
	Unamortized premiums, discounts and investment acquisition costs on debt securities 427
	<b>Total</b> \$ 330,094

Net cash provided by operating activities for the six months ended March 31, 2010, consisting primarily of the items described in Results of Operations and the investment activity described above, was \$39,235 as compared to net cash provided by operating activities of \$19,586 for the

six months ended March 31, 2009.

### **Financing Activities**

Net cash used in financing activities for the six months ended March 31, 2010 was \$40,250 and mainly consisted of net payments on the Credit Facility of \$30,000, distributions to stockholders of \$8,853 and \$1,323 in financing fees for the Credit Facility. On March 15, 2010, we entered into the Credit Facility. BB&T and ING also joined the Credit Facility as committed lenders. Net cash used in financing activities for the six months ended March 31, 2009 was \$15,550 and primarily consisted of distributions to stockholders of \$17,714, offset by net borrowings under our line of credit of \$2,340.

### **Distributions**

In order to qualify as a RIC and to avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. Further, our Credit Facility requires us to pay distributions only from estimated net investment income. In accordance with these requirements, we declared and paid monthly cash distributions of \$0.07 per common share for January, February and March 2010. In April 2010, our Board of Directors declared a monthly distribution of \$0.07 per common share for each of April, May and June 2010.

Table of Contents*Section 19(a) Disclosure*

Our Board of Directors estimates the source of the distributions at the time of their declaration as required by Section 19(a) of the 1940 Act. On a monthly basis, if required under Section 19(a), we post a Section 19(a) notice through the Depository Trust Company's Legal Notice System ( LENS ) and also send to our registered stockholders a written Section 19(a) notice along with the payment of distributions for any payment which includes a distribution estimated to be paid from any other source other than net investment income. The estimates of the source of the distribution are interim estimates based on GAAP that are subject to revision, and the exact character of the distributions for tax purposes cannot be determined until our books and records are finalized for the calendar year. Following the calendar year end, after we have determined definitive information, if we have made distributions of taxable income (or return of capital), we will deliver a Form 1099-DIV to our stockholders specifying such amount and the tax characterization of such amount. Therefore, these estimates are made solely in order to comply with the requirements of Section 19(a) of the 1940 Act and should not be relied upon for tax reporting or any other purposes and could differ significantly from the actual character of distributions for tax purposes.

The following GAAP estimates were made by our Board of Directors during the quarter ended March 31, 2010:

<b>Month Ended</b>	<b>Ordinary Income</b>	<b>Return of Capital *</b>	<b>Total Distribution</b>
January 31, 2010	\$ 0.071	\$ (0.001)	\$ 0.070
February 28, 2010	0.088	(0.018)	0.070
March 31, 2010	0.057	0.013	0.070

Because our Board of Directors declares distributions at the beginning of a quarter, it is difficult to estimate how much of our monthly distributions, based on GAAP, will come from ordinary income, capital gains and returns of capital. Subsequent to the quarter ended March 31, 2010, the following corrections were made to the above listed estimates for that quarter:

<b>Month Ended</b>	<b>Ordinary Income</b>	<b>Return of Capital *</b>	<b>Total Distribution</b>
January 31, 2010	\$ 0.098	\$ (0.028)	\$ 0.070
February 28, 2010	0.047	0.023	0.070
March 31, 2010	0.065	0.005	0.070

For distributions declared subsequent to quarter end, the following estimates, based on GAAP, have been made pursuant to Section 19(a) of the 1940 Act:

<b>Month Ended</b>	<b>Ordinary Income</b>	<b>Return of Capital *</b>	<b>Total Distribution</b>
April 30, 2010	\$ 0.119	\$ (0.049)	\$ 0.070
May 31, 2010	0.086	(0.016)	0.070
June 30, 2010	0.028	0.042	0.070

\* A positive number under Return of Capital indicates a return of capital was estimated whereas a negative number indicates that a surplus of income above the distribution was estimated.

**Issuance of Equity**

On October 20, 2009, we filed a registration statement on Form N-2 with the SEC, which was declared effective on January 28, 2010. The registration statement permits us to issue, through one or more transactions, up to an aggregate of \$300 million in securities, consisting of common stock, senior common stock, preferred stock, subscription rights, debt securities and warrants to purchase common stock, or a combination of these securities.

We anticipate issuing equity securities to obtain additional capital in the future. However, we cannot determine the terms of any future equity issuances or whether we will be able to issue equity on terms favorable to us, or at all. Additionally, when our common stock is trading below NAV, as it has consistently traded for most of the last 18 months, we will have regulatory constraints under the 1940 Act on our ability to obtain additional capital in this manner. Generally, the 1940 Act provides that we may not issue and sell our common stock at a price below our NAV per share, other than to our then existing stockholders pursuant to a rights offering, without first obtaining approval from our stockholders and our independent directors. As of March 31, 2010, our NAV per share was \$12.10 and as of May 3 our closing market price was \$13.87 per share. To the extent that our common stock trades at a market price below our NAV per share, we will generally be precluded from raising equity capital through public offerings of our common stock, other than pursuant to stockholder approval or a rights offering. The asset coverage requirement of a business development company under the 1940 Act effectively limits our ratio of debt to equity to 1:1. To the extent that we are unable to raise capital

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through the issuance of equity, our ability to raise capital through the issuance of debt may also be inhibited to the extent of our regulatory debt to equity ratio limits.

At our Annual Meeting of Stockholders held on February 18, 2010, our stockholders approved a proposal that authorizes us to sell shares of our common stock at a price below our then current NAV per share for a period of one year, provided that our Board of Directors makes certain determinations prior to any such sale.

**Revolving Credit Facility**

On March 15, 2010, we entered into a fourth amended and restated credit agreement which currently provides for a \$127,000 revolving line of credit. Advances under the Credit Facility will generally bear interest at the 30-day LIBOR (subject to a minimum rate of 2%), plus 4.5% per annum, with a commitment fee of 0.5% per annum on undrawn amounts. Subject to certain terms and conditions, the Credit Facility may be expanded up to \$202 million through the addition of other committed lenders to the facility. As of March 31, 2010, there was a cost basis of approximately \$53,000 of borrowings outstanding under the Credit Facility at an average interest rate of 6.5%. As of May 4, 2010, there was a cost basis of approximately \$28,400 of borrowings outstanding. We expect that the Credit Facility will allow us to increase the rate of our investment activity and grow the size of our investment portfolio. Available borrowings are subject to various constraints imposed under the Credit Facility, based on the aggregate loan balance pledged by us. Interest is payable monthly during the term of the Credit Facility. The Credit Facility matures on March 15, 2012, and, if the facility is not renewed or extended by this date, all principal and interest will be due and payable on March 15, 2013. In addition, if the Credit Facility is not renewed on or before March 15, 2012, we will be required to use all principal collections from our loans to pay outstanding principal on the Credit Facility.

The Credit Facility contains covenants that require Business Loan to maintain its status as a separate entity, prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions) and restrict material changes to our credit and collection policies. The facility requires a minimum of 20 obligors in the borrowing base and also limits payments of distributions. As of March 31, 2010, we had 23 obligors and we were in compliance with all of the facility covenants.

We applied ASC 825, Financial Instruments, specifically for the Credit Facility, which was consistent with our application of ASC 820 to our investments. ASC 825 requires that we apply a fair value methodology to the Credit Facility. We estimated the fair value of the Credit Facility using estimates of value provided by an independent third party and our own assumptions in the absence of observable market data, including estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. We also considered our own credit risk. Since the Credit Facility was entered into during the three months ended March 31, 2010, the cost basis of the Credit Facility of \$53,000 was determined to be the best approximation of the fair value as of March 31, 2010. The following table presents the Credit Facility carried at fair value as of March 31, 2010 and September 30, 2009, by caption on the accompanying consolidated statements of assets and liabilities for each of the three levels of hierarchy established by ASC 820-10:

	As of March 31, 2010			Total Fair Value Reported in Condensed Consolidated Statement of Assets and Liabilities
	Level 1	Level 2	Level 3	
Borrowings under Line of Credit	\$	\$	\$ 53,000	\$ 53,000

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Total                                   \$                                   \$                                   \$                                   53,000                                   \$                                   53,000

As of September 30, 2009

	Level 1	Level 2	Level 3	Total Fair Value Reported in Condensed Consolidated Statement of Assets and Liabilities	
Borrowings under Line of Credit	\$	\$	\$	83,350	\$ 83,350
Total	\$	\$	\$	83,350	\$ 83,350

*Changes in Level 3 Fair Value Measurements*

The following table provides a roll-forward in the changes in fair value during the three-month period from December 31, 2009 to March 31, 2010 and the six month period from September 30, 2009 to March 31, 2010, for the Credit Facility for which we determine fair value using unobservable (Level 3) factors. When a determination is made to classify a financial instrument within Level 3 of the

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valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated by external sources). Accordingly, the losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology.

**Fair value measurements using unobservable data inputs (Level 3)**

	<b>Borrowings under line of credit</b>	
<b>Three months ended March 31, 2010:</b>		
Fair value at December 31, 2009	\$	73,531
Unrealized depreciation (a)		(131)
Borrowings		2,600
Repayments		(23,000)
Transfers into/out of Level 3		
Fair value as of March 31, 2010	\$	53,000
<b>Six months ended March 31, 2010:</b>		
Fair value at September 30, 2009	\$	83,350
Unrealized depreciation (a)		(350)
Borrowings		5,500
Repayments		(35,500)
Transfers into/out of Level 3		
Fair value as of March 31, 2010	\$	53,000

(a) Included in unrealized depreciation on borrowings under line of credit on the accompanying condensed consolidated statements of operations for the three and six months ended March 31, 2010.

**Contractual Obligations and Off-Balance Sheet Arrangements**

As of March 31, 2010, we were not party to any signed term sheets for potential investments.

In July 2009, we executed a guaranty of a line of credit agreement between Comerica Bank and Defiance Integrated Technologies, Inc., one of our Control investments. If Defiance has a payment default, the guaranty is callable once the bank has reduced its claim by using commercial reasonable efforts to collect through disposition of the Defiance collateral. The guaranty is limited to \$250 plus interest on that amount accrued from the date demand payment is made under the guaranty, and all costs incurred by the bank in its collection efforts. As of March 31, 2010, we have not been required to make any payments on the guaranty of the line of credit agreement and we consider the credit risk to be remote.

**Critical Accounting Policies**



The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported consolidated amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ materially from those estimates. We have identified our investment valuation process as our most critical account policy.

***Investment Valuation***

The most significant estimate inherent in the preparation of our condensed consolidated financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded.

*General Valuation Policy:* We value our investments in accordance with the requirements of the 1940 Act. As discussed more fully below, we value securities for which market quotations are readily available and reliable at their market value. We value all other securities and assets at fair value as determined in good faith by our Board of Directors.

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We adopted guidance for fair value measurements on October 1, 2008. In part, this guidance defines fair value, establishes a framework for measuring fair value, and expands disclosures about assets and liabilities measured at fair value. The guidance provides a consistent definition of fair value that focuses on exit price in the principal, or most advantageous, market and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. The guidance also establishes the following three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 2 inputs are in those markets for which there are few transactions, the prices are not current, little public information exists or instances where prices vary substantially over time or among brokered market makers; and
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement. Unobservable inputs are those inputs that reflect our own assumptions that market participants would use to price the asset or liability based upon the best available information.

See Note 3, *Investments* in the accompanying notes to the condensed consolidated financial statements for additional information regarding fair value measurements.

We use generally accepted valuation techniques to value our portfolio unless we have specific information about the value of an investment to determine otherwise. From time to time we may accept an appraisal of a business in which we hold securities. These appraisals are expensive and occur infrequently but provide a third-party valuation opinion that may differ in results, techniques and scopes used to value our investments. When these specific third-party appraisals are engaged or accepted, we would use estimates of value provided by such appraisals and our own assumptions including estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date to value the investment we have in that business.

In determining the value of our investments, our Adviser has established an investment valuation policy (the *Policy*). The Policy has been approved by our Board of Directors, and each quarter our Board of Directors reviews whether our Adviser has applied the Policy consistently and votes whether or not to accept the recommended valuation of our investment portfolio.

The Policy, which is summarized below, applies to the following categories of securities:

- Publicly-traded securities;
- Securities for which a limited market exists; and

- Securities for which no market exists.

*Valuation Methods:*

**Publicly-traded securities:** We determine the value of publicly-traded securities based on the closing price for the security on the exchange or securities market on which it is listed and primarily traded on the valuation date. To the extent that we own restricted securities that are not freely tradable, but for which a public market otherwise exists, we will use the market value of that security adjusted for any decrease in value resulting from the restrictive feature.

**Securities for which a limited market exists:** We value securities that are not traded on an established secondary securities market, but for which a limited market for the security exists, such as certain participations in, or assignments of, syndicated loans, at the quoted bid price. In valuing these assets, we assess trading activity in an asset class, evaluate variances in prices and other market insights to determine if any available quote prices are reliable. If we conclude that quotes based on active markets or trading activity may be relied upon, firm bid prices are requested; however, if a firm bid price is unavailable, we base the value of the security upon the indicative bid price offered by the respective originating syndication agent's trading desk, or secondary desk, on or near the valuation date. To the extent that we use the indicative bid price as a basis for valuing the security, our Adviser may take further steps to consider additional information to validate that price in accordance with the Policy.

In the event these limited markets become illiquid such that market prices are no longer readily available, we will value our syndicated loans using estimated net present values of the future cash flows or discounted cash flows. The use of a DCF methodology follows that prescribed by ASC 820, which provides guidance on the use of a reporting entity's own assumptions about future cash flows and risk-adjusted discount rates when relevant observable inputs, such as quotes in active markets, are not available. When relevant

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observable market data does not exist, the alternative outlined in ASC 820 is the use of valuing investments based on DCF. For the purposes of using DCF to provide fair value estimates, we consider multiple inputs such as a risk-adjusted discount rate that incorporates adjustments that market participants would make both for nonperformance and liquidity risks. As such, we develop a modified discount rate approach that incorporates risk premiums including, among others, increased probability of default, or higher loss given default, or increased liquidity risk. The DCF valuations applied to the syndicated loans provide an estimate of what we believe a market participant would pay to purchase a syndicated loan in an active market, thereby establishing a fair value. We will continue to apply the DCF methodology in illiquid markets until quoted prices are available or are deemed reliable based on trading activity.

As of March 31, 2010, we assessed trading activity in syndicated loan assets and determined that there continued to be market liquidity and a functioning secondary market for these assets. Thus, firm bid prices or indicative bids were used to fair value our remaining syndicated loans at March 31, 2010.

**Securities for which no market exists:** The valuation methodology for securities for which no market exists falls into three categories: (1) portfolio investments comprised solely of debt securities; (2) portfolio investments in controlled companies comprised of a bundle of securities, which can include debt and equity securities; and (3) portfolio investments in non-controlled companies comprised of a bundle of investments, which can include debt and equity securities.

(1) **Portfolio investments comprised solely of debt securities:** Debt securities that are not publicly traded on an established securities market, or for which a limited market does not exist ( Non-Public Debt Securities ), and that are issued by portfolio companies where we have no equity or equity-like securities, are fair valued in accordance with the terms of the policy, which utilizes opinions of value submitted to us by Standard & Poor's Securities Evaluations, Inc. ( SPSE ). We may also submit PIK interest to SPSE for their evaluation when it is determined that PIK interest is likely to be received.

In the case of Non-Public Debt Securities, we have engaged SPSE to submit opinions of value for our debt securities that are issued by portfolio companies in which we own no equity, or equity-like securities. SPSE's opinions of value are based on the valuations prepared by our portfolio management team as described below. We request that SPSE also evaluate and assign values to success fees (conditional interest included in some loan securities) when we determine that there is reasonable probability of receiving a success fee on a given loan. SPSE will only evaluate the debt portion of our investments for which we specifically request evaluation, and may decline to make requested evaluations for any reason at its sole discretion. Upon completing our collection of data with respect to the investments (which may include the information described below under Credit Information, the risk ratings of the loans described below under Loan Grading and Risk Rating and the factors described hereunder), this valuation data is forwarded to SPSE for review and analysis. SPSE makes its independent assessment of the data that we have assembled and assesses its independent data to form an opinion as to what they consider to be the market values for the securities. With regard to its work, SPSE has issued the following paragraph:

SPSE provides evaluated price opinions which are reflective of what SPSE believes the bid side of the market would be for each loan after careful review and analysis of descriptive, market and credit information. Each price reflects SPSE's best judgment based upon careful examination of a variety of market factors. Because of fluctuation in the market and in other factors beyond its control, SPSE cannot guarantee these evaluations. The evaluations reflect the market prices, or estimates thereof, on the date specified. The prices are based on comparable market prices for similar securities. Market information has been obtained from reputable secondary market sources. Although these sources are considered reliable, SPSE cannot guarantee their accuracy.

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SPSE opinions of value of our debt securities that are issued by portfolio companies where we have no equity or equity-like securities are submitted to our Board of Directors along with our Adviser's supplemental assessment and recommendation regarding valuation of each of these investments. Our Adviser generally accepts the opinion of value given by SPSE, however, in certain limited circumstances, such as when our Adviser may learn new information regarding an investment between the time of submission to SPSE and the date of our Board of Directors assessment our Adviser's conclusions as to value may differ from the opinion of value delivered by SPSE. Our Board of Directors then reviews whether our Adviser has followed its established procedures for determinations of fair value, and votes to accept or reject the recommended valuation of our investment portfolio. Our Adviser and our management recommended, and our Board of Directors voted to accept, the opinions of value delivered by SPSE on the loans in our portfolio as denoted on the Schedule of Investments included in our accompanying condensed consolidated financial statements.

Because there is a delay between when we close an investment and when the investment can be evaluated by SPSE, new loans are not valued immediately by SPSE; rather, management makes its own determination about the value of these investments in accordance with our valuation policy using the methods described herein.

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(2) **Portfolio investments in controlled companies comprised of a bundle of investments, which can include debt and equity securities:** The fair value of these investments is determined based on the total enterprise value of the portfolio company, or issuer, utilizing a liquidity waterfall approach. For Non-Public Debt Securities and equity or equity-like securities (e.g. preferred equity, equity, or other equity-like securities) that are purchased together as part of a package, where we have control or could gain control through an option or warrant security; both the debt and equity securities of the portfolio investment would exit in the mergers and acquisitions market as the principal market, generally through a sale or recapitalization of the portfolio company. In accordance with ASC 820-10, we apply the in-use premise of value which assumes the debt and equity securities are sold together. Under this liquidity waterfall approach, we continue to use the enterprise value methodology utilizing a liquidity waterfall approach to determine the fair value of these investments under ASC 820-10 if we have the ability to initiate a sale of a portfolio company as of the measurement date. Under this approach, we first calculate the total enterprise value of the issuer by incorporating some or all of the following factors:

- the issuer's ability to make payments;
- the earnings of the issuer;
- recent sales to third parties of similar securities;
- the comparison to publicly traded securities; and
- discounted cash flow or other pertinent factors.

In gathering the sales to third parties of similar securities, we may reference industry statistics and use outside experts. Once we have estimated the total enterprise value of the issuer, we subtract the value of all the debt securities of the issuer; which are valued at the contractual principal balance. Fair values of these debt securities are discounted for any shortfall of total enterprise value over the total debt outstanding for the issuer. Once the values for all outstanding senior securities (which include the debt securities) have been subtracted from the total enterprise value of the issuer, the remaining amount, if any, is used to determine the value of the issuer's equity or equity-like securities. If, in our Adviser's judgment, the liquidity waterfall approach does not accurately reflect the value of the debt component, our Adviser may recommend that we use a valuation by SPSE or, if that is unavailable, a DCF valuation technique.

(3) **Portfolio investments in non-controlled companies comprised of a bundle of investments, which can include debt and equity securities:** We value Non-Public Debt Securities that are purchased together with equity and equity-like securities from the same portfolio company, or issuer, for which we do not control or cannot gain control as of the measurement date, using a hypothetical secondary market as our principal market. In accordance with ASC 820-10, we determine the fair value of these debt securities of non-control investments assuming the sale of an individual debt security using the in-exchange premise of value. As such, we estimate the fair value of the debt component using estimates of value provided by SPSE and our own assumptions in the absence of observable market data, including synthetic credit ratings, estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. For equity or equity-like securities of investments for which we do not control or cannot gain control as of the measurement date, we estimate the fair value of the equity using the in-exchange premise of value based on factors such as the overall value of the issuer, the relative fair value of other units of account including debt, or other relative value approaches. Consideration also is given to capital structure and other contractual obligations that may impact the fair value of the equity. Further, we may utilize comparable values of similar companies, recent investments and indices with similar structures and risk characteristics or our own assumptions in the absence of other observable market data and may also employ DCF valuation techniques.

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Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have been obtained had a ready market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned. There is no single standard for determining fair value in good faith, as fair value depends upon circumstances of each individual case. In general, fair value is the amount that we might reasonably expect to receive upon the current sale of the security in an arms-length transaction in the security's principal market.

*Valuation Considerations:* From time to time, depending on certain circumstances, the Adviser may use the following valuation considerations, including but not limited to:

- the nature and realizable value of the collateral;
- the portfolio company's earnings and cash flows and its ability to make payments on its obligations;
- the markets in which the portfolio company does business;
- the comparison to publicly traded companies; and
- DCF and other relevant factors.

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Because such valuations, particularly valuations of private securities and private companies, are not susceptible to precise determination, may fluctuate over short periods of time, and may be based on estimates, our determinations of fair value may differ from the values that might have actually resulted had a readily available market for these securities been available.

*Credit Information:* Our Adviser monitors a wide variety of key credit statistics that provide information regarding our portfolio companies to help us assess credit quality and portfolio performance. We and our Adviser participate in the periodic board meetings of our portfolio companies in which we hold Control and Affiliate investments and also require them to provide annual audited and monthly unaudited financial statements. Using these statements or comparable information and board discussions, our Adviser calculates and evaluates the credit statistics.

*Loan Grading and Risk Rating:* As part of our valuation procedures above, we risk rate all of our investments in debt securities. For syndicated loans that have been rated by an NRSRO (as defined in Rule 2a-7 under the 1940 Act), we use the NRSRO's risk rating for such security. For all other debt securities, we use a proprietary risk rating system. Our risk rating system uses a scale of 0 to 10, with 10 being the lowest probability of default. This system is used to estimate the probability of default on debt securities and the probability of loss if there is a default. These types of systems are referred to as risk rating systems and are used by banks and rating agencies. The risk rating system covers both qualitative and quantitative aspects of the business and the securities we hold. During the three months ended March 31, 2010, we modified our risk rating model to incorporate additional factors in our qualitative and quantitative analysis. While the overall process did not change, we believe the additional factors enhance the quality of the risk ratings of our investments. No adjustments were made to prior periods as a result of this modification.

For the debt securities for which we do not use a third-party NRSRO risk rating, we seek to have our risk rating system mirror the risk rating systems of major risk rating organizations, such as those provided by an NRSRO. While we seek to mirror the NRSRO systems, we cannot provide any assurance that our risk rating system will provide the same risk rating as an NRSRO for these securities. The following chart is an estimate of the relationship of our risk rating system to the designations used by two NRSROs as they risk rate debt securities of major companies. Because our system rates debt securities of companies that are unrated by any NRSRO, there can be no assurance that the correlation to the NRSRO set out below is accurate. We believe our risk rating would be significantly higher than a typical NRSRO risk rating because the risk rating of the typical NRSRO is designed for larger businesses. However, our risk rating has been designed to risk rate the securities of smaller businesses that are not rated by a typical NRSRO. Therefore, when we use our risk rating on larger business securities, the risk rating is higher than a typical NRSRO rating. The primary difference between our risk rating and the rating of a typical NRSRO is that our risk rating uses more quantitative determinants and includes qualitative determinants that we believe are not used in the NRSRO rating. It is our understanding that most debt securities of medium-sized companies do not exceed the grade of BBB on an NRSRO scale, so there would be no debt securities in the middle market that would meet the definition of AAA, AA or A. Therefore, our scale begins with the designation 10 as the best risk rating which may be equivalent to a BBB from an NRSRO, however, no assurance can be given that a 10 on our scale is equal to a BBB on an NRSRO scale.

Company's System	First NRSRO	Second NRSRO	Gladstone Capital's Description(a)
>10	Baa2	BBB	Probability of Default (PD) during the next ten years is 4% and the Expected Loss (EL) is 1% or less
10	Baa3	BBB-	PD is 5% and the EL is 1% to 2%
9	Ba1	BB+	PD is 10% and the EL is 2% to 3%
8	Ba2	BB	PD is 16% and the EL is 3% to 4%
7	Ba3	BB-	PD is 17.8% and the EL is 4% to 5%
6	B1	B+	PD is 22% and the EL is 5% to 6.5%
5	B2	B	PD is 25% and the EL is 6.5% to 8%
4	B3	B-	PD is 27% and the EL is 8% to 10%
3	Caa1	CCC+	PD is 30% and the EL is 10% to 13.3%
2	Caa2	CCC	PD is 35% and the EL is 13.3% to 16.7%



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<b>1</b>	Caa3	CC	PD is 65% and the EL is 16.7% to 20%
<b>0</b>	N/a	D	PD is 85% or there is a payment default and the EL is greater than 20%

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(a) *The default rates set forth are for a ten year term debt security. If a debt security is less than ten years, then the probability of default is adjusted to a lower percentage for the shorter period, which may move the security higher on our risk rating scale.*

The above scale gives an indication of the probability of default and the magnitude of the loss if there is a default. Our policy is to stop accruing interest on an investment if we determine that interest is no longer collectible. As of March 31, 2010 one Non-Control/Non-Affiliate investment and five Control investments were on non-accrual. As of September 30, 2009, one Non-Control/Non-Affiliate investment and four Control investments were on non-accrual. Additionally, we do not risk rate our equity securities.

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The following table lists the risk ratings for all non-syndicated loans in our portfolio at March 31, 2010 and September 30, 2009, representing approximately 97% and 96%, respectively, of all loans in our portfolio at the end of each period:

Rating	Mar. 31, 2010	Sept. 30, 2009
Average	6.3	7.1
Weighted Average	5.9	7.2
Highest	10.0	9.0
Lowest	2.0	3.0

The following table lists the risk ratings for all syndicated loans in our portfolio that were not rated by an NRSRO at March 31, 2010 and September 30, 2009, representing approximately 2% of all loans in our portfolio at the end of each period:

Rating	Mar. 31, 2010	Sept. 30, 2009
Average	7.0	7.0
Weighted Average	7.0	7.0
Highest	7.0	7.0
Lowest	7.0	7.0

For syndicated loans that are currently rated by an NRSRO, we risk rate such loans in accordance with the risk rating systems of major risk rating organizations, such as those provided by an NRSRO. The following table lists the risk ratings for all syndicated loans in our portfolio that were rated by an NRSRO at March 31, 2010 and September 30, 2009, representing approximately 1% and 2%, respectively, of all loans in our portfolio at the end of each period:

Rating	Mar. 31, 2010	Sept. 30, 2009
Average	B2	CCC+/Caa1
Weighted Average	B2	CCC+/Caa1
Highest	B2	B-/B3
Lowest	B2	D/C

***Tax Status***

We intend to continue to qualify for treatment as a RIC under Subtitle A, Chapter 1 of Subchapter M of the Code. As a RIC, we are not subject to federal income tax on the portion of our taxable income and gains distributed to stockholders. To qualify as a RIC, we must meet certain source-of-income, asset diversification, and annual distribution requirements. Under the annual distribution requirement, we are required to distribute to stockholders at least 90% of our investment company taxable income, as defined by the Code. We have a policy to pay out as a distribution up to 100% of that amount.

In an effort to avoid certain excise taxes imposed on RICs, we currently intend to distribute during each calendar year, an amount at least equal to the sum of (1) 98% of our ordinary income for the calendar year, (2) 98% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year and (3) any ordinary income and net capital gains for preceding years that were not distributed during such years.

***Revenue Recognition***

*Interest Income Recognition*

Interest income, adjusted for amortization of premiums and acquisition costs and for the accretion of discounts, is recorded on the accrual basis to the extent that such amounts are expected to be collected. Generally, when a loan becomes 90 days or more past due or if our qualitative assessment indicates that the debtor is unable to service its debt or other obligations, we will place the loan on non-accrual status and cease recognizing interest income on that loan until the borrower has demonstrated the ability and intent to pay contractual amounts due. However, we remain contractually entitled to this interest. Interest payments received on non-accrual loans are restored to accrual status when past due principal and interest is paid or due to a restructuring such that the interest income is deemed to be collectible, and in management's judgment, are likely to remain current. At March 31, 2010, one Non-Control/Non-Affiliate investment and five Control investments were on non-accrual with an aggregate cost basis of approximately \$26,422 or 8.0% of the cost basis of all investments in our portfolio. At September 30, 2009, one Non-Control/Non-Affiliate investment and four Control investments were on non-accrual with an aggregate cost basis of approximately \$10,022 or 2.8% of the cost basis of all investments in our portfolio. Success fees are recorded upon receipt and are contractually due upon a change of control in a portfolio company.

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*Paid in Kind Interest*

Two loans in our portfolio contain PIK provisions. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as interest income. To maintain our status as a RIC, this non-cash source of income must be paid out to stockholders in the form of distributions, even though we have not yet collected the cash. For the three and six months ended March 31, 2010 we recorded PIK income of \$49 and \$100, respectively. For the three and six months ended March 31, 2009, we recorded PIK income of \$13 and \$31, respectively.

*Services Provided to Portfolio Companies*

As a business development company under the 1940 Act, we are required to make available significant managerial assistance to our portfolio companies. We provide these services through our Adviser, who provides these services on our behalf through its officers who are also our officers. Currently, neither we nor our Adviser charges a fee for managerial assistance; however, if our Adviser does receive fees for such managerial assistance, our Adviser will credit the managerial assistance fees to the base management fee due from us to our Adviser.

Our Adviser receives fees for the other services it provides to our portfolio companies. These other fees are typically non-recurring, are recognized as revenue when earned and are generally paid directly to our Adviser by the borrower or potential borrower upon the closing of the investment. The services our Adviser provides to our portfolio companies vary by investment, but generally include a broad array of services such as investment banking services, arranging bank and equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing investments, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. When our Adviser receives fees for these services, 50% of certain of those fees are voluntarily and irrevocably credited against the base management fee that we pay to our Adviser, whereas prior to such date fees were 100% credited. Any services of this nature subsequent to the closing would typically generate a separate fee at the time of completion.

Our Adviser also receives fees for monitoring and reviewing portfolio company investments. These fees are recurring and are generally paid annually or quarterly in advance to our Adviser throughout the life of the investment. Fees of this nature are recorded as revenue by our Adviser when earned and are not credited against the base management fee.

We may receive fees for the origination and closing services we provide to portfolio companies through our Adviser. These fees are paid directly to us and are recognized as revenue upon closing of the originated investment and are reported as fee income in the accompanying condensed consolidated statements of operations.

**Recent Accounting Pronouncements**

Refer to Note 2 in the accompanying condensed consolidated financial statements for a summary of recently issued accounting pronouncements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

We are subject to financial market risks, including changes in interest rates. We estimate that ultimately approximately 20% of the loans in our portfolio will be made at fixed rates and approximately 80% will be made at variable rates. As of March 31, 2010, our portfolio consisted of the following:

85%	variable rates with a floor
2%	variable rates with a floor and ceiling
9%	variable rates without a floor or ceiling
4%	fixed rate
100%	total

There have been no material changes in the quantitative and qualitative market risk disclosures for the six months ended March 31, 2010 from that disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009, as filed with the SEC on November 23, 2009.

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**ITEM 4. CONTROLS AND PROCEDURES.**

a) Evaluation of Disclosure Controls and Procedures

As of March 31, 2010, we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective in timely alerting management, including the Chief Executive Officer and Chief Financial Officer, of material information about us required to be included in periodic Securities and Exchange Commission filings. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

b) Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

Neither we nor any of our subsidiaries are currently subject to any material legal proceeding, nor, to our knowledge, is any material legal proceeding threatened against us or any of our subsidiaries.

**ITEM 1A. RISK FACTORS.**

Our business is subject to certain risks and events that, if they occur, could adversely affect our financial condition and results of operations and the trading price of our common stock. For a discussion of these risks, please refer to the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009, filed by us with the SEC on November 23, 2009. In connection with our preparation of this quarterly report, management has reviewed and considered these risk factors and has determined that the following risk factors should be read in connection with the existing risk factors disclosed in the Form 10-K.

**Risk Related to Our External Management**

*There are significant potential conflicts of interest which could impact our investment returns.*

Our executive officers and directors, and the officers and directors of our Adviser, serve or may serve as officers, directors or principals of entities that operate in the same or a related line of business as we do or of investment funds managed by our affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in the best interests of us or our stockholders. For example, Mr. Gladstone, our chairman and chief executive officer, is the chairman of the board and chief executive officer of our Adviser; Gladstone Investment Corporation, or Gladstone Investment, a publicly-traded business development company; and Gladstone Commercial Corporation, or Gladstone Commercial, a publicly-traded real estate investment trust. Mr. Gladstone is also the sole stockholder of Gladstone Land Corporation, or Gladstone Land, a privately held agricultural real estate company managed by the Adviser. In addition, Mr. Brubaker, our vice chairman, chief operating officer and secretary is the vice chairman, chief operating officer and secretary of our Adviser, Gladstone Investment and Gladstone Commercial. Mr. Stelljes, our president and chief investment officer, is also the president and chief investment officer of our Adviser and Gladstone Commercial and vice chairman and chief investment officer of Gladstone Investment. Moreover, our Adviser may establish or sponsor other investment vehicles which from time to time may have potentially overlapping investment objectives with those of ours and accordingly may invest in, whether principally or secondarily, asset classes similar to those we target. For example, our Adviser recently filed a registration statement with the Securities and Exchange Commission for a proposed initial public offering of common stock of Gladstone Lending Corporation, a proposed fund that would primarily invest in first and second lien term loans. While our Adviser generally has broad authority to make investments on behalf of the investment vehicles that it advises, our Adviser has adopted investment allocation procedures to address these potential conflicts and intends to direct investment opportunities to the Gladstone affiliate with the investment strategy that most closely fits the investment opportunity. Nevertheless, the management of our Adviser may face conflicts in the allocation of investment opportunities to other entities managed by our Adviser. As a result, it is possible that we may not be given the opportunity to participate in certain investments made by other members of our Adviser and its affiliated companies or investment funds managed by investment managers affiliated with our Adviser.

In certain circumstances, we may make investments in a portfolio company in which one of our affiliates has or will have an investment, subject to satisfaction of any regulatory restrictions and, where required, to the prior approval of our Board of Directors. As of



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March 31, 2010, our Board of Directors has approved the following types of co-investment transactions:

- Our affiliate, Gladstone Commercial, may lease property to portfolio companies that we do not control under certain circumstances. We may pursue such transactions only if (i) the portfolio company is not controlled by us or any of our affiliates, (ii) the portfolio company satisfies the tenant underwriting criteria of Gladstone Commercial, and (iii) the transaction is approved by a majority of our independent directors and a majority of the independent directors of Gladstone Commercial. We expect that any such negotiations between Gladstone Commercial and our portfolio companies would result in lease terms consistent with the terms that the portfolio companies would be likely to receive were they not portfolio companies of ours.
- We may invest simultaneously with our affiliate Gladstone Investment in senior syndicated loans whereby neither we nor any affiliate has the ability to dictate the terms of the loans.
- Additionally, pursuant to an exemptive order granted by the Securities and Exchange Commission, our Adviser may sponsor a private investment fund to co-invest with us and Gladstone Investment in accordance with the terms and conditions of the order.

Certain of our officers, who are also officers of our Adviser, may from time to time serve as directors of certain of our portfolio companies. If an officer serves in such capacity with one of our portfolio companies, such officer will owe fiduciary duties to all stockholders of the portfolio company, which duties may from time to time conflict with the interests of our stockholders.

In the course of our investing activities, we will pay management and incentive fees to our Adviser and will reimburse our Administrator for certain expenses it incurs. As a result, investors in our common stock will invest on a gross basis and receive distributions on a net basis after expenses, resulting in, among other things, a lower rate of return than one might achieve through our investors themselves making direct investments. As a result of this arrangement, there may be times when the management team of our Adviser has interests that differ from those of our stockholders, giving rise to a conflict.

**Risk related to our External Financing**

*In recent years, creditors have significantly curtailed their lending to business development companies, including us. Because of the limited amount of committed funding under our credit facility, we will have limited ability fund new investments if we are unable to expand the facility.*

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In recent years, creditors have significantly curtailed their lending to many business development companies, including us. In March 2010 we entered into a fourth amended and restated credit agreement providing for a revolving line of credit, which we refer to as the Credit Facility. Committed funding under the Credit Facility is \$127.0 million. The Credit Facility may be expanded up to \$202.0 million through the addition of other committed lenders to the facility. However, if additional lenders are unwilling to join the facility on its terms, we will be unable to expand the facility and thus will continue to have limited availability to finance new investments under our line of credit. The Credit Facility matures on March 15, 2012, and, if the facility is not renewed or extended by this date, all principal and interest will be due and payable on March 15, 2013. As of May 4, 2010, we had \$28.4 million drawn and outstanding under the Credit Facility.

There can be no guarantee that we will be able to renew, extend or replace the Credit Facility upon its maturity on terms that are favorable to us, if at all. Our ability to expand the Credit Facility, and to obtain replacement financing at the time of maturity, will be constrained by then-current economic conditions affecting the credit markets. In the event that we are not able to expand the Credit Facility, or to renew, extend or refinance the Credit Facility at the time of its maturity, this could have a material adverse effect on our liquidity and ability to fund new investments, our ability to make distributions to our stockholders and our ability to qualify as a RIC under the Code.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

Not applicable.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

Not applicable.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

The 2010 Annual Meeting of Stockholders was held on February 18, 2010. The stockholders voted and approved the following matters:

- The election of three directors to hold office until the 2013 Annual Meeting of Stockholders.

Nominee	Shares Voted	Shares Voted	Shares
	For	Against	Abstained
Paul Adelgren	13,213,201	499,067	240,316
David Gladstone	13,204,448	516,099	232,037
John H. Outland	13,242,744	475,684	234,156

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The other incumbent directors whose terms of office continued after the meeting are listed below:

Director	End of term
Michela English	2011
Anthony W. Parker	2011
George Stelljes, III	2011
Terry Lee Brubaker	2012
Maurice W. Coulon	2012
David A. R. Dullum	2012
Gerard Mead	2012

- The authorization, for a period of one year, to issue and sell shares of our common stock at a price below our then current net asset value per share.

Voted For	Number of Shares		Broker Non-Votes
	Voted Against	Abstained	
11,443,907	2,208,563	300,114	5,414,736

- The ratification of the selection by the Audit Committee of the Board of Directors of PricewaterhouseCoopers LLP as our independent registered public accounting firm for our fiscal year ending September 30, 2010.

Voted For	Number of Shares	
	Voted Against	Abstained
19,009,665	186,829	170,826

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**ITEM 5. OTHER INFORMATION.**

Not applicable

**ITEM 6. EXHIBITS**

See the exhibit index.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**GLADSTONE CAPITAL CORPORATION**

By: /s/ GRESFORD GRAY  
Gresford Gray  
Chief Financial Officer

Date: May 4, 2010

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**EXHIBIT INDEX**

<b>Exhibit</b>	<b>Description</b>
3.1	Articles of Amendment and Restatement of the Articles of Incorporation, incorporated by reference to Exhibit a.2 to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
3.2	By-laws, incorporated by reference to Exhibit b to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
3.3	Amendment to By-laws, incorporated by reference to Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (File No. 814-00237), filed February 17, 2004.
3.4	Second amendment to By-laws, incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K (File No. 814-00237), filed July 10, 2007.
10.1	Fourth Amended and Restated Credit Agreement dated as of March 15, 2010 by and among Gladstone Business Loan, LLC as Borrower, Gladstone Management Corporation as Servicer, the Committed Lenders named therein, the Managing Agents named therein, and Key Equipment Finance Inc. as Administrative Agent, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 814-00237), filed March 16, 2010.
11	Computation of Per Share Earnings (included in the notes to the unaudited condensed consolidated financial statements contained in this report).
31.1	Certification of Chief Executive Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.

All other exhibits for which provision is made in the applicable regulations of the Securities and Exchange Commission are not required under the related instruction or are inapplicable and therefore have been omitted.